Why Invesco Senior Loan ETF (BKLN)

The World's Largest, Oldest & Most Liquid Senior Loan ETF[1]

Authors

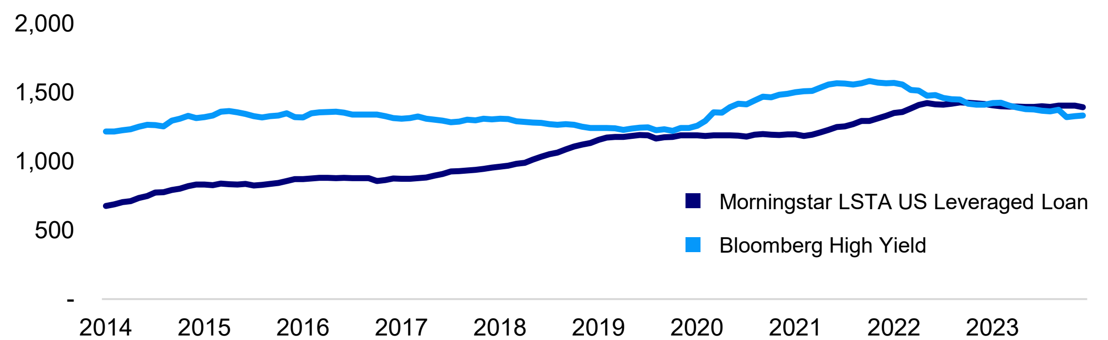
Brad Smith
Director, International ETF Specialist

Salman Zaidi
Head - Asset Management & Insurance, ETF

What are Senior Loans?

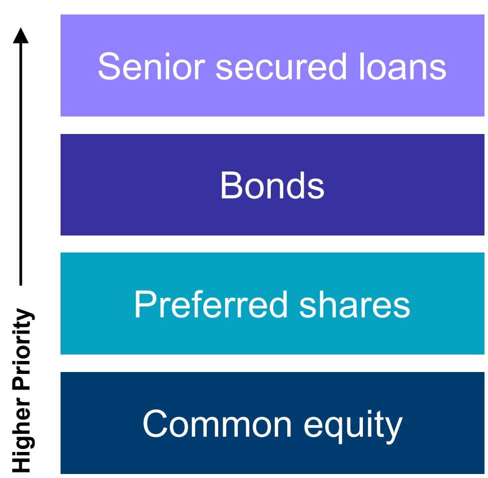
Senior loans, also known as leveraged loans, are debt securities utilized by companies to finance their operations, support business expansion, and refinance existing debt. These loans are termed "senior" due to their uppermost position in a company's capital structure, meaning they have the highest priority to be repaid in the event of a default. They are typically secured by the borrower's assets, such as cash, receivables, inventory or property. Senior loans are structured as floating rate loans, which means the interest paid on these loans fluctuates with interest rate changes. This syndicated loan market has grown to $1.4 trillion, larger than the high yield bond market. Historically, senior loans and high yield bonds have had similar default rates, but senior loans, due to being senior secured to high yield bonds, have had higher recovery rates, leading to a 1.1% credit loss rate over the past 25 years vs high yield's (2.0%)[2].

Syndicated loan market, larger than high yield bond market
$ Billions Outstanding



Source: Loan Syndications and Trading Association (LSTA), Bloomberg. High Yield represented by par amount outstanding for the Bloomberg US Corporate High Yield Bond Index, as of December 30 2023.

Capital Structure



- Generally, have **first priority** on the borrower's assets
- **Backed by collateral** leading to improved recovery rates and lower credit loss
- Historically **higher recovery rates** than high yield (64% vs 40%)[3]
- **Floating rate** has resulted in lower duration, helping mitigate interest rate risk and benefits from **higher coupon income** in a sustained higher rates scenario

The authors would like to thank the Invesco Senior Secured Management Team.

