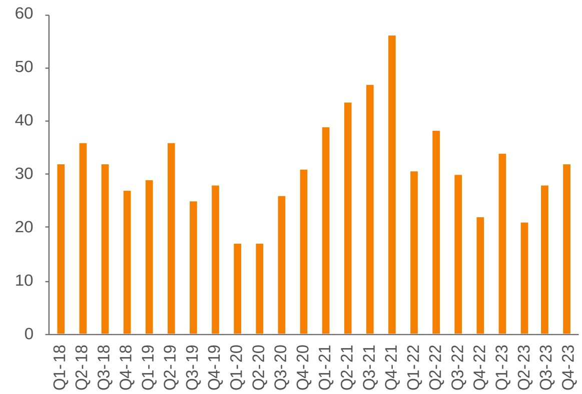
Voya Leveraged Credit Group

CLOs – 4Q Review

- In 4Q 2023, US CLO debt tranches delivered favorable returns across the stack. This was driven by stable carry and a strong rally in prices accounting for more than 50% of the return in the mezzanine tranches. These returns registered 2.18%, 2.6%, 2.89%, 4.65%,7.33%, 8.08% for AAA, AA, A, BBB, BB and B rating cohorts, respectively. For the full year in 2023, returns were strong and ahead of comparable fixed income asset classes, delivering 8.68%, 10.68%, 13.35%, 17.66%, 24.52% and 26.77% respectively.
- The CLO market remained resilient in 4Q despite the challenging arbitrage. Broadly syndicated loan (BSL) issuance volume, while tracking below last year, showed momentum as managers with captive or internal equity took advantage of tighter spread levels in liabilities and priced new issue deals alongside some reset activities. The continued strong demand across the stack, given the attractive yield, relatively stable fundamentals and manageable supply pipeline, provided strong technical tailwinds. This contributed to further tightening in spread levels amid a resilient macro and lower rate volatility.
- Barring a material tightening in AAA liability spreads, we project similar or slightly lower CLO issuance levels next year. AAA spreads remain relatively wide versus investment grade (IG) corporates and other parts of the securitized market, while U.S. banks haven't been an active buyer of CLO AAA tranches due to regulatory requirements. Unless we have further clarity around these overhangs, we don't see a catalyst for meaningfully tighter AAA spreads and a related spike in CLO supply above 2023 levels. With that said, we believe middle market CLOs will continue to gain traction, albeit from a small base, relative to broadly syndicated CLOs. Private credit markets remain an alternative and growing source of funding for borrowers.
- Managers with captive or internally sourced equity dominated BSL CLO issuance, given the prevailing challenged arbitrage during the year. This led arrangers to resort to creative structures and deal economics to facilitate syndication. Large manager absence was a notable theme vs. prior years with the top 20 CLO managers (which account for 45% of total U.S. CLO market) seeing 50% decline in issuance in 2023. Furthermore, among the 170+ U.S. CLO managers today, 76 U.S. CLO managers (approximately 40%) didn't issue in 2023 and 39 U.S. managers haven't issued since 2020, (half of which are small managers with less than $2 billion CLO assets under management). Potential for further manager consolidation remains topical, with at least 6 managers sold or acquired during the year.

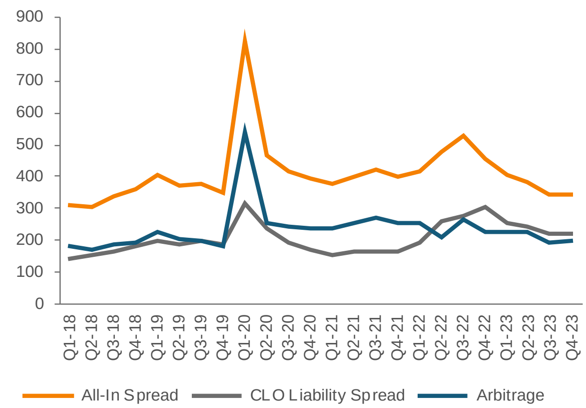
U.S. CLO Issuance ($ Billions)

