February 1, 2024

January Wrap: Loans return 0.68% as momentum slows; net supply remains elusive

By: Marina Lukatsky

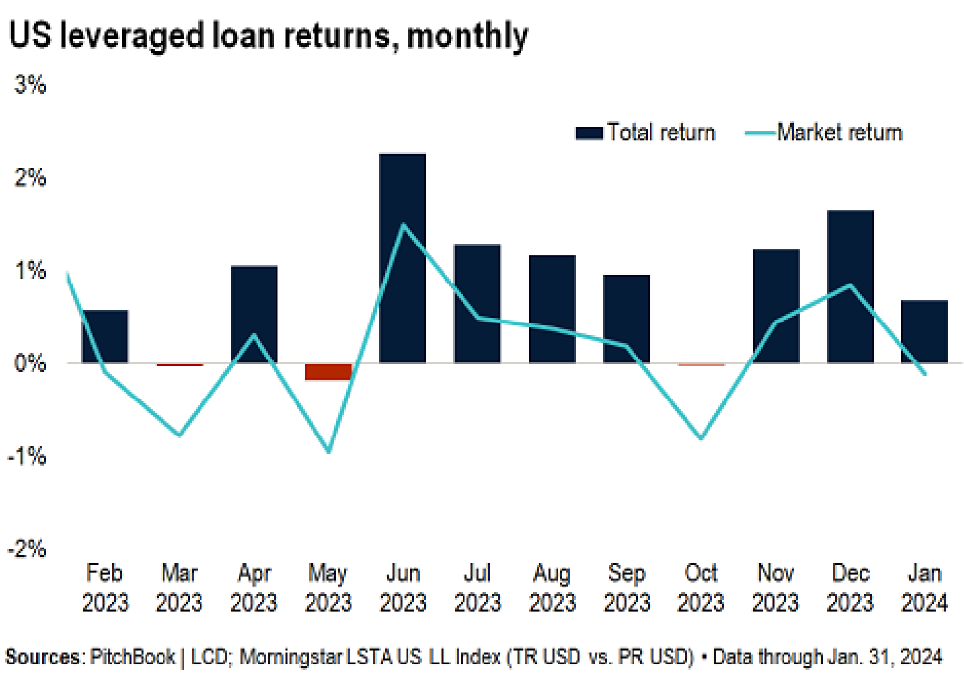
The Fed-pivot rally that propelled loan prices to an intra-year high by the end of December took a breather in January, bringing leveraged loan returns closer to historical averages. With little new-issue supply hitting the market and a still-strong technical backdrop, arrangers unleashed a barrage of refinancing and repricing transactions, culminating in the busiest primary market in seven years. However, net supply remains painfully elusive, and the size of the loan asset class shrank further.

Highlights:

- The Morningstar LSTA US Leveraged Loan Index posted the lowest gain in three months in January, at 0.68%.
- Gross leveraged loan volume surged to a seven-year high during the month, at $171 billion, but a record low 10.6% represents net supply.
- Refinancing-related issuance sets a new high in January, on the back of record activity from single-B borrowers.
- Repricing wave sweeps through the market — 10.4% of outstanding loans have been repriced since the start of September.
- The gap between supply of and demand for loans widens to the highest level since October 2021.

The Morningstar LSTA US Leveraged Loan Index gained 0.68% in January, starting off 2024 in less-spectacular fashion than in 2023, returns-wise. Last year the index gained 2.67% in January, the strongest month for that year, putting loans on the path to the highest annual gain since 2009. Last month's performance fell short of December and November gains, each topping 1%, but exceeded the 10-year monthly average of 0.37%.

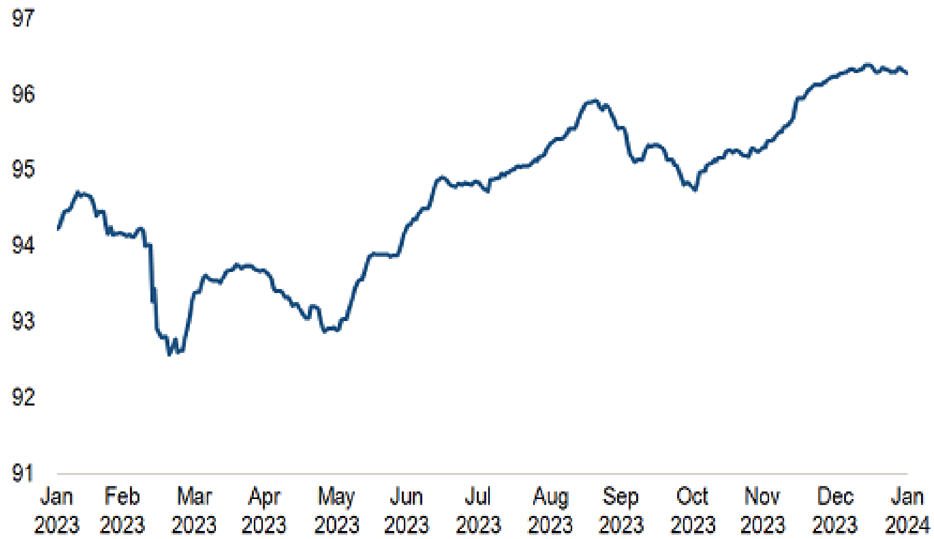
The market value return — which measures changes in secondary prices — was negative 0.12% last month, the first loss for any January in eight years. On average, leveraged loans have gained 0.89% per month over the last year, on a total return basis, and 0.12% on a market value basis.



The Morningstar LSTA US Leveraged Loan 100 Index, which measures the performance of the 100 largest issues in the US leveraged loan market, underperformed the broader index last month, gaining 0.32%, as it featured a steeper market value loss, down 0.44%. These most-liquid names posted higher gains in December, versus the LLI, as their prices advanced more dramatically during the end-of-year rally.

The weighted average bid of the broader index advanced 15 bps in the first two weeks of January, to 96.38, the highest reading since May 2022, before giving back some of these gains and closing out the month at 96.27. Recall that the weighted average bid advanced by 147 bps in November and December combined.

