



The Private Asset Revolution Is Here

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Private assets on the equity and credit sides of capital raising have been growing over the last two decades, fueled by an ability to adapt as the economy, regulatory environment, and markets have evolved.

Institutional investors with long-term investment horizons have recognized the potential advantages of private assets compared to the public markets for decades.

Illiquid private assets may provide the opportunity for enhanced return, yield, and portfolio diversification. The resilience of these assets through major market disruptions has added to the appeal.

Individual investors seeking to expand traditional 60/40 portfolios with alternatives are the next frontier in the growing demand for these assets.

Flexible structures can now provide access to long-term investment strategies while allowing limited liquidity.

The evolution of these two asset classes mirrors our changing economy, and private equity and private debt have played vital roles.

As we navigate a new business cycle with an aggressive Fed and the threat of recession, companies with private equity backing who seek private debt capital may be uniquely positioned to manage through difficulties.

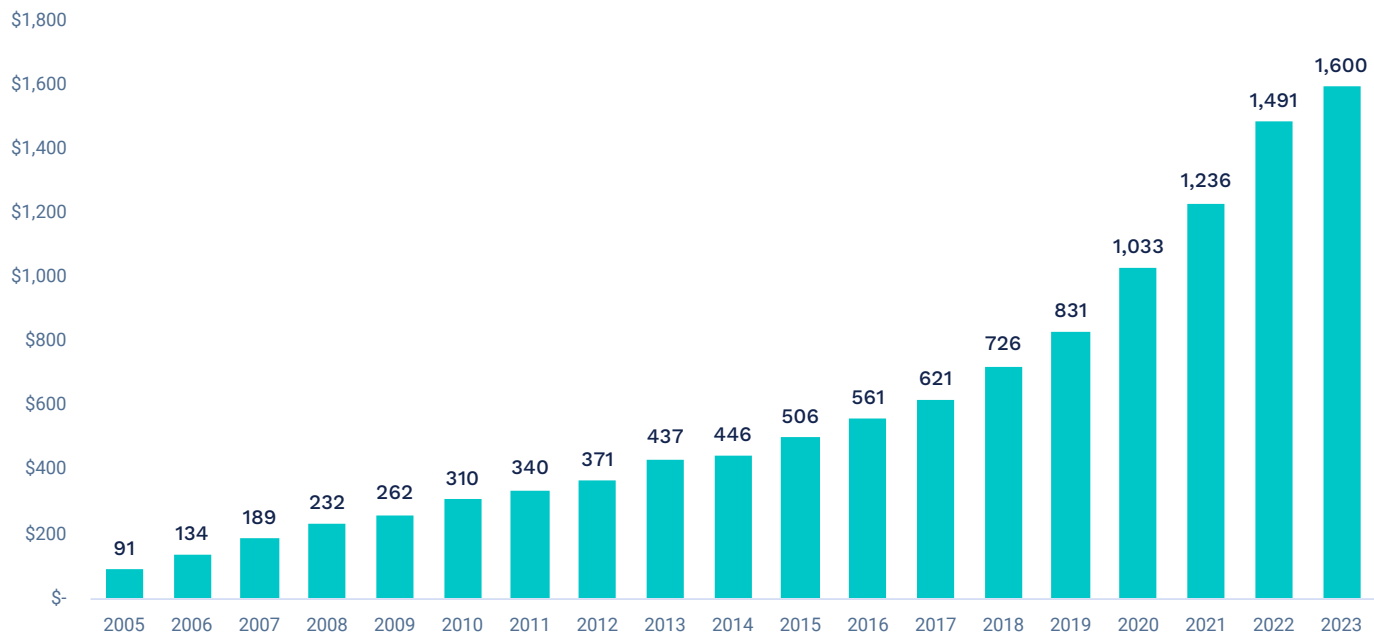
The Background

Private debt has always been the “little brother” to private equity, but it is catching up quickly.

