Private Credit
FUND INTELLIGENCE

INSIGHTS

Investor Intentions H1 21

A guide to investor thinking and alternative allocation plans

In association with

ALTERNATIVE CREDIT COUNCIL
LENDING FOR GROWTH

Contents

Key findings

Nearly 40% of investors plan to increase their private credit allocation in H1 2021, including over half (57%) of intermediaries. Private credit is also the asset class most likely to see inflows from institutional investors.

Based on surveys and interviews conducted with 65 investors in alternative assets throughout Q4 2020, *Investor Intentions H1 2021* provides private credit GPs with a window into the thinking of prospective clients, and investors with critical intelligence on the plans and sentiment of peers.

Concerned by the ongoing fallout from the Covid-19 pandemic, LPs cited risk management as their number-one priority moving into 2021. Enhancing returns came next, and LPs regard private equity and private credit as the alternative asset classes most likely to deliver outperformance.

Investors were more likely to be satisfied with the performance of their private credit portfolio in 2020 than with the performance of any other alternative asset class, after the industry successfully navigated a hugely challenging market environment.

Private wealth investors gave the highest overall satisfaction rating for private credit, while asset managers and other intermediaries were most likely to be "very satisfied".

Despite this strong demand, GPs should not become complacent. Both investors' expectations around performance and their understanding of the asset class have increased, meaning GPs' pitch to investors will also have to evolve to become more sophisticated.

Beyond superior performance, investors are also looking to private credit as a source of niche opportunities, with the asset class most likely among alternatives to be regarded as offering less commonplace opportunities to generate returns. Against a backdrop of yield compression, specialty finance vehicles pursuing strategies such as aircraft leasing are especially well placed to meet investors' needs in this regard.

As vaccination programmes gather pace throughout H1 2021, government support schemes may begin to be withdrawn. Creditors that have been sustained by such schemes could in turn experience financial distress, harming their ability to repay debts and forcing GPs to restructure deals. In this respect, ongoing transparency and communication with investors will be key to maintaining current levels of satisfaction and securing the continued growth of the industry this year and beyond.

> **"Both investors' expectations around performance and their understanding of the asset class have increased"**

#1 **38%** of LPs plan to commit further capital to private credit in H1 2021, the second highest rise among alternatives

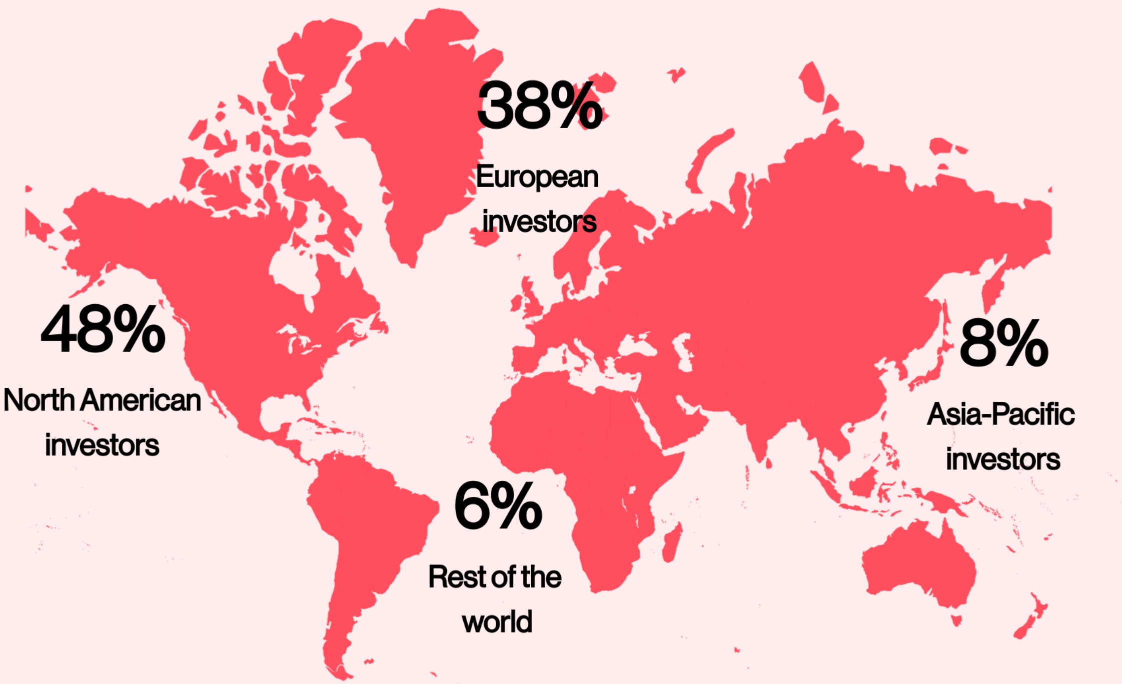
#2 Over **90%** of investors are satisfied with how their private credit portfolio held up in 2020

#3 Private credit is the asset class to which **institutions** are most likely to increase their allocation in H1 2021

#4 Investors regard private credit as the alternative asset class most likely to offer **niche opportunities**

#5 Investor plans for traditional assets in H1 2021 suggest they plan to **add risk** to their portfolios

About the respondents



65 alternative investors	*$3.8trn* in total investor assets	*$51bn* invested in private credit
39% Institutions	32% Private wealth	29% Intermediaries

Section one

Allocation plans

Private credit is the second most likely alternative asset class to see inflows

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Investors plan private credit increase

Private credit is second most likely among alternative asset classes to see investor inflows in the first half of 2021. This comes as there is a notable rise in funds in market pursuing special opportunities strategies.

