DEBT MARKET UPDATE

JUNE 2026

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Overview

The first half of 2026 has been plagued with a number of headlines with a focus on potential cracks in private credit. Some of these cracks are legitimate; for example, higher-for-longer rates are testing borrowers. Certain sectors are under strain. Several private equity and private credit funds have started implementing frameworks to assess the potential impact of AI to the underlying investments.

AI exposure has become a key factor in how portfolio managers are risk-rating their underlying investments. The M&A environment continues to remain slow mainly due to a mismatch in valuation expectations. This is especially the case for investments that were made in 2021 valuation peak. Questions around valuation and transparency remain. As a result of slow exits, limited partners have effectively bargained for lower management fees and more concessions and for general partners to contribute more capital. Inflation continues to be a concern with the uncertainty of the Iran conflict having significant risk from higher energy input costs and indirect macro effects from lower demand which can have a negative impact on issuers across certain sectors and regions. Consequently, direct lending volume and deal count have fallen to a three-year low, based on Pitchbook.

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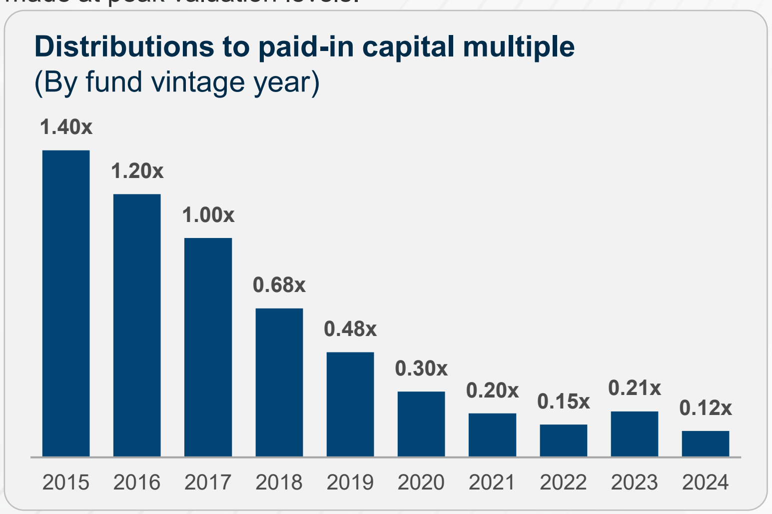
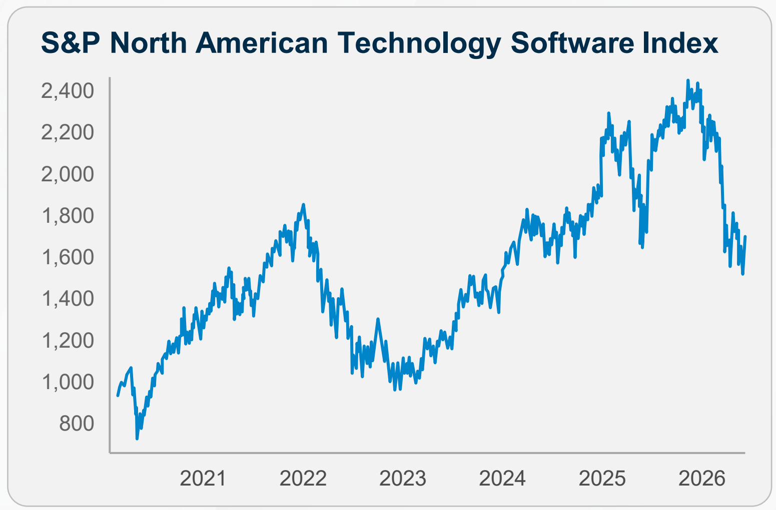
Software Disruption (1/2)

Software-as-a-Service (SaaS) companies were based on a model of having continued predictable subscription-based cash flows. With the potential of AI disruption, that business model has been fundamentally disrupted. Private credit managers have made the argument that their loans should not be at risk due to the seniority in the capital structure. In theory, the software firm's value would need to fall by 60% to wipe out the equity cushion and expose creditors to losses. However, that cushion may not be as substantial as expected if the investment was made at peak valuation levels. Medallia is an example where Thoma Bravo may risk losing $5 billion of equity from a deal made in 2021 at $6.4 billion. However, not all software or services are equally exposed to AI disruption risk and understanding the nuances is critical.

Software valuations have been under serious pressure amid fears that AI tools, including those from Anthropic and others, may cause some software firms to lose customers and pricing power. Most private equity firms were not aware of how profound AI may upend software business models. PE firms were also caught by the end of cheap money era as central bankers hiked rates to dissipate inflation. Many of these software companies were not highly profitable before interest expense increased to such high levels. As such, many of these issuers had to convert all or part of cash interest to payment in kind (PIK) to preserve liquidity. Dividend capitalizations and continuation funds which were used aggressively in the past, may not be viable options as valuations become more questionable. As shown in the chart below, PE has exited very few of its 2020-2021 investments, as the entries were made at peak valuation levels.





