BC PARTNERS

Quarterly Credit Check: Capitalizing on volatility and delivering equity-like returns

In this quarterly macro-commentary from the BC Partners Credit team, Ted Goldthorpe and Mike Terwilliger highlight how in today's uncertain and unstable market, credit can beat equity on both a risk-adjusted and absolute return basis.

Macro headwinds such as tariff whiplash, crumbling consumer confidence, and concerns over fiscal policy are eroding margins and compressing equity multiples. These risks suggest investors should favor a conservative portfolio allocation weighted toward credit.

However, a conservative allocation does not require sacrificing returns. BC Partners is uncovering credit deals that offer equity-like returns of 18-22% with downside protection – particularly asset-backed, non-sponsor, and fund finance transactions.

Read on for a deep dive into the current state of the market and examples of where the firm has identified opportunities for outsized returns.

Macro Backdrop: Uncertainty Reigns

The Redux

Investors experienced a roundtrip in 2025 following the market sell-off after the April 2nd "Liberation Day", only for the S&P 500 to post the strongest May return since 1990.[1] Despite this volatility, markets remain in much the same place: riddled with uncertainty.

However, we believe the April-May merry-go-round revealed two very important facts: (1) there are limits to the administration's ambitions to reshape the U.S. economy with tariffs; (2) the U.S. Treasury market (quiescent throughout much of the post-GFC era) has reemerged as the market's weapon for restraining policy.

The 10-Year Treasury yield jumped from 4.17% on April 1st to 4.34% on April 9th (material in the context of Treasuries). The rapid ascent during that equity selloff prompted a "pause" from the administration and markets subsequently rallied under the belief that the worst of tariff risks have passed — which, of course, remains to be seen.

In a shifting backdrop, offering conjecture on the path of U.S. markets and economy is rife with potential failure. Nevertheless, we posit that tariffs will likely persist for the next four years the risk of a shambolic collapse has faded. The administration will not, it seem, crash the economy to meet its trade goals.

This does not suggest the ill-effects of these levies have retreated as not shambolic does not mean benign. In fact, much of the damage from trade friction has already been done.

Somber Surveys

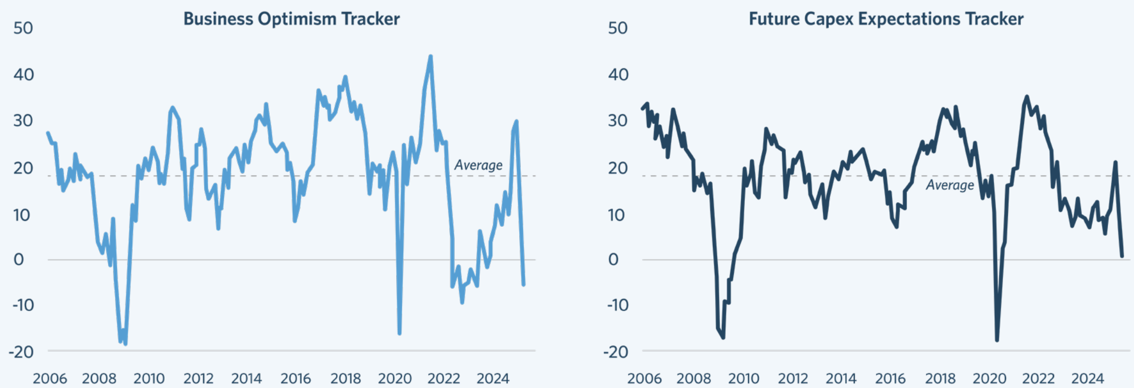
First, as noted last quarter, uncertainty kills economic activity; if you cannot plan, you will not spend beyond immediate needs.

Quoting directly from the Fed's Beige Book released on June 4th, "All Districts reported elevated levels of economic and policy uncertainty, which have led to hesitancy and a cautious approach to business and household decisions."

