XAInvestments

Introduction to Collateralized Loan Obligations ("CLOs")

February 2, 2021

Risk Disclosures

Senior Loan Risk: Investments in senior loans are generally below investment grade credit quality and subject to greater risks than investment grade corporate obligations. The prices of these investments may be volatile and will generally fluctuate due to a variety of factors that are inherently difficult to predict, including, but not limited to, changes in interest rates, prevailing credit spreads, general economic conditions. While such loans are generally intended to be secured by collateral, losses could result from default and foreclosure. Therefore, the value of the underlying collateral, the creditworthiness of the borrower and the priority of the lien are each of great importance.

CLO Risk: CLOs often involve risks that are different from or more acute than risks associated with other types of credit instruments, including: (1) the possibility that distributions from collateral assets will not be adequate to make interest or other payments; (2) the quality of the collateral may decline in value or default; (3) investments in CLO junior debt tranches and CLO subordinated notes will likely be subordinate in right of payment to other senior classes of CLO debt; and (4) the complex structure of a particular security may not be fully understood at the time of investment and may produce disputes with the issuer or unexpected investment results. CLOs may be difficult to value and often constitute illiquid investments. In addition, there can be no assurance that a liquid market will exist in any CLO. CLOs can be subject to significant losses if they are concentrated in a limited number of industries or borrowers. Moreover, the value of CLOs may decrease if ratings agencies lower their original rating of a CLO, and the complex structure of the security may produce unexpected investment results. During periods of economic uncertainty and recession, the CLO holding assets may not meet its criteria for investments.
CLOs are also generally directed by a collateral manager and depend on the financial and managerial expertise of the collateral manager’s investment professionals.

CLO Subordinated Notes Risk: Investments in the “residual” or “equity” tranche are junior in priority of payment and are subject to certain payment restrictions. In addition, CLO subordinated notes generally do not benefit from any creditors’ rights or ability to exercise remedies under the indenture governing the notes. The subordinated notes are not guaranteed by another party. Subordinated notes are subject to greater risk that the senior notes issued by the CLO. CLOs are typically highly levered, utilizing up to approximately 10 times leverage, and therefore subordinated notes are subject to a higher risk of total loss. Principal payments on subordinated notes may not be made unless all amounts owed to secured notes are paid in full. Also, if a CLO does not meet the asset coverage tests or the interest coverage test set forth in the indenture governing the notes issued by the CLO, cash would be diverted from the subordinated notes to first pay the secured notes in amounts sufficient to cause such tests to be satisfied.

Performance data quoted represents past performance. Past performance does not guarantee future results. Current performance may be lower or higher than the performance data quoted.

Today’s Speakers

Kimberly Flynn
Managing Director
XA Investments LLC

Kimberly Flynn serves as Managing Director at XA Investments, a wholly-owned subsidiary of XMS Capital Partners. She is a partner in the firm and responsible for all product and business development activities.

Previously, Kim was Senior Vice President and Head of Product Development for Nuveen Investments’ Global Structured Products Group. In her leadership role at Nuveen, Kim was responsible for asset raising activities through the development of new traditional and alternative investment funds including CEFs, ETFs, UITs and commodity pools.

Kim received her MBA degree from Harvard University and her BBA in Finance and Business Economics, Summa Cum Laude, from the University of Notre Dame in 1999. She received her CFA charter in 2005.

Robert Chenoweth
Vice President
XA Investments LLC

Robert Chenoweth is Vice President of Internal Sales at XA Investments and is responsible for supporting distribution efforts across a variety of wealth management channels.

Prior to XAI, Robert was Vice President and product specialist for Neuberger Berman's non-investment grade credit team, interacting with departments within the firm as well as clients. Over the course of Robert's 15 year career within the industry, he has developed broad knowledge of various asset classes and fund structures.

Robert earned the Certified Investment Management Analyst (CIMA) designation from the Wharton School of Business and received a BA in Spanish and General Business from Texas Christian University.

