

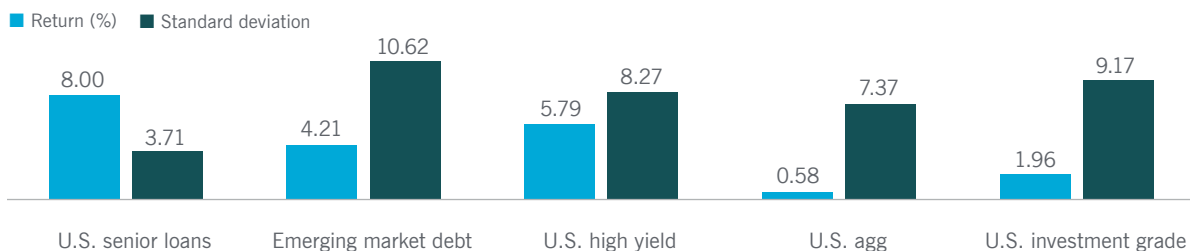
# Five reasons investors should consider allocating to U.S. senior loans

*U.S. senior loans, also known as broadly syndicated loans, floating rate loans or bank loans, have shot into prominence since the U.S. Federal Reserve (Fed) began hiking rates in 2022. Investors have taken notice of the attractive returns and remarkably low volatility provided by the asset class. While this market has grown to \$1.4 trillion in size, it remains relatively misunderstood and under-owned by investors. We focus on five compelling reasons loans deserve a seat at the strategic asset allocation table for global investors.*

## WHAT ARE U.S. SENIOR LOANS?

U.S. senior loans are debt instruments issued by well known, below-investment grade companies typically with average EBITDAs over \$500m.<sup>1</sup> These loans are structured and syndicated by banks to large groups of lenders including mutual funds, collateralized loan obligations (CLOs) and institutional investors. Notable issuers of loans include fast food giant Burger King and contact lens manufacturer Bausch & Lomb, as well as American Airlines, Formula One and Hilton.<sup>2</sup> Many issuers of U.S. senior loans are privately held companies, often backed by some of the largest private equity sponsors, including Blackstone, KKR and Carlyle.

**Figure 1: U.S. senior loans outperformed during rising rates**



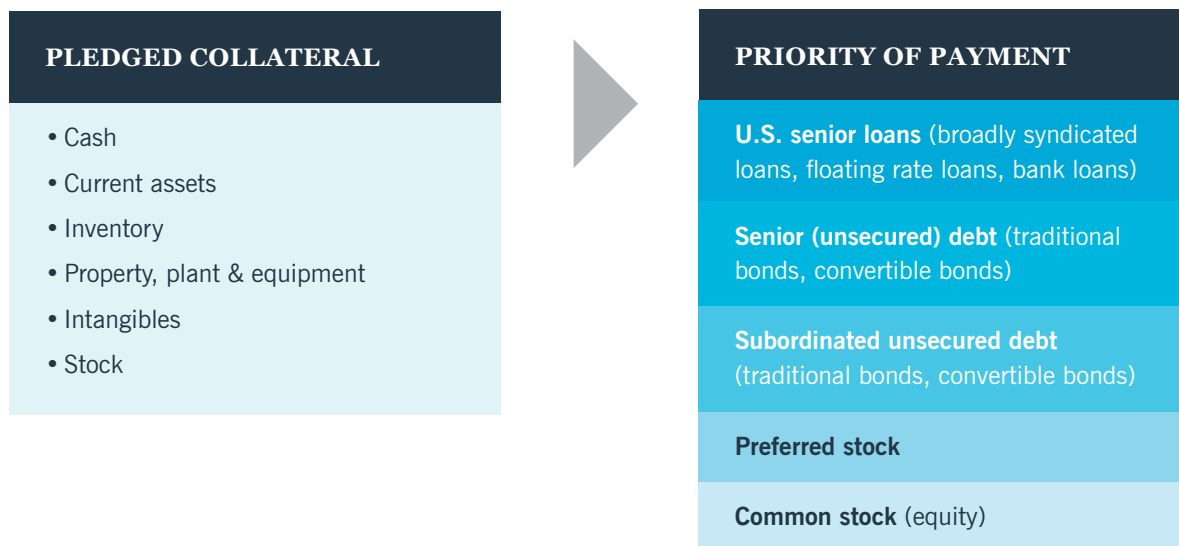
Data source: Morningstar, Time period shown is since first Fed rate hike during this cycle. 17 Mar 2022 – 30 Sep 2024. Performance data shown represents past performance and does not predict or guarantee future results. Representative Indexes: U.S. senior loans: Morningstar LTSA U.S. LL TR; Emerging markets debt: JPM EMBI Global Diversified Hedged TR; U.S. high yield: ICE BofA U.S. High Yield TR; U.S. agg: Bloomberg U.S. Agg Bond TR; U.S. investment grade: Bloomberg U.S. Corp Bond TR. It is not possible to invest directly in an index.

