



Sycamore Tree
Capital Partners

Credit Market Viewpoint: Bigger Markets, Longer Cycle, Wider Opportunity Set

February 2026

This provides our best thinking in an unusual, uncertain time. It is neither a prediction nor a recommendation about particular investments or strategies about companies.

Executive Summary

- **Size Matters**

- With corporate credit now a larger share of the economy, macro shocks are resulting in higher volatility for companies with exposure
- While average market spreads are not indicating stress, credit quality and industry dispersion reveal “K-shapes” where the cycle is already reflected
- We expect policy uncertainty to continue to drive and amplify credit volatility

- **It’s not “If,” it’s “When”**

- Tremendous growth in below investment-grade corporate credit over the past decade has led to rolling, elevated defaults (which we expect to continue), rather than a default “spike”
- Bank deregulation (e.g. repeal of the Leveraged Lending Guidelines) may further magnify the historical issuance/default relationship

- **Potential Strategies for Positioning Credit in 2026**

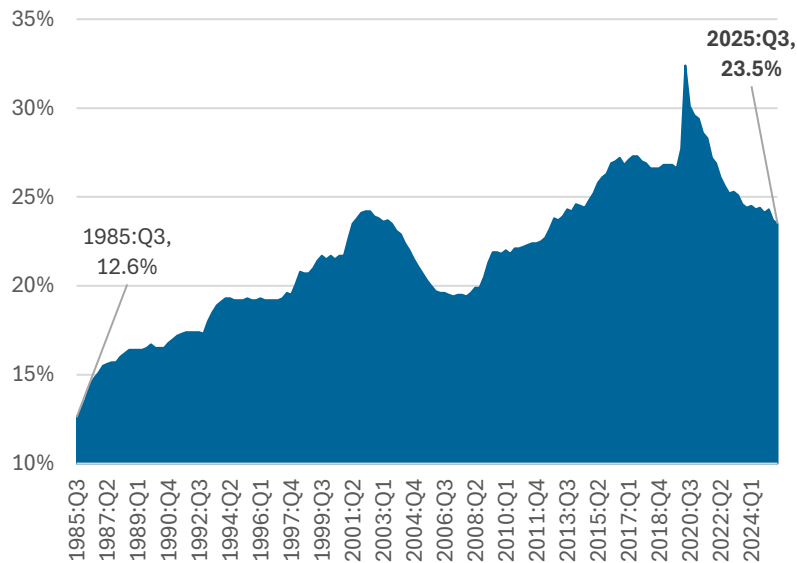
- **High Grade CLO Bonds and Senior Loans** provide solid yields alongside structural seniority
- **Opportunistic and Structured Credit** offer complexity premium and opportunity for alpha
- **CLO Equity** locks in historically cheap, long-term funding and offers diversified credit exposure



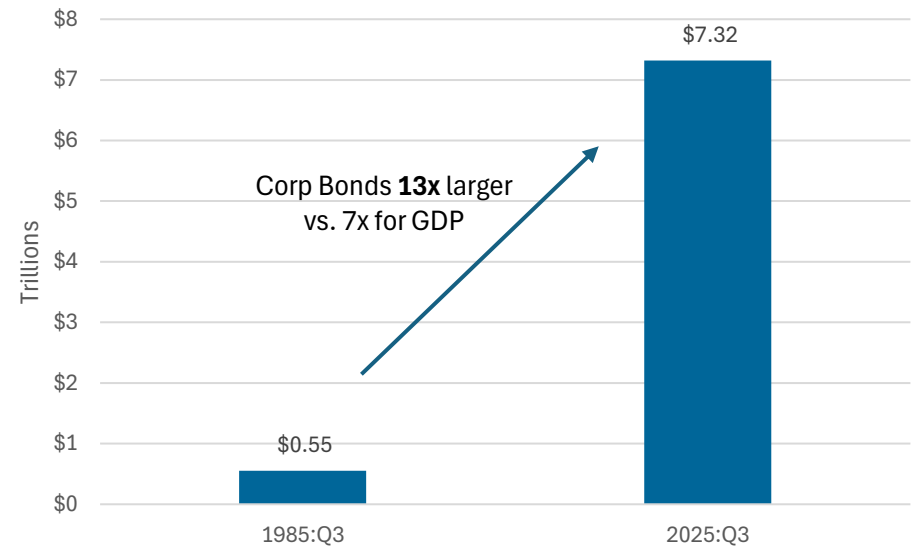
Size Matters: Corporate Bonds Have Doubled in Size Vs. Economy Over 40 Years

- Combined with higher borrower leverage incurred after 15+ years of easy monetary policy post-GFC, smaller macro shocks are leading to much higher price and earnings volatility

