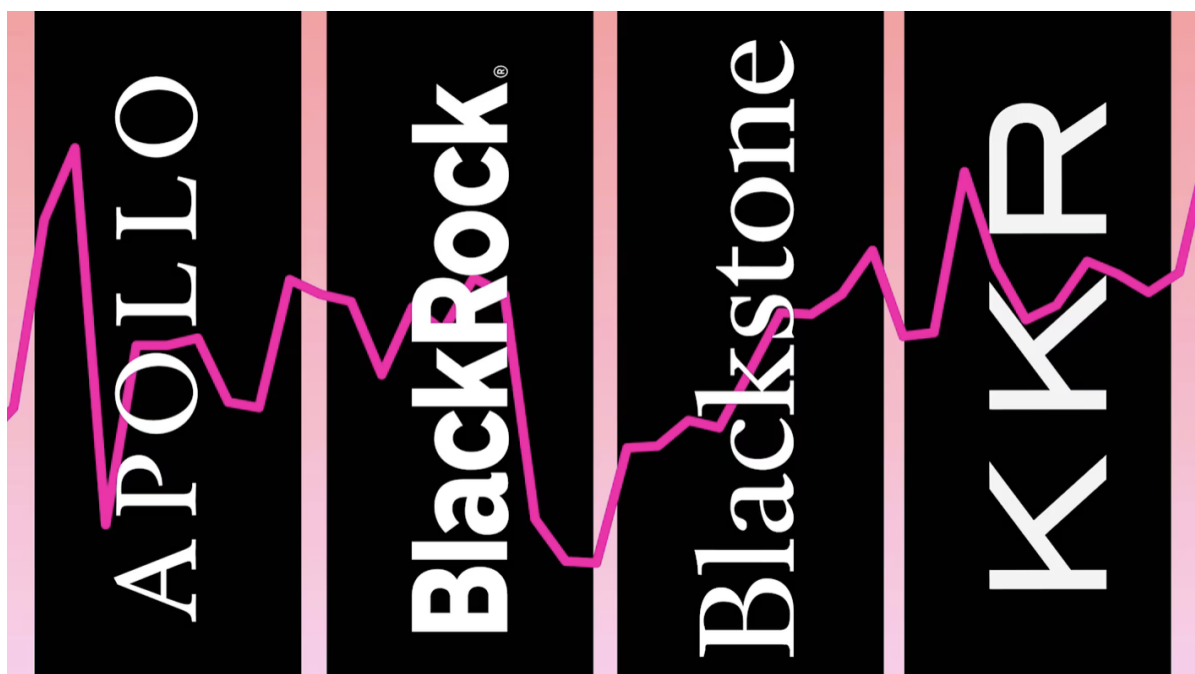


A Private Credit Deep-Dive

By Sean Freeburn

“99.5% of all companies in the world are non-investment grade debt companies...very few are investment grade and therefore you can imagine my excitement when everyone focuses on 500 companies, and I have 10 million to figure out what to do”

- Michael Milken, the investor who created the high-yield bond market in the 1970s, which later inspired the private credit sector we see today.



¹Michael Milken, during the 1965 Watts riots, met an African American man who lost his job and explained that he would never have access to capital or business loans because of his race. Finding this out, Michael Milken was hooked on studying credit in finance at Berkeley, with his research leading him to the realisation that the risk premium was often greater than the actual risk, forming his foundational research that allowed him to take advantage of the high-yield bond or “junk” market that he pioneered². With Milken’s work in this area, we later developed the now-trendy sector – private credit.

While private lending has lasted for decades, the modern private credit industry has experienced rapid growth since the 2008 GFC. This has been a result of regulatory reforms such as Basel III, making traditional leveraged and cash-flow lending to mid-sized companies unattractive or impossible. This gaping hole in the market has been filled by alternative asset managers, who have stepped into fill this credit vacuum. A market now estimated to be worth \$3.2 trillion³, has further runway that it can take advantage of in the next few years, but why now is everyone talking about it?

