Senior Loan Closed-End Funds off to a Strong Start in 2015

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After a challenging 2014 when the average senior loan closed-end fund (CEF) was lower by 1.93%, senior loan CEFs are off to a strong start in 2015. Indeed, the average senior loan CEF is up 5.53% year-to-date (YTD), which makes the senior loan CEF category one of the best-performing taxable fixed-income categories within the Morningstar universe so far this year. By comparison, the average taxable fixed-income CEF is up 2.91% YTD. (All data is from Morningstar on a share price total return basis through 3/25/15.)

I believe there are a few key reasons for the strong start to the year for senior loan CEFs including:

1. Investors are starting to recognize and take advantage of the compelling valuations as well as compelling fundamentals that exist in the senior loan asset class and senior loan CEFs. While many fixed-income asset classes trade on average above par, the average senior loan as measured by the S&P/LSTA U.S. Leveraged Loan 100 Index is trading at a slight discount to par. According to Bloomberg, the average senior loan price was 96.16 as of 3/25/15. Moreover, while average discounts to net asset value (NAV) have narrowed to 6.32% as of 3/25/15 from the 9.09% they ended 2014, according to Morningstar, they are still wider than historical averages. One year ago the average discount to NAV was 5.22%, three years ago the average discount to NAV was 0.66%, five years ago the average premium to NAV was 3.27%, and 10 years ago the average discount to NAV was 0.79% (Morningstar as of 3/25/15). Lastly, fundamentals continue to be sound with the default rate by number of loans falling to 0.73% in February from 0.75% in January, according to Standard & Poor's.

2. Investors are in the very early stages of repositioning their fixed-income portfolios to shorten durations ahead of a potential increase in the federal funds rate later this year.

While just under three months does not make a long-term trend, it has been encouraging to see share price momentum build in senior loan CEFs in 2015, particularly after a difficult 2014. Based on the continued strong fundamentals in the senior loan asset class, compelling valuations among senior loan CEFs and the senior loan asset class, I continue to believe senior loan CEFs should be part of a diversified CEF portfolio. Please see my CEF Quarterly Commentary from January for further comments on senior loan CEFs as well as other categories I currently favor. **Click here to view.**

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