



Q3 2026 Leveraged Loan Market Overview

Leveraged Loan Market: Shifting Tides

October 19, 2026

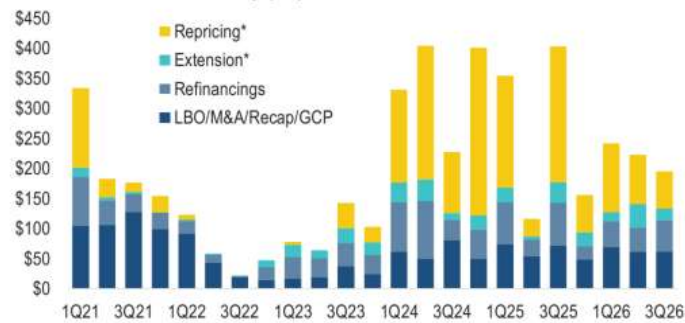


Q3 2026

MIXED SIGNALS IN THE LEVERAGED LOAN MARKET DURING THE THIRD QUARTER

The third quarter of 2026 was marked by a long-awaited return of M&A to the leveraged loan market, set against an increasingly selective credit backdrop. US institutional activity hit its 2026 low in Q3'26, with the decline coming from fewer amendment-driven repricings and extensions while new-money issuance kept pace with the first half of the year. In Q3'26, leveraged loans posted their best quarterly return since Q2'25, despite a backdrop of geopolitical conflict, an unsettled path for rates, and continued concern over AI disruption. Measurable loan demand rose to its highest reading of the year, driven by a rebound in CLO issuance from a three-year low. Yet credit quality divergence between higher- and lower-rated borrowers continues to grow, with borrowers rated BB-minus or higher capturing ~48% of M&A volume YTD, the highest share since the Great Financial Crisis ("GFC"). In Q3'26, the US syndicated loan asset class shrank to \$1.56 trillion, contracting ~1% from Q2'26.

US institutional loan activity (\$B)



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

LEVERAGED LOAN ACTIVITY FALLS AGAIN

Institutional loan activity (including repricings and extensions) in Q3'26 totaled \$195 billion, down ~13% from Q2'26 activity of \$224 billion and the lowest quarterly reading of the year. This downturn was driven entirely by fewer repricing and extension amendments. However, new-issue volume held steady compared to the first two quarters of 2026. Excluding amendments, BSL issuance totaled \$113 billion in Q3'26, the year's highest quarterly figure.

M&A's SEPTEMBER REVIVAL

Total Q3'26 issuance to support buyouts and M&A was \$39.9 billion, the lowest of this year's quarters, though September's \$30.6 billion of M&A-related issuance was the highest monthly total for the category since January 2022. LCD reported that September saw a dozen term loans exceeding \$1 billion supporting an LBO or M&A transaction, representing the highest count in five years. The month's largest deal was Paramount Skydance's \$8.5 billion TLB, part of the financing for its Warner Bros. Discovery acquisition, and the second-largest M&A term loan of 2026. LBO-related issuance accounted for half of all M&A-related supply in the third quarter, at \$20.0 billion, above its average share of 44% since the Fed began hiking rates in early 2022.

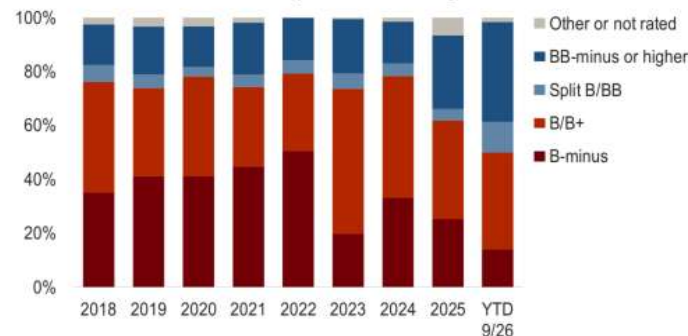
Although M&A recovered in September, a combination of geopolitical, interest rate, and AI-related uncertainty has led to M&A volume bifurcation between higher- and lower-quality credits. Borrowers rated BB-minus or higher have accounted for 48% of YTD M&A volume, the highest share since the GFC and double the average of the prior decade, while only 14% has gone to borrowers rated B-minus – a 14-year low and well off the 10-year average of 34%.

