

CLO-CKWORK PRECISION: INTEGRATING CLOs INTO PORTFOLIOS

Building portfolio resilience is a key objective for investors amid pervasive uncertainty. The Janus Henderson Portfolio Construction and Strategy (PCS) Team explore the performance of AAA Collateralised Loan Obligations (CLOs) as a standalone holding and as part of a diversified fixed income portfolio.

Within the securitised sector, CLOs can aid diversification in fixed income portfolios. They provide a compelling alternative to investment grade (IG) corporate credit, offering higher-quality income and negligible sensitivity to changes in interest rates.

At first glance, a securitisation can appear complex. Some clients we speak to therefore find the analogy of a library useful. While the analogy is far from perfect, it can help illustrate how in the same way as a library curator selects and groups books to suit reader tastes, so loans can be selected to maximise the risk/return profile of a CLO.

In this paper, we explore how CLOs can be maximised from a portfolio construction and strategy perspective and the potential rewards of their integration within a fixed income allocation.

Shelf logic: The ABCs of CLOs in the investment library

As described elsewhere by the securitised investment team at Janus Henderson¹, a CLO is a portfolio of corporate ("leveraged") loans rated below IG that have been securitised. Securitisation is the process of converting asset-based cash flows, like mortgage or loan payments, into financial securities. CLOs have become an important link between the financing needs of companies and investors seeking higher yields.

¹ For example, the 'Case for European Collateralised Loan Obligations (CLOs)' and 'Securitised Debt – An Introduction to the European Market'.



Matthew Bullock
Head of Portfolio Construction and Strategy, EMEA & APAC

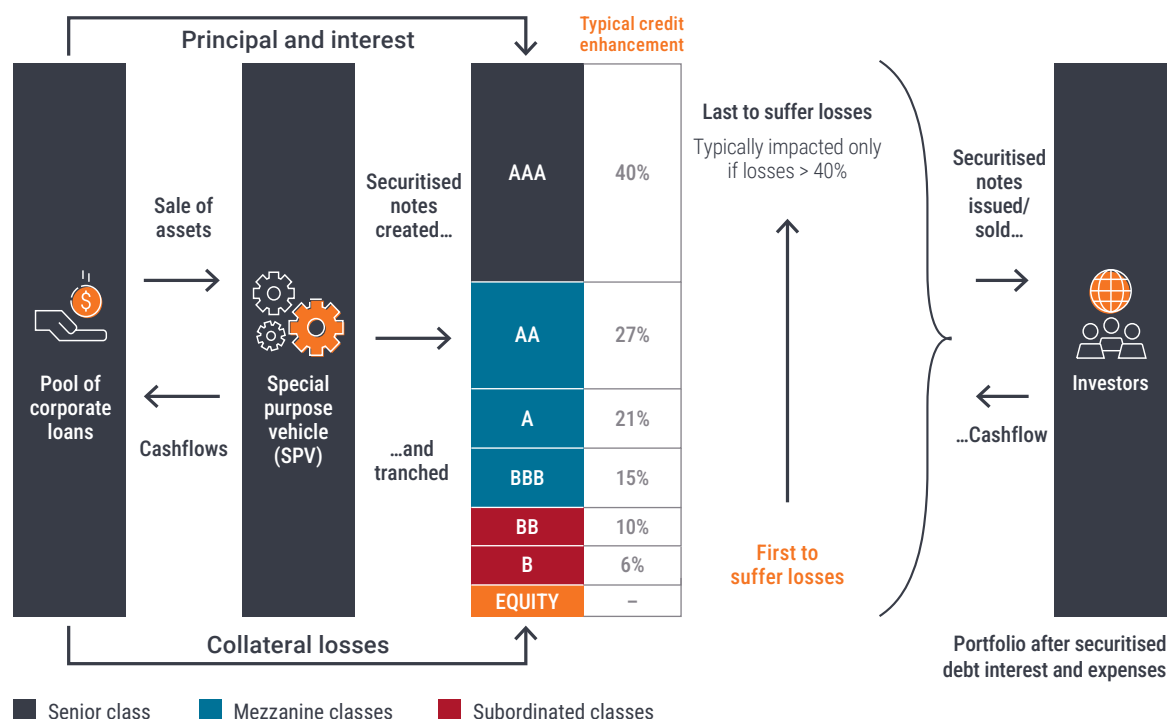


Sabrina Denis
Senior Portfolio Strategist, (PCS)



