Invesco Senior Secured Loans

US Loan Market **Snapshot**

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

The senior secured loan market finished 2019 on an ebullient note, gaining 1.60% in December and raising year-to-date returns to 8.64% – one of the strongest annual returns in the past decade.[1] Investors became increasingly comfortable adding risk during the month in light of the tentative 'phase-one' US-China trade agreement and diminishing fears of recession. The 'flight to quality' trade which had defined much of 2019 in the loan market began partially retracing in November, and that reversal accelerated in December. As investor sentiment improved, concerns about further downgrade risk – a headwind to lower rated credit for most of the year – faded from the foreground, enabling a risk rally. The loan market's distress ratio (i.e. percentage of loans trading below $80) eased from November's peak of 5.89% to 3.79% at year-end.[2]

Loans underperformed high yield bonds (2.11%) in December, but outperformed investment grade (0.33%),[3] and the 10-year Treasury (-1.02%). As prices moved up during the month, the percentage of loans trading above par rose from 32% to 53%.[4] "BBs" (0.88%) lagged "Bs" (1.94%) and "CCCs" (3.24%) amid the 'risk-on' pivot, but still outperformed both "Bs" and "CCCs" for the full year.[2] The rally in stressed names was also evident at the sector level as the Energy, Retail, and Healthcare sectors all outperformed the broader market. The average price in the loan market was $96.76 at the end of December.[5] At the current average price, senior secured loans are providing a 6.20% yield inclusive of the forward LIBOR curve.[5]

Fundamentals

- Economic data remained encouraging in December. Readings on business equipment spending, business sentiment, and labor markets pointed to stability while personal spending data (including initial holiday spend tracking) indicated a healthy consumer.
- The trailing 12-month default rate dipped slightly to 1.39% during the month as only 4L Technologies was added to the list of recent defaults.[2]

Technicals

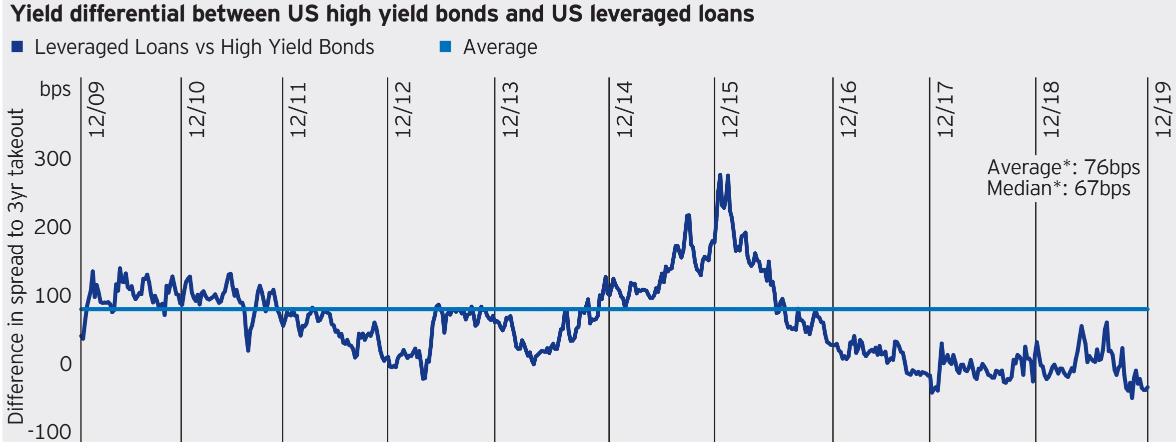
- Technicals were supportive of higher prices in December as sentiment improved and new issue supply was light. The buoyant price environment led to an uptick in repricing activity; 38% of 2019's loan repricings occurred in December.[4]
- Gross CLO volume was $8.5 billion in December, with $7.8 billion of issuance net of resets and refinancings. After a slow start to the year, issuance net of resets and refinancings totaled $118.8 billion in 2019, nearly matching 2018's record pace.[4]
- Retail mutual funds and ETFs continued to report withdrawals, with approximately $1.0 billion exiting the asset class in December (mutual fund outflows partly offset by ETF inflows). This brought year-to-date retail outflows to $37.2 billion.[4]
- New issuance activity slowed to $38.0 billion during the seasonally quiet month of December, with just $4.9 billion net of refinancing and repricing activity. For the full year, gross and net issuance were $391.6 billion and $192.2 billion, respectively (44% and 36% below 2018 levels).[4]

Relative value/market opportunity

Loans delivered strong risk-adjusted returns in 2019 despite several headwinds that might have spelled trouble for the asset class according to conventional market wisdom. These included declining LIBOR, steady retail outflows, moderating economic / corporate earnings growth, and mounting issuer downgrade risk. Yet the loan market overcame these challenges thanks to robust coupon income, balanced technicals, and investors' rational discernment of credit risk throughout the year. Weaker quality credits underperformed amid a combination of late cycle, sector, and idiosyncratic concerns, but that was more than offset by strong price performance among higher quality issuers with strong balance sheets and better earnings outlooks.