FOCUS ON CEFS AND INTERVAL FUNDS	• Access to strategies and managers that historically have been available only to large institutional and ultra high net worth investors • Custom product designs appeal to financial advisors and end investors
EXPERIENCED CEF DESIGN AND PRODUCT STRUCTURING TEAM	• Senior leaders have held management roles at notable asset management firms and average over 20 years of experience in financial services • Proven track record in product design and development with a unique combination of in-depth alternatives and registered fund experience
SALES AND DISTRIBUTION	• Dedicated team with strong sales and marketing execution capabilities • Emphasis on advisor education and serving as a valuable industry resource • Expertise in alternatives, less liquid and sustainable investments
PARTNERSHIP MODEL	• XAI partners with established investment managers • Demand driven decision making allows us to launch timely new products

Note: XA Investments LLC is the Registered Fund Division of XMS Capital Partners, LLC (“XMS”). XMS, established in 2006, is a global, independent financial services firm providing mergers and acquisitions, capital raising and cooperate advisory services to clients. XMS has over 30 professionals on its team and offices in Chicago, Boston and London.

Why Invest in CLO Debt & Equity

- Levered way to buy senior loans that offers credit enhancements and certain structural protections
- Actively managed and potentially diversified portfolio
- Potential for increased income from the excess spread between the cash flow and expenses for equity holders

CLOs Invest in Senior Loans

Attractive yield potential
Opportunity for incremental yield pick-up relative to similarly rated corporate bonds and other structured securities.

Protection against credit risk
Senior loans are typically secured and their senior positioning in the capital structure offers protection relative to bonds.

Portfolio diversification
Low correlations to investment grade corporate credit and equities and negative correlation to U.S. Treasury Bonds.

Floating rate
Coupons typically float over LIBOR, which benefits investors in periods of rising short term interest rates

Low historical defaults
CLO tranches have demonstrated low historical default rates.

What is a Collateralized Loan Obligation?

Collateralized Loan Obligations (CLOs) are securitizations backed by a pool of bank loans (diversified by industry and borrower), which offer investors exposure to a professionally and actively managed portfolio of loans.

- **CLO Collateral (**Assets**):** Senior loans
- **CLO Debt (**Liabilities**):**
  - Senior tranches: AAA, AA
  - Mezzanine tranches: A, BBB, BB, B
- **CLO Equity (**Equity**):** Residual stake, receives the excess spread between the CLO's cash flow and expenses

EXAMPLE - CLO BALANCE SHEET

ASSETS CLO Collateral Pool of Senior Loans (~150 to ~300 issuers in ~20 industries)	**LIABILITIES** CLO Senior Tranches AAA AA
	LIABILITIES CLO Mezzanine Tranches A BBB BB B
	CLO EQUITY Residual Stake

U.S. CLO Debt Market Overview

CLO Debt Tranche	Current Weighted Average Life (years)	Current Spread[1] (basis points)	Current Yield[2]
AAA	5-6	136	1.60%
AA	6-8	181	2.05%
A	6-9	250	2.74%
BBB	7-9	392	4.16%
BB	7-9	737	7.61%
Senior Loans			
S&P/LSTA U.S. Leveraged Loan 100 Index	N/A	318	3.42%

Source: LCD Quarterly Review, an offering of S&P Global Marketplace, as of December 31, 2020.
Note: (1) Current spreads represent the midpoint of a range of spreads to indicate manager tiering.
(2) Current yields reflect current spreads in basis points over 3-month LIBOR (.24%) for originally-rated categories. For illustrative purposes only.
Performance data quoted represents past performance. Past performance does not guarantee future results. Current performance may be lower or higher than the performance data quoted.

