Be Careful Out There

JOHN MAULDIN | November 25, 2015

Michael Lewitt, author of *The Credit Strategist*, likes to get right to the point. Here's the opening paragraph of this month's TCS:

> Commodity prices are plunging, the dollar is powering higher, the yield curve is flattening, ObamaCare is collapsing, global trade is plummeting and terrorism is spreading across the globe. The high yield credit markets are sending distress signals and 10-year swap spreads are negative. Energy companies are going out of business faster than you can say "frack" and trillions of dollars of European bonds are again trading at negative interest rates. The world is drowning in more than $200 trillion of debt that can never be repaid while European and Japanese central bankers promise to print more money and the Federal Reserve is being dragged kicking-and-screaming into raising interest rates by a paltry 25 basis points. Accurate pricing signals in the markets are distorted by overregulation, monetary policy overreach and group think. Hedge funds are hemorrhaging and investors, desperate to generate any kind of nominal return on their capital, continue to ignore the concept of risk-adjusted returns. Some market strategists believe this is a positive environment for risk assets; I am not among them.

Michael pays particular attention to the credit markets, and he doesn't like what he sees. He points out that corporate debt is now much higher than it was on the eve of the financial crisis in 2007, driven by Fed-fueled leverage. This leverage problem is really hurting the energy industry but goes far beyond it, as Michael explains:

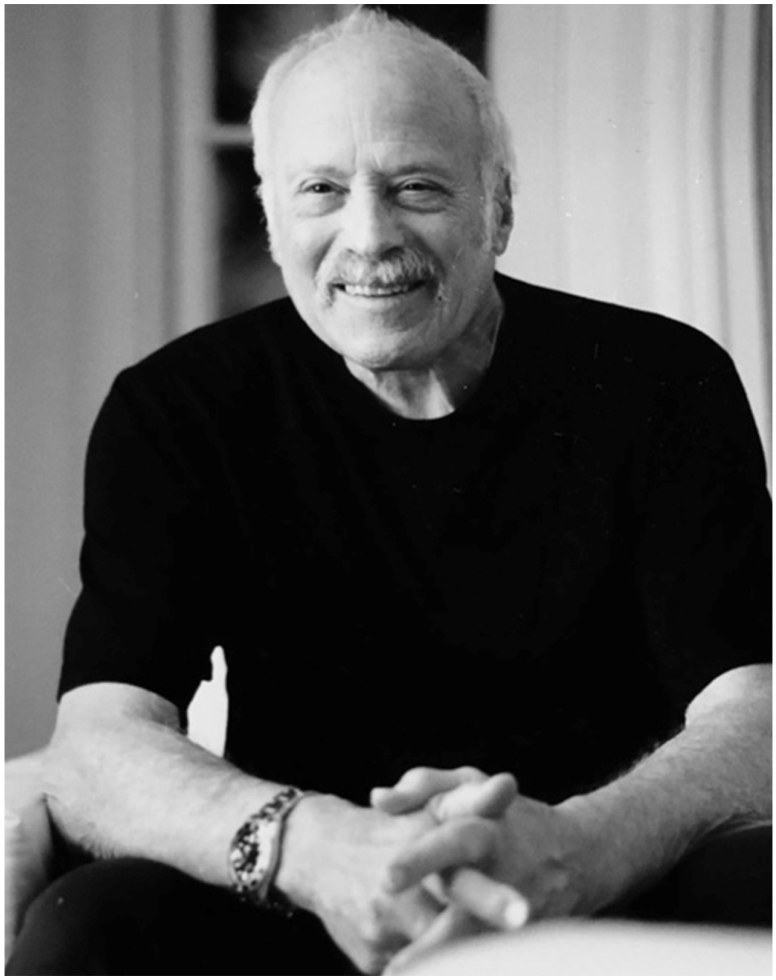
> Companies in the United States have taken advantage of low interest rates to issue record levels of debt over the past few years to fund buybacks and M&A. This has driven the total amount of debt on balance sheets to more than double pre-crisis levels. However, cash flows have not kept pace, resulting in leverage metrics that are the highest in 10 years.

This month's issue of *The Credit Strategist* is sobering, and I hereby forward it to you as this week's *Outside the Box* – at the risk of putting you off your Thanksgiving dinner! Michael consistently has one of the most well-reasoned perspectives in the Wide Wide World of Finance, and if you'd like to consider subscribing to TCS, visit his website at thecreditstrategist.com.

