First Eagle Investments

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Insights



3Q26 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.

The floating-rate structure typical of alternative credit helped buoy these assets during a challenging quarter for traditional fixed income.

Treasury yields moved sharply higher across the curve during the third quarter as the notion of higher-for-longer rates appeared to embed in the market's psyche. The two-year Treasury traded up about 74 basis points to finish the period at 4.9%, while the 10-year advanced 85 basis points to 5.3%. The bulk of these moves occurred in September, coincident with higher levels of interest rate volatility.[1]

We attribute the shift in the rate markets to a number of factors. Persistently above-target inflation in the US has pressured the short end of the curve, while concerns over the massive and growing sovereign debt burden were reflected in higher longer rates. Interest rates are now expected to be not only higher for longer but higher than previously anticipated.

Even though the Federal Open Market Committee voted unanimously to raise the federal funds target rate by 25 basis points in September, there are concerns that the central bank may be behind the curve in its battle against inflation and will need to act more aggressively than previously anticipated. Futures markets entered 2026 expecting a year-end policy rate around 3.1% but at the end of September were pricing in a rate of 4.2%.[2] While end-2026 levels implied by the market are consistent with the Fed's latest dot plot of policymaker forecasts, futures traders are biased toward three additional hikes in 2027 compared to zero in the dot plot.[3]

The trajectory of inflation in 2027 may depend on the status of the conflicts in the Middle East. The resurgence in the Iran war later in the third quarter pushed Brent crude oil back above $100 per barrel and intensified the inflation pressures facing policymakers worldwide.[4] The latest US consumer price index release, for September, showed core inflation of 3.7% driven by a 20.4% increase in the energy component.[5]

1,2. Source: Bloomberg; data as of September 30, 2026.
3. Source: Bloomberg and Federal Reserve Board; data as of September 30, 2026.
4. Bloomberg; data as of September 30, 2026.
5. US Bureau of Labor Statistics; data as of October 14, 2026.

The fundamental backdrop for credit investing remains constructive even as rates have moved to multidecade highs. After limited growth in fourth quarter 2025, real gross domestic product has gained momentum in 2026; after expanding at a rate of 2.5% and 2.2% in the first and second quarters, respectively, the economy accelerated to 3.4% in the third, driven by business investment and consumer spending.[6] The resilient economy has been a tailwind for corporate earnings; the S&P 500 Index is expected to deliver earnings growth of 36% and 15% in 2026 and 2027, respectively.[7]

Structured Credit: Higher All-In Yields Continue to Attract Flows

Generally, the high yields available in structured credit have attracted investors even as the prospect of meaningful spread tightening seems remote.

Asset-backed security (ABS) issuance remains on track for a new annual high-water mark in 2026.[8] Consumers have been resilient in the face of ongoing economic uncertainty and spiking energy prices, but the K-shaped economy suggests caution may be warranted in lower-rated cohorts; the uncertain path of conflict in the Middle East and its impact on inflation remain wildcards for consumers. Issuance of nonagency residential mortgage-backed securities (RMBS) is also trending toward a new record, though it has slowed somewhat of late in the face of higher mortgage rates.[9]

> The K-shaped economy suggests caution may be warranted in lower-rated cohorts within structured credit.

New issuance of collateralized loan obligations (CLO)—the primary driver of demand for broadly syndicated loans (BSL)—rebounded in the third quarter, though the market continues to run about 17% behind last year's pace. Around $46 billion of CLOs were priced over the last three months, a 37% improvement over the very slow second quarter. Retail demand for loans has continued to improve, posting inflows in five of the past six months after a very poor first quarter.[10]

Middle Market Direct Lending: Weak Dealmaking Activity Dented Volumes

Direct lending deal volume slowed to a three-year low during the quarter as leveraged buyout and add-on merger and acquisition (M&A) activity were both weak; at $152 billion year-to-date, volume is running 31% short of 2025's pace. Spreads in the lower middle market widened by 11 basis points in the quarter to 534 basis points. Spread per turn of leverage, in contrast, narrowed to its lowest level since August 2025.[11]

Covenant-lite structures accounted for 17% of direct lending deals through third quarter 2026—up from 14% in 2025—concentrated in the upper middle and large cap markets; cov-light structures represented less than 3% of deal flow in core and lower middle market loans. Lower middle market default rates over the past 12 months, at 1.8% by dollar amount and 1.5% by deal count, declined since last quarter and remain below 2025 levels. Software continued to see the most default activity.[12]

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

For many borrowers looking to optimize their capital structures, asset-based lending (ABL) can represent an attractive financing alternative to syndicated or direct loans. With higher rates and still-tight spreads relative to post-global financial crisis norms, large money-center banks remain selective about the companies and industries they will lend to. At the same time, some middle market companies may face numerus challenges to their margins, including supply-chain disruptions and soaring prices for input materials, wages and transport.

