AXA IM CLO Market Update
For Professional Investors Only

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REG ALERT! Tailwind for spreads?

Dear Investors,

The Federal Reserve adopted a more accommodative monetary policy stance in September, reducing the federal funds rate by 25 basis points to a target range of 4.00%–4.25%. This decision was driven by emerging signs of labor market softening and persistent inflationary pressures. The unemployment rate increased to 4.3%, while average monthly job creation declined to 29,000 in the third quarter, compared to 82,000 in the same period of the previous year. Wage growth remained modest, further indicating a deceleration in labour market dynamics.

Inflation continued to exceed the Federal Reserve's target, with core Personal Consumption Expenditures (PCE) inflation recorded at 2.7%. This was largely attributed to elevated goods prices and the impact of import tariffs. Nonetheless, economic growth surprised on the upside, with second-quarter GDP revised upward to 3.8% year-over-year, supported by robust consumer spending and a narrowing trade deficit.

October 2025

According to the Federal Reserve's Summary of Economic Projections, GDP growth for 2025 has been revised downward to 1.6%, with expectations of a gradual return to trend growth by 2028. Inflation is anticipated to converge toward the 2% target over the medium term, while the federal funds rate is projected to stabilize around 3.1% by 2028.

In Europe, the Eurozone economy remained subdued with GDP growth for 2025 projected at 1.2%. This represented a slight upward revision, reflecting stronger-than-expected performance in the first half of the year. However, growth remained uneven across member states, with volatility driven by trade policy adjustments and frontloaded economic activity, particularly in Ireland.

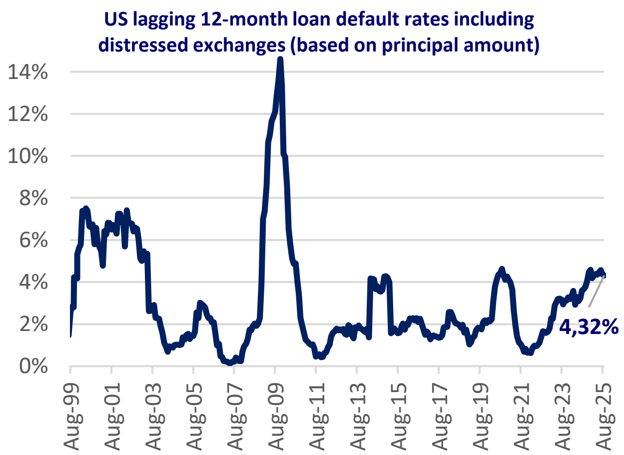
The European Central Bank (ECB) maintained its deposit rate at 2%, citing inflation levels near its medium-term objective and ongoing global uncertainties. The recent U.S.-EU trade agreement, which introduced 15% tariffs on European exports, exerted pressure on the external sector but contributed to a reduction in policy uncertainty.

Inflation remained close to 2%, with forecasts indicating a decline to 1.7% in 2026, followed by a rebound to 1.9% in 2027. Labor market remained resilient, with rising wages and employment expected to support domestic demand. Fiscal expansion, particularly in Germany, alongside easing financial conditions, is expected to underpin medium-term growth.

In summary, while the U.S. economy demonstrated resilience, the Eurozone continued to face some challenges.

Market(s) Update

The U.S. leveraged loan market experienced a notable resurgence in September, extending the positive trajectory observed throughout the third quarter. Market activity was predominantly driven by refinancing and repricing transactions, with new-money issuance comprising only 16% of total volume. Investor demand remained strong, underpinned by the Federal Reserve's recent interest rate reduction, which lowered financing costs and facilitated opportunistic borrowing.
Pricing conditions continued to tighten, with B-minus rated loans clearing in the S+360 basis points range, representing the narrowest spreads observed in recent years. Despite elevated issuance levels, net supply remained constrained, reflecting a measured approach by issuers amid ongoing macroeconomic uncertainty. Market participants anticipate a gradual increase in M&A-related issuance in the coming quarters, supported by sustained CLO formation and favorable technical conditions.
The Morningstar LSTA U.S. Leveraged Loan Index closed the month broadly unchanged at 97.10%, although valuations remained elevated, indicating a richly priced market environment. We continued to see decompression in terms of spread movement with higher rated assets outperforming lower rated ones. First Brands certainly contributed to the underperformance of that bracket of risk as the automotive aftermarket parts company saw a sharp drop in the value of its Loan following the probe from the US Department of Justice and ultimately its bankruptcy. This prompted investors to reassess exposure to specific sectors over concerns regarding the current softness in consumer and auto lending segment and may generally heighten sector tiering going forward.



