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INSIGHT

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LOAN & CLO REVIEW

Leveraged Loan and CLO New Issuance Surge

DREW SWEENEY & PALAK S. PATHAK, CFA | 25 JULY 2024

The sustained period of low volatility in the loan market has been astonishing. Moderating inflation and cooling labor market conditions have helped to support the growing consensus of peak interest rates and a soft landing. This dynamic has contributed to strong demand for levered credit and record-setting broadly syndicated bank loan issuance throughout the first and second quarters. The percentage of loans trading above par surged close to historical records (64% on May 15) and encouraged borrowers/arrangers to tap the market to slash borrowing costs. This tally (64%) was the highest level since October of 2018, which was followed by a period of significant volatility in December 2018. Unlike 2018, Q2 2024 did not see any subsequent volatility but rather a "repricing" wave, which continued to dominate quarterly issuance (following similar Q1 trends), shaving a combined 7-10 basis points (bps) from the average index spread. Despite the stronger risk sentiment, Leveraged Buyout (LBO) and M&A activity remained relatively subdued throughout the second quarter owing to the wide valuation gaps between buyers and sellers along with persistently elevated interest rates. This has extended typical hold times for private equity (>5 years now at a record 30% of deals) and increased the reliance on dividend recapitalization transactions to return money to fund investors.

Higher risk loans were used to offset spread loss related to repricing in the first quarter, but that dynamic did not carry forward to the second quarter as notable downgrades, topical Liability Management Exercises (LME), and CLO reset activity encouraged managers to take a more discerning approach to CCCs. Like borrowers in the bank loan market, CLO managers used the stronger market sentiment to begin resetting the significant percentage of deals (as high as 40% at the peak) out of reinvestment period. Many of these deals have already started amortizing with proceeds from term loan repayments, which naturally shifts the mix of collateral to higher risk loans (i.e., higher quality loans tend to repay/refinance at faster rates). In addition to buying incremental collateral to dilute higher risk exposure, managers have been forced to sell CCCs to bring exposures to more palatable levels for liability investors, which weighed on prices in the lowest quality cohort.

Manager risk aversion is at least partially attributable to rating agencies' inability to adapt to the current market environment, oftentimes confounding maturity risk with credit risk and failing to promptly upgrade companies with near-dated maturities that have improved operating metrics. The "one-size-fits-all" approach utilized by rating agencies does not fully capture the much broader pool of available capital for refinancing solutions (i.e., private credit, pro-rata, etc.) and highly dynamic economic conditions.

This heightened sensitivity to CCCs has once again clouded the refinancing prospects for more stressed borrowers. While the first quarter saw a dramatic reversal of private credit back to the broadly syndicated market (prioritizing level of execution over certainty of execution), the opposite was true of the second quarter. Borrowers undergoing idiosyncratic challenges or ratings-related dislocation have increasingly sought out private credit solutions, which provide certainty of execution, enhanced flexibility, and similar pricing. This has also raised the specter of LME for names that would have otherwise reached amend-and-extend deals with existing lenders (without the CCC ratings impediment). Sponsors, eager to cut debt and retain equity optionality, have increasingly struck deals with large, powerful lender groups, which oftentimes cut out smaller lenders in coercive exchanges. This, along with permissive credit agreements, has contributed to elevated default rates when accounting for distressed exchanges. And while these types of restructurings typically reduce legal fees and have modestly higher recoveries, they fail to adequately reduce leverage, which raises the probability of a more comprehensive restructuring at a later date.

Residual stress has increased levels of dispersion across the quality spectrum and capped aggregate loan index returns. This is evident in the composition of year-to-date (YTD) loan performance, which has been dominated by interest/coupon (98+% of YTD total returns) compared to price gains (~2% of YTD total returns). Lowest quality and idiosyncratic stories continue to constrain loan returns as rates remain stubbornly high and sector specific challenges (i.e., destocking, input cost inflation, etc.) linger. Adding to credit/industry specific challenges are fears of a slowdown in consumer spending and uncertainty over the U.S. election outcome. Protectionist trade policy, telegraphed by both political parties, has increased volatility in more heavily exposed sectors such as retail. Borrowers with significant exposure to global supply chains (i.e., those with manufacturing bases in China) will be forced to accept higher tariffs or quickly alter their existing manufacturing footprint. The uncertain impact on operations and margins has encouraged investors to reduce risk to this cohort of borrowers which started to weigh on prices toward the end of the quarter.

All of this has started to impact CLO performance and equity distributions, which continue to be the main driver of demand in the bank loan market. The first quarter began with record equity distributions amid a collapsing 1m/3m secured overnight financing rate (SOFR) basis spread, still wide spreads, and contained default rates. The combination of repricing activity (reducing spread by ~7-10 bps) along with steadily increasing default rates/distressed exchanges likely reduced those payments in the second quarter. That trend is unlikely to improve without sustained CLO refinancing/reset activity to reduce liability costs and provide additional cushion.

