Q2 2026 Leveraged Loan Market Overview

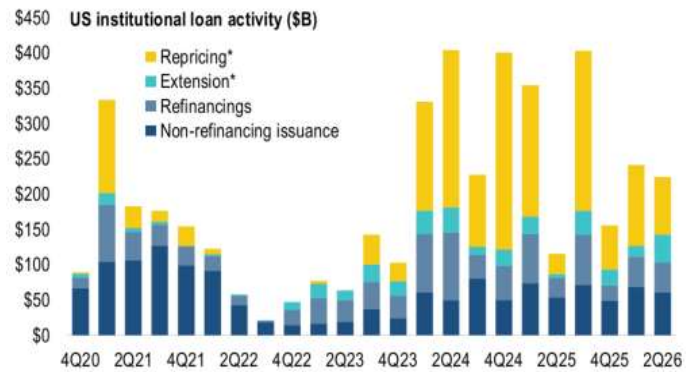
Leveraged Loan Market: A Tale of Two Cities

August 6, 2026

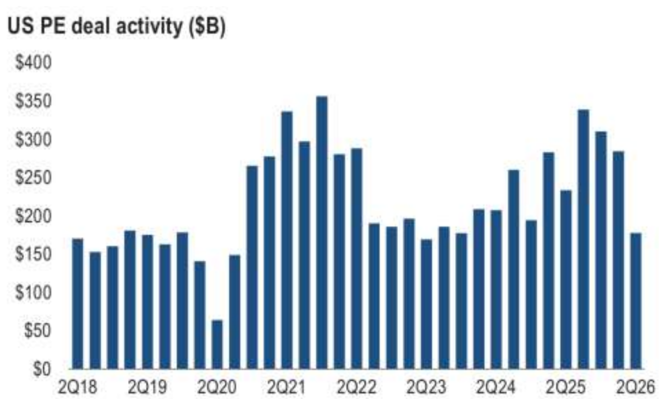
Q2 2026

LEVERAGED LOAN MARKET DIVIDED IN THE SECOND QUARTER

The second quarter of 2026 was characterized by an increasingly bifurcated leveraged loan market, with performance diverging between PE-backed issuers and corporates, higher and lower-rated borrowers, and software credits versus the broader index. US institutional activity and issuance both slowed in Q2'26 under a backdrop dominated by an energy-driven inflation concern related to the war in Iran, potential Fed rate hikes, and growing fears of further AI-driven disruption within the software sector. Even with positive retail fund flows, these headwinds caused Q2'26 measurable loan demand to fall to its lowest level since Q4'23, along with a sharp decline in quarterly CLO issuance. Additionally, credit quality divergence between lower and higher-rated borrowers continues to grow, as spreads for lower-rated borrowers widen while spreads for higher-rated borrowers have barely shifted. Yet, in Q2'26, the US syndicated loan asset class grew to a record $1.57 trillion, expanding by $40 billion (~2.6%) from Q1'26.



Source: PitchBook | LCD • Data through June 30, 2026
*Reflects repricings and extensions done via an amendment process only



Source: PitchBook • Geography: US • Data through June 30, 2026 • Uses extrapolated deal sizes

Source: PitchBook | LCD • Data through June 30, 2026

LEVERAGED LOAN ACTIVITY STUMBLES

Institutional loan activity (including repricings and extensions) in Q2'26 totaled $224 billion, down 7% from Q1'26 activity of $241 billion, though still 17% above the five-year quarterly average and roughly double the Q2'25 level. As a result of a collapse in private equity ("PE") dealmaking, only 27% of Q2'26 activity was unrelated to extensions or spread reduction, weighing on new supply. Through H1'26 overall, this figure is now only 28%. This is in stark contrast to the five comparable periods before the last rate hiking cycle began in 2022, where at least 50% of activity supported net new supply transactions (LBOs, M&A, and recaps).

