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And, Not Or: A Rules-Based Rotation Between CLO Debt and Equity Through Market Cycles

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Overview

Key takeaways

1. CLO activity has clustered at the extremes: investors have focused on top-rated CLO ETFs at one end of the stack or fast-growing CLO equity funds at the other. Few are paying attention to the area between the endpoints.
2. In assessing this opportunity, we used historical data to analyze the hypothetical impact of a rules-based rotation between junior debt and equity based on relative performance signals.
3. The rotation was contrarian by design. The rule added equity exposure after equity underperformed, not after a run, defying intuition. That discipline helped avoid some of the worst months while still capturing upside.

Executive summary

This paper explores whether a rules-based rotation between CLO equity and sub-investment-grade (IG) CLO debt can achieve a better balance of return and potential downside protection than either sleeve held on its own. Over the 158-month window from April 2013 through May 2026, the rotation produced a 10.5% net CAGR,[1] captured 92.8% of CLO equity's positive-month returns while participating in 73.1% of its down-months, and carried a less severe left tail than static sub-investment-grade debt. The strategy shifts between CLO debt and equity based on which has performed better over the prior 12 months. The specific rules for when to switch, how much to allocate, and how long to hold each position are outlined herein. The results suggest this kind of rotation can be a useful factor when deciding how to allocate across the more junior tranches of the CLO capital stack.

Rotation analysis key takeaways

April 2013 - May 2026

6

Rotations over 158 months

10.5%

net CAGR produced

92.8% vs 73.1%

Positive-month capture vs down-month participation

1. Extracted returns are pro forma; no fund investor actually achieved the net return shown. See Disclaimers for extracted return methodologies.

The opportunity between CLO market endpoints

Recent CLO product activity has clustered at the two ends of the capital stack. At the top, PitchBook LCD reports that CLO ETF assets rose above $50 billion in the second quarter of 2026, with 95% dedicated to AAA to A tranches. Down the stack, AUM and investor interest in captive CLO equity funds have grown rapidly, as seen in Bain Capital Credit's successful recent launch of the $1.5 billion CLO Management Fund III (CMV III). Between those endpoints lies a less-examined opportunity to actively allocate between junior CLO debt and equity as market conditions change.

Rotation analysis methodology

We tested a single question: Could an investor have improved the risk-return profile of a lower-stack CLO allocation by systematically shifting between junior debt and equity rather than holding either one, or a fixed mix, throughout the cycle? To answer it, we backtested a rules-based strategy that adjusts the allocation based on the prior 12 months of relative performance between CLO equity and a 50/50 BB/B debt blend. The time period, April 2013 through May 2026, was chosen because it was the first window in which the required debt and equity index series are all available. The analysis uses third-party market data and index-based return estimates from J.P. Morgan and Citi.

Framework attributes

Signal
Twelve-month trailing return spread (CLO equity minus sub-IG debt blend), standardized against the full history of that spread to date.

Thresholds
z below −1.0 moves to 60% equity weight. z above +1.0 moves to 10% equity weight. Inside the ±1.0 hold range, current weight is held unchanged.

Starting weight
35% equity while signal calibrates (before first valid z-score). The rule governs thereafter.

Minimum hold
Six months between target-weight changes, reflecting the liquidity profile of the market.

Lag
One-month implementation lag: signal measured end-of-month, weight applied at following month-end.

Costs
15 bp one-way on debt notional rotated and 60 bp one-way on equity notional rotated. Applied only on flip months.

Analysis exclusions

New-issue equity and captive equity fund performance are excluded because they reflect different entry points, cost bases, and arbitrage profiles. The analysis also does not attempt to model the broader set of decisions available to a CLO portfolio manager, including moving up in quality or liquidity, choosing between primary and secondary opportunities, allocating between US and European markets, selecting managers, or taking control positions that may create refinancing optionality.

With these exclusions, the analysis focuses on whether rotating between lower-stack debt and equity adds value on its own.

