

Structured Finance > Investment Grade



Collateralized Loan Obligations (CLOs): Senior Classes

Updated: Oct 1, 2015

Trade Idea:

- ▶ Purchase 'AAA'-rated senior classes off of recently issued CLO transactions to take advantage of the floating-rate nature and currently wide credit spreads. Note these are private placements issued under Rule 144a.

Investment Rationale:

- ▶ **Credit enhancement:** The senior tranche of post-crisis CLOs have credit enhancement of ~35%, vs. hi-20s% for pre-crisis CLOs. This provides significant protection from a deterioration in credit of the underlying leveraged loans, which saw 12-month default and loss rates of ~11% and <6%, respectively, during the credit crisis.
- ▶ **Technical factors:** Historically large money-center banks have been a large buyer of the senior classes of CLOs. Recent regulatory changes, including the Volcker Rule, have made banks less active purchasers lately and this, along with heavy issuance, has led spreads to remain wide. However, the second half of the year has brought a slowdown in issuance, due to risk retention and collateral sourcing issues, potentially leading to a favorable supply technical. In addition, the floating rate nature sees increased demand when rates are selling off, as they did during the taper tantrum, but less when rates are rallying. Secondary market appears to have felt more weakness than new issue, therefore, more attractive opportunities are likely to be found there.
- ▶ **Relative value:** Spreads have widened over the last couple of months due predominantly from increased market volatility stemming from broader economic concerns. This assets class offers the opportunity to get long credit spreads without taking on interest rate risk, which should be attractive in an economy that is growing and on the verge of a Fed tightening cycle.

Recommendation(s):

View	Trade Horizon	Deal & Tranche Info	Collateral Manager	Ratings	Cusip	Average Life / Spread Duration	Tranche Par	Discount Margin	\$ Price	Current Yield*	Ability to Source Similar
Buy	6-12 Months	DRSLF 2015-41A A	Prudential	AAA/Aaa (Fitch/Moody's)	26244KAA4	5.4/5.04	\$320.75 mm	+150	Par	2.98%	Large pipeline

* Using the forward curve, as of 9/28/15