Private Credit
FUND INTELLIGENCE
INSIGHTS

Investor Intentions H2 21

A guide to LP sentiment and allocation plans in H2 2021

In association with

ALTERNATIVE CREDIT COUNCIL
LENDING FOR GROWTH

Contents

Key findings

Over one third of LP investors plan to increase their allocation to private credit in the second half of 2021, as the industry continues to successfully navigate the effects of Covid-19 on the global economy.

Based on surveys and interviews conducted with 108 investors in alternatives during Q2 2021, *Investor Intentions H2 2021* provides private credit fund managers and investors with critical intelligence on the plans and sentiment of their peers in the second half of the year.

Satisfaction with private credit remains high (84%), albeit having fallen slightly since we conducted our last survey six months ago. With monetary and fiscal support having continued for longer than expected and preventing a wave of bankruptcies, we attribute this to mild concern over some of the newly raised distressed funds.

Satisfaction was high across investor types. Even among private wealth, the lowest ranked group, 74% were happy with private credit in H1. And of those family offices planning to increase their allocation, 40% said that reaching target was their principal reason for doing so. At first glance, this may seem banal, but in our view this speaks to the formalisation of private wealth LPs' approach to the asset class.

And when it comes to target allocations the picture for the industry is bright. 26% of investors are below target, against just 10% above, indicating that there remains considerable scope for growth, particularly among large institutional allocators.

Specialty finance strategies, as well as more common direct lending funds, can expect to see the strongest commitment activity in the second half of 2021. Also of particular interest to investors are bespoke products, such as separately managed accounts and co-investment vehicles, with nearly three quarters of those increasing their allocation planning to explore one or the other.

Elsewhere, investors are moving out of cash and long-only fixed income, but this capital is more likely to find its way into alternatives than long-only equities, which our data suggests may be nearing their peak.

All in all, performance during the past fifteen months has allayed investor reservations, particularly among those of a more cautious bent. This has accelerated a shift towards greater private credit allocations and means private credit managers retain considerable scope for growth as they look to H2 2021 and beyond.

> **“Private credit managers retain considerable scope for growth as they look to H2 2021 and beyond”**

#1 **37%** of LPs plan to commit further capital to private credit in H2 2021

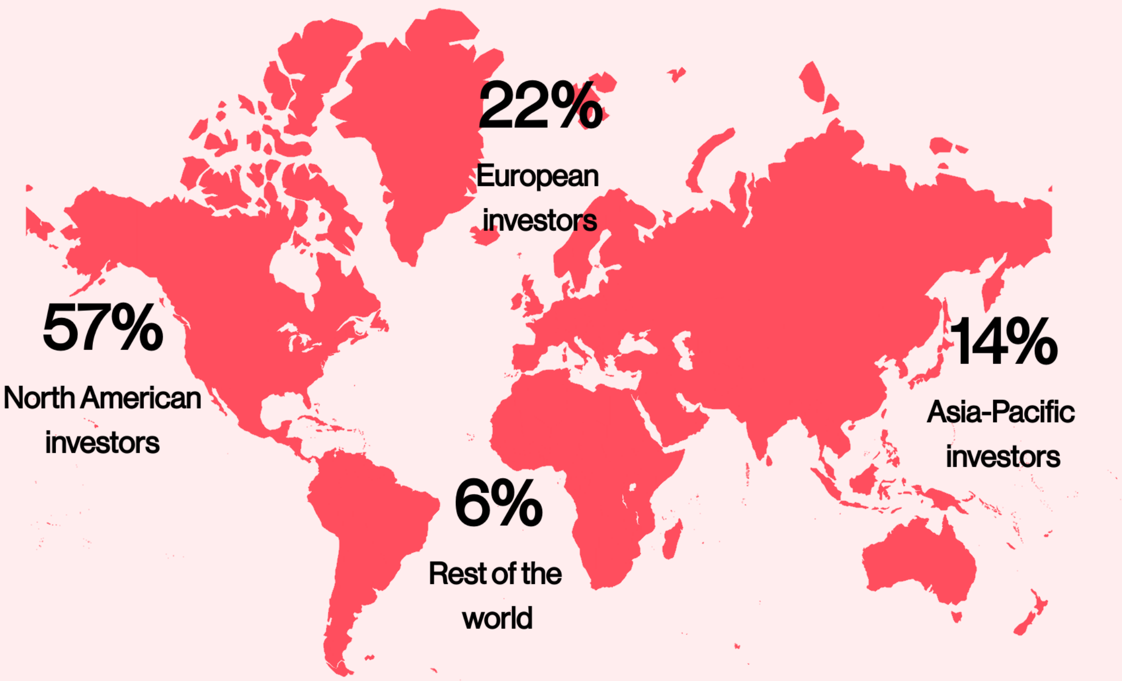
#2 Over **80%** of investors are satisfied with how their private credit portfolio performed during H1

#3 **47%** of those LPs increasing their private credit allocation in H2 will explore **co-investments**

#4 **Two thirds** of institutions are investing further in private credit to reach target allocation

