PRIVATE DEBT

Reset May Enhance Long-Term Risk-Adjusted Returns

This report is excerpted from the Third Quarter 2026 Fixed-Income Sector Views.

Disciplined lenders will be well positioned to capitalize on the recent direct lending reset.

Direct lending activity slowed to a nearly three-year low in the second quarter as market volatility, geopolitical uncertainty, and retail outflows curbed sponsor deal flow and buyout financing. The backdrop is nonetheless producing a healthier lending environment: spreads have widened 25–50 basis points, leverage is showing signs of pulling back, and documentation standards are improving across the market. This reset may be constructive over the mid- to longer term for investors seeking stronger risk-adjusted returns.

Sector Commentary

- Direct lenders provided an estimated $45.2 billion of new loans in the three months to May 31, the weakest since the second quarter of 2023 and down 40 percent from the first quarter this year. Deal count fell to 184 transactions, a 16 percent quarterly decline.
- Sponsor-backed activity followed suit, with volume of $28.9 billion and 102 transactions, both multiyear lows. Year to date, sponsor volume is down 25 percent and deal count down 16 percent.
- Buyout financing was hardest hit, falling to $15.6 billion from $23 billion in the first quarter, as AI-driven concerns weighed on software valuations and non-traded business development company redemptions rose.
- New origination spreads have moved out 25–50 basis points, with recent LBOs averaging Secured Overnight Financing Rate (SOFR)+490 basis points vs. SOFR+474 basis points in the first quarter, alongside modestly higher original issue discount debt.

Investment Themes

- Newly originated senior paper may provide stronger pricing compared to similar deals originated in late 2024 and 2025, as spread widening, lower leverage, and tighter documentation may help to improve the risk-adjusted return.
- We are seeing borrowers in the healthcare sector take volume from software deals, earning the top spot in institutional issuance for the first time since 2015. These deals have the scale and cash flow characteristics well-suited to direct lending structures.
- The market is trimming software exposure and demanding tighter terms on remaining names, given AI-disruption concerns, softer broadly syndicated loan sponsorship, and scarcer refinancing options for weaker credits.

By Joe McCurdy and Mark Pridmore

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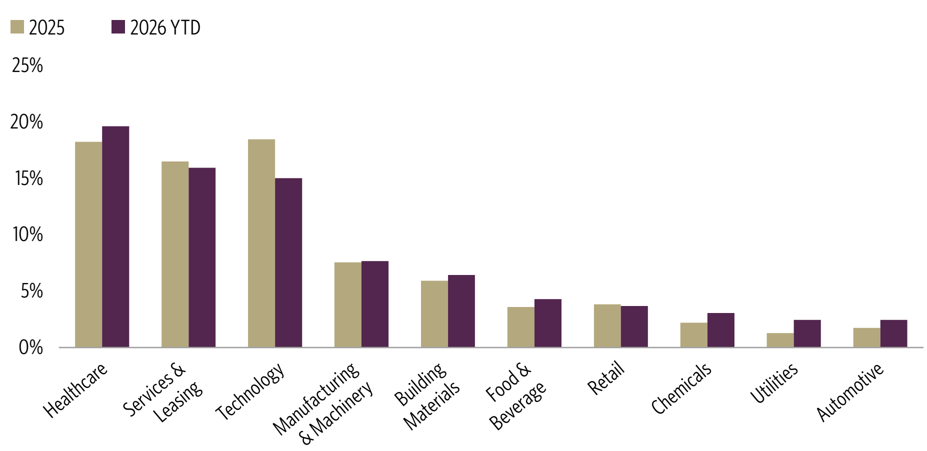
Pullback in Direct Lending Software Issuance



Source: Guggenheim Investments, LCD Pitchbook. Data as of 5.31.2026.

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One **basis point** is equal to 0.01%.

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