

Onex Credit Market Update & Sector Commentary

Q2 2026

Q2'26 Key Highlights

- 1 **Credit markets remain resilient**, despite geopolitical uncertainty, AI disruption concerns and a more hawkish rate environment
- 2 **Energy markets remain a key risk**, with tight refined product and LNG supplies creating greater vulnerability than crude prices suggest
- 3 **Economic growth remains stable**, but persistent inflation and elevated energy costs are keeping the Fed biased toward tighter policy
- 4 **Public and private credit are diverging**, as wider direct lending spreads drive larger, higher-quality borrowers toward syndicated markets
- 5 **AI is reshaping credit markets**, driving significant issuance and greater dispersion while increasing the importance of disciplined credit selection
- 6 **Sector fundamentals remain differentiated**, with stronger opportunities in aerospace & defense, power, energy and life sciences, while cable, select consumer categories, healthcare services and cyclical sectors remain more challenged

Key Macro and Economic Themes

- **Deal or no deal...we still don't know**
 - Seemingly every day brings reports of a potential deal or diplomatic breakthrough to resolve the Iran conflict, only for those expectations to be walked back and replaced by threats, military escalation, or another round of negotiations.
 - The conflicting signals have left markets indifferent to headlines on the Middle East conflict. Markets expect that President Trump's brinkmanship is unlikely to result in a significant escalation. This read is likely true – at least until midterms; however, the situation is more complex than walking back Liberation Day tariffs.
 - While the near-term path remains difficult to predict, the longer-term geopolitical implications are even less clear. Iran has now demonstrated the leverage it can exert global energy markets – a dynamic that is unlikely to disappear even if the current conflict is resolved in the near term. It may prove difficult to put the “genie back in the bottle”. Over time, we would expect this vulnerability to drive increased infrastructure investment designed to diversify energy routes and reduce reliance on the Strait, but that will likely take years to come to fruition.
- **Crude oil underestimates impact to energy – the real shortages are in refined products and LNG**
 - Despite a significant and sustained shock, energy markets have been relatively resilient. Oil is meaningfully higher YoY but has mostly remained below \$100 thus far.¹ Crude was oversupplied heading into this shock, providing an immediate buffer.² A combination of further supply response (mostly in the Americas), demand destruction, and reduced Chinese imports has helped further balance the market. The US economy is also much less energy intensive than in the past, and its status as a net exporter has further helped cushion the impact.³

¹ Source: Bloomberg. As of August 14, 2026.

² Source: International Monetary Fund. As of July 15, 2026.

³ Source: Federal Reserve Bank of Dallas. As of June 23, 2026.

- However, crude oil prices understate the true impact on the global economy. Market responses have largely been concentrated on the crude side where there are more levers to pull and strategic reserves to draw on. The more significant shortages are in refined products and LNG, where physical infrastructure has much longer lead times and disruptions to global flows do not have easy fixes.
- For now, markets are functioning well; however, the system has little slack. With balances this tight, the economy remains vulnerable to an “accident”. Further, China’s crude reserve levels also remain uncertain, making it more difficult to predict its behavior should the conflict persist. Europe and emerging markets face the sharpest headwinds heading into winter, with low gas storage and elevated prices. Diesel and fuel oil stocks are also depleted.⁴ A cold European winter or an unplanned outage at a single major refinery could result in real physical product shortages. We are seeing some of this energy risk premium being priced into energy stocks, but it is less clear that the broader market is adequately focused on the tail risks that remain.
- ***Economic data points are mixed, but overall, the economy appears stable***
 - Labor market appears to have modestly softened with the last two reports indicating decelerating momentum. Nonfarm payrolls declined by 23,000 in July, but a decline in labor force participation resulted in the unemployment rate edging lower to 4.1%.⁵ Hourly earnings growth slowed to 0.1% MoM⁶ and the JOLTs quit rate remains subdued at 2.0%.⁷
 - July retail sales came in well below expectations, contracting by 0.6% vs. expectations of +0.1% and U of Michigan sentiment fell from 55 to 51 in the initial August reading.⁸ With only 8% of consumers expecting income growth to exceed inflation over the next year, that was just under 20% in December.⁹ The decline was notable among older, lower-income and non-college educated consumers.¹⁰ This aligns with what we’re seeing thus far in Q2 earnings across our coverage universe, where companies levered to lower income demographics remain more challenged than those exposed to the higher end. Prior BAML consumer data appeared to indicate improving trends among lower-income cohorts, although BAML noted that some of the data may be affected by the FIFA World Cup and related changes in spending patterns (maybe Prime Day pull forward).¹¹
 - The latest US ISM PMIs are both firmly expansionary, with the sharp acceleration in manufacturing being particularly notable. The July manufacturing PMI reached its strongest level in more than four years at 55.6.¹² AI-capex related end markets were particularly strong, although the strength was broad based, with all sub-components also expansionary. The primary negative was a very high ‘prices paid’ reading, indicative of continued inflationary pressure and elevated energy costs. Further, European PMIs have also improved, with the S&P Euro Area Manufacturing PMI increasing to 51.9, and manufacturing output posting its strongest growth since March 2022.¹³
- ***Market expects the Fed to have a hawkish bias; fiscal support appears less likely***
 - At the July meeting, the FOMC voted 9-3 to hold rates steady, with the three dissenters preferring a 25-bps hike.¹⁴ FOMC Chairman Warsh reaffirmed the Fed’s 2% inflation target¹⁵ but has otherwise intentionally been less communicative at his press conferences. In his view, the Fed should communicate less guidance on policy expectations and let markets react directly to incoming data. This will likely mean greater uncertainty on the path of rates.
 - The market is pricing in a hawkish bias, with expectations for 1-2 hikes currently reflected in the curve. The curve has repriced by ~100 bps in the past six months, with expectations at the start of 2026 being for a few cuts. July’s CPI print of 2.5% YoY Core and 3.4% YoY Headline reinforced the narrative of a hawkishly biased Fed.¹⁶ At this point in the cycle, the Fed appears to be more worried about inflation risks than employment risks.