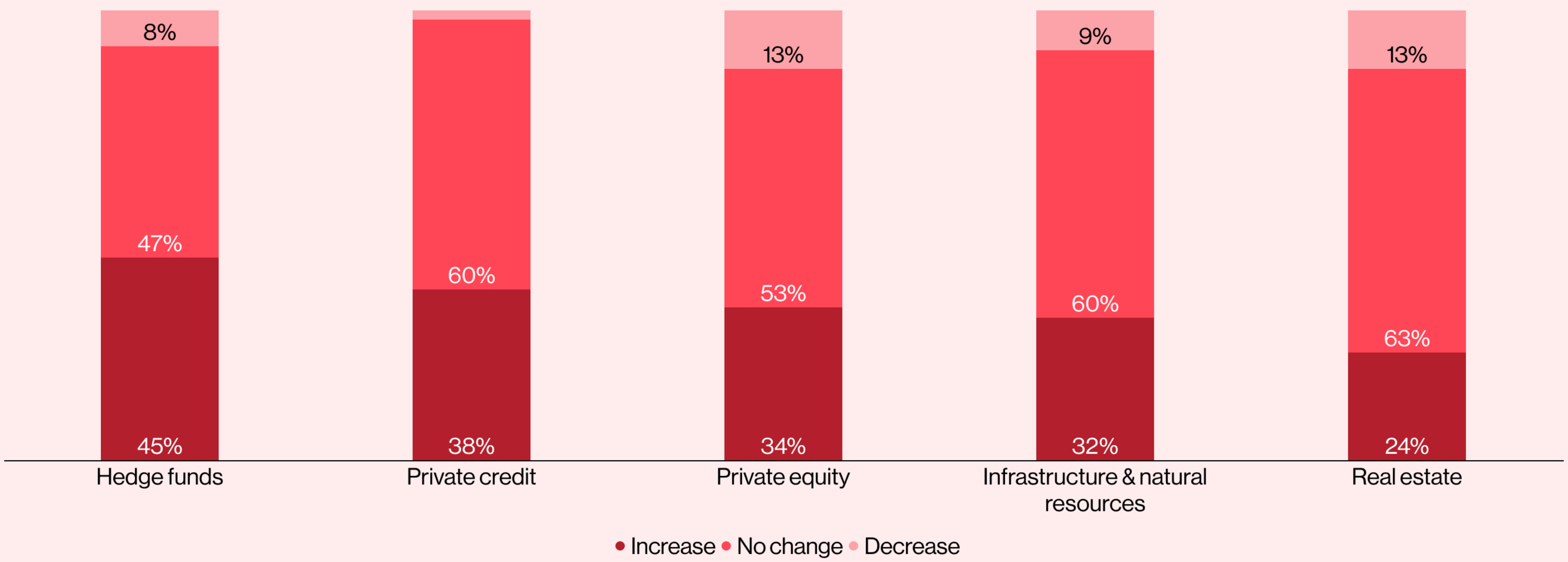
Few allocators expect to decrease

Just 2% of investors plan on decreasing their private credit allocation in H1. Factors behind this include private credit's status as a portfolio diversifier and the relative size of the private credit space compared to more established private markets.

Why it matters

Private credit managers can expect strong investor demand in H1 2021. As the asset class has grown, so too has investors' understanding of it, meaning both managers' offering and their pitch must become more sophisticated.

Exhibit 1.1: Investor alternatives allocation plans in H1 2021



Source: PCFI-ACC

Institutions are more likely to allocate to private credit than to other assets

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Institutions favour private credit...

Institutions are more likely to increase their allocation to private credit than to any other alternative asset class in H1. This group favoured other private markets too, seeking an illiquidity premium from locking up capital for longer.

