



# BANKS, PRIVATE CREDIT, AND THE FUTURE OF RISK

## **Announcer** 00:49

Please welcome the panel on "Banks, Private Credit, and the Future of Risk," moderated by Erik Schatzker, editorial director, Bloomberg.

## **Erik Schatzker** 01:20

Good morning, everybody. What's left of it. I just wanted to take a moment to recognize our panelists. It takes some courage to get up here and make predictions about the future of private credit. About a month ago, Howard Marks of Oaktree published a memo called "What's Going on in Private Credit?" It is, for those of you who haven't read it, an excellent primer on the history of non-bank lending, so I highly recommend it. One thing that Howard does in the memo, and which I'm going to do now, is draw a distinction between private credit and direct lending. What everyone is concerned about, and presumably, the reason you're all here in this room today, is the latter, which I suppose we can broadly define as non-bank loans to leverage buyouts and private equity-backed companies. So, that's where we're going to spend the majority of our time on this panel. Before we get going, I'd just like to say, please submit questions. I have an iPad here. You've probably seen this at every single session so far. Not every question gets asked, but the value of the questions is that they help me decide where to steer the conversation. They signal to me what you, the members of the audience, are interested in. Now, for my panelists, as you all know, far better than me, in fact, there are a number of competing narratives right now about the current state and future health of direct lending portfolios. To varying degrees, they all concern at least five things. The credit worthiness of the borrowers themselves, the companies. The quality of underwriting, what Howard would call a lack of discipline. The amount of leverage, some of it hidden, supporting this lending. The disruptive impact of artificial intelligence, mostly on the enterprise software industry. And, finally, the structure of the investment vehicles holding the loans. And then, of course, there's oil prices, the cost of gasoline and diesel, inflation, the economy, and interest rates on top of it all. So, the question I'd like to pose to all of the panelists to get us going is this, and I will start on the far end with you, Brad, and we'll just go down the line. Is there or isn't there a problem in direct lending?

**Brad Rogoff 03:38**

I think there's a problem, but I think that problem is not big enough to be a systemic problem, right? Which is one of the words that we often hear associated with it. So, and we'll get into the details of all this, and I'll keep it general here because I know you want everyone to touch base on this question. But, yeah, there have been lending practices that occurred in direct lending private credit that were more egregious than other areas we've seen. Now, I would put that up against historically some of the stuff that happened, say, pre-financial crisis in other markets, and I actually don't think it's quite as bad as that. And I think we'll get into that. But, it's more aggressive lending. It's concentrated in a particular industry, to your point on some of the software stuff. And the leverage is higher than what we're seeing elsewhere. So, there's a problem, and then there's the potential asset liability mismatch, which there's some of, but I think that is clearly not systemic in the size.

**Kristofer Kraus 04:39**

Yeah. To piggyback on the back of what Brad just said, don't think it's systemic. We've seen credit cycles develop in certain industries in the past. You're able to weather through it. You're able to get through it. I think it is highlighting a narrative around a set it and forget it. You buy it, you put it away on a mark-to-model, you mark it at par. There's a lot of call it price volatility that's suppressed as a result of that approach. And now you're beginning to see some of those cracks emerge in that sector. At the same time, we've seen headlines around that weaker credit underwriting, to the extent there's a liquidity event associated with the wrapper on that, can crystallize some of that credit deterioration and lead to some mark-to-market pain for certain folks.

**Erik Schatzker 05:30**

Molly?

**Molly Duffy 05:31**

Thank you. I also don't think it's systemic. I think there's a big difference as well between what you saw in the financial crisis in 2008, where you had a lot of concentration, and I think there's many more players now. It's much more distributed in terms of the risk. And we're just not seeing that at all, that there's a systemic problem here behind this.

**Erik Schatzker 05:55**

Jeffrey?

**Jeffrey Gundlach 05:55**

I think this is a moment which I've seen in other markets before, and that is tremendous growth and we saw it in the dot-com underwriting boom in the 1990s, where it was ridiculous. I mean, companies that had

no revenue were coming at big prices to markets, and that didn't end well. Then there was the mortgage problem, where suddenly we were turning triple B non-guaranteed mortgages into triple As and pocketing the difference, and that doesn't look really good. And now we have this problem with the mismatch of assets and liabilities, and it really came into play with the retail market, with the so-called semi-liquid feature, which I suspect is going to be a significant problem. Because my belief is that a lot of these products were sold at very high commissions, and while it's clear that prospectuses talked about the gating mechanisms, I have a feeling that the financial intermediaries, not all of them, of course, but enough of them, didn't explain. And I think many of the owners of these interval funds thought they could get all their money out every quarter, not really understanding that it's on the aggregated fund level. And so whenever there's a really big boom in a market, things start to deteriorate. I use the analogy of the Wild West. So, you're in 1840, and you've got a nice agrarian town out on the frontier, and everybody's living off the land. They're all God-fearing. You got a sheriff with a heart of gold like Gary Cooper in "High Noon," and everything's going fine. There's no crime, there's hardly any murders. People don't even bother to lock their door. And then something happens. Somebody discovers gold three miles away from the town, and all of a sudden, in comes the strike-it-rich crowd, the quick-buck people, and they come in. And they're not all quick-buck people, but a sufficient number of them are scoundrels and rascals. And all of a sudden, the crime rate is through the roof. There's murders. You now have to lock your door and barricade it, and the sheriff can't control the lawlessness. And that's what happens. And that's what happened in the dot-coms. That's what happened in the mortgage market, certainly the CDO market. "Hey, we turned triple Bs into triple As and pocketed the difference." "Hey, we made illiquid assets liquid and pocketed the difference." And this is going to unfold because I've a feeling that the opacity of these products was kept opaque and was not granularly described, and that's where the problem is, and that's why everybody suddenly wants their money back. They're starting to realize that they might be the bag holder. One thing that characterized the first quarter of 2026 was ever-increasingly large redemption requests that ended up in one being at 41 percent. If people ask for 41 percent and get 5 percent, the next redemption request cycle, they're going to ask for a lot more.

