Private credit: Setting the record straight

By Private Credit Portfolio Manager Nick Schwartzstein, CFA

If you're following financial news, you might think private credit is facing an impending collapse. Headlines about rising defaults, concerns over software sector disruption, and restrictions on withdrawals from certain funds have led some reporters and investors to question the strength and safety of this asset class. However, when you look beneath the surface, a much more compelling—and reassuring—story emerges.

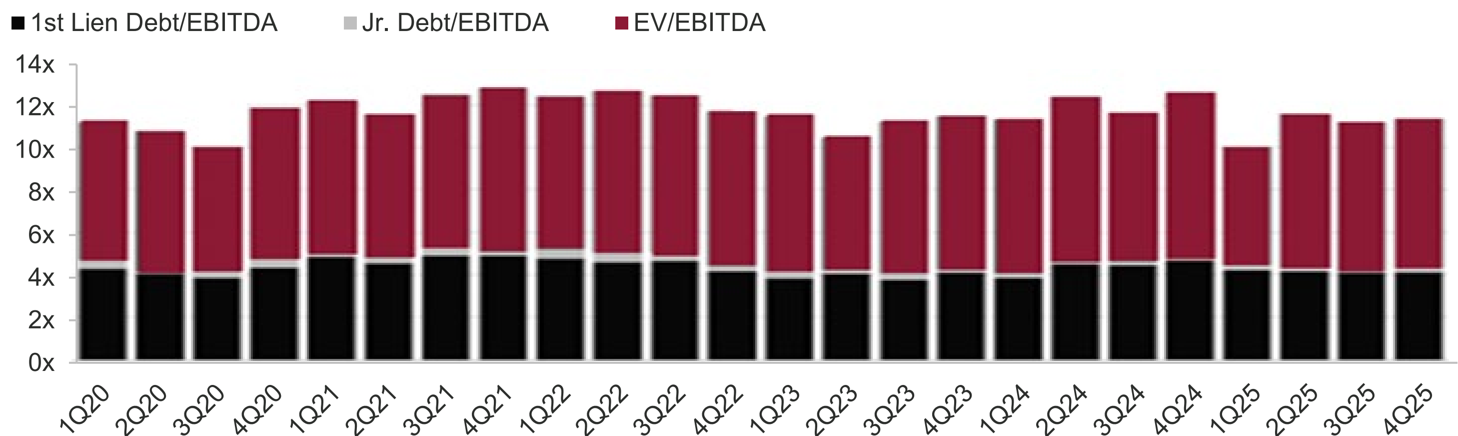
Facts—The only known cure for "doomscrolling"

1. Fundamental strength and structural safety

Despite the noise, the fundamentals of private credit speak for themselves. Private equity-owned mid-market companies—the main borrowers in the corporate segment of private credit (direct lending)—have maintained steady debt levels for years, with a typical debt-to-earnings (EBITDA) ratio of around 4-5x and moderate valuation multiples. These factors translate to healthy cushions for lenders, who only experience realized losses after a company's equity investors have been completely wiped out.

Exhibit 1: Average debt and valuation multiples remain at healthy levels

Debt-to-EBITDA & enterprise-value-to-EBITDA multiples



Source: Antares Market Brief, Q4 2025, citing LSEG LPC 4Q25 Middle Market Sponsored Private Deal Analysis. Only includes deals for which both purchase price and leverage figures were available. EV = Enterprise Value.

Additionally, direct lenders typically structure loans with multiple layers of downside protection, which may include financial performance covenants, minimum liquidity requirements, and restrictions on asset sales, dividend payments, and additional debt incurrence, all of which are designed to protect and preserve value for investors in direct lending funds.