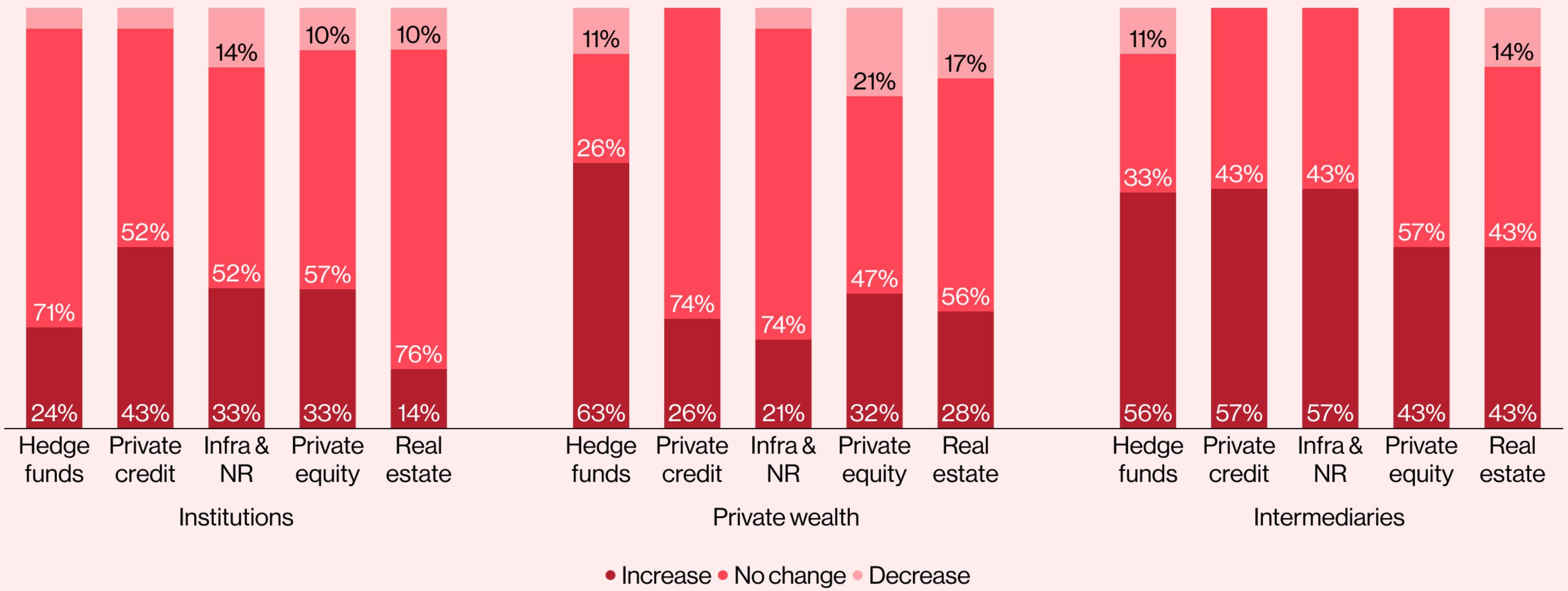
...but private wealth are more cautious

Private wealth investors are less likely than other allocators to increase their private credit allocation in H1. 42% of private wealth investors cited private market illiquidity as a reason for increasing their allocation to more easily exited hedge funds.

Why it matters

Managers will be pleased by the opportunity set among larger, stickier institutions. Those firms that do wish to attract private wealth money, however, should consider launching hybrid funds with open-ended structures.

Exhibit 1.2: Investor alternatives allocation plans in H1 2021 by investor type



Analyst note: Infra & NR refers to infrastructure and natural resources

Source: PCFI-ACC

Investors' traditional allocation plans suggest they will add risk in H1 2021

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Investors plan to add risk in H1

LPs' plans for traditional asset classes suggest they will add risk in H1 2021. This includes increased equity allocations and decreased exposure to less risky assets, such as cash and fixed income investments.

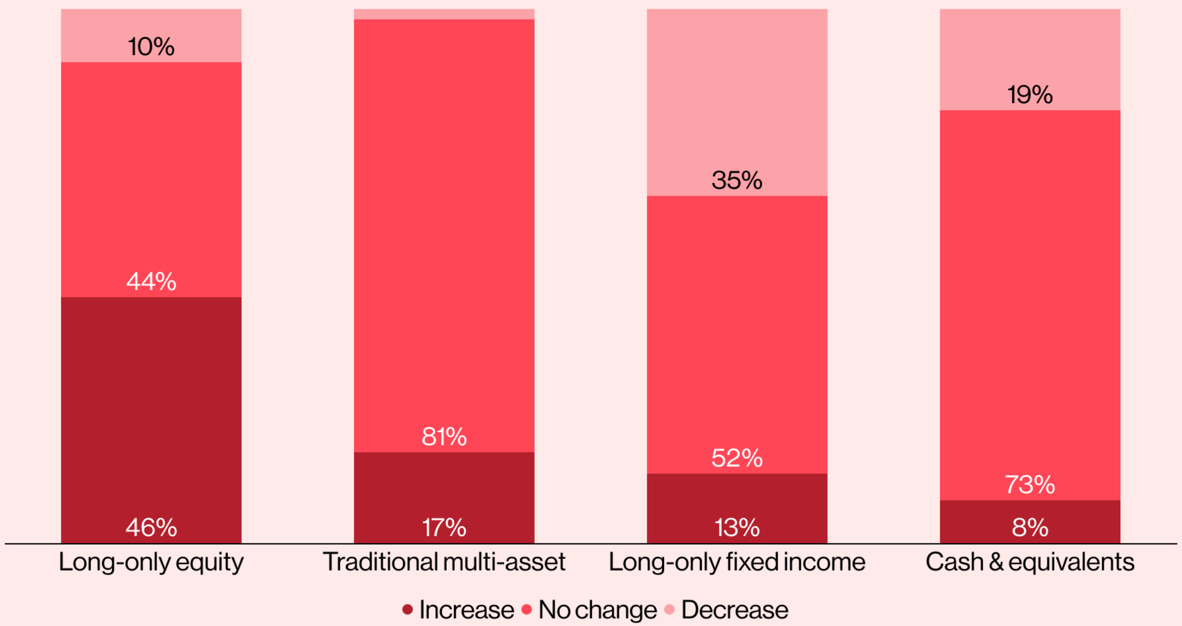
Tough first half for fixed income

Continued low base rates mean traditional fixed income is out of favour with LPs, and more plan to decrease their allocation than plan to increase. Private credit GPs can benefit from offering investors similar income-generating assets with higher yields.

