ESADE Master's Finance Club

FIXED INCOME MARKET MONITOR

OCTOBER 2026

PUBLIC MARKETS

RATES & GOVERNMENT BONDS

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INVESTMENT GRADE CREDIT

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HIGH YIELD CREDIT

JULES COPPENS

MORTGAGE-BACKED SECURITIES

HUGO HEISE

PRIVATE MARKETS

PRIVATE CREDIT & DIRECT LENDING

TIM ZIEGLER | GIULIA WEBER COLUSSI | LIAM THIELE

DATA

MARKET WATCH & CALENDAR

LUKA THOMSON

TEAM PROFILE

The Fixed Income Department



Luka Thomson
Head of Fixed Income

PUBLIC MARKETS



Nin Sacristan
Rates & Government Bonds



Joan Brugada Mestre
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Paul Manner
Investment Grade Credit



Jules Coppens
High Yield Credit



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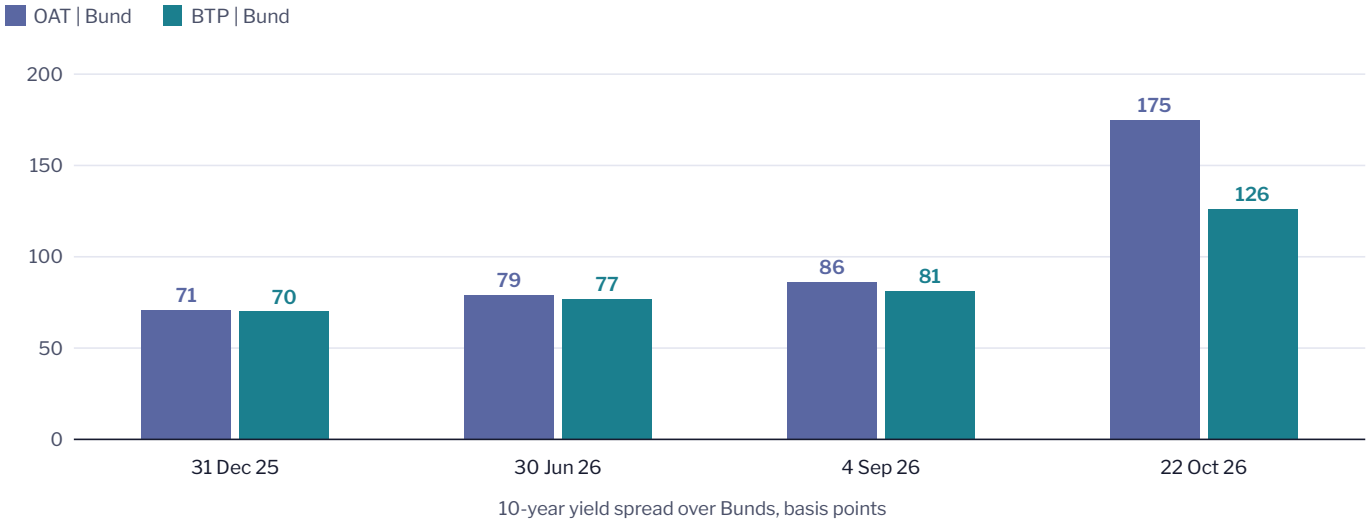


Giulia Weber Colussi
Direct Lending



Liam Thiele
Direct Lending

Chart of the Week: France Has Decoupled From the Euro Area



10-year yield spread over Bunds, basis points

The OAT–Bund spread has doubled since our last issue, to its widest in 15 years, and French 10-year paper now yields 50bp more than Italian.[14,16,70]

+89bp
French 10-year yield since 4 September, to 5.09%

+72bp
US high yield OAS since 4 September, to 340bp; IG +8bp

6.3%
Fitch US private credit default rate, TTM to August, a record

Macro backdrop

US nonfarm payrolls (Sep)	+29k
US unemployment rate (Sep)	4.2%
US headline / core CPI (Sep)	3.7% / 2.6%
Euro area headline HICP (Sep)	3.8%
Euro area core HICP (Sep)	2.5%
Brent crude (22 Oct)	~$113

Energy is driving headline inflation while hiring has stalled; core is far calmer than headline on both sides of the Atlantic.[18,19,20,69]

What we are watching this fortnight

FOMC decision; hike odds ~7%	28 Oct
UK Budget; gilts' fiscal test	28 Oct
ECB decision; hold expected, December live	29 Oct
BoJ decision and Outlook Report	30 Oct
Q3 BDC results; Kayne Anderson	5 Nov
US CPI (Oct)	10 Nov

The six items the desk is tracking into the next issue.[3,12,17,54,72]

RATES

"Our view is cautious on long-duration exposure while energy and fiscal uncertainty remain elevated."

Joan Brugada Mestre

INVESTMENT GRADE

"We therefore keep the quality tilt (A over BBB) and stay underweight long-dated AI-infrastructure supply."

Paul Manner

HIGH YIELD

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PRIVATE CREDIT

"Listed BDCs at about 0.7x book offer a more honest entry price than gated non-traded vehicles still transacting at NAV."

Giulia Weber Colussi

Where yields stand

US 2y 4.65% · US 10y 4.96% · 2s10s +31bp · Bund 10y 3.34% · OAT 10y 5.09% · BTP 10y 4.59% · Gilt 10y 5.34% · JGB 10y 2.88%

Where spreads stand

US IG 89bp · US BBB 111bp · US HY 340bp · US CCC 1,340bp · Euro HY 354bp

What is next

FOMC 28 Oct · UK Budget 28 Oct · ECB 29 Oct · BoJ 30 Oct · Q3 BDC results from 5 Nov · US CPI 10 Nov

RATES & GOVERNMENT BONDS

Government Bonds

Joan Brugada Mestre

FINDINGS

Government bonds remain under pressure in early October. The US 10-year Treasury yield closed at 5.24% on 9 October, after touching 5.31% the previous week.[1] By early trading on 13 October, it had eased to 5.193%, while the German 10-year Bund yielded 3.438%, down 3.6 basis points that morning as oil prices declined. These are intraday observations, rather than month-end levels.[2]

The US sell-off continues to reflect an oil-driven inflation shock and expectations of further Federal Reserve tightening. Mortgage hedging may amplify the pressure: higher rates reduce refinancing, extend mortgage-backed securities' duration and prompt investors to sell Treasury futures or adjust swaps. Its contribution to the broader move remains uncertain.[3][7] In the UK, fiscal sustainability is a key risk ahead of the 28 October Budget; the 10-year gilt yielded 5.440% on 12 October.[3]

COMMENTS

Our interpretation is that October's challenge is to distinguish changes in expected policy rates from the compensation investors demand for holding long-dated debt. A brief fall in yields alongside cheaper oil does not establish a sustained recovery. The US 2s10s curve and inflation expectations should help assess whether subsequent moves are concentrated in the policy-sensitive front end or the longer maturities.

