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# U.S. Leveraged Credit in 2025: Yields Offer a Cushion in an Aging Credit Cycle

While high starting yields should provide a buffer against potential volatility, credit selection will be critical as dispersion within and across sectors increases.

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## Executive summary

### Strong performance amid robust demand in 2024

The leveraged loan market delivered strong returns in 2024, supported by resilient economic growth, high carry and robust investor demand, with record repricing activity and CLO issuance driving borrower cost reductions and secondary price gains.

### Key trends in 2024

- **Performance:** Loans closed the year at their highest levels since early 2022, supported by stable earnings and strong risk appetite. Single-B loans outperformed, while high yield CCC bonds saw a late-year rally in select sectors.
- **Fundamentals:** While leverage ratios remained stable, interest coverage ratios continued to decline due to higher rates. Defaults, largely driven by distressed exchanges, edged higher but remained within manageable levels.
- **Supply and demand:** Net supply growth remained subdued, with refinancing dominating issuance. CLOs and retail investors drove robust demand, supported by high yields and strong market sentiment.

### 2025 outlook

Looking ahead, the leveraged credit market is well positioned to deliver attractive returns, with high starting yields providing a cushion against potential volatility. Key themes for 2025 include:

- **Macro and technical dynamics:** A positive macro environment, easing monetary policy and supportive technicals are expected to sustain demand for leveraged credit. However, stronger net supply, fueled by a rebound in M&A activity, may soften the supply/demand imbalance.
- **Default activity should stabilize:** Corporate fundamentals should improve as rates decline and earnings growth rebounds.
- **Corporate risk profiles are bifurcated:** The market will remain split, emphasizing the importance of careful credit selection. Risks include potential inflation surprises, geopolitical tensions, and sector-specific headwinds in retail, autos, and media.

### Performance outlook

The leveraged loan market is forecast to generate a 7.5-8.0% total return in 2025, slightly outpacing high yield bonds (7.0-7.5%).[1] Loans' carry advantage will support performance in the first half of the year, but this may diminish as repricing activity and rate cuts materialize. Credit selection will be critical as dispersion within and across sectors increases.

[1] Please see Exhibit 8 for more details.

## Review of 2024

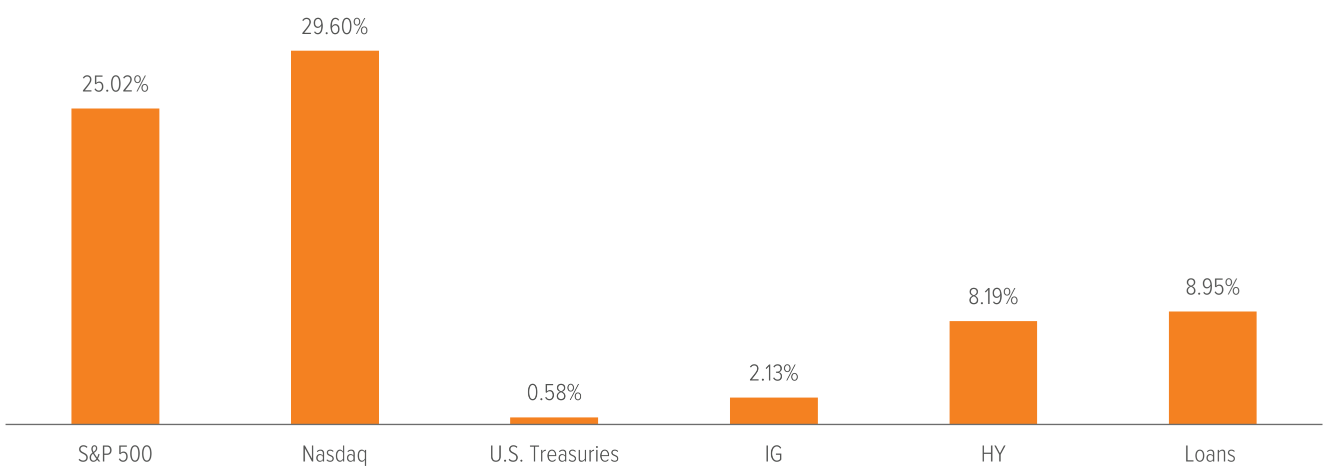
In many ways, 2024 was a continuation of the positive themes observed in 2023, with the macroeconomic environment providing a constructive backdrop. The U.S. economy and financial markets largely outperformed many investor expectations heading into the year. Growth continued to surprise to the upside, labor markets remained balanced, inflation cooled at a slower pace than expected, Treasury yields steepened, equity markets reached fresh all-time highs, and credit spreads tightened further. With no reliable historical parallels, this shouldn't come as a major surprise, since markets have hardly followed the traditional playbook since the pandemic.

