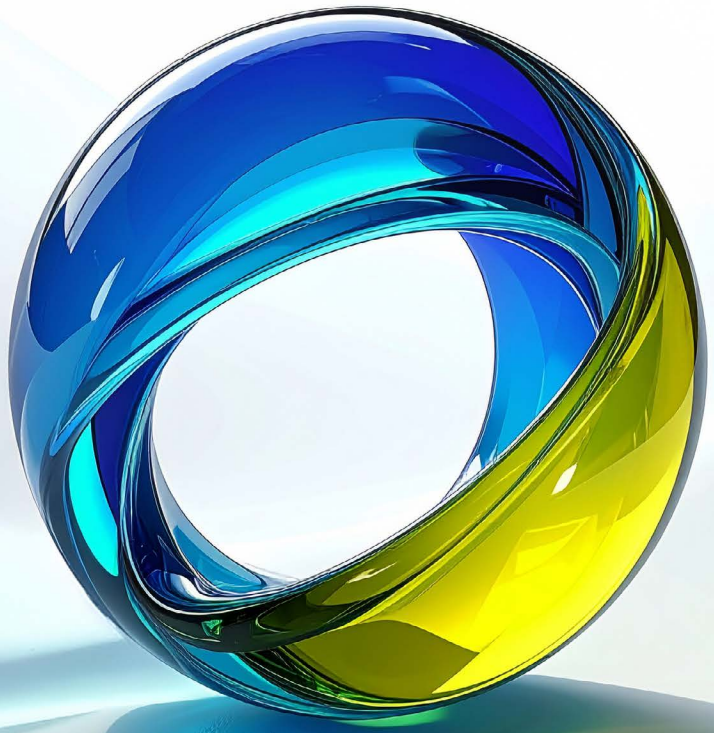
PGIM

# BEYOND CONVERGENCE

## A Framework to Assess Relative Value in Public-Private Credit Portfolios



April 2026

All investments involve risk,
including the possible loss of capital.

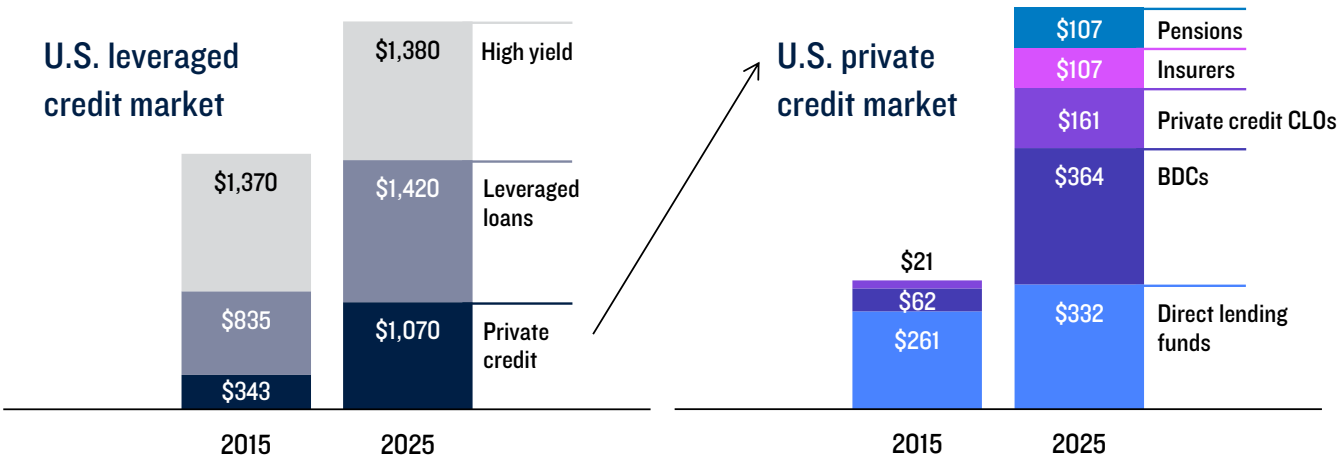
# THE CREDIT CONTINUUM

**The current challenges in the private credit sector echo the history of the credit market's evolution over the past 50 years. That evolution has demonstrated that stress in specific market segments not only represents important periods of price discovery, but also consists of notable alpha-generating opportunities. Yet, a consistent approach to capitalizing on these opportunities requires an asset allocation framework. As such, the following report describes PGIM's framework for assessing relative value in portfolios comprised of public and private fixed income assets.**

Public and private credit are no longer separate investment domains. Private markets have been a driver of growth in credit over the past decade (Exhibit 1), setting the stage for a deepening convergence across the credit continuum. As a result, institutional and global wealth investors are increasingly making allocation decisions between public and private assets, while issuers capitalize on public-private financing opportunities depending on cost, certainty of execution, and structure.

