

Public Credit Resilience, Private Debt Challenges

Hani Redha, CAIA, Global Multi-Asset Portfolio Manager

Credit markets are at a crossroads. Credit fundamentals have been gradually deteriorating under the strain of interest rates, which are still elevated by historical standards. Yet with expectations growing that a cutting cycle could begin as soon as this month, some relief is likely on the way. So far, the backdrop has been benign: Defaults remain low, spreads are contained, and fundamentals are broadly supportive of *current* valuations. The key question is whether we are past the danger zone as monetary policy begins to ease, or whether hidden risks are quietly building that could push defaults higher. Beneath the surface, a divergence is becoming clear.

Public credit fundamentals have undergone many structural changes over recent years. Investment grade (IG) issuers entered this cycle with unusually high cash and liquidity balances. As a result, despite higher policy rates, net interest expense initially *declined* as IG companies benefited from higher yields earned on large cash balances and from termed-out fixed-rate debt. Interest coverage remains strong, but that cushioning effect will now fade. As the Fed cuts rates, these firms will enjoy less interest income on their cash while also refinancing existing low-cost debt into marginally higher all-in yields. On balance, credit fundamentals will continue to modestly deteriorate, but we do not expect any macro risks to emanate from this part of the market.

Unlike all other parts of the credit markets, high yield (HY) has undergone a structural upgrade relative to previous cycles, with higher-quality issuers making up more of the market. Driving this shift are the rise of private debt, which has shifted the weakest borrowers out of HY and into less regulated private markets, and fallen angels from the investment-grade universe, which have lifted overall quality. As a result, HY now has the highest credit quality in its history, with the majority of constituents now at the BB rating level, while the riskiest segment (CCC), which historically drives defaults, has shrunk by roughly 30%-40% over the past 15 years. Here, too, we see limited scope for a large default spike.

Leveraged loans have seen the opposite dynamic to HY, with the average rating grinding down from BB to single-B. Although loans have weakened somewhat due to looser covenants, coverage ratios have improved from their recent trough, and further rate cuts should continue to ease the burden given the floating-rate nature of the asset class. Overall, both the HY and leveraged loan markets remain relatively strong, and defaults are expected to stay contained absent any exogenous events. Confirming this overall market outlook, our network of analysts see only idiosyncratic situations (mainly in the leveraged loan market) that could result in defaults.

The private market tells a different story. Over the last decade, enormous amounts of capital have flowed into private credit, which sponsors have struggled to deploy. This has led to a buildup of more than \$400 billion in dry powder as of August 2025 (according to Preqin). The excess demand relative to the opportunity set available has led to underpricing of risk and heavy use of payment-in-kind (PIK)¹ features. The greatest stress is concentrated at the upper end of the market, where platforms have exhausted institutional demand and are now looking to tap retail channels to sustain growth. The 2021–2022 vintages are the most problematic; struck in an era of inflated valuations, low base rates, and aggressive leverage, many of these companies failed to deliver the

¹ Loan features that allow borrowers to pay interest with additional debt or equity rather than cash. While it provides short-term cash flow relief, it increases leverage and can weaken recovery prospects if the company fails to improve performance.

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About This Report

PineBridge believes that not only do differences of opinion make markets, but they also foreshadow substantial moves ahead as these differences are resolved. Once a month, investment leaders from our global multi-asset, equities, and fixed income teams meet to share their diverse viewpoints. This report reflects those discussions and debates by providing insight on the topic of the month along with snapshots of our asset class views and convictions across the firm.

adjustments assumed at underwriting. With maturity walls building between 2025 and 2027, managers will face growing pressure from limited partners and stakeholders to resolve positions they can no longer defer. As a result, defaults are expected to rise in this cohort in 2026 and beyond, albeit from low levels.

In principle, monetary easing should offset this stress, but will it be too little too late? While the worst of the pressure may be behind us and monetary easing could provide some relief, rate cuts alone will not resolve the deeper structural issues confronting stressed private credit positions, as these companies face outsized obligations and diminished recovery potential. It is important to note, however, that with sufficient dry powder in the system, the asset class has the potential to absorb these stresses without broader spillover. Committed undeployed capital may step in, leading to losses for the prior lenders, yet without broader macro implications, such as a spike in layoffs.

