PGIM
GLOBAL ASSET MANAGEMENT

MULTI-ASSET

CREDIT ALLOCATION IN A CHANGING MARKET

Rethinking the Public-Private Balance

SUMMER 2025

INTRODUCTION

The growing complexity of credit markets has broadened the investment opportunity set for investors.

Securitized credit across the public and private universe: collateralized loan obligations (CLOs), asset-based finance (ABF), distressed debt, and residential and commercial real estate debt are part of an expanding array of choices amid rapid growth in credit exposure. Many investors have been actively exploring more options in public and private credit, even though added complexity in these markets brings new challenges to investors seeking the optimal mix of public and private credit in a multi-asset institutional portfolio.

For instance, while traditional corporate credit remains a core allocation among US life insurance portfolios, an estimated one-third of the $6 trillion US life insurance industry's invested assets was allocated to private credit at the end of 2024, according to a survey by Moody's Ratings.[1] Private credit has been gaining momentum with pension investors as well. As of September 30, 2024, defined benefit funds of the 200 largest US retirement plans reported $198.4 billion in private credit, a significant (~57%) increase from a year ago.[2]

However, allocations across private credit markets can vary widely. Institutional investors—facing their distinctive risk, return, diversification and liquidity considerations—have adopted divergent portfolio construction strategies with private-credit allocations. Residential mortgages, for instance, account for 1.6% of US life insurers' portfolios on average, Moody's found. Yet one firm that participated in the survey said it allocated nearly 12% of its portfolio to residential mortgages. On the opposite end of the spectrum, another insurer estimated its residential mortgage allocation to be roughly zero.

Strategic allocations to private credit alongside public credit may support diversification, duration management, and risk management within a multi-asset portfolio. As markets converge, investors may benefit from adopting holistic investment and risk-management strategies that span the full credit universe.

1 Moody's Ratings. (2025, June 2). *US Life Insurers Head Offshore as Private Credit Transforms Industry*. https://www.moodys.com/web/en/us/insights/data-stories/private-credit-transforms-life-insurance-industry.html. Accessed June 2025.

2 Pension & Investments. (2025, February 4). *No sign of private credit slowdown. Largest pension funds boost allocations by more than 50%*. https://www.pionline.com/pi-1000-largest-retirement-plans/private-credit-assets-jump-over-50-largest-pension-funds-pensions. Accessed July 2025

CHARACTERISTICS OF PUBLIC VS. PRIVATE CREDIT

There are several characteristics that can make public and private credit distinct from one another, and thus complementary, in a balanced multi-asset portfolio:

1. **Yields:** Private credit tends to offer a spread premium over public credit in exchange for illiquidity. While credit spreads across the board have tightened significantly, we still observe the spread premium today (see Figure 1).

