



## Panel #2 – Credit Alchemy: Turning CLOs And High Yield Into Income Opportunity

Wednesday, November 19, 2025

**MIKE TAGGART:** All right, well, thank you everyone for joining us today. So this panel, as you can see, is “Credit Alchemy”, so I have two alchemists on this panel. I’m Mike Taggart, I’m the head of closed-end fund relations at Aberdeen Investments, and today we’re fortunate to have with us, like I just said, two expert alchemists, even though they don’t have their names, they are in order up here. So we have Connor Dugan, a principal at Octagon Credit Investors, where his focus is on – oh, we do have names – his focus is on third-party CLO tranche investing, Octagon is a \$33 billion AUM asset manager with a focus on below investment grade and structured credit strategies, Connor joined Octagon in 2017. And then we have Kris Pritchett, a partner and portfolio manager in the Ares Credit Group, where he focuses on alternative credit, including asset-based finance investments, and he joined Ares in 2011. They know each other, so I expect some good ribbing up there, I’ve told them that. So about the funds they manage, Connor’s part of the team managing the XAI Octagon Floating Rate and Alternative Income Trust, ticker XFLT, the fund invests primarily in senior secured loans, CLO debt and CLO equity. Its investment objective, an attractive total return with an emphasis on income generation across the credit cycle, fund’s trading at about a 14% discount and has a price distribution rate of about 17.5%. Kris is part of the team managing the Ares Dynamic Credit Allocation Fund, ticker ARDC, the fund invests primarily in a broad dynamically managed portfolio of senior secured loans, high-yield corporate bonds, and CLOs. Its investment objective is to provide an attractive total return primarily through current income, secondarily through capital appreciation, and that fund is currently trading around a 4% discount and offering a 9.7% distribution rate on price. So first I want to start

big picture. What's that? Oh, see, they're already commenting on me. So I want to start big picture and then delve into portfolio specifics, so first question's for Connor, because I think it's driving a lot of sentiment. First Brands, is that a one-off or is that the canary in the coal mine?

**CONNOR DUGAN:** Sure, it's a great question. I will say this, I've never spoken about or been asked about a single credit more in my entire life than First Brands, I think the biggest lesson there is that when Jamie Dimon speaks, people listen. The CLO portfolios, they're investing in below investment grade credit, impairments happen all the time, it's normal course of business. With this one, and to answer your question, it's definitely our view that it's a one-off idiosyncratic loss. If you think about what happened there, it's a variety of factors, a very aggressive M&A spree from the borrower, very aggressive off-balance sheet financing, and at the end of the day it is at this point alleged fraud, which you really do not see very often. If the question is, do we see broader losses and this is the canary in the coal mine, as you said? No, there's not really alleged fraud that exists outside of this one name. Typically when you have broader-based losses, the economy is slowing down, maybe there's a sector that's facing a lot of headwinds that causes a number of different issuers some stress, but in this instance, it's absolutely our view that this is one-off idiosyncratic. I think it's also really important to talk about the positioning of the one name relative to the size of the loan market. Typically the loan market had around a third of a percentage point exposure to First Brands, if you were to buy the loan market, the loss from that one name would be offset with 10 days of interest accruals, so it's really not a very large portion of the loan market. And then we'll be talking about CLO tranches, typically the most junior debt involved in CLOs is the BB tranche, the way that those are structured, in order to lose money you'd have to absorb something the size of First Brands to the tune of 15 times every single year for the life of a CLO BB tranche, which could be 10 years. These structures are absolutely built to withstand many, many, many events like First Brands, so it's not this Armageddon that I feel the media's kind of frenzied into pitching us on believing right now.

**KRISTOFER PRITCHETT:** Yeah, I would agree with a lot of what Connor said there. If we think about what we're seeing in First Brands, so if we think about First Brands, it's a name that defaulted in a CLOs, names default in CLOs. You expect to see that, you underwrite to that, we have a loss budget when invest in equity, when we invest in debt. If you think about the

