

## Yield Promise

Bradley Rogoff  
+1 212 412 7921  
bradley.rogoff@barclays.com

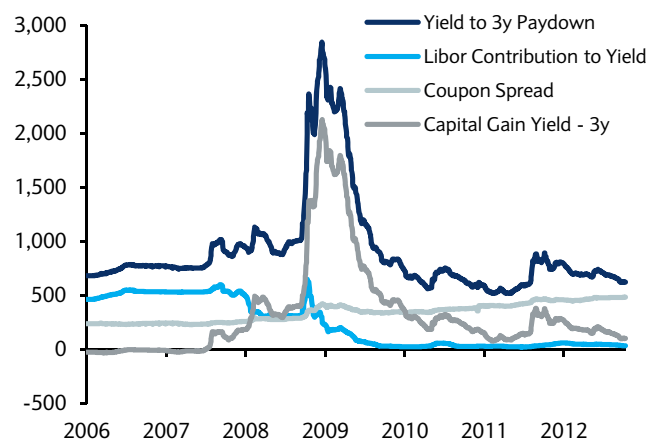
Eric Gross  
+1 212 412 7997  
eric.gross@barclays.com

Mike Kessler  
+1 212 412 3031  
michael.kessler@barclays.com

Trading levels in the cash loan market have been fairly stable over the past several weeks, despite some gyrations in the equity and high yield bond markets. As of Wednesday's close, the Barclays Performing Loan Index stood at \$96.96, down just \$0.06 on the week and down only \$0.11 from its 2012 peak reached on September 21. Stable market conditions have been a boon to issuers, who have responded with the largest supply of new loans at any one time since the 2008 financial crisis. Momentum has been building since Labor Day, as investor appetite for new loans shows no sign of slowing. According to S&P LCD, more than 100 new loan facilities have launched in the past 30 days, and the forward calendar has reached nearly \$50bn by par amount. Trends that we highlighted recently in [Repricing Reboot](#) and [Market Strength Pays \(for\) Dividends](#) have continued, as Ipreo and SNL Financial have launched covenant-light repricing transactions this week, while loans supporting LBOs (David's Bridal, Insight Global, GCA Services, SGS International) and dividend deals (TransDigm, Sportsman's Warehouse, Quintiles) continue to hold an outsized share of real issuance proceeds.

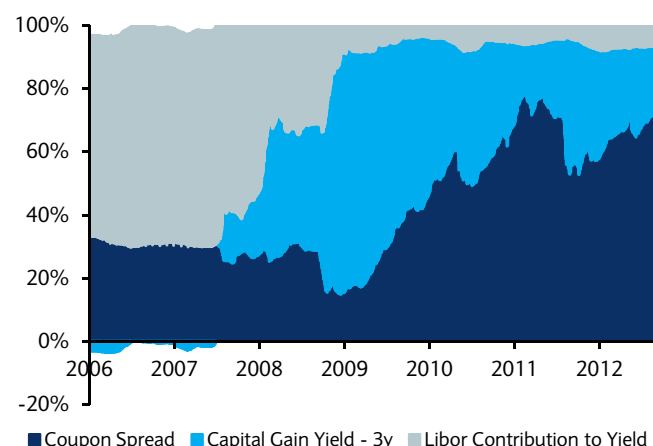
Despite the issuer-friendly nature of current primary market conditions, we continue to find loans fairly attractive in the context of a broader market in which most risk assets have been bid up to arguably unsustainable levels. As described in [Loans Ready for Pickup](#), loans currently offer an all-in yield to a three-year takeout that is similar to high yield bonds, even though loans offer superior security and higher recoveries in default. Another beneficial aspect of the loan market's post-crisis evolution is that most of the yield currently on offer is effectively "promised" to investors, in that it comes in the form of spread. In contrast, most of the loan market's pre-crisis yield was anything but guaranteed, even in a non-default scenario, as investors discovered in the aftermath of the financial crisis. As Figure 1 shows, loan yields are now similar to 2006-07 levels, but nearly two-thirds of the yield at that time came from Libor, while spreads were narrow and pull-to-par was negative in expectation because the index was trading above par (Figure 2). When Libor collapsed following the financial crisis, loan investors were left with extremely low-coupon securities, as thin pre-crisis nominal spreads were then being added to a suddenly paltry contribution from Libor.

