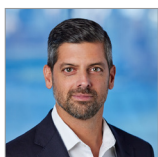




The Investment Conversation: Prospects for Private Credit in 2026



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In this podcast, Lord Abbett Portfolio Manager Steve Kuppenheimer discusses the landscape for private credit and direct lending in 2026.

ANDY D'SOUZA: Welcome back to *The Investment Conversation*. I'm Andy D'Souza, partner and chief marketing officer here at Lord Abbett. As part of our 2026 Investment Outlook, we're going to talk with our investment leaders about key themes for the markets in the coming year across equities, municipal bonds, taxable fixed income, and private credit.

Today I'm speaking with Lord Abbett's head of private credit, Steve Kuppenheimer, who's also a partner at the firm. Steve, glad to have you here.

STEVE KUPPENHEIMER: Happy to be here, Andy, thanks for having me.

D'SOUZA: Awesome. Last time you and I spoke about this was in June.

KUPPENHEIMER: Yeah.

D'SOUZA: Here in the studio. A lot's happened since June. A lot.

KUPPENHEIMER: We're on video now which is different.

D'SOUZA: And now we're on video, which is even better, so now they can see us in the flesh. So, let's talk about private credit, Steve. The market's continuing to evolve, and to grow, and expand. Even if it's just from a fundraising perspective we saw another almost \$90 billion in assets raised in sort of semi-liquid evergreen funds in the first half of the year.

But a little over half of that actually went into private debt strategies. So, the market was growing strongly into the first half of the year. It's continued since then, it looks like, but in your mind, what's changed, maybe, in the landscape overall in private credit in the last, let's say, six months?

KUPPENHEIMER: You started with fundraising so maybe I'll speak to that. I do think there's going to continue to be tailwinds to fundraising in private credit, as I know we'll talk

about some later. The benefits of private credit and especially high net worth portfolios, I think, are well understood now, and it's gone from being the focus of just a small percentage of financial advisors and investors to now a growing percentage.

And I do think that leads to really a multi-year if not decade-long tailwind to fundraising. As private credit [has been shown to] deliver a lot of stability, a lot of current income, that fit well for that exact client base. And at the same time the institutional space, which has been the historic strength of private credit, continues to benefit from it and allocate to it as well.

So those flows don't surprise me, and I do expect they'll continue some, although if I were to elaborate on your question and what else has changed since June, I do think there's more concern about credit in the markets. There's been a lot written and spoken about, some high profile defaults which interestingly weren't really private credit deals, but still kind of raised the question about "Are there chinks in the armor?"

And so, I know we'll talk about the substance of that question, but for a moment just the fact that that concern exists maybe more today than six months ago is one of the things I would note. Because I think one of the things that's defining the current market compared to six months ago is that there's a number of dynamics that I consider spread-widening; meaning conditions in the market that you think would result in more return being paid on the loans, and yet spreads are tightening, and I think they are continuing to tighten.

And I that's a very interesting dynamic. So, in terms of things that I think contribute to spread-widening would be the concerns in the market about defaults, it would also be supply has increased in terms of deal volumes. M&A [merger and acquisition] activity has come back strong.



I don't think we've fully unwound the slowdown, but deal activity is certainly up materially quarter over-quarter. Increased supply, that should also be spread widening. And then to continue on that, you also have interest rates getting cut.

So central government [banks] cutting base rates, that tends to have outward pressure on spreads also, for two reasons. One, lower base rates mean lower yield overall. And sometimes what you'll see is spreads make up for that. They don't fully retrace a rate cut, but they may kind of have some gravity around a gross yield.

And then finally is the reason for the rate cuts. The reason for the rate cuts will usually be more muted economic activity, which by itself is a spread-widening event. So, you have all of these spread-widening pressures, and yet the other thing I'd tell you, Andy, is since June spreads have continued to grind in some.

Not a huge amount, but the fact that they're tighter at all given the pressures in the market I think is notable. And my view of that is that private markets are just slow to turn around. So it takes a little bit of pressure build up. It's almost like turning a battleship in a river, it takes a few miles to do it. So, we do think these spread-widening pressures will continue into next year and it's already having an impact on how deals are getting negotiated, not on spread, but I think you'll see spread follow next year.

