Private Credit

A Balanced Assessment of Strengths and Weaknesses

April 2026

Executive Summary

Private credit has become one of the fastest-growing segments in global finance, reaching $3.5 trillion in assets under management by end-2024, a 24% compound annual growth rate since 2015. The asset class provides compelling advantages including superior yield (direct lending has averaged ~11.6% annually since 2008), portfolio diversification, and natural inflation protection via floating rates. However, investors must weigh meaningful risks: default rates are rising (Fitch's PMR index reached 9.4% in early 2026), BDC discounts-to-NAV are widening, IPO exit routes remain 74% below their 2021 peak, and the credit cycle is turning. This report provides an objective, data-driven assessment of both dimensions.

✦ Strengths	✦ Weaknesses
• Higher potential returns	• Illiquidity: multi-year capital lock-up
• Portfolio diversification vs public markets	• Valuation opacity / NAV smoothing risk
• Floating-rate inflation protection	• Rising defaults
• Bespoke structures & maintenance covenants	• Credit cycle sensitivity accelerating
• Lower mark-to-market volatility reported	• A misalignment of interests with investors
• Senior secured creditor protections	• Wide manager dispersion: selection critical

1. Private Credit at a Glance — Key Data

$3.5T	**24%**	**11.6%**	**$146bn**
Global AUM (2024)	**CAGR since 2015**	**Avg annual return**	**US dry powder**
AIMA/ACC, Dec 2025	*~7× growth in 9 years*	*Direct lending, 2008–2024*	*Record high, end-2025*

2. Market Growth — the Rise of Private Credit

From $500 billion in 2015 to $3.5 trillion by end-2024, private credit has delivered one of the most rapid expansions in the history of alternative asset management. The 24% compound annual growth rate has dramatically outpaced GDP, private equity, and most traditional credit markets. Deployment accelerated sharply in 2024, with $592.8 billion in fresh capital deployed, a 78% increase on 2023, driven by the structural retreat of banks from middle-market lending.

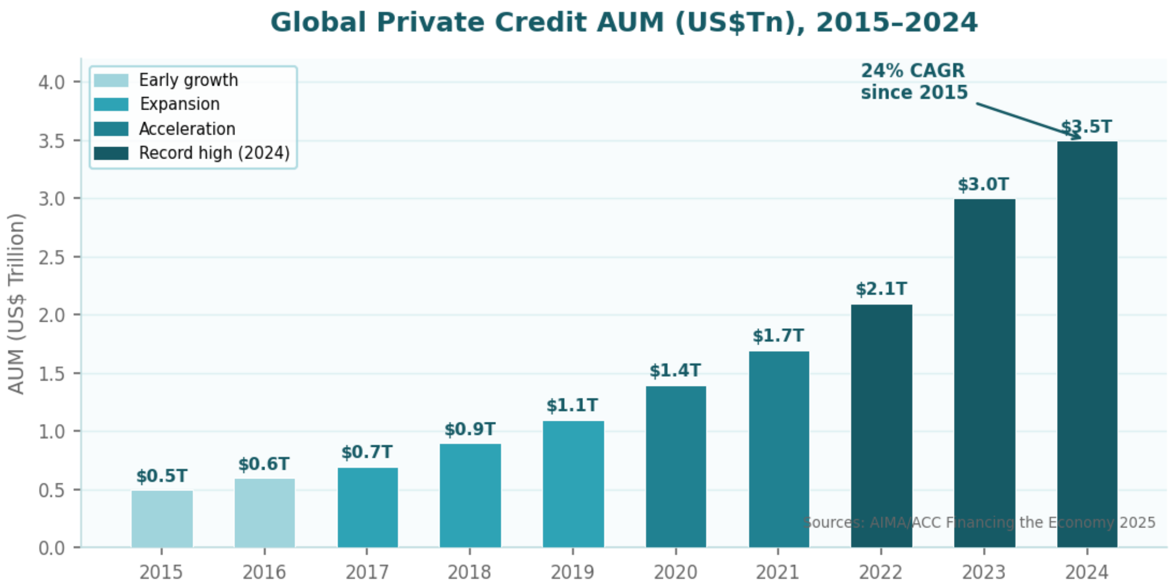

Figure 1: Global Private Credit AUM (US$ trillion), 2015–2024. Source: AIMA / ACC 'Financing the Economy 2025'.

The top 20% of managers deployed approximately 85% of capital in 2024. Blackstone's credit segment alone reached $432 billion AUM by Q3 2025 — over 12% of the global market. European private credit now represents ~30% of global AUM (up from 18% in 2019), with record fundraising of $65 billion in the first nine months of 2025, including Ares Capital Europe VI closing at €17.1 billion.

3. Credit Quality — Default Rates in Focus

Default rates represent the most scrutinised data point for private credit investors. The picture is nuanced and highly methodology-dependent,a distinction frequently overlooked in media coverage.

Private Credit Default Rates — Quarterly Trend (2023–2025)

