The Fed's rate cut leads to lower yields and higher borrower quality and spreads remain steady.

Most private credit term loans are pegged to floating benchmarks like 90-day SOFR, so rate cuts at the Federal Reserve transmit quickly to easing debt burdens for borrowers strained by the sharp rate hikes of 2022–2023. A borrower paying SOFR + 700 bps now sees their rate drop from ~11.5% to ~11.25%, improving coverage ratios and freeing up cash flow.

For lenders, this mechanical yield compression doesn't mean weaker returns on a risk-adjusted basis because of improved credit quality. In many cases, interest rate floors (1–3%) temporarily buffer against significant rate cuts. In other words, the absolute level of rates matters less than maintaining interest rate spreads over SOFR, disciplined underwriting, and high-quality deal flow. The lower middle market with an abundance of owner-managed companies, is perhaps more responsive to interest rate reductions because owner managed companies tend to borrow as little as they can and the impact of improved cash flow from lower rates is felt personally by the owners. Owner managers focus on reducing debt and investing in their businesses with the extra cash flow from lower rates. We see tremendous potential for growth and profitability of the smaller end of the lower middle market from lower rates. By contrast, we are seeing larger deals with lower spreads and lower rates driving higher levels of leverage and thereby increasing risk. As a lender, Mizzen is more aligned with the more conservative approach of owner managers than with sponsors, where the vast majority of them have under $100 million in revenues in the lower middle market. Mizzen will remain focused on smaller companies as long as this relationship remains consistent. Let's connect to explore how your allocation strategy aligns with this evolving environment.