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Letter from the North Country

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Our friends at Bloomberg hit the market last week with a startling headline: *"Private Credit Faces Worst Reckoning Since 2008."* Just in time for us to speak to hundreds of institutional investors at conferences in Traverse City, Michigan, and Toronto about private credit's virtues.

We did find evidence of solid risk management. A recent Fitch report on Canadian pension funds said investment portfolios "will remain pressured by a challenging market backdrop, as the increased cost of debt and anticipated slower growth weigh on private asset valuations." The good news, the report went on, is that "the exceptionally strong liquidity of the funds provides sufficient cushion to absorb investment volatility and gives them flexibility to work through troubled investments as they are not forced sellers of assets."

Not to say Canada doesn't have headline risk. Some retail and wealth investors suffered losses with a handful of private debt shops embarking on dubious ventures. The result was private income funds with private credit or asset-backed lending and bridge loans being gated. Banks and other large platforms accordingly moved to more sizable managers. Committee members read these news articles and infer all private credit is risky.

Real estate, a stalwart for Canadian pensions, has had a tough slog of late leading to the internalization of some large subsidiaries in order to reduce costs and increase efficiencies. A move to diversify globally has spurred potential government intervention. The idea is to mandate a domestic investment bias in areas like infrastructure, especially for the Maple 8 – Canada's largest public pension plans, including CPPIP, PSP, Caisse Depot, AIMCO and Ontario Teachers – to support the economy.

As has been the case in other jurisdictions, slower private equity realizations have impeded Canadian institutions using sale proceeds from existing investments to fund other investments. The impact has been especially felt among family offices who favor larger PE allocations, thanks to lower capital gains tax treatment.

Consistent with remarks from conference panelists, pension plans are looking at more niche private credit strategies to achieve diversified return profiles. Examples include secondaries, NAV financing, ABL, distressed, and real estate debt. In part, this is because the sheer number of managers that name private credit as their focus makes it challenging to navigate.

That's a lot to sort between "well-managed managers and unnecessary risk-takers."