Private Credit Opportunities Today

With persisting inflationary pressures and the prospect of rising interest rates on the horizon, many investors expect market turbulence and economic uncertainty in the year ahead. Private credit investments may continue to serve as a stable and resilient source of income for investors seeking shelter from the storm.

2021
Private loan issuance hit a record high

Great Expectations

Growth of private credit has significantly accelerated since the Global Financial Crisis, when increased regulatory oversight and balance sheet scrutiny led more banks to focus on lending to only the largest borrowers. This left a tremendous opportunity for private lenders to step in and fill the void for many other companies in need of financing solutions.

Private loan issuance hit a record high in 2021[1], and there are no signs of growth slowing down anytime soon. There are several reasons why private credit is expected to continue on its growth trajectory. For one, the pace of private equity raises hasn't slowed, and firms continue to raise more and more capital and have significant cash reserves, or "dry powder," to deploy.

[1] As of December 31, 2021
Source: Refinitiv LPC

This high level of private equity dry powder suggests there is meaningful room for additional growth in the space, and ample opportunity for private lenders.

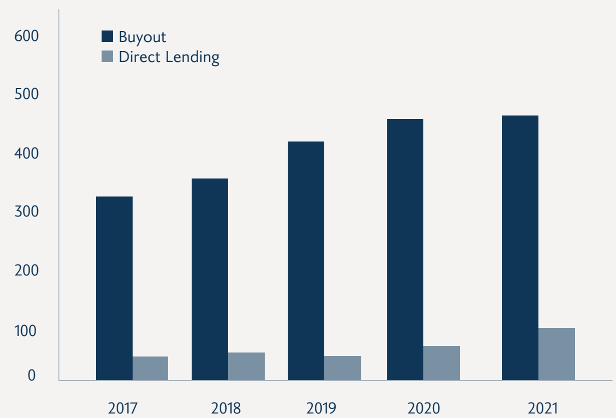
Origination activity, or the process borrowers and lenders undergo when executing a new loan, also points to continued private credit growth. As shown, in 2021 deal originations have reached their highest levels in five years. This suggests that borrowers—especially private equity sponsors—are increasingly willing to pay the small pricing premium for the expertise provided by many private credit lenders, particularly in complex acquisitions.

As origination activity has grown, so too have deal sizes. Deals are rebounding back to pre-pandemic levels, over $110 million in average size,[2] underscoring the continued need for companies to pursue private lending avenues.

> **$110 million**
> average size of deals, rebounding back to pre-pandemic levels

Private Equity Dry Powder Growth Can Drive Private Lending Opportunities

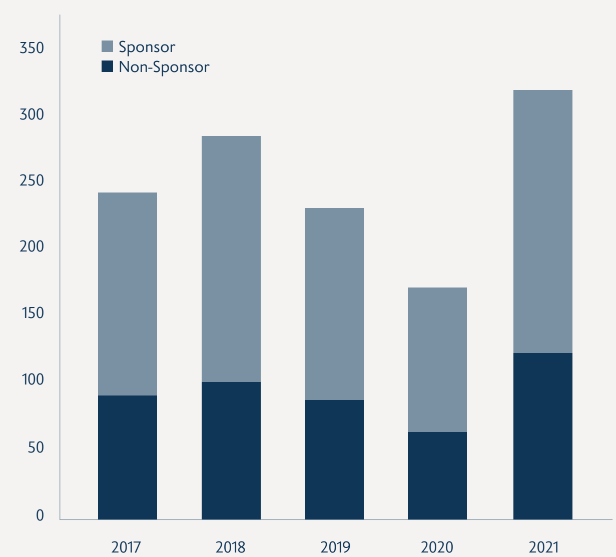
Dry Powder ($ in billions)



As of December 31, 2021
Source: Preqin

2021 Deal Originations Reach Record High

Loan Origination Activity ($ billions)



As of December 31, 2021
Source: Refinitiv LPC

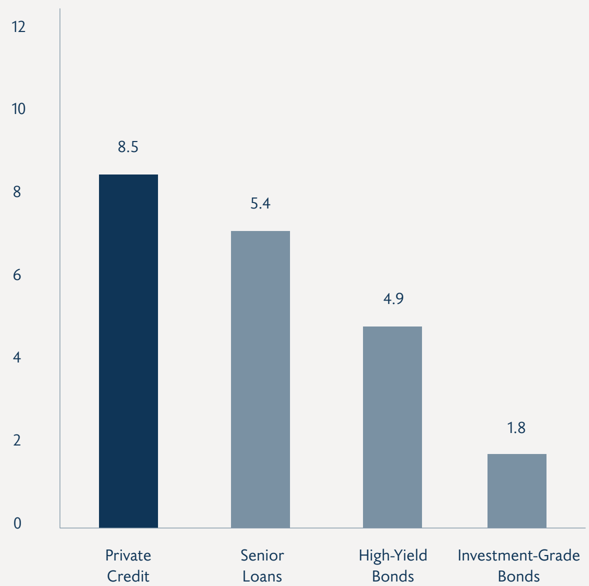
[2] As of December 31, 2021
Source: Refinitiv LPC

Rising Rates, Inflation on the Horizon

The prolonged low interest rate environment has resulted in historic low yields for traditional fixed income assets. As such, discerning investors have been turning to the private markets in search of yield—and discovering private credit's potential to deliver higher yields. As an example, private credit continued to outperform other fixed income assets throughout the 2021 low rate environment, both in terms of yield and total return.

