



BARINGS

The Benefits of Private Credit

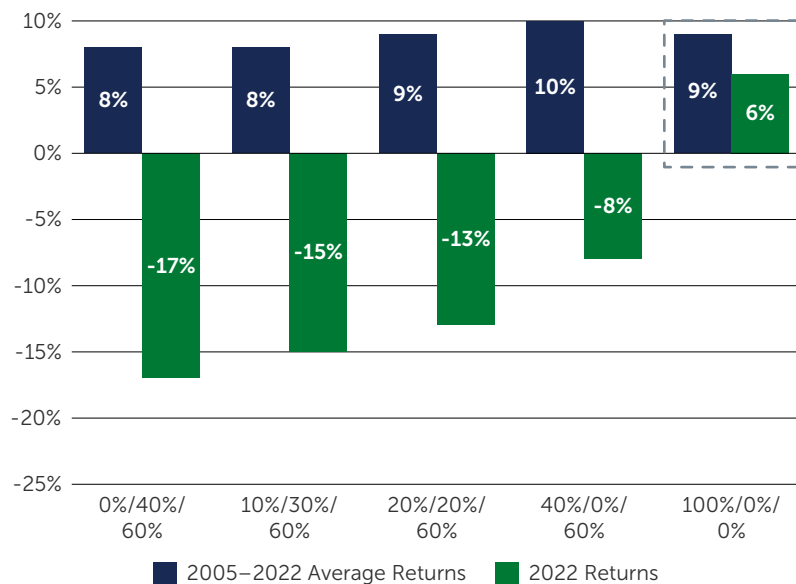
What is Private Credit?

The asset class known as private credit, or direct lending, refers to floating-rate loans, primarily senior secured, that are sourced and originated without a bank acting as an intermediary. Asset management firms use the breadth of their platforms to source private credit transactions through their relationships with private equity firms. Loans generally are made to middle market businesses—traditionally defined as those with \$25 million to \$75 million of EBITDA—that are portfolio companies of private equity firms.

Key Benefits of Private Credit

Private credit historically has delivered higher returns with less downside risk than publicly traded corporate bonds. Portfolios with private credit exposure outperformed in 2022 and since the inception of the Cliffwater Direct Lending Index (CDLI) in 2004.¹ For example, a traditional 40% U.S. corporate bond/60% S&P 500 portfolio in which corporate bond exposure is replaced by direct lending exposure would have outperformed by 8% in 2022 and by 2% on average from 2005–2022 (Figure 1).

FIGURE 1: PRIVATE CREDIT STRATEGIES COMPLEMENT OR EVEN REPLACE THE '40' IN '40/60', PRIVATE CREDIT (CDLI)/ U.S. CORP BONDS/S&P 500



Source: Cliffwater; LCD. As of December 31, 2022.

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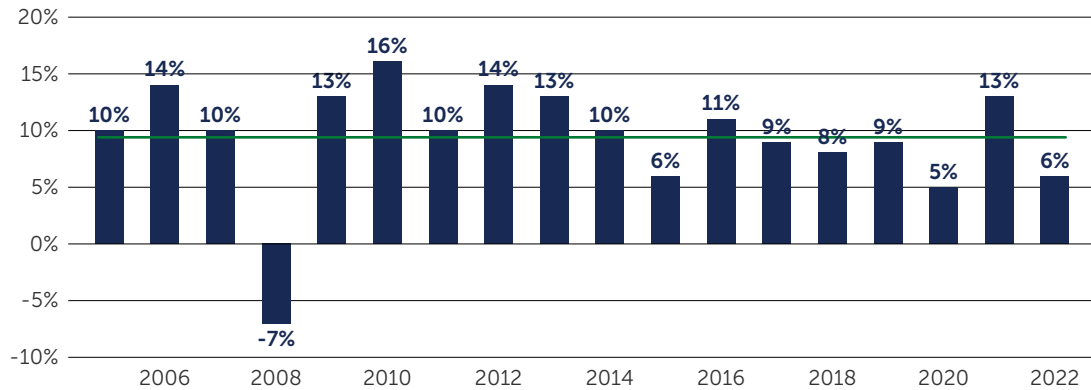


Private credit provides investors with a number of potential benefits:

1. POTENTIAL FOR DURABLE POSITIVE RETURNS

Since its 2004 inception, the Cliffwater Direct Lending Index (CDLI)—which seeks to measure the unlevered performance of U.S. middle market corporate loans—has delivered positive returns in every year except 2008.² In fact, the CDLI’s average annual return of 9% since 2004 is above the average return of the S&P 500 (Figures 2 and 3).