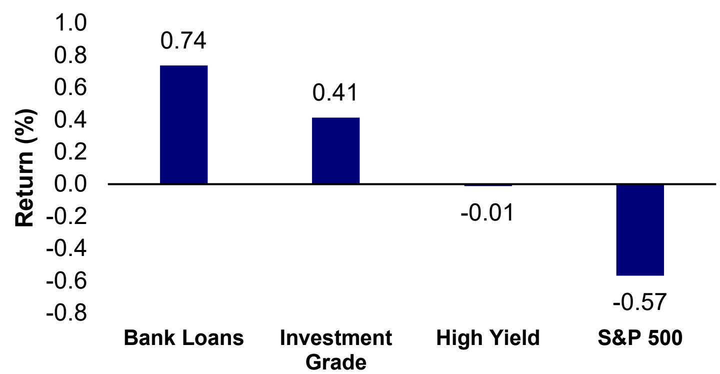
1. Source: Bloomberg as of December 31, 2023, BKLN was launched in 2011 and was the first Bank Loan ETF. Page 4 discusses its AUM and liquidity vs other ETFs.
2. Source: JPMorgan, 25-year average high yield and leveraged loan default rates are 3.4% and 3.0%, respectively.
3. Credit Suisse Leveraged Loan Index data through December 31, 2023.

Diversification During Downturns

The floating rate characteristic of senior loans, coupled with their collateralized nature and priority in the capital structure, has traditionally provided resilience for this asset class during market downturns. During the US economy's (measured by the S&P 500) 20 worst quarters, senior loans, on average, have outperformed high yield and even investment grade debt (chart on the right). Through various interest rate and economic environments the senior loan asset class has only posted negative returns over three of the past 31 years.[1]

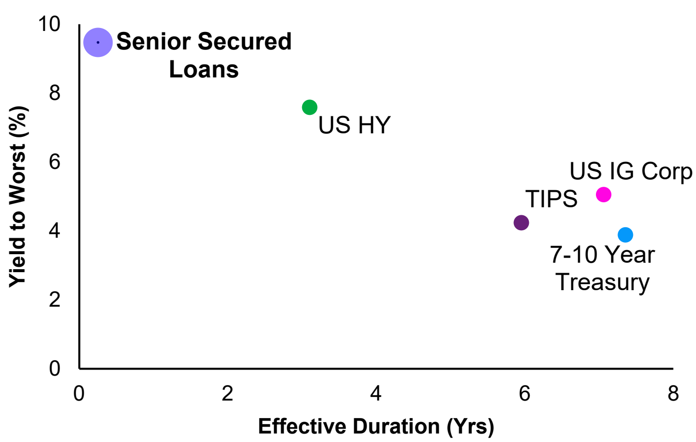
Source: Bloomberg from March 2011 to December 2023. Bank Loans represented by Morningstar LSTA US Leveraged Loan 100 Index, High Yield by Bloomberg High Yield Bond Index, Investment Grade by Bloomberg US Corporate Bond Index. Performance data quoted represents past performance, which is not a guarantee of future results.

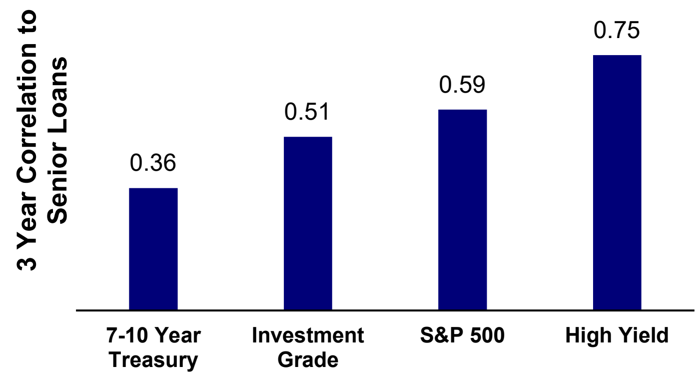
Median Return During the US Economy's 20 Worst Quarters



Attractive yield/duration profile along with low correlations to other asset classes

Senior secured loans have been offering yields above high yield with little duration. This, coupled with their seniority in the capital structure, has resulted in the segment having a low correlation to other asset classes.





Source: Bloomberg as of December 29, 2023. Senior Secured Loans represented by Morningstar LSTA US Leveraged Loan 100 Index, High Yield by Bloomberg US Corp High Yield Bond Index, TIPS by Bloomberg US Treasury Inflation Notes Index, Investment Grade by Bloomberg US Corporate Bond Index, S&P 500 by the S&P 500 Index, 7-10 Year Treasury by ICE US Treasury 7-10 Year Bond Index.

Why Senior Loans Now?

Senior loan's unique combination of appealing characteristics may position it as an enticing core holding in any environment.

