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# Swiss Army Knife of Capital (Part Two)

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Beyond yield, advisors and direct contribution (DC) plans look to private credit for diversification and deployment.

These goals are not unrelated. Quantity over quality, particularly at the higher end of the middle market or the large cap space, can result in chunky portfolio positions. These can add significantly to risk. A default or loss in a higher concentrated borrower can hurt returns, especially in a private credit strategy that delivers consistent income streams.

It's a balance. The more investors in a fund, the broader the allocation across those investors, and the less concentrated the positions. As the portfolio grows, every investor you add keeps pace with that target, and allows existing clients to maintain their level of deployment.

Diversification is an essential part of successful credit portfolio management. A failure of any one position, if small enough, has a minimal impact on investor returns. Discipline in this area is particularly critical in the early stages of portfolio building. Until a critical number of portfolio companies is reached, even relatively small, troubled positions could hurt performance.

Experienced portfolio managers use a variety of screening factors to improve diversification beyond position size. These include industries (and sub-sectors within an industry), borrower size, regulatory risk, and (for private equity-backed companies) by sponsor. Ongoing portfolio analysis ensures concentrations in any area are scrutinized and adjusted for market conditions.

Alternatives are less correlated to bonds and stocks, which helps reduce portfolio volatility, improve risk-adjusted returns, and provide downside protection. This is particularly true in US-centric middle market private credit where the impact of global macro risks is more muted.

Deployment is one of the most important considerations across a variety of institutional and wealth clients. If I invest my money with you, how quickly can you put it to work?

It may seem obvious that income and yield benefits from an asset class are moot if the assets aren't originated. But industry analysts discussing the relative virtues of public and private credit often fail to mention that BSL and bond issuance depends on buyer appetite. The rate hikes beginning in 2022 sidelined those markets. Private credit is available to issuers and investors regardless of markets, cycles, geopolitical or headline shocks.

A recent client survey we conducted showed 90% of respondents intended to keep or increase their allocation to private credit, regardless of interest rate direction. But they are keenly attuned to the popularity of the asset class and how much dry powder is coming into the space.

Last year we highlighted investing discipline is just the beginning. Having a deal sourcing model that keeps pace with fundraising is essential to successfully balancing deployment and diversification.