

Credit Currents Quarterly:

Insights across public and private credit

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Topics in this piece:

Macro
Liquid credit
Private credit

Estimated read time: 35 minutes

A (re)newed tightening cycle:

I. Macro (*pages 2-7*)

- Policy rates and forward expectations are moving higher as persistent inflation drives a renewed tightening cycle across regions. Global government bond yields are also repricing higher.
- Growth expectations remain broadly positive, though higher energy prices are adding to consumer expenses and inflation pressures.

II. Liquid credit (*pages 8-17*)

- Higher rates are reshaping credit returns, weighing on fixed-rate bonds while floating-rate loans have been more insulated. Still, excess returns point to more resilient underlying credit performance.
- Credit remains a yield story. Spreads are historically tight, while all-in yields remain attractive. Demand for those yields has helped keep spread volatility muted.
- Primary markets remain open, with U.S. issuance more resilient than Europe. AI-related financing is an increasingly important source of supply, particularly in US IG and HY bond markets.
- Defaults remain contained, with the aggregate leveraged finance default rate broadly in line with its 10-year average. Distressed exchanges have moderated from 2024 highs. Still, pockets of stress remain.

III. Private credit (*pages 18-25*)

- Private credit remains broadly resilient but increasingly differentiated. Interest income continues to drive private credit returns, and direct lending continues to offer a yield pickup relative to public credit.
- But unrealized losses have been a headwind to total returns, with recent markdowns most concentrated in software. Data from Lincoln International suggests these markdowns reflect AI-related uncertainty rather than broad deterioration in software fundamentals.
- Higher base rates can support yields but can also place renewed pressure on borrower coverage metrics. Continued earnings growth will be important in navigating a higher-rate environment.
- Deal activity remains uneven across regions, while recent takeout activity has favored syndicated markets. In our view, relative pricing, execution and market conditions will continue to influence where financing takes place.

Macro

Growth alongside a renewed tightening cycle

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A (re)newed tightening cycle

At the start of 2026, markets were largely anticipating further policy easing. As the year progressed, it has instead brought a renewed focus on the higher-for-longer rate environment, including the potential for a broader hiking cycle from central banks. With inflation elevated across regions and growth remaining broadly positive, the market’s focus has shifted to how far, and for how long, renewed tightening may extend.

Credit markets have, thus far, largely withstood this shift from a credit-risk perspective, but outcomes have been dispersed. Higher government bond yields have acted as a headwind to fixed-rate credit, including U.S. investment grade and high yield, while index spreads have remained relatively resilient. Floating-rate products, such as leveraged loans, by contrast, have been more insulated from the rates selloff, supporting their more recent outperformance.

In this *Credit Currents Quarterly*, we look beyond headline returns to understand how higher rates are shaping performance across public and private credit. We also consider how evolving financing needs and market conditions are influencing activity in credit markets.

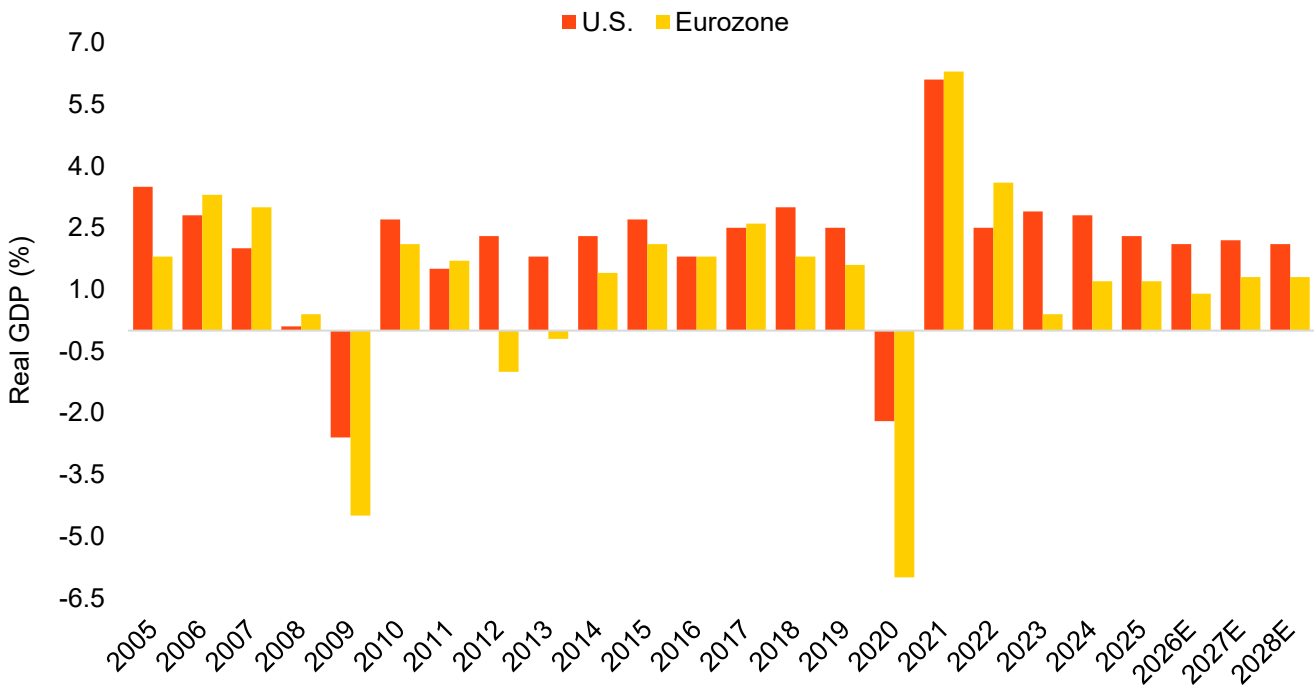
Growth expectations remain positive, led by the U.S.

The renewed focus on higher rates comes alongside a broadly resilient growth outlook. Both the U.S. and euro area are expected to expand over the coming years, with stronger growth expected in the U.S. (Exhibit 1). Consumer spending, a steady labor market, and historic investment in AI have helped support U.S. growth.

Geopolitical and trade-policy uncertainty has also eased somewhat from earlier in the year, though some of its effects, including higher energy prices, remain in focus. Those lingering effects are especially relevant for the euro area. While its outlook is set to improve over the next two years, growth expectations continue to trail the U.S., reflecting a number of factors including greater exposure to external shocks such as energy prices, as well as a more limited exposure to the AI investment theme.

Exhibit 1: U.S. and eurozone growth are expected to remain positive through 2028

Actual real GDP growth (annual, year-over-year) for the U.S. and eurozone from 2005 to 2025, and Bloomberg composite forecasts for full-year 2026 – 2028



Source: Bloomberg, BlackRock. As of October 2, 2026. 2026 – 2028 estimates use the Bloomberg Composite of forecasters. There is no guarantee any forecasts may come to pass.

Inflation is now squarely in focus for central banks

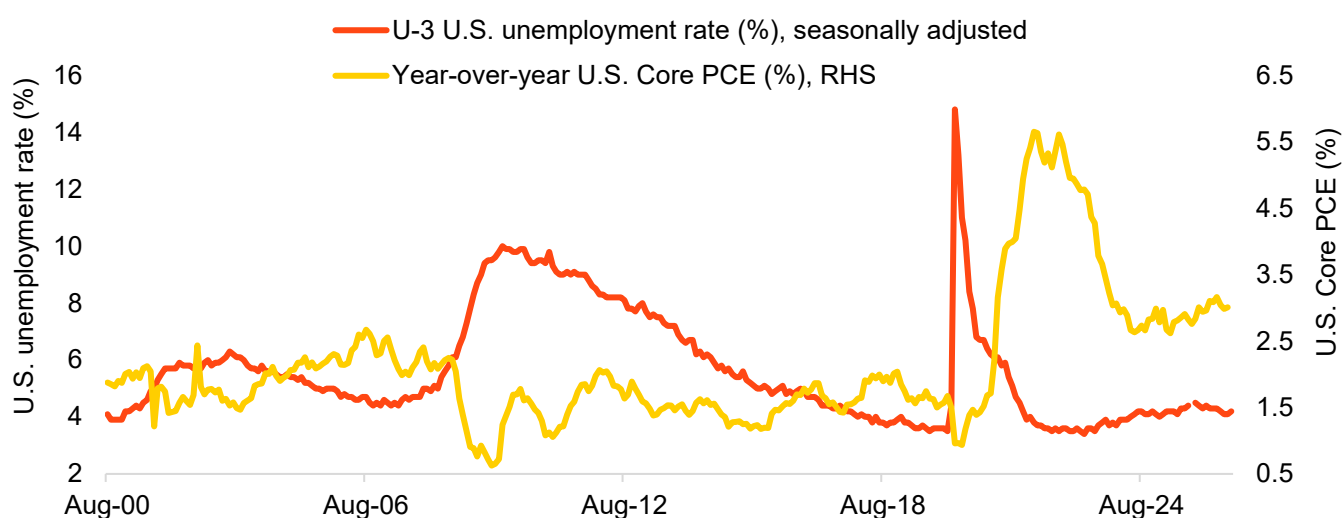
That resilient growth backdrop has also given central banks more room to focus on inflation, which has yet to return *sustainably* to 2% targets since the COVID-19 shocks, particularly in the U.S.

Further, the U.S. unemployment rate remains low by historical standards at 4.2%, broadly in line with recent levels. This labor market stability has given the Fed room to keep its focus on price stability, the other half of its dual mandate. Both headline PCE and core PCE inflation, which excludes food and energy prices, remain elevated (Exhibit 2).

In the euro area, inflation made positive progress toward the ECB's target in 2025 but has since picked up again, driven in large part by higher energy prices. With price stability at the center of the ECB's mandate, above-target inflation has contributed to renewed policy tightening, which we discuss on the next page (Exhibit 3).

Exhibit 2: U.S. labor market resilience has persisted alongside above-target inflation

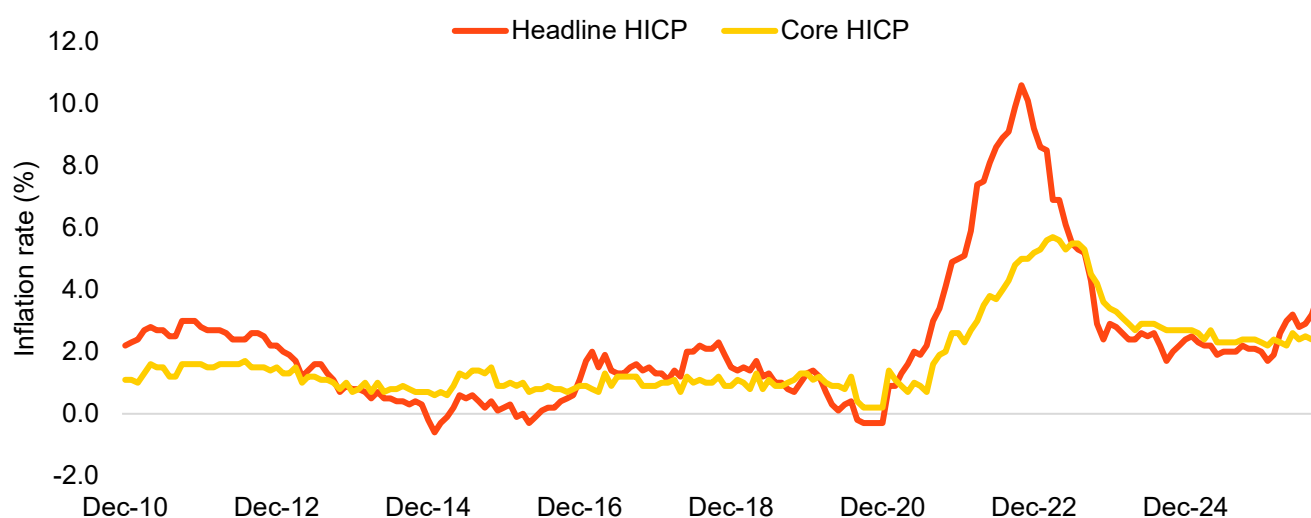
U-3 U.S. unemployment rate (%) seasonally adjusted, and year-over-year U.S. Core PCE inflation (%) seasonally adjusted, RHS



Source: Bureau of Labor Statistics, Bureau of Economic Analysis, BlackRock. Captures unemployment data as of September 30, 2026 and inflation data as of August 31, 2026.

Exhibit 3: Euro area inflation has moved higher from early-2026 levels

Year-over-year headline and core HICP inflation in the euro area



Source: Bloomberg, Eurostat, BlackRock. Euro Area Core Harmonised Index of Consumer Prices (HICP) inflation as of September 30, 2026. Core HICP excludes energy, food, alcohol and tobacco.

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Policy rates, and forward expectations, are moving higher

That renewed focus on inflation is now reflected in both policy decisions and market expectations. By the end of 3Q2026, the Federal Reserve (Fed), European Central Bank (ECB) and Bank of Japan (BoJ) had each raised policy rates, and markets increasingly expect those moves to mark the start of broader hiking cycles, rather than one-off adjustments.

Through 1H2027, markets have priced in roughly three additional hikes from the Fed, ECB, Bank of England (BoE) and BoJ (Exhibit 4). Outside of Japan, that pricing would somewhat unwind the easing delivered in recent years, though without returning policy rates to their prior peaks.

