Marketing Communication
March 2025

# AXA IM CLO Market Update

**For Professional Investors Only**

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

# Technicals

# As main driver of CLO performance

## Dear Investors,

In these dynamic times, recent shifts in both the American and European economic landscapes underscore emerging opportunities and challenges.

In the early days of President Trump's administration, markets experienced economic uncertainty. Announcements of prospective tariffs targeting nations such as Mexico, Canada, China – and industries including automotive, semiconductors, and pharmaceutical imports – triggered fresh concerns about growth and inflation. In parallel, jobless claims surged to the highest levels recorded this year amid rising job-cut announcements at federal agencies. The market reacted promptly: the yield on the US 10-year Treasury bond dropped sharply from 4.53% to 4.20%, and the S&P 500 declined by -1.42%. Investors have since been rotating from growth to value stocks and shifting focus from US equities to broader markets, with the NASDAQ falling by -2.81%, while indices like the HSI and Euro Stoxx 50 registered gains of +13.47% and +4.71% respectively through February. Notably, the momentum of early "Trump trades" appears to be subsiding.

In Europe, significant policy initiatives are underway. Germany's new Chancellor, Friedrich Merz of the CDU, is advocating a revision of the country's stringent "debt brake" law, which currently restricts public borrowing. The proposed reforms are designed to liberate greater public investment and expand defense spending, thereby positioning Germany for enhanced economic growth. Additionally, it seems the conflict in Ukraine may be nearing its end, a development that could further reshape the economic environment in Europe.

## Leverage Loan Markets

Loan repricing continued to dominate the European market in February, with secondary prices experiencing a strong rally. The Morningstar European Leveraged Loan Index saw a return of +0.74%, and the proportion of loans priced above par increased by 69%, reaching the highest level since February 2018. This was driven by robust CLO issuance, which kept the supply dynamics tight. Despite broader market volatility toward the end of the month, demand for leveraged assets remained resilient. Repricing was smoothly executed, often settling at or even tighter than initial guidance, before rising further after the break. Risk appetite also extended to lower-rated assets in February, with triple-C rated loans returning +3.17%, compared to +0.75% for single-B loans and +0.50% for double-B loans.

On the U.S. side, leveraged loan market sentiment soured amid tariff concerns, volatility in equity markets, and the potential effect of a less certain growth picture on borrower fundamentals. The share of index loans price at par or higher deflates to 36% from 66% on January 31. Nevertheless, refinancings remain the primary source of new supply. Then, there is new money with dividend recap transactions, add-on to finance acquisitions, or private credit borrowers now transitioning to the syndicated market. While market technicals remain imbalanced, the net supply shortage shrinks to a four-month low. Double-B loans outperformed in February as their secondary prices retreated less drastically than single-B loans.

In this context, most of the CLO managers are reluctant to add spread and/or build par from discounted loan purchases, preferring to decrease risk at current price levels instead. In terms of risk metrics, median CCC assets in CLO portfolios decreased to 4.6% in the U.S., to 3.7% in Europe.

## CLO Primary Markets

Both U.S. and European CLO primary markets continue to be active with interesting dynamics.

In the U.S., 2025 YTD has seen 56 new issue deals, 67 refinancings, and 79 resets, totalling \$28bn, \$27.9bn, and \$41.1bn, respectively. New issue volumes are down 16% year-over-year (vs. \$33.3bn issued in February 2024).

In Europe, 26 new issue deals printed YTD through February, along with 0 refinancings, and 11 resets, totalling €12.1bn, €0.0bn, and €4.8bn of issuance respectively. New issue volumes are up 122% year-over-year (vs. \$5.4bn issued in February 2024).

In the U.S., refi/reset activity outpaces new issuance. The record demand for ETFs AAA (~$7bn inflows YTD) which favour CLOs with short price to close periods was a key driver of that trend.

YTD, the net U.S. CLO supply picked-up but remains at a low level. It follows a year of weak net issuance level, supportive for the spread tightening of CLO debt tranches. We remind the CLO universe had aged significantly after several years of limited reset activity, with the percent of post-reinvestment (RP) period deals reaching a record 35%, and as a result, investors were being given cash back at record pace. Fortunately, the second half of 2024, we saw record new issuance, near record reset activity – and with the percent of post RP deals falling to 20% today.

