

BC PARTNERS

3Q 2026 Credit Check

While bonds burn, private credit shines



BC Partners' credit team Ted Goldthorpe and Mike Terwilliger highlight factors behind the quarter's defining market event: the global bond selloff.



They believe the rate reset will shape portfolio construction in the years, if not decades, ahead. The new environment, in which inflation ended the post-GFC era of near-zero interest rates, broadly favors fixed income investments. The current backdrop does not, however, equally favor all income-oriented solutions, as evident in the elevated correlation between stocks and bonds.

As a predominantly floating-rate product, private credit provides better expected returns and portfolio hedge amid the current inflationary backdrop.

Finally, the authors detail recent transactions underscoring the differentiation of the BC Partners platform.

Macro Backdrop

For the first time in recent memory, artificial intelligence did not drive the macro narrative this quarter, having been overshadowed by the dramatic global bond selloff.

Global sovereign yields peaked in 3Q 2026 with 10-year Bunds ~3.6% (17-year high), 10-year JGBs ~3.0% (highest since 1996), U.K. gilts at ~5.0% (highest since before the GFC), and U.S. 10-year Treasuries above 5.0% (highest level since 2007). These levels represent dramatic widening since the beginning of the year (JGBs ~155bps, Bunds ~55bps, gilts ~50bps and UST ~79bps).¹ As recently as 2022 both 30-Yr Bunds and JGBs skirted near zero yield.

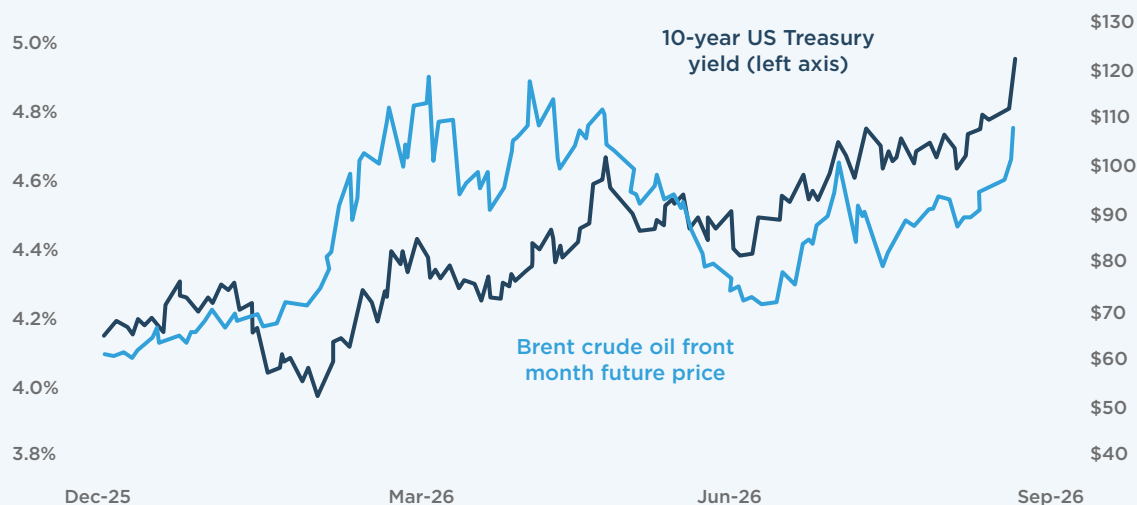
Due to the significance of the bond rout—seemingly sparing no corner of the market (Belgian 10-year OLO yields reached 4.1%, the highest since 2012)—we’re departing from our typical structure.²

Rather than examining concerning and positive macro factors, we’ll explore interrelated forces that drove the global rate reset.

Oil back in focus

Higher energy prices swayed markets, as the graph below reveals:

The 10-year US Treasury yield has surged to nearly 5%



Source: Goldman Sachs Global Investment Research

¹ Bloomberg, (09/12/2026)

² Bloomberg, (09/12/2026)

The collapse of another hoped-for diplomatic resolution in the Gulf combined with the return of kinetic activity and new pipeline disruptions, coincided with Brent spot topping \$109.5/barrel on September 9th.

Ominously, refined prices, including retail diesel fuel, reached \$6.00 per gallon during the period (+60% year-over-year), signaling future downstream cost pressures.⁴

Troubling datapoints

Headline inflation deteriorated in the quarter, largely reflecting higher energy prices. August CPI increased 0.4% month-over-month and 3.4% year-over-year, with gasoline contributing more than a third of the increase, and August PPI gained 0.4% month over month, with energy +4.2%.⁵

Notably, PPI measures upstream data (prices paid by producers/businesses), so this “hot” monthly print portends higher CPI/PCE (prices paid by the consumer) in the coming months. Importantly, September’s elevated spot prices are yet to be captured.

