LORD ABBETT®

September 2024

Investment Perspectives

Investment Brief: Addressing Key Questions on CLOs

As investor interest in collateralized loan obligations grows, we examine the important characteristics of the asset class—and its relevance for investors.

Joseph Graham, CFA,
Senior Managing Director,
Head of Investment Strategist Group

Alex Mink
Product Specialist

Over the last year, collateralized loan obligations (CLOs) have garnered increased attention from investors. With attractive spreads and historically low defaults compared to other areas of fixed income, we believe the asset class deserves attention. We have been investing in CLOs for over a decade across our fixed income strategies.

But while CLOs are achieving wider recognition, the asset class remains unfamiliar to many investors. Here, we offer an overview of CLOs and address some of the most common questions we receive.

What are CLOs?

At a high level, CLOs are structured financial products backed by a pool of loans, typically leveraged corporate loans. These loans are packaged together and sold to investors in different tranches, each representing varying levels of risk and return. The cash flows from the underlying loans are distributed to investors based on the seniority of the tranche they hold—senior tranches have historically received payment first and have lower risk, while junior or equity tranches bear more risk but offer higher potential returns.

This process of pooling and structuring risk has historically allowed a CLO manager to issue debt, on average among all the tranches, more cheaply than the rates on the loans it is buying, enabling the manager to profit from the spread over time.

Why would investors want CLO debt?

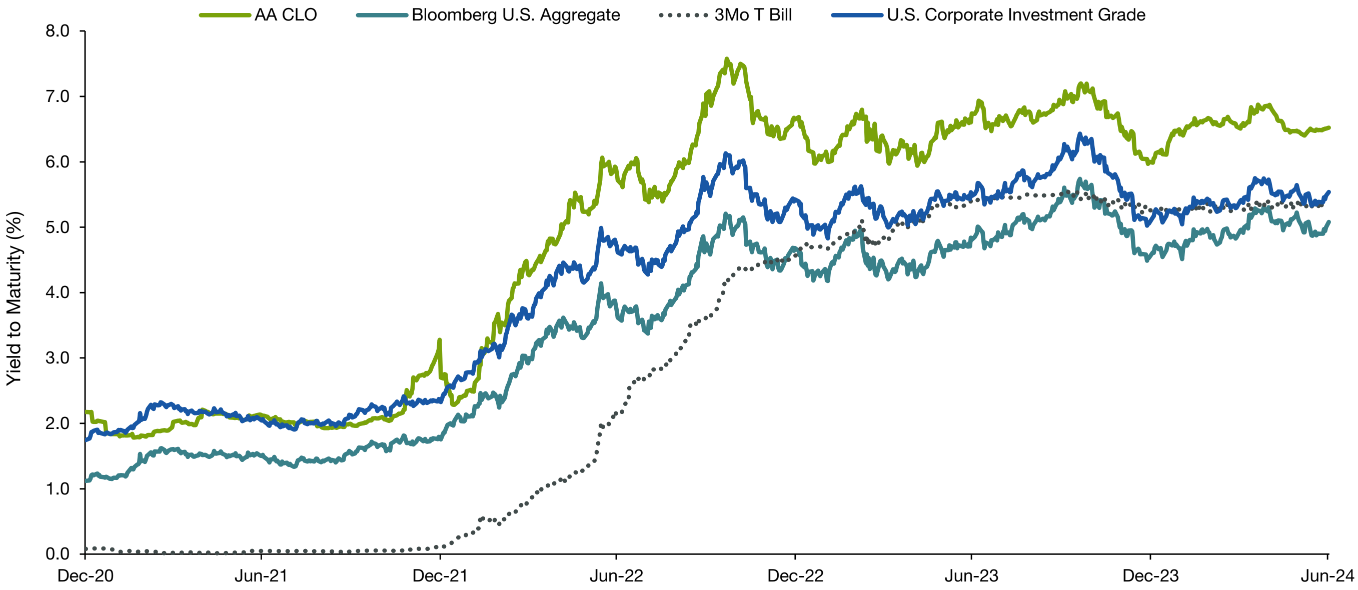
The investors in CLO debt receive high quality, diversified, floating rate loan exposure; CLO debt typically offers better spreads than corporate bonds of the same rating, and historically fewer defaults, based on data from S&P Global.

