

Improved Technical Backdrop

This report is excerpted from the [Fourth Quarter 2026 Fixed-Income Sector Views](#).

Fourth-quarter direct lending rewards structure and manager selection.

The current direct lending environment rewards sound deal structures and thoughtful manager selection. Retail redemption pressure and reduced business development company (BDC) deployment widened senior paper spreads by as much as 50–100 basis points. Existing credit is softening in parallel, with defaults at series highs but overwhelmingly expressed through amendments and unstructured payment in kind (PIK), rather than payment defaults. The technical backdrop is more favorable than last year, though returns will likely be driven by structure and manager selection rather than market beta.

Sector Commentary

- New-issue unitranche is pricing near Secured Overnight Financing Rate (SOFR)+525 basis points on average after widening 50–100 basis points since January, with software spreads ranging from SOFR+550 basis points to SOFR+1,000 basis points. The base rate has turned higher after the Fed's September rate hike, pushing all-in direct lending yields back toward double digits.
- The widening is a capital-supply event, not a credit event. Gross fundings at the 12 largest BDCs fell to \$5.7 billion in the first quarter of 2026 from \$9 billion in the fourth quarter of 2025, as non-traded vehicles absorbed accelerating redemptions and listed BDCs favored stock buybacks over new originations.
- Deal supply, not dry powder, is now the binding constraint. U.S. sponsors deployed \$545.1 billion across only 3,926 deals in the first half of 2026, with exits running near a third of the 2025 count. A reopened exit channel is the swing factor that could compress spreads again.

Investment Themes

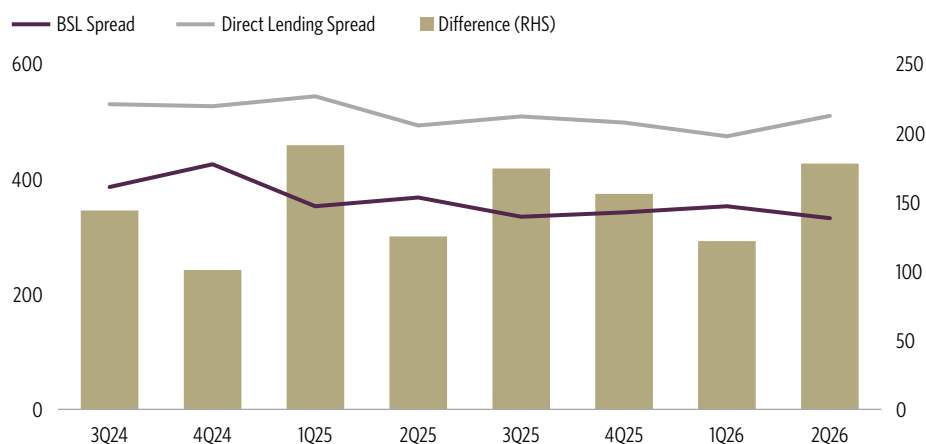
- Forward return potential has improved since the start of the year, and negotiating leverage has shifted toward institutionally funded managers rather than through the wealth channel, where redemption queues continue to constrain activity.
- Fitch's trailing 12-month default rate reached a record 6.3 percent through August, though roughly 88 percent of events were interest deferrals, PIK substitutions, or stressed extensions rather than payment defaults. Median interest coverage held at 1.6x, but median EBITDA growth posted the largest quarterly decline on record.
- Direct lending volume fell 55 percent quarter over quarter to \$33.6 billion in the second quarter, the lowest since 2023, as private equity-backed and LBO activity declined. Fundraising rebounded to \$16.3 billion over the same period. Competition from the syndicated loan market has picked up, with a record ~\$12 billion of direct lending deals refinanced into broadly syndicated loans (BSL) so far in the third quarter. This supports a continued focus on selectivity and pricing discipline.

By Joe McCurdy and Mark Pridmore

Retail redemption pressures and reduced BDC deployment have supported wider direct lending spreads.

Retail Redemptions and Slower BDC Lending Push Direct Lending Spreads Wider

Spread of LBOs financed in BSL (all borrowers) vs direct lending market



Source: Pitchbook, LCD. Data through June 30, 2026. Direct lending analysis is based on transactions covered by LCD News.



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

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