SEIX INVESTMENT ADVISORS
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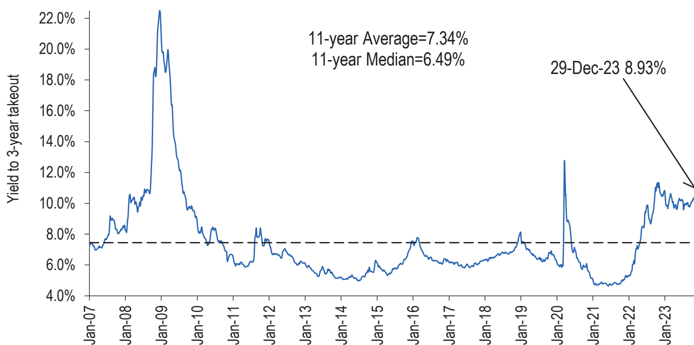
LEVERAGED LOANS

Still-strong momentum going into 2024

The J.P. Morgan Leveraged Loan Index had another strong quarter in 4Q as it participated in the broader fixed income rally—it was up 2.77% for the quarter, topping off an impressive performance of 13.17% for the year.

YIELD TO 3-YEAR TAKEOUT



Past performance is not indicative of future results.
Source: J.P. Morgan. Data as of December 29, 2023.

Looking ahead, we think current loan valuations are still attractive given that the three-year takeout yield is now at 8.9%. Even accounting for potential rate cuts from the Federal Reserve (Fed), we believe leveraged loans have the potential to outperform most other fixed income asset classes due to this strong starting-off point. The asset class continues to trade cheaply relative to its historical tights, with current spreads around 500 basis points (bps) versus the historical tights of 240-250 bps achieved in 2007.

From a quality perspective, the percentage of total distressed credits continues to decline and now accounts for about 7.5% of the market. This has relevance for default rate forecasts: historically, the default rate for the next 12 months usually reflects about a third of the distressed rate, which implies a default rate of about 2.5% versus the current consensus forecast of roughly 3.5%. We think this signals that the market is more pessimistic than is warranted, particularly as capital markets are now open to almost everyone.

We expect the heavy tilt toward refinancings to continue this year as companies look to push maturities out. We also expect private equity to continue to take lower-quality credits out of the broadly syndicated loan market—a trend we view positively from a technical and credit quality standpoint. Positioning wise, we have been focused on the aerospace, energy, cable, and financial industries, and have further reduced exposure to tech and healthcare.

4Q 2023 BANK LOAN TRENDS

Takeaway: Leveraged loans experienced modest retail inflows, a steady improvement in collateralized loan obligation (CLO) activity, and a subdued issuance profile. On balance, the index saw a solid increase in price/yield tightening.

SUMMARY PROFILE OF J.P. MORGAN LEVERAGED LOAN INDEXES

	Leveraged Loan	Liquid	Second Lien	BB/B	EUR/GBP
Market Value ($mn)	1,408,484	476,774	55,143	1,230,903	330,974
Number of Loans	1,586	189	195	1,279	467
Number of Borrowers	1,347	189	187	1,081	373
Average Rating	B	Split BB	Split B/CCC	Split BB B	B
Margin	L+378	L+346	L+719	L+361	L+404
Current Yield	9.56%	9.12%	14.83%	9.15%	8.47%
Years to Maturity	4.27 yrs	4.37 yrs	4.79 yrs	4.37 yrs	4.10 yrs
Average Price	96.41	97.53	85.43	98.79	96.10
Yield	8.93%	8.08%	16.39%	7.81%	8.27%
Spread	519bp	437bp	1266bp	409bp	566bp
DM	354bp	270bp	1100bp	242bp	430bp

Source: J.P. Morgan, S&P/IHS Markit. Data as of December 29, 2023.

Performance: For 4Q, the J.P. Morgan Leveraged Loan Index saw a return of 2.77%. For 2023, the index provided a strong 13.17% gain.

For 4Q, top contributors by industry were diversified media (3.33%), broadcasting (3.28%), and housing (3.19%.) No industry was a detractor, with retail (1.09%), transportation (1.85%), and chemicals (2.07%) contributing the least.

For 2023, top contributors by industry were metals & mining (16.85%), diversified media (16.17%), and housing (16.13%). No industry was a detractor, with broadcasting (9.04%), retail (9.49%), and telecommunications (11.11%) contributing the least.

For 4Q, single B-rated loans returned 3.04% compared to returns of 2.64% and 1.79% for BB and Split B/CCC-rated loans, respectively. For the year, single-B-rated loans returned 14.61% compared to returns of 10.23% and 16.96% for BB and Split B/CCC-rated loans, respectively.

As of 12/29/23: The yield to 3-year takeout was 8.9% (3Q: 10.01%), down 108 bps for the quarter and 190 bps for the year. The price on the index was approximately $96.41, up $0.52 for the quarter and up $3.59 for the year.

