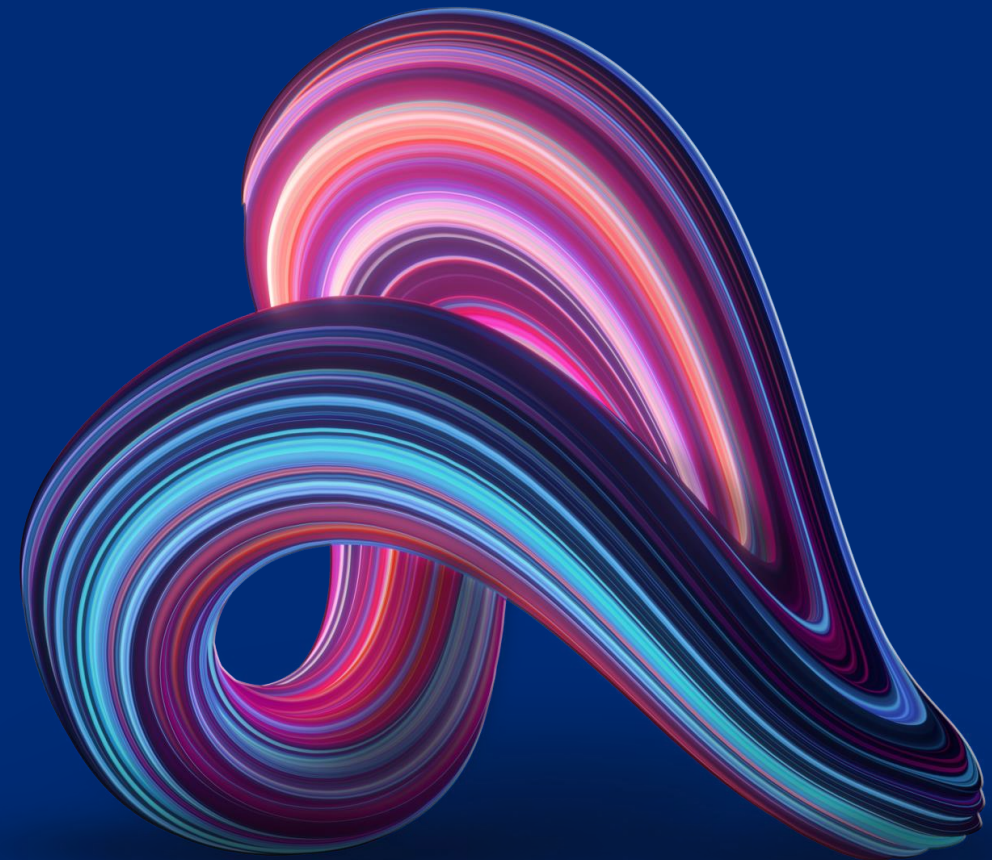


# Private versus Liquid Credit - Ihr Blick durch unsere Brille

September 2023

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# Introduction Private Debt



# What is Private Debt?

## Overview



**A bilaterally negotiated...**

**An asset manager sources and leads** the arrangement of a loan



**...replacement for bank loans...**

**Borrowers with no access to public debt markets**, or (increasingly) those who choose not to



**...to mid-market companies...**

**Typically privately owned companies.** EBITDA of \$5m to \$100m



**... with seniority and security...**

**Backed by senior claims** on company cash flows, or assets



**... and held to maturity or refinanced.**

Loans are **not traded** and are considered “illiquid”

# Long-term secular dynamics favorable

Banks continue to reduce lending activities, providing more opportunity for non-bank lenders to fill the gap

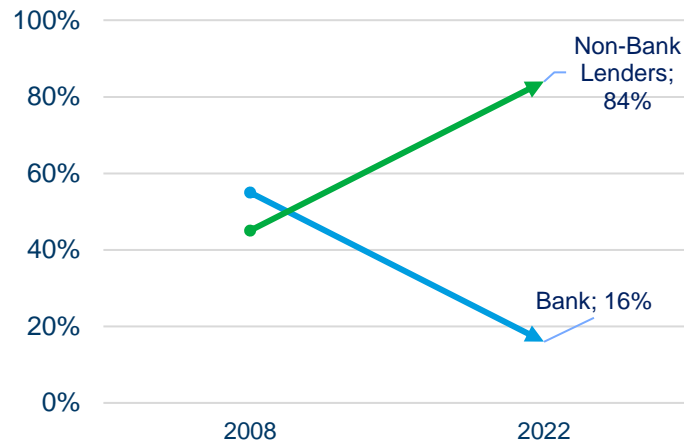
## Supply constraints

**Regulations and consolidation**  
*Banks continue to reduce lending activities.*

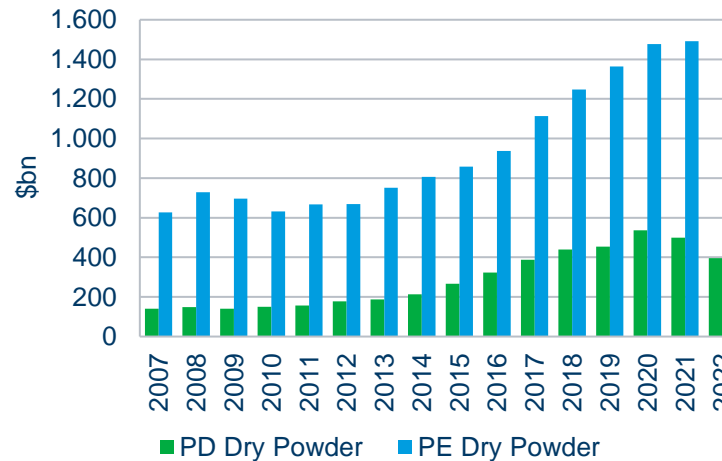
## Demand for private finance

**Private Equity growth**  
*Driving demand for credit no longer supplied by banks.*

**Bank Share of US and European Highly Leveraged Loans<sup>1</sup>**



**Growth in Private Equity and Private Debt Dry Powder<sup>2</sup>**



Notes:

1) Calculated as an average between US and Europe markets. LCD Global Leveraged Lending Review Q4 2022.

2) Preqin, as of December 31, 2022.

