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What Role Can Private Credit Play in Individual Investors' Portfolios?

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Private Credit first emerged as a major asset class following the Global Financial Crisis as new regulations such as Basel III increasingly restricted traditional bank lending. Over the past few years, amid capital market volatility and an expanded value proposition, this asset class has now cemented itself as a permanent fixture in investor portfolios as well as in borrower's toolkits. Historically, investors have been able to earn a compelling illiquidity premium without sacrificing credit quality while borrowers obtain certainty, speed of execution, and tailor-made capital solutions. And this year, amid elevated tariff uncertainty, Private Credit is delivering on the value proposition of providing strong yield, while acting to mitigate market volatility.

But questions remain on how, when and whether to incorporate Private Credit into an individual investor's portfolio, so herein we lay out some of the fundamentals especially considering the current dislocation in the market:

- What is Private Credit and how has the market evolved?
- Is Private Credit still attractive?
- What role can Private Credit play in an investor's portfolio?
- Is the concern about risks/a potential bubble in Private Credit warranted?

1. What is Private Credit?

Global Private Credit assets under management surged to more than $1.7 trillion in 2024 and is expected to reach nearly $2.8 trillion by 2028 (Exhibit 1). While this is still a fraction of the $141 trillion global fixed income market, the asset class is gaining traction fast. The landscape is expanding as traditional lenders—particularly in the U.S. and Europe—continue to pull back. As investors seek diversification and stable returns, the appeal of the asset class grows. With its potential for consistent, compounding, and contractual income through Direct Lending and Asset-Based Finance (ABF), Private Credit is increasingly seen as a strategic allocation by both institutional and individual investors.

When most people hear "Private Credit," they picture non-bank lenders providing capital directly to businesses. For one, there are several tranches within Direct Lending. At its core, senior Direct Lending involves senior secured loans extended to middle-market companies—typically those with $50 to $150 million in EBITDA. These private loans usually carry floating interest rates, with returns driven by both the underlying base rate and the credit spread lenders can command, which reflects the premium for illiquidity and complexity. In today's environment of elevated base rates and tight capital supply, both dynamics are tilting in favor of investors. Floating-rate assets have also become increasingly valuable, offering a hedge amid uncertainty around future interest rate moves. Even with some spread compression, higher base rates are keeping all-in yields attractive—particularly for senior secured exposure.

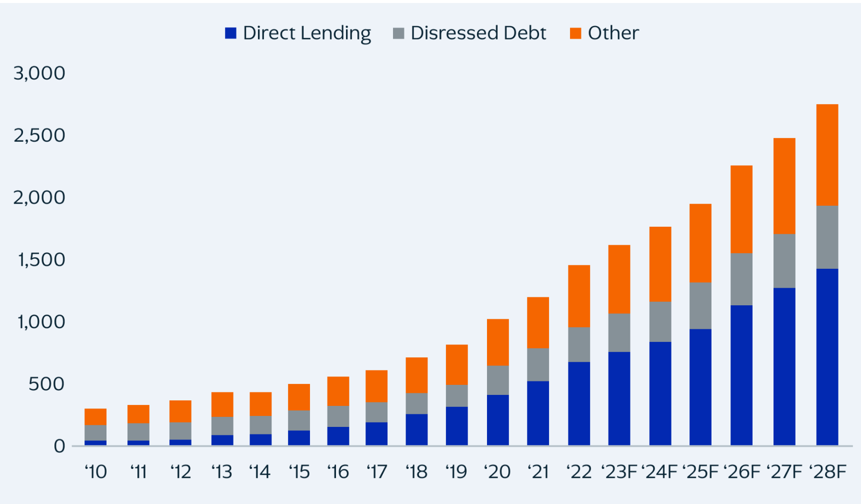
Importantly, Private Credit extends well beyond Direct Lending. Predominantly fixed-rate strategies—such as ABF—represent a significant and growing segment. ABF includes a wide spectrum of investments backed by diversified pools of tangible or financial assets that generate recurring, often contractual, cash flows. Examples include aircraft leases or consumer loans, where the underlying collateral holds intrinsic value. Notably, the replacement cost of physical assets tends to rise with inflation, offering investors both downside protection and a natural inflation hedge.

