Positive Outlook for Private Debt

We expect a robust deal market in 2025 driven by falling rates and higher M&A volumes.

Spreads for new private debt originations contracted for the sixth consecutive time in the third quarter, pressured by increased competition for deals. Continued pressure on spreads is a factor that underscores the need for a focus on downside protections, tight documentation, and high selectivity. We are encouraged by meaningfully higher M&A activity in the third quarter and expect to see a robust deal market in 2025 driven by the prospect of falling rates and higher M&A volumes.

Sector Commentary

- Spread compression continues to manifest across all deal sizes, driven by increased competition for deals. While private debt spreads have tightened, levels remain attractive relative to the broadly syndicated market.
- Covenant-lite deals are on the rise. Nearly 24 percent of all direct lender deal activity reviewed lacked traditional financial maintenance covenants, compared to just 12 percent for the entirety of 2023. We remain focused on sourcing deals with downside protections for our clients.
- We anticipate increased dispersion of returns among private credit managers, largely due to higher rates and default levels, highlighting the importance of strong credit selection.
- Leveraged buyout volume increased in the third quarter amid optimism about Fed policy, more agreement among sponsors on valuations, and continued pressure to return capital to investors.

Investment Themes

- Private credit spreads offer an attractive yield and illiquidity premium against the broadly syndicated loan (BSL) market on both an absolute and risk-adjusted basis. Spreads for new private credit originations have moved largely in line with the BSL market.
- We favor the upper middle market and emphasize the importance of originating deals with defensively positioned companies in well-defined market niches, with sustainable profitability and cash flow, experienced management, and strong managerial controls.
- We continue to avoid commoditized deals with falling spreads, weaker documents, and increased flexibility for borrowers that in our view do not offer a compelling risk-adjusted return.
- We remain constructive on private credit, especially as the supply of deals increases, fueled by M&A activity. We believe that there is attractive relative value within certain industries and pockets that are perhaps overlooked, such as non-sponsored deals.

By Joe McCurdy, Joe Bowen, Mark Pridmore, and Zac Huwald

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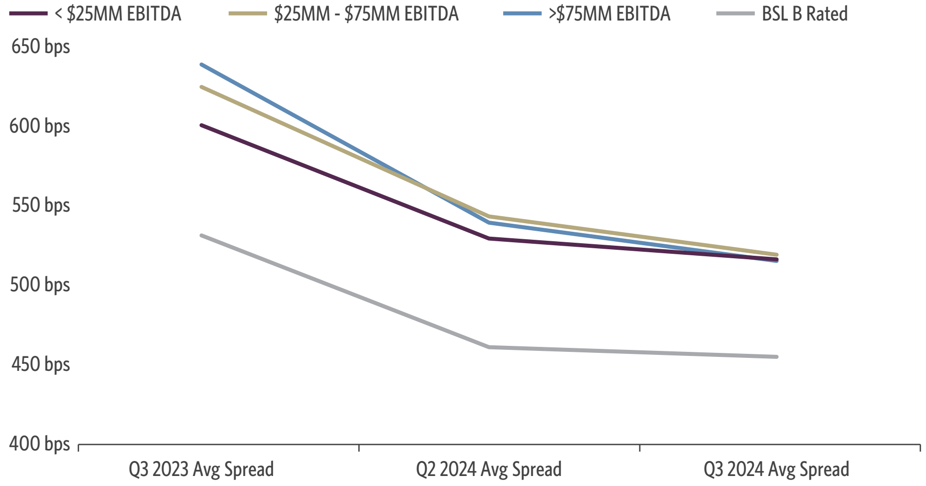
Private Credit Spreads Offer an Attractive Yield Premium Against the BSL Market



Source: Guggenheim Investments, Wells Fargo. Data as of 9.30.2024. BSL B-Rated Spread: Credit Suisse Liquid Leveraged Loan Index Discount Margin 3 Year Single B.

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