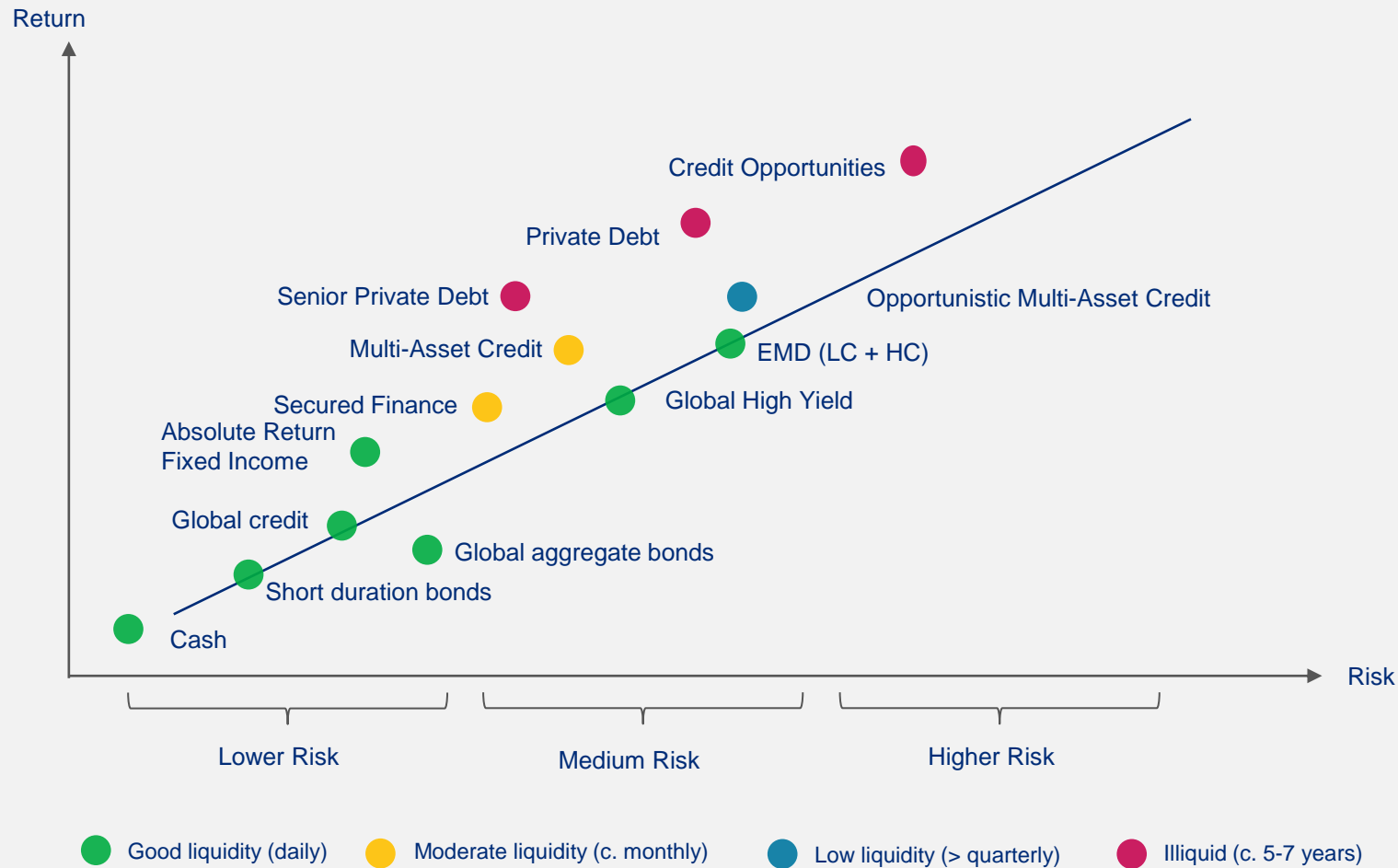
Past performance may not be indicative of future results.

# Why Private Debt now?



# Building robust portfolios

## Active Fixed Income range



Liquidity

Fixed v Floating

Yield v Income

Alpha v Beta

Duration

Credit Quality

Downside Protection

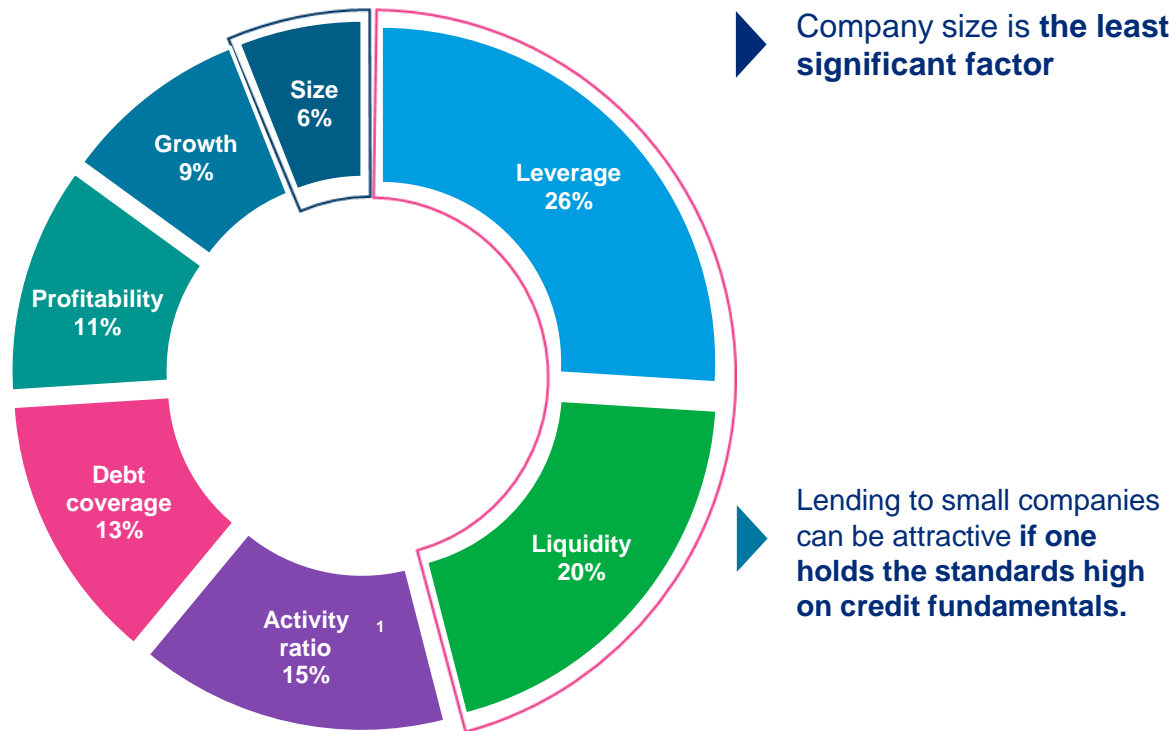
ESG

Investors should note that while ESG Integration forms part of the investment managers overall investment process, it is not implemented equally across all services and products. Integration depends on the degree to which it may be relevant or applicable to the strategy or asset class. For full information see the [Mercer ISE Sustainability Policy](#).