The CLO Structure

CLO Debt
(as a % of capital structure)

LIABILITIES

Senior Debt Tranches
- Lower yield
- Lower return potential
- Lower default risk
- More issuance than lower rated quality tranches

Mezzanine Debt Tranches
- Higher yield
- Higher return potential
- Higher default risk

EQUITY (Residual)

Equity Stake
- Residual cash flow (after interest & expenses)
- Highest return potential
- First loss position

AAA	(~61%)
AA	(~12%)
A	(~7%)
BBB	(~5%)
BB	(~5%)
CLO Equity	(~10%)

CLO Capital is Invested In:

ASSETS
CLO Collateral Pool

Diverse Pool of Senior Loans of ~150 to ~300 Issuers in ~20+ Industries

Source: Thomson Reuters Leveraged Loan Monthly, September 2015 (October 8, 2015).

CLO Collateral

CLO Debt
(as a % of capital structure)

LIABILITIES

Senior Debt Tranches
- Lower yield
- Lower return potential
- Lower default risk
- More issuance than lower rated quality tranches

Mezzanine Debt Tranches
- Higher yield
- Higher return potential
- Higher default risk

EQUITY (Residual)

Equity Stake
- Residual cash flow (after interest & expenses)
- Highest return potential
- First loss position

CLO Debt
AAA (~61%)
AA (~12%)
A (~7%)
BBB (~5%)
BB (~5%)
CLO Equity (~10%)

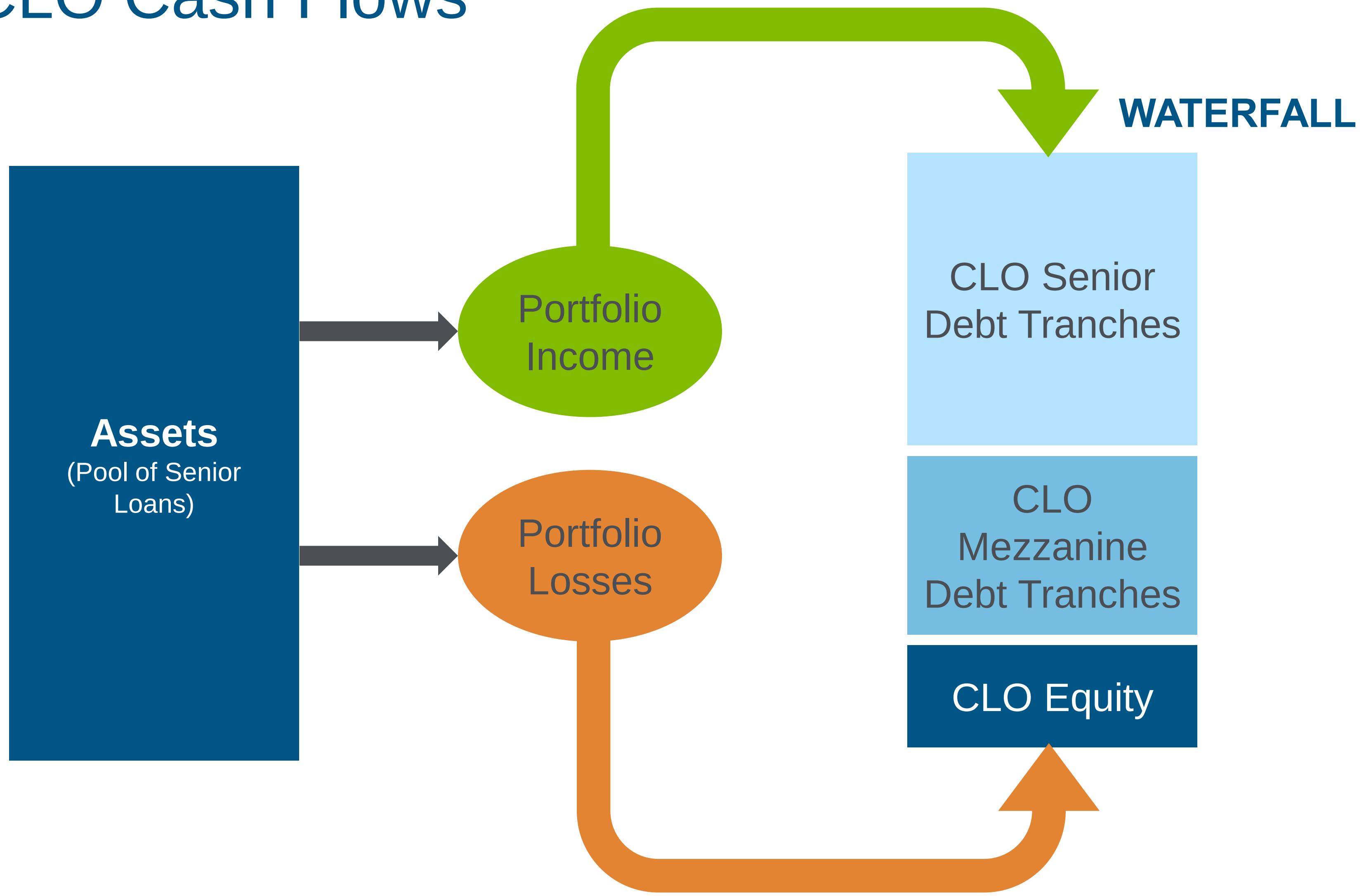
CLO Capital is Invested In:

