Private Credit: A Strategy for All Seasons

Regardless of whether interest rates rise, fall or hold steady, private credit has demonstrated its resilience and adaptability across a range of macroeconomic environments. Its ability to offer reliable income and an attractive risk-return profile highlights its potential role as a complementary portfolio allocation. In our view, private credit is a strategy built to perform—and endure—through all seasons.

Floating-Rate Nature Offers Potential Yield Protection

In Private Credit: The Floating-Rate Advantage, we note that a majority of private loans are structured with floating-rate coupons, which reset higher as base rates rise. As base rates rise, the income paid to investors also rises, helping preserve or even enhance yield potential in rising rate environments. When base rates decline, so does income from floating-rate loans. However, as described below, there are several important mitigants that can help offset the impact of lower base rates.

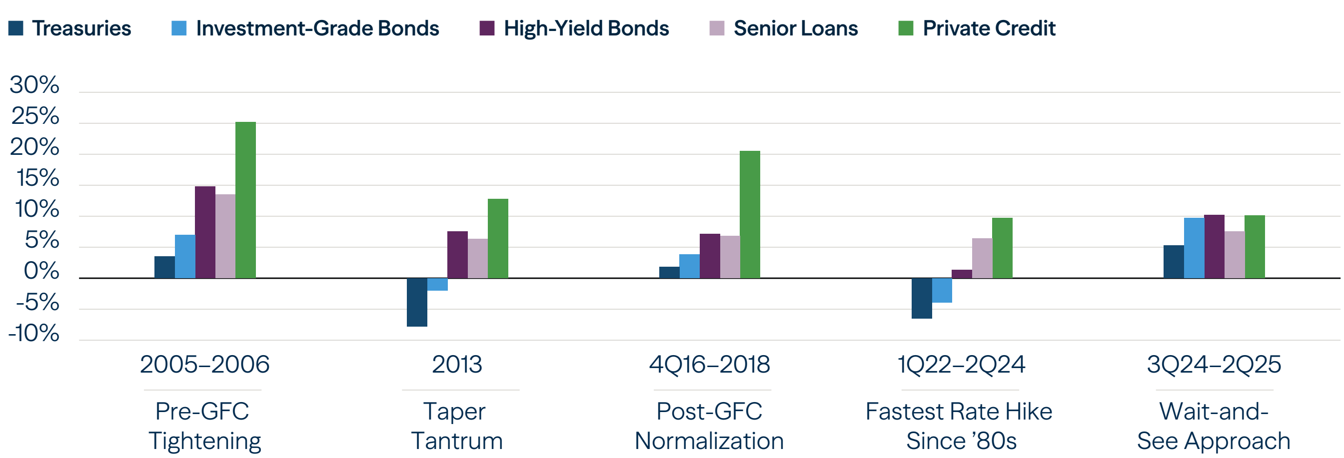
Borrowers are a notable beneficiary of lower rates. When rates decline substantially, floating-rate issuers can benefit from lower interest expenses. Lower interest expenses can subsequently result in higher cash flow and interest coverage, two key indicators of credit health. A more benign rate environment may contribute to lower defaults and fewer losses in portfolios.

However, lower base rates do not necessarily translate to lower yields for all lenders. In a lower base rate environment, spreads tend to widen, and prudent lenders practice more price discipline. Mergers and acquisitions activity may also pick up when rates decline. More deal activity typically translates to a greater supply of private credit deal flow, which would be a welcome development for a market seeing a supply and demand imbalance. A healthier pipeline of deals may also allow for more deal selectivity, better pricing and stronger lender protections.

Thus, private credit has historically exhibited a level of built-in protection that may be hard to find elsewhere in fixed-income assets. In various interest-rate cycles since 2005, private credit has historically delivered high total returns relative to Treasuries, investment-grade bonds, high-yield bonds and senior loans—and particularly during rate-hiking cycles (**Figure 1**).

Figure 1: Private Credit Has Historically Performed Well in All Interest-Rate Environments

Total return in the last five interest-rate cycles



Source: Cliffwater, ICE BofA, LSEG, Morningstar, S&P Global. As of June 30, 2025. Past performance is not indicative of future results. Chart shows performance over last five interest-rate cycles through June 2025. Treasuries are represented by FTSE 10-Year Treasury Benchmark Index. Investment-Grade Bonds are represented by ICE BofA Global Corporate Bond Index. High-Yield Bonds are represented by ICE BofA U.S. High-Yield Index. Senior Loans are represented by S&P UBS Leveraged Loan Index. Private Credit is represented by Cliffwater Direct Lending Index (data since index inception in 2005; as of June 30, 2025). Reflects cumulative returns. Indexes are unmanaged and an investor cannot invest directly in an index.