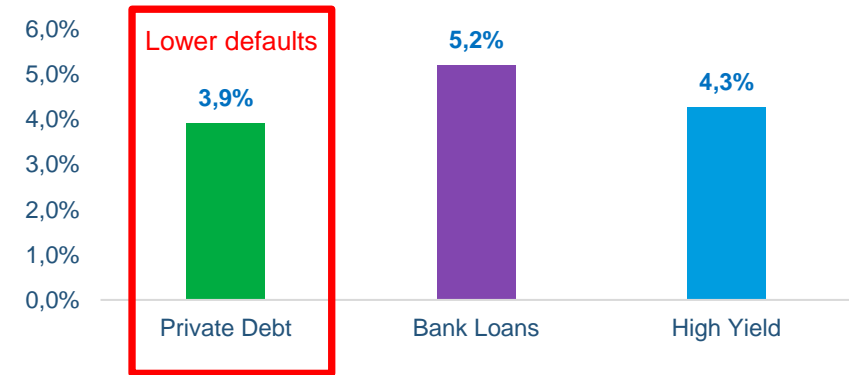
# Risk

## Lender protections versus liquidity

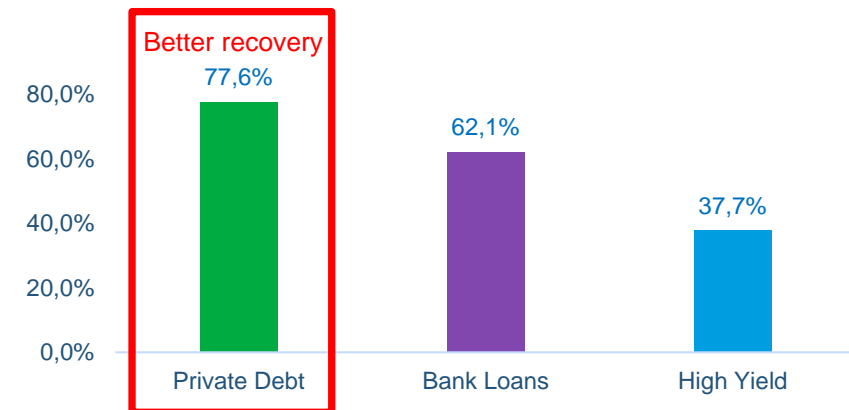
### Drivers of default<sup>1</sup>



### Average Annual Default Rate (1995-2022)<sup>2</sup>



### Average Annual Recovery Rate (1995-2022)<sup>2</sup>



Notes: 1) Deerpath Capital; Moody's Analytics RickCalc 4.0 U.S., April 30, 2012

2) Pitchbook LCD & Moody's (Private Debt and Bank Loans), ICE BofAML US High Yield Index (High Yield) as at March 31, 2022