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

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U.S. senior loans have three main features that set them apart from other comparable asset classes. First, they are the most senior debt of a company, meaning loan holders have the highest priority of claims in the event of default.

**Figure 2: U.S. senior loans sit atop the capital structure of high yield companies and are secured by collateral**



Second, loans are secured by assets such as physical and intellectual capital, equipment, accounts receivable and inventories. Consequently, assets can be transferred to loan holders if a company defaults, generally leading to higher recovery rates than other below investment grade credit, as shown in the table below.

	Default rate	Recovery rate
U.S. high yield	3.0%	40.0%
U.S. senior loans	2.9%	63.5%

Data source: JP Morgan as of 30 Sep 2024. Data represents 25-year annual averages.

Finally, U.S. senior loans are issued with a coupon that pays a predetermined spread above a variable rate, such as SOFR (Secured Overnight Financing Rate). Therefore, as rates rise, loan coupons reset and provide investors with higher income payments. It also means that loans have near-zero duration as these resets typically occur monthly or quarterly.

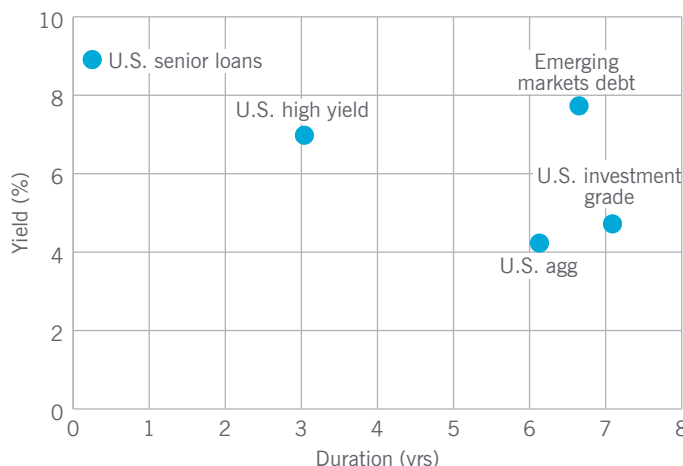
## Why do U.S. senior loans make sense for investors?

### 1. U.S. SENIOR LOANS OFFER A COMPELLING RISK-ADJUSTED RETURN

U.S. senior loans offer a high level of reward per unit of risk across several dimensions. When looked at from a yield per duration perspective, U.S. senior loans have one of the highest yields in fixed income coupled with very low sensitivity to interest rates (Figure 3). Investors may find similar levels of income in high yield bonds or emerging markets debt, both of which carry significantly longer duration.

When examined from a Sharpe ratio perspective, U.S. senior loans stand apart from fixed income peers (Figure 4). The combination of high coupons and relatively muted price changes at an aggregate level have enabled loans to generate high yield-like returns with investment grade-like volatility over the long term. As noted earlier, loans have near-zero duration which eliminates a major source of risk that besets bonds — interest rate risk. That said, U.S. senior loans are subject to credit risk, and therefore careful issuer selection is critical to success.

