Bank Loans

Coupons and Price Recovery Driving Strong Returns

Coupons remain attractive, but careful credit picking needed in higher-for-longer environment.

Institutional loan activity has significantly outpaced last year's volume, while secondary market returns were bolstered by high coupons and limited sensitivity to interest rate volatility. Meanwhile, repricing transactions have increased, allowing many borrowers to reduce interest costs by lowering the contractual spread by an average 50 basis points. Despite a minor increase in default rates, the loan market is supported by robust demand, stabilizing prices. We are mindful of the effect of high short-term interest rates, but continue to find favorable opportunities.

Sector Commentary

- Capital market activity accelerated in the first four months of 2024, bringing $185 billion of institutional loan gross supply ($81 billion excluding refinancing activity). Total volume is running 142 percent above last year's pace.
- Leveraged loans benefited from high coupons and insulation from interest rate volatility, with the Credit Suisse Leveraged Loan Index returning 2.8 percent year to date as of April 30. Loans continue to outpace high yield, driven by a high base rate and lack of duration as the market increasingly pushes out rate-cut expectations.
- Lower ratings categories continue to outperform given their higher coupons and lower prices, leaving more room for price appreciation. CCCs returned 5.9 percent year to date through April, followed by 2.8 percent for Bs and 2.2 percent for BBs.
- Loan default rates rose to 2.4 percent from 1.9 percent at the end of 2023, but still below the historical default rate of 2.8 percent.

Investment Themes

- The supply/demand technical backdrop continues to support loan secondary prices, as CLO issuance combined with retail flows outpaced new issuance for the fifth consecutive quarter.
- With 37 percent of loans trading above par, we expect more refinancing transactions and continued elevated repricing activity. This should support spreads as demand remains strong against limited net supply.
- Coupon rates are over 9 percent and are expected to remain elevated as long as the anticipated Fed easing cycle gets delayed.
- We remain cautious of where we are in the cycle, especially as defaults continue to pick up (albeit off of a low base), and issuer borrowing costs remain elevated.
- We view the new issue discount as compelling, and we continue to look to opportunistically exit or reduce positions that we believe have traded tight relative to their fair value.

By Christopher Keywork and Maria Giraldo

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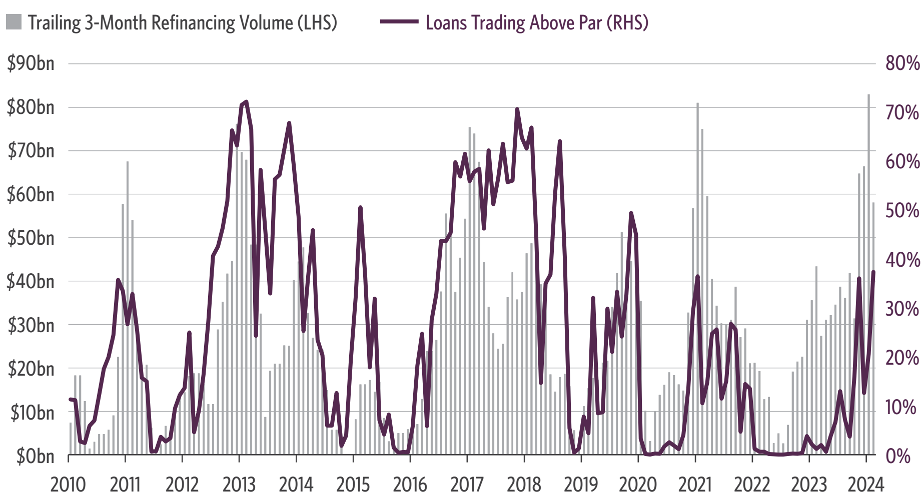
Refinancing Activity Will Continue as More Loans Trade Above Par



Source: Guggenheim Investments, Credit Suisse, S&P LCD. Data as of 4.30.2024.

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Investing involves risk, including the possible loss of principal. In general, the value of a fixed-income security falls when interest rates rise and rises when interest rates fall. Longer term bonds are more sensitive to interest rate changes and subject to greater volatility than those with shorter maturities. During periods of declining rates, the interest rates on floating rate securities generally reset downward and their value is unlikely to rise to the same extent as comparable fixed rate securities. High yield and unrated debt securities are at a greater risk of default than investment grade bonds and may be less liquid, which may increase volatility. Investors in asset-backed securities, including mortgage-backed securities and collateralized loan obligations ("CLOs"), generally receive payments that are part interest and part return of principal. These payments may vary based on the rate loans are repaid. Some asset-backed securities may have structures that make their reaction to interest rates and other factors difficult to predict, making their prices volatile and they are subject to liquidity and valuation risk. CLOs bear similar risks to investing in loans directly, such as credit, interest rate, counterparty, prepayment, liquidity, and valuation risks. Loans are often below investment grade, may be unrated, and typically offer a fixed or floating interest rate.

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