Marketing Communication
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AXA IM CLO Market Update
For Professional Investors Only

Strong start for CLOs…

Volatility ahead?

Dear Investors,

FOMC, ECB, POTUS inauguration, ceasefire, DeepSeek, wildfires, tariffs… only one month in the new year and the barrage of news hit us like a comet from space. The hawkish statements from Chair Powell at the end of January dampened hopes for a rate cut this coming March and we now anticipate the easing cycle to resume in 2026. The decision to hold interest rates unchanged marked the FED's first pause since it started its easing process in September, despite the US economy missing expansion forecasts with readings coming in at 2.3% on an annual basis for Q4 2024, down from 3.1% in Q3.

In Europe, the eurozone economy stalled in the last quarter of 2024 with no growth to report despite anticipations of a 0.1pp expansion. Christine Lagarde did not surprise markets and delivered a well anticipated cut of 25 basis points on the three key ECB interest rates on the 30st of January. Although largely backed by the data divergence with the US, it is interesting to note the striking difference in terms of monetary path between the US and the European Union as we anticipate further cuts in the old continent.

In terms of politic headlines, Trump's administration started the new term with a bang, announcing series of tariff hikes on Canada, Mexico, China whilst preparing ground for a similar deployment towards European goods. Trump is looking for fair trade agreements and clearly signals to the world and his historical business partners that the US is ready to face a growing domestic inflation in order to achieve their ultimate goal. This is putting back in the spotlight the notion of Trump trades, while we largely anticipate volatility to pick-up as policies and new announcements are implemented.

Leverage Loan Markets

The start of the year saw a surge in secondary prices for US leveraged loans and a flurry of primary market activity as borrowers capitalized on favorable credit conditions. While opportunistic transactions remain prevalent, following the trend already observed in 2024, we noticed an increase in M&A activity. This development could potentially counterbalance the decrease in loan yields, which has been ongoing due to the sustained wave of repricing activity, if sustained.

In January, the Morningstar LSTA US Leveraged Loan Index increased by 0.69%, marking a rise from December's 0.57%. However, this growth fell slightly short of the 12-month trailing average of 0.72%. The New Issue market saw a significant surge and broke records with a total activity of $212 billion, which included $138 billion worth of Refinancings. Furthermore, issuance not linked to Repricings or Refinancing climbed to approximately $35 billion, making it the second-highest monthly volume in the past three years. Loans with higher ratings underperformed in January: Double-B rated loans had a total return of 0.66%, slightly lower than the 0.67% return for the single-B Loans, while CCC assets outperformed rising by 0.96% on the month.

The European leveraged loan market experienced a positive momentum in January as well, driven by a decrease in inflation worries which in turn fueled a greater appetite for risk. As a result, triple-C risk saw its best monthly performance in the past two years at 3.47% while the European Leveraged Loan Index retuned +0.99%. We believe that the persistent technical supply shortage, coupled with a significant proportion of facilities priced above par, creates favorable conditions for more loan repricings in the future.

In terms of Loan formation, issuers capitalized on strong demand, ongoing technical supply shortages and decreasing borrowing costs to refinance circa €9 billion of debt. This marks the most active start to a year for European loan refinancings on record, surpassing the previous high of €5.8 billion set in January 2024. It is also significantly above the average monthly volume of €2.6 billion over the past ten years.

CLO Primary Markets

CLO Primary markets started the new year on a relative slow pace, as we had largely predicted. The slow pace in terms of issuance volumes marked a striking contrast with the rapid tightening of CLO spreads, which broke through the 2.0 era tights from Q1 2018 in the US, on an adjusted LIBOR/SOFR basis.

In the US, we recorded 18 new issue transactions (USD 10bn), 32 Refinancings (USD 14bn) and 18 Resets (USD 18bn). New Issue volumes were down c.

20% compared to January 2024, while demand for bonds was exceptionally strong, especially from ETFs that gathered multi-billions of inflows.

In Europe, there were 7 New Issue transactions (EUR 3bn), 6 Resets (EUR 2.5bn) and no Refinancings. This translated into a c. 125% increase in terms of New Issue volumes Jan. 25 vs. Jan. 24. Many transactions from Q4 2024 were postponed before Christmas in anticipation of better issuance terms in 2025, that backlog eventually cleared in January.

