Private credit faces rising risks and defaults, but still offers long-term yield and diversification benefits amid a more balanced near-term outlook. (UBS)

Diversifying across alternative assets makes sense amid the current uncertainty

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Private credit remains in focus amid headlines about AI-driven disruption in the software sector, defaults, and some managers enforcing contractual liquidity restrictions. While not necessarily a direct reflection of loan book credit quality, investors must be prepared to tolerate illiquidity in both favorable and challenging conditions.

CIO maintains a Neutral view on direct lending, as we see a balanced risk-return outlook in the near term.

Private credit investors have been worried about several recent developments.

- Investors have grown concerned that AI developments may disrupt legacy enterprise software companies, including those to which direct lenders have provided loans.
- Risks are rising, especially among lower-middle-market borrowers and loans that originated in 2021-22, which have seen higher defaults and non-accruals.
- Several evergreen funds have limited redemptions to protect asset values.

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Late-cycle dynamics and an increasingly split market support a selective approach

- The asset class still offers long-term yield and diversification benefits, but in the short term, we see a more balanced risk-return outlook and more moderate returns.
- Since September, we have recommended that investors consider biasing exposure toward funds focusing on senior, sponsor-backed, upper-middle-market loans in non-cyclical sectors, which are proving more durable.

Diversifying across alternative assets makes sense amid the current uncertainty.

- Investors with an overallocation to direct lending should consider broadening into diversified alternative strategies, including private infrastructure; seeking proxy hedges; or reducing exposure to high yield credit or equities in favor of quality bonds or low-correlation hedge funds to balance risks.

Did you know?

- According to Fitch, the private credit default rate in the fourth quarter of 2025 reached 11.7% for companies with EBITDA below USD 25 million, compared to just 2.4% for those above USD 100 million. Notably, loans from the 2021-22 vintages accounted for about half of new non-accruals in 2025,highlighting their greater vulnerability to the rate hikes of 2022-23.
- In our base case, we still expect direct lending to deliver total returns of around 6% over the next 12 months.

Investment view

CIO continues to believe a diversified allocation to direct lending can add value to a well-diversified portfolio over the longer term, but the risk-return outlook in the near term has become more balanced.

Original report: **Should investors worry about private credit?, 11 May 2026.**

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