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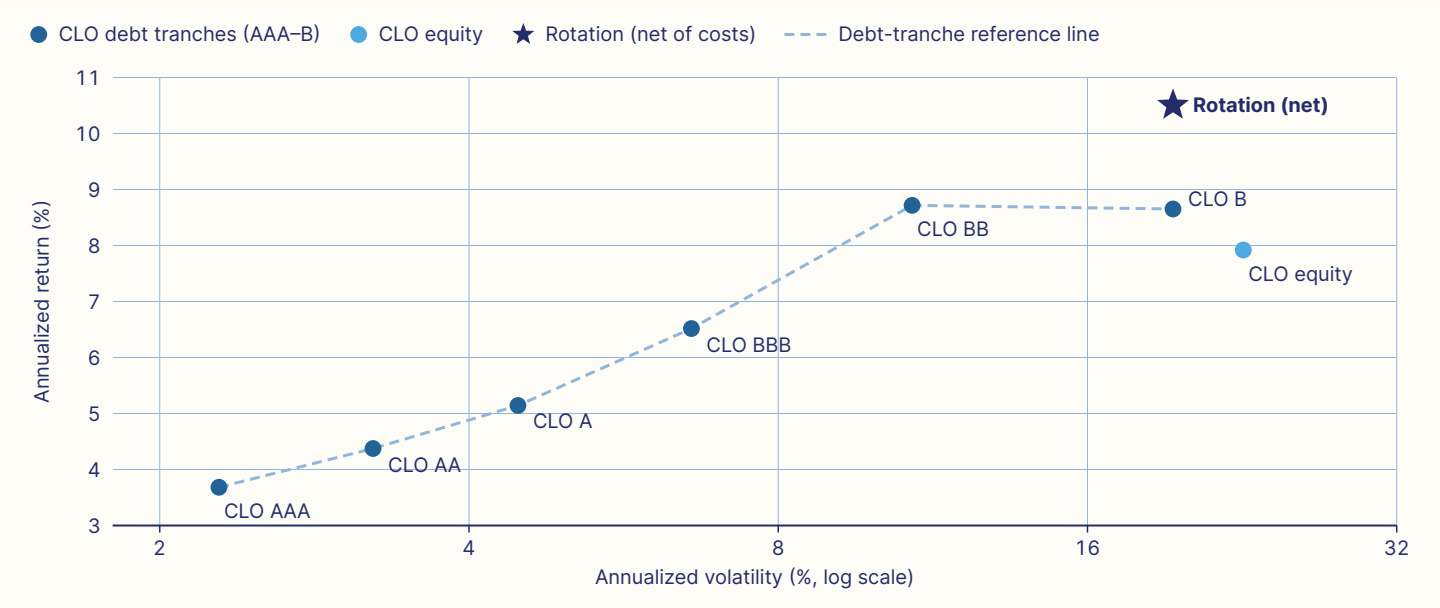
Why rotation matters in the lower CLO tranches

1. Capital-stack construction

CLO debt and equity are priority claims on the same collateral pool, but their payoff profiles differ materially. Debt tranches receive contractual priority distributions and benefit from credit enhancement, while equity receives the residual cash flows and carries first-loss exposure. Over the 158-month study window, correlations between debt tranches and CLO equity ranged from 0.41 to 0.63, indicating meaningful diversification across the capital stack.

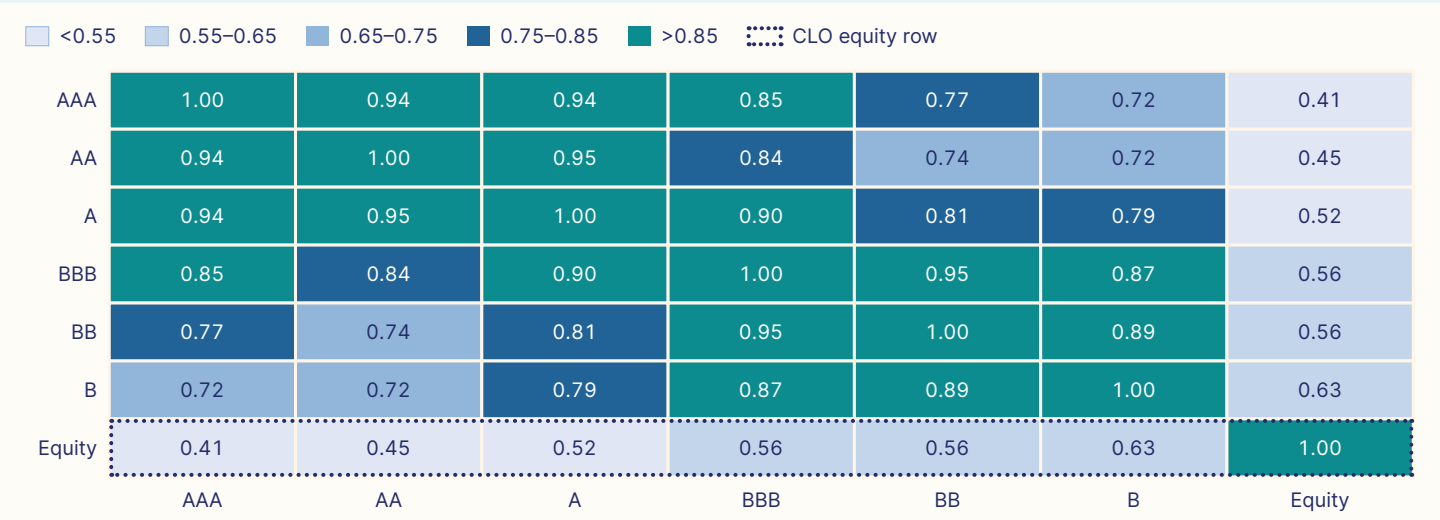
The distinction becomes more pronounced lower in the stack. A BB-rated CLO tranche remains a bond: its upside is capped, while downside can be significant in a stressed market. CLO equity has a wider range of outcomes and can capture greater upside as markets recover, benefiting from improving loan prices during the active trading period and wider reinvestment spreads against largely locked-in CLO liabilities. The allocation question, therefore, is which part of the capital structure offers the most attractive risk-adjusted return at a given point in the market cycle.