As evidenced below, business optimism and capex intentions have collapsed, marking the steepest two-month drop since COVID:

[1] Daily Chart Book, (05/31/2025)

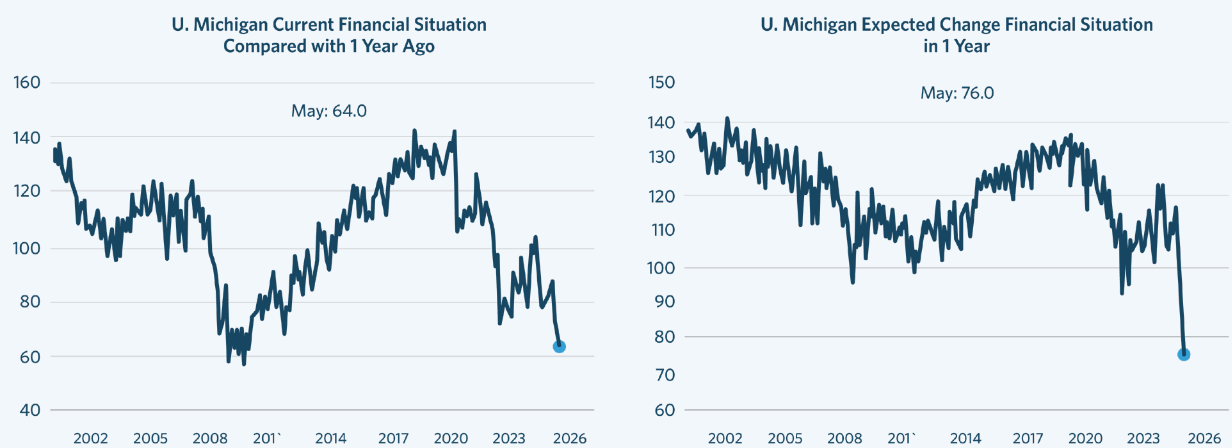
Business Optimism and Capex Expectations



Source BofA Global Investment Strategy, Bloomberg, Federal Reserve, *YTD change in U.S. household equity holdings because on YTD change in GWIM equity holdings (04/29/2025)

Household confidence has similarly plummeted, with Americans reporting a dramatic drop in their expectations for their financial future:

U. Michigan Household Financial Expectations



Source: The Daily Shot (05/19/2025)

Muted outlook data likely foretells a drag on future GDP.

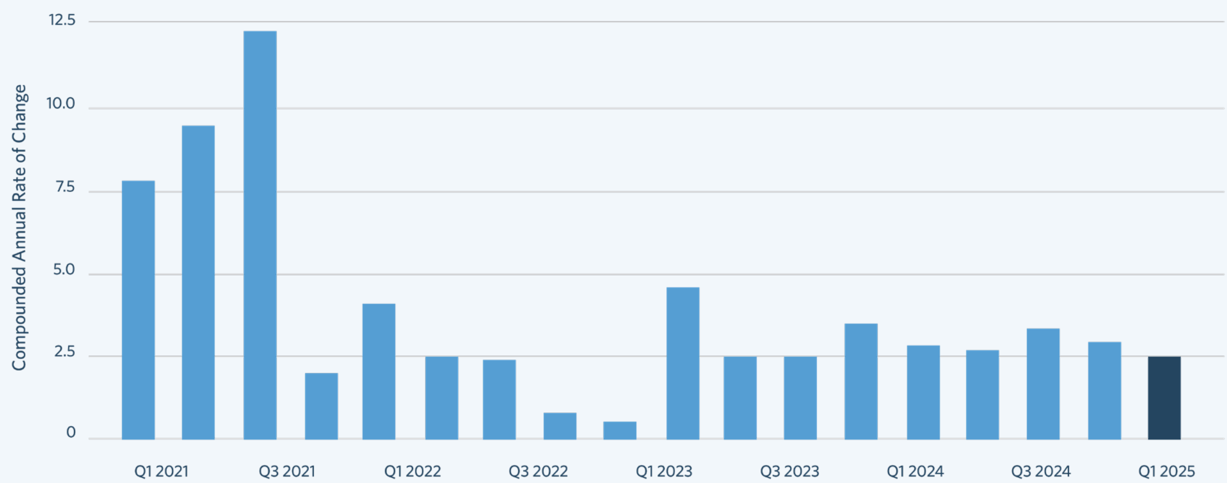
The battle of Soft vs. Hard data

Notably, however, there has been a yawning gap between "soft data" (survey observations) and "hard data" (reported economic metrics) thus far.

One component of the disconnect may stem from the hyper-partisan backdrop whereby some percentage of Americans view everything through a negative prism, while others adopt the opposite viewpoint. In short, partisan noise may skew survey results.

