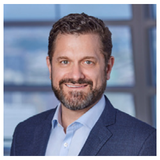
PODCAST TRANSCRIPT

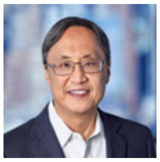
October 2025

LORD ABBETT®

The Active Investor: Dimensions of Private Credit and Direct Lending



Brian Foerster, CFA
Managing Director, Product Management



Vincent Lu
Partner, Portfolio Manager - Private Credit

In this podcast, Lord Abbett Portfolio Manager Vince Lu discusses the evolution and growth of the asset class--and addresses questions about whether a "bubble" is forming in the private credit market.

BRIAN FOERSTER: This is Brian Foerster, and welcome to *The Active Investor* podcast, our monthly look at what's happening across asset management, and how Lord Abbett's investment leaders are viewing today's markets, as well as the strategies that can help investors navigate different challenges and opportunities.

In this episode, we're digging into the private credit space, how it's evolved, the factors behind its strong growth, and some key considerations for today's investors in navigating the asset class. And we have the perfect guest for today's episode, Vince Lu, who's a partner and portfolio manager here at Lord Abbett. Vince has a tremendous background in private credit direct lending, which we'll get into in a bit. And he plays a central role in evaluating private market opportunities for our direct lending strategies. So welcome, Vince.

VINCENT LU: Great to be here. Thanks for having me.

FOERSTER: Great to have you. So, after the strong growth in private credit, many investors today are adding to their allocations, or for some, making their first investment in private credit, and specifically direct lending. And you've had sort of a front row seat to that growth. So maybe talk a little bit about how you first got into investing, and what's led you to private credit.

LU: Sure. So, I started my career in private credit about 25 years ago, as one of the original members of Blackstone's private credit team when the firm first started the business back in the early 2000s. At the time, I thought it was a pretty interesting opportunity: Raise a dedicated private credit fund. Back then it was mezzanine finance, where that consisted of committed capital that you could draw down patiently over time as you found attractive investment opportunities. We were pretty confident that we could deliver excess returns to investors, because the competitive environment for private credit back then was very limited, with only a handful of competitors. And we knew that with access to private-style information and management teams, we could deliver terrific returns for our investors. What I didn't know at the time was that I was about to catch lightning in a bottle and experience this period of incredible growth within private credit over the next 20 or so years, while I was working on all eight of the firm's flagship private credit funds across direct lending, mezzanine finance, and opportunistic credit.

FOERSTER: Okay.

LU: Over the last two years, I was fortunate enough to join Lord Abbett, to help build out the private credit effort as part of the firm's historic leveraged credit franchise, joining my former colleague and friend from Blackstone, Steve Kuppenheimer, who had been hired to build out private capital here at the firm. It's an amazing opportunity, once again. And we're happy to report that things are off to a great start.

FOERSTER: That's great. You used the words "back then" a couple times in that response. So maybe talk a little bit more about what has changed, how the private credit space has evolved. I know a lot certainly changed after the Global Financial Crisis [GFC]. But maybe give your view on how that evolution has unfolded.

LU: Sure. Absolutely. And so, when I started my private credit career, private credit was really just a niche strategy with a small institutional following. In fact, the first fund that I worked on back in 2000 was a $1 billion mezzanine fund, with just 20 institutional investors. Fast forward to today, and the asset class has absolutely exploded. Private credit is now a $1.7 trillion market.

FOERSTER: Right.

LU: And it represents around a third of all of leveraged credit, when you combine it with the traditional high yield and broadly syndicated loan markets. Private credit has gone from simply providing junior debt in middle market buyouts, to now providing a full range of private financing solutions up and down the capital structure and has been taking market share away from the traditional market, particularly with larger borrowers.

So, you might then ask, “Well, what’s driven all this growth in the asset class?” From a borrower perspective, in the right situations, private solutions can be a really attractive opportunity, alternative to traditional financing sources. When you’re looking for speed and certainty of financing, you’re looking for a tailored financing solution that meets your specific needs, if you’re looking for increased confidentiality, or simply you’re looking for a closer working relationship with your lenders--that’s driven a lot of demand from the borrower side for private credit. And we see that continuing in the future.

From the investor perspective, there’s been a similar increase in demand for the asset class. And that’s really tied to the strong performance through [market and economic] cycles. It probably comes as no surprise to you that when you combine higher rates, as well as lower leverage, better investor protections, and greater due diligence access, four things that are all tied into private credit, that the asset class will [potentially] outperform over time.

