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KKR Credit & Markets

Investment Insights

CTRL + ALT + CREDIT

Q4 2025 Market Review & 2026 Outlook

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Outcomes will
be designed, not
discovered.

Executive Summary

We have all lived through some version of the same moment: the screen is still on, the system is technically running, but the inputs stop matching the outputs. You're not staring at a black screen, but there is a drift: too many tabs open, too many background processes running, and just enough lag to make timing feel unpredictable. As we have discussed in prior notes, markets can be deceptively calm on the surface while the wiring underneath shifts and evolves. Dispersion rarely announces itself in real time. Asset prices may rally, yet rolling recessions can still play out across sectors, leaving behind a widening gap between the haves and the have-nots, similar to what we are seeing in the software sector today. That disconnect tends to show up in flows into asset classes, thin issuance windows, and outcomes that vary meaningfully based on how and where risk is taken. In a market like this, an overt focus on headlines can also distract from the more important story. The real work lies in how investors recalibrate from noise and become more deliberate about where and how risk is taken. That's the lens we are applying as we frame the year ahead around CTRL + ALT + CREDIT, an intentional way to think about controlling inputs, expanding opportunity sets, and avoiding unforced errors in credit.

Before we reboot, it is worth acknowledging where we are coming from — and why the system proved resilient. Global credit markets ended 2025 in better shape than many would have expected after a year of persistent macro uncertainty and episodic issuer-specific stress. Markets stayed open but remained disciplined. Global leveraged loan and high yield bond issuance was active, yet tilted heavily toward refinancing and repricings, a reminder that balance-sheet repair mattered more than growth for many companies. However, that outcome should not be mistaken for inertia. It was a byproduct of deliberate

choices made by management teams weighing what they could execute upon with certainty against what could wait amid an elevated level of uncertainty. When input costs, policy, impacts from AI, and demand are all moving targets, long-term planning becomes inherently difficult and preserving flexibility takes priority. This had a knock-on effect on M&A activity. While deal activity rebounded, it ultimately remained insufficient to satisfy the market's demand for new money supply. By year-end, investors had adopted a more pragmatic posture: selectivity, income generation, and structural protection moved back to the center of the conversation.

Looking ahead, our message is not to move to the sidelines. While we are in a more mature stage of the cycle with public equity valuations broadly feeling rich and anticipated credit losses continuing to normalize, we believe this environment calls for selectivity rather than retreat. As a firm, we believe the opportunity is to upgrade portfolio quality at a moment when the cost of doing so still appears cheap relative to history. That may be the most underappreciated asymmetry in the market today: even though many assets feel priced to perfection — the crosscurrents remain. Tariffs, monetary policy shifts, and persistent inflation are still working through the system, and geopolitics can create pockets of volatility overnight. This makes resilience, balance-sheet strength, and business-model durability more important than directional market exposure.

Income remains the predominant contributor to returns, and time is not neutral when income compounds. But good opportunities will be harder to source, and we believe more path-dependent. Deal activity is picking up, yet competition is intense and spreads are tight, particularly for higher-quality borrowers. The pressure to deploy is real, and that is often when structure gets watered down and downside protection is traded away for speed. At the same time, dislocations can still emerge when technicals gap or complexity pushes others to simplify. On the positive side, this reinforces our view that diversified income and constructing multi-asset portfolios across public and private credit will be the optimal path ahead.

In 2026, we believe outcomes will be designed, not discovered. Making your own luck, as we like to say, will not mean chasing beta in a crowded market. In our view, it means designing portfolios for resilience. That begins with controlling the inputs we can control, widening the opportunity set intelligently, and earning carry with structural protections, while recognizing that even the best protections might be tested in ways we cannot fully anticipate. That design discipline matters because the scoreboard is changing. Investors should be asking, relentlessly, what they are earning per unit of risk and where that risk lives: in the borrower, in the structure, in the liquidity, or in the assumptions embedded in “priced-to-perfection” markets. So, our reboot sequence is intentionally simple, even if the market is not.

With this framework in mind, we'll rewind 2025 to collect the data points that matter most and use them to organize the rest of this note around three inputs: CTRL, ALT, and CREDIT. But first, a look back on 2025 markets.

CTRL

is about controlling the inputs: higher-quality borrowers, robust structures, real downside protection, and disciplined underwriting that “makes its own luck” rather than renting market beta.

ALT

is about thinking in alternatives: integrating private, proprietary origination, and cross-asset solutions into a multi-asset credit portfolio, consistent with the idea of credit as an interconnected ecosystem of circuits.

CREDIT

is about selection as alpha: in 2026, avoiding mistakes may be the alpha as dispersion remains elevated, the herd grows louder, and the most important metric becomes return per unit of risk, not yield in isolation.

EXHIBIT 1

Global Credit Remained a Resilient Source of Income in 2025

2025 Returns Across Global Credit Markets



Source: S&P LSTA LL Index, Ice BofAML, JPMorgan CLLIE, Bloomberg and KKR Credit Analysis as of December 31, 2025 for returns and January 30, 2026 for yields.

2025 Market Rewind

Before we hit enter, it is worth running the playback on 2025 to collect the data that mattered, separate noise from signal, and establish the baseline for the CTRL, ALT, and CREDIT decisions ahead. If 2025 reinforced anything, it is that credit can appear calm even as the system underneath is quietly re-prioritizing and repricing. That disconnect became particularly visible in the months following Liberation Day. Over the past year, sentiment often ran on two tracks simultaneously. One was shaped by headlines and daily commentary, where narratives often shifted quickly and conviction was binary. The other was quieter and more consequential, reflected in the data: how capital flowed, where returns were generated, and which parts of the system proved resilient under pressure. This reboot is about choosing where you focus. **The level set is straightforward. While the headlines were often binary, the market is far more dynamic.**

That distinction matters because 2025 produced no shortage of negative headlines, particularly around private credit markets. Much of that commentary recycled familiar concerns around opacity, leverage, and defaults, without fully accounting for the facts and acknowledging how the credit ecosystem has evolved. In our view, that narrative missed the bigger story. The headlines tended to focus on the loudest corner cases, often overlooking the more constructive developments. Credit has become more diverse, more modular, and more integrated across public and private markets. For the investors positioned to underwrite across that ecosystem, we continue to view this evolution as positive. It creates room for selectivity, structural innovation and origination opportunities. We will go deeper on that topic later in this note.

We may have sounded like a broken record last year, but when you zoom out, the driver of outcomes was familiar: supply and demand, once again.

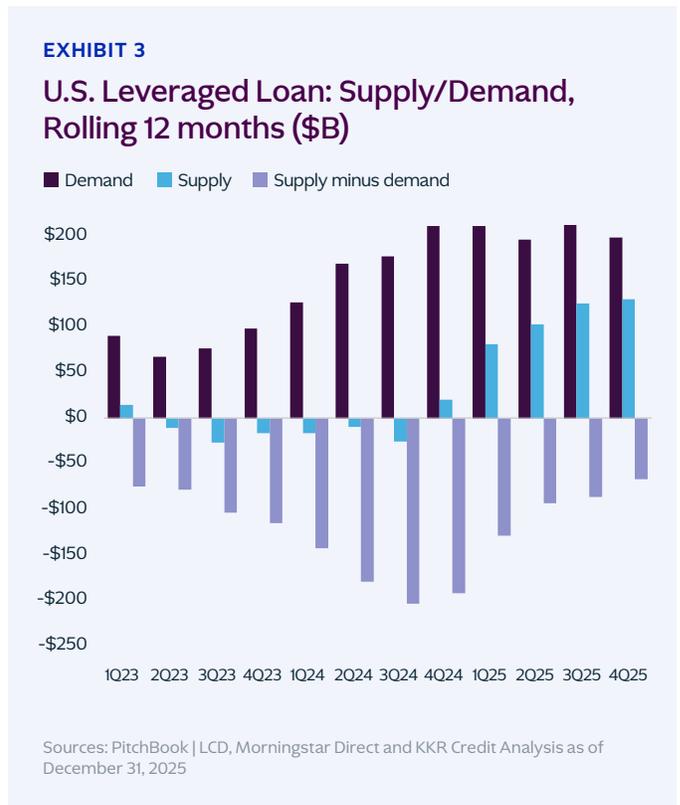
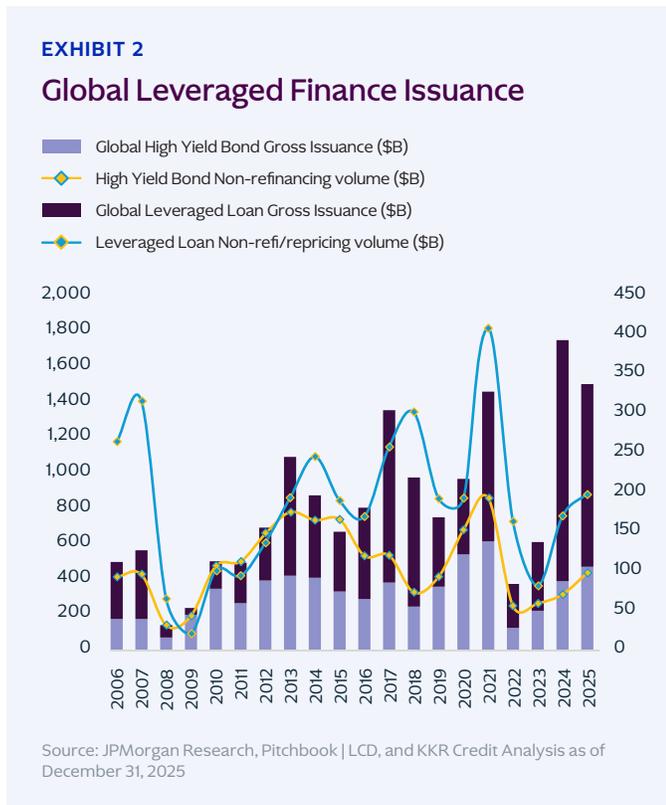
The technical bid persisted into year-end, but the supply continued to be predominantly refinancings and repricings accounting for 80%¹ of issuance last year, which was not the supply many were waiting for, a broad-based revival in LBO and transformational M&A financing. Borrowers did what rational actors do when the window is open: term out risk, lower coupons, and take uncertainty off the table. The “next wave” of new-money issuance kept getting discussed, but the market’s lived reality was that paper was still scarce in the places investors wanted to buy, and abundant in the trades issuers wanted to do.

