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2017 – A Look Ahead (Last of a Series)

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In this special series on the outlook for leveraged lending for the year, we've looked at what our readers can expect for deal terms, including pricing, leverage, structures, and covenants. We've also closely examined the factors that will affect the supply and demand for transactions. Last week, we covered the future of credit quality.

Finally, let's turn to what outside-the-box, exogenous factors could upset the credit applecart this year. A recent Preqin survey (see *Chart of the Week*) highlights some of these issues. Here's our take:

Interest rates – Despite its forecast of three rate upticks for 2017, there's no guarantee the Fed will actually do so. Chair Yellen has proven to be a reluctant hiker. The futures market seems to be skeptical about a move in March, though recent news on productivity and job growth will create pressure to act sooner rather than later.

Libor has risen steadily over the past six months, with the three-month benchmark now over 1%. Over the longer term, this will make Libor floors, many set at 1%, moot. Of course, if rates rise faster than markets expect, that would boost interest expenses for leveraged borrowers. Having said that, it would take quite a jump to match where Libor was before the credit crisis. In September 2007 three-month Libor was 5.6%. We've got a ways to go.

Geopolitical risk – With uncertainty surrounding immigration and NATO, as well as relations with Russia, China, and key allies in flux, the US is more exposed to unanticipated global events. That has introduced a greater measure of volatility into broader markets. A more acute North Korean military provocation, for example, could puncture the recent rally in equities, causing a ripple effect in asset valuations.

Unexpected policy moves – One thing the new Administration has proven is its capacity for upending conventional wisdom. Surprise, though, is not always welcomed by investors. There seems to be broad agreement that more long-term government spending will be required to maintain our nation's infrastructure. But economists worry that too many dollars chasing big projects will be inflationary and have negative consequences on federal deficits.

Similarly, ACA reform seems to be in the cards. But with healthcare representing one-sixth of our economy, any sector headwinds are bound to impact GDP. This includes sustained uncertainty as to what a revamped program would look like. The longer that lasts, the more of a drag it will be on deal activity.

Border conflicts – Immigration and trade issues have the potential to increase volatility in the credit markets. As we've seen in the past, tit-for-tat moves by trading partners could have repercussions across sectors and up-and-down supplier chains.

All these factors as well as unknown unknowns, will make 2017 an interesting year for the capital markets. Thanks to its relative insulation from more global volatility, though, US-centric private senior debt as an asset class will continue to get more than its share of attention from institutional investors as a safer haven.