And we’ve seen that in this market, with private wealth, and individual investors, as retail-friendly vehicles of lowered investment minimums, simplified tax reporting, and has provided greater investor liquidity has caused a lot of interest from that segment of the population as well.

FOERSTER: Right.

LU: And so when I look back at the evolution of private credit over the past two decades, what started off as really a specialized financing tool with a small investor following has now become a mainstream credit product across the leveraged finance ecosystem, with a broad array of investors, ranging from very large, sophisticated institutions all the way down to individual investors.

FOERSTER: Right. Yeah. A big democratization is happening right across alternatives, and particularly in direct lending, and across private credit. With evolution, though, also comes adaptation. And what have you seen in your time at Lord Abbett in how the firm has sort of adapted to these changes over time?

LU: So as an asset manager with a 96-year history, $240 billion of assets under management [approx., as of October 15, 2025], and real specialized expertise in leveraged credit on the public side, our firm, Lord Abbett has been adapting alongside these changes as well. We introduced a private credit capability around two years ago, which is a logical extension of the firm’s 50-year heritage of excellence in leveraged credit investing.

And we built out a 17-member team, an absolutely terrific team, dedicated to our private credit effort. At the same time, we’ve launched investor-friendly vehicles, tailored to our clients’ needs, ranging from rated note capital efficient structures for insurance clients, along with semi-liquid structures for our private wealth and individual investors.

So, as we sit here today, we couldn’t be more excited about the opportunity within private credit. We think we’re in a unique position, at the cross-section of the public and private credit markets. And we think as these markets continue to converge, which is one of the big mega-themes we see playing out within private credit over the next couple of years, we think our firm is very well positioned to provide differentiated investment solutions to our clients.

FOERSTER: Okay. Well, you definitely sound I would say bullish on private credit. Optimistic, let’s put it that way. You do hear some criticisms, though. You talked about some stats that you mentioned, that it went from sort of being a small, niche area of the market to now being a third of the leveraged credit space.

A lot of that happened fairly quickly, especially after the GFC. There are some who might use the term “bubble.” Or they’re concerned. Is it becoming a bubble? How do you respond to that question, when it comes up, talking to prospects and clients?

LU: So, Brian, that’s an excellent question. And if you were to go back and take a look at the performance of middle-market direct lending, which is a core strategy within private credit, what you’ll see is remarkable stability and consistency of performance over a 20-year period.

It doesn’t matter if you’re in an environment of economic growth or economic weakness, whether you have an environment of high interest rates or low interest rates. The asset class has delivered over time.

If you were to peel back the onion even further to actually look at the data in detail, what you’d see are two things. First, you’d see very stable 10% yield across the asset class over a long period of time. But second, probably more importantly, what you’d see is the resiliency of the asset class even during periods of economic stress. During the Great Financial Crisis, and during the COVID pandemic, the asset class generated a positive mid-single digit return.

And that’s because most of the investments are both senior and secured in the capital structure and provide excellent downside protection. It’s part of the reason we like to call direct lending an excellent all-weather strategy, and why it’s become a core holding amongst many large, sophisticated institutional investors, such as state and corporate pension plans, large sovereign wealth funds, as well as large insurance companies. And as we talked about a little earlier, also into the private wealth and individual investor market.

So, with that as a backdrop, we don’t see a bubble forming within the private credit market, given the stability of the asset class. Where we do see the potential risk of a bubble is at the individual manager level, as the influx of capital has made the market that much more competitive, and has put a lot of pressure on individual managers to be able to deploy effectively in a more competitive environment.

FOERSTER: I see. So, let’s talk a little bit more about those managers that you say are sort of getting into the space. What should investors really look for in private credit managers?

LU: So, Brian, there are certainly a lot of managers out there, and a lot of choices for investors. So, if we were advising an investor what to look for, we would tell them to look at three key things. First, real history and experience within leveraged credit, time-tested through multiple cycles.

Not a manager that has 10 to 12 years of experience that has yet to see a credit cycle, but one with 25-plus years with the proven skills to be able to navigate through trickier environments, ideally with the deep credit analysis skills required to be successful.

Number two, we would say find a manager that has broad access to all parts of the private credit market. What we mean by that is access to the core middle market, the upper middle market, and the lower middle market, so that you can maximize the number of opportunities that you can look at, and be selective in making new investments, while at the same time, being able to dynamically shift to where there's the best risk-return in the market at any given time.

To give you a real-time example of that, we set up our platform here to be able to access all parts of the market. And we've begun to pivot away modestly from the lower end of the market, where the 150 basis-point historical yield premium that you could get has largely disappeared. And we're now repositioning ourselves to focus a little bit more on the core and the upper middle market where we think the better risk-return [opportunity] exists.

