

POINT OF VIEW

Why CLO Equity Deserves a Seat at the Table — and Why Sophisticated Investors Have an Edge

In a world where attractive double-digit risk-adjusted yields are increasingly scarce and constant bouts of volatility are the norm, investors are searching for strategies that deliver both resilience and return.

In today's market, investors face a paradox: the hunt for yield often leads to higher risk, while safety comes at the cost of return. Enter CLO equity — a lesser-known but powerful strategy that sits at the intersection of innovation and income. At its core, CLO equity represents the first-loss tranche in a Collateralized Loan Obligation, a structured credit vehicle backed by a diversified pool of senior secured corporate loans. While CLO equity bears the most risk in the structure, it also captures the highest upside. Historically, that trade-off has delivered strong, risk-adjusted returns for those who understand its mechanics. Yet despite these attributes, CLO equity remains under-allocated and widely misunderstood.

So why isn't everyone talking about it? The answer lies in accessibility—and that's where the conversation gets interesting.

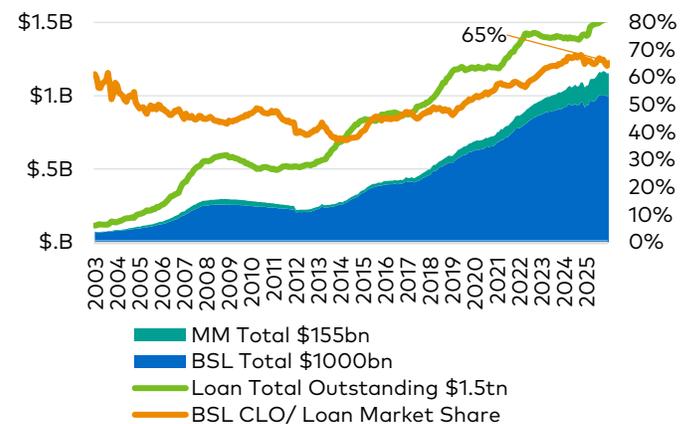
From Niche to Necessary: The Rise of CLOs

To understand why CLO equity matters, investors first need to understand how central CLOs have become to the leveraged loan market. Many investors still view CLOs as a niche corner of structured credit. The market suggests otherwise. The U.S. leveraged loan market now approaches \$1.5 trillion. CLOs hold roughly two-thirds of outstanding broadly syndicated corporate loans, making them the single largest source of demand. That scale changes the conversation.

As Figure 1 shows, CLO growth has mirrored the expansion of the loan market over the past two decades, reinforcing that CLOs are not cyclical opportunists, but structural participants. While market share has fluctuated across cycles, CLOs have remained central to the system — and today represent its dominant buyer base. Put simply: the modern leveraged loan market depends on CLOs.

At this scale and level of integration, CLOs are not a tactical allocation. They are embedded in the infrastructure of corporate credit. If CLOs form the backbone of this market, the question becomes how investors should access them.

Figure 1: CLOs: Core to the Leveraged Loan Market



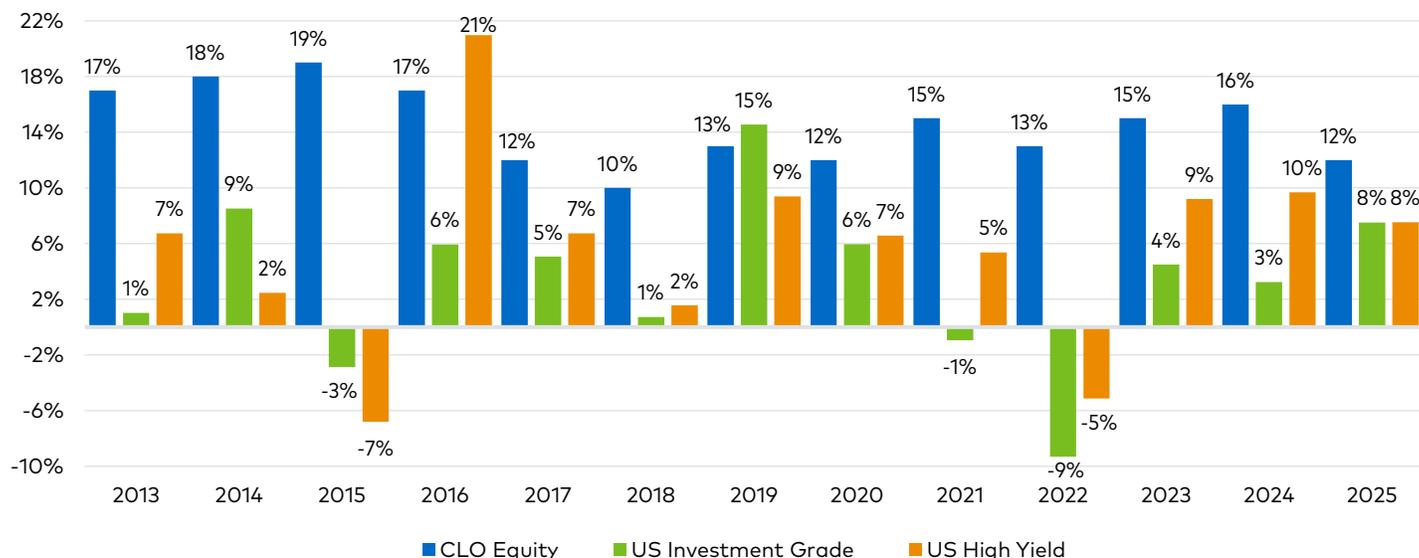
Source: As of 01-31-2026. BafA Global Research, Intex, LCD. Broadly Syndicated Loans (BSL) are large corporate loans syndicated to institutional investors and actively traded in secondary markets; the primary collateral for most CLOs. Middle Market (MM) Loans are loans to smaller companies, typically privately arranged and less liquid, commonly financed by private credit funds and middle-market CLOs.

