Inflection Point

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News reached us last week of a daring nighttime escape from the National Aquarium of New Zealand. An octopus named Inky sneaked out of a small hole in his tank, across the floor, and down a 164-foot drain pipe into Hawke's Bay. "Didn't even leave us a message," said the aquarium manager, Rob Yarrall.

What caught our attention was that Inky's tankmate, Blotchy, chose to stay behind. While some quickly tagged Blotchy as a bit of a chicken, our experience of investor behavior points us to a different conclusion. Blotchy assessed the risks, saw there would be real upside in now having the entire tank to himself, and wished Inky luck.

Similar decisions are facing accounts in the institutional loan market. As we've covered extensively in this space, credit buyers are fleeing the confines of this zero-yield environment into higher return assets. While this also entails more risk, experienced managers are encouraged by bullish economic news and improved public markets.

This is constructive for liquid credit. "Grinding higher" is how one analyst described activity in the secondary loan market (see our *Chart of the Week*). Loan prices are slowly, steadily marching upwards, as values of tradeable leveraged loans improve.

Market technicals play a lead role in this trend. First there's the lack of large deal flow. With limited new product on the shelf buyers cycle through familiar issues. And despite modest in-flows from CLOs and retail funds, cash comes back from large tranche repayments such as *Numericable* ($2.6 billion) and *Altice* ($3 billion expected).

This supply/demand imbalance has also pushed the share of credits trading above par. About 20% of loans in the S&P/LSTA Leveraged Loan Index are bid at par or higher. That's better than the 13% figure only one week ago and 10% a month ago.

Another tipping point sign is pricing flex activity so far this quarter. According to Thomson Reuters LPC, the first quarter saw $1 billion of middle market volume increase loan spreads in order to meet investor demand. Through April 22, however, almost $670 million has seen spreads lowered as buyer frothiness has taken hold.

Psychological factors are at work as well. As we head deeper into the year, managers are under increasing pressure to put money to work. This is particularly true given the weak first quarter many market participants experienced in deal volume. Structures and yields you passed over in January look better in June if you're behind budget.

But as we often note, conditions that lead to seller-friendly terms will eventually create momentum to shift back in favor of buyers. Arrangers report loan pipelines building, particularly in the middle market. That will put upward pressure on spreads once again.

So whether you tend to venture out or sit tight, the next quarter or two should provide plenty of options.