⁴ Source: International Energy Agency. As of August 12, 2026.

⁵ Source: U.S. Bureau of Labor Statistics. Employment Situation Summary. As of August 7, 2026.

⁶ Source: U.S. Bureau of Labor Statistics. Employment Situation Summary. As of August 7, 2026.

⁷ Source: U.S. Bureau of Labor Statistics. Job Openings and Labor Turnover Summary. As of August 4, 2026.

⁸ Source: Bloomberg. As of August 14, 2026.

⁹ Source: University of Michigan. As of August 14, 2026.

¹⁰ Source: University of Michigan. As of August 14, 2026.

¹¹ Source: BofA Global Research. As of July 10, 2026.

¹² Source: Institute for Supply Management. As of July 2026.

¹³ Source: Reuters. As of August 3, 2026.

¹⁴ Source: Federal Reserve Board. As of July 29, 2026.

¹⁵ Source: Federal Reserve Board. As of July 29, 2026.

¹⁶ Source: U.S. Bureau of Labor Statistics. Consumer Price Index. As of August 12, 2026.

- Midterms are now less than three months away and will likely begin to play a more prominent role in shaping investment narratives. Most political commentators¹⁷ and prediction markets¹⁸ expect the Democrats to win at least one chamber of Congress, likely ending Republican control of both branches of government. Such a result would likely increase political dysfunction during the next two years and reduce the odds of further fiscal stimulus. At the same time, divided government could be a positive for industries in the crosshairs of Republican policy, such as healthcare, by making more sweeping policy changes more difficult to implement.

Market Observations and Commentary

- ***Similar to Q1, credit markets continued to be resilient despite AI disruption fears, the Iran energy shock, and a more hawkish Fed***
 - The JPM Leveraged Loan Index is up ~2.29% YTD, while the JPM High Yield Index is up 1.86%.¹⁹ Rate volatility and expectations of a more hawkish Fed supported strong performance in loans in July, allowing loans to move ahead of high yield on a YTD basis for the first time this year. New loan supply and more modest CLO issuance over the past few months have modestly improved the supply/demand balance, but ~35% of the market is still trading above par, and repricing activity has continued.²⁰
 - CLO primary arbitrage remains challenged, as asset spreads continue to tighten in both the US and Europe at a faster pace than liabilities. Most new CLO equity is sponsored by “captive funds” that are motivated to grow assets under management and may seed CLOs despite challenging economics, while third-party CLO equity is often syndicated quietly at steep discounts. Secondary levels slipped in Q2 as fatigued CLO equity investors anticipated another repricing wave. We expect further tightening in CLO debt (increased demand for floating risk) and easing of repricing pressure to shift the economics in the quarters ahead.
 - Despite spreads remaining tight across most credit products, all-in yields have increased further amid expectations for a more hawkish Fed and the rise in 10-Year Treasury yields. This has supported strong flows into more liquid credit asset classes, despite AI-related concerns, negative private credit headlines, and BDC outflows. Spreads have remained relatively contained despite significant issuance related to the AI buildout. As more AI-driven issuance hits the market, and direct lending deals are refinanced into syndicated markets, spreads may see some relief.
 - Bifurcation remains significant and CCC loans continue to underperform the broader loan market. The overhangs we mentioned previously – Liability Management fatigue, CLO resets/liquidations, sponsors weaponizing DQ lists, and a dwindling buyer base for secondary distressed buyers – are unlikely to reverse in the short-term. The contrarian view, however, is that when a market becomes this dislocated on technicals, it can present an attractive entry point for longer-term investors, a view we share across select credits.
- ***Direct lending deal activity was subdued in Q2²¹ as the industry continued to grapple with outflows and skepticism around valuations***
 - Direct lending volumes were down 56% in Q2.²² We estimate that spreads for new direct lending deals have widened 50-75bps this year for credits not exposed to AI. For AI-affected names, pricing is more credit-specific, though market participants broadly remain hesitant to price new software deals.
 - Capital is still available for good deals, but competition has cooled as redemptions continue. Redemptions remain significant across most BDCs and many are only paying out their 5% cap.²³ We expect this to remain a continued headwind so long as BDCs continue to trade at significant discounts to NAV.
 - There have also been several secondary transactions for private portfolios.²⁴ Interestingly, despite assets being sold at a discount, these transactions have in some cases resulted in a positive stock price move as they have helped to narrow the discount to NAV for public BDCs trading in the secondary market. It’s difficult to generalize takeaways on price from these transactions, as the devil is in the details, given evaluating asset pools requires access to detailed information and significant diligence. The quality of each loan portfolio varies and each firm has their own valuation policy.

