



# INSIGHT

## MONTHLY COMMENTARY

# Loan Review – April 2018

DREW SWEENEY | MAY 14, 2018

CLOs represent nearly 50% of the buyer base for loans and April was a huge month for CLOs to be priced, reset and refinanced. There were 28 new issues and 32 resets and repricings, which set a monthly record for the market. Many CLOs require being reset on the coupon date, which led to April being an extraordinarily high month of issuance.

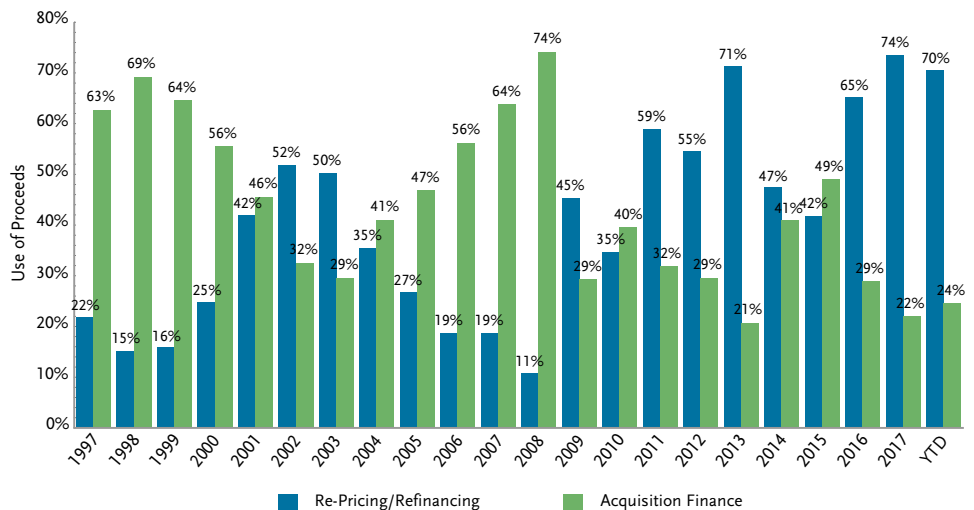
When CLOs are reset they generally extend the weighted-average life test. This test has been quite onerous for many managers as it can limit the amount of issuance available to be purchased. The test prevents managers from buying much new issue and also requires managers to focus on collateral with short maturities. Consequently, when a CLO is reset, it creates more demand for new issue even though the actual amount of CLO issuance has not increased. Demand from ramping CLOs, reset CLOs and mutual funds have all overwhelmed a very small new issuance calendar. The loan primary market produced only \$13.5 billion of net issuance (ex refinancing/repricing) in April versus \$29.9 billion in March.



**Drew Sweeney**  
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Mr. Sweeney is a Senior Vice President in the Fixed Income group where he trades leveraged loans. Mr. Sweeney joined TCW in 2015 from Bradford & Marzec, LLC where he managed loan strategies for both total return and CLO accounts as well as serving on the investment committee where he helped direct the firm's overall investment strategy. Prior to Bradford & Marzec, Mr. Sweeney worked for Macquarie Group (fka Four Corners Capital Management) in Los Angeles, where he managed both bank loan and high yield bond investments. Prior to Four Corners, he evaluated leverage loan and bond opportunities for Columbia Management (Ameriprise Financial, Inc.). He also worked as an Analyst with ING Capital Advisors and as a member of the investment banking team at First Union Securities where he gained additional experience in underwriting, structuring and syndicating leveraged transactions. Drew holds an MBA from the University of North Carolina Kenan-Flagler Business School and a BS from Rutgers University.