ASSETS
CLO Collateral Pool

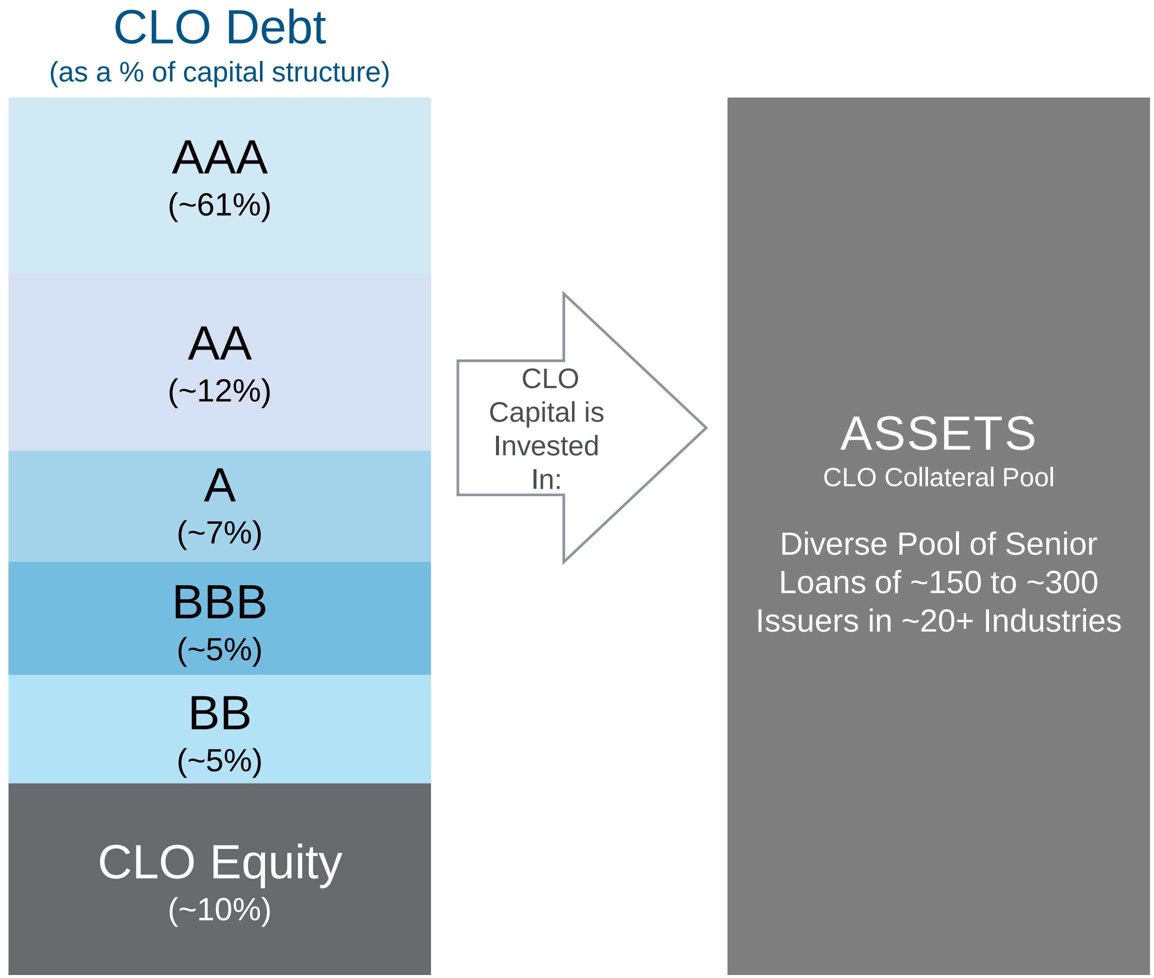
Diverse Pool of Senior Loans of ~150 to ~300 Issuers in ~20+ Industries

