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CIFC CLO funds outperform after using tech to identify tail risks

by Michelle de'Souza

CIFC Asset Management has been using technology to its advantage as two of its CLO funds were in the top 10 of our credit hedge fund return tables in April. CIFC CLO Opportunity Fund II and CIFC CLO Opportunity Fund III gained 10.32% and 9.34%, respectively.

Creditflux understands that the funds' equity positions all paid full cash distributions in April and did not trigger over-collateralisation or interest diversion tests.

Jay Huang, CIFC's head of structured credit investments, says the firm's technology platform runs a million simulations daily across various stress scenarios, including a test that simulates an elevated impact of the coronavirus pandemic on the economy, particularly on industries such as hotels, airlines, restaurants, and oil and gas.

"We have built an automated daily process where we quantify the tail risks of the entire CLO universe and then identify the double Bs that we believe can withstand draconian levels of credit stress," says New York-based Huang.

"We can measure the impact on every CLO bond if we enter an environment where up to 100% of companies in these high-covid 19 impacted industries default, and also run granular credit stresses identified by our credit research team and an elevated default environment for the next 10 to 12 years. Some stress scenarios show the cumulative default rate of some of the underlying loan pools reaching 35-45%," he says.

Huang says CIFC then isolates the top 20% of double Bs, which, even in that extreme environment, would get 100% of their principal and interest back. Double Bs were as wide as 15-17% yield (in March), tightening up to 9-14% today.

Despite the strong demand for double B tranches, prices are still lagging and are still down 15-20% from pre-covid-19. In February, double B rated CLOs in the US were around 98 cents on the dollar, dropping to 30-60 during the March sell off.