Issue 1

CIFC Wealth Intelligence

Direct Lending is Not Homogenous: The Importance of Choosing the Right Manager

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Featured Views and Insights

Private credit has moved from a largely institutional allocation into a core consideration for financial advisors, RIAs, and their clients. That shift has created meaningful opportunity, but it has also made manager selection more important. For wealth managers, the question is no longer simply whether clients should have access to private credit, but which segment of the market they are accessing, through which structure, and with which manager.

In benign markets, most direct lending portfolios look alike: floating-rate income, senior secured exposure, muted volatility — precisely the conditions in which managers are hardest to tell apart. True dispersion emerges most poignantly during periods of stress, by which point manager selection decisions are already locked in. The most important diligence, therefore, must occur before committing capital: identifying the manager whose underwriting discipline is rewarded when economic conditions deteriorate.

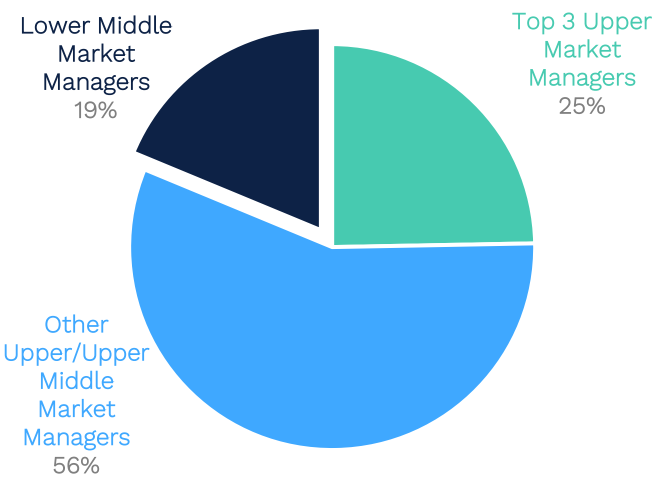
Direct lending is not a passive asset class, and it is not one uniform market. Outcomes are shaped loan by loan, sector by sector, and borrower by borrower. It is important for investors to consider whether they are allocating to managers with the sourcing relationships, underwriting discipline, structural protections, and portfolio-management experience required to navigate a full credit cycle. From what we have experienced, those attributes become most visible not when markets are calm, but when credit conditions begin to tighten.

Beyond the Headline Asset Class

Direct lending is not monolithic. A manager's target segment fundamentally shapes outcomes, influencing competition levels, underwriting standards, leverage tolerance, and documentation quality.

Significant capital has flowed into the upper-middle and upper market, where traditional managers compete with broadly syndicated loan and high yield bond markets. In these segments, competition can compress spreads, increase borrower leverage, and weaken lender protections. As a result, terms for some of these loans may increasingly resemble those of more liquid credit instruments, without providing real liquidity.

CIFC estimates that 80%+ of funds were raised by managers focused on upper middle or upper market sized deals[1]



Homyar Choksi
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Chief Investment Officer

Mr. Choksi is the Direct Lending Chief Investment Officer responsible for managing CIFC Direct Lending's investment functions and serves as a committee member of the Investment Committee. He has over 31 years of experience in large corporate and middle-market leveraged lending transactions, including both senior and junior debt and preferred and common equity, across a wide range of industries. Prior to CIFC, Mr. Choksi held various positions at GE Capital Corporate Lending, most recently leading the Financial Intermediaries Group in New York as Managing Director. Prior to GE Capital Corporate Lending, Mr. Choksi served as an Auditor with GE Capital Audit Staff. Mr. Choksi is a frequent speaker on middle market leveraged lending. Mr. Choksi holds a Master of Science, Finance from Purdue University, Krannert School of Management and a Bachelor of Commerce, Accounting and Economics from the University of Bombay, H.R. College.

Past performance is not indicative of future results.

By contrast, we believe the lower middle market offers a distinct structural opportunity. This segment tends to be more relationship-driven and less intermediated, providing lenders with deeper access to management teams, greater influence over deal terms, and stronger covenant protections. However, capturing these advantages requires specialization. In our experience, managers purpose-built for the lower middle market are generally better positioned than those extending down-market opportunistically. It is crucial that investors understand that a lower middle market strategy is not simply a smaller version of upper-market lending.

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Look Behind Headline Yield

Headline yield tells you how much a loan pays but not how it is paid. For investors building income portfolios today, that distinction can matter as much as the number itself. Reported yield alone provides limited insight into portfolio quality. A more revealing analysis examines how that yield is generated—specifically, how much is cash pay versus Payment-in-Kind (PIK) interest. PIK is interest that is not paid currently in cash; instead, it accrues on the balance sheet. In certain situations, particularly during a restructuring or temporary liquidity issue, PIK may provide flexibility that helps preserve value for lenders. But upfront or structural PIK can be a warning sign.

In effect, PIK is an IOU: the investor books income today but doesn't see the cash until later, if it shows up at all. If a borrower cannot service its cash interest from day one, that may indicate that leverage is too high relative to free cash flow. PIK toggle structures can be even more concerning, because they give the borrower or sponsor the option to stop paying a portion of interest in cash when convenient.

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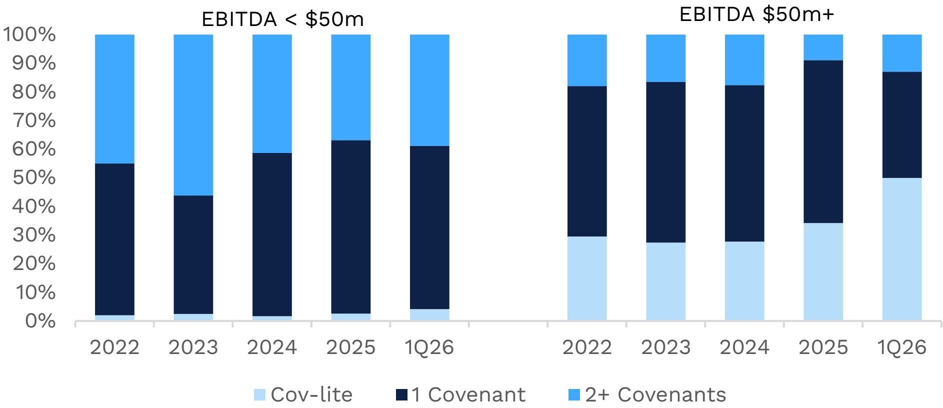
For investors and advisors, the diligence question is direct: how much of the stated yield is actual cash income, and how much is accrual? That distinction becomes especially important when clients are relying on private credit as an income-producing allocation. A manager's approach to PIK is a direct window into underwriting discipline and whether its interests are aligned with yours.

Covenant Discipline as an Indicator

Financial maintenance covenants are borrower metrics tested against preset limits, typically measuring leverage and the ability to service debt with cash flow. If performance deteriorates and those limits are breached, the covenant trip brings the borrower back to the table. These covenants provide lenders with early warning signals and a seat at the table before problems escalate. That early engagement matters. When a borrower breaches a covenant, lenders can reassess risk, engage with sponsors, and pursue corrective actions while options remain. Without such protections, lenders may be forced to wait for a payment default, often resulting in reduced recovery outcomes.

In a strong market, covenants may appear technical or secondary. In a weaker market, they can become one of the most important protections in the loan document. In our view, covenants are often negotiated away in the most competitive markets, precisely when discipline matters most. The willingness of a manager to maintain robust covenant protections is a meaningful indicator of its underwriting rigor.

Covenants per deal by market size (%)[2]



> Covenants are often negotiated away in the most competitive markets, precisely when discipline matters most.

Covenants alone are not enough though – they only work if they are structured well. A disciplined manager builds in real optionality and knows how to use it to limit losses after a breach.

Sector Selection Reveals Credit Discipline

Credit discipline also shows up in sector selection. Software and healthcare are a useful comparison. As we have seen in the news, software has become a significant exposure in many larger private credit portfolios. CIFC Direct Lending has mostly avoided software in part because we found many of those deals have historically been aggressively structured, with high leverage or leverage based on recurring revenue rather than cash flow. By contrast, CIFC Direct Lending has focused on domestically based, defensive businesses with strong cash flow, including sectors such as industrials, food manufacturing, business services, and healthcare services.

While CIFC has maintained its investment discipline by avoiding software, it has actively pursued healthcare services. We believe an aging population, systemic inefficiency, and persistent supply-demand imbalances create opportunities for companies focused on reducing cost, improving access, and delivering better outcomes.

> Manager experience within its segment and manager discipline will ultimately drive long-term performance, especially when the economic waters get choppy.

What Investors Should Ask Now

For investors evaluating direct lending today, the diligence process should move beyond headline yield and brand recognition. The better questions are more specific:

How much of the income is cash versus PIK? What leverage levels are embedded in the portfolio? How many loans have meaningful maintenance covenants? What type of EBITDA adjustments are permitted? What sectors has the manager avoided, and why? What is the manager's approach to portfolio construction? How consistently has underwriting discipline been applied across cycles?

These questions determine whether a portfolio has been built for benign markets only, or whether it has the structural protections, borrower relationships, and underwriting discipline to navigate volatility. As we enter a period of greater volatility, the key question should be - are you choosing the right manager to navigate a challenging environment? Manager experience within its segment and manager discipline will ultimately drive long-term performance, especially when the economic waters get choppy.

End Notes

1. Source: Fundraising data per Pitchbook custom screening performed by CIFC as of May 2026 targeting U.S.-based direct lending funds with vintages 2020-2026 and excluding funds identified by CIFC as having non-comparable strategies to CIFC such as asset-based lending or industry-specific funds. Upper vs. Lower per CIFC classification of manager strategy.
2. Source: Source: KBRA DLD Research, "Insights & Outlook: Private U.S. Sponsored Deals Analysis," published June 8, 2026. Data as of March 31, 2026.
3. Source: CIFC Direct Lending's portfolio fair value exposure to software companies and healthcare services as of March 31, 2026. BDC information S&P / LCD as of December 2025. Past performance is not indicative of future results.