PitchBook | LCD

July 1, 2024

June Wrap: Coupon clipping keeps loan returns in the black, but demand cools

By: Marina Lukatsky

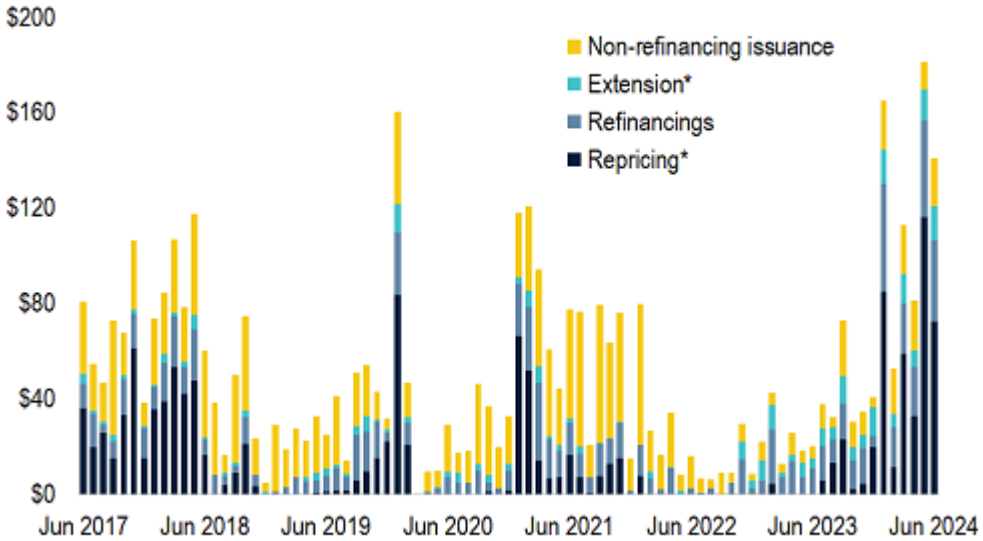
After a strong rally in May, US leveraged loans endured a relatively tough stretch in what otherwise has been a strong year for the asset class. Demand from loan investors — CLOs and retail mutual funds/ETFs — cooled from multiyear highs reached in May, and as a result loans posted the weakest monthly return of the year. Despite recent setbacks, however, loans remain on track for a strong return thanks to the elevated base rate and continued shortage of net supply.

June highlights:

- Loans post the weakest monthly return of the year, yet gain over 4% for 1H overall, thanks entirely to coupon-clipping.
- The weighted average bid of the Morningstar LSTA Loan Index fell by 34 bps in June, the largest month-on-month decline this year.
- After eight straight weeks of inflows, US loan funds saw two weeks of outflows at the end of June, while volume of new CLOs fell to a six-month low.
- Measurable investor demand for loans in June retreated to its lowest reading all year, yet reached record levels for the second quarter overall, at $58 billion.
- More than $400 billion of institutional loans have been repriced so far this year; that's 30% of the entire loan market.
- The spread compression across the entire institutional loan market is 13 bps this year (thanks to those repricings).
- The gap between loan supply and demand stands to $115 billion year-to-date.

Drilling deeper into returns, the Morningstar LSTA US Leveraged Loan Index gained 0.35% in June, the weakest month since October, down from 0.94% in May. Market-value return, which measures changes in secondary prices, declined 0.40% last month, also an eight-month low, down from 0.16% gain in May. On average, loans have gained 0.10% per month on a market-value basis and 0.88% on a total return basis over the last 12 months.

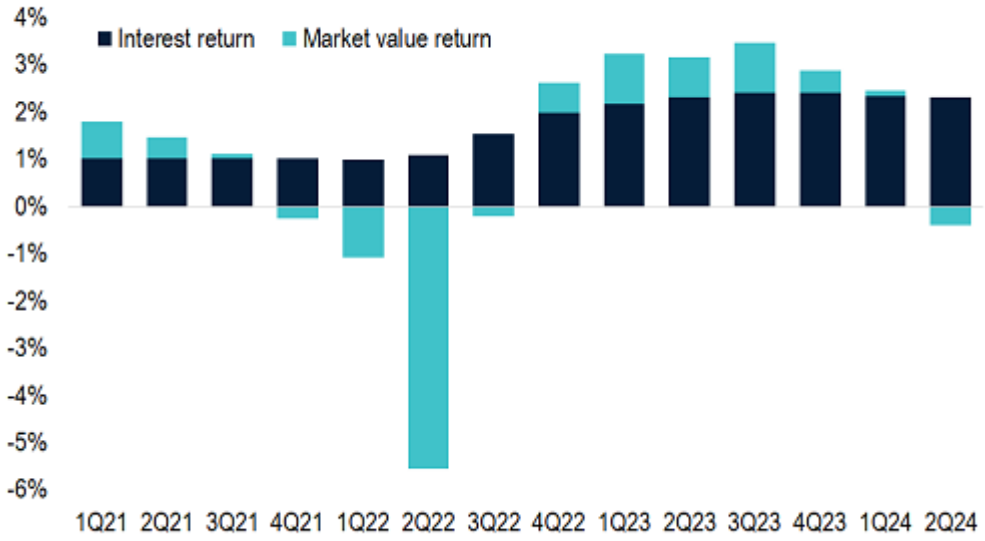
US institutional loan activity ($B)



Source: PitchBook | LCD • Data through June 30, 2024
*Reflects repricings and extensions done via an amendment process only

The index gained 1.90% in the second quarter overall, the weakest performance since Q3 2022, down from 2.46% in the first three months of this year. The difference in performance stems from the market-value return, which fell by 40 bps in the second quarter after gaining 12 bps in the first quarter.