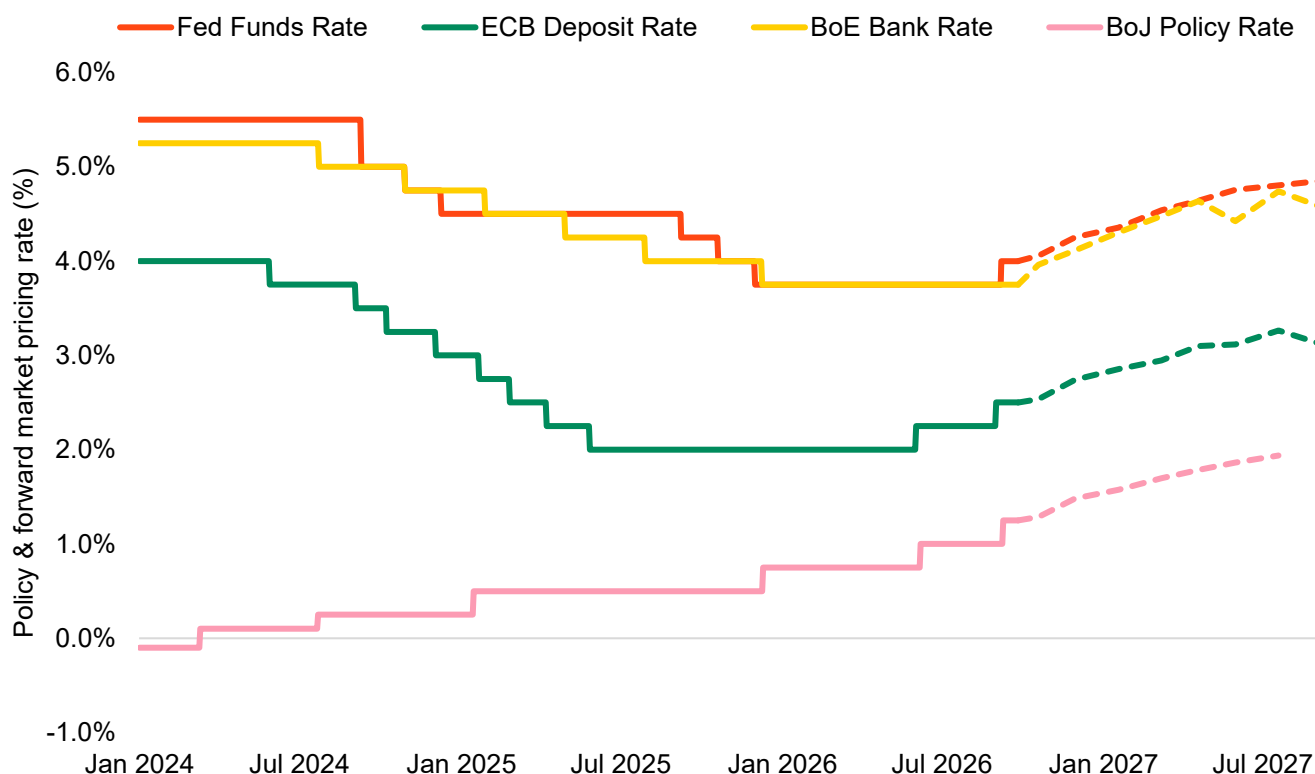
The BoJ is somewhat different. The expected cycle would bring its policy rate to its highest level since 1993. Japan has uniquely battled low inflation and weak wage growth for decades, keeping policy rates anchored in zero- or negative-interest-rate territory for much of that period. Its tightening cycle therefore represents a more structural shift in the policy backdrop.

Whether current market pricing is ultimately realized will likely depend on the persistence of inflation and central banks' commitment to returning it sustainably to their respective 2% targets. Those dynamics will shape how far, and for how long, this renewed tightening cycle extends.

For floating-rate credit, such as leveraged loans and private credit, the implications of higher policy rates are two-sided. Additional rate hikes could further support investor income through higher base rates, but would also raise borrowing costs, increasing the burden on highly levered borrowers.

Exhibit 4: Markets are pricing higher policy rates across major developed economies

Historical policy rates (solid lines) and market-implied paths (dashed lines) for the Federal Reserve (Fed), European Central Bank (ECB), Bank of England (BoE) and Bank of Japan (BoJ), as of October 2, 2026



Source: Bloomberg, European Central Bank, Federal Reserve, Bank of England, Bank of Japan, BlackRock. As of October 2, 2026. The Fed series uses the upper bound of a target range.

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Global government bond yields are rising across developed markets

Alongside that shift in policy expectations, benchmark yields have climbed across global government bond markets. At the 10-year point, the recent selloff has pushed yields to levels not seen since 2007 for U.S. Treasuries and UK gilts, 2009 for German Bunds, and 1996 for Japanese government bonds (JGBs) (Exhibit 5).

Although inflation remains a focus for central banks, real yields have driven much of the recent move in nominal yields, reflecting primarily the stronger growth backdrop. Since September 1, 10-year Treasury yields have risen roughly 50bp, while the difference between the nominal and real 10-year yields has been broadly unchanged. This suggests that the move has reflected higher real rates, rather than a meaningful repricing of inflation expectations.

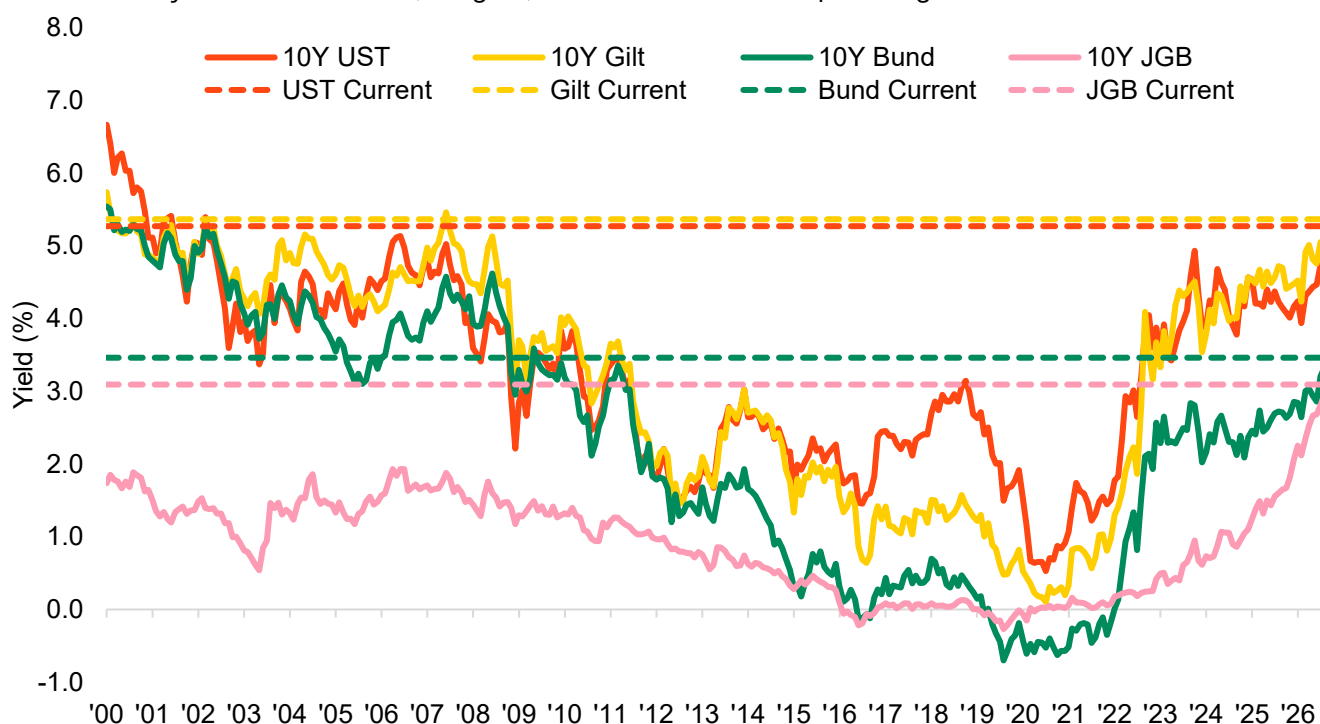
Competition for capital may also be contributing. During the September 2026 FOMC press conference, Fed Chair Warsh cited three factors influencing the 10-year Treasury yield: 1) economic strength, 2) competition for capital, including hyperscaler financing, and 3) geopolitics. Our colleagues in the *BlackRock Investment Institute (BII)* expect competition for capital to remain an enduring theme. Indeed, BII estimates that annual U.S. financing demand could exceed \$7.5 trillion by 2030, driven largely by capital needed for the AI buildout.

As BII recently highlighted, shifts in Fed expectations can influence rate moves in the near-term, but they do not alter the structural forces driving long-term yields. That distinction also helps frame the role of central banks. BII notes that central banks maintaining credibility can help “prevent an unnecessary rise in term premium,” or the extra compensation investors demand to hold long-term bonds.

For fixed-rate credit, including investment grade and high yield bonds, higher government bond yields have weighed on existing bond prices. For investors deploying capital today, however, the same move has elevated all-in yields, supporting income as an important component of forward returns, even as spreads remain tight. For issuers, the same backdrop keeps new-issue and refinancing costs elevated, making outcomes more dependent on balance-sheet strength, market access and sector positioning.

Exhibit 5: Government bond yields have moved higher across major developed markets

Yields on 10-year U.S. Treasuries, UK gilts, German Bunds and Japanese government bonds (%)



Source: Bloomberg, BlackRock. As of October 2, 2026.

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Higher energy prices are becoming an important macro driver

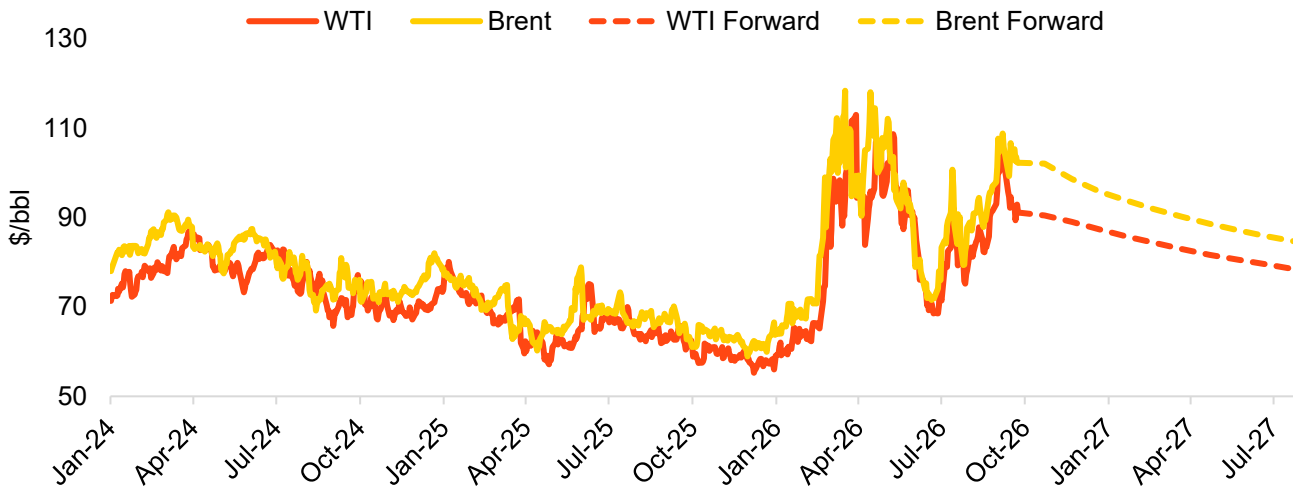
The longer-than-expected conflict in the Middle East has weighed heavily on energy markets. Entering 2026, Brent crude traded around \$60-61/bbl. Spot prices are now north of \$100/bbl, and although forward curves slope lower, markets still expect oil to trade in the mid-\$80 range through the midpoint of next year (Exhibit 6).

That rise in oil is increasingly feeding through to gasoline and diesel prices. Gasoline prices reached \$4.47 per gallon as of September 28, 2026, based on data from the U.S. Energy Information Administration, approaching the record levels of \$5.01 reached in 2022. Diesel prices have risen to \$6.38 per gallon, near their highest level since at least 2000 (Exhibit 7).

Higher fuel prices weigh on consumers by raising everyday expenses and potentially influencing spending decisions. This is especially true for lower income consumers, who tend to spend a larger share of total income on gasoline. But the effects extend beyond the consumer. Higher gasoline and diesel prices also add to inflation pressures and, in turn, can influence central banks’ policy decisions.

Exhibit 6: Oil prices remain elevated, while forward curves slope lower

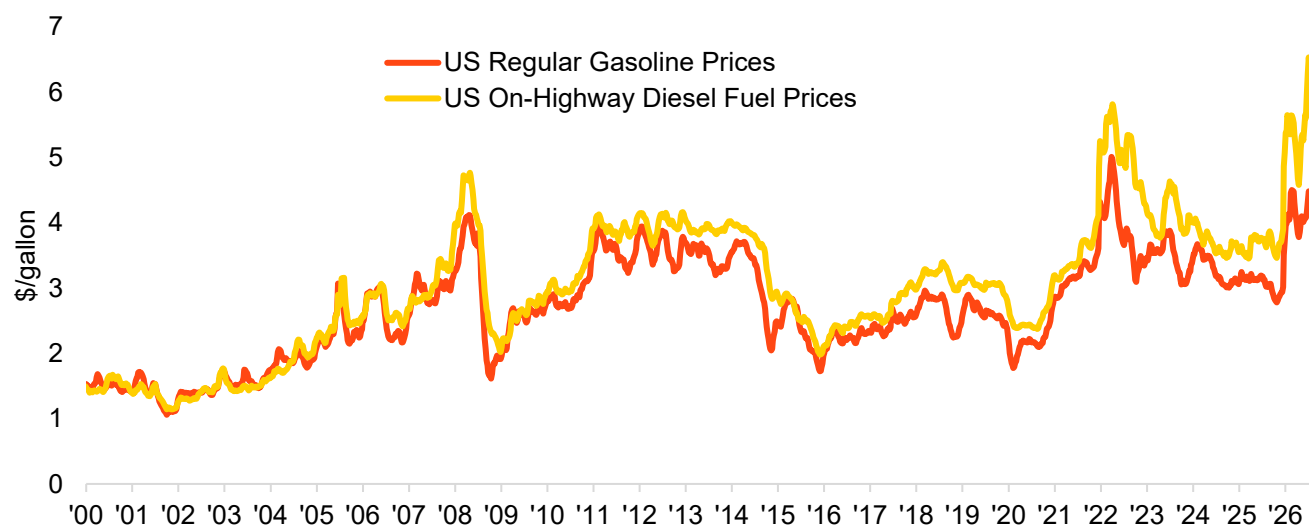
Historical prices and forward curves for West Texas Intermediate (WTI) and Brent crude oil (USD per barrel)



Source: Bloomberg, BlackRock. As of October 2, 2026. Solid lines show historical prices; dashed lines show forward curves. Forward prices reflect market pricing as of the date shown and are not a guarantee of future spot prices.

Exhibit 7: Gasoline and diesel prices are historically elevated

US Regular Gasoline Prices and US On-Highway Diesel Fuel Prices, dollars per gallon



Source: U.S. Energy Information Administration, BlackRock. As of September 28, 2026.

Liquid credit

Higher rates are reshaping credit returns, while spreads remain resilient

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Higher rates are reshaping credit returns, while spreads remain resilient

The recent Treasury moves have created a clear divergence in credit returns between fixed- and floating-rate products. Year-to-date (YTD), US leveraged loan total returns are notably higher than those of US high yield (HY), although much of that divergence emerged in September alone (Exhibit 8, below, and Exhibit 9, next page).