In Europe, monitoring French OAT and Italian BTP spreads against Bunds remains useful: rising sovereign yields alone do not demonstrate worsening country risk. Our view is cautious on long-duration exposure while energy and fiscal uncertainty remain elevated. Softer inflation or weaker activity could support bond prices; renewed oil increases or disappointing budget plans could put upward pressure on yields. October's final assessment will require updated market closes and the remaining policy and fiscal announcements.

Sovereign Ratings

Nin Sacristan

FINDINGS

France faces increasing downside rating risk with Moody's maintaining Aa3 (negative outlook), Morningstar DBRS shifting its AA trend to negative, and Scope downgrading it from AA- to A+.[4,6,7] Meanwhile, Spain (S&P A+ stable) benefits from strong economic growth, though S&P and Fitch note political uncertainty could delay fiscal consolidation.[8] The United States retains structural credit advantages, with Morningstar DBRS affirming its AAA rating (stable) and Scope affirming AA- (stable).[9] The UK holds a stable AA rating from Scope, supported by its strong institutional framework despite elevated public debt.[10] Lastly, China maintains its A+ rating with a stable outlook from S&P, backed by large reserves and policy capacity while navigating property-sector and domestic demand risks.[11]

COMMENTS

Fiscal credibility is the common theme across sovereigns, as rating agencies assess not only public debt levels but whether governments can implement credible medium-term fiscal consolidation plans, positioning France as the clearest near-term downside risk. In contrast, the United States and the United Kingdom retain substantial structural advantages via deep capital markets, institutional capacity, and reserve-currency flexibility that cushion high debt-service costs, even as fiscal headroom narrows over time. Spain illustrates that resilient economic growth does not automatically lead to sovereign credit upgrades without disciplined budget execution and political consensus to lower deficits. China contends with a different balance of risks, possessing ample policy intervention capacity to support key sectors but needing to revive domestic demand and resolve local-government and real estate debt without generating further liabilities.

Sovereign ratings at a glance

Sovereign	Agency	Rating	Outlook / action
France	Moody's	Aa3	Negative; affirmed at October review[5]
	Morningstar DBRS	AA	Trend cut to negative, 18 Sep[6]
	Scope	A+	Downgraded from AA−, 18 Sep[7]
Spain	S&P	A+	Stable; fiscal delay risk[8]
United States	Morningstar DBRS	AAA	Stable, affirmed 18 Sep[9]
	Scope	AA−	Stable, affirmed
United Kingdom	Scope	AA	Stable, affirmed 11 Sep[10]
China	S&P	A+	Stable[11]

France is the only sovereign here with negative momentum across agencies.[4,6,7,8,9,10,11]

CORPORATE CREDIT | INVESTMENT GRADE

Investment Grade Bond Market

Paul Manner

MARKET SITUATION

Both central banks hiked in September (the ECB for a second time this year), yet IG spreads barely moved. On 16 September, the FOMC voted 12-0 to raise the federal funds target by 25bp to 3.75–4.00%, its first hike since 2023, noting that inflation remains elevated.[21] The ECB had moved first on 10 September, lifting the deposit facility rate by 25bp to 2.50% with effect from 16 September; its staff now project headline inflation of 3.0% in 2026 and core inflation above 2% through 2028.[22]

The repricing landed in risk-free rates. The 10-year Treasury yield rose from 4.78% on 4 September to 5.22% on 8 October,[23] while the ICE BofA US Corporate Index OAS moved only from 81bp to 82bp. The path was not flat: spreads tightened to 77bp after the Fed decision, then widened to 86bp on 1 October, their widest since early April, before retracing.[24] BBBs traced the same arc (94bp low, 106bp high, 102bp now), while single-As sit at 69bp.[25] The stress showed lower in the capital structure: US high yield widened from 268bp to 315bp, lifting the HY/IG ratio from 3.3x to 3.8x.[26] With spreads anchored and Treasuries higher, the index effective yield now stands at 5.94%.[27]

In Europe, the ECB puts the cost of market-based corporate debt at 4.0% in July, well above its level before the Middle East conflict, with corporate bond issuance growing 3.4% year on year. President Lagarde named AI-related financing, now moving from equity into bonds and private credit, as one driver of the global rise in yields.[28] In the US, corporate bond issuance reached $2,195.1bn through September, 24.5% above last year.[29]

OUR VIEW

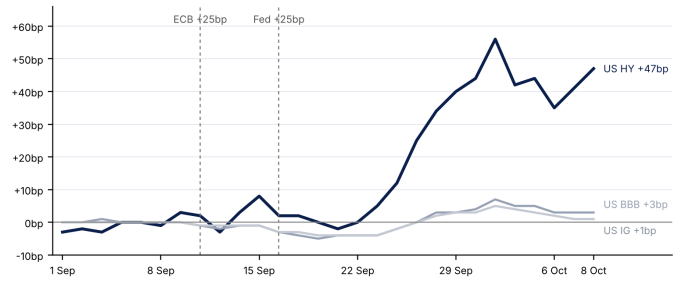
September vindicated last month's defensive call, through duration rather than spreads: rates did the damage while the IG spread barely moved, so carry, not compression, remains the return engine. Two things have changed. All-in yields near 6% now pay for holding IG even with a thin spread cushion. And the market has started to discriminate: since 4 September, US high yield has widened 47bp, investment grade 1bp.[24,26] We read this as tighter policy and higher funding costs being priced first where balance sheets are weakest. If that continues, BBB, the lowest rung of investment grade, is the most exposed part of IG.