US private equity dealmaking continued to fall in the second quarter marking the 3rd consecutive q/q decline as a combination of geopolitical tensions, macro headwinds, and widening borrowing spreads within some ratings categories froze sponsor activity. In Q2'26, US private equity volume declined 38% to $177 billion – the lowest level since Q4'24. As a result, new loan issuance by PE-backed speculative grade dropped 33% q/q in Q2'26, which was the lowest reading since Q4'23. However, the quarter's PE vacuum was filled by speculative-grade corporates, buoying the new-issue leveraged loan market.

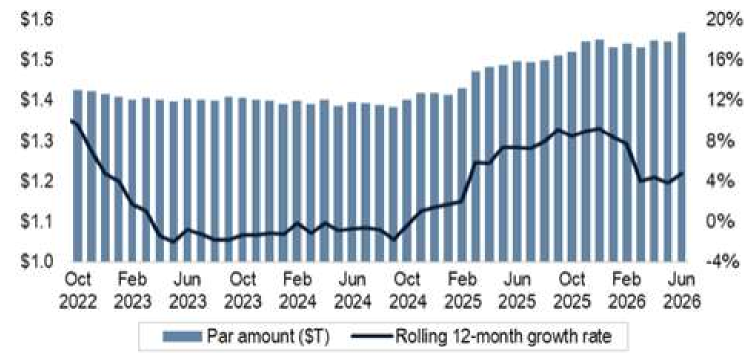
CORPORATES CARRY M&A ISSUANCE

Loan issuance raised by speculative-grade borrowers to support buyouts and M&A declined slightly in Q2'26, falling 14% from Q1'26 to $43.4 billion. Notably, sponsored M&A volume contracted by 54% q/q, while corporate borrowers more than doubled their activity, largely due to the $13 billion Warner Bros. Discovery (Ba1/BB+ corporate rated) term loan – the largest institutional loan since the Great Financial Crisis ("GFC"). Even with the removal of this deal, corporate M&A volume still would have increased q/q as corporates made up for the collapse in sponsored PE issuance during the second quarter.

LEVERAGED LOANS HIT NEW RECORD

After contracting to $1.53 trillion Q1'26, par amount outstanding expanded ~$40 billion in the second quarter to a record $1.57 trillion as repayments declined, especially in June ($18.3 billion vs $28.6 billion in May). Net loan supply is measured as change in outstandings, per the Morningstar LSTA US Leveraged Loan Index (newly issued loans minus repayments). The LLI posted its most meaningful expansion of the year in June, growing by $22.1 billion in the month alone – the largest single-month increase since November 2025.

Morningstar LSTA US LL Index: Par amount outstanding

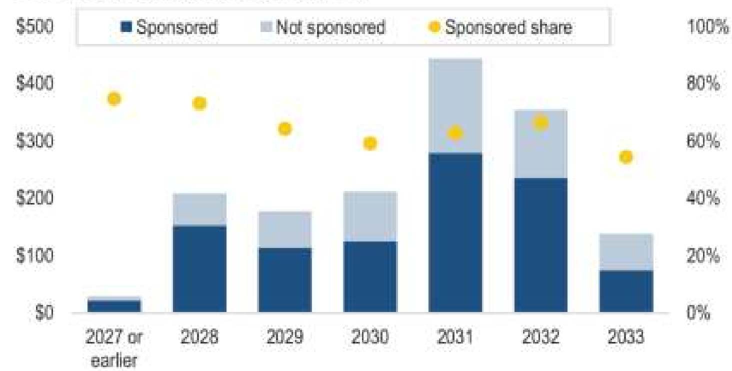


Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through June 30, 2026

SPONSOR-HEAVY MATURITY WALL

In Q2'26, the 2027 maturity wall fell by 36% to $28.4 billion, while the 2028 maturity wall was cut by ~15% to $208.5 billion, reflecting higher extension and refinancing volumes than Q1'26 when declining technical conditions and wider spreads weighed on refi activity. Of note, higher-rated corporate borrowers have cut their equivalent maturity exposure by 69% since late Q4'25 – almost twice the rate of sponsored peers. As a result, PE-backed companies account for 73% of the total 2028 maturity wall, though amend-and-extend volume in Q2'26 of $29.5 billion was the highest quarterly tally since the GFC.

