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Demystifying Private Credit Investing

A new wave of opportunity seems set to flow into private credit markets, which could enhance risk-adjusted returns and diversify portfolios. What's driving this potential, and how should investors think about integrating private credit into their existing portfolios?

JULY 2025

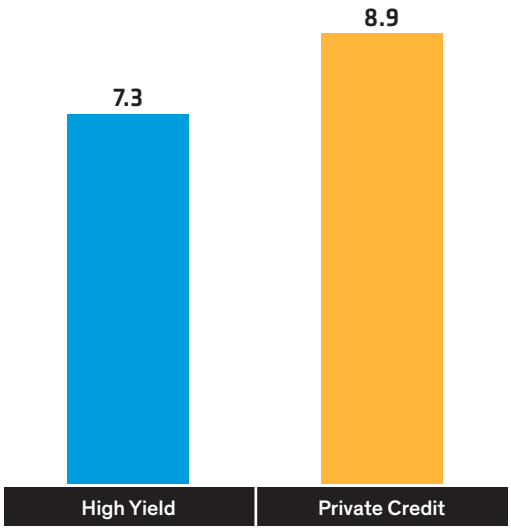
Investors have no doubt seen a flurry of headlines over the past few years extolling the benefits of private credit investing. They may have questions about this intriguing opportunity: What is this fast-growing asset class all about? How is it evolving? Does it make sense for me?

Many private credit stories start with the premise that investing in public markets is no longer an effective approach. We disagree. Sure, traditional investing faces challenges from policy uncertainty, economic headwinds and geopolitical risk, but public assets still offer a variety of sound building blocks for portfolio construction.

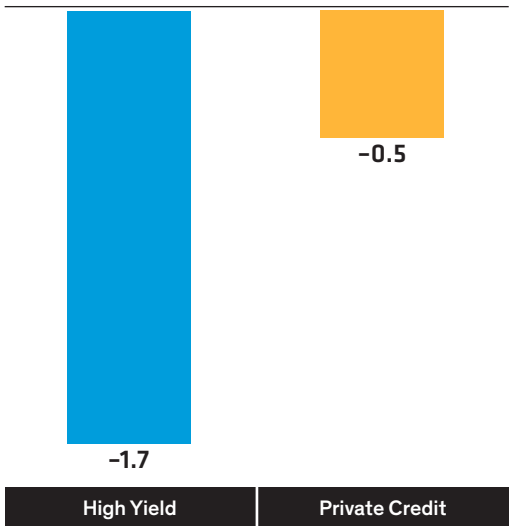
Private credit has a lot of allure, too, with the potential to enhance income, diversification and risk-adjusted returns. Historically, private credit has handily outperformed public credit, while also defending much better when markets turn turbulent. Despite this promise, the private credit dimension is either unexplored or underrepresented in many investors' portfolios today.

DISPLAY 1: PRIVATE CREDIT—HIGHER YIELDS, LOWER DEFAULTS

Liquidity Premium Generates Higher Yield
Current Market Yield (Percent)



Directly Negotiated Terms Have Reduced Defaults
Average Loss Rate (Percent)



Past performance does not guarantee future results.

High yield is represented by the Bloomberg US Corporate High Yield Index. Private credit is reflective of the US middle market, including senior secured, US-issued loans of less than $250 million.

As of December 31, 2024 | **Source:** Bloomberg, Leveraged Commentary & Data, S&P and AllianceBernstein (AB)

What's behind private credit's strong showing?

The answer is twofold. First, private assets offer premiums that compensate investors for accepting less liquidity: they may not be able to sell the security when they want (*Display 1, previous page*). These premiums generally put private yields above those of comparable public investments. Second, private lenders can negotiate loan terms directly with borrowers, adding covenants that add protection from defaults—along with generally higher recovery rates if defaults do happen.

The Private Credit Origin Story

The headlines about banks stepping back from lending are often top of mind when private credit is mentioned today. This isn't a new process—it's actually been in motion for decades, driven by interest-rate environments, regulation and innovation. Leveraged loans are a good example: at one time, banks accounted for 70% of the market; today that share is less than one-quarter.

Bank consolidation has also been at play, accelerating at around the time of the 2008 global financial crisis (GFC) that centered on the banking sector. Policymakers answered the weakness in the banking system—and the systemic risk it created—with the Basel III regulatory framework in Europe and the Dodd-Frank legislation in the US. These regulations sought to transfer risk to market participants, and some of the rule changes took aim at banks' financing of private equity–sponsored business. The result: a private credit boom, with corporate direct lending being the earliest beneficiary.

