

## High Yield & Leveraged Loans

# European HY vs. Loan RV

Valuation tilts in favour of loans versus bonds in Europe, but we are more cautious of downgrade risk in loans. We think risk-reward is most attractive in the BB space and favour BB loans versus bonds.

| CORE

## Relative Value - better carry and risk-reward in BB loans

### Expect better returns from European loans than bonds this year

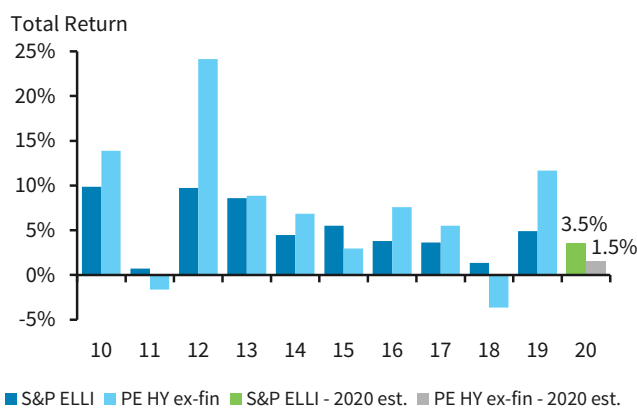
European HY non-fin corporates outperformed European leverage loans strongly in 2019, we expect European loans to return 3.5% compared to 1.5% (the latter is in part due to the strong beta rally we saw in December 2019) (Figure 1). In an historical context, these levels are also consistent with the general relationship observed between HY bond and loans returns over time (Figure 2), where we find that loan returns tend to be higher than those of bonds when either returns less than c.4%.

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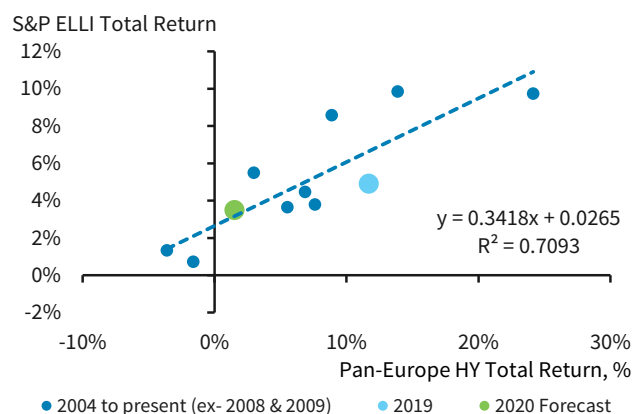
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FIGURE 1. We expect loans to outperform HY in total returns this year



Note that our 2020 forecasts were updated post December performance in HY & LL  
Outlook: Marking to market, 6 January 2020.  
Source: Bloomberg Barclays Indices, Bloomberg, S&P LCD, Barclays Research

FIGURE 2. HY versus loan returns in an historical context



Source: Bloomberg Barclays Indices, Bloomberg, S&P LCD, Barclays Research

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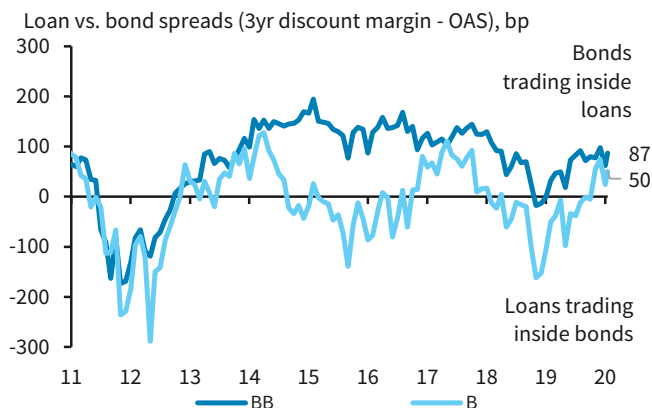
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## Valuation is more attractive for loans, particularly in BBs