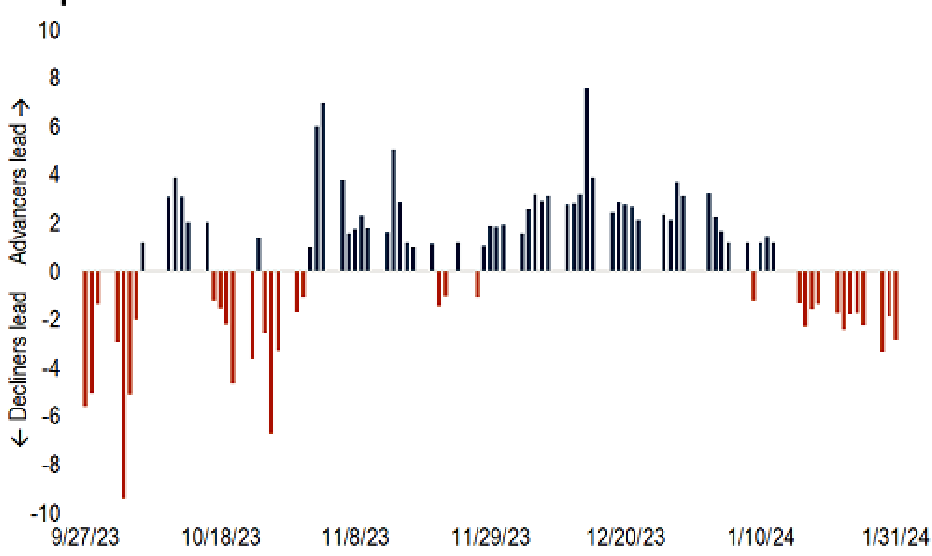
Weighted average bid of US leveraged loans



Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through Jan. 31, 2024

The shift in momentum at mid-month was evident in the advancer and decliner data. Advancers outnumbered decliners in virtually every trading session through Jan. 12, by an average ratio of 1.7 to one. However, in the last two weeks, decliners outnumbered advancers every day, by an average ratio of 2 to one. This is a notable departure from December, which was the only month last year when gainers led 100% of the time.

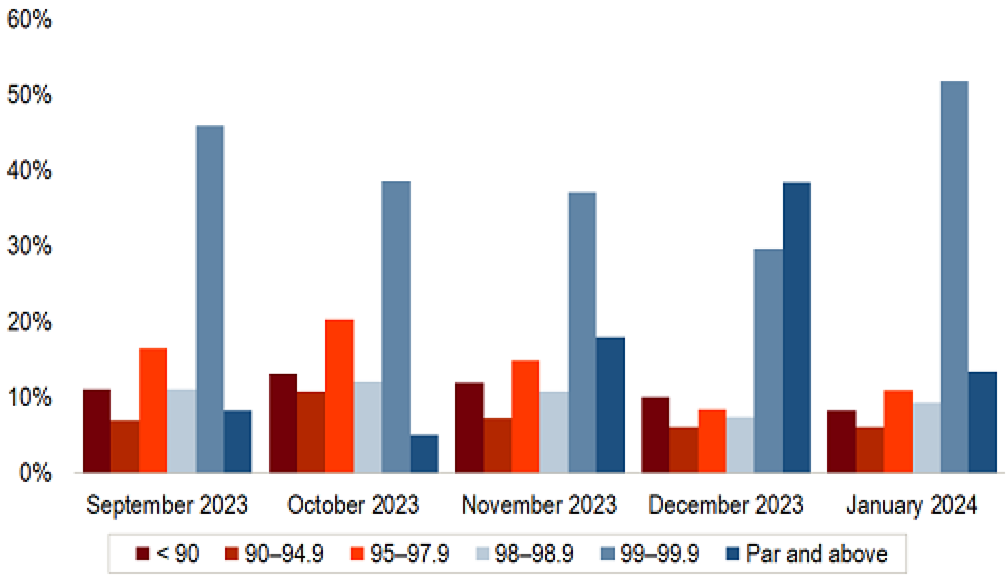
Bid price advancer/decliner metric



Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through Jan. 31, 2024

The market conditions softened in the latter part of January, with the share of performing loans priced at par and above retreating to 13% by month-end after topping 40% early this year. The bulk of the index is now in the 99-to-just-below-par bucket, with a 52% share, versus 30% at year-end.

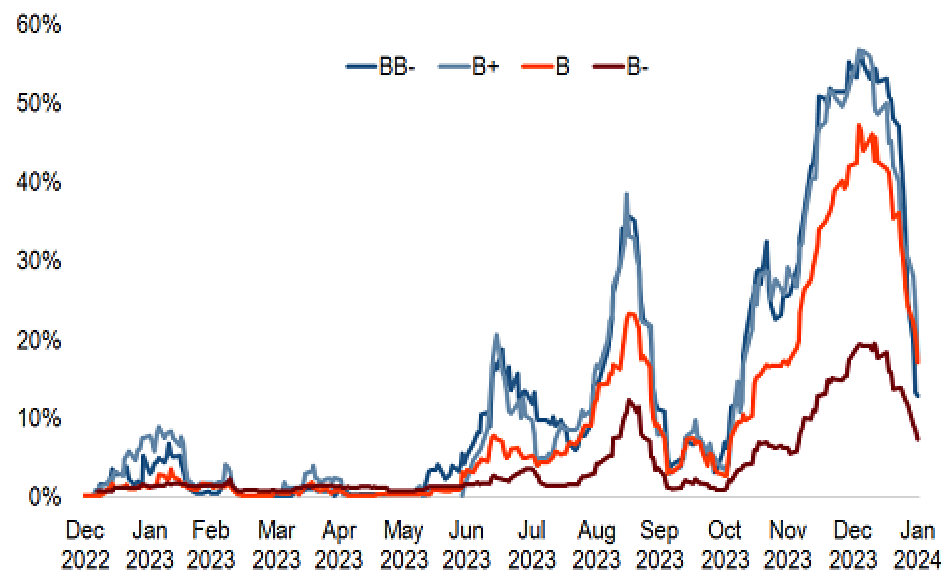
Distribution of outstanding US leveraged loan prices



Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through Jan. 31, 2024

Looking at the data by borrower rating, 57% of loans issued to companies rated BB-minus were priced at par or better in the first week of January, the highest reading since January 2021, but by the end of the month this share fell to 13%. Borrowers rated B-plus followed a similar trend, with 17% of the cohort falling into the par-or-better category at month-end, versus 57% a few weeks earlier. At the lower end of the credit quality spectrum, 7% of borrowers with a B-minus rating were in the par-or-higher cohort as of Jan. 31, down from a recent high of 20%.

