Oliver Wyman

PRIVATE CREDIT'S NEXT ACT

And why the barbell tolls for fixed income investing

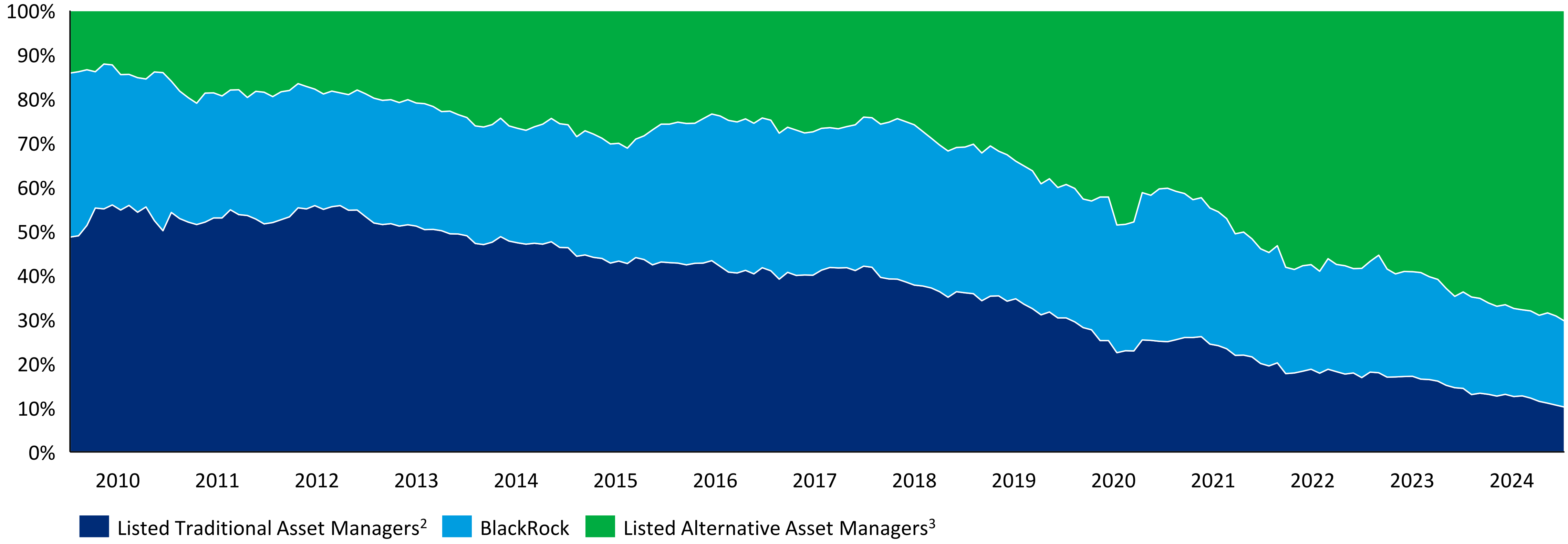
October, 2024

Huw van Steenis

A business of Marsh McLennan

WHAT'S IN THE PRICE?
ALTERNATIVES FIRMS NOW REPRESENT 2/3 OF MARKET CAP OF LISTED INVESTMENT FIRMS

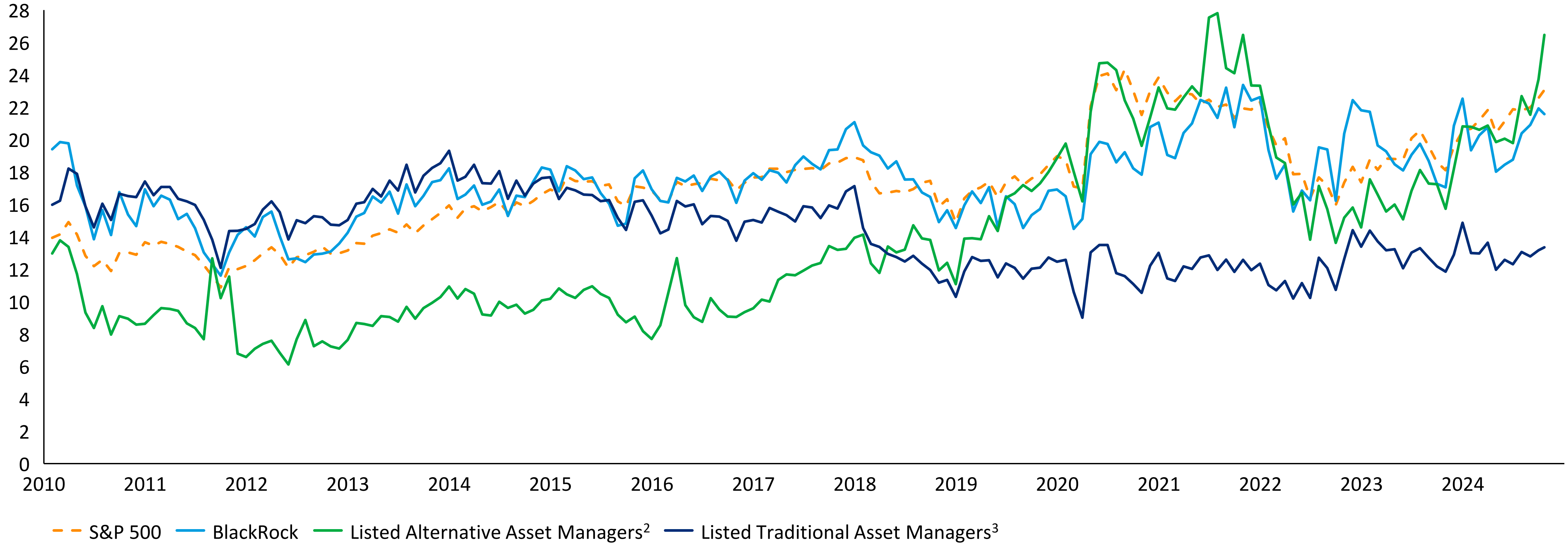
Share of market capitalisation of listed US independent investment managers[1]
%, Jan 2010 – Oct 2024



1. Share among selected peerset; 2. Listed Traditional Asset Managers includes T. Rowe Price Group, Janus Henderson, Invesco, Affiliated Managers Group, Franklin Resources, Federated Hermes, Cohen & Steers, Artisan Partners Asset Management, SEI Investments Company; 3. Listed Alternative Asset Managers includes Brookfield Asset Management, Bridge Investment Group, TPG, Apollo Global Management, Ares Management Corporation, Blackstone, KKR & Co., Blue Owl Capital ,The Carlyle Group, Hamilton Lane
Source: Capital IQ and Bloomberg, Data to October 21, 2024

WHAT'S IN THE PRICE? ALTERNATIVE INVESTMENT FIRMS NOW TRADE 2X THE P/E OF TRADITIONAL INVESTMENT FIRMS, REFLECTING EMBEDDED GROWTH PROSPECTS

Forward Price / Earnings NTM of listed US independent investment managers[1]
Jan 2010 – Oct 2024, monthly



1. Multiple calculated with equal weight excluding outliers/zeros; 2.Listed Alternative Asset Managers includes Brookfield Asset Management, Bridge Investment Group, TPG, Apollo Global Management, Ares Management Corporation, Blackstone, KKR & Co., Blue Owl Capital ,The Carlyle Group, Hamilton Lane; 3. Listed Traditional Asset Managers includes T. Rowe Price Group, Janus Henderson, Invesco, Affiliated Managers Group, Franklin Resources, Federated Hermes, Cohen & Steers, Artisan Partners Asset Management, SEI Investments Company | Source: Capital IQ, Data to October 21, 2024

KEY DEBATES

1

The next wave of bank disintermediation?

2

Why is asset-based lending in focus?

3

How will bank-private credit partnerships evolve?

4

How to position around the financial system reshaping?

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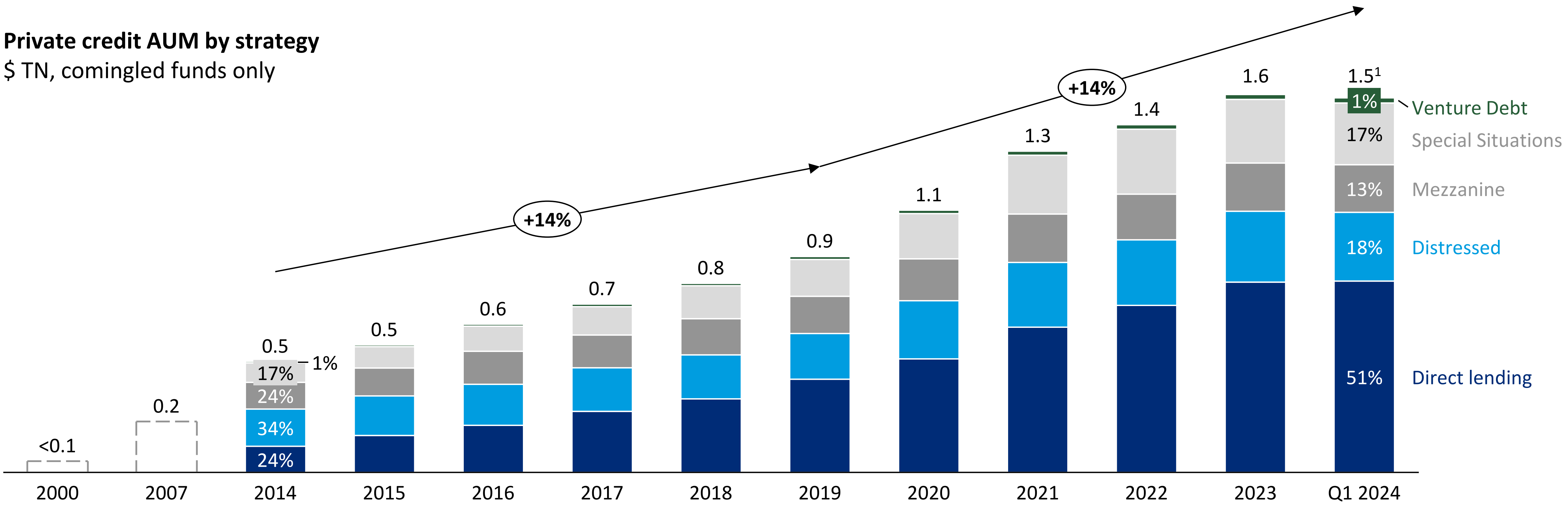
> How many times, how many decades are we going to learn this lesson of borrowing overnight and lending long?
> Whether it was the 1970s, the 1980s and 90s. ... I expect more disintermediation

