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Traders favour high-quality loans in bid to withstand volatility - IFR News

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- US SECONDARY
- Loan prices could start to drop in the autumn

By Aaron Weinman

July 24 - Traders in the US leveraged loan market are exercising caution in their activity across the secondary market. They are favouring bids for higher-rated loans more likely to perform as the economy continues to be pressured amid the coronavirus pandemic.

Some investment-grade and highly rated non-investment-grade institutional loans, including facilities for mobile telecommunications company T-Mobile and a credit for Dell International LLC, a subsidiary of computer maker Dell Technologies, are among the most actively bid tranches in the secondary market.

T-Mobile's US$4bn loan, rated Baa3/BBB–/BBB– and due in April 2027, was quoted at 99.5–100.25 cents on the dollar on Tuesday. Dell International LLC's loan, rated Baa3/BBB–/BBB– and maturing in 2025, was quoted at 98–99 cents.

Investors holding loans such as T-Mobile or Dell benefit from these companies' higher credit ratings and liquidity profiles, and lower leverage ratios. Dell International, for example, had approximately US$6.4bn in cash at the end of its 2020 financial year on March 31, according to Moody's.

Due to the pandemic, companies have encouraged their employees to work from home for the foreseeable future. Industries linked to technological growth, therefore, are in a position to gain from more consumers and workers stationed in their homes that require the latest in hardware and communications technology.

Conversely, loans for companies in industries severely hit by the health crisis are trading deeper in distressed territory.

American Airlines' term loan maturing in 2025 was quoted at 58–61.5 cents on Tuesday down from 63.5–66.5 cents one week earlier.

Despite the positive sentiment in the credit markets, concerns prevail that corporate earnings for the third quarter will disappoint as the pandemic keeps businesses shut. Some states, including Florida and California, have rolled back plans to reopen parts of their economies after a spike in cases of Covid-19 this month.

US deaths from the respiratory illness rose for a second week in a row to more than 5,200 people for the week ending July 19, up 5% from the previous seven-day period.

"Events that are far bigger than us are going to drive the markets," said Art Penn, managing partner of PennantPark Investment Advisers, which focuses on middle market credit investments. "The virus, prospects for a vaccine and actions from the Fed will be key to determine how the market reacts."

INCOMING OPPORTUNITIES

The LPC 100, a cohort of the 100 most liquid US leveraged loans, closed at 94.34 cents on the dollar on Monday. It hovered in the mid-90 cent range throughout July.

However, some expect loan prices to drop in the autumn months, starting in October, if states do not advance plans to reopen their economies and enable many people to get back to work.

"Things can only stay calm for so long. Markets are going to catch up with what's happening with respect to unemployment figures," said Jennifer Pastarnack, a partner who leads the global debt and claims trading practice at law firm Sullivan & Worcester.

"The lack of consumer spending, if that continues into the fall, can lead to liquidity issues for companies."

Consequently, a dip in loan prices may present an opportunity for investors to purchase credits in the secondary market at a steep discount.

"There is a stressed and distressed investment community waiting in the wings and they have a lot of dry powder available to fill the gap if and when (a drop in loan prices) happens," said Penn.

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