Private credit

For global professional / qualified / Institutional clients and investors.

Key trends and insights

Strategic asset-backed approaches

Credit market evolution

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The business covers a broad range of investment strategies across the liquidity spectrum of the credit market. From an underlying asset perspective, these include corporate credit (including direct lending, distressed, and capital solutions), structured corporate credit (CLOs, SRT, etc.), commercial real estate credit, residential real estate credit, reinsurance and specialty finance (consumer loans, small business lending, litigation finance).

Navigating opportunities in 2025

As we move through 2025, the private credit market continues to evolve, presenting both opportunities and challenges for investors. This article aims to provide an in-depth look at what we believe to be the current landscape of private credit, highlighting key trends, risks, and strategies to consider for client portfolios.

While private credit is often associated with (corporate) direct lending, the market extends far beyond just the corporate segment of the market. It encompasses asset-backed strategies which include privately originated loans secured by financial or real assets as collateral. These strategies offer unique advantages, including higher interest rates due to their illiquidity premium and better structure for lenders due to the ability to negotiate more favorable loan terms.

Additionally, private credit generally tends to have low correlation with public equities and bonds, which can reduce overall portfolio risk and improve diversification. These factors have contributed to the substantial growth in private credit over the past decade, particularly in corporate credit strategies, and is expected to experience substantial growth over the next couple of years.

One of our key advantages as a multi-manager is our ability to partner with a diverse number of credit platforms and shift capital opportunistically to better risk/return opportunities without being tied to a specific strategy or sector. In fact, in recent years we have seen and capitalized on various shorter duration (2-3 years) privately originated credit opportunities, ranging from transitional land banking strategies to small business or consumer lending and bridge-to-agency CRE loans.

Key trends and insights in corporate lending

Although it is difficult to accurately determine the size of the private credit market, corporate direct lending is recognized as the most significant strategy within private credit. Below are some recent insights into this area.

The current environment, shaped by rising interest rates, has increased the cost of capital, making the environment more challenging for borrowers. However, private credit, being senior in the capital stack, has shown resilience during this period. Default rates in private markets have followed the trends seen in the broadly syndicated loan (BSL) market, with the Proskauer Index showing a 2.7% default rate in 4Q, which is lower than the default rates for High Yield Bonds and Leveraged Loans. When factoring in only payment breaches, bankruptcies, and distressed exchanges, the default rate drops to 1.2%.

Interest coverage ratios have dropped from 3.4x in 2021 to 1.7x, reflecting the shift to a more normalized rate environment. Although cash flows are under pressure compared to 3 years ago, EBITDA trends remain positive, and leverage levels continue to be relatively low. However, we've observed that smaller companies are facing great difficulties managing the effects of higher rates compared to their larger counterparts.

Payment-in-Kind (PIK) income, which represent less than 10% of income for covered direct lending Business Development Companies (BDCs), have been a focal point in the media recently. While an increase in PIK deals can indicate financial stress from some borrowers, it does not necessarily lead to higher defaults in all cases. While the PIK income as a percentage of investment income has increased for the BDC sector as a whole over the past three years, there is a reasonable amount of dispersion by BDC in terms of the trends of total PIK income for a given portfolio.

Strategic asset-backed approaches

Given the current market conditions, incorporating asset-backed short duration strategies can be beneficial and complimentary to existing private credit portfolios. These strategies have consistently demonstrated strong performance even in more challenging markets and can offer added downside protection through collateral and strong covenants.

For direct lending, we believe that vintage selection, and enhanced monitoring of PIK components and interest coverage ratios are essential for maintaining a well-balanced portfolio. This proactive approach helps in identifying potential risks early and allows for timely adjustments to the portfolio.

Final thoughts

Needless to say, credit will always be subject to the prevailing business cycle. However, we believe that private credit has the potential to be resilient and may play a stabilizing role in the financial system, especially during periods of market stress. In times of stress, lenders have multiple levers to pull in order to work with borrowers to manage through challenging environments. While these actions may temporarily reduce cash flows, they can also provide necessary relief to borrowers, securing them the time to recover and stabilize their businesses.

In addition, higher base rates provide higher cash flow and interest income to lenders compared to prior years. Concerns around private credit being a potential bubble or posing financial systemic risks are, in our opinion, overstated. However, we do emphasize the importance of a rigorous credit selection and manager due diligence. We further observe that private credit funds typically have lower leverage than traditional banks and exhibit better asset and liability matching, and often include protective gating features within their fund structures. This can offer more stability compared to the daily liquidity risks associated with banks. Therefore, we believe the rise of private credit could actually be a stabilizing factor for the financial system. However, it is crucial to ensure investors are well-informed about the liquidity and other associated risks when investing in private credit.

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