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CLO Q&A-AGL Credit Management's Gleysteen: TOPLive Transcript

By Sally Bakewell

(Bloomberg) -- Below is a transcript of the live blog event "CLO Q&A: Ask AGL Credit Management's Peter Gleysteen" with entries in the order they were originally posted.

05/27 10:02 ET
Welcome to our Q&A blog on the risks and opportunities in the collateralized loan obligation market, which was hammered by the virus and now faces its biggest test since 2008. Join us at 11 a.m. New York time as CLO veteran Peter Gleysteen, AGL Credit Management CEO and CIO, takes your questions on what's ahead.

Credit reporter Sally Bakewell will moderate the discussion.

If you have questions for Peter, please send to in advance and we'll pick some to ask when the Q&A begins.

Peter Gleysteen is chief executive officer and chief investment officer of AGL Credit Management, which he founded in 2018 and launched in 2019. He previously founded CIFC and managed it as CEO from its inception in 2005 to 2014, and after the firm was sold, served as vice chairman and special adviser until 2016. Prior to that, Peter worked at JPMorgan and antecedent entities Chemical Bank and Chase Manhattan.

Any opinions Peter expresses are his own.

Anny Kuo TOPLive Editor

05/27 10:58 ET
Hi, I'm Sally Bakewell, a New York-based reporter for Bloomberg's U.S. credit team. Some of the best-known, everyday companies in the U.S., from American Airlines and Burger King to Charter Communications, get their funding from collateralized loan obligations. The market has more than doubled in size since 2008, helped by investor demand for riskier assets amid pervasively low interest rates.

I'm delighted to welcome our guest, Peter Gleysteen, CEO of AGL Credit Management, who'll take your questions on CLOs.

If you have a question for Peter, please send it to .

Sally Bakewell Credit Reporter

05/27 10:59 ET
The volatility in the near $700 billion CLO market has been remarkable, with spreads on the highest-rated parts of the securities almost doubling in one day in March as investors frantically sold their holdings to raise cash when pandemic fear took hold.

The market started to recover last month, with some new deals issued, but it continues to face heightened pressure from a record pace of downgrades to the leveraged corporate loans they package and sell as bonds. With limited help from the Federal Reserve, concerns are emerging about the soundness of CLO structures as more businesses default.

Sally Bakewell Credit Reporter

05/27 11:00 ET
To kick things off, a question for Peter: CLOs fared pretty well in the last financial crisis, emerging relatively unscathed from the subprime mortgage-induced pain. This time around, CLOs are on the front line. What makes you think that they can survive this crisis?

Sally Bakewell Credit Reporter

05/27 11:01 ET
As the saying goes, what doesn’t kill you makes you stronger. In the case of CLO structures, these have been improved from a risk standpoint after the ’08 financial crisis and ’09 recession, which they survived. CLOs then defied expectations afterwards by generating performance that ranged from respectable to outstanding.

The key of course is that CLOs are funds designed for long-term investing, utilizing long-term debt with no market value triggers, meaning no requirement to force-sell or liquidate loans at any time, and equity that is similarly long-term with no redemption features. Long-term debt and long-term junior capital is an excellent structure for the long-term investor.

Peter Gleysteen AGL Credit Management CEO, CIO

05/27 11:02 ET
A central part of a CLO’s structure are the self-correcting “loan to value” mechanisms that are triggered in the event of loan portfolio credit-quality deterioration. This causes cash flow to be diverted from distributions to the equity and some management fees, to prepay debt. Once the “loan to value” is back in compliance the debt prepayment stops.

So CLO structures are robust and tested, but this is the clothing, not the body inside. The body is the underlying portfolio of loans, which of course can vary a lot by manager, vintage and investment style. So CLO structures may be great suits but it is the health and physique inside that matter most.

Peter Gleysteen AGL Credit Management CEO, CIO

05/27 11:02 ET
It should be pointed out that CLO portfolios, contrary to impressions frequently created in the press, contain many large and medium-size corporations that are the bedrock of the U.S. economy, unlike S&P 500 multinationals, many of which employ as many or more people outside than in.

Back to performance, we will likely see a wide dispersion of returns and this will of course depend on both the severity of the recession underway and what kind of recovery follows.

But will CLOs survive? Yes.

Peter Gleysteen AGL Credit Management CEO, CIO

05/27 11:04 ET
Got a question for Peter? Please send it to .

Andrew Dunn TOPLive Editor

05/27 11:04 ET
Next question: What do you expect CLO equity returns to be like for 2020, and why?

Sally Bakewell Credit Reporter

05/27 11:06 ET
Beauty is in the eye of the beholder, which for CLO equity, depends on whether the investment horizon is long- or short-term, and when the investment was made, as in, at issue, or later in the secondary market.

As mentioned, the structure is great for the long-term investor, as it harnesses the ongoing actual cash generated by the underlying portfolio without being subject to prematurely sell assets, especially in down market conditions such as now.

Beauty can also be a function of timing, as CLOs that get issued this year, after the onset of Covid, will likely have excellent entry price points.

Peter Gleysteen AGL Credit Management CEO, CIO

05/27 11:06 ET
For pre-Covid CLO equity investors looking to get out now, depending on entry timing and price, returns can be poor or worse, as like the underlying loans, exit prices often reflect discounted liquidation values, not future performance.

From a valuation perspective investors can select, or be required as the case may be, to use mark-to-market or mark-to-model. Mark-to-market prices include a jumble of several factors -- market sentiment including at times panic, market technicals, that is supply and demand, and fundamentals, as in underlying expected credit quality and performance.

Today prices are mostly technically driven, with investors unsure how severe the recession will be, so all loans are discounted, some severely so. It is not a good time to be a forced seller.

So, subject to entry and exit timing, realized returns in 2020 for pre-Covid CLO equity investors should be poor or worse. These will also be unattractive on a mark-to-market basis, but good or better on a mark-to-model basis, as the latter reflects the longer-term earnings power of the underlying portfolios, versus a moment in time.

(CORRECT: A headline based on this post was corrected to give proper context surrounding pre-Covid returns.)

Peter Gleysteen AGL Credit Management CEO, CIO

05/27 11:07 ET
It is important to note that during CLO reinvestment periods managers can very actively change portfolio composition to improve risk, which directly benefits CLO equity investors.

It should be emphasized that if you think mark–to–market represents actual value, many related investments would have no value. Since virtually all loans trade today at a discount to par, this would mean that all the capital underneath senior secured loans, that is all the unsecured and subordinated debt, plus, importantly, all equity which is mostly private equity, is worthless.

By analogy any perceived impairment to CLO equity would imply severe losses to the junior debt and the equity underneath the loans in the CLO portfolios. Be a buyer if you can!

Peter Gleysteen AGL Credit Management CEO, CIO

05/27 11:08 ET
Got a question for Peter? Please send it to .

Andrew Dunn TOPLive Editor

05/27 11:09 ET
You mention that CLOs are funds designed for long–term investing. "Long–term" means different things to different people. Could you define what that means here?

Sally Bakewell Credit Reporter

05/27 11:10 ET
"Long–term" for investors usually means at least three years, but typically is five years or more.

The key point is not needing liquidity suddenly –– that is, having to liquidate an investment prematurely.

Peter Gleysteen AGL Credit Management CEO, CIO

05/27 11:12 ET
A client asks: What are the biggest challenges for CLO managers now in terms of active trading? What kind of trading strategies do you think CLO managers should take in the current challenging environment?

Sally Bakewell Credit Reporter

05/27 11:12 ET
Having a sufficient number of willing sellers and/or buyers, as the case may be, at the desired price points. There is some depth to secondary liquidity, but not as much as many would like. Put another way, some posted prices don't reflect actionable levels.

