TELLARO CAPITAL PARTNERS

CIO Perspective

Second Quarter 2026

Institutional Private Credit | Senior Secured Lending

A resilient but selective quarter. New-issue leveraged loan volume of $165 billion held modestly above the prior year even as acquisition financing stayed muted and refinancing, repricing, and extension activity dominated the calendar. Base rates remain elevated with the Federal Reserve on hold and increasingly hawkish, spreads have adjusted selectively, and the advantage sits with lenders underwriting structure and cash flow rather than chasing spread.

~$165B	7.41%	2.95%
Q2 2026 LOAN ISSUANCE	**AVG NEW-ISSUE HY YIELD**	**COMBINED LTM DEFAULT**
Down from Q1's $208B, above prior year	Below 7.79% a year earlier	Down from 4.70% peak in 2024

TELLARO MARKET ASSESSMENT

Selective Capital

Capital is abundant but discriminating. The marginal dollar is available only to borrowers that can evidence durable cash generation, a defensible market position, and creditor-protective documentation. Access itself has become a credit signal, and the premium for selection now accrues to lenders rather than to borrowers.

Allocation consequence: originate where structure and documentation set the return, and decline credits whose case rests on the availability of a future refinancing.

CIO PERSPECTIVE

- New-issue leveraged loan volume totaled $165.1 billion, down from the first quarter's $208 billion but modestly above the prior year. Refinancing, repricing, and maturity-extension activity dominated the calendar, with genuinely new supply scarce. That scarcity keeps origination competitive and rewards lenders with proprietary sourcing.
- Acquisition financing stayed muted, with M&A-backed issuance easing to 42% of institutional volume from 45% in the first quarter as sponsors slowed dealmaking and prioritized liability management through refinancing, extensions, and repricing. The thin pipeline of fresh, equity-supported credits places a premium on selectivity.
- Extension and repricing activity totaled $120.8 billion as sponsors moved to address a concentrated 2028 maturity wall. Extension does not repair a capital structure; it defers the reckoning and warrants scrutiny of underlying coverage. We treat every amendment as a reason to reunderwrite.
- Broadly syndicated lenders gained share of the new deals that cleared, while absolute new-money volume declined across both the syndicated and direct-lending markets. Direct lenders stayed selective amid software-sector risk and fewer sponsor-backed opportunities, continuing to command a premium for certainty of execution on middle-market credits.
- High-yield issuance remained robust at $101.1 billion, only the second quarter above $100 billion since the third quarter of 2021, and first-half volume of $180.8 billion ran roughly 25% ahead of the prior year. New supply was led by AI infrastructure and acquisition-related financing, preserving the bond-market refinancing path that underpins private-credit exits.
- Credit performance improved: the combined default rate, including distressed liability management exercises, fell to 2.95% on an LTM basis from a 4.70% peak in 2024, while payment-only defaults ran at 1.34%. LMEs remain the dominant restructuring mechanism, so headline default rates continue to understate the true incidence of creditor stress, which is increasingly resolved through documentation, not bankruptcy court.

- The FOMC held the target range at 3.50% to 3.75% and adopted an increasingly hawkish posture, paring expectations for near-term cuts. With term SOFR near 3.66%, an elevated and potentially rising base rate sustains attractive all-in yields on floating-rate senior secured paper and reinforces the case for conservative leverage.
- Dispersion widened. Refinancing rose to 41% of institutional volume from 34% a year earlier as issuers addressed the 2028 maturity wall, and the premium demanded of lower-rated borrowers widened while higher-quality credits stayed firmly bid. Lenders positioned in resilient, cash-generative businesses are being paid to be selective.

INVESTMENT CONCLUSION

The credit cycle has moved decisively out of the liquidity-and-refinancing phase that defined 2024 and 2025 into one governed by underwriting discipline and structural selectivity. Capital has not withdrawn; it has become discriminating. With refinancing at 41% of institutional volume and acquisition financing muted, the market is recycling existing risk rather than extending much fresh credit. In that setting, returns accrue to lenders who can distinguish businesses that can service and repay debt from those merely postponing a maturity.

