Strategy Insights | Invesco Private Credit

The Case for Senior Loans



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Q3 2026 market update

Investors continue to reassess the health and positioning of the global bank loan asset class amid a shifting macroeconomic backdrop. Several developments kept the market in focus through the third quarter: a turn toward tighter monetary policy, with the Federal Reserve raising the federal funds rate by 25 basis points in September and the European Central Bank raising rates to 2.50%, its second hike of the year; elevated geopolitical tensions in the Middle East that pushed oil prices higher; and a continued recovery in technology credits following the AI-driven volatility earlier in the year. We view this environment as constructive for the loan market. As a floating-rate asset class, loans can benefit directly from higher base rates, and in September loans outperformed high yield bonds by the widest margin since August 2022.[4] At the same time, these developments reinforce the longstanding need, in our view, to discover and invest in issuers with durable competitive positioning. Against this backdrop, three key questions have emerged:

1. How are underlying bank loan issuers performing in the current market?
2. How does a rising rate environment affect loan returns?
3. What is the outlook for the loan asset class?

This piece provides our view on the current market environment and attempts to answer these critical questions.

Why loans now?

In our view, there are three compelling reasons to consider investing in senior secured loans today:

1) Potential high level of current yield

Yield is driven by two primary components: income and price appreciation. For loans, the income component has become even more compelling, in our view. With central banks in both the US and Europe raising policy rates in September, the base rates that drive loan coupons have moved higher, while loan spreads remain near their long-term averages. At quarter-end, US loans offered a 9.62% yield inclusive of the forward curve, compared with 8.35% for US high yield bonds.[1,2] In addition, loans are currently trading at an average price of approximately 94 and 96 in the US and European markets respectively, providing incremental potential for price appreciation alongside income.[1] Historically, leveraged loans have delivered consistent and relatively stable returns across a range of market environments, including recessionary periods and cycles of both rising and declining rates.

2) Resilience to interest rate changes

Bank loans are uniquely positioned in today's market to pursue high income potential regardless of the direction of interest rates. As floating-rate instruments, their coupons reset regularly to SOFR, potentially helping insulate investors from the price volatility that affects traditional bonds. The third quarter provided a clear illustration: as Treasury yields rose to multi-year highs in September, US loans returned 0.26% while high yield bonds returned -2.52% and investment grade corporate bonds returned -2.72%.[1,2] In Europe, fixed-rate bonds likewise came under pressure while floating-rate loans materially outperformed.

In a rising rate environment, floating-rate loans can benefit directly: higher base rates translate into higher coupons and greater income for investors. Interest rate movements are notoriously difficult to predict, and the balance of risks has shifted toward further tightening as firmer energy prices add upward pressure on inflation. When rates rise, coupons increase; and even if rates were to fall, loans would reset lower while still offering competitive yields relative to other fixed income segments, with lower interest expense easing the burden on borrowers. This flexibility has made loans a resilient source of income across both rising and falling rate environments.

3) Compelling relative value

Loans have consistently provided some of the most attractive yields in the fixed income market, while also offering downside risk mitigation due to their senior position in the capital structure and being secured by a company's assets.

In 2025, high yield bonds outperformed loans largely driven by the longer duration of high yield bonds benefiting from rates falling.[1,2] In 2026, that trade has reversed: through September 30, US loans returned 3.42% year-to-date versus 0.10% for US high yield bonds, as rising yields weighed on longer-duration assets.[1,2] High yield bond spreads remain near historically tight levels, limiting forward return potential. In contrast, loan spreads remain near their long-term averages, and loans continue to trade at a discount, creating a potentially appealing entry point and price-upside opportunity.

Loans also offer these high yields with potentially lower risk. In a recessionary scenario, loans can provide further downside risk mitigation due to their senior secured status, which gives them the highest priority for repayment in the event of default. Historically, this seniority has translated into stronger recovery rates and lower credit losses during economic downturns reinforcing their role as a resilient asset class with historically positive annual returns.

