BSAMC

Bocconi Students Asset Management Club

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PRIVATE MARKETS: 2021 TO PRESENT

ALESSANDRO ROMERI - PRESIDENT
DARIO IORI - HEAD OF MARKET INSIGHTS

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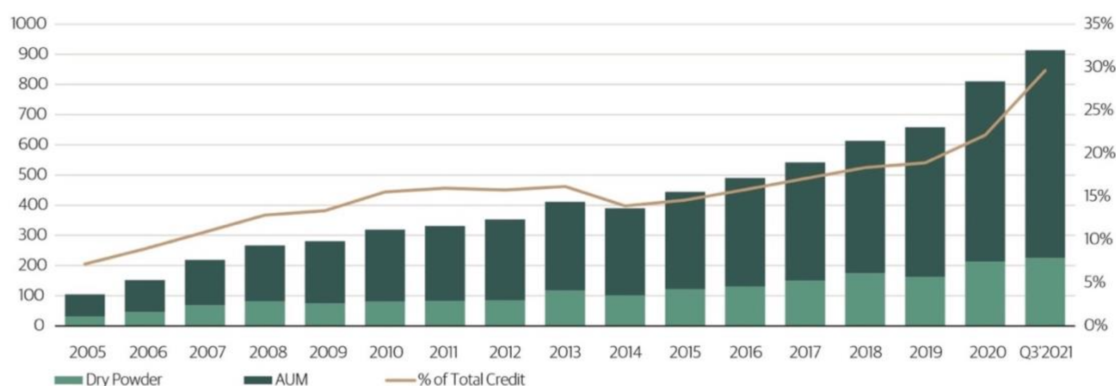
PRIVATE CREDIT OVERVIEW

Growth trend and market analysis

Private credit includes asset classes from secured debt to distressed debt that are used in private offerings or issued by private companies. The private credit market has been growing significantly in the past years, ever since 2008 when banks became more reluctant to lend to smaller and riskier borrowers. One of the main drivers for this growth is the private credit's appeal as a funding source for borrowers. The private credit market transactions are faster than those of public markets and there is potentially greater certainty as there are no changing terms related to market conditions. According to some views, the rapid growth in private credit is characterized to have bubble-like features. However, there are many reasons against this argument. Firstly, investors are seeking out alternatives as they face the possibility of low returns in the public markets. Also, the decrease of syndicated bank lending has caused a gap that private credit can fill. In addition, private credit is still relatively small with only occupying 30% of overall credit markets. Among many other reasons, these are the reasons indicating that private credit is still in the earlier stages of expansion.

Chart 1: US Private Credit Market / % of Total Credit Market



Lenders and borrowers negotiate directly in private credit which often ends up with lower leverage, additional collateral and maintenance covenants.

Chart 2: Yield Comparison across Fixed Income Asset Classes in 2021 (12-month annualized)

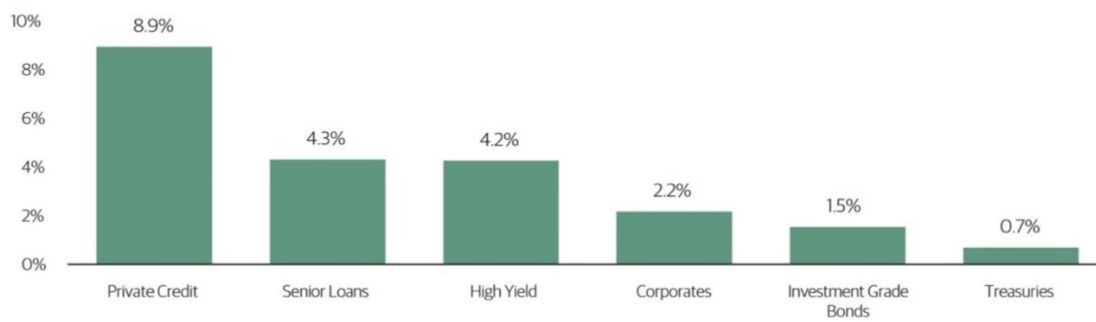


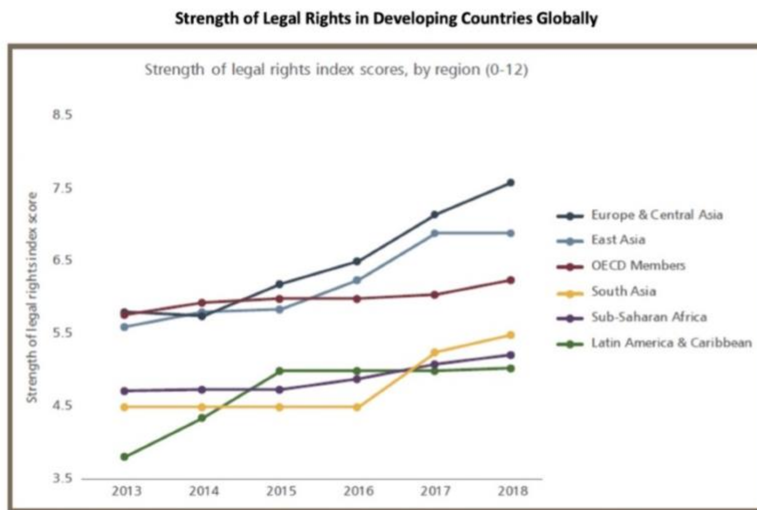
Chart 3: Comparing Risk and Return across Select Asset Classes (15 Years Annualized)