# Private Debt

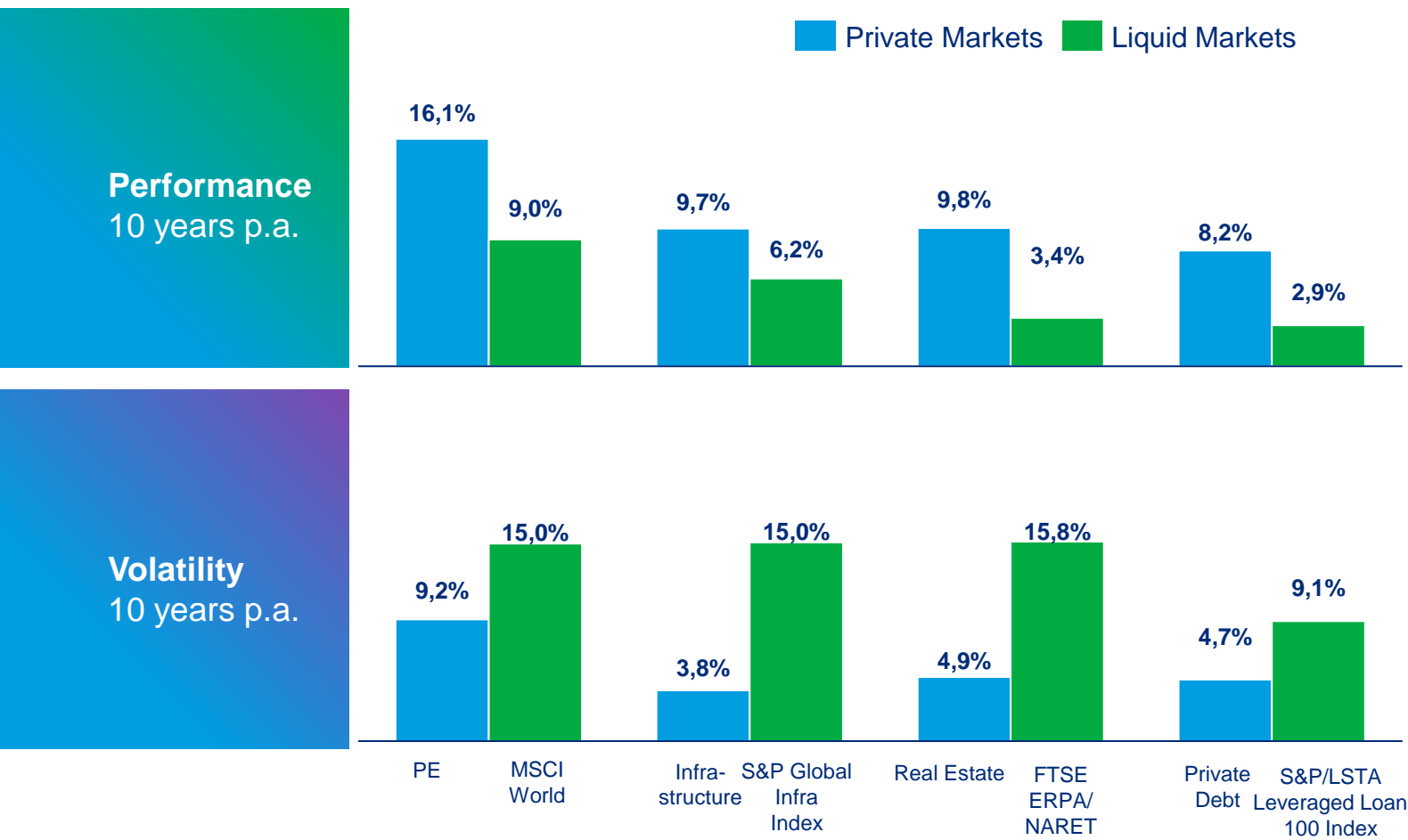
## Resiliency through the market cycle

Period	Year	Direct Loans	Syndicated Bank Loans	High Yield	Investment Grade Corporates
Rising Rates	2005	10.1% <input checked="" type="checkbox"/>	5.1% <input checked="" type="checkbox"/>	2.7%	1.7%
Rising Rates	2006	13.7% <input checked="" type="checkbox"/>	6.7%	11.9%	4.3%
Stability	2007	10.2% <input checked="" type="checkbox"/>	2.1% <input checked="" type="checkbox"/>	1.9%	4.6%
<b>Recession</b>	<b>2008</b>	<b>-6.5%</b> <input checked="" type="checkbox"/>	<b>-29.1%</b>	<b>-26.2%</b>	<b>-5.0%</b>
Recovery	2009	13.2%	51.6%	58.2%	18.7%
<b>Rising Rates Through Market Bottom</b>	<b>2005-2008</b>	<b>29.0%</b> <input checked="" type="checkbox"/>	<b>-18.8%</b>	<b>-13.5%</b>	<b>5.4%</b>
<b>Rising Rates Through Market Recovery</b>	<b>2005-2009</b>	<b>46.0%</b> <input checked="" type="checkbox"/>	<b>23.1%</b>	<b>36.8%</b>	<b>25.1%</b>
Rising Rates	2017	8.6% <input checked="" type="checkbox"/>	4.1%	7.5%	6.4%
Rising Rates	2018	8.1% <input checked="" type="checkbox"/>	0.5% <input checked="" type="checkbox"/>	-2.1%	-2.5%
Stability	2019	9.0% <input checked="" type="checkbox"/>	3.1%	7.1%	14.5%
<b>Recession</b>	<b>2020</b>	<b>5.5%</b>	<b>3.1%</b>	<b>7.1%</b>	<b>9.9%</b>
Recovery	2021	12.8% <input checked="" type="checkbox"/>	5.2%	5.3%	-1.0%
<b>Rising Rates Through Market Bottom</b>	<b>2017-2020</b>	<b>34.9%</b> <input checked="" type="checkbox"/>	<b>11.3%</b>	<b>20.8%</b>	<b>30.6%</b>
<b>Rising Rates Through Market Recovery</b>	<b>2017-2021</b>	<b>52.2%</b> <input checked="" type="checkbox"/>	<b>17.0%</b>	<b>27.1%</b>	<b>29.2%</b>

Source: Cliffwater Direct Lending Index, Credit Suisse Leveraged Loan Index & ICE BofA High Yield Index, Bloomberg US Corporate Bond Index.



# Private markets outperformed liquid markets with lower volatility



Sources: Bloomberg (NDDUWI, SPGTINTR, SPDAL, SPDEL; Indices unhedged in USD).  
Burgiss Private IQ Quarterly Returns in USD für private market investments, as per March 31, 2023.

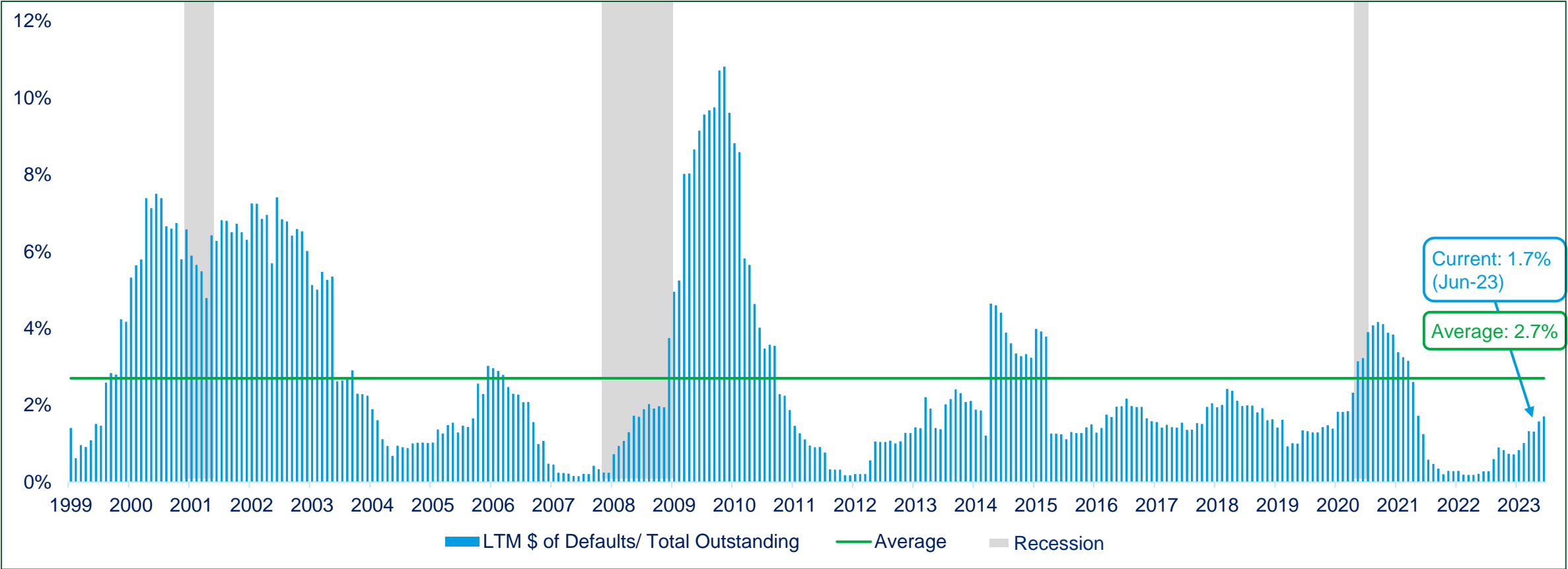
## Maximum drawdown for selected periods of time

	Dot Com	GFC	COVID-19	2022
Private Equity	-39%	-28%	-8%	-9%
Buyout	-24%	-31%	-10%	-5%
Venture	-69%	-18%	-3%	-20%
Private Debt	-3%	-29%	-9%	-1%
Infrastructure	-10%	-20%	-5%	0%
Real Estate	0%	-53%	-6%	-3%
MSCI World	-46%	-51%	-20%	-23%
Russell 3000	-42%	-50%	-20%	-22%
S&P Infrastructure	-10%	-51%	-29%	-15%
FTSE EPRA/NAREIT	-10%	-66%	-28%	-29%
Leverage Loan Index	N/A	-28%	-16%	-12%
High Yield Index	-16%	-26%	-15%	-18%