Mario Aguilar
Senior Portfolio Strategist, (PCS)

Figure 1: Typical CLO securitisation



Source: Janus Henderson Investors. For illustrative purposes only. Credit enhancement is used in a securitisation to improve the credit quality and ratings of the debt tranches. The percentages shown include a small amount of excess spread. Excess spread represents net interest earned on a loan portfolio after securitised debt interest and expenses.

Using our library analogy, a collection of many different types of books would be curated, with the CLO similarly holding different types of loans. In the library, books are organised into different categories or sections to meet different reader preferences. Similarly, a CLO contains loans which are structured into different tranches with varying degrees of risk and return, which investors can select based on their individual preferences.

The benefit of a library is the range of sections to choose from across the entire curated collection. These include mainstream sections containing books by popular authors, as well as sections featuring less well-known authors or niche genres. When applying the analogy to CLOs (bear with us here), senior tranches are the mainstream sections, while lower tier tranches, including 'mezzanine' and 'equity' ones, are the less prominent sections.

A CLO holds loans that are structured into these tranches spanning the capital structure. Cashflows are distributed to senior tranches first, followed by mezzanine, and then equity or junior tranches. Most of a typical European CLO is senior rated, which is where we focus our paper, specifically AAA CLOs. A typical CLO structure may contain 100-250 loans from 20-30 industries. Just like a librarian who curates a collection, a CLO manager constantly analyses opportunities, allowing them to actively buy and sell loans to maximise return and minimise risk dependant on economic conditions, underlying loan performance and investor needs.

Shelving the norm: highlighting the distinct advantages of CLOs

Once investors understand the overall concept of CLOs, they typically quickly see the benefits they bring as part of a fixed income allocation.

- ▶ **Enhanced quality:** A significant portion, approximately 80%, of European CLOs are rated AAA through A, indicating how the securitisation process enables the creation of high-quality credit opportunities.
- ▶ **Better yield:** Often presents a yield that is competitive when compared with corporate and government bonds of similar ratings.
- ▶ **Attractive relative value:** Exhibits a higher spread relative to other fixed income, supporting income generation.
- ▶ **Floating rate & negligible interest rate sensitivity:** Primarily features floating rate terms, aligning coupon rates with indices such as SONIA or EURIBOR, which limits the impact of interest rate moves.
- ▶ **Diversification potential:** Such floating rate and short duration characteristics bring diversification to fixed income portfolios.

► Transparent and robust regulatory environment:

Benefits from rigorous legal and regulatory frameworks, established through cycles of evolution, providing a layer of transparency and investor safeguarding not uniformly available across asset classes.

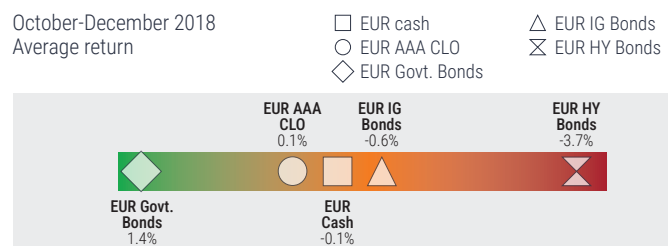
► Compelling liquidity:

Active secondary market and structures designed to naturally align bond amortisation with repayments from the underlying asset pool, offering a structured approach to liquidity and financial planning.