### New Issue Refinancing Versus Acquisition

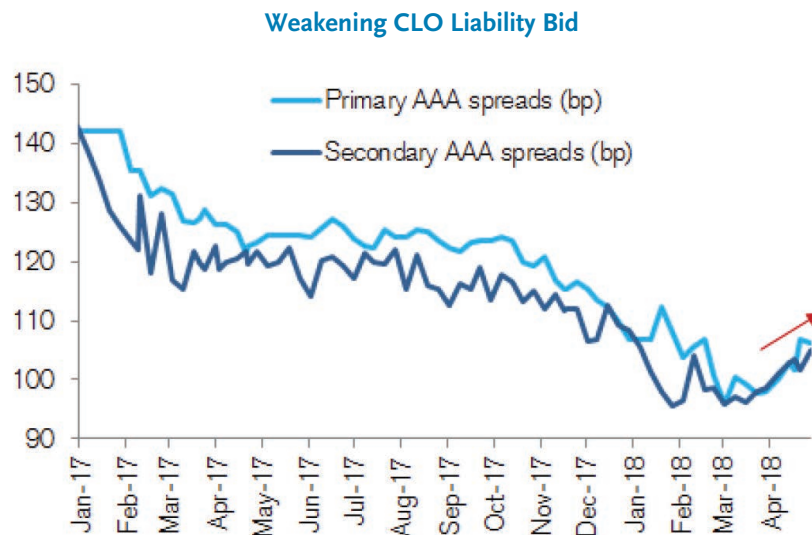


Source: JPM Morgan High Yield and Leveraged Finance Intelligence

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The dynamic of demand overwhelming supply has not only allowed borrowers to continue to refinance their spreads at a lower rate, it has created an environment where sponsors and borrowers alike continue their assault on credit agreements. April witnessed the persistent practice of extremely aggressive EBITDA addbacks, which help to create adjusted EBITDA that makes leverage seem more reasonable at closing.

While both loan performance and CLO generation were strong in April, CLO liabilities widened. Liability costs and the differential between 1-month and 3-month LIBOR, created a mismatch between loan assets and CLO liabilities, which could slow the CLO primary calendar.



Source: Credit Suisse

### Performance

In April, the Credit Suisse Leveraged Loan Index (CS LLI) and the S&P Leveraged Loan Index (“S&P/LSTA”) were up 0.48% and 0.41%, respectively.

- Year-to-date, ending April 30, the CS LLI was up 2.07% and the S&P/LSTA was up 1.87%.
- For the 12 months ending April 30, the CS LLI was up 4.69% and the S&P/LSTA was up 4.41%.

There was little differentiation between Split BBBs, Double Bs, Split Double BBs and Single Bs. Distressed term loans outperformed all categories.

### Total Return By Rating

	April	QTD	LTM
Split BBB	0.48%	1.59%	3.38%
BB	0.48%	1.67%	4.23%
Split BB	0.52%	1.75%	3.74%
B	0.50%	2.07%	5.13%
Split B	-0.08%	3.18%	8.11%
CCC/Split CCC	0.62%	4.28%	6.29%
Distressed (CC, C and Default)	1.03%	7.08%	3.11%

Source: Credit Suisse Leveraged Loan Index

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### Sector Performance

Nineteen of 20 sectors in the Credit Suisse LLI provided a positive return during the month. The top performing sectors in April were Metals/Minerals (+1.22%), Energy (+0.84%) and Food and Drug (+0.65%).

The worst performing sectors for the month were Consumer Non-Durables (-0.34%), Transportation (0.07%) and Retail (0.27%).

In the last 12 months, Metals, Utility, and Financials led all sectors with total returns of 6.73%, 6.33% and 5.52%, respectively. In contrast, Retail, Consumer Non-Durables and Consumer Durables were the worst performing sectors with returns of 2.24%, 2.03% and -2.58%, respectively. The changing landscape of how consumers shop continues to weigh on these sectors. Several borrowers are being directly impacted by online competition and other loans are lower in these three sectors based on fear of what the future will bring. In the table below, the top performers are highlighted in green and the bottom performers are highlighted in red.