US institutional M&A loan issuance (\$B)



Source: PitchBook | LCD • Data through Sept. 30, 2026

M&A/LBO loan volume share by borrower rating



Source: PitchBook | LCD • Data through Sept. 30, 2026

NET LOAN SUPPLY STALLS

After expanding to a record \$1.57 trillion in Q2'26, par amount outstanding fell slightly in the third quarter to \$1.56 trillion following a dormant new M&A issuance backdrop in July and August. Net loan supply is measured as the change in outstandings, per the Morningstar LSTA US Leveraged Loan Index (newly issued loans minus repayments). September's \$2.4 billion decline, the first since May, largely reflects timing. Much of the post-Labor Day M&A pipeline had not yet funded and entered the index in October.

Morningstar LSTA US LL Index: Par amount outstanding

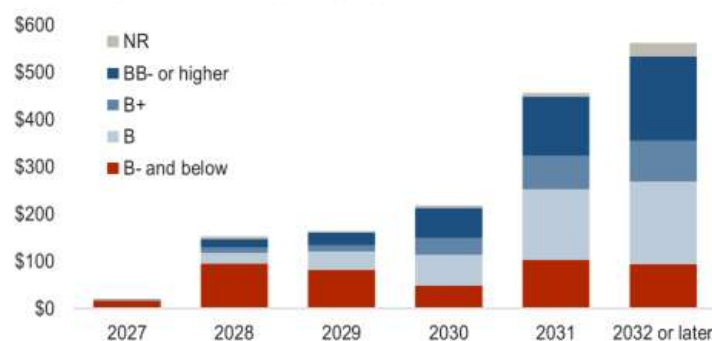


Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through Sept. 30, 2026

MATURITIES MANAGED ACROSS RATINGS

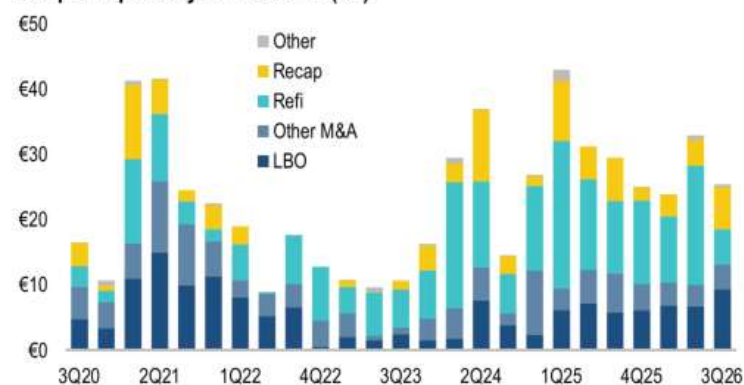
In Q3'26, the 2027 maturity wall fell by 33% to \$18.9 billion, while the 2028 maturity wall was cut by 27% to \$152.1 billion, as higher-rated credits continued to extend their near-term maturities. B-minus-and-below borrowers account for roughly 62% of the \$152.1 billion due in 2028 and half of the \$163.8 billion due in 2029. Progress on the 2028 maturity wall has been uneven. B and B-plus borrowers have cut their 2028 maturities by 64% this year, to about \$35 billion, while B-minus-and-below credits have cut theirs by only 35%, to about \$94 billion.

