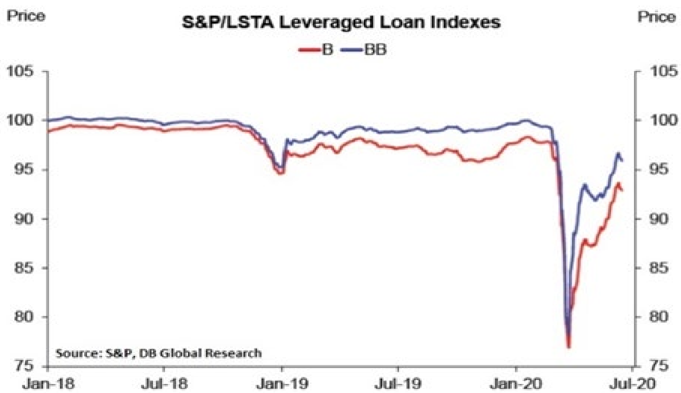
BLOG POST
Analyst Corner
Part 2
8/24/2020

Fixed Income – Leveraging the Leveraged

Possibly the most compelling market exhibiting a V-shaped recovery off of the March lows is the leveraged loan market. These are loans with non-investment grade companies that tend to be asset-backed loans, where the interest rate floats and changes occur. If we use the last recession as a guide, leveraged loan defaults peaked at 10.8% in 2009 and represented approximately $63B in defaults. The leveraged loan market has nearly tripled in size in the last 10 years with LCD estimating the market size today is over $1.8T. If a similar default pattern occurs, there could be as much as $200B in defaults from this recession. If defaults approach this level, it would seem the rapid recovery in leveraged loans is unsustainable. The impact of COVID is likely to have the greatest negative impact on companies that depend on the leveraged loan market making defaults higher than forecasted.



Technical – Beware of Zombies

The historically low interest rates that have been present for several years resulted in new issuance of debt at never before imagined levels. This has led to a proliferation of "Zombie" companies that have profits that are too little to cover their annual debt service. When profits are insufficient to cover debt service, companies rely on chronic borrowing to stay afloat, compounding the initial problem. The number of companies in this condition has a trend line that is already approaching 20% of U.S. companies according to Axios. Zombie companies tend to be very poor in terms of capital usage — many should simply fail and go away. The pandemic will likely allow these companies to gain access to additional government backed debt, even though their problems began long before COVID was an issue. What the tipping point for Zombie companies is to negatively impact GDP is being debated.