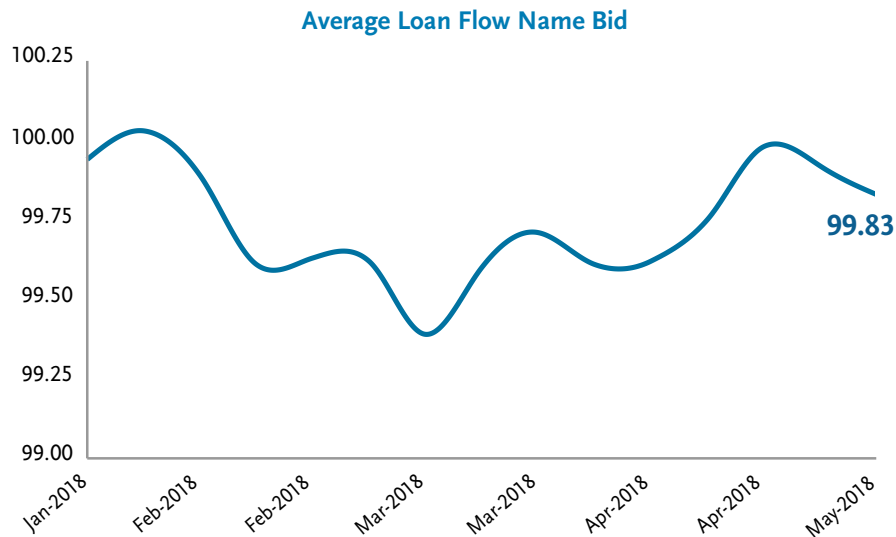
### Industry Returns

	April	YTD	LTM
Aerospace	0.45%	1.88%	5.29%
Chemicals	0.55%	1.84%	4.88%
Consumer Durables	0.38%	-0.19%	-2.58%
Consumer Non-Durables	-0.34%	1.46%	2.03%
Energy	0.84%	3.56%	3.79%
Financial	0.54%	2.00%	5.52%
Food and Drug	0.65%	2.71%	4.00%
Food/Tobacco	0.47%	1.83%	4.50%
Forest Prod/Containers	0.45%	1.48%	4.68%
Gaming/Leisure	0.50%	1.65%	4.90%
Healthcare	0.60%	2.14%	5.29%
Housing	0.53%	1.87%	4.98%
Information Technology	0.51%	2.08%	5.15%
Manufacturing	0.48%	2.01%	5.38%
Media/Telecommunications	0.47%	1.96%	4.36%
Metals/Minerals	1.22%	3.86%	6.73%
Retail	0.27%	3.58%	2.24%
Service	0.50%	1.88%	5.23%
Transportation	0.07%	1.96%	3.55%
Utility	0.44%	2.12%	6.33%

Source: Credit Suisse Leveraged Loan Index

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Leveraged loan prices rose in the first half of April and came down modestly off the high in the back half of the month amid pressure on credit and equities. The average bid of the S&P LCD's flow-name loan composite started the month at 99.62% and ended the month higher at 99.83%.

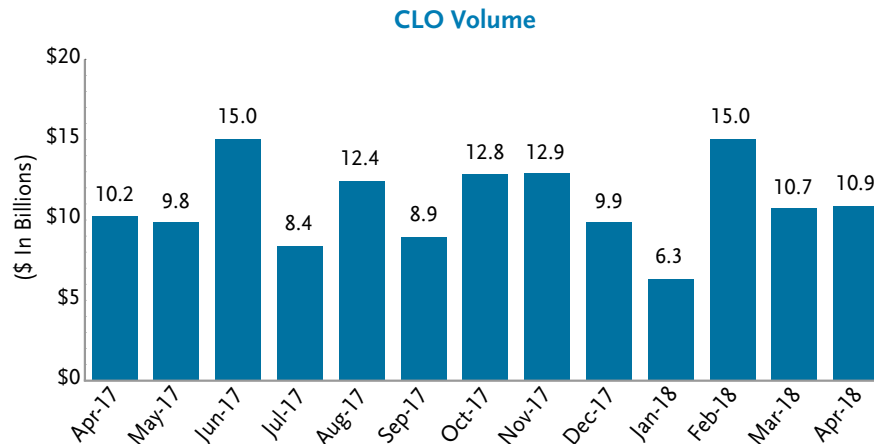


Source: LCD, an offering of S&P Global Market Intelligence

### Technical Conditions

In April, CLO markets printed \$10.9 billion of new deals reaching \$43 billion year-to-date. This is 58% higher than the 2017 comparison.

