Kevin Farley

Episode 186: CLOs: a critical market to insurance investors

GUEST Q & A

Stewart: Welcome to another edition of the InsuranceAUM.com podcast. My name is Stewart Foley, I'll be your host. Welcome back. Thanks for joining us. It's great to be with you and I hope you're having a great day. We are joined today by Kevin Farley, Managing Director, Structured Credit Portfolio Manager at Post Advisory Group, a subsidiary of Principal Financial Group. Kevin, thanks for joining us. Thanks for being on.

Kevin: Stewart, thank you for having me. Excited about the discussion today.

Stewart: It's great. Today's topic is collateralized loan obligations (CLOs). I want to learn more about CLOs, and, hopefully, you can help me with some of the concepts that're not entirely clear to me, but I also want people to know a little bit about you, and Post Advisory Group, and all of that. But before we get going there, we start them off like this. Where did you grow up? What was your first job? Not the fancy one. And what makes insurance asset management so cool?

Kevin: Yeah. Well, I grew up in a small suburb of New York City, so in a small town called Upper Saddle River. Upper Saddle River is a town of about 2,500 families, very small. I think it's five square miles. We had one store in the town; it was called Elmer's, and nothing else. I think maybe one traffic light and one small store. Good place to grow up, was about 20 minutes outside of New York City so access to New York City, but a good place to go. My dad was in the banking industry so I watched him commute in and out of New York City.

As far as my first job, I would say high school, my first job was in landscaping. I worked for a landscape architect one summer. Really, really good job. We would take and transform backyards from a sloping mushy grass, poor drainage backyard into something beautiful and tiered and with good drainage. I think I learned the lessons of hard work, first and foremost, and then the transformation from an ugly backyard to something beautiful. There were a lot of rewards from that first job.

As far as insurance asset management, I would say one of the things I really appreciate about the insurance industry is the collegial nature. It seems to be a market where shared ideas and best practices are at the forefront and the paramount to the members there. You tend to get a group of people that work together and want to avoid losses, and I think that's a little bit different from your typical Wall Street investing community where there's a little bit more sharp-elbowedness and a little more competition that might not be as healthy as there is in the insurance space.

Stewart: Yeah. I think you bring up a great point. It's a small family. It's a community. A lot of people know each other, have for a long time. I think that people are genuinely willing to help each other to solve problems. I've been at this a long, long time, and I think the people are what makes this so cool. Thanks for that. Tell me a little bit about Post Advisory Group. Just so that our audience is aware of who you are, you're part of Principal Financial Group, but just specifically about your firm and a little bit about your background, and then I want to get into the CLO market.

Kevin: Sure, yeah. Post Advisory Group is a $15 billion asset manager*. We focus exclusively on the non-investment grade corporate space: high yield bonds, leveraged loans, and structured credit. We've been around for over 30 years.

We are owned by Principal Financial Group, as well as Nippon Life in Japan. Really, really good team. We're headquartered out in Los Angeles. I joined Post about 15 months ago, so newer to the team. Prior to that, I was at Wells Fargo running the secondary CLO trading desk, but I've spent my entire career in structured credit. Really in the early 2000s, I moved over from trading government agency bonds and moved over when the market was really in its infancy. There wasn't much of a developed secondary market in the CLO and structured credit space and started filling that void shortly thereafter. Yeah, I've been trading CLOs and structured credit for a lot longer than I think people realize the product has been around.

Stewart: Yeah. It's such a big and important market for the insurance industry. I guess my first question is relatively straightforward. How easy is it to invest in CLOs and is it a scalable opportunity in both the primary and secondary markets? The reason I think that's important is that insurance companies have always got to be somewhat mindful of the liquidity in these various markets. What can you tell us?

