BANKERS EDGE
ADVISORY

Credit Market Update

Q2 2025

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Executive Summary

1

Despite headline noise, the U.S. economy looks poised for growth. Unemployment remains steady at 4.1%, signaling broad labor market strength, and while inflation ticked up slightly to 2.7%, CPI shows little evidence of tariff-related pressures—at least for now. Q1 GDP printed a negative figure, distorted by a surge in pre-tariff import activity that weighed heavily on the headline number. Still, fixed investment climbed to its highest level since Q4 2021, reflecting renewed business confidence. With core growth fundamentals largely intact and the "big beautiful bill" now signed into law, the economy appears set to accelerate into the second half of the year.

2

M&A roared back during the first half of the year, with deal value surging 30% year-over-year to nearly $970 billion. Fueled by a bullish macro backdrop, soaring business confidence, and a war chest of dry powder, dealmaking momentum looks to be building. While overall transaction count remains subdued, the spike in deal value signals a decisive pivot toward high-value megadeals—where fewer transactions carry far greater strategic weight.

3

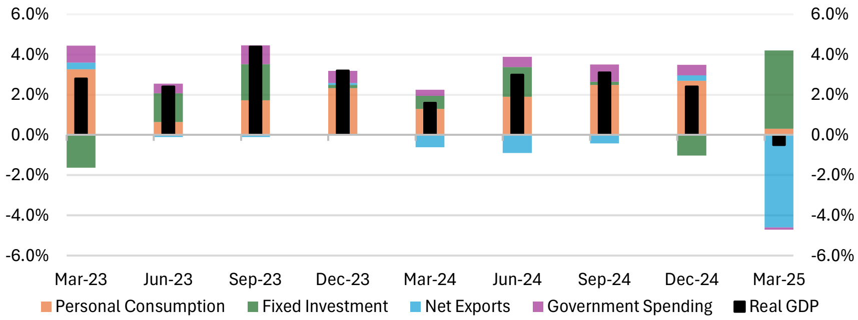
Lending markets remain flush, with banks and private credit sitting on vast reserves of capital. Bank deposit growth over the past four years has outpaced lending, driving loan-to-deposit ratios down to 61% as of Q1 2025—well below the pre-COVID norm of 80%. If banks returned to pre-COVID levels, up to $3.6 trillion in excess lending capacity could be unlocked. Combined with private credit's $400B in dry powder, and the prospect of Fed rate cuts, the stage is set for a financing boom. Dealmakers face a rare alignment: deep liquidity, falling rates, and financiers ready to deploy capital.

Macro Summary

Economic Commentary: Real GDP contracted by 0.5% in Q1 2025—a sharp reversal from Q4's 2.4% expansion—but the headline decline conceals more than it reveals. A 4.6% spike in imports, driven by pre-tariff inventory stockpiling, skewed the headline downwards. Meanwhile, private fixed investment surged to its highest level in over three years, with corporate spending on fixed assets hitting levels not seen since Q4 2021. The Q1 GDP downturn appears less a signal of slowing momentum and more a distortion fueled by trade tariff timing.

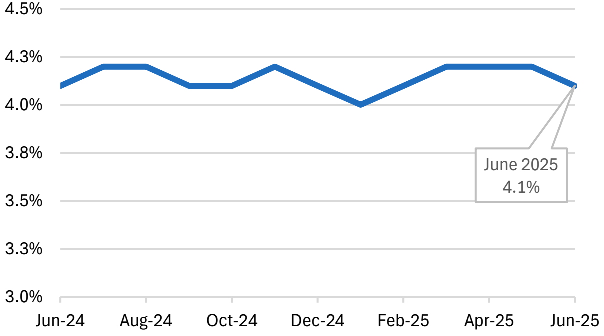
Employment and Wages: Resilient labor market conditions and steady wage gains through the first half of 2025 are setting the stage for continued growth in personal consumption. Unemployment has held steady at 4.1%, while wage growth is outpacing inflation—total compensation rose 3.6% year-over-year versus CPI at 2.7%—boosting household purchasing power. These trends should reinforce consumer confidence and fuel discretionary spending. This income-driven momentum should help sustain consumption across goods and services, positioning personal spending as a key engine of economic growth heading into the second half of the year.