Evolution in different regions

Private credit has become a note-worthy asset class in developed markets, growing rapidly after the 2008 Global Financial Crisis. Following this success, private credit is booming in emergent markets too. Global private credit AUM has grown to $666bn in 2017 from $248bn in 2008, growing at 12% annually, and is expected to grow at an increased pace of 15%+ annually. According to Preqin, private credit AUM reached $812mm in June 2019 and became the third-largest asset class in private capital, in front of infrastructure and natural resources. Following the Global Financial Crisis, capital raised for emerging markets' private credit strategies increased to $9.4bn in 2018 from $1.4bn in 2008. Regardless of the fast growth, emerging markets' private credit occupies a share of 1.2% of the global private credit market. However, there is still a large headroom for growth.

Private credit risks in emerging economies are declining due to better legal protection which is making private credit more attractive. This is shown in the figure below.

Chart 3:



Emerging markets' private credit offers more attractive return proposition while developed markets' private credit opportunities. EM vs DM out-performance across most sub-segments of private credit range from 5-10% points in USD terms, as per an EMPEA survey.

Table 1:

Average target returns of survey respondents in USD (gross IRR, gross cash multiple)

	Direct Lending	Mezzanine	Distressed Debt	Special Situations
Africa	13%, 1.5x	17%, 1.8x	18%, 1.9x	19%, 2.1x
China	17%, 1.3x	20%, 1.4x	20%, 1.5x	21%, 1.8x
India	13%, 1.4x	17%, 1.6x	20%, 1.8x	21%, 1.9x
Other Emerging Asia	14%, 1.3x	17%, 1.6x	20%, 1.6x	18%, 1.6x
CEE / Turkey / CIS	14%, 1.7x	17%, 1.8x	20%, 1.9x	21%, 2.2x
Latin America	14%, 1.5x	19%, 1.9x	20%, 2.1x	22%, 2.0x
Middle East	12%, 1.3x	17%, 1.6x	25%, 2.0x	21%, 1.9x
United States	6.5%, 1.2x	10%, 1.4x	15%, 1.7x	18%, 1.9x
Western Europe	7.0%, 1.2x	12%, 1.2x	17%, 1.7x	18%, 1.8x

Source: EMPEA Emerging Market Private Credit Survey, March 2019.

<u>PRIVATE CREDIT OUTLOOK</u>

In 2021, monetary and fiscal policy have been very accommodative, while increasing vaccination rates are bringing back pre-pandemic activity levels. Strong consumer demand, particularly for goods, has stressed supply chain disruptions and increased inflation. The stock of liquidity has remained high, providing broad support for risk assets, but we have seen the flow beginning to slow which foreshadowed a more volatile investment environment going forward. These conditions has set us up for a carry type of return

experience in credit overall also in 2022, with greater potential relative performance due to higher volatility from equities and higher rates from fixed income. This is likely to support continued demand for credit assets as investors increase their preference for income-driven return over price further in 2023. This is favourable in particular for private credit given the yield premiums available. The higher yield and proportion of return from income coupled with lower interest rate sensitivity keeps credit attractive relative to fixed-income assets. During 2022, expectations for higher interest rates have increased the appeal of shorter duration and floating rate credit, particularly private credit, with investors still well-compensated for taking illiquidity and complexity risk.

For 2023, we anticipate several key developments in the private credit market. Considering the current landscape and the trends observed thus far, it is expected that private credit will continue to be a sought-after financing option.

Private credit's familiarity and comfort among borrowers, coupled with challenges in other funding markets, have contributed to its attractiveness, while syndicated offerings have seen a decline in activity due to inflationary pressures and rising interest rates.
The private credit industry has expanded beyond North America, gaining momentum in other regions. In Europe, the private credit asset class has experienced significant growth, reaching $US187 billion in 2022, according to the Deloitte Private Debt Deal Tracker Autumn 2022.
Private credit demonstrates resilience and market share growth even in volatile conditions. Two significant trends contributing to its growth are private equity sponsors seeking debt for acquisitions and a shift toward longer-term partnerships with increased flexibility and reliability.

