

Direct Lending for the Tax-Aware Investor



GOLUB CAPITAL

This two-part series brings together the following white papers:

Opposites Attract 4

Munis and Direct Lending as Portfolio Complements

This piece shows that municipal bonds and direct lending have complementary attributes that blend well in a total portfolio. By pairing the well-known tax efficiency of munis with direct lending's high-income potential, low duration and strong historical returns, investors may build more diversified debt portfolios with a stronger risk-return profile and meaningful tax efficiency.

From Allocation to Location 10

Positioning Direct Lending in the Tax-Aware Portfolio

This paper argues that traditional theories of asset location (making asset class tax inefficiency the sole criterion) can overlook the potential benefits of tax-deferred compounding. We illustrate how direct lending's combination of equity-like returns and bond-like taxation makes it particularly well-suited for tax-advantaged accounts like IRAs.

For individual allocators, one challenge of investing in direct lending is the tax inefficiency of the asset class.

This two-part series from Golub Capital's Insights Team, *Direct Lending for the Tax-Aware Investor*, addresses this topic from several perspectives. Drawing on a 20+ year historical analysis of direct lending and other assets, we explore how tax-sensitive investors may best engage with the asset class.

Opposites Attract

Munis and Direct Lending as Portfolio Complements

Every part of the portfolio has a job to do. Stocks promise growth; bonds offer safety and yield—two characteristics often hard to find in a single package. For most of this century, traditional core bonds disappointed investors, causing them to search for higher and more stable income elsewhere, trading safety for yield. Direct lending, historically with low volatility and outsized yield, has emerged as an efficient way to solve for both. We compare the investment history of municipal bonds and middle market direct lending. Our findings suggest that whatever virtues each asset category has individually, investors may best harvest them through a blended allocation.

Opposites or Complements: Munis and Direct Lending

For taxable investors, municipal bonds—or “munis”—have long been a preferred core allocation. They offer an “anchor to windward” to offset equity volatility with greater tax efficiency than taxable fixed income.¹ But over the last two decades, munis have delivered only modest income and total returns.

We take a close look at the performance of munis compared to other higher-yielding debt alternatives—specifically, direct lending—and the comparison raises some questions. While generally considered “safe,” munis carry relatively high

interest-rate risk and only modest yield—characteristics that can leave the muni category particularly vulnerable to both rising rates and inflation.²

Direct lending has historically offered high income yield and robust total returns with little duration risk (as a floating-rate investment), making it more resistant to inflation. The two also have had very low correlations with one another and sit at either end of a tax-efficiency continuum (making direct lending a better fit for tax-deferred accounts). These two debt offerings, contrary in so many ways, can be attractive portfolio complements, balancing each other’s virtues and liabilities.

Exhibit 1

Opposites Attract

A Marriage of Completeness: Munis and Direct Lending

Munis		Direct Lending
Low Income/High Duration	←→	High Income/Low Duration
Vulnerable to Inflation	←→	Rises with Inflation
Low Return and Sharpe	←→	High Return and Sharpe
High Correlation to Agg	←→	Low Correlation to Agg
Tax-Efficient	←→	Tax-Inefficient

Source: Golub Capital. For illustrative purposes only.

1. Munis face no federal tax and, in some cases, no state tax either.

2. As measured by the Bloomberg U.S. Aggregate Index.

Income and Duration: There's a Middle Way

This paper explores a comprehensive array of investment characteristics among two asset categories: intermediate-duration munis and middle market direct lending.

We assess the results through the lens of pre-tax returns, presuming direct lending is properly “located” in a tax-deferred vehicle.³

We focus first on several bond-specific characteristics, particularly duration and yield.⁴ Over the full 21-year period, munis have a duration of 5.5 years, in line with traditional core bonds (see Exhibit 2, left side, blue). At the other end of the duration spectrum is direct lending: It consists almost exclusively of floating-rate instruments that reset quarterly in line with the Secured Overnight Financing Rate (SOFR) and have a duration of just several months (see Exhibit 2, left side, green).

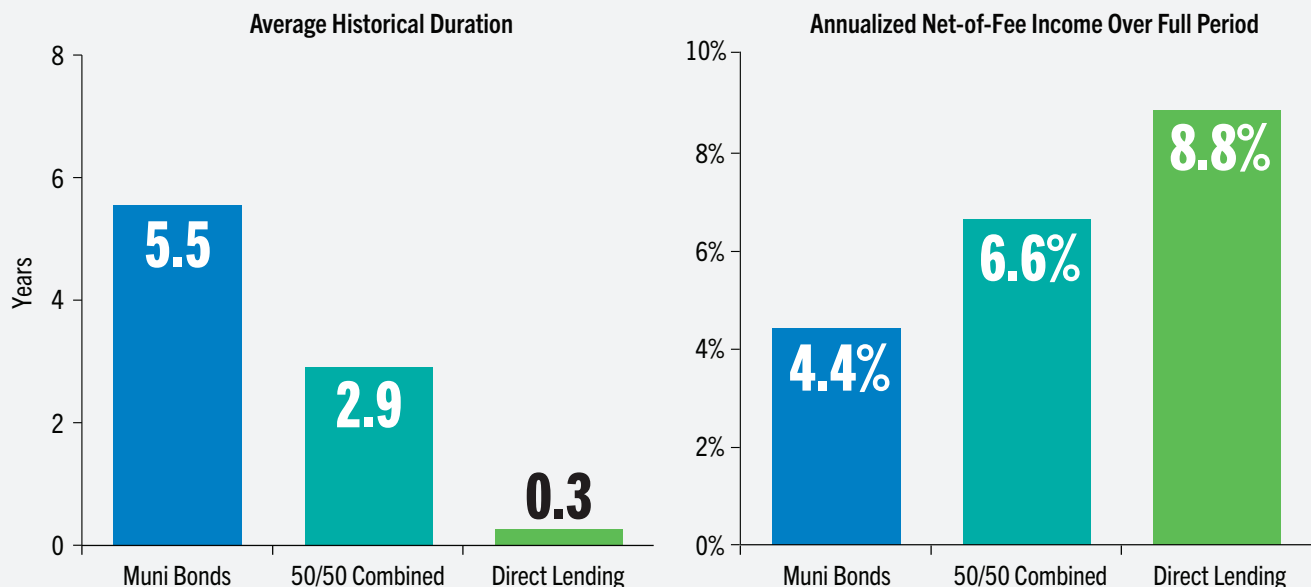
The higher duration of munis translates to potential price appreciation (or depreciation) as interest rates move down (or up). This generates substantial return volatility. The near-zero duration of direct lending means the “base rate” of the asset’s income yield rises on the back of rate increases, an important defensive characteristic relative to traditional fixed income. The impact of interest rate changes on private direct lending tends to be both less volatile and less binary in nature.⁵

The difference in income yield also stands out: Direct lending delivered annualized income averaging 8.8% net of fees over the last 21 years, double what munis have offered over that time frame (see Exhibit 2, right side, 4.4%).⁶

A balanced allocation across the two assets offers a middle ground. A 50/50 blend results in a 6.6% average annualized income yield, net of fees and a duration of just under three years, well below that of munis (see Exhibit 2, teal).⁷ The combination offers a more balanced exposure to both the liabilities and virtues associated with interest rate movements and income yield.