We therefore keep the quality tilt (A over BBB) and stay underweight long-dated AI-infrastructure supply. On duration, we move from short toward neutral in US IG, adding 5–7-year A-rated paper whose yields already discount further Fed tightening, while keeping the long end light in line with our rates team's view on term premium. In euro IG, we prefer the front end, with markets pricing in almost three further ECB hikes after the September decision.[28]

WHAT WOULD CHANGE OUR VIEW

A US IG OAS above 95bp, beyond this year's 94bp high in March, would make spreads, not just yields, worth adding.[24] A quick retracement of US high yield below 280bp would weaken the late-cycle signal.

High yield repriced, IG barely moved



Change in option-adjusted spread since 4 September 2026, daily closes to 8 October.[24,25,26]

Investment grade scoreboard

Measure	Level, 8 Oct 2026
ICE BofA US Corporate Index OAS	82bp (81bp on 4 Sep)
BBB / single-A OAS	102bp / 69bp
US high yield OAS	315bp (268bp on 4 Sep)
HY / IG spread ratio	3.8x (3.3x on 4 Sep)
Euro high yield OAS	326bp
US IG index effective yield	5.94%
US 10-year Treasury	5.22% (4.78% on 4 Sep)
Fed funds target	3.75–4.00%, +25bp on 16 Sep
ECB deposit facility rate	2.50%, +25bp from 16 Sep
Euro area cost of market-based corporate debt	4.0% (July)
US corporate bond issuance, Jan–Sep	$2,195.1bn, +24.5% y/y

Market levels at the close of 8 October 2026 unless stated.[21,22,23,24,25,26,27,28,29,67]

CORPORATE CREDIT | HIGH YIELD

High yield: open for business, but more selective

Jules Coppens

MARKET BACKDROP

The high yield segment of the fixed income market is subject to the same forces shaping markets more broadly. Two factors dominate the corporate credit landscape: rising government bond yields, which are pushing rates higher across the curve, and record corporate debt issuance (fuelled by AI-related investment), which hit $2,195.1 billion year to date through September in the US.[29] Within high yield (HY), however, these conditions are playing out in a few distinct ways.

SPREADS: WIDENING FROM HISTORICALLY TIGHT LEVELS

The spread between HY and investment grade (IG) credit has begun to widen modestly. This is not yet cause for alarm. The move is better read as a normalisation after spreads between the two remained unusually tight throughout 2025 and most of 2026.

That said, there are genuine signs that HY is under more pressure than its IG counterpart. The market appears to have absorbed the seasonally heavy September calendar less comfortably than last year. The HY–IG spread differential hit 2 percentage points in late September on Bloomberg's indices, a level last reached in October 2025 and the widest since then.[30]

SUPPLY: MORE NEW MONEY, LESS REFINANCING

The composition of this year's issuance offers a likely explanation. On a gross year-to-date basis, 2026 HY issuance is only modestly ahead of 2024 and 2025. The mix, however, has shifted noticeably: refinancing accounts for just 58% of year-to-date HY issuance, its lowest share since 2022.[31] Comparable volumes with a smaller refinancing share imply that more net new debt is entering the market than in the previous two years. This increases the overall stock of HY debt and tests investors' capacity to absorb supply. A significant portion of this new financing falls under project finance, a category that includes AI-driven investment, underlining how far the AI capex cycle is now feeding through to credit markets.

DEAL SPOTLIGHT

Several large transactions illustrate these dynamics. SoftBank, the Japanese technology investor with a significant stake in OpenAI, priced an $11.1 billion high yield bond offering in September, including 7.5-year notes yielding up to 9.75%.[32] The deal is a clear example of AI-related financing needs spilling over into the HY market.

Paramount Skydance's financing for its acquisition of Warner Bros. Discovery is another landmark transaction. The package comprised $30 billion of first-lien notes and a further $12.4 billion equivalent of HY bonds. Ratings on the first-lien notes are split: Fitch and S&P rate them investment grade, while Moody's places them one notch below.[33] As a result, the full $42.4 billion sits either in HY or on the boundary between the two markets, adding to supply pressure at the upper end of the HY spectrum.

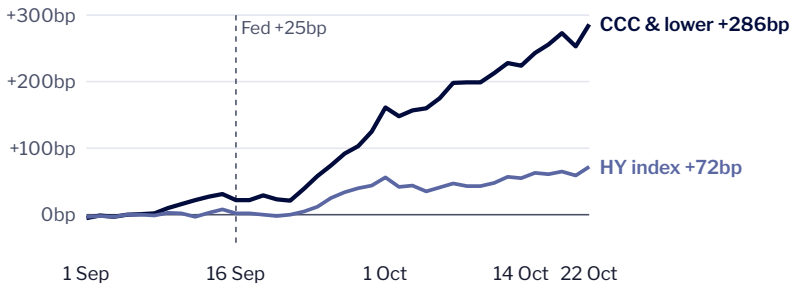
STRESS AT THE BOTTOM OF THE RATINGS SCALE

While the HY–IG differential is widening only gradually, the clearest sign of strain is the sharp widening in spreads on the lowest-rated debt. The mechanism is straightforward. As the supply of higher-quality HY paper grows, investors can earn attractive yields while taking less risk, and they rotate away from the weakest credits. To compensate, issuers rated Caa and below must offer a considerably higher risk premium, as the chart below illustrates.[34]

OUTLOOK

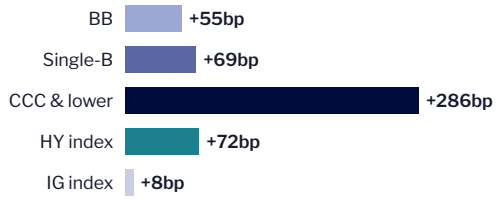
Taken together, the picture is of a market that remains open and functioning but is becoming increasingly selective. Headline spreads still look reasonable by historical standards. Yet the rising share of new-money issuance, a pipeline of jumbo AI- and M&A-related deals, and the growing gap between the stronger and weaker parts of the HY universe suggest that the burden of absorbing supply is falling disproportionately on the weakest issuers. As long as investors can find decent yields higher up the ratings spectrum, this bifurcation is likely to persist, making credit selection rather than broad market exposure the main driver of HY returns in the coming months. Key indicators to watch are the pace of AI-related issuance, the refinancing share of new deals, and Caa spreads relative to the broader HY index.

