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# CLOs Take More of the Demand Pie

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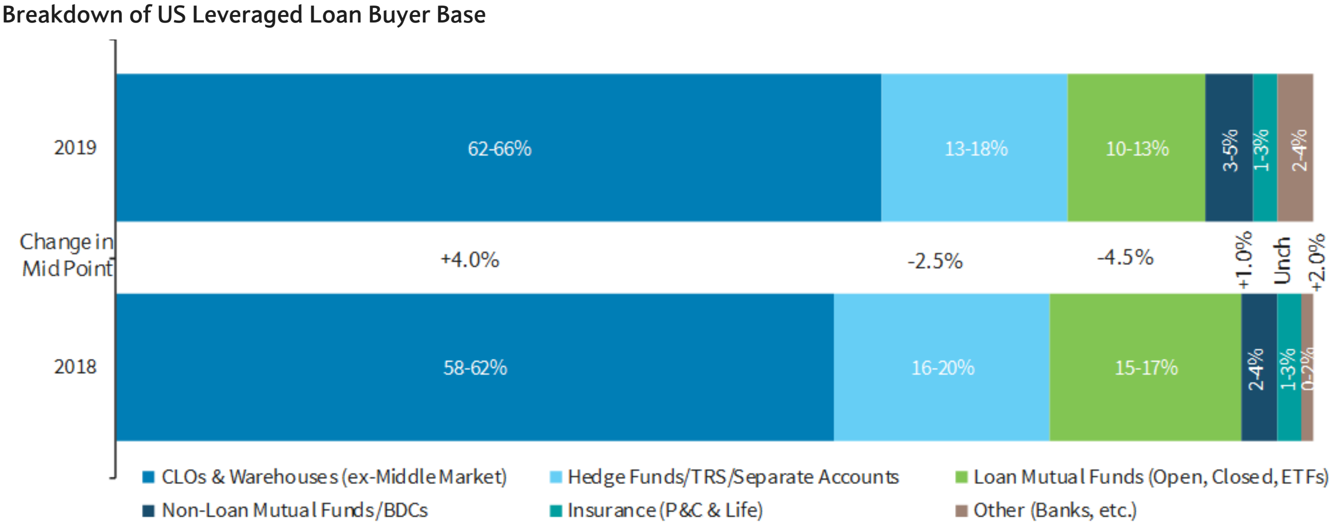
Despite year-to-date returns of over 6%, the loan market has lagged high yield and investment grade credit. While part of this underperformance can be attributed to the move in rates, demand has clearly contributed to the weaker performance. In contrast to strong retail inflows that have supported high yield bonds, the loan market has experienced record retail outflows. CLO assets, on the other hand, continue to grow at a faster pace than the loan market as a whole. We perform our comprehensive annual breakdown of ownership of the loan market, with specific focus on performing loans, and detail the changes in ownership below.

**CLOs and Warehouses (62-66%):** Demand from CLOs, with roughly $100bn of new issuance year-to-date, has been solid for much of the year and remains the single largest technical driver in the loan market. Furthermore, we estimate that the amount of loans held in CLO warehouses has remained at $18-20bn, representing an incremental source of demand that is not yet reflected in the loans held by CLO structures themselves. Given that CLOs hold nearly two-thirds of all loans, their rating breakdown cannot differ much from the corresponding loan markets. That said, as noted in *Breaking down B3 exposure in loans & CLOs*, US CLOs have a slight skew toward B+ and B-flat loans but are underweight B- and lower-rated credits relative to the broader market. With these loans coming under more pressure than BBs, the ability of CLOs to provide incrementally more demand will need to be monitored.

**Hedge Funds/Total Return Swaps (TRS)/Separate Accounts (13-18%):** We estimate that this investor base's share of loan ownership is down slightly relative to last year, with loan-dedicated AUM increasing somewhat less than the general growth of the market. Our conversations with managers suggest that the growth in SMAs (the largest investor base within this cohort) has slowed from past years but roughly kept pace with the 3% growth of the underlying loan market thanks to mandates from the US, as well as abroad. While the asset allocation mix of event-driven, credit, and relative value hedge funds is difficult to generalize, we believe they have been focused on the loan market as a result of the increase in stressed loans.

