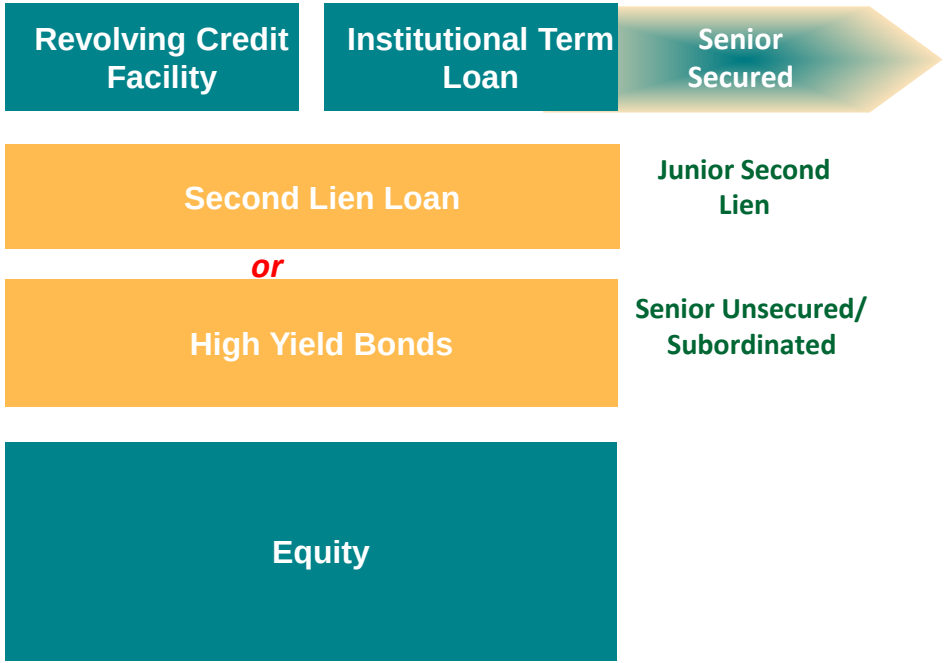
An Overview of the US Institutional Corporate Loan Market

Elliot Ganz, LSTA
Michael Nechamkin, Octagon
Jeff Bakalar, Voya
Howard Tiffen, First Trust

What are Leveraged Loans?

Corporate Capital Structure



Source: Credit Suisse

Senior Secured Loans

Senior
- Senior-most debt obligations in capital structure of non-investment grade companies
- Repaid before other debt obligations and equity holders

Secured
- Secured by collateral, generally a company's assets or stock
- Higher Recovery Value

Floating Rate
- Pays a base rate (typically LIBOR) plus an additional spread
- Coupons adjust in conjunction with changes in short-term interest rates
- Attractive yields

Covenants/Other
- Always benefit from Incurrence covenants
- Normally rated by Rating Agency's

Who are Borrowers of U.S. Leveraged Loans?

Note: The logos on this page are trademarks and service marks belonging to the respective companies shown above

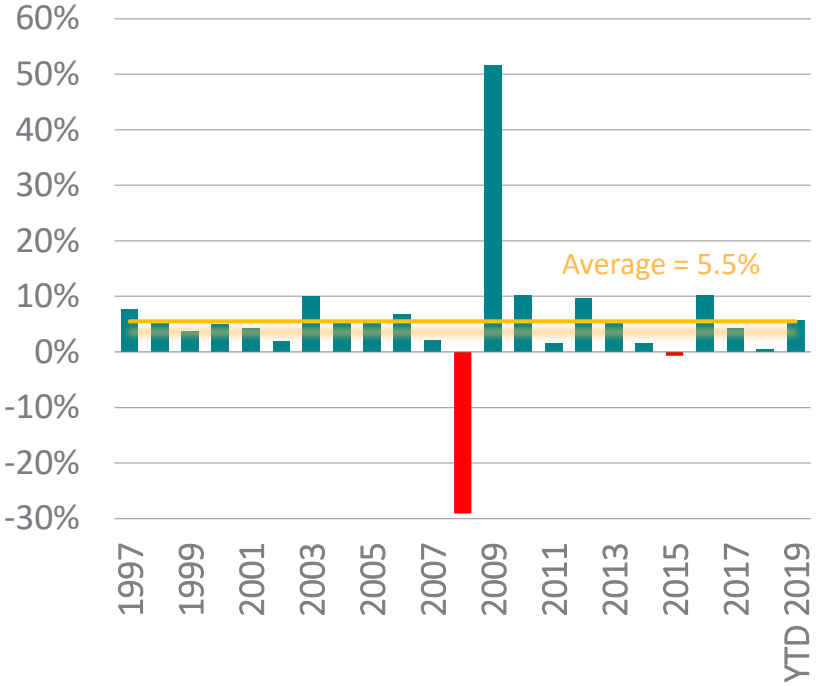
What are "Institutional" Term Loans and Who Invests in Them?