Why it matters

The shift away from long-only fixed income presents both a short-term and a long-term opportunity for private credit managers. As investors seek replacements for bond portfolios private debt funds can fill this gap.

Exhibit 1.3: Investor traditional allocation plans in H1 2021



Source: PCFI-ACC

29%

of LPs decreasing fixed income plan to increase their private credit allocation

Hopes of economic recovery in 2021 see institutions add long-only equity

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Institutions plan equity increase

30% of institutions plan to increase their long-only equity exposure in H1 2021. Hopes of economic recovery driven by vaccine rollouts and a more stable geopolitical environment have contributed to this upswing.

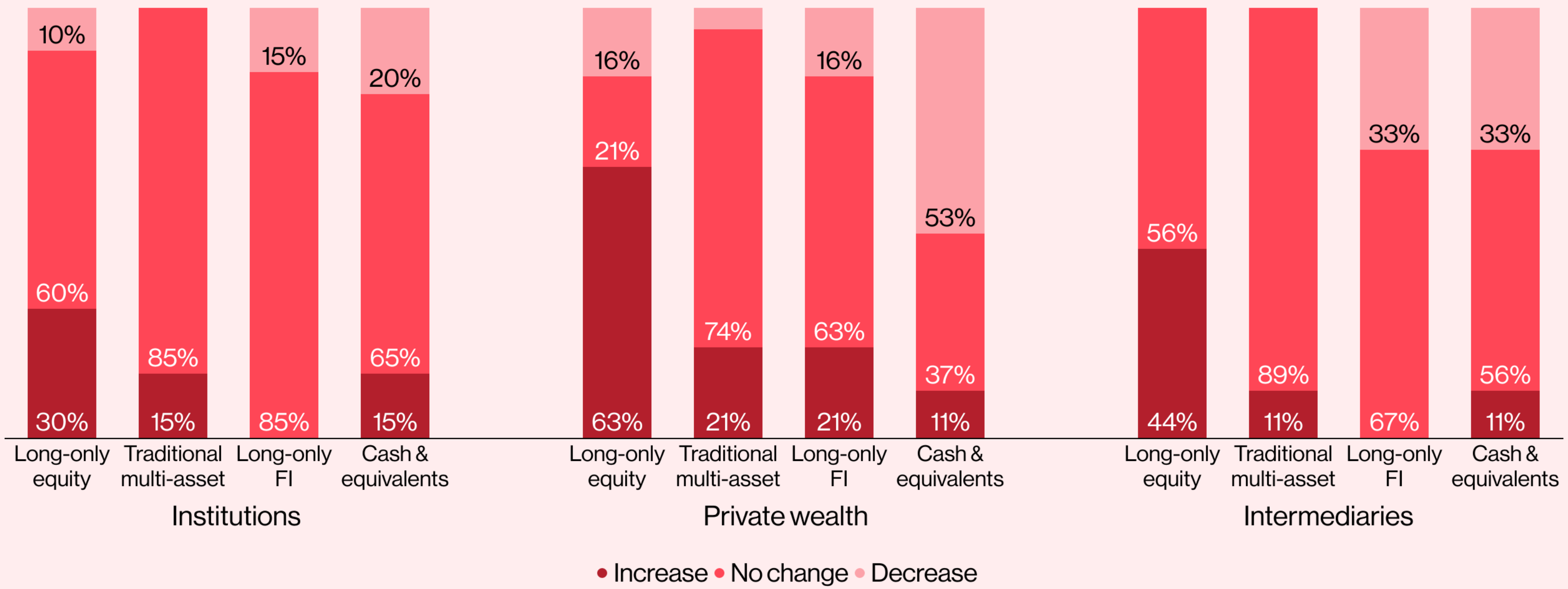
Fixed income fall may be modest

Most investors plan to pare back on long-only fixed income. But in monetary terms, this may not be so dramatic since just 15% of institutions, net, plan to decrease. As the largest holders of bonds this group's activities will have the largest market impact.

Why it matters

The outlook for long-only fixed income is more negative than for other asset classes. But while only private wealth investors are receptive to long-only, there is appetite across investor types for GPs' private credit offering.

Exhibit 1.4: Investor traditional allocation plans in H1 2021 by investor type



Source: PCFI-ACC

Private credit accounts for the second smallest share of investor portfolios

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Private credit small, but growing

Our data suggests private credit will take on a more significant role in investor portfolios in 2021. This comes from a relatively low base, with private credit the second smallest asset class proportionally after infrastructure and natural resources.

Institutions' credit exposure will rise

Asset managers and other intermediaries have the largest allocation to private credit as a share of their overall portfolio (7%), while institutions have the smallest. The latter share will rise over the year ahead as institutions make private credit a top priority in H1 2021.

