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What CLO investors should know in 2026



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Himani Trivedi, head of structured credit at Nuveen, and Tracey Jackson, CLO Client Portfolio Manager, explore the evolving CLO market and the outlook for 2026: the impact of interest rate changes on returns, ETF flows, captive equity trends, and spread compression across the capital stack—and how investors should position for tight arbitrage while preserving equity value.

Q: HOW WILL THE FEDERAL RESERVE'S SHIFT FROM RATE HIKES (2022-2024) TO RATE CUTS AFFECT CLO INCOME OPPORTUNITIES?

A: Collateralized loan obligation (CLO) equity returns are driven by a combination of ongoing income generation and terminal value, and lower rates can be constructive across several dimensions.

Credit fundamentals generally improve as borrowing costs decline. Higher base rates over the past few years increased interest burdens for issuers, pressured leverage metrics, constrained free cash flow and limited companies' ability to invest in operations or pursue M&A. A lower-rate environment alleviates these pressures, supporting liquidity and in many cases, improving credit quality at the underlying borrower level.

From a broader market perspective, declining rates could help stabilize or potentially reverse the



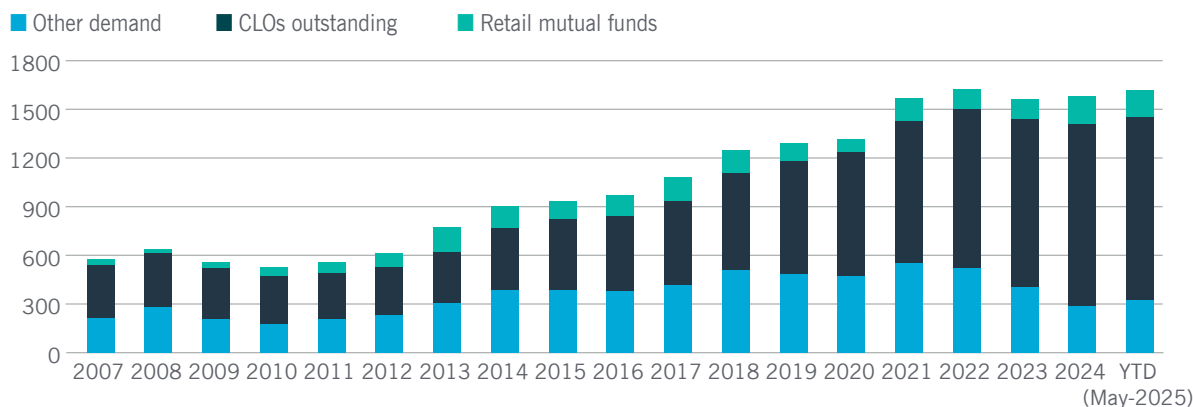
It is a common misconception that declining rates are inherently negative for floating-rate assets such as collateralized loan obligations (CLOs).

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

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Figure 1: CLOs represent over 60% of the U.S. broadly syndicated loan markets