¹⁷ Source: Politico. As of July 31, 2026.

¹⁸ Source: Polymarket. As of August 12, 2026.

¹⁹ Source: J.P. Morgan. As of August 3, 2026.

²⁰ Source: J.P. Morgan. As of August 3, 2026.

²¹ Source: Reuters. As of July 9, 2026.

²² Source: Pitchbook | LCD. Private Credit and Middle Market Quarterly Wrap. As of Q2 2026.

²³ Source: Fitch Ratings. As of July 7, 2026.

²⁴ Source: BlackRock. As of August 6, 2026.

- So far, the unwind has been relatively orderly and challenges in private credit have been localized to specific funds. We have not seen evidence of broader systemic or financial stability implications. Investors may bear losses, but we continue to believe the financial system is resilient enough to work through even a direct lending default cycle. In many ways, private credit has *improved* the resilience of the system by shifting losses to investors and away from highly leveraged financial institutions.
- ***Direct Lending to Broadly Syndicated Loan (“BSLs”) refinancings have been a significant source of new supply to the BSL market***
 - Spreads across the two markets appear to have diverged, with compression continuing in the BSL market versus widening in direct lending. This has further widened the gap in cost of capital, with the BSL market generally offering meaningfully lower costs for issuers that would receive ratings of B3/B- or better and are \$90mm+ in EBITDA. Direct lending remains a good option for core middle-market companies that are too small for the BSL market, and for borrowers that are likely under ratings pressure or need PIK toggles.
 - Several large borrowers have shifted from private credit to the BSL market in recent months. The BSL market refinanced nine deals worth \$4.1bn from the direct lending market in the second quarter, compared with just three deals worth \$1.3 billion moving the other way.²⁵ After the quarter, Catalent refinanced \$4.1bn of loans and cut its borrowing costs by 225 bps.²⁶ Flows between the two markets were much more balanced for most of 2025.
- ***Demand for credits with lower-AI risk remains strong***
 - Much remains unknown about the longer-term implications of AI for businesses across the technology and services sectors. This has shifted the relative value toward borrowers where investors aren’t required to make that judgment. We have observed credits trading above par are particularly concentrated in sub-sectors with lower AI-risk, driving further repricing activity.
 - New CLO deal pricing has skewed away from the technology sector. We are seeing managers that were previously overweight technology, shifting their new issue portfolios to be meaningfully underweight. Most new issue CLO portfolios remain underweight technology (8-10%) relative to existing secondary CLOs (12%+).²⁷ Technology is the largest sector within the loan index, so as managers are shifting new issue portfolios away from the sector, competition has increased for less-AI exposed credits. At the same time, in existing deals overall technology and business services exposure has remained flatter than one might expect. Across the US CLO universe, average technology exposure rose 0.1% y/y to 12.3% from 12.2%, while business services rose 0.8% to 8.9% from 8.1%.²⁸ Over the last 12-months, technology generated a -2.9% total return while business services generated a 5.1% total return.²⁹ The average numbers; however, are less notable than the dispersion across managers: a handful of managers who were overweight technology and had poor credit selection within the sector (total returns of -6% to -8%+) will likely have trouble syndicating CLO equity for several years, while a few managers, generated positive total returns within the technology sector by avoiding what we view as the most problematic AI names
- ***Increasing dispersion in software as markets sort through winners and losers***
 - Cybersecurity has been a notable outperformer and is perceived as the segment most insulated from AI.³⁰ Application software has performed worse³¹, but even within that segment there is meaningful dispersion between infrastructure and discretionary point solutions.
 - Two higher quality software names, Proofpoint and Imprivata, were able to term out maturities by offering a combination of higher spreads and enhanced document protections.
 - CCC-rated loans with near-term maturities have been particularly poor performers. We think there are interesting opportunities in this segment, but realizing value will likely require working through a process and potentially difficult negotiations with sponsors around contributing new equity to support meaningful deleveraging.
 - While this is more a feature of direct lending deals than BSL, we continue to believe that mezzanine and ARR loans are the most exposed to the valuation reset in software.

