Kennedy Capital Management®

Private Credit *Under Pressure:*

Risks and Opportunities Across an Evolving Asset Class

June 2026

Introduction

This paper articulates how Kennedy Capital Management's view of Private Credit has evolved from generalized skepticism in 2023 to active caution today, and what that evolution implies for our positioning — both within Private Credit equities and across the adjacent industries (BDCs, life insurance, banking, consumer lending) that have grown structurally dependent on Private Credit capital.

Our central argument has two parts. **First, the stress now visible in Private Credit is real and, in our view, likely to persist for longer than current valuations imply. Second, that stress looks materially different from the systemic banking failures of 2008 or 2023.** The industry does not exhibit the classic hallmarks of a financial crisis — extreme leverage, deposit-style asset-liability mismatch, or tight interbank interconnections — but it does exhibit a different and important problem: years of deteriorating underwriting have been layered into vehicles that pair illiquid assets with at least the appearance of liquidity. That structural mismatch is what we believe sits at the crux of what is unfolding and shapes our positioning today.

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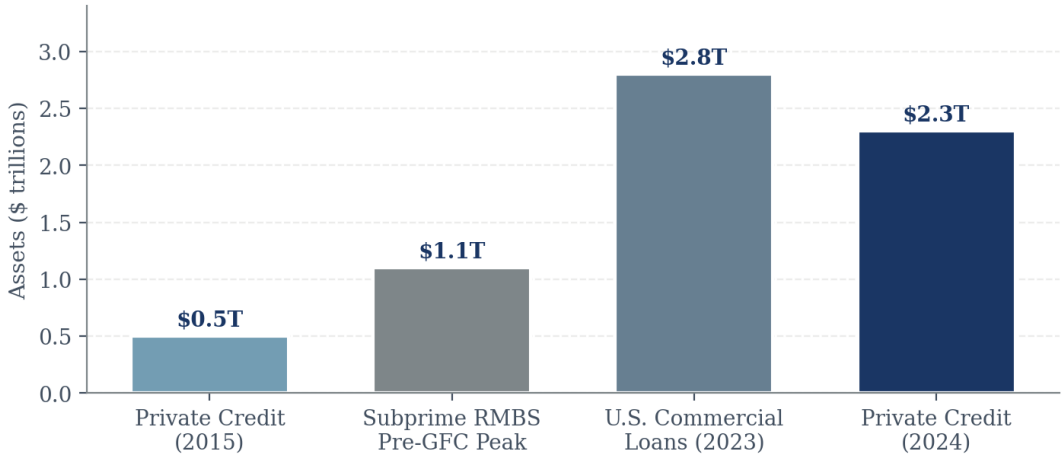
Context: The Industry We Are Evaluating

It doesn't take many cycles for investors to become skeptical of the benefits of "abundance" in capital markets. In simple terms, too much of a good thing usually ends up being a bad thing. The collapse of Silicon Valley Bank (SIVB) in March 2023 reminded us how suddenly the risks created by capital abundance can materialize — in that case, excess deposits from COVID-era stimulus exposed the duration mismanagement of certain institutions, some of which ultimately failed or were absorbed. Three years later, another industry is working through the hangover of that same abundance period: Private Credit.

Private Credit emerged over the last decade as the most effective disruptor to traditional banking. Through differentiated funding and credit structures, the industry has more than quadrupled in size — growing at a 18% CAGR since 2015 to approximately $2.3 trillion in assets at the end of 2024.[1] For context, that is roughly twice the size of the subprime RMBS market at its pre-GFC peak[2] and approaches the $2.8 trillion (2023) of commercial loans currently held on U.S. bank balance sheets.[3]

Private Credit Has Scaled Past the Subprime Peak



Sources: CION Investments; FCIC; Ares Management. Private Credit AUM growth in historical context.

Our skepticism around the sustainability of this trajectory meaningfully increased in June 2025, when Yale University — long considered the pioneer of the illiquid-yield endowment model — announced it would exit roughly one-third of its illiquid portfolio. The reversal of a multi-decade institutional preference was a meaningful signal. In June 2025, listed private-credit managers such as Blue Owl Capital, Inc. (OWL) and Ares Management Corporation (ARES) traded at roughly 20–30x forward cash earnings. An institutional rotation away from illiquidity, paired with valuations that pulled forward aggressive outcomes, prompted us to intensify our research.

