**altii interview**

Michael Craig, Senior Portfolio Manager Bank Loans at Invesco Fixed Income

“Good Prospects for European Senior Secured Loans!”

*Frankfurt am Main, 13. February 2017*

**altii: Why are you investing in European Senior Secured Loans?**

**Michael Craig:** Investors in European Senior Secured loans (EUR SSL) have received consistent, low volatility returns for two decades. The Credit Suisse Western European Leverage Loan Index (CS WELLI), a proxy for the market, has averaged a 5.4% annual return since inception in 1998, with only three negative return years in that 19 year period. The total return for 2016 was 6.5%. Historically the European Loan market has exhibited less volatility than alternative fixed income risk assets such as European High Yield (HY) bonds; the five year average volatility of the CS WELLI was 2.15% vs. 4.91% for the HY market. Accordingly, the loan market has had a higher Sharpe ratio than the CS Euro HY market, 2.77 vs. 1.85, respectively, for the five year period 2012-2016.

**altii: Why is now a good moment to invest?**

**Michael:** The Eurozone GDP growth, albeit modest, as well as a healthy, supply and demand balance in the underlying loan market are positives for European SSL. Furthermore, volatility is likely to remain low as European CLO and institutional investors, who tend to invest over the long-term dominate the investor base. This is an advantage over the Fixed Income markets, where retail (ETF, etc.) investors typically have shorter investment horizons are more prevalent.

There are two macro themes that add to the attractiveness of European SSL in 2017. Over recent years, long-duration asset classes have benefited tremendously from European Central Bank’s (ECB) stimulus policies. The question has been “when” not “if” the ECB will provide incremental stimulus. We are anticipating a softening in ECB policies, driven primarily by inflation data. The new question that will increasingly be asked will be “when” will the ECB start weaning the market off its accommodative monetary policy, which naturally leads to a rising interest-rates (Euribor) environment. This should lead to more demand for shorter-duration assets such as SSL, which are less sensitive to interest rate changes, than say, high yield bonds for example, as loans provide floating-rate income with coupons based on Euribor + margin. As the majority of European loans are structured with a minimum (i.e. floor) of zero per cent for the Euribor component (as at Dec. 30, 2016, 3 month Euribor was -0.3%) they are therefore insulated from Euribor’s current negative value and investor coupon income, will increase when Euribor surpasses the zero per cent floor value. In a steeping yield curve environment, the asset class has the potential to outperform longer-duration assets.

We also see a repeat of the heightened sensitivity over political events. The lack of reliable predictive tools for election results has led to increased market volatility before and after these events. Against this backdrop, we believe European SSL present a compelling allocation opportunity for investors given their defensive position in the capital structure (high recovery rate) and historically lower volatility than other fixed rate alternatives.

**altii: What are the biggest risks?**

**Michael:** The investor concern is often focused on the risk that a macro shock could lead to an increase in defaults. While loan volatility is relatively low, the risk of contagion from other asset classes and macro
events does exist.

Heading into 2017 credit fundamentals remain stable, with no clear catalyst for a spike in default rates – the macro-economic environment is supportive of risky assets with the Eurozone benefiting from the same trends seen in 2016: private sector demand and supportive government spending. At the borrower level, credit metrics look robust – particularly in terms of interest coverage, a measure of a company’s ability to meet its interest obligations, with coverage-ratios improving as several borrowers were able to their lower cost of debt and/or extend maturities throughout 2016.

The European loan market has limited systemic risk given it’s the minimal exposure to the Oil and Gas sector. Nevertheless, there are likely to some pockets of weakness. For example, some retailers and food manufacturers are exposed to softer demand (channel shift, macro-uncertainty and change in consumer habits) and dollar-denominated sourcing costs (cotton and food commodities) are vulnerable.

We expect a default rate of around 2% by principal amount - which remains well below the 4.6% historical average between 2009 and 2015.

**altii: Why is Invesco a good partner for such strategies?**

**Michael:** Invesco has been in the senior bank loan market for over 27 years – we launched our first European bank loan product in 2001. With $37.9 billion in bank loan assets under management, Invesco is one of the largest managers of the asset class. Our investment process is built on fundamental bottom-up credit analysis with a top-down macroeconomic overlay. Importantly, we view our investment process as full cycle. The investment horizon always looks across a full credit cycle with the belief that returns are maximised over the long run for all private, credit-sensitive assets such as senior bank loans. This long-term perspective is augmented by an active management approach that includes well-defined buy-sell disciplines and the application of several proprietary models which help us exploit shorter-term relative value opportunities during different phases of the cycle.

Our key credit consideration is twofold: (1) What is the risk of credit deterioration, or default, and (2) What is the recovery in the event of that credit deterioration? At Invesco, we employ 29 senior secured bank loan credit professionals focused on minimising credit risk. We perform due diligence on every issuer in our portfolio, focusing on key factors such as management quality, base case and downside cash flow projections, industry position and dynamics, sponsors and arrangers, the issuer’s capital structure, the asset quality and divisibility of the underlying security, the recovery rate, loan-to-value and relative value.

**About Invesco**

At Invesco, we’re dedicated to delivering an investment experience that helps people get more out of life. This means our employees as well as our clients, shareholders and the communities we serve. We strive to achieve this through our:

- Pure focus on investment: We are independent and solely focused on investment management for the benefit of clients.
- Diversity of thought: includes our comprehensive range of investment capabilities and geographies. It also reflects our collegial culture and collaborative decision-making style.
- Passion to exceed – our culture of high performance and not settling for average in everything we do.

We are privileged to manage assets on behalf of retail and institutional clients around the world by providing a comprehensive range of high-conviction investment capabilities designed to help clients achieve their investment objectives.

**About altii**

alternative investor information (altii – altii.com) is the digital marketing and online portal for all asset management strategies in the German-speaking regions (D/A/CH), altii is focusing on institutional investors and has a public and a product area. For investors the service is free of charge. The portal www.altii.de/en is supported by a targeted newsletter and through clear social media campaigns. www.altii.com, info@altii.de, @altii_news, +49 69 57708987

---

**altii content link**

The altii content link AL126544 references links from print to online. The identifier can be typed into a search box on altii.de or referenced directly by www.altii.de/AL126544. This delivers specific access to further reading materials, videos, strategy information and a lot more.