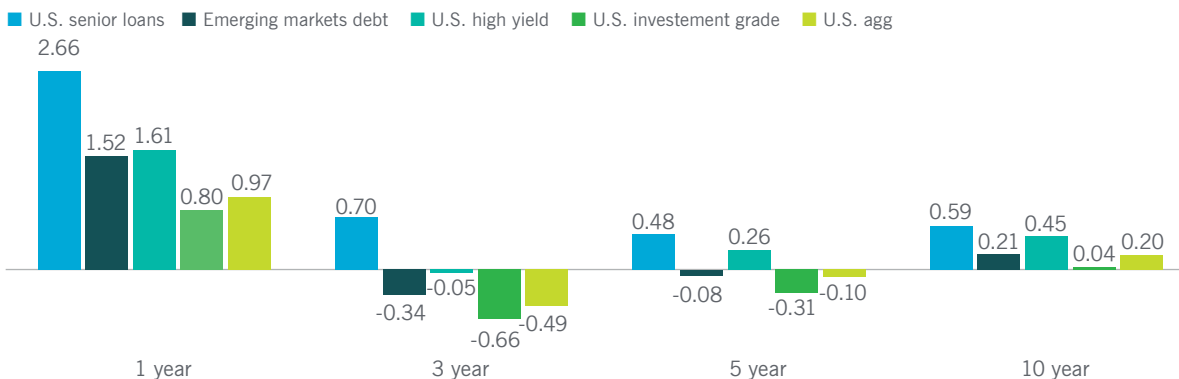
**Figure 3: U.S. senior loans vs. other fixed income asset classes**



Data source: Bloomberg, 30 Sep 2024. Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: U.S. senior loans: Morningstar LTSA U.S. Leveraged Loan Index; U.S. high yield: ICE BofA U.S. High Yield Index; Emerging markets debt: JPMorgan EMBI Global Diversified; U.S. investment grade: Bloomberg U.S. Corp Bond Index; U.S. agg: Bloomberg U.S. Aggregate Bond Index. It is not possible to invest directly in an index.

**Figure 4: Risk-adjusted returns for major fixed income asset classes**

#### Sharpe ratio



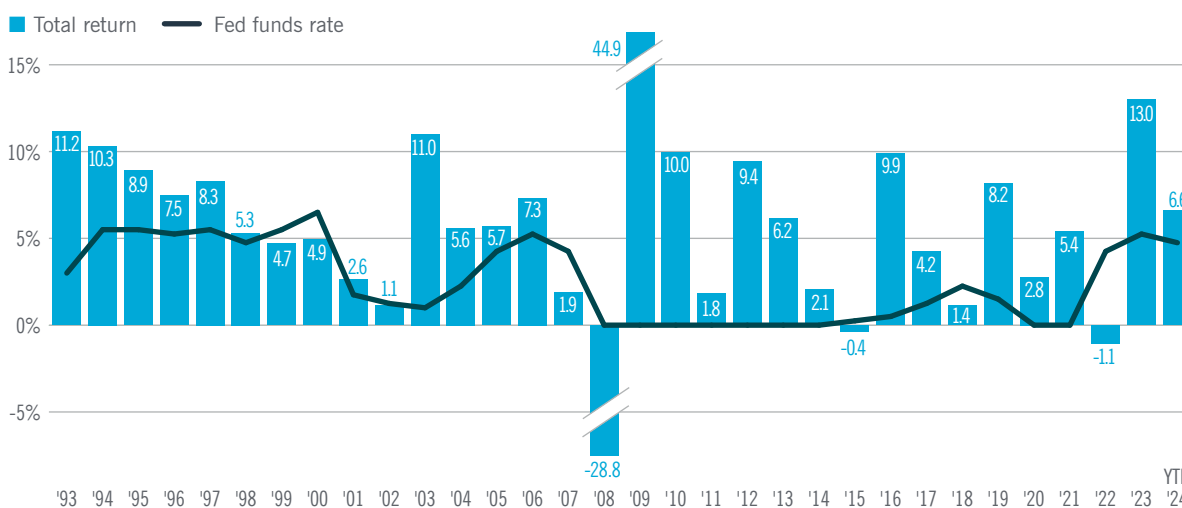
Data source: Morningstar, 30 Sep 2024. Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: U.S. senior loans: Morningstar LTSA U.S. leveraged loan index; U.S. high yield: ICE BofA U.S. High Yield Index; Emerging markets debt: JP Morgan EMBI Global Diversified; U.S. investment grade: Bloomberg U.S. Corp Bond Index; U.S. agg: Bloomberg U.S. Aggregate Bond Index. It is not possible to invest directly in an index.

