

The background features a complex financial visualization with a blue and orange color palette. It includes a candlestick chart, a line graph with data points, and various numerical values such as 1193, 1198, 59.53, 68, 28.66%, 47.21%, 64.47%, 28.65%, and 28.65%.

# BARINGS

## PRIVATE CREDIT

# Putting Direct Lending in Context

### INSIGHTS

Private credit is drawing increased attention, but not all strategies behave the same. Traditional middle market direct lending is best understood by looking beyond headlines to underlying fundamentals—an approach that helps explain its continued role in long-term portfolios.



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Private credit has been under a brighter spotlight recently. As the market has grown in size and visibility, periods of uncertainty have drawn **attention to the asset class more broadly, and to direct lending in particular**, often fueled by headlines tied to isolated credit events or shifts in capital flows. While that scrutiny has sharpened the conversation, it does not always capture how the strategy actually performs across cycles.

Against that backdrop, it is worth revisiting what traditional middle market direct lending is, including **what has changed, what hasn't changed, and how the market continues to evolve**. Its defining characteristics—seniority, contractual income, and an emphasis on downside protection—help explain why the strategy continues to play a meaningful role in long-term portfolio construction.

## Direct Lending, Defined

Traditional, sponsor-backed middle market direct lending represents a distinct and well-established segment within the broader private credit universe. In its most common form, it consists of **senior secured, first lien loans** to established businesses, structured around contractual income, lender protections and capital preservation. While approaches vary by manager, the core characteristics are consistent:

- **Senior secured exposure**, often first lien, with priority claims on borrower assets
- **Negotiated lender protections**, including covenants and reporting requirements
- **Sponsor-backed transactions**, frequently involving established private equity firms
- **Predominantly floating-rate**, contractual income streams
- **A buy-and-manage orientation**, where manager discipline materially influences outcomes

Direct lending is predominantly below investment grade. As a result, credit stress can occur over time, and outcomes are shaped by how portfolios are constructed and managed—through diversification across issuers and sectors, disciplined underwriting, and active monitoring of borrower performance. Ongoing engagement with both borrowers and sponsors, supported by consistent reporting and lender protections, plays an important role in identifying issues early and preserving value when conditions evolve. Because upside in senior lending is inherently limited, relaxing leverage or structure in pursuit of incremental yield can come at a meaningful cost when conditions tighten.

## What Has—And Has Not—Changed

Although the private credit market has evolved, many of the characteristics that initially attracted investors to traditional direct lending remain intact.

### WHAT HASN'T CHANGED

At its core, direct lending remains anchored by its **seniority in the capital structure** and reliance on contractual cash flows. Maintenance covenants and other structural protections are designed to support **early intervention and downside protection**. Unlike public markets—where pricing is often shaped by liquidity conditions and investor flows—direct lending performance tends to be tied more closely to fundamental credit underwriting and ongoing portfolio management. Those features are critical when volatility rises: **strong documentation and conservative leverage preserve flexibility** as earnings come under pressure, while weaker structures tend to show their limits quickly.

The asset class also continues to play a diversification role within broader portfolios. While not immune to macroeconomic pressure, private

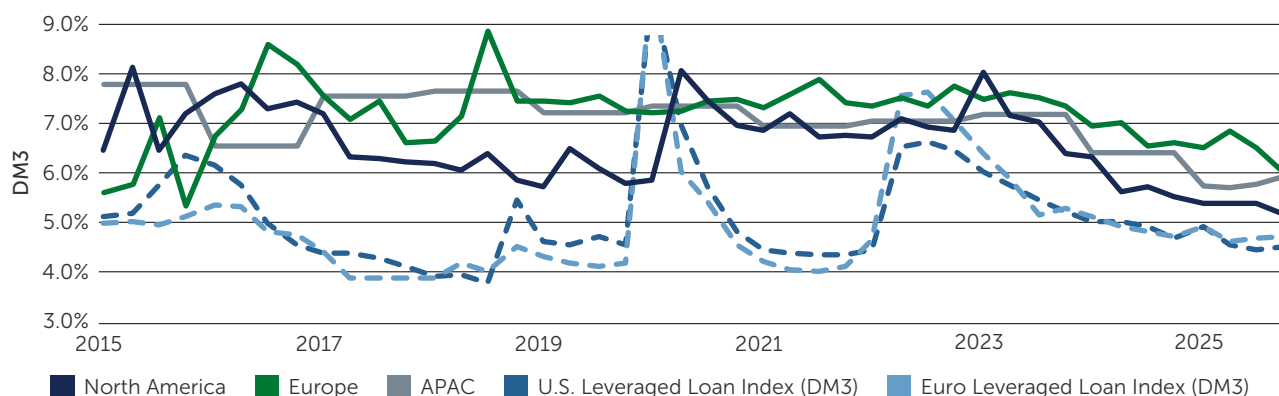
credit returns have historically shown **lower correlation to public equities and liquid credit markets**.