The data disconnect likely also reflects an element of timing. For instance, the U.S. BEA's 1Q report of Real Final Sales to Domestic Purchasers (a reliable gage of economic activity which excludes inflation, changes in inventories and net exports), would seem to refute sentiment data:

Real Final Sales to Domestic Purchasers



Source: U.S. Bureau of Economic Analysis and The Daily Shot (05/30/2025)

However, these readings demonstrate a degree of pulled-forward purchase activity, particularly in segments in the crosshairs of tariffs. For example, Wards Automotive reported vehicle sales of 17.27mn in April, describing it as "well above" the roughly 16.0mn otherwise anticipated, because of tariff-related purchases.[2] Reflecting this fleeting dynamic, Wards reported sales declined to 15.65mn units May, below the expected 16.00mn.

Commentary from the Cass Freight Index for May also demonstrates inventory stocking, as well as, ominously, early signs of its unwind:

> *Negative consequences of tariff effects are partly reflected in May data, as pre-tariff inventory stocking has started to turn to destocking, and those stocks will start to thin in the coming months.*[3]

[2] "Let's put some trade points on the board already," The Boock Report (05/02/2025)

[3] May Cass Freight Index (06/14/2025)

Relatedly, there has been a lag in companies pushing through higher costs; for instance, bellwether Walmart only started raising prices in late May. So, while most Americans have experienced the psychological impact of tariffs, which have dominated the news cycle for months, they are only just beginning to feel the pinch in their pocketbooks.

Lastly, tariff-related uncertainly prompted a 20.8% and 28.5% decline in container shipment volumes from China to the U.S., in April and May, which portends future inventory shortfalls.[4]

We expect economic headwinds may lie ahead. After depleting pre-tariff inventories and purchases, businesses and households may confront a combination of higher cost goods and/or a lack of available supplies (reminiscent of COVID), which could mute economic activity.

[4] "U.S. Container Import Volumes Drop in May Led by Sharp Decline in Imports from China," Talking Logistics (June 2025)

Dollar Doldrums

The U.S. dollar has declined 8% year to date against the DXY (a weighted currency index), contrary to the strength historically exhibited during periods of volatility.[5] A narrative of de-dollarization—essentially the reversal of American Exceptionalism (or what we have called T.I.N.A. U.S. of A.[6])— has emerged as the root of the dollar swoon.

Contributing to this thesis, concerns about governance and norms may have diminished the appeal of U.S. assets. Free trade, monetary independence and rule of law—central tenets of the U.S's economic success—have faced degrees of threat in recent months.

Beyond potential structural pressures, relative value considerations also contribute to the de-dollarization outlook. After a meteoric post-COVID rise, U.S. markets are expensive compared to much of the rest of the world, leading to the potential selling of USD to fund ex-U.S. investments.

Put plainly, should it come to pass, de-dollarization would deal a disruptive blow to the United States. The funneling of global wealth into U.S. markets has contributed to a lower cost of capital that has benefited businesses and households (most saliently through mortgage rates).

A meaningful reversal of this dynamic would stifle investment (by raising the bar on positive returns or higher WACC) and lower quality of life stemming from less disposal income (with more dollars dedicated to debt service). However, we do not believe de-dollarization would be a permanent phenomenon.

Death of the dollar has been greatly exaggerated

First, in our view, the bond market would check further erosions of U.S. market-based heterodoxy. Additionally, the world lacks anything approximating a replacement to the USD. Gold has already reached a once unfathomable zenith, the market value of "safe currencies" like the Swedish krona and Japanese yen represent a figurative thimble amid the oceans of USD assets. Crypto

[5] Maret Watch USD vs. DXY, January 1, 2025 – May 30, 2025. DXY measures the value of USD versus weighted versus six currencies: the euro (EUR), Japanese yen (JPY), British pound (GBP), Canadian dollar (CAD), Swedish krona (SEK), and Swiss franc (CHF).

[6] There Is No Alternative to the United States of America

remains crypto. Like it or not, the world is stuck with a dollar-based system, at least for the foreseeable future.