Loans priced at par and above by issuer rating

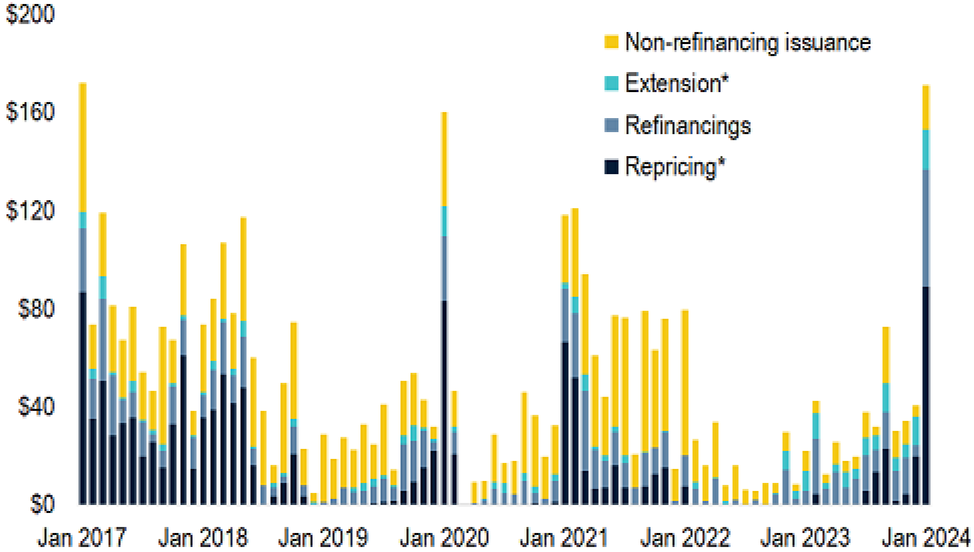


Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through Jan. 31, 2024

Refinancing and repricing frenzy

An elevated share of loans priced at par or above typically serves as a threshold for opportunistic activity, such as repricings, refinancings and dividend recaps. Indeed, this type of activity surged last month, bringing the gross leveraged loan activity to a seven-year high, at $171 billion. However, only 10.6% of this massive amount represents net supply — loans raised to finance buyouts, corporate acquisitions and other non-refinancing-related activity. This is the lowest share since the Global Financial Crisis.

US institutional loan volume ($B)



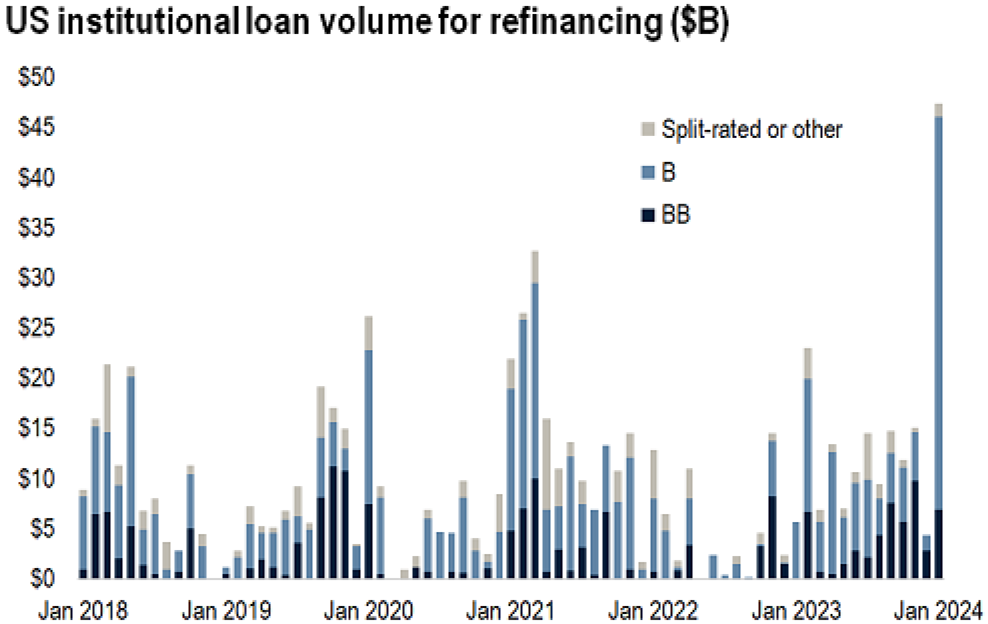
Source: PitchBook | LCD • Data through Jan. 31, 2024
*Reflects repricings and extensions done via an amendment process only

Breaking down that massive level of activity, borrowers seized the window of opportunity to lower interest expense at the fastest clip in four years. LCD tracked $91.2 billion of repricings in January, with the vast majority done via an amendment, the highest reading since $94.1 billion in January 2020 and the third-highest reading on record. In fact, last month's figure is only 10% short of the all-time high set in January 2017 (which was $101 billion), and more debt has been repriced in the first month of 2024 than during all of 2023 ($81.3 billion). Looking back to the start of September, $143 billion of loans have been repriced, representing 10.4% of the institutional loan market tracked by the index. Repricing transactions last month have allowed issuers to reduce spreads by 55 bps, on average.

Outside of repricings, refinancing-related loan volume rose to the highest level on record, $47.4 billion, as new-issue spreads contracted to multi-year lows, bringing many borrowers off the sidelines. Prior to January, refinancing-related loan volume averaged roughly $8 billion per month since the Fed started hiking rates. In 2021, when spreads dipped to near-record lows, the average was about $15 billion.

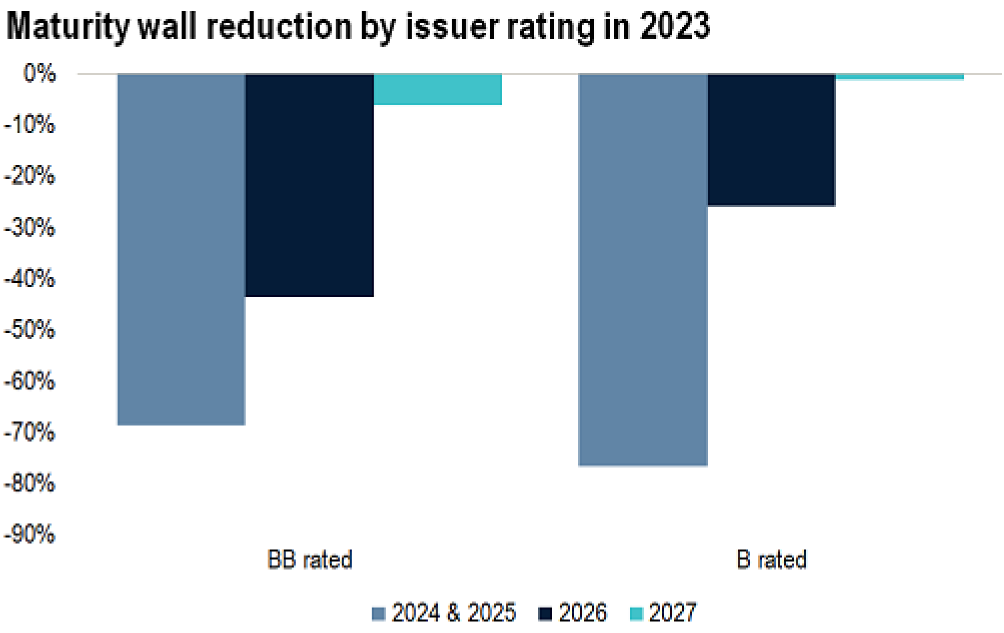
So far in 2024 spreads have reverted close to those 2021 levels, averaging Sofr+250 for term loans issued to BB or BB- borrowers, and Sofr+370 for B or B+ transactions. These levels are about 30% lower than 2022/2023 peak spreads for both cohorts.