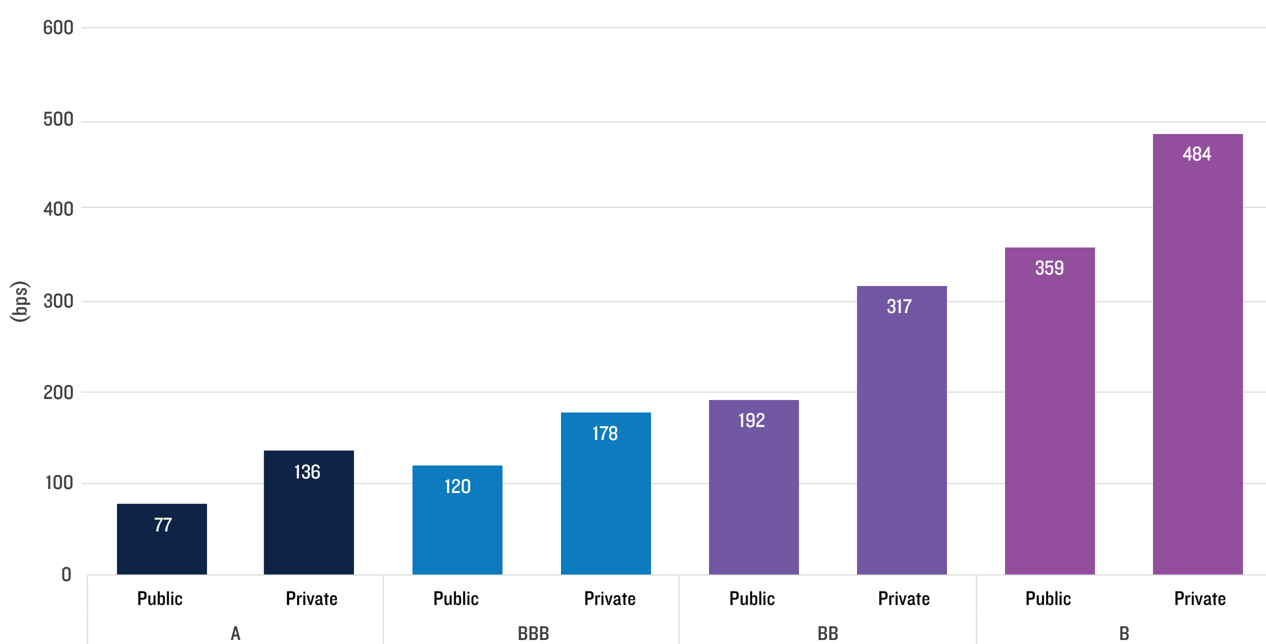
2. **Duration contribution:** Duration characteristics can vary among public and private credit. Most of the time, large institutional investors (e.g., insurers and pensions) need to source an appropriate amount of duration in order to hedge their underlying liabilities. The duration needs of the investor and the ability to utilize derivatives, for instance, can help inform the allocation between public and private credit as well as the types of private credit.

3. **Risk management features:** Private credit relies on customized loan terms, comprehensive underwriting, collateral arrangements, and strong covenants as structural safeguards aimed at mitigating downside risk.

4. **Liquidity:** Public markets offer greater liquidity and often quicker mark-to-market. Meanwhile, investors are typically compensated with higher spread premium for taking on greater illiquidity associated with private credit.

5. **Fee structures:** Private credit vehicles may have higher carried interest or management fees, and the pass-through of fund expenses can be significant.

Exhibit 1: Public vs. Private Credit Option-Adjusted Spread Comparison



Source: Bloomberg, PGIM. Data as of June 30, 2025. Provided for illustrative purposes only.

“

Investors can take advantage of a broad array of credit options while considering potential constraints, such as caps on allocations, as well as potential benefits that public and private assets could offer.”

Investors can take advantage of the broad array of credit options that public and private credit markets could collectively offer, while considering potential constraints. For pension plans and insurers, expanded duration and credit spread availability in private credit could help them match assets up well with their liabilities.

While investors and the broader media often reference private credit holistically, underneath the hood it encompasses a wide spectrum of strategies with compelling characteristics, return profiles and risks. Below, are examples of some key private credit strategies and their distinctive attributes:

Corporate direct lending to the middle and large-cap market could give investors access to privately originated floating rate loans that may offer broader diversification, along with potentially competitive terms and pricing. Direct lending strategies also allow investors to access differentiated originations in hard-to-reach corners of the market. Non-sponsored deals may provide additional diversification, but also a potential yield premium, stronger covenants and security documentation, to lending portfolios with exposure to private-equity-backed companies.

Private ABF offers diversity in collateral with exposure to a host of underlying assets, such as cars, homes and commercial properties. Robust collateralization mechanisms, coupled with comprehensive structural protections, aim to support credit quality while providing investors with potential diversification benefits compared with traditional debt strategies. Moreover, private ABF's evolution beyond traditional consumer and corporate lending provides investors with access to growing segments such as renewable energy financing and intellectual property, which could reduce a portfolio's sensitivity to economic cycles. Some ABF strategies, such as real estate-backed loans and infrastructure finance, may offer floating rates, inflation-linked revenues, or exposure to hard assets, which may help hedge real liability values. The self-liquidating nature of most ABF assets could support overall fund liquidity relative to other private credit strategies.