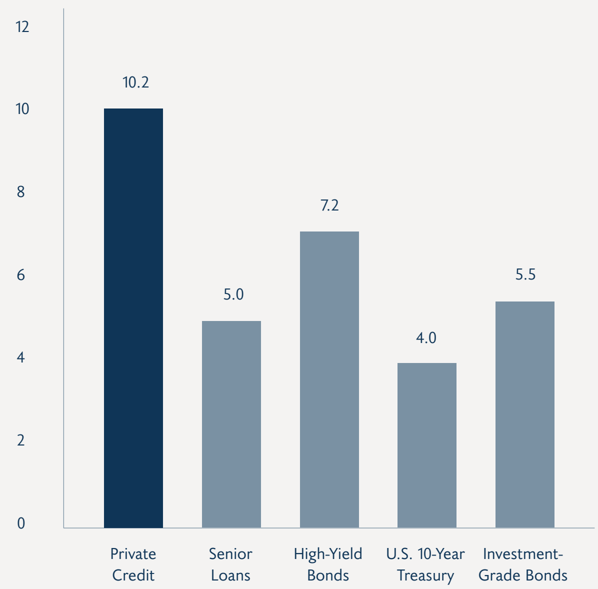
Looking ahead, inflationary pressures and a recovering U.S. economy have the Federal Reserve signaling as many as nine potential rate hikes in 2022. However, we expect the process of raising interest rates will be a slow and conservative one. As a result, traditional fixed income yields will likely stay well below historical averages for some time—and investors will likely continue their hunt for yield beyond traditional fixed income.

Private Credit Potential for Higher Yield
(% Yield)



Past performance does not guarantee future results. Illustration for discussion purposes only. All investments involve risk of loss, including loss of principal invested. Private Credit represented by Cliffwater Direct Lending Index, Senior Loans represented by Credit Suisse Leveraged Loans Index, High-Yield Bonds represented by ICE BofA U.S. High-Yield Index, Investment-Grade Bonds represented by Bloomberg Barclays U.S. Corporate Bond Index. An investor cannot invest in an index.
As of December 31, 2021
Source: Cliffwater, Credit Suisse, Bloomberg, ICE BofA

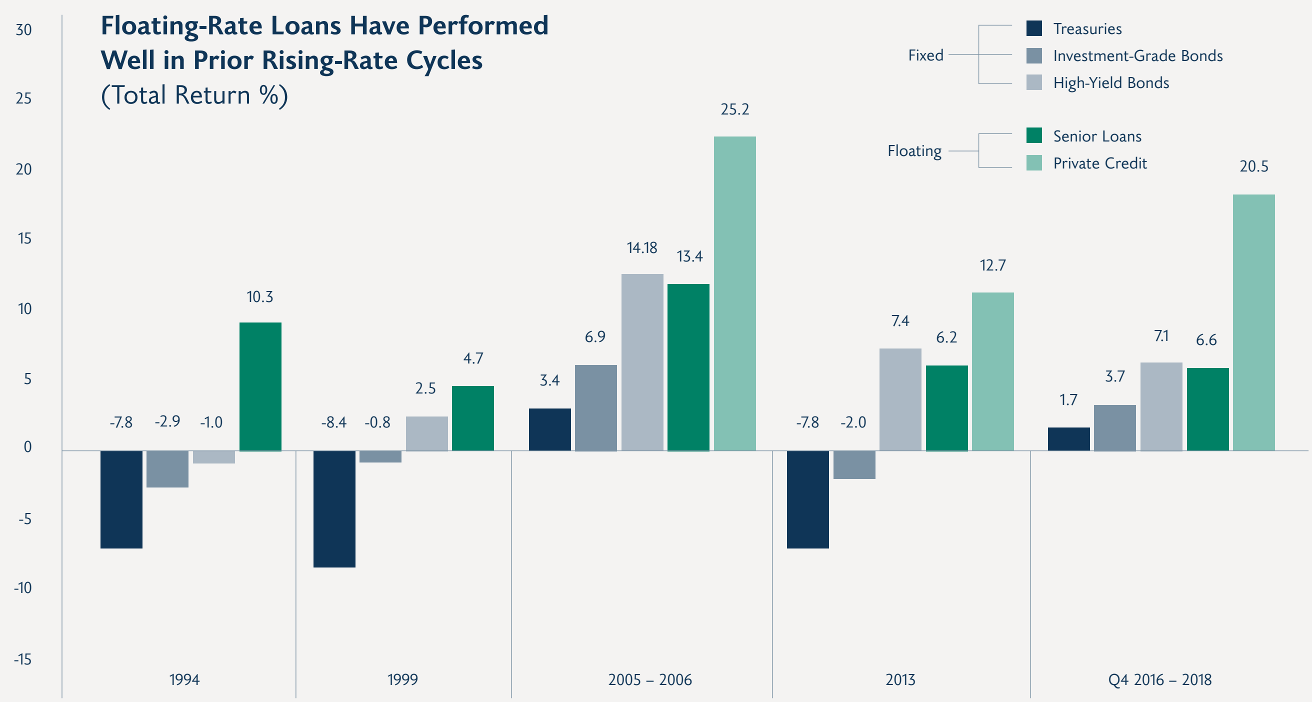
Private Credit Potential for Higher Total Return
(Total Return %)