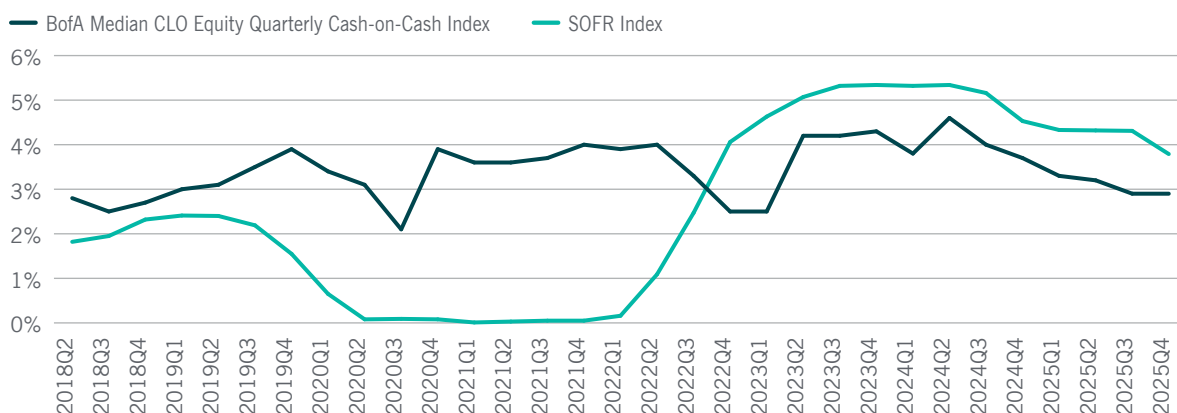
\$ billions outstanding



Sources: J.P. Morgan "US High Yield and Leveraged Loan Strategy" report as of 14 Jan 2026

Figure 2: Lower base rate does not mean lower CLO equity return

Cash flow distributions (%)



Sources: BofA Research CLO Equity Data and Bloomberg as of 31 Dec 2025

credit deterioration observed over the past couple years. Given CLO equity is levered exposure to corporate debt, this improvement in credit fundamentals can be a return tailwind if defaults decline or stressed loans appreciate in price.

Additionally, with private equity dry powder on the sidelines, the improved conditions and lower financing costs may catalyze leveraged buyout activity. This, in turn, could drive higher loan issuance in 2026, supporting growth in both the broadly syndicated loan market and CLO markets (Figure 1).

Importantly, CLO equity cash flows are largely insulated from rate cuts. In most structures, approximately 90% of rate decline will be netted between floating rate assets and liabilities. History shows that CLO equity cash-on-cash distributions have remained robust even in very low-rate environments. As illustrated in the chart, from 2020-2022, when the Secured Overnight Financing Rate (SOFR) was near zero, median CLO equity quarterly cash-on-cash distribution remained in the ~3-4% range (Figure 2).

For CLO debt, where the coupon is directly tied to SOFR, we do expect lower base rates to reduce the overall yield. However, CLO debt tranches

remain attractive on a relative value basis when compared to other asset classes. For example, as of this writing, in the single A credit rating bucket, corporate debt offers spreads of around 66 basis points (bps), while CLOs have spreads of around 186 bps, for a similar amount of credit risk.

Q: HOW SHOULD INVESTORS THINK ABOUT CLO ETFs IN A DECLINING RATE ENVIRONMENT? GIVEN THE MORE RETAIL-ORIENTED WRAPPER, DO YOU EXPECT RATE CUTS TO DRIVE OUTFLOW?

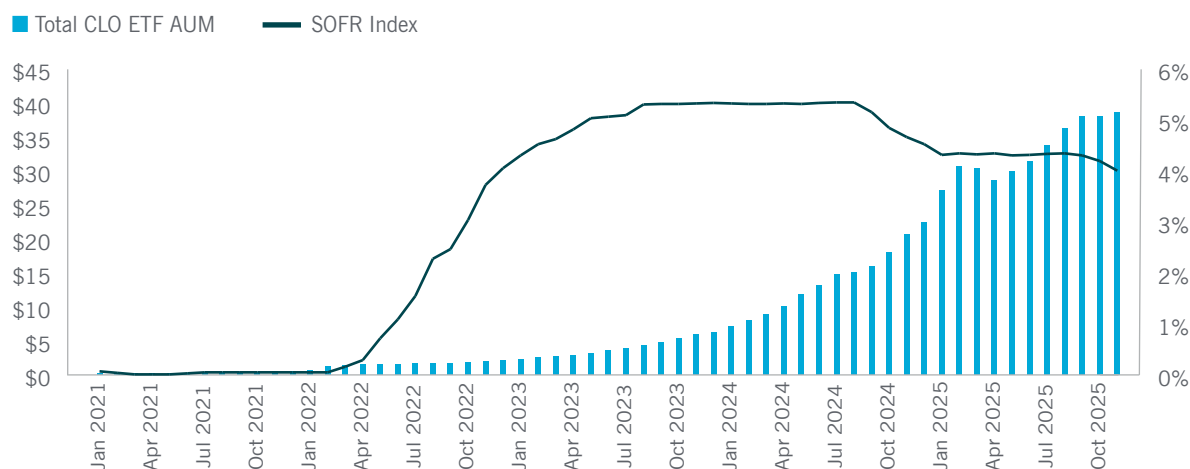
A: We do not believe that rate cuts alone will necessarily lead to meaningful outflow from CLO ETFs. We expect CLO ETF flows to be more sensitive to broader market volatility and risk sentiment than to changes in base rates alone. In 2025, CLO ETFs had a total inflow