We believe the structural tailwinds behind ABF are durable. The opportunity set is vast—estimated at over $6 trillion today and projected to surpass $9 trillion—larger than the combined syndicated loan, high yield bond, and Direct Lending markets. A major driver: public companies are increasingly offloading capital-intensive or lower-return assets through securitizations and divestitures, freeing up balance sheets to focus on higher-margin areas. This trend is unlocking high-caliber, previously inaccessible assets for private market investors.

Many segments of Private Credit now offer yields above their 10-year averages—although selectivity and a focus on quality are still critical. The asset class provides access to the enhanced return potential of private markets, while still benefiting from the senior positioning in the capital structure that credit investors value. In today's volatile interest rate environment, investors also have flexibility—gaining exposure to both floating-rate strategies like Direct Lending and largely fixed-rate opportunities through Asset-Based Finance.

Exhibit 1: Global Private Debt AUM, US$ Billions

Global Private Debt Assets Are Expected to Continue Hitting Highs



Other includes Mezzanine, Special Situations, Fund of Funds, Venture. Data as at September 30, 2024. Source: Preqin Future of Alternatives 2028.

2. Is Private Credit still attractive?

Private Credit first came across the radar of many individual investors when inflation and interest rates soared in 2022. Syndicated markets were largely closed, and borrowers flocked to private lenders as an alternative. Lenders could be extremely selective, earning compelling returns on high-quality loans in both Direct Lending and Asset-Based Finance.

Today, we remain in a period of elevated rates as part of our view of high inflation and rate volatility over the next 5 years. That said, we did see interest rate cuts last year as well as some spread compression, and our U.S. macro team expects the U.S. Federal Reserve to continue to lower rates this year as growth slows, but rates should remain higher relative to recent history.[1] As a result, the total return potential in Direct Lending looks better today than it did three years ago as investors can achieve strong returns (cash yields, attractive all-in spread, and absolute yield) without compromising on credit standards or assuming elevated risk (See question 3). Base rates and spreads move over time, but Private Credit has been a source of consistent, compounding income over the long term. Overall, we expect Private Credit to deliver stronger returns over the next five years compared to the past five years, driven by these elevated policy rates and a capital-constrained environment as traditional banks continue to face capital constraints.

[1] In fact, for much of the 14-year-period following the GFC, rates were near zero.

Like Direct Lending, ABF has grown as banks have retrenched. In this case, strategies have often been able to directly acquire the pools of high quality loans banks divested both in the wake of the GFC and the failure of Silicon Valley Bank, for example. The asset class is also a compelling solution for companies that want to focus on stable, higher-margin opportunities e.g., PayPal seeking a partner for its successful Buy Now, Pay Later program).

In volatile times, our Global Macro & Asset Allocation team has put a strong emphasis on what they call "collateral-based cash flows," meaning that the income an investor receives is often contractually determined and tied to a tangible asset with an intrinsic value. Asset-Based Finance fits the bill, and we expect demand for it to continue to rise among both borrowers and investors.

3. What role can Private Credit play in an investor's portfolio?

Private Credit can offer an appealing combination of yield, diversification, and downside protection relative to traditional asset classes. Direct Lending, with its floating-rate structure, provides a natural hedge in uncertain or volatile rate environments. Meanwhile, ABF brings added resilience through its asset-backed nature—offering both downside protection and inflation mitigation, thanks to the tangible value and contractual cash flows of the underlying collateral.