**Erik Schatzker 09:00**

Mm.

**Jeffrey Gundlach 09:00**

A lot more. It's like a bond allocation deal where there's a good bond with a good credit, and it's a \$300 million deal, and everybody wants it. So you put in for \$100 million when you're going to get \$10. That's the way these things tend to work. So, this is going to be an interesting period because the data points aren't as frequent as you got in those past prior booms that I referenced. So, I don't know what systemic means, but people are going to lose money here. And I heard yesterday that the SEC is investigating a couple of private credit firms, plural, for fraud. I have no idea what that means, but it doesn't sound good.

**Erik Schatzker 09:36**

Mm. Vivek?

**Vivek Bantwal** 09:37

Yeah. So, let's break that into two. Look, on systemic, I think I agree with the consensus, which is we don't see systemic risk. I think that first of all, when we're talking about this retail money, that's really in the BDC portion of the market. That's really only about 25 percent of the direct lending market. The other 75 percent of the direct lending market are drawdown funds from institutional investors, where it's long-term locked-up capital. As it relates to the retail money, and if you think about the BDCs and if you think about, I've seen this GFC analogy used, and is it similar to that or not? I think it's very different. One, before the GFC, you had banks that were levered 30 to 1. You had asset liability mismatch because we've seen what happens even more recently than that in terms of when deposits go out the door and you have long-dated assets. And then you had a concentration, right? So, some of these banks had more than 20 percent of their balance sheet invested in mortgage-backed securities, in some cases, subprime mortgage-backed securities. If you compare that to where we are right now, the BDCs are generally levered one to one or less, some a little bit more. There is asset liability matching because that's why these gates exist. Again, this only applies to 25 percent of the market. The other 75 percent market, there is no interim liquidity available. And so, we just don't—and then the other thing is, if you look at bank lending to private credit, loans to private credit from banks are less than 1 percent of bank balance sheets. And so, relative to before the financial crisis, where you had, kind of a real concentration among a couple handful of large players, here you have risk that's much more distributed throughout mostly the institutional and then some retail investors. So, that's on systemic. On the second part of it, look, our view is we have a big presence in public markets. We have a big presence in private markets—we think credit is credit. And so, right now—and Brad will know this data better than any of us—if you look at default rates in public credit right now, depending on which index you're looking at, they're about 1.5 percent. If you want to add back liability management exchanges and so on, you get to a 3-something or 4-something, depending on which dataset you're using. If you look at the non-accrual rate in the BDCs, it's 2 percent. But these are averages. We're, for example, at 20 bps. There's other people that are wider than that, but it averages to 2 percent. So, if you look at the levels of defaults in the market right now, and even if you add back PIK or if you want to add back LME, there's really nothing that sticks out when you look at long time series of data. I think what is the case, though, is there is the concern that when you have a benign credit cycle for an extended period of time, there is a tendency among some managers for lending standards to get more lax. And so, we're keeping an eye on that. But whether it's public credit or private credit, we don't see any systemic issue in either market, but we do think you'll get more dispersion. And if there were to be a turn in the economy, if there were to be a recession, that default rate would go up, and we think you'll see more dispersion. And so, we think what we're seeing right now is just early innings of more dispersion.

**Erik Schatzker** 12:32

I'm going to push back a little bit because that's my job. I'm sure everyone here is relieved to know that this isn't going to be a systemic event and another great financial crisis. We don't need one, obviously. But there's a big difference between that kind of a problem and other kinds of problems. And so we might all feel good going to sleep tonight knowing that we'll wake up tomorrow and there won't be another GFC, but there are other issues that perhaps are worth unpacking. And to the point that you were just making, Vivek, if it's not now, might be, depending on what happens to the economy, depending on how long the war lasts in Iran, on or off, we don't know when it's going to end, depending on some other factors, and we're going to get into artificial intelligence, we could be dealing with something. And here's what's been going through my mind, and I suspect the minds of others in this room and elsewhere, one of the things

that we learned in the global financial crisis is that stress in one corner of the credit market can migrate. It can become contagious and eventually, in fact, right, not just the rest of the credit universe, but spread to other markets and eventually the whole economy. So, what if things do get messy? How might a run of defaults and a loss of investor confidence in this asset class metastasize into something bigger, even if it isn't as big as the GFC? What's the mechanism?

**Vivek Bantwal** 14:03

Well, that's why I go back to what I mentioned, which is you look at interconnectivity to markets, you look at leverage, you look at mismatch between asset-liability matching. What could cause a run on the banks, and how could that create—

**Erik Schatzker** 14:13

—You don't think it's there.

**Vivek Bantwal** 14:15

The structures are designed to prevent that. Now, again, that's a very different thing than saying there won't be credit losses. Below investment-grade lending is a risky activity, whether it's public or private, and underwriting standards matter. And so, if losses go up and defaults go up, there will be losses and there'll be more dispersion among managers because some managers will have had better underwriting standards, and that'll become more clear as that unfolds. But if you think about, again, relative to those numbers I said earlier, the default rate at the peak of the global financial crisis was 10.84 percent, right? So, we have a long way before we get there. And then, by the way, equity, the S&P 500 peak-to-trough in the GFC fell 50 percent. So, yeah, if you were to have a severe recession or worse, could you have defaults? Yes. But remember, if you're lending first dollar in, the equity, and you have a default, the equity in that business is worth zero. And so, I'm not saying that there can't be a correction or that there can't be losses. There certainly can be. But in terms of contagion, there's not mark-to-market triggers in these facilities. There's not a mechanism by which something that's in one of these credit markets to kind of spread and domino in—sort of to other markets.