CLO portfolio, it is a high-yield portfolio and we see defaults, so when we first saw First Brands hit all the news stories, the team, we kind of shrugged our shoulders and said, "It's another default in the CLO market." It obviously caught fire, *Bloomberg* picked it up, there was alleged fraud, it was a nice story. At the same story you had Tricolor going on, so lots of stories that sounded similar, they made for a nice article. Nice articles that came from *Bloomberg* and lots of other news sources, where there was a thread that you could stitch together that made it sound like things were correlated, made it sound like, "Oh, are we late stage?" All these things, signs of something worse to come. But we don't really share that view, they seem somewhat idiosyncratic. You look at First Brands and there were red flags there, or maybe not quite red, but yellow flags. And if you talked to managers, which we did, we spoke to a whole collection of managers post-the event, "What did you do and why?" And it went from some guys who were like, "I didn't play in this name day one." It was a highly rated, highly priced, high coupon, high-yield instrument from Jeffries, generally didn't pass the smell test. Often if you think about underwriting a bank, some of them are a little bit stricter, some a little bit weaker, Jeffries are one that likes to get deals done and likes to be creative, and so that was a flag for some people, they passed on it. Other people saw signs, saw signs last year that actually something doesn't quite seem right here. Going through the financials they said, "If you look at it, it looks like they have some off-balance sheet financing." If you really dug deep on the underlying, things just didn't line up right, so some people sold at a 95. And then what we saw is the rumor of there was a short in the market, how do you short loans? Pretty unusual thing to hear. And so what we saw was there was a lot of noise around the name, and that also was a catalyst for people to sell. So when we look at what manager did across the market, it was pretty varied. And then some people rode it all the way and said, you know, this is a company, there's value here, it's a large company, it's top three in its industry, has a reason to exist, I think there is value here, and held it through the restructuring and are going through that now. So we saw a really big range of different outcomes, but at the end of the day on the CLO market, it didn't really impact it as much as you would think given the noise that it's created. If you think about ARDC, we had no exposure to the name, we don't have exposure to any kind of trade receivables, trade receivable finance. If we think about how we're positioned, we're in a diverse portfolio here, we don't see any hidden risks in the underlying portfolio that we're concerned about, and

that diversification that we get, we're about a third invested in bonds, about 40% in loans, and then about a third in CLOs, slightly under 30% in CLOs, so we have a diverse portfolio here. What we use, we use that CLO bucket that allows us to take less single name risk on the riskier part of the market, when I look at our bond portfolio, I look at our loan portfolio, it's higher quality than the index. We should avoid defaults, and we have done if you look at our track record, compared to both the loan and bond index. So we use the income from the CLOs to mean that those loan and bond portfolios don't need to be aggressive, so we don't need to step into names that maybe look like First Brands. But I would say, Jamie obviously had said cockroaches, there's more out there, I would say, yes, we have seen more. In particular in the private credit space, there's been a few managers, and you'll see on *Bloomberg*, Renova was a name that was announced I think last week, a pretty low recovery there, so there are names coming. Could you argue this is late-cycle behavior? Maybe. Again, not sure if I fully believe that. If we look at fundamentals in both the private credit space and the BSL space, we're chugging along okay, it's not great by any means but there is growth, it's relatively low growth, but you don't need stellar growth for credit, and we're in a bit of a Goldilocks scenario, if you will, for credit here. So when we look at our underlying portfolios, we're not seeing signs of stress, we're not seeing it be quite as bad as some of the news articles make it sound, and then if we look at how we position our portfolio in the higher quality part of the market, again, we're insulated again from that.

**MIKE TAGGART:** Excellent, thank you. So sticking with you, Kris, the Federal Reserve obviously just recently lowered rates another 25 basis points, the market's expecting more cuts in the year ahead, so how does that affect the senior loan, the high yield, and the CLO markets?

**KRISTOFER PRITCHETT:** I think it impacts them all differently, and that's what nice about ARDC being a multi-asset fund, having the ability to step into loans, bonds, and CLOs, and dynamically move between those asset classes when we see value. We move up and down with the asset classes from a rel-val standpoint, yes, but we also can pivot between, between the three different asset classes, and that's what we've done as we have different views on rates. If we think about rates over the last few years, well, actually if you think about the rates, pretty much forever the forward curve has never been right, if you look at the plots there, what it's always projected, you never line up. And the higher for longer story that

we've had in loans or in rates has really been a tailwind for loans over the last few years, now it feels like it is slowing down, but there's still uncertainty about how many cuts we're going to see, at least until the Fed chair is replaced. And so I think could loans be better off here in a higher than expected rate environment? Yes, but then so could bonds. And what's that going to do? I think it's going to start to drive a bit of volatility in those asset classes, and a little bit of relative value between the two, so we can now start to pivot our portfolio as we see opportunity in both. We like high-yield bonds today where we're positioned, high quality names, average coupons, 7.4%, giving us a nice income there. If I look at loans, they've taken a little bit of softness because of the rate story here, and now less loans are trading above par than bonds, so is that an opportunity now to capture discount, potentially get some capital gains into the fund? So we kind of start to position there, and as the rate view starts to play out going into next year, as we get more visibility on who the next Fed chair is and where we're going to go then, then we can take advantage of that. What I would note, is when we're in periods of volatility, what we see is it impacts the asset classes differently at different times, often CLOs lag loans for example, and that allows us to tactically move between the two asset classes as we see the risk and the value change between the two of them.