Gross global leveraged finance issuance totaled \$984 billion in 2025, the second largest annual total on record following record gross issuance of \$1.3 trillion² in 2024. Although 2025 produced a 4-year high net issuance of \$199 billion³, which was +17% ahead of 2024’s depressed levels, it

was still not enough to satiate investor demand. The numbers are deceiving. Investment grade issuance totaled ~\$1.6 trillion⁴ reinforcing the demand from corporate borrowers and investors seeking higher quality credit exposure.

That issuance mix also explains why performance looked steadier than the headlines suggested. Yes, there were tariff-driven crosscurrents, policy noise, and sector-specific stress, but the center of gravity for returns stayed anchored by income. 2025 reaffirmed carry over convexity in practice: when spreads are tight and upside is capped, it’s the contractual return that does most of the work — and it’s the quality of the structure that determines whether you get paid on time and at par. That’s also why dispersion mattered so much. Higher-quality credits did what they were supposed to do; lower-quality risk often did not get the benefit of the doubt.

Exhibits 2 and 3: The dominance of refinancing activity continues to support a persistent supply-demand imbalance.



From a performance standpoint, the market rewarded investors who leaned into income and remained flexible across regions and structures. U.S. high yield returned +8.5%, outperforming European high yield at +5.1%,⁵ aided by greater duration support as rates drifted lower. Both U.S. leveraged loans +5.9% and European leveraged loans +4.1%⁶ lagged high yield as the floating-rate tailwind faded. Investment grade delivered a solid +7.8%,⁷ while Asia stood out as a bright spot, with high yield and investment grade returning approximately +10% and +7.9%,⁸ respectively, supported by relative value and favorable technicals. These outcomes were a simple reminder: where you took risk mattered just as much as how much risk you took.

Structured credit told a similar story. CLO BBs continued to deliver strong returns, +9.1%,⁹ despite higher loan defaults and wider dispersion in parts of the loan market, underscoring the importance of structure, subordination, and cash flow prioritization. CLO BBBs also held up well returning +7.1%¹⁰ outperforming the broader leveraged loan index though they lagged the highest-quality loan cohorts.

This reboot is about choosing where you focus. While the headlines were often binary, the market is far more dynamic.

Exhibit 4: Income continues to be the driver of returns

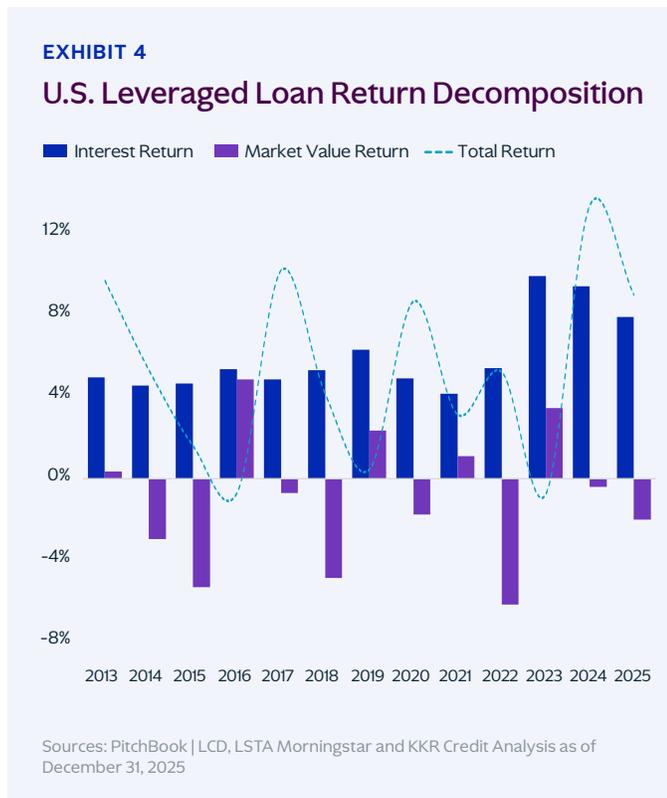
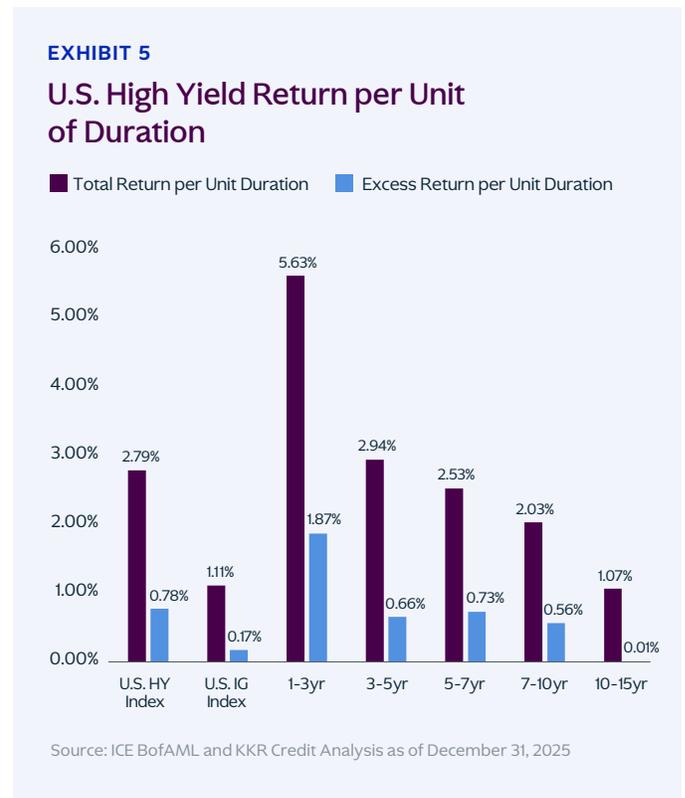


Exhibit 5: Short-dated U.S. high yield offers an attractive return per unit of risk in a tight market