The rise of direct lending expanded investors' access to a key segment of the US economy—the middle market. Home to 200,000 companies with revenues ranging from $10 million to $1.1 billion, it accounts for one-third of US private sector gross domestic product and employs 48 million workers. This is just one example of how private credit has capitalized on the bank retreat to offer investors strong return opportunities and diversification across new economic segments.

More than Direct Lending: Diverse Private Markets

The private credit market offers a wealth of investments that actually extend well beyond direct lending—it includes as many as 30 subsectors, depending on how you choose to segment the investments. That may seem a little daunting to consider, which is why we think it helps to think of private credit in two complementary buckets: corporate debt and asset-based finance (*Display 2*).

DISPLAY 2: TALE OF THE TAPE—TWO TYPES OF PRIVATE CREDIT

Corporate Debt		Asset-Based Loans
• Corporate Cash Flows • Uncollateralized • Bullet Maturity	**Backed By**	• Cash Flow–Producing Assets • Collateralized • Amortizing
• Direct Lending • Special Situations • Distressed Debt	**Key Sectors**	• Consumer Debt • Residential Real Estate • Commercial Real Estate • Hard Assets and Infrastructure
• Corporate Bonds • Collateralized Loan Obligations	**Public Market Equivalent**	• Asset-Backed Securities • Residential Mortgage-Backed Securities • Commercial Mortgage-Backed Securities

For illustrative purposes only.

As of May 31, 2025 | **Source:** AB

When corporations secure a private loan, their cash flow backs the interest payments and loan repayment. If the corporation defaults, it can take a while for the lender to recover a loan amount that's uncertain.

Asset-based loans are backed by income-generating hard assets, such as energy infrastructure or leased airplanes, or by pools of financial assets such as auto loans and residential mortgages. These assets secure the loan and generate their own cash flows. This has generally resulted in strong and more predictable default recoveries.

The loans are highly diversified, given the underlying assets' diverse economic drivers. Pools of consumer loans often include thousands if not tens of thousands of loans in each deal.

The principal of asset-based loans is repaid gradually, making them less risky over time. That's distinct from corporate loans, which generate income for the lender over time but whose principal is not repaid until the end of the loan term. And asset-based loans are credit remote, meaning they are not tied to company balance sheets and therefore are free from the risk of corporate defaults.

What's in a Private Credit Allocation?

For investors looking to build a portfolio of these private opportunities from scratch, we think a blend of corporate direct lending and asset-based lending could be a good start.

That means identifying a good manager of senior secured direct lending, which will make up a sizable portion of the private credit allocation. This asset class represents a substantial share of the investable private debt market. It also provides exposure to the expansive and dynamic middle market, a well-established arena offering income-focused returns.

To round out the private credit allocation, we think it makes sense to find an asset-based finance manager with the ability to access exposures in the important and vibrant consumer sector and in hard assets as well—generally, tangible assets with intrinsic value. These diverse exposures tend to be oriented more toward total return, with income and capital appreciation potential.

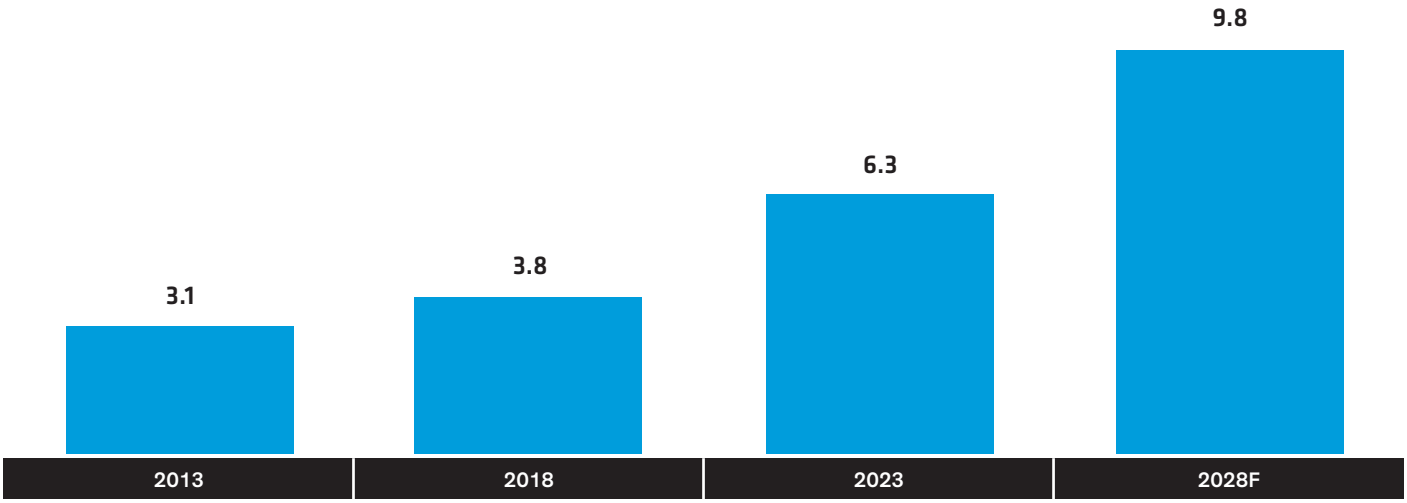
The Next Big Opportunity for Private Credit

