What's Ahead for 2015? (Part One)

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We had just polished off our second helping of pumpkin pie last Thursday evening when the first (of what we assume will be many) "2015 Market Outlook" hit our in-box.

Always big supporters of the crystal ball crowd, we thought we'd begin our own prognostication series by sharing some of the contents of that forecast with you.

Its author, Wells Fargo's Dave Preston, is a TLL friend and top CLO expert. His analysis is helpful, not only because CLOs still represent the largest share of the leveraged loan market, but also provide an excellent window into the behavior of the asset class itself. The study also encapsulates prospects for the overall market next year.

Let's first take a look at some of his thoughts on coming attractions for CLOs:

CLO Volume: 2015 will be a good year for issuance, but not quite as robust as 2014, which will wrap up around $120 billion – a record (we're at $115 billion). Call it $90 billion for next year. Impetus is locking in deals before risk retention rules take effect in 2016.

CLO Redemptions/Amortization: Estimated at $50 billion for 2015, with $21 billion exiting their reinvestment periods.

Triple-A Spreads: Currently at Libor+150-160 bps, spreads for the top of the CLO capital stack will remain in this range. Continued strong issuance will limit significant spread tightening, despite good demand from loan buyers.

CLO Equity: Volatility in the loan markets will benefit buyers of CLO equity, as these vehicles are proven loan investors through all cycles.

Risk Retention: Despite the recent ruling that arrangers hold 5% equity of CLO facilities, there's a two-year window for participants to build a better mousetrap. Until then, larger managers will use this hurdle to position themselves competitively.

Then there are further observations on the loan market in general:

Credit Quality: As other commentators have noted, Mr. Preston cites higher leverage and deteriorating issuer ratings as causes for concern. But default outlook is relatively benign and business conditions support better operating performance for borrowers.

Regulatory Pressures: Combined Volcker, Risk Retention, and Leveraged Lending Guidance will dampen loan liquidity and benefit large non-bank managers. Interestingly, the Guidance 6x leverage limit may unwittingly encourage the market to gravitate there.

Rates and Spreads: Expectations of higher rates should inevitably benefit floating-rate assets. Loan spreads have steadily widened this year and should remain at these levels.

Volatility: Forecast to be higher thanks to continued flight of retail cash, diminished bank trading capacity, and, aforementioned regulations and rates.So it appears that demand for loans next year from the biggest buyers will be solid, but not match 2014's appetite.

Next week we take a look at the supply side of that equation.
Click here for "The Case for Senior Secured First Lien Loans" as presented by Kevin Burke at the Wells Fargo Middle Market BDC CEO Forum.