

CLOs Today: High Risk, Low Reward

Sep. 2025

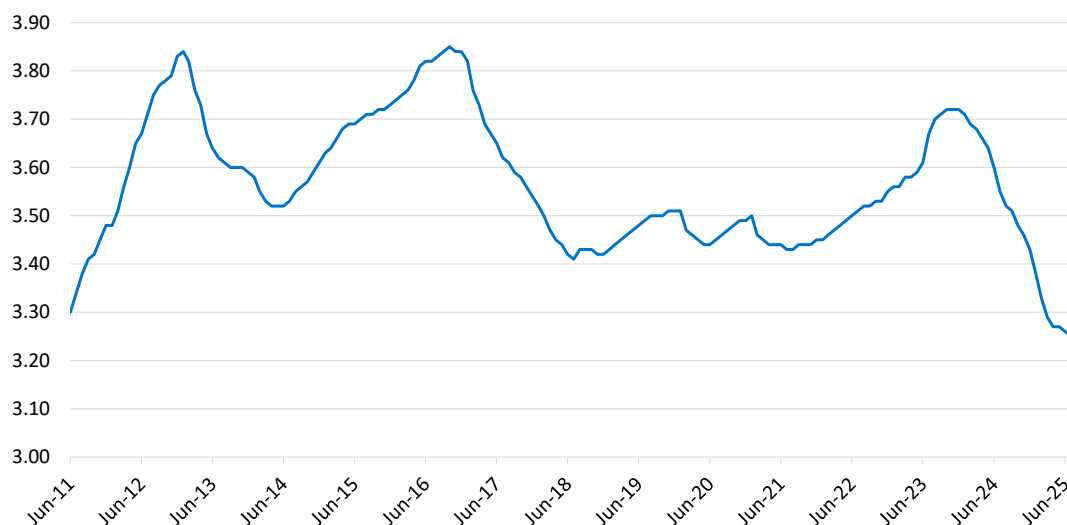
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For collateralized loan obligation (CLO) investors, today's underlying loan portfolios present an unfavorable tradeoff: Spreads have compressed to historic lows even as defaults remain elevated. This marks a sharp break from past cycles when loan repricing waves coincided with benign credit conditions. How should CLO investors position portfolios in a market that appears to offer high risk with low reward?

Spread Compression in a Repricing Wave

The median weighted average spread (WAS) on loan portfolios underlying CLOs reached 3.25% as of July 2025, marking the tightest levels in the post-Global Financial Crisis era.

CLO Portfolio Weighted Average Spread | As of June 30, 2025



Source: DoubleLine, Valitana

This spread tightening has been driven by a refinancing and repricing wave in which nearly 80% of outstanding loans were repriced within a 12-month period ended February 2025.¹ Loan repricing waves are a recurring feature of the CLO market. From 2017 to 2019, the loan market experienced a stretch of 25 straight months with a last 12-month (LTM) repricing rate above 30%. Repricings peaked at 70% in this period and brought the median WAS on CLO portfolios down from 3.85% to 3.40%. Similarly, the loan market experienced another stretch of repricings above 30% from October to December 2021.

¹ For simplicity, we will refer to refinancings and repricings together as "repricings" for the rest of this paper.

Is This Time Different?

The current run of repricings appears similar, with a peak LTM repricing rate near 80% in February 2025. However, one key difference stands out: Unlike past repricing waves that occurred in benign credit environments, loans today face an above-average default rate of 4.5% (including distressed exchanges). Tail-risk indicators are also elevated, with nearly 3% of loans in CLO portfolios trading below \$80 and about 5% rated CCC (the lowest tier of non-investment grade (IG) rating, just above default). During the 2017 and 2021 repricing waves, the default rate was below 2% when repricings peaked. Both of those periods also marked the share of loans trading below \$80 fall to 1%.

