INSIGHTS

SUCCEEDING IN THE NEW NORMAL OF FIXED INCOME

The investment landscape has changed dramatically over the past several years, with bonds and other fixed income assets being no exception. The benefits that traditional bonds have historically offered, namely diversification from stocks, lower volatility, and adequate income streams have gradually diminished. For many, the most important of these is current income. Such investors have found themselves in a quandary, as the only solution has seemed to be taking on greater risk they are uncomfortable with in order to get higher yields and income they need.

However, a rapidly growing class of alternative assets, private credit, has addressed these needs and concerns. Private credit primarily involves direct lending between a management company and small to middle market private businesses in the United States. Virtually all of these loans are senior secured loans, meaning they have priority over other creditors and are backed with collateral from the borrower. The entire process is performed in-house, with the management company originating, underwriting, and servicing the loan until maturity.

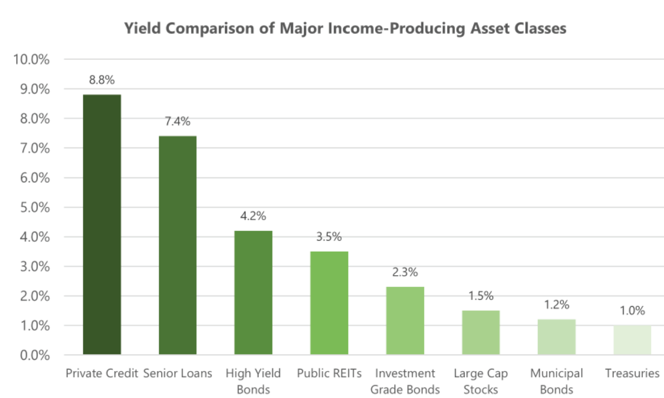
Previously, net worth requirements coupled with more limited liquidity compared to stocks and bonds made private credit largely available only to institutions or the most affluent investors. However, many private credit investments are now available to more traditional investors. The current economic environment, coupled with the benefits that these investments offer, make them an attractive and viable solution for those seeking to bolster the diversification, low volatility, and income aspects that traditional fixed income was previously effective at providing.

How does private credit perform in different market environments?

Because of its nature, private credit is suited for virtually all economic conditions. The below chart illustrates this point:

How does private credit compare with other income-generating assets?

The following two charts compare both the yields and volatility of major income-generating asset classes. Private credit leads the pack in both yield and risk-adjusted return among the group.



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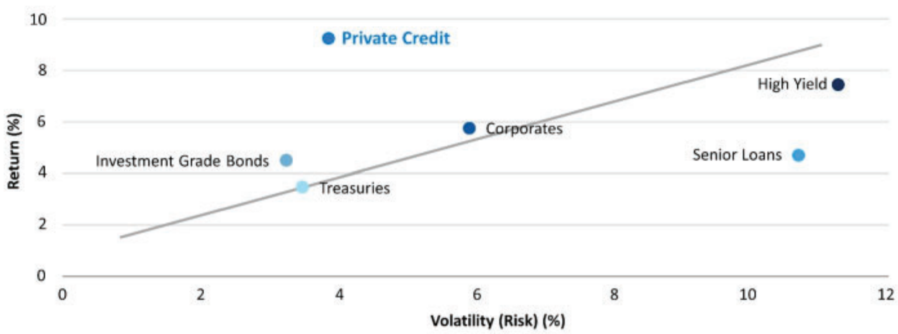
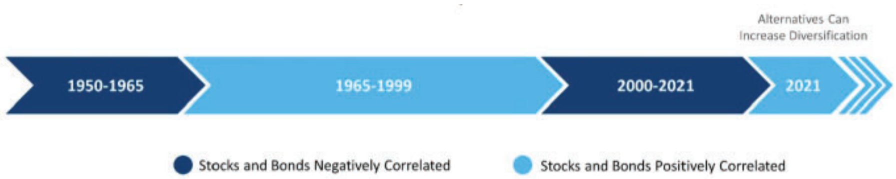
Risk-Return Comparison: 15-year historical returns as of December 31, 2020



Source: Morningstar. Cliffwater Direct Lending Index as of December 31, 2020. Volatility is measured using standard deviation. Morningstar computes standard deviation using trailing total returns for 15 years. All of the monthly standard deviations are then annualized and the volatility is expressed as a percentage

How does private credit diversify my portfolio?

One axiom of asset allocation is that stocks and bonds will move in opposite directions of each other, providing a natural hedge. But the reality is that the relationship between stocks and bonds is anything but certain. Over the last 70 years, periods when risk-free rates (i.e., Treasuries) were volatile and inflation was increasing have seen a positive correlation between stocks and bonds. As the chart below illustrates, once a trend has been established, it tends to last. In 2021, stocks demonstrated a positive correlation with bonds for the first time since 1999. To the contrary, alternatives like private credit tend to have low or negative correlations to both stocks and bonds.



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