Michael Milken, April 2023

PRIVATE CREDIT HAS BOOMED AND FORECAST TO DOUBLE IN 4-5 YEARS

Private credit AUM by strategy
$ TN, comingled funds only

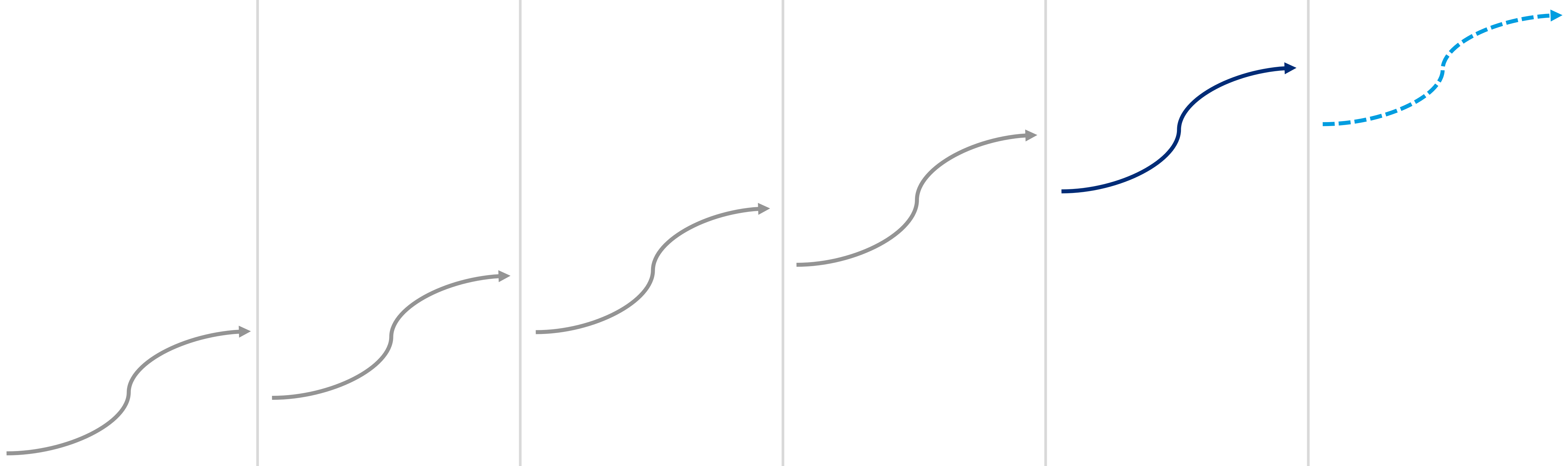


CAGRs of other Private Markets funds	2014–2019	2019–Q1 2024
PE	+15%	+15%
RE	+8%	+8%
Infra.	+19%	+13%

1. 1.5TN is only the tip of the iceberg – we estimate that at least 3TN AUM is deployed in private debt via SMAs and Direct Investments (not in Preqin data) | Source: Preqin, excludes Funds of Funds

US BANK DISINTERMEDIATION HAS WORKED IN LONG WAVES

Commercial paper	RMBs	CMBS	Sub-prime RMBS	Private Credit 1.0	Private Credit 2.0
Corporate lending	High yield	Credit cards	Synthetic credit risk	Mid-market	Specialty finance
		Auto loans		Leveraged finance	CRE
1974 – mid 1980s	1980s – mid 1990s	Mid 1990s – 2000s	2000s	2008 – 2022	2022 – present

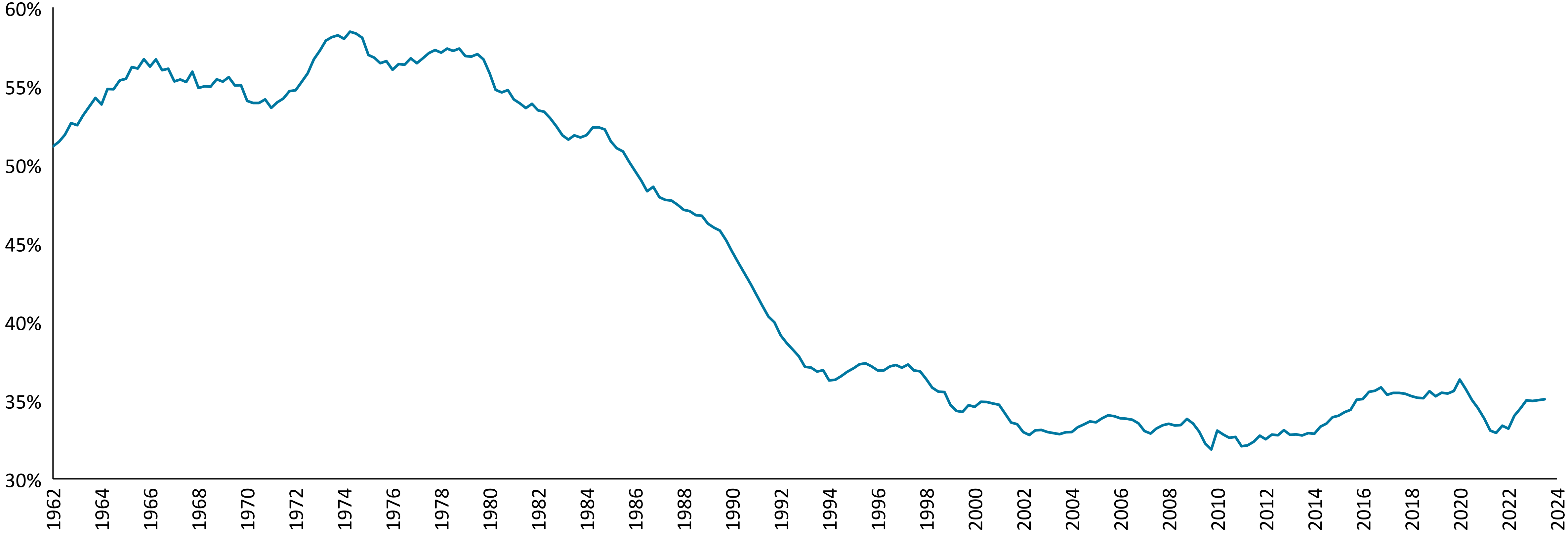


Source: Private Credit's Next Act, April 2024 by Huw van Steenis and colleagues, Oliver Wyman

WE'VE SEEN 50+ YEARS OF US BANK DISINTERMEDIATION, WITH SOME WAXING AND WANING – FURTHER SHIFTS TO COME THOUGH DEPENDENT ON REGS AND CYCLE

US bank share of total outstanding lending volume to households and non-financial businesses

%, 1962-2023



Source: Private Credit's Next Act, April 2024 by Huw van Steenis and colleagues, Oliver Wyman. Data from Federal Reserve Board, FRED (Federal Reserve Bank of St. Louis), Oliver Wyman analysis

LESSONS FROM PREVIOUS WAVES

Typically takes 2-3 years for weakened banks to recover from large interest rate shocks

Outdated financial regulations often exacerbate interest rate shocks (e.g. Regulation Q)

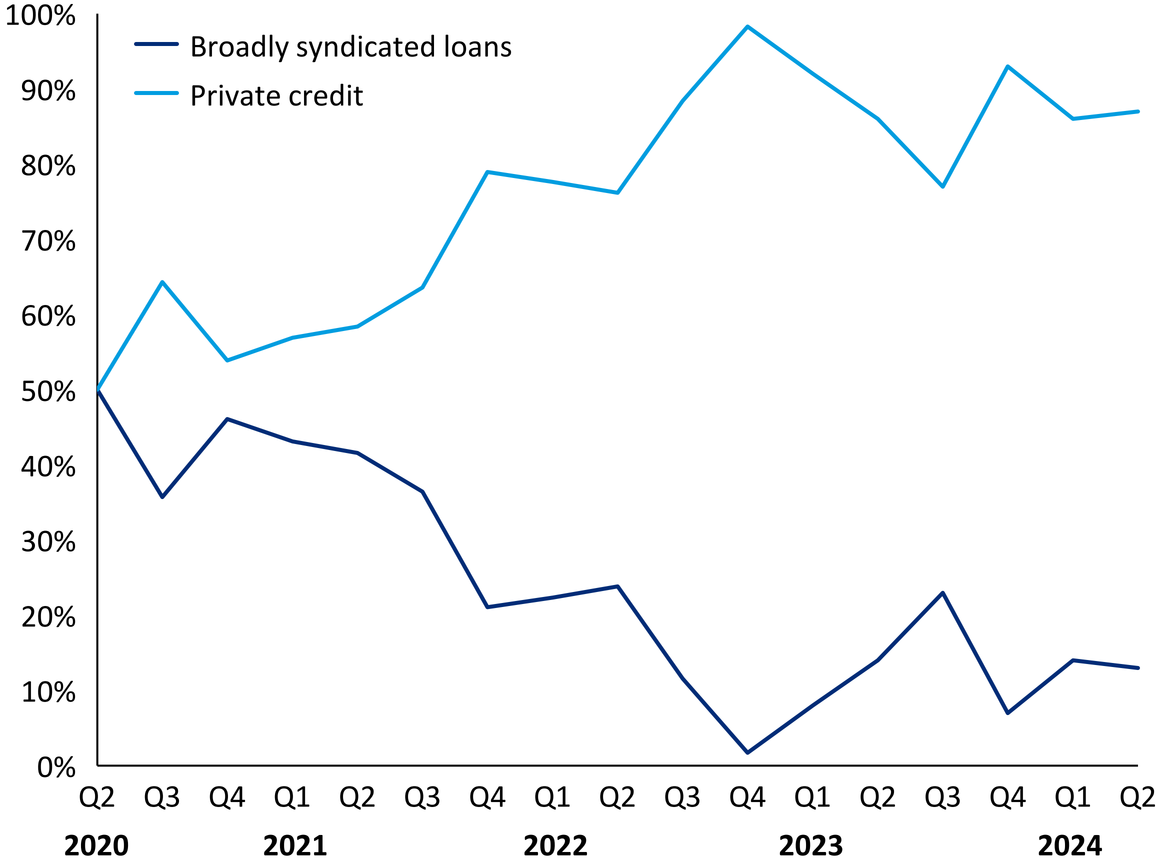
Financial product innovation is a key enabler for disintermediation (e.g. money market funds)

Regulations aimed at addressing bank vulnerabilities can inadvertently push lending elsewhere

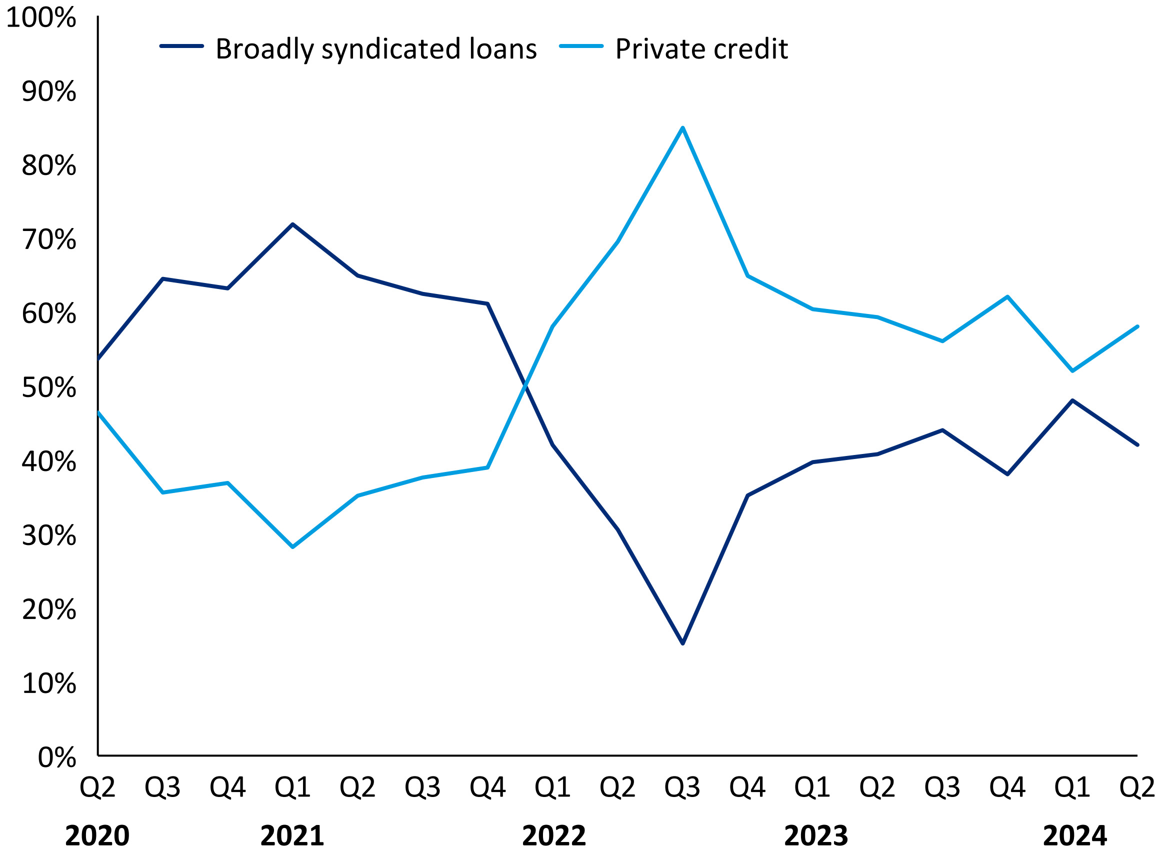
For more – see FT op-ed Is the boom in private credit losing steam? Huw van Steenis, Financial Times April 23, 2024

