BC PARTNERS

2026 Credit Check

Damn the torpedoes, private credit remains an avenue for alpha

In their 2026 macro-commentary, Ted Goldthorpe and Mike Terwilliger from BC Partners Credit strike a cautiously constructive tone. Accommodative fiscal and monetary policy and reduced policy uncertainty provide meaningful support to growth, but the U.S. economy remains exposed to downside risks from a softening labor market and crushing government deficits. Markets may be underestimating the fragility of today's AI-driven optimism — as quickly as the boom emerged, sentiment could reverse, which would stall capex and unwind recent wealth effects.

Despite this backdrop, the team challenges the recent swirl of negative private market headlines. The collapse of First Brands, often cited as a cautionary tale, is instead presented as a case study highlighting the value of covenants, selectivity, and disciplined underwriting. With public equities richly valued, spreads at or near multi-decade tights, and large-cap private credit increasingly commoditized, BC Partners Credit argues that private credit remains one of the few areas offering durable, risk-adjusted returns. To achieve these returns, capital must be deployed in the right segments – lower middle-market financing, non-sponsor lending, and segments of specialty finance – all which are core to BC Partners Credit.

First Brands

Before framing the macro, we want to first address a question we've fielded from all corners: our thoughts on First Brands.

First Brands has come to represent the ills of private credit. In our view, the company's demise reveals the benefits of private credit. Press reports suggest the company fraudulently securitized receivables, something undetected under its cov-lite broadly syndicated corporate capital structure.

We believe it is critically important that funds safeguard their LPs with legal protections. BC Partners, relying upon its market segment, generally negotiates credit agreements which do not permit borrowers to securitize anything without its express permission. Covenants, seemingly absent from First Brands' largely public capital structure, may have helped to protect investors from the company's alleged misconduct.

The holders of First Brand debt read like a veritable "who's who" of large and respected credit platforms. We cast no aspersions on these firms, but First Brands demonstrates the challenge of raising too much capital and the fact that pressure to deploy hoards of dry powder can increase the risk of bad outcomes.

Finally, the cross ownership of First Brands among large firms reveals the diminished diversification in today's credit market, where bad outcomes appear to trap major players due to overlapping holdings.

Not only does BC Partners have no exposure to First Brands, but across our portfolio, we maintain little common ownership with large funds—providing our LPs with true and meaningful diversification.

As a final thought, media reports suggest that First Brands may have intentionally misrepresented material facts about the company as perhaps did management of Tricolor Holdings—another recent high-profile bankruptcy. Willful misrepresentation (a polite way of saying fraud) represents the definition of idiosyncratic, not systematic, risk and therefore the demise of these companies—despite being in quick succession—does not signal either structural flaws in credit market or broader economic decline.

Macro Backdrop

“Tragicomical” is how we characterized the backdrop in early 2025 given the wave of market uncertainty.

AI essentially bailed us out by providing hope amid a seemingly bleak outlook. Regardless, one could be forgiven for expressing surprise, if not shock, at the resilience of U.S. markets and the economy.

As we turn the page to 2026, the outlook looks materially more constructive— fiscal and monetary policy provide accelerants to an already stable economy and with midterm elections looming, markets should benefit from less policy uncertainty.

However, from an investment standpoint, 2026 may prove ominous. With nearly every sell-side firm forecasting double-digit EPS growth, markets primed for growth often provide little margin for error.