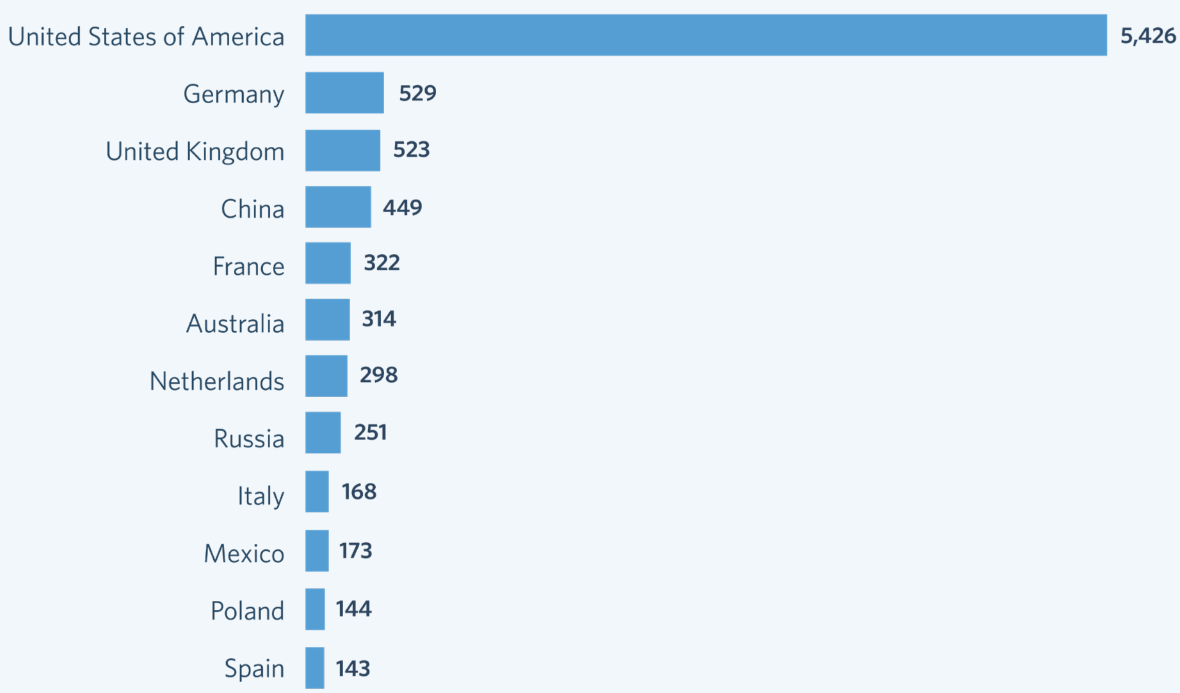
Lastly, and perhaps most importantly, valuations and fiscal considerations may dictate near-term capital flows but productivity and return on investment ultimately dictate their long-term path. Currency will ultimately migrate to whichever market provides the highest and best outputs, which has historically been the United States.

In 2025, 25 of the world's 30 most valuable public companies are domiciled in the U.S compared to 16 of 30 in 1995. Similarly, 25 of the world's 30 largest public technology companies are headquartered in the U.S. in 2025 versus 16 of 30 in 1995. We would posit these returns do not reflect the United States' fiat currency, but rather its leadership in commerce and technological innovation—at least to date.

We noted last quarter that greater fiscal spending in Europe could boost demand for European investments. However, Stuttgart does not transform into Silicon Valley overnight simply due to government spending.