Lower-rated companies accounted for a record $39.1 billion of January's refinancings, up from just a $6.3 billion average in 2023 and a $2.3 billion average in 2022. That January tally translates to an 83% share of total refinancing volume, up from 60% in 2023 and 50% in 2022. To put these numbers into perspective, double-B rated borrowers make up roughly 20% of all outstanding loans, while single-B companies account for 65%, by volume.



Source: PitchBook | LCD • Data through Jan. 31, 2024

Last year, borrowers rated B, B+ or B- made slightly more progress than the higher-rated companies in tackling their near-term maturity walls, but the trend flips when looking at maturities further out. The 2026 cohort was reduced by 44% for higher-rated names and 26% for lower-rated names. Loans falling due in 2027 were roughly unchanged for single-Bs while double-B rated borrowers cut down these outstandings by 6%.

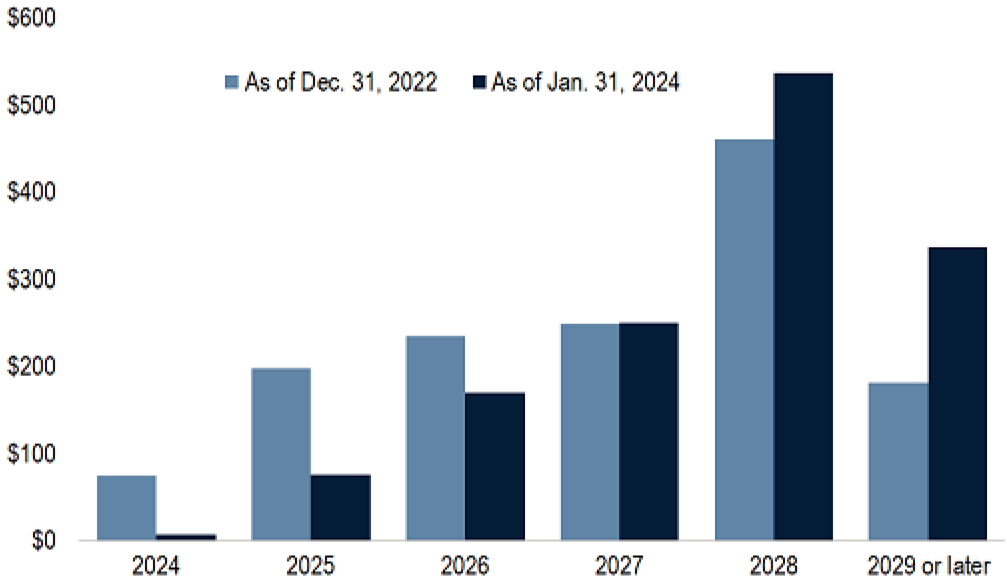


Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through Dec. 31, 2023

Now these lower-rated borrowers are jumping off the sidelines as spreads decline to multi-year lows, to not only reduce the near-term maturity walls, but to refinance more expensive debt — like second-lien term loans — or to take out loans that would not fall due for a number of years. LCD tracked 10 single-B rated borrowers that replaced second-lien paper with a first-lien term loan in January.

As a result of these refinancing efforts, combined with continued amend-and-extend activity, all borrowers tracked by the index reduced 2025 maturities by 9% in January alone, to $76 billion. Maturities for 2026 were cut down by 3% last month, to $171 billion, while 2027 maturities were reduced by 1%, to $251 billion. Nearly 40% of the loan index will mature in 2028, totaling $537 billion.

US leveraged loan maturity wall ($B)



Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through Jan. 31, 2024

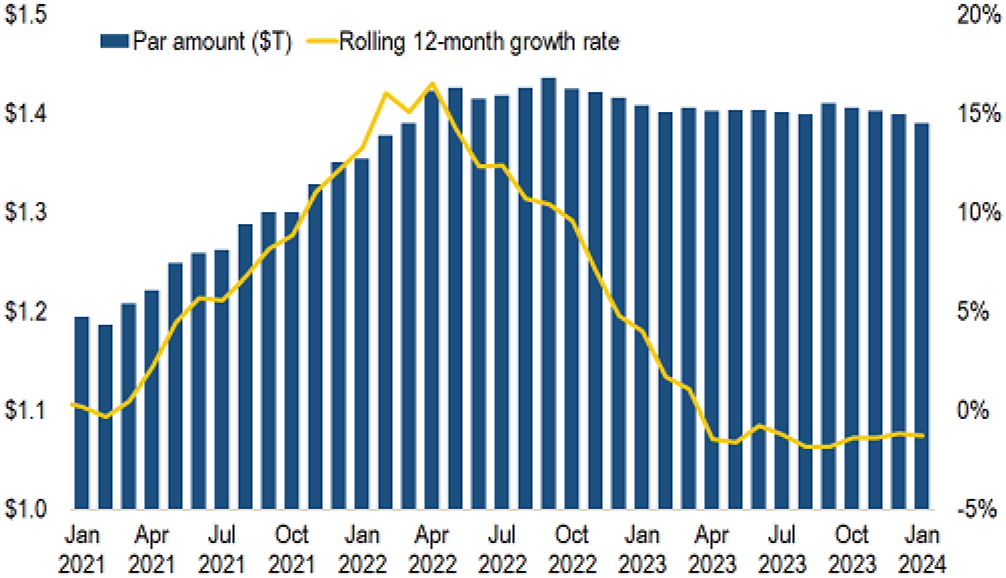
Shrinking asset class

Despite a blizzard of activity in the new-issue loan market last month, M&A activity has yet to return in a meaningful way. As a result, the technical imbalance that grew last year continues to widen.

