THE LEAD
https://theleadpc.com/whats-ahead-2015-third-series/

What's Ahead for 2015? (Third of a Series)

THE LEAD | December 17, 2014

We had planned on concluding our 2015 predictions with a forecast of structure and pricing in leveraged loans. But market developments compel us to address first what could a factor in changing both those elements dramatically next year.

Like all things unexpected, the precipitous drop in oil prices could have been foreseen if you knew where to look. But as often happens few knew where to look.

Back in July, when we ran our series "Are We Back to 2007 [link]," we said smart money was anticipating a recession 18-24 months hence. And when it came, they said, it would be triggered by an unanticipated exogenous event.

Welcome to the exogenous event! It was also in July that the US surpassed Saudi Arabia as the top oil producer. In the category of "Be careful what you wish for," the impact of falling prices is now hitting home with a vengeance.

Sure, momentary relief at the gas pump has heartened consumers and sparked spending on cars and other high-ticket items (though not houses). And lower energy costs help some corporate wallets (e.g. airlines). But we think this euphoria will be short-lived. Whatever fills one pocket in fuel savings, leaks from the other as tumbling stocks shrink our collective net worth.

Could this crude awakening be today's sub-prime mortgage? Evaporating real estate values swallowed investors and upended markets in 2008. They also revealed how much of the world was linked – directly or indirectly – to distribution of marginal housing securities. We're now learning how much of our economy is connected to black gold.

As the canary in the capital markets coal mine, high yield bonds are often first to react to credit news. 17% of junk issuance this year has been energy-related. Not quite the 20% level for telecom deals in 2000, but enough to sink overall credit markets. Our favorite junk guru, Martin Fridson, reports one-third of all energy bonds are now distressed.

Witness loan prices dropping this week to 95.28 (per S&P) for the most liquid names, down from 99 last August, and even off the 96.5 low during October's correction.

The anxiety from that correction has never truly dissipated, despite the Dow's run-up through December 5. Global growth concerns lingered and the surprise fall of oil prices gave form to that fear. Barring OPEC intervention to cut production – an unlikely event – the downward trend in oil prices is likely to continue.

On the positive side, the US economy is driven by more than oil production. And the Fed will pump its own version of crude to keep things afloat. This wouldn't be the first scary market event in 2014 that reversed itself in short order.

Some investors hope this petro-phobia persists. Lower prices and wider spreads could present loan and bond buyers the opportunity they've been waiting patiently for all year.

The Lead Left will be on holiday break until January 7 when we conclude this series.