There has also been a huge amount of activity in refinancing and resetting CLOs with nearly \$40 billion completed through April 2018.

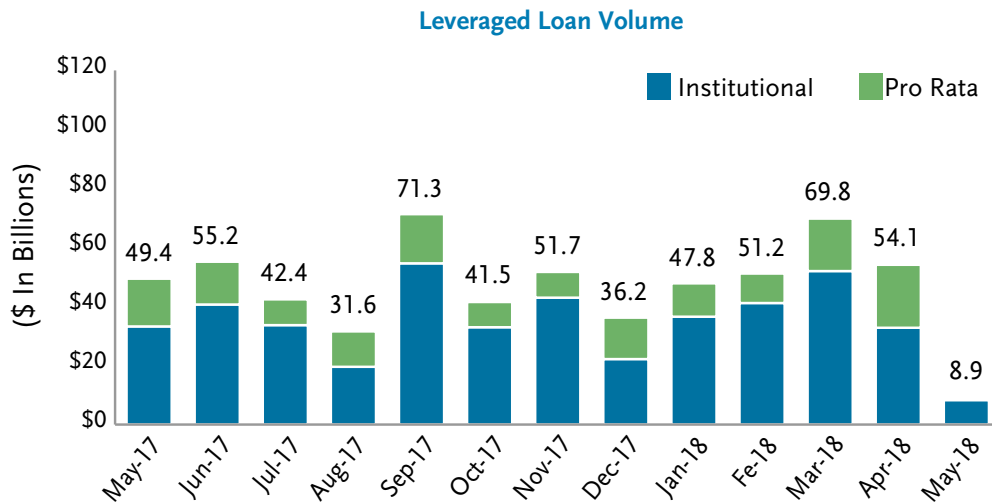


Source: LCD, an offering of S&P Global Market Intelligence

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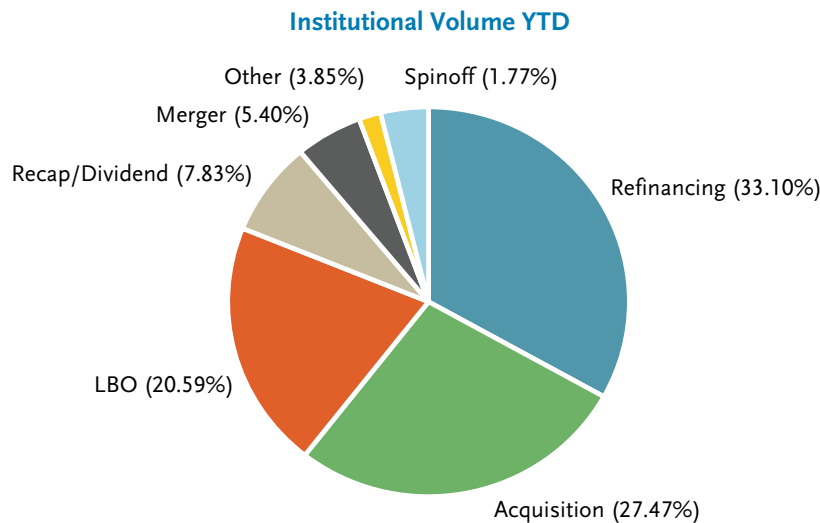
Leveraged loan funds reported a monthly inflow totaling a reported \$2.1 billion, down from \$3.2 billion in March. Assets under management totaling \$141 billion for the dedicated loan mutual fund base, which is now getting close to the all-time high of \$154 billion in April 2014. Inflows year-to-date for loan mutual funds total +\$7.1 billion compared to a +\$13.1 billion inflow in 2017.

