2Q26 Alternative Credit Market Overview

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

Despite generally upbeat data, underlying risks demand more than beta exposure.

Credit markets bounced back in the second quarter as investor appetite for risk returned. Signs of easing tensions in the Middle East—which here in July appear to have been mere head fakes—and the prospect of more normal energy prices encouraged investors back to risk markets after the challenges of the first quarter.

Recent indicators, overall, point to a resilient US economy. GDP is forecast to continue growing,[1] while consumer spending remains robust in large part to the outsized contribution of higher-income consumers.[2] The unemployment rate is well below long-term averages, and payroll growth, while moderating, continues positive.[3] At the same time, significant potential downside risks cloud the long-term outlook. Perhaps most notable among these is inflation, expectations of which remain well above target for the next several quarters.[4] With the war in Iran entering a new stage and the impact and duration of the oil shock highly uncertain, consumer-sentiment readings have sunk to record lows even as spending levels persist.[5]

Like the economy, financial markets have remained resilient—on the surface. Equity indexes have continued to find support from a narrow set of themes, most notably AI-linked capital spending and the resilience of higher-end consumers. Credit spreads have retraced a meaningful portion of the February and March weakness,[6] fund flows have improved, and primary markets have reopened selectively. Capital is still available, but it is becoming more conditional. In an overall stable environment with elevated yields, we are seeing meaningful underlying dispersion and we believe investors are less willing to forgive mistakes. One of our colleagues captured the paradox well: "Everybody wants yield, nobody wants risk."

This underscores our viewpoint that traditional credit beta increasingly carries vulnerabilities that are not obvious from spread levels alone. Public credit spreads remain relatively tight, covenant protection is often limited, and private credit exposure can be tied to the same corporate conditions that drive public leveraged credit. What looks diversified by asset class can share common risk factors.

1. Source: Federal Reserve Bank of New York; data as of July 17, 2026.
2. Source: Federal Reserve Bank of St. Louis; data as of May 31, 2026.
3. Source: Bureau of Labor Statistics; data as of July 2, 2026.
4. Source: BofA Global Research; data as of June 5, 2026.
5. Source: University of Michigan; data as of June 26, 2026.
6. Source: Bloomberg; data as of June 30, 2026.

For much of the last decade, credit investors have been rewarded for adding exposure. Liquidity has been abundant, refinancing markets open and beta often doing more of the work than anyone was willing to admit. Year-to-date has been a reminder that credit is not one beta. It is a collection of very different risks that share a label, thus requiring a more thoughtful approach. With markets as they are today, outcomes depend more on how risk is sourced, underwritten, documented, collateralized and controlled.

Structured Credit: Strong Overall Issuance with Caution Toward Lower-Rated Cohorts

Asset-backed security (ABS) issuance volumes are off to their busiest year ever. Despite the overall pace, year-to-date issuance of auto ABS, which represents the largest share of ABS, was off about 14% relative to 2025.[7] While consumers have been resilient in the face of ongoing economic uncertainty and spiking energy prices, the K-shaped economy—with higher-income consumers flourishing while less affluent consumers languish—suggests caution may be warranted in lower-rated cohorts, especially as protected unrest in Iran increases the potential for inflation.

Middle Market Direct Lending: Eased Activity with Widened Spreads in the Lower Middle Market

Direct lending deal volume eased slightly compared to the first quarter and remained well off the higher pace of second-half 2025. Financings related to add-on mergers and acquisitions dominated deal activity in the core middle market and above, while leveraged buyouts were more prevalent in the lower middle market. Spreads in the lower middle market widened modestly in the quarter and ended the period at their widest level since November 2025. Spread per turn of leverage, in contrast, narrowed.[8]

> The lower middle market remains differentiated by highly covenanted deal structures.

