



# CONSTITUTION

Capital Credit Partners

## A Deeper Look At Private Debt

Steve Shekane, Managing Director

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# Overview of Private Debt

# What is Private Debt?

- Providing funds to borrowers with financing needs that are not met as efficiently in the traditional debt markets
- Alternative to traditional lending sources:

**Small Companies**

**Mid-sized  
Companies**

**Large Companies**



**Local Banks**





**Private Debt Funds**

**Large Global Banks  
Leveraged Loan Market  
Corporate Bond Market**

# Five Key Points:

1. Serves a need in the marketplace
2. Performs well in increasing rate environments
3. Generally provides lower volatility
4. However – not a “traded market”
5. Various different strategies and approaches

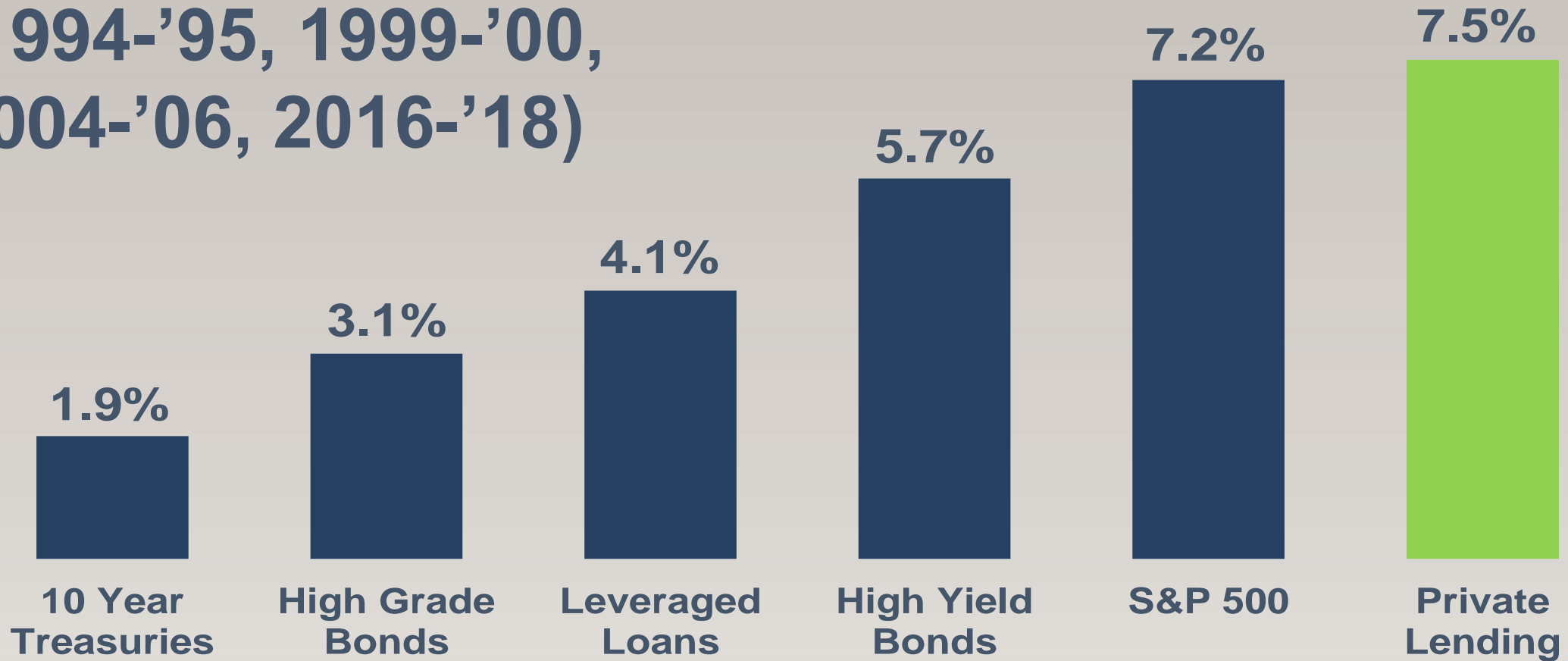
# 1. Serves a Market Need

	<u>% Change</u> <u>Since 2010</u>
■ # of U.S. banks	 (37%)
■ % of U.S. middle market loans owned by U.S. banks	 (24%)
■ “Dry powder” of middle market private equity firms	 121%
■ Size of the middle market	 58%

Sources: FDIC (number of FDIC-insured institutions), S&P LCD, Preqin (note: U.S. buyout firms < \$2B), National Center for the Middle Market.

