

Private Credit's First Crack Is the Wrapper

Why 2026 looks less like a default wave and more like a repricing cycle for semi-liquid funds, legacy books and sponsor finance

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WHAT CHANGES OUR MIND

HORIZON

6–12 MONTHS

Redemption pressure fades, BDC discounts narrow and software-linked marks stabilise

QUICK ANSWER

Cut broad legacy semi-liquid private credit exposure.

Private credit is not blowing up in the way markets normally expect. The large platforms still report mostly first-lien, floating-rate books and non-accruals remain contained. Yet the first signs of strain are already visible in the structures around those assets: redemption caps, discounts to NAV, selective loan markdowns and tighter bank financing. That combination matters because it suggests investors are finally charging for liquidity mismatch, valuation lag and old-cycle underwriting before headline defaults have done the work for them.

THE INVESTMENT QUESTION

Can private credit still be treated as a stable income diversifier when the first signs of pressure are showing up in redemption mechanics, loan marks and bank financing rather than in broad reported defaults?

KEY ANALYTICAL QUESTIONS

- Is the current stress showing up first in the loan book or in the liquidity wrapper around the loan book?
- How much of a legacy portfolio's headline yield is genuine compensation, and how much is simply stale pricing from an easier spread regime?
- What happens to sponsor IRRs and PE transaction volume when direct lenders ask for wider spreads, lower leverage and tighter structures?

THE FIRST CRACK

The Wrapper Gets Tested Before the Loan Book Does

The easiest way to misread private credit is to force it into a crisis template. If the asset class were already in a classic bust, the evidence would be cleaner. Non-accruals would be surging, recoveries would be collapsing and managers would be openly discussing impairment rather than "liquidity management". That is not where the market sits today. The better description is a repricing phase. The underlying loan books have not yet broken broadly, but the wrapper around them is being stress-tested, and that is enough to change the allocation debate.

That distinction starts with the semi-liquid funds. Ares Strategic Income Fund hit its quarterly withdrawal limit after redemption requests reached 11.6 per cent of shares. Apollo Debt Solutions did the same after

requests reached 11.2 per cent. BCRED posted its first monthly loss in more than three years and still had to lean on an expanded repurchase limit and sponsor capital to meet requests. None of that proves the underlying assets are impaired. It does prove that “periodic liquidity” only looks comfortable while investors are willing to accept slowly moving marks. Once they are not, the structure itself becomes a source of pressure.

Private credit was sold on two linked promises. The first was higher income than public credit. The second was a smoother experience than public credit. The first still broadly holds. The second is where the strain is showing. A semi-liquid fund is only as liquid as its tender terms, financing lines and remaining investors. When withdrawal requests run through the cap, investors discover that the wrapper behaves much more like locked capital than a high-yield cash alternative.

REPRICING MECHANICS

Why Legacy Books Can Feel Fine and Still Be Worth Less

The deeper issue sits behind the wrapper: legacy-book repricing. A private loan does not need to default to be worth less. If the market now requires a higher return for the same risk than it did when the loan was written, fair value falls even if the borrower keeps paying on time. Floating-rate coupons help against base-rate duration risk. They do not protect against spread widening, a higher illiquidity premium, weaker confidence in recoveries or a more sceptical view of the sector itself. A 9 or 10 per cent portfolio yield can still look fine in isolation while offering less compensation than investors now want for opaque, illiquid, sponsor-heavy credit.

Software has become the clearest pocket where this repricing is visible. The Medallia markdown mattered not because one name defines the asset class, but because it showed how a paying loan can still be revalued sharply when assumptions about cash-flow durability and AI disruption change. Once that happens, the effect does not stay inside one position. It feeds into bank financing, public market sentiment and the credibility of other marks across the complex.

Public markets are already leaning into that question. BXSL, OBDC and ARCC all trade below NAV, even though the larger listed BDCs still show manageable non-accruals and mostly senior secured portfolios. Those discounts do not prove the internal marks are wrong. But when listed vehicles trade at meaningful discounts while semi-liquid funds are gating withdrawals and selected loans are being written down, the signal is hard to dismiss. Equity investors are demanding a margin of safety before the reported NAV process has fully caught up.

MARKET STRUCTURE

Banks, Sponsor Finance and the IRR Problem

The banking angle makes the setup more important, not less. Private credit is not a closed loop of funds lending to companies. Banks provide financing, warehouse assets, write NAV facilities and increasingly help clients trade around the stress. JPMorgan has already marked down certain loans to private credit borrowers, particularly where underlying exposure was concentrated in software, and those markdowns reduce available leverage. Once banks financing the ecosystem begin re-marking collateral, private credit stops looking like a

one-way yield product and starts looking like an asset class the broader market is actively repricing.

That has immediate implications for private equity because private credit is now central to sponsor finance. If lenders demand wider spreads, lower leverage and tighter structures, sponsor math changes straight away. A higher debt burden compresses equity IRRs unless sponsors can offset it through lower entry multiples, stronger EBITDA growth or optimistic exit assumptions. The result is not the end of private equity transactions. It is a more selective deal market with less room for error.

ALLOCATION CALL

Why 2026 Looks Bifurcated Rather Than Broken

This is why 2026 should be thought of as a bifurcation year rather than a collapse year. The weak point is broad exposure to legacy, semi-liquid vehicles that were sold as smooth income while carrying older books written in a more forgiving spread regime. The more interesting opportunity may be fresh-vintage direct lending written at wider spreads, tighter terms and more realistic assumptions. In other words, the asset class itself is not dead. The easy version of the asset class is.

My conclusion is straightforward. I would lower private credit allocation here, specifically by cutting exposure to semi-liquid wrappers and older books where valuation lag can do as much damage as realised defaults. That is not a call to abandon the sector. It is a call to separate yesterday's exposure from tomorrow's opportunity. If spreads widen further and structures reset, new-vintage direct lending may become one of the better parts of the credit market. For now, though, the market is still discovering which products were built on durable underwriting and which relied too heavily on the illusion of stability.