Answers to the BDC questions you have…

What is a Business Development Company?

BDCs are lenders in the private markets, principally providing capital to small and mid-sized businesses. These companies are typically not large enough to access the liquid public markets and usually have financing needs that go beyond what typical commercial banks can provide. BDCs help fill this void and may also invest in private equity, often alongside their debt positions.

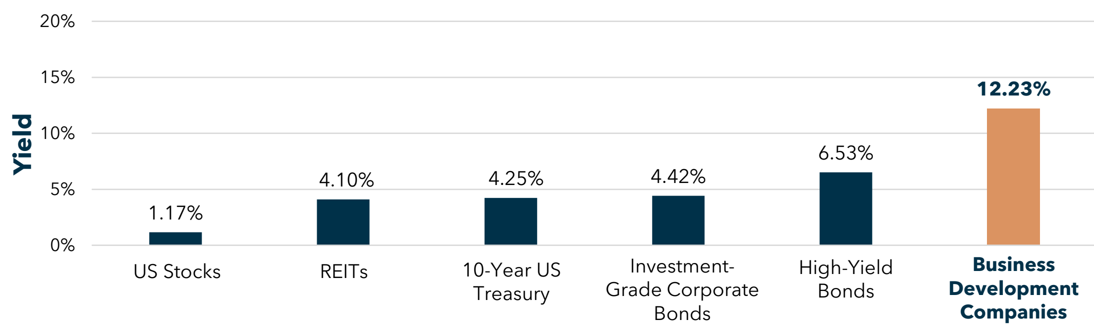
BDCs deliver most of their returns in the form of dividends. Because dividends are derived from earnings, particularly the return on equity, they reflect BDC profitability. While dividends can, at times, include a minor amount of "return of capital," the distributions are predominantly income. The BDC structure is similar to REITs in that they avoid paying most federal income taxes by distributing their income and gains through these dividends, which are generally not qualified.

Who should consider BDCs?

Investors who may consider BDCs include income-focused investors seeking higher yields, investors with equity risk tolerance, and those who want exposure to private and middle-market companies. BDCs provide a high level of current income and can be utilized as part of an equity allocation with a yield objective. They may also be considered as part of an "alternative investment" allocation. Over time, BDC returns have been highly differentiated relative to traditional equity and fixed income asset classes, creating a high level of diversification. BDCs may be suitable for investors who understand the associated risks, such as market volatility and illiquidity.

As of 12/31/2025, BDCs offered some of the highest yields when compared to other major asset classes, as shown in the chart below.

Yield Comparison Across Asset Classes



Sources: Bloomberg, Confluence. Indexes represented are included in the disclosures at the end of this document.

How can BDCs be utilized in an investment portfolio?

Because BDCs provide a high level of current income, they may be particularly useful where regular, periodic distributions are needed; examples include foundation disbursements, IRA RMD requirements, charitable remainder trusts, or other circumstances where portfolio distributions can help support income needs.

BDCs can provide a helpful measure of diversification when included as part of a domestic equity allocation. Although BDCs are positively correlated to other equities, the correlation is well below 1.0 (usually ranging 0.2-0.7). General volatility of BDCs tends to be similar to small and mid-caps much of the time, creating an opportunity to use BDCs for investors seeking this market exposure.

How large is the BDC industry?

The publicly traded BDC industry has 45-50 BDCs with a total market capitalization of approximately $75 billion, as of the fourth quarter of 2025. In addition to public markets, BDCs also raise equity capital through non-listed, private BDC structures.

BDC capital flow is high and growing, with equity capital growing for both publicly traded BDCs as well as those that are non-listed and private. Public BDCs have increased in both number and size in recent quarters. At the same time, private BDCs are raising billions of dollars each quarter through advisor and RIA channels. In part, this reflects investor interest in private credit markets, along with the adoption of the differentiated returns derived from BDCs.

Are there different types of BDCs?

BDC managers can employ a broad range of strategies. Some focus on particular industry niches, such as venture capital, software, or healthcare, while others apply a more generalized approach. Most BDCs lend to small or mid-sized companies, though some may lend to large private borrowers. And some BDCs may have a portion of their loans directed toward corporate reorganizations, asset-based lending, or even foreign loans.

Who borrows from BDCs?