## 2. U.S. SENIOR LOANS ARE RESILIENT

The senior loan asset class has proven to be resilient through most market cycles, as the income from loans helps drive overall positive total returns even during periods of price volatility. The U.S. loan market has produced positive returns in 28 of the last 31 years (note in 2022, the asset class was down 1% while the broader bond market was down 13%). Additionally, contrary to widely held perceptions that loans only generate attractive returns in rising rate environments, U.S. senior loans have posted positive total returns in eight out of nine years when the Fed has cut rates (the only year loans were negative during those periods was 2008) according to Bloomberg data.

**Figure 5: Historically positive total returns, even when NAVs fluctuate**

*Credit Suisse Leveraged Loan annual returns and fed funds rate (%)*

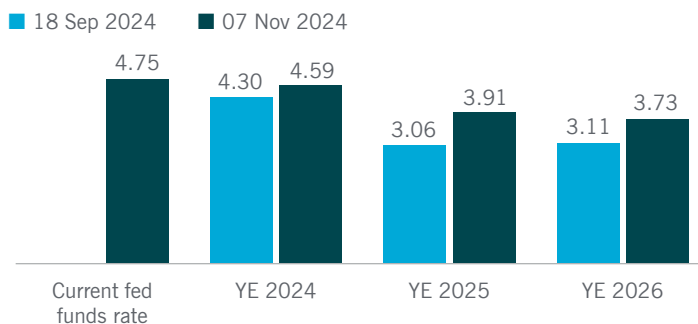


Data sources: Bloomberg, Credit Suisse Leveraged Loan Index, 01 Jan 1993 – 30 Sep 2024. Performance data shown represents past performance and does not predict or guarantee future results. It is not possible to invest directly in an index.

The Fed initiated its first rate cut of 50 bps in September 2024. Shortly following this, better than expected economic data was released, as well as U.S. election results leading to a change in party control. These data points led to further rate cuts being pared back substantially from prior expectations. The recent cuts (September and another 25bps in November) and economic outlook provide tailwinds for the loan asset class: as borrowing costs come down, we anticipate a rise in M&A activity supporting greater issuance, and companies that have good business but faced challenges in the higher rate environment should benefit from a lower cost of capital.