#5 Investors plan to meet an average of **two** new private credit GPs in H2

About the respondents



108
alternative investors

$7.6trn
in total investor assets

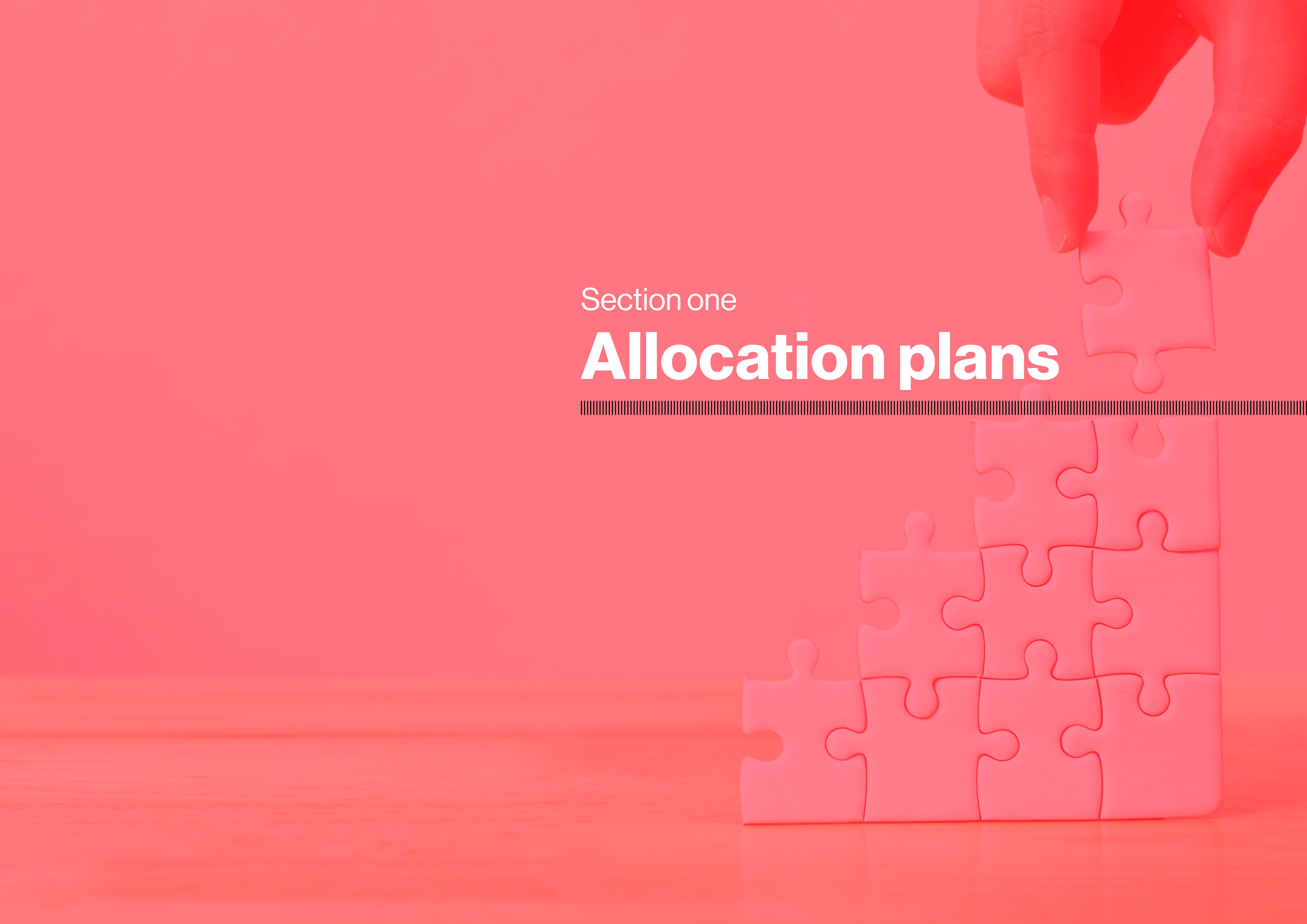
46%
Institutions

18%
Private wealth

36%
Intermediaries

Section one

Allocation plans



The proportion of LPs planning to invest further in private credit remains high

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Strong and consistent PC demand

37% of LPs surveyed by PCFI and ACC said they plan to increase their private credit allocation during H2 2021. This was broadly consistent with the 38% that said the same in H1, suggesting the appeal of private credit remains strong.

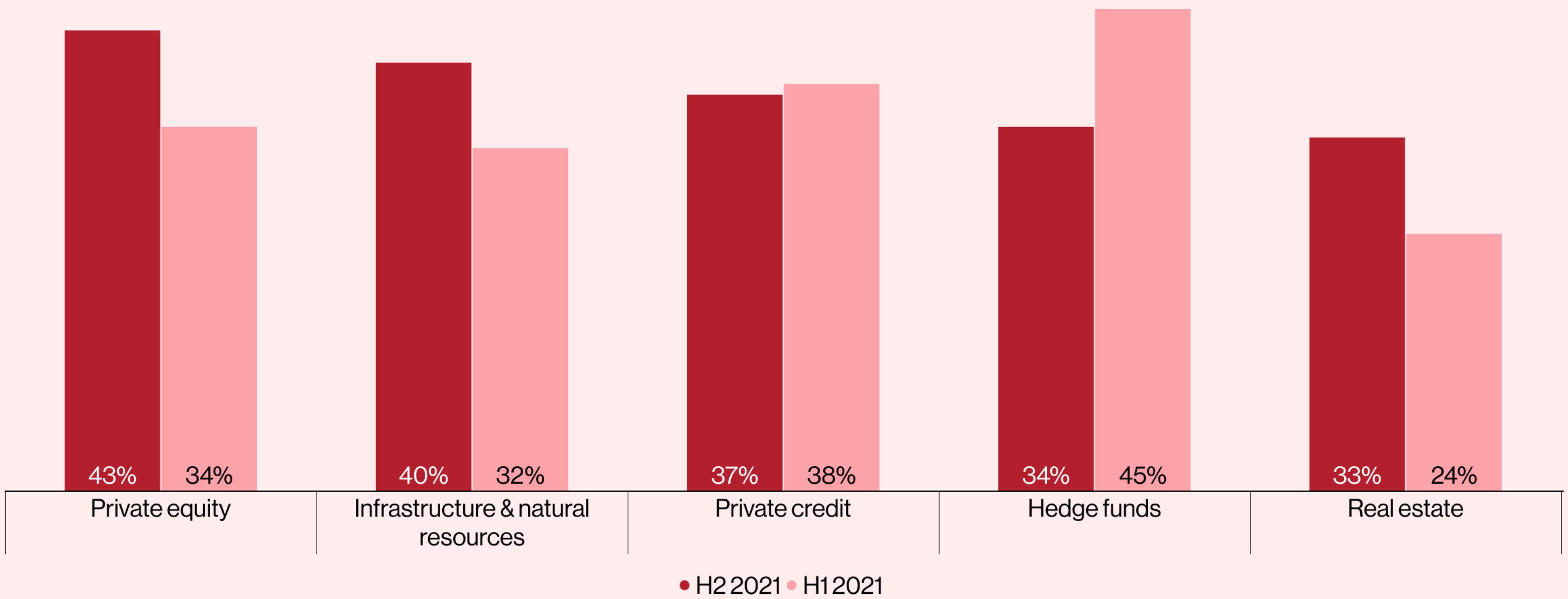
Private credit grew up in 2020

Before Covid-19, few private credit GPs had full market cycle experience, which meant many LPs were cautious with respect to investing. The pandemic has changed this, helping to explain the asset class's ongoing appeal.

Why it matters

Some LPs were reluctant to invest in private credit due to the industry's relative immaturity. With GPs having successfully navigated the pandemic, the time is ripe to contact LPs that previously rebuffed firms on this basis.

