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US/EMEA Market Commentary: CLO Q&A with Permira on Post-Liberation Day volatility, spread widening, increased tiering among managers slowing deal flow and transaction dynamics

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In an exclusive interview, *LFI* spoke with Co-Head of Permira Credit and Head of Liquid Credit Ariadna Stefanescu and Managing Director Jared Adler on high-level US CLO trends. Since 2018, Permira has priced 13 CLOs, including 11 in Europe and two in the US, covering over 380 credits across the US and Europe (see **US CLO: Permira prices $404.2mn new-issue 5NC2 BSL vehicle via BofA (1st NI YTD, 2nd USD deal); AAA S+139 DM**).

Permira emphasized how headline risks significantly impact CLO portfolios. Political factors, particularly White House commentary, have raised concerns about how prolonged trade wars might affect borrowers and their cost structures. The shifts in sentiment and consumer confidence tied to these disputes remain critical considerations. Additionally, liability management exercises (LMEs) continue to be a persistent issue that Permira must navigate, as they have become a lasting presence in the market.

Tariffs have notably influenced the CLO market, especially concerning liability pricing. Permira anticipated these changes early, allowing strategic adjustments. Although the exact extent of tariff impacts couldn't be predicted, Permira managed to price its second CLO shortly after major announcements. Currently, the market is in a discovery phase, with uncertainty around completing some liability stacks. Permira's conservative approach to ramping warehouses focuses on purchasing primary transactions or discounted assets, aligning with market conditions to avoid unsellable assets.

Permira said if the trade war persists, spreads might widen to 160-180bps. Conversely, resolutions might tighten spreads to around 135-140bps. Greater dispersion among managers is likely, depending on how scenarios unfold. Post-"Liberation Day," liabilities have widened and tiering among managers has increased, affecting deal flow and new transactions. Permira notes that while refi and resets drove much of 2024's record issuance, this may slow, driven by early 2024 transactions that remain non-call. The firm also sees potential for new US CLO managers, acknowledging the European market's relative saturation, but noting room for entrants with clear strategies.

Full Q&A

LFI: How are current headline risks impacting CLO portfolios?

Permira: Headline risks have been a dominant concern lately, particularly due to political, not least White House, commentary. These factors significantly impact our CLO portfolios. We're particularly focused on how prolonged trade wars might affect our borrowers and their cost structures. The ongoing negative shifts in sentiment and consumer confidence, tied to these trade disputes, are critical considerations. Additionally, LMEs remain a persistent issue, which we must navigate as they are clearly here to stay.

LFI: What impact do tariffs have on the CLO market and warehouses?

Permira: Tariffs have significantly influenced the CLO market, especially regarding liability pricing. We anticipated these changes early on, which allowed us to incorporate them into our strategies. Although we couldn't predict the exact extent of tariff impacts, we managed to price our second CLO shortly after major tariff announcements. Currently, the market is in a state of discovery, and there's uncertainty about the completion of some liability stacks. Our conservative approach to ramping warehouses focuses on buying primary transactions or assets at a discount, aligning with current market conditions to avoid being stuck with unsellable assets.

LFI: What are your projections for AAA spreads in the coming weeks?

Permira: We've observed significant widening in AAA spreads, currently in the 25-30bps range. Two scenarios could unfold: if the trade war persists, spreads might widen to the 160-180bps range. Conversely, if resolutions are reached, spreads could tighten to around 135-140bps. There will likely be greater dispersion among managers, depending on how these scenarios play out.

LFI: How has the market changed since Liberation Day?

Permira: Post-Liberation Day, we've seen widening liabilities and increased tiering among managers. The spread differential between Tier 1 and Tier 2 managers has widened. Investors are becoming more selective, impacting deal flow and new transactions. In terms of CLO issuance, a big component of 2024's record-breaking issuance in both US and European markets were refi and resets. We think that will slow down and be driven by early 2024 transactions that remain non-call, but the number of such deals is small.

LFI: How do resets differ from refinancings in CLO transactions?

Permira: Resets depend on the quality of the underlying portfolio and the availability of AAA capital. Last year, most of our resets followed the traditional European standard, but one involved a shorter structure, as this was the optimal structure for that particular CLO. In volatile markets, shorter-duration transactions can be advantageous.

LFI: Are backstopped deals a sustainable model for AAA tranches?

Permira: Backstopping is a powerful marketing tool, but it is not clear if it is sustainable long-term. While some arrangers continue to offer this, others have retrenched amid price discovery. Earlier this year, more arrangers supported backstopping, but the market's rapid changes have affected its prevalence.

LFI: Does Permira trade CLOs on other platforms?

Permira: Yes, we have a structured credit division focusing mainly on the junior part of the capital structure in Europe. However, we don't offer an ETF product. Our experience in the asset class spans 14 years, and we've pivoted between being a CLO manager and investor depending on the market opportunity at the time.

LFI: Any thoughts on loan default rates and shadow defaults?

Permira: Loan default rates remain low, slightly above 1%, with shadow defaults above 4%. In a prolonged trade war, these could rise. However, if trade deals are reached, rates might stabilize. Some capital structures are predisposed to defaults, but the situation is more manageable in a benign scenario.

LFI: What emerging trends do you see in the CLO industry this year?

Permira: We anticipate continued evolution in CLO exchange-traded structures (ETS) and increased tiering among managers. Investors will focus more on performance and strategy consistency. Additionally, captive risk retention funds have grown in importance, especially among established managers with strong track records.

LFI: Does your firm use captive funds or third-party capital?

Permira: Since 2021, our European issues have been supported by a risk retention fund.

LFI: Is there room for more debut US CLO managers?

Permira: Yes, we see potential for new entrants in the US market. Looking at the numbers, there is the argument that the European market is more saturated compared to the US, but as CLO products and equity become better understood, there's always room for new managers with clear strategies and plans.

LFI: What is your expected pace for new CLO deals in the US?

Permira: Our pace is guided by market conditions rather than set targets. We're committed to growing our platform sustainably, focusing on building quality portfolios. While we've issued two CLOs in the past five months, our future activity will depend on market opportunities and investor returns.

LFI: How challenging is fundraising in the current environment?

Permira: Fundraising is challenging due to increased competition and market volatility. However, CLO equity funds offer diversified risk across vintages, which can be advantageous during market dips. Our best-performing CLOs were executed during periods of dislocation, highlighting the strategic value of such funds.

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