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Q&A

PRIVATE CREDIT: SYSTEMIC RISK OR GROWING PAINS?

Challenges Facing the \$1.8 Trillion Market

Private credit, whereby companies borrow directly from investment funds rather than from banks, has grown into a \$1.8 trillion market and is suddenly front-page news. Several of the largest funds were overwhelmed by investor redemption requests in early 2026, defaults are rising, and regulators from the Federal Reserve to the International Monetary Fund have flagged the sector as a potential vulnerability. This Q&A offers a plain-language primer for investors who want to understand what is happening inside private credit and, more importantly, what it means for the public investment-grade and high-yield bond markets where most fixed income portfolios are concentrated.

Q: What is private credit, and why is it suddenly in the news?

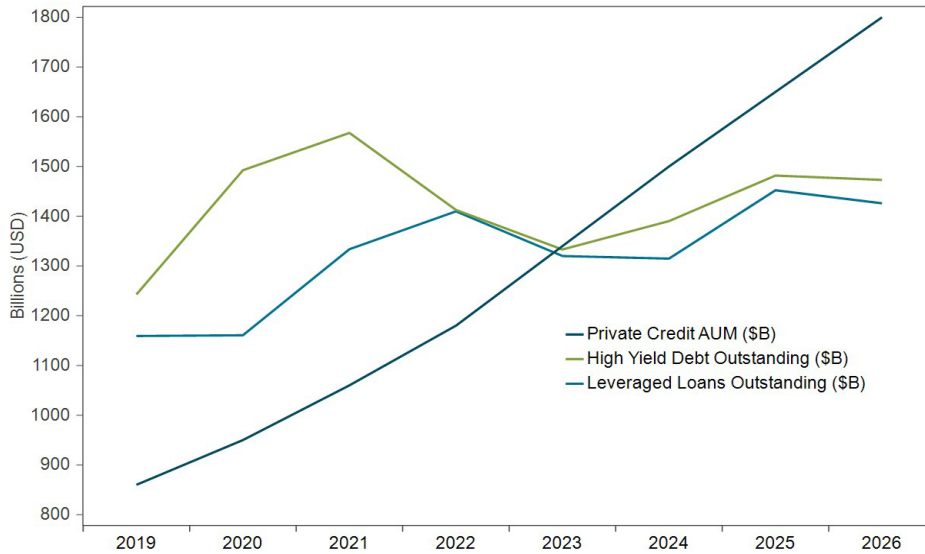
Private credit emerged after the 2008 financial crisis, when new bank regulations made it expensive for banks to hold risky corporate loans. Investment funds stepped in to lend directly to mid-sized companies, and institutional capital hungry for yield poured in. The market has grown sixfold since 2010, now rivaling the leveraged loan (~\$1.4 trillion) and high-yield bond (~\$1.4 trillion) markets in size, and representing roughly 30% of all below-investment-grade corporate debt in America (**Figure 1**).

Private credit reaches investors through several vehicles: publicly traded business development companies (BDCs), non-traded BDCs, interval funds that offer periodic redemption windows, and traditional closed-end funds with multi-year lockups. BDCs account for roughly a third of the market. The redemption pressure has been concentrated in the non-traded vehicles, where quarterly liquidity features collided with illiquid underlying loans. The IMF warned in 2024 that such liquidity features created a “first-mover advantage” for investors to exit funds with stale valuations before asset values are marked down, leaving the remaining investors to bear the losses.¹

¹ International Monetary Fund, Global Financial Stability Report, April 2024.

FIGURE 1

Private Credit Has Reached Parity With Public Credit Markets



Data as of March 31, 2026.
Sources: GW&K Investment Management, Bloomberg, Federal Reserve (Prequin), and Macrobond.

