



Ca' Foscari Private Equity Club

Private Credit Under Pressure

Has the Market Reached Its First Real Test?

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INTRODUCTION

Driven by a shared interest in alternative markets and the structural shifts reshaping the global credit landscape, the authors set out to provide a rigorous and accessible analysis of an asset class that remains, in many professional and academic circles, insufficiently understood.

Rather than a purely descriptive exercise, this work seeks to offer a constructive and engaging examination of the mechanisms and instruments that define private credit, with a particular focus on the United States market. The goal is to make a complex topic accessible without sacrificing analytical depth.

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What is private credit

1. General description

Private credit - also known as private debt or direct lending - denotes a form of non-bank financial intermediation in which debt is extended directly to borrowers outside of regulated markets. Unlike bonds or syndicated loans, private credit instruments are bilateral arrangements held to maturity by the originating entity, with no circulation on secondary markets. While no universally adopted definition exists across regulatory jurisdictions, the Federal Reserve describes private credit as "direct loans made to mid-market businesses, typically by non-bank vehicles such as private debt funds and Business Development Companies (BDCs)."

Private credit is best understood in contrast to its existing alternatives: on one side, traditional bank lending, subject to prudential supervision and the balance-sheet constraints of credit institutions; on the other, public debt markets, which require issuers to meet listing requirements, disclosure obligations, and minimum size thresholds. Private credit occupies the space between these two poles, catering primarily to firms that are too large or too risky for bank financing, yet too small or insufficiently creditworthy to access bond markets.

2. Key features

Private credit transactions share a set of structural characteristics that distinguish them from publicly traded debt. First, illiquidity: loans are held to maturity, and they are not traded on open markets. In exchange for accepting this illiquidity profile, investors typically earn a premium over comparable public instruments: the Bank for International Settlements estimates the spread on private credit loans at approximately 630 basis points above the Secured Overnight Financing Rate (SOFR).

Second, most private credit instruments carry floating interest rates, typically referenced to benchmark rates such as SOFR. This structure transfers interest rate risk to the borrower, shielding the lender from duration exposure.

Third, bespoke covenant packages are a defining feature of private credit transactions. Because loans are negotiated bilaterally, lenders can structure protective provisions - including maintenance of covenants, information rights, and change-of-control clauses - tailored to the specific risk profile of each borrower. This degree of customization is not available in the syndicated loan or bond markets, where standardization is necessary to facilitate broad distribution to a wide investor base.

3. Private Credit instruments and strategies

The instruments that characterize the private credit universe differ in terms of seniority, collateral structure, and the risk-return profile of the parties involved. The Bank for International Settlements identifies four principal strategies currently in use:

Direct lending is the dominant strategy, consisting of the direct origination of senior secured, floating-rate loans to mid-sized companies without bank intermediation. Repayment is based on the borrower's operating cash flows rather than hard collateral; this makes the contractual

financing clauses (covenants) a central element of credit risk management, as they govern - with binding force - the terms of disbursement and repayment of the facility.

Mezzanine lending refers to subordinated or junior debt extended to larger companies, frequently accompanied by equity participation rights (warrants or conversion options). This instrument bridges the gap between senior debt and equity in the borrower's capital structure and is typically employed in the financing of leveraged buyout transactions.

Asset-based lending involves the origination of credit secured against tangible assets such as real estate, infrastructure, aircraft, or trade receivables. The collateralized nature of this strategy provides greater downside protection relative to cash-flow lending and has historically attracted insurance companies and pension funds seeking stable, long-duration returns.

Distressed credit consists of the purchase of impaired or non-performing fixed-income instruments on the secondary market at prices significantly below par, with the objective of recovering value through restructuring processes, legal proceedings, or asset liquidation.

4. Investment vehicles and participants

Capital is allocated to private credit through a variety of fund structures. Closed-end funds - in which investors commit capital for a fixed term, typically seven to ten years, with limited early redemption rights - are the most prevalent vehicle, accounting for 81% of the market according to IMF (International Monetary Fund) data. Business Development Companies (BDCs), regulated investment companies that may be publicly listed, constitute a growing segment representing approximately 14% of the market and serve as the primary channel through which retail investors access private credit strategies. The remaining share is accounted for by Collateralized Loan Obligations (CLOs) backed by pools of private loans.

On the investor side, the asset class has historically been dominated by institutional capital. IMF data indicate that pension funds (28%), foundations and endowments (21%), and family offices and wealth managers (19%) collectively account for more than two-thirds of commitments to U.S. private credit funds. The long investment horizons of these institutions are well suited to the illiquidity profile of the asset class, allowing them to capture the illiquidity premium without the liquidity management pressures that constrain commercial banks.

5. Private Credit and Private Equity: Two Models, One Ecosystem

Private credit and private equity, while both operating outside public markets and relying predominantly on institutional capital, differ fundamentally in their investment logic, return drivers, and risk exposure. Private equity involves acquiring ownership stakes in non-listed companies, typically with the objective of enhancing firm value through strategic, operational, and financial interventions before exiting at a higher valuation. Private credit, by contrast, consists of directly originating or privately negotiating loans to companies, with returns primarily derived from contractual interest payments, fees, and structured protections rather than capital appreciation. The distinction is therefore rooted in ownership versus lending: private equity investors assume residual claims on firm performance, while private credit investors act as creditors with predefined repayment structures and priority in the capital stack.