Source: Thomson Reuters Leveraged Loan Monthly, September 2015 (October 8, 2015).

CLO Cash Flows



CLO Debt



LIABILITIES

Senior Debt Tranches
- Lower yield
- Lower return potential
- Lower default risk
- More issuance than lower rated quality tranches

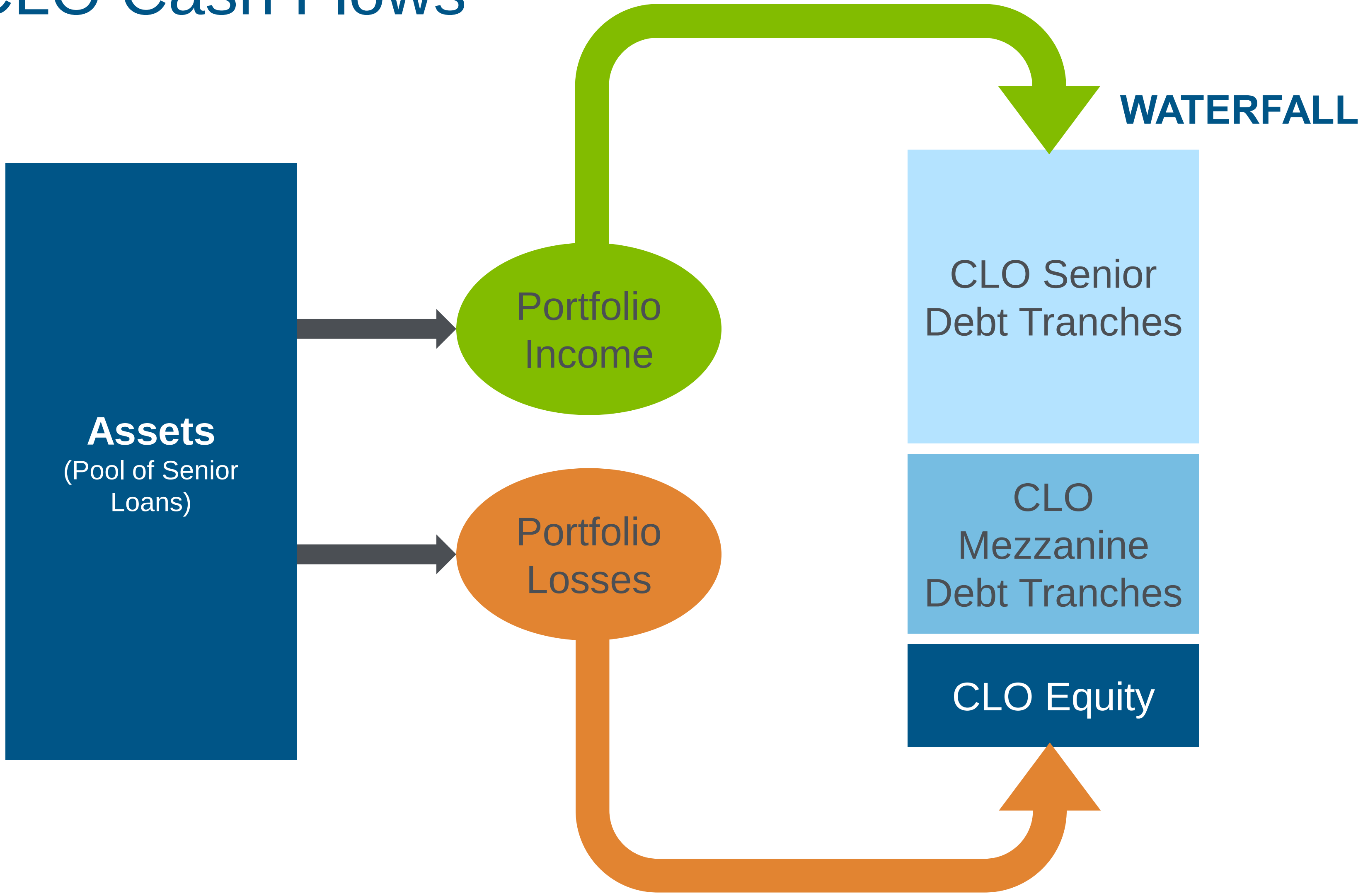
Mezzanine Debt Tranches
- Higher yield
- Higher return potential
- Higher default risk

