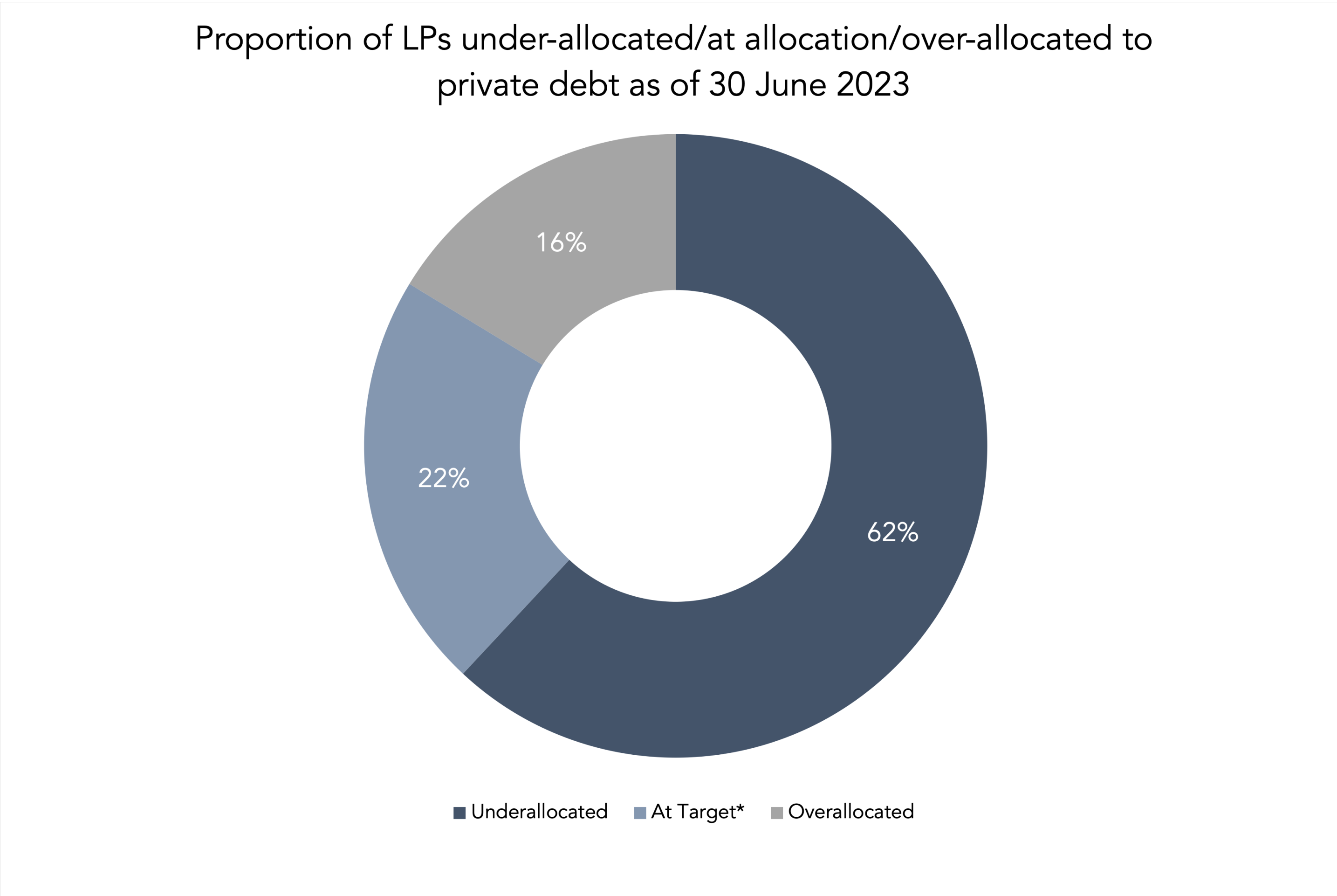
Is it really a golden age?

Private Debt Investor | September 14, 2023



Private credit has received plenty of acclaim as a well-positioned asset class for the times, but investors are not entirely void of concerns.

Private debt GPs, in common with GPs across all private markets, found fundraising to be a challenging task in the first half of 2023. Our data showed that just $84 billion was raised for private debt globally in the first half of this year – the lowest total for the equivalent period since 2016.
The major reason typically cited for this was the trauma experienced by public markets, leading to a denominator effect and tying investors' hands when it came to new allocations of any type – including private markets.

This was a practical issue that did not indicate investors had lost faith with private debt – to the contrary, surveys have consistently suggested that sentiment towards the asset class is more positive than ever. Moreover, as the chart above shows, LPs are generally under-allocated to private debt and keen to commit more capital to address this.

At our New York Forum last week, reference was made to a “golden age of private credit”. So what could possibly go wrong? Surely the fundraising faucet will be gushing before much longer? While that may be the case, investors at the event (which was under Chatham House rules) urged caution and pointed to a number of concerns that they feel should mitigate against complacency.

It was pointed out that while those lending on a floating-rate basis stand to benefit, rising rates would nonetheless pressurise borrowers and likely force up the default rate – at least one investor at the event feared to as much as 9 or 10 percent.

While it may indeed be a “golden age” for current vintages, there was a view that recent past vintages may struggle unless considerable underwriting discipline has been applied. “What happens when the music stops?” was the rhetorical question posed. It was also pointed out that a “higher for longer” rate environment would not sit well with the increased leverage that was liberally used when rates were at or near zero.

Concerns were also expressed around the more stringent demands from the SEC, private debt’s reputation as a laggard on the ESG front and fee charging in a more sober environment – should hurdle rates stay at the same level, for example? None of these worries are likely to derail the private debt train – but they should perhaps give pause for thought.

(Past performance is no guarantee of future results.)