



Separating the Baby From the Bathwater: Why Quality BDCs Look Attractive Now

BDC prices have fallen far faster than BDC portfolios. NAVs are still compounding, most markdowns are market marks rather than credit losses, and the market is lumping quality lenders in with the weak ones going into earnings season.



By John Cole Scott, CFS, President & CIO, CEF Advisors — October 2026

Data as of October 16, 2026 unless noted.

The Bear Case Is Real

Investors in BDC common stocks have had a hard year. BIZD, the largest passive BDC ETF, closed the week of October 16 at \$12.01. It is down 15.3% YTD and within 1% of its 52-week low, after four straight weekly declines. One experienced BDC analyst counts 32 of 45 BDCs down 10% or more in price this year, and 12 down 30% or more. Only five BDCs ended the third quarter above NAV, against 43 below. In our view, discounts have been this wide only during the financial crisis and COVID.

Some critics now question whether the public BDC model can absorb even modest stress. That question deserves a serious answer. The prices are real. What matters is whether the portfolios behind them have deteriorated by

as much. For most quality BDCs, the data says they have not.

The Portfolios Are Still Earning

Our two equal-weight BDC indexes tell the story. NAV total return is positive this year in both. Over three years, the gap between NAV and price total return has grown to about seven points a year. NAV total return reflects how the portfolios are performing; price total return reflects investor sentiment. The two have rarely been this far apart.

The fundamentals look similar across the broader universe. In CEFData's 48 listed debt-focused BDCs (10/2/2026 prices, 6/30 NAVs), median NII coverage is 104%. Median non-accruals are 1.5% of the portfolio at fair value, and median debt-to-equity is 1.20x. Fitch's 2Q26 review of rated BDCs found non-accruals averaging 2.5% at cost, realized losses of 0.5% in the first half of 2026, and leverage of 1.09x.

NAV has still declined. Income alone would have produced about 6% NAV total return YTD, but the actual figure is closer to 3%. Markdowns have cost about 3% of NAV, which is a real cost but not a collapse.

"The structure is working. What has broken down is the market price."

Key Takeaways

- **NAVs are still compounding.** Our Listed Debt BDC Index NAV total return is +3.2% YTD, while price total return is -8.6%.
- **Markdowns are mostly marks, not losses.** Realized losses are steady; unrealized marks drove the decline.
- **Quality is being sold with the weak.** The market prices dividend risk accurately but marks down quality and smaller BDCs far more than their NAVs justify.

Most Markdowns Are Market Marks, Not Credit Losses

Independent data shows the same split. StepStone puts trailing net realized losses on BDC portfolios at -0.37%, roughly unchanged from a year earlier. Trailing net unrealized losses are -1.28%, against -0.36% a year earlier. Most of the damage so far is in the marks, not in realized losses. That distinction matters: marks driven by wider spreads tend to reverse as loans season and approach maturity, while realized losses are permanent.

Listed Debt BDC Index: Price vs. NAV Total Return, since 12/31/2011



Source: CEFData.com, daily through 10/16/2026. Equal weight; unmanaged; cannot be invested in directly.

CEF Advisors Listed Debt BDC Indexes, Equal Weight (Total Return)

	YTD	1 Year	3 Yr (ann.)	5 Yr (ann.)	10 Yr (ann.)	Since 12/31/2011 (ann.)
Listed Debt BDC – Price	-8.6%	-3.8%	1.0%	2.1%	6.2%	7.6%
Listed Debt BDC – NAV	+3.2%	+5.4%	8.2%	8.5%	8.4%	8.8%
Large Cap Debt BDC – Price	-4.5%	-0.8%	1.6%	2.9%	6.2%	n/a
Large Cap Debt BDC – NAV	+4.4%	+6.5%	8.1%	8.7%	9.1%	n/a

Listed Debt BDC Index: debt-focused BDCs with more than \$1MM in average 90-day dollar volume. Large Cap Debt BDC Index: debt-focused BDCs with market caps of \$1B or more (history since 3/31/2015). Both equal weight and rebalanced quarterly. Source: CEFData.com, through 10/16/2026.

Managers of several large BDCs gave the same explanation for their recent NAV declines, attributing most of the decline to market and spread inputs rather than credit:

Share of Q1 NAV Decline From Spread/Market Marks

BDC	Per management
TSIX	~80%
HTGC	~75% (debt depreciation)
ARCC	~2/3
CGBD	~2/3

Source: company Q1 2026 earnings calls.