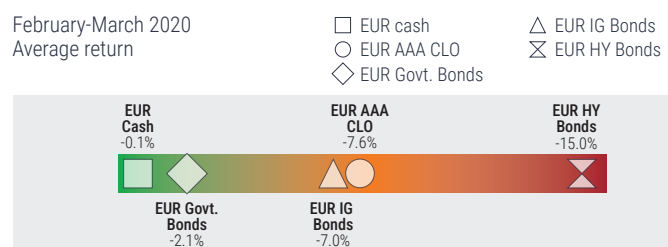
Unravelling the securitised stigma

Despite those powerful risk and return characteristics, the Global Financial Crisis (GFC) left a stigma around securitised debt, tarnishing it as “risky” and “illiquid”. Using our proprietary portfolio analysis tool, Janus Henderson Edge™, allows a deeper dive into performance during different market conditions and comparisons to other fixed income asset classes:

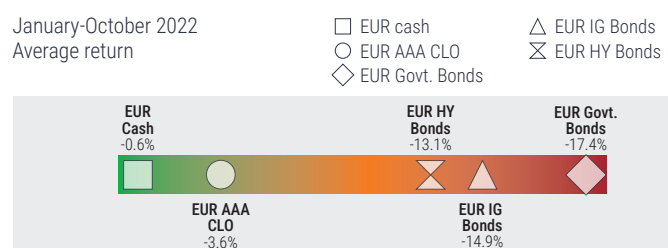
2018 Fed Hike mistake: the US Federal Reserve's decision to raise interest rates resulted in notable market volatility across bonds and equities. However, European AAA CLOs remained largely unaffected, showcasing their resilience and stability amid interest rate fluctuations, in stark contrast to the impact on Euro IG, Euro high yield (HY), and equities.



2020 Covid pandemic: The uncertainty and economic disruption triggered by the COVID-19 pandemic drove a widespread sell-off across various asset classes. European AAA CLOs performed largely in line with Euro IG in the initial reaction to the pandemic.



2022 inflation shock and rate hikes: Concerns about inflation and rate hikes globally stirred volatility in Euro IG, HY, and equities, but European AAA CLOs experienced minimal drawdowns. Their floating rate nature shielded them from the turbulence that affected fixed-rate asset classes like Euro IG and HY.



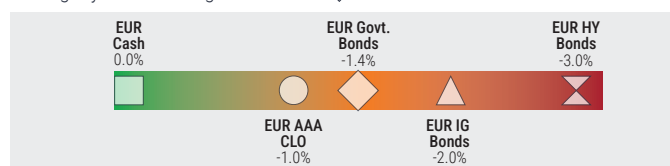
As our proprietary analysis on specific historical scenarios show European AAA CLOs manage to hold up in a similar or preferable fashion compared to other IG fixed income asset classes during market downturns.

Rising rates and spread widening: More generally, we can look at how AAA CLOs perform in challenging scenarios for fixed income, such as rising rates and spread widening. Amortising structures and the short-dated nature of European securitised sectors such as AAA CLOs naturally lowers spread duration – or the sensitivity of a fixed income investment to spread moves. In both scenarios, European AAA CLOs outperform Euro government bonds and corporate credit asset classes.

Spread widening scenarios

Top quintile spread widening months
Trailing 5-years – Average return

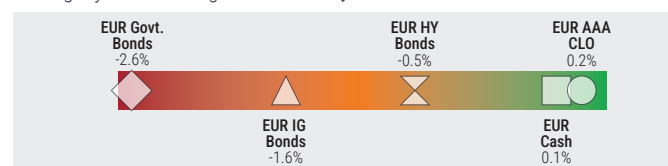
EUR cash
EUR AAA CLO
EUR Govt. Bonds
EUR IG Bonds
EUR HY Bonds



