Credit Market Conditions

Positive Credit Sentiment Returns to Leveraged Loan Market in Q2 2026 Following Q1's Disruption and Uncertainty Stemming from World Events

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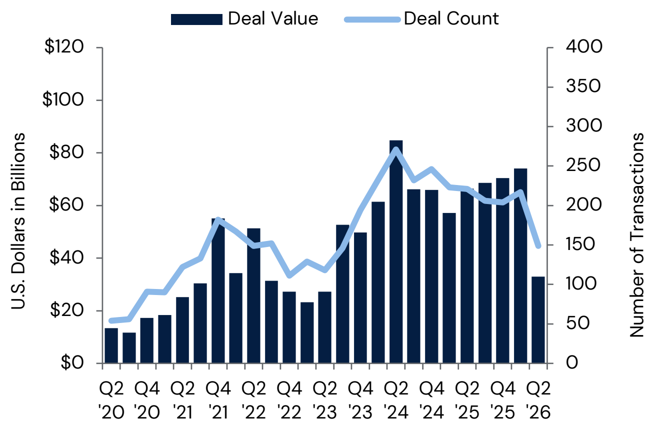
Second Quarter Review: From a lender/investor demand perspective, the U.S. Leveraged Loan market exited Q2 2026 in a position similar to much of 2024 and 2025: demand for new loans continued to exceed available supply. While declining issuances could suggest weakening lender appetite, survey data from both bank and private credit lenders has indicated demand for new lending opportunities remains robust.

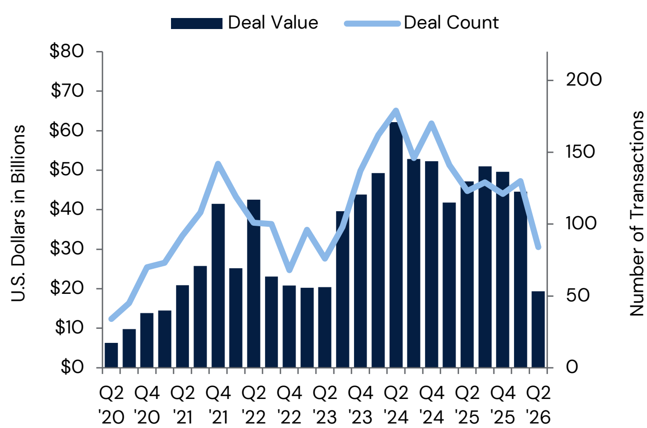
Loan Volumes Decline Significantly During Q2: Direct lending and private equity (PE)-backed credits declined on a volume and value basis during the quarter. Overall direct lending issuance value slipped 55.5% quarter-over-quarter (QoQ) from $74.1 billion in Q1 2026 to $32.9 billion in Q2 2026—the lowest quarterly reading since Q2 2023 ($27.2 billion), according to PitchBook LCD's Q2 2026 U.S. Private Credit and Middle Market Quarterly Wrap report.[1] PE-backed loan activity followed a similar trajectory, with only $19.4 billion of value in the quarter, similarly 56.5% less than the preceding quarter's issuance of $44.6 billion. On the surface, these declines suggest the Direct Lending market's willingness to extend credit diminished. However, direct lenders were very much open for business, and the pullback simply reflected a much sharper drop in new leveraged buyout (LBO) activity, a primary source of loan origination volume.

LBOs, The Main Driver of Loan Volume: Total LBO value and deal count dropped again for the third consecutive quarter after peaking in Q3 2025. Q2 2026's value of $68 billion was the lowest since Q2 2020, reflecting, in part, continued uncertainty stemming from geopolitical conflict in the Middle East, according to PitchBook's Q2 2026 U.S. PE Breakdown report.[2] Leverage loan activity is closely tied to LBO volume since new buyouts remain a major source of financing demand. Refinancings, add-ons, and dividend recapitalizations can absorb only so much lender capital. Encouragingly, in our

