Top 10 with…

Joseph Sciortino on private credit | **June 2022**

Key facts:

2021

MMPC business established

USD ~2.7tn

projected global private debt AuM by 2026[1]

15 years

experience investing in private credit[2]

4.8%

net annualized IRR of private debt fund over next 3 years[1]

"Our dedicated private credit team has been active in the complex world of lending for over 15 years developing a knowledge base and network unrivaled among allocators."

Joseph Sciortino, Head Multi-Managers Private Credit

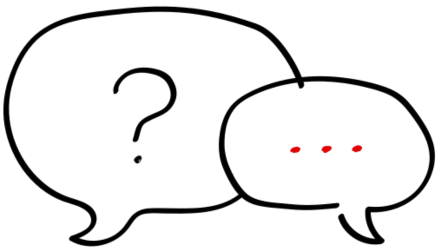
We've narrowed it down to…

Private credit as an asset class has flourished since the global financial crisis. In this period, it has grown from strength to strength with alternative lenders stepping in to fill the void left by banks who have de-risked their balance sheets amidst regulatory pressures.

Joe Sciortino, Head of Multi-Managers Private Credit explains the key trends in the credit market, how investors are benefiting from them and what differentiates the business from other players in this space.

Source: **1** Preqin; 2022. The net annualized IRR of private debt fund over next 3 years ending March 2021.
2 UBS Asset Management; May 2022. Past performance is not indicative for future results. For indicative purpose only.

1 How do you define private credit?

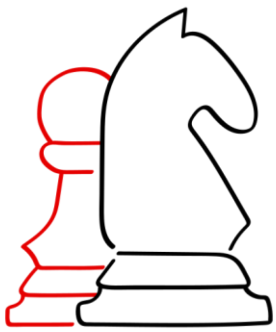


When most investors hear of private credit, they tend to think of closed-end funds with a 5-10 year time frame that invest in the corporate credit sector employing either a direct lending or distressed strategy. However, the world of credit is much wider and deeper than these strategies. Access to this broader universe can provide investors with a more robust yield profile and a more attractive risk/reward.

Here at UBS, the breadth of our experienced team allows us to invest across a wider range of sectors including residential and commercial real estate, structured credit and specialty lending. UBS has one of the largest and most experienced multi-manager real estate teams in the world opening up access and expertise to real estate debt strategies globally.

Our dedicated private credit team at UBS Asset Management has been active in the complex world of structured credit for over 15 years, developing a knowledge base and network unrivaled among allocators. Specialty lending is a broad universe that includes many asset-backed markets that overlap with the structured credit market, such as aircraft, consumer, transportation, small-business lending, and trade finance. We include all of these areas as part of our private credit offering and are uniquely positioned to underwrite a broader universe of investment strategies.

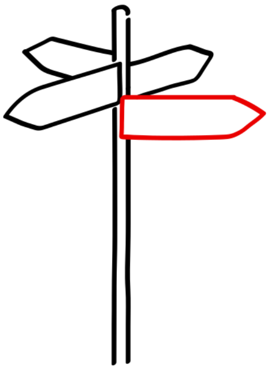
2 What role can private credit play in an investor's portfolio?



The breadth of the private credit universe provides investors with the opportunity to differentiate from traditional credit markets while solving for the clients preferred outcome. Some investors may be seeking uncorrelated yields with a low volatility profile, while others may be looking for increased returns with less concern for volatility and correlation.
We classify investments into two types of strategies: yield and total return.

Regardless of the type of exposure, the objective of private credit is to provide a higher return at a comparable or lower level of risk relative to the public credit markets. Our business breaks down investment strategies across four portfolio areas that define the mix of yield, total return and duration:
core income, short duration, opportunistic and hybrid.

3 How do you determine what areas to invest?

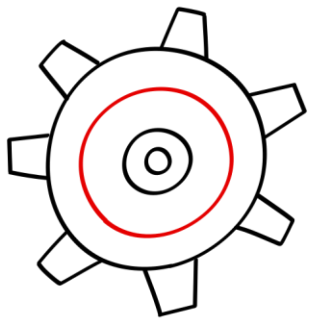


Our team employs a mosaic approach to investing that produces top-down views that guide our bottom-up research. We actively gather information on the market and manager level. From a market perspective, our specialists actively research credit markets across corporate, residential real estate, commercial real estate, structured credit and insurance sectors globally.

The team will develop themes around mis-pricings, volatility, regulatory changes or shifting capital flows that drive the diligence process. Concurrently, the investment team collects data from their interaction with investment managers around the world. We believe our primary edge is sourcing. Further to this, we believe we have more touchpoints with managers, originators and other players in the market than any other investor given our size, scale and breath of investment team. The team actively meets with hundreds of managers to discuss markets, investment themes, and co-investment opportunities every year.

While other groups may cover the top 50 private credit managers executing direct lending and distressed strategies, our team utilizes our broad sourcing capabilities to obtain and compare data points across a wider spectrum of strategies. This information is shared among the team, aggregated weekly and discussed as part of the monthly credit strategy meeting where we debate the merits of areas for investment and determine where to focus our efforts.

4 What areas of the market are you focused on today?



Depending on the client needs, we generally focus on one or two basic themes within each portfolio strategy. For core income, we favor lending strategies in Europe over the US. This is because Europe has a larger middle market relative to the US, and greater segmentation by geography which results in less competition and greater premium per unit of risk. However, in our short duration private credit strategy, we focus on the US consumer and real estate, and more specifically housing.