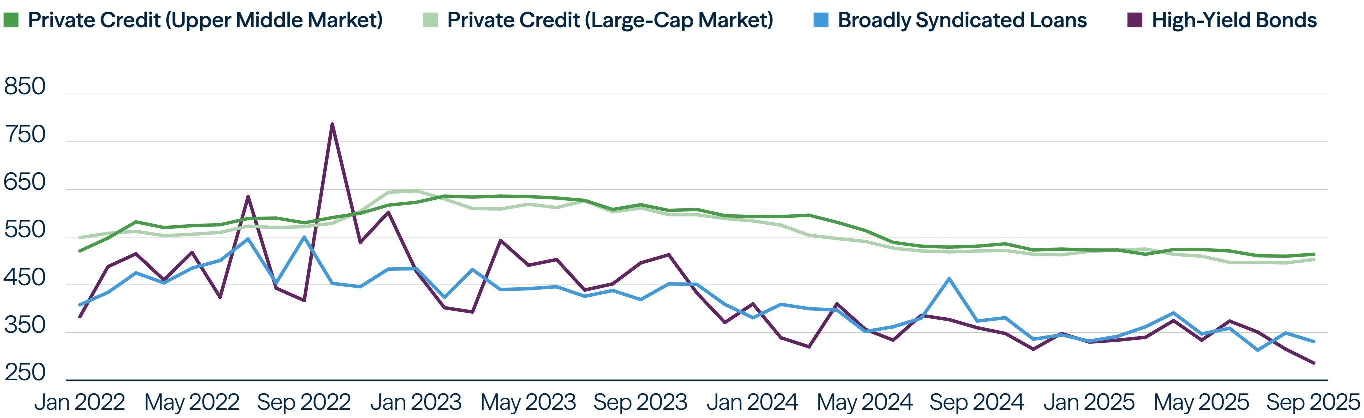
Opportunity Through Illiquid and Complex Transactions

Unlike traditional fixed income, private credit investments often involve holding less liquid positions and structuring customized solutions. In exchange for locking up their capital, investors are compensated for this risk with potentially higher spreads and more favorable terms when compared to other traditional fixed-income assets.

Since the start of the last rate-hiking cycle, private credit has offered an excess spread over public credit. Notably, private upper middle market spreads have offered a premium of 228 basis points (bps) and 183 bps over high-yield bonds and broadly syndicated loans, respectively (**Figure 2**).

Figure 2: Private Credit Has Historically Exhibited a Spread Premium Over Public Credit

Private vs. public: Average spreads by EBITDA (bps)



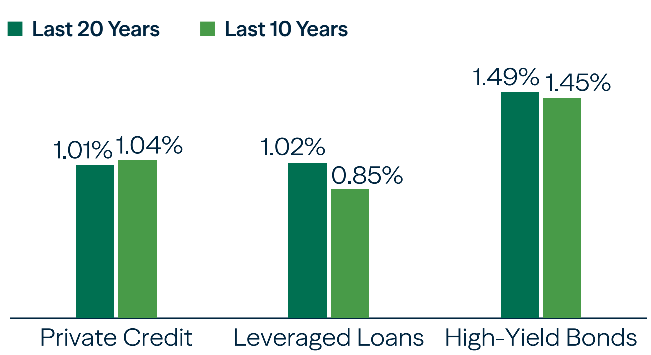
Source: KBRA DLD Research, PitchBook LCD, S&P Global. As of September 30, 2025. **Past performance is not indicative of future results.** Data points represent the three-month rolling averages of spreads. Private Credit (Upper Middle Market) represents companies with EBITDA of $50–100M. Private Credit (Large-Cap Market) represents companies with EBITDA of $100M+. Broadly Syndicated Loans (BSLs) represent single B-rated BSLs. High-Yield Bonds represented by S&P U.S. High-Yield Corporate Bond Index. Indexes are unmanaged and an investor cannot invest directly in an index.

A Potential Tool for Risk Mitigation

Through direct negotiations with borrowers, private lenders typically secure strong covenants and collateral backing. These private loans also sit higher in a company's debt structure when compared with equity, which means they are paid first in the event of a potential default. Such protections are designed to help lenders manage default risk and preserve value during periods of volatility, across varying rate backdrops (**Figure 3**).