- Part of a "leveraged loan"
- A term loan that:
  - Is drawn at inception
  - Has minimal amortization
  - Is repaid at maturity (or pre-paid before maturity)
  - Typically has 6-7 year maturity
  - Is usually callable at par at any time
- Also called "Term Loan B" or TLB

- Who are Institutional Investors?
  - Pension funds
  - Insurance companies
  - Sovereign wealth funds
  - Multinational companies
  - Private wealth funds
  - Trust companies
  - Family offices
  - Asset managers

Loan Market Returns Have Proven to be Extremely Stable for More Than 20 Years

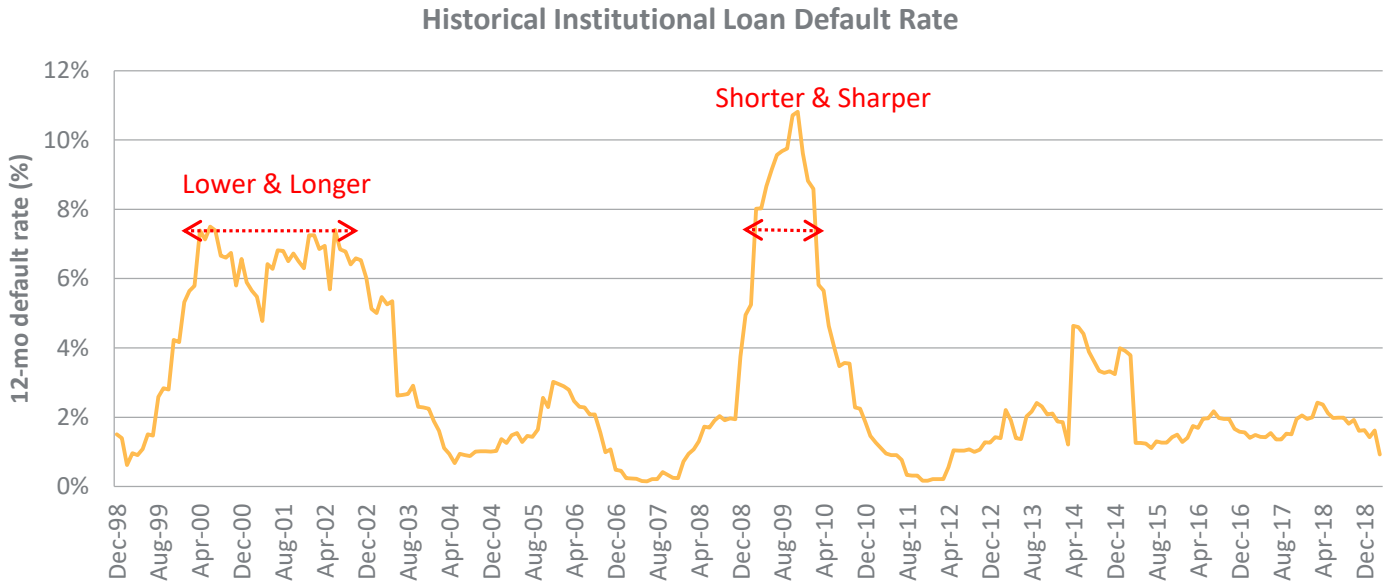
Annual LLI Returns Averaged **5.5% Since 1997**



90% of Rolling 12-Month Periods Have Been Positive

Source: The LSTA/S&P Leveraged Loan Index (LLI)

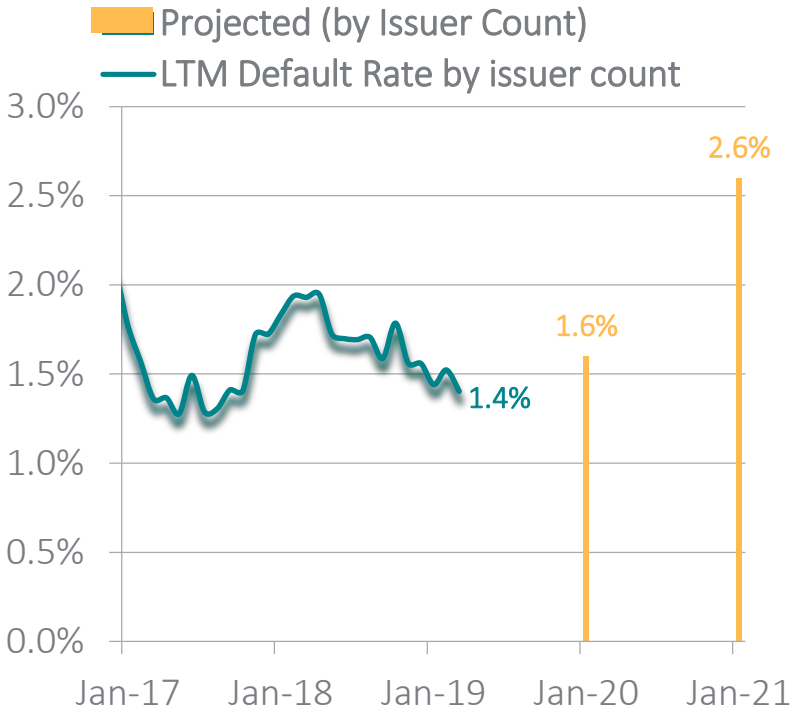
Managing Through the Credit Cycle: Historical Default Rates

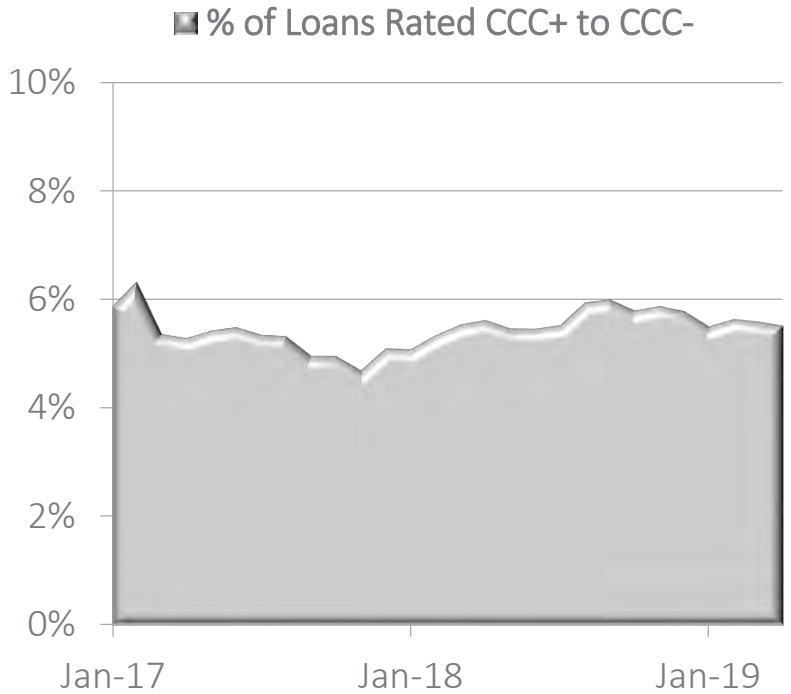


- The early 2000s default cycle had a lower default peak but longer duration
- The 2009 default cycle had a higher peak but a shorter duration