**Kristofer Kraus** 15:21

Yeah, I would say, I mean—

**Erik Schatzker** 15:22

—Oh, go ahead. Go, Kris.

**Kristofer Kraus** 15:22

You can go if you want. I was just going to say, look, if you want to play the devil's advocate, right? So, I agree with what Vivek is saying in terms of, okay, there's not necessarily this asset liability mismatch. But Jeffrey made a point, right? And his point, well, one of his points, was that there will be losses suffered. And in your scenario with higher defaults, there are losses suffered. And I'm less concerned in the sense of, you know, I do think maybe not everyone understands that you can only get 5 percent out, but then I guess the question becomes, once you do understand that you can get 5 percent out and that's it, do you try and take money from other places, right? And I think that becomes a little bit of the question of, okay, yes, there's going to be losses here. They may not be as large as anything we've seen in the financial crisis, et cetera, but there's some losses here. I'm concerned about that. I can't get enough money out of there. What are things that look like this where I can try and take my money out of, right? Whether it's other areas of leverage finance, of credit, of asset-backed lending or whatever it is, right? And that might have a little bit more flexibility. And, then you think about the point you were just making around the equity side of things. I often sit there and think to myself, how dependent is it that we need to have a healthy private credit market and a healthy private equity market, right? And those have become so much more important to each other over time because a lot of what you're doing, the ability to finance private equity deals in a market where equity valuations are pretty high, is based on cheap private credit. And so, if we believe the LTVs are escalating, and that's going to be the problem, and that's why you're going to suffer losses on the private credit side, then you've also got some of the same investors who have invested in private equities as alts have become a bigger allocation, for many people, probably even in the audience. That's, once again, not a GFC to your point, but it could spiral a little bit.

**Brad Rogoff 17:15**

Yeah, I was just going to add, it's going to hurt. I mean, it's—

**Kristofer Kraus 17:21**

*[Laughter]* Sorry to laugh—

**Brad Rogoff 17:21**

—If you're taking the lower end of the high yield market or the broadly syndicated market and essentially using direct lending to finance those names because you can get the spread that you think makes sense and the borrower is basically—I make the comment in the office all the time. Borrowers are not inherently stupid. They're going to go wherever they can get the best deal. And if that's in the public market, fine. If that's in the private market, they're going to go there. And so, you have to think about that migration of credit, and if we do get into a material contractionary period as an economy, it's not just going to be software where you're going to see these things bubble up. And we've seen this before, even in an environment where covenants were better. If I go way back to late '90s, early 2000s, you had names like WinStar and Aridium. These things recovered like 15 cents at best on first lien senior secured. So, these things can happen. But I don't think, if I go back to—Jeffrey brought up a good point in terms of subprime GFC. The correlations in the wiring were so obvious and pronounced at that time in terms of the role that banks played. You had a bunch of monoline insurers who hardly had any capital at all providing protection to billions and billions of risk, and there were some pretty notable blow-ups, and obviously then the phone

began to ring at Treasury and the Fed to come in and save the system. I don't think we're anywhere close to that at this point.

**Molly Duffy** 18:45

Yeah, I think both Brad and Kris bring up some very interesting points that I agree with, that the equity markets, the private equity markets, the private credit markets are quite linked. I also think that we really do need to talk about the growth that we've seen in alternatives. And people really do want diversification in their investments, and that's not that easy to get when you look at the S&P, which is really dominated by the Mag Seven. And if you look at where you want to get return, where are you going to go for it? It's going to be in the private markets, and that's why I think we've seen the growth in alternatives. I don't think you're going to see a complete unwinding of that, notwithstanding some of the pressures that have happened in the retail market. And it's hard to say, what were the terms of which they entered? Were they fully briefed on what the liquidity was like? Are they just needing to get out because the new cycle is bad and might come back in, actually? We've certainly seen institutional money coming back in. I think there's a lot of questions here that we don't really have the full picture in terms of the answers on.

**Jeffrey Gundlach** 19:48

Could—

**Molly Duffy** 19:49

—Yeah—

**Erik Schatzker** 19:49

—Jeffrey, if I could just—

**Jeffrey Gundlach** 19:50

—There's a certain appeal to your idea that other markets could be affected because if they can't get out on the gate, then they might go out somewhere else. There's an appeal to it, but I just want to make the point that there's no evidence of that happening.

**Erik Schatzker** 20:04

No, certainly not yet, no.

