CIO Office Insights

الجزيرة كابيتال
ALJAZIRA CAPITAL الجزيرة للأسواق المالية

The Art of Manager Selection

Private Credit

January 2025

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KEY TAKEAWAYS

Private credit continues to be a resilient asset class, demonstrating strength across various market conditions. Strong fundraising efforts and demand for capital reflect its solid fundamentals, indicating that it is well-positioned for attractive, risk-adjusted returns, appealing to those seeking yield and diversification.

The success of private credit investments depends heavily on selecting skilled, insightful managers, emphasizing the need for a thorough and well-informed manager selection process.

Multi-Manger funds has become an increasingly popular strategy, offering diversification by providing exposure to various fund managers, while enhancing risk-adjusted returns

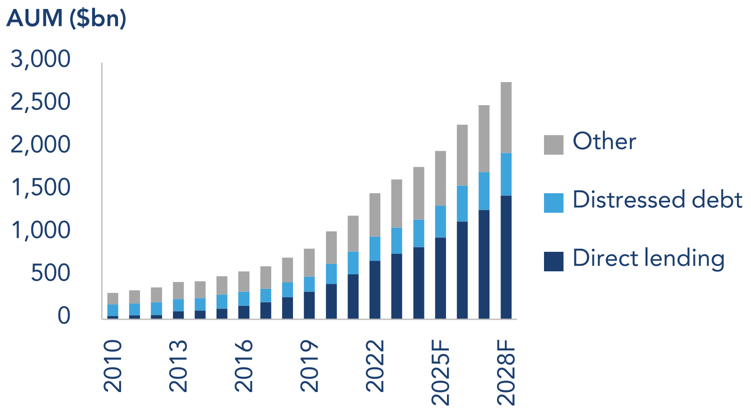
A well-rounded alternatives portfolio must include exposure to private credit, a strategy that continues to attract investors due to its ability to deliver resilient returns through robust structures and strong lender protections. As confidence in private credit grows, it remains a cornerstone for investors seeking reliable income and diversified exposure.

HOW HAS PRIVATE CREDIT MATURED?

STRONG CAPITAL DEMAND

- The private credit AUM increased multifold between 2010 and 2023, reaching almost $1.7 trillion. Projections suggest that this figure will rise to $2.8 trillion by 2028[1,2].
- There are around 1,080 private credit funds globally, indicating the market's growing scale and diversity[1,2].
- A Preqin survey of investors from June 2024 indicates that 42% of respondents plan to maintain their current allocation to private credit, while 50% intend to increase it over the long term[2], signifying that LPs expect returns to improve over the next year.

Private Debt AUM

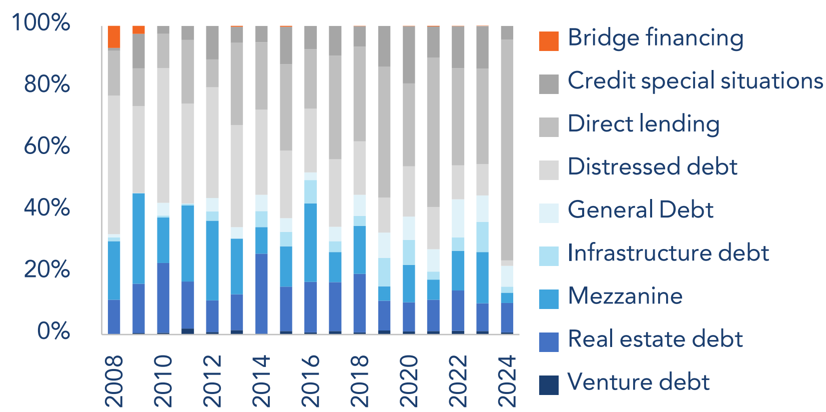


Demand Drivers: Reduced bank lending for leveraged transactions, the efficiency of non-bank lenders, and the rising prominence of private equity.

EVOLUTION IN SUB-STRATEGIES

- Private debt fundraising remained strong despite economic uncertainty. Direct lending captured 54.9%[1] of the capital raised during the year.
- Preqin survey suggests that investors are becoming slightly risk-averse, with sentiment towards higher-risk strategies like distressed debt and mezzanine decreasing slightly year over year[2].

Private Debt Capital Raised by Type



Investor Sentiment: Private credit offers attractive spreads ranging from 450 to 650bps and continues to attract investors seeking higher yields alongside robust credit protection[3].

1. Pitchbook 2. Preqin 3. Global Fund Research

HOW CAN YOU FIND THE BEST FIT FUND MANAGER?