This structural difference translates into markedly different return profiles. Private equity returns are inherently uncertain and backloaded, depending on the successful execution of value creation strategies and favourable exit conditions. Historically, these returns have been driven by a combination of operational improvements, such as margin expansion and efficiency gains, financial engineering through leverage, and multiple expansion at exit. In contrast, private credit offers a more stable and predictable return profile. Income is generated through periodic interest payments, often structured as floating-rate instruments linked to benchmarks such as SOFR (Secured Overnight Financing Rate)¹, alongside upfront fees and prepayment penalties. This floating-rate structure allows lenders to benefit from rising interest rates while transferring duration risk to borrowers, and the illiquid nature of private credit enables investors to capture an illiquidity premium significantly above that available in public debt markets.

Risk allocation further reinforces the divergence between the two asset classes. Private equity investors bear higher risk due to their subordinated position in the capital structure and their full exposure to firm performance in the event of financial distress; equity holders absorb losses first and may face complete capital impairment. Private credit investors, by contrast, benefit from structural protections including seniority in repayment, collateralization, and covenant packages tailored to the borrower's risk profile. These covenants serve as active risk management tools, allowing lenders to intervene early in case of deteriorating performance. Nevertheless, private credit is not risk-free; default rates, recovery values, and covenant quality remain critical determinants of performance, particularly in periods of economic stress.

Despite these differences, private credit and private equity are deeply interconnected and often operate in a complementary rather than competing manner. This relationship is most evident in leveraged buyouts, where private equity sponsors acquire companies using a combination of equity and debt financing. Private credit funds have increasingly emerged as key providers of such financing, particularly in the mid-market segment where traditional bank lending has been constrained by post-crisis regulatory reforms.² The retreat of banks from certain types of corporate lending has created space for private credit funds to offer flexible, tailored financing solutions. Bilateral negotiations, faster execution, and customized covenant structures give private credit a structural edge that syndicated loans or public bond markets cannot easily replicate.

Ultimately, the relationship between the two asset classes is not merely complementary; it is structural. Private credit has become one of the primary enablers of private equity activity, providing the debt financing that makes leveraged buyouts possible. In this sense, private credit does not simply coexist with private equity: it serves it.

¹ https://www.bis.org/publ/qtrpdf/r_qt2503b.htm

² https://www.bis.org/publ/qtrpdf/r_qt2503b.htm

2. NUANCES OF PRIVATE CREDIT

The Anatomy of a Private Credit Deal: A Mid-Market LBO as a borrower

1. Setting the Scene: The Representative Transaction

To understand private credit from the borrower's perspective, it is useful to reconstruct the economic and structural logic of a typical 2025 transaction: a mid-market company in the software or healthcare services sector, with approximately \$60 million in EBITDA³, being acquired by a private equity sponsor through a leveraged buyout financed with an untrenched direct lending facility. The untrenched structure, which combines senior and subordinated debt into a single contract at a blended rate, is not a minor technical detail: it has become the dominant format for mid-market LBO financing in the United States because it simplifies the process for all parties, eliminates intercreditor conflicts, and accelerates execution timelines.

The transaction described here is not a real deal. It is a composite built from observable market data for 2025, with parameters drawn from public sources, including Capstone Partners, Northleaf Capital, and Configure Partners, and corroborated by ARCC's public disclosures. It serves as a concrete reference point for the discussion that follows.

2. The Mid-Market Borrower Profile

The typical private credit borrower is a company with revenues between \$50 and \$500 million and EBITDA in the \$25–150 million range: large enough to require institutional financing, but too small, too risky, or insufficiently rated to access the investment-grade bond market or the broadly syndicated loan market on acceptable terms. Software, healthcare services, and financial services are the dominant sectors in private credit portfolios: a reflection of the economy's structural shift toward intangible-intensive businesses, where value resides in recurring revenues and contractual relationships rather than in hard assets. This profile is not incidental. Asset-light companies with low capital expenditure requirements convert a higher proportion of EBITDA into free cash flow, which is the primary source of debt repayment in a private credit transaction. For a lender holding a loan to maturity without the option of secondary market exit, the magnitude of that cash flow is the single most important underwriting variable. This makes low-capex businesses structurally preferable to capital-intensive ones, regardless of sector.

In the vast majority of transactions, the borrower is backed by a private equity sponsor. That detail matters: the sponsor brings a meaningful equity stake, access to management, the ability to inject additional capital in stress scenarios, and interests that are closely aligned with those of the lender. It is no coincidence that direct lenders systematically prefer sponsor-backed borrowers over non-sponsored companies of comparable size and leverage.

³ <https://www.capstonepartners.com/insights/middle-market-leveraged-finance-report/>

3. Capital Structure: Leverage, Pricing, and All-In Cost

A representative 2025 mid-market LBO would be structured at a leverage multiple of 4.5x–5.0x EBITDA. On a \$60 million EBITDA base, this implies total debt of approximately \$270–300 million, typically comprising a unitranche term loan and a revolving credit facility.

Unitranche pricing in 2025 settled at approximately 475–525 basis points above SOFR. With SOFR near 3.25%, the all-in cost of debt landed in the range of 7.75%–8.75%; this means that there was a significant compression from the 2022–2023 peaks, when spreads reached 700 bps. Relative to the syndicated market, private credit carries a premium of roughly 100–150 bps: a cost that almost all sponsors in 2025 accepted without resistance because, in exchange, they received execution certainty.

4. Structural Features: Covenants, Information Rights, and PIK Provisions

Three features distinguish a private credit agreement from its syndicated equivalent, and all three flow from the bilateral nature of the negotiation.

Covenants are the first and most important. In the mid-market (where borrowers' EBITDA is below \$100 million) private credit agreements still include financial maintenance covenants: typically a maximum leverage test and an interest coverage test, verified quarterly or semi-annually. If the company's results deteriorate, the lender is brought in well before the situation becomes irreversible. This is precisely the kind of early warning that the syndicated market cannot offer.

