Running Out the Clock

THE LEAD | December 7, 2016

Among the unlikelier events of this post-election season – other than the consideration of former World Wrestling Entertainment executive, Linda McMahon, to be head of the Small Business Administration – has been the confidence with which institutional investors have rotated into leveraged credit. This despite the uncertainty surrounding the future of all sorts of policy matters, from healthcare to immigration to China.

To some extent, this has been predictable. The incoming administration has at least made it clear that the domestic economy, particularly jobs and growth, will be front and center of their short-term considerations. That has helped spur a 1000 point Dow climb in the past month and a commensurate rise in interest rates.

That exuberance has raised inflation concerns and triggered speculation that the Fed will not only hike rates as predicted at their December meeting next week, but will do so multiple times during 2017. Analysts suggest such moves will chill investor interest in fixed income instruments and fuel that of floating rate loans.

Some have suggested the view that Trump policies will buoy GDP and re-energize what has been a listless recovery could represent the triumph of hope over reality. However, it is acknowledged by even the most sober market observers that sustained investor optimism across markets might make stimulus a self-fulfilling prophecy.

Certainly the broadly syndicated loan market has responded by handing issuers early holiday gifts. The buy-side has seen a flurry of repricings and refinancings, but also a decent mix of new buyouts and M&A volume.

According to LevFin Insights, some $20 billion of repricings hit the large cap market; a weekly level not seen since early September. That activity was impressive given the short calendar before year end, and was surely prompted by a combination of new CLOs being formed – $8.6 billion for November alone – and cash flowing into retail loan funds – almost $2 billion through the last four weeks (per S&P LCD).

We’ve witnessed a similar late inning upsurge of new financings in the middle market. That reversed a trend we noted in early November when it looked like both the quality and quantity of transactions had lost significant steam.

“We’re not trying to be heroes,” the head of capital markets for one prominent middle market manager told us a month ago. “We’ve had a good year, we’ve already made our budget, and we don’t want to screw it up. We’re just trying to run out the clock.”

That game plan may have changed. Deal flow has picked up in the past couple weeks, and quality with it. Sponsors seem sustained by the market’s new-found faith in next year’s economic pick-up. One partner explained it this way: “The idea earlier in the year that a recession was around the corner has been put on the shelf. It now looks like we’ve got another three years with the wind at our backs.”

That view was shared by a leading middle market lender. “We weren’t very excited about the January pipeline before the election. Now it looks like we’ll start the year with a bang.”