Rising rates scenarios

Top quintile rising rate months
Trailing 5-years – Average return

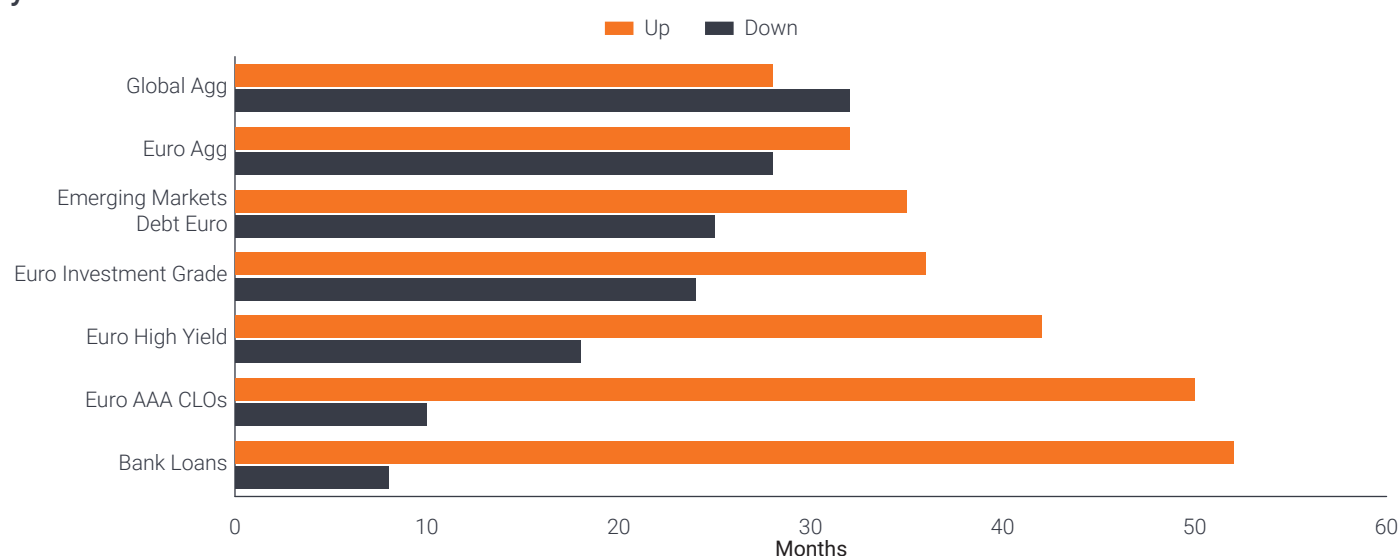
EUR cash
EUR AAA CLO
EUR Govt. Bonds
EUR IG Bonds
EUR HY Bonds



Nevertheless, as AAA CLOs are credit product, spreads widen during periods of volatility along with other credit asset classes, as seen during the recent tariff-induced market turbulence. During volatile periods, CLOs have typically retraced the downside within six to 12 months. Most importantly, CLO markets have stayed open, liquid and orderly during such periods with trading volumes increasing. High starting yields offered by CLOs can act as a buffer against spread widening, supporting returns in such scenarios. Widening spreads and risk-off market sentiment can also mark a more challenging environment for corporates, where defaults could creep up as corporate fundamentals deteriorate. In this scenario, investors may look to high quality fixed income asset classes to ride out the storm. When looking at 10-year impairment rates, these are lower in European CLOs versus Euro IG across all tranches². Moreover, no European AAA, AA and single A rated CLO tranches have ever defaulted, including during the GFC.

Another way to conceptualise the stability of returns delivered by AAA CLOs is to look at how the asset class performed over the last decade in terms of the months where average returns were better or worse than traditional fixed income. Compared to other fixed income asset classes, European AAA CLOs along with bank loans delivered more positive upside months and fewer downside months.

Figure 2: Number of upside versus downside months by fixed income sector over the past five years



Source: Janus Henderson Investors, Bloomberg, Morningstar, JPMorgan, as at 31 March 2025. Indices used as representative in hypothetical portfolio: Global Agg: Bloomberg Global Aggregate TR Hdg EUR; Euro Agg: Bloomberg Euro Agg TR EUR; EMD Euro: Bloomberg EM Hard Currency Agg TR EUR; Euro IG: ICE BofA Euro Corporate TR EUR; Euro HY: ICE BofA EUR HY Constrained TR EUR; Euro AAA CLOs: JPM EUR CLO AAA Index; Bank Loans: Credit Suisse Western European Leveraged Loan TR Hdg EUR; . **Past performance does not predict future returns.**

CLO cheat sheet

From this analysis, we summarise the distinct benefits of high-quality AAA CLOs versus other asset classes. We highlight IG corporate bonds and cash, where CLOs present themselves as an attractive alternative, particularly during rising interest rates but also deteriorating economic conditions that result in wider credit spreads and a higher incidence of defaults.