Source: S&P/ILSTA Leveraged Loan Index

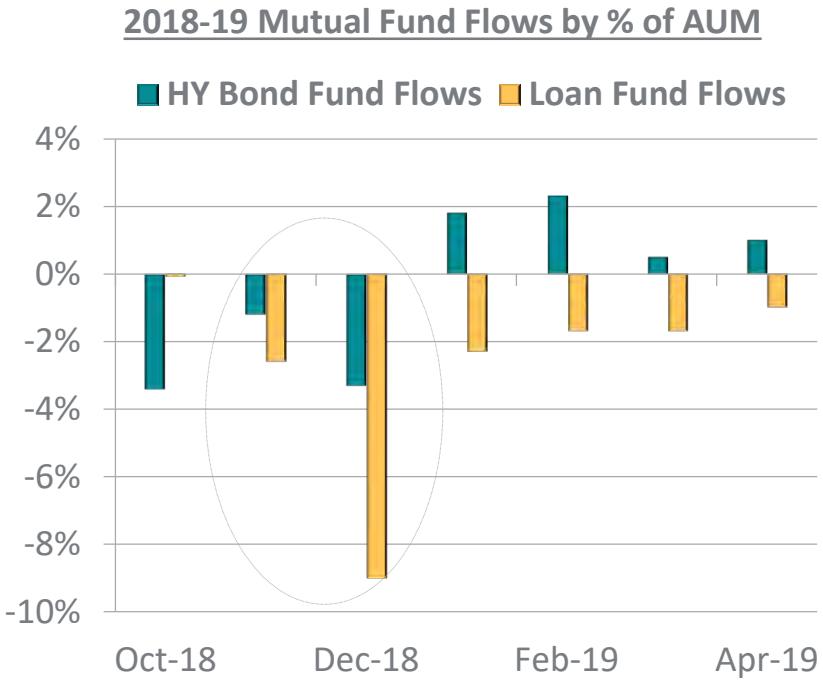
Despite Weaker 4Q18 Technicals, Fundamentals Remained Intact

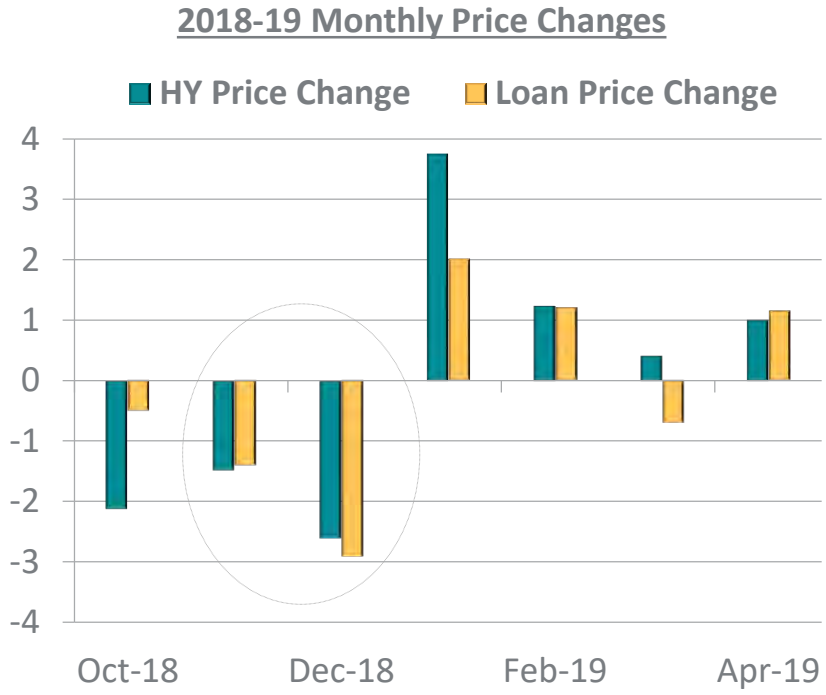




Source: LCD, S&P Global Market Intelligence.