For senior secured private credit the opportunity set remains constructive. A Fed funds target range of 3.50% to 3.75% and 3-month Term SOFR near 3.66%, with the balance of risk tilted away from near-term cuts, sustains all-in yields well above the levels of the prior cycle. Spreads have adjusted selectively, with the wider premium concentrated in lower-rated credits while the highest-quality corporates stay firmly bid at S+221 for BB/BB- and S+305 for B+/B. Slower sponsor activity has cooled entry valuations, with the average LBO purchase-price multiple easing to 9.4x from 11.6x a year earlier, and reduced competitive pressure on terms. The most attractive risk-adjusted opportunities lie in the lower-middle-market segments where bespoke structure and certainty of execution still command a premium.

The principal underwriting risks are structural rather than cyclical. Liability management exercises, which account for the majority of defaults, have demonstrated that creditor outcomes now turn on documentation as much as on business performance. Uptiering, drop-down, and priming transactions redistribute recoveries among creditors of the same borrower, and covenant erosion in the syndicated market has widened the gap between nominal and effective protection. Refinancing risk is concentrated in lower-rated borrowers facing the 2028 maturity wall. Collateral quality, anti-layering language, and intercreditor terms are now first-order determinants of realized loss.

Tellaro's response is unchanged in philosophy and sharpened in application. We originate senior secured loans to lower-middle-market companies where conservative leverage, meaningful equity support, durable cash generation, and creditor-protective documentation establish downside protection before capital is deployed. We prize certainty of execution, which is increasingly valued by borrowers navigating a headline-sensitive market, and we construct portfolios to compound durable risk-adjusted returns through the cycle rather than to maximize deployment in any single quarter. The current environment rewards that discipline.

TELLARO MIDDLE MARKET CREDIT CONDITIONS INDEX™

64 / 100

TMMCCI Q2 2026

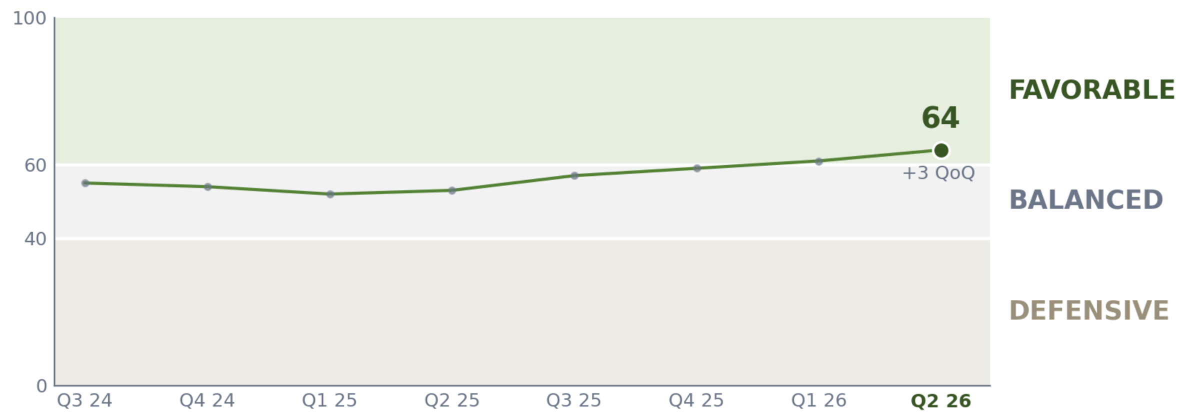
Favorable

Improving. Up 3 points from 61 in the first quarter of 2026.

A single measure of how attractive today's conditions are for originating senior secured loans to lower middle-market companies. Higher readings indicate more lender-favorable underwriting conditions.

Tellaro Middle Market Credit Conditions Index

Quarterly reading, 0 to 100. 60 and above is Favorable.



Source: Tellaro Capital Partners. Reading as of Q2 2026.