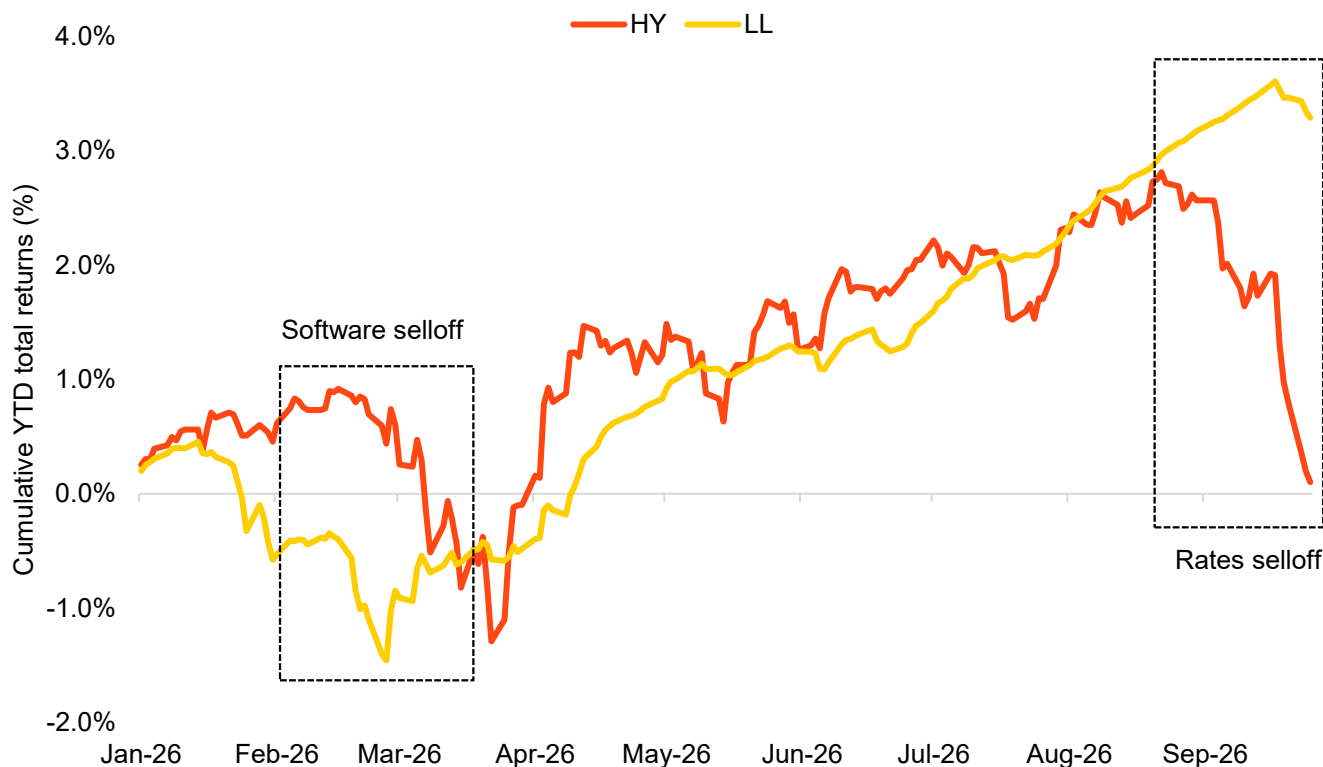
The difference largely reflects exposure to rates. For fixed-rate bonds such as investment grade (IG) and HY, the rise in Treasury yields has acted as a headwind to performance, pushing all-in yields higher and weighing on total returns. By contrast, floating-rate leveraged loans are less directly exposed to rate moves, given their sensitivity to policy rates. That distinction became especially evident in September, which represented the worst total return month for HY since September 2022, at -2.52%, and for IG since February 2023, at -2.72%, while leveraged loans returned 0.38%.

Excess returns tell a somewhat different story. HY has outpaced both IG and leveraged loans (Exhibit 10, next page). The recent rates selloff has also filtered through to spreads, but those moves have been much more muted, pointing to limited signs of broad-based credit stress. For example, despite widening 50 basis points in September, HY spreads are only 45 bps wider YTD and remain well inside their longer-term average of roughly 500 bps since 2000.

That said, rating 'tails' illustrate the distinction between rate and credit risk. AAA bonds and CCC loans are among the weakest total return performers this year, but for very different reasons (again, Exhibit 9, next page). AAA YTD excess returns are -0.1% versus total returns of -6.0%, reflecting the impact of their 10+ year duration. For CCC loans, excess returns are worse than total returns (-8.7% versus -6.0%), and duration is only 2.6 years. The result is similar headline weakness, but very different underlying drivers, with duration at the highest-quality end and credit deterioration at the lowest-quality end.

Exhibit 8: September's rates selloff drove the YTD return divergence

Cumulative year-to-date total returns for the USD HY and LL indices



Source: Bloomberg, Morningstar LSTA, BlackRock. As of September 30, 2026.

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Exhibit 9: Rates have weighed on fixed-rate credit total returns...

Year-to-date total returns (%) for various USD corporate credit indices

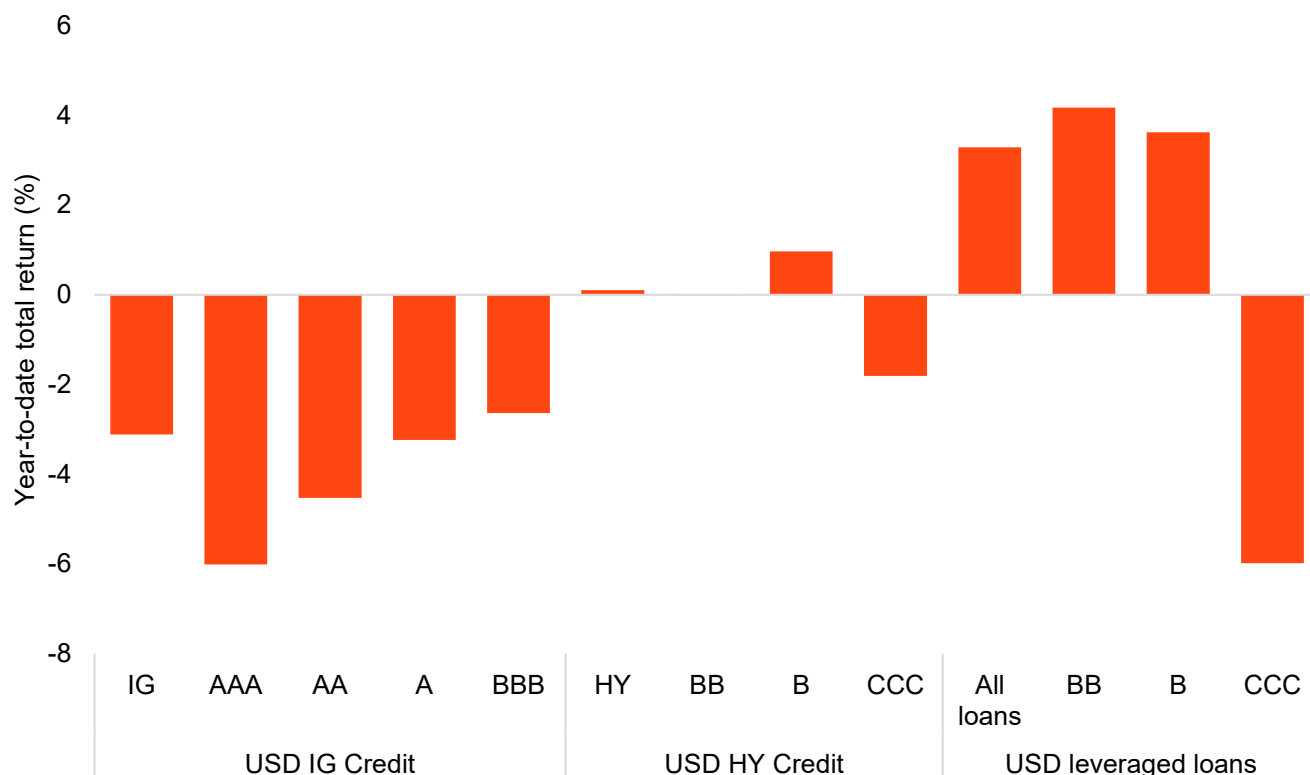
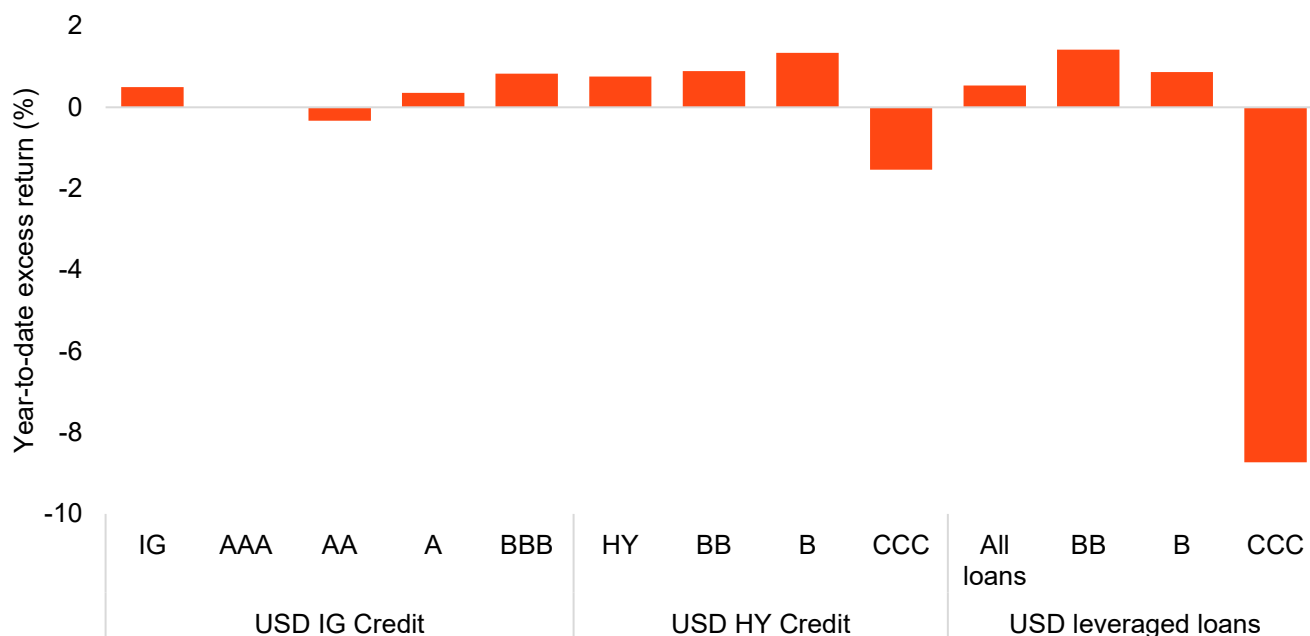


Exhibit 10: ...but excess returns point to more resilient underlying credit performance

Year-to-date excess returns (%) for various USD corporate credit indices



Source for both charts: Bloomberg, Pitchbook LCD, BlackRock. As of September 30, 2026. The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results. Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index. Excess return for USD leveraged loans calculated as total returns - YTD total returns of the Bloomberg U.S. Treasury Bills: 1-3 Months Index.

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Leveraged finance has historically held up well through hiking cycles

With the potential for additional hikes ahead, we look at how credit has historically performed around hiking cycles. From six months before the first hike through the 12 months following, median HY and leveraged loan total returns across prior hiking cycles have been 8.6% and 6.7%, respectively, roughly 1.3 and 1.6 percentage points above their respective median annual returns since 2000 (Exhibits 11 and 12).

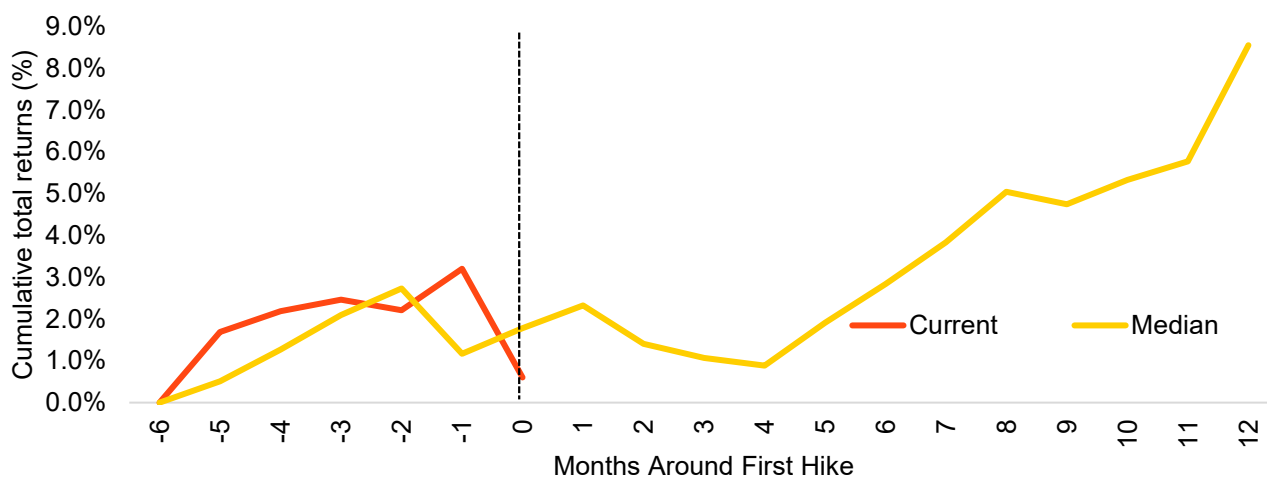
Generally, HY spreads have held up well in these environments. Across five prior cycles for which spread data are available, spreads have typically widened ahead of the initial hike and tightened thereafter.

Importantly, however, no two hiking cycles are equal. In 2022, an uncertain inflation outlook and unclear upper bound for policy rates drove a sharp risk-off move. Roughly six months after the first hike, cumulative HY returns had fallen to around -14%, while the S&P 500 declined 19%. By contrast, around the single 1997 hike, cumulative HY returns reached 20.6% 12 months later, and the S&P 500 rose 31%.

We believe the range of outcomes is a reminder that a rate cycle alone does not determine credit performance. Indeed, factors such as the broader economic backdrop, inflation dynamics and starting valuations are also important in shaping outcomes.

Exhibit 11: Both US HY...

