

Morningstar Leveraged Loan Monitor: Q3 2025

Rate cuts drive spreads to multiyear lows.

Morningstar

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Executive Summary

This is the latest installment of the Morningstar Leveraged Loan Monitor, which is designed to help investors stay on top of the latest trends in the leveraged loan market as tracked through the lens of three Morningstar Leveraged Loan Indexes: Morningstar LSTA US Leveraged Loan Index, Morningstar European Leveraged Loan Index, and Morningstar Global Leveraged Loan Index.

Key Takeaways

- ▶ The third quarter of 2025 marked a policy pivot by the Federal Reserve, which shifted its focus toward sustaining economic growth over curbing inflation, by reducing the federal funds rate by 25 basis points.
- ▶ The Bank of England implemented a 25 basis points cut, bringing the policy rate to 4% at the August 2025 Monetary Policy Committee meeting. In comparison, the European Central Bank, or ECB, kept the key ECB rates unchanged, maintaining the deposit facility rate at 2%.
- ▶ Shorter-maturity Treasury yields declined by an average of 35 basis points, while longer-maturity yields decreased more modestly, falling only 8 basis points.
- ▶ The Morningstar LSTA US Leveraged Loan Index provided the best risk/return characteristics over the third quarter of 2025 driven by increased demand in the loan market and comparatively higher base rates prevailing in the US.
- ▶ US leveraged loan spreads continued to tighten in the third quarter, extending the compression from April highs. In contrast, European leveraged loan spreads widened slightly but remain near long-term lows.
- ▶ Leveraged loan issuance gained momentum throughout the quarter. In the US, issuance reached USD 347 billion, an increase from USD 97 billion in the previous quarter. Similarly, European new issuances rose to EUR 72 billion, up from EUR 26 billion in the previous quarter.
- ▶ Returns across all rating cohorts in the US leveraged loan market were relatively uniform. In contrast, higher-rated cohorts outperformed their lower-rated counterparts in the European leveraged loan market.

Market Update

Federal Reserve Cuts Rates to Fuel Growth

The Fed reduced the target federal-funds rate by 25 basis points to 4% from 4.25% in the September 2025 Federal Open Market Committee meeting.

Real gross domestic product grew in the second quarter of 2025 by 3.8% compared with a 0.6% decline in the first quarter of 2025.¹ The projections for annual real GDP growth in 2025 increased to 1.6% from an earlier projection of 1.4%. Personal Consumption Expenditures inflation projections were unchanged.²

Cooling in the job market played a significant role in facilitating the Fed's decision to reduce interest rates. Despite inflation remaining slightly elevated, the Fed made the decision to pivot toward supporting economic growth and maintaining stable employment.

Bank of England Pauses After August Rate Cut Amid Sluggish Growth

The Bank of England cut interest rates by 25 basis points to 4% at the Monetary Policy Committee meeting in August 2025, then held rates steady in September.

The UK's real GDP witnessed an increase of only 0.3% in the second quarter of 2025, indicating a slight slowdown compared with the 0.7% growth recorded in the previous quarter. Some economic activity was accelerated into February and March in anticipation of US tariff adjustments.

The second quarter of 2025 reflected modest economic growth but sticky inflation. Following the August rate cut, the Bank of England made the decision to wait for clearer evidence of sustained disinflation before further adjusting policy.

European Central Bank Keeps Rates Unchanged

The European Central Bank decided to keep the three key ECB rates unchanged in the July and September Monetary Policy meetings. The Deposit Facility Rate stands at 2%, the Main Refinancing Operations rate at 2.15%, and the Marginal Lending Facility rate at 2.4%.

The euro area's real GDP grew by 0.7% in the first half of 2025 on account of resilience in the domestic market. The first quarter saw strong growth of 0.6%, whereas the second quarter saw marginal growth of 0.1%, mainly due to the frontloading of the international trade ahead of tariff implementations. Unemployment rate stood at 6.2% in July down from 6.3% in May, showing strength in the European labor market.

¹ Data source for GDP growth rates: Bureau of Economic Analysis, US Department of Commerce, released on Sept. 25, 2025.

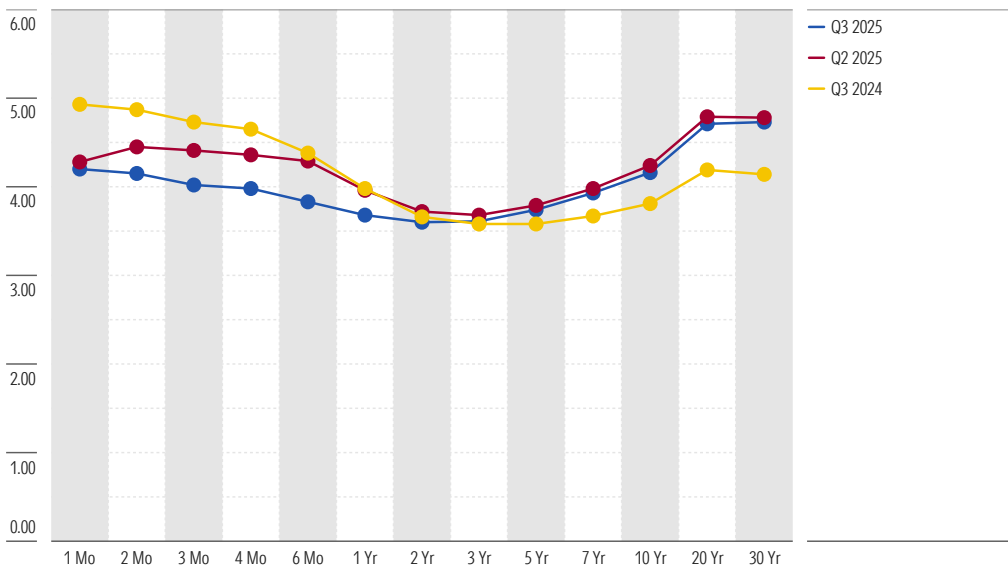
² Real GDP growth rates projections data source: FOMC Projection Material, Federal Reserve.

Inflation remained within the ECB's 2% target in the third quarter, with the headline Consumer Price Index holding steady at 2% in July and August. European Central Bank projections see inflation averaging 2.1% in 2025 before declining closer to the target in 2026, while GDP growth for 2025 is expected to be 1.2% up from the previous projection of 0.9%.³

US Yield Curve and Interest Rate Movement Summary

In the third quarter of 2025, short-term interest rates declined sharply following the Fed's rate cut, with Treasury yields up to one year falling by an average of 35 basis points. Longer-maturity-term yields beyond 10 years saw a more modest decline of 8 basis points, while medium-term maturities between two and seven years fell by an average of 7 basis points. The yield curve witnessed marginal steepening, specifically in the shorter end of the curve over quarter. However, a more pronounced steepening trend has occurred over the past 12 months.

Exhibit 1 Yield Curve (%)



Source: US Department of Treasury. Data as of Sept. 30, 2025.