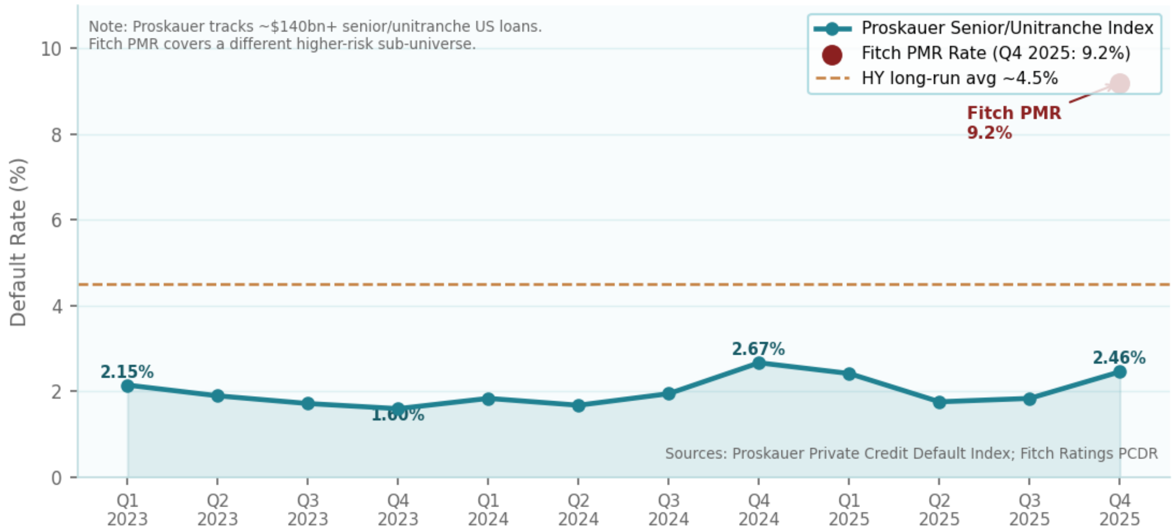

Figure 2: Private Credit Default Rates by provider, Q1 2023–Q4 2025. Proskauer tracks ~$140bn+ in senior/unitranche US loans; Fitch PMR covers a higher-risk rated sub-segment. Sources: Proskauer; Fitch Ratings.

The Proskauer Index recorded 2.46% in Q4 2025, up from 1.84% in Q3 but well below the long-run high-yield average of ~4.5%. Larger borrowers (EBITDA $50m+) saw a sharp spike to 2.4% in Q4 2025 from 1.2% in Q3, suggesting deterioration is climbing the quality curve.

The Fitch Ratings PMR default rate reached **9.4% in January 2026**, a record since inception in 2024, using a broader methodology that includes PIK conversions, distressed maturities, and covenant failures. Healthcare services and consumer products saw the highest defaulter counts. The gap between 2.46% and 9.4% is real and important: investors must understand the precise universe and definition behind any reported figure.

BlackRock's analysis adds nuance: companies with EBITDA above $100m show covenant default rates of just 1.4%, while smaller borrowers (EBITDA <$25m) experience disproportionate stress. Manager positioning within the credit quality spectrum is therefore the single most important variable in default risk.

4. Business Development Companies (BDCs) — Market Evidence

BDCs are listed vehicles providing transparent, real-time market signals on private credit portfolio quality. Their price-to-NAV multiples reflect investor confidence in reported valuations and forward credit performance.

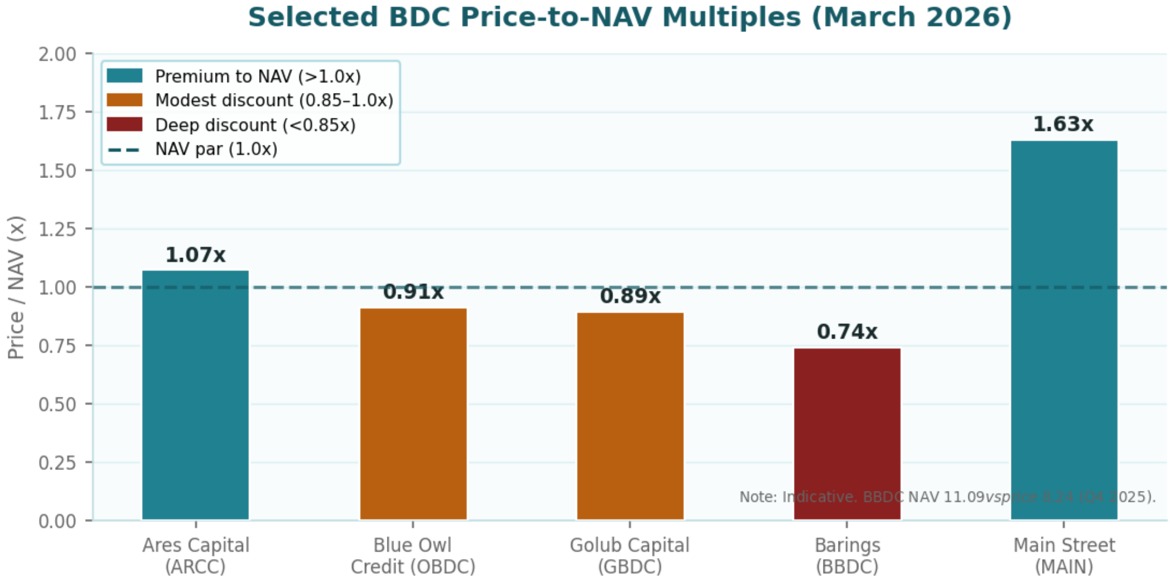

Figure 3: Selected BDC Price-to-NAV multiples (indicative, March 2026). BBDC stock price ~$8.24 vs NAV $11.09 (Q4 2025) = 0.74×. Sources: Q4 2025 earnings; SEC filings.

Main Street Capital (MAIN), internally managed with a 16-year track record, trades at ~1.63× NAV, reflecting high confidence in portfolio quality. Ares Capital (ARCC), the largest BDC with over $20 billion in assets, trades at ~1.07×. At the other end, Barings BDC (BBDC) trades at ~0.74× NAV, a 26% discount reflecting concerns about middle-market portfolio quality.

The spread between MAIN at 1.63× and BBDC at 0.74× ,**89 percentage points of NAV, underscores the critical importance of manager selection.** BDC discounts have widened materially since 2022 as higher base rates pressure borrower coverage ratios and anticipation grows of credit losses in lower-quality portfolios.

5. LBO Market — The Engine of Private Credit Demand

PE leveraged buyouts are the primary driver of new private credit origination. The structural shift in LBO financing over 2022–2025 illustrates both private credit's opportunity and its vulnerability to competition from traditional syndicated markets.