Entering the year, markets appeared convinced that disinflation would allow the Federal Reserve to ease monetary policy from peak rates in early 2024. This narrative shifted quickly after a series of hotter-than-expected inflation readings, which, combined with stronger growth, pushed the Fed's cut expectations to later in the year. By the end of the summer, labor market concerns became top of mind; this followed a significant miss in the July nonfarm payroll report and a rise in the unemployment rate. With greater confidence regarding inflation and growing fears about the labor market, the Fed cut rates by 50 basis points (bp) at its September meeting, describing the recalibrated policy as a reaction to "changing balance of risks." Despite multiple rate cuts during the year, Treasury yields ultimately finished the year higher. The primary catalysts were ongoing strength in economic prints during the fourth quarter and the U.S. presidential election outcome, which may slow the progress on inflation given higher growth expectations, tax cuts and deregulation.

Importantly, a "Goldilocks" economic scenario remained the central market theme, despite no shortage of mixed signals throughout the year, setting the stage for another strong year across risk assets (Exhibit 1). U.S. equities rallied aggressively and reached new highs on many occasions, while tighter credit spreads boosted corporate spread sectors.

**Exhibit 1: Risk assets delivered another year of strong performance**

2024 performance




As of 12/31/24. Source: LCD, Barclays, Bloomberg. Equities represented by the S&P 500 Index and by the Nasdaq Composite Index. U.S. Treasuries represented by the Bloomberg U.S. Treasury Index. Investment grade (IG) bonds represented by the Bloomberg U.S. Corporate Index. High yield bonds (HY) represented by the Bloomberg U.S. Corporate High Yield Index. Loans represented by the Morningstar LSTA U.S. Leveraged Loan Index. **Investors cannot invest directly in an index.**

## Spotlight on leveraged credit

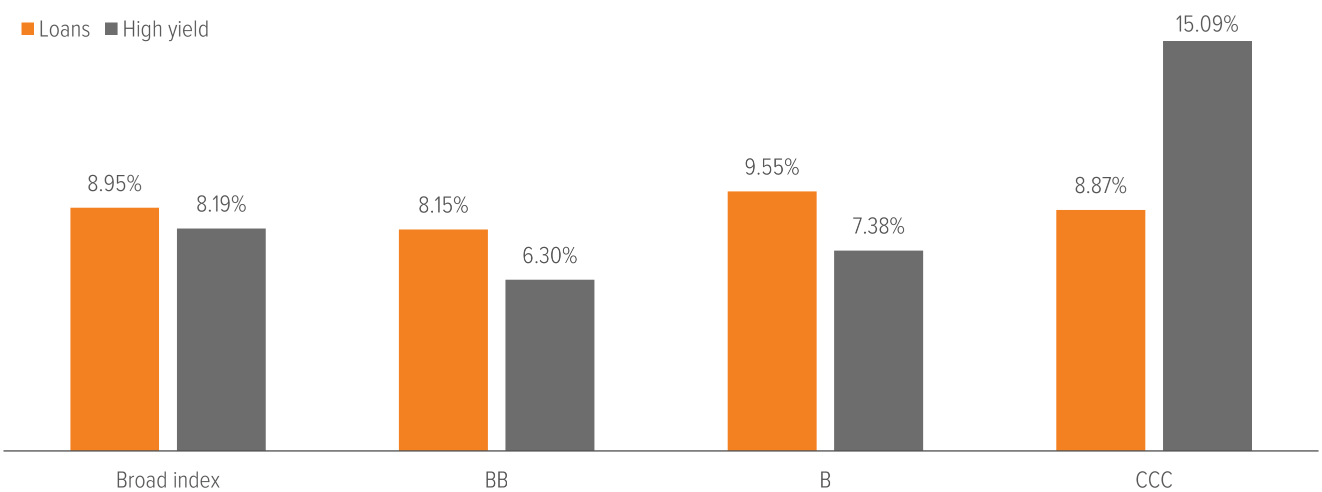
Given the resilient macro environment and high carry, leveraged credit had another strong year on the heels of double-digit returns in 2023. In terms of relative performance, loans modestly edged out high yield (after trailing for most of the year) following a selloff in rates in December. The robust technical picture continued to outweigh other factors, such as pressure on interest coverage ratios and increased defaults, driven by persistent demand from yield seekers. After a brief, episodic spike in early August, high yield bond spreads grinded tighter, reaching close to 20-year tights following the election outcome. Loan prices steadily climbed for most of the year, closing out the period at their highest level since early 2022.

Across the space, many of the same themes from last year were evident again: high carry, supportive technicals, risk-on sentiment and elevated idiosyncratic risk. The technical picture was once again conducive to performance, driven by an ongoing demand/supply imbalance that widened throughout the year. Corporate fundamentals remained on solid footing, as earnings growth was stable. Furthermore, issuers continuously tapped into the receptive primary market to successfully extend near-term maturities and further push out maturity walls. Healthy risk appetite spurred a meaningful return of repricing activity in the loan market, which eclipsed the prior annual record set in 2017.