From a macro perspective, it's the labor market that investors are nervous about. Job growth has ground to stall speed. We have a labor market that is seeing virtually no hiring, firing, or quitting – an unusual and precarious equilibrium. The public credit markets are not expected to see a significant rise in defaults and are therefore fairly benign with regard to their labor market implications. However, private credit stress could finally be resolved through higher defaults in 2026. Many of the portfolio companies in question are mid-sized firms with substantial employee bases, and we therefore remain watchful for any signs that firing decisions are taking hold. While this is not our base-case expectation, it represents one of the potential channels through which private credit excesses could spill into the broader economy. Watch this space.

Conviction Score (CS) and Investment Views

The Conviction Scores shown below reflect the investment team's views on how portfolios should be positioned for the next six to nine months. 1=bullish, 5=bearish, and the change from the prior month is indicated in parentheses.

Global Macro

Sam McDonald

Sovereign Analyst, Global
Emerging Markets Fixed Income

CS 3.25 (unchanged)

Following the July employment report and the sharp downward revisions to May and June jobs numbers, the US economy appears less robust than previously thought. While the jobs data do not signal an imminent recession, and risks related to labor markets and inflation seem about equal, the Fed is likely to be more attuned to growth risks than it has been recently.

Revisions to payrolls were -258,000 in total, with about half coming from private sector payrolls. The unemployment rate increased to 4.2%, while July payrolls were up by just 73,000, with education and health services adding 79,000. The modest private payroll growth points to weaker labor demand and a US economy that is in more of a stall speed.

Despite weaker-than-expected non-farm payroll data, weekly claims have still been relatively muted, JOLTS and Indeed new job postings have been stable, and July retail sales were robust, with widespread strength within the control group. Consumer sentiment indicators have picked up from their lows and paint a more optimistic outlook going forward. Third-quarter GDP growth looks to be tracking a bit stronger, closer to 1.5%, on the back of the uptick in consumption.

The tariff pass-through to goods prices was relatively benign in the July inflation data, but other business surveys are painting a less positive view of pricing increases. The Producer Price Index (PPI) and import price data indicate growing pressure, while services inflation has started rising despite the ongoing cooling in shelter; supercore services (healthcare, education, haircuts, and hospitality but not food, energy, or housing) increased by 0.5%, the most since January. However, some of the rebound in services was driven by more volatile categories (such as airfares) and a one-off jump in dental services. Further evidence of tariff impacts bleeding into services, or immigration cuts pushing up service inflation, could keep inflation stickier given that services represent approximately 60% of the Consumer Price Index (CPI) basket.

Although inflation data is still not to the Fed's liking, we believe the downside risks to growth are likely to dominate its thinking. Most Fed speakers since the July employment report have tilted dovish, but not to the extent that the market has been pricing. Chair Powell will likely want to push back against the market pricing for September while the Fed waits for the August non-farm payroll numbers and CPI data to give themselves optionality.

Looking to 2026, with the increases in tariffs largely behind us and the impact of immigration cuts under way, growth looks set to be marginally stronger, although not at the exceptional levels seen in recent years due to weakening in some supportive factors.

Rates

Gunter Seeger

Portfolio Manager, Developed
Markets Investment Grade

CS 4.00 (unchanged)

At Jackson Hole, Chair Powell gave the market what it wanted. He commented that tariffs were a short-term phenomenon and that the current restrictive federal funds rate could be a threat to the labor market. The markets reacted favorably to the conference and priced in a September rate cut. However, on the following Monday, the Trump administration fired Fed Governor Lisa Cook, leaving the market less certain about Fed accommodation, solidarity, and independence. While the wars in the Middle East and Europe have been the subject of dialogues and negotiations, fighting on the ground has increased in both, making a peaceful resolution less likely.

CPI rose from 2.4% in March to 2.7% in July (year over year). Over the same period, core Personal Consumption Expenditures (PCE) inflation (the Fed's preferred number) rose from 2.69% to 2.79%. Meanwhile, Chair Powell pointed to weaker jobs numbers in his Jackson Hole speech. Before the next Fed meeting, we will see another non-farm payroll number and additional CPI and PPI results. Both jobs and inflation need to fall to solidify a September rate cut. Our forecast remains the same: The US 10-year note will soon join the 20- and 30-year and will touch 5% before the end of the year.

Even though short-term rates are pricing in a rate cut, longer-term rates continue to rise in the face of coming cuts. The long end of the Treasury market is concerned about the prospects for future inflation.

Credit

Steven Oh, CFA

Global Head of Credit
and Fixed Income

CS 3.50 (unchanged)

The credit markets' summer theme continues: strong investor demand despite tight valuations. Signs of weakening employment growth and the reemergence of inflationary pressures pose a troubling combination for Fed policy action given its dual mandate. However, the central bank is poised to provide a measure of monetary policy relief with a rate cut in September and a measured approach toward easing over the next 12 months.

