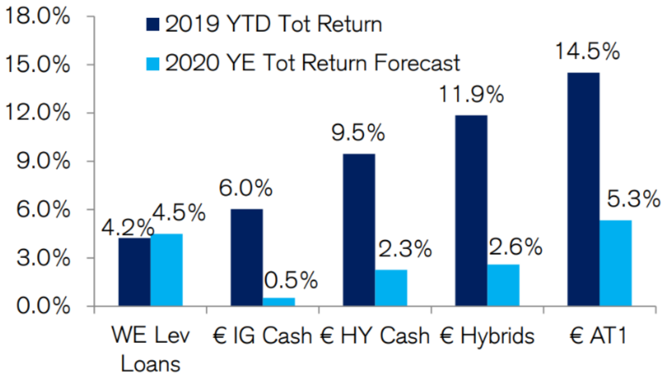
Selection in Dispersion!

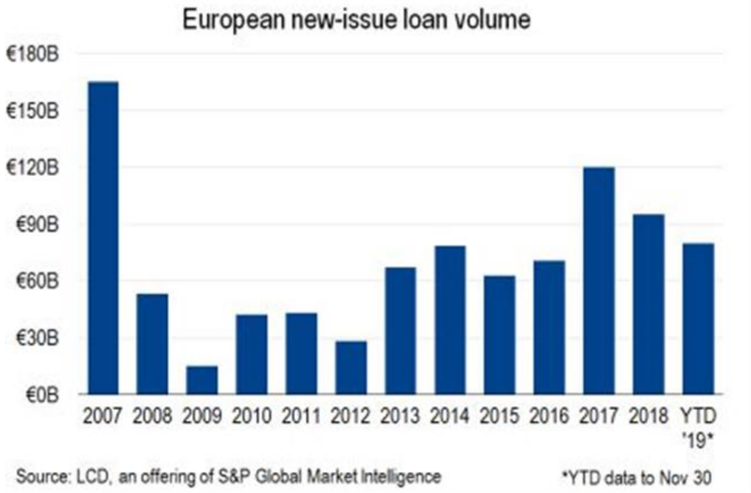
European loans seem to be the asset class to pick up in 2020. Different analysts and banks are supportive for the asset class as it could be the only one in the credit space to outpace the 2019 results. The chart below from Credit Suisse compares the expected results for 2019 and 2020 of different asset classes and, as can be seen, European loans are the only ones which are expected to confirm the good and consistent results of 2019, with an expected total return of 4.5%.



Source: Credit Suisse

ISSUANCE

Taking one step back and talking about 2019, with only one month to go, it has been a year characterized by lower issuances than 2018, even if, apart from 2017 and 2018, 2019's volume hasn't been reached since 2007. On a YTD basis, the total issuances are €80.1 billion, down from €95.1 billion in the same period of 2018.



Loans demand has remained particularly healthy, sustained by CLO supply that, in 2019, will break the record with roughly €29 billion of new issuance from 70 deals year to date, up from €27.32 billion and 66 deals in the same period last year.

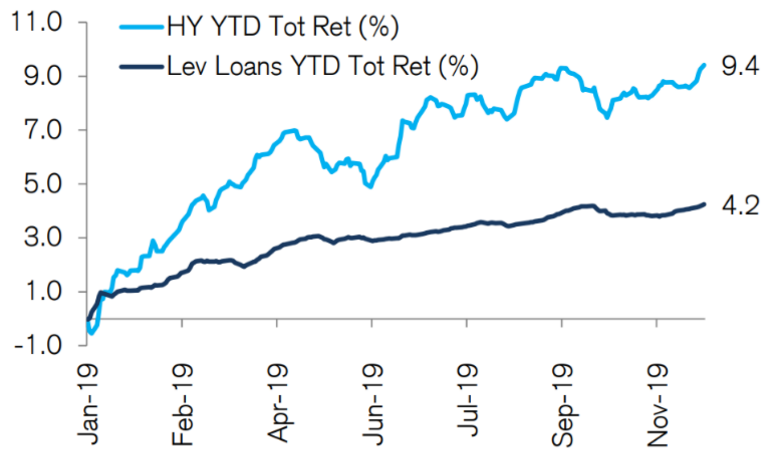
In 2020 new issuances in the loan space are expected to increase by 8% vs 2019, as private equity sponsors invest their available capitals and issuers start to take advantage of the better condition of the European market vs the US one. Falling angels and large public to private LBOs may contribute to the issuance growth.