**Relative value dynamics** also remain intact. Spread premiums over comparable public credit markets continue to be evident across geographies:

- **North America** is the largest and most mature market, with an average spread premium of roughly 175–200 basis points (bps) over broadly syndicated loans. Spreads have widened modestly from recent tightness as pricing has adjusted alongside shifts in the marginal buyer.<sup>1</sup>
- **Europe and developed Asia Pacific** continue to reflect more pronounced bank retrenchment and documentation discipline. Spread differentials versus broadly syndicated markets tend to be more consistent, at roughly **200–250 bps in Europe** and **200–350 bps in developed Asia Pacific**.<sup>2</sup>

Viewed on a spread-per-turn-of-leverage basis, direct lending continues to offer attractive compensation relative to the broadly syndicated loan market. Lower leverage, tighter structures, and greater lender control help preserve this advantage, even as absolute spreads fluctuate across cycles (**Figure 1**).

**Figure 1: Direct Lending Maintains a Structural Yield Premium Across Regions**

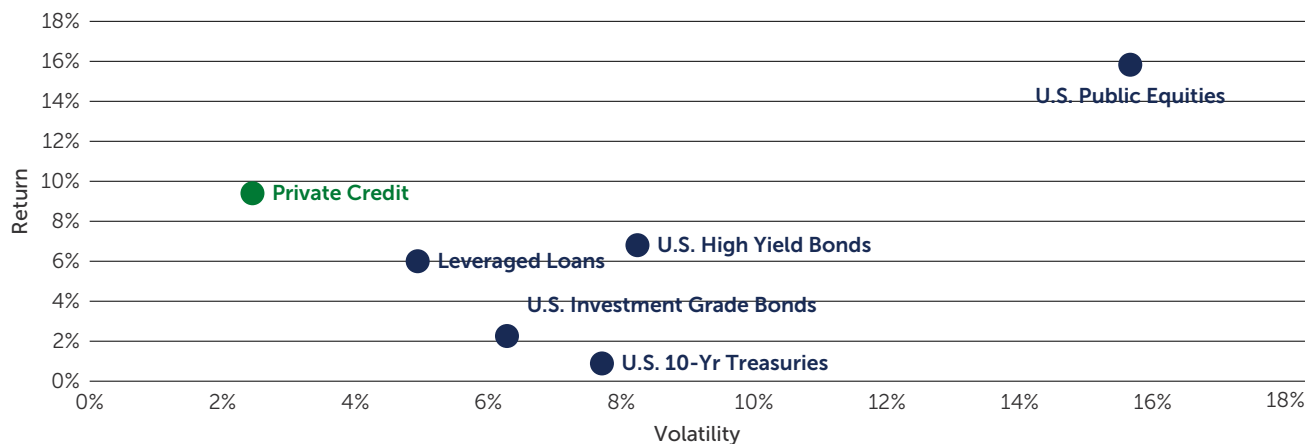


Sources: S&P UBS Leveraged Loan Index; Barings. Barings deployment calculated as an average of all transactions in each region completed over the quarter. As of February 2026.