Exhibit 2

Higher Income, Lower Duration Finding the Sweet Spot



Note: This analysis runs from Q1 2005–Q4 2025. Direct Lending is represented by the Cliffwater Direct Lending Index (CDLI); Muni Bonds are represented by the Bloomberg Intermediate Municipal Bond Index; 50/50 is represented as a blended version of the aforementioned indices. Annualized income represents the yearly income generated by an investment, after deducting fees. All returns are construed on a net-of-fee basis. For further details, see Appendix.

Source: Bloomberg, CDLI. Data as of December 31, 2025.

3. This analysis runs from Q1 2005–Q4 2025. The indices include the Bloomberg Intermediate Municipal Bond Index and the CDLI. The fees applied on munis (47 bps) represent the average asset-weighted fees on intermediate-duration munis based on the Investment Company Institute (ICI) 2025 Handbook; the fees applied to the Cliffwater Index (193 bps) are based on the August 19, 2024, analysis by Cliffwater regarding their recommended fee calculations. The CDLI is based on gross-of-fee returns and includes no leverage. For net-of-tax results, use a capital gains tax rate of 23.8% and the highest category of ordinary income tax of 40.8%. Assets are modeled with a 5% quarterly turnover rate for the purposes of calculating capital gains taxes.

4. In terms of credit risk, we acknowledge that munis tend to be default-remote, with a default rate over the last 10 years of under 0.1%, as per Moody's U.S. Public Finance Report, US Municipal Bond Defaults and Recoveries, 1970–2022. This compares to a direct lending credit loss rate over the same period of 1.04%. That said, muni defaults, while rare, can affect a large dollar volume of debt when they do occur, as recent examples in Detroit and Puerto Rico make clear. Interestingly, speculative grade municipal default rates were higher (0.6%) in this period and, during periods of stress, often exceeded those of speculative grade corporates.

5. For a long-term analysis of interest rate movements and the impact on both core bonds and direct lending, see “Cut and Run: Direct Lending and Interest Rates,” Golub Capital Insights.

6. The average annual tax-equivalent yield of intermediate-duration municipal bonds over the 21-year period was 7.4%, using the 40.8% ordinary income tax rate.

7. The 50/50 blended allocation assumes quarterly rebalancing.

Higher Highs, Softer Blows: A Total Returns Perspective

Turning from income yield and duration to total return reveals another contrast: Annualized net-of-fee returns for direct lending over the 21-year period were 7.5%, more than twice the level of munis at 3.0% (see Exhibit 3). Annually and over time, direct lending has historically had both higher and more consistently positive returns. In some periods, exposure to it would have provided a timely counterweight for the overall portfolio, buoying total returns when muni performance was low or negative.⁸

Several performance characteristics stand out from the analysis (see Exhibit 3):

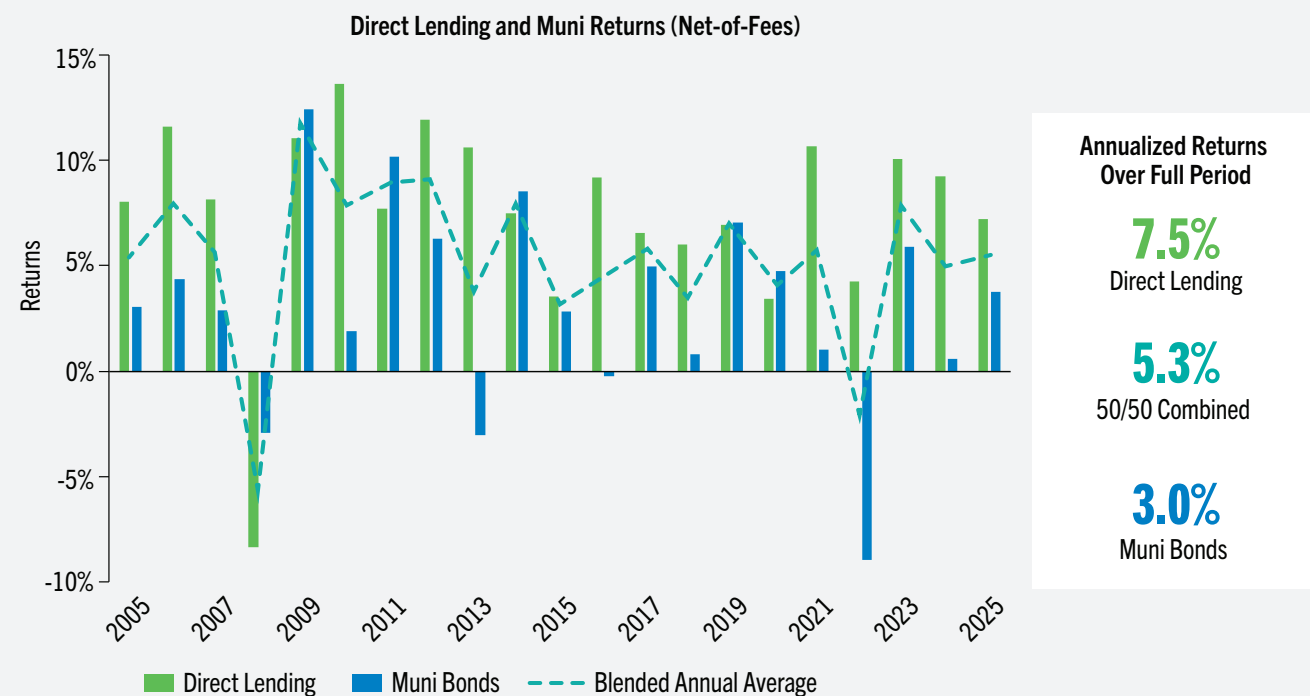
- Direct lending returns outpaced munis in 15 of 21 full calendar years.
- Direct lending outperformed on average by 7 percentage points; in the six years when munis led, they did so, on average, by almost 2 percentage points.
- Munis had negative returns in four calendar years; direct lending experienced just one down year (2008).
- In the three years when munis were negative but direct lending positive, direct lending provided a timely and substantial counterweight, with higher-than-usual positive performance (8 percentage points).
- In only one year did munis and direct lending both experience simultaneous negative returns (2008).