Source: PitchBook Data, Inc., Sep 2025

In Europe, Loan markets remained stable demonstrating resilience in the face of geopolitical tensions and subdued M&A activity. Issuance was similarly dominated by refinancings and repricings, while demand from CLO managers continued to exceed available

supply, maintaining pressure on arbitrage dynamics.
The Morningstar European Leveraged Loan Index also concluded the month unchanged, trading around 97.00, approximately one point below the peak levels recorded in January.

The U.S. primary CLO market remained active throughout September, sustaining the positive momentum observed earlier in the year. Issuance was underpinned by stable loan market technicals and strong investor demand, driven in part by expectations of further monetary easing. AAA-rated tranches priced in the +120bps range, reflecting continued tightening in spreads and a healthy appetite for floating-rate instruments. While new issuance volumes were broadly consistent with third-quarter averages, the market was dominated by resets and refinancings, as managers sought to capitalize on favorable liability pricing and enhance arbitrage efficiency.

In Europe, issuance activity continued at a steady pace, with several new transactions successfully priced. Investment-grade spreads, particularly for AAA tranches, remained stable averaging around +130bps. Elevated volumes of refinancing and reset activity reflected ongoing portfolio optimization efforts and a strategic focus on maintaining flexibility for active management.

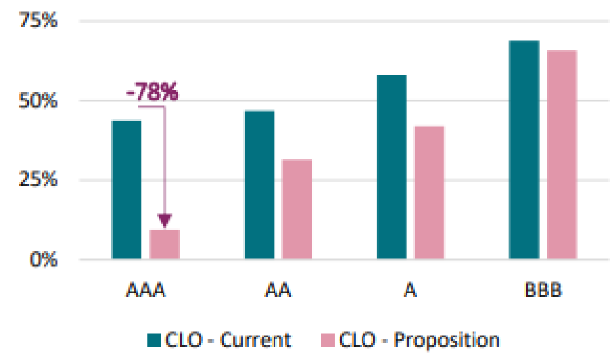
By month-end, secondary market dynamics began to evolve. Our Trading desk observed a certain decline in risk appetite, particularly for non-Investment Grade tranches. This shift was accompanied by a more cautious stance from major bank dealers, which increased bid/offer spreads and preferred to broker bonds instead of taking down the risk on their balance sheet. BB-rated tranches traded wider, moving from the 500bps range to mid-500s, while single-B tranches widened from the mid-700s to low-800s bps, indicating a recalibration of risk premiums.

Regulation Update

The European Commission has initiated a comprehensive reform of the EU securitisation framework aimed at streamlining regulation, enhancing market competitiveness, and improving the allocation of savings toward the real economy. The existing framework has been facing criticism for its overly conservative design, resulting in elevated capital and operational costs that have hindered market development.

Under the current Solvency II regime, disproportionately high capital charges have significantly constrained European insurers' participation in the securitisation market, in stark contrast to their U.S. counterparts. A recalibration down of regulatory treatments could potentially unlock up to €400 billion in additional demand from institutional investors.

Figure 1 : Capital charges for CLO *(3.5y dur.)*



Source: AXA IM Alts. Sept 2025.

For investors—particularly insurance companies operating under Solvency II—this reform could broaden their investable universe and include CLOs. For CLOs, classified as non-STS securitisation assets, the impact of a reduction in capital charges would be significant, although mainly impacting AAA, AA then A-rated tranches. That being said, tighter senior spreads will reduce the overall cost of the CLO liabilities and impact arbitrage, CLO formation and market dynamics. As such, AAA-rated CLOs would see a 78% capital charge reduction. We invite you to look at the document we published earlier this month; it includes a full breakdown of the proposals and study cases.

[Revitalising EU Securitisation: a holistic review of the EU Securitisation Framework | AXA IM Alts]

Performance & strategy

Whenever rate policy shifts are being implemented, floating-rate instruments inevitably come in focus. In the context of the current rate-cutting cycle, the picture becomes nuanced.

On one hand, fundamentals for issuers are poised to strengthen. Lower benchmark rates ease debt servicing burdens, improving interest coverage ratios and reducing default risk, particularly for loan-only capital structures. This environment supports credit quality and could extend the maturity runway for many borrowers.

