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Private Credit in 2026: Why Selectivity, Not Scale, Will Define the Next Chapter

After a year of heightened scrutiny, PennantPark Founder and Managing Partner Art Penn explains what the headlines reveal about private credit, why underwriting discipline matters, and where he sees opportunities heading into 2027.

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- **Not All Private Credit Is Created Equal: Differences in borrowers, market segments, and loan structures can meaningfully impact risk, making manager selection increasingly important.**
- **Underwriting Discipline Matters: Conservative leverage, financial covenants, and lender protections can help managers identify and address potential credit issues before they escalate.**
- **Selectivity Creates Opportunity: As investors reassess private credit allocations, Penn sees opportunities in the core middle market, government services, and CLO BB-rated debt heading into 2027.**

Private credit has experienced remarkable growth over the past two decades, evolving from a relatively specialized institutional strategy into a major component of investor portfolios. But 2026 has brought heightened scrutiny of the asset class, with headlines focused on high-profile defaults, artificial intelligence, portfolio valuations, and investor liquidity.

For Art Penn, Founder and Managing Partner of PennantPark, the events of 2026 reinforce a fundamental principle of credit investing: Understanding what you own and how it is underwritten matters more than ever.

In a recent fireside chat with Scott McCabe, Head of Private Wealth Solutions at PennantPark, Penn reflected on the industry's evolution, the lessons of 2026, and the opportunities and risks he sees ahead. Watch the Full Discussion Now

Private Credit is Not One Market

One of Penn's central observations is that private credit has become too diverse to be evaluated as a single asset class.

Much like public equities encompass different market capitalizations, geographies, and investment styles, private credit includes direct lending, asset-based finance, real estate debt, infrastructure lending, and other strategies. Even within direct lending, meaningful differences exist between upper middle market lending and the core middle market.

"The headlines all say private credit, but the stories underneath them are, in fact, very different," Penn observed.

That distinction became particularly important in 2026 as concerns surrounding individual borrowers and certain investment structures contributed to broader questions about private credit.

Penn believes much of the pressure has been concentrated in the upper end of the direct lending market, where significant capital inflows have intensified competition for large transactions. In his view, that competition has contributed to higher borrower leverage, tighter credit spreads, and weaker lender protections in certain segments.

Rather than interpreting every negative headline as evidence of systemic deterioration, Penn encourages investors to examine the specific borrowers, loan structures, and investment managers involved.

When Underwriting Discipline Becomes the Differentiator

The collapse of auto parts supplier First Brands illustrates the importance of that distinction.

The company's complex financing arrangements, substantial liabilities, and allegations of fraud raised questions about financial transparency and lender oversight. For Penn, the situation underscores the risks that can emerge when borrowers operate with limited reporting requirements and lenders lack meaningful contractual protections.

At PennantPark, underwriting discipline begins with a focus on capital preservation. The firm emphasizes conservative borrower leverage, substantial equity beneath its loans, ongoing financial reporting, and protective covenants.

Covenants serve as early-warning mechanisms, giving lenders an opportunity to engage with borrowers when financial performance deteriorates rather than waiting until liquidity becomes critical.

Equally important is the lender's role in the transaction. PennantPark seeks to originate and negotiate loans directly, often working with a small group of lenders. This can provide greater access to information and more influence over potential solutions when borrowers encounter difficulties.

These protections cannot eliminate credit losses, but Penn believes they can improve a lender's ability to identify and address problems before they escalate.

AI and Software: A Test of Credit Fundamentals

Artificial intelligence has introduced another layer of uncertainty, particularly for private credit managers with significant software exposure.

Penn expects AI to transform the software industry, but believes the effects will be uneven. Companies with undifferentiated products or highly leveraged balance sheets may face greater challenges, while mission-critical software providers serving regulated industries may be better positioned.

PennantPark's limited software exposure reflects a longstanding preference for cash-flow-based underwriting over lending primarily against recurring revenue metrics.
The firm has remained selective, favoring software businesses with established customer relationships, meaningful switching costs, and durable cash generation.

For Penn, the lesson extends beyond technology: lenders must understand not only a company's current financial performance, but also the durability of its business model under changing conditions.

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The Hidden Concentration Risk in Private Credit

Another important lesson from 2026 concerns diversification.

As a disproportionate share of private credit capital has flowed to a relatively small group of large managers, many have increasingly competed for the same upper middle market borrowers.
Consequently, investors allocating across several large private credit funds may unknowingly own overlapping loans, similar sector exposures, and comparable lending structures.

"Real diversification means different segments, different sourcing, different structures," Penn explained.