Information rights are the second distinguishing feature. A direct lender typically negotiates quarterly financial statements with management commentary, certified annual accounts, a board observer seat or quarterly management call right, and the right to conduct periodic business reviews. In practice, the lender does not wait for things to go wrong, it monitors actively.

The third element is **PIK optionality**. Around 10–12% of loans in BDC portfolios in 2025 included PIK provisions, allowing the borrower to capitalize interest rather than paying it in cash. It is not necessarily a distress signal, but it is almost always a sign that interest coverage is under pressure. PIK keeps the apparent default rate low while quietly compounding the debt outstanding: a dynamic that, as discussed in the preceding section of this report, requires a critical reading from investors and regulators seeking an accurate picture of underlying credit quality.

5. The Borrower's Rationale: Why choose private credit?

For the sponsor and the company, the choice between private credit and the syndicated market comes down to a trade-off between price and certainty. Private credit is structurally more expensive: the 100–150 bps premium is real and translates into millions of dollars in additional annual interest. In exchange, the borrower receives execution timelines of three to six weeks rather than eight to twelve, no risk of a failed syndication, and the flexibility to negotiate bespoke terms that a large, heterogeneous lender group could never accommodate.

The value of that certainty was demonstrated with particular clarity during the turbulence of April–May 2025, when tariff-related uncertainty effectively closed the syndicated new issuance window

for several weeks. Private credit lenders continued to execute; sponsors with live acquisitions turned overwhelmingly to direct lenders to avoid losing their deals.

6. Credit Risk and the Limits of the Model

The other side of the coin is equally clear. At an all-in cost of 7.75%–8.75%, annual interest on \$270–300 million of debt runs between \$21 and \$26 million, against an EBITDA base of \$60 million. The resulting interest coverage ratio is approximately 2.3x–2.9x: adequate under normal conditions, but fragile if revenues fall by 20–25%. It is no coincidence that the share of borrowers with an interest coverage ratio below 1.5x has more than doubled since 2019 — rising from 14% to 32% of the direct lending market by 2025 — while the average coverage ratio across the asset class has declined from a peak of 3.2x in 2021 to approximately 2.0x today.

Recovery risk presents a more nuanced picture than is often assumed. Historical data shows that direct lending portfolios have on average recovered approximately 69 cents on every dollar lent on senior secured first-lien positions, modestly above the approximately 65 cents recovered in the broadly syndicated loan market. This structural advantage reflects two features specific to private credit: direct lenders typically hold a single, concentrated position in the borrower's capital structure, which eliminates intercreditor coordination problems and accelerates the workout process; and the prevalence of blanket liens grants lenders a comprehensive security interest across all borrower assets. The risk, however, is concentrated and sector-specific. In asset-light industries — software, healthcare services, and professional services — value resides not in machinery or real estate but in customer relationships, contracts, and recurring revenue streams: assets that, in a default scenario, prove considerably harder to monetize than the models suggested at the time of underwriting.

In short, the anatomy of this representative transaction captures the fundamental tension of private credit in 2025: a structurally sound, relationship-driven financing model that delivers genuine value to borrowers and lenders alike, operating in an environment of compressed spreads, still-elevated rates, and abundant dry powder. Maintaining the credit quality that has historically justified the premium over public market alternatives requires sustained discipline from the lender at first and then from the borrower in managing its own balance sheet.

A comparison between US- and EU-based PC

1. European trend

Surprisingly and perhaps unexpectedly there is at least a little potential European primate over the US, to be validated over the next few years. If North America remains stably at the top of the volumes – both for what concerns PC market and nonbank corporate financing: 12% in Europe vs 75% in US – something is about to change, as highlighted by Marcus Maier-Krug, partner at Arcmont: “[...] *Europe has been more attractive than the US, largely because it has been perceived to be a more politically stable environment.*”

Moreover, the forecasts indicate a 2010 to 2030 CAGR of approximately 13%, a number that would mean Assets Under Management equal to € 4.5tn. Despite all these positive marks, however, the geopolitical continuously evolving scenario might present uncalculated risks: credit funds

exposure to software sector – now threatened by AI – and uprising and volatile energy costs due to supply chain shocks are all factors that could jeopardize Europe’s economy and undermine the ability of private credit borrowers to stay current with loan payment. In fact, and as this report will later show, it is exactly what is apparently happening in the US market, while for the moment Europe is displaying an unhelped robustness.

Furthermore, the American willingness to diversify portfolios, thus diversifying and lowering risks, as well as some concrete profitability opportunities in the old continent; notably the number of sponsorless deals⁴ is rising throughout various jurisdictions in Europe, with the German Mittelstand and Northern Italy being particularly champions.

2. Legal differences

As a thematic report by S&P Global shows, *“The shifting balance between European bank and nonbank lenders is another significant factor in the opportunity emerging for private credit. Banks are expected to cede more lending activity to private credit funds as they implement the post-global financial crisis risk-management reforms of Basel III and Basel IV.”*

Moreover, the EU’s credit market is further subdivided in many national jurisdictions, each of which is highly fragmented: because of this, success in Europe relies heavily on “local origination capacity” and having “boots on the ground” to operate alongside regional banks.

In an effort of harmonization among many different regulations, dated 2015 – which would naturally improve the health and the attractiveness of EU’s economy – the “ELTIF (European Long-term Investment Funds)” concept has been activated and is now fully operative. As the European Commission clearly states, these were needed *“[...] to increase the amount of non-bank finance available for companies investing in the real economy of the European Union. Action is needed at European level as there is no consistency among the funding vehicles in Member States.”*

One of the key concepts, needed because otherwise the fundamentals themselves of PC would collapse, is that investors can’t get their money back whenever they want, and only under specific and special circumstances the fund managers might allow some investors to withdraw only a tiny proportion of invested money. Generally, these vehicles have a duration of 10-12 years.