1. Sources: Barings; LSTA. Data from Q1 2022–Q1 2026.  
 2. Sources: Barings; LSTA. Data from Q1 2022–Q1 2026.

Investors typically evaluate direct lending alongside broadly syndicated loans, high yield, and investment grade credit within a broader portfolio framework—balancing return potential against volatility and downside risk (Figure 2). From that perspective, private credit has historically offered **competitive returns with lower observed volatility**, as measured by the Cliffwater Direct Lending Index. While the illiquidity premium embedded in private credit is not static, it remains central to the long-term allocation rationale.

Figure 2: Attractive Historical Returns with Low Volatility



Sources: Cliffwater; Morningstar Direct. Data represents average annual total returns from 2016–2025. Volatility is measured by standard deviations of annual total returns to average annual total returns. The following indices are referenced as follows: “Private Credit”—Cliffwater Direct Lending Index; “Leveraged Loans”—Morningstar LSTA LL100; “U.S. Investment Grade Bonds”—Bloomberg U.S. Aggregate; “U.S. High Yield Bonds”—Bloomberg U.S. Corporate High Yield; “U.S. 10-Yr Treasuries”—ICE BofA Current 10-Y U.S. Trsy; “U.S. Public Equities”—S&P 500. **PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS.**

For these reasons, **institutional demand** for the asset class remains strong. Despite market volatility and retail-focused private credit headlines, investors continue to turn to direct lending for its **yield potential, floating-rate profile, contractual cash flows and strong risk-return profile**. More recent market activity suggests investors also remain constructive on the long-term role that direct lending can play in portfolio construction, with continued deployment and active fundraising evident across established platforms.

### WHAT HAS CHANGED

What has changed is the structure of the market itself. Recent research from Preqin shows direct lending capital becoming more concentrated, and increasingly centered among a smaller group of large, established platforms with proven execution capabilities and institutional infrastructure.<sup>3</sup>

- **In North America**, the top 10 managers completed 38% of direct lending deals in 2025.<sup>4</sup>
- **In Europe**, a market perceived as less mature relative to the U.S., the top 5 managers completed 47% of direct lending deals in 2025, with the top 10 managers accounting for 65% of all direct lending deals over the year.<sup>5</sup>

3. Source: Preqin Investor Outlook: H1 2026.

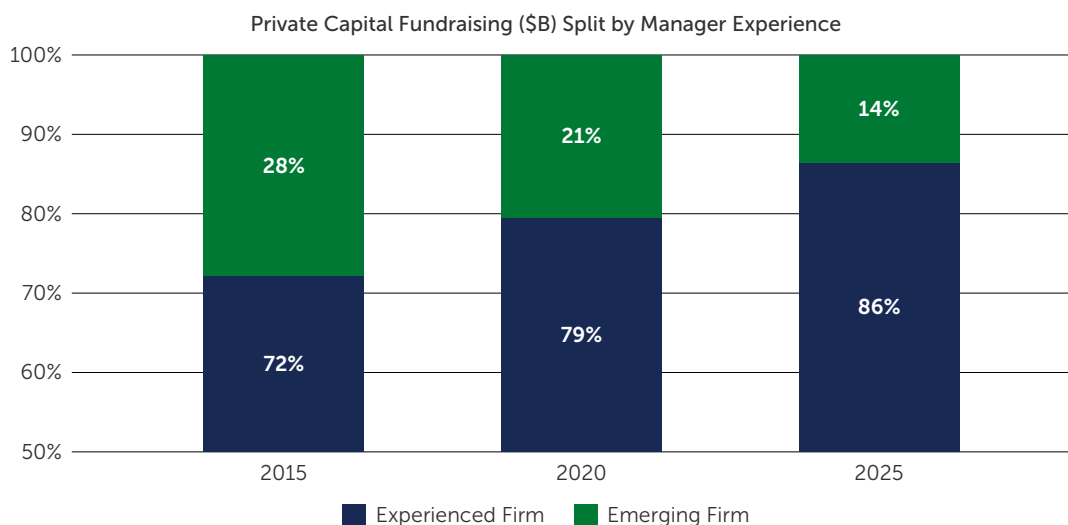
4. Source: Octus. As of December 2025.

