

A Tempest in a Teapot?



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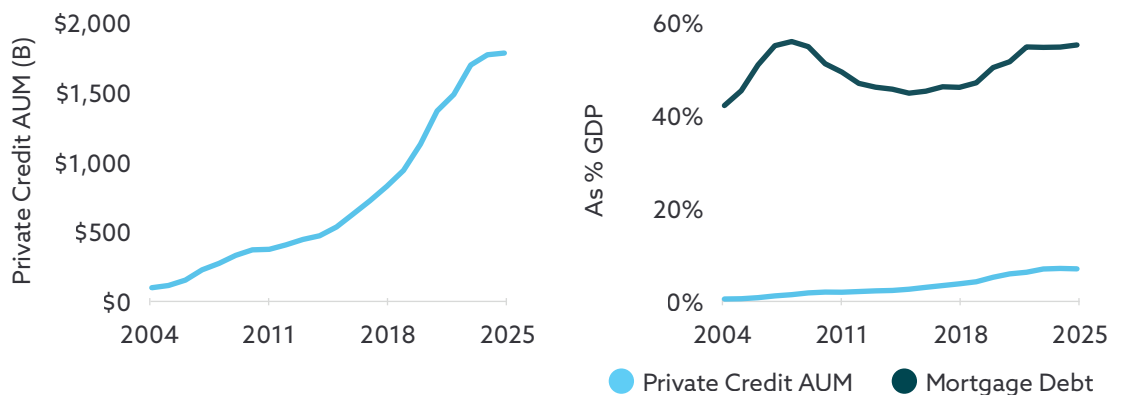
A succession of events roiled US risk markets to begin the year, leading to negative returns across equities and fixed income assets. First, the AI-driven risk-off trade in February led to significant declines in equity values for those industries and businesses deemed vulnerable to AI disruption, mostly in software- and technology-related sectors. These concerns then brought a renewed focus on risks in the private credit market, especially for those institutions with portfolios weighted toward susceptible industries.¹ As these market events unfolded, the US and Israel launched air strikes against Iran. The conflict escalated as Iran retaliated against neighboring countries, resulting in materially higher oil prices as well as supply constraints for other commodities.

All this has been a lot for markets to absorb in the space of a few weeks. We are not geopolitical experts and are therefore hesitant to make any predictions on the direction of events in the Middle East. However, we have articulated our current views on the war's potentially far-reaching [impacts on commodities](#) in the quarterly infographic. On the other hand, the two other risks introduced above fall squarely within the realm of the typical risks we evaluate as a bottom-up, fundamentals-focused asset manager.

Beginning with the concerns about private credit, the high-profile bankruptcies of Tricolor Holdings and First Brands put their opaque methods of financing transactions in the spotlight last year. After rigorous analysis, our credit research team concluded that the causes of the two bankruptcies were more [idiosyncratic in nature](#) and did not necessarily presage increased systemic risk. This view has been subsequently supported by the fact that company-specific fraudulent activity was shown to be a determining factor in both bankruptcies.

Having said that, a number of private credit firms have lent heavily to software firms, which in some cases account for up to a quarter of the book value of assets.¹ This exposure has made these private credit firms vulnerable to AI disruption concerns from the perspective of investors. Along these lines, there have been several headline-grabbing stories of prominent firms marking loans down to zero or closed-end funds limiting investor redemptions, raising concerns about the valuations of private credit firms as well as the potential for contagion to the rest of the market.^{2,3}

