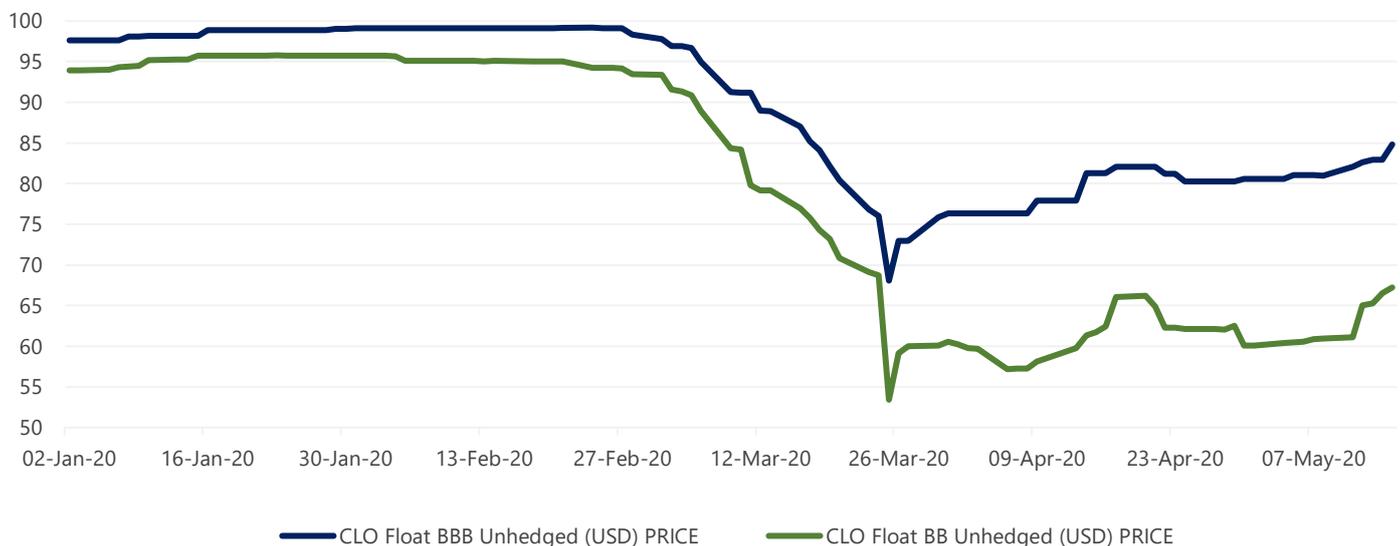


## CLO mezzanine rips tighter in the face of rating downgrades and potential cashflow diversions

Market indigestion over rating downgrade risk and shutting off of cashflows as tests are tripped through April seems to have somewhat subsided in mid-May as mezzanine CLOs (notably BBBs and BBs) ripped tighter. This surge came despite increased supply with the reactivation of the new issue market and decent secondary volumes. BBB CLOs are now offered 500-600 DM whilst BBs have tightened still further, to sit inside 1,000 DM, which is a strong move from circa 750 DM (BBB) and 1,200-1,500 DM (BB) that each tranche was trading at as recently as last week. More surprising has been the lack of real dispersion in BBs which is particularly notable given the growing risk of OC test driven cashflow diversions at the next payment date, caused by an increase in defaults and CCC exposures. This move tighter has been helped by the steady increase in loan prices, with the ELLI now above 90 again (from high 70s in March), along with the increased demand from recent fund raising.

With the V-shaped recovery seemingly further out of reach, we think fundamentals will put the brakes on any further move higher and so the current opportunity might actually be to lighten up on junior risk now with a view to re-enter amidst another bout of volatility at lower prices once actual downgrades and cashflow diversions have occurred.

**CLOIE BBB & BB Prices**



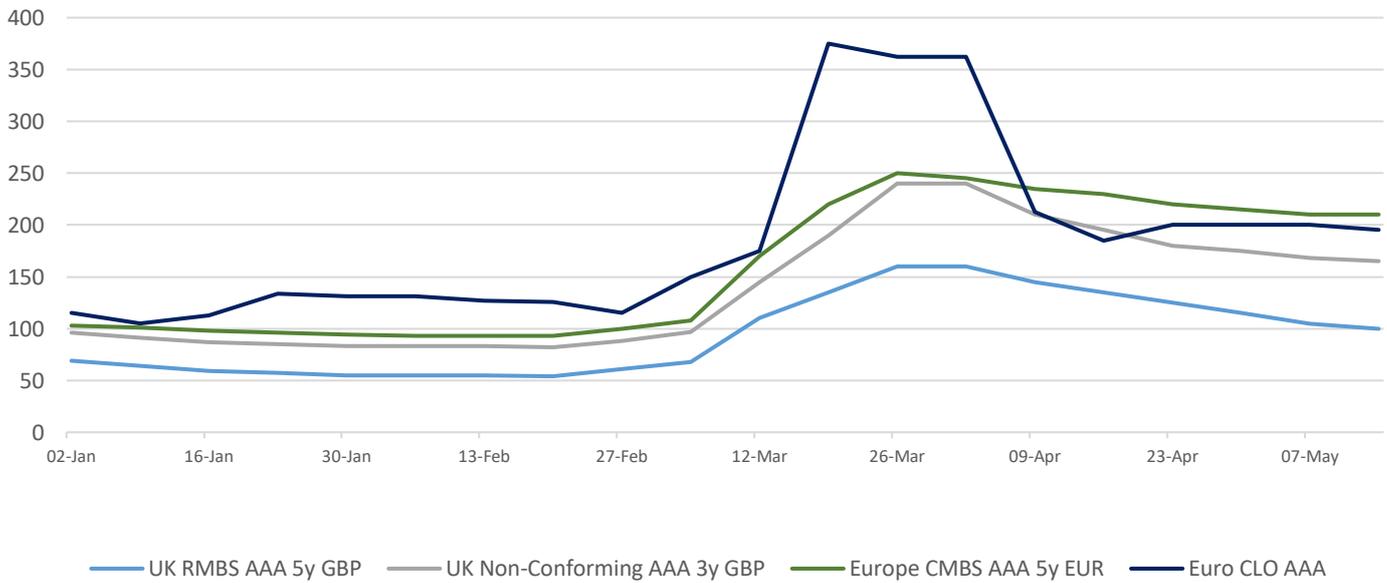
Source: J.P. Morgan Chase & Co., Copyright 2020, data as of 15 May 2020.