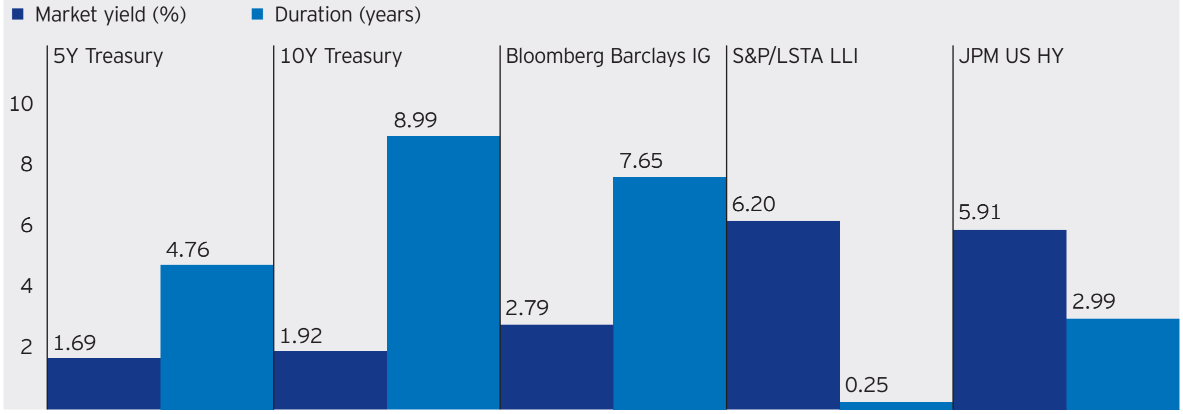
In total, 2019 again demonstrated why investors should consider an allocation to loans. Loans' advantageous position within the capital structure relative to other forms of junior ranking debt mitigates the risk of credit loss and lowers price volatility, beneficial to those seeking high income and credit exposure but with lingering concerns about the durability of the economic cycle. With the Federal Reserve having completed its "mid-cycle adjustment" to rates, interest rates are less likely to negatively impact loan returns next year. Meanwhile, the year-to-date outperformance of unsecured high yield credit (largely a duration play in response to policy rate easing) has driven bond yields below those of loans, an historically atypical situation that adds to a compelling relative value case for loan exposure.

Yield differential between US high yield bonds and US leveraged loans



Source: J.P. Morgan Leveraged Loan Index versus J.P. Morgan US High Yield Bond Index as of Dec. 31, 2019.
*Historical data includes periods Feb. 1, 2007 to Dec. 31, 2019.

Loans offered investors a high level of current income with short duration



Source: Bloomberg L.P., Barclays, JP Morgan, and S&P LCD as of Dec. 31, 2019. **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	100-09	1.69	–	–	4.76
10 Year Treasuries	98-15	1.92	–	–	8.99
Bloomberg Barclays US Agg. Index	105.61	2.31	T + 0.54	–	5.87
Bloomberg Barclays IG Index	109.13	2.79	T + 0.93	–	7.65
JPM US HY Bond Index	101.52	5.91	T + 4.24	–	2.99
S&P/LSTA Leveraged Loan Index	**96.76**	**L + 4.61**	**T + 4.59**	**6.20%**	**0.25**

Source: S&P LCD, Barclays, JP Morgan and Bloomberg L.P. as of Dec. 31, 2019. Loan "spread to worst" and "at forward Libor" incorporate LIBOR forward curve.

1 S&P/LSTA Leveraged Loan Index as of Dec. 31, 2019.
2 S&P LCD as of Dec. 31, 2019.
3 S&P/LSTA Leveraged Loan Index and Bloomberg as of Dec. 31, 2019. High yield represented by BAML US High Yield Index; investment grade represented by the BAML Investment Grade Index.
4 JP Morgan as of Dec. 31, 2019.
5 S&P LCD and Invesco as of Dec. 31, 2019.

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.

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