Note: Shows equal-weighted pooled DPI multiple
Source: Pitchbook

Source: Bloomberg

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Software Disruption (2/2)

According to Fitch Ratings, software exposure in BDCs can vary. It is also made more challenging given inconsistent disclosure on how software companies are classified.

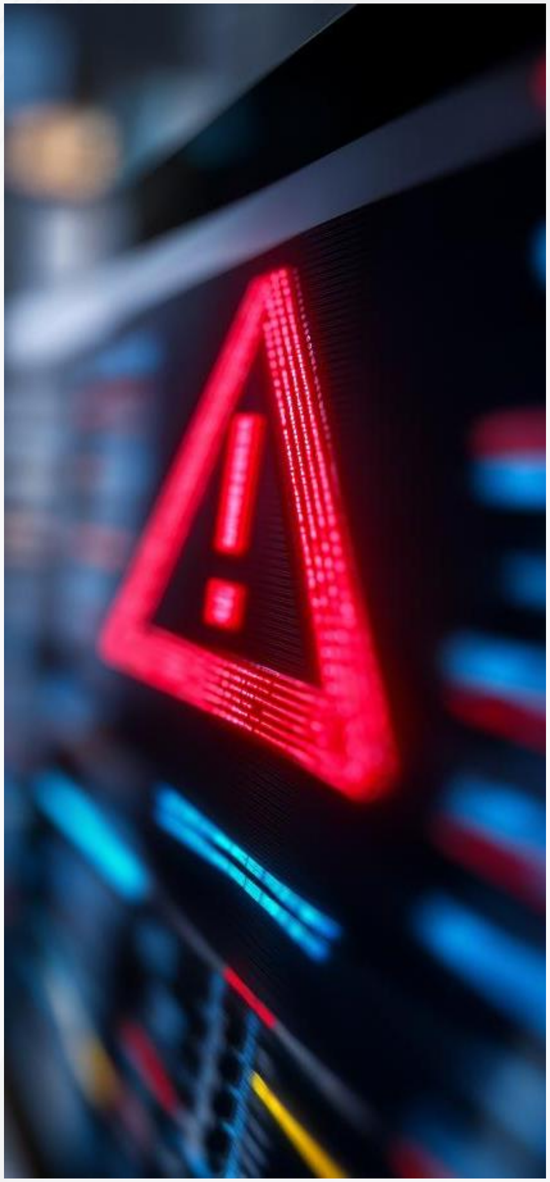
Reported Software Exposure	
Fitch Model-Based Credit Opinion Portfolio	~18%
Broadly Syndicated Loans CLOs	~13%
Middle Market CLOs	~17%
Business Development Companies (BDCs)	10-70%
Alternative Investment Managers	2-11%

Software alone accounts for 25% to 30% of portfolio fair value among the top ten BDCs and the real exposure may be greater. BDCs with higher software exposure have seen the highest drawdowns.

Other write-downs:

Ares Management Corp. wrote down three software loans in the first quarter of 2026 by 13 to 18 cents on the dollar. These three loans (Cornerstone OnDemand, Symplr, and DigiCert) were the largest contributors to the fund's $357 million of net unrealized losses, per Bloomberg.

Source: Fitch Ratings



Valuation Challenges and Inconsistency Between Funds (1/2)

Valuation scrutiny of private credit started by the threat of AI disruption to software companies. Timing mismatches are raising concerns about whether managers are proactive enough in adjusting portfolio valuations. An investor sued Blue Owl Capital in April 2026, alleging its adviser inflated the value of private credit fund assets to extract excessive fees. The lawsuit accuses Blue Owl Credit Advisors LLC of breaching fiduciary duties by manipulating valuations of the Blue Owl Capital Corporation (OBDC) fund, as reported by Reuters.

Portfolio overlap across the top 10 BDCs – Q4 2025

	MSDL	GSBD	GBDC	OBDC	FSK	BXSL	ARCC	TSLX	PSEC	MAIN	Total Overlap
MSDL		14.4%	30.3%	18.8%	14.0%	29.3%	31.1%	1.5%	0.8%	1.0%	66.1%
GSBD	19.7%		20.7%	7.2%	9.7%	10.4%	19.6%	2.4%		1.7%	51.1%
GBDC	20.9%	7.6%		14.6%	8.4%	18.6%	21.8%	3.9%		0.6%	48.1%
OBDC	13.9%	4.5%	16.8%		7.9%	15.1%	14.3%	2.2%	2.2%		44.6%
FSK	9.5%	5.7%	9.8%	13.4%		19.5%	21.3%	1.0%	0.7%		40.0%
BXSL	11.9%	4.0%	12.9%	16.6%	10.6%		14.7%	2.3%	0.0%		38.4%
ARCC	10.0%	3.9%	15.1%	11.5%	8.4%	12.8%		3.0%	0.9%	0.7%	37.2%
TSLX	2.4%	6.1%	12.7%	8.5%	1.9%	9.6%	13.5%				33.2%
PSEC	0.8%			2.3%	1.1%	0.1%	2.4%				3.7%
MAIN	0.1%	0.5%	0.5%				0.5%				1.3%

The top ten BDCs had roughly 2% portfolio overlap from 2015 to 2020. By 2025 that figure has skyrocketed with MSDL having the highest overlap at 66.1%. This raises the need for cross-manager valuation consistency to prevent credit risk from spreading across interconnected portfolios. The disparity is visible when valuations on the same loan vary differently across managers. For example, private loans to software company Medallia were valued at 91%, 82% and 77% simultaneously by three of its lenders. One lender considered the loan distressed while another marked the same loan at 91%.

