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CLOs in focus: Opportunity amid uncertainty



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Himani Trivedi, head of structured credit at Nuveen, shares her thoughts on how CLO markets are faring amid market volatility from Trump's tariff policy and highlights how experienced managers can find value across the CLO capital structure.

Q: Credit and equity markets have seen volatility during the second quarter on the back of the Trump administration's tariff policy. How has the change in the market reverberated in the CLO world?

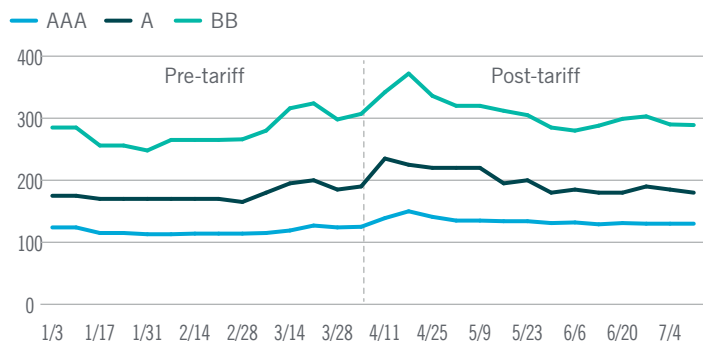
A: The spike in volatility was a sharp change from the relentless spread tightening witnessed across both the asset side and liability side throughout 2024 and early 2025. The levels we saw early in Q1 were historically tight and contributed to the boom in CLO issuance as managers and equity investors looked to lock in cheap financing levels for their transactions. While the April 2nd tariff announcement ramped up volatility across the board, the market had already softened in March with spreads coming off their tights going into Liberation Day (Figure 1).

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Prices and spreads have rebounded sharply on market optimism, though we expect volatility to return later in the year

Figure 1: Liberation day tariff announcement increased volatility and spreads

New U.S. CLO issuance Q1 and Q2 2025



Source: BofA Global Research CLO Factbook as of 11 July 2025. Past performance does not guarantee future results. There is no assurance that any asset class or index will provide positive performance over time.

The magnitude of the tariff announcement, however, caught many in the CLO market by surprise, surpassing the worst-case scenarios for many market participants. For new transactions that were in the market at the time of the announcement, clearing levels shifted dramatically for any tranches that were not spoken for. These deals were, however, able to be executed, albeit with wider spreads down the stack, illustrating that investor demand continues to be robust for the asset class. While some deals were pulled, new issuance only slowed slightly in April before recovering in May, though refinancings and resets slowed more meaningfully. On the secondary side, we witnessed an orderly sell-off with spreads widening across the board, though we did not come close to approaching the wide levels seen in the 2022 broad market sell-off.

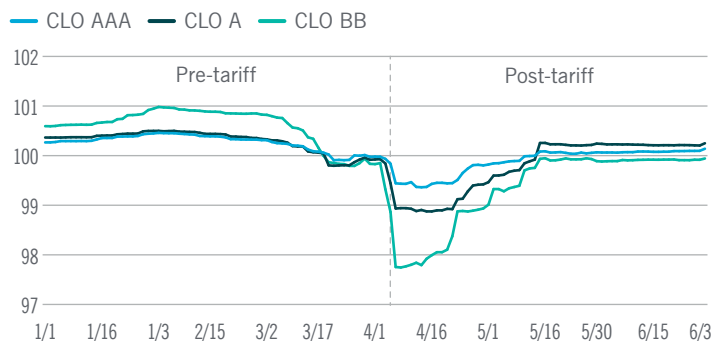
With the tariff posturing now shifting to a less aggressive stance, given the off-ramps with China and Europe, there has been significant retracement relative to the immediate shock on Liberation Day, with spreads moving closer to the late-March levels. The uncertainty, however, stemming from the yo-yo approach to policy still leaves us at a wider point relative to the tights we saw in early Q1, though as of today we are not that far off and continue to see spreads come in tighter.

Q: How do you view the opportunity set at the moment with respect to CLO debt investing up and down the capital structure?

A: Generally speaking, we think the opportunity in CLO debt, both in terms of price and spread, is more attractive now than earlier in the first quarter. Looking across the capital structure, tranches have generally recovered in price, though levels are still below their highs for the year (Figure 2), with spreads still wider now than in the first quarter as noted earlier. This varies, of course, in magnitude as you go up and down the capital structure. The price drop and widening on BBs, for example, is much more pronounced than in the investment grade rated tranches.

Figure 2: CLO tranche prices have generally recovered after tariff announcement

CLO prices Q1 and Q2 2025



Sources: Nuveen and Bloomberg as of 30 Jun 2025. CLO A: J.P. Morgan Collateralized Loan Obligation Index (CLOIE) – A-rated; CLO AAA: J.P. Morgan Collateralized Loan Obligation Index (CLOIE) – AAA-rated; CLO BBB: J.P. Morgan Collateralized Loan Obligation Index (CLOIE) – BBB-rated. Past performance does not guarantee future results. There is no assurance that any asset class or index will provide positive performance over time. Different benchmarks, economic periods, methodologies, and market conditions will produce different results. It is not possible to invest directly in an index.

