Q2 2025 Leveraged Loan Market Overview

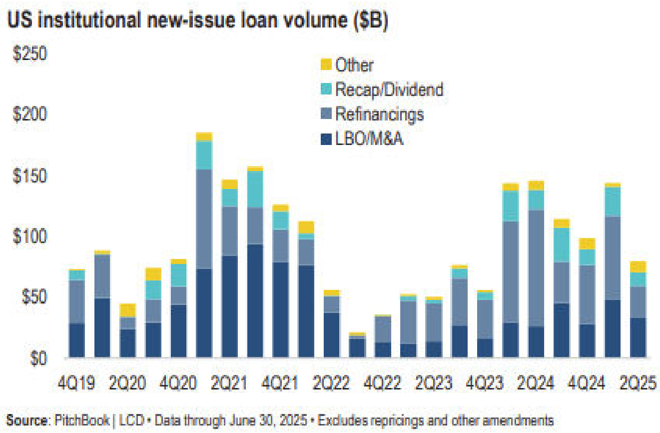
Volatility and Uncertainty Hinder Market Activity

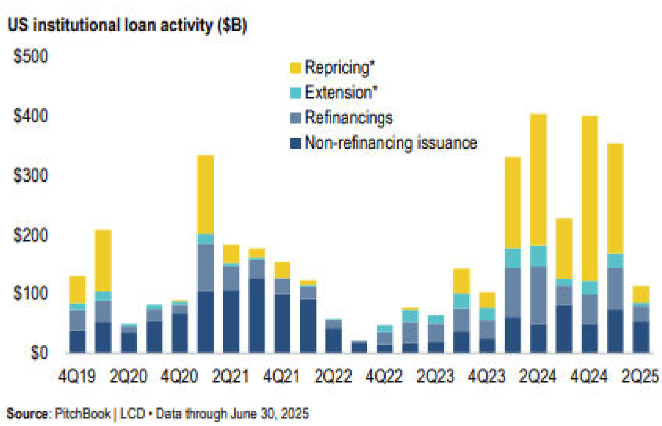
July 14, 2025

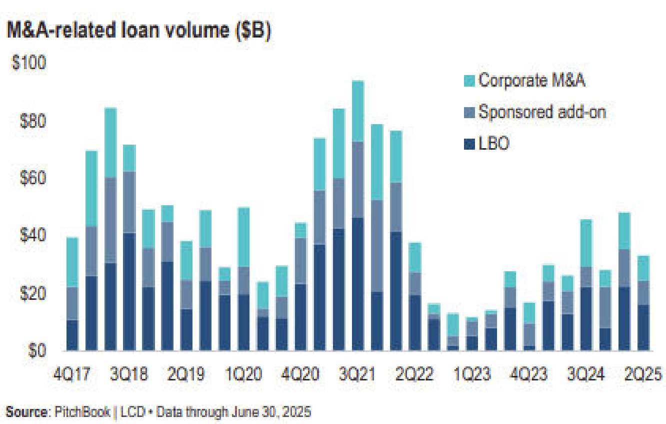
Q2 2025

SLOW START DAMPENS MARKET ACTIVITY

Halfway through 2025, M&A activity continued to disappoint despite high expectations set by the US presidential election in November 2024 and hopes for favorable regulatory and tax conditions. Tariffs, along with trade and monetary policy uncertainty, dampened deal flow, much to the dismay of both issuers and investors in the US leveraged loan market. More optimistically, after volatility in April from the "Liberation Day" tariff announcement, loan market sentiment improved, driven by a recovery in secondary prices. Despite subdued M&A activity, growth of the leveraged loan market accelerated to the fastest annual growth rate since late 2022 and reached a new record, expanding to $1.5 trillion outstanding as of Q2'25. CLO issuance remained strong in the second quarter, bouncing back from a slow start early Q2 to put 2025 on pace to end the year with the second highest yearly volume on record. On the other hand, refinancing ("refi's") and repricing volumes plummeted in Q2'25 as investors became increasingly risk-adverse amid volatility and widening credit spreads. New-issuance showed signs of recovery in May and June.