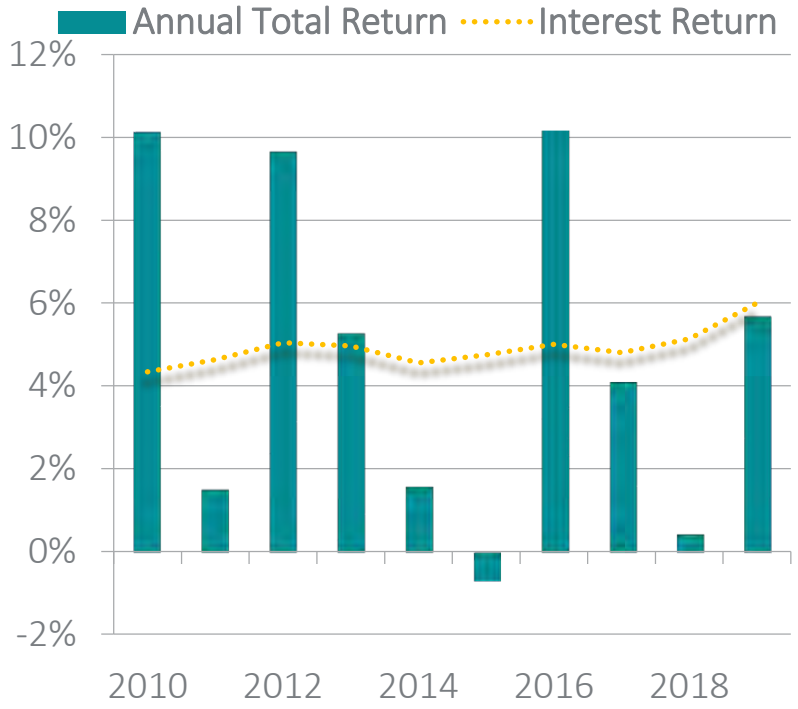
Loan Prices Have Proven to be More Stable Than HY Bond Prices During Periods of Large Mutual Fund Outflows

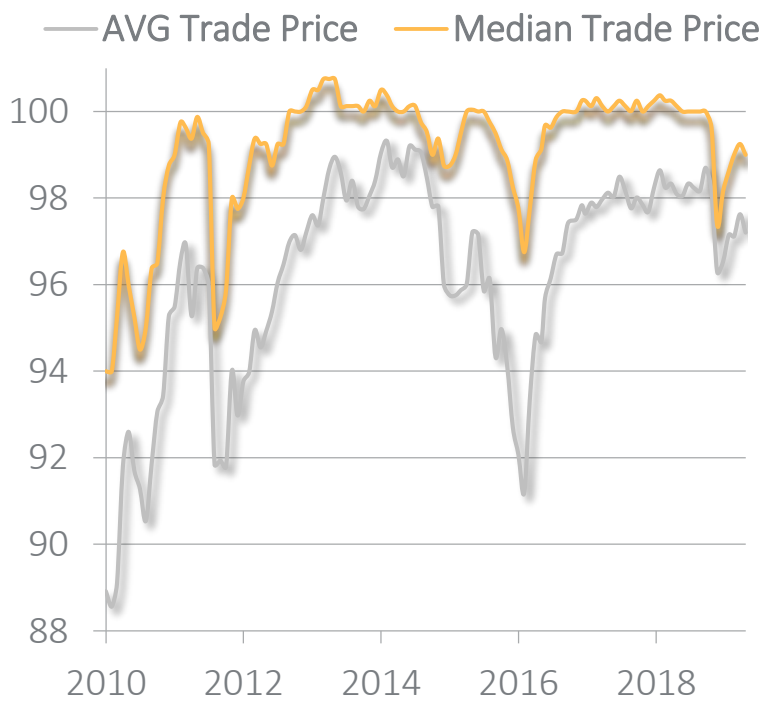




Source: Refinitiv LPC, Barclays, BAML ICE Index, S&P/LSTA Loan Index,

At a Total Return of 5.6% Through May 2019, The Loan Market is Off to Its Best Start Since the Post-Crisis Rally