PRIVATE CREDIT AUM HAS GROWN SUBSTANTIALLY, REMAINS A SMALL PART OF ECONOMY⁴



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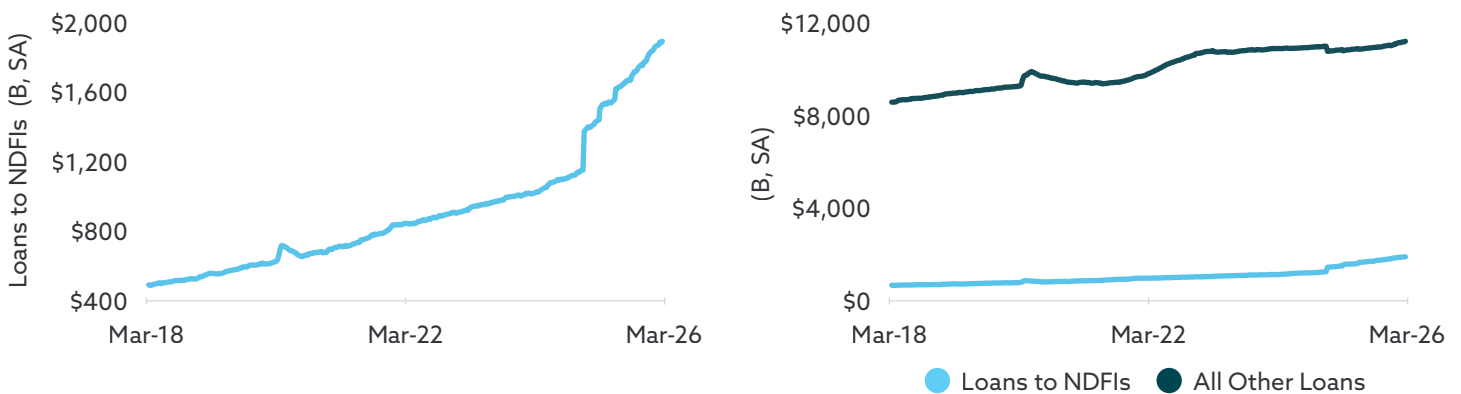
At PPM, our view is that the impact of private credit risks on financial markets is likely to be limited. As of June 2025, overall private credit lending to the economy is estimated to be nearly \$1.8T, which equates to 7.5% of US GDP.⁴ This includes loans made by [business development companies](#) (BDCs), a sub-sector that has been hit hard by the AI disruption fears. While the amount lent is substantial, we believe it is not overwhelming relative to the size of the economy. As a comparison, household mortgage debt was over 55% of GDP pre-Global Financial Crisis.⁴ Estimates are that approximately 8% of private credit loans will default with recoveries in the range of 70-80%, resulting in losses between 1.6% to 2.4% of book (or about 0.2% of GDP).⁵ Even if losses were meaningfully higher, they would still be small relative to US GDP in our opinion.

One area to keep an eye on is the transmission mechanism of private credit risks to the broader economy, the famous contagion risk. In this regard, banks come to mind as they have increased exposure to non-depository financial institutions (NDFIs) to \$1.95T.⁶ However, not all NDFIs are BDCs or lend to private credit. For example, bank loans to insurance companies would show up as lending to NDFIs.

Specifically to BDCs, bank lending to the sub-sector was approximately \$300B as of June 2025, representing roughly 2% of all US bank loans and leases at the time and a negligible percentage of US GDP.⁷ Based on this, we do not believe the contagion risk from private credit to the banking sector and the US economy overall to be material currently, even if losses in BDC loans to the software space and other sectors are worse than expected. Another factor mitigating contagion risk, in our view, is that BDCs can often limit outflows to 5% of AUM, protecting themselves from becoming forced sellers and depressing overall market values.

On the broader issue of AI disruption, we do not expect this will make markets riskier overall. When looked at through a historical lens, innovation (e.g., railroads, automobiles, the internet, etc.) has almost always caused market jitters but has not proven to be systemically negative for markets to this point. Quite to the contrary, innovation generally has led to better long-term growth and economic outcomes, both of which should be good for risk assets. Therefore, we believe that AI risks to market performance may not be as high as currently feared. Certainly, AI disruption is likely to result in winners and losers amongst various industries and companies. Determining who these will be and investing accordingly plays into PPM's credit research approach, which we believe can work in any market environment.

**AFTER QUADRUPLING IN 8 YEARS,
BANK LENDING TO NDFIs STILL SIGNIFICANTLY SMALLER THAN ALL OTHER LOANS⁶**



(5) Morgan Stanley. "Connecting the Dots Around Private Credit." 2 April 2026. (6) FactSet, Federal Reserve. Weekly data through 27 March 2026. 8 April 2025. (7) Moody's, FactSet, Federal Reserve. "US banks' private credit loan exposure nears \$300 billion." 21 October 2025.

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