



Bank Loan Market Update

A Commentary on the US Bank Loan Market

April 2009

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1 S&P/LSTA Index. As of March 31, 2009.
2 S&P/LSTA Index. As of April 15, 2009.
3 As of April 15, 2009.
4 Year-to-date and month-to-date figures are
as of April 15, 2009.
5 Source: Invesco Estimates; Standard &
Poors LDC. Positive market factors data as
of March 31 unless otherwise stated.

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“Price Recovery Trumps Defaults”

The bank loan market exhibited a strong and sustained rally during the first quarter with gains of 9.8%¹ across the broad market. Steadily improving technicals drove most of the gains but some improved confidence in the financial markets and forecasts that the economy may have hit bottom during last year’s fourth quarter provided further momentum to the market rally during the first two weeks of April. The acceleration of the rally in April brings y-t-d gains to 13.85%² and notably reverses the first quarter’s directional price bifurcation between BB and lower rated credits. Single B and CCC returns are up 5 to 6%^{3,4} on a month to date basis and evidence that the overall market is now better bid than offered at a broad average of \$.68.

Negative Market Factors⁵

(2008 “Technical Storm”)

Portfolio Unwinds and TRS Deleveraging

- US\$12.4 billion of bids wanted in competition (BWIC) in 2008
- US\$8.3 billion of Prime Fund outflows

Limited Demand Growth from Traditional Channels

- Prepayments less than 10%
- Collateralized loan obligation growth halted

Dealers on the Sidelines

- Concern over balance sheet management at year-end

CLOs and “Deep Discount” Effect

- Increased restrictions on trading activity with 70% of the senior secured loan market trading below US\$0.80

Weakening Fundamentals and Market Sentiment

Prices Hit All-time Lows in mid-December

- S&P Flow Names trade down to US\$63.53 on 16-Dec-2008
- S&P/LSTA Leveraged Loan Index average bid of 60.33 on 17-Dec-2008

Positive Market Factors⁵

(Early 2009 Catalysts)

New Issue Market at a Standstill

- No new supply with only US\$2.8 billion of new issue institutional volume YTD through 1Q09.

Hedge Fund and TRS Programs Stabilized

- Only US\$1.86 billion BWICs through 1Q09, representing 60% of the same period 2008 volume
- Hedge funds now less than 20% of the institutional loan market

16% Gross Yield Profile and Price Stabilization Pulling Money off of the Sidelines

- Value equity investors
- Distressed investors
- Prime fund inflows

Fed Stimulus

- Dealers now making active markets

Price rebounds through March

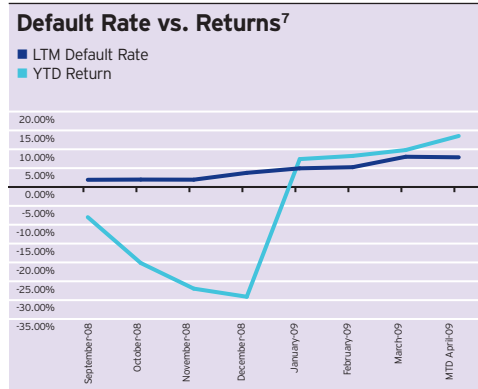
- S&P Flow Names trading at US\$76.64 as of 31-March-2009
- S&P/LSTA Leveraged Loan Index average bid of 66.4 on 3-Apr-2009

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Fundamentals

The strength of the market rally underscores how out of balance technicals had been at the end of 2008 and how over-sold the market was relative to fundamentals. This is readily apparent when comparing positive y-t-d returns with a significant escalation in defaults: 17 new defaults in 2009 totaling \$29.5 billion of principal.⁶



The aggregate default rate now sits at a record 8.02% by principal amount but this is not a surprise given weak macro economic conditions and declining corporate profits. As discussed in our last commentary we see defaults approaching 12% through year end before peaking in the mid to upper teens later in 2010. This default outlook has been widely shared across the market and was already "priced-in" by the hang-over of technical dislocation. The recent price rally brings the market back toward more of a fundamental story where credit performance should begin to dictate returns. With that in

mind we still see a compelling excess risk premium in the market with risk adjusted yields of 11.5 to 12.5% as highlighted in an update of our Market Yield matrix.

All data as of 31-March-2009 unless otherwise noted.

⁶ 2009 defaults as of April 10, 2009.

⁷ As of April 10, 2009.

⁸ Invesco, S&P/LCD, Bloomberg. For illustrative purposes only. The shaded areas highlight Invesco Senior Secured Management, Inc.'s view of Default and Recovery Rates. These views may not reflect the opinion of other affiliated Invesco Ltd. investment advisors. The Key Assumptions are on based on current market conditions as of March 31, 2009, and are subject to change. Accordingly, investment results, yields and volatility may differ significantly from those identified.

