An Introduction to Private Credit

A Primer for the Accredited Investor

In the search for yield and diversification, sophisticated investors are increasingly looking beyond traditional public markets. Private credit has emerged as a compelling asset class, offering the potential for attractive, income-oriented returns that are often uncorrelated with public equity and fixed income markets. Historically the domain of large institutions, this asset class is now more accessible to accredited investors. This guide serves as a high-level introduction to the world of private credit. We will define what it is, explore its key characteristics, and outline the potential risks and rewards. Our goal is to provide a clear, educational foundation to help you determine if this sophisticated strategy may have a role in your own diversified portfolio.

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What is Private Credit?

At its core, private credit is debt financing provided by non-bank lenders. Following the 2008 financial crisis, increased regulation led traditional banks to pull back from lending to small and mid-sized companies. This created a void in the market that has since been filled by specialized asset managers, creating the modern private credit market.
These managers raise capital from investors (like endowments, pensions, and accredited individuals) and lend it directly to private companies for a variety of purposes, such as funding growth, financing acquisitions, or providing working capital.

Key Characteristics

- **Potential for Higher Yields:** Because these loans are not publicly traded and are often made to smaller companies, they typically carry higher interest rates than publicly traded corporate bonds to compensate for the perceived risk and illiquidity.
- **Floating Interest Rates:** A significant portion of private credit loans are structured with floating interest rates (e.g., SOFR + a spread). This can be advantageous in a rising-rate environment, as the income generated by the loan increases with interest rates.
- **Senior Secured Debt:** Many private credit strategies focus on "senior secured" loans, meaning they are first in line to be repaid in the event of a borrower default and are backed by the company's assets. This provides a layer of downside protection.
- **Low Correlation to Public Markets:** Because these loans are not traded on an exchange, their value is based on the underlying creditworthiness of the borrowing company, not on daily market sentiment. This can provide a valuable diversifying element to a traditional portfolio.

Risks & Considerations

While private credit offers compelling potential benefits, it is a sophisticated strategy that carries a unique set of risks that investors must carefully consider.

- **Illiquidity:** This is the primary trade-off. Unlike a public bond, you cannot sell a private credit investment on a daily basis. Capital is typically locked up for a multi-year period (e.g., 5-10 years). This asset class is only suitable for capital that you do not need to access in the short or medium term.
- **Credit Risk:** There is always a risk that the underlying borrowing company will default on its loan. Diligent manager selection and a focus on funds with a strong track record of underwriting are essential to mitigate this risk.
- **Complexity & Fees:** Private credit funds are complex structures with management fees and performance fees that are higher than those of typical public market funds.

Conclusion: A Strategic Allocation

For the right investor, a strategic allocation to private credit can serve as a powerful tool for enhancing portfolio yield and providing valuable diversification away from public market volatility. However, due to its complexity and illiquidity, it should only be considered as part of a comprehensive, long-term financial plan and in consultation with a qualified financial advisor who can help you assess its suitability for your specific situation.

Important Disclosures