Europe's Leveraged Loan Market Comes of Age

The Morningstar European Leveraged Loan Index highlights a growing asset class popular with credit investors.

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Once a niche asset class, bank loans have entered the mainstream. Measured by the Morningstar European Leveraged Loan Index,[1] the market value for broadly syndicated loans, typically structured as senior secured corporate debt, has more than tripled over the past decade. In the US, the asset class is now larger than high-yield bonds, while in Europe, the two markets are of similar size. The comparison is relevant because leveraged loans share many characteristics with sub-investment-grade corporate debt. Both are favorites of credit investors.

There are key differences between the two asset classes, though, which have important implications. Leveraged loans are floating-rate in nature, whereas high-yield bonds typically have fixed-rate coupons, making them more price-sensitive to shifts in the yield curve. So, when central banks started hiking interest rates in 2022 and government-bond yields followed suit, the Morningstar Eurozone High-Yield Bond Index[2] declined nearly 11% on a total-return basis. By contrast, the European Leveraged Loan Index lost 3.5% that year. Meanwhile, leveraged-loan yields surpassed 9% in 2023.

Bank loans are not without risk. Their economic sensitivity was on display during the global financial crisis beginning in 2007, then again during the "pandemic panic" of March 2020, and amidst the market turmoil of 2025. That said, loans are interesting from a diversification perspective. Though many investors like to allocate to the asset class tactically, there's reason to consider a strategic allocation.

Key Takeaways

- The European leveraged loan market has grown significantly, as it has in the US. A range of industries and geographies are represented in the Morningstar European Leveraged Loan Index. Financing demand from private equity-backed borrowers and buying demand from collateralized loan obligations are key growth catalysts. Some investors use the asset class as a parking lot for private credit allocations.
- Thanks to higher interest rates, the Morningstar European Leveraged Loan Index's yield to maturity exceeds that of the Morningstar Eurozone High-Yield Bond Index by a substantial margin.
- Credit risk is a feature of the asset class. The Morningstar European Leveraged Loan Index's credit-quality profile is lower than that of its high-yield bond counterpart. The index has declined sharply in periods of economic stress, though overall volatility has been lower than that of high-yield bonds.
- Leveraged loans' low correlation with equities and government bonds gives them diversification appeal.

1 For a full discussion of index methodology, see " Morningstar Leveraged Loan Indexes Methodology."
2 For a full discussion of index methodology, see "Construction Rules for the Morningstar Bond Indexes."

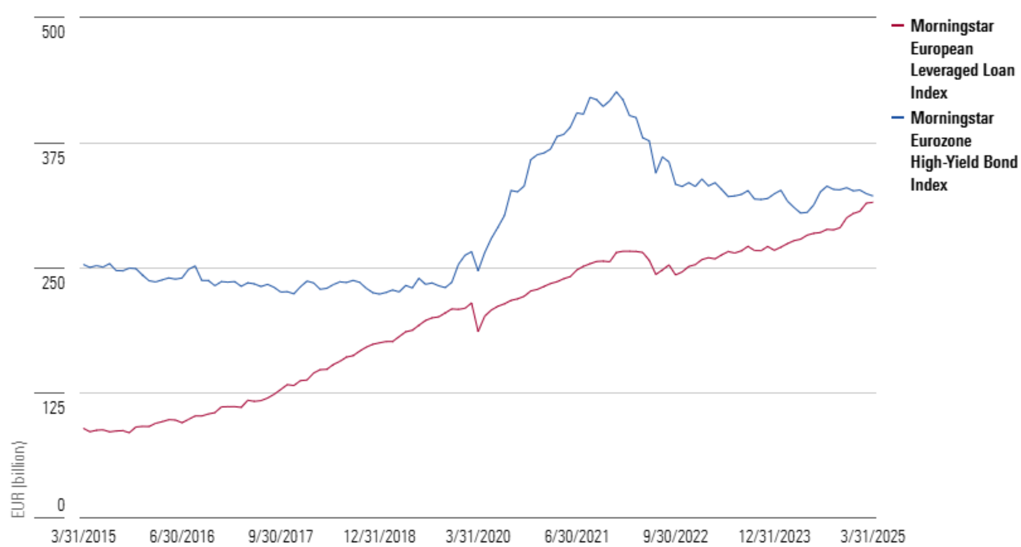
Leveraged Loans: A Growing Asset Class

For companies in need of financing, syndicated loans, a type of commercial credit facility, have real appeal. Compared with traditional credit lines, syndication (the process by which a group of lenders provide a commercial loan to a borrower) is often cheaper. That's especially true for borrowers rated below investment-grade. Loans from banks and other capital providers can finance mergers and acquisitions, back a recapitalization of a company's balance sheet, refinance debt, and fund operations. The loans are secured by collateral, most commonly receivables, and a robust secondary market has developed. Many leveraged-loan borrowers are owned by private equity.

