MEMORANDUM

30 June 2026

Phoenix Merchant Partners — Research

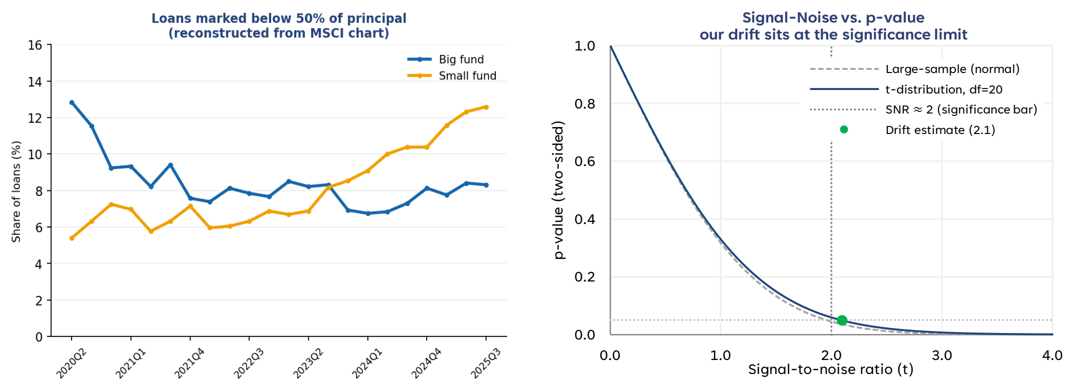
"Private Credit Stress Concentrates in Smaller Funds" ... a review of the facts

Apollo's recent *Daily Spark* argues that private-credit stress concentrates in smaller funds, which it attributes to lending to smaller, weaker companies and holding less diversified portfolios, leaving little cushion when credits deteriorate.[1] We agree that dispersion in outcomes is widening, but read the evidence differently. The claim of a particular stress in smaller funds, in our opinion, (i) is not robust in the presented data, (ii) understates the structural and funding-model risks borne by large lenders, and (iii) points away from the software sector concentration that is the actual driver of stress today.

1. The chart does not establish a robust size effect

The claim rests on MSCI's exhibit "In private credit, size has meant relative safety."[2] We reconstructed and tested its two series[3]. The small-minus-big gap in loans marked below 50% is highly persistent - close to a random walk, in which a rising line can appear by chance - so the appropriate test looks at quarter-to-quarter changes.

Figure 1: Robustness of "size has meant relative safety" claim



There the gap drifts up ~0.56 pp per quarter against a standard error of ~0.26: a signal-to-noise ratio of only ~2.1, barely past the ~2.0 that marks significance, with a 95% range (~0.01 to 1.1 pp) that nearly touches zero. The full-sample average gap is essentially nil and the entire effect sits in the last 6-8 quarters.

Critically, MSCI publishes no sample sizes, dispersion, or confidence bands, so a few impaired funds could be moving the aggregate. On the evidence shown, this is a suggestive recent signal, not an established size effect.

2. The structural fault lines run the other way

Scale carries its own concentration risk. To deploy multi-billion-size vehicles, the largest lenders increase deal size and focus on the upper middle-market, competing directly with broadly syndicated loans. Origination is driven by large sponsors' needs and concentrated in PE-heavy industries (incl. software)[4]. Rapid underwriting and deployment across multi-lender groups results in significant portfolio overlap[4], and competitive pressure that led to the prevalence of covenant-lite structures through the larger end of the market (~30% of upper-MM deals, >$50m EBITDA, lack maintenance covenants)[5]

It is well established in investment literature that expertise-intensive, capacity-constrained asset classes exhibit decreasing returns to scale[6]. Smaller lenders can build differentiated portfolios by operating below the mega-deal threshold, sourcing proprietary, often non-sponsor opportunities across a broader range of industries, preserving underwriting intensity, and securing stronger lender protections (incl. covenants, tangible collateral) through less competitive transactions.

We believe the more relevant differentiator today is the funding model rather than fund size. Much of recent growth among the largest private credit platforms has been driven by retail wealth channels, which are more susceptible to sentiment-driven redemption pressures, as demonstrated by the recent experience of several flagship non-traded vehicles[7].