PRIVATE CREDIT'S SHARE OF LEVERAGE LENDING EXCEEDED 80% IN 2023 AS BANKS WERE ON THE BACK FOOT – BUT THE GOLDEN MOMENT IS NOW BEHIND US

Share of US LBO financing
% of deals, Q2 2020 – Q2 2024



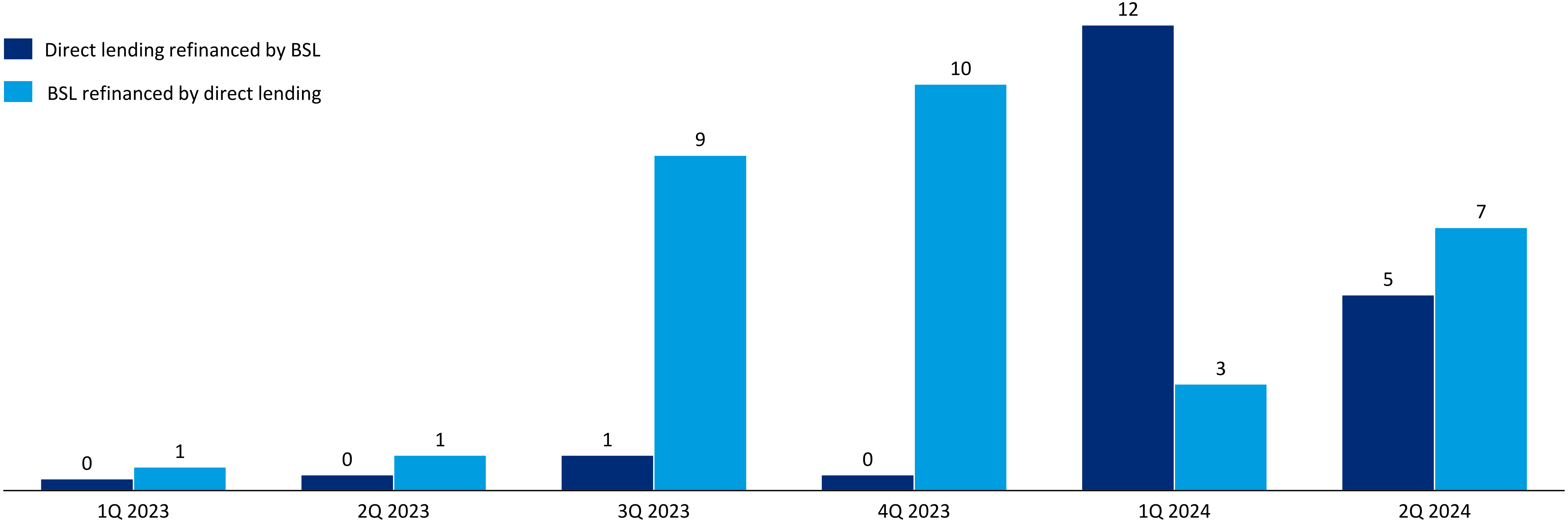
Share of US non-LBOs financing
% of deals, Q2 2020 – Q2 2024



Source: PitchBook LCD, Oliver Wyman analysis

LEADING BANKS ARE FIGHTING BACK HARD

Broadly syndicated loans (BSL) and direct lending takeouts
Q1 2023 – Q1 2024, $ BN



Source: PitchBook LCD

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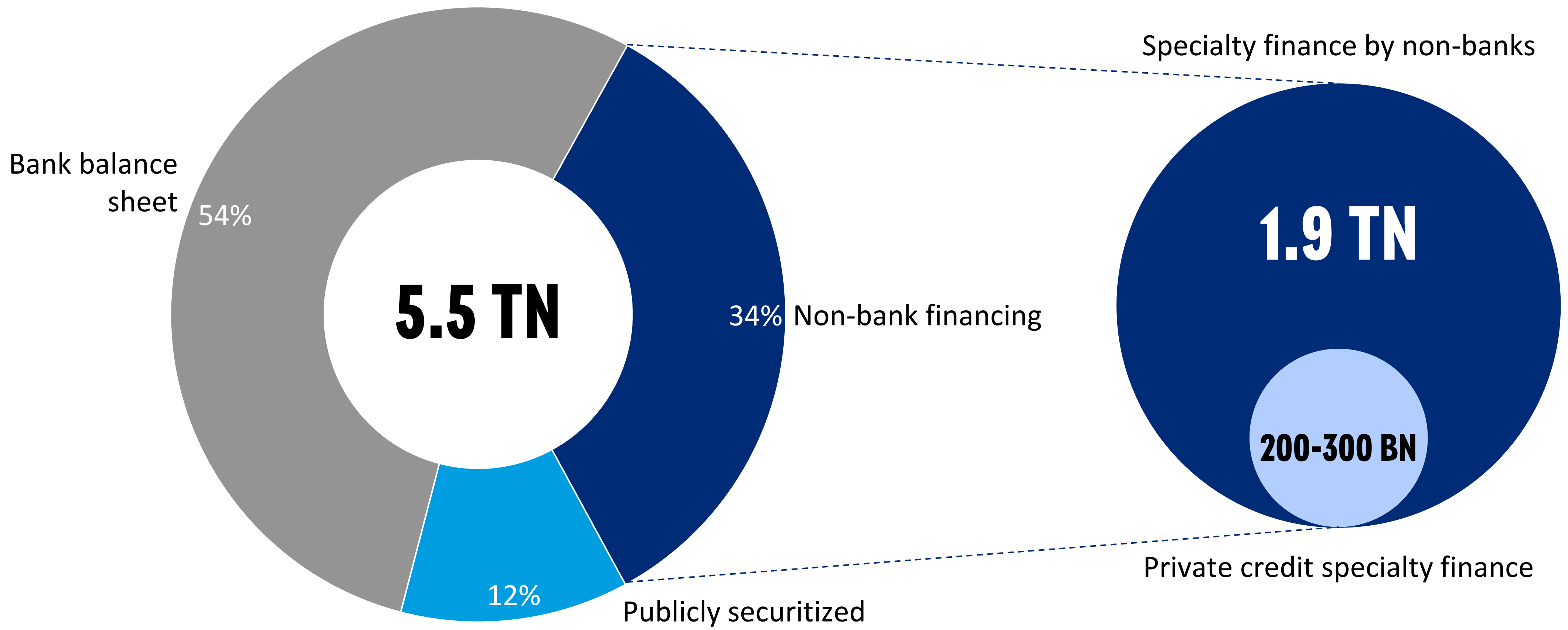
> Everything that is on a bank balance sheet is private credit.

Marc Rowan, Apollo, March 2024

WE ESTIMATE THE US SPECIALTY FINANCE MARKET IS ~$5.5 TN, OF WHICH ~1/3 SITS ON NON-BANK BALANCE SHEETS AND JUST ~5% FROM PRIVATE CREDIT

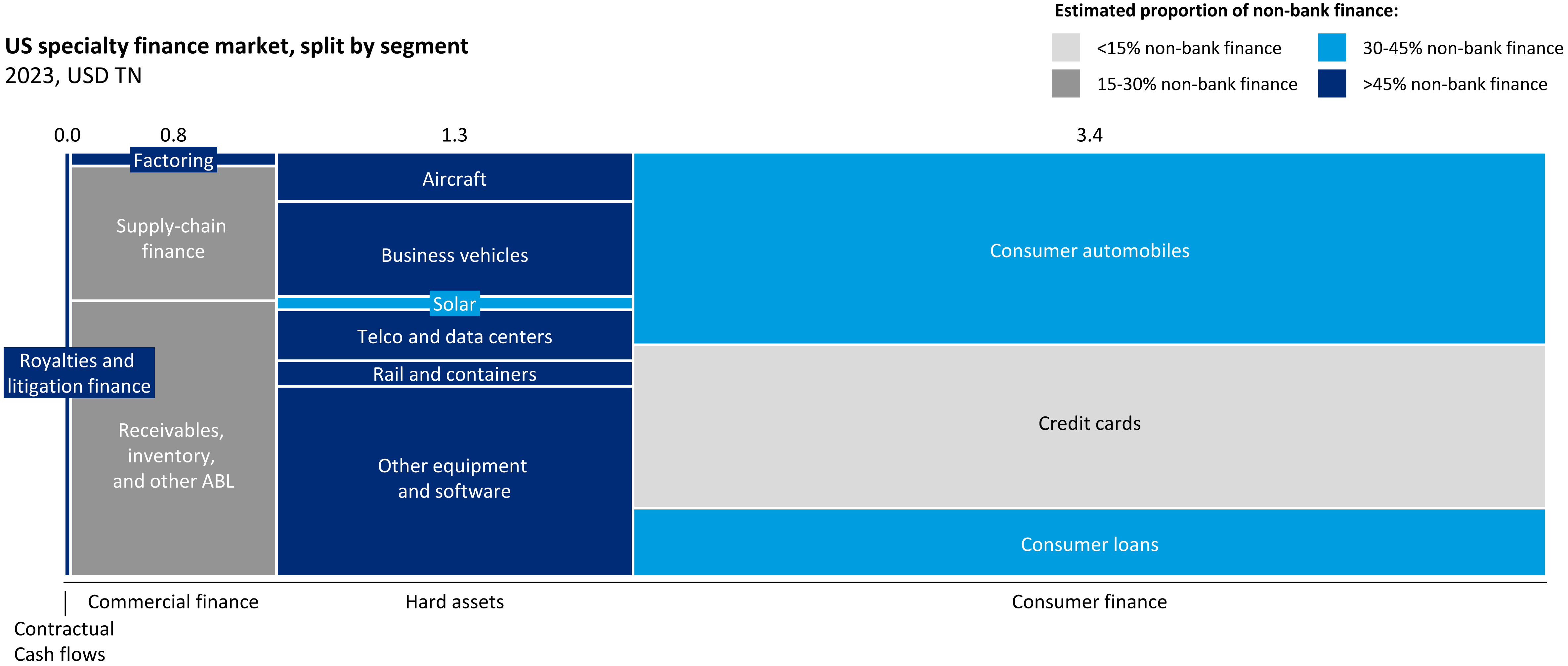
Total size of US specialty finance market, split by ownership
2023, USD



Source: Private Credit's Next Act, April 2024 by Huw van Steenis and colleagues, Oliver Wyman. Oliver Wyman analysis and estimates, aggregated from a range of sources including, but not limited to: Federal Reserve Board (Z1 tables, G19, G20 and H8); Federal Reserve Bank of New York; Federal Reserve Bank of Dallas; Bureau of Transportation Statistics (BTS); Dealogic; ©2024 Conning, Inc., Conning Esoteric ABS Strategy Fact Sheet – used with permission; Finsight.com; Structured Finance Association; Boeing (Commercial Aircraft Finance Market Outlook); Secured Finance Network; Equipment Leasing and Finance Association; Morgan Stanley Research; CACIB Research; company reports and disclosures.