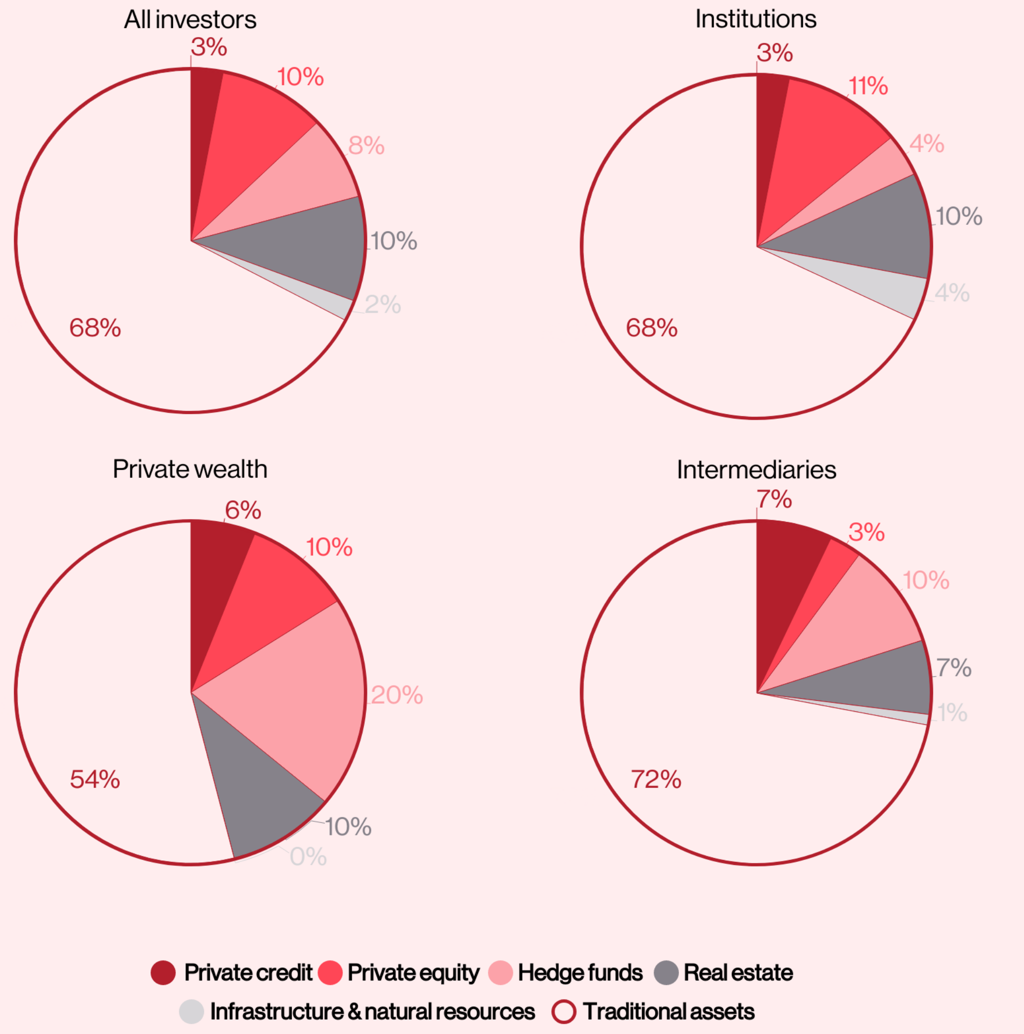
Why it matters

Proportionally, credit exposure will rise across investor types in 2021, but there remain challenges on the horizon for GPs. Full-market cycle experience will be an invaluable commodity in 2021, especially for managers seeking to close their first fund.

We want to create an all-weather, sleep-well portfolio

-European asset manager

Exhibit 1.5: Breakdown of investor portfolios by investor type



Source: PCFI-ACC

Section two

Investor sentiment

Over 90% of investors are satisfied with private credit performance in 2020

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Private credit satisfaction highest

Investors were more satisfied with private credit than any other alternative asset class in 2020. Swift monetary and fiscal stimulus left distressed managers with only a short window to act on market opportunities and dislocations.