BDCs are private debt market lenders. Their borrowers are typically middle-market companies with EBITDA generally in the range of $5-200 million. Many of these companies are owned by private equity investors. BDC managers often provide substantial support to borrowers through board seats and operational guidance.

How are BDCs different from other lenders?

BDCs lend from an equity capital base, with strict limitations on leverage. A BDC is generally not allowed to have more than 2:1 debt/equity in its capital structure, making it very different from traditional lenders that can have much higher levels of leverage. Unlike banks, BDCs are not capitalized with deposits. Also, BDCs mark their loan portfolios to market each quarter with full transparency and do not utilize hold-to-maturity accounting.

What are important considerations when selecting BDC investments?

The quality of the BDC management team is a primary driver of return outcomes. Managers must have the resources, relationships, and experience to make the right loans in the middle market. They also should have the ability to assist borrowers through growth periods as well as hard times. Good underwriting and risk management are critical drivers of a BDC’s operational success.

High-quality managers also properly align their own interests with those of shareholders. Both upside and downside are shared, often through collaborative and reasonable fee arrangements. These managers must also manage appropriate dividend policies, while also considering the BDC’s balance sheet liquidity and leverage.

What is the nature of BDC loans?

BDC loans are typically senior in capital structures (often first-lien) with floating rate coupons. Initial loans are often made for terms of five to seven years, but they tend to be repaid or refinanced in three to four years. Because these are private debt market loans, they typically have lower liquidity, and BDCs tend to hold them until they are paid off.

Which environments tend to be more or less favorable for BDCs?

As lenders, BDCs tend to perform well when credit default levels are low and borrowers are actively seeking capital. Typically, this kind of environment forms during periods of economic growth. Widespread credit problems and disjointed market conditions can create more challenges for BDC managers. That said, some BDC managers thrive during periods of uncertainty and have delivered attractive returns even as other lenders have struggled.

What is the default profile of BDC loans?

For publicly traded BDCs, the weighted average nonaccrual rate began 2025 at around 1.3%, with a range of 0%-13.3%. The wide range highlights the different outcomes that can occur among BDC managers. High-quality underwriting is one of the biggest factors driving the long-term success of a BDC.

Most BDCs lend from a secured position, usually focused on the borrower's cash flow. A smaller proportion of loans may be asset-based, particularly in the case of venture lending or in reorganizations. BDC managers may have to step in, effectively "taking the keys," to manage a company in the event of a default to protect capital.

What risk factors do BDC managers need to navigate?

A central risk for a BDC is credit risk. If a BDC loan defaults, not only does it tie up BDC capital in a non-interest-paying investment, but it also erodes book value. Another risk is limited capital availability. BDCs distribute almost all their income and gains, which means profits aren't going to build a larger equity base over time. BDCs also have their own debt, and although it's low relative to other lending industries, it still tends to amplify profits and losses.

For investors, what are the primary risks of investing in BDCs?

BDCs are financial stocks and typically reflect the volatility of other similarly sized companies. Historically, BDCs have often become particularly volatile during market panics, although this phenomenon has improved in recent years as the industry has matured. In addition, BDC borrowers include small to mid-sized private companies, who may have fewer resources than large, publicly traded companies. Other risks include adverse lending conditions, dividend cuts, and, for smaller BDCs, low trading liquidity.

How liquid are BDC stocks?

BDC stocks are similar to other publicly traded stocks, where larger capitalizations tend to have higher liquidity. Publicly traded BDCs provide adequate liquidity for most investors, although some smaller BDCs may lack the liquidity to accommodate larger investors.

