AXA Investment Managers

December 2023

AXA IM CLO Market Update

CLOs did not take part

CLOs took over

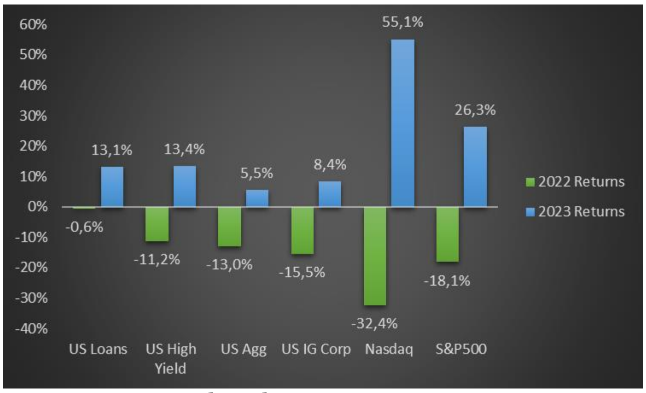
Dear Investors,

The anticipated economic downturn never materialized, and both the market and the economy successfully navigated the spring regional banking turmoil. Consequently, after the struggles of 2022, equity and fixed income returns turned to positive. High yield bonds and leveraged loans yielded double-digit returns, lagging equities but surpassing investment grade bonds.

Falling inflation dashed Fed's efforts to contain investor's expectations of a coming cutting cycle. Consequently, spreads tightened, and issuance accelerated, particularly in high yield bonds. In a noteworthy 4th quarter, bonds rally surpassed loans for the year. Within each asset class, high-beta assets led the way.

Most Equity indices delivered double-digit returns, the NASDAQ being the highest performer with its best year (+55.13%, including dividends). Treasury yields closed the year nearly unchanged, with the 10-years Treasury ending 2023 at 3.88%, the same level where it started.

2023 and its rising rate environment was a challenging year for the High Yield market. Most of the gains arise in the 4th quarter – the FTSE HY Index recorded its best quarter (+6.92%) since 2020. The Index closed the year up 13.54%, its best annual performance since 2019.



Source: AXA IM, Bloomberg

Primary CLO Markets

	End of 2023 (spread in bps)	YTD variation
US Primary CLO AAA	175	-53
US Primary CLO AA	243	-65
US Primary CLO A	283	-105
US Primary CLO BBB	463	-120
US Primary CLO BB	783	-148
EUR Primary CLO AAA	173	-50
EUR Primary CLO AA	278	-113
EUR Primary CLO A	375	-115
EUR Primary CLO BBB	525	-195
EUR Primary CLO BB	838	-213
EUR Primary CLO B	1088	-313

As usual, CLO issuances in December decreased. 27 US CLOs priced totalling $12bn (11-$4.9bn new issue, and 16-$7.1bn refi/reset), and 4 EUR CLOs totalling €1.5bn (2-€0.8bn new issues and 2-€0.7bn refi/reset).

In 2023, 324 US CLOs priced totalling $139bn and 75 EUR CLOs priced totalling €28bn slightly below 2022's figures of $152bn and €31.9bn. Private Credit/MM US CLOs share increased by 122% this year to reach a record volume of $31.2bn (with 67 CLOs issued).

The number of new entrants in both regions were significantly high with 9 newcomers in the US and 7 in Europe. On the contrary, big established platforms were less active this year waiting for better arbitrage to come. Only 5 US managers issued 5 CLOs or more this year, while there were 17 'serial CLO issuers' in 2022.

Reset/Refinancing activity resumed in the US around summer, after having been on pause for more than a year following the beginning of the Ukraine crisis. In Europe, very few have occurred yet. With more than 30% of US and EUR CLOs having reached the end of their reinvestment period by the end of 2023, we can expect Reset/Refinancing activity to accelerate in 2024.

Secondary CLO Markets

Trading volumes were surprisingly elevated for December in the US CLO market with a total of USD 18.2bn overall, including circa USD 5bn of BWIC supply (source: TRACE). In the context of a sharp tightening of the Credit indices over the course of the month (XOver/Main), US CLO tranches closed on a strong note as well: 12bps tighter on AAAs to 40bps on BBBs and 60bps on BBs. Most of the volumes were achieved in the first three weeks of the month, although a decent USD 300mm of bonds traded between Christmas and New Year eve, proof that the US market never really stops.

The picture in Europe was similar in terms of spread moves although quite different in terms of sheer traded volumes. All tranches saw a tightening bias in December, AAAs for instance moved from +160bps to +145bps; with recently issued transactions in the +180 context obviously showcasing outstanding returns in a very short period of time. Although market momentum was already on the path of compression, the tightening was amplified in reaction to the FED meeting held on December 13th as officials alluded to a rates policy pivot, thus triggering a surge of demand for risk. Total traded amount "only" stacked at EUR 0.5bn on the month which was in line with seasonal averages although much lower than what was observed in the US.

