

When In Choppy Waters, It's Best Up On The High Decks

By Dan Ramsden ■ *Bentley Associates, L.P.*

As I write this article, the historical stock charts on my desk are of the five-day and three-month Standard & Poor's 500 Index, and I am struck by the similarity between the two. Regardless of the timeframe, stock charts nowadays illustrate a turbulent passage, its turns seemingly without pattern beyond a certain peak and trough that is rarely surpassed. Trading professionals, of course, will point to moving averages, stochastics, and other momentum indicators that describe a method to the apparently random and nearly violent to and fro: a sharp rise followed by another, then both annulled by one day's broad collapse; this on the heels of a deceptively flat surface which had been preceded by light zig-zags of unsteady pace. One morning's futures point to a sharply lower open, but a late-day upswing wouldn't overwhelm us, not really, not any more than its precise opposite. Between oil price instability, interest rate uncertainty, and the evolving geopolitical dynamic...caught between economic optimism and the threat of inflation...with always the opportunity for a mid-day news item, a Fed Bank comment, or an overseas development...and, oh yes, election season is upon us, with a toss-up result at that...there is no shortage of surprise, and confusion, pursuing us at every turn.

Despite an overall improvement from prior years, IPO volumes have

not yet overwhelmed, (perhaps as a result of market uncertainty), and the private equity community, (which so often takes its cue from the public market), is fairly horizontal in its trend-line: In the aggregate, quarterly dollars invested by venture capitalists remain at the same approximate levels that had been experienced 12-18 months after the "bubble-burst" of 2000, and these are approximately 50-75% below the levels observed in 2000 and its immediate aftermath.

While some of this non-recovery may be due to the underperformance of sectors that had hereto been major private investment targets, the lack of refocus on substitute opportunities suggest other explanations as well. For starters, numerous private equity funds are nearing or have already passed the termination of their investment period. As many of these funds had closed in the late '90s boom period and were set up as five-seven year partnerships, the current priority is often to plan the next fund rather than chase new opportunities with nearly expired agreements.

There is, however, also another ex-



planation. Were we to classify public and private equity in the same category, and draw the comparison not between the two, but rather between pure equity and its alternative capital class—senior debt—we will note a major difference in current behavior. While equity volumes, overall, have not yet bounced back to pre-bear market levels, the senior credit markets have been a picture of contrast. Volumes have not only remained robust throughout the recent past, but credit terms have improved and the number of money sources has multiplied. In addition to the traditional banks and finance companies, which are aggressively in pursuit of ways to put liquidity to work, a host of institutional credit sources have emerged, offering senior debt finance

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at highly competitive maturities and borrowing costs. Often, these institutions offer their product in the form of long term and minimal amortization “B-loans,” which are packaged with more traditional amortizing “A-loans” (typically funded by banks). The result is a high-leverage long average-life offering for corporate issuers at terms and pricing that they may not have seen in years, if at all. And this is only one structural example...

Granted, the recent and continually robust fixed income volumes are partly a function of the low interest rate environment, making it attractive for issuers to refinance at lower all-in borrowing costs. But the attractiveness of the capital is not the point. Private equity and IPOs are also attractive funding to many businesses, and, as observed, the relative volumes and numbers of such transactions are thin in comparison to history.

Rather, the noteworthy aspect of today’s senior debt market is the proportionately wide availability of its capital, which, in a sense, stands to reason. If there is a central financial brain that rules capital flows—let’s call this entity The Money—it seems as though The Money is opting for the safer plateau of senior debt as it navigates a stubbornly choppy terrain. The space for senior debt is, after all, more likely to withstand turbulence than the volatile equity pockets below it. And if equity and equity related instruments represent upside potential during times of growth and a safety cushion to more senior capital during times of contraction, then The Money will, during times of uncertainty, opt to wait patiently atop a comfortable cushion, foregoing upside until the sea has calmed and it is safe to disembark into gentler waters.

As I finish reviewing a final draft of

this article, late in the day, the Standard & Poor’s 500 Index has recovered from its deeply negative daily low to linger in neutral territory. If recent history is an indication, there may still be another leg to the pattern before the close, upward or downward, and, anyway, tomorrow will come with fresh possibilities. Those senior lenders could just be on to something. Ahoy up there! How’s the view? ■

About the Author

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