Promised deflation, nowhere to be found

Sentiment remains impossible to gauge, but the market appears to have been reappraising the near-term price implications of AI.

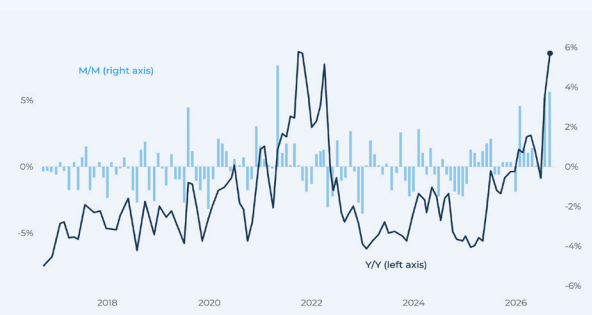
Initially expected to provide a powerful deflationary force, AI now appears a clear source of inflation from surging spending on data centers and related technologies like chips and semiconductors.

August CPI reflected AI’s direct cost impact on segments of our economy:

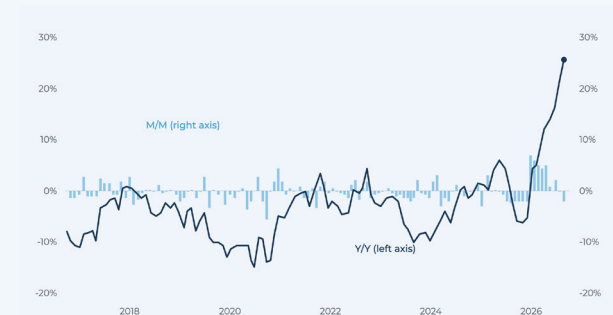
U.S. CPI: Computers & Peripherals and U.S. CPI: Software

— Y/Y ■ M/M (right)

U.S. CPI: Computers & Peripherals



U.S. CPI: Software



Source: U.S. Bureau of Labor Statistics: CPI

³ EIA (09/13/2026)

⁴ EIA (09/13/2026)

⁵ U.S. Bureau of Labor Statistics: CPI and PPI data

With AI funding increasingly tilting to debt markets, global yields have moved higher to absorb the deluge of issuance.

Global credit markets are traditionally guided by the axiom that governments borrow first, crowding out corporate issuance. With hyperscalers' credit profiles arguably stronger than sovereigns', could we imagine a world where AI debt crowds out government borrowings, further pressuring government funding costs?

Jobs whipsaw

The jobs picture remains murky but ultimately contributed to the rate reset.

Weak job growth in late 2025 and 1Q 2026 fueled expectations for lower Fed funds rates, with prospective easing framed as "insurance cuts" to support employment. Those expectations dimmed as the job market appeared to rebound in spring and early summer.

Chair Warsh's comments from Jackson Hole in late August, where he framed inflation, not employment, as the Federal Reserve's focus, extinguished the last flicker of hope for rate doves.

Fed shift

As recently as January 2026, Fed funds futures implied roughly 50bps of cuts, with easing expected in the back half of the year.

At its September meeting, the Fed hiked 25bps and signaled a more hawkish tone than some anticipated. Even with the move, the Fed remains in an unenviable position.

With inflation above target for the fourth consecutive year and near-term data flashing red, the Fed will face pressure to hike further. Standing pat would impugn the credibility of the institution by signaling capitulation to political pressure. Such a move would also risk further bond carnage on concerns that the Fed would fall behind on wrangling inflation.