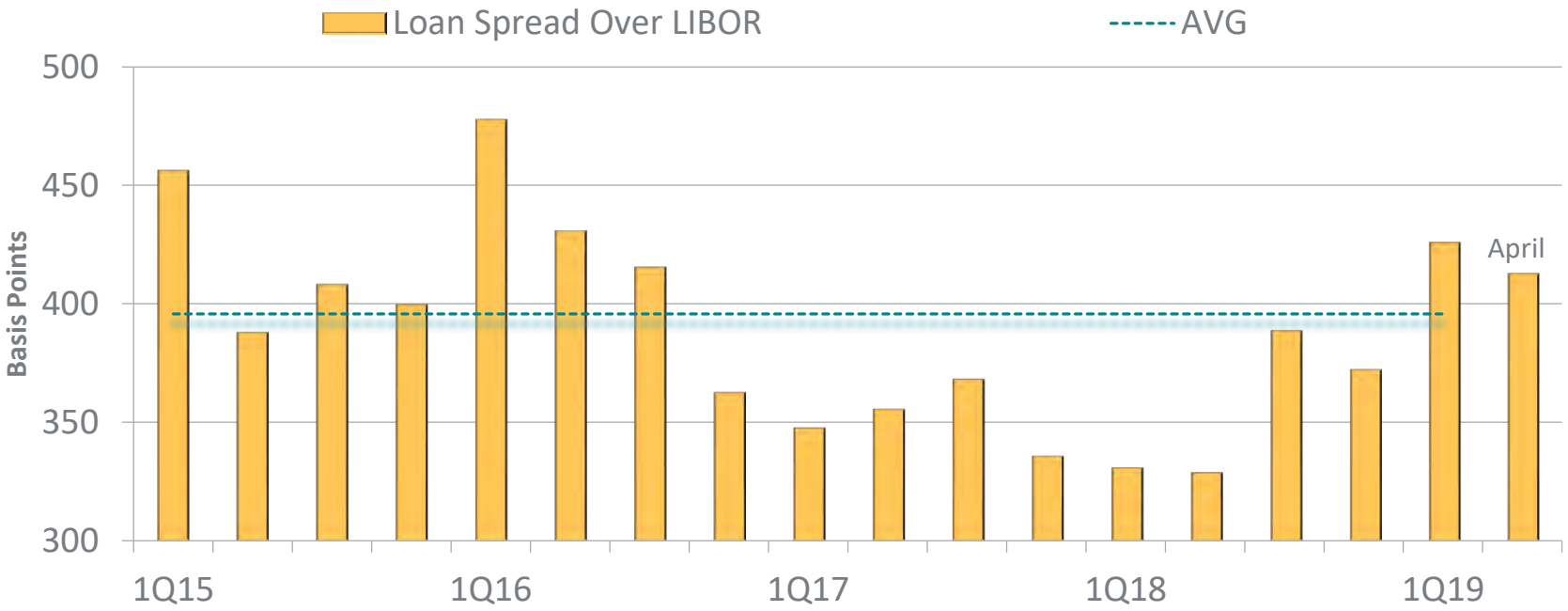




Source: S&P/LSTA Leveraged Loan Index

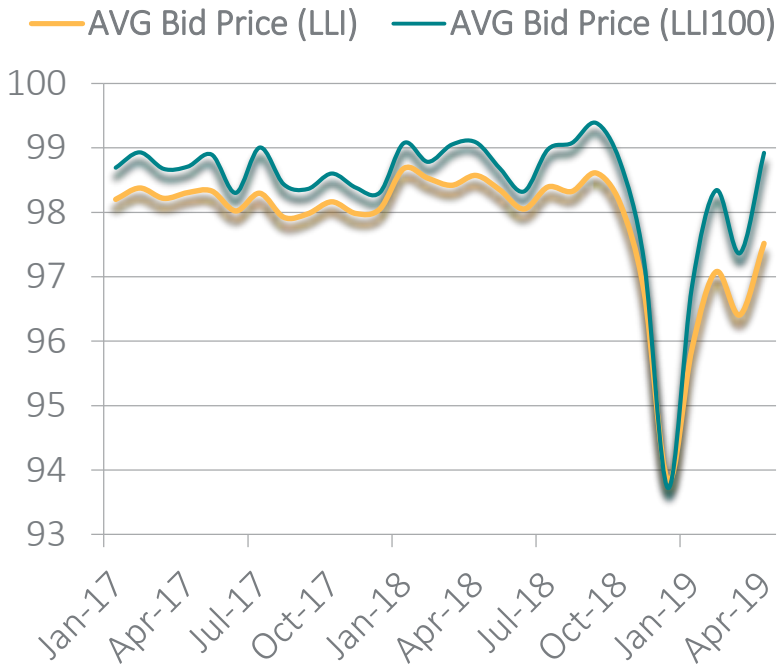
Source: LSTA Trade Data Study

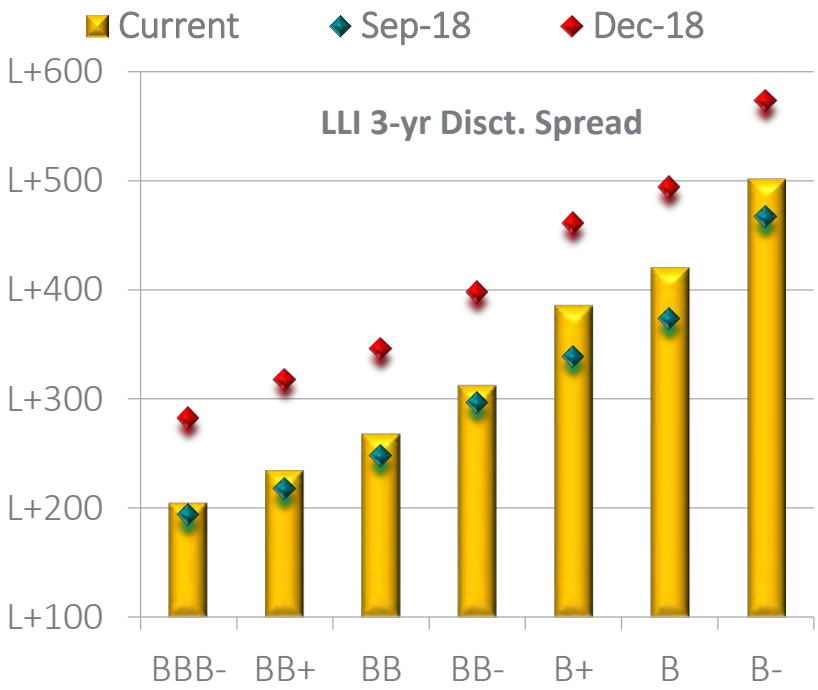
Primary Market Institutional Loan Spreads Increased Above 400 Basis Points in 2019



Source: Refinitiv LPC

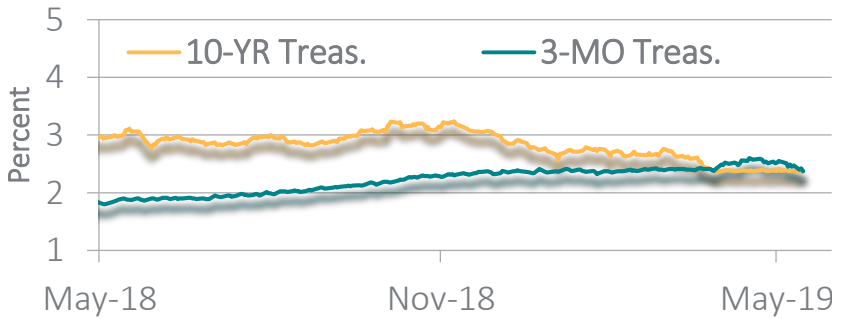
Liquidity and Quality Have Outperformed in 2019

