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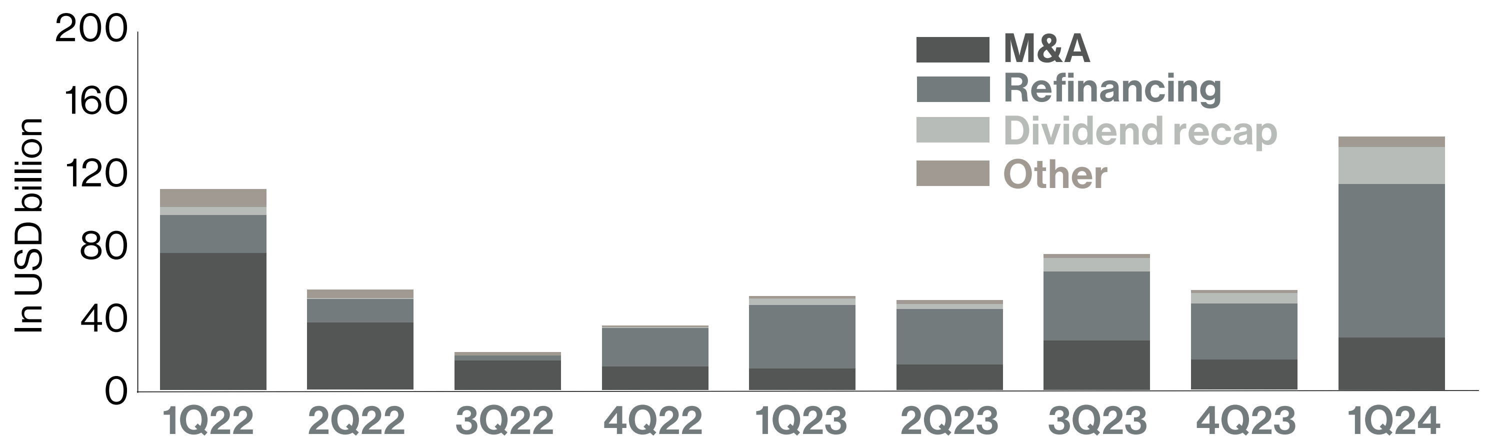
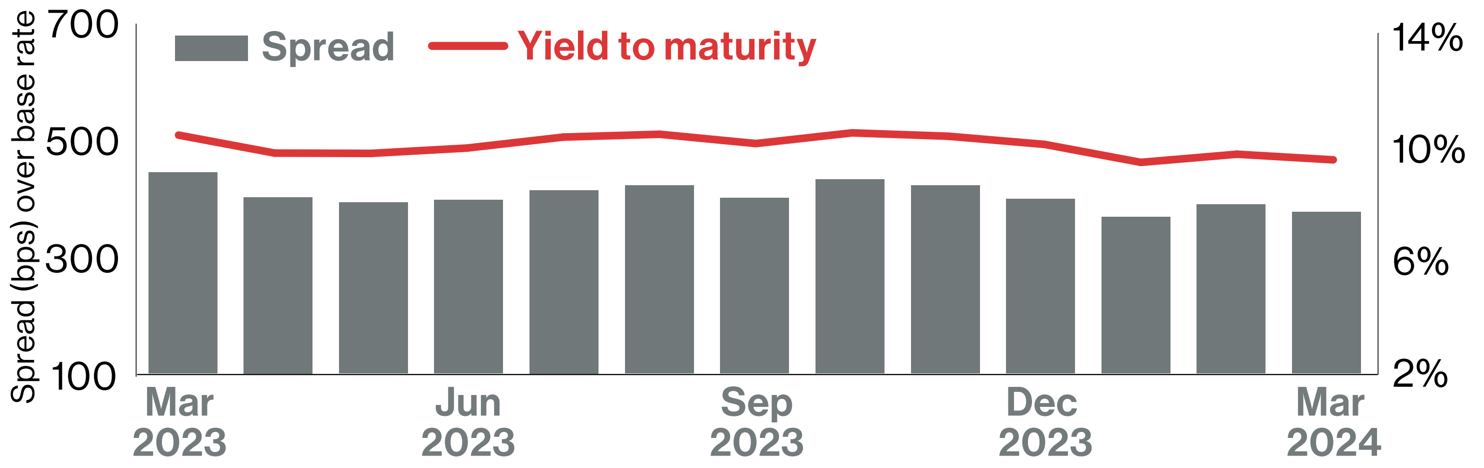
# Quarterly Liquid Loan Market Commentary Q1 2024 Issue 19

US new-issue institutional loan volume




US average new-issue loan spread and yield




US loans index average bid (LLI)


Source: PitchBook | LCD, March 2024. For illustrative purposes only.