D'SOUZA: Got it. You mentioned a couple of the headline defaults that are out there, or concerns in the press, and we've heard some high-profile names as you referenced, and Tricolor or First Brands, and some of the stuff maybe, allegedly out there--fraud, and things of that nature, maybe more idiosyncratic. And then of course you have some headlines from some other [investment industry] leaders saying things like, "When you see one cockroach [i.e., negative credit event] you're probably going to see some more."

KUPPENHEIMER: Yeah.

D'SOUZA: Where do you come down on that?

KUPPENHEIMER: So, I think both points of view are valid. We do get this question a lot and it seems to be posed as, "Do you think those are idiosyncratic or do you think that they're indicative of more defaults?" And I actually think that they are both.

And what I mean by that is certainly if you look at a company like First Brands where you had a very interesting CEO who had changed his name, and gone through pretty big lengths to remove himself from the Internet, and you had a very unique financing approach with factoring going every month and not being really known in the liquid markets, that all feels like a very specific story.

At the same time the fact that that loan got done in the market should tell all of us something about maybe a market that's moving a little bit too fast, maybe a market that's moving with a little bit less discipline, and that can be indicative of further defaults.

I would note a couple of themes with Tricolor and First Brands in that they both were really not private credit [deals]. They were syndicated bank loans, and I think some of the speakers of the market identified that. But I still wouldn't completely distinguish them on that basis because of what I just mentioned.

I do think, and we talked about this in June I think also, because

there's been a lot of capital raised over the last several years it's resulted in a bit of impatience that I do think leads to a lack of discipline and could sow the seeds of some other defaults.

So I think in a market like this we tend to think it's an attractive market. Because if you're a really disciplined investor you tend to believe in the book that you have. And we talked about some of the reasons why we think that's distinguished previously. And then as you come into a time where there's a little bit of concern in the market, a little bit in increased defaults, that really should lead to really strong investment opportunities. So actually, let me pause there.

D'SOUZA: Another question for you, Steve, regarding headlines that you see these days. A lot of these publicly traded BDCs [business development companies] are trading at pretty sharp discounts to NAV [net asset value]. Why is that, and then do you think this is something that's going to be here for a while, is it persistent? Is it something that's an overreaction to the marketplace? Or what are your thoughts on that?

KUPPENHEIMER: So first of all, BDCs traditionally were all raised to be publicly listed companies and have a public stock. It was really not until 2020-21 when the first perpetually private BDC came out. And one of the reasons I mention that is when you look at the stock market for BDCs, the actual traded equities, they do show a good amount of volatility.

That's one of the reasons perpetually private BDCs became popular -- investors are always coming out at net asset value, and that's determined by third parties, and so that has a more stable kind of feel to it. So, when I look at the market today and you've seen over the last 12 months, to your point, a number of publicly traded BDCs whose stock prices are not trading in relation to NAV as much anymore.

It's kind of lost that gravity. And last year they might have been a little bit above NAV, and this year they're notably below NAV. I think there's a few things that lead to that. So, one, some of the credit concerns we mentioned before certainly lead to that.

Two, most publicly traded BDCs have limited float meaning there's not that much stock available. So, a little bit of trading momentum tends to have a magnified impact on price. And then finally I think there are some concerns about those structures maintaining dividend yields.

They do tend to have much higher fees than the private BDCs, and that actually is relevant. That's not just "fees shouldn't be high for principle," reasons. But when you're in a fixed income dividend strategy if your fees are 1% or 2% higher that's coming right out of your dividend. Whereas the private BDCs have notably lower fees and are more able to keep up with their dividend yield.

D'SOUZA: Also, you mentioned this at the beginning of the conversation, and you also spoke about this back in June, and that was the effect that you thought the tailwind you think a pickup in M&A activity might have on the space. So how has that played out so far, and how do you see that going forward?

KUPPENHEIMER: So, we are seeing that start to fall out this quarter. I think [M&A deal] pipelines across the board are up pretty



materially. I think that for private equity firms, a number of things have come together. So, one, what caused M&A activity to drop, if we start with that, was really a disagreement of buyers and sellers of companies over value.

