

# Stanfield gets back to basics

**Credit downturns are nothing new to Stanfield Capital – so it has been preparing for the coming default cycle for some time. By *Michael Peterson***

**S**tanfield Capital Partners is a credit manager that began life at the top of the market. Not the recent top of the market, but the one in the late 1990s: when credit spreads were falling, when default rates seemed set on a permanently low course and when high yield bond CBOs were all the rage.

Since then, the firm has seen another bull market for credit and two bear markets. The first bear market was the period from 2000 to 2002, when high-yield bond defaults surged, technology and telecom-related companies went bust in their hundreds and bond recoveries turned out to be much lower than anyone had expected. This experience may give Stanfield an edge over the many CLO managers who came to the market long after the technology-media-telecom bubble had burst.

It is easy to forget how desperate the credit market seemed at the beginning of this decade, when the big concern was fraud. “Now you are looking at companies and working out how they will survive an economic downturn,” says Stanfield portfolio manager David Frey. “Then, you were not even sure you could believe companies’ financial statements. It was frightening.”

One of the early lessons of that credit crunch was that high yield loans seem to perform much better than bonds issued by the same type of companies. That allowed loan specialists such as Stanfield to take over the corporate CDO market. “We were never big in high yield bonds,” says Stanfield’s chief executive Dan Baldwin. “Though we took

on some accounts with bond exposure, loans were always the asset class that we knew best.”

Stanfield was born in 1998 when Baldwin left Chancellor Capital along with Stephen Alfieri and Chris Jansen at the time of its acquisition by Invesco. Baldwin had run Chancellor’s high yield group since the 1980s, and Jansen and Alfieri came on board from Manufacturers Hanover when Chancellor became one of the first asset managers to start buying bank loans around 1990.

Chancellor launched the ROSA deal with Nomura in 1990, which is thought to be the first CLO. It had a 20% equity tranche and only 30% triple A liabilities. That is a far cry from the typical CLOs of this decade, with their leverage of 10-14 times – most of it in the form of triple A notes. “We may have come full circle and be heading back to those days of low leverage,” notes Baldwin. “We can certainly say that we have seen every combination of structures that can be used to enter this market.”

Alfieri, Baldwin and Jansen were the founding partners of Stanfield

Capital, which is based in New York. They launched a series of CDOs and other credit vehicles, and now manage \$4.65 billion of assets in total. All of the current deals are backed by loans, except Bishopsgate CDO, which is linked to investment grade corporate credit.

During 2007, Stanfield Capital sold its hedge fund business and also sold a subsidiary that managed a structured investment vehicle (SIV). That move turned out to be well-timed given the subsequent collapse of the SIV market.

That streamlining was part of a strategy of refocusing on Stanfield’s core loan-management skills and reflected the firm’s growing nervousness about credit valuations. “In early 2007 it felt like the market was ready to break,” says Jansen. “We became very defensive, and that has set us on a good path as we move into this new phase in the market.”

The company began to move up the credit spectrum, shifting from single B to double B rated names. “It meant we had to give up some spread,” says Jansen. “But we achieved much better fundamentals.” Stanfield reduced exposure to areas such as real estate and autos, switching into defensive sectors such as satellites and consumer staples. “We now have very solid portfolios of companies,” he adds.

The portfolios may be solid, but trading out of deteriorating names can be expensive – especially when managing a CLO, where losses are crystallised in a reduction of the deal’s overcollateralisation (OC) ratio. However, the firm’s philoso-



**“We were never big in high-yield bonds – loans are what we know best”**

*Dan Baldwin*

phy is to take the OC hit if it believes it should no longer own the credit.

Jansen gives the example of a real estate name, Ginn Resorts, in which Stanfield sold a large position last year when it was trading at 97.5%. That trade was costly in OC terms, but was the right call, since the company later got into serious difficulties and missed an interest payment in June of this year.

“If your only focus is on how you trade versus the OC test, you have probably made a lot of mistakes,” says Jansen. “Our credo is that we never want the structure to dictate how we manage the portfolio.”

Stanfield is also prepared to see a reduction in the diversity score of its deals rather than stay in sectors it doesn't like. “We never preached the virtues of diversity,” says Jansen. “And our diversity scores have gone down recently as we have moved out of some sectors.”

The firm's preference for trading out of deteriorating names early is typical of its approach. It is a trading specialist that prides itself on being on dealers' first-call lists, not a buy-and-hold investor with a big work-out function. “Crossing your fingers and hoping things improve is a recipe for seeing a portfolio get vaporised,” says Frey, who joined Stanfield in 2004 from Katonah Capital. “When you make a mistake you need to exit, take your lumps, and move on. That is why we make sure we understand every position in the portfolio.”



**“We never preached the virtues of diversity – and we have quit some sectors”**

*Chris Jansen*

## At a glance

**Name:** Stanfield Capital Partners

**Headquarters:** New York

**Assets under management:** \$5.4 billion

**Current deals:** Stanfield CLO, Stanfield/RMF Transatlantic CDO, Stanfield Carrera CLO, Stanfield Modena CLO, Stanfield Vantage CLO, Stanfield Bristol CLO, Stanfield Azure CLO, Stanfield Veyron CLO, Stanfield Daytona CLO, Stanfield McLaren CLO, Stanfield Arnage CLO, Bishopsgate CDO, Stanfield Structured Opportunity Fund

Monitoring and trading its credit portfolio is keeping Stanfield busy at a time when the prospects of raising new CLOs has shrunk to zero. One area where the firm sees the potential to increase assets under management is its separate account business. The firm manages around \$750 million through unleveraged managed accounts, for clients including a family office, a large financial institution in Asia, and a large reinsurer.

The firm sees this as an obvious way to provide its expertise in loans to a new set of clients. “We are first and foremost a loan manager,” says Baldwin. “Our back office and risk management are geared towards the leveraged loan product. It is an asset class quite unlike any other asset class out there in terms of accounting and settlement.”

The company has an 11-person credit research team, headed by veteran buy-side analysts with 10-30 years of experience. “One of our key tenets is that we do not just analyse leveraged loans,” says Frey. “We analyse credits from large cap companies down to small non-investment grade firms. That gives us ideas on industry trends and opportunities in the leveraged loan space.”

Stanfield has revised its view on how great losses will be in this credit

cycle. “Clearly, default rates are going to go up and recovery rates are going to come down,” says Baldwin. “Our projection is that high yield default rates overall in 2009 will be 7% based on companies' inability to refinance. We raised that projection from 4% because of the illiquidity of the market.”

That will make life hard for all CLO managers, even those that have moved into defensive sectors. But it also presents opportunities. “This has gone back to being a credit pickers' market,” says Frey. “This is a unique opportunity to put on relative value trades. Even in the period around 2001, it was not possible to do that, because you had TMT trading at distressed levels and everything else was up at 97 cents in the dollar. Now, with everything down to the 90s or lower, it is a portfolio managers' paradise.”

Frey adds that some of the best value at the moment is the crop of companies that have come to the loan market since the financial meltdown began, such as Weather Channel and Wrigleys. The firm believes there are also companies trading in the 80s and lower that offer the potential for price appreciation. But not everything at these levels is a screaming buy. “You have to be able to go through the loan agreements and understand what can happen to these companies,” says Frey. “If you do that, you can pick up well-structured deals from world class companies priced in the 80s.”



**“When you make a mistake you take your lumps and move on”**

*David Frey*