FROM THE DESK OF:

New York Life Investments' Global Market Strategy team

# Credit: canaries in the coal mine, or a healthy reality check?

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New York Life Investments

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**Takeaways**

- With valuations near all-time highs and credit spreads tight, attention has turned to where cracks may appear. The recent bankruptcies of First Brands Group and Tricolor Holdings, alongside unexpected loan losses at Zions Bancorp and Western Alliance, have amplified that focus – prompting renewed scrutiny of credit risk.
- Despite the headlines, we do not believe a credit event is imminent. Economic activity, credit conditions, and market liquidity remain supportive.
- That said, we are late in the cycle, and late-cycle complacency can be costly. We continue to advocate selectivity, strong underwriting, and disciplined exposure – not because we expect imminent stress, but because resilience is best built before it's tested.
- We share a short list of conditions that, though not present today, would change our view on an otherwise fully invested credit allocation.

## *Why credit is back in focus*

The rapid growth and opacity of private credit have become key sources of concern. Just last year, the IMF dedicated a full chapter of its global financial stability report to private credit, warning that the migration of credit away from regulated and transparent markets should be closely monitored. For what it's worth, we don't see the lack of transparency as a risk in itself, as long as any potential losses are limited to investors in that space. But as private assets democratize, and as the credit cycle heats up, it's reasonable for investors to scan the horizon for what could "go bump in the night."

In the absence of robust, publicly available data, private credit remains vulnerable to headline-driven risks. Still, we view the recent credit events as largely idiosyncratic – each involving some degree of fraudulent activity rather than systemic weakness.

That said, the market reaction highlights broader unease about due diligence, leverage, and transparency across both public and private credit markets:

- **Tricolor Holdings**, a subprime auto lender, filed for bankruptcy in September amid allegations of fraud, including the double-pledging of collateral. The company had issued nearly $2 billion in ABS since 2022, and its collapse widened prime and subprime auto ABS spreads.
- **First Brands Group**, an auto-parts manufacturer, declared bankruptcy in October following an unsuccessful debt-fueled acquisition strategy and the discovery of fraudulent off–balance sheet financing. It had issued more than $5 billion in leveraged loans, many held across 80+ CLOs.
- **Zions Bancorp** and **Western Alliance** disclosed fraud-related loan charge-offs last week, sparking a sell-off in regional bank equities – the KBW Regional Bank Index fell more than 6% following the announcements.

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While these cases are isolated, they serve as a reminder that confidence in credit markets can erode quickly. True systemic risk is more likely to arise from economic deterioration or a sudden loss of liquidity than from individual frauds.

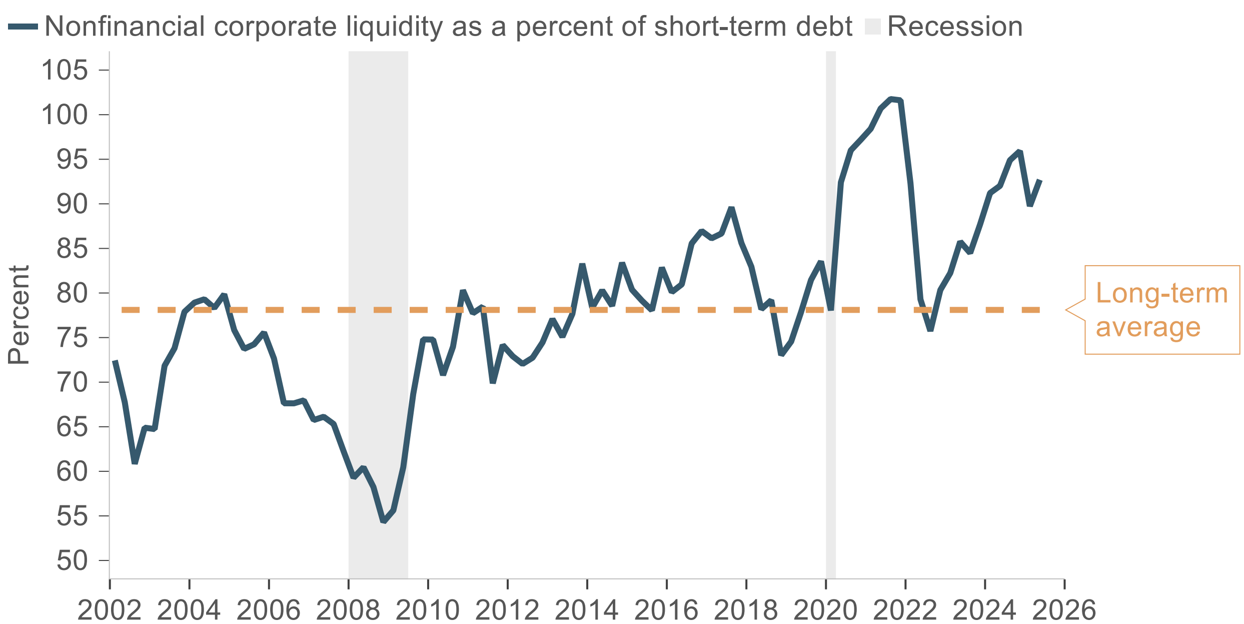
### *Why we are not overly concerned*

We remain constructive on credit for several reasons:

- **The economy is slowing, but from a strong base.** Businesses are facing headwinds from slower growth, operating uncertainty, and tariffs – but corporate liquidity remains well above the pre-pandemic trend, and small business optimism remains elevated.