Since 2011, private debt has been the only private asset class to grow fundraising yearly, including through the pandemic.¹ Preqin reported assets under management

exceeded \$1.2 trillion in 2022, and forecasts that private debt AUM will grow at a CAGR of 10.8% between 2021 and 2027 to reach an all-time high of \$2.3tn in 2027. And in terms of all alternative asset classes, private debt is forecast to be the fastest growing over the next four-to-five years.²

The Growth of Private Debt (\$bn)



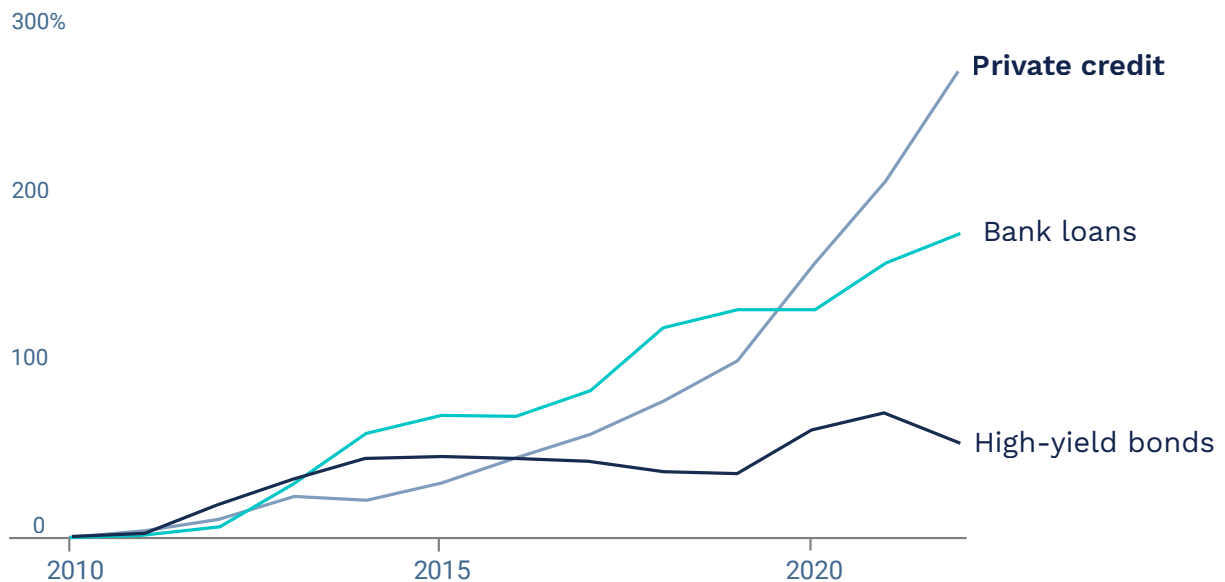
Source: Financial Times, Preqin, The Wall Street Journal

What Is Private Debt, Exactly?

Private debt, also called private credit, encompasses several strategies. The largest by far is direct lending to privately-held middle market companies. These companies historically accessed bank funding for capital needs, however, banks have been exiting this market for

decades, leaving a void that private lenders have filled. This was accelerated by regulatory changes after the Global Financial Crisis (GFC). The chart below shows how the growth in private lending debt outstanding has outpaced bank debt since 2010.

Growth in Debt Outstanding



Source: Barclays

The Characteristics of Private Lending

These loans are direct agreements between the company as the borrower and the private debt lender. They have several characteristics:



Often governed by covenants that:

- Allow the lender to monitor the company
- Prohibit certain behaviors
- Permit the lender to step in to prevent or remediate defaults



Loans are typically senior, secured by the company's assets.



Typically structured with floating rates and very short durations.

- Helps to provide interest rate risk mitigation
- Can help manage default risk



Yields are relatively higher than those offered by public debt markets.

- The "illiquidity premium" of private assets

Why Is the Partner So Important?

