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Private Credit—Performance and Yield

In this video, Lord Abbett Portfolio Specialist Michael Cibelli discusses the yield premium and highlights the historical risk-adjusted returns delivered by private credit.



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Michael Cibelli: So now that we've gotten to know private credit, especially as it relates to direct lending, what's the potential benefit to investors?

In this video, we'll explore the case for investing in BDCs (business development companies) that make private loans to companies in the U.S. and around the world.

This is Lord Abbett Explains: Private Credit.

Performance and Yield

As we've discussed, direct loans to corporations are not publicly traded. That means they're considered illiquid investments that cannot be easily or quickly converted into cash. Because of that, investors need to be compensated for giving up that liquidity. The term for that is the illiquidity premium. That's the extra yield investors can earn for holding onto loans that aren't easily sold. At the time we recorded this, that premium was around 200 basis points, or two additional percentage points above publicly traded loans.

Now, beyond the extra yield, direct lending has also historically offered attractive risk-adjusted returns. Public loans change hands all the time, with investors constantly buying and selling based on their views of value. That can lead to more frequent price swings. Private loans, on the other hand, are not traded, and therefore don't experience the same price volatility. Instead, they are valued periodically by third party valuation services. This combination of high income and low volatility has historically resulted in a compelling risk-reward profile.

This scatterplot shows where direct lending lands on the risk/reward spectrum. Here, it is compared to the Bloomberg Aggregate Bond Index, floating-rate loans, and high yield bonds. Anything that plots up and to the left signals a historical record of greater return with lower risk and lower volatility.

How Can this Work in an Investment Portfolio?

Direct lending strategies can be an effective complement to traditional stocks and bonds. It can help reduce overall portfolio volatility, enhance yield, and diversify exposure, especially alongside other alternative strategies like private equity, infrastructure, commodities, real estate, or hedge funds.

Let's Recap

So, to recap...

- Direct lending portfolios offer an incremental yield premium as compensation for giving up liquidity.
- Private loans aren't traded and therefore don't experience the price volatility of publicly traded loans.
- The combination of high relative income and low volatility has historically resulted in attractive risk-adjusted returns.

Thanks again for joining us on this installment of Lord Abbett Explains: Private Credit.

GLOSSARY OF TERMS

A basis point is a unit of measurement used in finance to express changes in interest rates, yields, or other percentages. It is one one-hundredth of a percentage point.

Business development company (BDC) is a type of investment company in the U.S. that provides capital to small and mid-sized businesses, as well as distressed companies. BDCs are designed to help these firms grow during their early stages or regain financial stability.

Direct lending is a type of private credit strategy that makes direct, illiquid loans to middle market companies outside of the traditional banking system. A direct loan refers to a privately negotiated loan provided by non-bank lenders directly to a borrower, typically a middle-market company.

A floating-rate loan is a loan whose interest rate changes periodically based on a benchmark or reference rate, such as SOFR (Secured Overnight Financing Rate),

Private equity refers to capital investments made in companies that are not publicly traded.

Private markets refer to investments made in assets that are not traded on public exchanges or stock markets (public markets). This includes private equity, where investments are made in private companies, and private debt, where investors lend directly to borrowers without a market to trade that debt. These markets are less liquid or illiquid.

Public markets are where securities are listed and traded on public exchanges. This includes stocks, bonds, and other financial instruments that are available to the general public and are considered liquid investments options.

Index Information:

Indexes are unmanaged, do not reflect the deduction of fees or expenses, and an investor cannot invest directly in an index.

The Bloomberg U.S. Aggregate Bond Index is an unmanaged index composed of securities from the Bloomberg Government/Corporate Bond Index, Mortgage-Backed Securities Index and the Asset-Backed Securities Index. Total return comprises price appreciation/depreciation and income as a percentage of the original investment. Indexes are rebalanced monthly by market capitalization.

Bloomberg Index Information

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