We strongly advocate for diversifying fixed income exposure in investment portfolios, including CLOs along with other asset classes, to balance risk and earn the additional carry available in corporate bonds, loans, and securitized products. We think CLOs are particularly effective for balancing fixed income portfolios because both the credit orientation and the floating rate feature help diversify the rate exposure that is often the most dominant risk in most fixed income portfolios.

In addition, the substantial yield advantages, as shown in Figure 1, can help provide protection against credit and interest rate volatility.

Figure 1. Comparing CLO Yields to Other Types of Investment-Grade Fixed Income

Yield to maturity on indicated indexes, December 31, 2020–June 30, 2024



Source: Bloomberg. U.S. Corporate Investment Grade= Bloomberg U.S. Corporate Bond Index. AA CLO= J.P. Morgan Collateralized Loan Obligation Index (AA-rated segment). Bloomberg U.S. Aggregate=Bloomberg U.S. Aggregate Bond Index. 3 Month T Bill=Three-month U.S. Treasury bill.

For illustrative purposes only and does not represent any specific portfolio managed by Lord Abbett or any particular investment. Indexes are unmanaged, do not reflect the deduction of fees or expenses, and are not available for direct investment. **Past performance is not a reliable indicator or guarantee of future results.**

What's driving the opportunity in CLOs?

Traditionally, this spread has been compensation for less liquidity rather than actual default experience, which has been near zero for investment-grade CLOs, based on S&P Global data. The primary buyers of CLOs were banks and insurance companies that took advantage of a capital cost arbitrage on the rating, but they tended to buy and sell at the same time, leaving the market volatile and without liquidity in times of stress.

In the last few years, though, a wider array of buyers, including retail investors through exchange-traded funds (ETFs), has come to the market seeking protection from rising rates. The benefit for the CLO market has been greater investor awareness, more trading, and increased liquidity. Data from Trace cited in a recent Top Chart report show that weekly trading volume in CLOs roughly quadrupled from the end of 2014 through June 30, 2024.

In addition, CLOs have had a greater opportunity set since the global financial crisis (GFC) of 2008–09, as banks curtailed lending in response to balance sheet regulation imposed by the 2010 enactment of the Dodd-Frank Act. The appetite for leverage among corporate issuers remains and CLOs have supported the syndicated bank loan market to fill that need.

What is the default experience of investment-grade CLOs?

CLOs do have principal risk, because they are sensitive to defaults in the loan pool, and liquidity and market risks due to fluctuations in credit spreads and market conditions.

The collateralization and prioritization of the debt tranches leads to a wide stratification of probabilities of principal loss and consequent yields over those tranches. An AAA-rated tranche of CLO debt will have around 40% in subordinate tranches, meaning that the loans bought by the CLO would have to generate 40% in principal losses before generating losses for the AAA tranche. Given historical recoveries in the 40% range for bank loans, this would mean over 65% of loans would need to default over the life of the CLO for that to happen. Trailing 12-month default rates for bank loans sit at 3.1% as of June 30, 2024, according to S&P Global; looking at recent history, defaults peaked at levels around 12% before quickly falling in each of 2009, 2002, and 1990, nowhere near levels that would cause loses for the AAA tranche.

While reinvestment periods and triggers that direct capital flows make the math not quite that simple in practice, the general safety of the AAA tranche (and even the AA- and A-rated tranches) is something that has not been tested throughout the GFC, the COVID-19 pandemic, and other market shocks, as shown in Figure 2.

Figure 2. Default Rates on Investment-Grade CLOs

Data as of June 30, 2024

CLO Rating	Default Rate
AAA	0.00%
AA	0.00%
A	0.00%
BBB	0.01%

Source: S&P Global. Latest available quarterly data.

Past performance is not a reliable indicator or guarantee of future results. Due to market volatility, the asset classes depicted in this chart may not perform in a similar manner in the future. For illustrative purposes only and does not represent any specific portfolio managed by Lord Abbett or any particular investment.

What is the CLO "feedback loop," and how might it benefit the market?

One of the things that separates CLOs from less well-conceived structures, in our view, is what can be considered a self-regulating ecosystem of issuance. The capital requirements for forming a CLO are relatively high, and the risks to equity are substantial, requiring a higher-percentage equity return to compensate for those factors. If underwriting standards loosen or defaults increase, a quick feedback loop ensures the cost of debt rises for the sponsor, making the structure uneconomical for the equity investors in the CLO, or, alternatively, the sponsor is forced to tighten underwriting standards.

