WEEKLY BRIEF: CREDIT

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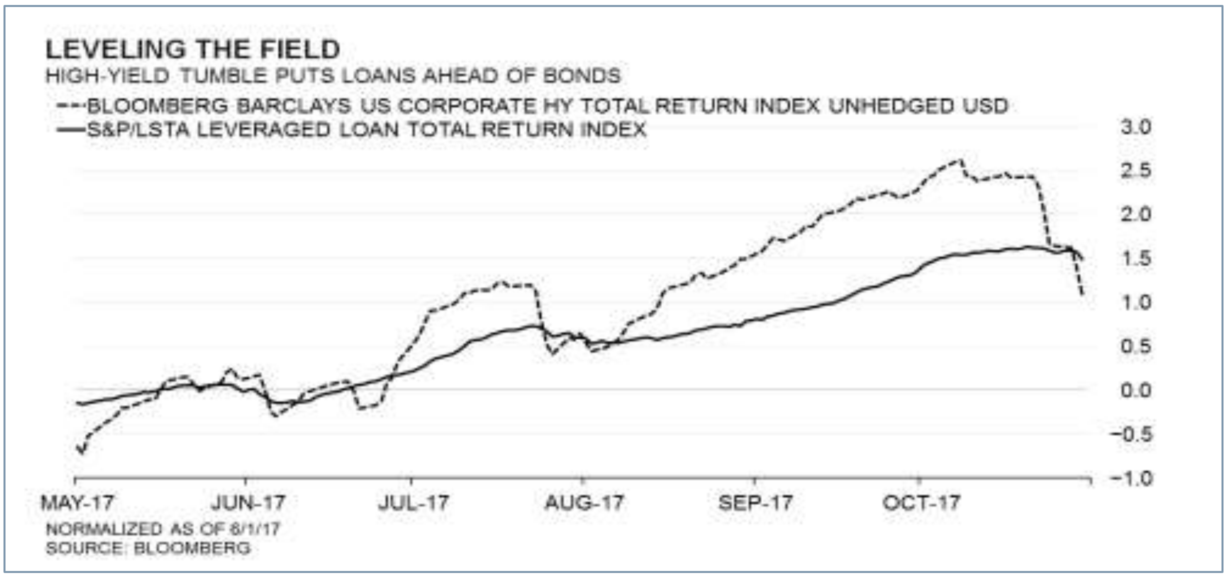
The business of risky corporate loans is running so hot, some investors wish the bout of volatility that roiled their junk-bond counterparts would seep into their market.

Repricings have surged as demand for yield sustains a wave of borrower efforts to slash interest, as investors worry about missing out on deals when supply is scarce. Yet despite the flow of repricings, leveraged loans are still generating returns that top gains from high-yield bonds, according to index data.



That's allowing junk-rated companies like GoDaddy to slash their borrowing costs. The yield investors demand above the Libor offered rate — or spread — has fallen to the lowest levels since 2009, in the wake of the financial crisis. Investors have accepted more than $400 billion of loans with a spread of 2.75 percentage points or less so far this year, versus just $174 billion in 2013.

"I don't see anything stopping repricings," said Frank Ossino, senior portfolio manager at Newfleet Asset Management, who manages bonds and loans. "We are all silently hoping that repricings will stop because of volatility."

GoDaddy, seeking to cut interest on its $2.5 billion loan, and airplane-parts maker TransDigm, aiming to lower the rate on $4.4 billion of debt, are just two in a sea of $54 billion of repricings to hit the market in the past two weeks. It's the busiest pace since January.

Helping maintain the flood are CLOs. They're the debt's biggest buyers and demand for them has also been insatiable.

"The loan and CLO markets have been on a path of tightening for the last 16 months," said John Wright, head of Bain Capital Credit's CLO and structured products business. "Some volatility would be helpful to the market."

Still, leveraged loans have outperformed high-yield bonds for the past six months, returning 1.49% since June compared with 1.09% from bonds, according to Bloomberg Barclays Indexes and S&P/LSTA Leveraged Loan Index data.

To be sure, loans have suffered in the past month, albeit in patches. But while poor earnings, particularly from the telecommunications and health-care sectors, infected the entire bond market, the same news was contained to peer companies in the loan world.

And when spells of weakness struck throughout the year, the market has been quick to rebound. Take Berry Global Group, which in June pulled a loan repricing due to market conditions. Just two months later, it was back to successfully complete the plan. Cable company Virgin Media was another that withdrew a repricing deal in June, only to return for another try later.

"What we have seen in the last couple of sessions are loans responding to missed earnings, which is natural and healthy," Bain Capital's Wright said.

If junk bonds continue to sell-off, however, investors may get their wish and loans could roil in sympathy. That could imperil some of the more than $30 billion repricing deals still in syndication.

In loans' favor, of course, is that they are senior to bonds in the capital structure, meaning holders get paid before high-yield bonds. They're also floating-rate, meaning any coupon slashing was partly offset by the rise in the three-month Libor Offered Rate. If the Fed hikes rates in December, the ensuing rise in Libor may start flowing to loan investors.

"If their view is that rates are continuing to rise on the end of the curve, then loans are arguably more attractive than high-yield," said Andrew Gordon, CEO at Octagon Credit Investors. "The difference is the rate environment. If people believe the short end of the curve is going to keep moving up with Fed activity, loans are a better place to be than fixed income."

— Lisa Lee and Sally Bakewell, with assistance from Lara Wieczezynski.