Kevin: That's a great question, Stewart. I think, historically, CLOs were always viewed as somewhat of a niche product and an outlier within the broader structured products universe. When we think about structured products, we think about agency mortgages, non-agency mortgages, CMBS, and ABS; CLOs always got lost in that mix. It was that piece of the pie that nobody really understood; nobody really thought was a scalable opportunity. When you look at CLOs today, it's now a trillion dollar asset class just in the U.S. There's another about $200 billion issued out of Europe. But just here in the U.S. alone, we've exceeded the trillion dollar mark, so I think we're beyond the point of saying we're a niche product any longer. It's one of the few asset classes where you can really scale a business in floating rate assets. Obviously, the underlying leveraged loans is one market; the other is CLOs. The majority of the fixed income universe is obviously fixed rates. In order to get floating rate exposure, CLOs and leveraged loans are probably two of the largest asset classes to do it.

When we look at what's happened in the last few years with the Fed hiking very, very aggressively from a zero rate policy to now north of 5%, floaters have become much more mainstream and much more of a focus in fixed income portfolios. I would tell you, the secondary market, when I first started, was very much a trade-by-appointment market. There were no broad markets put out by dealers. There was no real ability to just source paper through inventories or auction lists. It was a market that you had to work transactions, work orders. When people wanted to sell bonds, it often took weeks to move paper. It was not a market that you could just get in and out of very quickly. That market has changed dramatically. Year to date, there's been over $160 billion of secondary transactions in CLO product. That's according to the TRACE markets. TRACE has been a very, very good development for the market as we're now seeing a lot more of how much is actually moving day in and day out in both investment grade-rated tranches, as well as non-investment grade-rated tranches.

Unfortunately, CLOs are not TRACE eligible for price transparency, but you do get a very good idea of the volumes moving through the secondary markets. The other place where you can source paper is obviously a new issue. I think that's what most people view as the opportunity to source paper. This year, we just crossed the $100 billion dollar mark on issuance. That's significantly off 2021 when there was about $185 billion issued. We've seen a little bit of a pullback from the banking community. Mostly domestic banks have stepped back and have not been as aggressively adding to their portfolios. That's caused a little less demand on the top of the capital structure, which has led to lower issuance numbers in the last couple of years. Last year was around $130 billion of issuance. This year, we should finish around $110 billion, but $100 billion per annum is a pretty healthy place for CLOs to live.

When you get a little bit north of that, it starts to test the market as far as the ability and the technicals in order for market participants to absorb all the supply. A combination of secondary markets— around $200 billion of secondary trading where you can source paper, and new issue markets in the $100 billion to $110 billion of origination a year— you can amass pretty large portfolios quickly and scale the opportunity depending on what part of the capital structure you're looking to invest in.

Stewart: It's a really good point that you're making. I think it's worth noting. I mean, a lot of times, we talk about markets and we're generally tilted toward liquidity is not as good as it used to be, which is true in some of the investment grade (IG) markets. But to your point about the CLO market, liquidity is much better than it used to be. I've done this a long time, and I have maybe sometimes an antiquated view of a market. The way that I recall it isn't the way that it is today, and I think that that's true in a number of these markets. I guess it takes me to my next point or my next question. Can you talk about the major differences in the market, and, in particular, the deal structures that you're seeing today versus deals that were done pre-Great Financial Crisis (GFC), which is going back several years now, but I think it would be an interesting comparison?

Kevin: Yeah, absolutely. When we think about the CLO 1.0 universe, that was anything created 2007 and earlier, and really CLOs didn't get going until the late '90s, early 2000s. The market was a lot of high yield collateralized bond obligations (CBOs), a lot more fixed rate assets going into and less leveraged loans, and true CLOs going in. The market started to take hold in probably 2003- 2004; it's when issuance really picked up. Until about 2007- 2008, when obviously we had the GFC and the market froze, and issuance froze for a year or two, I remember being a secondary CLO trader thinking I am going to be trading AAA tranches which are basically going to be amortizing down, and that's about it. Anything that's going to be worth anything anymore, there'll be no more origination. I have these legacy transactions to trade, and I'm going to be out of a job. It was an interesting time to be in the market and really looking forward —the outlook was pretty darn bleak.

Stewart: Yeah. It's like you look up and it says, "This lane ends."

Kevin: Exactly.

Stewart: You're like, "This isn't good. I've got to merge somewhere. This isn't going to go well." I'm with you. I've been in that seat. I know what that's like.