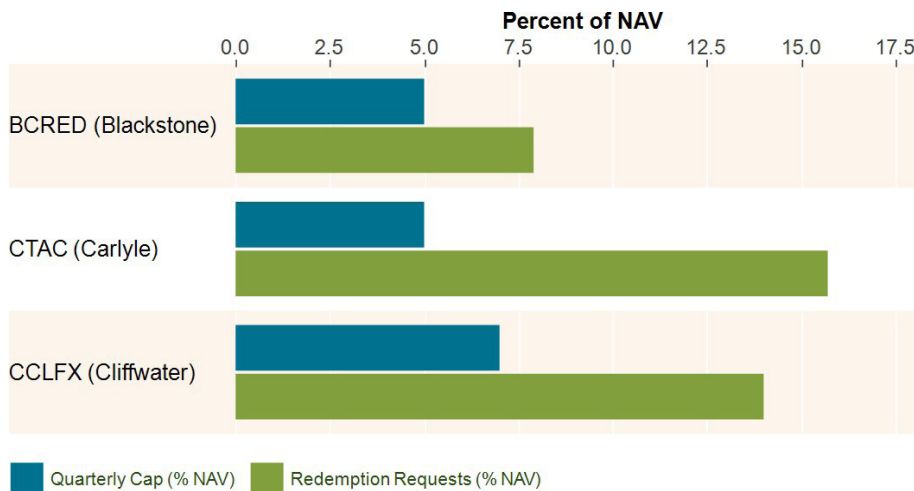
Private credit assets under management have grown roughly sixfold since 2010, reaching approximate parity with the leveraged loan and high-yield bond markets.

The asset class now represents roughly 30% of all below-investment-grade corporate debt.

Private credit is in the news because the market’s first serious liquidity test arrived in early 2026. Blackstone’s flagship non-traded BDC (BCRED) received \$3.7 billion in redemption requests — nearly 8% of net asset value — against a 5% quarterly cap (or contractual redemption limit). Carlyle’s CTAC, a non-BDC credit fund, faced requests for 15.7% of shares, more than three times its limit. In each case, investors received only a fraction of what they requested (**Figure 2**). These funds hold illiquid loans that cannot be sold quickly on an exchange, but they had been marketed to wealth management channels with quarterly redemption features that suggested public-market-style access. When stress arrived, the exit door turned out to be much narrower than the entrance. The mismatch between illiquid assets and quasi-liquid promises is the structural tension now at the center of the debate.

FIGURE 2

Q1 2026 Redemption Requests Far Exceeded Fund Caps



The first quarter of 2026 demonstrated the liquidity mismatch embedded in semi-liquid private credit vehicles. Redemption requests at BCRED, CTAC, and CCLFX all substantially exceeded their quarterly repurchase caps, forcing proration.

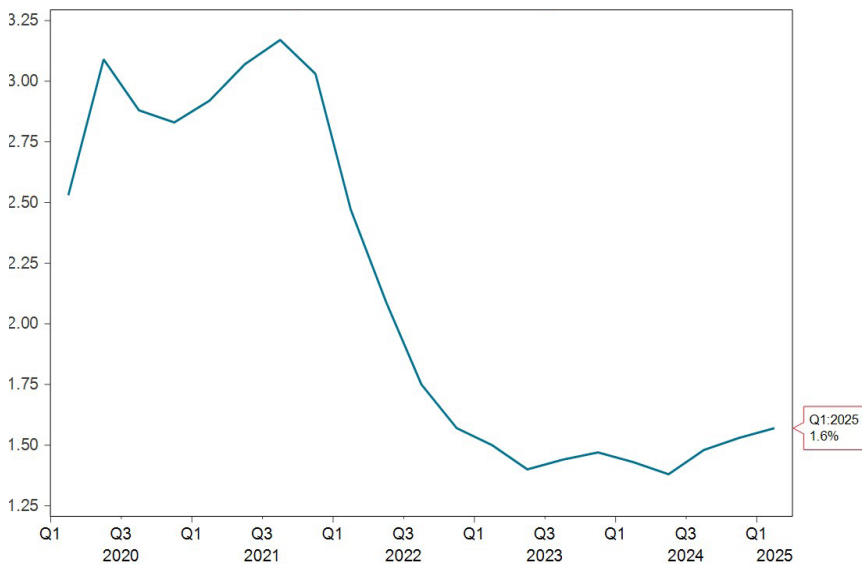
The funds referenced above are presented for illustrative purposes only and do not represent all funds affected by liquidity and redemption pressure across private credit markets during the period. This does not constitute a recommendation to invest, nor an indication that GW&K Investment Management accounts hold any specific company.