Richard Russell, RIP

I was saddened this week to learn that my friend Richard Russell had passed away over the weekend. He was 91. Dick was an icon of the investment analyst industry. He launched his *Dow Theory Letter* in 1958 and had writen the letter continuously ever since. He became famous for his uncanny calls of the twists and turns in the market. Early in the last decade he moved onto the Internet and began to write a daily commentary, which had a wide and loyal following. The expanded space gave him the opportunity to share his life with us. And what a life he had.

A World War II combat bombardier, jazz enthusiast, raconteur; he could sit and tell stories of his old Brooklyn neighborhood for hours. He recently noted the passing of his last high school buddy, as one by one the old fighters from World War II are disappearing.



The *Dow Theory Letter* is the oldest investment service written continuously by one person. He mentored so many of us. I always enjoyed going to La Jolla and reaching out to Dick (and his wife Faye), and we would have an early dinner somewhere. Even in his mid-80s he felt compelled to get up early to study the markets so that he could write, which meant early to bed.)

I organized a tribute dinner for Dick about six years ago in San Diego. My original thought had been to get together as many of the investment writers who began in the ’80s and ’90s as possible and simply honor one of our own, before he passed on and it was too late. Somehow, the evening morphed into a rather fabulous and elaborate banquet for some 400 people from all over the world.

One of the more amazing aspects of the event was Richard sitting at the head table with all three of his wives and their four kids, and then working the room like the Godfather of the industry that he was. Everyone was laughing and having a great time. Along with all the personal tributes from the attendees, Mark Skousen presented him with a book called *Fifty Years on Wall Street*, which included tributes from his readers and many compatriots in the business.

Dick was a true believer in gold and diamonds, as well as dividend-paying stocks. The diamonds were part of his Jewish heritage – he often told me that you can put them in a small bag and take them anywhere.

During his response that evening, he talked about the country, the markets, and the future. Although the following aren't exactly his words on that occasion, they are his words, and they do reflect what he said:

> The end of capitalism will be due to the unbelievable amount of debt that is currently being created. This will create monster inflation that will destroy every currency. The only currency that cannot be destroyed is gold. When investors realize this, we'll have the makings of the greatest bull market in gold ever seen.

He sadly didn't live to see that great gold bull market that he so passionately believed in. Those of you who would like to read a note from his family can click here. You can read the tributes from the book we did at this link.

As I get ready to start baking cakes and otherwise preparing for the big gathering tomorrow, there are so many things I'm thankful for. One of them is you and the generous gift of your time and attention to my musings, which has given me a life far beyond what I could have imagined 15 or 20 years ago. Perhaps, like my writing hero Richard Russell, I will still be writing to you when I'm 90. And you will still be reading.

Have a great week and don't forget, calories don't count on Thanksgiving!

Your getting his chef hat on analyst,

John Mauldin, Editor
Outside the Box

Be Careful Out There

> "The high recent valuations in the stock market have come about for no good reasons. The market level does not, as so many imagine, represent the consensus judgment of experts who have carefully weighed the long-term evidence. The market is high because of the combined effect of indifferent thinking by millions of people, very few of whom feel the need to perform careful research on the long- term investment value of the aggregate stock market, and who are motivated substantially by their own emotions, random attentions, and perceptions of conventional wisdom."
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> – Robert Shiller, *Irrational Exuberance*, Princeton, NJ, Princeton University Press (2000), p. 203

Commodity prices are plunging, the dollar is powering higher, the yield curve is flattening, ObamaCare is collapsing, global trade is plummeting and terrorism is spreading across the globe. The high yield credit markets are sending distress signals and 10-year swap spreads are negative. Energy companies are going out of business faster than you can say "frack" and trillions of dollars of European bonds are again trading at negative interest rates. The world is drowning in more than $200 trillion of debt that can never be repaid while European and Japanese central bankers promise to print more money and the Federal Reserve is being dragged kicking-and-screaming into raising interest rates by a paltry 25 basis points. Accurate pricing signals in the markets are distorted by overregulation, monetary policy overreach and group think. Hedge funds are hemorrhaging and investors, desperate to generate any kind of nominal return on their capital, continue to ignore the concept of risk-adjusted returns. Some market strategists believe this is a positive environment for risk assets; I am not among them.