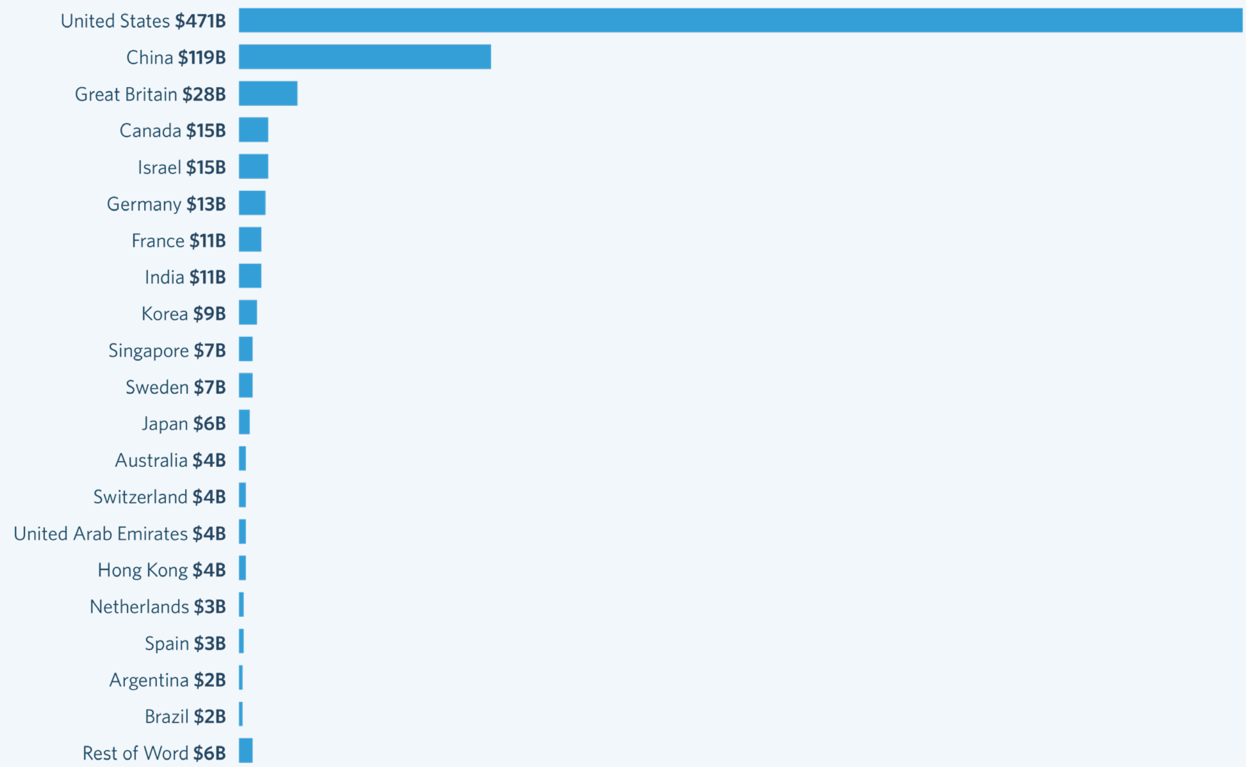
As proxies for potential future returns, we highlight the United States' share of data center and AI spending in the following graphs:

Number of data centers, leading countries, through March 2025



Source: Statistic (06/02/2025)

Total private spending on Artificial Intelligence, 2013 – 2024



Source: Visual Capitalist (04/21/2025)

Relatedly, the U.S. venture capital market has been estimated to be six times the size of Europe's.[7]

None of these facts ensure high future ROI, but they do highlight the structural advantages of the U.S. market that will continue to attract investment over time.

We believe the premium commanded by U.S. assets may retreat in the coming years, reflecting an uncertainty discount (as well as perhaps a modicum of nationalism), but this will not be a permanent condition.

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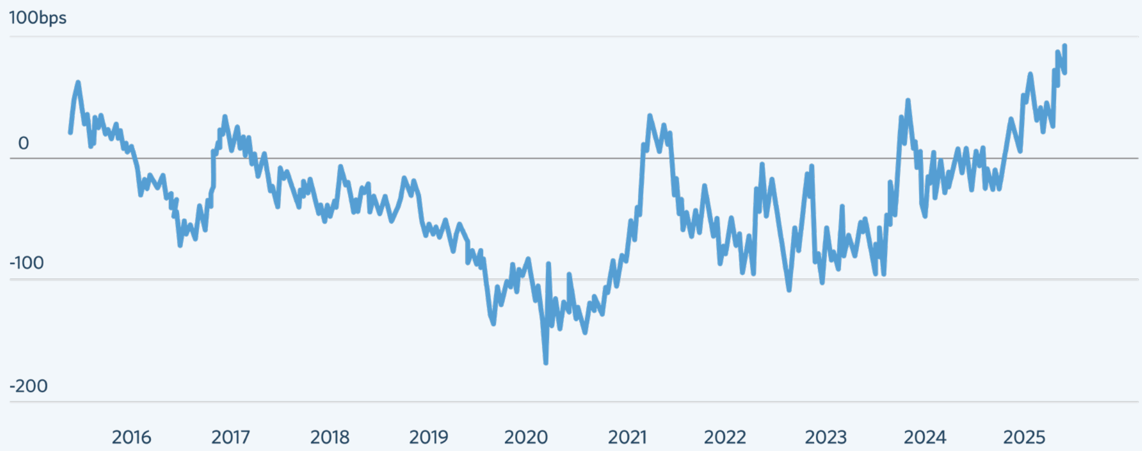
[7] "U.S. vs. Europe: Comparing Two Start Up Ecosystems," G2 Venture Partners (January 2024).