3. American PC interferences in the EU market

A double trend can be identified: firstly and more positively a flow of capital moving into European PC from across the Atlantic. Among classic private credit investors, we might include: (i) the State Board of Administration of Florida; (ii) the State Of New Jersey Police And Firemen's Retirement System and (iii) the Pennsylvania Public School Employees' Retirement System. They were all among the major US-based institutional investors actively building out allocations to European PC funds in 2025.

On the other hand, we should investigate the real origin of existing PC funds in Europe –as well as their native currency – and assess whether it is European or North American. Data from “With

⁴ A sponsorless deal (or non-sponsored deal) is a business acquisition or financing transaction where the company involved is not backed by a private equity fund.

Intelligence” point out that the two biggest funds which closed in 2025, Ares Capital Europe VI LP and CVC European Direct Lending IV, were effectively eurozone based and used euro as native currency. What’s interesting is that these two mega-closings were the two largest funds in 2025 with a total size of € 32,3bn.

4. Differences in default risks

More effectively than anything data itself starkly highlights an existing divergence between North America and EU: according to a February report by Fitch Ratings, the US PC default rate has climbed to 5.8%; conversely 2026 analyses by Morgan Stanley and GS point out that European headline default rates remain much lower, hovering around 2%.

Two different emotional feelings and approaches – not to be confused with moody investing, obviously – are offered by Patrick Schoennagel, co-head of investment bank Houlihan Lokey Inc.’s and David Scopelliti, global head of private debt at Mercer Inc.

If the former embraces a positive feeling: *“When things get really sporty and competitive, [fund managers] might stretch a little bit on leverage or reduce their price or agree to looser covenants or whatever, there could be erosion of credit quality in some individual lending decisions. But overall, when I read it that private credit is this time bomb waiting to explode and take down the global economy, from my seat here in Europe, I just don’t see reckless behaviour”*, the latter is less optimistic: *“There are going to be losses in PC. That just comes with the territory. [...] Covid was a mini test of private debt. I don’t think it was a full test of the cycle. I think we’re going to see very big dispersion of returns from managers when we do hit an economic cycle or a credit cycle.”*

3. WHAT IS CURRENTLY HAPPENING IN THE US

The general situation

The US private credit market has now probably entered its first real stress test after having spent the better part of a decade, and after achieving a systemic scale. Some evidence point out that this period is over, but the uncertainty attached makes every prediction hard to sustain. Estimated at between \$1.3 and \$1.6 trillion, the asset class grew by over 130% between 2017 and 2025, becoming structurally embedded in the broader financial system: to understand the scale US life insurers have allocated up to a third of their \$6 trillion in invested assets to private credit instruments, and banks have tripled their lending exposure to private equity and credit funds since 2018 to over \$300 billion. It is a recent news that President Trump and its administration, with an executive order, has opened the door to 401(k) retirement capital entering private markets.

The most visible symptom of the current stress is a severe liquidity mismatch triggered by retail and high-net-worth investors seeking exit. In Q1 2026 alone, investors attempted to withdraw over \$10 billion from major direct lending funds. Blue Owl alone faced \$5.4 billion in redemption requests – equivalent to 40.7% of its tech-lending vehicle’s total NAV – and was forced to cap withdrawals at 5%, just as many other did. For example, Morgan Stanley, Cliffwater, KKR, Ares, Apollo, BlackRock and Blackstone followed with equivalent restrictions. Across funds holding roughly \$275 billion in assets, just over half of total withdrawal requests were honoured, sometimes by taking funds directly from employees' assets. The industry, which had absorbed nearly \$200 billion in inflows over the preceding five years, is clearly living a phase of retreat.

The structural mechanism amplifying this flight is what analyst have termed the “stale pricing problem”. In fact, private credit NAVs are updated infrequently⁵ – typically quarterly – creating a first-mover advantage that is particularly destructive in periods of stress: investors who redeem early exit at valuations that have not yet absorbed macroeconomic deterioration, while those who remain bear the full weight of subsequent markdowns and forced asset sales. From a social behaviour perspective the rational individual behaviour is producing collectively irrational outcomes: what is best for the single is not necessarily best for the community.

Banks financing private credit funds have already responded by applying anticipatory haircuts to software-sector exposures, demonstrating a quiet institutional verdict on the reliability of currently reported figures. As a FT commentator pointed out, it is now clear that the market is pricing PC assets as though they are not as good as the industry claimed.

Beneath the mechanical liquidity friction lies a more fundamental problem: a broad and systematic weakening of credit standards during years of near-zero interest rates. JPMorgan CEO Dimon has warned explicitly that losses on leveraged lending will exceed expectations when the credit cycle fully turns. Among those responsible can be counted the proliferation of aggressive earnings add-backs, looser covenant packages, and growing use of Payment-in-Kind structures – where interest accrues as additional principal rather than being paid in cash. PIK now represent an average of 8% of revenue in publicly listed Business Development Companies (BDCs), effectively suppressing

⁵ And many PC funds have as main objective to try to quote NAVs more and more frequently, potentially reaching a daily update.

visible default rates while compounding future liabilities. The proportion of borrowers with interest coverage ratios below 1.5x has more than doubled since 2019. Credit hedge fund David Kampner estimates that there is currently \$768 billion of stressed debt across US leveraged loan and direct lending markets and describes a substantial portion of the PE industry as already stressed or distressed – a problem that lies today in the future timeline map.

Another lucky image coined by Jamie Dimon is the cockroach theory, which takes its inspiration from the sudden implosion of First Brands – an auto-parts supplier that had obscured \$2.3 billion in off-balance-sheet debt through private credit channels – illustrating how structural opacity can keep risk invisible until it implies. And as Dimon noted, when such a case emerges there are likely more.

