

Crossing Financial Intersections

When Opposed Views Converge, There Is A Market

By Dan Ramsden ■ *Bentley Associates, L.P.*

If financial markets establish price levels at the meeting point between the supply and demand sides of capital, the further apart these sides allow themselves to slide, the more difficult it is for financial markets to establish price levels. Stated another way, if the price of a financial security is the intersection between opposed perspectives, the more stubbornly opposed these perspectives become, the less likely the occurrence of an intersection. Optimism, pessimism, flexibility, or stubbornness, are relative terms, and each individual situation defines its own parameters to make its market. There is, however, in our current environment, an elevated risk of divergence—if this may be defined as a stubborn difference of opinion—leading at times to a spread between the bid and asking price that can be difficult to overcome.

If there are two sides to a coin, both molded on the same inherent substance, the coin in this case is the length and breadth of the bear market that has just ended, and the even longer and equally broad bull market that preceded it. We've lived through a prolonged period of two great extremes, of two divergent views that dominated their respective era. The imprint of each one is felt today, in varying degrees, and in some cases leads to a stubborn opposition.

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Many of today's financial issuers—for our purposes defined to include borrowers, sellers, and other seekers of capital—have witnessed and perhaps been actively involved in a historically unprecedented period of prosperity, in which the opposing market sides were not the optimistic and pessimistic, but rather the optimistic and not quite as exuberantly optimistic perspectives. Dating back to the 1980s, with the exception of two instances of

market turbulence that calmed and rebounded in fairly short order, the availability of capital for new issuers has been robust, so much so that financial instruments and products we now take for granted—high yield corporate bonds, asset securitization, equity derivatives—were largely born during this era to satisfy insatiable appetite for investment and massive availability of liquid capital.

Enter the bear. While this phase was technically short-lived, at least in comparison to the extensive bullish period that preceded it, the practical reality was far more devastating than its duration implies. Between the first quarter of 2000 and the first quarter of 2003, the Dow Jones Industrials lost some 40% of their value. The NASDAQ Composite declined by some 70% during that period.

As a result of this public market fallout, private equity funds saw exit strategies deteriorate and portfolio holdings get written down, and this just around the time that typical five-to-seven year partnerships (which had often commenced in the heady days of the late 1990s) were set to expire... or, what might be even worse, as some funds were only commencing. Lenders in the meantime watched their collateral values diminish and, in the case of junior bond holders, the safety cushion of equity disappear. Corporate acquirers, whose own stock currency was losing value and who were moreover facing uncertain economic prospects, pulled back from the Mergers & Acquisitions arena, shutting down another source of liquidity for private equity funds as well as certain lenders.

And this was all still taking place as recently as last year.

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While public equity markets have bounced back to a degree, and as private equity funds and lenders are taking meetings again, memories are fresh and psyches remain fragile. The least bit of economic doubt sends markets falling, and the overhang of international crisis and a tough election season looms. And yet...

Again: “public equity markets have bounced back to a degree, and investors are taking meetings.” A message that is vaguely reminiscent of the better days, and what a pleasant reminiscence it is, for all involved. A whisper of prosperity comes back, of relived potential and a second opportunity.

Herein, then, often lies a conflict: a perspective rooted in the multi-decade period of success, seeking to find a balance with its counterpart, the even more vivid imprint of a partial but current decade of enormous loss.

If the price of a financial security is the intersection between opposed perspectives, the more stubbornly opposed these perspectives become, the less likely the occurrence of an intersection. Public equity trading volumes, if these might be a proxy for the number of such intersections, have flattened, but in the case of the NASDAQ stocks are at 30% below recent peaks. New private equity investments remain at bear market levels, and

M&A multiples have not budged.

A financial advisor’s role is not only to help his or her clientele source, structure, and negotiate the best deals available in a given market, but to realistically advise his or her clientele on the nature of that market, and determine if the market is right for a particular client’s needs, views, and flexibility. Opposing views can and do converge, and market balances can and do exist. Deals can and do get done. When this occurs, there is a market. ■

About the Author

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