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Bond Bubble?

Are U.S. Corporations Using Excessive Amounts of Debt?

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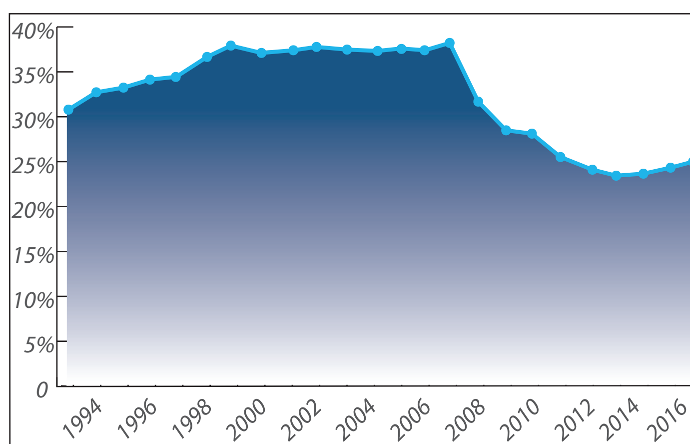
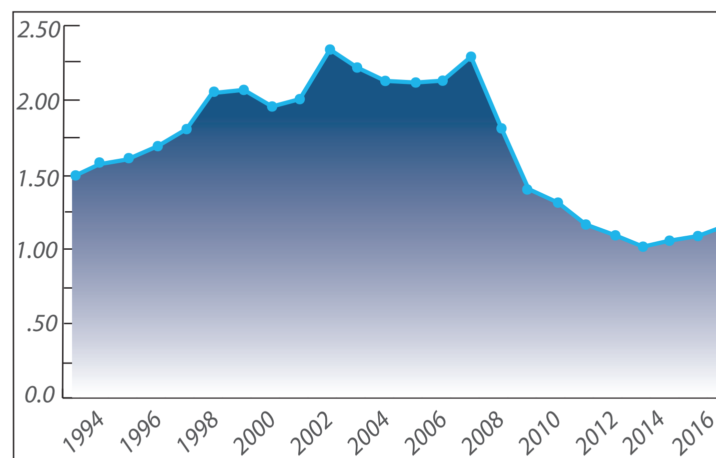
We have heard a lot of chatter recently regarding the corporate bond market. In particular, we are hearing concerns about the amount of debt companies are taking on and their ability to honor their obligations. Perhaps these questions are driven by the headlines of corporations issuing debt for either buying back common stock or for acquisitions. Looking at some readily available statistics paints a different picture and may help ease concerns.

This chart below shows the ratio of total debt to total assets for the companies in the S&P 500 Index. Essentially, it shows the percent of assets that have been financed through both short term and long term debt. Data from 1993 through 2015 shows balance sheet numbers on December 31 of each year. For 2016, the data is as of October 31. This data suggests that in the 1990s, the companies in the S&P 500 financed approximately 30% to 38% of total assets through debt. For 2000 through 2007, the use of debt was fairly steady in the 37% range. However, with the recession of 2008-09, companies deleveraged, reducing the debt to asset ratio to about 23.4% by 2013. While there has been a slight increase in the use of debt since then, debt usage remains far below that of the 1990s and early 2000s.



Data quoted represents past performance, which is no guarantee of future results.

The second chart shows the Debt/Equity ratio for the companies in the S&P 500 Index. The 1.50 reading in 1993 indicates companies had $1.50 of debt on the books for every $1.00 in equity. The ratio increased in the late 1990s and early 2000s to where companies had $2.34 of debt for every $1.00 of equity. Beginning in 2008, we again see reduced use of debt, just as we saw with the debt to total assets ratio. Again, while there has been a slight increase in debt relative to equity since then, debt/equity levels are half of the highs we saw over last decade.



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The third chart (next page) shows the Debt/EBITDA (earnings before interest, taxes, depreciation and amortization) ratio. Essentially, it is the cash available to cover the obligatory interest payments on debt. As debt usage increased in the 1990s and early 2000s, debt rose to almost $4.70 for every $1.00 of EBITDA. With the reduced use of debt from 2008 through 2013, companies in the S&P 500 Index were functioning with just above $1.00 of debt for every $1.00 of EBITDA. As we saw with Total debt/assets and debt/equity, while there has been a slight increase in debt/EBITDA since 2013, we are nowhere near the levels seen in the late 1990s and early 2000s.

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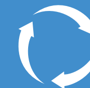

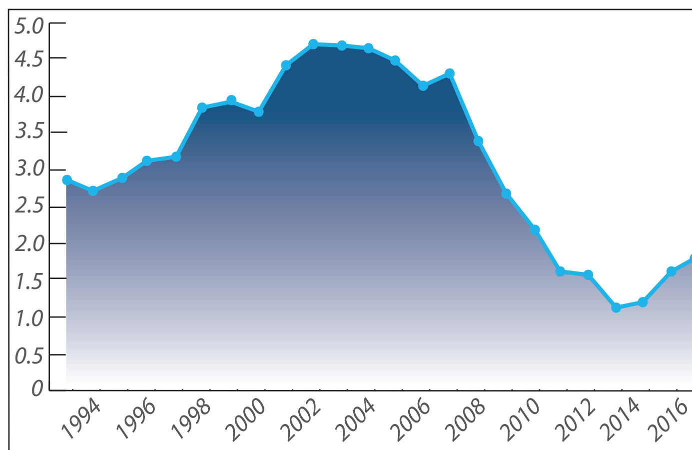

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CRAIG CALLAHAN *is the Founder and President of ICON, serves as a senior member of the ICON Investment Committee, and is a Portfolio Manager.*

Dr. Callahan created a valuation model that advances the investment methodology originally developed by Benjamin Graham, the "Father of Securities Analysis." The combination of industry rotation and bottom-up valuation of securities distinguishes ICON from other investment managers. Dr. Callahan received a bachelor's degree in psychology from The Ohio State University and a doctoral degree in business administration with emphasis in finance and statistics from Kent State University. He holds FINRA Series 7, 24, 63, and 66 registrations.

Summary

These three ratios show a big reduction in the use of debt by companies in the S&P 500 Index relative to total assets, equity, and EBTIDA from 2008 through 2013. A slight increase in the use of debt the last three years still leaves these companies far below the debt usage levels of the 1990s and early 2000s. This quick analysis would find little support for concerns about the corporate bond market.

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The unmanaged Standard & Poor's (S&P) 500 Index is a market value-weighted index of large-cap common stocks considered representative of the broad market. Individuals cannot invest directly in an index.

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