Moreover, unitranche facilities, blending senior and subordinated debt, have witnessed increased demand and larger deal sizes. Despite economic headwinds, private credit funds adapt by forming larger direct lender groups to sustain heftier unitranche financing. Although deal values may slightly decrease compared to 2021 and 2022, the sector remains optimistic.

Looking ahead to 2023, the private credit sector may face challenges in the macroeconomic environment, as rising interest rates dampen the appetite for higher-leverage deals. Borrowers are now operating in a less favourable environment for servicing their interest, particularly in the case of private debt with floating interest rate structures. Lenders and borrowers are adjusting their focus to interest coverage, resulting in less aggressive capital structures.

However, there are promising signs of recovery in syndicated markets. Institutional leveraged loan supply is projected to reach $US250 - $US300 billion, while high-yield supply is expected to be $US180 - $US200 billion.

As the market adapts to geopolitical and economic challenges throughout 2023, opportunities for both syndicated debt and private credit are likely to increase. While syndicated lending rebounds, private credit continues to grow, driven by its adaptability and attractive yield premiums.

REAL ASSETS MARKET ANALYSIS

Overall, the real assets market expected to say goodbye to the covid pandemic already in 2021, but also 2022 was a year of recovery and learning from previous mistakes. Mitigating risk is a hard task, especially after the experience of a two-year pandemic that no one saw coming, but that impacted every single sector of the world economy severely. Many investors have drawn important lessons since 2020, one of them being the great importance of diversification, both industrial and geographic. To help investors compensate for the volatility of a single geographical region, mutual funds and hedge funds are now increasingly focusing on the geographical scope of their portfolios.

Even though these assets were considered bullet-proof, great losses were experienced in retail- and office-investments. Surprisingly, these were offset partly by a great boom in the logistics sector. In fact, as social distancing and lockdowns were installed over the whole world, most companies turned to e-commerce solutions. It is true that the logistics sector has been increasing in the last decade, however, Covid accelerated the increase by a five years' worth. The economic gains might not have been evident during the pandemic because of an overall decrease in purchasing power, but the investments in logistics have gained market value considering the abundant increase in take-up of warehouses.

EMEA**:** In this region investment in real estate looks like it will return to pre-covid levels, while, as stated before, the logistics market is stronger than ever. However, as the pandemic has introduced a new level of smart working, the demand for office spaces is not expected to raise above pre-covid levels. In the same way, retail is recovering, but thanks to an increase in e-commerce, in-store sales are still below pre-pandemic levels, leading us to expect a decrease in retail-space investments. Finally, the residential market is estimated to grow both in volume and as a share of the investment market.
LATAM: The market in LATAM is quite heterogenous, hence why it is difficult to come to a general conclusion about the overall development. The residential real estate is growing fast, as it has been in the last decades, and the demand for housing with large outside spaces has increased even more. Furthermore, the pandemic created a need for a more digitalized real estate market, which now has led to expectations of a permanent switch to online home-purchasing processes.
APAC**:** APAC is recovering quickly from the covid-recession, and their steady economic expansion is expected to be reflected in the real assets market. The leasing demand for retail and office spaces is expected to rebound, and the logistics sector will continue to grow even quicker than before the pandemic. Overall, the outlook for the real estate market is good with opportunities in various sectors.
NAFTA**:** As the inflation is increasing, many investors look to private real estate to hedge. Two sectors have been proved as especially good investments during the pandemic: the logistics market and the multifamily market. Thanks to a quick recovery of the US economy in 2021, the real estate market performed particularly well, and is expected to do so also in 2022.

Other:

While joint ventures imply having to share the gains when business is doing good, it also implies sharing the losses when things are going bad. The Covid pandemic translated into losses in all investment sectors, making shared risk look even more interesting. While owning 100% of an asset may have resulted into quick growth, sharing the risk have come in handy in times like Covid. Furthermore, as many real assets remain undervalued as the pandemic is slowly becoming old news, taking advantage of the market prices requires having knowledge about the markets themselves. Therefore, the choice of creating joint ventures with local partners is crucial to taking advantage of the post-Covid market. These will have first-hand information about new vacancies, and open doors to valuable real estate that investors wouldn't necessarily find by themselves. Joint ventures can become the key to international investments, especially after the markets recovery from economic recession due to the COVID pandemic.

Looking ahead into 2023

Real assets often offer a stable yield, which helps them perform relatively well through the economic cycle. However, the current economic pressures may cause some divergence in performance across real assets, with some asset classes and sectors proving more resilient than others during periods of higher interest rates and weaker economic growth.

The current macroeconomic environment is characterized by higher and stickier inflation, higher interest rates, more stop-start GDP growth, and greater constraints on policymakers. As such, investors are incentivized to look beyond listed equities and bonds to alternative asset classes for inflation protection, stable yield, and portfolio diversification. The upcoming economic cycle will likely provide a variety of opportunities for patient investors across these asset classes.