**Exhibit 1: U.S. private credit markets have grown three-fold in the last decade, outpacing other forms of leveraged credit**

Growth across U.S. leveraged credit markets, 2015 vs. 2025, USD billion




As of September 30, 2025. Sources: Morgan Stanley Research and PGIM. Totals may not sum due to rounding. Note: A business development company (BDC) is a type of closed-end fund that invests in middle-market companies. Past performance is not a guarantee or a reliable indicator of future results.

# THREE LAYERS OF RELATIVE VALUE

**The construction of public-private credit portfolios faces a host of practical challenges, the foremost of which is assessing relative value considering the infrequent pricing and imperfect data pertaining to private assets. To accurately compare public and private credit, PGIM applies relative value analysis within three connected layers, which we describe in the following section (Exhibit 2).**

## Point of Purchase (Bottom-Up Relative Value)

In **public credit**, access is broad and widely available, putting an emphasis on credit selection. Relative value in public credit is identified through an evaluation of credit quality, pricing, spreads, liquidity, capital structure positioning, and technicals. In **private credit**, the relative value analysis begins with origination. A decentralized platform creates access to specialized deal flow, where value is expressed in structure, covenants, collateral, and underwriting discipline.

Despite these differences, the bottom-up layer also accounts for some fundamental aspects of credit investing. In general, credit involves selling options (i.e. an issuer is selling investors a call option on its ability to repay). Hence, this layer focuses on option-adjusted spreads when determining relative value.

Furthermore, relative value is constantly evolving. With the ability to adjust exposure to public assets, the relative value process is more dynamic and reflects changing views on industries, issuers, and individual securities. Private securities have a much longer expected holding period, emphasizing the importance of a consistent, relative value framework at origination given the challenges of exiting positions or generating alpha through active management.

Exhibit 2: PGIM applies relative value across public and private asset analysis within three layers

| | Public | | Private |
|---|---|---|---|
| | Public credit | Securitized and asset-based finance | Private credit and real estate debt |
| **CROSS-MARKET COMPARISON**<br>Top-down relative value | **PUBLIC-PRIVATE INVESTMENT COUNCIL**<br>Investment heads from public and private asset classes debate opportunity sets and develop firm relative value views | | |
| **PORTFOLIO CONSTRUCTION** | **MULTI-SECTOR PORTFOLIO MANAGEMENT**<br>Construct portfolios designed to meet specific client return and liquidity objectives incorporating both bottom-up and top-down perspectives | | |
| **POINT OF PURCHASE**<br>Bottom-up relative value | **ISSUANCE AND SECONDARY TRADING**<br>Centralized trading and portfolio management teams collaborate to identify value | | **ORIGINATION NETWORK**<br>Decentralized platform creates access to specialized, local origination |

As of April 2026. Source: PGIM. This is a stylized summary of a complex process, provided for illustrative purposes only. Underlying assumptions and our views are subject to change.

## Cross-Market Comparison (Top-Down Relative Value)

The concept within the cross-market comparison is encapsulated in a single question: "Where might investors find the optimal level of compensation for a given risk, once differences in liquidity, structure, and volatility are taken into account?" This comparison relies on public-market signals to inform assumptions about private assets, helping to avoid overreliance on smoothed private return data.

The cross-market layer involves comparing the available public-private opportunities, facilitating relative value views across markets while accounting for risk and compensation. Returning to our question above, the objective is to determine where capital is best rewarded across the credit continuum.

## Portfolio Construction

The portfolio construction layer is designed to reflect a client's specific return objectives and constraints, translating top-down and bottom-up relative value insights into portfolio outcomes. Rather than targeting specific public-private allocations, portfolios are constructed to meet liquidity needs and risk tolerances, while allowing allocations to adjust with relative value.