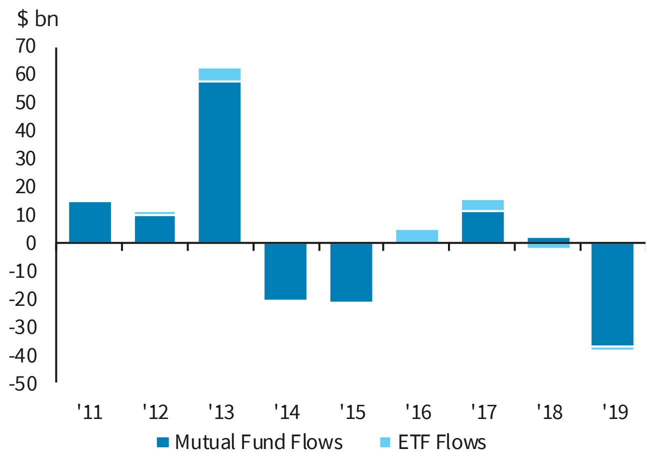
FIGURE 1
**Breakdown of US Leveraged Loan Buyer Base**




Source: S&P LCD, Lipper, Bloomberg, EPFR, HFR, Credit Flux, Federal Reserve, Refinitiv, Kanerai, Bloomberg Barclays Indices, Barclays Research

FIGURE 2

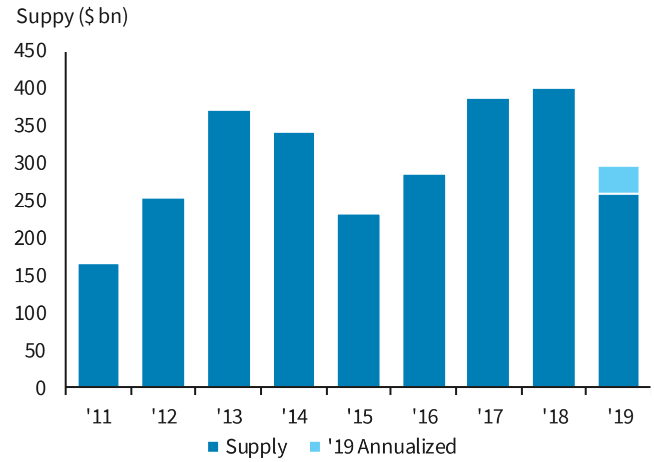
**Loan Retail Funds Have Had Record Outflows This Year**




Source: Lipper

FIGURE 3

**Supply (Ex-Repricings) Is Down 28% Year-over-Year, Partially Offsetting Lower Retail Demand**




Note: 2019 annualized amount based on average pace of issuance in 2017 and 2018. Source: S&P LCD

**Loan Mutual Funds (Open, Closed, ETFs) (10-13%):** Record retail outflows this year have resulted in a one-third reduction in loan retail fund AUM over the past twelve months. As seen in Figure 2, outflows this year have totaled nearly $39bn – far surpassing any other year on record. As a result, we have lowered the midpoint of our estimate for this segment's' ownership of the loan market by 4.5% y/y. We also examined the holdings and asset allocation mix of the top 20 open-end funds (a sample representing over half of the AUM of this cohort) and used this to estimate that the average fund has 4-5% of its AUM in high yield bonds.

**Non-Loan Mutual Funds/Business Development Companies (3-5%):** We estimate that the ownership share of this investor base has increased from last year as mutual funds with other focuses have increased their ownership of loans. For example, the top twenty high yield mutual funds (representing over half of all high yield funds by AUM) have a current weighted average allocation to loans of roughly 5.2%, up from 3.2% last year. The loan allocation of the largest flexible funds increased as well, while the largest balanced funds did not shift their allocations materially toward loans. BDCs' overlap with the broadly syndicated market we are examining remains small.

**Insurance (P&C/Life) (1-3%):** The loan ownership data from insurance companies comes directly from year-end financial filings, as a result of new disclosures beginning with 2018 data detailing loan-level holdings. As noted in *Insurance Perspectives: Investigating Insurers in Loans*, insurers' portfolios are skewed toward higher quality, including BBB-rated loans. Matching the loan-level holding data from insurance companies with the performing loan index provides us with a more detailed picture of this buyer base, which remains fairly modest.

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