BC PARTNERS

Quarterly Credit Check: Amid the Haze, the Path is Clear

In this quarterly macro-commentary, Ted Goldthorpe and Mike Terwilliger highlight why private credit solutions present a compelling alternative to equities.

Key Findings

01 Equity Headwinds Intensify

The shifting geopolitical and fiscal backdrop could upend the post-COVID rally of U.S. equities; the fragility of recent capital inflows further dims the outlook.

02 Diminished Fed Support

Resurfacing inflation concerns could constrain the so-called "Fed put," limiting the central bank's ability to intervene in downturns.

03 Amid the Uncertainty, Credit Offers Strong Value

High Yield spreads remain historically tight despite potential weakening macro-outlook and public credit remains subject to draw-down risk. Private markets offer investors higher absolute returns as well as lower volatility.

04 Private Market Opportunities

Private Credit has grown into a sizeable category. BC Partners believes non-sponsor direct lending, aviation financing, asset-backed lending, and fund financing stand out as attractive categories, offering equity-like returns for "dollar one" risk.

05 Strategic Allocation Shift

Amid heightened uncertainty, investors should rebalance away from overstretched equities and tilt toward private credit solutions offering greater downside protection.

Macro Backdrop: The Concerning

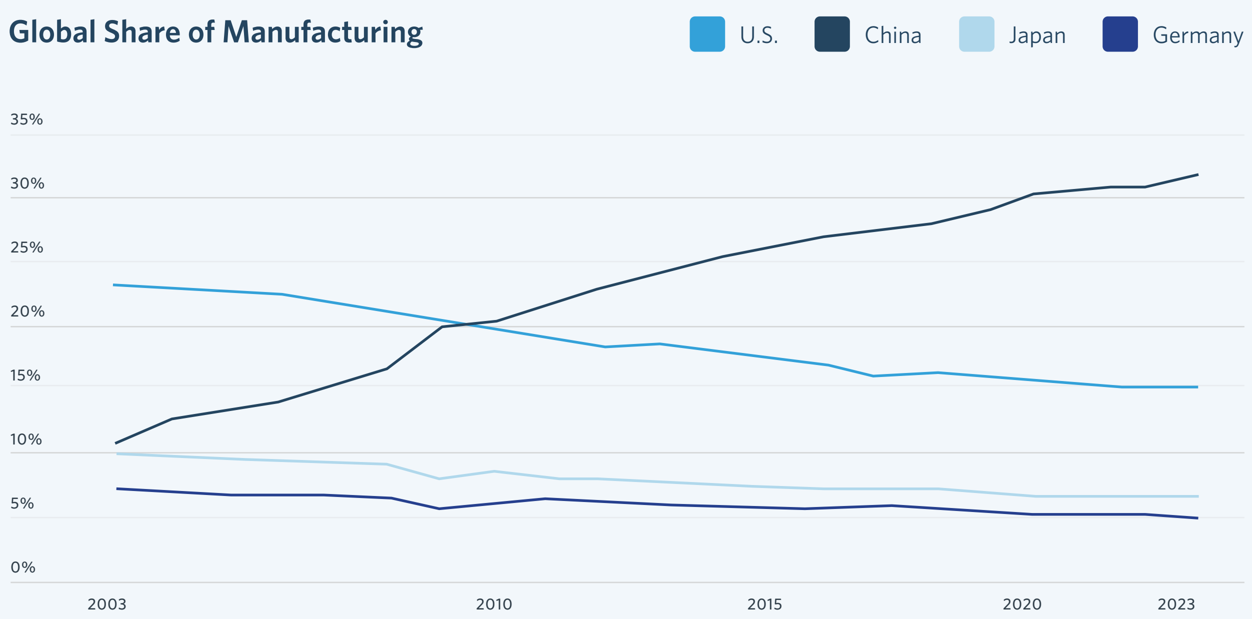
Uncertainty Reigns

Investors have confronted near tragicomic uncertainty in early 2025 as policy shifts threatened to unwind global trading patterns and security alliances. The resulting market selloff has witnessed a nuanced, but nevertheless potentially seismic, event—the decline of the U.S. dollar.

Historically, (and logically) the U.S. dollar should rise from tariffs as fewer purchases of overseas goods lowers demand for foreign currency. Additionally, the U.S. dollars has historically served as a haven during market turmoil as investors seek shelter. After the announcement of sweeping levies against Canada, China and Mexico in early March—prompting a selloff in risk-assets—the U.S. dollar, ominously, fell to the lowest level since early December.

One abnormal market response does not make a trend. However, one could surmise the unexpected dollar decline reflects dented confidence in the U.S. dollar—a cornerstone of the world economy since Bretton Woods.