For two decades, the private credit wave has been driven by GFC-induced stress in the banking system and the regulations enacted to address it. From our perspective, a similar chapter may be unfolding today as many banks contend with headwinds stemming from factors such as secular consolidation, recent stress among US regional banks and stiffer regulatory measures in Europe.

Banks remain under pressure, unable to meet the borrowing needs of the real economy, and private credit investors are again stepping in to fill the void. New entrants to lending markets, specialty

DISPLAY 3: THE RISE OF ASSET-BASED FINANCE

Size of the Asset-Based Finance Market (USD Trillion)



Historical analysis and current forecasts do not guarantee future results.

F indicates forecast.

As of June 30, 2023 | **Source:** Financial Stability Board, Integer Advisors and AB

finance companies, are one of the driving forces. Harnessing new technology and taking advantage of changes in financial markets, these nonbank lenders have provided capital to underserved consumers and small businesses.

Unlike banks, specialty finance companies don't have big balance sheets to hold loans, so they partner with outside sources of capital such as private credit investors. Specialty finance platforms source, originate and service the loans; private credit investors set the parameters for borrowers and collateral types, provide the capital, and own the loans.

A similar story and opportunity is emerging in Europe, though the market isn't as deep or standardized as its US counterpart. Data quality, commercial dynamics, and cultural and legal landscapes vary by country, requiring differentiated solutions. The good news: a fragmented market creates inefficiencies that savvy asset-based lenders may be able to capitalize on to enhance returns.

The rapid growth of the global asset-based finance market speaks volumes about its appeal for investors (*Display 3, page 2*). From 2018 to 2023, it ballooned from $3.8 trillion to $6.3 trillion. By 2028, it's expected to be just under $10 trillion. That also means an expanded opportunity set for investors. By embracing segments such as consumer loans and residential real estate, they can tap into the massive consumer sector, which is generally underrepresented in allocations.

Of course, access to opportunity doesn't ensure success. There are economic cycles to navigate, which can bring credit stress and potential defaults in down times, and as with public markets, individual segments will go in and out of favor. That puts a premium on experience in identifying, executing on and managing private credit investments.

Where to Make Room: The Portfolio-Sourcing Decision

For those seeking to tap into private credit opportunities, a proliferation of new investment vehicles is providing avenues for individuals to access these segments—effectively democratizing private markets.

Then there's the question of how to source private credit exposure from an existing portfolio allocation. There are several ways to do this. The simplest may be to carve exposure out of an existing bond allocation, which could bolster income and diversification while reducing drawdown risk.

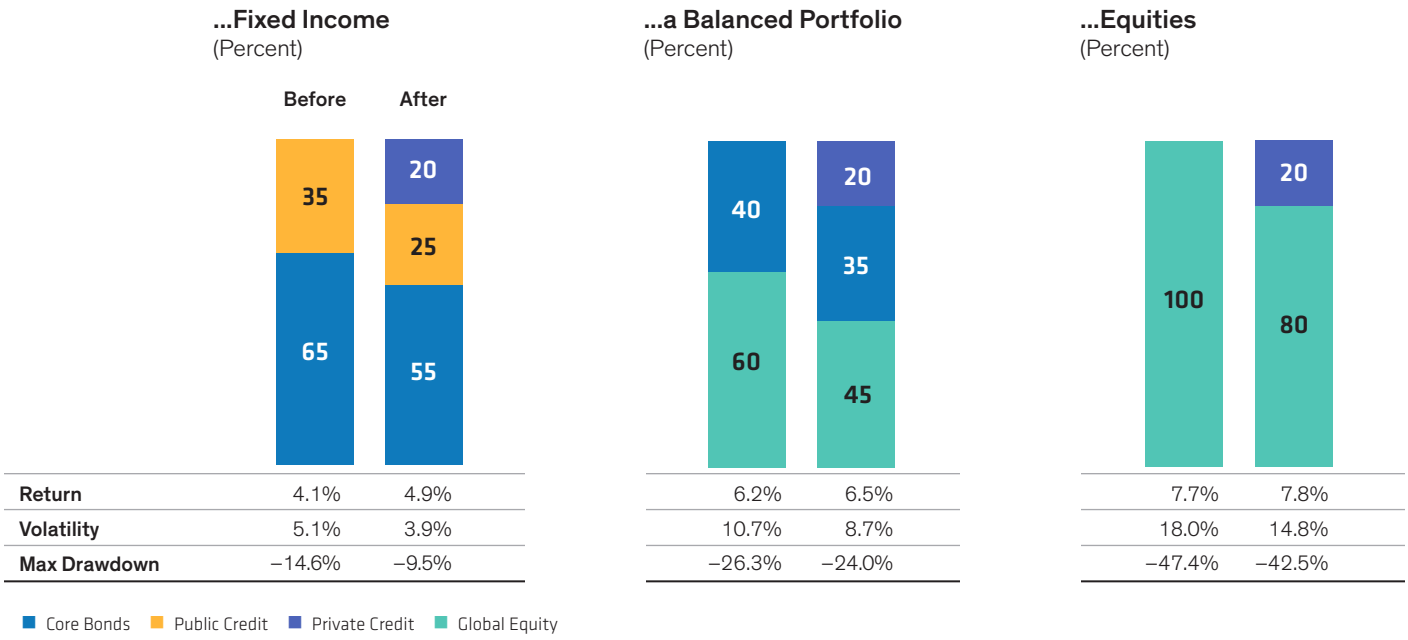
Because private credit has low duration, a modest credit beta and strong return characteristics, a slightly more creative allocator can find additional ways to source exposure (*Display 4*).

