# News Analysis: Lag lustre

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## Slower recovery in CLOs provides advantages and opportunities

Secondary CLO trading desks either side of the Atlantic are reporting greater re-engagement from the buy-side, which is helping to support prices. However, such support appears to be insufficient to prevent the CLO market lagging the recoveries seen elsewhere.

"CLOs have underperformed equity and other credit markets," concedes Miguel Ramos Fuentenebro, co-founder of Fair Oaks Capital. "But in my view, this is a rational position as we're not out of the woods yet – fundamentally, markets should not be back to the levels we saw in February, whether investors like it or not."

Figures from JPMorgan CLO research show that as at last Friday, 24 July, close, CLO spreads were still some way off 21 February tights. They estimated the recovery of mid-tier spreads from Covid wides as follows: US CLO AAA 80%, US CLO AA 79%, US CLO A 78%, US CLO BBB 69%, US CLO BB 78%, US CLO B 55%, Euro CLO AAA 81%, Euro CLO AA 85%, Euro CLO A 85%, Euro CLO BBB 69%, Euro CLO BB 72% and Euro CLO B 81%.

Ramos Fuentenebro continues: "We've not seen CLOs rallying like high yield, which makes investing based on sound analysis challenging. CLOs are recovering more slowly following a more sensible and rational approach – an advantage to being outside the scope of many investors or central banks."

Consequently, CLO investors are still being well compensated for the positions they take. "Triple-As are still paying in excess of 165bp, which compares very favourably with other similar securitisation opportunities," says Ramos Fuentenebro. "At the other end of the stack, equity at a deep discount provides the right upside/downside balance for those investors expecting a more favourable outcome to the current crisis."

Meanwhile, mezz – which had initially lagged the recovery in CLO seniors – has caught up to an extent on the back of hefty BWIC volumes in the past few weeks. However, Ramos Fuentenebro notes that the recovery is very much deal-dependent. "High quality triple-Bs or double-Bs are well bid, but weaker names trade much wider as CLO mezzanine investors are less focused on ratings and more on fundamental quality."

As a result, the market is returning to trading on a more focused basis rather than simply riding the wave back in. "People are looking for different opportunities," Ramos Fuentenebro says. "For example, now we've found liquidity in Europe, we're seeing activity around relative value versus the US. Some investors are getting into European mezz with the view that fundamentals between the US and Europe will diverge and the more conservative structures of European deals will provide greater protection at the same time."

Overall though, Ramos Fuentenebro concludes: "The strategy for now is that it's key to be nimble and flexible. However, you still require the right team with the right market knowledge to properly analyse opportunities. Large managers have raised opportunistic capital but it is unlikely that they will find it viable to trade the CLO market in the right size."

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