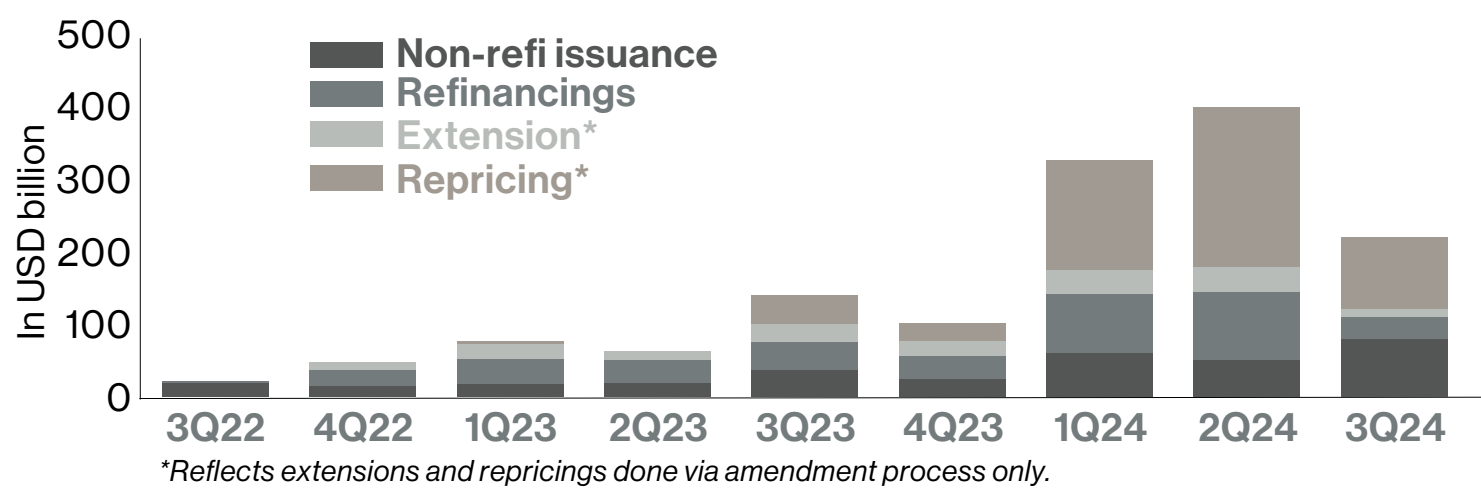
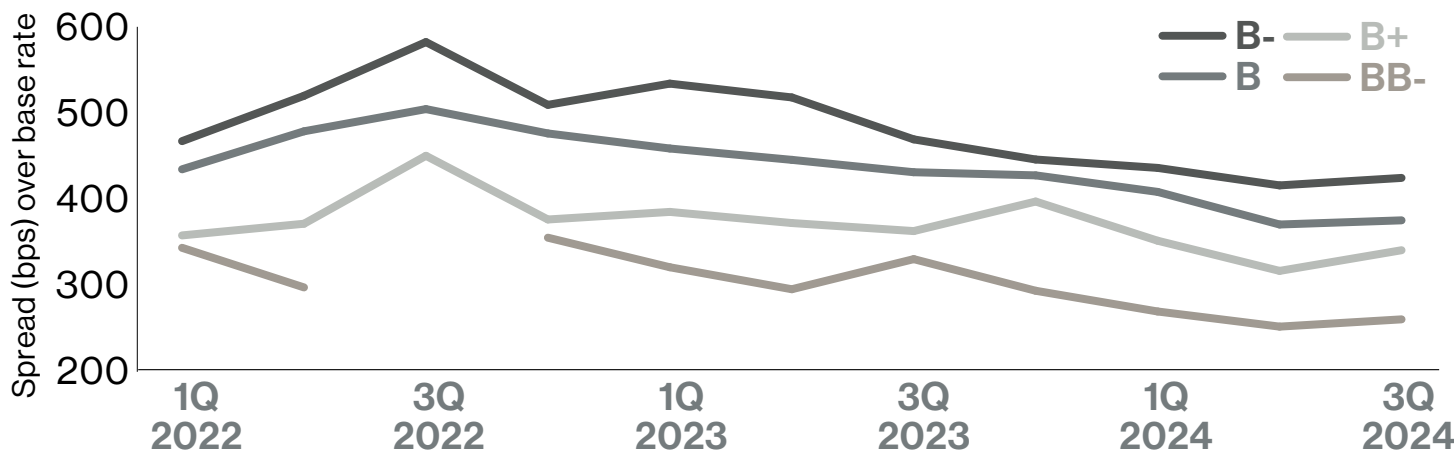