**Figure 6: Rate cut expectations have recently declined**

*Market expectations for the fed funds rate (%)*

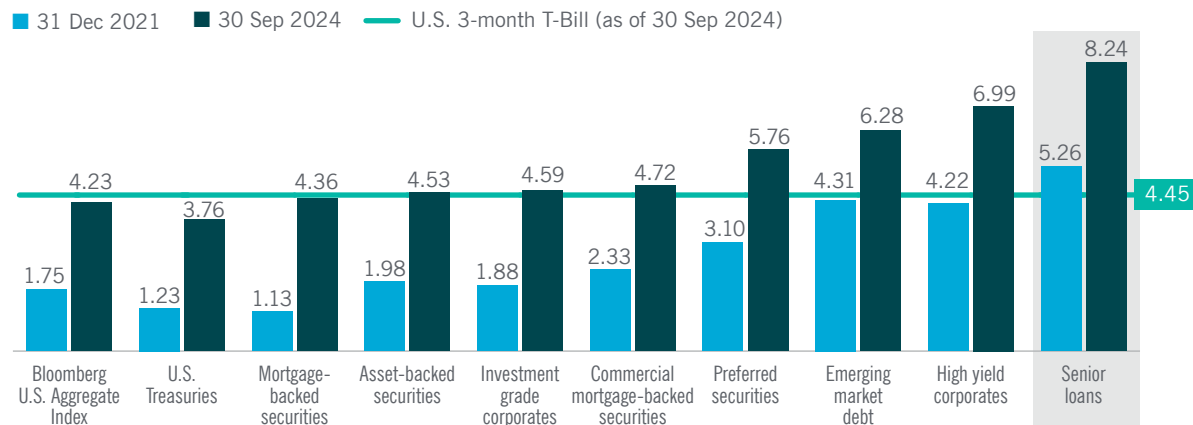


Data source: Bloomberg L.P., 07 Nov 2024.

The loan asset class maintains a 3-year yield of over 8%, which remains one of the highest within the liquid fixed income space. Furthermore, post the 2024 U.S. election results, the Fed has signaled a base rate target in the range of 3.75 – 4.00%, which is comfortably higher than the 0% base rate we experienced post Global Financial Crisis and Covid-19. With a 10-year average spread of 400+ bps,<sup>3</sup> loans would still yield over 7.5% making them an attractive diversifier in a fixed income allocation.

**Figure 7: U.S. loans remain one of the highest yielding asset classes in public fixed income**

Yield-to-worst by fixed income sector (%)

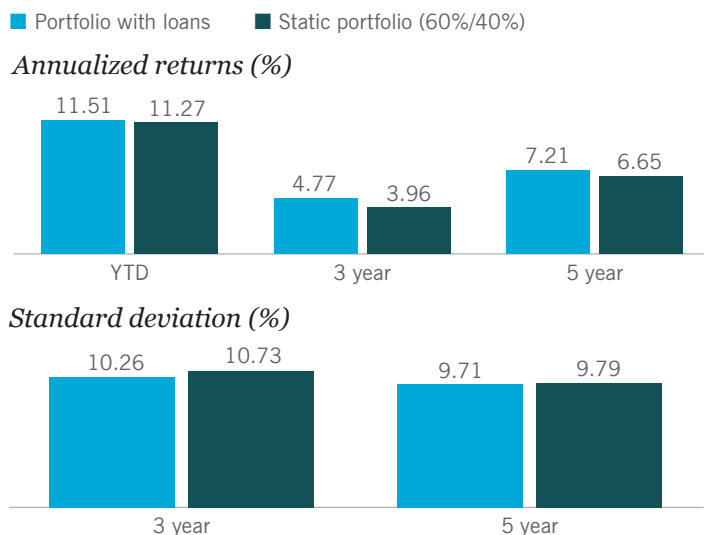


Data source: Bloomberg LP as of 30 Sep 2024; Credit Suisse. Performance data shown represents past performance and does not predict or guarantee future results. Representative indices: U.S. Treasuries: Bloomberg U.S. Treasury Index; ABS: Bloomberg Asset-Backed Securities Index; MBS: Bloomberg U.S. Mortgage-Backed Securities Index; CMBS: Bloomberg Commercial Mortgage-Backed Securities Index; Investment grade corporates: Bloomberg U.S. Corporate Investment Grade Index; Preferred securities: ICE BofA U.S. All Capital Securities Index; Emerging market debt: Bloomberg Emerging Market USD Aggregate Index; High yield corporates: Bloomberg U.S. Corporate High Yield 2% Issuer Capped Index; Senior loans: Credit Suisse Leveraged Loan Index. Past performance is no guarantee of future results. It is not possible to invest directly in an index.

### 3. DIVERSIFICATION BENEFITS OF U.S. SENIOR LOANS ENHANCE THEIR APPEAL

In addition to compelling risk-adjusted returns, U.S. senior loans bring diversification benefits to portfolios due to their lower correlations to other major asset classes. For instance, over the long-term, U.S. senior loans have a correlation of just 0.15 to high quality U.S. bonds and 0.60 to U.S. stocks. In comparison, U.S. high yield bonds have considerably higher correlations of 0.48 and 0.80 to high quality U.S. bonds and stocks, respectively.<sup>4</sup> Figure 8 is a simplified illustration of the advantages this asset class can bring to a balanced portfolio. Adding a 10% allocation of U.S. senior loans to high quality bonds, increases portfolio returns while simultaneously reducing volatility.