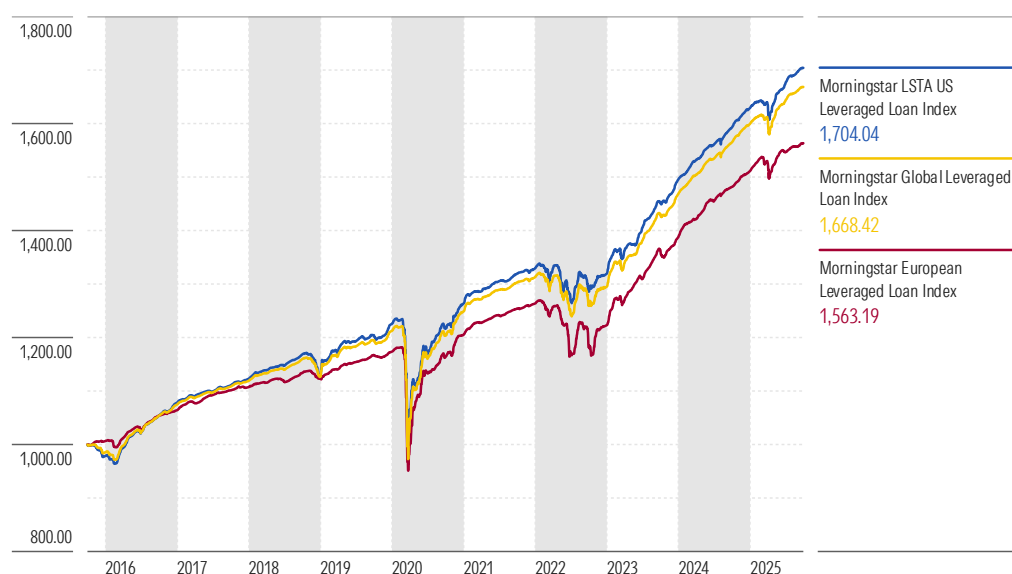
³ Growth, unemployment rate, and inflation data source: ECB September Monetary Policy Statement

Leveraged Loans Insights

Morningstar Leveraged Loan Indexes Performance Summary

Over the past 10 years, the Morningstar LSTA US Leveraged Loan Index has delivered the strongest overall returns, coupled with lower risk, as illustrated in Exhibits 2 and 3. The Morningstar Global Leveraged Loan Index, a fixed-weight composite comprising 75% from the Morningstar LSTA US Leveraged Loan Index and 25% from the Morningstar European Leveraged Loan Index, exhibits risk/return characteristics that closely mirror those of its primary contributor.

Exhibit 2 Performance Chart of Morningstar Leveraged Loan Indexes



Source: Morningstar Indexes. Data as of Sept. 30, 2025. TR LCL Variant.

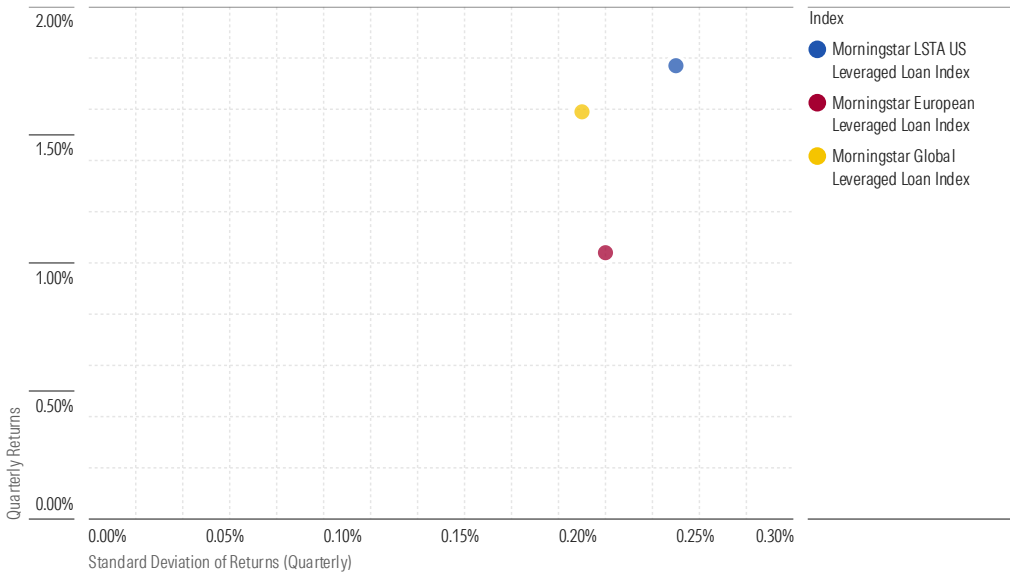
Exhibit 3 Risk/Return Characteristics

Parameters	Morningstar LSTA US Leveraged Loan Index	Morningstar European Leveraged Loan Index	Morningstar Global Leveraged Loan Index
Start Date	2015-09-30	2015-09-30	2015-09-30
End Date	2025-09-30	2025-09-30	2025-09-30
Return (%)	5.47	4.57	5.25
Risk (%)	5.41	6.37	5.57

Source: Morningstar Indexes. Data as of Sept. 30, 2025. TR LCL Variant.

The comparative risk/return performance of the Morningstar Indexes over the third quarter is shown in Exhibit 4. In the third quarter, market volatility declined compared with the second quarter, as the effects of tariffs began to stabilize. The Morningstar LSTA US Leveraged Loan Index led performance in the third quarter, with an impressive 1.8% return, followed by the Morningstar Global Leveraged Loan Index, which gained 1.6%. These positive results were primarily driven by increased demand, spurred by a surge in US institutional loan activity and a record repricing wave in Europe.

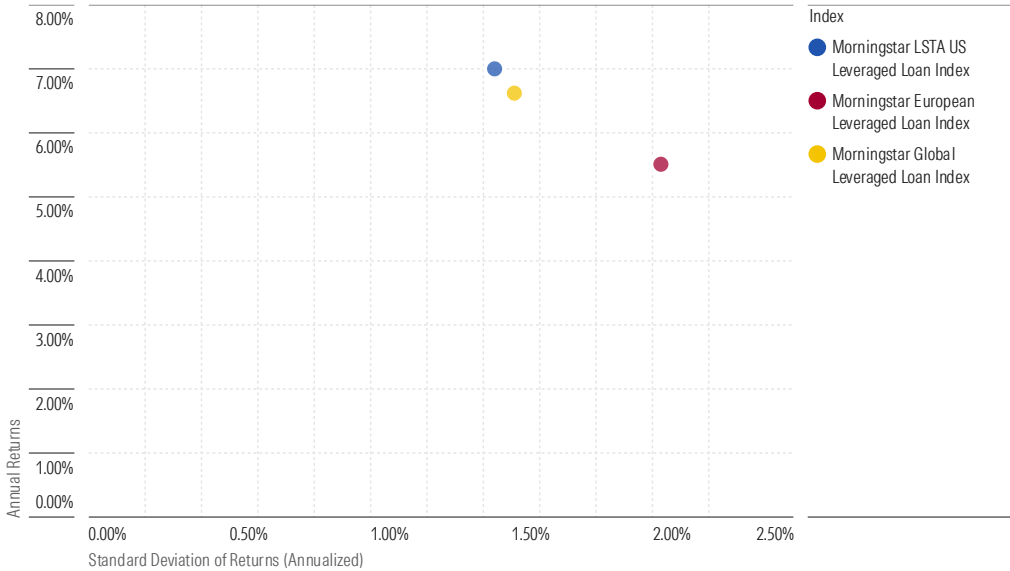
Exhibit 4 Third-Quarter 2025 Performance



Source: Morningstar Indexes. Data as of Sept. 30, 2025. TR LCL Variant.

