

CIO Perspective

First Quarter 2026

Institutional Private Credit | Senior Secured Lending



A front-loaded quarter. M&A supply carried the primary market before a March repricing of risk driven by Middle East tensions and a Federal Reserve pause. Base rates remain elevated, single-B spreads have widened, and entry multiples have moderated. The risk-adjusted case for senior secured private credit continues to strengthen where underwriting discipline and structural protection remain paramount.

~\$173.3B

1Q 2026 LOAN VOLUME
Up 25% QoQ, down 11% YoY

7.08%

AVG NEW-ISSUE HY YIELD
Spread-led, flat QoQ

3.48%

COMBINED LTM DEFAULT
Down from 4.70% peak

EXECUTIVE SUMMARY

- New-issue leveraged loan volume reached \$173.3 billion, recovering from \$138.1 billion in the prior quarter but below \$195.1 billion a year earlier. The rebound was front-loaded: January momentum gave way to a March contraction as the Middle East conflict and receding rate-cut expectations compressed risk appetite.
- M&A now carries the primary market. M&A-backed institutional loans totaled \$74.6 billion, or 46.0% of institutional volume, the highest since 1Q 2022. Opportunistic refinancing and repricing, the dominant 2025 use of proceeds, fell toward a March standstill.
- Direct lenders continued to take share from the broadly syndicated market on larger transactions, clearing at higher risk premiums even while tightening on AI-exposed software credits.
- High-yield issuance totaled \$79.7 billion at an average yield of 7.08%, supported by M&A and AI / data-center capital expenditure. Volume, like loans, weakened in March.
- The combined default rate declined to 3.48% on an LTM basis. Liability management exercises remained the restructuring instrument of choice at 59% of default activity, below the 73% prior-year peak.
- The FOMC held the target range at 3.50% to 3.75% and paused its easing cycle. Term SOFR near 3.65% and an oil-driven inflation impulse skew the forward path toward higher-for-longer, with tail risk of renewed tightening.
- Market access remains open for quality issuers across loans, high yield, and private credit. Dispersion is widening: lower-rated borrowers face a heavier near-term maturity load against a thinning refinancing bid.

INVESTMENT CONCLUSION

The credit cycle is transitioning from a period defined by abundant liquidity and refinancing activity to one defined by underwriting discipline and structural selectivity. Market access remains available for quality issuers; however, the dispersion between resilient borrowers and marginal credits continues to widen as refinancing requirements increasingly test business quality, capital structures, and creditor protections.

For senior secured lenders, the opportunity set remains constructive. Elevated base rates continue to support attractive all-in yields, while moderating purchase-price multiples and greater scrutiny of leverage provide improved downside protection on newly originated transactions. The most compelling opportunities are increasingly concentrated in event-driven financings where new capital structures are established alongside fresh diligence, sponsor equity, and negotiated documentation.

The principal underwriting challenge is not the absence of liquidity, but the mispricing of risk. Liability management exercises, covenant erosion, and refinancing constraints have reinforced the importance of originating with structural protections that remain effective through a downside scenario. In this environment, documentation, collateral quality, and business resilience are as important as headline spread.

Tellaro's approach remains focused on senior secured lending to lower-middle-market companies where rigorous underwriting, disciplined leverage, and bespoke structuring can create durable risk-adjusted returns. We believe the current environment favors lenders prepared to exercise selectivity, provide certainty of execution, and maintain discipline throughout the credit cycle.

MARKET OVERVIEW

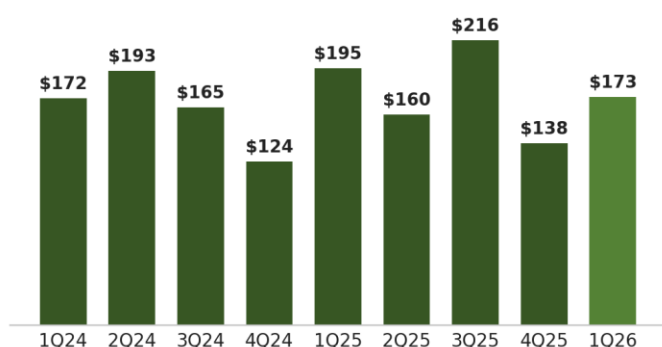
The quarter divided cleanly in two. A robust January, powered by M&A-backed supply and residual easing optimism, gave way to a March repricing of risk as hostilities in the Middle East and a more hawkish policy stance drained sentiment. New-issue leveraged loan volume of \$173.3 billion registered the split: up roughly 25% sequentially, down roughly 11% year over year.