# 2. Does Well When Rates ↑

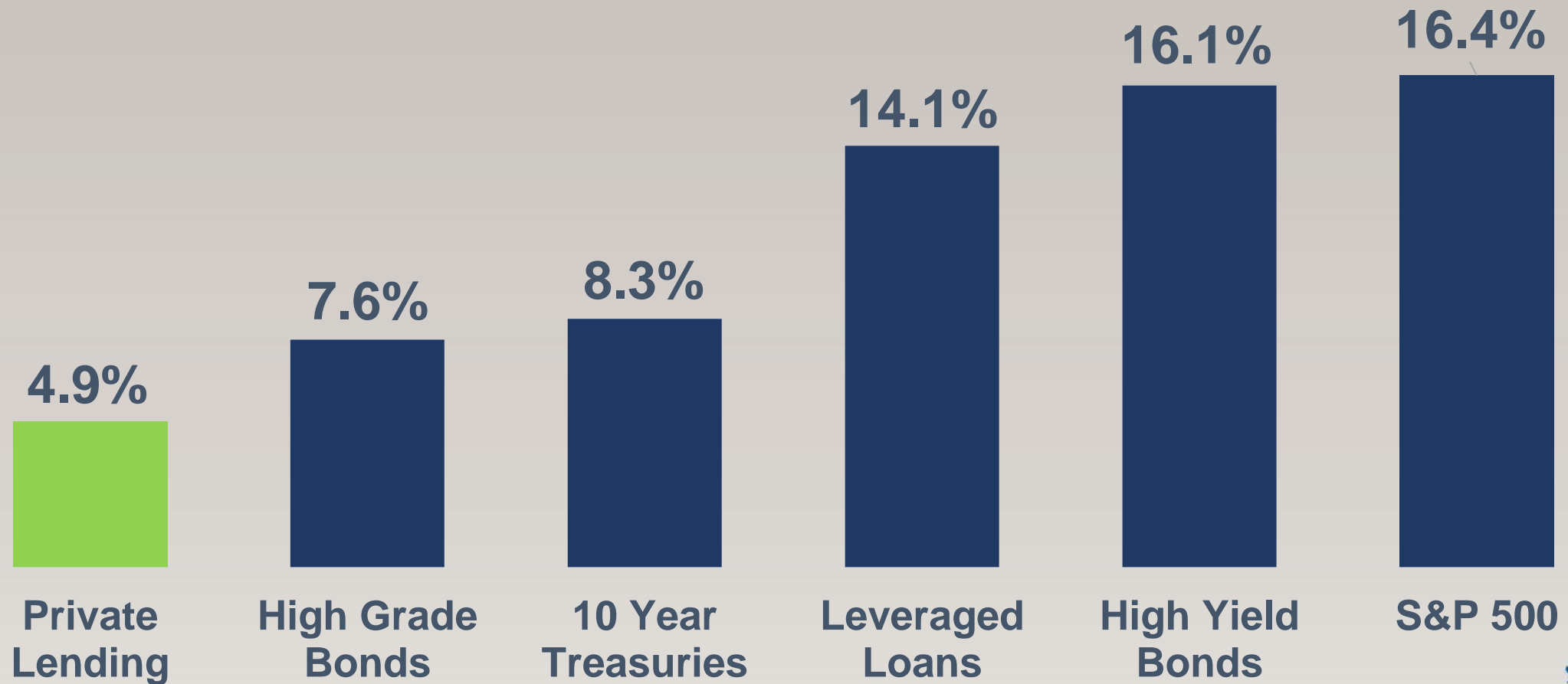
Returns In Past Increasing Rate Environments  
(1994-'95, 1999-'00,  
2004-'06, 2016-'18)



Notes: Represents average annualized returns. Private lending from CDLI where available.  
Sources: Bloomberg, BaML Indices, Cliffwater, CCP analysis.

# 3. Provides Lower Volatility

## Average Annual Volatility of Returns to Investors



# 4. Not a “Traded” Market

## Public Debt

## Private Debt

### Investment Structure

- Mutual funds, ETFs, etc.

- Closed end / locked up funds

### Liquidity

- Can sell (price?)

