

Roses are Red, Covenants are Few

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There comes a time when traditional means of communication fail. When other tools must be employed. According to Tuesday's WSJ, graduates at the University of Glasgow are using haiku to summarize their complex planetary and lunar projects.

These 17-syllable science-related poems, nicknamed "sciku," make extremely technical topics "more accessible." Given today's challenging interplay of elements in the credit markets, we thought our readers might benefit with a "cov-liku" or two.

Let's first cover noteworthy happenings in the more prosaic world of leveraged lending. Uppermost in investors' minds has been the Fed's increasing dovishness on rates, derived seemingly from further signs of a slowing economy.

Analysts are warning of a significant revising downward of fourth quarter 2018 GDP from the reported 2.6% to as low as 1.8%. Add to the mix the government shutdown, which may have been more of a drag on 1Q growth than previously thought. That could get us closer to a 2% GDP figure for 2019; not great for equities, but not bad for credit.

Then, after months of anticipation, the Treasury yield curve has finally inverted. The ten-year Treasury is at 2.42%; the three-month at 2.46%. An inverted curve has been a reliable predictor of, though not always immediately triggering, past recessions.

Finally the specter of zero-growth or a slowdown in Europe raised its ugly head as the German 10-year bund went negative. The universe of minus-yielding sovereign debt is now back over \$10 trillion for the first time in eighteen months. With the EU's GDP at 1% and the US slipping a gear, bond investors have been fleeing to quality.

For private credit, though, it remains a quasi-Goldilocks market.

At the PartnerConnect East conference in Boston, we joined a panel discussing the state of direct lending – both for users and suppliers. While volatility and a softening economy weigh on public markets, private equity and lenders find the climate constructive. We dubbed it the "Tale of Two's" – 2% inflation, 2% Fed funds, 2% Libor, 2% Treasuries, and 2% GDP growth. This should support reasonable dealflow for the rest of the year.

Still of concern to managers are weakened structures and topmy valuations. A backsliding economy, with a slump in borrowers' operating performance, will test both.

Next week we begin a new series on valuations. We believe modeling appropriate downsides to both cash flows and the enterprise values they generate is critical to minimizing credit defaults and losses. Private equity returns are certainly enhanced when exit ebitda multiples improve, but lenders have more modest goals.

Or, to put it in a cov-liku:

*Loans aren't equity:
You just want your money back,
Which is fine with us.*