Source: Pitchbook | LCD • Each cell = % of row BDCs total fair value held in companies also held by column BDC. Companies matched on Pitchbook company name. "Co-held" means any position – debt or equity, any priority – not necessarily co-lending in the same loan. Includes fund vehicles, CLO equity, and JV interests.
Note: How to read – MSDL x GSBD = 14.4% means 14.4% of MSDL's FV is in companies GSBD also hold. GSBD x MSDL = 19.7% is the reverse. Total overlap = share of each BDCs fair value in companies also held by at least one of the other 9 BDCs. Companies co-held by multiple peers are counted once.

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Valuation Challenges and Inconsistency Between Funds (2/2)

This can happen as each lender has its own valuation process. Most are based on similar concepts, but each fund applies its own assumptions and forecasts. Companies, such as Medallia, that go through turnarounds or management changes can see larger differences in valuations due to a wider range of inputs. This clearly illustrates why determining fair value of private assets is difficult and why it is a growing concern for investors. While valuation discrepancies do occur, these discrepancies may converge over time.

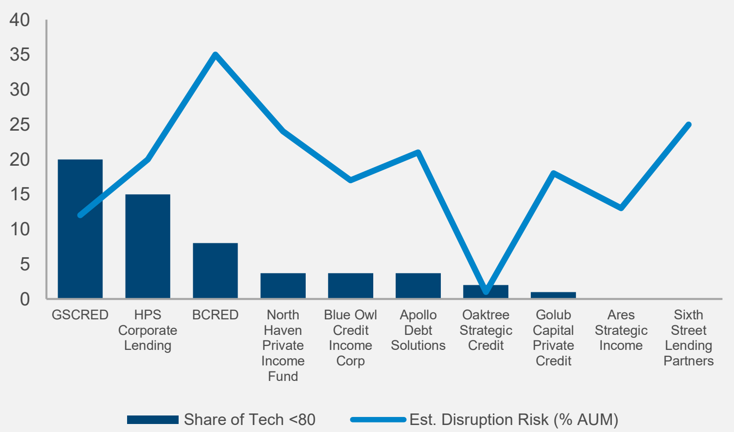
The top five co-held companies as of Q4 2025 include:

- Insight Software (525 bps cash spread)
- TurnPoint Services (500 bps cash spread)
- PDI Technologies (550 bps cash spread)
- Coupa Services (525 bps cash spread)
- Avetta (415 to 425 bps cash spread)

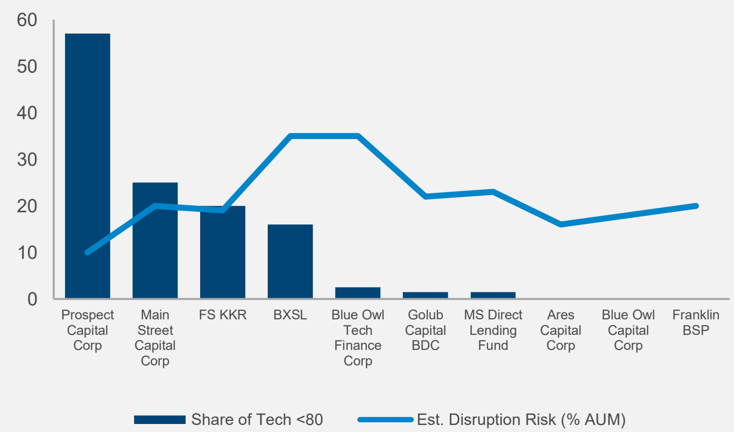
According to a research report by UBS, Marking to Market on Private Credit and BDC Valuations as of 4Q 2025:

- Within the tech sector, 60% to 65% of BDC loans across the largest public and private funds were marked at 97.5 to 100
- 7% to 8% of tech loans were marked below 80
- The May 2026 distressed ratios in the Broadly Syndicated Loan (BSL) market are 9% overall, 23% for tech, and 32% for low-rated tech, steadily rising since the start of the year

Estimated share of tech loans <80 across the largest 10 private BDCs as of Q4'25 vs. estimated AI disruption risk scores: Tech distressed ratios are averaging near 5%



Estimated share of tech loans <80 across the largest 10 public BDCs as of Q4'25 vs. estimated AI disruption risk scores: Tech distressed ratios are averaging near 12%, dragged higher by a few outliers