Well, what is it? Simply put, private credit is non-bank lending where private funds issue loans to companies in the form of corporate debt financing, not traded on public exchanges.

Where has it come from? While private lending has long existed, the modern industry of private credit evolved – as briefly discussed above – from the 2008 GFC. One of the lasting results of the GFC was the increased regulation imposed on commercial banks under Basel III and the Dodd-Frank Act, which were frameworks that ultimately tightened

¹ The Financial Times, ‘Private credit under strain as troubled loans swell’

² Bloomberg, ‘Private Credit’s Birthplace Gives New Rise to 1980s-Style Greed’

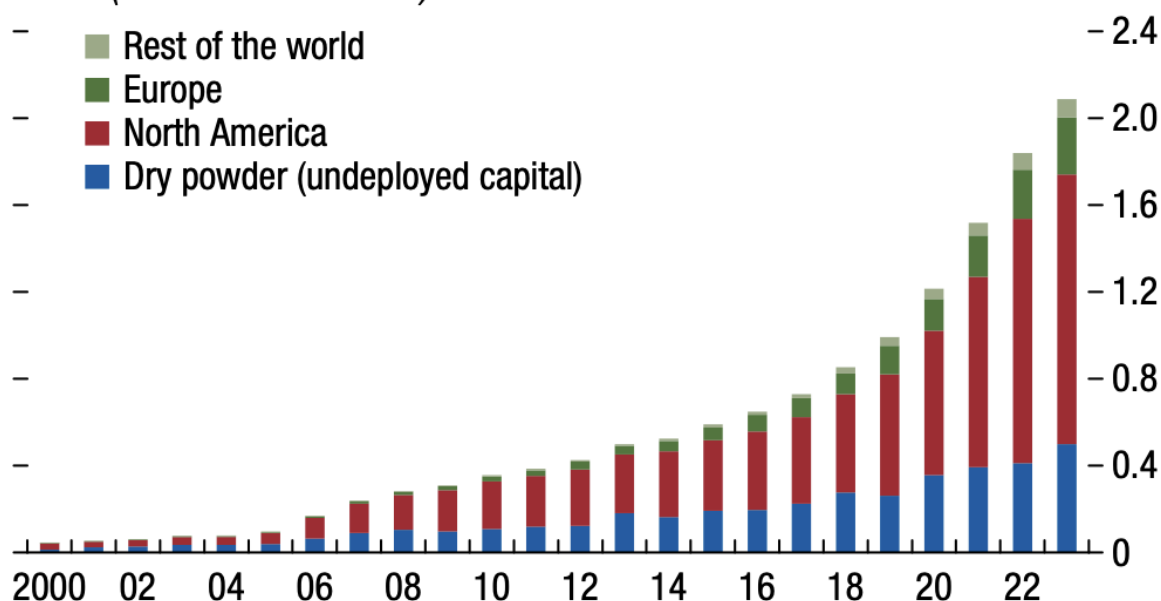
³ 2024 report by the Alternative Credit Council and EY

leverage restrictions, underwriting standards and raising capital adequacy requirements for large commercial banks. These post-GFC changes made holding riskier, non-investment grade loans on balance sheets increasingly capital-intensive for these banks. The result of this: focus shifted to larger/more liquid/investment-grade assets, and a gap in the market became apparent for small and medium-sized (SME) businesses that could no longer secure traditional corporate financing.

Okay, so the commercial banks had been pushed out of the SME private lending space, but how have non-commercial firms benefitted from these private credit tailwinds?

I believe mainly because of these 3 reasons – Low-interest rates, illiquidity premiums, and the private equity boom.

