

# Investment Conversations

Timely Topics – The State of Private Credit

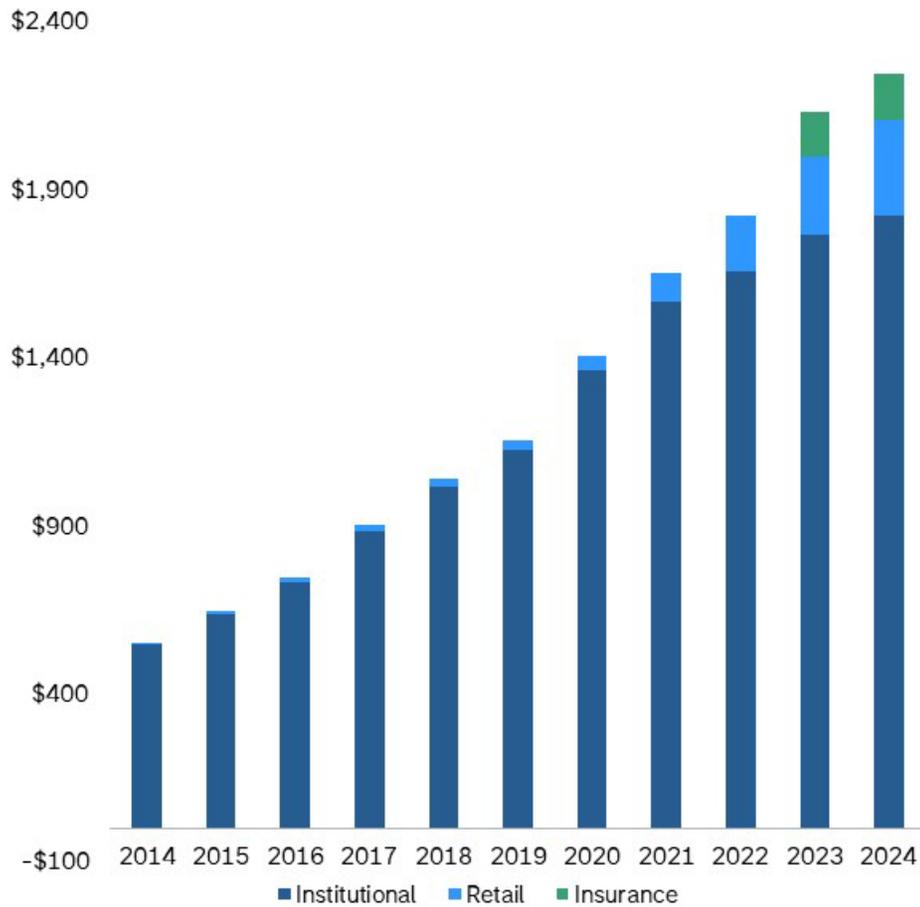


# Growth in Private Credit Fundraising and AUM

Institutional and retail fundraising has grown significantly in recent years, leading to elevated dry powder and assets under management (AUM). Tailwinds in the private credit market have led to investors recognizing the asset class as a viable allocation option during portfolio construction.

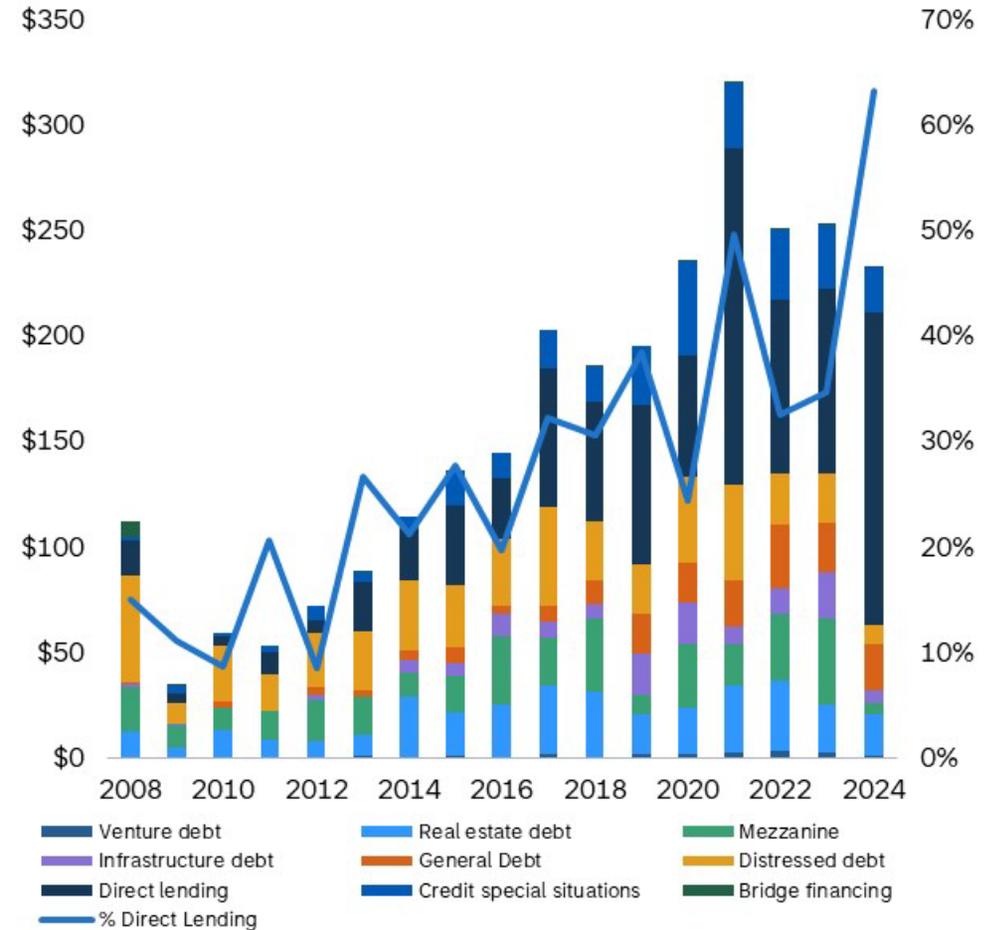
## PRIVATE CREDIT AUM (\$BN) BY INVESTOR TYPE

DATA AS OF JUNE 30, 2024



## PRIVATE CREDIT FUNDRAISING ACTIVITY (\$BN)

DATA AS OF DECEMBER 31, 2024



Source: Morgan Stanley Wealth Management GIO, PitchBook.