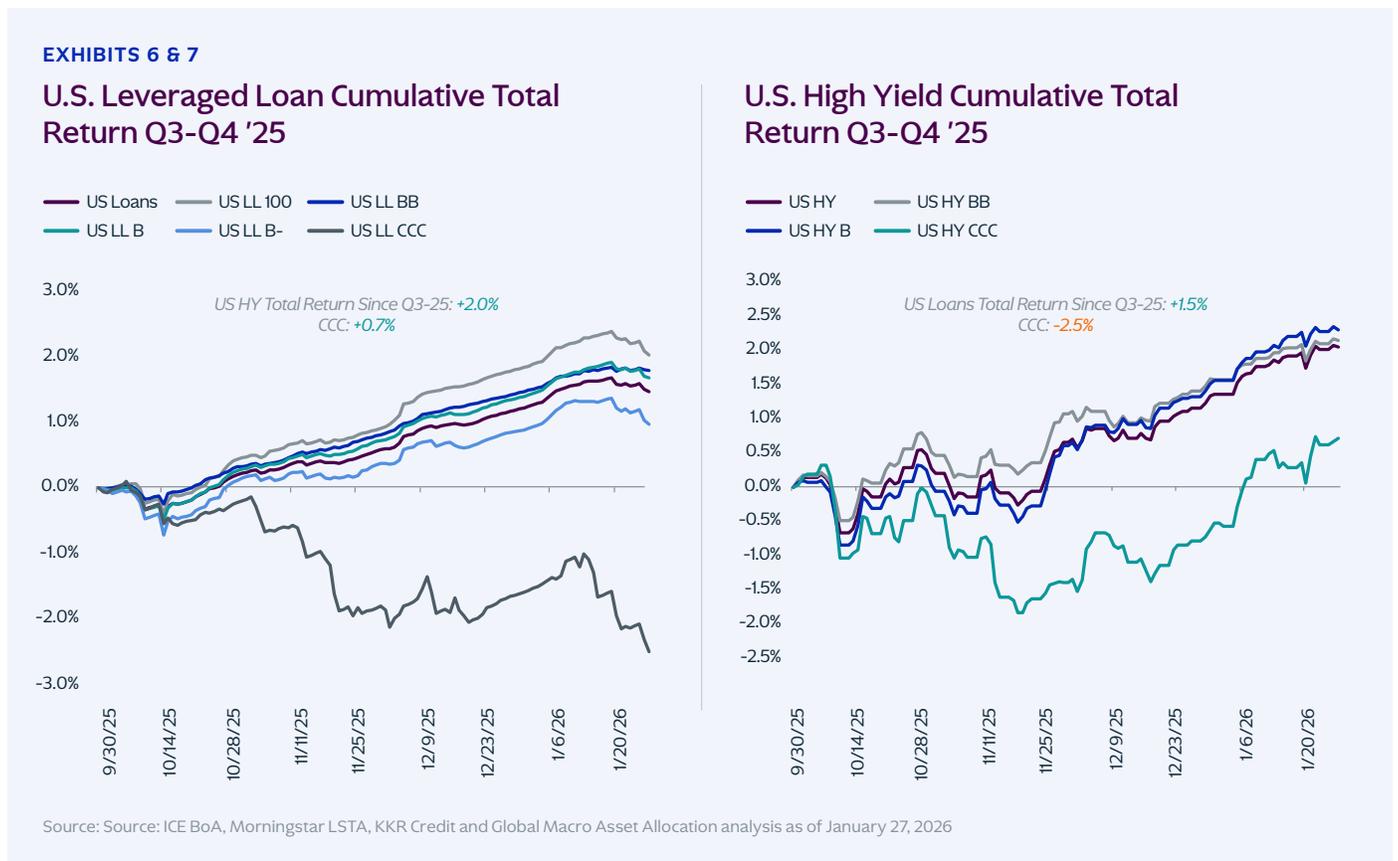


Across corporate credit, the up-in-quality theme played out consistently, reflecting a more favorable risk-reward trade-off at the higher end of the capital structure. U.S. high yield benefited meaningfully from falling rates, with roughly 6.2% of its 8.5% total return driven by rate moves rather than spread compression. Elsewhere, higher-quality segments such as the Morningstar LSTA Leveraged Loan 100 and European fallen angels saw modest spread compression, supported by constructive technicals and steady demand for income.

By contrast, lower quality pockets struggled as the market became less forgiving of leverage and weaker fundamentals. European BB experienced some widening spread, and

CCC-rated credits were generally the weakest performers across regions. The one notable exception was U.S. CCC high yield which delivered returns approximately +6.5%.¹¹ That outcome reflects a structural shift that has been underway since COVID in the high-yield market. Particularly over the past three years, the high-yield index has seen consistent net upgrades, with BB exposure rising to an all-time high of roughly 57%, making it the highest-quality composition the index has ever had. In contrast, the leveraged loan market has experienced persistent net downgrades and is over 60% single B credit. In this context, U.S. high-yield CCC performance was not about reaching for risk, but rather a function of improving credit quality and more supportive technicals.

Exhibit 6 & 7: There continues to be a growing bifurcation across High Yield and Leveraged Loans



Taken together, 2025 reinforced a simple but increasingly important reality. When quality slipped, the market responded quickly and often harshly, and that dynamic feels unlikely to soften in 2026. As our colleague Henry McVey highlighted in his “Outlook for 2026: High Grading”, investors should remain cautious about buying “cheap” assets that face intense competitive pressures and/or shaky capital structures. We unequivocally agree this will be paramount in credit.

CTRL

By the time outcomes show up in credit, most of the important decisions by an investor have been made. Selection, underwriting, structure and documentation all play meaningful roles in shaping returns. That reality brings us to the first and most important input for 2026: CTRL. Controlling what we can control, starting with borrower quality, capital structure, and downside protection. In an environment defined by rising dispersion, episodic volatility, and a higher cost of being wrong, credit outcomes have become more differentiated.

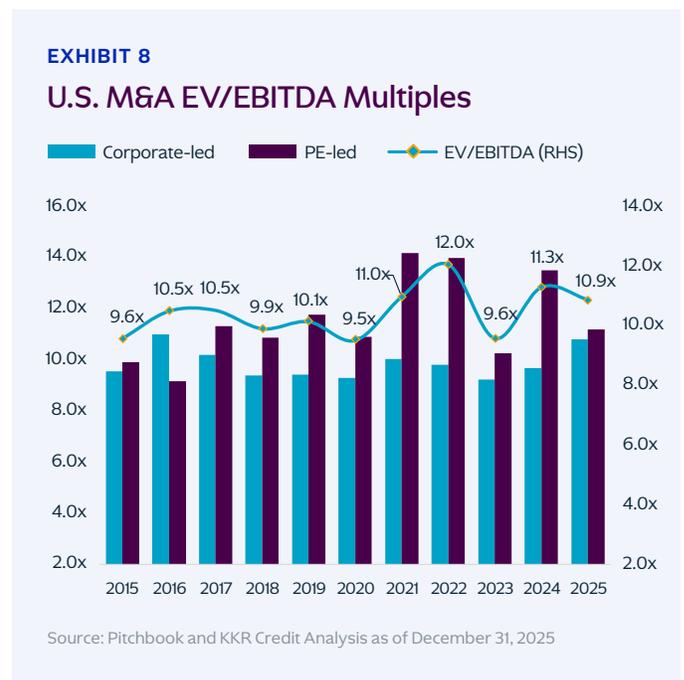
The gap between a good credit and a bad credit is no longer incremental. It is increasingly binary. Capital raised to refinance and extend runways behaves very differently from capital deployed to fund growth, transformation, or an asset-backed opportunity. One supports optionality and resilience. The other preserves time. That distinction sharpened over the course of 2025 and is likely to matter even more as markets transition toward a more normalized credit backdrop.

In an environment defined by rising dispersion, episodic volatility, and a higher cost of being wrong, credit outcomes have become more differentiated.

The same logic applies to how risk is accessed. Thoughtfully structured, directly originated solutions with aligned incentives and durable structural protections have shown an ability to meet the evolving needs of issuers while delivering more consistent outcomes for investors. This is not a critique of public markets, which remain essential sources of liquidity and price discovery. Rather, it reflects the growing importance of design in credit, both in origination and portfolio construction. Origination is not just about accessing volume. It is about shaping risk deliberately, with a clear understanding of where one sits in the capital structure and how cash flows are expected to perform across a range of outcomes and time periods.

When M&A activity is episodic rather than continuous, origination discipline matters even more. Credit does not disappear, but we have seen it reroute, favoring bespoke solutions tied to refinancing, carve-outs, and balance sheet management rather than volume-driven deal flow. That design discipline is increasingly what separates durable carry from fragile yield – or overreaching for risk. We will return to how these inputs translate into portfolio construction in the ALT section.

Exhibit 8: Corporate M&A activity continues to accelerate



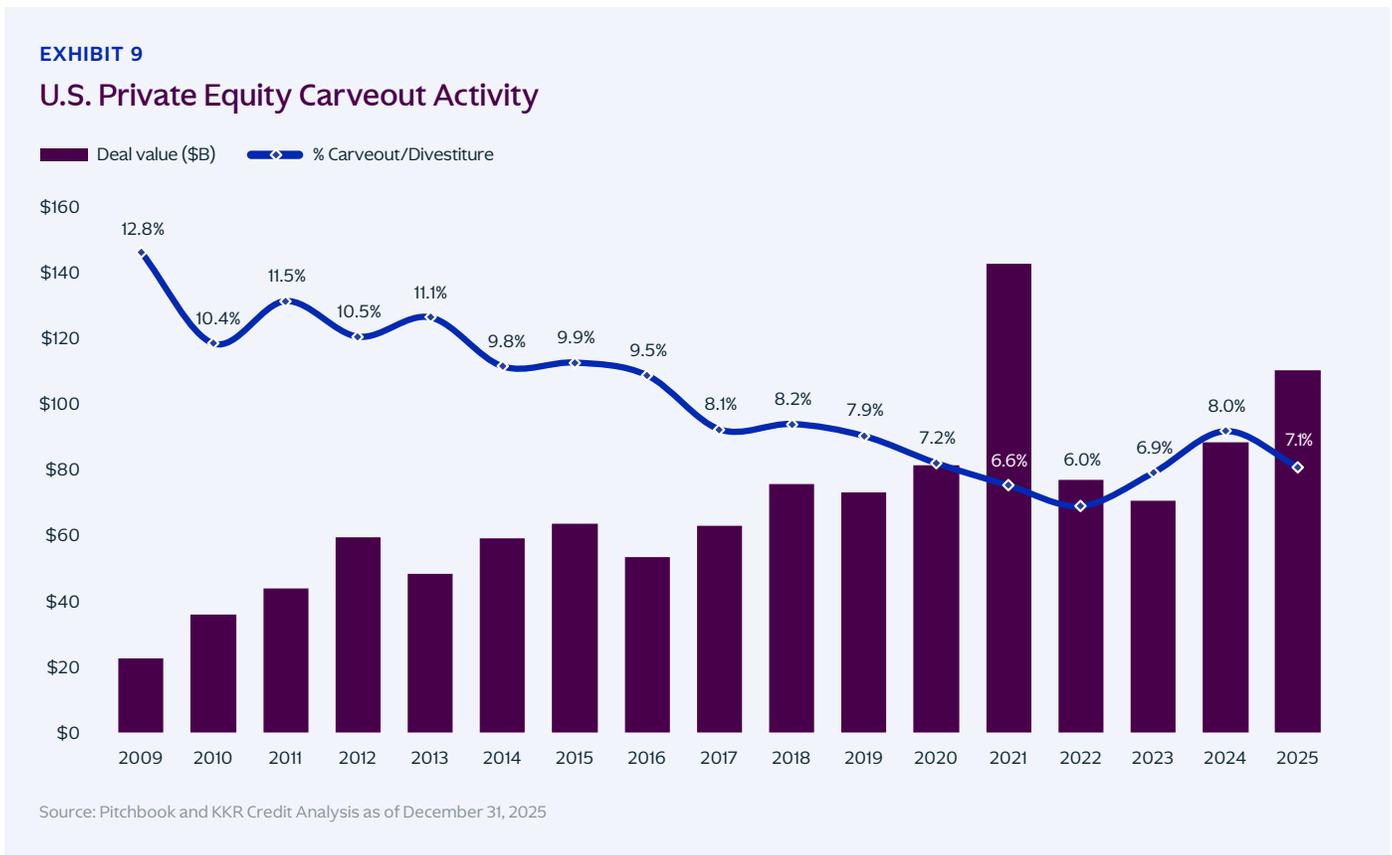
The private markets are not only expanding, but they are also deepening, with broader institutional participation, scale, and increasingly segmented specialization that is translating into new, non-traditional M&A.