Exhibit 1.1: Proportion of LPs that plan to increase their alternative assets allocations in H2 2021 vs. H1 2021



Source: PCFI-ACC

More investors are underweight private credit relative to target than overweight

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Net 16% are below private credit target

More investors are below (26%) their target portfolio allocation to private credit, than are above (10%) it as of the first half of 2021. This offers GPs considerable scope to occupy a larger share of investors' overall portfolios.

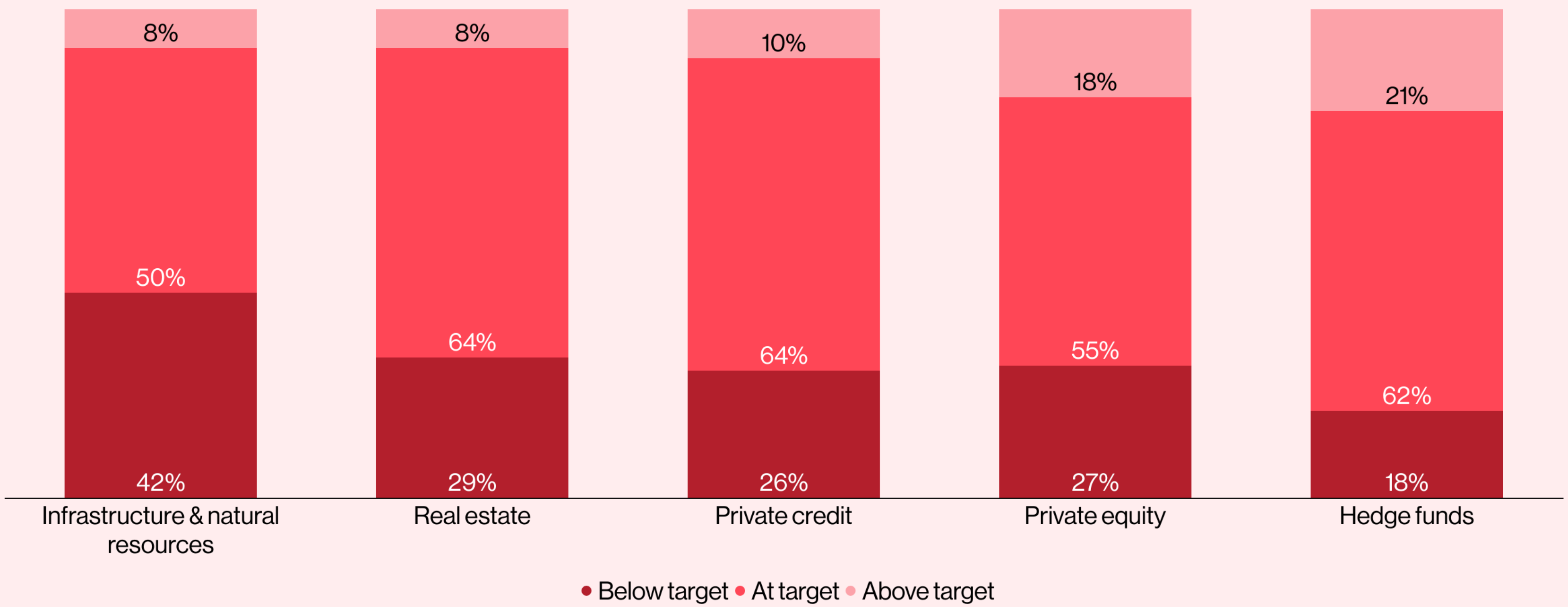
Private credit is middle of the pack

On a net basis, private credit ranks middle of the pack among alternatives in terms of the proportion of LPs that are underweight the asset class. The industry is experiencing strong asset growth and will continue to mature.

Why it matters

Private credit is fast becoming core to investor portfolios. As the industry evolves, GPs must consider how LPs perceive not only their firm, but the wider asset class too, and, importantly, how they wish to position their brand.

Exhibit 1.2: LP alternative asset weightings as of H1 2021



Source: PCFI-ACC

Demand for private credit in H2 is strongest among institutional investors

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Institutional demand the strongest

The greatest demand for private credit is likely to come from institutional allocators in H2, although demand from private wealth and intermediaries is also strong. Hardly any institutions plan to decrease their allocation either.