CCC spreads have widened four times as much



Change in ICE BofA option-adjusted spread since 4 September 2026, daily closes to 22 October.[26,34]

Widening by rating since 4 Sep



OAS change, 4 September to 22 October 2026. CCCs now sit at 1,340bp.[24,26,34]

MBS

Agency MBS: wider spreads, but extension risk persists

Hugo Heise

MARKET SITUATION

US agency MBS had their worst month in a while in September. The Bloomberg US MBS Index returned −3.38%, underperforming duration-matched Treasuries by 96bp, and its option-adjusted spread (OAS) widened 14bp to 43bp, from 29bp at the end of August.[35] Because the index lagged Treasuries as well as falling, the sell-off was not just a move in government yields: investors also demanded more compensation for mortgage-specific risk. The broader Bloomberg US Aggregate fell 2.61% over the same month, and MBS posted the weakest excess return of the major spread sectors Fidelity tracks.[35]

The pass-through to households has been fast. Freddie Mac's average 30-year fixed rate reached 7.40% on 8 October, up from 7.28% a week earlier and 6.30% a year ago.[36] Agency MBS carry government or GSE credit protection, so the exposure here is to rates, prepayments and liquidity rather than default. Compared with other high-quality spread sectors, the repricing was particularly pronounced in agency MBS: US investment grade corporate spreads widened by only 3bp and CMBS by 1bp, while ABS tightened by 4bp.[35]

WHY IT MOVED

The main driver is negative convexity. Homeowners can repay early, so when rates fall refinancing speeds up and caps price gains. When rates rise, refinancing slows and effective duration extends. September showed this: a 54bp rise in the 10-year turned a rate move into an MBS-specific sell-off.

Extension is also feeding back into rates. As expected cash flows lengthen, holders must add duration hedges, typically by selling Treasury futures or paying fixed in swaps. Reuters reported in October that MBS underperformance and wider mortgage spreads were consistent with convexity hedging, alongside increased activity in SOFR swap futures. It also noted the effect is likely smaller than in past sell-offs because the mortgage market is smaller than before 2008, and that how much hedging contributes to higher yields remains an open question.[37] We therefore treat hedging as an amplifier of the move, not its cause.

Another factor is technicals. The Fed's MBS holdings stood at about $1.90tn on 7 October, roughly $188bn lower than a year earlier.[38] Banks, asset managers and other private investors must absorb that supply. Offsetting this, mortgage rates above 7% suppress refinancing and origination, which limits new supply. Which effect dominates will decide whether spreads recover.

OUR VIEW

Relative value has improved, but we would not call this a buying opportunity yet. At 43bp, OAS is back to its level at the end of 2024 (43bp) and roughly double its end-2025 level of 22bp.[35] The sector's negative excess returns suggest part of the damage is already in prices. The risk is asymmetric, though. Higher yields extend duration and raise price sensitivity, while a sharp rally revives refinancing and caps the upside.

We therefore favour a selective allocation to pools with predictable prepayment behaviour, particularly seasoned or specified pools with favourable loan characteristics. We would stay cautious on low-coupon, long-duration paper, which has the most duration risk if yields keep rising. The constructive scenario needs stable Treasury yields, lower rate volatility and stronger institutional demand. Carry would then do the work and spreads would compress gradually. Persistent inflation, renewed Treasury selling or weaker private demand would mean further underperformance.

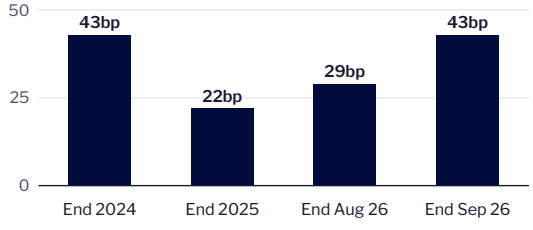
WHAT WOULD CHANGE OUR VIEW

We would turn more constructive if OAS stabilised or tightened from 43bp alongside falling rate volatility, with evidence of stronger bank demand and steadier effective durations. We would stay defensive if OAS widened materially again, excess returns deteriorated further or extension pressure accelerated.

HOW WE WOULD EXPRESS IT

Favour specified and seasoned pools over generic pass-throughs and keep duration short within the sector. Avoid low-coupon, long-duration exposure until rate volatility settles.

MBS spreads at end-2024 levels



Bloomberg US MBS Index OAS, basis points

OAS has nearly doubled from its end-2025 level in nine months; no other high-quality spread sector moved more than 4bp in September.[35]

Key figures

Measure	Level
US MBS Index return, September	−3.38%, 96bp behind Treasuries
MBS OAS	43bp, from 29bp end-Aug; 22bp end-2025
US 10-year Treasury, September	4.75% to 5.29%
30-year mortgage rate, 8 Oct	7.40%, vs 6.30% a year ago
Fed MBS holdings, 7 Oct	~$1.90tn, −$188bn y/y
Sept OAS change: MBS / IG / CMBS / ABS	+14 / +3 / +1 / −4bp

35,36,38

DIRECT LENDING

From price to deployment

Giulia Weber Colussi and Tim Ziegler

WHAT'S MOVING

Since our 4 September issue, the private-side story has shifted from price to deployment. The 25–50bp of spread widening market participants expected last issue has now arrived: new-issue direct lending spreads sit roughly 25–50bp above year-end 2025, with sponsor and buyout deals moving into the SOFR+500–549 range.[39,40,41] The drivers: AI-disruption worries around software borrowers, now priced 50–100bp wider;[41,42] higher base rates; and redemption pressure pushing some BDCs to favour buybacks and cash over lower-spread deals.[47] Syndicated loan spreads tightened over the summer (secondary B-rated loans moved from S+445 to S+412 between June and September),[41] so the gap between the two markets is growing again.[39,40] That reverses the compression to roughly 78bp we flagged last issue.