US leveraged loan maturity wall (\$B)



Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through Sept. 25, 2026

European quarterly loan volume (€B)



Source: PitchBook | LCD • Data through Sept. 30, 2026

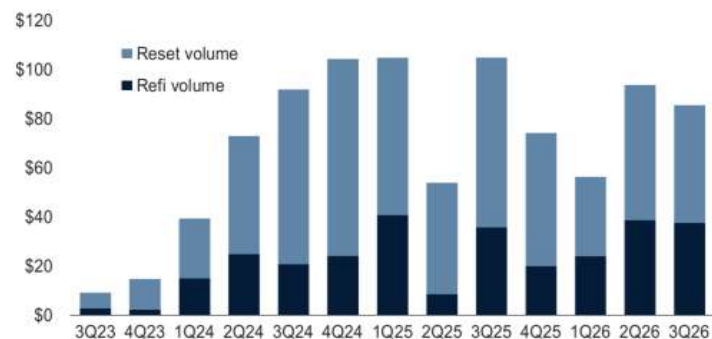
ISSUANCE: EUROPE

European leveraged loan issuance slid 23% q/q to €25.4 billion in Q3'26, driven by a nearly 70% collapse in refi volume from Q2'26 as higher spreads and yields weighed on activity. The third quarter's €5.5 billion of refinancing volume represents a 51% decline from Q3'25 and is the lowest quarterly reading since Q1'23, when this volume totaled €4.0 billion. On the other hand, M&A-related activity rose from €9.7 billion in Q2'26 to €13.1 billion in Q3'26 following the return of several large LBO financings. M&A-related activity's 52% share of quarterly volume is the highest since Q1'23.

CLO RESETS AND REFS COOL

In the third quarter, CLO resets and refis were \$47.7 billion and \$37.6 billion, respectively, totaling \$85.3 billion of activity – down ~9% from the second quarter total of \$93.7 billion. The Q3'26 total is roughly twice the quarter's CLO new-issue volume of \$45.8 billion. YTD refi volume is up ~18% y/y, though YTD reset volume is down ~24% y/y. However, the forward pipeline remains supportive. With new-issue AAAs pricing at S+117–125 in September, much of the ~\$270 billion pool of BSL reset candidates (Morgan Stanley, Aug. 7) carries coupons above S+130, making resets economical for much of it.

US CLO refinancing and reset volume (\$B)



Source: PitchBook | LCD • Data through Sept. 30, 2026

US CLOs BOUNCE BACK AS EUROPEAN CLOs CONTINUE RECORD PACE

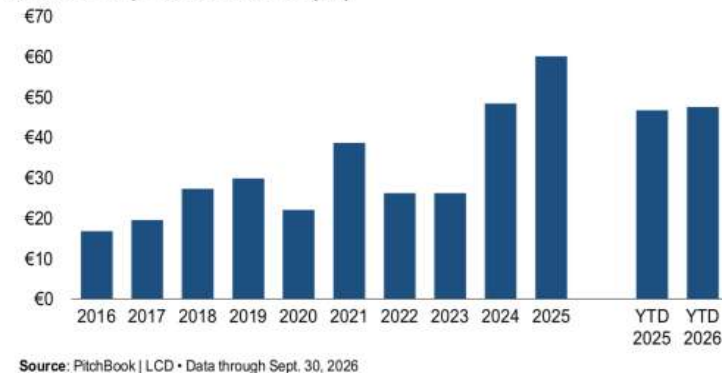
CLO issuance bounced back in Q3'26 with \$45.8 billion of new issuance priced across 99 transactions – a 37% increase from Q2'26's three-year low issuance number. Despite the Iran war driving Brent crude toward \$100 a barrel and the 10-year Treasury yield rising above 5% (shrinking the excess yield earned by owning CLO AAAs versus Treasuries), issuance remained solid over the quarter. BSL CLOs drove much of the gain in q/q issuance, increasing by 42% to \$34.6 billion, while middle-market CLO issuance was relatively flat until a late-September surge pushed the quarter-end total to \$11.2 billion. Overall quarterly volume was the third-highest third quarter reading since 2011 but still trailed the Q3'25 total of \$53.7 billion by 14.7%.

European CLO new issuance volume reached €47.5 billion through Q3'26, slightly ahead of the €46.7 billion in the same period of 2025. This is in stark contrast to the US market, where YTD new-issue volume is down ~18% y/y. European new issuance is still tracking for a record year following strong demand for rated CLO liabilities. Q4 issuance of just over €13 billion would set a new annual record, surpassing last year's print.