Performance – Loans

In the second quarter, the Credit Suisse Leveraged Loan Index (CS LLI) and the Morningstar LSTA US Leveraged Loan Index (LSTA LLI) posted returns of +1.86% and +1.90%, respectively, moderating from last quarter's strong returns of +2.52% and +2.46%, respectively.

In the first quarter, the Morningstar LSTA US Leveraged Loan 100 Index (L100), which includes the largest, most liquid borrowers, performed +2.07%, which is above the broader LSTA LLI. The largest liquid loans in the Index benefited from strong retail fund flows, particularly ETFs. While CCCs generally outperformed higher rated counterparts (BB), this reversed significantly towards the end of the second quarter and into the third. In fact, the vast majority of CCC outperformance was related to higher coupon/interest earned as market value return underperformed the broader index by more than 100 bps. In the beginning of the second quarter, strong underlying risk appetite overwhelmed idiosyncratic credit concerns; however, notable downgrades and ongoing LME activity prompted investors to more closely manage higher risk baskets. This has become increasingly important to defend already damaged overcollateralization cushions (OCs) against a backdrop of deteriorating recovery rates (Q1 saw record low last 12-months (LTM) recovery rates of 38%). And while LMEs are generally not as punitive for recovery rates, the market has thus far failed to show coordinated pushback on key protections within credit agreements. This has also complicated the characterization of the "high risk" basket as its constituents have become increasingly bifurcated depending on the prevailing situation. The vast majority of split B/CCC loans without imminent risk of a transaction (i.e., bankruptcy, liquidity, distressed exchange) remained well bid into the second quarter (i.e., performing CCCs traded 95-97). Outside of LME activity, investors remain acutely focused on upcoming second quarter earnings with most companies providing guidance for weaker first half numbers followed by a rebound into the back half. The path to achieving this along with emerging uncertainty surrounding the U.S. election will undoubtedly lead to more dispersion by industry, rating, and other factors. The highest and lowest quality cohort (Split BBB and Distressed) significantly underperformed other ratings cohorts over the LTM period with returns of +8.61% and -20.18%, respectively.

Total Return by Rating

By Rating	June 2024	Q2 2024	LTM
CS LLI Returns	0.27%	1.86%	11.03%
Split BBB	0.31%	1.91%	8.61%
BB	0.32%	1.94%	9.05%
Split BB	0.10%	1.79%	10.07%
B	0.36%	2.17%	11.92%
Split B	-0.80%	-1.54%	9.28%
CCC/Split CCC	0.45%	2.46%	19.12%
Distressed (CC, C and Default)	-2.63%	-12.28%	-20.18%

Source: Credit Suisse Leveraged Loan Index

Sector Performance

Fundamental variability accelerated during the second quarter of 2024 adding to the growing dispersion of the first quarter and closely following a year (2023) of more homogenous returns across sectors. The dispersion between the worst performing and best performing sectors expanded to +82 bps in the month of June and +225 bps for the second quarter. In Q2 of 2024, the top performing sectors were food and drug (+265 bps), gaming/leisure (+262 bps), and consumer durables (+261 bps) while the worst performing sectors were media/telecommunications (+40 bps), housing (+126 bps), and services (+141 bps). For the LTM period, healthcare, consumer non-durables, and food and drug led all sectors with total returns of +12.97%, +12.35%, and +12.29%, respectively, while media/telecommunications, food/tobacco, and metals/minerals were the worst performing sectors with returns of +8.12%, +9.81%, and +10.12%, respectively. Thematically, sectors that had underperformed during 2023 due to destocking pressures, input cost inflation, and other idiosyncratic reasons have rebounded into the second quarter as markets price in trough volumes and inflation moderates. Idiosyncratically, media/telecommunications emerged as one of the weakest sectors in the quarter as cord-cutting concerns in broadcasting and aggressive sponsor behavior in telco weighed on larger capital structures. Retail has started to become more topical into the third quarter as slowing consumer spending and potential impacts from tariffs following the election have weighed on prospective earnings, particularly for more discretionary products.