# Credit Defaults Remain Low

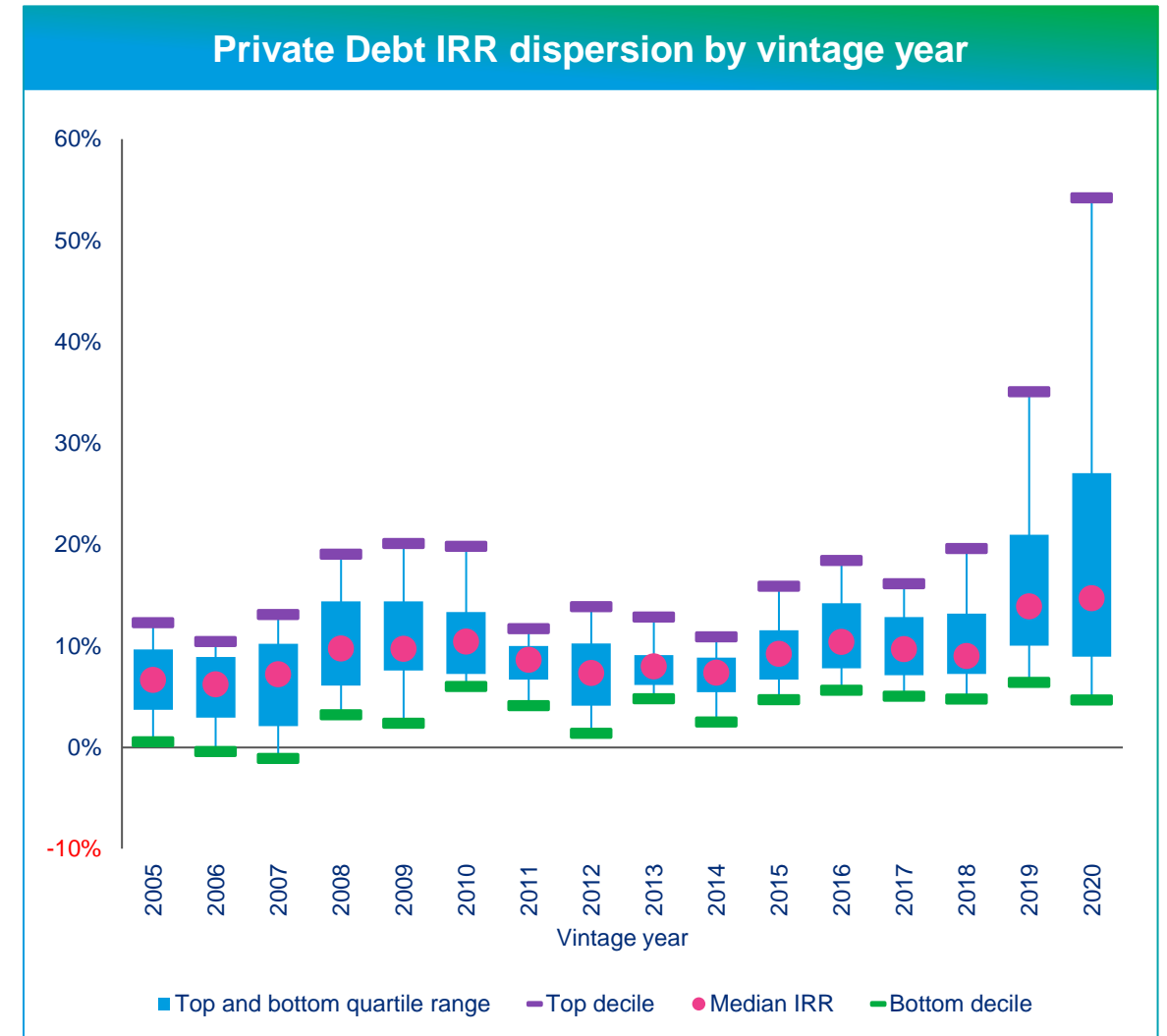
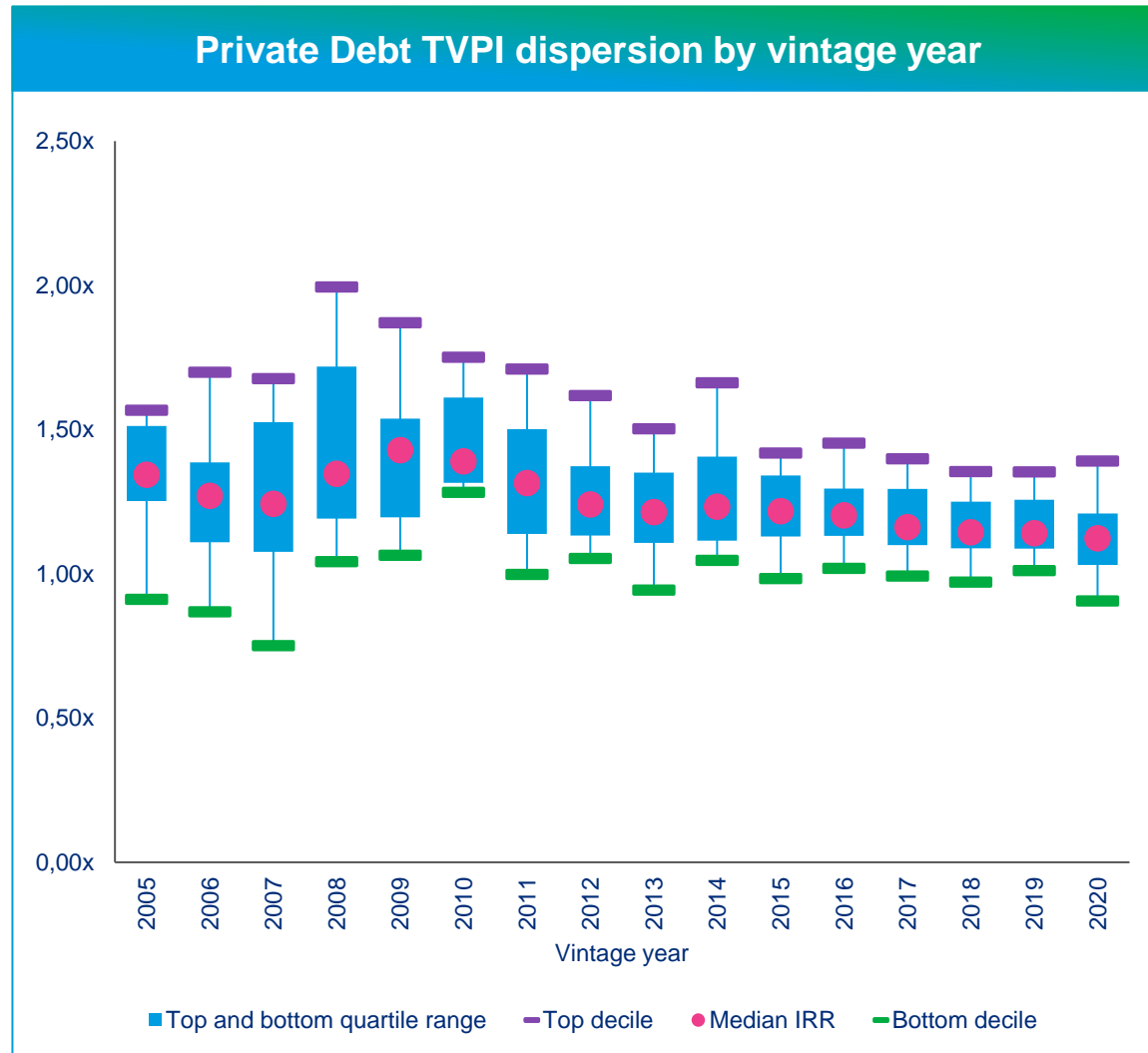
But on a rising trend

U.S. Leveraged Loan Default Rate by Amount



Notes: PitchBook LCD, as at June 30, 2023.

