



Oaktree Credit Quarterly

**2Q
2025**

STILL SPECIAL?

The United States has been on a remarkable run: exceptional growth and innovation, multiple structural advantages, and the financial market dominance to match. Yet this year there's been increased murmuring regarding the feasibility of continued U.S. exceptionalism, as several economic challenges seem to lurk. Given that U.S. assets form the core of most global portfolios, this uncertainty has naturally led to questions regarding asset allocation.

In our view, the U.S. is still special and rightly at the center of credit portfolios; however, the option for global diversification remains valuable, providing the requisite asset availability and manager capability exists. The U.S. has the deepest, most liquid capital markets in the world, particularly in the sub-investment grade credit space, allowing managers to deploy capital at significant scale. That's not to say investors should ignore compelling opportunities in other regions such as Europe and Asia: casting a broad net can only help in identifying the assets offering the best risk/reward balance.

If the massive advantage of the U.S. were to diminish, we believe it would be a larger headwind for equities than credit. With the S&P 500 at record-high levels, equity prices are predicated on continued growth and the willingness of investors to keep paying a significant premium for U.S. equities. Credit spreads appear on the tight side, but credit returns aren't reliant on exceptional U.S. economic growth and innovation: **these companies just need to survive for investors to get their (currently elevated) contractual income.**

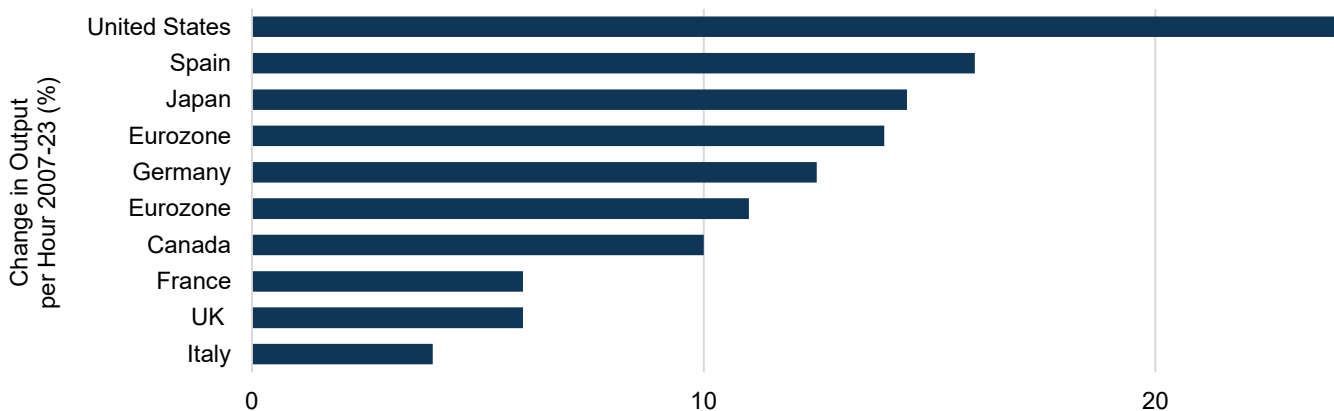
Foundations of Exceptionalism

The much-discussed U.S. exceptionalism is legitimately... exceptional. A country with less than 5% of the world's population represents around 65% of global equity indexes!¹ From the lows of the Global Financial Crisis, the U.S. has staged an equity market boom as public equities set new highs and private equity expanded dramatically. Accompanying this rise has been unprecedented debt issuance across the leveraged finance markets, with the notable rise of private credit to a mainstream asset class.

So why has the U.S. been such a consistent growth story? Here's just a few reasons:

- The U.S. dollar has long been the undisputed global reserve currency, leading to the consistent foreign demand for dollars that helps (a) compress borrowing costs on dollar-denominated debt and (b) permit significant budget deficits.
- The U.S. has been a consistent leader in labor productivity, benefiting from a talented workforce, culture of entrepreneurship, and high levels of technology adoption. (See Figure 1.)
- The U.S. has the most accommodative capital markets in the world, from venture funding for future unicorns to senior loans for jumbo-sized LBOs, providing the capital for U.S.-based businesses to rapidly scale. Meanwhile, the U.S. Federal Reserve has supported growth in a manner distinct to more conservative central banks.