**Figure 8: Adding U.S. senior loans enhances returns and reduces volatility compared to a static portfolio**



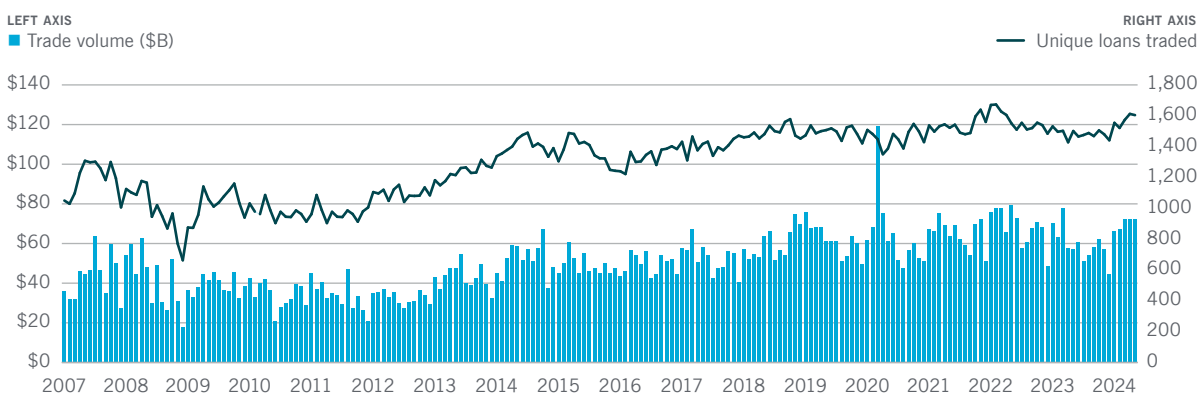
Data source: Morningstar, 30 Sep 2024. Performance data shown represents past performance and does not predict or guarantee future results. Static portfolio is a 60% bond/40% equities allocation. Bonds represented by Bloomberg U.S. Agg Bond TR USD and equities by S&P 500. Portfolio with loans is a 50% bond/10% loan/40% equities. Loans proxied by Morningstar LSTA U.S. LL Index. It is not possible to invest directly in an index.

#### 4. LIQUIDITY IN SENIOR LOANS PROVIDES FLEXIBILITY FOR INVESTORS

One of the most important attributes of U.S. senior loans is liquidity. Loans trade actively on the secondary market. In the 12-month period ending May 2024, the average total monthly trading volume in the U.S. senior loan market was approximately \$60 billion and cumulative volume was roughly \$740 billion, representing over 50% of total market size. Funds that invest in loans can offer daily or weekly liquidity to underlying investors.

This feature is important for two main reasons. First, it facilitates the active management of portfolios by allowing managers to trade positions either for risk mitigation or return-seeking purposes. Second, it benefits end investors, as liquidity provides optionality to express their asset allocation and relative value views in real time instead of being locked up in multi-year investment vehicles.

**Figure 9: U.S. senior loans are actively traded**



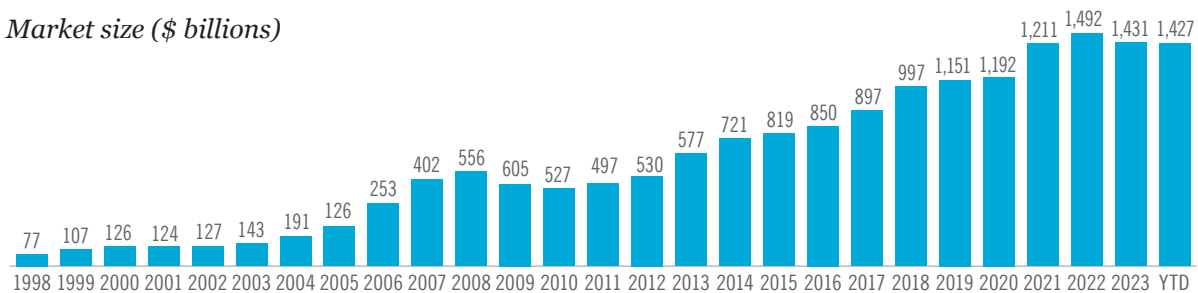
Data source: PitchBook | LCD, 31 01 Jan 2007 – 31 May 2024.