US leveraged loan maturity wall ($B)



Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through June 26, 2026

European quarterly loan volume (€B)

Source: PitchBook | LCD • Data through June 30, 2026

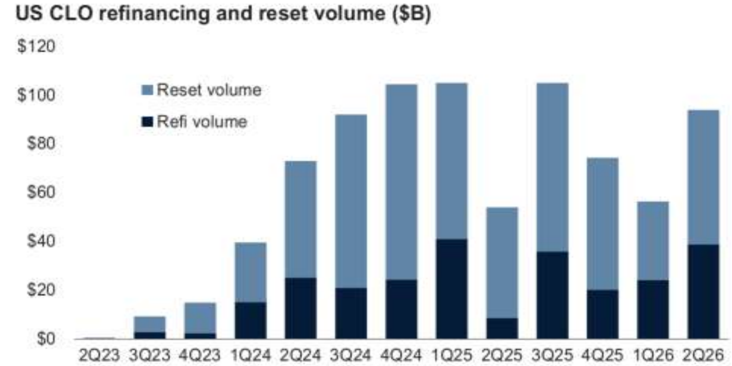
ISSUANCE: EUROPE

European leveraged loan issuance bounced back in the second quarter due to the return of borrower-friendly conditions, even after April volumes compressed following the start of the Iran War and software sell-off. Q2'26 launched €32.5 billion of loans, +36% from the €23.9 billion in Q1'26 and the busiest quarter since Q1'25. Refi activity contributed heavily to quarterly issuance volume, rising from €10.2 billion in Q1'26 to €18.2 billion in Q2'26. Meanwhile, both M&A-related issuance and buyout-specific activity fell slightly q/q, from €10.3 billion and €6.8 billion to €9.7 billion and €6.5 billion, respectively.

CLO RESETS AND REFIS BOUNCE BACK

In the second quarter, CLO resets and refis totaled $93.7 billion, representing the fourth-highest quarterly reading since 2016 and a 66% increase from the Q1'26 total of $56.2 billion. Refinancings are up ~20% y/y, with resets also accelerating later in the quarter. May alone featured a record $16.9 billion of refis, with weekly refi/reset volume peaking at $13.9 billion in the week of May 4-8. This dynamic arose given more favorable, or tighter, spread setups that led managers to pursue refis and resets rather than turn to new issuance or liquidation.

US CLO refinancing and reset volume ($B)