Leveraged Loan Markets

December secondary rally added to the already strong year of the Leverage Loan Markets

European primary remained strong in December with 13 deals issued, leading to a total volume for 2023 of around €78 billion compared with €37.4bn in 2022. €43.3bn of it were Amend-to-extend, the best way to address near-term maturity issue.

The US Loan market recorded a total issuance of $ 386bn for 2023, with $80bn of it from A&E activity. The size of the market, as proxied by the Morningstar/LSTA Index, shrunk by 1% in 2023 (the first time since 2010) due to a combination of a relatively quiet M&A/LBO pipeline and private credit gaining market share. We also saw significant bond-for-loan takeout activity as issuers opted for cheaper borrowing costs in high yield bonds.

Despite the rising rate environment, earnings uncertainty, and recessionary fears, leverage loans stood out as one of the biggest performers in 2023.

ELLI posted returns of 13.4% for 2023, in line with LSTA returns of 13.3% (the highest since 2009 and 2nd highest since the index's inception in 1997)

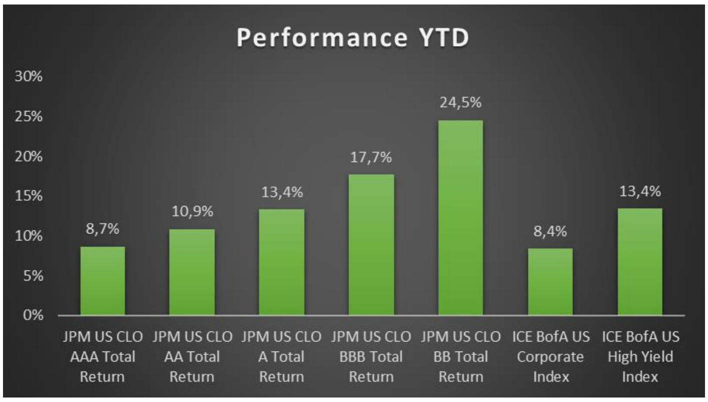
Similar to high yield, high-beta papers led the way, with the Tracker's CCC and Lower segment returning 16.9%, followed by B- at 15.4% and B at 15.2%. Second-lien loans also reached historic levels, returning 24.7%.

Loan valuations finished the year on a positive note too, with the average bid reaching 97.69 for LSTA and 96.07 for ELLI, respectively around 4 points and 5 points above January levels.

Performance and stategy

CLOs have returned outstanding performances in 2023, confirming their positions of best performers during the last 2 years.

The CLO debt stack posted total returns of 9-25%, helped by higher base rates and spread tightening. CLO single As and BBBs outperformed corporate IG, and BBs outperformed corporate HY on an excess return basis by a significant margin.



Source: AXA IM, JPM, Bofa

These performances were driven mainly by the elevated carry and floating rate nature of the assets (and partially by the spread tightening). CLOs are lagging the rally versus the rest of the credit market, and spread levels are still attractive in relative value (versus IG, HY and Loans), but also in absolute value (versus historical average). Spread tightening in 2024 should be the driver of future returns.

Japanese banks supported AAAs in the absence of US bank demand, insurance rotated out of BBB and below tranches, and hedge funds were the marginal bid for risk.

Demand for higher-rated CLOs should remain high in 2024. Japanese banks should still be there, but in a lower manner. US banks demand may return in 2024, especially given the proposed US bank capital regulations change.

Given the weaking environment (increasing defaults, increasing CCC buckets in US CLOs, high financing costs and refinancing pressure from elevated maturity wall) though, US insurances should also continue to switch their investments up in quality. As a result, we can expect a global CLO credit curve steepening (relative to ratings) in 2024.

Our view remains of a soft landing and a sluggish growth. This will be accompanied by a slow degradation of fundamentals, a progressive rise of defaults towards the historical average of 3.5-4% by the end of 2024 with lower recoveries, and a continuous decrease of margins and coverage ratios. We do not expect a jump in defaults as companies have managed quite well their maturity wall until today and they should be able to continue to do so.

Best regards,

Risk factors

The list of risk factors as shown below is not exhaustive. Each prospective investor should carefully read the portfolio's final prospectus or portfolio management agreement (as applicable) in its entirety, including any of its amendments or supplements.

