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

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Thanksgiving week in the US capital markets is always a mixed blessing. A wonderful time for families and friends, celebration and gratitude. Yet it's also smack in the mad year-end rush. Everyone juggling deals and holiday get-togethers – and all running on fumes. Six weeks before, incredibly, it starts all over again.

What will deal activity look like in 2022? Hard to beat 2021. As our friends at S&P LCD noted last week, high-yield bond and leveraged loan issuance set a new annual high of $1 trillion. Also, junk bond AUM topped $1.5 trillion. And the total leverage finance market surpassed $3 trillion.

Finally, as our *Chart of the Week* depicts, combined syndicated and direct loans set a record $228 billion, topping 2007's BSL-only mark.

Several causes contributed to this run-up. There's recognition that broad swaths of the economy, particularly B2B industries, are in great shape. The Fed has vowed to keep rates at rock-bottom until employment returns to pre-Covid levels, and ideally until their bond-buying taper is concluded. Assuming inflation remains contained.

Fueling liquid credit volume is insatiable appetite from CLOs and retail funds. The former has seen record vehicle formation – over 320 launched totaling more than $160 billion – while the latter enjoyed $30 billion in cash inflows so far this year (vs. $20 billion in 2020).

As S&P's Rachelle Kakouris wrote this week: "Inflows often indicate an anticipation of rising rates, and the prospect of Fed policy hikes in 2022 and continued strength for credit fundamentals provide strong tailwinds to leveraged loans."

On the direct side private credit managers remain bullish for the upcoming year. A long-time capital markets pro at a large non-bank shop told us a huge driver is the timing of private equity fundraising. Sponsors had dry powder from 2019 and 2020 campaigns, but Covid impacted deployment. The pipeline of transactions grew and has been streaming out ever since.

When will deal flow normalize? There's plenty of backlog, many report, keeping buyers and finance partners busy through the first half of 2022. After that is more of a question mark.

"There's less confidence in the second half," another private credit manager said. "There are so many variables – interest rates, inflation, the mid-term elections. It will all come together then. But even if the Fed begins to tighten, that's a plus for floating rate assets."

Market hiccups are rarely bad for private credit since they generally lead to more favorable investor terms. On the flip side the status quo is good for LPs hoping to put capital to work quickly. Either way the outlook for continued strong activity in both public and private credit remains favorable for next year.