

Private Credit's Other Lanes Still Offer Value

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Even as the direct lending sector faces scrutiny, private credit remains a broadly diversified market offering a variety of investable opportunities.

Concerns about private credit have intensified in recent months. Investors are grappling with questions about weakening credit quality, stale valuations, looser underwriting, redemption risk in certain types of funds, and the impact of AI-driven disruption. Much of the anxiety has centered on corporate direct lending – especially business development companies (BDCs) and semi-liquid vehicles¹.

This narrow focus, however, can miss the bigger picture. Private credit is a broader and more diversified asset class, offering a range of differentiated risk exposures. Beyond traditional corporate senior secured lending, private credit spans asset-based finance (ABF) and specialty finance, real estate, and special situations², each with distinct drivers of risk and return. Taken together, these distinctions point to a more nuanced set of investment implications, which can be grouped into a few key themes.

- **That broader private credit universe still earns its place in portfolios.** ABF and high quality consumer and mortgage credit has continued to offer meaningful diversification and more attractive value than direct lending. ABF is generally less correlated with the corporate earnings cycle and benefits from structural downside protection. Selective exposure to consumer and mortgage credit, particularly related to higher-income households, can offer a more attractive risk/reward profile.

- **Direct lending will ultimately meet the credit cycle ...** Like every mature segment of leveraged finance, direct lending should eventually face a full-blown default cycle – one that would test its resilience to both sector-specific and macroeconomic shocks. Early loan vintages, originated soon after the global financial crisis, benefited from stronger documentation and lender control. In the ensuing years, record fundraising has steadily eroded underwriting standards. As overlap with public markets has grown, direct lending funds have increasingly offered terms comparable to those in public leveraged finance – without providing any meaningful compensation for illiquidity. Persistent opacity and weak disclosure around issuer fundamentals are therefore likely to keep concerns about credit quality and portfolio price marks firmly in focus.
- **... While AI disruption risk and portfolio concentration will likely continue to cap performance.** Heavy exposure to the software industry in direct lending portfolios is likely to constrain relative performance versus both public markets and other segments of private credit. At the same time, the rise in portfolio overlap across managers has compressed performance dispersion, limiting the scope for manager-selection outperformance (alpha), a dynamic increasingly evident in the relative performance of recent vintages.

- **Mind the liquidity gap.** Across private markets, semi-liquid vehicles have expanded rapidly in recent years. While the risk of a “bank-run” style event escalating into a systemic shock remains low, given the structural safeguards embedded in these vehicles, recent episodes are likely to prompt investors to reassess both the amount of illiquidity they are accepting and the compensation they receive for it. They also underscore the importance of understanding how liquidity is accessed across different types of semi-liquid structures.

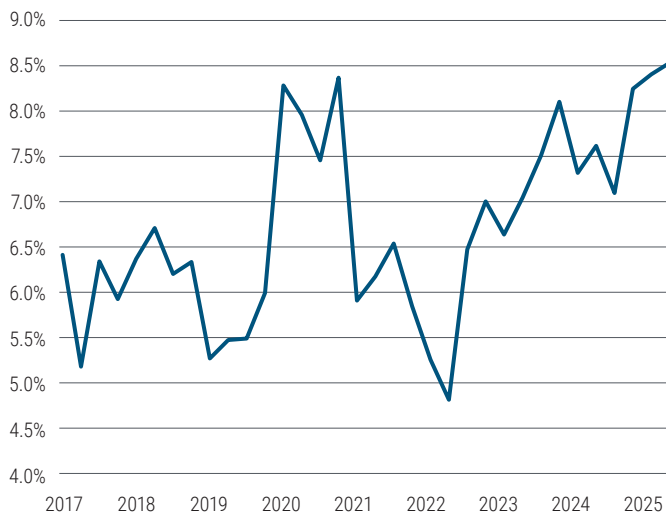
Direct lending fundamentals: Opaque by design, signaling caution by proxy

By design, direct lending portfolios – and private assets more broadly – are not publicly disclosed, which makes it harder to assess their underlying fundamentals. In the absence of transparency, market participants have relied on proxies. BDCs have emerged as a particularly useful reference point, given that they report quarterly and provide relatively detailed information on their holdings.