FOERSTER: I see.

LU: And then finally, I would wrap it up with one other thing, which is make sure you find a manager with both the right amount of capital as well as investing at the right time. And what I mean by that in terms of right amount of capital, a manager who has sized their capital base not based upon what they can raise, but rather what they can deploy effectively.

So, they're not forced to chase the market and not forced to stretch on credit if you've raised too much capital. And what I mean by the right time of the market, we do believe that vintage does matter, and that deals set up post-COVID in a higher base rate environment and safer capital structures will outperform those managers that had been deploying a lot of capital back in 2020 through 2022. And we're beginning to see some of those vintage-related issues surface.

So, putting it all together, our view is look for three things: Deep investment expertise, broad access to all parts of the market, and then finally, a properly sized capital base investing at the right time. And if you do that, you can find a manager that can outperform the market. And we, of course, would tell you we here at Lord Abbett are one of the few managers out there that check all three of those boxes.

FOERSTER: So, let's talk a little bit more about risk. And one of the topics that you hear more and more about since the end of the ultra-low-rate interest rate environment is this concept of payment-in-kind, or PIK. First of all, what is that? And second, how do you guys think about this concept of payment-in-kind in the way you invest?

LU: I'll touch on PIK in just a second. I'd like to start off by talking about risk management, because that's the single most important thing we do as our strategy, as a capital preservation strategy focused on downside protection and generating high current income at the same time.

So for us to be able to achieve that objective, the hallmark of our investment process really is around very detailed and rigorous due diligence, where we'll have access to very detailed information, private-style information in an attempt to be able to uncover risks that may not be apparent in the aggregate, that may be underneath the surface.

And then we'll evaluate those risks, and make sure that we can assess the potential impact on the business if those risks were to materialize. And we won't approve any transaction to put into the portfolio unless we have high conviction that even if those downside scenarios were to materialize, that we would still get all our principal back on each and every loan. And at the same time, the company would have sufficient liquidity to get through the cycle.

And it's our view if you maintain that discipline around risk management, and maintain high underwriting standards, that's how you can protect your investors' capital, avoid mistakes, and deliver investment outperformance.

So, Brian, now to your question about PIK, as you mentioned, PIK stands for payment-in-kind. And those are situations where a borrower is unable to pay all of its interest in cash and pays a portion of it in kind by adding it to the principal balance of the loan that gets paid in the future.

There are various nuanced uses of PIK interest. But in our view, for the most part, it's a sign of emerging stress in a company if it's unable to pay all of its cash interest or it needs to grow into its capital structure. Why this is particularly relevant today is that PIK interest as a portion of total income for an average manager in our market is now as high as 10% to 15%, with some managers high as 35%.

FOERSTER: Great. So one final question, Vince. How are you viewing the outlook for private credit? And maybe just talk a little bit about the environment today.

LU: Sure. So, we are very optimistic about the outlook for private credit for a lot of the reasons we talked about a little earlier. And in particular, our focus on the core middle market, which we define as companies with EBITDA or cash flow ranging from $25,000,000 to $100,000,000.

We think that's a very large opportunity set. If you look at the data, that suggests that there are 200,000 companies that fit within that cohort, just an incredible opportunity set for us of quality businesses to finance, with the staying power to get through any type of economic environment.

We also find that part of the market tends to be a little better protected, because it doesn't compete against the public markets. And so, you can get both a yield premium as well as lower risk structures, and better covenant protections. So, as we think about the outlook going forward, we think that the private credit asset class will continue its strong performance over time. There's been a pick-up in M&A [mergers and acquisitions] activity as well, which has increased the number of opportunities. And we look forward to the continued growth of the asset class over the next several years.

FOERSTER: Wow. A lot of great thoughts there. And we probably could go for another half hour. So maybe let's have a part two on this in maybe a few months. So, thanks for joining us today, Vince. And I do hope to have you back here again as a return guest.

LU: Thanks for having me.

FOERSTER: For investors wanting to learn more about Lord Abbett's views on the markets, please visit the "Insights" section of LordAbbett.com. We have a number of papers on private credit and direct lending that touch on a lot of what we discussed here today.

If you have any comments on today's episode or ideas for future episodes, please email Podcasts@LordAbbett.com. We welcome your thoughts and would love to hear from you.

So, we'll leave it there. This has been Brian Foerster with *The Active Investor* podcast. Thank you for listening.