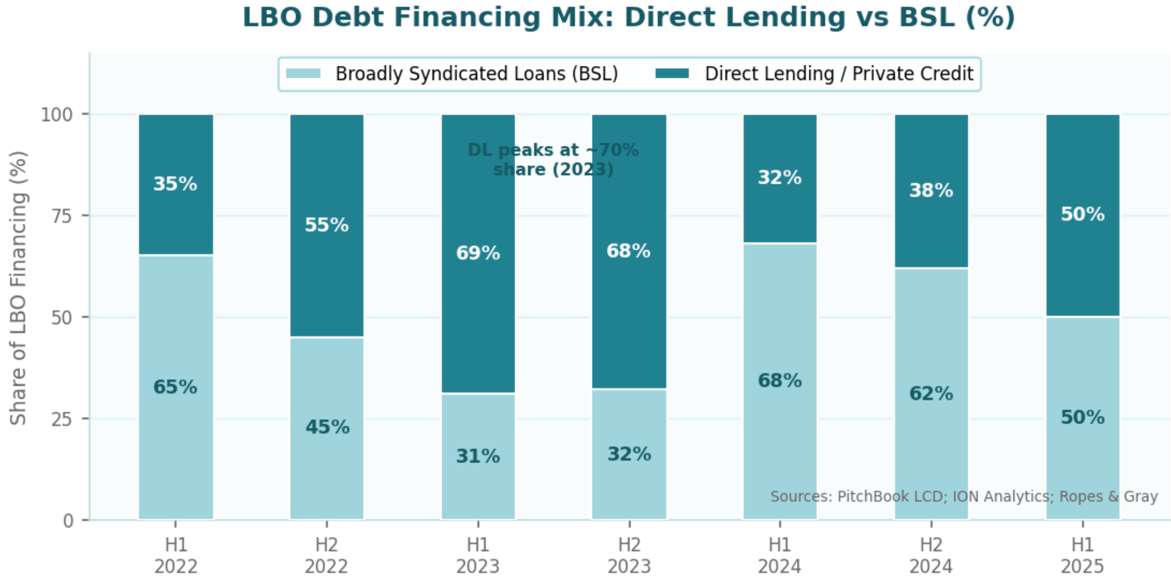

Figure 4: LBO debt financing mix — Direct Lending vs BSL as % of total LBO financing. Sources: ION Analytics DebtDynamics; PitchBook LCD; Ropes & Gray.

As banks pulled back in 2022–2023, direct lenders captured approximately 70% of LBO debt , culminating in a record $4 billion unitranche for Altaroc in 2025. However, 2024 brought a sharp reversal: BSL market share rebounded to ~68% as credit spreads normalised, with direct lending margins compressing from 668 to 527 basis points over SOFR between 2023 and 2024.

Global PE LBO value reached $150 billion in H1 2025, tracking ~140% of full-year 2024 at mid-year (S&P Global). LBO EBITDA multiples rose to 11.7× in Q1 2025 from 11.0× in 2024. Overall LBO volume remains ~20% below 2022 levels and ~59% below 2021, constraining origination and sustaining a record $146 billion in US dry powder.

6. IPO Markets — The Critical Exit Dimension

IPO activity determines the pace of PE sponsor exits, capital return to LPs, and ultimately new LBO deal flow,making it a structural driver of private credit origination volume.

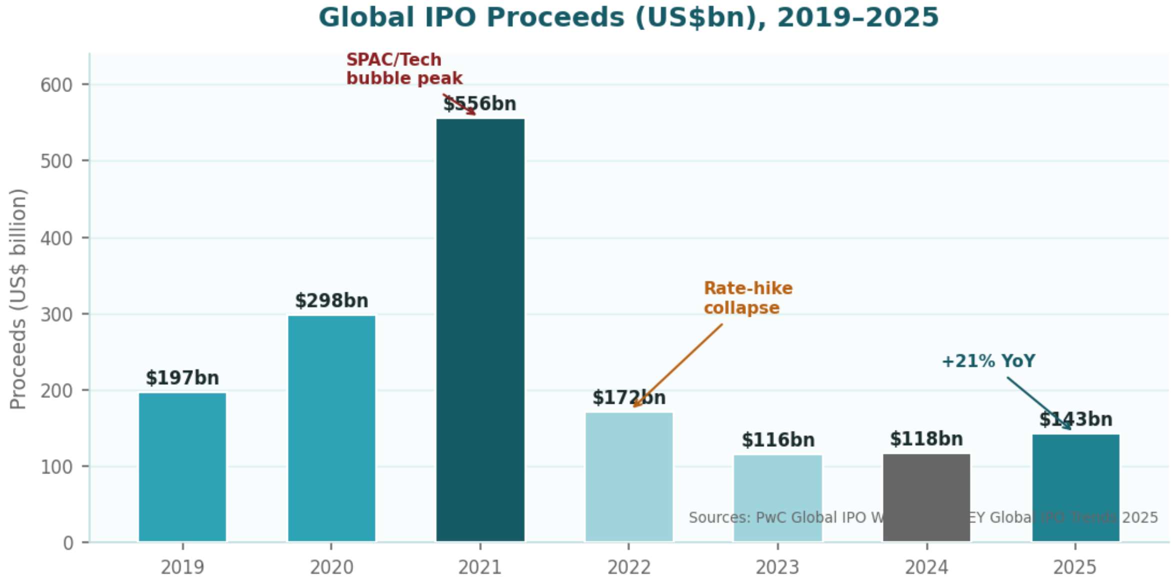

Figure 5: Global IPO proceeds (US$bn), 2019–2025. Sources: PwC Global IPO Watch 2025; EY Global IPO Trends 2025.

Global IPO proceeds peaked at $556 billion in 2021, then collapsed 69% to $172 billion in 2022. Recovery has been slow, $143 billion in 2025 represents a 21% improvement but remains 74% below the 2021 peak. US proceeds of $47.4 billion in 2025 were up 44% year-on-year, driven by 11 deals exceeding $1 billion.