To successfully navigate the intricacies of investing, it is crucial for an investor to embrace a **comprehensive investment philosophy** and **choose an appropriate fund manager**—someone capable of adeptly steering you through the uncertainties and fluctuations of constantly changing market dynamics.

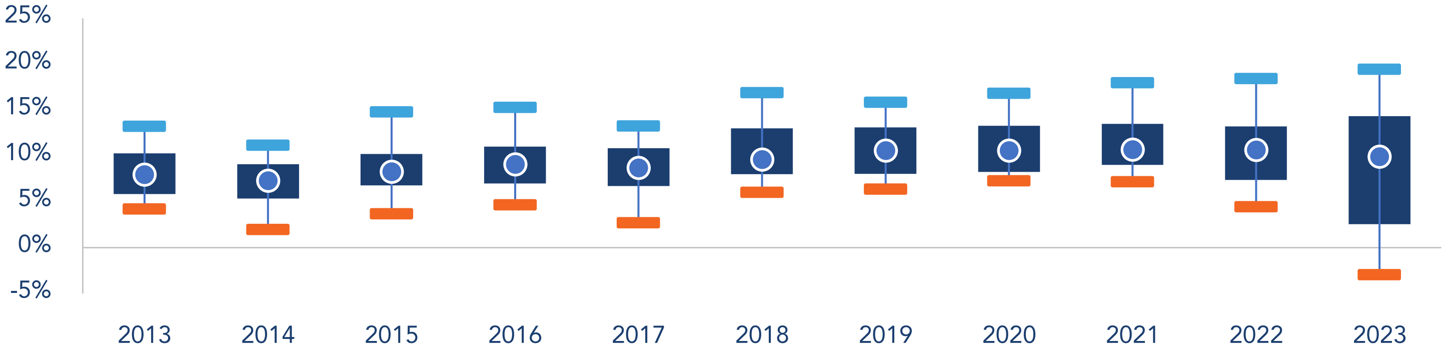
Experience is an irreplaceable virtue. The success of private credit investments hinges on the careful selection of skilled and experienced managers, as their expertise can significantly impact returns.

In global private debt, the average net IRR shows significant variation, with a performance disparity of over 11.8% between the top and bottom quartile managers in 2023.

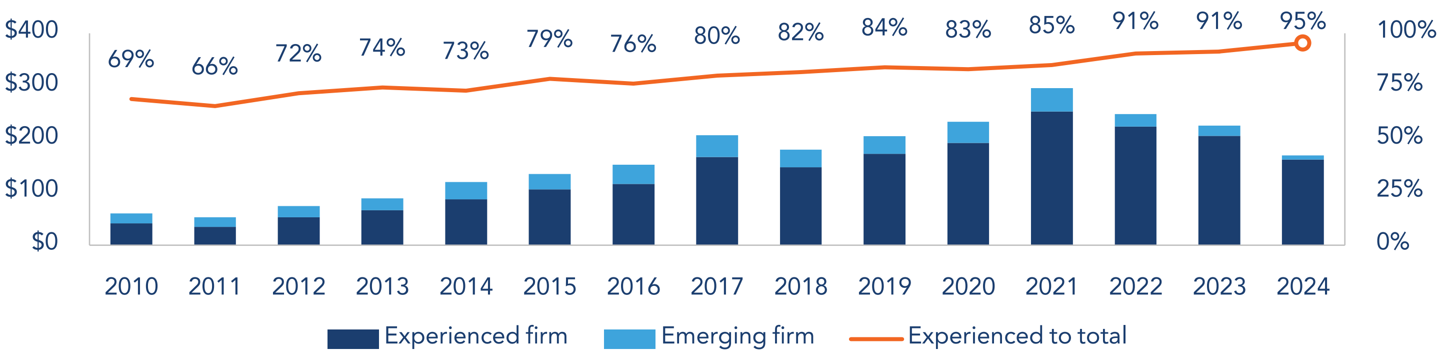
This disparity underscores the importance of identifying capable managers and understanding their strategies, risk management practices, and market positioning.

Additionally, the performance gap reflects the competitive advantage of seasoned managers who leverage proprietary deal flow, operational expertise, and strong relationships with borrowers.

Global Private Debt IRR by Vintage[1]



Private Debt Fundraising by Manager Experience[2]



Experienced managers have dominated the private debt fundraising market, with their larger platforms better equipped to capitalize on spikes in demand.

Experienced, top-performing managers typically excel in credit underwriting, deal sourcing, and borrower monitoring, allowing them to navigate complex market conditions and maintain favorable terms. A reliable strategy is to adopt a thorough, insight-driven process for manager selection as it can create all the difference for your private credit portfolio.