A blended 50/50 allocation delivered annualized performance of 5.3% over the full period (in teal)—higher than munis alone with less downside risk and greater consistency over time.

Exhibit 3

Higher, Tighter, Smoother

A Blended Allocation Offers Higher, More Consistent Total Returns



Note: This analysis runs from Q1 2005–Q4 2025. Direct Lending is represented by the Cliffwater Direct Lending Index; Muni Bonds are represented by the Bloomberg Intermediate Municipal Bond Index; 50/50 represents a blended version of the aforementioned indices. All returns are construed on a net-of-fee basis. For further details, see Appendix.

Source: Bloomberg, CDLI. Data as of December 31, 2025.

8. Looking at a post-tax or tax-equivalent analysis would show substantially different results.

The Alchemy of Complementary Assets

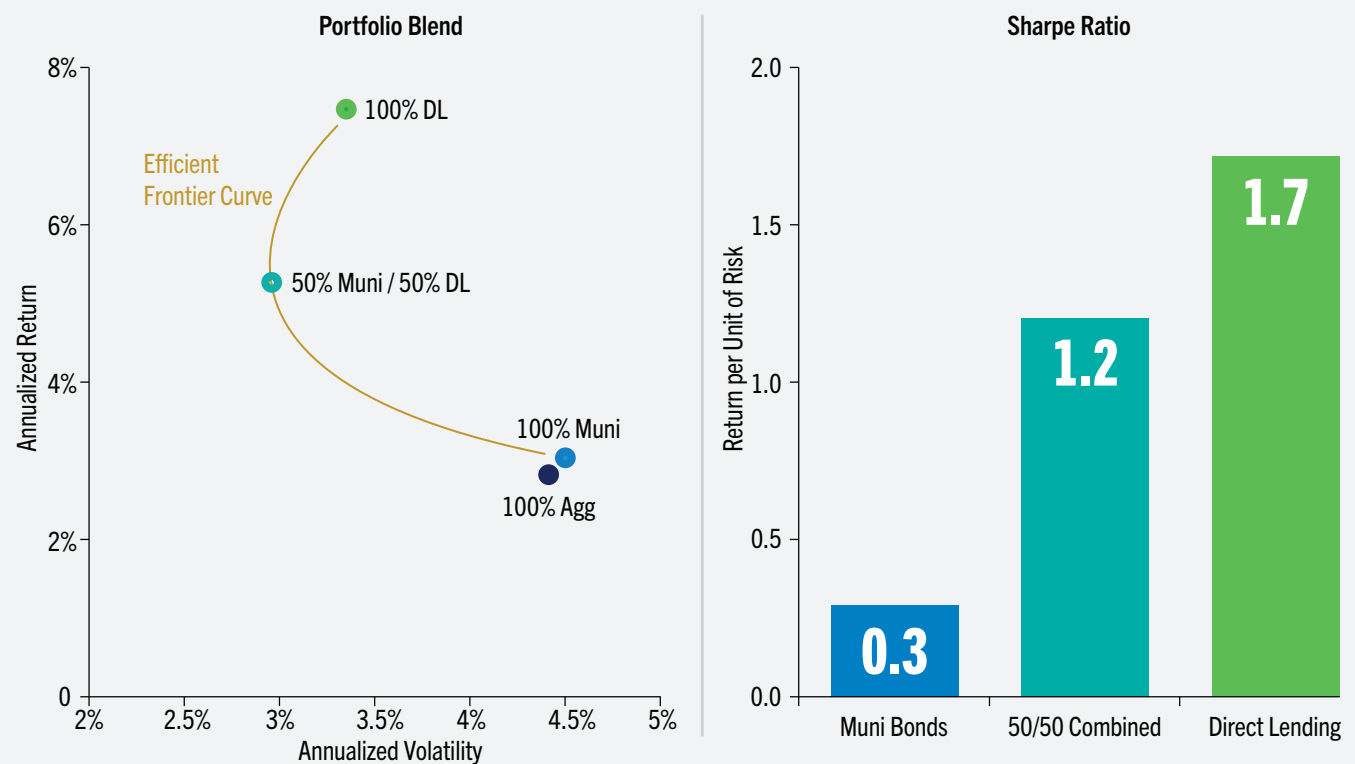
The appeal of combining low-correlated assets is a basic principle of portfolio construction. Over the past 21 years, munis and direct lending had a correlation of just 0.1. The alchemy of diversification suggests a mix of munis and direct lending would produce a single composite whole with more attractive risk and return characteristics than the two assets would individually.

The resulting portfolio blend delivers higher total returns—a more than 200 bps improvement in performance—and lower volatility than munis (see Exhibit 4, left side, teal). A classic efficient frontier capturing risk and return together illustrates the greater efficiency of the combined allocation: The 50/50 blend results in a Sharpe Ratio of 1.2 vs. 0.3 for munis alone (see Exhibit 4, right side, teal).

Exhibit 4

Better Together

Seeking Frontiers of Greater Efficiency



Note: This analysis runs from Q1 2005–Q4 2025. Direct Lending is represented by the Cliffwater Direct Lending Index; Muni Bonds are represented by the Bloomberg Intermediate Municipal Bond Index; 50/50 represents a blended version of the aforementioned indices. Agg is represented by the Bloomberg U.S. Aggregate Bond Index.

Sharpe ratio measures risk-adjusted return by comparing an investment's excess return over the risk-free rate to its volatility. All results are construed on a net-of-fee basis. For further details, see Appendix.

Source: Bloomberg, CDLI. Data as of December 31, 2025.

Extending the Tax-Efficiency Frontier

We close by moving from optimizing risk and return to an efficient frontier of a different kind—tax efficiency.

