



Bank Loan Market Update

A Commentary on the US Bank Loan Market

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1 Contact Invesco's Bank Loan team for a discussion of index comparisons and methodologies as of September 19, 2009.
2 Yield to maturity of the LSTA Loan Index as of September 19, 2009.
3 Effective Current Income = (90-Day LIBOR + Credit Spread) / Market Price.

All references to Invesco refer to Invesco Senior Secured Management, Inc. All data is as of September 19, 2009 unless otherwise stated. Source: Invesco, unless otherwise stated.

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Economic Recovery - A Positive Catalyst for Bank Loan Returns

Gains in the bank loan market are running at 9.0% for the third quarter placing year to date total returns for the bank loan asset class at 45.5% on the S&P/LSTA Leveraged Loan Index and 38.0% on the Credit Suisse Leveraged Loan Index¹. While these figures show that the pace of gains is slowing, the tone of the market continues to improve on positive economic data, better than expected corporate earnings and, an increased willingness of investors to take-on risk. We elaborate on these factors along with a few others in more detail below but, in short, Invesco maintains a "buy" recommendation on the bank loan asset class and underscore that the current all-in annual return profile of LIBOR + 8.24%² should eventually benefit from an upward sloping forward LIBOR curve.

The Bank Loan Market: By The Numbers

	Dec. 31, 2008	Mar. 31, 2009	June 30, 2009	Sept. 19, 2009
S&P/LSTA Leveraged Loan Index	61.74	65.61	77.97	84.67
Current Income Components				
90-Day LIBOR	1.43%	1.19%	0.60%	0.29%
Credit Spread	2.70%	2.90%	3.00%	3.10%
Effective Current Income³	6.69%	6.23%	4.62%	4.00%
All-in Annual Return (YTM)	L + 20.75%	L + 18.14%	L + 11.07%	L + 8.24%

Source: S&P/LCD, Bloomberg.

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4 Source: Invesco

Improving Fundamentals

There are clear signs that the U.S. economy has hit bottom with sequential GDP declines easing to 1.0% in the second quarter, stabilizing unemployment figures, and modest improvements in the housing market. These factors combined with inventory re-stocking, supported better than expected corporate earnings performance in the second quarter. This momentum is carrying into positive expectations for the third quarter and is setting the stage for improving credit performance throughout the remainder of the year.

Sequential Performance for Large Public Loan Issuers		
	Revenue	EBITDA
Q1 2008	1.79%	0.47%
Q2 2008	7.47%	10.80%
Q3 2008	-2.40%	-0.95%
Q4 2008	-6.47%	-14.63%
Q1 2009	-6.53%	-3.72%
Q2 2009	5.04%	16.91%
Source: S&P/LCD News, Capital IQ		

Quarterly Defaults Annualized	
1Q 2008	2.90%
2Q 2008	2.64%
3Q 2008	1.52%
4Q 2008	7.44%
1Q 2009	19.54%
2Q 2009	8.70%
3Q 2009 to Date	4.69%
Source: S&P/LCD	

The best direct evidence of improving credit performance can be seen in a material decline in the pace of defaults. During the first quarter of the year when a number of issuers capitulated on fears of a protracted recession and scarce liquidity the annualized default rate was 19.5% but since then the pace has declined to 6.7%.

Another key factor behind improving credit performance is the re-opening of the capital markets. This is providing renewed sources of liquidity for corporate loan issuers and is also enabling issuers to extend maturities, thus addressing the market's highly publicized "refinancing cliff" between 2012-2014. Based on the re-opening of the capital markets and the improved outlook for corporate earnings, we concur with recent "street" revisions to default forecasts and have lowered our peak expectation into an 11 to 12% range by Q4 2009 and a much more moderate 4 to 5% for 2010.⁴

Capital Markets Re-open	
Issuance	YTD through Sept. 19, 2009
HY Bond Deals	\$94 billion
Bank Loans	\$16 billion
Amend & Extend	26 deals
Source: S&P/LCD	

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Strong Technicals

In addition to improving fundamentals, the bank loan market continues to benefit from the strong technical trends that we have highlighted in earlier commentaries. Most notable among these trends are continuing inflows into bank loan and high yield funds, bond for loan take-outs, and normal course repayments. While the new issue market has reopened, it has been unable to keep pace with normal bank loan repayments and the positive flows into the market, thus putting a better bid tone across the market. The bid for senior secured bank loans has been strongest at the lower-rated end of the market, where prices on CCC-rated assets are up 60.8% year to date, indicating that investors are now comfortable taking on more risk.