Exhibit 5 highlights the comparative performance over the previous 12 months. The Morningstar LSTA US Leveraged Loan Index provided the best risk/return characteristics due to comparatively higher base rates prevailing in the US. Over the past 12 months, European leveraged loans experienced greater volatility, reflected in the higher risk and weaker returns of the Morningstar European Leveraged Loan Index. Meanwhile, returns of the Morningstar Global Leveraged Loan Index trailed the US, while exhibiting marginally higher volatility, largely due to the influence of European loans.

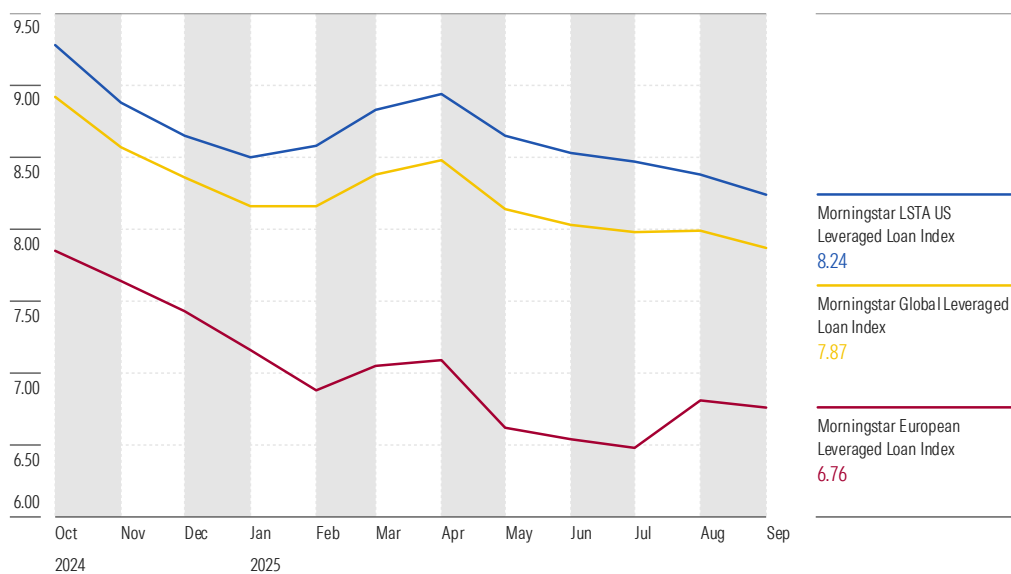
Exhibit 5 12-Month Performance Ending Sept. 30, 2025



Source: Morningstar Indexes. Data as of Sept. 30, 2025. TR LCL Variant.

Leveraged Loan Yields Continue to Ease After April Tariff-Driven Spike

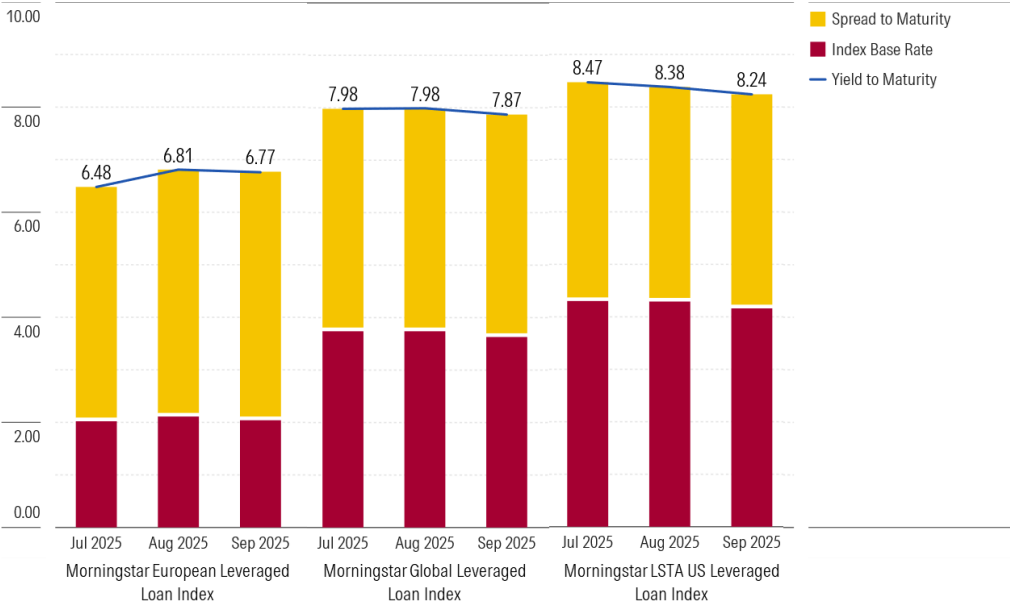
As seen in Exhibit 6, the yield to maturity for leveraged loans continued to decline from record highs in April 2025. By the end of September, the yield to maturity for the Morningstar LSTA US Leveraged Loan Index fell to 8.24%, a decrease from April's 9.43% reading. The Morningstar European Leveraged Loan Index followed a similar pattern, with the yield to maturity declining to 6.76% in September, compared with 7.67% in April.

Exhibit 6 Yield to Maturity (%)

Source: Morningstar Indexes. Data as of Sept. 30, 2025.

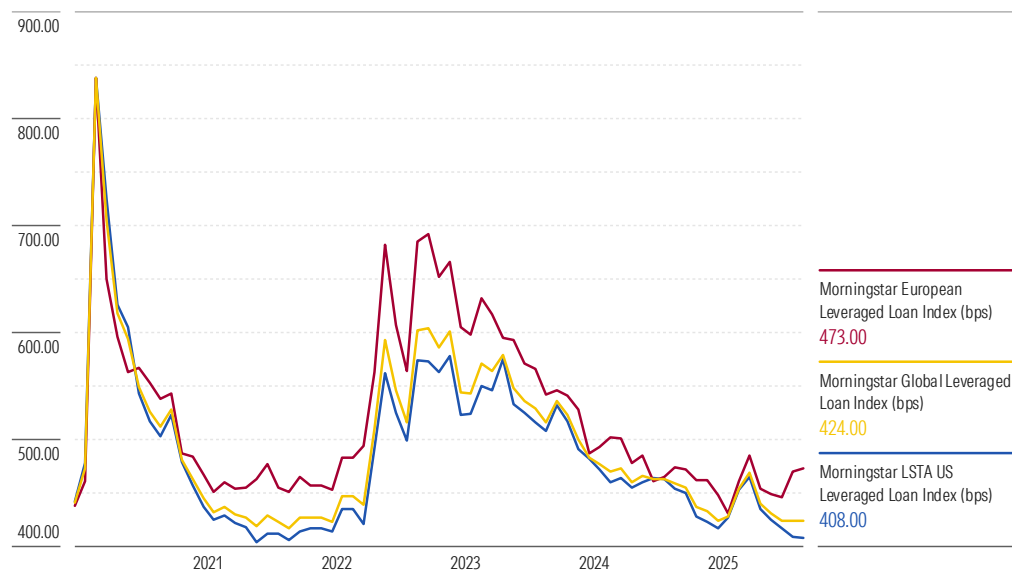
Exhibit 7 illustrates the impact of the Fed's September rate cut, which led to a decline in base rates for US leveraged loans and resulted in a lower yield to maturity for the index. During the quarter, the spread to maturity narrowed by 17 basis points in the US and 6 basis points for the Morningstar Global Leveraged Loan Index. In contrast, the yield for the Morningstar European Leveraged Loan Index rose by 24 basis points in the third quarter, reversing part of the approximately 70-basis-point contraction from April highs.