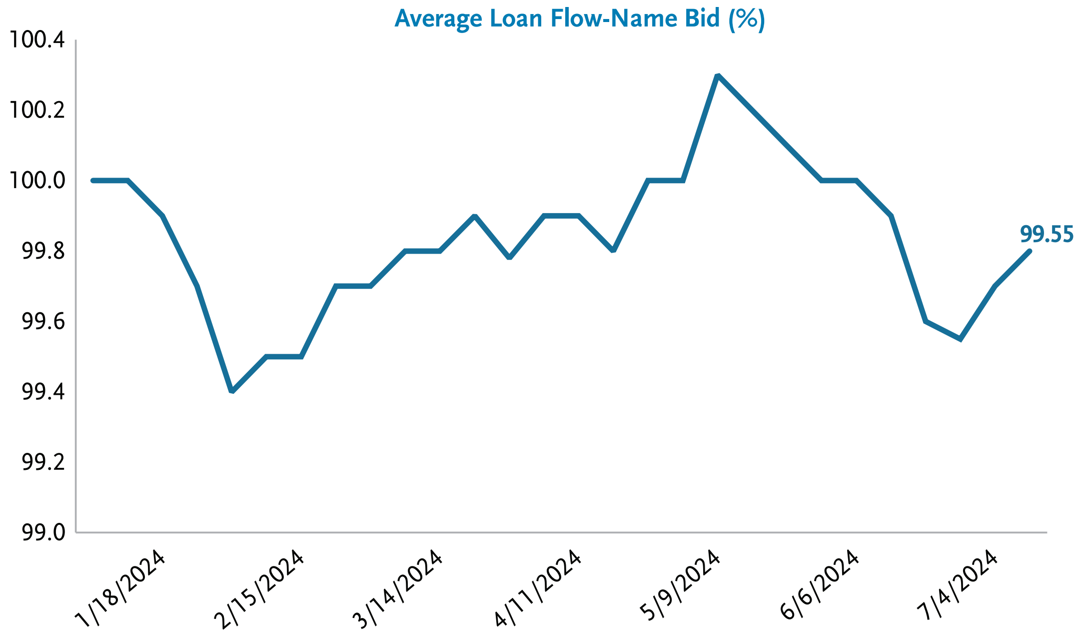
Industry Returns

Sector	June 2024	Q2 2024	LTM
AEROSPACE	0.38%	2.22%	11.03%
CHEMICALS	0.33%	2.40%	12.00%
CONSUMER DURABLES	0.41%	2.61%	11.06%
CONSUMER NON-DURABLES	0.70%	2.33%	12.35%
ENERGY	0.44%	2.34%	11.81%
FINANCIAL	0.41%	2.55%	11.61%
FOOD AND DRUG	0.71%	2.65%	12.29%
FOOD/TOBACCO	0.41%	2.03%	9.81%
FOREST PROD/CONTAINERS	0.44%	2.15%	11.47%
GAMING/LEISURE	0.59%	2.62%	10.89%
HEALTHCARE	0.33%	2.59%	12.97%
HOUSING	0.13%	1.26%	11.60%
INFORMATION TECHNOLOGY	-0.11%	1.53%	11.13%
MANUFACTURING	0.56%	1.98%	11.03%
MEDIA/TELECOMMUNICATIONS	0.17%	0.40%	8.12%
METALS/MINERALS	-0.04%	2.13%	10.12%
RETAIL	0.45%	2.30%	10.58%
SERVICE	0.15%	1.41%	10.38%
TRANSPORTATION	0.44%	1.67%	11.30%
UTILITY	0.46%	2.50%	11.92%

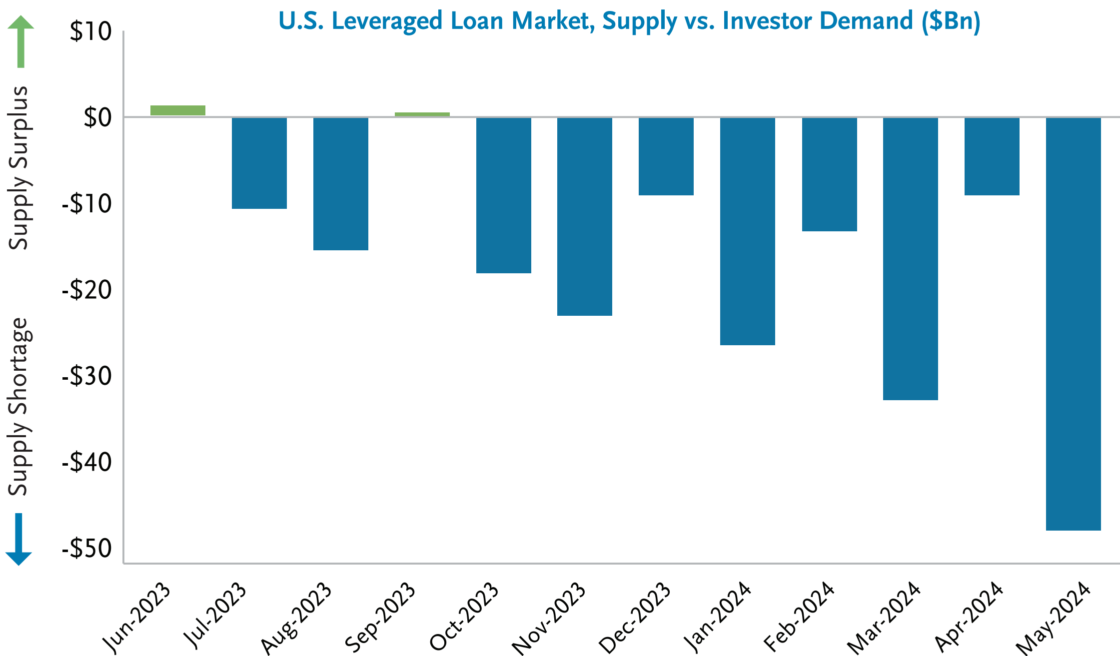
Source: Credit Suisse Leveraged Loan Index

