Partners Group
REALIZING POTENTIAL IN PRIVATE MARKETS

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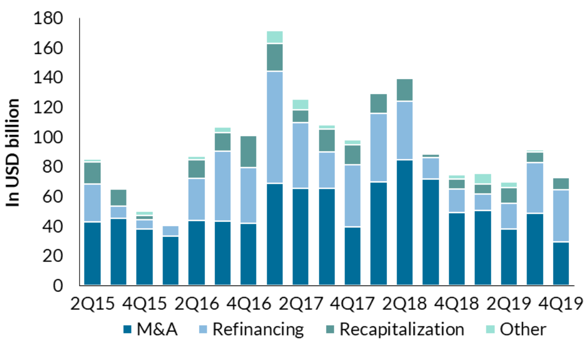
Quarterly Loan Market Commentary

US loan market overview

The fourth quarter of 2019 started with a continuation of credit risk aversion and bifurcation, as loan investors chased double-B rated names with little regard to price, while still remaining very selective on single-B rated credits. This flight to quality was not driven by retail buyers, as is typical, but by collateralized loan obligations (CLOs) seeking to offset weaker portfolio metrics following years of aggressive low single-B purchases, in light of lingering geopolitical and economic concerns.

US institutional loan volume

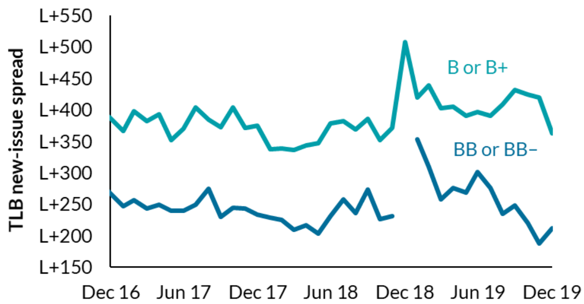


Source: S&P LCD, Q4 2019. For illustrative purposes only.

Not surprisingly, institutional loan issuance volume dipped in Q4 to USD 73.2 billion, from USD 91.1 billion in Q3, but was still comparable to the levels observed in recent quarters (Q3 2018 to Q2 2019). The issuance volume decline was largely driven by lower US M&A activity, which dropped 40% from Q3 levels, impacted greatly by macro market uncertainties and registering the lowest M&A quarter since 2013.

Some of the new loan issuance decrease was offset by a strong wave of opportunistic refinancings, as higher rated issuers cut loan spreads in response to the growing investor flight to quality. As a result, double-B rated issuance increased to USD 28.7 billion in Q4, its strongest quarter in two years and its best full-year issuance since 2002.

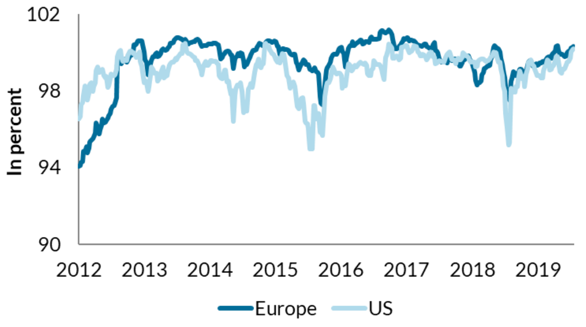
Spread gap between US BB and B loans



Source: S&P LCD; S&P/LSTA Leveraged Loan Index, Q4 2019. For illustrative purposes only.

While many double-B rated issuers were able to reduce loan spreads due to strong demand in Q4, many other single-B rated issuers could not, and paid much higher spreads to issue debt. With the decline in overall new loan issuance in Q4, investors with cash turned to the secondary markets to invest. Despite lower spreads, double-B rated loans were quickly bid higher, going above par, while other single-B rated loans with higher spreads also rose several points, topping 98% at quarter end. With most secondary loan prices rallying, the credit risk bifurcation and risk-off investment mentality receded.

Average bid for flow names

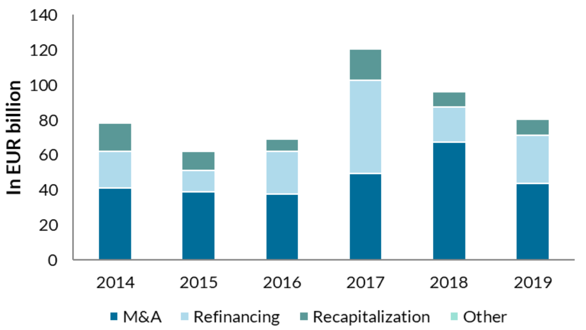


Source: S&P LCD, Q4 2019. For illustrative purposes only.

