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2021: The Great Reception (Last of a Series)

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We wrap our special series with an outlook for private credit.

The value proposition of the asset class was fully supported through last year's extreme volatility as experienced managers and their portfolios emerged mostly unscathed. But as market conditions develop this year, how will private credit terms be impacted?

BSL technicals, such as fund flows, have a mild gravitational effect on direct lending pricing and structures. When liquid loan yields widen or contract, illiquid loan yields follow, directionally if not in lock-step. Junk bond all-in yields for single-B new issues are down to 5%. For investors in secured, floating rate, private credit, earning at least 200 bps north of that is very favorable relative value.

With supply and demand in private credit driven by dry powder, won't 2021 be a continuation of the frothy market we saw at the end of 2019 (and early 2020), especially as the economy gathers steam? Hard to recall when lending wasn't competitive. But residual pandemic drag on some sectors should keep the foam off the latte.

What will help is businesses less impacted by the virus are earning purchase price multiples above pre-Covid levels. That provides lenders greater equity cushions. Also, volatility peaked last April with the VIX above 69. While down now to the mid-20s, it's still 10 points higher than 2018 and 2019. That should provide yield support.

Private equity fundraising fell sharply in the US last year, according to PitchBook, to $231 billion from $375 billion in 2019. Nevertheless dry powder remains over $500 billion. That's sufficient to drive new buyout activity and soak up the $100 billion of private credit capacity.

Inevitably the economy, capital markets and private credit are intertwined. Improved vaccine distribution will reach a tipping point, then reopening of commercial activity should accelerate. That will lead to further value restoration in the capital markets. And enhanced valuations energizes M&A – the lifeblood of private equity and credit investing.

Private credit emerged from the wreck of the Great Recession, came of age during the Great Stay-In, and will continue to flourish during the Great Reception. As one financial columnist put it succinctly, "A stronger economy…and higher interest rates. It's called a recovery."