5. Source: Houlihan Lokey Q4-2025 MidCap Monitor—European Unitranche Financings Q4 2025 (LTM).

*“Direct lending capital [is] becoming more concentrated, and increasingly centered among a smaller group of large, established platforms.”*

The concentration of capital is further evident in fundraising patterns, where experienced managers have captured a growing share of private capital commitments over the past five years (Figure 3). This has also reinforced a second structural shift: the **rising importance of incumbency-driven origination**. Managers overseeing large, seasoned portfolios are sourcing a greater share of opportunities through refinancings, add-on acquisitions, and repeat transactions, rather than relying primarily on new platform deals.

**Figure 3: Fundraising has Become Increasingly Concentrated Among Experienced Managers**



Source: Pitchbook (global fundraising). As of December 31, 2025.

At Barings, add-on financings today account for approximately 58% of deployment, compared with 42% for new platform transactions. **Five years ago, this mix was effectively reversed**, with new platforms representing roughly 70% of activity and add-ons closer to 30%.<sup>6</sup> These dynamics are notable because they reflect increasing access to off-market opportunities through existing portfolio company relationships. As a result, deployment is less reliant on broadly syndicated or sponsor-driven auction processes, and therefore less exposed to fluctuations in M&A and competitive market conditions, particularly during periods of volatility.

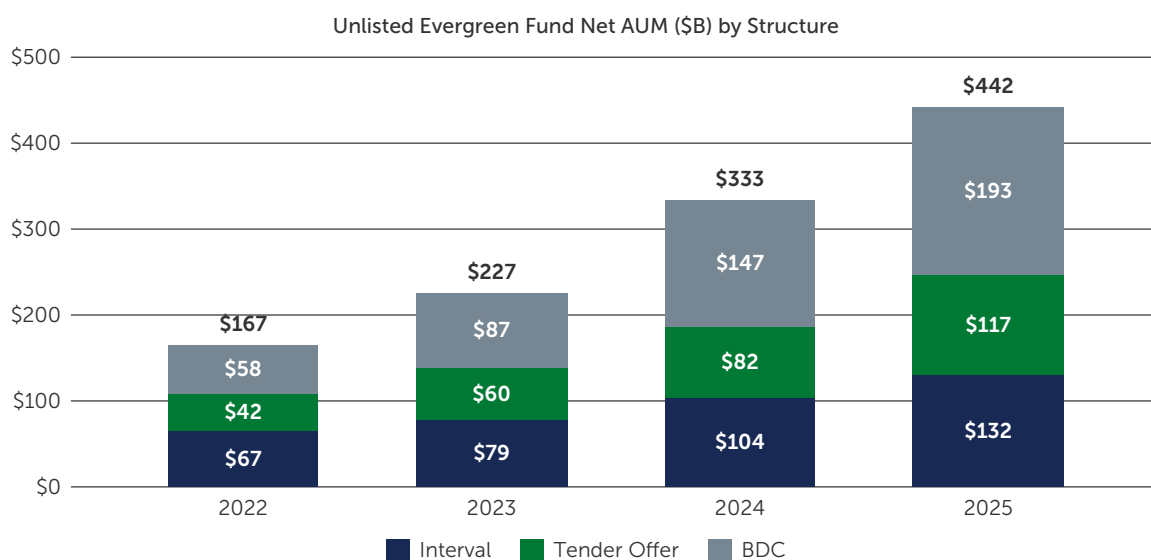
Scale and incumbency can also help **ensure influence over terms and outcomes**. Where lenders have access to primary origination and **control over deal terms**, workout paths tends to be clearer than in more fragmented or heavily clubbed transactions, where influence can diminish quickly. That distinction often determines who ultimately shapes outcomes when performance diverges from expectations.

6. Source: Barings. As of March 31, 2026.

### THE RISE OF RETAIL

Another key change is the evolution of the investor base, with wealth-related capital becoming a more visible feature of the market. This shift is reflected in the **growth of evergreen and semi-liquid vehicles** over the past several years (**Figure 4**). Aggregate net AUM in these vehicles has expanded meaningfully, and in parallel, the number of active evergreen funds in the U.S. has more than doubled since 2018.<sup>7</sup>

**Figure 4: Growth of Evergreen Private Credit Vehicles by Structure (U.S.)**



Sources: Morningstar; PitchBook. Data was aggregated on March 13, 2026.