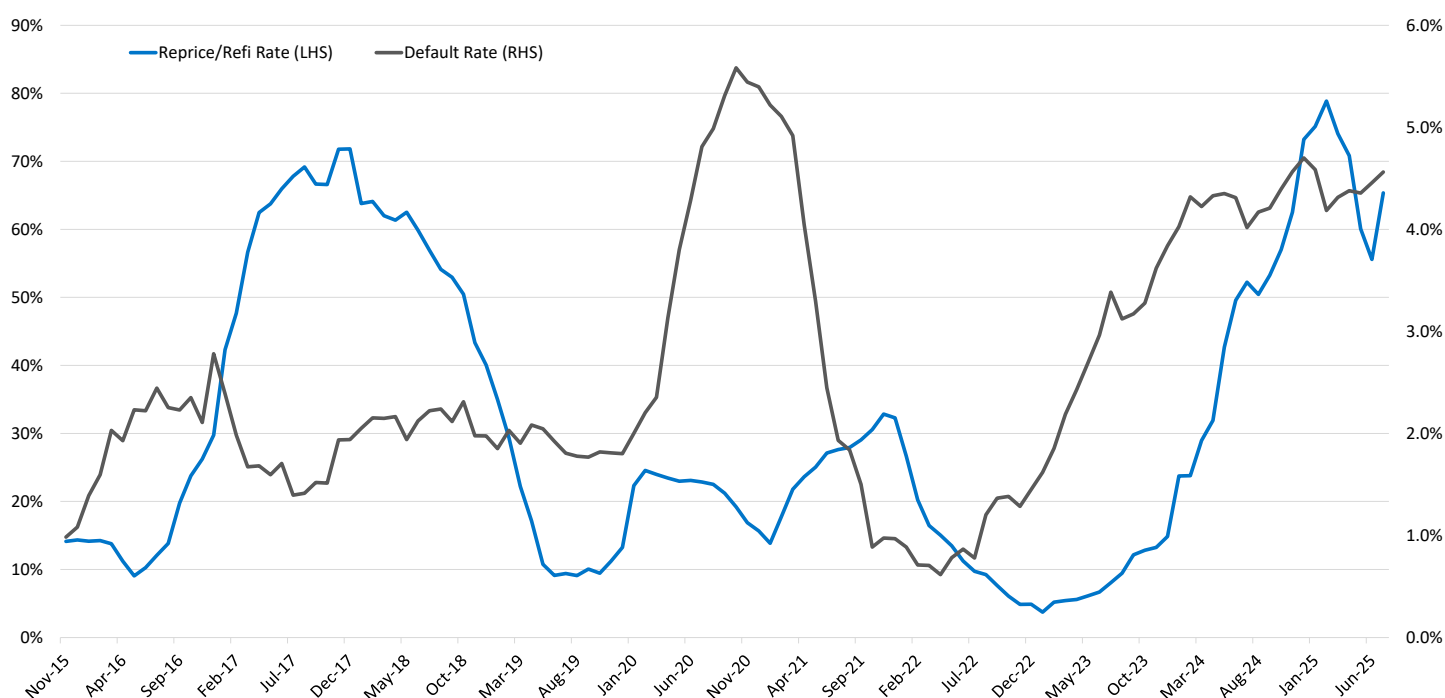
Repricing Wave	Peak LTM Repricing Rate	Peak LTM Repricing Rate Date	Default Rate	Trough Assets < \$80
January 2017 - January 2019	72%	November 2017	1.94%	1.0%
October 2021 - December 2021	33%	November 2021	0.71%	1.0%
April 2024 - Current	79%	January 2025	4.58%	3.0%

Source: DoubleLine, LCD, Valitana, as of August 2025

The chart below visualizes this anomaly. In 2017, the loan repricing rate spiked to over 70% as default rates fell below 2%. During the COVID-19 recession in 2020, the default rate increased to 5.6% and repricings slowed. Following this, default rates fell below 1% during the 2021 rebound while repricing rates increased to over 30%.

Starting in 2023, an unusual pattern emerged: Default rates rose as repricing accelerated, and this persisted into 2025, with repricing near post-GFC highs and defaults at levels last experienced during COVID-19.