In response to suppressed IPO activity, GPs have increasingly turned to continuation vehicles. **Global secondary transaction volume reached a record $408.8 billion in 2025, up 46.8% on 2024** (PitchBook). While providing some liquidity, continuation vehicles defer rather than resolve refinancing pressure on private credit borrowers.

7. Returns Evidence — Yield, Volatility, and Comparison

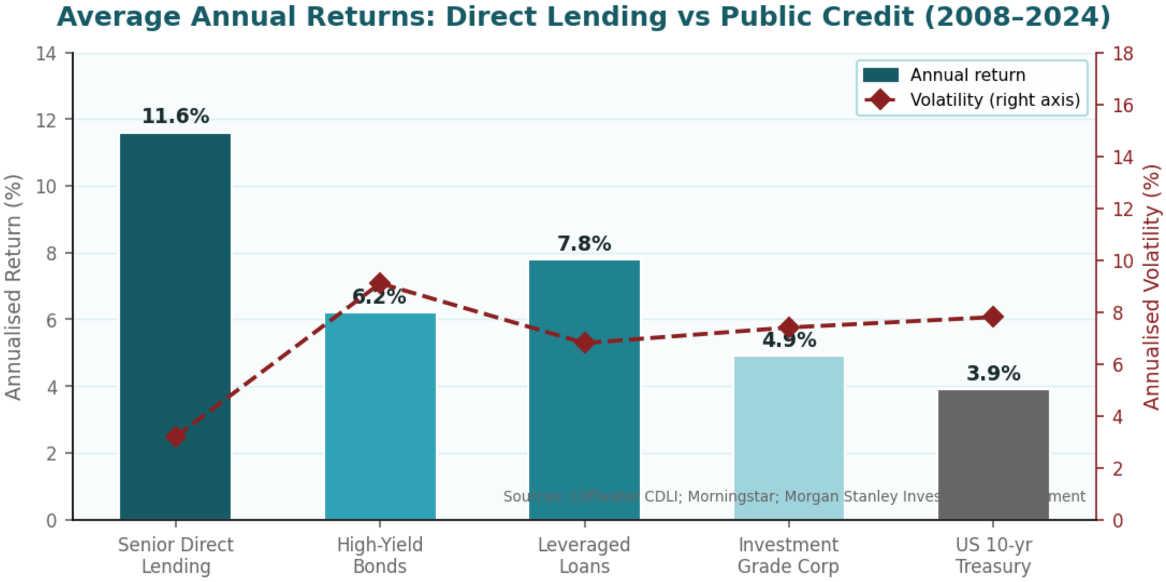

Figure 6: Average annual returns and volatility by credit asset class (2008–2024). Sources: Cliffwater CDLI; Morningstar; Morgan Stanley Investment Management.

Direct lending has delivered approximately 11.6% per annum since 2008 — roughly 350–480 basis points above high-yield bonds and leveraged loans. This superior return has been achieved at lower measured volatility, reflecting the absence of mark-to-market pricing and structural loan protections.

However, the volatility comparison requires careful interpretation. **Private credit's lower measured volatility is partly a consequence of model-based valuations rather than genuinely lower risk.** BDC market prices, where BBDC trades at 0.74× stated NAV, demonstrate that true economic volatility is substantially higher than reported NAV figures suggest. Investors who equate NAV smoothing with low risk may be materially mispricing their exposure.

8. Strengths of Private Credit

8.1 Attractive Risk-Adjusted Returns

The 150–300 basis point yield premium over comparable public instruments, combined with structural protections, makes private credit highly competitive for income-seeking investors. The Cliffwater Direct Lending Index has generated a ~9.2% compound return over 24 years, outperforming high-yield bonds and leveraged loans on both absolute and risk-adjusted bases. In the 2023–2025 environment, gross yields of 10–13% in senior direct lending represent exceptional income relative to public alternatives.

8.2 Portfolio Diversification

Low correlation to public market returns provides genuine portfolio construction benefits. During the 2022 equity correction, private credit NAVs remained broadly stable while high-yield bonds fell 15% and equities declined 20%. CalPERS, the largest US public pension plan, reported a 13.3% annual return on its private credit allocation as of 2024, its best-performing private asset segment, and raised its target allocation from 5% to 8%.

8.3 Inflation and Rate Protection

Floating-rate coupons benchmarked to SONIA or SOFR provide automatic income upside in rising-rate environments. Direct lending averaged 11.6% during seven rising-rate periods since 2008, consistently above its long-term average. Q4 2024 demonstrated continued resilience: direct lending returned 10.5% annualised even as the Federal Reserve cut rates by 100 basis points, outperforming public credit.

8.4 Structural Protections and Lender Control

Unlike covenant-lite syndicated loans, private credit transactions typically include maintenance covenants, comprehensive information rights, and consent requirements over major corporate actions. These enable earlier intervention when borrower conditions deteriorate, contributing to historically higher recovery rates than public high-yield bonds.

8.5 Access to the Middle Market

Private credit provides access to the large, diverse middle market — companies with EBITDA of £10–150 million — which are too small for public bond issuance and increasingly underserved by banks following post-2008 regulatory tightening. This segment offers relative value and information advantages for experienced managers with dedicated origination capabilities.

9. Weaknesses and Risks

9.1 Illiquidity and Capital Lock-Up

Investors commit capital for 5–10 years with limited ability to exit prior to fund termination. The growth of semi-liquid and evergreen structures, $644 billion AUM as of June 2025, up 28% in six months, introduces new liquidity risk. These vehicles promise periodic redemption windows but hold portfolios of inherently illiquid loans. During market stress, misalignment between redemption promises and portfolio liquidity could force distressed asset sales, imposing losses on remaining investors.

