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John Cole Scott says BDC 'software problems' aren't surfacing in the data

'Sometimes Dead Cats Bounce Higher': John Cole Scott on Why BDC Discounts May Be Overshooting the Real Risk

John Cole Scott
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Chuck Jaffe, in this episode of The NAVigator podcast, interviewed John Cole Scott, President & Chief Investment Officer at CEF Advisors. John walks through two quarters of fresh BDC data on dividend cuts, return on equity, and NAV performance, arguing the numbers don't yet support the "worse managers" narrative. He digs into non-accruals, PIK income, and AI-exposure metrics to separate real credit deterioration from headline-driven fear, and explains why activist 13D filers have kept buying discounted BDCs even as retail investors rush for the exits. Scott also breaks down the widening gap between BDC redemptions and new fundraising, and what BlackRock TCP Capital's troubled asset sale could signal for the rest of the sector.

TOPICS DISCUSSED

- Why two straight quarters of dividend cuts don't necessarily mean BDC managers are getting worse — and what the return-on-equity and NAV data actually show
- Why BDC non-accruals are barely above pre-COVID levels, suggesting the market may be pricing in defaults that haven't materialized
- Why PIK income — despite alarming headlines — is actually down quarter-over-quarter across both the strongest and weakest BDCs
- Why activist investors filing 13Ds have kept buying discounted BDCs, a sign they don't see the sector "on fire"
- How a $13 billion wave of BDC redemptions against just $7 billion of new inflows is exposing a widening institutional-versus-retail gating problem
- Why BlackRock TCP Capital's asset sale at 95 cents on the dollar could preview a wider BDC unwind — and who might pick up the pieces

The discussion is educational in nature and intended to help investors and advisors better understand the tools, trade-offs, and data points involved in evaluating income-focused strategies.

THE CONVERSATION

CHUCK JAFFE

It's been a rough year for business development companies. Is it going from bad to worse? We'll discuss it with John Cole Scott, president of CEF Advisors, now on The NAVigator.

This is The NAVigator, which is about all-weather active investing and plotting a course to financial success using closed-end funds. The NAVigator is brought to you by the Active Investment Company Alliance, a unique industry organization representing the entire closed-end fund industry — from fund sponsors and creators to managers, down to users and investors. In the search for excellence beyond indexing, The NAVigator is pointing you in the right direction.

Today we're looking at business development companies and the issues that have been plaguing them this year, and whether they're getting worse or whether they might be setting up an attractive buying opportunity. We're having that discussion with John Cole Scott, president of CEF Advisors. If you want to learn more about the firm or dig into its data on closed-end funds and business development companies, go to CEFData.com. John has also published some of the data we'll discuss today on his LinkedIn profile, so follow him there for more on closed-end funds. John is also chairman of the Active Investment Company Alliance, which you can learn about at AICAlliance.org — there's a LinkedIn page for AICA as well, where they publish data too, not always the same data, so follow both if you want the full picture.

John Cole Scott, welcome back to The NAVigator.

JOHN COLE SCOTT

Always great to be here, Chuck.

CHUCK JAFFE

John, it's been two straight quarters of dividend cuts — not for every BDC, of course, but for enough of the industry that this is a clear trend. Is the underlying trend simply that there are fewer good managers of business development companies, or that there are more bad ones now?

JOHN COLE SCOTT

The major trends we've talked about before, and that our listeners should keep in mind, are that interest rates are down and there's more concern about credit quality inside these BDCs. We first built this data table after first-quarter earnings season, and we've now updated it for the listed universe for the second quarter. We took the top 18 and bottom 18 BDCs with roughly $250 million-plus in market cap and sorted them by one metric: one-year return on equity.

In that data set, the average one-year ROE for the better cohort is currently around 10% and change, down from about 11% and change last quarter. The lower cohort stayed very stable — just above zero in the first quarter, ticking slightly higher in the second. No material change there.

People are probably more familiar with NAV total return, so we included that too. The one-year NAV total return for the better cohort was about 12% in the first quarter and is now about 11% — a slight erosion. The bottom cohort went from 0.8% to 0.6%, another slight nudge down.

What's interesting is that you and I can't actually buy the NAV of a listed BDC — we buy the market price. Market-price total return went from down 2% one year ago to down 3% now for the top cohort, and from down 16.5% to down 12% for the bottom cohort. So there's been some recovery in the weaker names, though they're still underperforming.

The average discount for these funds went from -3.2% in the first quarter to essentially flat in the second — a nice improvement of about two points. The weakest names were at -32%; now they're at -27% — a bigger bounce, but off a much bigger negative.

CHUCK JAFFE

And of course we can't necessarily say that's a trend showing the managers are doing a lot better.

JOHN COLE SCOTT

No — sometimes dead cats bounce higher. But look at the yield: it went from about 10% and change to 10% and change for the top cohort, and from 14% to 13% for the weaker ones — a similar story.