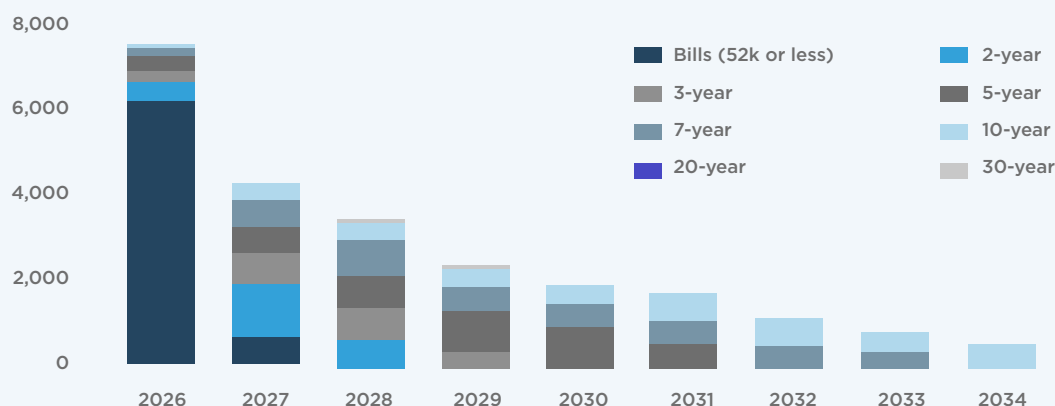
Plus, while hikes may temporarily quell the bond tantrum, they will amplify the nation's largest structural problem. Marketable U.S. Treasuries swelled to around \$31T today from less than \$5T in 2008. Put simply, every basis point of interest contributes to the seemingly intractable problem of too much government indebtedness.⁶

The Treasury weighted issuance to the front-end of the curve to minimize near-term interest pain, but this simply delays the inevitable refinancing of long-term government bonds. As reflected below, the U.S. Treasury must confront more than \$6T of bonds due within a year⁷:

⁶ U.S. Federal Reserve FRED (09/23/2026)

⁷ U.S. Federal Reserve FRED (09/23/2026)

Maturity profile of marketable treasury debt (\$bn)



Source: U.S. Treasury, BofA Global Research (09/14/2026)

This maturity wall presents a direct transfer mechanism of higher rates to higher government interest expense; the Fed has nowhere to hide.

Brief policy polemic: Part I

Credit to Stanley Druckenmiller for emphasizing this issue, but the U.S. Treasury's failure to term out debt during the Covid-trough represents perhaps the biggest mistake in the institution's history.

In June 2020, Austria issued 2.0bn Euro of 100-year bonds with a coupon of 0.85%. Could the U.S. Treasury have underwritten a 100-year zero-coupon bond at that time?⁸

Taxpayers are already feeling the impact of the Treasury's unforced error.

Lastly, "supply chain disruption" would be the politest way to characterize the root of today's higher oil prices. Rising near-term rates will do nothing to open transportation infrastructure. Similarly, AI spending appears essentially indifferent to interest rate dynamics.

The nexus of current inflation cannot be cured through monetary policy, at least in the near term. Hence, these hikes provide pain, in higher cost of debt, with little tangible gain.

Brief policy polemic: Part II

One must appreciate the irony of the divergent paths of the Treasury and the Fed in recent months. Chair Warsh reversed course from his predecessors by withdrawing forward guidance, with the stated intention of reducing the Fed's impact on markets.

We are sympathetic with his goal. In our view, since the GFC, the Fed accumulated too much power, effectively becoming the government's "first responder" in periods of crisis.

We believe fiscal policy should have clawed the country back from the GFC. Instead, after years of economic scuffling, the Fed provided a salve in the form of QE. Bond buying programs boosted asset prices and reignited the economy but profoundly reshaped our markets and society—far beyond the purview of our unelected monetary authority.

⁷ U.S. Federal Reserve FRED (09/23/2026)

⁸ Bloomberg

The Fed's elevated role in U.S. governance did not result from an intentional power grab but rather was an organic consequence of the leadership vacuum left by our increasingly ineffectual Congress.

Chair Warsh's attempt to mute the Fed stands in stark contrast to the Treasury, which in recent months has manipulated the yield curve by tilting issuance to the short end of the curve while buying the back end and intervened in a foreign currency market.

It is hard to square the two paths.

Japan

No reader looks to us for—nor do we profess to enjoy—cutting insights on Japan, but we can't discuss the bond blowup without acknowledging the country's central role.

While the U.S. has provided the reserve currency, Japan, in recent decades, has provided the globe its funding currency.

Decades of deflation and near-zero rates underpinned an enormous carry trade whereby market participants borrowed in yen (the cheapest source of funding) and purchased a grab-bag of higher-yielding assets—everything from the anodyne (e.g. U.S. Treasuries) to the esoteric (e.g. crypto and NFTs).

In recent years, Japan's economy has revived, resulting in real wage growth and gradual policy normalization, leading to higher JGB yields. Further, the recent surge in oil prices have accelerated inflation, pressuring the yen (as the country requires more USD per barrel).

