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Loan Index Monthly: Investors' search for yield continues to fuel rally

By: Marina Lukatsky

Prices in the U.S. leveraged loan trading market continued to advance in May as investors' search for yield added fuel to the rally within the riskiest corners of the market.

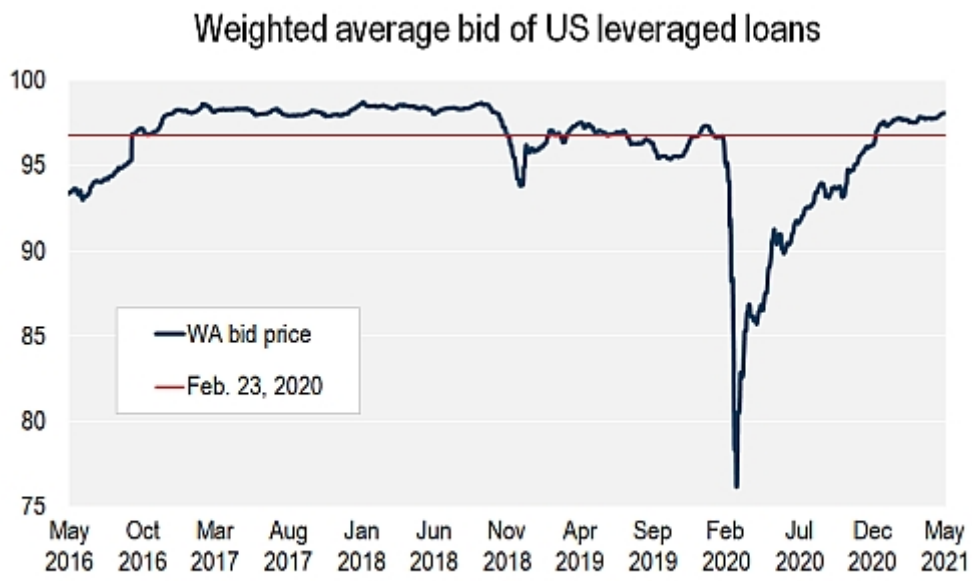
The gap between prices (and yields) of lower-rated and higher-rated loans continues to shrink. By the end of May, one year after pandemic-induced downgrades spiked to record levels, the average bid on debt of B-minus rated borrowers was less than a point away from par, with the discounted spread-to-maturity at the tightest level since the Great Financial Crisis.

More broadly, the S&P/LSTA Leveraged Loan Index gained 0.58% in May, up slightly from a 0.51% return in April and from a virtually flat March, when the index lost 0.0025%. The market has rallied roughly 22% over the last 14 months, gaining in every month besides March. The strength of the rally has declined in recent months, however, with the 2021 monthly average return at 0.57%, versus 1.92% between April and December 2020.

Data through May 31, 2021.
Sources: LCD, an offering of S&P Global Market Intelligence; S&P/LSTA Leveraged Loan Index

The market value return, which measures the increase or decrease in secondary prices, drove last month's positive performance. This metric hit a three-month high of 0.24% in May, up from 0.18% in April. On average, the market value return has gained 0.24% per month in 2021 and 0.63% per month over the last 12 months.

By the end of May, the weighted average bid of the S&P/LSTA Index rose to 98.09, up 30 bps from April and marking the highest reading since November 2018. The average bid has risen 189 bps since the start of 2021 and has gained roughly 9 points in the last 12 months.



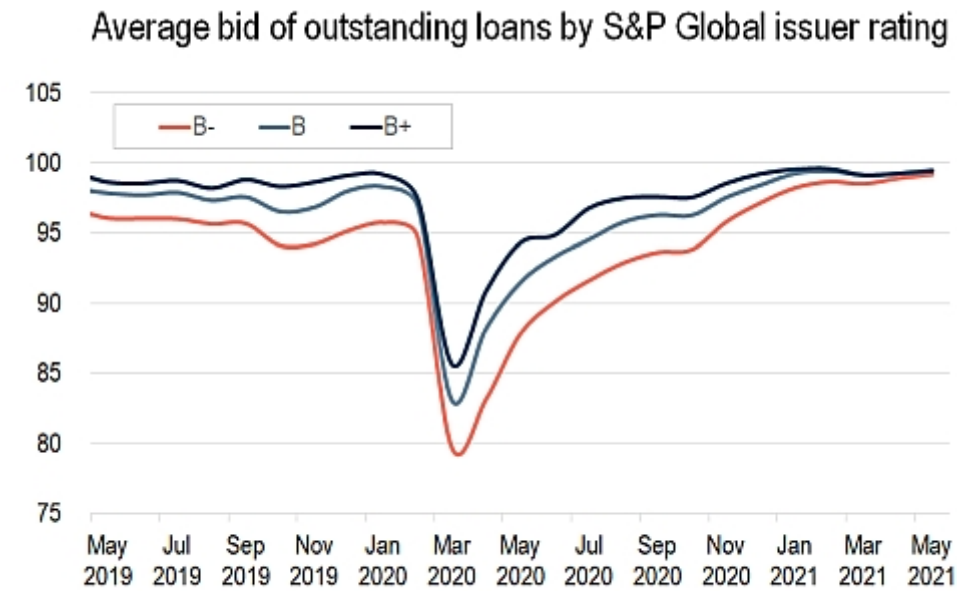
Data through May 31, 2021.
Sources: LCD, an offering of S&P Global Market Intelligence; S&P/LSTA Leveraged Loan Index