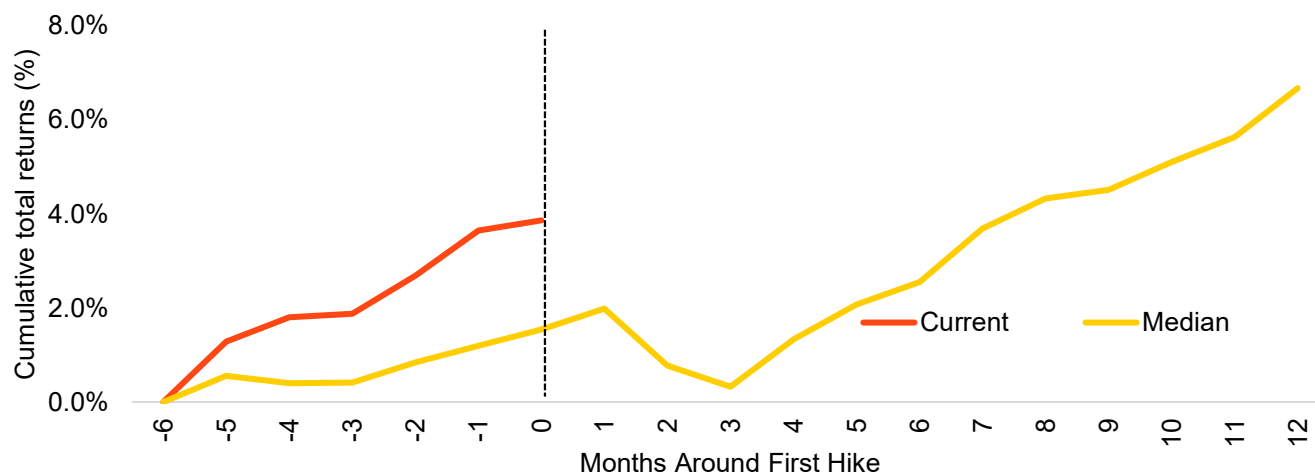
Cumulative US high yield total returns around the first Fed rate hike of a cycle: current cycle and historical median (%)



Source: Bloomberg, BlackRock. Using monthly LF98TRUU returns data. Median includes 1994, 1997, 1999, 2004, 2015, and 2022 rate hikes. Current as of September 30, 2026.

Exhibit 12: ...and US leveraged loans have historically delivered positive returns around the first Fed hike

Cumulative US leveraged loan total returns around the first Fed rate hike of a cycle: current cycle and historical median (%)



Source: Bloomberg, BlackRock. Using monthly SPBDAL returns data. Median includes 1999, 2004, 2015, and 2022 rate hikes. Current as of September 30, 2026.

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Credit remains a yield story, not a spread story

Tight spreads, and attractive all-in yields continue to define the credit market backdrop, even after recent spread widening. USD IG and HY spreads widened 2bp and 50bp, respectively in September. For HY, this was the largest monthly widening since March 2025, amid tariff announcements. Yet, at 311bp as of September 30, the USD HY index trades 124bp inside of its average spread since 2010.

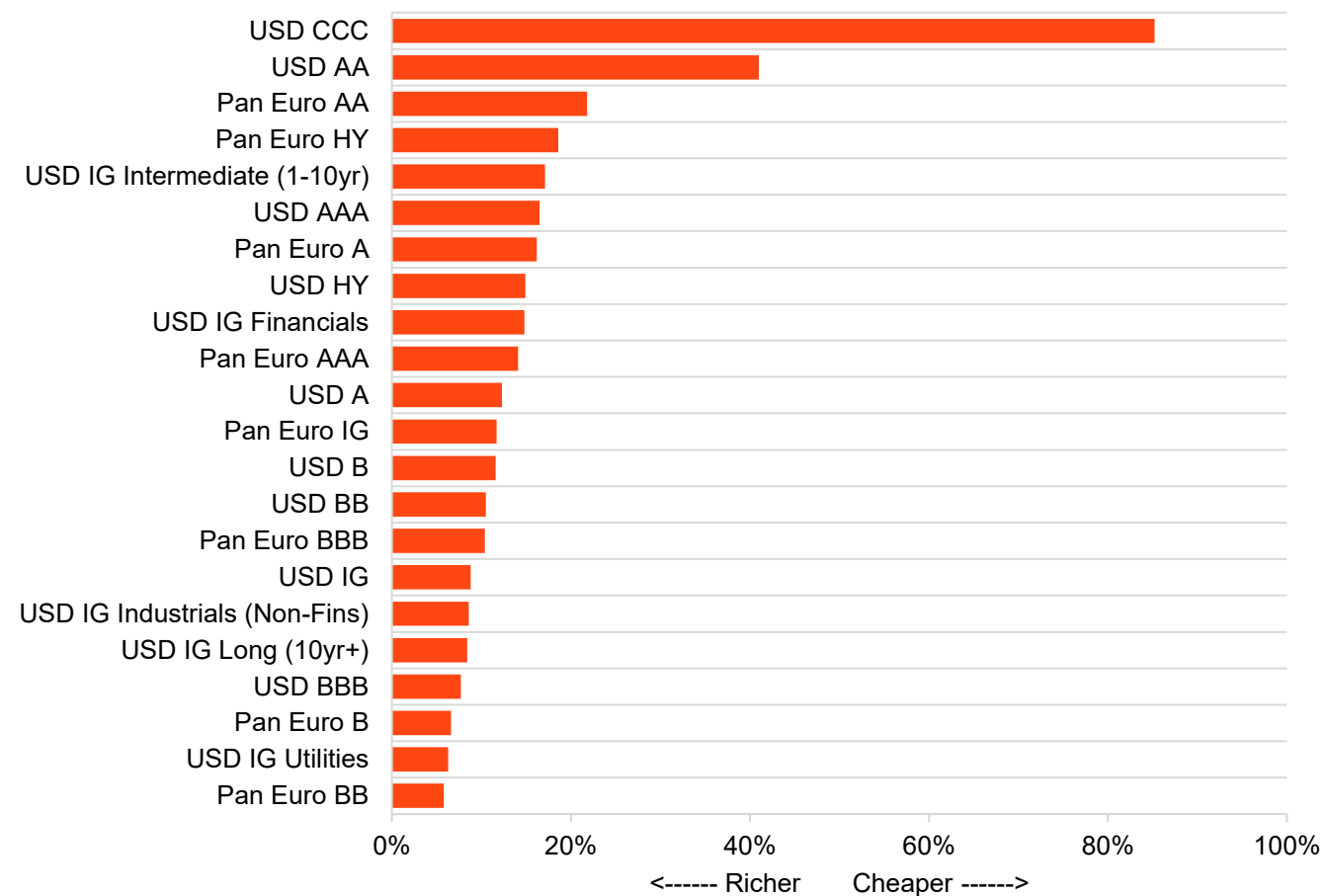
That richness extends across most of the market. Outside of the rating ‘tails’ in the USD market, no segment trades wider than its 25th percentile since 2010 (Exhibit 13). USD CCCs remain comparatively cheap as idiosyncratic stories dominate the space, while USD AAs have faced a historically elevated supply wave that has changed its landscape. Elsewhere, spreads would still need to widen considerably before appearing attractive relative to history.

The picture is even more pronounced when excluding CCCs. As we discussed in USD HY: Tight spreads, strong fundamentals, prior to the recent selloff, BBs had tightened to multidecade lows, and the HY index ex-CCCs now trades just 38bp from its tightest level since 2005 (Exhibit 14 – next page). While we believe there is fundamental support for these valuations, including a greater share of secured debt, resilient borrower fundamentals, strong earnings, and limited distress, current levels nonetheless offer relatively little spread compensation.

CCCs’ wide levels contribute 26% (80bp) to the index’s spread despite only accounting for 9% of the index’s market value. As recently as September 22, that contribution reached 30%, the highest since at least 2005, even as CCCs represented a record-low share of market value. Given the highly idiosyncratic nature of the CCC market, we believe the ex-CCC analysis provides a more representative view of underlying HY spread valuations.

Exhibit 13: Spreads remain notably tight across most rating cohorts

Percentile rank of daily index-level corporate bond option-adjusted spreads, since January 1, 2010

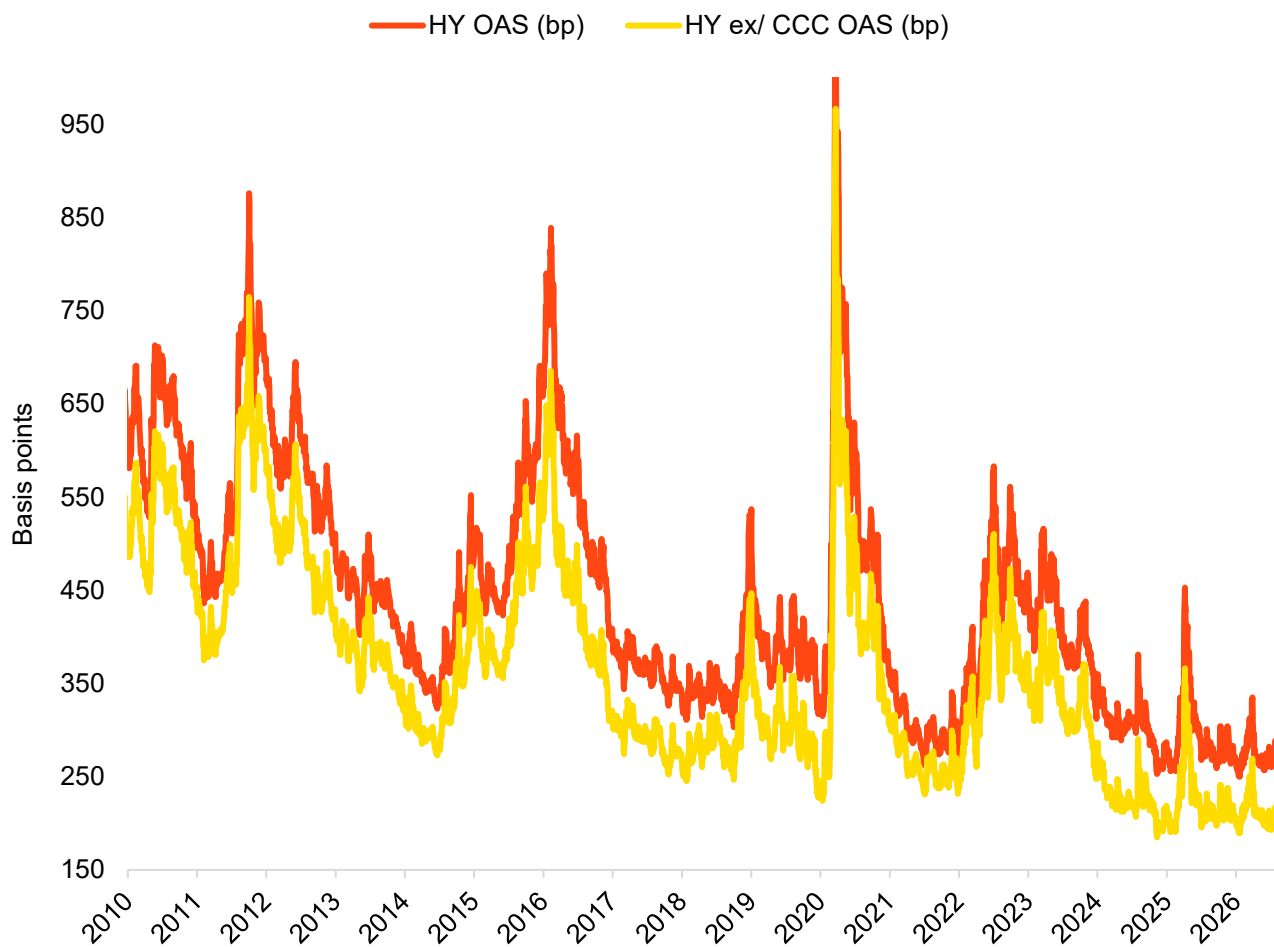


Source: BlackRock, Bloomberg. As of September 28, 2026. The figures shown relate to past performance. **Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs, or expenses. Indices are unmanaged and one cannot invest directly in an index.

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Exhibit 14: The HY index excluding CCCs trades near historically tight spread levels

Option-adjusted spreads (OAS) for US HY and US HY excluding CCCs



Source: Bloomberg, BlackRock. As of September 28, 2026.

All the while, the global rates selloff has pushed nearly all segments of U.S. and European credit markets to the upper end of their historical ranges since 2010 (Exhibit 15 – next page). As has generally been the story since 2024, apart from the tariff-related selloff in March and April 2025, concerns around rich corporate spreads have been outweighed by historically attractive all-in yields.

That dynamic also helps explain why spreads have remained relatively resilient. Despite concerns around the AI buildout, software disruption, private credit, inflation, and geopolitics, among others, strong demand for all-in yield has helped keep spread volatility muted and spreads historically tight.

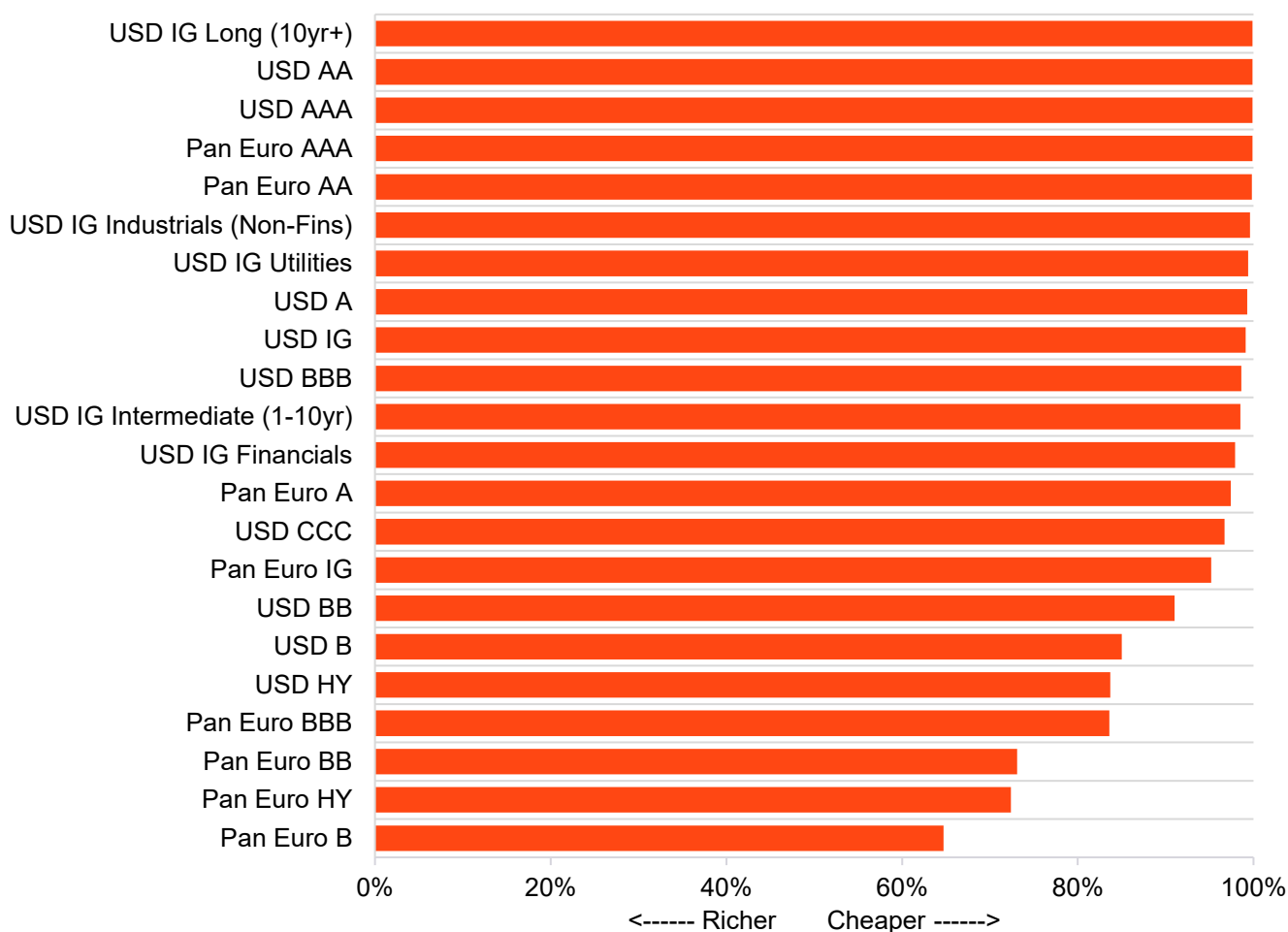
Though as we've discussed previously, tight spreads have historically not been a poor indicator for total returns. Indeed, when HY spreads have accounted for less than 40% of all-in yields (currently 36%), median forward returns since 2010 have remained positive: 1.42% over the subsequent three months, 4.19% over six months and 8.14% over 12 months.