Resulting lower yield differentials, particularly with the U.S., have raised concerns about the yen carry trade, currently the largest build-up of the last three decades, as noted in a recent *Jefferies* report.⁹

Worst case, markets now confront the risk of a disorderly unwind of the carry trade, which would result in massive selling of Treasuries. A mid-case concern entails an orderly but nevertheless pernicious liquidation of U.S. Treasuries by Japanese investors migrating capital back to the domestic markets, which now offer commensurate yields.

Concerns sufficiently rattled the U.S. Treasury to prompt direct policy intervention. In late July/early August, the Treasury sold euros in reverse and purchased yen—thereby signaling its commitment to strengthening the yen.

We'd like to note that BC Partners Credit warned LPs about the “nightmare fuel” of potential Japanese capital repatriation a year ago—12 months ahead of the Treasury.

What this is, and what this is not

We strained ourselves not to employ the most hackney metaphor in the Queen's English, but this quarter represents a “superlative maelstrom” whereby seemingly every development contributed to the bond bonfire.

To summarize: during the quarter, global markets recalibrated rates to reflect that monetary policy has shifted hawkish amid resurgent inflation from higher energy, supply chain friction and AI cost pressures (not to mention lingering tariff pass-through effects).

As part of that dynamic, long-horizon real forward yields (as measured by 5y5y and 10y10y) have moved 20-25bps higher from early summer through mid-September, which suggests the market has raised its path for future real rates.¹⁰ Higher term premia likely accounts for part of this increase. Importantly, some of this move may also reflect a partial repricing of longer-term neutral rates (the fabled R^*)—the cornerstone for all financing.

This is not, however, a credit crisis: concerns about market stress or heightened default risk would be evident in CDS, but the cost of insuring U.S. default risk fell in the third quarter.¹¹ Plus, U.S. high yield spreads would have blown out if credit concerns had driven the bond selloff, yet they remain at quiescent levels of ~270bps.

⁹ Japan: Rising Risk of Yen Carry Trade Unwind (*Jefferies*, 09/07/2026)

¹⁰ Bloomberg (09/23/2026)

¹¹ Bloomberg (09/18/2026)

The Opportunity



Thematically, we believe markets have entered a multi-year, if not multi-decade, shift.

For much of the post-GFC timeframe, equities drove portfolio returns as fixed income provided anemic yields. This dynamic fed a self-reinforcing cycle, whereby low rates (typified by trillions of negative-yielding bonds) reduced the cost of capital, rewarding equities.

Growth-based companies with far distant cash flows uniquely benefited from rock-bottom rates, which in turn gave rise to today's hyperscalers. Markets may not have funded Amazon's nearly two decades of FCF burn (before giving rise to the AWS cash machine), absent near-zero discount rates.

Hence, through growth and allocation, most portfolios remain heavily weighted to equities, with fixed income comprising a modest position—for ballast, but not for expected return.

Markets have entered a new paradigm, however, as post-Covid inflation killed the zero-rate epoch. This year's 3Q may be remembered as the point when markets more fully recognized the shift.

With equity risk premiums having fallen to levels last seen in the late 1990s (fueled by the market's furious post-Covid rally) and rising bond yields incremental capital will migrate into fixed income in the years ahead.¹² The earnings yield for the S&P 500 of ~3.9% now sits within the Fed funds target rate of 3.5%-4.0%. Recently, fewer than 4.5% of S&P 500 stocks yielded more than the U.S. 10-Year Treasury.¹³

Fortunately, with corporate balance sheets historically strong, credit fundamentals can enable this portfolio shift. Boosted by surging earnings, interest coverage ratios (EBITDA/Interest Expense) for U.S. High Yield and Investment Grade are near the top of their respective historic ranges.¹⁴ Similarly, the corporate default environment has remained tranquil and has, in fact, trended lower YTD relative to recent years.¹⁵

¹² "Competition for Capital," Goldman Sachs Research (09/17/2026)

¹³ NDR Research, The Daily Shot (09/09/2026)

¹⁴ "A New Era for Credit Spreads (Part 1)," Alpine Macro (08/12/2026)

¹⁵ Apollo (08/19/2026)

Of course, not all fixed income products yield the same benefit (pun intended). In an inflationary backdrop, correlations between stocks and bonds rise as higher rates punish both equities (through the discount rate) and bonds (by repricing existing issuance), as reflected below:



Investors simply must look elsewhere.

Private credit delivers

Data reveals the advantage of lower middle market

Options for investors appear to shrink with each passing quarter, but segments of private credit remain compelling both for alpha (with expected returns wrung from stocks) and diversification (given elevated stock/bond correlations).