Q2 2026 INDEX DRIVERS *quarter-over-quarter direction*

Spread and yield	Leverage discipline	Equity cushion	Competitive intensity	Loss environment
↑	↑	↑	↓	↓

Component	Weight	Metric and public source	Normalization	Score
Spread and yield compensation	20%	Unitranche and first-lien all-in yields; SOFR floor (Houlihan Lokey; KPMG; FRED)	Percentile, trailing 5-yr	**72**
Leverage discipline	15%	Middle-market senior debt to EBITDA (Houlihan Lokey; KPMG; Lincoln International)	Inverted percentile, 5-yr	**70**
Equity cushion	15%	Sponsor equity share of purchase price; LBO multiple (Houlihan Lokey; Lincoln; Bain)	Percentile, trailing 5-yr	**68**
Documentation and creditor protection	15%	Tighter-documentation share; PIK-decline share (Houlihan Lokey survey; Morningstar LSTA)	Percentile, survey history	**66**
Competitive intensity	15%	Dry powder to trailing new-money issuance (Preqin; KPMG; Houlihan Lokey; Bain)	Inverted percentile, 5-yr	**48**
Base rate and coverage	10%	Term SOFR level; SLOOS net tightening (FRED; Federal Reserve)	Range-normalized, 5-yr	**62**
Loss and recovery environment	10%	LME-inclusive default rate; distressed-loan share (KPMG; Morningstar LSTA; Moody's)	Inverted percentile, 5-yr	**52**
Composite Index	**100%**	**Weighted sum of the seven sub-scores**	**Favorable 60-100 / Balanced 40-59 / Defensive 0-39**	**64**

At 64, conditions are Favorable for disciplined senior secured origination and modestly better than the prior quarter. The improvement is earned in the terms that govern recovery: wider spreads, conservative leverage, a thicker equity cushion, and documentation that has swung back toward lenders. Two components restrain the reading and mark where discipline is required. Competition for the small pool of new-money credits is intense as record dry powder meets a thin deal calendar, and the loss environment is deteriorating beneath a low payment-default rate as liability management resolves most distress. The Index therefore describes a market that pays well for selectivity and penalizes reach. It supports deployment into first-lien, well-documented lower middle-market credits and counsels patience on any transaction whose return depends on winning a competitive process or on a benign recovery.

Methodology. *The Index is a fixed-weight composite of seven components, each constructed from public data published every quarter. For each component the underlying metric is converted to a percentile within its trailing five-year quarterly history and oriented so that lender-favorable readings score higher, producing a 0 to 100 sub-score; components built from more than one metric equal-weight their inputs before scoring. The composite is the weighted sum of the seven sub-scores at the weights shown, mapped to fixed bands of Favorable, Balanced, and Defensive. Construction, weights, sources, and bands are held constant; once constructed, the Index requires only a data refresh and applies the stated methodology without quarter-specific adjustments. The first quarter of 2026 is the back-cast baseline established at launch.*

MARKET OVERVIEW

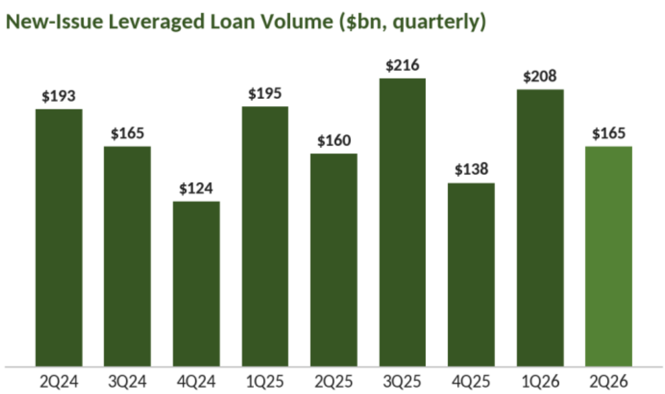
The second quarter was resilient but selective. New-issue leveraged loan volume of $165.1 billion fell from the first quarter's $208 billion yet held modestly above the prior year, a durable result given economic uncertainty, geopolitical tension, and AI-related disruption in selected sectors. The composition, not the headline, tells the story: refinancing, repricing, and maturity-extension activity carried the calendar, with sponsors moving early to address the concentrated 2028 maturity wall.

