MetLife Investment Management



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Private Credit Direct Lending Outlook: Tailwinds for 2026

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Key takeaways

- Private credit direct lending may benefit from several distinct tailwinds in 2026. These include a regulatory and tax regime that favors business expansion; lower interest rates, which are providing companies with more cash flow to support leverage and growth; and constraints on regional bank lending, which continue to sustain demand for private debt financing.
- We expect these factors to lead to a resumption in M&A and increased deal flow, less downward pressure on pricing, and potentially better spreads for lenders. We foresee a favorable environment for direct lending in 2026 and beyond, with increased volume allowing for more selective investment decisions.
- Risks to our outlook include potential for further negative headlines among larger firms related to performance deterioration, overly optimistic valuations, or greater use of payment-in-kind (PIK) facilities, which could unsettle investors. Unforeseen fallout from geopolitical events, along with unexpected declines in consumer spending, softer labor markets, or weaker middle-market company performance, could also pose risks.
- We believe investors working with experienced managers who embrace a prudent, transparent, and institutionally focused direct lending strategy serving small and midsize companies may consider investing in the direct lending market with greater confidence in 2026.

Direct lending continues to be characterized by two diverging narratives in 2026. At the largest asset managers, ever-growing inflows from retail investors through a variety of semi-liquid fund structures supplement strong commitments from institutional investors. These flows are creating asset pools that managers are using to meet the needs of large, often well-known corporate borrowers. They are also where recent negative headlines have been concentrated. That said, we believe these represent isolated, issuer-specific events rather than indications of systemic stress, and that the media narrative lumps together multiple subsegments of private credit, obscuring the meaningful differences between them.

At the same time, many smaller asset managers – whose direct lending vehicles are designed to attract institutional investors – have focused on serving a variety of niche markets where they have developed specialized credit analysis expertise. In these markets, borrowers are typically middle-market companies, which in the US collectively account for output equivalent to the world's third- or fourth-largest GDP. Very often, these companies are privately owned, either by founders and their families or private equity firms. These lower-middle-market companies, in our view, offer credit fundamentals, lender protections, and structural characteristics that are distinct from those found in other areas of private credit.

In the former group, recent headlines outlining allegations of fraud and underwriting failures at some large platforms have raised concerns among investors about possible contagion risk and a rise in defaults, and we expect these areas to generate more scrutiny in 2026. While we do not believe the negative events are representative of the broader market or the lower middle market direct lending space, they do underscore the importance of working with managers who embrace a prudent, transparent, and disciplined direct lending strategy.

Market drivers in 2026

Although M&A activity has been relatively subdued over the past year, we anticipate a significantly more constructive deal-making environment in 2026, supported by several tailwinds. These include a more stable and supportive macro backdrop – characterized by moderating inflation, lower interest rates, and easing tariff concerns. Additional catalysts include elevated private equity dry powder, increased motivation to exit aging portfolio companies as managers seek to return capital to limited partners, and more accommodative financing conditions stemming from a favorable tax and regulatory environment under the current administration. These tailwinds will directly boost the M&A environment and, in turn, direct lending opportunities. The favorable tax and regulatory regime, combined with the unlikelihood of any near-term changes in estate tax rates, should encourage many family-owned small and midsize businesses to pursue buyout opportunities this year.

The benign interest rate environment also should set the stage for continued economic growth in 2026, especially as the economy appears to have adjusted well to the tariff shocks of 2025. Other indications of the underlying vigor of the economy include the continued high level of capital investment and healthy corporate balance sheets, resilient labor markets, and strong consumer spending despite rising prices for many consumer goods and services.

Joining these cyclical factors are longer-term secular forces that continue to drive growth in the direct lending market. These include the commercial banking sector's ongoing retreat from corporate lending; despite the recent withdrawal of the 2013 leveraged-lending guidance by the OCC and the FDIC (the Federal Reserve has not withdrawn at this point), regional banks continue to be cautious on leveraged lending due to potential commercial real estate exposure challenges. Moreover, growing small and midsize companies increasingly prefer partnering with experienced, value-add private credit platforms to deliver customized financing solutions.

Risks to watch – and tactics to mitigate them

To be sure, there are risks to our generally optimistic outlook for direct lending. A general decline in interest rates, for example, would lower absolute returns to lenders even though relative return potential remains higher than with other credit market alternatives. Unforeseen fallout from tensions in Eastern Europe, the Middle East, the South China Sea, and Greenland could be a source of political and economic risks that flow to these markets. Unexpected declines in consumer spending, softer labor markets, and weaker middle-market company performance could also create market risk.

Moreover, if further headline-grabbing instances of performance deterioration, overly optimistic valuations, or greater use of payment-in-kind (PIK) facilities appear during the year, investors may pull away.

We continue to favor a direct lending approach that focuses on institutional investors and private equity-backed leveraged transactions involving strong founder- or family-owned businesses in the US lower middle market (with EBITDA of up to roughly $30 million). The most favorable target companies, in our view, are attractively “boring and basic” – those with stable, foundational businesses and long operating histories, preferably showing resilience through multiple credit cycles, including recessions.

Managers with high quality standards and established track records of performance, who can point to their ability to deliver actual cash distributions to investors on a regular, predetermined basis, are likely to continue performing well in this year’s market. In fact, if deal volume increases as expected, such managers are likely to be even more selective, enabling them to stabilize spreads and improve risk-adjusted returns.

For more insights into the trends moving markets in the coming year, see our **2026 Investment Outlook.**

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