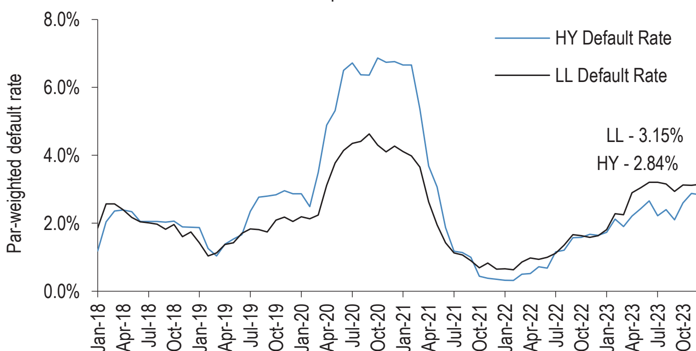
Seix Investment Advisors is a division of Virtus Fixed Income Advisers, LLC ("VFIA"), an SEC registered investment adviser.

Issuance: 4Q gross issuance totaled $112.2 billion, with 80.5% reflecting repricing/refinancing transactions, resulting in $21.9 billion net, compared to $28.7 billion in 3Q23. For 2023, issuance totaled $370.1 billion, with 77.9% reflecting repricing/refinancing transactions, or $81.8 billion net issuance, which was down 50% compared to 2022.

Demand: 4Q retail fund inflows totaled $0.4 billion. 2023's outflows for loan funds totaled -$17.7 billion (+$3.4 billion ETF), compared with an outflow of -$12.8 billion (-$5.0 billion ETF) the year prior. 4Q gross CLO volume was at $45.9 billion, up from $35.2 billion in 3Q23. For 2023, 322 U.S. CLOs priced totaling $138.9 billion ($23.3 billion refinancing) compared with 328 U.S. CLOs totaling $152.5 billion last year (-9% year-over-year).

Default Rates: The loan par-weighted default rate, including distressed exchanges, ended December at 3.15%, deteriorating 49 bps for the quarter and 151 bps for the year. For context, the long-term average default rate for leveraged loans is 3.1%.

LTM DEFAULT RATE based on par amount



Source: J.P. Morgan. Data as of December 29, 2023.

HIGH YIELD

A grab for risk

The quarter began with a negative tone in October owing to concerns around high levels of U.S. Treasury issuance and the Fed's interest rate path, but this was followed by tailwinds that contributed to strong performance for the rest of the quarter: first, Treasury issuance volumes weren't as high as forecasted, bringing stability to U.S. Treasuries; second, new data releases seemed to indicate cooling inflation; and third, the Fed indicated that interest rates may have peaked. U.S. Treasury yields dropped from 4.57% at the start of the period to 3.88% by the close. In another positive sign, financial conditions, as measured by Goldman Sachs, eased significantly in November and marked the biggest monthly decline in 40 years. Duration and risk assets outperformed in the risk-on market as investors enthusiastically bought both.

GOLDMAN SACHS U.S. FINANCIAL CONDITIONS INDEX

Source: Goldman Sachs and Bloomberg. Data as of December 9, 2024.

In this environment, we continue to believe the best risk-adjusted returns lie in the high-quality part of the market. We are still focused on protecting the downside and getting current income. We also continue to monitor opportunities among fallen angels, small issuers, and credits that are orphaned, mispriced, or oversold. Given high yield's high current coupon and relatively low default expectations, it has the potential to post a good year of returns, in our view.

4Q 2023 HIGH YIELD TRENDS

Takeaway: High yield saw a strong quarter driven by lower interest rates, strengthened soft landing expectations, and rate cuts being pulled forward by the Fed pivot. The asset class also enjoyed a strong technical market for the year as well, with minimal outflows compared to 2022 coupled with low issuance levels.

Performance: High yield, as represented by the ICE BofA U.S. High Yield Index, returned 7.06% for the quarter, with BB-rated credits leading the way (7.34%), followed by single-Bs (6.78%), and CCCs (6.60%). The asset class started with a yield-to-worst of 894 bps, which tightened by 125 bps over the period and ended at 769 bps. BBs started the quarter at 763 bps, tightened by 126 bps, and ended at 637 bps. Single-Bs started at 911 bps and ended the quarter at 776 bps. And finally, CCCs tightened 112 bps from 1415 to 1303. On a spread basis, option-adjusted spreads started at 403 bps, tightened 64 bps, and ended at 339 bps. BBs started at 275 bps and ended at 205 bps. Single-Bs started the quarter at 419 bps and ended at 341 bps; CCCs started at 923 bps and ended at 902 bps.

Issuance: 4Q issuance totaled $42.1 billion versus $39.2 billion in the third quarter, $55.1 billion in the second, and $40.5 billion in the first. We ended the year at $175.9 billion in gross issuance—$59.5 excluding refinancings. That compares to 2022 issuance of $106.5, or $56.1 billion excluding refinancings. 2023 saw the second-lightest high yield activity in more than a decade.

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Demand: Inflows for the quarter were at $5.3 billion and marked the sixth inflow for 2023. Outflows still totaled $7.9 billion for the year, but were significantly improved from 2022's outflows of $48.9 billion.

Default Rates: We ended the year with a default rate of 2.84%, up from 1.65% a year ago. In our view, defaults are likely to hit 3% in 2024.

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Leveraged Loans

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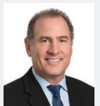

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ICE BofA U.S. High Yield Cash Pay Index is an unmanaged index consisting of all domestic and Yankee high-yield bonds maturing over one year. The quality range is less than BBB-/Baa3 but not in default (DDD1 or less). The **ICE BofA U.S. High Yield 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.

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