- **Liquidity remains abundant,** reducing the likelihood of significant credit stress this cycle. Ample cash continues to act as a buffer, sustaining a "buy-the-dip" mindset even amid rising risks. As the Fed lowers rates, flows from money markets and other cash-like instruments may further support corporate credit.

**Corporates' financial buffers are at a healthy level**



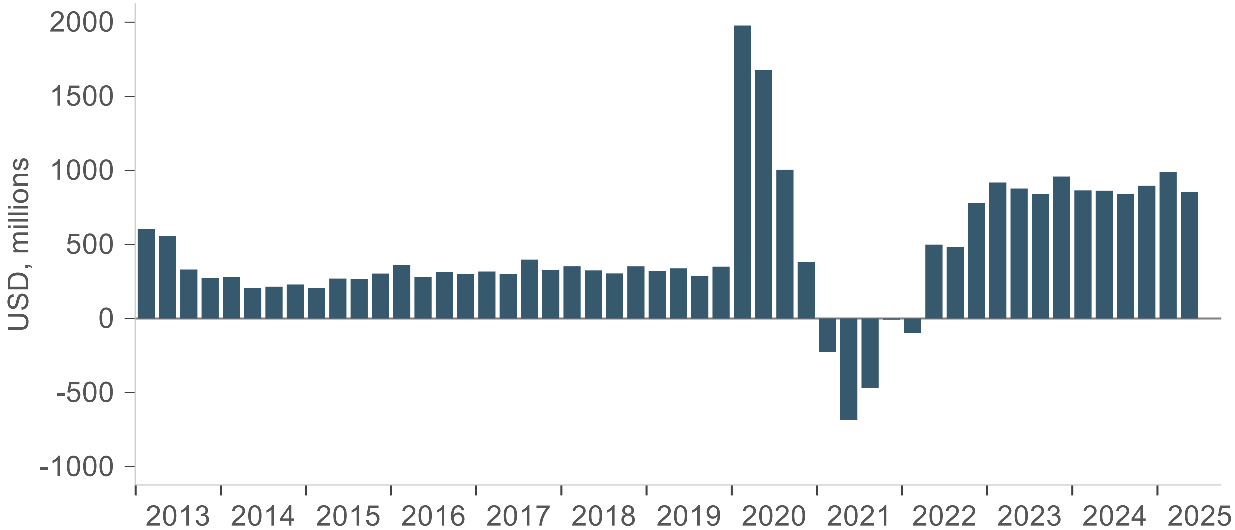

Sources: New York Life Investments Global Market Strategy, Federal Reserve, NBER (National Bureau of Economic Research), Macrobond, October 2025.

- **Defaults are low and credit spreads remain tight**. With the Federal Reserve restarting its interest rate cutting cycle, credit spreads may tighten further as investors move funds from the money market to short-duration credit opportunities.

- **The regional banking system has become more resilient**, following the 2023 regional banking crisis. Despite the headlines, loan-loss provisioning across the banking sector remains stable (see chart below). Regional banks have strengthened their capital positions, with Common Equity Tier 1 (CET1) ratios rising for most regional banks, and have reduced exposure to long-duration securities that created the 2023 mark-to-market losses.

**Loan loss provisions are tracking higher than pre-pandemic levels**

Regional banks' provisions for loan losses
(Cadence Bank, Citizens Financial, Columbia Banking, Truist Financial, Valley National, Prosperity, Popular, FNB, Southstate, UMB Financial)




Sources: New York Life Investments Global Market Strategy, Bloomberg, Macrobond, October 2025.

*What would make us more concerned? Sharing our red flags...*

Investors are right to look for "what could go wrong," but the next 12 months may still be about what's going right: resilient fundamentals, abundant liquidity, and a slow transition to a more normalized credit environment thanks to lower rates.

That said, we are late in the cycle, and late-cycle complacency can be costly. We continue to advocate selectivity, strong underwriting, and disciplined exposure – not because we expect imminent stress, but because resilience is best built before it's tested.

We continue to watch three key areas that could shift our outlook:

- **A macroeconomic slowdown that threatens credit health.** We are watching the U.S. consumer closely. Aggregate consumer health has been astonishingly resilient, but underneath the hood, a K-shaped recovery, in which lower-income and younger consumers have been struggling, may be extending into middle-income families. A significant or sustained rise in credit card, auto, or personal loan delinquencies – especially outside of the subprime segment – may signal broader cause for concern in the ABS space. We're monitoring developments in employment and the breakdown of consumer spending trends as early warning signals.

- **Liquidity drying up.** A contraction in bank lending, a tighter repo market, or a sustained equity market drawdown could remove the "buy-the-dip" dynamics that are keeping markets stable. Fed policy can also play a role here, though we anticipate that conditions for ending the Fed's quantitative tightening process are already being met, reducing this risk.

- **A sharp rise in corporate funding stress.** Delayed repayments, spikes in loan amendments, and maturity extensions could suggest cracks in private credit are widening. If not due to an economic slowdown or liquidity issues, these problems could arise if the cost or availability of financing tightened.

## *Portfolio strategy*

We remain fully invested in credit, focused on quality within asset classes rather than necessarily among them. In a challenging macro environment, selectivity will be critical – a rising tide may no longer lift all boats. In the near term, strong liquidity means that moments of spread widening may offer opportunities for investors. Defaults may rise, but we expect this to remain concentrated among lower-quality borrowers. In private credit, we see strong capital structures, collateral, covenants, and long-term borrower-lender relationships providing flexibility in the event that issues arise.

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