- **Duration Rally: Has it Come… and Gone for HY & IG Bond**
  2023's year end interest rate rally drove outside returns for long duration. Roughly half of high yield's recent run up can be attributed to duration. Year end levels for longer duration fixed income are factoring in 150bps of rate cuts in 2024. For long duration, the rally may have come and gone. Senior loans, being floating rate, have resulted in lower duration and have helped mitigate the impact of changes in interest rates[2].

- **Attractive Valuations: Both Absolute and on a Relative Basis vs HY**
  Senior loans spreads and yields remain attractive on a historical basis. Currently senior loan spreads[3] are 528 bps, 73 bps above their 455 bps long term average. Additionally, high yield's spread to worst has tightened to 3.63% and currently sits 129 bps below their 4.92% long term average[4]. On a relative basis, loans are 165 bps cheaper vs high yield on a spread basis[4].

- **2024 Outlook: Policy Makers are Expected to Pivot, but Rates Should Remain Elevated**
  We believe the broader loans segment is attractively valued and may fair well during 2024[5]. The loan market coupon is currently 9.36%[1], a function of nominal loan spreads at 3.98%[1] and CME Term SOFR at 5.38%[6]. The forward SOFR curve currently implies an average 3-month SOFR rate of approximately 4.5% over the course of 2024.[7] This reflects the broadly adopted market view that the US Federal Reserve (Fed) will pivot to easing interest rates in 1H 2024, but will unwind prior rate hikes cautiously. Despite the expectation of a gradual decline in rates, loan coupons remain near record highs[8].

1 Credit Suisse Leveraged Loan Index as of December 31, 2023
2 Source: Credit Suisse; Barclays; Bloomberg as of December 31, 2023.
3 three year discount margins.
4 Credit Suisse Leveraged Loan Index & Credit Suisse High Yield Index as of December 31, 2023. Long term averages based on data from January 31, 1992 to December 31, 2023.
5 Source: Invesco Senior Secured Management. There is no guarantee that the forecast will be realized. Forecast is based on coupon plus wider nominal spreads minus base rate declines minus price erosion.
6 Bloomberg December 4, 2023
7 Bloomberg January 4, 2024.
8 Source: PitchBook Data, Inc as of December 31, 2023.

BKLN: Industry Leading Efficient Access to Senior Loans

Invesco Senior Loan ETF (BKLN), launched in 2011, was the world's first senior loan ETF. BKLN has become known across ETFs for its liquid, efficient and transparent access to the leveraged loans market. BKLN provides market cap exposure to the 100 largest and most liquid loan facilities in the leveraged loan market.

BKLN: Constructed for Tradability

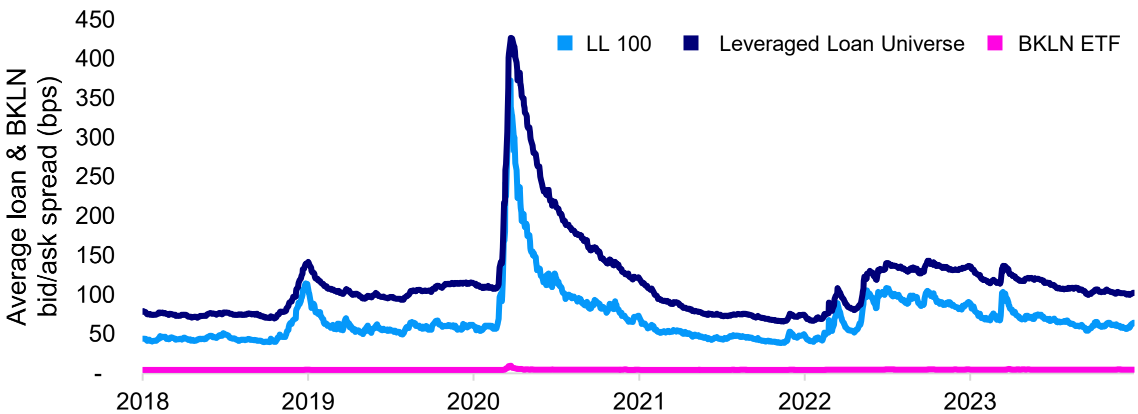
Index construction is key to maximizing tradability within the bank loan space. When designing BKLN, underlying market liquidity was a key consideration and is primarily why Invesco selected the Morningstar LSTA US Leveraged Loan 100 Index (LL100) as BKLN's underlying index. By narrowing the Morningstar LSTA US Leveraged Loan Index with 1,477 loans[1] to the largest 100 loans, the LL100 index provides an enhanced liquidity profile relative to the broader Bank Loan universe and other Bank Loan ETFs that may hold smaller, less actively traded loans. Historically, over the past 5 years, the loans in the LL100 have traded 45 bps tighter and more frequently than the broader loan universe. Additionally, the ETF structure adds another layer of liquidity. Even through COVID, BKLN's average bid/ask spread has averaged 5 bps.

