

Bank Loans

Technical Dynamics Drive Best Performance Since 2009

Maintaining a defensive stance remains crucial despite gains.

With a 10 percent total return year to date, the best since 2009, leveraged loan performance has significantly outperformed other fixed income sectors. Performance can be attributed to several factors, including lack of duration risk, high coupons due to the Fed's rate hikes, limited net issuance that supported loan prices and risk premiums, and the positive technical and fundamental impact of private credit. We anticipate this strong performance will persist throughout the remainder of 2023, concluding a strong return year.

While issuance has been constrained this year, it has gradually gained momentum, primarily directed toward refinancing activity. Of the \$195 billion in institutional issuance, refinancing activity amounts to \$112 billion, comprising 57 percent and on track to set a record. Subtracting refinancing activity from total issuance, net supply equals only \$83 billion, which is about the same volume as U.S. CLO issuance this year. This leaves little leftover for other sources of demand, such as institutional separately managed accounts, and does not account for paydowns and defaults that shrink the market size without replacement. Consequently, demand exceeds supply, keeping discount margins under 580 basis points since the regional banking crisis in the first quarter.

The prominence of private lenders this year is particularly noteworthy due to the scarcity of syndicated loans. Data from Pitchbook LCD

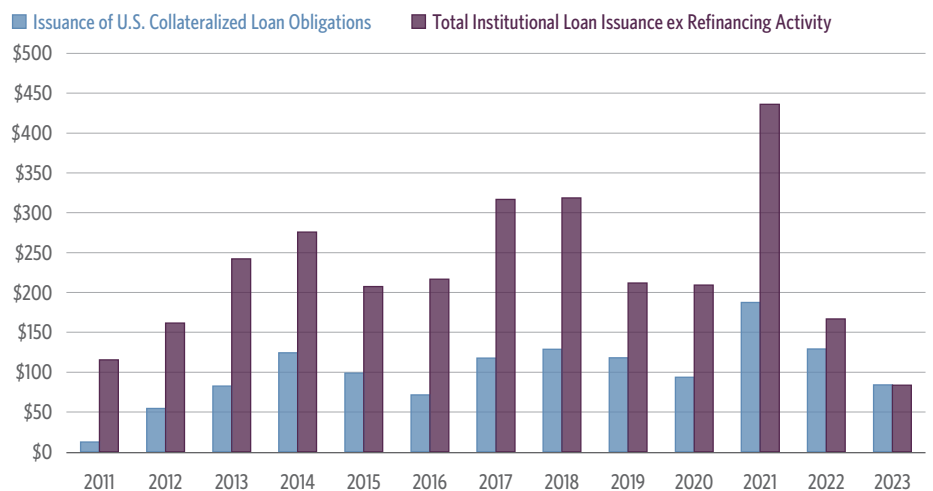
reveals that private lending has completed twice as many leveraged buyout activity debt transactions in the past few quarters compared to the syndicated loan market. Borrowers sometimes explore both the syndicated loan market and private lending channels to secure the best terms, and private lenders have stepped in on several notable occasions to assist distressed issuers, averting potential defaults. This activity has also helped support risk premiums in syndicated loans, and it is something we will keep monitoring.

Looking ahead, if interest rates remain elevated as the Fed has recently cautioned, we anticipate elements of performance in the next year that could resemble the second half of 2023: We believe the loan market will continue to offer an attractive coupon exceeding 8 percent, providing a potential buffer for overall returns. However, we also anticipate an increase in defaults and downgrades as more borrowers grapple with high interest expense levels while earnings growth decelerates. Maintaining a defensive stance remains crucial, but investors who have retained exposure to loans have been generously rewarded.

By Christopher Keywork and Maria Giraldo

Net institutional loan issuance has been roughly equal to the amount of new issue volume in the collateralized loan obligation market. This leaves no spare supply for other sources of demand. The loan market has also experienced shrinking due to loan paydowns and defaults. These dynamics have been favorable to returns by keeping spreads tight.

Technical Dynamics Have Been Favorable to Loan Returns



Source: Guggenheim, S&P LCD. Data as of 10.15.2023.

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