Through the first five months of the year, U.S. leveraged loans have gained 2.90%, ahead of the 5.68% loss through May last year but trailing the 5.49% positive showing two years ago. Looking over a longer time horizon, loans have gained 2.32%, on average, between January and May over the last 10 years.

Shouting distance of par

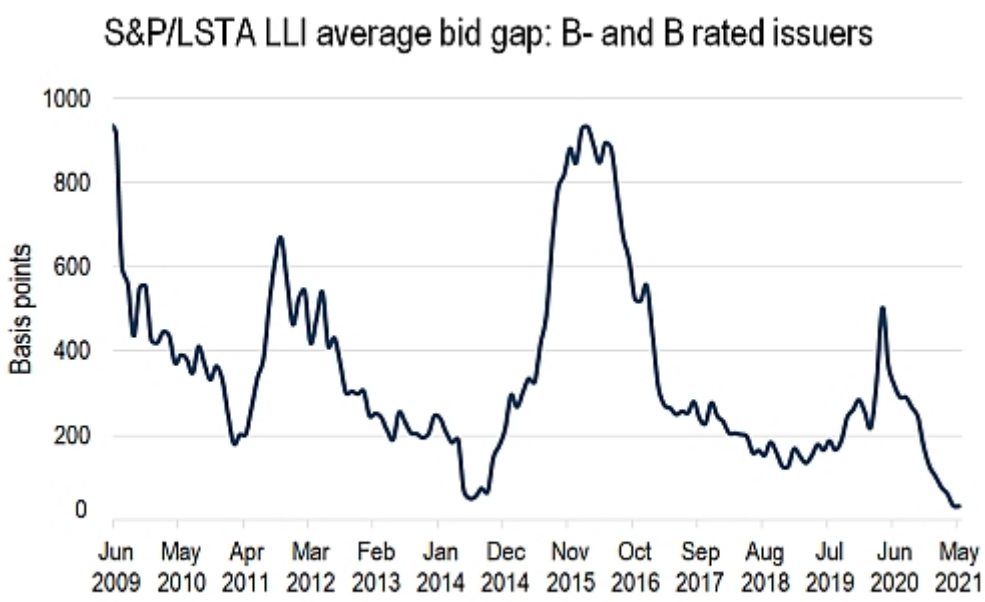
Declining yields across the board have fueled investor demand for lower-rated (and higher-yielding) paper. As a result, the gap between prices of lower-rated and higher-rated names shrank drastically in a relatively short period of time. In fact, there is now just a 31-bps gap in the average bid between B-minus rated issuers and B-plus rated issuers. This gap was roughly 100 bps three months ago and more than 200 bps at the end of 2020. A year ago — when the downgrade to upgrade ratio spiked to an all-time high of 43x — these two cohorts were 6.5 points apart.

With upgrades of leveraged loans outpacing downgrades at the fastest rate since May 2012, the average bid of loans to B-minus borrowers — which are just one notch above the CCC+ bucket — rose to 99.12 by May 31, the closest this cohort has been to par since July 2014. The average gained 2 points since the start of the year (when it was 97.12) and more than 11 points over the last 12 months.



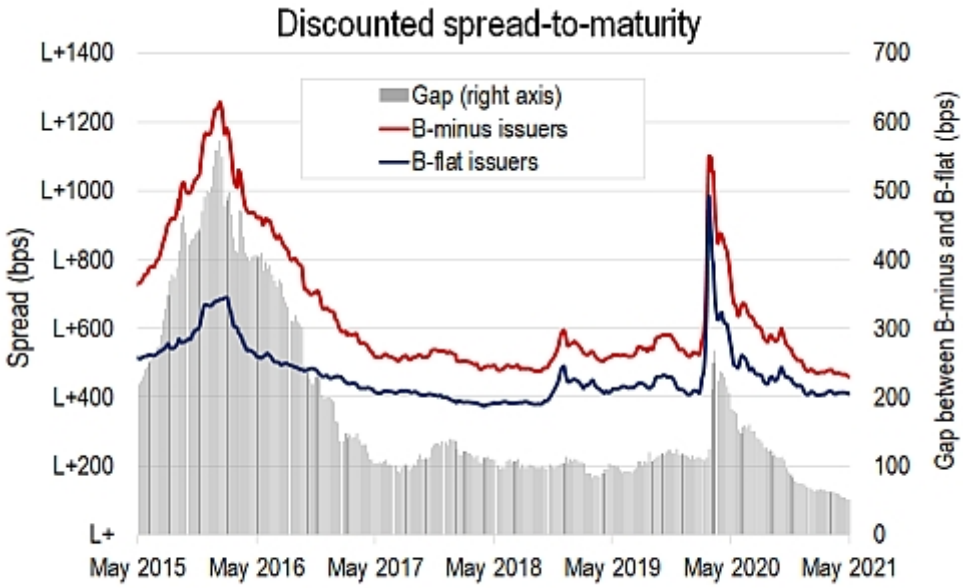
Data through May 31, 2021.
Sources: LCD, an offering of S&P Global Market Intelligence; S&P/LSTA Leveraged Loan Index