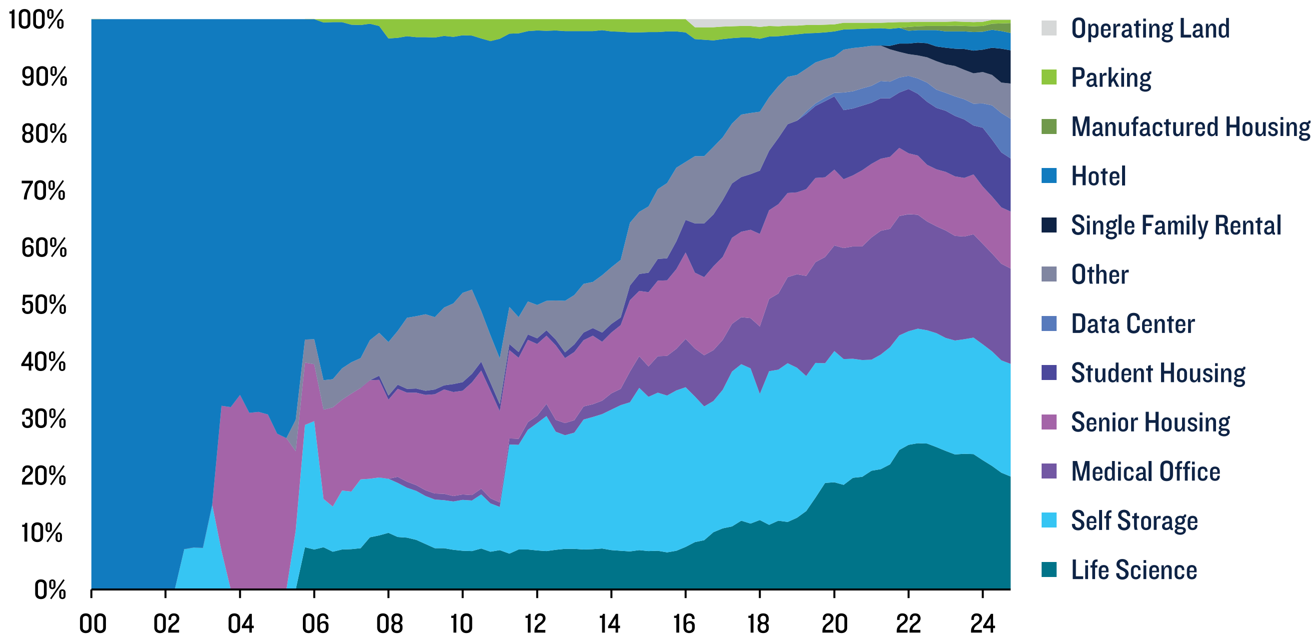
Real assets such as real estate and infrastructure debt feature defensive characteristics, which may help investors manage a volatile macroeconomic backdrop and inflation risk. This is especially noteworthy given the perceived risks of inflation and stagflation in the current environment. **Real estate credit** is an expanding opportunity set, offering diverse investment options that may give investors exposure to difficult-to-access assets. There has been notable growth in sectors such as senior living, self-storage, data centers, student housing, co-living and hotels—all of which reflect a focus on income generation. These assets require intensive asset management, creating new avenues for financing value creation strategies.[3] **Infrastructure debt** is seen as well-suited for institutional portfolios given the asset class's long-term horizon, its potential to generate relatively stable income streams, and the diversification provided by sectors such as transportation, energy, and data center projects. Infrastructure could also be a hedge against inflation, as investments are often indexed to inflation measures.

3 PGIM. (April 2025). *The Expanding Opportunity for Private US Real Estate Credit.* https://www.pgim.com/us/en/institutional/insights/asset-class/real-estate/expanding-opportunity-for-private-u.s.-real-estate-credit. Accessed June 2025.