**Jeffrey Gundlach** 20:05

At all. Just the opposite. You've got the spreads on investment-grade credit and high yield have come all the way back. Stocks are at the all-time high. There's no evidence of it. When it comes to how something unfold, I think one of the problems here is credit is based upon trust. I think the word credit comes from the Latin word for trust. And I feel like there's eroding trust that's been happening, and I think there's going to be more of it. I think the mismatch of the quarterly liquidity with the reality of the gate, that erodes trust. I think marking down a fund overnight from 100 to 81, that erodes trust. It's like, "What do you mean? Did you mark all your loans down 19 percent yesterday? When did you catch wind of that? That seems awfully abrupt." You know, and, "Was it all of the loans down 19, or was it half of the loans are rock solid and the other half are down 38?" Or is it, "Since I keep hearing that everything's fine, is it 75 percent of the loans are rock solid, and so the other 25 percent is down to 24?" Which one of those is better? And when this happens overnight, and it seems to be happening with some routine occurrences, that erodes trust. I think when you write down an equity position from down 98 percent overnight, and it goes from multiple millions, nearly \$100 million position, to an \$800,000, not even, position, and you've got the PIK bonds that you own \$56 million of, and you're still calling them current? In the old days, when somebody defaulted, we called it a default. We didn't call it a pay in kind. They're not performing, but they're on the books as performing. And what's really going to erode trust is what they're doing is saying, "Yes, the borrower cannot pay cash." So, what they're doing is adding, let's say it's a 10 percent payment, just to make life easy. They add it to the back of the loan. Well, what happens, you should be marking that loan down very significantly. The equity was just completely wiped out. You've got nothing here, and now you're accruing interest, and if you look at it, they keep marking the bonds at par. So, the best month you could possibly have for some of these funds is every bond defaults and PIKs, because they'll leave them at par, and you'll have a 10 percent monthly return in this example. That's going to erode trust. The reporting on what really is going on in terms of concentration in, say, software, is very much in the news. These are all starting to build up. It's sort of like—I keep hearing admissions that there's problems, that there's going to be losses, but everyone says, "Not with us." This is Lake Woebegone on steroids. Every firm is top decile, and nobody has any losses. Well, they're going to show up somewhere, and that's going to erode trust. And so, I feel that this could be very significant. I remember, just a story. It's such a good story, I want to tell it, about the Wild West in real time. In the CDO boom, we were issuing CDOs. We were pretty careful about it, but the industry was booming and booming. And the biggest underwriter, I won't say their name, they were not doing deals with us anymore.

### **Jeffrey Gundlach 23:24**

And I had dinner with their CDO team, and they all came out, and I said, "What's going on here? You're the biggest issuer, and we haven't done a deal in two years." And he says, "We don't want to do a deal with you. We want to do it with startups." I said, "Why do you want that?" You know. "Well, they'll buy what we tell them to buy, and you won't. And to boot, they charge less than half the fee that you charge." And I thought, "My golly! Are you kidding me?" So, I went and had lunch with the number two guy at this investment bank, the biggest CDO issuer, and I said, "You've got a problem. These guys are off the rails. I mean, they're just shoving stuff out the door." And he says, "We're underusing our balance sheet. We've only done \$25 billion of deals. I want to make it \$50." And I said, "You're going to blow this place up." And we were at a sushi restaurant, and the guy's just eating very calmly. And I was like, "Why can't I get a rise out of this guy? His firm's about to blow up. He's the number two guy." And he resigned that Friday after getting a bonus of over \$200 million and went back to Asia. That's the Wild West.

**Erik Schatzker** 24:27

Jeffrey, could I just stick with you for a minute on this? An important topic, as it were, bad behavior, right? Whether it's bad behavior when it comes to how you mark your book, whether it's other kinds of bad behavior that you've called out, garbage lending, for example.

**Jeffrey Gundlach** 24:45

That's been misused.

**Erik Schatzker** 24:48

Ah.

**Jeffrey Gundlach** 24:48

What I was saying, actually, was that the high-yield bond market is actually better credit quality than it used to be. Because in the old days, the poor credits, the garbage credits, ended up in the high-yield market.

**Erik Schatzker** 25:02

Yeah.

**Jeffrey Gundlach** 25:02

But now they're not in the high-yield market, so—

**Brad Rogoff** 25:04

—Best quality it's ever been.

**Molly Duffy** 25:05

Yeah.

**Jeffrey Gundlach** 25:05

It's not even close to what I'm saying. It's not even close. The high-yield market is way better than it was pre-GFC, and obviously that's made its way into private credits. I'm not saying all private credit is garbage.

I'm saying there's tiers of lending that are poor. How about Tricolor? How about First Brands? You know—

**Erik Schatzker** 25:22

—What I'm wondering, to the degree that you've looked at this and studied it and tried to understand it, and maybe our other panelists have a view on the subject as well, how widespread is the bad behavior? Is it concentrated with a certain number of underwriters and managers? Or is it across industry?

**Jeffrey Gundlach** 25:42

There's a lot of overlap in positioning. I think where the problems really lie are on firms that don't really have the infrastructure to do the real work on this stuff and tend to join syndicates and piggyback off of scaled entities. And, I think that's not going to be a major problem because by definition these would be smaller firms, but you get to a point where they'd have to say, "You know what? We did it because XYZ did it. If it's good enough for them, it's good enough for us. At least we're not going to be wrong alone."

**Brad Rogoff** 26:15

You're hoping someone did the underwriting.

**Jeffrey Gundlach** 26:17

You know that's going to happen. And some of these documents, you know, some of these firms, they have a total of, including the receptionist, of 30 people, and some of these loan documents are 200, 250 pages, and they're doing scores of deals in a year. They're not even reading these documents. It's not possible to read the documents. And I think most people, if you read the documents, you don't really know what it says. It's like if you're not a lawyer and read legal contracts or a prospectus. People don't know what prospectuses mean. So, it's always the bad actors that end up causing a black eye. It's just a question of what people think of the sales practices, what people think of the liquidity mismatch.

**Brad Rogoff** 27:06

These things can happen late cycle, though. Just the point. These fraud events can happen late cycle as maybe the core profit engine at that business has just been eroding given the sector that it's in or what's happening more broadly. And so, you can start to see this type of behavior come up, which you obviously need to keep an eye on.

**Kristofer Kraus** 27:22

But the fraud events aren't going to be enough, right—

**Brad Rogoff 27:25**

—No. I agree.

