The Market Now

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Our last *Market Now* series came in March 2022 [link] after Covid had peaked and begun to fade, when Russia invaded Ukraine. This week we think another pause to review conditions is appropriate given a number of dynamics at play.

First, the Fed has paused in its rate hikes as their gravity seems to have pulled many inflation indicators down. Employment remains tight, but shows signs of loosening. Real GDP rose at a healthy 2.4% pace for 2Q, yet real personal consumption decreased from 4.2% in the first quarter to 1.6% (see our *Chart of the Week*).

Public equity markets have responded in a buoyant fashion with the S&P 500 and DJIA up 18% and 7% for the year, respectively. Even the ten-year Treasury bond, in a year of rising rates, has eked out a 0.28% return.

The high-yield credit markets, while not exactly houses a-fire, are showing some signs of life. Total leveraged volume at $233 billion (per Pitchbook LCD) is off 6% from 2022's $249 billion, though first-lien TL activity was down more precipitously ($130 billion vs. $177 billion). Bond issuance made up the difference, improving from $70 billion to $100 billion, year over year.

Direct lending issuance, per KBRA DLD, came in at $36 billion for the first half of 2023; a softer performance than 1H 2022. DLD suggests lower jumbo deal volume as well as fewer new buyouts are contributory factors. Anecdotally our private equity sponsors report a steady flow of transactions coming from investment banks. Not the onrush expected earlier in the year, but a decent mix, skewing more towards add-ons than new platforms.

Purchase price multiples also continue to be close to record high levels we saw the last two years, particularly for the better, more defensive sectors. For larger software, tech-oriented businesses, those multiples can stretch well into the teens, if not higher.

Direct lenders themselves report a varied level of activity. For those with scale and relationships, the volume is close to what they experienced last year. For smaller platforms the pickings are fewer, and the quality not as good. But both have an eye on the calendar. With Labor Day less than a month away, the time to make 2023 budgets is shrinking fast.

Some firms with robust fundraising capabilities, but weaker sponsor relationship advantages, are reverting to the pre-Covid playbook of pitching aggressive (six times leverage) buyouts or recaps at below-market spreads and OID. It's too early to tell whether sponsors will lean more transactional versus relational. It's also not clear whether toying with toppy leverage in the current rate environment will end in tears.

We did note, however, that Proskauer's second quarter private credit default index improved markedly, from 2.15% to 1.64%. This suggests, as our June 28th commentary highlighted, that experienced private debt managers are equipped to manage through high rate, negative growth, or choppy markets in ways that some public credit funds have found challenging.