Yields

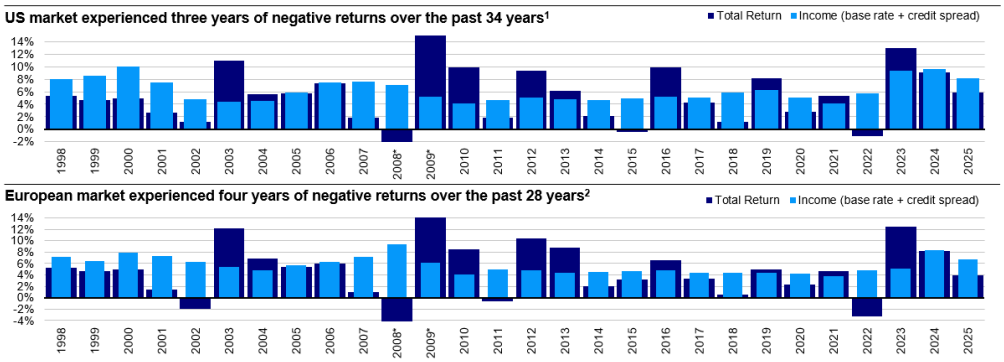
Loan yields are currently attractive both historically and relative to high yield bonds. With loans offering higher all-in yields (9.62% versus 8.35% for high yield at September 30, 2026) and trading below par, investors may benefit from elevated income potential and modest price appreciation compared to high yield bonds.[1,2]

Senior Loans: A Core Holding In Any Environment
A unique combination of appealing characteristics

			Investors Looking for:
1	**High Income**	• Potential for competitive monthly income and strong risk adjusted returns • Strong relative value[1]: – US Loan Yield to 3yr: 9.62% – European Loan Yield to 3yr: 8.61%	**Potential High Yield**
2	**Senior Secured Status**	• Highest priority to be repaid; lenders have first right to collateral in the event of a default • Higher recovery in case of default	**Potential Risk Mitigation**
3	**Floating Rate Feature**	• Effective duration of 0 years • "Pure" credit exposure, limited duration risk	**Potential Mitigation of Interest Rate Risk**
4	**Diversification Potential**	• Low correlation with investment grade fixed income[2] • 0.13 when comparing Loans to US Agg	**Alternatives Asset Class Exposure**
5	**Compelling relative value**	• Loans have offered one of the best yields in fixed income despite their senior secured status[1]	**Potential High Comparative Returns**

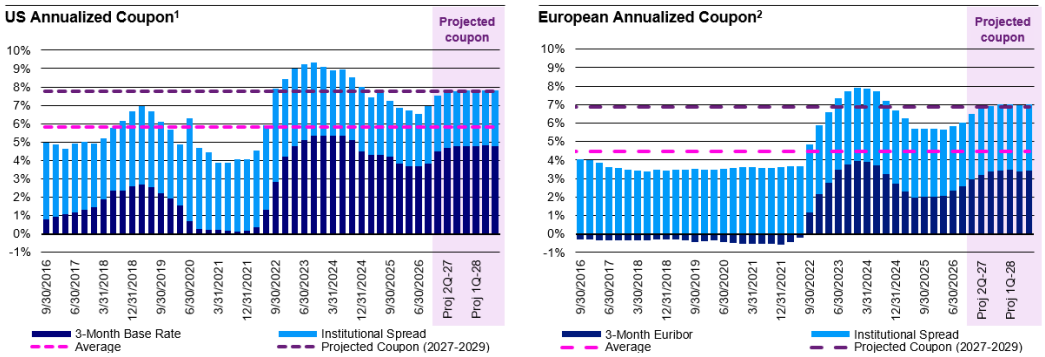
Source: [1]S&P UBS LLI and S&P UBS WELLI as of September 30, 2026. [2]Bloomberg Aggregate bond index correlation to S&P UBS LLI data from December 2015 to December 2025. Updated annually. **Past performance does not predict future returns**.