Why CLO Equity Belongs in Portfolios

CLO equity offers a compelling combination of benefits that make it a valuable addition to diversified portfolios:

- **High Yield Potential:** Historically, CLO equity has delivered returns far exceeding traditional fixed income. In a world where high-quality bonds yield 4–6%, that difference is hard to ignore — a point clearly demonstrated in Figure 2.

Figure 2: CLO Equity Has Delivered Higher IRRs Than Traditional Fixed Income (2013–2025)



Source: As of 12-31-2025. BofA Merrill Lynch, St Louis Fed, Intex, Bloomberg Finance LP, Deutsche Bank. CLO universe represented by all outstanding CLOs. **Past performance is not indicative of future results.**

- **Front-loaded, durable, and predictable cash distributions:** CLO equity tranches begin paying quarterly income shortly after a deal has closed. Historically, distributions have landed in the mid-teens annually — providing reliable cash flow without a private-equity-style J-curve. Figure 3 highlights the durability of this income stream.

Figure 3: CLO Equity Can Offer Durable Income



Source: As of 12-31-2025. Deutsche Bank, Intex. Excludes deals with less than 2 cashflows to equity. Returns are computed assuming equity issued at par. Deal universe includes both reinvesting and amortizing deals. **Past performance is not indicative of future results.**

- **Diversification:** CLO equity provides exposure to a diversified pool of senior secured bank loans, an asset class that has historically exhibited low correlation to both equities and traditional fixed income (see Figure 4). This structural diversification can help mitigate portfolio concentration and improve overall risk-adjusted outcomes.

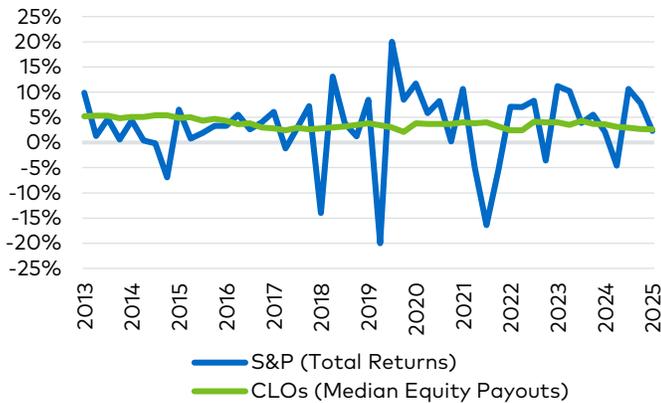
Figure 4: CLO Equity's Low Correlation with Equities and Traditional Fixed Income
Correlation of Annual Returns (2013–2025)

	CLO Equity	U.S. Investment Grade	U.S. High Yield	S&P 500
CLO Equity	100%			
U.S. Investment Grade	-9%	100%		
U.S. High Yield	0%	62%	100%	
S&P 500	15%	63%	59%	100%

Source: As of 12-31-2025. BofA Merrill Lynch, St Louis Fed, Intex, Bloomberg Finance LP, and Deutsche Bank. CLO universe represented by all outstanding CLOs. **Past performance is not indicative of future results.**

- **Lower Volatility Than Equities:** Despite generating higher income, CLO equity has historically demonstrated meaningfully lower volatility than public equities, driven by diversified loan exposure and structural protections (see Figure 5). The result has been more consistent risk-adjusted returns and improved portfolio resilience.