Leveraged Loan and CLO New Issuance Surge

The average bid of the S&P LCD (Leveraged Commentary & Data) flow-name composite was down -23 bps from 99.78 on March 31 to 99.55 on June 30. While most of the volatility in the quarter was centered around lower quality capital structures, the repricing activity weighed on larger, liquid structures trading above par and outside of soft call protection. However, a combination of CLO ramping activity, redeployment of prepayments, and strong positive retail fund flows provided support to loan prices albeit at slightly lower levels. The U.S. leveraged loan market became even more supply constrained compared to investor demand (CLO creation and fund inflows) throughout the second quarter owing to strong CLO issuance, retail fund flows, and limited new money issuance (i.e., LBO and M&A).



Source: PitchBook | LCD



Source: PitchBook | LCD • Data through May 31, 2024

Based on (a) new issuance minus repayments minus (b) CLO issuance and Prime Fund inflows

Performance – CLOs

CLOs performed well in the second quarter, matching similar returns earned in the first quarter as spreads continued to tighten. The JPM CLOIE Index earned a quarterly return of +3.35%, down ~10 bps from its Q1 performance of 3.66% but handily outperforming loans (+1.90%) as loan prices dipped. YTD CLOs are returning 4.44% outperforming Investment Grade (IG) credit (-0.46%), High Yield (HY) credit (+1.47%), and Loans (+4.40%)

Secondary CLO 2.0 Total Returns

	June 2024	YTD
CLO Total	0.49%	4.44%
AAA	0.41	3.64
AA	0.50	4.40
A	0.63	5.07
BBB	0.80	6.54
BB	0.80	11.24
B	1.38	21.68
IG Credit	-0.67%	-0.46%
HY Credit	0.94%	1.47%
Leveraged Loans	0.35%	4.40%

Source: JP Morgan CLOIE Index, Bloomberg, Morningstar

Spread compression continued to be the theme in markets as demand outstripped supply. With the majority of secondary bonds trading at a premium and out of their non call periods, investors turned to the primary markets to source bonds at par dollar prices with call protection. On the demand side, CLO ETFs have emerged as a powerful source and has become an asset class in its own right. ETF Inflows reached $7 bn as of June and total ETF assets under management have already eclipsed $13 bn versus $10 bn in April. Higher rates have attracted the attention of retail investors and CLO ETFs have benefited given all-in yields on AAA-rated floaters are currently north of 6.5%. In addition to ETF demand, historically high amortizations and liquidations have returned cash to investors that then needs to be re-deployed back into the market. This has disproportionately affected the AAA part of the capital structure given amortizations target AAAs first, which is driving net AAA issuance into negative territory. On the supply side, limited new issuance (ex refi/reset) has also served as a powerful tailwind supporting spreads.

Over the quarter, spreads tightened anywhere from 10-30 bps with mezzanine spreads benefitting the most as AAA prices were capped out at ~$100.5 for callable bonds. AAAs were very well bid with many bonds trading at a negative discount margin (DM) to worst given the premium prices and callability embedded within these profiles. The majority of AAs and single As were also trading at premium prices and spreads were anywhere from 10-15 bps tighter over the quarter. BBBs and BBs continued to be very well bid as loan fundamentals and market value metrics remained benign and investors found all-in yields offered in these tranches attractive. Equity trading picked up early in the quarter with May seeing the highest YTD monthly equity bids wanted in competition (BWIC) volume at over $700 mm. Equity continues to gain attraction with net asset values (NAVs) steady, resets/refis providing additional optionality, and median equity payments robust with April payments at their highest levels since 2016.