Senior secured loans have offered positive income through market cycles



Source: [1]S&P UBS Leveraged Loan Index data through December 31, 2025, updated annually. *Denotes returns in excess of the axis. 2008 returns were –28.75%, 2009 returns were 44.87%. An investment cannot be made directly in an index. [2]S&P UBS Western European Leveraged Loan Index data through December 31, 2025, updated annually. *Denotes returns in excess of the axis. 2008 returns were –30.24%, 2009 returns were 47.24%. An investment cannot be made directly in an index. **Past performance does not predict future returns**.

Total US and European loan coupons near all-time highs

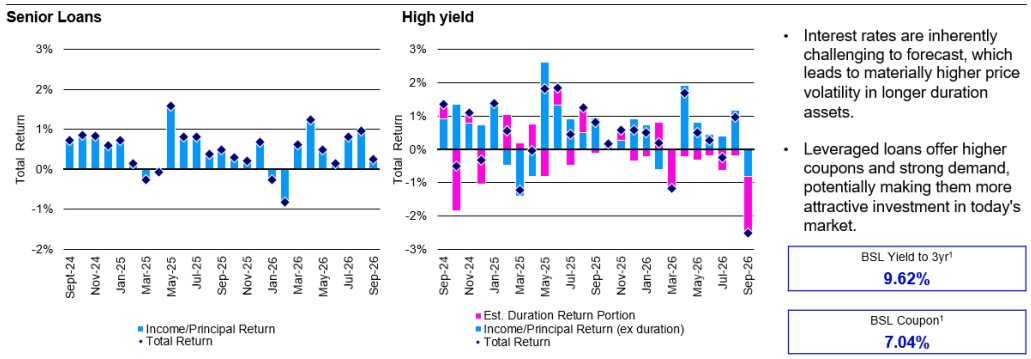


Source: [1]PitchBook Data, Inc. as of September 30, 2026, updated quarterly. Base rate reflects the average during the quarter. Uses three-month LIBOR (prior to 2023) or SOFR (2023 or later) plus the weighted average institutional spread. Forecasted coupon for future rolling 3-month data as applicable using average trailing 4 quarters spread levels and forward 3m SOFR rates as of September 30, 2026. 2026-2029 represented by the forecasts as of October 8, 2026. With dashed purple line representing average projected coupon in 2026-2029. [2]S&P UBS WELLI and EURIBOR 3-month rates as of September 30, 2026. Updated quarterly. Forecasted coupon for future rolling 3-month data as applicable using average trailing 4 quarters spread levels and forward 3m EURIBOR rates as of September 30, 2026. There can be no assurance that any projected coupons can be realized.

While high yield bonds outperformed loans by roughly 250 basis points in 2025, that advantage has already reversed in 2026. The duration trade has run its course, and with policy rates now rising, we believe senior loans are well positioned to deliver higher income, especially since forecasting interest rate moves remains inherently difficult. Loans' floating-rate structure offers built-in flexibility, making loans a strategic component in diversified portfolios, particularly when the direction (and magnitude) of interest rates is uncertain.

Monthly total return breakout

Impact of rate expectations on performance



- Interest rates are inherently challenging to forecast, which leads to materially higher price volatility in longer duration assets.
- Leveraged loans offer higher coupons and strong demand, potentially making them more attractive investment in today's market.

