Risk On/Risk On (Part One)

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What's the state of the US leveraged loan market, and what's the outlook for the rest of the year? Those were the among the questions posed to your correspondent and three other panelists at *Octus Webinar: H1 2025: "How Private Credit and Banks Traversed the Tariff Storm to a Brighter Second Half."*

We've discussed here at length the implications and effects of tariffs on the credit market. More interesting for readers was the panel discussion of what has been a full recovery from April's Liberation Day. At least one measure of this confidence was July's US leveraged loan activity of $222 billion, the largest monthly number ever recorded. As our *Chart of the Week* highlights, eight of the top ten busiest months came since January of 2024, according to Bloomberg.

One speaker attributed the abruptly risk-on market to "the tariff range of outcomes narrowing materially," with "no massive tail risk" at this point. High-yield bond spreads have returned close to where they were at the beginning of the year. July's BSL market is showing "the tightest spreads since the GFC." How does double Bs at S+175, single Bs at 225-250, and B3s in the upper 200s, grab you?

Borrower aggressiveness is showing up not just in tighter spreads but weakened structures, another panelist suggested. "Portability features, anti-cooperative provisions, and tariff-related Ebitda add backs" are being offered to better issuers. "The gap between adjusted ebitda and clean cash ebitda could be over 40%." He noted that "BSL has been more flexible on loopholes, while PC more studious." But how far will the largest direct lenders go to match these terms?

With tighter spreads and rates expected to ease later this year, refinancings should help borrowers reduce borrowing costs and improve interest cushions. But the quickened drumbeat of activity is misleading. The rub for investors is only 9% represented new money issuance. Of course, seeing existing assets repriced downwards isn't great, though only modest "deterioration in underwriting standards" was observed.

This is now the established path for larger transactions seeking to improve financing costs and structures. Loan spreads are driven by inflows to loan funds, which turned sharply negative in April, but have reversed since, given the more positive market tone noted above.

Amidst this BSL refi rush, we said on the webinar, the private credit pipeline for top arrangers was dominated by new LBO transactions. This is the proven strategy for middle market PE shops eager to continue the investment pace in business services and other resilient sectors regardless of tariffs, pandemics, or geopolitical issues. Deployment is about supply and demand of capital, not fund flows.