Source: Pitchbook | LCD, UBS

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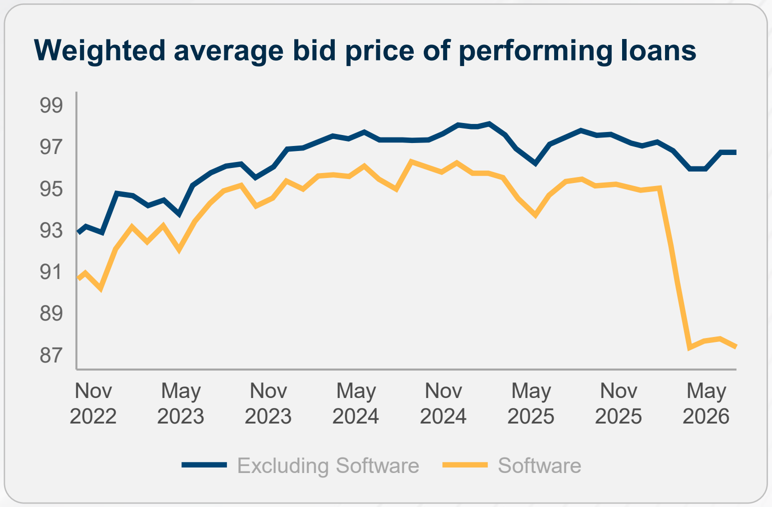
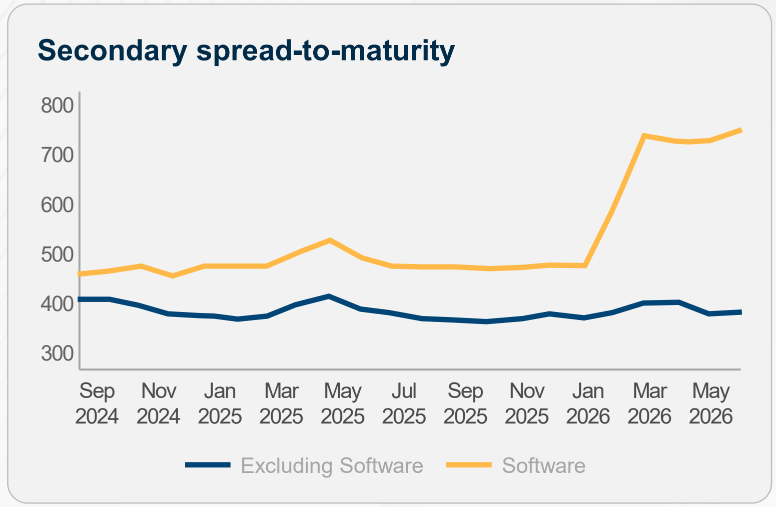
US Leveraged Loan Bids and Pricing

AI disruption fears continued to drive a sharp divide in loan pricing. Software sell-off began in late January with the weighted average bid at 87.71 as of May 2026. The gap between software and non-software is around 990 bps. Spread-to-Maturity (STM) for software loans was 809 bps as of May 2026, which was 395 bps wider than December 2025.