There was a 37% decline in institutional new issuance in April from the prior month. Total leveraged loan primary volume declined roughly 22% in April. On a year-to-date basis, institutional new issue was down 27% as compared to 2017.



Source: LCD, an offering of S&P Global Market Intelligence

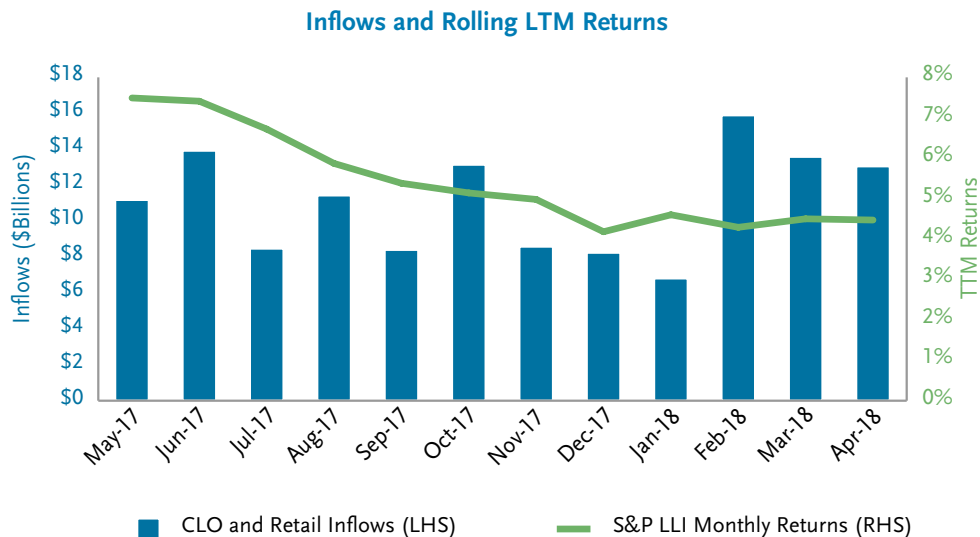
On a YTD basis, \$188.4 billion (excluding amendments) has priced and roughly 37% of institutional new issue was driven by refinancing existing debt.



Source: LCD, an offering of S&P Global Market Intelligence

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Amid strong inflows, the trailing 12-month returns continued to pace close to 4.5%. The combination of lower LIBOR spreads and price declines resulting from repricing activity have weighed on returns.



Source: LCD, an offering of S&P Global Market Intelligence

On a year-to-date basis, new issue spreads in April are -7.0% tighter for double Bs and -8.4% tighter for single Bs. The index spread for the CS LLI ended April at roughly L+347 basis points. This is the tightest spreads have been for the CS LLI index since October 2010.