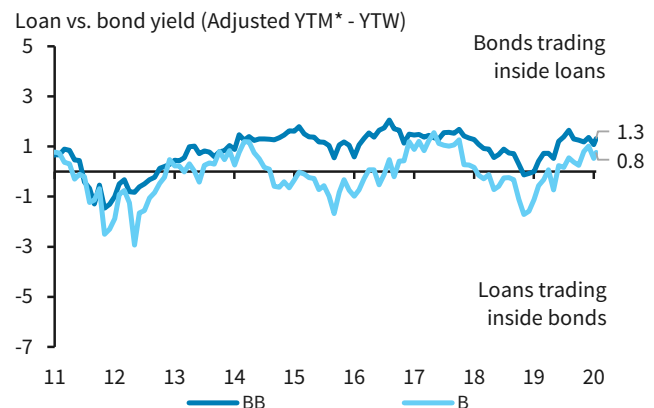
Given that the average quality of HY bonds and loans markets display differences (Figure 5), whereby the majority of bonds (61%) are BB-rated while the majority of European loans (77%) are single-B-rated, we look at relative value by ratings in Figure 3 and Figure 4. Here, we compare the average 3y discount margin for loans to the average OAS for bonds and find that although average BB and single B bonds now trade inside the average loans of the same rating, the difference is more significant for BBs where the average BB bond trades 87bp inside the average BB loan. That said, even for single Bs, the average bond trades 50bp inside the average loan.

Looking at the relative yield, we have compared the YTW of bonds to the yield for loans implied by the 3y discount margin (and EUR 3y swap rate, assuming zero floor) to better align the differences in the average bond OAD to the average years to maturity for loans. Although both bonds and loans in their respective indices have an average maturity of about 5y, the average OAD for bonds due to most being callable is 3.8 for BB bonds and 2.4 for single B bonds. This comparison assumes that loans are callable in 3 years on average. On this measure, similarly, both loans look more attractive on a yield basis than bonds (with loans being further supported by a zero floor cap generally). We find that the average BB loan yields 1.3% more than the average BB bond. We think this is in part due to the fact that low yields have caused non-traditional HY investors such as IG, insurers and private wealth investors to invest in BBs more than in loans; indeed, at an average 3y discount margin of 297bp for BB loans, it is also less appealing for CLO investors (who hold about half of the loan market) as the equity arb becomes less attractive.

**FIGURE 3. Loans look more attractive vs. bonds on a spread basis...**



**FIGURE 4. ...but also on a yield basis, adjusted for duration**



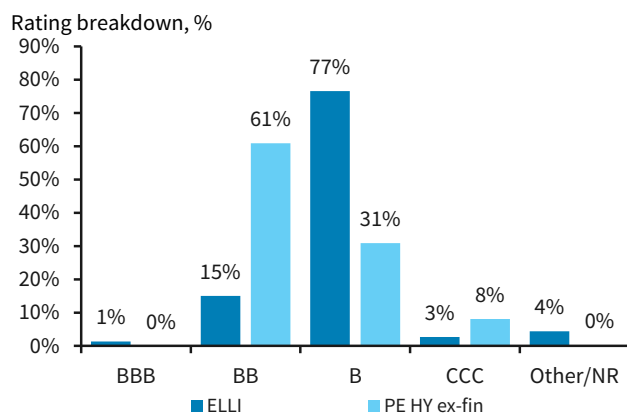
Note: To better reflect the differences in OAD for bonds and average maturity for loans, we calculate YTM for loans as the 3y discount margin + EUR 3y swap rate (assuming zero floor when it's negative).

Source: Bloomberg Barclays Indices, Bloomberg, S&P LCD, Barclays Research

Source: Bloomberg Barclays Indices, Bloomberg, S&P LCD, Barclays Research

## High negative convexity in BB bonds limits upside

Although the percentage of loans trading above par has continued to steadily increase since the start of last year to 59% currently, we note that the rate in the HY bond market is 83%; where 72% and 57% of EUR HY non-fin BB and B bonds respectively are currently call constrained, capping the upside of bonds. The average price of bonds in the index is, as one would expect, higher at 102.3 versus the average price of loans of 98.3.