²⁵ Source: Bloomberg. As of August 8, 2026.

²⁶ Source: Bloomberg. As of August 8, 2026.

²⁷ Source: Intex. As of August 11, 2026.

²⁸ Source: Intex. As of August 11, 2026.

²⁹ Source: Intex. As of August 11, 2026.

³⁰ Source: Apollo. As of July 26, 2026.

³¹ Source: Apollo. As of July 26, 2026.

- Reuters reported that Silver Lake is in talks to buy Workday.³² We had been waiting for software M&A to pick up but weren't expecting it to be one of the largest buyouts in history. If they are able to come to a deal, it incrementally could help restore confidence in software valuations, particularly for profitable, growing infrastructure software businesses. Financing structure on that will be interesting to see, we suspect it will be under levered relative to prior software LBOs.
- ***AI remains the dominant equity story, though broader equities demonstrated notable resilience in July***
 - After the parabolic price action in the months leading up to July, AI equities experienced significant volatility. The growth in leveraged ETFs likely contributed to this volatility due to their forced rebalancing mechanisms.³³ The unwind was most notable in Korea, with SK Hynix stock down 50% from its June peak.³⁴ The volatility significant enough that regulators stepped in to impose curbs on leveraged ETFs.
 - Despite this AI-related volatility, we've been pleasantly surprised by the resilience of broader markets in July. Breadth in equities has somewhat improved - the equal weight S&P has broken out to new highs despite parts of the AI ecosystem lagging in July. Previous laggards, such as healthcare and financials, have started to participate in the rally. Even software is roughly flat YTD, with increasing dispersion amongst winners and losers. Only 28% of stocks are trading within 10% of their all-time highs, so breadth remains relatively muted.³⁵
 - Concentration around the AI theme remains high within the S&P 500 with ~19% represented by semiconductor/memory and another ~17% by the major hyperscalers spending billions on AI.³⁶ That does not include names performing well through indirect exposure to AI spending – industrials, power, mining etc. Putting it all together, we wouldn't be surprised if close to half of the S&P 500 is being influenced in some way by the AI trade.
- ***AI capex continues to drive significant issuance in all segments of credit market***
 - Massive debt issuance from the hyperscalers is creating technical pressure and has resulted in spread widening, particularly in investment grade credit. JPM is forecasting \$230bn+ of unsecured issuance from hyperscalers in 2026. By the end of July, AMZN and META were ~23-25bp wider versus June 1st, MSFT and GOOGL were ~15-16bps wider, and ORCL had widened ~50bps.³⁷ Hyperscaler risk is relatively straightforward to price – these are investment grade-rated, large technology companies with relatively low leverage, significant free cash flow, and defensible business models. As a result, this move appears to be largely technical in nature.
 - While hyperscaler debt issuance has been substantial, it has represented 'only' 40% of YTD global AI-related debt issuance.³⁸ Off-balance sheet data center debt and GPU-backed financings have also become increasingly prevalent. As banks become increasingly saturated with exposure and existing financing channels are strained by the sheer volume of supply, we expect more of these transactions to come to market over the next 12-18 months.
 - These more bespoke deals are inherently complex to evaluate. They are typically anchored by a handful of key contracts, but the structure and creditworthiness of the counterparties can vary significantly. A triple net lease contract with an IG-rated MSFT represents a very different credit prospect than a GPU financing backed by short-term contracts with unrated counterparties. If the bull case plays out, AI demand continues to grow exponentially and capacity remains constrained for years to come, most of these financings will likely work out. However, in a downside case, these structural considerations could drive significant divergent outcomes across these financings. We are being picky on these deals.
- ***FX and Interest Rates are flashing potential warning signs***
 - Amidst inflation fears, global central banks have continued to tighten monetary policy. The ECB hiked in June, and the Fed is also expected to hike this year. The BOJ is continuing its multi-year normalization away from ultra-easy monetary policy. Global sovereign yields are under significant pressure from a variety of factors, including higher real rates amid strong global demand for investment capital (AI, defense, and the rebuilding and rerouting of energy infrastructure in the Gulf), elevated inflation risk, and higher fiscal deficits. The

³² Source: Reuters. As of August 13, 2026.

³³ Source: Bloomberg. As of August 10, 2026.

³⁴ Source: Bloomberg. As of August 11, 2026.

³⁵ Source: SPY Index. As of August 12, 2026.

³⁶ Source: SPY Index. As of August 12, 2026.

³⁷ Source: J.P. Morgan. As of July 7, 2026.

³⁸ Source: Goldman Sachs. As of July 27, 2026.