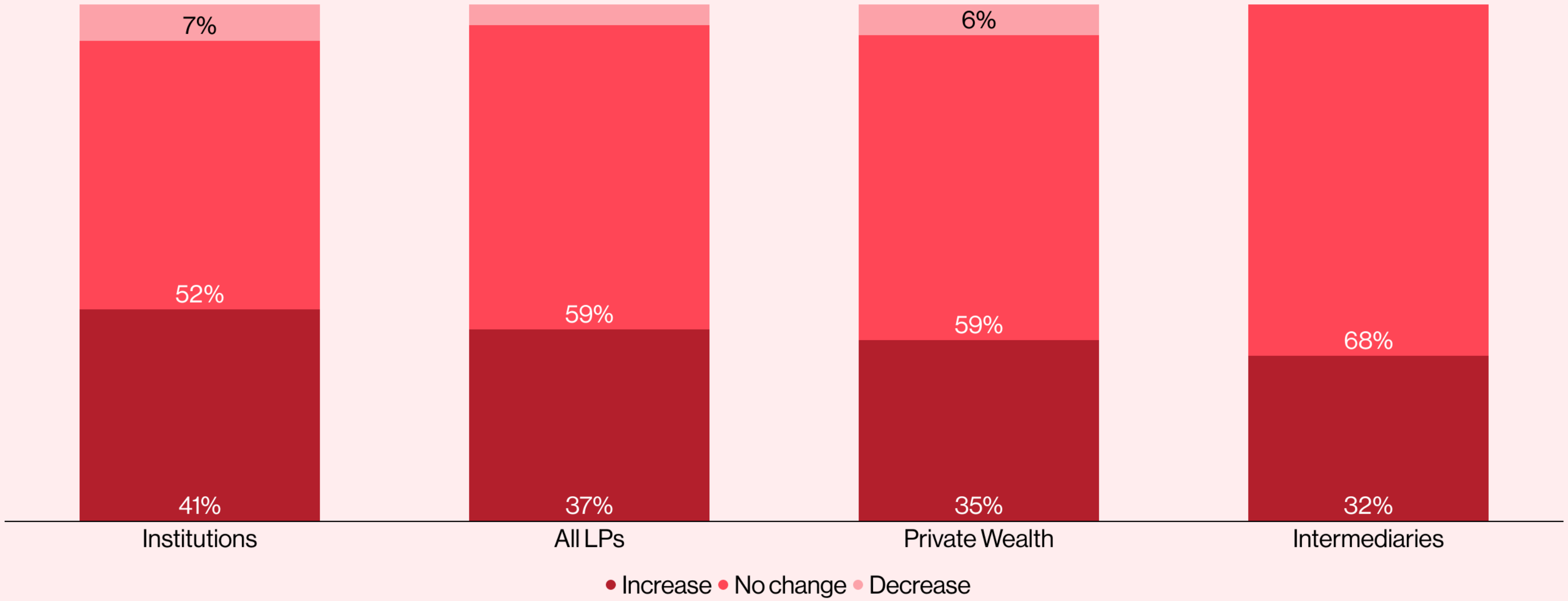
No intermediaries will decrease in H2

Although intermediaries are least likely to invest further in private credit, this group is also the only one not to plan on decreasing. To the extent that placation is necessary, institutions and private wealth are likely to be the focus.

Why it matters

On a net basis demand is greater among institutions and intermediaries than private wealth, but this may soon change. In Europe, the ELTIF and LTAF structures should ease access to the asset class for private wealth LPs.

Exhibit 1.3: LP private credit allocation plans in H2 2021



Source: PCFI-ACC

Specialty finance is the private credit strategy most likely to attract commitments

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Specialty finance set for commitments

Specialty finance strategies such as aircraft leasing can expect to see the most commitments from LPs in the second half of the year. Eastern Europe and Apac are likely to be of particular interest within the specialty finance sphere.

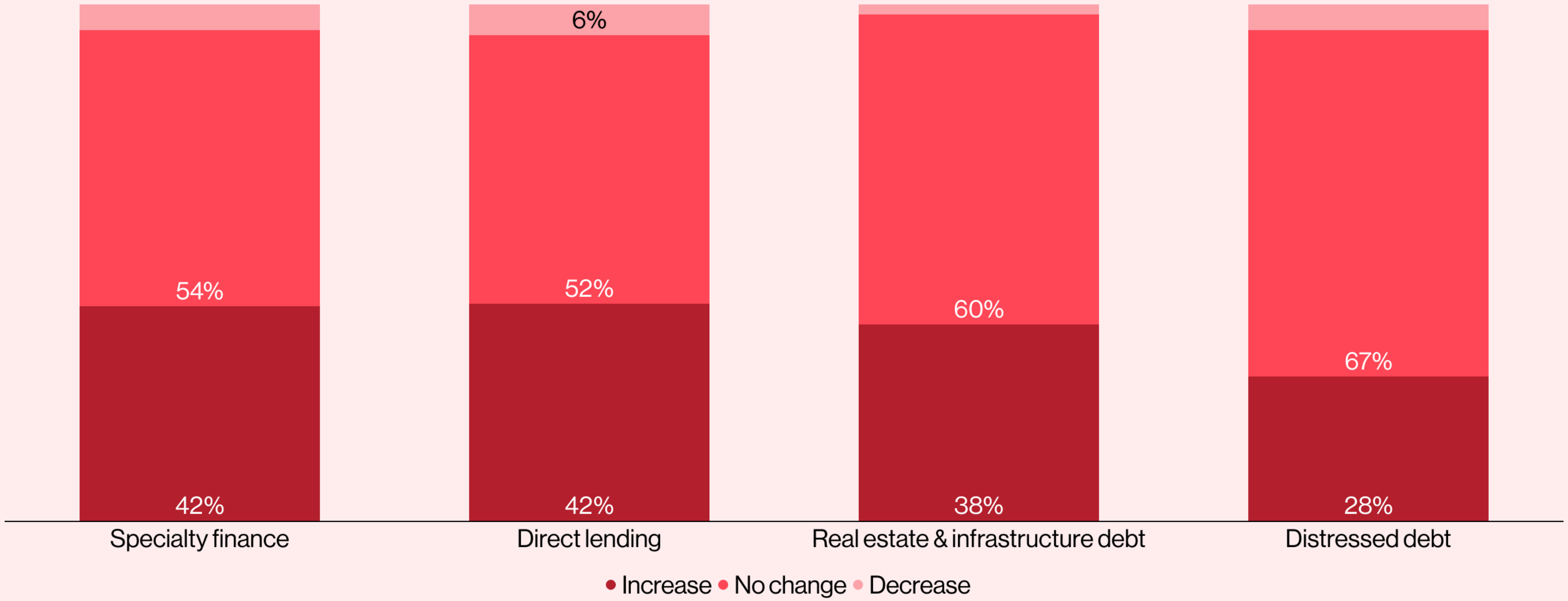
Gov't support dampens distressed

In 2020, many GPs raised distressed funds, but continued economic support meant few distressed opportunities presented themselves, explaining the relatively low proportion of LPs planning to invest in the strategy.

Why it matters

Specialty finance is likely to attract particular interest from LPs in H2, but this does not mean managers offering such products can rest on their laurels. Crucially, GPs need to consider what distinguishes their fund from its peers.

Exhibit 1.4: LP top-level private credit strategy allocation plans in H2 2021



Source: PCFI-ACC

73% of investors increasing private credit plan to explore bespoke products

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Bespoke product demand high

Bespoke products, such as managed accounts and co-investments are extremely popular among those LPs increasing their private credit allocation in H2. Nearly half plan to co-invest alongside GPs in individual deals.