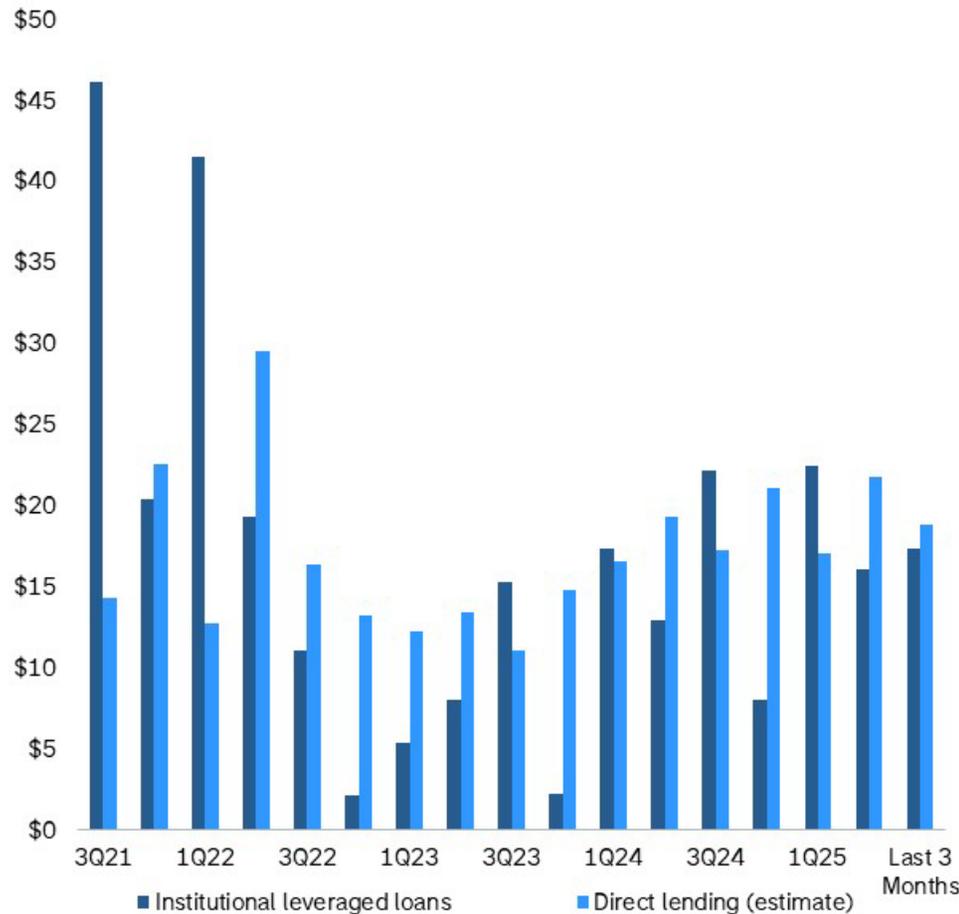
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# Private Credit Share of the LBO Market and Takeouts

Direct lending continues to take share of the leveraged buyout (LBO) market from the broadly syndicated loan market (BSL), with refinancing activities being heavily skewed towards BSL's in recent months.

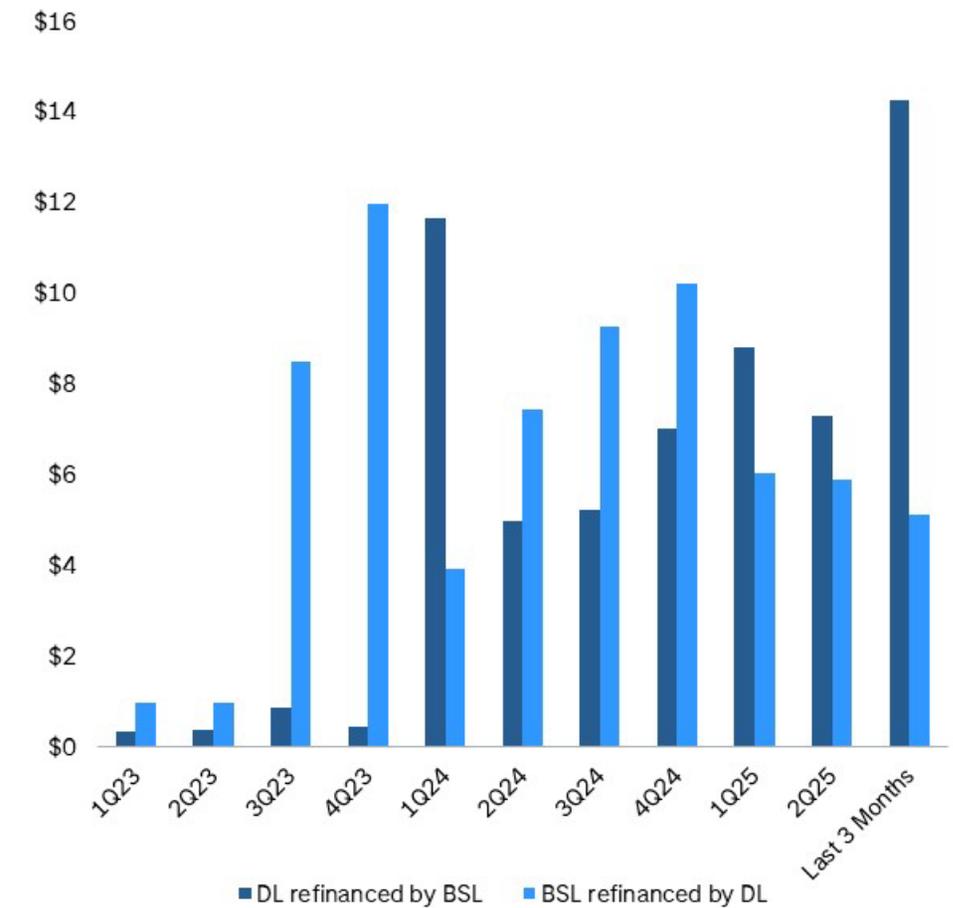
## LBOS FINANCED BY BSL AND PRIVATE CREDIT (\$B)

AS OF JULY 31, 2025



## DIRECT LENDING AND BROADLY SYNDICATED LOAN TAKEOUTS

AS OF JULY 2025



Source: Morgan Stanley Wealth Management GIO, PitchBook.

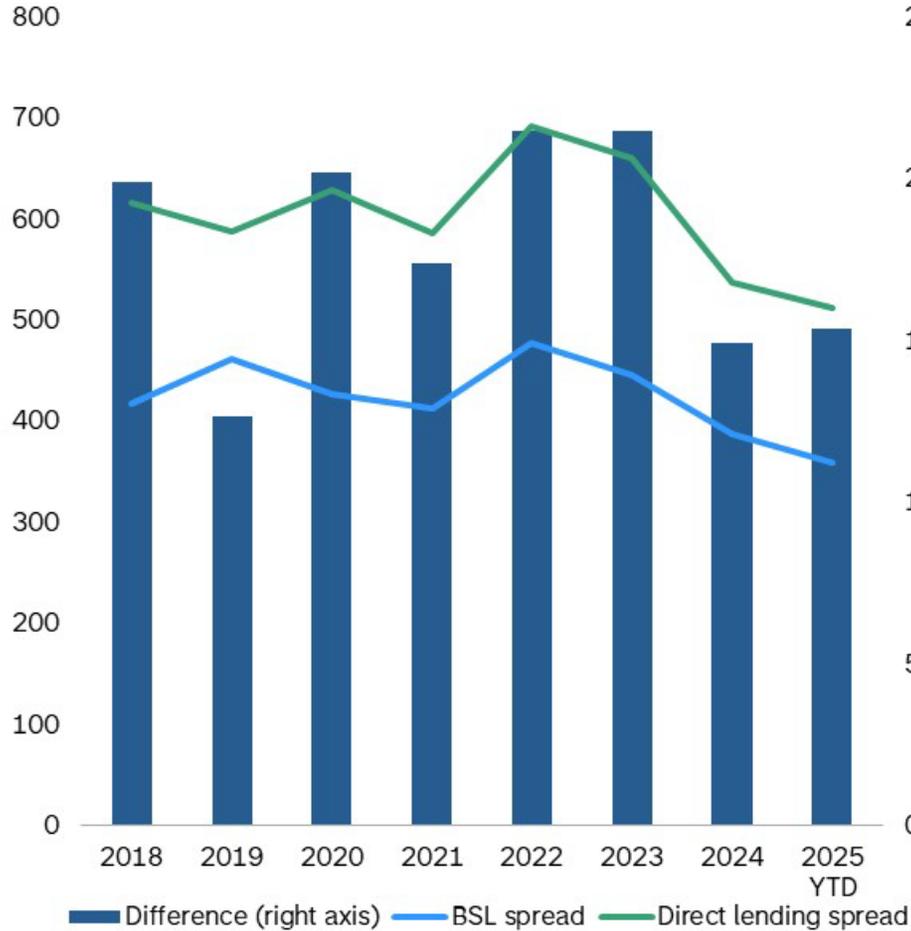
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# Spreads Have Compressed in Recent Quarters

Increased dry powder within direct lending funds has intensified competition among private lenders and also the broadly syndicated loan (BSL) market. Resulting in spread compression across both segments.