Higher starting yields also provide considerably more cushion for return 'breakevens'. Exhibit 16 (next page) illustrates how much yields would need to rise over one year for total returns to fall below zero across different starting yields and duration profiles.

For the HY index, with a starting yield-to-worst of roughly 8.26% and a duration of 3.17 years, that breakeven is approximately 250-285bp. Given changes in index composition, duration and cash flows, as well as the potential for defaults and calls, these figures are illustrative rather than forecasts of realized returns.

Exhibit 15: All-in yields remain historically attractive across most cohorts

Percentile rank of daily index-level corporate bond yield-to-worst levels, since January 1, 2010



Source: BlackRock, Bloomberg. As of September 28, 2026. The figures shown relate to past performance. **Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs, or expenses. Indices are unmanaged and one cannot invest directly in an index.

Exhibit 16: One-year all-in yield widening breakeven

Higher starting yields and shorter duration provide a strong all-in yield widening cushion before total returns turn negative

		Starting OAD (years)					
		2.8	3.0	3.2	3.4	3.6	3.8
Starting YTW (%)	6.5	232	217	203	191	181	171
	7.0	250	233	219	206	194	184
	7.5	268	250	234	221	208	197
	8.0	286	267	250	235	222	211
	8.5	304	283	266	250	236	224
	9.0	321	300	281	265	250	237

Source: BlackRock. Note: Analysis is illustrative, and assumes a constant index universe and observed total returns ultimately will incorporate several factors not included in this analysis. Box represents current HY statistics.

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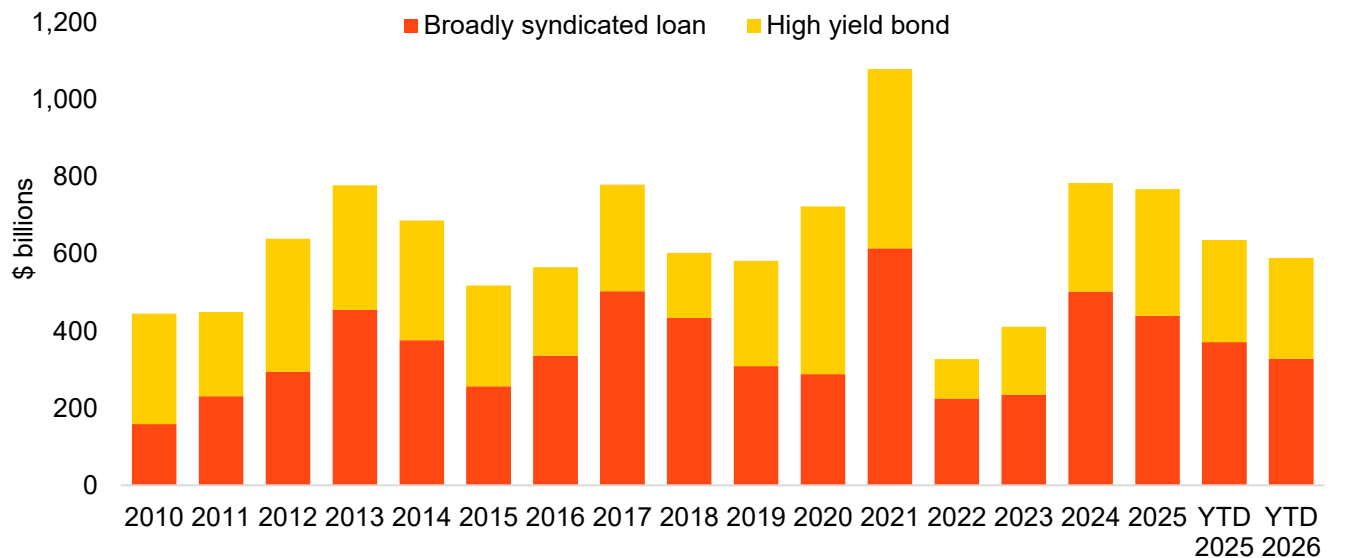
Both US and European primary markets remain open

Year-to-date issuance in the U.S. declined 7% versus the same period last year, driven primarily by slower activity in the broadly syndicated loan market, while HY activity has been more stable (Exhibit 17). As we highlighted previously, technology has been the largest sector driver of HY issuance YTD, supported in part by AI-related financing.

The picture has been more subdued in Europe. Combined new-issue volume across HY bonds and syndicated loans declined 15% YTD versus the same period last year (Exhibit 18). As in the U.S., the weakness has been concentrated in loans, with syndicated loan volume down 24%, while HY issuance has been comparatively more resilient. Importantly, this slowdown comes after notably strong activity in 2024 and 2025. Indeed, YTD 2026 issuance is already broadly in line with the annual average across both markets from 2010 to 2025. As such, we view the slowdown as consistent with a normalization in activity.

Exhibit 17: USD issuance has been considerably resilient YTD

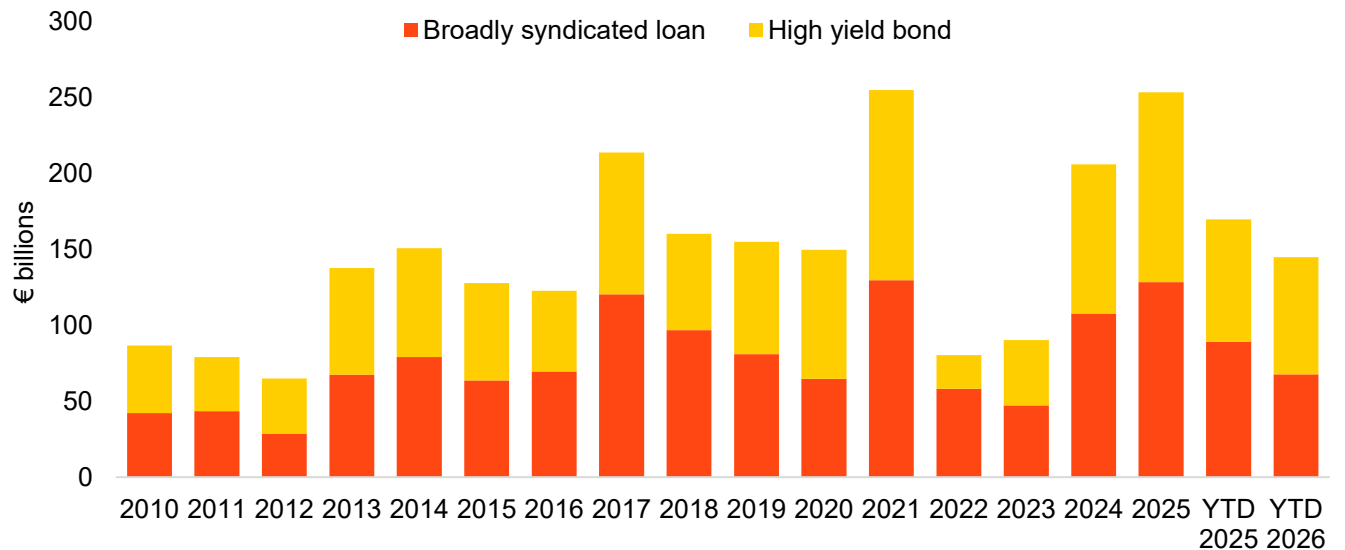
Annual US leveraged finance issuance, in \$ billions



Source: Pitchbook LCD, BlackRock. YTD as of October 1, 2026. Note: excludes repricing and extension volume.

Exhibit 18: YTD issuance in the EUR market has slowed vs. last year

Annual European leveraged finance issuance, in € billions



Source: Pitchbook LCD, BlackRock. YTD as of August 31, 2026 (most recent data available). Note: HY volume excludes PIK instruments & short-term bonds; reflects corporate bonds only. In case of a global issue, the portion allocated to European HY investors is counted (if unknown, the entire global issue is counted).

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AI-related financing is becoming an increasingly important source of credit supply

Within this resilient primary market backdrop, AI-related financing has become an increasingly important source of issuance, particularly in the IG and HY bond markets. Across markets, AI financing spans multiple sectors and financing structures. Isolating issuance by issuer, sector, or structure can provide useful context, but no single measure provides a comprehensive view of AI-related issuance.

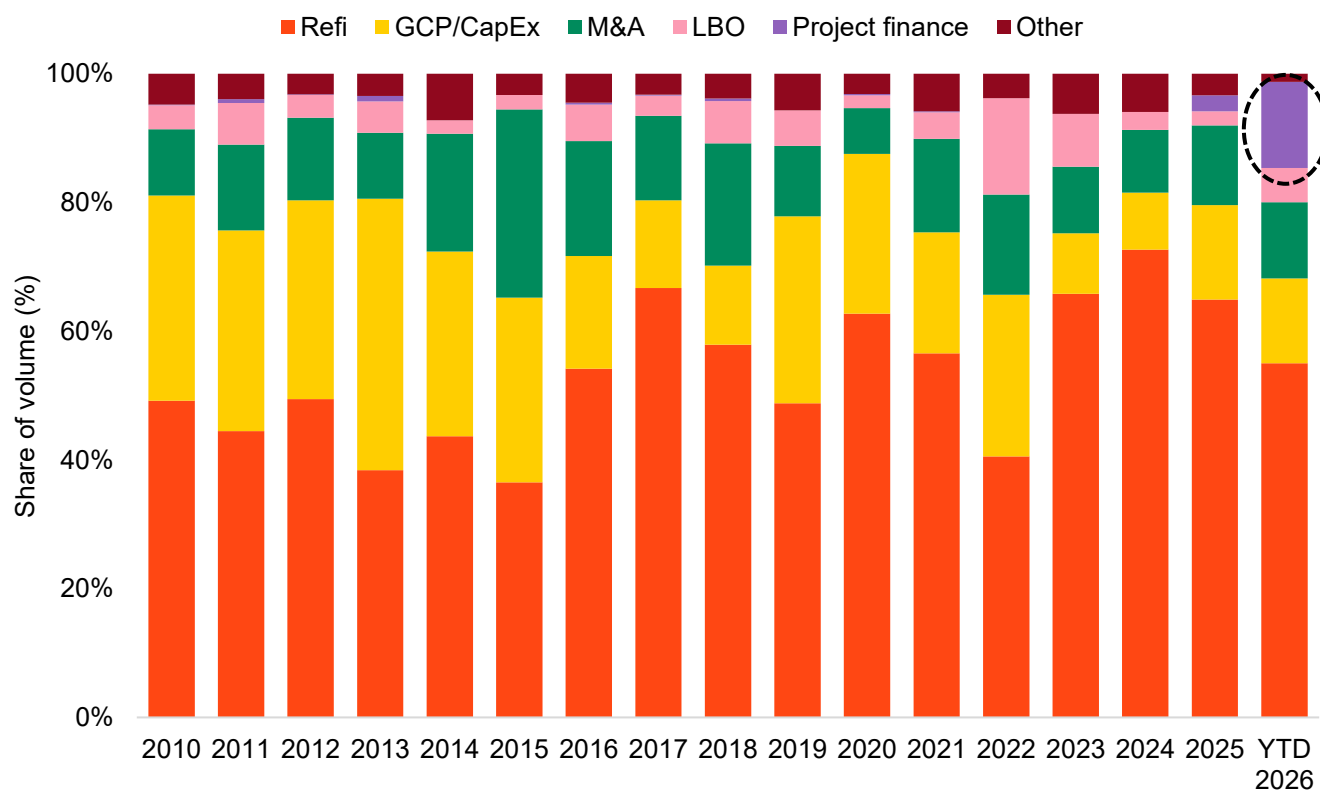
In IG, some AI financing has come through direct issuance, including by hyperscalers. Such hyperscaler issuance has accelerated alongside AI-related capital expenditures, totaling roughly \$230 billion across seven currency markets YTD, through September 30. This represents 7% of total gross IG issuance across relevant currencies, up from 3% in full year 2025 and well above its 1% average share from 2010 to 2024.

Data center bond issuance has expanded across both US IG and HY markets, as well. Such issuance has been an important source of AI-financing, particularly in US HY. Project finance issuance in US HY totaled \$37 billion YTD through September 30, or 13% of total gross issuance, up from \$9 billion the year prior (Exhibit 19). Further, the technology sector has represented 23% of gross U.S. HY issuance YTD, supported in part by AI-driven investment. Importantly, much of this activity represents new-money financing rather than refinancing existing debt, adding to the amount of net supply investors need to absorb.

By contrast, AI-related issuance has been more muted in the leveraged loan market than in HY, although a number of AI-related issuers have tapped the loan market in recent months. That activity has included data center financing, as well as direct corporate issuance. More broadly, computers & electronics, which includes software, represents 13% of YTD loan issuance, down from 21.5% over the comparable period in 2025. Even so, as financing requirements continue to grow and broaden across the AI value chain, we see scope for AI-related leveraged loan activity to expand over time.

Exhibit 19: Project finance has risen alongside AI-related activity

Share of USD HY gross issuance, annual and YTD 2026, by use of proceeds



Source: Dealogic, BlackRock. YTD 2026 as of September 30, 2026.

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Defaults remain contained, but warrant watching

Default trends reinforce the broader picture of aggregate resilience alongside concentrated pockets of stress. The last-12-month (LTM) par-weighted default rate for aggregate leveraged finance, including both leveraged loans and high yield bonds, is broadly in line with its 10-year average, but under the surface, a recent pattern has changed.