The favorable backdrop was supportive for the volatile CCC cohort within the high yield market (Exhibit 2). However, the bulk of the outperformance occurred in the back half of the year and wasn't uniform across all CCCs. Specifically, a subset of distressed issuers in sectors such as media and telecom that had been under pressure earlier in the year rallied sharply on company-specific news. Despite the overall strong performance from the right tail of the market, single-name risk coupled with secular industry challenges resulted in continued dispersion across industries and individual credits. This led to an elevated pace of distressed exchanges and other liability management exercises (LMEs), notably concentrated in the loan market.

Looking ahead, we're constructive on the 2025 outlook for leveraged credit. Although demand should remain strong, stronger net supply will counterbalance technicals as M&A activity ramps up. The strong macro backdrop and easing cycle is expected to provide ongoing support to credit fundamentals. While valuations are on the richer side, high carry should continue to cushion returns and protect from spread-widening events, absent an external shock. Credit selection remains key, as the market continues to be bifurcated between the "haves" and "have-nots."

**Exhibit 2: Single-Bs outperformed in loans, while high yield CCCs were a key outlier in 2024**




As of 12/31/24. Source: LCD, Barclays, Bloomberg. High yield bonds (HY) represented by the Bloomberg U.S. Corporate High Yield Index. Loans represented by the Morningstar LSTA U.S. Leveraged Loan Index. **Investors cannot invest directly in an index.**

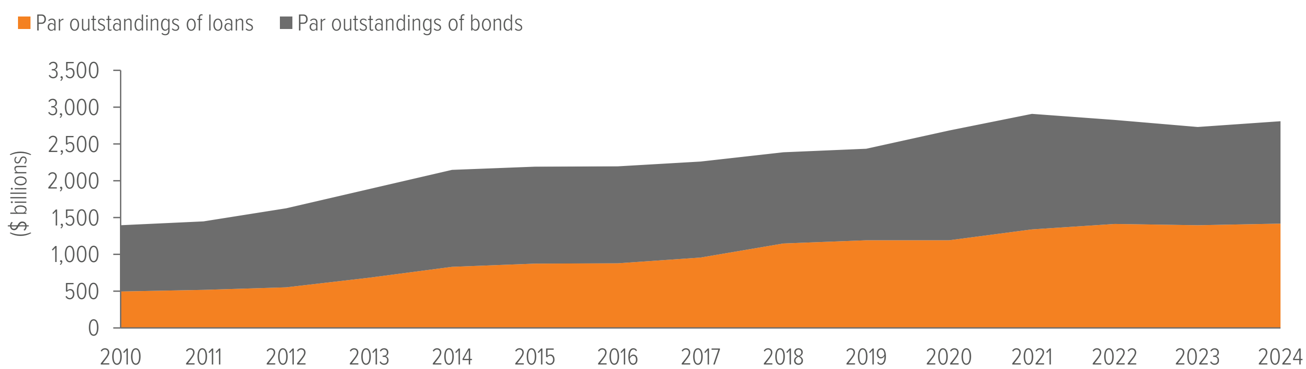
Source: LCD, Bloomberg.

## Supply and demand

A key driver of strong returns within leveraged credit over the last two years has been a constructive technical backdrop. Increased yields have attracted investors, while higher financing costs have limited organic issuance, allowing spreads to compress. Low net supply, along with net rising-star upgrades, muted the growth of leveraged credit markets over that period (Exhibit 3). While gross issuance grew materially in 2024, net issuance was quiet again, with only a modest pickup in M&A activity. Total loan gross issuance (excluding repricings) amounted to $501 billion, while high yield gross issuance was $282 billion (Exhibit 4). Of note, refinancing transactions dominated the use of proceeds in 2024, representing over half of issuance across both loans and high yield, given the need for borrowers to address upcoming maturities. Meanwhile, private credit cannibalization was benign after increased private credit takeouts of broadly syndicated loans (BSL) in 2023. In fact, many private credit deals were refinanced in the loan market, as financing costs cheapened.

Arguably, the overarching theme in the loan market was repricing transactions, which don't count toward new supply. Lackluster net supply and strong demand for credit gave borrowers leverage to lower their borrowing costs via repricing transactions. As secondary prices rallied, the share of loans priced at par or higher rose to roughly two-thirds of the loan index, leading to an aggressive repricing wave. For context, total repricing volume reached a new record of nearly $800 billion, including resyndicated repricings, with more than half of the loan market repriced during the year. Borrowers, on average, reduced their spread by 52 bp, which decreased the