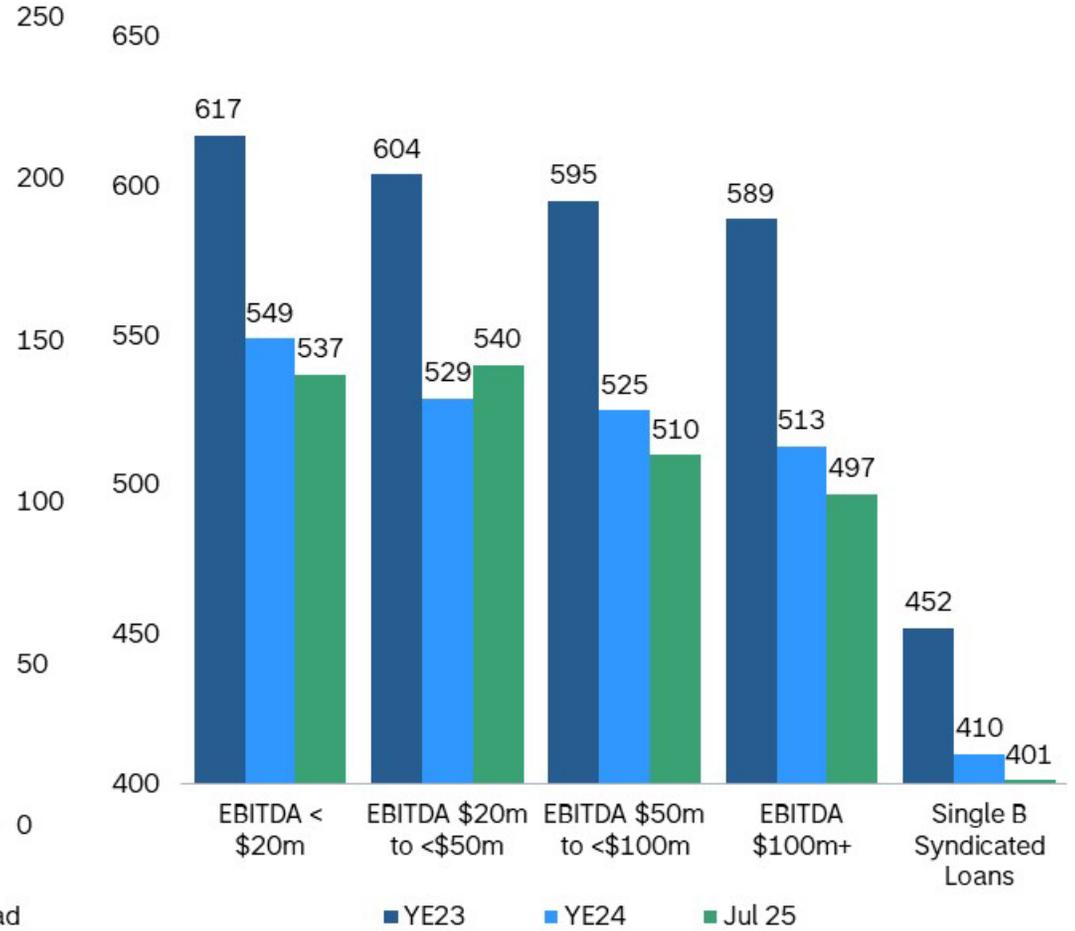
## SPREAD OF LBOS FINANCED IN BSL VS. DIRECT LENDING

AS OF JUNE 30, 2025



## COMPARISON OF SPREADS ACROSS DEAL SIZES

AS OF JULY 31, 2025



Source: Morgan Stanley Wealth Management GIO, KBRA, PitchBook.

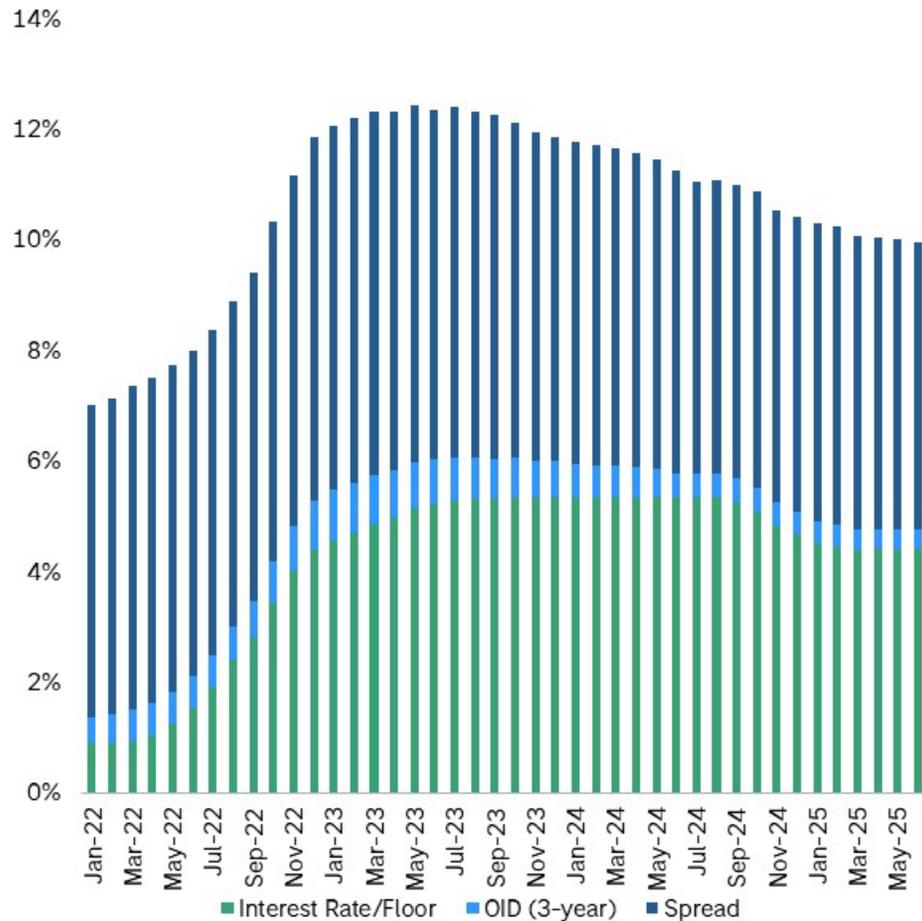
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# Evolving Base Rates and Spreads

Elevated base rates and wider spreads have driven higher all-in yields for direct lending in recent years. Interest rate cuts are anticipated, and yield expectations should be set lower but remaining within target returns.