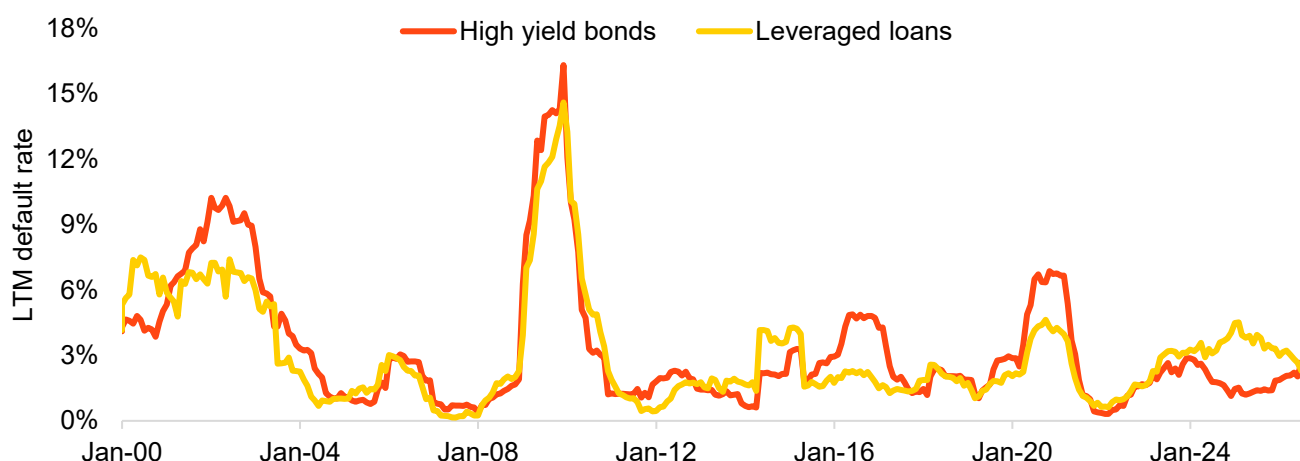
Since December 2022, the par-weighted loan default rate has generally outpaced HY bonds, driven in large part by the rapid increase in policy rates in 2022 and 2023. Floating-rate loan borrowers were forced to absorb higher borrowing costs relatively quickly, while fixed-rate HY borrowers were more insulated until refinancing. More recently, that relationship has shifted again, with HY bond defaults outpacing loans (Exhibit 20).

Further, over recent years, distressed exchanges have accounted for a more meaningful share of default activity, particularly among leveraged loans. Importantly, distressed exchanges have historically been associated with a higher incidence of repeat default, according to J.P. Morgan.

YTD distressed exchange volume suggests that such activity may be continuing to moderate from its recent highs in 2024, although it remains elevated relative to longer-term norms (Exhibit 21). As we have discussed previously, elevated distressed exchange activity has contributed to a more iterative workout cycle. As such, a sustained decline could ultimately support fewer repeat defaults in the years ahead.

Exhibit 20: The HY bond default rate has begun to outpace that of leveraged loans

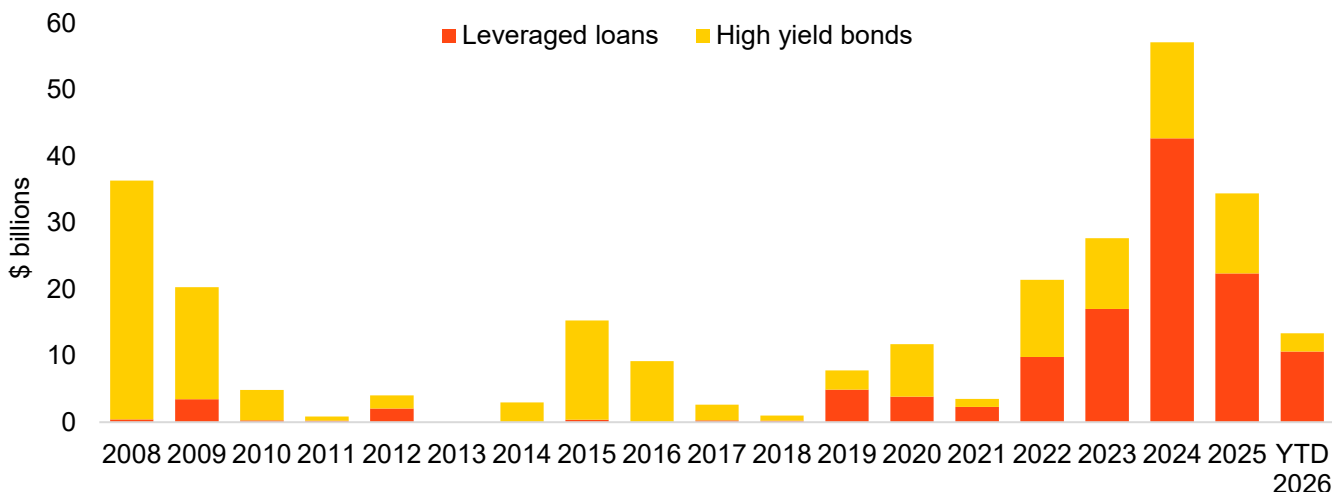
Last-twelve-month par-weighted default rate for high yield bonds and leveraged loans, including payment defaults and distressed exchanges



Source: J.P. Morgan, PitchBook, Bloomberg, S&P/IHS Markit Data, BlackRock. As of September 30, 2026.

Exhibit 21: Distressed exchange volumes have moderated from 2024 highs

Distressed exchange volume, in \$ billions, for the leveraged loan and high yield bond market



Source: J.P. Morgan, PitchBook, Bloomberg, S&P/IHS Markit Data, BlackRock. As of September 30, 2026.

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Private credit

Resilient in aggregate, with differentiation shaping performance

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Aggregate resilience, but with differentiation driving outcomes

We expect differentiation to remain a key driver of private credit outcomes in the coming quarters. The rate backdrop is one factor, alongside elevated inflation and sector-specific uncertainties, all of which are likely to impact borrowers, and their performance, differently. As such, looking beyond aggregate fundamentals remains important, with differences across sectors, borrowers and capital structures likely to shape performance.

Against that backdrop, we look at how these dynamics are showing up in private credit performance, including in income and losses. We also consider the drivers of recent valuation changes, borrower fundamentals, and how shifting market conditions are influencing where financing activity ultimately takes place.

Assessing private credit’s income backdrop

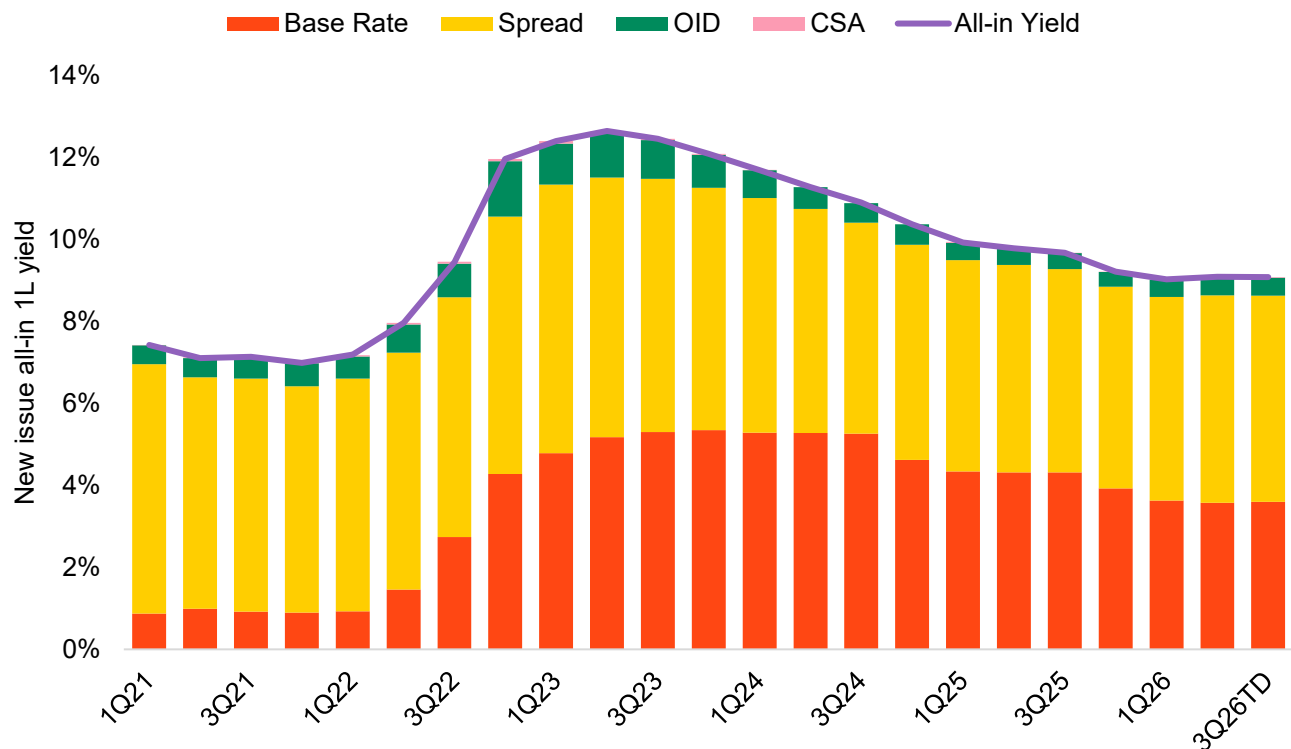
We start with the all-in yield available on direct lending. Its composition has shifted meaningfully over time, especially as base rates rose in 2022 and 2023. As of August 31, 2026, base rates represented 40% of all-in yields for new issue first lien loans in the Cliffwater Direct Lending Index (CDLI), versus an average of 13% in 2021 (Exhibit 22). This underscores how base rates have become an increasingly important component of all-in pricing for direct lending. Even so, spreads remain the largest component, at 55%.

Looking ahead, the potential for additional increases in base rates could further support the yield and income backdrop. Importantly, the most recent available data are as of August 31, 2026, before base rates rose in the U.S., meaning the latest increase is not yet reflected in these figures.

That yield backdrop has continued to translate into attractive interest income. The CDLI’s trailing-four-quarter interest income return was 9.92% through June 30, compared with net realized losses of 0.47%. As such, interest income remains a substantial component of direct lending performance, although, as we discuss ahead, *unrealized* losses can also weigh on total returns.

Exhibit 22: A higher policy rate should support private credit all-in yields

Quarterly all-in yields on new-issue sponsored first-lien loans in the Cliffwater Direct Lending Index (CDLI)



Source: Cliffwater Direct Lending Index, BlackRock. 3Q26TD is as of August 31, 2026. OID is amortized based on a 3-year term to repayment.
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Direct lending, in the context of its public market peers

Direct lending differs somewhat from its public market peers in both yield and valuation behavior, while remaining sensitive to many of the same macro drivers.

As of 2Q2026, direct lending yields remain elevated relative to high yield bonds and syndicated leveraged loans (Exhibit 23). The difference reflects a variety of factors, including an ‘illiquidity premium’ and differences in the borrower base. The size of this pickup ebbs and flows, but it has generally persisted over time. That said, yields across all three markets fluctuate as macro conditions change, demonstrating a degree of connectivity in pricing.

That connection extends to valuations, as well. Exhibit 24 compares valuation movements across the CDLI, Bloomberg U.S. High Yield Index and Morningstar LSTA U.S. Leveraged Loan Index. All three demonstrate sensitivity to the macro backdrop, though the degree and timing differ. Reported CDLI valuations appear less volatile than their public market counterparts, reflecting in part differences in how and when private loans are valued. Such methodologies can smooth reported price movements in private credit but do not eliminate the asset class’s sensitivity to underlying macro conditions.

Exhibit 23: U.S. direct lending has historically offered a yield ‘pickup’ vs. public markets

Average index yield-to-maturity levels

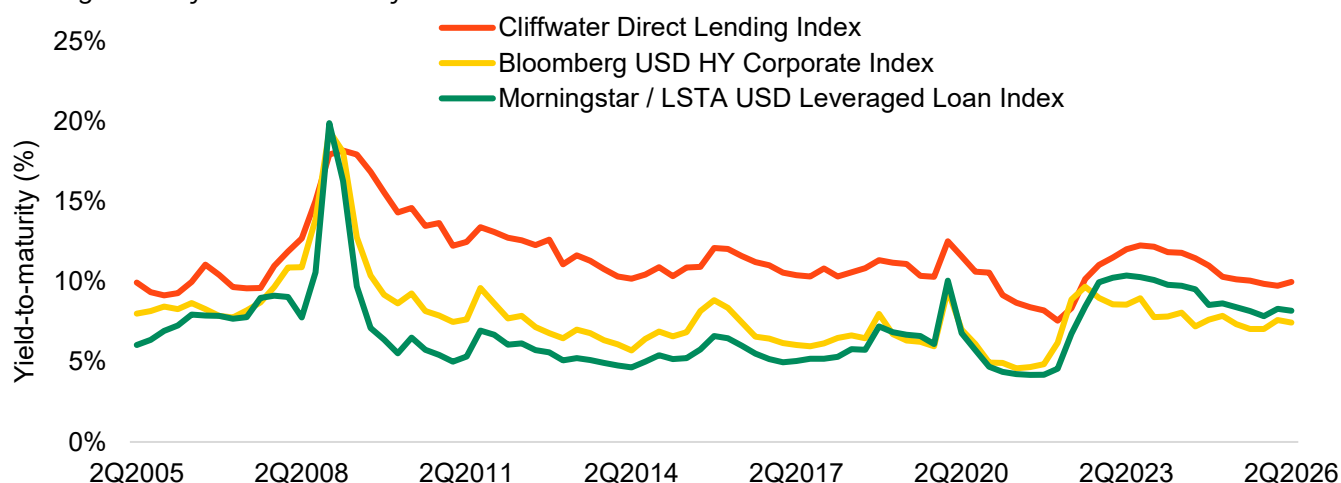
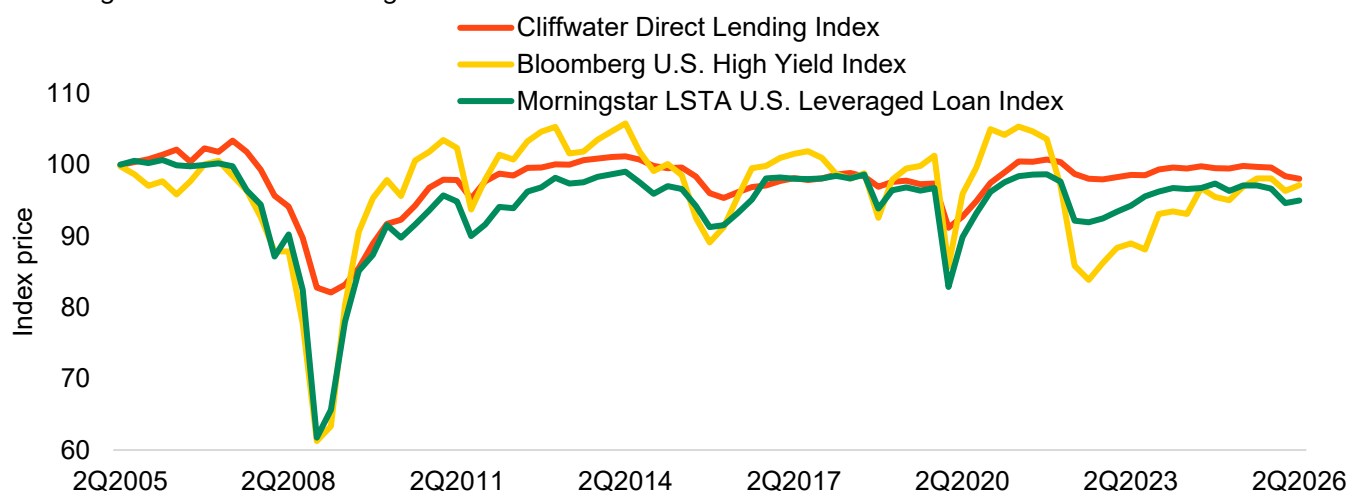


Exhibit 24: Private credit asset values are sensitive to the same macro drivers as US HY bond and US LL markets

Index price for the Cliffwater Direct Lending Index (CDLI), Bloomberg U.S. High Yield Index, and Morningstar LSTA U.S. Leveraged Loan Index



Source for both charts: Cliffwater, Bloomberg, Morningstar / LSTA, Pitchbook LCD, BlackRock. As of June 30, 2026. Index price for the CDLI defined as fair value / cost value. The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results. Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index.