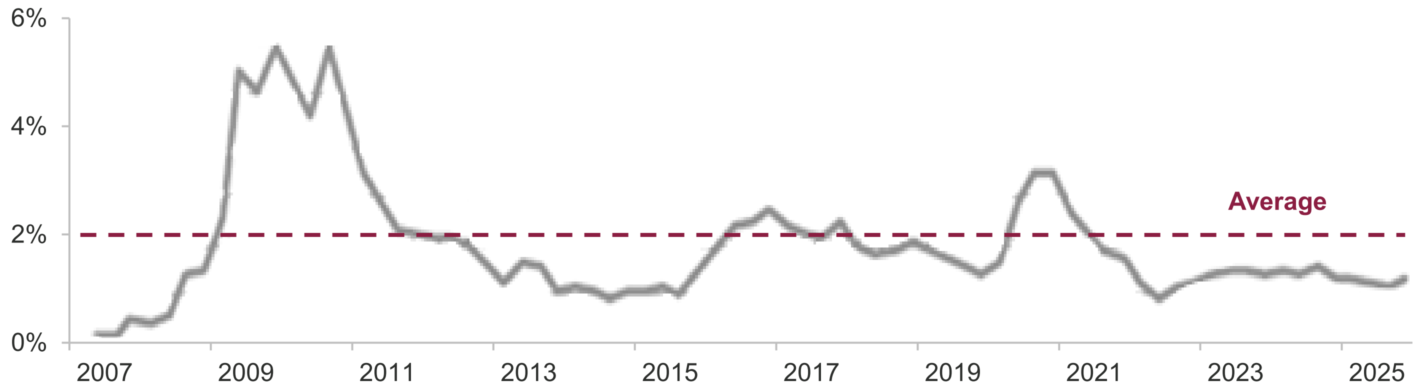
In addition to highlighting direct lending's positive fundamentals, one should note this market's size relative to other areas of credit. The financial media likes to frame direct lending as a market that has grown too large. In reality, it remains smaller than the high yield, syndicated loan, and bank loan markets. And, though it has taken significant market share from banks, it accounts for only 20-25% of total leveraged credit and has raised assets equal to only 5% of US gross domestic product (GDP).[1] Moreover, this growth has occurred with only modest amounts of leverage—typically 0-2x, well below leverage levels used by banks when they dominated middle-market lending pre-2008. These data points highlight that private credit is not a rapidly growing bubble or source of systemic risk, but rather the result of a prolonged shift in market share.

2. Defaults are low, even in tough times

Defaults are a normal part of lending and have remained low despite what recent headlines might suggest. Over the past 20 years, the average annual default rate has been approximately 2%, recently dipping as low as 1.27%. Even when defaults occur, lenders have historically recovered about 70% of their principal, which limits losses and helps portfolios maintain consistent performance. For example, during stressed environments like 2008-2009, diversified senior direct lending portfolios suffered modest losses but maintained relatively healthy returns, thanks to strong interest income and high recovery rates.

Exhibit 2: Mid-market default rates remain below the historical average

Weighted Average Non-Accrual (Payment Default) Rate



Source: Antares Capital 2026 Outlook, citing Cliffwater Direct Lending Index site for Weighted Average BDC Non-Accrual % @Cost as of 3Q25; LSEG LPC BDC Collateral database for Ranking of Non-Accrual % @ Cost For BCDs with >$1B of Net Assets as of 9/30/25. BDC = Business Development Companies.

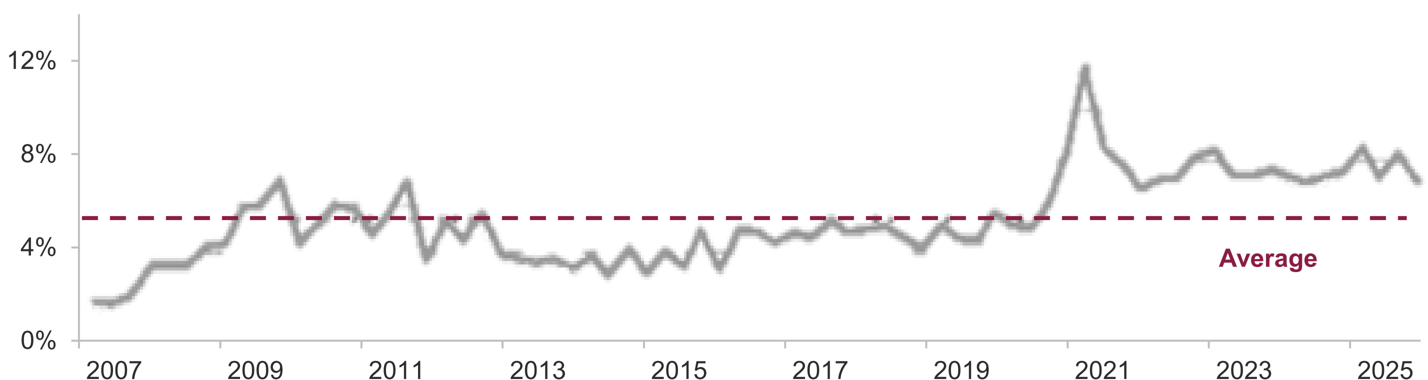
3. Stable interest income—A lender's best friend