Systemic vulnerability is not evenly distributed: PC is disproportionately concentrated in enterprise software companies acquired during the 2019 – 2022 buyout cycle, when zero-rate financing was abundant and recurring revenues for those companies were treated as certain. BDCs alone allocated roughly 26% of their assets to software and IT services, against just 3% in the US High Yield index. Today is crystal clear how these same companies face a potential double shock: on the one hand, floating-rate debt has eroded their equity cushions, while AI-driven improvements are actively threatening the revenue streams that justified the initial investment. A note of prudence and anti-enthusiasm is now needed: it is certainly true that AI companies are proving capable of optimizing repetitive tasks and a number of companies are undergoing a cycle of layoffs, but it is also proven that the level of AI-efficiency needed to successfully complete a “technological and social revolution” is far from being reached. Hence, we can most certainly attribute a fractional yet existent part of PC shock to a sort of emotional responsiveness to business news and improvements.

Software valuations multiples have collapsed, exits are practically foreclosed without deep discounts, and in a pessimistic scenario UBS projects PC default rates could approach 13% – well above the 8% projected for leveraged loans.

The push to extend this asset class further into retail portfolios has intensified the debate; the argument for democratisation – saying that ordinary savers deserve access to the same potential returns as institutional investors – is difficult to sustain once the current episode is closely examined. In fact, academics have noted that any performance premium in PC largely disappears as soon as leveraged and credit risk are considered, and that there is no mechanism to index private markets as there is for public ones. Unlike institutional investors, 401(k) holders cannot absorb multi-year illiquidity – and even if they could this financial instrument purpose is certainly not that – cannot negotiate fund terms and can't threaten to withdraw future commitments. Meanwhile, the regulatory infrastructure surrounding PC ratings remains fragile: the SEC has publicly questioned whether Egan-Jones – which rated over three thousand PC deals in 2025 alone – can consistently produce ratings with integrity, reopening broader concerns about rating shopping among insurers and fund managers obviously seeking inflated grades.

To conclude: the asset class was built on the comparative advantages of illiquidity, a sort of opacity, and bilateral negotiation – features that justified a premium over public markets. Under pressure from regulators, retail investors and its own mechanisms, it is now being pushed toward frequent pricing, greater transparency and greater liquidity. Can those implementations be added without

eliminating the premium that made private credit attractive? It is the central question that will define the asset class over the next several years.

Focus on specific lenders: Blue Owl Capital and Ares Management

Having outlined the structural mechanics of private credit and the pressures currently reshaping the United States market, the analysis turns to the role of specific lenders. This step is necessary because private credit is not a homogeneous asset class: its risk profile depends not only on the instrument employed, but on the identity of the lender, the architecture of its investment vehicles, the quality of its borrower base, and the nature of the underlying transactions it chooses to finance. Ares Management and Blue Owl Capital are examined here because they represent two distinct but analytically complementary models of private credit expansion. Ares illustrates the scale-based platform logic, in which competitive advantage derives from broad origination capacity, institutional relationships, and product diversification across multiple credit segments. Blue Owl, by contrast, represents a more concentrated sponsor-oriented direct lending model, whose identity is closely tied to the upper-middle-market, to private equity sponsor relationships, and to Business Development Company structures. Together, they allow the report to move from a general discussion of the asset class toward a more grounded analysis of how private credit actually operates, and where it is most vulnerable.

Blue Owl Capital

1. Company Overview and Strategic Identity

Blue Owl Capital represents a fundamentally different organizational logic from the mega-platform model of Ares or Apollo. Where those firms have constructed broad alternative asset management empires spanning credit, private equity, real estate, and infrastructure, Blue Owl has deliberately concentrated its capital formation activities around a smaller number of structurally complementary strategies. This decision has produced significant scale without sacrificing focus. As of year-end 2025, the firm reported total assets under management exceeding \$307 billion, having crossed the \$300 billion threshold in Q4 2025 and recording a full-year capital raise of \$56 billion, an 18% increase year-over-year and a new firm record.⁶ The milestone reflects both the maturation of its institutional relationships and the strong performance of its private wealth channel, which contributed \$15.4 billion in equity capital across five evergreen products during 2025.⁷

Blue Owl's organizational architecture rests on three platforms: Credit, anchored by the Owl Rock direct lending franchise; Real Assets, comprising net lease and real estate credit strategies; and GP Strategic Capital, the former Dyal Capital minority-stakes business. Of these, the Credit platform remains the primary engine of AUM and revenue growth. The firm ranked tenth in the 2025 PDI 200, having raised \$42 billion in private debt over the prior five years.⁸ This figure captures only

⁶ <https://www.blueowl.com/news/blue-owl-capital-inc-fourth-quarter-2025-results>

⁷ https://s202.q4cdn.com/477831904/files/doc_presentations/2026/Feb/25/Blue-Owl-Investor-Presentation-12-31-25vF.pdf

⁸ <https://www.privatedebtorinvestor.com/pdi-200/>

the institutional closed-end component and significantly understates the full scale of its credit deployment activity.

This organizational structure gives Blue Owl a distinct position in the private credit landscape. It is not merely a lender participating in isolated transactions; it is a large alternative asset manager whose business model directly reflects the broader structural shift from bank-based lending toward non-bank financial intermediation. Unlike smaller direct lenders focused on the lower-middle-market, and unlike broader platforms where credit is only one component of a diversified investment ecosystem, Blue Owl's strategic identity is concentrated around a narrow set of activities in which the Credit platform is both the revenue engine and the institutional reputation anchor.

