



# Oaktree Credit Quarterly

**4Q  
2025**

## DISPERSION

We believe we're entering a new era of dispersion in the performance of financial assets. Behind buoyant index averages are sharply bifurcated cohorts of winners and losers. Equities are flying high but remain mostly propelled by a handful of AI superstars. Credit appears healthy in aggregate, but there's a notable tail of unloved names. Economic growth looks robust but masks clear divergence in the experience of high- and low-income consumers, a phenomenon now termed the "k-shaped economy." These dynamics serve as a reminder that averages shouldn't be relied upon in a sophisticated investment process.

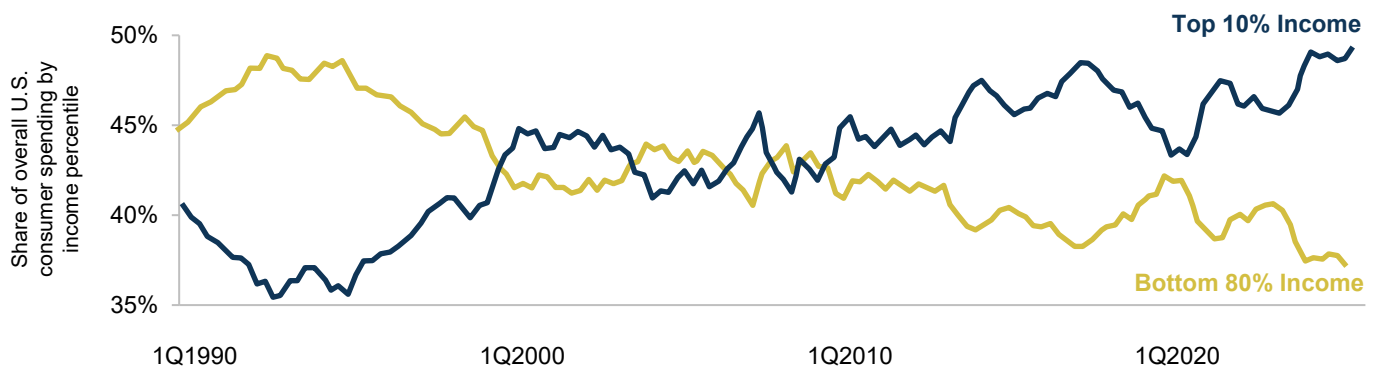
During the low-interest-rate environment of 2009-2021, credit was "bunched up," with limited dispersion around the index spread. Now yields are much healthier, but a tougher backdrop (and perhaps the residual impact of the prior period being too easy) means we're returning to a world where mistakes are punished – and potentially capitalized on. As Howard Marks [recently wrote](#), the next phase is set to be more "interesting."

### The U.S. Economy: K-Shaped

U.S. economic data remains challenging to interpret, though the headline metrics appear mostly positive. GDP growth has certainly surprised to the upside, recording an annual rate of 4.4% in 3Q2025. Resilient consumer spending has been a big contributor, but there's a more complex picture behind the headlines.

Aggregate consumption is reliant on a narrow cohort of high-income consumers, who've benefited the most from significant stock-market gains and continued to spend. (See Figure 1.) Meanwhile, the low-income consumer doesn't look quite so buoyant. This segment benefited from strong salary growth in the wake of the pandemic, but this has now tailed off, down to 1.4% YoY compared to 4.0% for high-income households.<sup>1</sup> Lower-income consumers have reduced their spending in several key categories, such as clothing and airlines, both categories in which high-income consumers have increased expenditure.<sup>2</sup>

Figure 1: Top Earners Increasingly Dominate Overall U.S. Consumer Spending



Source: Moody's Analytics, Financial Times

Similarly, overall capital expenditure metrics have been propped up by a dramatic increase in AI-related spending. Hyperscalers' capex is estimated to have reached around \$400 billion in 2025 amid the well-publicized AI arms race.<sup>3</sup> This represents an astonishingly high percentage of their revenue and remains complicated by a lack of clarity regarding return on investment. But right now, these companies are still soaring.

## Equities: AI and Everything Else

The S&P 500 once again confounded expectations to record a 16% return in 2025, marking its third consecutive year of double-digit gains. Where have the gains come from? **AI**: since the launch of ChatGPT in 2022, a relatively small group of AI-related stocks have driven a full three quarters of the S&P 500's return.<sup>4</sup> (See Figures 2 and 3.) It follows on that the major U.S. equity index has become very concentrated, with the 10 largest companies – mostly big tech – representing nearly 40% of the index.