# Quarterly Liquid Credit Market Commentary Q3 2024 Issue 21

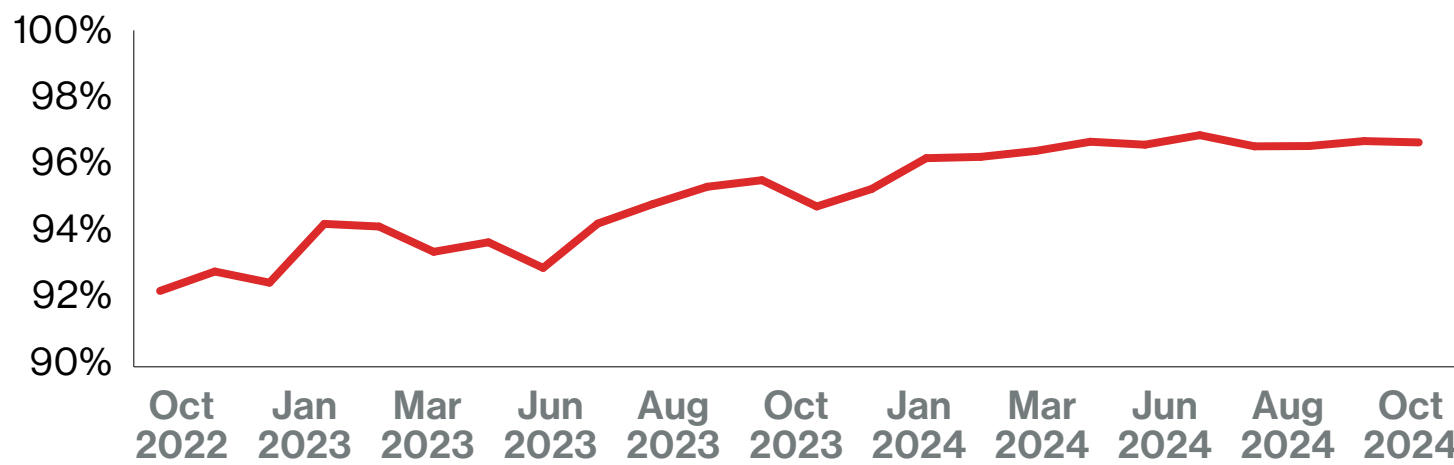
## US new-issue institutional loan volume



## US new-issue loan spreads



## US loans index average bid (LLI)



Source: PitchBook | LCD • Data through 30 September 2024. For illustrative purposes only.

## US liquid loan market overview

Two major market developments marked the third quarter of 2024: the beginning of the long-awaited US Federal Reserve interest rate cuts; and a pickup in US M&A activity that bolstered new-loan issuance volumes. In addition, the market saw a meaningful increase in dividend financings by private equity sponsors in response to persistent investor demand for additional loan supply. Even with this higher new issue volume, loan repricings and refinancings resumed, albeit at a slower pace than the first half of 2024. While insufficient to close the loan supply-demand gap that has prevailed for several quarters due to heavy new collateralized loan obligations (CLO) issuance volumes in 2024, new loan activity did suppress secondary trading bids coming from these same CLOs and slowed the pace of loan spread reductions and maturity extensions during the third quarter.

