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Risk On/Risk On (Part Two)

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What is coming through clearly in our conversations with credit professionals is that we are in a risk-on world. Somewhat delayed from earlier in the year, thanks to tariffs, but the strength and direction is unmistakable. This sentiment was amplified in our discussions about the US leveraged loan market in *Octus Webinar: H1 2025: "How Private Credit and Banks Traversed the Tariff Storm to a Brighter Second Half."*

And while confidence reigns across public and private markets, how managers operate in each channel in this environment is instructive. For example, primary deal terms in broadly syndicated loans are set by secondary prices, not the other way around. Syndicate desks look at where comparable loans are trading, then set new deal spreads accordingly.

This is as much art as science. No two borrowers are exactly alike. Multiple factors such as launch dates, issuer size, sector and leverage are considered. Experienced underwriters know if the new deal is priced "cheap to the market" – meaning its all-in yield makes it an attractive buy relative to what else is out there – CLOs and retail funds will buy it.

If we're in a risk-on environment, why should this matter? Because even a modest change in trading sentiment, such as Friday's disappointing labor report, moves BSL prices. A mismatch in new deal terms relative to what's available to buy in secondaries could end in a hung deal. Having underwriting banks stuck with unsold inventory hurts the tone for any new situations in the pipeline. Market noise affects public credit issuance.

Because private credit managers raise long-term committed capital allowing them to hold loans on balance sheet, there's no reliance on a secondary market to buy or price their deals. Private credit acts as a noise-cancelling device, financing LBOs regardless of whether risk is on or off.

Why should investors care about this? Because they depend on their credit managers to deploy their capital consistently, regardless of market cycles. When interest rates soared in 2022 and 2023, the public new deal pipeline slowed to a trickle. While direct lending volume also decelerated (see our *Chart of the Week*), it soon picked up, tariff pressures notwithstanding.

How do private managers ensure a steady flow of deals? By always being risk-on, lending in all markets through scary headlines, not just fair weather. Private credit financings are structured with investors in mind, not "the market." Spreads and other terms are set where comparable deals are getting done. But sponsors have close relationships with a handful of direct lenders they trust to execute in tough times, providing some protection from aggressive competitors.

Private credit never sleeps. Borrowers and investors have diversified beyond public markets to provide a buffer from volatility that otherwise impacts deployment, valuations, and returns. And unlike bank loans and high-yield bonds, illiquid middle market loans are insulated from the march to the bottom on spreads when risk-on exuberance takes hold.

? From the Editor: The Lead Left will be on its annual August break and will return the week of Sept 1.