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ASK THE **ADVISERS**

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Investing for Income

Income investors have traditionally relied on bonds to generate income and reduce overall volatility in their portfolios. Bonds are debt instruments issued by publicly traded companies, municipalities, or the federal government.

These bonds have fixed coupons that are paid to the bondholders. The interest rates will vary based on prevailing market conditions and the credit rating of the issuer. All bonds are subject to interest rate risk. When interest rates rise previously issued bonds become worthless because their interest rates are now below what new bonds are offering. The longer the duration of the bond, the greater the interest rate risk.

One underutilized income investment is called private credit. There are about 3,000 publicly traded companies in the United States that have over $100 million in annual revenue. However, there are over 18,000 private U.S. companies that have over $100 million in annual revenue. These private companies are not able to issue bonds.

When they need capital to expand or for other business purposes, they must seek out other sources of credit. Most banks do not lend in this space. Therefore, for many non-public companies, their only source of capital is to borrow from private credit funds. Private credit funds raise money from investors and underwrite the loans to these companies. Most of the loans are secured corporate assets.

Private credit funds are attractive to investors for several reasons. Firstly, these funds produce high levels of income for investors. They are currently yielding over 10%. Secondly, these funds have less interest rate risk than traditional bonds because the loans are floating-rate loans. This means if interest rates rise, the companies that are borrowing must pay more interest. In 2022 Investment grade bonds were down over 13% and holders of a 20-year treasury bond lost over 30%. However private credit was up 6.3%. Private credit has had very low default risk as well. Between 2005 and 2020 high yield bonds had a loss rate of 1.7% versus a loss rate of only .3% for private credit.

Sources: Yahoo Finance, Blackstone, and Hamilton Lane

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