Invesco Senior Secured Loans

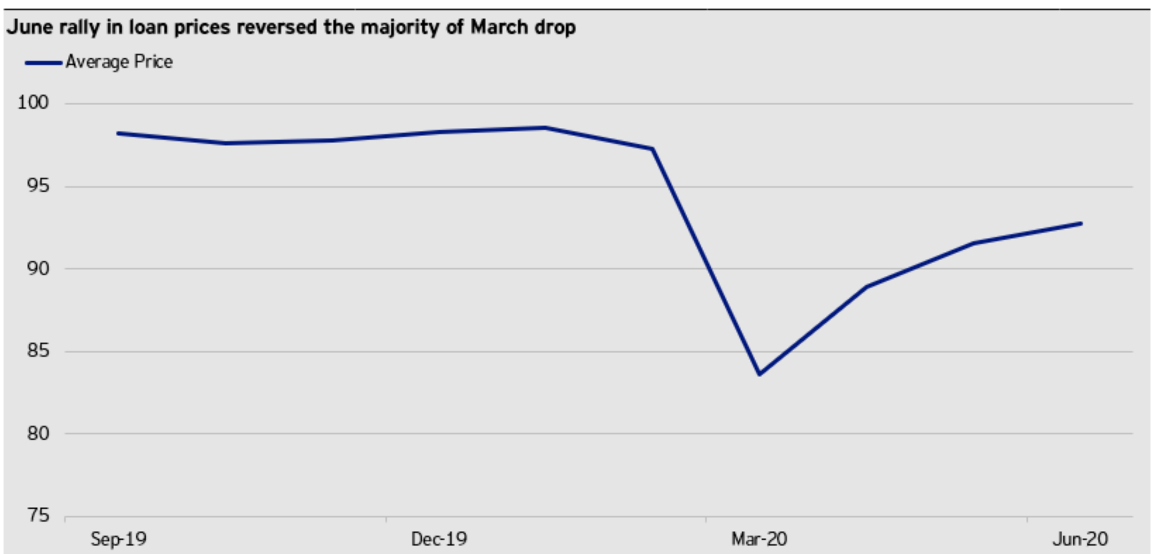
European Loan Market Snapshot

Monthly European loan market update: June 2020

The Credit Suisse Western European Leveraged Loan Index ("CS WELLI" or "Index") returned 1.57% in June, comprised of principal return of 1.21% and interest return of 0.36%.[1]

Economic data released during the month largely surprised to the upside. For example, European flash PMIs bounced from recent lows, US employment increased for the second consecutive month, and US consumer spending returned to 94% of the pre-virus level. Reopening of economies is progressing, albeit at various rates across the globe. On regained optimism, European and US equity markets increased by approximately 5% and 1%, respectively.[2]

This positive sentiment fed into the loan market. The CS WELLI advanced by 1.15 points in June to an average price of €92.74,[1] as the month closed out one of the strongest quarters on record. The European leveraged loan market rallied by 9.11 points during the course of Q2, which reversed the majority of the 13.7-point drop witnessed in March.[1]



Source: Credit Suisse Western European Index (EUR-hedged), as of June 30, 2020. An investment cannot be made directly in an index.

This momentum enabled European primary loan issuance to restart, with a flurry of new transactions coming to market in the month. Many deals were those underwritten earlier in the year, which led to new issuance of €6.5 billion (bn) during the month, almost double the €3.5bn new issuance volume that occurred in May. Several (often multi-currency) jumbo deals launched during June, such as the €8bn bond and loan financing of the corporate carve-out of *Thyssenkrupp Elevators* and the €2.0bn debt-package supporting the take-private of Spanish telecommunications operator *MasMovil*. As at 25 June, the average yield on single-B new issuance was 5%, which is significantly wider compared to the average of 3.7% seen in the first quarter before the magnitude of the COVID-19 pandemic became evident.[3]

Sentiment in the CLO market was constructive, with issuers placing in excess of €2bn of liabilities during the month. New-issue AAA CLO spreads are in the 150bps area and attention is turning to the ability of managers to open new warehouses and potentially increasing demand for loans.

Whilst uncertainty remains, optimism is evident across markets, loan arrangers, and investors. Central bank monetary and national fiscal-stimulus policies have helped to stabilize markets and economies. The European loan market remained active in primary and secondary trading: liquidity was evident. Rating agencies downgrades stabilized, and defaults remained contained and minimal. As we begin the second half of the year, attention will turn to second quarter earnings results that will reflect the peak COVID-19 crisis period.

