Special Report: The Great Unwind

THE LEAD | September 28, 2022

The Lead Left CHURCHILL from nuveen

The Great Unwind

The Lead Left - A Special Report

Beginning in July 2022 The Lead Left published a series of articles on credit market. This report consolidates those articles.

Introduction

One of the enduring mysteries of human behavior is our perpetual discomfort with the present. Why can't today be more like yesterday? Yet when tomorrow brings the hoped-for change, we are invariably chagrined. Oscar Wilde captured this tendency when he wrote, "When the gods want to punish you, they answer your prayers."

Lenders like to secretly root for downturns. Nothing serious, just enough to skim foam off the market latte. It also creates an optimal environment for risk officers to once again rule investment committees. Risk-off becomes an all-purpose directive to turn down deals with aggressive structures or story borrowers.

With 2Q 2022 GDP down 0.9%, we are officially in a recession. Until recently risk assets like high-yield bonds enjoyed a Fed back-stop, issuers pounced on low coupons, and investors suffered through low returns. Experienced credit managers looked at the low leverage and attractive spreads of the early 2000's and asked, Why can't we go back to *those* days?

But along with slower or negative growth, the current crop of technicals includes a complex mix of runaway inflation, and supply chain and labor shortages. Globally and more generally, we are also seeing the finale of a forty-year market run many called "the Great Moderation," as the Fed and other central banks work to unwind systemic liquidity and quantitative easing.

With the end of the bull bond market, we could be witnessing the reversal of demographic trends such as higher birth rates and looser immigration policies that buoyed job growth and a healthy labor market. Include also a dim outlook for globalization and free trade.

An excellent piece from FS Investments summarizes other elements that may run their course. Along with easy monetary policy, they cite long duration and extended business cycles. Russia/Ukraine also points to higher geopolitical instability and increased volatility overall. All leading to lower asset prices across the board and a decline in corporate valuations.

Does this portend a new investment era and world of market dynamics? Is higher inflation a permanent fixture of our economic landscape? Are higher rates here to stay? Are we headed for a mirror image of the past fifteen years? Or will the Fed be forced to backpedal when inflation cools and a recession looms, ushering in another zero rate cycle?

1

Beginning in July 2022 The Lead Left published a series of articles on credit market. This report consolidates those articles.

- Welcome to the Precession!
- QT and The Great Unwind
- The Great Unwind: Easy Money

[wpdm_package id=’60253?]