

US CLOs

A \$1 trillion industry is only going to get bigger



Gaurav Suri

Investment manager,
Livermore Investments
Group

Bullish

CLO warehouse first-loss and long-dated CLO equity

Bearish

Fixed-rate CLO debt tranches issued earlier this year

Greatest challenge

Sofr transition-related basis risk for existing CLOs

The US CLO market smashed records in the third quarter, with August becoming the highest ever month for deal flow and the total market cap for CLOs topping \$1 trillion. The underlying factors that led to the ballooning market earlier in the year will remain during 2021's final months, says Livermore's Suri.

"We continue to view the CLO market as one of the few areas where investors can generate high



Issuance of more CLOs than the underlying loan supply can support remains a challenge

cash-on-cash returns and double-digit IRRs, and the projected low default environment, combined with investors' strong desire for yield, is an attractive backdrop for new issue CLO equity," he says.

Both loan and CLO technicals remain strong, with investors rotating into floating rate paper in anticipation of rising interest rates. Additionally, the transition to Sofr in January is likely to push some CLO primary activity into the fourth quarter.

"Issuance of more CLOs than the underlying loan supply can support remains a challenge, and may result in aggressive documentation and lower spreads on loans going

forward," says Suri.

"However, underlying corporate fundamentals in the market are supportive and the macroeconomic backdrop in the US remains strong."

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