SECOND QUARTER NEW ISSUE SUPPLY SLUMPS

The Fed's decision to keep interest rates higher for longer – driven by the risk of renewed price pressures from tariffs – combined with wider credit spreads, contributed to a slowdown in new-issue loan volume in Q2'25. New-issue loan volume (excluding repricings and extension amendments) fell to $76.3 billion in the second quarter – the lowest quarterly total since Q4'23 – and a ~50% decline from Q1'25. Within this volume, LBO and M&A-related borrowing proved more resilient, while refis and dividend recaps saw much steeper pullbacks from the previous quarter.

Institutional loan volume for Q2'25 was just $113 billion, the lowest reading since Q4'23, down sharply from the $354 billion in Q1'25 and the record $404 billion in the same period last year. Issuance was down across all categories; opportunistic transactions experienced the largest drop off as spreads widened and investor risk appetite retreated. Repricings totaled $28.5 billion, the lowest since Q4'23 and down 85% from Q1'25. Refi activity also tumbled, falling 62% to $26.4 billion. Issuance not tied to refi's, extensions, or repricings fell more moderately by 28% to $53.3 billion, which still trails 2024 averages.

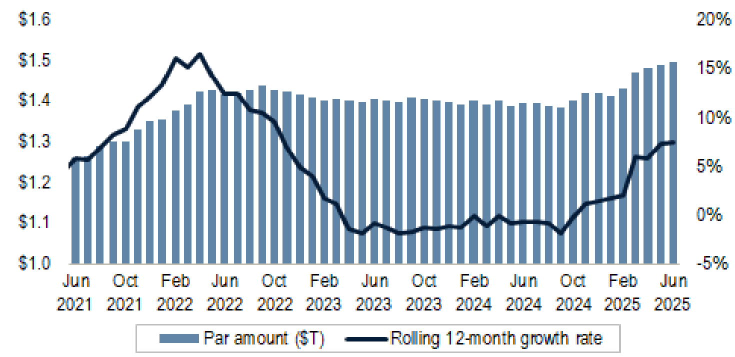
M&A MOMENTUM TAKES A HIT

Although strong compared to volume over the past three years, M&A-related loan volume fell in Q2'25 after a bounce back Q1'25. Both sponsor-backed and corporate transactions experienced comparable declines in the second quarter, as heightened market volatility and ongoing macroeconomic uncertainty weighed on deal volume. Private-equity firms raised $16 billion in the BSL market to fund buyouts in Q2'25 – a 29% drop from the first quarter, yet 24% above the level from Q2'24. While this represents an improvement over the $12.4 billion quarterly average since the Fed began raising rates in 2022, volume still remains well below historical norms. For context, in the three years leading up to the COVID-19 pandemic, LBO volume averaged ~$25 billion per quarter.

LEVERAGED LOANS REACH ANOTHER RECORD

Due to low repayment activity and persistently strong investor demand, the leveraged loan market continued to expand in Q2'25. The par amount outstanding grew to a record $1.50 trillion, eclipsing the previous record of $1.47 trillion set in Q1'25. Since February 2025, the US loan market has grown by $82.8 billion, or 5.9% – its fastest growth over any 5-month period since April 2022. On a 12-month basis, the LLI expanded by 7.4%, the highest annual growth rate since October 2022, and a sharp increase from 1.4% in 2024.

