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Late Cycle Characteristics

The performance of North American equity markets in May illustrated the escalating tensions between the worlds two biggest superpowers. The S&P 500 fell 6.5% for its worst month of the year and the Dow Jones Industrial Average posted its sixth straight weekly loss, which tallies the longest slump for the blue-chip index all the way back to 2011. All this is in part inspired by the free-spirited (or irresponsible) nature of the American president, and the level of unpredictability, to put it aptly, is astonishing. The continued surprises for financial markets are far beyond what could be imagined.

Beyond the headlines, though, I was struck by a couple of stories this week looking at corporate debt. The first was a headline from the world's largest brewer, Anhueser-Busch InBev, who's looking to venture further beyond beers sales in order to drive up sales or top line revenue. Essentially, the change in consumption habits by consumers of alcohol have seen declines in beers sales, putting pressure on select markets. Beyond the details of their business, it was a story of a major multinational company that was apart of a major debt financed acquisition in just 2016, and at the beginning of the year sat on over a hundred billion dollars in debt.

The theme or story for AB InBev doesn't seem all that different from other multinationals that have taken on debt to finance acquisitions or growth. Companies with stalled or troubled top line growth like Kraft-Heinz, Sears, or General Electric come to mind. The notion was a simple one emerging from the financial crisis. A market was saturated and the easiest was to find profit growth was to acquire or merge with your competitor and create synergies and/or massive cost savings. It's even what's being proposed between Fiat-Chrysler and French automaker Renault this past week. The troubling part of the story could be when the cost savings don't materialize.

Moody's Investor Services came out with a warning this past week on how there could be potential trouble in the corporate credit markets. The lowest level of speculative grade debt represented the largest share of corporate debt issuance in 2018. At 44%, it was double the level it was in 2007, preceding the subprime mortgage crisis and a series of corporate debt defaults. With Moody's warning was that the environment remained stable today; however, scenarios like slowing earnings growth or higher interest rates could be troubling and create additional financial pressures.

The Chief Investment Officers of PIMCO this week also issued similar warnings for the global credit markets and what they referred to as the riskiest credit markets ever. Like Moody's, they don't envision an imminent market triggering event, but they do see liquidity and quality issues in the credit market, and the question is certainly how that relates to the broader markets. Another part of PIMCO's call was a continued flight to US treasuries because of a lack havens, quality and safety.

No imminent shock suggests a "status quo" environment for the time being, but phrases like a credit market with "late cycle characterises," like 2005-2006 is a pretty loud warning for investors.