This is not to suggest the potential emerging changes are unilaterally bad. As suggested by the chart below, U.S. manufacturing has been crushed by global trade:

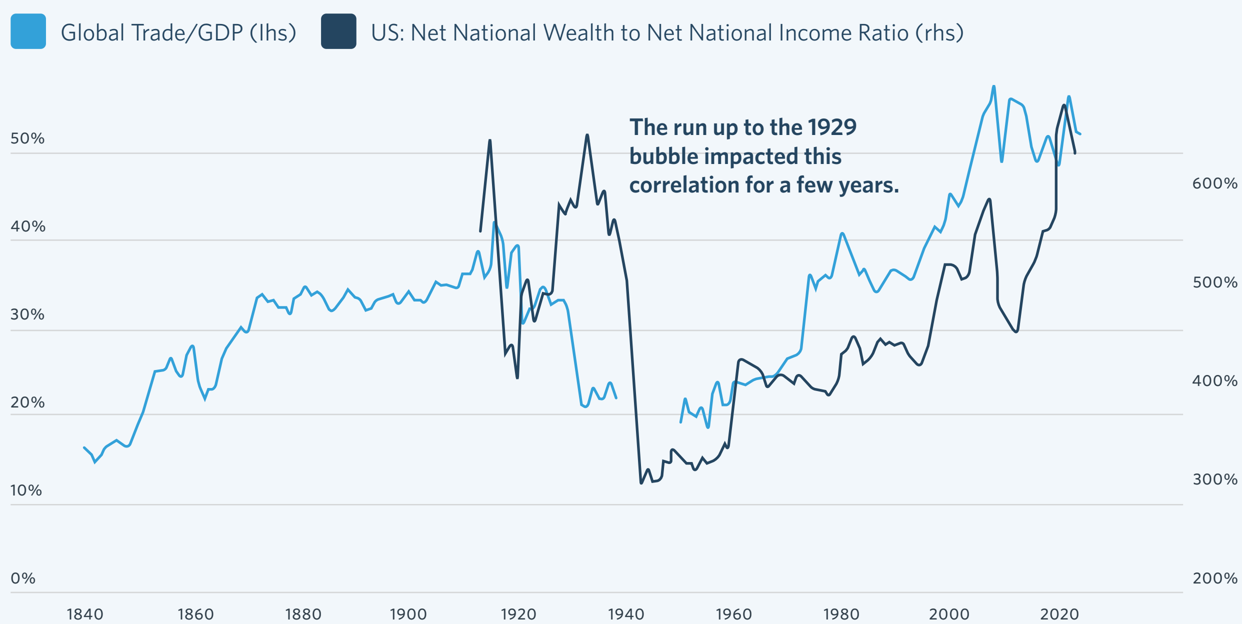


Source: United Nations Industrial Development Organization (02/04/2025)

The dollar's haven-status has amplified the U.S. industrial demise by increasing the cost of exports.

Nevertheless, the era of free trade, dollar dominance and global security has yielded tremendous economic growth—much to the benefit of U.S. markets and investors, as highlighted in the following chart:

Global Trade and U.S Net Wealth



Source: Deutsche Bank, Federico-Tena World Trade Historical Database, World Bank, World Inequality Database (02/04/2025)

These benefits have broadly lifted U.S. prosperity but have yielded clear "winners" (e.g. investors) and "losers" (e.g. U.S. blue-collar workers). Trying to readdress this imbalance by re-ordering global trade could benefit U.S. manufacturing (in time), but it will be costly.

Lower margins from trade friction will weigh on valuations for many U.S. businesses—threatening the wealth effects our economy has become reliant. Plus, ending the era of "cheap stuff" will reduce discretionary spending by effectively taxing household income.

Beyond the big picture, the recent global unease will likely hinder near-term GDP.

At its core, doubt foments inactivity. A business would be reluNctant to spend any meaningful capex if its source of raw materials and/or export markets remains unsettled. Should the U.S. implement clear and specific tariffs, businesses would plan accordingly. Publicly declaring levies, only to shortly thereafter announced their delay, has only prolonged the unknown.

Similarly, household consumption is fundamentally premised on confidence; choosing to spend today is based on optimism about tomorrow. Uncertainty can chill consumption, as reflected in the collapse of consumer sentiment data in recent weeks.

Adding to growth concerns, the potential for tariffs likely pulled forward purchases in the closing days of 2024, robbing GDP from early 2025.

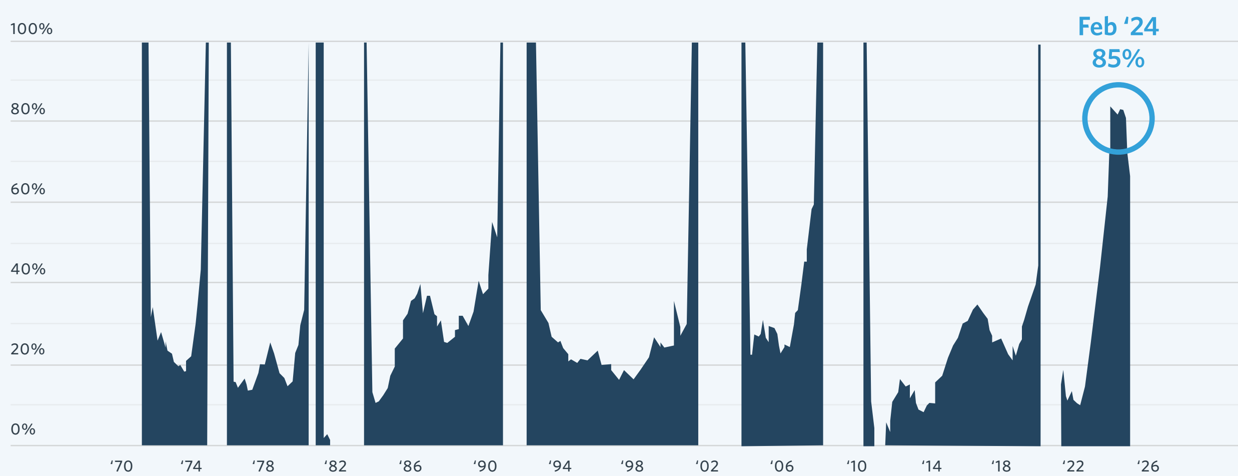
With that backdrop and amid the current haze of uncertainty, we believe the U.S. will be lucky to escape 1H 2025 without a dramatic decline in GDP growth.

