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Bones and Loans

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The 21st century and our prehistoric past met near a parking lot at NASA's Goddard Spaceflight Center. An amateur paleontologist spotted dinosaur tracks at the Greenbelt, MD facility, in an area slated for demolition to make room for an office building.

Once unearthed, a 8.5 foot long sandstone slab revealed more than eighty prints of both mammals and dinosaurs that walked together on this tract over 100 million years ago. "It's unusual to have such a large concentration of different kinds of tracks and small tracks in such a small space," said Martin Lockley, a professor of geology in Denver.

Apparently Dr. Lockley has never studied the world of private credit.

Many species of lenders inhabit the middle market. Senior debt providers with very different return parameters can work together in the same transaction. In both first-lien/second-lien and unitranche facilities lenders' blended rates provide sponsors and issuers with a variety of financing options.

With fundraising for credit vehicles at record levels and the new deal pipeline skimpy this year, debt investors worry all-in-spreads will tighten. As we've noted in this space, that challenges risk/return dynamics. Why should a high-yield bond yield the same as a fully secured loan with a covenant?

After this week's volatility in the public markets, however, the ground may be shifting.

For all of 2017, and the first month of this year, investors saw stock values soar. This despite underlying concerns whether the almost decade-long recovery can last. Add to that a robust job market and a tax reform-fueled GDP. How long can this last before inflation finally rears its ugly head? And what will happen to interest rates if it does?

With last Friday's job report showing a surprising lift in wages, both questions may be answered. What had been expected to be a three rate hike year by the Fed may be four or more. And the ten-year Treasury hit its highest yield in four years. Even more unnerving was the biggest ever percent jump (to 37) for the VIX – the CBOE's measure of volatility.

What's not hitting headlines though is the sentiment of credit investors. For the first time since the summer of 2015, the institutional crowd may be sensing a buying opportunity. The very nature of senior loans – secured, not liquid, and floating – make them an ideal option during periods when their liquid cousins are witnessing wild price swings.

There's nothing like a little market dip to send loan underwriters scurrying back to review their flex language. Even if volatility settles down, fears of another shoe dropping should buoy spreads and cool the more aggressive structures.

Indeed, more than a few asset managers we know were disappointed in Tuesday’s rebound in equities. “I was hoping for another 1000 point drop!” one veteran shared with us.

Our discovery for the week? Paleontologists and bankers should always be prepared for surprises. Amid the prehistoric imprints of therapods, pterosaurs, sauropods, and nodosaurs found in that ancient rock was a lump of coprolite, or petrified feces.

Maybe fossils and leveraged loans have more in common than we realized.