2. The Growth of Private Credit Markets (Trillions of US dollars)



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Interest Rates:

Following the GFC, central banks have maintained interest rates close to zero for over a decade, which in turn severely depressed yields in public corporate bond markets. This prompted a search for alternative methods of higher yields from institutional investors such as pension funds, insurance companies, and sovereign wealth funds. When banks faced off with rising inflation around 2022, a rate hike did not cause the private credit sector to wobble. This was largely reasoned to most private corporate loans being structured with floating interest rates (tied to SOFR or SONIA + a spread), their yields rose in lockstep with the benchmark rate increases. This mechanism acted as a hedge, generating further yields and protecting investors from duration risk that typically shook fixed-rate public bonds.

⁴ Global Financial Stability Report, April 2024, Chapter 2: The Rise and Risks of Private Credit

During this low-rate era, cheap debt capital was readily available and therefore in demand for corporate borrowers and sponsors to further leverage their growth, and acquisitions. The industry that realised most of this opportunity was private equity, which fuelled further capital deployment as their methods of generating returns (LBO's and other leverage-reliant methods) were benefitting from lower costs of borrowing - making returns elevated. This event came in tandem with increased customer demand, elevating portfolio companies' valuations and leading to even more high valuation multiples. This leads very naturally into my next point...

The Private Equity Boom:

The private credit and private equity industries somewhat exist in a symbiotic ecosystem, growing together over the last decades. Approximately 70% of all private credit transactions are sponsored deals, in other words, the borrowing company is backed by a private equity sponsor. This figure is even high upon a fund manager whose umbrella firm is also active in private equity, holding - on average - more than three-quarters of private credit assets. This would generally indicate that the more capital allocation given to PE, the more PC would benefit. In fact, this is what has happened with dry powder growing in PE as institutional capital flooded into private equity with PE funds growing exponentially, for example, European PE fund assets doubling to €720bn since 2020. With this, often PE sponsors bypassed traditional commercial banks, such as your JP Morgans, Goldman Sachs and Morgan Stanleys of the banking world - which are still constrained by post-GFC rules - and turned to private credit. The preference towards direct lenders, which offer quicker execution, confidentiality, and price certainty caused a massive wave of new customers to private debt funds who boasted 77% of the global LBO debt financing, in comparison with traditional banks at 23%⁵. This has resulted in somewhat of a virtuous cycle, whereby limited partner capital has flooded into PE funds - global private market assets (driven heavily by PE) have grown from \$1.5tn in 2005 to \$15tn at the end of 2024, which has leveraged it up with direct lending to buy portfolio companies, therefore creating steady, highly predictable deal flow for private credit managers.

The Liquidity Premium:

Beyond the effects of an improving PE landscape benefitting the PC sector, the liquidity premium is one of the most important structural concepts in alternative investing. It represents the extra yield investors desire (and borrowers will pay), to compensate for holding debt instruments that can't be traded on public exchanges and must typically be held to maturity. The return differential between public, fully liquid debt and illiquid private credit is substantial and is broken down to three factors in order to quantify the premium applied:

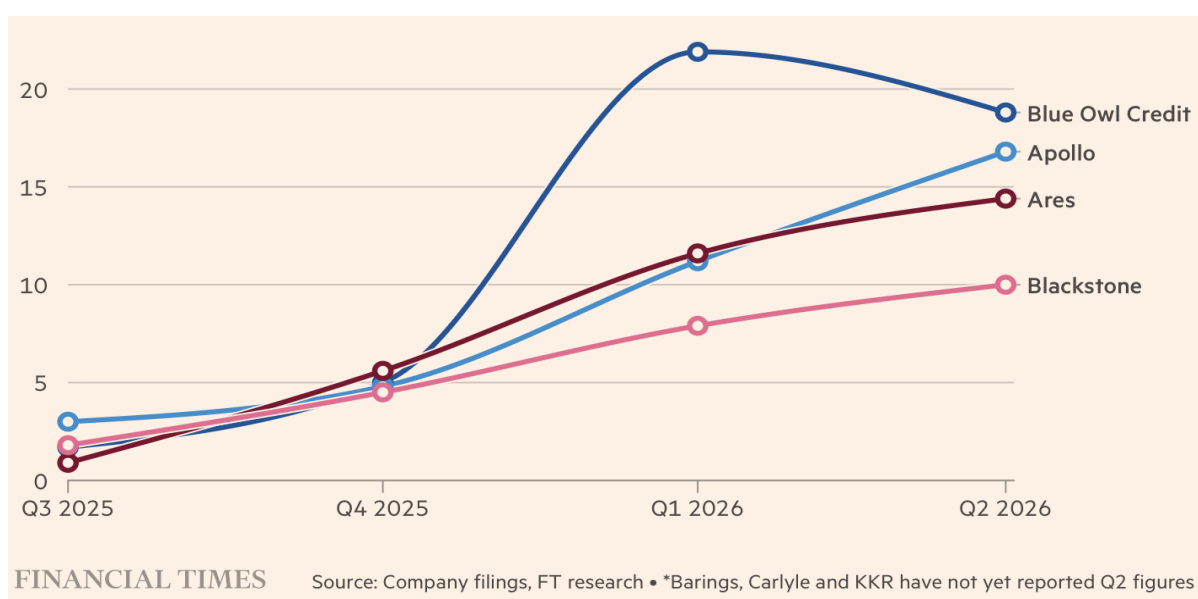
- **The Broad Credit Spectrum:** Across PC, the return premium typically ranges between 200-400 basis points over comparable public bonds. For example, direct

⁵ Blue Owl Capital, In Focus: Our lens on the private markets.

lending spreads have historically sat at c.100+ basis points above broadly syndicated loans and high-yield bonds.

- **The Investment-Grade Shift:** Historically, traditional corporate private placement market offered a modest premium of c.40 basis points. Today, however, bespoke high-grade capital solutions and asset-backed finance (private IG) generate an excess spread of 100-200+ basis points over public IG bonds.
- **The Compounding Power:** Portfolio analysis shows that replacing just 20% of a public investment-grade corporate allocation with Private IG can raise the overall portfolio yield by 50 basis points while maintaining equivalent average credit quality⁶.

The borrower, you can imagine, asks ‘Why Pay More?’ - the premium is not a penalty for illiquidity, it can be better referred to as an execution and customisation premium. Large corporate borrowers and PE sponsors are willing to pay this spread because PC offers valuable features that public markets cannot match. Firstly, there is a certainty of sourcing, that the lenders provide speed and complete confidentiality, preventing leaks of information to public markets and causing market volatility. Secondly, the bespoke structuring offered to lenders demand secured first-lien collateral and to maintain closer relationships to manage potential workouts smoothly. However, there are some sceptical associations with this premium. Wealth advisors suggest that the illiquidity premium is not entirely “free money” for accepting lockups, flagging several hidden risks. These include delayed price discovery - private loans do not trade, they are valued using model estimates and marked infrequently, creating a ‘stable price illusion’ that can mask credit deterioration until a hard event forces a discrete markdown. Furthermore, part of the premium may simply reflect higher underlying credit risk of middle-market borrowers, paired with heavy management and incentive fees that chip away at net returns.



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⁶ Apollo Global Management, Demystifying the Opportunity in Investment Grade Private Credit

⁷ Financial Times, ‘The great wealth transfer rattling Wall Street’

These premiums that I have discussed are designed to be for patient and long-term capital, such as pensions and multi-year liabilities. However, asset managers (Blue Owl, Apollo, Ares, and Blackstone most commonly) have recognised that the \$30tn in high-net-worth wealth is under allocated to alternatives. Consequently, they have engineered new fund structures to tap into this capital, for example, through the introduction of non-traded business development companies (BDCs) - closed-end funds that own private loans - and interval funds, which have similar structure to the BDCs but offer to buy back a limited percentage of shares (typically 5% of the NAV per quarter) at set intervals.

