Letter from Down Under (Second of Two Parts)

THE LEAD | April 13, 2025

"Manager performance is the beta of private credit. The alpha is client support. Transparency and timeliness of information is critical, especially at the outset." – Australian investor.

As the Australian market has matured, it has geared a variety of private credit products to different investor types. These embrace institutions, family offices, high-net-worth, and ultra-high-net-worth individuals. And as the asset class has become more sophisticated globally, investment structures were developed to meet the diverse needs and requirements of LPs.

In that regard, private credit users find a menu of options available for liquidity (evergreen or closed-end), fees (flat or performance-based), fund size (SMAs vs. commingled), and diversity of capital (credit vs. equity). Any manager worth their salt must be equipped with all these to offer. This is particularly important as funds allocated years ago are now maturing, or whose value has diminished. These often need to be taken out to make room for new strategies.

During our conversations with a variety of firms in our visits to the region last month (pre-Liberation Day), one question kept recurring: should we as investors expect continued spread compression given all the money moving into direct lending?

As with other geographies, large players, often focused on larger deals, are coming into the Australian wealth market. Along the way, they are communicating that spreads across the direct lending continuum are compressing because, they say, of too much capital chasing too few deals. Being touted as an alternative for investors to put money to work in a less crowded space is asset backed finance. We heard this in many of meetings in Perth, Melbourne, and Sydney.

We'll take up the case for ABF in future issues. While we support portfolio diversification, consumer and trade finance receivables carry their own risks, particularly today. It is also not responsive to the supply/demand worries about direct lending underpinning the move.

We have often reported on the amount of private equity dry powder, close to $600 billion. Assuming a 50% loan to value, that translates to $1.2 trillion in transaction volume, a fraction of the approximately $150 billion of uncommitted capital available to direct lenders.

As our *Chart of the Week* suggests, the BSL/bank market is an open system. Capital flows daily from CLO vehicles and retail funds, in for good news, out for bad. And as is evident from Bloomberg's feature below, that makes secondary loan prices (and therefore, primary terms and availability) subject to headline news on recession risk, weak GDP or higher inflation, and rate worries. One bad stretch like we've had lately can sideline liquid loans for years.

The traditional middle market is a closed system. Demand is from long-term institutional capital via experienced managers, and supply from their PE partners, also with locked-in LP dollars. Spread compression is therefore much more muted, even with relatively strong LBO activity. Indeed, as we laid out in our Australian conversations, with higher volatility on the horizon, a strong case can be made for spread widening in private credit this year.