Spread-driven marks tend to reverse as loans approach maturity, and new loans are being made on better terms:

New U.S. Direct Loans (StepStone)

	Earlier	June 2026
1L spread	489 bps (3/26)	510 bps
Gross yield	8.99% (3/26)	9.17%
Leverage	4.99x (6/25)	4.62x
Int. coverage	2.18x (6/25)	~2.5x

Source: StepStone, Recent Trends in Corporate Direct Lending 1H26.

PIMCO calls these “tentative green shoots.” Required equity cushions on new loans to mid-sized borrowers have risen from 45% to 50%. ARCC reports new deals pricing 50–75 bps wider with half a turn to a full turn less leverage, and CGBD reports new-deal spreads about 50 bps wider.

There is a partial offset. A record ~\$12 billion of direct loans was refinanced into the syndicated loan market in Q3 2026 (PitchBook), mostly by better-quality borrowers. The share of BDC investments yielding more than 600 bps fell from over half at year-end 2023 to 20% at year-end 2025. New loans are coming on at better terms, but some of the strongest existing borrowers are leaving, so the improvement in BDC portfolio yields will be gradual.

Quality Can Be Identified Ahead of Time

The selloff has hit the sector broadly, but the results underneath it have been very different. Dividing BDCs into thirds by one-year results:

BDCs by One-Year Cohort

Cohort	Total return	ROE
Top third	~+7%	~11%
Middle third	~-2%	~5%
Bottom third	~-15%	~1%

Source: CEF Advisors, CEFDData.com.

Our ROE study covered 36 BDCs with market caps of \$240MM or more. ROE predicted future dividends and NAV better than discount level or software/AI exposure did. High-ROE BDCs had fewer write-downs, non-accruals and realized losses. Their dividends fell 6.7%, against 16% for the low-ROE group. We would rather own the average high-ROE BDC near NAV than the average low-ROE BDC at a 28% discount.

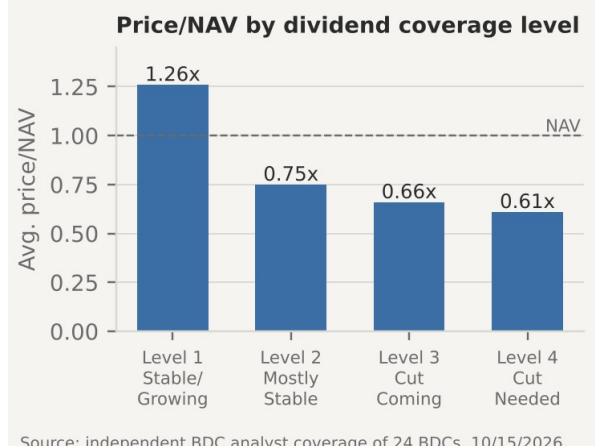
Longer-term figures from experienced BDC analysts support this. On a basis of NAV change plus dividends paid, a broad group of covered BDCs returned about 71% from 12/31/2019 through 6/30/2026, excluding the weakest names. The leaders were MAIN, HTGC, FDUS, CSWC, TSLX and ARCC. BDCs trading above NAV can also issue shares at a premium, which adds to NAV per share. MAIN, for example, has raised about \$902 million at an average premium of about 60%. BDCs at deep discounts cannot raise equity that way.

The warning signs appear well before a dividend cut. Experienced BDC analysts find that every BDC that cut its dividend by more than 15% in recent years did so because of credit problems. About 95% of those BDCs had enough spillover income to hold the dividend for another two to four quarters, so spillover is no guarantee of safety. The indicators that have mattered:

- **Realized gains and losses.** Losses range from 26% of NAV per share at GSBD to 90% at TCPC among the weakest names.
- **PIK above ~5% of interest income**, especially PIK added through amendments rather than at underwriting.
- **Coverage with full incentive fees.** Nine BDCs are not paying full incentive fees because of total-return hurdles, which inflates reported coverage.
- **Cost structure.** Internally managed BDCs and those charging a 1.00% base fee on assets keep more income for shareholders.
- **Watch-list exposure and first-lien concentration.**

Dividend Risk Is Priced Correctly. Quality Is Not.

Dividend coverage rankings from experienced BDC analysts show the market sorting BDCs by dividend safety. Each step down in coverage takes about 10 points off price/NAV.