Covenant-lite structures accounted for 18% of deals through the first half of 2026—up from 14% in 2025—concentrated in the upper middle and large cap markets. In contrast, cov-lite structures represented less than 4% of deal flow in core and lower middle market loans. Lower middle market default rates over the past 12 months, at 2.2% by dollar amount and 2.0% by deal count, remain below 2025 and unsurprisingly are concentrated in software.[9] We believe these dynamics reinforce the continued appeal of the lower middle market segment where market conditions remain differentiated from the upper middle and large cap markets and where typical deal structures are highly covenanted.

Asset-Based Lending: Attractive Yields from Asset-Rich Borrowers

For many borrowers, asset-based lending (ABL) represents an attractive financing alternative to syndicated or direct loans during periods of ongoing macroeconomic uncertainty. With still tight 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.

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

7. Source: Citi Research; data as of July 6, 2026.
8. Source: KBRA DLD Research; data as of June 30, 2026.
9. Source: KBRA DLD Research; data as of April 10, 2026.

US Residential Real Estate Credit: Pockets of Opportunity Within a Market of Homes

The rate on a 30-year fixed rate mortgage ended June at 6.49%, compared with 6.46% at the beginning of April, although rates fluctuated meaningfully during the period as the 10-year Treasury responded to inflation data, expectations for Federal Reserve policy and geopolitical developments.[10]

While higher borrowing costs and economic uncertainty have dampened both new and existing home sales activity, secular tailwinds persist. Pockets of opportunity prevail for specialized providers of residential real estate credit as the combination of a persistent US housing shortage, continued demand for renovation and development capital and the retreat of traditional banks from construction lending have created a supportive backdrop for experienced nonbank lenders.

Housing conditions remain highly regional. Rather than a single "housing market", the opportunity set is perhaps better characterized as a "market of homes". Focus on experienced developers with deep knowledge of local markets characterized by favorable household income trends, population growth, limited housing supply and relatively low days on market may be warranted.

Broadly Syndicated Loans/Collateralized Loan Obligations: Loan Issuance Eased Amid Lower Institutional Demand

Total broadly syndicated loan (BSL) issuance eased to $221 billion in the second quarter, off 9% from the previous quarter as muted sponsored issuance and historically weak private-equity deal activity continued to weigh on overall volumes. In the secondary market, the weighted average bid of leveraged loans rebounded from recent lows even as software prices continued to decline.[11]

The decline in collateralized loan obligation (CLO) new issuance—the primary driver of demand for broadly syndicated loans—accelerated in the second quarter, and the market is running about 23% behind last year's pace. Slightly more than $30 billion of CLOs were priced over the last three months, reflecting the slowest quarterly pace since third quarter 2023 when CLOs were processing the impact of regional bank failures.[12] Retail demand for loans, in contrast, has improved in recent months, posting inflows in April and May after eight consecutive months of outflows.[13]

Software Case Study: Diversifying Beyond Asset Class for Risk Mitigation

Software may be the clearest recent example of shared common risk factors across what on the surface appear as diversified asset classes. Before the selloff, the three largest artificial intelligence (AI)-impacted collateralized loan obligation (CLO) sectors—technology, healthcare and services—represented approximately $322 billion of US CLO holdings, or 37.5% of collateral.[1] Services and software loans saw their average price dip below $89 at their most challenged, with 14% below $80.[2]

While the advancement of AI tools is likely to have an impact across software—and many other sectors—we believe there is more nuance to the AI story than the headlines would suggest. The degree of dislocation will likely vary among borrowers. In our view, enterprise software platforms with differentiated offerings, large installed bases and deep integration in customer ecosystems are likely to be most resilient in the face of AI—or potentially even add value to their client relationships by leveraging emerging functionality.

1. Source: S&P Global; data as of February 20, 2026 (most recent available).
2. Source: S&P Global; data as of March 24, 2026 (most recent available).

10. Source: Freddie Mac; data as of June 30, 2026.
11. Source: PitchBook | LCD; data as of June 26, 2026.
12. Source: PitchBook | LCD; data as of June 30, 2026.
13. Source: PitchBook | LCD; data as of June 26, 2026.

