Alternative Credit Review: 3Q25

As credit market conditions have continued to buoy asset prices, they also reflect a growing imbalance between investor perception and, in some cases, underlying liquidity and credit fundamentals.

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 Napier Park team.

Systemic risks have risen modestly, in our view, reflecting late-cycle behavior. Investors are continuing to reach for yield across asset classes to capture income in what remains a high-rate environment, even as spreads in many areas are at multidecade tights[1] and idiosyncratic risks are on the rise. However, the issue of whether there are specific segments of the credit market that are in a bubble is more nuanced. While we perceive signs of reduced market discipline and unjustified asset pricing in certain credit market segments, we don't yet view the behavior as systemic. Were these trends to persist and broaden, however, the risk of a bubble increases materially, in our view.

We think it's fair to characterize the appetite for risk in the US as full; valuations lean rich relative to dispersion in fundamentals, even if near-term earnings support persists. Earnings growth forecasts remain constructive, driven by factors ranging from the impact of the artificial intelligence capital spending cycle to fairly accommodative fiscal conditions. At the same time, the Federal Reserve has cut its policy rate by 50 basis points over its last two meetings while also announcing the end of its qualitative tightening program as of December 1.

While these dynamics have supported corporate fundamentals overall, there has been a notable increase in idiosyncratic weakness at the lower end of the quality spectrum. Trade policy uncertainty, inflation and other sector-specific factors have compounded these pressures, and issuer-level loan defaults matched a post-global financial crisis peak earlier this year.[2]

1. Source: PitchBook | LCD; data as of September 30, 2025.
2. Source: PitchBook | LCD; data as of September 30, 2025.

Structured Credit: Despite Risks, Near-Term Support Can't Be Ignored

Structured credit markets in 2025 have been defined by strong demand for yield-oriented assets, and issuance has surged in concert. Issuance of both collateralized loan obligations and asset-backed securities are on pace for new annual highs, while residential mortgage-backed securities volumes are also elevated, if below peak levels.[3] With the high pace of issuance being met by robust demand, spreads across the structured credit universe, with a few exceptions, are at or near their tightest levels since the global financial crisis.[4]

> Widening spreads will be highly specific to market and asset class.

These tight spreads could be interpreted as evidence of investor exuberance but are more likely explained by continued attractive all-in gross yields, strong technicals—firm demand relative to net supply—and growth in participation from additional non-legacy capital bases such as ETFs. While we expect widening spreads going forward due to their low starting point, we recognize that this will be highly specific to the market and asset class in question, requiring security-level diligence and a deep understanding of how each market and risk profile will develop. Additionally, given a supportive backdrop of a still-growing economy, healthy corporate earnings and margins, and elevated base rates, it is difficult to say for certain that spreads have reached a floor. Further bolstered by the prevailing view that the Federal Reserve or Trump administration would intervene if market conditions were to meaningfully deteriorate, investors have continued reaching for yield without much hesitation.

Though we believe the downside risks to credit—including rising unemployment, slowing growth, persistent inflation and an already weakened real economy—remain significant, we cannot ignore the near-term support that continues to underpin markets.

Middle Market Direct Lending: Spreads Remain Tight Pending Prospective Equilibrium

Spreads in direct middle market loans compressed during the quarter and leverage ticked higher as lenders competed for a limited supply of deals. Activity remained sluggish as pipelines continued to slowly rebuild from the dislocations surrounding the tariff announcements. Meanwhile, many private borrowers looked to the syndicated market for more accommodative financing.

With leveraged buyouts still relatively constrained, add-on mergers and acquisitions (M&A) has been a more consistent source of demand for private credit lenders, accounting for nearly three-quarters of buyout transactions in the third quarter.[5] In the lower middle market, in particular, we are seeing activity in private equity rollups of basic, cash-flowing businesses with pricing power and inelastic demand—such as HVAC, plumbing, elevator servicing and landscaping. For private equity buyers, these smaller businesses offer an opportunity to professionalize, scale and consolidate within sectors of the US economy that have long remained outside the M&A mainstream.

It's possible that the Fed's recent rate cuts—with the potential for additional cuts before year end—may herald a change in M&A sentiment. If so, we believe that activity in the lower middle market is likely to accelerate before demand in the upper end. With relatively simple capital structures and limited leverage, smaller companies tend to be more sensitive to changes in the cost of capital and modest rate cuts can spur a pickup in dealmaking. That said, spread levels are unlikely to improve meaningfully even if volumes increase over the next few quarters, in our view, as it will take time for the market to reestablish supply/demand equilibrium.

3. Source: Citi; data as of September 30, 2025.
4. Source: Bank of America Global Research, Markit, ICE Data Indices, PitchBook | LCD; data as of October 17, 2025.
5. Source: PitchBook | LCD; data as of September 30, 2025.