Volume has not followed. Q3 direct lending volume fell an estimated 28% y/y to $49.8bn, and buyout financing hit its weakest level in three years,[39,43] as private equity buyouts slowed.[48] Meanwhile, institutional investors committed a record $129.2bn to direct lending funds in the first nine months (+35% y/y).[43] Too much capital chasing too few deals is the setup in which terms loosen.

The base rate is also no longer flat. On 16 September the Fed hiked 25bp to 3.75–4.00%, its first hike since 2023, with inflation still elevated and the median projection pointing to one more hike this year.[44] That lifts unitranche yields (spot 9.33–10.08%, from 8.98–9.73% in Q2),[41] but it raises cash interest most for the borrowers least able to carry it.

DEEP DIVE: WHAT Q2 BDC DATA SHOWS ABOUT REPORTED AND ADJUSTED NON-ACCRUALS

WHAT MOVED

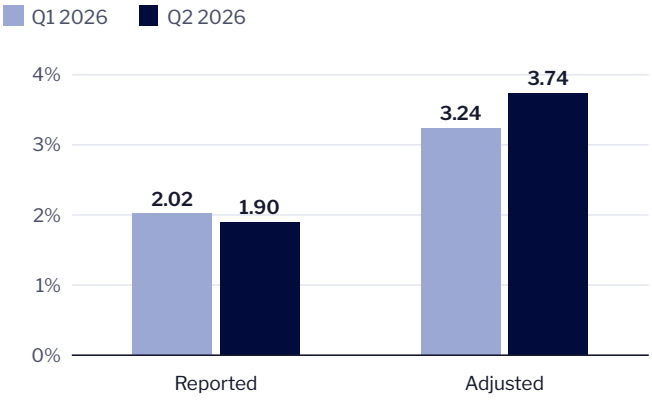
Across 173 BDCs, reported non-accrual debt fell about 5% q/q to $9.5bn, or 1.90% of debt at cost (from 2.02%), though it is still 58% higher y/y.[45] Adjusted exposure, which counts every tranche of any issuer marked non-accrual by at least one BDC, rose 17% q/q to $18.7bn, or 3.74%.[45,46] On our calculation from Octus's figures, that is roughly +50bp q/q, in line with the 50bp-plus increase we called last issue. The call was made on LCD's measure, whose Q2 broad-universe figures are not yet public, so we treat it as on track rather than confirmed.

Fitch's private credit default rate hit a record 6.3% (TTM, August). Almost nine in ten default events are PIK/interest deferrals (47%) or maturity extensions (41%), not bankruptcies, and the rate is 12.0% for borrowers under $25m EBITDA but just 0.6% for software.[49] PIK now makes up about 8% of public BDCs' gross investment income, up from 5.5% in 2021.[52] Lenders are extending rather than enforcing, which keeps names off reported non-accrual lists; software stress is so far a pricing fear, not a default reality.

WHY IT MOVED

The reported measure fell because lenders are working through problem loans. Restructurings and write-offs take names off non-accrual, and the number of borrowers marked down more than 15% fell to 102 from 135.[46] Adjusted exposure rose because the troubled companies are widely held: some lenders have marked them non-accrual, while others still carry the same borrower as accruing. Marks on the same loan differ by about 5–8 points depending on which BDC holds it.[40] So the stress is concentrated by borrower, not in "a subset of managers" as we said last issue. Vintage and maturity are the drivers. 2021–22 loans carry median net leverage of about 6.5–6.8x with only 1.7–1.8x cash interest coverage, against 4.8–5.3x and 2.2–2.3x for 2025–26 vintages,[41] and the September hike lands squarely on that legacy book. Moody's finds the discount is building where refinancing is near: loans maturing in 2026 are marked at 88.8% of cost versus 99.7% for 2030+, and 2026–28 maturities are about 2.8x as likely to be marked below 95%.[51]

Reported down, adjusted up



Non-accrual debt as % of debt at cost, 173 BDCs

The gap between the two measures widened from 122bp to 184bp.[45,56]

The discount sits where refinancing is near



BDC marks as % of cost, by loan maturity

2026–28 maturities are ~2.8x as likely to be marked below 95%.[51]

Vintage	Net leverage	Cash interest cover
2021–22	6.5–6.8x	1.7–1.8x
2025–26	4.8–5.3x	2.2–2.3x

Median, sponsor-backed direct lending loans.[41]

DIRECT LENDING | POSITIONING

OUR VIEW

Q3 BDC results (late October to November; Kayne Anderson reports on 5 November)[54] should show adjusted non-accruals up again, but by a smaller 25–50bp, with reported non-accruals roughly flat as restructurings keep clearing names. The full effect of the hike only shows in Q4. Medium conviction: last issue's near-par migration test is still untested for lack of loan-level data. The mark gap we said would become the story if it didn't close ($97.51 vs $94.95) has no fresh data: Cliffwater's latest index (19 Aug) puts private at $0.98 vs $0.96 for public loans.[53] The repricing is happening through BDC shares and redemptions instead. The median listed BDC trades at about 0.7x book,[40] and non-traded redemption requests averaged 9.8% of shares in Q3 (10.3% in Q2), nearly twice the 5% cap, though Fitch notes much of that is prorated carry-over.[50]

WHAT WOULD CHANGE OUR MIND

None of last issue's triggers fired (no slowdown below 20bp, no broadening across most large managers). We would be wrong if Q3 adjusted non-accruals come in flat or lower (Q2 was the peak), if reported non-accruals jump more than 25bp (stress spreading faster than restructurings clear it), if Q4 tender requests fall back toward the 5% cap, or if new-deal leverage moves back above 6x as record fundraising forces deployment.

HOW WE WOULD EXPRESS IT

Keep differentiating on trend: FS KKR (non-accruals down to 7.1% from 8.1%, debt-to-equity down to 127%) remains the Q2 reference case, to be re-tested against its Q3 results.[54] Add a vintage filter: prefer first-lien books weighted toward 2024–26 vintages with low software and PIK exposure. For similar assets, listed BDCs at about 0.7x book offer a more honest entry price than gated non-traded vehicles still transacting at NAV.