Kevin: Somewhere in late 2011, 2012, the markets started to get going again. Markets had calmed down. I think there was a separation of what was wrong in the market in the 1.0 phase and what was right in the market in the 1.0 phase. What was right were CLOs, quite frankly. If we want to take a step back quickly and just say what is a CLO? When you look at it, you have floating rate assets sitting within a capital structure that's floating rate liabilities, match funded, no interest rate mismatch. A lot of the high yield CBOs had an interest rate mismatch and had to embed swaps into their transactions. Those swaps got very misaligned. Within a CLO, you have match funding, so you have a term funding. You have no forced selling within a CLO. I think that's a little bit of a misnomer as well. There were market value CLOs graded in the 1.0 phase, and a market value CLO had mark-to-market triggers that would often cause liquidations. Today's vehicles, there are no market value CLOs. These are all term transactions.

There is no forced selling within a CLO. I think that's a very important distinction between the 1.0 and 2.0, people think, "Oh well, if there's a lot of downgrades to CCC, suddenly you're going to be forced to sell as a CLO manager." That's not the case. You are not forced to sell anything within a CLO. Number two, I think the biggest change that happened in the market from 1.0 to 2.0, the rating agencies took a step back and they said, "Okay, these structures were too levered. You had 12 to 15 times levered transactions, let's take that down to 10 times leverage." If you look at your AAA-rated tranche, it historically had 25% par subordination or credit enhancement; two terms we use for your credit protection within a securitization. They moved that from 25% to 35%, so a 10% increase. Pretty funny when you think that no CLO 1.0 AAA or AA-rated tranche ever took a loss, yet they still said, "We're going to require more." They also reduced the amount of unsecured baskets. The original CLO 2.0, did not allow other CLO tranches within their CLOs.

It did not allow high yield bonds, second-lien loans. They were pure first-lien securitizations coming out of the 2.0 universe. We've since relaxed that a little bit where we're allowing somewhere between 5% to 10% of the underlying portfolio in unsecured risk, so whether that's high yield bonds or second-lien loans, but you can't put other securitizations within your securitizations, effectively creating mini collateralized debt obligations (CDO) squares. A pretty meaningful change in leverage multiples, portfolio composition, and restrictions within the tests. Collateral quality tests, diversification within these structures has increased. But yeah, I would say that the biggest change would be the par subordination for the tranches in order to rate out the debt tranches. We also had much longer reinvestment periods in the 1.0 phase. It was generally a seven-year reinvestment period that the manager had the ability to trade and manage prepayments within a portfolio. That's now limited to five years, so the transactions are shorter duration as well.

Stewart: What does par subordination mean?

Kevin: Par subordination is effectively your credit protection. If I'm a AAA holder and think of it from a loan-to-value (LTV) basis, I'm lending you 65 cents on the dollar as the AAA holder. My par subordination is that extra 35% of par. If I do a $500 million deal, I may have $350 million of AAA-rated notes or maybe $300 million of AAA-rated notes, I can withstand a significant amount of defaults before I take a loss. Let's talk about the AAA specifically because insurance companies are very active AAA buyers in the CLO market, have been for a long, long time, ever since the early 2000s all the way up until now. We're starting to see more and more insurance companies come into the market and look for CLOs as a good interest rate hedge in some of their fixed rate portfolios, as well as a good way to match their duration needs within their portfolios.

But if you think about a AAA-rated tranche, it's 65%. The historical recovery rate on senior secured leveraged loans is 70%. I always like to say if you default 100% of the underlying portfolio within a CLO and recover the market average, your AAA will still be made whole. Now, the historical default rate is around 2% to 3% per annum. Hopefully, we never see a day where we see 100% annual default rates within a CLO, but even on 100% default rate, recovering the market historical average, you'd be fully recovered on your AAA tranche. That credit subordination, that credit enhancement, is very, very valuable and that's how you get to your AAA rating. There's not a scenario the agencies can come up with where you would ever take a loss, either on interest or principal, on your AAA-rated tranche.