To structure the discussion that follows, we evaluate Private Credit across four interlocking fundamentals.

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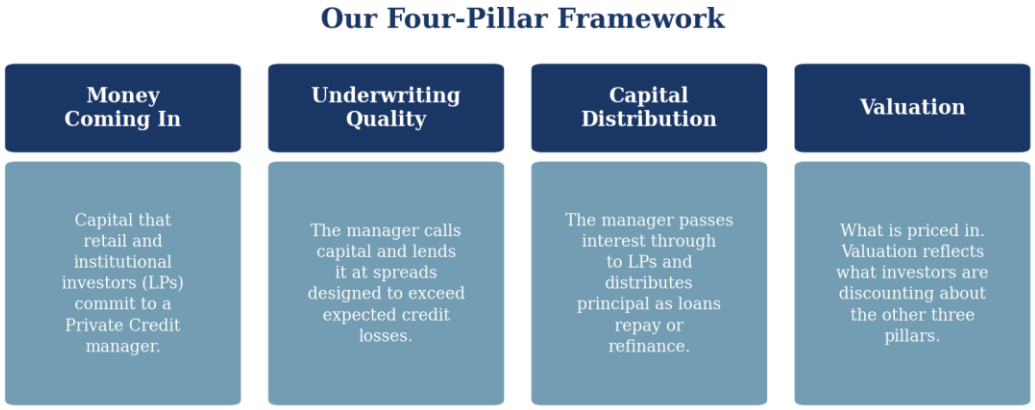
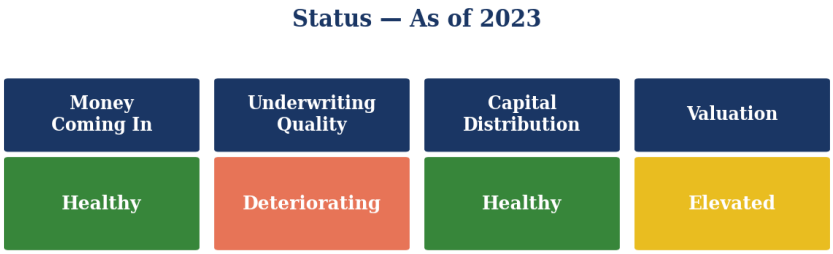


KCM's four-pillar framework for evaluating Private Credit.

The Original Concern (2023): Too Much Money Chasing Deals



Our concerns began in 2023 and were rooted in a simple idea: investors were clearly willing and able to deploy capital into Private Credit, but managers appeared to be redeploying that incremental capital into progressively lower-quality lending opportunities. Even before turning to loan-level data, the dramatic growth in headcount at the names we follow most closely raised flags. Ares increased headcount in its U.S. Direct Lending business by approximately 60% between 2021 and 2024 — pace that is unusual in financial services.[4]