Dividend growth is actually a really important data point here, Chuck. It went from -5.8% one year ago to -6.7% a quarter later — slightly worse, but not ugly. The weaker cohort went from -13.5% to -16% — a little uglier of a pullback.

We also track AI risk exposure, which we've discussed a few times this year. That went from 17.6% to 18% for the better cohort, and from 23.8% to 26.8% for the weaker cohort — showing a bit more

AI-related risk creeping into the portfolios already showing problems. But the weighted risk score stayed at roughly 5% and change across both quarters, for both cohorts — so we're really not seeing worse fundamental AI exposure in any of the BDCs we track.

We are seeing non-accruals move, though — from 1.23% to 1.4% for the better cohort, and from 1.98% to 1.86% for the weaker cohort. So not every data point moves the same direction; you'd like the weaker cohort's number to be a little worse than 90 days ago, but data is data — I can't change it.

And on all the headlines I read about PIK — payment-in-kind interest — "destroying" portfolios: it went from 5.8% to 5.7% for the better cohort, and 8.6% to 8.3% for the weaker cohort. So PIK is actually down quarter-over-quarter, and while it's not down from two years ago, it doesn't appear to be destroying the portfolio. I double-checked this last quarter too: is the "better" cohort this quarter just last year's "worst" cohort? The five-year average ROE was around 11% and change for both buckets, in both quarters, for the good ones, and went from 3.8% to 5.4% for the weaker ones — still a huge disparity in how these BDCs have performed.

What that means for our listeners: we're still not seeing software blowing up BDCs. But we need another quarter or two of data before I can really prove that thesis — I can't guarantee it today.

CHUCK JAFFE

Yeah, because that's what people were expecting, and that was a big part of why BDCs were getting hammered. More on why in a second — because here we are talking about two quarters of data, and you just said you're going to need more. So I know you don't think two quarters presents the full picture. But I also know, because we've talked about it in the past, that you've been watching net flows from activists and followers. It's proprietary data people can find on your CEFData.com website. But the story there — what's been happening with activist investors and followers — is more like an 18-month story than just the first six months, right? Explain what you're seeing.

JOHN COLE SCOTT

The rationale was, I wanted to look at the data before people cared about it — to normalize it against what was happening last year, before people were freaking out about software in the summer of 2025. So we looked at 13D filings for the universe: in the first quarter of 2025, there was a pullback of about $850 million; a smaller one in the second quarter of 2025, about $150 million. So about a billion dollars pulled back as people reacted to Q1 2025 — which, by the way, wasn't AI-related.

Then in the third quarter, the market turned the other direction: $1.4 billion went into listed BDCs, then a nice $140 million in Q4 2025. Then in Q1 2026, with discounts going crazy and headlines saying BDCs were going to go broke — maybe not that exact headline, but close to it — almost another billion dollars came in in the first quarter, and almost a quarter-billion in the second quarter. That's based on 13D filings logged in the EDGAR system through August 15 — the freshest data we can see. It tells me that people who vote with 13D filings are buying BDCs. Yes, they're buying at a discount, but it's not like they're avoiding BDCs because they think the whole sector is on fire.

CHUCK JAFFE

And the other problem for BDCs, beyond the software issues everybody thought would hit them, was the gating issue — where in the middle of everything, the market heats up, but investors find they can't get all their money out. You only need that to happen once, with one BDC, to make headlines and scare investors everywhere. So how big has the gating problem actually been?

JOHN COLE SCOTT

In the first half of 2026, we saw just over $7 billion in new fundraising into BDCs — down 70% from the previous year. Meanwhile, almost $13 billion was redeemed in the first half of 2026, including almost $6 billion in the second quarter alone. That's roughly double the inflow seen in 13D filers in the listed universe — and there's more than double the assets in the non-traded space. It matters because retail investors may not have fully understood or digested that this was a possible outcome, even in a good market. There's been a broad desire to get out among BDC holders — but at the same time, people aren't saying no to private credit or floating-rate loans generally. It's more that the fund structures themselves are pulling in different directions — institutional versus retail. I think that's been a really big story. Like the other data, we'll need another quarter, about 90 days, to see where the trend goes.

CHUCK JAFFE

You know, the gating issue always strikes me as the definition of a recession versus a depression — gating is a problem for the industry, but it's only my problem if it happens in my fund, with my money.

JOHN COLE SCOTT

Right — and just for perspective, in case people don't grasp those big numbers: that's about 12% of NAV for non-traded BDCs, and about 38% of the money requested was actually given back. Not 100%, but not 5% either.

CHUCK JAFFE

Beyond gating, the other thing that would scare investors is high interest rates leading to more defaults in the underlying credits. Interest rates have stayed higher for longer; most people think they're more likely to rise from here than fall. So how big has the non-accrual problem actually been for BDCs? Have we seen real problems, or did we just anticipate problems that didn't materialize?