Loan Reprice vs. Default Rate | As of July 31, 2025



Source: DoubleLine, LCD

Why Are Spreads Tightening Despite Rising Defaults?

One potential explanation for spreads tightening as defaults rise is a convergence in CLO management styles. Recovery rates on loans have been low, driven by liability management exercises and aggressive use of loose documentation by private-equity sponsors. LTM first-lien recovery rates have fallen below 40% compared with long-term averages above 60%.² In practical terms, the cost of mistaken credit selection has risen.

The market has responded to this by focusing on conservative portfolios to avoid losses. In previous eras, a subsector of CLO managers would attempt to outperform by running higher WAS and higher beta portfolios. However, recent experience has shown that higher spreads often fail to compensate for loan defaults when recoveries are low (single digits in some cases). In today's environment of low recoveries, chasing higher-WAS portfolios brings disproportionate downside, making loss avoidance paramount for CLO managers.

As a result, CLO managers have concentrated in low-spread loans, driving repricing tighter while leaving higher-spread, riskier credits with little support.

Risk-Reward Across the CLO Capital Stack

The combination of low WAS in underlying loans and elevated tail risks makes investing in lower-rated tranches of CLOs challenging. For CLO equity, low WAS reduces excess spread (the interest-only portion) while credit loss erodes equity net asset value (the principal-only portion).

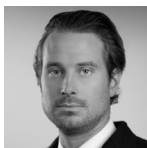
While CLO tranches rated BB have robust credit support and strong historical performance, a combination of tight spreads, elevated credit risk and weaker structures also argues for being selective. Primary CLO BB spreads were 535 basis points (bps) as of August, placing them in the first percentile of the post-GFC period.³

In addition to historically tight spreads, BB CLOs now face weaker structures due to the introduction of a junior tranche rated BBB. In the new structure, the safest portion of what used to belong to the BB bond is carved out and repackaged into its own "junior BBB" tranche. This reshuffling means that the remaining BB bond is thinner and riskier while the carved-out slice is sold as a more senior security. The result is that BB bonds look cheaper than they really are, since part of their protection has effectively been moved up the capital stack. Adjusting for this risk would make BB spreads appear even tighter. On the positive side, the top of the CLO capital structure seems to offer attractive risk-adjusted returns. New-issue tranches rated AAA at approximately 130 bps look attractive compared to IG corporates, which have recently touched spread highs not seen since 1998.

CLO AAA tranches also offer attractive relative value compared to loss-adjusted loan spreads. Adjusting the median CLO portfolio WAS of 3.25% for a 4% default rate and 50% recovery (2% net credit loss) yields a 1.25% spread – roughly in line with CLO AAAs. Although CLO managers expect the portfolios they are currently ramping to perform better than a 4% default rate, adjusting spreads for today's defaults and recoveries remains illustrative. On this basis, credit-risk-remote CLO AAAs offer similar loss-adjusted spreads to loan pools (with a weighted-average rating of B) despite higher ratings and lower volatility.

A Market That Demands a New Playbook

Historical anomalies often mark turning points in markets. Today's anomaly – tight spreads alongside rising defaults – signals that traditional CLO playbooks might no longer apply. For equity and BB tranches, compressed income and elevated credit risk create a poor tradeoff: high risk with low reward. By contrast, AAA tranches may offer a more attractive balance, with spreads that compare favorably to corporates and loans on a loss-adjusted basis. Investing in CLOs now requires a fresh perspective, recognizing that the risk-reward equation has shifted and aligning portfolios accordingly, with caution on equity and BB tranches and greater emphasis on AAA. ■



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Mr. Mezyk joined DoubleLine in 2016 as an Analyst focusing on CLOs and other structured products. Prior to DoubleLine, he was a Structured Products Analyst at American Capital, where he invested in CLOs for its Leveraged Finance Group. Prior to American Capital, Mr. Mezyk was an Analyst in PNC Financial Services' Asset-Backed Finance Group, where he focused on structuring different ABS transactions. He holds a BBA from the University of Notre Dame. Mr. Mezyk is a CFA® charterholder.