And that disagreement was due to rates going up very high, because that increases the discount rate, which decreases the present value of a company. So now you're seeing the market, one rates are coming down some.

Two, the market is agreeing more on where rates are going, and that agreement then leads to more buyers and sellers agreeing on price. And then secondly a lot of owners of companies in the form of private equity firms--they have been under historic pressure to create realizations.

Their average hold time has gone from three and a half years to almost seven years. Their LPs [limited partners who participated in the deal] are tired and kind of want their money back. And so, you have this combination of rates, let's say normalizing in the market, investor demand to get a return of capital, and that is causing an increase in M&A activity that we can see in our pipeline today.

And I think most market participants can. So, I think as this plays out, I don't think that has changed in a major way yet. I think we're starting to see the beginnings of that. So, I think deal activity will continue to increase into 2026 and, I think, present a good target environment for lenders.

D'SOUZA: And as we go back and forth from headwinds to tailwinds in the marketplace for direct lending and for private credit, M&A being seen here as now much more of a tailwind as you mentioned back in June, and you see that going forward. Going back to not necessarily defaults per se exactly, but just to talk again about PIK interest, right, payment-in-kind. And that's still out there, it's still being talked about quite a bit. What are your thoughts looking forward to 2026? Is this a major concern that you have in the marketplace?

KUPPENHEIMER: So, I do think that PIK interest is a very interesting concept because like some of the other things we discuss when we're together, this is another concept that didn't exist in the historic business. So historically in direct lending or private credit, loans didn't really have the ability to defer interest payments.

And that's become more normal now in recent years. It does tend to be isolated, or maybe more limited, by vintage, and by part of the market. So, it tends to be a feature in the larger private transactions that are pitching against capital markets solutions.

And it also tends to have really come into play in a lot of the deals originated kind of in 2020-21 on the back end of COVID when rates were very low, and there was a significant amount of capital coming into the space. So, it does concern us.

We certainly try to avoid it, and I think in more middle-market lending it's far less common. One of the helpful things with the PIK loans is that it's a bit of a leading indicator of stress. So, if you see loans "PIK-ing," if you see a given portfolio with more PIK than others, that's probably a fair correlation to eventual stress in the portfolio.

D'SOUZA: Gotcha. Speaking about asset raising in this space and investors coming into the asset class more and more, how is that evolving in your mind? In other words, it's been historically more institutional [focused]. It's coming into the retail and well channels much more these days it feels like, and even offshore. I know recently you were in Hong Kong and Singapore.

KUPPENHEIMER: Yes.

D'SOUZA: And I want to get some of your thoughts on how you see the investor base evolving in this space.

KUPPENHEIMER: So, we touched on this some in the earlier part of the conversation, but I do think it is growing. So, you have the historic institutional investors, insurance companies, pensions, endowments, credit-focused asset managers, that I think have had a very good, stable performance in the asset class.

And I think they will continue to allocate. And at the same time, you've had fairly recent history in wealth channels, but very successful history as you know. And I think that that will continue as well, continues to be a diversifier. So, I think you're going to continue to see the product grow across markets.

I think we've spoken before about if you go back to 2015 and you look until today the leveraged finance markets have tripled in size, just if you look at leverage finance overall. But if you look at the private part of that, the private credit part of leverage finance, it's gone up six times.

And that tells you one, there's investor demand, and growing investor demand. But also, borrowers are consistently using private solutions more as well, which is a theme I think across markets. You're seeing fewer companies being publicly listed. You're seeing more investment grade companies issue private debt for the first time.

But the original business, which is sub-investment grade corporate borrowers, continues to take market share from more traditional markets. And I think that also you're seeing the mirror of that on the investor side. I think broader adoption. So, it's not about accessing a new market. I think it's been in institutional, it's been in retail high net worth, but I think you're seeing it expand and get deeper in those markets.

D'SOUZA: Gotcha. We had a recent podcast with your colleague Vince Lu.

KUPPENHEIMER: Yes.

D'SOUZA: I want to read you a quote that Vince said and get your response to it, okay.

KUPPENHEIMER: Yes.

