



CIO Office

CIO Insights

Cusson Leung, Chief Investment Officer

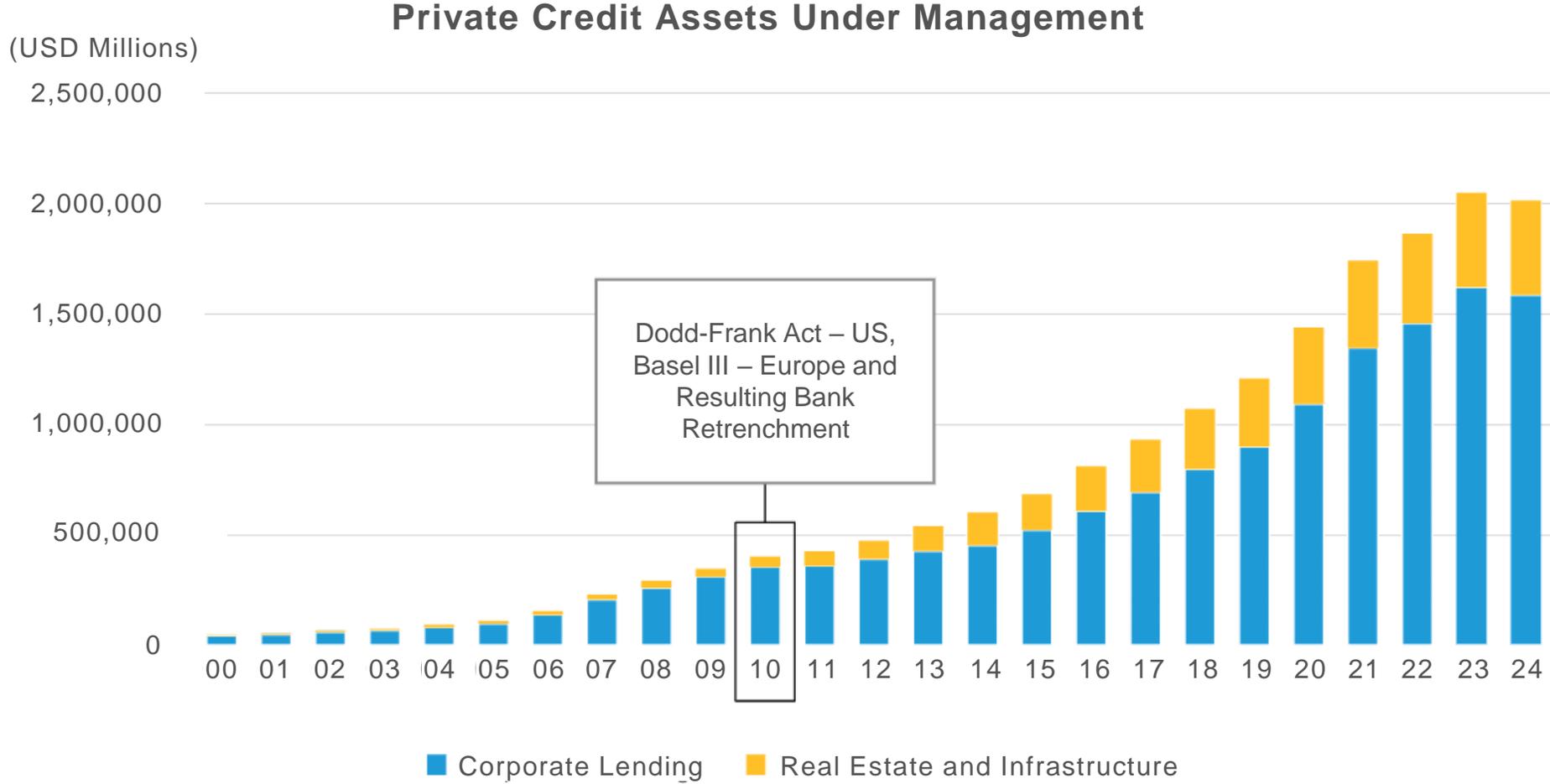
Beware of a Perfect Storm in the Making

Eyes have been distracted by the war in the Middle East

27 March 2026

Private Credit Has Been Growing At CAGR Of 14% In 10 Years

As Banks Are More Stringent On Asset Quality After The GFC



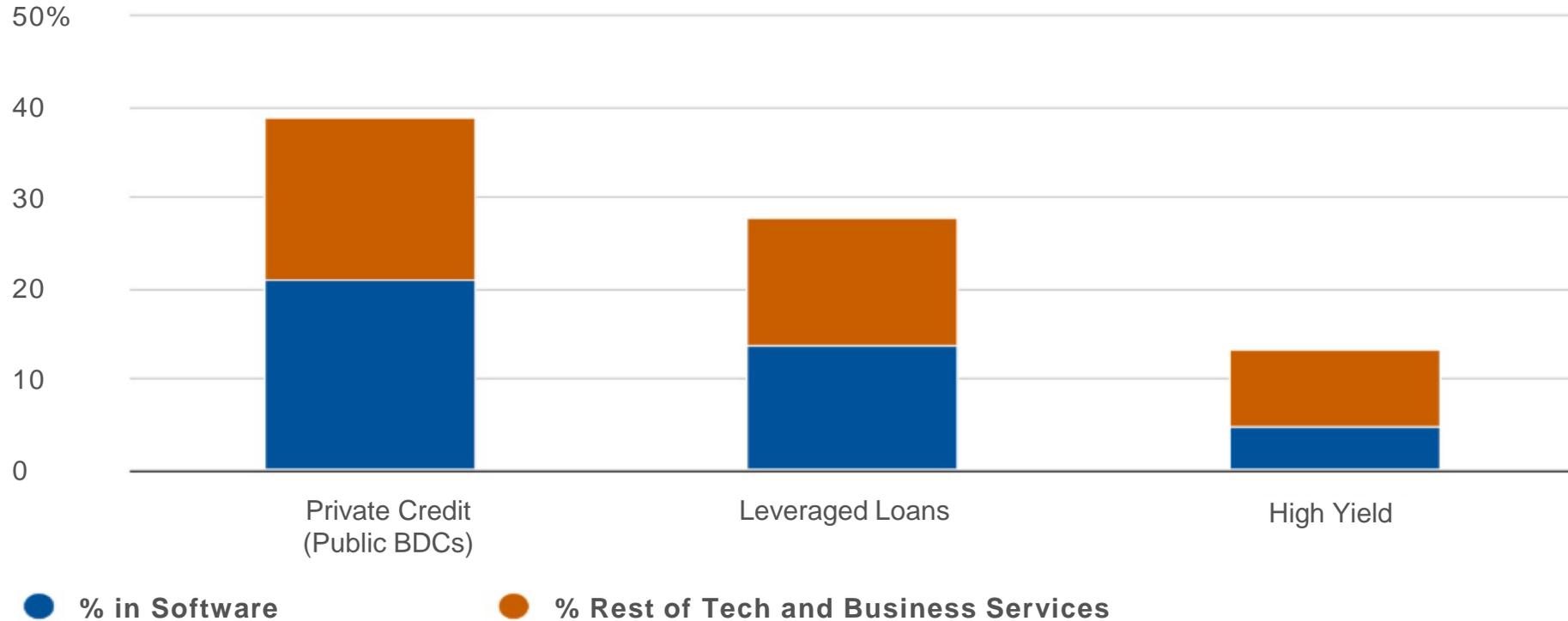
Source: Preqin and AllianceBernstein (AB), KGI



>50% Of The Exposures Of Private Credit To Software Sector

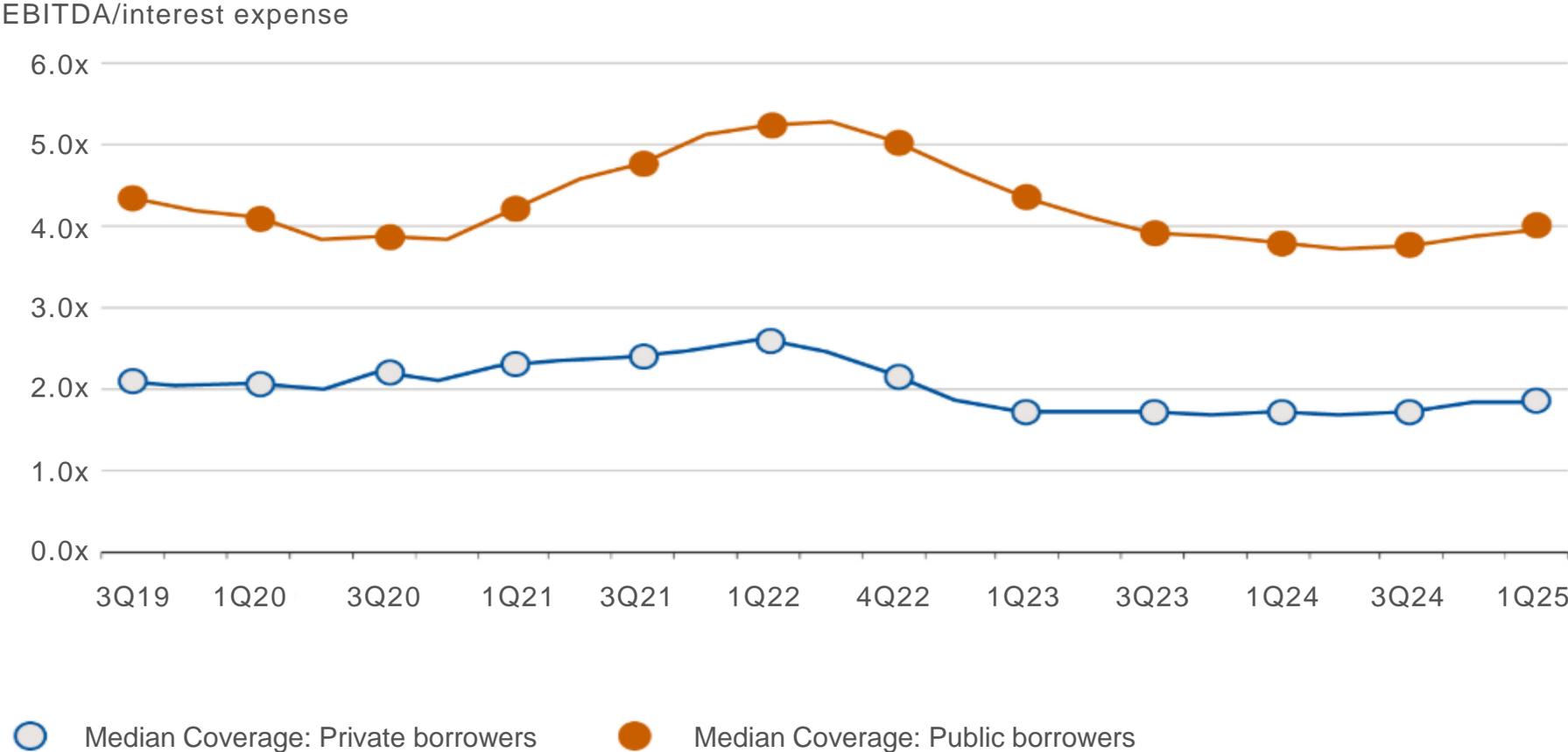
AI Disruption To Software Companies Is One Of The Catalysts To Spook The Sector

Private Credit: Largest Exposure to Software And Business Services



Private Credit: Median Coverage Well Below Of Public Debts

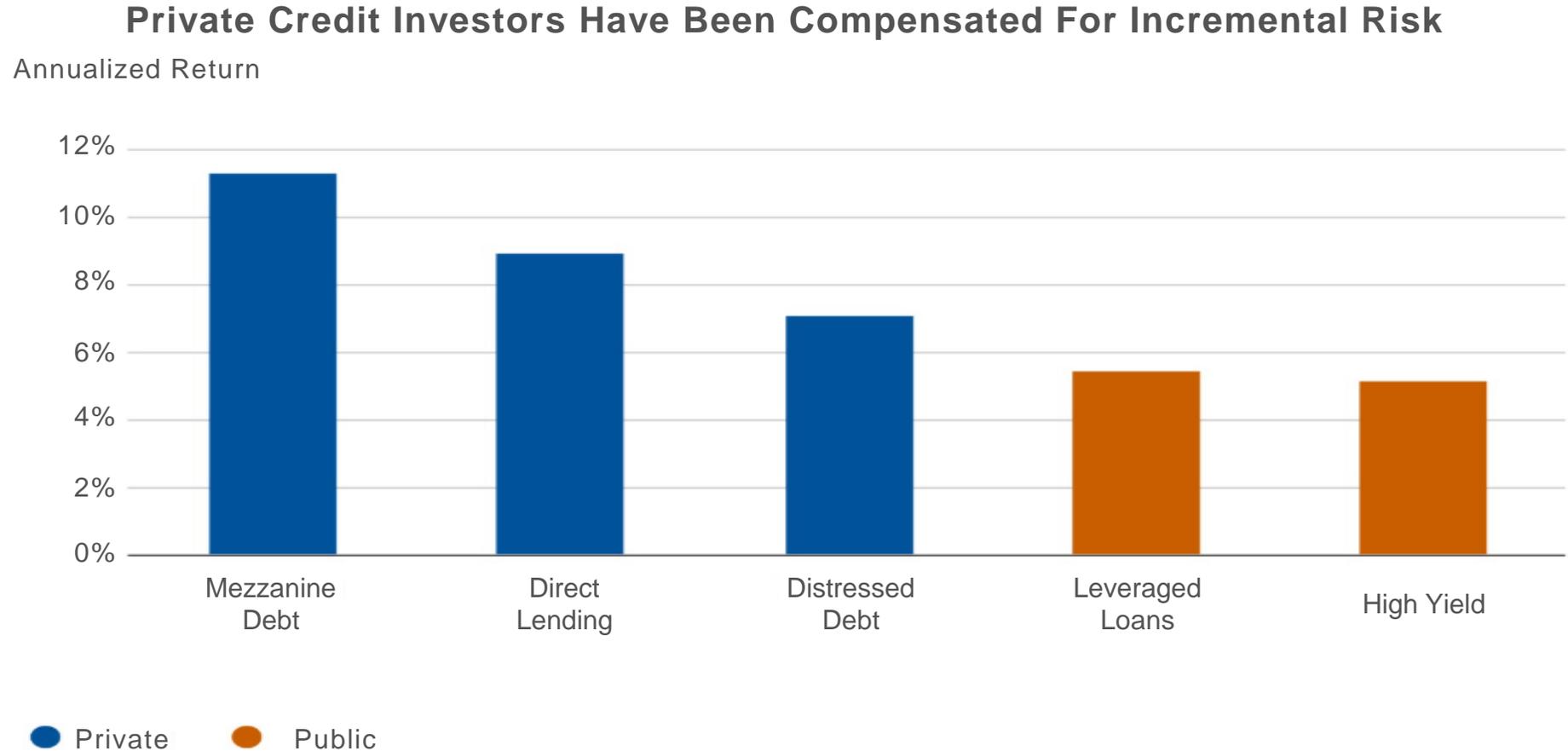
AI Development Has Not Been Helping To Boost Coverage At All