## US new-issue loan issuance

The Fed finally initiated a cycle of lowering interest rates in mid September, with an aggressive 50bps cut. This signaled to the market that the Fed was finally ready to take its focus away from inflation and on to other drivers needed for a stable economy and strong employment. It also confirmed the latest market sentiment anticipating a soft or no landing scenario for the US economy heading into 2025. This should fuel greater M&A and LBO activity,

the lifeblood for new-issue loans as well as new CLOs. For Q3 2024, primary loan market activity topped USD 222.7 billion, the fourth most active quarter on record, but still well below the USD 404.8 billion posted in Q2 2024. While much of this total again was driven by repricings, refinancings and maturity extensions, non-refinancing activity (i.e., new loan supply) totalled USD 80.6 billion. This was led by USD 24.7 billion of M&A, USD 20.6 billion of LBOs and USD 28.8 billion of dividend financings. The frenetic pace of activity brought non-refinancing related activity (year to date 2024) to levels last observed during the record year of 2021, which was propelled by the post-COVID economic re-opening in the US.

In 2024, much of the LBO, M&A and dividend issuance transaction activity was initiated by US private equity sponsors who have been waiting to exit many of their long-term equity positions to realize gains for their investors. Per data from Pitchbook/LCD, the median age of private equity portfolio companies in the US at the end of 2023 stood at 4.1 years (a ten-year high), while the median holding period for private equity owned companies prior to exit stood at an all-time high of 7.1 years. This has led to high expectations of numerous equity realizations over the coming year, which could create significant new loan issuance for a hungry loan market.

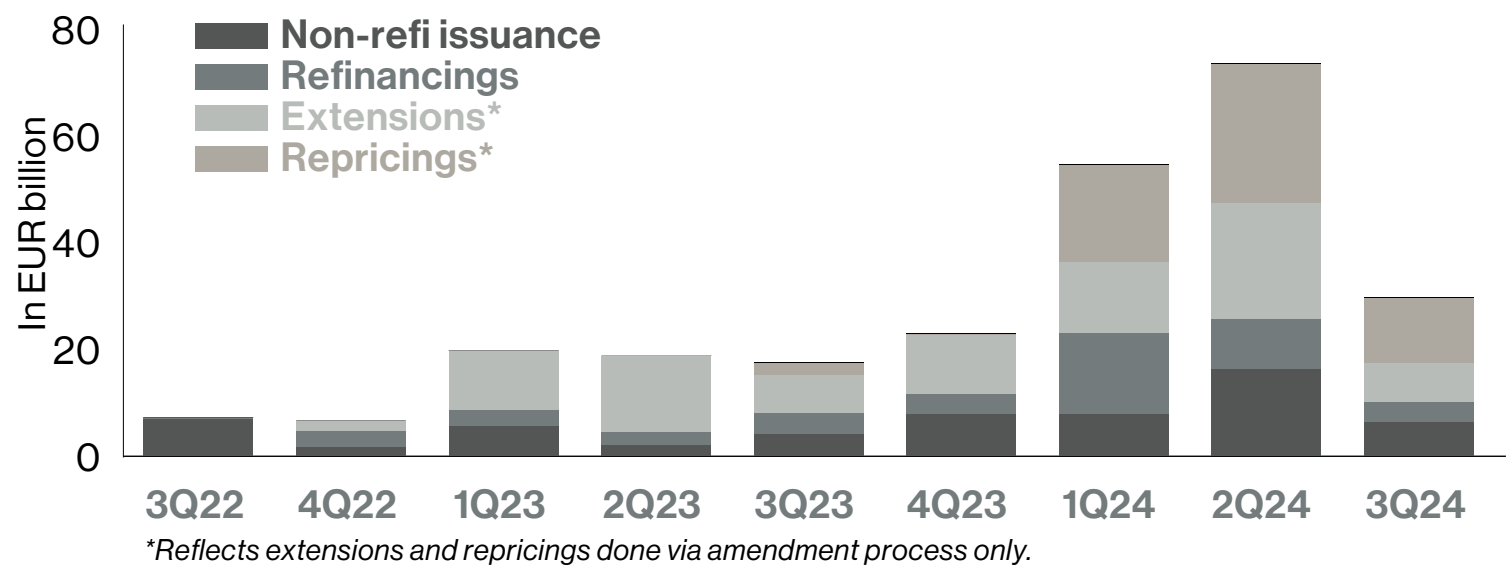
Loan repricing activity for Q3 2024 totalled USD 100.8 billion. While this was the fourth largest

