Credit Spotlight 3

# A more compelling yield than the lowest-rated bonds

## The case for leveraged loans

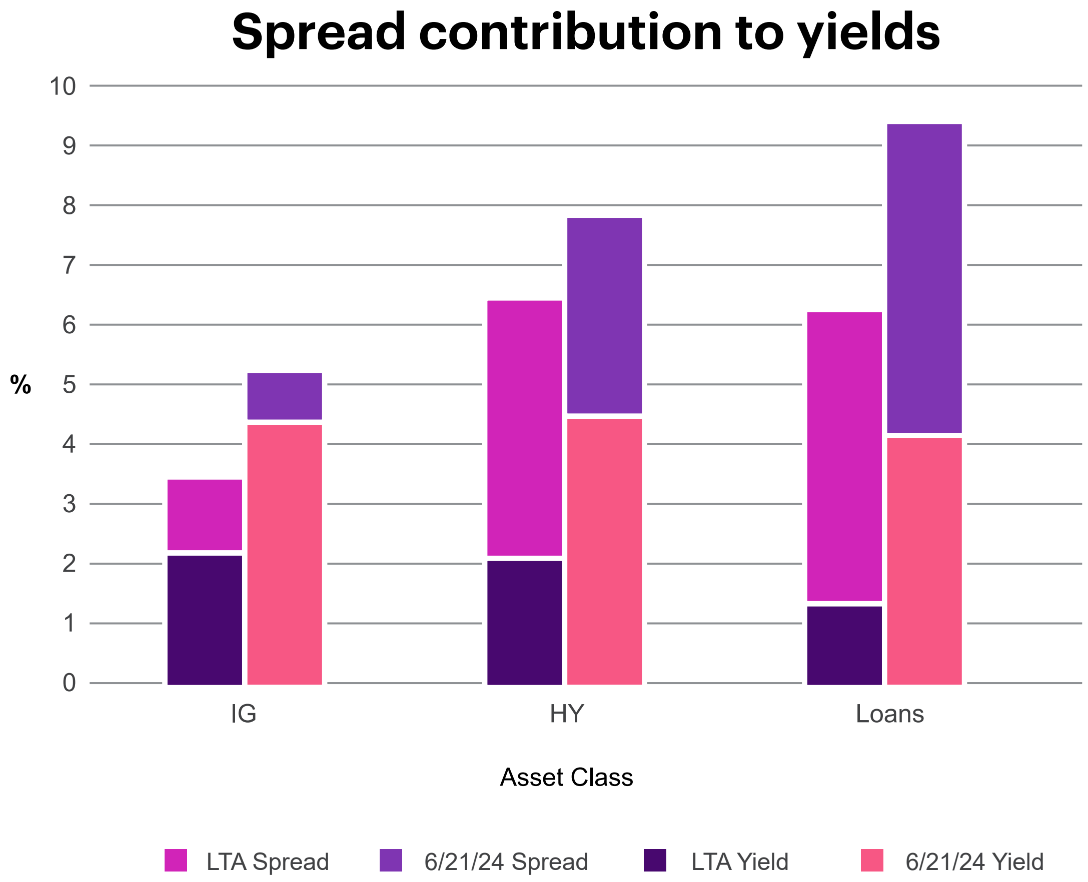
**With equities rallying since October 2023, it is important that investors consider which areas of the credit market can still offer value, with the benefit of also providing portfolio diversification. Leveraged loans remain an "under the radar" asset class that we believe can offer strong relative value in this market context.**

Spread tightening has been a major theme across the fixed income markets so far in 2024. Leveraged loans offer attractive **yield and spread on par with CCC-rated high-yield debt, without investing in the lowest-rated issuers**. Though many leveraged loan borrowers are facing higher interest payments due to stubbornly high cash rates, **higher recovery rates** and potential rate cuts can help mitigate that pain for investors.

Interest rate relief for borrowers can lead to further spread tightening, which may enhance total returns for investors; however, if rates remain high and strain company balance sheets further, it's noteworthy that borrowers who defaulted on leveraged loans historically experienced lower overall credit losses compared with the high-yield market. This is largely due to the senior secured nature of many leveraged loans.

The graph below shows the current and long-term average (LTA) overall yields and spread contribution to that yield for investment-grade corporate bonds, high-yield bonds and leveraged loans. All three asset classes are outyielding their LTAs, but leveraged loans offer significantly more yield. At over 9%, investors can receive income in line with or better than the long-term equivalent for many equity asset classes.

**Leveraged loans offer higher spread value compared with investment grade and high yield, with a level of yield similar to high yield**




Source: ICE Data Indices, ICE BofA US Corporate Index Option-Adjusted Spread, ICE BofA US Corporate Index Effective Yield, ICE BofA US High Yield Index Option-Adjusted Spread, ICE BofA US High Yield Index Effective Yield, Credit Suisse, CS Leveraged Loan Index. Data as at June 21, 2024.

## How should this impact investment decisions?

Leveraged loans remain an appealing asset class for healthy yields in what may be a higher-for-longer interest rate environment. Creative solutions in leveraged loans can supplement traditional allocations to both stocks and investment-grade debt while adding diversification benefits. It's important to emphasize that active management plays a critical role in avoiding pitfalls in the loan market and minimizing the impact of default losses on credit portfolios.

To learn more about credit capabilities at WTW, please contact us here.

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