FIGURE 2: CLIFFWATER DIRECT LENDING INDEX PERFORMANCE

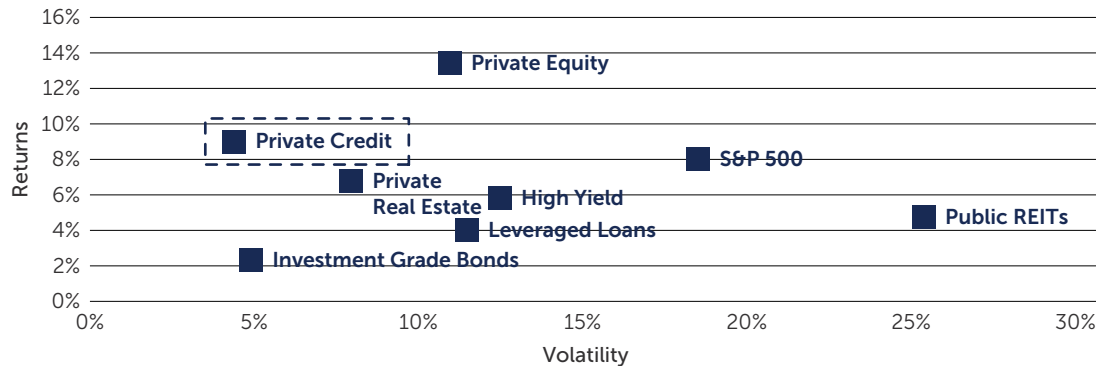


Sources: Cliffwater. As of December 31, 2022.

2. LOW CORRELATION & LOW VOLATILITY POTENTIAL

Private credit’s illiquid nature has traditionally shown lower volatility and therefore a low correlation to liquid stock and bond markets where prices often fluctuate. Over time, low volatility can potentially lead to outperformance without the need to increase risk (Figure 3).

FIGURE 3: 2005–2022 AVERAGE RETURNS AND VOLATILITY



Sources: Cliffwater; LCD. As of December 31, 2022.

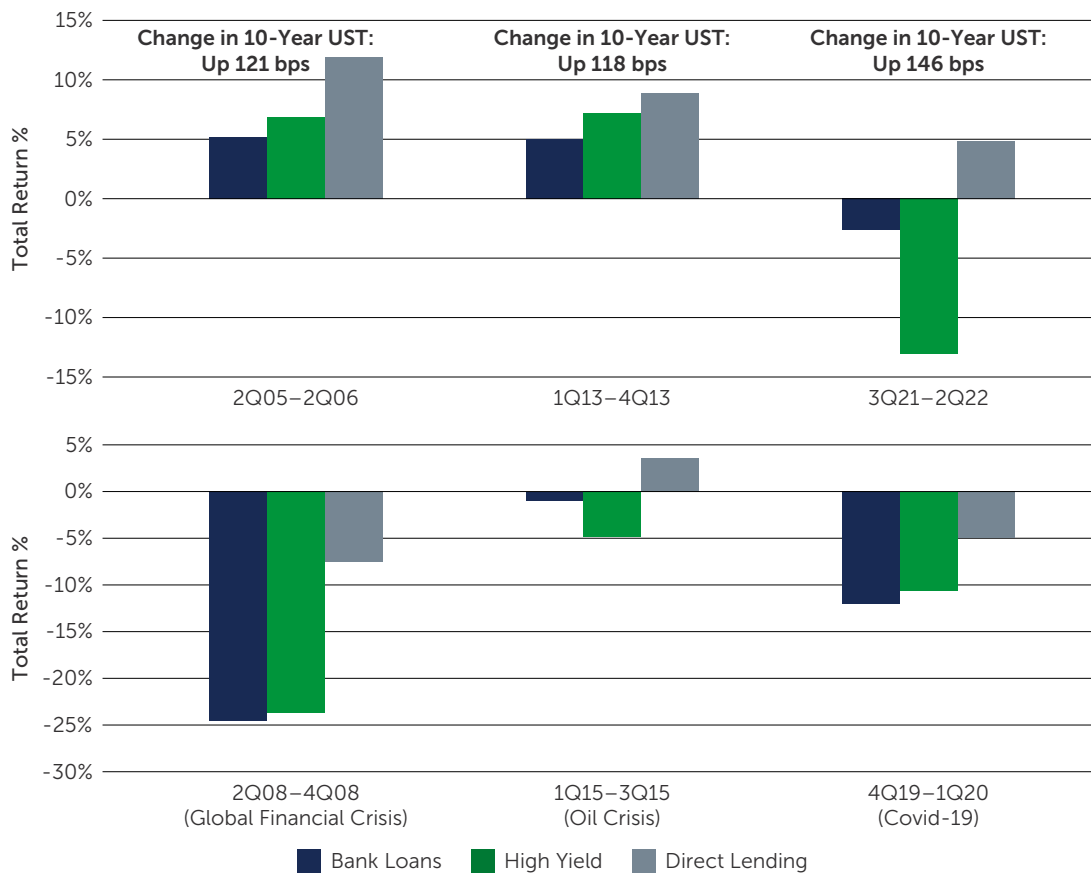
2. Sources: Cliffwater; LCD. As of December 31, 2022.