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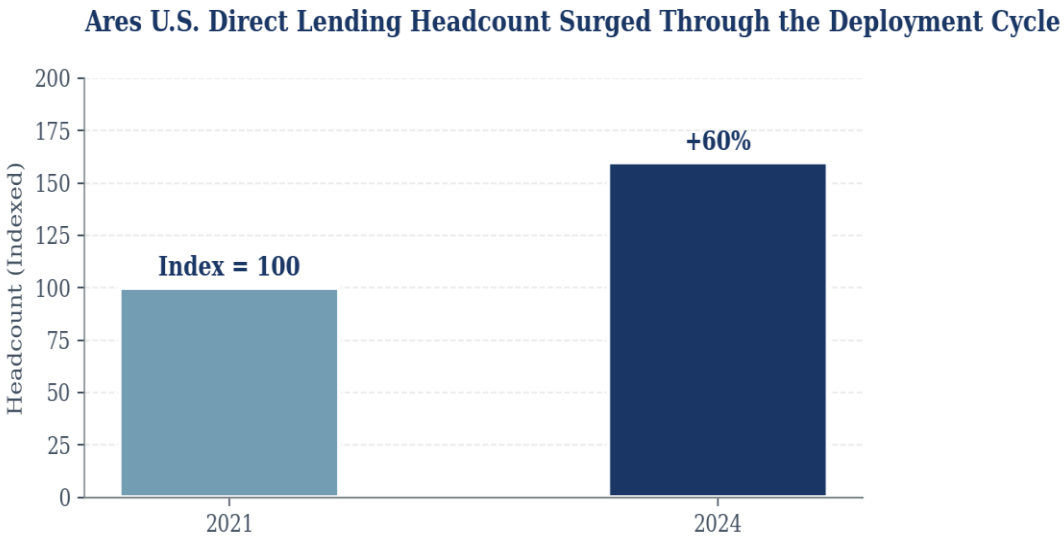
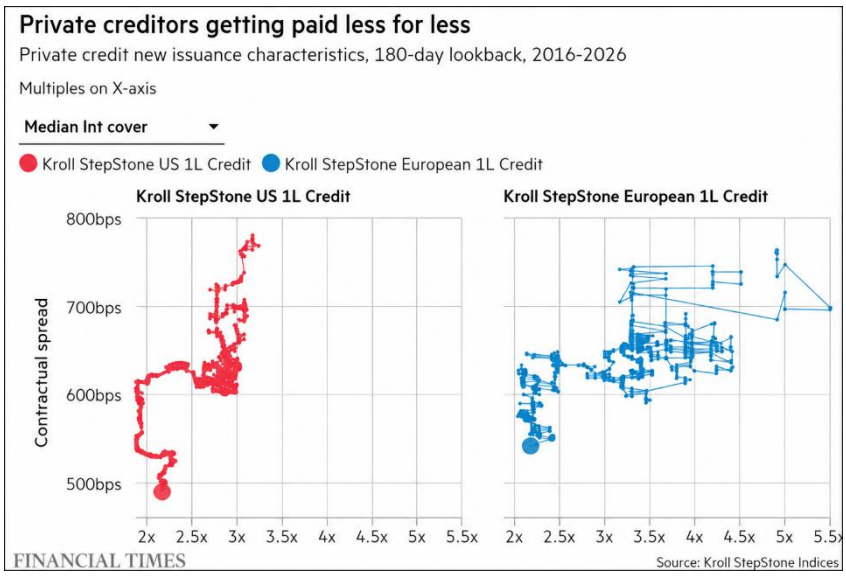


Source: Ares Management 10-K filings (2021, 2024).

In short: money was coming in nicely, but the quality of deployment looked to be deteriorating, all while valuations remained on an upward trajectory.

It did not take long to find supporting evidence, even behind the thick curtain provided by the relative lack of regulation in direct lending. The *Financial Times* recently documented the decline in deployment quality[5]; in its analysis, the data points at the top of the spread distribution coincide with originations in 2016, while those at the bottom coincide with originations in early 2026. The accompanying article observed that not only had overall spreads on new private credit loans hit new lows in the U.S. and Europe, but this relatively skimpy risk premium was being set in the context of median interest cover ratios that are close to decadal lows.



"Not only [are] overall spreads on new private credit loans ... hitting new lows in the U.S. and Europe. But this relatively skimpy risk premium is being set in the context of median interest cover ratios that are close to decadal lows." — Financial Times