January 1, 2018 to December 31, 2023



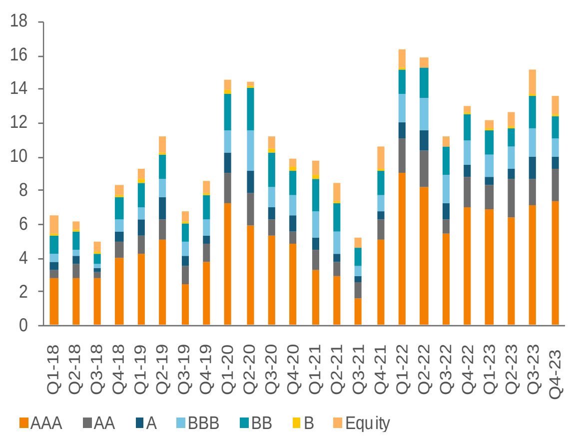
U.S. CLO Arbitrage at Issuance (Bps)

January 1, 2018 to December 31, 2023



U.S. CLO BWIC ($ Billions)

January 1, 2018 to December 31, 2023



Sources: LCD, BofA Global Research, Ratings refer to original rating, and spreads are generic. Actual spreads may differ based on structure, WAL, collateral and manager. Additional footnotes and disclosures on back page.

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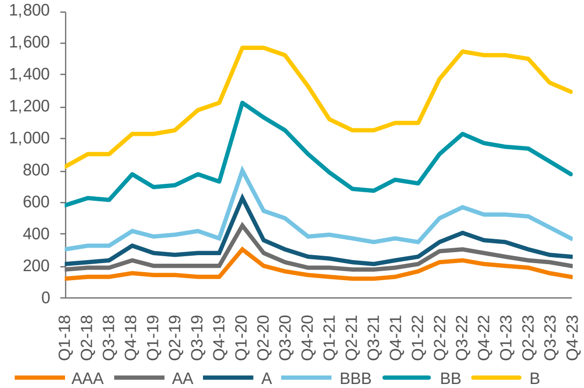
CLOs – 4Q Review (cont.)

- Overall, CLO credit metrics are still healthy from an aggregate level, but deceleration continues to be observed in post-reinvestment deals. Portfolios experienced increasing tail risk leading to further dispersion among managers, vintages and portfolios. This trend is likely to accelerate in 2024 as more CLO portfolios exit reinvestment periods. Thus far, 35% of deals are post-reinvestment and another 10% is slated to exit in a year or less. Given the quantum of post-reinvestment deals (highest in history of the asset class), we're likely to see higher liquidation and possibly reset activities if the loan market rally sustains.
- CLOs represent a significant portion of the loan investor base, with their ownership of the loan asset class now close to 70%. A credit to their attractive yields, floating rate features and structural protections, demand for CLO debt tranches continued at a healthy clip in 2023. Total CLO issuance amounted to roughly $116 billion, exceeding consensus expectations at the start of the year of around $90 billion. The CLO market successfully transitioned to SOFR in June 2023, with the majority of the floating-rate U.S. CLO debt market (over $900 billion in market size) priced to 3-month Term SOFR. In CLO portfolios, a substantial amount of loan collateral is priced to SOFR, with significant exposure to 2 benchmarks: 1-month Term SOFR (63%) and 3-month Term SOFR (36%).
- Looking ahead, we continue to like the relative value of CLO mezzanine tranches, which we find compelling vs. other fixed income asset classes. The current yield on offer across the CLO Mezz tranche universe is attractive even if base rates decline in the second half of the year. Our security selection remains biased towards primary and newer vintage reset opportunities with defensive positioning via exposure to larger managers with clean portfolios. While spreads have generally grinded tighter in 2023, we are cautious about some potential widening if rates volatility returns, macro environment weakens, loan fundamentals deteriorate and geopolitical risk intensifies. Given the backdrop and attractive yield opportunities on offer, we remain constructive on BBBs and BBs, but more selective on the latter and biased towards deals with stronger subordination and defensive portfolios.

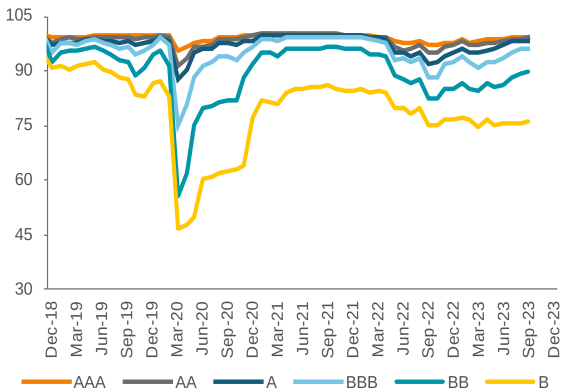
U.S. CLO 2.0/3.0 Secondary Spreads (Bps)

