Invesco

European Loan Market Snapshot

Invesco Senior Secured Loans

Monthly European loan market update: February 2022

The Credit Suisse Western European Leveraged Loan Index (CS WELLI or Index) returned -0.90% this month, generated by a principal return of -1.20% and interest return of 0.29%.[1]

The fall in markets during the month – including the CS WELLI which fell in price by €1.26 to €97.43 – resulted from the Russian invasion of Ukraine. Across the borrowers forming the CS WELLI, there is limited overall direct "Russian revenue" exposure.

The European Union (EU), US and others have introduced sanctions on Russia which aim to strongly limit trade-flows. Given Russia is one of the world's leading energy producers, this has sent oil prices up to approximately $110/barrel (WTI), or around 45% higher from the start of the year. Furthermore, upwards price pressure occurred across commodities in general, driving, in part, expectations of lower global economic growth. For example, the European Central Bank (ECB) has estimated that the Ukraine conflict may reduce the Eurozone's economic output by 0.3%-0.4% this year.

The CS WELLI's February return of -0.90%[1] was an outperformer relative to the Credit Suisse Western European High Yield Index (about -3%), the US S&P 500 Index (about -3%), and the STOXX Europe 600 Index (about -3.4%).[2,3] Specific sector returns are outlined below.

Unsurprisingly, primary loan issuance saw a sharp drop this month: €4.3bn was issued, which is 60% lower than the €11.2bn recorded in January. Issuance was concentrated in the first three weeks of the month, prior to significant market widening (margins) following the escalation of the Russia-Ukraine conflict. Several deals have been postponed. Markets are currently in a holding pattern with new issuance expected to be muted over the coming weeks.

CLO formation for the month came in at a relatively strong €4.6bn, approximately 21% higher compared to February 2021 (again concentrated in the beginning of the month). While AAA CLO liabilities priced at an attractive approximate 95bps level prior to the Ukraine events, deals currently in market are facing higher liability costs in the 105-110bps range.

Despite CLO liabilities widening, we expect good demand from CLO warehouses to continue providing stability for the leveraged loan market, as the current market environment is providing attractive arbitrage opportunities for newly setup warehouses.

The CS WELLI's nominal value at the end of the month stands at €392bn, up 21% year-over-year.[1]

Returns

- The Energy sector performed best during the month, driven by the steep increase in oil prices, returning 1.18%.[1] It was the only sector showing positive returns. The worst performing sectors were Consumer Durables (-1.87%), Forest Products/Containers (-1.81%), and Food/Tobacco (-1.43%).[1]
- 'CCC' rated loans performed best this month, with a total return of +0.10%, as compared to -0.80% for 'BB' rated loans and -1.04% for 'B' rated loans.[1]
- At month end, the average price of the CS WELLI was €97.43, down €1.26 during the month.[1] The CS WELLI's three-year discount margin was 4.59%, a significant widening of c. 46bps during the month.[1] For comparison, the Credit Suisse Western European High Yield Index fared materially worse and returned negative 2.92% for the month and had a spread-to-worst yield of 4.84%.[3]

Fundamentals

- The EU (and the UK) have introduced sanctions against Russian entities, individuals, and sectors. Banning Russian institutions from the European payments system (SWIFT) is unlikely to be an insurmountable hurdle for Russia and the EU to exchange payments related to energy supplies. This ban, however, could cause retaliation from Russian authorities, who place pressure on companies to reduce their exports to Europe. The ensuing risk of major supply disruptions (across Europe) would be the most impactful for European GDP in the near term.
- The Euro area ("EA") February composite PMI was revised slightly lower to 55.5. The Italian and Spanish readings indicate that services have quickly recovered from the Omicron slump. At face value, this data would bode well for a second-quarter recovery; however, the conflict in Ukraine and the possibility of energy supply disruptions implies significant downside risks (the sample period for today's PMI release pre-dated the start of the Russian invasion of Ukraine).
- Inflation in EA continues to rise. Inflation hit 5.8% in February with fears that the situation in Ukraine will further drive up the cost of living and increase pressure on the ECB regarding when to adjust monetary policy and how to balance rising prices with slower economic growth.
- Eurostat data indicates the January EA unemployment rate fell from its December value of 7.0% to a new all-time low of 6.8%, below consensus expectations.
- The last twelve-month default rate for the S&P European Leveraged Loan Index (based on principal amount) is 0.82%.[4] The historical average annual default rate is 3.16%.[4]

Index returns (%)

Name	2018	2019	2020	2021	Dec 2021	Jan 2022	Feb 2022
Credit Suisse Western European Leveraged Loan Index (EUR-HDG)	0.55	5.03	2.38	4.63	0.42	0.29	-0.90
Credit Suisse Western European HY Index (EUR-HDG)	-3.85	11.05	1.95	4.04	1.06	-1.65	-2.92

Source: Credit Suisse, as of February 28, 2022. **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 February 28, 2022. Past performance is not a guide to future returns. An investment cannot be made directly in an index.
2. STOXX Europe 600 Index and S&P 500 Index as of February 28, 2022, respectively. The STOXX Europe 600 Index has a fixed number of 600 components representing large, mid and small capitalization companies among 17 European countries, covering approximately 90% of the free-float market capitalization of the European stock market (not limited to the Eurozone). The S&P 500 Index is a stock market index that measures the stock performance of 500 large companies listed on stock exchanges in the United States.
3. Credit Suisse Western European High Yield Index in EUR as of February 28, 2022.
4. S&P European Leveraged Loan Index, average default rates covering June 1, 2007 through February 28, 2022.

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.