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Apart at Last

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Valentine's Day traditionally celebrates the marvels and mysteries of love. As a study of the latter, a travel site ran an article last week about a couple separating after almost a century together.

Born in 1897, Bibi and Poldi had been in a committed relationship since the 1920's. However, for reasons that have escaped their Austrian zookeepers, these Galápagos tortoises called it quits in 2011. Numerous attempts to reconcile them failed, and they've finally been moved into separate houses.

Their minders have not lost hope. A glass window gives them a view of each other. But when Bibi sees Poldi, "she hisses like a snake." Said the zoo's director, "We get the feeling they can't stand the sight of each other anymore."

Romance of another sort took hold of capital markets last week. With December's volatility a distant memory, loan investors jumped into relationships with borrowers, both new and old. LPC reports decent volume through mid-February, though both the large leveraged and middle market were behind last year's pace.

As our *Chart of the Week* shows, yields for both large and mid-caps continue to rise.

For mid-caps, all-in pricing hit 8.22%, thanks to higher Libor over time. Sponsors have also been willing to exchange higher cost for leverage. Direct lenders have been more than willing to comply, particularly with all-senior structures.

Broadly syndicated all-in spreads are also up – to 7.69% this quarter. That leaves just a 50 bp premium between liquid and smaller loans, the lowest since the third quarter of 2009. This so-called "illiquidity" premium is the additional cost investors demand for not being able to readily trade middle market assets.

The lower premium suggests to some that investors aren't getting enough yield to justify lending to borrowers with less scale or being unable to sell a faltering credit. But while the gap between these strategies appears to be narrowing, that's illusory.

As we've highlighted in past columns, the liquid loan market has been driven exclusively by supply/demand technicals. Cash separated from retail funds over the past thirteen consecutive weeks – $9 billion in January alone – as floating rate assets lost appeal in the current hike-less environment. That's pushed institutional yields up sharply since November.

Direct lenders, on the other hand, are fueled by $90 billion of long-term LP capital (fundraising from last year alone). Top arrangers each have capacity to hold at least $100 million per deal, putting downward competitive pressure on pricing.

Exactly where terms for liquid and less-liquid assets are headed depends on deal flow. LPC reports almost 70% of the current pipeline is M&A-related. Pricing on new buyouts and mergers is yielding 7.9%, better than the overall market.

Fresh faces should hold investor interest, if not for a century, at least for a quarter.