2. The Owl Rock Direct Lending Franchise

The platform's origination engine operates at a significant scale. In Q4 2025 alone, the platform originated \$12 billion in new commitments, its third-largest originations quarter on record, while full-year 2025 originations totalled approximately \$45 billion.⁹ Net deployment at the platform level was \$13.5 billion over the twelve months ending Q2 2025¹⁰, reflecting the elevated turnover driven by refinancings, repayments, and sponsor-driven exits. The firm's flagship publicly traded BDC, Blue Owl Capital Corporation (OBDC), reported \$16.5 billion in portfolio investments at fair value across 234 companies as of 31 December 2025, with over 80% of debt investments in senior secured positions and 96% in floating-rate instruments.

Performance metrics compare favourably with direct lending industry benchmarks. OBDC delivered a net return of 8.7% for the full year 2025, against 5.9% for the leveraged loan index over the same period, a spread of approximately 280 basis points reflecting the illiquidity premium, structural complexity, and bilateral origination discipline that characterize the strategy. Since its inception in 2016, OBDC has generated a total net return of 13.9%, outperforming leveraged loans by 800 basis points and high-yield bonds by 750 basis points over comparable periods. Net loss rates across the platform have remained below 10 basis points since inception,¹¹ a credit quality metric management has consistently attributed to the firm's emphasis on lending to large, sponsor-backed, non-cyclical businesses with durable and predictable cash flows.

These figures matter not only for what they reveal about size, but for what they reveal about the logic of Blue Owl's business model. In private credit, origination capacity is a central competitive advantage. The strongest transactions are not simply available to all lenders in the market; they are accessed through long-term relationships with private equity sponsors, advisors, and management teams. Blue Owl's strategy is therefore not predicated solely on the availability of capital to deploy. It is built on repeat transactions with a concentrated set of high-quality sponsor counterparties, a relationship-driven model in which familiarity, speed, and demonstrated execution history constitute genuine barriers to competition.

⁹ <https://www.privatebtinvestor.com/pdi-200/>

¹⁰ <https://www.blueowcapitalcorporation.com/investors/news-events/press-releases/detail/86/blue-owl-capital-corporation-announces-september-30-2025>

¹¹ <https://www.fool.com/earnings/call-transcripts/2026/02/05/blue-owl-owl-q4-2025-earnings-call-transcript/>

3. Target Borrower Profile

Blue Owl's direct lending strategy is explicitly upper-middle-market in orientation, a deliberate positioning that places the firm at the boundary between traditional private credit and

the broadly syndicated loan market and in direct competition with that market for larger transactions. The average OBDC portfolio company generates approximately \$1 billion in annual revenue and nearly \$240 million in EBITDA,¹² reflecting the firm's preference for scale, revenue diversification, and margin resilience as primary credit selection criteria.

This focus on larger borrowers implies lower yields per transaction, a trade-off that is justified by structurally lower default rates, stronger recovery prospects, and greater secondary market liquidity, all of which reinforce the predictability of EBITDA generation that remains, for a direct lender relying on operating cash flows rather than hard collateral, the first and most important underwriting criterion. The borrower universe is dominated by sponsor-backed, non-cyclical businesses in software, healthcare services, financial services, and business services, sectors characterized by recurring revenue models, relatively stable demand, and resistance to margin compression under normal operating conditions.

The underwriting philosophy emphasizes structural protection over absolute yield maximization. Blue Owl lends consistently at the top of the capital structure, senior secured, first lien, and negotiates financial maintenance covenants on substantially all transactions. This covenant discipline stands in deliberate contrast to the covenant-lite structures that have become standard in the broadly syndicated market and are increasingly prevalent even in larger direct lending transactions. Maintenance covenants, specifically leverage and interest coverage tests, tested quarterly or semi-annually, provide the lender with early warning and intervention rights if a borrower's financial condition deteriorates, preserving the optionality to engage proactively before a situation reaches formal default. The non-accrual rate at OBDC stood at 1.1% of portfolio fair value as of 31 December 2025, down from 1.3% as of 30 September 2025, a modest and stable figure consistent with the firm's conservative credit culture.¹³

Seniority and covenants, however, do not eliminate the fundamental risk dimension of lending to asset-light businesses. In the software or healthcare services sectors, the most valuable assets are often customer contracts, intellectual property, and brand reputation, intangibles whose value in a default scenario is realized through the sale or restructuring of the enterprise rather than through the liquidation of physical collateral. Recovery rates in direct lending average approximately 33 cents on the dollar, significantly below the 52-cent average for broadly syndicated loans¹⁴, a

¹² <https://www.federalreserve.gov/econres/notes/feds-notes/private-credit-characteristics-and-risks-20240223.html>

¹³ <https://www.blueowlcapitalcorporation.com/investors/news-events/press-releases/detail/90/blue-owl-capital-corporation-announces-december-31-2025>
<https://www.blueowlcapitalcorporation.com/investors/news-events/press-releases/detail/86/blue-owl-capital-corporation-announces-september-30-2025>

¹⁴ <https://www.federalreserve.gov/econres/notes/feds-notes/private-credit-characteristics-and-risks-20240223.html>

structural asymmetry that reinforces the importance of sponsor quality, equity cushion, and active portfolio monitoring as the primary defences against downside loss.

4. The GP Strategic Capital

Blue Owl's second defining strategic asset, the GP Strategic Capital platform, formerly Dyal Capital, represents a genuinely differentiated business that few direct lending competitors have replicated at a comparable scale. Founded in 2010, the platform acquires non-controlling minority equity stakes, typically 10% to 30%¹⁵, in established alternative asset managers, receiving in exchange a proportionate share of management fee income, carried interest, and balance sheet earnings. The strategy provides investors with exposure to the structural growth of the private markets industry itself, rather than to any individual fund's performance, and generates early, contractual cash distributions backed by the durable fee economics of underlying GP businesses.