LCD measures net loan supply as the change in outstandings, per the Morningstar LSTA US Leveraged Loan Index (or newly issued loans joining the index), minus loans being repaid. LCD defines investor demand as CLO issuance combined with cash inflows/outflows at retail investor loan funds.

About that supply: The par amount outstanding tracked by the index declined to $1.39 trillion last month, down $9.2 billion from the final reading of 2023. The size of the index has contracted in 10 out of the last 12 months, and the current par amount outstanding is 3% below the peak size for the asset class, $1.436 trillion set in September 2022. Last year, the loan market contracted for the first time since 2010. Prior to 2023, the loan asset class had grown by an average of 7.5% per year after the Global Financial Crisis.

Morningstar LSTA US LL Index: Par amount outstanding



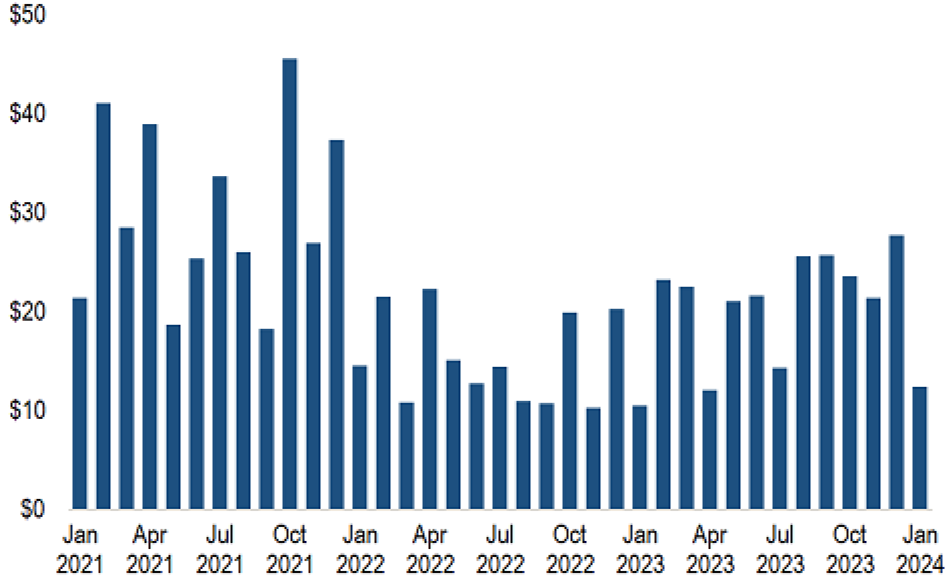
Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through Jan. 31, 2024

The universe of outstanding loans continues to shrink as M&A activity, which fuels the growth of the asset class, remains painfully constrained. So far this year speculative-grade borrowers raised only $7.9 billion of institutional leveraged loans for this purpose, slightly higher than during the same period last year but just a fraction of the $26 billion average during comparable periods between 2013 and 2022. Recall that total 2023 issuance of $70 billion was a post-GFC low, with the monthly average of $5.8 billion.

LCD's total forward calendar, which comprises transactions still in market or announced, but not yet launched, does not suggest an uptick in this activity in the near term. The calendar grew to $33.2 billion by the end of January, the highest reading since September 2022 and more than double the amount from the prior January. However, only $6.1 billion of that tally is intended to finance an LBO, acquisition or other type of M&A, in line with 2023 levels. For reference, in the first quarter of 2022, before the rate hike cycle began, this metric averaged nearly $30 billion.

At the same time, repayments retreated to $12.4 billion in January from $27.7 billion in December. Many of the largest January refinancings launched in the latter part of the month and had not translated into an index repayment by month-end, such as the $5.385 billion first-lien term loan for UKG Inc or the $3.435 billion seven-year term loan for Howden.

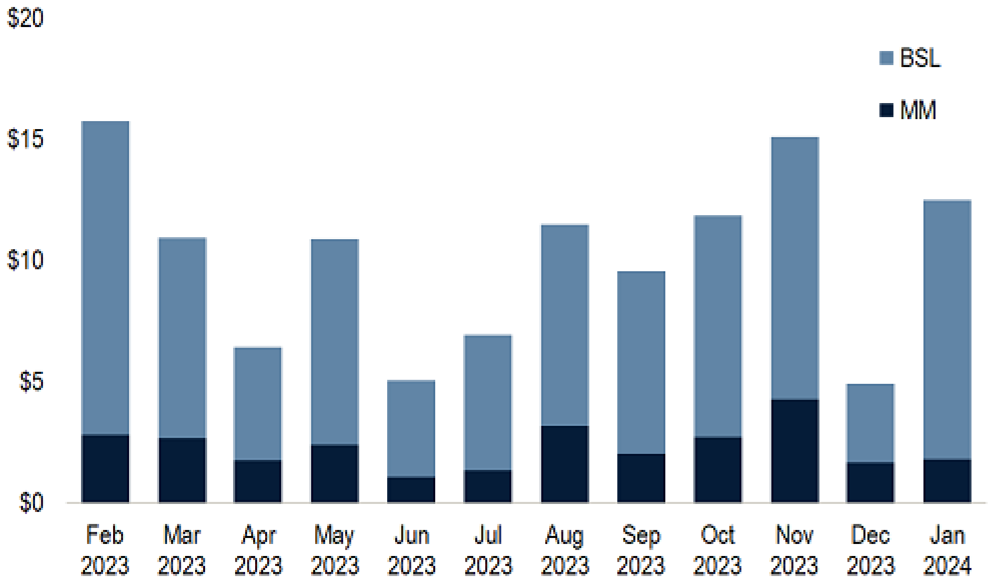
Morningstar LSTA US LL Index: Monthly repayments ($B)



Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through Jan. 31, 2024

Turning to demand, which LCD defines as CLO issuance combined with retail cash flows to US loan funds: US CLO managers priced 29 new-issue loan securitizations in January, totaling $12.5 billion, the highest-ever January level for new-deal CLO issuance. For comparison's sake, in January 2021 managers priced $9.2 billion on their way to a record $187 billion in full-year primary-market pricings. Tighter spreads are driving much of the broadly syndicated CLO activity, as deal costs decline for managers. The average coupon cost in January for two-year non-call vehicles (S+161 bps) falls inside the comparable Q4 average of S+176 bps.