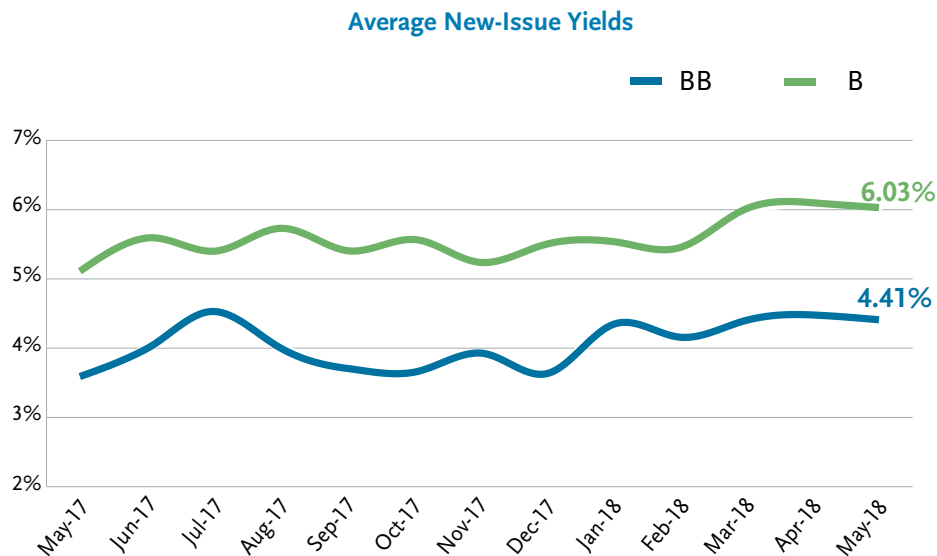
### New Issue Spread Changes

	BB/BB-	B+/B
Mar-17	243	382
Jun-17	240	370
Sep-17	243	373
Dec-17	233	375
Mar-18	224	341
Apr-18	217	344
Month-Over-Month Change	-3.3%	0.9%
YTD Change	-7.0%	-8.4%
LTM Change	-9.3%	-2.5%

Source: LCD, an offering of S&P Global Market Intelligence

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Average new issue yields widened month-over-month for Double Bs (0.10%) and for Single Bs (0.11%). Rising LIBOR has offset much of the tighter LIBOR spreads during the last 12 months. In April, 3-month LIBOR moved higher by another 5 basis points.



Source: LCD, an offering of S&P Global Market Intelligence

The default rate of the S&P/LSTA Leveraged Loan Index declined 5 basis points to 2.37% by principal amount in April. There was one default (Nine West).

The last 12-month default tally is 25. Retail defaults lead all categories with seven while Oil & Gas is close behind with five.

### Lagging 12-Month Default Rates

Actual	Feb-18	Mar-18	Apr-18
By Number	1.94%	1.93%	1.95%
By Principal Amount	2.00%	2.42%	2.37%
<b>Shadow Default Rate</b>			
By Number	0.43%	0.54%	0.65%
By Principal Amount	0.98%	0.65%	0.80%

Source: LCD Loan Stats

\* Shadow default rate includes potential defaults, including those companies that have engaged bankruptcy advisors, performing loans with SD or D corporate rating and those paying default interest

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### Valuation

Since 1992, the average 3-year discount margin (“DM”) for the CS LLI, is 462 basis points. If the global financial crisis (2008 & 2009) is excluded, the 3-year discount margin for the CS LLI is 417 basis points. At month end, the 3-year DM (382 basis points) was the tightest 3-year discount margin since October 2007.

The DM spread differential between double Bs and single Bs has widened from May 2017 to April 2018 by 7 basis points and is still 36 basis points wider than of the historical spread differential.

### 3-Year Discount Margin Differential Between BBs and Single Bs

1/1992-4/2018 Average	84.1
May-17	113.1
Apr-18	120.3

Source: Credit Suisse Leveraged Loan Index

### CS LLI Snapshot

YTD Total Return*	2.07%
Average Price	98.23
Spread	347.06
Coupon	5.57%
Current Yield	5.66%
Yield (3-year life)	6.66%
Discount Margin (3-year life)	382 bp

\*S&P LLI Total Return 1.87%

Source: Credit Suisse Leveraged Loan Index

	Spread	DM (3-Year Life)
Split BBB	204 bps	195 bps
BB	261 bps	250 bps
Split BB	319 bps	317 bps
B	381 bps	402 bps
Split B	529 bps	811 bps
CCC/Split CCC	664 bps	1,022 bps
Distressed (CC, C and Default)	582 bps	4,350 bps

Source: Credit Suisse Leveraged Loan Index



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### Summary

As of April 30, the S&P/LSTA Index imputed default rate was 1.10%, the second lowest level since October 2007.

Loan performance was strong in April driven by many of the same technical characteristics that have driven loan performance in 2017 and 2018. CLO generation remains robust both in terms of actual new issue and in terms of resetting deals. Rising LIBOR continues to drive investors into loan funds via mutual funds and separately managed accounts. Mergers and acquisitions and leveraged buyout volumes remain insufficient to satiate demand. In the absence of true net supply, borrowers and sponsors continue to aggressively reprice existing loan deals.

As CLO liabilities began to widen, loan prices moderated in the back half of April. The loan new issue calendar also began to grow in early May, which could lead to increased volatility of loan secondary prices. ■

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