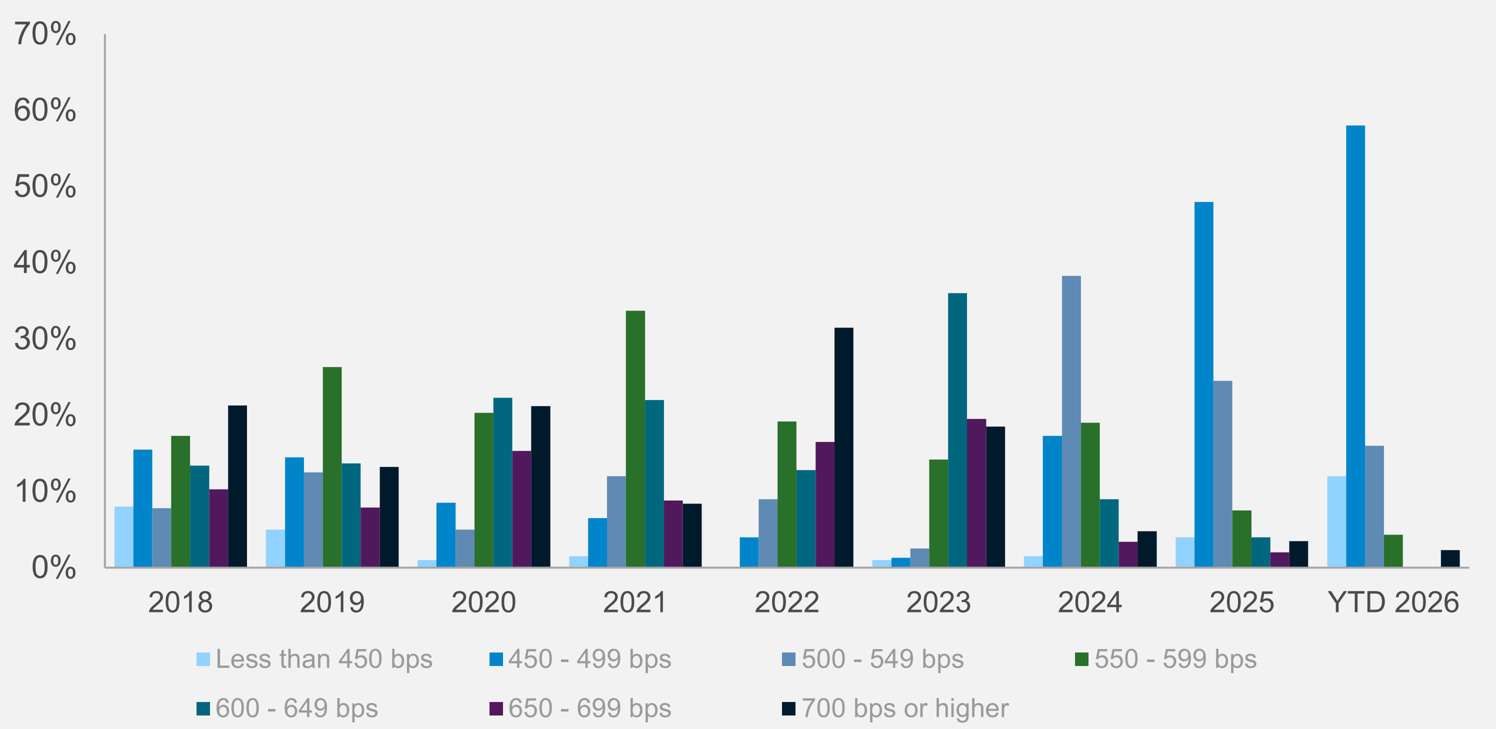


Source: Pitchbook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through May 31, 2026

New-Issue Spreads

The following is the new-issue spread distribution of LBOs financed in the direct lending market. According to PitchBook, spread migration into the 450 to 500 bps range continues. Spreads have decreased from their 2022 highs but recent market volatility points to potential upward pressure on spreads. The slow first quarter of 2026 was exacerbated by net outflows from retail products, geopolitical uncertainty, and capital market volatility. April deal activity has picked up meaningfully with slightly more lender-friendly terms.

New-issue spread distribution of LBOs financed in direct lending market



Sources: PitchBook | LCD • Geography: US • *As of May 31, 2026

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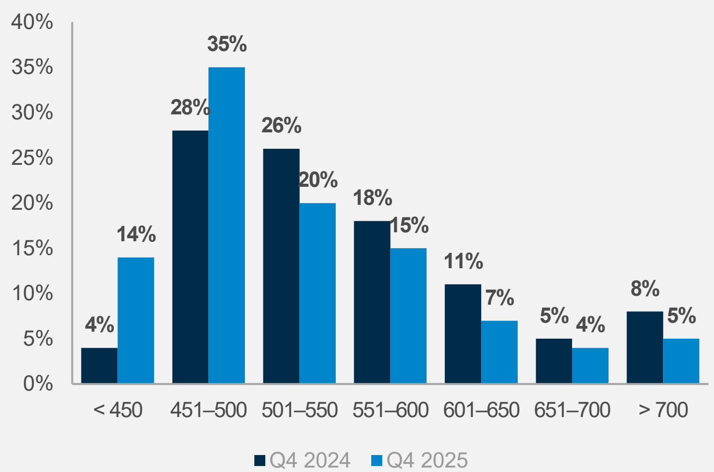
Spread Distribution

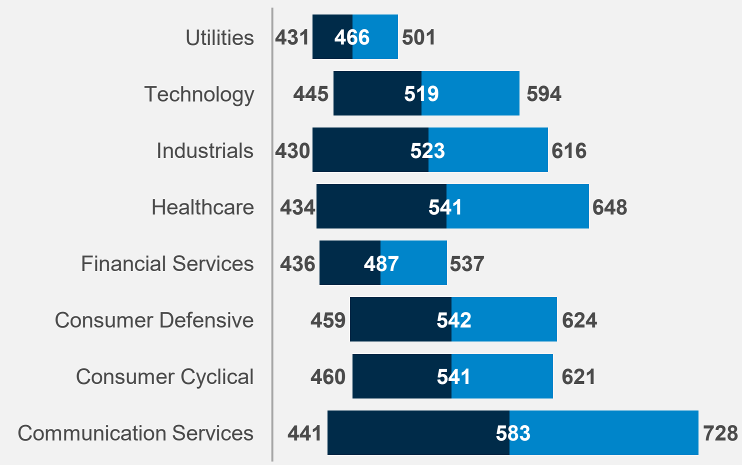
Across sectors, the average cash spreads were around 525 bps in Q4 2025 with the median around 500 bps. Most loans are priced within a very tight range. For most sectors that range is 75 to 100 bps.