**Kristofer Kraus 27:25**

To take down this kind of market. Those are going to be isolated and they can be painful, right? And I think Jeffrey's absolutely right in terms of some of the loan documents and the challenges with that, but at the end of the day, if you bought the right companies, the documents matter a heck of a lot less. The documents matter mostly when things go wrong. And I do think if we think about your question, Erik, and we think about what's happened this time around, and Jeffrey, I like your story where there was, you know, clearly maybe a little bit of malice going on in terms of who they're sticking with certain type of loans. Look, what happened this time around was you had private equity companies go out and buy companies for very high multiples, right? Because they thought there was a growth profile related to these companies, a lot of them in software, that meant you could buy them for 16X, 18X, 20X, whatever it is. And then you put what was a lot of leverage on it, not as per the LTV, right? So, if you then said, "I bought it for 16X, I put seven times the leverage," that's a sub 50 percent LTV. You have what you think is a large equity cushion, but then all of a sudden the growth doesn't happen and the valuations in an industry like software come down, and now that's been eroded. And then there are some companies that do poorly, then you get into the docs and all of that. You know, I think it's important to put it in the context of if you look at the LBOs that were occurring prior to the financial crisis, I mean, if there was a 30 percent equity check, we would think the private equity firm was being extraordinarily generous, right? And so, I do think there's a little bit less malice in some of this, to the point of Erik's question, even if you do get to the same point when, then, there's a liability management exercise, which is a nice way of saying default.

*[Laughter]*

**Erik Schatzker 29:11**

Vivek, your word.

**Vivek Bantwal 29:11**

Yeah, look, I think a couple things. I think that lots of good points made. I think that it's important to separate anecdotes from the data. And so, there's been a handful of these fraud instances across markets, right? In fact, none of them yet have happened in the BDC market, but, you know, they've happened in banks' balance sheets, they've happened in public markets, they've happened in more esoteric parts of the private credit market, the more structured part of it. And so, there's been a handful of instances of fraud. I agree with you, Brad, there's nothing to suggest that's happening on any kind of wide-scale level. If you think about five examples in a \$6 trillion sort of total market, again, I think denominator matters. I think on this point of marks, listen, it is true that when you think about public markets, one of the advantages you have as a public market investor is if you buy something today and you change your mind tomorrow, you can sell it and there's transparency on what that price is. And so, that's a fair point. In private credit, the setup is a little bit different, which is that the borrower is choosing to go to private credit because they

want some of the features that you can get in a private context that they can't get in a public context. On this point about marks, so, the good news is, again, with these BDCs, you get to see where every manager has every loan marked. And so we actually analyze this data, PitchBook LCD analyzes this data. If you look at the median, so for loans have—private credit loans that have three or more managers, if you look at the dispersion of marks, so high versus low, the median dispersion is 54 cents for the last quarter, okay? If you look at bid-ask in the broadly syndicated loan market for the last quarter, it's 97 cents. So, for the majority of the market, the marks are actually pretty tight. Where you do see some difference in both public and private credit is when you get to distressed, because distressed is tricky. Different people, reasonable people, can have, you know, different views on a credit. And, so if you look at private credit loans that are marked below 70, which by the way is only one and a half percent of the market, the median dispersion is eight and three quarters points. You compare that to the public market, last quarter, almost 10 percent of broadly syndicated loans price changed over the course of the quarter by 10 points or more. And so, again, in distressed, there is a wider bid-ask, there is a wider range of views in public. It's true in private. And, so I think that, again, sure, scale does matter, and I think not everyone is going to weather the storm in the same way. And so, again, this comes back to my point about differentiation and dispersion. I think you'll see more of that, but I think there is actually more transparency than we're giving it credit for when we point to one example of fraud on a bank balance sheet or one example of fraud here or something like that.

#### **Jeffrey Gundlach 31:49**

My eyes really got opened to what was happening here early in 2025 when a big insurance company, a big insurance company, a client of ours, came in, and he had a lot of private credit, which is not uncommon. And he had one position that was owned by eight managers, the exact same loan, eight managers. And he said the most recent valuation period that he got, one manager had it at 95, and one had it at eight. So, I thought, "Wow, this might be an isolated incident, although this guy is a big player." I thought, "That sounds odd to me, 95 and eight sitting next to each other in a portfolio." And so, I started following it a lot more carefully. And it's like a moving average marking process. Let's just admit it. That's kind of what it is. It's a moving average until it turns into a step function. That's the way it works. And that's actually one of the purported benefits of private credit, and that is its lower volatility. Well, if you use moving average pricing, you have lower volatility, and it is moving average pricing. And so, is the argument really valid? I don't know. The second argument was very powerful in raising ginormous amounts of money, and that was historical performance, which was really informed by 2020 to 2022, particularly versus public markets, where you marked bonds down 18 points in 2022 in parts of the corporate bond market. So that argument isn't really good because it's not working now. It's not working now. And then the third argument is the worst of them all. It's a repackaging of the volatility argument. It's owning this stuff helps you sleep better at night because you're not stressing so much over that volatility in your public credit. That's just a cynical repackaging of the first argument. So, the argument should be its higher return. I think it was for a while. Maybe it will continue to be. But it's clear that what's happening is people that can't get loans in the public market are paying higher interest rates to get loans in the private market. You can't get it in public. And there's this other device which I think is going to erode trust, and that's one that unfortunately is an echo of the CDO situation, and that's these investment-grade ratings that are being put on by not the big rating agencies. You don't really get an analysis. You get a price list of what rating do you want. And if you want an investment-grade rating, you're going to have to pay for it, you know. And I saw a pitch book by a major private credit for their big firm, private all over the place. And they had a bullet point that said one of their pillars is investment-grade private credit. That's a pillar that makes their fund so solid. And they had a

bullet point that said 2 percent of the loan market is rated double B or single B+ or low. 2 percent is rated higher than single B+. That's what their pitch book said. Well, that means that a bunch of that 2 percent is single B. So, it's not investment grade. So, what percentage is investment grade if 2 percent is B+ or higher? Well, not 1 percent is probably triple B. So, how the heck are you having a pillar of your portfolio and you're investing trillions of dollars, and one of your pillars is 1 percent of the market, and it's got an investment rating off a price list by Dewey, Cheatem, and Howe.