EXHIBIT 1 **Risk-return positions across the US CLO capital structure**



For illustrative purposes only. Source: J.P. Morgan CLOIE US CLO 2.0 (BB and B debt series) and Citi US CLO 2.0 Equity Estimates, Apr 2013 through May 2026 (158 months). Rotation net of 15 bp debt and 60 bp equity one-way transaction costs. Volatility is measured on annual (calendar-year) returns. Extracted returns are pro forma; no fund investor actually achieved the net return shown. See Disclaimers for extracted return methodologies.

EXHIBIT 2 **Return correlations across the US CLO capital structure**



For illustrative purposes only. Source: J.P. Morgan CLOIE US CLO 2.0 (BB and B debt series) and Citi US CLO 2.0 Equity Estimates, Apr 2013 through May 2026 (158 months). Pairwise Pearson correlations of monthly total returns.

2. March 2020 and downside behavior

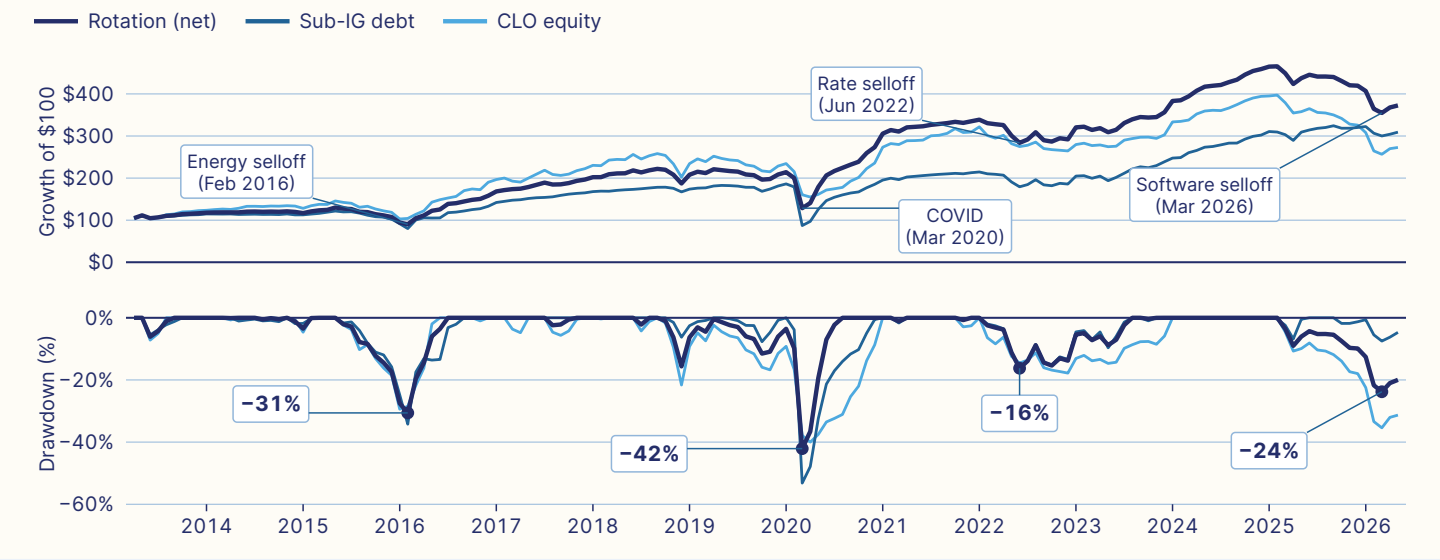
The March 2020 decline was severe but brief, with the largest drawdowns since the Great Financial Crisis (GFC). A portfolio that held only lower-rated CLO debt, represented by a 50/50 mix of BB and B tranches, lost 53.2% from peak to trough during the March 2020 selloff. True to those bond characteristics, upside remained limited while downside proved significant as loan spreads widened, prices fell sharply, and liquidity deteriorated.