1. Preqin 2. Pitchbook

To create a resilient portfolio, the manager's investment philosophy needs to align with the investor's objectives and risk tolerance to optimize returns, minimize risks, and ensure the stability of the portfolio. Investors must evaluate the manager's investment strategies and operational execution.

To achieve this, investors should consider the following criteria:

A Tailored Strategy for Sourcing and Securing Deals

- Effective sourcing is key to a strong portfolio. An experienced team uses its network and insights to find unique, high-quality investments, targeting less competitive segments for better risk-adjusted returns and enhanced fund performance.
- Studies show that around 70% of private credit deals are backed by private equity, with 77% in Europe and 72% in North America from 2021-23, highlighting the effectiveness of a well-connected manager in the sourcing process[1,2].

Historic Performance and Track Record

- Effective private credit management demands active engagement with portfolio companies and close collaboration with specialized teams to mitigate potential downside risks.
- Investors should assess a manager's historical performance across market cycles, as consistent returns, particularly during downturns, reflect robust underwriting discipline and risk management capabilities.

Due Diligence and Underwriting Process

- An ideal manager must deploy a wholesome approach while underwriting loans, assessing counterparty risks, and implementing financial covenants to ensure borrower quality and safeguard investments.
- Investors should assess how managers set key loan terms via a thorough risk identification and structuring process, backed by strong, time-tested loan documentation. This reflects a commitment to capital preservation and proactive intervention during financial distress.

A Robust Team and Alignment

- Assessing team stability and the duration of their collaboration across different market cycles is crucial in evaluating their capability and resilience.
- Sufficient resources, including strong infrastructure, capability of restructuring complex scenarios are also essential to support the investment and post-deployment process.
- High fees can erode returns, particularly in lower-yield strategies. Fee structures that emphasize performance—such as reduced management fees paired with higher carry and a meaningful hurdle—create better alignment between managers and investors, enhancing overall outcomes.

1. Preqin 2. IMF Data

WHAT IS THE KEY TO A BALANCED PRIVATE CREDIT PORTFOLIO ?

Investing in private credit can be lucrative yet complex, requiring deep expertise to assess various fund managers. As we've seen, there's a significant performance gap between top and bottom quartile managers. Multi-Manager strategy simplifies this by providing access to a diversified selection of top-tier managers, making the investment process easier and ensuring professional oversight.

In addition to streamlining the process, Multi-Manager fund's add substantial value by managing the complexities of secondary transactions, such as GP-led and LP-led deals. These transactions can offer liquidity or portfolio optimization opportunities that require specialized expertise. Multi-Manager funds excel at navigating these complexities, providing investors with opportunities for improved risk-adjusted returns, enhancing overall portfolio performance, delivering alpha, and refining the investment experience.

Inherent Benefits of Investment Through Multi-Manager Fund

Access to Niche or Exclusive Investments

Multi-Manager funds, managed by seasoned professionals, typically have smaller ticket sizes, providing access to top-tier funds that individual investors might otherwise be unable to access or that may require a larger capital commitment

Diversification Across Strategies

A typical Multi-Manager fund invests in 10–20 individual funds, gaining exposure to hundreds of underlying credit positions. By diversifying across multiple managers, strategies, vintages, geographies, and sectors, the Multi-Manager structure can reduce the standard deviation of returns by up to 30%.

Enhanced Liquidity Options

Even while direct investments in private markets can lock up funds for eight to twelve years, some Multi-Manager funds provide periodic liquidity through evergreen frameworks, usually on a quarterly or semi-annual basis.

Reduced Administrative Burden

By outsourcing tasks such as selection, due diligence, and monitoring, investors can significantly reduce the effort required compared to managing multiple direct investments individually. The aggregation of reporting also streamlines financial tracking, tax reporting, and compliance processes. Additionally, larger commitment sizes often allow for negotiated fees and side letters, further enhancing efficiency and aligning investor interests.

Private credit presents an appealing opportunity for investors seeking diversification, attractive returns, and control over investment terms. The success of these investments depends largely on the expertise of fund managers. Investors must engage in a thorough selection process, focusing on managers who excel at pricing deals, monitoring borrowers, and adapting to changing conditions.

Among the various investment structures, the Multi-Manager fund simplifies the complexities of manager selection and enhances diversification by providing access to a wide array of top-tier fund managers. By spreading risk across different managers and strategies, the Multi-Manager fund help investors achieve improved risk-adjusted returns while offering professional oversight to optimize performance.

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