READ-ACROSS WITH PUBLIC CREDIT

The roughly balanced refinancing flows of last issue (about $37bn vs $34bn) broke in Q3. $16.4bn of direct loans refinanced into the syndicated market, against $2.6bn moving the other way,[43] a record since LCD began tracking in 2022.[47] The reason is price. Borrowers good enough to syndicate, mostly B/B+ (only one of 18 was rated B-), cut their spread by about 182bp on average.[47] B- syndicated spreads, by contrast, are 50bp+ wider than at year-end,[47] so weaker credits have nowhere cheaper to go. Direct lenders are being left with the weaker credits, which makes last issue's pricing concern a credit-mix concern as well.

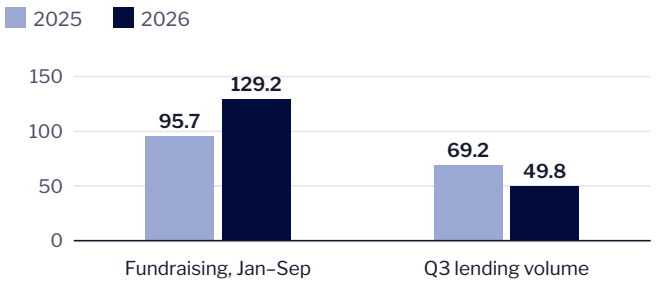
The refinancing flow has turned one-way



Loans refinanced between markets, Q3 2026

Over the year to our last issue the two flows were close to balanced (~$37bn vs ~$34bn). Q3 was a record for loans leaving direct lending.[43,47,70]

Capital raised faster than it is lent



US direct lending, $bn. Fundraising is up 35% while Q3 lending fell 28%. 2025 bars are implied from the reported year-on-year changes.[43]

Direct lending scoreboard

Measure	Level
Q3 direct lending volume	$49.8bn, −28% y/y
Direct lending fundraising, 9M	$129.2bn, +35% y/y
Secondary B loans, Jun to Sep	S+445 to S+412
Fitch PC default rate, TTM Aug	6.3%, a record
PIK share of BDC gross income	~8% (2021: 5.5%)
Median listed BDC, price to book	~0.7x
Non-traded BDC redemptions	9.8% of shares, Q3
Cliffwater price, private vs public	$0.98 vs $0.96
Direct loans refinanced to BSL, Q3	$16.4bn, a record
Spread cut on those refinancings	~182bp
B- syndicated spreads vs year-end	50bp+ wider
Buyout financing	Weakest in three years

40,41,43,47,49,50,52,53

Last issue's calls, scored

What we said on 4 September	What happened	Status
New-issue spreads widen 25–50bp	Now 25–50bp above year-end 2025[39,41]	Arrived
Adjusted non-accruals rise 50bp or more	+50bp q/q on Octus's 173-BDC series[45,56]	On track; LCD figure pending
Stress concentrated in some managers	By borrower; same loan marked 5–8pts apart[40]	Revised
BDC vs public loan mark gap should close	No update; Cliffwater's latest data is 19 Aug[53]	No new data

71,72

PRIVATE CREDIT | STRESS & LIQUIDITY

Lenders are waiting, investors are queuing

Liam Thiele and Tim Ziegler

SUMMARY

Reported stress in the BDC universe eased slightly in Q2, but the measures that look through to the borrower got worse, Fitch's default rate set a new high in August, and the big semi-liquid funds are still being asked for two to three times what their 5% caps allow them to pay. Regulators have started to pay attention to how these loans are valued.

WHAT'S MOVING

Fitch's trailing twelve month US private credit default rate reached 6.3% in August, up from 6.1% in July, and it has been above 6% every month since April.[49] August alone had 14 default events against 3 in July, and 11 of the 14 were first-time defaulters.[49] Across the year, 47% of events were interest deferrals or PIK substitutions and 41% were stressed maturity extensions. Uncured payment failures were 8% and bankruptcies or restructurings 4%.[49] Most of what Fitch counts is lenders agreeing to wait, which is a different thing from borrowers failing to pay.

The pressure is also showing up in liquidity. In Q3, HPS Corporate Lending Fund received requests for 11.5% of its shares and paid out 5%.[46] Blackstone's BCRED received requests for about 10% of shares ($4.3bn), roughly level with Q2's $4.5bn, and still carries about $2.3bn of unfilled Q2 requests.[60] Cliffwater's fund received about 16% against 17% in Q2 and plans to pay roughly a third of what was requested.[61] Requests eased a little from Q2 across the funds reporting so far,[46] but they remain well above the cap.

Valuation is now a regulatory topic. On 28 September the SEC's Chief Accountant and the Director of the Division of Investment Management issued a joint statement on fair value for private assets. It does not add rules, but it expects valuations to be calibrated to transaction prices, asks funds to say how much of their income is PIK, wants clear non-accrual criteria, and warns against boilerplate disclosure.[62] Semafor reports that the New York Fed has been visiting JPMorgan, Wells Fargo, Barclays and Morgan Stanley to ask about their lending to private credit firms, including the quality of the collateral.[63] Separately, investor lawsuits against FS KKR, Ares and Blue Owl challenge loan valuations and fees linked to PIK income. The firms dispute the claims and none of this has been decided.[64]

WHAT MOVED

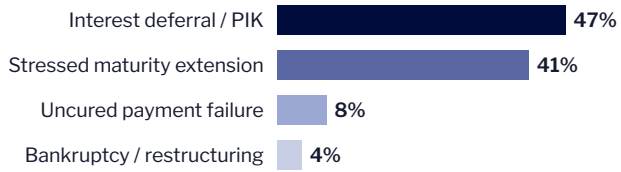
The Q2 non-accrual data is covered on page 8: reported down to 1.9% of debt at cost, adjusted up 50bp to 3.74%, so the gap between the two widened from 122bp to 184bp.[45,56] KBRA's median non-accrual rate for non-perpetual-life BDCs rose to 2.75% from 1.81%, which KBRA attributes to a small number of borrowers and managers rather than broad deterioration.[57]

