Q&A- Asset-based lending and private equity eye strong year as tight financial conditions, recession loom: Bruce Richards, Marathon Asset Management

As the Federal Reserve tightens financial conditions to contain high inflation, the probability of a U.S. recession has increased which will hit equity multiples and credit spreads, **Bruce Richards, CEO at Marathon Asset Management**, told the Reuters Global Markets Forum on Thursday, March 17.

Given this, asset-based lending is Marathon’s “number one call,” he said.

“Private credit should provide a low-teens, stable yielding return and given the collateral package, naturally insulates the credit in an inflationary environment,” Richards added.

Following are edited excerpts from the conversation:

Q: What are your thoughts on what we got from the U.S. Federal Reserve yesterday (March 16)? What's your expectations for them for the rest of this year?

A: Well, two years ago, at this exact meeting in March 2020, the Fed lowered rates 100 basis points in one shot and embarked upon a $5 Trillion QE (quantitative easing) that put too much money in the system and provided too much stimulus. The transitory position Powell maintained enabled inflation to run too hot and here we are with 8% inflation.

Behind the curve massively, the Fed will raise rates at every meeting for the next year. Expect Fed Funds at 2 1/2% 1 year out.

Q: So between that pace of tightening and QT (quantitative tightening), what impacts do you anticipate on capital markets?

A: The probability for recession is now substantially higher, with second half of 2023 to be the onset. Tighter financial conditions will impact the real economy, equity multiples, and credit spreads.

2022 is the worst start for credit market ever with high yield credit down 6%, investment grade credit down 9% and emerging markets down 12% coming into yesterday's Fed meeting. Only 3 worse starts for equities in the past 100 years too -- 1930's, 2008, 2020 -- so lots to discuss. I also note that the one year forward for Treasuries are inverted with the 2 year - 10 year at negative 25 bps, a tell-tale sign for recession.

Q: So given that, what sectors look interesting and on the flip side, what's to be avoided especially if we're eyeing a recession in another few years?

A: Avoid: Russia is #1 to avoid, it is actually un-investable and untradable. We like the re-opening trade and are long hospitality. Breaking news is RevPar (Revenue per available room) is now about pre-COVID levels, the highest on record as room rates – ADR (average daily rate) -- is a record high. We love air-travel too, as airlines and the metal, Boeing, Airbus commercial aircraft is a sector we have leaned into with a highly positive outlook. Asset Based Lending is our #1 call as private credit should provide a low-teens, stable yielding return and given the collateral package, naturally insulates the credit in an inflationary environment.

Every CEO (Chief Executive Officer) we speak with starts with cost pressure -- wages, commodity, parts, etc -- and this will begin to weigh on earnings in the coming year.

Q: Can you share your views on the present commodity cycle; is it going to sustain?

A: As for commodities, there has been a massive run, and while we are not bearish at today's prices, it is hard to be bullish at current levels. Inflation is definitionally supportive for commodities, however, one year out with a softer economy, it may prove more challenging for the commodity super cycle.

Q: What's your view on EMs (emerging market) outside of Russia, anywhere you're active right now?

A: We are turning much more constructive on EM sovereign bonds, Russia comes out of the index at month end -- March 31st -- while EMBI is -12% year-to-date with a 7% current yield, now that's value!

Q: Where are you seeing opportunities in distressed credit?

A: Private Equity will be active in '22 as equity multiplies have declined, yet loan market and financing markets are wide open. Marathon will be very active in providing financing and capital solutions in the private credit markets.

We also like manufacturing as supply chains are broken, onshoring will be a priority for many companies to bring the supply chain closer to home. This cost to onshore will require capex (capital expenditures) as Marathon stands ready to provide this non-dilutive growth capital. Any company that is being squeezed by costs represents an opportunity to provide capital solutions at attractive returns for our investor base. Restructuring.

Q: Any closing thoughts for us?

A: Big year to buy into the weaker credit conditions as default rates will remain low, and capital will become more dear. I have a hugely constructive outlook for the opportunities that result in a world of considerably tighter financial conditions.