

Private Credit – The Final Reckoning (Last of a Series)

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Markets happen when you're making other plans. This was true again last week as confrontation with Iran, instead of caving US markets, supported them. Equity indices approached record highs, and the US dollar strengthened, at least for a time. We expect inflation and rate uncertainty will continue to weigh on investors.

Nevertheless, April's "sell America" motif has shifted. "We didn't sell anything," one experienced investor told *FT*'s Katie Martin. "The world is overweight US for a reason." That again puts the spotlight on what private markets can do in an ever-changing macro landscape.

At the bank-replacement end of the market, large asset managers see convergence as a trend. One example is the confluence of channels: retail and institutional. Then there's the blurring of assets: public and private. And finally, as distribution from managers to investors becomes more sophisticated, differences in asset liquidity should narrow as well.

But traditional middle market loans will not necessarily be subject to these same dynamics. As a recent article in Bloomberg highlighted, big bank trading desks struggle to make an active secondary market in illiquids. "There are not many names that are really trading in private credit," a top alts investment manager said, "and I think there's going to be a lot of constraints around that."

Finally, supply and demand are front and center with private credit investors. Is there too much money chasing too few deals? According to the American Investment Council, there are 14,200 private equity-owned companies in the US. That's less than 5% of the 300,000 middle market companies between \$10 million and \$1 billion in revenues, per JP Morgan. As you go up the food chain, larger corporates are accessing the non-bank market, size notwithstanding. But fewer mega-deals by number compared to midcaps to meet investor demand.

Beyond traditional corporates, significant national long-term needs, by one estimate as high as \$100 trillion, exist for infrastructure, power and utilities, data centers, defense, and energy transition. Match that deal supply with potential appetite from sources including US retirement funds, an estimated \$45 trillion.

Outside the US, the share of private capital versus total scale of national economies is trivial. For example, European GDP is \$24 trillion, yet privates only represent \$500 billion, or 2%. Compare that to the US, with \$25 trillion of privates in a \$30 trillion economy.

As private credit investors weigh opportunities in the asset class today, they need to consider how top managers are performing. As Tom Cruise stays at the top of his game after decades of exacting work, the best direct lenders walk the delicate balance between accessing deals and markets while remaining investor-centric in asset selection. The final reckoning for the asset class over the next decade will involve how well that balance is managed.