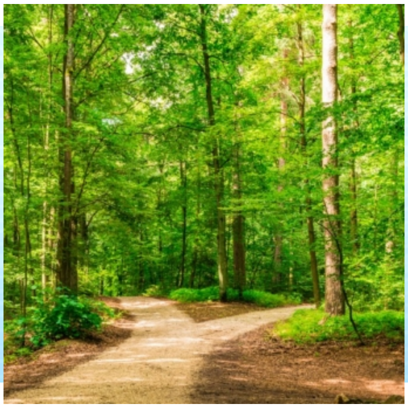

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# Is This a BDC Buying Opportunity?

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## If you look across the credit spectrum this year, one picture jumps out: High yield bonds are up nicely, while publicly traded Business Development Companies (BDCs) are down hard.

The below chart of BDCs versus high yield captures that gap clearly. A widely followed Bloomberg index of exchange-traded BDCs (CWBDC:IND) is down roughly 11–12% year-to-date and about 7–8% over the past year. Over the same period, the Bloomberg U.S. Corporate High Yield Index has delivered roughly 7–8% year-to-date, with similar one-year gains. In a world where many investors feel that "bonds are back," BDC shareholders are living through something that looks more like an equity correction. That sets up the core dilemma: Either BDCs are correctly flagging trouble ahead in credit, or they themselves are mispriced and represent an opportunity.