Because flows into and out of semi-liquid vehicles are more visible, they tend to attract disproportionate attention during periods of market stress or heightened activity. In reality, these vehicles **account for only a minority of direct lending AUM, which exceeds \$1.5 trillion**. The majority of capital in the market is invested through closed-end institutional funds that are not subject to redemption pressures. In addition, across evergreen and closed-ended funds, there is substantial undeployed capital—roughly \$500 billion of dry powder—alongside significant unused lending commitments from banks.

These factors underscore how direct lending remains supported by **deep and durable capital pools**, and institutional investors continue to be active allocators to the asset class. The overall availability of committed and deployable capital provides **multiple liquidity buffers**, even as the composition of capital has evolved. Thus, while periodic shifts in wealth-channel flows can influence pricing and structures at the margin, they do not—on their own—necessarily signal stress at the asset-class level.

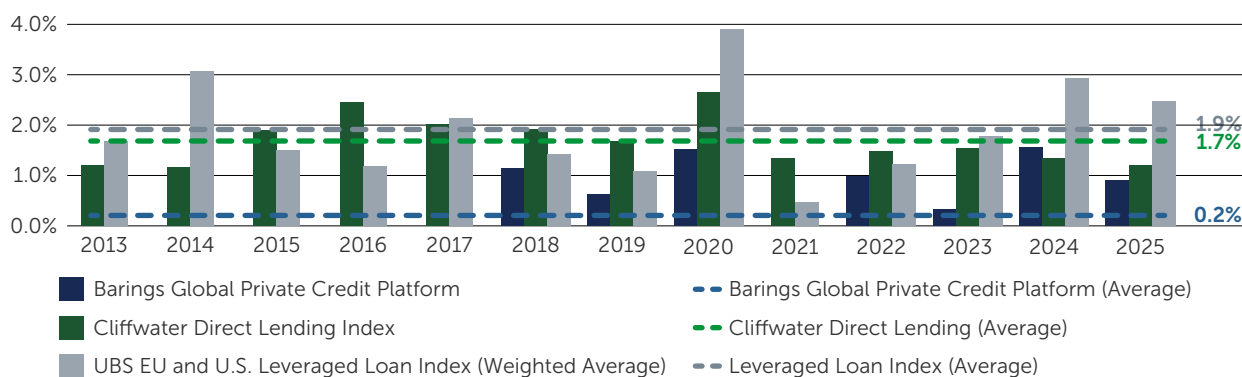
7. Sources: Morningstar; PitchBook. As of February 28, 2026.

### GROWING DISPERSION

As attention on the asset class has intensified, there is also a greater focus on underwriting standards and documentation quality. As capital becomes more abundant but access points narrow, differences in manager approach will be increasingly reflected in outcomes.

Against that backdrop, it is important to distinguish between **asset class behavior and manager-level results**. Historical average default rates in private credit have compared favorably to the broadly syndicated loan market, reflecting the asset class’s senior secured positioning and negotiated structures (Figure 5). That said, asset class averages can mask **variation beneath the surface**, as defaults can differ materially across managers depending on the quality of assets a GP has access to and how risk is structured and managed through periods of stress.

Figure 5: Average Defaults in Private Credit vs. Public Leveraged Loans



Sources: Barings; Cliffwater; UBS. As of December 31, 2025.

That distinction helps explain why dispersion continues to widen. Much of it is—and will be—rooted in decisions made earlier in the cycle. Underwriting considerations around **leverage, documentation quality and sector exposure** established during periods of abundant capital are now being tested as conditions normalize. The timing of capital deployment is another factor, with differences across vintages also contributing to divergent outcomes.

More resilient portfolios tend to comprise **businesses with defensive characteristics** or durable earnings profiles, while limiting exposure to areas more susceptible to cyclical or disruption. Shifts in technology, particularly in software and services, have reinforced the need for underwriting approaches that adapt to changing conditions rather than relying on backward-looking assumptions.