EQUITY (Residual)

Equity Stake
- Residual cash flow (after interest & expenses)
- Highest return potential
- First loss position

Source: Thomson Reuters Leveraged Loan Monthly, September 2015 (October 8, 2015).

CLO Cash Flows



CLO Equity

LIABILITIES

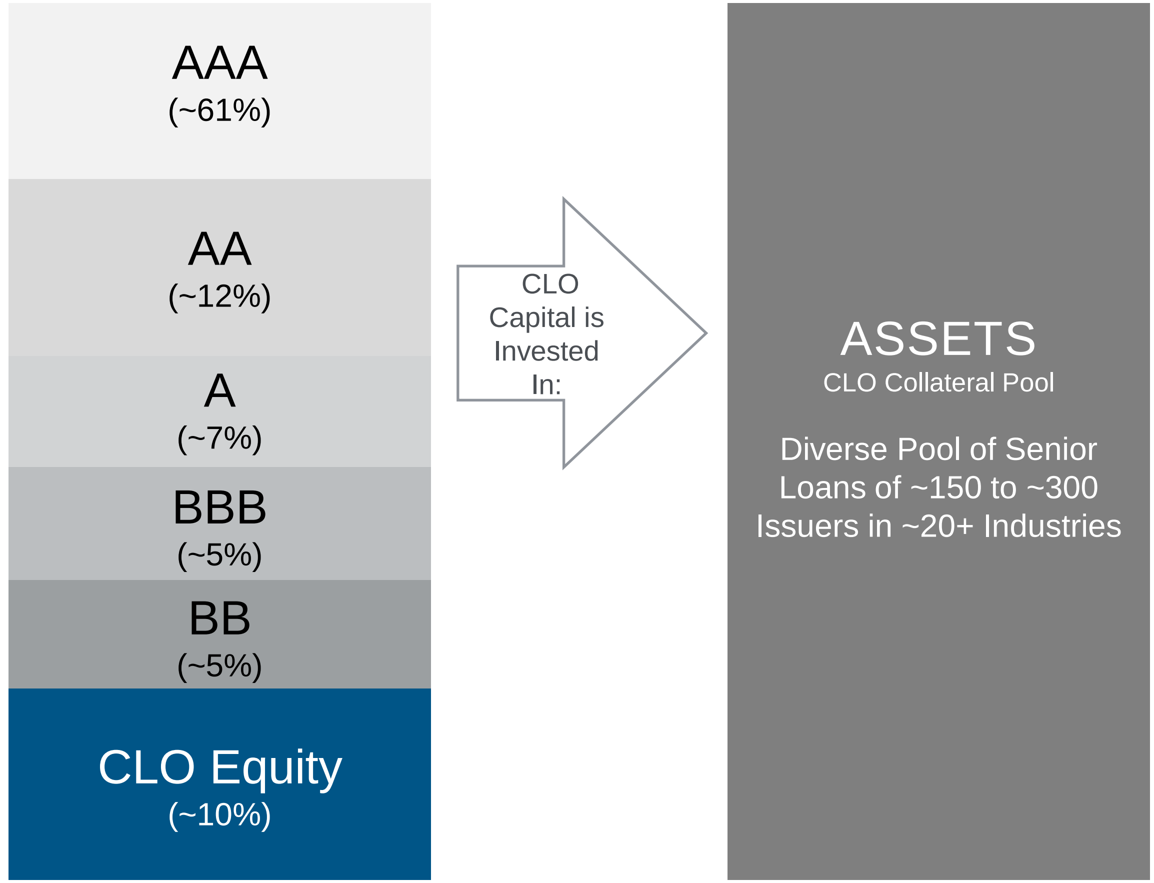
Senior Debt Tranches
- Lower yield
- Lower return potential
- Lower default risk
- More issuance than lower rated quality tranches

Mezzanine Debt Tranches
- Higher yield
- Higher return potential
- Higher default risk

EQUITY (Residual)

Equity Stake
- Residual cash flow (after interest & expenses)
- Highest return potential
- First loss position

CLO Debt
(as a % of capital structure)



Source: Thomson Reuters Leveraged Loan Monthly, September 2015 (October 8, 2015).

Octagon Credit Overview

Octagon Credit Investors

CREDIT EXPERTS

- Since 1994 — exclusive focus is below investment grade credit. $26.4bn[1] in AUM as of 12/31/2020

DISCIPLINED PROCESS

- Seasoned investment process rooted in fundamental credit and relative value analysis

PEOPLE

- Cohesive, experienced, cycle-tested investment team

PERFORMANCE

- Attractive, risk-adjusted returns over 25+ year track record

INSTITUTIONAL FOCUSED

- A leading institutional credit investor managing private funds and a registered fund

Note: (1) Octagon AUM as of December 31, 2020 is inclusive of one feeable account that is expected to be converted into cash flow CLO. There is no guarantee that such account shall be converted into a cash flow CLO or any other such account.

Performance data quoted represents past performance. Past performance does not guarantee future results. Current performance may be lower or higher than the performance data quoted.

Collateralized Loan Obligations – Webinar Series

Accessing CLOs - Webinar #2

March 2, 2021 at 10:00 AM – 11:00 AM CST

Join Kimberly Flynn, Managing Director at XA Investments, and John Dudzik, Managing Director at Octagon Credit Investors, as they provide insight into the ways investors can access CLO Debt & Equity.

CLO Marketplace - Webinar #3

April 6, 2021 at 10:00 AM – 11:00 AM CST

Join Kimberly Flynn, Managing Director at XA Investments, and Gretchen Lam, Senior Portfolio Manager at Octagon Credit Investors, as they provide a current update on the CLO Debt & Equity marketplace.

