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This Hidden Market Could Sink Stocks... And Investors Aren't Paying Attention

There's a corner of the market most investors don't watch... don't price... and don't fully understand.

And that's exactly why it matters now.

Private credit has grown from a niche strategy into a multi-trillion-dollar ecosystem. But the headline numbers don't tell the full story. As financial guru Steve Eisman has been pointing out, the real size of this market is likely much larger once you include fund-level leverage, insurance balance sheets, and various financing layers that sit on top of the loans themselves. In other words, what looks contained on the surface may be far more interconnected underneath.

That alone wouldn't be a problem—if the underlying credit were pristine. It isn't.

In the past few years, capital flooded into private credit. Pension funds, endowments, and individual investors all wanted in. The pitch was compelling: higher yields, senior secured loans, and tighter underwriting than the syndicated loan market. But when too much money chases too few deals, standards inevitably slip. We've seen a rise in aggressive EBITDA adjustments, weaker covenants, and structures that depend more on optimistic projections than durable cash flow.

Howard Marks has long emphasized that risk isn't what you see—it's what you don't. And right now, much of the risk in private credit is obscured by structure rather than eliminated by it.

Here's where the fault lines are forming:

- **The market is larger—and more opaque—than advertised.** Headline figures often exclude leverage layered on top of loans through fund financing and insurance balance sheets. Without real-time price discovery, stress can build quietly before it's recognized.
- **“Extend and pretend” is masking deterioration.** Loans are being amended, maturities pushed out, and interest capitalized rather than paid. Defaults look low, but much of that is because losses are being delayed.
- **Floating-rate debt is squeezing borrowers.** Companies that borrowed in a low-rate world are now facing sharply higher interest costs. Cash flows haven't kept pace, and coverage ratios are slipping.
- **Liquidity mismatch is a hidden risk.** Many investment funds offer periodic liquidity while holding highly illiquid loans. If redemptions rise, selling pressure could expose pricing that hasn't been tested.
- **Competition weakened underwriting standards.** A flood of capital led to covenant-lite structures and aggressive assumptions. What was marketed as safer lending increasingly resembles the risks it was meant to replace.

One of the clearest examples is the growing use of “extend and pretend.” Instead of forcing a borrower to refinance or default, lenders amend terms, push out maturities, or allow interest to be paid in kind. On paper, defaults remain low. In reality, stress is building beneath the surface. Losses aren't being avoided—they're being deferred.

Layer on top of that the impact of higher rates. Most private credit loans are floating rate. That worked beautifully on the way up—until it didn't. Companies that could comfortably service debt at 5% are now facing borrowing costs north of 10%. Revenue hasn't doubled to compensate. Margins are compressing. Interest coverage ratios are deteriorating.

This is where the story starts to rhyme with past cycles.

It's not that everything breaks at once. It's that pressure builds gradually, then suddenly finds a release point.

Another fault line sits in liquidity. Many of the funds offering access to private credit—interval funds, non-traded BDCs—promise periodic liquidity to investors. But the underlying assets are anything but liquid. Loans don't trade daily. Pricing is model-based. If redemptions rise meaningfully, managers are forced into difficult choices: gate withdrawals, tap credit lines, or sell assets at discounts that finally reveal what those loans are actually worth.

That's when perception shifts.

Author Morgan Housel often writes that the biggest risks are the ones people aren't even thinking about. Private credit fits that description today. It hasn't been through a full cycle at this scale, with rates this high, and with this much retail exposure layered on top.

And here's the nuance that matters.

Not all private credit is created equal. High-quality, senior-secured lending with conservative structures may hold up just fine. But other pockets—venture debt, highly levered sponsor deals, and anything reliant on payment-in-kind income to meet return targets—are far more fragile than advertised.

The danger for investors isn't just direct exposure. It's the second-order effects. Private credit touches private equity, which touches public markets through exits, valuations, and sentiment. If cracks begin to show, they won't stay contained.

To borrow a lesson from outside finance, famed chef Marco Pierre White once said that simplicity reveals everything. When conditions are easy, complexity can hide flaws. When conditions tighten, only the fundamentals remain.

Private credit is about to be tested on its fundamentals.

And the outcome may matter far more to the broader market than most investors realize.

Are you prepared?

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