Figure 5: S&P 500 vs. Median CLO Equity Tranche Quarterly Returns



Source: As of 12-31-2025. Intex, Bloomberg Finance LP, and Deutsche Bank. S&P 500 price returns, CLO median equity cash distributions all deals. **Past performance is not indicative of future results.**

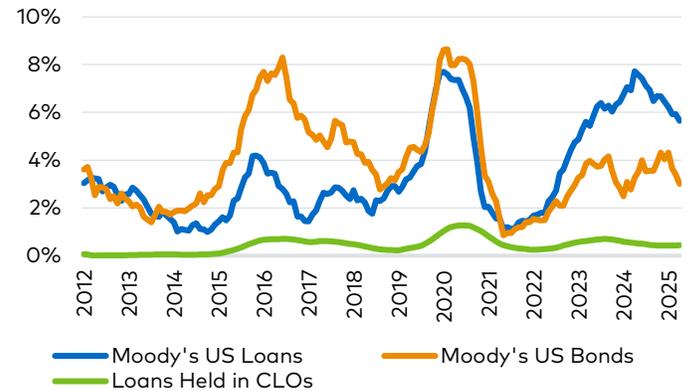
- **Structural Strength:** CLOs are actively managed vehicles with reinvestment periods and built-in credit enhancement features. Managers can trade loans, adjust risk exposures, and optimize portfolios over time — capabilities not typically available in traditional passive bond portfolios.
- **Strong Underlying Credit Quality:** Loan portfolios within CLOs have historically demonstrated stronger credit performance than the broader leveraged credit market, reinforcing the asset class’s resilience and contributing to more consistent long-term results.

Here’s how the three main paths to CLO exposure compare:

Figure 7: Options for CLO Exposure

Option	Pros	Cons
Public CLO Funds (ETFs, CEFs)	<ul style="list-style-type: none"> • Accessible to retail investors • Daily liquidity; lower minimums 	<ul style="list-style-type: none"> • Higher fees; little/no control over portfolio • Often levered at fund level
Credit Opportunities / Multi-Strategy Alternative Credit Funds	<ul style="list-style-type: none"> • Broader access; some CLO exposure • Semi-liquid structure 	<ul style="list-style-type: none"> • Limited liquidity • Blended strategies dilute pure CLO equity exposure; fees on fees • Leverage on leverage
Direct CLO Equity	<ul style="list-style-type: none"> • Highest return potential; direct exposure • Institutional-grade governance and underwriting framework • Strong alignment with Manager/GP • Optionality unique to owning majority control stake equity interests • No fees on fees, so lower all-in net fees 	<ul style="list-style-type: none"> • Requires higher minimums • Longer lock-ups (via captive equity fund) • Structural complexity • Accessible only to accredited investors and qualified purchasers

Figure 6: Loans in CLOs Have Lower Historical Default Rates vs. Broad Leveraged Credit 12-Month Trailing Default Rates



Source: As of 12-31-2025. PitchBook LCD, Moody’s Intex, and Deutsche Bank. US Loans and US Bonds represented by Moody’s indices, which are issuer weighted and covers all loans/bonds rated by the agency. CLOs represented by all CLOs (in and out of reinvestment) and is a measure of defaulted collateral held by CLOs during a specific point in time,

CLO equity’s structural complexity and limited liquidity can deter many investors. For sophisticated allocators, however, these same characteristics can provide access to an illiquidity and complexity premium that more conventional strategies cannot replicate (see Figure 7).

These advantages explain why CLO equity deserves a seat at the table — and why the real question for investors is not whether it belongs, but how to access it.

Accessibility

Here's the catch: CLO equity isn't for everyone. Regulatory hurdles, structural complexity, and high minimums keep it out of reach for many investors. Moreover, evaluating and managing these investments requires specialized data, modeling, and ongoing surveillance — capabilities that can create a competitive advantage but also add costs for institutional investors.¹

But the landscape is changing. While direct investment in CLO equity has traditionally been limited to qualified investors, innovation is expanding access to the asset class. Today, investors have three primary pathways — each with distinct advantages and trade-offs:

- **Public CLO Funds (ETFs, CEFs):** These vehicles offer the easiest access for investors, with lower minimums and, in many cases, daily liquidity. However, most CLO ETFs invest primarily in higher-rated CLO debt rather than equity tranches, which offer higher return potential but typically come with greater performance variability and more limited liquidity. Dedicated CLO equity funds often employ active portfolio management and may layer fund-level leverage and expenses on top of the underlying CLOs' structural leverage, adding complexity and cost.