In addition, the difference between the average bid of B-minus and B-flat buckets fell to the lowest level since Global Financial Crisis in May, at just 35 bps, down from 128 at the end of 2020 and pandemic peak of 504 bps last April.



Data through May 31, 2021.
Sources: LCD, an offering of S&P Global Market Intelligence; S&P/LSTA Leveraged Loan Index

As prices on B-minus loans advanced, the discounted spread-to-maturity, or STM, which accounts for bid price and nominal spread, fell to the lowest level since the Global Financial Crisis, at L+460 bps on May 31. That's 45 bps tighter than at the end of 2020 and 79 bps tighter than six months ago.

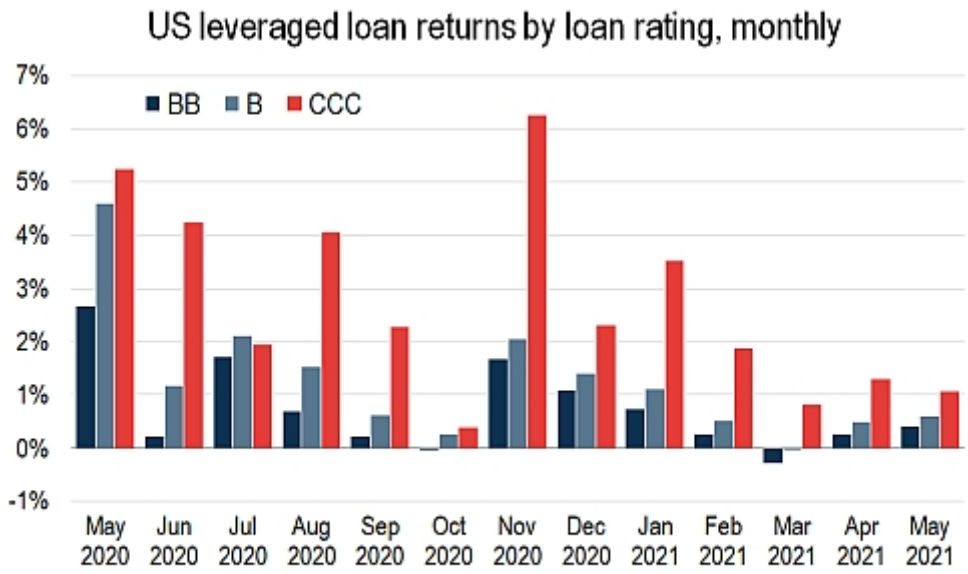


Data through May 28, 2021.
Sources: LCD, an offering of S&P Global Market Intelligence; S&P/LSTA Leveraged Loan Index

In addition, the gap between the discounted STM of the B-minus and B-flat borrowers has narrowed to just 51 bps, also the lowest reading since the Global Financial Crisis. At the end of 2020, the two cohorts were 75 bps apart, with the gap exceeding 100 bps for most of 2020. Looking at the three years before the onset of the pandemic, B-minus loans offered roughly 150 bps more than B-flat loans, on a discounted STM basis. (This analysis is based on issuer-level rating.)

May returns

Focusing once again on returns, higher-rated loans continued to underperform. The BB rated sub-index total return has trailed both the B and CCC sub-index returns in every month since April 2020. In May, BB rated paper, which represents about 20% of the $1.2 trillion U.S. leveraged loan asset class, gained 0.42%, while single-B rated issues, which account for roughly 60% of all outstanding loans, rose 0.61%. At the same time, the riskiest (and higher yielding) names in the Index, namely triple-C's, gained 1.08%. About 9% of all outstanding loans fall into this ratings bucket.