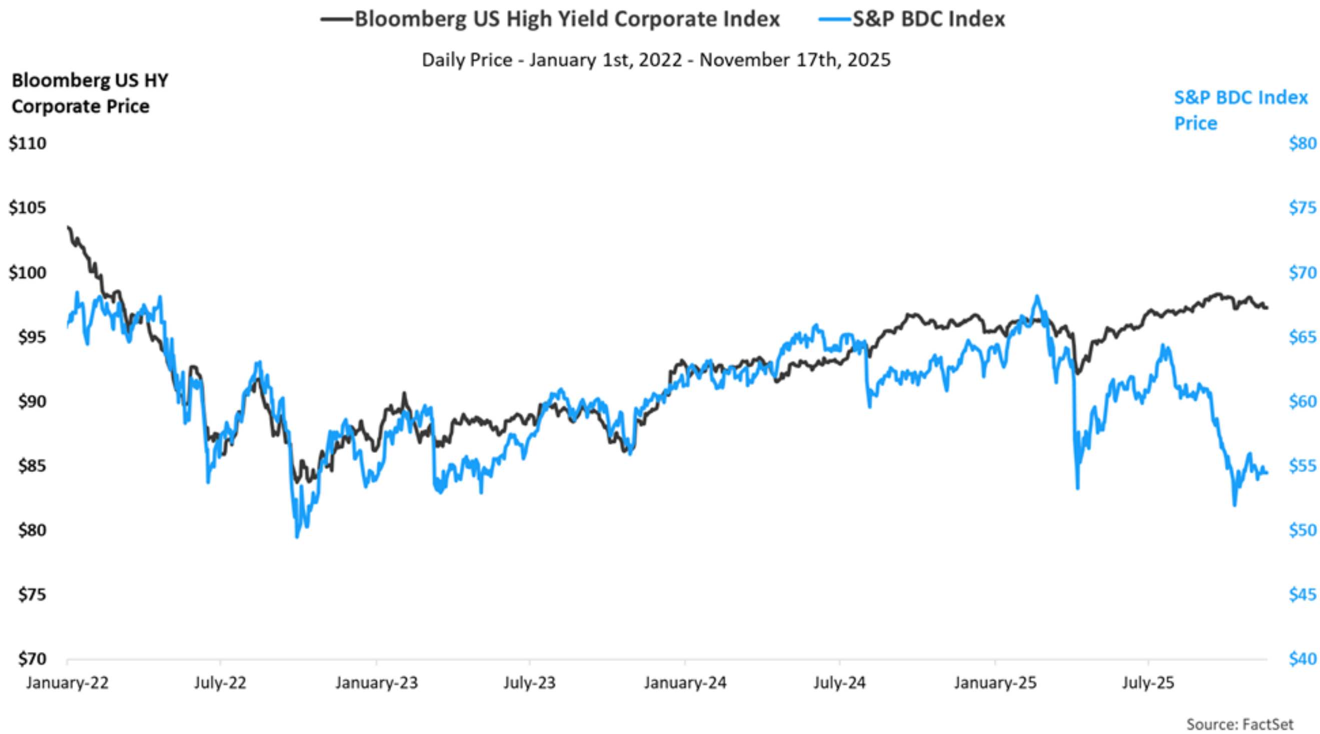


*Chart 1*

To decode that signal, it helps to remember what BDCs actually are. BDCs lend primarily to smaller, often private middle-market businesses. By regulation, at least 70% of their assets must be in small or mid-sized U.S. companies, and they must distribute most of their income, similar to a Real Estate Investment Trust (REIT). Portfolios are usually dominated by senior secured, floating-rate loans, with some junior debt and equity co-investments. Many BDCs are publicly traded, essentially private credit portfolios in a liquid stock wrapper. Daily liquidity means share prices can swing much more than the underlying loan performance when sentiment shifts, and that volatility can occasionally create opportunity.

Right now, that sentiment is clearly pessimistic. A broad screen of listed BDCs shows many names trading 10–30% below their last reported book values, while average yields are a bit above 10%. Investors are, in effect, demanding a significant discount and a double-digit income stream to own these vehicles at a time when many other parts of the credit market are producing positive returns without that kind of headline volatility.

One bearish interpretation would be that BDCs are the canaries in the coal mine. They lend to smaller, less diversified, more levered companies, and then layer their own leverage on top. If we're early in a more traditional default cycle, it would make sense for pressure to show up first in leveraged lenders to smaller companies. In that scenario, BDC valuations may be "right," and the relative calm in high yield could prove too optimistic.

The alternative reading is more constructive: BDCs are being mispriced for a deep credit problem that other credit instruments are not. Credit quality still appears reasonable, as non-accruals for many rated BDCs remain below historical averages, and on a fair-value basis they sit near 1% of investments. Many large-cap platforms emphasize first-lien, senior-secured exposures and report stable or improving coverage metrics. In that view, public BDCs are simply being asked to carry a higher risk premium than other parts of the credit market, despite fundamentals that, so far, look more “late cycle” than “crisis.”

For investors, the first step is to classify BDCs correctly before reacting to the disparity. Listed BDCs behave less like core bonds and more like a hybrid of high yield, leveraged loans, and small-cap value stocks. Their distributions can be attractive, but their prices are equity-like and clearly tied to shifts in risk appetite, the path of short-term rates, and evolving views on private credit.

In our view, high-quality bonds and diversified traditional credit should continue to provide the core ballast in portfolios. BDCs, if used at all, belong in the high-risk income bucket as a satellite exposure, sized thoughtfully within a client’s overall risk budget—not as a substitute for the part of the portfolio meant to cushion equity drawdowns.

Finally, this is where process matters more than prediction. Rather than declaring that “BDCs are broken” or “BDCs are a screaming buy,” a more disciplined stance is to measure and react to the underlying credit data over time—non-accruals, recoveries, realized losses, and dividend coverage—while comparing BDC trends to what we see in syndicated loans and high yield bonds. If credit metrics deteriorate materially, the BDC market will likely have been the canary. If they remain manageable and book values broadly hold up, today’s discounts and yield differentials may prove to have been an opportunity.

At Grimes & Company, we pursue that balance through a private fund, **High Income Opportunities**, which targets BDCs and related high-income credit exposures and implements them with a tactical risk-management overlay, consistent with many of our other risk-managed strategies. The fund is available only to **qualified purchasers who are also clients of the firm**. This material is for informational purposes only and does not constitute an offer to sell or a solicitation of an offer to buy any security. Any decision to invest should be made only after reviewing the fund’s offering documents and considering whether the risks are appropriate for your individual situation.