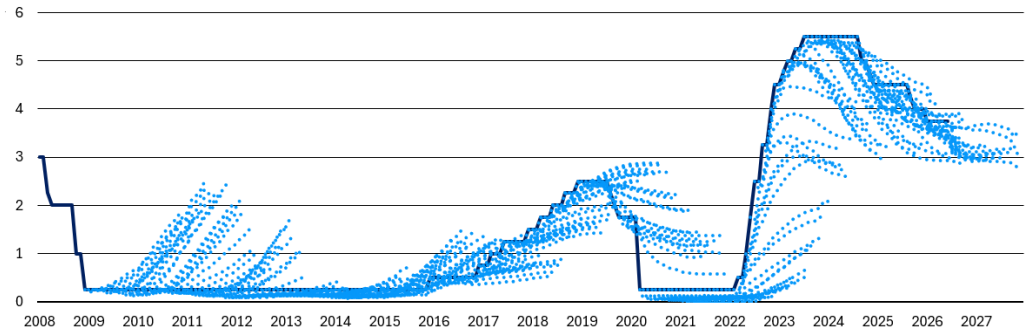
BSL Yield to 3yr[1]
9.62%

BSL Coupon[1]
7.04%

Source: S&P UBS Leveraged Loan Index & Bloomberg US Corporate High Yield Index data through September 30, 2026. An investment cannot be made in an index. **Past performance is not a guarantee of future results.** Estimated duration return based on modified duration as of prior month end and basis point change in yields of 5-year treasuries. [1]S&P UBS LLI index data as of September 30, 2026.

Floating Rate Feature

Forecasting is hard, especially about the future

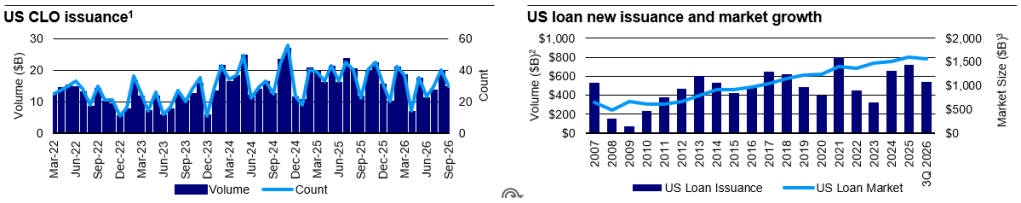


Source: Invesco, Bloomberg L.P., as of September 30, 2026. For illustrative purposes only. Solid line represents actual Fed funds rate while dotted blue lines represent point in time historical forecasts. There is no assurance that these forecasts will be met.

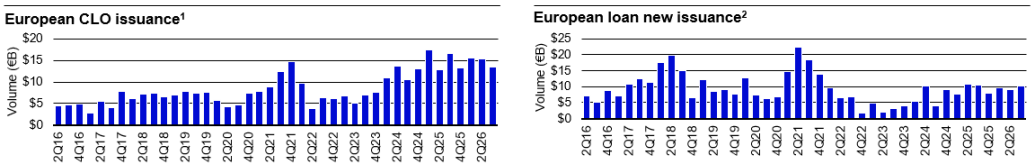
Market technicals

Technicals remained supportive through the third quarter. In the US, retail fund inflows strengthened in each month of the quarter, totaling $10.4 billion in Q3 versus $4.9 billion in Q2, while CLO gross origination increased to $132.2 billion.[4] September marked the busiest month for

M&A-related loan issuance since 2022 and the strongest month for net new institutional loan issuance since February 2022, and the syndicated loan market continued to win share from private credit as direct lending facilities were refinanced in the broadly syndicated market.[4] In Europe, CLO issuance reached €46.2 billion year-to-date by September 25, ahead of the same point in 2025, while a five-year-high autumn pipeline provided welcome new supply.[3] CLOs continue to represent over 70% of the investor base in the loan market, and 2025 saw record global CLO formation, with 569 CLOs pricing over $276 billion.[3] Historically, as demand for loans wanes, new loan issue supply will typically respond in kind to help re-establish equilibrium in the market, and this dynamic interplay between supply and demand helps provide price stability in the loan market.