The strategic rationale for combining GP stakes with direct lending extends well beyond diversification. Blue Owl's minority stakes in alternative asset managers create preferential access to deal flow: a GP in which Blue Owl holds an equity interest has a meaningful incentive to direct financing opportunities to the Blue Owl credit platform. This flywheel dynamic, while difficult to quantify with precision, reinforces the firm's origination advantage in a market where access to the best transactions is increasingly determined by the depth and exclusivity of sponsor relationships rather than by pricing alone. In Q3 2025, the GP Strategic Capital platform expanded its mandate to include professional sports minority stakes.¹⁶ This reflects both the growing institutionalization of sports franchises as an alternative asset class and the platform's continued search for structurally differentiated return streams.

5. Competitive Positioning and Key Risks

Blue Owl's principal competitive vulnerability is inherent in its upper-middle-market focus: at larger deal sizes, the boundary between private credit and the broadly syndicated loan market becomes permeable, and the pricing premium that justifies private credit execution narrows materially. Throughout 2025, direct lenders including Blue Owl were simultaneously originating large transactions that would previously have been syndicated and defending existing portfolios against refinancing into the broadly syndicated loan market as spreads in both segments converged. This dynamic compresses yields and creates the risk of adverse selection, the most creditworthy borrowers migrate to the cheaper broadly syndicated market, leaving direct lenders with a progressively less attractive residual pool.

A further structural consideration is the firm's exposure to non-traded BDC redemption pressure. Blue Owl's private wealth channel, a major driver of 2025 fundraising, distributes products through non-traded BDC structures that include periodic tender mechanisms. Elevated redemption requests in these vehicles, driven by retail investor liquidity needs or a deterioration in market sentiment, can create deployment pressure and capital management complexity that closed-end institutional funds do not face. The underlying loans cannot be sold quickly without a material discount; any mismatch between the liquidity profile of assets and the expectations of investors

¹⁵ <https://www.blueowl.com/gp-strategic-capital>

¹⁶ <https://pitchbook.com/news/articles/blue-owl-fund-close-gp-stakes>

accessing them through tender-eligible vehicles introduces a structural fragility that, as the broader dynamics of Q1 2026 have demonstrated, is not merely theoretical. Management has calibrated leverage and liquidity to absorb expected tender activity without forced asset sales, though this has yet to be tested under sustained retail withdrawal pressure.

Software and technology-adjacent sector concentration represents a third risk vector. BDCs broadly have allocated a disproportionate share of their assets to software and IT services, approximately 26% at the industry level, against just 3% in the U.S. High Yield index, and Blue Owl's borrower base, though concentrated in larger and higher-quality companies than the typical BDC, is not immune to the repricing dynamic that AI-driven disruption is beginning to introduce into enterprise software valuations. If recurring revenue assumptions prove less durable than historical patterns suggested, or if customer retention deteriorates as AI enables

substitution, the enterprise value underpinning senior secured positions may compress more rapidly than internal valuation models reflect.

Ares Management: Scale and Origination in Private Credit

Having examined Blue Owl, it is now time to turn to its principal rival in terms of scale and influence in the American private credit market: Ares Management, founded in LA in 1997. Where Blue Owl embodies the logic of focus, a limited number of strategies, executed with precision, Ares represents the opposite end of the spectrum: a platform built on breadth, on the capacity to operate across the full credit cycle and in virtually every segment of the market. The two models are not contradictory; they are, simply, different bets on how to build a durable competitive advantage in an industry that is still young and evolving rapidly.

1. Business Model and Origination Strategy

The organizing principle of Ares's private credit business is straightforward: to be the lead lender in every transaction. That positioning is not merely symbolic. Being the lead lender means controlling the terms of the agreement, the capital structure, the documentation, the protective covenants, and the pricing. It means not depending on a consortium of other creditors to close a deal. And it means being perceived by private equity sponsors as a trusted partner rather than one of many participants in an auction.

To sustain that position, Ares has built an origination infrastructure that few competitors can replicate: more than 200 credit professionals in the United States, active coverage of over 650 sponsor relationships, and a multi-channel approach that encompasses sponsor-backed transactions, direct contact with company management teams, advisor relationships, and co-investment structures. In a market where the best deals are not advertised but distributed through established relationship networks, that infrastructure is a genuine competitive asset (not easily replicated by those who enter the market with less history and less relational capital).

One further note on the funding model: Ares is following the same path as Apollo (with Athene) and KKR (with Global Atlantic), building or acquiring partnerships with insurance vehicles, in this case, Aspidia. The objective is to access patient, long-duration capital that is structurally aligned with the illiquid profile of private credit, reducing dependence on institutional fundraising cycles.

It is a quiet but meaningful shift in how the large alternative platforms think about their own capital base.

2. Investment Strategy and Portfolio Composition

The core of Ares's business is direct lending: it is senior secured, floating-rate loans to mid-market companies, with EBITDA ranging from a few tens of millions of dollars to well above \$500 million. That breadth of coverage is unusual: most direct lenders position themselves within a specific segment and stay there. Ares covers the full spectrum, and that coverage allows the firm to follow companies over time, as they grow and their financing needs evolve.

A growing share of the portfolio consists of unitranche structures such as loans that combine senior and subordinated debt into a single contract at a blended rate. The logic is attractive for both sides: the borrower simplifies its capital structure and avoids intercreditor complexity; the lender gains a single point of control over the entire debt stack. In the mid-market LBO market of 2025, the unitranche has become the dominant format precisely because it allows fast execution and certainty of closing.