The Concerning

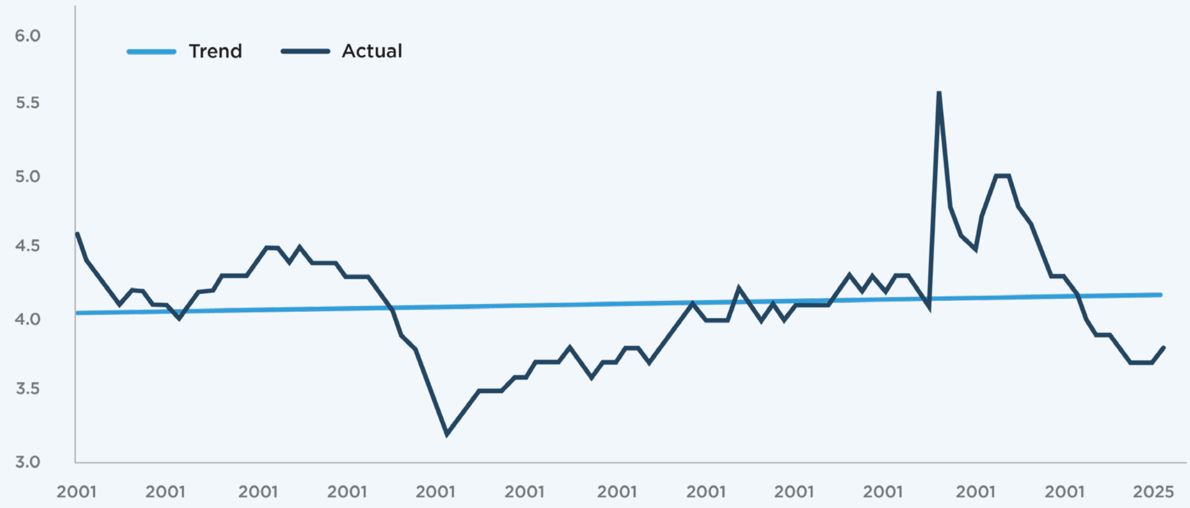
Jobs, Job, Jobs.

Job growth, or the lack thereof, remain among our chief concerns. Markets and policymakers alike are flying blind given the paucity of (and perhaps dubious faith in) data, due to the government shutdown.

In a classical cycle, slower hiring rates lead to higher unemployment, which, in turn, triggers a wave of layoffs. With 75bps of cuts in the second half of 2025, the U.S. Federal Reserve is clearly trying the steer the economy off this path.

As reflected below, over hiring during the post-Covid provides the most benign explanation of recent job erosion:

U.S. Private Hiring Rate



Source: Oxford Economics and Havner Analytics (12/10/2025)

Under this thesis, recent employment deterioration reflects reversion to the mean, not economic degradation.

Geopolitical uncertainty provides another less ominous explanation. If the veil of policy unpredictably continues to lift in 2026, the job market may regain its footing.

The jump in labor productivity, as shown on the right, provides another sanguine explanation for recent joblessness.

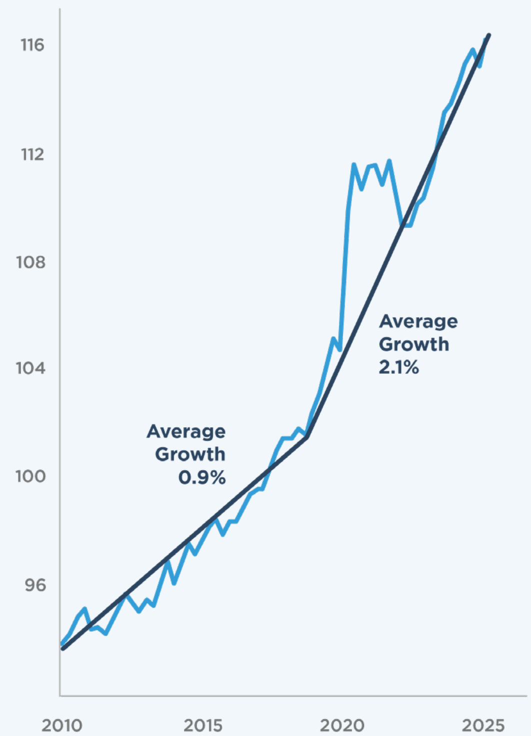
Heightened productivity—the ability to do more with less—represents the holy grail for an economy. However, better productivity metrics provide little succor for the increasing number of under- or unemployed in this country.

Artificial Intelligence almost certainly contributes to current joblessness, with publicly available job postings materially lower in AI-sensitive employment.

Jobs are the moat which separate an economy from recession. Hence, regardless of its nexus, the U.S. economy remains "at risk" until this dynamic reverses.

