AXA IM CLO Market Update
For Professional Investors Only

After the Summer party
Time for rates Fall

Dear Investors,

On August 5th, global markets faced a sharp downturn, reminiscent of historic crashes. Triggered by a rate hike in Japan and concerns over a slowing US economy, major indices plummeted across the board.

Primarily, mounting fears of a US recession after a particularly weak July jobs report spurred investor anxiety. Non-farm payrolls increased by only 114,000 for the month, far below expectations and a drop from June's revised figures. This slower job growth, coupled with an unemployment rate rise to 4.3%—the highest since October 2021—heightened worries about the economic outlook.

Additionally, the unexpected increase in Japanese interest rates added to the market's volatility. The Bank of Japan's decision to raise rates by 15 basis points—to 0.25% from nearly zero—further disrupted the yen "carry trade" and added to market volatility.

This rate hike, coupled with the anticipation of cuts by the Federal Reserve, led to a stronger yen and market sell-off as traders faced margin calls. This confluence of factors underscored the depth of the market's sensitivity to both domestic and international economic signals, leading to widespread declines across major stock indices.

This event shows a partial resemblance to the infamous "Black Monday" of October 1987, when the S&P 500 and Nasdaq lost 20% and 11.5% in a single day, respectively. Instead, this was seen in Japan, as the Tokyo Nikkei 225 index suffered one of its worst single-day losses, closing over 12% lower.

In the US, the fallout was less severe, with the Dow Jones (DJIA) dropping by 2.6%, while the broader S&P 500 and the tech-focused Nasdaq declined by 3%.

Additionally, the Volatility Index (VIX), which gauges market volatility, rose dramatically. It surged from around 17 a week prior, to 23 on the preceding Friday, and then peaked above 65 on the 5th of August morning. By the close of trading, it had moderated to 38.6, its highest closing since 2020.

Despite the volatility, markets recovered quickly and retraced most of it within days.

In the US, the August employment report confirmed that the labour market is cooling, but job creation remains positive, and wage growth is strong, suggesting no major economic downturn is underway and leaving room for the still expected soft landing.

Federal Reserve Governor Waller, expressed his openness to larger rate cuts, suggesting the Fed could cuts rate aggressively and at every meeting if necessary. While it led the market to think of a potential 50bps, the consensus is now back to a first cut of 25bps in September. The pace of subsequent cuts will then be assessed in light of the "totality of the data" rather than solely through the narrower lens of labour market estimates.

On the ECB front, the 25bps cut is largely expected on Thursday 12th September, without much suspense. The focus will be on ECB President Christine Lagarde's forward guidance regarding the central bank's next steps.

Leverage Loan Markets

The European loan market finished August with a monthly positive return of 0.54% and a YTD return of 6.42% after recovering from a sharp early month decline amid equity volatility and macro-economic uncertainty.

August 5th saw a 1-day decline of 0.32% for the ELLI's market-value return. It was the worst daily return since October 2023. The drop wiped 29 bps off the index, sending the average bid to 97.61 and taking the ELLI back to levels seen at the start of July. However, the bid subsequently climbed steadily throughout the rest of August, to finish the month at 97.84.

Fortunately, this event came at the start of the European August holiday season – when a big chunk of market players are off desks – and trading volumes were therefore muted. Moreover, lower prices were an opportunity for ramping CLOs to step in. These factors helped mitigate the effects of the equity sell-off, which took the Nikkei down by 13% on August 5th, its worst session since 1987.

Furthermore, loans were technically well supported in Europe and quickly stabilized, with the ELLI recording subsequent market returns of 0.06% and 0.04% on Aug. 6th and Aug. 7th, respectively.

The primary European loan market took its customary pause for the summer break, with only one deal launching, making it the quietest August in three years. This followed a slump in total loan volume in July to €3.7 billion, from €15.4 billion in June (the busiest month of the year far). Despite the drop-off in activity, year-to-date loan issuance reached a chunky €70.8 billion through August, compared to just €25.5 billion for the first eight months of 2023.

The share of ELLI bid above par remained elevated, at 37.90%, its third highest reading since January 2020, which could point to more loan repricings in the autumn.