The two default indices sit far apart. Proskauer's index fell to 2.51% in Q2 from 2.73% in Q1, based on 716 senior secured and unitranche loans with $195.6bn of original principal.[55] Fitch is at 6.3%.[49] Fitch's figure includes PIK substitutions and maturity extensions, and its sub-$25M EBITDA bucket alone runs at 12.0%.[49] We could not confirm from Proskauer's public release how it treats PIK and extensions, so we would not put the two on the same chart without checking. Both do show the $25M to $50M EBITDA band getting worse (Proskauer 3.1% to 3.4%;[55] Fitch 3.9% to 5.2% from July to August).[49]

By sector, Fitch has healthcare providers and industrial and manufacturing at 9.9% each, consumer products and services at 8.7%, and technology software at only 0.6%.[49] The software worry shows up in marks, where markdowns are concentrated in information technology, before it shows up in defaults.[46]

On activity, US direct lending volume fell about 55% on the quarter to $33.6bn in Q2, the weakest since Q2 2023, while North American closed-end direct lending funds raised $16.25bn against $1.3bn in Q1.[58] Guggenheim's figures use a different cut of the data (to 31 May) but tell the same story: $45.2bn of new loans, also the lowest since Q2 2023, with recent LBO loans at SOFR+490 against SOFR+474 in Q1.[59]

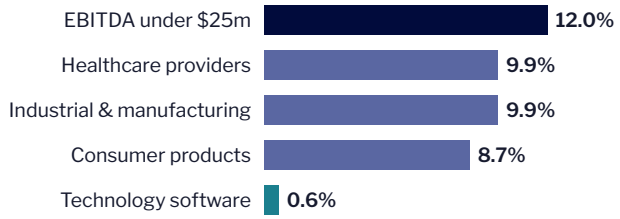
Most defaults are lenders agreeing to wait



Fitch US private credit default events by type, year to August 2026

Nearly nine in ten events are deferrals or extensions, not failures to pay.[49]

Small borrowers default, software does not



Fitch private credit default rate, TTM to August 2026

The software fear is in marks, not defaults.[49]

PRIVATE CREDIT | POSITIONING

WHY IT MOVED

The maturity wall explanation from September still holds. Loans written in 2021 and 2022 are refinancing into a much higher base rate. What has become clearer is how lenders respond. Deferring interest or extending maturity costs a lender less in the short term than recognising a loss, which fits Fitch's mix of events and fits reported non-accruals falling while adjusted ones rise. A loan only shows up in the reported figure once a lender is willing to put it there.

The redemption pressure feeds on itself. A 5% cap turns a request into a queue, and a queue is a reason for other investors to ask. Listed BDCs show where the market puts the underlying books: Raymond James has the group at a mean 0.74x price to NAV (median 0.68x), with 40 of 45 below NAV and most of the twelve-month dividend changes flat or negative.[66] Listed investors are paying well below NAV for similar books, while semi-liquid funds still redeem at NAV.

OUR VIEW

In September we expected the broader-universe adjusted non-accrual measure to rise by another 50bp or more, concentrated in a subset of managers. On Octus data it rose by exactly 50bp,[45,56] though by borrower rather than manager.[57] One caveat: September's 3.3% base came from LCD's 213-BDC series and the 3.74% here is Octus's 173-BDC series, so the match is on a like-for-like Octus basis and we have not seen LCD's Q2 figure. Going forward we expect three things.

1. Fitch's trailing twelve month rate stays at or above 6.0% in the September and October prints, the latter due in mid-November. Medium to high conviction, because the 14 events in August stay in the twelve month window and only a couple of normal months would dilute them. We would be wrong if it fell below 5.8%.
2. In the Q3 BDC filings due in mid-November, Octus's adjusted non-accrual rate rises by another 25 to 50bp while the reported rate is roughly flat, so the gap to reported goes beyond 184bp. Medium conviction. The new SEC statement could change how funds classify loans and make the series noisy. We would be wrong if the adjusted rate fell.
3. BCRED, HPS and Cliffwater each get Q4 tender requests above 5%, reported in December. Medium conviction. We would be wrong if BCRED's requests dropped to 5% or below.

WHAT WOULD CHANGE OUR MIND

Fitch's rate falling below 5.8% with first-time defaulters back near the 2025 monthly average of about six. Reported and adjusted non-accruals both falling in Q3. BCRED and HPS paying out in full without proration. We would also want to separate real improvement from reporting changes: if Q3 non-accruals jump because funds are following the SEC's disclosure expectations, that is a break in the series and not necessarily worse credit.

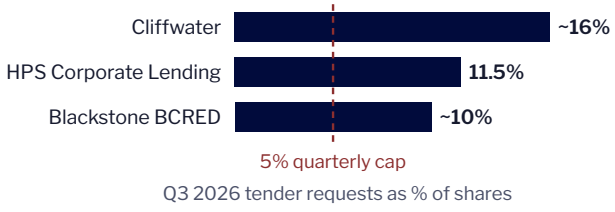
HOW WE WOULD EXPRESS IT

We prefer managers where both reported and adjusted non-accruals are falling and PIK is a small part of income. We would be careful with vehicles that lean on PIK (the Blue Owl technology fund named in the lawsuits took more than a third of last year's net investment income as PIK)[64] and with funds that have a redemption queue and above-average leverage. Senior secured, lower leverage books are still the conservative choice. If we wanted exposure to the stress itself, the listed discount[66] pays for mark risk in names where non-accruals are improving, which we find more attractive than the NAV of a gated fund.

READ-ACROSS WITH PUBLIC CREDIT

Fitch's 6.3% includes PIK substitutions and extensions, so it may not compare directly with public leveraged loan or high yield default rates. For investment grade, loans from US banks to non-bank financial institutions have grown from about $300bn in 2016 to over $1.5tn, now 11% of bank loans (FDIC data cited by Semafor).[63] A Fed review that led to tighter provisioning or capital treatment would reach bank credit through funding costs. Short interest in private credit ETFs rose to 2.7% of AUM in mid-September from 2.1% in August, against a record 3.4% in March, with net shorts of $88.6m in the first half of September, about double August.[65] The source links the move to the ongoing bond sell-off, which the rates section covers.