Morningstar LSTA US LL Index: Par amount outstanding

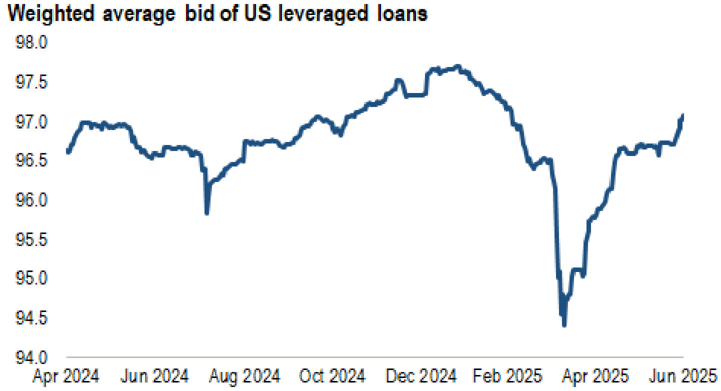


Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through June 30, 2025

SECONDARY PRICES RISE POST TARIFFS

Post-Liberation Day, volatility surged in the secondary markets with the weighted average bid for US leveraged loans falling nearly 2 points in the first nine days of April 2025 to 94.41, a low not seen since July 2023. However, after the White House alluded to a potential easing of trade policy in late April, prices quickly rebounded and sit roughly 80 bps above end-of-Q1'25 levels. As of the end of Q2'25, the weighted average bid for US leveraged loans was 97.07, which is 37 basis points higher than May levels. Similarly, the European Leveraged Loan Index (ELLI) bounced back from April lows to end the second quarter at a weighted average bid price of 97.69, although this is lower than mid-June's post-"Liberation Day" high of 98.08.

Weighted average bid of US leveraged loans



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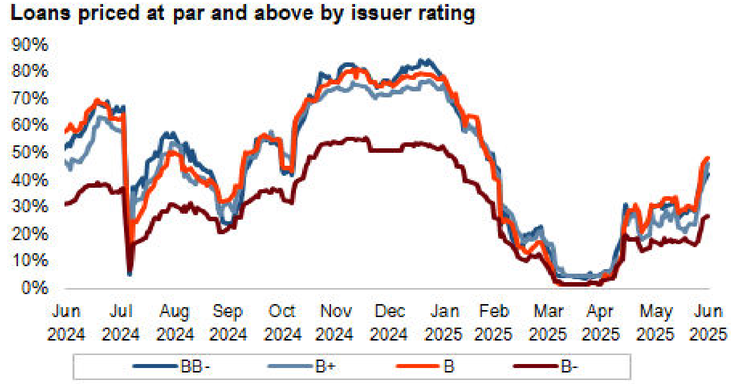
Loans priced at par and above by issuer rating



Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through June 30, 2025

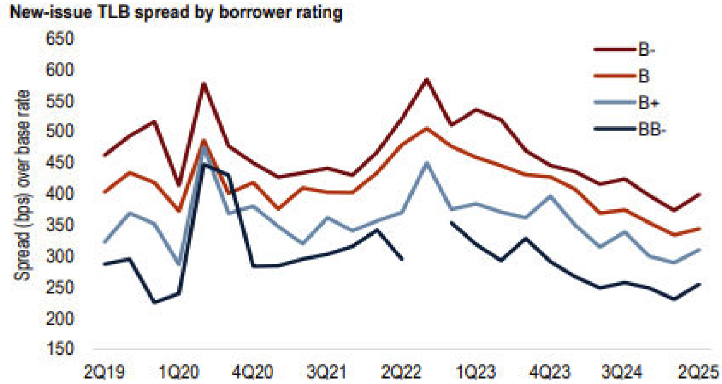
LOANS PRICED AT PAR/ABOVE ON THE RISE

As secondary prices rose during the back half of Q2'25, the share of loans priced at par or above increased to 41% at the end of June, up from 27% in May. This metric, which is often viewed as a gauge of strong investor demand, has fully rebounded from its post-Liberation Day decline, with improvements being the strongest for higher-quality borrowers. ~45% of companies rated B-flat or higher belonged to the par-or-above cohort, compared to ~27% of companies rated B-minus.

SPREADS REVERSE COURSE

Throughout the new-issue market, borrowing spreads widened across the credit spectrum in Q2'25, driven by a wave of risk aversion in April 2025. However, spreads began to narrow once again as sentiment improved and secondary markets rallied toward quarter end. As a result, spreads continue to hover near their lowest point in over a decade. New loans issued to companies rated BB-minus, B-plus, and B-minus all saw spreads widen, reaching S+255, S+310, and S+399, respectively.