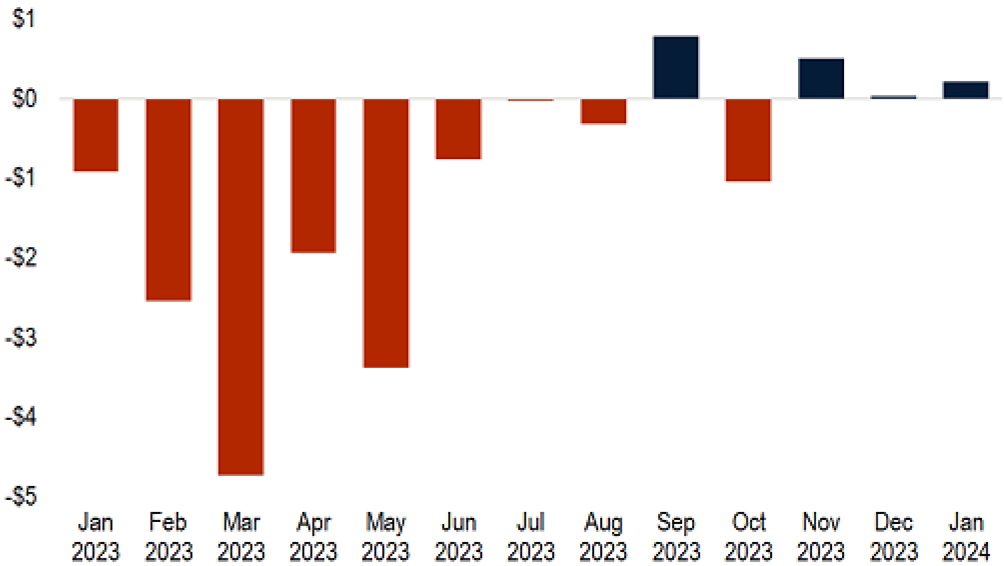
US monthly CLO issuance ($B)



Source: PitchBook | LCD • Data through Jan. 31, 2024

At the same time, investors pumped $215 million into loan retail funds in the four weeks ending Jan. 24, based on Morningstar data, a third month of inflows after October's withdrawals. The momentum shifted notably in the second half of last year, with a 50/50 split between inflows and outflows, on a weekly basis. In contrast, only one week registered an inflow in 2023's first half, and the first four weeks of the year saw $921 million of combined withdrawals.

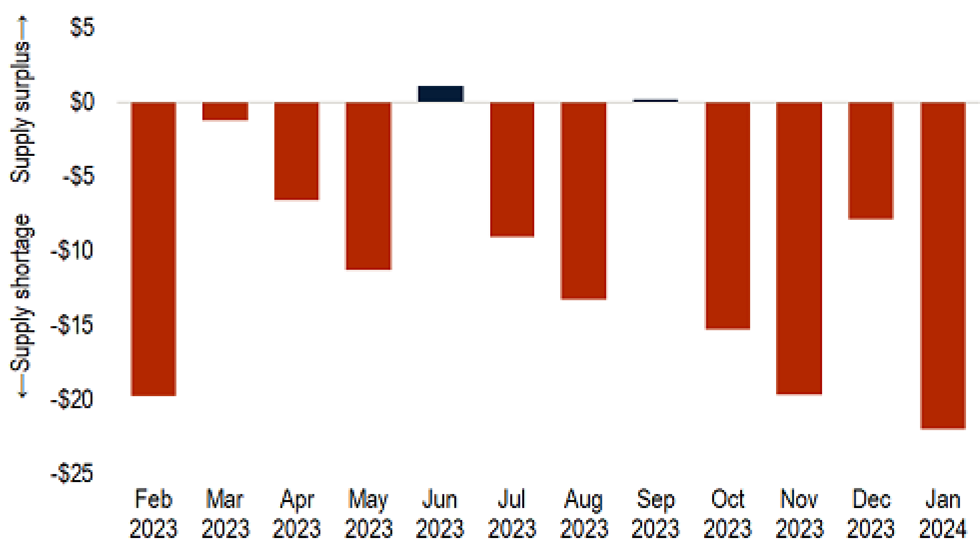
US loan prime-fund flows (weekly reporters only, $B)



Source: Morningstar Direct Asset Flows • Data through Jan. 24, 2024

More broadly, LCD estimates $307 million of inflows to retail loan funds in January (including monthly reporters), up from a $205 million investment in December. Adding this to CLO issuance ($12.5 billion) results in a total measurable demand of $12.8 billion, up from $5.1 billion in December and $8.2 billion monthly average last year. Combining the $9.2 billion decrease in outstandings in January — the proxy for supply — with $12.8 billion of measurable demand left the market with a $22 billion supply shortage, the most severe monthly shortage since October 2021. This adds to the $115 billion gap between supply and demand recorded in 2023.

US leveraged loan market, supply vs investor demand ($B)



Source: PitchBook | LCD • Data through Jan. 31, 2024
Based on (a) new issuance minus repayments minus (b) CLO issuance and Prime Fund inflows

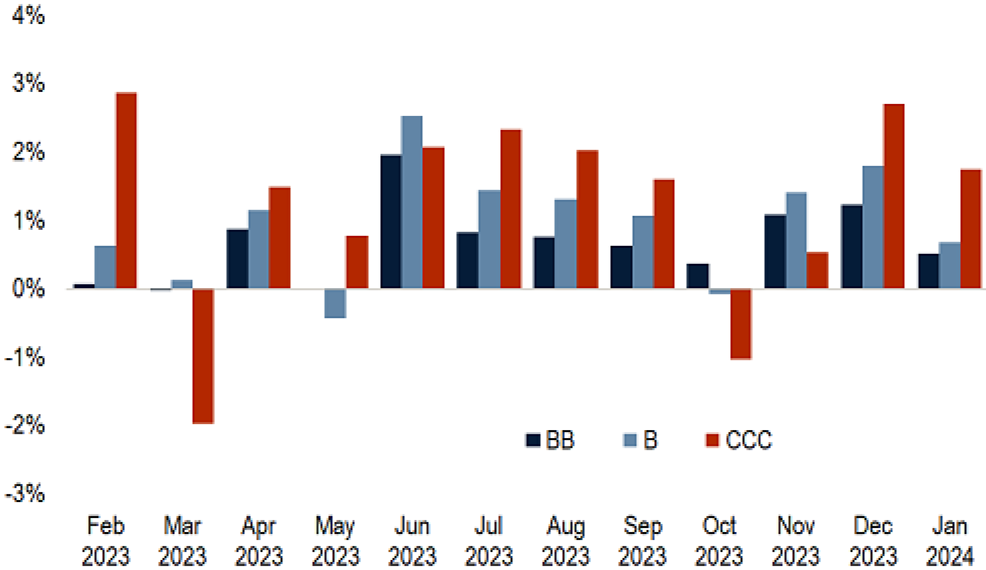
Riskiest names outperform

The riskiest names outperformed in the first month of 2024. Double-B rated loans, which account for roughly one-fifth of the index, gained 0.52%, the weakest performance in three months. Single-B loans, which account for a 61% share of outstanding universe tracked by the index, gained 0.67% in January, also the lowest reading since October.

