Alternative Credit Review: 1Q25

Though 2025 started well for risk assets broadly, sour sentiment took hold of US markets in mid-February as concerns mounted about the economic impacts of the Trump administration's policy priorities.

First Eagle's quarterly Alternative Credit Review provides an update on the investment environment for alternatives and a closer look at key asset classes managed by the First Eagle Alternative Credit and Napier Park teams.

Equity markets—and US equity markets, in particular—bore the brunt of fading enthusiasm over the course of the first quarter as it became clear that the new administration's policy timeline prioritized tariffs and program cuts over stimulative measures; the S&P 500 Index, for example, fell 4.3% for the period. Fixed income markets, in contrast, did a better job of holding on to their early-quarter gains even as momentum waned. The Bloomberg US Aggregate Bond Index gained 2.8% for the quarter, the Bloomberg US Corporate High Yield Index and the S&P UBS Leveraged Loan Index advanced a respective 1.0% and 0.6%.[1]

Of course, the environment changed markedly in the early days of the second quarter, as the tariff package announced on April 2—and the subsequent counter-tariffs, counter-counter-tariffs, tariff pauses, etc.—introduced profound instability to the global order and prompted some soul-searching among investors. Though in truth, the reflection process may have gotten underway in advance of the so-called "Liberation Day." While hard US economic data during the quarter continued to show persistent economic growth alongside stubbornly above-target inflation, soft indicators appeared to capture the early negative impacts of the new administration's policy erraticism and aggressive cost cutting. Consumers, for one, have grown decidedly more cautious in the face of the prevailing uncertainty. Consumer confidence as measured by The Conference Board has declined for four consecutive months, and its expectations index—which captures consumers' short-term outlook for income, business and labor-market conditions—fell to a 12-year low in March and sits well below the threshold that usually signals coming recession.[2] A survey from the University of Michigan indicated similarly crumbling sentiment,[3] while the New York Fed's latest consumer data revealed notable pessimism across prospects for household finances, employment, loan delinquencies and credit access.[4]

1. Source: FactSet; data as of March 31, 2025.
2. Source: The Conference Board; data as of March 25, 2025.
3. Source: University of Michigan; data as of March 28, 2025.
4. Source: Federal Reserve Bank of New York; data as of March 10, 2025.

Business attitudes have also darkened. On Main Street USA, the NFIB Small Business Optimism Index depicted waning confidence in the economy and high and rising uncertainty in what the future holds.[5] Globally, business confidence in the year ahead approached post-Covid lows in March, with US manufacturing to indicate Purchasing Managers' Index (PMI) slipping to below 50 indicating expectations of contracting activity.[6]

The tariffs' potential impacts on prices and economic activity have reawakened murmurs of stagflation. While this may be premature at this point, avoiding the stifling combination of higher inflation and slower growth likely will remain a challenge in the quarters ahead.

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While unsettling in the short term, dislocations—whether exogenous or systemic—can create significant opportunities for those who were appropriately positioned heading into the challenge, in our view. Although spreads and pricing in certain markets may not support meaningful new risk exposures at this time, already-compelling gross yields generally appear even more so given the year-to-date recalibration. As risk premia continue to reprice, selective buying opportunities may emerge for patient investors. As always, credit selection remains key to mitigating the impact of periodic drawdowns and generating attractive total returns over the long term.

Broadly Syndicated Loans: Technicals Softened Amid Still-Solid Fundamentals

Syndicated loan prices for the quarter were mildly positive, though March's monthly decline was the first since 2023. Demand for credit started the year strong but faded as tariff uncertainty ramped in late February and by March had turned negative—the first monthly outflows in six months. Institutional demand remained resilient; $16.8 billion of net collateralized loan obligation (CLO) volumes for March were roughly in line with 2024's monthly run rate.[7]

Capital markets activity also felt the chill of tariffs, and we saw repricing activity collapse as declining secondary market prices dragged down the portion of the market trading at par. Gross volumes in March totaled just $56 billion versus $186 billion in January and a monthly run rate in 2024 of $110 billion. Net volumes, driven by acquisition-related transactions, were fairly robust at $43.8 billion in the quarter and $17 billion in March—compared to 2024's monthly run rate of roughly $9 billion—but the continued escalation of tariff uncertainty may suggest the persistence of meaningful downside risk ahead.[8]

Issuer fundamentals continued to modestly improve throughout the period, providing a stable base in the event the business environment weakens. Borrower revenues expanded for the 16th consecutive quarter, EBITDA (earnings before interest, taxes, depreciation and amortization) increased both quarter-over-quarter and year-over-year, and margins remained healthy. Interest coverage improved, while leverage declined to levels not seen since Covid.[9] Default and restructuring activity generally moderated.[10]

With mergers and acquisitions activity likely still constrained in the near term, new transactions may come at wider spreads than recent comps in an environment of heightened risk aversion. Deal terms may also become more lender-friendly and include more conservative deal documentation, especially for larger transactions.

5. Source: NFIB; data as of March 11, 2025.
6. Source: S&P Global; data as of April 4, 2025.
7,8,9,10. Source: JPMorgan High Yield Bond and Leverage Loan Monitor; data as of April 1, 2025.

Middle Market Direct Lending: Domestic Focus May Mitigate Tariff Pressures

While it's difficult to obtain precise statistics on the more fragmented and less transparent direct lending market, past experience suggests that the challenges that emerged in the public credit markets will take time to trickle into the direct lending space, as the lack of a secondary market has tended to insulate valuations from short-term fluctuations.