Figure 1: U.S. Productivity Growth Has Exceeded Peers



Source: OECD, Financial Times; Constant 2020 dollars per hour, PPP converted

Exceptionalism Questioned

Meanwhile, those who question U.S. exceptionalism have now identified a few key threats to the country's dominance, such as a weakened U.S. dollar. It's hard to ignore that the dollar just experienced its worst first half of the year since 1973.² While there's debate about the overall impact of a weakened domestic currency, it's mostly agreed that it raises import costs and thus contributes to inflation. A precipitous sell-off may also reduce the status of the U.S. dollar as a haven that investors flock to in bad times. **However, although losing the benefits of being the primary global currency would be significant, it's hard to envision another currency taking over the status of number one in the world.** The U.S. dollar is involved in an extraordinary 88% of foreign exchange transactions and constitutes around 60% of global foreign exchange reserves, with no other currency coming close.³

Additional macroeconomic headwinds may include:

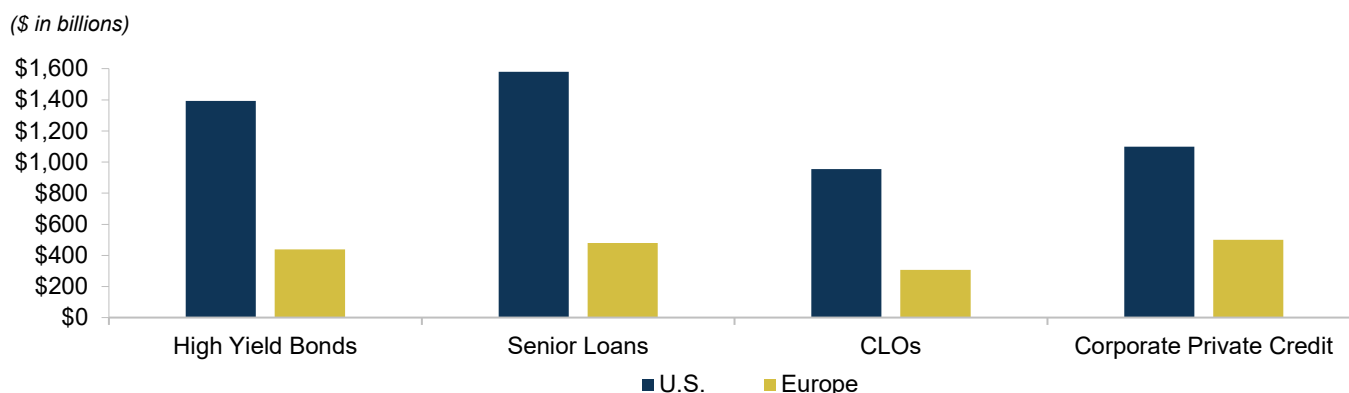
- A stretched low-income consumer, as the U.S. economy bifurcates into a relatively small cohort of very wealthy individuals and an inflation-pressured regular consumer. While an increase in real estate values may make home-owners wealthy "on paper," this wealth is locked up and may not support the consumption the U.S. economy relies on.
- Elevated national debt as a result of consistent reliance on budget deficits, even in healthy economic environments, including a \$1.8 trillion deficit in 2024.⁴ This leads to an increasing interest bill that diverts government spending away from more productive uses.
- Increased global competition, as other nations rapidly modernize and attempt to catch up with American technological superiority.

Some of these challenges may turn out to be more speculative discourse than eventual reality. The U.S. economy appears in good health and continues to power through potential challenges. That being said, macroeconomic outcomes are impossible to predict: for investors, regardless of geography, it remains a case of prioritizing fundamental selection, with a focus on risk management and close monitoring for potential signs of deterioration.