It's that tight feedback loop that leads to a stable market structure, in our view, something much different than, for example, subprime mortgages before the GFC. In that market, lending standards loosened for decades, drawing on conventional wisdom that home prices would continue to appreciate, and enabled by offloading of risk to third parties, which kept the market unchecked until a small slowdown created a large problem.

What about the potential for negative convexity?

The CLO manager's ability to refinance a CLO can lead to negative convexity in times of falling rates, as this refinancing option shortens the life of the security and caps the value near par, a condition that explains some of the increased spread when compared to instruments with a similar credit rating but more call protection.

We believe interest rates are entering a period of more certainty as the variance in U.S. inflation data begins to narrow from month to month. This means the option of refinancing (the option an owner of a CLO tranche is short) is worth less and the refinancing risk is less, making the high carry featured by CLO debt more attractive.

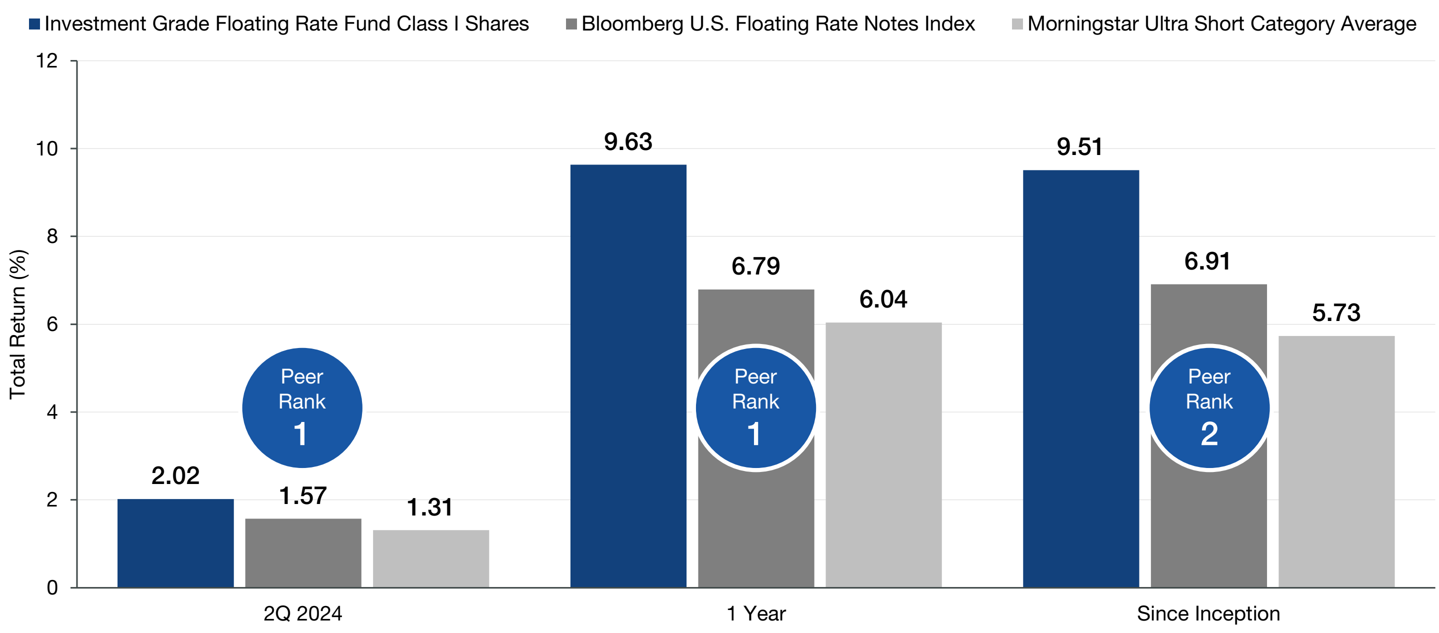
Why consider an active approach to CLO investing?

Over the last few years, there have been several investment products created to focus on investment-grade floating rate assets, including CLOs. We believe a flexible and diversified approach to investing in investment-grade floating rate instruments can have an advantage over a single asset class or rules-based structure, especially as market environments change and the opportunity set evolves.

