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Price Club

THE LEAD | June 9, 2016

Last week's disappointing employment report was another brushback pitch to the Fed as it hopes to hike rates sometime this summer. While some economists worried that diminished job creation could foretell a slowing in US GDP, others pointed to real wage growth, better consuming spending, and improved housing starts.

We have noted before the Fed's inclination to talk itself out of normalizing interest rates when exogenous events rear their ugly heads. Certainly the looming Brexit referendum on June 23rd qualifies; Chairperson Yellen has now identified it as a potential risk ahead of the Fed's meeting later this month.

This seesaw dynamic has caused investors in private credit and equity to worry less about rate policy and more about returns. As three-month Libor crept up to 0.66% from 0.37% last November, large cap double-B issuers have seen 75 bps subsidies fall away. With actual Libor near the floors, and strong corporate credits few and far between, investors are willing to see (for example) *Yum! Brands* lose the floor from its $2 billion TLB. Its L+300 bps spread was also cut to 275.

No sign of floors going anywhere for single-B leveraged loans; average Libor subsidies remain around 100 bps. Broadly syndicated spreads have settled in the 5.50-5.75% context, as institutional funds put cash to work against a strengthening, but still modest, deal pipeline.

Similarly, middle market yields remain range-bound in the 6.75% neighborhood. As we've often highlighted, this stability is attributable to the "closed" system of middle market loan demand. Arrangers put dollars to work in discrete investments among club participants, softening the impact of technically driven "open" system buyers.

Closed liquidity mutes price volatility. As our *Chart of the Week* shows, middle market club credit spreads (yellow and orange lines) are steadier than their syndicated counterparts (blue and green). That's because prices of these "closed" loans don't trade off with every dip of the Dow.

Of course, the private credit TLAs (orange), being structured as amortizing, shorter term instruments distributed to banks, carry much lower spreads than the back-ended, longer term TLBs (yellow) that are clubbed among non-bank direct lenders.

What's noteworthy is how correlated middle market syndicated loans (green) are with broadly syndicated (blue). While these mid-caps are less than $500 million, they carry public debt ratings so can be owned by institutional accounts requiring daily liquidity. In up and down markets, prices of these smaller loans swing with large caps.

For private credit investors, the uncertainty surrounding Fed policy is less disconcerting. Whether public markets swoon or sail this summer, private credit spreads look poised to continue their steady ways.