## US liquid loan market overview

The US leveraged loan market did not miss a beat in the first quarter of the year, continuing with its busy pace of activity. Perhaps fortified by new budgets and targets for assets under management (AUM), improving economic forecasts or the anticipation around Fed rate cuts later in the year, loan investors and issuers jumped straight into the mix early and the market saw robust activity throughout the quarter. As a result, new loan issuance, repricing and amendments, and secondary trading activity all posted recent highs.

Loan issuers quickly seized on insatiable investor demand for loans to extract loan spread repricings, maturity extensions and incremental term debt to pay down revolver drawings, fund minor acquisitions and repay more expensive debt. Additionally, broadly syndicated loans made great strides in recapturing several loans which were recently lost to direct private lenders just in the past year.

While M&A activity remained sluggish, activity was slightly higher during Q1, with market expectations for higher M&A and LBO volumes in 2024 more pronounced. Another driving factor for Q1 activity was a remarkable surge in issuance volumes of collateralized loan obligations (CLO). The continuing stability of the loan asset class helped vault CLO investor demand to the second highest volumes posted since the record-breaking year of 2021. Fervent investor demand was generally observed across all CLO liability tranches. As CLOs have long been the lifeblood of the US loan market, an active pace of CLO issuance is always welcomed by loan issuers.

## US new-issue loan issuance

From the USD 325 billion of leveraged loan activity recorded in Q1, new loan issuance contributed USD 142 billion. This total was dramatically higher than new loan issuance of USD 56 billion in Q4. Unfortunately for investors, loan refinancings made up over 60% of Q1 new issuance (USD 86.1 billion), making it the busiest refinancing quarter in the last ten years. And with most 2024 and 2025 loan maturities having been extended by the end of 2023, loan issuers have shifted focus to 2026, 2027 and 2028 maturities.

As often observed in periods of strong investor demand, loan issuers rated B3 or B- were the biggest beneficiaries of heavy investor demand during Q1, comprising 37% of total refinancing volume. Once again, investors were back in "risk-on" mode. B- rated issuer refinancing volumes in Q1 totaled more than all B-rated refinancings closed for all of 2023, which speaks to the incredible strength and resiliency of the US leveraged loan category. Unrelenting investor demand has carried the loan market since last summer, after extended weakness in 2022 and early 2023.

Beyond refinancings, M&A and dividend recap activity rounded out new issuance volume at USD 29.2 billion and USD 20.6 billion respectively during Q1, the highest quarterly postings for each category since the prolific issuance year of 2021. Also noteworthy in the refinancing volumes of Q1, USD 11.8 billion were loans prepaying private direct loans that were just issued in 2023.

