Distressed debt takes centre stage

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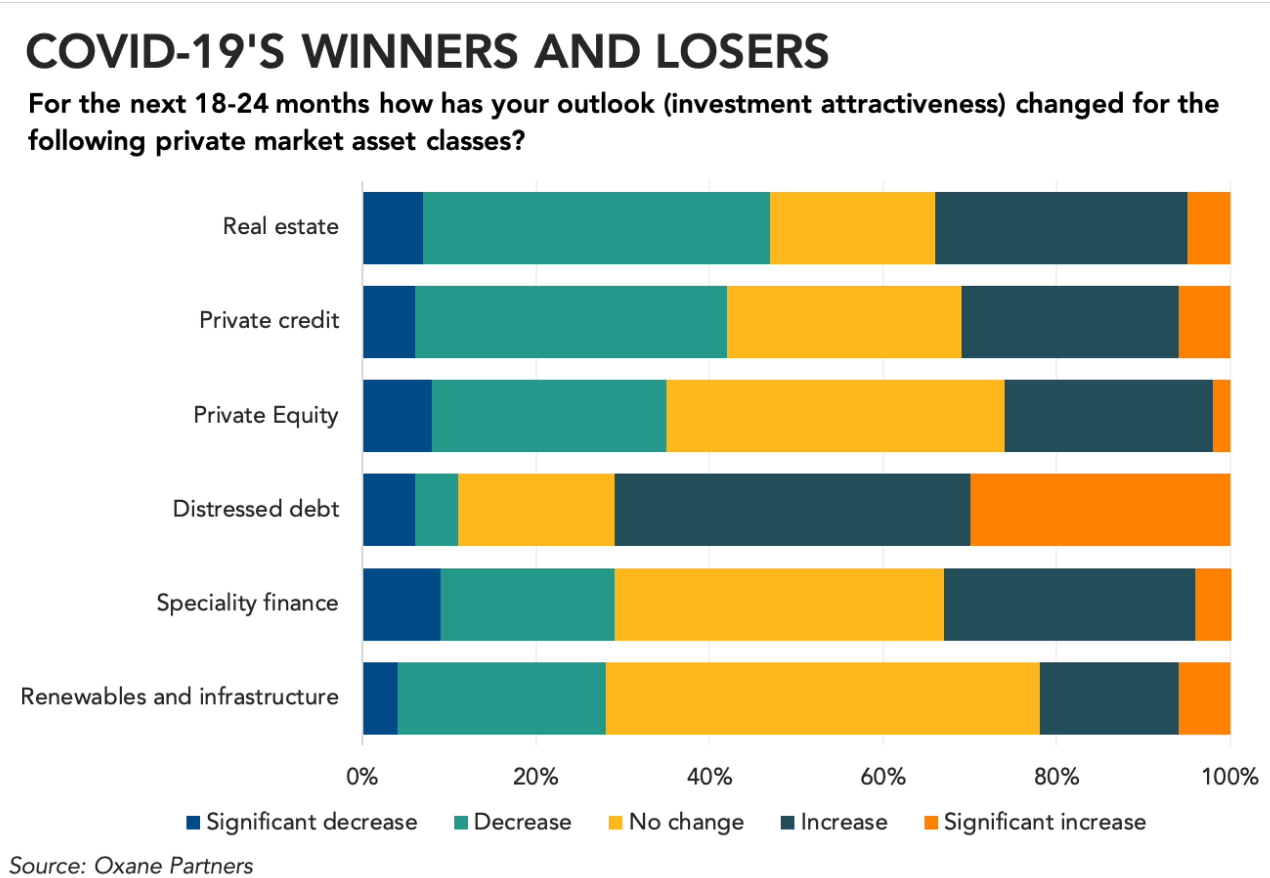

A recent survey of investors by Oxane Partners found 42 percent said private credit attractiveness overall has decreased for the next 18-24 months while only 31 percent said it has increased, a net negative of 11 percent.

But this loss could be distressed debt's gain as investors show huge interest in this area. A massive 71 percent see distressed as increasing in attractiveness over the next two years, with a mere 11 percent saying it was less attractive.

As an example of just how popular distress has become, KKR closed a $4 billion vehicle at the end of May focused on dislocation opportunities generated by the coronavirus crisis, reporting that the vehicle was raised in just eight weeks and included 20 institutional investors new to KKR and more than 40 who were new to KKR's credit arm. If other funds have a similar experience, then this could be one of the strongest fundraising years for distressed debt yet seen.

One market source told us: "The vast size of global credit markets today indicates that a large default cycle will likely take distressed credit to its highest absolute level in history. The US [investment grade] market was roughly $2.3 trillion in 2008 compared to around $6.7 trillion in 2020, nearly tripling the potential for fallen angels."

"So far this year, more than $170 billion of bonds have fallen from IG to junk, already more than in 2009 during the GFC."

Mispricing this year has already affected some high quality blue-chip names. This has now largely settled, but sources say meaningful dislocations are still occurring further down the quality spectrum which could offer investment possibilities for some time to come.

The sheer scale of the challenge facing businesses is enormous and this will play into the hands of distressed investors, but spotting the right opportunities to rebuild after the pandemic crisis passes will be a challenge that will separate the best performing fund managers from the rest.