RETURN

In November the average spread of new issued loans has been stable between 3.50% and 4.00%, in line with the whole 2019. Average yield on offer for euro-denominated single-B TLBs for the three months to the end of November was 4.02% (4.24% at the end of the first quarter).

Overall Euro loan YTD return remains strong at 3.85% and is expected to close the year slightly above 4.00%.

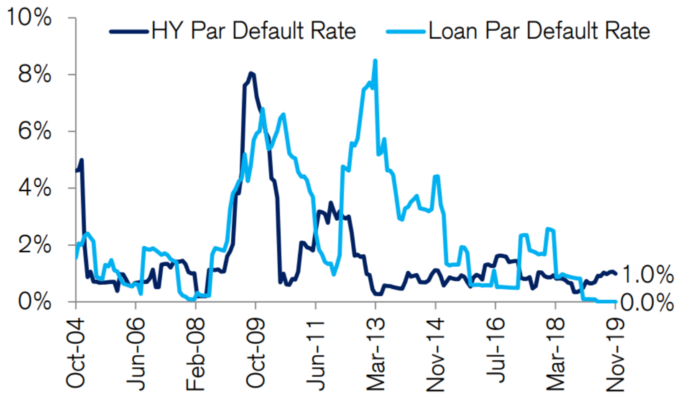
As in the past years, also 2019 has been characterized by low volatility as highlighted in the below figure.

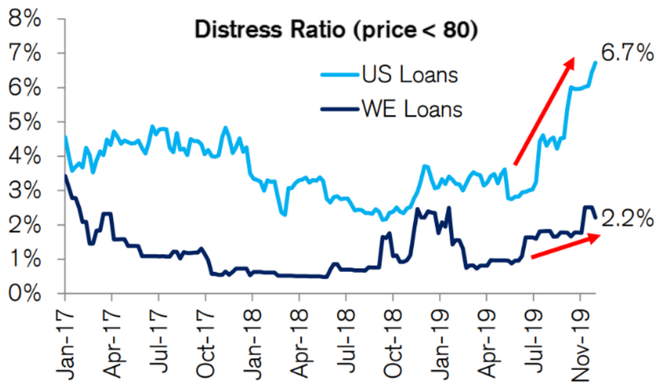


Source: Credit Suisse

DEFAULTS

In 2019 defaults remined low in the loan space and default rates are expected to slightly increase to 0.8% in 2020, with an expected loss from defaults of 0.2%. Therefore, overall numbers remain at relative low levels in Europe.





Source: Credit Suisse

VER CAPITAL VIEW

Increasing political certainty, amid fading concerns about macro issues such as U.S.- China trade and Brexit, could rise market prices of some names affected by these factors and boost M&A going into 2020. In our opinion this will lead to higher leverages, but also to higher spreads in order to reward investors for the risk. As a consequence, the total return of the asset class is expected to be around 4.5%.

A key final evidence of 2019 has been the increase in dispersion on returns across sectors and issuers. A similar scenario is expected for 2020 with slightly higher default and distress ratios. In fact earnings growth will be elusive next year, with the majority of borrowers now levered around 5x total debt/EBITDA, marking a late-stage cycle peak. In this market environment, we have a strong conviction that a fundamental approach to loan selection could yield consistent and resilient returns also in 2020.