The information contained in this material is provided by First Eagle Investment Management, LLC ("FEIM") and its global subsidiaries (collectively, "First Eagle"). FEIM is an investment adviser registered with the US Securities and Exchange Commission (SEC). Registration with the SEC does not imply a certain level of skill or training.

This material is for informational purposes only and reflects prevailing conditions and the judgment of the author(s) as of the date of publication, all of which are subject to change. This material should not be relied upon as investment advice; it does not constitute a recommendation to buy or sell a security or other investment; and it is not intended to predict or depict the performance of any investment. This material is not being provided in a fiduciary capacity and is not intended to recommend any investment policy or investment strategy or consider the specific objectives or circumstances of any investor. We consider the information in this material to be accurate, but we do not represent that it is complete or should be relied upon as the sole source of appropriateness for investment.

Prospective investors should inform themselves and consult with an investment, tax or legal professional as to any applicable legal requirements, taxation and exchange control regulations in the countries of their citizenship, residence or domicile that may be relevant prior to investing.

This material does not constitute an offer or solicitation in any jurisdiction where or to any person to whom it would be unauthorized or unlawful to do so.

All investments involve the risk of loss of principal.

Past performance does not guarantee future results, which may vary. The value of investments and the income derived from investments will fluctuate and can go down as well as up. A loss of principal may occur.

The information presented does not reflect the performance of any fund, strategy or account managed or serviced by First Eagle, and there is no guarantee that investors will experience the type of performance reflected. There is no guarantee that any market forecast set forth in this material will be realized. There is no guarantee that any historical trend referenced herein will be repeated in the future, and there is no way to predict precisely when such a trend will begin. The mention of specific securities is not a recommendation or solicitation to buy, sell or hold any particular security and should not be relied upon as investment advice.

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 that would be the case in absence of such arrangements; and
- Below investment-grade loans which may default and adversely affect returns.

Asset-based lending (ABL) is corporate borrowing supported by specific assets of the borrower rather than its cash flows.

Broadly-syndicated loans (BSL) typically refer to floating-rate commercial loans provided by a group of lenders—the syndicate—to a noninvestment grade borrower.

Collateralized loan obligations (CLO) 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."

Residential transitional loans (RTL) are short-term loans to real estate developers for the purpose of renovating a residential property. The loans are secured by the property being renovated.

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

Availability of the products or services described may be restricted by law in certain jurisdictions. This material may not be distributed, published or used by any person or entity in any jurisdiction or country where such distribution or use would be contrary to local law or regulation.

United Kingdom: Napier Park Global Capital Ltd. is authorized and regulated by the Financial Conduct Authority (FRN: 541427).

Middle East: This material is for information purposes only and has not been, and will not be, registered with or reviewed or approved by any regulator located in the Middle East. It does not constitute or form part of any marketing initiative, any offer to issue or sell, or any solicitation of any offer to subscribe to or purchase, any products, strategies or other services, nor shall it, or the fact of its distribution, form the basis of, or be relied on in connection with, any contract resulting therefrom. In the event that the recipient of this material wishes to receive further information regarding any products, strategies or other services, it shall specifically request the same in writing from an authorized financial adviser.

Canada: Pursuant to the international adviser registration exemption in National Instrument 31-103, First Eagle Investment Management, LLC. is informing you that: (i) First Eagle Investment Management, LLC. is not registered in Canada and is advising you in reliance upon an exemption from the adviser registration under National Instrument 31-103; (ii) First Eagle Investment Management, LLC's jurisdiction of residence is New York, USA; (iii) there may be difficulty enforcing legal rights against First Eagle Investment Management, LLC. because it is a resident outside of Canada and all or substantially all of its assets may be situated outside of Canada.

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.

G-TL-ACT-ACR262-P-LT