Contact Our Team with Questions

Addison West
XA Investments
Director, Business Development

Awest@XAInvestments.com
(610) 348–6107

Robert Chenoweth
XA Investments
Vice President, Internal Sales

Rchenoweth@XAInvestments.com
(312) 374-6938

XAInvestments.com | (888) 903-3358
321 North Clark Street Suite 2430 Chicago, IL 60654

Appendix

Senior Loans vs. High Yield Bonds

	Senior Loans	High Yield Bonds
Collateral	Secured	Unsecured
Coupon	Floating Rate	Fixed Rate
Covenants	Maintenance	Incurrence
Call Protection	Limited	Moderate
Recovery Prospects	High	Low
Investor Base	Concentrated	Diverse
Secondary Market Volume	~$3 billion per day	~$6 billion per day

Provided for illustrative purposes only. Information presented above does not capture all characteristics or risk of investing in Senior Loans or High Yield Bonds.

Source: Citi Research.

CLOs vs. ABS CDOs

	COLLATERALIZED LOAN OBLIGATIONS (CLOs)	ASSET-BACKED SECURITY COLLATERALIZED DEBT OBLIGATIONS (ABS CDOs)
UNDERLYING COLLATERAL	Non-Investment Grade Corporate Loans	Mezzanine Tranches & High Grade ABS Tranches
TRANSPARENCY	Transparent – Monthly trustee reports allow underlying loans to be analyzed and priced frequently	Opaque – Monthly Trustee reports allow identification of underlying ABS tranches but not the ultimate underlying assets
MANAGED VS. STATIC	Actively managed portfolio of corporate loans	Managed portfolio of tranches of static securitizations
CORRELATION AMONG UNDERLYING ASSETS[1]	Low	High
SECTOR DIVERSIFICATION:	High – Top industry typically limited to 12-15% of the portfolio	Low – Tied to the performance of the real estate sector
10 YEAR AAA CUMULATIVE DEFAULT RATE (1993-2017)[2]	0.0%	35.1%
10 YEAR AA CUMULATIVE DEFAULT RATE (1993-2017)[2]	0.0%	43.2%

Provided for illustrative purposes only. Information presented above does not capture all characteristics or risk of investing in CLOs or ABS CDOs.

Performance data quoted represents past performance. Past performance does not guarantee future results. Current performance may be lower or higher than the performance data quoted.

Note: (1) Correlation of underlying assets is intended to convey a measure of diversification of the underlying assets of the respective product, based on Octagon's assessment of the ultimate risk of loss for the underlying assets of the respective product.

(2) Source: ©1993-2017 Moody's Investors Services, Inc., Moody's Analytics, Inc. and/or their licensors and affiliates – used with limited permission*, Moody's Investors Services, Special Comment: Default and Loss Rates of Structured Finance Securities: 1993-2017. June 12, 2018*.

Key Benefits and Risks

Benefits	
Income	CLOs generate high levels of current income.
Short Duration	CLOs are floating rate instruments.
Active Management	CLOs are actively managed and may benefit from volatility in the loan market.
Structural Integrity	Strengths of the CLO structure include stable financing and various credit enhancements that protect debt holders. CLO financing is locked in for the life of the CLO. And, the structure has various features designed to protect debt holders.
Risks	
CLO Risk	1. Payments from collateral are insufficient to pay out CLO investors. 2. Quality of collateral may decline or default. 3. Junior CLO debt tranches and CLO equity are subordinate to senior CLO debt. 4. Complex structure might not be fully understood at time of investment.
CLO Equity Risk	Subordinated notes (CLO equity) are not guaranteed by any party and are subject to a higher risk of total loss than CLO debt.
CLO Management Risk	A CLO's success depends, in large part, on its manager.
Structured Credit Instruments Risk	CLOs are a type of structured credit and investing involves various risks, including, for example, CLO equity investors do not have claims against the underlying loans.
Liquidity Risk	CLOs are illiquid investments.
Leverage Risk	The use of leverage in subordinated tranches may magnify the adverse impact of changes in the value of the assets.