Stewart: That's really helpful. I understand that better now than I ever have. Thank you for that. Based on the conversations that I'm having both on air and off, it seems that there is an indication of some stress and more talk about the possibility of a recession hitting next year. Rates were up 400 or 500 basis points. There's floating rate assets, which are great, except for sometimes the underlying borrower can't pay the higher rates, which you're starting to see that in fixed coverage ratios in various spots. What are you expecting as a result of that? Do you see an uptick in losses or defaults in this market? You just talked about the amount of credit subordination, which is very helpful in that scenario, but is there anything else to add there?

Kevin: Yeah. Well, first, let's just start with a CLO. Currently, we're somewhere around 1.5% defaults in the high yield and leverage loan markets, 1.5% to 2%, which is still a little bit below the historic average. The historic average is 2.5% to 3%. We're not seeing the stress quite yet. At the start of 2023 most people were predicting the default rate to be around 3.5% to 4% at the end of 2023. We haven't seen that materialize yet. One of the things we are seeing, which does concern us, is liquidity within stressed credits. When an individual company misses earnings or forward guidance comes down significantly from what the market was projecting, we're seeing a vacuum of liquidity. Suddenly, a credit goes from, let's say, trading at 95 cents on the dollar down to 75 or 80 cents on the dollar, a very quick drop.

Historically, this is a par loan market. Loans have two options. They either default in some sort of distress exchange or they pay you at par. It's a loan. They need to pay you back, otherwise they're going into a workout situation. You generally don't see those kinds of moves. We're seeing more and more of that this year. While it's not widely a market move, even our forward distress signals are still in the 4% to 5% of these portfolios and are what's considered distressed. In the CLO market, we generally take anything pricing below 80, from a dollar price standpoint, and we use that as our projection for forward defaults. Most of these portfolios, if you look at the 2021 CLO issuance, most of those are on the 4% to 5% of the underlying portfolios trading in that sub-80 basket. The 2022 deals are probably 3% to 4%. The '23 vintages, are around 1%.

We're not seeing a lot of forward stress in our portfolios. Part of that was CLO managers were very proactive at reducing any exposures to the lower-rated credits. If you look at credits rated BBB/B-, they're one notch away from CCC. As I mentioned earlier, there's no forced liquidations of CCCs, but there are limitations once you exceed, let's say, a 7.5% exposure to CCCs. Managers were very proactive at trading out of the lower-rated credit in order to avoid that. That's helped them weather some of the weaker credits and some of the earnings misses that we've seen recently, specific to companies dealing with wage inflation, commodity inflation, and maybe a little bit slower consumer demand. They proactively traded the portfolios away from that. So far, not seeing a lot, but we do expect an uptick in 2024. To your point, you can't raise interest rates 400 basis points without having an impact on a levered company.

Stewart: Yeah, it makes total sense. It's interesting that as the CLO market has grown, the number of managers, not surprisingly in this market, have grown along with it. Why do you think there has been such an increase in market participants and how are you able to measure the performance of one manager versus others in a market like this?

Kevin: That's another really good question. I remember in, I think it was, 2014 when there was record issuance at the time, at $128 billion of issuance. I remember sitting down with three or four clients. We were just batting ideas and talking about different managers who we liked, who we thought was outperforming, who we thought may be underperformed. I remember the question being posed to the group was, "What was the ideal number of CLO managers? At what point is market saturation too high?" I think we went around the table and the average we came up with was 60. Looking today, we're about 130 broadly syndicated managers. When you look at the middle market space, there's another 40 managers. There's a little bit of overlap between some of those names, so call it between 150 to 160 of those managers, so well in excess of the 60 that we thought was probably needed within the CLO market. I guess the question is why. Why are there so many people coming into the CLO market as a CLO issuer?

I'll tell you, CLOs have always been an asset gathering game. It's a very, very scalable business. Let's say you're an insurance company and you have a credit investing arm, you have a team of analysts, you have a team of portfolio managers investing part of the insurance portfolio within corporate credit, CLO is a natural extension to that business. You don't have to hire new people, you might have to hire a CLO portfolio manager, who is well-versed with all the tests and compliance within a CLO and how to operate within a CLO. It's not a total rate or term vehicle, but it is very much a diversified portfolio with a set of rules that a CLO PM has to be very, very well-versed in. But effectively, you're leveraging what you already have with the team. If you have a team of credit analysts and credit PMs, you have the ability to go out and issue a CLO. It's a very scalable business, something that you can do very quickly without adding a lot of additional resources on top of it.

