Invesco Senior Secured Loans

European Loan Market Snapshot

Monthly European loan market update: April 2020

The Credit Suisse Western European Leveraged Loan Index ("CS WELLI" or "Index") returned 6.66% in April, comprised of principal return of 6.27% and interest return of 0.39%.[1]

After the sharp sell-off in March, April saw an impressive rally of markets. For example, US and European equity markets rose by around 10%.[2] The leveraged loan market joined the rally, with the average price of the Index increasing by €5.29 during the month, and thus recouping nearly 40% of March losses.[1] There are two important drivers behind this: (1) central banks started to buy assets in an unprecedented manner and offered additional emergency liquidity, and (2) social distancing measures have proven to be successful in slowing the spread of the coronavirus. Many nations, therefore, have started to ease lockdown measures and are now forming plans for a gradual reopening of their economies.

During April, we witnessed the severe impact of lockdown measures on economic activity across the globe. The US recorded over thirty million new jobless claims over the past 6 weeks – its highest level on record. First quarter Euro area GDP growth was -3.8%, with the ECB's president Lagarde warning that GDP could fall between 5% and 12% in 2020 with a 15% contraction in Q2 according to ECB staff estimates. The largest downside risks to any recovery is that of weak consumer demand once businesses reopen and further coronavirus outbreaks that could force new lockdown measures until there is a vaccine.

During April, businesses approached governments, lenders, and shareholders for additional liquidity in order to weather the lockdown period. For example, Hotelbeds, a provider of services to the travel industry, received a significant liquidity injection from its private equity owners to bridge temporary funding needs. Furthermore, the European leveraged finance market saw first signs of a reopening with two well-received high yield issuances, both aimed at providing additional liquidity to borrowers. There was no primary loan market issuance during the month notwithstanding the market conditions. The severe rating agency downgrades of loans (and subsequent expansion of the proportion of 'CCC' rated loans) caused the CLO market – a significant driver of demand of loan issuance – to focus on secondary market opportunities. Nevertheless, three CLO deals closed during the month, all with structural changes reflecting the current market conditions (smaller size, shortened non-call periods, and removal of junior tranches, for example). CLO AAA tranches have shaken out at a discount margin between 195-225 bps, around 100bps wider than pre-COVID crisis levels.

We expect the primary loan market to gradually reopen, most likely during the second half of the year. Anecdotal reports suggest that arranger banks have underwritten several deals and are assessing the market conditions as to when would be best to bring these deals to market. Looking ahead, we believe there will be more CLO activity with pre-crisis warehouses expected to launch, which should provide additional support for the loan market.

The CS WELLI's nominal value (size of the market) at the end of the month was approximately €318 billion, a 2.1% increase YTD.[1]

Returns

- Within the CS WELLI, the best performing industries were Food and Drug, which returned 20.47%, followed by Housing (12.60%), and Metals/Minerals (11.50%).[1] The weakest sector in the Index and the only sector delivering negative returns was Energy (-1.92%).[1]
- Lower quality 'CCC' loans performed best this month with a total return of 13.12%, as compared to 7.21% for 'B' and 5.56% for 'BB' rated loans.[1]
- At month end, the average price of the CS WELLI was €88.92, up by €5.29 during the month.[1] The CS WELLI's three-year discount margin is 7.55% (a 213bps decrease during the month).[1] For comparison, the Credit Suisse Western European High Yield Index returned 5.38% for the month and had a spread-to-worst yield of 7.81%.[3]

Fundamentals

- As expected, the macroeconomic picture is bleak. The Euro area economy contracted by -3.8% compared with the previous quarter – and lockdowns only began in March. As mentioned above, the ECB estimates 2Q GDP to contract by as much as -15% in a severe scenario.
- French quarterly contraction was -5.8% (versus -4.0% expected). Following the previous quarterly decline of -0.1%, this means that the French economy is now technically in recession. Italian GDP contracted by -4.7% (versus -5.4% expected). The Spanish economy saw a -5.2% contraction (versus -4.3% expected).
- Euro area flash CPI (inflation) estimate for April came in at +0.4%, the lowest inflation print since September 2016, driven by a decline in energy (oil) prices.
- German retail sales in March fell by -5.6%, the biggest monthly decline since January 2007, while the number of jobless claims rose by 373,000 in April.
- There are three defaults on a rolling twelve-month basis as of month-end. The last twelve-month default rate for the S&P European Leveraged Loan Index (based on principal amount) is 0.42%.[4] The historical average annual default rate is 3.39%.[4]

Index returns (%)	2013	2014	2015	2016	2017	2018	2019	Feb. 2020	Mar. 2020	Apr. 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	-1.03	-13.57	6.66	-8.30
Credit Suisse Western European HY Index (EUR-HDG)	9.10	4.31	1.36	9.63	6.28	-3.85	11.05	-1.78	-13.66	5.38	-10.53

Source: Credit Suisse, as of April 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 April 30, 2020.
2 S&P 500 Index (in USD) and STOXX Europe 600 Index in EUR as of April 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 Credit Suisse Western European High Yield Index in EUR as of April 30, 2020.
4 S&P European Leveraged Loan Index, average default rates covering June 1, 2007 through April 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 April. 30 2020 in Euro unless otherwise noted. Please note index returns represent total returns in respective base currencies.

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