D'SOUZA: So, Vince said to us there's "an influx of capital is making the private credit market much more competitive." And so, you just referenced this a little bit, but there's always, again, the discussions around, "Is it getting crowded? Is there more supply and more demand? Is it kind of matching itself, and it's not a concern?" But I want to get your thoughts on that.

KUPPENHEIMER: I think you have to say it's definitely a concern. And I definitely agree with Vince that it's getting more competitive. I



would take a deeper cut a bit, and if you look at the different parts of the private credit market, how supply is growing with demand, and look at the fundraising that's happening is not uniform.

So, let's unpack each of those. If I start with fundraising, a notable percentage of the capital that's been raised over the last call it five years has not been evenly dispersed across managers. And I think the largest few have spoken for the vast majority of that capital.

And so, what that has resulted in is that development changes their game a bit. If they originally were really middle market focused, they probably are now up market just due to scale, and so that kind of removes their focus from middle market and markets that maybe a little bit more open.

As I referenced in the previous question, it's not more dollars chasing the same number of assets. You're seeing the amount of assets also increase. As I mentioned, private markets are up 6X since 2015 in terms of size. So yes, the capital makes it more competitive. I think that's hard to disagree with. At the same time the market is growing and evolving really as we speak.

D'SOUZA: And as you talk about the size, and some folks maybe moving up-cap in the marketplace, give me an example of maybe a large player now, just where they would be in terms of a typical EBITDA [earnings before interest, taxes, and depreciation & amortization]. What would be the average EBITDA in some of these portfolios versus where maybe a new, fresh, mid-market manager would be coming in?

KUPPENHEIMER: You have very different ecosystems, to your point, across the private lending market. So, to answer your question directly I think you can see in public filings the largest managers are targeting companies with over \$200 million of EBITDA, sometimes getting north of \$300 million of EBITDA.

And that's on average. There are companies far larger than that that are executing on a private basis and that has different risks and rewards, that has different pros and cons, than you might have another portfolio that's focused on companies that are \$10 million of EBITDA or below.

Very different type of company and risk-return there, and a very different type of liquidity. And then you happen very core middle market [companies], which is kind of between those two, call it \$20 million to \$100 million of EBITDA. And these are all subject to different pressures, have different strengths and weaknesses.

We tend to like companies in the core middle market because these are companies that aren't big enough where you're competing with the broader capital markets to finance them, which has really been the core tenet of private credit for decades.

At the same time if we are doing our jobs and we make a loan today to a \$70 million EBITDA company and they're growing and doing well, then they may literally outgrow our capital in a few years. And that's another way we think about liquidity, another way we think about credit performance, is the company's ability to pay us back early, and that allows us to redeploy.

D'SOUZA: As you look going into next year, within that core middle market space, are there industry segments or company

profiles that you look for, and see opportunities in this kind of market environment?

KUPPENHEIMER: So first of all, absolutely, and maybe I'll go back for a second to First Brands and Tricolor, where interestingly these are both kind of auto-focused companies. First Brands is a parts supplier, Tricolor really financing subprime auto loans.

And auto in general is a highly cyclical industry. So, one of the reasons I think some people in the space in commenting on the "cockroach" comment had pointed out, those are liquid loans, is that the private markets do tend other focus on less cyclical industries.

So you'll see things like professional services, health care, parts of technology, where either the cyclicalities really muted, they might be counter-cyclical, let's say like an insurance brokerage, or they might have very, very strong tailwinds, like parts of tech or health care.

And so going into a market like this, one, I think you can tell from my earlier comments, we welcome it. I do think that a little bit more concern about credit is what this market has needed. It should lead to some spread-widening, although I think it'll take a little bit.

But I think you're already starting to see some discipline in the market. So even though spreads haven't widened out just yet, you are seeing more discipline around covenants, around leverage, around the documents in general. And that's kind of the first sign of a little bit of a tighter credit market.

D'SOUZA: And again, in the core middle market space where you guys are focusing a lot of your attention and time, how do you think about origination and sourcing? Is there anything that's changed in that part of the environment in terms of how you're finding the risk out there?

KUPPENHEIMER: Not a huge amount, Andy. I think the traditional way you source these deals is through direct sponsor coverage, or in other words, relationships with private equity firms that own middle market companies. And that's still the core of what we do.

