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2020 Hindsight

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Remember your summer internships in high school? Neither do we. There's a vague recollection of delivering mail for a financial advertising agency on Wall Street. (It's also where we first encountered the term "Lead Left," but that's another story).

Wolf Cukier's stint at NASA's Goddard Space Flight Center last summer could have been equally tedious. The Scarsdale, NY teenager began by scouring reams of satellite data, searching for anomalous star patterns.

But instead of mailing it in, he *focused*. On his third day he noted an odd image near a binary star system. It turned out to be a planet, now labeled TOI 1338 b. "It definitely colored the rest of the internship," recalled the seventeen-year old of his discovery.

Observers are scanning for similar signs of life in the leveraged loan universe. 2019 volume in the overall market slumped 35% from the previous year, from $1.2 trillion to $808 billion, according to Refinitiv LPC (see *Chart of the Week*).

In part, this is attributable to the natural ebb-and-flow of financings. 2017 was a stellar year at $1.4 trillion, a peak; the previous three years were in line with 2019. It's also rate-driven, as refinancings have fallen off with the bottoming of interest rates.

Then there's the issue of demand-side technicals. CLOs and mutual funds were uncertain buyers last year, thanks to challenged issuer ratings and negative fund flows, respectively. Those elements may find relief in 2020.

As we've noted previously, CLO managers have adroitly steered clear of weaker single-B credits, ameliorating the risk of clogging triple-C baskets. And for the first time since September, cash flowed *into* loan funds last week – $453 million to be exact. Not an astronomical number, but a good start nonetheless.

And the deal supply-side should be aided and abetted by hefty fundraising by PE funds. Preqin reported $595 billion of capital was raised globally last year by sponsors. No guarantee it will be deployed, but the pressure to invest will be on.

That will stimulate direct lending in the middle market for 2020, though the definition of "middle market" is stretching higher. Top asset managers have ramped fundraising to pick off financings over $500 million when broader syndications back up.

So what kind of year should we expect in credit for 2020? Put another way, when we write this column in January, 2021, how will we describe the year in hindsight?

The election will likely generate second-half volatility in liquid markets, creating urgency to get deals done sooner. The Fed has signaled little change in interest rates, so with a still-growing economy, the back-drop for business appears favorable.

The biggest question for leveraged issuers is whether projected synergies, cost cuts, and other Ebitda adjustments will be met. If not, and the general trend isn’t great, expect more stress in higher-risk portfolios. No matter how other stars align.