October 2023

AXA IM CLO Market Update

CLOs navigating choppy waters

Dear Investors,

October was an eventful month; the global markets have experienced significant volatility due to a combination of macroeconomic and geopolitical tensions. The risk-off sentiment prevailed, leading to decline in stocks markets, widening corporate credit spreads, and a sell-off in global bonds. Key factors contributing to these movements include strong economic data, particularly in the US, indicating a resilient economy, and rising sovereign yields, with US 10-year yields reaching almost 5.00%, German Bund close to 3%, UK 10-year yields at 4.55%, and JGB 10-year yield at 0.80%.

Geopolitical tensions remained high, especially in the Middle East, adding to market uncertainties. Despite this, market reactions were relatively contained, and political efforts were made to dampen escalation potential.

Economic indicators showed mixed signals, with the US economy displaying exceptional strength in the third quarter, marked by robust GDP growth, strong payrolls, and surging retail sales. China also reported stronger Q3 GDP growth, indicating a recovery in consumer activity. However, the Eurozone faced challenges, with stagnant growth prospects and fiscal concerns dominating the region.

Central banks' actions provided some relief to the markets. The Bank of Japan made marginal adjustments to its yield curve control settings and announced an unscheduled bond purchase program to curb rising yields. The Federal Reserve (Fed) and the Bank of England (BOE) both maintained their rates, with the Fed's pause considered dovish, signalling a focus on tightening financial conditions.

Recent economic data reflected the impacts of higher interest rates, with lower CPI numbers in the Eurozone and a contraction in Q3 growth outlook. In the US, the ISM manufacturing index fell in October, indicating a slowdown in the manufacturing sector. Then, unemployment rate climbed to 3.9%, and monthly wage growth slowed, thus US 10-year yields and EUR/USD cooled providing with a market relief for stocks, bonds, and credit.

Overall, there is a consensus that economic growth is slowing, and the impacts of central banks' tightening monetary policies are being felt. Company results in Q3 have confirmed this trend, leading to the belief that central banks have likely reached their terminal rates target.

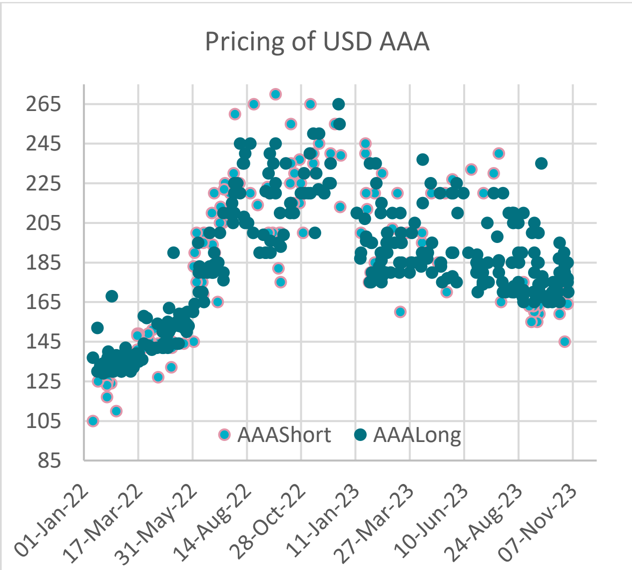
Primary CLO Markets

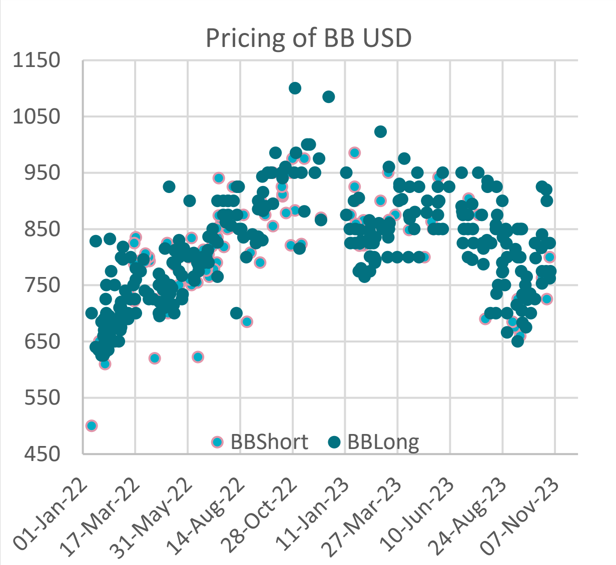
Issuances picked-up after Summer on both side of the Atlantic, but CLOs still lag last year's issuance pace. US broadly syndicated CLO new issuance (excluding refinancing transactions) decreased by 28% YoY to $75bn while EUR CLO issuances are catching up to last year's volume, trailing by only 4% at 23bn€.