Strategic weights anchor the portfolio to the targeted sectors and the desired mix of public and private assets. However, given that private credit strategies are usually self-liquidating, the opportunity to rotate is ever present. Hence, while private assets ramp up or pay down, and unallocated capital waits for the right opportunity, public asset classes can provide a bridge for portfolios seeking to add or reduce risk.

## The BDC Convergence

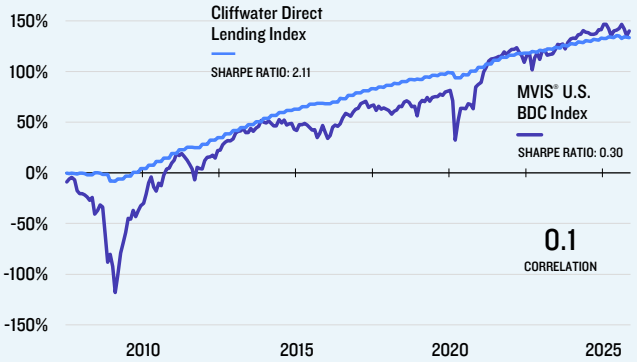
When discussing the convergence of public and private assets, listed business development companies (BDCs) in the U.S. serve as a case in point as they hold private assets in a vehicle that is publicly traded on an equity exchange. The combination provides useful information about how similar credit risks are valued across public and private venues (Exhibit 3).

As illustrated in the lefthand chart, BDC indices (the more volatile line) and direct lending indices (the smoother line) can exhibit materially different volatility and return profiles, despite the similarity of assets. These differences suggest that direct lending's smoother return profile could be due to valuation differences, rather than the absence of underlying risk. When those same assets are traded publicly, volatility becomes more visible. Indeed, the righthand chart shows a risk-equivalent investment in listed BDCs relative to broadly syndicated loans (BSLs) with their risk-adjusted returns moving in tandem in recent years and resulting in closer Sharpe ratios.

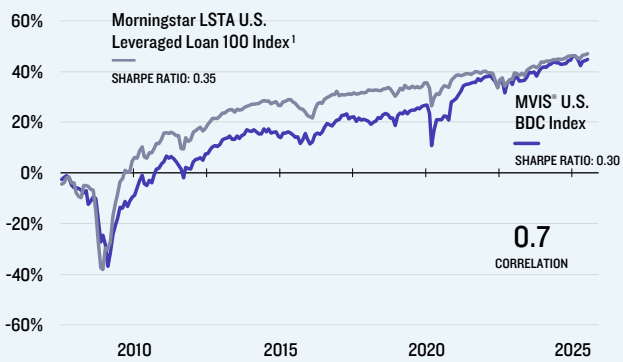
In listed BDCs with concentrated exposure, such as to the software sector, publicly available price movements reflected market sentiment changes more quickly than private valuations. This divergence is a reminder that credit risk in public and private assets surfaces through different mechanisms and on different timelines.

### Exhibit 3: As private credit assets move into public vehicles, listed BDCs reveal how similar risks can appear more volatile when priced and traded daily

**Comparing direct lending and BDC cumulative excess returns beginning July 31, 2007, %**




**Comparing BDC and BSL cumulative risk-adjusted returns beginning July 31, 2007, %**




As of November 28, 2025. Sources: Bloomberg, Cliffwater, and PGIM. Provided for illustrative purposes only. See the Important Information section for important disclosures, including benchmark descriptions. You cannot invest directly in an index. 1. Excess return minus 1% fee assumption.

# THE CREDIT MATRIX: ANCHORING ALLOCATION TO INVESTOR CONSTRAINTS

**With the context of our three layers of relative value assessment, we turn to our asset allocation process, which begins with the investor. The credit matrix (Exhibit 4) used in this step maps two inputs: illiquidity tolerance (low, medium, high) and risk tolerance (low, medium, high).**

These inputs define a set of feasible portfolio profiles rather than a single optimal allocation. Setting the private allocation to an illiquidity tolerance reduces the sensitivity of the public allocation to uncertain private-market return assumptions. The example below is based on the matrix in Exhibit 4 (a practical use case for the matrix also appears in the Appendix):

- An investor with **low illiquidity tolerance** may cap private allocations at roughly 25%,[2] regardless of its risk appetite.
- An investor with **high risk tolerance and low liquidity needs** may support materially higher private allocations, potentially approaching 75%.[2]

## How Much Liquidity, and When

From a liquidity perspective, we believe that it is neither binary nor static. Indeed, some public securities, particularly older, tightly held issues, may not trade for prolonged periods of time and will be relatively illiquid when compared to recently issued, on-the-run, large CUSIP bonds. Conversely, many private credit assets are self-liquidating, generating cash flows through coupons, amortization, prepayments, and maturities. Furthermore, private assets, particularly those from large-capitalization issuers, are increasingly traded. Hence, when starting liquidity discussions, the pertinent question is not, "Is the asset public or private?" Rather, the question becomes, "How much liquidity does this portfolio need, and when is it needed?"