## Structural Forces Supporting Continued Demand

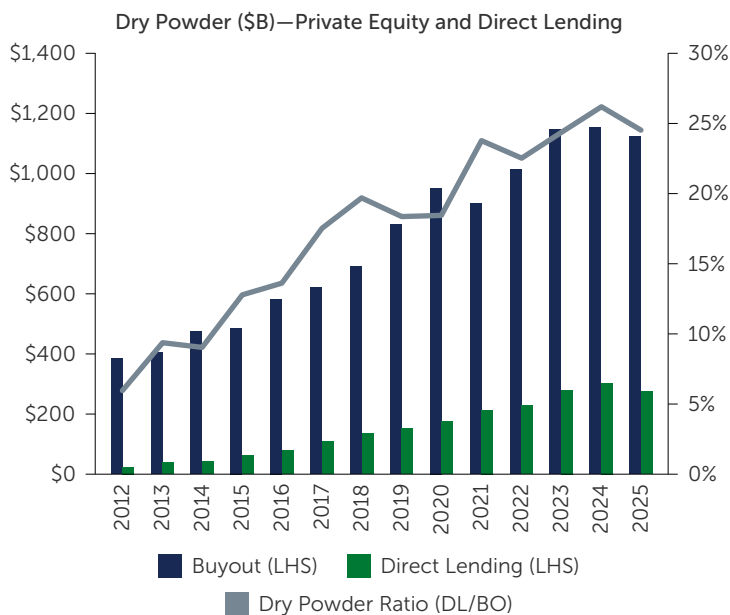
Even as the market has evolved, several long-term dynamics continue to support demand for traditional direct lending—reflecting changes not only in how borrowers access capital, but also in how investors are allocating it.

### PRIVATE EQUITY-DRIVEN BORROWER DEMAND

Private equity sponsors increasingly value **certainty of execution, flexibility and reliable financing outcomes**—particularly in environments where public markets can reprice abruptly. Direct lenders’ ability to provide customized structures and committed capital remains highly relevant, even as overall transaction volumes ebb and flow.

At the same time, sustained levels of undeployed buyout capital continue to create financing needs across new platforms, add-on acquisitions and refinancings (Figure 6). As a result, even as exit timelines extend, the existing gap between buyout dry powder and available direct lending capital should only reinforce demand for direct lending in the years ahead, as sponsors continue to deploy the capital that they have raised in prior years.

**Figure 6: Persistent PE Buyout and Direct Lending Dry Powder Supports Financing Demand**



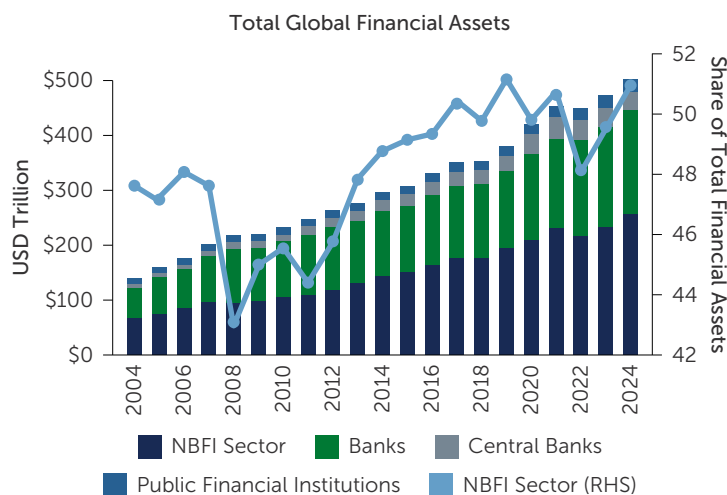
Source: Preqin. As of December 31, 2025.

## SUPPLY CONSTRAINTS

**Bank disintermediation** continues to reshape corporate lending markets. In the U.S., this transition is already well advanced, with non-bank lenders playing a central role in middle market financing. Outside the U.S., the trend has been gaining momentum in recent years—particularly in Europe and Asia Pacific—where a more restrictive regulatory environment, tighter capital requirements, balance sheet constraints and evolving risk appetites are increasingly limiting banks’ willingness and ability to extend certain forms of credit.

