THE LOAN SYNDICATIONS AND TRADING ASSOCIATION

LSTA Conference: On the Secondary

October 26, 2017 - This year's secondary market panel, "A Coupon State of Mind", was headlined by speakers Mike Clawson (Wells), Jason Friedman (Marathon), David Mechlin (CSAM) and Alex Stromberg (Barclays). Moderator, Ted Basta (LSTA), and the panelists first put this year's performance in a historical context. Given that the market achieved a double-digit return in 2016 and 55% of loans were trading at or above par to begin 2017, a "coupon-level" return was to be expected. However, "coupon level" at the beginning of the year was much higher than it is today - given the repricing wave that occurred during the first half of 2017. Even so, market value returns on the S&P/LSTA Leveraged Loan Index (LLI) are actually slightly negative, year-to-date, at -0.37%. And in order to pull that market value return into positive territory, sectors such as retail and media would need to see a stronger bid into year-end. That said, total returns are still tracking to a mid-4.5% range this year as technicals and fundamentals continue to support low volatility and modest downside risk. This trend is expected to carry into next year, unless there are exogenous shocks to the broader financial system.

What's the biggest surprise of 2017? An audience poll revealed that more than 50% of attendees were surprised that year-to-date CLO issuance, under Risk-Retention, eclipsed full year 2016 issuance. Panelists agreed that CLOs will continue to print as long as the arbitrage is working and investor demand is high. The high degree of interest in CLO equity this year was also noted as a new set of investors have entered an already crowded market.

On the fundamentals side, panelists agreed that default rates should remain below their historical average of 3.1% through 2019, and maybe even into 2020. The conversation then morphed into future recovery rates, which seemed to be a more pressing issue for investors than the actual cycle itself. The next poll revealed (perhaps surprisingly) that more than 50% of respondents believed that recoveries should remain within their historical average (north of 70%) during the next credit cycle. While the panel agreed, they are expecting to see a higher level of deviation in actual recovery rates (which will be very sector and borrower specific). Finally, panelists discussed liquidity, noting that secondary trading volumes have hit a record $630 billion over the last twelve months. The feeling was that the secondary market is deeper than it has been ever before – a credit to the diverse group of buyers and sellers that are in market today. The one caveat that remains is settlement liquidity. After a strong run to end 2016, settlement times have trended higher this year.