

BANK LOANS

Software Selloff Leads Loans Negative for Q1

This report is excerpted from the *Second Quarter 2026 Fixed-Income Sector Views*.

Prices are lower and spreads are wider as the market reassesses AI risk.

The S&P USB Leveraged Loan Index returned -0.6 percent for the first quarter, breaking the streak of 14 consecutive positive quarters for bank loans. Fears of AI-driven deflationary pressure on valuations drove technology and other AI-sensitive sectors lower for the quarter. Coupon helped to offset the 2 percent price return of the index, and the floating rate nature of loans insulated the asset class from rate moves that impacted more rate-sensitive asset classes. The distress ratio almost tripled quarter over quarter, finishing at 6.2 percent, and we remain cautious about low recovery rates, particularly in technology.

Sector Commentary

- The technology sector, representing 17 percent of the index (software 13 percent), was a material drag on performance with the sector down 4.15 percent for the period.
- Looking at the index broadly, three-year discount margins widened 59 basis points, finishing at 514 basis points. Three-year yields rose 0.84 percent, finishing at 8.70 percent, and the weighted average price of the index was down 2.1 points, closing at 93.81.
- The tech-driven volatility, amplified by the conflict in Iran, put a damper on new issuance. High quality and non-tech deals were able to get done, though somewhat sparingly. February and March saw just \$33 billion each in primary activity, well below the 2025 average of \$86 billion per month.
- On the demand front, CLO issuance did not seem all that impacted by the volatility, with a strong quarterly tally of \$49 billion. Retail flows were impacted, however, with \$7.5 billion of outflows from loan funds.

Investment Themes

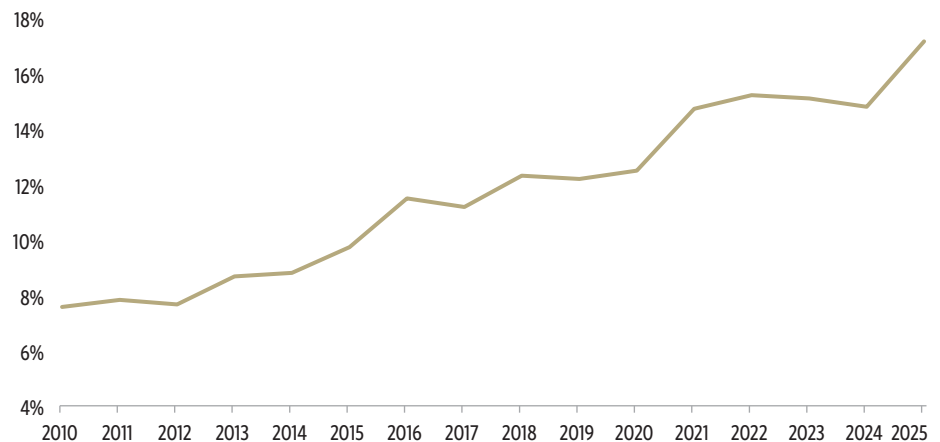
- Credit selection was highlighted during the quarter as the market looks to differentiate between winners and losers in the AI-efficiency race. Sector and subsector dispersion was the highest in some time.
- Our base case is for volatility to persist for the foreseeable future as the market will need to work to refinance more than \$150 billion of the lowest rung of B-rated issuance maturing in 2028 and as liability management exercises continue to erode first lien recoveries.
- In terms of positioning, we maintain our up in quality bias given the tail risk in the market and macro uncertainty. For businesses we view as insulated from some of these risks with appropriate capital structures, we will look to add to positions on weakness.

By Thomas Hauser, Alastair McKeever, and Brian McAuliff

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Technology, at 17% of the Index, Was a Significant Drag on Loans in Q1

S&P UBS Leveraged Loan Index Technology Weight



Source: S&P UBS Leveraged Loan Index. Data as of 12.31.2025.

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One **basis point** is equal to 0.01%.

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