US CLO issuance – quarterly



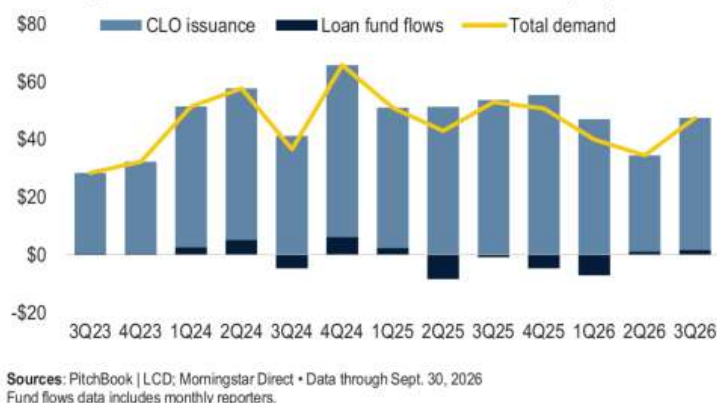
Annual European CLO volume (€B)



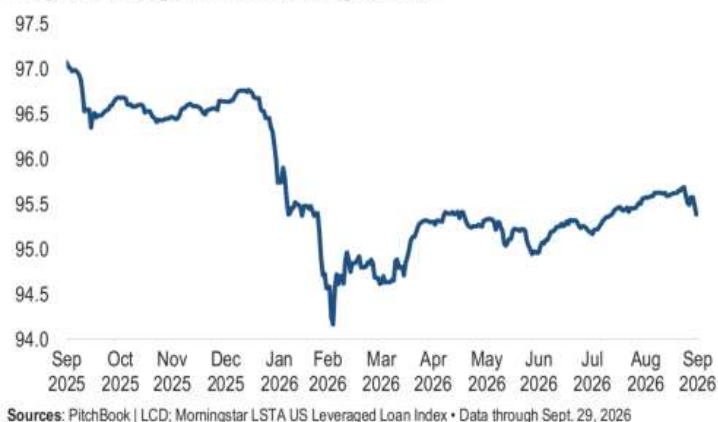
LOAN DEMAND REVERSES COURSE

Following two straight quarters of decline to begin the year, measurable investor demand for leveraged loans rose to \$47.5 billion in Q3'26, up 38% from Q2'26. Rebounding CLO issuance – which rose to \$45.8 billion in the third quarter following a 2.5-year low of \$33.3 billion in the second quarter – led this improvement, while loan fund flows also increased slightly in the run-up to the Fed's decision to hike interest rates. LCD estimates that loan funds attracted \$1.7 billion in Q3'26, marking the highest reading since Q1'25.

US leveraged loan market – measurable investor demand (\$B)



Weighted average bid of US leveraged loans

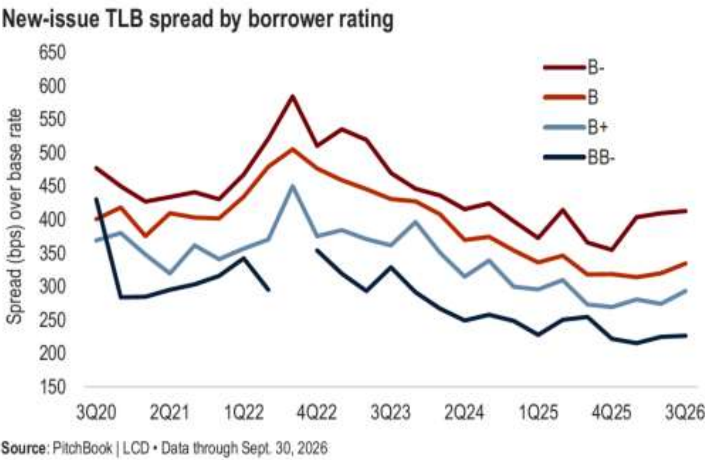


SECONDARY PRICES TREND UPWARD

Following an H1'26 that was defined by AI-disruption fears and the impacts of the Iran war, leveraged loans posted solid gains in Q3'26 due to strong technical factors and a partial rebound in software names. The weighted average bid of the US Leveraged Loan Index ("LLI") ended the third quarter at 95.32 – 115 bps above the intra-year low of 94.17, but still 132 bps below the 96.64 average bid from the start of the year. The index peaked in Q3'26 at 95.69 on September 22, its highest level since February, before pulling back in the final week of the quarter amid a spike in bond yields and increasing concerns around inflation.