quarter on record, it was notably lower than the USD 223.6 billion posted for Q2 2024, and USD 154.8 billion for Q1 2024. A record USD 479.2 billion of loans have repriced loan spreads lower this year at an average reduction of 53bps. This has resulted in an astounding USD 2.7 billion of cash interest expense that would have been payable to loan investors, but ended up being retained by borrowers instead, even before future interest savings accrued from lower SOFR base rates prompted by the recent (and future) rate cuts. For the first three quarters of 2024, the wave of loan refinancing, repayment and extension activity resulted in a loan turnover rate over 60% of the US loan universe. Confronted by this high turnover rate and with so many loan investors constantly long cash, it is no wonder US loan spreads have been contracting month over month during 2024.

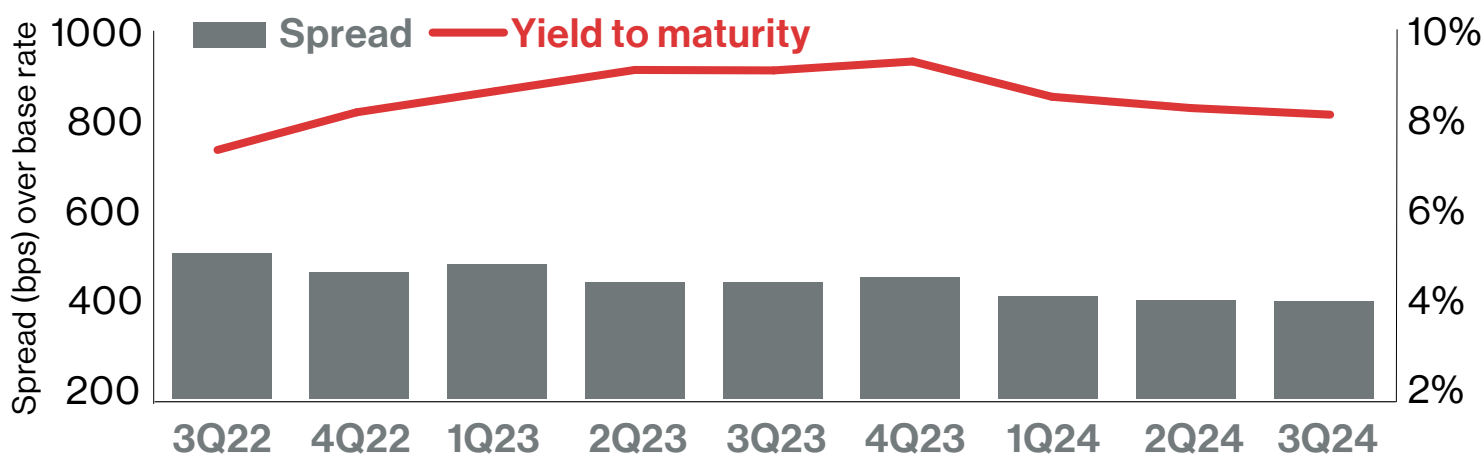
## US new-issue loan spreads

Despite investor demand continuing to outstrip loan supply, loan spreads on new issue actually ticked higher during Q3, as a greater number of M&A, LBO and dividend recap financings came to market. Spreads across loans rated BB- and lower actually saw some widening, reflecting higher leverage profiles for certain new issuers. Meanwhile, repricings and refinancings slowed, reducing the rapid spread contraction during the quarter. The spreads of new-issue loans rated BB- increased