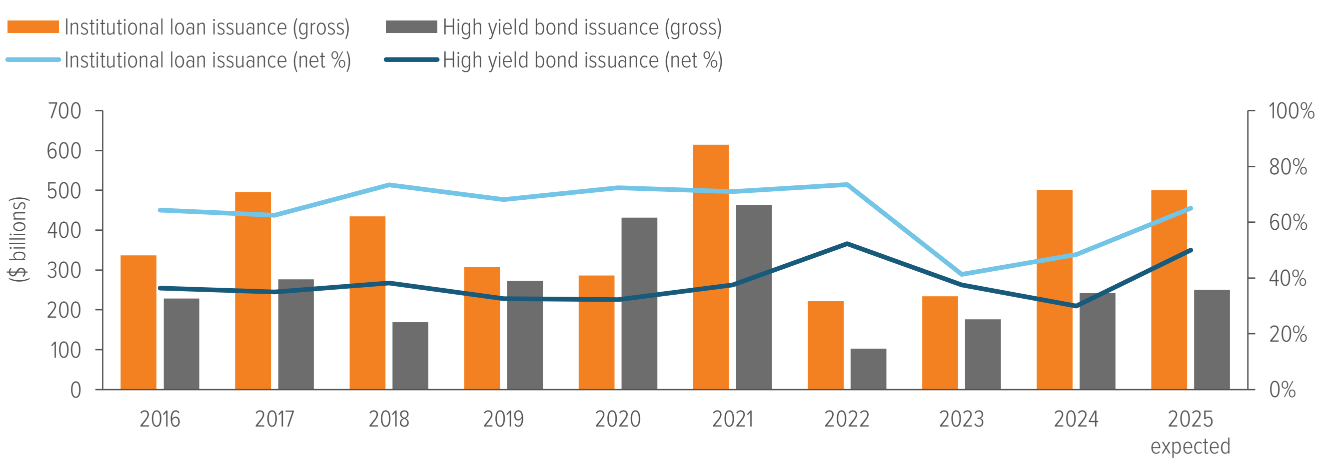
**Exhibit 3: Consistent repayment activity and subdued net issuance caused the size of the leveraged credit market to remain flat over the last two years**




As of 12/31/24. Source: LCD, Barclays, Bloomberg. See endnotes for index definitions and additional disclosures.

**Exhibit 4: Gross supply is expected to remain relatively flat, while M&A supply should boost net issuance**

Annual institutional issuance ($ billions)




As of 12/31/24. Source: LCD, Barclays, Bloomberg. See endnotes for index definitions and additional disclosures.

average nominal credit spread of the loan index to 341 bp (the lowest level since 2019). Given the prevalence of repricings, in addition to increased refinancings aimed at lowering borrowing costs, new-issue spreads in the loan market hit multi-year lows across various credit ratings.

Going forward, while we expect similar issuance levels next year, the composition of supply across both markets should be more balanced in 2025 (Exhibit 4). With the maturity wall still a burden, particularly in high yield, refinancing transactions are expected to remain prevalent. In the loan market, we don't expect the same pace of repricing activity, as many eligible issuers have already repriced (some multiple times) and BB spreads have compressed meaningfully. With that said, total repricing volumes should remain above historical averages unless trading levels sharply decline due to unforeseen events.

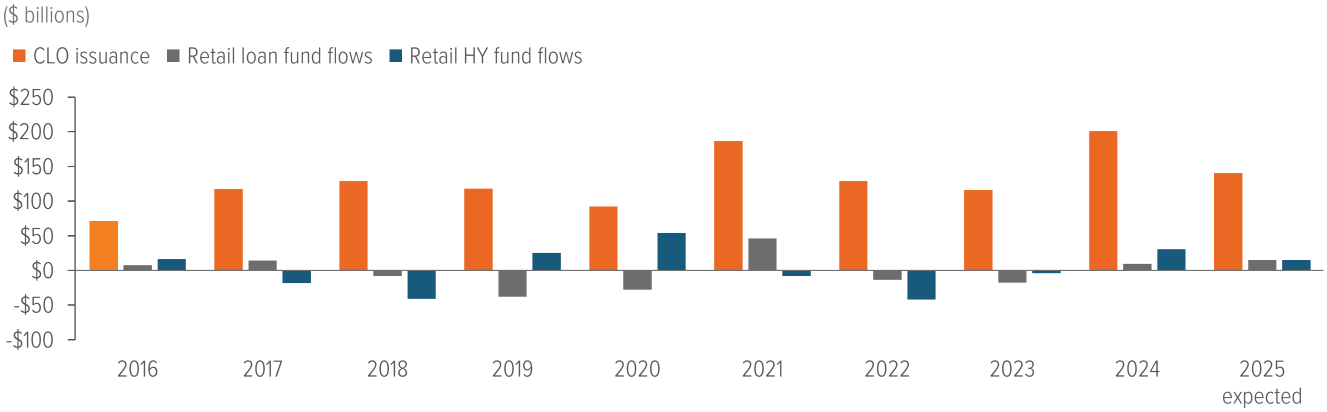
In 2025, M&A activity will likely see a solid rebound, particularly in the back half of the year, as more clarity forms on the path of rates and government policy. The healthy macro setup, falling rates and a more favorable regulatory backdrop should help boost corporate confidence and incentivize deal making among private equity sponsors. Consequently, the supply/demand imbalance should begin to fade as net issuance ramps up, which could give spreads some breathing room. In other words, historically strong technicals will likely soften modestly in 2025 but continue to support valuations.