I do think a couple things have changed, let's say, over the last five years or so where number one, most of the private equity firms now have capital markets teams. So, they didn't really used to [have them] ... their deal team would syndicate the debt as well, and it's usually one of twenty things they had to do to close the deal.

So, it wouldn't be as much of a focus. Now they have capital markets teams that are very thoughtful about who they go to in order to borrow money from, putting together small syndicates so they're not beholden to one lender, and have more awareness about what terms are going on.

So that's a little bit of a difference where you can now cover private equity firms maybe more easily through capital markets teams that they have. It makes it a little more competitive as well, but I think overall it has brought some more transparency into the space.

Secondly you are seeing more kind of let's call it origination partnerships or relationships where you might have a given firm that



has a unique or differentiated source of risk but doesn't have the balance sheet to take it. There could be very interesting ways to partner with firms like that, where you can provide them with a larger checkbook, more of a risk appetite to service their clients, and they get to keep the client relationship. And as you know we've executed on a couple of those pretty successfully, and I think you're going to continue to see those as a bit of the theme in the market.

D'SOUZA: Got it. And what about the actual structures of the deals themselves. Is anything evolving there, and do you see anything changing going forward in terms of how the deals are structured?

KUPPENHEIMER: So, there's been so much that's changed over the last five years. I know we're supposed to talk about the last six months so maybe I'll try to focus it on that a bit. But I will say some of these concepts like PIK, or portability, which is the inability to get repaid if a company's sold.

It means your debt just goes to the next buyer. Or a lot of the things we talked about on our last podcast, about liability management exercises, or LME, or lender-on-lender violence, these are all newer types of forces in the industry.

Really, again, I think a child of the confluence of that larger end of the market where you have large private credit deals competing with the liquid markets. They need to give more in structure to win that deal. I do think over the last six months, now getting to more recent times, you are seeing some more discipline around that.

I think especially on the LME side where you go back a year and a half, two years, and those are really viewed as negative surprises. People didn't have any clue that their loan could be reinterpreted the way it was interpreted. And so, you went through a period of that being kind of a shock to the market on the larger end.

Now there's more awareness around LME and I think the documents are getting more routinized, and I think to the benefit of lenders. I think you're seeing intentional provisions putting in limiting LME, and the market seems to be settling out more on that.

Now that's for new loans. That does not change the fact that you still have a lot of loans that were originated in the 18 months post-COVID where the documents weren't aware of this type of stuff, and those will take a bit of time to work through the system, and I think will be a bit of a theme next year. You might see some additional LMEs from that vintage.

D'SOUZA: So vintage matters?

KUPPENHEIMER: Vintage matters, I think, a great deal. I think you'll hear that from credit investors generally. I think in the private markets it matters even more because we don't really look to sell our loans to get out of the way of stress, right? Our credit work is very focused on the front end, getting it right, and making a multi-year commitment.

You're really living with that loan. If you find yourself selling it and it's a private loan, that's probably not the best outcome. So, in an illiquid market like that, the environment in which you originate the loan does matter. Because in that 18-month period post COVID, base rates were 25 basis points, so companies were being underwritten to afford less dollar amount of interest. Those same companies under those same documents now, SOFR [the benchmark secured overnight finance rate] is now at 380 basis points, it peaked at 525, that's a lot more dollar of interest that those companies have to afford.

D'SOUZA: And then I guess in general, anything we haven't touched on today that you're thinking about going into the New Year here?

KUPPENHEIMER: So not too deeply, Andy, but I would say I do think you're seeing the market thaw out a bit as we mentioned. And how that's going to interplay with these different ecosystems of private credit, some of the newer vehicles, I think it's a really interesting time.

So as deal flow comes back on, and as there remains to be some concerns about credit, I think you're going to see more and more differentiation in the portfolios. We haven't had a true credit cycle in some time. And as defaults heighten, I do think portfolios will behave very differently. And they should. In a private strategy the portfolios should really be more different from each other, and I think that'll play out.

D'SOUZA: Steve, thanks again.

KUPPENHEIMER: Thanks for having me, Andy. It was a pleasure.