Overall, in our opinion real estate investments can present opportunities during market volatility such as acquiring assets at higher capitalisation rates, equity and debt recapitalisations, and locations with supply-demand imbalances. Infrastructure investments can benefit from shorter-term debt and margin management in agriculture investments can help to produce better-than-average performance.

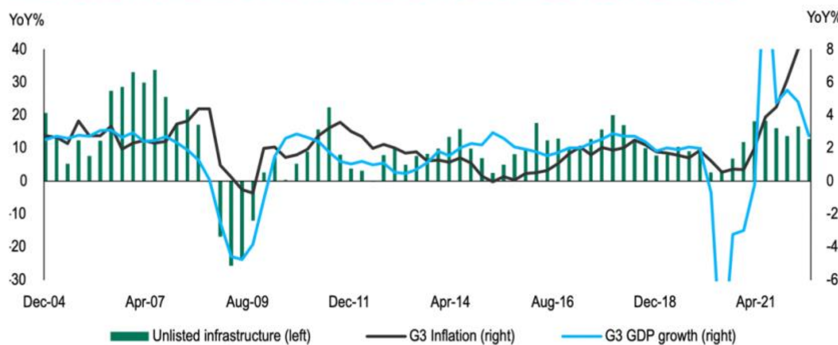
In particular, for 2023 we decided to focus especially on Infrastructure, which in our opinion is the best catalyst for a period characterized by high uncertainty, geopolitical risks and persistent inflation.

Infrastructure

Infrastructure has shown consistent long-term returns, averaging 9.9% annually since 2004. It performed exceptionally well in the previous year, delivering a 12.8% return and emerging as one of the strongest-performing asset classes. Despite anticipated economic challenges in 2023, infrastructure is expected to remain resilient, with core and core plus assets being particularly attractive to investors due to their defensive nature, high yield, and reliable inflation hedge. However, assets at the higher risk end may face uncertainty due to tight

monetary policy and weaker economic growth. Prudent leverage management and access to liquidity are crucial going forward.

Infrastructure's performance has been resilient through COVID-19 and so far in 2022



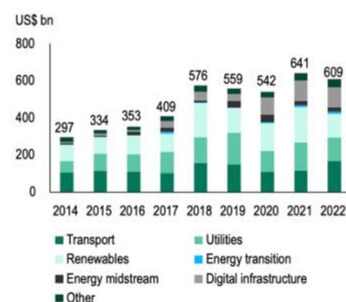
Source: Macrobond, Cambridge Associates (June 2022).

Infrastructure performance compared to Inflation and GDP growth

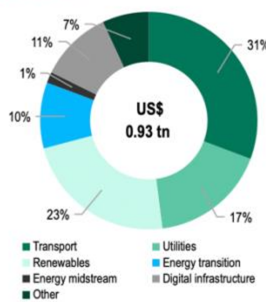
Geopolitical tensions, particularly the war in Ukraine, have compelled governments worldwide to accelerate their transition to clean energy sources for enhanced energy security and independence. Historical instances show that conflicts have often spurred transformations in the energy sector. The Inflation Reduction Act (IRA) in the US is anticipated to provide a significant boost to clean energy technologies, stimulating commercial deployment and attracting substantial private capital. This act may also serve as a catalyst for other nations to intensify their energy transition strategies.

Global infrastructure fundraising reached a record high of $139.6 billion in 3Q22, surpassing the total for 2021. Although there was a slowdown in the second half of 2022, it is expected to continue into 2023 due to economic uncertainties and the denominator effect. Nevertheless, infrastructure fundraising is likely to rebound, driven by the attractiveness of infrastructure investments to institutional investors aiming to reach their target allocations. Core and core plus strategies are expected to be in demand, while open-end structures and opportunities in the secondaries market may gain traction.
Infrastructure deal activity remained strong in 2022 and is expected to continue, particularly in energy transition sectors such as renewable generation, battery storage, green hydrogen, and electric vehicle charging infrastructure. Partnerships between infrastructure funds and other market participants, including governments and corporates, are anticipated to increase as capital is required to achieve carbon reduction and climate impact goals.