The difference in performance between the two ratings buckets stemmed from a slightly higher market value loss for double-Bs, which were down 19 basis points, versus 14 bps for single-Bs. In addition, given their lower rating, single-B loans also carry higher margins, on average, and as a result the interest return is also higher.

However, it was the triple-C sub-index that ran ahead in January, for the second month in a row, with a 1.74% gain, including a positive market value return of 0.65%. In fact, out of these three ratings-based sub-indices, the CCC index was the only subset that outperformed its trailing 12-month average return.

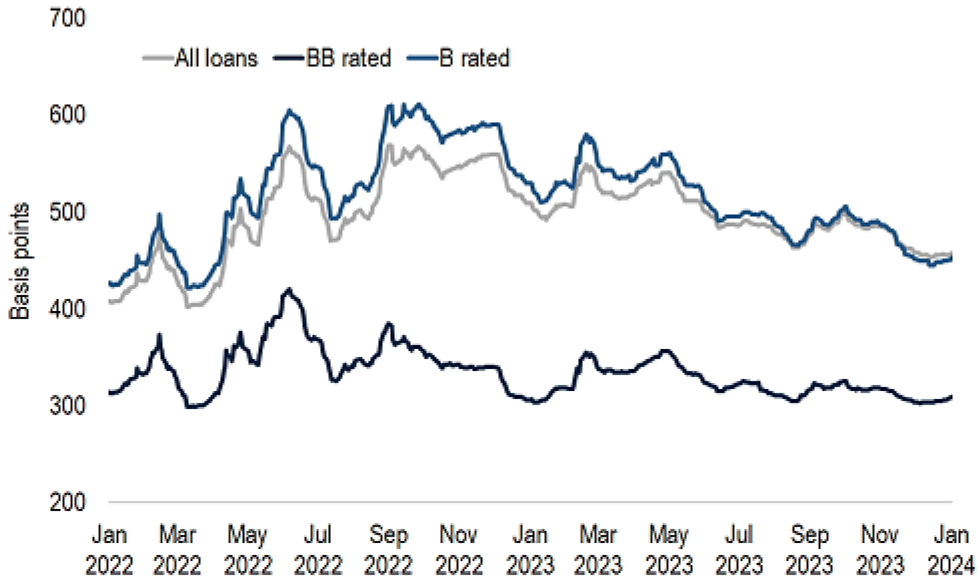
Morningstar LSTA US LLI monthly returns by facility rating



Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through Jan. 31, 2024

In January, the secondary spread-to-maturity (STM) was relatively unchanged for higher-rated names tracked in the index. STM accounts for the nominal spread and bid price of the loan. On Jan. 31 the weighted average STM on double-B rated loans was 310 bps, slightly above the year-end level and in line with a year-ago reading. Meanwhile, the STM of the single-B cohort was unchanged, at 452 bps, the tightest point since May 2022 and roughly 80 bps below the January 2023 level. As a result, the gap between the two cohorts contracted to just 142 bps, the lowest reading since May 2022 and more than a full point below levels at the start of 2023.

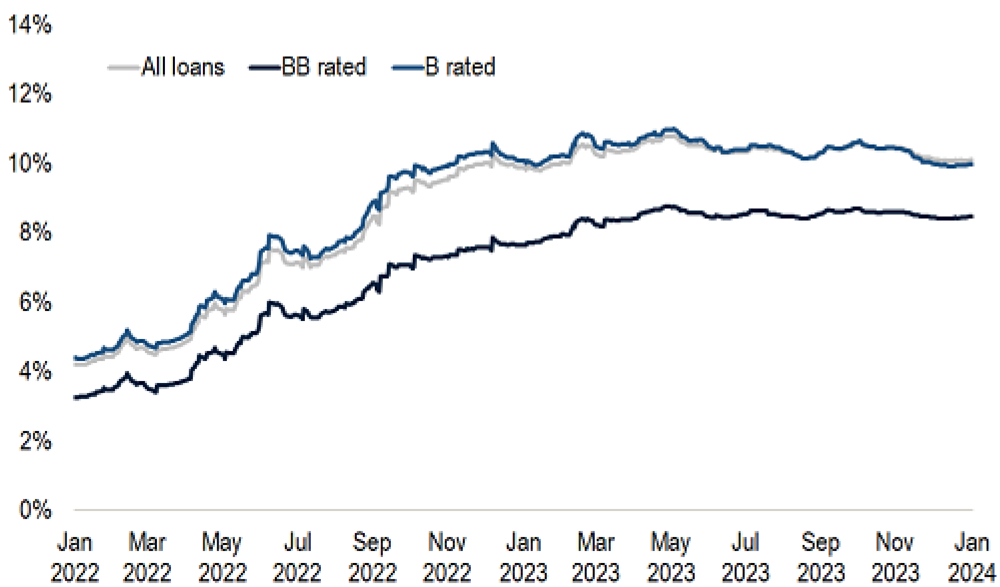
Secondary spread-to-maturity by S&P Global loan rating



Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through Jan. 31, 2024

Across the entire index, the average STM was 458 bps at the end of last month, the lowest reading since May 2022. At the same time, the yield-to-maturity, which also accounts for the base rate, declined to 10.10% for the overall index at month-end, the lowest reading since early March, and down roughly 70 bps from the 2023 peak in early June. Leveraged loan secondary yields were 10% at the end of 2022 and 4.2% at the end of 2021. On average, single-Bs were yielding 9.99% last month, the first time below 10% in almost a year, while double-Bs were yielding 8.48%, with the lesser-rated cohort shaving off nearly a point from 2023 highs.

