ASK THE **ADVISERS**

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Pension Funds Are Increasing Exposure to Private Credit

Searching for higher yields and total returns in their pension funds, investment officers across the country have been adding more private credit funds to pension fund holdings. Private credit consists of floating rate secured loans made to non-publicly traded companies. The asset class rapidly expanded when new laws, passed after the 2008 financial crisis, made banks more reluctant to make loans to middle market companies.

Large money managers like Ares Capital and Blackstone have created private credit funds in which they underwrite and service the loans made to middle market companies so institutional investors, pension funds, and high net worth individual investors can access the asset class. The funds make loans to companies for around five to seven years. The loans often go to private companies partially owned by equity funds in fields such as software or healthcare, to try to grow the company ahead of an eventual sale. The debt can finance any business purpose.

The default rate on private debt rose to 1.56% in the third quarter of 2022. However, for the 15 years ending Sept. 30, 2022, (which includes the 2007-09 financial crisis) private credit delivered an average return of 8.87% versus high-yield corporate bonds, which had an annualized return of 5.7%, according to Bloomberg index data.

Currently the typical pension fund allocates about 3.8% of their assets to private credit but the average allocation is expected to increase to 5.9%. For the last decade, pension funds have been increasing their exposure to alternative investments like private credit, private real estate, and private equity in search of higher returns and greater diversification. This approach was at least partially vindicated with the traditional 60/40 portfolio losing significant value in 2022.

High net worth investors could be wise to take the same approach. With private credit currently yielding 9-10% investors should consider emulating the pension funds and adding private credit to their portfolios.

*source WSJ

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