New-issue TLB spread by borrower rating

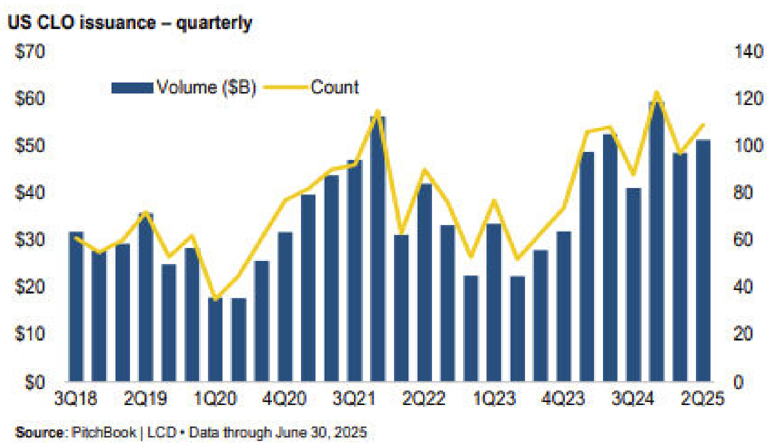


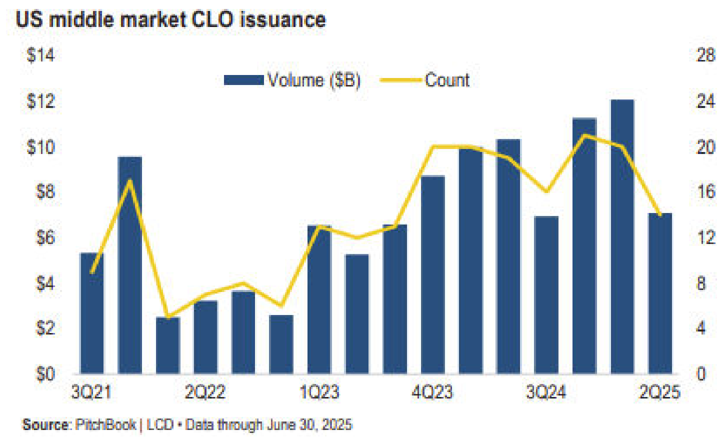
Source: PitchBook | LCD • Data through June 30, 2025

CLO ISSUANCE UNDETTERED BY WIDER SPREADS, TARIFF TURMOIL

CLO managers shrugged off widening spreads and Liberation Day market turmoil to maintain near-record pace in deal pricing during Q2'25. Although June was one of the slowest months for new-issue pricings in 2025, issuance picked up in the final week to push second quarter volume to $51.3 billion across 109 deals, exceeding $48.6 billion across 97 transactions in the first quarter. Concerns are still lingering, however, over a rising number of leveraged-loan downgrades and the potential for geopolitical and tariff-related economic impacts in some industries concentrated within securitized portfolios. Yet, total 2025 issuance is still on target to reach the second-busiest year on record.

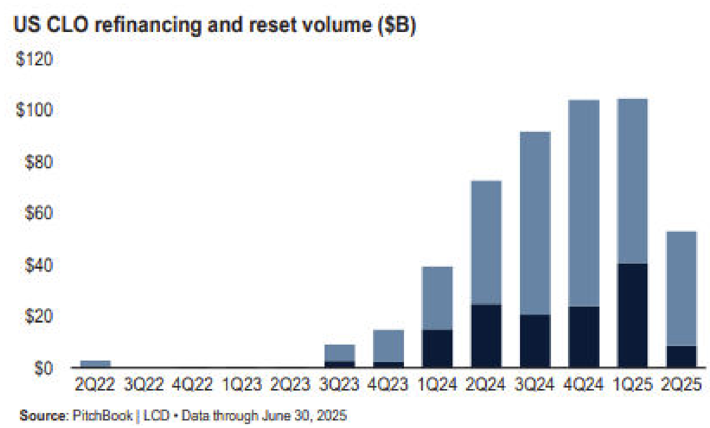
After a record start to 2025, middle market ("MM") CLO issuance slumped in Q2'25 due to the continued lull in M&A activity, given MM CLOs rely on new loan supply that is often driven by LBOs and sponsor-backed M&A. However, investor demand still remains strong; Q2'25 MM CLO issuance was $7.1 billion across 14 transactions, following a record Q1'25 output of $12.07 billion across 20 transactions.