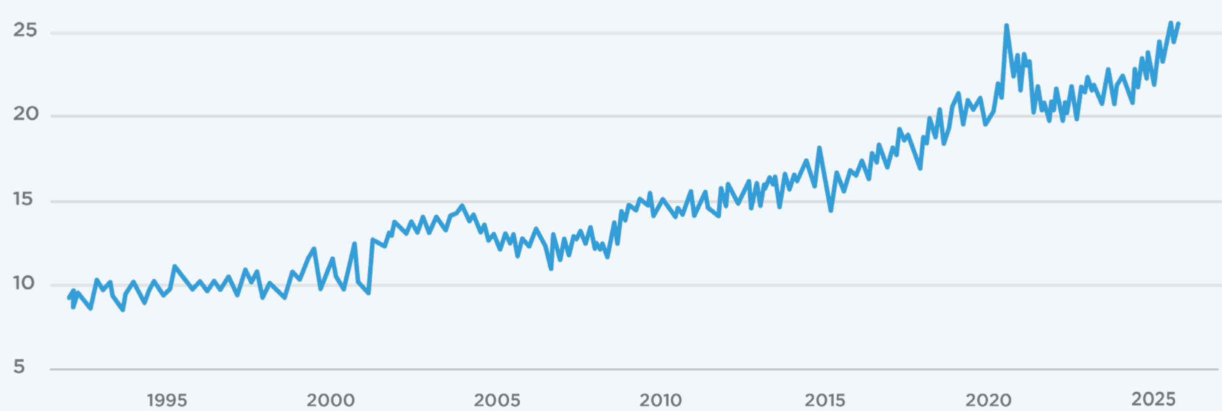
Lastly on the job front, we recently shared the graph with a coworker, with the line "herein lies the seeds of revolution:"

U.S. Labor Productivity



Source: "A Jobless Profit Boom," Alpine Macro (11/03/2025)

Share of U.S. Unemployed with Four-Year Degree



Source: Department of Labor, Bloomberg (11/21/2025)

The comment was in jest (somewhat), but the Arab Spring (most recently) and Iranian Revolution (most saliently) trace their roots to joblessness amongst the college educated. Regardless, the graph highlights that a growing segment of Americans face fragile employment prospects.

Fraying of the Consumer

The struggles of low-income households—those that have enjoyed little (or no) benefit from recent wealth effects and have borne the brunt of spiraling prices—have been well documented and will likely continue throughout 2026. In fact, this cohort may face further strain from lower Federal healthcare funding, particularly for Medicaid, under the OBBB.

Spending from high-end consumers (those enjoying supercharged wealth effects from sequential extraordinary market drivers—first, the fiscal and monetary largess from Covid and now AI) has powered the U.S. economy.

However, as reflected on the right, there are signs that consumer wariness has broadened.

Further highlighting consumer vulnerability, UMichigan sentiment readings in October reflected major purchase intentions hit the lowest level since the indices' inception in 1978.[1]

Consumer Sentiment by Income Cohort

Source: AlpineMacro and University of Michigan (12/11/2025)

[1] Pantheon Macro Monitor (12/08/2025)

Run It Hot

The Federal Reserve is cutting rates at its own peril.

With GDP firmly positive, inflation well above target, ebullient capital markets and stretched S&P 500 valuations, the U.S. economy — at its surface — does not seem to require monetary accommodation.

Regardless of the rationale for these cuts, the Fed's actions risk igniting market and economic growth that could unmoor inflationary expectations.

Hidden Leverage

As we've catalogued in previous quarterly letters, household and corporate balance sheets remain historically strong.

Notably, corporate debt-to-GDP has been declining since 2020, which bodes well for the economy. Late cycle periods of 1999, 2007 and 2019 witnessed steady increases in corporate leverage presaging (and contributing to) the eventual downturn.[2]

This is not to suggest their leverage remains quiescence across the economy. Hedge fund borrowing has been steadily increasing, as have retail products like zero-day options and levered ETFs, and, as shown on the right, margin debt.