Fiscal to the Foreground

Rising U.S. Treasury Term Premium

The market appears to have shifted its focus from recession risk to fiscal concerns, as evidenced by the steep increase in U.S. Treasury term premium:

10 Year U.S. Treasury Term Premium



Source: Adrian Crump & Moench Model, New York Fed (05/27/2025)

The budget busting "One Big Beautiful Bill" (or "OBBB") as well as lower likelihood of government spending cuts with the demise of DOGE have contributed to 10-year term premium approaching 100bps.

The House version of the OBBB could contribute roughly $3.8T to the deficit and we believe its passage risks a Liz Truss-esque bond market tantrum[8].

Relatedly, in a post-GFC conditioned world that expects the U.S. Federal Reserve to solve crises, on this fiscal front, monetary policy offers little succor. The Fed only controls the front end of the curve and cutting rates during a potential Treasury-tantrum risks inflaming bond vigilantes by stoking inflation. The path to fiscal responsibility, therefore, will be navigated through policy makers, not the Fed.

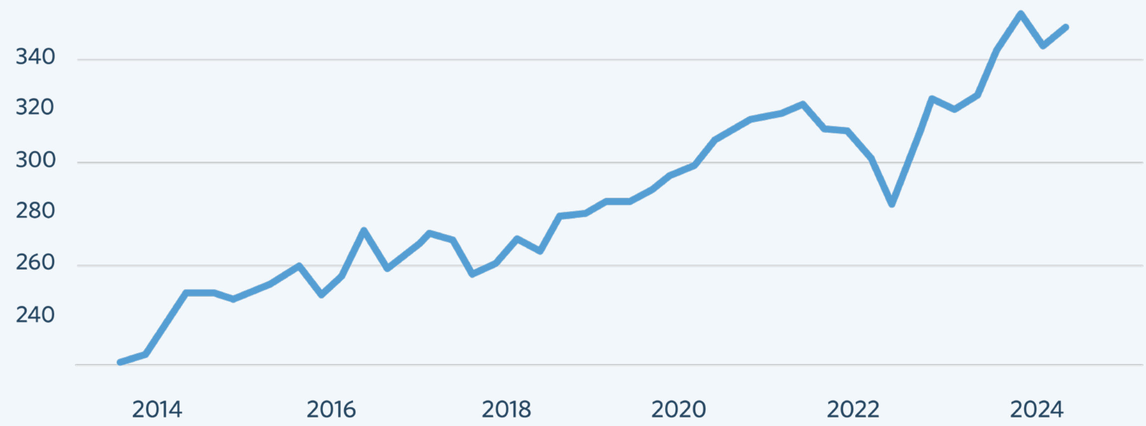
Fiscal flares in Japan

Fiscal concerns span the globe as uber-indebted Japan has come into focus with 40-year JGBs recently peaking at 3.689%.[9] This raised worries about the unwind of the Japan carry trade, whereby investors borrow cheaply in Yen to accumulate higher yielding overseas assets (particularly U.S. Treasuries):

[8] "Preliminary Analysis of the Distributional Effects of the One Big Beautiful Bill Act" Congressional Budget Office

[9] Bloomberg

Japanese Foreign Bond Holdings



Source: AlpineMacro (06/06/2025)

Continued increases in Japanese yields risk capital repatriating back to home markets. Increased cost of hedging, due to widening short-term interest rate differentials, potentially further limit Japanese demand for overseas investments.

Nightmare fuel for credit markets, Japan has historically been among the largest global holders of CLOs, which own 74% of the $1.4T U.S. levered loan market.[10] Higher Japanese yields represent a tail risk for the U.S. loan market if they mute future CLO demand.

Japan's persistent current account surplus (providing a stream of dollars that require investment) and potential BOJ intervention (with rumored plans to reduce tapering next year to cap rates) likely limits this threat, but Japanese CLO demand nevertheless bears monitoring.

OBBB's "Revenge Tax"

Related to our concern about capital flight both in Europe (discussed last quarter) and Japan (as detailed above), we identify another potential red flag in the OBBB.

Section 899 of the House bill proposes changes to the tax code to target countries with "unfair foreign taxes," largely digital-service taxes (DSTs)—or levies on online advertising, streaming services, eCommerce platforms and social media, among other online businesses—which disproportionally impacts U.S. tech companies.

The provision, as currently drafted, would tax foreigners for investment and income earned in the U.S., including dividends, profits from American subsidiaries of foreign businesses and proceeds from real estate sales.[11]

The proposal could be neutered or eliminated by the Senate. Supporting that outcome, the Joint Committee on Taxation noted that Section 899 would be a rare tax increase on the other side of the Laffer Curve—meaning it would reduce (not raise) tax revenue.[12] Section 899 may represent the "Art of the Deal," but it risks further driving capital away from U.S. markets.