Figure 1 shows that the share of payment-in-kind (PIK) loans, in which borrowers pay interest with additional debt, has been rising since 2022. Meanwhile, recent price action in public BDCs suggests investors are demanding higher compensation to guard against a variety of risks, including potential stale price marks and deteriorating fundamentals. As shown in Figure 2, BDCs now trade at the largest discount to their book value since the post-COVID recovery began.

Figure 1: The share of PIK loans in BDC portfolios rose in 2025 near post-COVID highs

Share of PIK loans in BDC portfolios



Source: PitchBook LCD and PIMCO as of Q3 2025

Figure 2: BDCs are trading close to their largest discount to book value since the post-COVID recovery started

Price-to-book ratio on the S&P BDC Index



Source: Bloomberg and PIMCO as of 24 February 2026

Larger deals, software heavy and alpha light

Total assets under management (AUM) in North American direct lending portfolios has increased roughly sevenfold over the past decade, from \$93 billion in 2015 to about \$644 billion by year-end 2025, according to Preqin. Any asset class that experiences such rapid growth is prone to developing imbalances, and direct lending is no exception.

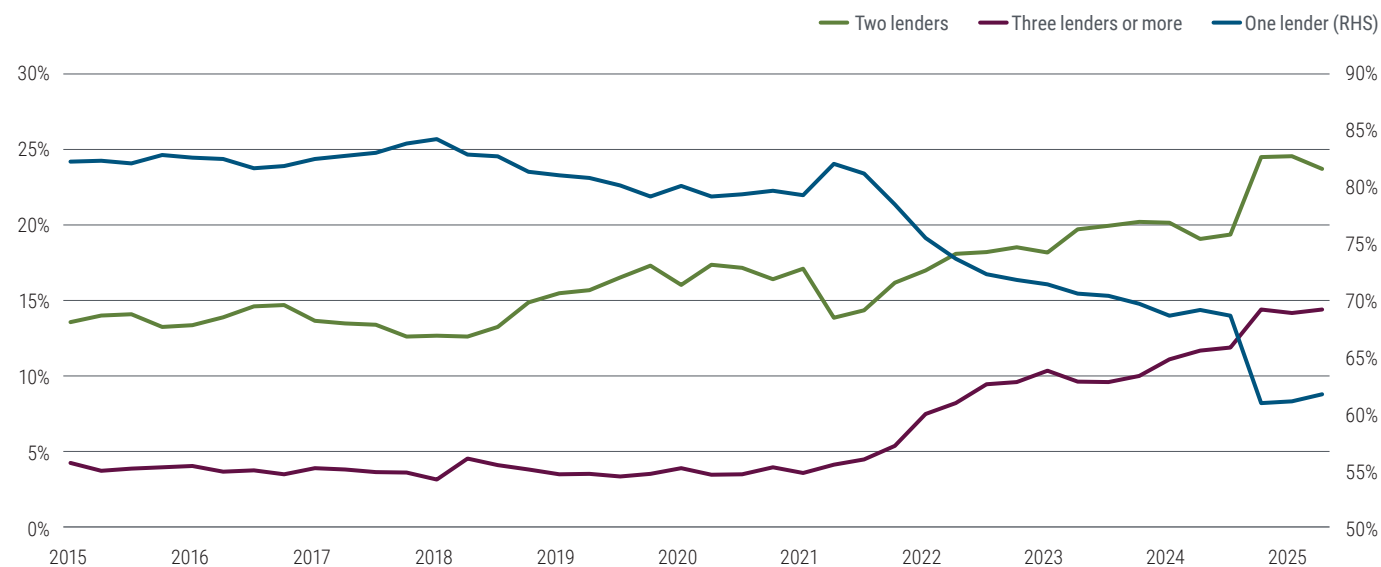
As capital inflows surged, demand for loans increasingly outpaced supply, fueling greater borrower- and sponsor-friendliness – and thus a gradual weakening of underwriting standards. At the same time, the sheer volume of capital committed to direct lending has supported larger transactions since 2023 – deals that would historically have been financed in the broadly syndicated loan market.

