



## Debt Begone!

**T**ucked inside its quarterly results earlier this year, a giant retailer reminded investors that it had recently repurchased more than \$2.5 billion of its own securities. But it wasn't buying back company stock, an ever-present feature of markets since the financial crisis. In this instance, it took a decidedly less trendy step: reducing its debt.

"Never spend money before you have it" might be one of Thomas Jefferson's wisest quotes, but that wasn't exactly the way of the world for most of the past decade. You may remember that with interest rates so amazingly low, the mantra was borrow, borrow, and borrow—until you dropped.

But take a look at their financial reports in the past year or so and you'll see a host of big firms in all sectors retiring debt. Peter Tchir, head of macro strategy at the New York-based financial firm Academy Securities, says he sees a shift in mentality going on. A big one. And he should know—sitting from his perch, he closely monitors

the bond market, where investors trade debt and companies seek to borrow.

We know, of course, that the rise of those idyllic rates, which were brought by a policy shift from the Federal Reserve, is behind a lot of this. After all, it has literally doubled the annual cost for highly creditworthy corporations to borrow for five years, moving from 1.8 percent in mid-2016 up to 3.8 percent last November, according to the Federal Reserve Bank of St. Louis, before falling back to around 3 percent this spring.

But 3 percent is still relatively low for borrowing money, so that doesn't totally explain corporations' new aversion to debt. Perhaps a bigger reason is more reputation based; as finance executives know, firms that carry high debt loads typically get lower credit ratings. That has a lot of far-reaching effects on how many organizations can run their business.

For some firms, the goal of reducing debt now is to avoid seeing their rating drop below BBB,

the lowest level of investment grade. A rating of BBB or better enables them to easily borrow from banks and access the liquid commercial-paper market—which is like T-bills for companies.

“There is now a consequence to being viewed as overly leveraged,” says Tchir. For many years after 2009, maintaining a BBB credit rating was considered optimal. “Companies now want to ensure that they remain solid investment grade, and that is boosting their stock price,” Tchir says.

And that gets to another critical issue: dividends. Investors like to see firms with less leverage because such companies are likely to pay their regular quarterly dividends. “They’d sooner sell the office furniture than cut the dividend,” a former boss on Wall Street told me once. And that’s no exaggeration; firms that cut dividends often get punished brutally on Wall Street, with huge drops in stock prices. “Everyone gets beaten up

if they cut the dividend or if investors anticipate a cut,” says David Campbell, UK director of the financial research firm HCWE & Co.

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Is there an answer, besides just keeping debt down? Interestingly, our friends in the UK have come up with one tack for the dividend issue. Instead of assuming regularly sized payouts, some public firms set their dividend policy (and debt level) with the expectation that annual dividends will move up and down. They do it by having two types of payout. There are regular, usually small, dividends that get paid each year no matter what. Then there are special dividends, which are paid when profits are bountiful. Think of it as a profit share: when times are good, investors get more cash and there’s less need to monkey with the debt.

Still, we probably won’t see anything like this in the US anytime soon, which will probably mean less corporate borrowing. Thomas Jefferson would be pleased. ▀

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