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A Loan for All Seasons (Last of a Series)

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Both veterans and newcomers to the asset class are familiar with the basics of private debt benefits. Thanks to its premium yield over liquid credit and consistent returns across economic, rate, and market cycles, investors have moved briskly into non-traded credit since the GFC.

Still, as we've seen and heard on several continents and at many gatherings and conferences this year, there remain unanswered questions. In the past two weeks we've addressed timing and defaults. This week we wrap up with what seems to be the overriding issue – liquidity.

In a way, this concern is the most surprising. After all, isn't it fundamental to the asset class? If you truly understand what makes private debt tick, then you know it's not like liquid credit. There's no ready secondary market because issue size is smaller, issues are private and not rated, and top arrangers are buy-and-hold managers.

Of course, illiquid doesn't mean there are no buyers. As one leveraged loan veteran told us years ago, "I don't want the stuff you're selling, I want the stuff you're keeping." Our own capital markets team is at any one time working with lending partners on a dozen or so primary financings we'd be very comfortable holding for ourselves.

The flip side of liquidity is volatility. If you can easily trade it, then it can easily trade off in a market downturn. Valuations also hinge on tradability. Holders of private debt were happy in 2022 it was part of their portfolio allocation, given how everything else sold off sharply.

Not surprisingly, investors want the best of both worlds: private debt's stability and yield with public equities and credit. Asset managers now offer evergreen features that provide some fund liquidity, but even public liquidity is an illusion. It's not there when you need it.

Whether your concerns revolve around liquidity, defaults or timing, they all point to the real question: What role should private debt play in a well-diversified investment portfolio?

Its growth to challenge broadly syndicated loans and high-yield bonds in market size means private debt now has an accepted position alongside them. Maybe you can't trade illiquid positions like bonds, but that's why you have fixed income as a standard allocation (see our *Chart of the Week*).

Finally, despite the virtues of private debt, say some observers, it really hasn't been tested. Much of its growth came after the GFC. Covid's down tick was so brief, it wasn't a true test.

Perhaps. If so, those same conditions over the past fifteen years – viral volatility, rate upswings and downswings, economic headwinds, and exogenous global risks – tested every other asset class on the planet. Private debt has still come out looking pretty darn good.