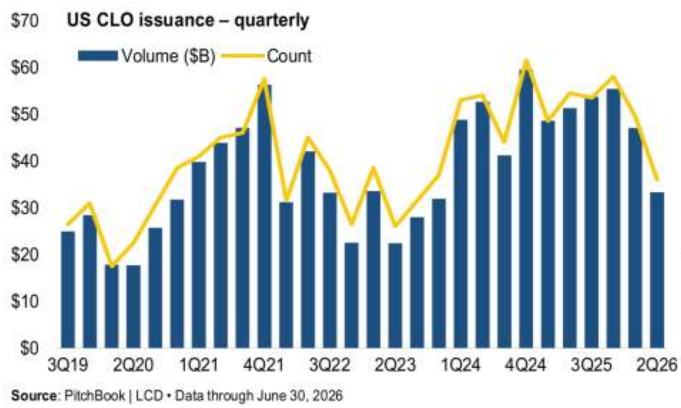


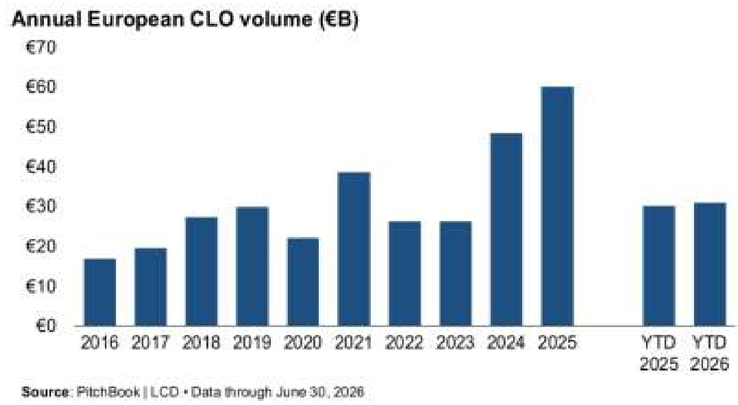
Source: PitchBook | LCD • Data through June 30, 2026

US CLOs FALTER AS EUROPEAN CLOs BOOM

After a slow Q1'26, CLO issuance pulled back further in Q2'26. New CLO issuance ended Q2'26 at $33.3 billion across 72 US CLOs – the lowest quarterly new issue volume since Q4'23. AI-driven disruption has increased risk in software names (the largest industry concentration sector in CLOs), while the Iran conflict has boosted volatility in energy-related names. Issuance bottomed in April at $6.2 billion – the weakest monthly volume since December 2023 – as loan supply fell and CLO spreads continued to widen. During this period, loan spreads tightened compared to CLO liabilities, leading managers to refi and reset rather than issue new. However, issuance bounced back in May and June to $16.8 billion and $10.3 billion, respectively.

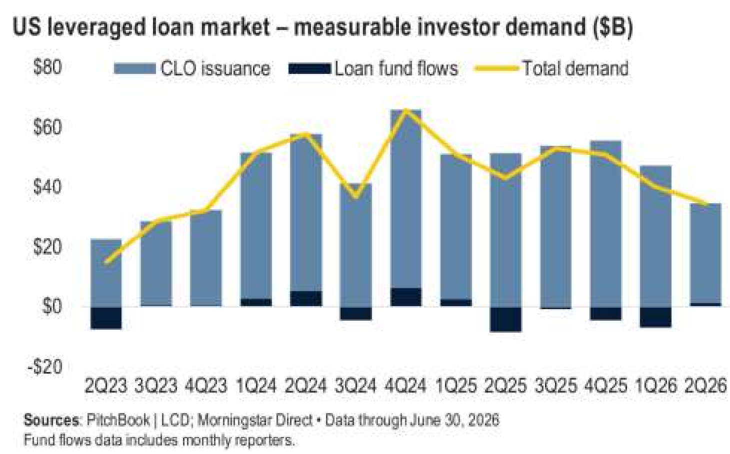
Q2'26 saw European CLO new issuance continue its strong start to the year with €15.2 billion of volume across 37 deals, down slightly from €15.7 billion across 37 deals in Q1'26 but well above the €12.7 billion across 31 deals in Q2'25. European new issuance is currently tracking for a record year following strong demand for rated CLO liabilities. However, conditions for managers are becoming challenging as asset spreads compress under a wave of loan repricings.