3. PRIVATE CREDIT HAS OUTPERFORMED TRADITIONAL LIQUID CREDIT STRATEGIES DURING PERIODS OF RISING RATES & UNCERTAINTY

During the Great Financial Crisis, Oil Crisis, and Covid 19, direct lending has comfortably outperformed liquid credit strategies. What's more, maximum drawdown was limited (when compared to other asset classes) even during the Great Financial Crisis. Clearly in periods of inflation/rising rates, private credit returns easily exceeded liquid credit strategies. (Figure 4).

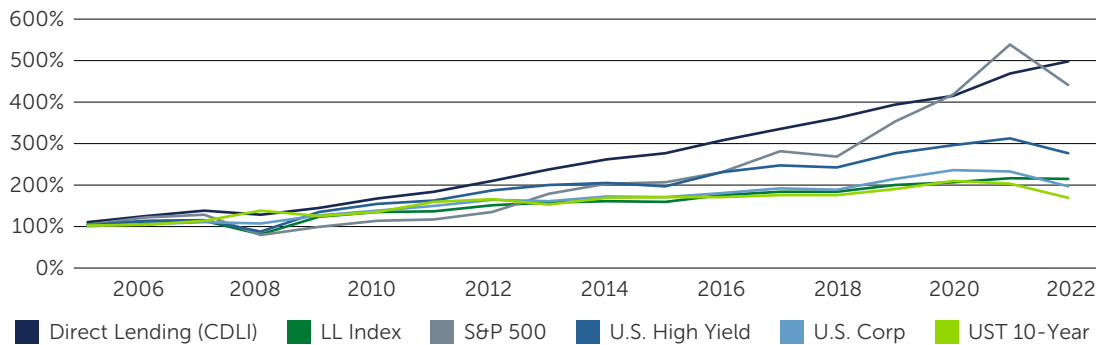
FIGURE 4: DIRECT LENDING OUTPERFORMED DURING PERIODS OF RISING RATES AND UNCERTAINTY



Sources: Cliffwater; LCD. As of December 31, 2022.

The recent market volatility drives this point home. In the wake of the S&P 500's dramatic decline in 2022, CDLI compounded returns since inception not only have outperformed traditional credit strategies, but also the equity market's chief benchmark (Figure 5).

FIGURE 5: CDLI HAS OUTPERFORMED LIQUID ASSET CLASSES SINCE INCEPTION



Sources: Cliffwater; LCD. As of December 31, 2022.

3. LESS INTEREST RATE RISK

Traditional fixed income bond portfolios tend to expose investors to significant interest rate risk as corporate bonds generally are fixed rate. Over the past few decades, fixed rate bonds investors have enjoyed a tailwind in the form of declining interest rates that have enhanced the value of their portfolios. But that tailwind has ended. With the potential for base rates to remain higher for longer, interest rate volatility may be here to stay. Private credit mitigates interest rate risk as private credit portfolios generally are floating rate, which means distributions increase when interest rates rise.



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