Japanese 10-year is yielding over 2.8% and the 30-year is near 4%, both at their highest levels in almost 30 years.³⁹ The US 10-year is around 4.6% and the 30-year is near 5.25%, at post-crisis highs.⁴⁰ Thus far, the move has been relatively orderly, and the US Treasury MOVE Index remains relatively subdued at ~75 compared with the elevated volatility of the past few years.⁴¹

- Japan's Ministry of Finance has been intervening in the USD/JPY market to counter what it views as an undervalued yen and limit imported inflation, particularly in the face of an energy shock. Japan has about \$1tr in foreign reserves, but only about \$160bn of that is held in cash.⁴² So far this year, the Ministry has intervened three times for a total of about \$160bn. The previous two interventions (April and May) were relatively quickly overwhelmed by market forces. To create a more sustained move, the Ministry may need to demonstrate that it is willing to defend a level and commit a greater portion of its reserves if needed to overwhelm speculative pressure.
- Deploying a greater portion of its reserves would require the Ministry to sell USTs to raise cash for intervention in the spot FX market. This could create a meaningful source of Treasury selling at a time when the US Treasury market is already under pressure. Further, a meaningful portion of longer-duration Treasury demand comes from hedge funds running leveraged basis trades rather than natural long-term buyers.⁴³ We think this potential source of instability may help explain the US motivation to support Japan's intervention efforts. The US Treasury has also been taking other steps to alleviate market pressure, including increasing issuance at the short end and using buybacks to consolidate liquidity in on-the-run securities.
- FX and interest rates are large and highly leveraged parts of the market. We don't speculate on these products directly, but they are worth monitoring because we have previously seen volatility in FX and rates spill over and create dislocations across other asset classes, as demonstrated by the 2022 UK GILT/pension crisis.

Sector Views and Earnings Commentary⁴⁴

Software – Identifying Winners from Losers

- **Software:** AI-related concerns drove a meaningful and largely indiscriminate sell-off across the sector in February and March, though a degree of stability has returned since. US software loans are currently bid around 86–87, having bottomed near 85 in June, and continue to trade at a substantial discount to the broader US loan index at 95.⁴⁵ Dispersion within the sector remains elevated: in our observations of companies we are exposed to, names we view as AI-resilient trade close to par, while credits we perceive as structurally exposed are often marked in the 60s and 70s. Software — the largest sector in the BSL index at 13% — rallied in July but remains down roughly 5% year-to-date.⁴⁶ Of the 12% of the US loan index bid below 90, software accounts for approximately half.⁴⁷ In Europe, the dislocation has been considerably more contained - software represents just 7% of the loan index, has recovered from a March low of 89 to approximately 93 currently, and accounts for only 10% of distressed names in the region.⁴⁸
 - While 2Q earnings were generally positive, it is still too early to assess the full impact of AI or to identify the clear winners.
 - Common themes among names that have rallied off lows include a proprietary data moat, deep workflow integration with clients, high switching costs, and credible AI strategies.
 - Focus has shifted away from growth at any cost and through acquisitions toward free cash flow, margins, and pricing power.
 - Cybersecurity remains the strongest segment as resilient budgets and new AI-driven risks across data, identity, models, and agents are supporting demand, particularly in identity, cloud, and data security.
 - Point solutions continue to face bundling risk. Palo Alto's \$25bn acquisition of CyberArk⁴⁹ reinforced the view that identity will be a critical control plane in an AI-driven world.

³⁹ Source: Bloomberg. As of August 12, 2026.

⁴⁰ Source: Bloomberg. As of August 12, 2026.

⁴¹ Source: Bloomberg. As of August 12, 2026.

⁴² Source: Ministry of Finance, Japan. As of July 7, 2026.

⁴³ Source: Federal Reserve Board. As of June 22, 2026.

⁴⁴ Sourced from the relevant company's earnings reports and filings.

⁴⁵ Source: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index. As of August 3, 2026.

⁴⁶ Source: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index. As of August 3, 2026.

⁴⁷ Source: PitchBook | LCD. As of August 3, 2026.

⁴⁸ Source: PitchBook | LCD. As of August 3, 2026.

⁴⁹ Source: Palo Alto Networks. As of February 11, 2026.

- Seat-based pricing is shifting toward usage-, task-, and outcome-based models, creating greater gross-margin uncertainty and less predictable revenue. Overall, we remain in the early innings of a fundamental structural change in the sector.
- **Tech Services:** AI consulting has emerged as the clearest growth opportunity, benefiting providers that are able to integrate AI into existing systems and demonstrate measurable returns. Talent shortages in AI, cloud, and security also continue to support further outsourcing. Traditional consulting and large transformational projects have been delayed. We expect the strongest performers to be companies able to pivot to this new demand environment. Europe is behind in AI implementation, and IT services remain a weak segment.
- **Hardware and Semis:** AI investment is broadening beyond GPUs into high-bandwidth memory, networking, optics, storage, power management, and cooling. A key emerging shift has been the transition from AI training to inference. Investor interest has also broadened from chipmakers to the broader hardware supply chain. The key question remains whether future AI revenues will justify the scale of the investment. PC shipments have slowed materially, reflecting memory shortages and a reversal of the strong growth seen in prior quarters.
- **Fintech:** We remain constructive on the sector, supported by healthy payment volume growth, stable pricing, and mission-critical software offerings embedded in customer workflows. M&A activity has accelerated (Advent/Stripe acquiring PayPal for \$53bn⁵⁰, Nuvei acquiring Payoneer⁵¹), reflecting continued strategic interest in high-quality payment and software assets.