**FIGURE 5. European HY market is largely BB-rated bonds while loans are largely single B-rated**

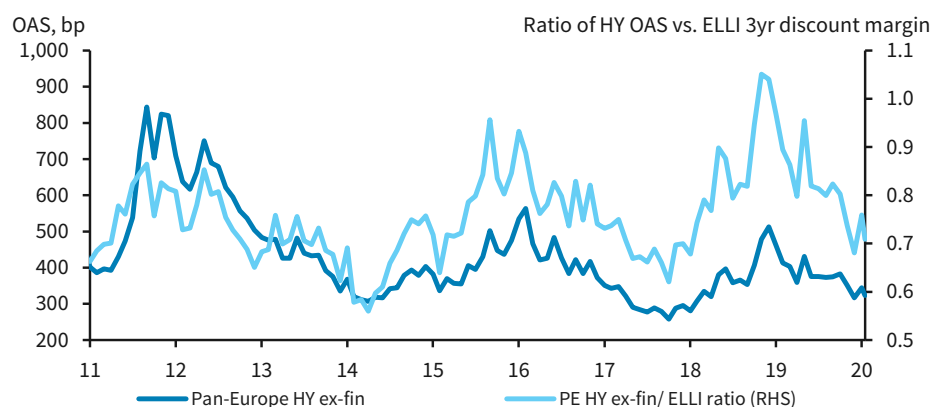
Source: Bloomberg Barclays Indices, Bloomberg, S&amp;P LCD, Barclays Research

**FIGURE 6. Negative convexity is high in bonds**

Source: Bloomberg Barclays Indices, Bloomberg, Barclays Research

### Loan market is more defensive in a sell-off

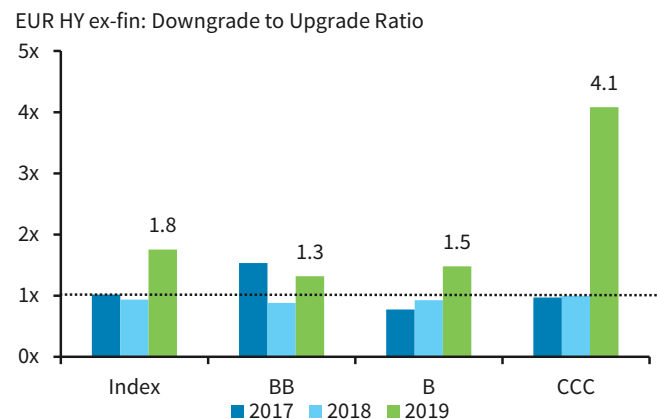
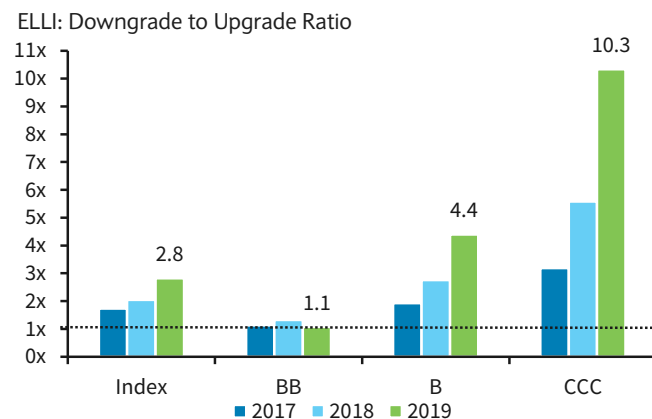
As [Figure 7](#) shows, the loan market has historically traded with a beta of less than 1 to the HY bond market. The former typically outperforms when the market is selling off and underperforms when the market is rallying. As we think the upside to spreads in the HY bond market is relatively limited and risks are skewed to the downside, adding loans to investor portfolios should also help limit the downside to returns.

**FIGURE 7. Leveraged loan market tends to underperform HY bonds when the market is rallying and outperform when the market is selling off**

Source: Bloomberg Barclays Indices, Bloomberg, S&amp;P LCD, Barclays Research

### Downgrades more severe in loan markets generally, but better in BBs space

Finally, as we wrote in [Downgrades: improvement more likely for HY bonds than loans](#), 7 February 2020, the rate of downgrades in the loan market has shown fewer signs of moderating compared to the bond market and we think is less likely to stabilise than the bond market. That said, we note that the downgrade ratio in BBs is actually better in loans than in bonds ([Figure 8](#) and [Figure 9](#)). In contrast, the downgrade ratios in single Bs and CCCs are significantly more severe in loans than bonds.