9.2 Valuation Opacity

Mark-to-model valuations lag economic reality, as demonstrated by BDC market prices trading at deep discounts to reported NAV. The Financial Stability Board and IMF have identified private credit valuations as systemic concerns, noting that loss recognition may be deferred 6–18 months after underlying economic stress occurs. Auditor scrutiny has increased materially, with several large BDCs facing revised marks in 2024–2025.

9.3 Rising Defaults: A Genuine Warning

Proskauer's Q4 2025 rate of 2.46% and Fitch's 9.4% PMR rate are both moving upward. Healthcare services, consumer products, and media companies have seen the sharpest deterioration. With approximately 40% of BDC borrowers estimated to have negative free cash flow before interest, and Moody's projecting leveraged loan defaults of 7.5–7.9% through Q1 2026, the private credit system has yet to be fully stress-tested at its current $3.5 trillion scale.

9.4 LBO Overhang and Exit Pressure

Suppressed IPO activity (74% below 2021 peak), constrained M&A exit volumes, and $146 billion in US dry powder create a challenging environment. Sponsors who deployed capital in 2021 at peak multiples face compressing EBITDA margins and higher interest burdens with limited exit options — implying a potential wave of amend-and-extend transactions in 2026–2027 requiring lenders to accept less favourable terms to avoid triggering defaults.

9.5 Regulatory and Systemic Risk

Regulators including the FCA, Bank of England, FSB, and US SEC are increasing oversight of the sector. Concerns centre on subscription credit line leverage, bank-private credit interconnections, and the potential procyclicality of closed-end fund structures. The US SEC's expanded Form PF reporting requirements (finalised 2023) increase disclosure obligations for large advisers. The potential inclusion of private credit in the $13 trillion US defined contribution market — recently granted regulatory approval — introduces retail-scale capital into an illiquid asset class, warranting careful monitoring.

9.6 Fees: A Misalignment of Interests

Management fees of 1.0–1.5% plus 10–20% carry generate total expense ratios of 2.0–2.5%+. Direct lending LBO spreads compressed from 668 basis points over SOFR in 2023 to 527 basis points in 2024, with 81% of 2025 direct lending LBOs priced below 550 basis points. Net-of-fee returns at these spread levels raise legitimate questions about adequate compensation for illiquidity and credit risk.

Furthermore, some leading Private Credit Managers are earning most of their revenue from management fees, which fails to deliver a minimum alignment of interests with investors. Retail investors may suffer further from significant additional fees at the wealth manager level. The high dispersion of returns is not matched by an equally high dispersion of fees.

10. Interest Coverage Ratios — The Canary in the Coal Mine

The interest coverage ratio (ICR), measured as EBITDA divided by interest expense, is arguably the single most important real-time indicator of private credit borrower health. When ICRs are high, borrowers have ample cushion to service debt even if earnings deteriorate. When ICRs compress toward or below 1.0x, borrowers are operating at or near the edge of their ability to meet interest obligations from operating cash flow, a condition that typically precedes default or distressed restructuring.

The trajectory of private credit ICRs over the past five years tells a stark and instructive story about the consequences of the rate-hiking cycle on leveraged borrowers.

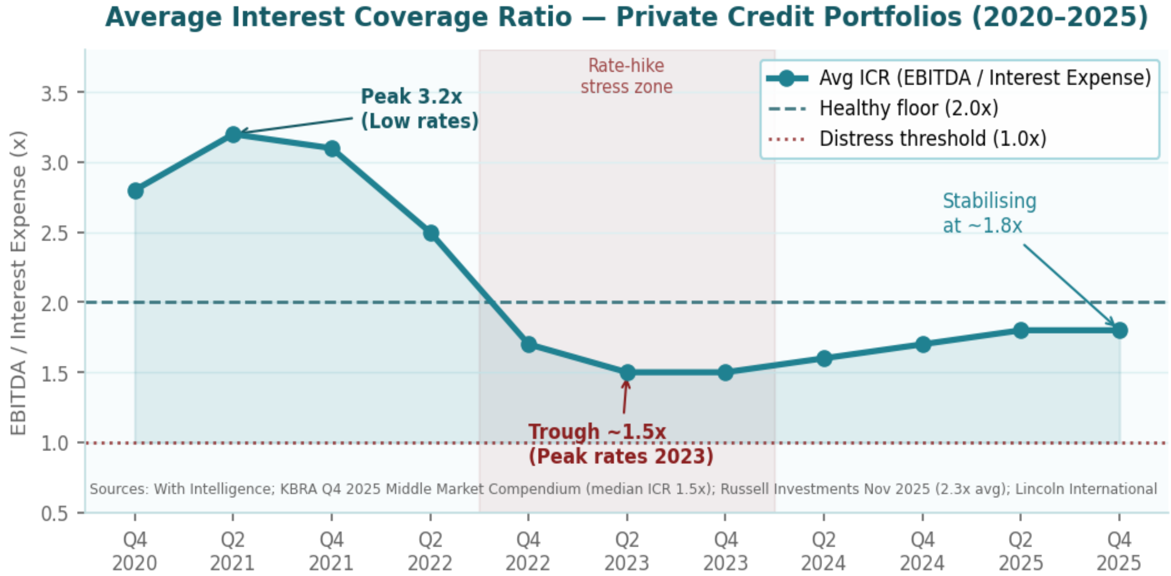

Figure 7: Average Interest Coverage Ratio (EBITDA / Interest Expense) across private credit portfolios, Q4 2020–Q4 2025. Shaded band marks the 2022–2023 rate-hike stress period. Sources: With Intelligence; KBRA Q4 2025 Middle Market Compendium; Russell Investments; Lincoln International.

