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Far too many recent mass-media articles critical of the CLO market are heavy on the hyperbole and light on the facts

We've recently observed an increase in mass-media articles that are critical of CLOs. Experienced market participants know these get printed from time to time. In my view, they typically represent sensationalist writing, often with headlines designed to capture the most clicks. Often the basic premise seems to be "CDOs were bad, CLO sounds like CDO, the leveraged loan and CLO markets have grown, and therefore loans and CLOs must be bad too."

Many of these articles feature an overly simplistic connecting of similar-sounding acronyms and are light on data. Many largely ignore the historical performance of both leveraged loans and CLOs and do not seem to consider that CLOs are, in fact, very different from CDOs. We have yet to find a mass-media article that devotes any attention to the potential merits of the CLO asset class, including how many CLO equity securities benefited from prior periods of loan price volatility.

This is not to suggest that there are not risks unique to the current environment that warrant careful consideration. Indeed, there are. With the demand for loans exceeding supply, it is a borrowers' market and many loan terms have shifted in their favour.

A recent headline that has understandably garnered attention is that the leveraged loan market is now roughly equal to the high yield bond market in size. However, what isn't mentioned is that the loan market has grown by approximately 8% per year since 2014, which we consider to be a healthy, but measured pace. For comparison, in 2007 alone (a time popularly associated with credit excesses), the leveraged loan market grew by around 39%. We simply aren't seeing that type of growth today.

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CLO assets aren't from risky borrowers

Certain articles have mentioned "risky borrowers", seeming to draw a connection with subprime borrowers whose mortgages populated CDOs prior to the crisis. However, what the authors fail to note is that the broadly syndicated loan market is comprised primarily of large American companies, which, although below investment grade in credit rating, don't necessarily conjure up images of high risk, fly-by-night operations. For example, although many of the corporate borrowers in the market are not household names, three of the largest borrowers today are Dell, American Airlines and Albertson's.

While we know that past performance is not necessarily a guarantee or indication of future performance, the fact is that leveraged loans and CLOs have performed positively over the long term, through both periods in which lending standards favoured the borrower and those in which they favoured the lender. For example, the US loan market, measured by the Credit Suisse Leveraged Loan Index, has generated positive total returns in 24 of its 26 years of existence. Very few risk asset classes have such a consistent track record of positive annual returns.

Sophisticated investors

From our experience, investors across the CLO capital structure (from triple A-rated CLO debt through to equity) are today sophisticated institutional investors who have studied the historical data relating to CLO debt and equity. For example, according to Standard & Poor's, BB-rated CLO debt (typically the most junior debt tranche of a CLO) has experienced defaults at a rate of 8 basis points per annum over the 20 years from 1994 through 2013. And among market participants, it is becoming known that for CLO equity, the 2006 and 2007 vintages had the highest median ultimate return of all vintages in the CLO 1.0 era, with very few failing to return at least invested capital to the equity.

While lending standards ebb and flow over time, we believe that the fundamental underpinnings of the CLO structure remain solidly in place. Specifically: senior secured loans are still the underlying asset class; CLO balance sheets are stable, with long-term, non mark-to-market financing; and the embedded reinvestment option within CLOs remains, which is particularly valuable during periods of loan market stress.

CLOs are certainly not immune to risk and not every negative article lacks merit. However, we believe readers are done a disservice by cursory pieces lacking in thoughtful analysis and data.