Over the 21-year period under review, munis stand out as arguably the most tax-efficient asset available to investors, with a “tax drag” of almost zero (see Exhibit 5, light-blue dot). Meanwhile, direct lending suffers relative tax headwinds on

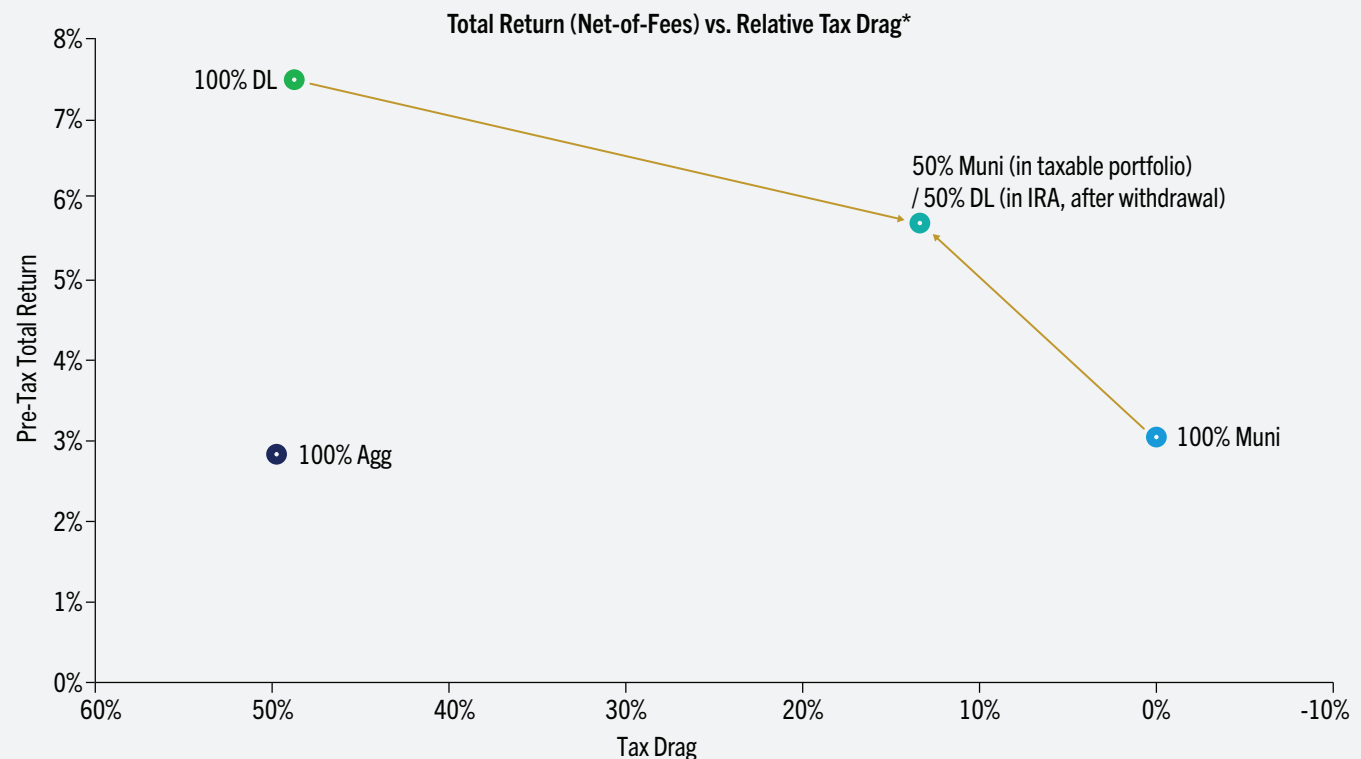
par with taxable core bonds, reaching just under 50% (see green and dark-blue dots).

But with the aid of tax-deferred portfolios and smart asset location (see teal dot), the combination of munis and direct lending could deliver many of the benefits discussed already (higher income and total return, as well as lower duration and less vulnerability to inflation) with less erosion (under 15%) from taxes.

Exhibit 5

A Tax-Efficient Blend

Mitigating the Tax Headwinds of Direct Lending



Note: This analysis runs from Q1 2005–Q4 2025. Direct Lending is represented by the Cliffwater Direct Lending Index; Muni Bonds are represented by the Bloomberg Intermediate Municipal Bond Index; Agg is represented by the Bloomberg U.S. Aggregate Bond Index. For the 50/50 portfolio, the DL allocation is held in a tax-deferred account and liquidated at the end of the 21-year period at a 20% implied federal tax rate.

*Relative Tax Drag is defined as the ratio of absolute tax drag to pre-tax returns, representing the reduction in an investment's return due to taxes on income distributions and realized gains. All returns are construed on a net-of-fee basis. For further details, see Appendix.

Source: Bloomberg, CDLI. Data as of December 31, 2025.

From Allocation to Location

Positioning Direct Lending in the Tax-Aware Portfolio

The traditional rule of thumb for asset location—prioritizing certain investments for inclusion in tax-deferred accounts—warrants a review. Conventional guidance focuses on sheltering assets with the most punitive taxation. But the compounding effect from tax-deferred growth is greater when the sheltered asset is higher-returning, regardless of its relative tax inefficiency. We develop a framework that accounts for both considerations. Our analysis suggests that assets that combine equity-like returns with bond-like tax headwinds, such as direct lending, may be optimal candidates for tax-deferred accounts.

Re-Thinking the Rule Book for Tax “Alpha”

Tax “alpha” can be both more robust and less variable than investment alpha, and smart asset location is an effective way to embed such tax-based tailwinds in the portfolio. But longstanding rules of thumb on asset location may actually get in the way of optimal outcomes.

