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“A Slow Sort of Country”

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“*Now, here, you see, it takes all the running you can do, to keep in the same place. If you want to get somewhere else, you must run at least twice as fast as that!*”

In *Through the Looking Glass,* the Red Queen’s response to Alice’s frustration in running hard yet not getting anywhere mirrors the state of the broadly syndicated loan market today.

According to PitchBook LCD, overall leveraged loan activity of $736 billion through June 30 was a record high. Yet despite that, new deals were only 13% of total 2Q volume, down from 18% in the first quarter, down from 25% for all of last year, and off sharply from the 52% average for the five years preceding the Fed hike regime in 2022.

Despite record large cap volume the Morningstar LSTA US Leveraged Loan Index actually shrank by 0.7% over the past twelve months. Imagine where the Index would be without at least some of the new deal activity.

Higher rates effectively shut down the liquid loan market for two years. 2024 marked its revival when the Fed signaled rates were likely down not up from here, giving new impetus to CLO managers and retail funds. Because new buyout activity was sluggish, most of the newly discovered cash went to repricing higher spread private credit financings.

Media coverage at the time trumpeted how banks were fighting to regain lost share to direct lenders. It also warned that this competition would hurt private credit returns by forcing those managers to cut their spreads to keep good assets from going away.

To some extent this happened. But as we predicted, while middle market spreads compressed by 100 bps or so, all-in yields for investors remained in the 11-12% range. We also expected the pendulum would swing back in the second quarter. As our *Chart of the Week* highlights, direct lenders treated banks to some of their own medicine, refinancing more deals away from the public side of the house than they lost.

Another measure of non-bank success has been the ratio of new deals to refinancings. Of the $260 billion of institutional-only volume measured by LCD so far this year, only about $28 billion, or barely 10%, was related to new LBOs. By contrast, KBRA DLD reports May’s LBO middle market activity of $7 billion as more than 36% of overall volume of $19.3 billion. Our own experience in the second quarter reflected 50% of volume from new deals.

The Red Queen calls Alice’s home “a slow sort of country” where you only get somewhere “if you run very fast for a long time.” In public credit markets, deploying capital today is not as productive as it might be. Private credit managers distinguish themselves by committing and holding debt for the benefit of investors. That means investors can expect to actually get somewhere when the manager is running hard.