On the demand front, there's been a noticeable increase in demand for leveraged credit across key investor segments. Unlike in 2023, when recessionary concerns curtailed demand for below investment grade spread products, both loans and high yield experienced significant inflows from retail investors, totaling approximately $9.6 billion and $30.3 billion, respectively. Retail flows are expected to remain positive in 2025, supported by elevated all-in yields and positive market sentiment. What's more, plenty of cash remains on the sidelines, waiting to be deployed. As front-end yields decline, thanks to additional Fed cuts, we expect a heavier rotation into fixed income in search of yield.

Collateralized loan obligations (CLOs) continued to be the dominant buyers in the loan market, creating ongoing bid support. CLO issuance reached $201 billion in 2024, far exceeding even the most optimistic projections from early in the year (and beating the previous yearly record, set in 2021). Low net supply issuance and tighter CLO liability spreads were key catalysts behind the material uptick, driven by strong demand for AAA rated tranches from U.S. and Japanese banks and other institutional investors. The CLO market saw increased demand from third-party equity investors given the improved arbitrage. Meanwhile, CLO ETFs, which are a relatively recent phenomenon in the leveraged credit space, quickly grew to roughly $20 billion in 2024, further adding to the momentum. Looking ahead, we expect gross CLO issuance to continue at a strong clip in 2025, but off the record-breaking pace set in 2024, with total volume projected to be around $130-150 billion (Exhibit 5). Many of the key factors driving issuance last year are expected to remain in place; these include strong institutional and retail demand for yield, tighter AAA spreads, and continued demand from CLO equity providers.

**Exhibit 5: CLO issuance should continue at a healthy pace**

($ billions)



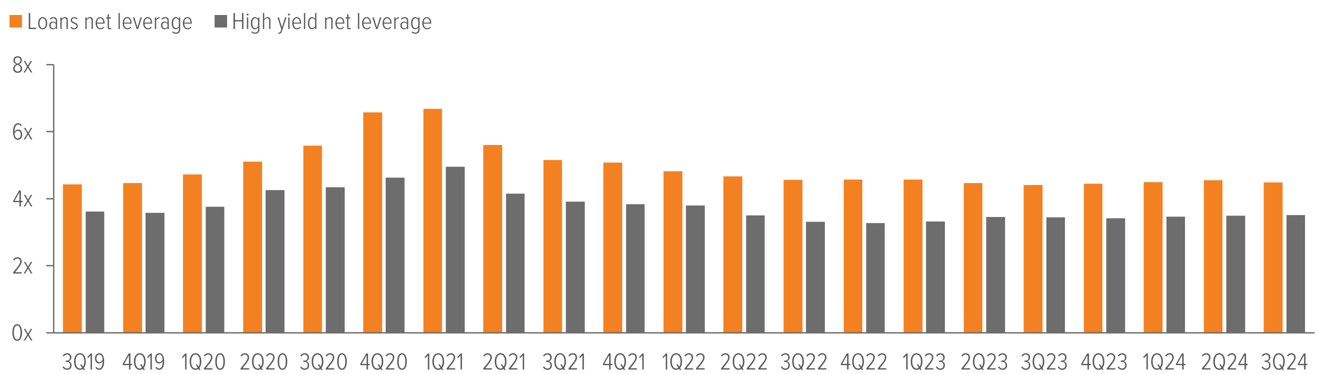

As of 12/31/24. Source: LCD, Morningstar.

