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Food for Thought

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News reached us on North Carolina's Outer Banks of an unusual find in an Egyptian tomb. Archeologists discovered a "mysterious white substance" in pots from the burial site of Ptahmes, a 13th century B.C. official. Chemical analysis proved it was cheese.

Past Egyptologists have made similar findings. In 1942 one team reported something dating back to 3200 B.C that had "no smell and only a dusty taste." Quite a contrast to explorations in our refrigerator after two weeks on vacation.

Setting the table for the post-Labor Day market, we see signs of better eating. For one thing, the economy continues to motor along. When we left for the beachy outback in mid-August (yes, it was hot), the street was fretting about the Turkish lira. Could that currency's tailspin pull other emerging markets down with it, à la Russia 1998?

Three weeks later, the NASDAQ is over 8000 – a record high. The S&P and Dow are also close to historic tops. Consumer confidence is at an eighteen-year plateau. Interest rates remain range-bound with inflation still more phantom than reality. And all the trade noise seems to have caused minimal damage to valuations in general.

Despite being all-but-unplugged from market chatter, we still overheard two lifeguards' concerns about an inverted yield curve. At 18 bps, the difference between the two-year and ten-year Treasurys was at an eleven-year low. If the long-end flips lower than the short-end, analysts say, a recession historically follows.

But to invoke an old philosophical saw, are rain clouds or opening umbrellas better predictors of showers? We suspect yield curves are more akin to umbrellas, being correlative rather than causative. Even if the curve flipped tomorrow, one banker suggested, it could take eighteen months to show up in the numbers.

Meanwhile, in the land of the middle market, the back to school picture looks pretty dishy. The National Center for the Middle Market reports 75% of its CEOs and CFOs surveyed reported better earnings for the first half of 2018. That amounted to 7.4% growth, below the 1Q number of 8.4%, but still better than the 6.7% average.

That resonates with Lincoln International's Middle Market Index (MMI), a newly launched metric showing the quarterly change in enterprise value for about 400 midcap borrowers, mostly sponsor-backed. Over the past four years, the MMI is up 31.4% (cumulative), vs. 38.1% for the S&P 500.

Our friend Ron Kahn, Lincoln's co-head of debt advisory and valuations, reports the two biggest contributors to that growth sector-wise are technology and industrials. There's sense to that, as sponsors look to take advantage of any trends favoring better valuations. In light of low single-digit background GDP overall, anything that pushes business efficiencies for small companies is a winner.

In the meantime, as the unofficial end of summer comes upon us, we expect the loan pipeline to start picking up. Who knows what tasty morsels credit investors will dig up?