We like the opportunity in the more junior tranches, given the current yield is now in the 10-11% context with the potential for some price appreciation on the margins pushing total return slightly higher. On the investment grade side, given the negligible level of default risk, we also think there is a compelling opportunity to earn excess spread with a high margin of safety.

We like single-A as a sweet spot in the capital structure where you can earn incremental spread relative to higher-rated tranches but still feel secure given the close-to-zero defaults historically.

That said, we have seen the market rally from the lows, and with the specter of additional volatility still looming, we think allocating capital in chunks over time makes sense.

Q: What about CLO equity? With higher debt spreads weighing on CLO equity, it seems like debt and equity investors might have opposing financial interests.

A: CLO equity remains interesting. On the asset side, loan spreads have largely retraced to pre-Liberation Day levels, if not tighter in some pockets. But much of this rally reflects sentiment rather than fundamentals. We think recent strength in earnings and macro data is hard to fully trust, as it likely reflects demand pull-forward. Many businesses and consumers accelerated purchases during the tariff pause, which may create demand air pockets in the second half of the year. Meanwhile, valuations have rebounded sharply, supported by optimism. As a result, we expect some volatility to return in the second half of the year.

On the new issue side, the retracement in leveraged loan spreads, which has thus far been more pronounced than the retracement in CLO spreads, means the new issue CLO arbitrage (the amount by which the yield of the CLO portfolio exceeds the cost of leverage) is out of sync currently. We favor taking a cautious approach to ramping new issue CLO equity, favoring high quality portfolios, as we believe returns in new issue equity may be more back-ended and influenced by portfolio residual values. Additionally, as loans appear priced to perfection and the shape of returns for newly issued looks increasingly negatively convex, we believe that defensive portfolios could offer an opportunity to rotate into names that may experience a more pronounced sell-off for technical reasons in the event of a spike in market volatility.

Notwithstanding the current state of the CLO arbitrage, we continue to be watchful of the market and well-positioned to capitalize on any pockets of market volatility. The ongoing tariff rhetoric remains a key overhang for growth outlook and subsequently is having a downstream impact on corporate fundamentals. In the immediate aftermath of the Liberation Day announcements in early April, we were able to originate attractive CLO equity with portfolios at attractive discounts of 1.75~2 points of price (which translates to significant value to the CLO equity tranche given the typical 10x leverage), discounts which have since evaporated as the market backdrop has improved. Our integrated platform, with a deep bench of loan and high yield traders, and strong relationships across the street, means that we can move quickly to deploy capital in size when these short windows present themselves.

On the secondary side, volatility can impact existing CLOs' equity NAVs and prices, which will factor in declines in the underlying loans. This creates opportunities across two dimensions. Tranche investors can find opportunities to buy discounted equity offered in the secondary market. In addition, at the loan portfolio level, skilled CLO managers can rotate their portfolios to take advantage of discounted loan prices. Manager expertise, however, is key to evaluate the portfolios, documentation and structures for making an investment, especially given the potential for optionality through capital structure events such as resets and refinancings which can unlock additional value.

Unpacking the interplay of debt spreads and equity returns, it can sometimes seem that the interests of debt and equity are at odds. After all, debt investors want more spread which drags down equity cash flows. However, the environments that drive higher CLO debt spreads can also serve to create the opportunity for total return in the loan portfolios, which can drive equity internal rates of return. For example, CLO debt investors might be able to garner outsized spreads on CLOs issued during broad market sell-offs when everything trades wider due to the risk-off environment. In those same periods, CLO equity investors are

eager to construct CLO portfolios as loan assets can be sourced at significant discounts which are magnified through the inherent leverage. That's why we can see deals issued in high spread environments, like 2022, have strong equity performance.

Q: A few headlines have flagged concerns around the nascent CLO ETF market and the outflows that have occurred amid the volatility. Do you see cause for concern in the ETF space or any implications more broadly for CLOs?

A: As noted earlier, the CLO market was not spared from the broader macro volatility of the second quarter, with CLO ETFs experiencing outflows concentrated after the tariff announcement. From our perspective, we would describe the sell-off as orderly, with the market absorbing all the supply the ETFs released into the secondary market. We continue to see ample demand across the capital structure, and we do not have any concerns about the CLO market stemming from the CLO ETFs.