## Fundamentals and defaults

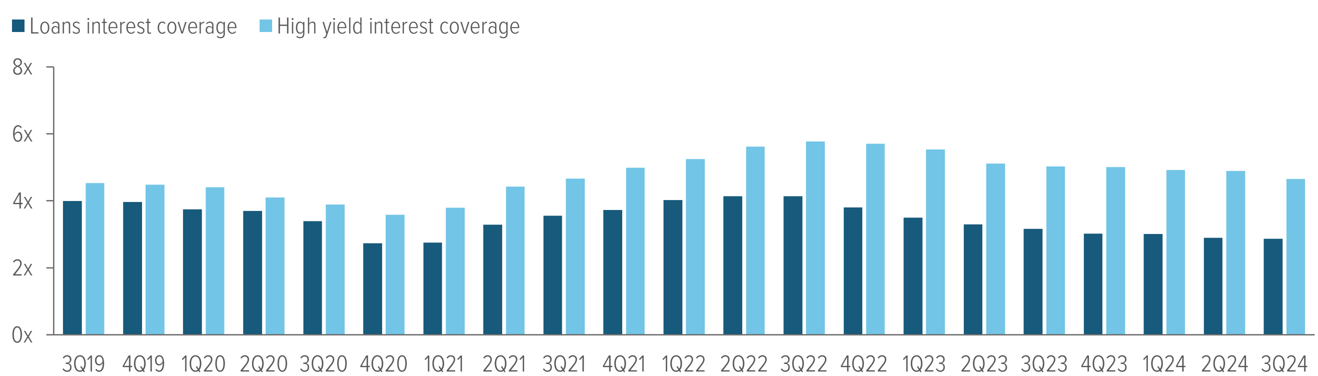
With the higher-rate backdrop, investor concerns have understandably focused on the impact of a "higher for longer" environment and assessing potential vulnerabilities in the more secularly challenged companies within leveraged credit. An ongoing counterbalance has been the unusually strong starting point in company fundamentals heading into this rate-hike cycle. This has provided a much-needed cushion, particularly in the loan market, where the transmission of rates was immediately felt. Still, fundamentals have clearly moved off cycle peaks and have moderated to pre-Covid levels across some metrics.

**Exhibit 6: Leverage ratios remain manageable, while interest coverage ratios have weakened considerably in the loan market**

Net leverage




Interest coverage



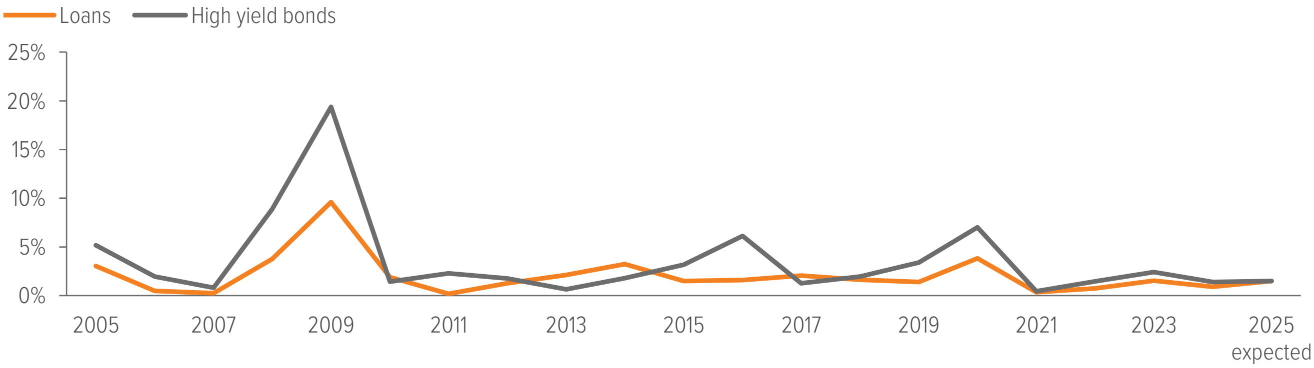

As of 09/30/24. Source: J.P. Morgan research. Loan data include both public and private borrowers tracked by J.P. Morgan. Interest coverage ratios represented by EBITDA/interest expense.

While leverage levels remained rangebound, interest coverage ratios degraded further in 2024 (Exhibit 6). Higher rates disproportionately impacted loan borrowers, while high yield issuers refinanced at higher coupon levels. As repricings reduced borrowing costs and the Fed began to ease rates, the pace of interest coverage degradation slowed in recent quarters. In general, we think there's room for further improvement in 2025 as the strong macro backdrop buoys earnings growth and financing costs decline further. Additionally, the prospect of a shift to more growth- and business-friendly policies by the new administration should provide additional support to corporate earnings over the coming quarters.

Similarly, we expect the default outlook to modestly improve in 2025 on the back of a positive macro environment. Using traditional default methods (e.g., bankruptcy filings and interest payment misses outside forbearance periods), we expect default levels across leveraged credit to remain muted and in line with current levels of around 1-2% (Exhibit 7), supported by healthy credit fundamentals. Of course, most loan default transactions recently have been in the form of distressed exchanges and LMEs given weaker documentation trends, driving the overall level of loan defaults higher in 2024. Using LCD's dual-rate tracker, which incorporates both traditional defaults and distressed exchanges, the combined loan default rate finished the year at 4.7%, having increased by 86 bp since the start of the year. While we expect defaults in the loan market again to skew heavily towards distressed exchanges, we don't expect them to continue at the same pace in 2025. The overall distressed cohort has decreased, both due to lower CCC percentages and fewer issuers trading at distressed levels (sub-80). Furthermore, private credit remains a refinancing avenue for select distressed borrowers facing liquidity challenges. Many low-single-B and CCC issuers have secured refinancing needs in the private credit market, thus alleviating some default pressures from the BSL market.