**MIKE TAGGART:** Interesting. Connor, do you have anything at Octagon?

**CONNOR DUGAN:** Yeah, our fund for one is the floating-rate fund, so we don't have quite as high the high-yield bond exposure, so a little bit more exposure to floating rate, but with that I think it's important to note the magnitude. I think SOFR right now is a hair under 4% and the forward curve suggests maybe low threes and maybe finds its footing somewhere in the mid-threes. The Fed really isn't positioning itself right now to be stimulative and have near-zero percent rates, and I think that floating-rate product is still really interesting in the income sphere. With a SOFR rate in the threes, if loans are paying 315 on top of that, it's still compelling income, if BB tranches are paying 550 over that, that's still pretty compelling income. It's pretty well-telegraphed on a downward sloping curve, but I think the magnitude there is helpful. And then zooming out, I think these tail-like events where the forward curve is wrong, they can happen. If you think about the lessons learned over the last three years, I think that it probably warrants a larger allocation to floating-rate product. There's some regional banks that don't exist today because they bought too many Treasuries with high duration, had they bought some more floating rate they'd probably be here today, so I think

that's worth calling out. This may be a little bit of a small detail, but there's pockets of the loan and high-yield market, or maybe just the loan market, that will benefit from lower rates, it'll help their interest expenses, we might see a pop in value for some of the lower priced loans within in the portfolios. And then specific to closed-end funds, a lot of them employ floating-rate leverage, so there might be some offset if we see lower rates, the leverage is typically connected to SOFR as well, so a little bit offset on that front.

**MIKE TAGGART:** That's a good point.

**KRISTOFER PRITCHETT:** And just add to that, I think lower rates, Connor, you touched on, it's going to help the loan market, some of the weaker names potentially recovering. It also could mean there's more M&A, there's more new issue, there's more transactions. I think once we get more clarity on where we're going on rates, rates are lower, you may see that bid-ask gap start to close and more transactions happen next year, which would mean more loans coming to the market, which again would be a good thing, a good thing for the market there.

**MIKE TAGGART:** Yeah. So you've both been looking after CLOs for a long time, market cycles, you've seen First Brands of the past, you've seen the Fed raise rates and lower rates. Looking back, are there any key lessons that have shaped your investment process or your investment philosophy? Connor, if you want to?

**CONNOR DUGAN:** Sure, it's a great question. Every single year there's different headwinds that impacts the CLO market, I'd say my answer is the lesson is that there will always be lessons. One thing we like to say at Octagon is, "Don't key in too much to what the output of what your model is saying," because it's assumption-driven and it's always going to be wrong, your assumptions will never be exactly correct, so keep your head on a swivel, keep looking for that next thing. I would say CLO equity specifically is pretty challenged 2025, what went wrong there isn't, in my opinion, an oversized area of underlying credit stress, it's not the First Brands of the world that caused that, it's really an overheating of the loan market, a lot of spread compression. If we were having this conversation 18 months ago, underlying loan spreads were probably somewhere in the neighborhood of 360-370, today they're low 300s, maybe hovering around 300. When you have a two-year non-call on CLO structures and a six-month soft call on loans, it's quite the mismatch, and I think that rapid compression is really what caused some of the headwinds to the asset class this year. There's always lessons, things can always be different, I'd say reversion to the mean analysis isn't

always correct. Before we were talking about rates, I guess the easy answer there is, to Kris' point, the forward curve is always incorrect. Another lesson there.

