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The hidden attraction of distress

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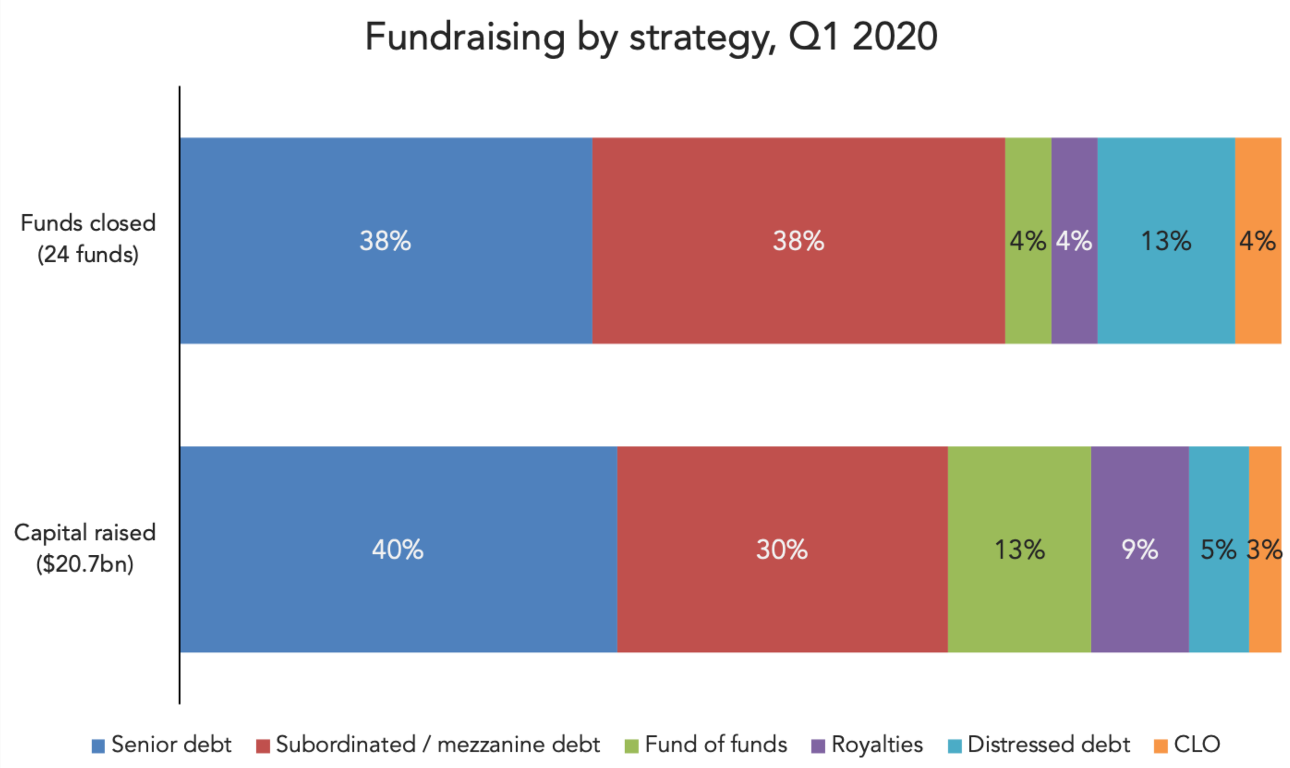

They may not be raking in fresh capital right now, but distressed debt managers have plenty of firepower to take advantage of current conditions.

In last week's Lead Left column, we noted that the proportion of fundraising by strategy in the first three months of this year was more or less in line with historic trends. The chart above provides a graphic illustration of this, showing that investor capital is continuing to flow strongly into senior debt strategies.

Distressed debt, meanwhile, accounted for just 13 percent of funds closed during the period and 5 percent of capital raised. However, this should not be confused with a lack of appetite for distressed strategies: managers in the space are already sitting on large amounts of capital raised in the peak fundraising year of 2017, when managers such as Apollo Global Management, GSO Capital Partners, Oaktree Capital and Lone Star Funds all took the opportunity to fill their treasure troves.

Such managers have the resources required for this volatile part of the cycle and will be focusing more on deployment over the coming period. While some market observers would urge caution with regard to those only now jumping on the bandwagon, there will no doubt also be managers transitioning to make the most of the current situation. Some may call it "style drift", but a more charitable view is that, where flexible mandates exist, they can be a sensible way of exploiting market dislocations.

One strategy that doesn’t yet show up in the fundraising figures is secondaries. Since the global financial crisis, private debt has been operating amid benign conditions and this has meant there has been no strong trigger for secondary activity. But with the turbulence brought about by the covid-19 outbreak, it’s all change – and a secondary market of scale at both the individual asset and portfolio level is expected to develop.

For all fundraising strategies, Private Debt Investor expects to see the further proliferation of a trend we have noted through our PDI 50 ranking in recent years – the flight to quality, as more and more capital gravitates to a chosen few. The coming months and possibly years will likely be seen as a time to keep faith with tried and trusted managers.