Source: J.P.Morgan, KGI

High Risk, High Return

There Is No Such Thing As Free Lunch

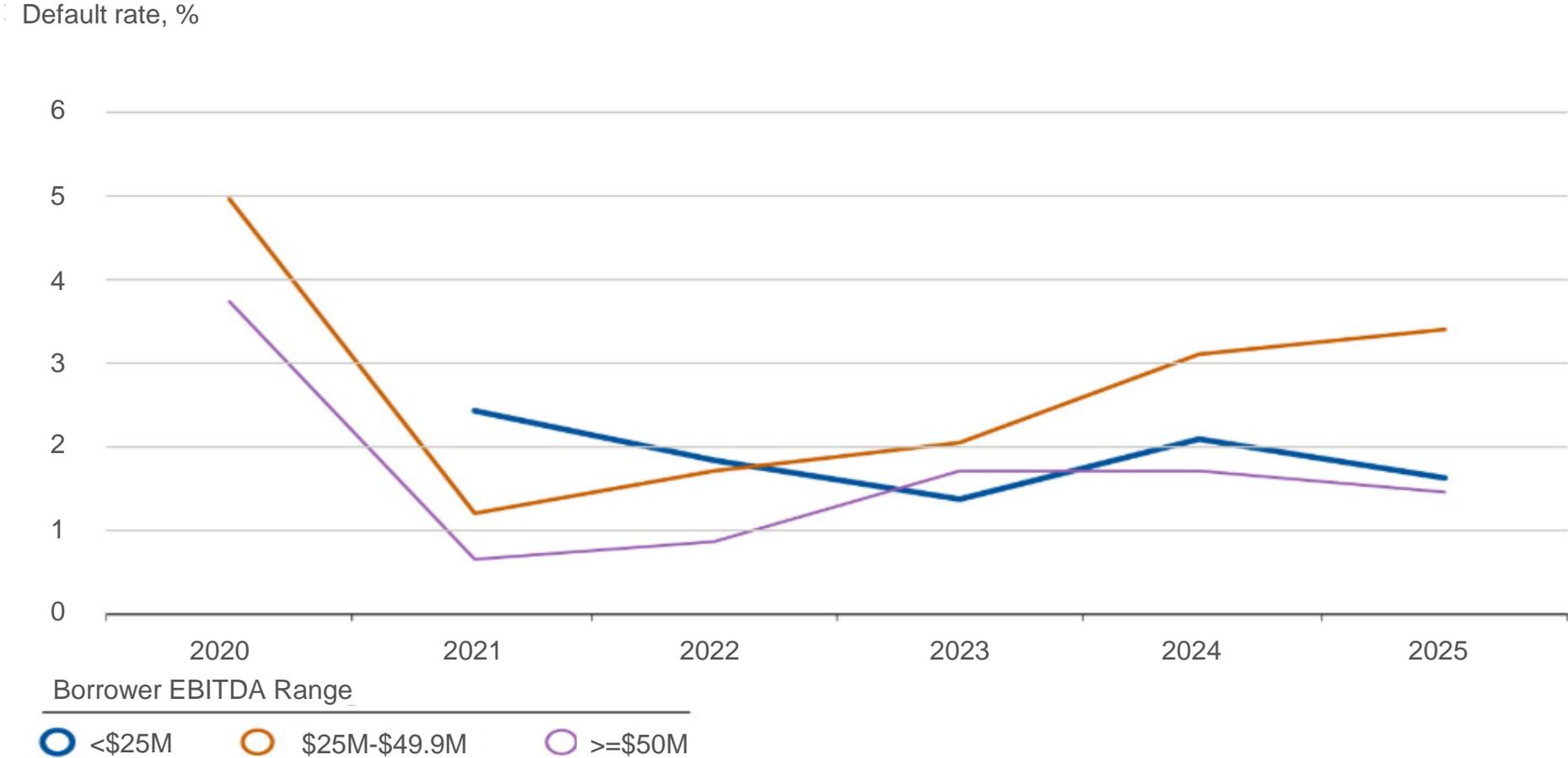


Source: J.P.Morgan, KGI

Private Credit Defaults Tick Up In Medium Size Businesses

This Is Likely To Be Under Pressure If The Overall Economy Slow Down Further

Private Credit Defaults Tick Up in Medium Size Businesses



Source: J.P.Morgan, KGI

Timeline Of Private Credit Events

"When You See One Cockroach, There's Probably More," Jamie Dimon Said On Oct. 14, 2025

Late 2025 ● "Cockroach" bankruptcies appear (e.g., auto lender Tricolor Holdings, auto-parts supplier First Brands). Dramatic lender losses (60%+ in weeks). Software sector cracks emerge. Defaults begin rising.

January 2026 ● Fitch Ratings reports US private credit default rate hits record 5.8% (trailing 12 months) – highest since tracking began, nearly double 2025 monthly averages. 11 default events in January alone. Full-year 2025 defaults hit 9.2% in some metrics.

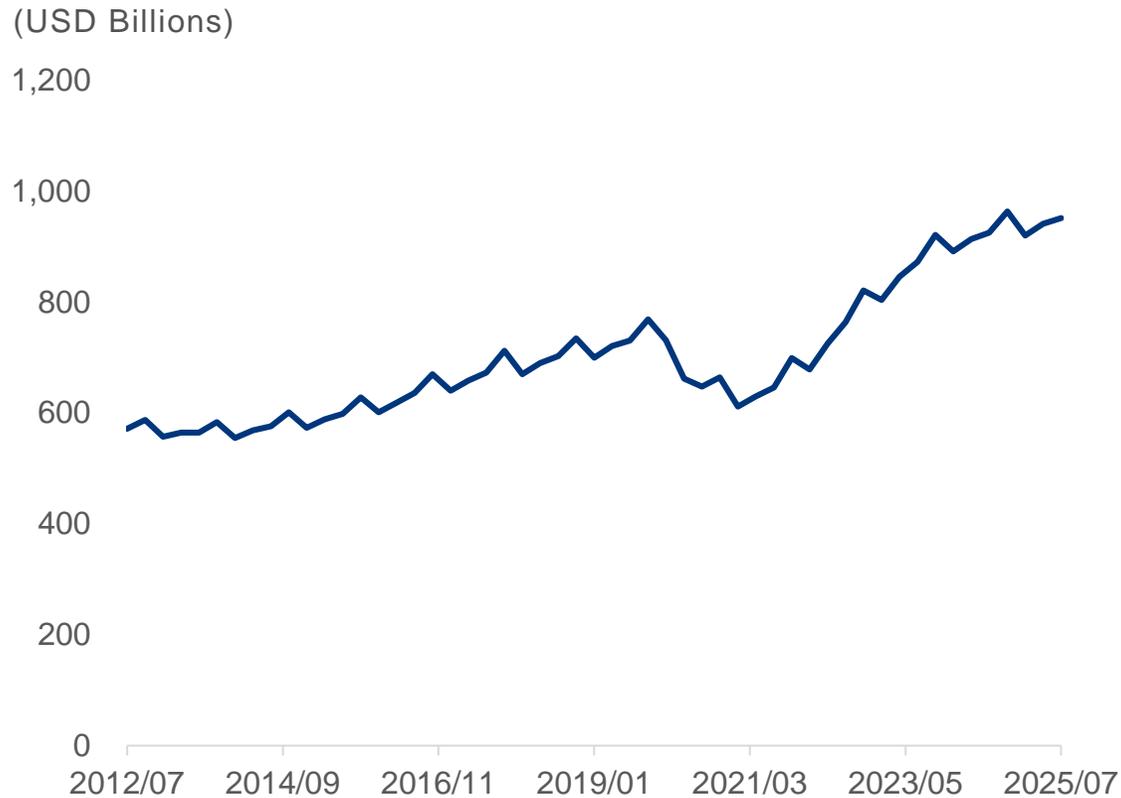
February 2026 ● Pivotal moment — Blue Owl Capital (one of the largest managers) permanently halts quarterly redemptions on its ~\$1.6–1.7 billion OBDC II retail BDC fund after a surge in withdrawal requests. Instead of tender offers, it sells ~\$1.4 billion in assets (at ~99.7% of par) to fund one-time return-of-capital distributions (~30% of NAV) and debt paydown. Other funds (e.g., MFS, New Mountain) face similar pressures. BlackRock marks multiple loans from 100 cents to zero in one quarter (e.g., Infinite Commerce Holdings). Investor outflows accelerate; stocks of major private credit managers drop sharply (\$265 billion in combined market cap erased since Sep 2025).
March 2026 (ongoing): Defaults ease slightly to 5.4% (Feb data) but remain elevated. Banks tighten

- Private credit, after a CAGR of 14% over the last 10 years, is only 9% of total borrowing. This also highlights that this "9%" of total borrowing is probably at the fringe of the credit quality chain.

