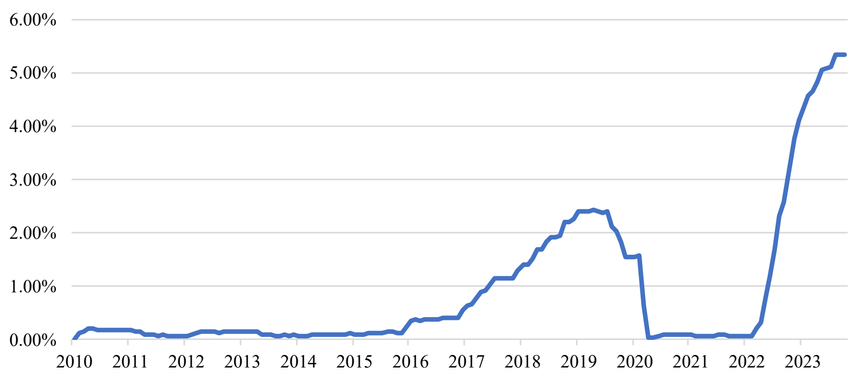
Private Credit: Investing in a Higher Rate Environment

While slower economic growth and higher interest rates have dampened M&A deal activity, private credit investors can stand to benefit in the current higher-for-longer interest rate environment. Prospect believes this current rate environment provides an opportune time for allocators to consider investing in private credit.

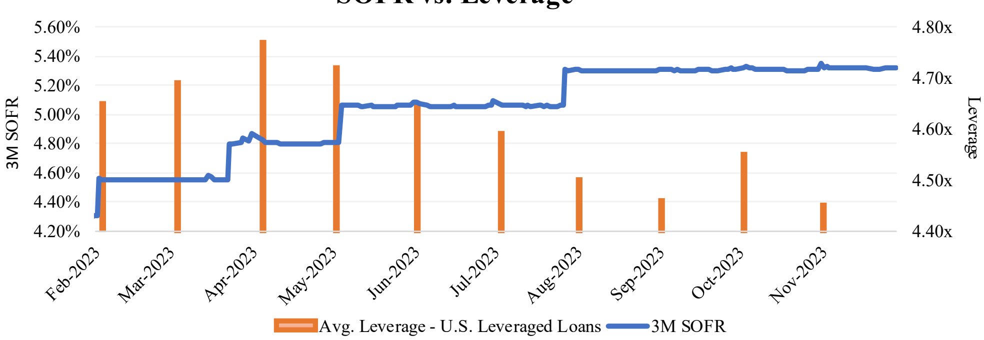
Higher Interest Rates May Benefit the Asset Class: Private credit investments often have floating-rate structures that apply a spread to a benchmark rate, typically the Secured Overnight Financing Rate (SOFR). SOFR is a broad measure of the cost of borrowing cash overnight collateralized by Treasury securities and closely correlates to the Federal Funds rate. To combat rising inflation, the Federal Reserve raised rates from near 0% to above 5% over the past twenty months. As a result, private credit yields today have reached levels not seen in over a decade.

Federal Funds Effective Rate[1]



Lower Leverage May Mitigate Default Risk: Current higher rates have led to lower leverage being placed on new originations as lenders focus on borrower ability to service debt. Lower leverage mitigates the risk of default, especially if rates decline, as companies will have less fixed charges and resulting higher ability to service debt. Additionally, lower leverage implies larger equity cushions and lower loan-to-value, which mitigates downside risk.

SOFR vs. Leverage[2]



Sources: (1) Federal Reserve Economic Data; (2) Pitchbook Leveraged Commentary & Data (LCD)

Disclosures

Past Performance is not indicative of future results

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