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

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The notion of a post-rate world is arguable, as anyone in the capital markets over the past two decades would attest. But with so many variables in today's crosswinds, investors in private capital believe that, as a relative matter, the direction of interest rates is less significant than how tariff policies will roll out in the coming months.

Relative performance is also critical to how those investors assess their choices among a myriad of alternatives as well as public options. With interest rates at the high end of historic levels, some specialized strategies such as litigation finance or pharma royalties may attract attention. The challenge is to attain scale of deployment and consistency of returns.

Private capital is never examined in a vacuum. It inhabits a portfolio among liquid and other illiquid asset classes, each with their own risk and return characteristics. Most US managers already have credible private credit exposure. To increase that share, they often have to find other categories to pull from, assuming those positions won't be sold at a loss.

And how much liquidity are they willing to sacrifice for better yields? Is fixed income more or less attractive now? That does depend on your view of rate direction, or at least the onset of more market volatility. After seven consecutive weeks of strong inflows, cash in high-yield bond funds reversed course in mid-March (see our *Chart of the Week*).

Finally, we hear more from investors about commitment pacing. They ask themselves under what timeframe to best deploy a specific private credit allocation, given all the macros we've been discussing, including the growing risk of an economic slowdown. A complex calculation that's different for every investor depending on the requirements of its beneficiaries.

More sophisticated buyers, and a broader set generally, still have direct lending as a core portfolio strategy. But they are increasingly exploring product extensions in junior capital, equity co-investments, and equity secondaries. This allows for further diversification within the asset class without sacrificing consistent premium returns.

At a recent conference, one experienced advisor told us the greater chance of a recession was two-edged. Such an eventuality might finally trigger better deal flow in their opportunistic, special situations, and distressed buckets. But it's also the reason they liked private credit's stability, particularly in senior credit. "Hard to disagree with the risk/return right now," they said. "With a little leverage you can be at mid-teens. Hard to argue with."

As we begin the second quarter, expect to see investors' underlying assumptions about the economy and markets be tested. And greater uncertainty and volatility will test managers across the asset spectrum. While we don't anticipate a sustained downturn, we do believe skating relatively unscathed through a tariff tantrum will prove to be another example of private credit’s resilience.