Limited Alternatives

Potential macroeconomic challenges may loom, but the reality is for some asset classes, there is simply limited alternative to U.S. exposure. **For alternative credit investors, there is no market outside the U.S. that offers comparable depth.** The U.S. high yield bond and senior loan markets combine to nearly \$3 trillion, with structured and private credit markets also remarkably extensive.⁵ (See Figure 2.) This is generally significantly more than other regions; for example, the U.S. high yield bond is around triple the size of the European market. Market environments fluctuate but managers can generally expect to rapidly put money to work in the U.S. leveraged finance markets and begin earning their coupons.

Figure 2: The U.S. Sub-Investment Grade Credit Markets Are Vast⁶



Source: ICE, UBS, BofA, Cambridge Associates

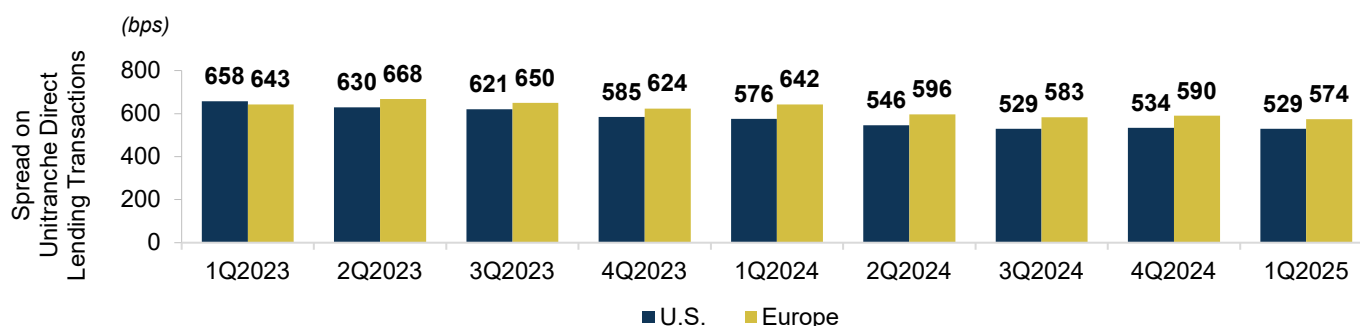
Broader Opportunities

While the size of the U.S. markets will keep them the de facto center of global credit portfolios, we believe there are also attractive opportunities outside of the U.S. Europe is an obvious example, with a GDP not much below the U.S. (\$29.2 trillion versus \$23.0 trillion) but with capital markets that are much smaller.⁷ When appraising opportunities in European credit, we note:

- **Attractive hedged yields and limited default expectations**, from sub-investment grade liquid credit instruments. The European high yield, senior loan, and CLO markets are small compared to their U.S. counterparts but still significant in absolute terms; they currently offer a strong value proposition, benefiting from the technical support of a robust buyer base.
- **Broad direct lending opportunities**, generally with a spread advantage over U.S. deals. (See Figure 3.) Because Europe is historically a bank-driven market, there's meaningful potential for alternative lenders to take share as traditional lenders retrench. Issuance in Europe has been relatively resilient despite macroeconomic volatility, with over €22 billion of direct lending volume in the first half of 2025.⁸
- **A strong macroeconomic backdrop**, standing to benefit from (a) increased government expenditure, most notably on defense, (b) a relatively stable policy environment, and (c) heightened demand from investors amid a perception shift towards Europe.

As we discussed in a [recent podcast](#), **European credit appears to be well-positioned for the current market environment, with limited default expectations and robust technical support.** We highlight the value proposition for the likes of European senior loans, which remains a very stable asset class, underpinned by consistent demand from CLOs and limited access for retail investors.