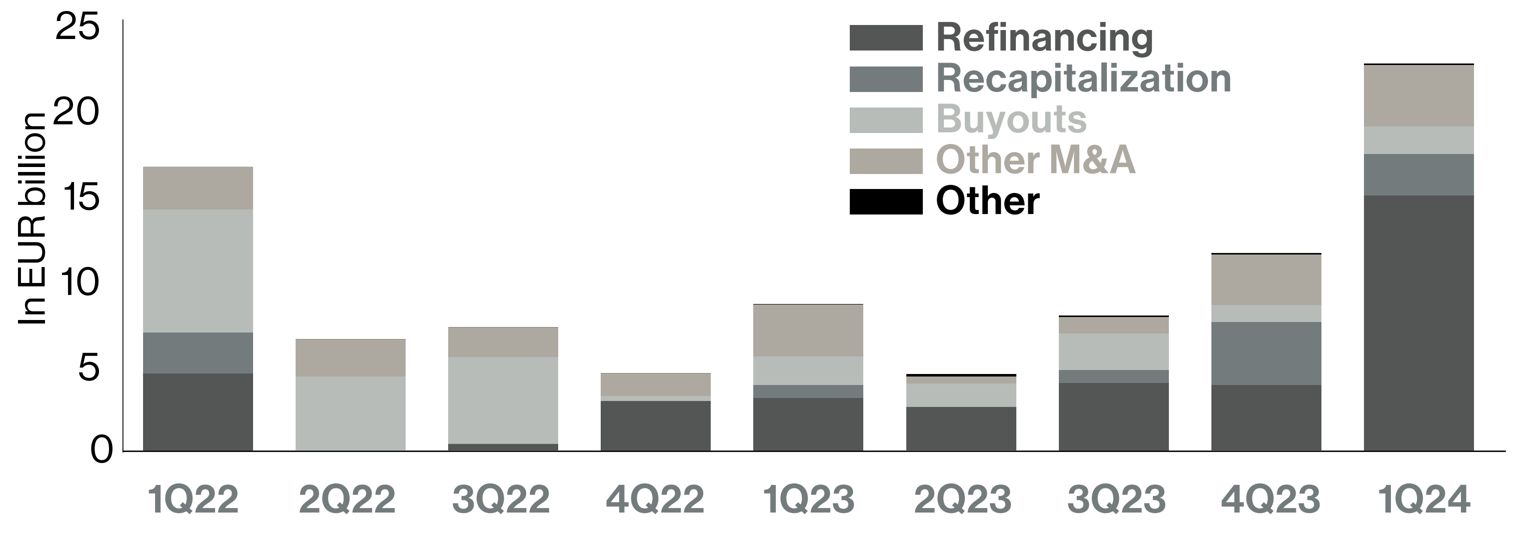
## US new-issue loan spreads

Strong investor demand naturally resulted in further tightening of loan spreads on new issue in Q1 across all active ratings levels. The greatest reduction in loan spreads was observed in B+ rated loans, which declined 46bps to 350bps, while BB-, B and B-loans dropped 35bps, 19bps, and 20bps, to 267bps, 408bps and 436bps respectively. These new-issue spreads in Q1 were the lowest spread levels posted since 2021. On a yield to maturity basis, new-issue loans rated B averaged 9.54% in Q1, down from 9.74% in Q4.

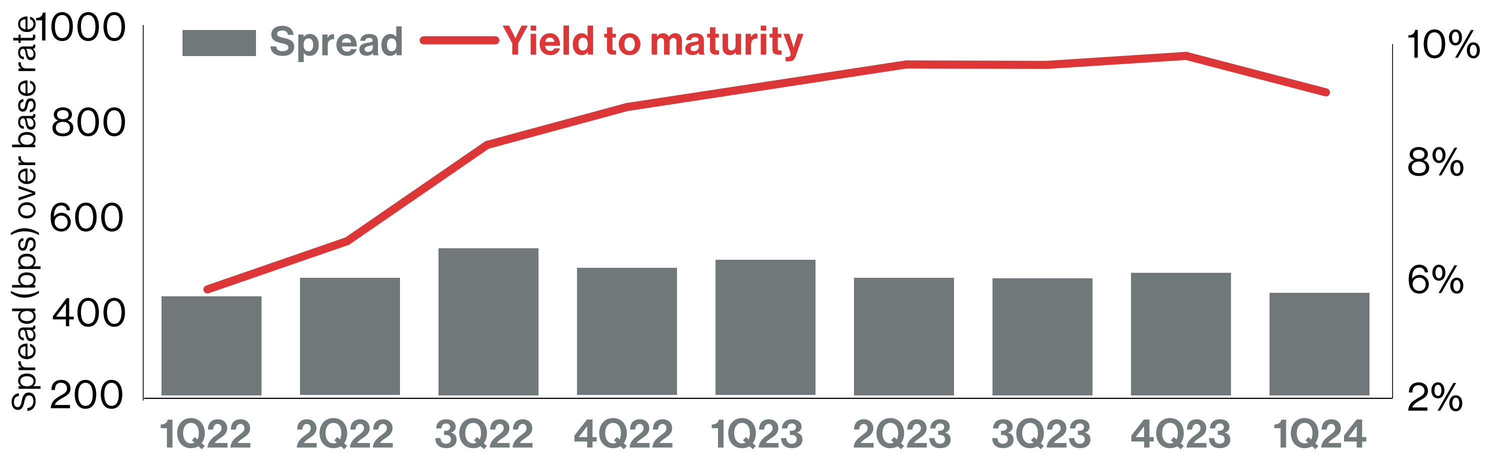
## US secondary loan trading

US secondary loan trading continued to rally in Q1 as supply still could not match investor demand. The Morningstar LSTA US Leveraged Loan Index (LLI) began January at 96.23% and ticked higher through the quarter to end at 96.69% at March end. Not only was investor demand driven by the proliferation of new CLOs issued in Q1, but there was a renewed