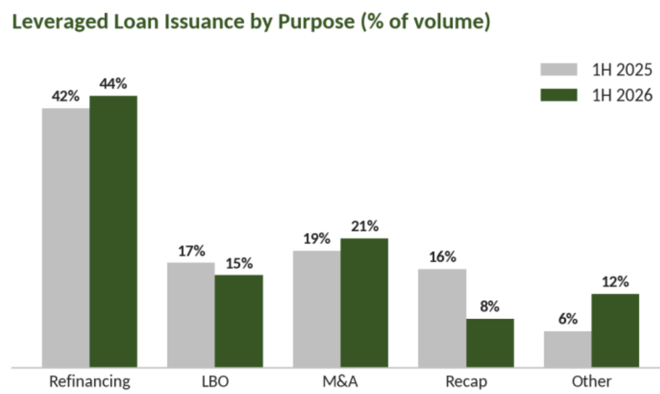
The rate backdrop hardened. The FOMC held the target range at 3.50% to 3.75% while adopting a more hawkish posture, reducing expectations for near-term cuts as inflation stayed elevated amid supply-chain and energy-price pressures. For a senior secured lender the arithmetic is favorable: term SOFR near 3.66% holds the floor beneath floating-rate coupons, and a base rate more likely to hold than fall raises, rather than erodes, prospective all-in yields. On new originations at prevailing first-lien yields near 8.9% and middle-market leverage of 4.3x to 4.8x, implied interest coverage sits near 2.4x to 2.6x, consistent with the conservative leverage we require.

Risk appetite became selective rather than absent. Market access remained available for quality issuers across loans, high yield, and private credit, but dispersion widened and the compensation required to hold marginal credit rose. Broadly syndicated lenders gained share of the new deals that cleared, while new-money volume declined across both the syndicated and direct-lending markets. Balance-sheet lenders that hold to maturity are comparatively insulated from the mark-to-market volatility that a headline-driven tape imposes on syndication risk.

LEVERAGED FINANCE

Composition, not headline volume, is the central credit signal. Refinancing rose to 41% of institutional volume from 34% a year earlier, and extension and repricing activity totaled $120.8 billion, as sponsors moved to address the 2028 maturity wall. Genuinely new supply was scarce: M&A-backed issuance slipped to 42% of institutional volume from 45% in the first quarter, and acquisition financing stayed muted amid slower sponsor activity. The market is managing existing risk more than underwriting new risk.

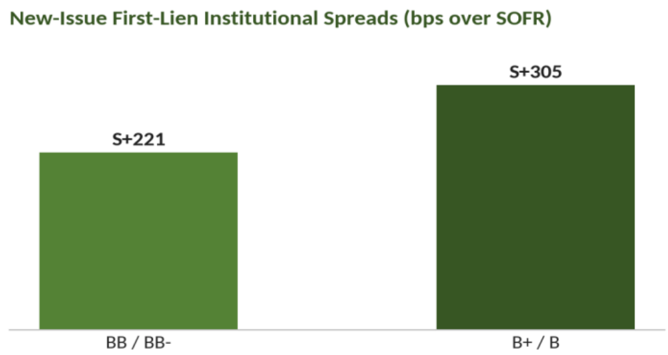




Left: new-issue leveraged loan volume by quarter, 2Q 2026 highlighted. Right: issuance by use of proceeds, 1H 2025 versus 1H 2026.

Broadly syndicated lenders gained share of the new deals that cleared, though absolute new-money volume declined across both the syndicated and direct-lending markets. Direct lenders stayed selective amid software-sector risk, slower sponsor activity, and vehicle-level liquidity considerations. For lenders, acquisition finance remains a higher-quality use of proceeds than opportunistic refinancing: it arrives with fresh diligence, current sponsor equity, and documentation negotiated at origination rather than loosened through serial repricing, and its scarcity this quarter is precisely why disciplined origination is rewarded. Entry leverage also eased, with the average LBO purchase-price multiple falling to 9.4x from 11.6x a year earlier, a constructive signal for attachment points and the equity cushion beneath senior debt.

