Q1 2022 Capital Markets Watch

Geopolitics and volatility curb capital raising in Q1

The roller coaster ride of the past two years is continuing, with US capital markets currently experiencing the longest extended period of high volatility since the 2008 financial crisis. Investors remain unsure about the future of the Russia-Ukraine conflict, other geopolitical concerns, and inflation in the US, all of which have contributed to negative equity market returns in the first quarter of 2022. While GDP growth was expected to slow, we expect growth to rebound in the second quarter and moderate thereafter. Our baseline expectation is for real GDP growth to slow to around 3% in 2022, a step down from 5.7% in 2021.

The outlook for equities is generally positive however, with a consensus 4% increase in 2022, albeit with a few bumps likely along the way. Global markets are down 5.5% in the first quarter, and the US S&P 500 is down 4.9%. The outlook for equity funding is strong,

with more than $1 trillion in US private equity and venture capital dry powder, a near record, looking to find transactions.

The outlook for debt is mixed. High-quality fixed-rate issuers will still be able to access the bond markets, but the fixed-rate high yield bond market is likely to struggle in an increasing rate environment. The floating rate nature of the leveraged loan market makes it an attractive financing tool. A risk on the horizon includes issues around Russian sovereign and company debt arising from the Ukraine conflict.

Commodities have been particularly volatile in the current environment, with record oil prices causing significant ripple effects through the US economy, disruptions in a variety of agricultural commodities, and many other hard assets attracting strong buying activity as a hedge against volatility and supply chain driven inflation.

"Geopolitical concerns, rising interest rates and inflation have resulted in a more cautious and sober tone in both the equity and debt markets. Debt investors, while more selective, should still be able to put capital to work, as acquisition-related issuance is expected to remain strong this year."

Rob Cohen

Debt Capital Markets Advisory Leader, PwC US

Geopolitical uncertainty stalls the IPO market — lowest quarter in 5 years

IPOs SPACs Venture capital

IPOs

Number of US IPOs and proceeds by quarter

Source: PwC analysis, Dealogic as of 3/31/22.

IPOs

Investor interest in IPOs in the first quarter of 2022 has stalled given the bouts of volatility. This quarter saw eight traditional IPOs, which raised $2 billion, an 88% decrease in volume and a 94% decrease in proceeds compared to the fourth quarter of 2021. This is the lowest quarter of traditional IPOs since the impact of Brexit in the first quarter of 2016.

Pharma and life sciences (PLS) led traditional IPO volume in the first quarter, with six IPOs raising $710 million. The financial services and technology sectors each had one traditional IPO raising $1 billion and $200 million, respectively.

IPOs slightly outperformed broader markets, with a negative return of 4%.

Marketplace uncertainty helped drive a large number of IPO withdrawals, with 15 companies withdrawing their IPOs. This is already over half of 2020's total withdrawals.

Looking forward we expect the IPO pipeline to build, with many quality issuers with proven earnings eyeing the markets.

SPACs

Number of SPAC merger announcements by quarter

Source: PwC analysis, Dealogic as of 3/31/22.

SPACs

SPAC IPOs and SPAC merger announcements also stalled in the first quarter of 2022. SPACs are facing increased challenges due to declining investor sentiment as illustrated in higher redemption rates and tightening in the private investment in public equity (PIPE) market, combined with relatively poor post-merger price performance. They also must contend with proposed new SEC regulations announced at the end of the first quarter.

The first quarter saw 54 SPAC IPOs, which raised $9 billion, a 67% decrease in volume from the fourth quarter. Similar to IPOs, this was a significant drop compared to the prior quarter.

The first quarter also saw 32 SPAC merger announcements, which was down more than 40% compared to the prior quarter. Twenty-seven companies completed their SPAC merger processes. SPACs that have announced mergers in the first quarter have shown a negative return of 13%, underperforming the broader market indices.

There is more than $140 billion in cash on the sidelines in SPACs that have yet to announce a merger. There is increasing pressure on the remaining SPACs to find investable companies in an ever shortening investment period. SPAC demand and investable company supply will eventually mismatch.

Marketplace uncertainty, combined with increased risks in potential SPAC mergers, drove SPACs to withdraw their IPOs in the first quarter at the fastest rate since 2016, with 44 SPAC IPO withdrawals.

Venture capital

Venture capital deal value

Source: PitchBook Data, Inc. as of 3/31/22. Includes US headquartered deals.

Venture capital

Venture capital (VC) investors followed the broader capital raising decline in the first quarter of 2022, due largely to a volatile macroeconomic backdrop — however the environment for private capital raising remains favorable from a historical perspective.

VC firms have been very successful in raising funds, with about 1,000 funds having raised roughly $200 billion last year and into the first quarter of 2022. They consequently have a large amount of dry powder to invest.

VC firms saw a slight decline in investing activity, with $71 billion invested in the quarter, of which $44 billion was invested in late-stage deals.

We count more than 550 unicorns, a staggering number with many more being created every quarter.

With dry powder at record levels, private companies are likely to stay private longer and exit via IPO when the markets are less volatile.

Deals continue to fund venture capital's favorite high-growth, scalable and disruptive sectors such as software as a service (SaaS), artificial intelligence/machine learning (AI/ML), fintech and blockchain.

Geopolitical uncertainty slows the debt machine

US debt markets raised $634 billion in the first quarter. The first six weeks saw the market humming on all cylinders. But after the Russia-Ukraine conflict began, the HY bond market essentially shut down for an unprecedented two weeks. Five high yield bond deals have already been withdrawn, equal to the total withdrawals in all of 2021. The leveraged loan market continued completing deals, but saw a slow down in new deals going to market in the middle of the quarter. M&A and LBO activities have slowed down significantly in February and March with acquirers hitting pause on new deals due to geopolitical uncertainty. That will likely pick up when volatility subsides.

The investment grade bond market remained steady, raising $442 billion, with the last gasp of issuers locking

in low rates ahead of rate increases in 2022.

US leveraged finance issuance (high yield bonds and leveraged loans) all but shut down upon the Russia-Ukraine conflict, with the high yield bond market dropping from $32 billion to only $11 billion from the first half to the second half of the quarter, and the leveraged loan market collapsing from $106 billion to $43 billion for the same period.

Debt investors showed a significant preference toward leveraged loans from high yield bonds with high yield funds having a net outflow of $22 billion for the quarter.

M&A and LBO volume reached $161 billion, largely due to the M&A activity at the start of the year, with most proceeds funding TMT deals.

Spreads have begun widening with inflation and the expectation of rate hikes. The spreads on the LL100 Index, the BofA US Corporate Index and the BofA US High Yield Index have widened by 29bps, 25bps, and 38bps, respectively, for the quarter.

The market has priced in about 7 rate increases in 2022, and the 10-year US Treasury has surpassed the 2% mark for the first time since 2019. Higher rates and continued inflation continue to cause spreads to widen.

Please note: IPOs with deal values of less than $25 million, best efforts offerings, oil and gas royalty trusts, business development companies, pricing on OTC Bulletin Board and OTC Pink Sheets are excluded from this narrative. Venture capital fundraising uses the close date of US domiciled funds. Rate hike estimate per S&P Global. Data from SEC filings and third-party databases as of 3/31/22.

With you when the bell rings

To create a clear path forward, you need the confidence that comes from working with a team of straight-talking advisors and actionable insights from a team of dedicated professionals. Find out how we can guide you through each step of the readiness assessment process and beyond.

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