As a result, a **growing share of global financial assets has migrated away from traditional banks**, with non-bank lenders now accounting for roughly half of global financial assets (Figure 7).

**Figure 7: Global Financial Assets Have Shifted Toward Non-Bank Lenders**



Source: Financial Stability Board. As of December 2025. NBFI includes non-bank financial institutions such as asset managers, insurers, pension funds, private credit funds and other market-based lenders.

### PERSISTENT INVESTOR DEMAND

Investor demand for **income-oriented credit strategies** also remains strong, particularly among institutions seeking yield with structural protection and floating-rate exposure. While flows may vary across vehicles and capital channels, **the strategic allocation case for direct lending continues to resonate** for investors focused on long-term portfolio construction rather than short-term market timing.

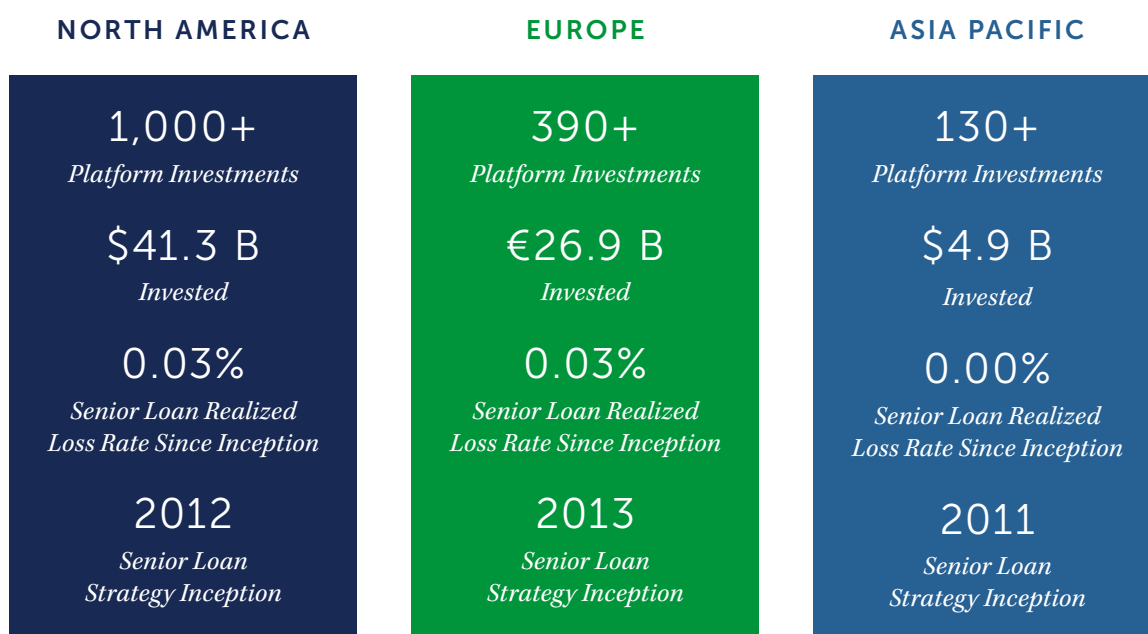
## Looking Past the Noise

As private credit has grown in scale and visibility, periods of uncertainty have brought louder—and often less nuanced—commentary. Headlines frequently conflate strategies and outcomes across a diverse market, obscuring important distinctions within the asset class.

For long-term investors, **the more relevant question is not whether volatility exists, but whether it reflects structural impairment.** In many recent episodes, repricing has been driven by shifts in capital flows and risk appetite rather than broad deterioration in underlying fundamentals.

Against that backdrop, direct lending’s role within portfolios is best understood through **fundamentals rather than headlines.** Discipline, selectivity and control continue to shape outcomes, reinforcing the role of traditional middle-market lending as part of long-term portfolio construction.

### Barings’ Global Direct Lending Platform



As of March 31, 2026.

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