



# MONTHLY INVESTMENT COMMENTARY

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## Private Credit: The Harder Questions

In February, [we wrote about the headlines dominating private credit coverage](#), arguing that outcomes are driven by manager selection, underwriting discipline, and portfolio construction rather than the news cycle. Two months later, the acute concerns about individual credit events faded. The questions we hear now are harder and more fundamental. Is the asset class still worth owning at today's yields? How should credit quality be evaluated? For investors considering whether to initiate or expand an allocation, what should guide that decision? These are the questions worth engaging directly.

## Returns: What Has Changed and What Has Not

The case for private credit over the past several years rested, in part, on yields that were difficult to ignore. Direct lending yields on newly-issued transactions sat in the 10% to 12% range at their 2023 peak before easing to roughly 9.3% by late 2025, according to J.P. Morgan research. Broadly syndicated loan markets have recaptured meaningful share, with banks' share of buyout financings above \$1 billion rising from a low of 39% in 2023 to just over 50% in 2025, according to PitchBook data.

The yield environment has changed, but the relative case has not changed nearly as much as the headlines suggest. Over the 21 years ending in 2025, the Cliffwater Direct

Lending Index returned 9.5% annually, compared to 6.6% for the Bloomberg High-Yield Bond Index, 5.1% for the Bloomberg LSTA Leveraged Loan Index, and 3.2% for the Bloomberg Aggregate Bond Index. Those excess returns reflect compensation for credit risk and illiquidity, and they have persisted through multiple market environments including the Global Financial Crisis and the COVID shock. The index delivered only one negative calendar year over that span in 2008, and it recovered fully within four quarters.

At current yields, a reasonable forward expectation for high-quality direct lending sits in the mid-to-upper single digits, net of fees and realized losses. That is a meaningful step down from what investors earned during the rate-hiking cycle, but it still offers a yield premium over comparable public fixed income for investors willing to accept less liquidity. The question for investors is not whether the return has changed, but whether the expected return still compensates for the risks involved given their specific circumstances.

## Credit Quality: What the Data Shows

The aggregate data on credit health is, on balance, reassuring. Credit losses in the CDLI came in at 0.64% for 2025, below the 21-year average of approximately 1%. Non-accruals stood at 1.3%, versus a historical average of 2.1%. Interest coverage ratios improved to 2.16x from a low of 1.85x when rates peaked in 2023, reflecting the pressure relief that middle-market borrowers

have received as the base rate has declined. These are not readings consistent with an asset class in broad stress. That said, aggregate data can mask real dispersion, and there are several areas that warrant closer scrutiny:

- 1. Payment-in-kind (PIK):** PIK allows borrowers to defer cash interest payments in exchange for adding the interest owed to the loan's principal balance. Used selectively, it is a legitimate feature of growth-oriented capital structures. Used broadly or rising rapidly, it can be an early indicator of borrower stress. At the index level, PIK remains contained, representing roughly 7% of total interest income in 2025. However, dispersion across managers is wide. PIK is not inherently bad, but rising PIK balances and heavy concentration in older vintages deserve attention. When evaluating a private credit fund, it is worth understanding not just the level of PIK in the portfolio but the trajectory and the underlying credits driving it.
- 2. Covenant Quality:** In the largest segments of direct lending, particularly deals competing with broadly syndicated loans for sponsor-backed transactions, covenant packages have converged toward public loan market standards. That convergence is less pronounced in the core and lower middle market, where lenders typically retain stronger covenant protections and closer borrower relationships. For investors, this means the "covenants and monitoring" advantage that has historically characterized private credit is not uniform across the asset class. It is strongest where it was always strongest, in traditional middle-market lending, and weaker in the largest transactions where private and public markets now directly compete.
- 3. Sector-Specific Forward Risk:** Credit statistics are useful, but they do not always capture emerging risks to portfolio quality. That is especially true in software and technology-enabled services, where AI-related disruption is beginning to create cracks in parts of the market. Private credit has roughly 21% direct exposure to software, reflecting lenders' long-standing preference for SaaS and other recurring-revenue models, and that figure does not include broader technology or business services exposure, where AI may also reshape competitive dynamics. Investors should be cautious about assuming that yesterday's credit metrics fully describe tomorrow's risks.

Dispersion across managers is a recurring theme across these points. The spread between top and bottom quartile private credit managers can exceed 13 percentage points in a single year, considerably wider than dispersion in public credit markets. That dispersion is an important practical reality of investing in the asset class.