As we discussed in *The Power of Credit*, today's financing environment has become far more modular. Companies are no longer limited to binary choices between public and private markets, or between debt and equity. Instead,

there is flexibility to mix public and private solutions, optionality between minority and majority stakes, and creative financing structures to achieve more targeted objectives. Partnership capital has expanded the toolkit, enabling corporates to optimize CapEx, return capital to equity holders, recapitalize balance sheets, and pursue acquisitions while preserving control and flexibility. Sale-leasebacks, carve-outs, minority stake sales, and structured partnerships have become practical tools for unlocking value and recycling capital.

The private markets are not only expanding, but they are also deepening, with broader institutional participation, scale, and increasingly segmented specialization that is translating into new, non-traditional M&A. This is not just a search for yield, but rather a response to the limitations of customized financing at scale.

Exhibit 9: The continued shift from capital-heavy to capital-light business models is driving increased carve-out activity and fueling demand for bespoke origination and creative capital solutions across the credit ecosystem.



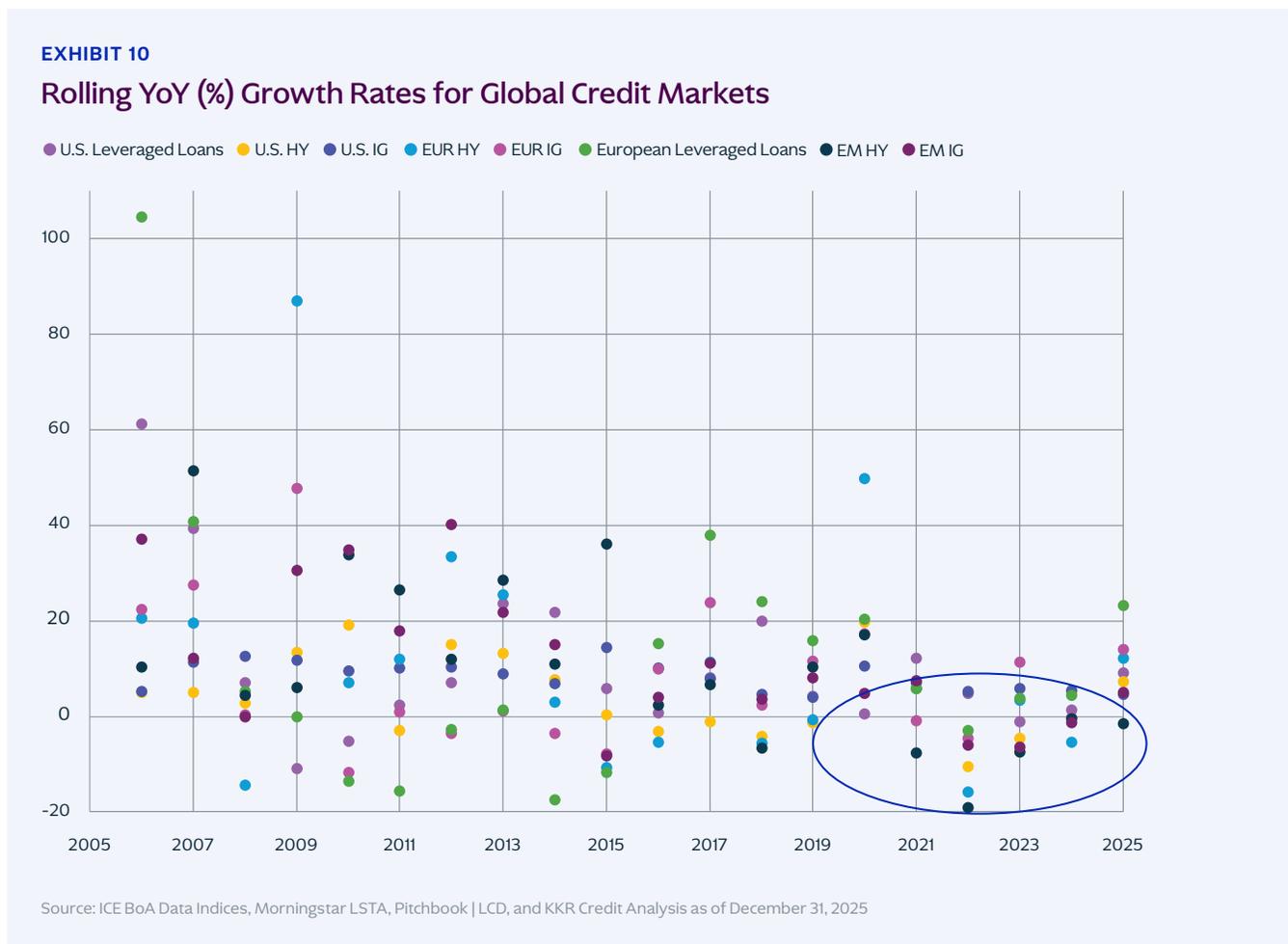
The opportunity today lies in access and in insight: understanding how scaled, specialized capital can deliver both returns and resilience. That, in turn, demands sharper engagement across the financing ecosystem, from originators and operators to the stakeholders impacted by these capital flows. In a modular credit ecosystem, control comes from origination breadth. The ability to structure across instruments and asset types has become a primary determinant of credit outcomes.

For us, this translates into an ecosystem-based approach to origination. Scale matters, but not in the sense of size alone. It is about the collective capability of an aligned plat-

Origination begets origination, and the power of relationships compound.

form, the ability to originate across multiple channels, and the connectivity that allows capital to move up and down the capital structure as conditions change. Origination begets origination, and the power of relationships compound. Governance rights, structuring expertise, and long-term partnerships allow investors to exert greater control over outcomes.

Exhibit 10: While U.S. and European high yield and leveraged loan markets have experienced periods of contraction over time, investment grade credit has shown more consistent long-term growth across regions.



The most effective version of this emerges when collaboration between investors and issuers deepens around shared incentives and aligned objectives. This is what we refer to as partnership capital. In an environment where many assets appear fully valued, that ability to control one's own destiny becomes a meaningful contributor to alpha. It is not just about seeing more deals, but about staying engaged through the life of the investment.

Importantly, this type of origination is becoming more relevant, not less. The evolution of the credit market reinforces this point. U.S. investment grade credit has historically had the most consistent growth across cycles, behaving as a balance-sheet absorber for the system with mid to high single-digit expansion through both benign and more challenging periods. Leveraged loans and high yield, by contrast, have followed a more episodic path. Growth tends to accelerate sharply during stable periods and slow materially or turn negative around stress points. That cyclicity is visible in both the U.S. and Europe, with European leveraged loans exhibiting even larger percentage swings given a smaller base and greater reliance on open market windows.

However, the throughline is that both U.S. and European leveraged loan and high yield markets have experienced negative growth in recent years. As a result, dispersion across asset classes has increased meaningfully, elevating the value of flexible capital that can originate outside narrow issuance windows. This shift reflects a combination of structural forces, including capacity constraints in traditional channels, greater and more diverse access to capital, heightened rate volatility, and the post-COVID normalization of macroeconomic and monetary policy.

These dynamics are unfolding against a shifting capital backdrop, which we will return to in more detail in the CREDIT section. For now, we believe the point is straightforward: capital is abundant, but much of it is increasingly constrained. There are many reasons for this such as rules-based mandates, benchmark sensitivity, rating and duration guardrails, and/or liquidity requirements, all of which have narrowed the set of opportunities that large pools of capital can pursue, even within the investment grade market. As a result, availability of capital does not translate directly into availability of financing for every situation. In this environment we anticipate this will be tested even further, making outcomes increasingly determined at the point of origination.