For investors, there's also lots to like about the asset class. As senior secured debt, most loans are higher in the capital structure than bonds, which means their payback is prioritized. They are also floating-rate instruments. So, unlike bonds, which lose value when interest rates rise, loan coupons move in line with borrowing costs. Collateralized loan obligations, special-purpose vehicles set up to hold and manage pools of leveraged loans, have been a key source of demand. Credit investors, including those looking to park "dry powder" while waiting for a private credit allocation to take shape, also find leveraged loans to be a convenient way station.

As displayed in Exhibit 1, the asset class has expanded significantly, even before the aggressive rate hikes of 2022 in response to sticky post-pandemic inflation. Europe's loan market has more than tripled over the past decade as measured by the Morningstar European Leveraged Loan Index's total market value. As of the end of 2025's first quarter, it exceeded EUR 315 billion, with 96% of loans denominated in euros and 4% of loans denominated in British pounds.

Exhibit 1 The Morningstar European Leveraged Loan Index's Total Market Value Has More Than Tripled in 10 Years



Source: Morningstar Indexes. Total Market Value in EUR billions as of 31 March 2025.

By comparison, the Morningstar Eurozone High-Yield Bond Index's market value stood at EUR 322 billion at the end of March 2025, roughly 27% larger than it stood one decade prior. The UK's high-yield bond market represents another roughly GBP 30 billion. So, leveraged loans in Europe are approaching the size of the high-yield bond market. In the US, leveraged loans have surpassed the size of the high-yield bond market.

Meanwhile, the index's industry and geographic representation demonstrate how popular bank loans have become as a means of corporate financing. The Morningstar European Leveraged Loan Index currently contains more than 400 loan facilities, across 74 distinct industries. As displayed in Exhibit 2, only one industry consumes more than 10% of the index's weight.

Exhibit 2 Morningstar European Leveraged Loan Index: Top 5 Industry Weights

Top 5 Industries	Index Weight (%)
Healthcare Providers & Services	11.2
Software	7.3
Commercial Services & Supplies	6.8
Chemicals	6.5
Diversified Telecommunication Services	6.3

Source: Morningstar Indexes. Data as of 31 March 2025.

As displayed in Exhibit 3, from a geographic perspective, loans from issuers domiciled in France and the United Kingdom hold the greatest share of market value (and total number of facilities).

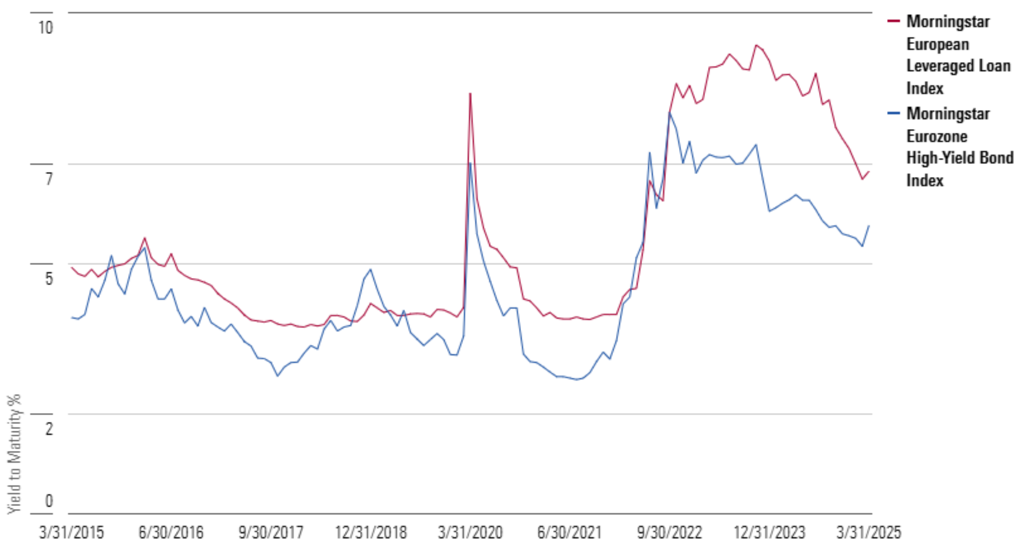
Exhibit 3 Morningstar European Leveraged Loan Index: Top 5 Country Weights

Top 5 Countries	Index Weight (%)
France	20.7
United Kingdom	18.6
Germany	13.5
Netherlands	12.2
United States	8.4

Source: Morningstar Indexes. Data as of 31 March 2025.

