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Michael Murphy: Why private debt is gaining traction with income investors

By Perpetual Asset Management

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Growth in Australia's private debt market is creating new opportunities for investors seeking income. Michael Murphy, who manages Perpetual's Diversified Private Debt Fund, explains

- Australia's private debt market is expanding
- Diversification helps manage risk and returns
- Find out about Perpetual's credit and fixed income capabilities

Australia's private debt market began to take shape after the global financial crisis, as tighter bank lending rules pushed more borrowers to seek alternative sources of funding.

Regulatory and prudential changes reduced banks' appetite for lending to sub-investment-grade corporates and increased subordination requirements in securitisation structures.

While private debt was once largely the domain of banks, it became accessible to investors.

Private debt includes private loans, such as syndicated loans issued to large corporate borrowers, and securitised assets — bonds secured against a diverse pool of underlying loans, including mortgages, commercial loans and personal loans.

Australia's private debt market continues to evolve, with its expansion broadening the range of opportunities available to investors.

Non-bank lenders are also taking a larger share of the market across mortgages, car loans and unsecured lending.

At the same time, private equity firms in Australia have record levels of dry powder available for deployment. Because these structures typically use leverage, they can create opportunities for lenders.

The leveraged syndicated loan market is growing by around $6 billion to $10 billion in new issuance each year.

Balancing risk across private debt markets

Murphy says diversification is central to investing in private debt.

Perpetual Diversified Private Debt Fund invests across private loans, securitised private credit, high-yield credit — bonds trading below a BBB- credit rating — and investment-grade credit — liquid bonds rated BBB or higher.

One area Murphy highlights is warehouse funding.

Warehouse securitisation can be thought of as a temporary holding structure for loans. When a lender, such as a bank or non-bank financial institution, originates loans, it may later pool them together and sell them as securities to investors.

Before that can happen, the lender needs a place to hold these loans until they are ready to be packaged and sold.

That interim step is managed through a 'warehouse', where lenders can earn income from the underlying loans before they are packaged and sold as a public securitisation.

"Warehouse funding offers lower volatility, shorter maturity (usually one year) – regular income at attractive yields, and strong covenants and controls," says Murphy.

Perpetual's credit and fixed income team looks for issuers and assets with a range of defensive characteristics, including:

- Sound underwriting
- Favourable structural features; and
- Capable management team and strong governance structure.

An important advantage of warehouse funding for investors, according to Murphy, is the short-dated nature of the facilities, which provides flexibility to the fund.

Loan market outlook

Murphy says the performance of borrowers has remained sound despite some economic headwinds.

"We continue to selectively build the fund's loan exposure, seeing attractive opportunities in both the primary and secondary markets," he says.

While the US sees high concentration in software and data centre loans, Australia continues to be concentrated to real estate. Perpetual Diversified Private Debt Fund does not invest in property development, but Murphy says he is seeing attractive opportunities across a variety of sectors.

Perpetual's credit and fixed income team has been investing in the private loans market since 2014, and Murphy says risk is managed through exposure to higher-quality borrowers.

"We're really focused on capital preservation," Murphy says. "We focus on robust structures that can withstand significant downturns without losses on the loans.

"We're focused on high-quality large corporates with significant economic moats.

"We're avoiding property lending and SME lending, where we think the risks are significantly higher."

Hear more from Perpetual's Credit and Fixed Income team

About Michael Murphy and Perpetual's Credit and Fixed Income team

Michael is a portfolio manager and senior high-yield analyst with Perpetual's credit and fixed income team.

Michael manages Perpetual Diversified Private Debt Fund.

Perpetual offers a range of cash, credit and fixed-income solutions.

Our credit and fixed income team are specialists in investing in quality debt.

They take a highly active approach to buying and selling credit and fixed income securities and invest extensively across industries, maturities and the capital structure.

Learn more about Perpetual's Credit and Fixed Income capabilities

Questions? Contact a Perpetual account manager

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