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Q&A

Anders Maxwell: Ready For The Next Downturn

*Anders Maxwell has been there and done that. A veteran of the credit markets for more than 30 years, Maxwell has spent the last eight of those as a managing director for New York-based investment bank **Peter J. Solomon Co.** His focus there is on corporate restructuring and strategic sales. His career has taken him from sales to trading to the advisory business, and he has worked for firms ranging from **GE Capital** to **Dean Witter**.*

What was it that initially attracted you to leveraged finance?

Maxwell: It really appeals to my architectonic sense. I was trained as an architect, and what I like doing is structure. Leveraged finance has a high content of structure and analysis. That's what I really enjoy, that's what I was trained to do and what I like. Your productivity is purely a function of your ability to think.

What attracted you to Peter J. Solomon Co.?

Maxwell: I had had it with big firms. I very much enjoy the advisory business, and I do not have much interest in anything else. That's really what Peter's committed to. You get to a certain point in your career when you have a working understanding of what makes you tick, and it's just a matter of being true to that.

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Firm: Peter J. Solomon Co.
Title: Managing Director
Previous firms: GE Capital, Dean Witter, Benedetto Gartland & Co., Kidder Peabody & Co., Salomon Smith Barney and Lazard Frères
Education: Bachelor of Architecture, University of California at Berkeley; M.B.A. from the Wharton School of the University of Pennsylvania
Hobbies: camping, traveling, trumpet playing

How has the high yield market changed most significantly in the past five years?

Maxwell: The size of the market in five years has, practically speaking, doubled. That's extraordinary. It’s gone from an order of magnitude of $600 billion to a number roughly twice that. That's without getting into all these allied debt markets. That's just talking about junk. What's happened in terms of compression in spreads is incredible, almost unprecedented. The quality of high yield has changed, and I would argue deteriorated markedly. Just looking at the proportion of new issuance that's triple C — it's pressing 40%, which is pretty alarming. At the same time defaults have been *de minimis*. We're talking about, practically speaking, no defaults.

What the numbers are telling you is that it's downhill from here. In other words, you have nothing to look forward to but deterioration in the performance of high yield, and the only question is: When does it become apparent and how dramatic and of what duration is that collapse?

How do you assess the state of the leveraged finance market today?

Maxwell: Spreads can't get tighter, default rates can't get lower. The quality of new issuances, if you just use credit rating as an indication, has never been this bad. I don't care what metric you use, the quality of paper that's being indiscriminately purchased today is deplorable.

The market has gotten much bigger and the risks of loss are, I would argue, higher than I've ever seen in my career. I have some basis for saying that. I've lived through several cycles. That's unusual in this market and another reason why things have gotten so out of control. You've got the inmates running the asylum. It is a market fraught with extraordinary risk.

What are your biggest concerns for the future of leveraged finance?

Maxwell: What is most concerning about the market is that the liquidity here is really a function of leverage on leverage on leverage. ... The multiplier effect of all that leverage is driving that market. And when that reverses itself, which history substantiates that it will, it will take your breath away. I've been there and done that. I was sitting at a trading desk in 1989 when that happened. Let me tell you, it's no fun.

All these kids that are running around and running these hedge funds and taking home these breathtaking compensations, they're going to get an education. They're going to see what happens when markets don't go up. That's going to impact everybody. We're going to have people taking some substantial losses, and I fail to see how it's going to be limited to one or two hedge funds.

It will seem extraordinary for those who are living through it the first time, but if you look back at history, this is the nature of things and the way markets behave. They go to excess and then they correct. We're going to have a good old-fashioned correction.

By way of full disclosure — I've been anticipating this for about a decade. I've been relatively bearish for a long period of time. I'm in awe of the markets and the duration this market has had in terms of its run.

You've spent a lot of time working on restructurings. How do you see the state of the restructuring environment today?

Maxwell: Restructuring, as it's conventionally defined ... is very, very quiet, and I think that's going to continue to be the case.

Restructuring itself is going through a change and metamorphosis. Our industry is changing. There's going to be more of a premium placed on strategic thinking and real value-added from advisors in terms of guiding companies through an increasingly dynamic environment.

In this last cycle you've seen how really cumbersome and expensive some of these bankruptcies have turned out to be. In part because of the changes in law, partly because of changes in perspective and certainly significant changes in terms of ownership of this debt and the sheer size of markets. You're going to see a lot of things change in restructuring. People are going to have to take a more pragmatic approach, particularly if I'm right about this tsunami coming. The market's going to change, and change dramatically, and the way people react is going to be different. It makes it that much more interesting and puts that much more of a premium on a thoughtful, analytical approach.

Do you have a general philosophy about investment banking?

Maxwell: Investment banking, as people like Peter Solomon define it, is an art, and it's an intellectual and otherwise study in integrity. You're telling people what you really think, and presumably what you think is valued because it's based on years of experience and a thoughtful approach. It's a business that doesn't generally exist any longer in the big firms because the big firms have gotten themselves into other — what they perceive to be as more lucrative — lines of commerce as opposed to unadulterated and thoughtful advice.

But that's what people of my generation were trained to do. That's certainly central to what Peter considers the competence of the firm. We don't write adulterated research, basically pawning off stale trading positions. We have no capital to deploy to front run our clients. We're not in the investing business. We don't have any inherent conflicts with our clients. We don't have a loan fund or a mezzanine fund or a private equity fund. We are in the business of sharing our thoughts as they are perceived to be helpful or useful in issues.

Asset classes such as second-lien loans have come of age during a healthy market economy. How do you think they will fare when there is a downturn in the market?

Maxwell: Generally speaking, the lack of discipline brought to lending as a result of this market awash in liquidity is going to come back to really cost people significantly in terms of losses. I would include in that high yield as well as these derivative products including second and third-lien positions that have become somewhat popular in the last two or three years. The lack of discipline in terms of buying these loans is going to become very evident when the market eventually changes. You're not going to get a more benign credit market than we have now. Things can only get worse from here; they can't get much better.

What I was taught when I started as a lending officer at General Electric credit many years ago was that it doesn't take much talent to make a loan. The issue is getting the money back. You're going to have a generation of fixed income portfolio managers that are going to learn that lesson the hard way, in my opinion. To put it simply, the second-lien market is going to have the same sort of performance you would expect to see in the unsecured market. ... If you look at a lot of the workouts over the past 18 months, you have a number of second liens in there where the investors have come away with less than they bargained for. ...With the degradation in underwriting standards, almost by definition you're going to have very significant underperformance in this next cycle. — *MS*

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