

E X P E R T Q & A

Diversification is paramount as investors look to private credit to provide safe yield, says Cliffwater's Blake Nesbitt



Why concentration never pays off

Q Where are you seeing the most interesting opportunities to deploy capital?

As credit investors, downside is the only thing available to you, so the best thing any of us can do is to stay heavily diversified, manage cost and orientate ourselves, as much as possible, towards managers that have a proven ability of mitigating losses through cycles. On the front end, that means working with managers that have good credit underwriting, and on the back end, managers with the resources to effectuate productive workouts and recoveries.

We are, of course, focused on finding those superior managers, but we also believe strongly in the importance of diversifying. We don't believe in

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calling sectors – just take the software industry as an example. A few years ago, everyone was keen to emphasise just how much software exposure they had, but today those same people have gone very quiet amid a slew of negative headlines. That just goes to show that markets are dynamic and the best thing you can do from a credit perspective is diversify.

Q Has the emphasis of your underwriting changed at all in the context of the current macroeconomic and geopolitical environment?

When it comes to macro risk, again, it's all about leaning into diversification. We do not believe that investors, and credit investors in particular, can successfully time the market.

I would add that our deployment is US-focused. These companies tend to be extremely well-governed, dynamic and adaptable. They are mostly private equity-backed and run by very focused and smart people, which tends to result in a lot of resilience. Management teams and sponsors are able to respond quickly to changing macro or industry dynamics, whether it requires cutting costs, pivoting into new markets, improving systems, or incorporating artificial intelligence (AI) – now a very topical discussion in board rooms.

Take tariffs as another recent

example. While input costs may have increased for some businesses, these are mid-market businesses where sales and cost structures are primarily happening in the US, so there is a degree of protection there. Management teams and boards also quickly responded by reducing cost structures. As long as you are diversified across industries, you should be able to weather any storm.

Finally, as it relates to the macro economy, we like the fact that direct lending is overwhelmingly a floating rate strategy. We don't believe anyone can predict interest rates sustainably, so that mitigates duration risk from the portfolio as well.

Q Where do you see the best relative value on the size spectrum, from lower mid-market through to large-cap?

We think risk premiums tend to be efficiently priced and we maintain market-weighted exposure to all pockets from lower mid-market to upper mid-market. On occasion, there may be tactical opportunities, however. A good example is late 2022 when market volatility caused banks to retrench. During those times, it may be possible to find better relative value in the upper mid-market due to reduced competition from the syndicated loan market. That retrenchment can mean you find that you are getting overpaid to lend to some of the biggest and highest quality companies out there.

By contrast, there are times when the reverse is true and there is a huge amount of money pouring into the upper mid-market direct lending space. During those times, risk premiums may start to look more attractive in the lower mid-market space. But by and large, for allocators, we think you should just aim to own the market.

Q Are we seeing a blurring of the lines between public markets and private debt?

There has been talk of a convergence

“We do not believe that investors, and credit investors in particular, can successfully time the market”

and we do see that happening on the margin, but I don't think there is going to be a collapse in the distinction between public and private markets. When we study it empirically, we see a consistent liquidity premium for investors in private credit and we expect that to continue.

Q How would you describe investor appetite for private credit overall?

Investor demand for private credit has been extremely strong and I don't see that changing. We have developed the Cliffwater Direct Lending Index, which is the primary benchmark for US private credit. That index, and our quasi-index fund, demonstrate that diversified, low-cost private credit can be resilient, delivering a significant yield premium for investors. That is driving demand from institutions and increasingly from private wealth and retail channels. Retirement markets are discovering private credit as well, all driven by a hunger for safe yield.

Q And what are all of these investors looking for in a manager?

I can't tell you what some investors are looking for, but I can tell you what we believe they should be looking for, because sometimes we feel investors

get caught up in trying to do something that is too targeted, or too interesting. As I mentioned, most investors are ultimately looking to private credit to provide them with safe yield. Taking a one-shot approach to particular managers, or niche strategies, can introduce unintended risk into the process.

Our view is that everything is priced fairly efficiently across subcategories and that, while a more targeted approach may see you outperforming for a short while, it will only be a matter of time before this approach backfires. In our opinion, concentration never pays off.

Q How are fund structures evolving to meet the needs of the wealth and retirement channels?

Clearly, we are seeing a big shift towards evergreen structures that allow investors to stay invested. These vehicles avoid the need for unfunded capital commitments and the drag that causes, and that is appealing to many different types of investors.

That said, the whole trend of more retail, wealth management and retirement capital coming into the private credit space is really interesting and it is an area where we view ourselves as a leader. We manage large mutual fund-like vehicles that offer private credit exposure to retail investors without the need for any kind of accreditation, and we are really excited about the innovation that is taking place in the industry to make that possible.

We have reached the point where we are truly able to give individuals the same access to this asset class as sophisticated institutions. In fact, our data shows that our interval fund product has actually beaten the vast majority of institutional private debt portfolios, so we now have that proof statement that anyone can have access to a high-performing private credit product. ■

Blake Nesbitt is chief investment officer at Cliffwater, winner of PDI's 2025 award for LP/Investor of the Year in the Americas