Market View

by Sergio Grasso

Summer 2026

The arrival of the summer period offers a welcome opportunity to step back from the daily flow of news and reflect on where credit markets are heading. After the first half of the year, two developments stand out to me. They are likely to shape market dynamics for the remainder of 2026.

1. Creditor-on-creditor violence is no longer the exception—it is becoming the rule in credit.

Creditor-on-creditor violence continues unabated. The balance of power can change overnight, winners and losers frequently change places depending on the sector, the issuer, the role played by financial advisers and the approach taken by company management. I will not comment on specific situations, as I am involved, directly or indirectly, in some of them. One of the most interesting battles remains the one between par-credit investors and hedge/distressed funds. The latter continue keeping their pressure on showing dry powder to deploy and greater flexibility in navigating financially stressed situations, while par creditors, final money accounts and CLO investors are often constrained by portfolio rules and tests, concentration and investment limits and structural requirements. Those limitations become increasingly relevant as credit quality deteriorates. My sense is that some par investors grew too comfortable during the era of zero interest rates and easy money. That regime is over. Today's market is far more demanding, reinforcing my conviction that this is one of the most challenging credit environments since the Global Financial Crisis.

As I have argued before, CLOs have been instrumental in providing abundant and inexpensive financing for acquisitions, dividend recapitalisations and other leveraged transactions. The model works exceptionally well while companies continue to perform. The challenge begins when borrower operating performance weakens in the context of a levered balance sheet. At that point, the same CLO vehicles that supported the financing can amplify secondary-market volatility, accelerate price declines and ultimately push issuers towards liability management exercises earlier than fundamentals alone would suggest. In today's restructuring environment, speed has become a decisive competitive advantage. Those who have money on the side and organise quickly can coordinate creditor groups and engage management early, often shaping the restructuring process and securing superior economics. Litigation has become a standard feature rather than an exception, with disputes extending well beyond creditors to include shareholders and other stakeholders. The inevitable consequence is that realised recoveries continue to disappoint relative to the assumptions embedded in many recovery models. Investors should not underestimate this structural shift. The unsecured and Holdco debt remains not correctly priced in Europe and in the US.

2. AI credit is experiencing its first meaningful (still don't know) reality check

July proved challenging for data centre developers, hyperscalers and AI-related issuers. Credit spreads widened materially as volatility increased and several institutional investors reduced exposure. The market reaction has been significant despite the fact that the long-term financing backdrop remains exceptionally supportive and capital continues to be available for capex and projects for artificial intelligence buildout. Some investors argue that recent volatility has been exacerbated by relatively inexperienced participants attempting to trade these names as if they were traditional industrial credits. Others feel already fatigue to absorb the quantity on the offer and therefore demand premium and more spread. There is certainly some truth to those arguments. However, I believe they explain only part of the recent price action. The more important issue is visibility. For many issuers, investors still lack sufficient clarity on future earnings, cash-flow generation and the pace at which AI-related investments will ultimately translate into sustainable returns. In the absence of that visibility, credit spreads become increasingly sensitive to sentiment, mood change, rather than fundamentals. For this reason, I place limited weight on credit ratings at the current stage. Credit ratings provide limited protection during periods when markets are rapidly repricing uncertainty rather than underlying credit fundamentals. In such episodes, market prices often adjust well before any actual deterioration in credit quality, with rating downgrades typically occurring only as a second-order effect. Therefore IG or HY categories are unlikely to provide a meaningful anchor or stability while credit investors continue to reassess valuations across the sector. The quality of the deals seen so far in the European HY market for data centre developers has been underwhelming and their performance disappointing (I am not talking about coverage in primary!), but the broader question is whether recent weakness can remains confined to AI-related issuers and hyperscalers or whether it marks the beginning of a wider repricing across credit markets. Persistent primary issuance, combined with this increasing "investor fatigue" mentioned above around a broader AI growth narrative, could gradually widen spreads more broadly. Alternatively, this may simply be the market correcting excess optimism in one of its most debated sectors. The answer will likely determine the tone of credit markets for the remainder of the year.

A quick note on Barings' middle-market CLO reset.

Barings recently completed the reset of its inaugural 2024 European middle-market CLO. The transaction is notable not only because it represents one of the earliest resets in the European private credit CLO market, but also because of the significant structural changes introduced. Most importantly, the deal transitioned from a static to a managed structure, reflecting both a shift in the manager's approach and the continued maturation of the European middle-market CLO market.

Two features are particularly noteworthy.

First, the transaction continues to offer a logical spread premium across most rated tranches relative to comparable broadly syndicated loan (BSL) CLOs. The magnitude and shape of the premium are broadly consistent with those observed in the more mature U.S. middle-market CLO market. The premium remains relatively modest through the AAA to single-A tranches before increasing more materially from the BBB to the BB notes. Comparisons with the original 2024 issuance are of limited relevance, however, as the initial transaction was structured as a static CLO, making its liability profile fundamentally different from that of the reset. Despite the transition to a managed structure, the reset reduced the weighted average cost of liabilities by approximately 30 basis points.

Second, the capital structure was simplified through the elimination of the single-B tranche, which was replaced with additional subordinated notes. This change is consistent with the characteristics of the underlying private credit portfolio and reflects a broader trend in private credit CLO issuance, where managers have opted for thicker equity cushions to enhance portfolio support and improve resilience under stressed scenarios. The revised capital structure has also altered the par subordination profile of the mezzanine and the first tranche of IG notes. In particular, the levels of par subordination available to the BBB and BB tranches differ meaningfully from those of the original 2024 transaction, making this an area worthy of closer analysis.

Overall, the transaction provides another important benchmark for investors assessing the evolution of the European middle-market CLO market. Beyond the improvement in funding costs, it demonstrates how managers are adapting transaction structures as the market matures.