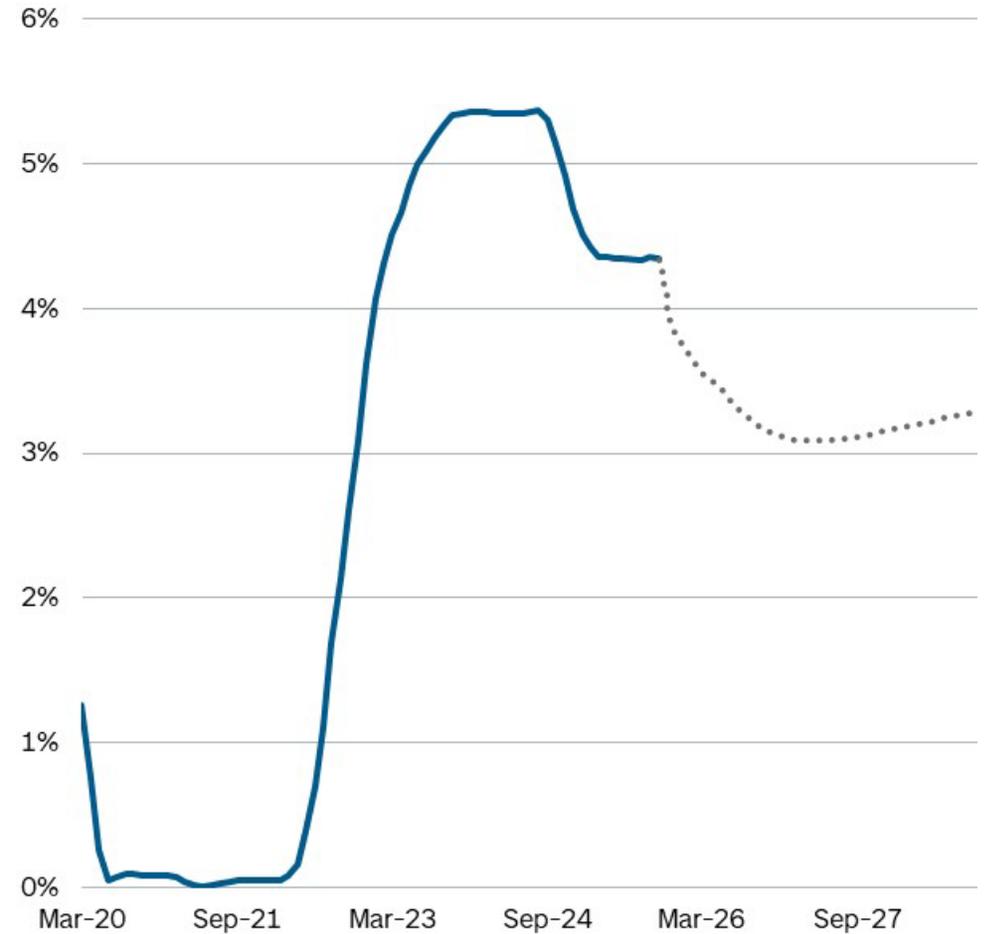
## AVERAGE FIRST LIEN MIDDLE MARKET YIELD (3-YR TERM)

AS OF JUNE 30, 2025



## 3-MONTH SOFR FORWARD CURVE

AS OF SEPTEMBER 30, 2025



Source: Morgan Stanley Wealth Management GIO, Chatham Financial, KBRA, MS & Co., PitchBook, St. Louis FED.

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# Private Credit Continues to Outperform Public Credit

Private credit has provided higher returns compared to the public leveraged credit markets, supported by the illiquidity premium and tighter lender protections, while delivering competitive results and a tighter range of outcomes relative to other private market segments.

## PERFORMANCE OF PUBLIC AND PRIVATE DEBT

AS OF JUNE 30, 2025



## RETURN (IRR) DISPERSION BY ASSET CLASS (2013-2022)

AS OF MARCH 31, 2025



Source: Morgan Stanley Wealth Management GIO, Cambridge, Cliffwater, ICE BofA, Morningstar LSTA.

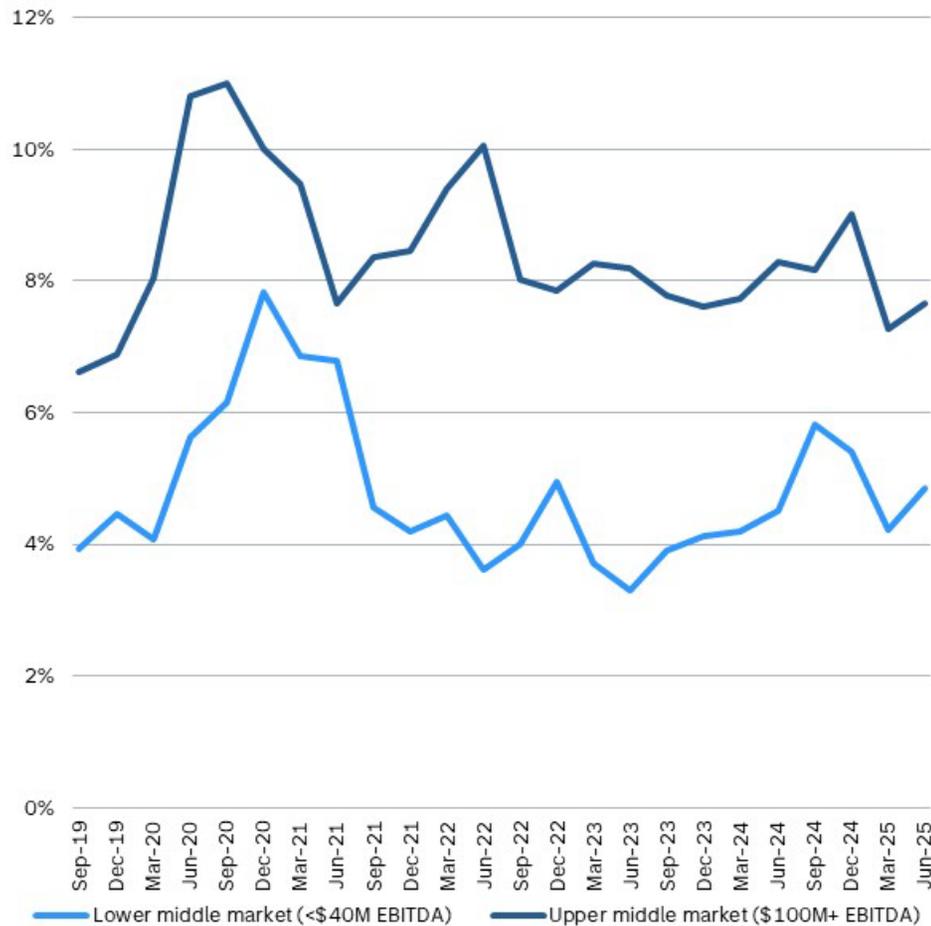
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# Payment-in-Kind and Covenants

