Credit Hedge Fund Opportunities

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I wanted to make a quick blurb/ overview of the different pathways in the overarching credit space but also seek feedback and other thoughts from other guys in space - knowing full well plenty of things on my list are guesstimates, anecdotal, etc - and that I'm more coming from a place of trying to create an open discussion on all facets of these pathways, rather than a dictation of what I think.

I think this is more geared to middle to senior level professionals in the credit space, but open to thoughts from anyone else with insight or experience.

The genesis of this is a reflection back on my own career in addition to looking forward, seeing other guys in the space and their pathways (from junior to senior), and not purely in relation to a firm/ investment focused scope but also thinking about lifestyle, fulfillment, and purpose as well.

CLO Platforms

Investment strategy - Structure/ launch a CLO fund with fees from fund management and underlying percentage of CLO equity ownership, trying to beat variety of leverage loan / CLO benchmark indices

Availability of opportunities - A sub-set within the overall credit space, there's ~10-15 Tier 1 shops and a variety of 2nd/ 3rd tier opportunities (mostly NYC focused but believe there's other places sprinkled around in Chicago, Dallas, SF, etc)

Skillset - Fundamental medium-term to long-term credit analysis in publicly syndicated leveraged loans in the primary/ secondary space. Frankly, think given ~$95-par trading levels focus, generally less intensive and more of a focus on risk management, diversification + underlying financial and business quality

Market space - Tied to CLO issuance, leveraged finance capital markets, and LP appetite for investment strategy/ product, has been robust since the financial crisis, but general concerns around lack of covenants/ structural protections in market place.
Compensation - Jr Analyst - $100 - 300k. Sr Analyst - $300 - 500k. MD/ PM status - $500k - $1mm+. Generally, the structure I've personally seen is for each CLO vehicle or group of vehicles, the team will be split into sector/ subsector with a variety of Sr-Jr Analysts covering the sectors with 1 PM/ MD-role in charge of overall portfolio weighting/ management.

Job Security - Relatively more stable within the 'high finance' world, a function of longer-term capital base and a lower yield/ risk adverse underlying product

Lifestyle - More lifestyle-oriented, ~8am - 6/7pm seems to be the average?

Examples of Investment firms - GSO, CIFC, Ares, Fortress, Carlyle, Octagon, Voya (more Tier 1)

High Yield/ Investment Grade/ Leveraged Loan Long Only

Investment strategy - Fundamental long only with a short to long-term horizon in HY and Lev Loan space, generally diversified across sector coverage, trying to beat a variety of aggregate HY and LL indices and sector-specific HY / LL indices

Availability of opportunities - Tied to issuance and size of HY and Lev Loan market, has generally been robust since the financial crisis, although more outflows from HY relative to Lev Loans? General concerns around lack of covenants/ structural protections in market place.

Skillset - Fundamental medium-term to long-term credit analysis in publicly syndicated leveraged loans in the primary/ secondary space, similar to comments for Lev Loan space. HY generally has more volatility given more liquidity, unsecured/ junior status in the capital structure, and more opportunity for higher returns/ losses

Market space - Tied to leveraged finance capital markets - although HY is generally less tied to private sponsor activity and more general UoP/ standardized source of funding. LP appetite for investment strategy/ product, has been robust since the financial crisis, but general concerns around lack of covenants/ structural protections in market place (I think more of a concern with the lev loan space given that lev loan is generally thought of as a more highly protected/ lending product vs HY bonds, but structure drift of lev loans have brought them closer to HY)

Compensation - Frankly, I am less sure - think it depends on the firm/ investment strategy (vehicles under a credit multi-strat vs large investment managers vs investment arms of insurance/ pension/ endowment/ sov wealth funds vs etc). Curious to see if anyone has thoughts?

Lifestyle - I would guess that long-only vehicles under multi-strat credit HFs would have a similar lifestyle to their contemporaries under that umbrella and firm culture, thus more the ~60-80 hour work weeks (12 hrs M-Thurs, 10 on Fri, +0 - 10 hrs over the weekend)?. I have less of an idea, but I would venture that large investment managers and pension/endowment/ sov wealth funds would be more 8a-5pm type of lifestyle?

Examples of Investment firms - credit multi-strat HFs with specific long-only investment vehicles, separate accounts (ex. GSO, Canyon, GoldenTree..?), larger asset managers with direct investing credit groups (BlackRock, Fidelity, State Street, PIMCO), pension/ endowment/ insurance funds (Insurance - Allianz, Legal & General, MetLife, MassMutual; Pension - CPPIB, Texas Retirement System; Endowment - Harvard, Yale; Sovereign

Wealth - ADIA, China Investment Corp, GIC, Temasek, etc)

Special Situation/ Distressed / Opportunistic

Investment strategy - I think there's a variety of spectrums that fall under this umbrella, from (a) one end being investment in higher yielding/ opportunistic credits but typically non-default/ restructuring (i.e., higher yield + credit market price appreciation/ depreciation) with generally a more short-to-medium term horizon to (b) 'true distressed' with investment in out-of-court restructuring or pre-, during, and/ or post-reorganization (Ch 11 or 7) with investment framework as 'small' as a quick trade to a potentially multi-year, actively engaged/ managed workout plan with a potentially large equity/ re-organized capital structure ownership

Availability of opportunities - Given the multi-year bull cycle from the ~08-09 (with corrections here and there), there has not been a large scale plethora of distressed opportunities asides from sector-level movements (namely, energy in 2014-2016 but still continuing and retail). There is a thought there should be a much larger set of opportunities driven by the potential recession in 2020 - 2022, but that's subjective / up for debate. Overall, can be tougher to source opportunities relative to other investment frameworks, with many of the larger distressed stories (PCG, etc) being widely owned and fought after.