**FIGURE 8. Downgrade ratio is better in HY than loans space except in BBs****FIGURE 9. Downgrade ratio for single B and CCC loans are significantly worse in loans than HY**

### Favour BB loans, more neutral on single Bs

Given the above factors, we thus favour BB loans to bonds, on better valuation, higher convexity in the BB bond market and relatively low downgrade ratios in the BB loan space. We are more neutral for single Bs as although valuation still tilts slightly in favour of loans, we are more cautious of downgrade risk here.

## Bond-loan RV screen

We screen for bonds and loans with the same ticker where the relative value in terms of price, relative spreads and/or yields favours the loan.

In the case of DOUGR, we note that our fundamental analysts have also written on this recently in Douglas: [A flawless quarter - favour the senior EUR 23s](#), 19 February 2020.

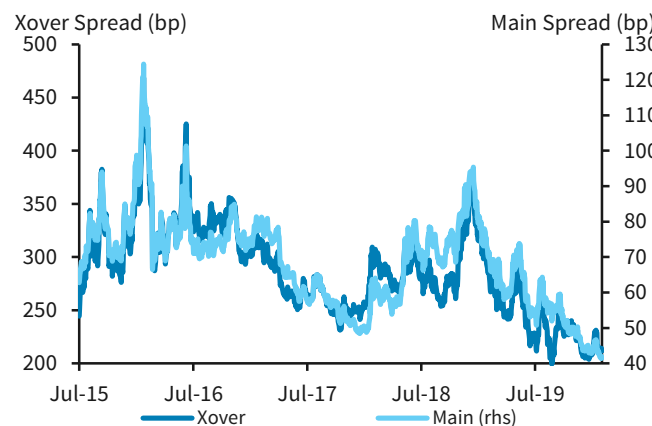
FIGURE 10. Relative value of bonds vs. loans for matched tickers