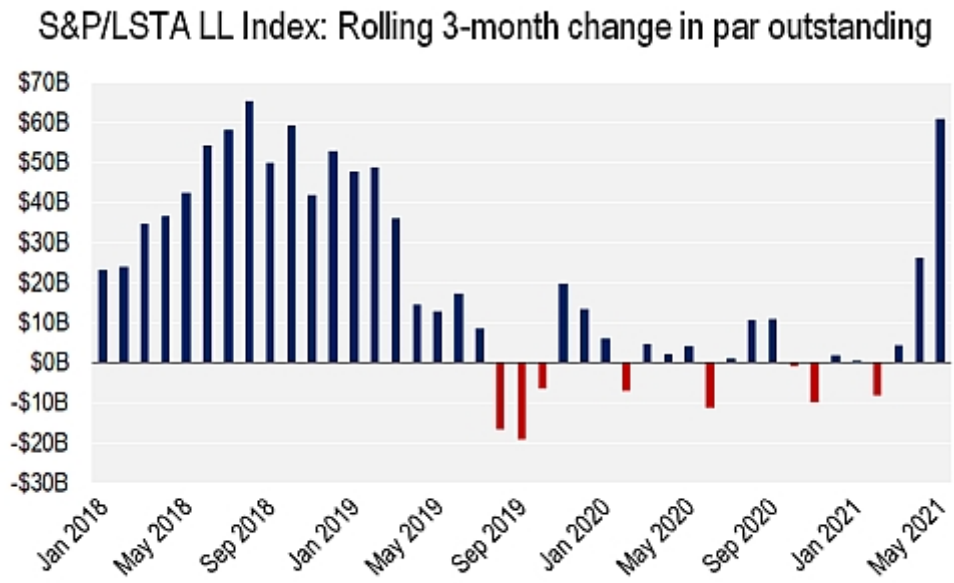
Data through May 31, 2021.
Sources: LCD, an offering of S&P Global Market Intelligence; S&P/LSTA Leveraged Loan Index

The CCC sub-index has now rallied for 14 consecutive months, gaining roughly 47% during this period. Recall that these names lost 22% in the March 2020 selloff as investor demand for riskier debt evaporated. (The rated subsets of the S&P/LSTA Leveraged Loan Index represent facility-level ratings).

Technicals

The technical scales finally tipped into lenders' favor in May, following three consecutive months of positive net supply — the longest such stretch since the onset of the pandemic. LCD measures net loan supply as the change in outstandings, per the S&P/LSTA 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.

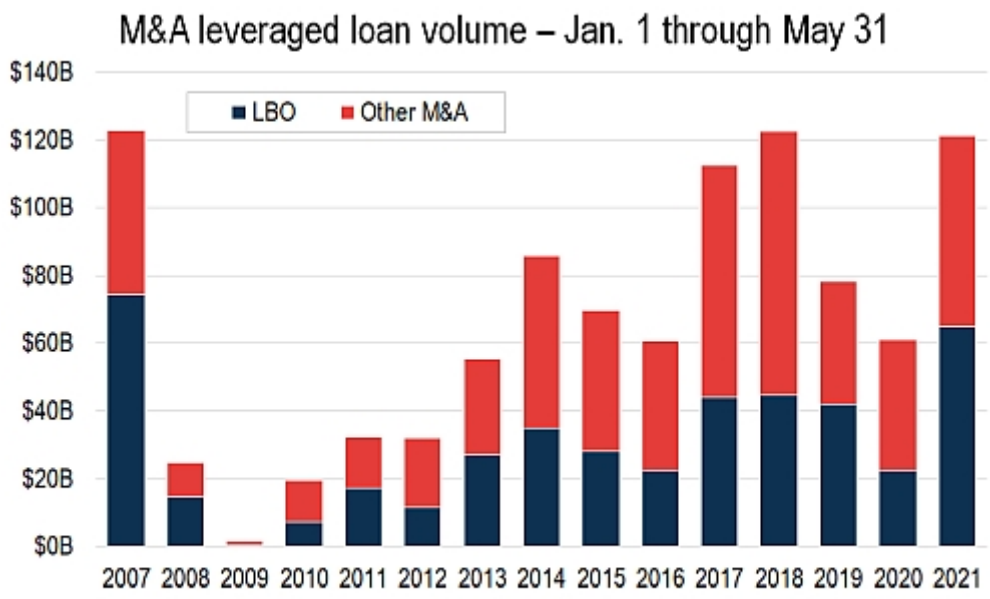
Starting with supply: The par amount outstanding tracked by the index expanded by $27 billion in May, the most since August 2018, on top of roughly $34 billion in March and April combined. The index has grown by nearly $61 billion over the last three months, the biggest growth spurt since the summer of 2018. Recall that in the second quarter of 2018, record-breaking loan issuance funded M&A activity ($84.5 billion), which typically translates to net supply.



Data through May 31, 2021.
Sources: LCD, an offering of S&P Global Market Intelligence; S&P/LSTA Leveraged Loan Index