Corporate Bonds as a Percentage of GDP¹



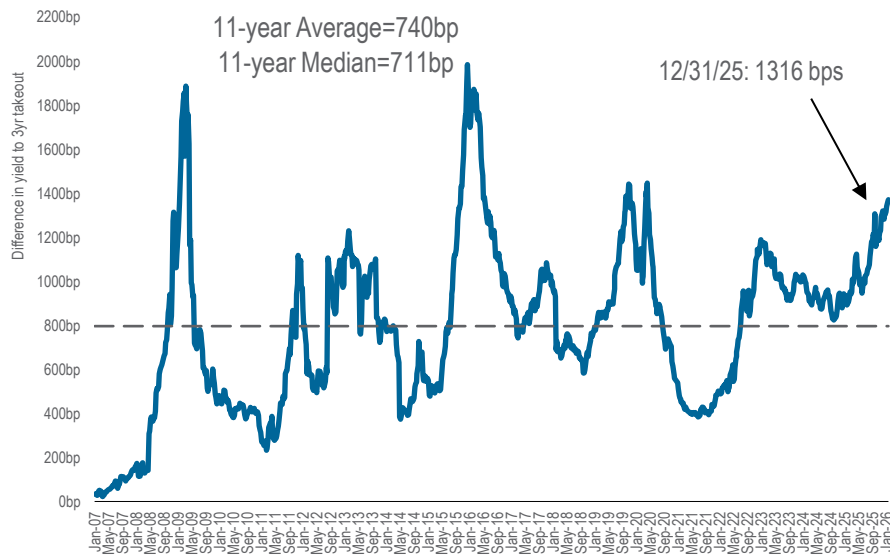
Size of Corporate Bond Market¹



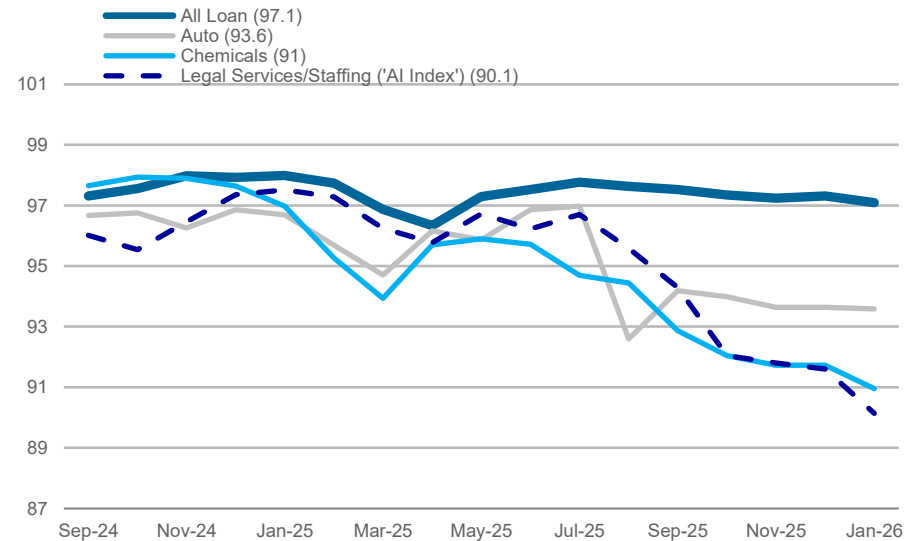
Beneath the Surface, Credit Outcomes are K-Shaped, Too

- **Balance Sheet K-Shape:** With investors seeking to avoid LMEs, poor performing low quality credits are trading at wider spreads relative to historical averages while higher quality credits are trading tighter
- **Industry K-Shape:** Industry performance split by “haves” and “have-nots.” Prices remain lower for those exposed to policy risk (e.g. tariffs) or business model disruption (e.g. AI)
- Trade, immigration policy, affordability/inflation sensitivity, and AI disruption will likely continue to drive the bottom of the “K”

Spread between loans rated Split-B/CCC & B¹



Loan Weight Average Price²



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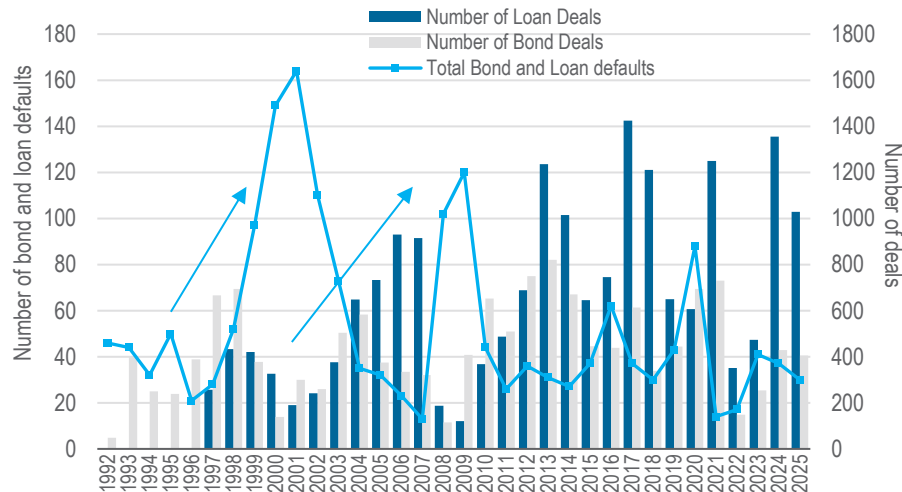
¹Source: JP Morgan North American Credit Research, High Yield Bond and Leveraged Loan Market Monitor, 1/5/26