I think a combination of asset managers, insurance companies, private equity companies, hedge funds that are really looking to grow their asset management business, a lot of the private equity companies are looking for that stable recurring income stream that CLOs provide. They've also become, I would say, permanent capital vehicles— would be an accurate description of what a CLO has become. But starting in 2014, CLOs started to issue themselves, and then two years post their non-call period, they would do what was called a reset, a market reset. A market reset is effectively taking your existing transaction and extending the life of it. Rather than, let's say, we had a five-year reinvestment period originally, two years have rolled down, we've moved it now out three years, we're going to extend that out even further. These deals continue to get reset multiple times and have now become effectively permanent capital vehicles.

Stewart: That's super helpful and I really appreciate the education. There's something that's with the Dodd-Frank Act, the risk retention requirement, as I understand it, in 2018, was rolled back. It's not my world. I don't understand. It would be helpful if you could explain to me exactly what that risk retention requirement rollback was and is that good or bad for the CLO market?

Kevin: Effectively, what the risk retention requirement in Dodd-Frank's regulation was to say, "If you are an originator of assets and you're doing securitization, we want you to have skin in the game." They define skin in the game by being 5% of the transaction size. You could do that in a vertical slice or a horizontal slice. A horizontal slice is literally taking 5% of the lowest-rated tranche, so the equity tranche, so via the notional size, or you could do it 5% of each tranche, which is the vertical nature. But what they were trying to get away from was bad origination. When we think about the subprime lending world and what really caused the GFC, it was fraud mortgages. A lot of times, no income verification, no job verification, but fraud mortgages, and originators creating these mortgages to generate fees. They were trying to get away from that.

When you lump in an open market CLO, and, by open market CLO, I mean a CLO manager in the broadly syndicated space is not originating any collateral, they're going out in the new issue loan market and the secondary loan market and acquiring a portfolio. They are not an originator, they're an aggregator of assets. The open market CLOs as opposed to the middle market CLOs, which are truly originated, open market CLOs got lumped into that. From 2016 to 2018, Dodd-Frank required managers to effectively bring their own capital to the table and say, "You have to have skin in the game. If you want to manage a CLO, you have to bring some money to the table and align yourselves with your investors." That got repealed in 2018.

The big reason it got repealed is exactly what we're talking about. This is not an originator structure. This is an asset manager gathering assets. Effectively, all these managers who wanted to remain in the business in that time period went out and started raising funds so that they could buy the equity within their CLOs. In doing so, they attracted a lot of pension and endowment money that was never involved in the space, because pensions and endowments are not set up to buy CUSIPs. They're set up to buy and invest in more fund structures. It created that vehicle for pensions and endowments to come in and say, "You know what? This CLO manager, we'd like to align ourselves with. Their transaction history is very, very strong. Their performance history is very strong. This is something we want to invest in."

In a weird way, and I think that when Dodd-Frank's risk retention requirement got repealed in 2018, the CLO community applauded it and was very excited about that for good reason. But at the same time, it brought a whole new set of investors to the market, which has really helped to stabilize the CLO equity part of the market. CLO equity is 10 times levered risk. It is very levered risk to what's happening in global macro markets, as well as the high-yield space. When we have a wide move and a lot of volatility in the markets, CLO equity can be very whippy on a mark-to-market basis. That historically sat with hedge funds and very levered players. Now that most of the CLO equity getting originated today sits in much more stable hands and private equity drawdown style funds where you don't have as much concern with mark-to-market triggers.

Stewart: That's really helpful. I guess when I think about that, every time we talk about CLOs, you end up in a discussion about potential changes by the NEIC. Based on my understanding, the changes that have been discussed mainly affect the equity tranches that you just mentioned. Without going down the regulatory bunny hole, am I directionally correct there?

