Direct Lending: Stay Disciplined

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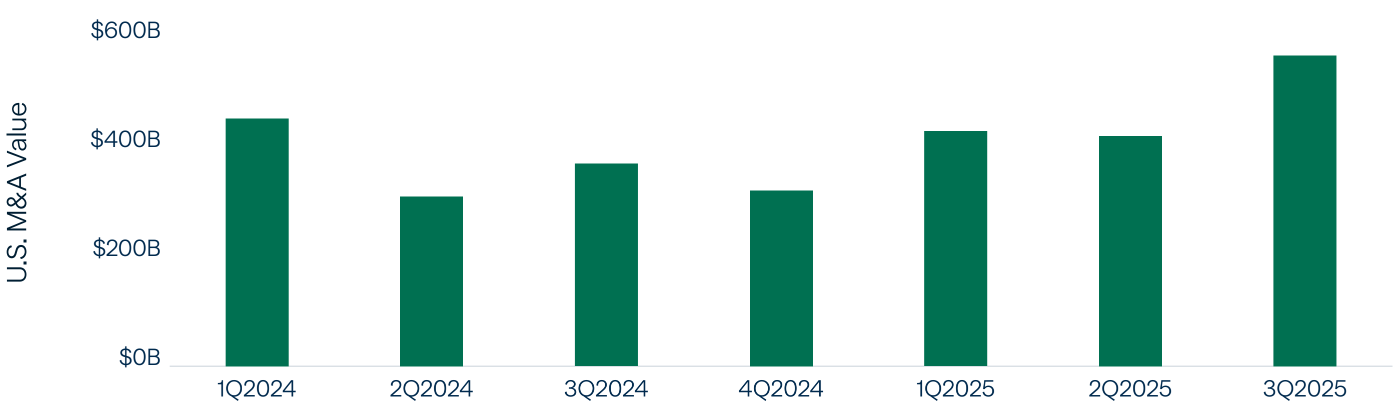
In the direct lending market, we're beginning to see a divergence in deal flow between large-cap and middle-market sponsor-backed deals. This year has seen an increasing number of large-cap sponsors opting to finance deals in the cheaper broadly syndicated loan (BSL) market: 63% of leveraged buyouts (LBOs) larger than $1 billion have been financed in the BSL market so far in 2025, compared to 51% in 2024 and 39% in 2023.[1] Alternatively, middle-market deal flow appears to have picked up meaningfully after the lull starting in 1Q2025. The volume of deals under consideration in the market today is above levels seen in the first half of the year, when policy uncertainty kept smaller sponsors sidelined.[2]

This increase hasn't yet been enough to reverse the tightening of pricing we've seen in recent months. The large volume of dry powder available to business development companies and other lenders exemplifies a supply/demand imbalance that has pushed average spreads in middle-market deals down to around 450-475 basis points (bps) over SOFR, only marginally above large-cap deals.[3] That said, mergers and acquisitions (M&A) activity has recently shown signs of positive momentum—if this trend continues into 2026, pricing could stabilize or even marginally widen. **(See Figure 1.)**

Prices remain tight and base rates have declined over the past year. Thus, the prospective risk-adjusted returns available in sponsor-backed direct lending today are lower than they were a year ago. We believe direct lending managers should stay disciplined, passing on opportunities where risk-adjusted returns fall short. To be clear, the direct lending market may offer attractive prospective yields and generally stronger creditor protections relative to many liquid-credit markets, making it a valuable component of a diversified portfolio in our view.

Figure 1: A Sustained Revival in M&A Activity May Improve Deal Flow for Direct Lenders
($ in billions)



Source: Kirkland and Ellis, LSEG.

Endnotes

1. Kirkland and Ellis, PitchBook LCD, September 30, 2025.
2. Kirkland and Ellis, Ontra: sell-side M&A NDAs from middle-market investment banks have meaningfully increased in number between 1Q2025 and 3Q2025, based on mandates processed by Ontra, an NDA automation platform.
3. Oaktree portfolio manager observations of recent deal flow.

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