

The Fallacy of Liquid Private Credit

Executive Summary

- Private credit is dominating headlines, with continued stories of redemption limits and valuations falling, prompting questions as to whether this asset class is headed for a systemic collapse.
- Private credit headlines today reflect liquidity stress and investor expectations more than a systemic collapse in credit quality. It remains unclear how much distress will emanate in private credit.
- Many investors treated semi-liquid private credit vehicles as liquid fixed-income substitutes despite the underlying assets being intrinsically illiquid.
- Redemption gates and withdrawal limits are often functioning as intended by preventing forced selling of underlying assets and protecting remaining investors.
- Private credit can be attractive when underwriting, manager selection, and vehicle structure are disciplined. In fact, it may become more attractive in the near term for investors in new loans if stress continues.
- Private credit should be viewed as having different risk-return characteristics than traditional private equity, as return potential may be more limited by contractual cash flows while maintaining illiquidity. It is also distinct from traditional fixed income investments, which generally offer greater liquidity.

Parsing Through the Noise of the Private Credit Headlines

The recent headlines around private credit, redemption limits / gating, valuation questions, Business Development Corporations (“BDC”) pricing volatility, and regulatory scrutiny have led many investors to ask whether private credit is entering a crisis. We do not believe the current environment represents a systemic collapse of the asset class. Instead, we believe the market is rediscovering something that was always true: private credit is fundamentally illiquid.

Much of the current stress appears less about widespread loan impairment and more about a mismatch between investor expectations and the underlying liquidity of the assets. In many

cases, investors appear to have treated semi-liquid private credit vehicles as though they were liquid fixed income substitutes. That assumption was always likely to be tested during a period of market stress or elevated redemption activity.

The core issue is not necessarily whether private credit is “good” or “bad.” The more important question is whether investors properly understood the bargain they were making.

To be sure, there are certainly examples of distressed loans. There are a lot of loans in credit markets which need to be refinanced, and rising rates naturally hurt companies which borrowed on a “floating rate” basis. But those dynamics are frequently present. What’s different this time is the fact that investors believed they could sell when the credit cycle turned because private credit was purportedly “semi-liquid.”

The Rise of Private Credit

Private credit has moved from a niche allocation to a major part of the lending ecosystem. Investors flocked to the asset class in the past five years believing they could attain double digit returns, beating public credit or fixed income, with shorter duration than private equity and the ability to get out when they wanted. With the base rate increases of 2022, the asset class returns started to pique more investor interest. As the number of “semi-liquid” funds massively increased, retail capital flowed into the space. It was the Goldilocks of investments. Or was it?

The Fallacy of Liquid Private Credit

As the credit market started to wobble, investors started to put in redemptions for their “liquid” private credit only to discover their redemption being limited or gated. How did that happen?

Private loans are not publicly traded securities. They are privately negotiated agreements that are often intended to be held to maturity. Secondary markets exist, but they are substantially thinner than public bond markets and can become especially constrained during periods of stress.

However, certain private credit vehicles, particularly those distributed through wealth-management channels, offer periodic liquidity through quarterly redemption programs or interval structures. Those redemption features often work smoothly during stable periods when redemption requests are modest and inflows continue.

The problem emerges when many investors seek liquidity simultaneously. At that point, funds have only a limited set of options:

- Borrow against the portfolio
- Reduce new lending
- Sell loans into a weak market
- Limit withdrawals

As a result, many vehicles include quarterly redemption caps, frequently around 5% of assets. Recent headlines have portrayed these limits as signs of distress. In reality, they are often functioning exactly as designed: preventing forced selling and protecting remaining investors. In our view, those caps generally make sense. They protect against a total mismatch between the vehicle and the underlying assets. Without them, managers could be forced to sell loans at unfavorable prices, harming long-term investors.

Without such limits, “run-on-the-bank” behavior can emerge, not necessarily because the underlying loans are collapsing, but because investor expectations and vehicle structures have become misaligned.

1. Investors request liquidity
2. Funds sell assets to meet redemptions
3. Asset sales pressure marks and transaction prices
4. Remaining assets are marked to the then-lower-prevailing market pricing
5. Lower valuations trigger more redemption requests
6. Managers become defensive precisely when opportunities may be improving

Notably, even the partial forced-selling noted above may be an opportunity for those with capital. A private credit fund facing heavy redemptions may need to keep more cash on hand rather than making new loans. That can prevent the manager from taking advantage of better spreads or stronger lender terms during market dislocation. A liquidity-constrained fund may be forced to play defense just when the best opportunities require offense. Those with permanent capital or offering access to private credit via typical drawdown private structures may be advantaged in this environment.

Recent headlines have included multiple well-known private credit managers with redemption requests upwards of 10-20%, with the outlier of 40% for Blue Owl’s Technology Finance Fund in Q1, far above the 5% threshold.¹ Many of these managers have enacted the 5% gate. It will be interesting to see if this potential shrinking demand for making loans, coupled with some poorly underwritten loans and a wall of maturity hitting in 2027/2028, leads to broader credit market distress.

A Re-evaluation of the Place for Private Credit

Recent market developments may prompt investors to re-examine the role of private credit

within their portfolios. As liquidity constraints have become more visible, investors may revisit the trade-offs among income generation, return potential, diversification benefits, and liquidity needs when evaluating where to allocate their illiquid capital.

Private credit can produce attractive income and may offer diversification, lower volatility, and better contractual protections than equity. But it is still credit. Upside is usually capped at interest and principal repayment. The lender does not generally participate in open-ended enterprise value creation in the same way an equity owner does. As a result, the risk-return profile of private credit differs from that of traditional private equity. It is also distinct from traditional fixed income investments, which generally offer greater liquidity.

With this rediscovered lesson that private credit is not liquid, we anticipate investors may re-evaluate the risk-return trade-off of private credit and the place it has in their portfolios.

Conclusion

The lesson from the current private credit debate is not that the asset class necessarily should be avoided. The lesson is that private credit must be underwritten carefully at three levels: the loan, the manager, and the vehicle. The vehicle level is most relevant today, as many of these “liquid” private credit structures are liquid until they are not. Unfortunately, semi-liquid usually means “liquid until you want or need liquidity”.

Private credit can be a useful allocation. But it is not a substitute for liquid fixed income, and it is not private equity with better liquidity. It is an illiquid credit strategy whose success depends on underwriting discipline, structure, valuation integrity, and thoughtful liquidity design. The next phase of the market will likely separate managers who earned the illiquidity premium from those who merely sold the prospect of this premium. We also believe that many investors will return to traditional private equity exposure for their illiquid allocation now that the market has come to agree broadly that semi-liquid means illiquid. Some investors appeared to believe they could earn nearly private-equity-like returns while receiving liquidity terms far superior to a traditional private equity fund. In many cases, both expectations were too optimistic.

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Footnotes

1. 40.7% in Q1 2026 for Blue Owl Technology Finance and 21.9% for Blue Owl Credit Income Corp <https://www.fundfire.com/c/5131154/723134>; 17% for Cliffwater’s flagship vehicle <https://www.fundfire.com/c/5176504/735654>; 15.7% for Carlyle Tactical Private Credit Fund <https://www.fundfire.com/c/5135154/727284>; 10% for Blackstone BCRED <https://www.fundfire.com/c/5178004/736884>.

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