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MEDIA RELEASE

Heading into 2024 private credit offers steady cash income with equities still vulnerable

Private credit funds will offer investors an attractive opportunity to benefit from regular cash income and low volatility regardless of which economic conditions prevail during 2024, a year which brings much uncertainty, according to the managing director of Tanarra Credit Partners (TCP), Graham Lees.

According to a new Insights paper from Tanarra Credit Partners (TCP), "TCP Outlook for 2024: Risk of Inflation Lingers", the private credit asset class finished 2023 with a strong performance. The JPM Credit Research: Leveraged Loan index gained 13.2 percent in 2023, with BB loans returning 10.2 percent and B loans gaining 14.6 percent.

"These were the second strongest returns for loans on record. We expect another strong year in 2024 despite a possible increase in financial market volatility, given the rise in official interest rates, which has raised the cost of credit generally. This flowed through to returns with the JPM Leveraged Loan index above 8 percent in January," said Mr Lees.

"Private credit as an asset class is likely to benefit from higher floating interest rates on corporate loans, and it is a low volatility option for investors against a backdrop of a very uncertain economic outlook," Mr Lees said.

Geopolitics risks are high with ongoing conflicts in Ukraine and the Middle East. In addition, with elections in 60 countries in 2024 including in major markets such as India and the US, and a possible Donald Trump victory, 2024 is likely to be a volatile year for financial markets.

"With so much uncertainty, it remains a challenging environment for investors. While cash rates at around 4 percent offer investors a reasonable return in nominal terms, the return is much less attractive in real terms, or after inflation which in most developed nations sits at more than 4 percent.

"We believe private credit offers investors a more attractive opportunity to benefit from higher interest rates and regular income, as well as strong investor protections which are built into corporate loans," Mr Lees said.

Unlike bonds, private credit is not issued or traded in public markets. Loans are organised by the lending partner according to the individual borrower's needs. Corporate loans deliver a regular income stream for lenders, and the floating rate structure helps hedge against inflation. Corporate loans typically have floating rate coupons, which are linked to the bank bill swap rate and are reset regularly by the lender.

“Importantly, private credit offers investors attractive risk-adjusted when compared to equities, and returns in-line with the long-run returns on shares.”

“Furthermore, we anticipate higher refinancing demand during 2024 from private equity sponsors facing challenges in exiting portfolio companies due to the low level of IPO activity.”

Private credit as an asset class has enjoyed strong growth in recent years with total global assets under management (AUM) rising over US$1.4 trillion in 2022. Within Australia, there is growing demand for private credit from Australian borrowers as it offers greater flexibility and access to credit compared to bank loans.

Borrowers frequently benefit from the greater speed of execution compared to traditional bank loans. In addition, there are several downside protections available for private credit investors.

“For instance, for those that largely invest in senior secured loans, the investment equity capital sits underneath the debt financing in the capital structure. This means significant value would need to be eroded before investors’ capital is at risk,” Mr Lees said.

“While borrowers typically do pay a higher interest rate for private credit financings versus regular bank loans, many borrowers are prepared to pay the higher cost in return for the benefits offered by private credit.”

According to Mr Lees, private credit has strong downside protection features that help fund managers mitigate the risks of underperforming borrowers during economic downturns. TCP investments typically feature the following protections. Senior ranking security provides first right to cashflows and assets of borrowers hence providing a buffer against any deterioration in corporate earnings.

“In addition, maintenance financial covenants are tested quarterly, which provides an early warning signal against any deterioration in the credit quality of a borrower, enabling us to take action if required to protect our investment,” he said.

“While private credit is clearly under the spotlight for investors as an asset class well-suited to navigate the complex economic environment ahead in 2024, we believe it is important to partner with an experienced fund manager to maximise the benefits offered by the asset class.”

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Tanarra Credit Partners is a private credit specialist with a demonstrated ability to originate a diverse pool of unique, high-quality investments across its broad professional network. The TCP Private Debt Income Fund is distributed by GSFM in the Australian market. It aims to provide investors with attractive risk-adjusted returns with a focus on capital preservation. TCP seeks to deliver a differentiated asset class exposure compared to other offerings in the non-Investment Grade credit space.