European loan market overview

European loan issuance volume for 2019 was EUR 81.0 billion, down from EUR 96.8 billion in 2018. Despite two consecutive years of issuance declines, the years 2017, 2018 and 2019 still rank as the three largest Euro loan issuance years on record. 2019 issuance volume was driven by a pick-up in opportunistic loan recapitalizations and refinancings (34% of 2019's issuance total, compared to 21% in 2018). Offsetting this was declining M&A activity, which comprised only 54% of 2019 supply, compared to 70% in 2018. Refinancing activity in Q4 was fueled by strong investor demand – aided largely by growing CLO issuance – which pushed up secondary prices further and led to compressed loan spreads.

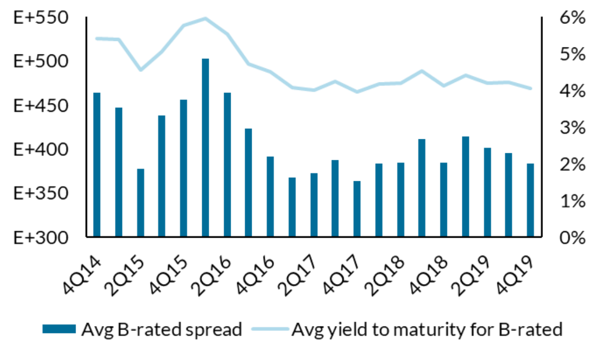
European institutional loan volume



Source: S&P LCD, Q4 2019. For illustrative purposes only.

As demand outstripped supply of Euro loans throughout much of 2019, new loan spreads continued to grind lower. By Q4, institutional spreads had compressed to 404bps, compared to 424bps in Q1.

Average Euro single-B primary spread and yield to maturity



Source: S&P LCD, Q4 2019. For illustrative purposes only.

With record European CLO issuance, growing demand from institutional managed accounts, and declining overall Euro loan issuance, secondary bids for institutional flow names jumped 200bps during 2019, from the mid-98s to the mid-100s.

US collateralized loan obligations

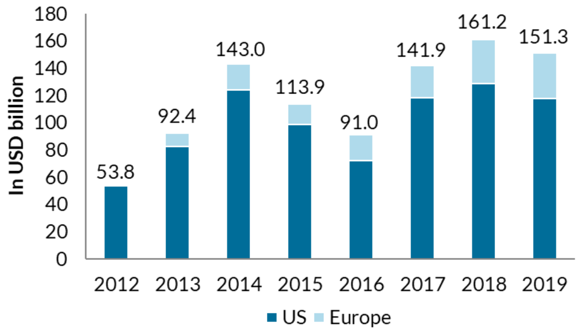
By most metrics, US CLO issuance in 2019 was strong, with 246 CLOs issued totaling USD 118.3 billion, down slightly from the record USD 128.9 billion of CLOs issued in 2018 (241 CLOs). Triple-A CLO new issue average spreads remained in a tight range, between Libor + 133-137bps, while the lower end of the capital structure (triple-B and double-B liabilities) experienced quarterly volatility in spreads, resulting in periods of more attractive and less attractive CLO arbitrage.[1, 2]

European collateralized loan obligations

European CLO issuance reached a record EUR 29.8 billion in 2019 from 72 issues, compared to EUR 27.3 billion from 66 issues in 2018. Triple-A new issue spreads in 2019 tightened for much of the year, averaging EURIBOR + 105bps. Much of this spread tightening occurred from September to November, when triple-A spreads dipped to EURIBOR + 95bps. While triple-A spreads improved through 2019, triple-B, double-B and single-B rated liabilities conversely languished, especially in Q3-Q4, pushing CLO mezzanine liability issuance spreads wider at year end.[2]

1 CLO arbitrage refers to the difference between the CLO collateral's interest income and the cost of CLO liabilities and ongoing expenses, available to be distributed to CLO equity investors.

Arbitrage CLO volume



Source: S&P LCD, Q4 2019. For illustrative purposes only.

2 All figures sourced from S&P LCD, Q4 2019.

Spotlight topic: US loan defaults

Despite annual expectations that the US business cycle will soon end and fears of the next recession, the current US business expansion has now moved into record territory at 127 months (from around June 2009) and shows no signs of ending. Cumulative US GDP growth for the period has been markedly sustainable. Nonetheless, leveraged loan investors remain focused on US leveraged loan default rates, which continue to be range bound and manageable at 1-2%. For 2019, the US loan default rate by issuer finished at 1.62%, while the rate for defaults by dollar amount was 1.39%.[3] Notably, these loan defaults were well spread across twelve industries and not driven by one sector.

3 S&P LCD, Q4 2019.

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