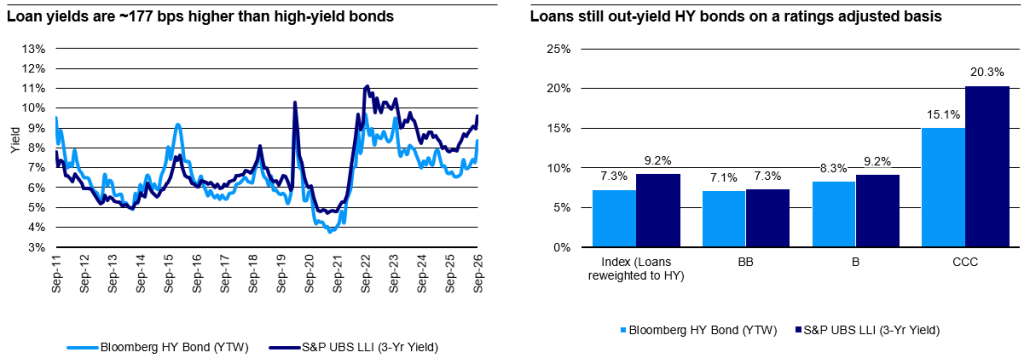
Source: [1]PitchBook Data, Inc. as of September 30, 2026, updated quarterly.



Source: [1]PitchBook Data, Inc. as of September 30, 2026, updated quarterly. [2]Loans represented by PitchBook Data, Inc. as of September 30, 2026, updated quarterly.

Relative valuations also favor bank loans compared to high yield bonds. Loan spreads are currently near their long-term average, while high yield bond spreads remain near historically tight levels. Loans have also been outyielding high yield bonds, by 127 basis points at quarter-end, with loan coupons historically high.[1,2]

Loans have offered higher yields than high-yield bonds



Source: [1]S&P UBS Leveraged Loan Index & Bloomberg US Corporate High Yield Index as of September 30, 2026. Long term medians based on data starting from 01/31/2001. Peak Senior loan 3yr DM of 1799 on 12/31/08 and HY spread of 1833 on 11/28/08. [2]S&P UBS Western European Leveraged Loan Index & Bloomberg Pan Euro HY Index (Avg option adjusted spread) as of September 30, 2026. Long term medians based on data starting from 01/31/2001. Peak Senior loan 3yr DM of 1973 and HY spread of 1953 on 12/31/08. Past performance is not a guarantee of future results.
Sources: S&P UBS Leveraged Loan Index and Bloomberg US Corporate High Yield Index as of September 30, 2026.

Market fundamentals

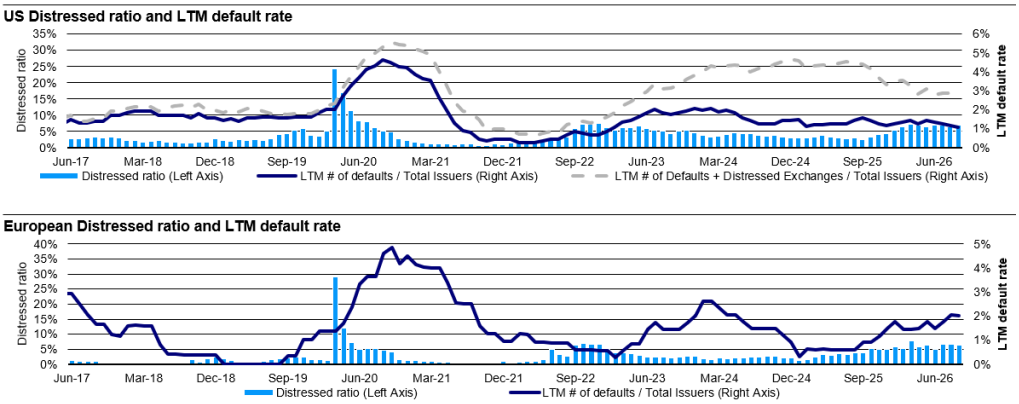
Market fundamentals for underlying loan issuers remain relatively strong.

Technology credits, which experienced broad and somewhat indiscriminate selling earlier in the year on concerns that advances in artificial intelligence could disrupt legacy software business models, rebounded in the third quarter. Information Technology was the strongest-performing sector in the US loan market in Q3, and also led European loan returns in September, as investors reassessed the durability of individual business models.[1] Importantly, we do not view the earlier volatility as indicative of broader credit weakness or systemic stress in the loan market. This environment reinforces the importance of distinguishing between issuers with durable competitive advantages and those more vulnerable to technological disruption, which is precisely where active credit selection can add value.