Sheltering traditional fixed income has long seemed the obvious choice since the bulk of its return comes in the form of income that is taxed at (higher) ordinary rates (see Exhibit 1, green box). Stocks, on the other hand, have higher expected returns than bonds, but their dominant driver is capital

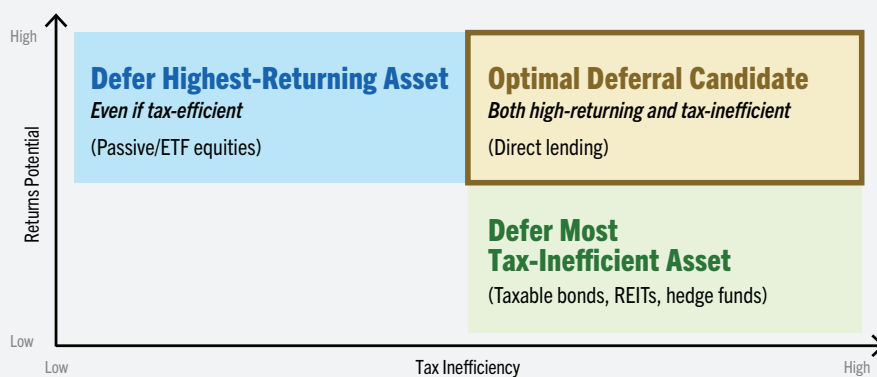
appreciation, with (lower) capital gains tax treatment (see Exhibit 1, blue box). Bonds face a higher relative tax burden, while stocks compound faster due to their superior returns. Which of the two should an investor prioritize for tax-deferred accounts?

Academic and practitioner studies struggle to provide a clear answer. The calculus hinges on time horizon, return assumptions, tax rates and other factors that are difficult or impossible to predict. But there’s an easier solution: The ideal asset to shelter would have both high equity-like returns and punitive bond-like taxation, where deferral enables less tax drag *and* higher compounding. We believe middle market direct lending best fits that description (see Exhibit 1, gold box).

Exhibit 1

Location, Location

Rethinking Asset Location Guidance



Source: Golub Capital. For illustrative purposes only.

Winning the Tax Drag Race

Tax is a drag on most individual investor portfolios. But there's a relatively clear framework for navigating its headwinds.

Marginal tax rates tend to be highest for assets whose returns are derived primarily from non-qualified interest income, which is taxed at (higher) ordinary income rates (currently 40.8%). This includes most bond portfolios, including core bonds, corporate debt, emerging market debt and mortgage bonds (and, by extension, REITs).¹ It also comprises leveraged loans and private direct lending, which are floating-rate in nature and see little capital appreciation from duration-related changes in rates—rendering their return stream largely income-based (see Exhibit 2).

Similarly, short-term capital gains tax rates, which are generally in line with the highest ordinary income levies, are incurred by portfolios with high-turnover strategies, such as actively managed equity and trading-heavy hedge funds.

Next in order of tax inefficiency are assets whose returns are derived primarily from long-term capital appreciation and qualified dividends. These typically benefit from more favorable

long-term capital gains tax treatment (currently 23.8%).

Examples here include tax-managed equities, often delivered in separately managed accounts, and passive long-only equity mutual funds or ETFs. Several private market investments belong in this category as well: Both venture capital and private equity tend to produce mostly capital gains, realized over long horizons, and little income.

That leaves munis in a category of their own, incurring no federal income tax and, in some cases, no state tax either. Passive equity ETFs benefit further from the “heartbeat” mechanism embedded within the exchange-traded structure, which enables equity ETFs to sidestep most capital gains charges altogether. For taxable accounts, equity ETFs and muni bonds together constitute arguably the most efficient constituents of an individual investor portfolio, often split 60/40.

But when it comes to tax-deferred accounts, conventional wisdom has been to prioritize assets based solely on asset-level tax inefficiency. We believe the calculus behind tax deferral should not be limited to a single metric based on tax. Decisions on optimal asset location should also include an investment's potential for higher growth via compounding.

Exhibit 2

It's a Drag

Tax Headwinds by Asset Class

	Tax Rate: 0%	Tax Rate: (Long-Term Capital Gains Rate) 23.8%	Tax Rate: (Federal Income) 40.8%
	Increasing Tax Rates		
	Municipal Bond Interest; Unrealized Capital Appreciation	Long-Term Capital Gains; Qualified Dividends	Short-Term Capital Gains; Interest Income; Non-Qualified Dividends
Traditional Assets	Muni Bonds (Equity ETFs)	Equity Index Mutual Funds, Tax Managed Equities (SMAs)	High-Turnover Equity, Core Bonds, High-Yield Bonds, Leveraged Loans
Alternative Assets		Private Equity, Venture Capital	Direct Lending, REITs, Macro Hedge Funds
	Increasing Value in Tax Deferral		

Note: Tax rates shown reflect the highest applicable federal long-term capital gains and ordinary income rates as of Q4 2025. Despite modest shifts over the last 21 years (Q1 2005–Q4 2025), tax rates have remained broadly at the levels indicated here, especially for high-income taxpayers. Long-term capital gains rates hovered at 20% over the last several decades, except for the period 2003–2013, when they dipped to 15%. A 3.8% surcharge related to the Affordable Care Act was initiated in 2012. Top ordinary income rates have oscillated just around the 40% level since the early 1990s.

Source: Golub Capital internal analysis. Data as of December 31, 2025. For illustrative purposes only.

1. Other asset classes that face the stiffest tax headwinds include REITs (real estate investment trusts), which are also heavily reliant on non-qualified income as generally the largest component of their returns.

It's About Time (and Returns): The Constituents of Compounding

After diversification, compounding is the second most important “free lunch” in investing. It’s mostly about time, hence the generic admonition to “start early.” But there are other elements that contribute to compounding’s money-making magic.

Investments with higher returns naturally compound at a faster rate than lower-returning assets. Removing annual taxation is another powerful tailwind, allowing capital to grow free of tax drag, at least during the deferral period.

Direct lending, with a long history of equity-like returns, can be a champion compounder. In a tax-deferred structure, its steady income can be reinvested continuously without tax drag, creating a compounding engine suitable for a long-horizon retirement portfolio.

