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Four for ’24 (First of a Series)

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2023 was characterized by several key themes in the capital markets. The Fed’s battle against inflation, the resulting impact on issuers of higher for-longer interest rates, a much slower M&A pace as buyers and sellers deal with mounting borrowing costs and compressed equity returns, and the steady disintermediation of buyout financings from public to private credit.

These dynamics have put private credit in the spotlight, not only for market participants, but regulators and the media. The latter two categories, for various reasons, struggles with how private credit has expanded in popularity with both issuers and investors. They attribute “growth” with “risk.” But as one asset manager put it, “mistaken pattern recognition leads some to attribute the historic behavior of public credit under stress with future private credit performance.”

For the year ahead we’ve identified four trends emerging from current dynamics that will impact deal making and fundraising. These trends reflect the complexity of capital formation and the nuances of asset management. But they also illuminate less well understood features of private credit. Understanding them will help dispel persistent myths that distort the realities of how today’s credit markets function.

New Normal Rates: The new macro and what this means. First, we’ll take a step back from the Fed versus inflation conversation and look more broadly at what appears will be a rate environment closer to historical averages than the most recent near-zero backdrop. Then we’ll ask what effect this will have on deal making in general. Finally, we’ll explore its impact on public credit and the banks in their battle to stay relevant in the leveraged finance game.

Winners and Losers: Continued dispersion from multiple dimensions of the market. Then we’ll examine the competitive landscape for private credit. Who will dominate the buyout financing game in the years ahead, and who will fall behind? What kind of tools are required to stay at the top of the deal league tables, and what kind of managers will be deploying them?

Stay Alive to Thrive: Portfolio excellence sustains investment activity/playing offense. Everyone says their portfolios are in great shape. But are they? What happens when SOFR and spreads don’t fall back to 2018-22 levels when many of the current crop of loans were originated? Is this another chance for more conservative credit managers, who resisted the urge to do stupid stuff to win business, to take market share?

Next Gen Private Credit: Private credit financing technologies, the next phase of applications. Finally, the higher-for-longer rate regime made life tough for public credit, as liquidity was leached from the financial system, CLO formation slowed to a crawl, and cash exited from retail funds. Direct lenders jumped into the vacuum and aren’t looking back. After large holds, unitranche structures and cov-lite capabilities, what other capabilities are top providers developing to meet the evolving needs of private equity sponsors?

Join us in the new year as we roll out expanded versions of these themes.

?? *From the Editor: The Lead Left will be on break until the week of January 8th. To all of our readers, best wishes for a safe, healthy and restful holiday season.*