# Private Debt



Source: PitchBook Data, Inc. Underlying data is net of fees and carry and based on pooled cash flow data and is based on Pitchbook classifications, which may differ from those of Mercer. This information is not intended to convey any guarantee as to future performance of the asset class. Past performance is not a guarantee of future returns. As of September 30, 2021

# Today's opportunity in traditional Private Debt

Lending terms and prices have improved while company leverage has fallen

	January-22		July-23		Change
Spread	550-575 bps	>	625-675bps	>	+75bps
OID & Fees	2.00%	>	3.00%	>	+1.00%
SOFR (3M) / Floor	0.09% / 0.75%	>	5.26% / 0.75%	>	+4.51%
Debt/EBITDA*	6.6x	>	5.1x	>	-1.5x
Projected IRR (3yr)**	7.04%	>	12.76%	>	+5.72%

Source: \* PitchBook as of June 30, 2023. \*\* KKR Credit & Markets as of July 3, 2023 (sample borrower). Past performance may not be indicative of future results.

# Private Debt Heat Map

The following represents our views in the context of building a private debt portfolio.

	CORE & CORE +		CORE +		VALUE-ADD
	Direct Lending	Structured Credit	Specialty Finance		Credit Opportunities
US	Senior	CLO	Single Sector Focus		Special Situations
	Unitranche	Portfolio NAV			Distressed Debt
	Mezzanine	ABS	Multi Asset Focus		Credit Dislocation
EU	Senior	CLO	Single Sector Focus		Special Situations
	Unitranche	Portfolio NAV			Distressed Debt
	Mezzanine	ABS	Multi Asset Focus		Credit Dislocation
Asia/ROW					

Very Attractive
Attractive
Neutral
Less Attractive
Unattractive
Not Enough Products to Rate

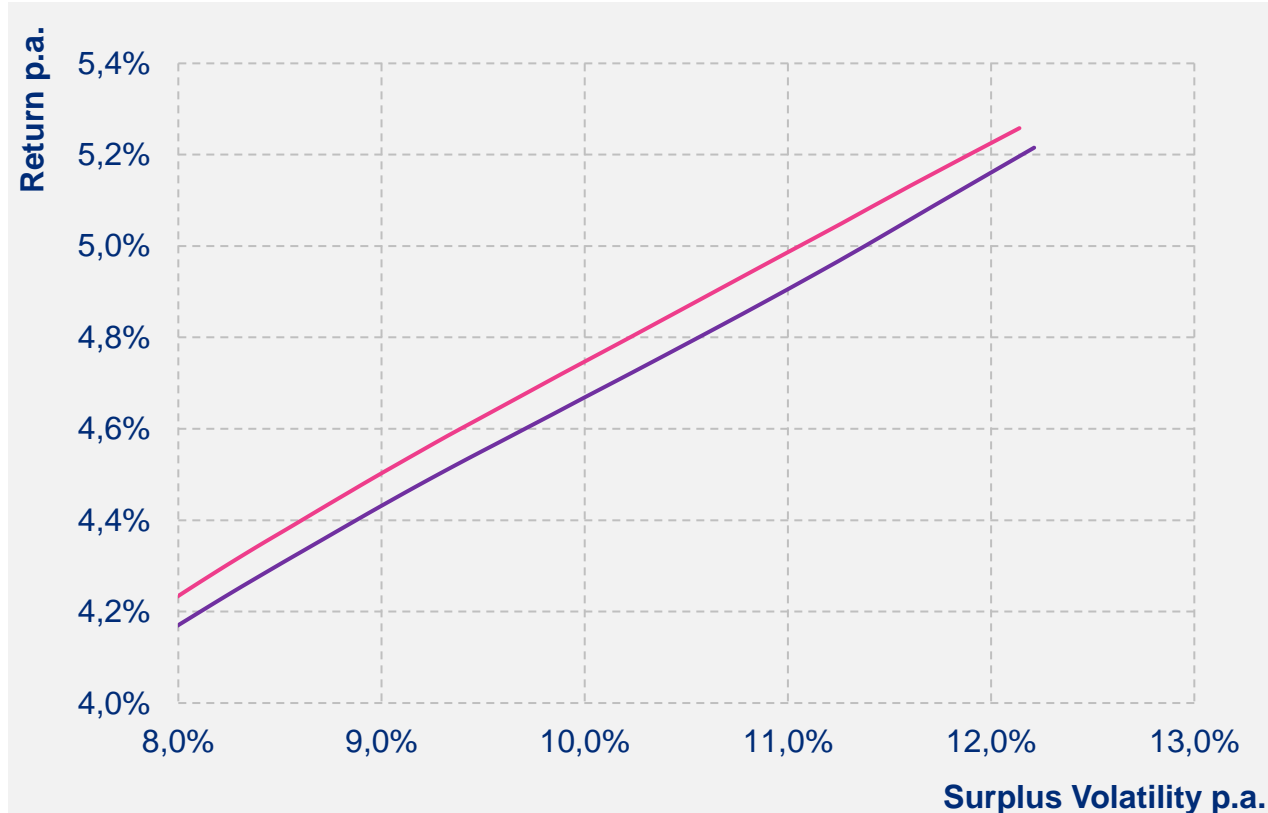
Note: The above broadly reflects our views as of December 2022. These views are subject to change. However, all categories present attractive opportunities and optimal allocations are subject to manager selection.