At the peak of the low-rate era in 2021, the average ICR across private credit portfolios reached approximately 3.2×. **By the trough of the rate-hiking cycle in 2023, it had collapsed to approximately 1.5×**, less than half the prior level. This compression was driven by the dual shock of higher SOFR rates inflating interest expenses on floating-rate loans, while EBITDA growth in many portfolio companies simultaneously decelerated under cost pressures. Interest costs for floating-rate borrowers rose by more than 50% in aggregate through the 2022–2023 hiking cycle (VRC).

Since late 2024, Federal Reserve rate cuts and spread compression have provided partial relief. The median ICR, as measured by KBRA's Q4 2025 Middle Market Borrower Surveillance Compendium covering over 1,000 names, stabilised at approximately 1.5×. Russell Investments, drawing on manager surveys in November 2025, reports an average of approximately 2.3× across broader portfolios, though this reflects selection bias towards larger, better-capitalised borrowers. PineBridge regards 2.0× as the minimum threshold for a healthy ICR, and 1.25× as the minimum for fixed-charge coverage adequacy.

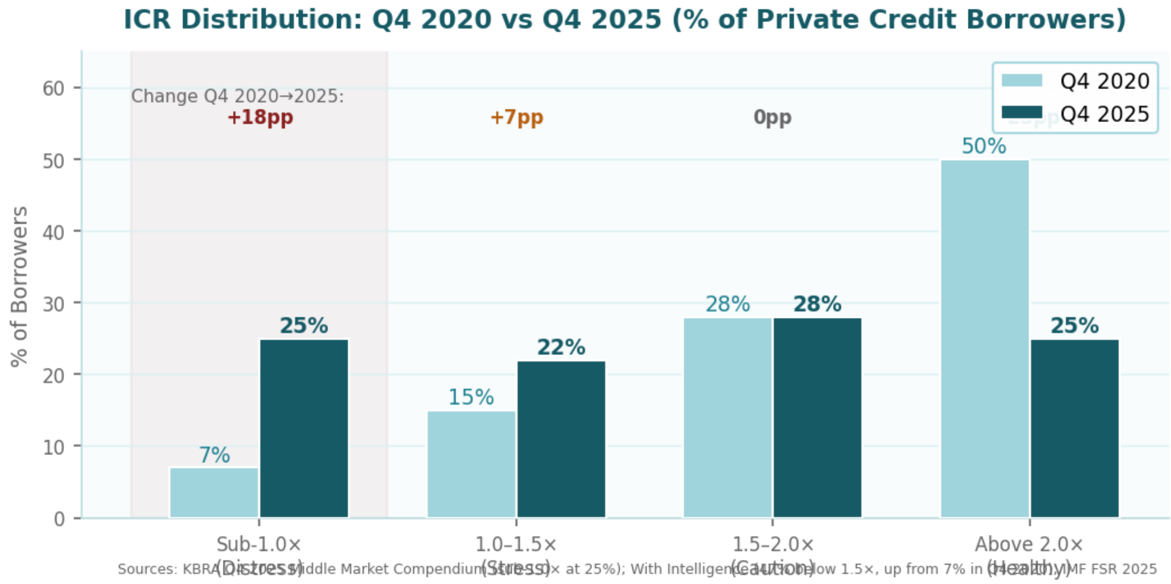

Figure 8: Distribution of borrowers by ICR band — Q4 2020 vs Q4 2025. Sources: KBRA Q4 2025 Compendium (sub-1.0× ICR at 25%); With Intelligence (47% of borrowers below 1.5×, up from 7% in Q4 2020); S&P Global; IMF Financial Stability Report 2025.

The distributional shift is the most alarming aspect of the ICR data. In Q4 2020, only 7% of private credit borrowers had ICRs below 1.5× (the combined distress and stress buckets). By Q4 2025, that proportion had risen to approximately 47%. The share of borrowers with sub-1.0× ICRs, meaning interest expenses exceed EBITDA, implying cash burn to service debt, rose from 7% to 25% over the same period, according to KBRA's Q4 2025 compendium. Conversely, the proportion of healthy borrowers (ICR above 2.0×) fell from 50% to just 25%.

The IMF's 2025 Financial Stability Report estimated that **over 40% of private credit borrowers have negative free cash flow**, a figure that aligns closely with the ICR distribution data and explains the sharp rise in payment-in-kind (PIK) facility usage as borrowers increasingly elect to defer cash interest payments.

