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U.S. Firms Shoulder Rising Debt

Companies and consumers are borrowing big, but stock and bond bulls point to data suggesting the burden is manageable

The New York Stock Exchange building on March 11. Stock-market margin debt hit $476.4 billion in March, the highest levelin records going back more than 50 years, according to the NYSE. *PHOTO: JEWEL SAMADIAFPIGETTY IMAGES*

By MIKE CHERNEY and DAN STRUMPF

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Companies and consumers are on a borrowing spree and, for now, are in a strong position to pay the money back.

U.S. corporate-debt issuance is running at its fastest clip ever in 2015 after three consecutive record years. Borrowing by investors against their stockbrokerage accounts has risen to fresh records. And household borrowing has picked up after plunging during the "Great Recession."

But while many leverage indicators are rising, bullish stock and bond investors stress that many measures of broad economic health and income are rising as well.

The increased borrowing is a sign that companies and individuals are feeling more confident about taking risks as a strengthening economy makes the debt more manageable, according to experts who say that the level of indebtedness isn't yet a cause of concern the way that it was before the financial crisis.

"I don't think there are any, at this point, canaries in the coal mine," said Jennifer Vail, head of fixed-income research at U.S. Bank Wealth Management, which oversees $128 billion. "Leverage has slowly ticked up, but you've got to expect that" in a low-rate environment.

Net leverage for highly rated U.S. nonfinancial companies, a measure that tracks debt less cash as a multiple of annual earnings, was 1.88 times at the end of 2014, according to Morgan Stanley data. That is up from 1.63 times at the end of 2007, on the eve of the financial crisis.

But the ratio of companies' earnings to their annual interest expense was 11.02 times, up from 9.43 times at the end of 2007, according to Morgan Stanley, indicating greater capacity to service obligations.

The U.S. economy has slowed from its surge in the middle of last year, when gross domestic product rose at a 5% annualized clip, but consumer spending continues to increase and the economy keeps adding jobs.

U.S. company profit margins are near their highest levels ever, giving firms abundant cash flow to service debt. Major stock indexes around the globe are soaring, expanding the value of investor stockholdings. Household debt-service costs have tumbled along with interest rates.

Rising leverage has been a charged issue in markets ever since the financial crisis, when banks were hit hard as prices tumbled for assets such as mortgage debt. Among the risks for investors: Overextended borrowers can need to raise cash in a downturn or market reversal, fueling fire sales that amplify asset-price declines.

U.S. corporate-debt issuance so far this year has jumped to $609 billion, from $568 billion in the same period last year, according to recent figures from Dealogic.

"The fact that corporate America is borrowing, that's a headwind" for bondholders, said Sivan Mahadevan, head of U.S. credit strategy at Morgan Stanley. 'But the tailwind is that they're borrowing at historically lower rates, and the cost for servicing debt is actually quite low."

Mr. Mahadevan is recommending investors hold more investment-grade corporate bonds, meaning debt rated triple-B-minus or above, than safe U.S.government debt.

Yields on 10-year government bonds have tumbled to nearly zero in Japan and Germany and to around 2% in the U.S., as the prices of the debt have climbed. Bond-market gains have been fueled in part by expansive central-bank policy. In the U.S., the Federal Reserve last year concluded its third round of bond buying. The European Central Bank and the Bank of Japan this year have been making huge purchases of bonds.

Junk-rated firms, with ratings double-B-plus or below, are borrowing at an elevated pace, sometimes a warning sign for analysts who track market cycles. But defaults remain low and few analysts expect to see a sharp rise in defaults until the economy falls into recession, something that isn't widely expected in the coming year.

The trailing 12-month default rate for junk-rated U.S. companies was 1.9% at the end of March, Moody's Investors Service said, compared with nearly 15% during the financial crisis.

Household debt, including credit-card debt and student loans, rose 1% in the fourth quarter of 2014 from the third quarter, to $11.8 trillion, the Federal Reserve Bank of New York said this year. But that figure remained 6.7% below its 2008 peak, allaying fears that consumers are strapped.

Borrowing is rising in the stock market as well. In March, stock-market margin debt hit $476.4 billion, the highest level in records going back more than 50 years, according to the New York Stock Exchange.

Rising margin debt "suggests people expect the rally to continue," said Ana Avramovic, trading strategist at Credit Suisse.

She said margin debt outstanding tends over time to track stock-market index levels. The Nasdaq Composite Index last month hit its first record close since March 2000. The S&P 500 has hit six record closing highs this year and the Dow Jones Industrial Average four. The two U.S. stock gauges have together hit 198 record closes since 2013.

State and local governments are actually borrowing less in the public-debt markets. The size of the municipal-bond market, which helps finance roads, schools and sewers, stood at $3.65 trillion at the end of 2014, compared with $3.77 trillion at the end of 2010, according to Fed data. In the aftermath of the recession, "there's less of an interest in infrastructure," said Chris Mier, chief strategist at broker-dealer Loop Capital Markets.

To be sure, not all the indicators are glowing green. At the end of the first quarter, 184 U.S. nonfinancial companies carried ratings of B3 with a negative outlook or below, up from 146 two years earlier, according to figures from Moody's.

Some investors say they are preparing for a market hiccup, holding on to cash that can be used to buy securities on the cheap."We have a lot more dry powder,"said Mary Singh,a portfolio manager at Brandes Investment Partners,which oversees $29 billion.

Medtronic Inc., AT&T Inc. and Actavis PLC all recently completed large debt sales for acquisitions,drawing solid investor demand.Some shied away from the deals, expressing concerns about increased leverage and uncertain earnings growth.

Christopher Coolidge,a portfolio manager at Brandywine Global Investment Management,which oversees about $65 billion, said his firm is casting a wary eye on leverage trends.

"If it keeps going for another year or two, that will really push us into the late [credit] cycle,"he said.

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