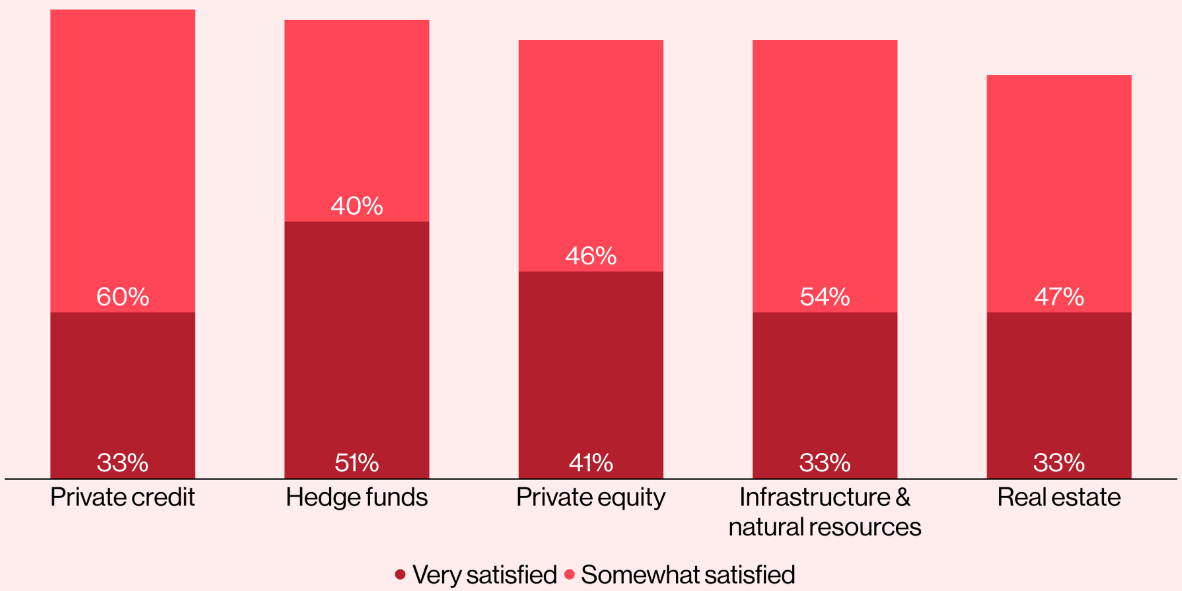
Communication essential in 2021

With many government support programmes due to come to an end, bankruptcies will mount in the year ahead. In 2020 investors were willing to give managers time to work through such issues, but will expect greater communication in 2021.

Why it matters

Returns will be key to maintaining satisfaction with private credit, but transparency is important too. Managers exposed to vulnerable sectors, such as retail, hospitality and travel, must prepare to field increased LP queries.

Exhibit 2.1: Investor satisfaction with alternative asset classes' performance in 2020



Source: PCFI-ACC

> *Our private debt portfolio disappointed, but that was due to too many level 2 assets and not enough level 3*
>
> - European asset manager

No other asset class received a higher satisfaction rating from institutions

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All investor types satisfied

All categories of allocator were satisfied with 2020 private credit performance. Liquidity concerns may explain the lower proportion of family offices and HNWIs that were "very satisfied", but this group was most satisfied overall.

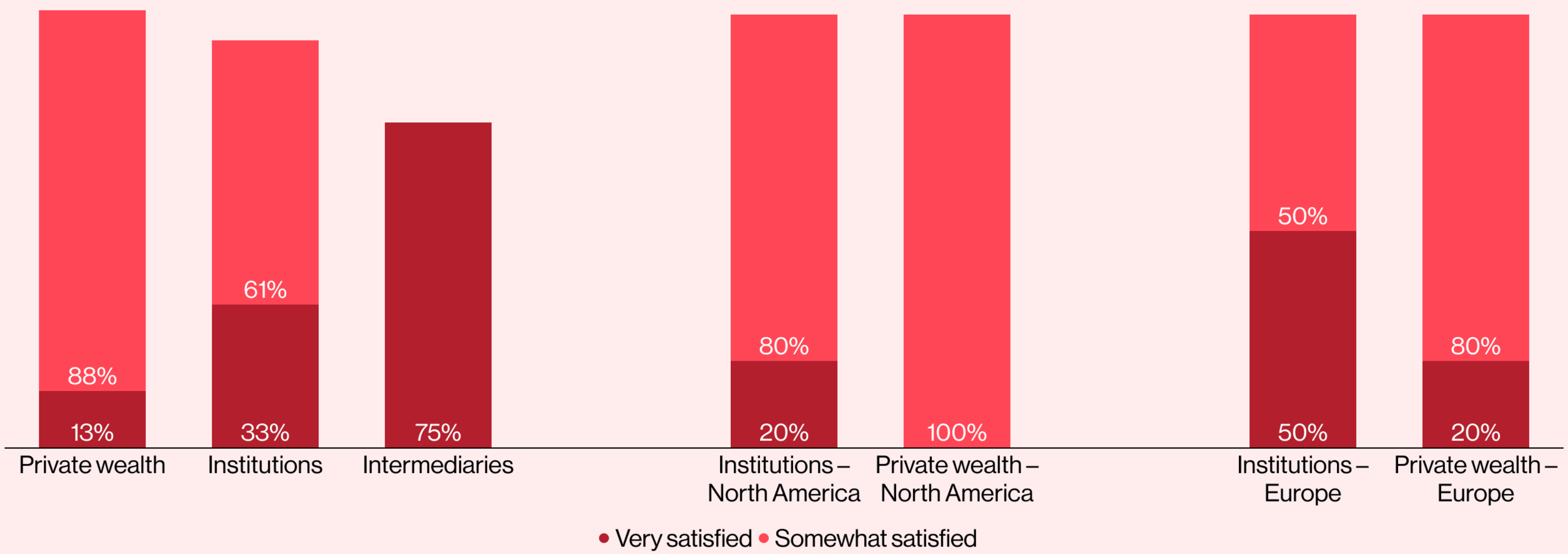
Private credit top among institutions

Private credit received the highest overall satisfaction rating among institutional investors. It also came joint second with real estate, after private equity (41%), in terms of the proportion of institutions that were very satisfied with 2020 performance.

Why it matters

Lower satisfaction among North American LPs can be attributed to higher expectations owing to the length and breadth of experience with the asset class. IRs may wish to monitor North American investors more closely in 2021.

