

Opportunity Ahead

Private Credit 2026 Midyear Outlook

MARKET INSIGHTS | 2026 MIDYEAR OUTLOOK | PRIVATE CREDIT | July 2026

“Forward return potential is more attractive today than at the start of the year, supported by wider spreads, stable borrower fundamentals and growing financing demand.”

Key Reflections

The first half of 2026 proved more unpredictable than many investors anticipated, yet it also reinforced several attributes that have made private credit an increasingly important allocation. The Federal Reserve remained on hold, inflation proved somewhat more persistent than expected, and concerns surrounding AI disruption contributed to a sharp repricing across parts of the software sector. At the same time, elevated redemptions from semi-liquid private credit vehicles reflected a change in sentiment across parts of the wealth channel.

Despite these headwinds, broader credit fundamentals remained notably resilient. A composite of broader default measures remains well below its 2024 peak (*Display 1*), reinforcing our view that credit stress remains concentrated rather than systemic. Meanwhile, interest coverage ratios inched higher, leverage ratios remained stable, and consensus estimates point to re-accelerating EBITDA growth among leveraged borrowers.¹ In our view, the first half of 2026 highlighted an important distinction: headlines grew more negative even as many underlying borrower fundamentals remained constructive.

The first half of 2026 was not the most favorable return environment for the asset class, but it managed to deliver the characteristics that many investors seek: reliable income, low volatility, and returns that compared favorably with many traditional fixed income alternatives. In our view, forward return

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¹ Source: Morgan Stanley Research report entitled US Credit Strategy 1Q 26 Fundamentals – Broad-Based Earnings Growth.

potential is more attractive today than it was at the start of the year, supported by wider spreads, stable borrower fundamentals and growing financing demand.

What We Are Seeing

The first half of 2026 tested several assumptions underlying our December outlook but ultimately strengthened our conviction that supply and demand dynamics are increasingly shifting in favor of lenders.

The pullback in technology underwriting, combined with net outflows in Business Development Companies (BDCs) and other private credit vehicles contributed to wider spreads on newly originated loans in both direct lending and the broadly syndicated market (*Display 2*). Following an extended period of spread compression, lenders are once again earning greater compensation for risk. We believe this creates a stronger foundation for future returns than existed at the start of the year.

For more solutions-oriented private credit strategies, the lender-friendly tilt has been more demand driven. The year 2026 is the second in a secular uplift in financing demand that is powered by private equity owners of long-tenured assets. By 2029, the net value of unsold PE assets at the end of their 12-year theoretical life could nearly double to \$903 billion.² Private credit is facilitating bespoke hybrid structures that are outside of traditional direct lending, collectively known as flexible capital. Demand for such solutions is growing among owners of fundamentally sound assets facing looming liquidity deadlines or acute financing needs.³

While net fundraising has moderated in parts of the wealth channel, institutional demand remains strong. Many long-term allocators, including pension plans and insurers, continue to increase exposure to private credit, attracted by the asset class's combination of income generation, diversification benefits and historically attractive risk-adjusted returns in a higher-rate environment.

What We Are Doing

Our investment approach continues to emphasize scale, underwriting discipline and deep sponsor relationships. While competition remains strong for the highest-quality

borrowers, we believe that today's market increasingly rewards lenders with broad origination capabilities and the flexibility to provide customized financing solutions.

Our direct lending strategy remains focused on senior secured lending to high-quality middle-market companies with durable cash flows and resilient business models. While not a primary sector of focus, we continue to favor mission-critical software platforms with high switching costs, embedded workflows and proprietary data assets. Although AI will inevitably create winners and losers, we believe the long-term impact is more likely to expand industry opportunity than diminish it, especially for well-positioned market leaders.⁴

In our flexible capital strategies, we continue to see attractive, recurring opportunities to provide hybrid capital, acquisition financing and other structured credit solutions for fundamentally strong companies that have unique fact patterns. This can span sponsored and non-sponsored middle market companies as well as special situations with bespoke assets. As M&A activity gradually broadens beyond the largest transactions, we expect financing demand to increase, creating additional opportunities to deploy capital on attractive terms.

What We Are Watching

Although uncertainty remains, we believe that current concerns about credit quality may not fully reflect the underlying resilience of many business models, especially in software. We are increasingly focused on the potential catalysts that could improve sentiment and reduce the perceived risks that have already received widespread attention. As that occurs, private credit assets have the potential to be re-valued upwards.