At Lord Abbett, we have a deep and experienced team of investment professionals who have been investing in corporate and securitized credit for decades. The Lord Abbett Investment Grade Floating Rate Fund was launched in 2023 to provide clients with access to quality floating rate investments, with a concentration in CLOs but the flexibility to find relative value in syndicated loans, ABS, CMBS, RMBS, and floating rate corporate bonds. Since that time we have established our ability to use an active approach to best the floating rate index and peers in the category, as shown in Figure 3.

Figure 3. Historical Performance of Lord Abbett Investment Grade Floating Rate Fund (I Shares)

Data as of June 30, 2024



Gross expense ratio (06/30/2024): 1.75%. Net expense ratio (06/30/2024): 0.35%.

The net expense ratio takes into account contractual fee waivers/expense reimbursements that currently are scheduled to remain in place through 11/30/2024. For periods when fees and expenses were waived and/or reimbursed, the Fund benefited by not bearing such expenses. Without such fee waivers/reimbursements, performance would have been lower.

Source: Lord Abbett and Morningstar. As of 06/30/2024.

Performance data based on total return at net asset value, including the reinvestment of dividends and capital gains, if any, but does not reflect deduction of any front-end sales charges which are not applicable for Class I Shares. Class I Shares are available only to institutional investors and certain others, including retirement plans.

Past performance is not a reliable indicator or guarantee of future results. Current performance may be higher or lower than the performance data quoted. The investment return and principal value of an investment in the Fund will fluctuate so that shares, on any given day or when redeemed, may be worth more or less than the original cost. You can obtain performance data current to the most recent month-end by calling Lord Abbett at 888-522-2388 or referring to lordabbett.com. The Investment Grade Floating Rate Fund I share Morningstar US Ultrashort Bond total return rankings as of 06/30/2024 were 1% (3/259) for the second-quarter period, 1% (5/252) for the one-year period, and 2% (6/249) since inception (05/04/2023).

Important Information

Investors should carefully consider the investment objectives, risks, charges and expenses of the Lord Abbett Funds. This and other important information is contained in the fund's summary prospectus and/or prospectus. To obtain a prospectus or summary prospectus on any Lord Abbett mutual fund, you can click here to obtain a prospectus or summary prospectus on any Lord Abbett mutual fund or contact your investment professional or Lord Abbett Distributor LLC at 888-522-2388. Read the prospectus carefully before you invest or send money.

Not FDIC-Insured. May lose value. Not guaranteed by any bank. Lord Abbett mutual funds are distributed by Lord Abbett Distributor LLC. For U.S. residents only.

Lord Abbett Investment Grade Floating Rate Fund

New Fund Risk: The Fund is recently organized. There can be no assurance that the Fund will reach or maintain a sufficient asset size to effectively implement its investment strategy.

A Note about Risk: The Fund is subject to the general risks associated with investing in debt securities, including market, credit, liquidity, and interest rate risk. The value of investments in debt securities will fluctuate in response to market movements. When interest rates rise, the prices of debt securities are likely to decline, and when interest rates fall, the prices of debt securities tend to rise. The Fund invests in various types of high quality, investment grade debt securities but may also invest in high yield, lower-rated debt securities, sometimes called junk bonds that may involve greater risks than higher rated debt securities. These securities carry increased risks of price volatility, illiquidity, and the possibility of default in the timely payment of interest and principal. The Fund may invest in foreign or emerging market securities, which may be adversely affected by economic, political, or regulatory factors and subject to currency volatility and greater liquidity risk. The Fund may invest in derivatives, which are subject to greater liquidity, leverage, and counterparty risk. The fund performance history at this time is very limited; therefore, performance achieved during its initial period of investment operation may not be replicated over longer periods and may not be indicative of how the Fund will perform in the future. These factors can affect Fund performance.

Asset allocation or diversification does not guarantee a profit or protect against loss in declining markets.

No investing strategy can overcome all market volatility or guarantee future results.

The value of investments and any income from them is not guaranteed and may fall as well as rise, and an investor may not get back the amount originally invested. Investment decisions should always be made based on an investor's specific financial needs, objectives, goals, time horizon, and risk tolerance.

Market forecasts and projections are based on current market conditions and are subject to change without notice. Projections should not be considered a guarantee.

Projections should not be considered a guarantee.