Investors continue to bid the prices of a select group of mega-stocks to unsustainable levels while most of the market experiences a stealth bear market. Market internals are terrible. The same is true in the credit markets where CCC-rated bonds are badly underperforming BB-rated bonds on a trailing 12-month total return basis (by 700 basis points overall and 460 basis points ex-energy). This has only occurred three times before – twice coinciding with developing credit crises in early 2000 and early 2008 and once in 2011 when the Fed kept markets afloat by announcing QE2. High yield is now underperforming equities and investment grade debt simultaneously, which is highly unusual considering that the asset class sits between these two asset classes on the risk spectrum. The last time this happened was early 2000 and late 2007 – periods that preceded credit crises. Deutsche Bank remarks that, "Last week [the week of November 16] was the best week for the S&P 500 since December 2014 but US HY continued to under-perform virtually all major comparable asset classes... The big question within credit and to the wider global markets community is whether this can be contained or whether it is reflecting a turning and deteriorating credit cycle that is going to be tough to stand in the way of." (http://www.zerohedge.com/news/2015-11-23/how-possible-deutsche-bank-asks-noting-canary-junk-bond-mine)

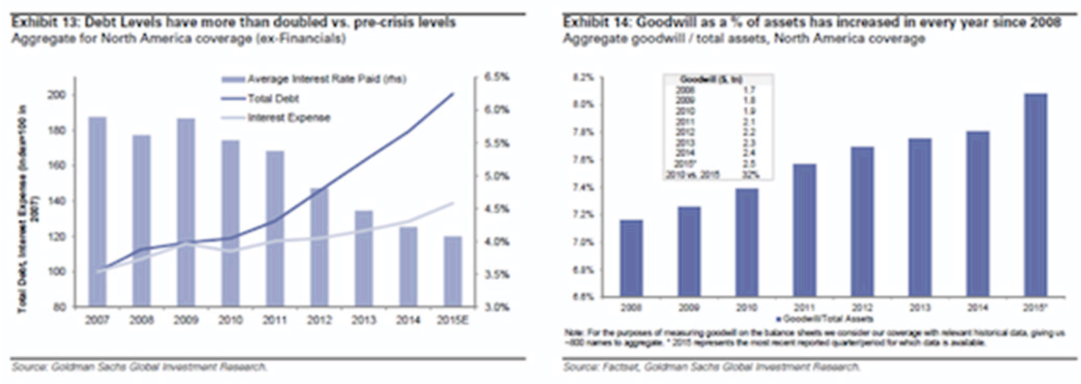
While some argue that high yield market weakness is primarily liquidity driven, careful analysis of company and industry data suggest that poor fundamentals are at work. While early in the year these problems were largely confined to energy and energy-related companies, weakness has since spread to the media and retail sectors. The media sector sold off over the summer and retail followed in the fall. Highly leveraged companies in all industries are unable to amortize the debts they have accumulated in the years after the financial crisis. While their high debt levels were disguised by record low interest rates arranged by the Fed, investors are finally waking up to the fact that corporate balance sheets are more leveraged than they were before the financial crisis in 2007. In an economy that struggles to grow at 2%, leveraged companies find it difficult to grow rapidly enough to service their debts. They rely on the complacency of lenders who are tired of eating at a restaurant that offers them small portions and lousy food. After years of mid-single digit returns that do not compensate them for such lousy fare, investors are starting to demand more, eating elsewhere, or going on diets.

The Real Story About Corporate Debt

Goldman Sachs recently caught up to the excellent work done by Andrew Lapthorne at Societe Generale regarding the releveraging of Corporate America. Mr. Lapthorne has been warning for more than a year that corporate debt is significantly higher than it was on the cusp of the financial crisis in 2007. (Andrew Lapthorne, Societe Generale Global Quantitative Research, "Quant Quickie: As US corporates pile on debt, leverage should now concern the market," June 12, 2014.) These higher debt levels have been disguised by the low interest rates engineered by the Fed. Now Goldman Sachs has confirmed Mr. Lapthorne's findings, writing: "Companies in the United States have taken advantage of low interest rates to issue record levels of debt over the past few years to fund buybacks and M&A. This has driven the total amount of debt on balance sheets to more than double pre-crisis levels. However, cash flows have not kept pace, resulting in leverage metrics that are the highest in 10 years." (Goldman Sachs, Equity Research, "What's Eating Corporate America? Leverage, Goodwill and FX," November 10, 2015.)