This shift has increased overlap in the borrower base, a dynamic often loosely described as “convergence.” What was once a market almost entirely dedicated to middle-market borrowers has thus taken on quasi-syndicated characteristics, with large deals often underwritten by a group of lenders.

This evolution has mechanically increased portfolio overlap across managers. Here again, BDC portfolio data corroborate this dynamic. The share of traditional single-borrower/single-lender transactions, long the hallmark of middle-market lending, has declined in recent years, while larger loans involving multiple lenders have become increasingly prevalent (see Figures 3 and 4).

Figure 3: The share of traditional single-borrower/single-lender transactions in BDC portfolios has declined

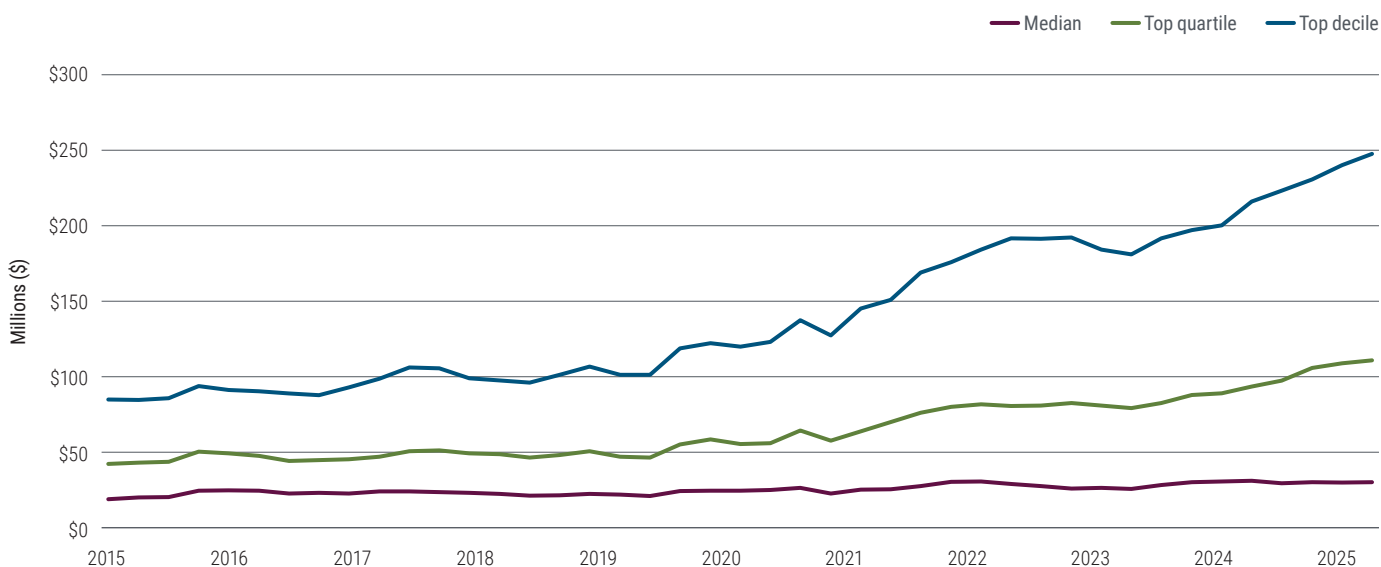
Share of loans in BDC portfolios involving multiple lenders per borrower