**Exhibit 4: Our portfolio allocation process starts with an investor's risk and illiquidity tolerance, aiming to define a range of feasible public-private allocations rather than a single optimal mix[2]**

RISK TOLERANCE

| ILLIQUIDITY TOLERANCE | Low<br>150 bps volatility | Medium<br>300 bps volatility | High<br>450 bps volatility |
|---|---|---|---|
| Low<br>25% private assets | A | B | C |
| Medium<br>50% private assets | D | E | F |
| High<br>75% private assets | G | H | I |

As of April 2026. Source: PGIM.
2. Allocation percentages are provided for illustrative purposes only and do not represent recommendations or target allocations. **All investments involve risk, including the possible loss of capital.**

# IMPLEMENTING THE FRAMEWORK

**Once private allocations are set, public assets play a critical role in completing the portfolio. Public credit provides flexibility, liquidity management, and the ability to rebalance as private assets amortize, prepay, or ramp up. This interaction helps mitigate the J-curve effects associated with private investing and supports more consistent portfolio behavior over time.[3]**

To address data limitations and to provide investors with more realistic expectations of long-term return volatility, private asset classes are mapped to comparable public assets for volatility and correlation assumptions. In this step, for example, corporate investment-grade privates are mapped to public BBB-rated corporates (Exhibit 5). This approach produces more conservative and realistic portfolio estimates as opposed to solely relying on private asset return series.

During periods of market stress, distinctions that appear clear in calm conditions can break down. Liquidity can deteriorate in public markets, while underwriting quality and structure become more important drivers of outcomes. By anchoring allocations to investor constraints and applying relative value consistently, portfolios can be positioned with greater clarity about what risks are being taken, and why, across different market environments.

**Exhibit 5: Private assets are mapped to comparable public assets to inform volatility and correlation assumptions and to set expectations that do not rely solely on private return histories**

| PRIVATE ASSET CLASS | | PUBLIC ASSET CLASS RISK ASSUMPTIONS |
|---|---|---|
| Asset-based finance IG | → | Public securitized[4] |
| Commercial real estate debt IG | | Public commercial mortgage-backed securities |
| Private corporates IG | ...mapped to... | Public BBB-rated corporates |
| Large cap direct lending | → | Public B-rated corporates |
| Middle market direct lending | | Public B-rated corporates |

As of April 2026. Source: PGIM. Provided for illustrative purposes only.
3. In this instance, the J-curve refers to a pattern of returns that initially declines before improving substantially.
4. Includes asset-backed securities (ABS), non-agency residential mortgage-backed securities (RMBS), collateralized loan obligations (CLOs), and commercial mortgage-backed securities (CMBS).

## Vehicle Transparency Matters

The increasingly frequent combination of public and private credit in portfolios highlights the importance of valuation discipline.

In drawdown-style private funds, all investors typically enter and exit together, which naturally mitigates many valuation and liquidity concerns. In open-ended or semi-liquid structures, investors may subscribe or redeem at different times. In those cases, the prices at which investors transact must fairly reflect the underlying assets. This places a premium on robust valuation processes, clear liquidity terms, and alignment between asset liquidity and vehicle design. Getting this right is essential for maintaining fairness across investors and preserving confidence in the structure, particularly when public and private assets coexist in the same portfolio.

Thoughtful portfolio construction does not eliminate these challenges, but it can help ensure they are acknowledged and explicitly addressed rather than assumed away.

# CONCLUSION

Investors exploring the implications of public-private portfolios often ask about the optimal mix of public and private credit. The honest answer is that it depends on the asset owner's liquidity needs and risk tolerance, with specific allocations reflecting trade-offs between liquidity, risk, return expectations, and implementation constraints. These trade-offs vary meaningfully across investors. A pension plan with predictable liabilities may approach these decisions differently than an investor with ongoing cash-flow needs or shorter time horizons.