First-lien term loan variable SOFR rate spread distribution (% of FV)



Source: Pitchbook | LCD • 1L variable-rate SOFR, non-PIK, accruing • % = bucket FV / total FV • Spread buckets based on cash spread to SOFR • Includes unitranche

First-lien cash spread dispersion by sector — Mean ± one standard deviation (bps)



Source: PitchBook | LCD • 1L variable-rate SOFR, non-PIK, accruing • Mean ± 1 sample std dev of non-zero cash spreads by GEC5 Sector • Includes unitranche

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Middle Market Yield Matrix

Only the best deals on the table are closing. Deal flow volume has come down sharply reflecting increased macroeconomic and geopolitical uncertainty as well as heightened scrutiny of private credit. Though most of the noise surrounding private credit portfolios is focused on the software companies negatively impacted by advances in AI, the contagion to the larger private credit sector is real, dampening liquidity, slowing down deal processes, and disproportionately targeting lower middle-market issuers.

We are mindful of issuers with AI-disruption risk that have a maturity wall coming in 2028 to 2030. We anticipate refinancing for these deals will be far more challenging. We anticipate that lenders will have more bargaining power and will require much better terms and concessions. The premium for direct lending spread over broadly syndicated loans remains tight. Even in turbulent times, competition remains fierce as funds continue to have excess capital to deploy.

Security	Small Cap	Lower Middle Market	Traditional Middle Market	Upper Middle Market
EBITDA	**$3.0MM to $7.0MM**	**$3.0MM to $15MM**	**$15MM to $75MM**	**$75MM to $150MM**
# Lenders	1 to 2	1 to 5	3 to 5	10 to 25
Liquidity	Illiquid	Illiquid	Relatively Illiquid	Partially Illiquid
Borrower Compliance	Traditional Covenants	Traditional Covenants	Traditional Covenants	Traditional/Cov-Lite
1st Lien	S + 4.75% to S + 5.75%	S + 4.50% to S + 5.50%	S + 4.25% to S + 5.00%	S + 4.00% to S + 4.75%

Source: Based on conversations with market participants as well as a review of multiple sources such as: (i) Pitchbook (LCD), (ii) SPP Capital, (iii) TheLeadLeft (Churchill Asset Management), (iv) public BDC filings; (v) PitchBook; and (vi) other research.

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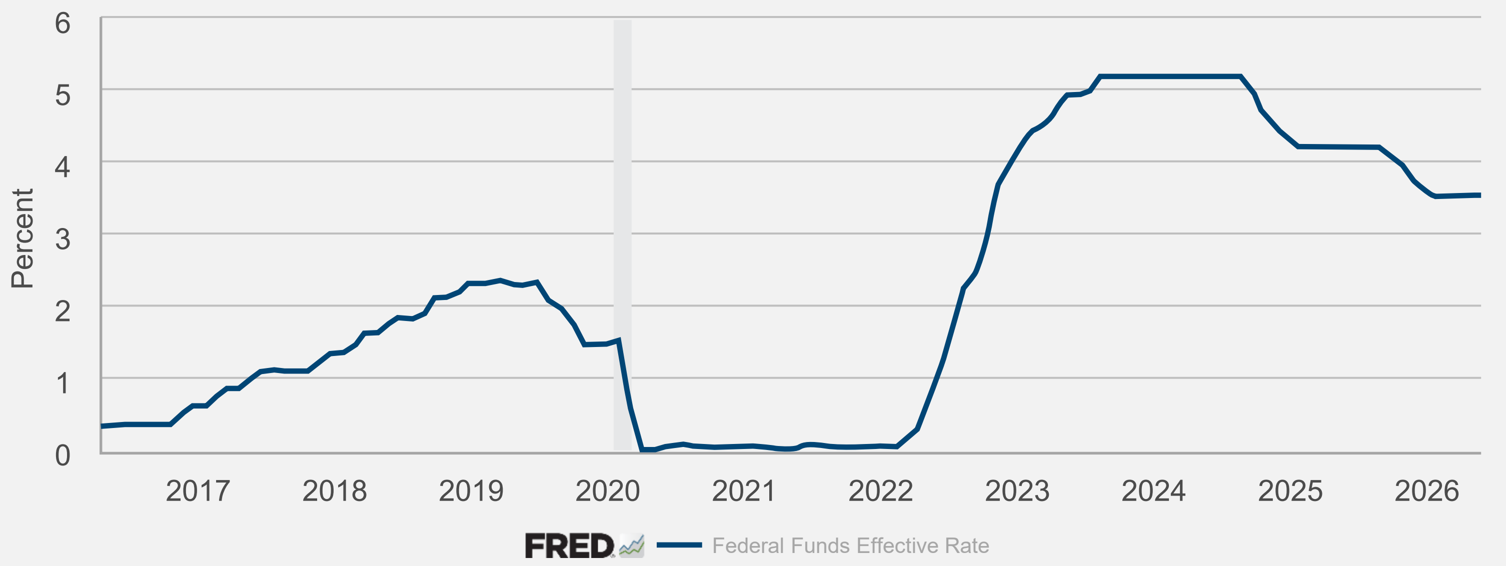
Fed Funds Rate with Market Expectations

In April 2026, the Justice Department dropped the criminal investigation of the Fed which cleared the path for the Senate to confirm Kevin Warsh in May 2026 to replace Jerome Powell as Fed chair. Given concerns over how the Iran war might impact inflation, the Fed kept rates unchanged at the April meeting. This represents the third consecutive meeting leaving the benchmark rate unchanged at 3.5% to 3.75%. This represents a total rate cut of 1.75% since 2024.

