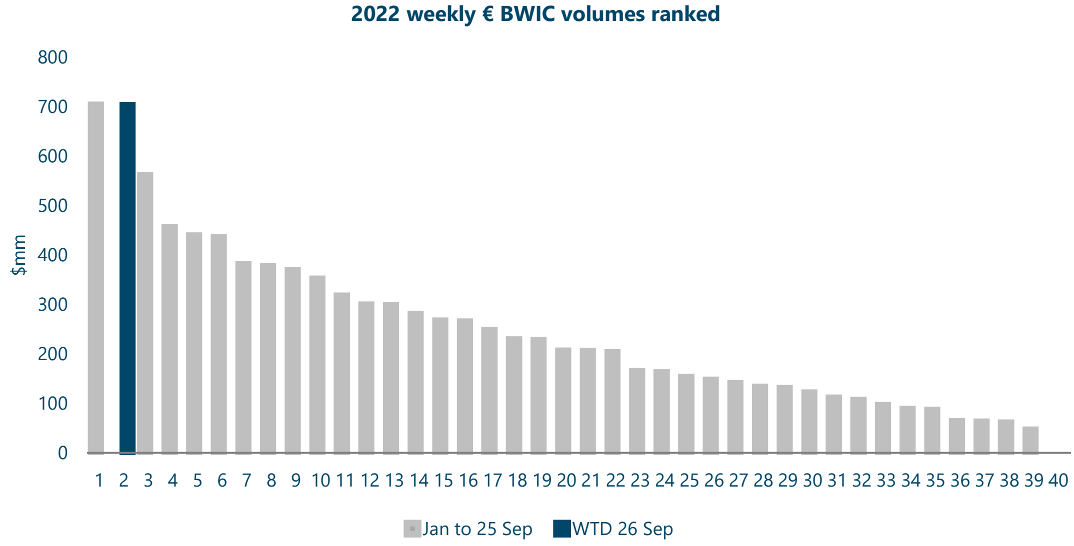
Market update note

29 September 2022

Please see important disclaimer below.

The EUR CLO market has seen a significant amount of BWIC supply over the last week (and in particular over the last three days). Since Monday, the market has had approximately $700mm of BWIC supply which already ranks it as the second-busiest week of volumes this year - rivalled only by, and likely to surpass, the volumes observed after Russia's invasion of Ukraine earlier this year.



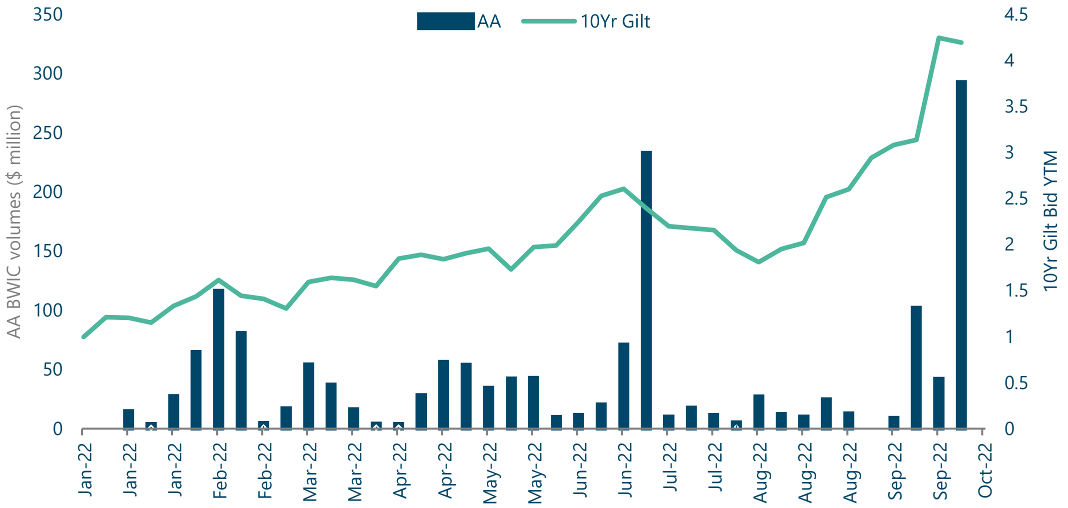
Source: Citi, 29-Sep-2022

While there is no shortage of macro headlines this year, the volumes over the last week have been primarily linked to recent Liability Driven Investment (LDI) flows. It is a well-covered topic elsewhere so Fair Oaks will limit remarks to:

1. LDI funds have been used by defined benefit pension schemes in the UK to hedge their long-dated rates exposure
2. As UK rates rise, the funds are required to post margin (either from cash to hand or through sales of other assets)
3. Given the significant jump in yields caused by the Chancellor's mini-budget last week, the funds have been forced to liquidate large asset holdings (which has included IG € CLOs) to meet their margin cash needs

Below is a graph of 10yr UK GILTs vs weekly AA BWIC volumes. While LDI funds have invested across IG tranches, colour from trading desks has suggested they are a significant portion of AA flows YTD (partly due to a more concentrated investor base in the tranche). Market colour suggests spikes in volumes in June-July and September were driven in part by LDI driven cash needs following rates rises.

€AA weekly BWIC volumes ranked vs. 10yr UKT YTM



Source: Citi, Bloomberg, 29-Sep-2022

Unsurprisingly, the volume of risk, combined with short notice processes and macro volatility, has resulted in an observed widening across the capital structure. Fair Oaks has approximated week to date DM and price moves below, however, would note markets continue to be volatile. Fair Oaks also notes that while we did see some sub-IG BWIC volume, it had significantly higher DNT percentages given investors did not have the same need to raise cash and limited appetite to sell at locally wide levels.

	DM					Price					Volume vs YTD Weekly Average			DNT Estimates	
	21-Sep-22		28-Sep-22		Change	21-Sep-22		28-Sep-22		Change	28-Sep-22	2022 Avg	Multiple of Average	Colour Available %	Estimated DNT Rate %
	Range	Mid	Range	Mid		Range	Mid	Range	Mid		$mm	$mm			
AAA	185-195	**190**	215-275	**245**	55	95-97	**96**	93-97	**95**	-1	**345**	96	**3.6x**	54%	**1%**
AA	310-345	**328**	375-450	**413**	85	91-94	**93**	87-90	**89**	-4	**290**	33	**8.9x**	63%	**4%**
A	350-425	**388**	450-565	**508**	120	90-93	**92**	84-89	**87**	-5	**81**	14	**5.6x**	61%	**16%**
BBB	500-575	**538**	675-775	**725**	188	87-90	**89**	80-88	**84**	-5	**91**	29	**3.2x**	77%	**64%**
BB	925-975	**950**	975-1250	**1,113**	163	81-85	**83**	70-80	**75**	-8	**111**	36	**3.1x**	91%	**17%**
B	1375-1450	**1,413**	1550-1800	**1,675**	263	73-77	**75**	60-70	**65**	-10	**17**	12	**1.4x**	100%	**85%**

Source: Fair Oaks Data, Citi, 29-Sep-2022

Overall, we see this as a technically driven episode of weakness (we observed some BWICs being cancelled after news that the BOE would intervene in longer dated Gilt markets). The future path of UK rates is likely to remain volatile and we could see a continuation of similar selling as a result. In IG we think this presents an interesting opportunity to capitalise on outsized flows from motivated sellers. In sub-IG, we maintain our preference for better quality risk at historically attractive levels when it is able to be sourced (note single-B DNT rate above).

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