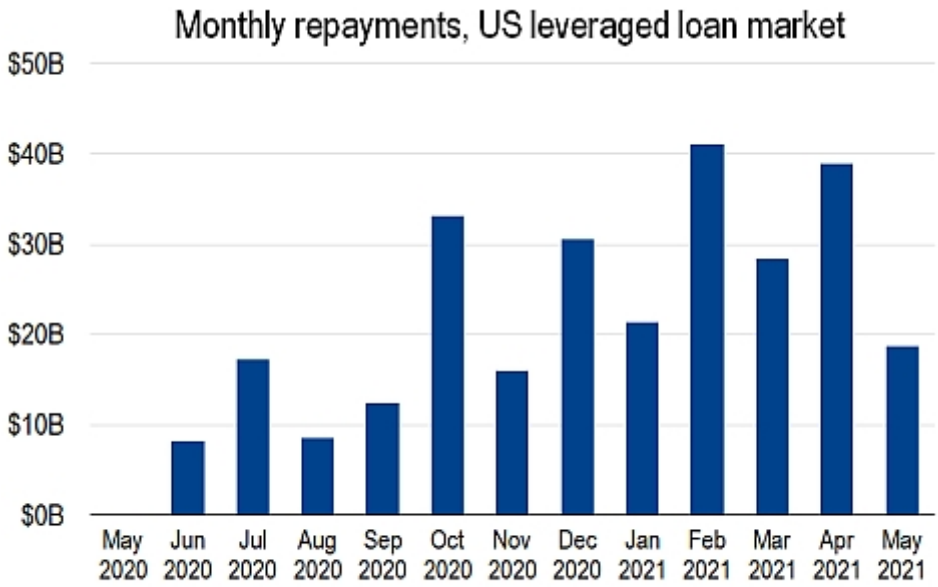
The current growth spurt also resulted from a surge in mergers, acquisitions and buyouts. LBO-related volume of $64.9 billion through May this year is running at the highest pace since the Global Financial Crisis and the second-highest pace on record behind the $74.4 billion in 2007. Total M&A loan volume — which includes non-private-equity sponsored activity as well as sponsored tack-on acquisitions — is at

record pace, $121.2 billion through May 31. This is slightly below the $122.8 billion of volume in the first five months of 2018, a year that set the annual record for M&A volume.



Data through May 31, 2021.
Source: LCD, an offering of S&P Global Market Intelligence

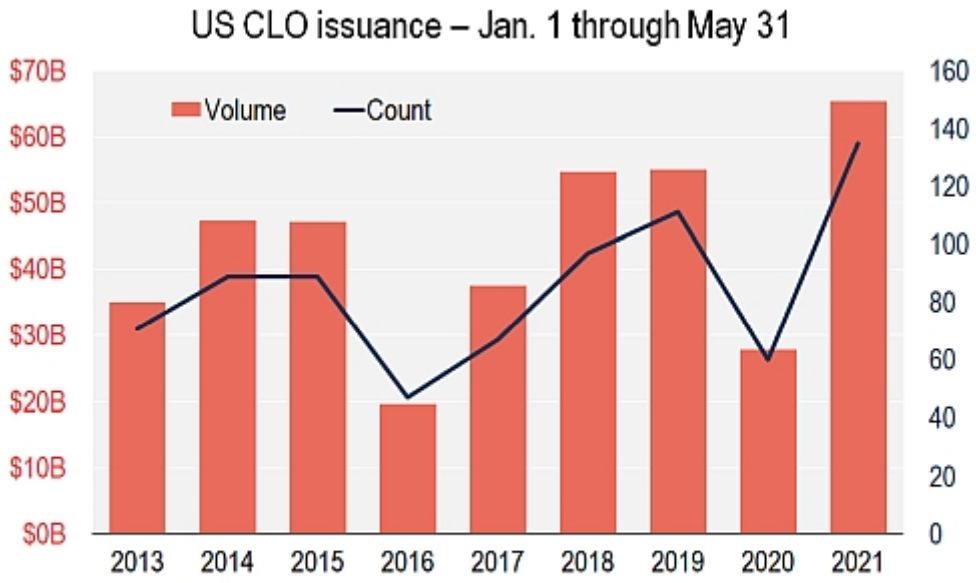
This year's surge of M&A financing bodes well for the growth of the loan asset class. In addition, repayments dipped to a six-month low in May, to $18.7 billion, roughly half of the April and February levels. Repayments have averaged roughly $30 billion per month in 2021 and $20.5 billion since the onset of the pandemic.



Data through May 31, 2021.
Sources: LCD, an offering of S&P Global Market Intelligence; S&P/LSTA Leveraged Loan Index

Refinancing-related loan issuance took a backseat in May, totaling a five-month low of $10.4 billion, down from $16.5 billion in April and a whopping $32.7 billion in March, which was a four-year high. As a result, only about a quarter of May's repayments stemmed from refinancing activity, versus 68% in March.