January 1, 2018 to December 31, 2023



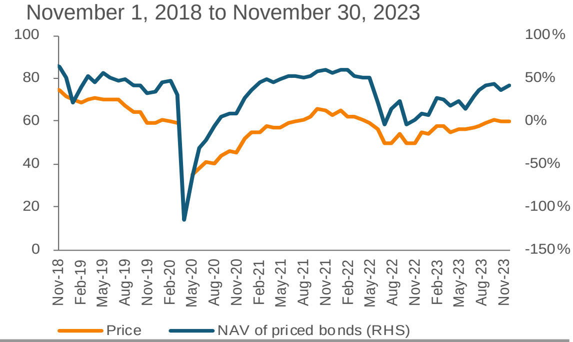
U.S. CLO Tranche Average Price

December 1, 2018 to December 31, 2023



Equity Price and NAV

November 1, 2018 to November 30, 2023



Pricing Across The CLO Stack

Rating	Credit Enhancement	Yield	Q4 Tranche Returns	YTD Tranche Returns	DM to 3Mo SOFR (bps)	QoQ Change in DM (bps)	YTD Change in DM (bps)
AAA	36.00%	5.70%	2.18%	8.68%	148	-22	-68
AA	25.00%	6.00%	2.60%	10.86%	215	-17	-73
A	17.00%	6.60%	2.89%	13.35%	271	-20	-106
BBB	12.50%	8.00%	4.65%	17.66%	409	-49	-147
BB	8.00%	12.40%	7.33%	24.52%	850	-75	-193
B	6.00%	19.20%	8.08%	26.77%	1503	37	-55

Sources: BofA Global Research, Morgan Stanley Research, and J.P. Morgan. Additional footnotes and disclosures on back page.

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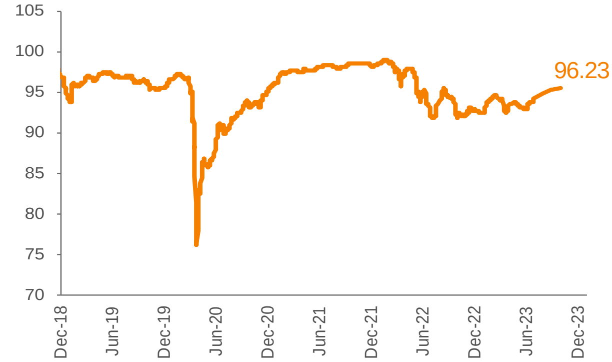
Leveraged Loans – 4Q Review

- The Fed's decision to keep interest rates unchanged at its final two policy meetings of 2023, along with ongoing disinflation in the U.S. resulted in a sharp rally across both fixed income and equity markets in 4Q, as the soft-landing narrative gained momentum. For the quarter, the Morningstar® LSTA ® U.S. Leveraged Loan Index returned 2.87%. The average bid price increased by 67 bp, closing out the year at 96.23. Price appreciation and elevated base rates contributed to this year's strong return of 13.32% (the strongest return since Global Financial Crisis).
- There was minimal dispersion among credit cohorts during the quarter. Double-Bs and Single-Bs trading levels experienced an uptick, while CCC saw a slight decline. In terms of performance, Single-B loans surpassed the broader Index and the other quality counterparts in 4Q. For context, Double-Bs, Single-Bs and CCCs returned 2.71%, 3.16% and 2.18%, respectively.
- Supply in the primary market moderated compared to 3Q due to the typical year-end seasonal slowdown. Volume was mainly driven by opportunistic transactions, although acquisition-related deals were prevalent in November. For the quarter, total supply stood at $55.7 billion. The size of the loan market, as represented by total Index outstandings, is now slightly below $1.4 trillion.
- Turning to investor demand, CLO issuance increased in 4Q to $31.9 billion across 74 deals from $27.96 billion last quarter. Full-year CLO volume was at $116 billion, behind last year's issuance of $129 billion. 2023 saw 268 new issuance deals, 14 refinancing and 43 resets, totaling $116.4 billion, $5 billion and $20 billion, respectively. New issue volumes are down 13% year-over-year (versus $133 billion in 2022). BSL new issue volume was down 26% to $88.4 billion, while middle-market CLOs accounted for 23% of total issuance in 2023 and increased by 100% to $28 billion. Refis are up 26%, while resets are down 7%.
- Continued solid formation in 4Q further increased the size of the US CLO market, which currently stands above $1.01 billion as of the fourth quarter, equating to more than a 100% increase from the start of 2017.