D'SOUZA: This has been *The Investment Conversation*. Be sure to visit LordAbbett.com to find our complete 2026 investment outlook along with other market and economic insights. Thank you all for listening.



GLOSSARY OF TERMS USED IN THIS BROADCAST

Asset-based lending is the business of loaning money in an agreement that is secured by collateral. An asset-based loan or line of credit may be secured by inventory, accounts receivable, equipment, or other property owned by the borrower.

A **basis point** is equal to one one-hundredth of a percentage point.

Base rate: Variable interest rates fluctuate in line with a base rate which, typically, shifts in reaction to market factors.

Broadly syndicated loans are floating-rate loans made to corporate borrowers with generally greater than \$50 million in EBITDA and in most cases, at least \$100 million. They are senior in the capital structure and have a first claim on the assets of the borrower.

Capital structure refers to the layers of debt and equity capital used by companies to finance operations. Within the capital structure, segments called tranches represent different risk classes that are available to investors.

Debt covenants are restrictions that lenders (creditors, debt holders, investors) put on lending agreements to limit the actions of the borrower (debtor).

Direct lending is a private debt strategy where non-bank lenders provide loans directly to private companies, bypassing traditional intermediaries like banks. These loans are typically senior secured, privately negotiated, and often backed by covenants that can protect the interests of a lender.

EBITDA refers to a company's earnings before interest, taxes, depreciation, and amortization.

Evergreen funds are perpetual investment vehicles in private markets. They allow investors to buy and sell periodically under certain conditions, offering more flexibility than traditional private equity funds. Investors contribute capital, which is then invested in private companies or assets. Profits from these investments are either distributed to exiting investors or reinvested.

Middle market lending: The middle market segment is typically considered to be credit for firms larger than small businesses but too small for large-scale commercial lending or syndicated credit.

Payment-in-kind (PIK) bonds are a type of debt instrument where the interest payments are made in the form of additional bonds rather than cash. This allows the issuer to defer cash interest payments, which can be attractive for companies in a cash-constrained situation.

Private credit refers to loans and debt financing provided by non-bank lenders to businesses, typically outside of public markets.

Risk-adjusted return measures how much risk is associated with producing a certain investment return.

The **Secured Overnight Financing Rate (SOFR)** is a broad measure of the cost of borrowing cash overnight collateralized by U.S. Treasury securities.

Securitized products broadly refer to pools of financial assets that are brought together to create a new security, which is then divided and sold to investors. The value and cash flows of the new asset are based on its underlying securities.

Spread is the percentage difference in current yields of various classes of fixed-income securities versus Treasury bonds or another benchmark bond measure. A bond spread is often expressed as a difference in percentage points or basis points (which equal one one-hundredth of a percentage point). The option-adjusted spread (OAS) is the measurement of the spread of a fixed-income security rate and the risk-free rate of return, which is adjusted to take into account an embedded option. Typically, an analyst uses the Treasury securities yield for the risk-free rate.

Underwriting is the process by which the lender decides whether an applicant is creditworthy and should receive a loan.

Vintage refers to the year in which a loan or investment is originated.

Yield is the income returned on an investment, such as the interest received from holding a security. The yield is usually expressed as an annual percentage rate based on the investment's cost, current market value, or face value. The gross yield of an investment is its profit before taxes and expenses are deducted.

Yield curve is a line that plots the interest rates, at a set point in time, of bonds having equal credit quality, but differing maturity dates. One such comparison involves the two-year and 10-year U.S. Treasury debt. This yield curve is used as a benchmark for other debt in the market, such as mortgage rates or bank lending rates. The curve is also used to predict changes in economic output and growth.

References to long-term performance of the private credit market are based on the Cliffwater Direct Lending Index, which seeks to measure the unlevered, gross of fees performance of U.S. middle market corporate loans, as represented by the underlying assets of Business Development Companies ("BDCs"), including both exchange-traded and unlisted BDCs, subject to certain eligibility requirements. The CDLI is an asset-weighted index that is calculated on a quarterly basis using financial statements and other information contained in the U.S. Securities and Exchange Commission ("SEC") filings of all eligible BDCs.

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Source for private credit and leveraged finance market data size and composition: PitchBook, as of December 31, 2024.

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