COLLATERALIZED LOAN OBLIGATIONS

CLO Monthly Monitor
September 2024

• CLOs delivered strong returns across the capital stack, with mezzanine tranches experiencing significant tightening.

Loan Market Review

• The CS Leveraged Loan Index returned 0.73% in September, which provided steady gains throughout the month. Notably, the long-anticipated first Federal Reserve rate cut occurred during the month, reducing the Fed Funds rate by a meaningful 50bps.

• While the direct impact of lower rates on loan issuers' interest burdens may take time to materialize, the near-term outlook for easing boosted the loan asset class, leading to a return of 2.08% for the quarter. However, the duration-related benefits for fixed-rate corporate bonds led to higher returns for Investment Grade (5.84%) and High Yield (5.28%) bonds.

• Lower reference rates stimulated activity in the primary loan market. Institutional loan issuance rebounded in September, reaching $73bn after a slower August. While the majority of issuance was driven by refinancing and repricing, LBO and M&A-related issuance totaled $47.9bn, the highest since January 2022. Excluding repricing activity, new issuance for the quarter was $114bn.

• CLO issuance remained robust at $11.9bn in September, marking the ninth consecutive month of issuance above $10bn in 2024. Retail fund outflows slowed from August, with $1.1bn leaving the asset class in September.

• Sector performance was positive across all 20 industries. Leading sectors included Media/Telecom (1.44%), Housing (1.01%), and Retail (0.99%), while Food/Tobacco (0.02%), Aerospace (0.09%), and Transportation (0.30%) underperformed.

• Performance by rating favored lower credit quality CCC and Distressed loans (CC & Below). Despite distressed loans returning 3.68% in September, distressed loans have significantly trailed the rest of the index year-to-date, returning -13.4%. The breakdown of returns by rating was as follows: BB (0.46%), B (0.66%), CCC (2.10%), and CC & Below (-13.44%).

• There were four loan issuer default in September (Digital Media Solutions, Mavenir Systems, American Rock Salt, and Polar US Borrower) affecting $2.1bn in loans outstanding. Despite the moderate uptick in default volume, the trailing 12-month default rate increased 10bps to 1.28%. However, when including rising distressed exchange activity, the 12-month default rate ended the month higher at 3.80%.

CLO Market Review

• CLO tranches delivered strong total returns in September, with the JP Morgan CLOIE Index reporting returns of 0.59% (AAA), 0.65% (AA), 0.69% (A), 0.97% (BBB), 1.55% (BB), and 2.05% (B).

• New CLO origination was $11.9bn in September, totaling $40.6bn of issuance in the third quarter. Although the pace of issuance has slowed since June, 2024 remains roughly $10bn ahead of the record pace set in 2021. Issuance year-to-date has originated from 281 deals by 109 managers (Source: LCD Research).

• As spreads tightened throughout 2024, with AAA spreads narrowing by 40bps, managers have increasingly shifted focus from new issuances to resets and refinancings. This shift has driven $198.2bn in reset and refinance activity this year. There has been a record total of $138.6bn in resets across 286 deals (Source: LCD Research).

• CLO ETFs, while still a small portion of the $1 trillion CLO market, have grown significantly in size and popularity, offering retail investors access to a market that was previously out of reach. Assets under management (AUM) for CLO ETFs have surpassed $15bn, with the number of available fund options increasing to 15. In September alone, there were three new CLO ETFs launched, two dedicated to AAA CLOs and one focused on mezzanine tranches.

• The recent uptick in LBO and M&A leveraged loan volume has been beneficial to CLO creation, as limited net new issuance earlier in the year had narrowed the selection of high-quality loans available to ramping warehouses.

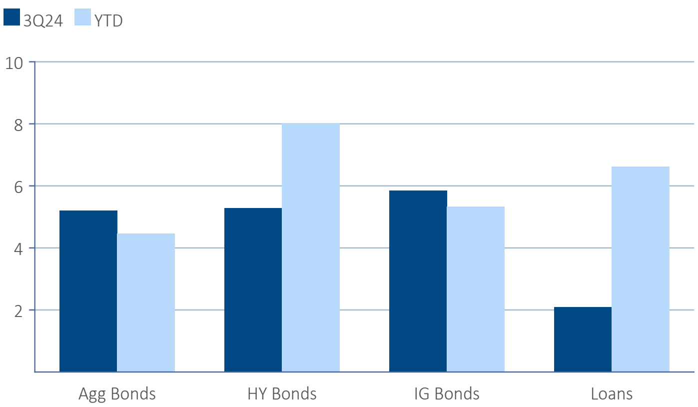
• With earnings through June 2024 released, loan issuers saw both revenues and EBITDA expand quarter-over-quarter at the fastest rate in two years. Interest coverage has declined to its lowest level since 2020, but further erosion is unlikely due to the anticipated additional Fed rate cuts and ongoing repricing wave.

• Despite U.S. Corporate and U.S. High Yield bond returns surging, CLO debt at each credit quality rating has continued to outperform year-to-date. Although fixed rate bonds have chipped away at the performance differential recently, CLO outperformance across ratings have ranged from 163 bps (AAA) to 742bps (BB). Strong technical dynamics within the CLO asset class, characterized by limited net new issuance and steady performance from the underlying collateral pools, are expected to support prices remaining near or above par throughout the capital stack.