OF THE ~$5.5 TN MARKET, NON-BANKS MOST PREDOMINANT IN FINANCING SPECIALISED HARD ASSETS

US specialty finance market, split by segment
2023, USD TN



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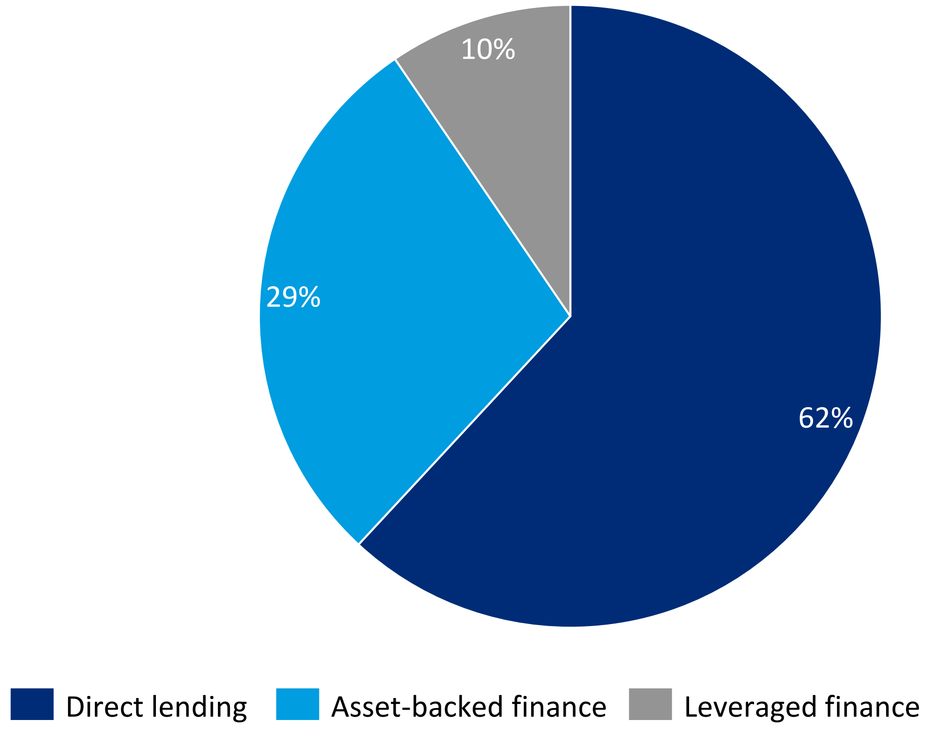
> What we are seeing is the re-tranching of the banking system where banks parcel the riskiest slice to private credit, providing less risky lending themselves. Private credit could be the Ozempic to help banks on yet another diet.

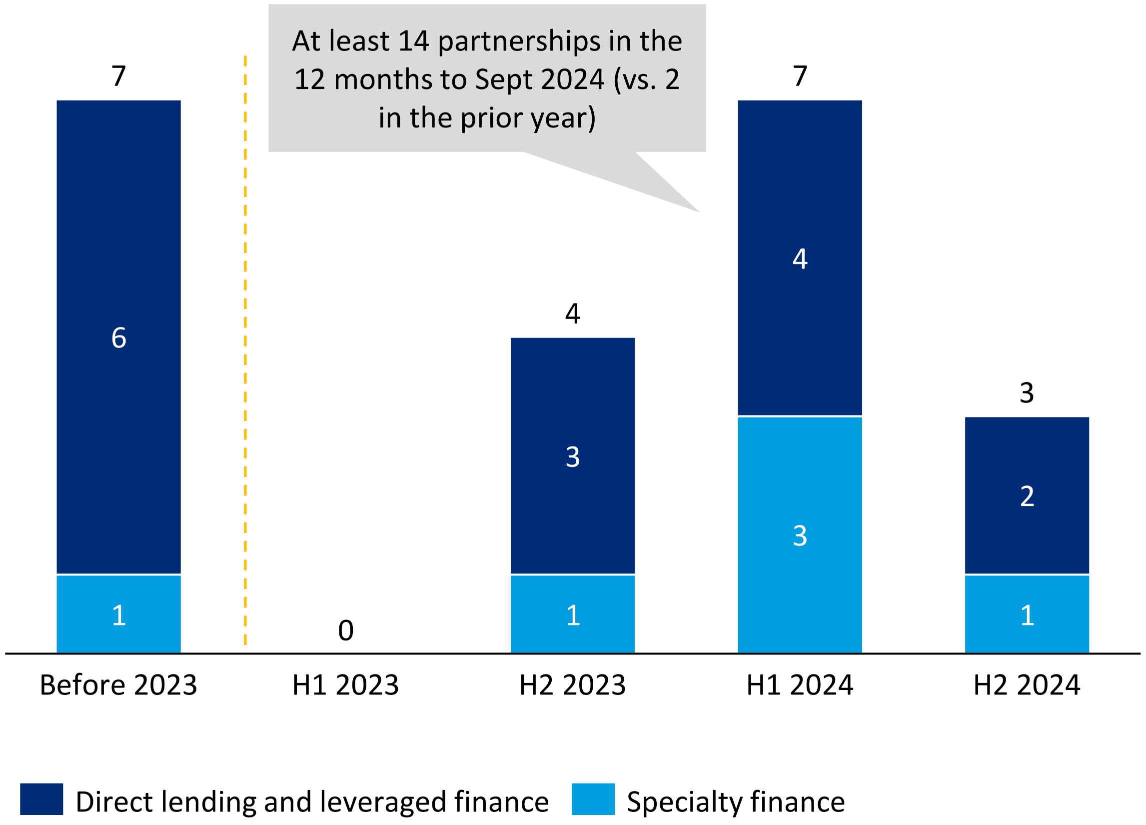
Huw van Steenis , FT OpEd April 2024

DIRECT LENDING HAS BEEN THE PREFERRED FOCUS OF PARTNERSHIPS, HOWEVER THERE IS GROWING INTEREST IN IG SPECIALTY FINANCE, OFTEN TO PACKAGE FOR INSURERS

Strategic focus of private credit partnerships[1]
% split strategic focus[2]



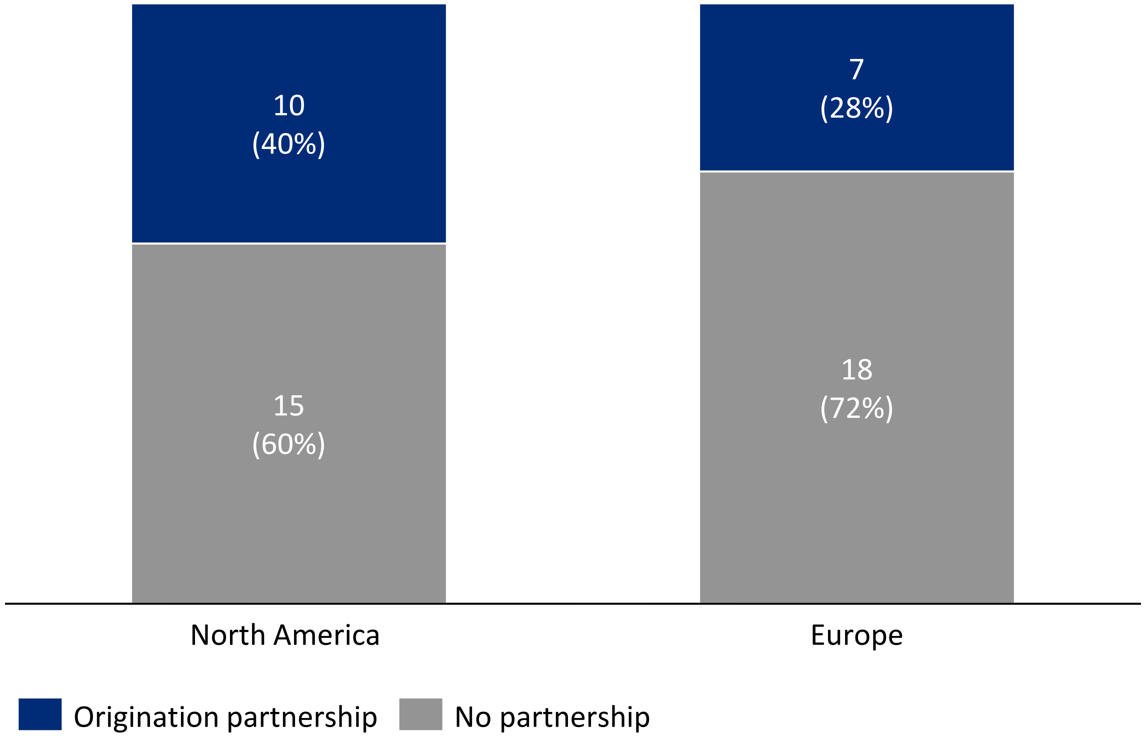
Private credit partnership announcements[1]
Count of partnerships[2], split by strategic focus



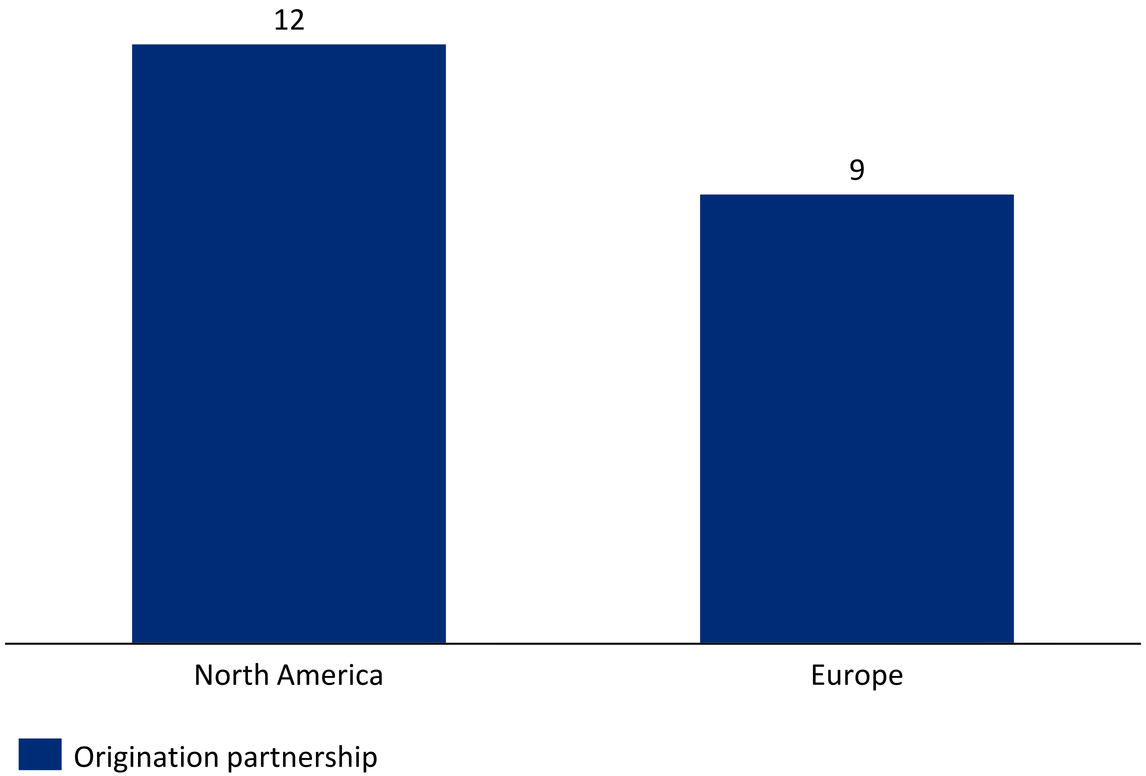
1. As of September 2024; 2. Covering largest banks in North America and Europe by $BN assets 2023.
Source: Private Credit's Next Act, April 2024 by Huw van Steenis and colleagues, Oliver Wyman. Data sourced from bank financials, industry press, Oliver Wyman analysis. Updated with latest H2 2024 data.

