PennantPark

# Private Credit, An All-Weather Asset Class

## April 2024

**Private credit can provide investors with diversification benefits due to its low correlation with traditional asset classes. Unlike public markets, it has historically delivered consistent income regardless of market conditions, offering a potentially more stable investment opportunity.**

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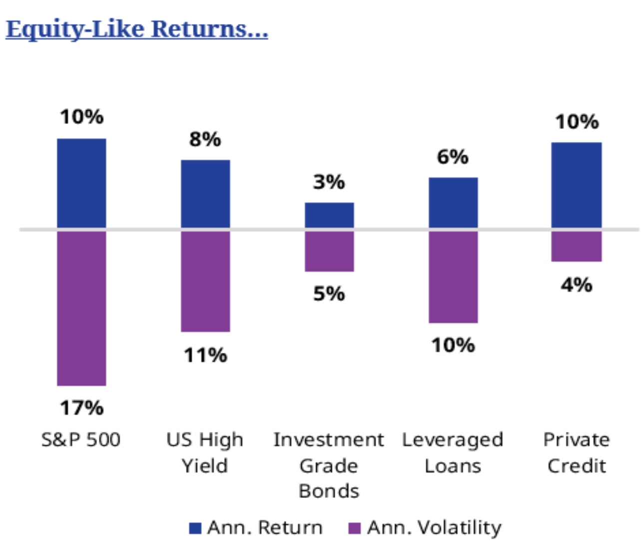
Through the sunshine of the recent bull market and the storm clouds of the Global Financial Crisis, private credit has historically shown itself to be an "all-weather" asset class.

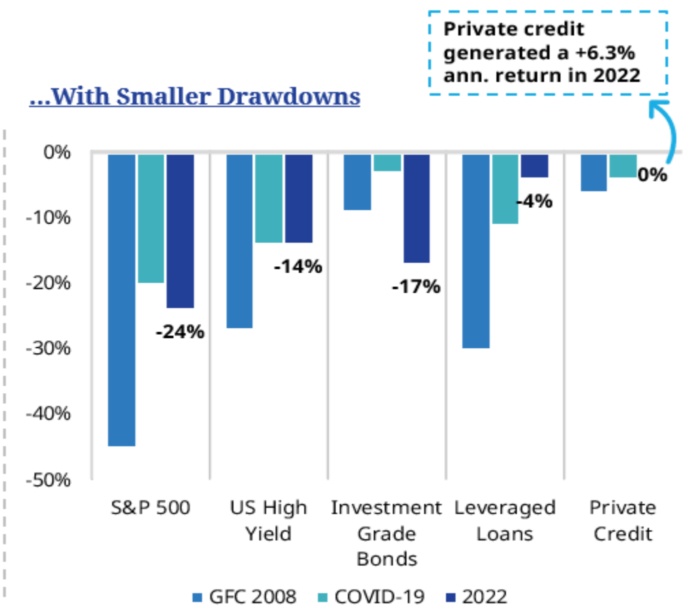
By potentially generating returns closer to those of private equity, while offering a better risk profile than traditional fixed income, private credit is increasingly becoming a preferred choice for investors seeking durable, reliable returns through various economic cycles.

### Low Correlation to Public Market Volatility

Private credit's historical ability to weather market storms is driven by its diversification and long-term investment focus. Unlike public markets, which can be particularly prone to volatility, private credit investments typically have a lower correlation with traditional asset classes such as stocks and bonds. This lower correlation helps to reduce portfolio volatility and provides a cushion against market downturns.

In addition, private credit investments often involve lending to private companies that are less sensitive to macroeconomic factors. These loan investments are typically structured with features similar to fixed income, providing a steady stream of income irrespective of market conditions. This stability makes private credit an attractive option for investors seeking capital preservation and consistent long-term returns.




*Note: Past performance is not necessarily indicative of future results. Invested capital is at risk. Volatility is measured using standard deviation. Data as of 12/31/2023. All of the quarterly standard deviations are then annualized. "Private Credit" is represented by the Cliffwater Direct Lending Index. "Leveraged Loans" is represented by the Morningstar LSTA US Leveraged Loan Index. "US High Yield" is represented by the Bloomberg US Corporate High Yield Index. "Investment Grade Bonds" is represented by the Bloomberg US Aggregate Bond Index. The indices presented are not subject to fees or expenses and it is not possible to directly invest in any index presented.*

Unlike investing in stocks, real estate, or waiting for exits in private equity, private credit investors can benefit from the contractual right to receive interest payments. This contractual right provides a level of predictability absent in other asset classes.

**Flexibility and Customization**

Private credit encompasses a wide range of strategies that span the capital structure and borrower type, ranging from real estate and infrastructure to corporate direct lending and specialty finance. This diversity can contribute to investors and their advisors constructing a portfolio that is resilient to sector-specific risks and economic cycles.