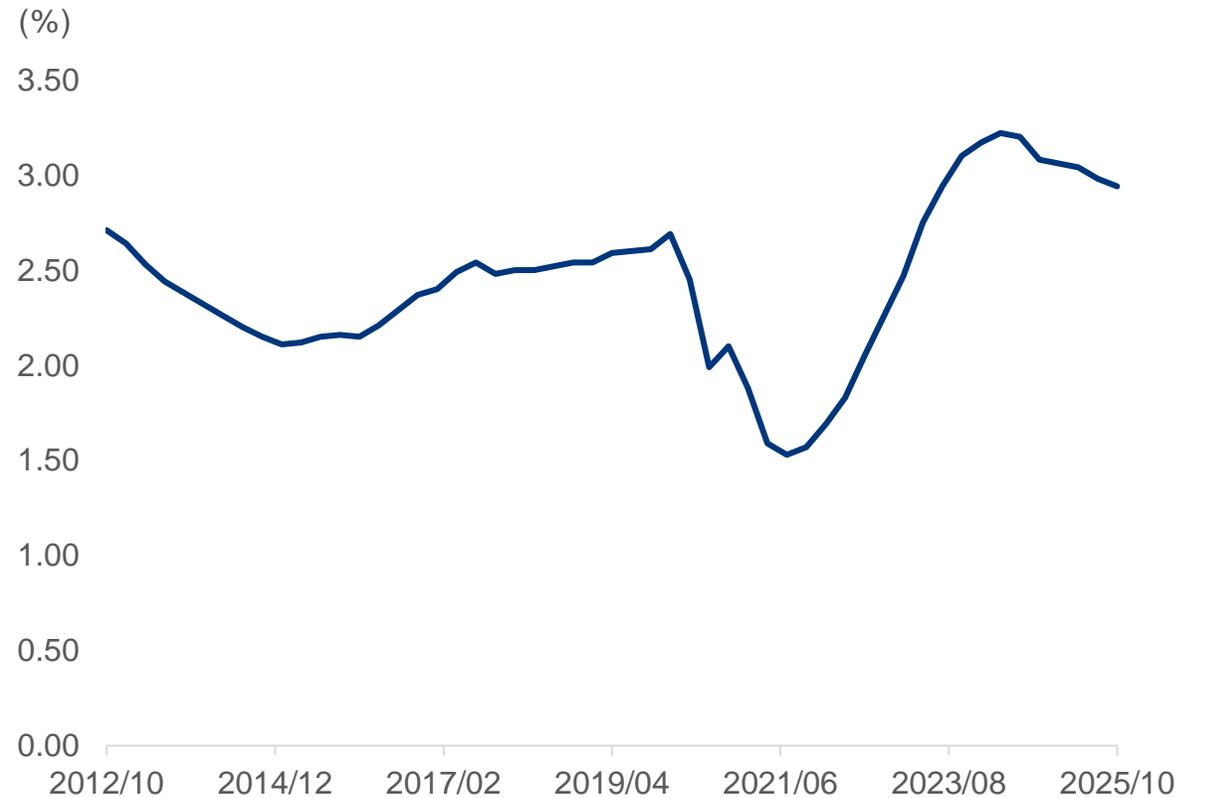
Credit Card Balances At Historic High In The US

Delinquency Rates Closely Tie To The State Of The Economy

Large Bank Consumer Credit Card Balances: Total Balances



Delinquency Rate on Credit Card Loans, All Commercial Banks



Source: FRED, KGI

Job Opening Has Seen The Sharpest Decline Since 2022

This Coincide With The Rising Default Rates Of The Medium Size Private Credit Borrowers

Job Openings: Total Nonfarm

(Thousands)



Source: FRED, KGI

The US Economy Is Showing Sign Of Slowdown

More Headwind From The Macro Economy

- **GDP Growth:** Real GDP growth slowed sharply in Q4 2025 to an annualized rate of 0.7% (revised down from initial estimates of 1.4%), a significant drop from 4.4% in Q3 2025. This reflects weaker consumer spending, exports, investment, and disruptions like a government shutdown. While 2026 projections anticipate a rebound to around 2.0–2.2% annually (driven by factors like tax cuts), **the recent deceleration signals reduced momentum heading into the year.**
- **Labor Market Weakness:** The unemployment rate rose to 4.4% in February 2026 (up from 4.3% prior), with the economy losing an unexpected 92,000 jobs that month—far worse than expectations of modest gains. Hiring has been sluggish, job openings have trended lower, and employment growth has slowed significantly (with some revisions suggesting losses in prior periods). **This "low-hire, low-fire" equilibrium indicates softer labor demand, partly due to reduced immigration but also broader cooling.**
- **Leading Economic Index (LEI):** The Conference Board's LEI has continued declining, falling 0.1% in January 2026 (to 97.5) after a 0.2% drop in December, marking multiple consecutive monthly declines. Over six months, it fell 1.3%, signaling headwinds to future activity despite some component strengths. **This has led to forecasts of a slow start to 2026 and slight downward revisions to growth expectations.**
- **Consumer Spending and Sentiment:** Consumer spending growth decelerated notably (e.g., to around 2.4% in Q4 2025 from higher prior rates), driven by higher-income households but pressured by inflation and saving drawdowns. **Consumer expectations and sentiment have retreated,** contributing to LEI weakness.

Risk Appetites Change When Rates Expectation Changes

What Will Higher Rates Do To Refinancing Capabilities Of The Private Credit Borrowers

