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On Demand

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We don't know anyone who's seen the latest *Godzilla* movie, yet it's grossed more than $375 million worldwide. On the other hand, the clearly-destined-to-be-a-cult-classic *Vampire Academy* has barely scraped in $15 million. Life, we suppose, is unfair.

While not as profound on the scale of life's mysteries, we have also cogitated on the ongoing spectacle of falling interest rates, and their impact on mutual fund flows.

Despite two thumbs up from public equities last week, as the Dow and S&P 500 hit record highs – suggesting investor confidence in corporate earnings over the next six months – bond yields continue to slump. The ten-year Treasury remains around 2.60%, off from 3.0% since January 1.

One theory is that investors were spooked by last week's sneak preview of first quarter GDP dropping 1%, down from the positive 2.6% showing for 4Q 2013. Another is that rate movements are now being driven less by economic concerns than technical issues, including higher demand globally for fixed income products.

And during times of uncertainty, which certainly describes some aspects of current capital markets, there's an extra emphasis on liquidity. Bonds are more tradable, thus preferable for investors seeking flexibility under more volatile conditions.

Of course when investors most want liquidity, it's harder to come by. Given their subordinate position in capital structures, bonds can trade off more sharply than loans with the threat of any credit hiccup.

Nevertheless, these factors have contributed to more cash being deployed into high-yield mutual funds of late and less into loans. According to S&P/Lipper, money has flowed out of retail loan accounts six of the last seven weeks. In contrast, junk bond funds have enjoyed four straight weeks of in-flows totaling $1.6 billion.

The audience of emboldened loan investors is making the most of this by pushing back on leveraged terms and pricing. On cue, loan arrangers are quick to sweeten deals to keep accounts in their seats. This is true also for middle market transactions, though fewer buyers of that paper hail from institutional zip codes.

What's less apparent is whether this favorable story line for loan buyers can be sustained into the third quarter and beyond.

In a world where retail loan cash is heading for the exits, does this accurately reflect the mindset of other investor classes? What about CLOs, which hold twice the market share of loan funds? Have floating rate investments lost their star power?

Speaking of the middle market, are participants there less enamored with loans as well?

Over the next few weeks, we'll take a closer look at the demand side of the loan market equation, for both broadly syndicated and middle markets.

Grab your popcorn, it’s showtime!