Has the Golden Age of Private Credit Lost its Shine?

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- Private credit investors are positioned to experience higher yields for longer.
- A significant funding gap exists between the amount of buyout dry powder and credit origination dry powder, suggesting a supply-demand imbalance.
- Private credit has demonstrated positive vintage year IRR for the past 23 years and has historically outperformed its public market equivalent.
- Defaults remain inside the long-term average.

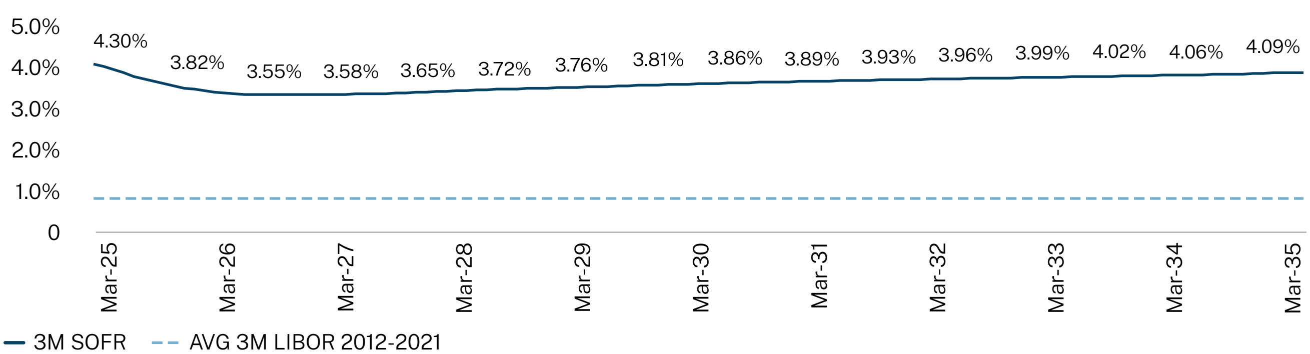
Amidst an evolving market backdrop, some investors are debating whether the golden age of private credit may be changing. We believe it will continue, and the data suggests that private credit has reason to continue delivering its consistency of performance and attractive yields in a higher-for-longer rate environment.

Higher for longer

Despite three rate cuts in 2024, private credit investors are well-positioned to experience higher yields for longer, which suggests the golden age has room to run and investors have not missed the opportunity. Where this is most evident is in the forward SOFR curve, which is U.S. private credit's typical reference rate. Looking ahead, **private credit investors are poised to benefit from 200 - 300 basis points (bps) of enhanced floating yield**, relative to the decade preceding 2022's rising interest rate environment (see the chart below).

Looking at the chart below, as of March 20, 2025, the 3-month term SOFR was 431 bps with a forward target between approximately 3.6% and 4.1% over the next decade. If we compare that to the 3-month LIBOR in the decade preceding 2022, it averaged less than 1%, leading to a reliance on the typical LIBOR floor of 1% for private credit deals during that period. The difference between the forward SOFR curve and historical LIBOR is where we expect investors will enjoy more floating yield.