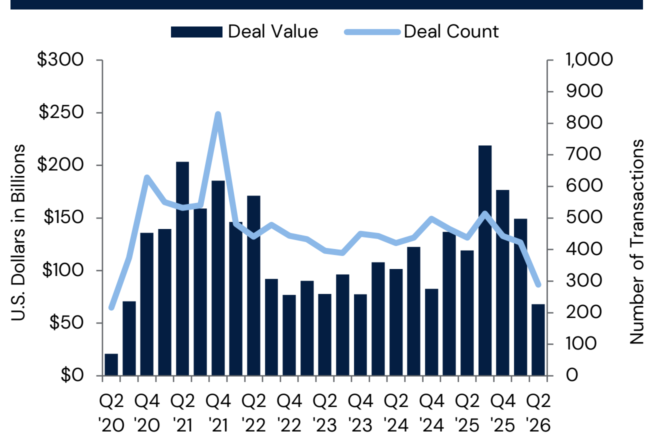
Direct Lending Deal Value & Count



PE-Backed Direct Lending Deal Value & Count



Total LBO Deal Value & Count

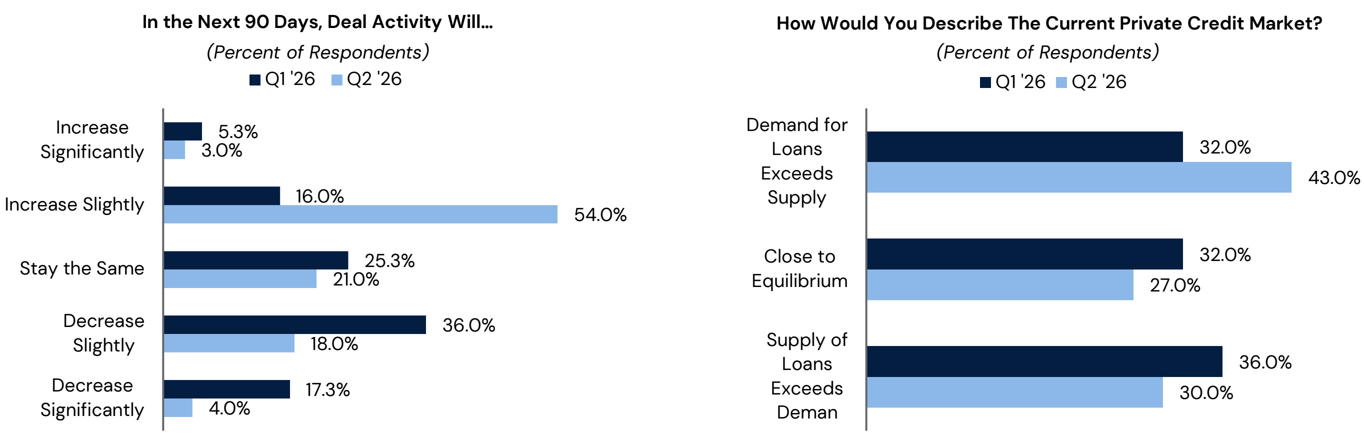


Source: PitchBook and Capstone Partners recent discussions with sponsors, we are generally hearing that the top of the merger and acquisition (M&A) funnel—new transaction launches from investment banks—began increasing throughout the summer. Although anecdotal, these signals should ultimately translate into new LBO closings in Q4 2026 and Q1 2027.

Lender Sentiment and Demand for New Loans Are Unequivocally Bullish: While Q1 and early Q2 still had the uncertainties of the Middle East conflict looming large, lenders seemed to have reverted to a business-as-usual posture with each passing day. Lenders, like sponsors, expect deal flow to increase in Q3, according to a survey in PitchBook LCD's Q2 U.S. Private Credit and Middle Market Quarterly report. More than half (57%) of lenders anticipate deal flow will increase in the next 90 days, a clear bullish pivot from Q1 when 53.3% believed deal flow would decline in the following three months.

Reinforcing this optimism, private credit lenders reported that demand for new loans now exceeds current supply. This loan supply/demand imbalance was the status quo outlook for much of 2024 and 2025, driving the loan spread compressions that occurred during those years. This signals an unmistakable "buy signal" from the Loan market; lenders clearly have capital to deploy but cannot source enough supply to absorb it. This sentiment also pivoted from the prior quarter where the lion's share (36%) of lenders felt there was excess loan supply—likely indicative of the macroeconomic uncertainty at the time. This data point for Q2 mirrors Capstone's regular discussions with lenders where we hear available deal flow remains insufficient relative to their 2026 capital deployment targets.

Survey Reponses Underscore Lender Optimism and Appetite



Data through June 8, 2026
Source: PitchBook LCD and Capstone Partners

It has not been just institutional or private credit lenders whose demand pendulum has swung back toward new loans. Bank lenders have echoed the shift, lending more freely, to more borrowers, and on friendlier terms. In July 2026, regulated bank credit officers reported that standards have eased across all commercial and industrial loan types compared to the prior year period, according to the Federal Reserve's Senior Loan Officer Opinion Survey on Bank Lending Practices.[3] Therefore, all categories of loan sources, from banks to institutional lenders, agree that current loan supply is insufficient to satiate loan demand. When demand outstrips supply for an extended period, lenders must compete more aggressively for mandates and offer more beneficial terms to issuers. They differentiate themselves by tightening spreads, raising leverage thresholds, loosening covenants, or expanding appetite for delayed-draw term loans. Further, when both banks and institutional lenders feel undersupplied, which historically has not always been the case, it creates competition across loan sources outside their respective cohort groups, further intensifies competition for new loan issuances, and reinforces a borrower-friendly environment.

Capstone Outlook: Capstone's Debt Advisory Group continues to hear from sponsors and lenders alike that new deal flow—LBO opportunities for sponsors and LBO financing for lenders—remains challenged relative to original expectations for the year. In these state-of-the-market discussions, many participants anticipate that when M&A activity ultimately reaccelerates, it will echo the 2021 deal flow super cycle with sponsors and lenders incredibly busy underwriting new deals. This super cycle outlook, however, was also the conventional wisdom at the end of both 2024 and 2025 but material macrocosmic disruption—"Liberation Day" tariffs in 2025 and the Middle East conflict in 2026—thwarted robust pipelines from materializing. Capstone believes the substantial backlog of PE-owned assets that have approached or already exceeded typical hold periods, among other underlying conditions, will support a future surge in sponsor-backed transaction activity. For the time being, all LBO market lenders will continue to source deals from an underwhelming supply environment, keeping competition for those new deals elevated in the near term. In the Private Credit market, lenders will likely keep using a combination of loan spreads, covenant cushions, excess cash flow sweep provisions, or committed delay draw term loan quantums to win new loans. Positive credit sentiment is indeed back in the Leveraged Loan market.

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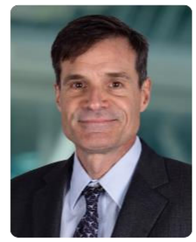

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Endnotes

1. PitchBook LCD, "Q2 2026 U.S. Private Credit and Middle Market Quarterly Wrap," pitchbook.com/news/articles/q2-us-private-credit-wrap-software-under-scrutiny-as-market-recalibrates, accessed August 25, 2026.
2. PitchBook, "Q2 2026 U.S. PE Breakdown," pitchbook.com/news/reports/q2-2026-us-pe-breakdown, accessed August 25, 2026.
3. Federal Reserve, "Senior Loan Officer Opinion Survey on Bank Lending Practices," federalreserve.gov/data/documents/sloos-202607.pdf, accessed August 25, 2026.