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# INVESTING IN PRIVATE MARKETS NORTH AMERICA 2021

Finding opportunities in the face of economic headwinds and inflationary pressures

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## **3.1** ROUNDTABLE DISCUSSION

# What role does corporate private placement debt have within an investment portfolio?

***Moderator***

**David Grana,**
Head of North America Media, Clear Path Analysis

***Panelists***

**Jennifer Potenta,**
Managing Director, Global Head of Corporate Private Placements, MetLife Investment Managementt

**Frank Monfalcone,**
Client Portfolio Manager, Private Capital, MetLife Investment Management

**Thomas Metzler,**
Managing Director, Institutional Client Group, MetLife Investment Management

## POINTS OF DISCUSSION

- *Investment-grade private credit provides favorable financial covenants and structures*
- *Since the onset of the pandemic, issuers have raised their liquidity levels, having accessed capital through the market*
- *Though this has been a market dominated by insurers, it is increasingly open to other investors, such as defined benefit pension plans*
- *A global rise in capital expenditure and M&A activity will likely open up new opportunities in the asset class*

**David Grana: How has private credit performed through previous economic crises and how do those numbers contrast with the current health crisis?**

**Jennifer Potenta:** It's important to level set where this team specializes in the private credit market, as it is a large and diverse market. Our expertise is the investment-grade segment, also known as the private placement market. Long-standing relationships with management teams, meaningful financial covenants and structures are the cornerstone of the corporate private placement market.

Looking back at the Global Financial Crisis of 2008-09, the asset class performed well, driven by the covenant protections that were in place, as well as management teams who protected cash flow and company balance sheets. The private placement market operates similarly to the banking market. Relationships, expertise, and a long history of lending to borrowers helps both markets work through challenging times together. The private placement market tends to be a longer-term lender, whereas the bank market tends to focus on shorter-duration loans.

Understanding and analyzing a vast array of industries, businesses and management teams helps private placement lenders make informed investment choices in private credit.  In addition, covenant protections give lenders a seat at the table alongside other senior lenders during challenging times, allowing them to work closely with issuers to balance borrower needs with the needs of investors.

The pandemic has been different than previous crises, as every industry was affected by the disruptions. Transportation, leisure and travel were among the hardest hit. As a result, private placement lenders worked closely with borrowers alongside other senior lenders to ensure that companies had adequate liquidity to get through what was, at the time, an unknown period. Lenders that provided temporary relief through covenant waivers and adjusted reporting requirements were able to help borrowers maintain liquidity and cover any near-term liabilities.

> THERE ARE CERTAIN INDUSTRIES THAT HAVE BEEN SLOWER TO RECOVER; HOWEVER, BECAUSE WE FEEL THOSE ASSETS HAVE GOOD LONG-TERM VALUE, THAT IS WHERE WE LOOK TOWARD EQUITY TO PROVIDE SOME SUPPORT

This allowed companies to work through these trying conditions and navigate successfully through the pandemic.

**Frank Monfalcone:** I would emphasize that having covenant protections built into the loan documents helps ensure that the private placement lender remains in the most senior part of the capital structure. This not only gives the lender a seat at the table during disruptions, but, we believe, the right seat at the table. Unlike in some circumstances, where bank lenders can jump ahead and become senior to other lenders, private placement lenders stay senior with bank lenders, which is critical in negotiating equitable solutions that work for both senior lenders and the issuers.

**David: What are some of the ways that you are protecting some of your positions and the positions of your investments through these short-to-medium-term difficulties that present themselves as we try to get back to some sense of normalcy?**

**Frank:** Steering affected issuers toward liquidity solutions has been our focus through this crisis. As Jennifer commented, certain industries were more dramatically affected and continue to be slower to recover. However, because those borrowers have business models and assets with good long-term value, we look toward equity to provide some liquidity support. In some cases, borrowers have gone into the public markets for equity infusions, while in other instances, owners have put cash directly into the business to provide liquidity. Lenders have also provided new capital into these businesses based on solid management teams and long-term business prospects.

**Jennifer:** In such cases, we have seen company management teams take the difficult but right steps to manage costs and optimize cashflows, and have been willing to add additional covenant protections and reporting for the near term.

**David: Why has the asset class been a favorite among insurers and how has it helped their portfolios achieve their return goals?**

**Jennifer:** The private placement market originated as an insurance company asset class, given the stable, intermediate-to-long duration, often-illiquid liability base.