The interest-rate hikes that began in 2022 in response to inflation have had a dramatic effect on leveraged-loan yields. During the many years of low interest rates following the global financial crisis, high-yield bonds yielded more than loans. But as displayed in Exhibit 4, European central banks' aggressive policy response to high inflation sent loan yields to a higher plane. "Coupon clippers" enjoyed yields exceeding 9% in 2023. Income levels for leveraged loans remain attractive, especially compared with high-yield bonds.

Exhibit 4 Yields for Leveraged Loans and High-Yield Bonds: Rising Rates Have Lifted Loan Yields Higher



Source: Morningstar Indexes. Yield to maturity %. Data as of 31 March 2025.

Leveraged Loans: Not Without Risks

Credit risk is a feature not a bug of the leveraged-loan asset class. A handful of syndicated bank loans are actually investment-grade-rated. But as displayed in Exhibit 5, nearly 80% of the Morningstar European Leveraged Loan Index's weight is currently represented by B-rated facilities. The asset class has an even lower credit-quality profile than the Morningstar Eurozone High-Yield Bond Index.

Exhibit 5 Credit Profile of Leveraged Loans and High Yield: Leveraged Loans Carry Higher Credit Risk

Credit Rating Breakdown	Morningstar European Leveraged Loan Index (%)	Morningstar Eurozone High-Yield Bond Index (%)
A	0.00	0.00
BBB	0.20	0.00
BB	13.8	69.9
B	78.5	23.6
Below B	3.4	6.5
Not Rated	4.1	0.0

Source: Morningstar Indexes. Data as of 31 March 2025.

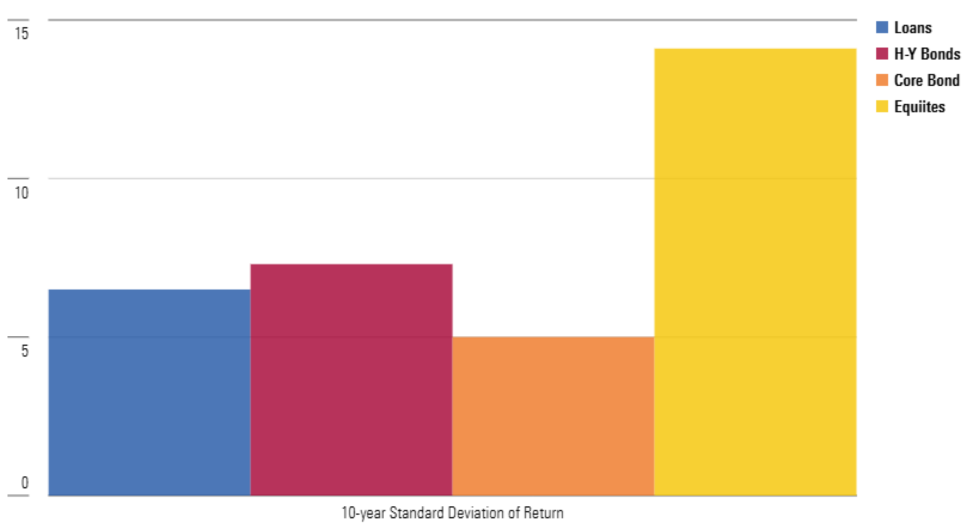
How has this credit profile translated into behavior? From a calendar year perspective, the Morningstar European Leveraged Loan Index has only notched a negative annual return in 2007, 2008, and 2015. The Morningstar Eurozone High-Yield Bond Index fell into negative territory in 2002, 2007, 2008, 2011, 2015, and 2018.

In times of economic stress, the leveraged loan index has tended to decline sharply. In 2008, the global financial crisis wreaked havoc on the asset class, in addition to high-yield bond. The pattern repeated in the first quarter of 2020 when covid-prompted societal lockdowns plunged the economy into recession and a pandemic panic roiled markets. Leveraged loans and high-yield bonds both declined roughly 15% that quarter, while European equities fell more than 23%, and the Eurozone Core Bond Index lost just 1%. All four asset classes rebounded later that year.

In 2022, both stocks and bonds sank deeply in response to generationally high inflation and the aggressive monetary policy response. Leveraged loans' floating rates provided a buffer from the pain of sharp rate hikes though, and the asset class lost less than bonds. Both leveraged loans and high-yield bonds have suffered small losses on economic fears in early 2025.