---

[1] Apollo, "The Daily Spark" (T. Slok, Chief Economist), apolloacademy.com/the-daily-spark, June 2026.

[2] MSCI, "The State of Private Markets 2026," theme 03 (Liquidity), Q3 2025 MSCI Private Capital Transparency data.

[3] Phoenix Merchant Partners, internal analysis (June 2026): Series from MSCI exhibit, tested with a unit-root-robust drift test. Digitization error ≈ ±0.5–1 pp.

[4] Phoenix Merchant Partners, "Diversification in Institutional Direct Lending" (June 2026), University of Chicago, "The Lending Technology of Direct Lenders in Private Credit" (Jan 2026) and Raymond James, "3Q25 BDC Portfolio Overlap" (Dec 2025).

[5] Covenant Lite Substack, https://covenantlite.substack.com/p/covenant-lite-22-guardrails-gone, June 2025

[6] Berk & Green, "Mutual Fund Flows and Performance in Rational Markets", 2024; Pastor, Stambaugh & Taylor, "Scale and Skill in Active Management", 2015

[7] Bloomberg, "Apollo Caps Private Credit Fund After 17% Request to Exit", June 2026, Apollo Debt Solutions BDC: Q2 2026 repurchase requests ~16.8% of shares against a 5% quarterly cap, met ~45% pro-rata

By contrast, smaller institutional funds backed by long-term committed capital do not face this structural liquidity pressure, irrespective of the size of their borrowers. Framing the problem around fund and/or borrower size understates both the sector concentration and the redemption fragility that sit disproportionately with the largest, partially retail-funded platforms.

3. Where the stress sits: Software, in the largest books

The most systemic strand of today's distress is software, and the bulk of that exposure, including the marquee mega-deals, sit in the large, sponsor-driven books[8].

Under deployment pressure, the largest lenders financed the 2021–2022 vintage of software LBOs at high leverage, frequently underwritten against recurring revenue rather than EBITDA. With benchmark rates still elevated, all-in coupons in the low double digits now consume the bulk of these borrowers' cash flow, while generative-AI disruption pressures the terminal value of legacy SaaS. As equity cushions erode, sponsors grow reluctant to inject fresh capital, leaving the lender holding a leveraged, underperforming asset.

Medallia is emblematic: Taken private by a large PE-Manager in 2021, its PIK toggle was not extended and expired at the end of 2025, the resulting switch to cash interest lifted debt service to ~$300m against ~$200m of earnings; by mid-2026 a lender group took control in a debt-for-equity restructuring, crystallizing losses. It is one of several 2021/22 software mega-deals, held across large direct lending platforms. Combined, the 15 largest transactions are estimated to account for ~$30bn of debt financing, illustrating the potential for correlated portfolio stress across large funds[9].

Smaller lenders, particularly those prioritizing proprietary non-sponsor origination, typically do not participate in mega-deals. Their portfolios are built through directly sourcing across a broader range of industries, enabling greater selectivity and stronger structural protections. This approach generally results in lower software exposure and greater reliance on asset collateral with demonstrable recovery value, rather than enterprise-value or ARR-based underwriting.

In Conclusion

Outcomes in private credit are dispersing, and some smaller managers will struggle. But the specific proposition that "Stress Concentrates in Smaller Funds" is not supported by evidence. On the data presented it appears a suggestive signal, not an established effect, and runs against three features of the current credit cycle,

A. The structural pressures that push scaled lenders into the most competitive end of the market
B. The redemption fragility of partially retail-funded vehicles, and
C. The concentration of 2021/22 vintage software exposure in the largest direct lending books.

In our view, size is the wrong dimension. Rather, underwriting quality, lender protections, sector concentration, funding model, and, importantly, diversification across origination channels can explain a greater share of dispersion than AUM.

A portfolio sourced through a single, sponsor-driven pipeline inherits the overlap and common-factor risk now surfacing in software. Whatever its size; broadening origination, for example toward bank-sourced, non-sponsor lending, widens sector exposure and tilts the portfolio toward more robust collateral and protections. That, instead of fund size, is the more durable risk lesson of this cycle.

[8] S&P Global, "Software debt sell-off signals cyclical turn for private equity and credit", March 2026.
[9] Phoenix Merchant Partners, internal research, June 2026.