**KRISTOFER PRITCHETT:** Yeah, I think from our side, when you think about the fund, we've been managing this fund since 2012, we've gone through different rate environments, different cycles, from a credit standpoint, and then lived through that and performed. If you look at the performance that we've put up, it's been good, that's how we feel about that. And then if we think about, why is that? A lot of that is just the benefit of being on a large platform like Ares. If you think about what we do, we touch everything from the illiquid side, private credit, direct lending, ARCC, a large BDC there, we're very active in that space, we go all the way through to the BSL, liquid loans. We don't quite touch IG, but we do kind of cover that below-IG credit space. We also invest in real estate, we invest in secondaries, we have a close relationship with an insurance company, it feels like we see a lot of what's going on in the market. And the way that we're set up in Ares is all around collaboration, and it's making sure these groups aren't siloed, so we're always talking and sharing information, so we can see trends in different markets that impact everyone else. If you look at today, data centers all over the news, our infrastructure team is very active there and knows it very, very well, but it feels like that infrastructure space isn't large enough to fund it, so what we're seeing is data centers and people looking for funding in data centers getting creative, going to insurance, going through the loan market, trying to get into structured markets to come up with solutions there. We're seeing that from the origination and we understand why it's happening because we have that connectivity with our infrastructure team, understanding that. If I think about back to what happened in Covid, one of the things that we saw was in our direct lending portfolio, healthcare companies started to see wage inflation, and this was before all the news came through. In discussions with that, we were having, at the time going through Covid, weekly, monthly calls across the firm, "What are you seeing in this?" "What are you seeing in that?" and one of the things was this healthcare, wage inflation is really a problem, and we saw it coming up in that private credit space. About 70% of our private credit names report monthly, compared to on the BSL side you report quarterly, so we're getting quasi-real-time data from the private credit portfolio. If I think about what we have in alternative credit, we have exposure to consumer loans, so we're seeing what the consumer is doing on a, not quite daily but weekly basis there, so what we're seeing is almost

real-time trends in the underlying markets, and what we saw was wage inflation going up in healthcare, so on the BSL side we sold a lot of healthcare names in the 90s, at par, mid-high 90s, they dropped into the 70s. Once the numbers came through, once that inflation played through into the numbers and the markets saw it, it readjusted. So having the ability there to really lean on that whole platform was how we add value, and the firm is set up like that. When we bring a name to IC, the question is, “Who else at the firm have you spoken to?” If you’re bringing a BSL name to your IC, you should be talking to the private credit coverage, the PE coverage of that sector, of that industry. If it’s something that touches alternative credit or touches infrastructure, you should be talking to those teams that understand what’s going on. The same with real estate, the same with anything else across the platform. It really is, collaboration is in our DNA, and it allows us to see stuff that others may not, and so that’s a really, really big thing. That married with the fact these are all scaled teams, our credit analysts pool, we’ve been investing in credit since the inception of the firm in the late nineties, we’ve been investing in CLOs since 2011. Formally when I joined, informally they did make investments through the GFC, we as a team were investing since the mid-2000s, so we’ve all been in this a long time, we all have scaled teams. This isn’t CLOs as a little hobby, a team of two, three people, we sit within alternative credit where we have a 100-person team. Our credit team, we have a buildout credit team in the US, in Europe, we’re seeing credit globally. We have two loan PMs, we have two bond PMs, we have that scaled team that gives us the ability to go deeper on credit, really underwrite credit, and really do surveillance on a level that impacts our investing across that, and that kind of helps us navigate these times of volatility and shifts in the market, because of the information that we have access to.

**MIKE TAGGART:** Yeah. Thanks, Kris. So Connor, I just want to give you the opportunity, because Kris has touched on ARDC’s internal structure, so I’m going off script here a little bit, but can you tell us a little bit about Octagon, how you’re set up internally in the same manner? Are you set up in silos, are you set up across the firm? What’s your structure?

**CONNOR DUGAN:** Sure. So if we’re talking XFLT specifically, our closed-end fund, that is managed by Lauren Law. Lauren, I work with quite closely, she manages both CLO tranches and underlying leveraged loans, she’s the portfolio manager for a number of the Octagon managed CLOs. She sits on the investment committee with all of our other PMs, our head of



capital markets, our CEO, that committee is responsible for all things investing in Octagon credit, so we're not siloed at all, we don't have a tranche investing business that sits somewhere else. Our team is running investments through an approval process and committee that is also approving the individual credits that we're lending to, we're a \$33 billion asset manager, the bulk of that is on single name credits underlying primarily in loans. So the portfolio managers that we have, even on structured credit strategies, they know intimately the underlying credits and we're extremely integrated with those teams, it's really just one team that's overall managing this product. In terms of the product itself, right now the allocations of the fund are roughly 37% CLO equity, 12-13% CLO BBs, and then the balance would be in loans. There's a small sleeve for high-yield bonds, but it's pretty small right now. It's meant to be a floating-rate product, and it's 98% floating rate.

**MIKE TAGGART:** Excellent, thank you. So Kris, back to you. Active management, why do you believe active management is important for managing the assets that you do?