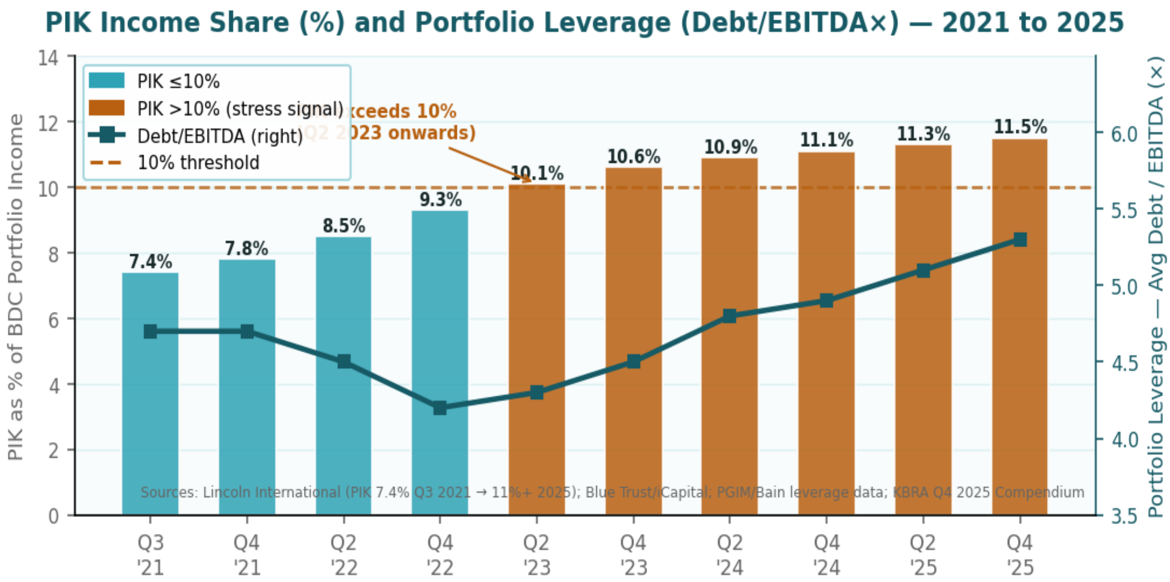

Figure 9: PIK income as % of BDC portfolio income and average portfolio leverage (Debt/EBITDA×), Q3 2021–Q4 2025. PIK exceeded the 10% stress threshold from Q2 2023 onward. Sources: Lincoln International; iCapital/Blue Trust; PGIM/Bain & Co.; KBRA Q4 2025 Compendium.

PIK usage is a particularly revealing indicator: it is the mechanism through which borrowers who cannot service cash interest defer the obligation by adding the unpaid interest to the principal balance, compounding the debt load. The share of BDC portfolio income comprising PIK has risen steadily from 7.4% in Q3 2021 to approximately 11.5% by Q4 2025. Crossing the 10% threshold, which occurred around Q2 2023, is widely regarded by practitioners as a meaningful stress signal. While some PIK is structural and reflects healthy, cash-generative growth-stage companies conserving capital for expansion, the current trajectory is consistent with 'defensive' PIK: borrowers under cash flow pressure choosing to defer rather than pay.

Simultaneously, average portfolio leverage (measured as debt-to-EBITDA) has crept upward from approximately 4.7× in 2021 to 5.3× by end-2025, despite post-pandemic deleveraging expectations. S&P Global reports that for its universe of US middle-market companies with credit estimates, average leverage reached 7× in 2024 — with 20% of companies below 1× EBITDA interest coverage. Under a mild stress scenario (10% EBITDA decline plus a 50 basis point rate increase), S&P projects over 25% of these companies would breach 1× coverage.

The interest coverage picture is not uniformly dire. Larger borrowers, those with EBITDA above $50 million, have generally maintained healthier coverage ratios, as EBITDA growth has been stronger at the upper end of the market. KBRA notes that median revenue and EBITDA CAGRs across its monitored portfolio remain healthy at 12% and 28% respectively.

The stress is concentrated at the lower end: smaller borrowers (EBITDA below $25 million) with higher leverage and less EBITDA growth resilience are disproportionately represented in the sub-1.0× bucket. Manager positioning along the size spectrum is therefore a critical differentiator of ICR risk.

11. Sector Exposure — Concentration Risk in Focus

Private credit portfolios are not uniformly exposed across industries. The sector composition of a private credit portfolio materially determines its vulnerability to specific economic stresses, and the current distribution of exposures — shaped heavily by a decade of PE-backed buyout activity, carries meaningful concentration risk in several areas.

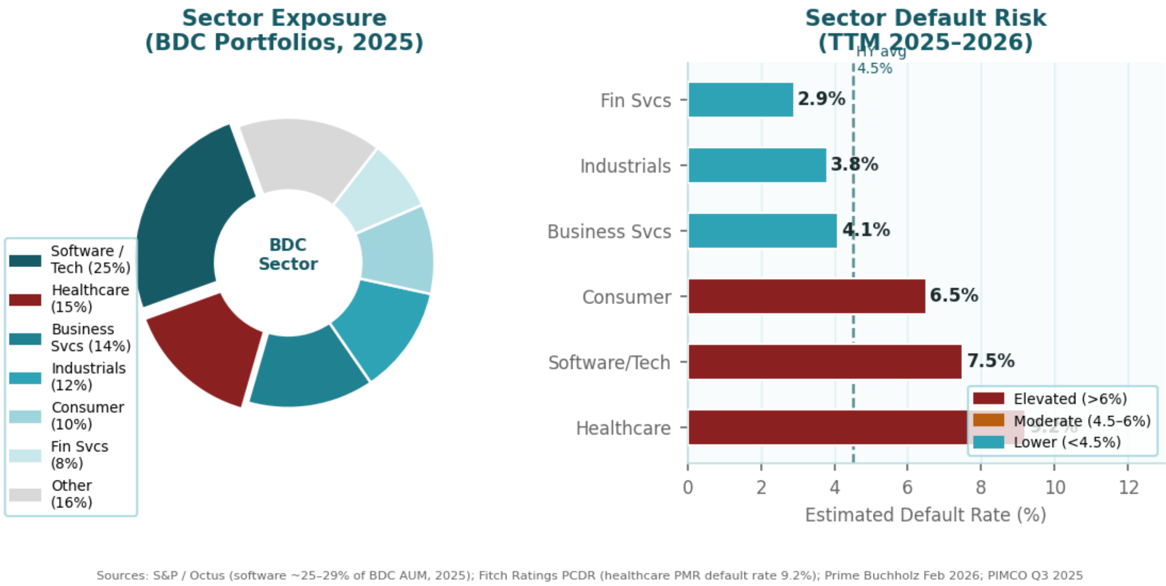

Figure 10: Private credit sector exposure (BDC portfolio mix, 2025) and estimated sector default rates (TTM 2025–26). Sources: S&P / Octus BDC analysis ($152.6bn, Sept 2025); Fitch Ratings PCDR (healthcare PMR rate 9.2%); Prime Buchholz Feb 2026; PIMCO Q3 2025.

11.1 Software and Technology — The Dominant and Contested Exposure

Software and technology companies represent the largest single sector exposure in private credit, accounting for approximately **25% of the private credit market by year-end 2025** (S&P Global). Octus's analysis of 155 public and private BDC portfolios totalling $152.6 billion in debt principal found software exposure at approximately 29% when including healthcare technology and software-enabled business services. PIMCO notes that the software share of BDC portfolios has more than doubled over the past decade, driven by heavy PE sponsor involvement in the sector and its reliance on direct lending.