Strong & Improving Sectors

- **Aerospace & Defense:** Fundamentals remain strong, with commercial aerospace supported by resilient aftermarket demand and improving OEM production despite ongoing supply constraints. Traffic moderated temporarily, while higher fuel prices tied to the Middle East conflict also weighed on the sector. For the companies in our coverage universe, aftermarket generally outperformed OEM, supported by high fleet utilization and low retirement rates. The defense outlook continues to strengthen amid robust order growth, replenishment requirements, and funded backlogs, although execution and production capacity remain the key challenges. We have added exposure to a select number of parts suppliers through the primary market.
- **Power:** AI-driven electricity demand continues to support strong fundamentals. The July PJM auctions illustrated the strength of demand for dispatchable generation and provided strong visibility. Tight capacity markets, improving cash flow from stronger pricing in earlier auctions, and robust M&A activity are driving attractive valuations and providing strong revenue visibility for power generation assets. While the sector has performed very well, we remain cautious around certain single-site operators and aggressive holdco issuance.
- **Freight:** Conditions continued to improve, driven primarily by tighter industry capacity rather than stronger demand. Spot truckload rates excluding fuel were up 36% YoY. We remain constructive on scaled, asset-based carriers with pricing power, while brokers face a more challenging outlook due to rising costs and increased legal liability. The Supreme Court case *Montgomery v. Caribe Transport II*, which allowed negligent-carrier-selection claims against brokers to proceed, was followed by an approximately \$604mm adverse verdict against C.H. Robinson.⁵²
- **Life Sciences:** Sector fundamentals improved, supported by stronger biotech funding, healthier Contract Research Organization (CRO) demand, and improving bookings. Biopharma equity capital raised, an indicator of pharma research spending, rose 180% YoY and 66% QoQ.⁵³ We are more constructive on the near-term outlook while continuing to monitor the longer-term impact of AI on drug development. In European pharma, M&A activity remains robust (Zentiva, Stada, and Recordati)⁵⁴, supported by the sector's defensive characteristics, fragmented market structure, and upcoming patent expirations. Contract Development and Manufacturing Organizations ("CDMOs") continue to perform well, successfully passing through higher costs. Looking ahead, we expect the sector to remain an active source of new issuance in the European leveraged loan market.
- **Energy:** Elevated commodity prices continue to support strong sector fundamentals, driving disciplined increases in upstream activity and LNG infrastructure investment. Credit quality remains robust, aided by conservative capital allocation, ongoing industry consolidation, and a focus on maintaining resilient balance sheets through the commodity cycle.

⁵⁰ Source: Bloomberg. As of July 15, 2026.

⁵¹ Source: Bloomberg. As of June 15, 2026.

⁵² Source: Freight Waves. As of July 24, 2026.

⁵³ Source: Deutsche Bank. As of July 27, 2026.

⁵⁴ Source: Company filings; Zentiva, April 9, 2026; STADA, March 31, 2026; GBL/CVC, May 22, 2026.