Private placements are privately-negotiated, fixed-rate debt investments which provide pension and insurance portfolios with the dual benefits of potential yield enhancement and contribution to the hedging of underlying liability risks. The private placement market can also provide pensions and insurers diversity across industries that may complement their public bond holdings. The industry mix is vastly different in private placements than public corporate bonds, given that many companies, based on their sector or size, tend to prioritize the same financing channel. Diversification can be significant at the issuer level as well. Investing across different private credit segments and structures can provide exposure to a much larger pool of issuers, mitigating overall credit and concentration risk.

Exhibit 2: Growing Universe of Property Types Shifting Toward More Operational-Intensive Assets

NCREIF Sector Allocation Within "Other" Property Types



Source: NCREIF, PGIM. As of April 2025. Provided for illustrative purposes only.

FINDING THE RIGHT MIX BETWEEN PUBLIC AND PRIVATE CREDIT

First and foremost, investors need to consider what is most important to their objectives when designing a portfolio comprising public and private credit.

This includes, but is not limited to, duration needs for hedging purposes; liquidity needs; the diversification of underlying exposures based on factors like sector and geography; yield enhancement provided by private credit and how it compares to public credit; and regulatory and tax implications.

As an example, an insurer or pension plan that allocates to generally shorter duration and often floating rate private credit (e.g., ABF or direct lending) should be complemented with allocations to more liquid and longer-duration assets to complete their overall hedge against their underlying liabilities. Oftentimes, the ability to use derivatives can help improve capital efficiency while achieving the necessary asset-liability hedge. Leveraging robust asset-liability management (ALM) and credit monitoring capabilities will help achieve the optimal strategic asset allocation across public and private credit convergence.

$6 TRILLION

The US life insurance industry's total cash and invested assets in 2024—one-third of which was allocated to private credit.

Source: Moody's Ratings

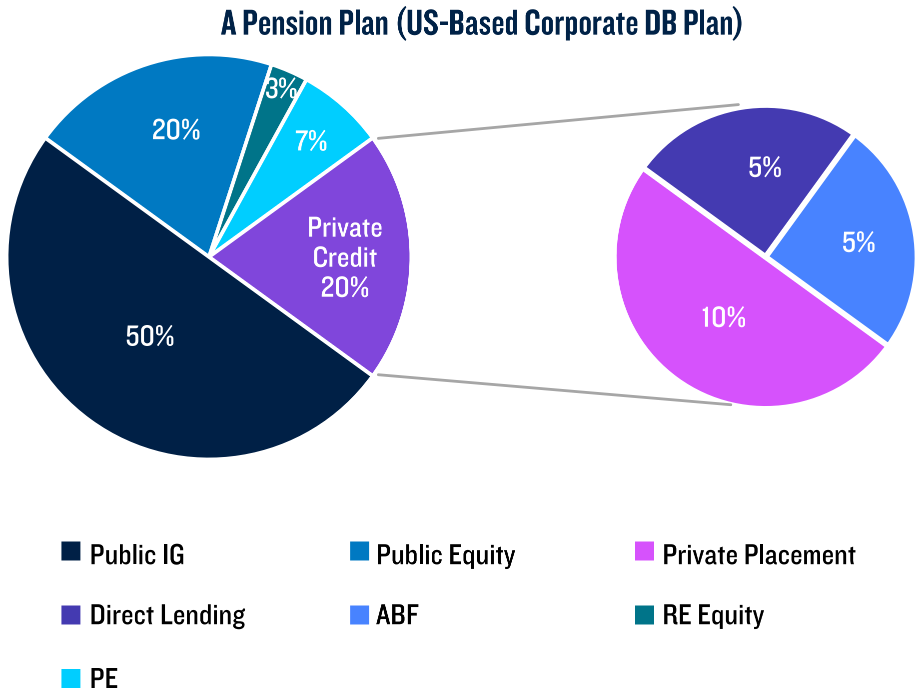
Portfolio Illustrations Incorporating Public and Private Credit