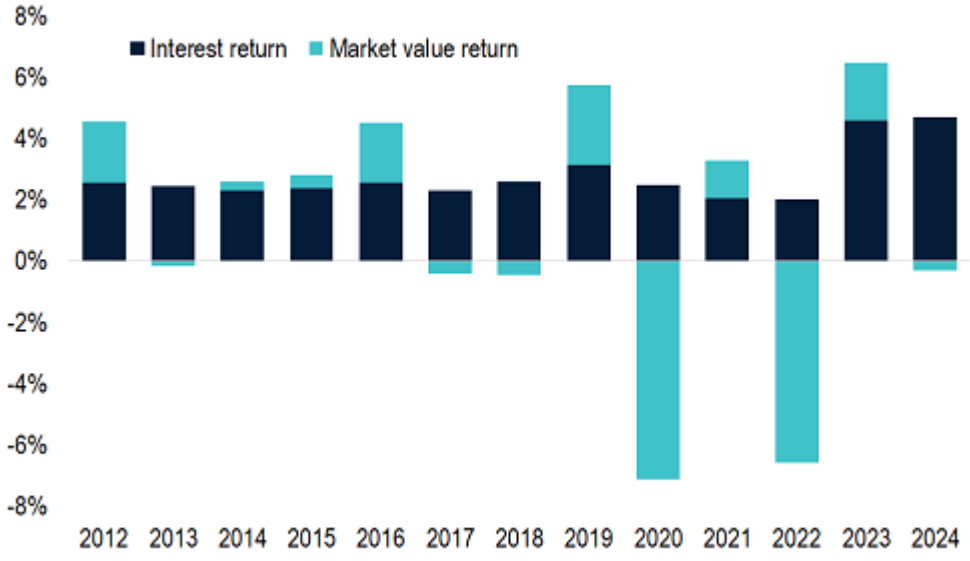
US leveraged loan returns, quarterly



Sources: PitchBook | LCD; Morningstar LSTA US LL Index • Data through June 30, 2024

Loans gained 4.40% in the first half overall, trailing the first half of 2023 (up 6.48%) but outperforming comparable periods in 2020, 2021 and 2022. Loans have gained roughly 2.5%, on average, in each January-through-June period since the end of the Global Financial Crisis.

US leveraged loan returns, January – June



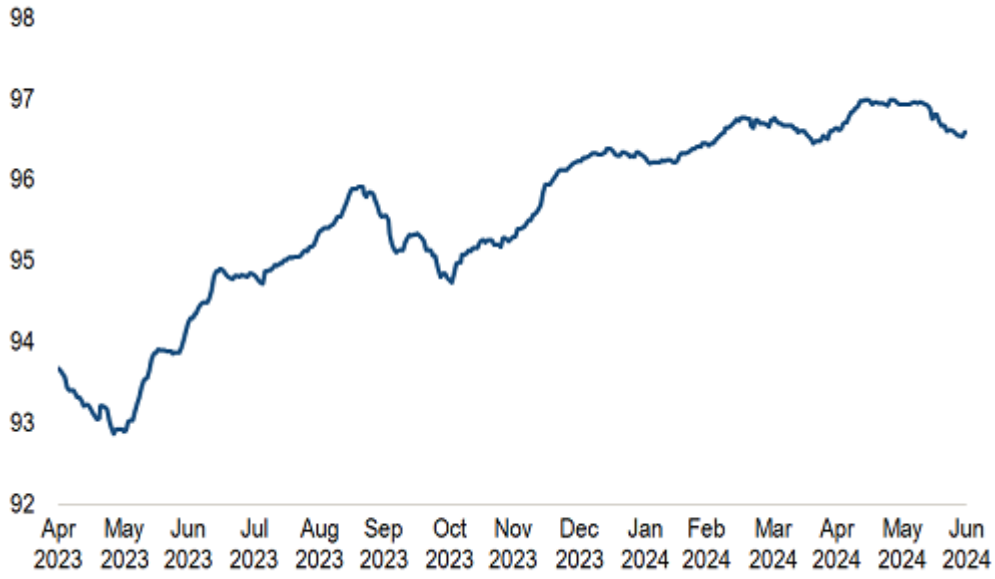
Sources: PitchBook | LCD; Morningstar LSTA US LL Index • Data through June 30, 2024

Loans continue to benefit from higher base rates. The interest return, which reflects the base rate and nominal coupon on the loan, is 4.69% in the year to date, a record high, up from 4.58% at this time in 2023. For reference, this metric averaged roughly 2.43% for comparable time periods between 2013 and 2022.

The weighted average bid of the loan index retreated by 34 bps last month, to 96.59, the largest month-on-month decline since October. Prices fell by 13 bps on June 14 alone, on the heels of the latest FOMC meeting, the biggest daily decline thus far this year.

The latest weighted average bid level is midway between the intra-year high and intra-year lows for the year, 96.99 in mid-May and 96.20 at the beginning of February. The weighted average bid ended 2023 at 96.23. Over the last 12 months the weighted average bid has gained more than two points.

Weighted average bid of US leveraged loans



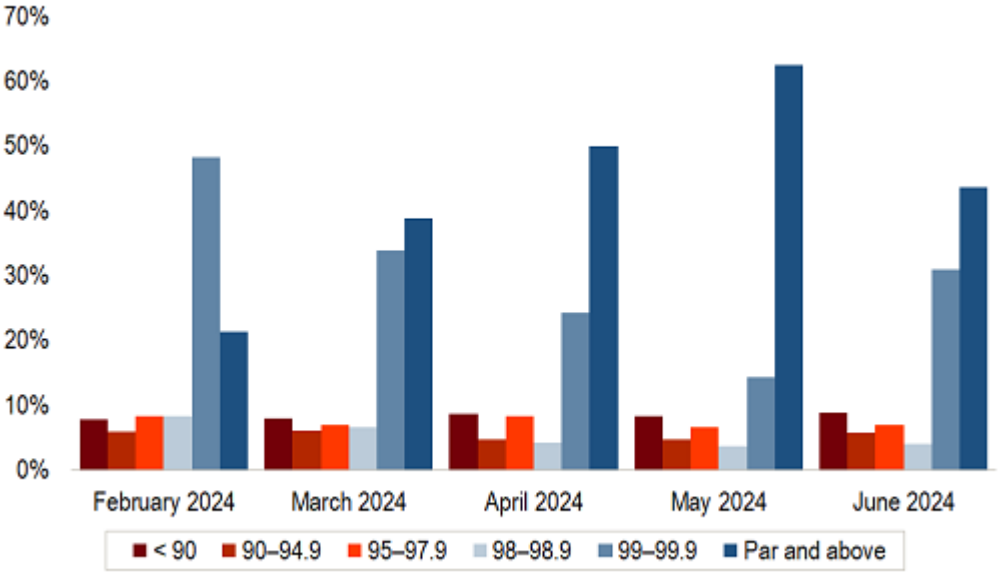
Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through June 30, 2024

As prices declined the share of performing loans priced at par and above fell to 44% by the end of the month, from the 60% area in the first two weeks of the month.

The latest reading is roughly in line with April levels. This cohort shrank while the share of the index that belonged to the 99-to-just-below-par category expanded to 31%, from 14% in May.

In total, 75% of the index by par amount was priced at 99 or above by the end of June, roughly in line with the preceding few months.

Distribution of outstanding US leveraged loan prices



Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through June 30, 2024

On the other end of the spectrum, 8.8% of performing loans were priced at less than 90 in June, close to April levels and lower than the 10% level at the start of 2024.

