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Half-Time Report (First of a Series)

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“2018 will be a good year for loans.”

Back in January, that was the way we characterized what to expect in leveraged loan land for the year ahead. At the half-way mark, our forecast seems to be holding true.

According to Thomson Reuters LPC, volume for the entire loan syndication market in the US hit $1.5 trillion for the first six months of 2018. That was the best half-time showing since last year, when activity was $1.3 trillion. This number comprised both investment and non-investment grade lending.

On the leveraged loan front, this year so far has been almost as active as 2017. Volume of $737 billion was the second highest ever only to last year’s $770 billion. Second quarter’s story, unlike a year ago, was more M&A-related. The share of refinancings has slowed as interest rates have risen.

A frothy M&A market combined with strong economic growth are two dynamic programs running in the background of loan formation. Dealogic has global deal activity running at $2.35 trillion through June 30; almost 60% higher than the same period in 2017. At that rate, 2018 will break the all-time 2007 record of $4.3 trillion.

Economists estimate that 2Q GDP will measure 4-5% – far above the first quarter’s 2.0% metric. Corporate tax cuts and general business optimism seem counterweights to concerns about trade and tariffs. At least for now.

As always, supply/demand is worth noting. CLOs, ever the lion’s share of appetite for liquid loans, are being formed at a record post-crisis pace. S&P LCD reports almost $66 billion in new vehicles to date. Combine that with $8.4 billion of net cash in-flows to retail loan funds, and there’s plenty of institutional money at work.

But the supply side is more than keeping up. The large cap pipeline swelled to $30 billion by June’s end. With that flood, as we highlighted last week, has come investor pushback. A raft of financings – QualTek, Yak Mat, Next Level Apparel, MeridianLink, Senneca, and DMT Solutions, to name a few – were forced to flex spreads wider to make it across the finish line.

Inevitably, loan prices in the secondary market traded down, as the buyside worked through supply in the primary calendar. Also inevitably, arrangers launching new deals scurried to find clearing yields. In some cases spreads have moved anywhere from 25 to 50 bps outside the wide end of “talk,” to 75 and 100 bps or more.

This is happening across a wide spectrum or credits; not just broadly syndicated, but larger midcap loans as well. And it’s not just pricing that’s flexed. Delayed draw term loans have been shrunk or dropped, covenants have been added, soft-calls extended, free-and-clear baskets reduced, and grower baskets eliminated.

Not since the China/commodities tantrum of August 2015 have we seen such buyer-friendly moves. Next week we’ll look at how the middle market is faring.