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Letter from Stockholm

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Our recent visit to Sweden was the 12th country in our 2023 global private credit tour meeting clients and prospects. The Nordic region has always been strong in terms of investor interest and commitment to alternatives. Amid higher rates, that appetite has sharpened, as our colleagues at Arcmont (and Nuveen for real estate and green energy) who joined us attested.

As with all jurisdictions, it seems private credit has captured an increasing share of investor allocations. Private credit's traditional benefits – price stability, yield premiums, conservative structures, and portfolio diversification – are well understood. Now you can add double-digit all-in, unlevered yields as well as lower borrower leverage and even tighter structures.

Investors shared similar concerns about the impact of higher rates on borrower defaults. Common questions included how loan values are being affected, what's the default rate now compared to a year ago, and how are you dealing with troubled situations?

To step back, there are regional differences even within geographies that, to the untutored, should otherwise behave alike. We'd already seen this play out in the Middle East and Asia, for example, and we witnessed it again in the Nordics. Sweden, as with most of developed Europe, has a sophisticated banking system with commercial lending experience, including to the middle market. But throughout Europe the opportunity for direct lenders is growing.

Since 1960 the Swedish pension system has included so-called buffer funds. They account for about 20% of the total SEK 6 trillion AUM in the system. Designed to rebalance with demographic changes, the funds have increasingly diversified away from public equities and fixed income; a dynamic likely to accelerate following 2022's poor performance of those assets.

In 2020 fund reform allowed the "AP" funds that manage Sweden's pensions to increase their allocation to illiquids from 5% to 40%. This change allowed the funds to select from a wider range of strategies in alternatives, particularly unlisted assets, including real estate and infrastructure.

While the allowance for alts appears to be a dramatic modification, in practice it has been built out in a measured and thoughtful fashion. Sweden is historically more of a private equity-oriented country, but current return levels suggest more investors may be tempted to explore the benefits of private debt. That interest has historically been centered around insurance companies, thanks in part to its favorable treatment under the European Parliament's 2009 Solvency 2 directive.

Our conversations in Stockholm last month with a variety of institutional investors indicate their appetite has been whetted by significantly higher returns and more conservative risk parameters than was the case before central banks raised rates. Economic and market developments suggest those tailwinds will continue for the foreseeable future.