Figure 2: AI-Related Stocks Have Been Red Hot...

Since launch of ChatGPT (November 2022)

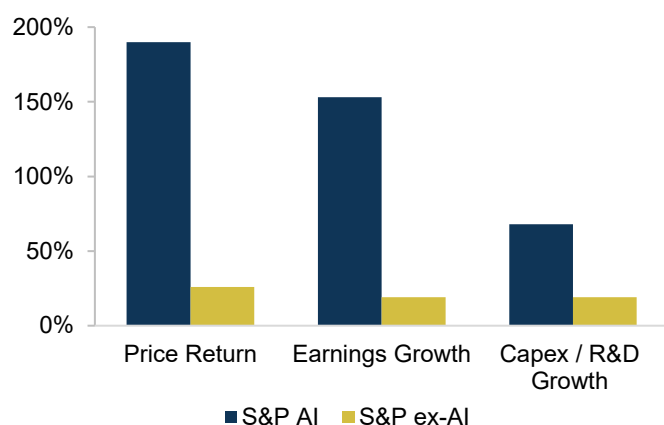
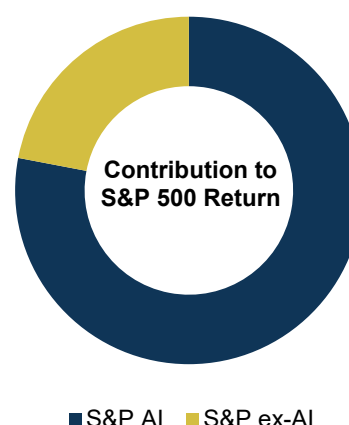


Figure 3: ...Driving Over 75% of the S&P 500's Return!

Since launch of ChatGPT (November 2022)



Source: JP Morgan, Bloomberg, as of December 22, 2025. "S&P AI" represents 42 companies within the S&P 500 identified by JP Morgan as being linked to generative AI.

This leaves a portion of the index comprised of many companies that haven't dramatically increased earnings and aren't contributing meaningfully to investor returns. It's particularly visible when looking at the divergence in performance between sectors: the S&P 500 Info Tech index boasts a three-year annualized return of 33.8%, but Consumer Staples languishes at 6.5%, Energy at 1.8%, and Real Estate at 1.9%.<sup>5</sup> In short, there's only been one game in town.

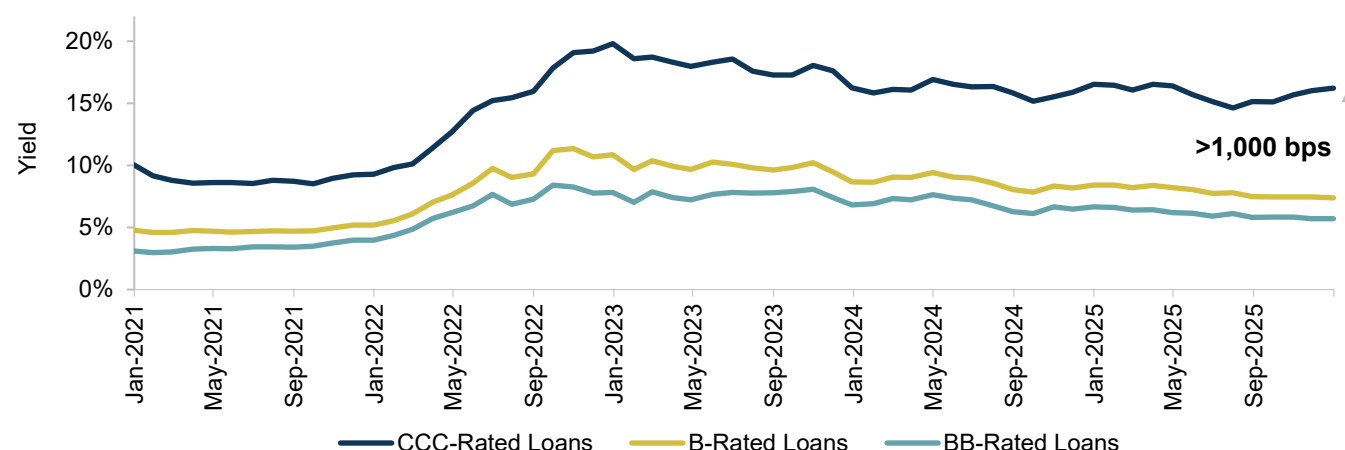
## Credit: Haves and Have-Nots

"Tight spreads but good yields" has become the familiar refrain in the sub-investment grade credit universe. While that's broadly accurate, looking under the hood gives a more nuanced perspective.