Source: PitchBook LCD and PIMCO as of Q3 2025

Figure 4: The composition of BDC portfolios has been gravitating toward larger capital structures

Issuer total principal outstanding in BDC portfolios

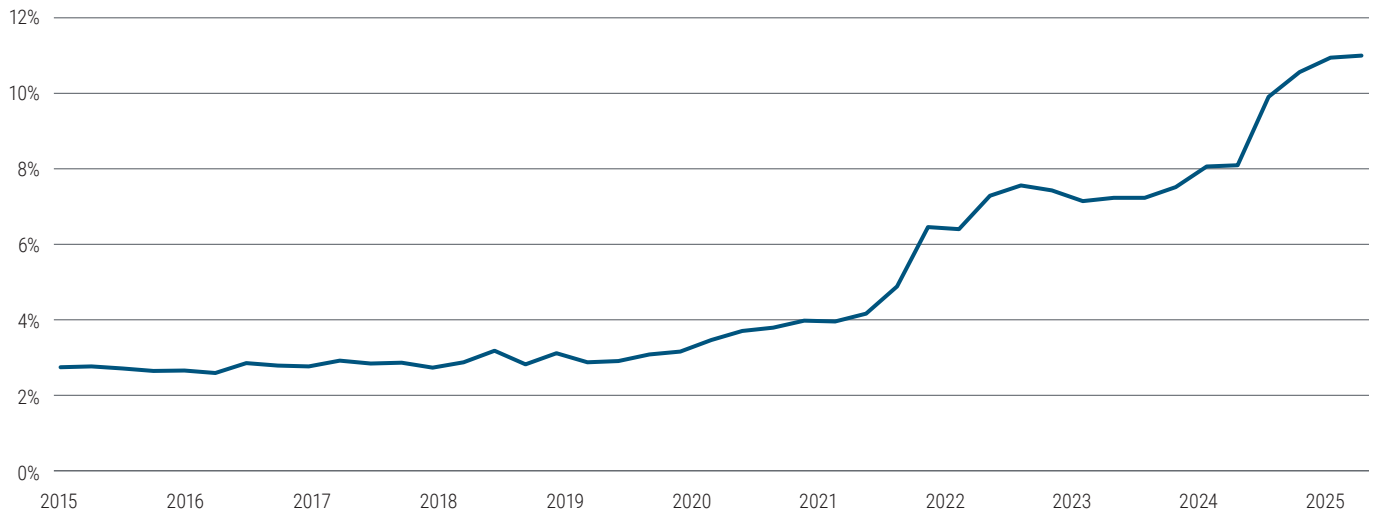


Source: PitchBook LCD and PIMCO as of Q3 2025

In parallel, two other shifts have also taken place. First, portfolio overlap across managers has been on a steady rise. Figure 5 illustrates this trend by mapping the intersection of portfolio holdings for the median pair of BDCs, highlighting the commonality of exposures.