We see a case to be made that current tight valuations are warranted in the face of an accommodative backdrop of low but positive growth combined with tailwinds from monetary stimulus and upcoming stimulative fiscal policy actions. However, history would suggest maintaining a more cautious bias whenever valuations are approaching such tight levels. Although we do not believe this is a market environment in which to become hyper defensive, we are trimming the highest risk/beta positions within portfolios and adding back an element of dry powder.

Currency (USD Perspective)

Anders Faergemann

Senior Sovereign Portfolio
Manager, Emerging Markets
Fixed Income

CS 3.00 (unchanged)

A recoupling of correlations between the US dollar and rate differentials should reestablish monetary policy expectations as key in determining the direction of the US dollar. So far this year, the dollar has underperformed versus rate differentials and dropped approximately 10% against the euro in the first half. The market's ongoing skepticism provides us an opportunity to be contrarian and buy the US dollar on dips.

We expect the Fed will move to protect the labor market and ease policy in September and proceed to cut three more times over a 12-month period, kick-starting an economic recovery that was helped by the sequential easing in fiscal policy by the OBBBA. In many ways the second quarter may have been the weakest point for the US economy, US market sentiment, and the US dollar. Yet uncertainty over what the Fed "will do" compared with what the Fed "should do," in parallel with a sharp divergence in monetary policy expectations between the Fed and European Central Bank, may delay the full resumption of normal practice, and flows may continue to work against the US dollar.

Dollar bears maintain that the currency has lost its safe haven appeal and that US exceptionalism has diminished, provoking repatriation and increased foreign exchange (FX) hedging. Still, we believe peak support for this view is behind us and doubt that the euro has the underlying strength to provide a viable alternative, despite the good intentions of German fiscal spending and the Draghi report.

Erosion of Fed independence will undoubtedly weigh on the US Treasury curve and could mitigate some of the benefits of rate cuts. The higher risk premium associated with US assets will be a factor weighing on the US dollar. To counter this sentiment, we are hearing positive stories on productivity, AI, and potential disinflation over a longer investment horizon.

Emerging Markets Fixed Income

Joseph Cuthbertson
Sovereign Analyst, Global
Emerging Markets Fixed Income

USD EM (Sovereign and Corp.)
CS 3.00 (+0.25)

Local Markets (Sovereign)
CS 3.00 (unchanged)

Emerging market (EM) spreads remain supported by expectations of looser financial conditions, both domestically and externally, consistent with our “soft landing” macroeconomic scenario. Spread widening has been largely confined to issuers facing idiosyncratic challenges.

The domestic macro environment is favorable for most EMs, and we expect sovereign credit metrics to improve throughout 2025. EM economic data remains robust, and external buffers are showing increases. Domestic conditions in most countries still support policy easing. Our expectation for credit rating changes include rising stars Azerbaijan, Oman, and Serbia attaining investment grade status and upgrades from the CCC bucket for Pakistan and Nigeria. We expect a pickup in supply after the summer quiet period from names that market participants expect. Evidence suggests that fund cash balances going into this period will be supportive and that fund flow data have strengthened over recent weeks.

In corporates, second-quarter results have been broadly neutral to our expectations for the nearly 50% of our coverage base that has reported. The positive beats came from the consumer and technology, media, and telecommunications (TMT) sectors. The negative misses were from the industrial and utilities categories. Meanwhile, oil and gas and mining and metals were more mixed. In primary markets, we expect a busy start to September with front-loaded issuance. However, given the higher scheduled cash flows, strong demand from EM and crossover investors, and resilient market sentiment, we believe the market will absorb the upcoming supply well.

Commodity markets are expected to stay in a favorable range for EM countries, while recently announced tariff levels remain manageable. Any adjustments to tariffs on pharmaceutical products are likely to affect only a limited number of names.

Multi-Asset

Deanne Nezas
Portfolio Manager,
Global Multi-Asset

CS 3.00 (unchanged)

The US economy is finally showing evidence of slowing, even before the fallout from tariffs, which have now arrived and were recently upsized. We expect growth to decelerate further, leading the Fed to restart its easing cycle. After some angst, the Fed is likely to succeed in rebooting 2026 growth. Against this backdrop, we maintain a neutral score of 3.0, striking a balance between near-term caution and our optimism about AI’s potential to boost prospects in 2026.