Resilient Sectors

- **Professional Services:** AI continues to be the dominant strategic theme, driving industry consolidation — highlighted by Grant Thornton's \$5bn acquisition of CBIZ aimed at enhancing AI-enabled service delivery.⁵⁵ Fundamentals remain solid, with stable demand, strong growth in testing and inspection services, and record engineering backlogs supported by data center, energy, and infrastructure projects. We remain constructive on the sector, favoring larger, diversified firms that are best positioned to leverage AI and benefit from scale.
 - Environmental services continue to perform well, as pricing and cost pass-throughs offset volume softness. The sector remains defensive, supported by non-discretionary demand, limited rate sensitivity, and favorable contract structures. Hazardous and regulated waste continues to outgrow solid waste, benefiting companies with scarce, permitted disposal assets.
 - In Europe, the staffing market appears to be bottoming out, with improving sequential trends led by industrial hiring, though white-collar demand remains subdued and a meaningful recovery has yet to emerge. Profitability continues to outpace the recovery in volumes as cost initiatives and productivity gains drive operating leverage.⁵⁶ AI is viewed as a productivity enabler that should increasingly differentiate firms based on their ability to leverage workflow integration, proprietary data, and margin improvement.
- **Autos:** Fundamentals remain constructive, supported by resilient vehicle demand and an expected production recovery in the second half of the year as temporary disruptions, such as the Novelis aluminum plant outage, ease.⁵⁷ We expect stable performance from Tier 1 suppliers, while aftermarket demand continues to benefit from an aging vehicle fleet despite some pressure from deferred maintenance and macroeconomic uncertainty.
- **Industrials:** Demand remains stable despite the Middle East conflict, with the US and APAC showing some signs of recovery and EMEA improving modestly but still trailing the US. Growth continues to be led by energy, infrastructure, and HVAC, alongside structural themes such as decarbonization, grid investment, and AI/data center infrastructure. Fire safety businesses continue to benefit from resilient demand and strong M&A activity given their non-discretionary nature. Short-cycle and project-driven industrials continued to face weak demand, delayed customer capex, and some Middle East-related disruption. Most companies have effectively mitigated the impact of tariffs through pricing and supply chain strategies.
- **Airlines:** Demand remains strong, but higher fuel costs have compressed margins and delayed earnings recovery. Airlines have raised additional liquidity to provide a buffer against further geopolitical and fuel volatility. United Airlines was rumored to have pursued a merger with American and Delta, though the antitrust implications would be significant.⁵⁸ While liquidity remains solid for the major carriers, we remain cautious given ongoing cost uncertainty, despite continued strength in premium travel and pricing.

Consumer-Related Sectors - Selective but Still Holding Up Well

- **Consumer/Retail:** Spending has remained resilient, though purchasing behavior is increasingly value-oriented amid ongoing macroeconomic uncertainty. We continue to favor businesses with strong brands, pricing power, recurring demand, and exposure to value or premium niches, while remaining cautious on lower-income discretionary and large-ticket categories. We also see opportunities among retailers that stand to benefit from tariff refunds after previously paying higher tariff rates, while the K-shaped consumer environment continues to favor businesses serving higher-income consumers.
- **Leisure:** In the US, performance remains mixed, with cruise lines continuing to benefit from strong demand and forward bookings, while theme parks and broader entertainment continue to face softer demand. We remain focused on summer visitation trends and pricing power as key indicators for the sector. In Europe, demand is mixed, with larger destination theme parks remaining under pressure while regional parks perform better. Dutch holiday parks face VAT-related headwinds, whereas the UK market is benefiting from a temporary summer VAT discount and favorable weather, supporting stronger demand. Higher gasoline prices are also weighing on consumers' inclination to visit "drive-to" theme parks.
- **Lodging:** Fundamentals remain strong, with better-than-expected US RevPAR growth supported by the FIFA World Cup and robust travel demand. Strength has extended beyond luxury hotels, with economy segments also benefiting from data center-related construction activity.

⁵⁵ Source: Bloomberg. As of July 29, 2026.

⁵⁶ Sourced from the relevant company's earnings reports and filings.

⁵⁷ Source: Yahoo Finance. As of June 10, 2026.

⁵⁸ Source: Bloomberg. As of July 26, 2026.

- **Gaming:** Industry fundamentals remain healthy, with resilient demand supporting both land-based and online gaming. M&A activity remains elevated with Fertitta (or Icahn) pursuing Caesars⁵⁹ and MGM receiving an unsolicited bid from IAC⁶⁰. Las Vegas has rebounded following a challenging summer in 2025. Online gaming continues to grow despite uncertainty surrounding prediction markets. We expect the legality of sports betting via prediction market platforms to remain in limbo until the Supreme Court is forced to opine, which is unlikely in the near term.

Sectors - Slowing but Still Strong

- **Financial Services:** Operating performance remains healthy, supported by favorable secular trends and limited exposure to tariffs and geopolitical disruption. While M&A activity has moderated, private valuations remain strong as evidenced by Oak Hill's recapitalization of insurance broker IMA at a mid-teen multiple and Carlyle's acquisition of wealth manager MAI at 20x.⁶¹
 - **Insurance Brokerage:** Organic growth continues to normalize amid softer pricing and increased competition which is driving higher switching, with private brokers benefiting at the expense of public brokers. AI is viewed as a margin enhancement opportunity rather than a disruptive threat, particularly for scaled, integrated brokers.
 - **Wealth Management:** Wealth platforms continue to benefit from strong markets and the ongoing shift toward independent advisors. Higher interest rates continue to support earnings for independent broker-dealers through cash sweep income.
 - **Fund Administration:** Growth has moderated alongside slower alternative fundraising but remains healthy at a mid-single-digit pace. The rapid pace of M&A-driven consolidation in the space has also slowed. AI and automation are being used primarily to improve efficiency and service quality, with providers expected to retain much of the resulting cost savings.
- **Auto Services:** Trends remain mixed, with softer demand in tires and moderating collision repair volumes, while lubricant suppliers continue to benefit from higher oil prices.

