It's Official:

This is the Longest—and Junkiest—Bull Market on Record

By Michael Eisenband

Last month marked the longest bull market on record at 3,450 days, with the S&P 500 Index making an all-time high in late August, surpassing the previous record run from late 1990 through early 2000. It has been a remarkable run since the end of the financial crisis, fueled by record-level corporate earnings, artificially low interest rates and some $3 trillion of liquidity provided to financial markets courtesy of the Federal Reserve. Even better, this bull run, which has seen the S&P 500 more than triple off its lows of the 2008 crisis, has been characterized by low volatility and surprisingly few white knuckle moments for investors. It is also the junkiest bull market on record.

What do we mean by "junkiest"? Specifically, we refer to U.S. corporate credit quality, a proxy for which is the ratings distribution of speculative-grade issuers. We measured credit quality in two related ways; the percentage of all speculative-grade issuers rated B- or worse, often referred to as deep junk (**Exhibit 1),** and an average speculative-grade credit rating based on a numeric shorthand (BB+=1, BB=2...CC/C=7) (**Exhibit 2**). Both these measures of credit quality in Exhibits 1-2 are juxtaposed against the S&P 500 Index.

Corporate credit ratings during periods of economic expansion are influenced by two distinct and countervailing forces. Credit quality in times of cyclical growth should improve as corporate operating performance strengthens and operating metrics trend more favorably. This is often offset, to varying degree, by more aggressive financial policies during prosperous times, as issuers are disposed to borrow more heavily against improved earnings and cash flows to finance expansion and shareholder returns. The latter typically tends to outweigh the former in the late phases of an expansion, and credit quality tends to weaken, on balance, over the course of an economic upswing. This has been the case during previous expansions of the late 1990s and 2003-2007. But we are in uncharted junk terrain today compared to precedent periods of the last three decades, with corporate credit quality, as measured by ratings distribution, far weaker than at previous credit cycle peaks of 2000 and 2007. It isn't even close. Much of this deterioration has occurred since early 2015.

Consider the following:

- Currently, 56% of all S&P rated U.S. corporate issuers are speculative-grade compared to 49% in 2009.
- There are currently 1,866 U.S. speculative-grade corporate issuers, 22% more than the previous credit cycle peak in June 2007 and 32% more than in the midst of the financial crisis in December 2008.
- There are currently 456 U.S. corporate issuers rated B- or worse (deep junk), double the number of similarly

rated issuers at the previous credit cycle peak in June 2007 and 20% more than in March 2009 at the depth of the financial crisis.

- Nearly 24.5% of U.S. speculative-grade corporate issuers are currently rated B- or worse (deep junk) compared to 14.6% at the height previous credit cycle in June 2007 and 27.8% in March 2009. The proportion of CCC/C rated issuers is nearly twice as high as in mid-2007.

So much has been written in recent months about deteriorating credit standards and the frothy state of corporate credit markets that it almost seems pointless to add to the conversation. Much of the evidence is in plain sight but fixed income investors remain undaunted. Cautionary commentary is largely ignored or dismissed by perma-bulls who see the good times rolling on indefinitely and have lots of money to put to work.

This has been an impressive economic recovery from the brink of financial collapse—sputtering in the early post-crisis years and accelerating of late. But make no mistake about it; U.S. corporate credit metrics, however one measures them, are worse today than in mid-2007 when the previous credit cycle was peaking. A saving grace for highly leveraged companies is that interest rates remain lower today than in 2007, but there's no reason to expect this will prevail, especially as the Fed ramps up its run-off of some $2+ trillion in treasury and agency securities over the next few years.

Many spec-grade companies today, led largely by private equity sponsors and pliant lenders, are choosing to shun financial prudence and ignore relevant lessons from the near-death experience of 2008, which is now a distant memory that's often viewed as a rare black swan event rather than the specific result of financial markets' excesses. In doing so, they leave themselves vulnerable to a shock event or economic downturn after nearly a decade of mostly uninterrupted prosperity. We can't recall seeing any five-year P&L forecasts lately that included a recession scenario. How can this not end badly—eventually?

EXHIBIT 1

S&P U.S. Ratings Distribution

% of Spec-Grade Issuers Rated B- or CCC/C

Source: S&P Ratings Direct

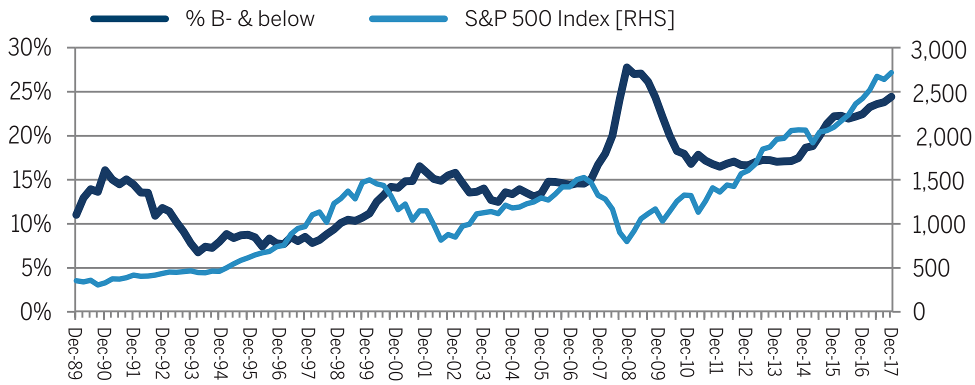
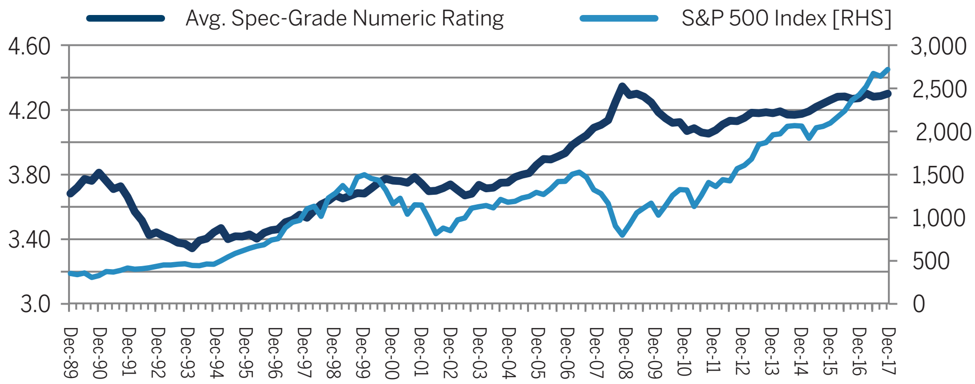


EXHIBIT 2

S&P U.S. Ratings Distribution

Avg. Numeric Spec-Grade Issuer Rating

Source: S&P Ratings Direct and FTI Consulting, Inc.



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