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Markets at the Midpoint (First of a Series)

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“What’s the most depressing holiday?” Suspecting a joke, we hesitated before answering our friend’s query at a backyard barbecue last Saturday. “July 4th,” he said without waiting. Really? “It means the summer is almost over,” he finished glumly.

For credit market participants, the year’s too-swift passage also signals 2016’s halfway point – time to reflect on what the year has delivered so far, and what’s to come.

Over the next several weeks we’ll speak to credit buyers, sellers, and users about their perspectives on deal volume, leverage, pricing and overall terms.

We begin with a look at the overall economy. A mere three weeks has passed since the Brexit vote upended the European market, giving economists cause to retune global growth expectations. Globally there’s $13 trillion of sovereign debt sporting negative interest rates, per BAML. At Brexit’s epic-center, the Bank of England is expected to lower interest rates in a preemptive move to avoid a downturn.

Yet here at home the news has been quite different. Buoyed by continued good data on the employment front, public equities are back to their record highs of last summer. According to Bloomberg, $2 trillion in value has been restored to stock investors.

Confounding economists, this bullish development has been coupled with a dip in Treasury rates, with the 30-year at its lowest level in US history. Apparently driven by global investors’ flight to quality, it’s tough to square this trend with growth expectations elsewhere. Will corporate earnings catch up with stock prices, or is the market ahead of itself? Will rates drift up with that momentum, or will they remain at rock-bottom.

These questions are significant for credit buyers, particularly of leveraged loans. If Brexit inadvertently highlighted the relative strength of the US economy, it has also put a spotlight on the resilience of senior credit. Broadly syndicated financings resumed coming to market, albeit at a slower mid-summer’s pace, with no discernible difference yet in post-Brexit terms. Thomson Reuters LPC reports loan activity was up almost 150% to $214 billion vs. 1Q, bringing first half volume to over $460 billion.

Middle market issuance also has maintained a good run. According to S&P LCD, the volume of loans below $350 million has steadily improved since April, which represented the lowest month in the last twelve. Arrangers tell us there’s a decent pipeline of new business building over the past several weeks. Hopes are these will launch before the Labor Day break (another unhappy date for summer fans).

What will govern pricing, leverage and terms from now until then is less about Brexit and more about supply and demand. Given the soft 1Q, we expect more urgency from lenders to put dollars to work.

That goes for sponsors as well. Fundraising so far this year has been ahead of last year’s numbers. Firms will need somewhere to put investor cash.

Next week we take a look at issues middle market players are focused on for the second half of the year.