Market Technicals By The Numbers

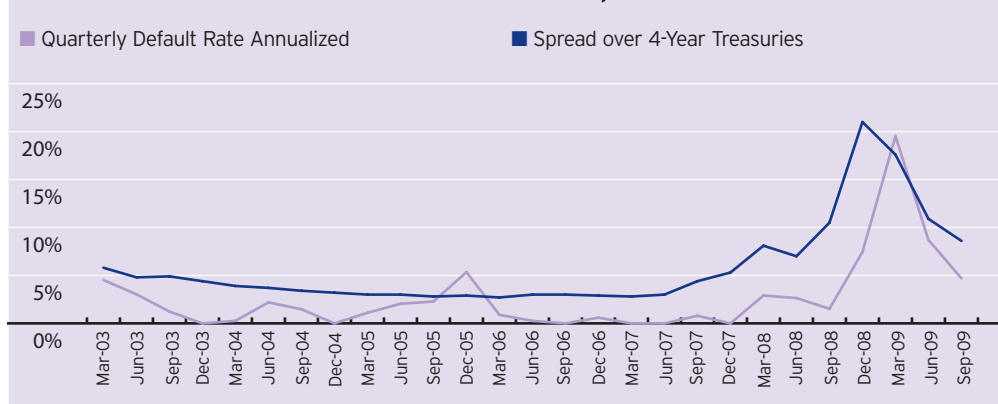
Size of the Institutional Segment of the Bank Loan Market		Net Market Contraction (YTD)	
December 31, 2008	\$596 billion	Bank Loan Repayments	\$50 billion
September 19, 2009	\$562 billion	New Issue	\$16 billion
			\$34 billion
Loan Market Inflows ⁴			
Bank Loan Retail Funds			\$2.6 billion
Institutional Flow Estimates			\$7.5 billion
			\$10.1 billion

Of further interest is the select reopening of financing via the Total Return Swap (TRS) market and early indications that the Term Financing market is also beginning to stir. However, we expect that it will take some time before economics and terms are attractive enough to put meaningful capacity back into the market. That said, we are encouraged by the developments and see early potential for a new vintage of bank loan related products and this could further spur market demand.

Bank Loans: Still a Compelling Investment Story

Although the market has shown a strong year to date rally and most of the "low hanging" excess return opportunity has been realized, Invesco still sees good relative value in the asset class. The market yield to maturity is currently at L+ 8.24% which swaps to T+ 9.16%.⁴ With what appears to be the beginning of an economic recovery and Invesco's expectation for improving credit performance, we believe T+ 9.16% to be a compelling risk/return for bank loans relative to historic trading ranges and also relative to other segments of the fixed income market.

Historical Pace of Bank Loan Defaults vs. Bank Loan Spread to Treasuries



Source: S&P/PMD, Bloomberg, BBA.

Recall that we use swap spreads when comparing bank loan yields to Treasuries to account for the fact that bank loans are a duration neutral asset class where the LIBOR interest component resets every 90 days. Unlike more traditional duration-exposed fixed income assets, bank loans

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allow investors to benefit from future increases in interest rates. We believe this is a very compelling feature in the current market environment and note that if we apply the forward LIBOR curve the expected YTM on the bank loan market moves to 11.88%.

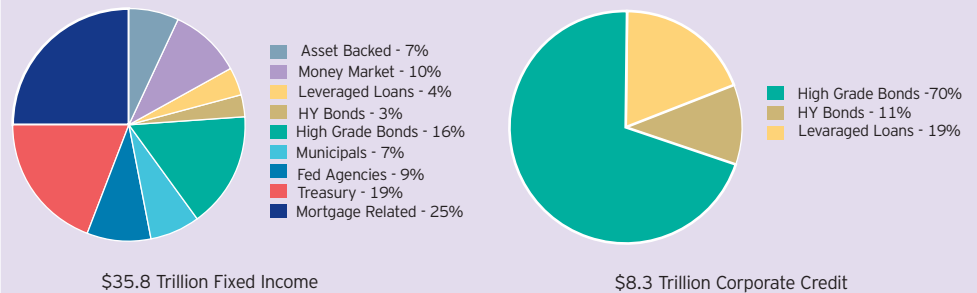
	Yield	Swapped	At Forward LIBOR
5 Year Treasuries	2.36%		
10 Yr Treasuries	3.42%		
I.G. Credit	4.28%		
H.Y. Bonds	10.09%		
Bank Loans	L+8.24%	11.06%	11.88%

Source: Bloomberg, Invesco as of September 19, 2009.

Based on our current view of the credit markets, Invesco recommends overweighting bank loans based on yield expectations and as an **alternative** duration hedge relative to more traditional fixed income asset classes.

Senior Secured Loans Represent 19% of the Fixed Income Market's Exposure to Corporate Credit

- Leveraged Loans comprise 4% of the \$35.8 trillion fixed income market
- Leveraged Loans comprise 19% of the \$8.3 trillion market for corporate credit



Source: Credit Suisse, Securities Industry and Financial Markets Association as of March 13, 2009.

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