The purpose of a public-private framework is not to identify a single solution, but to define a feasible range of portfolio profiles that align with investor objectives. Within that range, relative value and portfolio construction decisions can evolve as markets change, without violating the investor's core constraints.

# APPENDIX

The examples below are hypothetical investor profiles[5] intended to make the credit matrix more tangible. Each letter corresponds to a matrix cell defined by risk tolerance (low, medium, high) and illiquidity tolerance (low, medium, high) and highlights the types of portfolio construction trade-offs typically faced in that setting.

| ILLIQUIDITY TOLERANCE \ RISK TOLERANCE | Low<br>150 bps volatility | Medium<br>300 bps volatility | High<br>450 bps volatility |
|---|---|---|---|
| Low<br>25% private assets | **A** | B | C |
| Medium<br>50% private assets | D | **E** | F |
| High<br>75% private assets | G | H | **I** |

### PROFILE A

Low risk tolerance + Low illiquidity tolerance

A corporate cash and short-duration reserve portfolio that must meet uncertain near-term outflows (e.g., payroll, acquisitions, working capital) and is judged on capital stability. The portfolio favors high-quality, highly liquid public credit (e.g., front-end investment-grade, high-quality securitized) with minimal drawdown tolerance. Any private exposure is limited to very short-dated, highly structured opportunities and only where liquidity terms are tightly controlled.

### PROFILE E

Medium risk tolerance + Medium illiquidity tolerance

An insurance general account (or similar regulated balance sheet) seeking carry and diversification while managing capital charges, asset-liability matching, and credit migration risk. The portfolio blends public core credit with select private opportunities where structure and covenants can improve risk-adjusted outcomes. Implementation tends to emphasize pacing, diversification by borrower and sector, and using public credit to keep duration and quality targets stable as private allocations ramp.

### PROFILE I

High risk tolerance + High illiquidity tolerance

A long-horizon, return-maximizing investor (e.g. endowment-style pool with high tolerance for drawdowns and limited near-term liquidity needs) using credit as a high-octane return sleeve. The portfolio can allocate heavily to opportunistic and complex private credit (e.g., distressed, structured settlements, niche asset-based financing) alongside less liquid public opportunities when dislocations arise. Success depends on underwriting depth, governance alignment, and explicit planning for periods when liquidity disappears and private marks lag fundamentals.

As of April 2026. Source: PGIM.
5. Hypothetical investor profiles and allocation descriptions are provided for illustrative purposes only and do not represent recommendations, investment advice, or any specific investor outcome. **All investments involve risk, including the possible loss of capital.**


PGIM

# 留意事項

本資料は、海外グループ会社が作成した情報提供資料をPGIMジャパン株式会社（以下「当社」）が日本国内の投資家向けにご提供するものです。
本資料は、金融機関、年金基金等の機関投資家およびコンサルタントの方々を対象としたものです。
本資料は、当社グループの資産運用ビジネスに関する情報提供を目的として作成されたものであり、特定の証券や金融商品等の販売・勧誘・推奨を目的としたものではありません。
本資料に記載された内容等については今後変更されることもあります。
過去の運用実績は将来の運用成果等を保証するものではありません。
本資料に記載されている市場関連データ及び情報等は信頼できると判断した各種情報源から入手したものですが、その情報の正確性、確実性について当社が保証するものではありません。
本資料は法務、会計、税務上のアドバイスを行うために作成されたものではありません。必要に応じて専門家とご相談ください。

当社は、世界最大級の金融サービス機関プルデンシャル・ファイナンシャルの一員であり、英国法人のプルーデンシャルplcおよび英国法人のM&G plcの子会社であるプルーデンシャル・アシュアランス・カンパニーとは何ら関係がありません。
プルデンシャル生命保険株式会社、ジブラルタ生命保険株式会社、PGF生命（プルデンシャル ジブラルタ ファイナンシャル生命保険株式会社）及びPGIMリアルエステートジャパン株式会社は当社のグループ会社であり、別法人です。

PGIMジャパン株式会社
金融商品取引業者 関東財務局長（金商）第392号
加入協会：一般社団法人資産運用業協会、一般社団法人第二種金融商品取引業協会
PGIMJ128591
5405168-20260420