

Private Credit: Navigation Headwinds and Opportunities



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Markets are currently experiencing heightened concern about private credit. This has been fueled by headlines, redemptions, and worries about AI-related headwinds impacting public and private markets exposure to software companies.

This narrative has primarily prompted retail investors to sell on headlines, creating redemptions exceeding the typical 5% per quarter liquidity these vehicles were designed to provide. The situation intensifies when asset managers activate stated redemption gates. Given recent redemption waves from non-institutional investors we are watching how managers will evolve their liability management, liquidity and gating strategies. The good news is to-date all funds have met their stated quarterly liquidity in full, including in some instances honoring redemptions that were in excess of requirements.

However, we expect these negative headlines to persist as we enter a credit cycle characterized by “known unknowns” and widening credit spreads. Investors are reassessing the durability and valuation of software businesses, which represent one of the largest sector exposures in many private equity-backed direct lending portfolios. While only time will tell, we are seeing a fundamental shift in how software risk is priced and underwritten in both the public and private markets.

Despite these challenges, we believe private credit continues to offer attractive value, generating higher yields with historically lower default rates, and demonstrating resilience through market dislocation. Trailing twelve-month direct lending defaults¹ remain stable at 1.1%, compared to 4.2% for syndicated loans and median year-on-year earnings growth for private markets companies came in at 8.2%² as of September 2025.

Success in this environment depends on fundamentals: sourcing quality credits, maintaining underwriting discipline, and diligent collateral monitoring, but liquidity management will also be key. While the environment may not be easy for every borrower, the ability for investors to actively navigate evolving dynamics and adapt to long-term secular trends will be critical for success.

BDCs and their role in Private Credit

Much of the recent news has focused on ~48 publicly traded and 112 non-traded and private Business Development Companies (BDCs), that collectively represent approximately \$482 billion in assets³. This is a subset of the estimated \$3 trillion+ sub-investment grade private credit market⁴. It is important to note that public BDCs trade more like equities and their prices are not directly correlated to the underlying direct lending loans they hold. A simple analysis of correlation over various trailing periods shows a higher correlation to the S&P500 (generally 0.5 to 0.75) than to leveraged loans (less than 0.25 in trailing 1 to 3 year periods, and 0.25 to 0.5 in trailing 7 and 10 year periods). Furthermore, direct lending BDCs represent

¹ KBRA DLD Default Research TTM through February 16, 2026.

² Houlihan Lokey U.S. Private Credit Market Newsletter, October 2025

³ Houlihan Lokey Fall 2025 BDC Monitor

⁴ Estimate as at end of 2024. Sourced from Financing the Economy 2025 report by the Alternative Credit Council (ACC), the private credit arm of the Alternative Investment Management Association (AIMA)

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only a portion of the broader private credit market, that is estimated at around \$40 trillion⁵ when including structured credit, asset-backed finance/specialty finance, and the sizable private investment-grade market.

Private Credit performance and quality

Private credit has consistently offered a significant premium over more liquid credit strategies. The Cliffwater Direct Lending Index measures the performance of U.S. middle market corporate loans and is a useful proxy given its long history and broad coverage⁶. Reviewing performance from Jan 1, 2005 to December 31, 2025, we can see strong returns over various trailing periods, covering crises, recessions, and several credit micro-cycles.

All credit strategies, public or private, experience defaults and losses and just because an investment is private does not inherently make it more or less risky than publicly traded credit. Most private credit benefits from structural protections, negotiated terms, and the ability to work bilaterally through periods of stress. Lenders are aligned with equity investors to preserve franchise value rather than owning companies outright.

Currently, we do not see systemic issues similar to the Global Financial Crisis. In aggregate, most borrowers have grown EBITDA, and interest coverage ratios have improved from previous troughs. Stress is concentrated in vulnerable sectors like software rather than being broad-based.

Investors should expect ongoing valuation volatility in software loans to impact near- and medium-term performance until it becomes clear which companies will fail and which will successfully leverage AI or technology to transform their business models.

Public BDC pricing suggests that current price-to-net asset value dislocations are driven more by technical factors and sentiment than by fundamental credit deterioration outside of software. Raymond James⁷ notes that the equity-weighted BDC group is trading at approximately 0.80x P/NAV, compared to a five-year average of 0.98x. Despite high-profile BDC redemptions and the so-called “SaaS apocalypse,” trailing twelve-month defaults have been relatively benign for direct lending at 1.1%, compared to 4.2% for syndicated loans and 1.9% for high yield bonds.

Looking ahead, KBRA forecasts a modest increase in direct lending default volume to 2.0% in 2026, with software loans expected to have a slightly higher default rate of 2.5%. These levels are consistent with 2024 rather than an outlier. Default forecasts for syndicated loans and high yield bonds also suggest that liquidity and credit stress are not isolated to private borrowers. It is also important to remember that direct loans offer meaningful spread pick-up

⁵ Estimates from Apollo Global Management of the total private credit universe

⁶ The Cliffwater Direct Lending Index (CDLI) seeks to measure the unlevered, gross of fees performance of U.S. middle market corporate loans, as represented by the underlying assets of BDCs, including both exchange-traded and unlisted BDCs. The CDLI was launched on September 30, 2015, with performance history back to September 30, 2004, with asset coverage of over \$42bn and over 17,000 loan holdings.

⁷ Raymond James, Business Development Company Weekly, published March 16, 2026.

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relative to public counterparts, despite exhibiting similar or better credit quality, to compensate for any potentially higher loss.

Underneath the surface, a few high-profile frauds, late-cycle underwriting slippage, and macro uncertainty are driving greater dispersion among private credit managers and more rigorous reviews of structures and liquidity. We view this as a healthy development for the market.

Private Credit redemptions, liquidity management & gates

Liability management and access to multiple sources of liquidity are critical in managing semi-liquid, evergreen, and/or vehicles that trade publicly. These vehicles behave very differently from closed-end credit funds. As we have seen a wave of redemptions across both public and private vehicles there have been different approaches to gating and liquidity management.

Non-traded BDCs have seen an increase in redemption requests; some have met redemptions even when exceeding contractual gates, while others have chosen to follow their liquidity caps. Importantly, all funds have met their stated quarterly liquidity in full.

Going forward, more widespread use of gates would preserve BDCs' liquidity and financial flexibility but may also reduce inflows or increase outflows from these vehicles.

Demand trends for Private Credit

Capital continues to flow into private credit primarily from institutional investors, even as retail fundraising wanes temporarily. New flows into non-traded BDCs were \$43 billion over 2025, well in excess of redemptions, and 23% higher than the \$35 billion raised in the year prior⁸. New flows into other private credit vehicles, across strategy types, were \$234 billion over 2025, and kept pace with the \$241 billion raised in the year prior⁹.

In summary

- We believe private credit remains an attractive asset class, offering higher yields with historically lower default rates than syndicated loans.
- It continues to play a critical role as a reliable source of capital for direct lending, asset-based, opportunistic, or serving high-grade borrowers with bespoke solutions.
- The “cockroaches” metaphor serves as a useful reminder for renewed discipline.
- The period ahead requires careful credit selection, disciplined underwriting and robust liability and liquidity management.

⁸ Analysis from Robert A. Stanger & Company

⁹ Pitchbook 2025 Annual Global Private Market Fundraising Report

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