Amidst turmoil, BKLN delivered **price discovery**

Bid/ask spreads:
Loan market: 372 bps
BKLN: 7 bps

Tighter Underlying Loan Spreads Provide Enhanced Liquidity

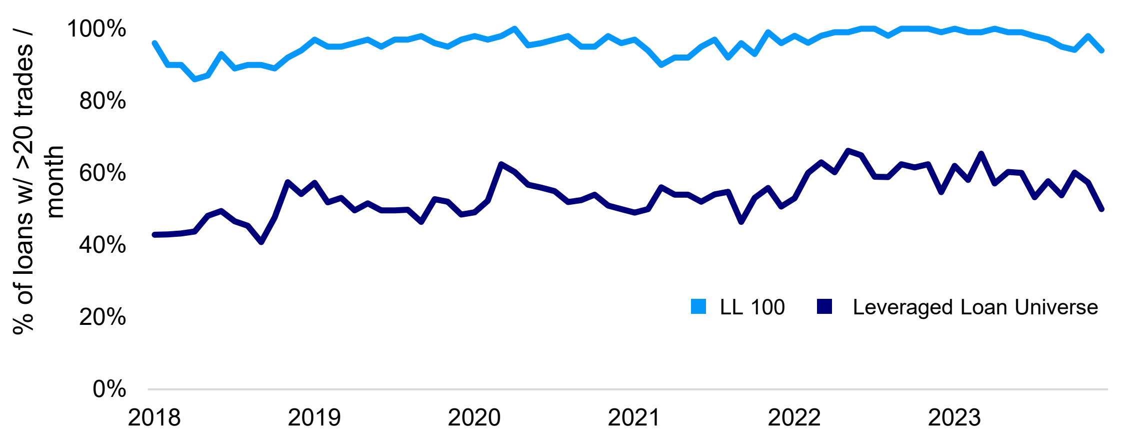
Average spreads Morningstar LSTA US Leveraged Loan 100 Index vs broader US Leveraged Loan market



Source: LSTA/LSEG LPC MTM Pricing, Morningstar LSTA US Leveraged Loan 100 Index and Bloomberg. Five years as of December 31, 2023.

LL100: Higher Trade Frequency Aids Liquidity

Nearly all the loans in the LL100, BKLN's benchmark, trade >20 times a month, nearly double the broader universe

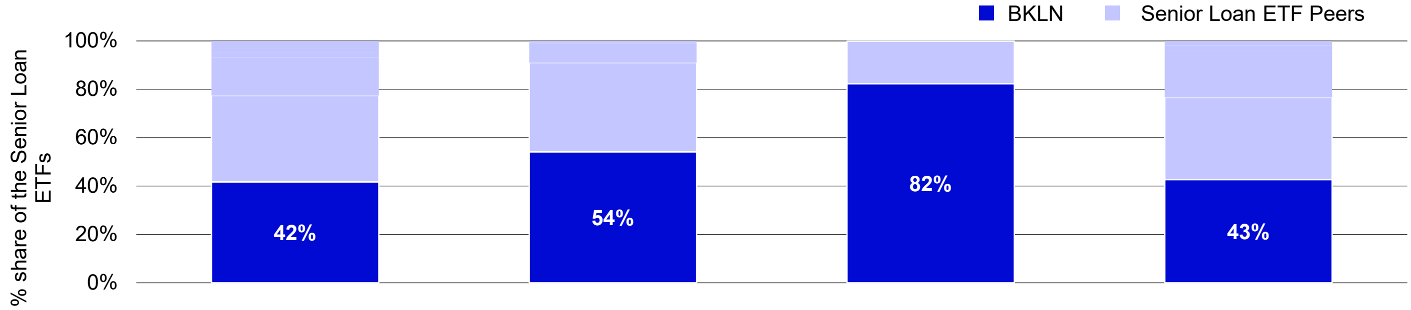


Source: As of December 31, 2023. LSTA Trade Data Study, Morningstar LSTA US Leveraged Loan 100 Index

