Letter from Seoul (Second of Two Parts)

THE LEAD | May 30, 2023

"Private credit is the only bright spot in asset allocation right now."

The themes around private credit of consistent returns, valuation stability and low-risk portfolios were repeatedly underlined in the twenty or so meetings we had with investors in our weeklong trip around Seoul, South Korea.

Fortunately conditions are increasingly propitious for both private credit managers and investors in this country. Regulatory relief is helping. Recently released proposals ease burdens of foreign investor registration and off-market trading.

Also, according to Preqin, amendments in 2021 to the Capital Market Act allow South Korean PE firms "to use mezzanine financing, a mix of debt and equity financing if all their investors are institutions." As our *Chart of the Week* highlights, private debt represents one of the fastest growing assets in Korea.

Some of the fundraising is focused on domestic markets, particularly financing opportunities for *chaebols*, or Korean family-run industrial conglomerates. Others address distressed borrowers.

Interest in private debt dates back over a decade when large US and European managers began to study the market. First product offerings began to surface in 2013. Insurance companies like KB took a year to study the market. There was a growing realization that these present opportunities to do loans away from banks.

Over the next several years, development of the asset class grew in parallel with fundraising overseas. Rated note feeder funds afforded insurance companies higher yields and allowed them to meet tax and regulatory requirements. Private equity firms still attracted the majority of AUM, with some investing in direct loans, but it's a small share.

Then in 2022 the rapid global rise of interest rates caught many investors by surprise. The downdraft of valuations in public equities and fixed income accelerated appetite for alts. In Korea that included KIC, a sovereign wealth fund. At $200 billion it's small by Middle East standards, but significant for APAC.

Another group focused on private debt are mutual aid pension funds. SEMA, the association for Korean scientists and engineers, is a good example of these profession-specific plans. POBA, directing benefits for public officials, is another of about ten major funds.

The era of near-zero rates that ended last spring was relatively benign for borrowers. 2023 presents a new set of challenges. How do you manage amid record high borrowing costs leading to a potential recession?

Besides the perennial benefits of private credit, you can add defensive portfolio construction and more conservative structures. As one Korean investor told us, "Private credit is the only alt still attracting attention."