GDP Breakdown by Component



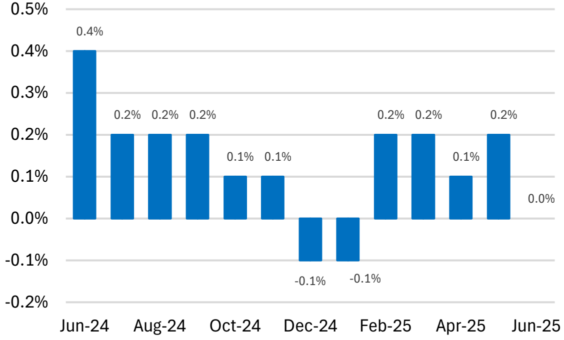
Source: US Bureau of Economic Analysis

Unemployment Rate



Source: US Bureau of Labor Statistics

Wage Growth (MoM)



Source: US Bureau of Labor Statistics

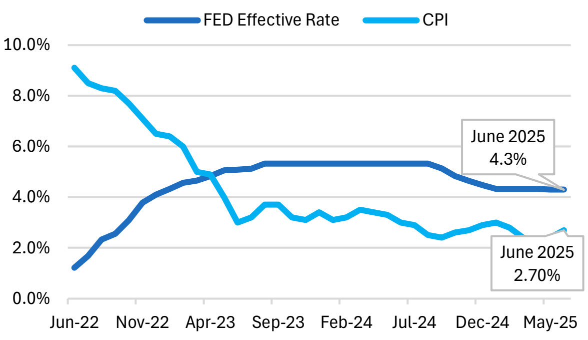
Public Credit Markets

Public Credit Markets: Credit conditions remain favorable in the near term, with public markets well-positioned to support risk-taking. Anticipated Fed rate cuts and declining yield expectations are creating a more attractive borrowing environment for both consumers and corporations.

Treasury Yield Curve: Since the start of 2025, the yield curve has shifted noticeably, revealing a pronounced "kink" in the intermediate maturities—a clear reflection of rising expectations for Fed easing later this year. Yields on 2- to 7-year Treasuries have fallen as markets price in roughly 65 basis points of cuts by year-end, with a September move widely seen as the likely starting point. Meanwhile, long-end yields have remained elevated, driven by sticky inflation, strong macro data, and a growing term premium tied to fiscal uncertainty and expectations for increased Treasury issuance.

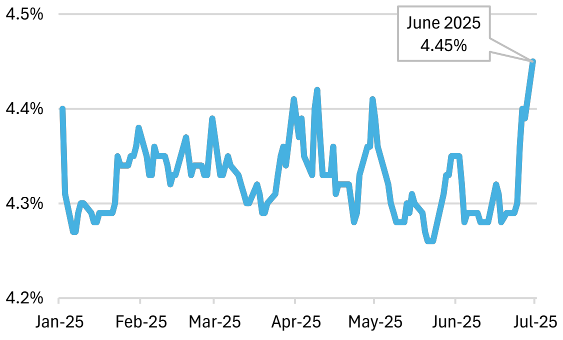
Decoding the "Kink'd" Curve: The shape of the curve signals investor conviction that rate cuts are coming—but also skepticism about how far and fast the Fed will be able to ease rates. In essence, the curve is pricing in near-term accommodation with longer-term skepticism and concern.

CPI vs. FED Effective Rate



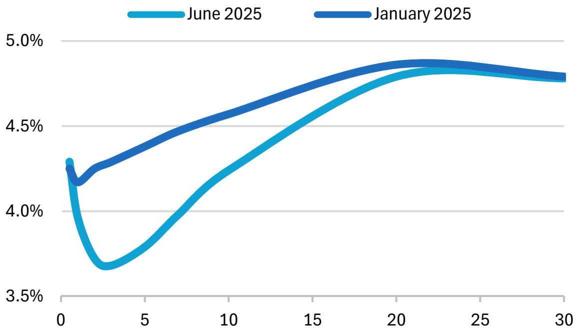
Source: US Bureau of Labor Statistics and Federal Bank of St Louis