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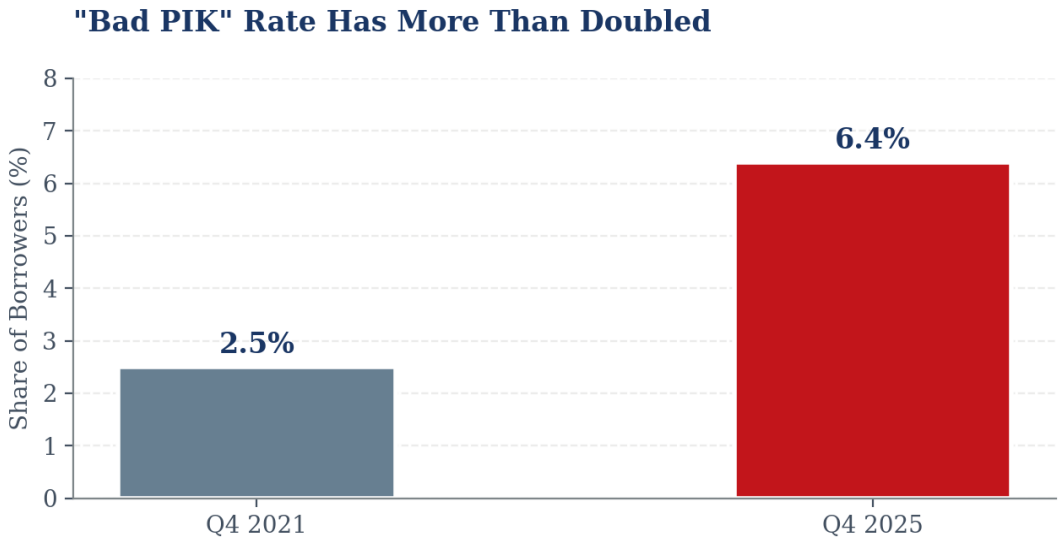
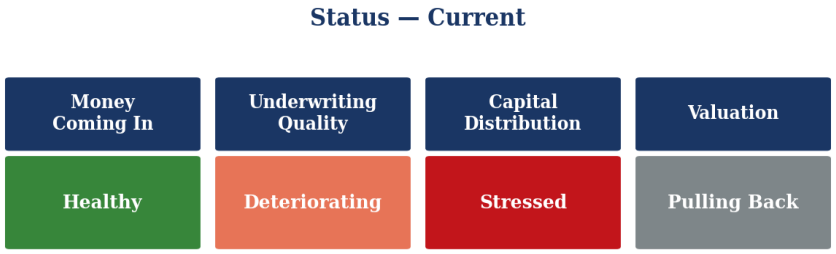
A decline in underwriting quality of this magnitude should eventually translate into higher defaults. Because Private Credit funds are significantly less regulated than banks, measuring credit trends is harder. But the data provider Lincoln International examined 7,000 company valuations across 225 asset managers and reached a concerning conclusion: the "shadow default" or "Bad PIK" rate — the share of companies that took on unexpected additional lending conditions midway through their loan terms — rose from 2.5% in Q4 2021 to 6.4% in Q4 2025.[6–7]



Sources: Fortune (Feb 2026); Bloomberg (Feb 2026).

In banking parlance, those would be "Modified Loans" (formerly Troubled Debt Restructurings) — a category that bank investors treat as a leading indicator of future credit losses.

The Perfect Storm: A Cockroach, the SaaS Apocalypse, and a Structural Reckoning



There is a lot in the name of this section, but it all unfolded over three months.[8] More importantly, those three months did something the prior two years of underwriting commentary could not: they

Please refer to the footnotes on page 12 of this document.

exposed a structural flaw at the heart of how a meaningful share of Private Credit had come to be packaged.

The fall of 2025 produced two of the largest fraud-related defaults in recent memory. TriColor Holdings primarily affected large commercial banks, but FirstBrands Group stayed within Private Credit. Both involved double-pledged collateral and falsified financial documents, raising direct questions about underwriting diligence in the asset class (and, candidly, in the bank-syndicated market as well). Jamie Dimon added fuel to the fire when he remarked that "when you see one cockroach, there are probably more."[9]

"When you see one cockroach, there are probably more."

— Jamie Dimon, October 2025

The market entered 2026 nervous, but with Private Credit equities broadly recovering — until the second shoe dropped. The severe public-market repricing of software businesses, triggered by concerns about AI disruption, prompted a wave of investors with software-heavy illiquid portfolios to seek liquidity. In mid-February, Blue Owl Capital, Inc., overwhelmed by redemption requests, eliminated the redemption mechanism in one of its vehicles entirely and liquidated a portion of the portfolio to honor outstanding requests. The good news: those loans sold at par. The bad news: the market did not care.