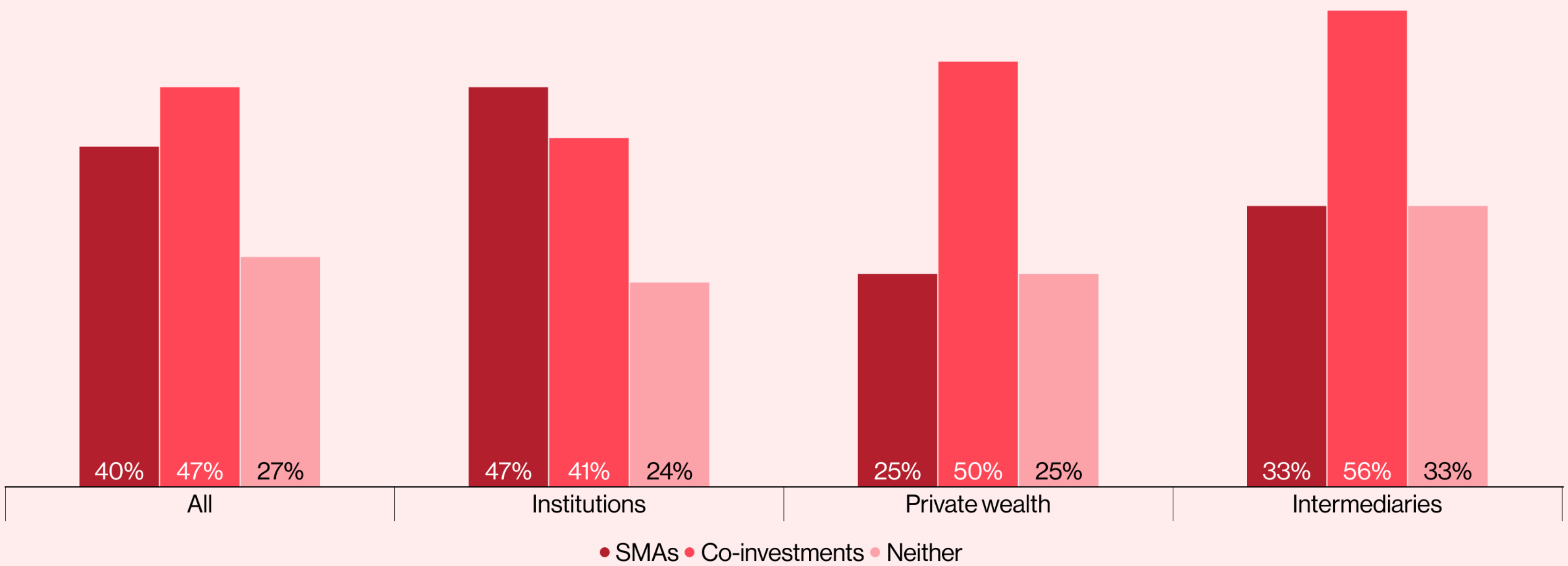
Private wealth will be opportunistic

Large institutions are most likely to allocate to SMAs, but the share of private wealth LPs planning to co-invest is higher than one might expect. This may be a result of a more opportunistic approach among this group.

Why it matters

Product customisation has been gaining in popularity for some time and there are no signs of this abating in H2 2021. GPs coming up against position limits or seeking new ways to raise capital should explore such vehicles.

Exhibit 1.5: Bespoke private credit product allocation plans among LPs increasing their private credit allocation in H2 2021



Source: PCFI-ACC

LPs are moving out of risk-free assets and alternatives will be the beneficiaries

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LP addition of risk to benefit alts

LPs plan to move out of risk-free assets in H2. However, the proportion planning to increase their traditional equity and multi-asset allocations is offset by those decreasing their allocations, which suggests alternatives will benefit instead.

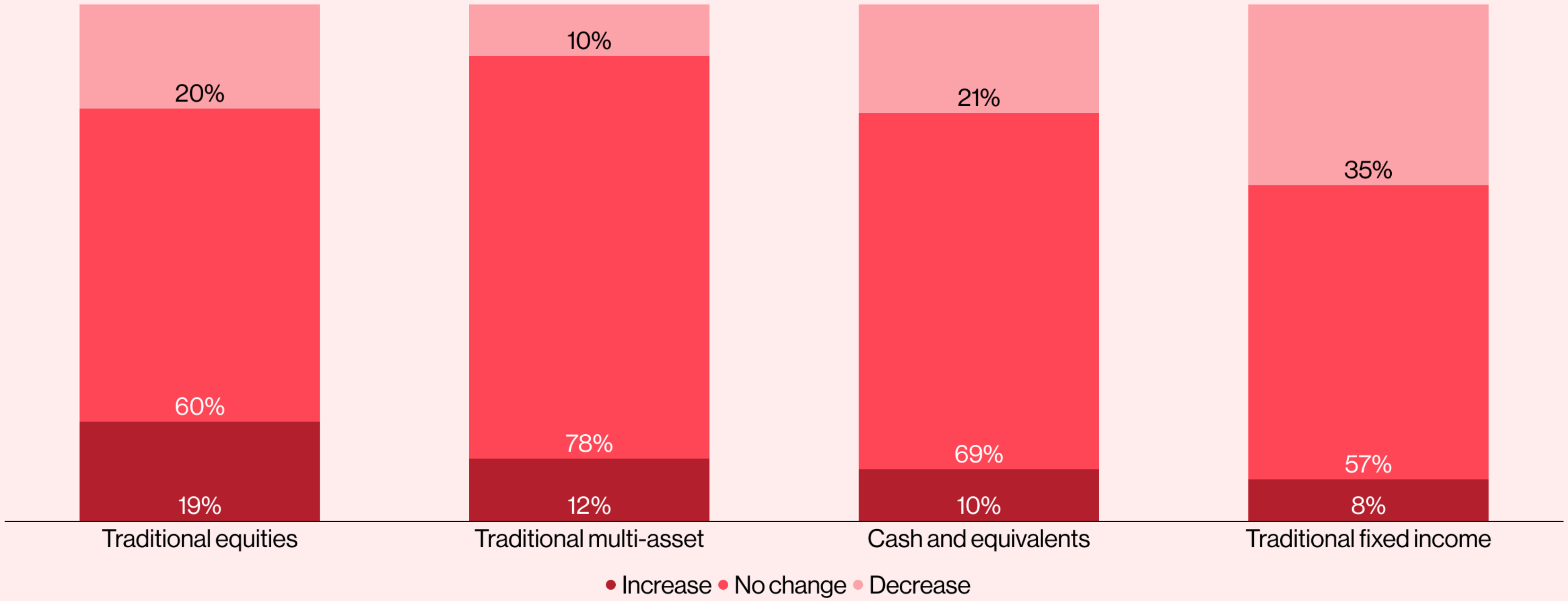
FI exit will be private credit boon

The move out of long-only fixed income marks both a short-term and long-term trend, as investors hunt for yield. Private credit is particularly well-positioned to fill this gap, given the parallels between the asset classes.

Why it matters

Equity allocation plans suggest the market peak may be near. This could pre-empt an upswing in private equity deals and by proxy benefit the private credit funds that finance them. GPs should be aware of this and ready to act.

