European Loan Market Snapshot

Invesco Senior Secured Loans

Monthly European loan market update: August 2024

The Credit Suisse Western European Leveraged Loan Index ("CS WELLI" or "Index") returned 0.58% this month, generated by an interest return of 0.67% and offset by a principal return of -0.09%.[1]

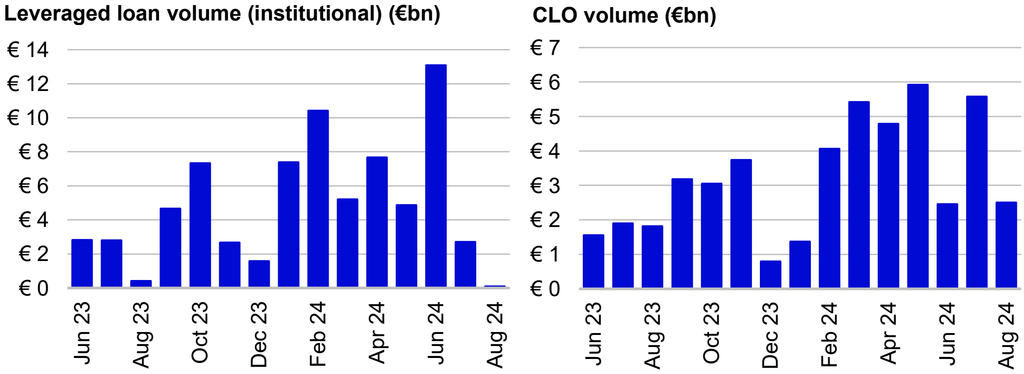
August, normally a muted month as vacations kick-in and deal activity pauses, was a "month to remember" this year. It started with large moves across financial assets as US non-farm-payroll numbers surprised (negatively), leading to a rapid US-rate rally. With cuts priced, unwinding of Yen carry-trades occurred, leading to equities selling-off across the globe (previously the low Japanese interest rate allowed for funding leg*). This unwinding and payroll reaction led to the S&P 500 dropping about 5%, the Nikkei 225 over 10%, while the VIX went up over 100%, all in one day. In the following week, substantial gains for these indexes were seen – JPY depreciated (helped by BoJ reassurances)- and better economic data cooled recession fears. Over the rest of the month, risk assets price levels improved and rates slowly grinded tighter.

The WELLI, as shown above, also returned positive total-returns for the month, driven by positive carry, as average prices were flat for the month; moving to 97.40 from 97.43. Accoringly, the index's three-year-discount margin was 470 bps, average-spreads at 394 bps, and current yield of 8.29% (each only moving 1-3bps over the month) [1].

As typical for the summer period, deal flow was limited (about €100m in volumes, vs approximately €400m last year), although robust CLO activity continued - continuing the firm, long established, technical across loan prices – with around €2.5bn of CLO volumes in August printed (vs €1.8bn last year). [2]

In speaking to various syndicate banks, a reaonsable forward calendar is anticipated, with activity expecting to materialize mid-September. Overall, this dynamic remains construtive in the near term for loan prices as several CLO warehouses continue to ramp (buy) assets. We also expect some new issuers to enter the loan market, refectling an improving M&A / LBO environment, an overall positive dynamic.

Figure 2: Supply/demand backdrop



Source: Pitchbook Data Inc. as of August 31, 2024.

Returns

- The Energy sector performed best this month, returning 1.08%, followed by Media/Telecommunications and (1.05%) and Forest Prod/Containers (0.71%).[1] Consumer Durables (-0.18%) was the only negatively performing sector during the month.[1]
- 'CCC' rated loans performed best this month with a total return of 1.28%, followed by 'BB' rated loans (0.55%), and 'B' rated loans (0.49%).[1]
- At month end, the average price of the CS WELLI was €97.40, down €0.03 during the month.[1] The CS WELLI's three-year discount margin was EURIBOR + 4.70%, a tightening of approximately 1bps during the month.[1]

