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Investors proclaim 'CLO arb is good'

by **Sayed Kadiri**

Hold on to your hats: at long last market participants agree that US CLO economics are in favour of equity tranche investors. This brings to an end a decade-plus run where value was centred on triple A-rated tranches (which, in the US, have been paying about five times as much spread as they did before 2008).

"We have never seen a situation where new issue systematically offers better value than CLO equity in the secondary market," says Michael Kurinets, chief investment officer at Capra Ibex Advisors in New York. He says Capra Ibex typically buys CLO equity in the secondary market, but nine of the 11 deals it has executed this year have been in the primary market.

"New issue is cheaper by as much as 3 percentage points in yield and 10 points in price," he says. "For secondary equity to match that you would have to come up with a scenario where there is a liquidation within three years to fast-track principal repayments."

Debdeep Maji, senior portfolio manager at Oxford Funds, says tight CLO debt spreads, combined with a potentially more benign default environment for the next 12 to 18 months, has created an attractive outlook for CLO equity. For this reason, Oxford, which has opened and completed warehouse take outs on several CLOs this year, favours five-year reinvestment new issue CLOs. "This year over 50% of our purchases have been in the primary market, whereas last year almost 80% were in the secondary," says Greenwich-based Maji.

These factors are creating unique cashflows

Michael Kurinets
CIO and Portfolio Manager
Capra Ibex Advisors

The head of CLO origination at a large bank concurs that CLO equity is well bid with lots of new entrants this year. He claims that CLO manager fees are increasing, which is the clearest indication that CLO economics are in good health.

"If tier one managers can price triple As inside 120bp and a capital stack inside 180bp, then CLO equity is very appealing," says the new issue banker.

Of the 21 new US CLOs that have priced in June, 16 satisfy those parameters, according to Creditflux data.

According to Kurinets: "We have never had an environment where CLO spreads are tight, loan spreads are reasonably wide in the mid-300s and Libor floors are kicking up to 3.5 points a year to equity. These factors are creating unique cashflows."

Although demand has increased, so has supply.

Kurinets, who led Credit Suisse's CLO trading business before joining Capra Ibex in 2013, says that the amount of captive capital available to CLO managers is not as large as in 2018. This has increased new issue CLO supply as some issuers are syndicating minority equity for the first time in years.

"A large dealer showed me a list of 13 CLO managers and asked if I was interested in their equity," says Kurinets. "I've not seen such an effort to syndicate equity since before 2018." He adds that this is the first time since the firm launched a fund in 2015 that there has been a shift in relative value from secondary to primary equity.

The head of CLO trading at a large bank says that secondary market supply of CLO equity is also increasing with trade flows peaking in June.