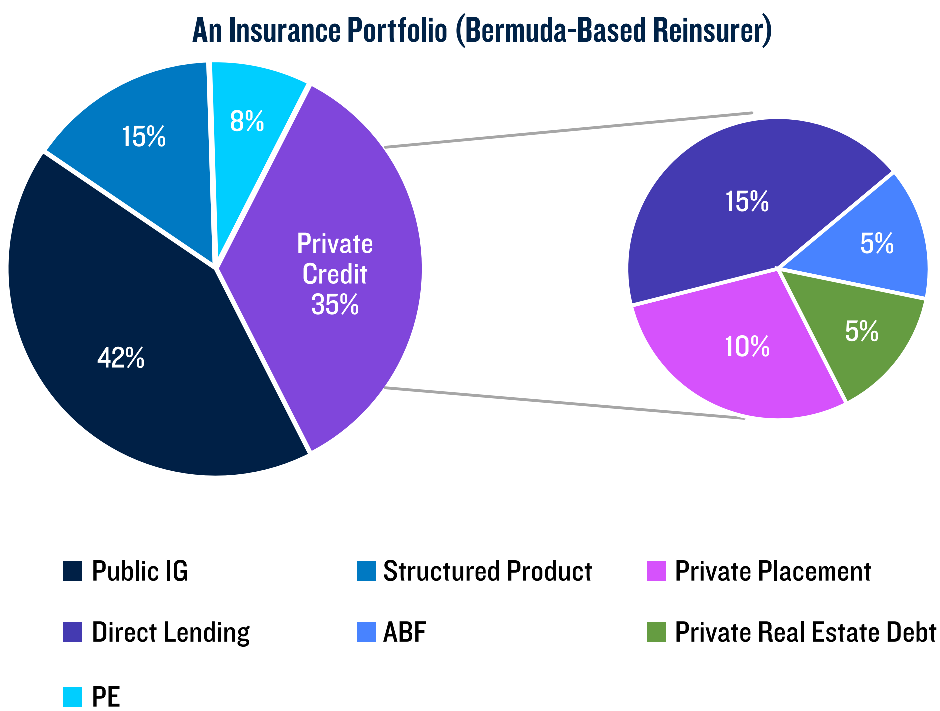
Even though many pensions and life insurers have similar goals to support their long-duration liabilities, their allocations to public and private credit may still be significantly different. The case study, as shown in Exhibit 3, illustrates some key differences driving varied asset allocation decisions between a US-based corporate DB plan and a Bermuda-based reinsurer.

For instance, it is important for a US-based DB plan to enhance portfolio returns to meet ERISA plan funding ratio requirements. Compared with insurers, DB plans may have more flexibility in selecting their growth assets. Apart from high-yielding private credits, DB plans may have meaningful allocations to equities (public and private) to boost returns. However, insurers may have very limited or even no allocations to public equity to avoid higher capital charges. Bermuda-domiciled insurers may also need to take additional considerations in the credit rating mix in their asset selection, as the Bermuda reinsurance regulations place a 10% limit on non-investment grade assets used to back liabilities under the Scenario Based Approach for liability valuation.

"Even though many pensions and life insurers have similar goals to support their long-duration liabilities, their allocations to public and private credit may still be significantly different."

Exhibit 3: Illustrative Portfolio Allocations with Public & Private Credit





Source: PGIM. Provided for illustrative purposes only.

LIQUIDITY AND RISK MANAGEMENT OF PUBLIC AND PRIVATE CREDIT PORTFOLIOS

A robust liquidity and risk management framework can help investors remain agile in the face of downside challenges and upside opportunities that arise with the increasing convergence of public and private credit markets.

Maintaining sufficient liquidity is a critical consideration when allocating between public and private credit. Powerful analytics tools can help investors evaluate the tradeoff between liquidity and performance of alternative allocation strategies to make more informed portfolio allocation decisions.[4] The example, as shown in Exhibit 4, illustrates the portfolio impact of alternative allocations between public and private credit. In this example, the investor currently has 60% of the total portfolio invested in public IG and is considering reallocating one-third of that into private IG. An immediate impact is that the insurer is dealing with less readily available liquidity (Figure 4.a). With more allocations to private credit, the investor boosts portfolio returns by 30bps, i.e., 1.8% vs. previously 1.5% net annualized returns. In the meantime, the portfolio is exposed to higher liquidity drawdown risk, 31.7% versus the previous 23.8% average maximum annual liquid asset (i.e., cash and public IG) drawdowns (across 5,000 simulated market paths).