Sources: GW&K Investment Management, Bloomberg, Fund Filings, and Macrobond.

Q: How stressed are private credit borrowers, really?

More than headline numbers suggest. Average borrower leverage has risen to 5.1 times EBITDA. Interest coverage — the ratio of earnings to interest payments — has fallen from 3.1 times in 2021 to 1.6 times in 2025, because nearly all private credit loans carry floating rates that surged alongside the Fed’s rate increases (**Figure 3**). S&P Global recently found that 11% of middle-market borrowers now cannot cover their interest from operating cash flow.² The IMF reported that over 40% had negative operating cash flow at year-end 2024.³

FIGURE 3
Private Credit: Average Interest Coverage Ratio



Source: S&P Global With.Intelligence (based on Houlihan Lokey data).

Interest coverage — the ratio of earnings to interest payments — has fallen from 3.1 times in 2021 to 1.6 times in 2025, because nearly all private credit loans carry floating rates that surged due to Fed rate hikes.

The headline default rate — roughly 2.5% — dramatically understates actual distress. A growing number of borrowers are deferring cash interest through payment-in-kind (PIK) arrangements, where unpaid interest is added to the loan balance. Of all PIK in business development company (BDC) portfolios, 57% is now “bad PIK” — added after origination as a rescue measure, not a cash management choice.⁴ When PIK-by-amendment is counted alongside formal defaults, the effective “shadow default rate” approaches 6% — more than double the headline figure (**Figure 4**). Morgan Stanley projects defaults could reach 8% as AI disrupts the software companies that dominate private credit portfolios.⁵

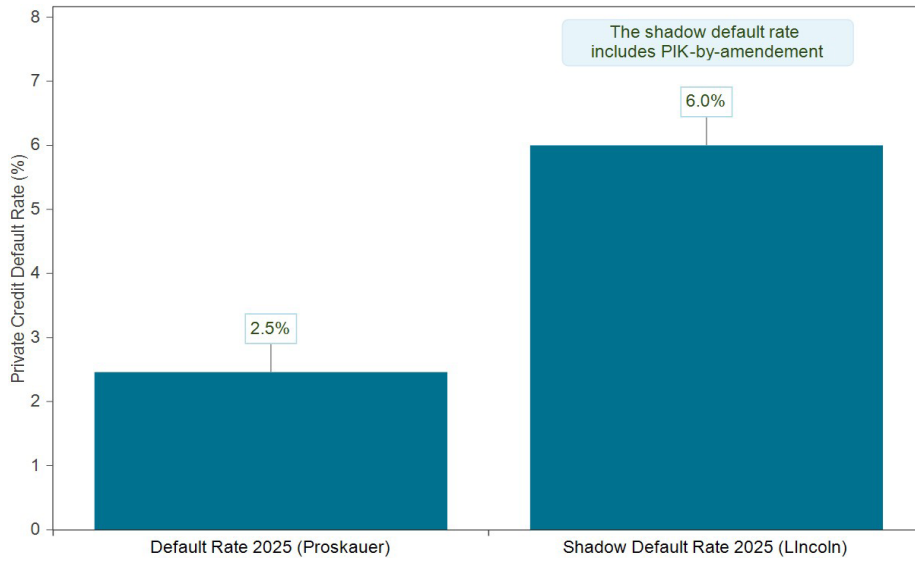
Q: Why is everyone talking about software companies and AI?

Private credit has a concentration problem. Software and technology account for more than a quarter of BDC loan portfolios (**Figure 5**). Software was considered the ideal borrower — recurring subscription revenues, high margins, predictable cash flows — and private equity sponsors funded leveraged buyouts at generous multiples.

² S&P Global, “Beyond the Golden Age: Private Credit Confronts Growing Pains,” February 24, 2026.
³ International Monetary Fund, Global Financial Stability Report, April 2025.
⁴ Jim Edwards, “Private credit deals see a rise in ‘bad PIKs’ showing ‘cracks’ in the market for corporate debt,” Fortune, November 21, 2025.
⁵ Rene Ismail and Emily Graffeo, “Morgan Stanley Sees Private Credit Default Rates Hitting 8%,” Bloomberg News, March 17, 2026.