Exhibit 7 Third-Quarter 2025, Yield to Maturity, Spread to Maturity, Index Base Rate



Source: Morningstar Indexes. Data as of Sept. 30, 2025.

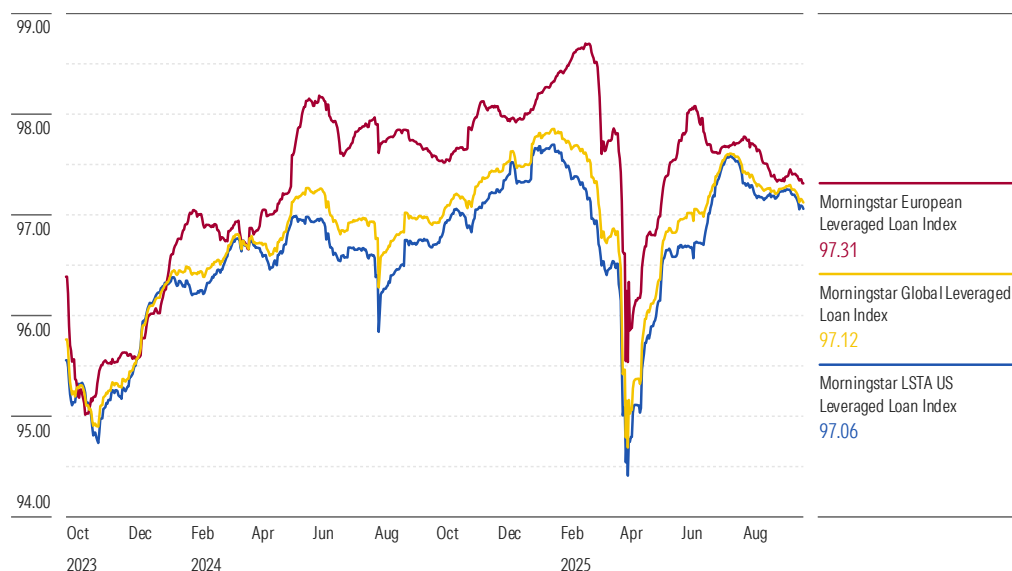
As shown in Exhibit 8, US leveraged loan spreads continued to tighten in the third quarter, extending the downward trend after reaching record results in April. In contrast, European leveraged loan spreads edged slightly higher but remained close to historically compressed levels.

Exhibit 8 Spread to Maturity for Morningstar Leveraged Loan Indexes

Source: Morningstar Indexes. Data as of Sept. 30, 2025.

Leveraged Loan Prices Rebound From April Lows

Across both the US and European markets, leveraged loans demonstrated a notable recovery since April, as seen in Exhibit 9. By quarter-end, prices rebounded by more than 2.0 points above the April troughs, closing at 97.06 for the Morningstar LSTA US Leveraged Loan Index, 97.12 for the Morningstar Global Leveraged Loan Index, and 97.31 for the Morningstar European Leveraged Loan Index.

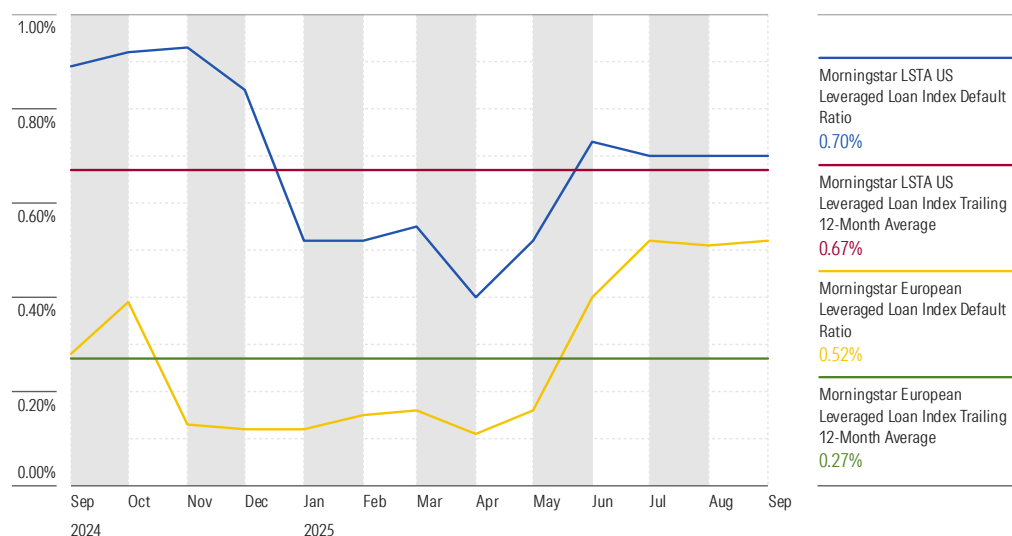
Exhibit 9 Weighted Average Bid Price

Source: Morningstar Indexes. Data as of Sept. 30, 2025. In USD.

Default Ratios See Spike After Altice France and First Brands Defaults

As shown in Exhibit 10, the default ratio⁴ for both the Morningstar LSTA US Leveraged Loan Index and the Morningstar European Leveraged Loan Index trended downward through the first half of the year. This trajectory changed in June, following the default of Altice France on its USD 5.6 billion and EUR 1.6 billion loans. A second significant default occurred in September, when First Brands failed to meet obligations on its USD 4.4 billion and EUR 0.6 billion loans. These events triggered sharp increases in the default ratios, pushing both indexes about their respective trailing 12-month averages.

