

Up is Down? How Recent Market Dislocation is Affecting Senior Loans



Jeff Bakalar
Group Head and Chief
Investment Officer,
Senior Loans



Dan Norman
Group Head and Senior
Managing Director,
Senior Loans

In times of strain, investors sell what they can sell—not what they want to sell. In the senior loan market this dynamic has played out in two important ways.

First, loan market volatility has been exacerbated by a material pick up in selling via retail loan funds preparing for redemptions and aggressive low bids by credit opportunities funds. For context, four of the eight worst trading days in the senior loan market have taken place over the past three weeks (with the rest in October 2008).

Second, the larger, more actively-traded loans in the market, (which we emphasize across our portfolios) have been easier for investors to sell, which means they have been more susceptible to the recent liquidity-driven dislocation in the loan market.

As seen below, this dynamic was evident through March 20, 2020, where BB-rated loans trailed lower quality ratings cohorts and the S&P/LSTA Broad Index. However, as the market began to rebound on March 23, 2020, higher-rated loans were the primary beneficiaries of the upward price movement and captured most of the momentum. BBs are now ahead of lower credit quality through the YTD period as of March 25, 2020.

A Victim of Their Own Liquidity

Amid indiscriminate selling, higher-rated, more actively traded loans have faced disproportionate pressure because they are easier to sell

	Nominal Spread	Weighted Avg Price (3/20)	Weighted Avg Price (3/25)	MTD Total Return (3/20)	YTD Total Return (3/20)	MTD Total Return (3/25)	YTD Total Return (3/25)
S&P/LSTA Index	3.45%	78.35	77.91	-17.26%	-17.90%	-17.66%	-18.29%
BB Loans	2.58%	80.05	81.14	-17.80%	-18.72%	-16.95%	-17.89%
B Loans	3.76%	79.09	78.36	-17.39%	-17.90%	-18.07%	-18.58%
CCC Loans	5.67%	66.14	62.71	-18.61%	-19.28%	-22.95%	-23.59%

As of 3/25/2020. Source: S&P/LSTA.

Like prior market shocks, the technical forces that have caused massive price distortions in loan markets will prove unsustainable. Our central case moving forward sees fundamentals defined by a sharp global recession followed by a stubbornly low growth world coupled with the odd bedfellows of high debt levels and low risk free interest rates. The lack of a “V” shaped recovery is likely to result in the higher risk areas of the loan market facing a persistent fundamental headwind moving forward. As this plays out, we expect the factors driving current market dislocation—technical selling pressure (driven by fear), leveraged unwinds, U.S. dollar funding needs, and portfolio rebalancing—will abate. In other words, risk will transfer to more appropriate holders, deleveraging will occur where necessary, monetary policy will take root and panic will ultimately subside. In the meantime, this environment will create a bounty of opportunities to purchase fundamentally sound investments at steep discounts.

For example, in the loan market there is a unique opportunity to buy heavily discounted Ba/BB credits, allowing for a large pull-to-par potential when the market recovers. On average, BB loans are now trading in the low-80s, down over 15 points since the beginning of the year. The yield/discount margin profile has not looked that attractive for strong issuers since the late summer of 2011 when similar rated loans were trading roughly 10-12 points higher than current levels.

Like the broader fixed income arena, there is no need to reach down in credit quality in today's loan market. Opportunities to earn attractive yields through higher-quality investments with high conviction, low risk outcomes are bountiful. As we prepare for what is likely to be a Zero Interest Rate Policy world ahead, the current market dislocation presents an attractive opportunity to prepare by building a relatively defensive, and attractively priced, loan portfolio built for the long term.

This commentary has been prepared by Voya Investment Management for informational purposes. Nothing contained herein should be construed as (i) an offer to sell or solicitation of an offer to buy any security or (ii) a recommendation as to the advisability of investing in, purchasing or selling any security. Any opinions expressed herein reflect our judgment and are subject to change. Certain of the statements contained herein are statements of future expectations

and other forward-looking statements that are based on management's current views and assumptions and involve known and unknown risks and uncertainties that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. Actual results, performance or events may differ materially from those in such statements due to, without limitation, (1) general economic conditions, (2) performance of financial markets, (3) changes in

laws and regulations and (4) changes in the policies of governments and/or regulatory authorities. The opinions, views and information expressed in this commentary regarding holdings are subject to change without notice. The information provided regarding holdings is not a recommendation to buy or sell any security. Fund holdings are fluid and are subject to daily change based on market conditions and other factors. **Past performance is no guarantee of future results.**

©2020 Voya Investments Distributor, LLC • 230 Park Ave, New York, NY 10169 • All rights reserved.

CMMC • IM1132761 • WLT25000