THE LEAD
https://theleadpc.com/theres-a-new-tariff-in-town-second-of-two-parts/

# There’s a New Tariff in Town (Second of Two Parts)

THE LEAD | May 14, 2025

One criticism of private credit goes something like this: “Sure, private credit has a pretty good track record. But that’s because it’s never been tested by a real recession.”

The point is valid for most direct lenders. According to one study, only 5% of those managers were around before 2009. But during the past 16 years, *all* asset classes went through identical conditions. Regardless how “real” you consider Covid and its significant aftereffects, we’ve had a string of mini crises since the GFC: budget standoffs, supply chain disruptions, geopolitical events and now tariffs. Private credit steered through them with steadier values and returns.

Emerging threats today are the knock-on effects from tariff policies, including consumer confidence (near record lows) and recession risk. The latter has been validated by an unexpected 1Q US slowdown to -0.3%. The unpredictability of these policies has also led to pencils down for M&A mandates until a clearer trade picture emerges.

Sometimes headwinds do act as tailwinds. Private credit is, after all, a countercyclical strategy. When public markets go offline because price discovery there is challenging, the less-correlated privates readily fill the vacuum. Indeed, private markets are becoming the growth engine in the global economy. Thanks to investor appetite, there’s plenty of liquidity for strategies up and down the capital structure and across the risk spectrum to dedicate to this task.

At this writing, we’re seeing some rapprochement between US and China, easing tensions. But tariffs remain high overall, adding to inflation pressures. This provides opportunities for traditional US middle market companies backed by experienced private equity sponsors.

As was the case during Covid, defensive, business service sectors provide protection against trade and supply chain dynamics now. These companies also are attracting purchase price multiples close to record tops because they are more insulated from tariff noise. This produces historically low loan-to-value ratios, around 35% – extremely favorable for lenders.

So where is the opportunity for private credit in this ever-changing landscape? First, deal sourcing and portfolio quality are linked when managers have strong PE partnerships, based on a history of trust and execution. The broader the toolkit of the capital provider, the more attachment points with the capital user. This is true not just for their portfolio companies, but for the GP in the form of secondaries, NAV finance, and continuation vehicles.

When public credit reacts negatively to headline risk, private credit benefits from enhanced volume, better terms, and tighter structures. We expect spreads to remain in their current range, even a modest widening if deal flow picks up later in the year, which is likely.

Will tariffs kick off a “real recession”? Perhaps. Expect continued volatility and uncertainty around trade policies. Don’t be surprised if tariff adjustments to earnings become the new Covid adjustments. And recognize markets happen when you’re making other plans.