Equity Investing Risks

The value of investments in equity securities will fluctuate in response to general economic conditions and to changes in the prospects of companies and/or sectors in the economy. While growth stocks are subject to the daily ups and downs of the stock market, their long-term potential as well as their volatility can be substantial. Value investing involves the risk that the market may not recognize that securities are undervalued, and they may not appreciate as anticipated. Smaller companies tend to be more volatile and less liquid than larger companies. Small cap companies may also have more limited product lines, markets, or financial resources and typically experience a higher risk of failure than large cap companies.

Fixed-Income Investing Risks

The value of investments in fixed-income securities will change as interest rates fluctuate and in response to market movements. Generally, when interest rates rise, the prices of debt securities fall, and when interest rates fall, prices generally rise. High yield securities, sometimes called junk bonds, carry increased risks of price volatility, illiquidity, and the possibility of default in the timely payment of interest and principal. Bonds may also be subject to other types of risk, such as call, credit, liquidity, and general market risks. Longer-term debt securities are usually more sensitive to interest-rate changes; the longer the maturity of a security, the greater the effect a change in interest rates is likely to have on its price.

The credit quality of fixed-income securities in a portfolio is assigned by a nationally recognized statistical rating organization (NRSRO), such as Standard & Poor's, Moody's, or Fitch, as an indication of an issuer's creditworthiness. Ratings range from 'AAA' (highest) to 'D' (lowest). Bonds rated 'BBB' or above are considered investment grade. Credit ratings 'BB' and below are lower-rated securities (junk bonds). High-yielding, non-investment-grade bonds (junk bonds) involve higher risks than investment-grade bonds. Adverse conditions may affect the issuer's ability to pay interest and principal on these securities.

This material may contain assumptions that are "forward-looking statements," which are based on certain assumptions of future events. Actual events are difficult to predict and may differ from those assumed. There can be no assurance that forward-looking statements will materialize or that actual returns or results will not be materially different from those described here.

The views and opinions expressed are as of the date of publication, and do not necessarily represent the views of the firm as a whole. Any such views are subject to change at any time based upon market or other conditions and Lord Abbett disclaims any responsibility to update such views. Lord Abbett cannot be responsible for any direct or incidental loss incurred by applying any of the information offered.

This material is provided for general and educational purposes only. It is not intended as an offer or solicitation for the purchase or sale of any financial instrument, or any Lord Abbett product or strategy. References to specific asset classes and financial markets are for illustrative purposes only and are not intended to be, and should not be interpreted as, recommendations or investment advice.

Certain information contained herein has been obtained from third party sources and such information has not been independently verified by Lord Abbett. No representation, warranty, or undertaking, expressed or implied, is given to the accuracy or completeness of such information by Lord Abbett or any other person. While such sources are believed to be reliable, Lord Abbett does not assume any responsibility for the accuracy or completeness of such information. Lord Abbett does not undertake any obligation to update the information contained herein as of any future date.

Please consult your investment professional for additional information concerning your specific situation.

Glossary & Index Definitions

Asset-backed security (ABS) is a security whose income payments, and hence value, are derived from and collateralized by a specified pool of underlying assets.

Bank Loans or Leveraged Loans are loans extended to companies or individuals that already have considerable amounts of debt. Lenders consider leveraged loans to carry a higher risk of default and, as a result, a leveraged loan is more costly to the borrower.

Call protection refers to protection from investment risk to bond investors that exists by limiting the conditions under which a bond issuer may elect to call (redeem) bonds before a bond's stated maturity date.

Carry is the difference between the yield on a longer-maturity bond and the cost of borrowing.

Collateralized Loan Obligation (CLO) is a special purpose vehicle (SPV) with securitization payments in the form of different tranches. Financial institutions back this security with receivables from loans. Collateralized loan obligations are the same as collateralized mortgage obligations (CMOs) except for the assets securing the obligation. CLOs allow banks to reduce regulatory capital requirements by selling large portions of their commercial loan portfolios to international markets, reducing the risks associated with lending.

Commercial mortgage-backed security (CMBS) is a type of mortgage-backed security backed by commercial and multifamily mortgages or mortgages on commercial property.

Convexity measures the relationship between bond prices and bond yields, which shows how a bond's duration changes with interest rates.