### Mind the Spread Gap

The senior loan index currently offers a yield of 7.9%, but BB-rated loans are at 5.7% and CCCs are at 16.1%!<sup>6</sup> (See Figure 4.) It's a similar story in the high yield bond universe, where index dispersion is the highest on record.<sup>7</sup> Even within rating brackets, there's meaningful dispersion: over 40% of CCC-rated high yield bond market value trades within a 400 bps spread – but 12% trades at over 1500 bps, reflecting the importance of a credit-by-credit investment approach.<sup>8</sup>

Figure 4: CCC-Rated Loans Trade More Than 1,000 bps Outside of BBs



Source: UBS Leveraged Loan Index, as of December 31, 2025

So why are unloved names falling so far through the cracks?

- Weak credit documentation has heightened fears of poor recoveries, meaning struggling names can face immediate selling pressure. The data justifies this fear. While payment default rates remain low, recoveries are well below their long-term average: the recovery rate on first-lien loans stands at 37.7% versus the 25-year average of 62.3%.<sup>9</sup>
- In the case of broadly syndicated loans, the dominant buyer – CLOs – has limited appetite for stressed loans. These managed vehicles must meet strict tests, including on CCC exposure, and must be relatively free of stress to secure economical financing from liability investors. This leads to structurally reduced demand for stressed credits.
- Aside from technical pressure (i.e., fewer willing buyers for structural reasons), some credits are trading at elevated spreads because they're fundamentally troubled. A good portion of CCC-rated credits are genuinely under significant strain: 40% of CCC-rated borrowers have operating cash flow coverage below 1.0x.<sup>10</sup>

Combine these factors, and it's clear why certain names become pariahs. Encouragingly, part of the problem is that solid yields on performing names mean certain investors don't need to reach for risk: performing credit investors can construct high-income portfolios without purposefully buying heavily discounted names. Meanwhile, more specialized investors might want to access oversold names, particularly if they have the capabilities to come out on top in a potential liability management exercise or restructuring.

## Performing and PIKing

In the private credit world, dispersion is harder to map out. Without a developed secondary market, true price discovery is limited. However, it seems private credit loans are also increasingly bifurcated into fundamentally solid and fundamentally struggling, reinforcing the importance of selectivity.

Earnings have been generally strong, with EBITDA growth of over 8% YoY in 3Q2025, and net leverage has trended down over recent quarters.<sup>11</sup> (See Figures 5 and 6.) Default rates also remain very low, but there's some stress under the surface, manifesting most evidently in the form of a reliance on payment-in-kind (PIK) interest as opposed to cash payment. Roughly 20% of private loans have PIK optionality and over half have ended up taking the option.<sup>12</sup> But the good news is the instances where PIK emerges after the origination of a deal due to borrower stress remain relatively limited, representing around 4-5% of private loans.<sup>13</sup>

Figure 5: Earnings Have Been Strong...

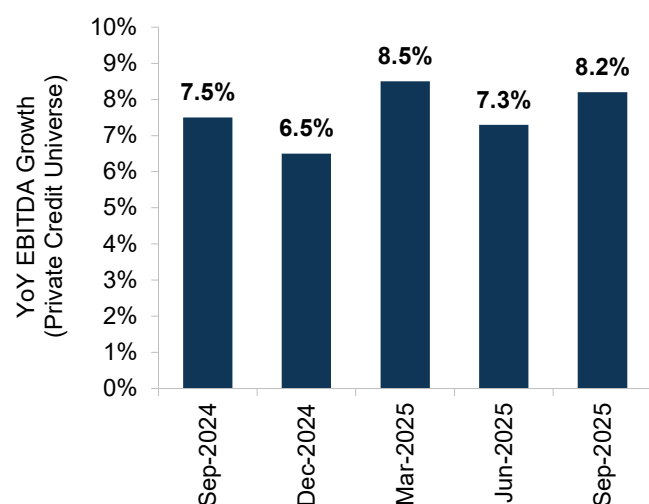
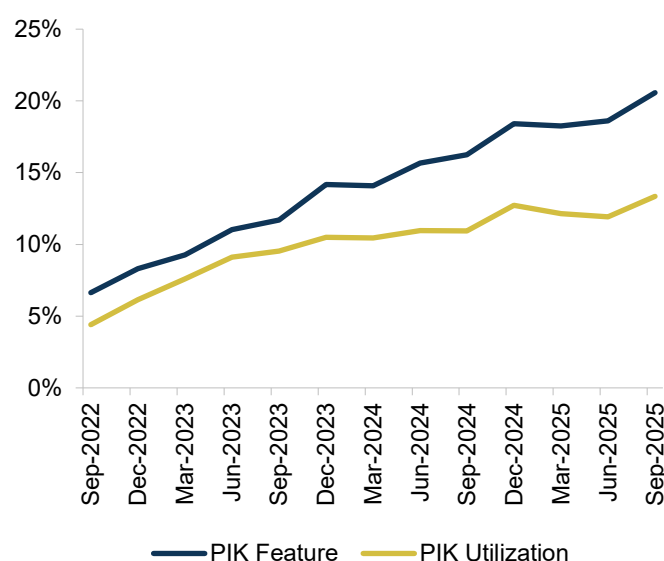