**Jeffrey Gundlach 35:40**

And I think that that's a systemic problem in that we're trying to do financial alchemy. We're trying to turn defaulted bonds into payers. We're trying to turn below investment-grade bonds into marginally investment-grade bonds by going into shadow rating agencies. Everywhere I look, I see hand-waving. I feel like I'm listening to that Justin Timberlake song. You dance, dance, dance. The facts are that there is problems. Everyone admits there's problems. And when the recession comes, it's clear that there are going to be significant losses because this area is not like Silicon Valley Bank but suffers from the same problem: victim of their own success. Silicon Valley Bank had all that COVID money pile in, and they couldn't invest zero. It was piling in because they were offering an interest rate, and the government wasn't. And so they ended up buying 30-year treasuries because they yielded, like, 1.5 percent in Ginnie Maes. And of course, people realized that other people were withdrawing their money from SVB, and so everyone's got a phone, and it's this instant redemption. So, but this asset class has the same problem: victim of success. They were so successful in 2020, '21, '22, that all this money came in, and now that's going to have to be refinanced, a lot of it. And the rates are going to be higher. If you're picking on loans from 2001—

**Kristofer Kraus 37:10**

—But therein lies the opportunity.

**Jeffrey Gundlach 37:12**

If you're picking on loans from 2001—

**Kristofer Kraus 37:14**

Right.

**Jeffrey Gundlach 37:14**

How are they going to pay loans at the new interest rate that's more reflective? And Treasury rates have been going up. And as I said on CNBC, if your only argument for risk assets is you're going to get two rate cuts from the Fed in 2026, you're backing the wrong horse. Right now, the odds are higher that they hike rates this year, although I still don't think that's the odds on bet. But I'd bet more on a hike than a cut. And that's not going to relieve stress.

**Erik Schatzker** 37:44

While we still have some time, I think we should talk a bit about enterprise software. And with all due respect, you're absolutely right, Vivek. And an anecdote doesn't make a trend, but I'm going to share an anecdote all the same. Okay. I talked last night here in Los Angeles to a CEO in pharmaceutical operational services who's training his entire staff, he employs thousands of people, to code on Gemini, ChatGPT, and Claude, and he said that they've already eliminated the need for Smartsheets, Slack, and dozens of other licenses. So, it's a data point, but it was surprising at the very least to me. And I guess none of you here, quite obviously, is an expert on artificial intelligence, but there is an awful lot of collected wisdom at the firms where you work, and so we'd all like to know whether you think there will or won't be, or to what degree a SaaS apocalypse. Who wants to take that on first?

**Vivek Bantwal** 38:52

I'm happy to start. Look, I think a couple things. So, listen, I think that first of all, I think we all have to acknowledge that this technology is evolving rapidly. It's going to have an impact, and no one can say for certainty exactly what the impact is going to be. And so, I think we all have to be a little bit humble as we see this sort of all unfold. That said, for us, AI is not a new theme. We turned our first deal down for AI back in 2023. And to Jeffrey's point earlier about scale, we have 13,000 engineers that work at Goldman Sachs. We have a partnership with Anthropic. It's been publicly disclosed. We were an early investor. We have Anthropic engineers that work in our building every day. And so, when we screen deals, we don't just do it as an investment team. We get access to internal and external sort of resources around this. I think you're starting to see the public market start to distinguish that not all software is created equally. So, if you look at the public equity market, the index is down something like 25 percent, give or take, but there's a range of outcomes around that. So, there's some stocks that are up, and there's some stocks that are down 50 percent or more. In credit, there's also dispersion, but the magnitude is smaller. So the best-performing names in the below investment-grade space are down less than a percent. There's other names that are down 15 points or more. What these things map to is what are the characteristics of the software business. And I think the general view when you kind of study it, and you look at what is the market pricing in, if you're a software business that provides enterprise software, that system of record, front to back, the whole bones of the business, and you have proprietary data, so you have a sticky customer relationship where you have proprietary data, and you're verticalized in an industry where you have a network effect because you do everyone in that industry, you have all of their data. So, when user N+1 types something in, you can actually detect a mistake because you actually know what the other thousand of your customers do. You provide customer reporting. There's a regulatory overlay. If the cost of failure is more expensive than the cost of the software, these are hard things to disrupt, and this is one of the reasons that you're seeing these partnerships where if you're an LLM and you want to penetrate that business and you don't have that data, you have to actually partner with people that have that data. And so, that's a very different end of the spectrum than if you're a point solution that's horizontal, that provides a service that someone can vibe code perhaps a better service than you because there's nothing proprietary about your data, and you don't really have a moat around your customers. There's a lot of stuff sort of in between, but when you look at the disparate impact, some stock's up because people think they'll be a beneficiary of AI, the average down 25 percent. In credit, remember, if you are lending to profitable software companies, right? So, like a third of public software companies are kind of rule of 40. If you're lending to rule of 45, rule of 50, rule of 55, rule of 60, your starting point is a very good starting point. And actually, if you look at the way rule of 40 companies trade versus not in the public markets,

they actually trade at like 20X free cash flow for rule of 40 companies, and they trade at closer to 15X for non-rule of 40 companies. So, the market is kind of starting to differentiate this. I think it's early innings. There will clearly be some companies that get disrupted. But again, like with anything else, concentration matters, underwriting standards matter, humility matters, and we'll see how it all evolves.