Secondary CLO 2.0 Spreads

	June 2024	QoQ Change (bps)
AAA	105-130	-10
AA	160-185	-10
A	190-225	-15
BBB	285-400	-30
BB	575-750	-25
B	850+	0

Source: TCW

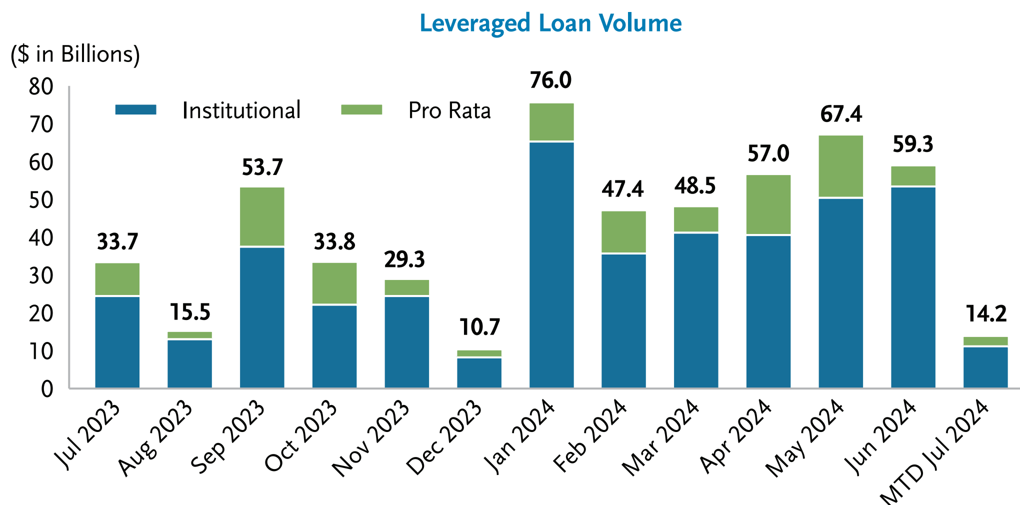
Leveraged Loan and CLO New Issuance Surge

Overall secondary volume declined in the second quarter with TRACE reporting $50 bn in volume, down 20% from Q1. The decline was largely due to lower IG volumes as non-IG volumes picked up by 12% quarter over quarter. Notably, dealers got $1.2 bn longer over the quarter, adding to the $500 mm in dealer adds during Q1.

Technical Conditions – Loans

Leveraged loan funds reported inflows of $5.40 bn in the second quarter of 2024 as still-high coupon rates and strong risk sentiment underpinned robust demand for ETF and actively managed floating rate product. This was the sixth consecutive month of inflows, which brings the positive flows to eight of the past 24 months as prospects for a soft landing and still-resilient U.S. economy provide support to above historical average interest rates and contained default activity. Retail investors continue to receive historically high all-in yields and significant incremental compensation above pari-passu fixed rate notes despite the early signs of price exhaustion in the loan market. As the FOMC gets closer to making its first cut to interest rates since 2020, there becomes a higher probability of realizing the relatively steep forward curve which has historically resulted in outflows to the floating rate product. Even with full realization of the curve, bank loans continue to demonstrate strong relative value compared to fixed rate counterparts which are predominately unsecured.

Primary issuance surged again in the second quarter bringing the YTD issuance to $736 bn, which includes $378 bn of repricing (51%), $246 bn of refinancing/extensions (33%), and just $112 bn of M&A/Dividend/LBO/General Corporate Purposes (GCP) related deals (15%). Borrowers and arrangers used the still supportive market conditions (near record percentage of loans above par in the second quarter) to slash borrowing costs and push out maturities. The strong technical backdrop (retail inflows, CLO issuance, voluntary loan prepayments, etc.) together with limited net new supply underpinned robust demand for new issue, which swelled order books. The vast majority of deals during the quarter were able to flex pricing tighter from initial talk and syndicate deals without key lender protections included in credit agreements. Over the past couple of years, the leveraged loan market has witnessed significant compositional shifts in issuance trends beginning with the growth in pro-rata during the volatility of 2022, evolving to private credit for more stressed refinancing and highly levered LBOs in 2023, moving back towards syndicated term loan B market in the beginning of 2024, and finally arriving at a more balanced mix of private credit, syndicated term loan B, high yield bond, and pro-rata during the second quarter. What has become increasingly apparent is that even borrowers who had historically only accessed one market exclusively have a number of “stress relief valves” through new investors’ bases. This has created a fluidity between private credit, broadly syndicated loans, and the high yield bond market to support financing needs of leveraged borrowers. As market conditions evolve, borrowers will undoubtedly shift between certainty of execution (i.e., private credit and pro-rata) and level of execution (i.e., broadly syndicated loans and high yield bonds) to optimize financing costs and capital needs.