Pricing adjusted selectively rather than uniformly. New-issue first-lien institutional spreads held near S+221 for BB/BB- credits and S+305 for B+/B, with the wider premium concentrated in the lower-rated, refinancing-exposed cohort where a disciplined lender should demand compensation. In the lower-middle market, where syndication is not an option, direct lenders continued to clear transactions on structure and certainty rather than on price alone. For allocation, this argues for committing capital where terms are set at origination and declining paper loosened through the syndicated repricing bid.



New-issue first-lien institutional spreads by rating tier. The wider premium sits with the lower-rated cohort most exposed to refinancing and cyclical risk.

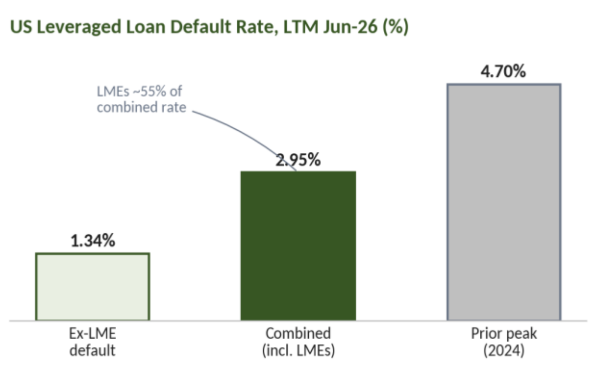
HIGH YIELD MARKET

High-yield primary markets were robust and quality-led. Issuance totaled $101.1 billion, only the second quarter above $100 billion since the third quarter of 2021, and first-half volume of $180.8 billion ran roughly 25% ahead of the prior-year period. New supply was led by AI-infrastructure buildouts and acquisition-related financing. The average new-issue yield was 7.41%, below the 7.79% of a year earlier but elevated relative to recent conditions. Access remained open for higher-quality issuers, preserving the bond-market refinancing option that underpins private-credit exit assumptions.

The AI-linked capital expenditure bid is the structural feature to watch, and it must be evaluated through a credit lens rather than a growth narrative. These are capital-intensive, long-payback projects whose credit profiles depend on demand forecasts that remain unproven. Enterprise value may accrue to the equity, but debt is repaid from durable cash generation and is protected by collateral and creditor priority. For a senior secured lender the relevant questions are asset specificity, contract and offtake visibility, and the seniority of any secured claim against hard assets. Where those tests are not met, growth alone does not underwrite the loan.

CREDIT QUALITY

Reported defaults do not fully capture creditor stress. The combined default rate, which includes distressed liability management exercises, fell to 2.95% on a trailing-twelve-month basis through June, down from a 4.70% peak in 2024, while conventional payment defaults ran at 1.34%. The gap between the two measures is the essential signal: liability management exercises account for the majority of default activity, roughly 55% of the combined rate, which means much distress is being resolved through negotiated maneuvers rather than payment default or bankruptcy.



Combined default rate (incl. LMEs) against the ex-LME measure and the 2024 peak; LMEs account for the majority of the combined rate.

For senior secured lenders the implication is procedural as much as statistical. Uptiering, drop-down, and priming transactions redistribute recoveries among creditors of the same issuer, so position in the capital structure and the quality of intercreditor and covenant protections increasingly determine outcomes independent of headline default frequency. Cov-lite structures now account for roughly 90% of the syndicated institutional loan market, which is precisely why the maintenance covenants still available in the lower middle market function as protection rather than formality. Documentation negotiated 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 lower-rated borrowers precisely as the opportunistic refinancing bid thins and the software segment, once a reliable source of issuance, derates on AI-disruption concerns. Better credits will refinance; weaker ones face a narrowing window and rising execution risk. We allocate into that divergence on the evidence of documents and collateral, not on the promise of a refinancing.