**Jeffrey Gundlach** 42:05

I feel like I just read a prospectus. That was very detailed. It's good.

**Vivek Bantwal** 42:12

We try to be nuanced. This is nuanced stuff. But to the point earlier, by the way, again, I don't know that people are making these arguments, but people shouldn't be—This is not a risk-free asset. This is not a liquid asset. We don't use the word semi-liquid. These are illiquid assets. We didn't scale in the RIA community like some others did, and so people were making these arguments about volatility. So, we agree, people sort of shouldn't be doing that. I do think that the lack of nuance is not limited to private markets. I see people in public markets kind of oversimplifying stuff, and that can lose nuance, too. So, I think it is important to be nuanced.

**Jeffrey Gundlach** 42:45

Semi-liquid is kind of a diabolical name because semi means half—and liquid means liquid. So, half the time, it's liquid. It's liquid when you don't want your money, and it's illiquid when you do want your money. That's what semi-liquid diabolically, it was probably subconsciously termed that way because it's really telling.

**Erik Schatzker** 43:05

Isn't AI a bit different from your typical sort of credit issue in as much as it is, I don't know what analogy to draw, but like the asteroid that's coming in and going to hit—

**Brad Rogoff** 43:20

—But one thing—

**Erik Schatzker** 43:20

“Planet Credit”.

**Brad Rogoff** 43:22

One thing about AI is at the end of the day, AI is software, right? And it's not—necessarily free, right? Right now everyone's in this stage where if you talk to most companies that have a good balance sheet, they're going to tell you they're not counting how much the tokens cost, they're not counting how much it's going to cost to run these things over the long term, right? I've had a lot of those type of conversations, and look, I candidly don't think most people here, that their firms are doing that, right? But there is a cost to that, right? And so what does it do? It lowers the barriers of entry, right? It takes away pricing power for a lot of the existing software vendors that we're talking about. And I agree with the system of record stuff and working at a large bank, and thinking about some of the things that we need, we can't take chances with that. And I'm sure others feel the same, but there are certainly vendors that over time, I think we will feel we need less, or if the price of that comes down, then maybe it does make sense, right? And so then once again, I think what you're getting into here and why, I don't know if I use the SaaSocalypse, but you're going to have much higher default rates, and it can't affect the credit markets in such a great way because investment grade is not going to be that relevant, and high yield, you're talking about three-something percent of the market. Not all of it's going to wind up being bad. So, you're only talking about loans and private credit where that potentially is really a major issue, right? But you bought these companies for these high multiples, and we look back at, Jeffrey, you made the point about the 2021 vintage, and that's where you guys were all making that point that you were buying companies without much EBITDA, that you were relying on a lot of growth. There was these ARR recurring revenue loans, and the problem is if you look at a subset of broadly syndicated loans and software that were around in the end of 2022 and still around now, well, "Guess what's happened?" They never de-levered. The leverage is roughly the same as it was back then because the growth didn't materialize in the way that they were hoping to, and if you bought them with a 40 percent LTV then, and equity valuations have come down, well, now you're looking at least at 70 to 75 percent LTV on average.

**Kristofer Kraus** 45:34

Yeah, I think if you're at a company, there are no sacred cows when you're looking at the expense side of the business today, and I think that everyone is, "How can we use AI to save money here, here, here, here?" And whether that's external software, whether that's human capital, everything is on the board, and is being evaluated. And maybe some will be adopted today, but that is now part of the process. It's three months, six months, 12 months forward. As you think about budgeting, it's very much in scope.

**Molly Duffy** 46:02

And also, are you paying for it at a certain price now that's going to exponentially increase? So, it's difficult to map out.

**Kristofer Kraus** 46:10

Mm-hmm.

**Erik Schatzker** 46:11

Kris, maybe this is a good one for you from our audience. Points out that software is the largest underlying industry in both private equity, private credit. I don't know whether that's true. Let's assume it is. He or she wants to know, points out, A, the refinancing wall is massive. Looming out whatever—

**Kristofer Kraus 46:33**

—Yep—

**Erik Schatzker 46:33**

—Two, three years from now. And that—wants to know, and maybe it's a good question for Pimco, you know, at what rate would you be willing to recapitalize a performing software business today?

**Kristofer Kraus 46:48**

Good question. Look, I think part of our business is where can we be a provider of liquidity when maybe others aren't necessarily willing to step in? There's a price obviously associated with that, and we've done that over the years, and it's worked out pretty well for us. Near term, as you look at that maturity wall, it's manageable in '26. It's potentially manageable into '27. I think in '28 and '29 is when you really begin to have some pretty material sizes that need to work their way through the system, but every one of those is going to be bottoms up, manual underwrite. What do we think about distributions of outcomes when it comes to that particular investment? Understand the left tails. How can we be compensated for that? And obviously in a world of technology and AI and the disruptive factors associated with it, can you actually get comfortable with the level? And I think that's going to be part of that opportunity set that I think has become a lot more interesting as we look at direct lending and how some of these names are frankly going to have to be refinanced. And whether, in fact, you brought up the point earlier, Brad, that I thought was relevant, as you've seen multiples come down significantly in some of these businesses, how much equity is there today to support that debt? In many cases it's zero. It's negative at this stage. So, how do you re-rack that capital structure to have something that on a go-forward basis makes some sense?