Figure 1

Bloated Corporate Balance Sheets



Goldman refutes the argument that low rates render these higher debt levels innocuous: "Now, the counter-argument one hears is that the cost of this debt has never been this cheap with the average interest rate paid dropping from close to 6% to 4% in 2015. Put another way, as debt has more than doubled, the amount of leverage expense has only gone up by 40%. This is all good until you normalize EBITDA. Indeed, if EBITDA was at 'normalized levels' (which we define as median NTM EBITDA from 1Q07-2Q15), leverage would move to 1.75x, over 30% higher than the average over the last 10 years." Balance sheet health is further inflated by $1 trillion of goodwill that has been added over the last ten years. This is the type of data that investors should be focusing on rather than being fooled by phony non-GAAP earnings adjustments, stock option accounting and stock buybacks that paints a false picture of corporate health. The data on corporate leverage is another reason why I believe the bull market ended late in 2014.

This leverage problem goes far beyond the energy industry, which continues to fall apart in a manner reminiscent of the Internet and telecom industry 15 years ago. In mid-November, four energy companies owing a combined $4.8 billion warned that their auditors had expressed doubts that they could continue as going concerns – Penn Virginia Corp., Paragon Offshore Plc, Magnum Hunter Resources Corp. and Emerald Oil Inc. The tens of billions of dollars of capital that was lured into propping up the industry earlier this year when oil rebounded to over $60/barrel during the second quarter is now worth roughly 25% less with little prospect of rapid recovery (as we warned at the time). Capital invested in companies that can ride out the cycle can be recovered but investments in highly leveraged energy companies may end up being written off. Now investors don't want to touch anything oil-related (hedge fund have ratcheted up their short positions in oil) and banks are trying to reduce their exposure as the consensus has caught up to the reality that oil prices are not going to recover for a long time (again, as we have repeatedly warned since the oil collapse began last year).

Commodities

And speaking of commodities, with the dollar trading at multi-year highs, the prospects for a recovery in commodity prices are dim. Commodities trade in dollars and the strengthening dollar is depressing their prices (more on the dollar below). But supply and demand conditions are also contributing to the decline - and most of the trouble is coming out of China. Several prominent investors, including David Tepper, Daniel Loeb and John Burbank, recently echoed warnings that readers of this publication have been reading all year that China's economy is not going to recover anytime soon. China is now engaged in depreciating its currency and pumping out as many cheap commodities as possible to keep its broken economic engine going, but all these measures will succeed in doing is dragging the rest of the global economy down. I have written it before and I will repeat it again – China is a house of cards built on a flimsy foundation of debt. Counting on a Chinese economic recovery is a fool's errand.

Aluminum

China's surging exports of aluminum and steel are crushing prices around the world. According to The Wall Street Journal, China's aluminum exports are up 14.4% this year. (The Wall Street Journal, "China Exports Depress Aluminum Prices," November 11, 2015, p. C3.) Prices can't seem to find a bottom. As of November 11, benchmark 3-month aluminum futures were trading at around $1,492/ton on the London Metal Exchange, just above a six-year low. Six years ago the world was in the midst of the worst financial crisis in a century. By November 23, they had dropped further to $1,439.50 per ton. China also appears to have no intention of cutting back its exports. Chinese producers have added 3 million tons of new capacity this year and could add another 1 million before year-end, forcing the Chinese market into further oversupply and leading them to export more.

Copper

Dr. Copper is ailing as well and is also trading at six-year lows. Copper prices have dropped 28% year-to-date. The December copper futures contract in New York was trading at $2.2175/pound on November 10, its lowest closing price since July 2009. The November contract also closed at a six-year low of $2.2165/pound on that date. But matters deteriorated further after that. By November 23, the contract had dropped to $2.0210/pound.

