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Floating-Rate Loans | Leveraged Credit

Postelection loan rally caps a remarkable 2020 rebound

Picture of

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Boston - In a year noteworthy for surprises, the fourth quarter of 2020 certainly has not disappointed. On the strength of an unexpected postelection rally in all risk asset sectors, the total return for the S&P/LSTA Leveraged Loan Index broke even for the year-to-date on November 5. From the pandemic-induced March low, the index has recorded a remarkable 28% total return, and a year-to-date return of 2.54%, through December 10. Here are some year-end takeaways:

Loans are still a bright spot for yield. Despite the strong run, the index yielded 4.76% on December 10 — it's a senior/secured asset class yielding more than the other major fixed-income sectors, including high-yield and emerging markets debt.[1] The yield on loans is more than four times that of the Bloomberg Barclays US Aggregate Index.

The default picture has improved. Before the November 9 vaccine announcement, managers were anticipating that the default rate would rise above 5.5% a year from now. Default forecasts steadily improved since the initial panic, in parallel with the actual decline to 3.89% in November, which is just one point above the long-term average. The improvement in the ***distressed ratio*** — the percent of the index trading under $80 — has been more dramatic. It has fallen from 25% at its worst to 3% — lower than it was at the beginning of March. We would not be surprised to see the rates for both realized and expected defaults continue to moderate.

A return to income. The long-term return from loans has been overwhelmingly from their income component. During aberrant streaks like 2020, it's easy to lose sight of the fact that loans are instruments that accrue to par, on average over three years. Volatile stretches capture the headlines — they are facts of life in a liquid secondary market. But income has delivered the long-term returns, as the larger dips and advances have averaged themselves out.

Seeking value in quality. Today's market is a reminder of how active management can seek value in the dispersion of prices. Current loan valuations suggest there may be modest price appreciation potential, but it is not evenly distributed — a significant percentage of the market already trades close to face value. The average loan price in the index was as high as $97 in January of this year, about 1.25 points higher than on December 10.

Insight has never been timelier. The loan market broadly appears well supported going forward, with the likelihood of continuing monetary and fiscal stimulus, and an anticipated balance of supply and demand. However, after the large gains of the past eight months, selectivity is especially important. The encouraging news on the vaccine front has to be balanced with thorough analysis of the impact that the pandemic has had on the wide range of loan issuers.

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Bottom line: For more than three decades, Eaton Vance has believed that focusing

on quality, income and risk reduction is the key to pursuing long-term investment goals. As we emerge in 2021 from the historic social and economic challenges of 2020, our commitment to this approach on behalf of our clients remains as strong as ever.

[1] As represented by the ICE BofAML US High Yield Index, the JPMorgan Government Bond Index - Global Diversified (GBI EM) and the JPMorgan Emerging Markets Bond Index - Global Diversified (EMBI).

S&P/LSTA Leveraged Loan Index is an unmanaged index of the institutional leveraged loan market.

ICE BofAML US High Yield Index is an unmanaged index of below-investment-grade US corporate bonds.

JPMorgan Government Bond Index - Global Diversified (GBI EM) is an unmanaged index of local-currency bonds with maturities of more than one year issued by emerging markets governments.

JPMorgan Emerging Markets Bond Index (EMBI) is an unmanaged index of USD-denominated bonds with maturities of more than one year issued by emerging markets governments.

Bloomberg Barclays US Aggregate Index is an unmanaged index of domestic investment-grade bonds, including corporate, government and mortgage-backed securities.

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