



Credit market dynamics to watch

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Private credit’s software exposure faces AI disruption risk. Defaults are possible, but public high yield bonds potentially offer safer positioning.

Key Takeaways:

- **Concentrated exposure meets constrained capital:** Private credit’s ~20% allocation to software – underwritten on forward-looking revenue assumptions rather than cash flow – faces a dangerous collision with technical market constraints.
- **2028 maturity wall threatens differentiated outcomes:** Approximately one-third of software names across private debt and leveraged loans could face restructuring over the next three years. This may create stark performance dispersion between companies with proprietary data advantages and vulnerable niche providers.
- **Quality and liquidity trump yield:** High yield bonds may offer safer risk-adjusted positioning versus private debt and leveraged loans, providing broader investor access, greater transparency, and lower CCC exposure, while the February selloff created selective opportunities for investors.

The concentration of software assets in private credit markets is raising important questions about default risk, market spillover effects, and where institutional investors should position themselves in the face of AI-driven disruption.

The private credit market’s approximately 20% exposure to technology and software companies has become a focal point for institutional investors navigating an era of rapid artificial intelligence advancement. This concentration, combined with the unique structural characteristics of private debt markets and an approaching maturity wall in 2028, creates a complex risk landscape that demands careful analysis and strategic positioning.

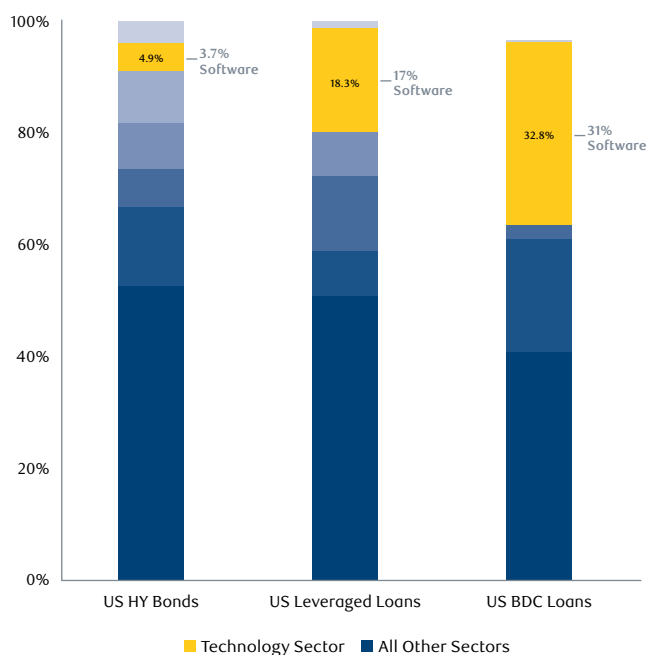
Understanding the Concentration

The substantial allocation to software within private credit portfolios is no accident. Private equity firms have historically favored software acquisitions due to their asset-like characteristics, attractive growth trajectories, and robust free cash flow projections. Unlike traditional lending based on last twelve months EBITDA or cash flow, much of this software exposure has been underwritten on annual recurring revenue expectations – a forward-looking metric that assumes continued growth and customer retention.

This underwriting approach reflects the reality that many software businesses in private credit would struggle to access traditional financing channels. These companies are typically unrated, highly levered, and require the confidentiality that private debt structures provide. By design, private debt operates as an opaque, club-like market with limited participants – a feature that serves borrowers well during good times but creates acute challenges when circumstances deteriorate.

The leveraged loan market tells a similar story, with approximately 18% exposure to software and technology, while US BDC loans average over 30% exposure. However, the US high yield bond market presents a stark contrast, with only 5% allocated to the sector. This differential exposure across credit markets will prove crucial as the industry faces potential disruption.

Technology exposure across leveraged finance sectors



Source: ICE BofA, Bloomberg, as of February 28, 2026. Note: US High Yield Index refers to the ICE BofA US High Yield Index and Leveraged Loans refers to the Bloomberg US Leveraged Loan Index. BDC loans refer to subset of loans with instrument source = BDC in Bloomberg, USD only.

The Default Question

The question on every investor's mind is whether this software concentration translates into a wave of defaults. While predicting individual company failures remains impossible without granular due diligence, market dynamics suggest that approximately one-third of software names in both private debt and broadly syndicated loans could face restructuring, distressed exchanges, or bankruptcy filings over the next three years.