The bull case for software lending rests on the historically high recurring revenues, low physical asset intensity, and sticky customer bases of SaaS business models. These characteristics made software companies attractive to direct lenders seeking predictable debt service. However, the durability of these characteristics is now under scrutiny. Many buyouts were completed at peak 2021 valuations underpinned by aggressive revenue multiples that assumed sustained growth rates that have since decelerated. Additionally, the rise of AI threatens to commoditise certain software categories, compressing the pricing power and customer retention metrics that underpinned original underwriting assumptions.

SaaS company loan defaults are estimated at potentially reaching 13% in 2026 for the most stressed sub-segment (24/7 Wall St. analysis, Feb 2026). **Blue Owl Capital's OTF vehicle , with particularly heavy SaaS concentration, experienced NAV deterioration and non-accruals rising to 4% of portfolio** by Q4 2025. Golub Capital BDC (GBDC), with approximately 26% software exposure, cut its dividend by 15% in early 2026 as falling base rates compressed floating-rate income on a portfolio that had been optimised for a higher-rate environment. Notably, only 9.7% of software loans across BDC portfolios mature before 2028 (Octus), providing some near-term refinancing breathing room, but also deferring the reckoning.

The key risk factor for software lenders is asset tangibility: in the event of default, the recoverable assets are primarily intellectual property, contracts, and recurring revenue streams, all of which may erode rapidly if customer confidence falters or a business is wound down. Recovery rates on software defaults are therefore expected to be materially below those on asset-backed lending, where physical collateral provides a floor. Lenders who underwrote software credits at 5–7× leverage in 2020–2022 on the assumption of asset-light resilience may find recovery outcomes disappointing.

11.2 Healthcare — Structurally Stressed and Regulatory-Exposed

Healthcare services is the **highest-defaulting sector in private credit by Fitch's PMR methodology**, with the sector recording the largest number of unique defaulters over the 12 months to January 2026. Consumer products ranked second. Fitch's sector default rate for healthcare services has been consistently above 9% on the PMR basis, reflecting a confluence of specific pressures: post-pandemic volume normalisation, Medicaid redetermination reducing covered lives, higher labour costs in care settings, and reimbursement rate pressures from both government and private payors.

Private credit exposure to healthcare grew rapidly during 2020–2023 as PE sponsors aggressively bought and financed healthcare businesses (physician practices, home health agencies, dental service organisations, and veterinary chains). According to Secured Research analysis cited by ABF Journal, private credit exposure to healthcare has grown by 27% since 2022. Many of these businesses were acquired at elevated multiples based on pre-pandemic utilisation and reimbursement assumptions that have since proved overly optimistic. The 2025 Medicaid Act's stricter eligibility rules, expected to reduce enrollment and increase the uninsured population, is an additional headwind specifically for providers reliant on Medicaid reimbursement.

11.3 Business Services, Industrials, and Consumer

Business services companies, typically software-enabled outsourcing, staffing, and professional services businesses, represent approximately 14% of BDC portfolios. Their ICR profile is generally more stable than software or healthcare, though they share some of the same AI disruption risk as software-adjacent companies. Default rates in this sector are estimated at approximately 4.1%, modestly below the high-yield long-run average.

Industrials (approximately 12% of portfolios) have generally demonstrated resilience, supported by near-shoring trends and infrastructure spending. Consumer-facing credits (approximately 10%) present more nuanced risk: lower-end consumer discretionary businesses have faced sustained pressure from inflation-squeezed household budgets and are represented among the higher-defaulting sub-segments. Fitch's consumer products sector default rate rose from 6.1% in January 2025 to 12.8% by January 2026, the sharpest acceleration of any sector in its PMR universe.

11.4 The Concentration and Overlap Problem

Beyond absolute sector weights, a less-discussed risk is the growing overlap across manager portfolios. PIMCO's Q3 2025 analysis shows that median BDC portfolio overlap has risen materially over the past decade, driven precisely by the concentration in software and PE-backed business services companies. In a market stress scenario, high portfolio correlation across managers could mean that secondary market transactions, whether forced sales or voluntary rebalancings — hit the same underlying credits simultaneously, amplifying price declines and recovery rate deterioration.

Allocators should therefore evaluate not just the sector mix of a specific fund, but the degree to which that mix is differentiated from the broader market. A fund that claims diversification across 50–60 portfolio companies but holds the same software and healthcare credits as the industry benchmark has not genuinely diversified away the systemic sector risk that currently characterises the private credit market.

12. Conclusion

Private credit has earned a legitimate and increasingly important role in institutional portfolios. The evidence is compelling: a 24% CAGR in AUM, 11.6% average annual direct lending returns since 2008, and structural attributes, floating rates, tight covenants, senior security, that have outperformed public alternatives across multiple interest rate cycles.

Yet the data assembled in this report supports a more cautious framing than the industry typically presents. Default rates are rising across multiple indices. BDC discounts to NAV are widening for lower-quality managers. IPO and M&A exit routes remain deeply suppressed relative to their 2021 peak. The rapid inflow of capital through semi-liquid retail structures introduces liquidity risks the asset class has not previously faced at scale.

The credit cycle has turned. The gap between manager-reported NAVs and BDC market prices suggests the full scale of deterioration in private credit portfolios may not yet be visible in official statistics. Allocators should model base, adverse, and severe scenarios; stress-test liquidity assumptions; and ensure net-of-fee returns genuinely compensate for the risks being assumed.

Approached with appropriate diligence, manager selection rigour, and realistic return expectations, private credit remains a compelling asset class. Approached as a source of easy, low-risk yield, it carries the potential for unexpected and difficult-to-reverse losses.