**KRISTOFER PRITCHETT:** Again, I would point to performance. If we look at what we've done, the outperformance versus passive alternatives, over the past five years ARDC has delivered nearly doubled the annualized total returns of passive high-yield ETFs and loan ETFs, and so I think that really just drives to the performance, and that's where you need to be active. I think active management, married with the platform that we have, allows us to make informed decisions and makes us better investors. I think being on that platform, we can do that, also having the ability to position in those asset classes. As I mentioned earlier, we have loans, we have bonds, we have CLOs, and we can move between them as we see value, as we see risk, and that adds to the alpha of the fund, but it also means that we can avoid areas that we don't like. If the loan markets get too hot, if the bond market gets too hot, we can hang out in CLOs, or vice versa, if we think CLOs are really, really well bid and that risk is mispriced, we can move into loans and bonds. In a fund that's more constrained, you have to move up in quality. If you don't like CLO BBs, do you buy BBBs to hang out? We have the ability to go across the different asset classes and play that tactically, and then active management has come through in the performance of the fund, so I think that's a big tailwind for how we think about the active versus the passive. I also think if you think about a passive fund, if you think about an ETF, if you think about you want to buy the market, you're going to have the exposure to a tail, and we see that when we look at defaults, in particular in CLOs.

If you look at the default rate within the CLO market, it's significantly lower than what you see in the broader loan market, CLOs buy somewhere between 70 and 80% of loans, so where are those defaults? They're not in CLOs, so therefore they're in loan funds. Are they in the ETFs that buy an index? Quite possibly, because you almost have to own those loans to replicate the index. In ARDC and in CLOs, you can avoid them. In ARDC, we're avoiding that tail risk by getting yield from CLOs, we like doing that, CLOs offer you massive diversity. If we think about, what is a CLO? Down to first principles, it's a loan fund that has an underlying of somewhere between 150 and 350 names, position sizes are maybe a point in the US on the upper end, typically 50 bps, so you've got this, or less, so you've got a massively diverse portfolio. Then Connor touched on it earlier, BB's, to break a BB you need to see defaults rates well in excess of what we've seen for a sustained period of time to break a BB. So then you can now kind of start to really add value by moving into these asset classes where the risk is better, which you can't do in a passive fund, your hands are tied. And so having the ability to do that, to go into CLOs where we think that diversification, we think that subordination, be it hard subordination or soft subordination, really offers a different risk-adjusted return, means that we can avoid that tail risk in loans, we can avoid that tail risk in bonds, which you can't do on the passive side. So having that ability is very, very important, and as I said, it feeds through to that performance. I think we've been doing this now for so long, it helps when the team is the same. Seth, Charlie, Sam, myself, we've worked together closely for a long, long period of time, which just helps us move between the asset classes. There is no view that, I want CLOs to be this percentage, or I want loans to be this, or high yield, it really is about relative value across the market and positioning that, and that kind of goes back to the fact that we have scaled businesses. ARDC doesn't drive any one of the businesses, so we can make the rel-val calls without getting involved in politics or involved in, I want to protect my assets, because we all think about it as what's best for the fund.

**MIKE TAGGART:** Thanks. Connor?

**CONNOR DUGAN:** Kris, I think you did a great job summarizing a lot of that. But yeah, one of the points you made is 70-80% of the loan market is owned by CLOs, and all of those are dynamically managed, so the hefty share of the loan asset management business is done on an active basis. Going back, we started this conversation with First Brands, right? The first thing when we heard the story there was we quickly polled which managers held, which

managers sold, which managers were buying into the weakness, which managers never owned at all, and that's just a function of active management, and that's one credit. You zoom out and you take the toll of 20 of those events over the last three years, you get a pretty good idea of who the good managers are and who's worth being a steward of your capital. I think the biggest aspect of CLO management, when it comes to investing down the stack in the equity and BBs, the thing that we spend the most time on is manager selection. If you look at our portfolio, it's public holdings, you can go pull it, we're pretty concentrated in about 20 managers. In the CLO universe there's roughly 130 unique CLO managers, I'd say 20 of those managers are probably 95% of our underlying portfolio. We feel very confidently in this small list of managers, Ares is one of the managers that we invest with on the CLO side, so manager selection is absolutely huge. I think active management's huge, but you've got to make sure that you have the right managers, and selecting that is really a full-time job, it's not easy. As to investing in CLO tranches, I think we're seeing definitely growth in the retail space and ETFs, and I think more or less the AAAs I could say so far have been working, I think it might be a little bit of a challenge though for some of the junior mezz products that have been launched. If you think about CLO BBs, there are only \$10-12 million in size, and when you have forced inflows, it's pretty difficult to go out to the market and put that money to work on an efficient basis without eating too much bid-ask spread. And then obviously on the other side of that, not that we've seen drastic volatility since those products have been launched, but it might be a little bit of a challenge for a passive ETF strategy within junior CLO tranches.