Thanks to supportive technicals, the CLO spreads have pursued their compression trend. However, we start to see some push back from U.S. banks having other investment alternatives such as Agency CMO floaters, or Japanese banks rather contemplating the lagging European CLO AAA market. We think EUR CLO AAA at Euribor 3M + 120-125pbs and AA at Euribor 3M + 170-180pbs, still far from their historical tights, offer a good carry opportunity.

Looking ahead, we expect the supply/demand dynamic to become more balanced as the CLO pipeline build up through the year leading to CLO spreads evolving in a range, with some decompression in the near term.

It is noteworthy that the demand for CLO BB has been fierce, with continuous appetite from wealth management chasing the yielder debt tranches. It is frequent to see prints at base rate + 450-480bps spread for both U.S. and European papers. Historically, the credit spread component is at the tight end, and the spread basis between AAA-BB is also at an historical tight (~350bps vs. ~700bps two years ago). To us, the risk of widening has increased.

For those looking for yield, and income stream, CLO equity has continued to become more and more popular as the excess spread remains at an historical high level. We think looking at the prospect of locking in liabilities at potentially local minimums, and benefit from potential volatility in the loan market makes sense. Besides, the front-ended profile of the CLO equity with quarterly cash flows complements other alternative strategies such as PE with back-ended returns.

# CLO Secondary Markets

Compared to the same period last year, we saw less secondary activity, with a trading volume of $28.5 billion in the U.S., according to TRACE (-37% down), and approximately €8 billion in Europe, based on our estimates (-38% down).

This indicates a buyer's market, where investors are experiencing inflows and strong reinvestment demand, driven by prepayments from amortizing and called CLOs.

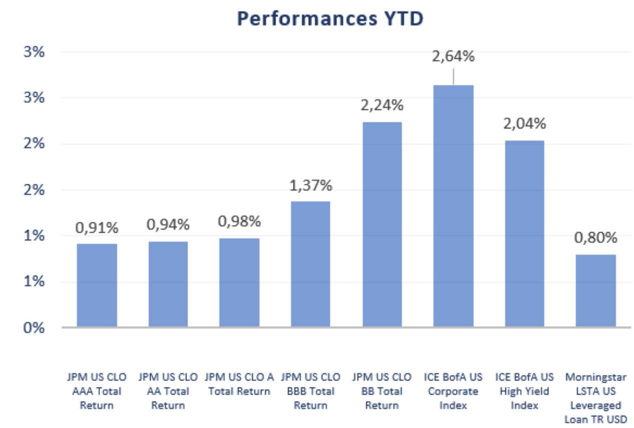
It is noteworthy that retail flows add liquidity to the CLO market. For instance, several weekly ETF AAA inflows exceeding $1bn pushed secondary spreads well inside those of the primary market. The maturity curve steepened with AAA prints at SOFR 3M+ 85bps in the secondary, compared to AAA prints at SOFR 3M+115pbs in the primary market.

In recent months, most CLO debt tranches in the secondary market have been trading at a premium. It is also common to see callable assets trading a few points above par.

For CLO equity, demand is firm as the default rate of leveraged loans stays low, attracting investors seeking mid-teen returns, discounted prices, or optionality through extension scenarios. Supply is coming from investors who clean or rotate their portfolios into longer dated equity with more optionality.

# Performance & strategy

Year-to-date CLOs returned solid performances. Fixed-income outperformed as growth headwinds quieted the hawks at the Fed.




Source: Bloomberg as of February 28th, 2025

We view CLOs as a strategic asset class in credit allocations, serving as diversifiers and offer excess returns compared to traditional corporate credit instruments for equivalent ratings.

Nowadays, facing a relatively flat CLO credit curve, and heightened decompression risk, we actively manage our mezzanine portfolios, underweight beta exposures, and focus on carry opportunities. Being agile across geographies, markets (primary/secondary), and ratings are for us key drivers to generate superior returns.

For our CLO equity funds, we appreciate the high cash-on-cash nature of CLO equity and its short duration profile. Our preferred route for CLO equity is in the primary market, where we can select the right manager, benefit from tighter CLO liabilities and source sizes to target mid-teens returns. We also explore the secondary market to optimize our funds.

Best regards,

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.<br>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.<br>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.