## European CMBS: the next frontier

The April rally initially started in the most senior and liquid asset classes only, with sectors like U.K. Prime RMBS, ECB-eligible senior ABS/RMBS, and the most vanilla US ABS prominent. These assets benefited most directly from the immediate support from central banks, governments and regulators. As investors expanded their horizon in the month, AAA CLOs were increasingly sought after on both sides of the Atlantic before liquidity flowed to mezzanine tranches in the CLOs structures as the loan prices recovered.

The same recovery was not necessarily observed on European CMBS, with many senior bonds still trading at spreads equivalent to single-A to BBB rated mezzanine CLOs, for example. We recognise the challenges faced by many property types across Europe both currently – many Italian retail or U.K. hotel properties are currently closed for example – and going forward given the macroeconomic shock on the demand side. The protections offered by the underlying loans and by the CMBS structure, however, comfort us in the view that the prospect of losses on the most senior classes of Notes remains remote. Notwithstanding the highly idiosyncratic nature of individual CMBS deals, we do generally see attractive value in these senior bonds.

### European ABS Credit Spreads (bps)



Source: J.P. Morgan Chase & Co., Copyright 2020, data as of 15 May 2020.

### Negative US Rates

Over the last week we saw the repricing of the Fed Funds curve, with the market currently pricing in negative rates by the end of this calendar year. Some market participants explain this move by technical forces, which does not translate in a fundamental change in Fed’s mental framework around setting rate policy. In the past, the Fed had maintained the stance that they are not contemplating negative rates and that they would prefer to use other monetary policy tools to provide further accommodation but opinions change as the facts change. There is also the argument that markets are putting pressure on the Fed to move towards that direction, while President Trump also indicated that this would be his preferred route, which makes us wonder if what was considered near impossible a few months ago is about to become the new norm.

### US ABS primary market wheels have begun to slowly turn

The Fed’s willingness to provide a price floor to US ABS markets with its announcement of TALF 2.0 on 23<sup>rd</sup> March had its intended psychological effect and allowed the primary market to re-open after a five week closure. New issue supply remained muted with only circa \$14 billion in total issuance, an amount less than 40% of usual volume. As anticipated, the first wave of transactions were dominated by vanilla sectors which did not need TALF support but there were also some sprinklings of non-generic deals including the first private student loan deal (although the collateral pool consists of high quality collateral). To the dismay of most, the much-awaited TALF FAQs released on May 13<sup>th</sup> did not specify a start date for the program but more importantly left unanswered a number of questions that both issuers and investors have that enable the readying of TALF deals. The market is still waiting with bated breath for the next round of clarity, but in the meantime observing whether the forward course from both a supply and spread compression perspective continues.

This document provides information about the Prytania Athena Fund ('Athena'), Galene Fund ('Galene'), Metreta Fund ('Metreta') and the services provided by Prytania Investment Advisors LLP ('the manager') as well as a general market update. Opinions, forward looking statements and projections expressed represent the views of the contributor at the time of preparation. The Manager does not accept any liability whether direct or indirect arising from the use of the information contained in this newsletter, which, to the knowledge of the Manager is reliable and accurate but cannot be guaranteed. The Manager is authorised and regulated by the Financial Conduct Authority ('FCA'). The Manager is registered as an Investment Advisor with the United States Securities and Exchange Commission. This document must not be construed as investment advice or offer to invest in any Prytania fund and has been provided to you solely for your information and may not be copied, reproduced, further distributed to any other person or published, in whole or in part for any purpose. Any other person receiving this document should not rely upon its content. This document is intended for use by Professional Clients, Eligible Counterparties and accredited investors, as defined under Regulation D of the United States Securities Act of 1933, as amended (the 'Securities Act') only. Past performance is not necessarily indicative of future results and nothing contained herein shall constitute any representation or warranty as to the future performance of the fund, any financial instrument or other market or economic measure. All returns are net of fees. Only year-end returns are audited. The representative and Paying Agent of the Athena and Galene Funds in Switzerland is REYL & Cie Ltd, with its registered office at 62, Rue du Rhône, CH-1204 Geneva. The distribution of Shares in Switzerland must exclusively be made to qualified investors. The place of performance and jurisdiction for Shares in the Fund distributed in Switzerland are at the registered office of the Representative.