Rates Predicted to Stay Higher For Longer
Three-Month SOFR Forward Curve



Sources: Chatham Financial. Data through March 25, 2025.
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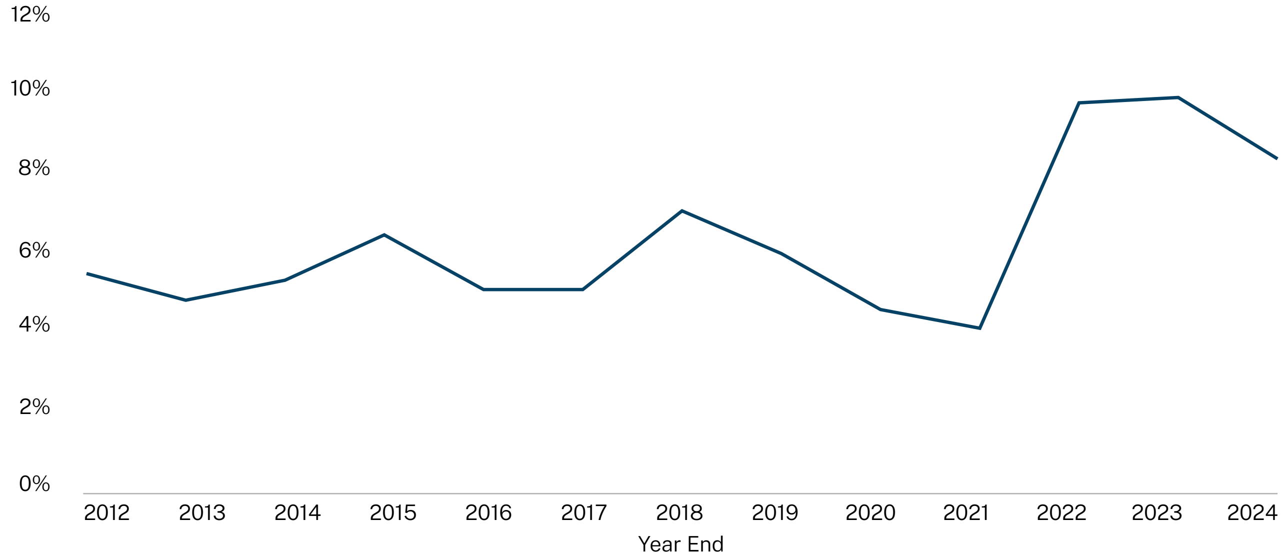
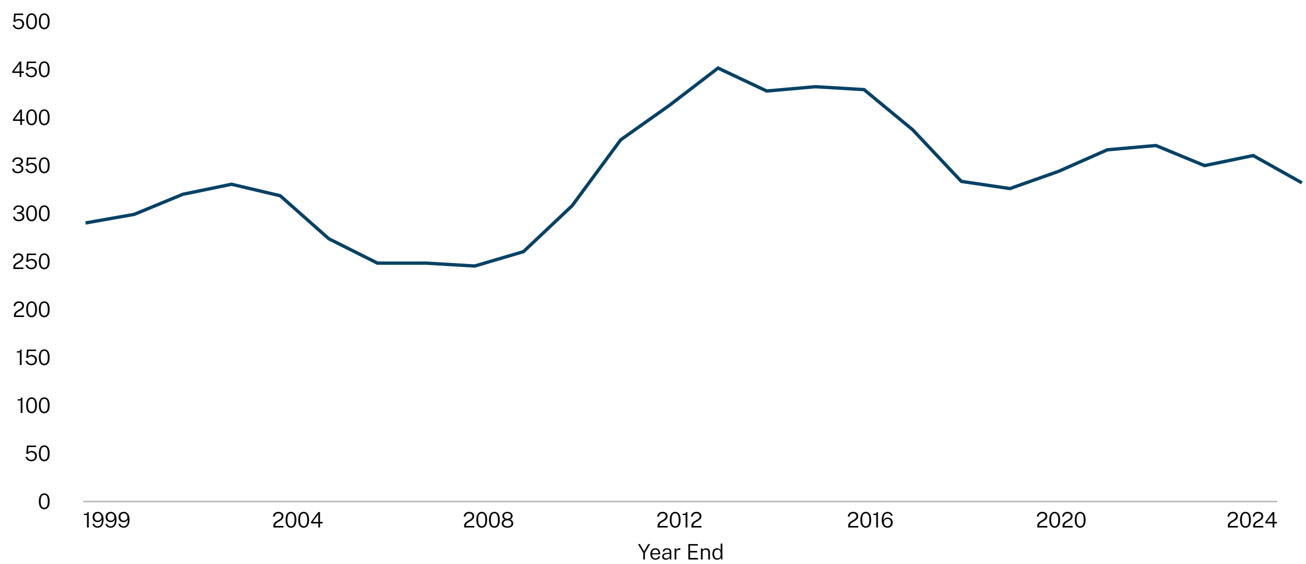
Looking through the lens of the leveraged loan index paints a similar picture. The yield to maturity (YTM) for leveraged loans averaged 5.52% over the decade leading up to 2022's rising rate environment. From 2022 to 2024, the average YTM was 9.56%, up 73% over the prior decade. And while the YTM softened from 2023 to 2024, particularly as spreads tightened, we anticipate leveraged loans overall will benefit from a higher-for-longer rate environment. For context, weighted average nominal spreads were ~341 bps across the leveraged loan market in 2024 against a long-term average of ~348 bps. Based on recent market volatility, large U.S. banks are forecasting credit spreads to widen by as much as 200 basis points by Q2 2025.

Yield to Maturity - Leveraged Loan Index



Source: LCD Leverage Loan Fact Sheet - December 2024

Long-term Leveraged Loan Spreads



Source: LCD Leverage Loan Fact Sheet - December 2024

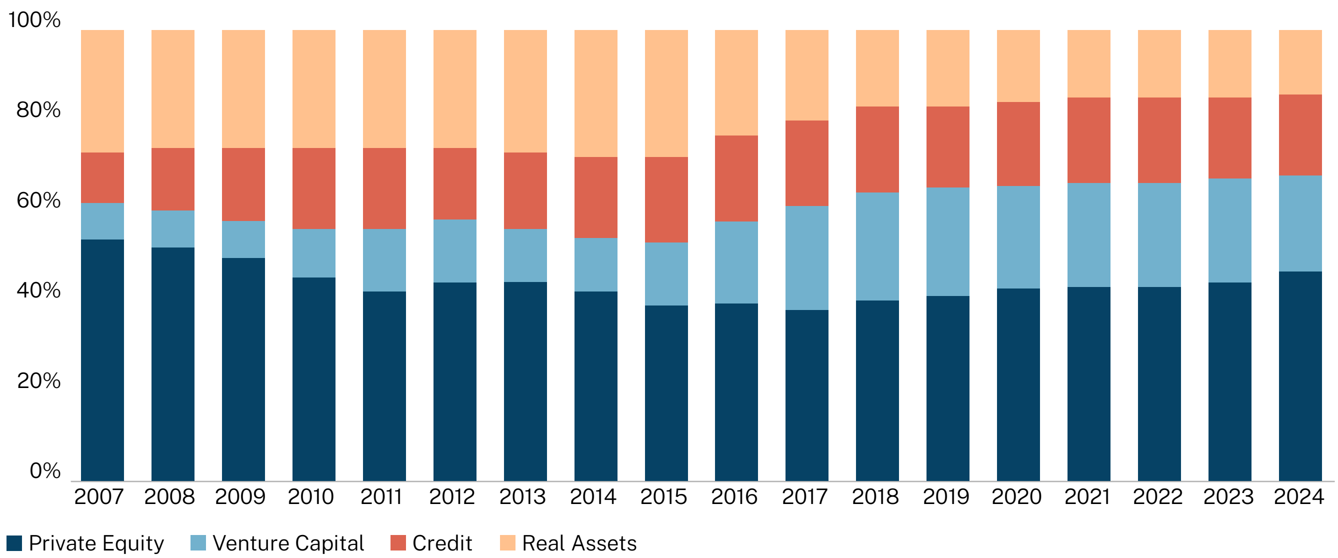
From a policy perspective, the Federal Open Market Committee (FOMC) has two objectives: to achieve maximum employment, and an inflation target of 2%. In support of its goals, the FOMC concluded to maintain the target range for the federal funds rate at 4.25-4.5% during its March 2025 meeting. Reflecting on the Fed's December 14, 2024 meeting, the rate cut was accompanied by FOMC member forecasts, which reflected expectations for fewer and slower additional Fed interest rate cuts through the end of 2025, 2026 and 2027 than the FOMC forecasted on September 18, 2024.[1] Compared to September figures, median forecasts of interest rates were raised to 3.9% for the end of 2025, up from 3.4%, and 3.4% for the end of 2026, up from 2.9%.[2] Yet another higher-for-longer data point.