NOTICE TO RECIPIENTS

THIS DOCUMENT IS FOR INFORMATIONAL PURPOSES ONLY AND SHOULD NOT BE RELIED UPON AS INVESTMENT ADVICE. This document has been prepared by Phoenix Merchant Partners, LP ("Phoenix") and is not intended to be (and may not be relied on in any manner as) legal, tax, investment, accounting or other advice or as an offer to sell or a solicitation of an offer to buy any securities of any investment product or any investment advisory service. The information contained in this document is superseded by, and is qualified in its entirety by, such offering materials. This document may contain proprietary, trade-secret, confidential and commercially sensitive information. U.S. federal securities laws prohibit you and your organization from trading in any public security or making investment decisions about any public security on the basis of information included in these materials.

THIS DOCUMENT IS NOT A RECOMMENDATION FOR ANY SECURITY OR INVESTMENT. References to any portfolio investment are intended to illustrate the application of Phoenix's investment process only and should not be used as the basis for making any decision about purchasing, holding or selling any securities. Nothing herein should be interpreted or used in any manner as investment advice. The information provided about these portfolio investments is intended to be illustrative and it is not intended to be used as an indication of the current or future performance of Phoenix's portfolio investments. Investment Examples were chosen based on objective, non-performance-based criteria for the purpose of describing the investment processes and analyses Firm uses to evaluate such investments.

AN INVESTMENT IN A FUND ENTAILS A HIGH DEGREE OF RISK, INCLUDING THE RISK OF LOSS. There is no assurance that a Fund's investment objective will be achieved or that investors will receive a return on their capital. Investors must read and understand all the risks described in a Fund's final confidential private placement memorandum and/or the related subscription documents before making a commitment. The recipient also must consult its own legal, accounting and tax advisors as to the legal, business, tax and related matters concerning the information contained in this document to make an independent determination and consequences of a potential investment in a Fund, including US federal, state, local and non-US tax consequences.

PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS OR A GUARANTEE OF FUTURE RETURNS. The performance of any portfolio investments discussed in this document is not necessarily indicative of future performance, and you should not assume that investments in the future will be profitable or will equal the performance of past portfolio investments. Investors should consider the content of this document in conjunction with investment fund quarterly reports, financial statements and other disclosures regarding the valuations and performance of the specific investments discussed herein. Unless otherwise noted, performance is unaudited.

DO NOT RELY ON ANY OPINIONS, PREDICTIONS, PROJECTIONS OR FORWARD-LOOKING STATEMENTS CONTAINED HEREIN. Certain information contained in this document constitutes "forward-looking statements" that are inherently unreliable and actual events or results may differ materially from those reflected or contemplated herein. This information is provided to discuss general market activity, industry or sector trends, or other broad-based economic, market or political conditions. Economic and market forecasts presented herein reflect our judgment as of the date of this presentation and are subject to change without notice. These forecasts are subject to high levels of uncertainty that may affect actual performance. These forecasts do not take into account the specific investment objectives, restrictions, tax and financial situation or other needs of any specific client. Actual data will vary and may not be reflected here. Accordingly, these forecasts should be viewed as merely representative of a broad range of possible outcomes. These forecasts are estimated, based on assumptions, and are subject to significant revision and may change materially as economic and market conditions change. Any references to indices, benchmarks or other measures of relative market performance over a specified period of time are provided for your information only. Phoenix does not make any assurance as to the accuracy of those predictions or forward-looking statements. Phoenix expressly disclaims any obligation or undertaking to update or revise any such forward-looking statements. The views and opinions expressed herein are those of Phoenix as of the date hereof and are subject to change based on prevailing market and economic conditions and will not be updated or supplemented.

EXTERNAL SOURCES. Certain information contained herein has been obtained from third-party sources. Although Phoenix believes the information from such sources to be reliable, Phoenix makes no representation as to its accuracy or completeness.

THIS DOCUMENT IS NOT INTENDED FOR GENERAL DISTRIBUTION AND IT MAY NOT BE COPIED, QUOTED OR REFERENCED WITHOUT PHOENIX'S PRIOR WRITTEN CONSENT.