Exhibit 10 Default Ratio: Morningstar Leveraged Loan Indexes



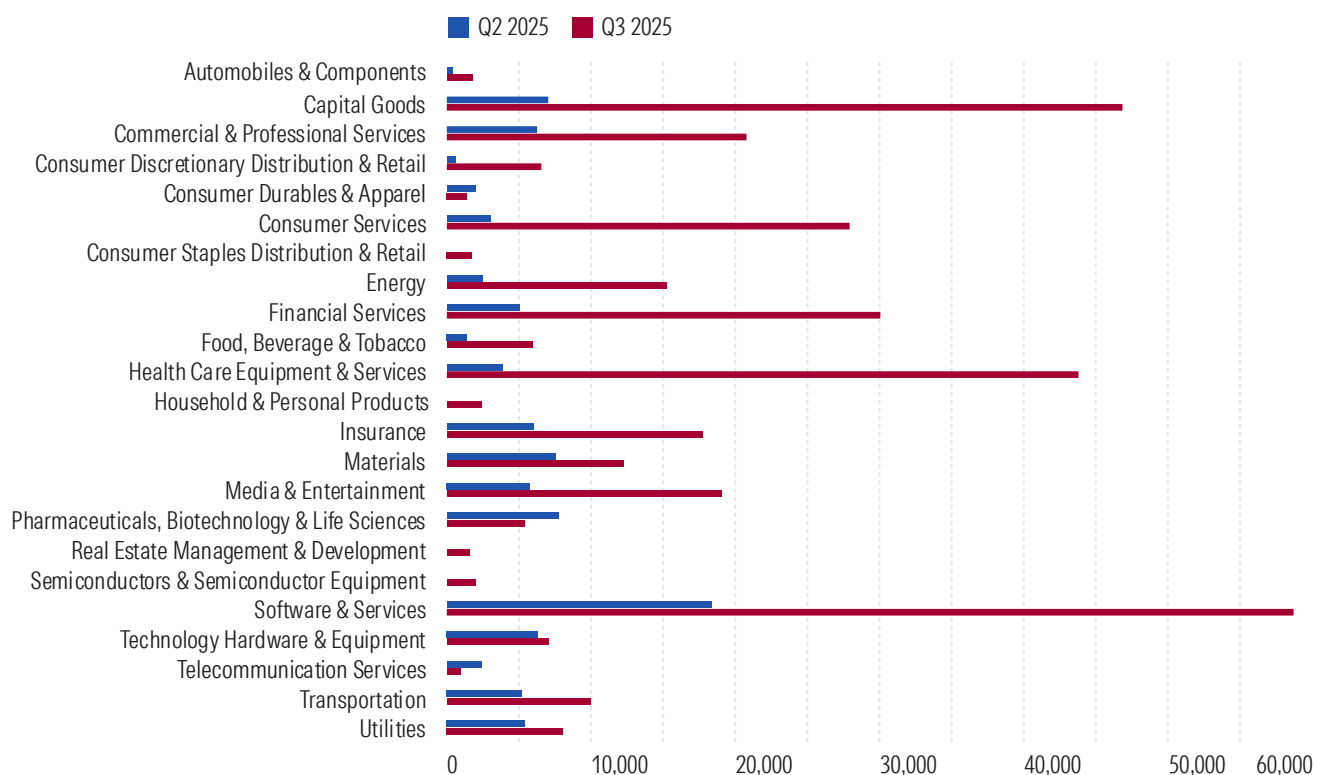
Source: Morningstar Indexes. Data as of Sept. 30, 2025.

Sector Spotlight

Software Tops US Leveraged Loan Issuance; Health Care Leads in Europe for Q3 2025

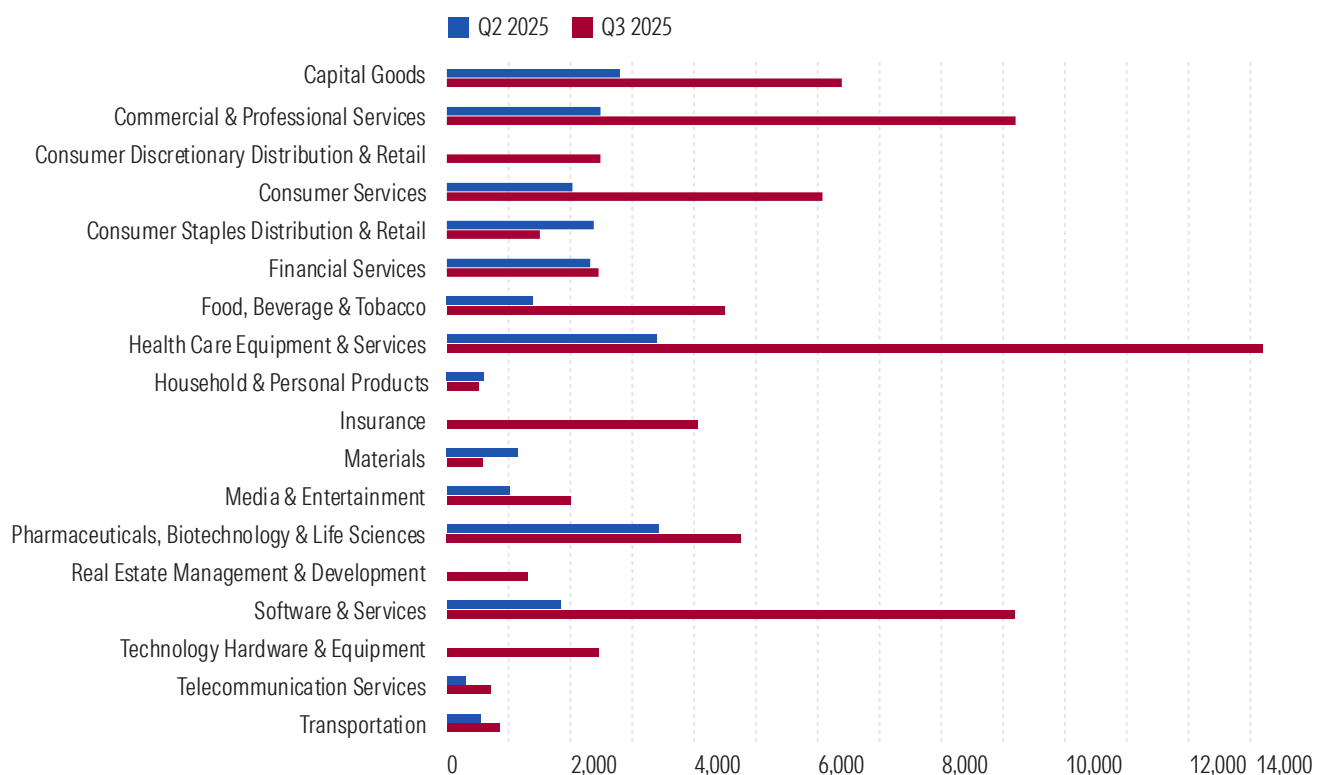
New loan activity gained momentum during the quarter. According to the Morningstar LSTA US Leveraged Loan Index, USD 347 billion in new loan issuances were added, more than triple the USD 97 billion recorded in the second quarter. The most active sectors included software & services, capital goods, and healthcare, as shown in Exhibit 11. Among the leading issuers were Medline Industries and Cloud Software Group, issuing USD 7.6 billion and USD 6.4 billion, respectively.

⁴ The default ratio is calculated as the total amount outstanding of defaulted loans divided by the total amount outstanding of all the loans in the index on each effective date. Monthly default ratios are obtained by averaging the daily default ratios within each calendar month. The 12-month average default ratio is computed as the trailing 12-month average of these monthly ratios.