Growth engine reversing gears

While headline numbers remain strong, the U.S. job market continues to reflect fractures.

As reflected below, 85% of recent payroll gains have stemmed from just three segments—government, education and healthcare:

Government and 'education & health' as % of payroll growth



Source: BofA Global Investment Strategy, Bloomberg (03/03/2025)

With government workers getting DOGE'd, the U.S. Department of Education threatened with closure and Medicaid in the crosshairs, the sectors that once drove job growth, will likely now drive job losses. Further, data from placement firm Challenger, Gray & Christmas showed that planned layoffs increased 245% in February 2025, levels not seen since the last two recessions.[1]

Relatedly, many U.S. businesses have begun clamping down on remote work, with Amazon, Dell and Washington Post (among others) having announced stricter office mandates;[2] JP Morgan's Jamie Dimon captured frontpage news for his strident anti-WFH commentary.

Back-to-office provides businesses a backdoor for shrinking their workforce (though "elective attrition") and therefore further reflects labor market deterioration.

Shifting fiscal landscape

The U.S. economy/markets have catapulted past global peers in recent year, in part, due to the (astonishing) $5.6T of tax cuts and spending programs unleashed in the pandemic. However, with debt-to-GDP ratios now at precarious levels (despite a heretofore strong economy) and the administration promising belt tightening, the U.S. fiscal impulse appears to be fading.

The mantle may be tilting to Europe.

The forces that have driven the post-war German economy (cheap Russian natural gas, Chinese demand for goods and U.S. military security) have simultaneously vanished. The resulting economic malaise (with consecutive years of negative GDP) and increased security concerns (amid the United State wavering commitment to Ukraine), may prompt dramatic change.

In recent weeks, Germany has taken steps to lift its constitutional "debt brake" (implemented under Angela Merkel, but whose psychological roots trace to the Weimar Republic), which had limited

[1] Challenger Job-Cut Announcement, Reuters and LSEG Datastream (03/06/2025)
[2] "An Update on Return to Office Policies As We Enter 2025," Forbes, (12/12/2024)
[3] Euro Strategy: Germany's Major Fiscal Pivot, CreditSights (03/04/2025)
[4] "Shifting Sands," Alpine Macro (03/07/2025)
[5] Trading Economics and St. Louis Federal Reserve

structural deficit to 0.35% of GDP.[3] Friedrich Merz, Germany's next chancellor, announced plans for as much as 500bn of deficit spending for rearmament and infrastructure.

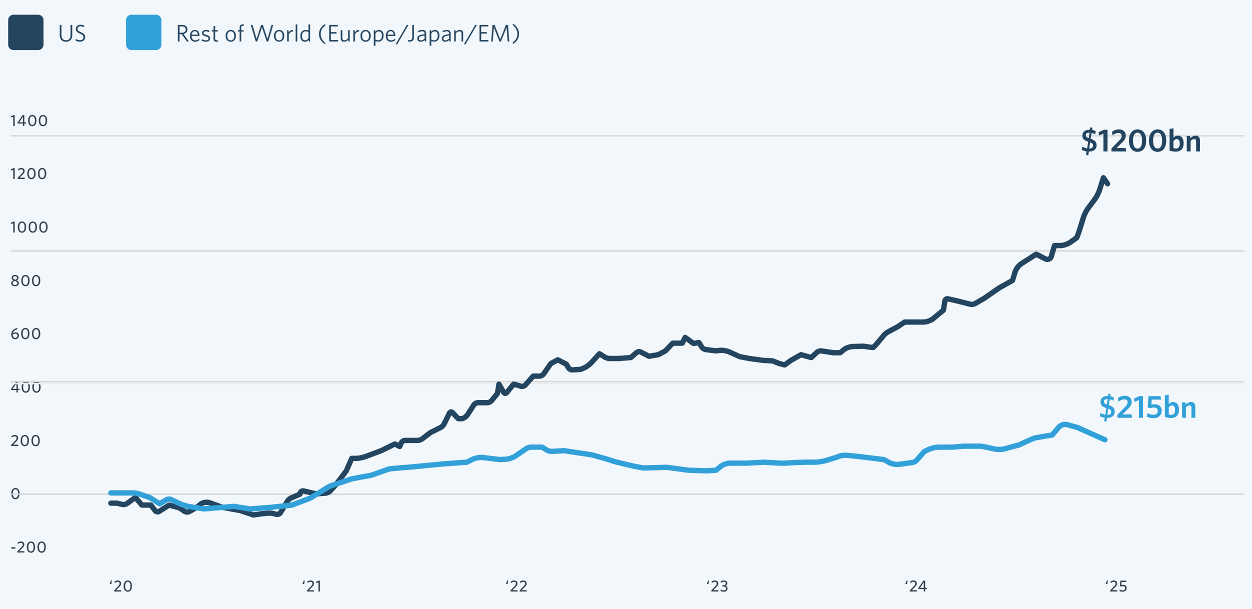
In a world of large numbers, perspective can sometimes be challenging. To frame the capital significance of Merz' proposal, 500bn represents roughly 11% of normal German GDP.[4] The prospect of greater growth and greater debt issuance saw German bonds suffer their greatest sell-off since the 1990s.

