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A Market in Full (First of a Series)

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Of the many unanticipated consequences of Covid, one that caught our eye was the recent *NYT* headline: "Birds Thrived During Lockdowns." Seems that while we were stuck at home last spring, our feathered friends were out partying.

Urban areas, otherwise crowding out some species, saw hummingbirds and bald eagles return at 14 times pre-pandemic levels. "I am shocked at the fact we saw so many changes in bird behavior," a Canadian conservation biologist reported. Pigeon populations were unchanged.

Leverage finance has experienced similar post-Covid behavior. This week the broadly syndicated market set a record for annual issuance – $505 billion, according to S&P LCD. With the bulk of the fourth quarter to go, 2021 will easily surpass 2017's record $503 billion.

What's behind this resurgence of animal spirits? Investor appetite for yield is playing a leading role. The S&P/LSTA Index is 4.42% year-to-date, only a tick below the BAML High-Yield Index of 4.67%. Not exactly "high" yield, but lofty compared to investment grade corporates and government bonds.

CLOs remain the primary driver of institutional loans. New vehicle volume is $134 billion – a record high – thanks to low liability spreads and attractive equity arbitrage. Fresh capacity demands fresh assets. Single-B spreads are actually higher since the start of the year.

Another source of loan liquidity is retail cash. In a refreshing reversal from 2020, prime-fund flows have been solidly positive. LCD reported $3 billion of such in-flows in September alone, representing the tenth such month in a row.

Fueling overall M&A is private equity finance, comprised of new buyouts, acquisitions, refis, and dividends. The latter, per S&P, demonstrated the greatest increase of volume over the past four years. Not surprising, given that raising new funds demands old fund realizations, whether from sales or recaps.

Capital gains tax uncertainty is another tailwind. Founders selling their businesses could put more cash in their pockets this year than next. Fresh with LP dollars, sponsors are obliging with a spree of buying, pushing Ebitda multiples to record highs.

Appetite for yield assets continues to pressure structures and terms, meaning selectivity is everything. On the bright side borrower quality has held up, and cash equity as a percent of total capital is at an all-time high.

Whether you're a hummingbird (new entrant to the asset class) or a pigeon (permanent resident), the future looks fruitful for credit investors.