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[10] As of August 2024, "2025 U.S. CLO Outlook: Another gangbuster year expected," Pitch Book (01/02/2025)

[11] "Who would pay America's 'revenge tax' on foreigners?" The Economist (06/04/2025)

[12] "Who would pay America's 'revenge tax' on foreigners?" The Economist (06/04/2025)

Hard "math" for U.S. equity investors

Beyond the structural and geopolitical, "math" paints a dim picture for U.S. equity investors.

Earnings and multiples, the main drivers of market returns, both appear at risk in this backdrop. Margins for the S&P 500 averaged 7.8% from 2000 to 2015, but last year, boosted by globalization, reached 10.7%.[13]

U.S. businesses could have potentially sidestepped targeted tariffs (due to currency shifts, product substitution, etc.), but higher costs (and resulting lower margins) will prove inevitable under the sweeping levies currently contemplated.

Compounding the difficulties for markets, higher expenses will weigh on multiples if they prolong higher interest rates. Long-run price-to-earnings ratios in U.S. markets averaged 16, compared to the trailing P/E of 25.[14] Reversion to mean would seem likely, if not inevitable, in our current unstable market.

[13] "This Economy Doesn't Bode Well for Share Prices," Wall Street Journal (04/29/2025)
[14] "This Economy Doesn't Bode Well for Share Prices," Wall Street Journal (04/29/2025)

Last quarter, we highlighted segments within private credit where BC Partners has been uncovering opportunities (e.g. non-sponsor, asset-based, fund financing, NAV loans). This quarter, we would like to emphasize deal structures that BC Partners believes are attractive in the context of the broader market.

Opportunities

Diminished (if not reversed) opportunity cost of credit

As a backdrop, foregone gains had been the Achilles' heel for credit investors throughout much of the post-GFC era. Why own any credit with risk-free rates around 1% and equity markets punching above their historical average? Put plainly, that era is over.

The long-term outlook for U.S. markets remains favorable, but current trends are not. Uncertainty, higher production costs and supply-chain disruptions combined with high valuations and market concentration do not foretell strong equity returns in the intermediate term.

Combined with higher risk-free rates and the continued retreat of traditional lending, stock investors may bear the opportunity cost of forgone gains in credit.

Structured credit presents potential opportunities

With equity risk premiums the most expensive relative to bonds since the Dot.com Bubble, credit will almost certainly produce higher risk-adjusted returns than equities, in our view.[15] However, more notably for our investors, many of BC Partners' structured credit investments may provide an attractive opportunity set.

Combining traditional debt with preferreds or other forms of equity participation may offer compelling returns, in isolation, but even more so, when accounting for the downside protection.

These deals are not "cookie cutter" directly originated private loans, which is the core of most private credit franchises. Rather, structured credit transactions highlight BC Partners' ability to potentially generate returns by designing unique and flexible financial solutions.

Because of the difficulties in scaling this category due to the bespoke nature of each transaction, most credit platforms eschew structured credit. However, given our dexterity, BC Partners can unlock these positively skewed deals, which would be attractive in any market, but even more so given the bleak outlook for traditional assets.

As we discussed last quarter, private equity firms have struggled to exit investments, partially due to higher rates. This inability to return capital may prompt more businesses to seek structured solutions, providing an attractive backdrop for this core BC Partners strategy.

Additionally, BC Partners has continued to see an uptick in lending backed by hard assets.

The unsettled economy has reduced business confidence in future cash flows, and higher rates continue to drain cash and weigh on valuations. Adding traditional debt would reprice cheap legacy loans (due to most favored nations or MFN covenants), and as a result, many companies are seeking alternative means for raising new debt.

Trade uncertainty and inflation have lifted the value of many existing assets. As an example, the cost of a mainframe computer has risen 10-15% in 2025 because of tariffs on high-tech imports.[15] This dynamic has, in many instances, increased the value of in-place assets.

Consequently, BC Partners has been leveraging higher collateral values for new financings in aviation, equipment leasing and asset-heavy verticals. As noted last quarter, these deals provide first dollar risk on potentially valuable (and in a worst-case scenario, foreclosable) assets—a compelling profile amidst an otherwise underwhelming investment environment.

[15] Goldman Sach Global Investment Research (05/27/2025)

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