Despite higher overall credit risk, bank loans have been less volatile than high-yield bonds. As displayed in Exhibit 6, the Morningstar European Leveraged Loan Index has had a lower standard deviation of returns over the past 10 years than the Morningstar Eurozone High-Yield Bond Index, which itself has been significantly less volatile than equities. The government bond-heavy Morningstar Eurozone Core Bond Index has provided a smoother ride.

Exhibit 6 Asset-Class Volatility: Leveraged Loans Stand Between High Yield and Core Bond



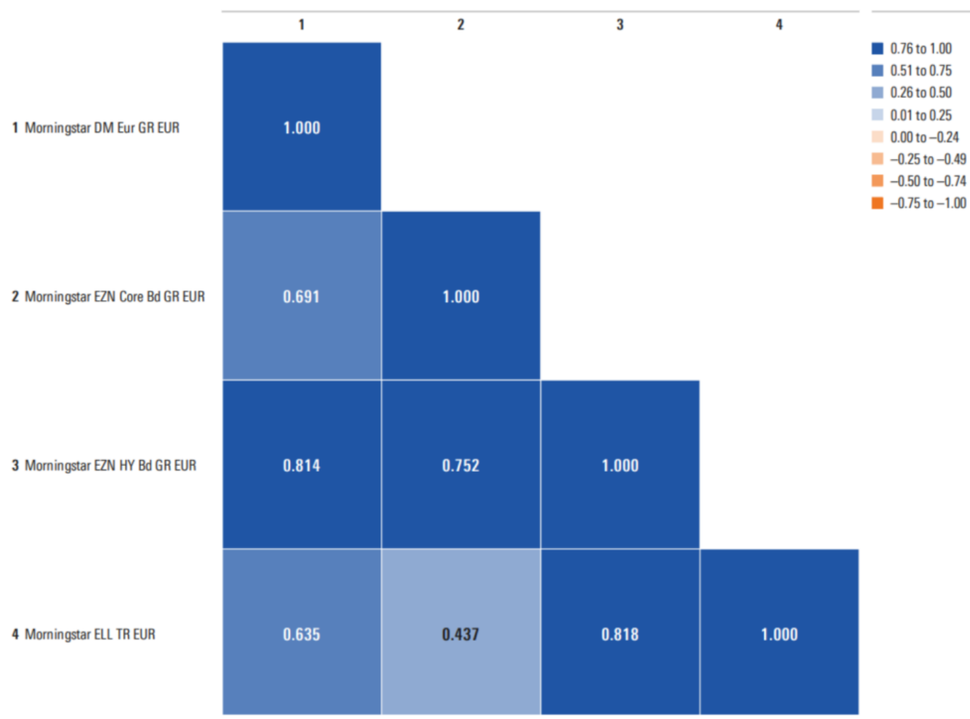
Source: Morningstar Direct. Ten-year standard deviation of returns data for total-return index variants in EUR. Data as of 31 March 2025. Indexes displayed: Morningstar European Leveraged Loan, Morningstar Eurozone High-Yield Bond, Morningstar Eurozone Core Bond, and Morningstar Developed Markets Europe (Equities).

Leveraged Loans in a Strategic Asset Allocation

Leveraged loans are often allocated to in a tactical manner. Yield-chasing is a natural temptation for income-focused investors. The asset class is also part of the opportunity set for many credit investors weighing its merits against high yield and private credit. Since private credit investments can take time to allocate, leveraged loans are sometimes used as a temporary parking lot for "dry powder."

But there's also a strategic use case for leveraged loans. The asset class is intriguing from a portfolio diversification perspective. As displayed in Exhibit 7, the Morningstar European Leveraged Loan Index has exhibited a lower correlation coefficient over the past decade with the Morningstar Developed Europe Index of equities and the Morningstar Eurozone Core Bond Index than has the Morningstar Eurozone High Yield Bond Index.

Exhibit 7 Correlation Matrix of European Equities and Fixed-Income Asset Classes



Source: Morningstar Direct. Ten-year index correlations as of 31 March 2025. ELL = Morningstar European Leveraged Loan Index. DM Eur = Morningstar Developed Markets Europe Index. EZN Core Bd = Morningstar Eurozone Core Bond Index. EZN HY Bd = Morningstar Eurozone High Yield Bond Index.

The relationship between leveraged loans, equities, and core bonds may shift over time. However, there's a fundamental logic to the low correlation between leveraged loans and government bonds. By design, bank loans' floating rate coupons rise when interest rates rise and, hence, when government bonds weaken. Current yields on leveraged loans may not persist. That said, the direction of inflation and interest rates has been devilishly difficult to forecast. While an economic downturn remains a perennial risk, the Morningstar European Leveraged Loan Index highlights a growing asset class that can play an intriguing role as a portfolio diversifier, as well as an income source.

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