Inflation is a key concern going forward for a number of reasons. Chinese exporters are beginning to lift prices on a variety of goods as the Iran war drives up oil-linked input costs such as synthetic fibers, rubber, plastic, and other oil-derived chemicals. Other factors, such as policies and tariffs, have created uncertainty. The war with Iran is a key driver, given its impact on energy prices. The Bureau of Labor Statistics said the consumer price index increased 2.4% in February and 3.8% in June 2026, the most since mid-2024. Almost three-quarters of the increase in March was due to higher gasoline prices.



Source: Board of Governors Federal Reserve System (US) via FRED®

Default, PIK, and Liquidity

According to Morningstar DBRS, defaults have increased sharply in May 2026. The volume of downgrades has increased by 50%. For the first half of 2026, the two biggest loan defaults were Medallia and Affordable Care.

- Medallia could no longer service about $3 billion of loans from firms including Blackstone, KKR and Apollo. The lenders took control from Thoma Bravo, which lost the roughly $5 billion it invested in 2021
- Affordable Care's sponsor Harvest Partners is in discussions with lenders to restructure a $1.4 billion loan

The private credit default rate reached 5.8% in January 2026 and 5.4% in February according to Fitch Ratings. The January default rate was at the highest level since August 2024. UBS predicts private credit default rate will double in 2026. UBS stated software loans at high risk of AI disruption could see default rates as high as 11%.

According to Fitch Ratings, the default rate for private credit for US corporate borrowers rose to 9.2% in 2025, up from 8.1% in 2024 Refinancing risk is building as debt maturities for leveraged borrowers are concentrated in the 2028-2030 window. Many sources are anticipating default rates to increase in the future. Debt PIK and non-accrual exposure remains highest in technology followed b industrials and healthcare.

Debt PIK & non-accrual exposure by sector (Q4 2025)

Select sector	PIK # of companies	PIK % FV	PIK FV/Cost	Non-accrual # of companies	Non-accrual % cost
Technology	95	16.8%	95.8%	13	0.8%
Industrials	62	16.6%	91.9%	16	3.8%
Healthcare	53	18.9%	90.6%	16	4.8%
Consumer Cyclical	49	18.0%	86.3%	16	5.2%
Consumer Defensive	18	9.9%	90.0%	5	3.4%
Financial Services	14	15.1%	100.2%	1	0.1%
Other	31	27.8%	96.0%	4	2.3%

Source: PitchBook | LCD • FV/Cost uses strict criteria: debt only.

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Other Notable Trends (1/2)

Redemption Risk & Fundraising

Redemption requests for U.S. perpetual non-traded BDCs rose 36% quarter-on-quarter in 1Q26, driven by investor concerns about software exposure and valuation uncertainty. Apollo, Ares, Morgan Stanley, Cliffwater, BlackRock and Blue Owl have all capped redemptions from their multibillion-dollar private credit funds. A Bank of America report by Craig Siegenthaler predicts that redemptions will continue to increase in Q2 and Q3.

Fund Name	Actual Q1 2026	BofA Estimate Q2 2026
Apollo Debt Solutions	11.2%	15.0%
Ares Strategic Income Fund	11.6%	14.0%
Blackstone's BCRED	7.9%	12.0%
Blue Owl's OCIC	21.9%	28.5%
Blue Owl's OTIC	40.7%	52.9%
HPS' HLEND	9.3%	13.0%
Carlyle Tactical Private Credit Fund	15.7%	NA

Although retail and wealth channels have seen some redemptions, this has not been the case for institutional and insurance clients. The news on redemptions has been led by a small number of large investors. Fundraising in private credit continues to see traction. According to Pitchbook:

- StepStone Group closed a new fund with more than $1.58 billion in commitments, exceeding its target of $750 million.
- New York State Teachers' Retirement System recently approved $450 million of new commitments to private credit vehicles. Commitments are to Manulife Comvest Credit Opp Fund II and Manulife Comvest Specialty Lending Fund I.
- Silver Rock Tactical Allocation Fund raised more than $4 billion.

Note: Represents redemptions as a percentage of shares outstanding.
Source: Pitchbook report on Bank of America report by Craig Siegenthaler as of April 2026.

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Other Notable Trends (2/2)

Era of Mega-Layoffs

Companies from Snap to Block to Amazon have entered a new era of workforce reduction. It is heavily concentrated in technology, retail, and logistics, with companies restructuring, investing in AI, and managing costs. Top firms, including Amazon, KPMG, Intel, and Verizon, have cut thousands of roles, with 2026 tech layoffs already showing high momentum. Key sectors affected include retail, finance, and tech. While overall layoffs fell in the first four months of 2026, AI helped drive more than 85,000 job cuts at technology companies.

