Instant Thoughts

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A Time to Gate

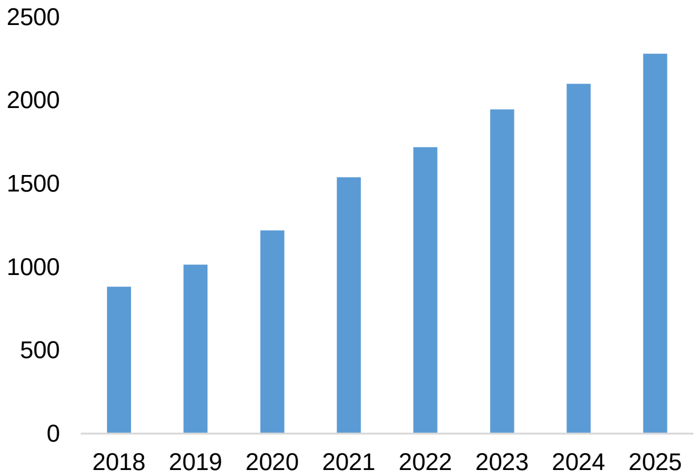
- **The AUM of private credit assets has spurted to US$2.3 trillion in 2025.**
- **Software and IT services represents 25% of private creditors' holding. The last things they want is the existential challenges posed by A.I. disruptor.**
- **If private credit default rates rise from the current 5.4% to 10%, it takes a toll of about US$105 billion. Private equity is holding more than US$2 trillion of dry power globally. And unlike subprime lending, private credit isn't a primary funding source for the mortgagers.**
- **Lenders newly tapped would likely demand better disclosure and stringent underwriting discipline. Things will get worse before they get better.**

Private credit holders were in celebration mode until several funds shut the redemption gates.

Back to square one, what is private credit? As a younger sibling of the private equity market, it generally refers to not publicly-issued or traded debt extended from non-bank financial institutions and business development companies (BDCs).

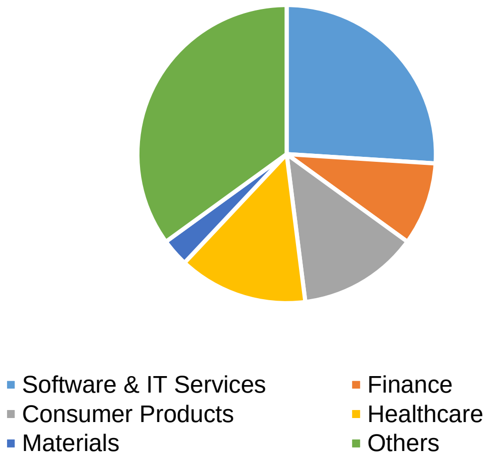
It does take two to tango. The spectacular returns of Yale endowment, run by the legendary David Swensen, are envied by too many. So a new generation of fund managers wanted to "be like Yale." Separately, a group of borrowers secretly seek a funding solution anew outside established finance. These PE-owned, unrated corporates care more about the speediness and predictability of a funding facility than anything. Higher spreads and stricter covenants are problems for another day. Consequently, the AUM of private credit assets has spurted to US$2.3 trillion in 2025 (Exhibit 1 & 2). Floating-rate, senior secured products with tenor in the 5- to 7-year bucket are the most common in this universe.

Exhibit 1: AUM of Private Credit (US$bn)



Source: S&P Global, Shanghai Commercial Bank

Exhibit 2: Borrower's Profile



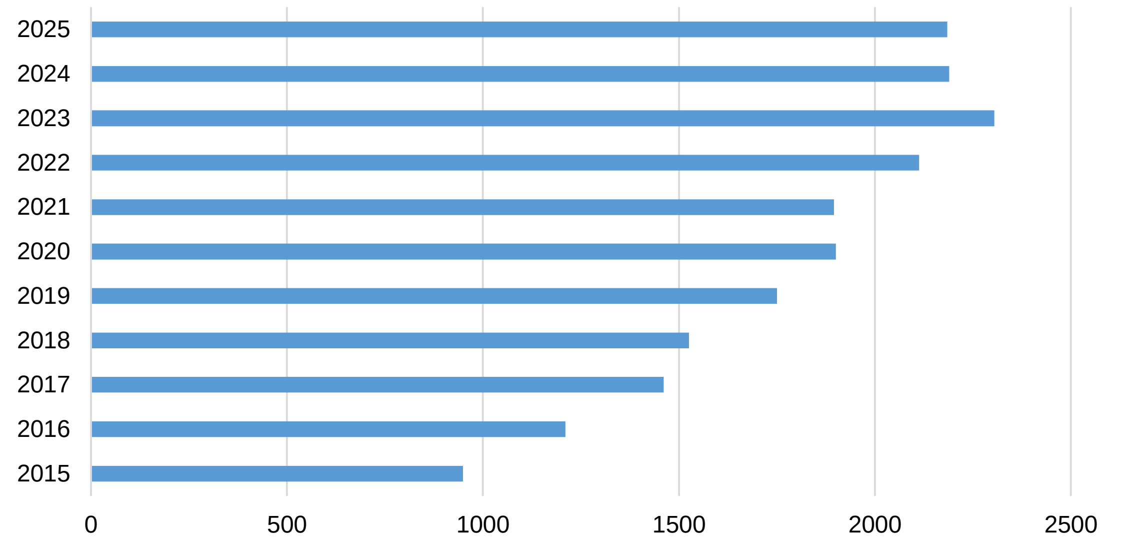
Source: PitchBook, Shanghai Commercial Bank

It only captures one side of the story. So why the sudden dash for cash? Apparently, the Yale wannabes' portfolio is heavily skewed towards software and IT services. By PitchBook's measure, software and IT services represents 25% of their holdings in total (Exhibit 2). The last thing they want is the existential challenges posed by A.I. disruptor. Worse, the borrowers tend to be smaller, have weaker business profiles, higher leverage (~8x debt-to-EBITDA), and hold inflated ratings by private credit agencies.

Their mark-to-make-believe models are constantly torched. Ostrich isn't any safer from the lion, however experienced it is. Low volatility of the direct lending segment could be, quite possibly today, revealed as spurious and accounting-driven. No one, even as battle-tested as the life insurers, can grasp the full gravity of what was already in the pipeline until the loans mature or are sold. Unmooring valuation has a way of exposing fragile borrowers.

The pockets of stress are popping up. Whether it will set the stage for the race to the bottom is the question of the time. We take some solace in the wisdom that risk can be transformed, though it can't be destroyed. If private credit default rates rise from the current 5.4% to 10%, it takes a toll of about US$105 billion. The silver lining comes from abroad. Globally, private equity is holding more than US$2 trillion of dry power. More likely than not, the losses in private credit can be absorbed by private equity. And unlike subprime lending, private credit isn't a primary funding source for the mortgagers. Its drainage won't kill the all-important housing market.

Exhibit 3: Dry Powders of Private Equity (US$bn)



Source: S&P Global, Shanghai Commercial Bank

Credit re-shuffling is more of a feature than a bug in our maximalist society. But it is by no means simply a matter of money exchanging hands. Lenders newly tapped would likely demand better disclosure and stringent underwriting discipline. This slow-burning process of risk re-rating could ripple across public markets for a prolonged time. Things will get worse before they get better.

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