Demand held for well-rated paper and dislocated at the margin. The FOMC decision to hold at 3.50% to 3.75% removed the easing tailwind the loan market had priced through 2025. With term SOFR near 3.65% and energy prices injecting fresh inflation risk, coupon relief for floating-rate borrowers stalled. For a senior secured lender the arithmetic is favorable: all-in yields on first-lien paper remain elevated by historical standards, and the base-rate floor is holding rather than eroding. Geopolitics moved from background to foreground; oil-price volatility now transmits directly into the policy function and, through it, into primary-market cadence. Episodic pauses of the March variety should be treated as the base case. Underwriters carrying syndication risk into a headline-sensitive tape face real markdown exposure; balance-sheet lenders that hold to maturity are comparatively insulated.

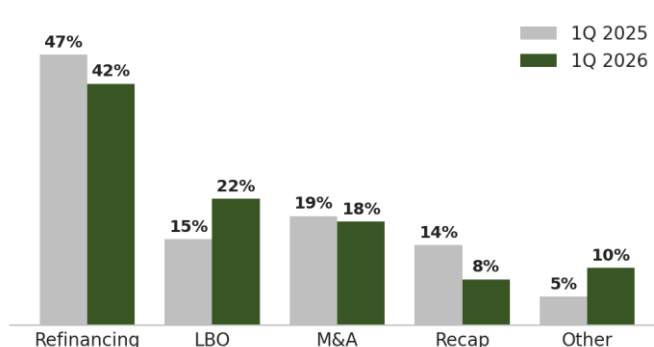
LEVERAGED FINANCE

Composition, not headline volume, is the story. Refinancing fell to 37% of institutional volume from 49% a year earlier, and extension and repricing activity, excluded from new-issue tallies, collapsed from a strong January to a near freeze in March, ending the quarter at \$171.3 billion against \$280.3 billion a year earlier. The opportunistic engine that defined 2025 has stalled. M&A filled the vacuum: M&A-backed institutional loans reached \$74.6 billion, 46.0% of volume and the strongest since 1Q 2022, sustained by a handful of megadeals. Issuance by purpose confirms the rotation, with LBO share rising to 22% from 15% as refinancing receded.

New-Issue Leveraged Loan Volume (\$bn, quarterly)



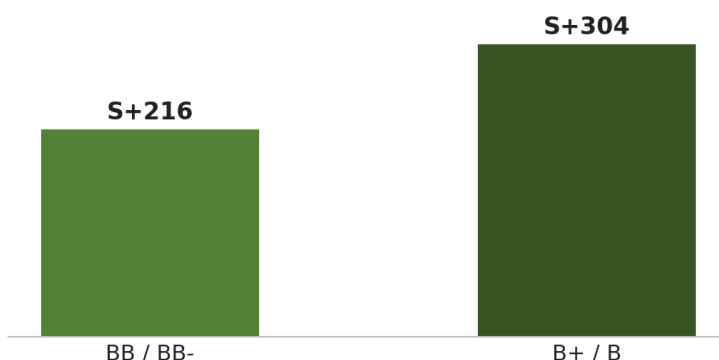
Leveraged Loan Issuance by Purpose (% of volume)



Left: quarterly new-issue leveraged loan volume, 1Q 2026 highlighted. Right: use-of-proceeds mix, 1Q 2025 versus 1Q 2026.

