

E X P E R T Q & A

Amid private credit's rapid expansion, Barings' Tyler Gately and Stuart Mathieson discuss how mid-market direct lending has evolved and how it addresses growing investor demand for access to the asset class



Inside the direct lending market

Q Private credit has grown significantly and drawn increased attention. What do you think is misunderstood about the asset class today?

Tyler Gately: Private credit has certainly come under a brighter spotlight. As the market has grown, periods of uncertainty have drawn more attention to direct lending in particular, prompting questions around whether the strategy itself is undergoing a fundamental shift. In reality, many of the core characteristics that define traditional mid-market lending – senior positioning in the capital structure, contractual cashflows, and an emphasis on downside protection – remain firmly intact.

Stuart Mathieson: That distinction is important. Headlines often focus on a

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handful of high-profile defaults or periods of repricing and use them to frame the state of the entire market. Direct lending has always been a sub-investment grade asset class where outcomes naturally diverge. What determines results is not the absence of credit stress, but the quality of underwriting, documentation and portfolio management behind each strategy. Without that context, it's easy to conflate isolated outcomes with broader structural deterioration, but the reality is more nuanced.

Q What distinguishes traditional, mid-market

direct lending within the broader private credit universe?

TG: Traditional mid-market direct lending is anchored by its seniority in the capital structure and reliance on contractual cashflows. These are senior secured, first lien loans to established businesses, and typically include maintenance covenants and other structural protections that are designed to support early intervention and downside protection. The objective is to generate durable income while preserving capital through disciplined underwriting and conservative structures.

SM: Unlike public markets, where pricing is often shaped by liquidity conditions and investor flows, direct lending performance tends to be tied more closely to underwriting quality and

portfolio management. This difference becomes most apparent as conditions change. Strong documentation and conservative leverage preserve flexibility, while weaker structures tend to show themselves more quickly.

These characteristics also help explain the role direct lending continues to play in broader portfolios. Returns have historically been less correlated with public equities and liquid credit markets, in part because the negotiated nature of each investment and the absence of daily mark to market pricing.

TG: Relative value has also remained consistent. Across North America, Europe and developed Asia-Pacific, direct lending continues to offer a yield premium over comparable public credit markets – particularly when viewed on a spread per turn of leverage basis. Lower leverage, tighter structures and greater lender control help sustain this, even as absolute spreads fluctuate across cycles.

Q What has changed as the market has evolved?

TG: While the strategy's core fundamentals remain intact, the structure of the market itself has changed meaningfully. Capital has become far more concentrated, with the largest platforms accounting for a majority of global direct lending assets. At the same time, sponsors are placing greater emphasis on certainty of execution, making scale and reliability increasingly decisive. This shift is evident in fundraising patterns, where experienced managers have captured a growing share of direct lending commitments in the past decade.

SM: The concentration of capital has also reinforced the importance of incumbency-driven origination. Managers overseeing large, seasoned portfolios are sourcing a greater proportion of opportunities through refinancings and add-on transactions relative to new platform deals.

Where lenders have access to primary origination and control over deal

terms, workout paths also tend to be clearer than in more fragmented or heavily clubbed transactions, where differing investor interests can hinder or slow decision-making. This distinction often determines who ultimately shapes outcomes when performance diverges from expectations.

TG: The investor base has evolved as well, with wealth related capital now playing a more prominent role. Because flows into and out of retail vehicles are more visible, they tend to draw outsized attention during periods of market stress. In reality, these vehicles represent only a minority of direct lending AUM, with most capital still invested through closed-end institutional funds that aren't subject to redemption pressures.

Sustained investor demand for the asset class further confirms that direct lending remains supported by deep and durable capital pools – with this level of momentum and demand expected to persist as buyout firms continue to deploy their record levels of dry powder.

Q As dispersion in the market becomes more pronounced, what's driving differences in outcomes?

SM: As access points narrow, differences in manager approach will be increasingly reflected in outcomes. Periods of strong fundraising and elevated competition have increased the importance of underwriting standards and documentation quality, two key drivers of dispersion.

In senior lending, where upside is inherently limited, relaxing leverage or structure in pursuit of incremental yield can come at a meaningful cost when conditions tighten – and I think we'll see increased performance dispersion among managers as a result.

TG: It's also important to distinguish between asset class behaviour and manager-level results. While historical average default rates in private credit have compared favourably with the

broadly syndicated loan market, those averages can obscure variation beneath the surface. Defaults can differ materially across managers depending on how risk is structured and managed through periods of stress.

Much of the dispersion today is – and will be – rooted in decisions made earlier in the cycle. Choices around leverage, documentation quality, and sector exposure made during periods of abundant capital are now being tested as conditions normalise.

SM: More resilient portfolios have tended to emphasise businesses with defensive characteristics or durable revenue profiles, while limiting exposure to areas where cyclical or disruption can undermine visibility. Shifts in technology, particularly in software and services, have reinforced the need for underwriting that adapts to changing conditions rather than relying on backward-looking assumptions.

Q How should investors think about direct lending going forward?

SM: The focus should remain on fundamentals. For long-term investors, the relevant question is whether recent volatility reflects cyclical adjustment or structural impairment. In many recent episodes, repricing has been driven more by shifts in capital flows, marginal buyers, or risk appetite than by broad deterioration.

TG: Structural demand drivers also remain in place. Private equity sponsors continue to value certainty of execution and flexibility, while bank disintermediation – particularly outside the US – continues to constrain certain lending channels. At the same time, investor demand for highly diverse income orientated strategies with structural protection and floating rate characteristics remains strong. Taken together, these dynamics reinforce why traditional mid-market direct lending continues to play a role in long term portfolios. ■