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Unpacking the components of private credit’s total returns

Private credit total returns reflect a combination of income and realized and unrealized gains and losses.

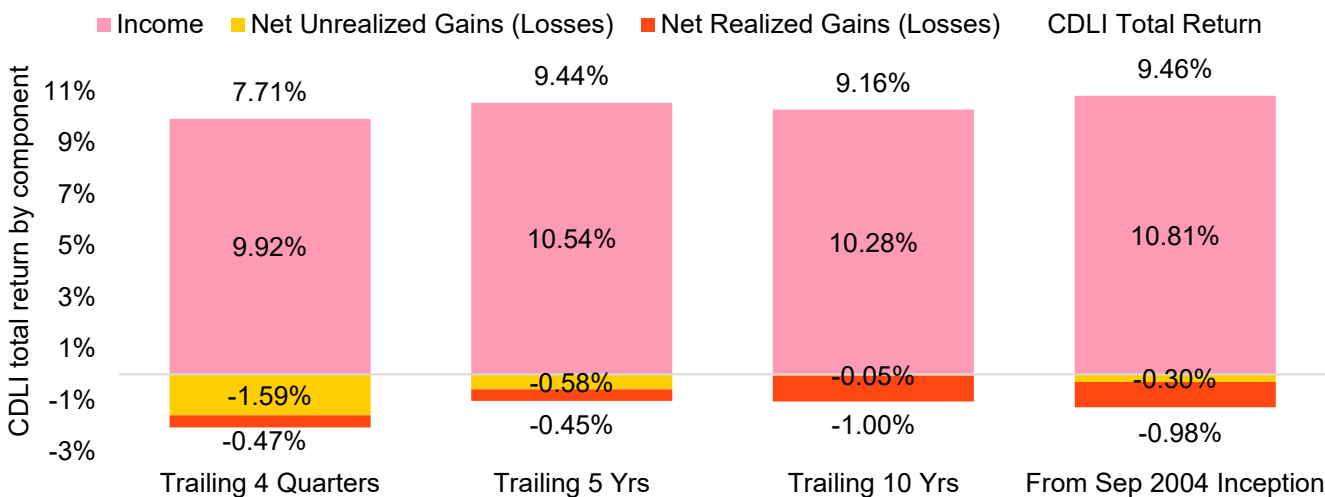
Exhibit 25 demonstrates how these components have historically influenced total returns for the CDLI. Notably, unrealized losses have been a considerable headwind over the trailing four quarters, detracting 1.59 percentage points from total returns, a larger drag than over the trailing five- and ten-year periods and since inception. At the same time, realized losses have remained modest relative to the longer history.

As we have discussed previously, unrealized losses can be a signal of future realized losses, but the relationship is not one-for-one. A Cliffwater analysis of select prior stress periods found that subsequent realized losses equaled roughly half of preceding unrealized losses, as some markdowns ultimately reverse. Exhibit 26 shows the longer-term relationship between net unrealized and net realized gains and losses.

With this context, the recent increase in unrealized losses suggests realized losses could rise toward their long-term average of approximately 1%. In our view, an orderly increase toward that level would be more consistent with normalization than broad-based deterioration. Conversely, if current valuation adjustments prove overly conservative, a reversal in unrealized losses could support total returns.

Exhibit 25: Unrealized losses have been a headwind to performance in the trailing 4 quarters

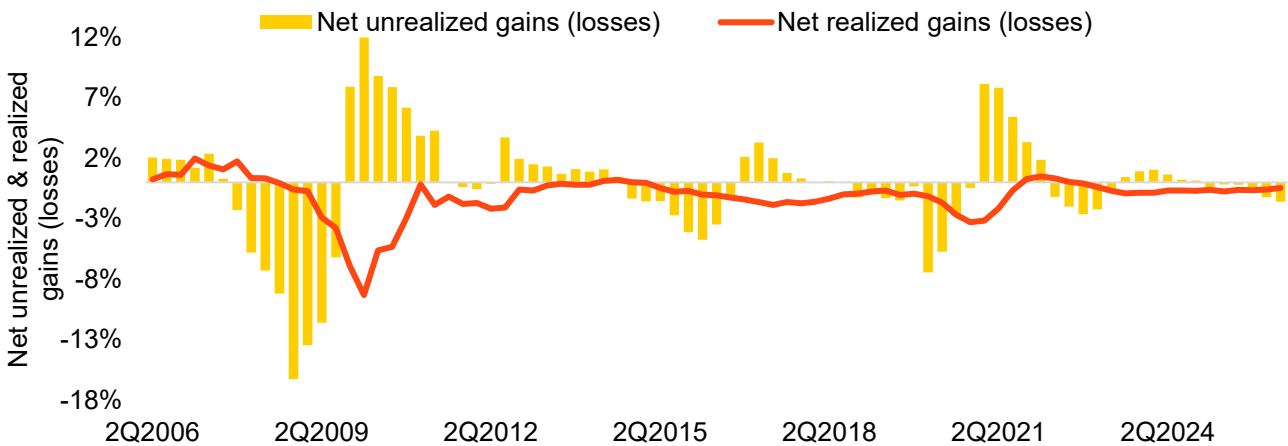
Total return by component for the Cliffwater Direct Lending Index (CDLI)



Source: Cliffwater Direct Lending Index, BlackRock. Data through June 30, 2026. Return subcomponents may not add exactly to total return due to compounding effects. Performance data represents past performance, which does not guarantee future results. There is no assurance that similar investments will be made or that similar results will be achieved.

Exhibit 26: Unrealized losses have historically been more volatile than realized losses

Trailing 4 quarter net unrealized and realized gains (losses)



Source: Cliffwater Direct Lending Index, BlackRock. Data through June 30, 2026.

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Recent markdowns have been concentrated in software

Importantly, the drivers of recent unrealized losses have been highly concentrated. As shown in Exhibit 27, markdowns to software loans have accounted for roughly two-thirds of total unrealized losses since 4Q2025. The weighted-average valuation of first-lien software loans declined from near par at year-end 2025 to approximately 97% of cost as of 2Q2026, while moves across other sectors have been considerably more modest.

Data from Lincoln International suggests, however, that these markdowns have not reflected a broad deterioration in software fundamentals, but rather uncertainty around the terminal value of these businesses amid AI-related disruption. As of 2Q2026, 68% of software borrowers generated positive year-over-year growth in LTM adjusted EBITDA, compared with 64% of the broader Lincoln universe. Average adjusted EBITDA growth was also somewhat stronger for software borrowers, at 6.8% versus 5.6% for the broader universe.

That said, Exhibit 28 also underscores the dispersion within software. According to Lincoln data, software borrowers with higher retention rates tend to support greater leverage, highlighting meaningful differences in business quality and reinforcing the importance of credit selection in underwriting.

Exhibit 27: YTD unrealized losses were driven by software & services fair value markdowns

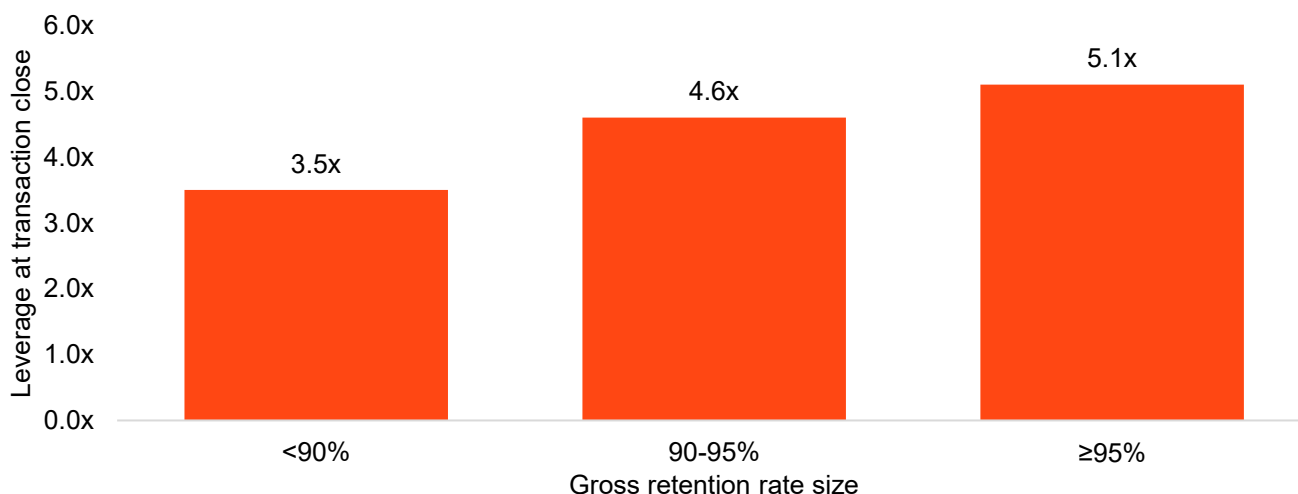
Fair value / cost on first-lien debt by sector

Fair Value / Cost on 1st Lien Debt by Sector				Changes %		
CDLI Industry Groups	4Q25	1Q26	2Q26	1Q26 vs. 4Q25	2Q26 vs. 1Q26	Total 2 Quarter Change
Materials	98.03%	98.37%	98.49%	0.35%	0.12%	0.48%
Energy	98.56%	98.33%	98.68%	-0.23%	0.36%	0.13%
Automobiles	97.18%	95.88%	97.14%	-1.34%	1.32%	-0.05%
Industrials	100.26%	99.84%	99.60%	-0.42%	-0.24%	-0.66%
Diversified Financials	101.13%	100.30%	100.30%	-0.82%	0.00%	-0.82%
Health Care Services	98.81%	97.95%	97.93%	-0.87%	-0.03%	-0.89%
Business Services	99.86%	99.12%	98.96%	-0.74%	-0.16%	-0.90%
Insurance	100.71%	100.13%	99.72%	-0.58%	-0.41%	-0.99%
Consumer Services	99.22%	98.54%	98.07%	-0.69%	-0.47%	-1.16%
Media & Entertainment	99.13%	98.09%	97.86%	-1.05%	-0.24%	-1.29%
Software & Services	99.97%	97.82%	97.09%	-2.15%	-0.74%	-2.88%
Weighted Avg.	99.55%	98.63%	98.33%	-0.92%	-0.30%	-1.22%

Source: Cliffwater Direct Lending Index, BlackRock. As of 2Q2026.

Exhibit 28: Higher-retention software borrowers tend to support greater leverage

Leverage by gross retention rate at transaction close (2019 - 2026)



Source: Lincoln Lens, BlackRock. As of 2Q2026.

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Higher rates support yields, but also raise borrower costs

As with leveraged loans, higher policy rates can support yields for lenders, but they also translate into higher borrowing costs. For floating-rate borrowers, changes in base rates flow through relatively quickly. Exhibits 29 and 30 show how that dynamic has historically impacted interest coverage ratios for U.S. and European borrowers tracked by Lincoln International.

Coverage metrics have improved from their 2024 lows, driven in part by moderating base rates. As we consider the potential impact of additional rate hikes, however, the starting point is important. The previous deterioration in coverage followed a steep hiking cycle from near-zero policy rates. Today, borrowers are already operating with elevated borrowing costs, so the incremental impact of further hikes may be different. Even so, additional increases in base rates could place renewed pressure on coverage metrics, making continued earnings growth important to borrowers' ability to absorb higher interest costs.