This is where the deeper insight emerges. Underwriting deterioration is the well-documented problem; **the structural mismatch is the accelerant.** A growing share of Private Credit capital had been raised through semi-liquid wrappers — interval funds, non-traded BDCs, and similar vehicles — that pair fundamentally illiquid assets with a promised liquidity profile the underlying assets cannot reliably deliver under stress.

As long as redemptions are modest and new money is plentiful, the structure works. When sentiment shifts, the manager is forced to choose between gating, selling assets at potentially unfavorable prices, or both — and each option erodes the next investor's confidence. George Soros's concept of reflexivity, suddenly topical again, applies precisely here: investor concerns about exiting these vehicles drive redemption requests, which drive gates and forced sales, which deepen the concerns.[10]

Please refer to the footnotes on page 12 of this document.

What This Is Not: The Hallmarks of Systemic Crisis Appear Largely Absent

Before drawing forward-looking conclusions, it is worth being explicit about what is *not* happening, because the answer materially shapes how we are positioned.

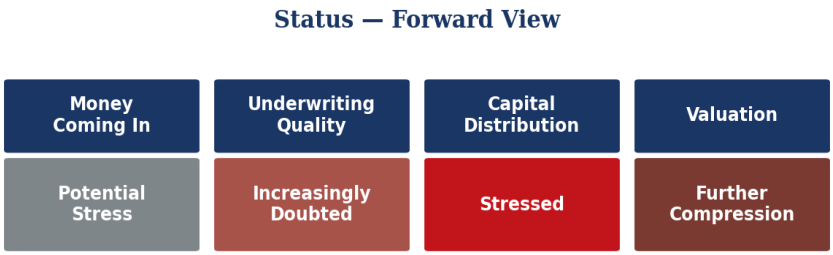
Private Credit today does not exhibit the classic hallmarks of a systemic financial crisis. The funding architecture is fundamentally different from — and in important respects superior to — that of a deposit-funded bank. LP commitments are long-dated and called over time; the institutional vehicles do not offer daily redemption. Even in the semi-liquid wrappers where redemption pressure is most acute, gates and queues are explicit, contractual features of the structure rather than emergency interventions. Had Private Credit's funding side been as fragile as a bank's deposit base, the parallels to 2023 would be far more direct than they have proven to be.

Leverage in the asset class is also moderate by banking standards. Private Credit managers are not running 10:1 or 12:1 asset-to-equity ratios; the leverage that does exist — primarily within BDCs and SMAs — sits at levels that have so far absorbed mark-to-market pressure without forcing widespread distress.

Interconnections, while growing — we address this directly in the section on Collateral Damage — remain meaningfully looser than the interbank exposures that propagated 2008 or the deposit flight that propagated 2023. Private Credit funds do not lend to one another at scale and do not depend on each other for day-to-day funding.

None of this makes the stress benign. But it does shape what the stress is likely to look like: protracted earnings pressure, isolated fund-level failures, slower capital raising, and an asset class forced to mature — **not a 2008-style cascade.** Our cautious investment posture flows from the former, not the latter.

The Future of Private Credit: Our View on the Likely Scenario



A group that not long ago traded at twice the valuation of commercial banks is now experiencing, in a more moderate form, a similar chronology to what banks lived through in 2023. The principal reason it is more moderate is the one identified in the prior section: Private Credit's funding side is structurally more robust.

Our base case is that the factors driving the current wave of redemptions persist for more than a few quarters and create a sustained need for liquidity in direct lending. We have heard the argument that as long as new money keeps coming in, managers can use that liquidity to satisfy redemptions. We see two problems with this view. First, using newly committed capital to honor existing LP redemptions feeds the negative feedback loop and hinders fee-paying AUM growth — and ultimately earnings growth. Second — and in our judgment the more durable driver — capital rarely pours into areas where more seasoned capital is asking to leave. Both effects point in the same direction: downward pressure on fee-paying AUM and earnings.

