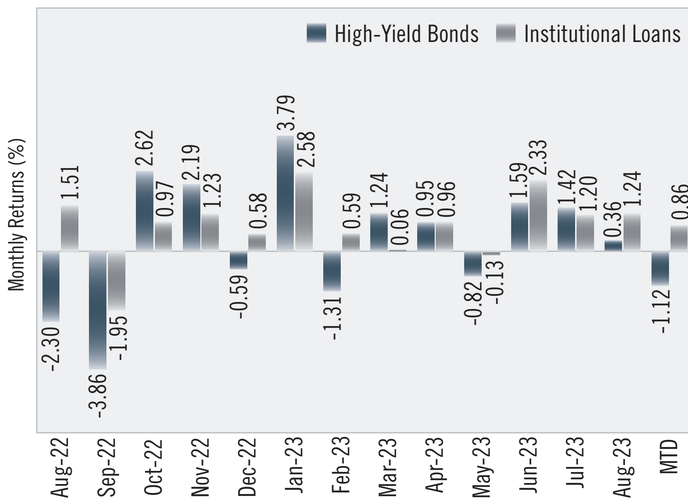
SEIX INVESTMENT ADVISORS
A VIRTUS INVESTMENT PARTNER

LEVERAGED LOANS

Another strong quarter for loans

Strong technicals driven by increased demand for loans helped propel solid performance for the asset class, which was up 3.34% for the quarter and just a little over 10% year-to-date.

LOANS OUTPERFORMED BONDS BY 198 BPS IN SEPTEMBER – A HIGH SINCE AUGUST 2022



Past performance is not indicative of future results. As of September 29, 2023.

The default rate for loans has also moderated, with the par-weighted default rate, which includes distressed exchanges, ending September at 2.66%—an improvement of 28 basis points (bps) for the quarter.

That said, given the current environment, we continue to favor higher quality, and are maintaining our underweights in technology, healthcare, and services. We continue to have an overweight to aerospace along with minor overweights to energy, financials, chemicals, media, and telecom. We are seeing more cracks in some of the tech names, so we continue to be careful there.

Looking ahead, we are hopeful that loans will continue to see an uptick in demand, given that the overall yields are still north of 9%. Loans are still on track for a double-digit return for the year, with rates producing roughly 75 bps of carry a month. Short of geopolitical events that may take us in a risk-off environment, we foresee the market only moving a little tighter from a price and spread perspective for the balance of the year.

3Q 2023 BANK LOAN TRENDS

Takeaway: The loan product experienced a modest rebound in retail flows. Collateralized loan obligation (CLO) activity remains subdued, but supportive. Issuance picked up substantially compared to 2Q23 and 1Q23. On balance, the J.P. Morgan Leveraged Loan Index saw an uplift in price/modestly lower yield. Default rates moderated.

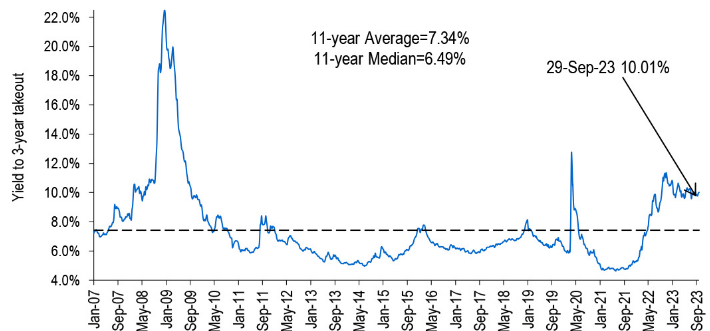
Performance: For 3Q23, the index saw a return of 3.34%, with YTD return of 10.09%.

Top contributors by industry were metals/mining (+5.14%), healthcare (+4.14%), and diversified media (+4.11%). Laggards were retail (+1.52%), paper & packaging (+2.52%), and cable & satellite (+2.64%.)

Single B-rated loans returned +3.72% compared to returns of +2.27% and +5.50% for BB and Split B/CCC-rated loans, respectively.

As of 9/29/23: The yield to 3-year takeout was 10.01% (2Q23: 10.19%), down 18 bps for the quarter. The price on the index was $95.89, up $0.92 for the quarter.