Figure 6: ...But PIK Reliance Presents a Concern



Source: Houlihan Lokey Private Credit Databank, as of September 30, 2025

The direct lending market has expanded significantly (and rapidly) to reach a similar size to the more established broadly syndicated loan market. It continues to present excellent opportunities for income-seeking investors, but the next phase of direct lending is likely to be defined by selectivity and risk management as opposed to origination volume. Accessed prudently, the direct lending market remains a valuable core of private credit portfolios, augmented by less-tapped verticals such as asset-backed finance and various sectorial niches.

## What Next?

A dispersed market requires a nuanced management approach, rewarding both prudent risk control and intrepid opportunism. Relying on index averages won't be enough, as the performance of assets within the same universe drift apart. Part of the conundrum, as always, will be delineating between assets that are (a) unreasonably discounted due to psychological aversion and (b) appropriately discounted because they're fundamentally flawed.

The vast scale of the sub-investment grade credit markets means both the performing bulk and stressed subset will each be of significant absolute volume. There's potentially excellent income opportunity accessible through the performing side of the private and liquid credit markets, while the few percent of distress also creates a substantial dislocation opportunity.

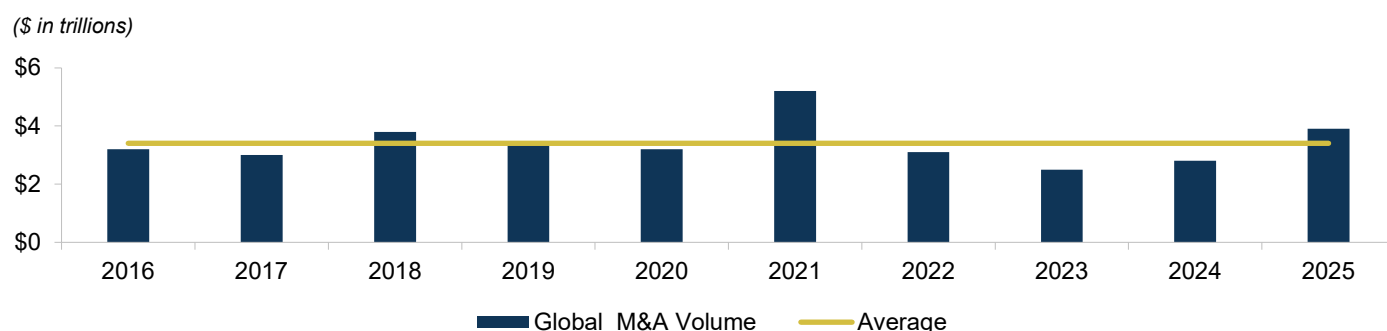
## Credit Markets: Key Trends, Risks, and Opportunities to Monitor in 1Q2026

### (1) Supply on the Horizon?

In today's technically driven credit markets, the level of supply may be the defining factor determining the direction of spreads in 2026. New issuance has been limited over the past few years, putting downward pressure on credit spreads amid a sustained wave of demand from yield-seeking investors. There are positive signs that deal activity may be returning, with M&A trending upward in 2025. (See Figure 7.) However, depressed private equity activity remains the main barrier to serious credit issuance, and, consistent with our dispersion theme, timely exits remain much easier for high-quality portfolio companies, leaving less-desirable businesses held for an extended period.