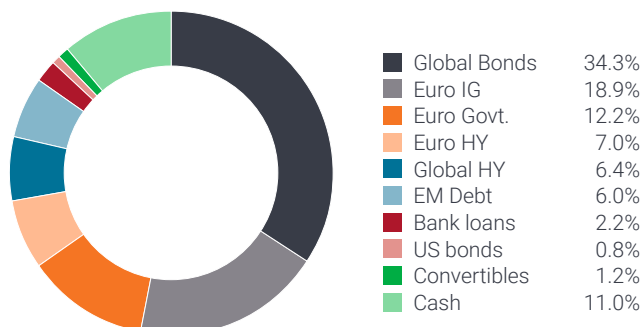
	Return	Rising rates	Spread widening	Declining rates	Increased defaults
Cash	Low	Positive	Positive	Least favourable	N/A
Investment grade	Med	Least favourable	Least favourable	Positive	Least favourable
High yield	High	Less favourable	Least favourable	Positive	Least favourable
AAA CLOs	Med	Positive	Less favourable	Less favourable	Less favourable

² Moody's Investors Services **Credit Suisse/UBS, as at 31 October 2024. Loss rate calculated based on cumulative defaults and 60% recovery rate. **Past performance does not predict future returns.** For illustrative purposes only.

Curated collections: Integrating CLOs for balanced risk and return dynamics

So far, we have seen the advantages of AAA CLOs as an alternative to other traditional core fixed income products. The asset class can perform differently in various scenarios, just as books can fall in and out of favour. While librarians (or CLO managers) curate the collections of books (or loans) in their CLO libraries, asset allocators have the same task. We now illustrate the impact on the portfolio's risk-return dynamics when adding 10%, 20% and 30% of AAA CLOs to a typical European client fixed income portfolio, according to our database of model portfolios using Janus Henderson Edge™ in 2024.

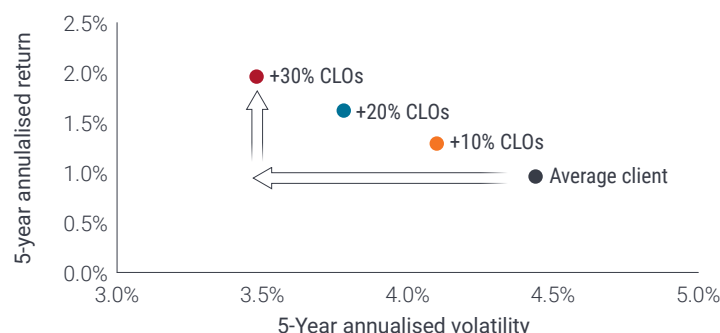
Figure 3: Average fixed income portfolio of a European investor



As shown in **Figure 3**, most of an average fixed income portfolio is held in global bonds (around 33% of the portfolio), followed by a diversified allocation to European fixed income assets, including Euro government bonds, IG and HY corporate credit.

Source: Janus Henderson Investors, Portfolio Construction and Strategy. Average fixed income portfolios based on data from Janus Henderson EDGE™ in Europe incl. UK from January-December 2024.

Figure 4: Adding 10%, 20% and 30% AAA CLO allocation to a typical fixed income portfolio (5 years)



By allocating to European AAA CLOs and upping the allocation to 30%, this improves the portfolio's risk-adjusted return dynamics over the long term (**Figure 4**). It can also be seen as a helpful diversifier to fixed income portfolios given its low correlation to other fixed income asset classes, such as US bonds, Euro government bonds and global bonds (**Figure 5**).