Figure 3: European Direct Lending Can Offer a Spread Premium



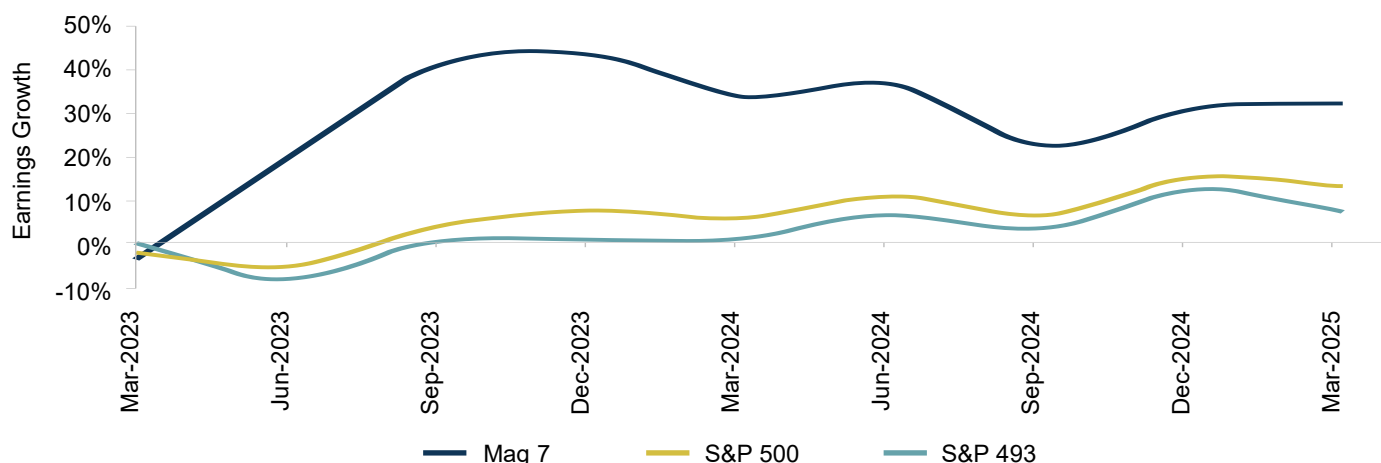
Source: KBRA, as of March 2025

Equities Most Exposed to a Slowdown

Even a modest decline in U.S. exceptionalism could present meaningful challenges for public equities. Over the last several months, the S&P 500 has reached record highs and now trades at a price/earnings (p/e) ratio of 23, significantly above the long-term average and also far above the level of equity markets in other regions, being predicated on the continuation of the U.S. as the best business environment in the world.⁹ Historically, buying into equities at such elevated p/e levels has led to meager returns, with research indicating buying the S&P 500 at today's multiples leads to long-term returns between -2% and 2%.¹⁰

It's well broadcast that there's an extraordinary level of concentration in the S&P 500 right now, with the Magnificent Seven making up over 30% of the index.¹¹ These high-flying companies all trade at elevated p/e ratios. However, Magnificent Seven investors can take some comfort in the fact these companies are legitimately exceptional, with unrivaled cash generation, deep competitive moats, and most crucially, an ability to keep growing earnings at an unusual rate. (See Figure 4.)

Figure 4: Growth Outside the Magnificent 7 Is Limited



Source: Bloomberg, JPMAM, as of March 31, 2025

Perhaps, somewhat ironically, it's the "S&P 493" that presents the biggest concern, even with its more modest p/e ratio. Excluding the Magnificent Seven takes the index multiple down to 21.¹² But that's still high, and many of the constituent companies aren't high-growth superstars: they're growing slowly (or not at all) and beginning to feel the pain of higher interest rates. Notably, the "S&P 493" generate most their revenue domestically (unlike the more international Magnificent 7), reducing the insulation provided by foreign earnings should U.S. growth slow. Ultimately, **should these companies be unable to substantially grow the "e" in their "p/e" ratio, and investors stop tolerating the inflation of equity multiples, then it'll be the "p" that must adjust downward.**

In Summary

The U.S. remains the center of the sub-investment grade credit universe, offering extensive opportunities to deploy at scale in the likes of high yield bonds, structured credit, and private credit. A dramatic increase in borrowers since the GFC allows for the creation of diverse U.S. credit portfolios but we continue to greatly value the additional diversification and opportunities provided by credit in other geographies. **Managers with expertise in both the U.S. and regions such as Europe and Asia stand to benefit from building global portfolios with a disciplined focus on relative value.**

We note some U.S. economic challenges, and though it's hard to imagine these being catastrophic, there is a chance of a slowdown. This potential downturn will likely deflate S&P 500 multiples before it hits credit. In other words, diversified credit portfolios remain a solid bet in this uncertain environment.

