THE WEEKLY LEAF

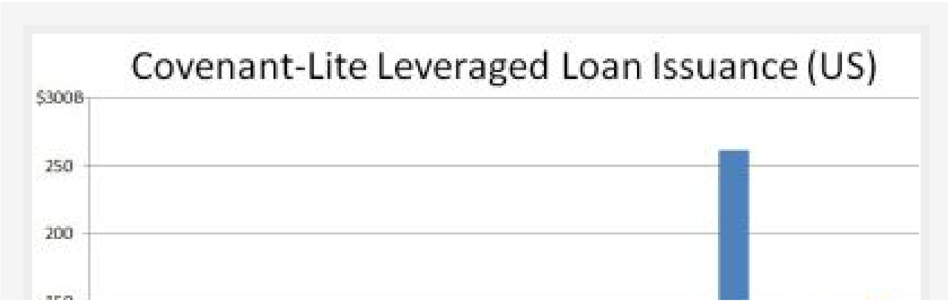
THE DESTINATION FOR RELEVANT NEWS, ANALYSIS AND OPINION

Are we in another credit bubble?

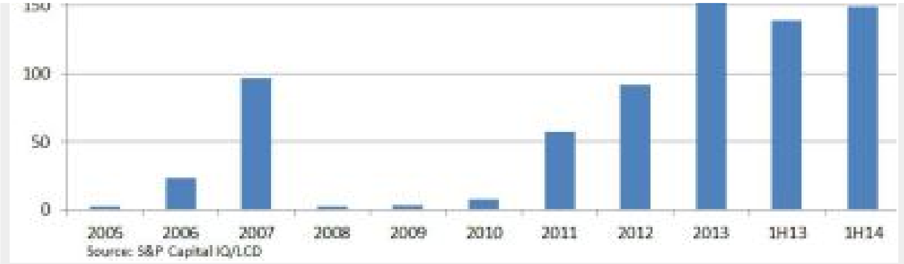
October 7, 2014 by stevenyoder Leave a Comment

Only six years after the Great Recession canceled more than $16 trillion in household wealth and resulted in 4 million people losing their jobs, investors are again aggressively pursuing people, companies, and countries looking to borrow money.

Consider the "peer-to-peer" lending market, through which websites like Prosper.com and Lendingclub.com match up investors with individual borrowers seeking lower interest rates. Borrowers get to take out or refinance loans at lower rates than what they pay to banks and credit card companies. Investors get better returns than they would from fixed income instruments like CDs and money market funds, given today's rock-bottom interest rates.



But the "P2P" market is so hot today that in the last 18 months, institutional investors like hedge funds, sovereign wealth



Source – Leveragedloan.com/S&P Capital IQ/LCD: Loans to higher-risk companies that carry limited restrictions

funds, and even banks are starting to take over the space. There's at least twice as much demand as supply for these loans, Matt Burton, CEO of a firm that helps institutions invest in peer-to-peer loans, told the *New York Times*. In search of new borrowers, Lending Club now is expanding into small business loans, while players like freedomplus.com are facilitating loans to borrowers with marginal credit. All that is happening in the absence of any evidence of how P2P loans will perform in a downturn, given that the market arose after the recession.

P2P is a small fraction of the total lending market. But it's an indicator of larger trends. With interest rates still at or near historic lows, investors are searching far and wide for better yields and are sinking money into riskier instruments. And that may be creating another dangerous bubble.

Start with the fact that U.S. companies are carrying higher levels of borrowed money than at any time since late 2009, according to data compiled by the *Wall Street Journal*.

There's also the explosion in sales of corporate junk bonds, so called because they carry a higher risk of default than investment-grade bonds. Global sales of those bonds are now at their highest level since at least 2006, and junk bonds as a percentage of total corporate bond sales hit a record high in 2013.