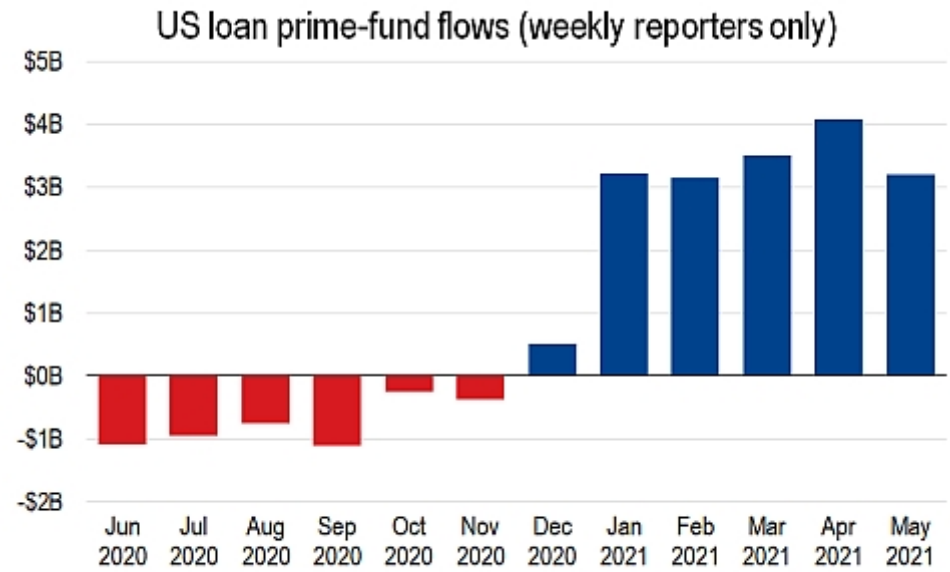
Turning to demand: LCD defines investor demand as CLO issuance combined with cash flows to U.S. loan funds. Although the CLO new-issue market has slowed from the frenetic pace early in 2021, it is already off to its strongest start to a year since the Global Financial Crisis, with $65.8 billion priced through May 31, based on 136 vehicles. In May alone, 26 CLO vehicles priced, totaling $12.7 billion, versus the trailing 12-month average of 24 vehicles/$10.9 billion.



Data through May 31, 2021.
Source: LCD, an offering of S&P Global Market Intelligence

At the same time, the retail investor return to the U.S. leveraged loan market, which began in November 2020 after a brutal, pandemic-inspired flight from risk earlier in 2020, continues to pick up steam. In fact, the only redemption among the weekly reporters to Lipper was during the first week of the year, when a scant $10 million was withdrawn from the segment. There were net inflows in 20 of the 21 weeks through May 26, totaling $17.2 billion.

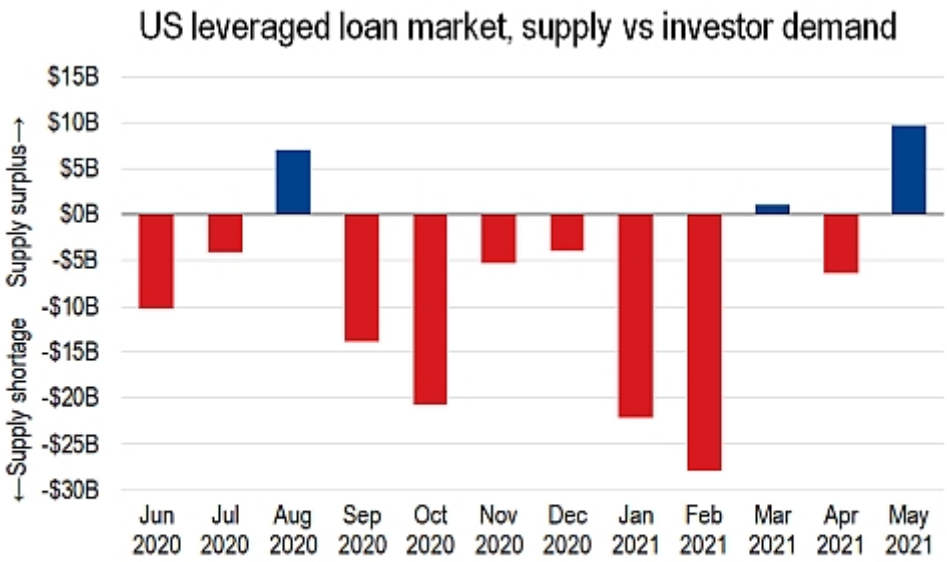
For the four weeks through May 26, the inflow tally was $3.2 billion, down from $4.1 billion in April but roughly on par with monthly levels in the first quarter. This follows a year in which cash redemptions at these funds and ETFs totaled $19.1 billion, on top of a crushing $27.7 billion withdrawn from the asset class in 2019.



Data through May 26, 2021.
Source: Lipper FMI

More broadly, LCD estimates $4.5 billion of inflows into retail loan funds in May, the sixth consecutive monthly inflow. The sum of these retail loan fund investments and CLO issuance ($12.7 billion) stands at $17.2 billion, a four-month low but well ahead of the trailing 12-month average at $12.5 billion.

Combining the $27 billion increase in outstandings — the proxy for supply — with $17.2 billion of measurable demand leaves the market with a $9.7 billion supply surplus, the biggest surplus since March 2020, versus a $6.3 billion supply shortage in April. In the year through May, measurable demand exceeded supply by $45.5 billion.