Geopolitical events had the unintended benefit of quelling the media's recent obsession with private credit, allowing fundamentals to regain focus.

First, the declining default rate in the U.S. High Yield and Levered Loan market underscores the gap between perception and reality for private credit. As we have noted before, segments of the same market (corporate credit) cannot have widely divergent default expectations. Put plainly, remonstrations about private credit default concerns are logically inconsistent.

Second, within private credit, we highlight several recent data points underscoring the benefits of the lower middle market, BC Partners' core segment.

The chart below provides little ambiguity; it outpaced competing segments on yield, return and volatility over the long-term:

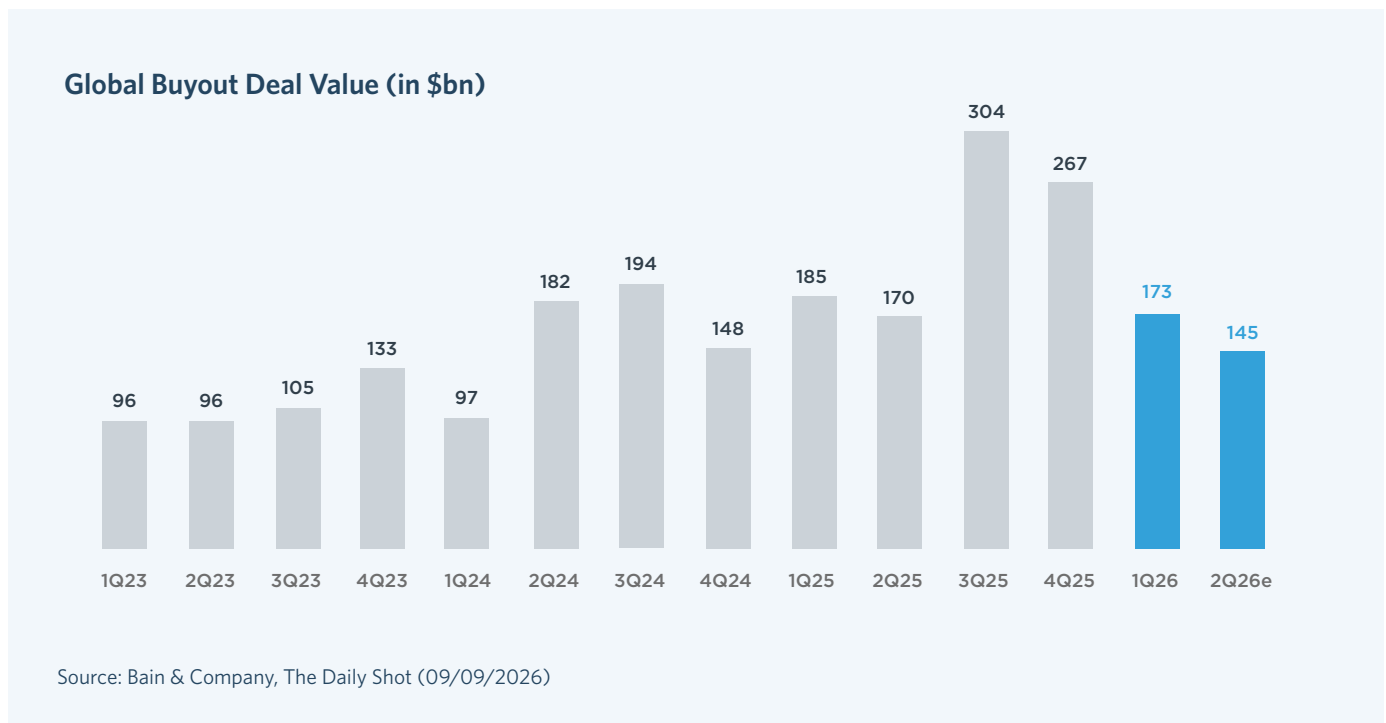
Total returns, volatility, Sharpe ratio and correlation across private credit

2015 - 2026 (Jun)	Private Debt			
	All	Lower MM	Core MM	Upper MM
Annualized Returns	7.8%	8.2%	7.6%	8.0%
Annualized Return Volatility	2.1%	1.8%	2.1%	2.9%
Sharpe Ratio	3.6	4.7	3.7	2.8
Yield (2017-Now)	9.9%	11.1%	10.0%	9.5%
Correlation with Private Debt	-			

Source: Private Credit Tracker 26 2026 – Resilience Meeting Risk (Morgan Stanley, 09/08/2026)

Investors may correctly highlight that this may not repeat, which we do not dispute. However, the data reveals an unambiguous relative advantage for over a decade—a dynamic we expect will widen in the coming quarters.