While these are simply forecasts, the velocity of rate changes will ultimately be influenced by various factors. The Fed will likely ease policy more slowly if inflation remains elevated. Some of the negative forces on inflation include tariffs and immigration policy, supply chain disruption caused by geopolitical events, stronger-than-expected household spending and persistent housing cost increases. On the other hand, policy easing could take place more rapidly if labor market conditions deteriorate, economic activity weakens or if inflation returns to 2% more quickly than anticipated. Regardless of the velocity of rate changes, what the FOMC forecasts have made clear is that interest rates will remain elevated.

Credit Tailwinds

Private Markets Fundraising

Trailing Three-Year Private Markets Fundraising By Strategy

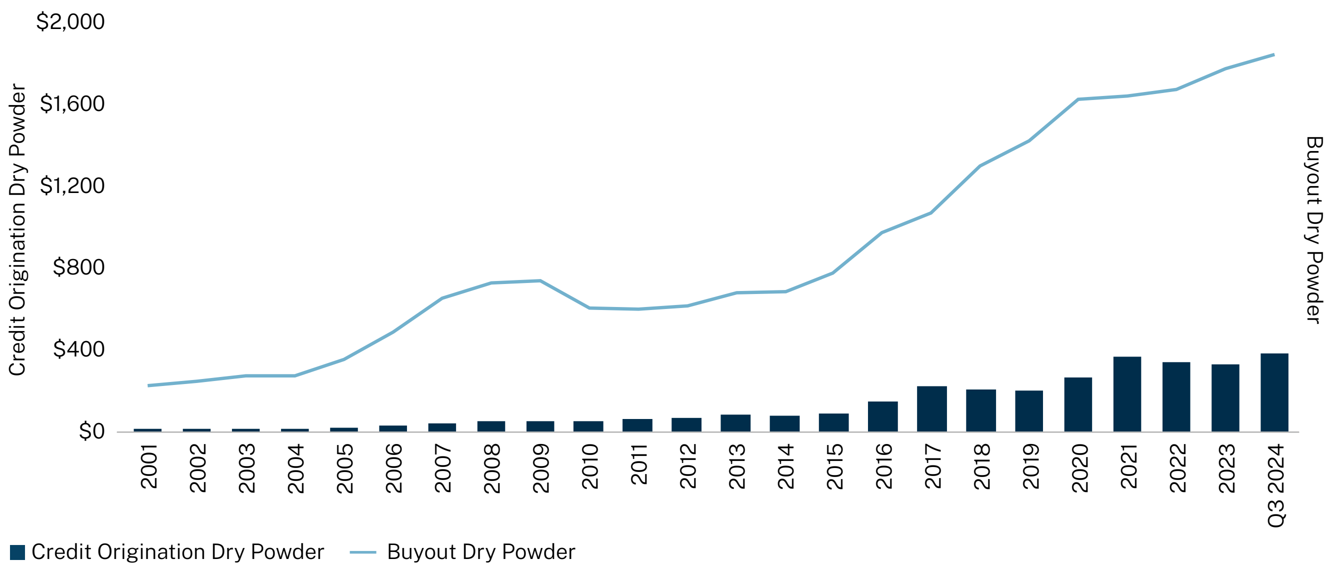


Source: Pitchbook, Bloomberg (January 2025)
Note: Excludes Fund-of-funds, secondary fund-of-funds, co-investment funds, core real estate and core infrastructure. Private Equity refers to primary funds in Buyout and Growth Equity strategies. Fundraising by vintage year includes funds with at least a first close and funds that have had their final close.

While global private markets fundraising saw a third consecutive year of decline in 2024, private credit fundraising as a percentage of total private markets fundraising was up slightly from 2023 to 2024 and evergreen fund growth also expanded over that period. Not only is this trend seen in the data, but it is felt by investors globally as they are dizzy with choice. Having distributed my time across five continents in 2024, investors consistently asked me, “Is private credit too crowded? Is too much money being raised?” I often responded in a respectful, convivial way: “Unequivocally, no. Take a breath with me and let’s look at the fundamentals.” As of Q3 2024 there was a $1.4 trillion funding gap between the amount of private equity buyout dry powder raised and the amount of credit origination dry powder raised. If we marry that figure to a growing maturity wall of over $600 billion in performing loans through 2028, we estimate that there is comfortably a $2 trillion funding gap over that period.