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Critically, this risk does not appear adequately reflected in current spreads – particularly within private credit. While new private debt deals have widened by roughly 100 basis points, existing portfolio marks have yet to adjust materially. The opacity that characterizes private debt makes true price discovery difficult until forced selling begins.

The timeline for this stress is important. The real pressure point arrives in 2028, when a significant maturity wall hits the market. In 2027, companies with access to capital markets will begin proactive refinancing efforts to extend their runway. Those unable to secure refinancing will face difficult choices as their 2028 maturities approach.

Technical Market Dynamics

Beyond fundamental credit concerns, technical factors will significantly influence how this plays out. The collateralized loan obligation (CLO) market, which provides the primary bid for leveraged loans, faces mounting constraints. CLO vehicles are approaching maximum allocations in two critical areas: software exposure and lower-rated B3 credits. Additionally, many CLOs are nearing their limits on CCC-rated holdings, which restricts their ability to absorb downgrades and stops cash flow distributions to equity investors.

This creates a problematic dynamic. As software companies face performance challenges and rating downgrades, the natural buyers for their debt are simultaneously reaching capacity constraints. The result is a narrowing funnel of available capital precisely when these borrowers most need liquidity.

Private debt faces an even more acute version of this challenge. The limited investor base that can access and analyze private debt deals – a structural feature designed to maintain confidentiality – becomes a liability during periods of stress. When funds face redemption requests and need to sell assets, the pool of potential buyers shrinks dramatically. Unlike broadly syndicated markets, where hundreds of investment funds might consider an opportunity, private debt deals may have only a handful of qualified buyers.

Systemic Risk Assessment

Despite these challenges, the situation does not appear to pose systemic risk to the financial system. Today's regulatory environment has successfully kept these concentrated exposures out of regional bank balance sheets – a crucial difference from pre-2008 dynamics. Insurance companies and pension funds maintain diversified portfolios, and the gate mechanisms at private debt funds are functioning as designed, protecting institutional investors from forced liquidations.

The market is fundamentally safer than it was during the global financial crisis. However, “not systemic” does not mean “without consequences.” Specific sectors and individual issuers will trade down materially from current levels. Investors who fail to differentiate between winners and losers within the software sector will likely face significant performance headwinds.

Identifying Winners and Losers

Not all software exposure is created equal. Companies positioned closest to proprietary data – whether client data, compliance information, or banking software – face lower disruption risk. These businesses will more likely use AI to enhance their offerings rather than face wholesale replacement.

Similarly, software companies integrated into hardware solutions, serving cybersecurity needs, or providing services to investment-grade customers demonstrate more durable business models. Public companies with existing bond and equity market access benefit from multiple funding sources and broader investor bases, creating better options during times of stress.

Conversely, niche enterprise software providers, particularly those serving narrow end markets at high leverage multiples (10-12x), face significant vulnerability. Call center solutions and other easily replicable offerings could see their competitive positions erode rapidly. Private companies with single tranche senior secured structures and limited financial transparency will struggle to find refinancing options as their maturities approach.

Strategic Positioning

For institutional investors, this environment demands an “up in quality” approach across credit markets. The high yield bond market offers compelling relative value compared to both broadly syndicated loans and private debt. With lower CCC exposure, higher concentrations of double-B credits, greater transparency through public markets, and access to a broader investor base (300-500 potential funds versus a handful for private debt), high yield may provide better risk-adjusted returns.

Within software specifically, February's market selloff created attractive entry points for selective investors. Not every software company faces existential AI risk, and indiscriminate selling has created opportunities for those able to differentiate credit quality.

The coming 24 months will likely see performing software credits refinance leveraged loans into bond form, exiting the constrained CLO bid. This refinancing wave will create additional opportunities for active high yield managers while further pressuring the distressed segment of the loan market.

Conclusion

Private credit's software concentration, combined with technical market constraints and an approaching maturity wall, will create significant dispersion in credit performance over the next three years. While not systemically threatening, this environment will likely reward active management, careful credit selection, and strategic positioning toward higher-quality, more liquid market segments. For distressed debt specialists with patient capital, the dislocations ahead may indeed prove opportunistic. For traditional institutional investors, however, the path forward emphasizes transparency, liquidity, and quality overreaching for yield in increasingly constrained private markets.

The winners may well include those who recognize that in a market facing structural challenges, not participating in every opportunity is itself a crucial investment decision.

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