Global unlisted infrastructure deal activity



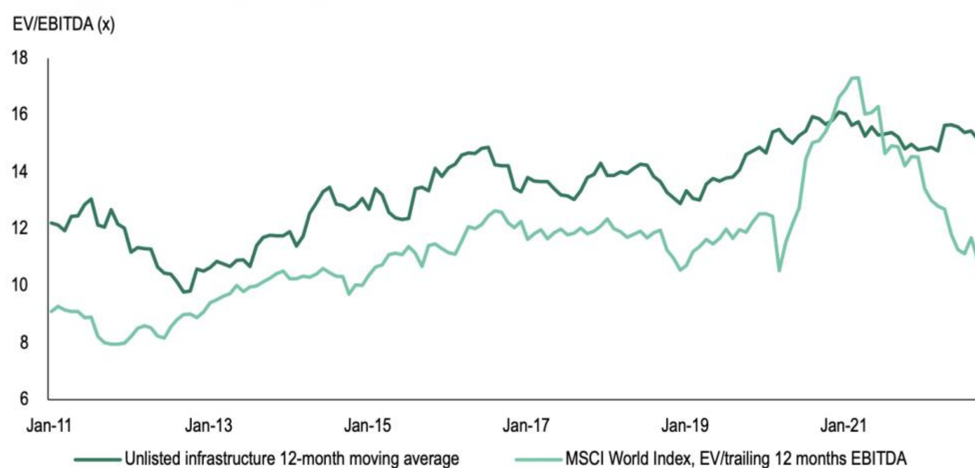
Expected pipeline of deals over the coming 12-24 months



Source: Infralogic by Inframation (December 2022). Excludes energy upstream and downstream. Energy transition sectors include EV infrastructure, hydrogen, battery storage, carbon capture, energy efficiency. Pipeline of opportunities refers to live transactions launched over the past 12 months, excluding cancelled or on-hold deals.

Valuations in the infrastructure market remained stable in 2022 despite market volatility and rising interest rates. Infrastructure assets, supported by regulation or long-term contracts with creditworthy counterparts, are likely to exhibit greater resilience in valuations. However, there may be a divergence in valuations in 2023, with assets having strong inflation-linked cash flows or high-quality growth platforms demonstrating better resilience compared to assets with weaker links to inflation and lower-quality growth.

Unlisted infrastructure EV/EBITDA transaction multiples have been stable so far despite the derating in the listed equities space



Sources: Inframation, Bloomberg, Macquarie Asset Management database of transaction multiples (October 2022).

Unlisted infrastructure valuations remain solid compared to equity market

Overall, while acknowledging potential risks, the report highlights the positive outlook for infrastructure investments in 2023, emphasizing their historical performance, resilience, and attractiveness to investors amidst the prevailing economic and geopolitical circumstances.

GROWTH EQUITY MARKET AND TRENDS

Growth equity has become one of the fastest-growing sectors of the private capital industry, the demand for higher-returning equities is at its peak and ever-larger companies flourish in this market. This investment strategy has long existed as a halfway between traditional venture capital that acquire small stakes in nascent companies, and private equity funds that usually buy more mature ones. But lately, capitals flowed into private markets from investors seeking alternatives to classical investment strategies. Growth equity does not have the same return profile as venture capital, it concerns a later stage of a firm's development; nonetheless the investment still aims at high returns, but the overall risk is lower.

Growth equity has more than doubled since the end of 2016, to almost $920bn at the end of March 2021. Morgan Stanley has estimated that growth equity is the fastest-expanding subsector of private capital, with a compound annual growth rate of about 21 per cent in the past ten years, compared with 10 per cent for private equity and 16 per cent for venture

capital. A survey of 200 institutional investors by Numis Securities found that 73 per cent planned to increase their asset allocation to growth equity.

This boom is partly due to the fact that many private equity and venture capital firms have limited capacity and have accumulated large war chests of money without finding a market where to funnel them. In 2021, the total private equity deals value reached $1.2 trillion, up 96 percent from the previous year. It was also the first time that the industry crossed the $1 trillion milestone.
Private equity firms are launching more growth funds that accept minority stakes to get in earlier in a company's life, while some venture capital firms have established growth funds that can hold on to investments longer and inject bigger flows of money than they normally would. At the same time, hedge funds jumped into growth equity as well. The latter are joining growth equity markets to address the fact that many companies are staying private for far longer than they have historically. Another reason why private market investors are moving toward earlier-stage investments is to avoid near-term public debuts in a scenario of high volatility.

2021 marked the first trillion-dollar year for the industry. In the past growth capital funds were defined by relatively small pools of capital; in 2021, however, growth funds raised a record $102 billion, up 53 percent from a year before and up 74 percent from the average of the previous five years, according to an Ernst & Young report.
This investment strategy has allowed private equity funds to outperform most of their public market counterparts. In 2021, they generated an IRR of 27%, the highest among all private asset classes. According to McKinsey, private credit also delivered reliable low-volatility returns that exceed fixed-income alternatives with an average of 10.1 percent IRR in the first three quarters of 2021.

The rise of growth equity funds also helped push private market activity to new heights. Growth equity funds, which invest in relatively mature private companies, have grown at a compound annual growth rate of 4.2 percent over the last five years, as firms traditionally focused on venture capital and private equity moves towards this space.

During 2022, many experts questioned the sustainability of such an unprecedented level of private market activity. "A new set of risks emerged at the beginning of 2022 with the potential to undermine growth and performance," the McKinsey's report said. In addition, the Russian invasion of Ukraine, higher inflation and interest rates, and supply chain and labour challenges already increased volatility making the sector more unstable.

Outlook for 2023

The private markets in growth equity are expected to experience further declines in valuations as they normalize. Many private companies raised significant capital in the past years, aiming to grow into their high valuations. Venture capital fundraising reached record highs, resulting in a substantial amount of available capital for existing portfolio companies. This capital infusion is expected to delay near-term valuation markdowns. Late-stage deals have seen companies raising bridge rounds to maintain their valuations and extend their IPO timelines.

Looking ahead, the extended closure of IPO markets will increase pressure on private companies, making founders more receptive to raising capital at flat or lower valuations to extend their runway. In the technology and climate technology sectors, opportunities are expected to arise in late-stage venture and early growth stage rounds, such as Series B and Series C deals. Structured equity deals with downside protective provisions may become more common. The narrowing gap between founder and investor valuation expectations presents attractive investment opportunities.

Generative AI sector

The generative AI sector is experiencing significant advancements driven by breakthroughs in machine learning techniques. Foundational models now have the ability to generate high-quality content such as text, images, and videos. These applications have the potential to greatly enhance productivity in various sectors, ranging from assisting developers with coding recommendations to enabling marketers to quickly generate robust content.

The economic opportunity in the generative AI sector is substantial. Viral platforms built on leading foundational models have already garnered millions of users, resulting in billions of dollars in value creation through direct spending on AI products and efficiency gains for enterprises. The sector presents multiple vectors of value creation, including companies developing foundational models, vertical-specific solutions built on top of these models, and infrastructure players such as streaming data and machine learning operations companies.

While generative AI offers exciting investment opportunities, caution is advised regarding valuations. Some companies in the sector have raised rounds at high valuations relative to their commercial traction. It is important to evaluate the sustainability of their differentiation and moats in a landscape where many foundational models are open source. Investing in players with demonstrated traction, differentiation, and sustainable business models will be crucial in navigating the generative AI sector.

Life Science sector

The life science sector offers attractive investment opportunities as valuations have corrected and present more favourable conditions. The market experienced a substantial expansion followed by a correction in recent years, with both public and private valuations

adjusting. The gap in the market is now focused on finding investors with expertise in company formation, scientific knowledge, and commercialization experience.

As valuations have corrected, there is an increased appreciation for experienced investors and company builders who can navigate the sector effectively. The shift in generalist investors from the biotechnology space has created an opportunity for those with deep expertise to capitalize on the market's potential. This environment allows for investing earlier in the biotechnology company lifecycle, seeding high-potential clinical assets, and leading syndication of pivotal Series A financings.

The life science sector offers significant value creation potential, driven by accelerating scientific innovation and the need for large pharmaceutical companies to acquire new, high-potential assets. This combination of factors creates an unusually favourable time to invest in the life science sector, with a focus on experienced investment teams that can leverage their knowledge and network to identify promising opportunities.

INFLATION AND PRIVATE ASSETS

Private Credit to combat inflation

Private debt loans are floating rate and therefore offer investors some protection from inflation eating away their returns, in comparison to fixed rate bonds which lose value in a higher inflation or rising interest rate environment.

In a rising rate environment, the higher returns for private debt managers means there is a greater obligation for private debt managers to service that debt. The cost of ongoing repayments increases, which would obviously weigh on the company's bottom line. Therefore, it is incumbent on private debt fund managers to remain vigilant and carry out sensitivity analysis, to see whether underlying companies can service their debt as interest rates increase. Ensuring fund managers can maintain comprehensive underwriting standards and investment discipline on companies that potentially have cash flow sensitivity is crucial.

Advantages of Private Credit compared to High Yield bonds: the case of European ABS

Given their favorable carry characteristics and lower asset volatility than public market equivalents, investors have discovered opportunities to pick up additional yield in the floating-rate European asset-backed securities (ABS) market by simply collecting the assets' coupons until maturity. We think there may still be opportunity for further spread compression in the ABS markets, barring any unforeseen shocks, despite the fact that spread reduction has boosted underlying asset prices.

There have been some private ABS deals with mezzanine tranches that have significantly outperformed public mezzanine ABS and high yield indices. These are privately constructed

forward finance arrangements that lend against collateral like US credit card receivables and US home improvement loans.
These private transactions are special in that the complexity of the structuring and the bespoke documentation can both assist in reducing downside risk.

