

Credit Markets Have Yet to Price in “Stability”

The European leveraged loan market is experiencing a renewed wave of repricing activity, with a growing number of issuers returning to the market only six months after completing their previous syndications. Borrowers are opportunistically refinancing to capture spread compression driven by exceptionally strong investors demand. Margin reductions of 50bps have become standard for performing credits, while even more challenged names are securing spread reductions of around 25bps.

The ability to reprice transactions so shortly after issuance highlights the significant imbalance between investors demand and net loan supply. OIDs have largely disappeared from syndicated issuance, while spread flex has overwhelmingly shifted in favor of borrowers. In most transactions, final clearing levels are pricing inside initial price talk, underlining the depth of demand and the limited negotiating leverage available to lenders.

The current market backdrop closely resembles the repricing environment observed throughout 2025. Approximately half of the European institutional loan universe now trades at or above par, creating a sizeable pipeline of potential refinancing candidates. As a result, loan investors should continue to expect elevated levels of repricing activity. BB-rated issuers are generally clearing well inside E+300bps, while B/B2 borrowers are pricing around the E+300bps level. The traditional premium associated with lower-quality credits has narrowed materially, which is typical of a bullish market.

Throughout 2026, I have repeatedly described this phenomenon as a flat credit spread curve. Unfortunately, these scenarios may result in inaccurate credit judgments and investment decisions.

Provided structured-product flows continue to drive leverage assets demand, the technical backdrop should remain supportive of spreads, notwithstanding isolated credit exceptions.

The Private Credit faces a more challenging environment under these risk-on conditions and is increasingly focused on more complex credit situations, including difficult credit stories, financing solutions for borrowers constrained by stressed secured and unsecured debt, and companies facing a near maturity

wall. This process is already being observed across three credit cases (not yet public).

CLOs remain the dominant buyers of leveraged loans. CLO portfolio managers continue to buy higher-quality assets in order to preserve portfolio quality metrics and comply with structural tests, while simultaneously barbell portfolios with selected higher-spread, riskier credits to enhance the WAS. This technical demand has intensified competition for scarce quality paper and has increasingly manifested itself through privately negotiated fungible additions.

The current market environment presents challenges for all CLO managers, newcomers and seasoned platforms. As liability arbitrage remains constrained, managers are increasingly relying on both sides of the vehicle balance sheet to generate value for the subordinated notes. While portfolio construction remains critical, refinancing and reset opportunities have become equally important levers for improving economics and maintaining competitive returns. This should be a central topic of debate at the Barcelona conference. Today the WAS is arguably more important than credit quality. The first is a compelling problem, the credit issues can be postponed as we saw in many cases.

Portfolio managers have various levers available to manage the spread. However, altering an established portfolio positioning can be costly and may involve significant transaction costs and par loss. For this reason, I recommend that CLO investors closely monitor trading activity and analyze executed trades on a monthly basis. It is more sophisticated than just observing CCC bucket and MVOCs.

On the liability side, CLO funding costs continue to compress. AAA spreads have tightened materially and appear capable of reaching the 120bps area. Combined with lower funding costs across the capital structure, many recently issued or refinanced vehicles are now achieving a weighted average cost of debt below 200bps (165 to 195 for being precise. The market differentiates managers although not as much as it should). Nevertheless, the liability arbitrage available to CLO PMs remains relatively tight and force equity investors to take a long view to their investment.

Further spread tightening is also occurring across BB and single-B CLO liabilities.

While valuations remain supported by strong technicals and limited supply, mezzanine tranche investors should remain selective (also to the docs). Lower-rated tranches are increasingly exposed to idiosyncratic collateral deterioration and adverse portfolio migration. Consequently, the margin for error when investing in the low part of capital stack, is becoming increasingly limited, particularly in transactions backed by lower-quality loan pools or

managers with weak performance. Europe offers no shortage of such examples and the market's transparency allows for objective comparison across a broad range of vintages and managers.

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