China drives roughly 40% of world copper demand, where it is used in construction and manufacturing. There is little chance that other countries can take up the slack created by China's economic slowdown. Copper is a particular problem for Glencore PLC, which I have written about on Sure Money (www.suremoneyinvestor.com). Glencore, which is struggling under a mountain of debt and plummeting commodities prices, earned 20% of its operating profit from copper in the first half of 2015. Moody's Investors Service believes that copper below $2.20/pound poses a potential threat to Glencore, which is struggling to reduce the debt load it accumulated in rosier times. While large producers have shut down some mines, others are still completing expensive long-dated projects that are adding to global supply and extending the downturn. According to Barclay, four new mines will increase world production by 5.1% next year. Other companies feeling the pressure include Anglo American plc and Rio Tinto plc.

Oil

Oil is testing the $40 per barrel (WTI crude) level due to dollar strength and continued global oversupply. Investors poured tens of billions of dollars into new energy investments during the second quarter of this year when oil rallied back to over $60 per barrel. At least one large credit fund run by Chicago firm Achievement Asset Management announced it is closing down after being hurt by investments in energy bonds. According to The Wall Street Journal, "Achievement, which had more than $2 billion under management in mid-2014, is the largest hedge fund casualty to date from the reversal of a trade that was supposed to carry the year for many star investors. Many managers spotted an opportunity over the last year in beaten-down debt from energy companies hit hard by oil's slide." (The Wall Street Journal, "Chicago Hedge Fund To Close, Hit by Slide in Energy-Firm Debt," November 18, 2015, p. C3.) What these investors missed was the fact that a strong dollar would make it virtually impossible for oil to sustain its mid-year rally even if industry fundamentals improved, which they did not. Readers of this publication knew better. The energy downturn is going to last much longer than people think; managers who fail to factor in currency and other factors will continue to miss the mark and fail their investors. The manager of Achievement should be commended for saying that he didn't think it was appropriate to run a "laboratory experiment" with his clients' money. There are too many Victor Frankenstein's in this business already.

Legislators Running Wild

The next time somebody tries to convince you that legislators have memories longer than the half-lives of fruit flies, refer them to the following two examples of epic stupidity.

The first is Fannie Mae and Freddie Mac rolling out a new program called "Home Ready" that allows homeowners to obtain a mortgage with a 3% down payment. In the third quarter, Fannie Mae's profit fell by 50% year-over-year while Freddie Mac reported its first quarterly loss in four years. Both companies' earnings were hurt by a decline in the value of their massive derivatives portfolios. After the companies announced their results, their government overseer, the director of the Federal Housing Finance Agency Mel Watt, warned that they may require another government bailout.

The second involves the regulation of business development companies (BDCs), a type of publicly traded closed end fund that makes loans to small and mid-sized businesses. As of June 30, there were 88 active BDCs with net assets of $52.3 billion; the largest ones are affiliated with large publicly traded equity firms. Currently, roughly 90% of BDCs are trading below net asset value and can't raise additional capital without further diluting their stock price. In a move reminiscent of removing the leverage caps on large broker dealers in 2004, which led firms like Bear Stearns and Lehman Brothers to blow themselves up, Congress has decided in its infinite wisdom to raise the limit on how much borrowed funds BDCs can use to enhance their returns. Further, BDCs will be allowed to charge management fees on levered rather than unleveraged assets. Finally, the legislation would allow BDCs to increase their lending to opaque financial companies like banks, brokers and insurance companies when they were originally intended to focus on operating companies that provide non-financial goods and services. SEC Chairman Mary Jo White testified against this legislation in Congress, warning that it would significantly increase the risks of these funds for the retail investors at whom they are aimed. Coming at the late stages of an epic credit cycle, this is classic pro-cyclical legislation that can only lead to trouble.

Climate Change and Your Investments

While politicians and political commentators debate whether climate change is a greater strategic threat to the United States than radical Islam or Vladimir Putin (it is not), investors need to take the regulatory response to this issue seriously. While the precise impact of climate changes is still being debated, two recent regulatory moves signal potential trouble ahead for investors in industries such as energy, industrials, autos and any other activity that politicians decide has a negative effect on the environment.