JOHN COLE SCOTT

For this one I had to go back further, to remember the world before COVID. Looking at our CEF Advisors Equal-Weight BDC Index, average non-accruals were 1.43% after Q4 2019 earnings season. Six months later, marking as of June 30, 2020, that jumped to 2.5% — a big move, but not crazy scary. A year after that, it dropped below 2019 levels, to 1.05%. Between Q4 2021 and Q4 2025 — a four-year range — it bounced between 1.19% and 1.83%, moving up and down but nothing aggressive. After Q1 2026, the index was at 1.77% — higher than 2019, but nowhere near COVID levels. And as of today — I pulled this data just before we recorded, so I didn't know it going in — it's 1.64%. Non-accruals are lower today than 90 days ago, and only barely above where they were in Q4 2019.

I think that's a powerful way to say: yes, when you lend money as a credit manager, you're going to lose some of it every quarter, every year, every decade — but we're not seeing exacerbated losses on these loan marks in any material way.

CHUCK JAFFE

So it's the market anticipating a problem that's driving the price down and widening the discount, without the problem actually impairing the BDCs.

JOHN COLE SCOTT

Exactly. Another way to look at it: annual NAV total return. 2020 was basically flat — meaning NAVs were actually down roughly 10%, since yield gets added back into that total-return figure. 2021 was up over 20%, which I'd call a full healing from the prior year. Then 7.5% in 2022, 10.3% in 2023, just under 10% in 2024, and just under 8.7% in 2025. You can see a little waning in performance, but nothing terrible. Half-year 2026 is at 4.24% — which, if the next two quarters matched the last two (they almost certainly won't, but if you annualize the run rate), works out to something between 6% and 7%. Not a robust year, but nothing like the pain of COVID. It could tick lower than 6-7%, but once this is in the rearview mirror, I'd expect BDC NAVs to recover the way they did after COVID.

CHUCK JAFFE

I want to bring up one more thing in the time we have left. You talk about the "bottom cohort" — a statistical way of saying the dregs of the database, or in investor parlance, the BDCs that are underperforming their peers. There's one situation playing out right now: BlackRock TCP Capital. Walk us through what's going on, how you think it'll be resolved, and whether investors will conclude it's every bit as bad as being in the "bottom cohort" suggests.

JOHN COLE SCOTT

I'd say "bottom cohort" by this data view means the lowest-ranked — not necessarily the worst outcome, but the lowest by the numbers. This is the BDC that BlackRock took over when it acquired

Tennenbaum Capital. If our listeners have owned these funds a while, it's been a mix of missteps, miscalculations, and just not operating the business well.

They tried to relieve pressure with a large asset sale out of the NAV — around 95 cents on the dollar, which isn't ugly, but isn't great if you thought those assets were worth a dollar 90 days earlier. Given the market's reaction, there's a good chance the rest of the portfolio gets carved up. Ares Capital and Prospect Capital are being floated as potential buyers, because both of those BDCs did exactly this to other BDCs before: after the 2008–09 recession, Patriot Capital became Prospect Capital, and Allied Capital became part of Ares Capital. They picked those up at very steep discounts, because that was an even uglier period for BDCs than COVID.

So that's the thinking here — this could be a chance for the board to essentially step back, whether that means selling the management contract to someone else and saying "you try," or, more likely, unwinding the entire fund at a reasonable price so the capital and underlying loans get run off properly. The thinking is that the easy, liquid loans probably already got sold off first, which suggests what's left on the balance sheet isn't the easy stuff — though no one can guarantee that, since they didn't originate these loans. That's the suspicion, anyway. We probably won't know for a quarter or so, since there have to be proxy votes and other mechanisms under the Investment Company Act of 1940.

CHUCK JAFFE

Doesn't exactly inspire confidence that even 95 cents on the dollar is what shareholders will end up getting — but at least we have a sense of what might happen if you're stuck in that bottom cohort, which is exactly what you want to avoid. John, great stuff as always. We'll talk again soon.

JOHN COLE SCOTT

Always a pleasure.

CHUCK JAFFE

The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe — yes, that's me. Learn more about my show at MoneyLifeShow.com, or find it wherever you get your podcasts. For more on BDCs, closed-end funds, and interval funds, go to AICAlliance.org, the website for the Active Investment Company Alliance. Thanks to my guest, John Cole Scott, president of CEF Advisors in Richmond, Virginia, and chairman of the Active Investment Company Alliance. Learn about his firm and dig into its research and data at CEFData.com, and follow him on LinkedIn for more of the data we discussed today. The NAVigator is available every Friday — follow or subscribe on your favorite podcast app so you don't miss an episode. We'll be back next week with more closed-end fund talk. Until then, happy investing, everybody.

John Cole Scott is president of CEF Advisors and chairman of the Active Investment Company Alliance. His firm is online at CEFData.com. For more of the data discussed today, follow John and AICA on LinkedIn, or visit AICAlliance.org for more on BDCs, closed-end funds, and interval funds.

And speaking of more — we've got a lot more coming up on today's show, including the Money Life Market Call, where we'll be talking stocks with Greg Halter of Carnegie Investment Trust. Stick around.

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