Skillset - Subjective take, but I think this is one of the hardest/ most complex - asides from understanding the same dynamics as other guys (fundamental analysis of company + sector, financial analysis of company, rel val analysis of credit + mkt, analysis of credit agreement/ governing docs), you have to deal with complex legal scenarios and if taking an active engaging role, there is a large element of scenario analysis, behavioral psychology, and cooperation in groups in creating value with your investment with competing alignments and incentives from multiple parties. Ultimately, I think it's fundamental analysis (typical market HF investor framework) + control-ownership and business 'change' analysis (more of a PE mindset than anything) + legal processes (lawyer perspective).

Market space - Tied to credit/ market cycles and default/ CCC-or-below downgrades as a % of total credit markets and generally comes in waves (2000-2001, 2007-2009, 2014-2016 were the last big cycles)?

Compensation - Reflective of the 'hardness' of the skillset and more of an ability to steer outcomes, generally a distressed fund will target a larger return profile more align with a PE fund (+20-30% IRRs, I'd assume) - and thus, compensation across all ranks would reflect that? From what I've seen, it more follows the typical PE title structure - (a) Associates/ 'associate level analyst' - $200 - 400k; (b) VPs - $400 - 600k; (c) D/ MD - $500k + ~$1/2mm - usually larger component is carry so pretty variable. I think a more 'higher yield'/ opportunistic fund would mirror the more typical market hours investment analyst structure/ compensation.

Lifestyle - Given the moving pieces in a restructuring/ etc and time-sensitive objectives (and from personal anecdotes), this will be more of a 'stressful' PE type of lifestyle - i.e., generally, M - Thurs, 9a to 9-11pm, Fri - 9a to 7pm, Sat & Sun - ~5-10 hours... but work will generally travel in cycles, i.e., a few months of terrible back-to-back weeks in relation to active work in investments, and a few months of easier weeks in relation to more passive processes in investments/ lack of active engagements.

Examples of Investment firms - Oaktree, Elliot, Silver Point, GSO, Baupost

Direct Lending

Investment strategy - Directly originate or otherwise source private lending opportunities with primarily middle market companies (who like size/ scale to access traditional leveraged finance or equity markets), build a portfolio of loans into an investment vehicle with a focus on par recovery and interest income.

Availability of opportunities - Direct origination or indirect sourcing through commercial bank/ investment bank relationships. Seems much more entrepreneurial and ad hoc relative to the more typically defined capital raising pathways in leveraged finance, DCM, or ECM

Skillset - More of a fundamental business and financial skillset, with a more entrepreneurial spirit (in dealing with private management teams, negotiated terms, etc).

Market space - Not sure what public data is there, but think private middle market lending space is there/ available... and not sure about competitive dynamics regarding private lending from an investment manager/ HF platform against typical commercial banking divisions. Growing amounts of capital have been deployed to this space since the recession and I believe at FY17, it surpassed the peaks in 07-08

Compensation - Frankly, unaware - think hierarchy structure is more similar to IB/ CB as far as analyst, associate, VP, MD, etc

Lifestyle - I would assume more lifestyle-oriented, so 9am - 7pm M-F thing? Unsure though

Examples of Investment firms - Ares, Centerbridge, THL, etc

Mezzanine & 'higher yielding' Private Credit

Investment strategy - Directly originate or otherwise source private lending opportunities with primarily middle market companies with structured preferred equity/ equity kicker component to increase overall return

Availability of opportunities - I think the middle market space is relatively open for these opportunities, although more of a niche/ complex source of capital relative to private debt/ lending and public debt and equities. Not too sure about origination, but given complexity and uniqueness of structure, would venture that it would be more direct origination.

Skillset - Blend of a direct lending analyst and private equity - need to understand downside scenarios, risk assessment, and credit agreements/ governance - but also valuation and growth upside

Market space - I think this space may be facing a squeeze given the inflow of capital into private debt funds with a lower return profile target - and on the other end by traditional PE

Compensation - Think closer to traditional PE, but with a haircut given lower return profile in general

Lifestyle - Would venture to think that it's generally M - Thurs, 9a to 9-11pm, Fri - 9a to 7pm, Sat & Sun - ~5-10 hours... but work will generally travel in cycles, i.e., a few months of terrible back-to-back weeks in relation to active work in investments, and a few months of easier weeks in relation to more passive processes in investments/ lack of active engagements.

Examples of Investment firms - HPS Investment Partners, GSO, Crescent Capital, etc

Other strategies - long/ short credit, BDCs, CDS/ rate/ etc-focused strategies?

Caveat -*these are just kind of generalized thoughts and guesstimates, I wanted to see if anyone else has thoughts, anecdotes, etc as well?*