Default activity remained well contained. The US trailing twelve-month par-weighted default rate declined to 0.55% at the end of September 2026 from 0.97% at the end of June, while the trailing twelve-month principal amount-weighted default rate for the Morningstar European Leveraged Loan Index was 2.15%, below its long-term historical average of 2.61%.[3] Additionally, the senior secured nature of loans has historically provided a high recovery rate in the event of default, and firms that go through liability management exercises (LMEs) tend to have higher recovery rates

compared to those that do not. Issuers pursuing LMEs typically exhibit signs of distress well in advance of a restructuring, which is precisely where active management can add value by identifying and reducing exposure to vulnerable credits before stress crystallizes.

Distressed ratio has served as a good leading indicator of potential default activity

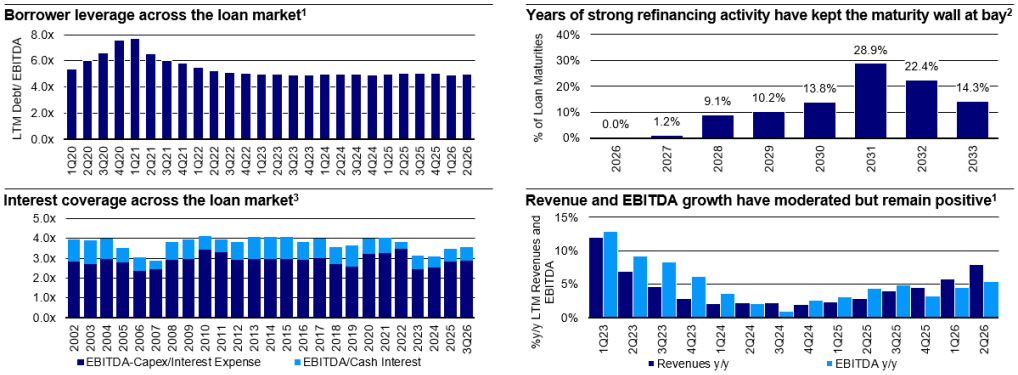


Sources: PitchBook Data, Inc.; Morningstar LSTA US Leveraged Loan Index, Morningstar European Leveraged Loan Index. Data through September 30, 2026, updated quarterly.

We still see the risk/return opportunity stronger in the loan market than in high yield which has seen spreads compress. The average leverage of companies in the leveraged loan market serves as an indicator of the financial health of bank loan issuers. The majority of borrowers continue to have healthy balance sheets, and average leverage in the market has returned to pre-pandemic levels. Borrowers have also pushed out their debt maturities, with virtually no loans maturing in 2026 and only around 1% in 2027, leaving little near-term refinancing risk.[3]

Another important investor concern is how higher rates will impact issuers' ability to service their debt. The average borrower has entered this cycle with a very strong ability to service their debt. Interest coverage ratios have remained robust, improving to 3.54x in the third quarter from 3.48x at year-end 2025, indicating that companies continue to have sufficient capacity to meet their interest obligations.

Credit fundamentals have stabilized despite prior leverage and growth headwinds



Sources: [1]JPMorgan as of June 30, 2026 (data represents the last 12 months); data is quarter lagged or most recent available. [2]PitchBook Data, Inc., as of October 2, 2026, updated quarterly. [3]PitchBook Data, Inc. Interest coverage ratios of leveraged loans. Data through September 30, 2026.

