Invesco

Invesco Senior Secured Loans

US Loan Market **Snapshot**

Monthly US loan market update: August 2020

Loan prices continued marching back towards pre-COVID levels in August, as the asset class gained 1.49% during the month and improved year-to-date returns to -1.29%.[1] Less-bad-than-feared Q2 earnings, improving economic activity, hopeful signs for vaccine development, and unwavering monetary policy support all facilitated asset price recovery even as COVID infections remain worryingly high and political gridlock has delayed the reauthorization of crucial fiscal support measures. Technicals remained supportive even with muted CLO issuance as the typical August lull in supply set in, contributing to a steady technical balance. Case in point, loan prices advanced in every trading session of the month except for one.[1]

Loans outperformed high yield bonds (0.98%) and investment grade (-1.15%) in August amid a comparatively smaller new issue supply surplus.[2] The percentage of loans trading below $80 declined from 8% to 6% while the top end of the market moved higher; the percentage trading at or above $98 increased from 26.0% in July to 35.8% in August.[3] From a credit quality perspective, lower quality outperformed in August; "BBs" (0.70%) lagged "Bs" (1.53%) and "CCCs" (4.07%).[1] The average price in the loan market was $94.20 at the end of August.[3] At the current average price, senior secured loans are providing a 6.08% yield inclusive of the forward LIBOR curve.[3]

Fundamentals

- Economic data, including PMIs and labor market metrics, showed continued improvement in August. While the labor market and economic activity broadly have recovered in recent months, the impact of permanent job losses and business closures remain as growth headwinds going forward.
- The trailing 12-month par-weighted default rate rose in August to 4.08%, even as only two new issuers defaulted. Approximately 70% of that default activity has occurred since February.[4]

Technicals

- Loan technicals were supportive during the sleepy month of August even as CLO formation slowed. Paydown activity freed up enough cash in the market to absorb the modest new supply.
- New CLO formation was quiet in August, printing just $5.2 billion of issuance.[3] CLO liabilities tightened during the month, improving the equity arbitrage for new deals; as a result, the number of CLO warehouses swelled, which bodes well for issuance prospects in the near-term.
- Retail mutual funds and ETFs reported outflows of $0.7 billion during the month.[3]
- New issue activity improved from July's paltry levels, with 33 deals pricing for a total of $22.7 billion.[3] Net of refinancing, volume was $12.0 billion.[3]

Relative value/market opportunity

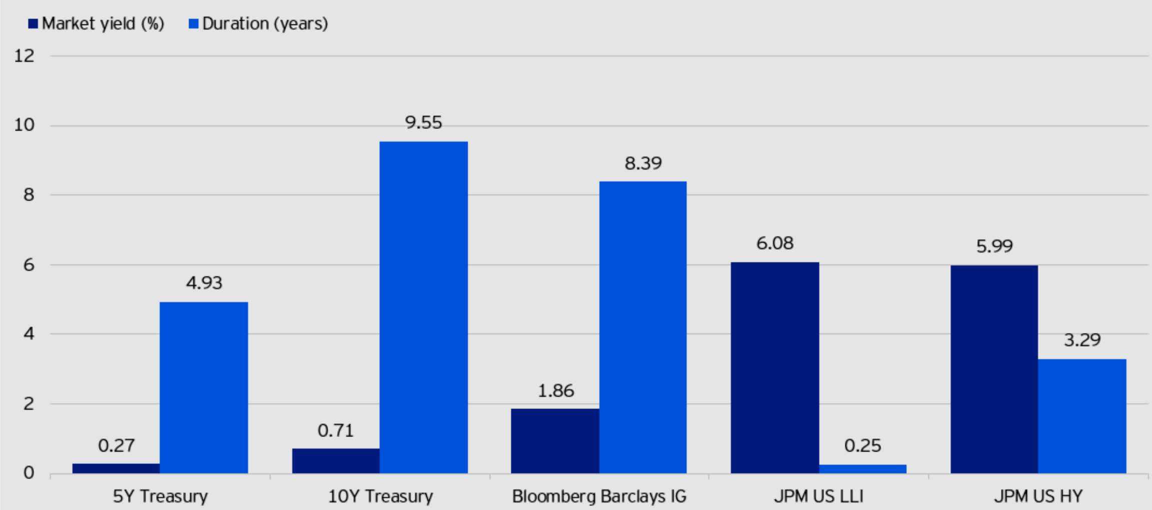
Year-to-date, leveraged loans have underperformed high yield bonds by 204 basis points as demand for fixed rate credit surged along with the decline of interest rates.[2] However, excluding the impact of duration from returns, loans are outperforming high yield bonds as is historically typical during periods of market weakness and depicted in Figure 1. This derives from loans' structurally senior ranking in issuers' capital structures which provides better protection from principal loss than unsecured bonds. Thus far in 2020, high yield bond retail funds have attracted $42.7 billion of inflows while $24.4 billion has been withdrawn from loan retail funds.[3] In response, high yield bond issuance has been extremely robust while loan new issuance has been subdued. Moving into the balance of the year, new supply in high yield is likely to remain abundant while supply expectations in the loan market are muted. Limited supply combined with a growing pipeline of CLO warehouses created by managers hoping to capitalize on recent tightening of liability spreads, should create a comparatively favorable technical backdrop for loans.

Removing the impact of duration, historically senior loans have outperformed high yield bonds during risk off periods, as displayed by excess returns

Figure 1: Downside protection of senior loans
Average last twelve month (LTM) excess return differential: loans – high yield bonds

Source: BofA Global Research, S&P LCD, ICE Data Indices LLC, as of August 31, 2020. **Past performance is not indicative of future results.**

Figure 2: Loans offered investors a high level of current income with short duration



Source: Barclays, JP Morgan and Bloomberg L.P. as of August 31, 2020. **Past performance is not a guarantee of future results.** An investment cannot be made directly in an index.

Relative yield				
	$ Price	**Yield to worst (%)**	**Spread to worst**	**Duration (years)**
5 Year Treasuries	99-29	0.27	–	4.93
10 Year Treasuries	99-07	0.71	–	9.55
Bloomberg Barclays US Agg. Index	110.52	1.15	T + 0.70	6.09
Bloomberg Barclays IG Index	114.17	1.86	T + 1.21	8.39
JPM US HY Bond Index	101.10	5.99	T + 5.73	3.29
JPM US Leveraged Loan Index	**94.20**	**6.08**	**T + 5.84**	**0.25**

Source: Barclays, JP Morgan and Bloomberg L.P. as of August 31, 2020. Loan "yield to worst" and "spread to worst" incorporate the LIBOR forward curve.

1 S&P/LSTA Leveraged Loan Index as of August 31, 2020.
2 S&P/LSTA Leveraged Loan Index and Bloomberg as of August 31, 2020. High yield represented by BAML US High Yield Index; investment grade represented by the BAML Investment Grade Index.
3 JP Morgan as of August 31, 2020.
4 S&P LCD as of August 31, 2020.

About risk

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

Many senior loans are illiquid, meaning that the investors may not be able to sell them quickly at a fair price and/or that the redemptions may be delayed due to illiquidity of the senior loans. The market for illiquid securities is more volatile than the market for liquid securities. The market for senior loans could be disrupted in the event of an economic downturn or a substantial increase or decrease in interest rates. Senior loans, like most other debt obligations, are subject to the risk of default.

Important information

All data provided by Invesco unless otherwise noted. All data is US dollar and as of August 31, 2020, unless otherwise noted. By accepting this document, you consent to communicate with us in English, unless you inform us otherwise.

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