



Private credit and direct lending strategies remain a long-term source of income, diversifier of returns, and potential improver of a portfolio's risk-return characteristics. (UBS)

# Where are the opportunities in private credit?

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**Headlines suggest private credit investors need to pay closer attention to borrower stress, choose the right managers, and understand the role of private debt in the wider economy.**

CIO believes the asset class still offers opportunities to generate fresh sources of portfolio income. We favor senior upper-middle-market and sponsor-backed loans and top-tier managers with experience in stress environments. Investors must be aware of private credit's unique risks.

**Headlines underscore pockets of challenge in private credit.**

- Overall default rates rose to 2.7% in the second quarter of 2024, up from 1.8% in the first quarter, according to Proskauer.
- Central banks and regulators are scrutinizing private credit to monitor and avoid potential systemic shocks.

**But we believe the asset class offers continued long-term opportunity to diversified investors.**

- The Cliffwater Direct Lending Index returned 5.7% in the first half of 2024, outperforming US leveraged loans (4.4%) and US high yield (2.6%).
- Private credit managers tend to favor senior secured debt, which is among the most insulated from company losses.
- Current yields for private loans are around 11%, offering a favorable yield pickup compared to US leveraged loans and high yield, at 130bps and 310bps, respectively, as of June 2024.

**So investors who are selective in private credit should be better positioned to navigate a more complex second half.**

- We continue to see a place for private credit and direct lending strategies as a source of income in well-diversified portfolios.
- Investors should focus on top-tier managers with experience deploying capital in stress environments, hold well-diversified portfolios, and have strict underwriting principles.
- Investors should consider the risks inherent to private markets before investing, including illiquidity, long lockup periods, leverage, and over-concentration.

**Did you know?**

- New direct lending volumes for sponsor-backed borrowers rose to roughly USD 50bn in the second quarter of 2024, the highest level since 2022, according to Pitchbook LCD data.
- Europe's private debt market has grown fourfold since 2015 to roughly USD 460bn in AUM in 2023.

**Investment view**

Private credit continues to offer attractive opportunities, in our view, particularly in senior upper-middle-market and sponsor-backed loans. Private credit typically exhibits lower volatility than conventional credit with similar ratings, resulting in more moderate reactions to public market volatility and changes in risk sentiment. Private credit and direct lending strategies remain a long-term source of income, diversifier of returns, and potential improver of a portfolio's risk-return characteristics, in our view.

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