The middle market recorded the sharpest mix shift: acquisition finance rose to 57% of middle-market volume from 21%, while refinancing fell to 12% from 65%. For lenders, event-driven supply is higher quality than opportunistic supply. It arrives with fresh diligence, current sponsor equity, and covenant packages negotiated at origination rather than loosened through serial repricing. Direct lending extended its encroachment on the syndicated market, capturing share on larger transactions by clearing at higher risk premiums even as private lenders tightened underwriting on AI-exposed software. The broadly syndicated market stayed active on large M&A, but only at wider spreads across the rating spectrum.

New-Issue First-Lien Institutional Spreads (bps over SOFR)



New-issue first-lien institutional spreads by rating tier. The single-B tier carries the premium a disciplined lender should demand for cyclical and refinancing exposure.

Purchase-price multiples cooled to 10.6x from 11.7x a year earlier, a constructive signal: lower entry leverage on new LBOs improves attachment points and the equity cushion beneath senior debt.

HIGH YIELD MARKET

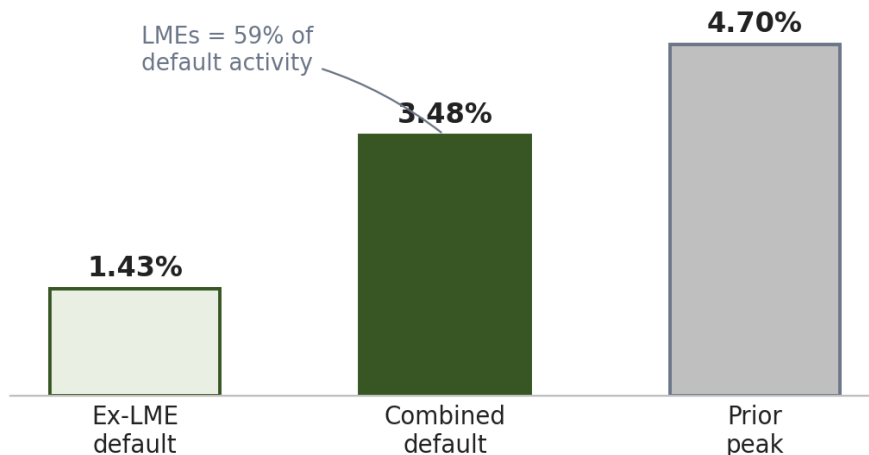
High-yield issuance totaled \$79.7 billion, above both the prior quarter (\$65.9 billion) and a year earlier (\$68.5 billion). New supply skewed toward M&A / LBO financing and, increasingly, AI and data-center capital expenditure. The average new-issue yield held at 7.08%, flat sequentially and inside the 7.67% of a year earlier, evidence that spread compression, not base-rate relief, drove the improvement in borrowing cost. As with loans, the market cooled in March.

The AI-linked capex bid is the structural feature to watch. It is real and large, but it concentrates issuance in capital-intensive, long-payback projects whose credit profiles depend on demand forecasts that remain unproven. For a senior secured lender these are collateral-quality and covenant questions before they are growth stories: asset specificity, contract coverage, and the seniority of any secured claim against hard assets warrant scrutiny. Sponsor-backed borrowers retain full access to the bond market, which sustains the refinancing option for higher-quality names and preserves the take-out path underpinning private-credit exit assumptions.

CREDIT QUALITY

The combined default rate declined to 3.48% on an LTM basis through March, extending its descent from a 4.70% peak as the rate cycle turned. Stripped of distressed liability management exercises the rate was 1.43%, and the gap between the two measures is the central credit-quality signal of the quarter. LMEs accounted for 59% of default activity, down from a 73% share a year earlier but still dominant, which means much distress is being resolved through negotiated maneuvers rather than conventional payment default. Reported default rates understate the true incidence of stress.

US Leveraged Loan Default Rate, LTM Mar-26 (%)



Combined default rate against the ex-LME measure and the prior-cycle peak. The wedge between the two current bars is the quarter's key credit signal.