**MIKE TAGGART:** I think you're touching on this, but where are the opportunities in the CLO market today, and how are you positioning the fund specifically around CLOs? We can stay with you, Connor, because I think you were touching on it.

**CONNOR DUGAN:** Sure. If you zoom out and you're a credit investor right now, I think the objective is to try to find something with sufficient income without taking on too much risk, that's really the goal of credit. My short answer is junior CLO debt, BB-rated tranches I think are really compelling right now. If you look at the track record there, over the last five years I think there's a CLO BB index called CLOIE, I think the total return of that fund over the last five years is something, 12-13%, where high-yield did 4%. You take the 8% gap there, compounded over five years, it's a pretty stark delta in terms of the overall total return. Do I

think CLOs are going to return 12-13% going forward? No, I think that that's pretty lofty, but it's pretty easy to see a picture in which they get to 9-9.5%. I really feel strongly in the prospects of the structure, the underlying credits, getting to high single-digit coupon without taking on leverage, with having subordination and diversity, I just feel very comfortable making that my pick for relative value right now.

**MIKE TAGGART:** Okay. Kris?

**KRISTOFER PRITCHETT:** Yeah, I think to pick up on that, if we think about where we're seeing value in the market, let's take a step back and go through what's happened in CLOs and what's happened to loans so far this year? Connor touched on the loans, we saw two [inaudible 0:30:49], one at the beginning of the year, one over the summer where we saw massive spread compression. I think Connor said 360-370 down to the low 300s, 50-60 basis points of spread compression. What did that do to the CLO market? Well, it meant that CLO equity came under pressure. CLO equity, the pricing, the return, the value there is driven by the excess spread that you get. When you get compression on your access side, you have less [inaudible 0:31:15], valuations on CLO equity goes down, and that's one of the reasons why CLO equities underperformed this year. [Nomura 0:31:21] put out some research last week saying the median CLO equity position this year was down about 11%, it was a pretty wide band, the 75th percentile was about flat, the 25th was down about 20%, so general underperformance there because of the spread compression. BBs are a different story, BBs continue to tighten, BBs last year were in the low 500s, what do I mean by that? New issue was coming at SOFR plus, say 525, that today, we hit tights this year of SOFR plus 440, today a deal priced a couple of weeks ago at SOFR plus 450, so [inaudible 0:32:00] tights of the market, CLO BBs have outperformed CLO equity this year. As Connor touched on, the five-year return of BBs has been great, that's where we were and that's how we got here, loans compressing, loan prices staying high, loan return has generally been good, CLO debt has been good, CLO equity has lagged. But if I think about where we sit today, the cost of debt for new issue CLOs is very tight, we're seeing weighted average cost of debt on the CLO financing in lines with the tights post GFC, and the way that we like to think about that, it's kind of like a mortgage on your house, you want to refi to the lowest level possible. We're at those low levels today, so we think that CLO going forward, there's a lot of optionality in that new issue of CLO equity, you've got a five-year reinvestment period, you've got locked up liabilities at

very tight levels, will allow the managers to take advantage of any volatility that we see coming in that five-year period. So we like CLO equity in the new issue market today, we're seeing some value in secondary, if I think about BBs, BBs rate's today is 4%, if they go down to 3%, we're still 400 over, so you're still looking at an income there of 6, 7, 8%, which is still pretty healthy, so I think CLO BBs are interesting. Digging into BBs in a little bit more detail, what we're now starting to see signs of is dispersion. I would say what we saw this year was a tightening market, [inaudible 0:33:28] compression in the space, you weren't really getting paid to invest in the weaker managers, the less followed managers. The basis between, in the CLO market we talk in tiers for debt, tier 1, 2, and 3, the basis between tier 1 and tier 3, very compressed, pick a number in the new issue market, 25 bps, in a volatile market that widens out to about 100. It feels like we're starting to go there. If we look at the secondary market, Connor, jump in here, I know you look at all this stuff, if you want to, there's a lot of diversion we're seeing starting to appear in that secondary market, and we think there are pockets of value. Again, it's signs of this volatility that we think we're going to play within CLOs. Where we are today, to summarize, new issue equity we think is nice, we see value coming in BBs, it provides a great safe income from the downside protection, and there's going to be pockets of opportunity we think going into year end. The way the CLO market is trading right now is quite interesting, a lot of the trading desks have made their year, they're taking a step back. If you look at the CLO calendar, from a human aspect, we have Thanksgiving, we have the CLO conference, actual trading days left in the year, I think we're about 15, 15 days left. So if you do get something happening in maybe one of the public ETFs, if you get some forced selling there, the trading desks aren't going to support levels, we could see pockets of volatility that we're positioned to step into, so we're watching that. That's kind of married with there was some auctions this week, we call them [BWICS 0:35:02] in our market, and what we noticed was levels were back pretty significantly from where they were a couple of weeks ago, especially for certain profiles, so it does feel like we're seeing opportunity there on the debt side. And then it's going to be a question of what happens in January? If we think about the CLO market broadly, the CLO market today is very different to what it was 10-15 years ago, the buyer base has massively expanded, it's a lot more institutional, the money there is a lot stickier, and so I think we may see a bit of a January Effect in the market with money coming in that could lead to either levels being supported here or going tighter. So

