Credit Market Update

May 2025

Executive Summary

BANKERS EDGE ADVISORY

1

Despite trade concerns, U.S. economic data continues to show resilience, marked by stable employment and easing inflation. Recent reports reveal the unemployment rate held steady at 4.2%, while inflation edged up 0.1%, maintaining an annual rate of 2.4%. Additionally, wage growth remains robust, with average hourly earnings rising 3.9% year-over-year. Sustained income growth is expected to support consumer spending, bolstering optimism for ongoing economic expansion.

2

M&A activity slowed in Q1 2025, but activity is poised to rebound in the second half of the year. Tariff threats prompted buyers to reassess deals amid shifting trade policies. However, by the end of May, markets had roared back from April lows, fueled by the administration's more measured tariff approach and continued strength in economic indicators. With surging confidence and abundant capital availability, dealmaking momentum looks poised to increase as we enter the second half of the year.

3

Lending markets remain flush with cash. Banks and private credit are well positioned to support an increase in M&A and financing activity. Private credit has roughly $400B in dry powder, while banks boast the highest Tier 1 capital ratios in decades, signaling they are flush with excess depository liquidity available for lending. Moreover, Forward rate markets anticipates that the Fed will begin cutting rates in the near future, a move likely to reduce financing costs.

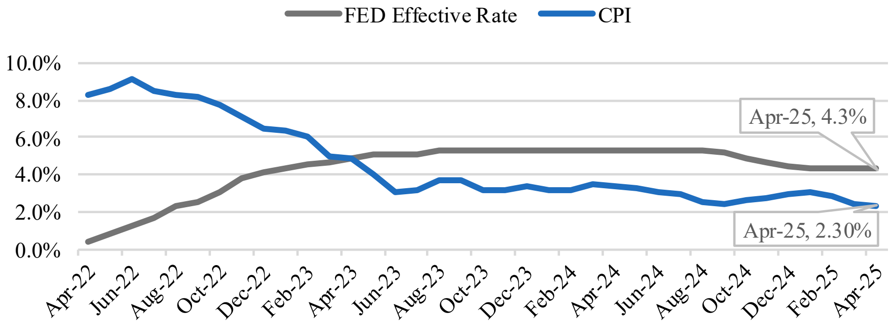
Macro Summary

The U.S. economy remains resilient, with stable employment, steady wage growth, and inflation gradually easing toward the Federal Reserve's 2% target. Amid improving market confidence and expectations of rate cuts, financial conditions appear increasingly supportive of investment and expansion in the second half of 2025.

CPI & Federal Reserve Policy: Despite tariff-related inflation concerns, CPI rose just 0.1% month-over-month and held at 2.4% annually, signaling ongoing disinflation. As inflation nears the Fed's 2% target, markets increasingly expect near-term rate cuts, which could lower borrowing costs and support investment through the remainder of 2025.

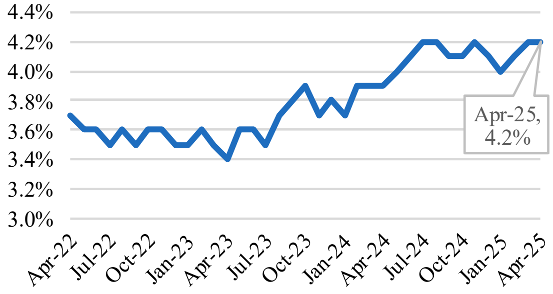
Unemployment & Wage Growth: The U.S. labor market remains resilient, with the unemployment rate holding steady at 4.2%, and wage growth is showing signs of strength with average hourly earnings up 3.9% year-over-year. Increasing incomes should be supportive of consumer spending bolstering confidence in the economic outlook. While wage gains have moderated from pandemic-era highs, their current pace is consistent with a soft-landing narrative—one that maintains low unemployment without reigniting inflation pressures.

Consumer Price Index vs. FED Effective Rate



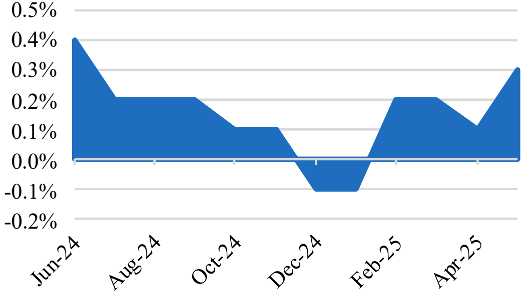
Source: US Bureau of Labor statistics and Federal Bank of St Louis