For senior secured lenders the implication is procedural as much as statistical. LMEs, uptiering, drop-downs, and priming transactions redistribute recoveries among creditors of the same issuer. Position in the capital structure and the quality of intercreditor and covenant protections increasingly determine outcomes independent of headline default frequency. Document discipline at origination, anti-layering language, collateral protections, and restrictions on unrestricted-subsidiary transfers, is now a primary determinant of realized loss. The maturity wall compounds the risk: near-term maturities skew toward B- and lower-rated borrowers precisely as the refinancing bid thins. Better credits will roll; weaker ones face a narrowing window and rising execution risk. Public BDC price-to-book multiples, near 0.77x and declining from parity through 2024, corroborate a more cautious posture toward the lower end of private credit even as top-tier fundamentals hold.

TELLARO PERSPECTIVE

The first quarter confirmed a transition in private credit from a liquidity-driven market to a selection-driven market. The broad availability of capital has not disappeared; rather, it has become increasingly selective. High-quality borrowers continue to access attractive financing markets, while companies with elevated leverage, weaker cash-flow conversion, or uncertain refinancing paths are encountering greater scrutiny.

For Tellaro, this environment strengthens the case for disciplined senior secured lending. We continue to prioritize transactions where downside protection is established at origination: conservative leverage, meaningful equity support, durable business models, strong collateral coverage, and documentation designed to preserve creditor rights through a stressed environment. Lower entry multiples and wider spreads at the lower end of the market create a more favorable underwriting backdrop, provided lenders remain selective.

We are particularly focused on event-driven opportunities within the core lower-middle market, where acquisition financing provides a stronger underwriting foundation than opportunistic refinancing activity. New transactions typically incorporate current diligence, sponsor capital at risk, and negotiated credit agreements reflecting the circumstances of the investment rather than amendments to legacy structures. These characteristics improve transparency and create a more attractive basis for long-term credit selection.

We remain cautious where valuation narratives have advanced more quickly than underlying credit fundamentals. AI-related infrastructure investment, highly valued software businesses, and capital-intensive growth initiatives require underwriting against demonstrated cash-flow generation, contractual support, and tangible downside protection rather than strategic narratives alone. Growth potential may create enterprise value, but debt repayment ultimately depends on durable cash generation and creditor priority.

The continued prevalence of liability management transactions reinforces a fundamental principle of private credit: structure matters. Credit outcomes are increasingly determined not only by whether a borrower experiences stress, but by the protections negotiated before that stress occurs. We therefore continue to emphasize robust covenant packages, restrictions on value leakage, anti-layering protections, collateral integrity, and intercreditor provisions that preserve seniority through a restructuring scenario.

The primary risk to the current outlook remains a renewed tightening of financial conditions. An inflationary resurgence driven by energy prices or other supply-side pressures could increase borrowing costs and challenge highly levered borrowers. We view this as a factor requiring disciplined underwriting rather than a reason to reduce activity. The appropriate response is conservative leverage, rigorous diligence, and selective deployment of capital.

The current environment favors lenders capable of distinguishing capital availability from credit quality. Our focus remains unchanged: originate senior secured loans where structural protection, business fundamentals, and pricing provide durable risk-adjusted returns through the cycle.

KEY Q1 2026 MARKET METRICS

Metric	1Q 2026	1Q 2025	Private Credit Investor Read-Through
Leveraged loan new-issue volume	\$173.3B	\$195.1B	Up 25% QoQ, down 11% YoY
High-yield new-issue volume	\$79.7B	\$68.5B	Higher on M&A and AI capex
Average new-issue HY yield	7.08%	7.67%	Cost relief is spread-led, not rate-led
90-day term SOFR	~3.65%	n/a	Base-rate floor holding
Fed funds target range	3.50 to 3.75%	n/a	Easing cycle paused
Refinancing share of institutional loans	37%	49%	Opportunistic engine stalling
M&A-backed institutional loans	\$74.6B (46%)	n/a	Highest since 1Q 2022; better-quality supply
Average LBO purchase-price multiple	10.6x	11.7x	Lower entry leverage, deeper equity cushion
First-lien spread, BB / BB- (inst.)	S+216	n/a	Modestly wider at the margin
First-lien spread, B+ / B (inst.)	S+304	n/a	Single-B premium widening
Combined LTM default rate	3.48%	n/a	Down from 4.70% peak
LME share of default activity	59%	73%	Distress resolved off-market; underwrite docs

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