Figure 5: Portfolio overlap has materially increased in recent years

Average portfolio overlap within the top 10 largest BDCs

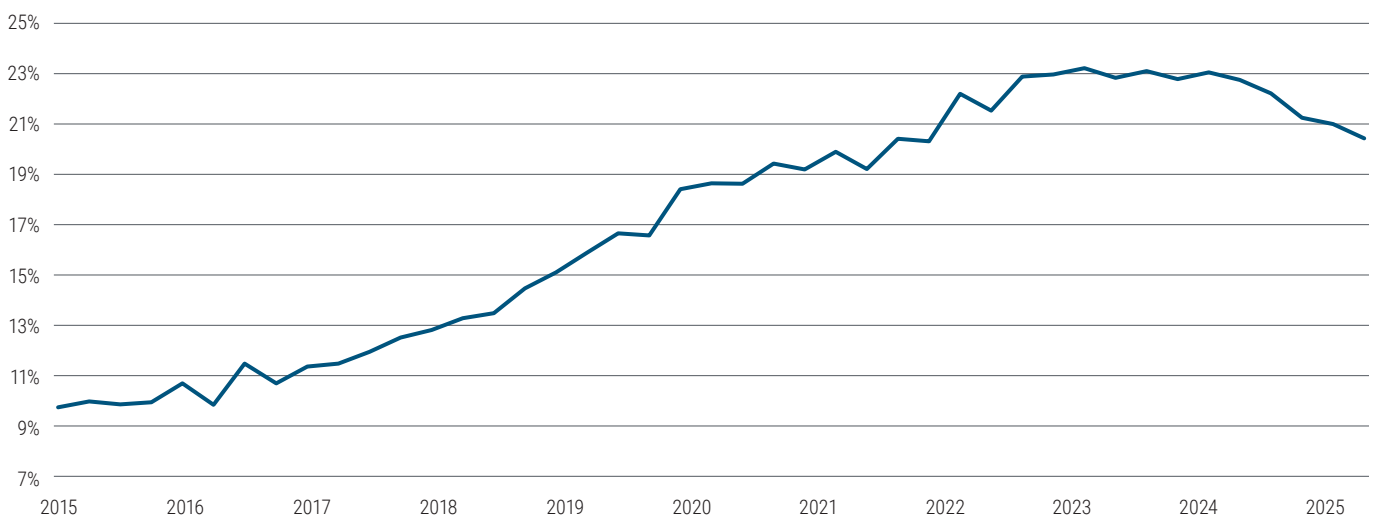


Source: PitchBook LCD and PIMCO as of Q3 2025. For each pair of BDCs, we sum up the minimum weights of overlapping issuers in both portfolios. We then calculate the average across all pairs.

Second, the heavy involvement of private equity sponsors in software companies, combined with their reliance on direct lending as a preferred financing channel, has driven pronounced sector concentration, with the share of software more than doubling in a decade (see Figure 6).

Figure 6: The share of software companies in BDC portfolios is elevated

Share of software loans in BDC portfolios



Source: PitchBook LCD and PIMCO as of Q3 2025

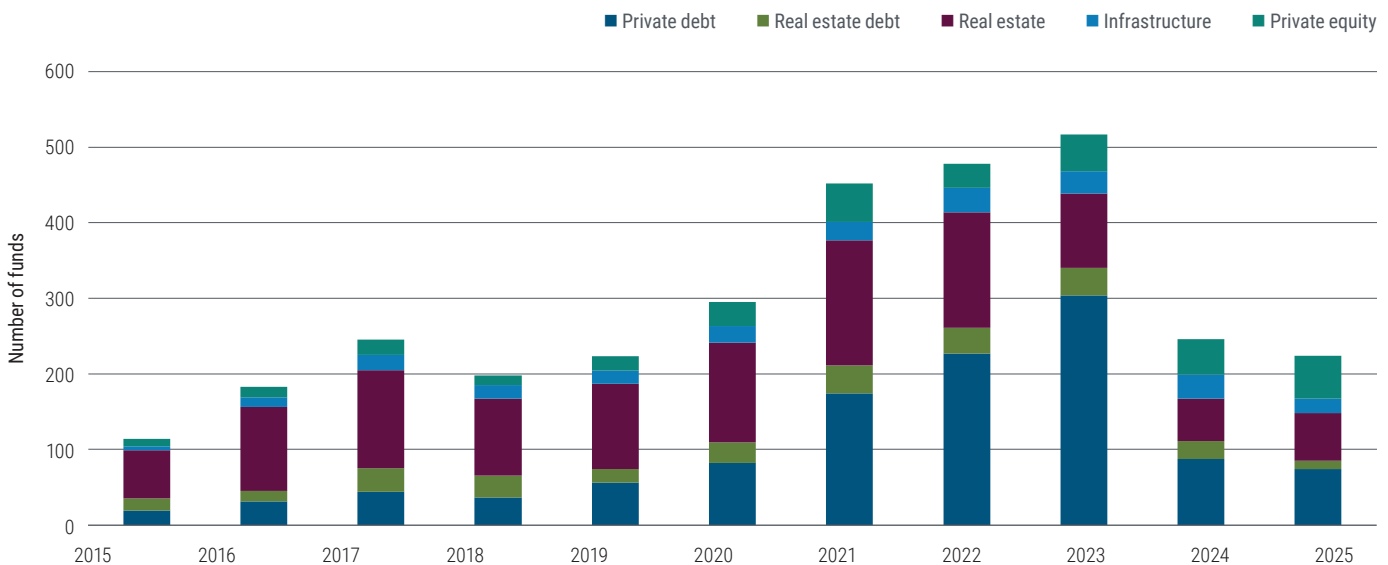
For investors, the combined impact of these forces is weaker diversification and higher cross-portfolio correlation across managers.