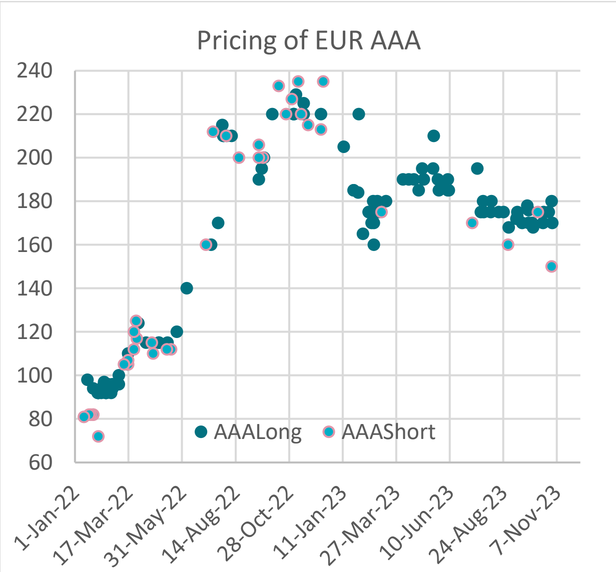
For US, private credit has a growing influence in corporate lending, particularly in middle-market CLO issuance. That was a focal point at the Miami summit. To illustrate that trend, private credit CLO issuance reached $19.4bn, approaching the 2021 record. There is no reason to stop as banks are getting some lending constraints and seasoned broadly syndicated CLO are struggling on their reinvestment tests.

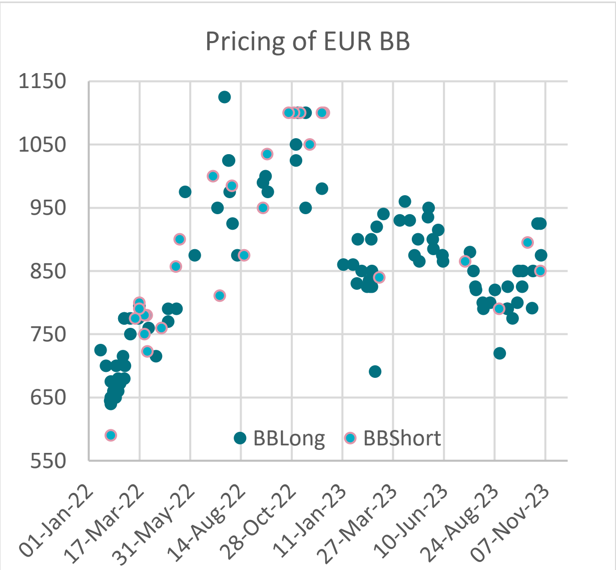
One catalyst for recent issuances was the rally observed for the CLO debt tranches, improving the CLO arbitrage. Some CLO warehouses were launched earlier when loan prices were much cheaper. Consequently, as CLO costs of liabilities decreased, it fuelled the CLO formation.

Despite the recent rally in CLO debt tranches, their spreads remain healthy from a historical perspective. Dynamics show some softness due to a heavy CLO primary calendar scheduled by year-end. This timing represents a good opportunity for medium and long-term investors. Tiering among managers is also changing, leading to attractive premiums on certain names.









Source: AXA IM, Pitchbook LCD, Bloomberg

Looking ahead to next year, as most CLO transactions will have exited their reinvestment period, prepayments will materialize, and investors will redeploy at least a portion, providing technical support for CLO spreads. Additionally, refinancing activity is trending upwards, starting with CLOs issued in 2022 at wider costs. We anticipate reaching $15 billion and 3 billion€ for US and Europe, respectively, this year.

Secondary CLO Markets

On European side, despite slight spread widening, investor sentiment remains positive amidst macro volatility. As primary activity continues at a strong pace, leading to varied pricing outcomes for different deals. AAA spreads have widened by around 10bps, while AA/As have softened by 15-30bps, reaching levels in the +M200s-300s and LM300s-L400s, respectively. There is notable interest in 2022 issued paper, especially in BBBs and BBs tranches, where higher credit enhancement levels and higher spreads attract demand. Equity payments have increased this month, reflecting a narrowing Euribor tenor basis.

On the US side, the action took place at IG part for 84.5% of the secondary trading volume. Spreads were not immune to market turbulence, but outperformed other traditional credit markets as the floating rate component helps.

This year, we continue to like the European market as the CLO debt tranches exhibit more convexity since the floating rate component is lower. And there is no surprise, the US investors are attracted and represents a large part of the EUR CLO investor base enhancing market liquidity due to their substantial demand.