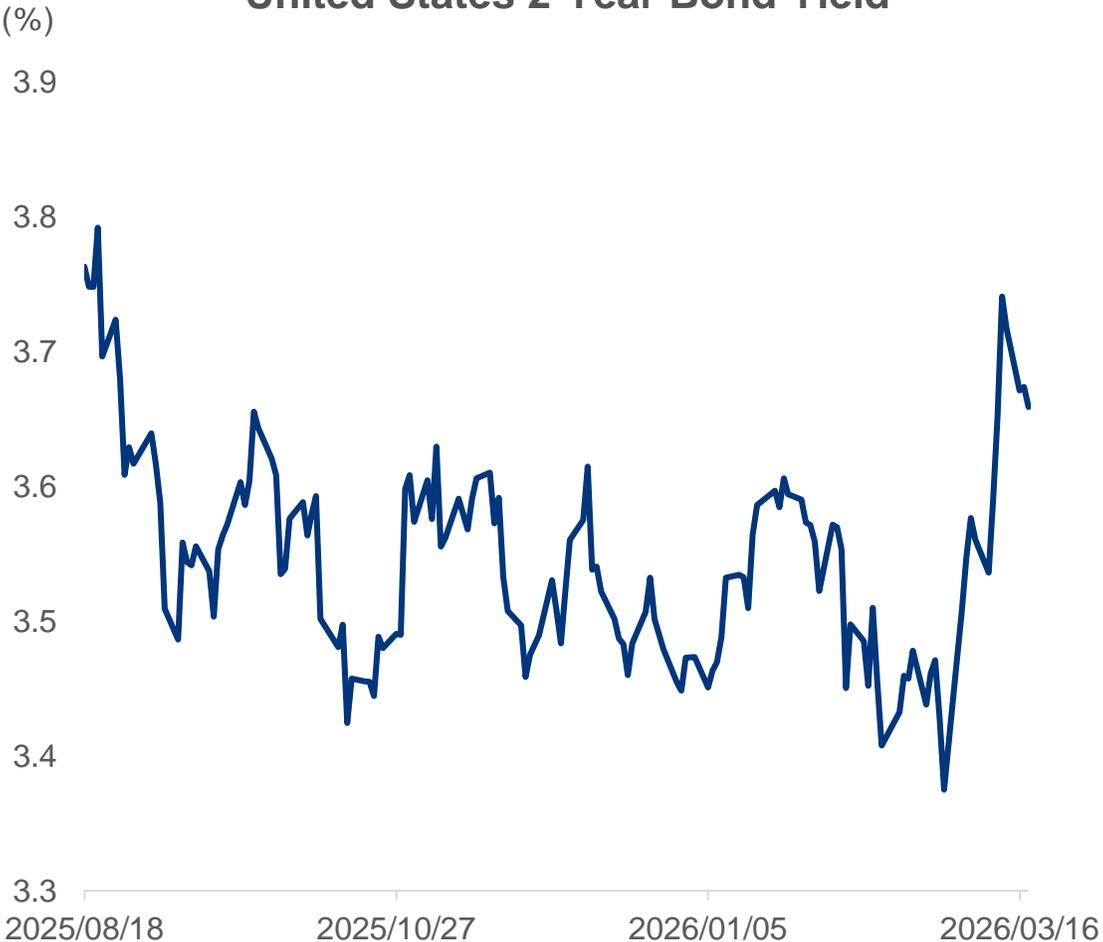
	# of Hikes/Cuts		
	3/16/2026	2/16/2026	12/16/2025
3/18/2026	-0.006	-0.093	-0.573
4/29/2026	-0.048	-0.285	-0.844
6/17/2026	-0.244	-0.859	-1.385
7/29/2026	-0.428	-1.305	-1.684
9/16/2026	-0.619	-1.843	-2.027
10/28/2026	-0.728	-2.165	-2.184
12/9/2026	-0.958	-2.499	-2.359
1/27/2027	-0.998	-2.705	-2.354
3/17/2027	-1.055	-2.674	-2.386

Source: KGI

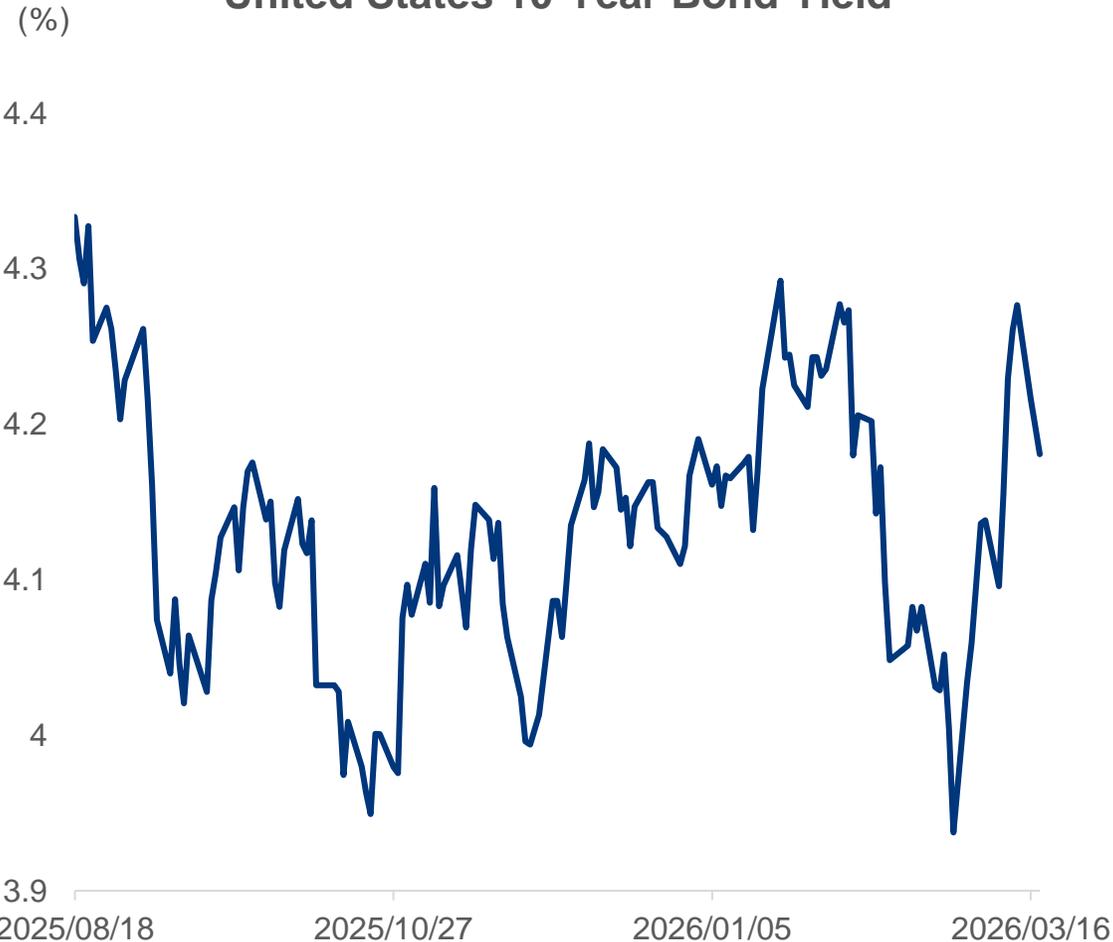
Upshift in the US Yield Curve to Reflect Inflation Expectation