We discussed the outlook for European credit supply in more detail in a [recent podcast](#).

Figure 7: M&A Volume Appears to Be Recovering

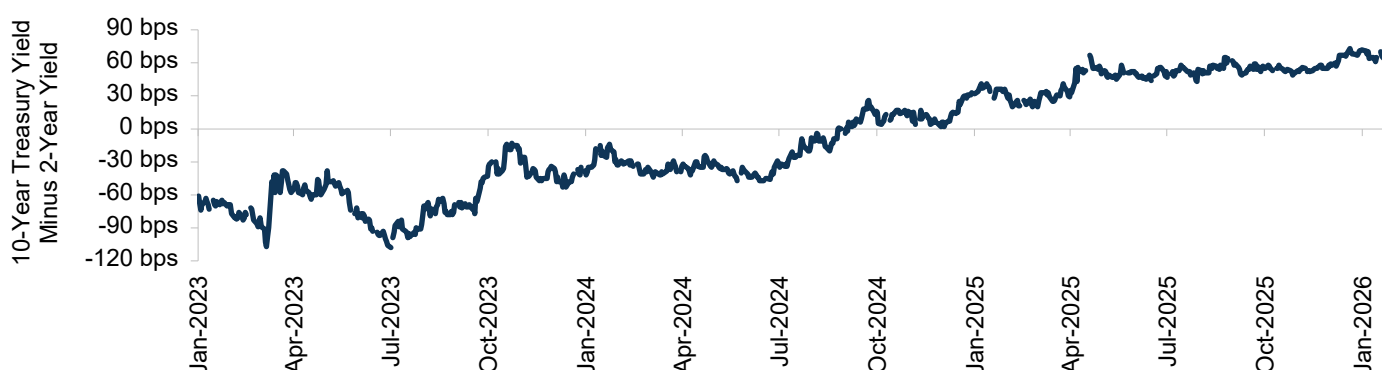


Source: LSEG, Morgan Stanley, as of December 31, 2025; includes announced transactions of over \$100mm and excludes terminated transactions

### (2) Return of Term Premium

The yield curve was inverted for all of 2023 and most of 2024, with the two-year treasury yield briefly exceeding the ten-year by over 100 bps in 2023. (See Figure 8.) More recently, it's been around 65-70 bps the other way, representing a dramatic swing. In short, it seems like term premium – the additional compensation for holding long-dated paper – has returned to the treasury market, as investors fret over sticky inflation and the potential unsustainability of the fiscal deficit.

Figure 8: The Yield Curve Has Steepened



Source: Federal Reserve Bank of St. Louis, as of January 26, 2026

### (3) Angel Watch

Nearly \$55bn of investment grade debt was downgraded to high yield in 2025, the highest volume since 2020 and far outweighing the volume of rising stars. Barclays predicts an even greater volume next year, at around \$70-90bn: notably, this isn't based on predictions of systematic strife, but a handful of large BBB-rated fallen angel candidates.

## Market Conditions: 4Q2025

### Investment Grade Credit<sup>14</sup>

#### Return

0.8%

Investment grade bond performance was supported by lower rate expectations and an uptick in economic data surprises.

#### Defaults (LTM)

N/A

#### Issuance

\$338.7bn

After finishing the year with the largest fourth quarter on record, U.S. investment grade supply for 2025 totaled \$1.7tn.

#### Value Proposition

In short-duration investment grade credit, we find a compelling balance of liquidity and yield for investors concerned about market volatility.

### High Yield Bonds<sup>15</sup>

#### Return

1.3% (U.S.)

0.6% (Europe)

High yield bonds modestly outperformed their higher-rated fixed-income counterparts in 4Q2025, though returns fell short of a coupon-like quarter.

#### Defaults (LTM)

1.9% (U.S.)

0.7% (Europe)

#### Issuance

\$65.4bn (U.S.)

€25.8bn (Europe)

Refinancings continued to drive the majority of issuance during the quarter, as issuers took advantage of the favorable market conditions to extend maturities and reduce near-term refinancing risk.

#### Value Proposition

New issue activity is expected to be robust in 2026, and default rates are likely to remain below the long-term average.

### Senior Loans<sup>16</sup>

#### Return

1.2% (U.S.)

0.7% (Europe)

U.S. loans recorded a solid return in the fourth quarter, while performance in Europe was more modest.