**Exhibit 7: Default activity should remain muted across leveraged credit**

Historical default rate




As of 12/31/24. Source: LCD, BofA Global Research. Default rates do not include distressed exchanges.

On the other hand, downgrade activity should remain prevalent, but we expect modestly improved ratings trends in 2025. Key contributing factors include a slowing in coverage ratio deterioration, a termed-out maturity wall and less restrictive financial conditions. Nonetheless, lower-quality issuers in stressed sectors will remain susceptible to downgrade risk and will warrant careful credit selection. When looking at both asset classes, loans will remain more vulnerable to downgrade risk relative to high yield. The proportion of credits rated B- and below remains elevated in the loan market, while the quality of the high yield market has improved in recent years, with more than half of the market now rated BB.[2]

## Risks, sector views and market opportunities

A healthy macro environment, supported by a focus on growth and deregulation, will be constructive for risk assets. Although downside risk has diminished recently, we remain attuned to a few potential headwinds that could create volatility. On the macro front, we believe the main risks are stalled inflation and lower consumer spending stemming from a weaker labor market. If inflation surprises to the upside, perhaps ignited by the proposed tariffs and immigration policies under President Donald Trump, the Fed will likely delay its cutting cycle, which would leave rates higher for longer and put additional stress on borrower balance sheets. Consumer spending has been a key driver of the U.S. growth story in the last few years, supported by a tight, albeit moderating, labor market and positive wealth effects. To the extent we see further softening in the labor market, consumer spending may pull back and lower the overall growth outlook.

Other areas we are watching include the evolving M&A landscape, as deregulation and a cheaper cost of capital may potentially ignite "animal spirits." This could lead to more aggressive corporate behavior and releveraging, which may ultimately pressure credit spreads and fundamentals. Lastly, there's no shortage of global geopolitical risks that warrant caution. In particular, uncertainties around U.S.-China relations remain an area of focus given the prospects for tariffs and ongoing trade tensions in the era of Trump 2.0. We believe the rhetoric from the administration will serve as a negotiating tactic, but actual policy will be watered down to have less of a negative impact. Uncertainty regarding the sequencing, magnitude and duration of proposed policies will create short-term disruptions, but market reaction will compel the administration to temper policies before they derail growth.

[2] As of 12/31/24. Source: LCD, Barclays, Bloomberg.

On the balance, the election outcome is expected to have positive implications for most industries within leveraged credit. The combination of expected fiscal policies, lower corporate tax rates and potential regulatory relief would provide a benefit to earnings. However, tariffs could pressure some sectors, including retail, autos, industrial/machinery, building products and other consumer-dependent segments. While utilization ratios continue to improve in health care, the outlook is mixed due to a more uncertain regulatory environment for the space. The outlook has improved for select pockets within the secularly challenged media and telecom sectors, but it's an area where careful selection remains critical. Moreover, we've become more constructive on cyclicals, but we prefer domestic-oriented cyclicals vs. global, with the view of U.S. growth outperforming other regions in 2025. Lastly, the energy space should continue to benefit from geopolitical uncertainty, assuming growth holds up.

The still elevated rate environment and dispersion within certain sectors will continue to result in a bifurcated market. As such, we believe the current environment will remain favorable for experienced credit pickers, with plenty of relative value opportunities. The right tail of the market will remain vulnerable to downgrade risk, but upside scenarios could develop if growth continues to surprise to the upside.

**Exhibit 8: We project that leveraged credit markets will deliver attractive returns in 2025, driven by high starting yields**

| | Senior loans | | High yield bonds | |
|---|---|---|---|---|
| | **12/31/2024** | **Projected 12/31/2025** | **12/31/2024** | **Projected 12/31/2025** |
| Rate (bp) | 447 | 400 | 435 | 425 |
| Spread (bp) | 341 | 325 | 314 | 300 |
| Coupon/yield (bp) | 788 | 725 | 749 | 725 |
| 2025 return projections | 7.5-8.0% | | 7.0-7.5% | |

As of 12/31/24. Source: LCD, Barclays, Bloomberg. Loans represented by the Morningstar LSTA U.S. Leveraged Loan Index. High yield bonds (HY) represented by the Bloomberg U.S. Corporate High Yield Index. Loan rate represented by a blended rate of SOFR contracts tracked by MarkIt partners; loan spread is LCD's nominal credit spread for the loan index. HY spread is the average spread of the HY index, while the rate component backs out spread from the yield-to-worst of the HY index. **Past performance is no guarantee of future results. Investors cannot invest directly in an index.**

## Conclusion: Return expectations

While there can be no guarantees of future performance, barring any unforeseen shocks, leveraged credit should deliver another year of attractive returns in 2025. Considering the market's high all-in carry, a relatively benign default cycle, and only modestly wider projected credit spreads, it's difficult to envision a scenario where the market prints negative total returns for an extended period of time, absent a more significant slowdown in growth.