Exhibit 2.2: Investor satisfaction with private credit performance in 2020 by investor type and location



Source: PCFI-ACC

LPs see private credit as the most promising source of niche opportunities

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LPs invest in private credit for returns

62% of LPs allocate to private credit for outperformance, the second highest among alternative asset classes. Anecdotally, performance expectations for the latest vintage of funds is even higher, while competition for deals is greater than ever.

Niche opportunities key selling point

Private credit is most likely to be regarded by LPs as a source of niche opportunities. IR professionals should highlight opportunities beyond mid-market lending, especially those at firms pursuing specialty finance strategies, with less yield compression than other market segments.

Why it matters

The importance placed upon niche opportunities in relation to private credit means having a strong sourcing network will be key to success in 2021 and beyond. Where possible managers should seek to call attention to the strength of their own network.

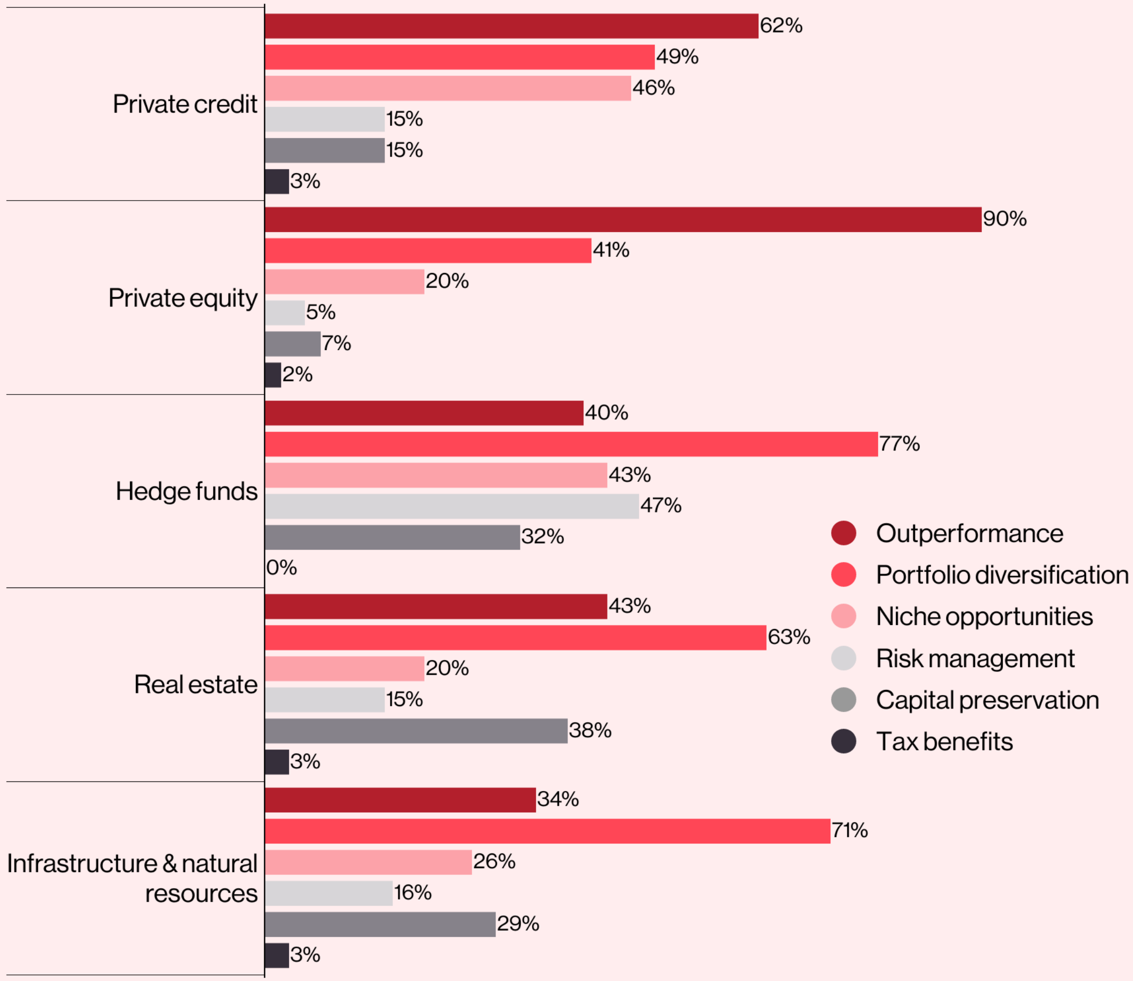
"

We want to use alts to capture long-only returns, while also mitigating risk

- US family office

"

Exhibit 2.3: Why allocators invest in alternative assets



Source: PCFI-ACC

Outperformance is institutions' main reason for investing in private credit

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Performance expectations are high

Outperformance is the principal reason for allocating to private credit among institutions and intermediaries, the investor groups most likely to increase exposure in H1. IRR expectations are even higher for 2021 vintage funds.