# Portfolio considerations



# Example from an ongoing ALM / SAA Study

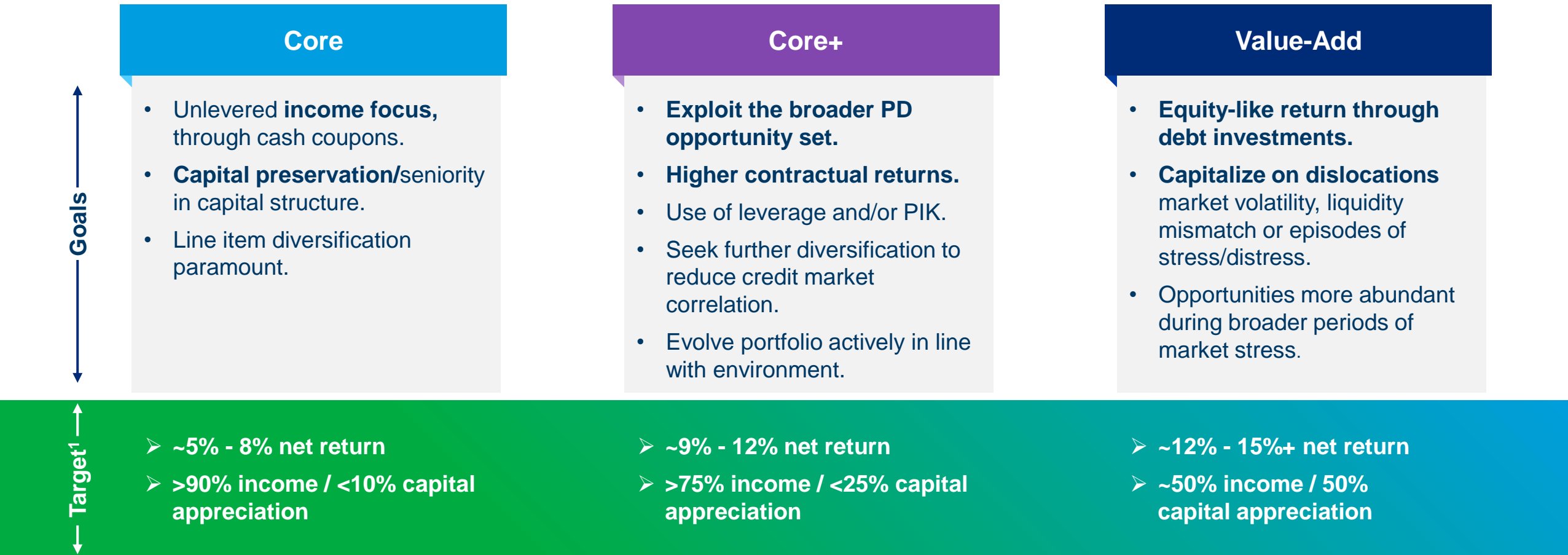
Private Debt allows to reduce Equity allocation, reduce total portfolio volatility while still aiming for a high expected return



	Current universe	Incl. Private Debt
Expected return p.a.	5.0%	5.0%
Volatility p.a.	9.2%	8.7%
Surplus volatility p.a.	11.4%	11.1%
Equities	41%	37%
Private Debt	-	7%

# Building Private Debt portfolios

Mercer Support: Portfolio construction, Manager Selection and Private Debt programmes<sup>1</sup>

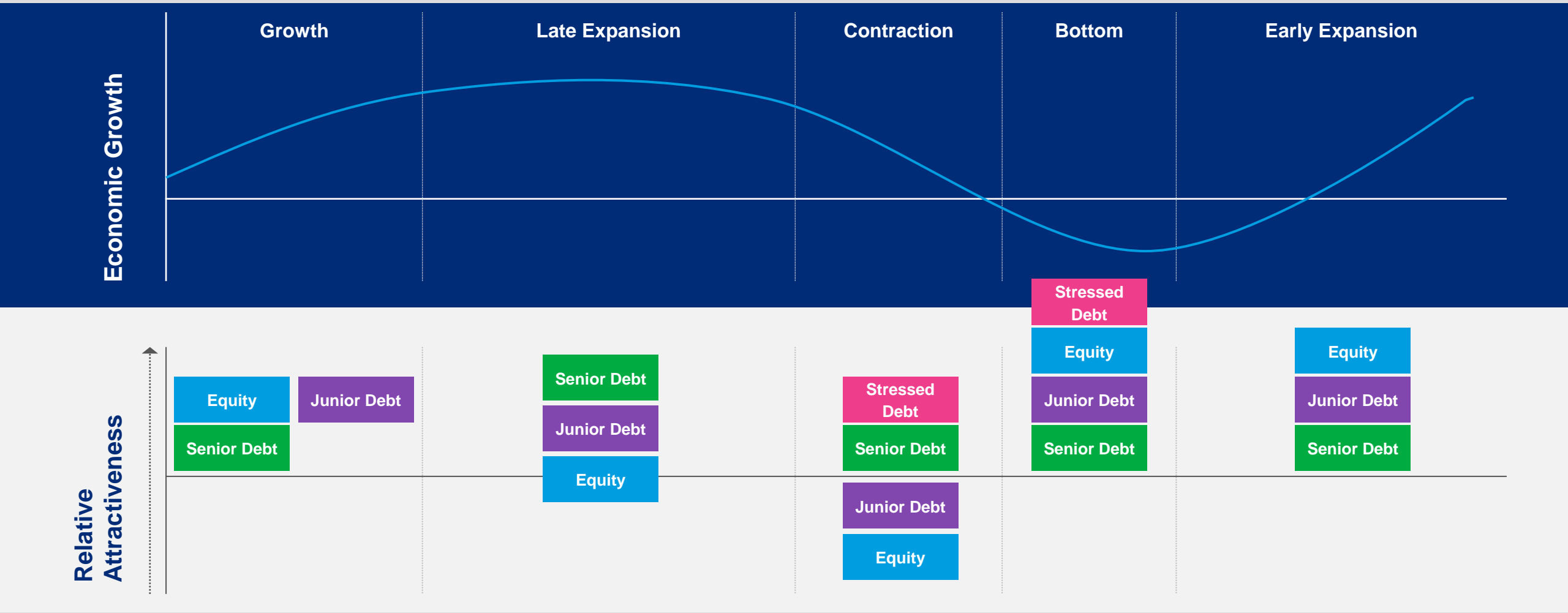


Notes: For illustration and educational purposes only. Actual returns may vary from those shown.

1) Based on target performance of underlying fund investments.



