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The funhouse mirror of CLO equity hedges

CLO equity cannot be directly hedged, so people are buying approximations and hoping for the best

Faye Kilburn

 @Fayekilburn

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NEED TO KNOW

- CLO equity tranches offer potentially huge gains, with crisis-era vintages beating comparable investments by hundreds of basis points.
- But they're not for the faint-hearted. Equity tranches can shed as much as 50% of their value in tough spells.
- Hedging them is challenging – they're non-linear and subject to high levels of idiosyncratic risk – and some think too costly.
- Mill Hill, a hedge fund invested in CLO equity since 2007, has cut its allocation right back. "Very few CLO equity tranches are properly hedgeable," says its CIO.
- Others are keeping faith, choosing the best among incomplete hedging solutions. "It's an art not a science," says one.

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