Worse, many of the junk bonds being sold lack typical protections for lenders, such as limits on how much debt that borrowers can amass, according to *Bloomberg News*. More than half of the U.S. junk bonds sold this year lacked such protections. Moody's

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December 4, 2014

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Investors Service says that borrower defaults on those bonds are more frequent than on any other type of junk bond, according to *Bloomberg*.

Plus, risky financing tools that were used before the recession have reappeared. One of those—pay-in-kind bonds, which allow the borrower to pay the interest on debt by issuing more bonds, are coming back, according to the *Wall Street Journal*. A group of investors used $600 million of such bonds last fall to buy Neiman Marcus.

The company GT Advanced Technologies offers a case study in just how desperate investors are for yield. In November 2013, the company signed a multi-year agreement to provide sapphire for the glass displays in Apple's new iPhone 6. Wall Street investors snapped up the company's bonds based only on that promise, and its debt levels ballooned from $75 million in 2012 to $644 million this year. But then the iPhone 6 was released in September—without GT's sapphire glass, which was found to be no more durable than Apple's current product, according to reporting by *Business Insider*. From that point, GT's stock crashed, and on October 6 the company announced it was filing for bankruptcy.

Consumer credit levels are ballooning too after dipping following the recession. After falling 4 percent in 2009 and 1 percent in 2010, they increased by about 6 percent in 2012 and 2013. This year, they've climbed even faster—up almost 7 percent in first quarter 2014 and 8 percent in the second quarter. A study this year by personal finance site Card Hub found that in the second quarter of this year, consumers added $28 billion in consumer debt, the greatest quarterly build-up since at least 2009. Average household credit card debt will hit more than $7000 in 2014, a level not seen since 2010. And a report from credit monitoring service Equifax indicates that the consumer debt boom is due at least partly to more lending to subprime borrowers.

In a July report to Congress, Federal Reserve chair Janet Yellen called the junk-bond sector overheated. But if we are seeing a credit bubble, most experts say that it's at least partly due to the Federal Reserve's own low-interest rate policy, which is

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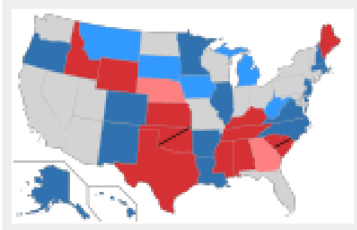

November 11, 2014

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designed to boost the economy by making it cheaper for companies to borrow money. But a side effect of that approach is that it's pushing investors to seek out riskier investment options.

Yellen is trying to constrain bad lending by tighter regulation—in its semiannual report, the Fed said it would be conducting more supervisory reviews of banks. In a speech at the International Monetary Fund, Yellen said that more regulation should play a "primary role" in preventing bubbles, according to *Bloomberg*. And last spring, the Fed, Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation issued updated guidance on leveraged lending, noting that high leverage more than six times profitability "raises concerns."

Some analysts want to see more exacting oversight. "The banks are lending freely, quite freely," Brian Kleinhanzl, an analyst with Keefe, Bruyette & Woods, told *Bloomberg*. Regulators, he said, "need to give more specific criteria and say these are the ratios that must be used by industry."

minority at East Asian summit

October 31, 2014

As Myanmar, a country with an incipient democracy and alarming human rights record, prepares to host a prestigious regional issues summit in coming weeks, the Southeast Asian nation's galling treatment of its ethnic minority populations is receiving renewed attention. It's an inopportune time for the country's president, Thein Sein, for these issues to be resurfacing in […]

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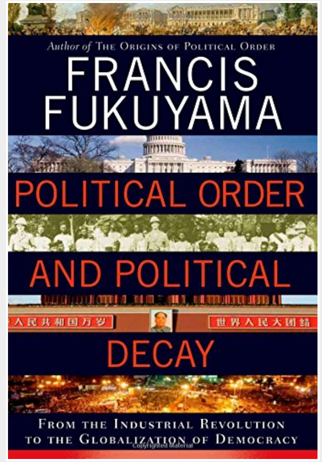

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Book recommendation:

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