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What Inning Are We In? (Second of a Series)

THE LEAD | May 30, 2018

In a move that's bound to suggest we're late in some kind of cycle, the US Postal Service announced last week it would soon be issuing the first-ever "scratch-and-sniff" stamps. "Frozen Treats Forever" are designed as popsicles in ten flavors including kiwi and watermelon fruit bars, as well as chocolate and root beer ice cream pops.

"Won't this be cool to put on an envelope to your friends?" we told our four-year old. "What's an envelope?" she asked.

Meanwhile, in the more prosaic delivery world of leveraged loans, we asked the perennial "inning" question of the co-head of a direct lending platform in NYC. His reply was revealing: "I'll tell you what inning we're in, if you tell me what game we're playing."

Experienced credit investors have observed, since the early stages of this recovery, sectoral differences within the broader economy. Thanks to the crash of oil prices in 2014, energy was the first to hit a recession. Housing prices and home building clawed their way back from 2009, but remain tied to local markets. And retail is arguably already a few innings into its own downturn.

Perhaps the next cycle will be an accumulation of mini-cycles rolling through inter-connected industries. Or instead of an event-driven or bubble-induced cycle, we might be in the midst of a rate cycle. While issuer-friendly terms are reminiscent of the immediate pre-credit crisis market of 2007, the current rate setting tells a different story.

As last week's *Chart of the Week* highlighted, despite the Fed having hiked five times since December 2015, the funds rate is still less than 2%. That's 3.5% from where we sat at the peak of 5.25% in June 2006. Put another way, if the Fed raised rates 25 bps each quarter for the next three and half years, we wouldn't reach that level again until December 2021.

Yet the prospect of higher rates, and the long runway the Fed has adroitly provided itself to stay on its inflation target, has market observers on high alert. "There's an element of risk that's pervaded the markets that we didn't have at the start of 2018," said one bond strategist. "We're watching new-home sales like a hawk," said a global bank economist, "to tell us the Fed has raised interest rates too high."

This pervasive seventh-inning-ism should provide comfort that, unlike the last correction, investors won't be caught off guard when the game ends. On the other hand, relentless micro-analysis of every indicator provokes mini-market tantrums. Witness the breathless headlines generated each time, for example, the ten-year Treasury breaks above or falls below, the 3% yield level.

Cycle watching matters more today because so many investors were caught flat-footed in 2008. They are determined not to repeat that mistake. Yet the best minds in global finance have scrutinized every scrap of market and economic data, and admit they have no idea how long the current recovery will last. Nor do they know what will trigger a decline or what that recession will look like when it happens.