Our three model portfolios (see 2Q25 Global Wealth Investment Playbook) for individual investors consider three different primary investment goals: Generate Income, Preserve Capital, and Boost Returns. In all of them, we recommend an allocation to Private Credit of at least 5% (Boost Returns) and up to 15% (Generate Income).[2]

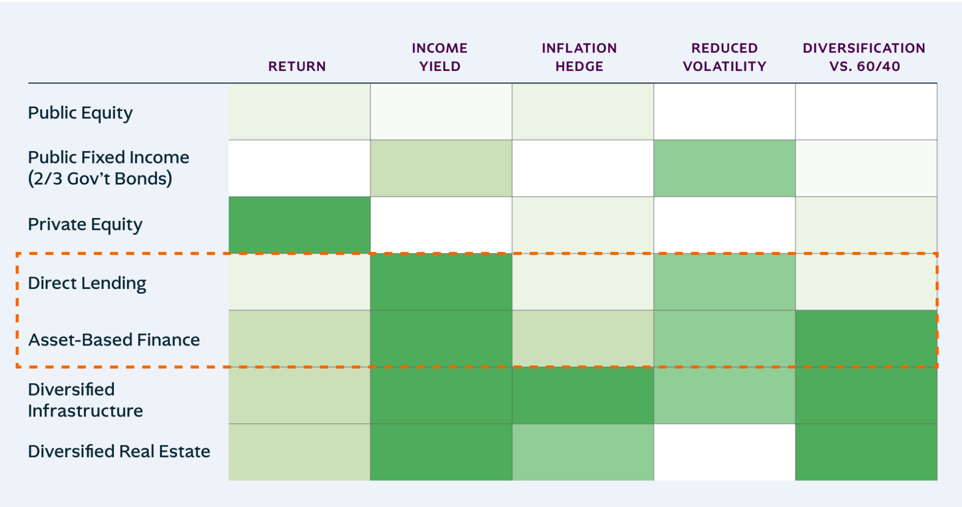
That's because Private Credit can offer a buffer against volatility, compelling yield, a potential inflation hedge, and diversification (Exhibit 2). Let's consider each of these benefits in turn.

Exhibit 2: Global Index Proxies and Their Generic Asset Class Attributes

Factor Analysis Can Empower Investors to Evaluate Asset Class Trade-offs, Informing Portfolio Construction Decisions

Global Index Proxies and Their Generic Asset Class Attributes

Darker Green Signifies More Attractive Attribute



Note - Darker green signifies more attractive attribute. Return refers to expected returns. Income Yield refers to the long run expected cash yield. Asset inflation hedge characteristic is based on exposure to inflation surprise, calculated as the sum of the coefficients in a multi-linear regression with GDP surprise and inflation surprise up to two quarterly lags. Inflation surprise defined as difference between true value and prediction made a year before. Analysis using data as of 09/30/2023, based on following quarterly YoY return data after desmoothing*: Buyout : Cambridge US Buyout from 1986Q2 to 2023Q3 - Growth : Cambridge US Growth from 1988Q2 to 2023Q3 - Infra : Burgiss US Infra from 2000Q3 to 2023Q3 - Real Estate : Cambridge US RE from 1986Q4 to 2023Q3 - Venture Capital : Cambridge VC from 1986Q2 to 2023Q3 - Credit : Cambridge US Senior Debt from 1996Q1 to 2023Q3 : Real Estate Credit : Giliberto-Levy 1 from 1991Q3 to 2023Q3. Factor data from Bloomberg. *Desmoothing model based on Geltner D. (1993a) "Estimating market values from appraised values without assuming an efficient market." Reduced Volatility refers to the volatility of the returns, which have been desmoothed based on Geltner D. (1993a). Diversification vs 60/40 refers to the correlation with a 60% public equity and 40% Global Agg portfolio. Return and Volatility figures calculated using annual data from 2005-2023. Correlations are calculated using quarterly data from 2020 to 3Q 2024, or until available. Public Equity refers to the S&P 500, Public Credit refers to the Bloomberg Global Agg, Private Equity refers to the Cambridge Index, Direct Lending refers to the Cliffwater Direct Lending Index (except for Inflation Hedge which refers to the Cambridge Index), Asset-Based Finance is based on KKR's experience investing in and analyzing the asset class, Diversified Infrastructure refers to a 50% weighting of the Cambridge Core & Core Plus Infrastructure Index and a 50% weighting to the Cambridge Value Added Infrastructure Index, Diversified Real Estate refers to a 50% weighting to the Cambridge Real Estate Index and a 50% weighting to the Giliberto Levy Commercial Mortgage Index. Color shading based on KKR's current and expected assessment of underlying quantitative figures. Source: Bloomberg, Cambridge, Cliffwater, Giliberto-Levy, KKR GBR analysis . For Financial Advisor Use Only.