17 OF THE LARGEST BANKS IN NORTH AMERICA & EUROPE HAVE AGREED ORIGINATION PARTNERSHIPS

North America and European private credit partnerships[1]
Number of partnerships for the largest 25 banks by geography[2]



Number of credit partnerships[1]
Number of partnerships, split by geography[2]



1. As of September 2024; 2. Largest banks in North America and Europe by $BN assets 2023.
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We used to talk about equity having more of a "barbell effect". I think we’re starting to see that here in the bond market.

Larry Fink, BlackRock Chairman & CEO,
Q2 Earnings Call July 2024

THE BARBELL TOLLS FOR FIXED INCOME - AS IT HAS FOR EQUITIES OVER THE LAST 20 YEARS

Source: The Asset Management Barbell, Huw van Steenis, Bruce Hamilton, 2004; Morgan Stanley Research.

A YEAR OF RECORDS IN FIXED INCOME INVESTING

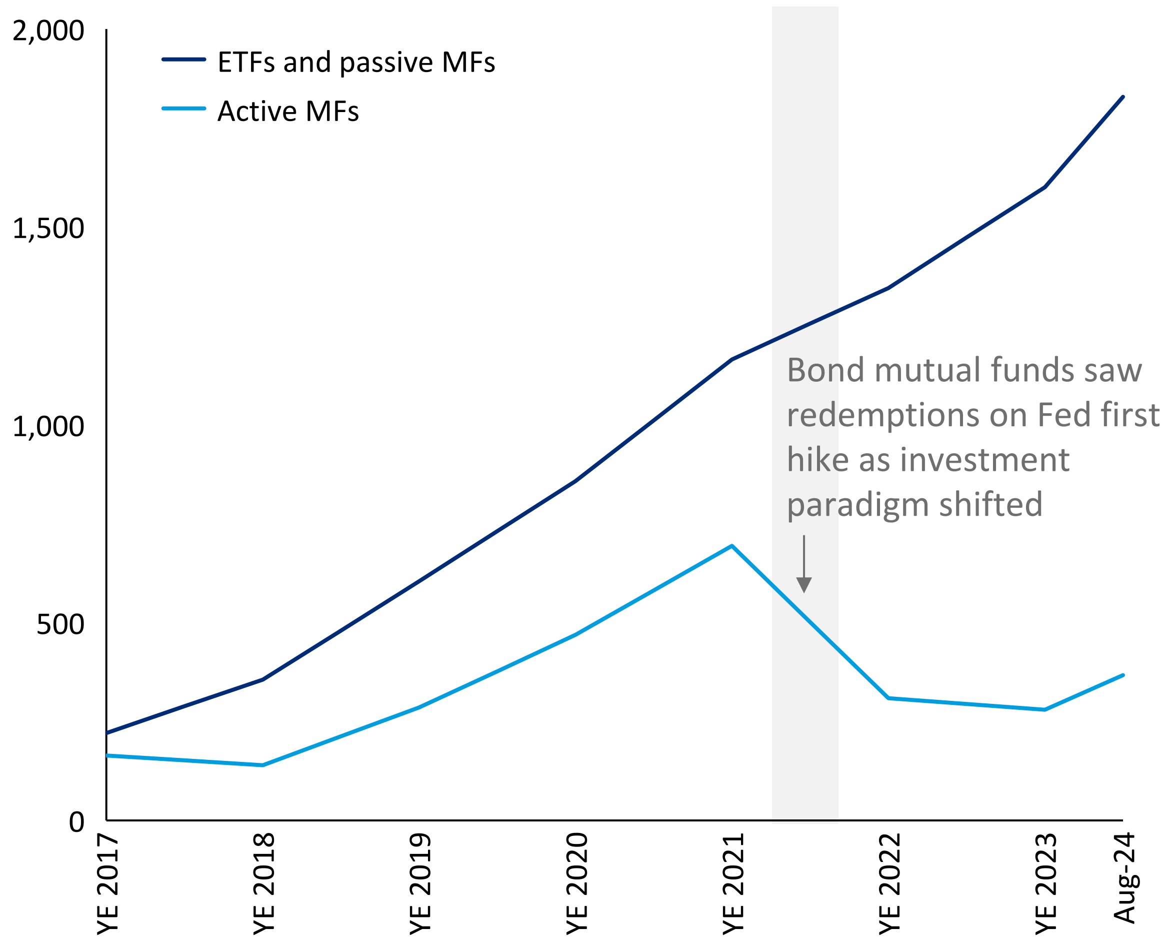
Investors have poured $187bn into US fixed income ETFs this year to August according to Morningstar, 50% higher than this time last year

Ares raised the largest private credit fund in history at $34bn

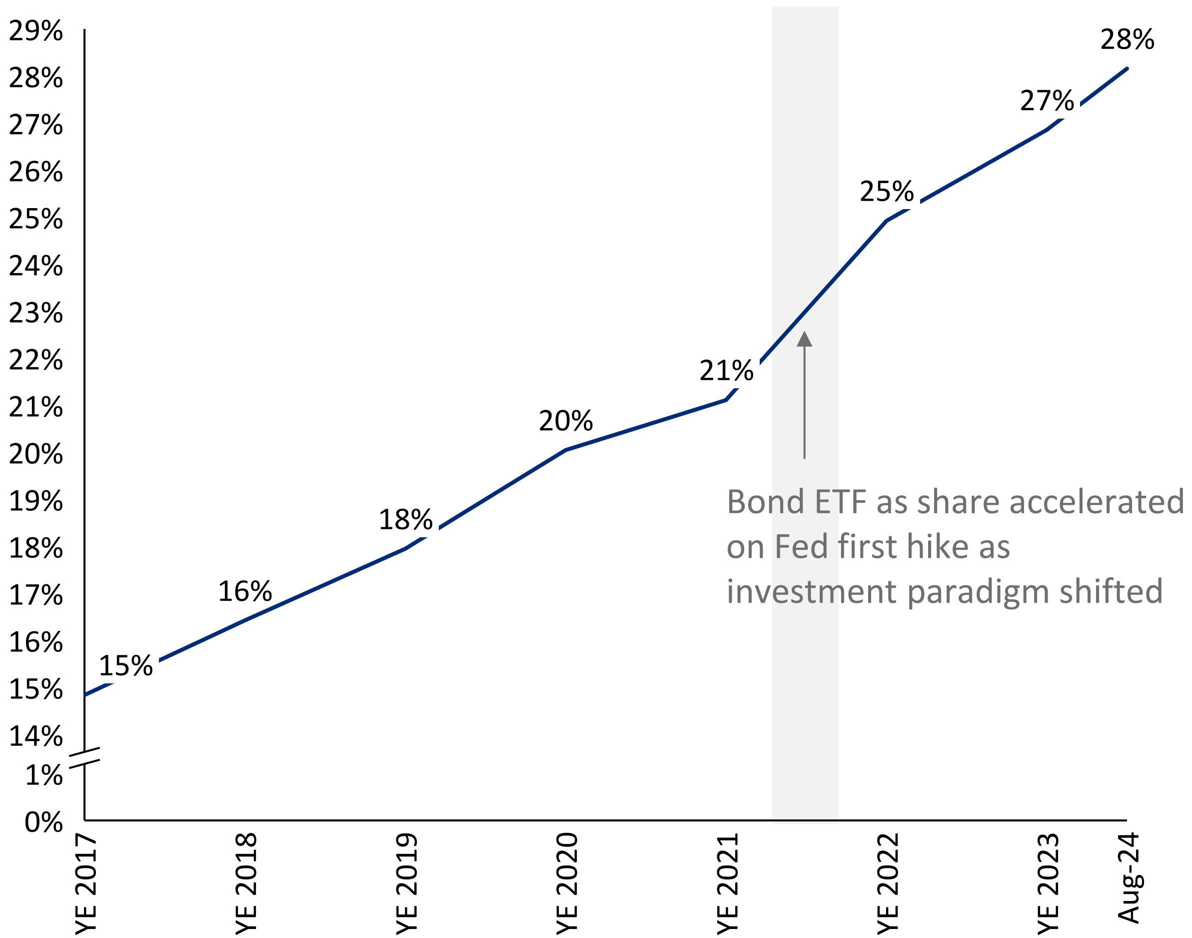
14 major banks have formed partnerships with private credit firms to distribute their loans in the last year – vs 2 the year before

AT ONE END: THE BARBELL EFFECT ACCELERATED IN FIXED INCOME FUNDS FROM THE FIRST FED RATE RISE IN 2021

Cumulative fixed income flows into US ETFs and mutual funds
2020 – H1 2024, USD BN



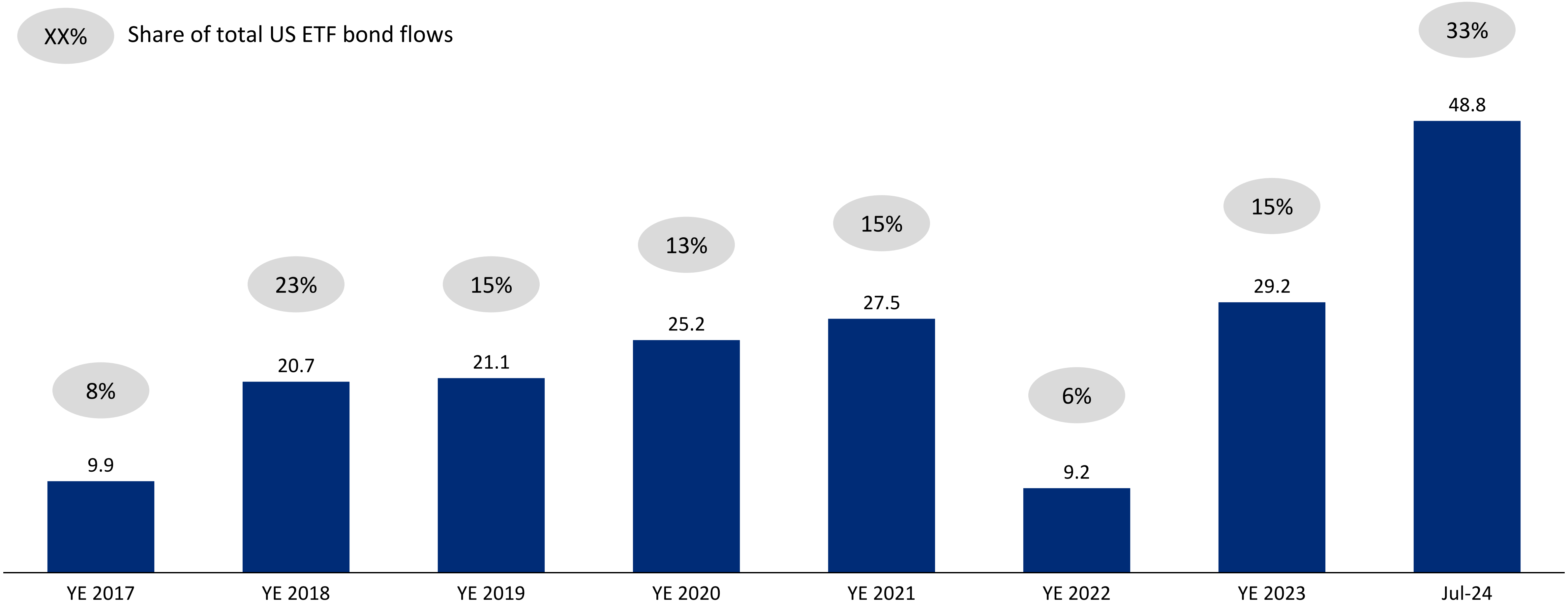
Assets in US bond ETFs as a share of total assets in US FI ETFs and MFs
2017 – July 2024, %



