



Q1 2026

Intro

Welcome to this edition of *Credit Conditions*, a quarterly publication from McDermott Will & Schulte that analyzes recent debt market trends.

End-of-year dealmaking accelerated across M&A, private equity (PE), and credit markets, even as Federal Reserve (Fed) uncertainty, tariffs, and shifting regulations pulled markets in competing directions. With renewed initial public offering (IPO) exits, record loan repricings, and fierce competition between the broadly syndicated loan (BSL) and private credit markets, Q1 sets the stage for a volatile but opportunity-rich 2026.

Access the full newsletter below.

In depth

Key debt market trends

Macro headwinds and tailwinds

- The Fed delivered two quarter-point rate cuts in Q4, [lowering its top rate to 3.75% after its October and December meetings](#). Fed Chair Jerome Powell [described the US economy as “very unusual”](#) as the Fed tries to balance [persistent labor-market softness](#) and stubbornly high inflation, [which ticked up to 3% at the end of September](#). Policymakers were also flying partially blind because of a five-week data blackout caused by the federal government shutdown, compounding their challenges. Notably, the [October Consumer Price Index \(CPI\)](#) and [jobs reports were canceled](#), and the November CPI, jobs reports, and initial estimate of Q3 gross domestic product (GDP) [were delayed until after the December Fed meeting](#). Forecasting the Fed’s future decisions is also more difficult without this data, as the Fed has consistently [emphasized that its decisions will be data dependent](#). Projections issued by the Fed after its December meeting showed [the median policymaker supported only one cut of 25 basis points \(bps\) in 2026](#) while [market projections point to an additional cut for a total of 50 bps in 2026](#). Economists expect [unemployment to reach and stay around 4.5% in 2026 and inflation to fall to 2.6%](#), well above the Fed’s traditional 2% target, leaving the Fed to [navigate a widening tension between its employment and price-stability mandates](#).
- Tariff-driven uncertainty continued to ripple through the economy. US manufacturing extended an [eight-month slowdown by late October, as new orders weakened and supplier delays mounted](#). Some retailers [front-loaded spring inventories to dodge tariffs](#) while many businesses [struggled to pass tariff costs through to consumers](#), which [reduced profit margins](#). Economists estimate that [US companies currently absorb 51% of tariff costs, with consumers paying 37% and the balance falling on foreign exporters or avoidance-related expenses](#). However, as tariffs become the new normal, [more of the tariff burden is expected to shift to consumers](#), with their share likely [rising to 55% and businesses’ share falling to 22%](#). Overall, [tariffs are estimated to add 0.25% to 0.75% to inflation this year](#) but with potentially more to come if consumers begin to bear more of the tariff costs.

M&A animal spirits return

- Global M&A roared back in Q3, [topping \\$1 trillion in deal value \(only the second time on record\)](#). Year-to-date volumes at the end of Q3 [exceeded \\$3 trillion](#), up 35% from last year and on pace for the strongest year since 2021. Mega-deals dominated in Q3 with [14 transactions closed, each valued at more than \\$10 billion, pushing the year's total to a record 63](#). PE dealmaking also surged, [rising 53% year over year through early November](#), with expectations of increased activity as rates decline. Dealmakers credit [pent-up demand](#) and [a more accommodating regulatory climate](#) for the growing activity. Healthcare and financial services were standout sectors as [investors sought insulation from macroeconomic uncertainty](#), but [investments in artificial intelligence and related infrastructure saw significant increases as well](#).
- PE exits are also returning to the market. [US PE exits through October nearly matched the 2024 count \(1,300 compared to 1,369\) and have already surpassed the 2024 value by 63% \(\\$621.7 billion compared to \\$379.6 billion\)](#). Globally, [PE exits climbed 40% year over year, with 156 large cap deals announced in Q3, including six valued at more than \\$10 billion](#). A reopening of the US IPO market contributed to the resurgence, with [a 13% increase this year through early November, raising more than \\$255 billion](#), which is the highest in four years. Further easing of public market regulations is [expected to continue this trend into 2026](#).
- Despite increasing exit activity, the backlog of unsold PE-backed companies continued to rise. Globally, [an estimated 31,764 portfolio companies remained on PE balance sheets at the end of Q3, up 793 from Q2](#). Median hold times stretched to [3.9 years, up from three years in 2022, and 30% of investments are now more than seven years old](#). The US middle market also remains challenging, with [estimates of 1,425 missing exits, which is roughly triple the number of current active deals](#). The hangover [of high 2021 valuations remains a major obstacle, with average EBITDA multiples in the United States declining from 15.53x in 2021 to 11.76x in 2025](#). With [mounting pressure from limited partners for distributions, many sponsors have turned to continuation vehicles, which totaled \\$41 billion in the first half of 2025, constituting nearly 20% of total exits and 60% higher than 2024](#). So even though exit activity is improving, clearing the backlog will likely take some time.

BSL: Bouncing back

- The BSL market snapped back in Q3 from the post-Liberation Day lull. [US institutional loan issuance hit a Q3 record of \\$343 billion, up 65% year over year and more than triple the Q2 volume](#). New issue spreads pushed to historic lows, with [single B loans averaging SOFR + 319 by late November](#). With spreads tightening, the deal mix was heavily tilted toward repricings, refinancings, and maturity extensions making up roughly 84% of deal activity. Roughly one third of the 2024 BSL term loans have repriced year to date, trimming spreads by an average of 51 bps. Analysts expect the repricing wave to continue, with [estimates of \\$54 billion to \\$154 billion of potential repricing targets](#), depending upon market conditions.
- New money BSL financings for M&A and dividend recaps at the end of Q3 rose 12% year over year and 15% quarter over quarter, coming in at \$62.3 billion for Q3, even if lagging 23% behind

last year's Q3. Sponsors have increasingly tapped dividend recaps amid limited exit opportunities, with \$22.6 billion in Q3, the third-highest quarterly figure ever, bringing the 2025 total to \$33.9 billion, which is the highest in seven years and more than all of 2024. New money issuances are expected to build through Q4 and beyond as the M&A and deal pipeline reloads.

