Invesco Senior Secured Loans

US Loan Market
Snapshot

Monthly US loan market update: March 2020 (covering Feb)

Fears of the economic fallout from COVID-19 drove global risk markets lower in February, and the senior secured loan market was no exception. After a calm start to the month, markets dropped precipitously in February's final week as the number of countries reporting infections multiplied and investors across every asset class fixated on the implications of a potential pandemic. Equities declined by 8.23% during the month, and by 12.70% from their February 19th peak,[1] amid a flight to quality that pushed the 10-year Treasury yield down to 1.15%. Against this backdrop, loans came under pressure, returning -1.32% in February and bringing year-to-date returns to -0.77%.[2] As risk aversion set into the secondary trading environment, widened spreads causing several issuers to abandon repricing efforts and postpone opportunistic financings.

Amid the volatility, loans outperformed high yield bonds (-1.55%) in February, but underperformed investment grade (1.29%)[3] and the 10-year Treasury (3.62%) which benefited from demand for safe-haven assets. Price declines pushed the percentage of loans trading above par down from 48% to just 4%, while the percentage of loans trading below $80 rose to 5.1%.[4] Despite the risk-off frenzy, "BBs" (-1.42%) underperformed "Bs" (-1.27%), though not "CCCs" (-2.09%), as sellers exited large, liquid loans to raise cash.[5] The average price in the loan market was $95.40 at the end of February.[6] At the current average price, senior secured loans are providing a 5.99% yield inclusive of the forward LIBOR curve.[6]

Fundamentals

- Economic data was supportive in February, with the manufacturing PMI signaling expansion for the first time in months while job growth and wage growth remained strong. The impacts of COVID-19 have yet to appear in the economic data.
- The trailing 12-month default rate rose to 2.03% during the month as American Commercial Lines, RentPath, NPC International, Pier 1 Imports, and Phillips Pet Food joined the list of recently defaulting issuers.[5]

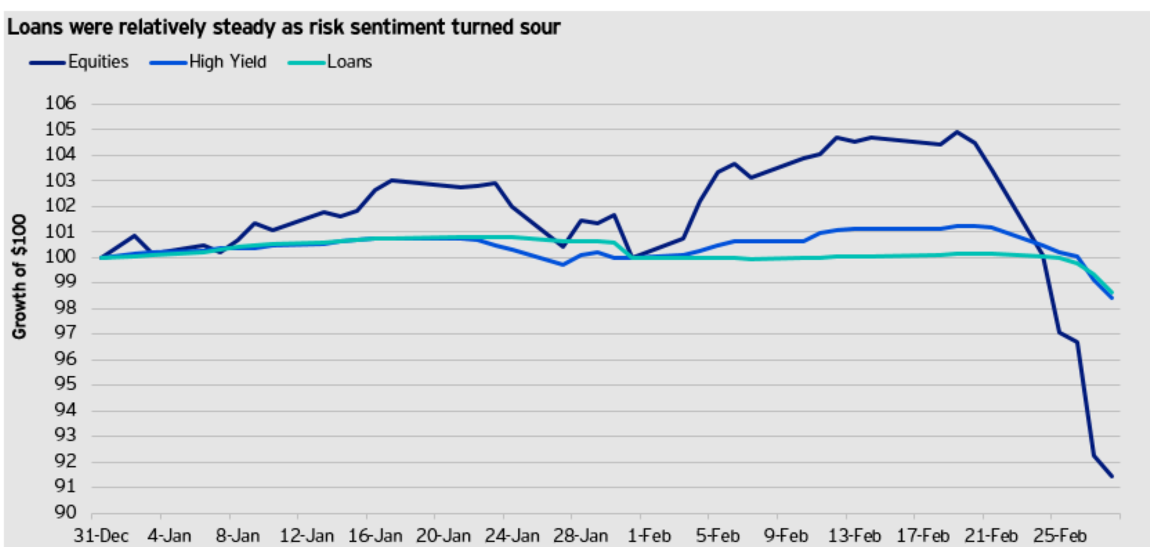
Technicals

- Loan technicals were balanced/tight to begin the month as decent supply was not enough to match loan paydowns and CLO issuance. However, as investors became more risk averse and outflows picked up, the market technical softened.[5]
- Gross CLO volume increased markedly in February to $30.5 billion, with $10.7 billion of issuance net of resets and refinancings. Deals were primarily completed before the market correction ensued; thereafter, widening liability spreads and general market volatility stifled further issuance as the month came to a close.[5]
- Retail mutual funds and ETFs reported an outflow $1.6 billion during the month.[5]
- New issuance activity declined from the prior month's record but remained elevated at $71.8 billion. This amount included the tail end of January's repricing wave, which then stalled as loan prices fell. Excluding the $45.8 billion of repricings and refinancings, new issuance was $26.0 billion (far short of the $54.6 billion of loan paydowns).[5]