YIELD TO 3-YEAR TAKEOUT



Source: J.P. Morgan, S&P/IHS Markit

LEVERAGED LOAN INDEX PROFILE

Summary profile of J.P. Morgan Leveraged Loan Indexes as of September 29, 2023

	Leveraged Loan	Liquid	Second Lien	BB/B	EUR/GBP
Market Value ($mn)	1,404,778	489,172	56,145	1,242,576	310,617
Number of Loans	1,582	197	199	1,297	461
Number of Borrowers	1,354	197	191	1,104	366
Average Rating	B	Split BB	Split B/CCC	Split BB	B
Margin	L+377	L+340	L+721	L+360	L+398
Current Yield	9.67%	9.16%	14.91%	9.29%	8.26%
Years to Maturity	4.33 yrs	4.35 yrs	4.99 yrs	4.40 yrs	4.10 yrs
Average Price	95.89	96.86	85.43	97.82	96.43
Yield	10.01%	9.19%	17.71%	9.06%	9.11%
Spread	541bp	460bp	1312bp	446bp	549bp
DM	451bp	370bp	1220bp	356bp	491bp

Note: Yield, spread, and DM are to 3-year takeout and based on forward curve analytics. Source: J.P. Morgan; S&P/IHS Markit.

Issuance also saw a welcome uptick in activity in 3Q23, totaling $28.7 billion in volume—a high not seen since 2Q22—and was up +75% from $16.4 billion in 2Q23 and $14.1 billion in 1Q23. Year-to-date, leveraged loan gross issuance totals $257.9 billion, or $59.2 billion excluding refinancings and repricings, compared to $205.0 billion, or $145.1 billion excluding refinancings and repricings over the same period last year (+25.8% and -59.2%, respectively).

Demand: 3Q23 fund inflows total $869 million, with August and September seeing inflows. Of note, loan fund flows have seen improvement over the last three months, as July's $73 million outflow was the lightest in the 15-month stretch. Year-to-date outflows for loan funds total -$18.0 billion (-$444 million ETF), compared with an outflow of -$66 million over the first nine months last year.

Year-to-date, 213 U.S. CLOs have priced totaling $91.8 billion ($5.8 billion refinancing) compared with 272 U.S. CLOs totaling $127.8 billion over the same period last year (-28% year-over-year). Year-to-date, volume totaled $55.3 billion (excluding refinancings and repricings) compared with $72.0 billion (excluding refinancings and repricings), -23% year-over-year.

Default Rates: The loan par-weighted default rate, including distressed exchanges, ended September at 2.66%, an improvement of 28 bps for the quarter, aided by sizeable defaults in September 2022 rolling off the 12-month calculation. For context, the long-term average default rate for leveraged loans is 3.1%.

HIGH YIELD

Rate fears drove CCC-rated bond outperformance

High yield saw positive returns for the third consecutive quarter, with CCCs generating a 2.83% return. Duration concerns drove performance, with single-Bs returning 95 bps and BBs, which are more rate sensitive, returning negative 34 bps. Strong CCC performance this quarter is a continuation of a trend over the last three quarters—the ratings tier is up 12.91% for the year versus BBs, which are up by only 3.82%.

Though high yield fundamentals have softened in the aggregate, overall, they have been remarkably resilient, in our view, with the metrics still looking healthy compared to historical averages. Corporate management teams continue to prioritize balance sheet flexibility as they prepare for a possible economic slowdown.

We currently see value in certain lower-rated BB credits and higher-rated single-B credits that offer attractive yields with downside protection. Yields are at attractive levels, but spreads are now a little wide of 400 bps, which we view as being on the tight side.

OUTLOOK

As inflation stays sticky, higher quality offers value

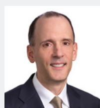
The technical backdrop for high yield has been solid despite outflows from the asset class. This dynamic was driven by low net issuance combined with a significant portion of high yield being upgraded to the investment grade category. That said, we foresee a slowdown in activity through the end of this year and into next year.