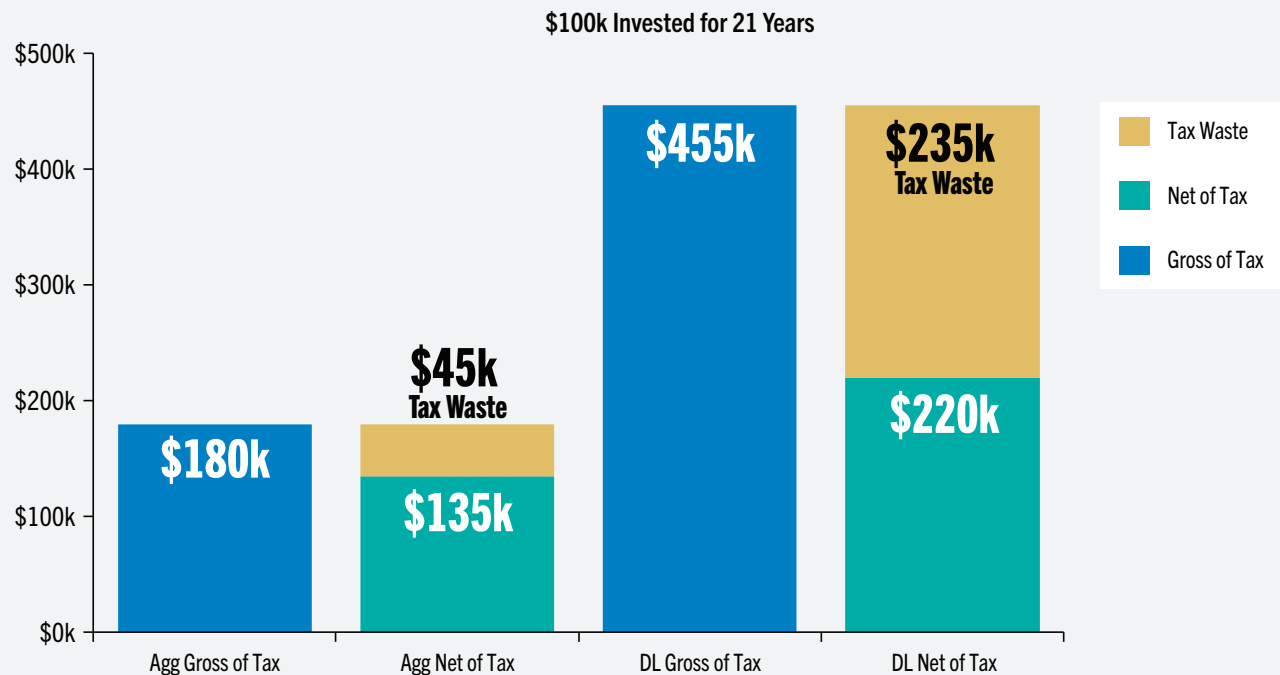
Since tax-efficient munis have no need for tax deferral, we limit our analysis to traditional core bonds and direct lending.² We measure returns over an extended 21-year period (appropriate for retirement accounts) to assess terminal wealth and the magnitude of returns lost to federal taxes, which we refer to as investment “waste.”

We put \$100k into both assets, reinvest the proceeds and watch them grow, tax-free, over the period (see Exhibit 3). On a pre-tax and net-of-fee basis, direct lending delivers roughly 2.5x the growth of core bonds (\$455k vs. \$180k). More striking is the tax impact: Direct lending loses over 5x as much to taxes (\$235k vs. \$45k).³ But even on an after-tax basis (presuming withdrawal at the highest ordinary income tax rate), direct lending delivers a wealth outcome about 1.5x greater than core bonds (\$220k vs. \$135k). Direct lending is the superior compounder and, as a result, suffers greater erosion from taxes. It’s the asset that most deserves its location in a tax-deferred setting.

Exhibit 3

Waste Not

Strong and Steady Wins the Tax-Drag Race



Note: This analysis runs from Q1 2005–Q4 2025. Direct Lending is represented by the Cliffwater Direct Lending Index; Agg is represented by the Bloomberg US Aggregate Bond Index. For the gross of tax analysis, we grow both assets tax-free for the 21-year duration of the analysis. To illustrate “tax waste,” we liquidate both assets in year 21, applying the highest ordinary federal tax rate (40.8%). All returns are construed on a net-of-fee basis. For further details, see Appendix.

Source: Bloomberg, CDLI. Data as of December 31, 2025.

2. We exclude equities in this analysis because of their inherent tax efficiency—especially in ETF form—and we maintain a 60/40 equity/bond allocation in both taxable and tax-deferred accounts, per common advisory practice.
3. To capture capital gains taxes, we assume 5% quarterly turnover.

Accounting for Tax-Headwinds: Optimizing Asset Location

What is the optimal asset “location” for direct lending in a tax-aware portfolio? The answer is straightforward: tax-deferred accounts such as IRAs or insurance-dedicated funds.

But let’s work through the argument analytically. We examine the return history of core bonds, munis and direct lending (see Exhibit 4), applying both relative and, in this case, absolute measures of tax drag—the difference between pre-tax and after-tax returns.⁴

If held in a taxable account, direct lending suffers a nearly 50% return haircut due to taxes, about the same in percentage terms that core bonds experience.⁵ But in absolute terms, this represents a sizable 3.6 percentage-point erosion from the asset’s 7.5% pre-tax, net-of-fee return (see Exhibit 4, green

dot). Compare that to a pure muni allocation, with zero tax drag, and a pre-tax net-of-fee return of 3% (see light-blue dot).⁶

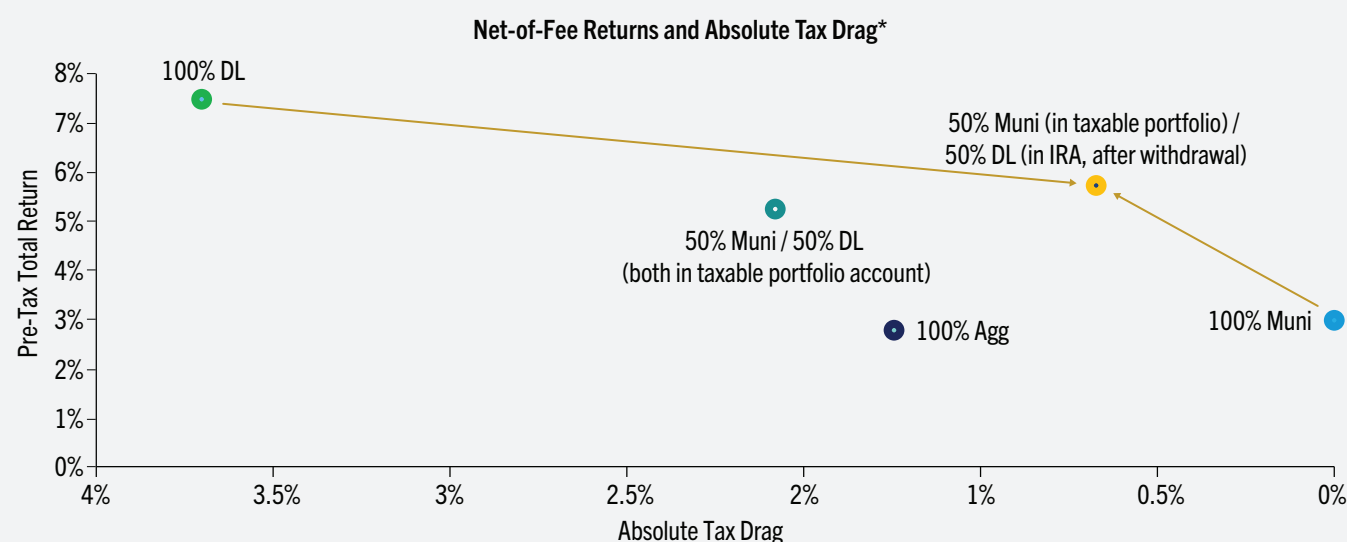
When we blend the two assets together in a single allocation (in a taxable account), the absolute tax drag declines by roughly 1.5 percentage points from just over 3.5% to approximately 2% (see teal dot). This boosts the pre-tax return of standalone munis from 3% annually to a blended return of over 5%.