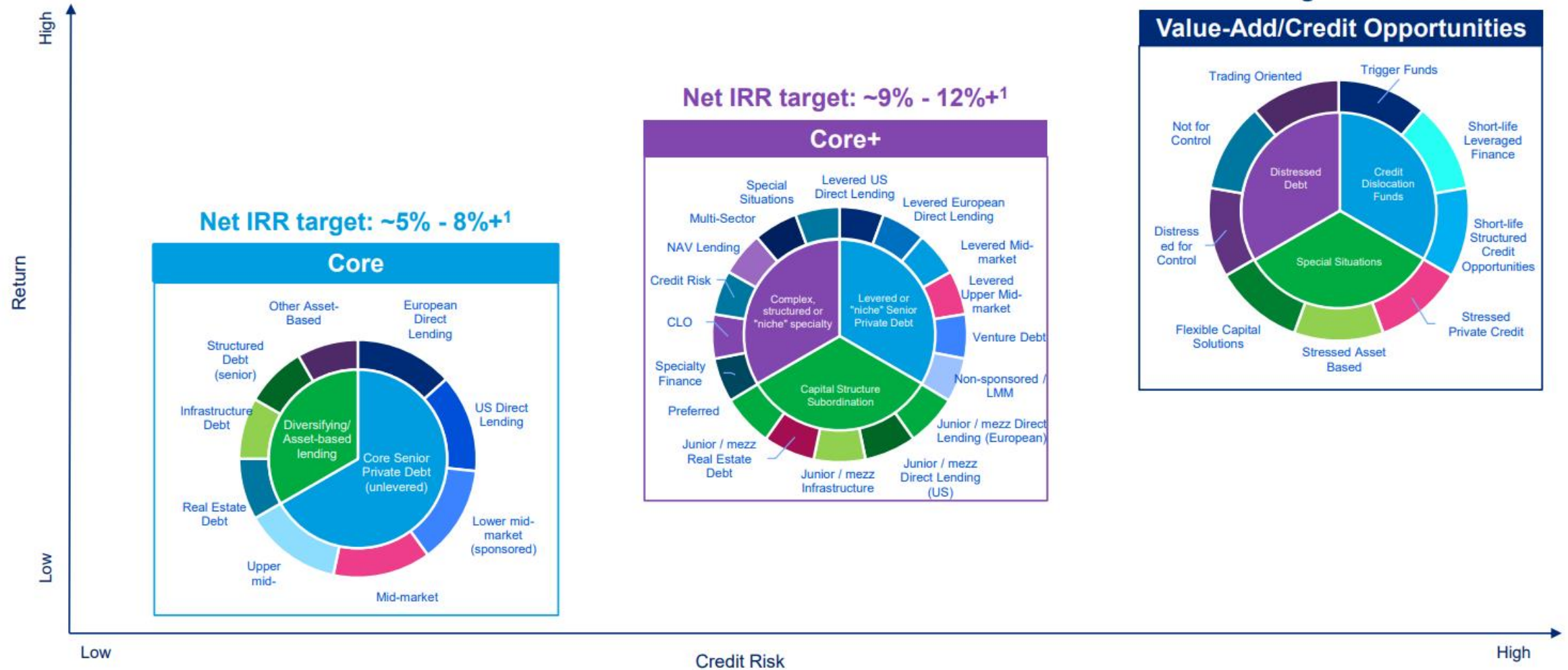
# Attractiveness across the economic cycle



Please note: Above charts are for illustration and educational purposes only.

# Hypothetical portfolio solutions

## An example straw man



Notes: For illustration purposes and educational purposes only. Actual asset allocations will vary from those shown. 1) Based on target performance of underlying fund investments. Mercer cannot guarantee future access to or fee discounts with managers. Past performance may not be indicative of future results.

# MercerInsight ® - Private Debt Searches ytd

What Mercer clients are searching for

- Global Opportunistic Debt
- US Opportunistic Debt
- US Special Situations Debt
- US Senior Direct Lending
- Europe Senior Direct Lending
- Private Debt Asia

# Kontaktinformationen



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Partner, Leiter Investments

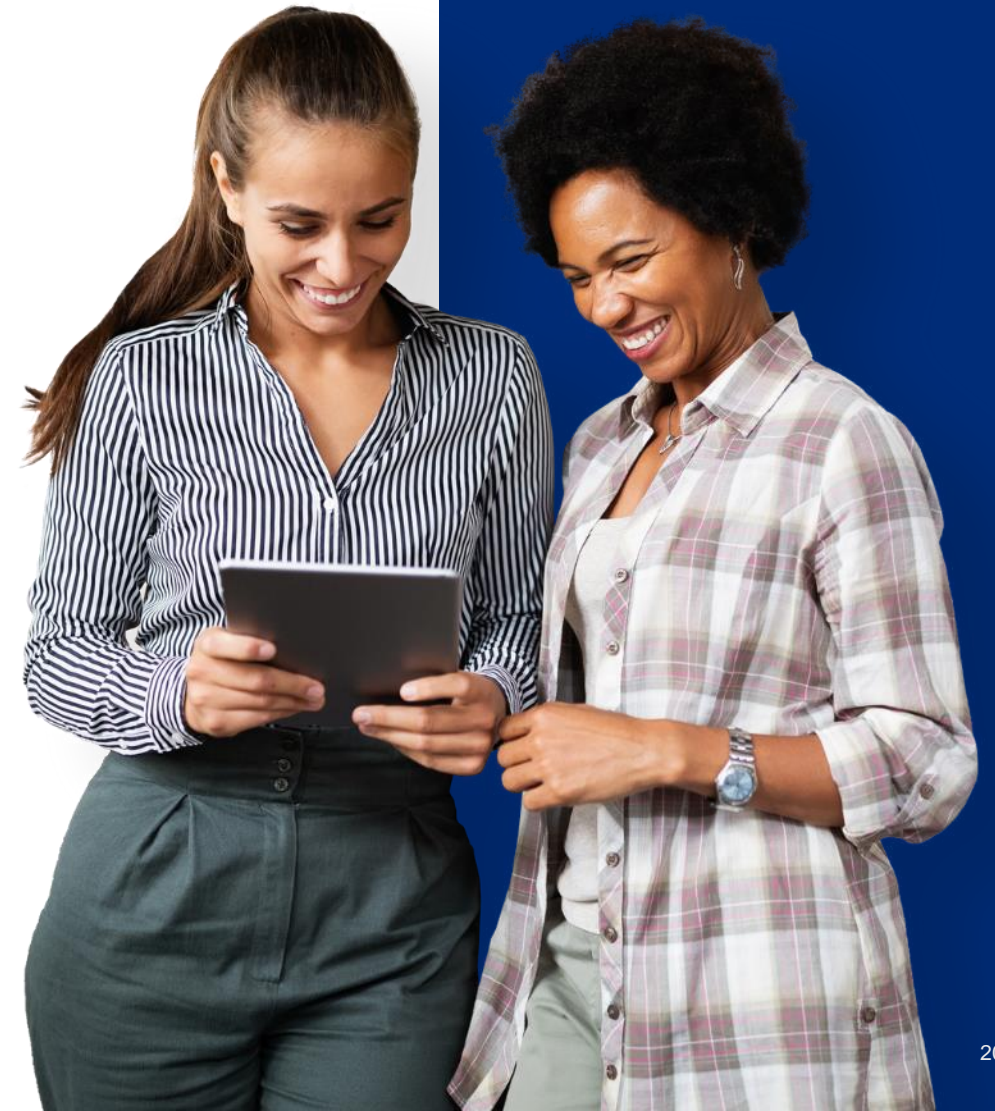
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