The bear case would involve forced liquidations at meaningful discounts, exposing which managers had been swimming naked and damaging the asset class's reputation for years. We believe scaled Private Credit managers have enough financial and strategic levers to avoid that outcome.

That said, a lending business with deteriorating underwriting and no earnings growth has a difficult time supporting an 18x forward earnings multiple,[11] so we will continue to take a cautious stance on Private Credit equities.

Interestingly, it is in the publicly-traded BDC space where valuations are beginning to reflect something closer to the bear case. Blue Owl Capital, Inc. liquidated portfolio loans at par, but the broader BDC group trades at approximately 80% of NAV[12] — historically an attractive entry point for equity investors.

Please refer to the footnotes on page 12 of this document.

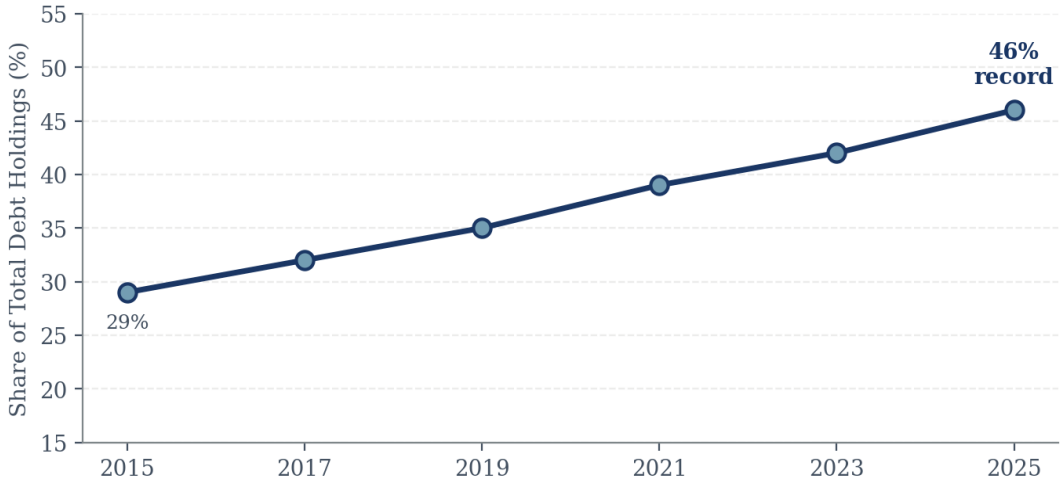
The Collateral Damage: A Potential Shift in Capital Supply

We have discussed the struggles of an industry spanning more than $2.3 trillion in assets and one that is, by design, interconnected with other parts of the economy. Private Credit has become a significant source of capital for businesses across multiple sectors. Within the financial ecosystem alone, Private Credit funds banks and consumer lenders (by buying loans they originate), investment banking and Private Equity (by financing M&A), and — especially — life insurers and annuity providers (which monetize illiquidity premia in their long-duration liability matching).

The full set of linkages deserves a deeper examination than we can offer here. For our purposes, it suffices to say that if Private Credit attracts and deploys less capital going forward, the earnings profile of many businesses in the categories above will, at a minimum, come under pressure. This is a risk that we evaluate critically and factor into our investment decisions.

Life insurance is the clearest example. A.M. Best estimates that life and annuity insurers held a record 46% of their total debt holdings in private credit in 2025.[13]

Life Insurers Are Increasingly Reliant on Private Credit



Source: A.M. Best

The level of interconnection has also increased meaningfully: approximately one-fifth of investments at Athene's U.S. Life Group (owned by Apollo) and at Global Atlantic (owned by KKR) now come from affiliates.[14] That dynamic increases complexity, reduces transparency, and could perpetuate the negative perception now emerging. When Blue Owl Capital, Inc. came under pressure to return cash to investors in one of its funds, it found a buyer for some of its loans in its insurance affiliate Kuvare, according to people familiar with the deals.