Buyout Credit Financing Demand

USD in Billions



Source: Hamilton Lane data via Cobalt, Data through September 30, 2024.
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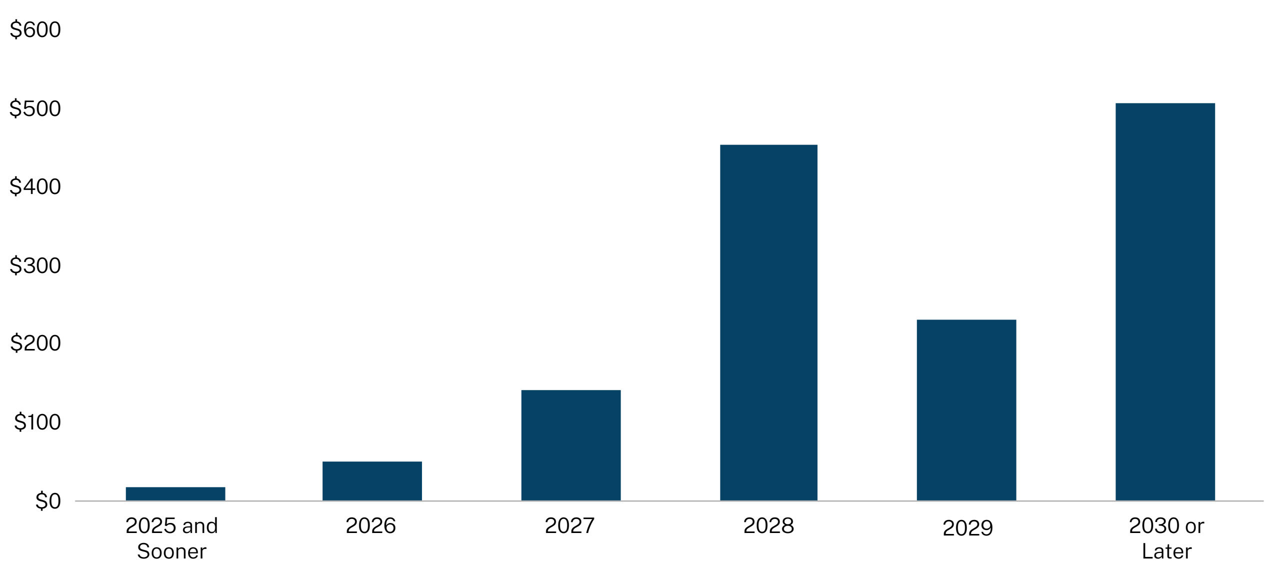
Maturity Breakdown of Performing Loans

USD in Billions



Source: PitchBook LCD. Data as of November 30, 2024.
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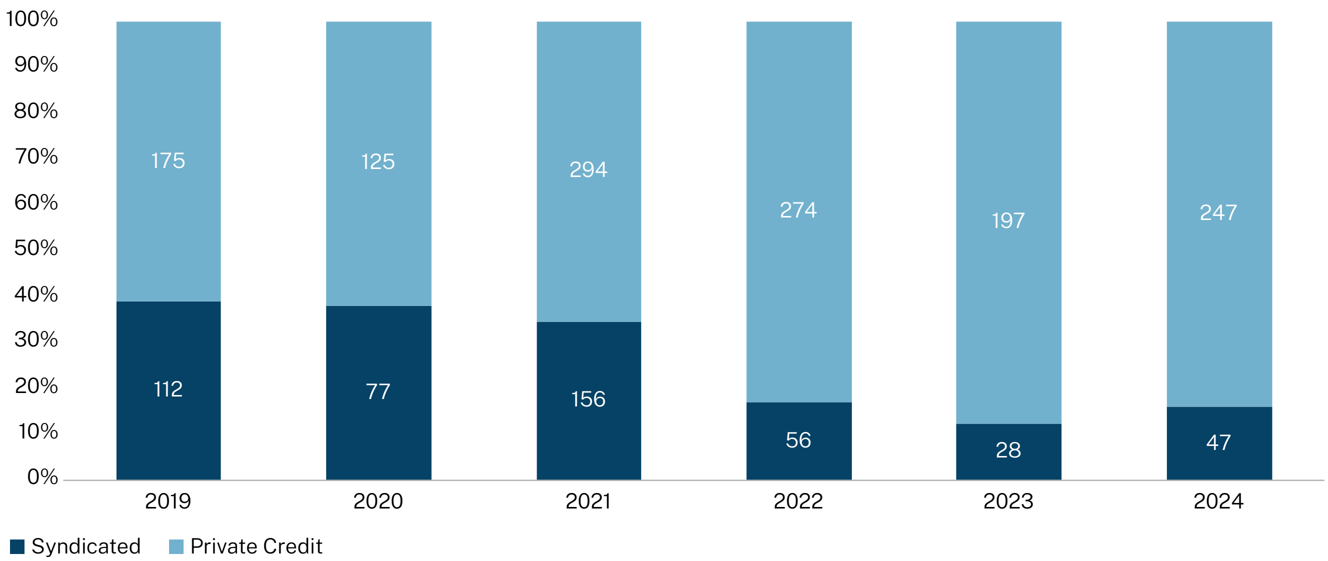
I know what you are thinking: “Won’t the banks fill that gap?” It’s unlikely, and for two reasons. First, bank regulation following the global financial crisis (GFC) helped to accelerate market share gains by non-bank lenders, a trend that was already underway. Look at the count of leveraged buyouts (LBOs) financed in private credit versus the broadly syndicated market over the past 5-6 years. Private credit execution has meaningfully outpaced bank-led LBO financing. In the near-term, it’s also worth acknowledging that “Liberation Day” has led to market volatility, which could open the possibility for a renewed bank retrenchment as we saw in 2022.