Unemployment Rate



Source: US Bureau of Labor statistics

Percent Change in Wage



Source: US Bureau of Labor statistics

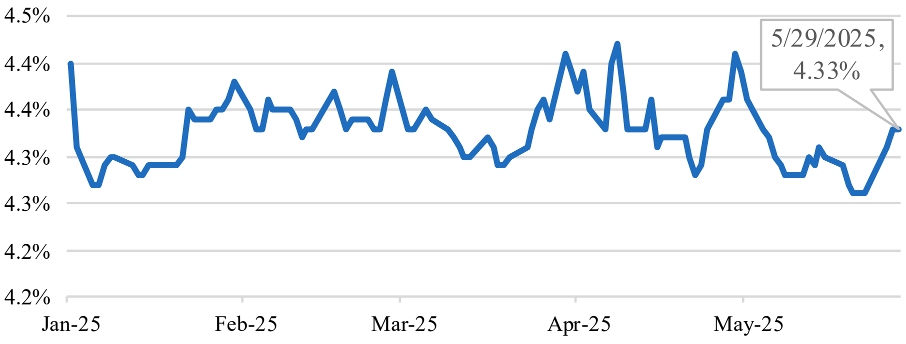
Public Credit Markets

Public credit markets have tightened amid a cross-current of factors but remain within levels broadly supportive of risk-taking.

SOFR and Treasury yields have been climbing in response to various headwinds, with markets particularly focused on Moody's downgrade of U.S. credit and concerns over a projected $3.8 trillion deficit tied to the administration's tax plan. These developments have driven up borrowing costs and dampened demand for syndicated loans.

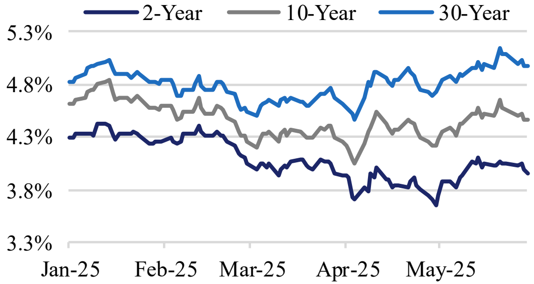
Baa-rated corporate spreads have widened to their highest level since 2023, reflecting reduced investor appetite for public debt and rising risk premiums linked to tariff and geopolitical uncertainty. While credit conditions have tightened somewhat from year-end lows, they remain within healthy ranges and are unlikely to meaningfully constrain household or corporate decision-making.

US SOFR Overnight Rate



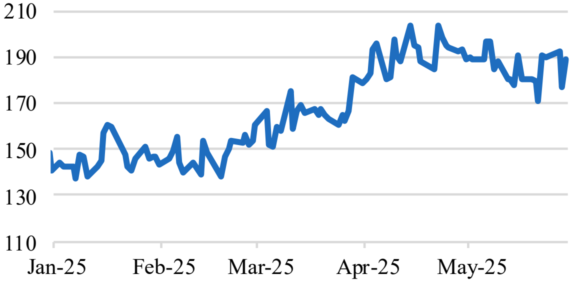
Source: Bloomberg

US Treasury Yields



Source: Bloomberg

US Corporate Credit Spreads (Baa OAS)



Source: Bloomberg

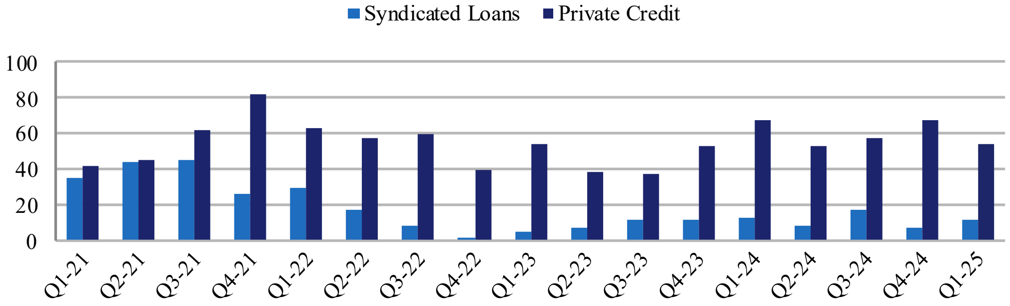
Private Credit Markets

Private credit has demonstrated greater resilience than the bank syndicated loan market since Q4 2021, largely due to its ability to deploy capital directly with fewer regulatory frictions.

Private credit markets have shown resilience where bank syndicate lending has pulled back. With $4.1 trillion in AUM as of May 2025—up 18% year-over-year— global private credit managers are benefiting from committed capital and fewer regulatory hurdles. Although deal activity has slowed ($306 billion deployed vs. $258.9 billion QoQ), private credit markets have significant dry powder and are aggressively competing with traditional banks for lending opportunities.

