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GLOBAL OUTLOOK 2026

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HEAD OF EUROPEAN PRIVATE CREDIT AND CAPITAL SOLUTIONS

BARINGS

RESILIENCE AND RISK

The global direct lending market has expanded at an extraordinary pace, attracting unprecedented capital and a broader borrower base across North America, Europe, and Asia Pacific. This surge has unlocked opportunities but also introduced new layers of complexity. Heightened competition has led some lenders to stretch leverage, accept tighter pricing, or ease documentation standards.

Sustainable performance isn't about chasing momentum, it's about discipline. Resilient managers stay rooted to core strengths and underwriting standards. Not all direct lending is equal – the traditional middle market continues to offer attractive risk-adjusted returns, especially first-lien senior debt supported by strong documentation.

Despite tighter spreads, origination yields have held steady at roughly 9% for the last 12 months through June, with premiums over broadly syndicated loans of 100-150 basis points in North America and 200-250 basis points in Europe. Sponsors remain willing to pay for resilience and certainty of execution. Muted M&A has slowed deal flow for some, but established lenders with scale, a large existing portfolio and permanent capital remain well-placed to source distinctive opportunities through off-market origination and add-ons from incumbent borrowers. Direct lending is maturing. Success now depends on discipline, scale, and deep relationships to navigate heightened competition.

ARE DEFAULTS A CONCERN?

Context matters. Defaults making news have been isolated, idiosyncratic events, more about fraud than credit stress, and outside core middle market lending, but they've prompted questions about risk amid macro divergence. AI-driven investment supports some sectors, while labour markets and consumer sentiment show strain. Policy volatility adds complexity.

A modest uptick in defaults is likely, especially in cyclical segments or where underwriting slipped. Managers are responding with proactive monitoring, swift remediation, and contractual levers to protect capital. The "red pen" signals prudent stewardship.

We're seeing a renewed focus on diligence and documentation: tighter covenants, stricter limits on incremental debt, and enhanced reporting. Investors are asking tougher questions, and managers are codifying risk controls in legalterms. Even in competitive environments, walkingaway from deals that fail standards is essential.

WHAT ROLE DOES PIK PLAY?

Payment-in-kind (PIK) features have attracted attention, but they remain immaterial in our portfolios. Our focus remains on performing senior secured, cash-pay loans. In Europe, borrowers may opt for PIK if needed, but uptake is limited – minimum cash-pay requirements of around 4% are standard. PIK may feature in the broader market, but it is not core to our approach or the middle market.

REGIONAL DYNAMICS

North America remains the largest and most mature market, though tariff impacts and margin pressure demand careful underwriting. Europe is undergoing structural change – non-bank lending is gaining share, and risk-adjusted returns remain attractive. Developed Asia Pacific offers selective diversification opportunities for those with local expertise. The ability to adjust exposures toward regions with the most compelling risk-adjusted returns is now a hallmark of sophisticated portfolio construction.

KEY TAKEAWAY FOR 2026

Direct lending is evolving – not fading.Headlines amplify noise, but the real story is a market rewarding discipline, risk management,and regional nuance. Success will hinge onpartnering with managers focused on fundamentalsand able to recalibrate as conditions shift.

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