Average Bid: Morningstar LSTA LLI

December 1, 2018 to December 31, 2023

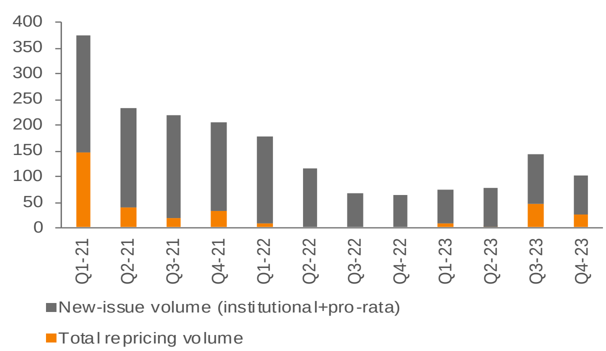


Average 3-YR Call Secondary Spreads: Morningstar LSTA LLI [2,3]

December 1, 2018 to December 31, 2023

Loan Issuance and Repricing Activity ($ Billions)

January 1, 2021 to December 31, 2023



Morningstar ® LSTA ® Leveraged Loan Index Stats

	Weighted Average Nominal Spread*	Weighted Average Price	4Q Price Return	4Q Total Return	2023 Price Return	2023 Total Return
Index	**3.69%**	**96.23**	**0.46%**	**2.87%**	**3.46%**	**13.32%**
BB Loans	2.94%	99.59	0.55%	2.71%	1.63%	10.18%
B Loans	3.94%	97.96	0.68%	3.16%	4.54%	14.82%
CCC Loans	4.88%	79.99	-1.02%	2.18%	3.85%	17.54%

Source: LCD, The Morningstar ® LSTA ® Leveraged Loan Index. Additional footnotes and disclosures on back page. **Past performance is no guarantee of future results. Investors cannot invest directly in the Index.** *The Index's average nominal spread calculation includes the benefit of LIBOR floors (where applicable).

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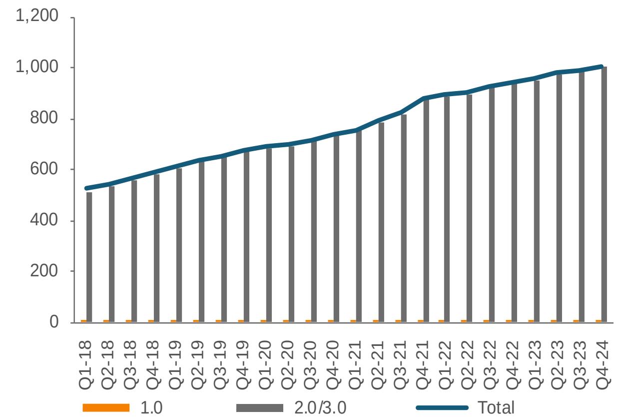
Leveraged Loans – 4Q Review (cont.)

- On the other hand, retail loan funds experienced a net outflow of $960 million during the quarter. 2023 outflows amounted to approximately $17.3 billion.
- Default activity increased in 4Q compared to last quarter. There were three defaults in the Index during the quarter as the trailing 12-month default rate by principal amount moved up to 1.53%, from 1.34% in September (remains well below historical average). Although defaults have picked up recently from historically low levels, we expect the trailing rate to see additional increases in 2024 to a level that nears and even exceeds the historical average range of roughly 2.5–3%.
- The ratio of downgrades to upgrades increased in 4Q, with the rolling 3-month downgrade-to-upgrade ratio increasing to 2.42x (from 1.73x in 3Q23). Lower-quality names in stressed sectors contributed to the accelerated pace of downgrades this month, which led to a slight uptick in CCCs. Downgrade activities should continue to pose a challenge, especially for issuers in the lower rating spectrum, as key downgrade themes include earnings, margin pressure, elevated leverage levels, increased borrowing costs and developing sectoral themes.
- We expect macro-related volatility to remain a prominent theme globally, as economies shift to below-trend growth. The increased cost of capital will curb investment and consumption, an effect that ongoing global government support will partially counter. While the U.S. economic outlook has been favorable compared to the rest of the world, policy rates will remain restrictive in the medium term and there are risks that consumer spending weakens in 2024. With inflation cooling and labor markets moderating, we believe the Fed is done hiking but think markets may be too aggressively projecting cuts in 2024, as the last mile in getting inflation back to its 2% target will be the most difficult
- Looking ahead, we expect a continued supportive technical backdrop in 2024 for the loan market, as net issuance creation remains low, while demand continues at a steady clip. CLO issuance should remain the primary driver of demand in the loan market, while retail loan fund flows are expected to ebb-and-flow in 2024, corresponding to general investor sentiment. In terms of fundamentals, we believe the sustained "higher for longer" rate environment, nearing maturity walls, and an expected slowdown in GDP growth will lead to an uptick in downgrades and defaults. As a result, our focus will remain on credit selection.