Figure 3: Private Credit Has Historically Experienced Lower Losses Compared With Other Fixed-Income Assets

Historical credit losses



Source: Cliffwater, J.P. Morgan Markets. As of December 31, 2024. **Past performance is not indicative of future results.** Private Credit represented by Cliffwater Direct Lending Index Middle Market Debt (Realized Credit Losses). Leveraged Loans and High-Yield Bonds data from J.P. Morgan Markets. Indexes are unmanaged and an investor cannot invest directly in an index.

Private Credit Demand Has Continued to Grow

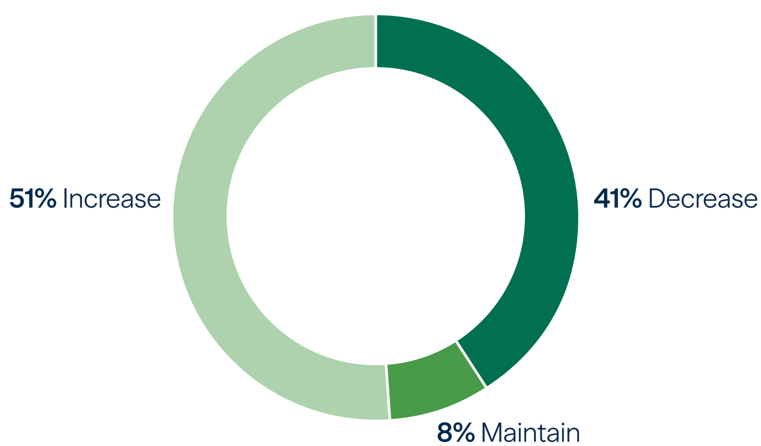
As we look ahead, the demand for private credit remains abundant. In higher-rate environments, banks have often pulled back from lending, creating opportunities for private lenders to step in to meet the financing needs of mid-size companies with more complex balance sheets and riskier credit profiles. In lower-rate environments, businesses have still turned to private credit for flexible, tailored capital that public markets may not be able to provide.

Recent market research and surveys have shown that investors are still interested in incorporating private credit within their portfolios, with a majority of investors looking to increase or maintain their private credit allocations in the longer term (**Figure 4**).

Together, we believe these key trends and characteristics suggest that private credit remains a compelling investment opportunity for investors seeking current income and long-term capital preservation across all seasons.

Figure 4: A Majority of Investors Plan to Increase Allocations to Private Credit Over the Longer Term

Expected allocations to private credit



Source: Preqin Investor Outlook: H2 2025, August 2025. Preqin survey asked investors: "How will you allocate to private debt over the longer term?" There is no assurance that such events or projections will occur, and actual outcomes may be significantly different than those shown here.

A Word About Risk

As an asset class, private credit comprises a large variety of different debt instruments. While each has its own risk and return profile, private credit assets generally have increased risk of default, due to their typical opportunistic focus on companies with limited funding options, in comparison with their public equivalents.

Because private credit usually involves lending to below-investment-grade or non-rated issuers, yield on private credit assets is increased in return for taking on increased risk.

Alternative investments often are speculative and include a high degree of risk. Investors could lose all or a substantial amount of their investment. High-yield bonds are subject to interest-rate risk. When interest rates rise, bond prices fall; generally, the longer a bond's maturity, the more sensitive it is to this risk. Yields are subject to change with economic conditions. Yield is only one factor that should be considered when making an investment decision.

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Index Definitions

Cliffwater Direct Lending Index measures the unlevered, gross-of-fees 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.

FTSE 10-Year Treasury Benchmark Index measures the performance of total returns for the current ten-year on-the-run Treasuries that settle by the end of the calendar month.

ICE BofA Global Corporate Index tracks the performance of U.S. dollar-denominated investment-grade corporate debt publicly issued in the U.S. domestic market. It includes bonds from various sectors and regions, providing a comprehensive view of the corporate debt market.

ICE BofA U.S. High Yield Index tracks the performance of U.S. dollar-denominated below-investment-grade corporate debt publicly issued in the U.S. domestic market.

S&P UBS Leveraged Loan Index measures the market-value-weighted performance of the investable universe of U.S. dollar-denominated leveraged loans.

S&P U.S. High Yield Corporate Bond Index is designed to track the performance of U.S. dollar-denominated, high-yield corporate bonds issued by companies whose country of risk use official G-10 currencies, excluding those countries that are members of the United Nations Eastern European Group (EEG). Qualifying securities must have a below-investment-grade rating (based on the lowest of S&P Global Ratings, Moody's, and Fitch) and maturities of one or more months.

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