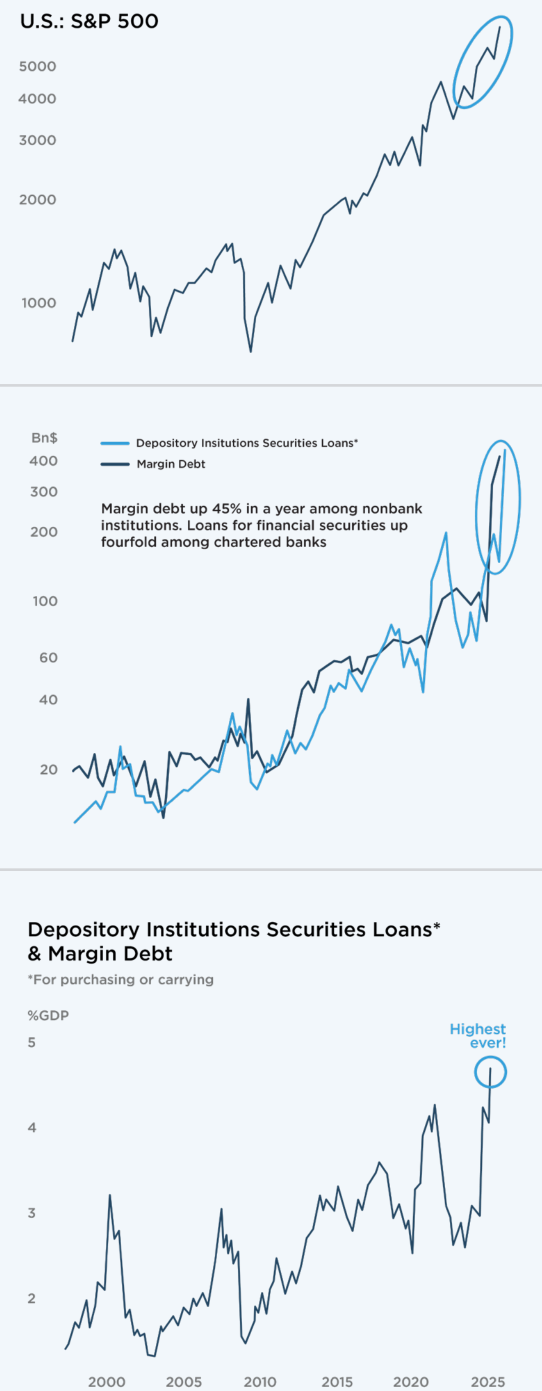
Fiscal Situation

This is effectively a permanent bullet point in our letters.

Fiscal deficits +4% of GDP have effectively been normalized with attempts at cutting government spending fading quicker than you could spell DOGE. AI's potential to boost future growth has likely contributed to the market's tolerance of once unfathomable deficits.

During good times, markets largely ignore high levels of indebtedness, but this can reverse quickly as deficit concerns can trigger a sharp downward cascade when the cycle turns.

Increasing Financial Leverage



Source: Alpine Macro (11/18/2025)

[2] Federal Reserve, Pitchbook LCD, Morgan Stanley Research (12/08/2025)

The Good

The positives in our backdrop are more readily apparent than this time last year, which gives us a measure of pause.

Dialed Down Noise

This tail-risk of "Liberation Day" gradually lifted throughout 2025 until we reached our present state: a degree of stasis in tariffs and trade.

In our view, rare earth leverage prevented (and will continue to limit) the degree to which the U.S. can battle China over trade. This is not to suggest conflict will fade. In fact, we believe reorientation away from China (and the Chinese reciprocal) will be the prevailing geopolitical driver of the coming decade. However, we expect a gradual decoupling versus the more dramatic ruction signaled early last year.

USMCA will likely represent the most significant trade negotiation of 2026. There will be friction, but because Canada and Mexico do not present existential threats to the U.S., we anticipate a less disruptive negotiation.

Tranquility is likely too much to ask, but absent further assaults on monetary authority, which we expect could trigger a galvanic market response, we expect policy noise will fade in 2026.

