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The Great Stay-In (Second of a Series)

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This week we've been doing bedchecks on our lender friends in the credit markets. We caught up with one long-time practitioner, hanging out in the home office with family (as he put it) in "bathrobes and bunny slippers." But clearly plugged in.

"The capital markets went from price perfection to price combustion," he told us. "Last month deals were sailing through. Today it's a whole new ballgame. There's a lot going on behind the scenes, and nothing going on in the market."

A leading CLO manager had a similar assessment. "There's a massive bid/ask spread with liquid names, but trading is going on. It's not a lock-down yet. That's been important for managers cleaning up positions in travel and airlines."

What impact, we wondered, does the cratering of secondary prices *(Chart of the Week)* have on primary issuance? The S&P/LSTA Leveraged Loan Index has tumbled in the last few days to a low 80's context, down from 95 earlier in the month.

Another credit pro from a NY shop gave us some insights. "This is the first time since the depth of the Great Recession that none of the index names were priced at par. We're nowhere near where we were post-Lehman, when the index bottomed at 67. But it's early days. We still don't know what the rating agencies will do."

Unlike the early versions of CLOs, today's models aren't mark-to-market. "That's true," he said. "But warehouses are. Banks can govern the quality of assets in a warehouse by requiring margin calls. Remember the old BWICs? They were often warehouse portfolios being unwound. We could start seeing those again."

Leveraged loan returns have taken a big hit this month, down 15%. What does this mean for loan investors?

"Loan managers don't buy and sell the index," our NY-based friend told us. "It's comprised of over a thousand names. Portfolio managers focus on the more liquid issuers. It's too early to distinguish active performance from the benchmark."

You mentioned ratings. How will the agencies meaure the impact of COVID-19?

"Ah, that's the real question," he replied. "All this is unfolding real-time. So much of the US is shut down. The consumer, which has saved us in the past, is stuck at home. That's not going to just hit travel and leisure. All kinds of spending is on hold.

"And it's not just triple-C downgrades," he went on. "It starts with negative credit watches. CLOs aren't mark-to-market, but if triple-C baskets fill up, it hurts vehicles' over-collateralization (OC) tests. That will compel asset managers to either put in more equity, or sell loans. In that event, the larger, more well-capitalized firms are better positioned."

? Next week: We look at private equity activity. Are deals getting done?