Germany's high savings rate (roughly 20.5% vs. 4.6% in the U.S.) could amplify the fiscal impact if optimism loosens household purse strings.[5] Several other Euro nations have also pledged greater defense spending. Plus, at some point, Ukraine will need to be rebuilt, likely on the back of other European balance sheets.

These changes across the pond could profoundly impact U.S. markets.

As starkly demonstrated below, amid otherwise languid global growth, the United States decade-to-date has enjoyed a tidal wave of overseas capital into our equity markets:

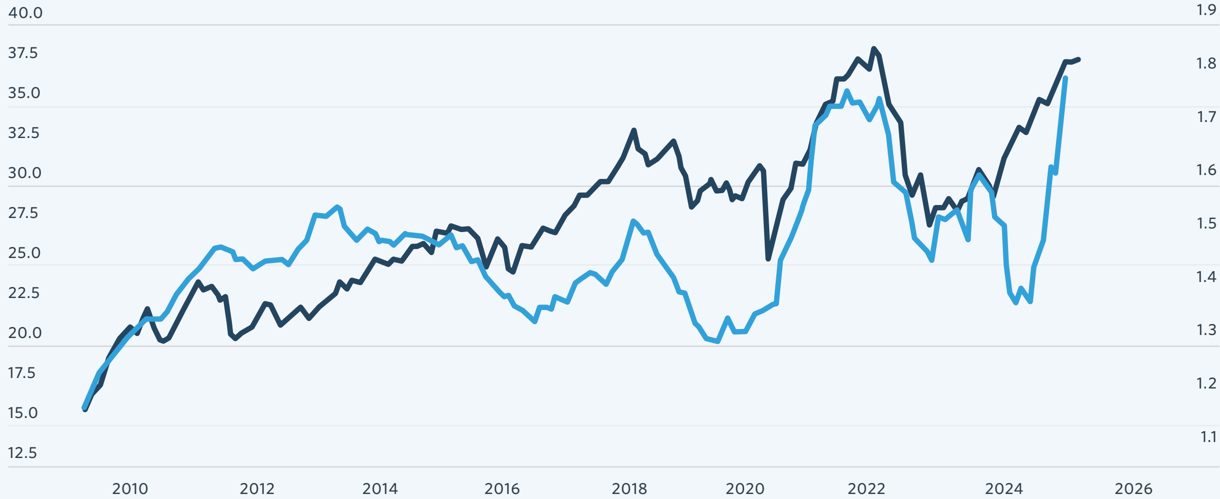
Decade-to-date inflows to equity funds (US$, bn): U.S. vs. Rest-of-the-World



Source: BofA Global Investment Strategy, EPFR (01/21/2025)

These foreign inflows had helped lift the S&P 500 to multi-year highs:

S&P Cylically-Adjusted PE Ratios (in Black) and Net Private Foreign Inflows to U.S. Equities (in Blue)



Source: The Conference Board (02/26/2025)

This international capital has amplified U.S. GDP through the flywheel of wealth effects; asset prices rise, increasing consumer confidence, which prompts spending, which in turn boosts corporate profits and then increase asset prices, etc…

A fiscal tilt to Europe could jeopardize this dynamic if economic growth (perceived or realized) prompts capital to flee U.S. markets (beset by uncertainty and high valuations) into lower priced overseas markets. Nationalist instincts could amplify this dynamic. Further, last year, a record number of European firms eschewed domestic exchanges to list on U.S. markets.[6] We would envision this dynamic may reverse if the *T.I.N.A. U. of A.* unwinds.

[6] PitchBook (02/02/2025)

Macro Backdrop: The Uncertain

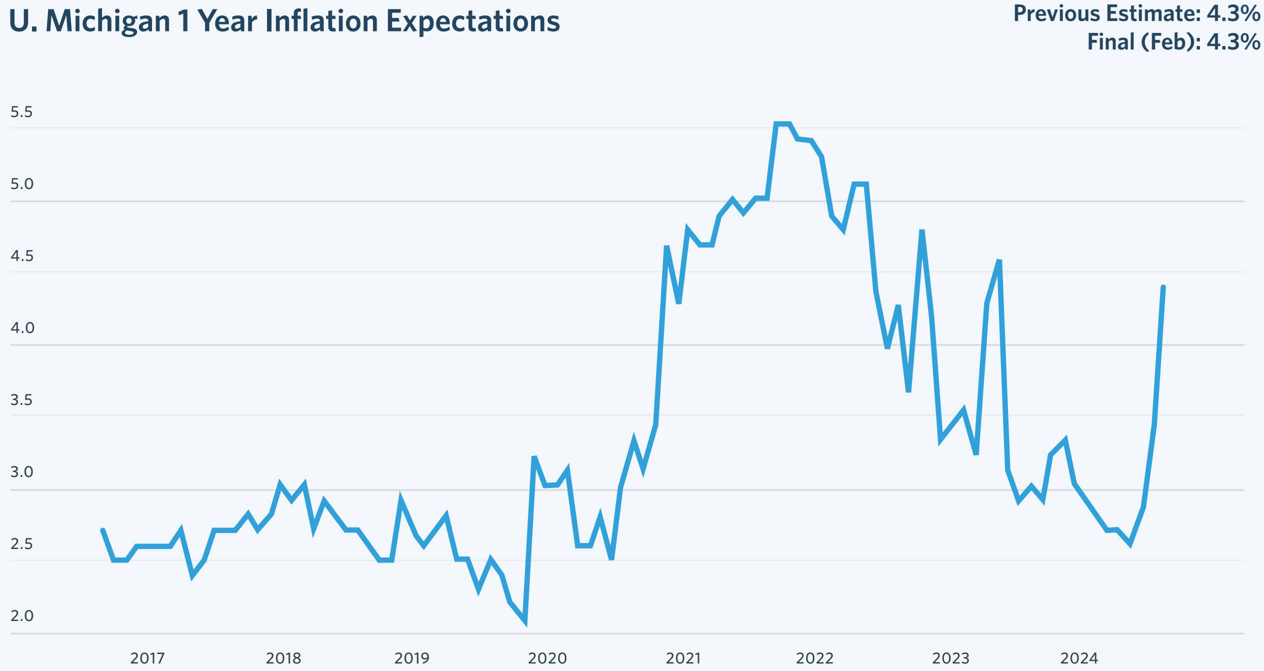
Inflation and Rates: The $64,000 Question