Source: PitchBook | LCD
*MTD updated as of Friday, July 12, 2024

Leveraged Loan and CLO New Issuance Surge

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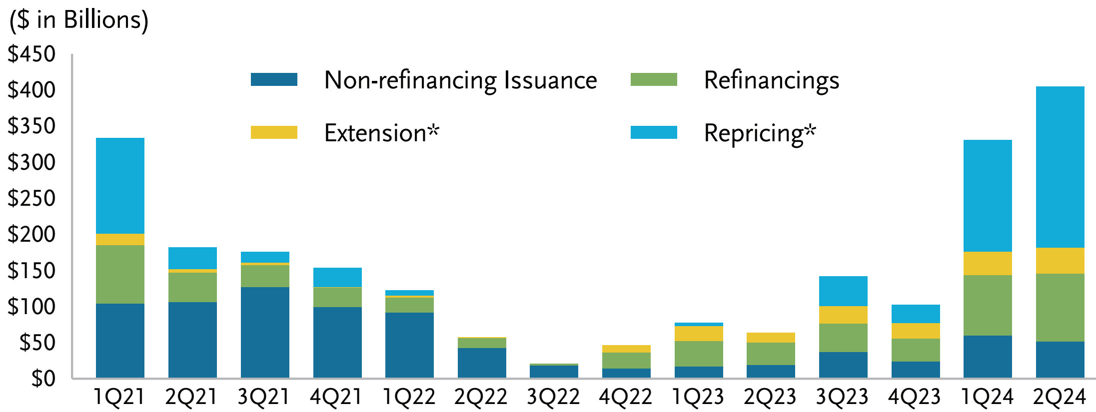
U.S. Institutional Loan Activity

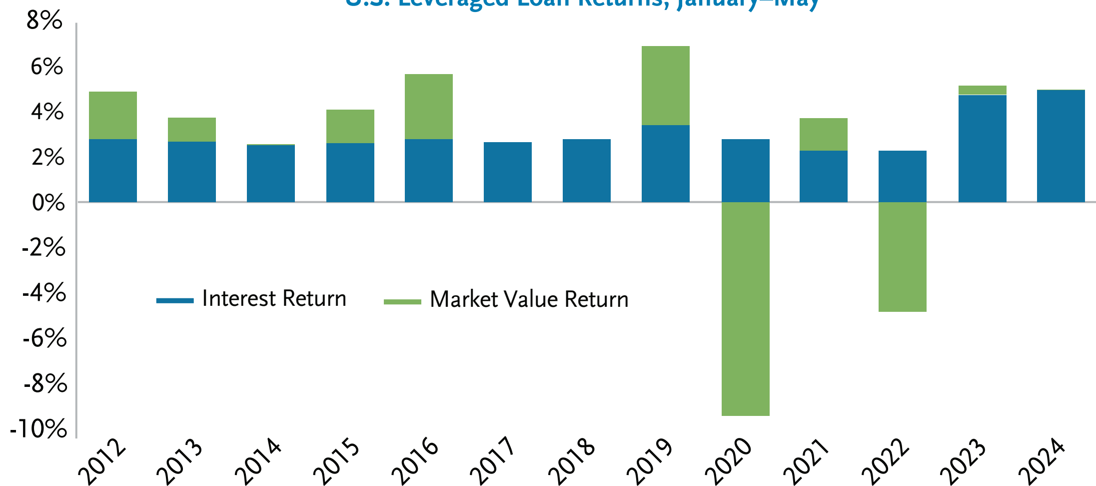


Source: PitchBook | LCD • Data through June 30, 2024

*Reflects repricings and extentions done via an amendment process only

CLO issuance increased significantly in the second quarter of 2024 (+$51 bn) compared to just (+$21 bn) in the same period last year. Strong equity distribution payments in the first quarter, collapsing 1m/3m SOFR basis spread, and rapidly tightening liabilities proved sufficient to offset higher collateral prices, repricing activity, and elevated default/distressed exchange rates. The repricing wave has grown into one of the broadest and most influential in the history of the loan market, encompassing more than 25% of issuers and shaving an estimated 7-10 bps from the index spread. This has encouraged managers to incorporate higher percentages of second liens and reduce bond baskets to hit spread thresholds from prospective equity investors. In the second quarter, this dynamic became even more challenging by weaker reception to higher risk credits (CCCs) in new issue/reset portfolios. Liability investors have taken a more discerning approach to the lowest priced and highest risk collateral obligations, oftentimes penalizing managers with above market concentrations. Even with the tightening spreads, high collateral prices, and risk aversion from liability investors, the equity arbitrage remains supportive given rapidly tightening liabilities. Against this backdrop, LTM loan returns accelerated slightly compared to the same period last year +11.11% compared to +10.72% a year prior in 2023. In 2023, loans posted the first double digit full year return since 2010; however, price appreciation moderated into 2024. In the first quarter of the year, coupon/interest payments rather than price appreciation dominated returns, a trend that continued into the second quarter. In fact, the second quarter actually witnessed some modest price declines (more pronounced for lower quality), given weakness surrounding repricing loans trading above par and higher risk, idiosyncratic credits. This bifurcation is set to continue given the significant percentage of loans still above par (~40%) and residual stress in the loan market.