TELLARO PERSPECTIVE

The Tellaro Underwriting Hierarchy

Regimes change; our order of priority does not. We ask five questions of every credit, in the same order, before we discuss price.

1 Recovery. What do we collect if the business fails? Collateral quality and the attachment point set the floor on loss.

2 Documentation. Can our claim be primed, subordinated, or diluted before we can act? Anti-layering, anti-drop-down, and intercreditor terms are collateral in their own right.

3 Position. Are we senior and first-secured against the assets, not merely first in name?

4 Durability. Does the business service and repay its debt from its own cash generation, without depending on a favorable refinancing?

5 Price. Only now do we ask whether the spread compensates for the residual risk the first four tests cannot remove.

Price is the last question we ask, never the first.

The second quarter confirmed the transition we have described for several quarters: private credit has moved from a market defined by capital availability to one defined by capital selection. Capital remains plentiful, but it is discriminating, flowing readily to large, higher-rated corporates while extracting a widening premium from lower-rated and refinancing-dependent borrowers. The muted pace of acquisition financing and the dominance of refinancing and extension over new supply tell the same story from different angles: the market is managing existing risk, not underwriting much new risk, and the credits that do come to market deserve heightened scrutiny.

We see the clearest opportunity in sponsor-backed acquisition financing within the core lower-middle market, where our sourcing, underwriting, and structuring capabilities are most differentiated. Even as sponsor activity contracted in aggregate, the transactions that proceed carry fresh diligence, committed equity, and documentation set at origination. Recurring-revenue businesses with durable cash conversion, defensible market positions, and conservative leverage remain our priority. Lower entry valuations, with LBO multiples easing to 9.4x, and selectively wider spreads at the lower end of the market improve the underwriting basis for lenders prepared to be selective, and the premium the market now pays for certainty of execution favors disciplined balance-sheet capital over syndication-dependent alternatives.

We remain cautious where valuation narratives have outrun credit fundamentals. AI-related infrastructure and data-center credits require underwriting against contracted cash flow, asset value, and creditor priority rather than secular-growth projections; we will not substitute a growth thesis for collateral and coverage. We are equally cautious on highly levered software businesses, a segment now visibly derating, on borrowers whose viability depends on a favorable refinancing that the current market may not provide, and on cyclical businesses exposed to energy-driven inflation and the associated policy risk. In each case our posture is not avoidance but conservative leverage, rigorous diligence, and pricing that reflects the true risk.

Our underwriting principles are unchanged and, in this environment, more valuable. We size leverage to downside cash flow rather than to sponsor projections, we require meaningful equity subordination, and we lend to businesses whose cash generation is demonstrated rather than promised. We treat maturity extensions and amendments as signals to reunderwrite, not as neutral events. Certainty and speed of execution are part of the value we provide, and they are increasingly what borrowers select for when markets are volatile.

Documentation is now the decisive underwriting variable, and we treat it as such. The prevalence of liability management exercises has proven that credit outcomes depend on protections negotiated before stress occurs. We insist on anti-layering and anti-drop-down provisions, robust collateral coverage with controls against value leakage, tightly drawn restricted-payment and investment baskets, limits on unrestricted-subsidiary transfers, and intercreditor terms that preserve senior priority through a restructuring. In a market where a borrower's own creditors are increasingly the counterparty to its next restructuring, these terms are not boilerplate; they are the difference between par and impairment.

We construct portfolios accordingly, favoring granularity, senior secured first-lien positions, and diversification across end markets that do not share a single macro dependence. We accept lower gross yields in exchange for structural protection and position in the capital stack, because durable net returns through the cycle are earned by avoiding impairment rather than by reaching for spread. We would rather forgo a transaction than compromise on leverage, collateral, or documentation.

The environment favors lenders capable of distinguishing capital availability from credit quality. Abundant liquidity is not the same as sound credit, and a market that recycles risk through refinancing and extension is not the same as one that underwrites it soundly. Our focus is unchanged: originate senior secured loans to lower-middle-market companies where structure, business fundamentals, and pricing together deliver durable risk-adjusted returns, and exercise the discipline to decline everything else.