Kevin: Yeah. I would say that the non-investment grade tranches and the equity tranche. They're looking at materially increasing the capital requirements for holding either the equity tranche, the B-rated tranche, or the BB-rated tranche. Now, the good news is insurance companies predominantly have stopped at the BBB-rated tranche. We see participation AAA, AA, A, and BBB-rated tranches. We don't see a lot of insurance company participation in the BB-rated tranches. Where they got involved with equity tranches was in combo notes. Combo notes were some sort of strip of investment grade-rated tranches and equity put into one investment and got rated to principal-only. They got a principal-only rating and that was their combo note.

The equity component of the combo note was a way to increase the return for insurance companies. That's virtually gone away. I think the existing combo notes will stay in a legacy format. I don't think there'll be any forced selling or forced breakup of the combo note into the individual components, so it shouldn't be too impactful for the insurance industry, which is great. Like I say, from BBB and higher, there's very little proposed increase in the capital requirements on those tranches, so I think we're in a pretty good space in the insurance side.

Stewart: I really appreciate that. We keep hearing about growth in private credit and the cannibalization of larger BSLs, which stands for broadly syndicated loan market. What is driving this shift and are the private credit investors the same as the broadly syndicated investor base?

Kevin: Well, first, I would say kudos to whoever came up with the private credit moniker, because a lot more fun sounding than direct lending or middle market lending. I think private credit has got this panache about it and it's private, and, "I want to get into the club." This rebranding has really helped, I think, take this market from a very small component of the non-investment grade corporate market to, numbers I've heard, one and a half trillion dollars raised in private credit, so pretty substantial. Now, a lot of that has not been deployed as of yet, but there's a lot of dry powder sitting there waiting to capture some of the pullback maybe in the broadly syndicated space, as well as a material pullback from regional banks, as well as larger banks, as well, who've somewhat pulled back from the space because of their own capital challenges that they're going through. I'll say, historically, the middle market space, the direct lending space, the private credit space, whatever you want to call it, they've focused on issuers in the $5 million to $250 million revenues, so much smaller companies.

I think the attraction of the capital is, number one, you have one lender generally. When a company gets into trouble and they have to come back to the lender, they're not going to a group of 40 to 50 individual lenders in the broadly syndicated space that all have to come up with an agreement of what we're going to do in order to fix this situation. If you're a private lender and you're dealing one-on-one with a company, you can say, "Okay. We can inject more capital into your business, but this is what we're going to need to see." The negotiation to start with is much, much easier. What you give up when you go into the private credit space is liquidity. Because you're only dealing with one lender from both the issuer side as well as the investor side, there's not a lot of ability to move around and replace that capital, because these are very small companies generally and there's not a lot of public available information about these individual credits.

So, you're long, you hope you're not wrong. That's what we've seen in the private credit space. In the broadly syndicated space, obviously, if you have a view change on an individual credit, you can very easily, in a very liquid and efficient manner, move in and out of credit. There's a liquidity give up when you're moving into the private credit space.

The trade-off for that is you generally get a higher yielding asset. I think there's a combination of things happening here. There's number one, a little bit more yield. Number two, the lack of transparency and the daily mark-to-market, so to speak. There's a lot of investors that want to get away from that daily mark-to-market volatility. They want to know that, "Listen, if a company's getting in trouble and there's going to be a workout situation, we're made aware of that, but we are not marking it on a daily basis based on the whims and flows of this secondary market."

Stewart: That's super helpful. Last question, last official question. What's your market outlook for 2024? Just to wrap up a little bit, what are two, three takeaways that you want our audience to take with them from today's discussion?

Kevin: I think we talked a little about issuance, which has come down materially since 2021. I think we continue that into 2024. There's a lot of unknown in the market cycle and where we are— the economy. Do we have an increase in default rates? Do we not have an increase in fall rates? Nobody knows the answer to that. Obviously, as the Fed and today's CPI numbers came in much more benign than some market pundits were expecting, and the market is viewing that very, very favorably today. Rates are in 15 to 20 basis points. When we look at the market going forward, we don't know what's going to happen, but what we do know is it's going to be a credit pickers market. If you pick good credit and avoid losses within a CLO, you're going to do very, very well. But with volatility, the market generally pulls back and takes a pause. I think issuance, I think we're still going to be in that $100 to $110 billion of issuance next year.