Samuel Garza
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Mr. Garza joined DoubleLine at its inception in 2009. He is a Portfolio Manager on the Macro-Asset Allocation team and oversees the CLO team. Mr. Garza is a permanent member of the Fixed Income Asset Allocation and the Structured Product committees. Prior to DoubleLine, he was a Senior Vice President at TCW, where he held several positions over his tenure. Prior to TCW, Mr. Garza worked at Union Bank of California in the Commercial Banking Group, where he was involved with corporate loan underwriting. He holds a B.A. in Business Economics from the University of California, Santa Barbara, and an MBA from the Anderson School of Management at the University of California, Los Angeles.



Angela Caliri
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Ms. Caliri joined DoubleLine in 2011. She is a Trader on the Structured Products team, where she specializes in CLOs. Ms. Caliri is also part of DoubleLine's Responsible Investment team, overseeing the Responsible Investment integration framework for the CLO team. Prior to DoubleLine, she worked at TCW as an Analyst in the Risk Group. Ms. Caliri holds a B.A. in Mathematics and M.S. in Mathematical Finance from the University of Southern California.

Basis Points (bps) – Basis points (or basis point (bp)) refer to a common unit of measure for interest rates and other percentages in finance. One basis point is equal to 1/100th of 1%, or 0.01% or 0.0001, and is used to denote the percentage change in a financial instrument. The relationship between percentage changes and basis points can be summarized as: 1% change = 100 basis points; 0.01% = 1 basis point.

Below Investment Grade (IG)/Non-Investment Grade (Non-IG) – Term indicating a security is rated below investment grade (IG). These securities are seen as having higher default risk or being prone to other adverse credit events. They typically pay higher yields than higher-quality bonds in order to make them attractive. They are less likely than IG bonds to pay back 100 cents on the dollar.

Beta – Measure of the volatility – or systematic risk – of a security or portfolio compared to the market as a whole.

Collateralized Loan Obligation (CLO) – Single security backed by a pool of debt.

Distressed Exchange – A bank loan distressed exchange is an out-of-court negotiation where a company facing financial difficulties proposes to exchange existing debt for new debt, often with a reduced principal amount or modified terms, to avoid bankruptcy.

Investment Grade (IG) – Rating that signifies a municipal or corporate bond presents a relatively low risk of default. Bonds below this designation are considered to have a high risk of default and are commonly referred to as high yield (HY) or "junk bonds." The higher the bond rating the more likely the bond will return 100 cents on the U.S. dollar.

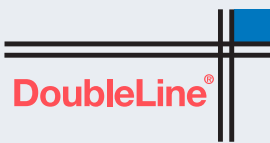
Liability Management Exercise (LME) – Strategic process used by companies to manage, modify or optimize outstanding debt, often as an alternative to bankruptcy or traditional restructuring. LMEs involve techniques such as debt exchanges, maturity extensions, tender offers and covenant modifications.

Net Asset Value (NAV) – Net value of an entity calculated as the total value of the entity's assets minus the total value of its liabilities. Most commonly used in the context of a mutual fund or an exchange-traded fund (ETF), the NAV represents the per share/unit price of the fund at a specific date or time.

Par – Short for "par value," par can refer to bonds, preferred stock, common stock or currencies, with different meanings depending on the context. Par most commonly refers to bonds, in which case, it means the face value, or value at which the bond will be redeemed at maturity.

Spread – Difference between yields on differing debt instruments, calculated by deducting the yield of one instrument from another. The higher the yield spread, the greater the difference between the yields offered by each instrument. The spread can be measured between debt instruments of differing maturities, credit ratings or risk.

Weighted Average Spread (WAS) – Par-weighted average spread (generally above SOFR) of the performing floating-rate securities in a portfolio (typically loans).



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