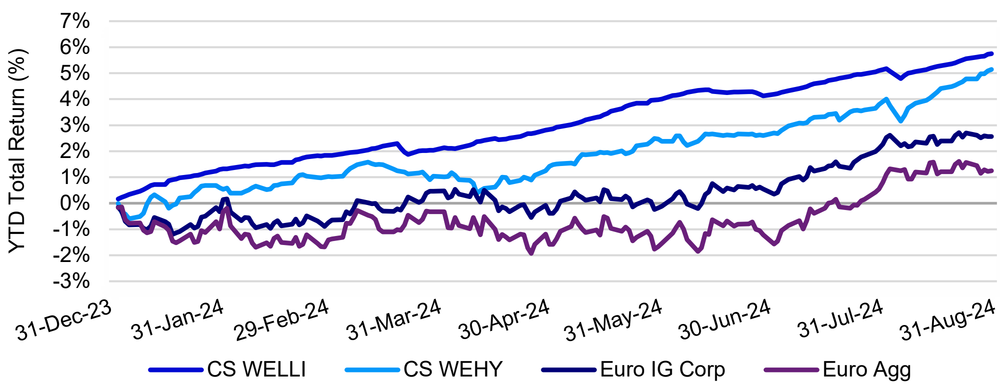
Fundamentals

- Euro Area (EA) August flash composite PMI increased 1.1pt to 51.2. A 0.6 point (pt) decline in Germany to 48.5 was reported, while the French index increased 3.6pts to 52.7 (weighted towards services component, and influenced by the Olympics). The composite PMI increased 0.9pt across the remainder of the EA to 52.5. The EA PMI had declined meaningfully over June-July. Excluding the noisy French number, it is a postive to observe that the PMI overall improved in August: strength in the periphery regions and the Olympics impact in France more than offset the weakness in Germany and manufacturing.
- EA headline HICP decreased to 2.2% in August (from 2.6%). Core edged down 2.8% (from 2.9%, in line with consensus). The main driver for headline getting closer to the 2% target was energy inflation declining to -3.0%, due to large base effects from last year and a fall in fuel prices this month.
- Germany's Ifo Business Climate index, showed further erosion in economic sentiment in August, although the decline was not as bad as consensus. Automotive export expectations fell to their lowest levels since 2008 and 2020, which could anticiapte weak demand or uncertainty about trade relations with the US and China.
- The European Central Bank (ECB) is expected to lower deposit rates in their September meeting.
- The last twelve-month default rate for the Morningstar European Leveraged Loan Index (based on principal amount) is 0.78%.[3] The historical average annual default rate is 2.82%.[3]

Market opportunity

Macroeconomic trends have helped to facilitate a robust loan market. While growth has potentially plateaued in Europe (but remaining positive), going forward we believe funding costs will likely become lower supportive for credit. Demand from CLOs is expected to remain constructive. We envision better M&A during the latter parts of the year. Overall, the supply/demand technical remains favorable for loan assets. Loans have delivered low volatility – and thus high risk-adjusted returns – year-to-date as depicted in Figure 3, and are on track to deliver another year of exceptional returns.

Figure 3: Year-to-date stable asset class performance



Source: Credit Suisse, Barclays, Bloomberg as of August 31, 2024. **Past performance is not a guarantee of future results**. CS WELLI represents the Credit Suisse Western Leveraged Loan Index, CS WEHY represents the Credit Suisse Western European High Yield Index, IG Corp represents the Bloomberg Euro Aggregate Corporate Total Return Index, and Euro Agg represents the Bloomberg Euro Aggregate Total Return Index.

Relative yield

	$ Price	Yield to worst	Spread to worst	Duration
Bloomberg Euro Aggregate Total Return Index	93.97	2.98	N/A	6.35
Bloomberg Euro Aggregate Corporate Total Return Index	95.74	3.46	N/A	4.41
Credit Suisse Western European High Yield Index (EUR-hedged)	95.35	6.89	4.06	2.89
Credit Suisse Western European Leveraged Loan Index (EUR-hedged)	97.40	7.53	4.70	0.25

Source: Barclays, Credit Suisse and Bloomberg L.P. as of August 31, 2024. Loan “yield to worst” and “spread to worst” incorporate the EURIBOR forward curve. An investment cannot be made in an index.

1 Credit Suisse Western European Leveraged Loan Index (CS WELLI) in EUR as of August 31, 2024. Past performance is not a guide to future returns. An investment cannot be made directly in an index.

2 Pitchbook Data Inc. as of August 31, 2024.

3 Morningstar European Leveraged Loan Index, average default rates covering June 1, 2007, through August 31, 2024.

* The borrowing of money in a currency with a low interest rate which is then used to invest in higher return assets, such as equities

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.