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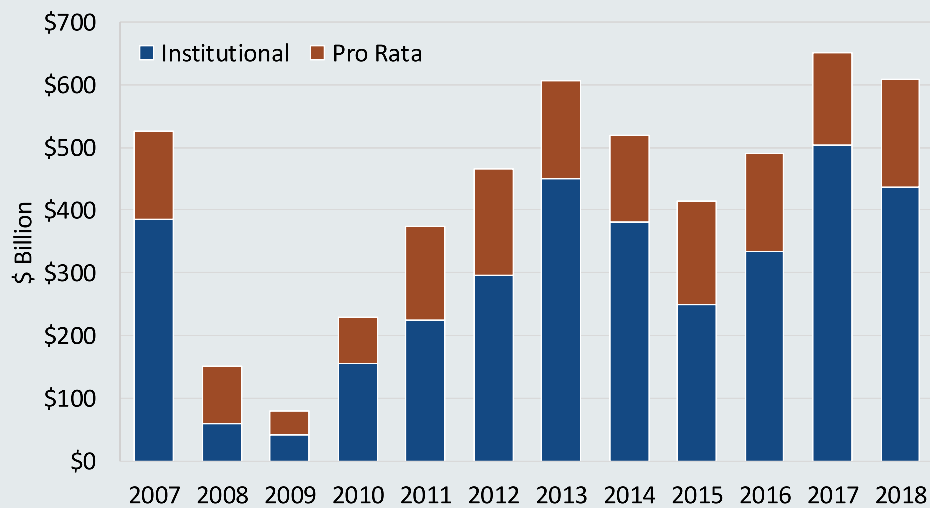
Investment Insights:
Is the Leveraged Loan Market a Signal?

As investors in equity and credit securities, we watch the credit markets closely as credit risk premia affect equity returns. The leveraged loan market has grown in significance as issuance has increased over the last few years—and their prices have fallen dramatically since mid-November.

We believe that quality matters in this environment, so investors should be wary of highly leveraged companies whose stocks tend to perform poorly in periods of widening credit spreads and tend to receive lower multiples, generally, over time.

US Leveraged Loan Issuance Downshift in 2018

Investors seeking higher yields have supported rapid growth in the leveraged loan market over the last few years.



As of December 14, 2018. Source: LCD, an offering of S&P Global Market Intelligence
http://www.leveragedloan.com/us-leveraged-loan-issuance-downshifts-2018-609b-volume/

Leveraged Loan Price Index Drops to Lowest Since October 2016

After holding up relatively well through the middle of November, prices of leveraged loans have begun to reflect the concerns of equity and other credit markets, e.g., High Yield.

As of December 26, 2018. Source: Bloomberg.

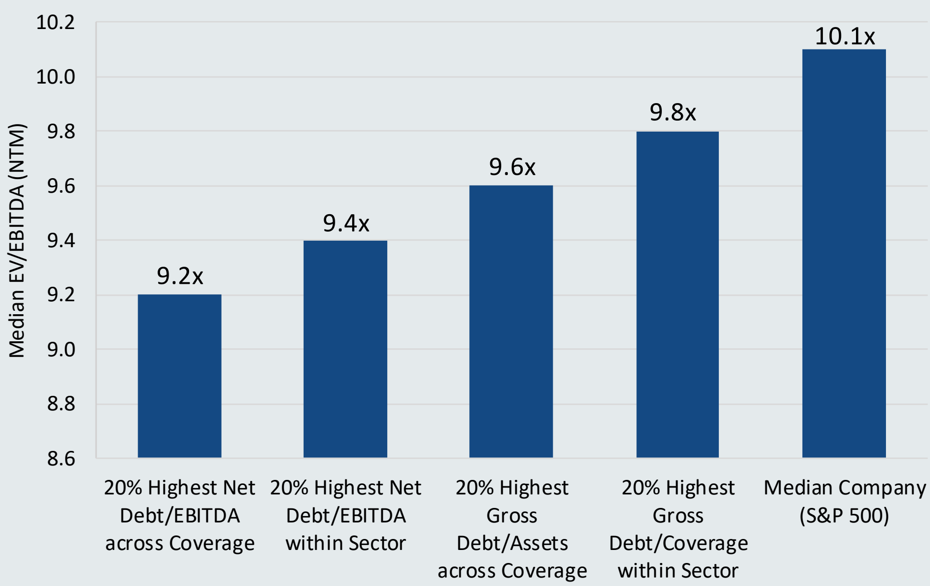
US Leveraged Loan Default Rate Dips to 1.61%

Losses in the leveraged loan market have been modest, historically. Yet the recent price weakness and the widening of spreads suggests investors may be growing concerned that we will see a rise in defaults in 2019.

As of December 3, 2018. Source: LCD, an offering of S&P Global Market Intelligence
http://www.leveragedloan.com/us-leveraged-loan-default-rate-dips-1-61/

Highly-levered Stocks Have Lower Valuation Multiples on a Median Basis

We believe that it is prudent at this stage of the economic cycle to focus on quality. The equity securities of highly leveraged companies are penalized with lower multiples over time and tend to perform poorly during periods of rising credit spreads.



As of December 2018. Source: FactSet, Goldman Sachs Global Investment. Median EV/EBITDA (Consensus NTM) for stocks with the highest 20% (Quintile 5) Net Debt/EBITDA in GICS Level 1 sector vs. All companies; GS coverage (ex Fins & RE).

In sum, while we don't see the recent weakness in credit markets and the leveraged loan market in particular as an imminent issue, we are watching them closely as a potential signal of investor risk appetite.

Disclosures

ABOUT US

Nicholas Investment Partners, L.P. is an independent, employee-owned and majority women-owned investment boutique focused on investing in dynamic, less efficient markets such as US small- and mid-cap equities and convertible bonds. We believe that change creates opportunity. We invest in dynamic companies with accelerating revenue and/or earnings growth in which our research confirms the company's growth is sustainable and the company's stock is a timely investment. Our edge comes from combining fundamental equity and credit research with the objectivity and efficiency of quantitative analytics. We have a results-driven and client-centric culture centered on building lasting and value-added relationships with a select group of institutional and private wealth clients and consultants.

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