Based on (a) new issuance minus repayments minus (b) CLO issuance and Prime Fund inflows.
Data through May 31, 2021.
Source: LCD, an offering of S&P Global Market Intelligence

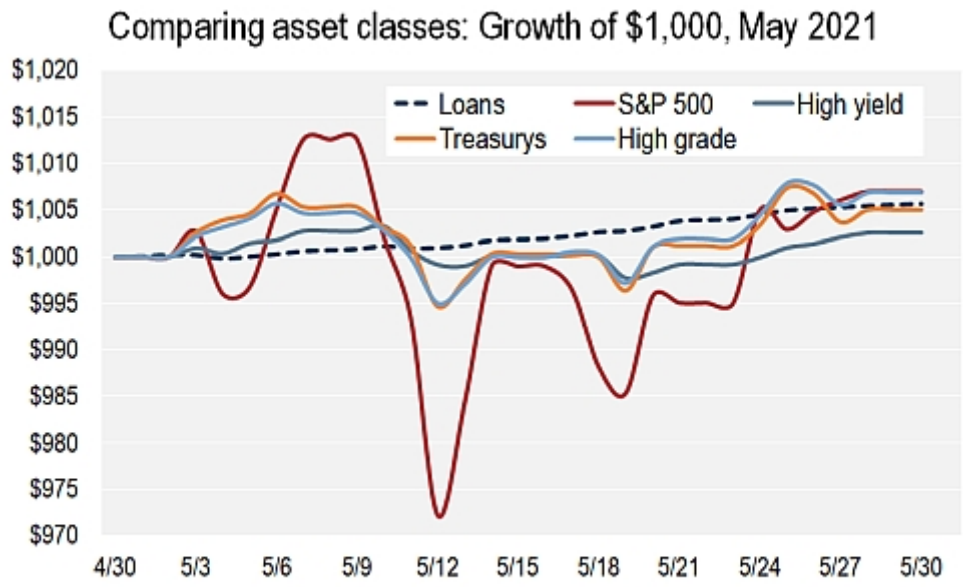
US leveraged loan returns, by sector			
	May 2021	YTD	Weight
Aerospace & Defense	0.46%	3.49%	2.20%
Air Transport	0.46%	4.99%	1.93%
All Telecom	0.32%	2.42%	4.00%
Automotive	0.61%	3.60%	3.04%
Building & Development	0.77%	2.31%	3.13%
Business Equipment & Services	0.57%	3.32%	9.90%
Cable & Satellite Television	0.42%	1.58%	3.38%
Chemicals & Plastics	0.49%	2.31%	4.37%
Clothing/Textiles	1.21%	4.43%	0.60%
Containers & Glass Products	0.56%	2.60%	2.13%
Cosmetics/Toiletries	1.11%	6.17%	0.41%
Drugs	0.30%	2.01%	2.52%
Ecological Services & Equipment	0.48%	2.79%	0.63%
Electronics/Electrical	0.59%	2.67%	15.57%
Equipment Leasing	0.49%	2.25%	0.58%
Financial Intermediaries	0.46%	1.41%	1.89%
Food Products	0.46%	2.05%	1.81%
Food Service	0.54%	2.59%	2.49%
Health Care	0.68%	3.01%	9.77%
Home Furnishings	0.58%	4.18%	0.56%
Industrial Equipment	0.59%	3.11%	3.48%
Insurance	0.60%	2.13%	3.75%
Leisure Goods/Activities/Movies	0.74%	6.08%	3.69%
Lodging & Casinos	0.48%	2.95%	3.48%
Nonferrous Metals/Minerals	2.65%	5.49%	0.37%
Oil & Gas	0.68%	6.21%	2.39%
Publishing	0.28%	4.37%	1.37%
Radio & Television	0.64%	0.29%	2.00%
Retailers (except food & drug)	0.71%	2.86%	2.77%
Steel	0.50%	2.16%	0.25%
Surface Transport	0.56%	3.17%	0.89%
Utilities	0.62%	0.54%	2.40%
Total LLI return	**0.5808%**	**2.90%**	**100.00%**

Data through May 30, 2021.

Sources: LCD, an offering of S&P Global Market Intelligence; S&P/LSTA Leveraged Loan Index