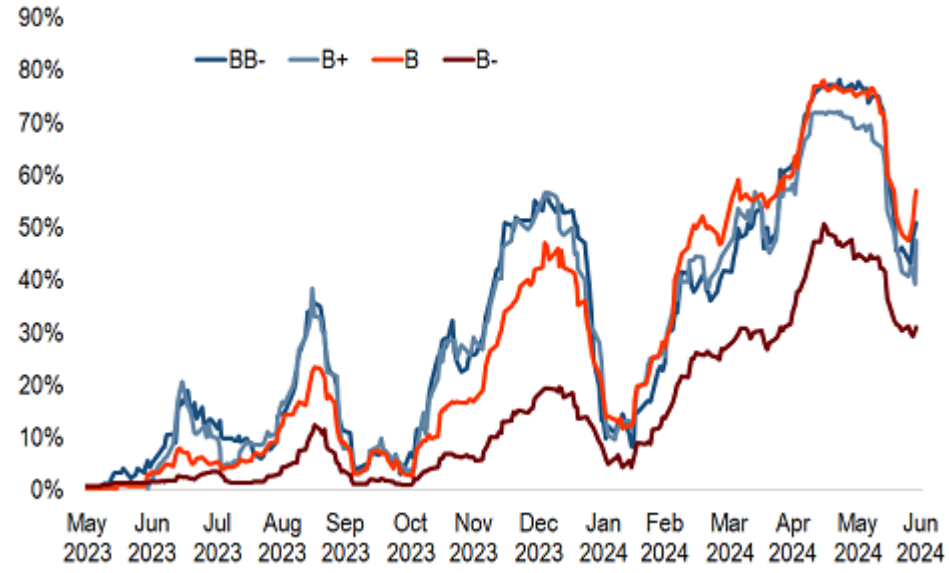
The Morningstar LSTA Leveraged Loan Index distress ratio — which captures the share of performing loans in the index priced below 80 —was unchanged in June, at 4.4%, in line with the final reading for 2023.

Bid distribution data by credit quality showed softer market tone across the board. By the end of June, 31% of loans issued to companies rated B-minus were priced at par or better, down from a recent peak of 51% in mid-May but roughly in line with mid-April levels.

At the end of March, 27% of these issues belonged to the par-or-better cohort. Last year's peak was 17%. These riskier loans account for 26% of the overall loan market by par amount outstanding, the most for any ratings bucket.

The B-flat category, the second-largest cohort of the index, followed a similar trend. By the end of June, 57% of deals in this group were priced at par or higher, down from 78% in mid-May, but up from 49% at the end of March.

Loans priced at par and above by issuer rating



Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through June 30, 2024

Although the share of par-or-higher issues retreated from recent peaks, it remains elevated, and the syndicated loan market repricing wave continues to roll on. Total primary market deal activity was $141 billion in June, an impressive figure following a record-breaking $181 billion in May.

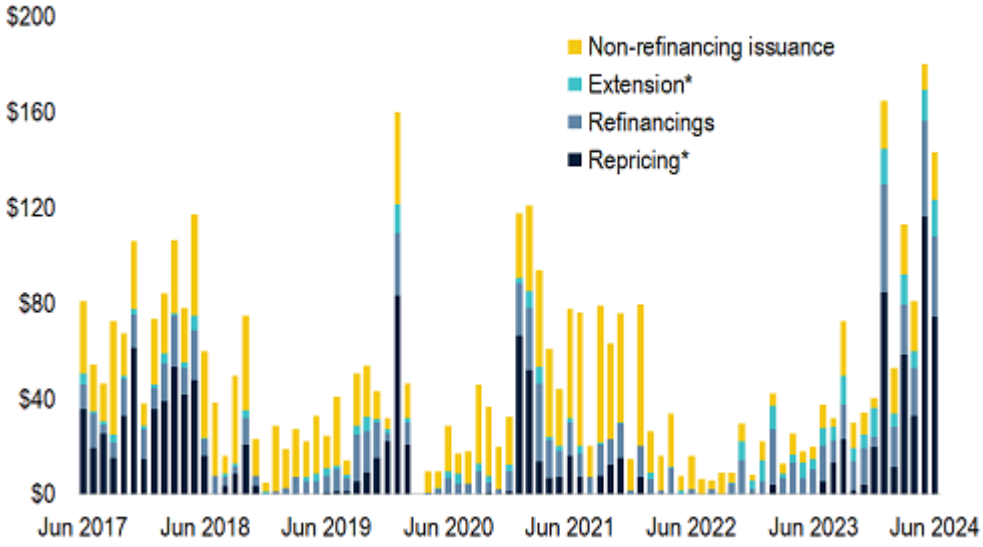
Four of the last six months have featured more than $100 billion of loan activity. To put this into perspective, prior to 2024, the last month to break through the $100 billion barrier was February 2021.

As a result of the recent quarter, 2024 deal activity is running at record pace, totaling $736 billion through June, up from $141 billion at this point last year.

Breaking down last month's overall activity, repricing amendments again dominated, accounting for $74.3 billion, or 52% of the total.

Speculative-grade borrowers have approved $378 billion of repricing amendments over the last six months, or $403 billion when including a handful of re-syndicated repricings done via a refinancing. These figures eclipse the prior record pace set in 2017, which was $336 billion for all repricings through June.

US institutional loan activity ($B)



Source: PitchBook | LCD • Data through June 30, 2024
*Reflects repricings and extensions done via an amendment process only

On average, companies reduced the borrowing spread by 54 bps via these transactions, translating into $2.2 billion of annual savings. Putting these numbers into perspective, 30% of the $1.4 trillion loan asset class has been repriced this year, based on the Morningstar LSTA US Leveraged Loan Index.

Besides lowering the cost of debt, speculative-grade borrowers continue to push out the maturity wall at the fastest clip on record. Institutional amend-and-extend volume totaled $69 billion in the year to June 30, higher than any other comparable period since the Global Financial Crisis. The full-year 2023 tally — the current record — was $83 billion. Outside of amendment activity, borrowers launched $34 billion of refinancings in June, bringing the year-to-date total to $177 billion, the fastest pace on record.