This creates a severe duration mismatch: the funds hold illiquid 5-7 year corporate loans but offer periodic redemption windows, meaning in times of market volatility (e.g. 2025 & 2026), redemption requests at some funds surged to 10-15% (21.9% in some cases) and with the example of Blue Owl being struck with massive redemption requests in July 2026, which have caused their shares to drop even further after a rough year to date.

Blue Owl hit by \$4.7bn of redemption requests as investor exodus persists

Withdrawal requests at 20 private credit funds tracked by FT totalled more than \$22bn in second quarter

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Where does the PC industry sit right now?

It has become a highly publicised area under the watchful eye of rising retail redeemers, who have placed pressure on asset managers with software sector anxiety and flight to high-quality credit at the forefront of news in mid-2026. In my opinion, with an ever-cautious retail crowd becoming more pessimistic, the comparisons to a “GFC 2.0” are using the PC industry to fuel their fire. Currently, the real pressure point seems to stem from the liquidity strain facing semi-liquid evergreen vehicles (such as non-traded business development companies and interval funds). The First Brands and Tricolor (large private borrowers) bankruptcies caused widespread retail investor concerns and due to the illiquid nature of these loans, investors commenced redemption requests. This move by retail investors meant that asset managers had to offer contractual 5% quarterly redemption gates to prevent asset fire-sales. We saw this exact mechanism with huge firms, such as Ares redemption rate at 11.6%, Blue Owl as high as 21.9% and established funds such as Carlyle’s CTAC facing 15.7% redemption rates⁹. As the private market enter late 2026, the era of easy, momentum-driven capital deployment is no more. The transition to prioritising higher quality credit is forming, and the industry requires a period of testing.

⁸ Financial Times, ‘Blue Owl hit by \$4.7bn of redemption requests as investor exodus persists’

⁹ Long Angle, ‘Private Credit Perspectives Q1 2026: Signs of Stress or Sound Plumbing?’

A full-circle realisation:

This important test is shaping up to be the refinancing and maturity wall that is quickly approaching. An estimated \$300bn-\$350bn of private credit and leveraged loans were formed in the pandemic-era peak and are now entering the refinancing windows. As widely covered in the news many of these loans were SaaS business valued at astronomical multiples of EBITDA and now, they face a tough time. The companies must refinance loans where EBITDA multiples have collapsed, and the SaaS industry has slid under the dark shadow of productive AI platforms that have the potential to replicate their businesses at a fraction of the cost. To add to this, headline payment default rates remain at lower levels of 2%-2.7%¹⁰, shadow default indicators tell a more complex story – these indicators provide an under the hood look through Payment-in-Kind (PIK), synthetic PIK, and distressed exchanges state that latent stress in the market is c.5%-6%¹¹. With managers looking toward higher-grade investment opportunities, increased scrutiny has forced portfolios to upgrade their overall quality, tighten loan documentation and focus on asset structures backed by stable, operational cash flows. This mechanism is the exact reason attributing to the rise in popularity of asset-backed finance, where much of the investment risks can be mitigated from self-liquidating structures where principal is paid back over the life of the loan.

In conclusion, we have an evident full circle realisation, 50 years on from Michael Milken's pioneering of the high-yield bond market. The overarching certainty within the PC industry remains – the non-investment grade corporate universe is massive, underserved, and represents a huge part of the engine of the global economy. Yes, like all industries there remains an air of volatility, especially in BDC prices and evergreen redemptions within PC, but I believe it is an industry whereby disciplined managers can navigate workouts and underwrite with rigour to ultimately benefit from those some 10 million non-investment grade companies.

¹⁰ Moody's, 'Default rates are easing. Credit risk is fragmented and fragile across markets.'

¹¹ Chartered Alternative Investment Analyst Association, 'SaaS and AI Concentration in Private Credit'