Bank Loans

Loan Performance Proves Resilient Against Outflows

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A decline in institutional loan gross issuance offsets lower demand from mutual funds.

The bank loan sector has continued to experience net outflows from mutual funds and ETFs this year, though as we expected, the pace of weekly outflows has been slowing compared to the end of 2018. Year to date, investors have pulled over $10 billion from bank loan mutual funds and ETFs combined, or approximately 6 percent of the assets under management as of the end of 2018. Over the past five years, flows have been loosely correlated with six-month changes in 10-year Treasury yields (see chart, top right). Our Macroeconomic and Investment Research Group believes Treasurys are overbought, so we expect to see loan outflows continue to diminish if we see a near-term bounce in rates.

The loan market's performance has been strong despite net outflows. The Credit Suisse Leveraged Loan index gained 3.8 percent in the first quarter of 2019, the best quarterly return since 2010. Performance across all rating categories was positive, with split-Bs as the best performing rating category, returning 5.3 percent in the quarter followed by BBs with a return of 4.2 percent. CCC loans noticeably lagged in performance with only a 2.2 percent total return for the quarter.

A 41 percent year-over-year decline in institutional loan gross issuance helped offset some of the technical weakness caused by lower demand from mutual funds. With that decline came a lower share and volume of refinancing activity compared to the same period of 2018 and previous years (see chart, bottom right). Moreover, we found that new-issue volume of CLOs has been robust, which helped soften the impact of fund outflows. CLO volume was down only 8.7 percent year over year through the first quarter. With fund outflows continuing, CLOs have picked up a portion of the slack and have been price setters in many contexts on new issue and secondary transactions. Thus, lenders that did not shy away from credit risk in the first quarter were compensated, in our opinion, with the average term loan pricing at an average of 400 basis points over Libor, compared to an average of about 330 basis points in March 2018.

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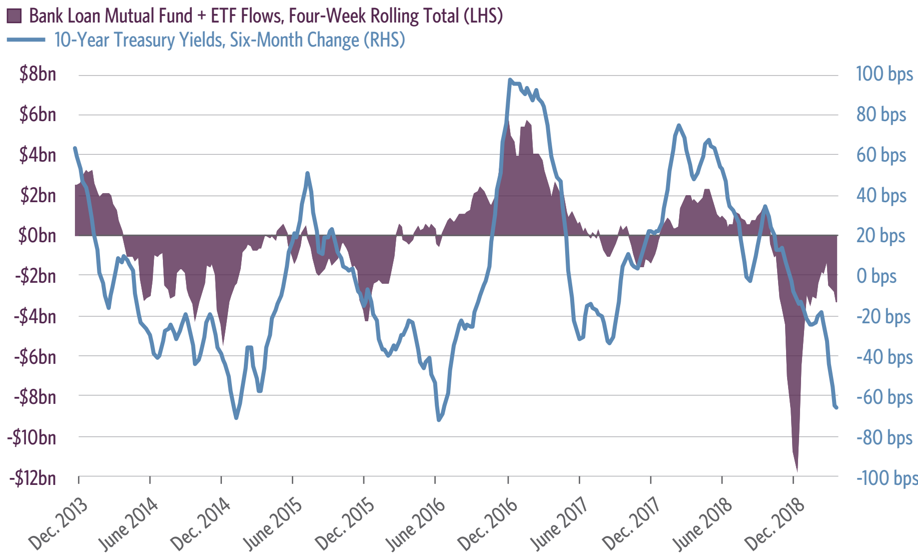
Loan Fund Flows Loosely Correlated to Treasury Yield Changes



Source: Guggenheim Investments, EPFR, Haver Analytics, Bloomberg. Data as of 4.17.2019.

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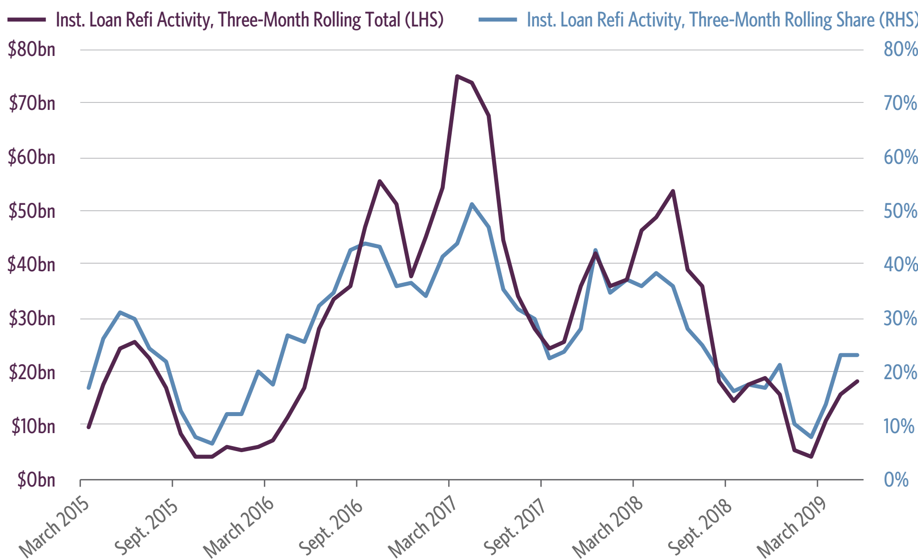
Institutional Loan Refinancing Volumes Plunge



Source: Guggenheim Investments, S&P LCD. Data as of 5.31.2019.

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