#### 5. U.S. SENIOR LOANS HAVE MATURED FROM NICHE TO MAINSTREAM

At \$1.4 trillion, U.S. senior loans can hardly be classified as niche. This rise has partly been fueled by robust issuance of CLOs, single securities backed by pools of debt, in this case, senior loans. CLOs currently make up two-thirds of the investor base in U.S. senior loans. These securities typically have a seven-to-ten-year life, making them long-term investors in the asset class. In addition, institutional investors comprise nearly 30% of the buyer base, bringing further stability to the loan market.

**Figure 10: U.S. senior loans have grown steadily**

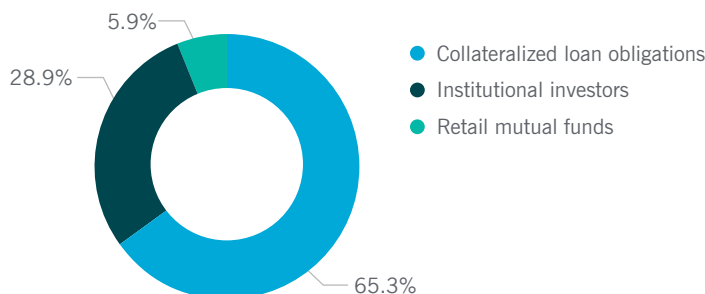
Market size (\$ billions)



Data sources: JP Morgan, S&P/IHS Markit, 30 Jun 2024.

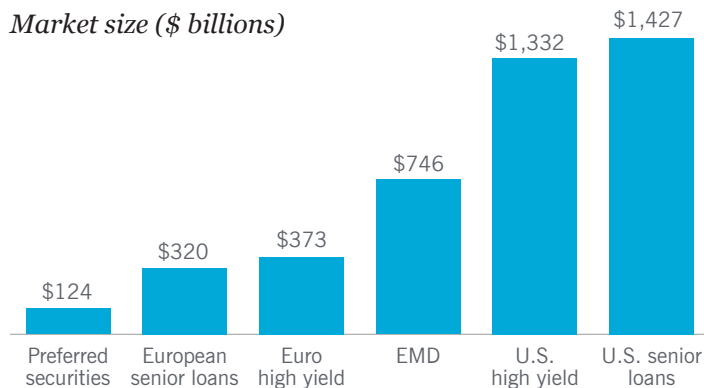
U.S. senior loans are now considerably larger than many other fixed income asset classes that are deemed mainstay in traditional portfolios, including emerging markets debt, U.S. high yield and European high yield.

**Figure 11: Investor base for U.S. loan market is predominantly institutional**



Data source: JP Morgan, 31 Oct 2023; updated annually.

**Figure 12: The size of the U.S. senior loan market is larger than other mainstay fixed income asset classes**



Data sources: JP Morgan, Bloomberg, Morningstar as of 30 Sep 2024. **Representative indexes:** Preferred securities: ICE BofA Fixed Rate Preferred Securities Index; European senior loans: Morningstar Western Europe LL Index TR; Euro high yield: ICE BofA Euro High Yield Index; Emerging markets debt (EMD): JP Morgan EMBI Global Diversified Index; U.S. high yield: ICE BofA U.S. High Yield Index; U.S. senior loans: Morningstar U.S. LL Index. It is not possible to invest directly in an index.