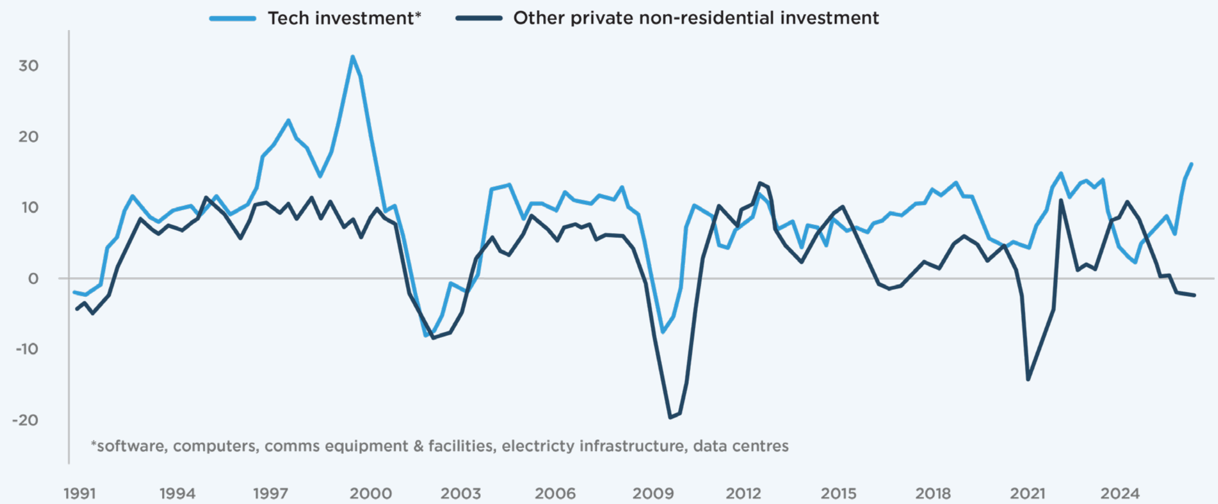
Fiscal and Monetary Tandem

While their merits can be debated, fiscal and monetary policy will provide twin boosts to our economy in 2026.

On the fiscal front, non-tech corporate spending has been moribund in recent years.

Provisions under the OBBB enabling companies to immediately expense new equipment as well as portions of domestic R&D may invigorate non-tech capex. The shrinking U.S. workforce (due to less migrant labor) as well as companies' attempts to offset tariff costs could further drive investment in labor-saving PP&E.

U.S. Investment, Tech and Other Private Non-Residential Investment



Source: Oxford Economics (11/25/2025)

Relatedly, many households will enjoy higher than usual rebate checks in 1H 2026 related to the delay in tax withholdings.[3]

Joining the fiscal party, Germany should ramp its multi-year defense and infrastructure spending this year and Japan's new(ish) Prime Minister, Sanae Takaichi, unveiled an unabashedly pro-spending agenda (BOJ rate hikes be damned). Unlike England's aborted fiscal jolt in 2022, Germany's decades of miserly budgeting and Japan's current account surplus should power these spending programs.

Further, lost in the headlines of the December rate cut, the Fed announced it would begin purchasing $40bn a month in T-bills to inject "ample reserves." While framed as purely "operational," it will provide stealth QE that could push down Treasury yields. In fact, Bank of America forecasts that $380bn of these "reserve management purchases" in 2026 could lower 10-year Treasury yields by 20 to 30bps.[4]

M&Aen Vogue

The deal market has shown signs of life, with announced deal volumes up 43% in 3Q 2025.[5] The well documented mass of dry powder buoying private equity funds, tight credit spreads and little heed to antitrust concerns should keep transactions rolling in 2026.

In an era of large numbers, it is easy to lose perspective, but the $55bn Electronic Arts deal in October represented the largest LBO of all time.[6] In the wake of EA, Paramount's rejected offer for Warner Bros. Discovery of $108.4bn (approaching the GDP of Ecuador) suggests elephant hunting is back.[7]

M&A should contribute to the 2026 flywheel.

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[3] "Corporate bond managers face bleak choices (again)," AlpineMacro, (12/11/2025)

[4] "The Fed just made an overlooked decision that's even more important than its last rate cut," Business Insider (12/15/2026)

[5] "The Year of Risk Reboot" (Morgan Stanley, 11/16/2025)

[6] "Electronic Arts Goes Private for $55 Billion in Largest LBO Ever," Wall Street Journal (09/29/2025)

[7] "Warner Bros likely to reject $108.4 billion Paramount bid, back Netflix in bidding war," Reuters (12/17/2025)

Banks Back in Business?

Consistent with its deregulatory push, the Administration recently withdrew leveraged lending guidelines, which had somewhat handcuffed banks to the benefit of non-banks.[8]

For context, in 2013, the Federal Reserve, FDIC and OCC published guidance that limited the degrees of leverage banks could provide.[9] The framework was never presented to Congress and never became enforceable, but it still prompted banks to eschew “risky” loans.

Eliminating the guidelines may have limited practical impact. Banks largely package and sell, not warehouse, risk, so public market appetite for leverage will determine its ultimate impact. Banks may, however, innovate junior debt products to better compete.

In a market already suffuse with debt, the regulatory retreat could potentially unleash a significant wellspring.