He encourages advisors to look beyond the number of managers in a portfolio and examine underlying holdings, borrower overlap, leverage, paid-in-kind interest exposure, and origination strategies.

PennantPark's focus on companies generating $10 million to $50 million in EBITDA provides access to a different borrower universe than that typically targeted by the largest direct lending platforms.

Penn believes this segment remains attractive because fewer competing lenders can create opportunities to negotiate credit spreads, leverage levels, and covenant protections.

Transparency Matters as Much as Structure

The year's valuation and redemption headlines also reinforced the importance of understanding how private credit investment vehicles operate.

Private loans are inherently less liquid than publicly traded securities, and periodic repurchase provisions should not be confused with guaranteed liquidity.

Penn also emphasized the importance of independent portfolio valuations. PennantPark engages third-party valuation firms to evaluate its investments each quarter, with additional review by independent auditors and board-level oversight.

For advisors, understanding valuation practices, distribution coverage, and redemption limitations should be essential components of manager due diligence.

Looking Ahead to 2027: Opportunity Through Specialization

Despite the year's challenges, Penn remains constructive on the opportunities available to disciplined credit managers.

He is watching two developments: whether capital flows return to private credit more broadly and whether investors increasingly diversify toward specialized managers and differentiated strategies.

Within PennantPark, two areas stand out.

Government services and technology represents a longstanding area of expertise. PennantPark has deployed more than $3 billion across 66 transactions in the sector, where government spending priorities, mission-critical services, and specialized technical capabilities can support durable borrower demand. Penn sees continued opportunities associated with defense and technology investment, while recognizing the importance of evaluating individual contracts and cash flows.

CLO BB-rated debt represents another area of interest. These floating-rate securities offer exposure to diversified portfolios of corporate loans, with structural protections that distinguish them from CLO equity. PennantPark's ability to evaluate both broadly syndicated and middle market CLOs provides flexibility in identifying opportunities across the market.

Nevertheless, Penn remains attentive to recession risk and the potential impact of higher interest rates on borrowers. While floating-rate loans can generate additional interest income as rates rise, higher borrowing costs can also pressure companies' ability to service debt.

That balance makes conservative underwriting and interest coverage particularly important.

The Lesson for 2027: Know What You Own

Nearly two decades after founding PennantPark, Penn believes the principles of successful credit investing remain unchanged.

The firm was built around disciplined underwriting, long-term relationships, and a culture that prioritizes investors over growth for its own sake.

The events of 2026 have reinforced the importance of those principles.

For advisors evaluating private credit allocations, Penn recommends asking tougher questions: How are loans originated? What protections exist if a borrower struggles? How are distributions funded? Who values the portfolio? And how does the fund's liquidity actually work?

His conclusion is straightforward:

"In the end, selectivity, not scale, is what pays off."

As private credit enters its next chapter, Penn believes the distinction between managers will increasingly depend not simply on how much capital they manage, but on the quality of the loans they originate, the protections they negotiate, and their ability to navigate challenging conditions.

For investors, understanding those differences may be one of the most important lessons to carry from 2026 into 2027.

Watch the Full Discussion

Hear more from Art Penn and Scott McCabe as they discuss the evolving private credit landscape, the importance of disciplined underwriting, and what investors should be watching heading into 2027.

- **Access the Recording**

If you have questions or want to discuss how private credit can fit into your portfolio allocations, we welcome a conversation. Please contact invest@pennantpark.com or the professionals listed below.

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About PennantPark:

PennantPark was founded in 2007 as an independent middle market credit platform. The firm was founded by Art Penn, a private credit industry veteran that previously co-founded Apollo Investment Management. We have invested over $28 billion across multiple economic and credit cycles since inception, and we manage $11 billion in AUM today[1]. PennantPark serves a broad range of sophisticated investors with product offerings that include business development companies, private capital funds, joint ventures, and other specialized funds.

Our highly experienced team primarily invests in the core middle market, targeting companies with earnings of $10 million to $50 million. These mid-sized companies are often overlooked by banks and large investment managers, resulting in senior secured loans that generally feature higher yields, lower leverage, and stronger lender protections when compared to the upper middle market and broadly syndicated loans. We focus on five key industry verticals where we have the most expertise and experience. These industries include healthcare, government services, business services, consumer, and technology.

[1] Assets under management ("AUM") is defined as the sum of gross asset values, unfunded commitments, joint ventures and undrawn available leverage for active funds as of 6/30/2026. Invested capital represents the cumulative sum of capital invested across the PennantPark platform since inception through 6/30/2026. Figures are rounded to the nearest billion.

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