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"The Best Place to Be" (Last of a Series)

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The name George Laurer may not be familiar to our readers. But his invention certainly is. Mr. Laurer, who passed away two weeks ago at the age of 94, created the bar code.

The UPC is now a universal feature of consumer products, but prior to its adoption in 1974, cashiers had to manually input a description or item number. An early bulls-eye symbol smeared too easily. The first official test at an Ohio supermarket scanned a 10-pack of Wrigley's Juicy Fruit gum. It cost 67 cents.

Private credit, like automated check-out counters, seems a given today. And certainly the asset class has a longer history than generally recognized [link]. But its prominence in asset selection discussions among institutional investors has only taken off in recent years.

As we've outlined in this special series, private credit has been a darling of investors who saw its credibility as a consistent performer considerably strengthened coming out of the Great Recession. As the current cycle has lengthened, many of the same investors are questioning if private credit's benefits will continue to hold true.

Being a floating rate asset hasn't helped during the Fed's loosening phase this year. But just when fixed income fans were getting their mojo back, a combination of strong job reports and a possible China trade breakthrough has put further rate cuts on hold. Indeed, the likelihood of the next move being a rate *increase* is not out of the question.

Broader media outlets have taken turns swiping at "risky loans," with focus on covenant-lite, toppy borrower leverage, sky-high private equity valuations (see *Chart of the Week*), and the prevalence of weak single-B and triple-C assets.

All these elements are indeed features of a later-than-you-think cycle. Some have infected the large end of the middle market. But traditional midcap managers have largely avoided the worst leveraged loan excesses.

Yes, the cushions are wider between projected issuer performance and covenant tests. But at least there's a test. Leverage is up across the board, but remains lower for middle market deals. Purchase price multiples are rising, but so is the share of equity-to-capital in buyouts. Refinitiv LPC reports the number at 51%.

Rating agencies, leery of again underestimating defaults, have highlighted public loan ratings at the lower end of the risk spectrum. Despite that, Moody's "B3-or-worse" category stands at 12.9% – better than the long-term average of 14.8%.

Smaller companies, and their leveraged loans, aren't rated publicly. Direct lenders make their own credit judgments, and don't outsource underwriting. They don't trade the loans, so liquidity (and ratings driving institutional appetite) isn't needed.

All this suggests that, while market conditions evolve, private credit is no less relevant or attractive an asset class. Its adaptability in different cycles is a virtue itself. It's also the reason, as some would say, for investors today, it’s “the best place to be.”

From the Editor: The Lead Left will be on break until January 6th. To all of our readers, best wishes for a wonderful holiday season.