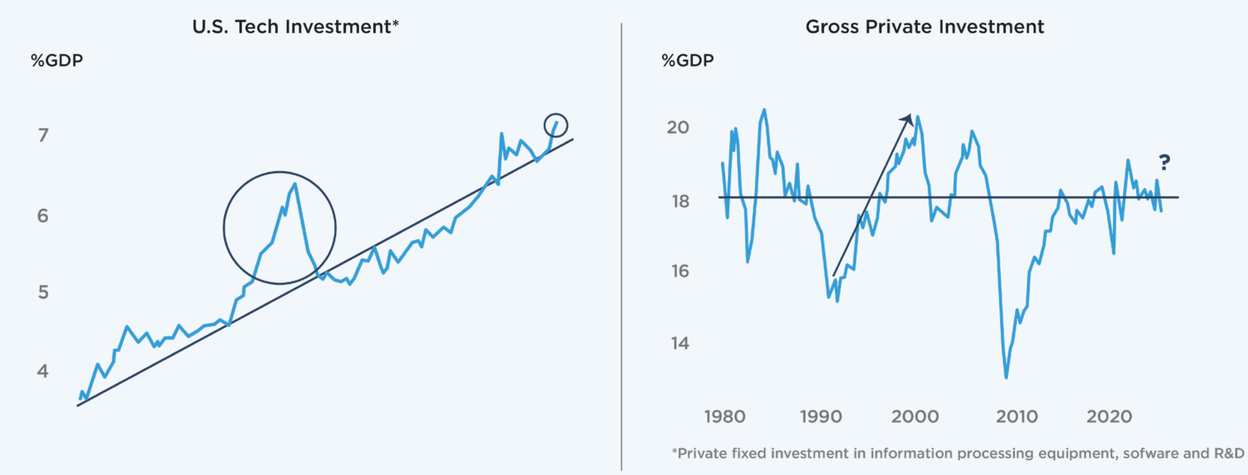
AI Room to Run

Try as we may, market commentary without a discussion of artificial intelligence appears incomplete.

We view the “bubble” narrative as healthy because it may limit overinvestment, particularly among overenthusiastic retail investors. The rent-like cash flows of hyperscalers make them essentially immune from such concerns, but it enables them to spend with impunity (at least for now).

However, the graph below provides a counter the “bubble” thesis. While tech investment as a percentage of GDP is elevated, it remains well below Dot-com levels:

U.S. Investment, Tech and Other Private Non-Residential Investment



Source: “Climbing AI’s Wall of Worry: Deprecation, Capex and Leadership Changes,” Alpine Macro (12/08/2025)

Bubble or not, AI should again provide a growth driver this year.

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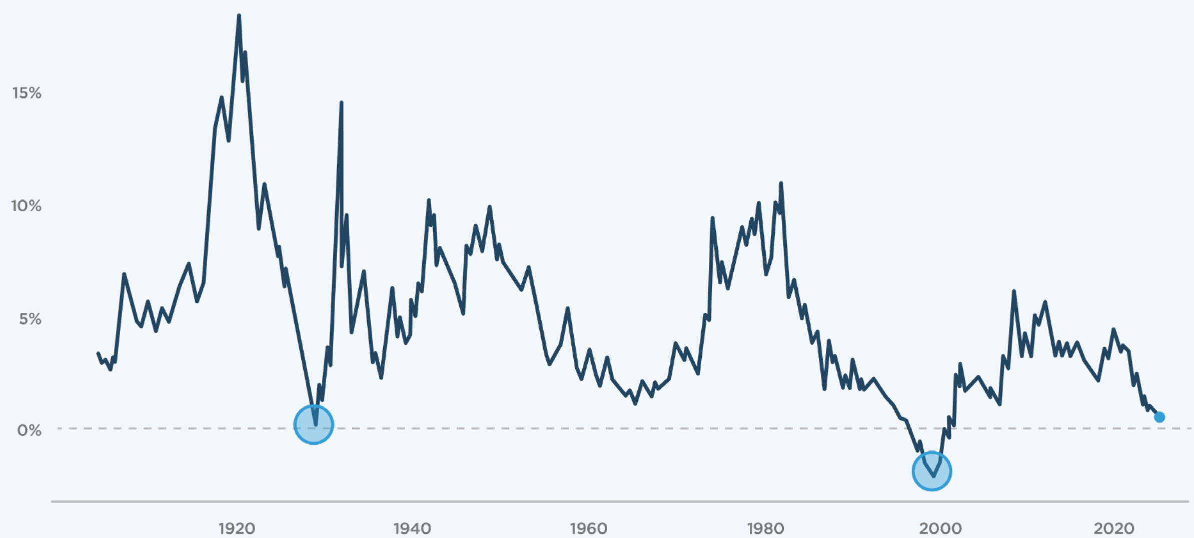
[8] https://www.fdic.gov/news/press-releases/2025/interagency-statement-occ-and-fdic-withdrawal-interagency-leveraged