GLOSSARY OF TERMS USED IN THIS BROADCAST

Asset-based lending is the business of loaning money in an agreement that is secured by collateral. An asset-based loan or line of credit may be secured by inventory, accounts receivable, equipment, or other property owned by the borrower.

A **basis point** is equal to one one-hundredth of a percentage point.

Base rate: Variable interest rates fluctuate in line with a base rate which, typically, shifts in reaction to market factors.

Broadly syndicated loans are floating-rate loans made to corporate borrowers with generally greater than $50 million in EBITDA and in most cases, at least $100 million. They are senior in the capital structure and have a first claim on the assets of the borrower.

Capital structure refers to the layers of debt and equity capital used by companies to finance operations. Within the capital structure, segments called tranches represent different risk classes that are available to investors.

Debt covenants are restrictions that lenders (creditors, debt holders, investors) put on lending agreements to limit the actions of the borrower (debtor).

Direct lending is a private debt strategy where non-bank lenders provide loans directly to private companies, bypassing traditional intermediaries like banks. These loans are typically senior secured, privately negotiated, and often backed by covenants that can protect the interests of a lender.

EBITDA refers to a company's earnings before interest, taxes, depreciation, and amortization.

An **interval fund** is a pooled investment vehicle that offer limited liquidity when compared to an open-end mutual fund. On a periodic basis, typically quarterly, interval funds offer to repurchase a limited number of outstanding shares, as set forth in the fund's prospectus.

Mezzanine financing is a layer of financing that fills the gap between senior debt and equity in a company. It can be structured either as preferred stock or as unsecured debt, and it provides investors with an option to convert to equity interest.

Middle market lending: The middle market segment is typically considered to be credit for firms larger than small businesses but too small for large-scale commercial lending or syndicated credit.

Opportunistic credit is an investment strategy that seeks to generate high returns by capitalizing on inefficiencies and dislocations in credit markets, often by investing in companies or assets that are stressed, distressed, or misunderstood.

Payment-in-kind (PIK) bonds are a type of debt instrument where the interest payments are made in the form of additional bonds rather than cash. This allows the issuer to defer cash interest payments, which can be attractive for companies in a cash-constrained situation.

Private credit refers to loans and debt financing provided by non-bank lenders to businesses, typically outside of public markets.

Rated note structures, commonly known as rated note feeder funds, converting higher-risk equity exposure in alternative investments into lower-risk, rated debt, thereby reducing the amount of regulatory capital the investor must hold against the investment.

Risk-adjusted return measures how much risk is associated with producing a certain investment return.

Securitized products broadly refer to pools of financial assets that are brought together to create a new security, which is then divided and sold to investors. The value and cash flows of the new asset are based on its underlying securities.

Spread is the percentage difference in current yields of various classes of fixed-income securities versus Treasury bonds or another benchmark bond measure. A bond spread is often expressed as a difference in percentage points or basis points (which equal one-one hundredth of a percentage point). The option-adjusted spread (OAS) is the measurement of the spread of a fixed-income security rate and the risk-free rate of return, which is adjusted to take into account an embedded option. Typically, an analyst uses the Treasury securities yield for the risk-free rate.

Underwriting is the process by which the lender decides whether an applicant is creditworthy and should receive a loan.

Vintage refers to the year in which a loan or investment is originated.

Yield is the income returned on an investment, such as the interest received from holding a security. The yield is usually expressed as an annual percentage rate based on the investment's cost, current market value, or face value. The gross yield of an investment is its profit before taxes and expenses are deducted.

Yield curve is a line that plots the interest rates, at a set point in time, of bonds having equal credit quality, but differing maturity dates. One such comparison involves the two-year and 10-year U.S. Treasury debt. This yield curve is used as a benchmark for other debt in the market, such as mortgage rates or bank lending rates. The curve is also used to predict changes in economic output and growth.

References to long-term performance of the private credit market are based on the Cliffwater Direct Lending Index, which seeks to measure the unlevered, gross of fees performance of U.S. middle market corporate loans, as represented by the underlying assets of Business Development Companies ("BDCs"), including both exchange-traded and unlisted BDCs, subject to certain eligibility requirements. The CDLI is an asset-weighted index that is calculated on a quarterly basis using financial statements and other information contained in the U.S. Securities and Exchange Commission ("SEC") filings of all eligible BDCs.

Indexes are unmanaged, do not reflect the deduction of fees or expenses, and are not available for direct investment.

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Source for private credit and leveraged finance market data size and composition: PitchBook, as of December 31, 2024.

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This episode was recorded on October 14, 2025.