FIGURE 4

The Shadow Default Rate for Private Credit Indicates Elevated Borrower Distress



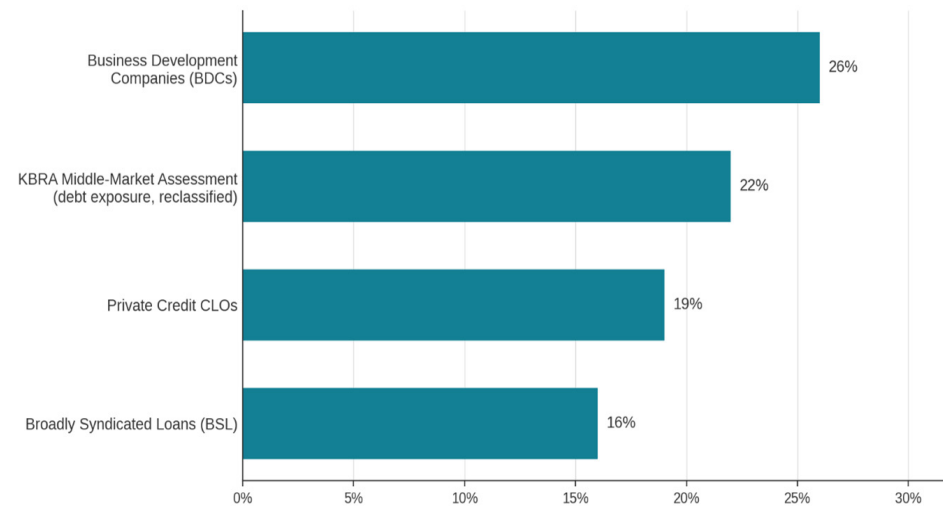
Sources: GW&K Investment Management, Lincoln International, Proskauer, and Macrobond.

Headline private credit default rates remain moderate, but the “shadow default rate” is 6%, more than double the reported figure. The shadow rate includes payment in kind (PIK) by amendment and forbearance.

FIGURE 5

Software Dominates Private Credit Exposure

Software/technology as % of portfolio, by credit-market segment (latest available)



Sources: Morgan Stanley Research (Mar 16, 2026 note by J. Jiang et al.; Mar 2, 2026 'Thoughts on the Market'); KBRA 'Framing AI and Software Risk' (Feb 5, 2026).

Software / technology concentration is now colliding with AI disruption risk. Morgan Stanley warns that direct-lending defaults could reach 8%, approaching COVID-peak levels.

That logic was built on a pre-AI world. Generative AI is now threatening to compress the pricing power and margins of precisely the subscription software businesses that private credit loaded up on. In an era where complex proprietary code can be replicated in weeks rather than years, the ‘moats’ protecting high-premium subscriptions are evaporating into a sea of low-cost alternatives. BIS research documents that BDCs with high SaaS exposure have underperformed peers by roughly five percentage points since October 2025.⁶ Marathon Asset Management has stopped making new software loans entirely, predicting sector defaults will triple over the next five to seven years.⁷ For investors, the question is simple: if you wouldn’t put 30% of your stock portfolio in one sector, should you accept that concentration in a fund you can’t easily exit?

Q: If loans go bad, won’t “senior secured” status protect investors?

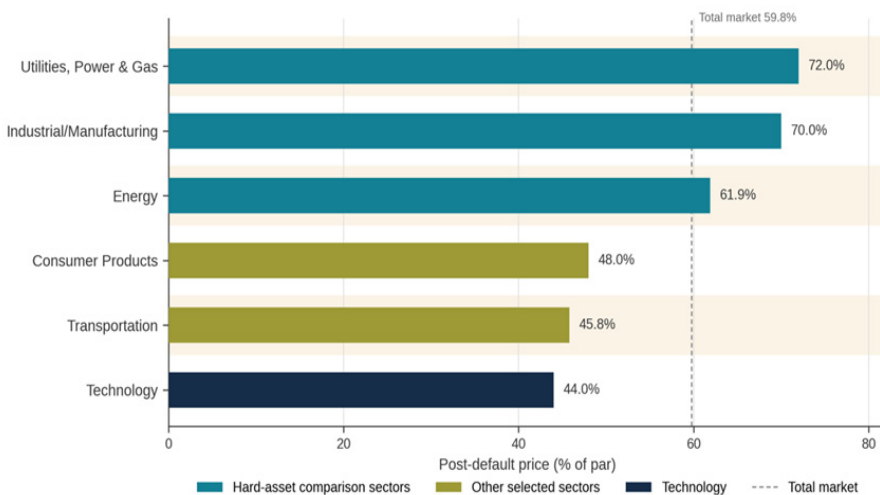
“Senior secured” sounds safer than it sometimes is. It means the lender is near the front of the repayment line. It does not mean there will be enough valuable assets left to repay the loan.