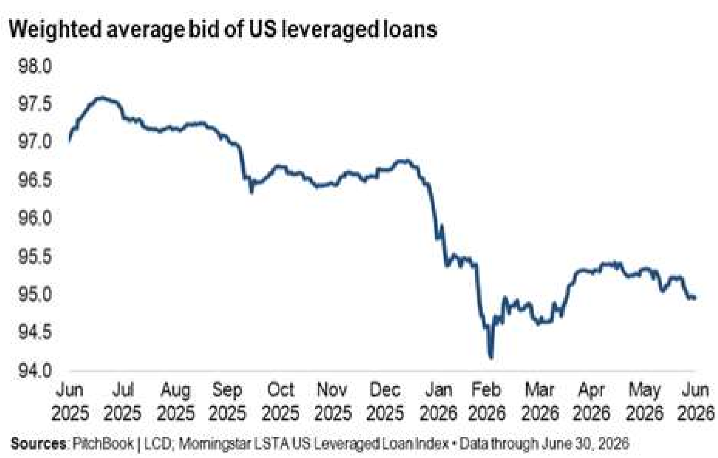




LOAN DEMAND CONTINUES ITS DECLINE

Q2'26 was the weakest fiscal quarter in terms of total measurable investor demand since Q4'23, totaling $34.5 billion of demand. This weakness stemmed from a pullback in CLO issuance – prompted by AI disruption and energy volatility – which fell from $47 billion in Q1'26 to $33.3 billion, the lowest quarterly CLO volume in two and a half years. Loan fund flows turned only marginally positive in the second quarter at $1.2 billion after several consecutive quarters of outflows. However, this was not enough to bolster the demand backdrop that has deteriorated over the past few quarters.





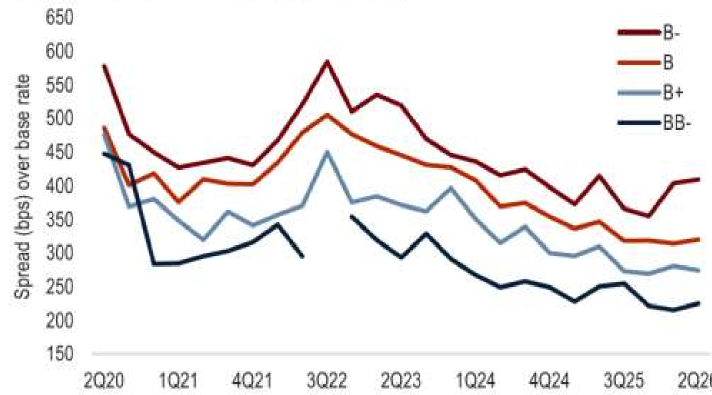
SECONDARY PRICES STAGNATE

The software sell-off continued to weigh on the US Leveraged Loan Index in Q2'26, with the weighted average bid closing the quarter at 94.96. While a minor improvement from the first quarter's closing weighted bid of 94.63, prices remain 167 bps below the beginning of the year. Momentum weakened further in June with the index's weighted average bid declining 36 bps, erasing the gains of the prior two months. As discussed in further detail below, loan prices excluding software loans largely held up in Q2'26, preventing another significant downturn in weighted average bids.

SPREADS REMAIN STABLE AT THE TOP

New-issue TLB spreads were relatively stable from Q1'26 to Q2'26, with spreads remaining tighter than a year ago across credit rating categories. However, compared to Q4'25 levels, spreads for B-minus rated borrowers have widened by 55 bps to S+409, while higher-rated buckets have moved by less than five bps. Additionally, the gap between new-issue spreads for B-minus and B-flat borrowers has widened to almost 90 bps, up from the 36 bps in Q4'25. The widest since COVID-19, the current premium to lend to B-minus borrowers signals a divergence in risk tolerance at the two ends of the credit spectrum amid persistent uncertainty and macro headwinds.

New-issue TLB spread by borrower rating



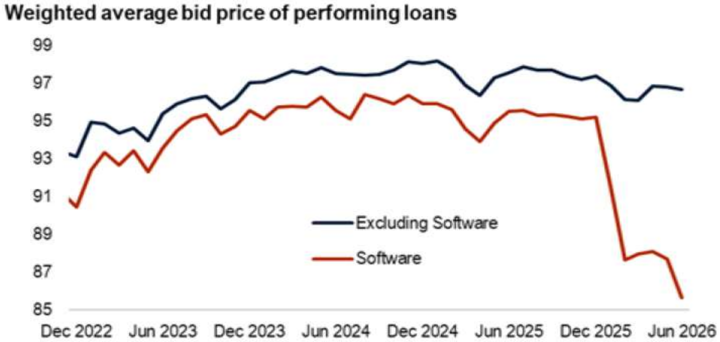
Source: PitchBook | LCD • Data through June 30, 2026