Source: Morningstar | Note: Excludes fund of funds and feeders

ACTIVELY MANAGED BOND ETFS HAVE CAPTURED A GROWING SHARE OF ETF BOND FLOWS – LIKELY TO MORE THAN DOUBLE IN 2024 ON 2023

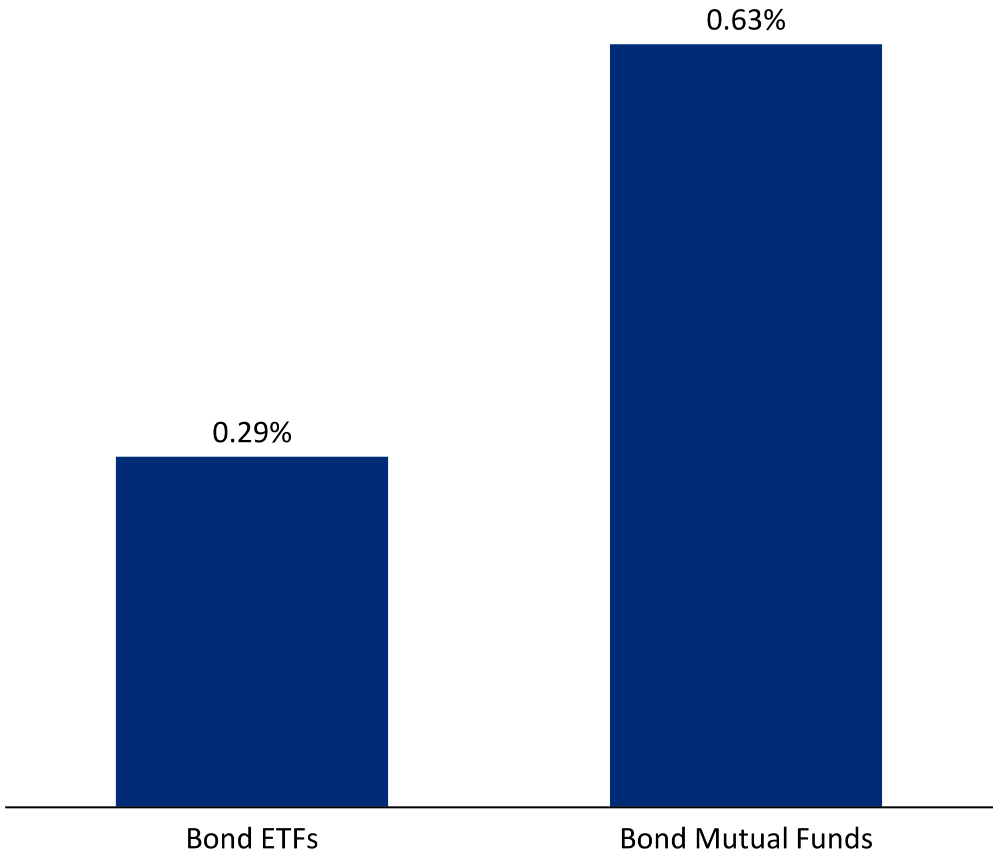
US active bond ETF net flows
20117 – July 2024, $ BN



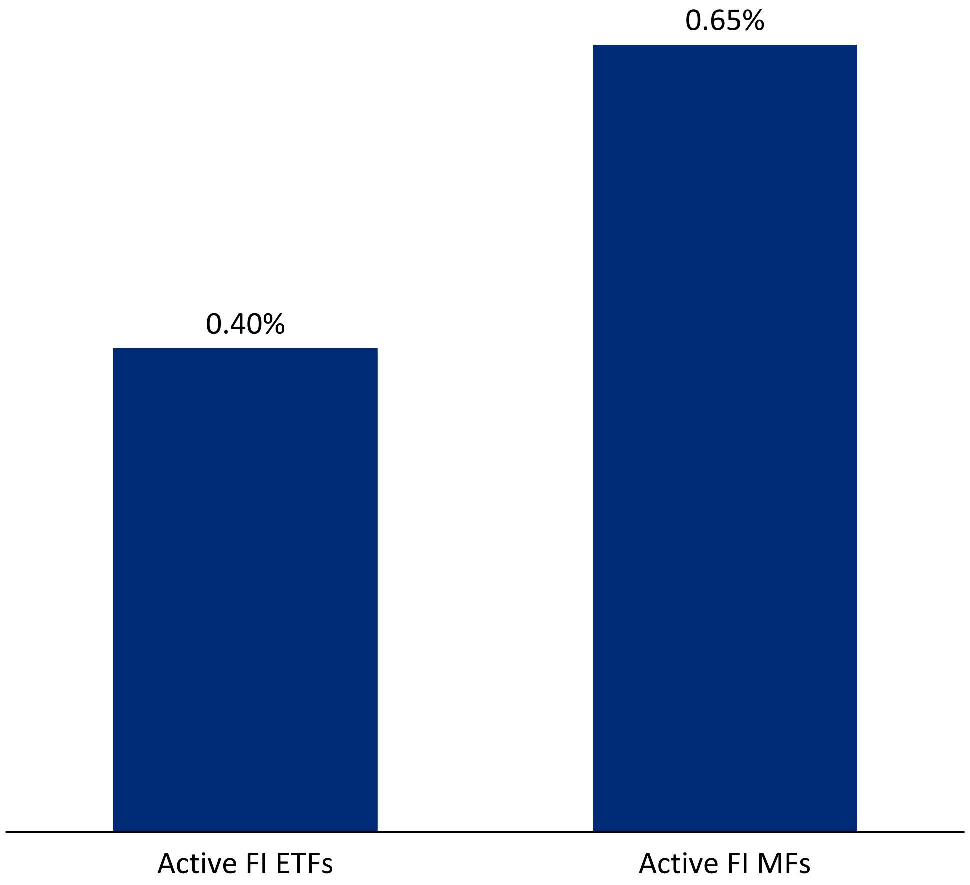
Source: Morningstar | Note: Excludes funds of funds and feeders

IN PART AS ACTIVE FIXED INCOME ETFS AT LEAST A THIRD CHEAPER THAN MUTUAL FUNDS

Median net expense ratio
Bond ETFs vs. mutual funds



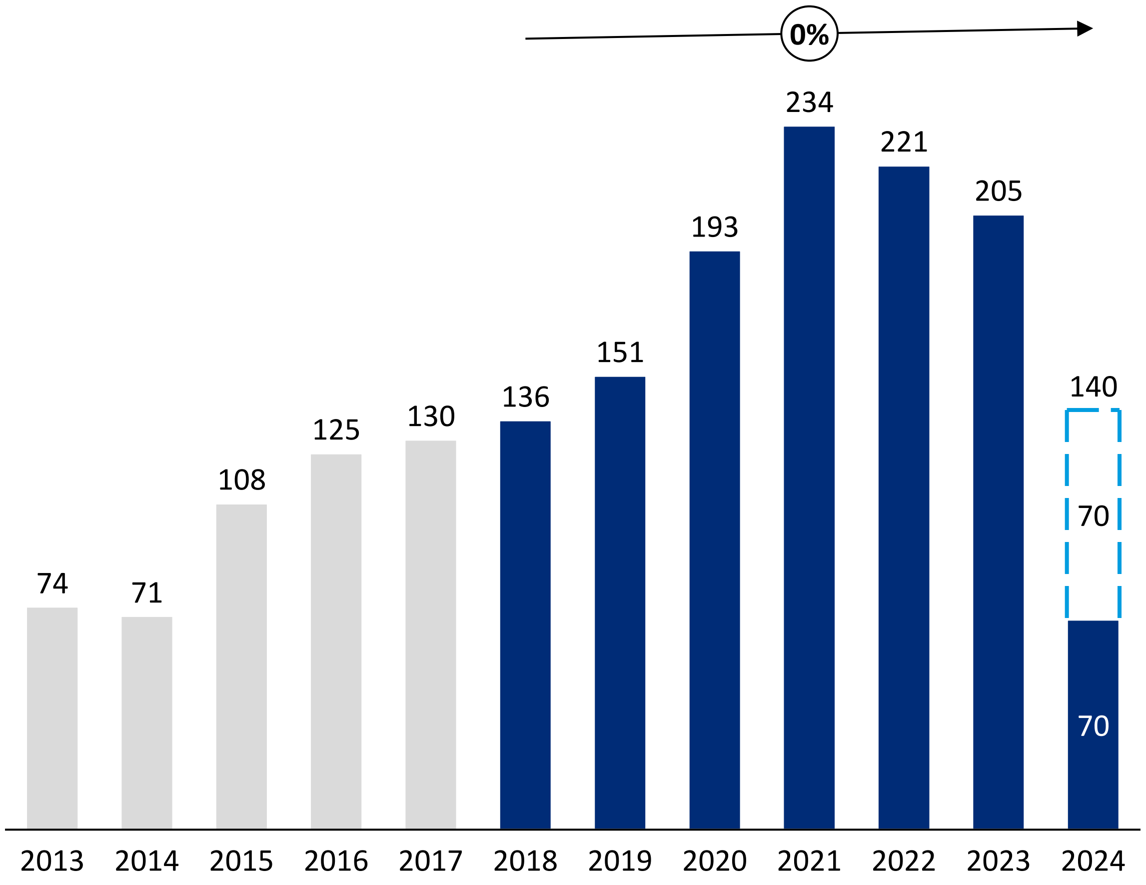
Median net expense ratio
Active fixed income ETFs vs. active mutual funds