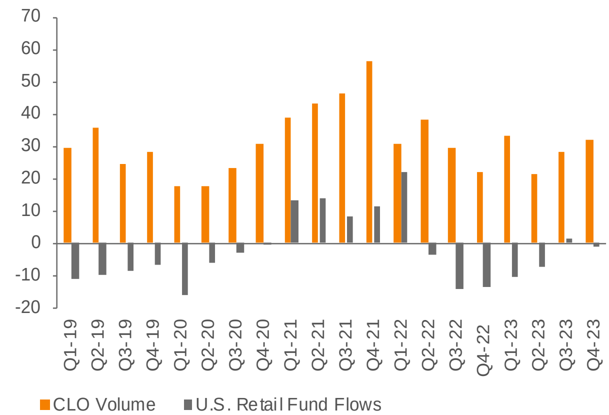
U.S. CLO Market Size ($ Billions)

January 1, 2018 to December 31, 2023



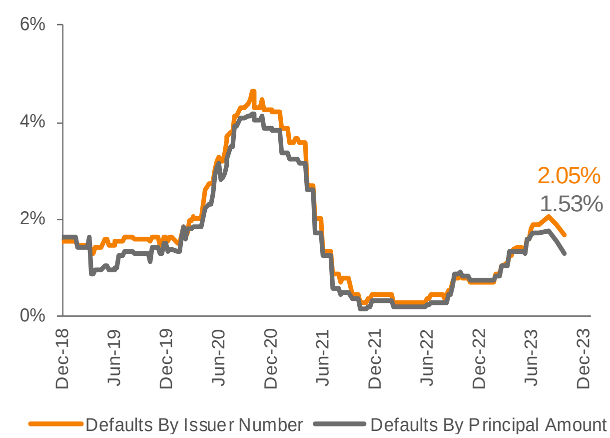
CLO Volume and Retail Fund Flows ($ Billions)

January 1, 2019 to December 31, 2023



Lagging 12M Default Rate: Morningstar LSTA LLI[4]

December 1, 2018 to December 31, 2023



Source: BofA Global Research, LCD, Morningstar ® LSTA ® Leveraged Loan Index. Additional footnotes and disclosures on back page.
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To the extent the data is sourced from LCD, LCD does not make any representations or warranties as to the completeness, accuracy or sufficiency of the data in this report.

[1] J.P. Morgan Collateralized Loan Obligation Index (CLOIE) has been obtained from sources believed to be reliable but J.P. Morgan does not warrant its completeness or accuracy. The Index is used with permission. The Index may not be copied, used, or distributed without J.P. Morgan's prior written approval. Copyright 2022, J.P. Morgan Chase & Co. All rights reserved.

[2] Assumes 3 Year Maturity. Three-year maturity assumption: (i) all loans pay off at par in 3 years, (ii) discount from par is amortized evenly over the 3 years as additional spread, and (iii) no other principal payments during the 3 years. Discounted spread is calculated based upon the current bid price, not on par.

[3] Excludes facilities that are currently in default.

[4] Comprises all loans, including those not tracked in the LPC mark-to-market service. Vast majority are institutional tranches. Issuer default rate is calculated as the number of defaults over the last twelve months divided by the number of issuers in the Index at the beginning of the twelve-month period. Principal default rate is calculated as the amount defaulted over the last twelve months divided by the amount outstanding at the beginning of the twelve-month period.

General Risks for Floating Rate Senior Loans: Floating rate senior loans involve certain risks. Below investment grade assets carry a higher than normal risk that borrowers may default in the timely payment of principal and interest on their loans, which would likely cause the value of the investment to decrease. Changes in short-term market interest rates will directly affect the yield on investments in floating rate senior loans. If such rates fall, the investment's yield will also fall. If interest rate spreads on loans decline in general, the yield on such loans will fall and the value of such loans may decrease. When short-term market interest rates rise, because of the lag between changes in such short-term rates and the resetting of the floating rates on senior loans, the impact of rising rates will be delayed to the extent of such lag. Because of the limited secondary market for floating rate senior loans, the ability to sell these loans in a timely fashion and/or at a favorable price may be limited. An increase or decrease in the demand for loans may adversely affect the loans.

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