Bond								Loan								Bond minus Loan Difference		
Issuer	Security	Curr	Price	OAS, bp	YTW, %	Index Rating	Security Type	Issuer	Security	Maturity	Cou- pon	Price	Disc. mrgrn bp	Yield %	Average Rating	Price	Spread bp	Yield, %
DOUGLAS GMBH	DOUGR 6 1/4 07/15/22	EUR	101.6	-2,000	-16.6	B3	1st lien	DOUGLAS GMBH	DOUGR TL B8 1L EUR	13/08/2022	3.3	92.6	693	6.5	B3	9.0	-2,693	-23.1
DOUGLAS GMBH	DOUGR 6 1/4 07/15/22	EUR	101.6	-2,000	-16.6	B3	1st lien	DOUGLAS GMBH	DOUGR TL B1 1L EUR	13/08/2022	3.5	93.6	674	6.3	B3	8.0	-2,673	-22.9
INEOS GROUP HOLDINGS SA	INEGRP 5 3/8 08/01/24	EUR	102.8	-1,753	-14.6	B1	2nd lien	INEOS FINANCE PLC	INEGRP TL B 1L EUR	31/03/2024	2.5	100.0	290	2.5	BA1	2.8	-2,043	-17.1
VERISURE MIDHOLDING AB	VERISR 5 3/4 12/01/23	EUR	103.0	-1,640	-13.7	CAA1	Sr Unsecured	VERISURE HOLDING AB	VERISR TL B 1L EUR	21/10/2022	3.5	100.6	369	3.3	B2	2.3	-2,009	-16.9
VERISURE HOLDING AB	VERISR 3 1/2 05/15/23	EUR	102.6	-161	-1.5	B2	Secured	VERISURE HOLDING AB	VERISR TL B 1L EUR	21/10/2022	3.5	100.6	369	3.3	B2	1.9	-529	-4.8
VERISURE HOLDING AB	VERISR 3 1/2 05/15/23	EUR	102.6	-161	-1.5	B2	Secured	VERISURE HOLDING AB	VERISR TL B 1L EUR	21/10/2022	3.5	100.6	369	3.3	B2	1.9	-529	-4.8
INFOR US INC	LWSN 5 3/4 05/15/22	EUR	101.4	-744	-6.6	CAA1	Sr Unsecured	INFOR US INC	LWSN TL B2 1L EUR	01/02/2022	3.3	100.6	338	2.9	B2	0.9	-1,082	-9.5
LSF10 WOLVERINE INVEST	STKGRP 5 03/15/24	EUR	102.6	-491	-4.6	B2	Secured	LSF10 WOLVERINE INVEST	STKGRP TL B 1L EUR	30/09/2026	4.3	100.2	454	4.2	B2	2.4	-945	-8.8
CONSTANTIN INVESTISSEME	CERBA 5 3/8 04/15/25	EUR	103.6	-445	-4.4	CAA1	2nd lien	CERBA HEALTHCARE SASU	CERBA TL B2 1L EUR	20/04/2024	3.5	100.6	376	3.4	B2	3.0	-821	-7.7
CONSTANTIN INVESTISSEME	CERBA 5 3/8 04/15/25	EUR	103.6	-445	-4.4	CAA1	2nd lien	CERBA HEALTHCARE SASU	CERBA TL B 1L EUR	20/04/2024	3.0	100.1	339	3.0	B2	3.5	-784	-7.4
COTY INC	COTY 4 04/15/23	EUR	102.5	-198	-1.9	CAA1	Sr Unsecured	COTY INC	COTY TL B 1L EUR	05/04/2025	2.5	99.4	301	2.6	BA3	3.2	-498	-4.5
NIDDA BONDCO GMBH	SAZGR 7 1/4 09/30/25	EUR	106.6	133	1.4	CAA1	Sr Unsecured	NIDDA HEALTHCARE HOLDING	SAZGR TL B1-DD 1L EUR	21/08/2024	3.5	100.3	602	5.5	B2	6.3	-468	-4.1
NIDDA BONDCO GMBH	SAZGR 7 1/4 09/30/25	EUR	106.6	133	1.4	CAA1	Sr Unsecured	NIDDA HEALTHCARE HOLDING	SAZGR TL D 1L EUR	21/08/2024	4.0	100.6	424	3.8	B2	5.9	-291	-2.5
NIDDA BONDCO GMBH	SAZGR 5 09/30/25	EUR	103.1	310	3.2	CAA1	Sr Unsecured	NIDDA HEALTHCARE HOLDING	SAZGR TL B1-DD 1L EUR	21/08/2024	3.5	100.3	602	5.5	B2	2.8	-292	-2.4
NIDDA BONDCO GMBH	SAZGR 7 1/4 09/30/25	EUR	106.6	133	1.4	CAA1	Sr Unsecured	NIDDA HEALTHCARE HOLDING	SAZGR TL E 1L EUR	21/08/2024	3.5	100.6	374	3.4	B1	5.9	-241	-2.0
GRIFOLS SA	GRFSM 3.2 05/01/25	EUR	102.2	-131	-1.2	B2	Sr Unsecured	GRIFOLS SA	GRFSM TL B 1L EUR	15/11/2027	2.3	100.8	242	2.2	BA2	1.5	-373	-3.4
UNILABS SUBHOLDING AB	UNILAB 5 3/4 05/15/25	EUR	103.6	40	0.4	CAA1	Sr Unsecured	UNILABS DIAGNOSTICS AB	UNILAB TL B 1L EUR	30/04/2024	3.5	100.7	373	3.3	B2	2.9	-332	-2.9
UNILABS SUBHOLDING AB	UNILAB 5 3/4 05/15/25	EUR	103.6	40	0.4	CAA1	Sr Unsecured	UNILABS DIAGNOSTICS AB	UNILAB TL B 1L EUR	30/04/2024	3.0	100.1	337	3.0	B2	3.5	-297	-2.5

