IN THIS REPORT

News around private credit may sound alarming, but the outcomes don't have to be. As always, prudent manager selection, strong underwriting, and a diversified portfolio can provide a more comfortable future than the headlines may lead you to believe.

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Recent Private Credit Headlines and the Importance of Manager Selection

Recent headlines around private credit have reignited familiar investor concerns. Reports of sharp valuation adjustments in individual vehicles, rising non-accruals, and questions around leverage have prompted some to ask whether stress in private credit is becoming systemic. While these developments deserve attention, they are best understood as a reminder of an enduring feature of private markets rather than evidence of a broad breakdown. Manager selection is critical in private credit, and outcomes are driven far more by underwriting discipline and portfolio construction than by macro headlines.

Private credit is not a single market. It is a collection of thousands of individual loans, negotiated privately, each with its own borrower, capital structure, and risk profile. As a result, performance differences across managers and strategies can be wide. When problems emerge, they tend to be concentrated rather than evenly distributed. A small number of troubled credits, particularly when paired with higher leverage or less diversified portfolios, can have an outsized impact on returns.

Media headlines often frame markdowns as verdict on private credit broadly, but history suggests they are more often a verdict on specific underwriting choices. Loans made at aggressive leverage levels, to weaker credits, or with limited covenant protection are more vulnerable when conditions tighten. When those exposures are concentrated, the resulting losses can dominate portfolio outcomes even if most loans continue to perform as expected.

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The structural role of private credit has not changed. Since the Global Financial Crisis, banks have retreated from large segments of middle-market lending due to regulatory constraints. Private lenders stepped into that gap, offering borrowers speed, certainty of execution, and flexible capital solutions. Middle-market loans are generally not rated, are considered non-investment grade, and are not traded in the secondary market. As a result, yields are generally greater than traditional broadly syndicated bank loans and publicly traded high-yield bonds.

Several factors consistently separate resilient private credit portfolios from fragile ones:

1. **Positioning in the capital structure.** Senior secured, first-lien loans provide a very different risk profile than junior or equity-like credit exposures. In periods of stress, seniority matters. Recovery rates, loss severity, and cash flow stability are all heavily influenced by where a lender sits in the borrower's capital stack.

2. **Diversification.** Private credit portfolios are only as diversified as their underlying borrowers. Concentration by issuer, industry, or private equity sponsor increases vulnerability to idiosyncratic risks. In contrast, broadly diversified portfolios are better positioned to absorb individual credit losses without allowing them to dominate the results of the fund.

3. **Leverage discipline.** Leverage can enhance returns in calm environments, but it amplifies mistakes when underwriting proves too optimistic. Higher leverage increases sensitivity to credit losses and reduces flexibility when conditions deteriorate. Conservative leverage is a critical aspect of risk control.

4. **Underwriting standards and monitoring remain critical.** Ongoing borrower oversight, covenant enforcement, and early intervention are essential to preserving capital. Strategies that emphasize deal volume or yield maximization at the expense of underwriting rigor tend to experience more volatile outcomes over full cycles.

Liquidity is another area where expectations matter. Private credit is designed to be held through cycles. Mismatches between asset liquidity and investor expectations tend to surface during periods of stress, precisely when patience is most valuable. If you plan on including an allocation to private credit within your portfolio, proper sizing is essential.

From a portfolio construction standpoint, private credit continues to serve a specific role. It is not appropriate for every investor, it is not a substitute for equities, and it is not a risk-free alternative to traditional fixed income. Its appeal lies in its high floating-rate yield and diversification benefits when implemented thoughtfully.

The recent wave of concern reinforces a familiar conclusion. Private credit is not broken, but it is unforgiving of weak underwriting, excessive leverage, and poor diversification. Investors who focus on structure, discipline, and manager selection are far better positioned than those who rely on labels or headline yields. As always, we continue to monitor developments across credit markets closely. Periods of heightened scrutiny can be uncomfortable, but they often provide useful clarity.