

Private Credit Comes of Age

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At a loan conference some years ago we referred to middle market loans as the Rodney Dangerfield of capital markets. These small, illiquid instruments were the poor step-child to high-yield bonds and large leveraged loans. But at Creditflux's inaugural New York conference on private credit this past June, it was clear the situation has changed.

In a series of remarkable panels, the leading players in what has become the hottest asset class on the planet talked about the opportunities and challenges of middle market direct lending. Topics included credit quality, capital formation, risk management, the competitive landscape and the regulatory environment.

The most thought-provoking conversation was among the leaders of the top middle market firms – Antares, Ares, Churchill, Golub and NewStar. These CEOs (or, as we dubbed them, the heads of the Five Families) were asked to describe the state of the middle market in one or two words. This is what they said:

“Transparency.” Middle market arrangers have worked hard to provide investors with the same level of information on both portfolio metrics and asset-level performance as public and rated instruments. That has greatly enhanced the attractiveness of private credit to institutional and retail buyers.

“Institutionalisation.” In the same way that broadly syndicated loans are documented with consistent terms and comfortably securitised within CLO vehicles, so middle market loans have become more standardised. This has paved the way for arrangers to create for investors numerous side-pockets of capital which managers control. These “cargo pants” structures enable lenders to write larger tickets with no syndication risk.

“Distribution.” While middle market loans are not known for tradeability, direct lenders are adding capital markets resources (syndicators and traders) to their staff. Not only does this help source new buyers for primary issuance, but it supports existing credits with bids and improves trading opportunities.

“Education.” As managers make the rounds in Europe and Asia, more investors are learning the nuances of middle market loans. Attention has turned to which managers are best qualified, have a strong track record, have proprietary origination and have the most discipline to meet risk-return criteria.

“Resilience.” Through the downturn, private credit performed as advertised. Managers who held onto loans ended up preserving the value of their portfolios for investors. That has created real barriers to entry for new entrants into private credit who don't have that experience. Middle market loans also have proven high-single-digit yields over almost two decades, creating a ready solution for investors in this zero-rate climate.

These key words all point to a credit strategy finally coming of age. Just as high-yield bonds evolved from small bespoke private placements in the late 1980s, and as broadly syndicated loans matured from clubby, bank-only affairs in the early 1990s, private credit has grown up in the post-crisis era.

Looking forward, private credit's less-correlated model will be seen as a defensive play. Expectations of ongoing volatility will favour loans that are held, not traded, and that are less exposed to the vagaries of liquid markets.

Liquidity, investors have learned, proved to be illusory: it was there until it was not.

This column first appeared in the weekly newsletter of [Creditflux](#), a leading global information source for the credit trading and investment market.