Investors should also consider the potential risks associated with the market environment. The current higher-for-longer environment may enhance the appeal of floating-rate private credit investments, but investors must also be mindful of risks that higher interest rates could pose to borrowers. As borrowing costs increase, some lower-rated credits and businesses with cyclical exposure may face greater financial strains. As the interest rate environment and credit cycle evolve, investors can better mitigate emerging credit risks (e.g., downgrades, defaults and impairments) through disciplined origination and a fundamental approach to underwriting. It is important for investors to remain selective and avoid reaching down in quality in search of yield without recognizing the underlying credit risk, particularly as more capital enters lending markets and competition intensifies.

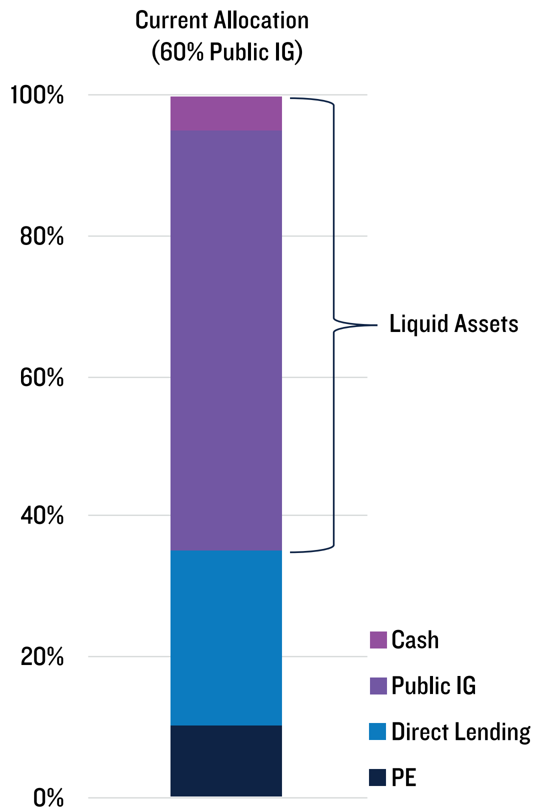
Sophisticated partners offering multi-asset solutions, analytics tools, and platforms with a broad spectrum of credit assets may help investors build portfolios that seek to capture opportunities and manage risks as the interplay between public and private credit intensifies. In particular, working with an investment platform that has visibility into both public and private markets can help investors capitalize on information asymmetry that may be beneficial to overall portfolio outcomes.

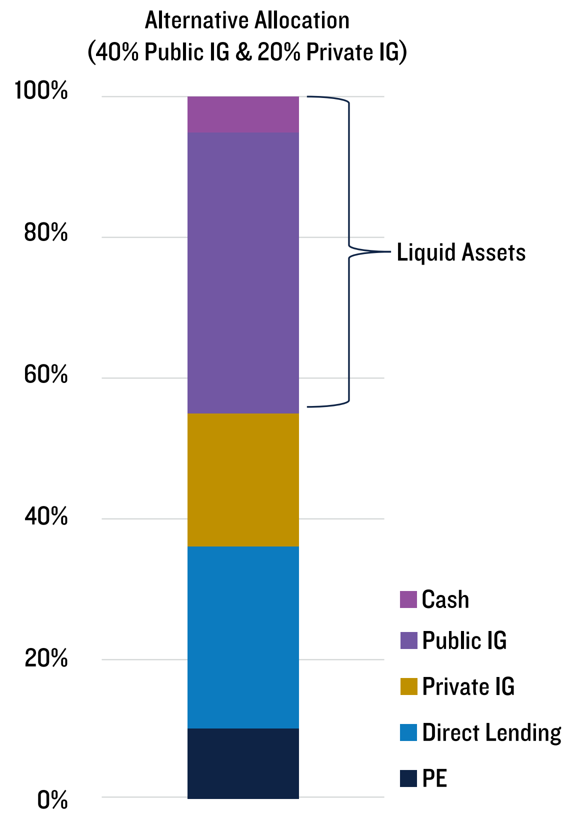
“Maintaining sufficient liquidity is a critical consideration when allocating between public and private credit.”