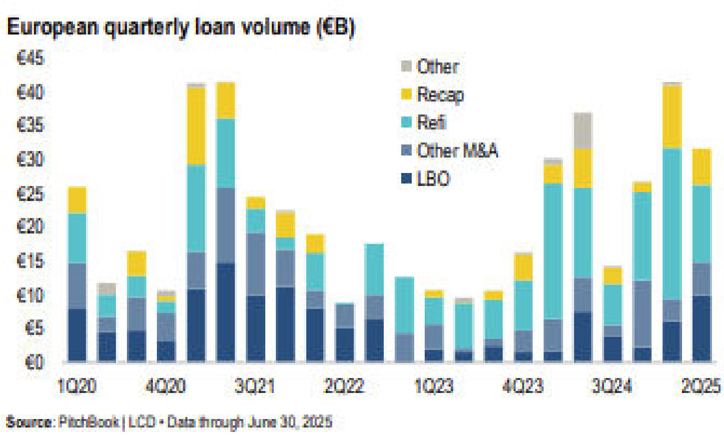




CLO REFI & RESET DECELERATES

After a strong Q1'25 that set a record pace, US CLO refi (dark blue) and reset (light blue) volume was severely hampered in Q2'25. Activity in the second quarter was limited to $8.6 billion of refis and $44.4 billion of resets, both steep drops from first quarter values of $40.9 billion and $63.9 billion, respectively. The decline in volume arose as widened spreads spawned by the risk-off, global market selloff in April 2025 hindered refi and rest activity. However, the combined YTD $158 billion volume total is still ahead of the pace for most full-year projections, as reset activity has picked up in the latter stages of the quarter given June's improving spread conditions.



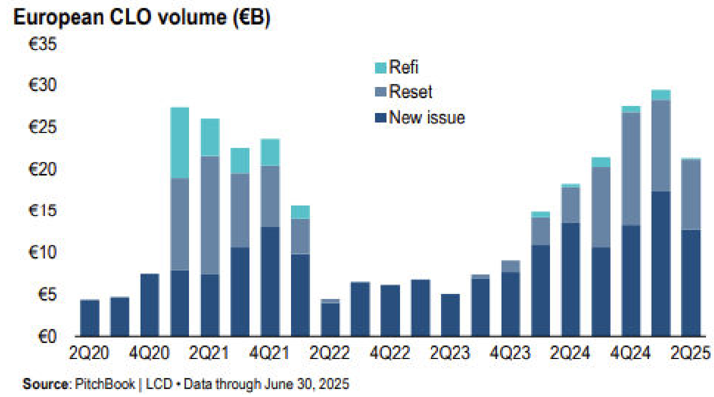


ISSUANCE: EUROPE

European loan volume totaled €31.6 billion in Q2'25, down from the staggering €41.4 billion recorded in Q1'25. Although overall quarterly issuance declined, the market rebounded sharply in June following a brief dislocation in April caused by the abrupt market closure and volatility triggered by the U.S. tariff announcement on April 2. With issuance staging a strong comeback in June, it became the busiest month of the year to date. Despite the quarter-over-quarter drop, Q2'25 volume remained above both Q4'24 and Q3'24 volumes of €26.8 billion and €14.3 billion, respectively.