Exhibit 11 New Issuances: Morningstar LSTA US Leveraged Index (USD Million)

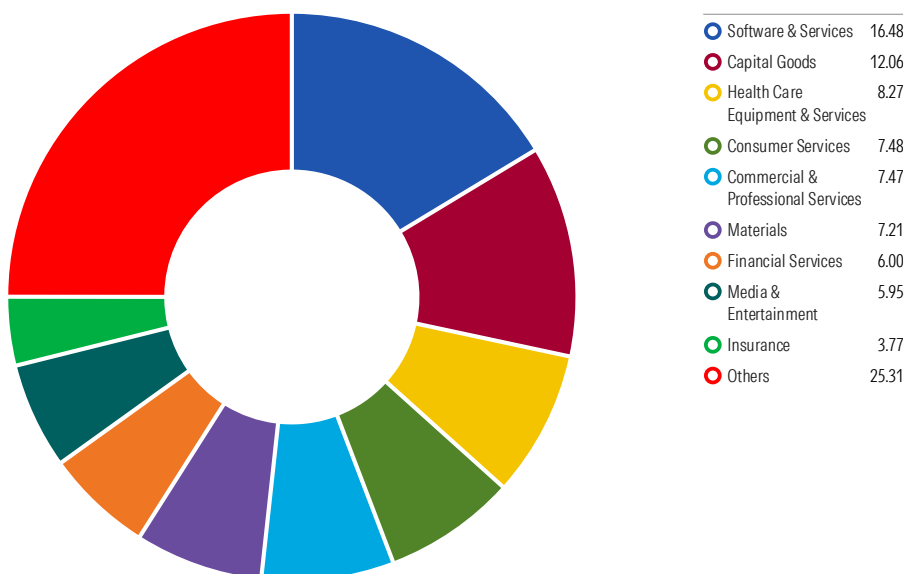
Source: Morningstar Indexes. Data as of Sept. 30, 2025.

The European leveraged loan market also experienced a notable pickup in issuance activity. According to the Morningstar European Leveraged Loan Index, new loan issuances in the third quarter totaled EUR 72 billion, a significant rise from the EUR 26 billion added in the second quarter. The healthcare and commercial and professional services sectors led the activity, as illustrated in Exhibit 12. Leading the momentum were IFCO Systems NV and Stada, issuing EUR 2.4 billion and EUR 2.3 billion, respectively.

Exhibit 12 New Issuances: Morningstar European Leveraged Index (EUR Million)

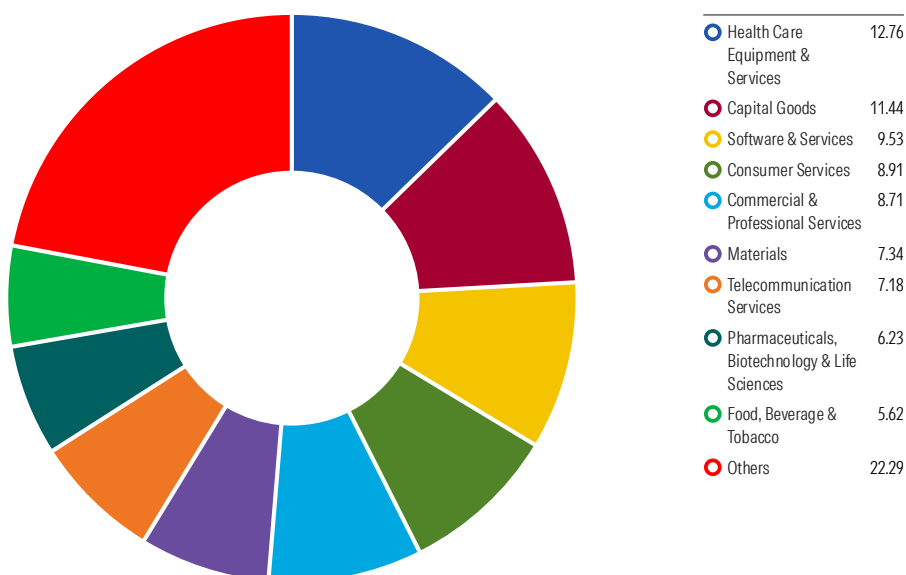
Source: Morningstar Indexes. Data as of Sept. 30, 2025. TR LCL Variant.

As shown in Exhibit 13, the largest sector exposures within the Morningstar LSTA US Leveraged Loan Index include software & services, capital goods, healthcare, and commercial & professional services, which collectively account for approximately 45% of the index's total market value.

Exhibit 13 Morningstar LSTA US Leveraged Loan Index Sector Distribution

Source: Morningstar Indexes. Data as of Sept. 30, 2025. TR LCL Variant.

A similar sector concentration is observed in Europe, as illustrated in Exhibit 14, where healthcare, capital goods, software & services, and consumer services sectors represent the largest exposures within the Morningstar European Leveraged Loan Index, encompassing approximately 43% of the index's total market value.

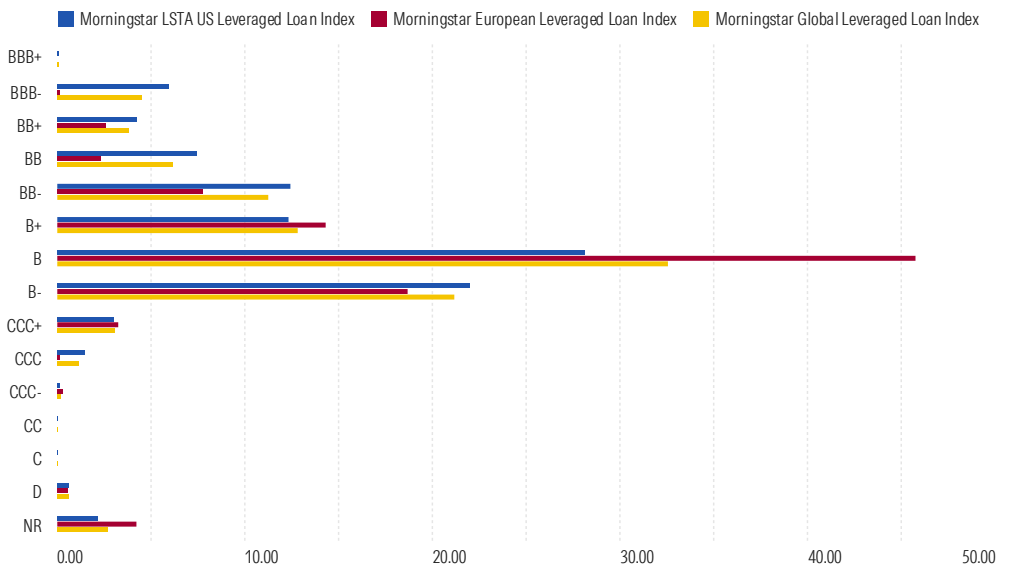
Exhibit 14 Morningstar European Leveraged Loan Index Sector Distribution

Source: Morningstar Indexes. Data as of Sept. 30, 2025. TR LCL Variant.

Credit Ratings Radar

Exhibit 15 breaks down the credit quality composition of the loan market, highlighting that single-B rated loans constitute the largest share across the Morningstar Leveraged Loan Indexes. This ratings cohort comprises 63% of the Morningstar LSTA US Leveraged Loan Index, 79% of the Morningstar European Leveraged Loan Index, and 67% of the Morningstar Global Leveraged Loan Index.

