

Are Historically Based Default and Recovery Models in the High Yield and Distressed Debt Markets Still Relevant for Investment Funds in Today's Credit Environment?

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Abstract

This paper explores the impressive growth in the high-yield, leveraged loan and distressed debt markets and comments on the unusually low current default rates and high recoveries in these markets. The main reasons for these low default rates are the unprecedented growth in liquidity from non-traditional lenders, like hedge and private equity funds, as well as, again, from traditional lenders. We speculate on whether this excess liquidity will continue to dominate the market or will we observe a regression to the long-term mean and where default and recoveries will once again be based on firm-fundamental and more traditional demand/supply risk patterns.

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