That distinction matters more than it used to. A lender’s claim on a factory, inventory or hard equipment is one thing. A claim on software code, customer relationships, or a shrinking stream of subscription revenue is another. Fitch notes that leveraged loans are usually secured, but that collateral quality varies; physical assets are generally preferable to stock pledges.⁸ Fitch also singles out software companies as “asset-light” borrowers and warns that their collateral may be less of a safeguard than in prior credit cycles.

Using Fitch’s public leveraged-loan data as a recovery proxy, Technology loans traded at 44.0 cents on the dollar 30 days after default in 2019 (Figure 6).⁹ That was well below tangible-asset sectors such as Utilities/Power & Gas at 72.0, Industrial/Manufacturing at 70.0, and Energy at 61.9. Fitch describes 30-day post-default prices as a widely used, observable proxy for recovery, though not the same thing as ultimate recovery.

FIGURE 6

Technology Recoveries Trail Several Hard-Asset Sectors
Selected 2019 US leveraged loan 30-day post-default prices (% of par)



Note: Technology is a broad sector proxy, not a Software/SaaS-specific recovery series.
 Sources: Fitch Ratings, Fitch U.S. Leveraged Loan Default Index, Refinitiv LPC, and Bloomberg.

Loan recovery rates vary notably by sector. Fitch data from 2019 showed leveraged loan recovery rates for Technology indicated at only 44% of par compared to much higher recovery rates for hard-asset sectors like Energy (62%), Industrials (70%), and Utilities (72%).

⁶ Sebastian Doerr, et al., “Private Credit’s Software Lending Meets AI Disruption.” BIS Quarterly Review, March 2026.
⁷ Nabila Ahmed and Matthew Miller, “Marathon’s Richards Refuses to Buy Software on ‘Coming’ Defaults,” Bloomberg News, March 4, 2026.
⁸ FitchRatings, “The 2023 Annual Manual: A Primer on the Leveraged Finance Market,” March 30, 2023.
⁹ FitchRatings, “Fitch U.S. Leveraged Loan Default Insight,” September 18, 2020.

The caveat is important: this is not a perfect private-credit dataset, and Technology is not the same as software-only lending. But it is publicly available evidence for the same basic risk. Seniority helps most when there is durable enterprise value or hard collateral to seize. In asset-light businesses, the collateral can lose value at the same time the borrower gets into trouble.

The lesson is simple: senior secured is a place in line, not a guarantee of getting paid.

Q: Could this trigger another 2008 financial crisis?

We believe it is unlikely — but the reasons why matter, because they do not mean private credit is risk-free. The structural differences from pre-2008 securitized credit are real: fund-level leverage is moderate at 1 – 1.5 times (versus 30 – 40 times pre-crisis), and most capital is locked up for years in closed-end funds rather than runnable demand deposits. Crucially, there are no collateralized debt obligation-style securitization chains of comparable scale, though a small but growing private credit collateralized loan obligation market — roughly 3% of assets — represents an early move back toward the securitization model and warrants monitoring. The Fed’s 2025 stress test found banks could absorb even severe nonbank stress (**Figure 7**). During Q1 2026 earnings calls, bank CEOs universally downplayed systemic risk — JPMorgan’s Jamie Dimon called the \$1.8 trillion market still small enough to pose no significant threat, and Morgan Stanley’s Ted Pick described it as “an adolescent moment” for a young asset class —while US Treasury Secretary Scott Bessent concurred that none of his department’s work had flagged a systemic problem.¹⁰