#### Defaults (LTM)

2.9% (U.S.)

2.2% (Europe)

#### Issuance

\$171.3bn (U.S.)

€39.2bn (Europe)

New issue volumes declined in the fourth quarter, but 2025 was the second-busiest year on record for primary market activity in the U.S.

#### Value Proposition

Technical support for senior loans remains strong, driven by ongoing CLO issuance and a limited supply of new-money loan deals.

### Emerging Markets Debt (Corporate)<sup>17</sup>

#### Return

1.6%

EM high yield debt markets mirrored the strength of the global fixed income markets in the fourth quarter, reflecting fund inflows and resilient macroeconomic fundamentals.

#### Defaults (LTM)

3.0%

#### Issuance

\$26.9bn

Primary market activity was healthy during the period, concluding a robust year for EM high yield bond issuance.

#### Value Proposition

While spreads are historically tight, volatility surfaced briefly in October following a few events of corporate credit stress in Latin America. Rigorous security selection remains important to manage risk amid broad-based demand at the start of 2026.

## Market Conditions: 4Q2025

### Global Convertibles<sup>18</sup>

Return	Defaults (LTM)	Issuance	Value Proposition
<b>-1.0%</b> Convertible bonds declined in the fourth quarter on the back of weak underlying equity performance, though full-year returns remained strong at over 13%.	<b>2.1%</b>	<b>\$40.6bn</b> Primary market activity was strong in 4Q2025, with issuance in 2025 reaching \$166bn, just shy of the annual record.	Convertibles remain attractive amid near-record issuance levels, strong year-to-date performance, and structural tailwinds, offering a conservative way for investors to capture equity upside with bond-like downside protection.

### Structured Credit (Corporate)<sup>19</sup>

Return	Defaults (LTM)	Issuance	Value Proposition
<b>1.0%</b> (BB-Rated U.S. CLOs) <b>1.5%</b> (BBB-Rated U.S. CLOs) In the fourth quarter, corporate structured credit generated stable returns supported by reliable coupon income as spreads remain tight.	<b>N/A</b>	<b>\$53.8bn</b> (U.S.) <b>€13.0bn</b> (Europe) Global CLO issuance was lower in 4Q2025 compared to the same period last year.	Structured credit's high income makes it one of the most attractive asset classes within fixed income, particularly as corporate defaults remain low.

### Structured Credit (Real Estate)<sup>20</sup>

Return	Defaults (LTM)	Issuance	Value Proposition
<b>2.3%</b> (BBB-Rated CMBS) Following the 50 bps of interest rate cuts by the U.S. Federal Reserve in 4Q2025, the fundamentals for the asset class have continued to improve.	<b>7.3%</b>	<b>\$41.0bn</b> In 2025, total private-label CMBS issuance reached approximately \$158.0bn, setting a post-GFC record and representing an increase of 39.6% year-over-year.	Most commercial real estate sectors continue to rebound from the lows seen in 2024 and are now showing more signs of stabilization.

### Private Credit

In the sponsor-backed direct lending market, the imbalance between the supply of deals and the demand from investors largely persisted over the course of 2025. Intense competition among direct lending managers continued as they sought to deploy what were robust capital inflows into a lackluster M&A environment. This competition has resulted in sustained downward pressure on direct lending yield spreads, although direct lending deals still command a roughly 100 bps premium over new-issue broadly syndicated loans of similar quality. As we enter 2026, competition among direct lending managers remains as intense as ever. However, we're beginning to see early indications that this supply-demand imbalance could moderate soon. On the supply side, we expect 2026 could finally bring an upswing in M&A as private equity sponsors seek to deploy dry powder from their on-the-run funds, return capital from their liquidating funds, and turn bullish amid receding tariff uncertainty. On the demand side, what were once robust capital inflows appear to be slowing. This is particularly true in the perpetual BDC channel, which has served as a significant engine of direct lending AUM growth. Should this imbalance dissipate, direct lending yield spreads could stabilize if not marginally widen. All that said, competition today remains hot, and an uncertain macro environment could quickly drive M&A activity downward.