The percentage of ELLI constituents priced below 80 – a typical marker of distress – decreased to 6.1% at the end of August.

Default rate remains low at 0.78% by principal amount at the end of August.

On the US Loan market, this burst of volatility put a damper on new-issue loan volume in August, which is already a slow month. Gross volume tumbled to $26.3bn from $82.7bn in July and $42bn in August 2023, though the decline in the net total as compared with the prior month was modest, at $13.1bn in August versus $15.3bn in July, in large part due to the very limited repricing volume. As a comparable, Net issuance in August 2023 was up $8.3bn.

Within the same pattern than in Europe, the US secondary loan market experienced a strong volatility after the softer-than-expected jobs report spurred recession fears and the unwinding of the Japanese carry trade, though sentiment improved later in the month.

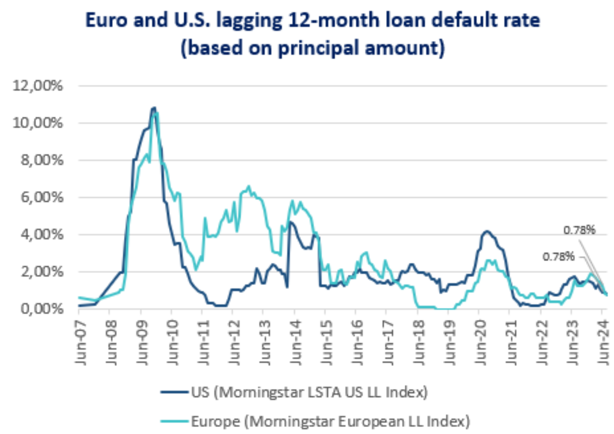
The average bid price of the Credit Suisse Leveraged Loan Index closed out the month at 95.69, down 3bps from 95.72 at the end of July, though well off the low of 95.12 touched on Aug. 5th.

The selling was felt more deeply in the US than in Europe, with the Morningstar LSTA US Leveraged Loan Index losing 0.55% on the 5th of August.

The CS Index posted a 0.6% return in August, down from 0.73% in July, and a year-to-date return of 5.78%.

As of August 31, the percentage of CS Loan Index bid at less than 80 was 9.4%, a tick higher than July's read of 9.3%.

With no new bankruptcy filings or interest payment misses, and with two issuers rolling off the trailing twelve-month calculation, the default rate by amount fell to 0.78%, from 0.92% in July.



CLO Primary Markets

August was torrid for the US CLO market with 33 New Issues for a total of $15.4bn, and 68 Reset/Refi for $30.4bn.
The tightest AAA level this month was at 135bps in a $755m US BSL CLO from Apollo, and the wide was 143bps for a less programmatic CLO Manager, Silver Rock.
Middle Market CLOs are still offering an average spread pick up of 30-35bps versus US BSL CLOs.

Year-to-date BSL new issue volume stands at 664 deals for $292.9bn, with 274 new issues for $128.8bn and 390 Reset/Refi for $164.1bn. This compares to 189 CLOs totaling $80.8bn at the same time last year.

Year-to-date MM new issue volume is running strong with 75 deals for $36.1bn, up 108% YoY. It represents 18% of YTD US CLO new issuance.

The weighted average cost of capital receded to 193bps YTD from 259bps a year earlier, which was driven by tighter weighted average AAA spread at 150bps from 197bps in 2023.

Despite its improvement, new issue BSL arbitrage is still not particular strong as the cost of debt is stubbornly high and loans are expensive. But market issuance remains high as market participants continue making the assumptions that they will be able to Refi/Reset these new issues later, which would increase the return of the transaction.

The European CLO market didn't get much holiday either as August was not the usual expected quiet month.
12 CLO priced totalling €4.5bn, comprising 6 new issues for €3.5bn and 6 Reset/Refi for €2.0bn.

Year-to-date, 116 CLOs have priced, totalling €46bn, with 77 new issues amounting to €32.7bn and 39 Reset/Refi amounting to €13.3bn. An increase of 105% versus 2023 at the same period.