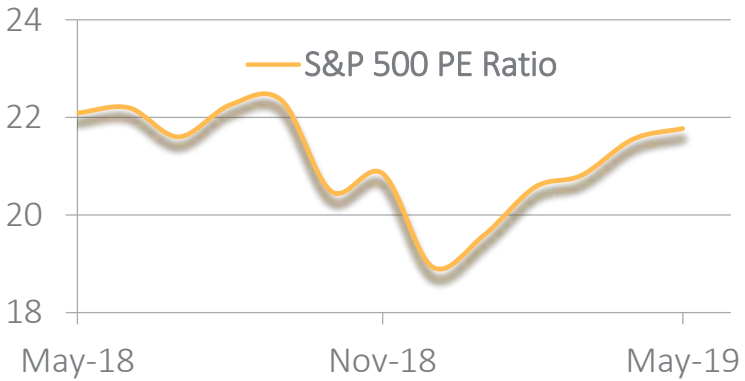


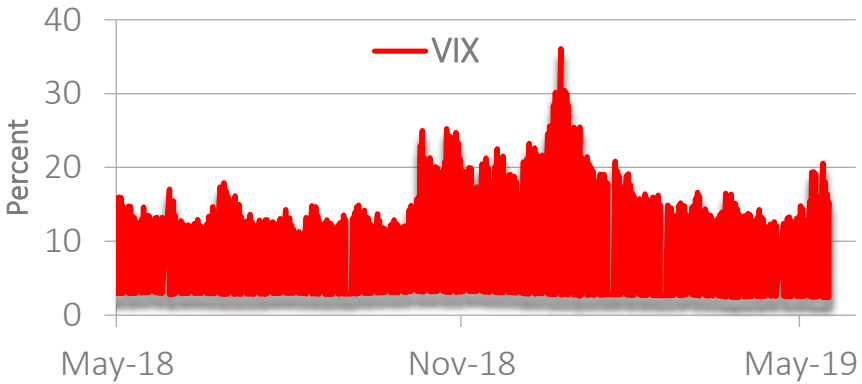


Source: LCD, an offering of S&P Global Market Intelligence

Global Growth Concerns and a Prolonged Trade War With China Once Again Threatened Stability in the Markets During May

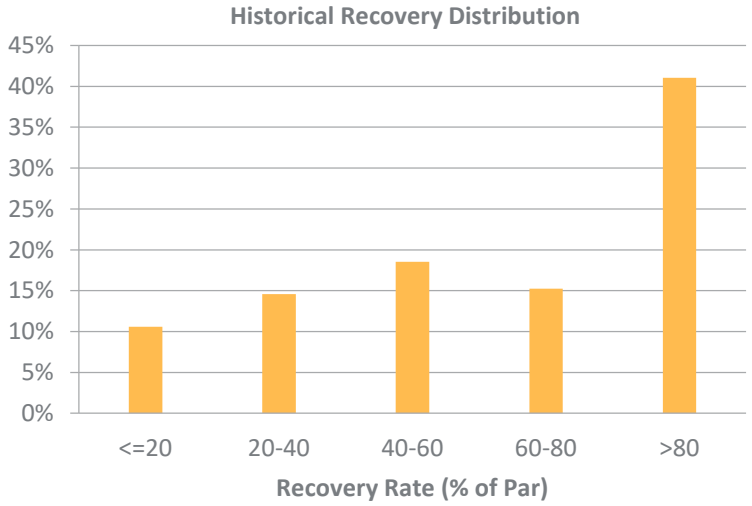


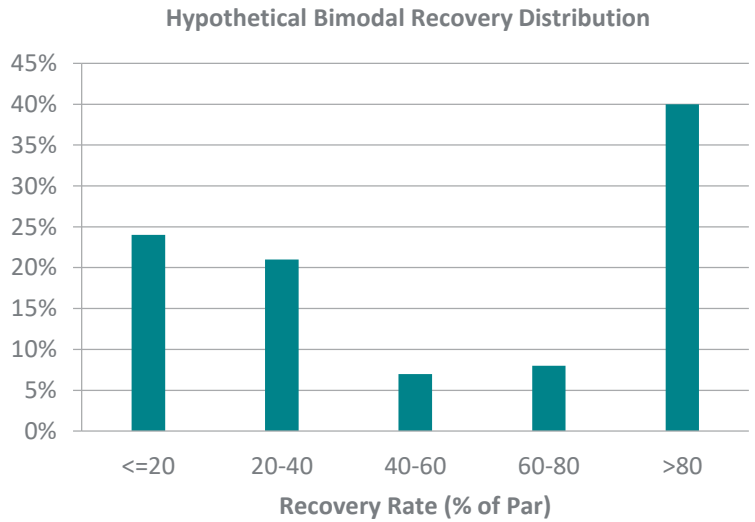




Source: Bloomberg

Managing Through the Credit Cycle: How Might Recovery Given Default Change?