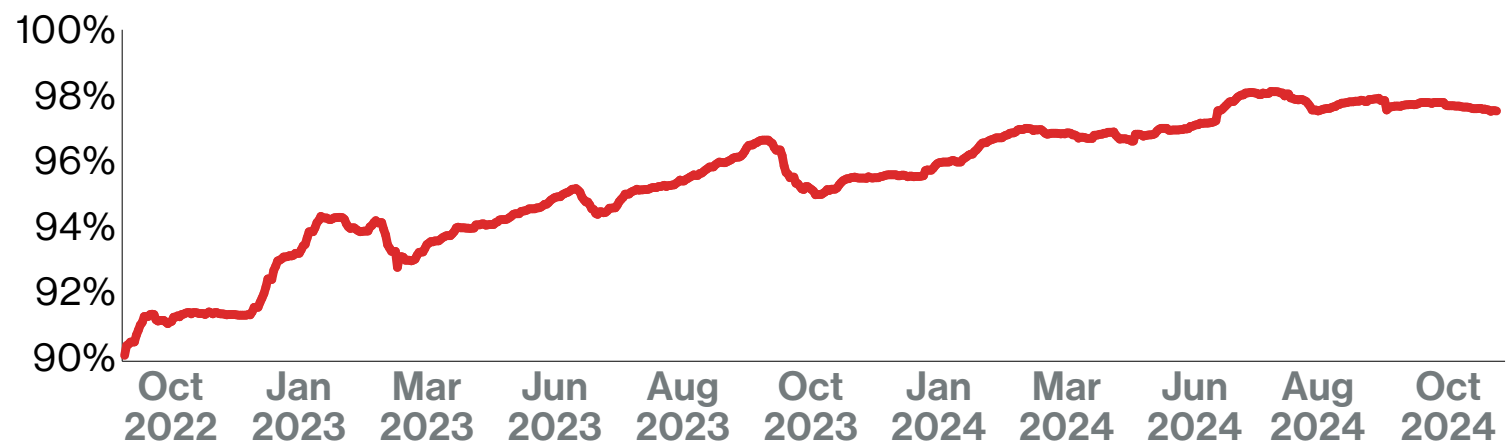
European new-issue institutional loan volume



European average new-issue loan spreads and yield



European loan index (ELLI)



Source: PitchBook | LCD • Data through 30 September 2024. For illustrative purposes only.

slightly to 257bps in Q3, from 249bps in Q2. Issuers rated B+ saw spreads rise in Q3 to 339bps, compared to 314bps in Q2. Average spreads of loan issuers rated B and B- rose to 374bps and 424bps, respectively, compared to 369bps and 415bps in Q2. These Q3 spread increases preserved Q2 new-issue spread levels as the low point observed in the US market over the past six years.

US secondary loan trading

Secondary US loan bids in the third quarter remained rangebound once again. The Morningstar LSTA US Leveraged Loan Index (LLI) opened July 2024 at 96.60% and ended the quarter in September at 96.71%, a modest 0.11% increase. For Q3, this resulted in the LLI gaining 2.02%, a slight improvement from Q2 at 1.89%. For the three quarters of 2024, the LLI has gained a respectable 6.36%. This trails the US recent record from the first nine months of 2023 at 10.16%, but outperforms the same periods of 2020, 2021 and 2022.

European liquid loan market overview

Much like in the US, market technicals in Europe continue to be driven by the inability of new loan supply to meet persistent investor demand – demand which is fed by a strong CLO bid for loan paper. New loan issue, refinancings, maturity extensions and repricings all ticked higher in Q3, but there was a slowdown in pace across each segment with the summer holiday season widely thought to be the primary reason. As September unfolded, loan activity volumes resumed, largely affirming this view.

European new-issue loan issuance

Looking across the landscape of institutional loan activity in Europe in Q3, it was still loan repricings that dominated the market's attention, totaling EUR 12.2 billion. However, this was notably lower than the EUR 26.1 billion posted in Q2. Maturity extensions in Q3 contributed EUR 7.3 billion of volume, also down significantly from the EUR 21.7 billion seen in Q2. New-issue loan volumes dipped to EUR 6.2 billion in Q3, compared to the EUR 16.3 billion posted in Q2, as M&A and buyout volumes slipped in Q3. Lastly, refinancings totaled EUR 3.8 billion in Q3, down from the EUR 9.3 billion in Q2. The main takeaway from these statistics is the net new issue amount (EUR 6.2



billion) which was added to European institutional loan roles in Q3. Pitchbook/LCD estimated that the rolling 6-month European institutional loan supply balance stood at EUR -12.1 billion at the end of September, a level which has now been negative each month dating back to October 2021. This will be an area of focus when the European loan market becomes constructive again for loan investors.