Neither the Short nor the Long End of the Curve Are Safe

United States 2-Year Bond Yield



United States 10-Year Bond Yield

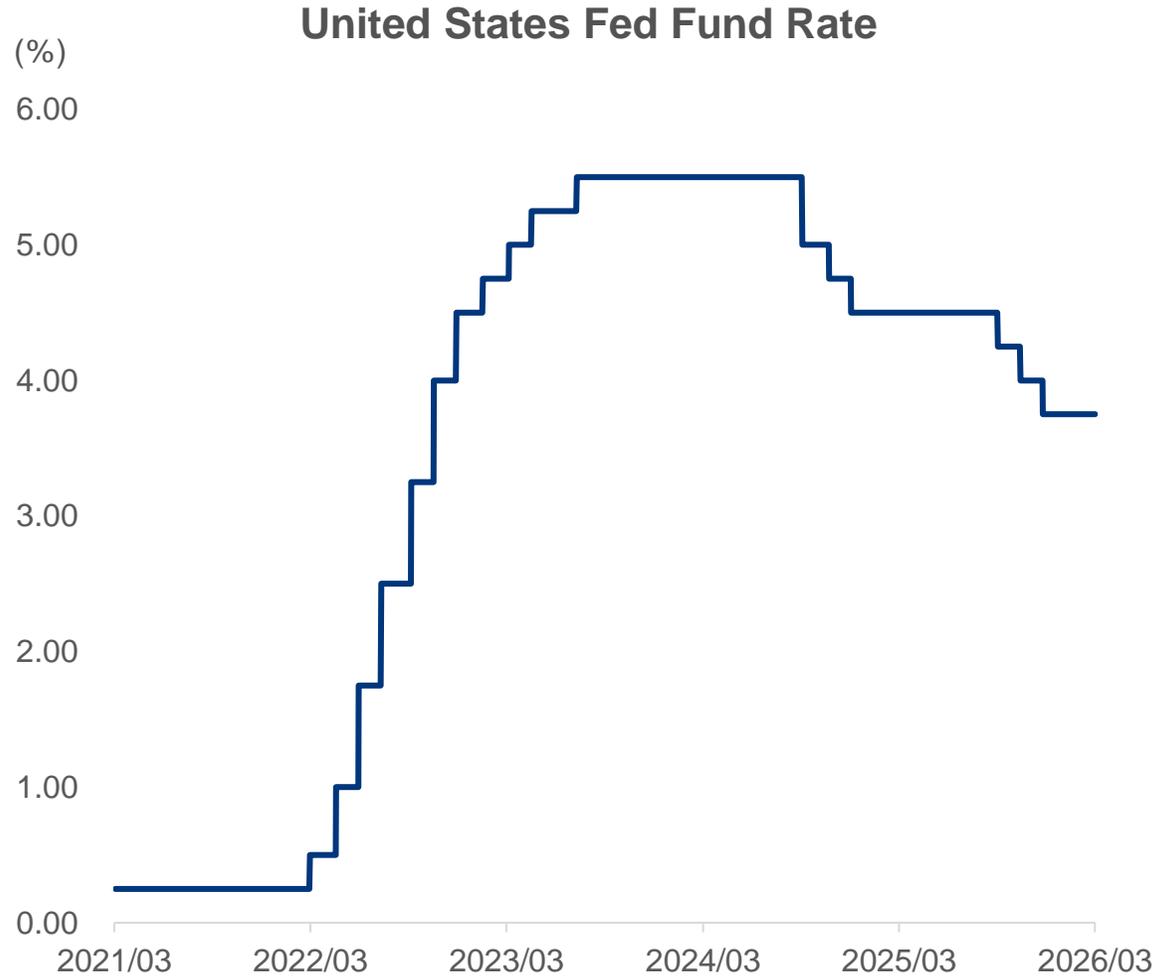
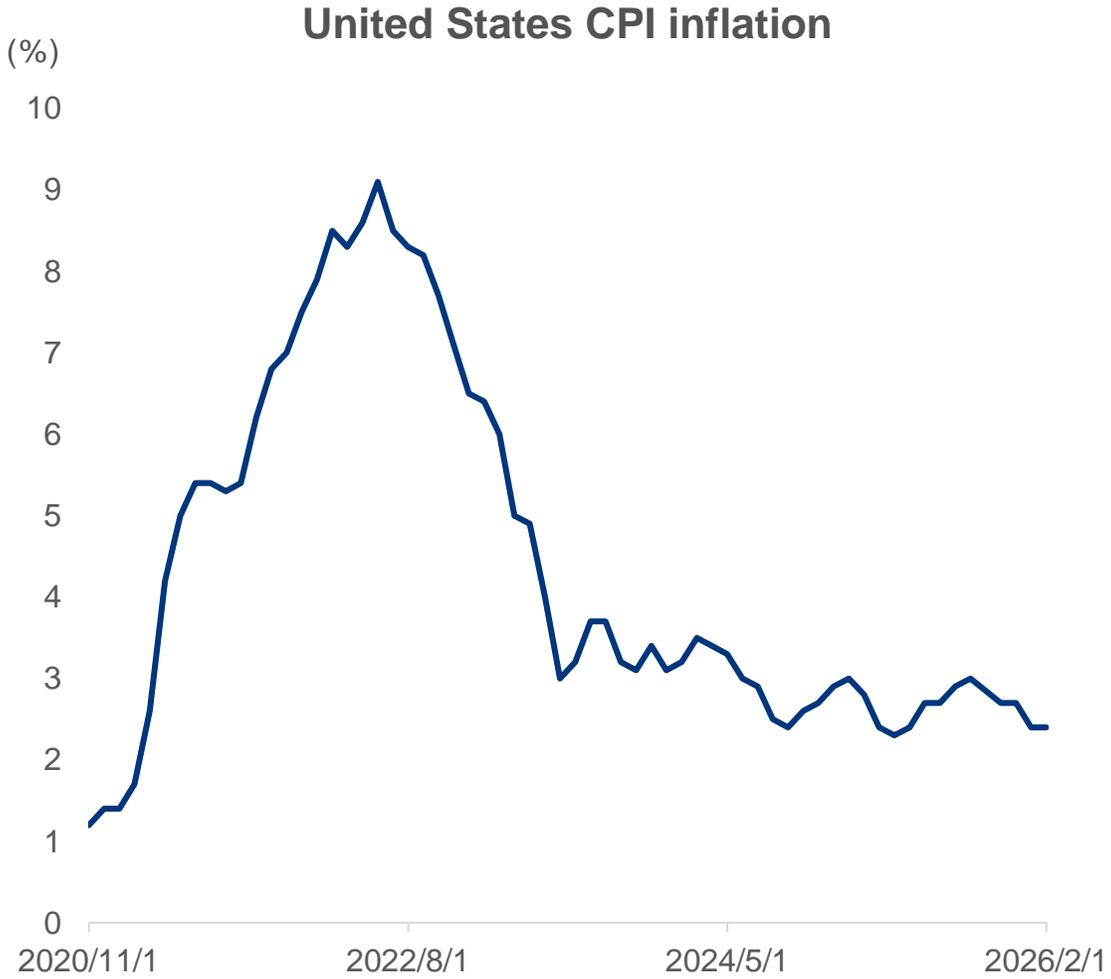