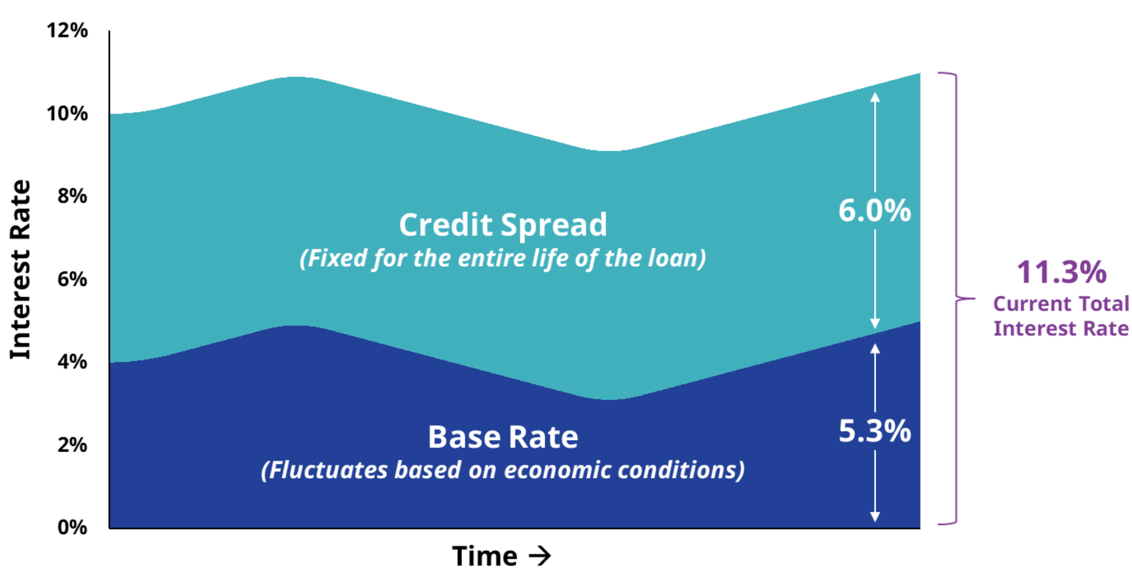
At PennantPark, we focus on lending to U.S. core middle market companies with earnings of $10 to $50 million in non-cyclical industries that are less susceptible to macroeconomic factors. These companies are profitable, owned by established private equity sponsors, have proven management teams, and leading market positions with significant competitive advantages. These companies tend to provide products and services that are integral to their customers' businesses, making them difficult to remove or replace in distressed market conditions.

**Built-in Hedge Against Inflation**

In high inflationary environments like what we've recently experienced, private credit portfolios of floating-rate loans provide a natural hedge against inflation. As base interest rates increased to counteract inflation, so, too, did private credit loan interest payments. In contrast, fixed rate bonds can be highly sensitive to changes in interest rates, resulting in price volatility. In the current market environment of elevated high interest rates, first lien loans are generating an attractive 12% yield[1].

**Base Rate + Credit Spread = Total Interest Rate**

*(For Illustrative Purposes Only)*




[1] Denotes the unlevered asset-level yield, calculated as the sum of the Secured Overnight Financing Rate ("SOFR"), credit spreads of 5.50% to 7.00%, and the original issuance discount ("OID") of 1-2%, amortized over the life of the loan.

**Enhanced Structural Protections**

To help weather more unsettled market conditions, most core middle market private credit investments have built-in protections from losses in the form of subordination, which means that the equity owners of a company will experience losses long before private credit investors do. Private credit loans are typically collateralized by all of the assets and enterprise value of a company. At PennantPark, most of our first lien loans have loan-to-value ratios of 40% to 50%, meaning 50% to 60% of a company's value would need to erode before we experience any losses on our investment. In addition, almost all of our loans have structural protections, such as financial covenants, that allow us to step in to intervene at the first signs of financial underperformance at a portfolio company. If a covenant is breached, we can reprice our loan, require the equity owner of the company to inject additional capital, or even step in to manage the company if we believe it is in the best interest of our investors.

**The Importance of Active Management**

Importantly, private credit managers typically have the flexibility to adapt their strategies in response to changing market conditions. Whether tightening credit standards during periods of economic uncertainty, such as during the Global Financial Crisis, or capitalizing on opportunistic investments in times of market dislocation, active management plays a crucial role in navigating the complexities of the private credit landscape.

In an investment landscape fraught with volatility and uncertainty, we believe private credit stands out as an all-weather strategy that offers stability, income generation, flexibility, and risk mitigation. By potentially providing potential diversification benefits, stable income streams, and customization options, private credit has become increasingly attractive to investors seeking to navigate turbulent market cycles.

We welcome a conversation; please contact invest@pennantpark.com or the professionals listed below.

# Contact Us

## About PennantPark:

PennantPark is an independent middle market credit platform founded in 2007 by private credit industry veteran Art Penn (Co-Founder and former Managing Partner at Apollo Credit). As of 2024, PennantPark has invested over $20 billion in over 700 private credit transactions since its inception. Our clients include some of the world's largest and most sophisticated institutional investors. We are in the process of expanding our offerings to focus on the private wealth market. The Firm is headquartered in Miami and has additional offices in New York, Chicago, Houston, Los Angeles, and Amsterdam. PennantPark primarily invests in the core middle market, defined as companies with earnings of $10 million to $50 million. Our industries of focus include business services, government services, healthcare, consumer, and software/technology. PennantPark offers investment strategies through various public and private fund structures, including BDCs, LP drawdown vehicles, CLOs, SMAs, and joint ventures.

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**Index Definitions:**

S&P 500 Index is a stock market index tracking the stock performance of 500 of the largest companies listed on stock exchanges in the United States.

The Cliffwater Direct Lending Index (CDLI) seeks to measure the unlevered, gross of fee performance of US 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.

Morningstar LSTA US Leveraged Loan Index is a market value-weighted index designed to measure the performance of the US leveraged loan market based upon market weightings, spreads and interest payments.

Bloomberg US 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.

Bloomberg US Aggregate Bond Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the US investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis.