

Safe Landing

THE LEAD | December 3, 2015

While most Americans were in the midst of Thanksgiving preparations last week, Amazon founder Jeff Bezos was making space history.

In the first successful test flight of a rocket with all reusable parts, the *New Shepard* booster landed four feet from where it had taken off on the plains of West Texas. Next step: human passengers. “I’m thinking it could be sometime in 2017,” Mr. Bezos said.

This triumph came after earlier industry failures, which had led critics to question private space travel. Similar skepticism surrounds vehicles of a different sort.

As our [Chart of the Week](#) highlights, new CLO issuance is sputtering as the year winds down and is predicted to be off next year as well. Wells Fargo’s guru of collateralized loan obligations, [David Preston](#), is calling for \$75 billion of new volume for 2016. That compares to about \$90 billion so far this year, and \$124 billion in 2014 – a record year.

This trend has some in the financial media all but writing off this highly adaptable financing tool. Yet the slowdown is mostly attributable to risk retention rules which take effect in about thirteen months. These rules require CLO managers to invest a minimum of 5% of the total tranche size as equity. To achieve any scale as an asset manager thus requires a significant capital outlay, limiting frequent issuance to all but the largest firms.

Another consideration is the Fed lift-off. Market observers fret that a higher Fed funds rate will boost Libor as well. Although CLO liabilities float at a spread above Libor, CLO assets mostly incorporate 1% floors. That yield subsidy would be less helpful as actual Libor rises, thus reducing arbitrage spreads for CLO equity.

But this well-telegraphed hike has already been priced into the market. With few economists predicting further tightening, asset spreads will likely remain stable. If anything, supply/demand technicals favor wider spreads, particularly as several hung underwritings have spooked loan arrangers in the broadly syndicated world.

Meanwhile, on the cost side of the equation, bellwether triple-A spreads average L+160 bps for large cap structures. Depending on timing and manager that can swing 10 bps up or down, but has remained within the same range for the past four years.

As rocket technology has evolved from NASA to New Shepard, so CLOs have undergone design iterations since their launch over two decades ago. What will change is the scale and resourcefulness of firms that manage them.

In Memoriam

We learned last week of the untimely passing of Carol Buch of BMO Capital Markets. Banking is about people, and Carol was one of the best. No job-related worries clouded her eternally sunny outlook, making her highly popular at industry gatherings. Her devotion to family was a constant as she greeted us. “First, let’s see pics of the girls.”

Those who knew Carol best remember her glowing smile and hearty laugh. We could use them now. She will be truly missed.