Yield to Maturity Matrix⁸

Default Rate	Recovery Rate							
	85%	80%	75%	70%	65%	60%	55%	50%
5.00%	15.18%	14.93%	14.68%	14.43%	14.18%	13.93%	13.68%	13.43%
6.00%	15.01%	14.71%	14.41%	14.11%	13.81%	13.51%	13.21%	12.91%
7.00%	14.83%	14.48%	14.13%	13.78%	13.43%	13.08%	12.73%	12.38%
8.00%	14.65%	14.25%	13.85%	13.45%	13.05%	12.65%	12.25%	11.85%
9.00%	14.47%	14.02%	13.57%	13.12%	12.67%	12.22%	11.77%	11.32%
10.00%	14.29%	13.79%	13.29%	12.79%	12.29%	11.79%	11.29%	10.79%
11.00%	14.11%	13.56%	13.01%	12.46%	11.91%	11.36%	10.81%	10.26%
12.00%	13.94%	13.34%	12.74%	12.14%	11.54%	10.94%	10.34%	9.74%
13.00%	13.76%	13.11%	12.46%	11.81%	11.16%	10.51%	9.86%	9.21%
14.00%	13.58%	12.88%	12.18%	11.48%	10.78%	10.08%	9.38%	8.68%
15.00%	13.40%	12.65%	11.90%	11.15%	10.40%	9.65%	8.90%	8.15%

Assumptions

Index Spread (Libor+)	2.70
Average Purchase Price (% par)	67.90
Index Maturity (yrs)	4.55
3-Month Libor (%)	1.16
% of Defaulted issuers paying current	50.00

Source: S&P/LCD, Bloomberg

Notwithstanding positive sentiment attached to the loan market's rally and similar sentiment attached to a recovery in equity prices from mid-March lows, we are not yet ready to make any revisions in our cautious fundamental outlook for 2009. Thus we continue to highlight a 12% default rate and \$.65 to \$.75 recovery rates on these defaults as the most likely combination of scenarios in our Market Yield matrix. Our most specific concerns are: (1) ongoing weakness in the consumer sector as evidenced by weak housing numbers, unemployment at 8.5% and, rising charge-offs of consumer related debt underlying otherwise decent first quarter earnings

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numbers from the banks and, (2) lack of capital flows and limited or no access to financing for many corporate borrowers - until this corrects borrowers have limited options to deal with liquidity constraints or refinancing needs (features in recent defaults) and fundamental valuations will remain constrained.

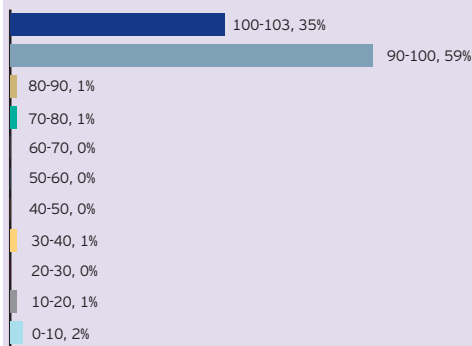
Market Segmentation and the CLO Effect

Looking at the market on a more segmented basis we see opportunities being created by collateralization pressures and en-mass rating downgrades across the CLO participants. This is a very "rules driven" segment of the market that is struggling with: (1) the impact of collateral "haircuts" attached to CCC and Defaulted asset holdings, (2) price driven trading restrictions and, (3) overall ratings criteria. CLO managers have adopted a variety of strategies to deal with these segment specific challenges but in most cases are being forced to avoid or reduce (sell) lower rated assets. Since the CLOs represent north of 50% of all loan market participants their restrictions are a primary contributor to significant price dispersion in the market. This level of price dispersion creates the opportunity for un-encumbered and actively managed strategies to materially outperform the overall market via highly focused credit selection criteria otherwise known as manager alpha.

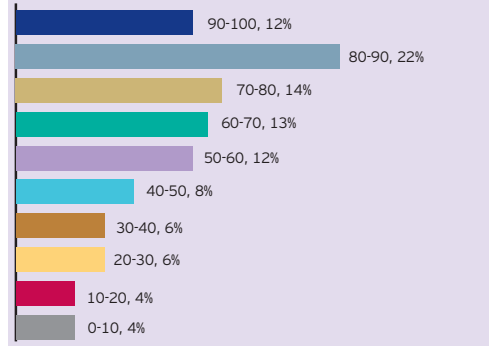
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9 Source: S&P/LSTA Loan Index. Data provided by the loan syndication and trading association. Specific timeframes were selected to illustrate a volatile period (2002), a normalized period (2006) and then current and high volatility (2009).

Price Distribution "Bull Market"
12/31/2006⁹



Price Distribution "Current Market"
3/31/2009⁹



The pressures being exerted on CLOs have been well publicized and may in fact dictate much of the loan market's tone as we progress throughout the remainder of 2009. Aside from the issues highlighted above we are specifically watching Event Of Default provisions contained in some CLOs since this could potentially lead to "unwind" risk and offer side pressure on market prices if credit conditions deteriorate meaningfully beyond current forecasts. For now this appears to be a manageable "technical" risk as we anecdotally believe it is limited to less than 15% of CLOs and even then the unwinds would not be automatic.

Conclusion

Timing remains good for bank loans and we reaffirm the buy recommendation from our last commentary. While the market has rallied over the first part of the year there is still an attractive excess risk premium tied to price entry points between \$.65 and \$.70 along with a significant margin for error to cover a weak fundamental outlook for the economy in 2009. The varied trading levels of assets within the loan market also create the best opportunity we have ever seen for active credit selection. This makes for a compelling current and total return opportunity relative to both equities and other credit driven strategies many of which are also exposed to duration risk.

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