Figure 1: Loan Index Yield with Components (bp)



Note: Loan index yield assumes a three-year pull to par.  
Source: Barclays Research

Figure 2: Portion of Loan Index Yield from Each Component



Note: Loan index levels were above par for much of 2006 and 2007, causing pull-to-par to be negative in expectation. Source: Barclays Research

This near total lack of income helps explain why the Performing Loan Index nearly touched \$60 during the crisis, seemingly pricing in a default rate greater than 100% given the historical average recovery rate of approximately 70%.

The subsequent evolution of Figure 2 shows how the loan market's forward yield proposition has changed as market conditions have slowly recovered. In 2009, with coupon spreads still narrow and loans deeply discounted, most of the market's yield came from expected price appreciation (which, fortunately, was subsequently realized for most credits). While the dramatic post-crisis fall in rates harmed loan yields, it helped bondholders by offsetting spread widening, but with yields now at historic lows, this dynamic appears unlikely to repeat in the future. If anything, the loan market now appears better positioned to benefit from future changes in interest rates than the high yield bond market, as there is much more room for rates to rise than fall.

Today, nearly 80% of total yield comes in the form of simple income from coupon spread, including the effect of Libor floors. By comparison, expected capital gains (which are uncertain) contribute only a small amount, while Libor (ex floors) contributes almost nothing. While some of the income from coupon spread is being skimmed off by repricing transactions, it remains a more predictable source of yield than the potential for further price appreciation or the future direction of Libor. Buoyant primary market conditions notwithstanding, today's loan market investors can take some comfort that most of their yield compensation is in the form of an explicit promise to pay on the part of the issuer, making the link between loan yield and risk the strongest it has been in years.

### New Issue Volume

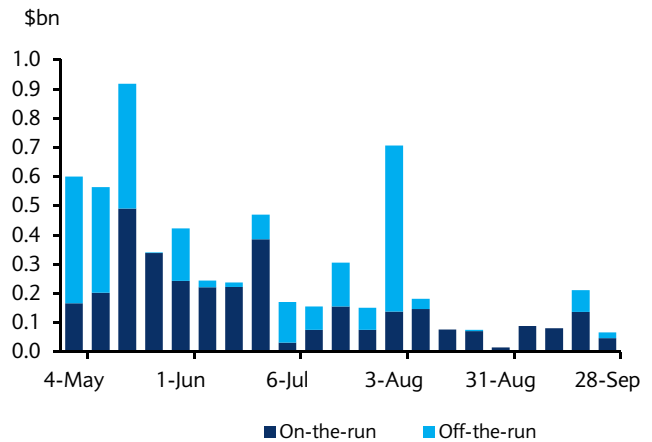
Institutional Leveraged Loans	No. of Deals	Amt (\$bn)
Trailing 1m Launches	110	64.9
Forward Calendar	87	49.3
Year-to-Date Priced (ex-repricings)	436	162.5

CLOs (BSL and MM)	No. of Deals	Amt (\$bn)
Forward Calendar	5	2.0
Year-to-Date	84	35.2

