Now Where Were We?

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When we last reported on market conditions two years ago the Dow had closed at 12,929. Today it stands at 16,408 – a 27% improvement. Greek bonds back in April 2012 easily yielded mid-teens returns. Last week a five-year Greek bond auction was seven times oversubscribed and priced at 5%. After the first sixteen games of the 2012 season, the NY Mets win-loss record was 8-8. This year they were 8-8.

Well, some things never change.

But could a sea change be afoot? A significant streak ended last week when, after 95 consecutive weeks of cash in-flows to loan mutual funds, S&P Capital IQ reported withdrawals of $249 million (as measured by Lipper). While all good (or bad) things eventually come to an end, it's not clear what this development portends.

On the one hand, buy-siders are cheering that at least one source of seemingly endless liquidity, which since 2012 had contributed to the demand/supply imbalance in the leveraged loan market, has been stoppered. The hope, of course, is that this signals, if not an end to market froth, at least a pause in the madness.

Never ones to waste a good crisis, investors got arrangers to juice spreads on several deals last week to get them over the finish line.

But economic indicators hardly point to an unfriendly debt issuance environment. Continued tamed inflation and an accommodating Fed pushed investment grade bond volume to a post-recession quarterly high of $317 billion for 1Q 2014. As a counterpoint to loan fund dynamics, cash is flowing into high-yield accounts, sending bond yields down to 3.6% – levels not seen since before the credit meltdown.

And no one is proclaiming the leveraged loan market is closed for business. Robust demand is there from the still growing universe of institutional buyers for all types of paper…at a price. This includes middle market borrowers well below $50 million in Ebitda – tranches larger accounts have often eschewed for lack of liquidity.

One dependable indicator of a bullish market has been the frequency of covenant-lite structures for middle market companies. On that score, things are still pretty aggressive. More than half of term loans so far this year between $200-500 million had incurrence tests only. Savvy investors realize avoiding transactions based on lack of maintenance covenants alone has the effect of skewing their portfolios to weaker credits.

Two years ago, middle market leverage was at 3.4x senior debt/Ebitda and 3.8x total. Those metrics are now a full turn of leverage higher (4.47x/4.56x, per S&P). Similarly, loan spreads have trended issuer-friendly since 1Q 2012, with all-in institutional spreads dropping 70 bps to L+525 (from L+590, again per S&P).

So do recent signs point to a continuation of the past two years, or are we at some kind of inflection point?

Stay tuned here for answers. We promise not to make you wait two years for them.