Figure 5: Correlations European AAA CLOs versus other fixed income asset classes (5 years)

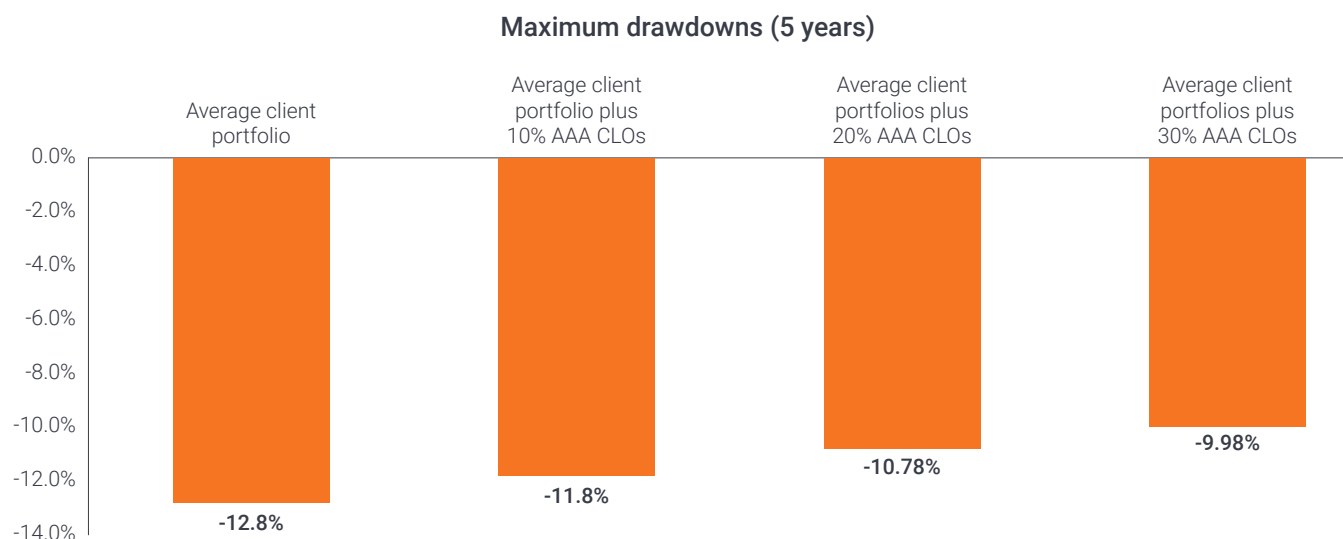
	US Bonds	Euro Govt.	Global Bonds	EM Debt	Euro IG	Convertibles	Global HY	Euro HY	Bank Loans	Euro AAA CLOs
US Bonds										
Euro Govt.	0.54									
Global Bonds	0.42	0.91								
EM Debt	0.74	0.60	0.56							
Euro IG	0.53	0.99	0.92	0.63						
Convertibles	0.29	0.54	0.67	0.64	0.65					
Global HY	0.62	0.53	0.45	0.88	0.57	0.70				
Euro HY	0.19	0.60	0.66	0.64	0.67	0.84	0.77			
Bank Loans	0.16	0.34	0.41	0.56	0.40	0.71	0.69	0.85		
Euro AAA CLOs	0.14	0.34	0.38	0.47	0.34	0.6	0.56	0.72	0.91	

Source: Janus Henderson Investors, Bloomberg, Morningstar, JPMorgan, as at 31 March 2025. Indices used as representative in hypothetical portfolios: Global Bonds: Bloomberg Global Aggregate TR Hdg EUR; Euro IG: ICE BofA Euro Corporate TR EUR; Euro Govt: Bloomberg Euro Agg GvtR TR EUR; Euro HY: ICE BofA EUR HY Constnd TR EUR; Global HY: Bloomberg Global High Yield TR EUR; EM Debt: Bloomberg EM Hard Currency Agg TR USD; Bank Loans: Credit Suisse Western European Leveraged Loan TR Hdg EUR; US Bonds: Bloomberg US Agg Bond TR EUR; Convertibles: Refinitiv Europe CB TR EUR. Euro AAA CLOs: JPM EUR CLO AAA Index. Average client portfolio is based on the average of Janus Henderson European clients' fixed income portfolios. Portfolios are hypothetical and performance is based on historic index returns. Investors should not assume they will have a similar investment experience. **Past performance does not predict future returns.**