SPREADS DIVERGE ACROSS RATING SCALE

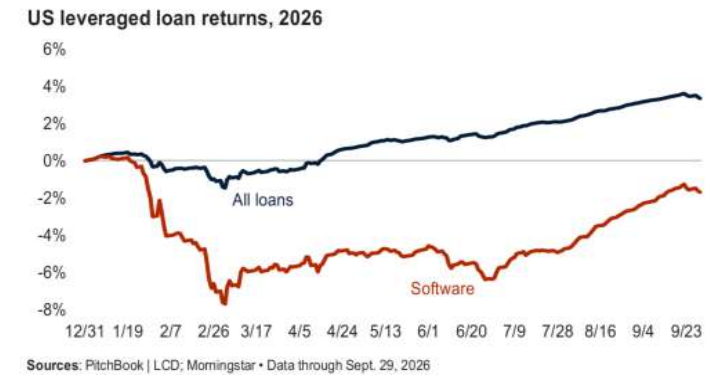
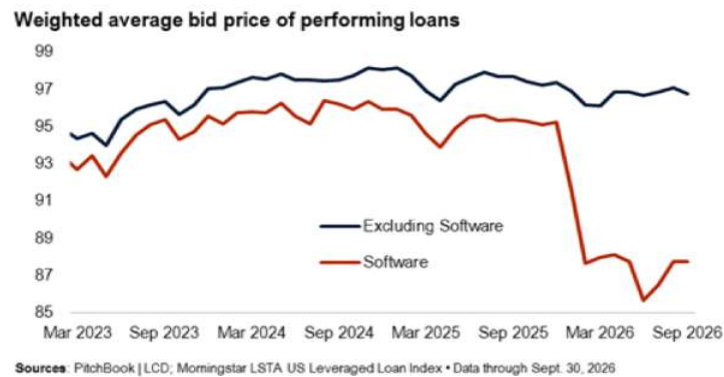
New-issue TLB spreads, though remaining relatively stable q/q, have continued to widen since the multiyear lows of late 2025/early 2026. The most pronounced moves have come from the lowest-rated names, as spreads for B-minus-rated borrowers have risen by more than 50 bps, to S+413, since the end of 2025, while deals in both the B and B-plus categories have followed a similar pattern. The premium B-minus issuers pay over BB-minus peers has nearly doubled over the past year, from ~100 bps to ~190 bps. This suggests lenders are demanding higher compensation for riskier, refi-driven credits while continuing to accept tighter pricing for higher-quality credits.



SOFTWARE STILL LAGGING, THOUGH RETURNS TICK UPWARD

After two quarters of weighing on the broader index, the software sector began to recover from its downturn earlier in the year. The weighted average bid price of software performing loans rose by 209 bps over the course of Q3’26, closing the quarter at 87.74. Software bids peaked at 88.48 on September 22 – a seven-month high – before reversing course in the final week of the month. The rest of the market (excluding software) now sits 99 bps above its intra-year low of 95.75 and just 64 bps below its level at the beginning of the year. Software issuers have accounted for just 10% of YTD 2026 BSL issuance, their smallest share since 2015.

Software’s underperformance relative to the broader market narrowed in Q3’26, though the sector’s returns remain negative YTD at -1.72% compared to overall returns of 3.29%. This is a significant improvement for software compared to the end of Q2’26, when returns were -6.31% against a 1.31% gain for the broader index. Despite a year of AI-driven reassessment, with thinner new issuance and wider spreads, software remains the index’s largest sector at 11.3% of market value.



