Toro Limited

27 June 2016

Brexit impact on Toro Limited

The Portfolio Manager would like to share their first thoughts with Toro Limited ("Toro" or the "Company") investors as to the impact of the "Brexit" vote on the European ABS market and performance of the Toro portfolio, as well as the potential consequences of Brexit on the strategy.

Initial impact on the European ABS market and Toro performance

Following an initial sharp sell-off in risky assets, the European credit market rebounded as Friday morning progressed (iTraxx Xover retraced 50bps from the intra-day wide levels of 450bps). The European ABS market was rather calm and orderly with decent buying inquiries across the spectrum initially and no forced sellers in sight. Indeed, bottom fishers emerged and bids across the stack improved to clear on the following levels: UK non-conforming senior RMBS at a discount margin of 210bps (+50bps), BBB CLO 2.0 tranches traded at a discount margin of 475bps (+75bps) and Spanish high beta senior RMBS at a discount margin of 475bps (+100bps) just to name a few.

Therefore, benchmarking Toro's positions to these levels and extrapolating for other sectors, we would expect the Company's exposure to Public ABS to be marked down by 3% (gross estimate subject to revisions). Public ABS represented 61.7% of the NAV as at 31 May 2016.

On the Private Asset Backed Finance strategy, exposure to CLO warehouse will also be marginally marked down although offers on leveraged loans in performing high quality credits remained at or above par as there were few forced sellers and ample cash positions within recently printed CLOs.

Toro's large cash position (22%), low leverage ratio (78%) and hedging policy reflected a defensive positioning that we have been advocating for months, ahead of this binary event. Such mitigating factors are likely to offset the mark-to-market losses and Toro's NAV is expected to be marginally down month-to-date (-1% to 0%).

Consequences of Brexit on the strategy

Clearly, the capacity of the Portfolio Manager to assess the impact of Brexit is limited until a post-Brexit trajectory is agreed by the UK and the EU or at least proposed by the incoming Prime Minister. There is a lot of uncertainty ahead, but also some offsetting factors such as policy responses from central banks and political bodies in the UK and abroad that would dampen expected market volatility.

Brexit is likely to harm the UK economy first as both investments and consumption wane. A mild recession could be accompanied by falling real estate prices, increasing arrears and default rates affecting directly UK consumer ABS transactions. Exposure to UK assets in Toro (especially non-conforming and buy-to-let RMBS) was reduced significantly in Q1 2016. The Portfolio Manager has stress tested the remaining 6.5% of UK RMBS exposure and expects no losses under such a scenario. Indirect exposure to UK corporate through the CLOs is 2.2% and benefits from limited exposure to domestic consumer risk.

The overall European economy is also expected to be impacted and, although the current short term outlook remains benign and technically supported by the ECB's accommodative stance, the UK referendum could trigger further political instability in the EU. Therefore, the Portfolio Manager expects to continue to manage actively tail risk hedges. Both mortgage loan origination in Europe and Leveraged loans CLO formation are also likely to slowdown, potentially delaying the implementation of the origination strategy.

The increase degree of risk aversion in the market is also likely to last, as uncertainty from a Brexit should remain in place for an extended period of time given the complexity and duration of the process. A calm and opportunistic approach to investment, made possible by Toro's capital structure, should create better entry points both on liquid and illiquid assets as markets adjust to the new reality.

Enquiries:
Kirstie McLaren
Chenavari Investment Managers
Email: tlir@chenavari.com
Telephone: +44 207 259 3600