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The Great Stay-In (First of a Series)

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In our January 8th 2020 commentary, “Of Bubbles and Gum”, we reviewed credit market conditions in the wake of the assassination of Iranian General Suleimani. Could this be the exogenous factor that sparks a Middle East war, and triggers a recession? Or will it fade quickly like so many other candidates?

We concluded with the following observation: *“Whether the Fed can continue mainlining enough liquidity all year to overcome any exogenous risks – bubbles or stickier stuff – remains to be seen.”*

Little did we know, and as happens with these things, no one predicted, that *the* risk had already surfaced four weeks earlier. Not from mortgages, oil, high-tech, or leveraged loans, but a lethal virus originating in a seafood market in Wuhan, China.

Today that virus has upended global markets and captured worldwide attention in a way that nothing ever has. Did anyone notice North Korea’s three missile launches?

We have seen other dips that didn’t end up in a recession – 2011 when the US was downgraded and Congress squabbled about the debt limit. And 2018’s worries about China trade and tariffs. But this is different. As Bill Callahan, an investment strategist from Schroeders put it, “It affects the way people go about their lives.”

What’s driving the power of this threat is uncertainty. Beyond the obvious issues of personal health, how will rolling production stoppages, inventory shortages, worker absenteeism, consumer home bound-ism affect corporate earnings? How long will the effects last? And once the virus runs its course, will life return to normal?

It’s clear things in the U.S. will get worse before they get better. The first COVID-19 cases have just started to appear on the East Coast. Workplace and school closings are happening. One loan veteran has christened this The Great Stay-In.

The question for our readers is, what does this all mean for private credit, for private equity, for M&A, and for the capital markets overall? As a lawyer friend said to us the other day, if you can’t shake hands, how can you do deals?

Variables to examine are legion, the interrelationships complex. Interest rates are at astonishingly low levels, which hurts yields, but helps borrowers. Volatility challenges valuations, yet makes prices affordable. Throw oil into the mix – lowering operating costs and pummeling energy companies – and it’s a puzzle inside an enigma.

Armies of analysts are working to crack the code. We’ve reviewed a host of these studies examining the potential outlook for the economy, the markets, and the deal environment. Over the next several weeks we’ll try to sort through it all and make some sense of the situation for our fifty thousand Lead Left subscribers.

? Next week: What’s the impact of the coronavirus on the leveraged loan market?