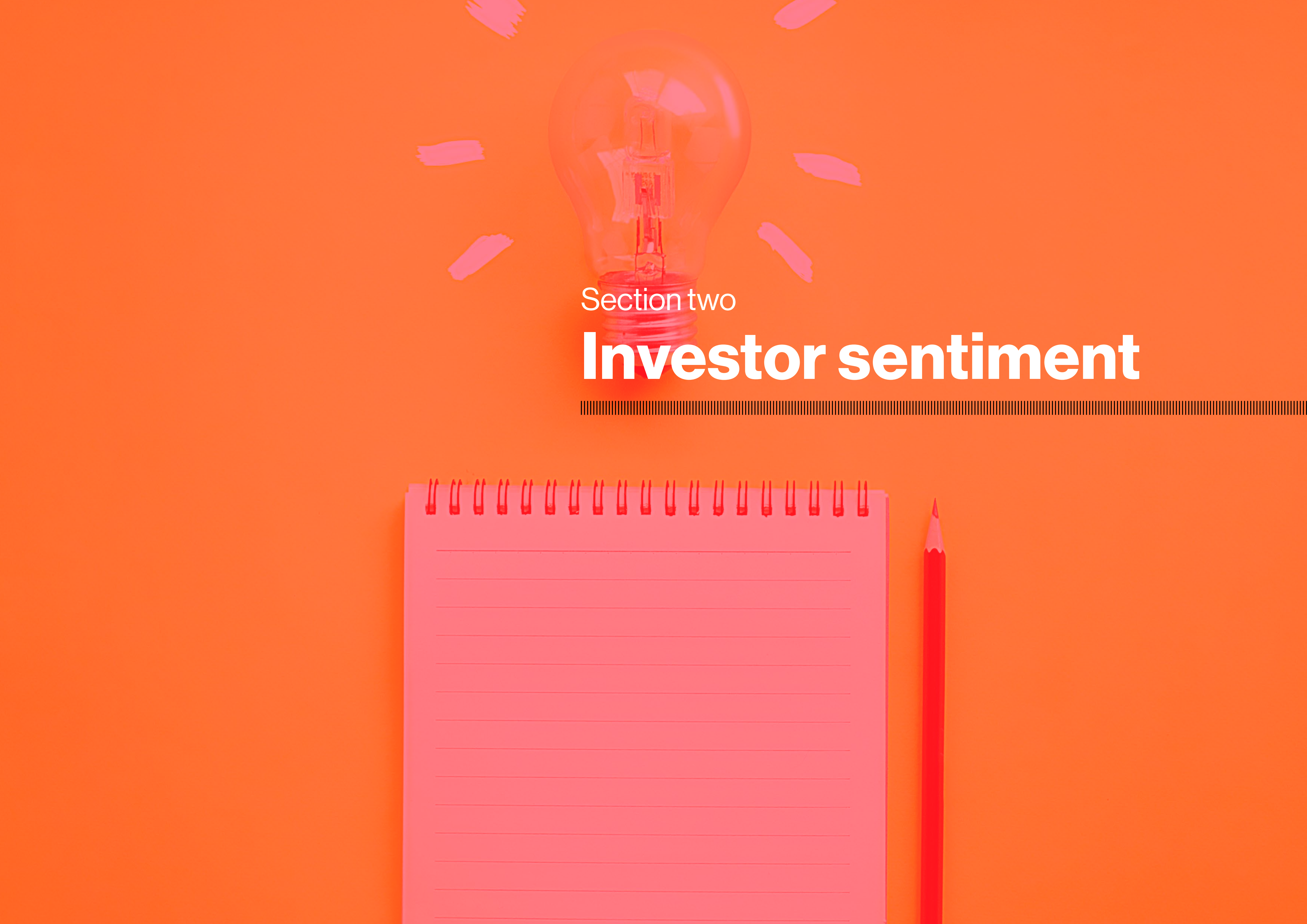
Exhibit 1.6: LP traditional asset allocation plans in H2 2021



Source: PCFI-ACC

Section two

Investor sentiment



Private credit received the second highest satisfaction level among alts in H1

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Over 80% satisfied with private credit

Over four fifths of LPs were satisfied with private credit in the first half of 2021. This represents a strong showing for the industry and demonstrates the ongoing appeal of private credit, not least core strategies like direct lending.

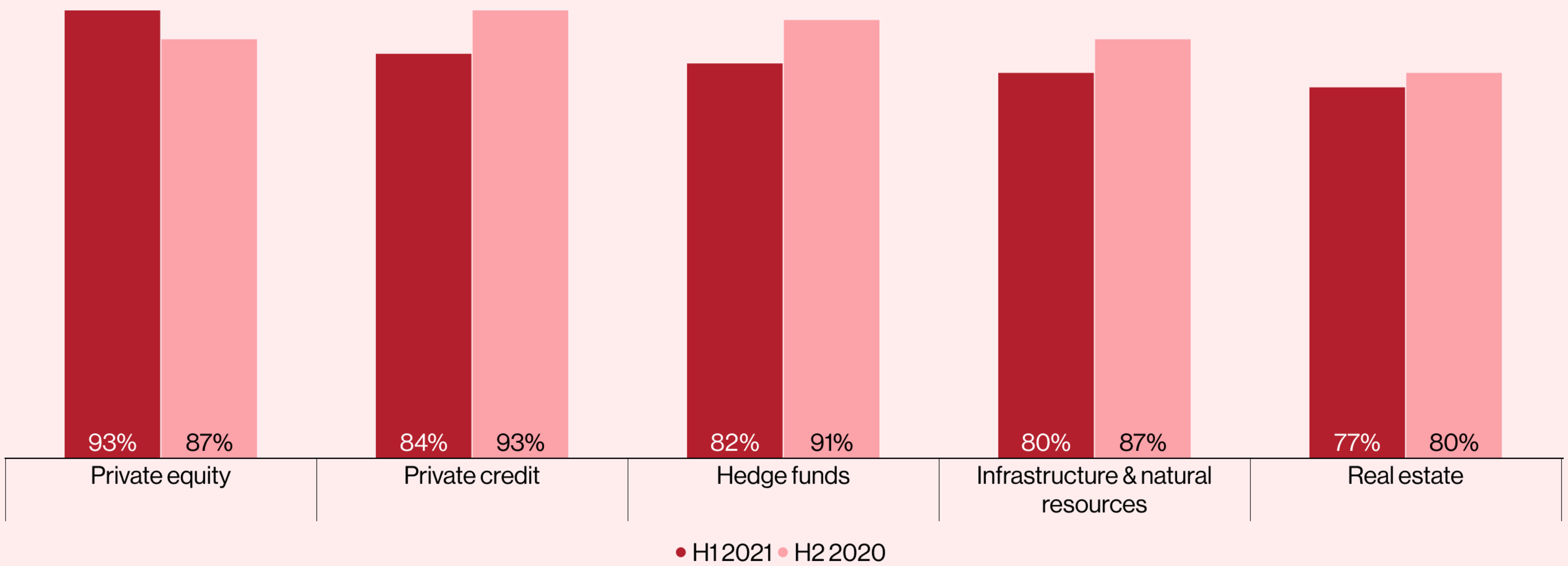
Distressed weighed on satisfaction

Nonetheless, this marked a slight drop from the 93% that were satisfied over six months. The failure of a wave of Covid-induced bankruptcies to materialise may have hurt newly raised distressed funds, explaining the lower figure.