EUROPEAN CLO VOLUME FALLS

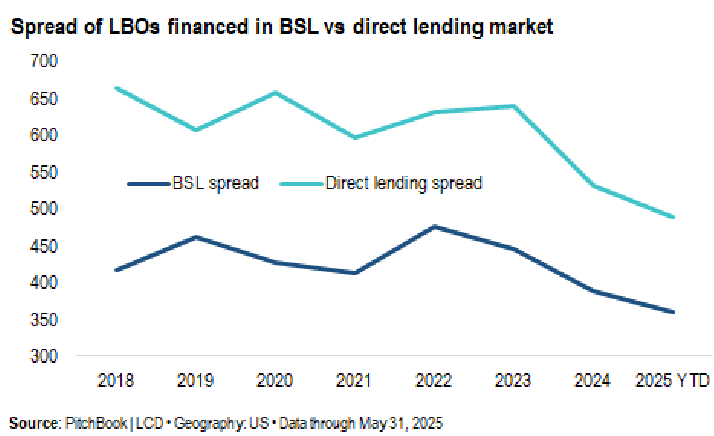
Second-quarter new issuance volume for Q2'25 came in at €12.7 billion across 31 transactions, with roughly €6 billion of this supply priced in a two-week window ending June 6. Although this volume was below the record quarterly volume of €17.3 billion seen in Q1'25, the European CLO market printed a record first-half volume and deal count of €30 billion across 69 deals, already surpassing full-year new issuance figures for 2022 and 2023. Reset volume also declined from the previous quarter, while refi volume was nonexistent.



BSL AND DIRECT LENDING SPREADS CONTINUE TO TIGHTEN

The shortage of M&A/LBO activity relative to funds that have been raised to finance such transactions is creating fierce competition among private credit lenders for quality deal opportunities, with the impact most evident in the compression of spreads, especially for larger loans. So far this year, nearly 40% of direct lending transactions in the US and Europe had spreads under 500 bps, while the first quarter of 2024 saw only 14% of deals priced in the sub 500 bps bucket. Savings on lower spreads for BSLs have sent some borrowers to the syndicated loan market, as pricing is a powerful driver when sponsors and borrowers are deciding between financing options.

The technical imbalance in private lending worsened in Q2'25 as demand for loans had already outstripped supply, while M&A and buyout activity had once again disappointed market participants. According to Pitchbook LCD's Private Credit Monitor report, although the number of buyout deals fell in the three-month period ending May 31, estimated direct lending volume supporting buyout activity rose over that period to ~$23 billion, the highest level since Q2'22. Additionally, many deal processes underway at the time of the volatility spurred by US tariff announcements in April ultimately moved forward – but with private credit rather than syndicated loans.

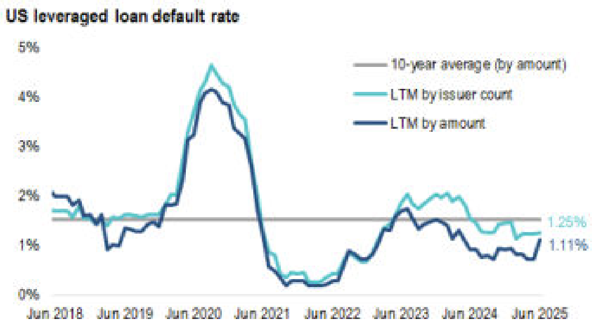


LOAN DEMAND CONTINUES TO SINK

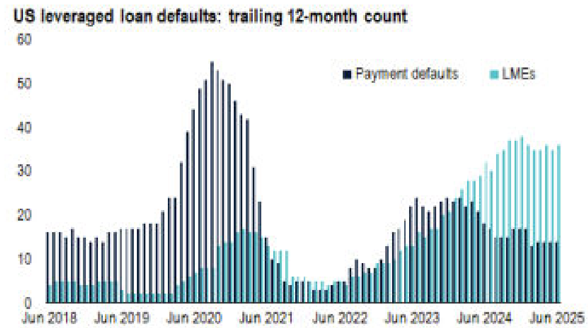
Following the decrease in Q1'25, Q2'25 saw a slight decline in total measurable demand, with levels at ~$42 billion due to significant retail fund outflows in April following market volatility and uncertainty surrounding tariffs. Similar to the first quarter, market volatility and widening spreads continued to draw investors into floating-rate CLOs, leading to steady CLO issuance in Q2'25 when compared to Q1'25 levels. However, loan fund flows saw the largest outflow levels since Q1'23 as retail redemptions skyrocketed in April, before finally ceasing in mid-May after a 10-week outflow streak.