> Uncertainty around trade policy seems a likely continued weight on consumer and business sentiment.

Though slowing economic activity likely will pose risks for all leveraged borrowers in the US, the direct financial impact of tariffs would seem to be muted among lower middle market companies, which tend to be smaller in scope and have revenues driven primarily by domestic or even regional demand trends, resulting in limited exposure to global trade dynamics. Businesses with low capital expenditures, high revenues and limited cyclicality—often found in areas like healthcare services, professional services and software—may be particularly well positioned to withstand the macroeconomic impacts of tariffs.

Asset-Based Lending: Appeal Grows as Other Financing Options Grow Scarce

Although the need for asset-based lending (ABL) facilities is persistent, demand strength historically has been countercyclical to direct lending; borrower interest in ABL tends to increase when rates rise and cash flow-based loans become less affordable or accessible.

As tariff angst began to emerge midquarter, a number of borrowers have proactively reassessed their financing options in the event credit availability grows scarce in the future. In many cases this has included exploring asset-based structures that might enable them to generate additional liquidity through unencumbered assets on their balance sheets, including accounts receivable, inventory, machinery & equipment, real estate and intellectual property. Similar to direct lending, asset-based loans lack a secondary market that facilitates price discovery, underscoring the importance of thoughtful underwriting, especially in challenging times.

Structured Credit: High Base Rates Provided Cushion

In contrast with equity markets, the credit market response to the Liberation Day package of tariffs was fairly measured. Synthetic instruments like credit-default swaps were the first to move due to their liquidity and widespread use among macro- and technicals-focused investors. In contrast, trading volumes within cash credit markets were limited, and bid-ask spreads have widened, if in an orderly fashion.

It's worth noting that the story may have been much different—and much worse—10 years ago amid near-zero policy rates. With base rates much higher today, relatively attractive gross yields potentially could be had on an unlevered basis. As a result, credit investors limited explicit leverage and sidestepped outsized risk-taking, thus mitigating position unwinds or margin calls during the tariff-related selloff that may have otherwise crushed credit markets.

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Risk Disclosures

All investments involve the risk of loss of principal.

Diversification does not guarantee investment returns and does not eliminate the risk of loss.

Alternative investments can be speculative and are not suitable for all investors. Investing in alternative investments is only intended for experienced and sophisticated investors who are willing and able to bear the high economic risks associated with such an investment. Investors should carefully review and consider potential risks before investing. Certain of these risks include:

- Loss of all or a substantial portion of the investment;
- Lack of liquidity in that there may be no secondary market or interest in the strategy and none is expected to develop;
- Volatility of returns;
- Interest rate risk;
- Restrictions on transferring interests in a private investment strategy;
- Potential lack of diversification and resulting higher risk due to concentration within one or more sectors, industries, countries or regions;
- Absence of information regarding valuations and pricing;
- Complex tax structures and delays in tax reporting;
- Less regulation and higher fees than mutual funds;
- Use of leverage, which magnifies the potential for gain or loss on amounts invested and is generally considered a speculative investment technique and increases the risks associated with investing in the strategy;
- Carried interest, which may cause the strategy to make more speculative, higher risk investments than would be the case in absence of such arrangements; and
- Below-investment-grade loans, which may default and adversely affect returns.

Definitions

Asset-based lending (ABL) facilities are corporate loans secured by specific assets of the borrower.

Broadly syndicated loans (BSLs) are loans extended by a group of financial institutions (a loan syndicate) to a single borrower. Syndicates often include both banks and nonbank financial institutions, such as collateralized loan obligation structures, insurance companies, pension funds or mutual funds.

Collateralized loan obligations (CLOs) are financial instruments collateralized by a pool of corporate loans.

Credit default swaps (CDS), most commonly, are derivative contracts that transfer the default risk of a particular fixed income security from the swap buyer to the seller in exchange for a fee.

Direct lending refers to a loan agreement negotiated between a borrower and single or small group of nonbank lenders. Direct lending can also be referred to as “private credit” or “private lending.”

Purchasing managers’ index (PMI) measures the growth or expansion of certain segments of the economy.

Structured credit is a financial instrument that pools together groups of similar, income-generating assets.

Bloomberg US Aggregate Bond Index (Gross/Total) measures the performance of the investment grade, US dollar-denominated, fixed-rate taxable bond market in the US, including Treasuries, government-related and corporate securities, fixed-rate agency MBS (agency fixed-rate and hybrid ARM passthroughs), ABS, and CMBS. A total-return index tracks price changes and reinvestment of distribution income.

Bloomberg US Corporate High Yield Bond Index (Gross/Total) measures the US-dollar-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody’s, Fitch and S&P is Ba1/BB+/BB+ or below and is composed of fixed-rate, publicly issued, non-investment grade debt, is unmanaged, with dividends reinvested, and is not available for purchase. The index includes both corporate and non-corporate sectors. The corporate sectors are Industrial, Utility and Finance, which includes both US and non-US corporations. A total-return index tracks price changes and reinvestment of distribution income.

S&P 500 Index (Gross/Total) measures the performance of 500 of the top companies in the leading industries of the US economy and is widely recognized as a proxy for the US market as a whole. A total-return index tracks price changes and reinvestment of distribution income.

S&P UBS Leveraged Loan index (Gross/Total) formerly named the Credit Suisse Leveraged Loan Index, measures the performance of the investable universe of the US dollar institutional leveraged loans. A total-return index tracks price changes and reinvestment of distribution income.

Indices are unmanaged and do not incur management fees or other operating expenses. One cannot invest directly in an index.

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