US SOFR Overnight Rate



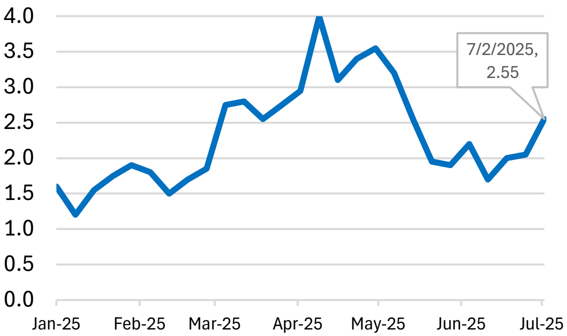
Source: Federal Bank of St Louis

Treasury Yield Curve



Source: U.S. Department of the Treasury

Number of FED Cuts Priced in the Market



Source: Bloomberg

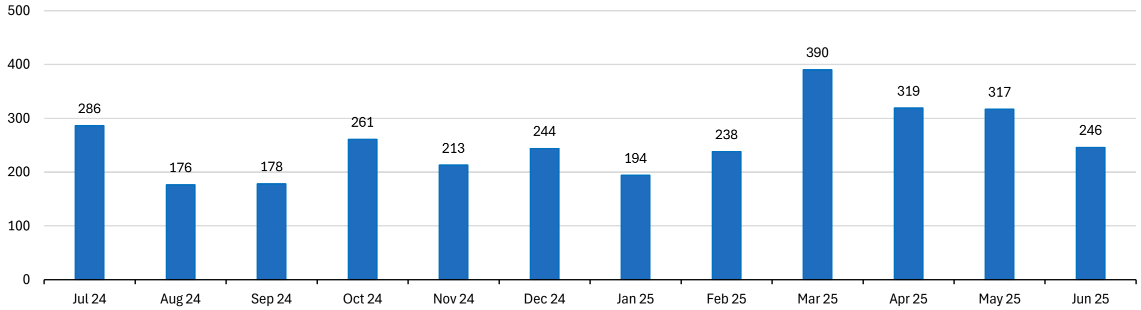
Private Credit Markets And M&A Activity

Private credit continues to outpace the broadly syndicated loan (BSL) market, weaponizing its direct-lending model that operates outside regulatory constraints throttling traditional finance. As of May 2025, sector assets under management surged to $4.1 trillion—an 18% year-over-year spike—armed with committed capital that moves swiftly even as syndicated issuance stalls under regulatory drag and volatile markets.

Despite a modest slowdown in volume, private credit deployed $306 billion across Q1—up from $258.9 billion in Q4 2024—proving its capacity to absorb larger, higher-caliber transactions amid tariff uncertainty and risk repricing. With dry powder levels still north of $150 billion, the sector remains liquid, aggressive, and poised for growth.

M&A activity remained elevated in Q2 2025, reflecting persistent dealmaker appetite. Capital deployment reached $319 billion in April, held firm at $317 billion in May, and eased slightly to $246 billion in June—still well above long-term historical norms. Momentum appears intact, with expectations for sustained high levels of deal activity into the second half of the year.

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



Month	May 24	Jun 24	Jul 24	Aug 24	Sep 24	Oct 24	Nov 24	Dec 24	Jan 25	Feb 25	Mar 25	Apr 25	May 25	Jun 25
Capital Invested ($B)	230	146	286	176	178	261	213	244	194	238	390	319	317	246

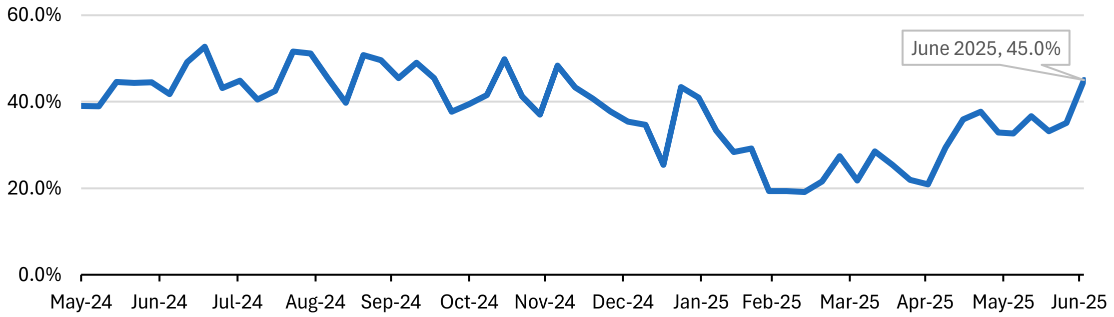
Source: Pitchbook

Market Sentiment

Investor sentiment in Q2 2025 mirrored the market's whiplash. Confidence cratered in April as trade tariff shocks and foreign conflicts rattled investors—bullish sentiment in the AAII survey hit a record low 20.9%, while the Economic Policy Uncertainty Index surged to levels not seen since the COVID-era peak. Fears over new tariffs, tighter credit, and macro instability froze risk appetite, dragged down public markets sentiment.