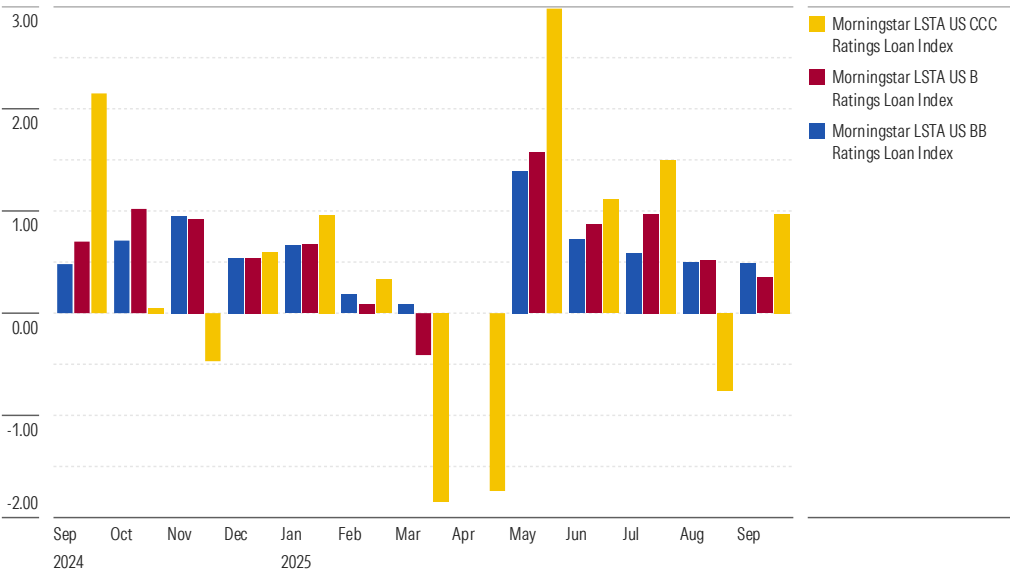
Exhibit 15 Morningstar Leveraged Loan Indexes Rating Distribution



Source: Morningstar Indexes. Data as of Sept. 30, 2025. TR LCL Variant.

As observed in Exhibit 16, returns across all US leveraged loan rating cohorts were relatively uniform in the third quarter. The Morningstar LSTA US B Ratings Loan Index, which tracks loans with B- to B+ ratings, led the pack with a return of 1.85%. Triple-C rated loans, measured by the Morningstar LSTA US CCC Ratings Loan Index, followed closely with a return of 1.7%. Represented by the Morningstar LSTA US BB Ratings Loan Index, double-B credits, delivered a return of 1.59% for the quarter.

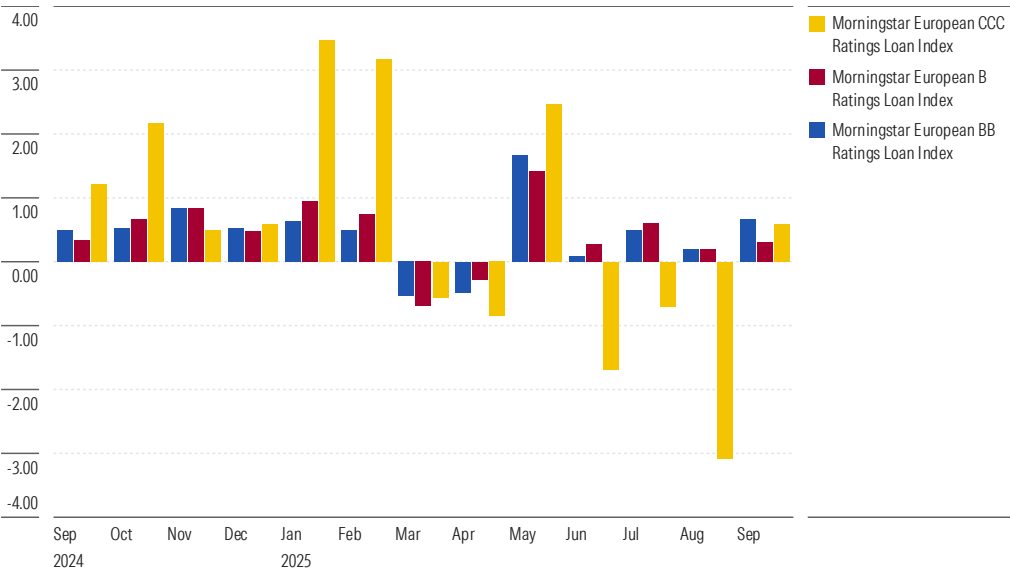
Exhibit 16 Morningstar LSTA US Leveraged Loan Index Monthly Returns by Loan Rating



Source: Morningstar Indexes. Data as of Sept. 30, 2025. TR LCL Variant.

In contrast to the US market, performance in the European leveraged loan was more differentiated by credit quality; only the highest-rated loans outperformed during the quarter. Double-B credits, as measured by the Morningstar European BB Ratings Loan Index, led with a return of 1.37%. Single-B credits, tracked by the Morningstar European B Ratings Loan Index, followed with a return of 1.1%. Meanwhile, the Morningstar European CCC Ratings Loan Index, which measures Triple-C loans, was the weakest performer, posting a negative3.2% loss for the quarter.

Exhibit 17 Morningstar European Leveraged Loan Index Monthly Returns by Loan Rating



Source: Morningstar Indexes. Data as of Sept. 30, 2025. TR LCL Variant.

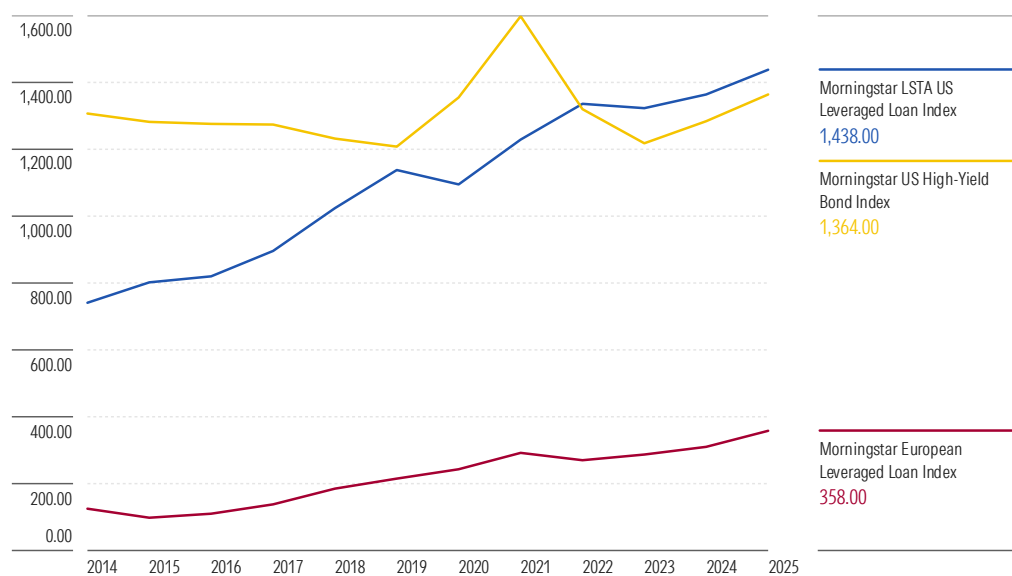
Comparison With Traditional Fixed-Income Benchmarks