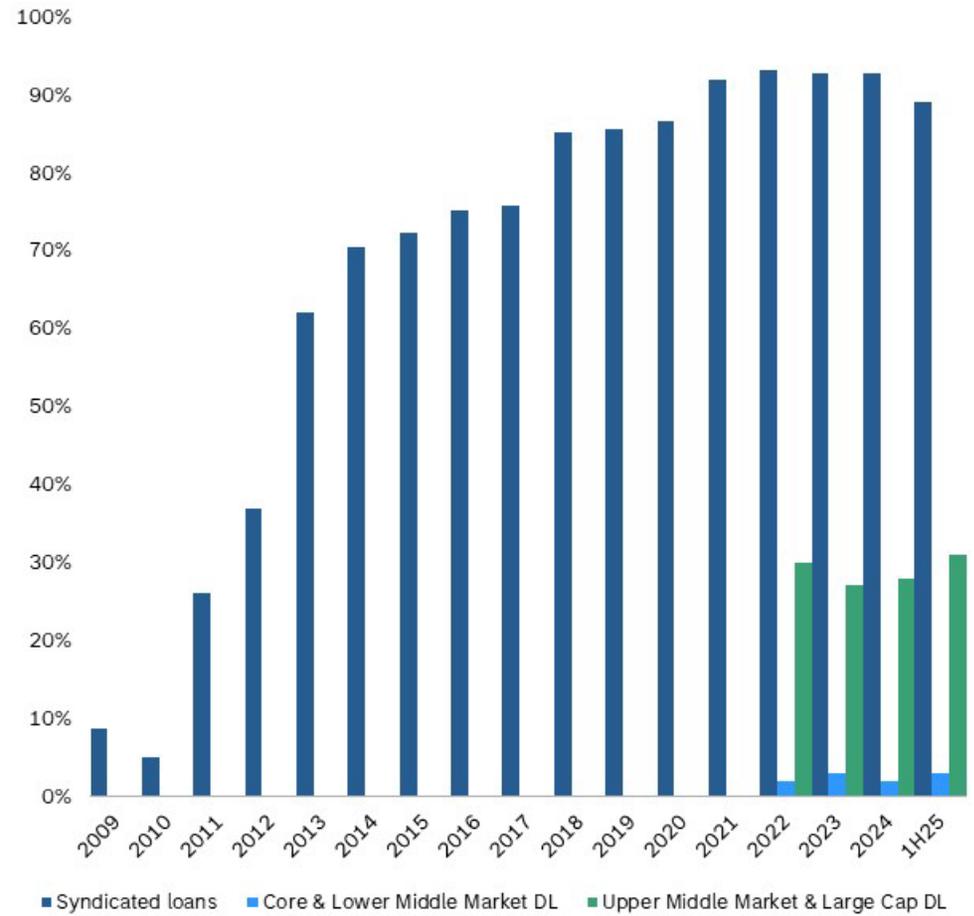
Increased levels of PIK usage within upper middle market (UMM) borrowers has been a consistent theme given more borrower friendly terms relative to the lower middle market. To remain competitive, relative to the BSL market, we have seen a rise in UMM covenant-lite volumes.

## QUARTERLY PIK INCOME AS % OF DIRECT LENDING INV. INCOME COVENANT LITE VOLUME AS % OF ISSUANCE

AS OF JUNE 30, 2025



AS OF MARCH 31, 2025



Source: Morgan Stanley Wealth Management GIO, Cliffwater, KBRA DLD.

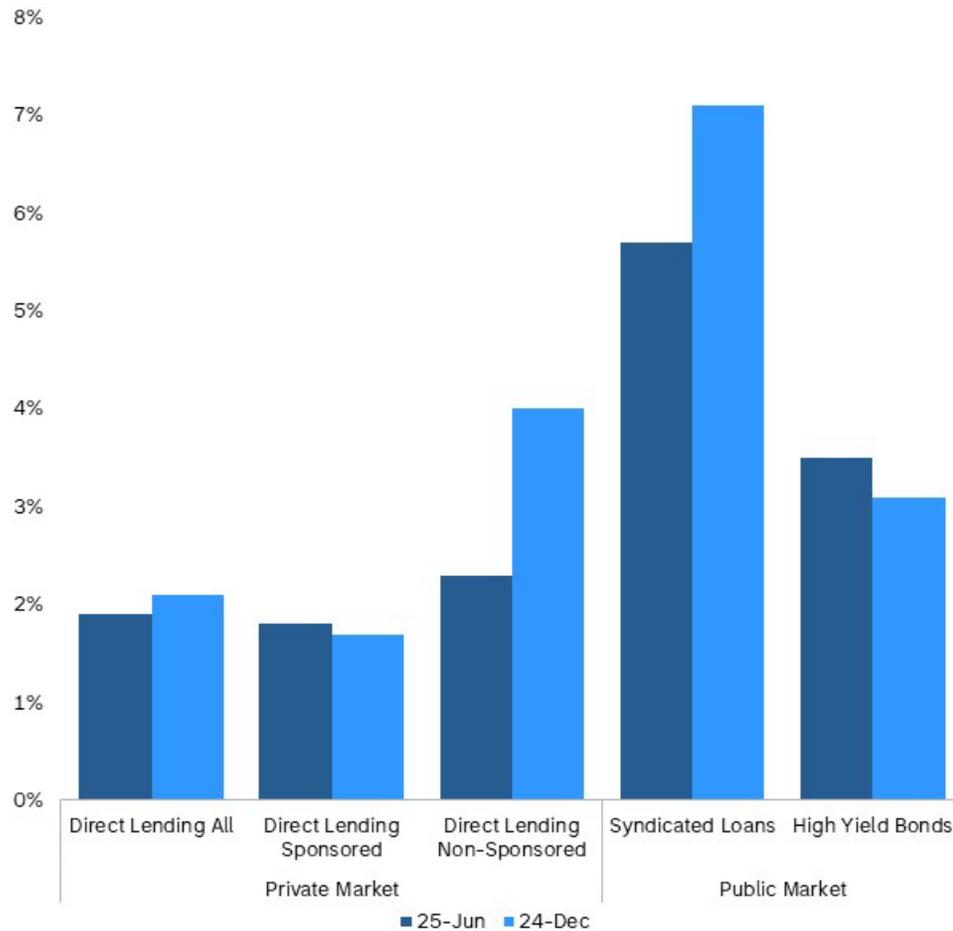
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# Default and Recovery Rates

Direct lending default rates have retreated narrowly since the end of 2024, being more pronounced within non-sponsored lending. Recoveries within direct lending have proved to be more resilient at varying stages relative to the BSL market.