LEVERAGED LOANS: SAFE HARBOR

The Leveraged Loan Index gained 1.95% in Q3’26, following a 1.88% gain in Q2’26. Loans were the only fixed-income asset class to provide a positive return over the quarter, with HY bonds, corporate bonds, and 10-year Treasuries all generating losses in Q3’26 amid September’s rate shock and heavy issuance. However, loans lagged US equities (S&P 500) by 35 bps in Q3’26. After a bumpy Q3’26 for fixed income, two asset classes now hold negative YTD returns (corporate bonds and 10-year Treasuries).

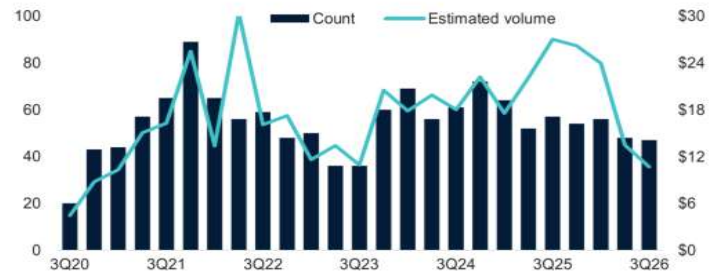
Returns by asset class	Sep 2026	Aug 2026	3Q’26	YTD	LTM
Morningstar LSTA US LL Index	0.21%	0.93%	1.95%	3.29%	4.55%
Morningstar US High-Yield Bond	-2.52%	1.01%	-1.76%	0.09%	1.50%
Morningstar US Corporate Bond	-2.72%	0.44%	-4.01%	-3.05%	-2.44%
S&P 10-year Treasury Index	-3.73%	0.16%	-5.22%	-5.24%	-4.29%
S&P 500	-0.35%	2.72%	2.30%	12.75%	15.74%

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

PRIVATE CREDIT LBOs CONTINUE TO SLIP

Direct lenders financed 47 LBOs totaling \$10.7 billion in Q3'26, down 21% q/q from Q2'26 (\$13.5 billion, 48 deals) and down roughly 60% y/y from Q3'25 (\$27.0 billion, 57 deals). Large buyouts financed by private credit were largely absent in the third quarter as market participants weighed the impacts of geopolitical uncertainty, rising inflation, and the September Federal Reserve rate hike.

Direct lending deal count & estimated volume (\$B), LBOs

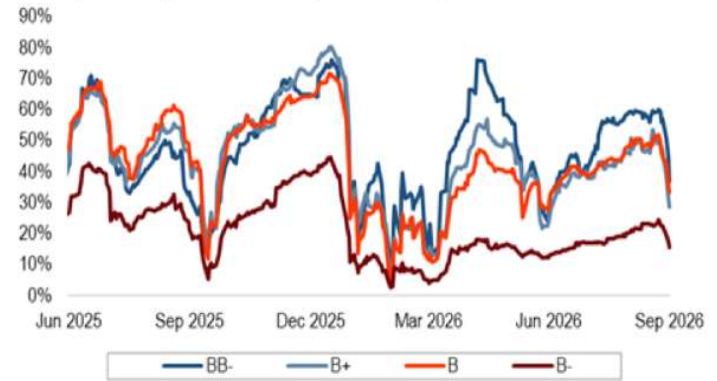


Source: PitchBook | LCD • Data through Sept. 30, 2026
Direct lending analysis is based on transactions covered by LCD News

LOANS PRICED AT PAR/ABOVE TUMBLE IN SEPTEMBER

At the end of Q3'26, the share of loans priced at par or above – often a proxy for strength of investor demand – stood at 28%, up from 22% at the end of Q2'26, though down 14 percentage points from 42% in August after a late-September risk-off move due to unexpectedly strong business activity, a spike in yields, and inflation worries. This decline was more pronounced for BB-minus-rated borrowers, which had a higher initial share of par-or-above names. Additionally, the distressed cohort – or share of loans priced below 80 – stood at 7% at quarter-end, well above the 4.4% level at the beginning of 2026 and the 2.6% level in September 2025.

