What Inning Are We In? (First of a Series)

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That's the perennial question that leading direct lenders addressed last week on a panel moderated by your correspondent at the 25th Annual Atlantic Conferences Middle Market Symposium. As the event was technically closed to the press, we can't report on what was discussed. Instead, let's cover the broad themes confronting market observers as they focus on where we are in the business cycle.

The "inning" metaphor is well-worn. We came across a media report forecasting the US is in the "final innings of economic growth." That came out over two years ago (http://www.businessinsider.com/us-is-final-innings-of-economic-growth-2016-3).

We know the exuberance of the current leveraged loan market dates back to at least 2014. That's when debt/ebitda levels started feeling toppy again. "This should last for a couple more innings," investors told themselves, and modeled in a downturn for 2016 or 2017. But two years later, the mantra was, "It still feels like we're in the seventh inning."

With each passing year, the end of the game keeps getting pushed off. Accordingly we nominate for the 2018 Merriam-Webster Word of the Year:

*"**Seventh-inning-ism:** the sense investors have of being perpetually in the late stages of a market cycle, but with few signs that a game-ending recession is near."*

Perhaps a more meaningful question would be *"What Inning Are We In* talking about *What Inning We're In?*"

The economy certainly seems to be chugging along. Unemployment has fallen below the 4% floor for the first time since 2000. First quarter GDP grew at a 2.3% clip and looks likely to clock in a 3% number for 2Q. Industrial production and manufacturing output both rose 0.7% and 0.5%, respectively. And April's consumer confidence was close to its record February high of 120. These and other data compelled the Fed to stay on track with its message of continued rate hikes for the balance of this year, and next.

Countercurrents, though, aren't hard to find. Housing starts, for example, slumped 3.7% after an up month in March. Concerns that rising rates might slow down home buying has dampened that sector as well as home buying. Interest rates may also be a drag on auto sales. New vehicle sales dropped last year after a record 2016 of 17.5 million units. 2018 is projected to be down again.

Capital markets reflect a similar batch of mixed messages on the current cycle stage. It's not difficult to identify many characteristics of this decidedly late-stage issuer-friendly market. Higher leverage, record purchase price multiples, plenty of capital being raised and deployed into direct lending, large cap structures migrating down to the middle market, increasingly loose terms and contracting spreads.

Yet running in the background is the higher Libor program. That affords higher Libor program. That affords higher all-in yields, particularly for investors in middle market credits. But it also raises interest costs for borrowers. Spread out across corporate America, that could prove to be a persistent drag on earnings. Especially if this cycle goes into extra innings.