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Private Credit – The Final Reckoning (First of a Series)

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Moviegoers know that Tom Cruise "does his own stunts." We always assumed this mostly meant riding motorcycles fast. And even watching his *Mission Impossible* and *Top Gun* acrobatics over the years, we figured riskier sequences involved some kind of green screen technology. Until we saw practice runs for his motorcycle jump on the latest *MI* thriller.

This astounding daredevil performance (Cruise did six takes to get the perfect shot) was not even the highlight stunt of the film. Yet it shows how with repetition comes reputation. In the world of private credit, experienced managers have been executing tricky maneuvers for years, with a select few doing so before and through the GFC. Practicing the minutest details of sound underwriting and careful portfolio construction eventually pays off in premium track records.

Last week we attended Moody's first New York private credit conference – *Credit Frontiers 2025*. Panelists see growth, convergence, and risk as major themes for the asset class. Other dynamics include liquidity, leverage and transparency. Convergence means partnerships with significant asset users such as insurance companies leading to more innovations. It also suggests private markets will look a lot more like public markets, and vice-versa.

While private credit is expected to grow from $1.7 trillion to $3 trillion over the next few years, other factors could cause it to expand even further. Capital is still flowing out of banks into private markets, insurance companies and retail. ABF is the latest asset class to explore homes in private hands.

Panelists spoke in detail about the diverse ecosystem called private credit. Besides direct lending, it's what is sitting on bank balance sheets, a majority of which is actually investment grade, including corporate credit, mortgages, and ABS. That translates to $40 trillion in potential private markets.

After 15 years of zero rates (2008-2022) it was natural that demand for yield drove income generating assets, particularly since rates have gone up 500 bps since 2022. This is helpful when the cost of capital for pensions, endowments, and other retirement funds is 6-7%.

It's also important to understand that leverage doesn't increase going from public markets to private. Compare bank leverage of 20x to private credit CLOs of 3-6x or private fund leverage of 1-2x. Post the GFC, the capital charge imposed by regulators on middle market leveraged loans was onerous for banks, so many private assets – not just direct lending, but aviation, housing, shipping – are transitioning. Capital can get misallocated to certain sectors that create waves of defaults and losses. Those under pressure today include healthcare, energy, and real estate.