A steady read

A distinct advantage of European AAA CLOs is their high-quality defensive income and lower returns volatility given their inherent structural protections. This explains why when we evaluate the maximum drawdown of the average client portfolio and compare it to a portfolio with an allocation to European AAA CLOs, we see an improvement in the drawdown as the allocation is increased (up to 30%). This underscores the stabilising effect European AAA CLOs can have on portfolio performance.

Figure 6: Improving portfolio resilience by adding high-quality CLOs



Source: Janus Henderson Investors, Bloomberg, Morningstar, JP Morgan, as at 31 March 2025. Indices used as representative in hypothetical portfolios: Global Bonds: Bloomberg Global Aggregate TR Hdg EUR; Euro IG: ICE BofA Euro Corporate TR EUR; Euro Govt.; Bloomberg Euro Agg GvtR TR EUR; Euro HY: ICE BofA EUR HY Constnd TR EUR; Global HY: Bloomberg Global High Yield TR EUR; EM Debt: Bloomberg EM Hard Currency Agg TR USD; Bank Loans: Credit Suisse Western European Leveraged Loan TR Hdg EUR; US Bonds: Bloomberg US Agg Bond TR EUR; Convertibles: Refinitiv Europe CB TR EUR; Cash: ICE BofA EUR Ccy 3M Dep BdRt CM TR EUR. Euro AAA CLOs: JPM EUR CLO AAA Index. Average client portfolio is based on the average of Janus Henderson European clients' fixed income portfolios. Portfolios are hypothetical and performance is based on historic index returns. Investors should not assume they will have a similar investment experience. **Past performance does not predict future returns.**

Refining the asset mix

Revisiting our library analogy, just as a librarian meticulously gathers books on a specific subject to create a comprehensive and valuable collection, an investor selects a variety of assets to construct a portfolio tailored to meet specific financial goals and risk tolerances. Incorporating volumes of CLOs could contribute to the overall richness and stability of a portfolio. Typically, investors aim to use AAA CLOs as a diversifier to other IG fixed income, such as corporate credit, or as a high-quality cash enhancement. The asset class offers investors an avenue to access quality IG floating rate exposure.

Just as select books enhance the appeal and value of a library, our analysis shows that incorporating securitised investments, including CLOs, into a multi-asset portfolio can improve performance and resilience. This is a strategy we have successfully applied in client portfolios at Janus Henderson for many years. It's important for investors to recognise that securitised assets, including CLOs, form a specialised asset class that demands expert analysis to thoroughly understand the risk-reward dynamics of each transaction. Those willing to conduct the necessary due diligence can expect securitised assets to play a valuable role in their investment portfolios.

About Janus Henderson's Portfolio Construction and Strategy Team

Janus Henderson's Global Portfolio Construction and Strategy Team has analysed more than 25,000 model portfolios based on consultations with 6,500 financial professionals. The team's goal is to help investment professionals make sense of what's happening in the market, understand the implications for portfolio construction, and create and adjust portfolios for future success.

FOR MORE INFORMATION, PLEASE VISIT JANUSHENDERSON.COM

Janus Henderson
— INVESTORS —

Important information:

The views presented are as of the date published. They are for information purposes only and should not be used or construed as investment, legal or tax advice or as an offer to sell, a solicitation of an offer to buy, or a recommendation to buy, sell or hold any security, investment strategy or market sector. Nothing in this material shall be deemed to be a direct or indirect provision of investment management services specific to any client requirements. Opinions and examples are meant as an illustration of broader themes, are not an indication of trading intent, are subject to change and may not reflect the views of others in the organization. It is not intended to indicate or imply that any illustration/example mentioned is now or was ever held in any portfolio. No forecasts can be guaranteed and there is no guarantee that the information supplied is complete or timely, nor are there any warranties with regard to the results obtained from its use. Janus Henderson Investors is the source of data unless otherwise indicated, and has reasonable belief to rely on information and data sourced from third parties. **Past performance does not predict future returns. Investing involves risk, including the possible loss of principal and fluctuation of value.**

