Third Quarter Report (First of a Series)

THE LEAD | October 11, 2018

William McChesney Martin, the chairman of the Federal Reserve under five presidents from Truman to Nixon, famously said the Fed's job was to remove the punch bowl just as the party was warming up. Seems like the current occupant of that job expects the bar to be open all night.

As our Quote of the Week highlights, chairman Jerome Powell weighed in earlier this month on the inevitability of the recovery phase going on "indefinitely."

That articulation had at least one of our more astute credit investor friends fretting. In a conversation about the state of the market, he told us, "When even the Fed chair says this cycle could go on essentially forever, that tells you a lot."

Where have you gone, Janet Yellen?

Until equities took a dive this week, a bullish posture was hard to dispute. It seemed the Dow was headed for 27,000, despite all the noise on tariffs and trade. After all, last Friday saw the jobless rate hit 3.7% – a level not seen since December 1969.

On the commodity front, oil hit a four-year high, with Brent crude reaching $85/barrel. Gold prices, usually an inflation bellwether, slumped as investors expected a rising dollar and higher interest rates would diminish the yellow metal's value.

All this has weighed on the appetite of loan buyers not at all. Admittedly issuance for the quarter just completed was off from the second quarter. Overall institutional leveraged loan volume, according to S&P LCD, was just under $87 billion, down from 2Q's $130 billion or so. That despite the fact that 3Q numbers included Refinitiv, Azko Nobel, and Envision Healthcare – three of the largest buyouts in years.

In middle market land, the story was similar. LPC reported total middle market 3Q activity rang in at $35.6 billion. For the previous quarter, that figure was $55.3 billion. Digging a bit deeper, we noted LPC's data showed sponsored-only volume was $13.7 billion, down from $24.1 billion in the second quarter.

The reason for this general decline was purely supply-driven. In the case of broadly syndicated loans, the step-up in Libor, thus overall spreads, has been a buzz kill to refinancing and repricing activity. New buyouts, however, remained fairly steady.

Mid cap activity, on the other hand, slipped across the board. For example, new money deals (not refinancings or repricings) dropped 42% from $14.7 billion to $8.4 billion, quarter to quarter (per LPC). Other sub-categories such as syndicated loans, non-sponsored deals, and dividend recaps followed similar trends.

The one area that demonstrated resilience was new middle market LBOs – companies not already owned by other private equity firms. Those loans ticked up from $4 billion in the second quarter to $4.1 billion for 3Q.

So much for supply. Next week we’ll take a look at the demand side.