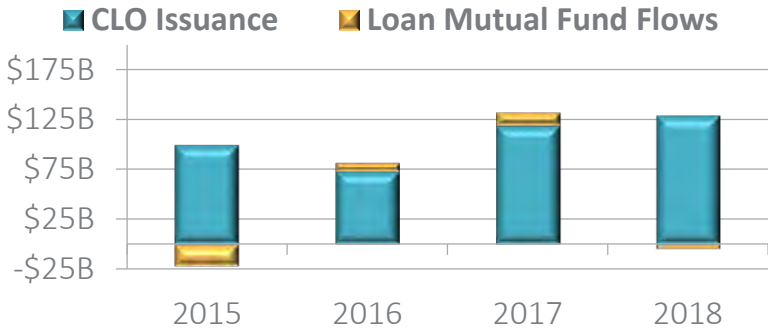


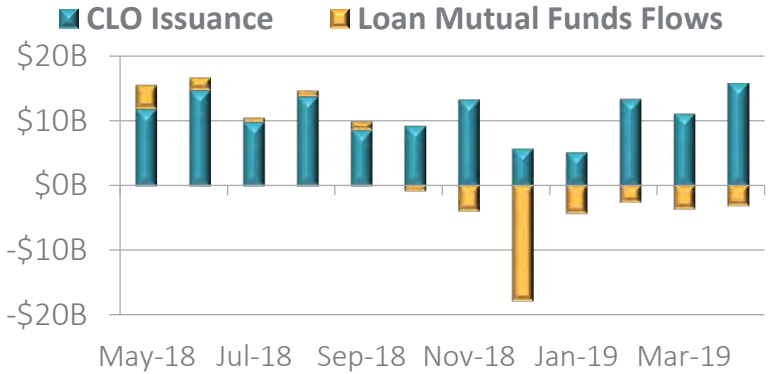


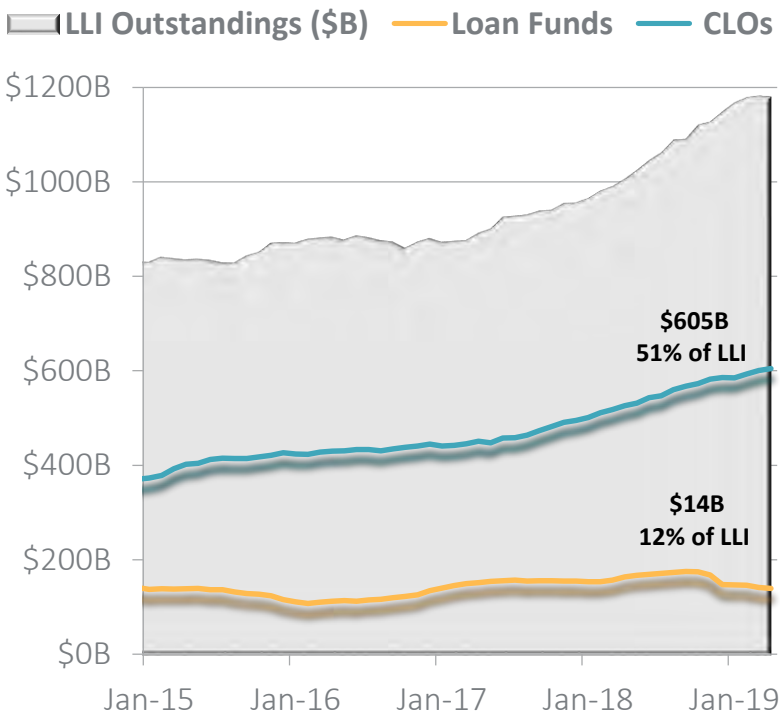
- Historical Recovery Given Default (RGD) has been clustered close to par, with a long tail back toward zero
- Could changing documentation and borrower behavior shift RGD to a bimodal distribution?
- How do managers envision these scenarios…and what does it mean for management styles?

Source: Fitch Ratings, LSTA

Technical Dislocations Can Create Buying Opportunities as Supply and Demand Levels Shift Unexpectedly







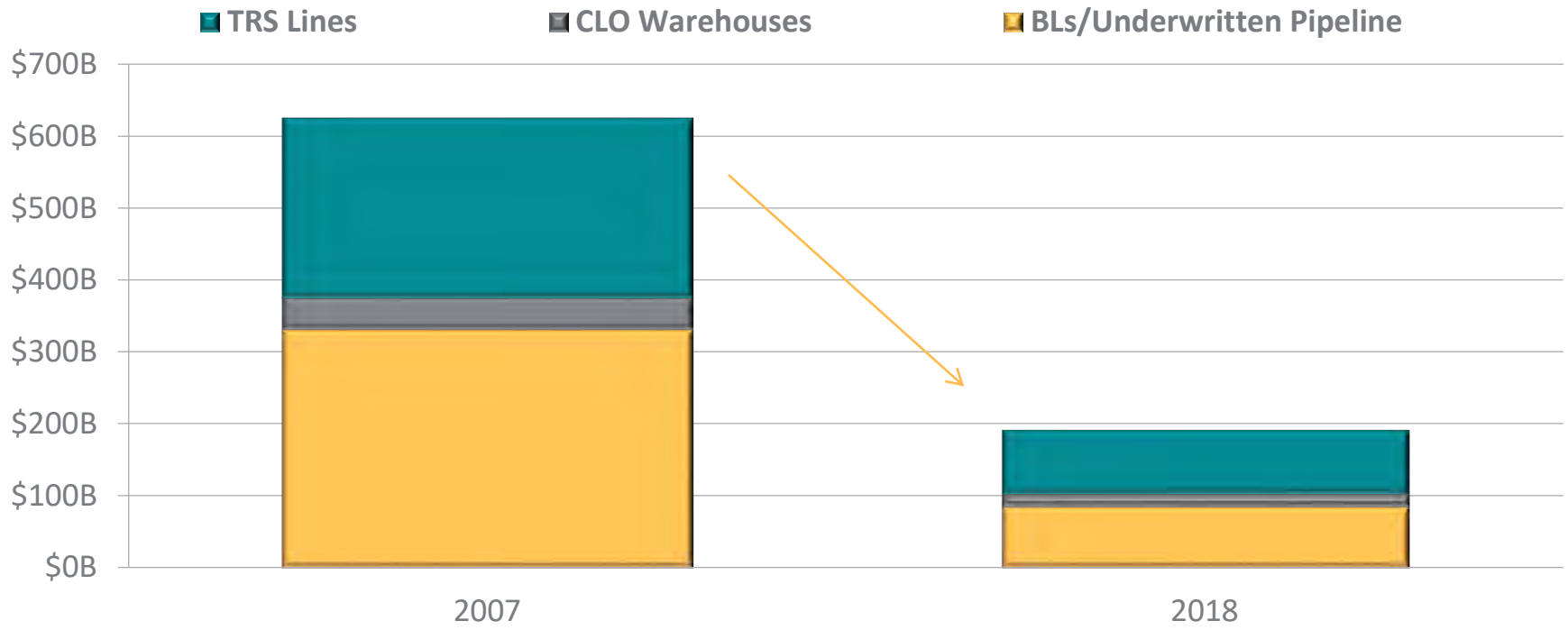
Source: Refinitiv

Source: S&P/LSTA Leveraged Loan Index (LLI)

Leveraged Loans- Bad News?