The first move occurred in New York where politically ambitious Attorney General Eric Schneiderman invoked the controversial Martin Act to subpoena records of Exxon-Mobil going back thirty years related to the oil giant's response to and public statements regarding climate change. News of the subpoena was leaked to The New York Times, which reported on November 5 that the New York Attorney General had "begun a sweeping investigation of Exxon Mobil to determine whether the company had lied to the public about the risks of climate change or to investors about how these risks might hurt the oil business." The Martin Act was enacted in 1921 to prosecute stock boiler rooms. It doesn't require prosecutors to prove intent to defraud and in this case would not require proof that any Exxon investor was harmed. The law also doesn't require probable cause to commence an investigation. The Martin Act was a favorite tool of Mr. Schneiderman's predecessor Eliot Spitzer. One would think that the types of disclosures the AG is asking about fall within the purview of securities regulators, not the state attorney general. I would advise Exxon Mobil to the subpoena by informing Governor Andrew Cuomo that it will begin moving as many of its offices and other facilities outside of New York State as possible and by refusing to cooperate with this unlawful investigation.

The second move came when the Department of Labor issued new regulations on October 26 that affect the law governing how fiduciaries manage pension assets. Amending a 2008 interpretive bulletin that it now believes "unduly discouraged plan fiduciaries" from considering environmental, social and governance factors in their investment decisions, the Department of Labor issued new Interpretive Bulletin 2015-01 that now requires managers to take such factors into account. Under the new guidelines, while fiduciaries cannot accept lower return expectations or greater risks, they are required take environmental, social and governance factors into account at "tiebreakers" when all other factors are equal. "Environmental, social and governance issues may have a direct relationship to the economic value of the plan's investment. In these instances, such issues are not merely collateral considerations or tiebreakers, but rather are proper components of the fiduciary's primary analysis of the economic merits of competing investment choices." Wall Street is objecting to this intervention into the investment process by the government. By warning fiduciaries that consideration of the environmental factors is required in cases where they have a direct impact on the value of an investment, the Department of Labor is effectively intervening in the investment process.

If an investment is in fact affected by climate change and a fiduciary fails to factor that into the analysis, he or she could now be deemed to be violating his fiduciary duty. On the face of it, there is nothing unreasonable about including such factors in one' investment analysis. Investors are wise to consider whether companies are subject to environmental risks, for example. The problem is that with the hammer of potential liability hovering over their heads, this type of vague guidance could lead large fund managers to start avoiding investments in sectors such as energy, utilities or autos. Whether that will happen until the Department of Labor starts taking action against fund managers for violating this new guidance remains to be seen. But the guidance alone is a roadmap for political activists and their attorneys to pressure pension funds to steer away from such investments. As I write in my new book The Committee to Destroy the World, much of the law that governs fiduciaries is outmoded in today's world. Concepts such as the efficient market hypothesis and diversification that govern fiduciaries have been repeatedly discredited. The last thing we need is the government telling investors what factors they should and should not consider when they allocate capital. This is an inappropriate intervention into free markets.

The Disaster that is ObamaCare

There is a reason that adults are told to don their oxygen masks before assisting children in the event of an emergency on an airplane. If the most capable people are disabled, the weakest are unlikely to be able to help themselves. The same adage applied to the U.S. economy when Barack Obama took office in January 2009. In the midst of the worst financial crisis in a century, it was imperative that everything be done to address the causes of that crisis and to strengthen the fabric of the economy to position it for sustainable economic growth. That wasn't done. Instead, the president made a historic decision that will rank among the great policy errors of the 21st century. Appealing to his political base, he decided to pursue healthcare reform despite opposition from a majority of the American people and a near-majority of Congress. He managed to sneak the legislation through by a bare majority using a reconciliation process designed for budget items and sold it as a phony civil rights measure. In the rush to pass the highly complex law before losing his Congressional majority, neither the president nor the vast majority of those who voted for the law read the bill or evaluated its unintended consequences.

The result, as you might expect, is the infliction of enormous damage on the American economy and tens of millions of Americans whose medical care has been turned upside down in the name of providing another entitlement without asking anything in return of the recipients. ObamaCare has increased medical costs, deprived Americans of their chosen physicians and treatments, and contributed to a culture of dependency that has no place in a land of liberty.

The law is also, predictably, a financial shambles. Eleven of the 23 regional coops formed under the law have failed. The largest health insurer in the country, United Health, warned that it may withdraw from state exchanges after suffering hundreds of millions of dollars of losses. We are also learning the true costs of the law's expansion of Medicaid to the states – and they are nothing short of catastrophic. While the Obama administration thought it could conceal the true costs of the law by pushing them off until after it leaves office, the chickens are already coming home to roost. ObamaCare was designed to incentivize states to expand their Medicaid programs by offering to pay 100% of additional costs through 2016, dropping to 90% by 2020. This free money led many states to take what appeared to be a great deal, but they are learning that there are no free lunches.

