The New Paradigm (First of a Series)

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This week we chaired Day One of SuperReturn's Private Credit US conference in New York. It's a measure of the popularity of the asset class (and the outstanding agenda) that the auditorium was standing room only. Not including other SuperReturn strategy sessions on another floor.

In preparing for the opening keynote, we gave thought to how far private credit had come since 2022's conference last September. Back then the Fed had only boosted rates about halfway towards its goal (so far) of 5.5% today. And inflation was just under 8%, compared to 3.7% (by one measure) and 2.4% (by another).

Since then, investors and credit analysts have had time to ponder the impact of those high rates on leveraged loan portfolios. They've also seen their effect on bank balance sheets. But so far, given the record pace of the Fed's tightening, including its QT regime, it's also been a remarkably stable approach to what increasingly appears to be a soft landing.

That doesn't eliminate warnings of dramatically higher defaults, systemic financial risk, and investor losses. After over four decades in the middle market, we've recognized this negativity comes with illiquid territory. But we had hoped the clear benefits of private credit amid market volatility, in which public asset prices took a pounding, would be recognized.

So where are we (as one conference panel posed the question) in the evolution of the asset class? For one thing, the zero-gravity environment private credit inhabited for over a decade of its existence is past. Higher-for-longer is here to stay for the foreseeable future. As is volatility. Consider this the new norm in the economy and capital markets.

Public credit has seen some restoration of loan prices, assisting CLO formation which still lags last year's activity. Retail loan funds are decidedly negative on out-flows year-to-date. All that means the BSL world struggles to compete with private credit in financing new-issue buyouts. That's compelled banks to urgently develop "buy-side" capabilities or create partnerships with established private credit platforms.

Ironically, large direct lenders are mimicking investment banks by committing to $1 billion-plus holds, then opportunistically (and lightly) selling down to create aligned clubby syndicates while still retaining a sizeable chunk. The buy-side is becoming the sell-side.

All to say that a key aspect of the new paradigm for private credit is that distinctions between middle market and large cap transactions, between private and public, have blurred. This is because top-tier managers aren't driven by the issuer's size or ratings. They have the luxury, for example, of not caring whether CLOs, who need ratings, will buy the paper.

In a real sense, this spectrum of financing reflects the broad range of choices managers can offer investors. Sophisticated buyers appreciate the nuances of market segmentation. For example, the traditional middle market enjoying the benefits of better yields and more conservative structures. The question for investors then becomes, how best to access those benefits?