Source: Bloomberg Barclays Indices, Bloomberg, S&amp;P LCD, Barclays Research

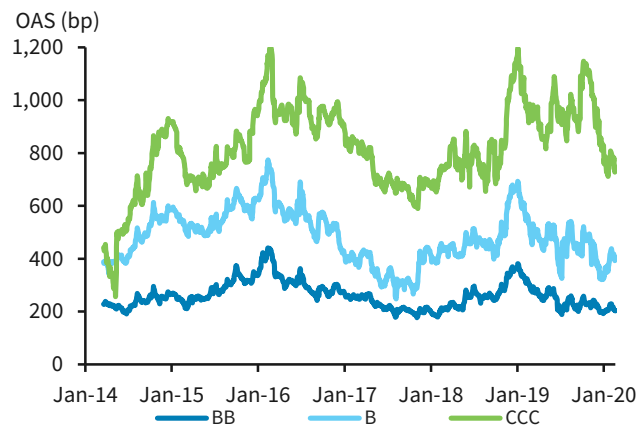
## HY credit at a glance

**FIGURE 11. iTraxx Crossover vs. iTraxx Main**



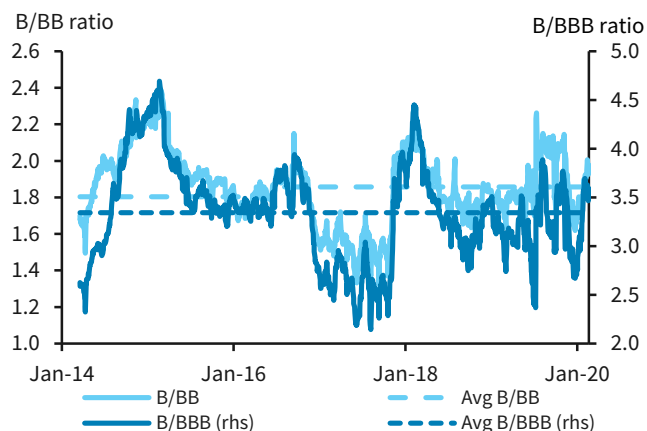
Source: Markit, Barclays Research. Please click [here](#) to see on Barclays Live.

**FIGURE 12. Pan-Europe HY (ex-financials) spread by rating**



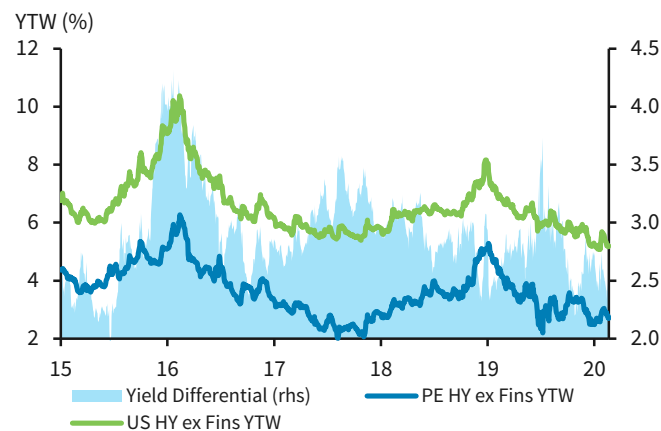
Source: Bloomberg Barclays Indices, Barclays Research. Please click [here](#) to see on Barclays Live

**FIGURE 13. Pan-Europe HY (ex-financials): B vs. BB and BBB ratios**



Source: Bloomberg Barclays Indices, Barclays Research. Please click [here](#) to see on Barclays Live

**FIGURE 14. Pan-Europe HY vs. US HY (ex-financials for both)**



Source: Bloomberg Barclays Indices, Barclays Research. Please click [here](#) to see on Barclays Live

**FIGURE 15. European HY issuance (including FRNs)**

Issuers:	All firms, in any European currency		European firms
Market:	Pan-European High Yield		US High Yield
Crcny:	€	£, CHF, other	\$
WTD	0.5	0.0	0.2
MTD	4.9	0.7	1.0
FY '20	18.1	1.2	3.5
YoY	+301%	-	-
YTD '19	4.5	0.3	0.0