European new-issue loan spreads

As investor demand continued to outstrip supply (as described earlier), the limited new loan issuance in Q3 came at tighter spreads again. New-issue loan spreads for a typical single-B credit tightened to 410bps in Q3, compared to 414bps in Q2 and 422bps in Q1. The average yield to maturity for new-issue loans also declined slightly in Q3 to 8.16%, from 8.30% in Q2 and 8.54% in Q1. This 8.16% yield for Q3 now stands a full 1.00% lower than peak market yields observed in Q4 2023.

European secondary loan trading

With loan investor demand unfilled by new issuance totals in Q3, secondary loan trading was again critical for sourcing assets for both new-issue CLOs and for cash redeployment. Surprisingly, however, secondary trading was rangebound during the third quarter. The Morningstar European Leveraged Loan Index (ELLI) began Q3 in July at 97.61%, ticked modestly higher during late July and much of August, before retracing to finish September at only 97.58%. The total return for ELLI in Q3 was still a healthy 1.89%, while year to date (30 September), the ELLI return was 6.78%.



## US collateralized loan obligations

### US CLO issuance

After recording the second highest quarterly issuance in Q2 at USD 52.6 billion (108 CLOs), new CLO issuance volumes of USD 40.6 billion (87 CLOs) for Q3 was a slight letdown. Perhaps a summer lull contributed to the slower new issue pace, but the catalyst was more likely a pickup in CLO resets and

### US CLO liability spreads

#### US CLO average coupon and weighted average cost of capital (bps)

Time frame	AAA	AA	A	BBB	BB	WACC
4Q22 (SOFR+)	231	322	415	582	850	298
1Q23 (SOFR+)	196	261	335	541	825	261
2Q23 (SOFR+)	198	273	336	549	853	259
3Q23 (SOFR+)	187	260	314	495	790	245
4Q23 (SOFR+)	176	256	302	483	786	235
1Q24 (SOFR+)	156	209	254	390	687	205
2Q24 (SOFR+)	149	189	227	344	633	191
3Q24 (SOFR+)	138	172	202	309	613	176
Change from 2Q24	-11	-17	-26	-35	-20	-15
Change from a year ago	-49	-88	-112	-186	-177	-69

Source: PitchBook | LCD • Data through 30 September 2024. For illustrative purposes only.

refinancing activity. In Q3, US CLO resets totaled USD 69.1 billion, while refinancings added another USD 20.8 billion to activity, as CLO managers redirected their attention to improving existing CLO liability costs against a strong investor bid.

### US CLO liability spreads

With over 40% of all US CLOs past their reinvestment period and most experiencing heavy AAA-rated tranche amortization (estimated USD 48.7 billion of CLO liability amortization for Q3, according to Pitchbook/LCD), most CLO investors had to either engage on the new issue and reset calendar, or redeploy the wave of incoming CLO cash into other asset classes. With the consistent investor bid for new and reset CLOs, weighted average cost of capital (WACC) for Q3 CLO issuance dropped to 176bps in Q3, compared to 191bps in Q2, and 205bps in Q1. With WACC declining over 100bps from recent highs in late 2022, it is no wonder CLO managers sought to capture significantly lower liability costs from the 2022 and 2023 CLO vintage. For individual liability tranches, Q3 saw CLO AAAs decline to an average of 138bps, compared to 149bps in Q2 and 156bps in Q1. Meanwhile, liabilities rated AA, A, BBB and BB also had meaningful spread tightening during Q3, in a range of 15-35bps.

### US CLO secondary trading

The record primary activity recorded during Q3 resulted in a dearth of secondary trading. Volumes were down 15% quarter-on-quarter and 24% year-on-year, while liability spreads continued to compress to the tightest levels observed since the first half of



2022. The growing sector of CLO ETFs has become a significant market buyer, especially for short investment grade paper, further limiting the amount of AAA-rated paper available in the secondary market. While prices have compressed since 2023, the high coupon provided by CLOs has propelled returns in the quarter, registering as high as 12.4% on an annualized basis for the BB-rated tranches.