U.S. Leveraged Loan Returns, January–May



Source: PitchBook | LCD; Morningstar LSTA U.S. LL Index • Data through May 31, 2024

Leveraged Loan and CLO New Issuance Surge

Technical Conditions – CLO Primary

CLO Primary volumes continue to surprise to the upside with over $51 bn pricing, up slightly from Q1. Spreads remained on their tightening path across the capital stack led by T1 AAAs ending the quarter at SOFR + 140 bps, 11 bps tighter from the end of Q1. AA to BB primary spreads also tightened anywhere from 25-40 bps with single As, BBBs and BBs close to breaking through their floors of +200, +300 and +600 respectively.

This tightening is even more impressive given the deluge of refi/reset activity pricing over the quarter. We count 66 refis and 98 resets pricing over the quarter as tighter spreads and expiring reinvestment periods encouraged managers to restructure their deals.

Private credit/middle market CLO volume was also robust with 19 deals pricing totaling $10.3 bn. Demand for private credit CLOs remained strong with PC CLO AAA spreads tightening another 15-20 bps to end the quarter at SOFR + 165 bps.

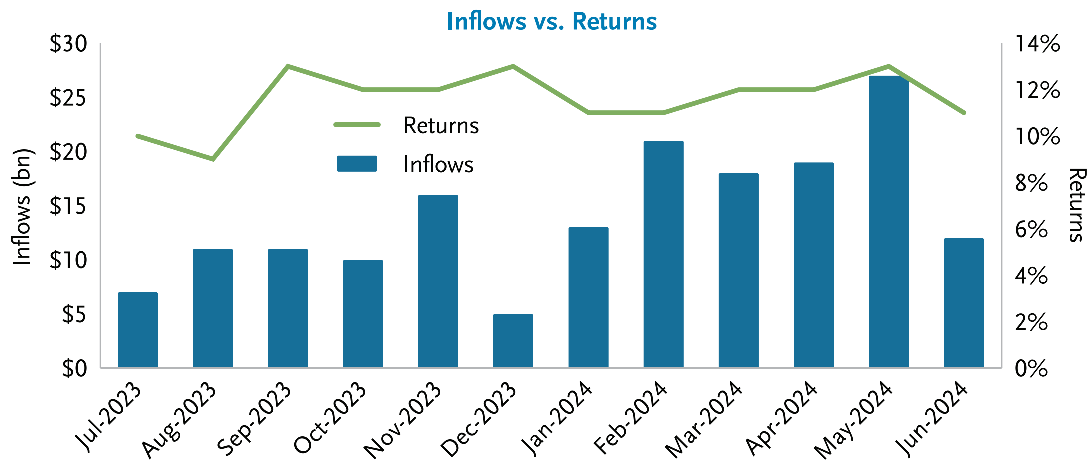
CLO New Issuance

	Q2 2024	YTD 2024	YTD 2023	% Change
New Issue ($bn)	$51.70	$101.40	$53.90	88%
Refi (#)	66	104	0	
Reset (#)	98	149	2	

Source: TCW

Fundamentals – Loans

Inflows vs. Returns



Source: LCD, an offering of S&P Global Market Intelligence

Lagging 12-Month Default Rates

Actual	April 2024	May 2024	June 2024
By Number	1.99%	1.83%	1.55%
By Principal Amount	1.31%	1.08%	0.92%
Shadow Default Rate			
By Number	0.09%	0.09%	0.09%
By Principal Amount	0.07%	0.07%	0.07%

*Shadow default rate includes potential defaults, including those companies that have engaged bankruptcy advisors, performing loans with SD or D corporate rating and those paying default interest.

