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Private Credit – Better than Ever (Last of a Series)

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"If you liked private credit before, you'll really like it now." – Managing director of a private debt investment firm.

As we wrap up our special series on the "new" private credit, let's look at factors influencing both quantity and quality of deal flow next year.

First, the economy. Recent employment numbers point to a worrisome trend. While unemployment is down, it's not for good reasons. The number of job searchers has declined, meaning people have given up looking and dropped out of the work force.

Also the pandemic has wreaked havoc on many consumer-facing sectors. While half of the 22 million jobs lost in the early stages of COVID-19 have been restored, about 4 million jobs have been permanently lost. Many of these are in the restaurant, travel, hospitality and leisure industries.

As our *Chart of the Week* highlights, US air travel has been decimated. TSA data shows that airline activity is just one-third of what it was a year ago. And that shows little sign of coming back until infection fears subside.

These dynamics speak clearly to a slower recovery for businesses most affected by the coronavirus. Meanwhile, as we've noted in this series, the better positioned businesses will command the best financing terms.

While 2021 will likely be a "one-step forward, one-step back" kind of year, market timing is not something associated with private credit. Because middle market assets are illiquid, investors and managers realize the importance of investing through cycles.

We noted recently several large pension funds announcing intentions to lean into the asset class. "If you invested in 2017 and 2018," Creditflux reported one consultant saying, "those vintages may not perform as well as the vintage before or after. The worst thing you can do as a private debt investor is to hold off this year."

Will the 2021 vintage be as attractive as 2020? Expect credit fundamentals for less COVID-sensitive borrowers to remain constructive. Expect market volatility to continue roiling public valuations, thus enhancing the virtues of illiquid assets. And expect interest rates to remain flat, strengthening the case for the premium yield private credit enjoys.

Finally, expect some virus overhang – uneven business recoveries, delayed vaccine rollouts, and political uncertainties – to last well into next year and beyond. That should keep financing terms relatively investor-friendly.

But will the sense of urgency propelling M&A and financings this quarter persist into the new year? Private credit supply has been driven historically by the impetus of private equity dry powder. We see no signs of that abating.

Indeed, with many sponsors behind in their 2020 investing budgets, the drive to put money to work will prove irresistible for the foreseeable future.