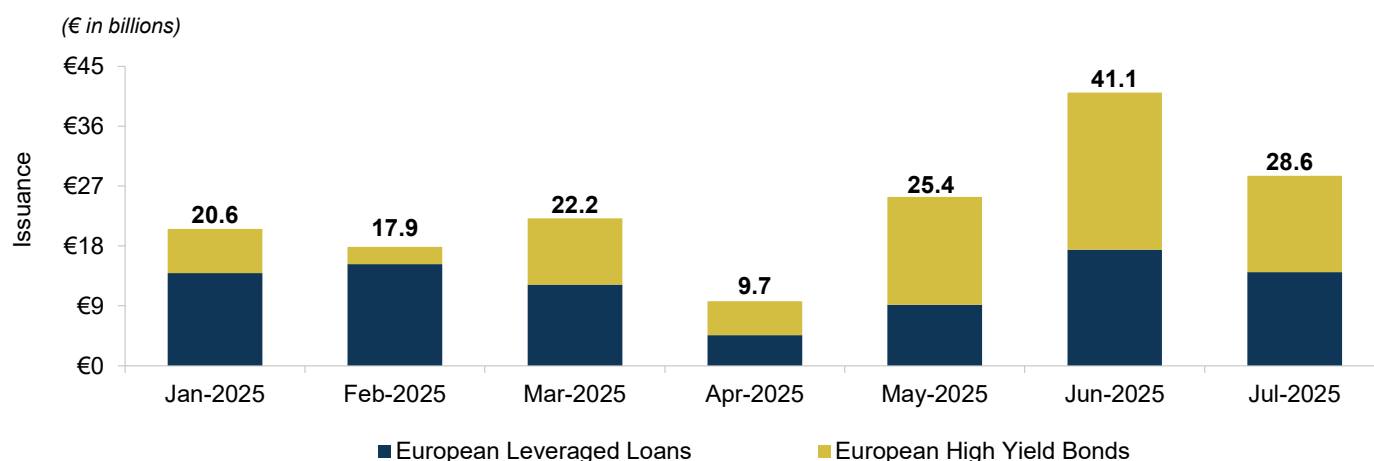
Credit Markets: Key Trends, Risks, and Opportunities to Monitor in 3Q2025

(1) Signs of Supply?

In *Oaktree Credit Quarterly 1Q2025: Gridlock*, we discussed the supply/demand imbalance in the leveraged credit markets. Put simply, credit issuance has been limited as private equity sponsors deal with the headache of rising interest rates, while demand from yield-seeking investors has been robust. Market participants have been waiting for more primary issuance – and there are some signs it’s starting to return.

Sub-investment grade credit issuance has accelerated since the tariff-induced pause in April. Activity in Europe has been particularly notable, supported by improving investor sentiment toward the region. While much of the volume is refinancings, the €17.4bn of loan issuance in June still represents the highest level since March 2021.¹³ (See Figure 5.)