of over \$15 billion, driven by investor demand for high-quality, investment-grade (IG) rated CLO paper in wrappers with daily liquidity, as well as protection from interest rate volatility. During the year, there were only three months where we saw outflows: -\$150mm in March, -\$1.5bn in April, and -\$200mm in December, with the bulk tied to the short-lived Liberation Day market turmoil (Figure 3).

CLO ETFs are no longer a new product. Since the first CLO ETFs launched in late 2020, retail and wealth investors have gained approximately five years of experience in the asset class. We believe a lower base rate environment may encourage migration down the capital stack as investors seek to offset the yield decline. CLO mezzanine ETFs are roughly 2% of the market today, indicating there is ample room for growth. As liquidity is relatively less in mezzanine tranches, significant outflows from ETFs could have a more material impact, but

Figure 3: CLO ETFs has growth should be grown to nearly \$40bn in size

Left axis: AUM \$ billions; Right axis: SOFR Spread in %



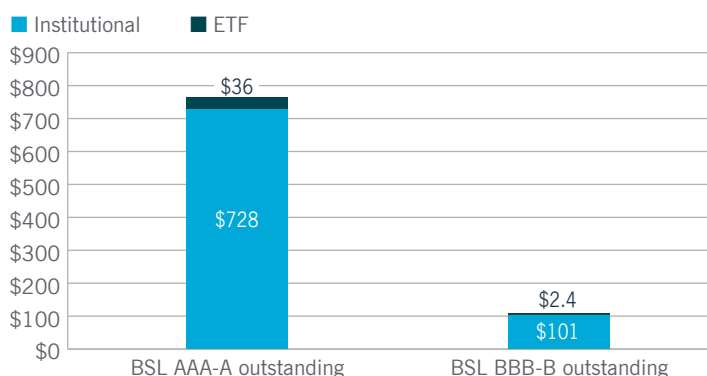
Sources: BofA Factbook and Bloomberg as of 31 December 2025



retail and wealth investors have around five years of experience in the asset class and a greater level of comfort.

Figure 4: Despite strong growth, CLO ETFs remain small in the context of total CLO outstanding debt

\$ billions outstanding



Source: BofA Factbook as of 31 Dec 2025.

we are far from that point. For now, CLO ETFs remain small relative to total CLO debt outstanding across both IG and mezz tranches (Figure 4).

Q: THE USE OF CAPTIVE CLO EQUITY FUNDS REBOUNDED IN 2025. WHAT'S DRIVING THIS GROWTH AND WHAT DOES IT MEAN FOR CLO INVESTORS?

A: Several factors are fueling this growth. The primary driver has been strong performance leading to follow-on fundraising, as managers successfully launch their second and third captive equity funds.

Large institutional investors have been the primary backers, investing directly with managers to benefit from improved economics and reduced fees. These investors view CLO equity as a diversifier between private equity and fixed income, seeking programmatic exposure and vintage diversification over several years rather than timing specific deals.

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Another key benefit for captive fund is the ability to quickly issue in the primary market during periods of volatility, allowing managers to capture dislocated loan prices.

European risk retention regulations have also played a role, requiring managers facing to European investors to retain “skin in the game” through majority equity positions held by captive funds.

Another benefit of captive funds is that it allows managers with size and scale to benefit from pockets of market volatility.

A clear example was the April “Liberation Day” sell-off, when the price dropped from \$97 to \$94 in the span of days. A three-point discount is highly impactful in a 10x levered structure. That window of opportunity proved short-lived and dissipated within weeks. In that context, the speed and certainty of execution offered by a captive fund is decisive.

