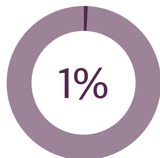
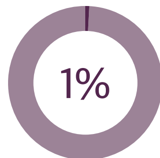
Bank Loans

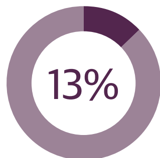
December Lessons



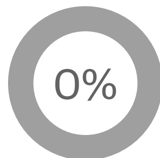
Guggenheim Core



Guggenheim Core Plus



Guggenheim Multi-Credit



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Loan investors learned about illiquidity during December's volatility, but careful positioning can still add value.

Demand for floating-rate assets waned when market expectations for Fed rate hikes in 2019 fell from two to zero, resulting in record fund outflows. This repositioning caused mutual fund managers and exchange-traded funds (ETFs) to shed their more liquid holdings to cover redemptions, which led to larger loans underperforming smaller, less liquid loans on a price and total return basis (see chart, top right). The bank loan market's limited liquidity, combined with heavy outflows, exacerbated the negative pressure on loan prices, and resulted in performance that appeared to be more driven by liquidity concerns than credit. For example, as the selloff intensified in December, the gap between first- and second-lien discount margins (based on a three-year life) tightened by 34 basis points for the quarter. The painful lesson learned: liquidity is not a given, and the exits tend to shrink on the way out.

While the Credit Suisse Leveraged Loan index lost 3.1 percent in the fourth quarter of 2018, reducing full year returns to 1.1 percent, loans outperformed high-yield corporates for the first time since 2015. Performance across all rating categories was negative, with BBs losing 3.2 percent, Bs losing 2.9 percent, and CCCs losing 4 percent. Despite their underperformance in the fourth quarter, CCCs were the best-performing category in 2018.

In contrast to market expectations, our Macroeconomic and Investment Research Group expects the Fed will raise rates once in 2019, with the hike occurring in the second half of the year. Even without rate hikes, we think bank loans offer comparable value to high-yield corporates. The average BB loan trades at a yield below comparable corporates (see chart, bottom right). This typically occurs toward the end of a hiking cycle. Ultimately, loans should once again outperform other sectors when the Fed recommences its hiking campaign. Given late-cycle dynamics, we continue to defensively position credit portfolios through higher quality, which entails a preference for first lien over second lien loans, with a continued focus on less-cyclical business models with stable cash flows and strong liquidity positions.

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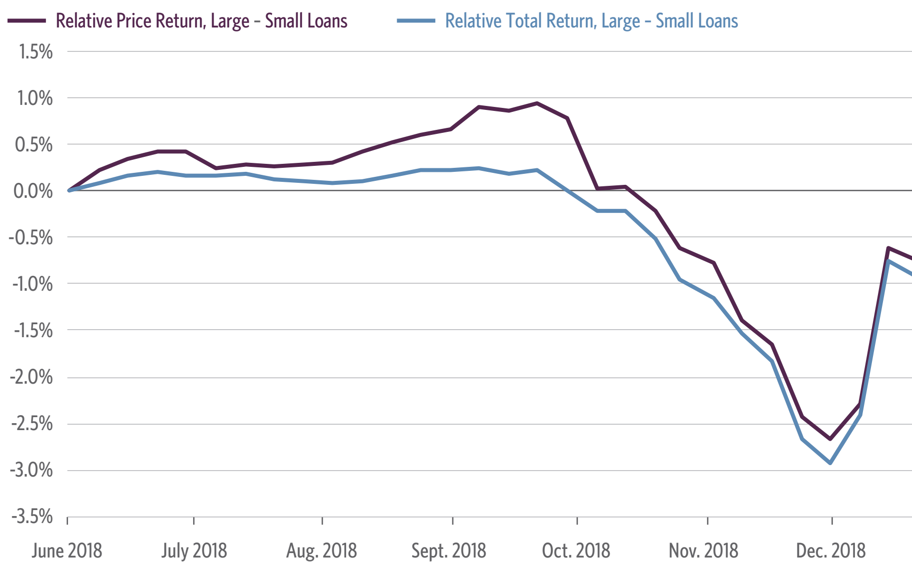
Forced Selling from Record Fund Outflows Caused Large Loans to Underperform



Source: Guggenheim Investments, Credit Suisse. Data as of 1.17.2019. Small loans represent tranche sizes between $200 million and $300 million, large loans represent tranche sizes greater than $1 billion.

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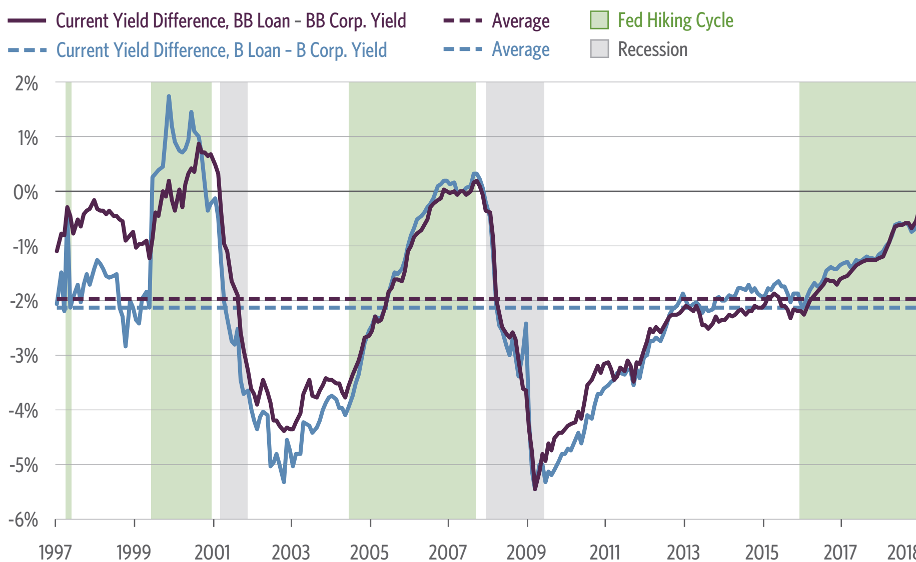
Loan Yields Look Competitive to Similarly Rated Corporates



Source: Guggenheim Investments, Credit Suisse. Data as of 1.24.2019.

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