Figure 5: European Leveraged Finance Activity Has Rebounded



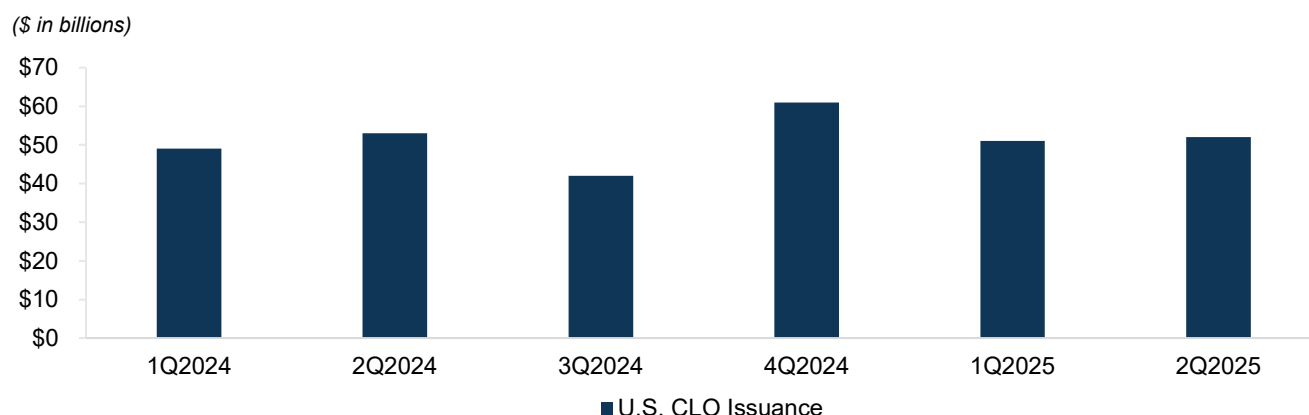
Source: PitchBook, as of July 25, 2025

(2) CLOs keep coming!

There’s sometimes talk of a looming slowdown in CLO issuance – and what it would mean for the leveraged loan market – but aside from brief pauses when uncertainty is particularly acute (e.g., April 2025), the CLO market has demonstrated the ability to “keep calm and print on.” So far this year, we’ve seen \$125bn of new CLO issuance in the U.S. and nearly €40bn in Europe, supported by significant demand from investors for floating-rate debt with attractive coupons.¹⁴ (See Figure 6.) This demand contributes to the tightening of CLO liability spreads, providing a significant boost for CLO managers.

However, most CLO managers will likely remain hopeful that the apparent rebound in loan issuance will continue. If the resumption of primary market activity holds, managers will have the ingredients to fill warehouses and rotate out of certain portfolio holdings in favor of accretive primary paper. Moreover, an easing of the supply/demand imbalance will give CLO managers greater power to push back against aggressive loan repricings and unreasonably tight primary issuance.

