Creditflux

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Credit Rendezvous

US CLOs

Look to the wings of the capital structure and new CLOs with restructuring-friendly language

Ujjaval Desai

Head of structured products investing, Sound Point

Bullish

Senior part of the capital stack and equity

Bearish

Triple Bs and double Bs, and seasoned deals

Greatest challenge

CLO covid exposure and performance

New issue US CLO equity is an attractive proposition as liability spreads have tightened quickly, says Ujjaval Desai, with triple As moving from 165bp over Libor to 130bp in a few weeks. But the New York-based investor adds that the spread on senior tranches is still wide of similarly rated ABS and corporate bonds, making the opposite ends of the capital structure appealing.

"The value of CLOs is in the senior part of the cap stack and in equity. But we don't like the belly of the structure," he says.

The spread tightening at the top of the capital structure was faster than the underlying assets of CLOs and therefore new issue CLO equity is appealing as "the arbitrage of US CLOs has improved over the past year".

The tightening of US CLOs has meant that new issue US CLO triple and double Bs are not valued as highly by Desai. "Triple Bs have downgrade risk. Although we are not expecting a wave of downgrades, that risk is there, while double Bs are being issued at close to par so we don't see much upside."

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New issue CLOs are also more desirable as the transactions coming to the market have changes to their documents that allow CLO managers to be more proactive in restructuring processes.

But in general, CLOs have performed as expected and Desai points to the return of 'five-year reinvestment and two-year non-call' deals as a sign of the "stability and comfort of the market".