Taking a look at the market, we believe that while some sectors are delivering great relative value when compared to public market equivalents, others are still offering rising prices as a result of surplus liquidity chasing yield in lower credit tiers. Utilizing a window of opportunity to strategically allocate funds to European leveraged loans, while high yield index spreads are at better levels. The strength of loan issuance in Europe in 2021 has also been taken into account in this research.

In addition, the entry of new issuers into the market in 2021 has given corporations a wider option, which has resulted in wider prices. This year, new loan issuance was tied to supporting fresh M&A activity as private equity sponsors prepared to spend considerable sums of dry powder.

The pictures below describe the European ABS comparison with High Yield (Figure 1) and Corporate Debt Spreads (Figure 2)

Figure 1 Comparison of private mezzanine ABS spreads to US & UK high yield option-adjusted spreads (basis points)

Source: ICE BofA Sterling High Yield Index (HL00). ICE BofA Euro 1-3yr US High Yield Constrained Index (H1AC). Mezzanine ABS margins: The source of the information is based on M&G experience trading in the market. Information is subject to change and is not a guarantee of future results.

Figure 2 Corporate debt spreads – leveraged loans and direct lending deals have offered a premium (basis points)

Source: Credit Suisse Western European Leveraged Loan Index (CS WELLI) 3-year discount margin. ICE BofA European High Yield Index (H0A0). Leveraged loan and direct lending margins: The source of the information is based on M&G experience trading in the market. Information is subject to change and is not a guarantee of future results.

Due to the well-known advantages of high running income potential and low duration due to their floating-rate coupon, as well as secondary trading opportunities in the senior-secured loan market, loans also present a relative value opportunity. When value arises, we have the ability to rotate into other private and illiquid opportunities thanks to an active secondary loan market, which offers relative liquidity compared to other areas of the private credit universe.

Growth factors of Private Credit and threats

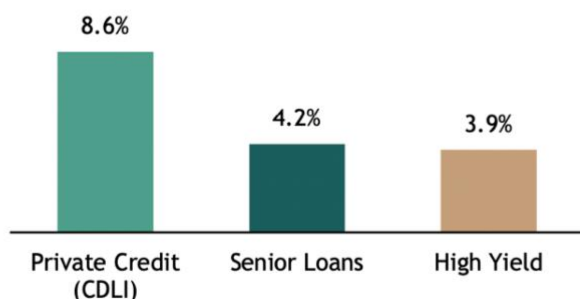
Private equity managers are bypassing banks and going directly to private credit funds to obtain financing for deals. Approximately 45% of private equity firms have increased their use of private credit financing in buyouts.

Advantages in comparison with classic lending process

1. Faster execution and higher certainty to close compared to public markets
2. Ability to partner with sophisticated lenders and have structuring flexibility
3. Private assets with few public disclosure requirements
4. Terms are less likely to change due to market conditions once terms are set
5. More efficient process with less management distraction

Annualized Yield

12-Month



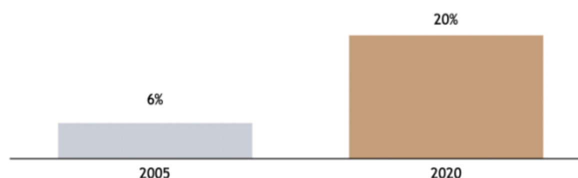
Source: Morningstar, Cliffwater Direct Lending Index, S&P/LSTA Leveraged Loan Index. As of September 30, 2021.

Bank Lending Has Retreated Since 2005

Bank Participation in U.S. Loans(1)

Private Credit Addressing Financing Needs

Private Credit as a percentage of the Credit Markets(2)



HIGHER INCOME THAN OTHER FIXED INCOME SECTORS

	Private Credit	Senior Loans	High Yield
Floating Rate	✓	✓	
Call Protection	✓		✓
Covenants	✓		
Senior Secured	✓	✓	
Bank / Syndicate Sourcing		✓	✓

Source: Blackstone Credit, 2021

Threats:

1. The upper end of the mid-market has become very competitive and some private equity firms had to make concessions to get deals done, relatively to covenants and margins.
2. Moreover, returns have been on a downward trend, with the rolling three-year internal rate of return dropping from 8.5 per cent in 2015 to 5 per cent in 2020, according to Preqin.
3. It can result as asymmetric if analysed in terms of returns on offer relative to the risk

In our opinion Private Credit strategies can result attractive moving forward but only if borrowing companies ability to face rising costs related to Russia-Ukraine war and to the global inflationary cycle is proven.

This is part of the bigger trend of private equity creating partnerships with SMEs to help them go through a difficult inflationary cycle and shifts in monetary policy.

In fact Private equity firms may have an opportunity to reinforce their position with mid-market portfolio companies not only as sources of financing but as strategic partners that can advise businesses on a sound financial strategy to succeed through inflation.
According to the World Economic Forum, SMEs businesses are particularly vulnerable to the effects of rising prices, yet they are essential in a post-pandemic economy.
Private equity will play an important role in supporting those businesses.