Since the volatility subsided, we have seen investors return to CLO ETFs with upwards of \$1.5 billion of inflows to the market in May and June. U.S. CLO

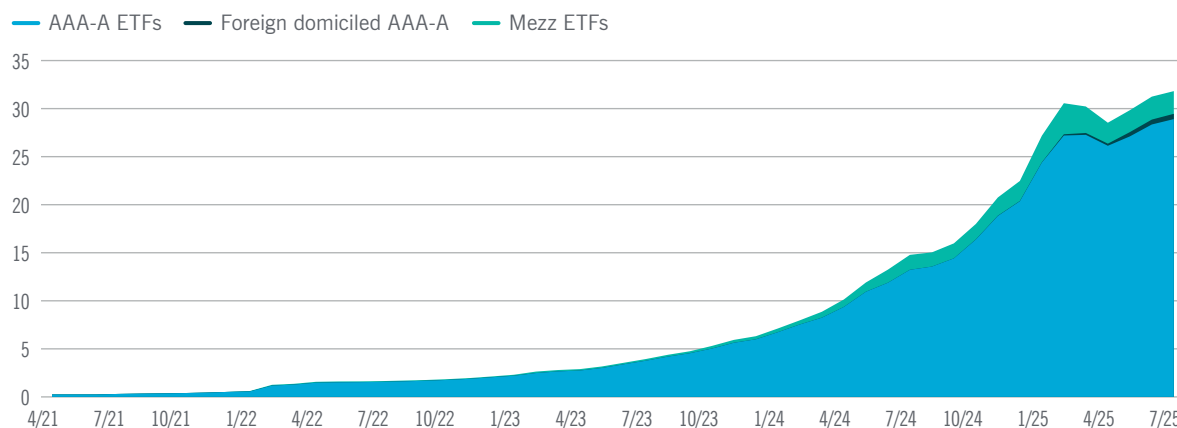
ETF AUM now totals more than \$30 billion, which compares to \$10 billion at this time last year and \$22.5 billion to start 2025, with the vast majority in AAA CLO ETFs (Figure 3). We think the growth trajectory has been impressive and a testament to the expansion of interest in the asset class, which did not exist in the ETF world in 2020.

To put things in perspective, however, the CLO market is roughly \$1 trillion in size, so the ETF AUM only represents approximately 3% of the overall CLO market size. Our view is that the outflows seen to date in the CLO ETF market may have had an impact on the margins but have not materially impacted or moved spread levels in the overall market, which is far larger in size. The overall market sentiment (tied to the broad sell-off in equity and credit) in response to the tariff announcements has been the primary driver in the widening of liability spreads, not the CLO ETF flows which again are a smaller portion of the overall CLO and AAA market.

There may come a time in the future when ETFs grow to a more substantial portion of the CLO market and have a more material impact with respect to their flows, though we are not yet at that point.

Figure 3: The CLO ETF market has more than tripled in size since Q1 2024

CLO ETF AUM as of July 2025 (\$ billions)



Source: BofA Global Research CLO Factbook as of 11 July 2025. **Past performance does not guarantee future results.** There is no assurance that any asset class or index will provide positive performance over time.

Q: Given the ETF outflows, what have you observed with respect to trading liquidity in the market today for CLO tranches?

A: Historically, volatile environments have affected CLO liquidity by expanding bid-ask spreads and prices gapping lower. We witnessed these dynamics during the 2008 global financial crisis when tranches across the capital structure traded at severe discounts as well as during the height of the Covid sell-off in 2020.

The magnitude of the sell-off in 2025 thus far has been relatively muted when we compare it to 2008 or 2020, or even 2022 when spreads widened on inflation concerns. We have not approached the post-Covid wides set in 2022, as spreads only widened to levels from early-to mid 2024, which was a healthy CLO environment.

When we look at the trading dynamics and technicals, we see a market with strong depth, especially in high quality tranches, which has helped the sell-off maintain order. The market itself has grown in terms of size, but the number of participants, breadth and access to technology have also improved in the last decade. We view this as another sign of the CLO market's maturity and growth, with new investors watching the asset class across both the institutional and wealth channels.

Q: What CLO metrics or qualities are key for investors to consider as they evaluate the range of products in the market?

A: CLOs have many metrics to consider which should be viewed holistically rather than in isolation. At the CLO level, key metrics we like to dig into include overcollateralization (OC) tests, collateral quality tests (spread, ratings, portfolio diversity) and various concentration limits (CCC especially). Some of these metrics help us understand the overall health of a deal and ability to service the CLO debt (and make equity distributions). Others provide data on the makeup of the underlying loan portfolio. In aggregate, these data points, as well as qualitative factors such as manager reputation or style, paint a picture for us to evaluate a CLO investment.

Importantly, investors shouldn't look at a couple factors on their own. For a CLO (or a fund holding CLO tranches), the reasons why metrics might be high or low need to be unpacked. If spread is high, are they achieving that through lower quality managers or through higher credit risk at the loan level? If two CLOs have similar percentage exposure to CCC-rated loans, are their exposures to names that are deteriorating and headed for default or names that are stable but more highly levered? This can be challenging to evaluate without the benefit of an integrated CLO management and investing platform, where credit level views inform the tranche evaluation.

Answering these questions requires knowledge of the CLO market landscape and deep credit expertise. Our view is that for most investors looking for CLO exposure, selecting a skilled CLO tranche manager that has a long history in the market, deep relationships, and the ability to formulate loan level views is critical for investor success.

For more information, please visit nuveen.com.

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