Semi-liquid structures: No systemic threat in U.S., but a wake-up call on selectivity

In addition to non-traded BDCs and private real estate investment trusts (REITs), the semi-liquid universe expanded rapidly from 2019 to 2023 to include evergreen and interval funds³ (see Figure 7). This growth has been driven by the uptick in investors' appetite to deploy capital into private markets in real time rather than to be constrained by discrete vintage cycles, though the bulk of private assets continue to be largely invested in vintage funds (see Figure 8).

Figure 7: Semi-liquid vehicles have experienced material growth in recent years

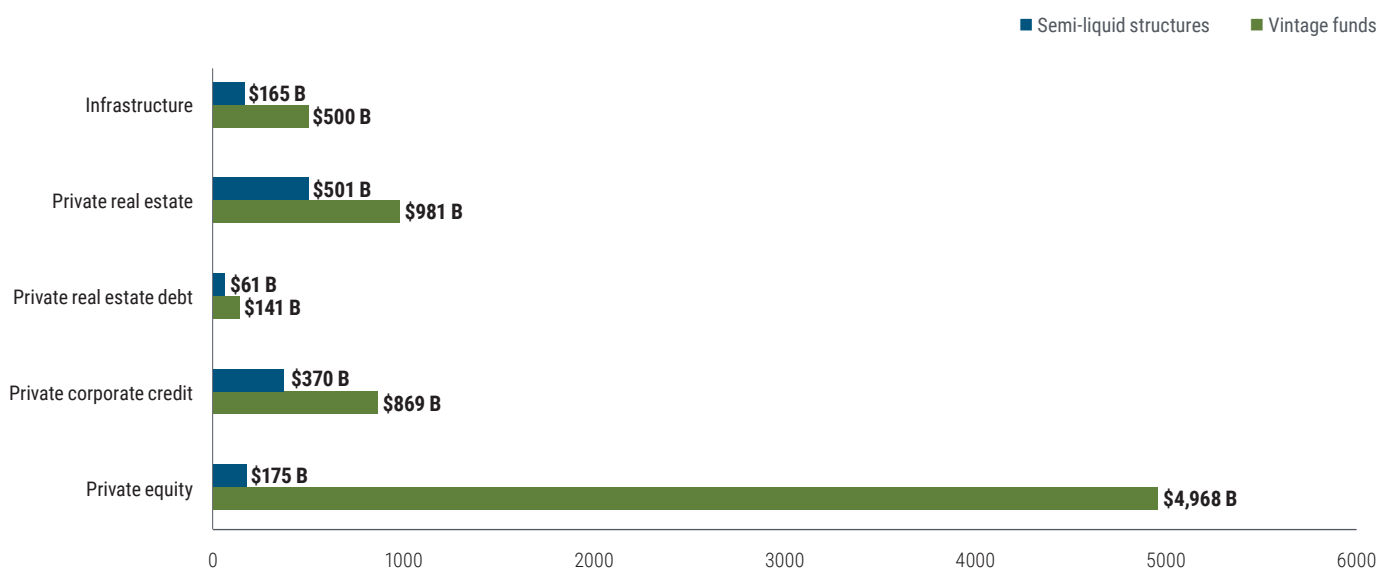
Number of semi-liquid vehicles launched by vintage year



Source: Preqin and PIMCO as of December 2025. Non-traded BDCs and private REITs are not included.