FIGURE 7

Private Credit vs Pre-2008: Different Architecture, Different Risks

Dimension	Pre-2008 Structured Credit	2024 – 2026 Private Credit
Market Size	~\$2T (subprime MBS + CDOs)	~\$1.8T (direct lending)
Fund-Level Leverage	30-40x at SIVs/banks	1-1.5x (moderate)
Borrower Leverage	High (no-doc mortgages)	5.1x EBITDA (elevated)
Securitization	Deep CDO/CDO ² chains	Minimal (hold-to-maturity)
Valuation	Market-based (but illiquid)	Model-based (quarterly)
Run Risk	Extreme (repo, CP, demand deposits)	Moderate (semi-liquid vehicles)
Bank Exposure	Direct balance sheet exposure	Indirect (\$95B committed)
Regulatory Oversight	Minimal (shadow banking)	Growing (Fed, SEC, FSOC)
Key Transmission	Repo runs, bank insolvency	Redemptions, insurer stress

A collateralized debt obligation squared (CDO²) is a complex derivative security backed by a pool of other CDOs. Sources: IMF GFSR, Federal Reserve, BIS, FSOC Annual Reports.

Private credit’s risk architecture differs fundamentally from pre-2008 structured credit.

Fund-level leverage is moderate, securitization chains are absent, and run risk is limited. However, valuation opacity and rising borrower leverage warrant vigilance.

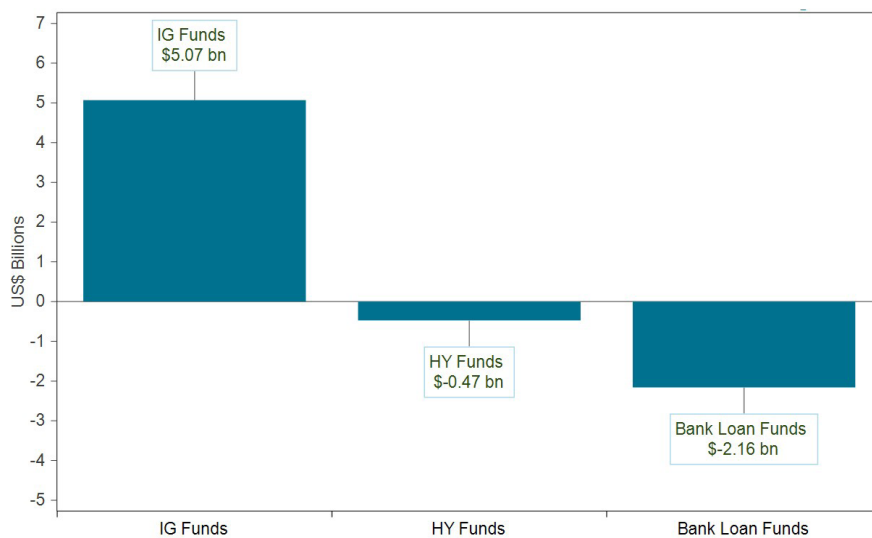
¹⁰ Hannah Levitt, “Bank CEOs Say Private Credit Isn’t a Worry: Businessweek Daily”, Bloomberg News, April 15, 2026.

That said, banks have \$95 billion in committed credit lines to private credit vehicles — up from \$8 billion in 2013 — and the Boston Fed documented \$300 billion in total commitments to private equity and private credit funds, 30 times the level of a decade ago. Insurance companies affiliated with private equity firms hold massive private credit concentrations. US Fed Governor Lisa Cook identified the market as one of four key financial stability risks in January 2025.¹¹ The most probable adverse scenario is not systemic collapse but a protracted shakeout: rising defaults, forced markdowns, restricted redemptions, and tighter credit availability for mid-sized businesses — painful for affected investors and borrowers, but not a threat to the deposit-taking banking system.

Q: How is private credit stress affecting the public bond markets?

