# European Loan Market
# Snapshot

## Monthly European loan market update: April 2020 (covering Mar)

The Credit Suisse Western European Leveraged Loan Index ("CS WELLI" or "Index") returned -13.57% in March, comprised of principal return of -13.94% and interest return of 0.36%.[1] The average price of the Index is €83.64.[1]

During the month, accelerating developments around the COVID-19 coronavirus has triggered the most volatile conditions in global markets since the 2008/2009 global financial crisis (GFC). European and US equity markets have fallen significantly, most by at least 20% from their peaks, ending the longest bull-market run in history.[2] GDP in the US and Europe is expected to decrease sharply – by at least 10%. A global recession in 2020 is expected.

Most countries are now in a state of "lockdown" (of various degrees) aimed at limiting further spread of the disease. The US, Italy, and Spain are currently the epicenter of the pandemic. A rapid rise in infections in the UK and emerging market economies is expected in a matter of days.

The negative economic consequences of these lockdown measures have resulted in unprecedented monetary and fiscal policy responses. In the US, a $2.2 trillion stimulus package, equivalent of 10% of US GDP, was agreed upon and interest rates were cut to 0%. European governments announced stimulus measures of 2%-4% of GDP combined with extensive loan guarantees. Fiscal/budget restrictions (Germany, for example) were discarded; wage payment schemes, business tax suspension, etc., have been introduced. The ECB unveiled a €750 billion bond purchasing plan and stated that there are "no limits to its commitment [to the Euro]".

While these actions have helped stabilize markets from a mid-month period of intense selling pressure and a flight to safety (quality), the leveraged loan market has not been immune to the daily double-digit percentage swings seen in equity markets. The CS WELLI's average price declined by 14% during the month,[1] although off the intra-month lows by around three-points, as the myriad of government measures were announced. However, bid-offer spreads remained wide and trading liquidity was diminished as uncertainty remains. As we closed the month, higher rated credits continued to be well-bid, while lower rated credits started to gain more traction, although were slower to catch the modest rally. On a sector level, the Food/Tobacco, Technology, Media & Telecommunications (TMT), and Healthcare sectors have performed better than the Leisure/Travel, Energy, and Consumer Discretionary sectors.

The focus of the leveraged loan investor base is on borrower liquidity needs. Borrowers have increasingly started to draw down their revolving credit facilities, reducing non-essential capex spend and requesting access to the numerous governmental support packages (tax deferrals, wage subsidies, etc.) to support their businesses. Default rates are expected to increase; however, these measures should act, to a degree, as a mitigant. Rating agencies have begun downgrading companies to reflect the current macroeconomic environment.

Amidst the volatility, there have been no meaningful primary transactions. New CLO issuance has similarly stagnated, with spreads on AAA CLO liabilities rising to as high as 300 basis points (bps), up by approximately 200bps during the month. The CS WELLI's nominal value (size of the market) at the end of the month was €316 billion.[1]

## Returns

- Within the CS WELLI, no major industry delivered positive total returns during the month. The best performing industry was Food/Tobacco, which returned -7.63%.[1] The weakest sectors in the Index were Energy (-23.18%), Consumer Non-Durables (-22.24%), and Gaming/Leisure (-21.14%).[1]
- Higher quality 'BB' loans performed best this month with a total return of -9.15%, as compared to -14.00% and -20.39% for 'B' and 'CCC' rated loans, respectively.[1]
- At month end, the average price of the CS WELLI was €83.64, down by €13.66 during the month.[1] The CS WELLI's three-year discount margin is 9.68% (a 522bps increase across the month).[1] For comparison, the Credit Suisse Western European High Yield Index returned -13.66% for the month and had a spread-to-worst yield of 11.36%.[3]

## Fundamentals

- A severe economic contraction – globally – in 2Q will occur. Much debate and research reports are aiming to predict the longer-term implications of COVID-19, and when and how quickly growth will return. Various scenarios have been posited. The broad consensus is that the Eurozone, the US, and the UK will end up with drops in 2020 GDP between 10% and 15% on the assumption that the worst is worked through in Q2 and that the recovery during H2 will be fast because of the policy measures, and as private balance sheets (banks, for example) are better relative to the GFC.
- The latest economic data and estimates are bleak and illustrate the severity of the collapse in economic activity across Europe and the US. Flash PMIs tumbled to all-time lows and consumer confidence indices acted similarly. In France, the INSEE (National Institute of Statistics and Economic Studies) said it estimates activity – using electricity consumption data, etc. – to have decreased by a third relative to a normal week, suggesting that every month of lockdown may subtract about 3% of annual GDP. US jobless claims jumped to over 3 million, the highest number on record, while the German government said that it expects the number of (public supported) short-time workers to reach 2.4 million.
- Rating agencies have increased their default expectations. Fitch Ratings revised its 2020 forecasts for European high yield corporate default rates to 4%-5% for bonds and 4% for loans. The agency expects default rates to increase further in 2021, towards 8% and 7%, respectively. S&P Global Ratings reported in mid-March that it expects a surge in defaults, potentially reaching double-digits for speculative-grade-rated non-financial corporates in the US, and a material increase to the high-single-digits in Europe (lower than US estimates due to fewer Energy-related credits in Europe) over the next six to 12 months.
- 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 0.43%.[4] The historical average annual default rate is 3.41%.[4]

| Index returns (%) | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | Jan. 2020 | Feb. 2020 | Mar. 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 | 0.51 | -1.03 | -13.57 | -14.03 |
| Credit Suisse Western European HY Index (EUR-HDG) | 9.10 | 4.31 | 1.36 | 9.63 | 6.28 | -3.85 | 11.05 | 0.12 | -1.78 | -13.66 | -15.09 |

Source: Credit Suisse, as of Mar. 31, 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 Mar. 31, 2020.
2 S&P 500 Index (in USD) and STOXX Europe 600 Index in EUR as of Mar. 31, 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 Mar. 31, 2020.
4 S&P European Leveraged Loan Index, average default rates covering June 1, 2007 through Mar. 31, 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 Mar. 31 2020 in Euro unless otherwise noted. Please note index returns represent total returns in respective base currencies.

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