Next, we include a tax-deferred account option such as an IRA. With direct lending in the tax-deferred account, it is spared further wind shear from taxes during the investment period (see gold dot). Absolute tax drag for the 50/50 Muni/DL portfolio—with DL now properly “located”—declines from around 2% to just over 0.5%. The annualized after-tax return of the blended and tax-aware allocation (upon withdrawal) rises to nearly 6%, almost double what the muni allocation alone provides, and not far from the 7.5% pre-tax net-of-fee return for direct lending on its own.

Exhibit 4

From Allocation to Location

Constructing Tax Alpha in the Portfolio



Note: This analysis runs from Q1 2005–Q4 2025. DL is represented by the Cliffwater Direct Lending Index; Muni Bonds are represented by the Bloomberg Intermediate Municipal Bond Index; Agg is represented by the Bloomberg US Aggregate Bond Index. For DL (in IRA), the asset grows for the 21-year duration of the analysis in a tax-deferred account and is liquidated in year 21 with an implied 20% federal tax rate.

*Tax drag represents the reduction in an investment’s return due to taxes on income distributions and realized gains.

Source: Bloomberg, CDLI. Data as of December 31, 2025.

- The period of this analysis runs from Q1 2005–Q4 2025. The indices include the Bloomberg Intermediate Municipal Bond Index and the Cliffwater Direct Lending Index (CDLI). The fees applied on municipal bonds (47 bps) represent the average asset-weighted fees on intermediate-duration municipal bonds based on the Investment Company Institute (ICI) 2025 Handbook; fees to Agg Bonds are 37 bps and 42 bps for equities; and the fees applied to the Cliffwater Index (193 bps) are based on the August 19, 2024, analysis by Cliffwater regarding their recommended fee calculations. The CDLI is based on gross-of-fee returns and includes no leverage. For net-of-tax results, we use a capital gains tax of 23.8% and the highest category of ordinary income tax of 40.8%. Assets are modeled with a 5% quarterly turnover rate for the purposes of calculating capital gains taxes. Portfolios of blended assets assume quarterly rebalancing. We do not rebalance between retirement and taxable accounts but rebalance within respective accounts when applicable. IRA is assumed to be liquidated at the end of the analysis, with a 20% tax rate, to estimate full after-tax impact.
- Our analysis shows very similar tax headwinds for other taxable bond categories, including investment-grade corporate bonds, high-yield bonds and, of course, public broadly syndicated loans. A natural question to consider is why the tax headwind (of nearly 50%) is higher than the applicable 40.8% ordinary rate. The CDLI, over the period studied, has produced income and net capital losses; therefore, total return is lower than income. In our model, net-of-fees annualized income is ~8.8%, while annualized price return is ~1.3%, and total pre-tax returns are 7.5%. We pay taxes on the 8.8% income return at the 40.8% income rate (roughly 3.6% in taxes). Then we lose 1.3% on price return. Realized capital losses do not offset ordinary income, so if the investor holds only CDLI, there are no gains to offset. Even if there were realized gains, they would only soften the blow modestly to ~1.1%. It’s still a net loss, lowering your total return below the income return.
- It’s important to note that, even with the punishing tax erosion direct lending faces, this still leaves the asset class with an after-tax advantage of 80 bps–3.8% vs. the 3.0% from munis over the 21-year period.

The Holistic Tax-Aware Portfolio: Allocation and Location Together

Finally, let's move from a discussion of the bond portfolio in isolation to a comprehensive client allocation—one that includes equities and bonds, in both taxable and tax-deferred accounts. For simplicity's sake and for comparison purposes, we assume the investor maintains a 60% equity and 40% bond portfolio and keeps that 60/40 allocation consistent across both taxable and tax-advantaged accounts.⁷

First, we look at a basic (and not particularly tax-aware) allocation, blending equities and taxable core bonds across both types of accounts, taxable and tax-deferred. Its net-of-fee and after-tax return is just about 6.3% annually, with 9.7% volatility (see Exhibit 5, dark-blue dot).

Next, we look at a more tax-aware portfolio, using munis in the taxable account (minimizing tax drag there) and placing the taxable core bond allocation in the tax-advantaged IRA (see light-blue dot). The investor scores an easy gain in returns of about 30 bps annually, to 6.6%.