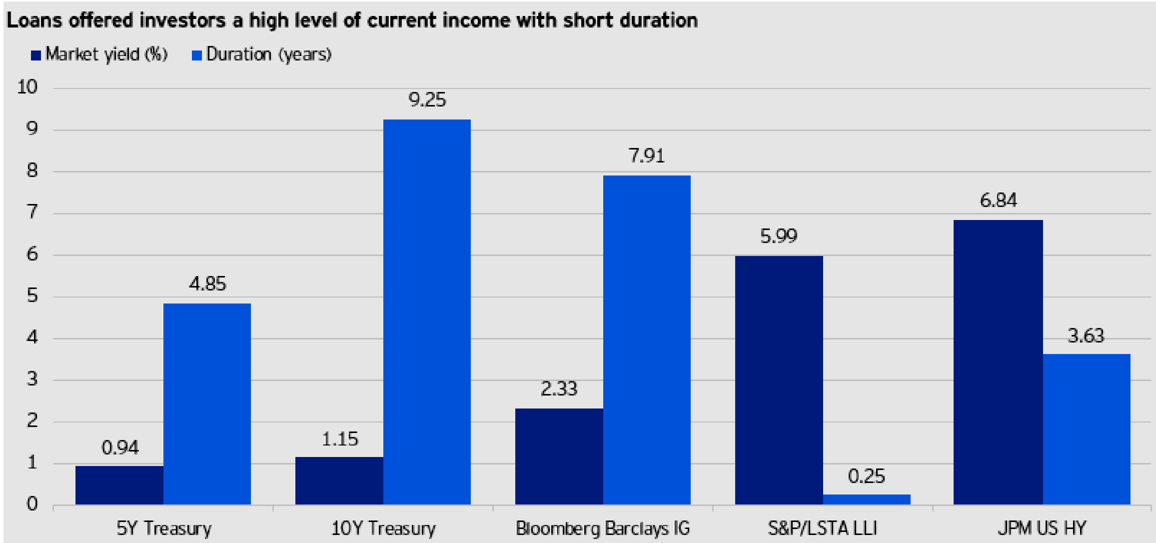
Relative value/market opportunity

The COVID-19 outbreak has generated significant concern about a potential recession and impaired corporate earnings environment in the near term, particularly as the virus continues to spread globally. However, absent a worst-case pandemic scenario, this exogenous disruption is likely to be relatively short-lived. Factories in China, the epicenter of the outbreak, have slowly begun to restart operations as citizens are permitted to return to work. Meanwhile, governments around the world are signaling their intent to proactively intervene with stimulus measures to soften the impact to their domestic economies. The US Federal Reserve announced a surprise 50 basis point rate cut on March 3rd while additional fiscal measures are being discussed by Congress and the White House. Although the reduction in rates could form a headwind to loan investors' current income, it could also serve to improve risk sentiment and market function overall.

Broadly speaking, loan market issuers maintain healthy balance sheets that can withstand a temporary economic slowdown. This is even truer following the recent wave of repricings and refinancings that lowered interest expense and extended maturities for many issuers. At this point, the most negatively impacted sectors from COVID-19 are likely to be Airlines, Travel & Leisure, and Energy, each of which comprises a relatively small percentage of the overall market. Given the senior secured status of loans and the reliable cash flow from issuers servicing their debt, the asset class remains investable even amid the uncertainty and will likely present compelling relative value opportunities for level-headed, long term investors as more information becomes available.



Sources: LCD, an offering of S&P Global Market Intelligence; Bank of America Merrill Lynch as of Feb. 29, 2020. Equities represented by the S&P 500 Index; high yield represented by the Merrill Lynch US High Yield Master II Index; loans represented by the S&P/LSTA Leveraged Loan 100 Index. **Past performance is not a guarantee of future results.** An investment cannot be made directly in an index.



Source: Bloomberg L.P., Barclays, JP Morgan, and S&P LCD as of Feb. 29, 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**	**At forward Libor**	**Duration (years)**
5 Year Treasuries	100-29	0.94	–	–	4.85
10 Year Treasuries	103-09	1.15	–	–	9.25
Bloomberg Barclays US Agg. Index	109.07	1.68	T + 0.64	–	5.88
Bloomberg Barclays IG Index	112.51	2.33	T + 1.19	–	7.91
JPM US HY Bond Index	99.20	6.84	T + 5.84	–	3.63
S&P/LSTA Leveraged Loan Index	**95.40**	**L + 5.10**	**T + 5.09**	**5.99%**	**0.25**

Source: S&P LCD, Barclays, JP Morgan and Bloomberg L.P. as of Feb. 29, 2020. Loan "spread to worst" and "at forward Libor" incorporate LIBOR forward curve.

1 S&P 500 Index in USD as of Feb. 29, 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.
2 S&P/LSTA Leveraged Loan Index as of Feb. 29, 2020.
3 S&P/LSTA Leveraged Loan Index and Bloomberg as of Feb. 29, 2020. High yield represented by BAML US High Yield Index; investment grade represented by the BAML Investment Grade Index.
4 JP Morgan as of Feb. 29, 2020.
5 S&P LCD as of Feb. 29, 2020.
6 S&P LCD and Invesco as of Feb. 29, 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 Feb. 29, 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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