Last quarter we noted that tariffs do not necessarily cause broad-based inflation due to changes in consumption, import substitution and FX response. However, we were remiss not to note that tariffs can (as we have seen in recent weeks) change inflation expectations.

Buffeted by tariff headlines (despite modest implementation), higher prices have seeped into the consciousness of U.S. consumers. Egg'flation, though wholly unrelated to tariffs, has contributed to this dynamic as grocery items are particularly salient; shoppers confront those prices daily (unlike a new car, for example).

As shown below, inflation expectations have rocketed:

U. Michigan 1 Year Inflation Expectations



Source: University of Michigan Survey Data and The Daily Shot (02/24/2025)

On-again, off-again tariffs further risks anchoring inflation by keeping the topic front of the news cycle.

The risk is clear. Whether real or perceived, inflation can mute economic activity by eroding consumer confidence. Tangentially, it can also provoke distrust of government institutions writ large, as evidenced by the global electorate punishing incumbents in recent year (i.e. Biden/Harris, Sunak, Trudeau)

Elevated inflation concerns and potential for sluggish GDP has surfaced the risk of Stagflation as well.

Inflation can undermine GDP, but it nevertheless represents a solvable problem (albeit painfully). As Paul Volker demonstrated, higher rates can arrest higher prices, in time, by sacrificing aggregate demand.

Stagflation, however, is more pernicious because it can immobilize policy makers. Lowering rates (or fiscal stimulus) to jumpstart a lagging economy would only inflame higher prices, while rising rates (or tightening fiscal policy) would further drag GDP.

This backdrop decidedly complicates the interest rate outlook.

Nascent signs that the U.S. economy is losing stem (as evidenced by the 10 Year U.S. Treasury declining from a high of ~4.8% in mid-January to ~4.3% in early March), would seem to suggest the potential for rate cuts.[7] Interestingly, the CME is pricing just 0.8% chance the Fed Fund's rate remains at 4.25-4.50% in December 2025.[8]

However, in our view, the bar for lowering rates will be high due to inflation expectations. Additionally, the diminished growth outlook has arguably been self-induced—driven by policy versus fundamental degradation. The Fed therefore may be reticent to respond to potentially transitory factors.

Arguably, 1Q 2025 may represent peak uncertainty as the market adjusts to the new administration and therefore recession and inflation concerns may soon fade. For now, we expect the Fed will be stuck in place.

[7] Bloomberg, U.S. Generic Government 10 Year Index.

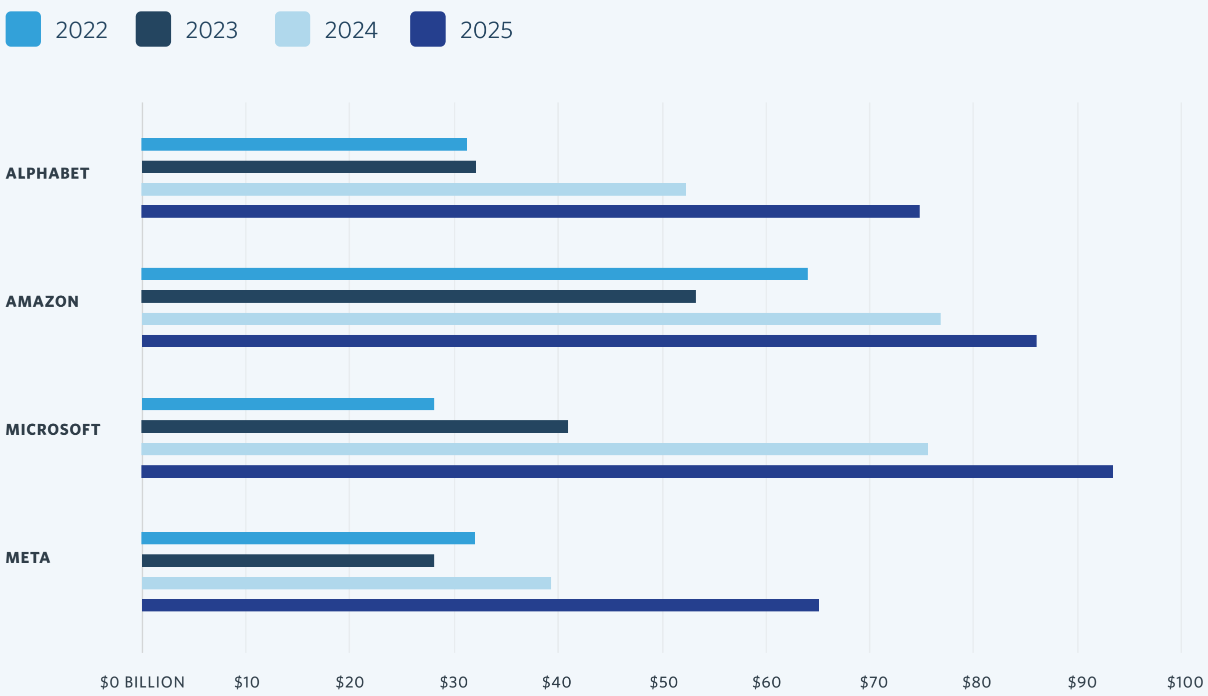
[8] CME Group FedWatch Tool (03/10/2025)

