The Quarterly Big MAC Letter

Multi Asset Credit Outlook

Overview

- Energy price pressures have softened, while fiscal measures are gradually gaining traction and European economic activity is showing signs of improvement, albeit from a low base.
- AI-related infrastructure investment remains an important driver of US growth dynamics.
- Tighter spreads and weaker CLO arbitrage reinforce our preference for selective exposure to AAA CLOs, diversified B-/CCC loans, and European lower-middle-market private debt.

Market Backdrop

By the start of H2 2026, tensions in the Middle East remained a contained macroeconomic shock rather than evolving into a broader systemic risk event. Shipping activity through the Strait of Hormuz improved, although conditions had yet to fully normalize, while oil prices retraced from highs above $100 per barrel as investors increasingly priced in a more durable de-escalation despite lingering uncertainty around a ceasefire. The outlook for energy prices remains a key consideration for Europe, where inflation and economic growth are more sensitive to higher energy costs than in the US due to the region's continued reliance on imported energy.

The European Central Bank's (ECB) projections are consistent with a manageable rather than persistent energy shock. Oil and gas futures are currently broadly consistent with the ECB's so-called milder scenario, in which real GDP growth is expected to improve from around 0.8% to approximately 1.4%, before reaching 1.6% by 2028. Lower oil prices would also allow headline inflation to fall below 2%, while core inflation is expected to remain slightly above target at around 2.1%. With slightly more only one rate hike currently priced as energy pressures have normalized, markets continue to view the inflation impulse as temporary rather than the beginning of a renewed tightening cycle.

However, the expected improvement in growth does not alter Europe's broader challenge of structurally weak growth and subdued investment. Current PMIs continue to point to limited near-term momentum, leaving the earnings outlook vulnerable and reinforcing the importance of issuer selection. Beyond the gradual cyclical improvement, Europe's longer-term growth potential will partly depend on whether fiscal spending and structural reforms translate into higher investment and productivity. Fiscal and infrastructure spending in countries with available fiscal capacity may provide some support, while deeper banking and capital markets integration could improve the allocation of capital across the region.

The ECB estimates that national restrictions currently leave approximately €225bn of capital and €250bn of liquidity trapped within local bank subsidiaries, illustrating the degree of financial fragmentation. The economic impact of reform will ultimately depend on implementation, although the IMF estimates that broader financial reforms could raise long-term EU GDP by around 3%.

At the same time, the US continues to benefit from an investment impulse that Europe currently lacks. AI-related capital expenditure, data-centre construction and power infrastructure are providing a material offset to softer parts of the economy. While import-intensive equipment investment can weigh mechanically on net trade, the underlying domestic investment cycle remains supportive of US activity.

Source: Eurostat, as of Q1 2026.

Strong technicals are compressing loan spreads and challenging CLO arbitrage

European leveraged finance markets continue to benefit from strong investor demand, while new issuance linked to M&A and LBO activity remains limited. Primary market activity has instead been dominated by amend-and-extend transactions and refinancings, resulting in limited net new supply despite healthy headline issuance volumes.

This imbalance between strong investor demand and limited new supply continues to favour borrowers. Loan repricing activity remains elevated and average margins have compressed by approximately 50bps in the first half of 2026. While this lowers funding costs for issuers, it also reduces prospective returns for broadly syndicated loan investors.

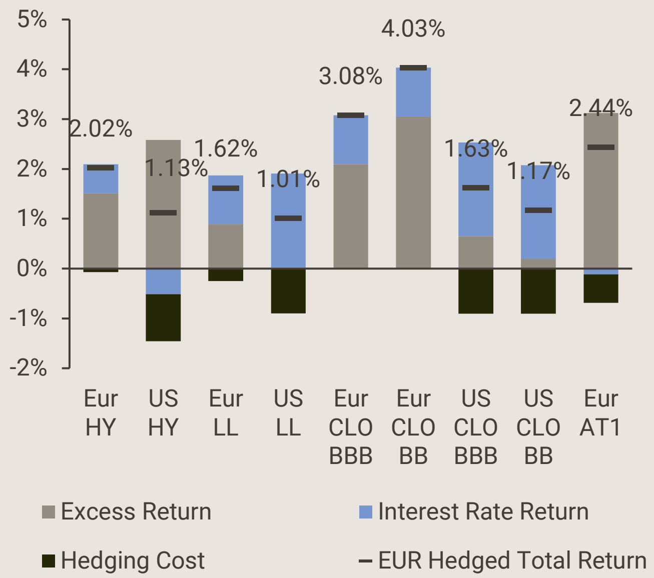
PER HENRIK LINGS ALLÉ 2, 8TH FLOOR, 2100 COPENHAGEN Ø, DENMARK
T: +45 3525 6100 | CAPITAL-FOUR.COM | INFO@CAPITAL-FOUR.COM

CLO formation remains robust. European CLO gross new issuance reached €31bn in the first half of the year, a record level and broadly in line with the pace observed in 2025. However, the headline gross issuance number overstates the increase in risk available to investors. Net CLO supply is only approximately €9bn according to Bank of America, as a meaningful share of deals has been redeemed. However, strong CLO demand for newly issued loans remains an important technical support for the loan market. At the same time, "headline" CLO equity arbitrage has become less attractive as loan spreads have compressed faster than CLO liability costs.

Recent developments in European single-B CLO tranches highlight the growing dispersion at the lower end of the CLO capital structure. CLO managers have had to navigate bouts of loan-market stress, with the distress ratio rising above 6% - above the 75th percentile since 2013 - underscoring the weaker collateral backdrop. Against this backdrop, the European CLO market recently recorded the first principal impairment of a CLO 2.0 single-B tranche.