Figure 6: CLO Issuance Remains Robust



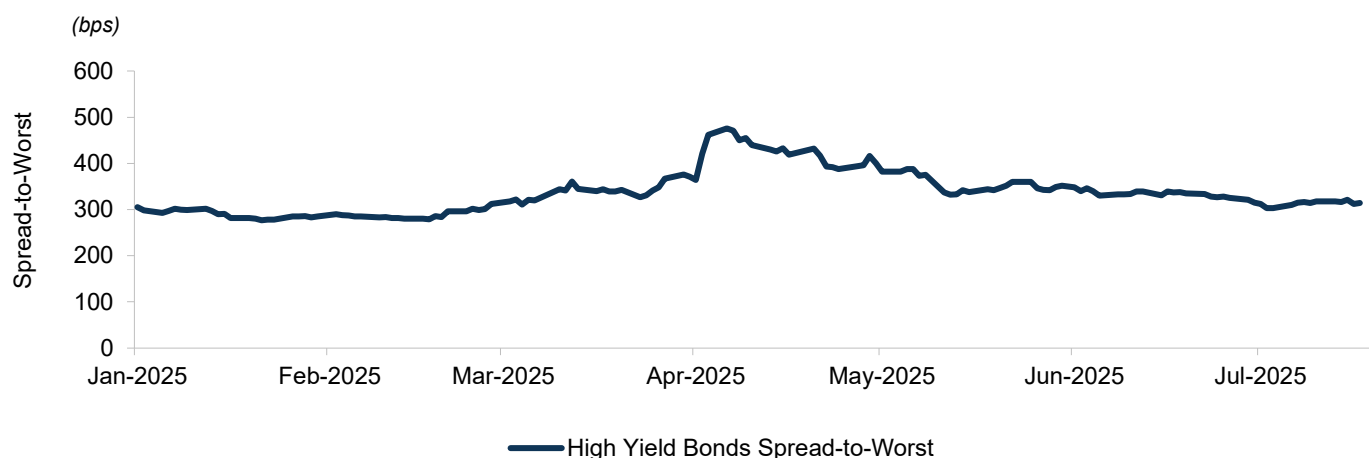
Source: PitchBook, as of June 30, 2025

(3) Spreads don't break

In April, credit spreads properly widened for the first time in a long time. High yield bonds went from trading at a spread of below 300 basis points to nearly 500.¹⁵ (See Figure 7.) That's big but not that big given the circumstances: massive uncertainty regarding trade policy and a seemingly imminent all-out trade war. This has become a familiar theme – the sub-investment grade credit markets are able to shrug off volatility and, when dislocation does briefly occur, the rebound is remarkably quick. We assessed why on a [recent podcast](#), but here's a few factors worth highlighting:

- Market quality: the U.S. high yield market is now over 50% BB-rated, with that percentage even higher in Europe.¹⁶ With a higher average quality than the high yield market of old, it's reasonable to expect a more moderate average spread range.
- A broader lender base: private credit has rapidly risen to become a complement to the syndicated markets. This has (a) transferred smaller borrowers from the public to private markets and (b) given borrowers a second funding option when syndicated debt placement is challenging.
- More opportunistic buyers: a proliferation of distressed debt managers has created a cohort of buyers ready to step in as spreads widen, serving to create a floor in pricing.

Figure 7: Spread Widening in April Was Notable but not Seismic



Source: ICE, US High Yield Constrained Index

Market Conditions: 2Q2025

Investment Grade Credit¹⁷

Return	Defaults (LTM)	Issuance	Value Proposition
1.8% Strong coupon income alongside spread compression drove positive returns in the quarter against a back-drop of curve steepening.	N/A	\$383.0bn Despite some deceleration in the first two weeks of April, primary market activity remains healthy and competitive, with oversubscription rates above 4x in 2Q2025.	Investment grade corporates, particularly at the front-end of the yield curve, continue to offer attractive yields for investors that are risk conscious or patiently awaiting wider spreads to deploy into sub-investment grade credit.

High Yield Bonds¹⁸

Return	Defaults (LTM)	Issuance	Value Proposition
3.6% (U.S.) 2.2% (Europe) During a volatile period, high yield bonds generated outsized returns, driven by rallying CCC-rated bonds.	1.4% (U.S.) 1.3% (EU)	\$77.3bn (U.S.) €45.0bn (Europe) Roughly 70% of new issuance was driven by refinancings during the quarter.	The average quality in the market remains high and overall credit fundamentals continue to be solid. While yield spreads have tightened, high yield bond default rates have been relatively limited.

Senior Loans¹⁹

Return	Defaults (LTM)	Issuance	Value Proposition
2.3% (U.S.) 1.4% (Europe) The performance of senior loans was driven by strong coupon income in the second quarter.	1.4% (U.S.) 2.1% (EU)	\$103.9bn (U.S.) €31.7bn (Europe) Issuance remains dominated by refinancings and repricings.	Attractive yields and strong technical support from CLOs can create stable investment opportunities.

Emerging Markets Debt (Corporate)²⁰

Return	Defaults (LTM)	Issuance	Value Proposition
1.5% EM high yield debt markets held up well, despite the brief global market turbulence. Yield spreads fully recovered to their first-quarter levels by quarter-end.	3.8%	\$39.7bn Year-to-date EM high yield bond issuance is running at its fastest pace since 2021.	Spreads remain tight relative to lingering global and EM-specific risks. Rigorous security selection is crucial to manage risk.