The median S&P CCC bucket in the US is 6.3%. It is lower in Europe at 3.7%. The median junior OC is slightly above the US at 4.2%, and only 1.2% of deals are breaching their O/C tests in comparison to the 6.5% in the US.

In aggregate, US CLO ETFs have more than doubled the assets they manage this year, to more than $13bn, at the expense of mutual funds;

inflows drove half of the rise in AUM, asset appreciation the other half.

The strong demand from ETFs has driven holdings of US CLO triple-As across other asset managers to decline as net issuance of CLO AAA has been flat. ETF demand in the US side is driving secondary spreads tighter and is likely to persist in the mid-term.

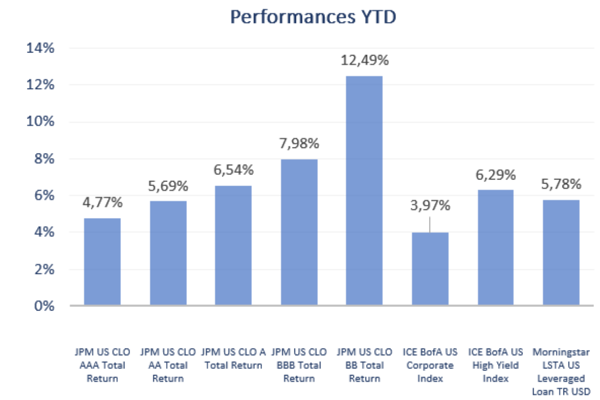
The success of CLO ETFs in the US had sparked speculation that it was only a matter of time before these ETFs cross the Atlantic. It has now materialized with Fair Oaks announcement of first European-domiciled CLO ETF. Fair Oaks ETF is expected to invest exclusively in AAA CLO tranches.

CLO Secondary Markets

August 2024 witnessed a more intense market activity than expected, largely influenced by volatile macroeconomic events. Similarly to broader markets, CLO secondary markets saw a surge in volatility accompanied with significant volumes on the week of August 5th. We saw €600m of EUR CLO and $1.2Bn USD CLO traded in BWIC, followed by a quieter period thereafter (€60m/week and $430m/week in BWIC over the rest of the month). Spread levels fluctuated, IG tranches widened by 15-20bp and Sub-IG ones by 30-50bps on the first week of August on both sides of the Atlantic. However, spreads quickly recovered back to end of July levels for all mezzanine tranches and 5bps wider on AAAs. The recovery in CLOs spreads from mid-august followed similar trends as credit markets (EUR HY credit indexes returned to pre-august levels despite a 70bp spike). But this recovery was also fuelled by a very light supply, with dealers struggling to replenish their inventory.

Performance & strategy

CLOs returns remain strong across the capital structure, with year-to-date returns of 4.77% to 12.49% from AAA tranche to BB tranche.



Source: Bloomberg as of August 31st, 2024

Debt tranches spreads remained globally in line with July's levels. Our view on positioning on the investment grade side hasn't changed, as all debt tranches are still offering both attractive absolute and relative value. EUR CLO AAAs (hedged to US) have been increasingly looking richer in comparison to US CLO AAAs over the course of the year, with a spread differential narrowing from 36bps at the start of 2024 to 17bps at the end of August. Secondary is looking cheaper on US AAA tranches, with a current spread basis between Primary and Secondary of 12bps versus 27bps 6 month ago. On EUR CLO tranches, the basis remains elevated with 23bps versus 28bps 6 month ago.

On the high yield front, B-rated tranches are still favoured over BB-rated tranches due to the higher convexity and the 250-300bps spread pick-up. EUR CLO BBs hedged to US are relatively much cheaper than US CLO BBs. From 126bps at the start of 2024 (YTD widest), it tightened to 27bps in early March, and is now at 115bps at the end of August. Regarding CLO Equity, we still strongly favour the combined investment Warehouse / Equity to benefit from the additional carry of the warehouse and the enhanced power of negotiation on CLO structure and price. Opportunistic purchases on secondary market are still contemplated, but with an even more stringent selection as dispersion across CLO Managers is growing due to increasing loan downgrades and higher CCC buckets.

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

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