Source from a Public Bond Portfolio: We've argued that a credit barbell is the most efficient bond allocation—for example, a public credit barbell with 35% in high yield and 65% in core bonds. Carving 10% from each component funds a 20% private credit allocation that has the potential to increase annualized returns, reduce volatility and drawdown risk, and boost income.

Source from a Traditional Balanced Portfolio: Private credit can also be sourced from a traditional stock/bond portfolio, such as a 60/40 strategy. Taking 15% from stocks and 5% from bonds to fund private credit may enhance returns, reduce risk and produce a better overall outcome.

Source from a Global Equity Portfolio: Another option for incorporating private credit is to enhance a global portfolio of public stocks. For example, 20% of an all-equity strategy can be allocated to private credit exposure, another approach that has enhanced return and risk metrics.

DISPLAY 4: SOURCING PRIVATE CREDIT FROM...



Return	4.1%	4.9%	6.2%	6.5%	7.7%	7.8%
Volatility	5.1%	3.9%	10.7%	8.7%	18.0%	14.8%
Max Drawdown	–14.6%	–9.5%	–26.3%	–24.0%	–47.4%	–42.5%

Current forecasts do not guarantee future results.

Core bonds are represented by the Bloomberg US Aggregate Bond Index, global equities by the MSCI World Index and public credit by the ICE BofA US High Yield Index. Private credit is represented by the Preqin Private Debt Index. Simulated or hypothetical performance results have certain inherent limitations. Unlike the results shown in an actual performance record, these results do not represent actual trading. Results include estimates of trading costs and market impact; however, because these trades have not actually been executed, results may have under- or overcompensated for these costs. Simulated or hypothetical trading programs in general are also subject to the fact that they are designed with the benefit of hindsight. No representation is being made that any account will or is likely to achieve returns or a volatility profile similar to those being shown.

As of December 31, 2024 | **Source:** Bloomberg, ICE Data Indices, MSCI and AB

Next Steps: Thinking Through a Private Credit Allocation

Investors may be wondering how to approach the private credit opportunity. We think it's sensible to follow a set of concrete steps along the path from consideration to implementation.

1 Assess Opportunity

We hope that this paper has provided an effective overview of the growing opportunity in private credit. But you may want to conduct additional due diligence on your own to get more comfortable with the private credit opportunity.

2 Determine Sourcing

If a private credit allocation seems right for you, think about how you'll make room in your portfolio. Will it come from your public fixed-income allocation, your overall stock/bond mix in a balanced portfolio or from an all-equity strategy?

3 Design Allocation

A blend of corporate direct lending and asset-based lending may be a good starting point, but what allocation to each building block makes sense for your portfolio? Which private credit strategies will be within each building block? And which managers are best equipped to guide them?

Looking at the Big Picture

A new round of banking sector regulation is poised to create a new wave of potential in private credit markets. Investors looking to capture that wave have an opportunity to enhance portfolio income and returns while bolstering diversification through access to segments of the US economy—and increasingly, of Europe's economy—that have been absent from or underrepresented in many allocations.

For investors whose profile is suitable for private credit investing, targeted investments in direct corporate lending and asset-based lending may create a well-diversified private allocation. This exposure can be sourced from a number of portfolio segments: public fixed income, a traditional balanced strategy or an existing alternatives allocation, with vehicles tailored to specific private credit segments.

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