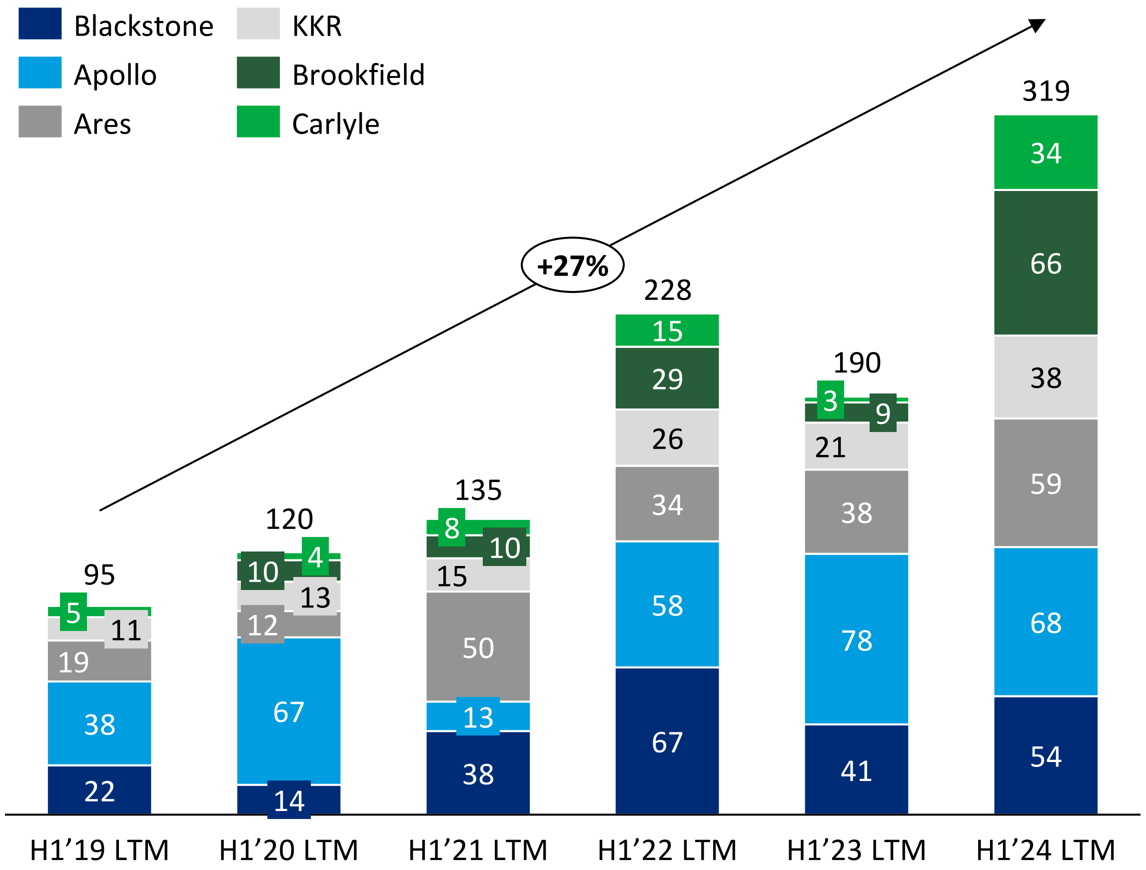
Source: SSGA

FUNDRAISING IN PRIVATE CREDIT HAS SLOWED DUE TO PRIVATE MARKET INDIGESTION - BUT THE LARGEST PLAYERS CONTINUE TO GROW FASTER SINCE FIRST FED RATE HIKE

Private credit fundraising
2013 – H1 2024, USD BN



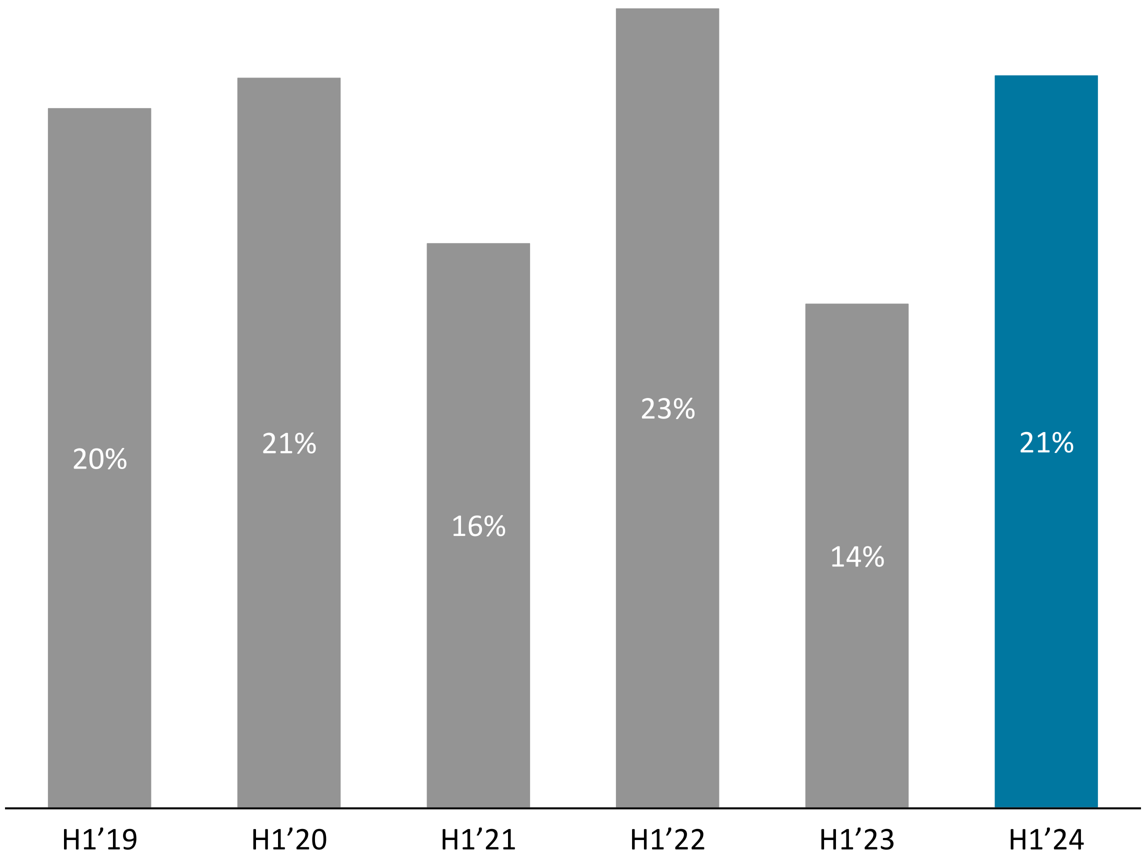
Net credit strategy flows for selected asset managers[1]
H1 2019 LTM – H1 2024 LTM[2], $ BN



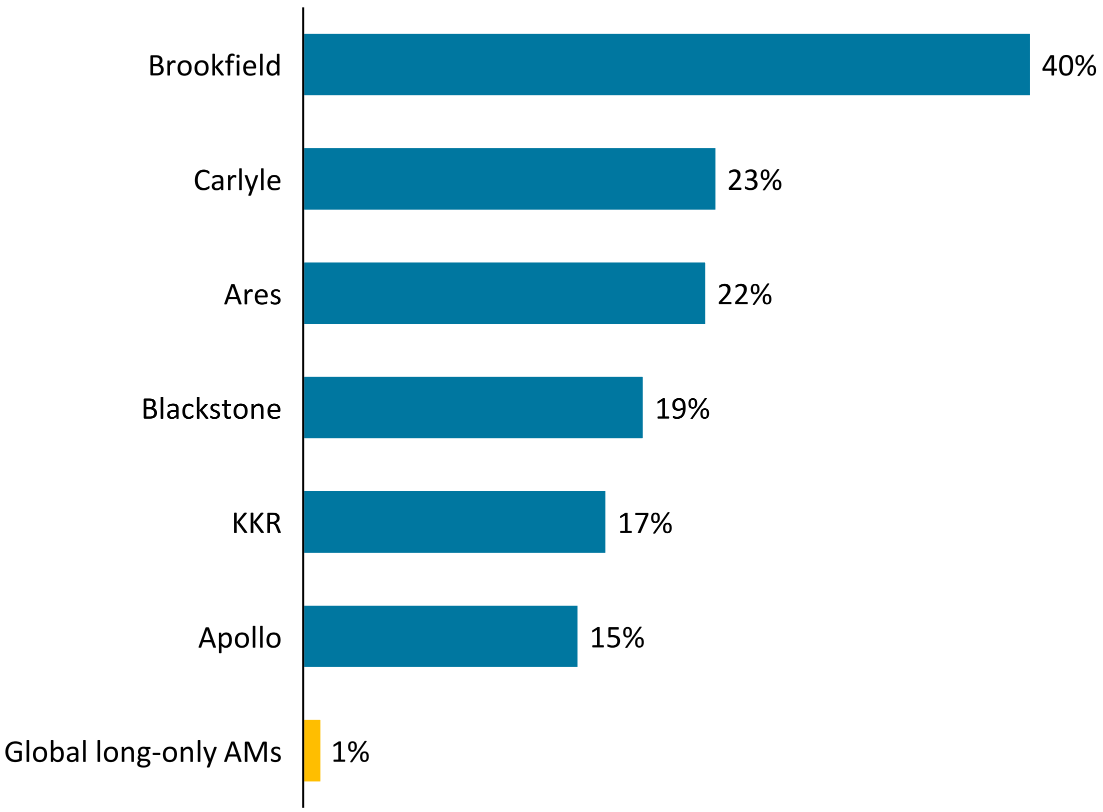
1. Blackstone, Apollo, Ares, Brookfield, Carlyle, KKR; 2. Last twelve months | Note 1: Does not include 2Q’19 LTM for Brookfield, credit flows not available prior to acquisition of Oaktree; Note 2: In-year flows exclude acquisitions; Note 3: Estimates for KKR from 2019-2022, extrapolated assuming annual growth rates in line with peers | Source: Preqin, company annual reports and presentations

FIXED INCOME NNM FOR LARGEST ALTERNATIVE PLAYERS IS ROBUST AND FAR HIGHER THAN TRADITIONAL LISTED PLAYERS

Credit strategy NNM as a share of total credit AUM for selected asset managers[1], H1 2019 LTM – H1 2024 LTM[2], %



NNM growth in credit strategies for selected managers
12 months to H1 2024, %



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THERE IS A CAMBRIAN EXPLOSION OF INNOVATION IN HYBRID FUNDS – SIGNIFICANT BETS ON THE MAINSTREAMING OF PRIVATE CREDIT

