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Breakfast of Champions

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If it's not one thing, it's another.

The FDA last month began a formal investigation into complaints that eating Lucky Charms was making people sick. On www.iwaspoisoned.com, a social media forum for food ingestion concerns, over 7000 reported serious stomach problems after eating the popular cereal.

As responsible adults we had always assumed breakfast items consisting mainly of sugar and food coloring in dubious shades were low on the nutrition ladder in the best of circumstances. Nevertheless, the story may also be a case study of today's supply chain issues.

According to a professor of nutrition the incident could have resulted from "an ingredient change, because many food companies experienced not being able to get an ingredient and having to source it from a new provider over the past couple of years."

Speaking of ingredient changes, investors have also been actively exploring ways to adjust portfolio allocations in light of stomach-churning market volatility and economic conditions.

As we noted in a *Bloomberg Radio* interview Monday, the last two months have seen a significant reset of equities and fixed income. The combination of steeper rate hikes and stubborn inflation is creating growing recession fears. Higher food, energy, and commodity costs are weighing on consumer confidence, though not necessarily showing in spending data.

The high-yield bond market is reeling from retail fund outflows – $2.6 billion last week and $30 billion this year (per Lipper). Secondary prices have dropped 10 bps to 88 since late February, pushing single-B yields over 8%. Bank desks are reporting trading losses are the worst since early 2020. The new-issue market is effectively stalled, with YTD volume down 76% (per S&P).

In stark contrast, the tone of private markets remains highly commercial. Leading credit managers are stepping into dislocated bond processes with replacement second-liens (e.g. Apollo and Ares for Nielsen's LBO and Goldman Sachs for CDK Global) or significant bond underwriting support (Apollo in Carvana).

Amid this turmoil the traditional 60/40 (equities/fixed income) allocation model is leaving a bad taste with investors. No surprise that enthusiasm for alternatives remains strong. Our private debt survey [link] showed 93% of investors reported their intention to maintain or increase their exposure to the asset class.

Are there risks in doing so in advance of an economic slowdown? Experienced managers are employing their Covid playbooks in sticking with defensive B2B sectors. They are scrutinizing new investments for compressed margins from supply chain pressures and wage inflation. But they know recessions are periods when private debt can shine.