Source: LCD, an offering of S&P Global Market Intelligence

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There were six defaults in the second quarter of 2024 bringing the LTM default tally to 22, a significant decrease from the full year default rate of 34 that occurred in 2023. Healthcare and telecom led all sectors with three defaults each followed by retail, services/leasing, chemicals, and food and drug with two each. There were no other sectors with more than two defaults over the LTM period. The default rate of the LSTA LLI by issuer count declined to 1.55% while the par outstanding default rate decreased to 0.92%, which was the lowest LTM figure in the past 14 months. However, the default rate, when accounting for distressed exchanges (an increasingly common form of debt reduction for stressed borrowers) increases by 276 bps over the trailing 12-month period. Notably, distressed exchanges constituted 64% of total recorded defaults, which is the highest number on record and validates a seismic shift in sponsor/market participants' handling of distressed situations. It should be noted that these transactions are distinctly different than conventional bankruptcy filings. They typically feature a much smaller debt reduction, instead opting for transfer of value between group/non-group, first/second lien, and sponsor equity to guarantee liquidity for operations. This oftentimes leaves the pro-forma company with ample liquidity but a still unsustainable capital structure. The success/failure of these transactions will likely be displayed over the next couple years when post-distressed exchange companies need to come to the market and refinance debt.

Fundamentals – CLOs

CLO fundamentals were steady over the quarter as managers with CCC rated loans increased to over 7% while exposure to defaulted loans declined. As a result, weighted average rating factor (WARF) levels remained steady: however, junior OC cushions declined as managers experienced par loss while de-risking their portfolios. Market value metrics remained steady with median BB market value overcollateralizations (MVOCs) at 106% for reinvesting deals and equity NAVs at $60.

Loan Valuation

Since 1992, the average 3-year DM for the CS LLI is 472 bps. The 3-year DM finished the quarter at 524 bps which was +15 bps wider than the first quarter. The DM spread differential between double Bs and single Bs is now +171 bps, which is 70 bps tighter from the same period last year and slightly tighter than the historical differential since inception. The spread differential between double Bs and single Bs was slightly tighter (10 bps) compared to the level at the end of the first quarter. Market dispersion has evaporated for performing single and double B credits and is currently only present in the highest risk cohort of the market (CCCs) where idiosyncratic, earnings, and LME-related news has generated significant price dislocation.

3-Year Discount Margin Differential Between BBs and Bs

Average Since Inception	192.1 bps
June 2023	240.9 bps
June 2024	170.5 bps

Source: Credit Suisse Leveraged Loan Index

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CS LLI Snapshot

YTD Total Return		4.40%
Average Price		95.68
Spread		386 bp
Coupon		9.19%
Current Yield		9.60%
Yield (3-year life)		9.36%
Discount Margin (3-year life)		507 bp
	Spread	**DM (3-Year Life)**
Split BBB	238 bps	238 bps
BB	280 bps	290 bps
Split BB	368 bps	429 bps
B	407 bps	461 bps
Split B	458 bps	1,247 bps
CCC/Split CCC	529 bps	1,271 bps
Distressed (CC, C and Default)	526 bps	4,115 bps

Source: Credit Suisse Leveraged Loan Index

Summary and Looking Forward

The first half of the year saw one of the heaviest repricing and refinancing volumes on record as borrowers capitalized on strong market sentiment to slash borrowing costs and push out maturities. The overwhelmingly supportive technical backdrop was reinforced by accelerating retail fund flows and strong CLO creation throughout the second quarter. This demand was not met with a commensurate increase in new money deals as LBO/M&A activity remains subdued given the still-wide valuation gap between buyers and sellers along with persistently high interest rates. This undersupplied dynamic swelled order books for the small number of new money deals resulting in material flex activity and credit agreements notably lacking key lender protections. Broader market strength witnessed at the beginning of the year ceded to greater risk selectivity from both liability investors and CLO managers alike. Returns continue to be dominated by coupon/interest payments (near historical highs) as prices begin to soften in higher risk areas of the market. Bifurcation has returned to the lowest quality corner of the market (CCCs) as manager baskets increase, reset activity picks up, and LMEs continue. The dispersion is likely to persist (at least in lower quality) amid emerging uncertainty surrounding the U.S. election and corresponding policy changes (particularly surrounding global trade and supply chains).

Looking forward, managers will continue to focus on reducing higher risk exposure (CCCs) while limiting the damage to already weakened overcollateralization cushions. The more cautious tone on CCCs in the market implies that managers will no longer be able to replenish weighted average spread (depleted from the repricing wave) with higher risk names. Instead, adding non CCC 2Ls and reducing bond baskets have been the most frequently utilized counterbalances. While liabilities have tightened significantly since the beginning of the year, they appear to have reached a point of exhaustion (AAAs stabilizing in the +140-145 range) without a corresponding slowdown in bank loan repricing. In order for the CLO equity arbitrage to remain supportive, CLO liability spreads would have to go materially tighter. Even with lower liabilities, the arbitrage continues to tighten with lower risk tolerance for new CLOs along with the persistent repricing wave. Managers continue to wait for a period of “episodic volatility” which will allow for stronger deal economics and the ability to rebuild overcollateralization cushions damaged by recent defaults and LME activity. ■

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