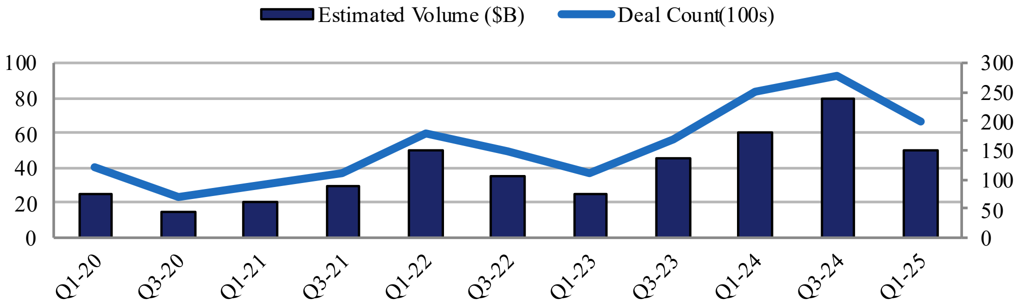
Sector performance has remained strong, with one-year returns at 9.5% and floating-rate strategies exceeding 11%. While risks such as rising defaults (2.7%) and lower recovery rates (68%) persist, private credit is better positioned than banks to provide capital in the second half of the year, buoyed by continued investor appetite for private credit funds, more flexible terms and higher certainty to close.

Syndicated Loans (BSL) vs. Private Credit Market ($B)



Source: Pitchbook

Direct Lending Deal Count and Volume



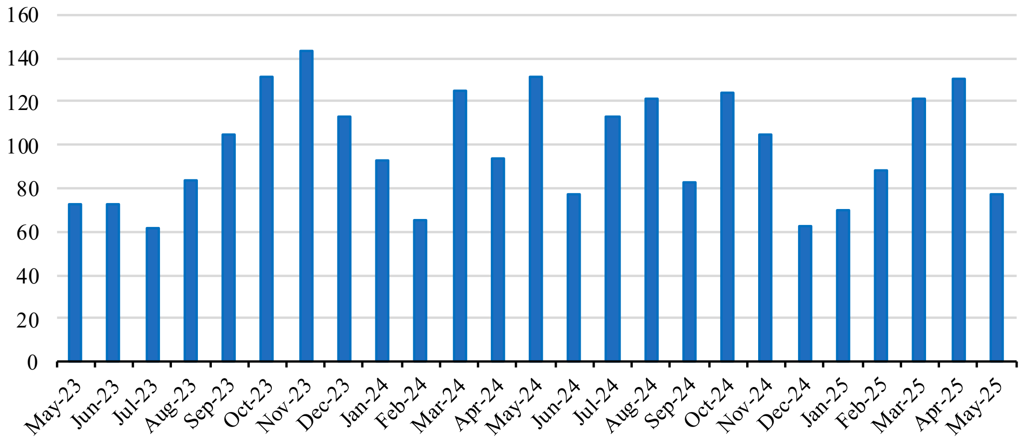
Source: Pitchbook

M&A Activity

M&A activity in May 2025, while down YoY remains robust. Activity was led by traditional M&A activity, which made up 58% of total deals, outpacing leveraged buyouts at 42%. The financial services and national banking sectors drew significant capital inflows, highlighted by Capital One Financials' $35.3 billion acquisition of Discover Financial Services—the largest transaction of the month so far this year

The period also saw a surge in add-on transactions, underscoring firms' preference for smaller, strategic acquisitions over large-scale buyouts. This trend likely reflects elevated federal funding rates and broader market uncertainty. Despite these headwinds, overall deal volume remained solid, signaling continued strength in the M&A market amid a challenging credit backdrop.

M&A Deal Volume by Capital Deployed ($B)



Source: Pitchbook

677 Companies	**678** Deals	**747** Deals
482 Exits	**$35.30B** Largest Deal	**$77.31B** Capital Invested

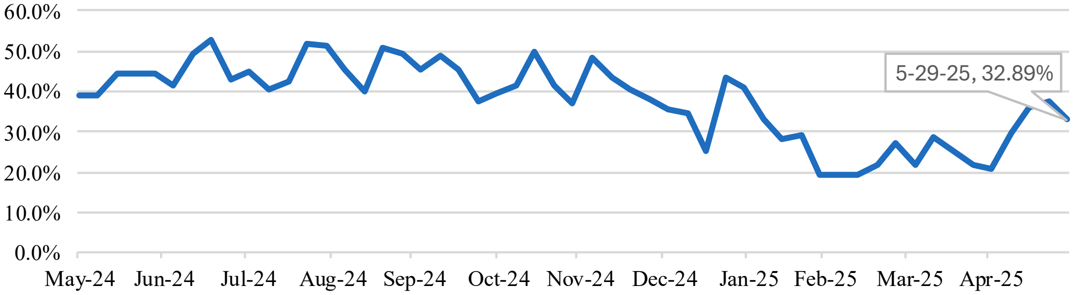
Market Setiment

Investor sentiment has closely tracked market volatility, with confidence shaken amid policy uncertainty and fiscal concerns. The AAII retail investor survey recorded an all-time high bearish reading of 61.9% in early April—the highest in its 38-year history—while the U.S. Economic Policy Uncertainty Index spiked to levels reminiscent of early 2020, during the peak of the COVID-19 pandemic. These developments reflect investor anxiety over trade policy shifts, credit tightening, and broader macroeconomic uncertainty, echoing the trends seen in public lending and M&A activity.