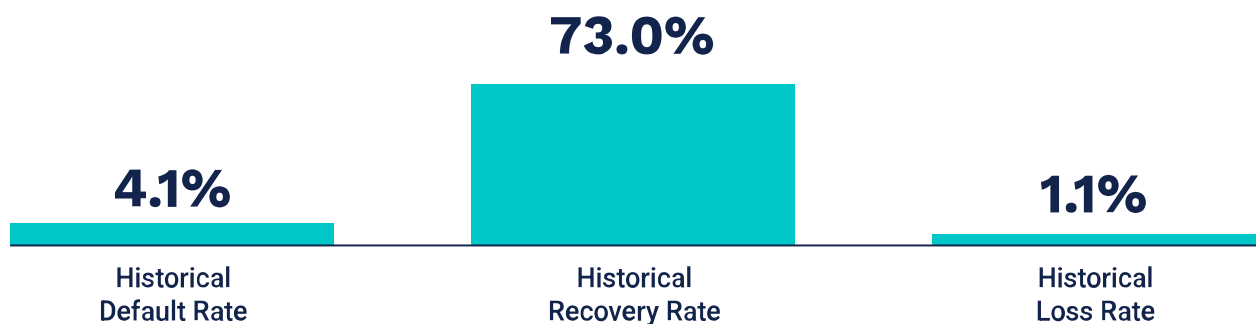
The original impetus for middle market companies to use private lenders was necessity. As the asset class has matured and lenders have developed relationships and track records, many middle market companies have come to prefer private credit, and also tend to work with the same lender multiple times.

Private lenders can offer more flexible funding, the assurance that a deal will close, and shorter timelines to close. In addition, covenants on the loan work to ensure the lender can provide oversight and assistance if a rough patch arises, as what happened during 2020-2021.

A recent survey by the Alternative Credit Council (ACC) reported that during 2020, private credit manager respondents deployed almost \$200 billion in capital, as compared to the \$113 billion that had been expected by a similar survey in early 2020. The ACC referred to private credit as a “vital provider of capital support” during economic uncertainty.³

Private lenders are senior stakeholders in the company, and often require covenants. This means that they can collaborate with company management, get involved early and mitigate potential issues.

Middle Market Loans Performance, 1995 - 2021



Source: CreditPro/LossStats, an offering of S&P Global Market Intelligence, 1995 - IQ 2021; Middle market loans include total facility sizes of less than \$500 million.

Changes to Private Equity Boost Private Credit Growth

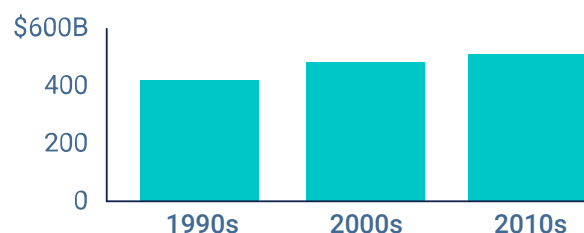
IPOs make headlines but aren't as common as the media attention makes it appear. In fact, the number of IPOs annually has been shrinking for decades, while the value of the deals and the size of the newly public company have grown. Looking at the data on IPOs tells an interesting story about how companies that go public have changed.

The number of IPO deals plunged 63% from 5,724 in the 1990s to 2,106 in the 2000s. At the same time, the total value of the deals increased from \$482 billion to \$569 billion.⁴

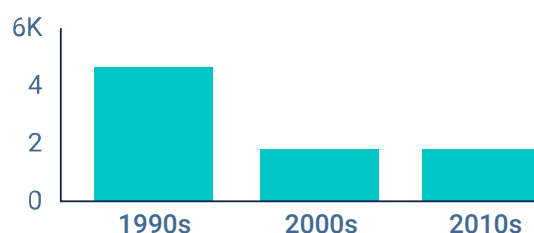
The steady-state over the 2000s validates that companies now stay private much longer.⁵

IPOs Priced on U.S. Exchanges

Deal Value (USD - Billions)



Deal Count (in Thousands)



Source: Bloomberg Law as of January 4, 2020. Priced initial public offerings of $\geq \$1$ million, listed on a U.S. stock exchange during the time period indicated.

How are companies remaining private? Growth in private equity assets under management has been nothing short of explosive, with assets accelerating from \$500 billion in 2000 to \$7.6 trillion by June 2022.⁶

Private equity investors bring a long-term focus to company growth and are active partners that can provide assistance and expertise across all dimensions of a company's business model.