The loan market enters the new year with a carry advantage and should continue to clip a historically elevated coupon, with only a few rate cuts expected in 2025. Loans also benefit from higher exposure to U.S.- centric businesses, which will keep them somewhat insulated from geopolitics and global macro events. As a result, we're slightly more constructive on loans in the first half of the year. However, the carry advantage should fade heading into the second half of the year given continued repricings and expected rate cuts, which should favor high yield. Although a range of scenarios could shift return outcomes, our base case projection is a total return range of 7.5-8.0% for loans and 7.0-7.5% for the high yield bond market (Exhibit 8). We expect high yield spreads to move off current tights, but this will be partially offset by rates likely moving lower. Broad market volatility will remain a prominent theme as the credit cycle matures. With increased bifurcation, individual credit selection will remain a key driver of performance.

### A note about risk

**Principal risks for senior loans:** All investing involves risks of fluctuating prices and the uncertainties of rates of return and yield. Voya's senior loan strategies invest primarily in below investment grade, floating rate senior loans (also known as "high yield" or "junk" instruments), which are subject to greater levels of liquidity, credit and other risks than are investment grade instruments. There is a limited secondary market for floating rate loans, which may limit a strategy's ability to sell a loan in a timely fashion or at a favorable price. If a loan is illiquid, the value of the loan may be negatively impacted and the manager may not be able to sell the loan in order to meet redemption needs or other portfolio cash requirements. The value of loans in the portfolio could be negatively impacted by adverse economic or market conditions and by the failure of borrowers to repay principal or interest. A decrease in demand for loans may adversely affect the value of the portfolio's investments, causing the portfolio's net asset value to fall. Because of the limited market for floating rate senior loans, it may be difficult to value loans in the portfolio on a daily basis. The actual price the portfolio receives upon the sale of a loan could differ significantly from the value assigned to it in the portfolio. The portfolio may invest in foreign instruments, which may present increased market, liquidity, currency, interest rate, political, information and other risks. These risks may be greater in the case of emerging market loans. Although interest rates for floating rate senior loans typically reset periodically, changes in market interest rates may impact the valuation of loans in the portfolio. In the case of early prepayment of loans in the portfolio, the portfolio may realize proceeds from the repayment that are less than the valuation assigned to the loan by the portfolio. In the case of extensions of payment periods by borrowers on loans in the portfolio, the valuation of the loans may be reduced. The portfolio may also invest in other investment companies and will pay a proportional share of the expenses of the other investment company.

**Principal risks for high yield bonds:** All investing involves risks of fluctuating prices and the uncertainties of rates and return and yield inherent in investing. High yield securities, or "junk bonds," are rated lower than investment grade bonds because there is a greater possibility that the issuer may be unable to make interest and principal payments on those securities. As interest rates rise, bond prices may fall, reducing the value of the portfolio's share price. Debt securities with longer durations tend to be more sensitive to interest rate changes than debt securities with shorter durations. Other risks of the portfolio include, but are not limited to, credit risk, other investment companies risks, price volatility risk, the inability to sell securities and securities lending risks.

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### Index definitions

An investor cannot invest directly in an index, and index performance does not reflect the deduction of any fees, expenses or taxes. Index comparisons have limitations, as volatility and other characteristics may differ from a particular investment. The S&P 500 Index is an unmanaged index that measures the performance of securities of approximately 500 of the largest companies in the United States. The Nasdaq Composite Index measures all domestic and international common stocks listed on the Nasdaq Stock Market. The Bloomberg U.S. Treasury Index is an unmanaged index that includes public obligations of the U.S. Treasury. Treasury bills and certain special issues, such as state and local government series (SLGS) bonds, as well as U.S. Treasury TIPS and STRIPS, are excluded. The Bloomberg U.S. Corporate Index measures the performance of investment grade, USD-denominated, fixed-rate, taxable corporate bond market securities. The Morningstar LSTA Leveraged Loan Index is an unmanaged total return index that captures accrued interest, repayments and market value changes. The Bloomberg U.S. High Yield Index covers the universe of fixed-rate, non–investment grade debt. Eurobonds and debt issues from countries designated as emerging markets are excluded, but Canadian and global bonds of issuers in non-EMG countries are included. The Bloomberg Corporate High Yield Index is an unmanaged index that measures the performance of fixed income securities generally representative of corporate bonds rated below investment grade. Bloomberg® is a trademark and service mark of Bloomberg Finance L.P. and its affiliates (collectively "Bloomberg"). Bloomberg or Bloomberg's licensors own all proprietary rights in the Bloomberg Indexes. Bloomberg does not approve or endorse this material, nor guarantee the accuracy or completeness of any information herein, nor make any warranty, express or implied, as to the results to be obtained therefrom and, to the maximum extent allowed by law, shall not have any liability or responsibility for injury or damages arising in connection therewith.



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