[9] https://www.fdic.gov/news/press-releases/2025/interagency-statement-occ-and-fdic-withdrawal-interagency-leveraged

The Opportunity

With earning yields (the inverse of P/E) in range of the Roaring Twenties and the Dot-com bubble levels, this graph captures the equity market's challenging valuation:

U.S. Equity Risk Premium, CAPE Earnings Yield—Real Yields



Source: The Daily Shot (11/25/2025)

For emphasis, a dollar invested in September 1929 did not reach breakeven until November 1954.[10] Similarly, a March 2000 NASDAQ investment didn't recover until April 2015.[11]

High valuations provide little use in predicting one-year returns, but over a 10-year horizon, the inverse relationship between starting valuation and returns becomes irrefutable—particularly with high CAPE measures.[12]

Further, based on the relationship between the indices' forward P/E ratios and subsequent 10-year returns, the Apollo Chief Economist recently forecasted that investors should expect a zero return from the S&P 500 over the next ten years.

What about AI? We posit that the market's furious +40% return between 2022 to 2025 represented the pull forward of artificial intelligence's bull case. Hence, absent a paradigm shift, investors face little upside from AI and maintain 100% of its downside should sentiment shift.

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[10] S&P 500 Index (ticker: SPX) Price Change from 09/03/2029 to11/01/1954 = -0.0037%, Bloomberg

[11] NASDAQ Composite Index (ticker: CCMP) Price Chage from 03/01/2000 to 04/01/2015 = +0.132%Bloomberg

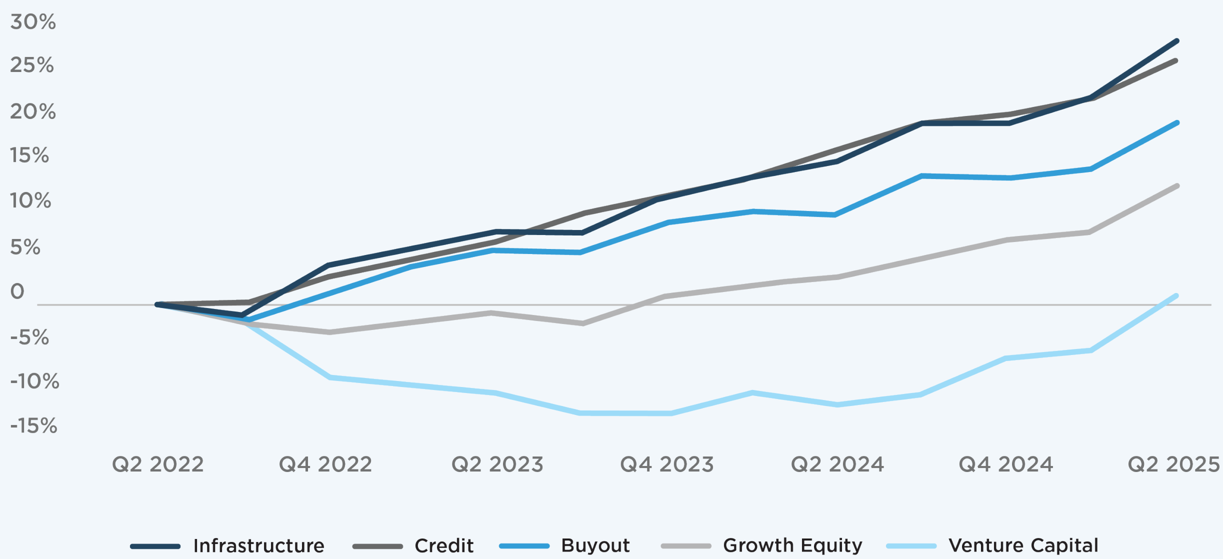
[12] Source: The Economist, Robert Schiller, Yale University and Bloomberg (12/08/2025)

With all of this in mind, where should you put your incremental dollar?

The rewardless risk of equity markets should prompt investors to expand their fixed income exposure. Even with tight public spreads, credit should produce returns competitive with equities on a nominal basis, and notably higher on a risk-adjusted basis.