WHAT WE'RE WATCHING

Consistent with the Selective Capital regime, we monitor a concise set of leading indicators rather than offer forecasts. Each is chosen for what it would imply for underwriting, not for what it predicts about market direction.

Indicator	Why It Matters	Potential Underwriting Implication
The 2028 maturity-wall clearing rate	The pace at which lower-rated borrowers refinance rather than extend signals whether deferred stress converts into realized loss.	Slower clearing argues for higher attachment quality, tighter covenants, and reunderwriting at every amendment.
LME share of total defaults	A rising liability-management share means recoveries turn on documentation rather than on payment capacity.	Reinforce anti-layering, anti-drop-down, and intercreditor terms; price for the risk of being the next restructuring counterparty.
Direct-lending spreads and OID	Whether the lender-friendly reset holds or compresses as undeployed capital competes for a thin new-money calendar.	Lock structural gains while terms favor lenders; step back where spreads compress without a commensurate gain in protection.
BDC discounts and evergreen redemptions	Vehicle-level liquidity pressure, independent of credit performance, can force selling into a thin bid.	Maintain hold-size discipline and prepare to supply liquidity to motivated sellers on our terms.
Software and AI-infrastructure performance	Binary AI-disruption outcomes and unproven data-center demand concentrate tail risk in a small set of correlated credits.	Underwrite contracted cash flow, asset specificity, and creditor priority rather than secular-growth projections; decline where offtake visibility is absent.

WHAT COULD CHANGE OUR VIEW

We hold our conclusions with conviction but without certainty. The following developments would weaken the thesis and, if sustained, would change how we allocate. None is our base case today.

- A durable easing cycle that restores inexpensive refinancing and reopens new-money issuance at scale, shifting the market from selection back toward availability and compressing the premium for discipline.
- A sustained decline in liability-management frequency, with recoveries reverting to historical norms, which would reduce the primacy of documentation over business performance.
- A broad recovery in sponsor M&A that restores new-money supply and competitive tension, eroding the lender-friendly terms available today.
- Evidence that AI-infrastructure and data-center demand is contracted and durable rather than speculative, which would raise our appetite for that collateral on its own terms.
- A deterioration concentrated in lower-middle-market fundamentals rather than in headline-sensitive large-cap credits, which would challenge our preference for that segment.

Each of these would change allocation, not philosophy. Our discipline is built to be right across regimes, not only in this one.

Q2 2026 CREDIT MARKET DASHBOARD

Metric	Q2 2026	Q2 2025	Private Credit Investor Read-Through
Leveraged loan new-issue volume	$165.1B	~$160B	Down from Q1's $208B; modestly above prior year
Refinancing share of institutional volume	41%	34%	Opportunistic activity still dominates the calendar
M&A-backed share of institutional volume	42%	n/a	Down from 45% in Q1; acquisition finance muted
High-yield new-issue volume	$101.1B	n/a	2nd quarter above $100B since Q3 2021; 1H ~25% YoY
Average new-issue HY yield	7.41%	7.79%	Elevated but easing year over year
90-day term SOFR	3.66%	~4.3%	Base-rate floor holding beneath floating coupons
Fed funds target range	3.50-3.75%	4.25-4.50%	Cuts pared; increasingly hawkish stance
First-lien spread, BB / BB- (inst.)	S+221	n/a	Higher-quality credits stay firmly bid
First-lien spread, B+ / B (inst.)	S+305	n/a	Wider premium concentrated lower down
Combined LTM default rate (incl. LMEs)	2.95%	n/a	Down from 4.70% peak in 2024
Ex-LME default rate	1.34%	n/a	LMEs remain the dominant restructuring tool
Average LBO purchase-price multiple	9.4x	11.6x	Lower entry leverage; deeper equity cushion

Sources: PitchBook | LCD and Morningstar LSTA US Leveraged Loan Index; Federal Reserve (FOMC); New York Fed (90-day term SOFR). Figures are period measures, rounded, and reflect data available through quarter-end; certain prior-year comparatives are not disclosed on a like basis (n/a).