**Vivek Bantwal 48:13**

I would just add, there's no one size fits all. So, the point that was made earlier, if you have an ARR loan that you thought was going to flip to cash flow and it doesn't flip to cash flow, and so that's a very different situation where if you're lending six times against a company that's rule of 55, so it has 40 percent margins and it's growing 15 percent cash-on-cash EBITDA per year, where there's positive free cash flow and you can actually introduce amortization into the structure, and that's just sort of a very different kind of place to be. And so, I think you're going to have kind of a range of differences. If you're in that six times context and you're rule of 55 and the public comps used to trade at 24X and they went to 18X, and so now you're 33 LTV instead of—That's a very different thing than if you were lending, you thought it was 33 times, but because you don't have cash flow, it's really 100 percent or more LTV. So, I think this is going to be very kind of company specific based on its characteristics.

**Erik Schatzker** 49:06

Molly, given what we've acknowledged here and what underlies that question, this overlap, if you will, between private and credit and private equity in enterprise software or software in general, a question that you might be able to answer. I hear increasingly that trouble in private credit potentially spells disaster for private equity because any default on one of these loans means that the underlying equity is worthless. And you're the sponsor banker on the panel, and so you have perhaps some insight into this that others might not, given the conversations that you have with these private equity and private credit managers. Maybe you could share with us what you're hearing candidly that we might not get publicly.

**Molly Duffy** 49:56

Yeah, sure. So, I think we've talked about a range of some fraud examples, some companies with 30 people, not including the receptionist, not doing great due diligence on documents. We're looking at the largest names, and also, I think when you are a private credit investor or a private equity investor, you know your clients very well, very intimately. And if you're a bank supporting some of that financing, you're also quite involved in those documents, and you pick your people very well that you work with. So, I'm sure there can be some issues that, as we've talked about, "Is there contagion here?" "Is there something systemic?" But what I see with the names that we're speaking to, and similar to the bank that you mentioned, our private credit exposure's also sub 1 percent. Guess that's the number that most of us have. I don't see this as being some large issue, notwithstanding some of the comments, Jeff, that you made, that you brought up. But it all, I think, comes down to the clients that you're dealing with, the companies that you're investing in, the terms that you have, the documents that support that. All of that goes into that transparency piece as well.

**Erik Schatzker** 51:12

One topic we haven't touched on that perhaps we can get into with the time that we've got left is the behavior of the institutional investor. We've talked a lot about the behavior of the retail, of the private wealth investor who's been in these non-traded BDCs, for example, or stuck in some other credit vehicle with redemption limits. And of course, those redemption limits are awfully unpopular with the people who want to get out, but they're totally within their rights to put them up. They're in the documents. Vivek, Kris, Jeffrey, you've all got institutional LPs. How are they behaving? What are they telling you? What do you denote, I guess, or infer from what you see and hear from them?

**Vivek Bantwal** 52:06

Yeah, look, our institutional dialogue, I've been going all day since Sunday, is as busy as we've ever been. We have a primarily institutional platform. 83 percent of our capital is in drawdown funds. Of our BEC capital, two-thirds of it comes from our ultra-high net worth channel and institutions. So, our exposure to traditional retail is between 5 percent and 6 percent of our platform. And so what we're hearing from institutions is with the retail money leaving the market, spreads are going back up. One of the things that happened is in 2022, when rates started going up, Russia invades Ukraine, the broadly syndicated loan market was dislocated. Everything was coming private credit, and so spreads were very high, and that's

been on a straight line down. Public spreads have obviously come in in that timeframe as well. And so, when you got to the end of last year, you know, spreads were at all-time tights. We're now seeing a big retreat of that. And so, on new deals that we're competing on, we're getting materially better spreads than we did in the fourth quarter of last year. We actually pulled back deployment towards the end of last year, particularly in the US, because the spreads were getting a little too tight. And so, now we're seeing a really interesting opportunity, and our institutional LPs are really, really excited about going in and taking advantage of the wider spreads that they used to benefit from a couple years ago.

**Erik Schatzker** 53:14

They aren't on, like, nobody's looking for liquidity?

**Vivek Bantwal** 53:17

Nope. In fact, we disclosed this publicly. We've been having a record institutional fundraising recently. We just had our earnings call a couple of weeks ago, and we went through that.

**Jeffrey Gundlach** 53:26

We've seen, more so outside the US than the US, but we've seen a noticeable ramp-up in demand for diversification products by sovereign wealth funds and things like this. And what I mean by diversification, I'm not talking about gluing private equity with private credit. I'm talking about they want something that is no corporate credit risk. Nothing. They want credit risk still because they want spread, but we've customized portfolios where it's all non-corporate credit, and it's a growing trend. In the US, haven't seen that so much. Most of our institutional clients feel like they're okay with their allocations to private markets, and if they get marked down, what with public markets going up, they'll probably re-up to rebalance. That's their mindset currently. So, I haven't seen a real aversion from the institutional crowd. It seems to be retail.

**Brad Rogoff** 54:27

Yeah, just to jump in, I think from my perspective on the institutional side, they understand our approach to how we build portfolios and how relative value matters across different asset classes. They understand our approach to sizing positions, which matters a lot when you're going through different cycles, the role that risk management plays, the role that liquidity plays. And so, we haven't seen that sort of run for the exits the way that your question suggests.

**Erik Schatzker** 54:51

Ladies and gentlemen, I want to thank you for joining us, and I would like you to help me thank our panelists, Brad Rogoff, Kristofer Kraus, Molly Duffy, Jeffrey Gundlach, and of course, Vivek Bantwal. Thank you.

**All panelists** 55:01

Thank you.

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