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# Private Credit – Why Now? (First of a Series)

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In recent weeks we've devoted considerable space to how the Fed's Great Unwind and rate hikes have impacted the economy, capital markets, and private credit. We've also examined the backdrop for growth (or recession). Our economist friends have helped sift data to guide investors on where US and global economies are headed. Finally, we've analyzed how private credit terms are affecting both issuers and investors, particularly compared to public credit.

One issue of growing interest among investors is timing. It's all very well that private credit attributes – lower leverage, higher yields, and tighter structures – are tilting the field towards debt buyers. But why not wait until terms improve even more? And then whatever landing – soft, medium, hard – happens is behind us and things go back to normal.

Market conditions are also lifting other boats. As our *Chart of the Week* highlights, leveraged loan spreads and yields have soared since the Fed began its inflation busting program. High-yield bond yields have kept pace with loans as lower secondary prices demand better economics on primary issuance.

With the risk-free rate headed to 5%, high-grade corporate debt has seen spreads increase in lock-step. Average triple-B new-issues are yielding more today than triple-C junk bonds earned less than one year ago!

To further complicate matters, the denominator effect – the distortion of asset allocations caused by the downswing of public asset valuations – has pushed the portfolio percentage dedicated to alternatives above some plan targets. To reset those allocations in the short-term means either selling illiquid assets (not ideal) or buying more liquid names (whose prices are subject to further volatility, thus compounding the problem).

There are also worries that leveraged credit generally ("risky loans!") will suffer worse defaults and losses given the weaker structures and higher leverage characteristics of pre-Covid vintages. While it's reasonable to project higher defaults off today's record lows, it also depends on the track record and experience of each asset manager.

Private credit involves smaller companies with less scale and limited access to capital markets. This leads to a perception that in a downturn large caps are better equipped to manage through an environment of higher costs and/or shrinking revenues. As it turns out, middle market loans have performed better in terms of defaults and losses than liquid loans over the past two decades, but for reasons not necessarily apparent to the casual observer.

In this special series we'll take a closer look at how top managers and experienced institutional buyers consider timing as a factor in their decisions to invest in private credit.