Even if credit stress and defaults rise, diversified senior lending portfolios benefit from meaningful cushions provided by interest income on the healthy loans in the portfolio. For example, even if a loan portfolio experienced a 10% default rate in one year and earned a 50% recovery rate on those loans, the remaining 90% of its portfolio would generate more than enough income (in most interest rate environments) to fully offset losses on the defaulted loans.

Some analysts have argued that direct lenders' collective use of payment-in-kind (PIK) interest— paid when loan principal is repaid, not via regular interest payments—represents an outsized risk to returns. However, in reality, PIK income remains a small percentage of total income and remains close to historical averages (7.3% in Q4 2025).[2] Additionally, the PIK feature is used in different ways by different lenders—sometimes to support growth in a high-quality company and sometimes to offer debt relief to a struggling company. Though certain direct lenders who have used PIK too aggressively may experience above-average losses, the vast majority of direct lending funds remain focused on cash-pay loans, which provide notable downside protection.

Exhibit 3: PIK income remains stable and within historical averages

PIK interest as a % of total income



Source: Antares Capital 2026 Outlook, citing Source: Cliffwater Direct Lending Index site for BDC PIK as a % of Total Income as of 3Q25; LSEG LPC BDC Collateral database for Ranking of Non-Accrual % @ Cost For BCDs with >$1B of Net Assets as of 9/30/25 (Note includes all BDCs with 3Q25 reported data as of Dec. 8, 2025).

4. Fund withdrawal restrictions are a feature, not a drawback

One of the topics on which the financial media has focused most closely has been recent withdrawal restrictions in business development companies (BDCs). While some investors may have been frustrated to receive only partial liquidity in recent months, these withdrawal restrictions are critical in protecting investors. They are designed to align the expected volume of quarterly loan repayments with the liquidity offered to investors. With this alignment, funds significantly reduce the risk of needing to sell good loans into a bad market at depressed prices, imposing realized losses on all investors. This structure helps the fund remain resilient, even during periods of negative sentiment.

5. Software—The struggle is real but not destabilizing for direct lenders

Concerns about artificial intelligence disrupting the software sector are valid, but well-managed private credit portfolios are built to withstand shifting trends. Diversification is a core principle; exposure to any single sector (even to historically popular sectors, like software) is intentionally limited, reducing potential downside risk from disruptions in any one area. Expect a wide range of outcomes in software lending, as strong credit selection and private equity partnerships will allow some lenders to weather the storm while others will struggle to maintain value in disrupted companies owned by weaker private equity sponsors.

The real value of private credit

One of the most appealing aspects of private credit is its potential for attractive returns while maintaining strong downside protections. Since 2003, direct lending's annualized returns have nearly kept pace with public equities, despite its more senior position in corporate capital structures. On a realized basis, historical returns have ranged from 9% to 14% annually, demonstrating the asset class's appeal and resilience.[3] Additionally, private credit's low historical volatility levels have provided portfolios with valuable diversification to public equities and bonds. The vast majority of investments in private credit funds are held by institutional investors in long-term fund structures, significantly reducing the possibility of panic selling and large markdowns.

Headlines may attract attention and achieve high "click" rates, but the underlying fundamentals in private credit tell a different story. Private credit offers investors exposure to well-structured, income-generating loans held in funds designed to be resilient as market conditions change. Defaults will happen and may rise from current levels, but private credit has weathered elevated default rates in the past and is well positioned to do so again.

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1 All data sourced as of December 15, 2025. Nominal US GDP data from FRED; Bank C&I Loans data from FRED; Private Credit AUM (including BDCs) data from Preqin; High Yield Bonds data from MarketAxess; Syndicated Loans data from Pitchbook LCD.
2 Cliffwater Direct Lending Index – 4th Quarter, 2025 webinar, April 2026.
3 Bloomberg L.P., https://www.fticonsulting.com/-/media/files/insights/articles/2024/oct/private-credit.pdf, covers the period between 2004 and 2023.

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