CLO equity also marked down sharply during the selloff, but its return profile was different. While lower-rated debt repriced directly as credit spreads widened and prices moved further below par, CLO equity retained greater upside to a recovery in loan prices and the opportunity to reinvest at wider spreads. As a result, the BB/B debt index ultimately fell further than the equity return estimates used in the analysis.

The rotation entered the March 2020 selloff at its equity ceiling, so it held the part of the stack that retained more recovery participation. As is common in many severe drawdowns, and as also seen in the 2015-2016 energy selloff, the recovery can be nearly as rapid as the shock itself, and capturing it requires already holding the position.

The rotation finished calendar 2020 up approximately 31%, which converts the deepest drawdown into the framework's strongest year. As seen in Exhibit 3, the downside path is also less severe.

EXHIBIT 3 **Indexed total returns and downside path**



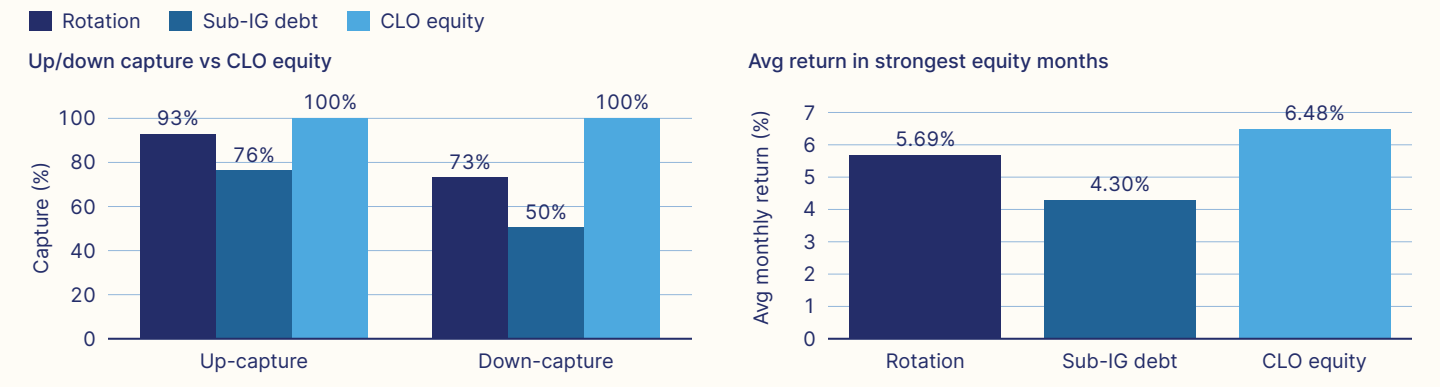
For illustrative purposes only. Source: J.P. Morgan CLOIE US CLO 2.0 (BB and B debt series) and Citi US CLO 2.0 Equity Estimates, Apr 2013 through May 2026 (158 months). Rotation net of 15 bp debt and 60 bp equity one-way transaction costs. Downside panel measured from each series' prior high-water mark.

3. CLO equity up- and down-market capture

The rotation rule increases its equity weight after equity underperforms debt and shifts toward debt after equity's relative return moves above the upper threshold.

Over the full window, the rotation captured 92.8% of the returns in CLO equity's 97 positive months and 73.1% in its 61 down months. The difference between positive-month capture and down-month participation was a full 19.7 percentage points.