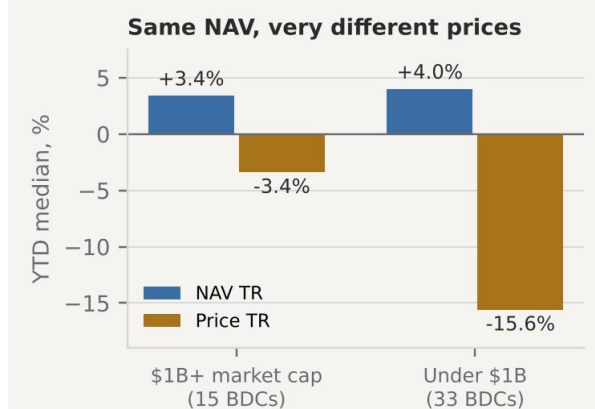
Source: independent BDC analyst coverage of 24 BDCs, 10/15/2026.

Dividend Coverage Level vs. Valuation

Coverage level	Price/NAV	Yield
1: Stable/Growing	1.26x	10.8%
2: Mostly Stable	0.75x	12.9%
3: Reduction Coming	0.66x	18.7%*
4: Reduction Needed	0.61x	19.5%

* 15.5% excluding PNNT. Base-case yields include projected supplemental dividends. Source: independent BDC analyst research; price/NAV as of 10/15/2026.

On dividend risk, the market is grading accurately. On size, it is not. Across CEFDData's universe, BDCs above and below \$1B have earned nearly the same NAV total return YTD (median +3.4% and +4.0%). Yet the larger group is down 3.4% in price and the smaller group 15.6%. Every BDC trading at a premium has a market cap above \$1B.



Source: CEFDData.com, 48 listed debt BDCs, 10/2/2026.

“Large and small BDCs earned nearly the same NAV return this year. Small-cap prices fell about four times as much.”

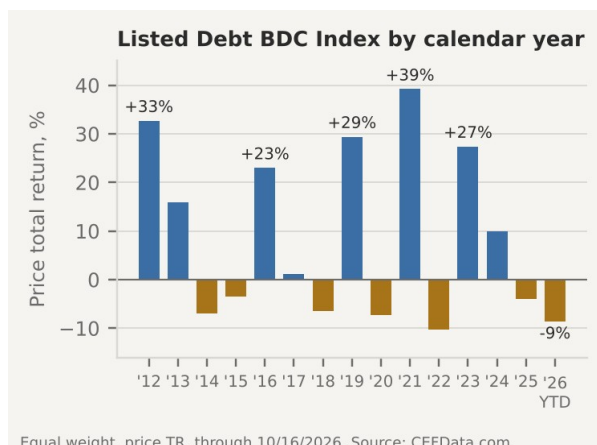
Within each size group, the selling has also hit strong and weak credits alike. In a 24-name coverage table maintained by an experienced BDC analyst, 22 of the 23 BDCs with data trade below their 50-day moving average. TRIN is 9.8% below, TSLX 6.3% and MAIN 4.8%, even though most of the best-covered names still have 50-day averages above their 200-day averages.

How a fund is built matters more than whether it is passive or active. BIZD is cap-weighted and down 15.3% YTD in price. PBDC, the actively managed Putnam BDC Income ETF, is down 10.5% YTD; its two largest positions make up about 21% of the fund. Our equal-weight Large Cap index is down 4.5%. Concentration in a few large names has hurt both ETFs.

The opportunity is in quality BDCs that have fallen along with the weak ones.

Recovery Catalysts

- **Rates.** The Fed raised rates 25 bps in September to 3.75%–4.00%, its first hike since 2023. The median 2026 dot is 4.125%, and the minutes show most policymakers expect another increase by year-end. Floating-rate BDCs benefit as long as borrowers can still pay.
- **Earnings.** We expect the average BDC’s NII to grow about 8% in the coming earnings cycle.
- **Seasonality.** We expect tax-loss selling to bottom in late November or early December, followed by a 3%–4% bounce into 2027.
- **Activists and consolidation.** Activist investors hold shares in 21 of 48 listed debt BDCs. Saba filed a 13D on TCPC this month, and WHF, TCPC and ICMB are reviewing strategic options.
- **Institutional ownership.** 13F ownership of BDCs has risen as discounts have widened, which should improve governance.
- **History.** BDC prices have crossed back above NAV after earlier drawdowns, in 2011–12, 2017, and before and after 2020. Excluding COVID (February–April 2020), the Listed Debt index’s worst price drawdown was 27.0%, from July 2014 to February 2016. The index gained 23.0% in 2016.



Listed BDCs are also where losses get priced in. Stanger’s non-traded BDC index returned +6.2% over the twelve months through Q1 2026, while the S&P BDC Total Return Index fell about 14%. Non-traded BDCs had their first-ever net outflow in Q1 2026, and PIMCO notes that model-based marks are not price discovery. Listed BDCs mark to market daily, and the discount compensates investors for that.