Leverage Loan Markets

In October, the European leveraged finance market experienced a slowdown due to increased market volatility, causing a decline in fixed-rate high-yield bond supply. Consequently, loans took the lead, with a monthly volume of 7.28bn€ (or

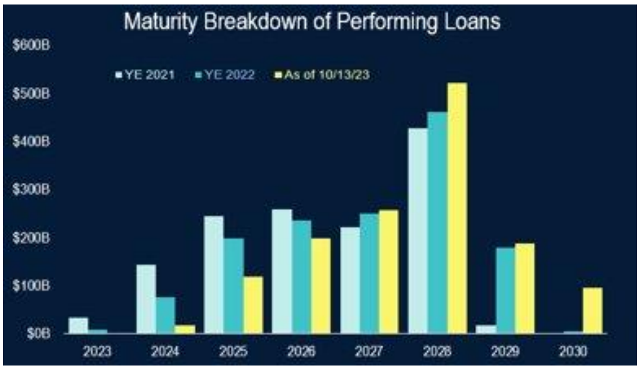
9.84bn€ including extensions). Year-to-date, the total volume reached 73.35bn€ euros, including 35.09bn€ in extensions, surpassing the high-yield bond volume of 36.54bn€. Pricing was influenced by a weaker secondary market, although the average new-issue spread and yield for euro-denominated, single-B loans narrowed slightly to E+445 and 9.02%, respectively, for the three months ending in October.

The trajectory of the Morningstar European Leveraged Loan Index (ELLI) exemplified this swift movement. After a summer rally, the average bid in the Index peaked at 96.69 in late September, only to drop to 95.02 by mid-October. Following a dovish stance from the Federal Reserve rate-setting meeting, the index rebounded strongly, closing at 95.39 on Wednesday.

In the US, new-issue volume in the leveraged loan market decreased to $22.2bn in October, down from the robust $38.6 billion in September. The composition of deals changed significantly, with LBO and M&A issuance dropping to $7.4bn in October, from $18.9 billion the previous month. LBO deals played a substantial role, with issuance plummeting to $1.2bn, from $11.7bn. The decline in refinancing volume was less dramatic in October, at $11.4bn, down from $15.3bn in the previous month and just below the 2023 monthly average through September of $11.8bn.

October's market turbulence, driven by increasing uncertainties in the geopolitical landscape, prolonged high-interest rate expectations, signals from the busy earnings season, and speeches from Fed officials, impacted leveraged loans. Despite their lowest return in five months (-0.02%), loans outperformed other major asset classes. They still maintain a year-to-date increase of 10.14%, potentially making 2023 one of the strongest years since the Global Financial Crisis. Additionally, loans significantly outperformed other major asset classes in October and continue to lead on a year-to-date basis.

Regarding forward guidance, issuers are facing challenges due to slower global economic growth and high interest expenses. While they have significantly benefited from inflation, allowing them to increase prices and margins, tougher liquidity conditions are expected to exert pressure. On a positive note, many issuers have effectively managed refinancing risks for short-dated maturity loans through refinancing and amend and extend activities, delaying the maturity wall from 2023-2025 to 2026-2028 in average. In this context, we anticipate default rates to rise but remain manageable, reaching 4% for the US and 3% for Europe. For example, Fitch recently revised its European Leveraged Loans default rates forecast downward to 3.0% from 4.5%. Since CLOs are actively managed portfolios, default rates within CLOs are expected to be lower than these broader market levels, projected at 3% for the US and 2% for Europe in 2024. To underscore the contained risks, the distressed ratio for the Morningstar LSTA US Leveraged Loan Index stands inside 5% at 4.36%, and the median CCC bucket for EUR CLOs is below 4% at 3.9% for S&P, 3.8% for Moody's.



Source : Pitchbook LCD

Performance and stategy

Performance-wise, CLOs deliver solid outcomes through the year outperforming traditional credit markets. Performances were driven by price appreciation and elevated carry improved by the floating rate component.

Nom court	%YTD
JPM CLO AAA Post TR Level	+7.07%
JPM CLO AA Post TR Level	+8.59%
JP Morgan CLOIE A	+10.52%
JPM CLO BBB Post TR Level	+12.57%
JPM CLO BB Post TR Level	+16.69%
JPM CLO B Post TR Level	+17.00%

Euro Corp	+3.58%
Euro High Yield	+6.97%
US Corp	+1.48%
US High Yield	+7.08%

In terms of portfolio management, after a strong rally emphasized by less supply during Summer, we took profits early September on high beta names and moved higher in rating and quality. As volatility rises and the primary calendar is packed by year-end, we are well positioned to rotate our portfolios and seize opportunities on the primary market at attractive levels for investors. We still bear in mind 40% of the CLOs exit their reinvestment period by year-end providing with prepayments to be reinvested next year for a large part adding technical support for the market. Besides, we believe CLOs offering attractive spreads in the credit market with structures designed to successfully navigate through cycles.

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:

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