Count of LBOs Financed in Private Credit vs. BSL Market



Sources: PitchBook | LCD, Data through December 31, 2024, unless otherwise noted.

Secondly, private credit can offer borrowers numerous benefits over public financing alternatives, despite being more costly. Some of those benefits include:

- **Closer relationships:** The ability of a small lender group to work collaboratively and efficiently with their borrower on incremental facilities and amendments.
- **Speed of execution:** The ability to provide financing in a short period of time.
- **Greater financing certainty:** Public markets may shut down during periods of volatility while private credit typically remains open due to its committed capital nature.
- **Ability to understand complexity:** Public markets are not always receptive to transaction complexity, including business carve-outs and divestitures.
- **Stricter confidentiality:** The ability to limit access of sensitive information to a small private lender group vs. sharing it more broadly in the public markets.

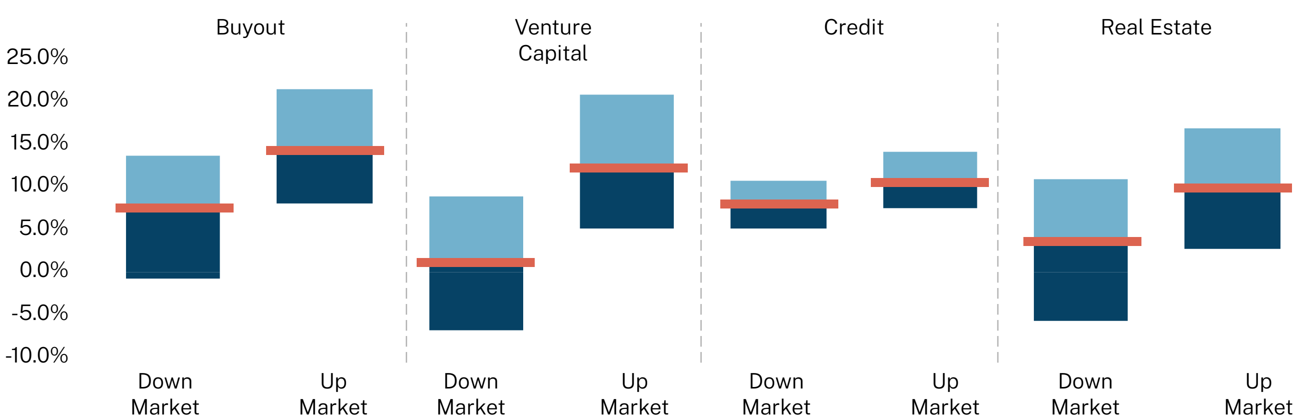
Consistency of performance: Steady returns across market cycles

Bank regulation isn't the only reason private credit continues to proliferate. Performance is a large contributor. Private credit has demonstrated positive vintage year IRR in every year for the past 23 years and has historically outperformed the Credit Suisse Leveraged Loan Index (a public market equivalent) in every vintage year. Pause and think about that. The asset class has experienced three recessions over that period. And not only has it demonstrated consistent performance over long periods, but it has also done so with the narrowest spread of returns in up and down markets relative to other private markets assets. It makes you wonder if private credit is simply the golden asset class. Forget ages.

Credit IRR vs. PME by Vintage Year

Sources: PitchBook | LCD, Data through December 31, 2024, unless otherwise noted.

Spread of Returns by Down and Up Markets



Source: Hamilton Lane Data as of 9/30/2024 (January 2025)
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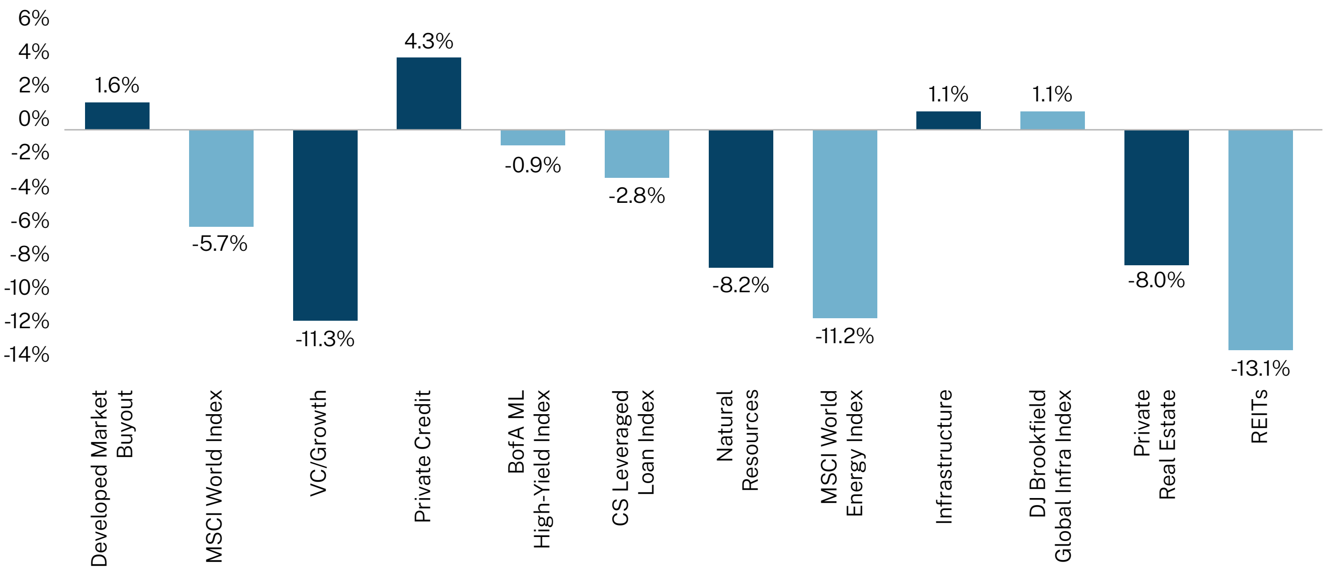
And if you still aren't convinced, just look at the five-year annualized low point. Private credit historically has the highest performance relative to public and private alternatives. This is one of the many reasons we view private credit as an all-weather strategy.