For investors, we believe the implications are also clear. Access to origination is becoming a source of alpha. As generic spread beta is competed away, the edge moves upstream into sourcing, information flow, and structuring capability. Scale combined with specialization matters. Platforms that can originate across asset classes include equity, corporate credit, asset-based finance, infrastructure and real estate are positioned to remain selective, navigate cycles, and execute the right deal (or just as importantly pass on the wrong one) as conditions change. This ability to deliver the right deal in the right wrapper, or to step aside when the risk-reward is asymmetric, is what ultimately will drive more durable, risk-adjusted returns in the year ahead.

Access to origination is becoming a source of alpha. As generic spread beta is competed away, the edge moves upstream into scale, platform diversification and specialization.

+ALT

Once control over the inputs is established, the focus shifts to where flexibility and relative value is best expressed across the credit ecosystem, setting the stage for **ALT: thinking in alternatives**. If CTRL is about improving the inputs, ALT is about redesigning the system those inputs sit within. Much like Credit's iPhone moment, the breakthrough is not a single new product, but a more integrated and flexible architecture that allows investors to assemble multi-asset portfolios and diversify income streams in ways that were not previously available.

Over the past several years, one conclusion has become increasingly difficult to ignore: the traditional portfolio map is no longer as reliable as it once was. That is evidence that the markets have evolved, which is healthy. The key change is not added complexity, but rather choice. Traditional fixed income has become a less reliable diversifier to equities, correlations have proven less stable during drawdowns and forward returns across traditional asset classes appear more compressed than in the prior cycles.

In fact, it was not long ago that most institutional investors did not have a dedicated allocation to private credit. Today, it has become a core component of many portfolios, marking one of the most significant structural shifts in capital flows the market has seen. What began as a tactical allocation has increasingly become permanent, reflecting the role private credit plays in income generation. In other words, alternative credit has shifted from a supplemental allocation added after the fact to a foundational component around which portfolios are increasingly constructed.

A meaningful driver of this shift is how capital now moves through the system. Large portions of public credit and fixed income exposure are accessed through daily liquidity vehicles such as mutual funds, ETFs, and other rules-based strategies. In benign markets, that liquidity is a feature. In periods of stress, it can become a source of correlation, which has been evident in every drawdown the market has experienced: COVID-19, rate hike tantrum in 2022, and most recently, April 2025 Liberation Day. Fund flows, redemp-

tion mechanics, benchmark constraints, and FX hedging dynamics often dominate fundamentals, pulling otherwise distinct assets into the same trade. Diversification erodes not because cash flows converge, but because capital is forced to move in unison due to forced selling.

ALT is about taking different risk, not more risk. It means expanding beyond traditional stocks or bonds toward alternative assets, alternative routes to return, and portfolio construction that leans more deliberately on private markets, structure, and thoughtfully managed illiquidity. The objective is to restore resilience, improve diversification, and enhance outcomes in a regime where the old shortcuts no longer work.

The multi-asset approach is not just limited to public credit markets. We continue to see growing demand for customized multi-asset portfolios that allocate across global corporate private credit, leveraged credit, asset-based finance, junior debt, CLO equity, Asia credit and capital solutions. These portfolios can be designed to either enhance yield or total return by specifying target allocations to multiple asset classes spanning the risk spectrum in accordance with the desired risk tolerance. Exposure to various credit strategies also acts as a powerful diversifier, particularly in non-obvious markets where relative value is hard to identify. Increasingly, investors are combining public and private allocations as complementary building blocks in their portfolios.

Alternative credit has shifted from a supplemental allocation added after the fact to a foundational component around which portfolios are increasingly constructed.

Incorporating leveraged credit into a public-private portfolio provides an efficient way to deploy what would otherwise remain as cash and helps mitigate the J-curve inherent in many drawdown vehicles by putting capital to work immediately. Maintaining consistent exposure to credit has historically been accretive to returns, particularly during periods of market dislocation, when the allocation can also be used tactically to capture relative value or episodic opportunities while preserving adequate liquidity.

In today's market, alternatives in portfolio construction are a practicality. As the exhibits that follow illustrate, diversification across corporate credit, asset-based finance, and real asset credit can materially improve return per unit of risk. While these strategies often offer comparable

headline yields, they are driven by very different cash flow dynamics, collateral profiles, and sensitivities to the economic cycle.

Incorporating a leveraged credit allocation into a private credit multi-asset portfolio provides an efficient way to deploy what would otherwise remain as cash and helps mitigate the J-curve inherent in many drawdown vehicles.

Exhibit 11: A multi-asset private credit architecture can deliver compelling expected returns per unit of risk. By combining structurally protected income across public and private credit, illiquidity premia, and proprietary origination, multi-asset portfolios have historically occupied a more efficient risk-return profile than public equity benchmarks.



When combined thoughtfully, they allow investors to maintain attractive income while reducing volatility and improving downside behavior. Historically, adding diversified credit sleeves has improved portfolio Sharpe ratios by approximately ~0.2 to 0.4 relative to public-only credit allocations, underscoring the impact of diversification rather than incremental risk-taking.

The key insight is that correlations matter more than labels. Corporate-oriented credit strategies tend to move together during periods of stress, regardless of where they sit

on the rating spectrum. By contrast, asset-based finance is anchored in different borrower behaviors, collateral pools, and contractual cash flows. It is less exposed to daily redemption pressure and global fund flow dynamics, allowing fundamentals to assert themselves over time. The result is a portfolio that can target similar, or even higher, expected returns with less variability and shallower draw-downs. This is not about reaching for yield. We believe it is about engineering resilience across the credit ecosystem through a diversified multi-asset approach.

Exhibit 12: A diversified credit architecture improves resilience by combining strategies with fundamentally different cash flow drivers.

EXHIBIT 12
Optimizing Between Yield and Capital Appreciation*

Estimated Pairwise Correlations (Based on Public Proxies)

		Corporate							Asset Based Finance	Real Estate	
		US Direct Lending	EU Direct Lending	Junior Debt	Capital Solutions	Distressed	Asia Credit	CLO Equity		SASB CMBS B-Piece	Opportunistic Credit
Corporate	US Direct Lending	1.00	0.93	0.94	0.91	0.83	0.76	0.79	0.42	0.40	0.45
	EU Direct Lending	0.93	1.00	0.84	0.86	0.69	0.76	0.74	0.44	0.36	0.41
	Junior Debt	0.94	0.84	1.00	0.92	0.90	0.78	0.82	0.49	0.45	0.51
	Capital Solutions	0.91	0.86	0.92	1.00	0.85	0.83	0.75	0.54	0.48	0.56
	Distressed	0.83	0.69	0.90	0.85	1.00	0.65	0.75	0.36	0.33	0.57
	Asia Credit	0.76	0.76	0.78	0.83	0.65	1.00	0.55	0.69	0.59	0.39
	CLO Equity	0.79	0.74	0.82	0.75	0.75	0.55	1.00	0.32	0.38	0.37
Asset Based Finance		0.42	0.44	0.49	0.54	0.36	0.69	1.00	0.74	0.50	
Real Estate	SASB CMBS B-Piece	0.40	0.36	0.45	0.48	0.33	0.59	0.38	1.00	0.39	
	Opportunistic Credit	0.45	0.41	0.51	0.56	0.57	0.39	0.37	0.50	1.00	

ASB CMBS = Single-Asset Single-Borrower Commercial Mortgage-Backed Securities

In a harder market, where volatility is more frequent and forward returns are narrower, multi-asset credit can provide a portfolio construction advantage. Allocating across complementary credit engines can produce stronger risk-adjusted returns and more durable outcomes than concentrating exposure in a single, familiar sleeve.

This evolution is not confined to higher-yielding segments of the market. We see it increasingly in investment grade as well, through the growth of what is often referred to as private IG. These exposures are not discovered in transactional markets. They are deliberately designed: privately

originated, senior, and structurally protected investments that allow capital to be deployed with intent, whether the objective is liability matching, income generation, or incremental return. In this sense, ALT is about designing portfolios that improve the odds of good outcomes. Not by reaching for yield, but by aligning structure, duration, and cash flows to specific portfolio needs. This ability to separate liability-driven allocations from return-seeking capital, and to build each deliberately rather than inherit them from the market, is a key reason alternative credit has evolved from the margins to the core.

