Manager Minutes

The Private Credit Opportunity

Private credit today is estimated to be every bit as large of an asset class as leveraged loans and high yield bonds. And a lot of that growth has come obviously in the last couple of years. If you start with private credit, private debt, those two terms are interchangeable, credit being debt. And a key distinction is both deals that are negotiated and issuers issuing debt on a private side basis. It means generally the debt does not trade. Although not always, the debt is not rated by an agency. What that includes today has gotten much broader. It includes fixed rate, long duration bonds, floating rate loans, which direct lending sits within, many other forms of private debt, energy credit, infrastructure credit and so on.

What's underpinning that growth is the issuer set, and we use the U.S. as proxy here, but I think you can say the same for Europe and many developed markets around the world, 87% of companies in the United States, more than $100 million of revenue are still private. Those are exactly the target issuers for this type of capital and increasingly those companies are embracing this capital.

Direct lending really defines what is the leveraged lending asset class within private credit. And generally there, you're providing floating rate loans to middle market companies with more leverage and therefore the investors are receiving more return. These are directly negotiated, directly held loans. You can require additional covenants, risk protection, and finally call protection.

What is the case for private credit? Number one, the asset class has shown consistently strong returns on an absolute basis versus alternatives sources of investment, whether it's publicly available high yield or fixed income opportunities, rated syndicated loans, et cetera. They have proven very good relative returns over time as well.

The next feature that I think is attractive to an investor is attractive income. The loans themselves, they are typically priced as a floating rate coupon. It's a base rate plus a spread, with fees and some other forms of income and commission. And what that does is provide natural inflation protection in a loan security.

And then finally, the asset class is large and growing and that's a key part of this, because of course, if the first two points attract more demand in terms of capital of the asset class, if supply is also not growing, i.e., the number of investment opportunities, that will compress the value on those first two points. More and more companies are seeking alternatives to banks for their financing needs.

When you have bank volatility or capital markets volatility, companies look for stability of capital solutions and capital providers and that's where direct lending can take a little bit of a longer-term view. And so we continue to see that trend being quite attractive.

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