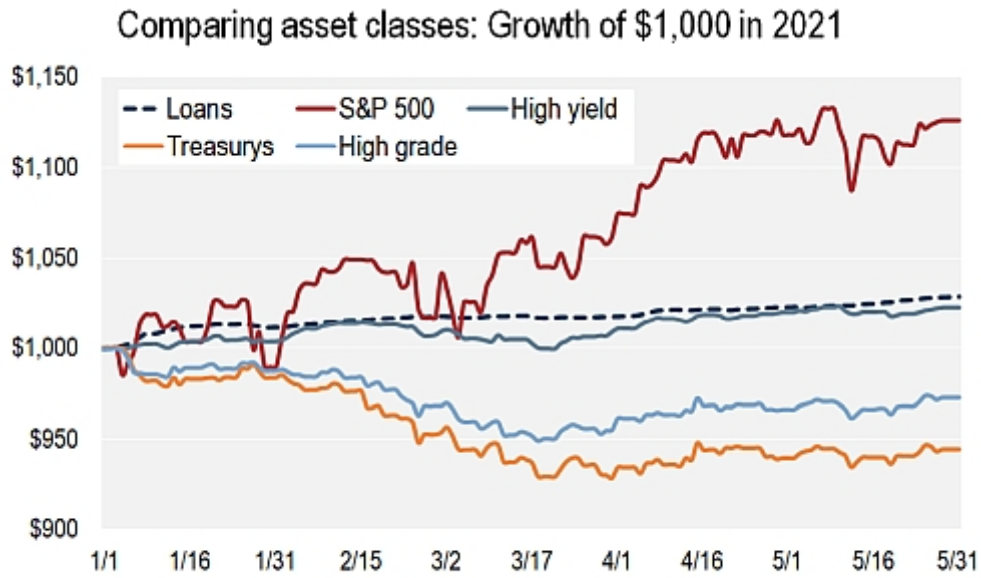
Other asset classes

In May, leveraged loan returns were in the middle of the pack, based on all the asset classes LCD tracks for this analysis. High-yield bonds underperformed, rising just 26 bps, their weakest performance in eight months, while high-grade bonds added 68 bps, although they remain in the red for the year. Equities outperformed, gaining 70 bps in May, following three months of super-charged returns totaling more than 12%. In the year-to-date, equities remain at the top of the pack, up 12.62%, with loans taking a second position, up 2.90%.



Data through May 31, 2021.

Sources: LCD, an offering of S&P Global Market Intelligence; Bank of America Merrill Lynch



Data through May 31, 2021.

Sources: LCD, an offering of S&P Global Market Intelligence; Bank of America Merrill Lynch

Returns by asset class

	May 2021	Apr 2021	3ME May-21	YTD	LTM
S&P/LSTA Index	0.58%	0.51%	1.10%	2.90%	12.51%
BAML HY Master (H0A0)	0.26%	1.10%	1.53%	2.27%	15.07%
10-year Treasury (GA10)	0.50%	1.19%	-0.84%	-5.53%	-6.81%
S&P 500, including dividends (SPX)	0.70%	5.34%	10.72%	12.62%	40.32%
BAML High-Grade Corp (C0A0)	0.68%	1.19%	0.47%	-2.70%	4.51%

Data through May 31, 2021.

Sources: LCD, an offering of S&P Global Market Intelligence; Bank of America Merrill Lynch

Biggest movers

While the triple-C rated segment led the S&P/LSTA Leveraged Loan Index for monthly returns in May, as it has for every month in 2021, five of the top decliners were in the triple-C rated category. Among the top decliners was Clarke American, which was downgraded to CCC from CCC+ on May 26. The issuer's ABL revolver and term loan are both due May 2022 as a result of springing debt maturities in its credit

agreement. Elsewhere, bids on GTT Communications Inc. dipped in May as the company continues potential restructuring negotiations with creditors, according to recent reporting from Bloomberg. The company's previous forbearance agreement ends June 3, and the issuer's 7.875% unsecured bonds due 2024 have an interest payment due June 30.

AMC Entertainment Holdings Inc. was among the top advancers this month, with the issuer's first-lien term loan due April 2026 (L+300, 0% Libor floor) gaining over 4 points by month-end, to 92/93, from around 87.875/88.75 at the start of the month. The company has raised more cash, boosting liquidity through an at-the-market equity offering.

US leveraged loan "big movers" in May 2021

Down	S&P Global loan rating	Sector	Index return contribution
GTT Communications Inc	CCC-	All Telecom	-0.0045%
Clarke American	CCC	Publishing	-0.0035%
Geo Group Inc	BB-	Financial Intermediaries	-0.0029%
McDermott International Inc	NR	Oil & Gas	-0.0022%
Mallinckrodt Inc	D	Drugs	-0.0020%
Audio Visual Services Corp.	CCC	Business Equipment & Services	-0.0015%
WaterBridge	CCC+	Oil & Gas	-0.0015%
Lumileds	CCC	Automotive	-0.0013%
Securus Technologies Inc	B-	All Telecom	-0.0009%
Revlon Consumer Products Corp	CC	Cosmetics/Toiletries	-0.0009%
Up			
Travelport LLC	B-	Business Equipment & Services	0.0081%
Team Health	B-	Health Care	0.0075%
AMC Entertainment Inc	CCC	Leisure Goods/Activities/Movies	0.0066%
Envision Healthcare	CCC	Health Care	0.0053%
Peabody Energy Corp	CCC	Nonferrous Metals/Minerals	0.0048%
SeaDrill Partners	D	Oil & Gas	0.0045%
American Airlines	B-	Air Transport	0.0044%
NeuStar Inc	CCC	Electronics/Electrical	0.0041%
DTZ U.S. Borrower LLC	B+	Building & Development	0.0037%
Lightstone Generation LLC	B+	Utilities	0.0036%

Data through May 31, 2021.
Source: LCD, an offering of S&P Global Market Intelligence

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