+ CREDIT

As we often say, the north star of credit investing is capital preservation. Consistent with Henry McVey's "High Grading" framework, the focus here shifts from portfolio construction to investment outcomes. In a market where mistakes are penalized more quickly and recoveries remain challenged, disciplined underwriting and real downside protection will act as contributors to return. Technical strength continues to coexist with rising idiosyncratic risk, which makes precision, selectivity, and active portfolio management essential. We believe in this environment, avoiding permanent capital impairment matters more than capturing incremental spread. **This is where CREDIT discipline ultimately shows up, and where alpha is either earned or lost.**

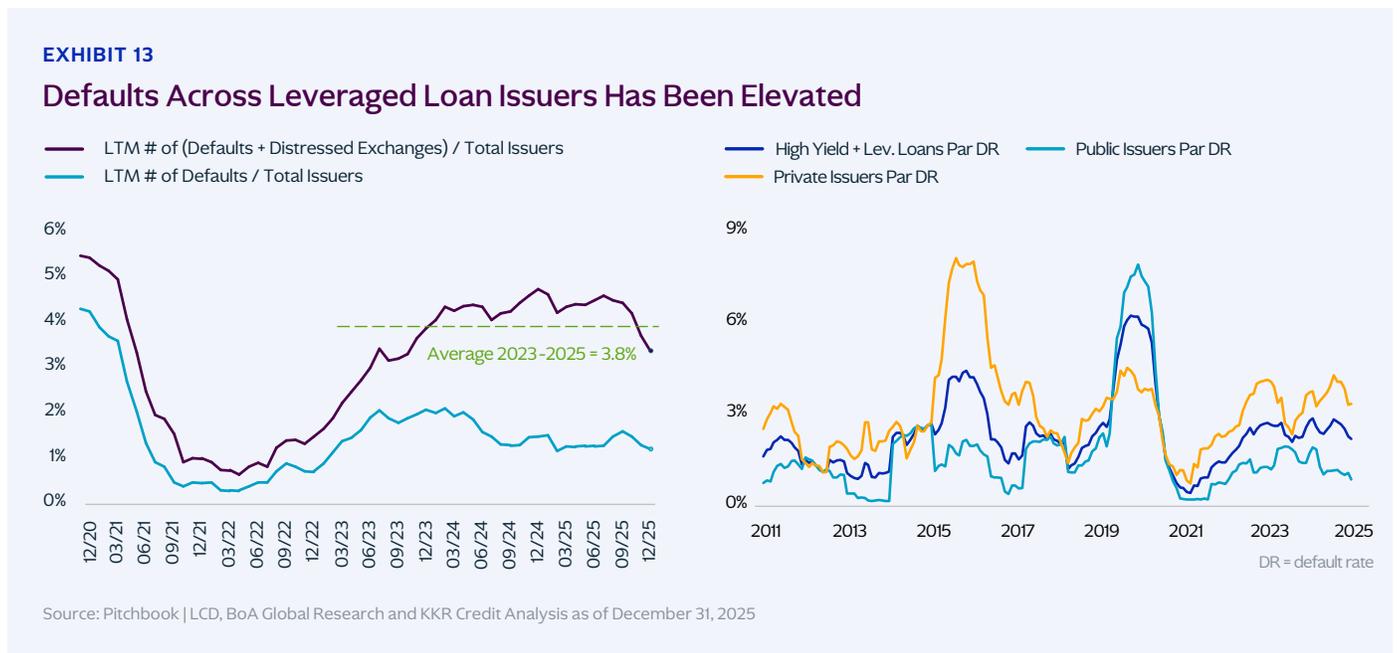
Defaults have felt loud, but the data tells a more nuanced story. What we have experienced over the past several years is the impact of rolling recessions. The cycle has been digesting stress in pockets, and the market is now paying you less for being imprecise. This is where leverage, refinancing needs, and business model disruption overlap.

In a market where mistakes are penalized more quickly and recoveries remain challenged, disciplined underwriting and real downside protection will act as contributors to return.

For example, retail, food and beverage, paper and packaging and automotive have accounted for the highest share of defaults over the last twelve months. Yet in aggregate default rates remain near historical norms, but outcomes have become more path dependent.

That path dependence is showing up most clearly in leveraged loans. Loans accounted for roughly 60% of default and liability management exercise activity for the fifth consecutive year, even as headline defaults remained contained. Nearly 40% of leveraged loan defaults involved repeat issuers that had already been through a prior default or distressed exchange.¹²

Exhibit 13: Defaults in Leveraged Loans have averaged 3.8% over the last three years due to rolling recessions and have not been a signal of sudden stress.



While this underscores the growing role of documentation, covenant design, and value leakage in shaping outcomes, it also reflects the steady pressure from secular decliners that have been building beneath the surface. Leveraged loan defaults have averaged approximately 3.8% over the past three years, indicating a period of sustained rolling recession stress than a sudden deterioration in credit conditions. The issuers driving these outcomes have largely been business models that were more sensitive to cyclical pressures and less resilient to higher financing costs. The key takeaway is that defaults have been ongoing for some time and have not been a signal of sudden stress. Importantly, in this environment recognizing when a credit thesis has broken and cutting losses decisively has become as important as initial underwriting discipline.

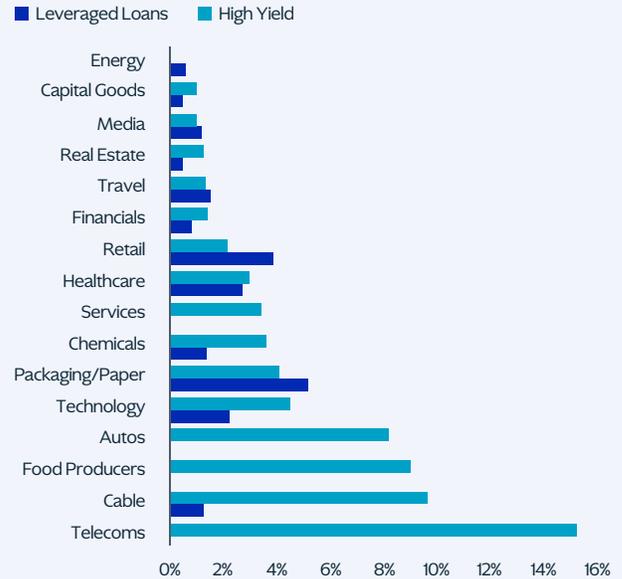
Downgrades reinforce that message and pressure in leveraged loans remains elevated particularly among loan-only issuers. The recent sell-off in software has brought this dynamic into sharper focus. While parts of the market are reassessing software risk through the lens of AI disruption and valuation compression, this pattern is consistent with a normalizing credit cycle rather than a signal of systemic stress. Looking ahead, we expect a broadly normal default backdrop in 2026 (consistent with what we have seen in last three years) rather than a new wave of distress as the macro backdrop remains resilient, and the distressed universe does not warrant elevated concern. Even within software, outcomes are increasingly dispersed with credit risk being driven by business model durability, cash flow visibility and underwriting discipline.

Our lending approach across industries, including software, has long emphasized companies with predictable revenues, durable cash flows, flexible cost structures, and low capital intensity. As a result, our exposure to more speculative, annual recurring revenue (ARR)-dependent, or high growth nascent software businesses has remained intentionally limited. Importantly, the recent moves in software could be seen as constructive as it retreats from a growth-at-all-costs mentality toward a greater emphasis on profitability and cash flow discipline. As growth moderates, margins and free cash flow should become more predictable, which is credit positive even if headline growth rates are lower.

EXHIBIT 14

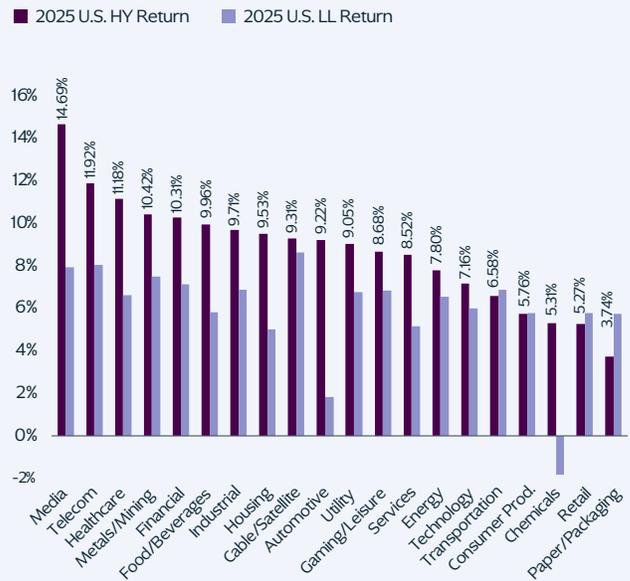
Sector Dispersion will persist in 2026

Default Rate by Sector



Source: Pitchbook | LCD, BoA Global Research and KKR Credit Analysis as of December 31, 2025

2025 Returns by Sector in Leveraged Loans and High Yield



Source: ICE BofA, Morningstar LSTA, JPMorgan Research and KKR Credit Analysis as of 12/31/2025

At different points in time, AI has been viewed either as existentially disruptive or as a potential enhancement to business models, with the implications still unfolding in real time. History suggests reality lies in between, with outcomes varying meaningfully on a case-by-case basis. That same dispersion is increasingly evident across credit markets more broadly. While the leveraged loan market may face more challenges than high yield due to the underlying credit quality, downgrade pressure and technical reliance due to CLO demand, this remains an environment defined by selection rather than broad-based stress.

This is where an important misconception deserves to be addressed directly. Elevated defaults in parts of the market are not evidence that private credit, broadly defined, is inherently lower quality. As we often say, investors should lean into credit that can bend, not break. What has been breaking are weak capital structures, permissive documentation, and business models that were never fit for a higher-for-longer cost of capital. Those risks can exist in public and private markets alike. The differentiator is not the label attached to the asset, but the quality of the underlying borrower and underwriting discipline embedded at entry.

These dynamics also help frame the evolution of private credit more broadly. Private credit did not appear overnight, nor has its growth been unchecked. Its growth has been methodical over more than a decade, shaped by the Global Financial Crisis, regulatory changes shaped by Dodd-Frank, and the steady expansion of the private equity ecosystem as companies stayed private for longer. As banks became more selective and capital rules raised the cost of incremental risk assets, private lenders stepped in to meet a clear financing need. That pattern looks far more like the evolution of leveraged loans, CLOs, or early ETFs rather than speculative excess.