Post-global financial crisis, we underbuilt housing in the US for 9 years. Coupled with migration there is a supply/demand imbalance across the southern part of the country. Our more opportunistic private credit allocations are selectively invested in areas of distressed recovering from the pandemic, i.e. European hospitality, and strategies that can benefit from volatility in credit markets, such as Collateralized Loan Obligations (CLO).

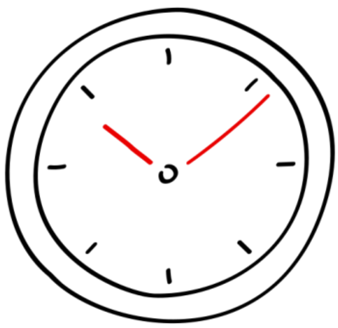
5 Why invest in private credit with a multi-manager?

Opportunities within the credit market ebbs and flows by sector, geography and profile. An open architecture platform is able to shift the focus of each vintage, taking advantage of what the market offers without being wedded to any particular strategy.

For example, today, we could be focused on housing, but tomorrow this could shift toward corporate distressed, or European structured credit. We also have the luxury of being able to partner with specialists that have deep expertise in niche strategies or specific sectors.

In this regard, we recently partnered with a group that is uniquely positioned to provide growth financing to US agricultural cooperatives. This strategy provides several hundred basis points of excess yield over the average middle market direct lending strategy while arguably taking less risk. This is not something a multi-strategy credit fund could access. However, just as important, we aren't committed to that strategy forever. If the market shifts, we can let our exposure run off and shift our focus, too.

6 How has the Multi-Managers business evolved over time?



As investors, we are much more active than before the 2008 global financial crisis. At UBS, we have the luxury of scale, and we use it to create customized exposure, negotiate terms and re-write documents to benefit our clients. Our focus is utilizing the value of the open-architecture platform to create attractive exposure for our portfolios without diluting them with non-optimal strategies or over-diversification. The focus is creating better outcomes for our clients through the tools we have in place.

7

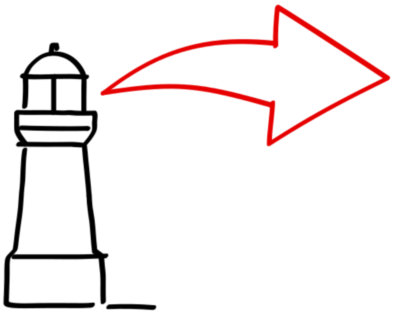
Where do you think investors are making mistakes?

Many investors only focus on the biggest managers. I guess their thinking is “XYZ manager has grown with allocations from large endowments because they are the best”. Or maybe they just don’t want to sift through dozens of funds to find one investment. But we have to consider that markets are finite and size can be a big disadvantage.

Investors also don’t take the time to really breakdown how IRRs are created. Is the manager using more leverage, or investing in weaker credits or is there really alpha through the manager’s underwriting, origination or asset management capabilities? Our team has vetted over 1,200 private credit funds in the past 5 years. We pride ourselves on the depth and breadth of our research coverage.

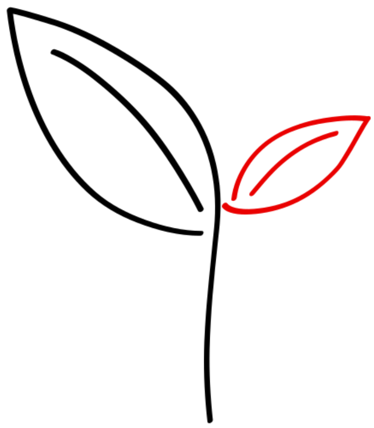
8

What risks are you really taking with private credit?



I think many investors solely focus on credit risk underestimating extension risk. They ignore how there capital can get stuck in investments for years, eroding the IRR over time and leading to disappointing results.

9 How does ESG come into play?



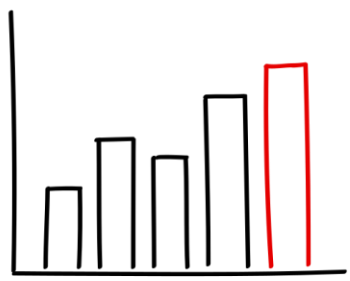
Increasingly, ESG has become an important factor investors are attempting to solve for. The rules for ESG are still evolving however, and so is the consensus on the approach and the reporting.

As an investor, we often hear that providers of finance are unable to influence ESG matters because 'they don't own the equity', however we believe that there is important role for ESG-considerate lending.

UBS takes a conservative approach to ESG and prides itself with providing clients with products that are at the forefront of the ESG movement. We are pushing the limits and setting the tone for the entire market in private credit with our new European Core Income strategy that looks to incorporate forms of ESG incentivization into its strategy.

10 What areas are you growing in your business?

As I mentioned earlier, we are launching a new core income strategy focused on European markets with a strong ESG overlay. We believe this will be a great solution for investors searching for an attractive yield that is floating rate and uncorrelated to traditional credit markets. We continue to grow our short duration strategy focused on specialty lending and real estate debt. Additionally, our ability to offer custom solutions to larger clients has been a core driver of growth for our multi-managers platform over the past decade. We look to continue this trend in private credit.



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