Lost in Translation

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2018 ended in the high-yield loan and bond markets not with a bang, but with an olufsen. That's our rendition of "whimper," borrowed from the Danish audio products company. There are signs 2019 might be off to an upbeat start. But there are contrary signals as well.

Volatility caused by rate and trade concerns held fast as secondary prices tumbled in December. That caused a complete cessation in junk issuance – a happenstance that last befell markets in the midst of the credit crisis a decade ago.

In the case of leverage lending, deals in market mostly got done, although with spread or terms concessions. Opportunistic refinancings were generally shelved. The year ended with cash outflows from retail loan funds of a whopping $12 billion for the prior six weeks.

Early January continued that trend. Last week saw another $2.3 billion departing accounts. That's left CLO's as the prime demand drivers for broadly syndicated loans. As a supply/demand matter, though, loan analysts pointed to over $10 billion of CLO warehouses being ramped to offset those outflows.

While it's unclear if this recent volatility will slow new CLO formation, the largest asset managers remain bullish on loans. "I challenge you to find any other asset class that's batting over .900," one CEO told a CLO conference.

Hard to tell, as we've noted before, whether these market jitters are creating new clearing prices for leveraged loans, or indicative of a coming economic slowdown. Or could it be some transitory mix?

As our *Chart of the Week* shows, secondary loan prices for the 100 most liquid issues (as tracked by LPC) jumped by about 2% in the past week. This investor confidence is mirrored by the 1000 point rise in the Dow since Friday.

Better asset values coincided with the Fed chair's more measured stance on rate hikes ("We will be prepared to adjust policy quickly and flexibly"), as well as what was generally viewed as a strong November jobs report.

The backdrop for loans also continues to be constructive. Default rates for S&P LCD's Leverage Loan index actually hit a three-year low (1.61%) in November and stayed flat last month. If rate hikes ease this year, as is now expected, that could be a plus for issuers.

In the middle market, the big question remains: will the more investor-friendly BSL trend leak over to small loans? Since direct lenders aren't fueled by hot retail money – instead, long-term capital – could that create some volatility insulation? Will competition for good assets continue to put a lid on spreads and a pedal to the metal on terms and leverage?

Regardless it's our strong suspicion that markets have not seen the last of volatility. Which makes it tough to predict where we go from here. From walls to trade wars there are plenty of things to keep us guessing. And publishing.