SOFTWARE CONTINUES TO WEIGH DOWN THE BROADER INDEX

The divergence between software loans and the broader market continued to expand in Q2'26 due to sustained concerns surrounding the impact of AI on software and software-as-a-service ("SaaS") credits. While the overall index excluding software has moved into positive territory since mid-April (96.67 at quarter-end), the average bid on performing software loans continues to decline, tumbling to 85.65 at quarter-end, down over 230 bps from 87.97 at the end of Q1'26. The gap between secondary prices of software names and the rest of the index has widened to 11 points, up from nine in May and about two at the beginning of the year. Of note, only 9% of loans issued in the US BSL market YTD have come from software companies – the lowest share since 2013 and roughly half the 2025 level.

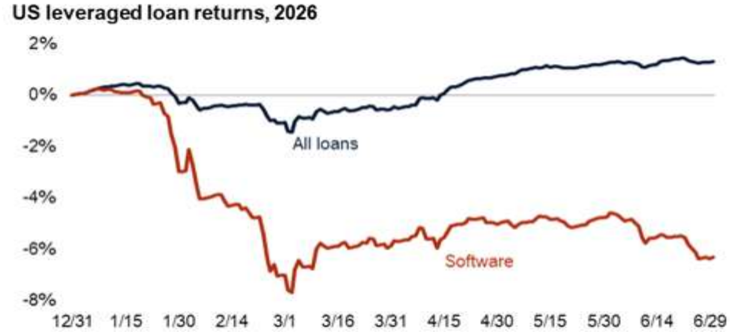
Though it made a slight comeback through the first two months of the quarter, the software sub-index gave up a majority of its gains in June, losing 1.66% during the month. On a YTD basis, the overall index has gained 1.31% while software has lost 6.31%, with no signs that the software retreat will reverse any time soon. LCD's leveraged finance sentiment survey found that 71% of respondents named software as the least favorable sector for credit investment in H2'26.

Weighted average bid price of performing loans



Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through June 30, 2026

US leveraged loan returns, 2026



Sources: PitchBook | LCD; Morningstar; S&P Dow Jones Indices • Data through June 30, 2026

LEVERAGED LOANS: MIDDLE OF THE PACK

The Leveraged Loan index gained 1.88% in Q2'26, bouncing back from a negative Q1'26 and placing second amongst the other fixed-income categories, trailing only HY Bonds' 2.44% quarterly return. However, all fixed-income categories severely underperformed against US equities in the second quarter behind a rally in memory and chip names and a rebound in software equities. Peace deal discussions in the Middle East also fueled the major rally in the S&P 500. After a Q2'26 that saw all asset classes produce positive overall returns, only one remains negative YTD (10-year Treasuries).

Returns by asset class

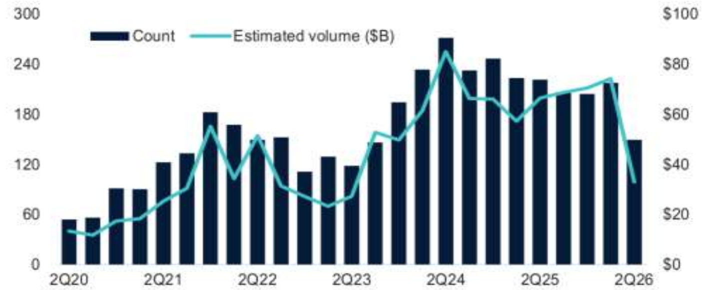
	Jun 2026	May 2026	2Q	YTD	LTM
Morningstar LSTA US LL Index	0.08%	0.51%	1.88%	1.31%	4.36%
Morningstar US High-Yield Bond	0.25%	0.47%	2.44%	1.88%	5.83%
Morningstar US Corporate Bond	0.11%	0.76%	1.41%	1.00%	4.32%
S&P 10-year Treasury Index	0.33%	0.07%	0.18%	-0.02%	2.85%
S&P 500	-0.95%	5.26%	15.20%	10.21%	22.32%