Periods of moderation, including occasional contractions, reflect a market that is maturing and becoming more selective. In fact, on a year-over-year basis global corporate private credit (sub-IG), which is predominantly direct lending, grew at a slower rate.¹³ This shift has occurred

Elevated defaults in parts of the market are not evidence that private credit, broadly defined, is inherently lower quality.

alongside a resilient real economy, particularly in the U.S. middle market, which represents roughly one third of private-sector GDP and employment, accounts for approximately 60% of new private-sector job creation and generates more than \$10 trillion in annual revenue.¹⁴ Despite persistent macro volatility, middle market revenues grew approximately 10.7% over the past year, well above large-cap corporate growth, underscoring that credit demand has remained fundamentally tied to operating businesses. In that context, the growth of private credit reflects a diversification of funding sources supporting a critical segment of the economy. At the same time, U.S. commercial and industrial loan growth turned negative, running roughly -3% YoY on a 3-month moving average through late 2025, while Europe was low-single-digit positive but modest.¹⁵ Against this backdrop, direct lending has gained share by providing access to capital where there are acute supply/demand needs.

Investment grade deserves some scrutiny in this context as well. We have said in the past don't always judge a credit by its rating, the same is true for investment grade. Rating labels capture the probability of default, but they say far less about loss severity. In several recent cases, assets deemed stable, essential, or infrastructure-like have exhibited risk characteristics that could translate into more binary outcomes should stress emerge. These surprises often reflected reliance on corporate guarantees, assumptions about asset criticality, or insufficient appreciation for project-level risks rather than balance sheet leverage. In this market, severity has been more frequently mispriced than default probability in our view. Concentration quietly amplifies this risk too. In many cases, the underlying risk is not traditional corporate risk, but rather structural risk embedded in the investment mechanics and documentation such as lender protections on leases for example.

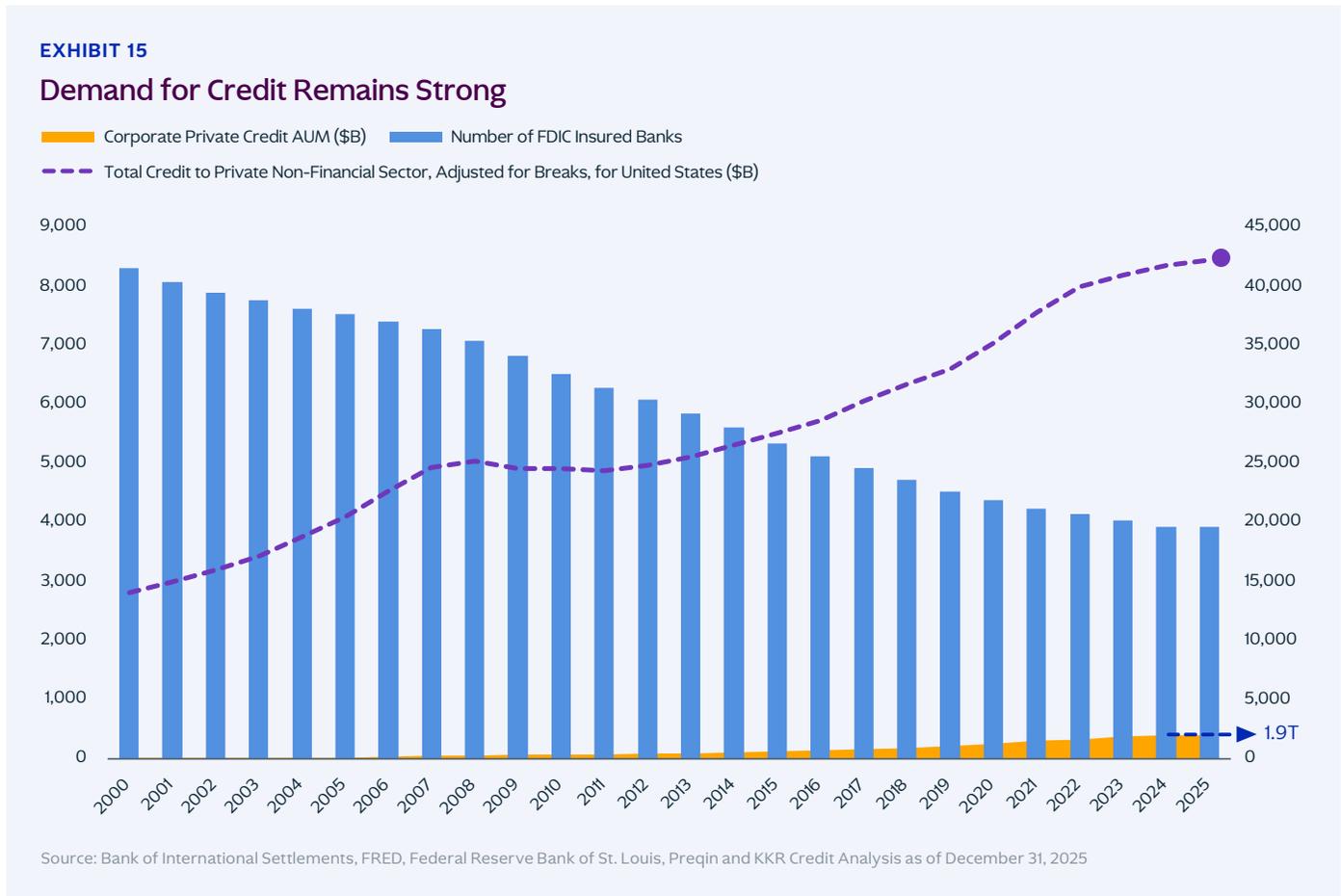
Even secured positions can behave unpredictably when portfolios cluster around similar business models, cash flow assumptions and capital structures. This is why portfolio diversification and construction discipline must work together. Structure and correlation matter as much as seniority.

These dynamics also solidify why scale matters in credit today, but scale alone is not sufficient. Craft and specialization matter just as much. Capital preservation does not come from optimism. It comes from understanding where risk actually lives - what is the true return per unit of risk taken. This is especially true as capital continues to flow into bespoke, asset-intensive opportunities such as data centers, digital infrastructure and energy transition assets. As these markets expand, the distinction between corpo-

rate credit and project finance is increasingly important to define. The headline risk may read like investment grade credit. In practice, the underwriting burden is far more complex and specialized.

The growing universe of private investment grade capital solutions is where underwriting meets industrialization. In these transactions, what matters is not just who the borrower is, but what the lender has agreed to. Construction risk, delay provisions, force majeure clauses, termination rights, commissioning milestones, offtake mechanics, and step-in remedies all shape downside outcomes. Certain provisions can temporarily or permanently release borrower obligations while leaving the lender fully exposed. These are not theoretical distinctions.

Exhibit 15: Although the size of the direct lending market has experienced rapid growth in recent years, the demand for credit from the non-financial sector has never been greater



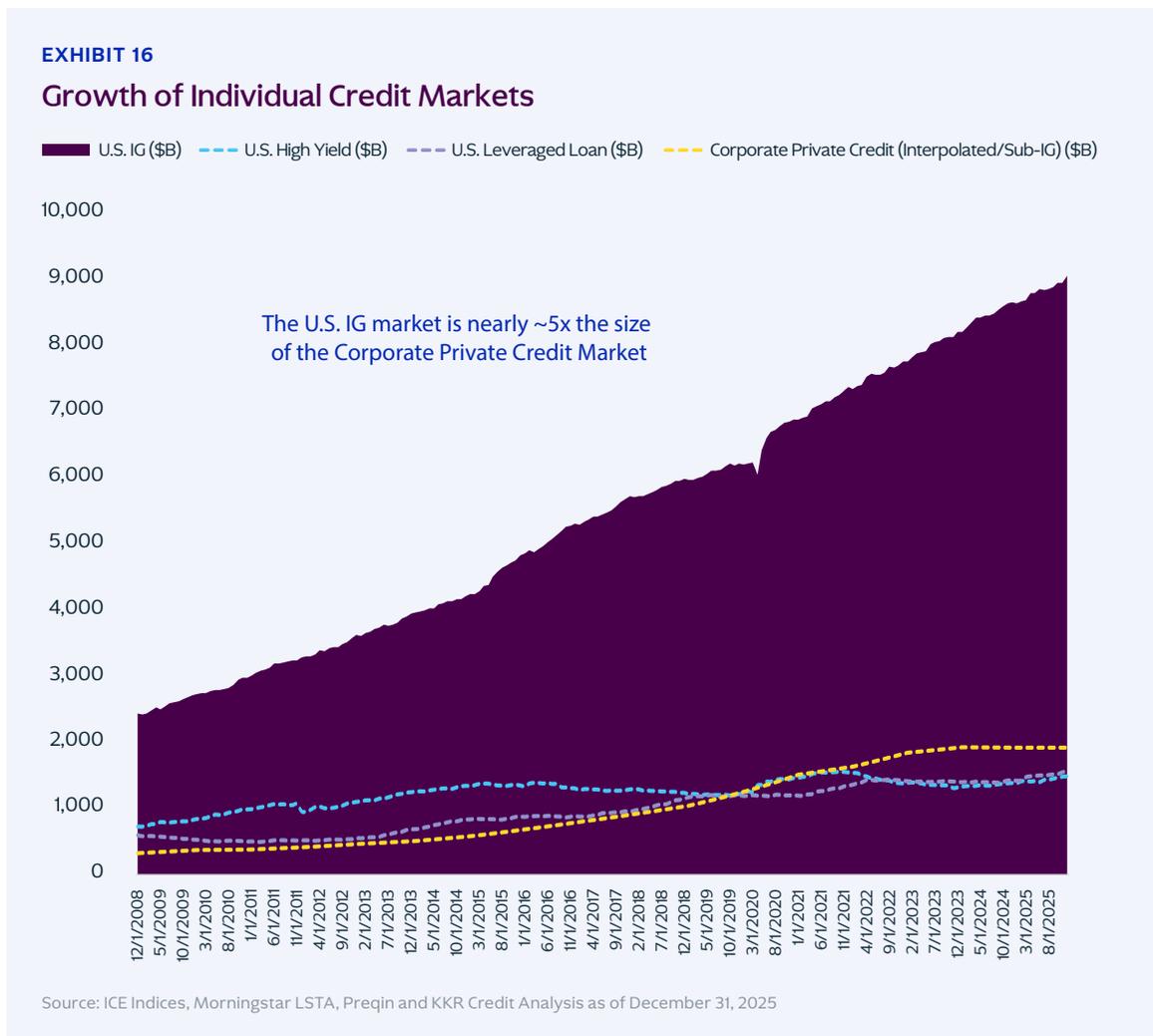
They directly influence recoveries and the timing of cash flows when projects encounter stress.