Exhibit 29: U.S. borrower coverage has improved, but higher rates remain a risk

Median interest coverage and fixed charge coverage, RHS, ratios for U.S. firms tracked by Lincoln International's Proprietary Private Market Index

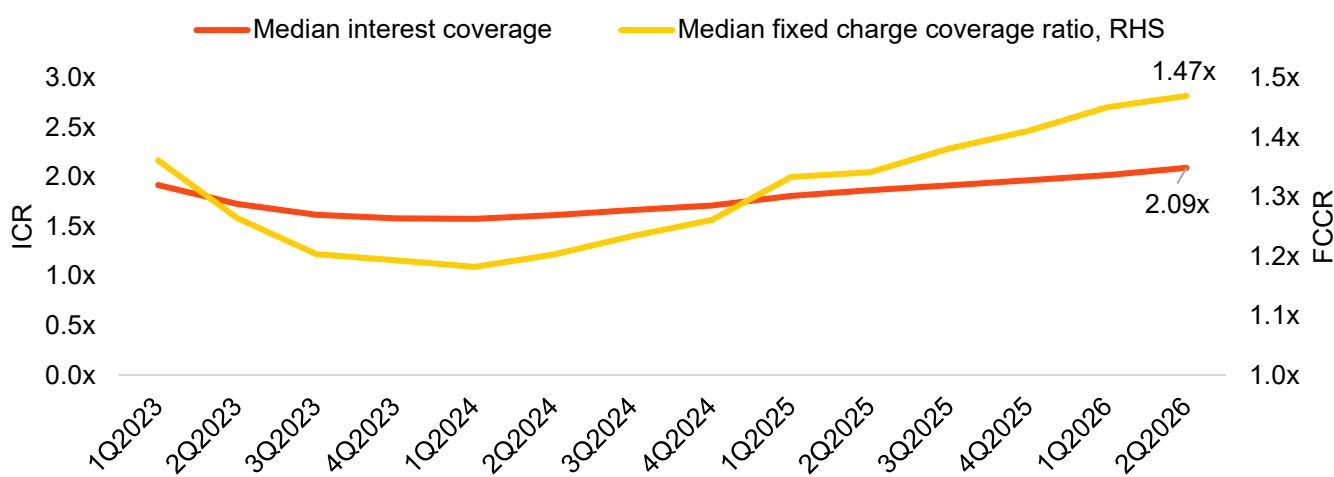
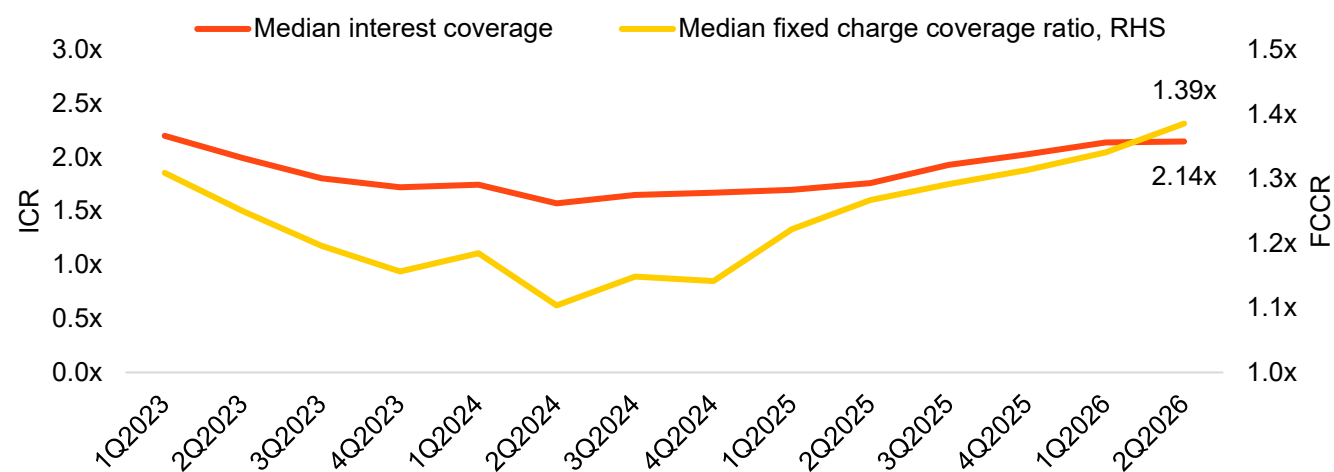


Exhibit 30: European borrower coverage has also improved from 2024 lows

Median interest coverage and fixed charge coverage, RHS, ratios for European firms tracked by Lincoln International's Proprietary Private Market Index



Source for both charts: Lincoln International, BlackRock. Data is as of 2Q2026. Calculation of Interest Coverage = PF LTM EBITDA / Interest. Calculation of fixed charge coverage ratio = (PF LTM EBITDA – Taxes – Capex) / (Interest Expense + (1% * Total Debt)). Capital Expenditures (“Capex”) utilizes LTM capex by default. If LTM Capex is unavailable, a proxy is determined using either NFY Capex, LFY Capex, or by estimating it as a percentage of revenue. Note: Interest calculations exclude companies using Payment-in-Kind (PIK) interest if cash interest is not being paid. Adjusted EBITDA rather than reported EBITDA was utilized within the analysis.

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Private credit deal activity remains uneven across regions

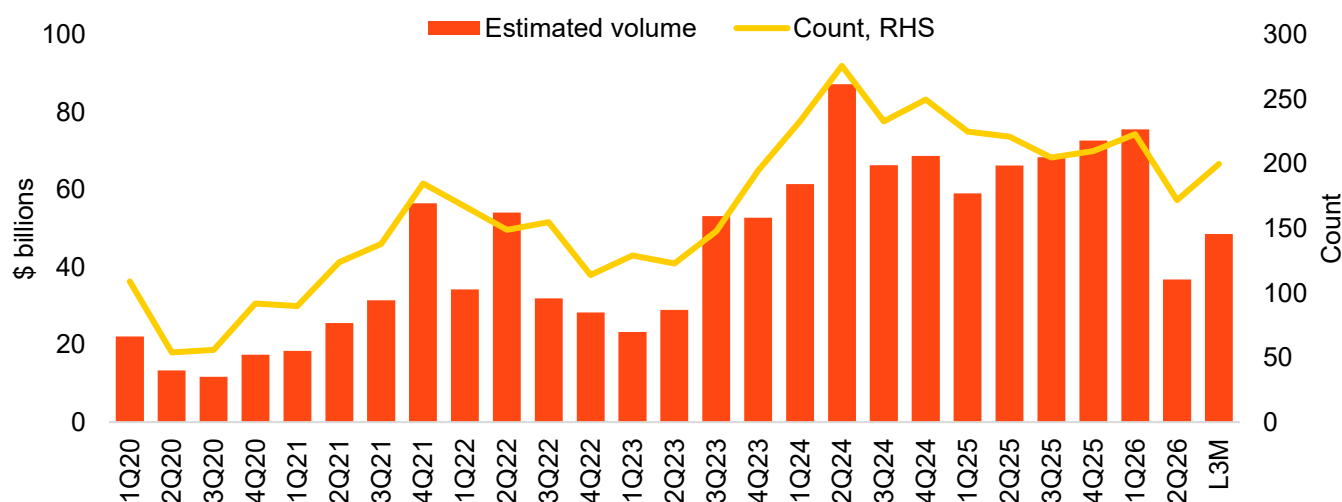
Private credit deal activity has fluctuated throughout the year and across regions. Tracking such activity provides a useful gauge of the investable opportunity available to private credit lenders and the pace at which they can put capital to work.

Exhibit 31 shows U.S. direct lending deal volume and count. While activity was strong in the first quarter, it slowed notably in the second, with quarterly deal volume falling to its lowest level since 2Q2023. More recent data, however, point to a modest improvement, with activity picking up on a last three-month basis as of August 31, 2026. Direct lending activity has been somewhat more stable in Europe, albeit with both deal volume and count slowing gradually throughout the year (Exhibit 32).

Looking ahead, the opportunity available to private credit lenders will depend not only on the overall level of financing activity, but also on where that activity takes place. As the addressable market for private credit has expanded, borrowers have increasingly been able to move between direct lending and syndicated markets.

Exhibit 31: Direct lending deal volume has rebounded in the last three months, but remains well below 1Q activity

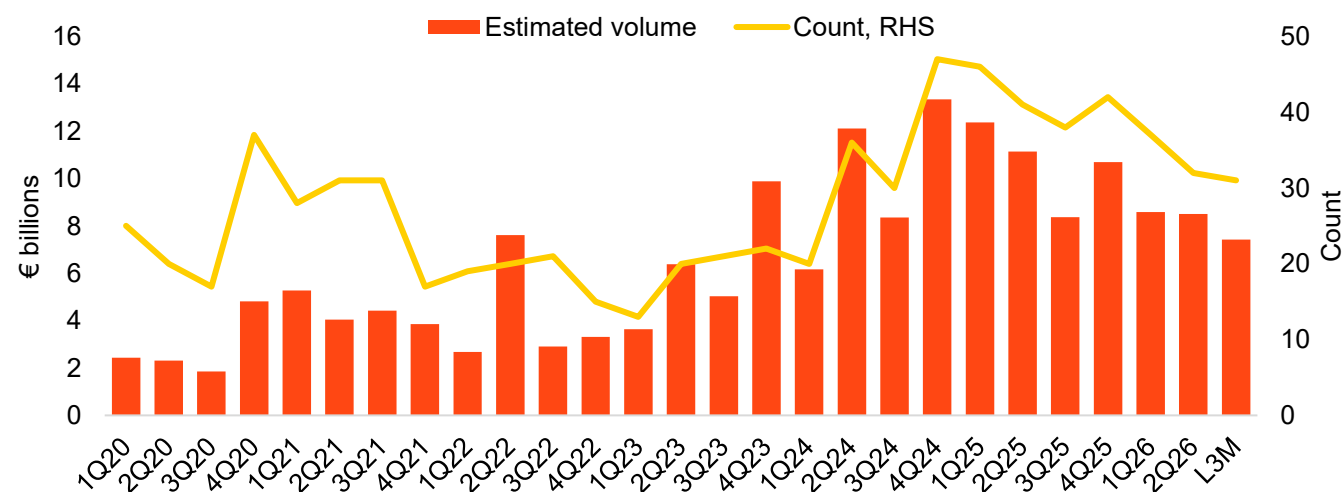
US direct lending estimated deal volume, in \$ billions, and deal count, RHS



Source: Pitchbook LCD, BlackRock. Deal count is based on transactions covered by LCD News. As of August 31, 2026.

Exhibit 32: Activity in the European direct lending market has been considerably more stable, albeit moderating throughout the year

European direct lending estimated deal volume, in € billions, and deal count, RHS



Source: Pitchbook LCD, BlackRock. Deal count is based on transactions covered by LCD News. As of August 31, 2026.

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Recent takeout activity has favored syndicated markets

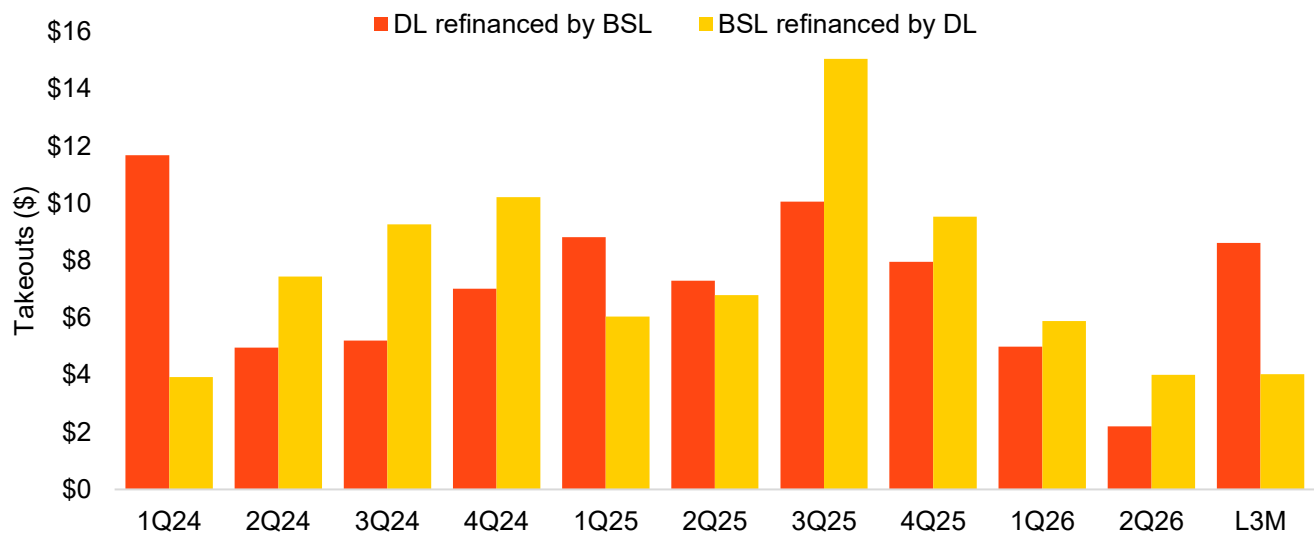
The movement between private credit and syndicated markets is evident in recent “takeout” activity in both the U.S. and Europe (Exhibits 33 and 34). Over time, we expect that activity between the two markets will ebb and flow based on relative market pricing, execution and sentiment in the public credit markets.

Direct lending offers borrowers certainty of execution, flexibility, and privacy from the public domain, but generally at a higher cost of borrowing. By contrast, when syndicated loan markets are functioning well and are able to offer reliable execution, they can generally provide more attractive pricing.

Recent activity illustrates this dynamic. YTD, refinancing activity between US private credit and the broadly syndicated loan market has been relatively limited. That said, in both markets, over the last three months, activity has increasingly favored syndicated markets, supported by a broader risk-on tone in public credit markets. We expect that a continued risk-on tone will support marginal issuance moving to the syndicated markets.

Exhibit 33: Recent U.S. refinancing flows favored BSL markets

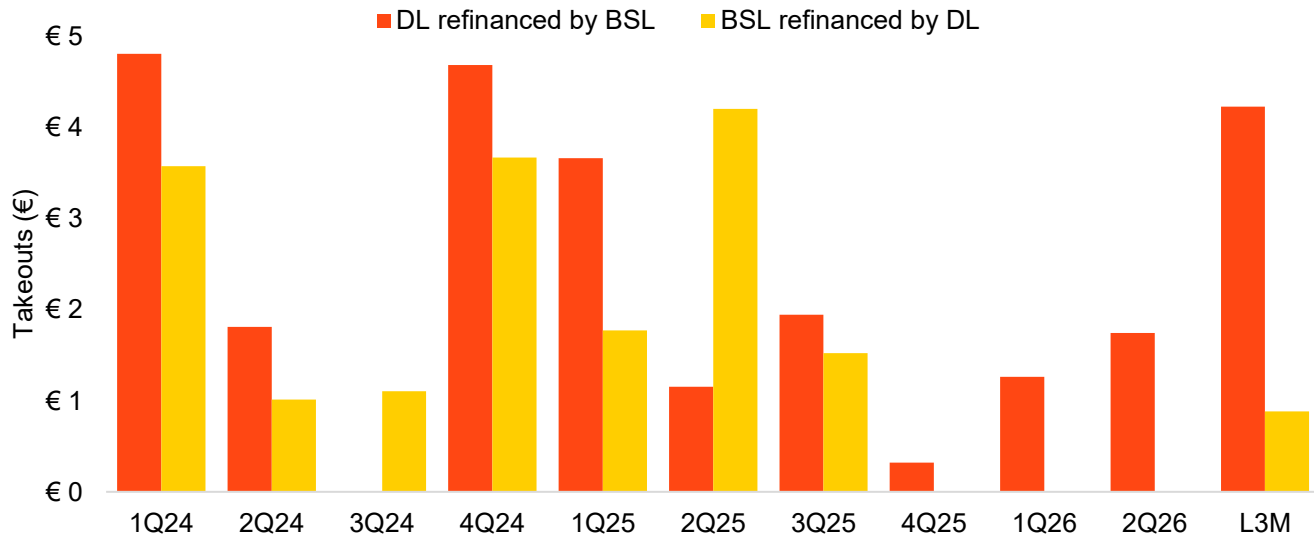
US broadly syndicated loans and direct lending takeouts, in \$ billions



Source: Pitchbook LCD, BlackRock. Historical data is subject to revisions as LCD collects additional information. As of August 31, 2026.

Exhibit 34: European refinancing flows also favored syndicated loans

Europe broadly syndicated loans and direct lending takeouts, in € billions



Source: Pitchbook LCD, BlackRock. Historical data is subject to revisions as LCD collects additional information. As of August 31, 2026.

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