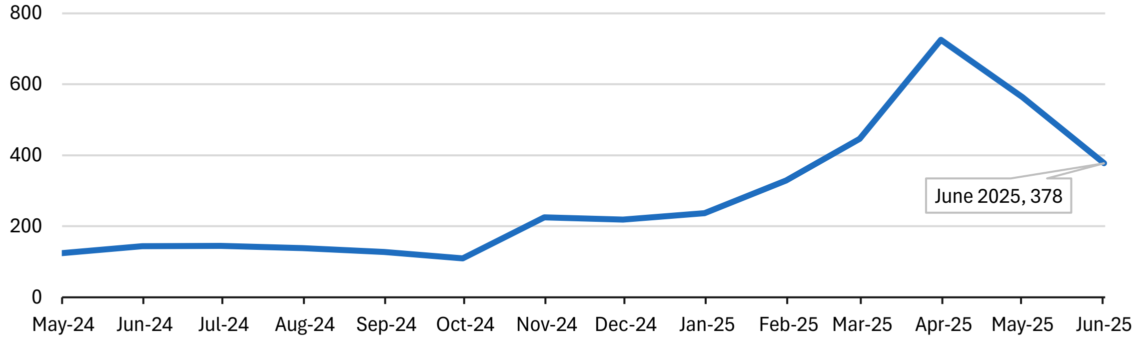
As quickly as it vanished, sentiment whiplashed back—snapping markets into rebound mode. Trade tensions cooled, earnings surprised to the upside, and investors responded fast. Bullish sentiment surged from 21% to 45% by quarter-end. Markets rallied, the S&P 500 hit fresh highs, and credit spreads narrowed—fueling a resurgence in dealmaking, with over $1 trillion in H1 M&A volume. Investor conviction has returned with a vengeance, as dry powder burns hotter and demands a home. Beneath the surface, the setup feels combustible—setting the stage for a second-half food fight as capital chases increasingly scarce opportunity.

US Investor Sentiment Bullish



Source: AAII Survey

Economic Policy Uncertainty Index



Source: Baird

Outlook

The setup for a second-half breakout is hard to ignore.

The macro backdrop looks robust and increasingly primed for acceleration, with resilient labor markets and steady consumption anchoring growth.

Liquidity remains abundant, and with the Fed likely pivoting toward rate cuts, financing conditions are poised to turn sharply more accommodative.

Meanwhile, receding trade and foreign policy uncertainty is unclogging deal pipelines—Q2 M&A activity already picked up, and all signs point toward a year-end surge as capital hunts for a home.

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Mr. Consul brings over 20 years of expertise in domestic and international capital markets as a Senior Portfolio Manager and Fixed Income, Currency, and Commodities Strategist. Most recently, serving as Senior Portfolio Manager and Fixed Income Strategist for Victory Capital's institutional fixed income team, where he was a member of the investment committee overseeing nearly $7 billion in assets under management across Total Return, Short-Duration, and Convertibles strategies. Throughout his career, Mr. Consul has been a trusted business partner for corporate, banking, and insurance clients, helping them navigate and solve complex challenges related to liquidity, risk management, Asset-liability Management (ALM), and secondary market dynamics.

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Mr. Vermet brings nearly a decade of experience in institutional asset management and investment banking to the team. He has been an integral part of close-knit investment teams responsible for the portfolio construction and tactical asset allocation of over $30 billion in institutional capital, helping clients manage and structure their balance sheets with strategic asset liability management solutions. As a trusted advisor, Mitch has consistently guided clients to solutions for their most immediate challenges while helping to enable them to prudently manage risk and be dynamically positioned to capitalize on opportunities over all possible future macroeconomic scenarios.