No two years are the same — but 2025 is shaping up to be strong

Thomas Majewski

Founder & managing partner

Eagle Point Credit Management

Tariffs, trade wars and inflationary pressures are unlikely to prevent CLOs doing well this year

In many ways, 2024 was a year of records. New CLO issuance volume exceeded USD 200bn and total issuance volume, including refinancings and resets, reached USD 509bn, surpassing 2021's high mark of USD 438bn. Importantly, net issuance remained balanced at USD 70bn, leaving many CLO debt buyers with less capital deployed than anticipated at the beginning of 2024.

Resets went into orbit, numbering well over 400 and accounting for more than USD 210bn of issuance. Tightening spreads and healthy investor demand drove this impressive showing, as did the emergence of a sizeable backlog of would-be transactions that had stalled in the face of 2023's market conditions.

What might lie ahead for 2025? We believe that CLO investors will have plenty of reasons to be cheerful. No two years are the same — but 2025 is shaping up to be another strong year.

Expect a slight fall in issuance

Many in the industry expect primary market CLO issuance to again reach or even exceed USD 200bn, but we anticipate volumes to fall a bit lower given that CLO equity arbitrage isn't where it was a few months ago. Certainly, without a significant influx of true new issue loans into the market and loan prices hovering around par, we are setting our net CLO issuance expectations low for 2025, at USD 50bn.

In our view, spreads are likely to tighten further, corporate default rates should remain quite low and triple C concentrations should fall. Indeed, CLO triple As could end the year somewhere between 90bps and 100bps, which would take us into territory not seen since before the pandemic.

With the saga of Serta Simmons having now dragged on for five years, the likely fate of liability management exercises (LMEs) in 2025 merits mention. The recent ruling by the US Court of Appeals for the Fifth Circuit offers an interesting legal hammer against sponsors who have been promulgating lender-on-lender violence. Though we hope to see a reduction in the aggressive activity that creates unequal outcomes, we believe it is incumbent upon all CLO security investors — both debt and equity — to push their CLO collateral managers vigilantly to combat these trends with their relationships and dollars.

There are several 'known unknowns' to consider as we enter 2025. The impact of tariffs, trade wars and inflationary pressures underline that we are living in a risk-on world where volatility is not so much possible as practically inevitable. Against this backdrop, CLO investors may wish to keep in mind two important points.

Firstly, barring a major unknown macro event, we believe that none of the above means a big default cycle is imminent. Moreover, even if there were such a turn of events, the best CLOs within their reinvestment periods should be able to outperform. Our portfolio of CLO equity typically comes out of cycles looking better than it did going in because the deeply discounted loan purchases made during a dislocation outweigh the losses from defaults.

Secondly, put simply, "the rumour is worse than the news". The reality is that inflation and interest rates have relatively minor impacts on CLO equity. Rates are worth watching, but CLO equity is ultimately a spread arbitrage product. Rather than rates, spread compression poses a bigger risk to CLO equity, but CLO equity investors can mitigate the spread reduction by driving proactive refinancing and reset activity.

As Mark Twain once said: "History doesn't repeat itself, but it often rhymes." While 2025 won't be a repeat of 2024, we see rhyming trends from 2024 playing out in 2025.