1 Source: Morningstar as of January 31, 2024.

BKLN: Leads in Senior Loans

BKLN's thoughtful composition has yielded a robust ecosystem that makes it the leading bank loan ETF across **AUM, trading volume, options open interest** and **institutional ownership.**



	AUM	30D Avg $ Volume	Total Option Interest	Institutional Ownership
BKLN	$6.1B	$190M	47,685	$4.5B or 74% of BKLN
BKLN % Share	42%	62%	82%	43%

Source: Bloomberg as of December 29, 2023. All US-listed senior loan ETFs are used for the peer group to calculate BKLN's % share. Institutional ownership is measured by the percent of shares outstanding held by institutions. Institutions include 13Fs, US and International Mutual Funds, Schedule Ds (US Insurance Companies) and Institutional stake holdings that appear on the aggregate level. Based on holdings data collected by Bloomberg.

Institutional Use Cases for BKLN

Liquid beta exposure

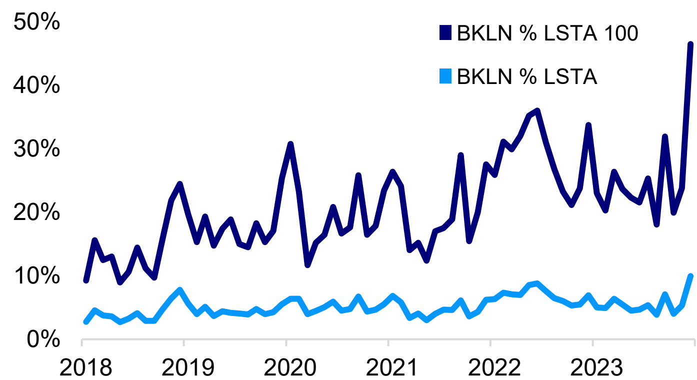
- **BKLN has become an integral part of the loan ecosystem**. The Syndicated Loan market has grown to $1.4 trillion, larger than the High Yield bond market, and BKLN trading volumes have kept pace, satisfying demand for a trading vehicle in an instrument where standard settle is still t+12 (Par-Median Settlement)[1].
- **The ETF provides a key link to institutional investors looking for quick, efficient access.** In a year where secondary trading loan volumes declined to a six year low of $715 billion, BKLN notional traded volumes represented, on average, ***21% and 5% of ALL syndicated loans and LSTA 100 loans respectively each month (left hand side chart below).***
- **BKLN volumes all time highs in December 2023.** Expressed as a percentage of all LSTA secondary market loan trades, BKLN represented 9.9%, an all time high since inception, and 46.5% when expressed as a percentage of LSTA 100 secondary market trades[2].

Liquid proxy for private credit

- **Senior loans provide a high correlation, low duration, efficiently traded proxy for private credit.** To illustrate, we examined quarterly returns for the last decade for a widely utilized index for private credit, the Cliffwater Direct Lending Index (CDLI).
- **Over the past 10 years, the correlation for Direct Lending vs. Senior Loans was relatively-high (0.82)**, followed by High Yield (0.78). Rising rates pressured many asset classes causing correlations to break down in 2022. Now that rates have stabilized, correlations have returned to their long term averages. CDLI total returns had a significantly lower correlation with high duration broad IG benchmarks like the Bloomberg Aggregate Index or Bloomberg Corporate IG[3].
- **Given the relative ease of building positions in BKLN, institutional investors have expressed increasing interest in utilizing BKLN while they source private deals and partner with private asset managers.** With average daily volumes of $160mm in 2023, and average bid-offer spread of just over 1c over the last decade, BKLN provides a compelling solution as a proxy for investors building private credit portfolios[4].