## Questions to Ask Before Allocating to Private Credit

Investors considering whether to initiate or expand a private credit allocation should ask themselves these four questions:

- 1. What liquidity tools does my private credit fund have in place to meet redemptions during periods of stress?** Most interval funds and non-traded BDCs offer quarterly redemption windows capped at 5% of fund net assets. Historical data suggests funds can meet those redemptions from normal portfolio cash flow in most environments. CDLI cash flow from loan maturities and refinancings has averaged 8.4% of portfolio value per quarter over 21 years. However, during the first quarter of 2009, that figure dropped to 2.8%, and during the first quarter of 2023 it dropped to 3.6%. These stress episodes are rare, but they are not hypothetical. Some private debt funds, like BDCs, can simply reduce their 5% redemption offers at the discretion of their Boards. Others, like interval funds, cannot reduce their redemption offers and must have tools in place to access liquidity to meet redemptions during periods of stress.
- 2. What size position makes sense?** Private credit is a complement to traditional fixed income, not a replacement. It is not an equity substitute. Private credit allocations should be sized such that a severe drawdown in the asset class would not require liquidating at the wrong time or destabilize the broader financial plan. For most investors, a thoughtful allocation represents a modest slice of the overall portfolio.
- 3. Does my investment horizon match the asset class?** Private credit loans typically have seven-year maturities at origination, and portfolios are structured to be held through full credit cycles. Investors whose circumstances may require capital access within shorter timeframes should either avoid the asset class or size the allocation conservatively enough that liquidity needs can be met from other parts of the portfolio.
- 4. Do I have confidence in the manager I've selected for my private credit exposure?** Manager selection matters more in private credit than in most asset classes. Dispersion between top and bottom quartile managers is considerably wider than in public markets. For most individual investors, this argues in favor of broadly diversified vehicles, open-architecture platforms that aggregate exposure across multiple managers, or working with an advisor who conducts institutional-quality diligence on the investor's behalf.

## Bottom Line

The aggregate data on private credit quality remains solid, but the variance underneath that data has widened. For investors who entered the asset class with appropriate sizing, appropriate liquidity tolerance, and with a high-quality manager, the case for continued exposure has not materially weakened. For investors considering whether to initiate an allocation, the questions are the same ones that always applied, just asked in a more demanding environment. The headlines of the past year did not invalidate private credit. What matters, as always, is the fit between the investment and the investor.

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## Sources

1. Cliffwater press release on 2025 CDLI results: [CDLIFileDownload](#)
  - a. At the index level, PIK remains contained, representing roughly 7% of total interest income in 2025.
2. Cliffwater Article: [New Private Credit Data Contradicts the Recent Risk Narrative](#)
  - a. Over the 21 years ending in 2025, the Cliffwater Direct Lending Index returned 9.5% annually, compared to 6.6% for the Bloomberg High-Yield Bond Index, 5.1% for the Bloomberg LSTA Leveraged Loan index, and 3.2% for the Bloomberg Aggregate Bond Index.
3. JP Morgan Private Bank, "Private Credit Under the Microscope – Separating Headlines from Fundamentals": [Private Credit Under the Microscope – Separating Headlines from Fundamentals | J.P. Morgan Private Bank EMEA EN](#)
  - b. Direct lending yields on newly-issued transactions sat in the 10% to 12% range at their 2023 peak before easing to roughly 9.3% by late 2025, according to J.P. Morgan research.
  - c. Private credit has approximately 21% direct exposure to software, and that exposure rises to roughly 40% when broader technology and business services are included
4. CNBC/PitchBook: [Private credit's cracks spark a new tug of war with Wall Street banks](#)
  - a. Broadly syndicated loan markets have recaptured meaningful share, with banks' share of buyout financings above \$1 billion rising from a low of 39% in 2023 to just over 50% in 2025, according to PitchBook data.
5. Cliffwater Article: Ten Misconceptions About Private Debt: [Ten Misconceptions About Private Debt](#)
  - a. Credit losses in the CDLI came in at 0.64% for 2025, below the 21-year average of approximately 1%. Interest coverage ratios improved to 2.16x from a low of 1.85x when rates peaked in 2023, reflecting the pressure relief that middle-market borrowers have received as the base rate has declined.
  - b. CDLI cash flow from loan maturities and refinancings has averaged 8.4% of portfolio value per quarter over 21 years. However, during the first quarter of 2009, that figure dropped to 2.8%, and during the first quarter of 2023 it dropped to 3.6%.
  - c. The spread between top and bottom quartile private credit managers can exceed 13 percentage points in a single year, considerably wider than dispersion in public credit markets.

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