

Value Opportunities: A Tale of Two Markets



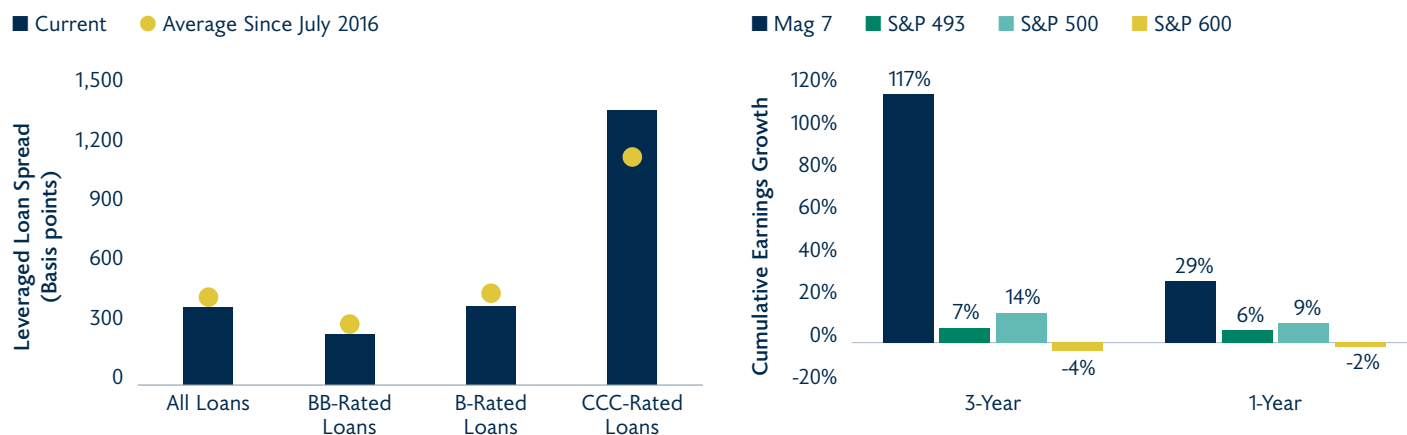
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It's not unusual for what we see at the surface to hide underlying currents. Today, the undertow is large, as growing disparities lurk behind the stable picture presented by major indices. This bifurcation into "haves" and "have-nots" and divergence in valuation creates inefficiencies in both equity and credit: (a) unloved investments with few prospective buyers and (b) excessive complacency regarding companies that "seem fine."

Equities acutely illustrate this dynamic, as the Magnificent 7 ("Mag 7") continues to drive index performance while earnings in the "S&P 493" remain lackluster (**Figure 1**). Broadly across equities, companies with "AI" in the ticker trade at meaningful premiums, while those without "AI" trade at discounted levels. These discrepancies underscore an economy struggling to find true escape velocity. Artificial intelligence spending accounted for roughly 0.5% of 1H2025 GDP, or one-third of total growth.¹ Absent AI, 1H2025 GDP growth would be closer to 0.9%.² By the end of 2026, AI spend could comprise 40-50% of GDP growth.³ If and when AI spend slows, the outcomes appear obvious.

We see a similar pattern in credit, shaped by lender risk tolerance. Solid borrowers face little resistance: BB-rated loans yield 6.9%—a spread of just 257 bps—yet still attract capital from both public and private markets⁴ (**Figure 1**). In contrast, CCC-rated loans trade at 1,388 bps.⁵ The spread reflects a bleak outlook. From 2010 to 2021, LBO volumes accelerated on the back of zero-rate policies, fueling acquisitions with excess leverage and high multiples. Today, floating-rate debt from those pre-2022 deals has doubled in cost. The result: median cash flow coverage for CCC-rated loans has dropped below 1x, and it is only slightly higher for bonds.⁶ Many of these CCC issuers can't invest to grow and will struggle to refinance, making restructurings likely, most commonly in the form of liability management exercises. We believe that for opportunistic credit managers, there may be a structurally elevated opportunity to buy deeply discounted debt, potentially for many years to come.

Figure 1: The Haves and the Have-Nots



Source: PitchBook LCD Compass, as of August 31, 2025; reflects LSTA Leveraged Loan Index. Earnings growth sourced from Bloomberg, as of August 31, 2025.

ENDNOTES

¹ Pantheon Macroeconomics.

² Ibid.

³ Morgan Stanley, U.S. Federal Reserve.

⁴ LSTA Leveraged Loan Index, as of August 31, 2025.

⁵ LSTA Leveraged Loan Index, as of August 31, 2025.

⁶ BofA, as of May 15, 2025. Assumes a fed funds rate of 3.5%.

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