

Why Private Credit

In an environment shaped by ongoing market shifts, positioning portfolios for both robust income and resilience is crucial. Private credit stands out as a strategic option for investors navigating today's landscape.



KEY TAKEAWAYS

- Public markets have started 2026 with constructive growth and stable inflation, but valuations remain elevated, and short term volatility is likely.
- Private credit may deliver higher yields via mainly senior, floating rate loans, with returns less tied to public-market pricing.
- Risks include credit quality, strong covenants, and manager skill. Rigorous underwriting and portfolio management are vital.

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Today's Investment Landscape

Entering 2026, markets are navigating an unusual mix of supportive fundamentals and tight pricing. U.S. growth has remained resilient, and inflation pressures have been relatively stable, while credit spreads in public markets have remained narrow. All these are signals that corporate fundamentals remain broadly healthy. At the same time, equity valuations are

above longer term averages, leaving markets more sensitive to surprise changes in rates, earnings, or geopolitics.

For allocators, this backdrop elevates two objectives: (1) maintain diversification and downside resilience, and (2) seek durable sources of income that do not rely solely on long-duration bond exposure. Private credit can help address both when implemented with discipline.



What Private Credit Is and How It Earns Returns

Private credit refers to loans originated and held by non bank lenders outside the public bond and broadly syndicated loan markets. The core strategy is direct lending: most commonly, first lien, senior secured loans to middle market companies, often with floating rate coupons that reset off a short term benchmark such as SOFR.

Return components typically include:

- **Base rate:** The floating benchmark that resets periodically.
- **Credit spread:** Contractual compensation for borrower risk.
- **Fees and call protection:** Upfront fees and other structural economics that can enhance total return.

Because most direct loans are floating-rate, private credit has a relatively short duration. This can be helpful when investors want income that is less sensitive to rising rates than traditional fixed rate bonds.

Why Private Credit Can Be Compelling Now

- **Higher starting income potential:** Private credit has historically delivered a yield premium versus comparable public credit, reflecting compensation for illiquidity, complexity, and bespoke structuring.
- **Floating rate structure:** Income adjusts as base rates move, supporting total return in environments where short term rates remain meaningfully above pre pandemic levels.
- **Contractual protections and seniority:** Many loans are senior secured and sit at the top of the borrower's capital structure, with collateral and documentation designed to provide lender control in adverse scenarios.
- **Smoother reported volatility:** Private loans are typically valued periodically rather than traded daily. While economic risk remains, the return path is often less dominated by public-market price swings.

Key Risks and How to Manage

Private credit's higher income potential comes from taking on risks that must be actively managed. In our view, outcomes are driven less by the label "private credit" and more by underwriting discipline, documentation quality, and a manager's workout capabilities.

- **Borrower fundamentals:** We assess the financial strength of borrowers by analyzing their leverage (the amount of debt relative



Private credit is a complement to traditional fixed income, not a replacement for high-quality bonds.

to equity), interest coverage (ability to service debt), free cash flow (cash generated after expenses), and resilience of their business models throughout economic cycles. Weak fundamentals can increase the risk of default, potentially leading to losses.

- **Structure and covenants:** Strong lender protections such as clear collateral, meaningful covenants, and safeguards against borrower-friendly restructurings are essential. Weak structures or loose covenants can expose lenders to greater loss risk if a borrower faces difficulties, as they offer fewer tools to mitigate losses.

- **Vintage and competition:** In highly competitive environments, spreads can compress, increasing risk, and covenants can weaken, reducing lender protections. Selectivity matters to mitigate these risks.
- **Default and loss severity:** The default rate is one measure, but what ultimately matters is the loss experienced after a default. Seniority, collateral backing, and how a manager intervenes during distress are key factors that influence final loss amounts for investors.
- **Liquidity and portfolio fit:** Private credit investments cannot be quickly sold and may tie up capital for longer periods compared to public credit. Allocations should be matched to the investor's cash needs and time horizon to avoid forced sales or liquidity mismatches.

Role in a Diversified Portfolio

Private credit is often positioned as a complement to traditional fixed income and liquid credit — not a replacement for high quality bonds that provide liquidity and ballast in risk off periods. In balanced portfolios, it can serve as:

- An income-oriented allocation with contractual cash flows.
- A diversifier within credit, driven more by idiosyncratic company outcomes than public-market technicals.
- A potential stabilizer of overall return patterns, given periodic (not daily) pricing, while still requiring careful risk management.

Implementation Considerations

Investors access private credit through several structures (e.g., drawdown funds, private BDCs, interval and other evergreen vehicles). Structure selection should reflect liquidity needs, tax considerations, and the desired exposure (core direct lending vs. opportunistic credit).

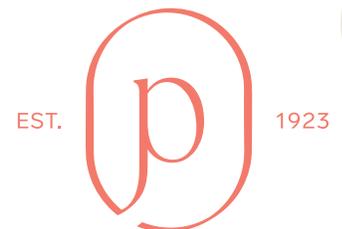
We emphasize manager selection because dispersion is wide.

- Underwriting and sourcing: Repeatable origination channels and conservative credit standards
- Portfolio construction: Diversification across issuers, industries, and sponsors; prudent position sizing
- Active monitoring and workouts: Demonstrated ability to negotiate amendments, restructure when needed, and protect recoveries
- Transparency and alignment: Clear reporting, sensible fees, and alignment of incentives

In Conclusion

In today's environment of constructive growth, stable inflation, and tighter public-market pricing, private credit can provide a practical way to seek higher income and broaden diversification within fixed income. Consider incorporating private credit into your portfolio, ensuring the allocation is appropriately sized, the structure aligns with liquidity needs, and the manager has proven underwriting and workout capabilities.

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