THE LEAD
https://theleadleft.com/all-ahead-full-private-credit-outlook-2022-first-of-a-series/

All Ahead Full: Private Credit Outlook 2022 (First of a Series)

THE LEAD | November 17, 2021

As investment managers run through the tape towards an incredibly productive 2021, many are now looking ahead to 2022. What will the new year bring?

Two years ago no one could have foreseen the imminent downturn or the agent that caused it. Nor one year ago were the course of the pandemic, vaccines, or 25% run of public equities predictable.

So we approach forecasts knowing variables are legion and interrelationships complex. But having witnessed remarkable private credit performance over the past 24 months, we feel comfortable highlighting key themes around the outlook for next year.

Activity levels. 2021 was characterized by the unleashing of pent-up private credit demand from issuers and investors. Some was a response to catching up from last year‘s stuck-at-home dynamics. But a lot was attributable to the virtues of the asset class highlighted by Covid: relative yield, less correlation and lower defaults. Will these benefits hold for next year, or weaken from competitive pressures?

Portfolio construction. Choosing the right sectors is always critical to manager performance, but particularly since 2020. Portfolios in consumer-facing businesses got swept into whatever path Covid sent them. B2B climbed the wall of infection worry and now frolics in a booming part of the economy. How will selectivity and diversification affect future defaults and recoveries?

Mega-tranche trend. Disintermediation to direct lenders away from broadly syndicated loans accelerated this year. The vehicles were $1 billion-plus unitranches, often with bond-like (cov-lite) covenants, and highly leveraged. The borrowers were large cap software buyouts sporting sky-high purchase price multiples. While financings were clubbed, as deal sizes grow will more paper be distributed? Will the buy-side start looking like the sell-side?

Inflation and interest rates. We’ve devoted a special series to inflation and written extensively about rate expectations. Now that the Fed’s intentions have firmed, the question is simple: Will the pandemic-induced spike in prices for goods and services ease as supply/demand forces rebalance, or has Covid fundamentally changed the true cost of things? And what will higher (or lower) growth do to interest rates?

Does ESG matter? While socially responsible investing has been around for centuries, its recent emergence as ESG has captured worldwide attention. As a driver in both investor and manager behavior in the asset management sphere, the trend has created both opportunities and challenges. Will political pressure surrounding ESG motivate real change or defensive box-checking – so-called “greenwashing” – that’s more form over substance?