This is where specialization and team structure earns its keep. The ability to diligence assets deeply, negotiate documentation precisely, and structure for downside protection is what separates durable, investment-grade-like outcomes

from asymmetric risk. We have been fortunate to collaborate with our infrastructure and real estate colleagues who know and can ascertain the complexities of these contractual terms. As capital continues to flow into AI, software and digital infrastructure, dispersion will widen meaningfully between transactions that are truly underwritten and those that simply assume growth will solve everything.

That is the core point of CREDIT. In 2026, selection is the alpha. Avoiding mistakes matters more when recoveries are uncertain, dispersion is elevated, and the cost of being wrong is high. Capital will continue to be deployed, but the difference in outcomes will come down to precision. In this environment, getting fewer things wrong may be just as valuable as getting a few things right.

Exhibit 16: Direct Lending credit is now on par with the major public leveraged finance channels. Global corporate private credit AUM, which is majority direct lending, was \$1.9 trillion at year-end 2025, versus \$1.5 trillion U.S. leveraged loans and \$1.5 trillion U.S. high yield.



Outcomes are designed, not discovered

As we look ahead, it feels like we are in a market that will increasingly reward patience and punish shortcuts. Capital will be put to work and carry will continue to compound, but we think the path will matter more than ever. Credit has always been a discipline where history rhymes and the patterns are familiar. When portfolios are built thoughtfully and deployed with discipline, returns tend to accumulate quietly. When mistakes creep in, the math often works in reverse. In a less forgiving environment, preserving the ability to compound may be the most valuable form of risk management.

While forecasts still matter, we believe portfolio construction and credit selection have the upper hand. We cannot control markets, but we can control our inputs. That means being deliberate about where risk lives, widening the opportunity set intelligently, and designing portfolios that can withstand periods of stress without sacrificing long-term income potential. Underlying this approach is the belief that good outcomes are rarely accidental. They are shaped through collaboration, perspective, and the ability to connect dots across asset classes, sectors, and capital structures.

For us, that mindset is embedded in **CTRL + ALT + CREDIT**. Control the inputs. Build alternative routes to return. And remain disciplined where risk ultimately shows up. It is an approach grounded in collaboration across credit, private equity, real assets, and insurance, where insights travel across platforms and underwriting benefits from breadth as much as depth. That is how we are approaching the year ahead, focused less on chasing what is loud and more on compounding what is durable. We have often found that when attention narrows and a herd mentality forms, opportunities often widen elsewhere. We continue to focus on areas where capital is more scarce, proprietary origination and structure are needed, and outcomes can be shaped with intention.

Bob & Carl Reboot

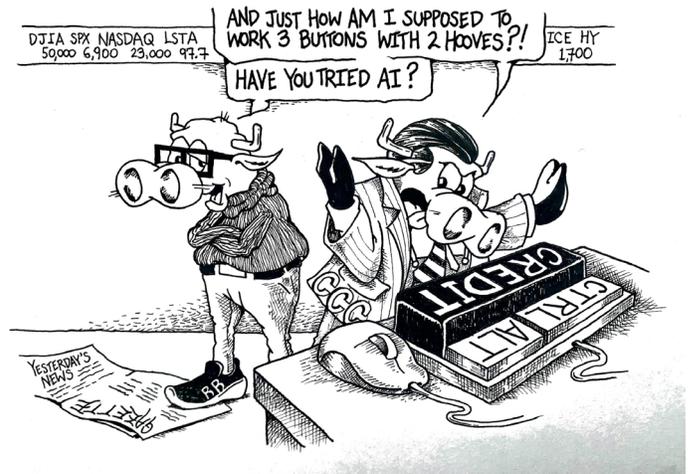


Illustration by: Jerry Capria, KKR Credit.

Thank you to our investors, partners and readers for your continued trust and partnership. As always, we welcome your feedback on our letter and are grateful for the opportunity to discuss our market views with you.

Christopher A. Sheldon

Footnotes

1. Pitchbook | LCD, JPMorgan Research, KKR Credit Analysis as of December 31, 2025
2. Pitchbook | LCD, JPMorgan Research, KKR Credit Analysis as of December 31, 2025
3. Pitchbook | LCD, JPMorgan Research, KKR Credit Analysis as of December 31, 2025
4. Pitchbook | LCD, JPMorgan Research, KKR Credit Analysis as of December 31, 2025
5. ICE BofA as of December 31, 2025
6. Morningstar LSTA LLI as of December 31, 2025
7. ICE BofA as of December 31, 2025
8. ICE BofA as of December 31, 2025
9. JPMorgan CLOIE as of December 31, 2025
10. JPMorgan CLOIE as of December 31, 2025
11. ICE BoA as of December 31, 2025

PAST PERFORMANCE IS NOT A GUARANTEE OF FUTURE RESULTS

PRIVATE		
ASSET CLASS	EXPECTED RETURN SOURCE	VOLATILITY PROXY
Private Equity	KKR Capital Market Assumptions	Cambridge Buyout
Real Estate	KKR Capital Market Assumptions	Cambridge Real Estate
Infrastructure	KKR Capital Market Assumptions	Cambridge Infrastructure
Direct Lending	KKR Capital Market Assumptions	Cambridge Senior Debt
Asset-Based Finance	KKR Marketed Net Returns	KKR ABF Composite
Capital Solutions	KKR Marketed Net Returns	KKR Capital Solutions Composite
PUBLIC		
ASSET CLASS	EXPECTED RETURN SOURCE	PROXY
Global Bonds	KKR Capital Market Assumptions	Bloomberg Global-Aggregate Total Return Index Value Unhedged USD
US Loans	KKR Capital Market Assumptions	Morningstar LSTA US Leveraged Loan TR USD
US IG	KKR Capital Market Assumptions	ICE BofA US Corporate Index
US HY	KKR Capital Market Assumptions	ICE BofA US High Yield Index
Global Equities	KKR Capital Market Assumptions	MSCI World Index

12. JPMorgan Research as of January 15, 2026
13. Preqin and KKR Credit Analysis as of December 31, 2025
14. The National Center for The Middle Market Report as of October 2025
15. Board of Governors of the Federal Reserve System (US) as of December 31, 2025

* Note: Pairwise correlations derived from historical quarterly returns (from 3/31/11 to 12/31/24) of public proxies, for each private credit strategy. The Private Credit strategies are modelled using the following proxies: US DL: Morningstar LSTA US Leveraged Loan TR USD; EU DL: Morningstar European Leveraged Loan TR EUR; Junior Capital: 55% S&P LCD Second Lien Index, 45% ICE BofA US High Yield Index; Opportunities / Capital Solutions: 10% FTSE NAREIT Mortgage REITS TR Index, 25% ICE BofA US High Yield Index, 25% Morningstar LSTA US Leveraged Loan TR USD, 40% ICE BofA US Convertible Index; Asia Credit: 35% ICE BofA Australia Corporate Index (x1.25), 20% ICE BofA High Yield Emerging Markets Corporate Plus India Issuers Index, 22.5% ICE BofA BB Asian Dollar High Yield Index, 22.5% ICE BofA B Asian Dollar High Yield Index; Distressed: ICE BofA US Distressed High Yield Index; CLO Equity: J.P. Morgan CLO B Post-Crisis Total Return Level (x1.20); Asset Based Finance: 50% Bloomberg U.S. Securitized: MBS/ABS/CMBS and Covered TR Index Value Unh (x3.0), 50% ICE BofA AA-BBB US Asset Backed Securities Index (x3.0); SASB CMBS B-Piece: Bloomberg US CMBS 2.0 Aa Index Total Return Index Unhedged; RE Opportunistic Credit: KKR Real Estate Finance Trust Inc, backdated with FTSE NAREIT Mortgage REITS Total Return Index (x0.6)

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