Source: Creditflux, Bloomberg, Total Securitization, S&P LCD, Barclays Research

### LCDX Weekly New Contract Volume



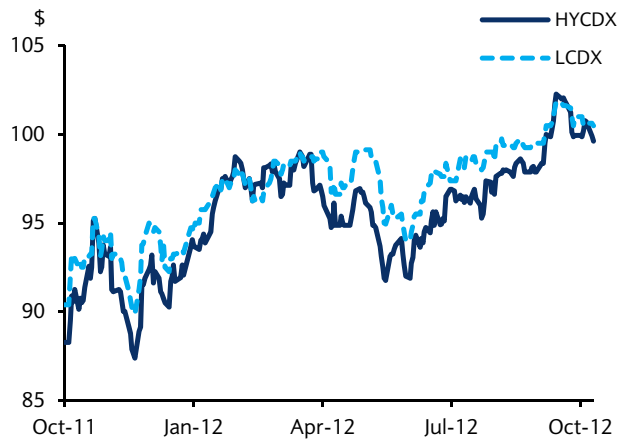
Source: DTCC

### LCDX Historical On-the-Run Spreads



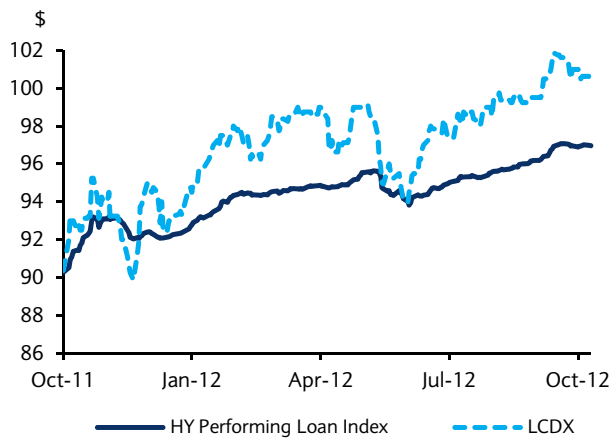
Note: Current market assumes 70% recovery on LCDX.  
Source: Barclays Research