Why it matters

Although performance satisfaction has dipped over the past six months, the 84% of LPs satisfied with the asset class means IRs can be assured of a warm reception while fundraising in the second half of the year.

Exhibit 2.1: Proportion of LPs satisfied with alternative assets performance in H1 2021



Source: PCFI-ACC

Private wealth investors exposed to riskier strategies may be the reason for the fall

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Private wealth satisfaction down

All LP types were broadly satisfied with private credit in H1, but private wealth satisfaction dropped significantly. This group likely has greater exposure to opportunistic strategies that have had few distressed opportunities to act upon.

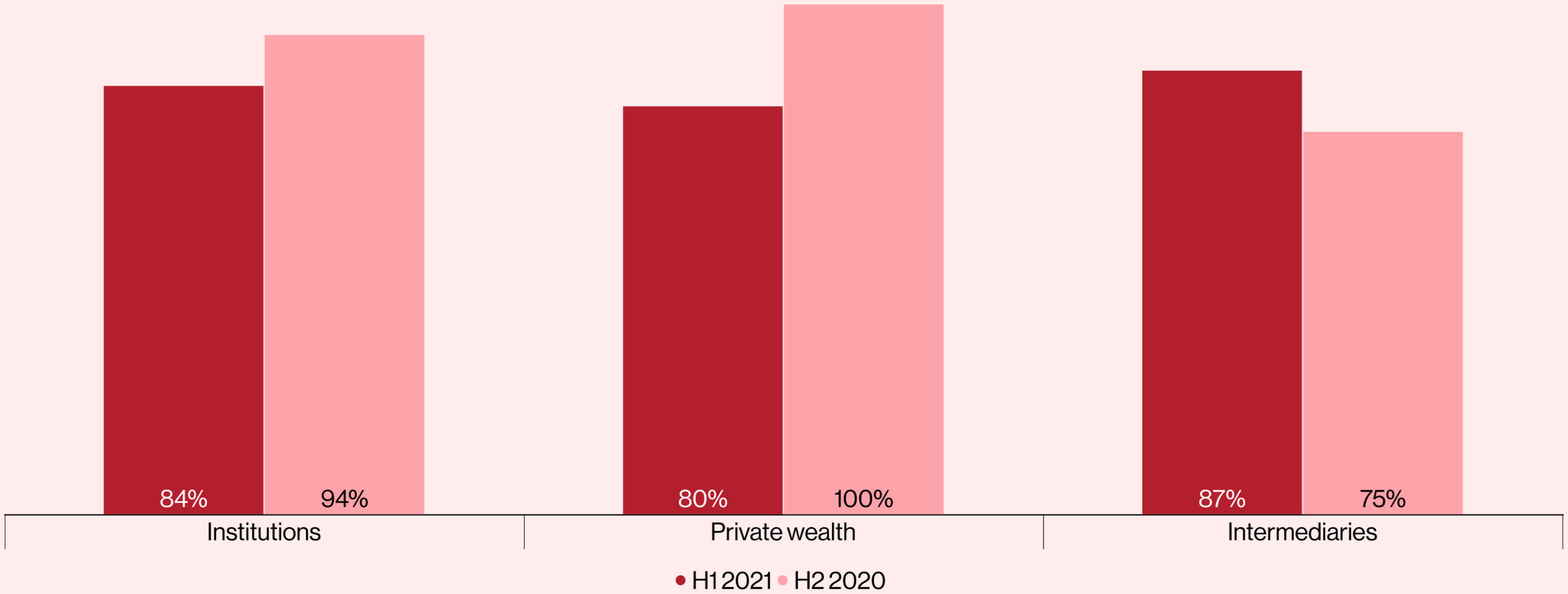
Core strategies held up

Meanwhile, institutions, where the fall in satisfaction was less pronounced, and intermediaries, among whom satisfaction rose, are likely to have had greater exposure to core strategies, which held up well during the pandemic.

Why it matters

Performance satisfaction remains high, but private wealth investors in particular are less impressed than they were six months ago. Exploring bespoke products may be the best route for GPs seeking to engage with this group.

Exhibit 2.2: Proportion of LPs satisfied with private credit performance in H1 2021 vs. H2 2020 by LP type



Source: PCFI-ACC

Private credit can benefit from expected strong private equity returns

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Private credit opportunities abundant

Beyond reaching target allocation, exciting new opportunities are what attract LPs most to private credit. As mentioned earlier opportunities in Apac and Eastern Europe, as well as bespoke products stand out in particular.

Private credit rides LP PE interest

The strong return expectations and allocation plans for private equity bode well for private credit, as PE GPs increasingly seek to finance their deals through private credit funds. GPs should be alive to this opportunity in H2.

Why it matters

The low proportion citing inflation concerns as a reason for investing in private credit shows this could be a pinch point as inflation rises. In this regard, IRs should highlight that most private debt is floating, rather than fixed, rate.

Exhibit 2.3: LP reasons for increasing their alternatives allocations in H2 2021

Hedge Funds	Private Equity	Private Credit	Real Estate	Infrastructure & Natural Resources
To reach target allocation 41%	Expect strong returns 56%	To reach target allocation 55%	To reach target allocation 41%	To reach target allocation 57%
Exciting new opportunities 38%	To reach target allocation 56%	Exciting new opportunities 29%	Expect strong returns 37%	Inflation concerns 31%
Expect strong returns 31%	Exciting new opportunities 31%	Expect strong returns 26%	Inflation concerns 30%	Expect strong returns 29%
Low fixed income yields 25%	Equity valuation concerns 8%	Low fixed income yields 26%	Exciting new opportunities 22%	Exciting new opportunities 23%
Equity valuation concerns 22%	Inflation concerns 8%	Equity valuation concerns 6%	Low fixed income yields 22%	Low fixed income yields 14%
Inflation concerns 19%	Low fixed income yields 0%	Inflation concerns 3%	Equity valuation concerns 4%	Equity valuation concerns 11%

Source: PCFI-ACC

Private wealth may be adopting a more institutional private credit framework

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Private wealth takes formal approach

Two fifths of private wealth investors said their principal reason for investing in private credit is to reach target allocation. This suggests private wealth investors are taking a more structured approach to the asset class.