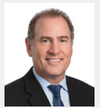
Our view is that inflation will remain somewhat sticky, and that the labor market continues to look strong, though certain fundamentals have softened. We continue to monitor potential risks on the horizon, including the Federal Reserve, a possible government shutdown, and the resumption of student loan payments. Given where spreads are, we're not predicting meaningful spread tightening in the near term. We continue to favor good credits with solid income generation and downside protection. As inflation continues to drive performance, we favor higher-quality bank loans, and, among sectors, the energy industry.

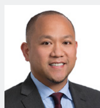
continued

Authored by:

Leveraged Loans

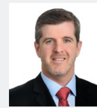

George Goudelias
Head of Leveraged Finance, Managing Director,
Senior Portfolio Manager
Seix Investment Advisors


Vincent Flanagan
Portfolio Manager,
Senior High Yield Research Analyst
Seix Investment Advisors


Eric Guevara
Portfolio Manager,
Head of Leveraged Loan Trading
Seix Investment Advisors

High Yield

Michael Kirkpatrick
Managing Director, Senior Portfolio Manager
Seix Investment Advisors


James FitzPatrick, CFA
Managing Director, Portfolio Manager,
Head of Leveraged Finance Trading
Seix Investment Advisors

Seix Investment Advisors, a division of Virtus Fixed Income Advisers, LLC, is an investment management boutique focused exclusively on managing fixed income securities since 1992. Seix seeks to generate competitive absolute and relative risk-adjusted returns over the full market cycle through a bottom-up focused, top-down aware process. Seix employs multi-dimensional approaches based on strict portfolio construction methodology, sell disciplines, and trading strategies with prudent risk management as a cornerstone.

ICE BofA U.S. High Yield Cash Pay Index is an unmanaged index consisting of all domestic and Yankee high-yield bonds maturing over one year. The quality range is less than BBB-/Baa3 but not in default (DDD1 or less). The **ICE BofA U.S. High Yield Constrained Index** is a market-value-weighted index of all domestic and Yankee high-yield bonds, including deferred interest bonds and payment-in-kind securities. Issues included in the index have maturities of one year or more and have a credit rating lower than BBB-/Baa3 but are not in default. The ICE BofA U.S. High Yield Constrained Index limits any individual issuer to a maximum of 2% benchmark exposure. The **J.P. Morgan Domestic High Yield Index** is designed to mirror the investable universe of the U.S. dollar domestic high yield corporate debt market. The **J.P. Morgan Leveraged Loan Index** is designed to mirror the investable universe of U.S. dollar institutional leveraged loans, including U.S. and international borrowers. **ICE BofA U.S. High Yield Index (H0A0)** tracks the performance of U.S. dollar denominated below investment grade rated corporate debt publicly issued in the U.S. domestic market. To qualify for inclusion in the index, securities must have a below investment grade rating and an investment grade rated country of risk. The **ICE BofA BB U.S. High Yield Index (H0A1)** is a subset of the ICE BofA U.S. High Yield Master II Index and includes all securities with a given investment grade rating BB. The **ICE BofA CCC & Lower U.S. High Yield Index (H0A3)** subset includes all securities with a given investment grade rating CCC or below. The **ICE BofA Single-B U.S. High Yield Index (H0A2)** subset includes all securities with a given investment grade rating B. The indexes are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and are not available for direct investment.

The **Secured Overnight Financing Rate (SOFR)** is widely accepted as the LIBOR replacement for loans. SOFR is based on overnight Treasury Repo Rates with nearly $1 trillion of underlying daily transactions and not subject to market manipulation. Since SOFR is a daily rate, Term SOFR was developed as a forward-looking rate from SOFR futures trading.

A **Basis Point (bp)** is equal to 0.01%.

Collateralized Loan Obligations are securities backed by a pool of assets often low-rated corporate loans.

The commentary is the opinion of Seix Investment Advisors. This material has been prepared using sources of information generally believed to be reliable; however, its accuracy is not guaranteed. Opinions represented are subject to change and should not be considered investment advice or an offer of securities.

Past performance is no guarantee of future results.

All investments carry a certain degree of risk, including possible loss of principal.

2208 10-23 © 2023 Virtus Investment Partners, Inc.