When we look at the amount of CLOs that are in runoff mode, and by runoff mode, I mean they've exited their reinvestment period, they're starting to amortize down, that's a very large percentage of the market. We're expecting about $70 to $80 billion in market runoff in CLO product next year. If we issue $100 billion and we have $80 billion runoff, obviously not tremendous growth in the market. That's going to be a strong technical for the market, where managers who have exposure to CLOs and are now starting to get paid back on those exposures are looking to redeploy. That should provide a very, very strong technical bid for the market. I think spreads will be tighter from where we are today, especially in the AAA part of the curve. The AAA part of the curve is trading somewhere around swaps plus 170 to 180 basis points right now, so you're getting about a 6.5% yield to forward rates. I think when you look at that versus historicals, that's about the 87th percentile wides.

There's not a lot of markets where we're still at the 87th percentile wides. Spreads, I believe, will be tighter. I've been told many, many times, "Don't make predictions on spreads, because 9 times out of 10, you'll be proven wrong," but I do think spreads will move tighter over the balance of the next year. I think private credit will continue to grow. Historically, it had been about 10% to 11% of the outstanding market. This year, it's been about 20%. I could see 25% next year as there's more and more dry powder and capital available for the private credit space. That continues to grow. I think despite the fact that we've grown way past the 60 CLO managers that we thought was the right number and we're somewhere around 150, I think we're going to continue to see new entrants. Call it 5 to 6 new entrants to the CLO management space as well as more and more businesses try to scale their own credit businesses through the CLO vehicle. My final prediction was the New York Mets, I think they'll have a losing record next year as well.

Stewart: I love it.

Kevin: Because they always do.

Stewart: I love it. That's great. I've learned so much today, I really appreciate it. I've got a couple of fun ones for you at the door. What's the best piece of advice you've ever gotten, and who would you most like to have lunch with, alive or dead?

Kevin: Best piece of advice, I would say... I worked at Paine Webber in Hawaii.

Stewart: Me too.

Kevin: That was my first... You were there as well.

Stewart: I was.

Kevin: Oh, great.

Stewart: Yeah, that was part of my illustrious career early. Oh, yeah.

Kevin: Yeah. The House of Paine, we called it. I worked there from 1996 till the acquisition by UBS in 2001. There was a man, his name was Bob Pellegrino. He ran our American Stock Exchange floor operations. He once told me, he said, "Kevin, I've never lost an employee that I didn't want to lose." I just thought about that for a minute. What does that mean? "I never lost an employee that I didn't want to lose." It was just a very powerful message to take care of the people that are your best workers and that are loyal to you. Obviously, if somebody is not your best worker, sometimes it's better to move on and to start over. I thought that was just a good message, to really take care of the people that you value most within your organization. As far as who I'd like to have lunch with, I would say John Wooden. John Wooden.

Stewart: Wow, there you go.

Kevin: The Wizard of Westwood. One of the things I appreciate about John Wooden, I read a book about John Wooden, and one of the funniest stories I heard him say is that his first practice every season, so his freshman class would be coming in and you have all these big young strapping men, and they're like, "What is this oracle going to teach us today?" He's the greatest coach of all time. His first lesson and his first practice was, "This is how you put your socks on and this is how you tie your shoes. Because if you develop a blister, you can't play for me, so we got to take care of the little details before we get to the big details." I think from a leadership perspective, I don't think there was a better leader. Away from the basketball courts but just as a leader of men on the basketball court, I think John Wooden would be somebody that I could learn a lot from and have a great lunch with.

Stewart: Wow, that's great. I've really enjoyed this podcast, Kevin. Thanks for being on. Thanks for taking the time with us.

Kevin: Thanks for having me. I look forward to future conversations with you.

Stewart: Thank you. We've been joined today by Kevin Farley, Managing Director, Structured Credit Portfolio Manager at Post Advisory Group, a subsidiary of Principal Financial Group. Thanks for listening. If you have ideas for podcasts, please shoot me a note at podcast@insuranceaum.com. Please rate us, like us, and review us on Apple Podcast, Spotify, Google Play, Amazon, or wherever you listen to your favorite shows. My name's Stewart Foley, and this is the InsuranceAUM.com podcast.

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