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The Everything Rally

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Inflection points are often apparent only in hindsight. While it's premature to call a top to the current rate and inflation cycle, signs are evident that change is underway.

Last week's Fed rate hike of 25 bps, a deceleration from its previous three monthly moves, is a case in point. At 4.50-4.75% we are within a hike or two away from the 5%-ish terminal rate at which the market expects the Fed to level off for a wait-and-see.

The questions are how long will they wait, and what will they see? Last Friday's job report may have given them pause. Is the economy still in need of a smack down, or will the labor market settle down as other inflation indicators seem to have done?

Having all but summited the rate mountain in record-time, regulators have time consider their options. Assuming 6% is the point when financial markets grind to a halt, they have well into the summer to continue with a ¼ point per meeting rise. Lots could happen by then.

Meanwhile the "everything rally" continues. Since last October public equities have steadily marched upwards about 15% on hopes of a soft landing. In a similar vein leveraged loan secondary bids have pushed up from 92 to 94 (see our *Chart of the Week*), while flow names have improved to 98.5 from 93.5 (all stats per LCD).

Value restoration has resulted in the best leverage loan performance since the end of the Great Recession. For January alone, the Morningstar LSTA US Leveraged Loan Index was up 2.77%. As is generally the case, better secondary valuations improve primary receptivity. Single-B rated issuers represented $6.2 billion in January volume, the largest monthly number in a year.

CLOs are also efficient indicators of market health. High liability costs have lowered equity returns (the "arb") below investor expectations, better asset yields notwithstanding. But that trade might be improving marginally, based on new vehicle issuance. At least for top arrangers. Last month saw $6.5 billion in prints. Compare that to the $25 billion seen in October 2021.

2023 has also been good so far for middle market CLOs. Four deals of $2 billion have already closed, comparing well to all of 2022's $12 billion.

Not that investing opportunities have been robust. January's M&A financings totaled $3.4 billion, a far cry from the $30.9 billion a year ago. Most of the loan pipeline has consisted of refinancings and amend-and-extends (A&E). But for many borrowers that activity is constructive, and CLO managers are happy to participate with the right names and ratings.

How long this BSL rally will extend is an open question. It's dependent on the capacity of CLOs and the amount of cash in retail funds. The former may be challenged by expiring reinvestment periods, and the latter by continued out-flows. But if the everything rally continues, it could carry both along.