Past returns

Five years ago this month, Creditflux reported on the looming spectre of a US tax change that could trigger a **MASS UNWINDING** of CLOs.

The Foreign Account Tax Compliance Act (Fatca) provides a lesson in the dangers of crying wolf. CLO managers, we reported, argued that the requirement to disclose investors' names to the US tax authorities would drive up the cost of borrowing for US companies.

In reality, compliance with Fatca was manageable and it didn't lead to a loss of jobs among borrowers.

10 years ago, the structured credit market was reeling from a now almost **FORGOTTEN CRISIS**. Widening in Ford and General Motors CDS sent spreads on the 0-3% index tranche sharply wider, catching many hedge funds and prop desks on the hop.

Spreads on mezzanine index tranches also tightened, depressing the issuance of bespoke synthetic tranches. We noted a sharp drop in the volume of CDOs-squared issued during the second quarter of 2005.

Join the debate

"Few of these vehicles have the collateral manager actually owning a majority. Who is going to be first to take the risk to find out if '10% plus control' really works?"
US managers race down affiliate route as risk retention looms, 9 July

"Nice to see the rating agencies staying on top of shadow ratings..."
CLOs take a hit as shadow-rated borrower files for bankruptcy, 8 July

"Many of these deals have middle market underlying assets. It would be great to see middle market and broadly syndicated lists separately."

"Did all of the equity roll from the original transaction to the refi? Typically, in 2006, that didn't happen. If there wasn't a full roll, it is unfair to look at what is effectively two separate deals together."
Highly levered Invesco CLO records stellar final IRR, 10 July

Family offices welcome alternative credit into their households

Large family offices are shifting their attention to illiquid debt after being put off by the lacklustre returns produced by vanilla credit assets, according to various sources.

In the past, these organisations have been big buyers of corporate bonds and equities. Now the emphasis is said to have turned towards bumping up allocations to alternative credit assets.

Albert Konrad, a partner at wealth manager Kehrli & Zehnder, which handles portfolio construction for family offices, says his firm has begun investing in CLOs and direct lending funds on behalf of clients.

He says private banks will usually advise family offices to split their portfolios between bonds, equities and alternatives, but that his firm has taken this approach a step further after seeing family offices demand greater exposure to alternatives.

"Keeping portfolios diversified is a primary objective for us," says Konrad. "Alternative buckets are getting bigger and we feel that the best way to manage this part of our portfolios is to sub-divide it into its constituent asset classes."

Demand for higher yielding assets such as credit alternatives has grown substantially and Zurich-based Kehrli & Zehnder has, for some clients, been pushing into market segments such as structured credit, trade finance and private debt.

Oh: 'less liquid strategies'

In the investment grade bond space, yields have fallen to 3.2%, according to the BofA Merrill Lynch US Corporate Master Effective Yield index. Returns have increased over the past two months but remain inside 2011 levels, when the index was above 4.2%. In contrast, CLO equity tranches typically yield over 12%.

Los Angeles-based PineBridge Investments works with family offices across a number of strategies, but particularly in alternatives. Steven Oh, PineBridge's global head of credit and fixed income, says that family offices tend to have a high risk and return appetite, which makes CLO equity, corporate loans and direct lending appealing.

"We have seen broad investor interest, including from family offices, in less liquid strategies as investors struggle for yield in their portfolios," he says.

"Accommodative central bank monetary policies have resulted in an extraordinarily low rate environment and are incentivising investors to take on incremental credit and liquidity risks."

CSAM deal brings Libor 'ceiling' to CLOs

A recent multi-currency European CLO managed by Credit Suisse Asset Management was structured to mitigate the impact of future interest rate rises, it has emerged.

Cadogan Square CLO VI, which closed via Credit Suisse on 30 June, features a Libor cap of 4.5% on its sterling-denominated tranches, to help protect the deal's euro investors in the event of an increase in the three-month sterling Libor rate.

The CLO has a 10% bucket for investing in sterling-denominated loans, partially hedged with a vertical strip of sterling tranches. This strip makes up 5% of the CLO's total liabilities, and also makes up CSAM's risk retention piece. By agreeing to a sterling Libor limit, CSAM eliminates the need to engage in perfect asset swaps in the event that the sterling portion of the CLO's portfolio pays down slower than the euro-denominated portfolio.

Cadogan Square VI is