COLLATERALIZED LOAN OBLIGATIONS

CLO Monthly Monitor

June 2023

• June returns were positive across the capital stack, driven by strong coupon returns coupled with modest price appreciation.

Loan Market Review

• The CS Leveraged Loan Index returned 2.24% in June. Loans posted their second highest return in the last 12-months, which was supported by a pause in Federal Reserve rate hikes, an upwardly revised 1Q23 GDP print and cooling inflation.

• The risk-on rally in the leveraged loan market saw the weighted average price of the index increase $1.45 in June to $93.55, the largest month-over-month improvement since July 2020. Noteably, lower priced loans (<$90) saw the greatest price appreciation during the month, increasing $3.94 from their weighted average price at the end of May.

• Leveraged loan issuance was $14.3bn in June, bringing 2Q23 issuance to $49.0bn and $101.4bn year-to-date. Loan issuance for the first half of the year, of which 65% has been comprised of refinance activity, is off to the slowest start in over 12 years. Issuance in 2023 is down 40% through the same period last year and down 70% from the record first half in 2021.

• Limited supply in the loan market was also met with a similar slowdown in CLO issuance, June CLO origination at $4.28bn makes it the lightest volume in 3 years. Retail fund flows also moderated during the month, with just $1.1bn in outflows, down from the prior 12-month average outflow of $4.3bn.

• Sector performance was positive for all 20 industries in June. Performance was led by Consumer Durables (3.54%), Media/Telecom (2.84%) and Housing (2.74%), while Food (0.77%), Consumer Non-Durables (1.30%) and Utilities (1.54%) lagged the rest of the index.

• Credit quality returns generally favored lower quality loans in June, with distressed loans by rating (CC, C, Default) returning 7.06%. Split B-rated loans were the next best returning credit quality at 3.42%, outperforming single-B rated loans at 2.40%. BB-rated and CCC-rated lagged the rest of the index, each returning 1.65%.

• There were four defaults in June, affecting $2.6bn in outstanding loans. Activity included Diebold Nixdorf (DBD), Colorado Buyer (COLBUY), Lucky Bucks (LUCBUC) and World Kitchen (WKIHLD). As a result, the year-to-date default volume reached $25.4 billion, increasing the trailing 12-month issuer-weighted default rate to 2.12%.

CLO Market Review

• CLO tranches had positive total returns in June. JP Morgan estimated returns for June were 0.81% (AAA), 1.02% (AA), 1.07% (A), 1.84% (BBB), 2.32% (BB), and 1.78% (B).

• CLO issuance fell to its lowest level in 3 years, with just $4.28bn issued in June. CLO issuance had been moderating since mid-March, as elevated borrowing costs have weighed down the arbitrage. June's muted volume brought the quarterly CLO issuance to its lowest amount since 1Q17.

• The overall lack of CLO supply in June helped new issue CLO AAA spreads price lower, with top-tier managers printing at 170 bps above SOFR. CLO new issuance this year has come from 122 deals by 79 managers (Source: LCD).

• As the Libor cessation date has passed as of June 30th, only 22.9% of U.S. CLOs have transitioned to SOFR as the new benchmark rate. The share of CLO's transitioned to SOFR is expected to increase substantially following the upcoming payment cycle which begins in July. Meanwhile, 63% of leveraged loan held in CLO portfolios have transitioned to SOFR. The quicker transition to SOFR for loans can be attributed to elevated refinance activity year-to-date and higher adoption of 1M vs 3M terms. (Source: JP Morgan).

• With fundamentals for underlying loan issuers available through 1Q23, revenues and EBITDA growth are both experiencing a slowdown, although both remain positive year-over-year. More than half of loan sectors are experiencing margin deterioration, as higher costs stemming from sticky inflation and higher wages have outpaced revenue growth. Companies have been responding to slowing growth and higher interest rates by limiting new borrowing and reducing capital expenditures, reducing leverage for loan issuers to a 4-year low.

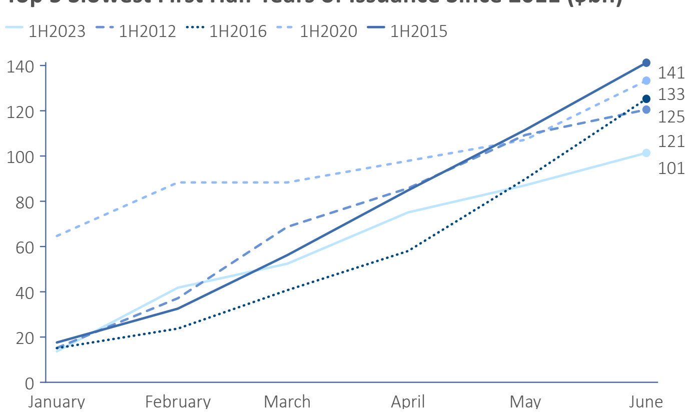
• With a U.S. economy that continued to surprise to the upside, despite numerous looming headwinds, CLO debt across the capital stack has exhibited strong returns year-to-date. Relative to fixed-rate corporate credit peers, which have been impacted by significant interest rate volatility, CLOs debt tranches rated AA-B have outperformed Investment Grade and High Yield bonds at each credit quality rating. JP Morgan estimated year-to-date returns for CLOs were 3.81% (AAA), 4.85% (AA), 5.84% (A), 6.24% (BBB), 8.44% (BB), and 8.24% (B).