Macro Backdrop: The Good

CAPEX Bacchanal

As well documented and evidenced below, U.S. mega-caps plan to ramp capex significantly in 2025, largely related to all things-AI:

Capital spending by calendar year



Source: Visible Alpha, company data (02/07/2025)

History demonstrates that emerging technologies represent a thin reed for markets to attach its hopes. That said, however long the current mania lasts, AI will boost our economy through outsized capital investments and by lifting market values.

Further, even after the bubble pops, these AI enterprises will have built infrastructure that will hopefully accrue to the long-term benefit of our economy.

For instance, the U.S. overallocated to housing in the run-up to 2008. Much of the equity and some of debt got wiped out in the downturn, but the housing stock remained. Imagine how much worse the U.S. housing situation would be without the pre-GFC overbuild.

Any potential AI overinvestment will hopefully follow a similar path. Most companies will likely go bust, but, in time, the data centers, power generation and computing power will find productive uses.

As a final (tangential) thought on AI, Big Tech has gained spectacular wealth and influence in recent decades–perhaps broadly stifling competition. We would highlight that the U.S. government dismantled AT&T in 1984 on anti-competition ground. At its peak, AT&T commanded a $60bn market cap, or roughly $150bn in today's dollars. Meanwhile, Apple eclipsed a once unfathomable $4T market cap in 2024.

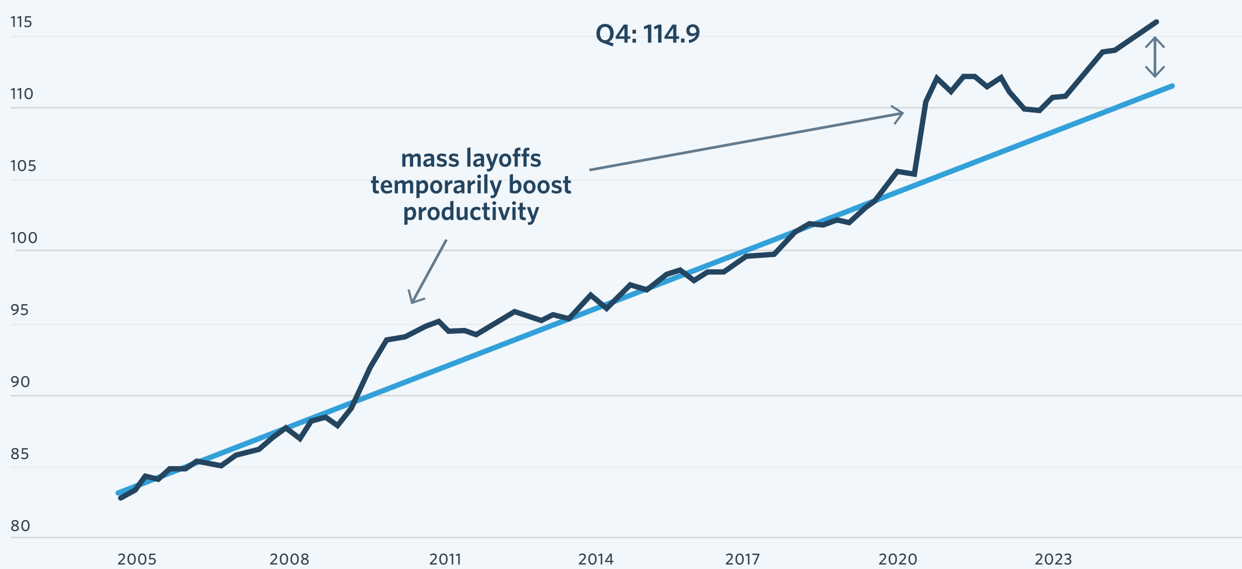
An unintended consequence of Big Tech dominance, however, may have yielded the U.S. an edge in the artificial intelligence race. U.S. Mega tech's monopoly-esque rents now provide a seemingly bottomless war-chest for private-sector AI investment, which, given the industry's potential winner-take-all dynamics and the (purported) gains of DeepSeek, motivates them to spend.

Productivity Boost

The uptick in U.S. productivity represents another clear economic positive.