Duration is a measure of the sensitivity of the price (the value of principal) of a fixed-income investment to a change in interest rates.

Residential mortgage-backed security (RMBS) is a type of mortgage-backed security backed by residential real-estate mortgages.

Spread is the percentage difference in current yields of various classes of fixed-income securities versus Treasury bonds or another benchmark bond measure. A bond spread is often expressed as a difference in percentage points or basis points (which equal one-one hundredth of a percentage point). The option-adjusted spread (OAS) is the measurement of the spread of a fixed-income security rate and the risk-free rate of return, which is adjusted to take into account an embedded option. Typically, an analyst uses the Treasury securities yield for the risk-free rate.

A **syndicated loan** is a loan extended by a group of financial institutions (a loan syndicate) to a single borrower. Syndicates often include both banks and non-bank financial institutions, such as collateralized loan obligation structures (CLOs), insurance companies, pension funds, or mutual funds. After origination, shares of syndicated loans can be traded in the secondary market, changing the composition of the loan syndicate.

Yield is the income returned on an investment, such as the interest received from holding a security. The yield is usually expressed as an annual percentage rate based on the investment's cost, current market value, or face value. **Yield-to-maturity** (YTM) represents the expected return (expressed as an annualized rate) from the bond's future cash flows, including coupon payments over the life of the bond and the bond's principal value received at maturity. **Yield-to-worst** refers to the lesser of a bond's (a) yield-to-maturity or (b) the lowest yield-to-call calculated on each scheduled call date.

The Bloomberg U.S. Aggregate Bond Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities.

The Bloomberg U.S. Corporate Bond Index includes all publicly held issued, fixed-rate, nonconvertible investment-grade corporate debt. The index is composed of both U.S. and Brady bonds.

The Bloomberg U.S. Floating-Rate Note Index measures the performance of USD-denominated, investment-grade, floating-rate notes across corporate and government-related sectors. This index is not part of the U.S. Aggregate Index, which is a fixed coupon index.

<u>Bloomberg Index Information</u>

Indexes are unmanaged, do not reflect the deduction of fees or expenses, and are not available for direct investment.

<u>Morningstar Category Information</u>

Ultrashort bond portfolios invest primarily in investment-grade U.S. fixed-income issues and have durations of less than one year (or, if duration is unavailable, average effective maturities of less than one year). This category can include corporate or government ultrashort bond portfolios, but it excludes international, convertible, multisector, and high yield bond portfolios. Due to their focus on bonds with very short durations, these portfolios offer minimal interest-rate sensitivity and therefore low risk and total return potential.

<u>Important Information for U.S. Investors</u>

Lord Abbett mutual funds are distributed by Lord Abbett Distributor LLC.

FOR MORE INFORMATION ON ANY LORD ABBETT FUNDS, CONTACT YOUR INVESTMENT PROFESSIONAL OR LORD ABBETT DISTRIBUTOR LLC AT 888-522-2388, OR VISIT US AT LORDABBETT.COM FOR A PROSPECTUS, WHICH CONTAINS IMPORTANT INFORMATION ABOUT A FUND'S INVESTMENT GOALS, SALES CHARGES, EXPENSES AND RISKS THAT AN INVESTOR SHOULD CONSIDER AND READ CAREFULLY BEFORE INVESTING.

The information provided is not directed at any investor or category of investors and is provided solely as general information about Lord Abbett's products and services and to otherwise provide general investment education. None of the information provided should be regarded as a suggestion to engage in or refrain from any investment-related course of action as neither Lord Abbett nor its affiliates are undertaking to provide impartial investment advice, act as an impartial adviser, or give advice in a fiduciary capacity. If you are an individual retirement investor, contact your financial advisor or other fiduciary about whether any given investment idea, strategy, product, or service may be appropriate for your circumstances.

<u>Important Information for non-U.S. Investors</u>

Note to Switzerland Investors: In Switzerland, the Representative is ACOLIN Fund Services AG, Leutschenbachstrasse 50, CH-8050 Zurich, whilst the Paying Agent is Bank Vontobel Ltd., Gotthardstrasse 43, CH-8022 Zurich. The prospectus, the key information documents or the key investor information documents, the instrument of incorporation, as well as the annual and semi-annual reports may be obtained free of charge from the representative. In respect of the units offered in Switzerland, the place of performance is at the registered office of the representative. The place of jurisdiction shall be at the registered office of the representative or at the registered office or domicile of the investor.