### WHY NUVEEN FOR U.S. SENIOR LOANS?

For investors looking to access this exciting market, active management is key to success. U.S. senior loan indices are difficult to replicate, and ETFs that proxy broad loan market exposure tend to underperform. For instance, the largest such ETF has lagged peers 70% of the time in the past 10 years.<sup>5</sup> Nuveen has invested in U.S. senior loans for more than 20 years through multiple market environments and credit cycles. Our leveraged finance team of over 40 investment professionals oversees more than \$40 billion<sup>6</sup> in leveraged finance assets, giving us the scale, resources and access that are necessary for success. Our investment approach emphasizes: 1) active management through daily re-underwriting of credits to identify relative value opportunities in buys and sells, 2) a preference for larger, more liquid loans that allow us to be more nimble than peers, and 3) greater selectivity in the new issue market, seeking to avoid overpriced loans and weaker business models. An unwavering commitment to these tenets has enabled us to deliver compelling risk-adjusted returns for nearly a quarter of a century in the U.S. senior loan asset class.

**For more details on how senior loans can play a role in your portfolio, please consult with your local Nuveen representative or visit [nuveen.com](https://nuveen.com).**

#### Sources

- 1 EBITDA stands for Earnings Before Interest, Taxes, Depreciation and Amortization.
- 2 References to specific company stocks should not be construed as recommendations or investment advice. For illustrative purposes only.
- 3 Data source: Credit Suisse Leveraged Loan Index as of 30 Sep 2024.
- 4 Over a 10 year period from 01 2014 – 30 Sep 2024. **Representative indices: High quality U.S. bonds:** Bloomberg U.S. Agg Bond TR; **U.S. equities:** S&P 500; **U.S. high yield:** ICE BofA U.S. High Yield TR; **U.S. senior loans:** Morningstar LTSA U.S. LL TR
- 5 Invesco Senior Loan ETF (ticker: BKLN). Ten year look back from 2014 – 2023. Performance period is each calendar year. Peer category is Morningstar US Bank Loan Fund.
- 6 As of 30 June 2024. Nuveen Leveraged Finance assets under management (AUM).

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#### Important information on risk

Investing involves risk; principal loss is possible. Different types of asset investments have different types of risks, which may provide higher returns but also greater volatility. Income is only one component of performance and an investor should consider all of the risk factors for each asset class before investing. Except in certain circumstances, income is generally subject to both federal and state taxes. Fixed income securities may be susceptible to general movements in the bond market and are subject to credit and interest rate risks. Credit risk arises from an issuer's ability to make interest and principal payments when due, as well as the prices of bonds declining when an issuer's credit quality is expected to deteriorate. Interest rate risk occurs when interest rates rise causing bond prices to fall. The value of, and income generated by, debt securities will decrease or increase based on changes in market interest rates. Government bonds are guaranteed as to the timely payment of principal and interest. However, there are other factors that can contribute to how securities react in various interest rate environments. Below investment grade or high yield debt securities are subject to heightened credit risk, liquidity risk and potential for default. The issuer of a debt security may be able to repay principal prior to the security's maturity, known as prepayment (call) risk, because of an improvement in its credit quality or falling interest rates. In this event, this principal may have to be reinvested in securities with lower interest rates than the original securities, reducing the potential for income. Senior loans may not be fully secured by collateral, generally do not trade on exchanges, and are typically issued by unrated or below-investment grade companies, and therefore are subject to greater liquidity and credit risk. Preferred securities are subordinate to bonds and other debt instruments in a company's capital structure. They combine the features of bonds and stocks, and have credit risk based on the issuer's ability to make interest and dividend payments when due. Certain types of preferred, hybrid or debt securities with special loss absorption provisions, such as contingent capital securities (CoCos), may be or become so subordinated that they present risks equivalent to, or in some cases even greater than, the same company's common stock. Asset-backed and mortgage-backed securities are subject to additional risks such as prepayment risk, liquidity risk, default risk and adverse economic developments. Concentration in specific sectors may involve greater risk and volatility than more diversified investments.

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