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# Private Credit in a Post-Rate World (Fourth of a Series)

THE LEAD | March 17, 2025

The proponents and beneficiaries of private capital have long recognized its virtue of being less correlated with headline risk than fixed income and public equities. But one of Covid's most enduring financial legacies was the higher interest rate regime imposed by the Fed in 2022.

While it appears their long-sought soft landing was achieved, more costly financings of leveraged buyouts and M&A resulted in a $3 trillion backlog of unrealized value held in businesses to be sold globally. That iceberg would have been slow to melt if the Fed continued its pause on rate cuts. The question is, will that dynamic change amid looming tariff threats?

That seems to depend on whether rate direction will be more influenced by higher inflation kicked off by a trade war (up), or the increased likelihood of an economic slowdown (down). Of course, a recession is not the ideal method to improve financing conditions. But the threat of one could compel more clarity and moderation on the policy front.

Experienced executives know that bad news is often better than uncertainty. As we enter the second quarter, more dealmakers are putting a hold on transactions for which the imposition of tariffs could have a material effect on valuations. That doesn't help LPs looking for realizations from legacy investments to commit to new funds.

In our recent travels, we've heard investors looking to maintain or increase their exposure to private capital face similar concerns. While today's macro issues clearly are weighing on them, buyer confidence comes down to two things: deployment ("How fast can I put my money to work?") and risk/return ("If I trade liquidity for yield, will the asset class hold up over time?").

There are always questions about competition ("Isn't direct lending a crowded space?") and yields ("Aren't spreads compressing?"). But as *Lead Left* readers know, they can be answered (No, and No) if you understand the context and nuances of private credit. More pressing now is the deal flow outlook, and how that supply/demand equation impacts returns.

Systemic, investment bank-driven M&A helps, but in middle market private equity it's not about auctions. Instead deal flow is driven by how operating partners, with long experience in niche sectors, identify consolidation opportunities. These strategies develop over decades and don't easily get derailed by macro pressures. But financing costs affect entrance and exit multiples, and right now those are slowing the deployment-to-realization cycle.

What would improve that outlook? Confidence in the economy and markets. If buyers believe future corporate growth and earnings remain on a positive trajectory, they can lean into investments even with financing costs where they are. And sellers can justify to themselves and their LPs that today's portfolio realizations will help tomorrow's fund returns.

Next week, we conclude our series by examining what private credit investors are hoping from this asset class relative to performance from other alternatives as well as public options.