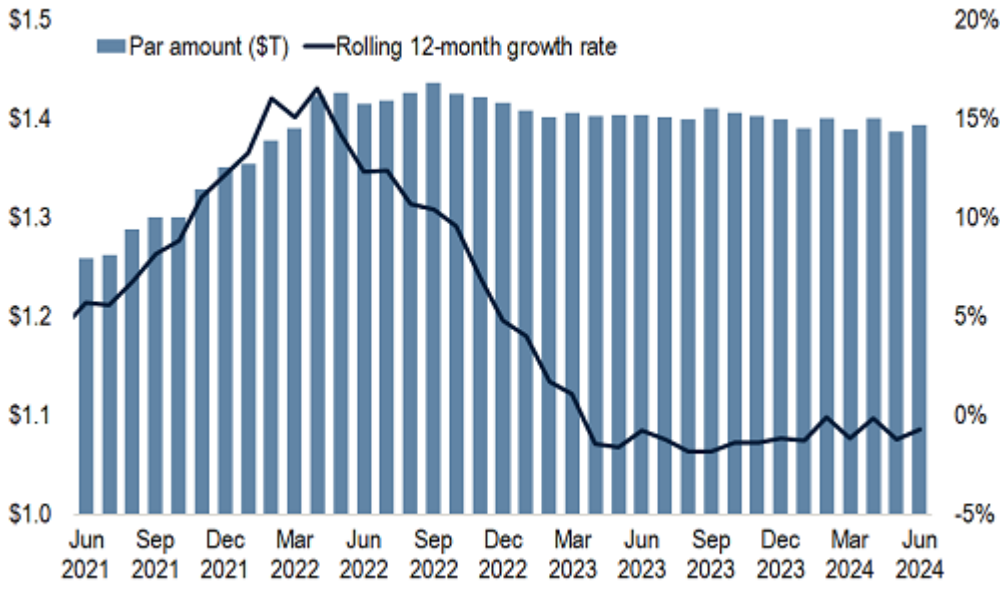
Investor demand for loans retreats in June, yet reached record levels for Q2 overall

In June, measurable investor demand for loans cooled to the lowest level this year but continues to outpace net supply. As a result, the technical imbalance that grew last year continues to widen.

LCD measures net loan supply as the change in outstandings, per the Morningstar LSTA US Leveraged Loan Index (or newly issued loans joining the index), minus loans being repaid. LCD defines investor demand as CLO issuance combined with cash inflows/outflows at retail investor loan funds.

About that supply: The par amount outstanding tracked by the index rose by $7.3 billion in June, following a $14.3 billion dip in May, bringing the size of the index to $1.394 trillion. So far this year the index constituency has shed $5.5 billion, or roughly 0.4%, as net supply remains elusive. Over 12 months the data is similar — a 0.7% decline in the size of the loan market. In fact, the index has not registered growth on a rolling 12-month basis since March 2023.

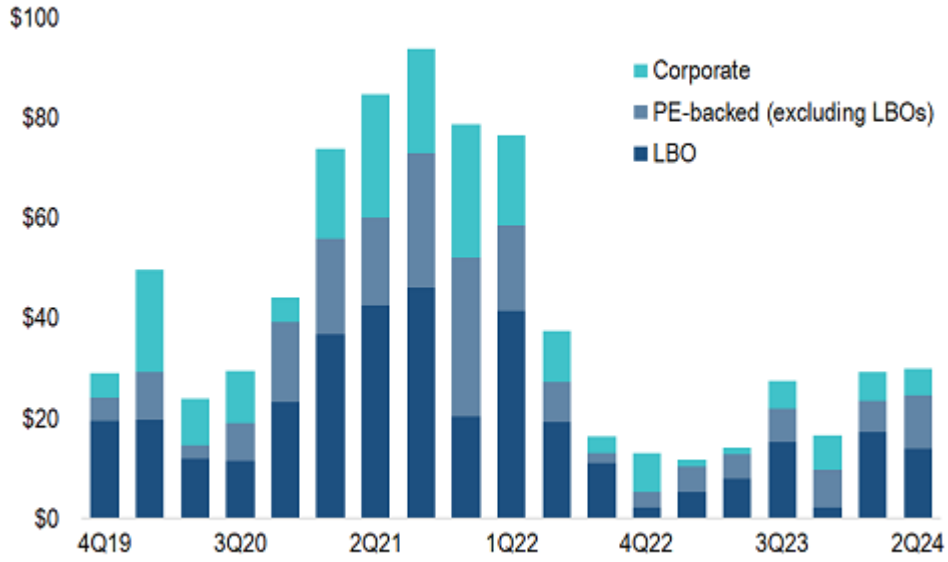
Morningstar LSTA US LL Index: Par amount outstanding



Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through June 30, 2024

Typically, growth of the loan asset class is closely tied to M&A activity, which generates net supply for investors. The low point in dealmaking appears to have been hit in early 2023, but volume remains below the long-term trend, hindered by elevated rates and the lack of exit opportunities for private equity sponsors. In the second quarter, leveraged loan issuance to finance buyouts and other types of M&A stayed roughly on par with the first quarter, at $30 billion. M&A-related loan volume averaged $58 billion per quarter between 2017 and 2021, and the long-term average in the post-GFC era is $40 billion.

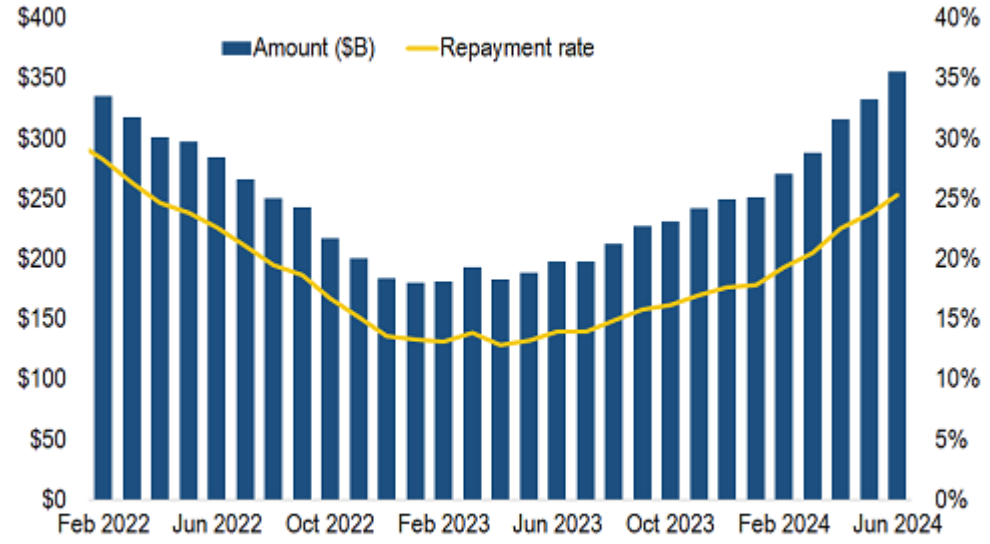
US institutional loan volume backing M&A ($B)



Source: PitchBook | LCD • Data through June 30, 2024

At the same time, repayments increased to $44.8 billion in June, the most since October 2021 ($45.6 billion). Over the last six months a whopping $217 billion has been repaid thanks to a flurry of refinancings and other borrower efforts to reduce debt. This equates to 15.5% of all outstanding loans at the start of the year, a much higher rate than during the first half of 2023, at 8%.