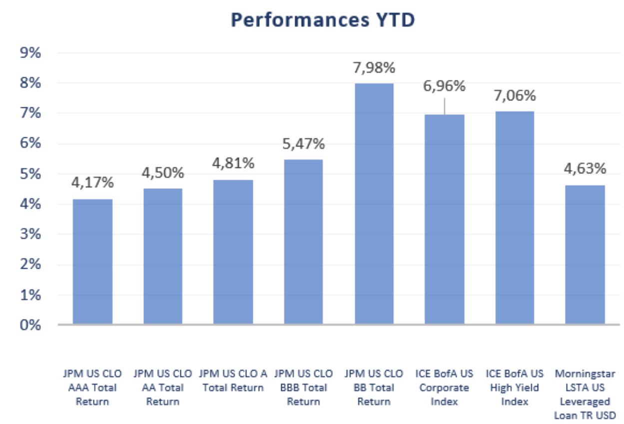
On the other hand, falling rates compress total returns for investors. Since leveraged loans and CLOs are tied to floating benchmarks, their yield advantage diminishes as rates decline. This can dampen demand from rate-sensitive investors, especially those seeking income-driven strategies.

However, the market isn't one-dimensional, and CLO issuance has remained robust, providing structural support to demand. Additionally, non-traditional buyers are stepping in, drawn by relative value as loan yields continue to outpace comparable bonds even in a declining rate environment. The real wildcard lies in supply dynamics. If rate cuts spark a resurgence in M&A and LBO activity, net supply could rise sharply. That influx, especially if it shifts away from refinancings toward new issuance, might outpace demand and pressure secondary market valuations. In short, while rate cuts may bolster credit fundamentals, they also introduce return compression and supply-demand imbalances. Navigating this cycle will require a sharp eye on issuers' performance, deal flow momentum and investors' behavioural patterns.

Issuers in the broadly syndicated loan market (BSL) are already seeing improved fundamentals following the Federal Reserve's rate cuts that began in September 2024. By Q2 2025, the median interest coverage ratio for BSL issuers rose to c. 2.0x (unadjusted EBITDA) and c. 2.5x (adjusted EBITDA), up from c. 1.7x and c. 2.3x at year-end 2023. The riskiest segment of the market—loans with ICRs below 1x—has shrunk and is expected to continue declining if rate expectations hold, contributing to falling default rates. However, as mentioned above, lower base rates may reduce the yield appeal of BSLs, posing risks to demand. While CLO issuance may remain strong, other demand sources—particularly retail investors—could be more sensitive to declining yields. Non-traditional investors, such as high-yield mutual funds, have been increasing their exposure to BSLs, attracted by all-in yields that continued to outperform bonds on a ratings-adjusted basis. A drop in Loan yields could reverse that recent trend and provide room for wider pricing in the BSL market, a move that the CLO buyer base would actually welcome given the current tight arbitrage conditions.

Another potential risk to valuations could come from a surge in net supply, driven by renewed LBO and M&A activity. As modelled internal rates of return (IRRs) improve under a dovish rate outlook (simply speaking, it is cheaper to finance these types of transactions when rates are lower), deal flow shall increase. If new issuance accelerates and eventually outpaces demand, declines in secondary market valuations should take place.

The next question becomes invariably the effects of such changes in Loans dynamics on the CLO markets. The most obvious impact is that when rates do go down, so does the overall income captured by investors when holding floating-rate notes. We recently went through this cycle in Europe and did not necessarily establish a strong connection between reduced all-in CLO yields and CLO outflows. As benchmark rates went down, spreads tightened: improved macro-outlook and the avoidance of a hard lending recession type of scenario actually proved extremely supportive for Credit.



Source: Bloomberg as of Sep, 2025

In terms of spread direction, our anticipation is that lower all-in yields should impact significant

CLO players such as Insurance companies (historically matching maturities and levels) as well as cross assets investors and ETF, which are traditionally driven by relative value. We do see positives counter-balancing the arguments developed above though, mainly from the regulation angle. Looking at the drivers of demand from Asian investors, Fed cuts coupled with BoJ hikes will render hedging costs more efficient and could also bolster demand from that side of the planet.

Looking at CLO Equity tranches, the first benefit we see to rate cuts is improved CLO metrics, namely lower WARFs, lower CCC buckets, lower bond buckets, increased margins on Interest Coverage tests as well as Overcollateralization tests. In terms of price direction for that particular side of the CLO structure, our view is that lower rates offer lots of opportunities. Firstly, if rate cuts trigger a spurt in Loan New Issuance, we believe that increased Loan supply will provide CLO managers more options to efficiently turn the risk on their portfolios at lower prices and build par. Secondly, tail risk may see a repricing up and therefore support NAVs. On the micro front, CLO Equity distributions reached c.4% and 5% respectively in the US and Europe in H1 2025, then steadily reduced. We continue to believe that one's ability to invest in warehouses and drive the timing of the CLO execution brings a lot of value and will generate strong income going forward. Timing the entry point is key to successfully investing in CLO Equity and warehouse facilities do provide a platform that enable investors to play the volatility and hit Go when the economics are optimum.

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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