Beyond direct lending, Ares operates in asset-backed finance with loans secured against real assets such as real estate, infrastructure and trade receivables. This is great chance because this segment is gaining strategic importance as banks cede portions of their balance sheets to meet the capital requirements of Basel III and IV. The European platform, with approximately \$84.7 billion in AUM, adds a significant cross-border dimension and allows Ares to benefit from the same structural dynamic unfolding on the other side of the Atlantic.

3. The ARCC Franchise: Transparency as Competitive Advantage

One of Ares's most distinctive assets is **Ares Capital Corporation (ARCC)**, the largest publicly listed Business Development Company in the United States. ARCC is, in essence, a public window onto the Ares portfolio: quarter after quarter, the company publishes earnings calls, SEC filings, and detailed data on credit quality. In an industry historically defined by opacity, that level of transparency is rare and carries real institutional value.

According to the sources, ARCC has historically recorded net realized losses of less than 1 basis point per year in U.S. direct lending: this is a figure lower than the average annual losses in public credit markets over the same period. That is not a coincidence: it is the product of a disciplined approach to underwriting and a culture that prefers to work alongside the borrower to resolve a problem rather than selling the position at the worst possible moment. As of the first trimester of 2026, ARCC held approximately \$6 billion in available liquidity, a concrete advantage during periods of market volatility; this gave the ability to keep doing deals when everyone else has stopped.

4. Ares' Strength

Ares's competitive advantages are not the result of a single fortunate decision: they are the cumulative product of nearly thirty years of patient construction. Three elements deserve particular attention.

Scale and dry powder: by mid-2025, Ares held the largest amount of dry powder among global private credit managers. In a market where windows of access to public capital markets close quickly

and without warning, the ability to write large cheques immediately is an advantage that is difficult to overstate.

Origination depth: in private credit, the best transactions are not offered to everyone: they arrive through relationships. The network of over 650 active sponsors and more than 200 credit professionals in the United States represents a real barrier to entry, not a theoretical one. The more quality deal flow a lender receives, the sharper its underwriting capabilities become; and the better its underwriting, the more quality deal flow it attracts. It is a virtuous circle that is hard to break from the outside.

Portfolio diversification: unlike lenders concentrated in a single geographic or sector segment, Ares has built a platform that can absorb stress in one part of the portfolio without the entire structure faltering. If U.S. direct lending comes under pressure from rising defaults in the software sector, the European business, asset-backed finance, or liquid credit strategies can partially offset the drag. That diversification is not merely a risk management feature — it is also a revenue stabilizer.

5. Risks and Structural Vulnerabilities

Scale and diversification protect Ares from many risks, but not from all of them. Three deserve attention.

Spread compression: in 2025, average spreads on LBO transactions fell consistently below 550 basis points - well below the peaks of 2022–2023. The cause is structural: too much capital chasing too few quality deals. When lenders compete aggressively for the same transaction, the first thing to give is the price, then the contractual protections. Ares has responded by shifting its focus toward less crowded segments of the market but spread compression at the core of direct lending remains a drag on returns.

Software sector exposure and AI risk: as of the first trimester of 2026, Ares disclosed that approximately \$1 billion in software company investments had been classified as at medium risk of AI disruption: a small number relative to total portfolio size, but not an immaterial one. Some specific positions showed significant mark-downs relative to acquisition cost, a sign that pressure on software valuations is not merely theoretical. The third-party review commissioned for the 2026 earnings concluded that the majority of the software book is at low AI risk.

6. Overall Assessment

Ares is, likely, the most complete example of success in American private credit: a platform built on scale, relationships, and underwriting discipline, capable of executing transactions when others cannot, and of managing risk better than the market average. ARCC, with its public transparency and a twenty-year track record, is a genuinely unique asset in the alternative credit landscape.

And yet, like every structure of this size, Ares carries within it the tensions of the industry it helped build because of the pressure on spreads, the accumulation of dry powder, exposure to sectors being tested by AI disruption and elevated rates. The question is whether the discipline that justified the illiquidity premium can survive growth, competitive pressure and a credit cycle that may prove to be something more than a mini-test.

4. CONCLUSION and ANALYTICAL ASSESSMENTS

Private credit is no longer an alternative. It is, by most measures, a permanent feature of the actual financial landscape that has quietly displaced banks as the primary source of capital for mid-market companies across the United States and, increasingly, Europe.

For borrowers, private credit offers something that public markets cannot like speed, flexibility and a lender willing to understand the business rather than simply price the risk. For investors, it offers yield, predictability and a degree of structural protection that syndicated markets have gradually eroded. That is a genuine value proposition, not a financial illusion.

However, the risks are equally significant. Interest coverage ratios have declined materially, spreads have compressed and abundant dry powder may gradually weaken underwriting discipline. Concentration in asset-light sectors such as software, healthcare and financial services also means that, in a stress scenario, the collateral supporting these loans may be considerably harder to monetize than traditional lending models assume. At the same time, redemption pressure, infrequent valuations and the mismatch between illiquid assets and investor expectations have exposed important weaknesses in some private credit vehicles.

The comparison between the United States and Europe further shows that private credit does not face identical conditions across markets. The United States currently displays greater signs of stress, including higher defaults, redemption pressure and concerns surrounding credit quality, while the European market appears comparatively more resilient. Nevertheless, Europe remains fragmented across national jurisdictions and exposed to its own regulatory, geopolitical and sector-specific risks.

Private credit has faced important shocks, but it has not yet passed a prolonged, system-wide credit-cycle test. When that test arrives, the strongest firms will not necessarily be those that deployed the most capital, but those that preserved underwriting discipline, maintained appropriate liquidity structures and accurately assessed risk before committing funds. Private credit may continue to expand, but its long-term legitimacy will depend on whether growth can be reconciled with transparency, investor protection and responsible lending.

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