Note: Supply in billion

Source: S&amp;P LCD, Bloomberg, Barclays Research

**FIGURE 16. European HY issuance monthly trends (including FRNs)**

Issuers:	All firms, in any European currency				European firms	
Market:	Pan-European High Yield				US High Yield	
Crcny:	€		£, CHF, other		\$	
Year:	2019	2020	2019	2020	2019	2020
Jan	2.8	13.2	0.2	0.5	2.5	
Feb	2.7	4.9	0.1	0.7	1.0	
Mar	5.0					
Apr	8.1		0.9			
May	6.6		0.7		3.6	
Jun	2.1		1.0		0.5	
Jul	7.0		0.5		2.4	
Aug	0.9				0.5	
Sep	7.8		0.6		1.0	
Oct	9.0				2.2	
Nov	10.6		0.4		1.0	
Dec	3.3					
Total	65.9	18.1	4.3	1.2	11.3	3.5

Note: Supply in billion

Source: S&amp;P LCD, Bloomberg, Barclays Research

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**CERBA HEALTHCARE SASU**, J/K/M/N

**CONSTANTIN INVESTISSEMENT 3 SASU**, CD/J/K/M/N

CERBA 5 3/8 04/15/25 (EUR 103.08, 19-Feb-2020)

**COTY INC**, CD/CE/J/K/M

COTY 4 04/15/23 (EUR 102.22, 19-Feb-2020)

**DOUGLAS GMBH**, CD/J/K/N

DOUGR 6 1/4 07/15/22, Underweight (EUR 101.31, 19-Feb-2020)

**GRIFOLS SA**, CD/FA/J/K/M/N

GRFSM 3.2 05/01/25 (EUR 101.87, 19-Feb-2020)

**INEOS FINANCE PLC**, A/CD/D/E/J/K/L/M/N

**INEOS GROUP HOLDINGS SA**, CD/D/E/J/K/L/M/N

INEGRP 5 3/8 08/01/24, Market Weight (EUR 102.41, 19-Feb-2020)

**INFOR US INC**, CD/E/J/K/L/M/N

LWSN 5 3/4 05/15/22 (EUR 101.11, 19-Feb-2020)

**LSF10 WOLVERINE INVESTMENTS SCA**, CD/J/K/M/N

STKGRP FLOAT 03/15/24 (EUR 100.00, 19-Feb-2020)

**NIDDA BONDCO GMBH**, CD/J/K/M

SAZGR 5 09/30/25 (EUR 102.55, 19-Feb-2020)

SAZGR 7 1/4 09/30/25 (EUR 105.97, 19-Feb-2020)

**UNILABS DIAGNOSTICS AB**, J

**UNILABS SUBHOLDING AB**, CD/J



UNILAB 5 3/4 05/15/25 (EUR 103.09, 19-Feb-2020)

**VERISURE HOLDING AB**, CD/J/K/M

VERISR 3 1/2 05/15/23, Market Weight (EUR 102.19, 19-Feb-2020)

**VERISURE MIDHOLDING AB**, CD/J/K/M

VERISR 5 3/4 12/01/23, Market Weight (EUR 102.54, 19-Feb-2020)

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**Market Weight (MW):**

For sectors rated against the Bloomberg Barclays U.S. Credit Index, the Bloomberg Barclays Pan-European Credit Index, the Bloomberg Barclays EM Asia USD High Grade Credit Index or the Bloomberg Barclays EM USD Corporate and Quasi-Sovereign Index, the analyst expects the six-month excess return of the sector to be in line with the six-month excess return of the relevant index.

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**Underweight (UW):**

For sectors rated against the Bloomberg Barclays U.S. Credit Index, the Bloomberg Barclays Pan-European Credit Index, the Bloomberg Barclays EM Asia USD High Grade Credit Index or the Bloomberg Barclays EM USD Corporate and Quasi-Sovereign Index, the analyst expects the six-month excess return of the sector to be less than the six-month excess return of the relevant index.

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**Sector definitions:**

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Sectors in European High Grade Research are defined using the sector definitions of the Bloomberg Barclays Pan-European Credit Index and are rated against the Bloomberg Barclays Pan-European Credit Index.

Sectors in Industrials and Utilities in European High Yield Research are defined using the sector definitions of the Bloomberg Barclays Pan-European High Yield 3% Issuer Capped Credit Index excluding Financials and are rated against the Bloomberg Barclays Pan-European High Yield 3% Issuer Capped Credit Index excluding Financials.