- Limited

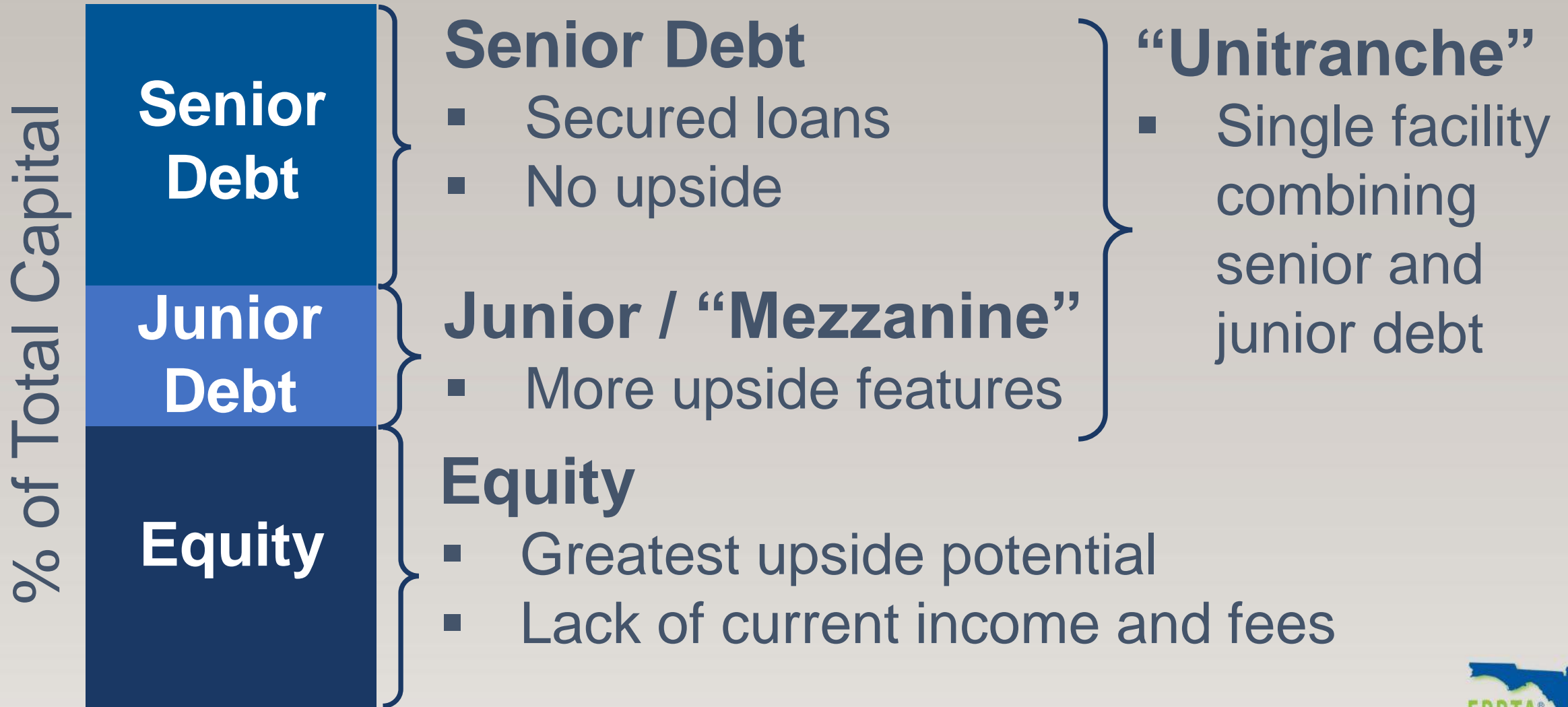
### Ability to “Index”

- Can “buy” with index funds

- Not indexed, actively managed



# 5. Various Strategies Exist



# Market Conditions

# Cyclical Factors

- Rising Interest Rates / “Fed tightening”
- Macroeconomic risks
- Private markets fundraising / “dry powder”