• Despite the recent movement tighter, CLO spreads in aggregate remain modestly tighter to where they entered the year, and wide to historical averages. In addition, mezzanine CLO spreads (BBB-B) in particular look attractive relative to high yield bonds and leveraged loans which have tightened 79 bps and 53 bps, respectively. We believe these historically elevated spreads and yields, combined with the structural protections offered by CLOs, may continue to provide an attractive entry point.

Charts of the Month

1. The first half of 2023 has had the slowest pace of leveraged loan issuance since 2012, with just $101bn in loans issued YTD

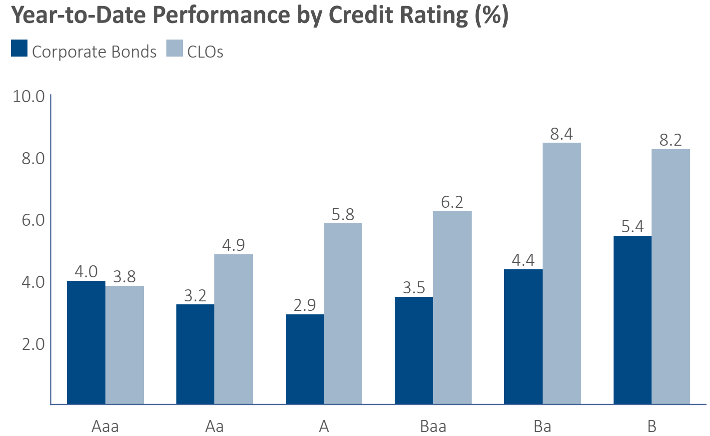
Top 5 Slowest First Half Years of Issuance Since 2011 ($bn)



Source: Pitchbook/LCD Research, as of June 30, 2023

2. CLOs debt tranches rated AA-B have outperformed similarly-rated Investment Grade and High Yield bonds in 1H2023

Year-to-Date Performance by Credit Rating (%)



Source: Bloomberg, JP Morgan, as of June 30, 2023

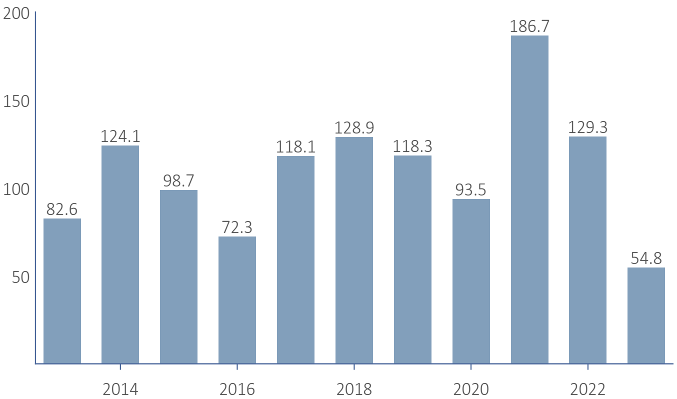
CLO MONTHLY MONITOR
JUNE 2023

Market Data	Jun-23 Return (%)	1-Year Return (%)	Yield (%)	Yield Change (%)	DM (BPS)	Price ($)
JP Morgan CLO Indices						
AAA-Rated	0.81	6.71	6.4	0.3	197	98.7
AA-Rated	1.02	8.32	6.7	0.3	264	97.5
A-Rated	1.07	8.97	7.5	0.3	340	96.0
BBB-Rated	1.84	9.71	9.4	0.1	532	92.6
BB-Rated	2.32	12.46	14.6	0.3	1,025	85.8
B-Rated	1.78	9.31	20.3	0.1	1,586	68.5
Credit Suisse Leveraged Loan Index						
BB-Rated	1.65	11.15	7.82	0.19	331	98.85
B-Rated	2.40	10.76	10.22	-0.21	572	95.52
CCC-Rated	1.65	-1.33	19.48	0.74	1,501	77.23
Distressed (CC, C, and Default)	7.06	-35.75	30.23	5.23	2,591	29.34

Source: JP Morgan, Credit Suisse, as of June 30, 2023

Technicals

Annual CLO New Issuance ($bn)



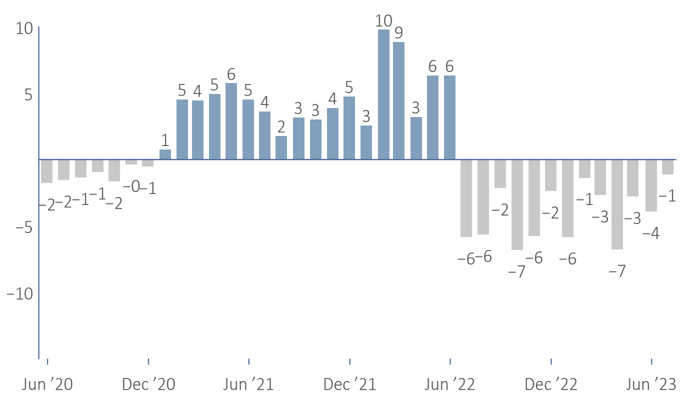
Source: Pitchbook/LCD Research as of of June 30, 2023

Valuations

Yields on Various Asset Classes (%)

Source: JP Morgan, Credit Suisse, Barclays, as of of June 30, 2023

Monthly Bank Loan Fund Flows ($bn)



Source: Pitchbook/LCD Research, as of of June 30, 2023

CS Leveraged Loan Index

Source: Credit Suisse, as of June 30, 2023

ABOUT ARISTOTLE PACIFIC CAPITAL

Aristotle Pacific Capital, LLC specializes in institutional fixed income management with a focus on corporate credit. As of June 30, 2023 the firm managed $21bn across bank loan, high yield, corporate, and CLO strategies.

IMPORTANT NOTES AND DISCLOSURES