Loans priced at par and above by issuer rating



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

DEFAULT RATES IMPROVE WHILE LMEs RISE ONCE AGAIN

For the second straight quarter, the US leveraged loan payment default rate (by dollar amount; left chart below) fell sharply, declining from 0.97% in Q2'26 to 0.55% in Q3'26 as the quarter saw only a single new payment default with two sizable defaults falling off the rolling 12-month calculation. The current payment default rate by amount is well below the comparable five-year and ten-year historical monthly averages of 0.97% and 1.47%, respectively. As discussed in previous Quarterly Updates, this can be partly attributed to the rise in distressed liability management exercises (“LMEs”). In line with default rate by amount, the payment default rate by issuer count (excluding LMEs) also declined in the third quarter, improving to 1.08% from 1.34% in Q2'26.

The Q3'26 payment and selective default rate by issuer count (including LMEs) was 2.97%, almost three times as high as the rate excluding LMEs and 20 bps higher than the 2.77% at the end of Q2'26. However, the number of LMEs on a trailing 12-month basis has fallen significantly since Q3'25, declining from 31 in September 2025 to 21 in September 2026, though the LME total rose from 19 in August, marking the fourth consecutive monthly increase.

US leveraged loan default rate



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

Dual-track US loan default rate: issuer count

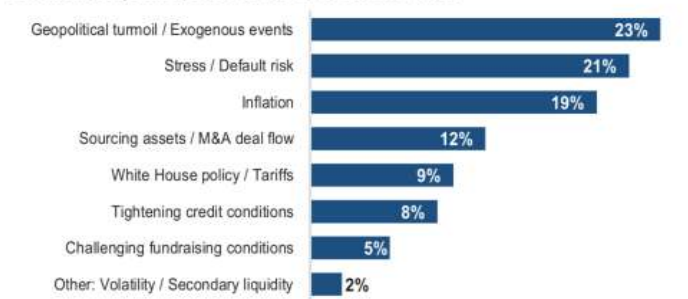


Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through Sept. 30, 2026

LOOKING FORWARD

According to LCD’s Q3’26 survey, geopolitical turmoil/exogenous events was the top concern among leveraged loan market participants over the next six months (23% of votes) due to the ongoing wars in the Middle East and Ukraine that have disrupted global energy supply. Stress/default risk, which was third in Q2’26, rose to second in Q3’26 (21% of votes), while inflation, which was first in Q2’26, fell to third in Q3’26 (19% of votes). Sourcing assets/M&A deal flow remained fourth in Q3’26 (12% 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 Sept. 28, 2026

Survey participants also continued to note White House policy and tariffs (9% of votes in Q3’26 vs. 7% of votes in Q2’26), tightening credit conditions (8% of votes in Q3’26 vs. 12% of votes in Q2’26), and challenging fundraising conditions (5% of votes in Q3’26 vs. 4% of votes in Q2’26) as potential headwinds, while 2% cited other factors, including volatility and secondary liquidity.

Given geopolitical tensions, upcoming US midterm elections, shifting inflation and interest rate outlooks, and AI-related disruption, volatility is likely to persist through the rest of the year, even after leveraged loans delivered their strongest quarterly return in over a year in Q3’26. September’s surge in M&A financing has market participants expecting deal flow to build. In LCD’s survey, 58% forecast higher M&A issuance and none expect a decline, though respondents see stricter terms and wider pricing ahead. Interest rates remain a central variable, with inflation holding well above the Fed’s 2.0% target and markets pricing in at least one further hike by year-end. For floating-rate borrowers, each hike raises cash interest costs. That supports investor returns but further squeezes coverage for lower-rated issuers already facing 2028 maturities. ARC, however, continues to see heightened deal activity and demand for credit insurance. With bifurcation between higher- and lower-rated credits steadily expanding, ARC believes its disciplined credit selection and deep understanding of the market will allow it to continue to achieve low loss ratios.



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