According to the Associated Press, at least 14 states have seen new enrollments exceed their original estimates, causing seven of them to increase their cost estimates for 2017. California expected 800,000 new enrollees after the state's 2013 Medicaid expansion but ended up with 2.3 million. Enrollment outstripped estimates by 44% in New Mexico, 73% in Oregon and more than 100% in Washington. Illinois, which is already hopelessly bankrupt, originally projected that its Medicaid expansion would costs $573 million for 2017-2020; but 200,000 more people enrolled than expected and the cost has increased to about $2 billion. Where the state is going to come up with this money is anybody's guess. Enrollment overruns in Kentucky (which just elected a Republican government who promised to end the Medicaid expansion) forced officials to double their estimates of the cost for 2017 to $74 million from $33 million and the figure may rise to $363 million in 2021. Ohio, home of presidential candidate John Kasich, has seen state spending on its Medicaid program grow by $5.8 billion since 2011. It now projects the total cost of its Medicaid program to hit $28.2 billion in 2017 – a 59% increase during Mr. Kasich's tenure.

Why is this important? Among other things, states have to balance their budgets by law. If their Medicaid budgets are blowing up, they are going to have to make sharp cuts in other areas or raise taxes significantly. Municipal bond investors are going to have to pay special attention to deteriorating credit quality in states that decided to enter the Devil's Bargain known as ObamaCare. This law is profoundly flawed and is going to have to be repaired or repealed before it completely destroys the American healthcare system.

Private Equity Never Learns

While most of the big busted LBO deals of the mid-2000s have been flushed from the system, the private equity industry is in the process of repeating its past mistakes on a smaller scale as we reach the terminal state of the current credit cycle. Standard & Poor's recently released a report warning that the recent crop of LBOs faces mounting credit risks as a result of too much leverage, rising borrowing costs and slowing economic growth. (Standard & Poor's, "Why The Recent Crop of Leveraged Buyouts Faces Mounting Credit Risks," November 3, 2015.)

The number of buyouts has dropped sharply since the mid-2000s. The peak came in 2007 when 434 of these transactions were done. Since then, the highest number of LBOs was 164 in 2013; 119 were done in the first nine months of 2015. Alarmingly, however, the average EBITDA multiple has increased sharply in recent years to a record 11.2x in the third quarter of 2015. By way of comparison, however, 2014 (9.7x) and the first nine months of 2015 (10.3x) saw EBITDA multiples that were as high as the 9.7x multiple paid in 2007, the top of the LBO bubble. Pro forma LBO leverage has also crept up to 5.7x in 2014 and 5.6x in the first nine months of 2015, approaching the 6.1x level seen in 2007. New deals have taken advantage of looser creditor protections as evidenced by the explosion of covenant-lite bank loans, which hit a new record volume of $66 billion in 2014. In many cases, covenant-lite bank loans are bank loans in name only; they do not possess greater covenant protections than bonds and are a sure sign that lenders have reached what my friend Doug Kass would call "peak complacency." (I wrote about some of the ridiculous covenants that bondholders and bank lenders have agreed to extend to buyout firms in my chapter in the new book Martin Fridson, editor, *High Yield Future Tense: Cracking the Code of Speculative Debt*, New York, New York Society of Securities Analysts, Inc., 2015. See Michael E. Lewitt, "The High Yield Bond Market: A Tale of Boom and Bust.")

Naturally, LBO sponsors are exiting LBOs at a rapid clip and are now sitting on more than $500 billion of dry powder just as stock prices are trading at high valuations that offer little value for buyers. This has already been apparent in the double-digit multiples paid over the last couple of years. The fact remains that, for the most part, private equity consists of substituting debt for equity on the balance sheets of perfectly healthy companies; it is an activity that contributes little to the productive capacity of the economy, to social welfare or to economic growth. Its risk-adjusted returns are also not all that great except in the hands of a limited number of practitioners. Investors can now look forward to poor returns and potentially significant losses on the deals done at ridiculously high multiples over the last couple of years.

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