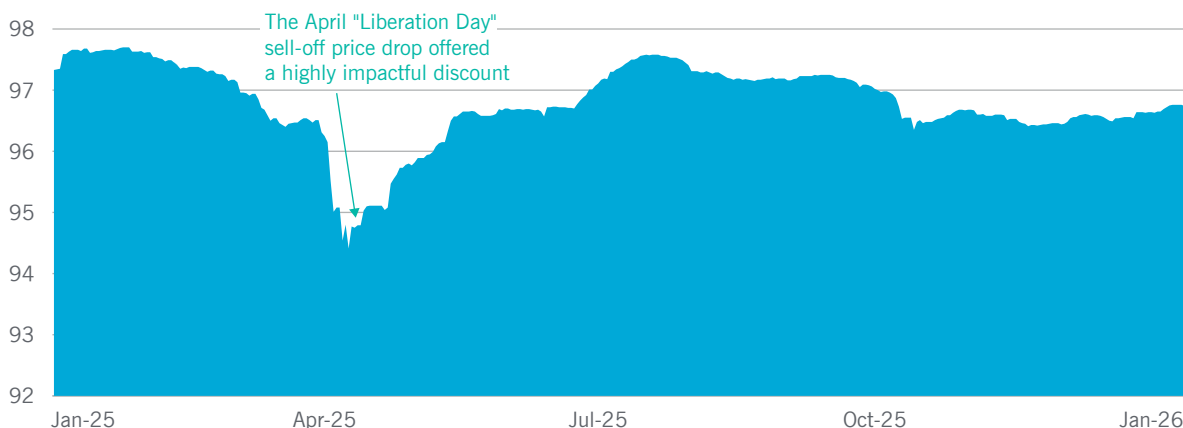
Finally, an additional consideration is that captive funds are traditionally buy-and-hold strategies, which could further limit secondary market liquidity for CLO equity as more positions remain locked within these long-term structures rather than being available for trading.

Q: WHILE BASE RATES HAVE BEEN DECLINING, CLO DEBT SPREADS ARE ALSO ENTERING 2026 AT THEIR TIGHTEST LEVELS SINCE THE MOVE TO SOFR IN 2022. WHAT'S THE SPREAD OUTLOOK FOR 2026, AND WHERE DO YOU SEE RELATIVE VALUE IN CLO DEBT?

A: CLO debt spread levels are entering 2026 at the tightest spread levels the primary market has seen since moving from LIBOR to SOFR in 2022. Looking forward to 2026, there is a potential that the end of next year could close at even tighter levels than 2025, but we do not expect a straight line of tightening throughout the

Figure 5: Market volatility opens windows of opportunity for captive CLO equity funds

\$ price of the Morningstar LSTA US Leveraged Loan Index



Source: Bloomberg as of 13 Jan 2026

year. The first half of 2026 is expected to continue to have high supply of CLO debt, with 2024 vintage CLOs coming out of their non-call period, these CLOs will look to reset or refinance as soon as possible given their relatively high cost of liabilities.

This supply, along with a steady pace of new issue CLOs, could cause widening CLO debt levels throughout the 1H of 2026, along with potential short bouts of volatility from macro or geopolitical catalysts, as we saw in 2025 with Liberation Day. From here, we expect a quieter second half of the year, which may tighten CLO debt as we head toward the end of 2026.