Morningstar LSTA US LL Index: Repayments



Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through June 30, 2024
Data is on a rolling-twelve-month basis.

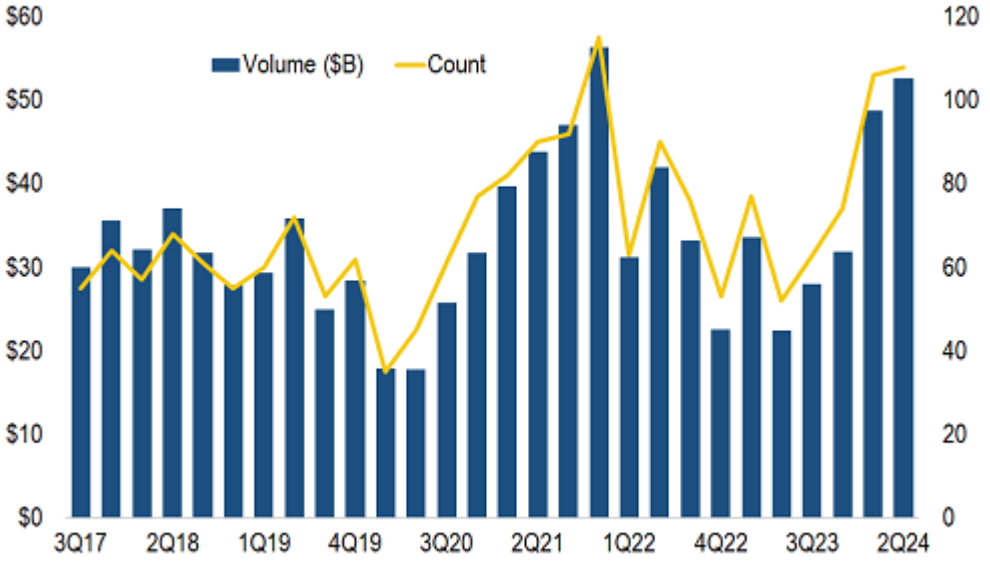
Refinancings continue to drive repayments this year, keeping borrowers in the broadly syndicated market. The volume of new loans for this purpose is running at a record pace this year, at $177 billion, near the full-year total for 2021, at $179 billion. In addition, a small subset of borrowers has exited the broadly syndicated market in favor of a direct lending solution.

LCD data show 17 BSL companies have refinanced $9.4 billion of debt in the private credit market this year. That's up from $1.5 billion in the first half of 2023 and is about halfway to last year's total ($20.2 billion).

A much larger cohort — about 40 companies — either fully exited or reduced their exposure to the floating-rate loan market this year in favor of the fixed-rate asset class, affecting roughly $29 billion of loans. That's more than full-year totals in each of the last 10 years, except for 2020.

Turning to demand, which LCD defines as CLO issuance combined with retail cash flows to US loan funds: managers priced the second-highest quarterly volume of new deals in CLO market history in Q2 2024, issuing $52.6 billion, at a record annualized pace that has thus far defied market expectations of an eventual slowdown. June issuance slowed to $11.3 billion, a six-month low, but the year-to-date total of $101 billion across 214 deals is at record pace. That compares to just $56 billion midway through 2023, involving 129 transactions.

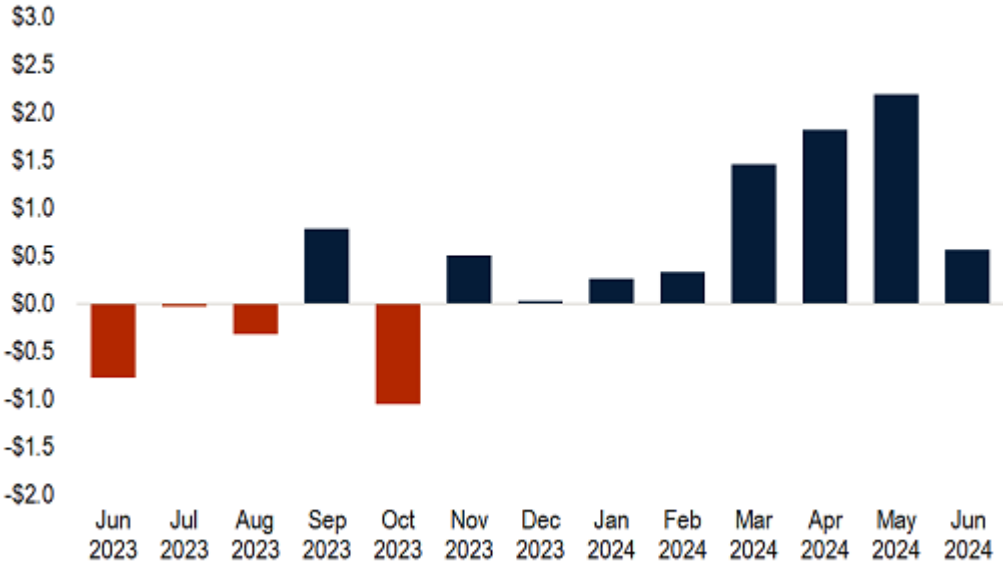
US CLO issuance – quarterly



Source: PitchBook | LCD • Data through June 30, 2024

At the same time, mutual funds and exchange-traded funds investing in loans saw an outflow of $223 million for the week ended June 19, snapping an eight-week inflow streak, according to Morningstar. Still, the outflow only marginally dented the $3.8 billion total inflow that investors produced during the prior eight weeks. In the year to June 26, only seven of 25 weeks registered an outflow, with those outflows mostly concentrated in January/February, based on weekly data from Morningstar. Cumulatively, investors poured $6.6 billion into the asset class in the first half of 2024, vs $14.3 billion of redemptions at this point in 2023.

