



Public insights on private credit

Only one of private credit's "four horsemen" is real



Private credit has faced apocalyptic scrutiny recently, suggesting the industry's US\$3 trillion edifice is cracking.

The evidence is seemingly everywhere: allegations of fraud-driven bankruptcies, candid admissions that returns will compress, a rush of retail redemption requests, and the looming disruptive power of artificial intelligence (AI) on software companies.

The temptation is to connect these dots into a single line pointing toward systemic risk. But weaving these events together reflects recency bias rather than sound analysis. In short, there are four horsemen of the apocalypse charging toward private credit investors, but three are phantoms. One, however, is real.

Horseman 1: Fraud, bankruptcies and cockroaches

The bankruptcies of First Brands and Tricolor are serious. They reflect failures of due diligence and weak controls around off-balance-sheet structures. But they are not evidence of systemic credit deterioration in private lending.

Both cases allegedly involved criminal fraud, which sits at the heart of the problem. Unfortunately, some fraud exists in all markets, so the discovery and prosecution of these cases is evidence of the system working.

Moreover, exposure to First Brands' term loans were primarily underwritten and syndicated by investment banks. This was a broad capital markets event, not a private credit one.

Jamie Dimon's "cockroaches" comment followed, spurring questions around what else was lurking in private credit.

Not much according to the numbers. Credit rating agency KBRA's data, covering 2,416 middle-market borrowers representing over US\$1 trillion in direct lending debt, shows a market that is stable at the median even as stress appears at the margins.

Default rates in direct lending remain comparable to broadly syndicated loan (BSL) markets, with a direct lending default rate by volume of 1.5% for 2025, down from 1.8% in 2024. For comparison, the BSL market default rate reached 3.8% over the same period.¹

1. Source: Cliffwater LLC. As of December 31, 2025.

Horseman 2: Returns compression

When Blackstone's Jon Gray said last year that lower base rates and tighter spreads would make mid-teens returns harder to achieve in senior private credit, critics argued the asset class was losing appeal.

What Gray actually said was while absolute returns may come down from their cyclical highs, the premium relative to liquid credit—around 150-250 basis points—would endure because of private credit's structural advantages: connecting investors directly to borrowers and eliminating costs, while adding flexibility and certainty. The relative value proposition, not the absolute return level, is what defines the asset class's appeal.

Framing return compression as a crisis confuses the normalization of an interest-rate cycle with structural impairment. Private credit delivered outsized absolute returns during 2022-2024 precisely because the Federal Reserve (Fed) raised rates and floating-rate loans repriced upward. The reversal, with the Fed having cut rates and expected (pre-Iran conflict) to make additional reductions through 2026, mechanically reduces gross yields. This is not a bug; it is how floating-rate instruments work.

An environment where returns are potentially lower, but credit quality is improving, is the tradeoff a fixed income allocator should welcome.

Horseman 3: Retail and liquidity risk

A business development company's (BDC's) high-profile event last month has fueled a narrative of structural fragility, just as private credit managers push into the retail channel.

The firm's handling of its redemption requests deserves scrutiny, and there were idiosyncratic reasons for how this played out. But it reveals more about investor education and accurate valuations.

The typical, advertised redemption policy for these "semi-liquid" funds is 5% of net asset value (NAV) a quarter. So, what was returned was a creative means of distributing more capital than was strictly necessary.

The firm opted instead to sell US\$1.4 billion in loans at 99.7% of par value and return approximately 30% of the fund's NAV to investors through periodic distributions. That the loans sold at near par on the dollar validates the underlying portfolio valuations—they appear to be good credits.

There is a legitimate critique of the semi-liquid BDC structure's growing pains with retail investors. But more education, product innovation and time should resolve these.

Horseman 4: AI disruption

Having dismissed three phantom horsemen, we arrive at AI. The risk that AI disrupts software companies, which comprise around 20%-25% of direct lending portfolios, is real and qualitatively different from the other horsemen.

It is forward-looking and structural, not backward-looking and idiosyncratic. The concentration is significant, with total debt exposure of approximately US\$224 billion, according to KBRA. And the risk is underpriced given automation threatens to erode the fundamentals on which these loans were underwritten.

But software is a broad sector with different moats. For example, enterprise systems of record embedded in Fortune 500 business processes are qualitatively different from narrow application-layer software. The disruption will be differentiated.

Investors should be asking their private credit managers: What is your software exposure by sub-sector? What percentage of your software book is application-layer versus systems-of-record? What loan-to-value and amortization protections do you have for your software loans? Have you stress-tested your portfolio's cash flows across a range of scenarios, from a modest 10% revenue headwind to a severe 50% plus impairment driven by AI substitution?

These are the right questions. "Is private credit broken?" is not.



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