BKLN Continues to Fulfill the Need for Broad Market Access

BKLN $ Volume % of Loan Universe



Senior loans have been highly correlated to private credit

10 Year Correlations vs Cliffwater Direct Lending Index

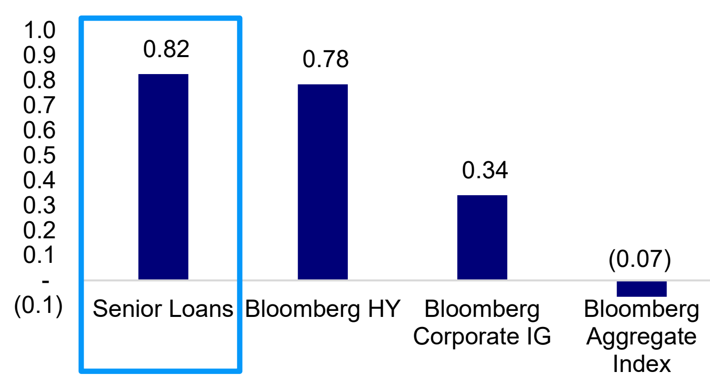


Chart on the left: LSTA, Bloomberg. As of December 30, 2023. Chart on the right: Cliffwater Direct Lending Index, Bloomberg. As of September 30, 2023. The latest quarterly data available for CDLI is as of end September, 2023. Senior Loans represented by the Morningstar LSTA US Leveraged Loan 100 Index. High yield, IG Corp and Aggregate all represented by Bloomberg's US Indexes. 1 Source: LSTA Secondary Trading & Settlement Monthly, January 2024. 2 Source: LSTA, Bloomberg, monthly data as of December 30, 2023. 3 Source: Cliffwater Direct Lending Index, Bloomberg as of September 30, 2023. 4 Bloomberg.

Important risks and information

There are risks involved with investing in ETFs, including possible loss of money. Shares are not actively managed and are subject to risks similar to those of stocks, including those regarding short selling and margin maintenance requirements. Ordinary brokerage commissions apply. The Fund's return may not match the return of the Underlying Index. The Fund is subject to certain other risks. Please see the current prospectus for more information regarding the risk associated with an investment in the Fund.

Investments focused in a particular industry or sector, are subject to greater risk, and are more greatly impacted by market volatility, than more diversified investments.

Shares are not individually redeemable and owners of the Shares may acquire those Shares from the Fund and tender those Shares for redemption to the Fund in Creation Unit aggregations only, typically consisting of 10,000, 20,000, 25,000, 50,000, 80,000, 100,000 or 150,000 Shares.

Most senior loans are made to corporations with below investment-grade credit ratings and are subject to significant credit, valuation and liquidity risk. The value of the collateral securing a loan may not be sufficient to cover the amount owed, may be found invalid or may be used to pay other outstanding obligations of the borrower under applicable law. There is also the risk that the collateral may be difficult to liquidate, or that a majority of the collateral may be illiquid.
An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating.

Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa.

Non-investment grade securities may be subject to greater price volatility due to specific corporate developments, interest-rate sensitivity, negative perceptions of the market, adverse economic and competitive industry conditions and decreased market liquidity.

The risks of investing in securities of foreign issuers can include fluctuations in foreign currencies, political and economic instability, and foreign taxation issues.

The Fund is non-diversified and may experience greater volatility than a more diversified investment

Reinvestment risk is the risk that a bond's cash flows (coupon income and principal repayment) will be reinvested at an interest rate below that on the original bond.

The Fund may engage in frequent trading of its portfolio securities in connection with the rebalancing or adjustment of the Underlying Index.

The Fund's use of a representative sampling approach will result in its holding a smaller number of securities than are in the underlying Index, and may be subject to greater volatility.

The Fund may hold illiquid securities that it may be unable to sell at the preferred time or price and could lose its entire investment in such securities.

Under a participation in senior loans, the fund generally will have rights that are more limited than those of lenders or of persons who acquire a senior loan by assignment. In a participation, the fund assumes the credit risk of the lender selling the participation in addition to the credit risk of the borrower. In the event of the insolvency of the lender selling the participation, the fund may be treated as a general creditor of the lender and may not have a senior claim to the lender's interest in the senior loan. Certain participations in senior loans are illiquid and difficult to value.

The Fund currently intends to effect creations and redemptions principally for cash, rather than principally in-kind because of the nature of the Fund's investments. As such, investments in the Fund may be less tax efficient than investments in ETFs that create and redeem in-kind.

ETFs disclose their holdings daily.

Before investing, investors should carefully read the prospectus and/or summary prospectus and carefully consider the investment objectives, risks, charges and expenses. For this and more complete information about the fund(s), investors should ask their financial professional for a prospectus/summary prospectus or visit invesco.com/fundprospectus.

20240221-3402523-NA