Challenged Sectors

- **Cable:** Equity and debt prices have sold off significantly in both the US and Europe as the sector faces intense competition from fixed wireless at the lower end and fiber at the higher end, alongside ongoing broadband subscriber losses. Stretched balance sheets and refinancing risk remain concerns, especially for the European cable players such as Virgin Media and Ziggo. We are encouraged by actions taken by some cash flow-rich credits, such as Charter's decision to pause share buybacks and instead prioritize debt repayments.⁶²
- **Education:** The sector remains challenged by a constrained funding environment, although purchasing trends are beginning to normalize following the expiration of federal COVID relief funding. AI adoption is accelerating across EdTech, while increasing concerns around student screen time represent a growing headwind for digital learning solutions.
- **Media & Entertainment:** Advertising benefited from the FIFA World Cup, while investor focus has shifted from subscriber growth toward audience engagement, resulting in greater scrutiny of streaming platforms. Industry consolidation had accelerated amid intensifying competition for consumer attention, as highlighted by the \$110bn Paramount/Warner Bros merger⁶³ and the \$22bn Fox/Roku combination⁶⁴. Further, AI adoption also continues to expand across content production.
- **Food:** We remain cautious on packaged food issuers, where price reductions are increasingly being used to stabilize volumes as consumers seek value amid inflation, higher fuel prices, and broader affordability pressures. We favor protein-focused businesses as a way to position for continued GLP-1 adoption and note that suppliers of sauces and condiments to restaurant chains have proven comparatively resilient. Food safety remains a near-term watch item following the recent cyclospora outbreak. M&A continues to drive consolidation and portfolio optimization across the sector, most notably through McCormick's combination with Unilever's foods business at an enterprise value of approximately \$44.8bn.⁶⁵

⁵⁹ Source: Caesars Entertainment, Inc. As of May 28, 2026.

⁶⁰ Source: MGM Resorts International. As of June 1, 2026.

⁶¹ Source: Company filings; IMA Financial Group, Inc., May 13, 2026; Carlyle, March 31, 2026.

⁶² Sourced from the relevant company's earnings reports and filings.

⁶³ Source: Paramount. As of February 27, 2026.

⁶⁴ Source: Fox Corporation. As of June 15, 2026.

⁶⁵ Source: Bloomberg. As of March 31, 2026.

- **Packaging:** Earnings proved more resilient than expected as companies managed to offset resin cost inflation through inventory management and pricing. However, demand remains soft, with glass continuing to underperform amid secular volume declines.
- **Healthcare Services:** In the US, the loss of Affordable Care Act (ACA) coverage is resulting in higher uncompensated care and weaker elective procedure volumes, pressuring profitability, particularly at hospitals. Underlying operating trends remain stable. In Europe, healthcare services continue to benefit from solid volume growth, stable reimbursement, and moderating labor costs, although the medium-term outlook remains uncertain given fiscal pressures and regulatory changes across key markets, including the UK, France, and Germany.

Cyclical Sectors - Recovery has been Further Delayed

- **Chemicals:** Feedstock disruptions following the Strait of Hormuz closure have been less severe than initially feared. Low-cost Asian imports were curtailed, leading to higher prices and margins for commodity chemical producers, although underlying demand remains weak. Specialty chemicals experienced a more mixed impact due to raw material cost pass-through timing, but pricing acceptance is improving. Looking ahead, pricing is normalizing from 2Q peaks, while easier year-over-year comparisons should support performance through 2H26. Europe remains structurally disadvantaged over the long term.
- **Building Products:** The 30-year mortgage rate now back at a 12-month high of 6.8%, continues to weigh on demand and delay a broader recovery.⁶⁶ The market remains bifurcated, with move-up and luxury housing outperforming the entry-level segment. First-time buyers now represent just 21% of the market, a record low compared to a historical norm of 40%⁶⁷, further compounding the persistent shortage of affordable entry-level homes. We continue to favor businesses with diversified end markets, greater repair and remodel exposure, and resilient operating models well positioned for an eventual housing recovery.
 - In Europe, activity improved sequentially in 2Q following a weather-impacted 1Q, but the recovery remains modest as residential construction and renovation demand remain weak. Persistent cost pressures, competitive pricing, and higher interest rates continue to weigh on the sector, particularly for distributors, delaying a broader housing recovery despite somewhat improving near-term trends.
 - Across many US and European suppliers and distributors, leverage remains elevated, free cash flow is limited, and meaningful recovery in fundamentals has yet to emerge. These challenges are further compounded by looming 2028 and 2029 maturities. Discussions between lenders and sponsors have begun or are ongoing to reach consensual solutions — including some combination of capital injection, debt reduction, and tighter documentation — positions these credits to take advantage of an eventual recovery rather than simply extending maturities without addressing the underlying leverage.

⁶⁶ Source: Bloomberg. As of August 13, 2026.

⁶⁷ Source: National Association of Realtors. 2025 Profile of Home Buyers and Sellers.

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