In addition, the asset class is very customizable from both a tenor and currency standpoint. Within a diversified insurance company with short and long-duration liabilities, investors can invest anywhere along the curve. Due to a diversified client base, origination opportunities can be in any major currency, across the entire maturity spectrum, including short floaters to long, 30-to-40-year deals. This provides client portfolios with a robust, diversified opportunity set.

Moreover, there are the covenant protections which serve as key structural protections to dampen downside volatility. One of the key objectives for insurers is to minimize losses while generating incremental book yield. This asset class has a demonstrated track record of lower losses relative to other public asset classes, which makes it a nice fit for insurers.

The potential for incremental book yield private placements generate is through a combination of an illiquidity premium, as well as the opportunity for incremental income over time. This can be in the form of coupon enhancements in deals if a credit starts to deteriorate from its original credit profile, for example. This type of mechanism helps protect investors from a potentially higher capital charge. There are also prepayment protections built in to protect against a liability mismatch in a situation where private placement notes might be paid off early. All of these factors have made it an attractive asset class for insurers and one where we have seen increased allocation over time.

**Frank:** These are all reasons that insurance companies have been investing in this asset class for about a century. We believe it is a perfect fit for the industry to generate income to support long-term liabilities. In the past, it took an insurance company with enough size to make private placement investing work; however, through investment managers such as ourselves, the market is now also open to smaller companies.

**David: Have defined benefit (DB) pension plans also benefited from private credit investments? What has been their feedback since allocating capital to the asset class?**

**Tom Metzler:** Many insurance companies match liabilities, similar to DB pension plans. There are many different nuances to those liabilities, which have a lot of different variables.

Often times, publicly traded fixed income serves as a hedge in these portfolios, and we found that private placements may be a nice complement to this allocation. It also provides diversification to companies that do not issue debt in public markets. And we should not fail to mention that it provides incremental income potential over the public markets, in addition to helping manage downside risk in a negative credit environment. We are starting to see that more plans are turning to private placements as they continue to de-risk and look toward other asset classes to allocate their capital.

**David: Can investors gain global exposure through private credit investments and is it dollar-denominated or in local currency?**

**Jennifer:** Absolutely. Quality borrowers from around the world come to the private placement market based on the market's flexibility, efficiency of execution and privacy. Global managers, like ourselves, with offices across North America, Europe, Latin America and Asia can access and closely monitor private placement deals. Having a local presence provides greater opportunities and diversification into unique borrowers. Investments in regions like the UK and Australia also have a very supportive equity investor base, which can benefit a company's long-term credit profile. Managers experienced in hard - and local - currency management can also add value in the asset class.

**Frank:** Some non-US companies issue in US dollars, while others issue in their local currency or even in a third currency. The private market knows how to assess and price these issuances accordingly. This further diversifies an investor's portfolio. We have clients that are specifically looking for this type of global diversification.

**David: Based on your conversations with asset owners, what is the outlook for private credit for the short to medium term?**

**Frank:** We are seeing significant demand from asset owners and investors for the private credit asset class. New investors are coming into the market, and existing investors are looking for new ways to expand their access and allocation to the market. The potential opportunities in the sector continue to be recognized and appreciated by the investor base and I don't see any of this changing. Fortunately, issuance for the last two years has been very robust to support this demand. The market grew from $60 billion per year to over $100 billion[1].

**Jennifer:** We feel the outlook is quite positive, with investors increasing their demand and, as a result, the capital that they are committing to the asset class. The manager's role is to generate and uncover a deep and broad set of private placement investment opportunities for their clients, aligned with their investment objectives. From an issuer standpoint, as the economic recovery continues to unfold and we continue to see more positive news, we expect increased issuance. We believe an increase in capital expenditure and M&A activity will present new opportunities in the private placement market globally.

**David: Thank you for sharing your thoughts on this topic.**

[1] *Source: private placement monitor*


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Registered office: 601 London Road, Westcliff-On-Sea, United Kingdom, SS0 9PE.
Trading office: Business Design Centre, 52 Upper Street, London, N1 0QH

**W** www.clearpathanalysis.com
**T** +44 (0) 207 688 8511
**E** marketing@clearpathanalysis.com
ClearPathAnalys
clear-path-analysis