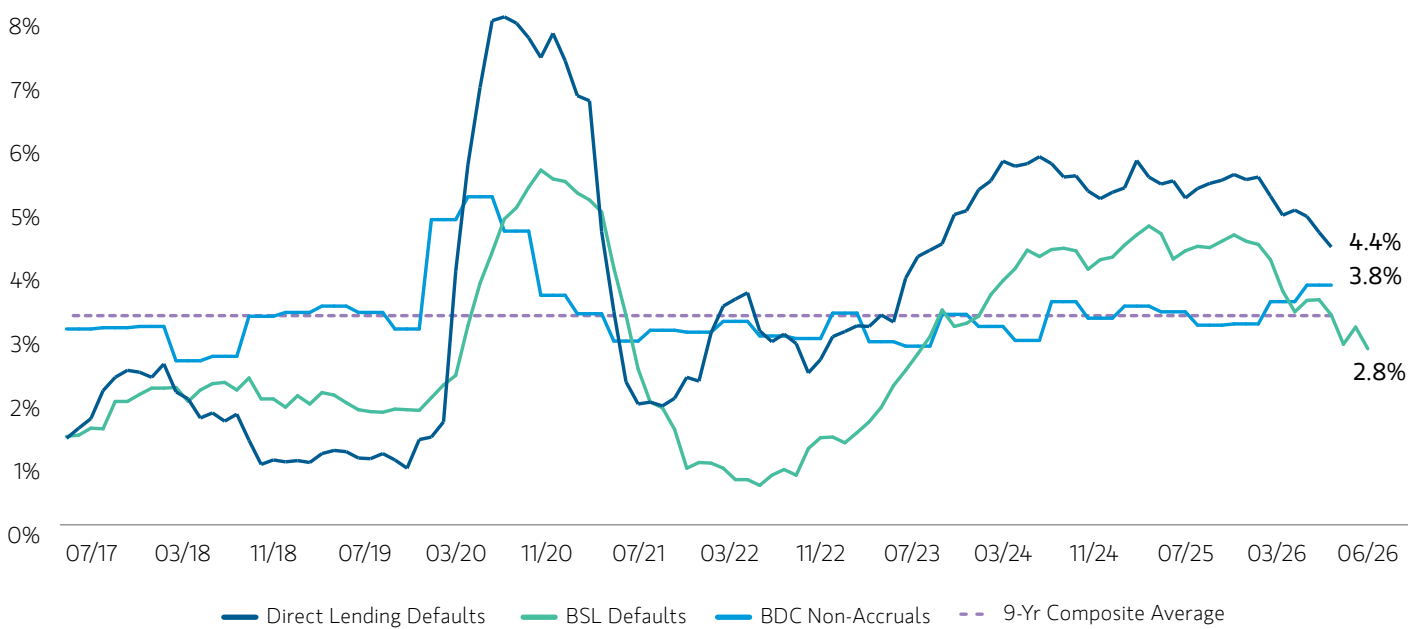
We are also monitoring redemption trends within non-traded BDCs. While recent redemption activity has received considerable attention, these vehicles continue to provide the liquidity mechanisms for which they were designed. Moreover, periods of investor caution have historically coincided with some of the most attractive lending vintages, as financing providers gain negotiating leverage and underwriting standards remain disciplined. In our view, the current environment increasingly resembles those periods.

² Source: PitchBook, Morgan Stanley Investment Management. 8+ year Net Asset Value of US buyout funds with a 4-year shift. As of September 30, 2025.

³ Source: Morgan Stanley Investment Management report entitled [Opportunistic Credit: Flexible Capital for an Evolving Market](#), June 29, 2026.

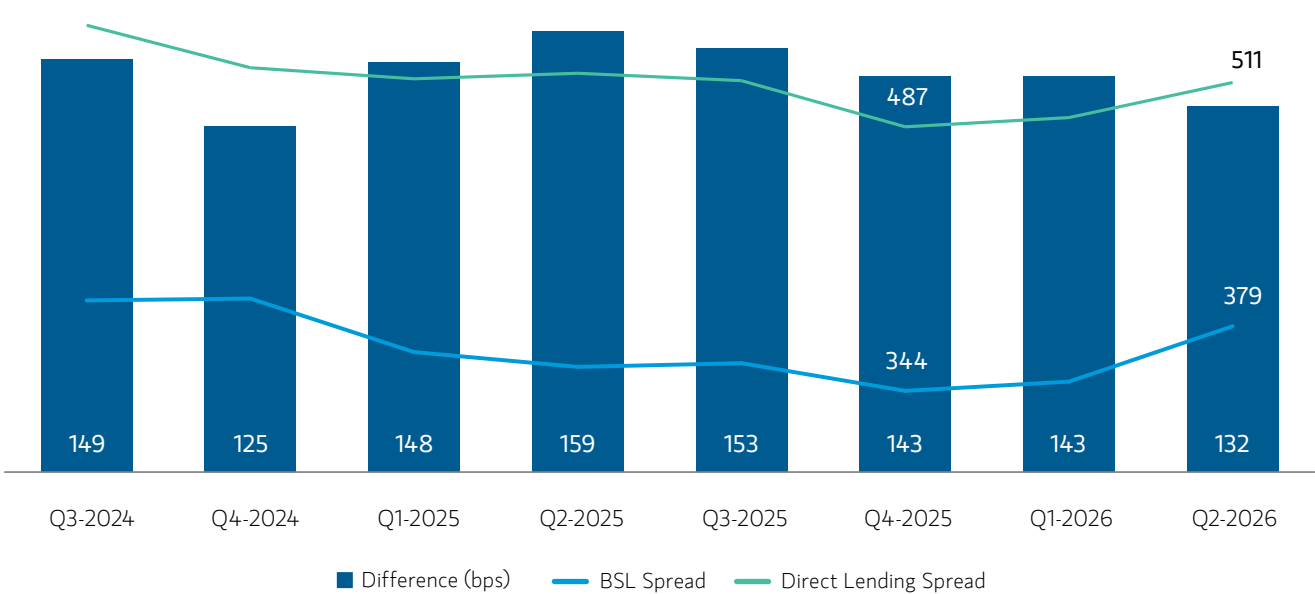
⁴ Source: Morgan Stanley Investment Management report entitled ["AI-Related Sell-Off in Software: Framing Investor Concerns and Underwriting Implications,"](#) March 2026.

DISPLAY 1
Trailing 12-month Default and Nonaccrual Rates



Source: PitchBook LCD, S&P Global, LSEG. US only. DL default and non-accrual rates as of March 31, 2026. BSL default rates as of May 31, 2026. For illustrative purposes only.
 Note: Non-accrual rates are for traded BDCs only to reflect seasoned loan portfolios.

DISPLAY 2
Spreads on New M&A-Related Loans to PE Borrowers



Source: PitchBook | LCD. Data through June 30, 2026. US only.
 Note: Reflects fully disclosed new-issue spreads on LBO and add-on loans to non- rated or B-rated borrowers (BSL only). For illustrative purposes only.

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