Past performance does not guarantee future results. Illustration for discussion purposes only. Information does not represent returns of the Fund. Annualized Return is periodic returns rescaled to a period of one year. Volatility is represented by standard deviation, which measures the degree to which an investment's return varies from its mean return. Risk-adjusted returns are represented by Sharpe Ratio, which measures the excess return (or risk premium) per unit of risk (measured by standard deviation) in an investment asset or a trading strategy. An investor cannot invest in an index. Corporate Investment-Grade Bonds represented by Bloomberg Barclays U.S.Corporate Bond Index; Senior Loans represented by Credit Suisse Leveraged Loans Index; U.S. 10-Year Treasury represented by FTSE 10-Year Treasury (OTR); High-Yield Bonds represented by ICE BofA U.S. High-Yield Index; Private Credit represented by Cliffwater Direct Lending Index.
Total Returns January 30, 2010, through December 31, 2021
Source: Bloomberg, Cliffwater

Shelter from the Storm

While private credit can provide a reliable source of yield in a low interest rate environment, it can also serve as a valuable hedge against the impact of rate increases. The investable universe of private credit mainly consists of floating-rate loans—and the variable interest rates associated with these assets means they can offer protection against the impact of rising rates and inflation.



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Source: Bloomberg, ICE BofA, FTSE 10-Year Treasury, Credit Suisse, Cliffwater

Private credit investments also have a shorter duration—or less sensitivity to interest rate changes—than fixed rate debt. As such, they're less likely to decline in value as interest rates rise. This downside protection is evident when examining how private credit has fared in past rising rate environments. As shown, private credit has performed well in previous cycles.

Further, private credit loans are also collateralized, high in the capital structure, and normally include covenants designed to protect investors from unforeseen risks—such as the borrower taking on additional debt. As such, they offer better downside protection built into the loan agreements, as well as the potential for lower losses in a default when compared to other types of debt instruments.[3]

[3] Source: Cliffwater, S&P LCD, S&P Dow Jones, J.P. Morgan, Lincoln International

The Right Time for Private Credit

The private credit market has grown at a rapid clip over the past two decades, and several signs point to continued growth ahead. And while private credit has historically provided high yields relative to traditional fixed income, we believe it can offer additional benefits in the face of today's inflationary pressures and anticipated rising rate environment. The floating-rate loan composition of private credit—and the frequently built-in protection for investors—can make them a valuable hedge against the impact of rising rates.

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Index Definitions

Bloomberg Barclays U.S. Aggregate Index is a broad-base, market capitalization-weighted bond market index representing intermediate-term investment-grade bonds traded in the United States.

Bloomberg Barclays U.S. Corporate Bond Index measures the investment-grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by U.S. and non-U.S. industrial, utility and financial issuers.

Bloomberg Barclays U.S. Corporate High-Yield Index measures the USD-denominated, high-yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on the indices' EM country definition, are excluded.

Bloomberg Barclays U.S. Municipal Index covers the USD-denominated long-term tax exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds and prerefunded bonds.

Cliffwater Direct Lending Index measure the unlevered, gross of fee performance of U.S. middle market corporate loans, as represented by the asset-weighted performance of the underlying assets of Business Development Companies (BDCs), including both exchange-traded and unlisted BDCs, subject to certain eligibility requirements.

Credit Suisse Leveraged Loans Index tracks the performance of senior floating rate bank loans and is designed to mirror the investable universe of the USD-denominated leveraged loan market. This index tracks the investable market of the U.S. dollar-denominated leveraged loan market. It consists of issues rated "5B" or lower, meaning that the highest rated issues included in this index are Moody's/S&P ratings of Baa1/BB+ or Ba1/BBB+. All loans are funded term loans with a tenor of at least one year and are made by issuers domiciled in developed countries.

FTSE U.S. Treasury Benchmark (on-the-run) Indices measure total returns for the current two-, three-, five-, seven-, ten-, twenty- and thirty-year on-the run Treasuries that settle by the end of the calendar month. As a result of the reduced auction schedule for one-year Treasury bills, as of May 2000, an existing coupon bond with approximately one year to maturity is selected as the one-year benchmark. In most cases, this is an old two-year security.

ICE BofA U.S. High-Yield Index is market capitalization weighted and is designed to measure the performance of U.S. dollar-denominated below-investment-grade (commonly referred to as "junk") corporate debt publicly issued in the U.S. domestic market.

brookfieldoaktree.com
info@brookfieldoaktree.com
+1 212-549-8380 or 855-777-8001

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