Numbers, Again

THE LEAD | June 10, 2014

“What did you learn in math class today, honey?” Picking our daughter up from her second day of an after-school program, we hoped to hear progress in our mission for her to reach coding stardom and launch the next Uber.

Our four-year old made a long face, “Numbers, again,” she replied sadly.

We sympathize. Hard to avoid them, especially if you’re an observer of the capital markets where we’ve been inundated with numbers like 16,964 (what the Dow closed at last Friday), $1.1 billion (how much cash departed loan mutual funds last week), and 0.15% (the record low ECB refinancing rate).

Even *negative* numbers (the ECB deposit rate is now -0.1%) have made headlines.

What’s particularly confounding is that these numbers don’t necessarily add up. New additions to the US labor force (217,000, if you must know) push employment back up to pre-credit crisis levels. But then the Fed wrings its hands that market confidence and low volatility simply sets us up for a steeper fall when bubbles burst.

As we said last week, investors are steering cash out of loan funds into other alternatives like junk bonds. The new big exit number means $2.5 billion was subtracted from those funds in the last month. Does this matter in the grand scheme of loan demand?

Here’s a relative number to consider: $746 billion. That’s the total universe of US leveraged loans, according to S&P/LCD. Here’s another: 22%. That’s Thomson Reuter’s estimate of market share enjoyed by loan funds. CLO’s (41%) and other accounts (36%) make up the difference.

So while retail cash swings get the attention, other investor classes actually dominate the loan space. And it appears that, for example, CLO investors don’t share the bearish mindset of the fast cash crowd.

In our *The Lead Left Spotlight* Wells Fargo’s CLO guru, David Preston, shares with us why these vehicles are enjoying a renaissance not seen since the heady days of 2007 (see also our *Chart of the Week*). Clearly institutional money remains attracted to the virtues of floating rate, senior secured assets.

Figures like 2.52% (a recent ten-year Treasury low) have clearly spooked funds expecting rising rates, but the longer view is that higher capital costs are an inevitable trend. When rates tick up, you could see outflows turn to inflows faster than you can say “numerology.”

The key takeaway? Media ‘rithmetic doesn’t tell the whole demand story. Asset managers and direct lenders who build businesses for the long run don’t change strategies or chase spreads at the drop of a stat. Let the hot money go. Experienced platforms will benefit from a more balanced supply/demand equation.

Next week’s class: Why CLO’s are here to stay.