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To view sector definitions and monthly sector returns for Asia, EEMEA and Latin America Research, go to <https://live.barcap.com/go/research/EMSectorReturns> on Barclays Live.

**Explanation of the Barclays Research Corporate Credit Rating System**

For all High Grade issuers covered in the US, Europe or Asia, and for all issuers in Latin America and EEMEA, the credit rating system is based on the analyst's view of the expected excess return over a six-month period of the issuer's index-eligible corporate debt securities\* relative to the expected excess return of the relevant sector, as specified on the report.

**Overweight (OW):** The analyst expects the six-month excess return of the issuer's index-eligible corporate debt securities to exceed the six-month expected excess return of the relevant sector.

**Market Weight (MW):** The analyst expects the six-month excess return of the issuer's index-eligible corporate debt securities to be in line with the six-month expected excess return of the relevant sector.

**Underweight (UW):** The analyst expects the six-month excess return of the issuer's index-eligible corporate debt securities to be less than the six-month expected excess return of the relevant sector.

**Rating Suspended (RS):** The rating has been suspended temporarily due to market events that make coverage impracticable or to comply with applicable regulations and/or firm policies in certain circumstances including where the Investment Bank of Barclays Bank PLC is acting in an advisory capacity in a merger or strategic transaction involving the company.

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**Market Weight (MW):** The analyst expects the six-month total return of the debt security subject to this rating to be in line with the six-month expected total return of the relevant sector.

**Underweight (UW):** The analyst expects the six-month total return of the rated debt security subject to this rating to be less than the six-month expected total return of the relevant sector.

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Where a recommendation is made at the issuer level, it does not apply to any sanctioned securities, where trading in such securities would be prohibited under applicable law, including sanctions laws and regulations.

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#### **Distribution of ratings assigned by Barclays Corporate Credit Research at the issuer level:**

27% have been assigned an Overweight rating which, for purposes of mandatory regulatory disclosures, is classified as a Buy rating; 59% of issuers with this rating category are investment banking clients of the Firm; 77% of the issuers with this rating have received financial services from the Firm.

46% have been assigned Market Weight rating which, for purposes of mandatory regulatory disclosures, is classified as a Hold rating; 60% of issuers with this rating category are investment banking clients of the Firm; 83% of the issuers with this rating have received financial services from the Firm.

27% have been assigned an Underweight rating which, for purposes of mandatory regulatory disclosures, is classified as a Sell rating; 47% of issuers with this rating category are investment banking clients of the Firm; 80% of the issuers with this rating have received financial services from the Firm.

#### **Distribution of ratings assigned by Barclays Corporate Credit Research at the bond level:**

21% have been assigned an Overweight rating which, for purposes of mandatory regulatory disclosures, is classified as a Buy rating; 50% of bonds with this rating category are investment banking clients of the Firm; 71% of the issuers with this rating have received financial services from the Firm.

54% have been assigned Market Weight rating which, for purposes of mandatory regulatory disclosures, is classified as a Hold rating; 57% of bonds with this rating category are investment banking clients of the Firm; 78% of the issuers with this rating have received financial services from the Firm.

25% have been assigned an Underweight rating which, for purposes of mandatory regulatory disclosures, is classified as a Sell rating; 45% of bonds with this rating category are investment banking clients of the Firm; 72% of the issuers with this rating have received financial services from the Firm.

#### **Explanation of the Barclays EM Sovereign Credit Issuer Rating System**

##### **Overweight (OW):**

The analyst expects the six-month excess return of the country's index eligible bonds to exceed the six-month excess return of the Bloomberg Barclays EM USD Sovereign Index.

##### **Market Weight (MW):**

The analyst expects the six-month excess return of the country's index eligible bonds to be in line with the six-month excess return of the Bloomberg Barclays EM USD Sovereign Index.

##### **Underweight (UW):**

The analyst expects the six-month excess return of the country's index eligible bonds to be less than the six-month excess return of the Bloomberg Barclays EM USD Sovereign Index.

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BRCF2242