Napier Park’s credit strategy claimed the top spot in the Creditflux 2020 HF rankings. The Napier Park strategy invests across the junior CLO space, leveraged loans and high yield.

Michael Micko, Partner and Head of European Credit, says the general strategy the team employ is focused on careful underwriting of individual credits and CLO structures but is tactical and opportunistic in nature and its strategies are not constrained.

Napier Park partly credits its 2020 high performance to early and active de-risking, raising cash and hedging pre-Covid. They began to buy and extract liquidity premium at the market bottom and captured multiple legs of the recovery by continually rotating into lagging assets as the recovery gained pace. The strategy also does not use leverage and was not under any pressure to sell assets at any time, instead it had ample liquidity to purchase from other forced sellers.

Napier Park was fully invested at the start of 2020, and preferred CLO mezzanine compared to the overly buoyant CLO equity market, Micko says, but they started actively selling single names credits and CLO mezzanine and equity early, as markets were initially ignoring the growing early signs of COVID risk, at least until liquidity dried up in early March.

Raising cash early gave Napier Park firepower to aggressively start buying dislocated CLO paper at the peak of the march sell-off which continued through the rest of the year.

“The bid-offer widened out dramatically for all asset classes,” says Micko. “At the peak, HY was down 20-25pts on average and lev loans were down around 20pts. But dislocation was most pronounced in CLOs; double Bs were down 30-40pts, single Bs 50-60pts, and equity maybe 30-40pts from lower starting cash prices.”

By April, Napier Park focused initially on double Bs but Micko says the key was picking the top quartile quality deals, adding that prices were homogenous across the quality range. The rebound in April and May driven by central banks and liquidity support meant Napier started to rotate out of double Bs and gain more exposure to single Bs and some selected CLO equity in order to capture a second leg of the dislocation.

“Strategy turnover for 2020 in our long positions was over 100%,” says Amit Sanghani, product managing director at the London-based team. “We traded over $1.65 billion across CLO equity and mezz in Europe alone, in addition to rotating the portfolios and selling around $600 million notional.”

CLOs continued to be attractive on a relative basis for the rest of the year. “Even though CLOs did start to rebound, the asset class lagged high yield and leveraged loans recovery,” Micko says.

Napier Park also partly credits performance with increasing hedging dramatically. In February, for example, the firm started placing individual shorts in travel related names like airlines and hotels as well and increasing existing hedges through liquid credit indices. It dramatically increased hedges in early March and crystallised most of the gains at the peak of the dislocation towards the end of the month, just at the time it began actively buying.

At the peak of the dislocation, Micko says he had confidence to begin buying by concluding, following a comprehensive name by name bottom up credit review the leveraged loan and high yield universe the team undertook, that the market dislocation was predominantly a liquidity disruption rather than a more permanent COVD disruption, as less than 18% of credits would be directly or meaningfully impacted. With 100% of underlying credits trading at distressed prices, on this basis the sell-off was in his opinion overdone.
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