Lowest 5-Year Annualized Performance



Source: Hamilton Lane Data as of 9/30/2024 (January 2025). Please refer to definitions in endnotes.
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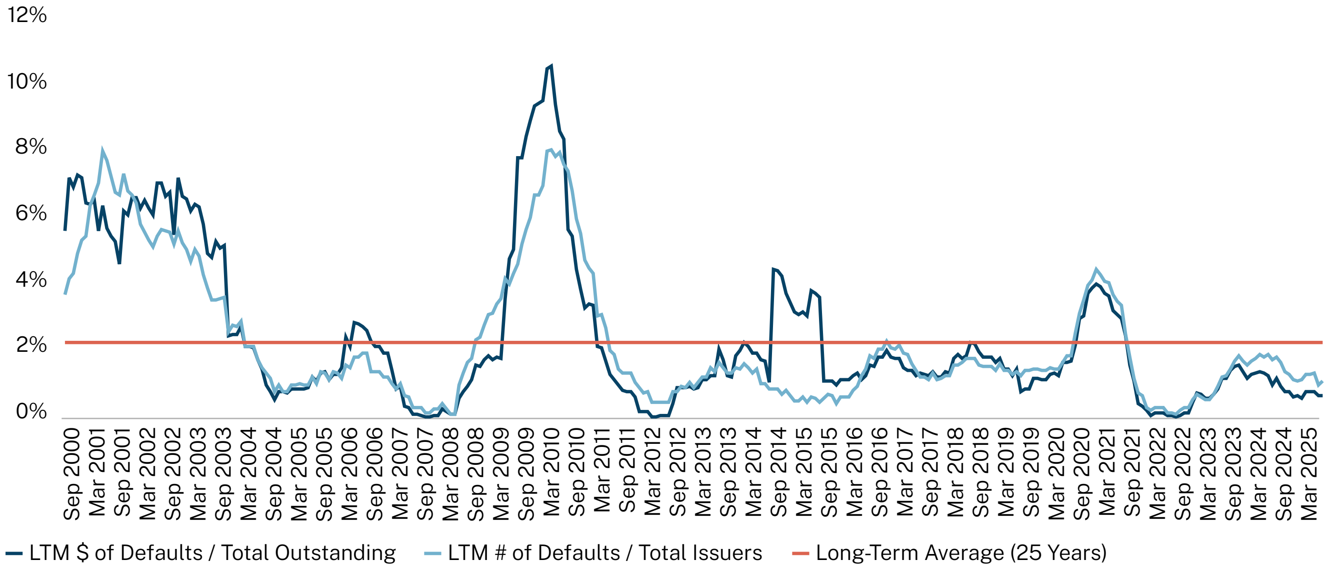
Defaults

2022 ushered in concerns of a credit default cycle on the heels of what was a rapidly rising interest rate environment. Many investors wondered if borrowers could support elevated interest expenses, particularly those who had borrowed floating rate debt in a zero-interest rate environment. To give readers a sense of the impact of rising rates, a term loan priced at S+500 in 2021 would have cost a borrower 6% in annual interest expense using a 1% SOFR floor. Today, that same loan costs 9.3% in interest expense, which is an increase of 55% based on 3-month SOFR as of March 20, 2025.

Despite expectations for elevated defaults, leverage loan default rates have remained below their 25-year average of 2.43% by issuer count. As of March 2025, the last twelve months (LTM) default rate was 1.23%. A strong consumer driven by higher levels of employment has been among the contributing factors. Including distressed exchanges, the leverage loan default rate is slightly higher at 4.31% by number of issuers.

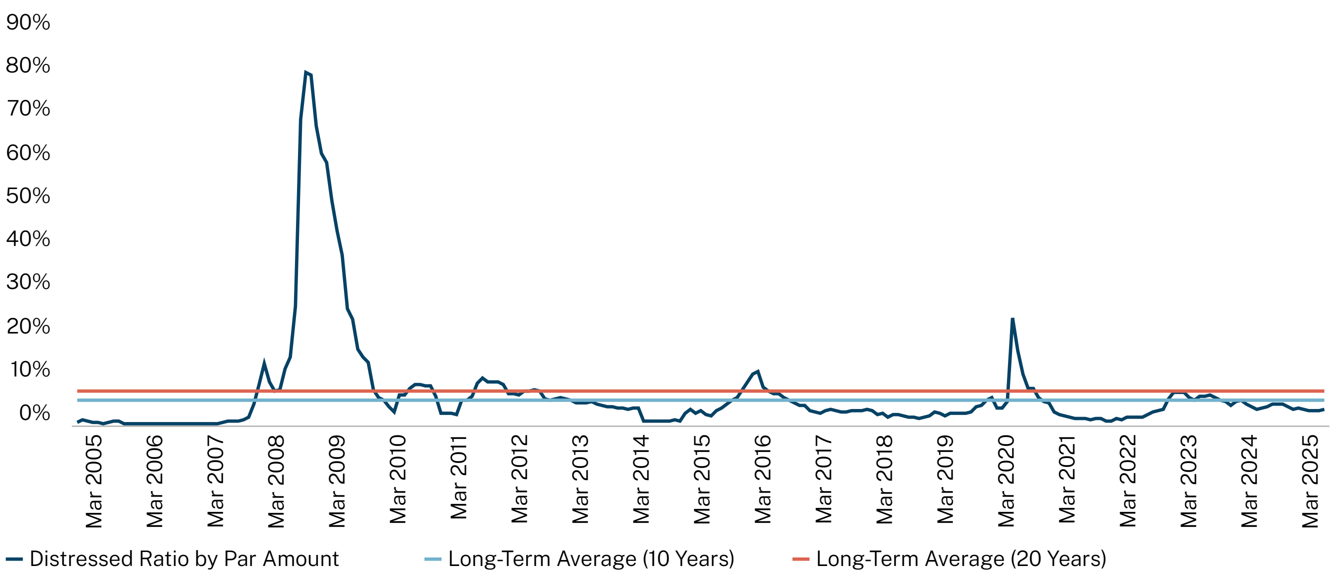
Finally, the March 31, 2025 distressed ratio was 4.5%, by issuer count, which is inside of the 10-year average of 5.4% (and inside the 20-year average of ~7.5%). The distressed ratio is the ratio of loans trading below 80 cents on the dollar relative to the total number of loans. Historically, the distressed ratio has been a leading indicator of future default activity.

