Invesco Senior Secured Loans

European Loan Market

Snapshot

Monthly European loan market update: January 2020 (covering December 2019)

The Credit Suisse Western European Leveraged Loan Index ("CS WELLI" or "Index") returned 0.75% in December, comprised of principal return of 0.39% and interest return of 0.36%.[1] Year-to-date ("YTD") returns are 5.03%.[1]

Markets ended the year in December with strong performance across most asset classes given positive news on the two large macroeconomic worries: US-China trade war and Brexit. President Trump announced that a "large and comprehensive" Phase 1 trade deal will be signed in January. The deal sees the US suspending a further $160 billion (bn) of tariffs on Chinese imports, with China agreeing to increase its purchases of agricultural products. While Phase 2 talks are yet to begin, this has temporarily calmed fears of a trade war escalation. The S&P 500 rallied 3.25% during the month of December.[2]

Elections in the UK delivered a clear majority for Prime Minister Boris Johnson and the Conservative Party, with the UK now set to leave the EU on January 31. The British Pound rallied to as high as 1.35 versus the US Dollar – its highest level since mid-2018 – but has since shed 2 points as the market is now focusing on the upcoming UK-EU trade negotiations during the year-long transition period in 2020.

Such risk-on sentiment also supported the European loan market. In particular, riskier 'CCC' assets performed strongly with a 4.27% return during the month significantly ahead of returns for 'B' loans (+0.86%) and 'BB' loans (0.59%).[1] On average, secondary prices advanced by 48 basis points (bps), as primary issuance slowed down considerably during the holiday period. There was only about €0.4bn of new loan primary issuance in December, which was below the €1.7bn during the same period in 2018. For the full year of 2019, primary volume closed in at €69.5bn, at 11% below 2018 levels.

Despite issuance being slightly weaker year-over-year, demand remains strong with the CLO market recording its fourth consecutive year of record annual volume. In 2019, new CLO supply stood at approximately €29.0bn from 70 deals (versus 2018 with €27.3bn from 66 deals). Against this backdrop, pricing has moved tighter, with rolling 3-month new issue yield for Term Loan B (TLB) facilities decreasing to 3.90% as of December, which is approximately 30bps lower compared to the start of the year.

As we move into 2020, the new issuance pipeline looks healthy with the S&P Leveraged Commentary & Data's (LCD) forward loan calendar standing at €7.6bn from 11 deals. For the year 2020, we expect loan supply to kick-off strongly in Q1 and then follow 2019 trends totaling around €70bn. While the credit cycle is aging, default rates in Europe are still significantly below historic averages at 0.44%[3] and only forecasted to increase modestly in 2020.

The CS WELLI's nominal value (size of the market) at the end of the month was €311bn, a 9% increase YTD.[1]

Returns

- Within the CS WELLI, the Consumer Durables sector was the top outperformer during the month, with a total return of 3.83%, followed by the Aerospace sector, which returned 2.25%, and the Retail sector which returned 1.85%.[1] The Energy sector's return was the weakest, at -4.60%.[1]
- Lower quality CCC rated loans performed best this month, with a 4.27% total return. Returns for B and BB rated loans were 0.86% and 0.59%, respectively.[1]
- At month end, the average price of the CS WELLI was €98.32, up €0.48 during the month.[1] The CS WELLI's three-year discount margin is 4.06% (a 24bps decrease across the month).[1] For comparison, the Credit Suisse Western European High Yield Index returned 1.22% for the month and had a spread-to-worst yield of 3.81%.[4]

Fundamentals

- The Euro Area (EA) economy continues to hold slightly above contraction, as low unemployment and good consumer spending coupled with growth in the services sector just about made up for the continued weakness in manufacturing. Q4 GDP EA growth is expected to come in at around 0.1%, which would close the calendar year 2019 at 1.2% GDP growth.
- Major equity markets finished 2019 at record highs, with the Euro Stoxx 600 up 23.2%[5] and the S&P 500 up 28.9%[4] over the year recording their strongest annual performances since 2013 and 2009, respectively. Despite worries of a global economic slowdown, markets were supported during the year by rate cuts from both the US Federal Reserve and the European Central Bank, as well as consumer sentiment remaining high.
- Eurozone Composite PMI for December surprised to the upside. The index used as gauge of private-sector activity climbed to 50.9 in December – slightly ahead of estimates and the 50.6 reading in November. This was the highest reading in four months, but remains amongst the lowest levels in the past six years.
- For most major economies, the Services PMI reading remained above the Manufacturing PMI: Factory activity contracted for the 11th month straight (Manufacturing PMI of 46.3 down from 46.9 in November) while Services PMI increased to 52.8 (51.9 in November). Manufacturing remains weak as the US-China trade war continues to weigh on activity, but sentiment started to improve towards the end of the month with business confidence reaching its highest level since May.
- 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 0.44%.[6] The historical average annual default rate is 3.47%.[6] The number of distressed credits within the S&P European Leveraged Loan Index is increasing, but remains a small proportion.

Index returns (%)	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**Oct. 2019**	**Nov. 2019**	**Dec. 2019**	**2019**
Credit Suisse Western European Leveraged Loan Index (EUR-HDG)	8.73	1.96	3.14	6.52	3.30	0.55	-0.35	0.41	0.75	5.03
Credit Suisse Western European HY Index (EUR-HDG)	9.10	4.31	1.36	9.63	6.28	-3.85	0.02	0.55	1.22	11.05

Source: Credit Suisse, as of Dec. 31, 2019. **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 Dec. 31, 2019.
2 S&P 500 Index (CS WELLI) in USD as of Dec. 31, 2019. 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.
3 S&P European Leveraged Loan Index as of Dec. 31, 2019.
4 Credit Suisse Western European High Yield Index in EUR as of Dec. 31, 2019.
5 STOXX Europe 600 Index in EUR as of Dec. 31, 2019. 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.
6 S&P European Leveraged Loan Index, average default rates covering June 1, 2007 through Dec. 31, 2019.

Investment 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. Most senior loans are made to corporations with below investment-grade credit ratings and are subject to significant credit, valuation and liquidity risk. The value of the collateral securing a loan may not be sufficient to cover the amount owed, may be found invalid or may be used to pay other outstanding obligations of the borrower under applicable low. There is also the risk that the collateral may be difficult to liquidate, or that a majority of the collateral may be illiquid. Compared to the investment grade bonds, junk bonds involve greater risk of default or price changes due to changes in the issuer's credit quality. Diversification does not guarantee profit or eliminate the risk of loss.

Important information

All data provided by Invesco, as at Dec. 31, 2019 in Euro unless otherwise noted. Please note index returns represent total returns in respective base currencies.

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