Requests run two to three times the cap



Q3 2026 tender requests as % of shares

Requests eased slightly from Q2 but remain well above what the funds can pay.[46,60,61]

Private credit scoreboard

Measure	Level
Fitch US PC default rate, TTM, Aug	6.3% (Jul 6.1%)
Fitch PMR / MCO series, Aug	8.5% / 5.6%
Proskauer default index, Q2	2.51% (Q1 2.73%)
BDC reported non-accruals, Q2	1.9% (Q1 2.02%)
BDC adjusted non-accruals, Q2	3.74% (Q1 3.24%)
Borrowers marked down >15%, Q2	102 (Q1 135)
Median non-accruals, non-perpetual BDCs	2.75% (Q1 1.81%)
US direct lending volume, Q2	$33.6bn (Q1 $74.7bn)
HPS Corporate Lending, Q3 requests	11.5% vs 5% cap
Listed BDCs, mean price to NAV, 8 Oct	0.74x

45,46,49,55,56,57,58,66

Credit spreads

OAS (bp)	22 Oct	4 Sep	31 Dec 25	Since 4 Sep
US IG corporate	89	81	79	+8bp
US BBB corporate	111	99	101	+12bp
US HY corporate	340	268	281	+72bp
US BB	210	155	169	+55bp
US single-B	346	277	301	+69bp
US CCC & lower	1,340	1,054	885	+286bp
Euro HY corporate	354	266	270	+88bp

ICE BofA indices. Every rating bucket has widened since our last issue; the lower the rating, the further.[24,25,26,34,67]

Compensation for credit risk, public vs private

Measure	Level	Direction
US IG corporate OAS	89bp	+8bp since 4 Sep
US HY corporate OAS	340bp	+72bp since 4 Sep
HY / IG spread ratio	3.8x	From 3.3x
US CCC & lower OAS	1,340bp	+455bp YTD
Fitch private credit default rate	6.3%	Record, Aug
BDC adjusted non-accruals	3.74%	+50bp q/q
Listed BDCs, price to NAV	0.74x	40 of 45 below NAV

Public spreads are finally paying more for risk; private stress is still building.[26,34,45,49,66]

Commodities

Price	22 Oct	4 Sep	31 Dec 25	Since 4 Sep
Brent ($/bbl)	~$113.17	$96.28	$60.85	+17.5%
WTI ($/bbl)	~$99.47	$91.48	$57.42	+8.7%
Gold ($/oz)	~$4,038	$4,430	$4,319	−8.8%

Brent is up 18% since our last issue and 86% this year, on Houthi attacks on Saudi Arabia and Iran tensions.[69,70]

Rates and policy

Yield / rate	22 Oct	4 Sep	31 Dec 25	Since 4 Sep
Policy				
Fed funds (eff.)	3.88%	3.63%	3.64%	+25bp
ECB deposit rate	2.50%	2.25%	2.00%	+25bp
United States				
Treasuries 2y	4.65%	4.37%	3.47%	+28bp
Treasuries 10y	4.96%	4.78%	4.17%	+18bp
2–10 slope	0.31%	0.41%	0.70%	−10bp
Europe				
Bunds 10y	3.34%	3.34%	2.85%	0bp
OATs 10y	5.09%	4.20%	3.56%	+89bp
BTPs 10y	4.59%	4.15%	3.55%	+44bp
Gilts 10y	5.34%	5.13%	4.48%	+21bp
Asia				
JGBs 10y	2.88%	2.91%	2.06%	−3bp

Policy rates are 25bp higher on both sides of the Atlantic; France has moved more than any market in the table. Fed funds effective as of 20 October.[13,14,15,67,70]

Currencies

Rate	22 Oct	4 Sep	31 Dec 25	Since 4 Sep
Euro ($/€)	1.1205	1.1614	1.1746	−3.5%
Pound ($/£)	1.3376	1.3519	1.3475	−1.1%
Yen (¥/$)	157.04	156.26	156.71	+0.5%

The euro has fallen 3.5% against the dollar since 4 September as French risk resurfaced.[68,70]

Calendar

Date	Event	Expectation
28 Oct	FOMC decision	Hold expected
28 Oct	UK Budget	Fiscal test for gilts
29 Oct	ECB decision	Hold at 2.50%
30 Oct	BoJ decision, Outlook Report	Hold at 1.25%
5 Nov	Kayne Anderson BDC Q3	First large BDC
10 Nov	US CPI (Oct)	Prior 3.7% y/y
Mid-Nov	Q3 BDC filings; Fitch defaults	See credit calls
9 Dec	FOMC decision	Dots: one more hike
17 Dec	ECB decision	Live for a hike
18 Dec	BoJ decision	Swaps ~80% hike

[12,16,17,44,54]

Every exhibit in this issue is listed below with the reference numbers that support it; the numbered list that follows is the full reference list for the whole publication. Market levels are as of the close on 22 October 2026 unless stated otherwise; analyst sections use the dates stated in their text, mostly the close of 8 October.

Exhibits and sections

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Notes on the data

Credit spreads. All US and euro high yield spreads on the data pages are ICE BofA option-adjusted spreads via FRED, for every column, so that the 4 September and 31 December figures differ by a few basis points from the Bloomberg-based figures printed in the September issue. ICE does not publish a free euro investment grade OAS and we have no free source for the EMBI spread, so both rows are omitted this issue.

Yields. US yields are Treasury par-curve closes. Bund, OAT and BTP levels are from Il Sole 24 Ore's 22 October close (Bund derived from the quoted spreads); gilt and JGB yields are Trading Economics prior-close levels. The 4 September and 31 December columns repeat the September issue.

Currencies and commodities. Currencies are ECB reference rates; dollar crosses are derived from them. Oil is the Thursday settlement implied by Reuters' quoted Friday moves; gold is the December futures price late on 22 October. Both are approximate.

Index definitions. OAS is an option-adjusted spread; BSL the broadly syndicated loan market; BDC a business development company; PIK payment in kind; TTM trailing twelve months; PMR and MCO are Fitch's privately monitored ratings and model-based credit opinions series.

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Own work

71. Analyst sections by Joan Brugada Mestre, Nin Sacristan, Paul Manner, Jules Coppens, Hugo Heise, Giulia Weber Colussi and Liam Thiele.
72. Club analysis. The watchlist, headline figures and read-across tables are the desk's own compilation of the figures cited above.