Decade-Long Evolution of Leveraged Loans and High-Yield Bonds

Exhibit 18 highlights market value trends for the US leveraged loan, US high-yield bond, and European leveraged loan markets from 2014 to 2025. The US leveraged loan market represented by the Morningstar LSTA US Leveraged Loan Index has shown consistent growth, reaching a market value of USD 1.44 trillion as of September 2025. In contrast, the US high-yield bond market, according to the Morningstar US High Yield Bond Index, experienced a sharp rise, peaking at USD 1.62 trillion in 2021, followed by a notable contraction and eventual stabilization at USD 1.36 trillion in 2025. The European leveraged loan market, while much smaller in scale at USD 358 billion (EUR 329 billion), demonstrated steady growth since 2014.

These trends highlight the relative resilience of the US loan market compared with the more cyclical nature of high-yield bonds while also underscoring the steady development of the European loan market.

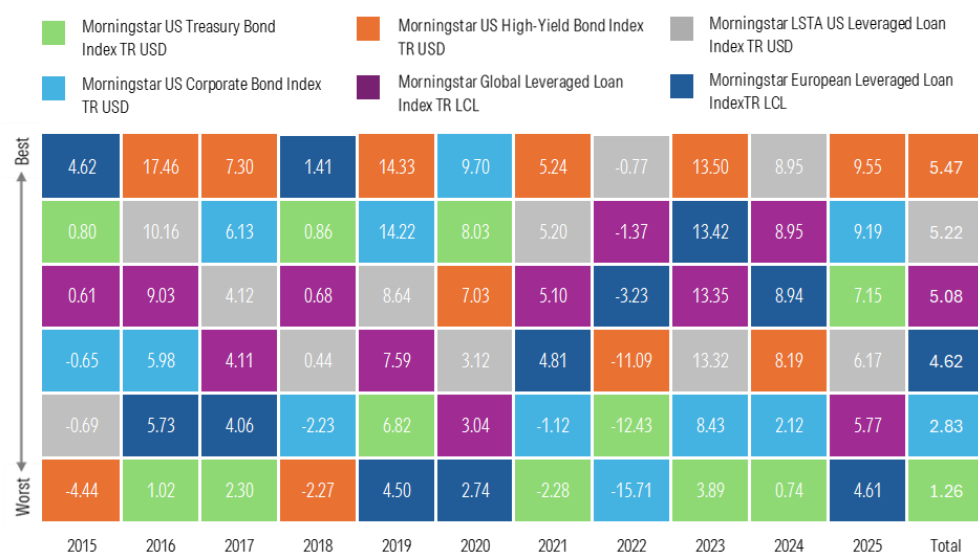
Exhibit 18 Market Value in USD Billion



Source: Morningstar Indexes. Average Daily Market Value for the Year. Data as of Sept. 30, 2025. USD.

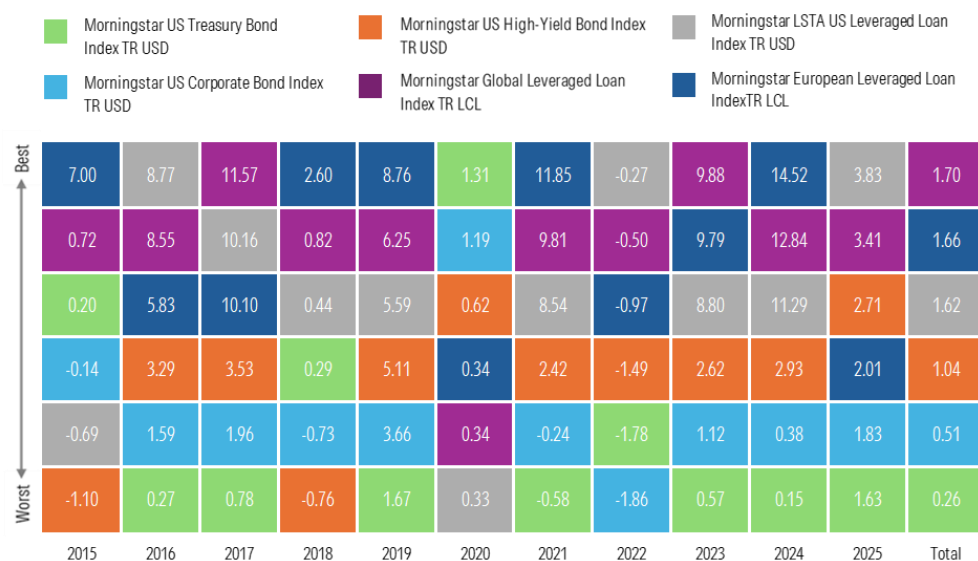
Horizon Returns

Exhibit 19 compares the performance of traditional fixed-income asset classes with leveraged loans over the past decade. While the Morningstar US High-Yield Bond Index has delivered the highest overall returns, the Morningstar LSTA US Leveraged Loan Index, the Morningstar Global Leveraged Loan Index, and the Morningstar European Leveraged Loan Index closely follow.

Exhibit 19 Horizon Returns

Source: Morningstar Indexes. Data as of Sept. 30, 2025.
 2025 Horizon - Annualized Returns (Data as of Sept. 30, 2025).
 Period for Total - Dec. 31, 2014 to Sept. 30, 2025.

Although the Morningstar US High-Yield Bond Index demonstrates strong absolute returns, its performance is less compelling when volatility is considered. Exhibit 20 provides a risk-adjusted performance comparison between traditional fixed-income indexes and leveraged loans. Notably, the Morningstar Global Leveraged Loan Index emerges as one of the top performers, supported by its stable return profile and lower volatility due to the floating-coupon payment structure. The US and European Leveraged Loan Indexes also show favorable risk-adjusted results, outperforming traditional fixed-income benchmarks and reinforcing the relative resilience of the loan market.

Exhibit 20 Return/Risk Performance

Source: Morningstar Indexes. Data as of Sept. 30, 2025.

2025 Horizon - Annualized Returns and Risk (Data as of Sept. 30, 2025)

Period for Total - Dec. 31, 2014 to Sept. 30, 2025

Reliable Benchmarks in a Dynamic Credit Market

Amid shifting interest rate cycles and evolving credit conditions, the Morningstar Leveraged Loans Indexes continue to serve as a reliable benchmark for tracking performance across US, European, and global loan markets, now a significant component of the broader fixed-income universe. The indexes capture the nuances of credit quality, sector allocation, and regional risk premiums, enabling investors to analyze trends and manage exposures effectively. By providing consistent, transparent coverage, the index suite supports informed decision-making in one of the most dynamic segments of the fixed-income market. For more information, visit <https://indexes.morningstar.com/leveraged-loan>.

About Morningstar Indexes

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