March 2020

Monthly Market Insights

Private debt

Panic over the coronavirus is causing havoc in public markets. In private markets, it will test the resilience of private debt deals, while at the same time calling in direct lending and distressed-debt investors in especially. Following a period of low defaults & distressed cases, current volatility opens the floor for specialized investors seeking opportunities. Private debt lenders will likely find more attractive opportunities than in the past. On the other hand, growing risk aversion could fuel funding costs. Private debt hence is likely to find itself at a crossroad with some investors focusing on higher risk/return opportunities on the one hand, and low risk/return investments on the other. Should the current turmoil continue, it could also materialize into a test for private debt managers having yet to prove their ability to ride a crisis others have already successfully mastered. The near future could well prove to be a health check to ensure private debt is following the right sign post and investors are applying sound underwriting scrutiny.

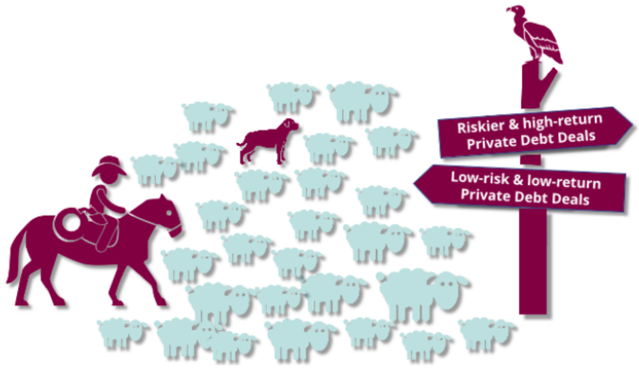
Capital markets

Covid-19 has spread across more than 70 countries having major macro impacts not expected a short time ago. Sectors reliant on consumer discretionary spending and cross border supply chains – highlighting a side-effect of globalization - are especially exposed from a credit rating perspective, with both revenues and cash flows facing uncertainties in terms of the severity and duration. Following an initially optimistic view, capital markets have reacted in an alarming way sending equities down, partially closing bond markets and sending bond spreads sky high especially for lower rated issuers, giving the leveraged loan markets a beating, and running for shelter in highly rated assets and strong currencies. Government yields such as the 10 year Treasury hit historical levels at below 1%. High funding costs for higher leveraged and lower rated borrowers is a looming risk. Some relief might be found in fiscal policies rather than monetary actions such as the rate cut in the US on 3 March. Nevertheless, risk aversion is likely to remain high pending more visibility.

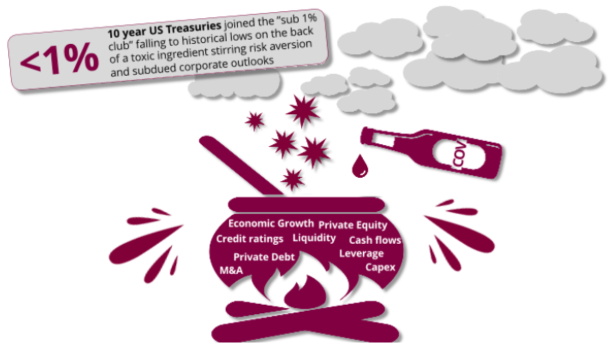
Rating market

As the rate of spread and timing of the peak of COVID-19 are still uncertain, a global recession is turning evident caused by the sudden stop in the economy and the massive efforts to contain it. The collapse in demand and a wide-spread lack of visibility weigh heavily on cashflows, financing conditions, and ultimately on ratings across all categories. Thus, defaults are expected for US non-financials to head towards 10% and above, and European counterparts towards high single digit over the next twelve months, according to S&P. Companies in the massively grown "B" category and below are prone to suffer most from funding disruptions given their weak financial flexibility to weather the challenges. The investment-grade segment is likely to show more resilience, albeit with caution to sectors such as airline and oil & gas. The most affected sectors as of 20 March: Media & Entertainment, Retail & Restaurants, Transportation, Hotels & Gaming, Consumer Products and Automotive.

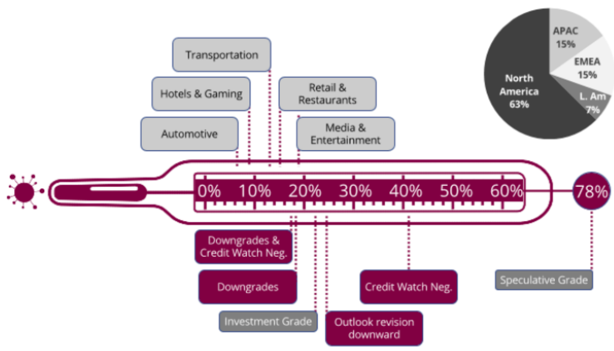
Spreading fears brings private debt to crossroads



COVID-19 spoils the broth & spurs risk aversion



COVID-19 taking a toll on corporate ratings



Source: S&P (171 non-financial corporates up to 20.03.2020)

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