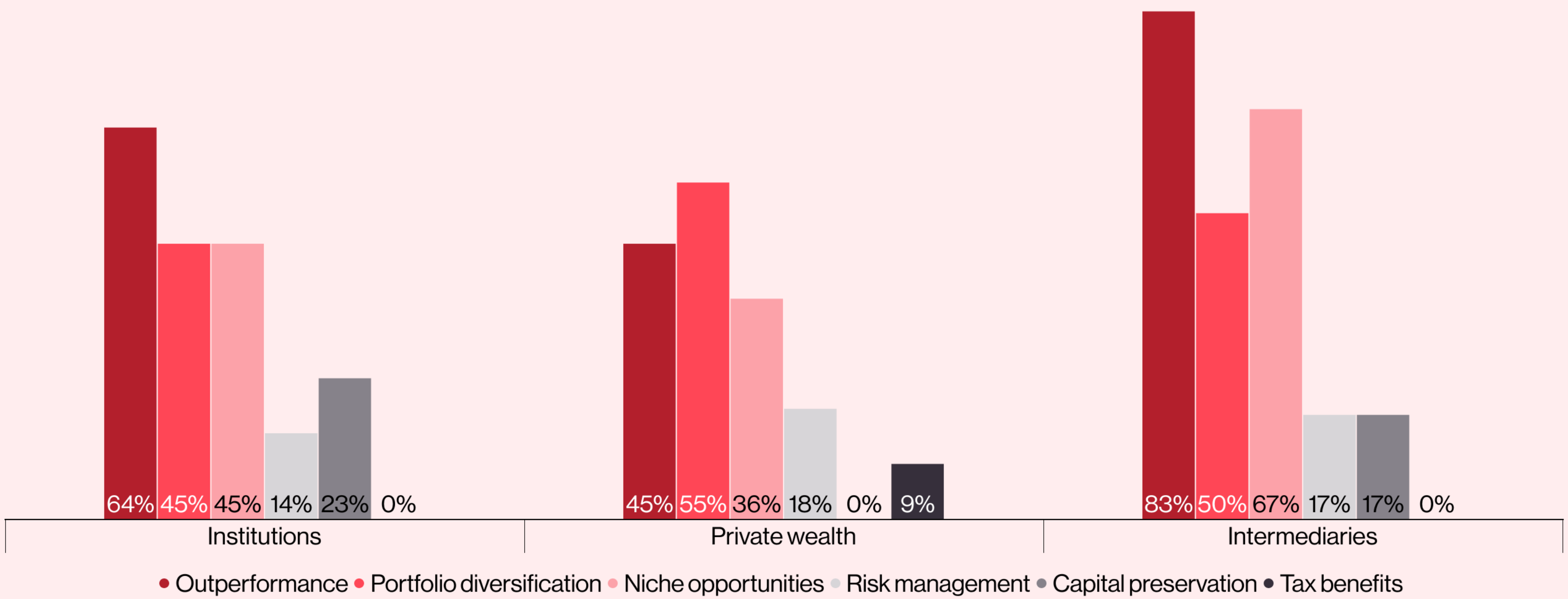
Private wealth seek flexibility

Private wealth investors, meanwhile, are most likely to value private credit's diversification benefits. Within this the ability to invest across both illiquid private and more liquid public credit markets is also desirable to private wealth investors.

Why it matters

Increased performance expectations and a crowded marketplace for deals are significant challenges for GPs in 2021. Both will require strong communication from IR professionals in order to manage those expectations.

Exhibit 2.4: Reasons for allocating to private credit by investor type



Source: PCFI-ACC

LPs' focus on enhancing returns in H1 plays to private credit GPs' strength

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Risk management before returns

After a turbulent year, risk management is investors' top priority moving into 2021. LPs invest in private credit for its ability to deliver strong performance, but IRs should expect increased emphasis on risk management during LP conversations.

GPs well positioned on returns

Private credit GPs are well positioned when it comes to investors' number two priority: returns. Private credit is second after private equity as a driver of returns within the alts bucket. IRs should continue to drive this home as they seek to raise new funds in H1.

Why it matters

While risk management is LPs' top priority, enhancing returns is a close second and something private credit GPs are seen as well positioned to deliver. IRs should pitch their funds as complementary to other asset classes within the alts bucket that offer superior risk management.

"If you want double-digit returns you have to be willing to digest some volatility as well"

- European family office

Exhibit 2.5: Allocators' top investment objectives in H1 2021

Overall	Institutions	Private wealth	Intermediaries
Managing risk 97%	Managing risk 96%	Managing risk 100%	Enhancing returns 100%
Enhancing returns 89%	Enhancing returns 84%	Enhancing returns 86%	Managing risk 95%
Increasing income 48%	Increasing income 48%	Increasing income 43%	Increasing income 53%
Reducing fees 31%	Reducing fees 48%	Improving liquidity 33%	Reducing fees 32%
Improving liquidity 20%	Improving liquidity 12%	Capturing market beta 29%	Improving liquidity 16%
Capturing market beta 15%	Capturing market beta 12%	Reducing fees 10%	Capturing market beta 5%

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 the global body representing asset management firms in the private credit and direct lending space. It represents over 170 members that manage $400bn of private credit assets. The ACC is an affiliate of AIMA (the Alternative Investment Management Association). The ACC provides guidance on policy and regulatory matters, supports wider advocacy and educational efforts and produces industry research. The ACC seeks to explain the value of private credit by highlighting the sector's wider economic and financial stability benefits.

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