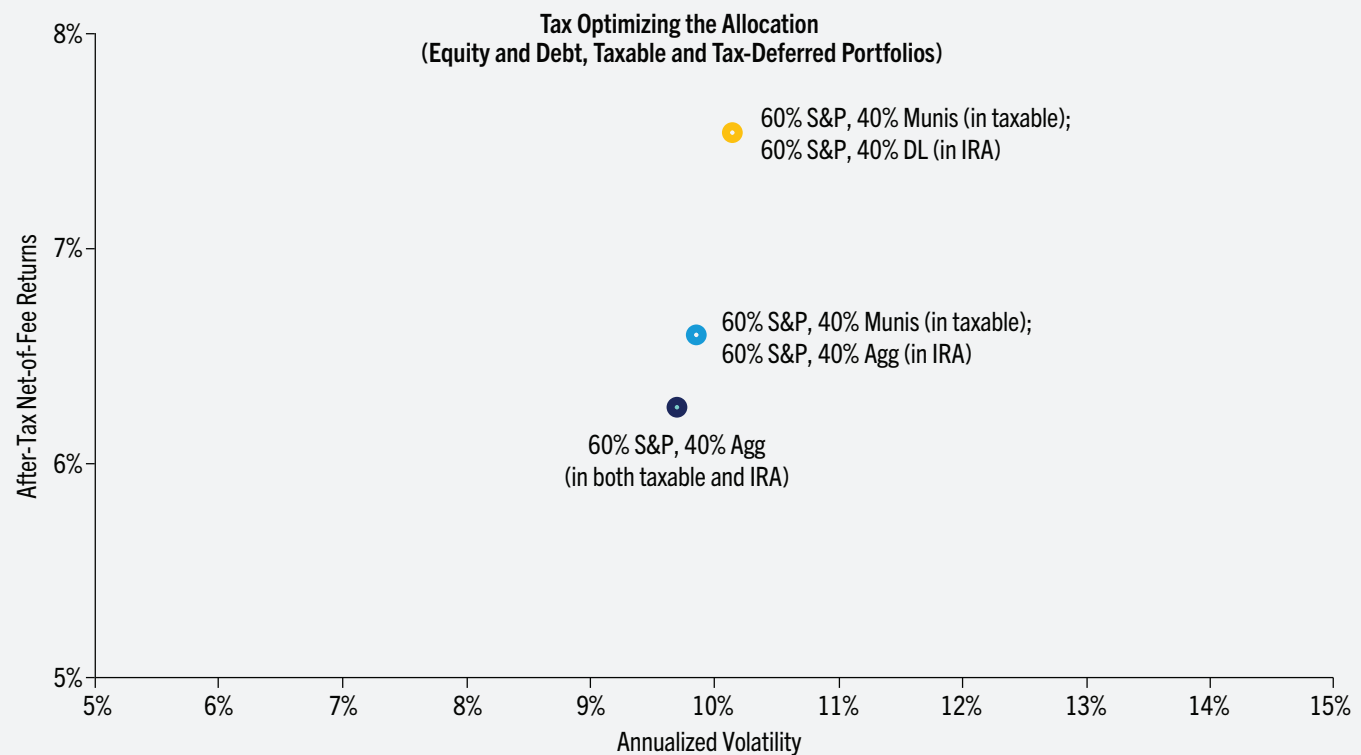
Now consider a tax-aware allocation that also includes higher-returning direct lending. Tax-efficient munis occupy the taxable portfolio, and tax-inefficient direct lending is sheltered in the tax-deferred account (see gold dot). By eliminating the tax shear on direct lending, after-tax net-of-fee returns for the combined portfolio reach 7.5%, about 120 bps higher than the core bond allocation, with just a modest increase in risk.

An allocation to direct lending can take many forms. But positioning the asset in a tax-aware portfolio requires special considerations. For optimal client outcomes, we believe smart asset location should inform the inclusion of direct lending in the portfolio.

Exhibit 5

Great Taste and Less Filling

A Holistic, Tax-Aware Portfolio with Direct Lending



Note: This analysis runs from Q1 2005–Q4 2025. Direct Lending is represented by the Cliffwater Direct Lending Index; Muni Bonds are represented by the Bloomberg Intermediate Municipal Bond Index; Agg is represented by the Bloomberg US Aggregate Bond Index. Equities are represented by the S&P 500. All returns are construed on a net-of-fee basis. For further details, see appendix. For DL in IRA, the asset grows for the 21-year duration of the analysis in a tax-deferred account and is liquidated in year 21 with an implied 20% federal tax rate.

Source: Bloomberg, S&P, CDLI. Data as of December 31, 2025.

7. Maintaining some allocation to equities in the tax-deferred account supports enhanced compounding, as suggested earlier.

Appendix

The analysis runs from Q1 2005–Q4 2025, a full 21 years. The indices include the Bloomberg Intermediate Municipal Bond Index, Bloomberg U.S. Aggregate Index, S&P500 for equities and the Cliffwater Direct Lending Index (CDLI). We pull total return, price return and income return for each. For net of fee analysis, the fees applied on municipal bonds (47 bps), U.S. Agg (37 bps) and equities (42 bps) represent the average asset-weighted fees on each asset class based on the Investment Company Institute (ICI) 2025 Handbook; the fees applied to the Cliffwater Index (193 bps) are based on the August 19, 2024 analysis by Cliffwater regarding their recommended fee calculations. The CDLI Index is gross of fees and includes no leverage. For net tax results, we use a capital gains tax of 23.8% and the highest category of ordinary income tax of 40.8%. Assets are modeled with a 5% quarterly turnover rate for the purpose of calculating capital gains taxes. We calculate and pay taxes on a quarterly basis, and we assume that tax liability is paid in the quarter it has occurred. Bonds and CDLI income are taxed at the federal top marginal ordinary income + NII rate of 40.8%, and equities income is taxed as qualified dividends + NII rate of 23.8%. Capital gains/losses arising from turnover or rebalancing are assumed to be long-term. Any unused capital loss is carried forward for future periods. Capital gains are taxed at the top marginal rate + NII of 23.8%. Cash arising from turnover and income is used to pay taxes at the end of the quarter, and the remaining amount is redeployed at the

beginning of the next quarter in the target portfolio weights. Retirement accounts follow the same assumptions as Taxable accounts without taxes, which is equivalent to weighted pre-tax net-of-fees asset returns in a given quarter. When we compare Retirement accounts to Taxable accounts to capture the effect of the taxes at withdrawal, we withdraw the full amount and tax it at a 20% rate (presuming a lower effective tax rate in Retirement accounts). When we show allocations of 50% Taxable/50% Retirement, we do not rebalance between Retirement and Taxable accounts. We purchase 50% in the beginning in each account and let the two accounts proceed independently, subject to their own internal allocations; therefore, actual allocation will tend to drift slightly over the period. The CDLI, over the period, has produced both income and net capital losses; therefore, total return is lower than income return. We subtract fees of 1.93% from the income return. In our model, the net-of-fee annualized income return is approximately 8.8%, the annualized price return is -1.3% and the total pre-tax return is 7.5%. We pay taxes on 8.8% at a 40.8% ordinary income rate, which amounts to roughly 3.6% in taxes, which represents the absolute tax drag on direct lending. To find the relative tax drag, we divide absolute tax drag by pre-tax returns, resulting in a 48% relative tax drag, higher than the 40.8% ordinary income rate used throughout. Direct lending over the period suffers a 1.3% loss on price return, but realized capital losses do not offset ordinary income.

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