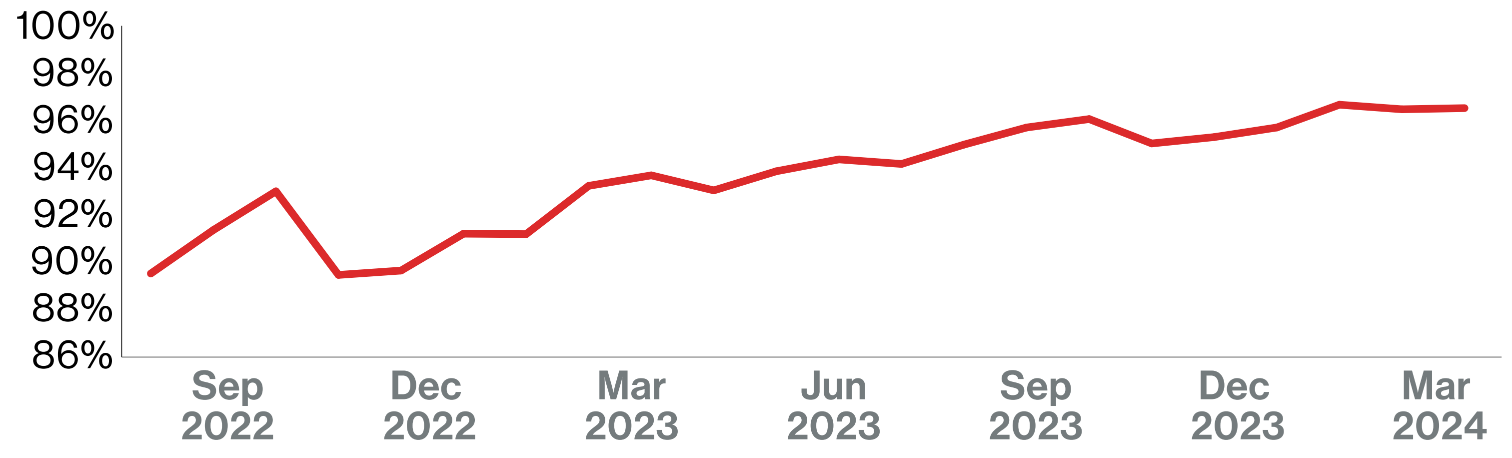
European new-issue institutional loan volume




European average new-issue loan spreads and yield




European loan index (ELLI)




**Source: PitchBook | LCD, March 2024. For illustrative purposes only.**

inflow of cash from retail investors seeking to capture prevailing high single-digit returns, while the Fed contemplated its timing on rate cuts. The strong market performance resulted in the LLI delivering an attractive 2.46% total return for Q1.

## European liquid loan market overview

Similar to the prevailing trends in the US, European syndicated leveraged loans during Q1 posted the strongest quarter of activity since Q2 2021. With investor demand consistently exceeding supply, new loan issue, refinancings, amendments, and secondary trading volumes all jumped higher. But the hopes of a more robust M&A market were dashed again, leaving loan refinancing and repricing as the focus for market participants. Inadequate supply of new-issue loans pushed secondary loan bids even higher, many above par, constrained only by rising repricing risk.

Issuers also seized the opportunity to extend maturities on their loans, even for those maturing in 2027 or beyond. Lastly, Q1 saw a surprising return of several issuers to the syndicated loan market, following brief interludes borrowing from private direct lenders. Broadly syndicated loan arrangers and investors demonstrated a growing willingness to offer cheaper financing to lure better performing issuers back from the private credit markets.

## European new-issue loan issuance

New loan issue volumes in Europe continued to be sluggish in Q1, with only EUR 5.3 billion posted,


compared to EUR 4.1 billion in Q4 2023. However, refinancing activity jumped to EUR 14.9 billion in Q1, to go along EUR 2.4 billion in recapitalizations, compared to EUR 3.8 billion and EUR 3.7 billion respectively in Q4. Issuers took advantage of strong market demand and successfully negotiated meaningfully lower financing costs and maturity extensions.

Total institutional loan volume for Q1 reached EUR 22.7 billion, nearly twice the activity posted in Q4, despite Q4 having just been the busiest quarter since Q1 2022. Altogether, it was a very positive quarter for market participants and a good indication of how the rest of 2024 might unfold.