Not all products or services are available in all jurisdictions. This material or information contained in it may be restricted by law, may not be reproduced or referred to without express written permission or used in any jurisdiction or circumstance in which its use would be unlawful. Janus Henderson is not responsible for any unlawful distribution of this material to any third parties, in whole or in part. The contents of this material have not been approved or endorsed by any regulatory agency.

Janus Henderson Investors is the name under which investment products and services are provided by the entities identified in the following jurisdictions: (a) **Europe** by Janus Henderson Investors International Limited (reg. no. 3594615), Janus Henderson Investors UK Limited (reg. no. 906355), Janus Henderson Fund Management UK Limited (reg. no. 2678531), (each registered in England and Wales at 201 Bishopsgate, London EC2M 3AE and regulated by the Financial Conduct Authority), Tabula Investment Management Limited (reg. no. 11286661 at 10 Norwich Street, London, United Kingdom, EC4A 1BD and regulated by the Financial Conduct Authority) and Janus Henderson Investors Europe S.A. (reg. no. B22848 at 78, Avenue de la Liberté, L-1930 Luxembourg, Luxembourg and regulated by the Commission de Surveillance du Secteur Financier); (b) the **U.S.** by SEC registered investment advisers that are subsidiaries of Janus Henderson Group plc; (c) **Canada** through Janus Henderson Investors US LLC only to institutional investors in certain jurisdictions; (d) **Singapore** by Janus Henderson Investors (Singapore) Limited (Co. registration no. 199700782N). This advertisement or publication has not been reviewed by Monetary Authority of Singapore; (e) **Hong Kong** by Janus Henderson Investors Hong Kong Limited. This material has not been reviewed by the Securities and Futures Commission of Hong Kong; (f) **South Korea** by Janus Henderson Investors (Singapore) Limited only to Qualified Professional Investors (as defined in the Financial Investment Services and Capital Market Act and its sub-regulations); (g) **Japan** by Janus Henderson Investors (Japan) Limited, regulated by Financial Services Agency and registered as a Financial Instruments Firm conducting Investment Management Business, Investment Advisory and Agency Business and Type II Financial Instruments Business; (h) **Australia** and **New Zealand** by Janus Henderson Investors (Australia) Limited (ABN 47 124 279 518) and its related bodies corporate including Janus Henderson Investors (Australia) Institutional Funds Management Limited (ABN 16 165 119 531, AFSL 444266) and Janus Henderson Investors (Australia) Funds Management Limited (ABN 43 164 177 244, AFSL 444268); (i) the **Middle East** by Janus Henderson Investors International Limited, regulated by the Dubai Financial Services Authority as a Representative Office. This document relates to a financial product which is not subject to any form of regulation or approval by the Dubai Financial Services Authority ("DFSA"). The DFSA has no responsibility for reviewing or verifying any prospectus or other documents in connection with this financial product. Accordingly, the DFSA has not approved this document or any other associated documents nor taken any steps to verify the information set out in this document, and has no responsibility for it. The financial product to which this document relates may be illiquid and/or subject to restrictions on its resale. Prospective purchasers should conduct their own due diligence on the financial product. If you do not understand the contents of this document you should consult an authorised financial adviser. No transactions will be concluded in the Middle East and any enquiries should be made to Janus Henderson. We may record telephone calls for our mutual protection, to improve customer service and for regulatory record keeping purposes.

Outside of the U.S.: For use only by institutional, professional, qualified and sophisticated investors, qualified distributors, wholesale investors and wholesale clients as defined by the applicable jurisdiction. Not for public viewing or distribution. Marketing Communication.

Janus Henderson is a trademark of Janus Henderson Group plc or one of its subsidiaries. © Janus Henderson Group plc.