For existing CLOs, risk management is the priority and being able to substitute lower credit risk loans for better ones, by selling on market strength and buying on market weakness.

Peter Gleysteen AGL Credit Management CEO, CIO

05/27 11:13 ET
Got a question for Peter? Please send it to .

Andrew Dunn TOPLive Editor

05/27 11:18 ET
Meanwhile, Wells Fargo said in a report today that the BBB-rated tranches of CLOs are now offering investors the best value. Spreads on the debt are the widest relative to AAAs since the first half of 2016, and almost all are expected to pay off at par, according to the report.

Read more here:

CLO Debt Rated BBB Now Offers Investors Best Value: Wells Fargo

Sally Bakewell Credit Reporter

05/27 11:22 ET
Another client asks: As bank loan prices fell, threatening financing lines, or warehouse facilities, obtained to buy the loans, how have equity investors approached lower projected returns while broader risk markets generally remain wider?

Sally Bakewell Credit Reporter

05/27 11:22 ET
One of the many positives of the bank-loan asset class is a lot of excess spread, especially on a risk-adjusted basis.

So the returns on pre-Covid loans are lower than post-Covid ones, but both have “juice,” and in the right combination, work for securitizing in a post-Covid environment. A key fact is whether the equity investor is a long-term one or a “tourist.”

Peter Gleysteen AGL Credit Management CEO, CIO

05/27 11:24 ET
Got a question for Peter? Please send it to .

Andrew Dunn TOPLive Editor

05/27 11:30 ET
A client asks: Given unprecedented loan downgrades and most CLOs breaching or close to breaching the CCC limit, how do you think CLO managers should manage their CCC assets? Actively cutting and taking a loss, or sitting on it and hoping to ride it out?

Sally Bakewell Credit Reporter

05/27 11:31 ET
The essence of credit investing is an informed analytical conclusion on a company’s fundamental value, both now and in the future, including stressed situations such as the recession underway now.

The hold-or-sell question is fundamentally whether the exit price is materially better than a projected future recovery. This conclusion, then, has to be balanced with the overall risk profile of the CLO in question, so the overall ratings distribution makes sense from a risk standpoint.

Peter Gleysteen AGL Credit Management CEO, CIO

05/27 11:32 ET
If you have a question for Peter, please send it to .

Andrew Dunn TOPLive Editor

05/27 11:35 ET
Do you think that all of the macro risk from the pandemic is fully priced in to both leveraged loans and CLOs? Could we see another selloff of both this year?

Sally Bakewell Credit Reporter

05/27 11:36 ET
More loan-market volatility is likely for 2020. How much will depend on severity of the recession and pace and strength of recovery after.

If consumers stay home and the recession stretches out, and/or if a “second pandemic wave” hits, the loan market won’t just bounce around but will have another downleg.

Peter Gleysteen AGL Credit Management CEO, CIO

05/27 11:39 ET
Got a question for Peter? Please send it to .

Sally Bakewell Credit Reporter

05/27 11:45 ET
CLOs have a huge Asian buyer base, including Japan’s Norinchukin bank, but the bank has been paring its holdings after booking about 400 billion yen ($3.7 billion) in losses on the securities. How significant is this?

Sally Bakewell Credit Reporter

05/27 11:48 ET
Three points on this, as it depends where you sit. Overall this has not been significant as the universe of CLO liability investors, especially AAA ones, keeps expanding, so a pullback in one place is more than offest elsewhere. For CLO equity investors, you always want even more buyers, so anyone pulling back tilts the supply-demand equation away from what it could have been.

For AAA investors on the other hand, they prefer a smaller universe so that fewer buyers support stable or tighter spreads versus spread compression from more investors. The ultimate arbiter in this equation is the total amount of net new CLO supply versus CLO liability demand.

Peter Gleysteen AGL Credit Management CEO, CIO

05/27 11:53 ET
We saw some consolidation in recent years, with bigger credit shops or insurance companies buying smaller CLO managers. Do you expect this to continue?