The challenge for private equity firms is to diagnose exposure to inflation across the portfolio and then devise strategies to react quickly. This starts with setting up a “control tower” at the fund level to quickly gather essential information: Which companies are seeing supply cost increases? Which is already working on pricing initiatives? What are they hearing in the market?

At the portfolio company level, the imperative is to diagnose cost pressures and pricing opportunities product by product, customer by customer. Blanket pricing moves don’t work. Companies need to be careful in the selection process based not just on input costs, but also on factors like the value of a customer or segment, historical performance, and the company’s position in the relevant market.

BLACKSTONE PRIVATE-CREDIT CASE (2021)

Blackstone Inc. raised $32.6 billion of cash last year for a new private-credit fund amid booming demand for the growing asset class that offers higher yields and interest payments that rise as inflation jumps.
Blackstone Private Credit Fund delivered a 12.4% total net return last year, according to its website. This is a clear overperformance on the market return for leveraged loans of 5.2% in the same period. Blackstone is among several large lenders in the roughly $1 trillion private-credit market who've been offering products like BCRED for individuals to invest in loans to midsized companies filling a hole in the supply. One of the risks for investors choosing this type of investment instead of a leveraged loan mutual fund is the lower liquidity.
The increasing size of these private lenders funds has allowed them to compete with big banks in funding leveraged buyouts. Blackstone's private credit arm led the financing for Warburg Pincus LLC's $2.3 billion takeover of Informa Plc's Pharma Intelligence division. BCRED was a lender in 19 loans of $1 billion or more in 2021. Those deals included a $2.65 billion loan to Guidehouse Inc., a provider of public sector consulting services, and a $2.6 billion loan to Inovalon Holdings Inc., a cloud-based services firm to the healthcare industry, according to the firm's website.
Other direct lenders seeking individual investors for their funds include Apollo Global Management Inc., which set up a new company earlier this year, and HPS Investment Partners, which has $1.2 billion to invest from a new private BDC called HPS Corporate Lending Fund. Of the $32.6 billion of cash raised by BCRED in 2021, $15.8 billion was equity commitments from investors, and the rest was borrowed money.

Informations taken from Bloomberg.com

CONCLUSION

The greatest trends that are driving investments in private assets are:

- Democratization of private markets
- More focus on impact investing
- Innovative structures with new liquidity
- Movement from illiquidity premium to complexity premium

The main challenges related to private investments are high fees, inflation, increased competition and high risk.

The main advantages are the floating rate, diversification and the fact that companies stay in private ownership for longer (from six to eleven years in the last decade), and a larger share of the value is created at a private level.

Given these risks, the continued evolution of private markets requires seasoned investors with differentiated sourcing advantages, expertise in fundamental analysis and a disciplined

and consistent underwriting approach. This approach, coupled with the floating rate nature of many private credit assets, should serve market participants well in the year ahead.

Upon reviewing each asset class, we believe that Infrastructure may be the most reliable option moving forward, especially considering the anticipated period of high inflation.

Within infrastructure debt investing, renewable energy and the energy transition to decarbonization should be interesting investment areas as new government policies target net-zero carbon emissions by 2050. Battery storage, electric vehicle charging infrastructure and merchant renewable energy markets may benefit from additional tailwinds as companies seek to meet emission reduction and focus on sustainability efforts Infrastructure sectors impacted by COVID-19, such as digital infrastructure and healthcare assets, are also promising.

Infrastructure is expected to remain relatively resilient in 2023 due to its ability to pass through inflation and the essential nature of the services it provides, as well as its high yield and reliable inflation hedge. Traditional merger and acquisition activity is expected to soften, but activity across all energy transition sectors, including renewable generation and battery storage, is expected to increase. There could be an increase in partnerships between infrastructure funds and other market participants, and policy support is expected to be a catalyst for additional private capital deployment. High-quality digital infrastructure assets could stand out in comparison to lower-quality classes.

While the performances in 2021 have been exceptional for the other asset classes such as private credit and growth equity, this has not repeated in 2022 and we think that it will be the same for 2023 due to risks such as the continuation of the Russia-Ukraine war, persistent inflation and high interest rates. Supply chain and labour challenges are also contributing to increased volatility.
Finally considered the slowdown in M&A activity and decreased deal size we believe it is better to shift to other asset classes within the private markets spectrum.
Even if we mentioned the potential of private credit earlier in the report (see PRIVATE CREDIT OUTLOOK) we believe that considered the risks, both macro and geopolitical, it’s not an investment as effective as it used to be in the past and we prefer to shift our attention towards Infrastructure, which we perceive as a more solid asset class in a period of high uncertainty and volatility.

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