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Letter from Down Under (First of Two Parts)

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"When my 2-year-old opened up her toy chest, things tumbled out. She's 15 now, so it's a well-organized make-up box. That's how private credit has matured here." – Australian investor.

In our travels last month to Perth, Melbourne, and Sydney, we had over twenty meetings with clients and friends that included superannuation funds, wealth management firms, financial advisory and consultants, and private banks. As we discovered in other locales, private credit continues to gain in acceptance there as a valuable alternative to liquid assets, both in terms of relative risk/reward premiums, consistent income, and stable valuations.

In particular, institutional investors have progressed from conversations in which corporate direct lending was considered only as a rotational portfolio holding. Today market sentiment suggests an appropriate private credit allocation starts in the 2% range, to 5-7% if other alternatives such as infrastructure were included. At the extreme end, one market leader said alts and PC represented almost 40% of their portfolio.

With a greater share of allocations comes an increasing number of offshore managers looking to raise capital from Australia, with a growing number targeting the wealth market and establishing Australian-friendly vehicles to do so.

Several key themes arose from discussions with those managers. As the early threat of tariff impositions became more of a global reality, recession and stagflation worries to the asset class grew. There were also questions related to their impact on M&A and deal financing activity.

More generally, there are continued concerns about supply/demand for private capital. With more capital flowing into the asset class, would there be enough deals to satisfy growing investor appetite? And as private credit flourishes, how do the different strands beyond core direct lending (for example, asset-backed finance) compare in terms, risks, and returns.

For perspective, we spoke with clients about how they looked at private credit relative to other strategies and structures. In many cases, the Australian market for alternatives was geared first to real estate, both property and infrastructure. Even catastrophe bonds. "Private credit was zero two years ago," one advisor said. "But real estate had its pressures, construction risk being a primary one. That opened the door."

"Investing in alts doesn't come with daily liquidity," another investor told us. "You just have to accept the trade for higher, more consistent income. But the menu can include a variety of private market investments, including private equity and credit, even liquid alts such as ETFs."

That trade-off has also fueled investor appetite in Australia for BDCs and registered products, particularly those including a mix of growth and income-producing assets. But the core is often the same: as one investor put it: "It's about first bedding down the core direct lending piece of our portfolio."