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# 2016 – A Look Ahead in the Middle Market (First of a Series)

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Just before the holidays we caught up with a friend who runs a middle market credit fund. So how was the year for you, we wanted to know? “Beyond crazy,” he said. “Time just flew by so fast. It seemed like every fifteen minutes, I was having breakfast.”

That perfectly captures the velocity in the world of middle market deal making today. There seems to be many reasons for this. One big driver, we believe, is the overhang of capital in both the private credit and private equity markets. Investors have been fundraising at a breakneck pace for years and are eager to put cash to work.

That liquidity naturally spurs competitiveness. The deal cycle has accelerated steadily since the Great Recession, giving both sponsors and lenders less time in the bidding and due diligence process. What used to take three to six months, or sometimes a year, is now down to a matter of a few weeks. Bankers are using the opportunity to create extremely seller-friendly terms and drive up purchase price multiples.

Another factor is where we are in the business cycle. Last year we discussed at length the irony of a Fed move to higher rates just as the rest of the world – and some sectors of US business – was bracing for higher defaults and the increased probability of a recession. Being now a solid seven years into the recovery, public markets are showing clear signs of being at some sort of inflection point.

While it’s too early to tell if this is more than a post-holiday pause, the stumble out of the gate by equities has underlined the general market unease. With little fresh economic data to ponder, investors are toggling to risk-off, resulting in continued fund flows out of retail loan and high yield bond funds.

For the risk-on crowd, particularly in the middle market, there’s a sense that public, large cap volatility will help maintain an upward bias on loan spreads. The unrelenting regulatory pressure on bank lending will rein in the more extreme leveraged transactions. Nimble non-bank asset managers worked around the clock last year to invest in good deals, not knowing how long these favorable conditions will last.

Over the next several weeks, we’ll examine the outlook for the coming year in the middle market lending space, including predictions on where we’re headed with terms and conditions – particularly pricing and leverage.

We’ll also take a look at what PE firms are seeing in their pipeline, and how much of this will result in actionable activity for debt financing teams.

Finally, we’ll explore overall credit conditions, where default rates will go, the environment for CLOs and BDCs, and strategies the best asset managers will employ to help sponsor clients deploy capital.

*Next week, we start with thoughts on liquidity and credit appetite in the middle market for 2016.*