Source: Bloomberg, KGI



Interest Rate Cannot Curb Rising Oil Prices.....

But It Can Tame Demand in Other Sectors Thus Controlling Overall Price Level

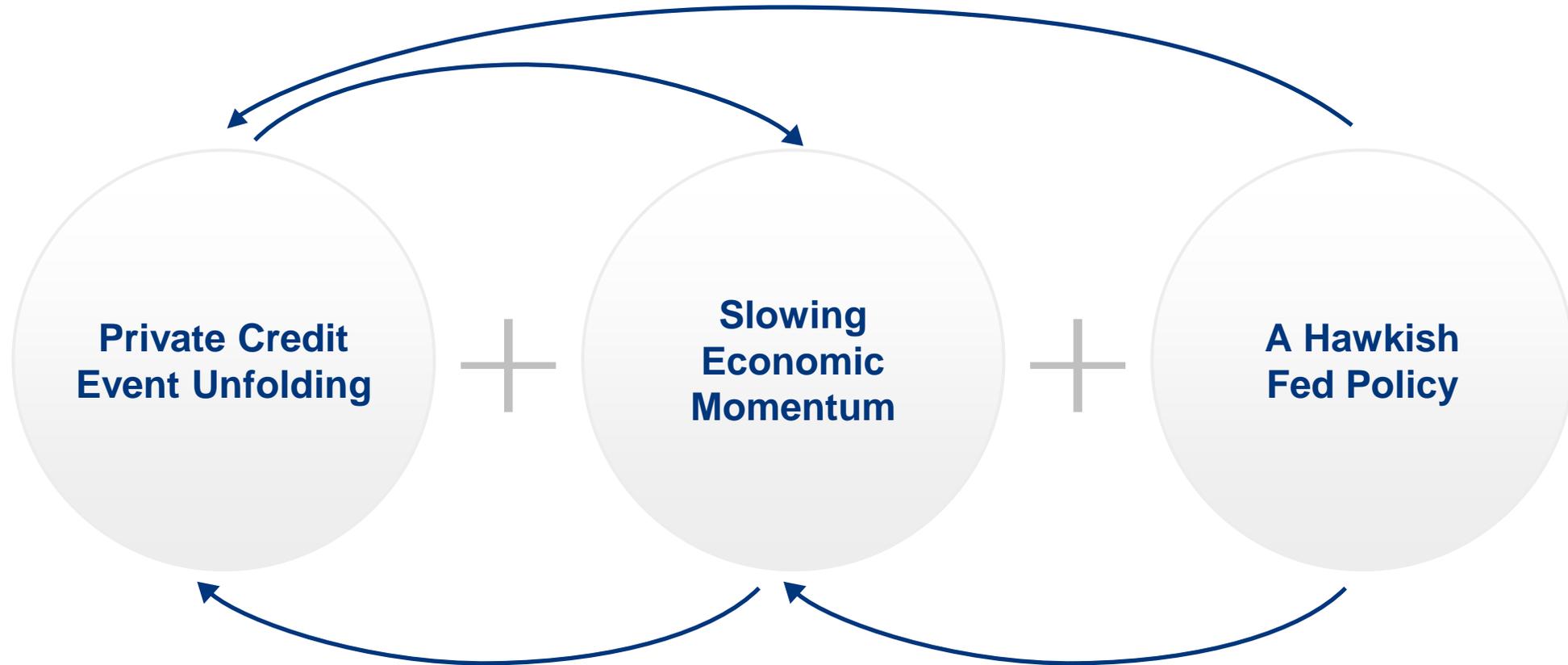


Source: Bloomberg, KGI



A Perfect Storm In The Making

It Is A Tail-risk But Most Investors Are Focusing On The War In The Middle East Right Now



Investment Strategies

- **Prefer cheap to expensive valuation stocks.**

Expensive valuation stocks often can be justified by its above-average earnings growth momentum. However, this is a luxury when the market is filled with abundant liquidity. When interest rates are believed to be not cutting by as many times, we expect valued and defensive sector will Outperform.

- **Prefer IG bonds to government bonds and private credit.**

The higher-than-expected interest rates are expected to aggravate the fiscal burden to the US government while the IG corporate balance sheets are significantly stronger. The risk-off phenomenon is likely to drive further narrowing of the IG bond spread. The higher-than-expected interest rates will also worsen the quality of the lower-credit corporate sectors.

- **Prefer Asia/China tech to US tech.**

The US tech is usually the leaders in their field while Asia tech is mainly focusing on the supply chain and applications. However, given the discounted valuation of Asia/China tech, we believe they will become the preferred choices when investors are rationing their capital.

- **Prefer Asia to the US.**

The US is in the Centre of focus under the current rise in geopolitics tension and the high valuation of the market will make it relatively more vulnerable. Asia is still trading at a substantial discount to the US.

- **Prefer China to Japan.**

Oil's share in Japan's total primary energy supply (TPES) was at 37% in 2024 versus 18% in China. Oil accounts for less than 5% of China's electricity generation. The lower oil dependency will make China more resilient than other Asian countries if oil price is sustained at high level for a prolonged time frame.

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