

Investing in newer CLO platforms

We look at whether the spread pick-up appropriately compensates investors.



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Securitized Credit team

Matt Maggio

Managing Director
Senior Portfolio Manager

Ajeet Atwal

Portfolio Manager

Mark Shohet

Portfolio Manager

“Our deep bench of ~40 investment professionals (including 25 analysts) gives us a level of bandwidth that would make it difficult for smaller, “new” shops to compete with.”

In a May 2024 report, Nomura CLO Research identified that across manager cohorts, newer CLO managers in aggregate have outperformed more established managers over the past 1-2 years, with this group having lower defaults and CCC downgrades in the same vintage groups. This is noteworthy because CLO managers are tiered, with newer managers trading wider, and sometimes significantly so, than established managers.

Small managers have an advantage in their ability to be nimble

We believe smaller, more nimble CLO managers, such as RBC BlueBay, have a performance advantage relative to larger, more established managers. This is due to the following factors:

- 1. Credit selection:** smaller managers have the ability to be real credit pickers. For example, we invest in ~300 of ~1,400 issuers in the broadly syndicated loan (BSL) market versus 600+ for larger managers. Larger managers are often “forced” players, given the need to put their AUM to work.
- 2. Flexibility:** smaller managers have the ability to swap positions or make significant sector rotations, more easily enabling them to minimise bid/ask spread more effectively.
- 3. Trading:** the ability to take more concentrated positions for short-term holds enables smaller managers to take advantage of new issue original issue discount in a hot, volatile market.

BlueBay: a “newer” CLO manager steeped in a long history of leverage loans and high yield

In just the last two years, there have been over a dozen new US BSL CLO managers enter the marketplace (and nearly 30 since the pandemic in 2020). Many are independent CLO shops, as opposed to a broader platform such as RBC BlueBay which has a long history of leveraged loan and high yield investing (including the related operational requirements, risk management best practices, and a dedicated Responsible Investment team).

The scale of our global leveraged finance business of close to USD20 billion provides us with access to attractive deals and allocations¹. Our deep bench of ~40 investment professionals (including 25 analysts) gives us a level of bandwidth that would make it difficult for smaller, “new” shops to compete with – and we can do this without the size constraints of larger players in the market.

¹ RBC GAM.

Looking beyond RBC BlueBay: setting a high bar when investing in the CLO tranches of others

In addition to our own CLO management platform, we also manage various Securitised Credit funds in which we invest in CLO tranches of other managers – and within these strategies, we are very keenly aware of the same new manager trends. While we are generally open-minded when it comes to new managers, we have a high bar to investment. Some of the questions we ask managers include:

4. **CLO equity capital:** is there a commitment in place to support a long runway of growth via firm or external equity capital?
5. **Investment style:** what kind of portfolios will the manager build and what may cause these strategies to drift over time?
6. **People:** what is the size, experience, and turnover of the investment team?

The bottom line is that while newer managers can provide an attractive spread pick-up to CLO liability investors, particularly in the primary market where deadlines are tight and many investors don't have the capacity to do the proper diligence, we still need to feel as though we are adequately compensated in spread or structural protection for the unknowns of a newer platform (and the lower liquidity that comes with this).

Recently, we are seeing many instances where that yield pick-up does not feel worthwhile, as CLO debt investors are experiencing record repayments (USD55 billion in BSL CLO calls and amortisations YTD through May 2024²), causing aggressive buying and a compression in the established versus newer manager basis. However, in cases where we have done proper diligence on a manager and find that their style aligns with our views – and we not only buy into the story but are also getting properly paid for the risk – we are open to investing, and doing so in large sizes.

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New does not mean inferior

While we may be classified as a “newer” manager based on our deal count (4 Euro deals and 4 US deals), our CLO business is part of RBC Global Asset Management within the established BlueBay Fixed Income platform, which spans 13 geographies and USD120 billion+ AUM across numerous strategies³. We believe this unique positioning provides us (and our investors) the best of both worlds, in which we can be nimble in our investment approach, while still maintaining the safety and support of an established broader organisation.

² Morgan Stanley.

³ RBC GAM.



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Lower Credit Quality Securities. CLO portfolios and interest could be deemed by rating agencies to have substantial vulnerability to default in payment of interest and/or principal. Other securities could have the lowest quality ratings or be unrated, have been downgraded or have been placed on “credit watch” for future downgrades. Lower rated and unrated securities can have large uncertainties or major risk exposures to adverse conditions and can be considered to be speculative. Generally, such securities offer a higher return potential than higher rated securities but involve greater volatility of price and greater risk of loss of income and principal. The market values of portfolios or interests in CLOs also tend to be more sensitive to changes in market or economic conditions than other securities. The value of the leveraged loans underlying a CLO can also be affected by changes in the market’s perception of the entity issuing or guaranteeing them, or by changes in government regulations and tax policies.

Leverage Risk. Leverage can result from certain transactions, borrowing and reverse repurchase agreements and derivatives. Leverage can exaggerate the effect of a change in the value of the portfolio’s securities, causing the portfolio to be more volatile than if leverage was not used. Losses incurred on leveraged investments will increase in direct proportion to the degree of leverage employed. CLO portfolios and investors also incur interest expense on borrowings used to leverage its positions. The use of leverage also can result in the forced liquidation of positions (which could otherwise have been profitable) as a result of margin or collateral calls. For CLO portfolios and investors, to the extent the Adviser can adjust leverage levels, the Adviser could increase (or decrease) leverage at times when it is not advantageous to do so and, as a result, the value of certain securities issued by the CLO could decrease.

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