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Floating-Rate Loans | Leveraged Credit | Multi-Asset Credit

Loans Stand Out in Wake of War's Shock

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Boston - Heavyweight boxer Mike Tyson once said that "everyone has a plan until they get punched in the mouth." From the perspective of whether an asset class can "take a punch," floating-rate loans are a standout in fixed-income portfolios.

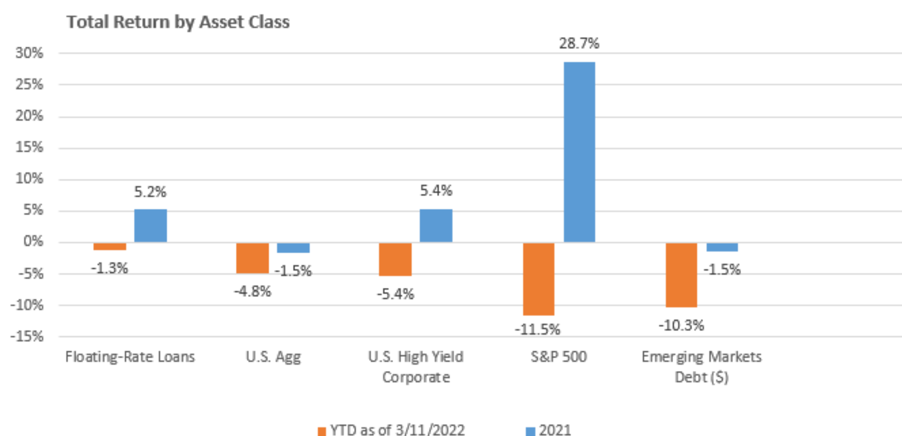
Of course, the Russian invasion of Ukraine is first and foremost a great humanitarian crisis that has shocked the world. But the second-order impact has shaken global capital markets and forced investors to revisit the bullish outlook for credit that was in place just a couple of months ago.

At the start of 2022, our expectations for a strong year in loans were guided by robust economic activity and a strengthening labor market, low credit stress and the structural tailwinds of the U.S. Federal Reserve's anticipated tightening cycle.

That was the plan then, and to some extent, it remains so now. Like capital markets at large, however, this outlook is suddenly subject to the vagaries of the war's impact on inflation, commodity prices, supply chains and other known and unknown variables — including investor confidence. It will take a while for uncertainty to abate. In the meantime, the floating-rate loan asset class has showcased its "anti-fragility" yet again.

Consider the chart below. Loans have held up better than all other major U.S. asset classes for the first two months of the year —down slightly more than 1% in total return, as measured by the S&P/LSTA Leveraged Loan Index. In contrast, U.S. equities are down more than 11%, and a spectrum of fixed income asset classes have fallen around 5%, with emerging markets debt naturally faring the worst.

Loans have held up better after Russia's invasion of Ukraine, as in 2021



"While loans have certain tailwinds and innate strengths relative to other asset classes, predictions can be especially hazardous in today's environment. However the crisis develops, we believe that active management may help to ensure that loan portfolios remain well positioned."

Sources: Eaton Vance, S&P/LSTA, Bloomberg, as of March 11, 2022. Data provided is for informational use only. Past performance is no guarantee of future results. It is not possible to invest directly in an Index. Loans are represented by the S&P/LSTA Leveraged Loan Index, an unmanaged index of the institutional leveraged loan market. High-yield bonds are represented by the ICE BofA U.S. High Yield Index, an unmanaged index of below-investment-grade U.S. corporate bonds. U.S. Agg is the Bloomberg U.S. Aggregate Bond Index, included as a broad measure of U.S. investment-grade bonds; it is an unmanaged index of domestic investment-grade bonds, including corporate, government and mortgage-backed securities. Emerging markets debt is represented by the JPMorgan Emerging Markets (EMBI), a broad measure of U.S. dollar-denominated government and corporate emerging markets bonds.

The performance of loans *last year* tells an equally important story. As most of the bond market sold off in 2021 in anticipation of rising inflation and interest rates, loans were second only to high yield bonds in total return. Thus, in 2021's strong growth environment — and so far in this year's case of shock — an allocation to loans has showcased its value to fixed income portfolios.

How are loans shaking this off?

We believe much of the stability stems from an orderly market where supply and demand are well balanced — at the end of the day, that's what determines pricing. New-issue volumes have been more modest of late, given broader market volatility and now moderately higher yield levels, so that has been helping. Meanwhile, collateralized loan obligations (CLOs) continue to be created. This proxy for institutional buyers has been further supported by net buying in retail loan mutual funds. Both sides of the institutional/retail divide have been showing net inflows into the asset class.

The picture of steady flows can perhaps be attributed to several factors. Most topical at the moment, *no issuers in the asset class are domiciled in Russia or Ukraine*. To be sure, we have analyzed not only the S&P/LSTA index but also the S&P European Leveraged Loan Index, its counterpart across the pond, and neither includes any corporate issuers in this troubled region. They are simply not part of the asset class opportunity set, which may be reassuring to investors. Digging deeper to look at end-market revenue sources, our review of index constituents finds little exposure to the two countries.

An important bedrock for loans is a reality that not even war can change: Capital

Bottom line: Loans have proved their ability to "take a punch" in a difficult market and to do well in a less complicated growth scenario, too. We think that bodes well for loan investors as markets work their way through the repercussions of the Russia/Ukraine conflict.

Investing entails risks and there can be no assurance that any strategy will achieve profits or avoid incurring losses.

Active management attempts to outperform a benchmark index and assumes considerable risk should managers incorrectly anticipate changing conditions.

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