Sentiment began to recover in May, with bearish outlooks declining to 51.5% and bullish sentiment rebounding to 29% from a recent low of 21%. The temporary 90-day halt on new tariffs offered a measure of relief, contributing to a cautiously optimistic tone in markets. That said, bearish sentiment remains elevated relative to 52-week averages, underscoring continued investor wariness in navigating the evolving policy landscape.

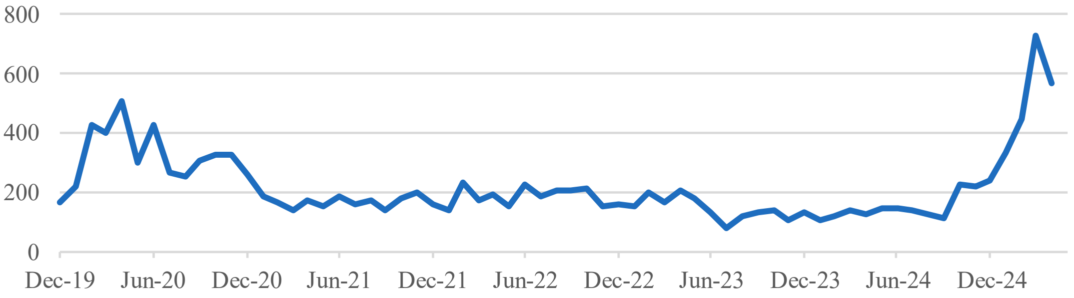
Sources: 1 AInvest, 2 Baird.

US Investor Sentiment Bullish



Source: AAII Survey

Economic Policy Uncertainty Index



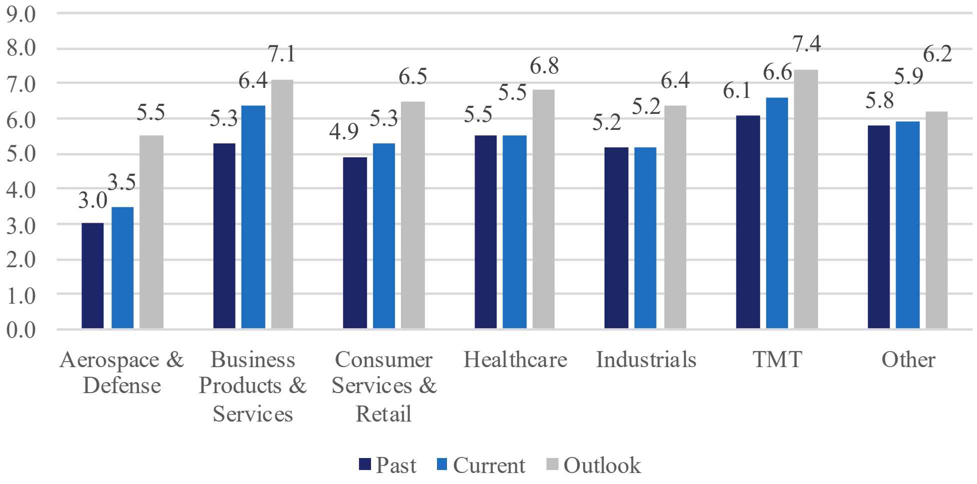
Source: Baird

Outlook

As market uncertainty begins to ease; FTI Consulting's Market Sentiment Survey appears to indicate participants have a favorable expectation for an M&A rebound in the second half of the year. Private credit markets remain well capitalized, and the Federal Reserve's anticipated rate cuts are expected to lower financing costs and expand debt capacity—laying the groundwork for renewed transaction activity across key sectors.

The macro economic backdrop remains favorable with inflation showing signs of moderating toward the Fed's 2% target, unemployment remaining stable and wage growth showing signs of picking up—creating a constructive environment for consumption and business activity. While uncertainty surrounding trade policy and fiscal deficits has pushed Treasury yields higher and fueled volatility in public credit markets, investor sentiment has begun to rebound, signaling cautious optimism for the quarters ahead.

Sentiment Rating (0-10 scale)



Source: FTI Consulting

Sources: 1 FTI Consulting, 2 Prairie