Banks Withdraw & Increasing Exposure

Wall Street banks reported at least $100 billion of exposure to private credit firms. While some major U.S. banks are tightening lending standards, some banks are also increasing their commitments such as Bank of America's $25B push.

- Wells Fargo stated that about $36 billion of its nonbank lending was related to corporate debt. Within that category about 23% of that exposure was to BDCs which translates to about $8.3 billion of lending to BDCs.
- JPMorgan Chase: JPM has about $50 billion in nonbank lending to private credit.
- Citigroup: Citigroup stated its private credit warehousing financing totaled about $22 billion.

The exact classification is not clear and comparable across banks due to how the banks choose to classify certain loans. The Fed is asking major US banks for details about their exposure to private credit following a surge in redemptions to assess the level of stress in the private credit industry.

SEC Monitoring Private Credit

The SEC has stated the opacity in private credit can be an issue. The SEC is closely monitoring private credit for a number of reasons including:

- Redemptions: investors are seeking nearly $15 billion in withdrawals from BDCs
- Sector concentration risk of private credit with top two sectors in technology/software and healthcare
- High leverage – A number of deals done at very high leverage
- Future default risk

Private Equity Trends

Investors in private equity funds are gaining more sway over general partners that manage the vehicles as the industry's payouts continue to lag historical averages. Limited partners now expect the managers to put up more of their own capital when launching new funds as well as demanding more concessions. Private equity firms have also had to cut their management fees.

Distributions of capital as a percentage of total assets under management dropped to 6% last year across the industry, down from 14% over the past 10 years on average, according to Bloomberg.

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Summary

Publicly traded BDCs share prices have declined reflecting a confluence of pressures: negative sentiment stemming from recent headlines, mounting concerns over redemptions and loan underwriting standards, and the threat of AI-driven disruption, particularly given private credit's outsized exposure to the software sector. Dividend cuts in a handful of managers, as yields normalize, have further weighed on performance. Other key themes include:

1. Private credit portfolios that are well diversified across sectors and vintage and that remained disciplined about not lending to risky borrowers to gain higher yields can meaningfully mitigate credit quality risk and navigate in this turbulent market.
2. Investor sentiment toward BDCs has become more cautious because of software exposure and valuation concerns. This has contributed to share price declines, redemptions and slower fundraising in recent months.
3. Given the distressed ratios seen in the BSL market, there is an expectation that distressed ratios for private and public BDCs will also increase.
4. In private credit, debt maturities are concentrated in the 2028 to 2031 period, meaning significant refinancing activity will begin as early as 2027, a window that may also coincide with greater clarity on the ultimate scale of AI disruption across the software sector. Private equity sponsors may be less willing to support companies facing structural disruption which will greatly increase refinancing risk in the future.
5. M&A exits will continue to be a real challenge for 2020-2021 vintages.
6. Recapitalizations and refinancing activity have declined in the first quarter of 2026.
7. Direct lending activity increased for healthcare while declining for technology due to unfavorable sentiment toward technology/software.
8. There are early signs of spread widening.
9. Secondaries are expected to continue to see much higher volumes as investors enter the growing asset class. Several institutions have successfully raised significant capital to continue to invest in secondaries.
10. The all-in yield on first lien debt is down approximately by 100 bps from a year ago due to spread tightening and a lower SOFR base rate.
11. As mentioned in prior past quarterly reports, EBITDA add-backs continues to be aggressive as add-backs can comprise around 30% of EBITDA.

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Melissa Brady

- Mrs. Brady brings more than twenty years of experience providing valuation services across multiple asset classes, including fixed and floating rate debt, unitranche loans, convertible debt, preferred equity, common equity, warrants and options. She has worked with business development companies (BDCs), private equity, credit opportunity funds and venture capital funds.
- Mrs. Brady is an expert in the assessment and valuation of illiquid debt and equity securities that fulfill management's fiduciary duties, mitigate risk of fraudulent conveyance, enhance the credibility and transparency of investor reporting, protect shareholder value and provide benchmarks and support for fund raising and management fees.
- She has presented on the topic of middle market leveraged loans, broadly syndicated loans (BSLs) and bonds at several conferences, webinars and other industry-focused groups. Mrs. Brady has been a contributing author and presenter on valuation best practices topics for the AICPA's valuation best practices guide and a working member on the Alternative Investment Management Association's 2018 Guide to Sound Practices for the Valuation of Investments.
- Prior to joining A&M, Mrs. Brady spent eight years with RSM US LLP in New York, where she most recently served as the valuation industry leader for the financial services. Prior to that, Mrs. Brady spent seven years with Houlihan Lokey focused on alternative investments.
- Mrs. Brady earned a bachelor's degree in economics from Occidental College. She is a Chartered Financial Analyst (CFA) Charterholder and a member of CFA Society New York.

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