we think there could be an opportunity going into year-end in CLO debt, just as the market gets a little bit volatile.

**MIKE TAGGART:** Thanks. Go ahead, real quick.

**CONNOR DUGAN:** I was going to say, if you don't mind me butting in, my call on best relative value is CLO BB tranches. It's probably worth noting, XFLT, the fund we've talked about thus far is only allocated roughly 12-13% to CLO BBs. The view of rel-val there is not just a Connor decision, I think this is a generally a broader Octagon decision, with that, we've put together a new interval fund about a year ago, it's called OCTIX, and the core of that strategy is CLO BBs, I think it makes up over 90% of the fund. So I just wanted to call that out, maybe XFLT being as little allocated to my call there, but there is another income product that we have that's out there that is more core to that.

**MIKE TAGGART:** Absolutely. I have one more question left, but I do want to give y'all a chance to ask questions. If there are any questions in the audience, now's the time to ask. Or one of the times, I can ask my question and come back. Great, Jacob?

**AUDIENCE QUESTION:** Hi Connor, I'm just curious on your view, if the damage is done for CLO equities? It seemed like that was kind of the tone after spreads compressing this year and really underperforming, I think you said it was 37% of XFLT. I'm curious what your outlook is going forward and what you're looking for in the CLO equity market?

**CONNOR DUGAN:** Yeah, definitely the elephant in the room has been CLO equity underperforming, and again it's really not due to outsized credit loss, it's due to the lack of excess spread. To get a little bit more in the detail, I think Kris kind of talked about this, did a pretty good job of summarizing, but CLO liabilities are typically structured with two years non-call, whereas the underlying loans are structured with six months of soft non-call, so there's a little bit of a mismatch there. When things drift tighter, generally that's okay and we've seen that over the last 10 years, it's when it happens so sharply and suddenly that you have a mismatch there in terms of the income stream. We've seen the spreads of underlying pools go from 360-370 down to 300, and the CLOs are kind of playing catch-up there, a lot of them are still in their non-call. In fact, I'd say about half of the XFLT portfolio has some upside right now to re-work their liabilities, but they're still a non-call through 2026, so you might be able to get some of that value back. I think a good question though is where do we go from here? What the spread compression has done has caused CLO equity to trade at a pretty hefty

premium to NAV, down to right around what the current NAV levels are. So in the worst case scenario we see somehow another 60 basis points of spread compression, which I think anyone in our market would say is very unlikely, it's kind of that natural floor as to what valuations could do, because you could just call a CLO and realize the principle value. I think from here, the prospects for CLO equity are certainly much better just given a lack of projected spread compression going forward. To Kris' point earlier, there might be some M&A activity on the issuer side and that could create pipeline, that could create new supply, that could impact the supply and demand economics of issuing new loans and building spread potentially, and really more so preventing the compression that we've seen. That's really the story for CLO equity, I don't want to hide behind that, it definitely has been negative, however will that repeat from here? I think that that's extremely unlikely.

**KRISTOFER PRITCHETT:** Yeah, and just to add to that, I think about it in two ways. One is on the asset side, what have we seen this year? Spread compression. Why have we seen spread compression? Lack of new issue on the loan side. Again, adding the human aspect, bankers need to get paid, what are they going to do? They're going to call up an issuer and say, "You can re-fi, pay me a quarter, pay me a half, pay me something," so they can kind of make their year. If new issuer opens, if we see M&A, the bankers are going to be busy doing their big deals, they're not going to be doing the re-fi, they're not going to be out pitching that, and so if that does happen you're going to see, from a human aspect, from a banking standpoint, less bankers out there looking for re-fi. That's going to impact the market, new collateral coming to the market should soften loan prices. Again, now you're starting to see the spread compression in loans starting to slow based on those two dynamics, so you could argue that now we're bottoming out on spread for the loan market and therefore CLOs. Then you add into that the liability side that Connor touched on, CLOs two year non-call, going back two years AAAs were 150, costs of debt for that capital stack was, if not in the high 100s, call it 200 for round numbers, today for round numbers we're 150. If we stay tight going into next year, you can do a re-fi, you can do a reset, and you can take 50 basis points out of your financing for a CLO. CLOs ten times levered, that's worth about five points [inaudible 0:40:36] equity, five points over when you run that off means you're going to see a price pop, you're going to see price appreciation on that equity coming back. So when we look at CLOs and what has happened over the last few years, and in similar environments, spread