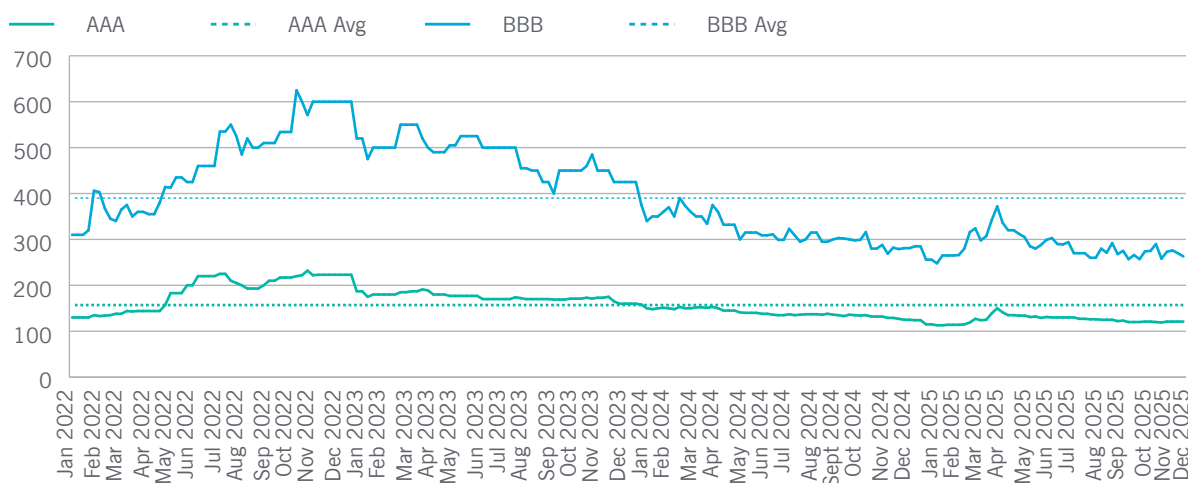
Balancing volatility with total return, we find value in CLO IG at current levels. 2026 may have opportunistic periods of volatility to actively rotate from IG to below-IG. Looking at historical spread averages of IG versus below IG since 2022, Current IG spreads are 27% tighter than their 2022-2025 average, while below IG is 31% tighter. Given our expectation volatility in 2026 will be short-lived, with the potential for additional tightening longer term, we continue to favor IG within the CLO complex until below IG widens closer to historical averages (Figure 6). Below IG tranches do offer compelling relative value compared to other comparably rated fixed income asset classes with substantially higher yields and spreads.

Q: WHAT DOES THAT MEAN FOR CLO EQUITY DISTRIBUTIONS GOING FORWARD?

A: There is a common phrase about CLOs: “you buy your CLO debt, and you rent your loan assets”. As we saw in figure 6, CLO debt spread levels are near post-crisis all-time tight. Issuing a CLO now, and investing in CLO equity, locks in these low financing costs while the underlying loan portfolio will continue to move with market conditions. The low current arbitrage today between CLO debt and loan portfolio spreads is only a starting data point for a five year or more investment with an actively managed and rotating underlying portfolio.

We have seen this dynamic before. In 2018, loan spread levels tightened, reducing quarterly CLO equity payments, similar to the decline in equity distributions we have seen over the course of 2025.

In 2018, this was temporary; equity payments ultimately increased when the market normalized, and asset spreads pushed wider (Figure 7). Back then, CLOs with the tightest debt costs were able to take the greatest advantage of widening loans spreads for their equity investors. We believe new issues and recently reset transactions with cheap financing costs will once again be well positioned

Figure 6: CLO Debt remains tight to historical averages*Historical New Issue CLO Spread*

Source: Bloomberg as of 13 Jan 2026

to take advantage when we see a mean reversion in asset spreads.

Q: WHAT ARE THE KEY CATALYSTS TO WATCH IN THE LOAN MARKET FOR 2026, AND HOW SHOULD CLO INVESTORS BE THINKING ABOUT POSITIONING?

A: At a high level, the macro environment remains supportive heading into 2026. While the U.S. economy has slowed and the labor market has softened, conditions are expected to improve. Several key factors will matter heading into the year.