EXHIBIT 4 **Participation in CLO equity's strongest months**



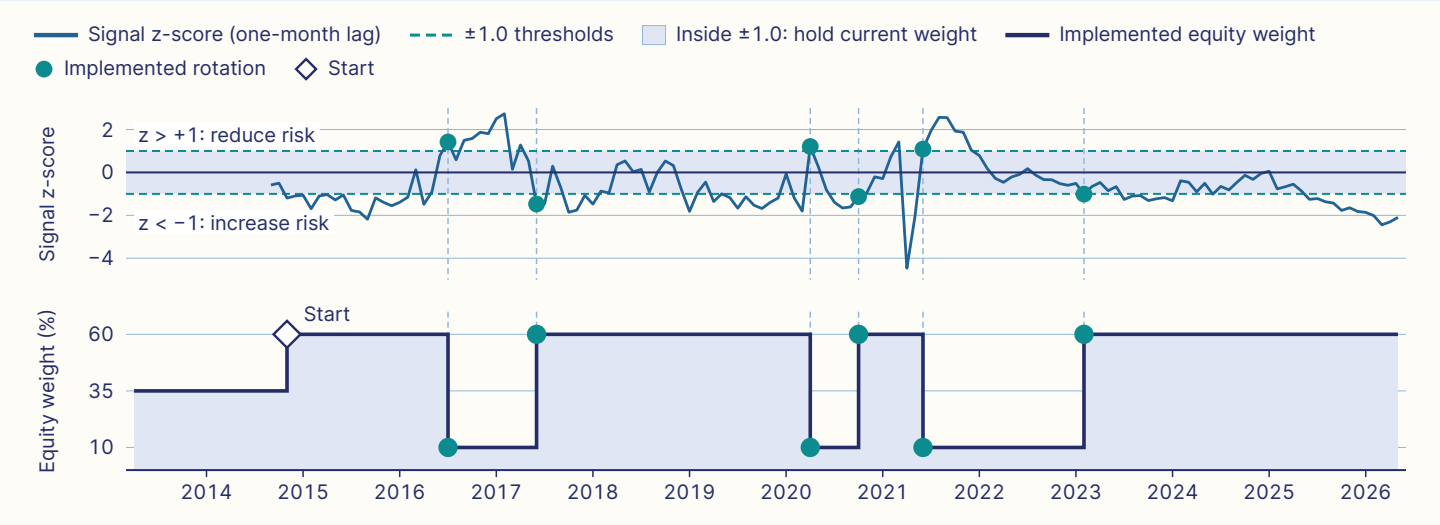
For illustrative purposes only. Source: J.P. Morgan CLOIE US CLO 2.0 (BB and B debt series) and Citi US CLO 2.0 Equity Estimates, Apr 2013 through May 2026 (158 months). Up/down capture computed vs CLO equity. Strongest-month threshold is the 75th percentile of the full-sample equity distribution. Average monthly returns shown in the right-hand panel are presented on a gross basis.

4. How the signal behaved in practice

Across the full 158-month analysis window, the framework made one initial allocation and six subsequent rotations. Exhibit 5 shows when those shifts occurred and how the implemented equity weight changed over time.

As of May 2026, CLO debt had out-earned CLO equity on a trailing basis since 2023, which the contrarian signal treated as a relative dislocation. The allocation was kept at its 60% equity bound. This is similar to the trend seen following the 2016 and 2020 relative-return dislocations.

EXHIBIT 5 **Signal thresholds and implemented equity weight**



For illustrative purposes only. Source: J.P. Morgan CLOIE US CLO 2.0 (BB and B debt series) and Citi US CLO 2.0 Equity Estimates, Apr 2013 through May 2026. Top panel shows the one-month-lagged signal used for implementation. Bottom panel shows the implemented equity weight. Dots mark implemented rotations. Citi Velocity attribution applies to the yield backdrop table only.

Sub-IG yield backdrop at rotation dates

Month	Event	Action	Equity move *(lagged for pacing)*	Sub-IG spread	Base rate	All-in yield
Nov 2014	Start	Shift toward equity	35% to 60%	757 bp	0.1%	7.7%
Jul 2016	Signal event 1	Shift toward debt	60% to 10%	1066 bp	0.4%	11.1%
Jun 2017	Signal event 2	Shift toward equity	10% to 60%	667 bp	1.2%	7.9%
Apr 2020	Signal event 3	Shift toward debt	60% to 10%	1938 bp	0.1%	19.5%
Oct 2020	Signal event 4	Shift toward equity	10% to 60%	1338 bp	0.1%	13.5%
Jun 2021	Signal event 5	Shift toward debt	60% to 10%	951 bp	0.0%	9.5%
Feb 2023	Signal event 6	Shift toward equity	10% to 60%	1181 bp	4.6%	16.4%

Table is included to show the level of all-in yield available in the sub-IG debt market at rotation dates. Source: Citi Velocity, USD CLO 2.0 BB and B spread series and short-term USD base-rate proxy. Base-rate proxy uses SOFR where available and spot LIBOR before SOFR is available. Sub-IG spread is defined as a 50/50 average of BB and B spreads. All-in yield proxy equals sub-IG spread plus base-rate proxy using the most recent available observation on or before each implemented rotation month-end. Shift toward equity means rotating toward CLO equity. Shift toward debt means rotating toward sub-IG debt.