compression when it is as violent as this, you typically have CLOs somewhere between, a new issue, somewhere between a naught percent, maybe down five to 10 over that two-year period. But if that market stays tight, the ability to do that refi, to do that reset, you then get a jump, you get a pop back there that compensates you somewhat for that two years of underperformance, so we think that CLO equity is quite nicely positioned here to take advantage of that.

**MIKE TAGGART:** Questions? Another question? Yeah?

**AUDIENCE QUESTION:** Hey guys, just a quick question. You touched on BSL quite a bit, you haven't really mentioned middle market, that's a space that looks like spreads are significantly wider than BSL at the moment. Is that an area that you guys are looking at? Do you see opportunities in that space? And then secondly, a little bit of a tangent, are you guys looking at collateralized fund obligations or feeder fund structures, some of the new ABS-type products that are similar to CLOs but a less mature market?

**CONNOR DUGAN:** We should probably preface this by saying, Octagon Credit has recently launched a private credit business, and it's pretty small but growing. It's a new business venture, whereas Ares is a behemoth in this space, so Kris is probably the better person to answer this. I would say this about private credit, with the right manager I think it's a great asset class. Typically you do get paid more to be in private credit versus public credit, and the offshoot there is you don't have the transparency, you don't have the liquidity, and depending on the kind of investor you are, that could be important. I think there's a space for private credit. For me specifically I actually do look at the debt from private credit or middle market CLO tranches, particularly at the investment grade level, there's a pickup there, there's better structural protections, I think it's an interesting place to park cash at the IG level. So yeah, that's kind of a yield enhancer that we've used for strategies that are a little more IG focused right now, but to answer your question, I think it's pretty manager specific. I think a lot of people do a really good job at private credit. Is that always the case? We'll see, that's kind of the thing with illiquid markets and less transparency, you don't really know until you know, so I think there might be a story there but we don't know yet.

**KRISTOFER PRITCHETT:** Yeah, I think to talk about ARDC in particular, we don't invest in middle market loans, we don't invest in middle market CLOs, but Ares across the platform, we have a large middle market private credit business, and we think that we've set that up



in the right way. When you think about private credit, a lot of it's about access to credit, so how do we solve that problem? We have a large team of originators, and [inaudible 0:43:31] on a lot of names, and we see a lot of repeat business there, so we have that large scale platform, we're seeing value. I think it's harder for other players out there arguably, especially some of the smaller names trying to get into the space, the private credit market has grown a lot in recent years with a lot of new entrants, and I think it's sometimes difficult to really understand what is their differentiator? What is their special sauce? What makes them perform versus peers of their size? And so that's something that we are concerned about. We look at the space, you asked about [inaudible 0:44:05], fund structures, fund finance, we invest in all of that stuff in the alternative credit business where I sit. If I think about [inaudible 0:44:16], if I think about fund finance, similar but different analysis to CLOs. Again, underwriting that manager is very, very important, who are they? Why do they exist? What's their story? What's the management team look like? How are they set up to move forward? Do they have a reason to exist? And so we look at a lot of that. If you think about the fund finance transactions that are out there, a massive market there, they're really sat in the banks for a long, long time. CS were a big player in that market, CS is no longer with us. With what we're seeing with a bit of a retrenchment in banking, it's starting to create gaps, and that fund finance market is one that we have seen over the last three, maybe four years, it's been interesting. I would say about four years ago it was really interesting, because that's when the market really pulled out and we were able to get pretty nice levels. What you can do in that space is you can get those tranches rated, and a lot of them go into insurance capital today, and we have seen spread compression just given the flow of capital into that. When we think about fund finance, it really comes down to the structure, the manager, and we've come up with some pretty creative structures, but it's really getting under the hood there. Again, it's a private transaction, it's privately negotiated, it's just finding the right partner to work through that, but it's an interesting market we think at the moment.

**MIKE TAGGART:** I think we're out of time. If somebody has a quick question? All right, well, I'd like to thank Connor and Kris for participating, and thank you all for asking questions and listening.

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