Why Invest in Leveraged Loans?

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Leveraged loans should continue to have technical support, especially as the Federal Reserve Board (Fed) continues to move from its far-dovish end of the spectrum. The Federal Open Market Committee decision to increase interest rates in March 2017 by 25 bps is indicative of rising confidence in the U.S. economy's overall health. This marks the third hike in the tightening cycle, and the Fed implied one more rate hike this year could be likely. As a result, loan investors are starting to reap the benefits of investing in a floating rate product as 3-month LIBOR increased from 1.00% at the end of 2016 to 1.31% (as of 8/2/17).

Additionally, in response to a cooperative macroeconomic backdrop and steadily improving capital market conditions, loan default rate forecasts were reduced from 2.0% to 1.5% for 2017.[1] This reduction in near-term defaults implies market conditions should not cause excessive harm overall. Leveraged loans are an attractive asset class given this market backdrop, and at the top of the capital structure, are poised to have higher recoveries than fixed-rate securities in the event of restructuring.

Ultimately, combined with attractive valuations in the marketplace, leveraged loans offer a source of consistent income and less interest-rate sensitivity to other asset classes. Credit risk will continue to be at the forefront and potentially provide the alpha generation necessary in order to outperform relative peers. Active management plays a dominant role when investing in leveraged credit, which is why Seix's core focus on detailed, fundamental analysis can provide solid risk-adjusted returns for investors.

1. Source: JPMorgan Securities as of 3/31/17

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All investments involve risk. Debt securities (bonds) offer a relatively stable level of income, although bond prices will fluctuate providing the potential for principal gain or loss. Generally, fixed income securities will decrease in value if interest rates rise and vice versa. Floating rate loans are typically senior and secured, in contrast to other below-investment grade securities. However, there is no guarantee that the value of the collateral will not decline, causing a loan to be substantially unsecured. Loans generally are subject to restrictions on resale. The value of the collateral securing a floating rate loan can decline, be insufficient to meet the obligations of the borrower, or be difficult to liquidate. Participation in certain types of loans may limit the ability to enforce its rights and may involve assuming additional credit risks.

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