In Depth: Direct Lending – Is Past Performance Promising Too Much?

Stockholm (HedgeNordic) – As institutional investors have been chasing yields on the back of ever decreasing interest rates in traditional fixed-income investments, private debt and direct lending strategies, in particular, have become a mainstream allocation in recent years. As with many alternative investment strategies, direct lending has spread from the US to Europe and has increasingly brought the attention of Nordic investors.

Looking at past performance of the strategy, there is little reason not to look at the asset class as a viable option to traditional fixed income exposures. Over the last ten years, according to the Cliffwater Direct Lending Index, the strategy has delivered 9,6 percent annually to a volatility of around 3.4 percent. But as always, past performance is not indicative of future returns, and the question is if the strong risk-adjusted performance can be contained.

Source: Private Debt Investor

Recent yield compression in the industry suggests that tougher times might lie ahead. Increased competition for deals in certain segments of the market has put pressure on internal rate of returns and an ever-increasing inflow of assets to the industry has also left large amounts unused leaving so-called dry powder, i.e. capital not put to work, at elevated levels.

In an effort to put direct lending strategies into a Nordic context, HedgeNordic has interviewed asset managers and allocators active in the region. We sought to find out what trends that are seen in the industry and among investors, what potential risks that lie ahead and whether the appetite for investments in the direct lending space remains.