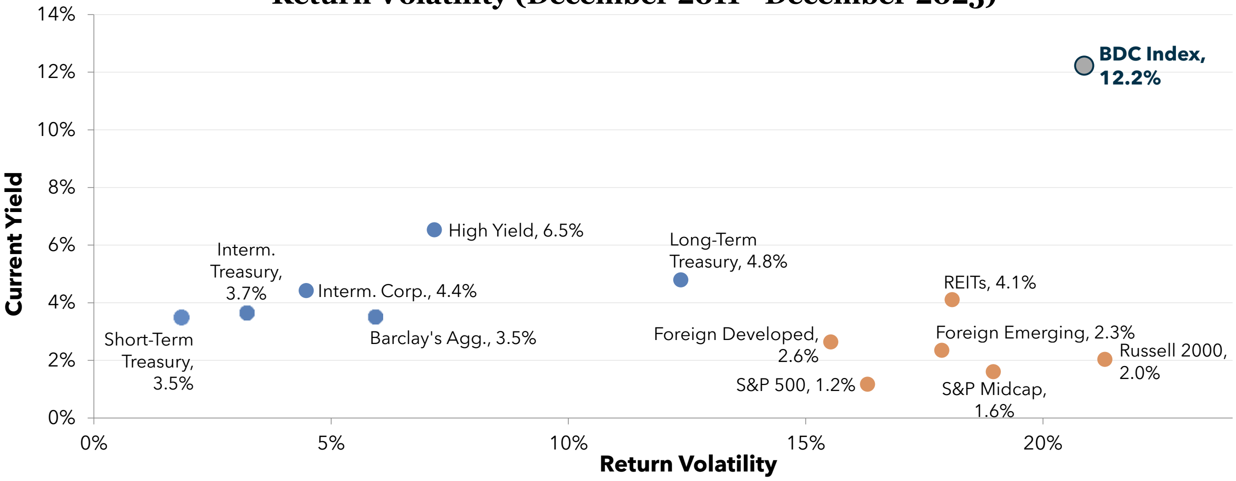
What about fees and taxes?

Holding BDCs can cause large fee disclosures for some investment vehicles, including mutual funds, ETFs, and closed-end funds, which are also regulated by the Investment Company Act of 1940. Regulations related to Acquired Fund Fees and Expenses (AFFE) attempt to clarify "fee stacking" when one '40 Act vehicle is owned inside another. Therefore, BDC fees and expenses must be included in fund fee disclosures, even though these costs are not directly paid by the investors of these vehicles. Separately managed account fees are not affected by AFFE.

How can investors address BDC market volatility?

Relative to other primary asset classes, BDCs have unique return, yield, and volatility characteristics. Therefore, they can serve as a strategic component of a well-diversified portfolio. One straightforward way to mitigate BDC market volatility is to pair an allocation with investment-grade bonds. Under normal circumstances, this combination can create an attractive cash flow stream, which can be distributed in a relatively predictable cadence or reinvested opportunistically. Both approaches can help manage normal market volatility. In highly disrupted market periods, bond and BDC prices tend to move in opposite directions, creating a high level of diversification at times when it may be most needed.

Current Yield (12/31/2025) vs.
Return Volatility (December 2011 - December 2025)



Sources: Bloomberg, Confluence. See full disclosures below.

Disclosures

Yield Comparison Across Asset Classes: Indexes represented: US Stocks: S&P 500 Index; REITs: FTSE NAREIT All Equity Index; 10-Year US Treasury: US 10-Year Treasury Note; Investment-Grade Corporate Bonds: Bloomberg Barclays US Intermediate Corporate Bond Index; High Yield Bonds: ICE BofAML US High Yield Index; BDCs: MVIS US Business Development Companies Index. Investors cannot invest directly in an index.

Current Yield vs. Return Volatility: Uses monthly index volatility data; bond indices depicted in blue and equities in orange. Investment-grade bonds are Bloomberg Barclays bond indexes: 1-3-year Treasury; Interm. Treasury; Interm. Corporate; Long-Term Treasury; and Global Agg. High Yield: ICE BofAML US High Yield Index. REITs: FTSE NAREIT All Equity. Equity indexes: S&P 500; S&P Midcap; Russell 2000; MSCI ACWI ex-USA Net; and MSCI Emerging Net. BDC Index: Wells Fargo BDC Index through Q2 2021 (index discontinued Q3 2021); beginning Q3 2021, MVIS US BDC Index.

Bond index yields are Bloomberg calculations of yield-to-worst. Equity index yields use Bloomberg consensus forecast for dividend yield. Yield-to-Maturity shown for 10-Year US Treasury. BDC Index yield reflects Bloomberg portfolio analytics estimated current dividend yield. Dividend yield is not provided as a measure of performance returns to be expected, but rather a benchmark provided for comparative and illustrative purposes only. Dividend yield is a financial ratio that provides an estimated annual dividend amount based on the current calendar year, divided by the current stock price.

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