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# Top Ten Myths About Private Credit (Fourth of a Series)

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This week in our continuing special series on the private credit myths, we come to:

**Myth #3: "We're late in the cycle, so loans now are risky."**

Let's first take the issuer side of the equation. One of the virtues of private credit is being available when public markets are shut or expensive. Invariably those times coincide with periods of uncertain price discovery. Buy-and-hold private credit managers have locked-in capacity. Since the assets are not liquid, transactions can be structured with long hold periods and without relying a market take-out.

For investors, this means successful managers can operate through business cycles, regardless of market volatility. These managers don't rely on investment timing, but deliver consistent returns with a premium over where liquid assets are yielding.

While high borrower leverage and weak covenant packages are reasons for caution, traditional middle market loans provide a safer haven. Instead of a risky bet, private credit represents a flight to quality. Having a priority security interest in the borrower's assets and cash flows and being senior in the capital structure is precisely the comfort investors should be seeking in the event of a downturn.

It's also a fact that private equity owners work actively to improve the performance of their portfolio companies. Management team upgrades, professionalization of certain business functions, M&A to better diversify the business, are all value creation strategies. They are also credit-enhancing, benefiting senior lenders below sponsors in the capital structure, which is ultimately beneficial to credit investors over time.

Finally, because recessions are notoriously tough to predict, experienced direct lenders model into each portfolio company a downside case. Assuming a severe downturn next year, how will this borrower fare? Sticking with market-leaders in defensive sectors with strong free-cash flows creates a weather-proofed portfolio.

**Myth #4: "Who needs floating rate assets if interest rates aren't going up?"**

The Fed kept rates flat for seven years after the Great Recession, raised them for two years, then lowered them last year. What's the outlook for 2020?

Given the strength of the US economy, the Fed has signaled no change to rates for the year. Some economists had built in at least one cut. But now with the coronavirus threatening global growth, traders are adding a second rate cut to their models.

But who knows? As with forecasting recessions, the direction of interest rates is a crap shoot. That's why having a mix of floating and fixed rate assets helps mitigates some of that uncertainty. A private credit portfolio including senior and mezzanine investments can provide that rate hedge.

**? Next week: Myth #5: “No one uses mezzanine debt anymore.”**