U.S. Labor Productivity increased for the ninth consecutive quarter in 4Q 2024 and annual productivity increased at that highest pace in 14 years (ex. COVID) in 2024:

U.S. Labor Productivity (2017 = 100)



Source: The Daily Shot (02/07/2025)

[9] Parmy Olson, Supremacy: AI, ChatGPT and the Race That Will Change the World, St. Martin Press, New York (2024)

It would be too early to attribute this leap to AI and more likely reflects two other COVID-related phenomena.

As noted earlier, the normalization of remote work has expanded the size the U.S. workforce. Additionally, difficulties in hiring during the pandemic prompted investment in labor-saving technologies (e.g. plant automation, kiosks at fast food), which have bolstered efficiency.

The recent productivity lift echoes the dot.com era where economic efficiency helped forestall inflation even as the economy roared, enabling Chairman Greenspan to keep interest rates flat.

If the current market regains its footing, this post-pandemic uplift would combat inflation and potentially contribute to the reemergence of the "higher for longer" rate outlook.

The Opportunity: Seek Shelter
Darkening equity backdrop

The shifting macro backdrop paints an ominous tableau for equity returns.

Again, reorienting supply chains will come at a cost: either businesses or households will be burdened with added expense. Either path hurts markets.

Further, pulling apart NATO would undermine the stability that has enabled post-war growth. Stability is indispensable for economic gains

In the near-term, a muted U.S. fiscal outlook, waning consumer confidence and (potentially) resurgent Europe could reverse key factors that have propelled our post-COVID economy/markets.

Additionally, money plowed into equities immediately post-election ($140bn in January 2024 alone). Should the administration further signal that "growth" is not paramount, these dollars could cascade out of the market.

Finally, post-GFC, the Fed has seemed to step-in to quell market turmoil despite largely healthy economic conditions—with 2019 providing the most poignant example. After a sudden selloff in 4Q 2018, the Fed cut interest rates three times despite little sign of economic deterioration.

Low inflation has been the lodestone for this "Fed put." However, the days of slashing rates with impunity may have died in COVID, limiting the Fed's ability to intervene in the next downturn, which could accelerate a future selloff.

The Fed put is lower than the market believes, in our view.

Compelling Relative Value

After consecutive years of +20% returns, the earnings yield of the S&P 500 is hovering around 3.45%; this yield would further compress should earnings falter.

Stretched valuation amid an unsettled environment screams for investors to crystalize equity gains to increase their credit allocation. Credit will, in our view, provide greater absolute returns for investors while also muting future volatility.

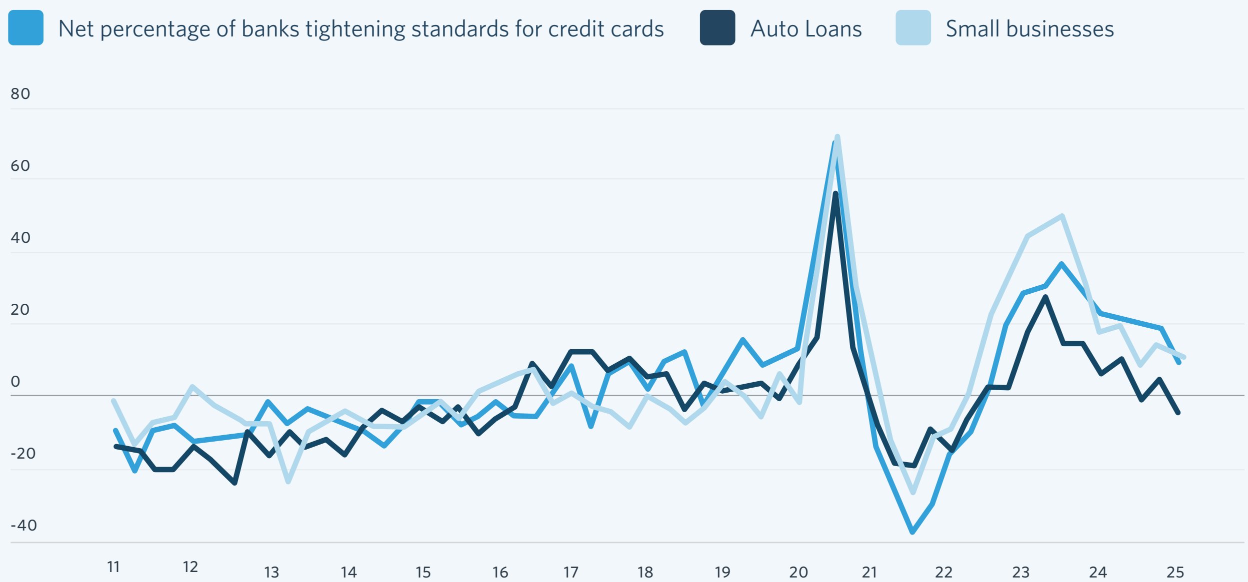
High Yield spreads have backed up roughly ~30bps in 2025, but at roughly 316bps over

Treasuries, remain historically tight and far from compelling value. We concede that all-in yield of 7.4% (helped by high risk-free rates) can be alluring, but believe investors risk downside-volatility at these levels, particularly if slowing growth ratchets defaults. Plus, High Yield can get mauled in risk-off markets and our investors recognized the structural flaws of many traditional credit vehicles.

Within credit, the opportunity remains decidedly titled towards private markets.