What Could Go Wrong

A balanced case has to state the risks clearly:

- **Stress is rising even where defaults are not.** The BDC payment default rate was 2.1% as of March 2026 (StepStone). Some lenders are switching struggling cash-pay borrowers to PIK, which defers interest rather than forgiving it; including those amendments, the figure is 4.3%. PIK is 6.83% of BDC income, against a 5.22% long-term average. PIMCO’s broader measure counts defaults, non-accruals, problem PIK, maturity extensions and restructured equity. It covers 18.8% of BDC borrowers, up from 8.6% in 2015. Most of these loans are still performing, but a larger share of income now depends on borrowers paying deferred interest later.
- **Older vintages.** PIMCO argues loans from the peak fundraising years have not finished absorbing losses. Fitch rates the sector outlook “deteriorating.”
- **Recession.** A recession would turn mark-to-market losses into realized losses, and discounts could widen from here.
- **Fee waivers flatter coverage.** Analyst estimates show that with full incentive fees, Q2 2026 coverage would have been about 81% at BXSL and 71% at TPVG. BXSL management has said it plans to move to a lower dividend.

- **More dividend cuts are likely.** Experienced BDC analysts expect further cuts at FSK, GSBD, MFIC, TCPC and TPVG.
- **Funding costs.** Unsecured borrowing costs are rising.
- **Timing.** We do not expect discounts to return quickly to their 10-year averages. The price chart looks more range-bound than distressed, and the recovery may take longer than in past cycles.
- **Volatility.** Ten-year market price volatility for BDCs is about 36, roughly double that of senior loans.

- **Data lag.** NAVs are reported quarterly, and Q3 results begin in about two weeks. Marks could still disappoint.

“PIK is deferred income, not a default. But more BDC income now depends on it.”

What We Are Watching in Q3 Earnings

BDCs begin reporting in about two weeks. These are the items that, in our view, will separate the quality lenders from the rest this quarter:

What to watch	Why it matters	What we want to see
NII vs. dividend, with full incentive fees	Fee waivers and total-return hurdles can make coverage look better than it is	Core NII covering the regular dividend without relying on waivers
Non-accruals (cost and fair value)	The first sign that marks are turning into credit losses	Stable or lower, and below roughly 2% at fair value
Realized gains and losses	Losses taken through restructurings can hide credit problems that never show up as non-accruals	Small net realized losses relative to NAV
PIK share and how it was added	PIK is deferred income; PIK added through amendments signals borrower stress	PIK under ~5% of interest income, mostly underwritten at origination
NAV per share and the source of marks	Spread-driven marks should start to reverse; credit-driven marks may not	Managers attributing changes mostly to market inputs, with marks recovering
New-loan spreads vs. repayments	Better terms on new loans offset the strongest borrowers refinancing away	New originations at wider spreads and lower leverage than the loans being repaid
Dividend announcements and guidance	Several cuts are already flagged by analysts; surprises move prices	Cuts that are announced in advance and set at a level the BDC can over-earn
Buybacks, fee changes and activist responses	Capital actions show whether boards are taking the discount seriously	Buybacks at deep discounts and permanent fee reductions, not temporary waivers

Source: CEF Advisors. Views are opinions as of the publication date.

Putting It Into Practice: Our BDC Select List

Going into Q3 earnings season, CEF Advisors maintains a BDC Select List of 10 holdings, weighted between 8% and 13% each. We are not naming the holdings here. The list applies the criteria above: credit quality and dividend coverage first, then valuation.

BDC Select List vs. Listed BDC Universe

	Select List (wtd.)	Universe median
Discount to NAV	-17.1%	-32.6%
1-yr avg. discount	-9.7%	-22.6%
Market yield	11.8%	13.8%
NII coverage	105.0% (core)	104%
Non-accruals (FV)	0.92%	1.5%
First lien	82.1%	78%

Select List data as of 10/16/2026, weighted by list allocation. Universe: 48 listed debt BDCs, CEFData.com, 10/2/2026 prices and 6/30/2026 NAVs, so the columns are not perfectly comparable.