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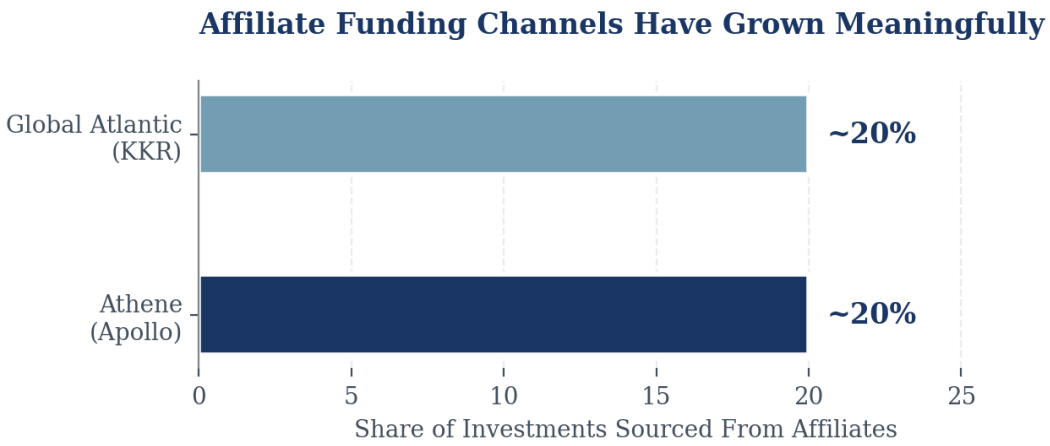

Sources: Financial Times; company filings; KCM analysis.

Conclusion

Stanley Druckenmiller recently observed that "you have to use the volatility as opposed to being abused by the volatility." We work to make sense of the volatility across the market in order to position our clients' capital as effectively as possible.

This paper has tried to demonstrate two things: a dynamic understanding of what has happened and is currently happening in Private Credit, and a framework for thinking about the consequent effects on adjacent — and even seemingly removed — areas of the market. We have spoken, and will continue to speak, with management teams across consumer lending, banking, life insurance, and wealth management to deepen our understanding and be ready to act decisively when valuations offer favorable risk/reward profiles.

> *"You have to use the volatility as opposed to being abused by the volatility."*
>
> *— Stanley Druckenmiller*

Important Disclosures

1) CION Investments, "With Direct Lending, Deal Selection Is Where It's At": https://cioninvestments.com/insights/with-direct-lending-deal-selection-is-where-its-at/

2) Roubini & Parisi-Carbone, FCIC archive: https://fcic-static.law.stanford.edu/cdn_media/fcic-docs/2009-01-00%20Roubini%20and%20Parisi-Carbone.pdf

3) Ares Management, "Understanding Private Credit 2024": https://aresmgmt.com/sites/default/files/2024-04/Understanding-Private-Credit-2024.pdf

4) Ares Management 10-K filings: 2024 (https://www.sec.gov/ix?doc=/Archives/edgar/data/1176948/000162828025008665/ares-20241231.htm) and 2021 (https://www.sec.gov/ix?doc=/Archives/edgar/data/1176948/000162828022004289/ares-20211231.htm).

5) Financial Times: https://www.ft.com/content/d49d4ab5-dfcc-4f46-9ae7-2df231c1b421

6) Fortune, February 2026: https://fortune.com/2026/02/22/private-credit-market-shadow-default-rate-deals/

7) Bloomberg, "Bad PIK Is Climbing Again", February 2026: https://archive.ph/20260211193251/https://www.bloomberg.com/news/articles/2026-02-11/-bad-pik-is-climbing-again-as-private-lenders-scrutinize-books

8) Truist Securities, "Private Credit – FinTech" by Matt Coad

9) CNN: https://www.cnn.com/2025/10/16/business/jamie-dimon-us-economy-cockroaches

10) George Soros, The Alchemy of Finance (1987). KCM analysis.

11) Goldman Sachs – Research, "The way forward for ALT Managers: Reframing growth and valuation"

12) Raymond James, "Business Development Company Weekly"

13) A.M. Best via The Wall Street Journal: https://www.wsj.com/livecoverage/stock-market-today-dow-sp-500-nasdaq-03-05-2026/card/life-insurers-hold-more-private-credit-than-ever-4YmcDCl9craWUTGHB1Ut

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