6. US Bureau of Economic Analysis; data as of October 30, 2026.
7. LSEG I/B/E/S; data as of September 4, 2026.
8. Citi Research; data as of October 19, 2026.
9. KBRA DLD Research; data as of October 14, 2026.
10. PitchBook | LCD; data as of September 30, 2026.
11. KBRA DLD Research; data as of October 14, 2026.
12. KBRA DLD Research; data as of October 14, 2026.

Conditions 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.

US Residential Real Estate Credit: Persistent Shortages Create Opportunity for Lenders

Higher mortgage rates—7.28% at the end of the quarter versus 6.48% at the start[13]—continue to challenge housing markets. Though higher mortgage rates can weigh on housing demand, historical experience suggests they do not necessarily trigger widespread home-price declines when accompanied by continued economic growth and low unemployment, as we are seeing today.[14]

At the same time, strong demand triggered by persistent housing shortages and an aging housing stock contribute to a supportive environment for 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 builder finance transactions— which provide homebuilders with capital to acquire and develop entitled and permitted land, including finished lots ready for construction. The short durations and fast payoffs associated with RTLs may generate higher cash flows, potentially providing additional optionality to redeploy capital as investment opportunities shift.

Differing characteristics of individual opportunities underpin the importance of underwriting the specifics of each potential investment. 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 few days on market may be warranted.

> Strong demand contributes to a supportive environment for nonbank providers of real estate capital.

Broadly Syndicated Loans: Healthy M&A Demand Supported Steady New Issuance

A decline in repricings and extensions weighed on headline issuance of broadly syndicated loans (BSL) during the quarter, but healthy merger and acquisition activity supported a steady volume of new paper. While total issuance of $195 billion represented the slowest quarter of the year, the $113 billion raised ex-amendment activity was higher than the first and second quarters.[15] Generally speaking, new issuance has been biased toward higher-rated credits, and a meaningful widening in the spread between the weakest and strongest borrowers suggests lenders are seeking greater compensation from the former. In the secondary market, the weighted average bid of leveraged loans continued to rebound from March lows as software credits slowly recaptured losses from earlier in the year.[16]

13. Source: Freddie Mac; data as of October 1, 2026.
14. Source: Citibank Research; data as of October 9, 2026.
15. Source: PitchBook | LCD; data as of September 30, 2026.
16. Source: PitchBook | LCD; data as of September 30, 2026.

Frictions in the AI Narrative May Trigger Some Asset Repricing

The artificial intelligence (AI) capital expenditure cycle has been a driving force behind equity returns, index-level earnings expectations and private investment in the economy, but we've begun to see frictions emerge in the data-center narrative. While demand for such facilities remains very strong, the marginal economics of supply have come under pressure; higher financing costs and rising input prices are pushing prices higher while political reticence and concerns over potential power shortages have slowed permitting. Acknowledgement that the emergence of such a transformative technology is unlikely to follow a straight line may result in some general repricing of assets.

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- 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-backed securities (ABS) are debt securities whose payments of principal and interest are backed by the cash flow generated by pools of income-producing credit assets.

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."

The **Federal Open Market Committee (FOMC)** is the committee of the Federal Reserve System that sets US monetary policy to promote maximum employment and price stability.

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.

10-year Treasury yield is the interest rate paid on a US Treasury bond with a maturity of 10 years upon issuance.

Two-year Treasury yield is the interest rate paid on a US Treasury note with a maturity of two years upon issuance.

Consumer price index (CPI) (Price) measures inflation as experienced by consumers in their day-to-day living expenses by capturing the average change over time in the prices paid for a representative basket of consumer goods and services. A price-return index only measures price changes.

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.

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

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