Sally Bakewell Credit Reporter

05/27 11:55 ET
There are two ongoing trends. For asset-management complexes to have full, rounded offerings, especially in credit, this means building or buying broadly syndicated loan capability, including CLOs, if they don't have already.

The second is a larger percent of loans are being managed by fewer managers. Over time, this suggests further consolidation. A key point now, of course, is which CLO managers can bring new CLOs to market.

Peter Gleysteen AGL Credit Management CEO, CIO

05/27 12:01 ET
Why is everyone so scared of CLOs generally, especially the mezzanine and equity?

Sally Bakewell Credit Reporter

05/27 12:01 ET
Two words: bad press.

The superior track record of CLOs speaks for itself, as does the continuing inflow of capital seeking to invest in it at all levels, from AAAs to the equity. Despite the safety provided by diversified portfolios of senior secured loans with resilient and thick ongoing cash flows, CLOs are deemed guilty by association -- first by the three-letter acronym and superficial similarity to other securitized products, but also the link to private equity.

Both continue to be political footballs, which of course the press cannot resist.

Peter Gleysteen AGL Credit Management CEO, CIO

05/27 12:09 ET
A client chimes in: A lot of talk is about CLOs within their reinvestment period and the manager's ability to actively trade collateral. How are you looking at CLOs past their reinvestment period?

Sally Bakewell Credit Reporter

05/27 12:09 ET
The ongoing performance of CLOs, when they delever post the reinvestment period, is a function of portfolio quality. Here the effects of both what the manager selected, and how effective risk management was during the reinvestment period -- that is, to decrease the credit risk of the remaining portfolio -- becomes super evident.

The point is to manage tail risk down, and to do that in the reinvestment period. These are long-term funds that require a long-term view starting day one.

Peter Gleysteen AGL Credit Management CEO, CIO

05/27 12:14 ET
A telling weakness was exposed in the CLO market recently, when CLOs, which came to own equity in a company through a corporate restructuring, were prohibited by their indentures from participating in a rights offering by

that company to raise much-needed liquidity -- potentially wiping out the value of their stake.

It was a small example of a potentially bigger problem. Could CLOs be a disadvantaged hand if a wave of corporate defaults hits?

Sally Bakewell Credit Reporter

05/27 12:14 ET
Yes, this is a disadvantage and an example of unintended consequences. This restriction is part of making CLOs super-safe, in this case by not investing in a restructured capital structure that the CLO is already in, even if it is in the best interest of all CLO investors.

While unfortunate from an opportunity and fairness standpoint (this is manna to "loan to own" distressed investors), I would not expect it to materially affect outcomes for CLO investors.

Peter Gleysteen AGL Credit Management CEO, CIO

05/27 12:20 ET
Peter, thanks for your time. Here's a final question:

What is the single biggest risk to the CLO market right now, and what is the biggest opportunity?

Sally Bakewell Credit Reporter

05/27 12:20 ET
That would be a mega-market meltdown where investors of all kinds, including CLO managers, are too frightened to invest, or unsure enough to make decisions given extreme uncertainty.

This would freeze markets, or worse, put us in an Ice Age. The good news is, despite the unprecedented nature of the Covid-caused recession, markets, including for new-issue CLOs, are open. The opportunity is for CLOs to continue to grow as the preferred and most constructive supplier of long-term capital to private companies that are the mainstay of the U.S. economy.

Peter Gleysteen AGL Credit Management CEO, CIO

05/27 12:25 ET
Thanks so much for following us on this live Q&A blog. We hope it answered some of your questions about CLOs. And many thanks to Peter Gleysteen for his insights.

You can find real-time coverage of the CLO market on the structured finance channel at {FIRS <GO>}, or {NI BFWMORUS <GO>}. Also, check out Bloomberg's Structured Finance Weekly.

For a schedule of upcoming TOPLive events, please see TLIV on our Terminal.

Sally Bakewell Credit Reporter

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