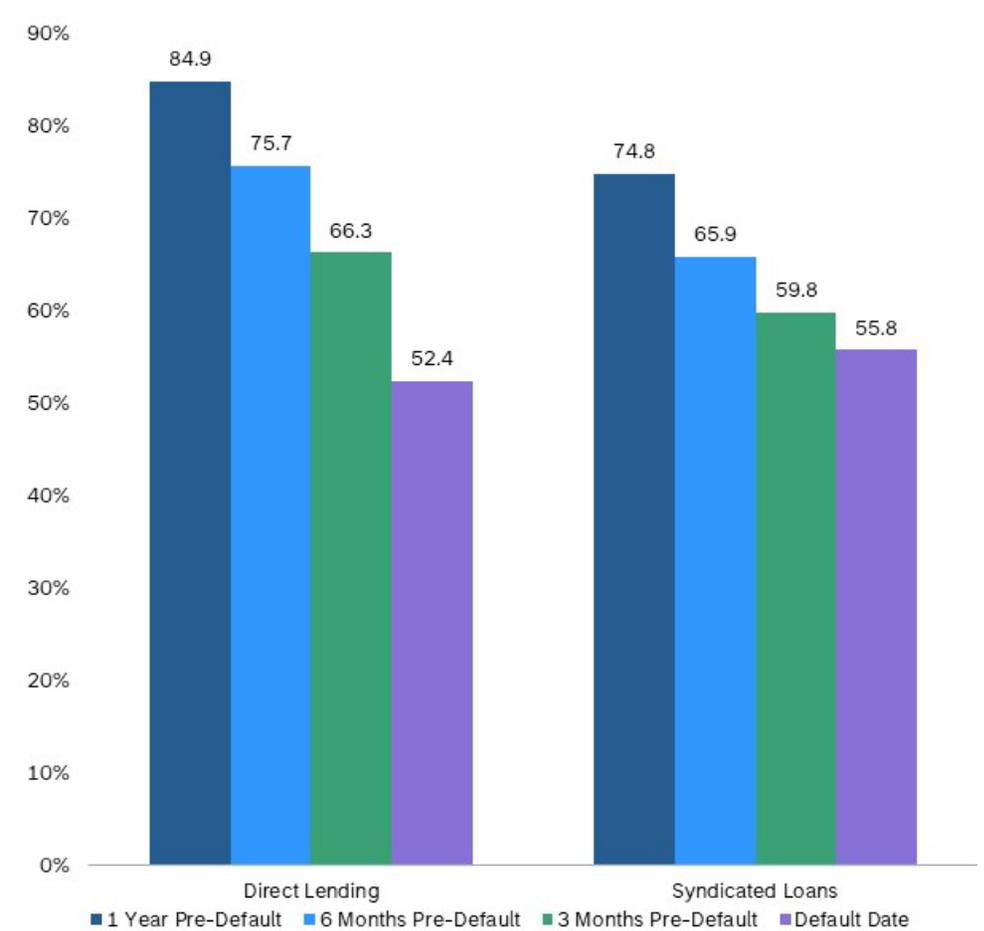
## DIRECT LENDING ISSUER DEFAULT RATE

AS OF JUNE 30, 2025



## DIRECT LENDING AND SYNDICATED LOAN RECOVERY RATES

AS OF JUNE 30, 2025



Source: Morgan Stanley Wealth Management GIO, Morgan Stanley Research, KBRA DLD.

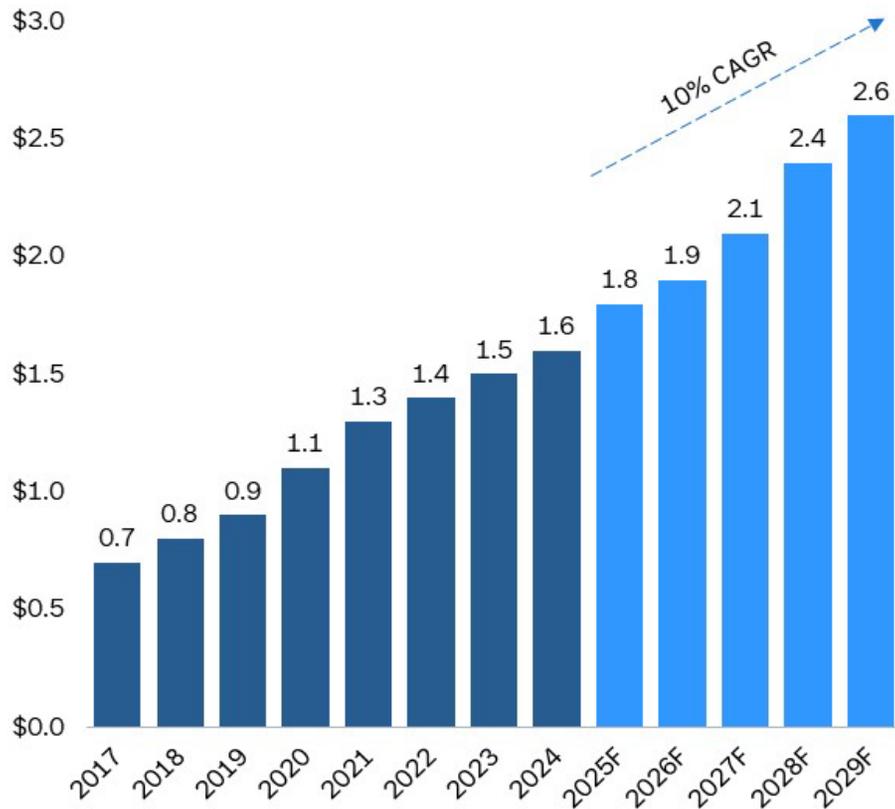
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# How Will Private Credit Develop Going Forward?

The global private credit market is projected to reach \$2.6 trillion in AUM by 2029, driven by supply-demand imbalances and borrowers seeking alternative financing. Abundant dry powder and anticipated interest rates stabilization are expected to boost future deal activity.

## PRIVATE CREDIT AUM (\$TN) 2017 – 2029 FORECAST

AS OF DECEMBER 31, 2024



## BUYOUT FINANCING GAP (\$BN)

AS OF MARCH 31, 2025



Source: Morgan Stanley Wealth Management GIO, Colbalt, Hamilton Lane, Pantheon, Preqin.

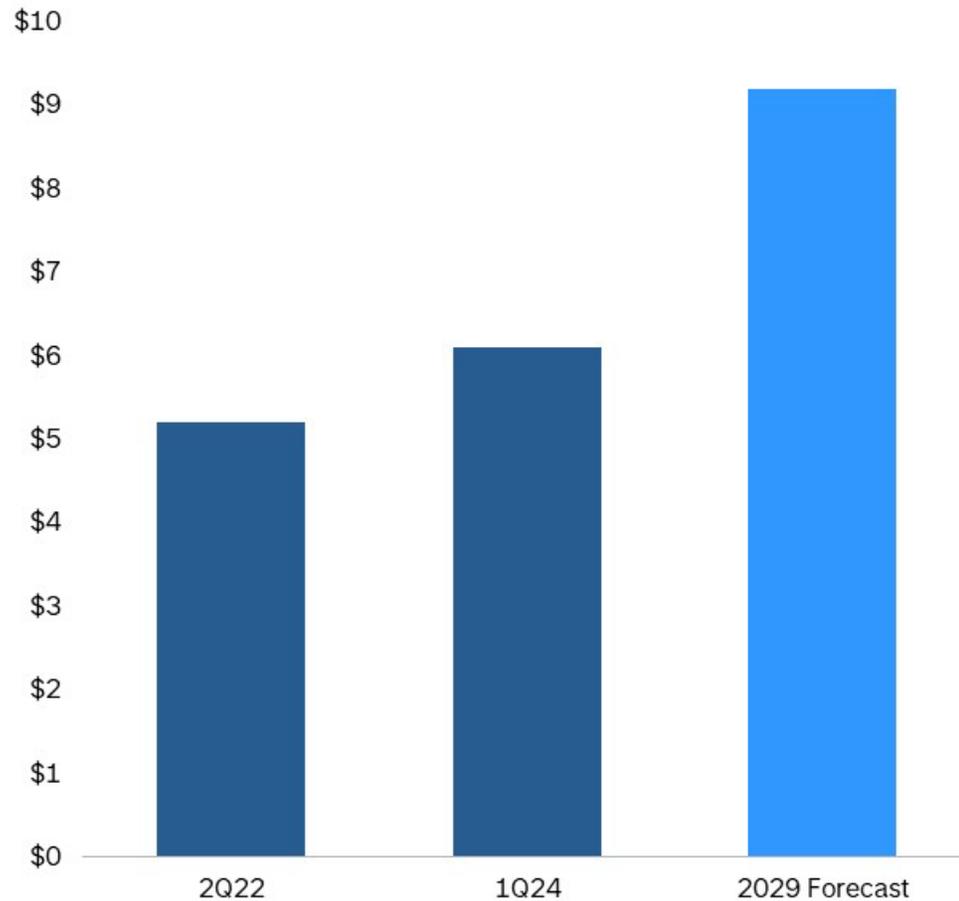
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# The Emergence of Non-Bank Lenders

As traditional lenders remain sidelined, non-bank lenders are creating opportunities for private credit lenders. As non-bank lenders lack access to traditional forms of capital, private credit managers can be selective, often earning higher yields and tighter credit agreements.

