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A report noted that immigration policy changes 'are an event risk' for auto lender Tricolor. MARK FELIX/
BLOOMBERG NEWS

How U.S. Threw a Wrench Into Credit Markets

Tariffs and other policy swings are exposing strains at highly indebted companies

Leverage combined with dramatic policymaking is proving to be a volatile mix.

This year, investors held their breath as the extent of President Trump's tariff policies were laid out. But in the months that followed, it became evident that the impact on the large businesses that comprise the S&P 500 may be mostly manageable. The index has since surged to all-time highs.

That doesn't mean any policy effects went away. And some companies that are more vulnerable to policy changes, either by the nature of their business, or because they had more fragile financial underpinnings, are feeling it.

That, in turn, is creating headaches for the Wall Street ecosystem that extended credit to these companies. Many of these businesses aren't publicly listed or well known. But they are important cogs in the markets they serve and employ large numbers of people.

Changes to things like tariffs, healthcare spending or immigration policy are rarely cited as the sole cause of any company's trouble. But the strain that policy changes may be putting on companies, or their customers, have been noted as events that helped exacerbate other issues.

Another common factor is a heavy debt load, a risk that some investors worry has been accumulating in an exuberant and fastgrowing market for company debts. There are even concerns about cases of fraud, which sometimes flourish in buoyant markets.

In late September, auto-parts supplier First Brands Group filed for bankruptcy. According to a court filing from its chief restructuring officer, recent "geopolitical uncertainty and headwinds from newly imposed tariffs have pressurized global supply chains and layered additional complications on the company's operations."

These included the company spending about \$220 million on things such as pre-buying inventory and increasing its investment in a project to produce certain parts in the U.S., according to the filing. At the same time, the company faced "mounting funded debt and lease obligations," the filing said, and these factors all "snowballed into a liquidity crisis."

The bankruptcy is complicated, as the company used forms of "offbalance sheet" financing. Outside directors installed at the company are investigating the ways in which account receivables were used to secure financing.

Other bankruptcies cited the effects of tariffs. In June, auto-parts supplier Marelli filed for bankruptcy protection. Its chief executive, in a court filing, cited "macroeconomic headwinds associated with the imposition of tariffs in countries around the world." Those headwinds "cast uncertainty on the company's forecast and ability to service a large capital structure that would be magnified by the quantum of new financing required," the filing said.

Note
Home-decor retailer At Home Group filed for bankruptcy in June. A court filing cited tariffs, including on imports from China, where it sources many of its goods, as a factor complicating its efforts to address its liquidity and manage its debt load.

In September, auto lender Tricolor Holdings filed for a Chapter 7 liquidation. The causes of its bankruptcy appear to be complex. The Wall Street Journal reported that one of the company's bank financing partners alleged fraud related to the collateral used to secure financing.

Before its bankruptcy, a different policy swing out of Washington caused concern about the company's lending. A June presale report by S&P Global Ratings' structured finance group on a Tricolor securitization noted the lender's market niche included many immigrants, and that "changes in immigration policies and enforcement are an event risk that could lead to higher delinquency and loss levels."

So far, despite recent bankruptcies, there hasn't been a surge in defaults in some key markets. Even accounting for First Brands' bankruptcy, the trailing 12-month payment default rate as of the end of September on a Morningstar LSTA index of U.S. leveraged loans was 1.47% of the loan amounts, still well below the postpandemic peak of 1.75% hit in July 2023, according to figures compiled by PitchBook LCD.

Still, a relative paucity of visible failures isn't the same thing as an all-clear signal for all borrowers.

Morningstar DBRS in a September report said that among some of the weakest middle-market borrowers, there hasn't been "any notable strengthening of operating performance," and "this trend may be exacerbated next year by incremental stress from tariffs or further de-acceleration in economic activity."

Though recent problems have surfaced for borrowers in the auto industry, or in retail, other sectors also may have vulnerabilities.

A report from ratings agency KBRA recently cited emerging "setbacks" to roll-ups of healthcare practices, which collectively carry about \$45 billion in total debt. Their possible challenges include the potential for lower reimbursement rates from Medicare and Medicaid to squeeze their profitability, the report said.

Many companies will muddle through new challenges as they did the pandemic, or surges in interest rates. Some will even benefit from policy changes, like tax cuts, or a shift to domestic production, or get a lift from Federal Reserve rate cuts. And even in the best of times, some borrowers will run into idiosyncratic problems.

But investors struggling to understand why some people are worried about the economy, even when stock indexes are flying high, might find explanations within less-visible parts of the market.

—Telis Demos

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