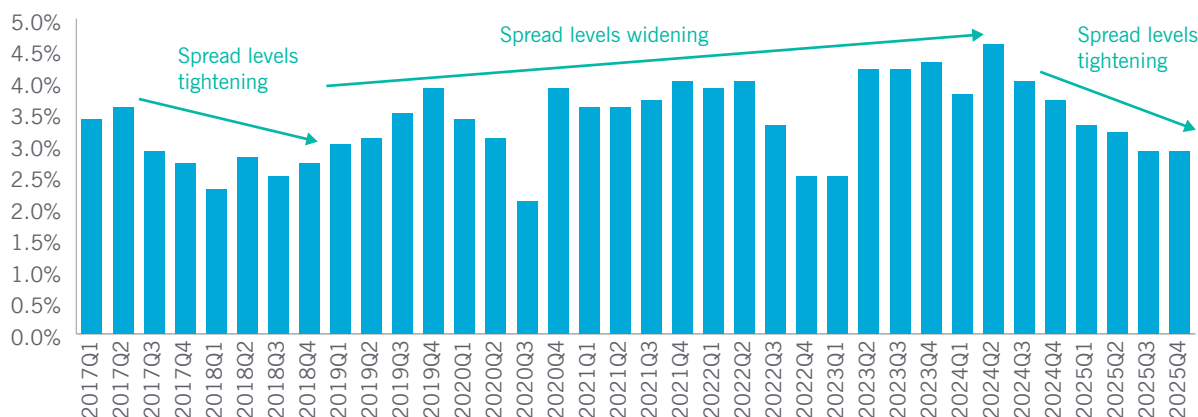
AI evolution remains critical to monitor. While direct impacts have begun to distinguish winners from losers, secondary effects could become more apparent throughout 2026. We've seen stress in AI-exposed credits facing business disintermediation risks, and we remain guarded as the technology continues to evolve rapidly. We've developed and continue to refine a framework leveraging International Data Corporation's (IDC) S-curve adoption construct to assess how AI interacts with

specific workflows across time horizons. We believe AI most easily disrupts rule-based, high-volume and repeatable workflows, while businesses relying on high-touch services or data ownership are potential winners.

Liability management exercises (LMEs) continue to garner investor attention and are expected to drive performance dispersion across CLO managers. The ability to benefit depends increasingly on portfolio size and workout capabilities.

Larger managers have demonstrated advantages through influential holding sizes and ad hoc or steering committee positions, driving better outcomes in non-pro rata negotiations. Sell-side research estimates that relative recoveries from non-pro rata LMEs have driven around 100 bps of annual dispersion in portfolio equity returns across managers. For CLO managers, the ideal outcome is exiting credits at reasonable levels before a potential LME. When that's not possible, each situation requires case-by-case evaluation—where size, scale and workout experience matter most.

We expect continued bouts of volatility throughout 2026, though the timing, duration and exact drivers remain difficult to predict.

Figure 7: The impact of evolving loan market spreads on CLO equity payments*Median quarterly payments*

Source: BofA Research CLO Equity Data as of 31 Dec 2025

The tightening CLO arbitrage environment, coupled with a loan market that has an increased default/LME rate and wide dispersion of recovery rates has led CLO equity performance to become more and more reliant on its terminal value. Across CLO manager risk styles, higher portfolio risk should equal higher loan spread, which should equal higher quarterly equity payments. In a 10x levered CLO structure, adding 0.3% in portfolio spread should generate an additional 3% of income to equity annually. If a CLO manager wants to increase quarterly equity payments by adding spread (i.e., risk), this additional income may be offset by an increased loss rate degrading the terminal value.

Breaking down the returns – a widely used assumption of a 2% default rate and 70% recovery rate (aka 2/70) equates to 0.60% portfolio loss annually, and 6% loss to equity. CLOs could experience a higher loss rate, especially if a CLO portfolio has purchased lower rated or CCC loans.

This annual erosion of terminal equity value would need to be compensated by income to achieve similar overall total return. This requires investing in higher spread loans, which are currently in short supply. Loan market spreads have compressed to a narrow band, not giving managers the ability to build a high spread portfolio with enough annual income make up for the possibility of a higher loss rate.

This leaves CLO managers building defensive portfolios of higher quality and lower spread loans. This protects equity terminal value and reset optionality, while maintaining the ability to rotate into higher risk and higher spread loans with a better entry point due to widening loan spreads. When that volatility returns to the market, those managers that have positioned their portfolios accordingly will be best able to take advantage and drive returns for equity.

Single A credit spread source: The Bloomberg A Corporate Index; CLO A spread source: JPM US CLOIE A duration-weighted discount margin (to worst)
Assumes that when a CLO is 10x levered, an increase of 0.3% spread would have a 10x impact to equity.

For more information, please visit nuveen.com.

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