

## THE CALM BEFORE THE CREDIT STORM: HOW STABLE ARE PRIVATE CREDITS?

For the past few years, investors have been obsessing over the daily swings of equity markets and the geopolitical shocks driving commodities. Yet, beneath this visible volatility lies **a quieter, far larger story, one that rarely makes headlines.**

A significant portion of global institutional capital today sits in **private credit**, an asset class marketed as stable, income-generating, and insulated from market turbulence. But history suggests something uncomfortable:

Private credit doesn't eliminate risk. It postpones its recognition. And that delay can be dangerous.



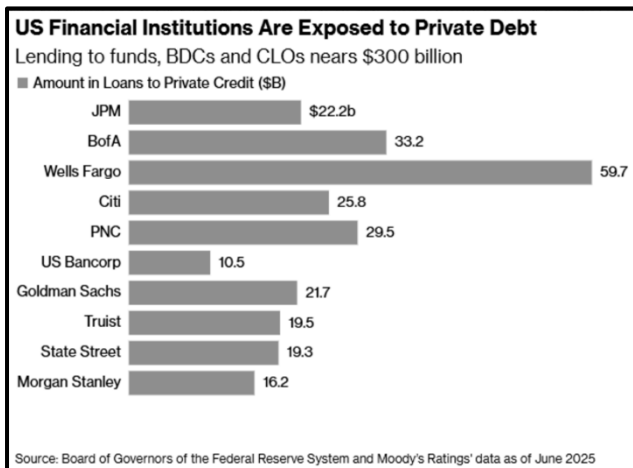
### The Great Migration to Private Credit

Over the last decade (accelerated post-COVID), private credit has emerged as a preferred destination for institutional money. Pension funds, sovereign wealth funds, and insurance companies have poured capital into the space seeking:

- ▲ Stable yields in a low-rate environment
- ▲ Lower mark-to-market volatility
- ▲ Illiquidity premiums

Global private credit assets have surged past **\$1.7 trillion**, with large players such as JP Morgan, Morgan Stanley Private Credit, Blue Owl Capital, Ares Management and Apollo Global leading the charge.

India has not been immune. Domestic AIFs (Alternative Investment Funds) and global players have aggressively expanded lending, especially to mid-market companies, real estate developers, and new-age tech firms.



### The Software Lending Bubble: A Quiet Risk

One of the most underappreciated risks today lies in private credit exposure to software and tech-enabled businesses.

During 2020–2022, SaaS and tech companies saw sky-high valuations, revenue growth assumptions were extrapolated aggressively and private lenders stepped in to provide structured debt often with loose covenants

Now, the environment has shifted dramatically:

- ▲ AI is compressing software margins and moats
- ▲ Growth expectations are normalizing
- ▲ Many business models are being disrupted faster than anticipated

**The result?**

**Cash flows that once justified leverage are becoming uncertain.**

**Bonus Read:** Click to explore our article, “**The Wake-Up Call for Indian IT,**” where we examine how Indian IT companies are building (or missing) long-term competitive advantage.

### Rising Rates: The Silent Stress Amplifier

Private credit thrived in a low-rate regime. But, with global uncertainty increasing amidst war scenario and energy becoming ever more expensive, global interest rates might remain elevated. Consequently, borrowing costs for companies will increase further adding to the risk of refinancing. **Existing lenders might have to relook at the price of debt.**

Unlike public debt markets, where distress shows up immediately through spreads and prices, private credit masks stress through:

- ▲ Restructurings
- ▲ Payment deferrals
- ▲ PIK (Payment-in-Kind) interest

### Early Warning Signs: Cracks Beneath the Surface

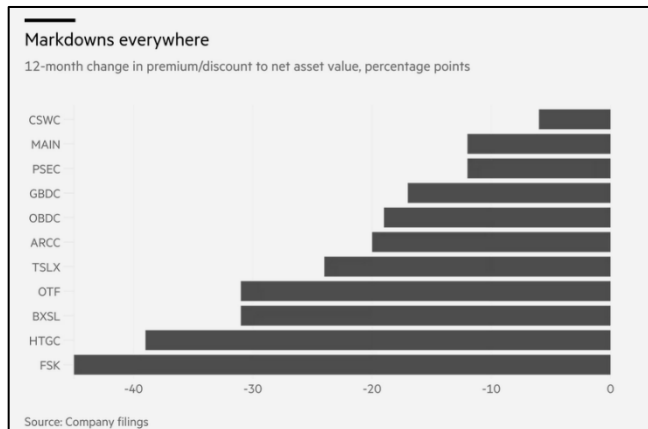
While the narrative remains largely optimistic, **subtle indicators** suggest growing stress:



1. **Rising PIK Interest:** An increasing number of borrowers are opting to **pay interest in additional debt** instead of cash. This artificially sustains “performing” loan status but signals liquidity stress at the borrower level.
2. **Redemption Pressures & Capital Controls:** Several large private credit platforms have slowed or **gated redemptions, extended lock-ups and limited investor withdrawals.**  
This has been observed across global platforms, including strategies managed by Blue Owl, Blackstone (in related private vehicles), and others, reflecting liquidity mismatch between investor expectations and underlying assets.
3. **Covenant Flexibility Becoming a Problem:** Loans issued during peak optimism often included covenant-lite structures and aggressive

underwriting. These are *now delaying default recognition* and increasing eventual loss severity.

4. **Shorting Private Credit:** Major global banks like Goldman Sachs and JP Morgan are offering hedge fund clients *ways to bet against the private credit market*. As per an article published by Bloomberg, the firms may have assembled a basket of listed entities with investments in the Private Credit space.



Unlike public markets private credit is not marked-to-market daily and valuations rely on models and internal assessments.

This leads to artificially low volatility, but not necessarily lower risk.

### A Familiar Pattern: Lessons from History

This is not the first time credit markets have appeared deceptively stable.

#### Global Financial Crisis (2008)

- Structured credit products showed minimal volatility pre-crisis
- Losses were latent, not absent
- When defaults emerged, repricing was sudden and severe

#### COVID Credit Shock (2020)

- Private credit funds initially appeared resilient
- But behind the scenes:
  - Payment deferrals surged
  - Amend-and-extend strategies were widely used
- Eventually, losses surfaced with a lag

The pattern is consistent. Credit cycles often show long periods of calm followed by abrupt dislocation.

### Why Private Credit Feels Safer? And Is It...?

Private credit benefits from structural advantages like seniority over equity, contractual cash flows and negotiated restructurings. However, these features do not eliminate losses. They simply delay recognition and smoothen reported returns. In reality, equity absorbs losses immediately, while credit absorbs them gradually. Having said that, **it's a matter of when and not if.**

## India: Echoes of the Global Trend

India's private credit market is still maturing but already showing similar traits:

- Rising exposure to real estate and mid-market corporates
- Increased participation from global credit funds
- Growing use of structured and mezzanine financing

### Emerging concerns:

- Cash flow mismatches in real estate
- Over-leveraged mid-sized companies
- Refinancing risks as rates remain elevated

While not yet systemic, these are early-cycle warning signs.

## What Could Trigger a Turn?

Several catalysts could expose underlying fragility:

- **A prolonged high-interest rate environment:** We have for a long time since 2009 lived in a low-interest rate environment with quantitative easing being the go-to solution for all crises. However, nothing can be sustained forever, and the era of cheap money might be behind us. With increasing cost of capital, the debt prices could be up for revision leading to investors taking a hard look at their investments.
- **Widespread earnings compression in tech and SaaS:** While the overall software market continues to grow, many platforms are seeing their valuations and margins compress as investors evaluate long-term feasibility.
- **Increased default clustering** in mid-market companies
- **Forced selling due to investor redemptions:** With a difficult job market looming in the US, we might see unemployment rates going up further. This could trigger investor redemptions due to institutions' obligation to their pensioners and insurance holders.
- **Regulatory scrutiny** on valuation practices

## Conclusion



### This is not a prediction of an imminent collapse.

Private credit remains a critical and valuable part of the financial ecosystem. But it is important to recognize that private credit doesn't avoid losses. It delays them. And in financial markets, delayed risk is often amplified risk.

**PS:** In uncertain environments, it is prudent to avoid leverage in any form until stability returns.



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