Asset-Based Lending: Ongoing Opportunity Within a Heated Credit Market

For many borrowers, asset-based lending (ABL) represents an attractive financing alternative to syndicated or direct loans during periods of ongoing macroeconomic uncertainty. Despite a pullback in rates and tighter spreads, the cost of capital remains high relative to post-global financial crisis norms, and large money-center banks remain selective about the companies and industries they will lend to. At the same time, middle market companies today face numerous challenges to their margins, including supply-chain disruptions, recession fears and soaring prices for input materials, wages and transport.

> ABL facilities, secured by specific assets, can provide flexible access to capital.

Times like these historically have created opportunities for nonbank lenders to work with borrowers and their sponsors to provide flexible access to capital, including ABL facilities secured by specific assets of the borrower—such as inventory, accounts receivable, real estate, machinery and equipment, and intellectual property—and featuring structural provisions designed to preserve the value of those collateral assets.

US Residential Real Estate Credit: Strong Fundamentals Beyond the Current Cycle

The latent demand for housing resulting from the chronic US housing shortage and commensurate affordability crisis came into sharp focus in the third quarter. With mortgage rates easing toward the low 6% level in September—in line with January 2023 rates but still elevated compared to those that prevailed through most of the post-global financial crisis era—market data such as mortgage applications and new-home sales showed an appreciable uptick in activity.[6] The existing-home market, which accounts for the vast majority of US housing market activity, was less responsive to the quarter's lower rates, as the "lock-in effect" continued to weigh on supply.[7]

In our view, the reaction to what was a relatively minor rate move during the quarter underscores the pent-up demand for housing in the US and the ongoing need for capital to refurbish existing homes and to develop lots for new homes—durable tailwinds we believe are supportive of nonbank providers of capital to the real estate industry. This includes capital to finance residential transitional loans (RTLs)—short-duration, value-add renovation loans—and land-banking arrangements—off-balance-sheet financing provided to publicly listed developers for the acquisition of raw land and the development of buildable lots.

Broadly Syndicated Loans: Demand More Than Devoured Limited New Supply

Following tariff-induced disruptions in March and April, syndicated loan activity rebounded during the third quarter to comprise the busiest quarter of the year and the third-highest on record in terms of volume. Activity was dominated by loan refinancings, repricings and extensions; only 18% of the quarter's primary issuance represented new-money transactions. This constrained new supply helped drive a rally in the secondary market, and—despite some hiccups along the way—nearly half of all performing loans in the Morningstar LSTA US Leveraged Loan Index were trading above par by mid-September with spreads at their lowest level in more than a decade.[8]

The high-profile bankruptcies of Tricolor Auto Group and First Brands Group seemed to have little impact on loan demand during the quarter, which continued to far outstrip supply. While there were no signs of contagion from these failures, issuer-level defaults are at post-global financial crisis highs and underscore a troubling complacency; markets appear willing to overlook idiosyncratic risk so long as aggregate liquidity remains abundant, heightening our own usual vigilance for issuer- and sector-specific risk.[9]

6. Source: US Census Bureau; data as of September 17, 2025.
7. Source: National Association of Realtors; data as of September 25, 2025.
8. Source: PitchBook | LCD; data as of September 30, 2025.
9. Source: PitchBook | LCD; data as of September 30, 2025.

The opinions expressed are not necessarily those of the firm. **These materials are provided for informational purposes only.** These opinions are not intended to be a forecast of future events, a guarantee of future results or investment advice. Any statistics contained herein have been obtained from sources believed to be reliable, but the accuracy of this information cannot be guaranteed. The views expressed herein may change at any time subsequent to the date of issue hereof. The information provided is not to be construed as a recommendation to buy, hold or sell or the solicitation or an offer to buy or sell any fund or security.

Past performance is not indicative of future results.

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.

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."

Exchange-traded funds (ETFs) are listed investment vehicles that seek to provide exposure to a benchmark, index or actively managed strategy.

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

Morningstar LSTA US Leveraged Loan Index (Gross/Total) is a market value-weighted index that measures the performance of the US leveraged loan market. 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.

FEF Distributors, LLC ("FEFD") (SIPC), a limited purpose broker-dealer, distributes certain First Eagle products. FEFD does not provide services to any investor but rather provides services to its First Eagle affiliates. As such, when FEFD presents a fund, strategy or other product to a prospective investor, FEFD and its representatives do not determine whether an investment in the fund, strategy or other product is in the best interests of, or is otherwise beneficial or suitable for, the investor. No statement by FEFD should be construed as a recommendation. Investors should exercise their own judgment and/or consult with a financial professional to determine whether it is advisable for the investor to invest in any First Eagle fund, strategy or product.

First Eagle Investments is the brand name for First Eagle Investment Management, LLC and its subsidiary investment advisers. First Eagle Alternative Credit and Napier Park are brand names for the two subsidiary investment advisers engaged in the alternative credit business. Effective September 5, 2025, the investment activities of Napier Park Global Capital and First Eagle Alternative Credit (FEAC) have been aligned under Napier Park's management and brand.

©2025 First Eagle Investment Management, LLC. All rights reserved.

M-TL-ACT-ACR253-P-LT