As we’ve noted, deal flow represents the lifeblood of sponsor-led private lending; without transactions, pipelines evaporate, regardless of AUM. AI-related disruption, higher energy prices and geopolitical noise muted private equity activity in 1H 2026, as reflected below:



It is not a mere coincidence that direct-lending volumes plummeted, down 23% year-over-year.¹⁶ Most private credit solutions are both PE-reliant and inherently procyclical.

However, what hinders most participants paradoxically benefits BC Partners. Borrowers look to us for total capital solutions, not run-of-the-mill first lien loans.

During the quarter, BC Partners completed the recapitalization of a leading football equipment manufacturer. The bespoke capital solution we forged and funded along with our LP co-investors included first lien debt, preferred and common equity.

Pipeline builds when others fade; Capitalizing on PE headwinds

In addition to highlighting the dexterity of BC Partners' private credit, that transaction is an example of how we can benefit when others face headwinds.

The sports equipment maker initially contemplated an exit, but private equity's struggles prompted the company to seek a structured equity solution with us.

BC Partners has been among the most active providers of NAV loans. With fewer exits, PE firms increasingly seek us out to provide debt capital secured against their funds and related fees.

This represents yet another core segment for BC Partners with relatively less competition given its complexity. There is no formulaic approach to NAV lending. Each highly structured transaction effectively requires a triple underwrite of the funds, fees and assets for every deal, and it is this complexity that yields the source of potential excess returns.

During the period, BC Partners closed a portfolio of complex NAV loans against a broad range of secondary and fund-of-funds investments with exposure to U.S. and European middle-market buyouts; the deal included 1.25 percentage points upfront and a coupon of S+750bps (cash pay) as well as a 50% LTV draw stop. We would highlight the structure's strong investor protections including a pre-consent to seize and sell LP positions in the event of default.

Potential deal in the headlines

Shifting gears, our partners may have seen recent media reports regarding a significant potential sports-related transaction involving BC Partners. While we can't comment on the specifics at this stage, we believe the opportunity underscores the merits of our platform.

After emphasizing our focus on the lower middle market, a deal of this magnitude may seem incongruent. However, it demonstrates the flexibility of the BC Partners platform.



¹⁶ "Private Credit Tracker 26 2026 - Resilience Meeting Risk" (Morgan Stanley, 09/08/2026)

Unlike firms that have chased growth (and management fees), we've remained true to our core, raising mid-size funds that enable us to remain an investment firm, not an asset manager.

BC Partners' decades of private market success (highlighted by the celebration of our 40th anniversary this year) have cultivated relationships with global LPs, many of whom seek direct investments alongside us.

This dynamic provides enviable agility. BC Partners Credit's core is, and always will be, the less competitive lower middle market, but deep co-investment relationships enable us to compete for larger idiosyncratic deals.

Conclusion

As a spin on the famous Milton Friedman quote, 3Q 2026 reminded investors yields are always and everywhere a global phenomenon. Higher energy prices will, over time, fade, as will AI supply-chain limitations, which will alleviate near-term inflationary pressures, but the market regime change remains clear.

The zero-interest-rate era of the post-GFC period represented a historical anomaly that gradually, and then all at once (to borrow Hemingway's phrase), was upended by post-Covid inflation. What was characterized as "higher for longer" will, in time, be recognized as the new baseline.

This paradigm shift will prove less friendly to equities and favor fixed income, though income-only investment provides fewer options for excess returns. Total returns from buying bonds/loans or bond/loan funds require proper timing of rates, and a modest misreading would wipe out returns within days, if not hours. Plus, mechanically, individual bonds and loans offer little potential for capital appreciation without commensurate credit risk.

BC Partners' credit solutions, while income-led, focus on structured investments that include total return mechanisms such as warrants and fixed minimum returns.

Investors must recalibrate their portfolios amid the current backdrop. LPs historically slotted BC Partners in their fixed income or private credit allocation, categories which should command larger AUM in the new market regime.

A reasonable investor would consider private credit, at this stage, to be a substitute for equities. With lower return potential from current S&P 500 valuation, BC Partners' attractive current yields (far exceeding the market's dividend yield) and total return potential, make our solutions a compelling replacement.

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