# Rising U.S. Interest Rates

## U.S. Federal Funds Effective Rate



Sources: Bloomberg, US Federal Reserve

# Macroeconomic Risks

## Key Risks

## Implications for Private Debt

**U.S.  
Recession**

- Potential risks from credit losses
- Better protected than other assets

**Trade War  
uncertainty?**

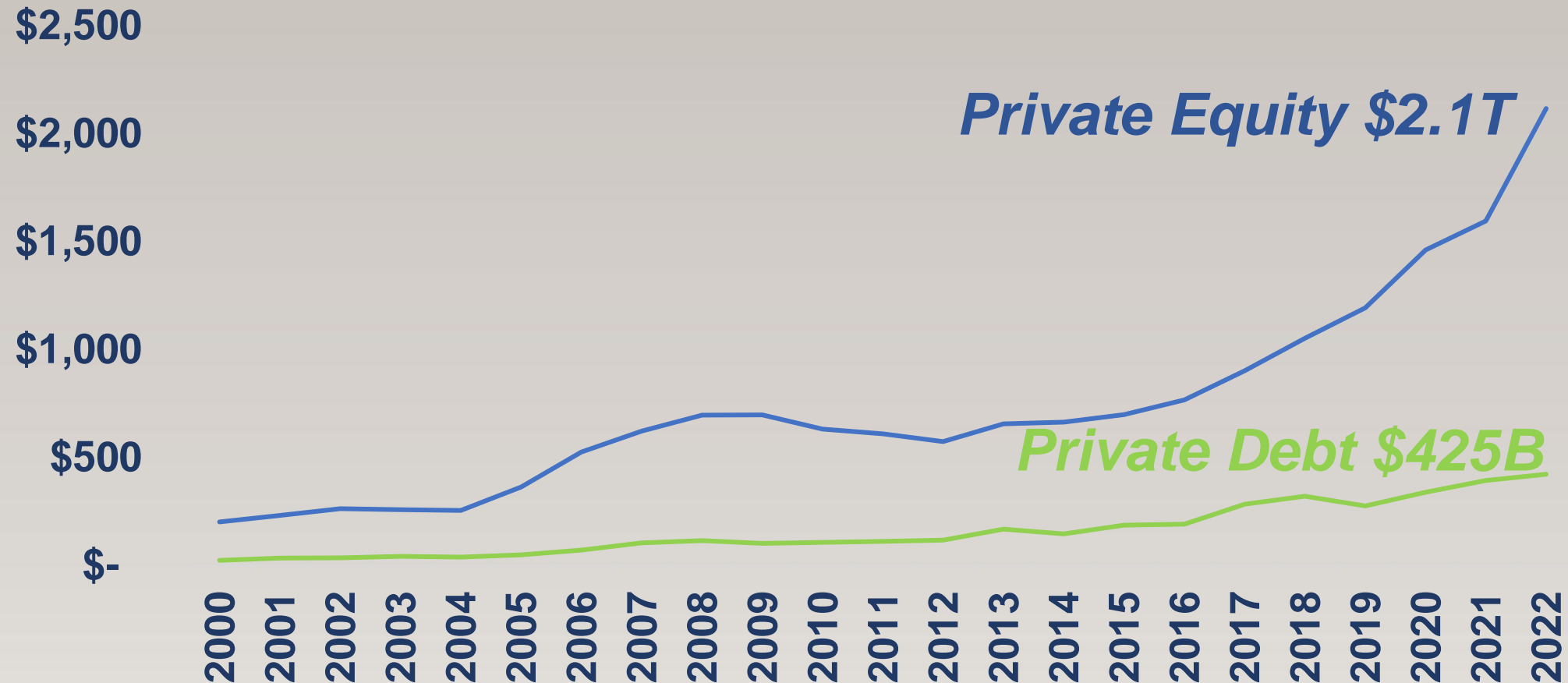
- Generally focused on domestic U.S. middle market companies

**Geopolitical  
uncertainty?**

- Impossible to predict impact – but likely bad for all asset classes

# Private Markets Fundraising

## Dry Powder (Billions of Dollars)



Source: Preqin.

# Investing in Private Debt

# Overview

- Senior and junior/mezzanine direct lending are the primary strategies in private credit
- Fund strategies can be generalist or highly specialized / narrow, and U.S. or global
- Sourcing, diligence, and monitoring are more important / challenging in the private markets
- Controlling fees and aligning manager incentives help mitigate “J-curve” negatives of private funds



# Investment Strategy Selection

## Fund Strategy

### *Options:*

- Generalist
- Niche industry / asset

### *Considerations:*

- Opportunity window?
- Specialization?

## Geographic Focus

### *Options:*

- U.S.
- Other markets

### *Considerations:*

- Creditor protections
- FX risk

# Fund / Manager Selection



# Takeaways

- Shifts in the capital markets have created an opportunity for private credit strategies
- Can provide higher returns with lower volatility than public markets
- There are a broad range of options, but North American private debt is the most popular
- Manager selection and alignment of interests are important