Market Conditions: 2Q2025

Global Convertibles²¹

Return	Defaults (LTM)	Issuance	Value Proposition
5.9% Convertible bonds were supported by strong equity market performance during the second quarter.	2.8%	\$47.1bn The asset class experienced its highest level of quarterly issuance since 2021, driven by strong volumes in the U.S.	Equity valuations remain sensible and new issue pricing has meaningfully improved over the last several years, offering better coupons and convexity.

Structured Credit (Corporate)²²

Return	Defaults (LTM)	Issuance	Value Proposition
3.6% (BB-Rated CLOs) 2.1% (BBB-Rated CLOs) Despite experiencing volatility during the quarter, corporate structured credit generated strong returns supported by high coupon income.	N/A	\$50.8bn (U.S.) €12.2bn (Europe) CLO issuance remains in line with the same period last year.	Structured credit's high coupon income makes it one of the most attractive asset classes within fixed income, particularly as corporate defaults remain low.

Structured Credit (Real Estate)²³

Return	Defaults (LTM)	Issuance	Value Proposition
1.0% (BBB-Rated CMBS) The asset class generated a positive return during the period as CRE capital markets continue to thaw.	5.4%	\$30.0bn Private-label CMBS issuance continued its positive momentum following the trough in 2023.	Valuations remained unchanged quarter-over-quarter, signaling a broader trend toward market stabilization.

Private Credit

Private credit showed resilience in 2Q2025 despite a challenging macroeconomic backdrop. In early April, expectations of significant spread widening in direct lending driven by trade war volatility didn't fully materialize. New deal flow slowed following initial tariff announcements but ample capital from direct lenders offset the decline. Spreads widened modestly for about a month, by 25-50 basis points across strategies.²⁴ While LBO and M&A activity has risen from its April lows, it remains subdued relative to the market's inflated expectations at the end of 2024. Refinancing volumes are rising as existing deals remain outstanding for longer; as a result, deal flow remains active, though quality varies. In this environment, it's important for direct lending managers to remain disciplined, passing on opportunities where risk-adjusted returns fall short. Similarly, investors should prioritize managers with strong credit selection and workout capabilities over those focused on rapid deployment.



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

Oaktree Capital Management is a leading global alternative investment management firm with expertise in credit strategies. Our credit platform has \$149 billion in AUM and encompasses a broad array of strategy groups that invest in public and private credit instruments across the liquidity spectrum.²⁵ 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. MSCI, as of June 30, 2025; census.gov, as of July 24, 2025.
2. Bloomberg, as of June 30, 2025.
3. Federal Reserve, IMF.
4. Congressional Budget Office.
5. ICE, UBS.
6. Incorporates multiple sources, with extrapolation where appropriate.
7. International Monetary Fund, December 2024.
8. PitchBook, as of June 30, 2025.
9. Bloomberg, as of July 31, 2025.
10. JP Morgan.
11. LSEG Datastream, as of July 18, 2025.
12. Bloomberg, as of July 31, 2025.
13. PitchBook.
14. PitchBook, as of August 1, 2025.
15. ICE US High Yield Index.
16. ICE US High Yield Index, ICE BofA Global Non-Financial High Yield European Issuer Excluding Russia Index, as of July 31, 2025.
17. ICE U.S. Corporate Index for all return data; Bank of America for all issuance data (reflects U.S. issuance).
18. 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).
19. S&P UBS Leveraged Loan Index for all U.S. Senior Loans return data; Credit Suisse Western Europe Leveraged Loan Index for all European Senior Loans return data; JP Morgan for all U.S. default rates; UBS for all European default rates (excluding distressed exchanges); PitchBook LCD for all U.S. and European issuance data (including refinancings).
20. JP Morgan Corporate Broad CEMBI Diversified High Yield Index for all return data; JP Morgan for default rates (including distressed exchanges) and issuance (including refinancing) data.
21. Refinitiv Global Focus Convertible Index for all return data; Bank of America for default rates and issuance data.
22. JP Morgan CLOIE BB Index and JP Morgan CLOIE BBB Index for all return data; PitchBook LCD for all issuance data.
23. 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.
24. Oaktree Market Observations.
25. The AUM figure is as of June 30, 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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