Note to European Investors: This communication is issued in the United Kingdom and distributed throughout the European Union by Lord Abbett (Ireland) Limited, UK Branch and throughout the United Kingdom by Lord Abbett (UK) Ltd. Both Lord Abbett (Ireland) Limited, UK Branch and Lord Abbett (UK) Ltd are authorized and regulated by the Financial Conduct Authority.

LORD ABBETT®

A decision may be taken at any time to terminate the arrangements made for the marketing of the Fund in any EEA Member State in which it is currently marketed. In such circumstances, Shareholders in the affected EEA Member State will be notified of this decision and will be provided with the opportunity to redeem their shareholding in the Fund free of any charges or deductions for at least 30 working days from the date of such notification.

Lord Abbett (Middle East) Limited is authorised and regulated by the Dubai Financial Services Authority ("DFSA"). The entire content of this document is subject to copyright with all rights reserved. This research and the information contained herein may not be reproduced, distributed or transmitted in any jurisdiction or to any other person or incorporated in any way into another document or other material without our prior written consent. This document is directed at Professional Clients and not Retail Clients. Any other persons in receipt of this document must not rely upon or otherwise act upon it. This document is provided for informational purposes only. Nothing in this document should be construed as a solicitation or offer, or recommendation, to acquire or dispose of any investment or to engage in any other transaction. Nothing contained in this document constitutes an investment, an offer to invest, legal, tax or other advice or guidance and should be disregarded when considering or making investment decisions.

Note to Singapore Investors: Lord Abbett Global Funds I plc (the "Company") and the offer of shares of each sub-fund of the Company do not relate to a collective investment scheme which is authorized under Section 286 of the Securities and Futures Act, Ch. 289 of Singapore ("SFA") or recognized under Section 287 of the SFA, and shares in each sub-fund of the Company are not allowed to be offered to the retail public. Pursuant to Section 305 of the SFA, read in conjunction with Regulation 32 of and the Sixth Schedule to the Securities and Futures (Offers of Investments) (Collective Investment Schemes) Regulations 2005 (the "Regulations"), the Lord Abbett Global Multi-Sector Bond Fund, the Lord Abbett High Yield Fund, the Lord Abbett Short Duration Income Fund, the Lord Abbett Ultra Short Bond Fund, the Lord Abbett Climate Focused Bond Fund, the Lord Abbett Emerging Markets Corporate Debt Fund and the Lord Abbett Multi Sector Income Fund have been entered into the list of restricted schemes maintained by the Monetary Authority of Singapore for the purposes of the offer of shares in such sub-funds made or intended to be made to relevant persons (as defined in section 305(5) of the SFA), or, the offer of shares in such sub-funds made or intended to be made in accordance with the conditions of section 305(2) of the SFA. These materials do not constitute an offer or solicitation by anyone in Singapore or any jurisdiction in which such an offer or solicitation is not authorized or to any person to whom it is unlawful to make such an offer or solicitation.

Note to Hong Kong Investors: The contents of this material have not been reviewed nor endorsed by any regulatory authority in Hong Kong. An investment in the Fund may not be suitable for everyone. If you are in any doubt about the contents of this material, you should consult your stockbroker, bank manager, solicitor, accountant or other financial adviser for independent professional advice. The Fund is not authorised by the Securities and Futures Commission ("SFC") in Hong Kong pursuant to Section 104 of the Securities and Futures Ordinance (Cap 571, Laws of Hong Kong) ("SFO"). This material has not been approved by the SFC in Hong Kong, nor has a copy of it been registered with the Registrar of Companies in Hong Kong and, must not, therefore, be issued, or possessed for the purpose of issue, to persons in Hong Kong other than (1) professional investors within the meaning of the SFO (including professional investors as defined by the Securities and Futures (Professional Investors) Rules); or (2) in circumstances which do not constitute an offer to the public for the purposes of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32, Laws of Hong Kong) or the SFO. This material is distributed on a confidential basis and may not be reproduced in any form or transmitted to any person other than the person to whom it is addressed.

Lord, Abbett & Co. LLC | 30 Hudson Street | Jersey City, NJ 07302-4804 | T 1.888.522.2388 | lordabbett.com

IP-IB_CLO
09-24