As reflected below, those subscribing to a negative market narrative of private credit do so at their own investment peril:

Three Year Cumulative Return (2Q 2023 – 2Q 2025)



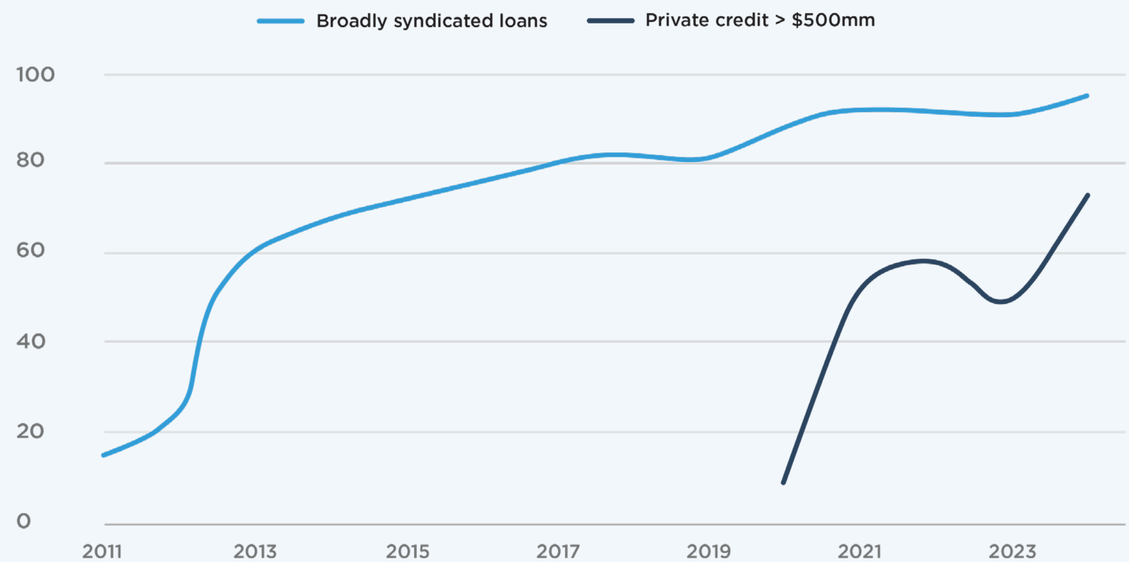
Source: Hamilton Lane (October 2025)

How We Are Making Money

As we've observed, the preponderance of capital in recent years has been allocated to large funds managed by monster firms and these strategies have become effectively indistinguishable.

Plus, as shown below, cov-lite structures now comprise greater than 70% of deals greater than $500mn.

Covenant-lite share of new-issue loans



Source: Satori Insights, Kirkland & Ellis, BIS, Covenant Review (12/11/2025)

The private market grew partly in response to the cov-lite structures of the broadly syndicated market. In Greek philosophy, Telos refers to "reason for being" or "purpose." In our view, covenants provide the Telos of private markets. Without them, you do not have private credit.

This is not to entirely discredit this segment, but to encourage allocators to view these funds as private credit beta and while seeking active managers like BC Partners to provide alpha.

In the fourth quarter, the firm closed its largest credit deal yet, a $1.3bn aviation transaction, which BC Partners Credit underwrote along with our capital partners. Specialty finance deals such as these, requiring bespoke underwriting and quick capital deployment, remain in focus this year.

Sports & Entertainment is another segment of focus for BC Partners Credit. Recently, we funded the acquisition of entertainment IP.

Working with our partner, we also funded another tranche of YouTube programming which had been reformatted and packaged as shows to major streamers.

On the back of these deals, with traditional entertainment firms in retreat, BC Partners has been shown a range of media opportunities which we expect to explore in 2026.

We remain bullish on sports as a vital cog in the global entertainment ecosystem, but purchasing these teams remains highly competitive and subject to sky-high valuations as these franchises remain positional, rather than economic, assets as would-be buyers seem focused on elevating their status. Hence, BC Partners has chosen to focus on adjacent categories instead of, for example, the acquisition of a professional sports franchise.

BC Partners also recently provided financing for a roll-up in minor league baseball, which benefits from the same powerful trends of sports broadly, but at a fraction of the market multiple.

Wrap-up

BC Partners remains bewildered by the negative dialogue surrounding private credit. That said, it is not entirely unwelcome.

The most challenging segment of the market remains the beta providers, which should promote opportunities for true active managers like BC Partners. Plus, the negativity swirling around the segment should force allocators to examine and delineate between managers.

A deep dive of our structure and strategies will reveal, without ambiguity, that BC Partners is truly a "one of one" in an otherwise crowded market.

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