Sources: PitchBook | LCD; Morningstar; S&P Dow Jones Indices • Data through June 30, 2026

PRIVATE CREDIT PLUMMETS

Direct lending and private credit faced a challenging landscape in the second quarter amidst the Iran war and continued software sell-off. Private equity deal flow also plummeted in Q2'26, contributing to lower direct lending volumes in the quarter. Q2'26 saw $33 billion of direct lending volume across 149 transactions, both steep declines from the $74.1 billion of volume across 217 deals in Q1'26, and the lowest volume since Q2'23.

Direct lending deal count and estimated volume

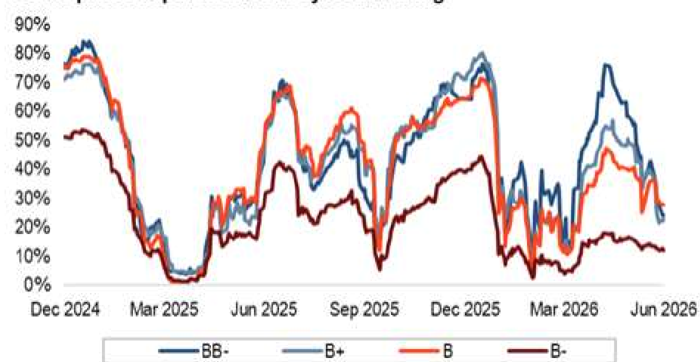


Source: PitchBook | LCD • Data through June 30, 2026
Direct lending analysis is based on transactions covered by LCD News

LOANS PRICED AT PAR/ABOVE REMAIN WEAK

At the end of Q2'26, the share of loans priced at par or above – a proxy for strength of investor demand – stood at 22%. Though higher than the 14% seen at the end of Q1'26, this figure is roughly half the 40% seen in April and May, and well below the mid-60% range held in January pre-software sell-off. The decline in June stemmed from a sharp retreat among higher-quality borrowers as market sentiment turned negative, with the share of BB-minus rated credits priced at par or above falling to 24% at quarter-close, down from 58% at the end of May. Though not as sharply as higher-rated borrowers, the share of B-minus rated credits priced at par or above declined slightly at quarter-end, falling from 17% to 12% in June.

Loans priced at par and above by issuer rating



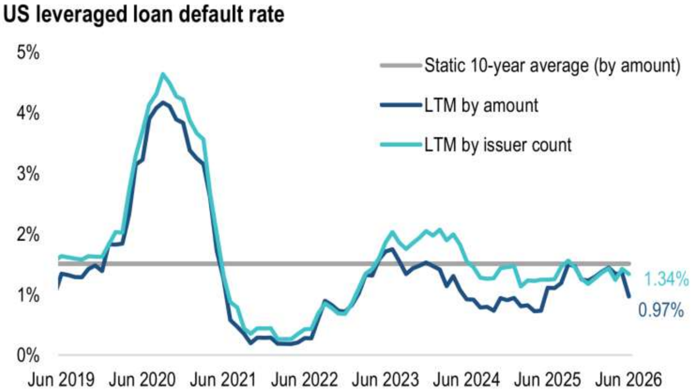
Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through June 30, 2026

DEFAULT RATES IMPROVE

The US leveraged loan payment default rate (by dollar amount; left chart below) fell sharply from 1.44% in Q1'26 to 0.97% in Q2'26 as there were no defaults during the month of June to impact the rolling 12-month calculation. Current payment default rate level is in line with the running five-year historical average (0.96%) and below the 10-year historical average (1.51%). As discussed in previous Quarterly Updates, this can be partly attributed to the rise in distressed liability management exercises ("LMEs"). Similarly to default rate by amount, the payment default rate by issuer count (excluding LMEs) also fell in the second quarter, improving to 1.34% from 1.44% in Q1'26.