### On-the-Run HYCDX versus LCDX



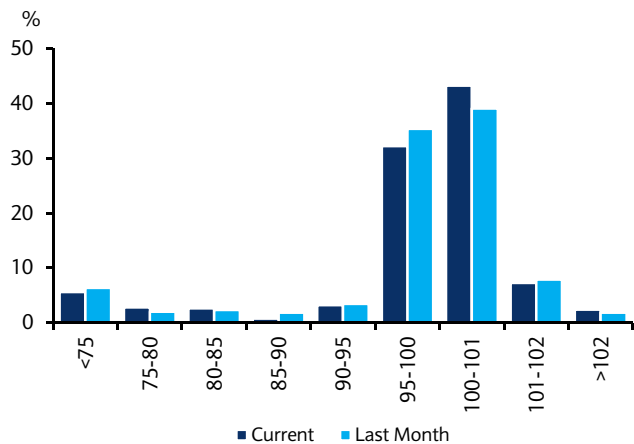
Source: Barclays Research

### On-the-Run LCDX versus Loan Index Price History



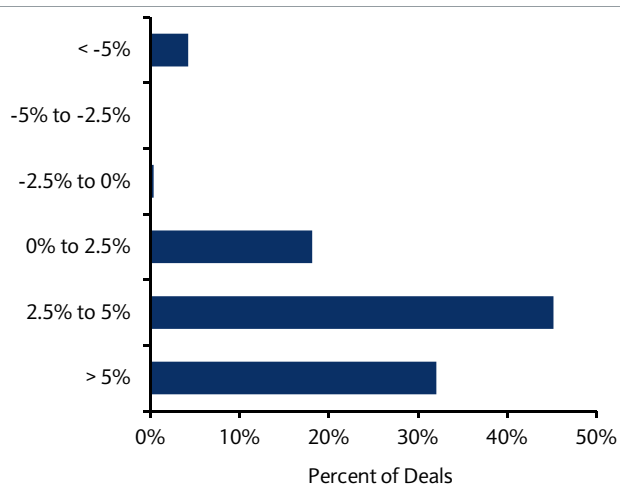
Source: Barclays Research

### Loan Index Price Distribution by Par

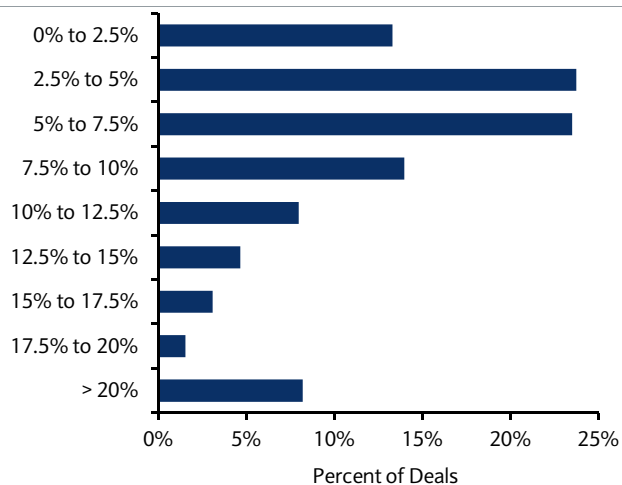


Source: Barclays Research

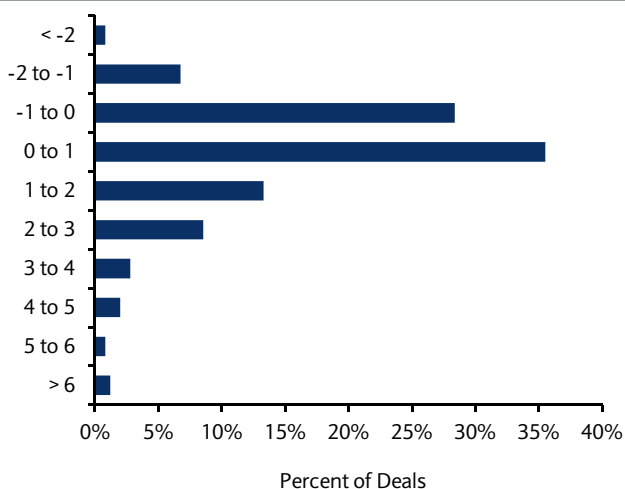
## Junior OC Test Cushions for U.S. CLOs



## CCC Bucket Size for U.S. CLOs

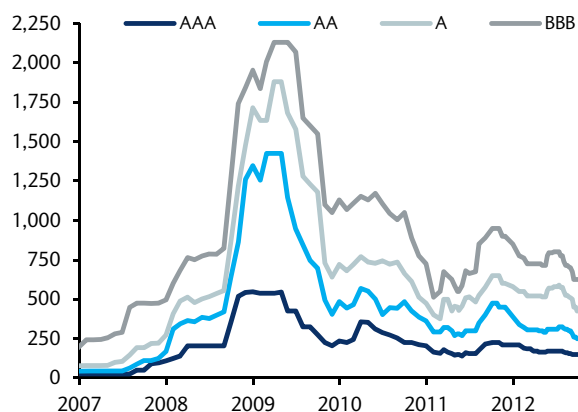


## Weighted Average Life (WAL) Test Cushion for U.S. CLOs



## U.S. CLO Moody's Ratings Upgrades

	Rating as of July 1st									
	Aaa	Aa	A	Baa	Ba	B	Caa	Ca/C	WR	Total
Rating as of July 31st	Aaa	979	-	-	-	-	-	-	12	991
	Aa	10	523	-	-	-	-	-	2	535
	A	-	9	356	-	-	-	-	-	365
	Baa	-	-	6	361	-	-	-	1	368
	Ba	-	-	-	7	551	-	-	4	562
	B	-	-	-	-	129	-	-	-	129
	Caa	-	-	-	-	-	27	-	-	27
	Ca/C	-	-	-	-	-	-	20	-	20
	Total	989	532	362	368	551	129	27	20	2,997

U.S. CLO Spread Performance by Rating (bp)<sup>1</sup>

Note: <sup>1</sup> Spread data from BWIC levels.

Source: Moody's Investor Services, Intex, Barclays Research

## Cash Amount for U.S. CLOs

	Reinvestment Period		Total
	In	Post	
U.S.			
Cash (\$bn)	5.6	3.8	9.4
Total Par (\$bn)	167.8	74.5	242.3
Cash Percent	3.33%	5.08%	3.87%

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