Private credit competition

- Private credit deal flow rebounded at the start of Q4, with [211 deals worth \\$63 billion for the three months ending in October](#), reversing from the Q3 slowdown, which was [the slowest quarter of the prior seven quarters](#). [Middle-market private credit activity also accelerated and is expected to continue rising](#). With exits still scarce, sponsors have continued to rely on private credit for [dividend recapitalizations to show returns to limited partners](#). However, competition remained intense as [lenders chased limited high-quality opportunities](#) and with some concerns that the [uptick in volume reflects more lower-quality deals coming to market](#) as managers feel [pressure to deploy abundant dry powder](#).
- Competition with the BSL market kept pressure on private credit pricing, [pushing unitranche spreads into the SOFR + 450 range](#). Flows between markets year to date through October were roughly balanced, with about [\\$29 billion shifting each way](#). BSL financing remains attractive to borrowers because of its [capacity to fund the M&A megadeals](#), [lighter covenants](#), and [cheaper pricing, which is often more than 100 bps below private credit](#). Private credit, however, still retains advantages of [speed, flexibility, certainty, and the ability to provide large delayed draw term loans \(DDTLs\)](#). Adding to the appeal, private credit lenders have recently broadened DDTL use of proceeds beyond the typical acquisition funding, now often including [capital expenditures, restrictive payments, and, for stronger borrowers, general corporate purposes](#). While [dual-track processes will continue to force the two markets to compete](#), collaboration is also starting to appear in the market, with [private credit contributing \\$2 billion in second lien loans to the \\$12 billion financing for the Hologoc leveraged buyout, as well as \\$4.5 billion to the \\$18 billion financing for the Walgreens take-private](#).

Shifting landscapes

- Consolidations and partnerships across the finance industry continued at a brisk pace. [Fifth Third's October announcement that it will acquire Comerica in a \\$10.9 billion all-stock deal](#) will create [the ninth-largest US bank](#) and underscores the need for regional lenders to consolidate to [obtain scale to compete with the biggest US banks and mitigate increasing technology and regulatory compliance costs](#). Roughly 150 bank mergers worth \$45 billion have been announced this year, including Huntington Bank's acquisition of Cadence Bank for \$7.4 billion and PNC's acquisition of Colorado's FirstBank for \$4.1 billion, putting 2025 on track to be the busiest bank M&A year since 2021. Deal activity is also increasing because of a more favorable regulatory environment. Approval times for bank mergers have fallen to four months, down from a high of seven months under the prior administration and the shortest since at least 1990. The more favorable regulatory environment may also help increase financing volume, with estimates that reduced capital requirements could unlock \$2.6 trillion of new bank lending capacity.

- Private credit similarly continued its push into the retirement, retail, and wealthy investor segments, with new strategic partnerships, including between [Goldman Sachs and T. Rowe Price](#), [PGIM and Partners Group](#), and [KKR and Capital Group](#). The partnerships come as wealthy Americans are on track to invest a record amount in private credit this year, with [\\$48 billion invested through the first half alone, already surpassing 2023 and on pace to top the 2024 record of \\$83.4 billion](#). New regulatory guidance, likely in February, is expected [to open up the \\$12 trillion 401\(k\) market to private credit and spur further partnerships between retirement managers and private credit](#). [New private-credit exchange-traded funds targeting retail investors are also in the pipeline](#), further blurring the line between public and private markets.

Distress: Disguised and diverging

- Distress remains a lingering concern across credit markets, but traditional distress indicators continued to ease in the BSL market. As of November, [issuer payment defaults fell to 1.25% while dual-track defaults \(including liability management exercises\) fell to 3.68%, the lowest readings since late 2023](#). [Both have been declining from December 2024 peaks of 2.07% and 4.70%, respectively](#), and are [expected to continue trending lower in 2026](#).
- In private credit, stress has been concentrated in the lower middle market. In Q3, [non-accruals reached 3.15% for borrowers under \\$25 million of EBITDA, versus 1.20% for midsized companies with \\$25 million to \\$75 million of EBITDA and 0.24% for larger companies with more than \\$75 million of EBITDA](#). However, [increasing usage of payment-in-kind \(PIK\) interest, which is often a sign of liquidity constraints, suggests actual distress may be higher](#). The inclusion of [“bad” PIK loans boosts the shadow default rate to 6.1%, up from under 2% in 2021](#). Lenders are also increasingly resorting to [debt-for-equity swaps to restructure troubled borrowers](#). Still, with falling rates, balance sheets and liquidity should improve and help reduce private credit distress levels over time.

Key debt market data on CreditSights & Octus

- [Private Credit Pricing & Leverage Data](#) (January 5, 2026)
- [BSL Leverage Trends November 2025](#) (December 8, 2025)
- [BSL vs. PC Spread & Covenant Trends Q3 2025](#) (November 19, 2025)
- [BSL Documentation Trends November 2025](#) (December 1, 2025)
- [BSL Aggressive Terms Trends Q3 2025](#) (October 10, 2025)

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