Candidly, heading into 2025, we had a modicum of concern that deregulation would awaken small- and-medium sized banks. However, as the chart below shows, banks have continued to tighten:

Bank Lending Standards



Source: Pantheon Macro (02/21/2025)

Growth risk will likely keep banks pinned to the sidelines.

We have said it before, and we will say it again: not all private credit solutions are the same. Much as there are growth and value equities that provide different attributes, there are different types of private credit.

As we've shared with our partners for years, the structure of the U.S. credit markets hinders potential returns. Unlike the equity markets, the credit space is dominated by monster firms and monster funds. There are limited returns to scale within fixed income. After a certain point, size can limit returns by hindering dexterity and shrinking the available universe.

This dynamic has recreated itself within private credit. The preponderance of capital in recent years has flowed to a handful of funds, whose size forces them to chase large opportunities. The backdrop will provide tough sledding for these strategies, in our view.

First, tight credits spreads enable fierce competition from the public market. Plus, private credit is no longer a new phenomenon and therefore the public markets have likely been picked over for "easy" private refinancing; adverse selection likely remains. Lastly, large and sponsor-based transactions require just that: transactions. Volatility and shifting macro dynamics will almost certainly chill deal activity, providing fewer opportunities for large cap private credit.

BC Partners continues to see a variety of opportunities in our wheelhouse of non-sponsor direct lending and specialty finance.

Aviation remains an area of focus. Broadly, COVID crunched the balance sheets of many airlines, increasing the need for non-traditional capital.

Beyond this attractive market set-up, BC Partners also likes the unique risk of this niche. Each aircraft deal is specific and one-off; there is no "buy the market" passive equivalent. Instead, excess returns stem from the hard work of sourcing and structuring deals and (equally important) navigating exits.

Equipment-leasing and asset-backed lending remain in focus as well. Much like, aviation, active management and pipeline can unlock equity-like returns from 1st dollar risk. Plus, given that we lend against vital equipment/infrastructure, there is limited earnings risk.

Even if a company "misses" on EBITDA, our investors collect our monthly lease payments. Should the company and/or market collapse (due to recession, trade war, etc.), equipment payments are typically the first-priority payment. Term Loan lenders may grant a forbearance, but a company needs to pay for critical equipment to keep its lights on. These payments are rarely interrupted in a bankruptcy (to maintain value of the estate) and hard assets protects in the rare case of liquidation.

We believe these are the risk/rewards investors should lean into.

Fund financing also provides a rich seam for our investors.

As alluded to earlier, the macro environment will likely reduce deal activity, providing fewer PE exits; private equity holding periods are at decade high. Mounting pressure from LPs to return capital and difficulties raising dollars has expanded NAV lending opportunities.

BC Partners has captured meaningful share in this niche—once the domain of traditional lenders. These facilities provide yields in the low- to-mid double digits, backed by a diversified portfolio of assets at a low attachment point (typically under 30%). Importantly, obtaining liens on fees (the lifeblood of PE) ensures that firms wake-up every day and go to bed everything night, thinking about our loan.

Again, we view this as an alluring counter-cyclical private market niche; we expect opportunities should expand with slower economic growth.

The last growth segment we would highlight is venture lending—also negatively correlated with the economy.

VC firms have been chasing all things AI, to the exclusion to nearly every segment, cooling valuations and capital availability for many growth businesses. Issuing equity in this backdrop has become punitively expensive, leading many firms to seek venture debt solutions.

These venture loans enjoy full collateralization and LTVs frequently 30% or lower from the last funding round. Yields typically begin in the mid-teens and with structured upside, total returns push into the high teens.

We anticipate the potential for a deluge of opportunities if the economy slows.

BC PARTNERS

Should the market reaccelerate, "higher for longer" would return as market narrative, supporting continued high yield-based returns for our investors.

Wrap-up: Amid the haze, the path is clear

Investors should never extrapolate long-term trends from a small amount of information. That said, the first several months of 2025 signal potential for dramatic shifts that could impact the U.S. economy. Markets are typically slow to react to big changes and then, often dramatically over-correct. Investors therefore have an incentive to move early.

Sluggish GDP and tempered equity gains seem increasingly like the base-case for 2025. Fortunately, this backdrop provides a straightforward path for investors: crystalize returns from the furious post-COVID equity rally and expand allocation to private solutions that will thrive amid a slowdown.

Important Information:

All information contained herein has been sourced from BC Partners Advisors L.P. (the "Advisor"), unless otherwise noted. Certain information contained in this Presentation may have been obtained from published sources prepared by other parties. Such information is believed to be reliable, but has not been independently verified or audited. The information presented herein is for illustrative purposes only and should not be considered reflective of any particular security, strategy, or investment product. It represents a general assessment of the markets at a specific time and is not a guarantee of future performance results or market movement. The information contained herein does not constitute financial, legal, tax or other advice, and is intended solely for the person(s) to which it has been delivered. It may not be reproduced or transmitted, in whole or in part, by any means, to third parties without the prior consent of the Advisor. Nothing herein is or should be construed as an offer to enter into any contract, investment advice, a recommendation of any kind, a solicitation of clients, or an offer to sell or an offer to invest in any particular fund, product, investment vehicle or derivative. The information contained herein is not complete, may not be current, and is subject to change. The Adviser is under no obligation to update such information. This material is not directed at, nor is it available for distribution to, U.S. investors or any persons in any jurisdictions in which the Adviser or its affiliates are prohibited by law from making this information available.