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Monday on Wall St.: Jitters Rather Than Mergers

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Monday, the day when Wall Street announces some of its biggest deals, may not be the same for a while. And that could cause more jitters in stock and bond markets, following their worst week in nearly five years.

For several years, the size and volume of deals announced at the start of the week set the tone and pace for the global financial markets for the next five days, more often than not sparking rallies that sent shares to new highs. But given the rout in the markets last week, “Merger Monday,” as the day is known, may be on hold — indefinitely.

Rather than negotiating new deals to take public companies private with billions in easy and cheap credit, many bankers and private equity firms spent the weekend trying to figure out what to do with dozens of pending deals that are now faced with the higher cost of debt. Some bankers said yesterday that they were willing to wait out the turmoil, others were discussing the prospect of paying breakup fees to get out of some transactions.

After the stock market’s 5 percent drop and a sharp jump in yields on high-yield debt last week, many investors spent the weekend trying to regroup. Some began turning over stocks and bonds in search of bargains. Portfolio managers said they were raising cash for potential shopping trips in distressed pockets of the market.

“We see extraordinary activity,” said Girish V. Reddy, managing partner at Prisma Capital Partners, a hedge fund that invests in other funds and has been approached in recent days by managers who have opened funds to new investors. “The traditional distressed space has kind of come alive.”

That is not to say that a wave of buying will lift the market when trading resumes this morning. Mr. Reddy and others said it had become exceedingly difficult to predict the ever more volatile market. Just consider the last half hour of trading on Friday, when stocks plunged after having recovered most of their losses for the day.

“You still have a couple of days before month’s end,” he said. “People may do some irrational things to balance the books. That is adding to the complexity.”

The Standard & Poor’s 500-stock index ended last week down 4.9 percent, its worst weekly performance in nearly five years. It is now up 2.9 percent for the year, down from 9 percent earlier this month. The Dow Jones industrial average is up 6.4 percent for the year but has lost about 735 points, or 5.3 percent, since it hit 14,000 a week and a half ago.

In the debt markets, the yield on junk bonds, which are the most risky, has spiked to 8.7 percent, up from 7.7 percent a month ago, according to KDP Investment Advisors, a research firm. The spread between high-yield bonds and Treasury debt, a crucial indicator of the premium investors want in exchange for holding risky assets, has nearly doubled since early June.

Wall Street bankers assert that the economy and companies they are raising money for remain healthy but acknowledge that they may need to change the terms and price of debt they are trying to sell. Some say they would be willing to hold onto loans rather than selling them at a loss.
With several big offerings yet to be marketed, the impasse between banks and investors could take a few weeks to several months to play out.

"It is really a pricing question," Gary L. Crittenden, Citigroup's chief financial officer, told investors on an earnings conference call with analysts a week ago. "We are comfortable with the underlying credit quality, but we will see some revenue effect from the deals underway." Banks are also in a standoff with their biggest clients, private equity firms. Some bankers are starting to consider whether abandoning acquisitions by paying breakup fees may be better than selling loans at deep discounts.

One senior banker who was not authorized to publicly discuss the issue said yesterday that nobody was actively engaged in such talks, but that the idea is making the rounds on Wall Street.

One deal that could come under a particularly harsh spotlight is the buyout of Cablevision. It is one of only a handful of buyouts that include what is known as "financing conditions" that would allow Cablevision to walk away from the deal.

The true test for the buyout boom will come after Labor Day, bankers and private equity executives said. Tens of billions in debt need to be sold starting in September for some of the most prominent private equity deals of the last two years.

On the list are $24 billion for the credit card processor, First Data, and $37 billion for the Texas energy giant, TXU. In the meantime, bankers for the Chrysler Group, the automaker acquired by Cerberus Capital Management, will try to sell $8 billion of debt this week after failing to last week, according to Standard & Poor's Leveraged Commentary and Data.

David Hendler, a longtime analyst at CreditSights, the debt research firm, said investors had swerved from complacency to hysteria about the risks associated with the recent buyout boom.

He noted that the premium investors were demanding to hold certain kinds of loans are at their highest levels since the early 1990s.

"When you have this reversal," Mr. Hendler said, "the markets are throwing the baby out with the bathwater."

Still, there are signs that the markets may move up with the help of individual and institutional investors who have been on the sidelines in anticipation of turbulence in the financial markets. They include hedge fund managers who were skeptical about the financial engineering that drove the mortgage and private equity booms. Others sold out of long positions last year or earlier this year and have been husbanding their resources for just this moment.

It is hard to know exactly how much money is set aside for bottom-fishing activities, but some telling signs suggest it is a substantial sum.

More than $160.9 billion flowed into money market funds — cash that can be quickly invested — through the middle of this month, according to AMG Data Services. That is more money than flowed into stock or taxable bond mutual funds. Since the end of 2005, assets in money market funds are up 24.5 percent, to $2.5 trillion.

Investors often use money market accounts to park cash they are waiting to invest. And in the first six months of the year, hedge funds raised $118 billion, almost as much as they raised in all of 2006, according to Hedge Fund Research, which is based in Chicago.

To be sure, it is unclear when investors with the financial means and a skeptical bent will decide that prices have fallen enough to make a move. Assets in money market funds climbed steadily for two years after the Internet bubble burst before many investors felt comfortable enough to dive back into the stock market in late 2002.

Consider the market for mortgage securities, which provided the first jolt to the debt markets earlier this year. It remains largely frozen with traders and investors reporting little trading and even fewer new deals being brought to market.

Mortgage securities, which are groups of bonds backed by thousands of mortgages to homeowners, can be hard to analyze and price even in good times. But it can be extremely difficult to value them when home prices are falling and many borrowers are defaulting and being foreclosed on as they are today. The task is even more complex with collateralized debt obligations, securities that owns dozens of mortgage-backed bonds.

Westwood Capital, a boutique investment bank in New York that specializes in mortgage and related securities, has been raising $500 million to buy distressed loans, said Daniel Alpert, a partner at the firm. But it has made few deals because, like in the market for single-family homes, sellers and buyers cannot agree on a price.

“A lot of the stuff we are talking about is not trading because people are not willing to lay it off,” he said. “That’s what the problem is — it’s a liquidity crisis.”