## European collateralized loan obligations

European CLO activity in Q3 picked up due to continued strong investor demand and stable liability spreads. This contributed to a balanced mix of new issue and resets/refinancings, as managers grew CLO assets under management and also improved liability costs for older

### Euro CLO liability spreads

#### Euro CLO average coupon and weighted average cost of capital (bps)

Time frame	AAA	AA	A	BBB	BB	WACC
4Q22 (E+)	210	387	467	625	790	312
1Q23 (E+)	180	297	394	577	728	275
2Q23 (E+)	191	321	410	618	793	296
3Q23 (E+)	174	256	336	513	733	263
4Q23 (E+)	172	266	357	560	789	266
1Q24 (E+)	149	224	276	407	674	227
2Q24 (E+)	146	211	263	377	663	222
3Q24 (E+)	129	194	227	327	614	199
Change from 1Q24	-17	-16	-36	-51	-48	-23
Change from a year ago	-45	-62	-109	-186	-119	-64

Source: PitchBook | LCD • Data through 30 September 2024. For illustrative purposes only.



CLOs, especially the 2022 and 2023 vintage. While new-issue volumes in Q3 were marginally lower than those posted in Q2, new Euro CLO issuance for 2024 is currently on pace for the strongest new-issue year on record (in amount and number of CLOs).

### Euro CLO issuance

European CLO new issuance in Q3 2024 totaled EUR 10.5 billion and 25 CLOs, down from EUR 13.6 billion and 32 CLOs issued during Q2. Conversely, CLO reset and refinancing activity increased, with EUR 9.7 billion of resets in Q3, compared to EUR 4.3 billion for Q2, and refinancings totaling EUR 1.2 billion in Q3, compared to EUR 400 million in Q2.

### Euro CLO liability spreads

Despite healthy Q3 new-issue and reset volumes, WACC for European CLOs for Q3 declined to 199bps, from the 222bps achieved in Q2, and was significantly lower than a year ago in Q3 2023 at 263bps. Notably lower liability spreads were observed across most of the CLO liability stack in Q3, with the exception of

B-rated tranches. Q3 saw AAA spreads tighten to 129bps compared to 146bps in Q2, while in other rated liability tranches spreads declined 16bps to 194bps for AA-rated tranches, and as much as 51bps to 377bps for BBB-rated tranches. As referenced earlier, only B-rated tranche spreads ticked wider during the quarter, having increased 10 bps to 844bps in Q3.

### Euro CLO secondary trading

Activity in the secondary trading market was subdued during Q3, with trading volumes down 30% year-on-year, and flat compared to the previous quarter. A period of volatility in August, along with increased primary issuance during the rest of the quarter, diverted investor attention away from the secondary market. Despite the elevated new-issue volume, demand for CLO liabilities pushed spreads to the tightest levels posted since 2022, despite a very brief spread widening in August. The premium between the best and worst performing bonds compressed, while the premium paid in the secondary versus the primary market widened again (with AAA-rated bonds trading -35bps tighter versus primary), due to the limited supply.



## Spotlight topic: Long-awaited US interest rate-cut cycle begins

After many months of market speculation and anticipation, the Federal Reserve began cutting interest rates in September 2024, capping an extended period of higher rates for borrowers in the US liquid credit space (loan issuers which borrow primarily on a floating rate basis SOFR). Beyond an immediate interest expense savings for loan borrowers who saw SOFR rapidly rise by over 5.00% since 2022, the next area of focus for the market will be on how quickly rates will decline over the next 12-18 months and how low. SOFR declining to 3.00-3.50% would result in substantially improved conditions for the liquid credit markets.

Improved issuer cash flow and lower leverage levels, combined with higher M&A, LBO, dividend recaps, and refinancings activity would allow the loan market to regain some equilibrium. (To some



extent, the market had already begun doing just this during Q3 2024, as already discussed in the market activity statistics earlier in this commentary.) Such an environment would boost new loan volumes, reduce secondary loan demand and widen loan spreads, bringing supply and demand to a better balance. US CLOs would also benefit, as asset credit quality would improve and weighted average spread would widen in portfolios, enhancing CLO arbitrage for equity investors.

### About the author



Mark Hanslin is a Managing Director & Senior Portfolio Manager who leads Partners Group's Liquid Credit Team in New York. He has over three decades of liquid credit underwriting, investment and portfolio management experience for global corporate banks and investment management companies.

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