

2Q2025 Outlook for Defaults, Recoveries, and Returns from U.S. Private Credit Strategies

Defaults Projected to Increase to 5%, Recoveries to Decline to 65%, Yet 10%+ Gross Returns After Losses Could Continue in 2025

NEW YORK, March 20, 2025 - Grayrock Global, a leader in liquid credit income strategies, announced its 2Q 2025 outlook for defaults, recoveries, and returns on senior secured loans in the U.S. Private Credit market. The commentary focuses on senior secured loans. Below is a summary based on current trends and analyses.

DEFAULTS

DEFAULT RATES MAY INCREASE TO 5%

Economic Uncertainty: Tariffs, persistent inflation, high interest rates, and geopolitical tensions will pressure corporate margins and cash flows.

Massive Maturing Debt: An estimated **\$1.07 trillion** in corporate debt is expected to mature in 2025, which could lead to defaults if refinancing conditions remain tight.

Weaker Credit Quality: Overleveraged companies, especially in sectors like retail, real estate, and small-cap firms, may face challenges.

Moody's and S&P Global estimate default rates could reach **4–5% in 2025**, compared to historical averages of around 2.5–3%.

RECOVERY RATES

RECOVERY RATES MAY DECLINE TO 65%

Structural Subordination: An increasing use of covenant-lite loans and aggressive capital structures could reduce recovery rates.

Sector-Specific Risks: Recovery rates in distressed sectors like energy or retail are typically lower compared to industrial or technology sectors.

Historically, senior secured loans have recoveries in the range of 65–80%.

Grayrock Global estimates that recovery rates could trend toward the lower end of this range to around 65–70% in 2025, given weaker collateral values and liquidity constraints.

KEY DRIVERS

Interest Rate Environment



Continued high rates increase debt service costs for leveraged companies.

Borrowers with floating-rate debt face significant pressure.

Sector-Specific Risks



Technology and healthcare sectors may fare better due to growth potential.

Energy and retail face elevated risks due to demand fluctuations and e-commerce competition.

Capital Market Conditions



Tightening credit availability makes refinancing difficult for highly leveraged firms.

Distressed debt investors may target undervalued assets, influencing recovery prospects.

INVESTMENT RETURNS

In a 2025 scenario that assumes a year over year higher Default rate of 5%, a lower Recovery rate of 65%, on a portfolio of senior secured loans with an Initial Gross Yield of 13%, Loan Losses would represent only 1.75% and the Gross Yield After Losses would be 11.25%. Please see Table 1 below.

TABLE 1

Initial Gross Yield ¹ (A)	Default Rate (B)	Recovery Rate (C)	Loan Losses [B*(1-65%)] = D	Gross Yield After Losses A-D
13%	5%	65%	1.75%	11.25%

OPPORTUNITIES FOR INVESTORS

1

Technology and Healthcare:

Both sectors offer stronger recoveries and lower default risks relative to others, presenting safer bets for lenders.

2

Distressed Debt:

Energy and CRE sectors could present opportunities for distressed debt investors, who might acquire undervalued assets at significant discounts. For example, some commercial real estate auctions have resulted in prices that represented land value only.

3

Focus on Secured Loans:

Senior secured loans remain a more stable investment compared to junior or unsecured debt, given their prioritization in recoveries.

INVESTMENT CONSIDERATIONS

Risk Profile: Senior secured loans are higher in the capital structure and secured by collateral, offering some protection against defaults. However, they are typically issued by below-investment-grade companies, which introduces credit risk.

Market Dynamics: The growing interest in collateralized loan obligations (CLOs) and related ETFs has increased accessibility to this asset class, potentially influencing demand and pricing.

¹ In 2023, the U.S. leveraged loan market returned approximately 13.04% comprised mostly of coupon income. This trend continued into 2024 with loans offering among the highest yields in the credit markets. Source: Pitchbook.



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