## PRIVATE ABF GROWTH FORECAST (\$TN)

AS OF MARCH 31, 2024



## CORRELATION OF KEY CREDIT MARKETS (Q3 2017 – Q4 2024)

AS OF DECEMBER 31, 2024

	U.S. Direct Lending	Treasuries	U.S. Agg	IG bonds	HY bonds	Leveraged Loans	Asset-based finance
U.S. Direct Lending	1.00	-	-	-	-	-	-
Treasuries	-0.41	1.00	-	-	-	-	-
U.S. Agg	-0.04	0.91	1.00	-	-	-	-
IG bonds	0.40	0.57	0.85	1.00	-	-	-
HY bonds	0.80	0.04	0.43	0.79	1.00	-	-
Leveraged Loans	0.89	-0.30	0.09	0.57	0.91	1.00	-
Asset-based finance	0.71	-0.26	-0.03	0.29	0.51	0.61	1.00

Source: Morgan Stanley Wealth Management GIO, FS Investments, Integer Advisors, KKR Credit. ABF = Asset-Based Finance

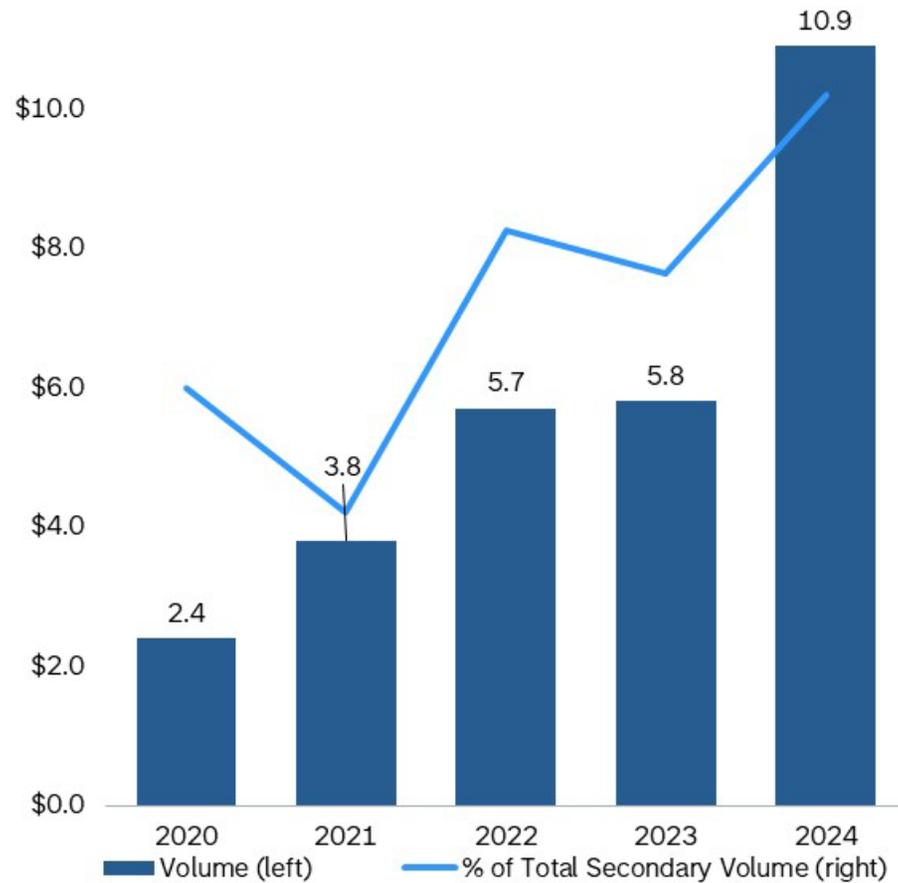
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# Private Credit Secondaries Accelerate

Driven by the rapid growth in private credit, limited partner liquidity pressures, and GP-led continuation strategies, private credit secondaries are becoming a core building block in a private credit allocation with secondary volume growing in recent years.

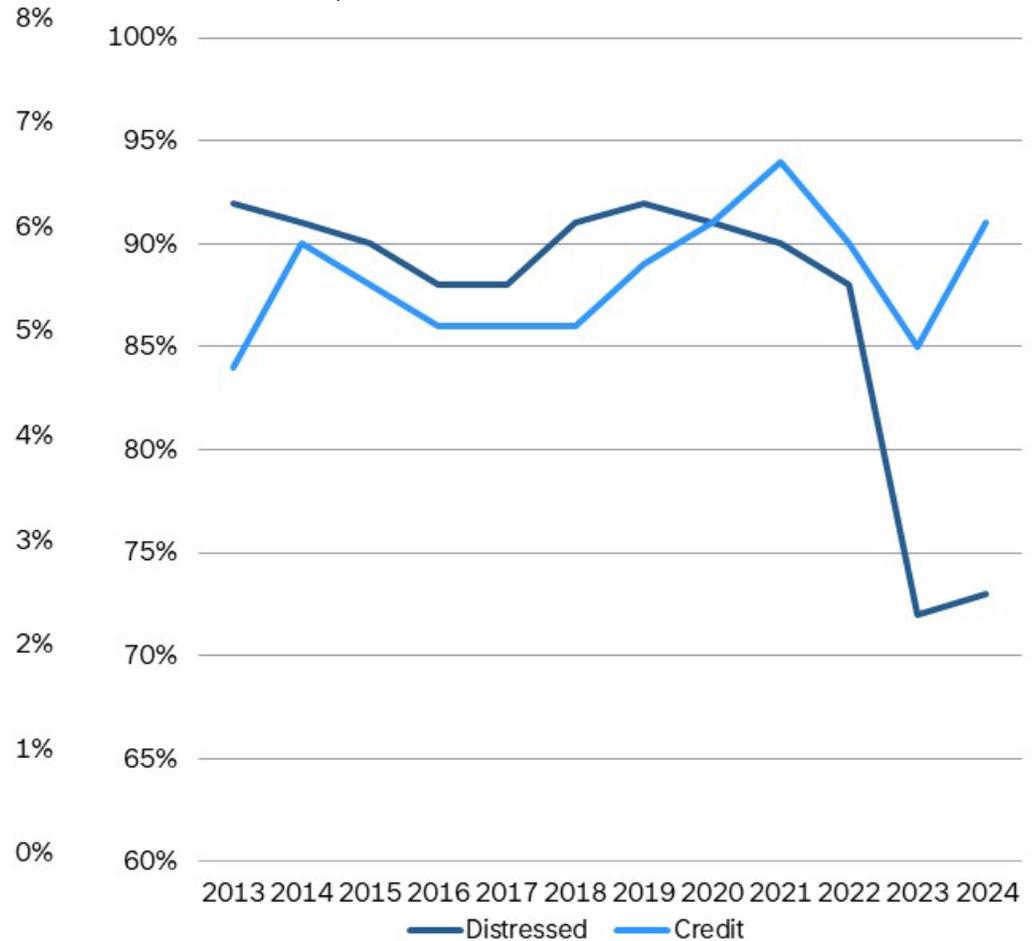
## CREDIT SECONDARY VOLUME (\$BN)

AS OF DECEMBER 31, 2024  
\$12.0



## LP-LED SECONDARY PRICING TRENDS

AS OF DECEMBER 31, 2024



Source: Morgan Stanley Wealth Management GIO, Evercore.