US loan prime-fund flows (weekly reporters only, $B)



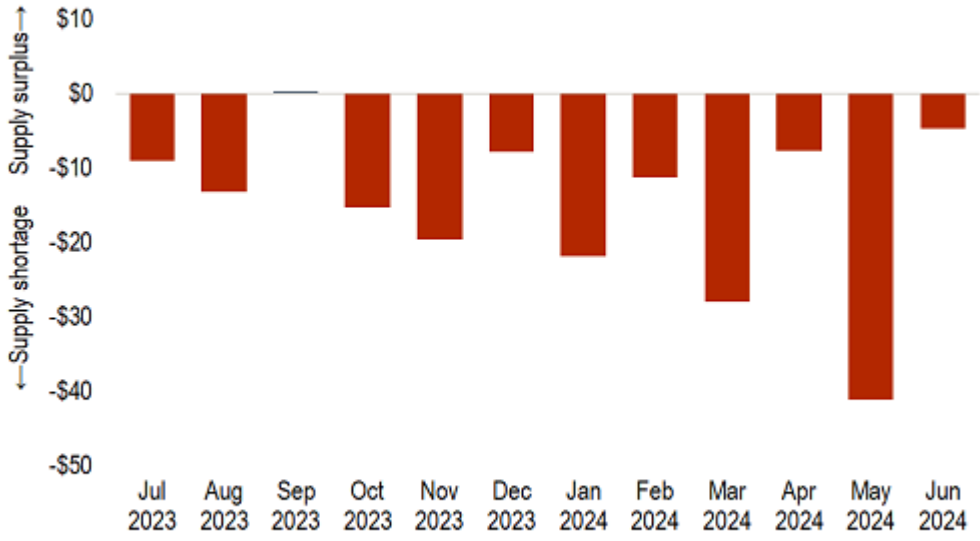
Source: Morningstar Direct Asset Flows • Data through June 26, 2024

More broadly, LCD estimates $804 million of inflows to retail loan funds in June (including monthly reporters), a four-month low, down from $3 billion in May, which was the strongest allocation to the loan asset class since the Fed started hiking rates. Adding this to CLO issuance ($11.3 billion) results in total measurable demand of $12.1 billion, the lowest reading so far this year, retreating from the multi-year high set in May ($27 billion).

Nonetheless, total measurable demand reached record levels for the second quarter overall, at $58 billion, narrowly exceeding the prior peak, $57.3 billion three years ago. For the first half of 2024 the demand figure stands at a whopping $109 billion, the second-highest reading for any comparable period on record, behind $111 billion in 2021.

Combining the $7.3 billion decrease in outstandings in June — the proxy for supply — with $12.1 billion of measurable demand leaves the market with a $4.8 billion supply shortage, well in from the $41.2 billion shortage recorded in May. In the year to date, the shortage of supply relative to demand is $115 billion, the highest comparable reading on record, up from $50.2 billion at this point last year.

US leveraged loan market, supply vs investor demand ($B)



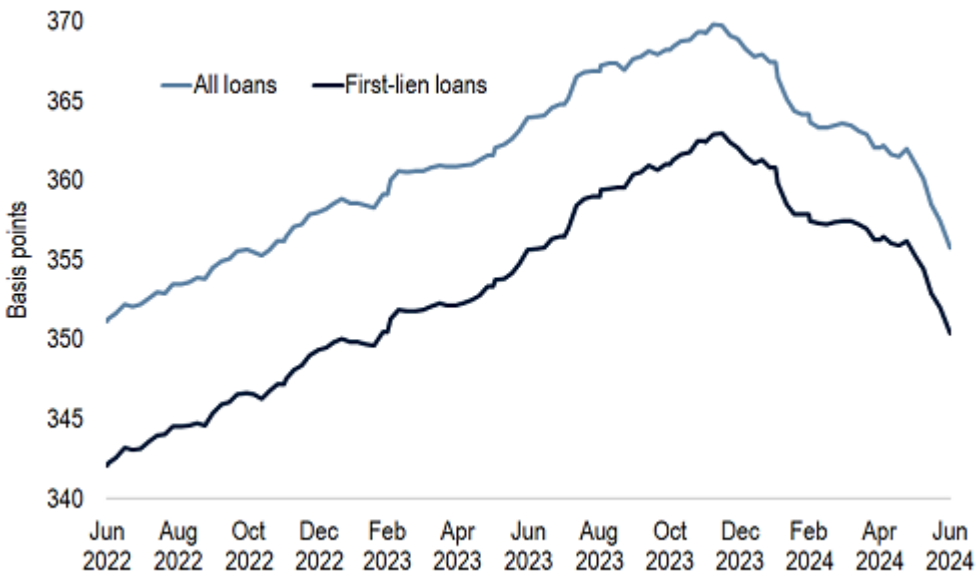
Source: PitchBook | LCD • Data through June 30, 2024
Based on (a) new issuance minus repayments minus (b) CLO issuance and Prime Fund inflows

Repricings impact loan spreads

As trading prices retreated in June the secondary spread-to-maturity (STM) widened, even though repricing activity continues to compress average nominal spreads of outstanding loans. STM accounts for the nominal spread and bid price of the loan.

Across the entire index, the average STM widened slightly in June, to 430 bps, although it remains below April levels (436 bps). At the same time, the weighted average nominal spread of outstanding loans fell by five basis points, to 356 bps. The effect of this year's massive repricing wave is translating into spread compression across the market. In the last six months, the weighted average nominal spread across the Index fell by 13 bps. This metric reflects the contractual spread over a base rate and does not take into account the impact of a floor under the base rate or a deal's credit spread adjustment (CSA), if any. Excluding second-lien facilities, the current average spread is 350 bps, down 12 bps from the start of 2024.

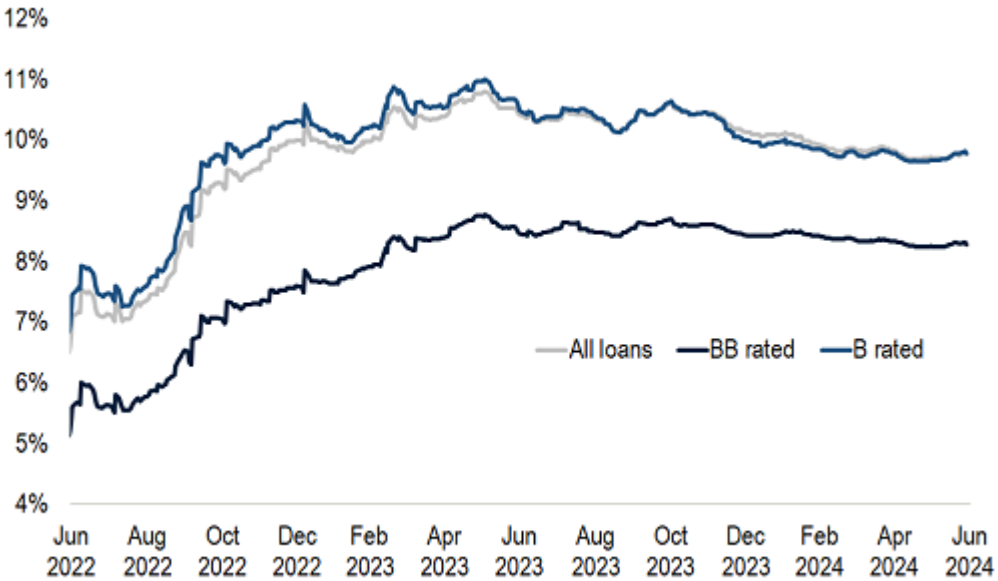
Weighted average nominal spread of outstanding loans



Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through June 30, 2024

At the same time, the yield-to-maturity, which also accounts for the base rate, widened slightly, to 9.77%, from 9.70% at the end of May. The current level is 37 bps below the final level of 2023 and 64 bps tighter than a year ago. Nonetheless, loan yields remain attractive relative to pre-rate-hike levels — for context, they averaged some 4.4% in the first quarter of 2022.

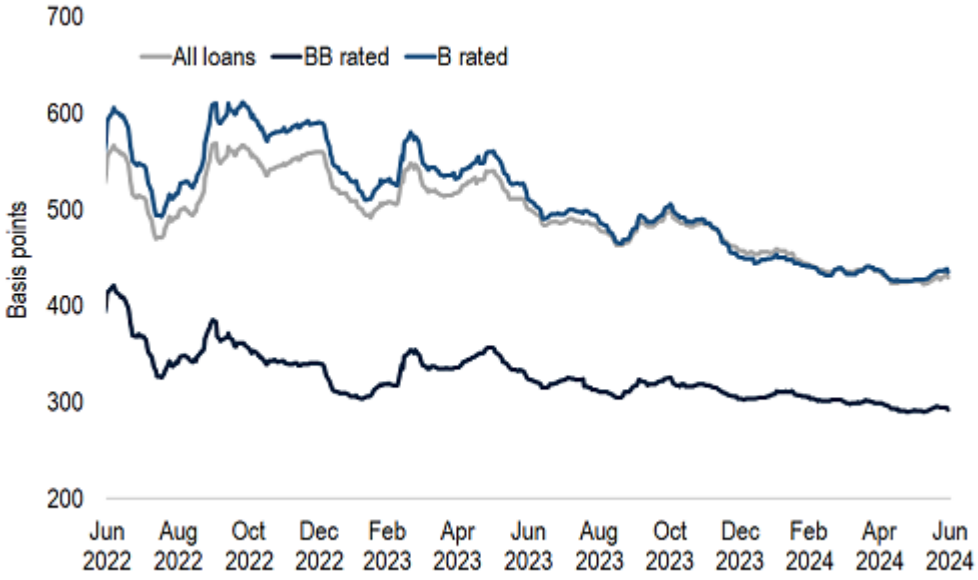
Secondary yield-to-maturity by S&P Global loan rating



Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through June 30, 2024

Looking at the index constituents by facility rating, single-Bs were yielding 9.78% at the end of last month, up 12 bps from May but below 10% at the end of 2023. Double-Bs were yielding 8.28%, up three bps from the prior month but 16 bps below the starting point of 2024.

Secondary spread-to-maturity by S&P Global loan rating



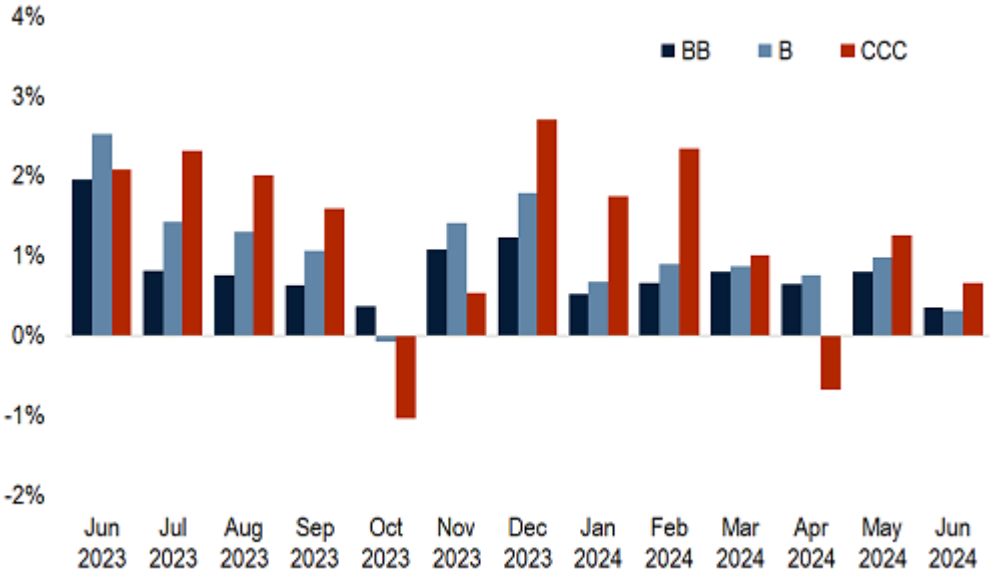
Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through June 30, 2024

Riskiest loans underperform

Amid a softer market tone, single-B names underperformed double-B names for the first time since October, signaling lower risk appetite. Double-B rated loans, which account for roughly one-fifth of the index, posted a 0.35% gain in June, a 13-month low. Nonetheless, this return exceeded that of the much larger single-B sub-index, which gained 0.31% last month, the weakest result since October. Both cohorts declined on a market-value basis as secondary prices retreated, but the lower-rated names saw bigger losses, down 0.46% vs down 0.33%, respectively.

The riskiest loans, those falling into the triple-C sub-index, outperformed both single-B and double-B loans, gaining 0.66%, down from 1.26% in May. These loans account for a 7% share the index by par amount. The market value component of total return for this cohort lost 32 bps last month.

Morningstar LSTA US LLI monthly returns by facility rating



Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through June 30, 2024

For the year overall, triple-C names also come out ahead, gaining 6.48%. The single-B sub-index is up 4.57%, leading the double-B cohort, which has gained 3.84%. All three sub-indices are underperforming last year's comparable due to a weaker market-value return.