The CS WELLI's nominal value (size of the market) at the end of the month was approximately €313 billion, a 0.6% increase year-to-date (YTD).[1]

Returns

- Within the CS WELLI, the best performing industries were Consumer non-durables, which returned 4.81%, followed by Energy (4.51%) and Housing (3.69%).[1] No industry delivered negative returns during the month. [1]
- Lower quality 'CCC' loans performed best this month, with a total return of 6.02%, as compared to 1.51% for 'B' rated loans and 0.11% for 'BB' rated loans.[1]
- At month end, the average price of the CS WELLI was €92.74, up by €1.15 during the month.[1] The CS WELLI's three-year discount margin is 6.17% (a 37bps decrease during the month).[1] For comparison, the Credit Suisse Western European High Yield Index returned 2.34% for the month and had a spread-to-worst yield of 6.54%.[4]

Fundamentals

- The Eurozone PMIs rebounded strongly in June in response to the easing of social distancing restrictions. Whilst the Composite PMI increased significantly by 15.6 points to 47.5, the economy remains in contraction (recall that in April when lockdown was at its zenith, PMIs hit an all-time low of 13.6). Expectations of composite output in one year's time became positive (55.7, after 46.8 in May and 34.9 in April), indicating that recovery expectations are improving. Services PMIs, which suffered a deeper collapse during the crisis, jumped by 16.8 points to 47.3 in June, while Manufacturing PMI increased by 8.0 points to 47.4. Across seven of the eight economies covered by the manufacturing PMI survey, the headline index stands at its highest level since April (in Germany and Netherlands) or March (in Italy, Spain, Greece, Ireland, and Austria), although below its pre-COVID-19 level from February.
- Broadly speaking, domestic demand seems to be picking up more than foreign demand at present. Employment reductions in both sectors continued, although at a slower pace than in recent months.
- Q2 is likely to return a double-digit GDP contraction, following a first quarter decline of -3.6% quarter-over-quarter (-3.1% year-over-year). There is a higher-than-usual degree of uncertainty around the forecast, as it rests on key assumptions of further containment of the pandemic and the speed at which economies can continue to reopen.
- The ECB has stepped up its pandemic asset purchase program (PEPP) that will provide support to the economy over the coming months. Expectations are for the ECB to maintain sizable sovereign bond purchases for a prolonged period.
- The European Commission's proposed Recovery Fund is likely to be ratified later this year, lending additional fiscal support to the countries most affected by the virus. Germany has committed to a significant stimulus plan (around 3.8% of GDP, €130bn) to secure the economy.

- While the trajectory of the coronavirus and the severity of its economic impact remain highly uncertain, we see the prospect of a virus "second wave" as the biggest risk to the global economic outlook.
- The last twelve-month default rate for the S&P European Leveraged Loan Index (based on principal amount) is 2.09%.[4] The historical average annual default rate is 3.38%.[5]

Index returns (%)	2013	2014	2015	2016	2017	2018	2019	Apr. 2020	May 2020	June 2020	YTD 2020
Credit Suisse Western European Leveraged Loan Index (EUR-HDG)	8.73	1.96	3.14	6.52	3.30	0.55	5.03	6.66	3.28	1.57	-3.80
Credit Suisse Western European HY Index (EUR-HDG)	9.10	4.31	1.36	9.63	6.28	-3.85	11.05	5.38	2.91	2.34	-5.77

Source: Credit Suisse, as of June 30, 2020. **Past performance is not a guide to future returns.** An investment cannot be made directly in an index.

1 Credit Suisse Western European Leveraged Loan Index (CS WELLI) in EUR as of June 30, 2020. Past performance is not a guide to future returns.
2 S&P 500 Index (in USD) and STOXX Europe 600 Index (in EUR) as of June 30, 2020. The S&P 500 is widely regarded as the best single gauge of large-cap U.S. equities. The index includes 500 leading companies and covers approximately 80% of available market capitalization. The STOXX Europe 600 Index is derived from the STOXX Europe Total Market Index (TMI) and is a subset of the STOXX Global 1800 Index. With a fixed number of 600 components, the STOXX Europe 600 Index represents large, mid and small capitalization companies across 17 countries of the European region: Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Norway, Poland, Portugal, Spain, Sweden, Switzerland and the United Kingdom.
3 S&P Global Market Intelligence, LCD European Weekly as of June 26, 2020.
4 Credit Suisse Western European High Yield Index in EUR as of June 30, 2020.
5 S&P European Leveraged Loan Index, average default rates covering June 1, 2007 through June 30, 2020.

About risks

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, as at June 30, 2020 in Euro unless otherwise noted. Please note index returns represent total returns in respective base currencies.

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