4 Portfolio Research, PGIM (January 2023), *Is There a Need for a Chief Liquidity Officer?* https://www.pgim.com/us/en/institutional/insights/asset-class/multi-asset/multi-asset-solutions/there-need-for-chief-liquidity-officer. Accessed June 2025.

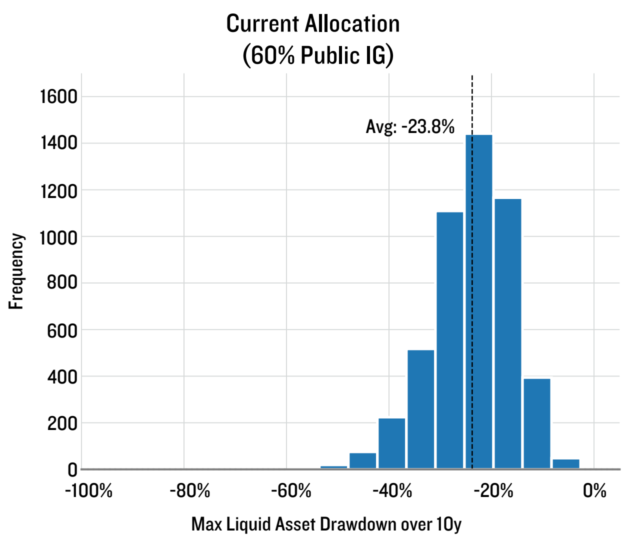
Exhibit 4: Portfolio Impact of Alternative Allocations Between Public & Private Credit

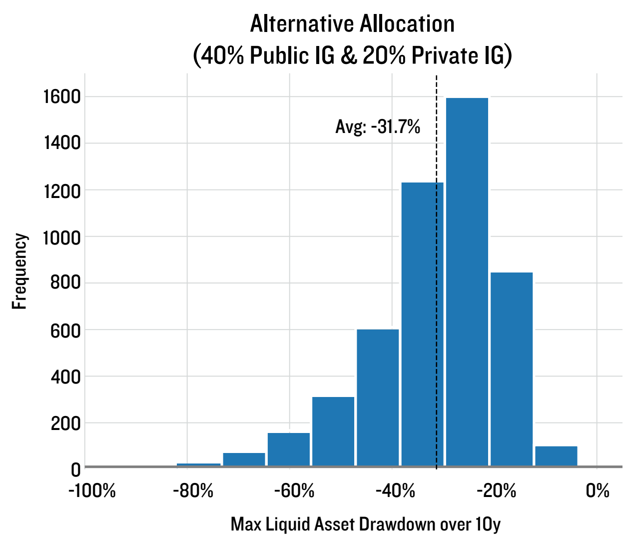
4.A: Liquidity Waterfall





4.B: Distribution of Max 1-Year Liquid Asset Drawdowns Over 10-Year Period (Across 5,000 Market Paths)





Source: PGIM. Provided for illustrative purposes only.

CONCLUSION

Amid the rapid evolution of credit markets, institutional investors face new challenges and opportunities as they seek to integrate public and private credit assets into diversified portfolios. Strategic allocations to private credit have become a fixture of institutional multi-asset portfolios, but determining the optimal mix of public and private credit will likely require a tailored approach. As they pursue portfolio resilience and returns in complex markets, investors can leverage multi-asset solutions, robust portfolio analytics, and an expanding assortment of sophisticated credit strategies to achieve their long-term objectives.

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