So far, the pattern has been risk rotation rather than risk-off — and the distinction matters enormously. In a classic crisis, stress triggers indiscriminate selling across all risky assets. Instead, capital has been flowing out of private credit and into more liquid, higher-quality public bonds. Investment-grade new issuance hit \$115 billion in one week of April 2026, just shy of the all-time record. Investment-grade funds have seen large inflows that offset outflows from high-yield and bank loan funds (Figure 8). Even in high yield, net institutional buying has increased despite retail outflows, and public default rates remain well below long-term averages. Treasury yields have backed up on oil-related inflation concerns rather than rallying on a safe-haven bid. In a further sign of easing stress, BDC bond issuance resumed in mid-April after a two-month drought: Goldman Sachs Private Credit sold \$750 million of notes and Blue Owl Capital issued \$400 million — with Pimco purchasing the entire Blue Owl offering at a yield of approximately 6.5%, widely interpreted as a vote of confidence.¹² BDC credit spreads, while still elevated, tightened from roughly 2.6 percentage points in March to about 2.25 percentage points by mid-April.

FIGURE 8
Risk Rotation, Not Risk Off:
Cumulative Q1 2026 Fund Flows Across Credit Strategies



Note: Fund flows proxied by key ETF flows. IG Funds: LQD & VCIT; HY Funds: HYD & JNK; Bank Loan Funds: BKLN & SRLN.
 Sources: GW&K Investment Management, Bloomberg, and Macrobond.

In the first quarter, strong inflows into investment-grade (IG) bond funds offset modest outflows from high-yield (HY) and bank loan funds.

¹¹ Lisa D. Cook, "A Policymaker's View of Financial Stability," Federal Reserve Speeches, November 20, 2025.
¹² Davide Barbuscia and Brian Smith, "Private Bond Sales Signal Fear of BDCs Has Eased," Bloomberg News, April 14, 2026.

The risk to watch is what could turn this constructive rotation into contagion. Three channels matter: forced fund liquidations that could depress pricing on broadly syndicated loans shared with public markets; sector contagion if AI-driven software defaults spill into publicly traded tech bonds; and a confidence shock from simultaneous BDC gates that triggers disorderly selling. Banks are already tightening lending to private credit funds — prudent for their own risk, but potentially amplifying stress within the private credit ecosystem. That said, the largest banks' disclosed direct exposures to private credit — roughly \$50 billion at JPMorgan, \$36 billion at Wells Fargo, \$22 billion at Citigroup, and \$20 billion at Bank of America — are modest relative to their balance sheets, and all emphasized structural protections, including overcollateralization and covenants on their credit lines. In prior stress episodes, the Fed was able to intervene because banks were the gatekeepers; that playbook remains available, though the transmission chain is less direct. The addition of AI as a genuinely novel disruption variable adds a dimension that historical precedent cannot fully address.

Q: What does all of this mean for investors?

For public credit investors, the near-term picture is relatively supportive. Private credit stress is driving capital toward quality and liquidity, underpinning investment-grade demand and keeping public high-yield default rates below the levels of distress appearing in private portfolios. The risk to monitor is sector-specific: if AI-related credit deterioration begins appearing in publicly traded technology bonds, not just private loans, it would warrant reducing tech exposure within high-yield allocations.

Four signals will tell you whether the constructive rotation is holding or breaking down: primary market access (can companies still issue at reasonable spreads?), secondary liquidity (are bid-ask spreads widening?), fund flow direction (is the rotation orderly or accelerating?), and public default trends (are they following private credit higher, or diverging?). As long as those four signals remain constructive, the read-through to public portfolios is limited. The mid-April resumption of BDC bond issuance — over \$1.1 billion placed in two days, with a major institutional buyer (Pimco) stepping in as sole purchaser of one offering — is an early positive reading on the first of those signals, though spreads on the new deals still carried meaningful concessions above existing debt.

For investors who hold private credit directly, the considerations are more pressing. Know your redemption mechanics before you need them. Recognize that “private credit” is not a monolith: core middle-market lending with full covenants and tangible collateral is structurally different from upper-market covenant-lite software lending where “senior secured” offers legal priority but no economic protection. The income buffer is real, but recovery rates in distress situations may prove to be less than expected due to potential AI disruption. The asset class is not broken, but the next 12 to 18 months will separate disciplined underwriters from late-cycle tourists. For those whose exposure is in public bonds, this is the moment to actively monitor the transmission channels that would signal the stress is no longer staying in its lane.



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