DEFAULT RATES ON THE RISE

The US leveraged loan default rate (by dollar amount) rose significantly from 0.82% at the end of Q1'25 to 1.11% at the end of Q2'25. As seen in Q1'25, liability management exercises ("LMEs") – or actions a company takes to restructure or optimize its debt, often to extend maturities or reduce leverage when facing financial stress –still heavily outpace payment defaults. For the 12-months through June 30, 2025, LMEs made up 72% of the restructuring landscape, just shy of the 73% seen in February 2025 that set a new high mark. In reversal of the historical norm, LME and distressed exchanges have exceeded defaults and bankruptcies in every month since January 2024.



Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through June 30, 2025



Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through June 30, 2025

LOAN RETURNS BOUNCE BACK

The Leveraged Loan index gained 2.32% in Q2'25, almost a 5x increase from Q1'25, after the Fed's signaling of a dovish turn over the back half of 2025. Loans lagged behind only one fixed-income category – HY Bonds – over the course of the second quarter. Loans also trailed US Equities, which had an extremely positive quarter, generating a 10.9% return after both trade policy and inflation seemed to soften, up from the -4.3% return in Q1'25. Overall, all asset classes produced positive returns in the second quarter of 2025, with all YTD returns positive as well, even after a tougher Q1'25.

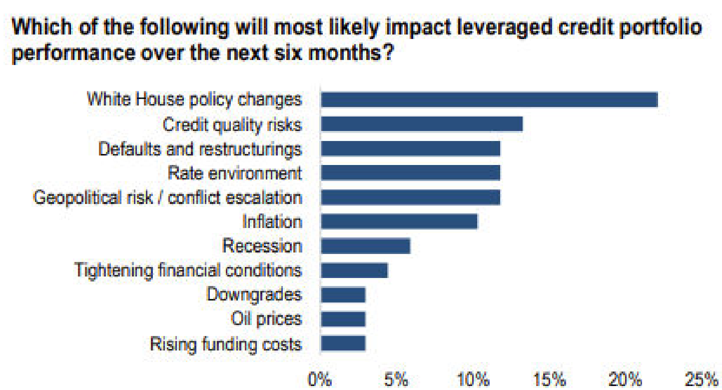
Returns by asset class

	Jun 2025	May 2025	Q2	YTD	LTM
Morningstar LSTA US LL Index	0.80%	1.55%	2.32%	2.81%	7.29%
Morningstar US High-Yield Bond	1.85%	1.68%	3.57%	4.61%	10.30%
Morningstar US Corporate Bond	1.86%	-0.04%	1.75%	4.14%	6.84%
S&P 10-year Treasury Index	1.61%	-1.36%	1.01%	5.01%	5.35%
S&P 500	5.09%	6.29%	10.94%	6.20%	15.16%

Sources: PitchBook | LCD; Morningstar; S&P Dow Jones Indices • Data through June 30, 2025

LOOKING FORWARD

According to LCD's Q2'25 survey, sentiment remains cautious due to uncertainty surrounding US trade policy and tariffs' effects on the market. White House policy changes (22% of votes) remains as the number one concern among leveraged finance bankers for leveraged credit performance over the next six months given fast approaching tariff deadlines. Meanwhile, credit quality risks (13% of votes) jumped up to second in Q2'25 from ninth in Q1'25, while defaults and restructurings, rate environment, and geopolitical risk/conflict escalation tied for third. Inflation, which was second in the Q1'25 survey, dropped down to the fifth highest concern in the most recent survey.



Source: PitchBook | LCD • Data through June 16, 2025

While the announcement of Liberation Day tariffs sent a shockwave through the leveraged loan, bond and equity markets, conditions have broadly stabilized. Markets have since digested the geopolitical and trade developments, which, while still evolving, appear less disruptive than initially feared. The tariff extension—coupled with a series of diplomatic trade agreements brokered by the White House—has supported recovery across risk assets, including loans. That said, ARC experienced strong deal flow in Q2, particularly in May and June. Notwithstanding this, sentiment remains cautious as elevated base rates and inflationary risks continue to weigh on risk appetite and pricing dynamics. All eyes are on the September Fed meeting and the potential for a long-anticipated rate cut—an outcome that could offer relief to borrowers facing multiple years of elevated interest costs and may help reignite M&A activity in the second half of the year.

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