Two thirds of institutions underweight

41% of institutions plan to increase their private credit allocation, of these, 65% have yet to reach their target portfolio weighting. This shows the industry retains significant scope for growth with heavy-weight investors.

Why it matters

It is an exciting development for the industry that private wealth investors may be looking at private credit through a more institutional prism. IRs should seek to incorporate this idea into conversations with private wealth LPs.

Exhibit 2.4: LP reasons for increasing their private credit allocation in H2 2021 by LP type

All LPs	Institutions	Private Wealth	Intermediaries
To reach target allocation 55%	To reach target allocation 65%	To reach target allocation 40%	Exciting new opportunities 44%
Exciting new opportunities 29%	Expect strong returns 29%	Low fixed income yields 40%	To reach target allocation 44%
Expect strong returns 26%	Exciting new opportunities 24%	Exciting new opportunities 20%	Expect strong returns 22%
Low fixed income yields 26%	Low fixed income yields 24%	Expect strong returns 20%	Low fixed income yields 22%
Equity valuation concerns 6%	Equity valuation concerns 0%	Equity valuation concerns 20%	Equity valuation concerns 11%
Inflation concerns 3%	Inflation concerns 0%	Inflation concerns 20%	Inflation concerns 0%

Source: PCFI-ACC

LPs plan to meet two new private credit GPs during the second half of the year

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LPs will meet 2 new GPs in H2

Investors plan to meet an average of two new private credit GPs in the second half of 2021. The comparatively lower figure for private credit may be due to the industry's smaller size and its dominance by a handful of larger players.

LPs focus on quality over quantity

Another factor behind the relatively lower figure could be a focus on quality over quantity. One LP said he preferred doing a deep dive into one or two private credit GPs, over meeting with large numbers of hedge fund managers.

Why it matters

Continued travel restrictions represent a third factor potentially depressing meetings numbers in H2. For IRs that had planned to travel, that budget may now be better deployed enhancing the firm's virtual ODD capabilities.

Exhibit 2.5: Median number of meetings planned by LP with new GPs in H2 2021 by asset class

Source: PCFI-ACC

Apac offers the best meetings prospects, as well as investment opportunities

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Intermediaries get the lay of the land

Intermediaries plan the most meetings with new private credit GPs in H2. Asset managers and funds of funds are more likely than their peers to meet speculatively with managers so as to gain a bird's eye view of the industry.

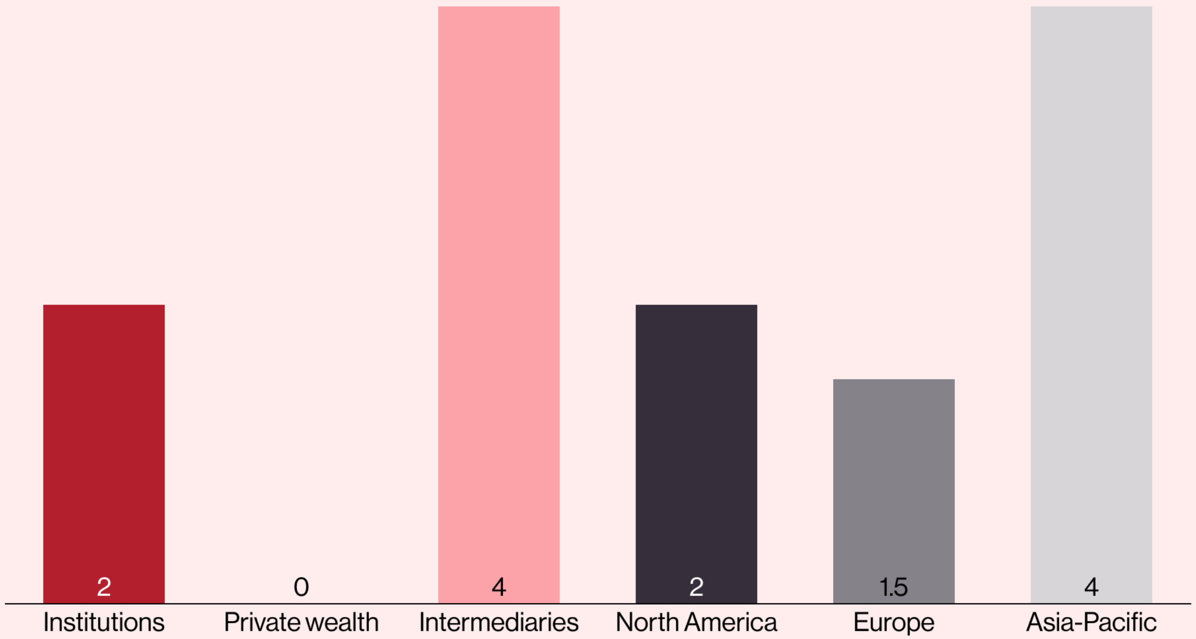
Apac offers the best prospects

Asia-Pacific LPs also look set to show a strong interest in private credit in H2. Within the region, Greater China and Australia are likely to offer the best prospects both from an investment and capital-raising perspective.

Why it matters

One potential stumbling block for GPs could be again private wealth. Those IRs that plan on focusing on the private wealth space should know meetings may be more difficult to come by with this group during H2.

Exhibit 2.6: Median number of meetings planned by LPs with new GPs in H2 2021 by LP type and region



Source: PCFI-ACC

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ABOUT PCFI

PCFI provides business intelligence for the private credit investment community; combining a comprehensive database with exclusive industry intel to ensure fund managers can successfully raise assets, investors can pinpoint the best allocation opportunities, and service providers can source and qualify new business opportunities, in private credit investment markets.

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ABOUT ACC

The Alternative Credit Council (ACC) is a global body that represents asset management firms in the private credit and direct lending space. It currently represents 200 members that manage over $450bn of private credit assets.

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