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The OG of Private Credit: You Are What You Eat

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In private credit, the character of your deal sourcing determines the destiny of your portfolio. How new transactions come in the door, and how you choose the best ones to close, drive your performance. Nothing else matters.

As we've learned in this series, private credit developed from the core middle market (CMM) (see *Chart of the Week*). This set the principles that became popular with issuers and investors alike: loans to small-to-medium-sized enterprises (SMEs) in diverse, defensive sectors backed by private equity sponsors with conservative terms and structures.

Select lenders stuck to this strategy even as enormous retail inflows reshaped the large end of the market. Terms there mimic bank loans and bonds – large exposures in momentum-driven sectors, high leverage, low spreads, and, critically, public style liquidity – elements contributing to private credit's current difficulties.

One friend, a veteran CLO manager, put it plainly: "You wanted to be a mature asset class? Congratulations, you're a mature asset class!" Fast growth brings scrutiny. Structures, narratives, and promises that worked in benign conditions are tested under macro pressures.

As Highpoint Private Credit has observed: "The distinction that matters is not whether a private credit portfolio has been touched by this transition, but how it was constructed in the first place." That framing applies as much to the liquidity question as it does to AI exposure. If you argue that private credit liquidity is converging with publics, investors are conditioned accordingly. Confronting the reality of 5% redemption limits had predictable results.

Bank loans and bonds are traded on secondary markets. This allows CLO managers to position portfolios to minimize risk. Large private loans don't trade, so managers, like those in the CMM, need to get it right going in. Even so, portfolio quality is governed by deal terms, which in large caps are less investor-friendly across the board than with CMM loans. That's because if they aren't borrower-friendly enough, banks can compete!

If smaller loans are less risky, why are liquid loan spreads historically tighter? The answer is that active credit traders, like public equity traders, value liquidity over almost everything. They accept lower yields and weaker structures knowing they can exit quickly if needed. If your goal is to own, not trade, CMM assets provide better returns and protection.

Like "Europe," "private credit" is a label for a collection of distinct entities with their own identities, legal jurisdictions, and value propositions. Investors must understand how valuations, structures, fund liquidity differ for each "nation" within the private credit "continent."

As private credit has moved from a niche to broadly held asset, investor education needs to catch up. Meeting that test is the biggest headwind in capital markets today.