What the list holds:

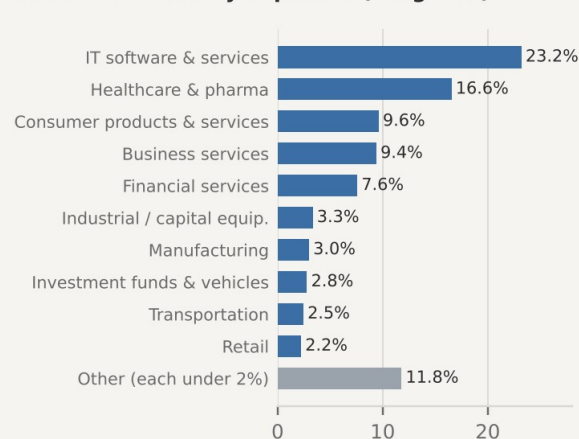
- **Broad diversification.** Combined, the 10 BDCs hold 5,029 loans to 2,685 companies. No single portfolio company exceeds 0.8% of the list on a look-through basis.
- **Low non-accruals.** Every holding has non-accruals below 2% of fair value. The weighted figure is 0.92%.
- **Positioned for higher rates.** 90.9% of portfolio assets are variable rate, while 54.8% of leverage is fixed rate. Rising rates should lift income faster than borrowing costs.
- **Modest leverage.** Total leverage is 52% of assets, with an estimated borrowing cost of 6.7%.

- **Discounted relative to its own history.** Every holding trades at a wider discount than its own one-year average. The weighted discount of -17.1% compares with a 1-year average of -9.7% and a 3-year average premium of +1.8%.
- **A mix of valuations.** About 17.5% of the list is in BDCs trading at a premium to NAV, and 58% is in BDCs trading more than 20% below NAV. The discounted holdings are BDCs that, in our opinion, still pass our credit and coverage tests. Several are smaller BDCs below \$1B in market cap, where the size discount is widest, but most are run by large, well-resourced managers.

The list has weak spots too:

- **Dividend cuts.** Four holdings, 39% of the weight, cut their dividends in the past year; the weighted 1-year dividend change is -5.8%. We see those resets as largely done, but they happened.
- **Coverage.** Two holdings run core NII coverage below 100%, at 99.5% and 86.6%.
- **Software exposure.** Software is the largest industry exposure at 23.2%, followed by healthcare at 16.6%. We monitor software/AI risk with our AI exposure scoring.

Select List industry exposure (weighted)



Look-through, as of 10/16/2026. Source: CEFData.com.

- **NAV.** Last quarter, NAV per share fell 0.65% on a weighted basis, and portfolios are marked about 2.2% below cost in aggregate.

Positioning

We remain overweight BDCs, typically at 1%–3% per position, as part of a broader income allocation. We lean into larger managers, which bring lower costs, cheaper and more flexible financing, deeper credit and workout teams, and stronger deal flow. Alongside them, we selectively own smaller BDCs that we believe are higher

quality, where the market has cut prices far more than NAV results justify.

In every case quality comes first: high ROE, low non-accruals and realized losses, limited PIK, reasonable costs, and dividends covered without relying on fee waivers. Smaller BDCs take more work to underwrite, and we do that work name by name. We avoid BDCs with high PIK, large realized losses and dividends that depend on fee waivers. Some of them may struggle to survive the next year or two.

“Selling the whole sector because of its weakest names is a mistake.”

The opportunity is in quality BDCs that are priced as if they were among the weak ones.

BDCs by the Numbers

5 of 48	Listed debt BDCs trading above NAV
+3.5% / -9.5%	Median YTD NAV vs. price total return
104%	Median NII coverage
2.1%	BDC payment default rate (StepStone, 3/2026)
21 of 48	Listed debt BDCs with activist holders
3.75%–4.00%	Fed funds target after the September hike
~8%	Expected average NII growth, next earnings cycle

Sources: CEFData.com (10/2/2026), StepStone, Federal Reserve, CEF Advisors.

Sources: independent BDC analyst research and commentary (August–October 2026); Fitch Ratings 2Q26 BDC peer review and sector outlook; StepStone, “Recent Trends in Corporate Direct Lending 1H26” (August 2026); PIMCO, “The Credit Market Lens: Green Shoots and Legacy Risks in Direct Lending” (10/13/2026); PitchBook/LCD (9/25/2026); Stanger via ECMSource; MUFG September 2026 FOMC recap; ETF Central (PBDC, 10/14/2026); company earnings calls; CEFData.com Listed Debt BDC Index – Equal Weight (#427), Listed Large Cap Debt BDC – Equal Weight (#1973), and BDC universe data (10/2/2026); CEF Advisors 3Q 2026 CEF, BDC & Interval Fund Update (10/14/2026). Drawdown comparisons exclude February–April 2020 (COVID).

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