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# Navigating the Current Private Credit Landscape

## GIMA Conviction

Lower

Higher

### Direct Lending

Supply and demand imbalances drove recent growth in direct lending and strong returns. This growth has attracted investor flows. In an environment with lower base rates, moderate deal activity, increased dry powder and growing competition with the banking, direct lending yields will compress compared to recent years.

### Opportunistic

Following the most aggressive rate hiking cycle in four decades and continued banking disintermediation, leveraged finance markets have seen significant growth. As the Fed transitions into a cutting cycle, corporate borrowers will look for alternative solutions to help address potential issues within their businesses. Opportunistic credit managers have the ability to strategically invest in attractive opportunities that may emerge in this developing environment.

### Special Situations

Current macroeconomic trends have created a favorable environment for special situations investing, where managers can unlock value through event-driven opportunities. These strategies target strong companies burdened by weak balance sheets or high-quality assets facing temporary challenges.

### Asset-Based Finance

Regional Banks have been the primary lender for Asset-Based Finance investments, however due to tighter regulatory scrutiny and increased capital reserve mandates, banks have become constrained from lending to these types of investments, providing an opportunity for private lenders to step in to fill the void. Rapid growth in the ABF market is expected to propel its AUM to \$9.2 trillion by 2029.

### Final Thoughts

Macroeconomic conditions and secular trends have created a compelling investment case for private credit and are informing our convictions as conditions evolve as we move through 2025. Although we expect rates to decline and spreads to compress in direct lending, the opportunity set across a wider area of private credit remains attractive, particularly in ABF and Opportunistic/Special Situations. Clients should continue to explore various private credit strategies as a means of diversifying their portfolio.

Source: Morgan Stanley Wealth Management GIO.

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The value of fixed income securities will fluctuate and, upon a sale, may be worth more or less than their original cost or value at maturity. Bonds are subject to interest rate risk, call risk, reinvestment risk, liquidity risk, and credit risk of the issuer. Yields may change with economic conditions and should be considered alongside other factors when making investment decisions. Credit ratings are subject to change. High yield bonds carry additional risks, including increased risk of default and greater volatility due to lower credit quality of the issues. In the case of municipal bonds, income is generally exempt from federal income taxes, though some income may be subject to state and local taxes and to the federal alternative minimum tax. Capital gains, if any, are subject to tax. Treasury Inflation Protection Securities (TIPS) adjust coupon payments and underlying principal to compensate for inflation in line with the consumer price index (CPI). While the real rate of return is guaranteed, TIPS typically offer lower returns and may significantly underperform conventional U.S. Treasuries during periods of low inflation. There is no guarantee that investors will receive par if TIPS are sold prior to maturity. The Ultrashort-term fixed income asset class consists of high-quality securities with very short maturities and is therefore still subject to the risks associated with debt securities such as credit and interest rate risk.

**Money Market Funds:** You could lose money in money market funds. Although government money market funds (defined as investing 99.5% of total assets in cash and/or securities backed by the U.S. government) and retail funds (defined as money market funds open to natural person investors only) seek to preserve value at \$1.00 per share, they cannot guarantee doing so. The price of other money market funds will fluctuate, and when you sell shares they may be worth more or less than originally paid. Money market funds may impose a fee upon sale or temporarily suspend sales if liquidity falls below required minimums. During suspensions, shares would not be available for purchases, withdrawals, check writing or ATM debits. A money market fund investment is not insured or guaranteed by the Federal Deposit Insurance Corporation or other government agency. The Fund's sponsor has no legal obligation to provide financial support to the Fund and investors should not expect that the sponsor will provide financial support to the Fund at any time.

Investing in **Commodities:** Commodity prices may be affected by factors such as supply and demand, government policies, domestic or international political and economic events (including war or terrorism), changes in interest and exchange rates, trading activity in commodities and related contracts, pestilence, technological developments, weather, price volatility, and liquidity constraints. Physical precious metals are speculative, non-regulated products that may experience short- and long-term price volatility. Precious metals do not make interest or dividend payments and therefore may not be appropriate for investors who require current income. Precious metals must be stored, which may impose additional costs on investors.

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For more information, please refer to additional Investment Advisory Programs disclosures here: [www.morganstanley.com/wealthbooks#investment-advisory-programs](http://www.morganstanley.com/wealthbooks#investment-advisory-programs).

### Products and Services

**Annuities and insurance products** are offered in conjunction with Morgan Stanley Smith Barney LLC's licensed insurance agency affiliates. Not all products and services discussed herein are available through Morgan Stanley Smith Barney LLC's licensed insurance agency affiliates. Since life and long-term care insurance are medically underwritten, you should not cancel your current policy until your new policy is in force. A change to your current policy may incur charges, fees and costs. A new policy will require a medical exam. Surrender charges may be imposed and the period of time for which the surrender charges apply may increase with a new policy. You should consult with your own tax advisors regarding your potential tax liability on surrenders. Investment, insurance and annuity products offered through Morgan Stanley Smith Barney LLC are: NOT FDIC INSURED | MAY LOSE VALUE | NOT BANK GUARANTEED | NOT A BANK DEPOSIT | NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY.

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**Residential mortgage loans and home equity lines of credit** are offered by MSPBNA, Member FDIC an Equal Housing Lender. Nationwide Mortgage Licensing System Unique Identifier #663185. **The proceeds from a residential mortgage loan (including draws and advances from a home equity line of credit) are not permitted to be used to purchase, trade, or carry eligible margin stock; repay margin debt that was used to purchase, trade, or carry margin stock; or to make payments on any amounts owed under the note, loan agreement, or loan security agreement; and cannot be deposited into a MSSB or other brokerage account.** The pledged-asset feature allows eligible securities to be used as a substitute for a cash down payment. The pledged-asset feature allows eligible securities to be used as an alternative to a cash down payment. Clients must maintain collateral levels and may be subject to liquidation if requirements are not met. Interest-only and adjustable-rate mortgages (ARMs) carry specific risks, including payment increases and higher total interest costs. ARMs are based on the SOFR 30-Day Average. Relationship-based pricing is available based on eligible household assets held at the Firm.

**Cards and Cash Management:** Debit Cards offered through the Firm are issued by MSPBNA under license from Mastercard. American Express Cards offered through the Firm include the Platinum Card®, Blue Cash Preferred®, and the Morgan Stanley Credit Card. Eligibility requires an "Eligible Account" at the Firm. Cards are issued by American Express National Bank. Terms, conditions, and restrictions apply. The Greenlight App and Debit Card is provided by Greenlight Financial Technologies, not the Firm or any of its affiliates. The Morgan Stanley CashPlus is a brokerage account offered through MSSB. Conditions and restrictions apply. For more information, see the CashPlus Disclosure Statement.

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