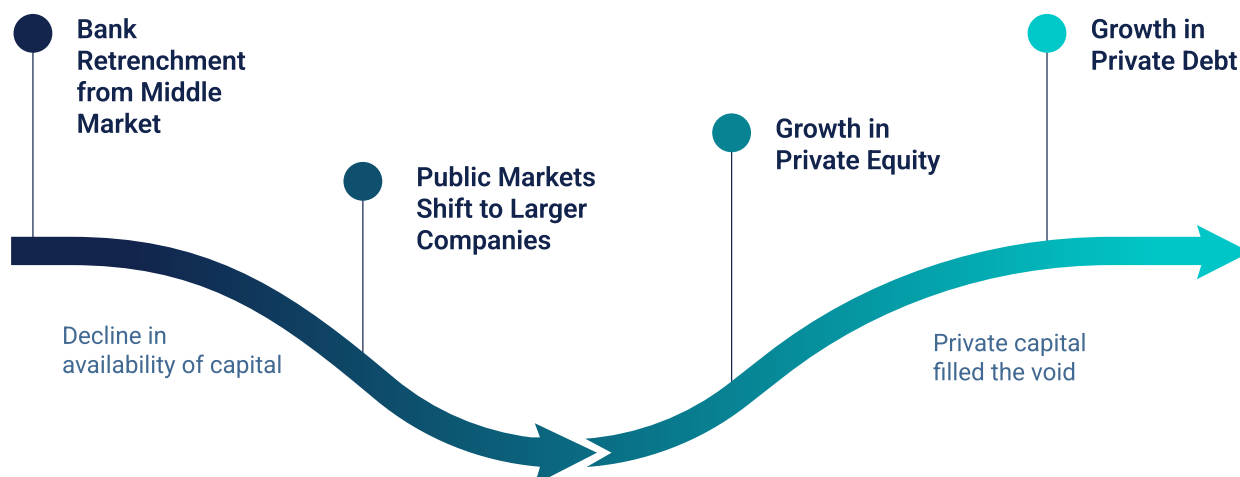
Private equity firms are increasingly turning to private credit to fund buyouts. A recent survey found that 45 percent of surveyed private equity firms have increased

their use of private credit financing in buyouts over the last three years. This represents a ten percentage point increase over the previous year's survey.⁷

The same survey found that over half of surveyed private equity firms prefer private credit over traditional bank financing.

The report, based on the responses of 100 private equity managers with \$500 million+ in assets under management, attributed this preference to the customizability and dependability of private credit.

The Source of Capital for Private Companies Has Evolved



Private Assets in Tandem Can Mitigate Risks

Institutional private equity owners can also add capital when companies struggle, especially during unexpected downturns. The resiliency of private credit with low default rates throughout 2020-2021 is likely partly due to this advantage.

The combination of lenders who can play an active role in helping a company manage debt burdens, along with private equity owners who are willing to contribute additional capital, can result in companies successfully managing a crisis.

From an Investor Perspective

The growth in private credit is also fueled by demand for these assets.

An aggressive Federal Reserve has enacted 11 rate increases in an attempt to bring inflation down by slowing the economy. The Fed may not be done, and has consistently messaged that rates are likely to be higher, for longer.

This resulted in historically negative performance for the traditional 60/40 portfolio in 2022, and bonds are continuing to struggle in 2023.

Private debt, through floating rate assets, can help mitigate interest rate risk in a rising rate environment.

The asset class offers lower volatility as it is less liquid. Low correlation to traditional credit assets brings portfolio diversification. These attributes make an argument for considering private credit in a traditional allocation that resonates with many investors.

* Disclosures

1. McKinsey Global Private Markets Review 2023 (March 2023)
2. Acuity Knowledge Partners, (Re)Imagine: Private Debt Gaining Traction As An Asset Class, July 2022
3. Institutional Investor. "Private Equity Funds Fuel Growth in Private Credit" November 10, 2021
4. Clearly Gottlieb, The IPO Overview and Guide, December 2021
5. Ibid.
6. McKinsey Global Private Markets Review 2023 (March 2023)
7. Institutional Investor. "Private Equity Funds Fuel Growth in Private Credit" November 10, 2021

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