## European new-issue loan spreads

As Euro investor demand continued to exceed loan supply, new-issue loan subscription was very strong and new-issue loan spreads for a typical single-B credit tightened considerably during Q1 to 421bps, compared to 464bps in Q4 2023 and 491bps a year earlier, in Q1 2023. The average yield to maturity for new-issue loans also declined significantly to 8.52% in Q1, compared to 9.29% in Q4 2023.

## European secondary loan trading

Investors continued to source much of their loan supply via the secondary market, as European new loan issue volumes disappointed again. As a result, secondary loan prices continued to grind higher throughout Q1. The Morningstar European Leveraged Loan Index (ELLI) rose from 96.02% at the start of January to end the first quarter at 96.87%. This price rally in the first quarter resulted in a total return of 2.42% for the ELLI. And while behind the pace of 2023, this was still a very strong return to start off the year.

# US collateralized loan obligations

## US CLO issuance

Q1 saw the highest volume of new CLO issuance since Q4 2021, as liability tranche spreads tightened and compressed across managers. Investors came into 2024 with ample cash to invest and perhaps a growing measure of fear of missing out, which helped spur both new CLO issuance and reset activity. This was accomplished despite the rising costs of loan collateral, with secondary loan prices climbing higher week after week and month after month since the beginning of last summer. Many CLO managers who had been warehousing assets chose to move forward and issue, despite continuing tight equity arbitrage, in order to progress business plans and wean warehouse risk.

As a result, Q1 saw 87 broadly syndicated loan CLOs issue totaling USD 39.1 billion, compared to 54 CLOs and USD 23.2 billion in Q4 2023. As impressive as this first quarter issuance was, it fell far short of the 115 CLOs and USD 56.3 billion issued in the most recent peak in Q4 2021. Additionally, USD 24.4 billion of CLO resets and USD 14 billion of CLO refinancings were completed in Q1, to complement new issuance volumes.

### US CLO liabilities spreads

**US CLO average coupon and weighted average cost of capital (bps)**

| Time frame | AAA | AA | A | BBB | BB | WACC |
|---|---|---|---|---|---|---|
| 2Q22 (SOFR+) | 163 | 233 | 294 | 411 | 756 | 224 |
| 3Q22 (SOFR+) | 212 | 302 | 400 | 533 | 834 | 282 |
| 4Q22 (SOFR+) | 231 | 322 | 415 | 582 | 850 | 299 |
| 1Q23 (SOFR+) | 196 | 261 | 335 | 541 | 825 | 270 |
| 2Q23 (SOFR+) | 198 | 273 | 336 | 549 | 853 | 275 |
| 3Q23 (SOFR+) | 187 | 260 | 314 | 495 | 790 | 260 |
| 4Q23 (SOFR+) | 176 | 256 | 302 | 483 | 786 | 254 |
| 1Q24 (SOFR+) | 157 | 209 | 255 | 392 | 689 | 213 |
| Change from 4Q23 | -19 | -47 | -47 | -91 | -97 | -41 |
| Change from a year ago | -39 | -52 | -80 | -149 | -136 | -57 |

Source: PitchBook | LCD • Data through 31 March 2024. For illustrative purposes only.

## US CLO liability spreads

The primary catalyst for the heavy new-issue volumes was the significant tightening in CLO liability spreads, which helped lower the weighted average cost of capital (WACC) for new CLOs from 254bps in Q4 2023 to 213bps Q1 2024, the largest quarterly tightening of liability spreads seen in many years. For AAA-rated liability tranches, spreads declined from 176bps to 157bps during Q1, while spreads on AA- to BB-rated tranches declined between 47bps and 97bps.

## US CLO secondary trading

Despite the elevated primary issuance, the secondary market remained very active with USD 14 billion trading (roughly flat year-on-year), thanks to strong demand

from every corner of the market. The higher-for-longer interest rates scenario lent additional support to the asset class, given its floating rate nature, with high coupon CLOs from 2022-2023 often trading above par. In addition, the surge in reset and refinancing activity during Q1 led to an increasing amount of cash to redeploy in the CLO market. The spread on AAA tranches compressed by 10bps, trading at a widening premium with respect to the primary market, while BB tranches returned 7.4% during the quarter, matching 2023's strong performance on an annualized basis.

# European collateralized loan obligations

European CLO issuance also jumped in Q1, as improving economic conditions and strong investor appetite for CLO liability tranches set the table, prompting managers to step up their pace of issuance. And not only was CLO new issuance active, but resets and refinancings picked up again, to levels not seen since early 2022.