Secondary yield-to-maturity by S&P Global loan rating



Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through Jan. 31, 2024

PitchBook | LCD

US leveraged loan returns by sector, with weight greater than 1%		
Top ten	**January**	**MV weight**
Automobile Components	1.53%	1.75%
Media	1.30%	4.12%
Health Care Providers & Services	1.28%	5.00%
Construction & Engineering	1.19%	1.29%
Health Care Technology	1.01%	1.95%
Specialty Retail	0.95%	3.05%
Chemicals	0.90%	3.77%
Independent Power and Renewable Electricity Producers	0.87%	1.18%
Building Products	0.86%	1.47%
Professional Services	0.85%	3.20%
Bottom ten		
Diversified Telecommunication Services	-0.06%	3.65%
Health Care Equipment & Supplies	0.21%	1.41%
Diversified Consumer Services	0.30%	1.58%
Entertainment	0.33%	1.72%
Electronic Equipment, Instruments & Components	0.37%	1.10%
Software	0.39%	11.79%
Ground Transportation	0.41%	1.19%
Insurance	0.49%	3.19%
Life Sciences Tools & Services	0.54%	1.65%
Hotels, Restaurants & Leisure	0.54%	5.48%

Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through Jan. 31, 2024

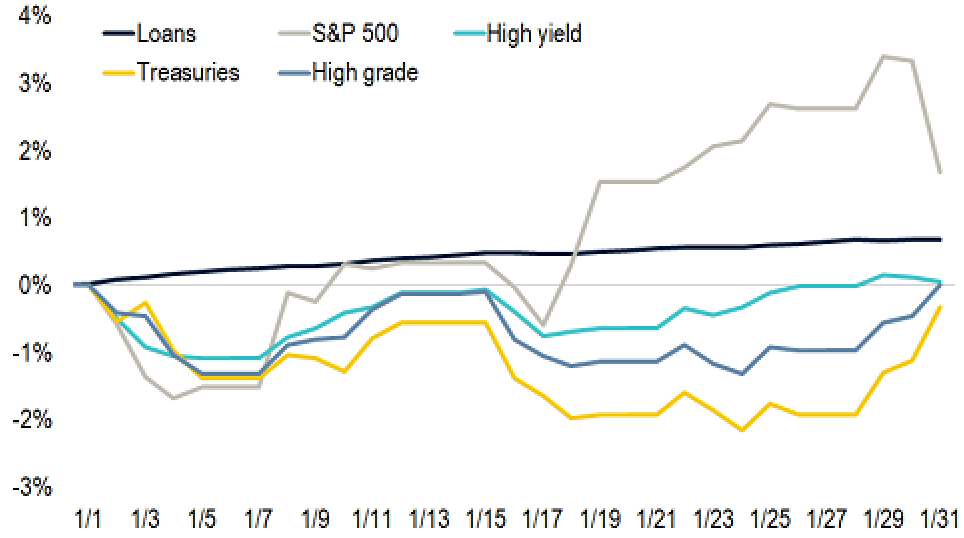
Other asset classes

High-grade bond returns were flat on the month as spread-tightening offset the pressure on prices from weaker Treasuries, versus a marginal 0.05% gain for high-yield and a 0.7% gain for loans. High-grade bonds have solidly outperformed high-yield and loans since the Fed triggered a rally in credit with a dovish statement at the Nov. 1 FOMC statement, though loans and high-yield retain much stronger performance net of the last 12 months.

Treasuries stumbled out of gate in 2024 after a powerful rally over the final two months of 2023, with the 10-year Treasury note returning negative 0.3% for the month. The benchmark closed at 3.97% on Jan. 31, up on net from 3.86% at the end of December, with high trades in January near 4.20%.

Rate volatility notwithstanding, the notion of easier Fed policy ahead continued to channel investor funds to equities. The S&P 500 saw new all-time highs in the closing sessions of the month, driving a 1.68% gain for that index, which has now returned more than 16% since the November FOMC meeting, and nearly 21% over the last 12 months.

Returns by asset class, Jan. 1–31, 2024



Sources: PitchBook | LCD; Morningstar; S&P Dow Jones Indices • Data through Jan. 31, 2024

Returns by asset class

	Jan 2024	Dec 2023	3ME	LTM
Morningstar LSTA US LL Index	0.68%	1.65%	3.58%	11.12%
Morningstar US High-Yield Bond	0.05%	3.68%	8.48%	9.24%
Morningstar US Corporate Bond	0.00%	4.12%	10.34%	4.35%
S&P 10-year Treasury Index	-0.32%	4.20%	8.90%	-0.27%
S&P 500	1.68%	4.54%	16.01%	20.82%

Sources: PitchBook | LCD; Morningstar; S&P Dow Jones Indices • Data through Jan. 31, 2024

Biggest movers

Of the loans that lost ground last month, the top five are rated CCC+ or lower, and only three are in the single-B ratings bracket. Leading the biggest decliners was GoTo Group, formerly known as LogMeIn, which was downgraded on Jan. 12 to CCC+ by S&P Global Ratings, with a negative outlook. The agency cited a projected free operating cash flow deficit and high leverage. The issuer was cut to Caa1 by Moody's in November.

US leveraged loan "big movers" in January 2024			
Down	**S&P Global loan rating**	**Sector**	**Index return contribution**
GoTo Group, Inc.	CCC+	Software	-0.0271%
Securus Technologies Inc	C	Diversified Telecommunication Services	-0.0137%
Covis Pharma Sarl	CCC-	Health Care Providers & Services	-0.0105%
McAfee Enterprise	CCC-	Software	-0.0093%
Xplornet Communications Inc	CCC+	Diversified Telecommunication Services	-0.0092%
Weight Watchers International Inc	B	Diversified Consumer Services	-0.0081%
Research Now Group Inc	CCC	Software	-0.0064%
AMC Entertainment Inc	B-	Entertainment	-0.0055%
Heubach Group	D	Chemicals	-0.0050%
STG Logistics Inc	B-	Air Freight & Logistics	-0.0040%
Up			
Air Medical Group Holdings Inc	CCC+	Health Care Providers & Services	0.0212%
Sinclair Broadcast Group	BB-	Media	0.0167%
Radiology Partners, Inc	CCC+	Health Care Providers & Services	0.0114%
SFR	B-	Diversified Telecommunication Services	0.0110%
Cablevision Systems	B	Media	0.0087%
Team Health	CCC	Health Care Providers & Services	0.0080%
Tenneco Automotive	B	Automobile Components	0.0074%
PowerTeam Services	CCC+	Construction & Engineering	0.0061%
Asurion Corporation	B	IT Services	0.0061%
Cloud Software Group, Inc.	B	Software	0.0059%

Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through Jan. 31, 2024

Notable among the largest secondary market gainers in January was Sinclair Broadcast Group, which announced mid-month that it settled all outstanding litigation with bankrupt subsidiary Diamond Sports Group.