²Source: BofA Global Research, 2026 Year Ahead Outlook (CLO), 11/25/25

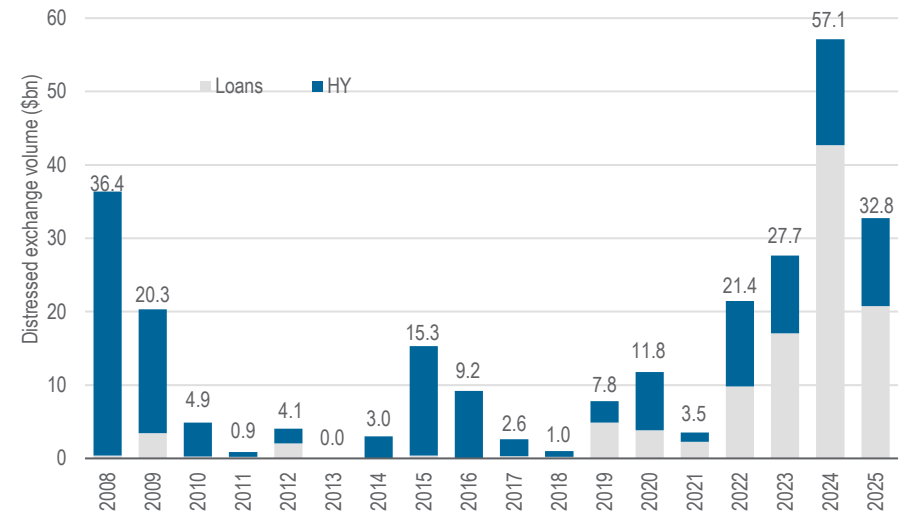
Default Outlook: It's Not "If," it's "When"

- Issuance booms usually result in higher defaults three or four years later. Given the robust growth of the below-investment grade debt markets, we expect elevated levels of defaults to continue over a longer time period, versus a 2008-style spike
- While the market tries to extend the cycle using liability management, we believe pressure on the weakest issuers will persist, due to over-levered capital structures and higher cost of capital

Easy credit availability leads to an increase in defaults¹



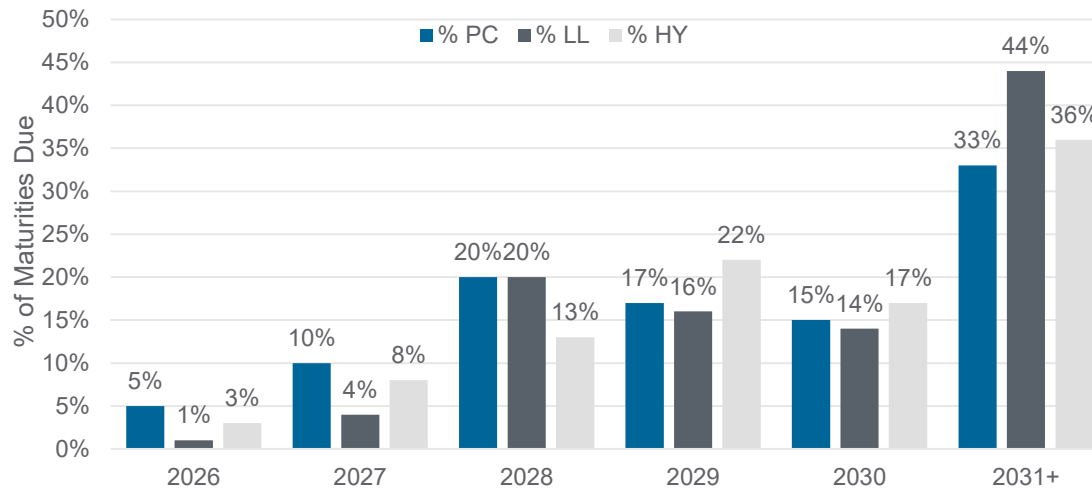
Distressed exchanges/LMEs totaled \$33bn in FY25, which ranks as the third highest total on record¹



Bank Deregulation May Potentially Amplify Issuance/Default Relationship

- The 2013 Leveraged Lending Guidelines, which limited banks' ability to participate in riskier deals and helped guide lending activity to the private credit industry, were withdrawn by OCC and FDIC in December 2025
- If this leads to more aggressive bank lending, borrowers may find it easier to refinance and extend maturity walls. Longer-term, we believe the default cycle simply shifts out, with more occurring later on

Maturity Wall Across Below Investment-Grade Credit¹



Potential Strategies for Positioning Credit in 2026

- **High Grade CLO Bonds and Senior Loans:**

- Play defense with floating-rate, yield-oriented assets; structural seniority provides downside protection

- **Opportunistic Credit and CLO Mezzanine Bonds:**

- Play offense through selective, discounted credit opportunities, where complexity premium exists, or structurally advantaged CLO debt, where there are fewer natural buyers and market volatility creates alpha opportunities

- **CLO Equity:**

- Lock in historically cheap, long-term funding and obtain diversified, high quality credit exposure with upside optionality in the event of spread/price volatility



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