## **Armen Panossian**

### **Co-Chief Executive Officer and Head of Performing Credit**

Mr. Panossian serves as co-Chief Executive Officer, primarily focused on overseeing the organization and performance of Oaktree's investment teams. He is also Head of Performing Credit, where his responsibilities include oversight of the firm's liquid and private credit strategies and as a portfolio manager within the Global Private Debt and Global Credit strategies. Mr. Panossian joined Oaktree's Global Opportunities group in 2007. In January 2014, he joined the U.S. Senior Loans team to assume co-portfolio management responsibilities and lead the development of Oaktree's CLO business. He became head of all performing credit in 2019. Mr. Panossian joined Oaktree from Pequot Capital Management, where he worked on their distressed debt strategy. Mr. Panossian holds a B.A. degree in economics with honors and distinction from Stanford University, where he was elected to Phi Beta Kappa; an M.S. degree in health services research from Stanford Medical School; a J.D. degree from Harvard Law School; and an M.B.A. from Harvard Business School. Mr. Panossian serves on the Advisory Board of the Stanford Institute for Economic Policy Research. He is a member of the State Bar of California.



## **Danielle Poli, CAIA**

### **Managing Director and Assistant Portfolio Manager**

Ms. Poli is a portfolio manager within Oaktree's Global Credit strategy, which is the firm's flagship multi-asset credit offering. She is a founding member of its Investment Committee. Ms. Poli is also a regular commentator for mainstream and financial media and has been named to Barron's list of 100 Most Influential Women in U.S. Finance. Ms. Poli joined Oaktree in 2014 following graduation from the UCLA Anderson School of Management, where she received an M.B.A. and the Laurence and Lori Fink Investment Management Fellowship. Prior thereto, she worked at PAAMCO KKR Prisma (formerly PAAMCO) where she helped manage hedge fund portfolios for institutional clients. Ms. Poli holds a B.S. degree in business administration from the University of Southern California and is a CAIA charterholder.

# Oaktree's Credit Platform

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Oaktree Capital Management is a leading global alternative investment management firm with expertise in credit strategies. Our credit platform has \$160 billion in AUM and encompasses a broad array of strategy groups that invest in public and private credit instruments across the liquidity spectrum.<sup>21</sup> All Oaktree investment activities operate according to a unifying philosophy that emphasizes key principles including the primacy of risk-control and benefits of specialization.



# Endnotes

1. BofA Consumer Checkpoint, as of December 10, 2025.
2. BofA Consumer Checkpoint, as of November 12, 2025.
3. CreditSights, projection of \$443bn in 2025 capex, as of November 10, 2025.
4. JP Morgan, Eye on the Market, January 1, 2026.
5. S&P 500 index data, as of January 21, 2026.
6. UBS Leveraged Loan Index.
7. Barclays Credit Outlook, as of December 3, 2025.
8. Ibid.
9. JP Morgan December Default Monitor.
10. Barclays Credit Outlook, as of December 3, 2025.
11. Lincoln International, as of 2Q2025.
12. Houlihan Lokey, as of September 30, 2025.
13. Ibid.
14. ICE U.S. Corporate Index for all return data; Bank of America for all issuance data (reflects U.S. issuance).
15. ICE BofA US High Yield Constrained Index for all U.S. High Yield Bonds return data; ICE BofA Global Non-Financial High Yield European Issuer Excluding Russia Index for all European High Yield Bonds data; JP Morgan for all U.S. default rates; UBS for all European default rates (including distressed exchanges); PitchBook LCD for all U.S. and European issuance data (including refinancings).
16. S&P UBS Leveraged Loan Index for all U.S. Senior Loans return data; S&P UBS Western Europe Leveraged Loan Index (EUR Hedged) for all European Senior Loans return data; JP Morgan for all U.S. default rates and issuance data; UBS for all European default rates (including distressed exchanges); PitchBook LCD for all European issuance data (including refinancings).
17. JP Morgan Corporate Broad CEMBI Diversified High Yield Index for all return data; JP Morgan for default rates (including distressed exchanges) and issuance (including refinancings) data.
18. Refinitiv Global Focus Convertible Index for all return data; Bank of America for default rates and issuance data.
19. JP Morgan CLOIE BB Index and JP Morgan CLOIE BBB Index for all return data; JP Morgan Weekly CLO Issuance for all issuance data.
20. Bloomberg US CMBS 2.0 Baa Total Return Unhedged Index for all return data; Trepp for default rates (%; 30+ day delinquency, and REO); JP Morgan for all issuance data.
21. The AUM figure is as of December 31, 2025 and excludes Oaktree's proportionate amount of DoubleLine Capital AUM resulting from its 20% minority interest therein. The total number of professionals includes the portfolio managers and research analysts across Oaktree's performing credit strategies.

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