The weighted average cost of capital was unsurprisingly tighter in both Europe and the US, driven by lower AAA spread: T1 US AAAs printed in the +135bps context in early December 2024 and achieved +113bps in the following month. We noticed a collapse in terms of Managers Tiering as well as the discount applied to Reset transactions vs. New Issue ones, which gave fuel – to some extent – to the tightening momentum.

We believe that New Issue deals offer higher protection than repackaged vintaged portfolios and that the later should offer investors some kind of spread compensation. The frenetic buying spree from January neglected that concept and took the opposite view.

In terms of CLO risk positioning, we noticed a slight decrease of CCC exposure in both US and European CLO collateral pools. The median CCC-rated assets exposure in US CLOs established at 4.8% end of Jan. 25, it was 3.8% in Euro CLOs. Loan Recovery rates, which we use to model transactions' cashflows and bond prices, continued to recover from local lows of Dec. 2023 and reached 62% in the US, significantly higher than Corporate Bonds ones at 48% (MS Research).

CLO Secondary Markets

In January, the European CLO market saw its BWIC supply rise to €723m, an increase of 18.5% over December. However, this figure remains 19% below November's levels. Notably, only AAAs experienced a decline, dropping 23% compared to December. This reduction in senior supply suggested that investors may have become slightly less inclined to offload their higher-rated investments, with the lowest duration. Spread data further strengthen this picture: for AAA notes, spreads tightened from 100–120bps in December to 90–105bps in January, signalling strong investor appetite for risk.

Tightening was also experienced across sub-investment grade ratings, particularly on BBs and single-Bs, reflecting a more favourable risk sentiment among investors toward these lower-rated instruments, on the back of decent underlying collateral performance.

The secondary US CLO market mirrored the dynamics from Europe: January saw total trading volumes of $15.1 bn, up 17.1% from December. BWIC activity also surged, reaching €5.6 bn — an increase of 55% compared to the previous month. The market's momentum picked up later in the month, with half of January's BWIC supply occurring in the final week. Supply was heavily concentrated in AAA CLOs, which accounted for 50% of total volumes.

Dealers ended January as net sellers across the entire capital structure, a sign of robust demand - likely driven by growing ETF inflows – and willingness to take some profits. Spreads tightened throughout the entire capital structure, with BB tranches compressing by 62bps to trade between 425 and 575bps, and BBB tranches narrowing by 35bps to a range of 230–300bps. This pronounced tightening among lower-rated tranches suggests a strong risk-on sentiment, with investors increasingly willing to chase higher-yielding assets amid renewed confidence in the U.S. economy, a sentiment that echoes the positive tone observed in December.

Performance & strategy

Over the past ten years, both US and European CLOs have proven to be a reliable source of income for portfolio managers. In fact, US CLOs outperformed and delivered returns 2-3x higher than traditional credit instruments (BofA Global Research). Even though US CLO spreads are close to their tightest when stripping out the LIBOR/SOFR basis, we believe they offer plenty value and should be pivotal to any multi-assets portfolio construction.

While European CLOs may currently offer slightly higher spreads, elements such as a stronger economy, low unemployment, decent GDP growth and the outlook for higher rates for longer are supportive to US investments. Lower growth forecasts in Europe and expected rate cuts from the ECB reinforce the view that downside risk may be on the rise in Europe, spreads may adjust slightly wider.

We also see 2025 as a favorable year to active portfolio management strategies. Trump tariffs and the potential trade wars arising from the US administration policies may induce periods of market volatility which we will see as entry-points. We note that the market rally in January was fueled by ETF inflows which may have a dual effect: while they lower the barrier to entry for new institutional investors, they also introduce a volatility element given the liquidity they offer to their investors. In that context and given that we see Secondary market levels much tighter than Primary levels on both an absolute and historical basis, we are happy to selectively take some profits.

Regarding CLO Equity investments, we saw decent sell volumes over the course of the month, mainly in lower tier & short profiles that have limited reinvestment optionality. January Equity distributions reached an average of 4.2% in Europe, with 2020/2021 vintages top performers due to their tight cost of debt. This level of distributions is historically high, although the tightening in asset prices will likely impact them going forward. In that risk bracket, we believe that our ability to invest in warehouses and drive the timing of the CLO execution brings a lot of value. This will remain the main axe of development for 2025.

The Secured Finance team

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

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