U.S. Leveraged Loan Default Rate



Sources: PitchBook| LCD, Data through March 31, 2025

U.S. Leveraged Loan Distressed Ratio



Sources: PitchBook| LCD, Data through March 31, 2025

Looking ahead

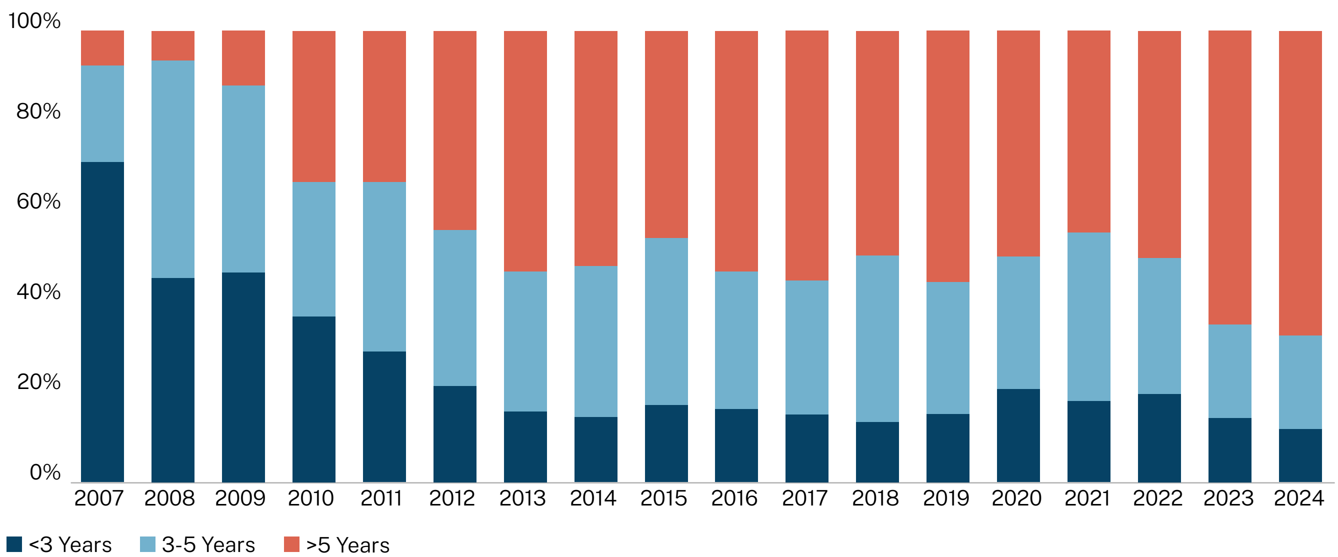
Uncertainty abounds, particularly as the world comes to grips with tariffs. The uncertainty driven by trade tensions is likely to lead to a deterioration in business and consumer sentiment, a weaker labor market and open the door to recession risk. Investors will seek safety and strategies like senior direct lending will offer safe harbor. Macroeconomic uncertainty is also likely to be accompanied by a widening spread environment, which will benefit private credit investors as it did in 2022.

Amidst this uncertainty, we anticipate that private markets transaction activity could slow; however, we are optimistic private credit will maintain certain deal flow drivers. Companies will still demand incremental facilities and recapitalizations, and a large maturity wall remains, which will demand fresh credit capital. Limited Partners also remain liquidity starved as hold periods have gotten longer. On average, +67% of buyout deals exited in 2024 were held for more than five years. Also, private markets distribution activity in 2024 remained well below the long-term average of 23%. This is likely to pressure buyout GPs to find creative ways to deliver liquidity, which could usher in a wave of transaction types ranging from continuation vehicles to GP financing solutions, which private credit is well-suited to support.

It is also worth reflecting on how the broadly syndicated markets respond to volatility. Not well. These periods of bank retrenchment are when private credit tends to shine. 2022's rising rate environment is a good near-term example. Banks sat on the sidelines while private credit providers enjoyed higher spreads, stronger covenant protection and lender-friendly credit documentation.