Liquidity Risk	Low liquidity offered to investors during the life of the strategy.
CLO structure risk (leverage, maturity, subornation/rating migration)	CLO are designed as leveraged exposure to a portfolio of loans. Depending on the rating of the CLO debt tranche, level of leverage varies and thinness of the tranche varies. Reaching a certain level of default and loss post recovery in the underlying portfolio could trigger a downward rating migration and even losses at tranche level. The subordination of any class of CLO securities will affect their right to payment in relation to the more senior securities. Interruptions in payments to subordinated classes may occur. Following acceleration of CLO securities, payments of interest proceeds and principal proceeds from the CLO issuer's assets will generally be applied on a strict seniority basis. The investment in CLO have an expected maturity that may be shorter or longer depending on market conditions and portfolio management. Market conditions may affect CLO tranche maturity and spread when for example there is a refinancing.
Underlying loan exposure risks	CLO are exposed to performance of leveraged loans with inherent risks such as among other things default, recovery, prepayment, liquidity and interest rate risk.
Market Risk	The investments contemplated herein may at any time be subject to significant price movements, which will impact negatively the valuation of the Portfolio and may lead to the loss in case of redemption.
Performance Risk	The investment strategy's performance described herein may be lower than anticipated due notably but not limited to market drawdown, loss in underlying portfolio and forex impact.

Source: AXA IM

Disclaimer:

Not for Retail distribution: This document is intended exclusively for Professional, Institutional, Qualified or Wholesale Clients / Investors only, as defined by applicable local laws and regulation. Circulation must be restricted accordingly.

This document is for informational purposes only and does not constitute investment research or financial analysis relating to transactions in financial instruments as per MIF Directive (2014/65/EU), nor does it constitute on the part of AXA Investment Managers or its affiliated companies an offer to buy or sell any investments, products or services, and should not be considered as solicitation or investment, legal or tax advice, a recommendation for an investment strategy or a personalized recommendation to buy or sell securities.

Due to its simplification, this document is partial and opinions, estimates and forecasts herein are subjective and subject to change without notice. There are no guarantees forecasts made will come to pass. Data, figures, declarations, analysis, predictions, and other information in this document is provided based on our state of knowledge at the time of creation of this document. Whilst every care is taken, no representation or warranty (including liability towards third parties), express or implied, is made as to the accuracy, reliability or completeness of the information contained herein. Reliance upon information in this material is at the sole discretion of the recipient. This material does not contain enough information to support an investment decision.

Before making an investment, investors should read the relevant Prospectus and the Key Investor Information Document / scheme documents, which provide full product details including investment charges and risks. The information contained herein is not a substitute for those documents or for professional external advice.

The products or strategies discussed in this document may not be registered nor available in your jurisdiction. In particular units may not be offered, sold or delivered to U.S. Persons within the meaning of Regulation S of the U.S. Securities Act of 1933. The tax treatment relating to the holding, acquisition or disposal of shares or units in the fund depends on each investor's tax status or treatment and may be subject to change. Any potential investor is strongly encouraged to seek advice from its own tax advisors.

Past performance is not a guide to current or future performance, and any performance or return data displayed does not take into account commissions and costs incurred when issuing or redeeming units. References to league tables and awards are not an indicator of future performance or places in league tables or awards and should not be construed as an endorsement of any AXA IM company or their products or services. Please refer to the websites of the sponsors/issuers for information regarding the criteria on which the awards/ratings are based. The value of investments, and the income from them, can fall as well as rise and investors may not get back the amount originally invested. Exchange-rate fluctuations may also affect the value of their investment. Due to this and the initial charge that is usually made, an investment is not usually suitable as a short-term holding.

Information concerning portfolio holdings and sector allocation is subject to change and, unless otherwise noted herein, is representative of the target portfolio for the investment strategy described herein and does not reflect an actual account. The performance information shown herein reflects the performance of a composite of accounts that does not necessarily reflect the performance that any particular account investing in the same or similar securities may have had during the period. Actual portfolios may differ because of client-imposed investment restrictions, the timing of client investments and market, economic and individual company considerations. The holdings shown herein should not be considered a recommendation or solicitation to buy or sell any particular security, do not represent all of the securities purchased, sold or recommended for any particular advisory client, and in the aggregate may represent only a small percentage of an account's portfolio holdings.

Representative Accounts have been selected based on objective, non-performance-based criteria, including, but not limited to the size and the overall duration of the management of the account, the type of investment strategies and the asset selection procedures in place. Therefore, the results portrayed relate only to such accounts and are not indicative of the future performance of such accounts or other accounts, products and/or services described herein. In addition, these results may be similar to the applicable GIPS composite results, but they are not identical and are not being presented as such. Account performance will vary based upon the inception date of the account, restrictions on the account, along with other factors, and may not equal the performance of the representative accounts presented herein. The performance results for representative accounts are gross of all fees and do reflect the reinvestment of dividends or other earnings.

Issued by AXA INVESTMENT MANAGERS PARIS, a company incorporated under the laws of France, having its registered office located at Tour Majunga, 6 place de la Pyramide, 92800 Puteaux, registered with the Nanterre Trade and Companies Register under number 353 534 506, and a Portfolio Management Company, holder of AMF approval no. GP 92-08, issued on 7 April 1992. In other jurisdictions, this document is issued by AXA Investment Managers SA's affiliates in those countries.