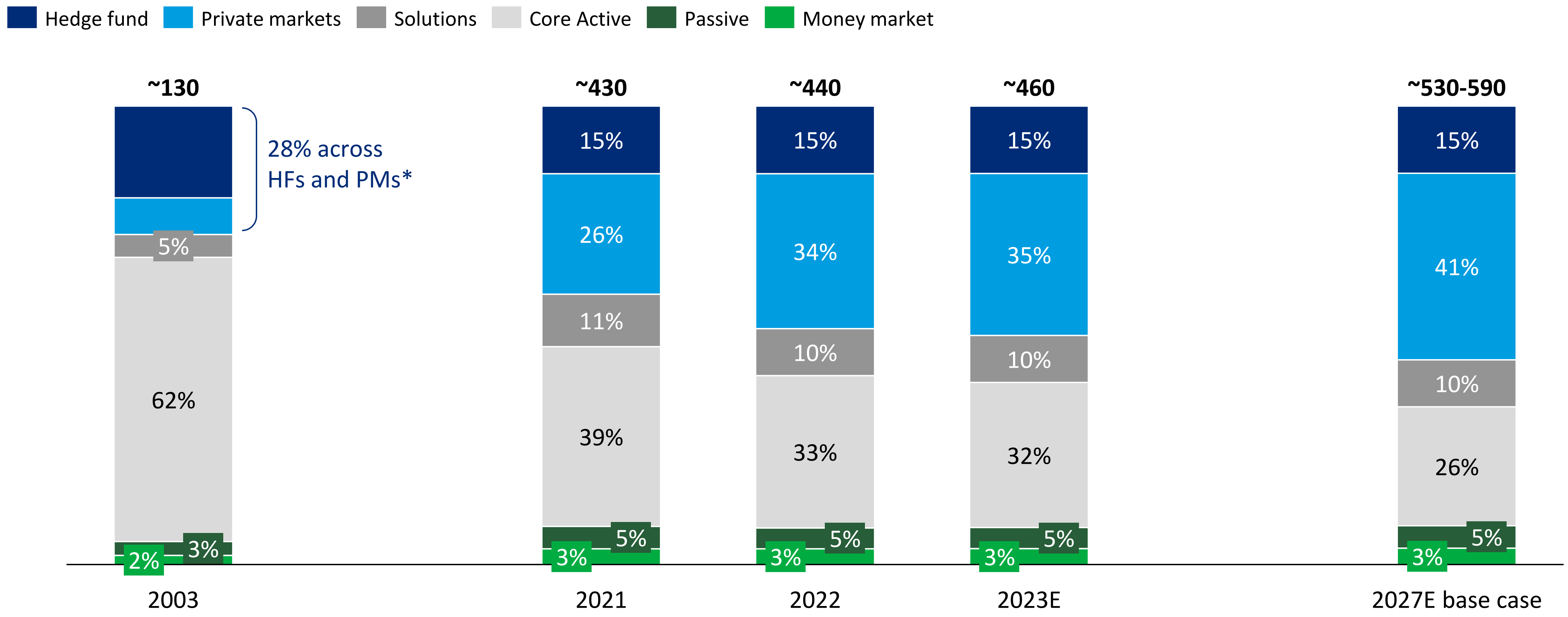
KKR and **Capital International** > to create the first public-private private credit fund

Blackrock and **Partners Group** > to create first blended US private markets fund

Apollo and **State Street Global Investors** > to create first hybrid ETF fund (with up to 15% private credit)

FURTHER POLARISATION OF RISK AND FEE BUDGETS TOWARDS PRIVATE MARKETS LIKELY

Revenue growth projections by product
$BN, 2003-2027

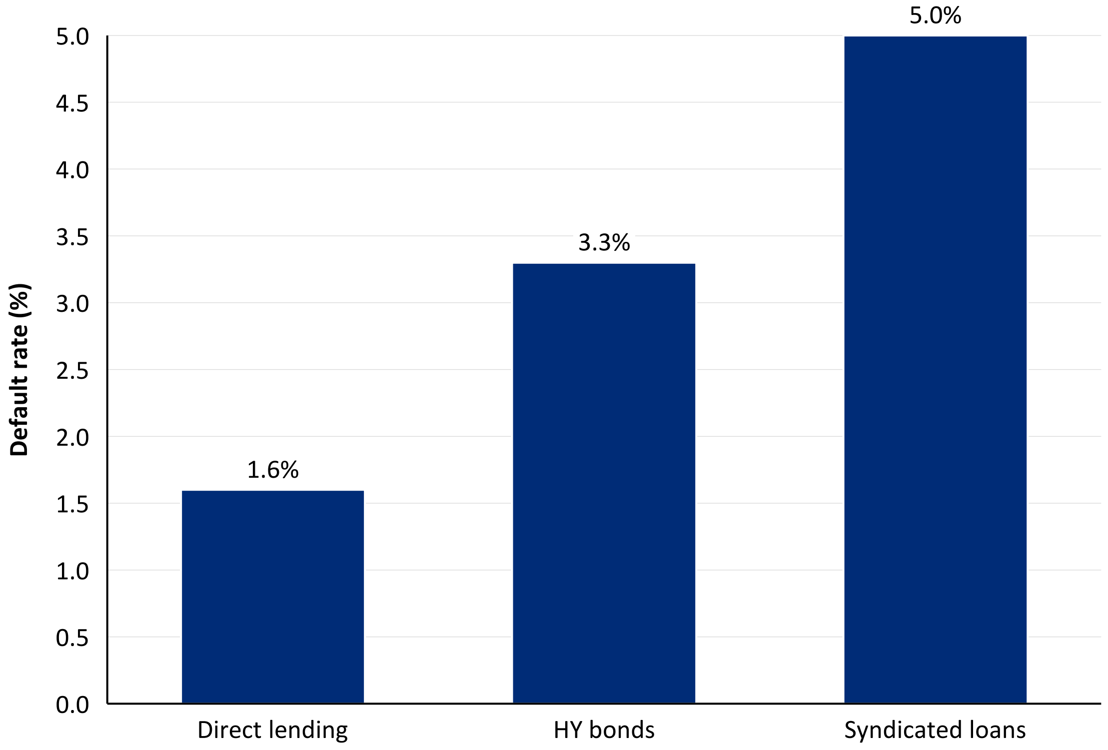


Source: Oliver Wyman and Morgan Stanley Research | *No split between Hedge Funds and Private markets in 2003 sample

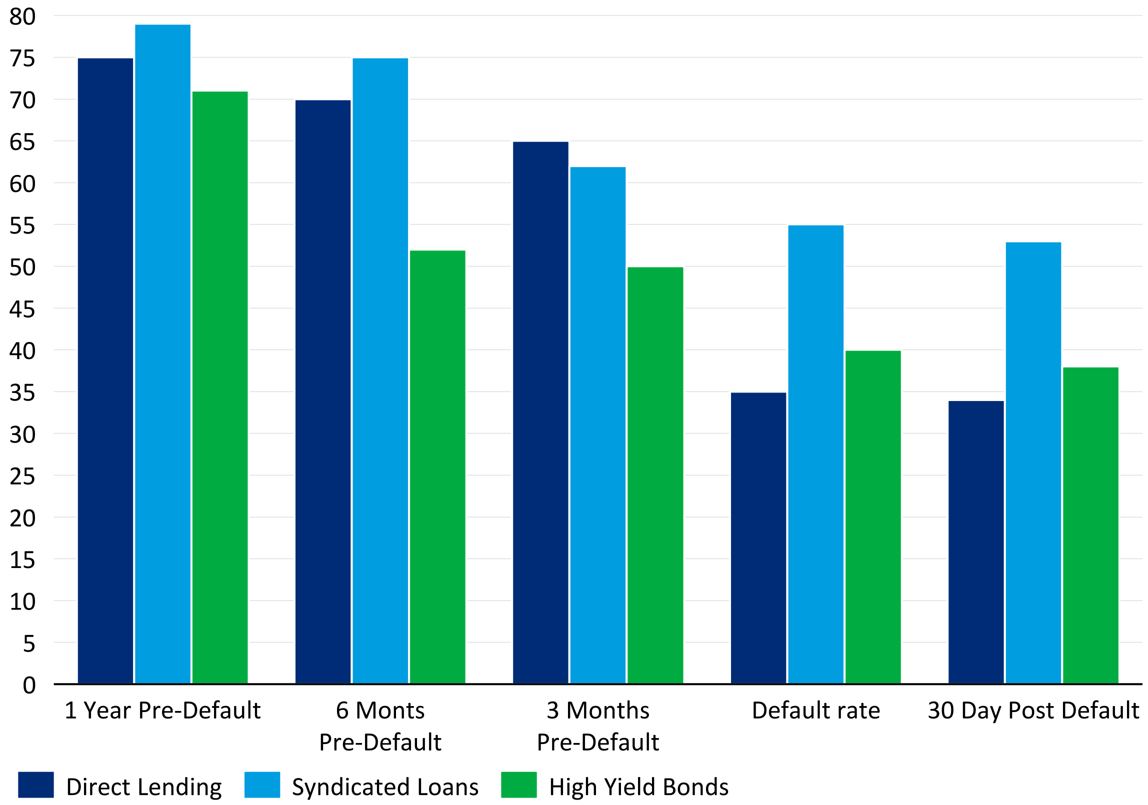
HOW CREDIT QUALITY EVOLVES AS PRIVATE MARKET SCALES AND MACRO SHIFTS REMAINS A PIVOTAL QUESTION

So far, private credit has enjoyed far better credit dynamics than High Yield and Syndicated Bank Loans (though higher LGD)

Default Rate [1]
2023



Recovery Rate [1]
2023



Source: KBRA DLD, Federal Reserve (1) YTD to Oct 23

BULL AND BEAR POINTS IN OUR CONVERSATIONS

A case for optimism…

Sea change in allocations to credit after 15 years of zero or negative rates

As cost of capital falls, relevant for even more investment grade assets on banks' balance sheets

Third, banks around the world are under pressure to diet into a range of new regulations.

Innovation on funds and new clients types e.g. wealthy

But several headwinds…

Private credit boomed with ultra-low rates & banks on back foot

Will credit quality hold as the sector scales? And could weaker players hit reputation?

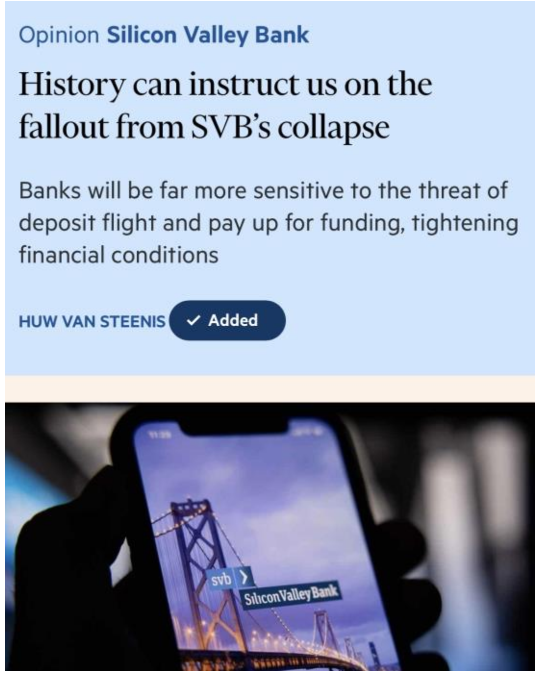
Greater regulatory scrutiny on private credit could impede growth

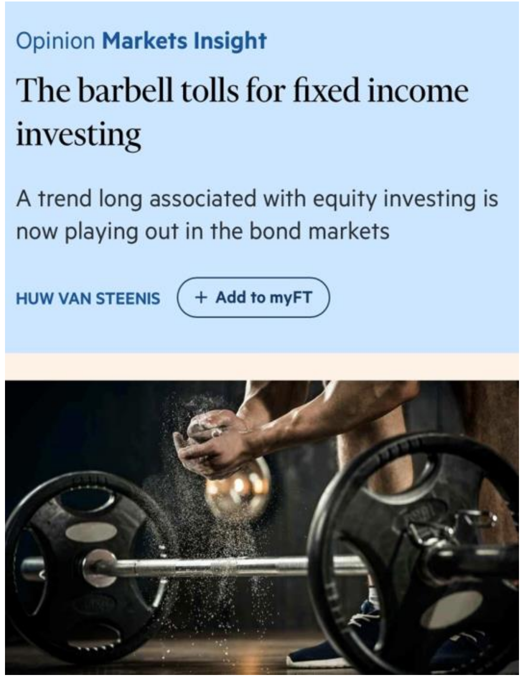
Worst case of Basel endgame now averted and now more moderate capital increase expected

ANY QUESTIONS?

With thanks to Laura Watkin and colleagues

FURTHER READING





Into the Great Unknown

Private credit boom will trigger a new squeeze

History can instruct us on the fallout from SVB's collapse

The barbell tolls for fixed income investing

QUALIFICATIONS, ASSUMPTIONS AND LIMITING CONDITIONS

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