The Fed is now in a tough spot, needing to prioritize its employment mandate over its inflation mandate just as the latter begins to show life in the months ahead. We believe labor market concerns are preparing markets for a reboot of the Fed’s cutting cycle. The deceleration of job growth will warrant at least several cuts to ease financial conditions for the most vulnerable segments of the economy, including lower-income borrowers and the housing market. Lower rates will also support the investment needed to boost productivity. By 2026, we anticipate a transition toward higher productivity and faster economic growth, particularly in the US. Disinflationary pressures should build in services (courtesy of AI) while the 12%-13% of domestic consumption represented by imported goods continues to inflate due to sequential one-off tariff pass-throughs.

Risk assets have priced in de-escalation of trade and geopolitical pressures just as tariffs arrive and the confrontation between the US and Russia over Ukraine heats up, leaving them somewhat vulnerable. Our stance remains neutral, and over the coming months, we believe dips should be expected (and bought).

Global Equity

Chris Pettine, CFA
Research Analyst, Equities

CS 3.00 (unchanged)

Developed equity markets are pushing higher. Europe has outperformed the US. Trade deals are progressing better than feared, and tariff costs thus far have been absorbed without a significant impact on CPI. The progress is encouraging, but it’s too soon to know whether negative impacts have simply been delayed to the second half. Labor market softening is a new concern that bears watching. Meanwhile, second-quarter earnings were better than expected on lower tariff costs. Consumer spending is holding up relatively well, and AI investment remains strong. Markets appear to be looking through to 2026 and to lower interest rates, less policy uncertainty, and a more business-friendly environment of lower taxes and deregulation.

Earnings growth has broadened beyond technology to industrials, financials, and healthcare. Consumer spending remains supported, and company commentaries generally indicate an ability to absorb tariff impacts almost fully in 2025 and fully in 2026.

Global Emerging Markets Equity

Taras Shumelda
Portfolio Manager,
Global Equities

CS 3.00 (unchanged)

Emerging markets are trying to keep up with trade and geopolitical announcements. US dollar weakness remains supportive of global EM equities, which are enjoying their best run since 2020 year-to-date but will need to see earnings upgrades for the outperformance to continue.

In China, yet another extension of the tariff truce points to efforts to find a solution. The reporting season for portfolio companies in China is off to a good start with Tencent, Lenovo, and Geely all delivering strong beats. In India, there is some political and economic tension due to a standoff with the US over purchases of Russian crude. The reporting season has been mixed so far. In Korea, earnings in our coverage have exceeded expectations, but after a 45% year-to-date return, some profit-taking is being seen in the local market. In Taiwan, TSMC and other tech companies kicked off the reporting season with generally good numbers and upbeat guidance.

Quarterly results in Latin America have been good, with strength in financials and in some consumer discretionary names. Staples have had a few misses, while industrials, utilities, and telecoms were mixed. The market seems to be shrugging off US-driven trade tensions with Brazil, although the Magnitsky Act sanctions, if acted upon, can be a problem.

The White House meeting with President Zelensky and several EU leaders went better than expected, but without tangible results; projections for peace thus far are low. Earnings reporting out of EMEA has been good, especially in central and eastern European banks.

Overall, August saw a continuation of the prior month's themes, where geopolitics again overtook bottom-up developments as the main stock driver. We favor companies that we believe are relatively isolated from top-down shocks and focus on the long-term outlook, which in this environment is admittedly challenging.

Quantitative Research

Yang Qian
Fixed Income
Quantitative Strategist

Our stance is unchanged versus last month, with tighter credit spreads and no change in the curve's slope.

Global credit forecasts remain negative, with slight improvement in developed markets and deterioration in emerging markets, leading to a relative preference of DM over EM. In DM industries our model favors technology, banking, capital goods, and natural gas. It dislikes utilities, basic industry, transportation, and insurance. Among EM industries, our model likes utilities and financials and dislikes real estate and diversified companies.

Our global rates model forecasts higher yields for Japan, Switzerland, and Denmark and lower yields for Oceania, the UK, North America, and most of the euro area. Our model forecasts a flatter curve for most of the euro area, Canada, and New Zealand, but the UK, Switzerland, and Norway are on the steeper side.

The rates view expressed in our G10 Model portfolio is overweight global duration. It is overweight the UK, France, New Zealand, Canada, and Italy. It is underweight the US, Germany, and Japan. Along the curve, it is overweight the six-month, 10-year, and 20-year. It is underweight the two-year, five-year, the Japan seven-year, and the 30-year.

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