Other asset classes

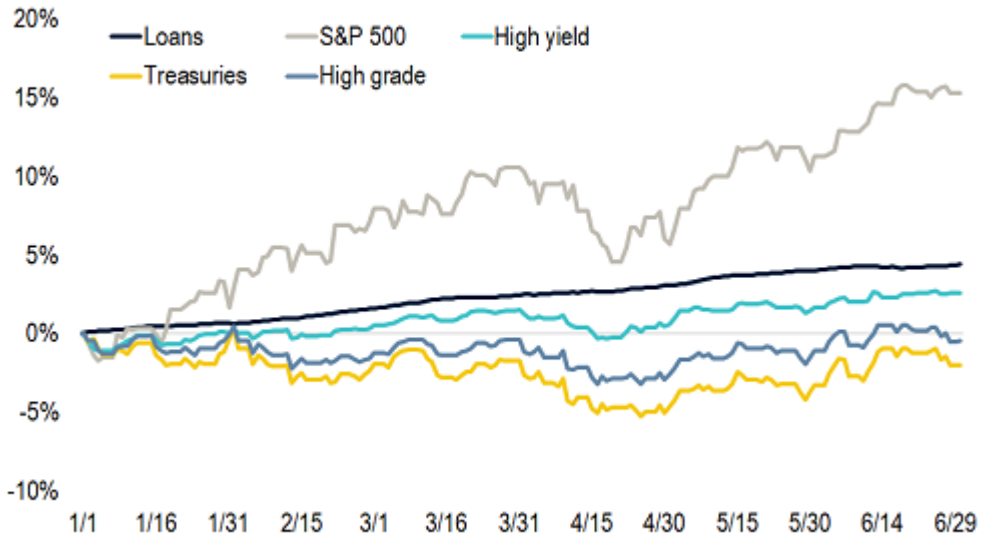
In fixed income, the only shelter from rate volatility for investors this year has been at the lower rungs of credit quality. While high-yield returns for the second quarter (positive 1.07%) and YTD (positive 2.62%) lagged those for loans and equities, they have consistently outperformed investment-grade bonds and risk-free reference bonds amid meandering progressions for reference rates. Investment-grade returns were narrowly negative for the quarter as losses in April overwhelmed gains in May and June, leaving the category in a loss position for the year (negative 0.45%). The 10-year Treasury index has generally underperformed, with a slight loss for the second quarter and a 2% loss YTD. For equities, gains continue to pile up as the Fed attempts a high-stakes soft landing via a higher-for-longer rate policy. The S&P 500 posted strong gains in May and June, erasing a loss of more than 4% in April and lifting gains to 4.28% for the latest quarter, 15.29% for the year, and nearly 25% for the last 12 months.

Returns by asset class

	Jun 2024	May 2024	3ME	YTD	LTM
Morningstar LSTA US LL Index	0.35%	0.94%	1.90%	4.40%	11.11%
Morningstar US High-Yield Bond	0.94%	1.14%	1.07%	2.62%	10.50%
Morningstar US Corporate Bond	0.63%	1.85%	-0.05%	-0.45%	4.48%
S&P 10-year Treasury Index	1.29%	1.88%	-0.27%	-1.99%	-0.69%
S&P 500	3.59%	4.96%	4.28%	15.29%	24.56%

Sources: PitchBook | LCD; Morningstar; S&P Dow Jones Indices • Data through June 30, 2024

Returns by asset class, Jan. 1 – June 30, 2024



Sources: PitchBook | LCD; Morningstar; S&P Dow Jones Indices • Data through June 30, 2024

Biggest movers

The biggest decliner last month was triple-C rated **Landslide Holdings** (though the majority of the top 10 decliners in June fell into the single-B cohort). Single-B loans underperformed both double-B and triple-C loans in June. **Allen Media** was also among the biggest decliners last month, with its term loan slipping into distressed territory, to 74/77, by month-end after the issuer was downgraded by Moody's to Caa1, from B2, and its outlook was revised to negative. The ratings report noted industry trends that will lead to weakening operating performance for the company.

US leveraged loan "big movers" in June 2024

Down	S&P Global loan rating	Sector	Index return contribution
Landslide Holdings Inc	CCC	Software	-0.0186%
Cubic	B	Aerospace & Defense	-0.0174%
GoTo Group Inc.	NR	Software	-0.0070%
Yahoo/Verizon Media	B	Interactive Media & Services	-0.0068%
LaserShip Inc.	CCC-	Air Freight & Logistics	-0.0061%
Verifone Inc	B-	Electronic Equipment Instruments & Component	-0.0061%
Virgin Media Finance	B+	Diversified Telecommunication Services	-0.0056%
Weight Watchers International Inc	B-	Diversified Consumer Services	-0.0056%
Allen Media LLC	B+	Media	-0.0056%
Medical Solutions	B	Health Care Providers & Services	-0.0053%
Up			
RSA Security	CCC	Software	0.0113%
Cablevision Systems	CCC+	Media	0.0108%
AMC Entertainment Inc	B-	Entertainment	0.0080%
Radiate Holdco	CCC+	Diversified Telecommunication Services	0.0077%
Quest/One Identity	CCC	Software	0.0052%
Hearthside Food Solutions LLC	CCC	Food Products	0.0050%
CoreLogic Inc	CCC	Professional Services	0.0041%
Peraton	NR	Aerospace & Defense	0.0040%
Zayo Group LLC	B-	Diversified Telecommunication Services	0.0040%
First Brands	B-	Automobile Components	0.0035%

Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through June 30, 2024

Of the top gainers in June, triple-C rated issuers accounted for six of the top 10 gainers, as the lowest-rated portion of the index outperformed. AMC Entertainment was one of the biggest movers to the upside, with its term loan B due April 2026 (S+300, 0% floor) climbing over four points, to 94.5/95.5, by the end of the month. The company in early June completed an exchange of $164 million of its second-lien notes due 2026 for common equity.

US leveraged loan returns by sector, with weight greater than 1%		
Top ten	**Jun-24**	**MV Weight**
Entertainment	1.03%	1.66%
Food Products	0.79%	1.50%
Independent Power and Renewable Electricity Producers	0.77%	1.19%
Specialty Retail	0.77%	2.59%
Automobile Components	0.62%	1.66%
Health Care Technology	0.61%	1.97%
Life Sciences Tools & Services	0.60%	1.54%
Pharmaceuticals	0.57%	1.39%
Capital Markets	0.53%	3.56%
Containers & Packaging	0.49%	2.23%
Bottom ten		
Aerospace & Defense	-0.49%	1.86%
Software	0.04%	11.88%
Diversified Telecommunication Services	0.07%	3.38%
Media	0.20%	3.62%
Diversified Consumer Services	0.21%	1.71%
Professional Services	0.22%	3.36%
Health Care Providers & Services	0.25%	4.76%
Construction & Engineering	0.25%	1.41%
Ground Transportation	0.28%	1.14%
Building Products	0.28%	1.59%

Data through June 30, 2024

Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index

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