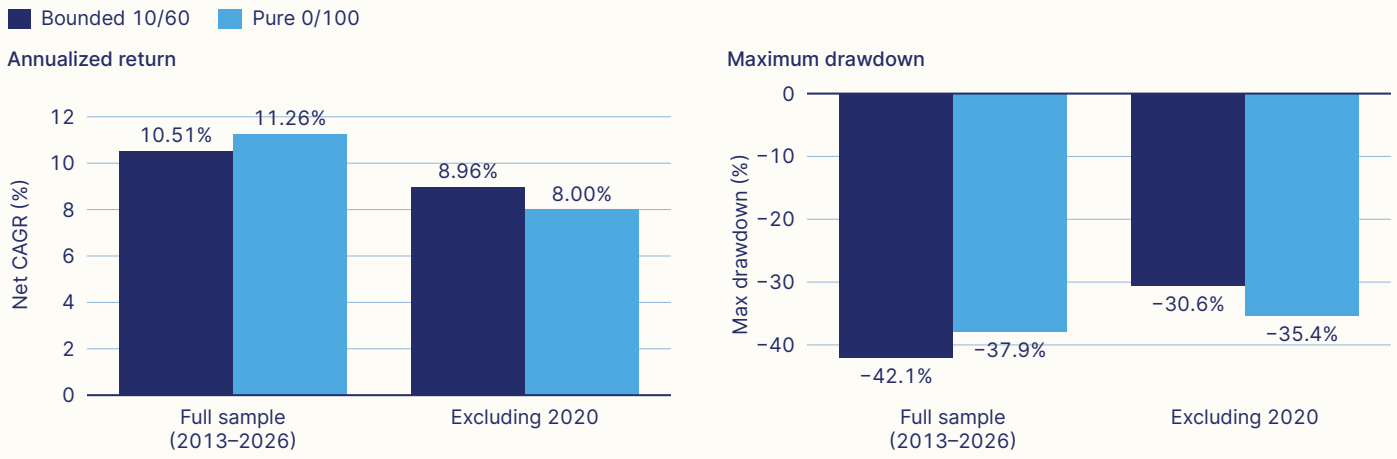
EXHIBIT 6 **Summary statistics, Apr 2013 through May 2026 (158 months)**

Strategy	CAGR	Ann Vol	Max DD	Best Month	Worst Month
Rotation (net)	10.51%	19.38%	−42.1%	27.13%	−35.81%
Static 50/50	8.93%	17.78%	−43.4%	17.44%	−38.39%
Sub-IG debt	8.95%	14.67%	−53.2%	29.68%	−51.32%
CLO Equity	7.92%	22.69%	−40.0%	16.95%	−25.47%

For illustrative purposes only. Source: J.P. Morgan CLOIE US CLO 2.0 (BB and B debt series) and Citi US CLO 2.0 Equity Estimates, Apr 2013 through May 2026 (158 months). Rotation net of 15 bp debt and 60 bp equity one-way transaction costs. CAGR = geometric annualized return. Ann Vol = standard deviation of calendar-year returns. Max DD = peak-to-trough decline. Volatility is measured on calendar-year returns because CLO equity is valued from estimated, periodically updated marks rather than frequent trade prints, so a monthly measure understates its dispersion.

As a separate analysis, we let the strategy move all the way to 100% debt or 100% equity, rather than limiting how concentrated the portfolio could become. That more extreme approach produced higher returns and a smaller drawdown over the full period, but most of the advantage came from 2020, by far the most unusual and unpredictable period in the sample. Excluding 2020, the more balanced approach delivered both higher returns and a smaller drawdown.

EXHIBIT 7 **Sensitivity: bounded 10/60 versus unconstrained 0/100 rotation**



For illustrative purposes only. Source: J.P. Morgan CLOIE US CLO 2.0 (BB and B debt series) and Citi US CLO 2.0 Equity Estimates, Apr 2013 through May 2026 (158 months). Rotation net of 15 bp debt and 60 bp equity one-way transaction costs. Bounded framework applies 10%/60% equity-weight limits; unconstrained applies 0%/100%. All other rule parameters held identical. 'Excluding 2020' removes the twelve 2020 monthly observations.

In closing

The results of our analysis suggest investors do not need to choose between junior CLO debt and equity as static allocations. A disciplined rotation between the two can help capture much of equity's upside while reducing participation in weaker periods, creating a more balanced risk-return profile through the cycle. While hypothetical and based on historical data, the framework suggests that actively shifting between debt and equity can improve how investors manage the lower CLO capital stack.

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2. Bain Capital Credit professional headcount as of October 1, 2026.