### Euro CLO liabilities spreads

**Euro CLO average coupon and weighted average cost of capital (bps)**

| Time frame | AAA | AA | A | BBB | BB | WACC |
|---|---|---|---|---|---|---|
| 3Q22 (E+) | 189 | 363 | 450 | 606 | 769 | 306 |
| 4Q22 (E+) | 210 | 387 | 467 | 625 | 790 | 312 |
| 1Q23 (E+) | 180 | 297 | 394 | 577 | 728 | 275 |
| 2Q23 (E+) | 191 | 321 | 410 | 618 | 793 | 296 |
| 3Q23 (E+) | 174 | 256 | 336 | 513 | 733 | 263 |
| 4Q23 (E+) | 172 | 266 | 357 | 560 | 789 | 266 |
| 1Q24 (E+) | 149 | 224 | 276 | 407 | 674 | 227 |
| Change from 4Q23 | -23 | -42 | -81 | -153 | -115 | -39 |
| Change from a year ago | -31 | -73 | -118 | -170 | -54 | -48 |

Source: PitchBook | LCD • Data through 31 March 2024. For illustrative purposes only.

## Euro CLO issuance

New European CLO issuance in Q1 topped EUR 10.8 billion from 26 CLOs, compared to EUR 7.6 billion and 20 CLOs in Q4 2023. This was the strongest quarter of issuance in Europe since Q4 2021, when 31 CLOs totaling EUR 13 billion hit the market, and the second most active quarter dating back to the Great Financial Crisis in 2008. CLO reset and refinancing activity totaled EUR 4 billion in Q1 2024, compared to EUR 1.8 billion for the full year of 2023. This drove total CLO activity in Q1 to EUR 14.9 billion. Market expectations point to CLO issuance remaining active into Q2, if current economic conditions hold.

## Euro CLO liability spreads

Similar to the US, the European CLO market experienced notable tightening in CLO tranche liability spreads in Q1 as investor demand outpaced supply.

The WACC for European CLOs issued in Q1 declined to 227bps in Q1, compared to 266bps in Q4 2023, and 275bps from a year ago, in Q1 2023. Significant reductions in liability spreads were seen across the capital stack, with AAA spreads tightening to 149bps in Q1 compared to 172bps in Q4. The decline in liability spreads in other tranches ranged from 42bps for AA-rated tranches to 153bps for BBB-rated tranches.

## Euro CLO secondary trading

In line with the US, primary issuance in Europe surged to more than 50% year-on-year and secondary activity followed, with approximately EUR 5 billion trading in bid wanted in competition (BWIC) over the quarter – up 10% year-on-year and 50% quarter-on-quarter. Despite the elevated volumes, discount margins across the capital structure compressed quickly, leaving AAAs in the mid-120s and 30bps tighter quarter-on-quarter.

## Spotlight topic:

# US leveraged loan returns – stronger for longer?

After the US and European syndicated leveraged loan markets posted remarkable 13% returns in 2023, market expectations for a repeat performance in 2024 were understandably low. The long-awaited taming of inflationary pressures were expected to lead to the Fed and the ECB to finally initiate interest rate cuts by mid-year, eroding the floating rate basis embedded in loans.

But as Q1 2024 wrapped up, prevailing rate cut assumptions were once again being actively debated and reassessed, with the number and magnitude of US rate cuts during 2024 and 2025 now potentially much lower than earlier consensus. And if this were to play out, where should credit investors put cash to work? Maybe they could just leave it in leveraged loans. The floating rate basis component in syndicated loan returns is well suited for times of interest rate uncertainty. US loan investors have already been rewarded with returns of 2.5% for Q1 2024.

While maybe not on track to match 2023 record levels, this still offers a very competitive return against the backdrop of a stronger than anticipated economy. Should new loan issuance activity remain constrained by the weak M&A and LBO environment prevalent since 2022, secondary loan bids could keep loan returns strong in Q2 and perhaps for longer. In this market environment in which loan defaults remain below average, a diversified portfolio of syndicated loans can offer investors the opportunity to enjoy "stronger for longer" returns.

## About the author

Mark Hanslin is a Managing Director & Senior Portfolio Manager in Partners Group's Private Credit Liquid Loans Team based in New York. He has over three decades of liquid loan investment and portfolio management experience for global corporate banks and investment management companies.

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**Media relations contact**
media@partnersgroup.com

**Client contact**
clients@partnersgroup.com