Direct or controlling CLO equity investors can influence key life-cycle decisions — including refinancings, resets, and call timing — allowing them to manage positions through the full CLO term. Investors accessing CLO equity through public funds, however, generally relinquish this discretion to the fund manager.

- **Credit Opportunities / Multi-Strategy Alternative Credit Funds:** These semi-liquid vehicles broaden access for investors and may allocate opportunistically to CLO equity alongside other higher-yielding credit exposures. The trade-off is limited liquidity and typically indirect — and often modest — exposure to CLO equity, as allocations are made within a diversified, multi-strategy fixed income mandate
- **Direct CLO Equity (including by investment in a captive fund):** Typically available to qualified investors, this approach provides the most direct exposure and highest return potential. It requires selecting an experienced manager with specialized underwriting and surveillance capabilities, as well as committing higher minimum capital for longer lock-up periods.

Bottom line: For investors able to access direct CLO equity, it often represents the most compelling approach — offering direct exposure to double- return potential and structural advantages that other vehicles cannot replicate.

The Edge of Complexity: CLO Equity and Sophisticated Portfolios

While these benefits are broadly applicable, CLO equity is particularly compelling for sophisticated investors. These portfolios are designed to capture complexity premiums, enhance diversification, and accept illiquidity in pursuit of higher returns. CLO equity aligns naturally with this framework:

- **Access to Complexity Premium:** CLO equity is less widely understood than traditional credit strategies, creating the potential for informed investors to capture excess returns that may not be available in more broadly accessed segments of the market.
- **Customization and Control:** Direct investments enable tailored exposure, deliberate manager selection, and structural optimization — advantages that pooled retail vehicles are generally not designed to provide.
- **Rigorous Governance, Due Diligence, and Active Oversight:** All CLO investors benefit from the underlying manager's credit underwriting and ongoing collateral management. However, investors participating through controlling or captive structures can combine meaningful equity ownership with enhanced oversight on a single platform. This alignment may strengthen governance, support long-term hold strategies, and allow investors to capture structural optionality — key components of harvesting complexity and illiquidity premiums within diversified portfolios.
- **Capacity for Illiquidity:** CLO equity is typically illiquid. Investors able to commit capital over longer time horizons, however, can incorporate such allocations in exchange for enhanced return potential.
- **Strategic Diversification Beyond Public Markets:** CLO equity provides exposure to leveraged loans in a manner that complements private credit and alternative allocations, helping reduce reliance on traditional public fixed income and equity markets.

CLO Equity: A Strategy Whose Time Has Come

CLO equity belongs in portfolios because it delivers what investors need most today: yield, diversification, and resilience. But it is more than just another income strategy. It provides exposure to a \$1+ trillion leveraged loan market that underpins corporate America — where CLOs are not niche players but the primary source of capital in the leveraged loan market. In other words, this is core credit infrastructure, not a bespoke side strategy.

Access has historically been limited, but the landscape is evolving. While new pathways have emerged, direct investment remains the most powerful expression of the opportunity. For sophisticated investors able to allocate directly, the advantage is clear: the ability to harness complexity, exercise structural influence, and commit long-term capital in pursuit of durable, risk-adjusted returns.

¹For example, tools such as Bloomberg, Intex, Kanerai, and MarkIt Data, each of which are expensive and not easily accessible to non-institutional investors, are regularly utilized by CLO investors to monitor the status of their investments.

Important Disclosures

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Past performance is not indicative of future results.

In a market where traditional fixed income struggles to deliver meaningful income and public equities bring heightened volatility, CLO equity offers something rare — a structural source of cash flows with built-in adaptability. That combination is difficult to replicate and increasingly relevant in today's environment.

Explore Whether CLO Equity Belongs in Your Portfolio

CLO equity is complex by design — and that complexity can be a source of advantage. Connect with our team to discuss how CLO equity may fit within your broader credit and alternatives strategy.

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Definitions:

Correlation measures the degree to which two variables move in relation to each other, expressed on a scale from -1 to +1. A positive correlation means they move in the same direction, a negative correlation means they move in opposite directions, and a correlation near zero indicates little to no linear relationship.

Internal Rate of Return (IRR) is the annualized rate of return that makes the present value of an investment's future cash flows equal to its initial investment, reflecting both the timing and magnitude of cash flows.

J-curve describes the tendency for certain investments, especially private market or closed-end structures, to show negative returns early on before rising to stronger positive returns over time. Early drawdowns reflect upfront costs or delayed cash flows, while later periods capture value creation or income generation.

The S&P 500 Index, which is maintained by S&P Dow Jones Indices, is a market capitalization weighted index that measures 500 common equities that are generally representative of the U.S. stock market. The performance of an index does not reflect any transaction costs, management fees, or taxes.

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