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Data sources. J.P. Morgan CLOIE US CLO 2.0 monthly total return series for the BB and B debt tranches, used under license. Citi US CLO 2.0 Equity Estimates monthly total return series, used under Bain Capital Credit's licensed research subscription. The equity series is total return without distribution reinvestment, and rotation returns are constructed on this convention. Citi Velocity for USD CLO 2.0 BB and B spread series. New York Fed for SOFR, with spot LIBOR proxy before SOFR is available. Market context for CLO ETFs and captive equity funds is based on PitchBook LCD, Q2 US CLO Wrap (June 29, 2026) and Captive equity boom rewrites rules for CLO and loan markets (May 21, 2026). Full analysis window is April 2013 through May 2026 (158 months), the first month in which the required debt and equity series are all available. Index returns are not directly investable.

Methodology notes. The valuation signal uses an expanding-window z-score with a minimum six-month history, computed on J.P. Morgan CLOIE debt series and the Citi US CLO 2.0 Equity Estimates series. The rotation backtest uses US BB and US B CLOIE debt series to preserve a single US index framework. European single-B CLO debt may provide useful lower-stack market context, but is not substituted into the backtest given the shorter available history and cross-market basis. The target weight is carried forward when the z-score falls inside the +/-1.0 hold range. Rotation bounds are 10% equity and 60% equity. The starting weight prior to signal calibration is 35%. A six-month minimum hold and one-month implementation lag are applied throughout. Exhibit 5 plots the one-month-lagged signal on the implemented month for visual alignment. Annualized returns are geometric (CAGR). Annualized volatility is the standard deviation of calendar-year returns. Maximum drawdown is the largest peak-to-trough decline in a growth-of-$100 series. Supporting workbook available on request from Bain Capital Credit.

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General Market and Credit Risks of Debt Securities. Debt portfolios are subject to credit and interest rate risk. "Credit risk" refers to the likelihood that an issuer will default in the payment of principal and/or interest on an instrument. Financial strength and solvency of an issuer are the primary factors influencing credit risk.

Limited Amortization Requirements. From time to time, the Fund will invest in debt that will typically have limited mandatory amortization and interim repayment requirements. A low level of amortization of any debt, over the life of the investment, will increase the risk that a portfolio company will not be able to repay or refinance the debt held by the Fund when it comes due at its final stated maturity.

High Yield Debt. From time to time, the Fund will invest in high yield debt, a substantial portion of which is rated below investment-grade by one or more nationally recognized

statistical rating organizations or are unrated but, in the adviser's opinion, of comparable credit quality to obligations rated below investment-grade, and have greater credit and liquidity risk than more highly rated debt obligations. High yield debt is generally unsecured and is often subordinate to other obligations of the obligor.

Financially Troubled Companies. From time to time, the Fund invests in the obligations of companies that are financially troubled and that are either engaged in a reorganization or expect to file for bankruptcy. Investments in financially troubled companies involve significantly greater risk than investments in non-troubled companies, and the repayment of obligations of financially troubled companies is subject to significant uncertainties.

Bank Loans. The investments of the Fund at times include interests in loans originated by banks and other financial institutions. The loans invested in by the Fund may include term loans and revolving loans, may pay interest at a fixed or floating rate and may be senior or subordinated.

Priority of Repayment for Certain Investments. The characterization of the Fund's investments as senior debt or senior secured debt does not mean that such debt will necessarily be repaid in priority to all other obligations of the businesses in which the Fund invests. Furthermore, debt and other liabilities incurred by non-guarantor subsidiaries of the borrowers of senior secured loans made by the Fund are often structurally senior to the debt held by the Fund. In the event of insolvency, liquidation, dissolution, reorganization or bankruptcy of a portfolio company, the debt and other liabilities of such subsidiaries will generally be repaid in full before any distribution can be made to an obligor of the senior secured loans held by the Fund.

Risks of Secured Loans. Funds have in the past and may in the future invest in secured loans that are over-collateralized at the time of the investment, but such secured loans nonetheless may be exposed to losses resulting 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.

Distressed Investments. The Fund is also generally authorized to invest in the securities and obligations of distressed and bankrupt issuers, including debt obligations that are in covenant or payment default. Such investments generally are considered speculative. The repayment of defaulted obligations is subject to significant uncertainties. Defaulted obligations might be repaid, if at all, only after lengthy workout or bankruptcy proceedings, during which the issuer might not make any interest or other payments and the amount of any recovery is typically affected by the relative seniority of the Fund's investment in the capital structure of the issuer. In addition, distressed investments are more likely to be challenged as fraudulent conveyances and amounts paid on those investments will be subject to avoidance as a preference under certain circumstances.

