

AI and the software sell-off

Flash Fixed Income | February 2026

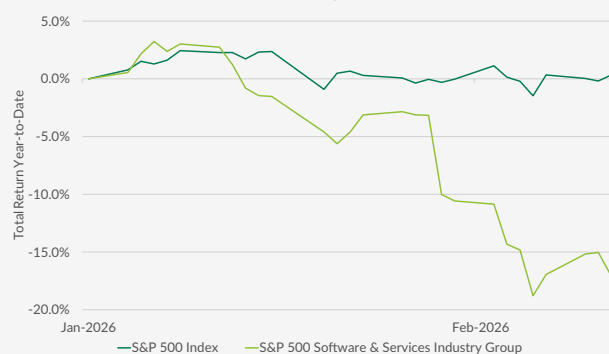
- Market focus has shifted in recent weeks from hyperscaler spending to the threat AI could pose to numerous software-as-a-service (SaaS) businesses.
- We see clear risks for software firms with narrow moats and low switching costs, but AI could also benefit platforms with proprietary data or niche sector expertise.
- Public and European credit have relatively low exposure to the sector, and we view the risks as manageable, though they will not be immune to volatility given AI's rapid evolution.

Risk markets have remained resilient in the face of heightened geopolitical tensions this year, although one notable area of weakness has been in the technology sector.

Uncertainty around artificial intelligence (AI) is nothing new, and thus far it has mainly been focused on the pace and scale of capital expenditure needed from the hyperscalers, how this would pressure balance sheets, and what the execution risk of those investments would be given a largely unknown return on investment.

In recent weeks, however, and following the release of Anthropic's legal plug-in for its Claude Cowork AI tool, the market is re-underwriting the AI threat to a large number of software-as-a-service (SaaS) businesses, and the sell-off has seen equity multiples in this sub-sector compress significantly (see Exhibit 1). Credit, while in aggregate remains resilient, has certainly not been immune, with many software bonds and loans down a number of points this year.

Exhibit 1: The SaaS sell-off in equities



Source: Bloomberg, 11 February 2026

Credit market performance

	Total return YTD (%)	Total return last 30 days (%)	Yield (%)	Duration (yrs)
EUR IG	1.02	0.73	3.1	4.4
GBP IG	0.41	-0.35	5.1	5.9
US IG	0.95	0.69	4.8	6.5
EUR HY	0.90	0.38	4.9	2.8
GBP HY	1.61	0.93	7.8	2.8
US HY	0.82	0.42	6.7	2.9
EM HY	1.55	1.23	7.0	3.9
Euro Senior Banks	0.94	0.66	2.9	3.7
COCO	1.41	0.86	5.5	3.6



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Indicative market indices, data as at 10 February 2026. Past performance is not a reliable indicator of current or future results. Included for illustrative purposes only. Shown in local currency terms. It is not possible to invest directly into an index and they will not be actively managed. Source: Bloomberg, TwentyFour, 10 February 2026.

Is SaaS growth sustainable?

Stepping back, one can see why the market has been happy to underwrite software credits in recent years. Solid non-cyclical organic revenue growth, driven by high retention rates and steady increases in average revenue per user (ARPU), have coupled with high Earnings Before Interest, Taxes, Depreciation, and Amortisation (EBITDA) margins and robust free cashflow. This fundamental profile has allowed issuers, particularly those that are sponsor-led, to layer leverage onto structures, especially for businesses that typically trade at elevated equity valuations. Net debt-to-EBITDA of 5-6x is not uncommon, with the market underwriting these credits on a loan-to-value (LTV) of less than 50% given average Enterprise Value (EV)/EBITDA multiples in the low-to-mid teens (as an example, net debt-to-EBITDA of 5x on a business valued at 13x EBITDA equates to an LTV of 38%).

However, the recent moves call into question whether the level of growth going forward is sustainable for many of these businesses, and there will likely be more scrutiny on LTVs after the sharp equity sell-off.

From an operating perspective we would be particularly nervous around sub-scale, single-feature SaaS companies. Firms with narrow moats and low switching costs will be most impacted by AI disruption, as customers look to both consolidate platforms or even build in-house. Generic or repeatable process driven SaaS companies already see the threat of Claude et al. on their shoulder, and the complexity of the models developed by the frontier AI labs (Anthropic, Open AI etc.) are evolving quickly.

AI can also benefit software firms

Having said that, many software companies could benefit from those developments. Platforms and databases that are deeply integrated in workflow, offer proprietary data (data that is not easily scraped online), niche sector expertise, and comply with local regulation, could be well positioned to take advantage of AI advancements. Integrating AI tools into existing platforms will be critical, but companies that do this well would expect to increase the stickiness of their customer relationships and help protect ARPU.

So, we don't think we are at the start of an AI "cliff" within sub-investment grade credit. The risks are real, but so is the opportunity, both from a corporate perspective (if they can leverage AI through the business) and an investment perspective.

If we consider earnings, the most likely impact we see, at least in the credit space, is less on business model obsolescence and more on the ARPU side. Unless a company can demonstrate its unique selling point and prove its moat, either via proprietary data or sector expertise, then even platforms that are imbedded in workflow might struggle to offer costs that are many multiples higher than the frontier lab equivalent. Positively, costs are in any case relatively low as a percentage of operating expense for most of the corporate customers they serve. We believe that AI will also benefit the cost bases of the very SaaS companies they threaten on the revenue side, particularly in development and coding. However, we expect investors to stress their "base case" assumptions in the upcoming earnings round if they haven't done so already, and we expect the market to become more discerning between the potential winners and losers.

Public and European credit have lower software exposure

Across sub-investment grade markets, sector exposure is most concentrated in the private credit space (US Business Development Companies have an average exposure of 26%, according to Morgan Stanley data) and least concentrated in high yield bonds (only 3% of the European and US HY market is in the software sector), with the broadly syndicated loan market in between (US 10%, Europe 7.5%). Outside of private markets, therefore, we think exposures are manageable, and it is worth saying that software covers a wide remit, from consulting to outsourcing, productivity, risk analysis, operating system, multimedia, design, and so on. Some sub-sectors will of course be more exposed than others.

Ultimately, the rapid evolution of AI will clearly throw up both risks and opportunities for credits in the bond and loan markets. European credit is less exposed to the sector, though not immune, and we view the risks as manageable. Undoubtedly, volatility in the space is likely to continue as the technology continues to leap forward.

Rates dashboard

		Change (bp)			
	Current %	1w	1m	YTD	
US Treasury	2yr	3.45	-12	-8	0
	10yr	4.14	-12	-3	2
	30yr	4.78	-11	-4	-2
UK Gilt	2yr	3.64	-7	-1	-9
	10yr	4.51	-1	13	1
	30yr	5.33	4	22	10
German Bund	2yr	2.07	-5	-3	-5
	10yr	2.81	-8	-3	-5
	30yr	3.49	-6	5	1

		Change (bp)			
	Market projection	Current %	1w	1m	YTD
Base rate 3.75%	end-2026	3.10	-11	-9	1
	end-2027	3.19	-15	-13	-3
Base rate 4.00%	end-2026	3.31	-7	2	-4
	end-2027	2.22	-7	-9	-16
Base rate 2.00%	end-2026	2.00	-3	-6	-11
	end-2027	2.22	-7	-9	-16

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