Charts of the Month

1. While loans have provided steady returns throughout 2024, fixed rate bonds have claimed most of their performance in the third quarter.

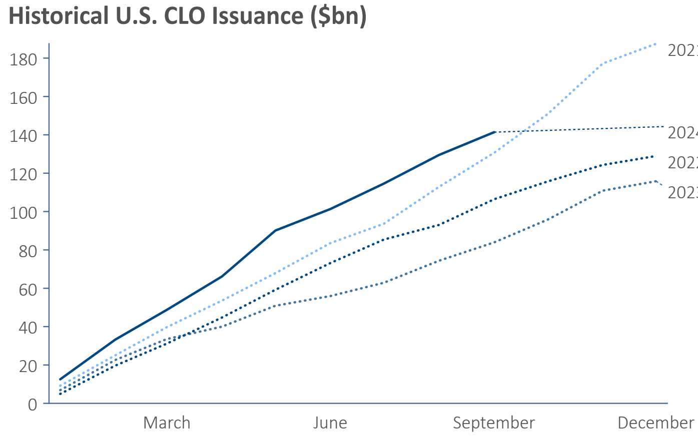
Asset Class Performance Comparison - 3Q24 & YTD



Source: Bloomberg, Credit Suisse, as of September 30, 2024

2. YTD CLO issuance remains ahead of 2021's record pace, however, the margin has narrowed to just $10.7bn.

Historical U.S. CLO Issuance ($bn)



Source: Pitchbook/LCD, as of September 30, 2024

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PACIFIC CAPITAL

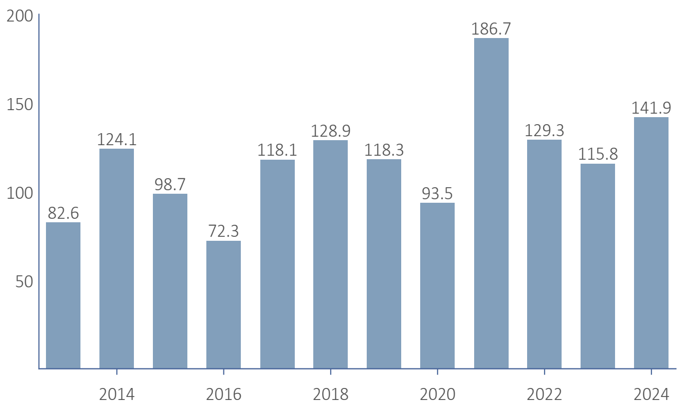
CLO MONTHLY MONITOR
SEPTEMBER 2024

Market Data	Sep-24 Return (%)	1-Year Return (%)	Yield (%)	Yield Change (%)	DM (BPS)	Price ($)
JP Morgan CLO Indices						
AAA-Rated	0.59	7.69	5.4	-0.3	101	100.2
AA-Rated	0.65	9.14	5.8	-0.3	133	100.3
A-Rated	0.69	10.38	6.1	-0.3	165	100.3
BBB-Rated	0.97	14.10	7.1	-0.3	275	100.1
BB-Rated	1.55	22.60	11.1	-0.3	686	96.1
B-Rated	2.05	36.79	17.0	-0.3	1,327	74.1
Credit Suisse Leveraged Loan Index						
BB-Rated	0.46	8.80	6.1	-0.2	277	99.7
B-Rated	0.66	10.05	7.8	-0.2	455	98.3
CCC-Rated	1.84	14.24	15.7	-0.9	1,262	80.2
Distressed (CC, C, and Default)	3.68	-11.53	34.9	-3.6	3,240	37.0

Source: JP Morgan, Credit Suisse, as of September 30, 2024

Technicals

Annual CLO New Issuance ($bn)



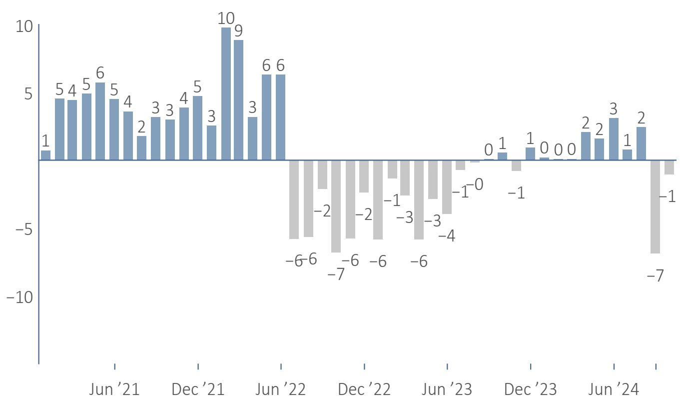
Source: Pitchbook/LCD Research as of September 30, 2024

Valuations

Yields on Various Asset Classes (%)

Source: JP Morgan, Credit Suisse, Barclays, as of September 30, 2024

Monthly Bank Loan Fund Flows ($bn)



Source: Pitchbook/LCD Research, as of September 30, 2024

CS Leveraged Loan Index ($)

Source: Credit Suisse, as of September 30, 2024

ABOUT ARISTOTLE PACIFIC CAPITAL

Aristotle Pacific Capital, LLC specializes in institutional fixed income management with a focus on corporate credit. As of September 30, 2024 the firm managed $29bn across bank loan, high yield, corporate, and CLO strategies.

IMPORTANT NOTES AND DISCLOSURES