Figure 8: The bulk of private market assets remain invested in vintage funds

AUM: Semi-liquid vs. vintage funds



Source: PitchBook LCD and PIMCO as of Q3 2025

While the risk of a true “bank-run” dynamic in these vehicles is generally low, given explicit contractual limits on redemptions and the ability of managers to gate flows, semi-liquid does not mean fully liquid. As with traditional vintage funds, investors must still assess their own liquidity needs and tolerance for constrained access to capital, particularly during periods of elevated volatility. The recent scrutiny on redemptions in semi-liquid direct lending funds has brought this distinction into focus, underscoring that liquidity is conditional, rather than guaranteed.

What is often less appreciated, however, are the meaningful differences within the semi-liquid universe itself. While these vehicles offer investors the option to deploy capital on a rolling basis, they operate under different regulatory regimes and differ when it comes to giving investors access to liquidity.

For non-traded BDCs, private REITs, and evergreen funds, access to liquidity ultimately sits at the manager’s discretion. In effect, investors are short a put option⁴ to the manager. The value of this put option rises precisely in states of the world when aggregate liquidity demand increases, or market conditions deteriorate. In those moments, the gap between stated redemption terms and realizable liquidity can widen materially.

By contrast, interval funds eliminate this optionality. Repurchases occur at pre-determined intervals and are capped at a fixed percentage of the stated net asset value (NAV), providing investors with certainty of execution on the terms offered.

To be clear, interval funds are not more liquid. Rather, they are less ambiguous and more transparent: Liquidity is explicitly limited, rule-based, and applied systematically rather than discretionarily.

Private credit’s other lanes still offer value

Private credit extends well beyond direct lending and continues to merit a place in well-diversified portfolios. As the cycle matures, the relative appeal of ABF as a diversifier is likely to continue to increase, precisely because returns are driven more by collateral and structural protections than by pure earnings growth.

The opportunity set spans a wide range of exposures across the economy, including residential and commercial real estate, consumer credit, and specialty finance. And unlike direct lending, which is predominantly non-investment-grade corporate credit, ABF may provide investment-grade-like risk profiles that are less capital-intensive for large allocators such as insurance companies. The result is a large and still underappreciated opportunity where diversification and downside resilience, rather than headline yield alone, underpin the investment case.

Recent PIMCO research using public securitized products as rough beta proxies for ABF – an approach that abstracts from both liquidity premia and manager selection alpha – suggests that potential ABF risk-adjusted returns are not only more attractive than direct lending but also exhibit greater resilience to market downturns and lower sensitivity to fluctuations in risk sentiment, as proxied by equity returns.

- 1 BDCs are funds that invest in small and midsize private U.S. businesses. Semi-liquid vehicles are investment funds that offer periodic redemption opportunities rather than daily liquidity.
- 2 ABF and specialty finance are terms that are often used interchangeably to describe private lending secured by specific assets and collateral such as aircraft, auto loans, and mortgages. Special situations refer to unique, often one-off events that affect asset valuations and present investment opportunities.
- 3 Evergreen funds are investment funds with no fixed termination date that continuously raise capital and recycle proceeds from exits into new investments, allowing investors to enter and exit periodically rather than at a single fund maturity. Interval funds are closed-end investment funds that offer liquidity to investors only at scheduled intervals (such as quarterly or semiannually) through limited share repurchase offers rather than daily redemptions.
- 4 A put option is a financial contract that gives the holder the right, but not the obligation, to sell an underlying asset at a specified price on or before a specified expiration date.

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