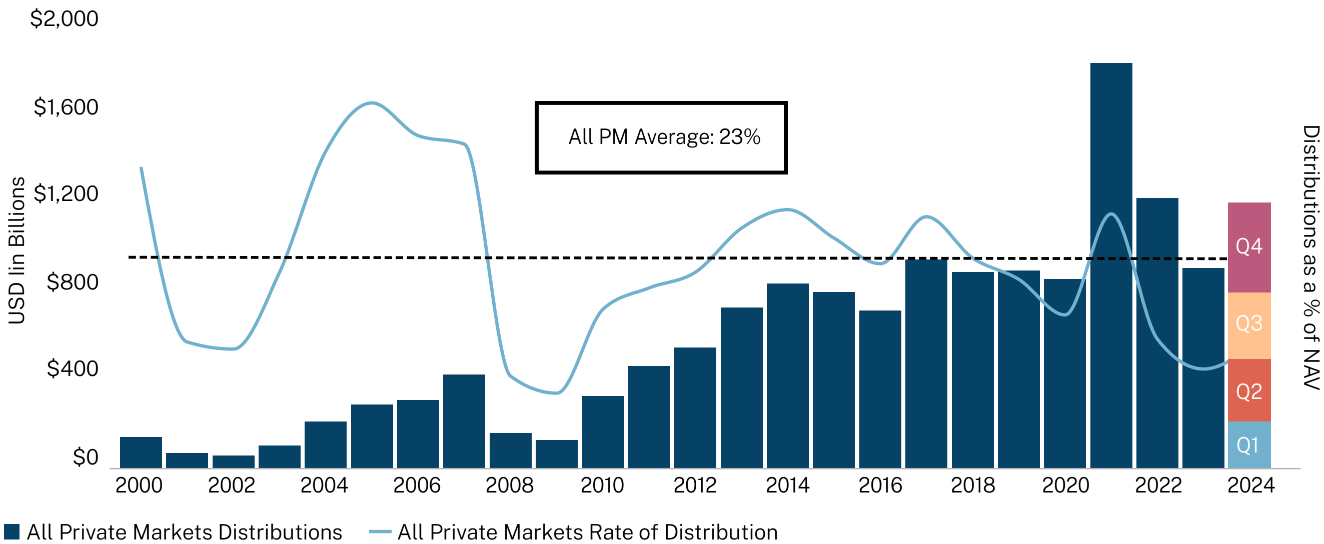
Holding Period of Exited Buyout Deals

% of Deal Count by Year of Exit



Source: Hamilton Lane Data (January 2025)

Distributions
Annual Private Markets Distributions



Source: Hamilton Lane Data via Cobalt (February 2025)

With various unknowns, credit selection discipline will continue to be paramount, and lenders will adapt to the changing landscape. They will likely deprioritize companies with globally dependent supply chains, while emphasizing cycle-resistant capital structures, and many will gravitate to seniority and collateral protection. For nearly a quarter century, private credit has demonstrated positive and consistent performance through multiple market cycles and proven itself as an all-weather strategy. There is no reason to believe this time is different.

[1] https://www.federalreserve.gov/monetarypolicy/fomcprojtabl20241218.htm
[2] https://www.federalreserve.gov/monetarypolicy/fomcprojtabl20240918.htm

STRATEGY DEFINITIONS

All Private Markets – Hamilton Lane's definition of "All Private Markets" includes all private commingled funds excluding fund-of funds, and secondary fund-of-funds.

Corporate Finance/Buyout – Any PM fund that generally takes control position by buying a company.

Credit – This strategy focuses on providing debt capital.

PME (Public Market Equivalent) – Calculated by taking the fund cash flows and investing them in a relevant index. The fund cash flows are pooled such that capital calls are simulated as index share purchases and distributions as index share sales. Contributions are scaled by a factor such that the ending portfolio balance is equal to the private equity net asset value (equal ending exposures for both portfolios). This seeks to prevent shorting of the public market equivalent portfolio. Distributions are not scaled by this factor. The IRR is calculated based off of these adjusted cash flows.

Venture Capital – Venture Capital incudes any PM fund focused on financing startups, early-stage, late stage, and emerging companies or a combination of multiple investment stages of startups.

Real Estate – Any closed-end fund that primarily invests in non-core real estate, excluding separate accounts and joint ventures.

Private Equity – A broad term used to describe any fund that offers equity capital to private companies.

Real Assets – Real Assets includes any PM fund with a strategy of Infrastructure, Natural Resources, or Real Estate.

DM Buyout – Includes any buyout fund that is primarily investing in developed markets of North America, Western Europe and Global.

VC/Growth – Includes all funds with a strategy of venture capital or growth equity.

Natural Resources – An investment strategy that invests in companies involved in the extraction, refinement, or distribution of natural resources.

Infrastructure – An investment strategy that invests in physical systems involved in the distribution of people, goods, and resources.

INDEX DEFINITIONS

Credit Suisse Leveraged Loan Index – The CS Leveraged Loan Index represents tradable, senior-secured, U.S. dollar-denominated non-investment grade loans.

MSCI World Index – The MSCI World Index tracks large and mid-cap equity performance in developed market countries.

BofAML High Yield Index – The BofAML High Yield index tracks the performance of below investment grade U.S. dollar-denominated corporate bonds publicly issued in the U.S. domestic market.

MSCI World Energy Sector Index – The MSCI World Energy Sector Index measures the performance of securities classified in the GICS Energy sector.

DJ Brookfield Global Infrastructure Index – The DJ Brookfield Global Infrastructure Index is designed to measure the performance of companies globally that are operators of pure-play infrastructure assets.

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As of April 22, 2025

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*As of December 31, 2024