Despite an ultimate recovery of approximately 66 cents on the dollar, the Bain-managed single-B CLO tranche is estimated to have generated an IRR of around 5% over its life, reflecting the significant coupon received prior to maturity and issued price below par. More broadly, around 8% of European CLO single-B tranches are currently not covered if they were liquidated today, with MVOC ratios below 100%. We expect more CLO tranche defaults with a single-B rating, but defaults in the CLO asset class should remain lower than for corporate bonds with the same credit rating, as has been the case historically. The widening dispersion between clean and stressed structures reinforces the importance of collateral quality and manager selection.

Q2 2026 Cross Assets Returns



Source: Capital Four calculations based on ICE BofA and S&P UBS indices. Returns shown are euro-hedged.

Portfolio implications: three investment recommendations

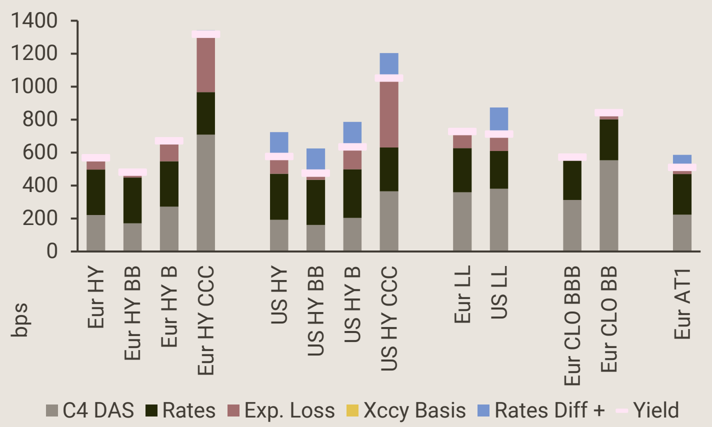
Against this backdrop, we continue to see compelling relative value in AAA CLOs. Primary AAA spreads remain comparatively wide, with European new issues pricing in the mid-to-high 120bps area depending on manager tiering. In our view, the combination of seniority, floating-rate spread and continued technical support, including favourable upcoming solvency treatment, provides an attractive risk-adjusted return profile, particularly relative to investment-grade alternatives.

Opportunities also remain in European lower-middle-market private debt, where illiquidity and transaction complexity continue to support discount margins of around 625bps over a three-year horizon. Our focus remains on first-lien senior secured loans with strong covenant protection and conservative leverage, typically corresponding to an implied BB- credit profile. In our view, this segment offers materially stronger structural protection than the primary European broadly syndicated loan market, with an average B rating, or the European high-yield market, where the average rating is BB-.

Importantly, European lower-middle-market private debt differs significantly from the larger, globally focused upper-middle-market segment that often attracts media attention. Much of the public discussion has centred on managers operating in the B-/CCC-rated market, as highlighted by the Financial Stability Board. By contrast, European lower-middle-market lending generally features higher credit quality, lower leverage, stronger documentation and more lender-friendly structures.

Finally, dispersion in leveraged loans continues to create bottom-up opportunities. In parts of the Caa1/CCC+ and wider B2/B-rated market, credit risk premia can overstate fundamental deterioration, particularly in businesses with meaningful equity cushions and limited disruption risk. Given the idiosyncratic nature of these credits, diversification, prudent position sizing and liquidity discipline remain essential to preserve downside protection

Excess Spread Comparison



Source: Capital Four calculations based on ICE BofA High Yield and S&P UBS Leveraged Loan indices. Excess spread components reflect Capital Four's proprietary default-adjusted and euro-hedged methodology. As of 30th June 2026. C4 DAS: Capital Four Default Adjusted Spread

Source: Capital Four, ICE BofA, S&P UBS, JP Morgan. As of October 30, 2025. For illustration purposes only.

Authors



Rene Kallestrup, PhD
Partner
Copenhagen
21 years of experience

Mathi Danmark
Quantitative Analyst,
Managing Directo
Copenhagen
10 years of experience

Althea Spinozzi
Product Specialist,
Director
Copenhagen
12 years of experience

Focused Leveraged Finance Manager*

High Yield	Leveraged Loans	Multi-Asset Credit	Structured Credit	Private Credit
Since 2001 €5.1bn AuM	Since 2013 €8.1bn AuM	Since 2010 €2.6bn AuM	Since 2019 €0.7bn AuM**	Since 2015 €9.0bn AuM

Notes

* As of June 2026.
** Includes structured credit assets under management in multi-asset credit funds and mandates

Disclaimers

This information is issued by Capital Four AIFM A/S (‘Capital Four’). It was produced by and the opinions expressed are those of Capital Four as of the date of writing and are subject to change. This document has been prepared solely for information purposes and for the use of the recipient. It does not constitute an offer or an invitation by or on behalf of Capital Four to any person to buy or sell any security or investment product. Any reference to past performance is not necessarily a guide to the future. The information and analysis contained in this publication have been compiled or arrived at from sources believed to be reliable but Capital Four does not make any representation as to their accuracy or completeness and does not accept liability for any loss arising from the use hereof. This document may not be reproduced either in whole, or in part, without the written permission of Capital Four. Capital Four is licensed, regulated and supervised by the Danish Financial Services Authorities. Prospective investors should have the financial ability and willingness to accept the risk characteristics of the investments of the fund.

Before entering into a transaction, investors should determine the suitability of these products with regard to their particular circumstances and independently (in consultation with their professional advisors) examine the special risks (maximum loss, currency risk, etc.) and legal, regulatory, credit, tax and accounting consequences. This document does not disclose all product related risks. For the full risk disclosure please consult the offering documents. No assurance can be given that the investment objective will be achieved or that investors will receive a return on their capital.