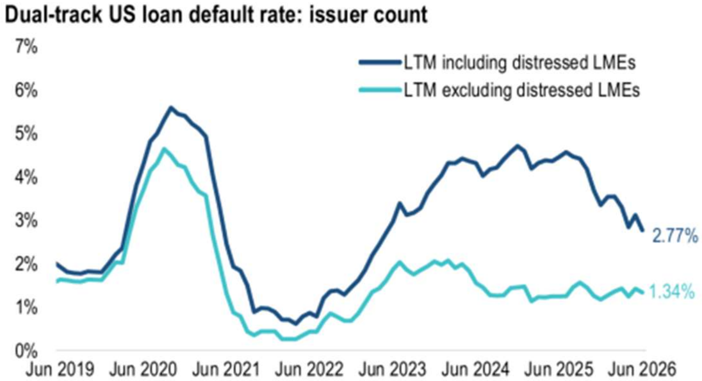
Of note, the Q2'26 payment default rate by issuer count that includes LMEs was 2.77%, more than double the rate excluding LMEs. However, the number of LMEs on a trailing 12-month basis has fallen dramatically since Q2'25, declining from 36 in June 2025 to 16 in June 2026. The June 2026 LME count is the lowest level since August 2023 (15 LMEs).

US leveraged loan default rate



Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through June 30, 2026

Dual-track US loan default rate: issuer count

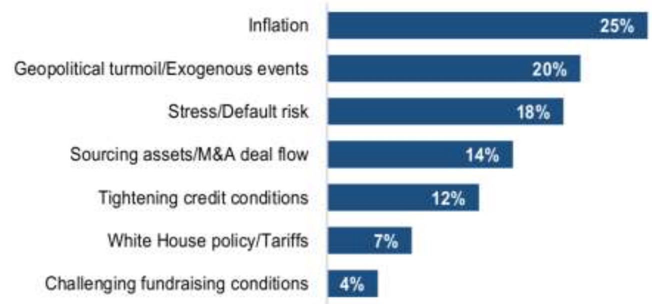


Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through June 30, 2026

LOOKING FORWARD

According to LCD's Q2'26 survey, inflation is the number one concern among leveraged loan market participants over the next six months (25% of votes). Geopolitical turmoil/Exogenous events, which was overwhelmingly first in Q1'26 with 36% of votes, fell to second in Q2'26 (20% of votes) as peace talks and apparent ceasefires partially soothed concerns over prolonged conflict with Iran in the Middle East. Stress/Default risks, which was fourth in Q1'26, came in at third in Q2'26 (18% of votes), while Sourcing assets/M&A deal flow, which was third in Q1'26, landed at fourth (14% of votes).

Which of the following will present the strongest headwinds to leverage loan market participants in the next six months?



Source: PitchBook | LCD • Data through June 29, 2026

Notably, tightening credit conditions, which placed second in the Q1'26 survey, fell three spots to the fifth highest concern in the Q2'26 survey. Participants also continued to note White House policy and tariffs as a potential headwind even as percentage of votes fell (11% in Q1'26 vs 7% in Q2'26), while challenging fundraising conditions cracked the top seven responses for the first time.

Bifurcation is likely to remain the defining characteristic of the leveraged loan market through the second half of 2026 as market risks stay elevated across rates, geopolitics, and AI-driven credit concerns, particularly in software. Despite Q2'26 institutional activity holding well above its five-year average, it leaned upon corporates rather than sponsors, meaning the long-awaited private equity rebound driving net new supply has yet to materialize. Fed rate cut expectations have faded with a new Fed chair and as inflation concerns have resurfaced amid oil price volatility stemming from the Iran war, removing a tailwind that was long priced into the market. However, looking past the turbulent macro backdrop, the fundamentals of the broader loan market appear sound, with the second quarter's weakness concentrated in software, rather than broadly distributed across credits. ARC continues to see both heightened deal activity and demand for credit insurance, and expects its disciplined credit selection, especially at the higher-quality end of the spectrum, to provide strong returns in the long run.

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