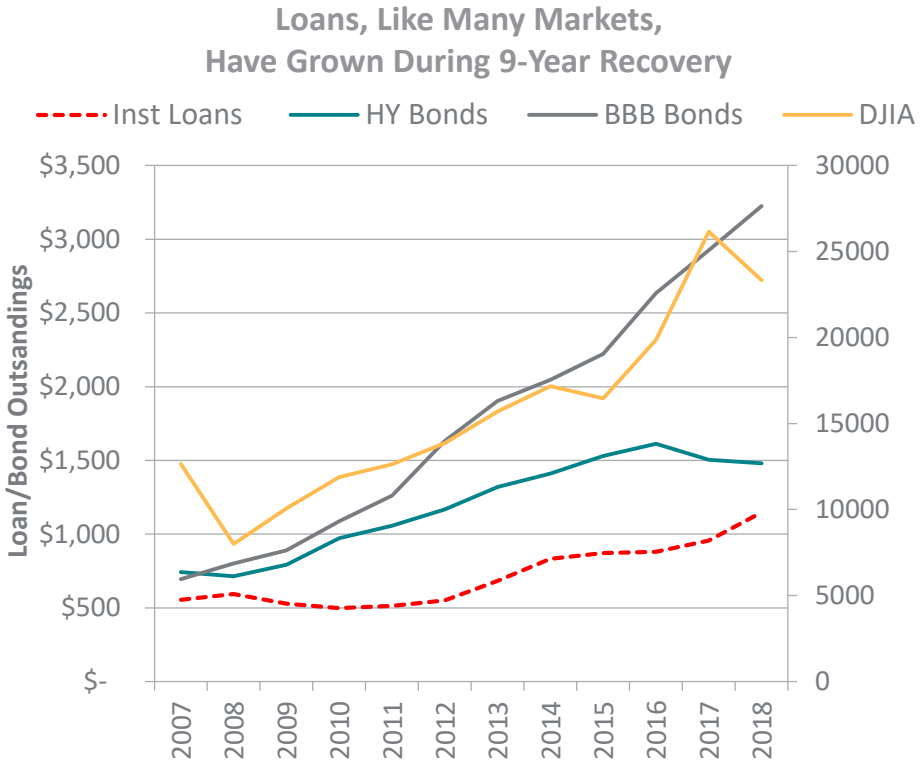
- S&P warns of risks in leveraged loan market as deals surge - FT
- Wall Street Bankers Pile Leverage Onto Riskiest U.S. Buyouts - Bloomberg
- High demand for collateralized loans weakens lender protections - FT
- The booming loan market is getting riskier – CNBC
- Wall Street Competes With Unregulated Banks for the Riskiest Loans – Bloomberg
- The junk debt that tanked the economy? It's back in a big way - WaPo opinion
- Iffy Loans, Collateralized Debt, Wealth Transfer From Bottom To Top: Here We Go Again – Forbes
- Wall Street's Latest Love Affair with Risky Repackaged Debt – New York Times
- Regulators, Investors Zero In on Corporate Debt Market – Wall Street Journal

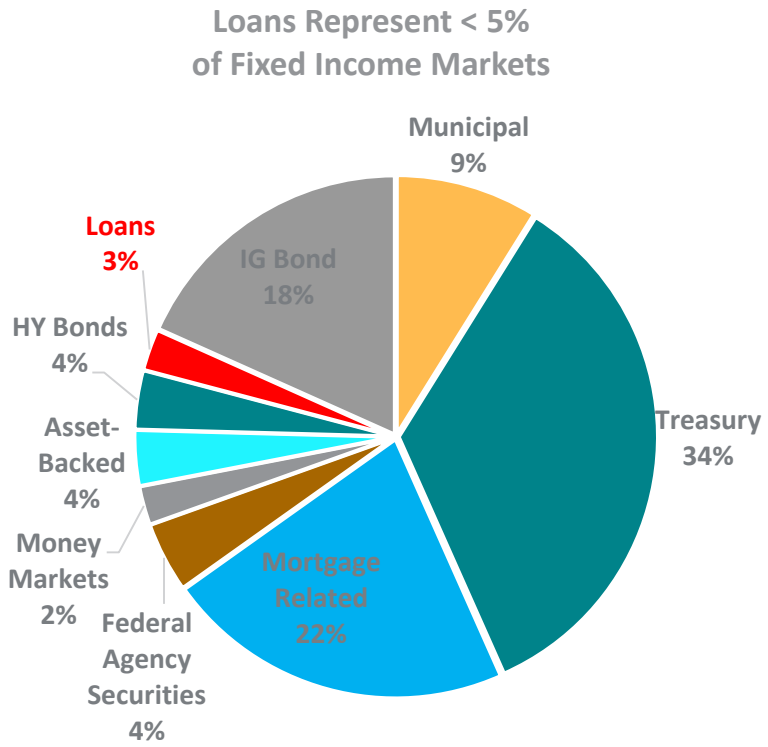
Systemic Leverage is Far Lower Today Than During the Credit Crisis



Source: PIMCO, JPM

Comparing Institutional Loan Growth and Size to Other Asset Classes





Source: SIFMA, Bloomberg, LSTA, Barclays, Yahoo Finance