Structured Products. The adviser has in the past and will in the future cause the Fund to invest in structured products, including assets typically referred to as "CLO debt" and "CLO equity." These investments will typically consist of equity or subordinated debt securities issued by a private investment fund that invests, on a leveraged basis, in the bank loan, high yield debt or other asset groups. The Fund's investments in structured products will be subject to a number of risks, including risks related to the fact that the structured products will be leveraged. Utilization of leverage is a speculative investment technique and will generally magnify the opportunities for gain and risk of loss borne by an investor in the equity or subordinated debt securities issued by a structured product.

Mezzanine Debt. The mezzanine investments in which the Fund intends to invest are typically contractually or structurally subordinate to senior indebtedness of the applicable company, or effectively subordinated as a result of being unsecured debt and therefore subject to the prior repayment of secured indebtedness to the extent of the value of the assets pledged as security. In some cases, the subordinated debt held by the Fund will be subject to the prior repayment of different classes of senior debt that is "layered" ahead of the debt held by the Fund. In the event of financial difficulty on the part of a portfolio company, such class or classes of senior indebtedness ranking prior to the debt held by the Fund, and interest thereon and related expenses, must first be repaid in full before any recovery will be had on the Fund's mezzanine or other subordinated investment. Subordinated investments are characterized by greater credit risks than those associated with the senior or senior secured obligations of the same issuer.

Investments in Direct Lending. The Fund may make investments in the debt of companies directly. Direct lending by the Fund may be riskier than other more established asset classes. Such investments are often negotiated directly with the company itself, with a private equity sponsor, or with another third party, as applicable. As a result, these investments are not broadly syndicated to a large, diverse group of lenders by a financial institution in the manner of bank loans, high yield bonds, or other similar assets in which the Fund invests. The Fund may be the only lenders or part of a small, concentrated group of lenders invested in this part of the company's capital structure. These investments are generally highly illiquid. There is a risk the Fund may not be able to sell or otherwise dispose of these assets or that any such disposition may be on terms that are not favorable to the Fund.

Indices information

These indices may not necessarily be indicative of the investment strategies for the investment vehicles advised by Bain Capital Credit. Assets and securities contained within indices are different than the assets and securities contained in Bain Capital Credit's investment vehicles and will therefore have different risk and reward profiles. Prospective investors should note that there are significant differences between the investment vehicles advised by Bain Capital Credit and the investments included in the various indices described herein. The investment vehicle advised by Bain Capital Credit will not necessarily invest in any of the investments that are included in an index, and may invest in types of investments not included in any index. The investment vehicles advised by Bain Capital Credit may have higher levels of risk, including through the limited use of leverage and concentrated positions, and volatility.

The returns of the indices are provided solely as an illustration of the market and economic conditions generally prevailing during the periods shown. Indices are not investments, are not professionally managed and do not reflect deductions for fees or expenses. It is not possible to invest directly in an index. Investors pursuing a strategy similar to an index may experience higher or lower returns and will bear the cost of fees and expenses that will reduce returns.

Hypothetical and backtested performance

The rotation results shown throughout this paper are hypothetical and backtested. They were derived by applying the rules-based framework described herein to historical J.P. Morgan CLOIE and Citi CLO 2.0 equity index series over April 2013 through May 2026; no account or fund actually traded this strategy over this period, and no investor achieved the returns shown. The results reflect the benefit of hindsight in the selection of the rule parameters, are net of estimated transaction costs only (15 bp debt and 60 bp equity, one-way) and reflect no management or incentive fees, and are not indicative of future results. Index returns are not directly investable.

Notes regarding pro forma investment returns

1. Certain information herein reflect estimates, opinions, or predictions based on Bain Capital Credit's models or the judgment of Bain Capital Credit investment professionals, which may change in the future. There is no guarantee that such estimates, opinions or predictions will be realized.
2. Some of the performance information presented in this presentation is pro forma and includes assets held in various Bain Capital Credit funds and separately managed accounts. Those funds and accounts also held other investments and no fund or account investor actually achieved the returns shown in this presentation. In addition, the pro forma information does not take into consideration any leverage that may have been used. These pro forma performance results may have inherent limitations, including that they are prepared with the benefit of hindsight. These are provided for illustrative purposes only, and no representation is made that any investor will or is likely to achieve returns similar to those shown. The information contained herein is unaudited, subject to change, and is provided for informational purposes only. Other performance calculations may produce different results.
3. Returns are calculated in local currencies and then rebased into a single currency as though perfectly hedged.



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