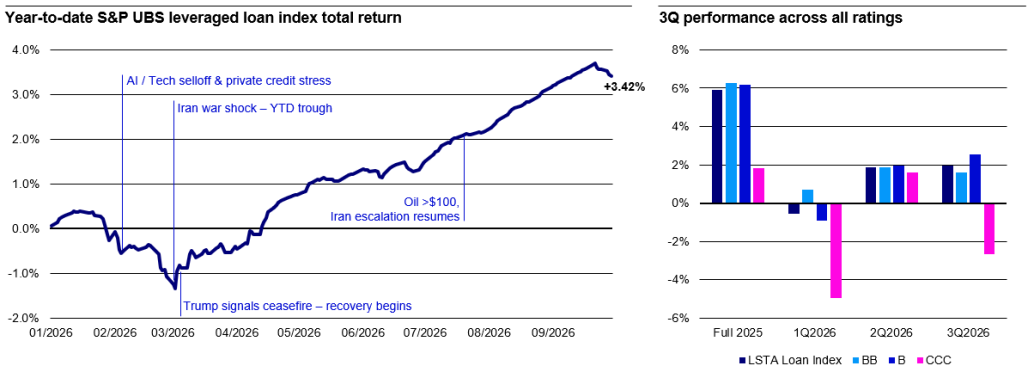
Conclusion

As we look ahead, we believe senior secured loans remain well positioned to deliver attractive risk-adjusted returns. While the broader credit landscape continues to evolve, marked by rising interest rates and headline-driven volatility, loans can offer compelling value through high and rising income, discounted entry points, and resilient credit fundamentals.

In 2025, US Loans delivered a total return of 5.94% (8.15% interest return, -2.21% principal return), and European Loans delivered 4.00% (6.71% interest return, -2.71% principal return).[1] In the third quarter of 2026, US Loans returned 2.03% (1.83% coupon income, 0.20% principal return), with positive returns in every month of the quarter, and European Loans returned 1.06% (1.61% interest income, -0.55% principal return).[1] This highlights the asset class's ability to generate meaningful income across various market environments. With policy rates moving higher in both the US and Europe, coupons are projected to remain well above historical averages.

For investors seeking stability, yield, and resilience across market cycles, senior secured loans may continue to stand out as a strategic allocation. The asset class has historically proven durable across a wide range of economic environments, offering an evergreen option for investors navigating market fluctuations. The chart below illustrates this resilience clearly. Over the course of 2026, the loan market absorbed a series of meaningful shocks, including the artificial intelligence and technology sell-off paired with private credit stress early in the year, a sharp drawdown to the year-to-date trough around the Iran war shock, and a shift toward central bank tightening in the third quarter. In each case, the setback proved short-lived, and loans continued to grind higher, delivering a total return of 3.42% in the US and 2.84% in Europe year-to-date through September 30, 2026.[1] B- and BB-rated loans posted positive returns in the third quarter, underscoring that strain remained concentrated in a limited number of lower-rated credits rather than systemic.

Despite significant volatility through 2026, leveraged loans remained resilient and continued to provide positive total returns



Source: Bloomberg (YTD S&P UBS Leveraged Loan Index total return); PitchBook (Morningstar LSTA US Leveraged Loan Total Return Index and B, BB, and CCC rated loan data). Data as of September 30, 2026. **Past performance does not predict future returns**. An investment cannot be made directly into an index.

Investment risks

Many senior loans are illiquid, meaning that the investors may not be able to sell them quickly at a fair price and/or that the redemptions may be delayed due to illiquidity of the senior loans. The market for illiquid securities is more volatile than the market for liquid securities. The market for senior loans could be disrupted in the event of an economic downturn or a substantial increase or decrease in interest rates. Senior loans, like most other debt obligations, are subject to the risk of default. The market for senior loans remains less developed in Europe than in the U.S. Accordingly, and despite the development of this market in Europe, the European Senior Loans secondary market is usually not considered as liquid as in the U.S. The value of investments, and any income from them, will fluctuate. This may partly be the result of changes in exchange rates. Investors may not get back the full amount invested.

[1]S&P UBS as of September 30, 2026.

[2]Bloomberg as of September 30, 2026. High yield represented by the Bloomberg US Corporate High Yield Index; investment grade represented by the Bloomberg US Corporate Bond Index.

[3]PitchBook LCD, PitchBook Data, Inc., Intex, Bloomberg, S&P UBS as of September 30, 2026.

[4]JP Morgan as of September 30, 2026.

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