[2] For illustrative model portfolios, we use 5-15 %; actual allocations depend on an investor's objectives, risk tolerance and liquidity needs.

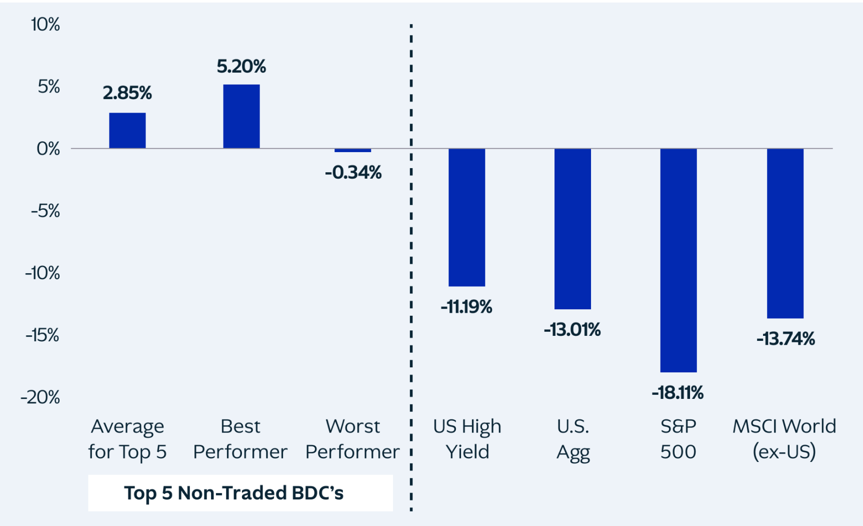
A Buffer Against Volatility

We think Private Credit remains a compelling buffer against volatility. Markets that don't trade every day are not driven by public sentiment, creating less pressure to time investments. Returns in Direct Lending are instead largely determined by spreads and prevailing interest rates. In both Direct Lending and ABF, contractual agreements determine the coupons investors receive.

Direct Lending has historically outperformed stocks and traded credit markets during market corrections, while taking less subordinated risk. In a world where rates stay higher for longer this cycle, we believe that some exposure to floating rate debt and its income generating component is still the prudent approach. The illiquidity premium may act as a solid buffer to absorb growth or default concerns that public markets are less adept at navigating, in our view. Since the fourth quarter of 2005, Direct Lending has generated some 90% of the returns of publicly traded Equities with less than a quarter of the volatility (Exhibit 3).

Exhibit 3: 2022 Total Return, %

Non-Traded BDC's Performed Well During 2022, a Period of Heightened Uncertainty Associated With Interest Rate Spikes and Recession Fears



Data as at December 31, 2022. Source: Bloomberg and fund family websites for the Top 5 non-traded BDCs.

Yield and Returns

Like most private market asset classes, Private Credit offers a stable source of income and a return premium over many publicly traded assets (Exhibit 4). Policy rates seem likely to remain elevated for some time yet, which should result in desirable absolute yields for floating-rate, senior-secured Direct Lending assets (Exhibit 5). All told, we expect Direct Lending returns over the next five years to be commensurate with those of the last five years.

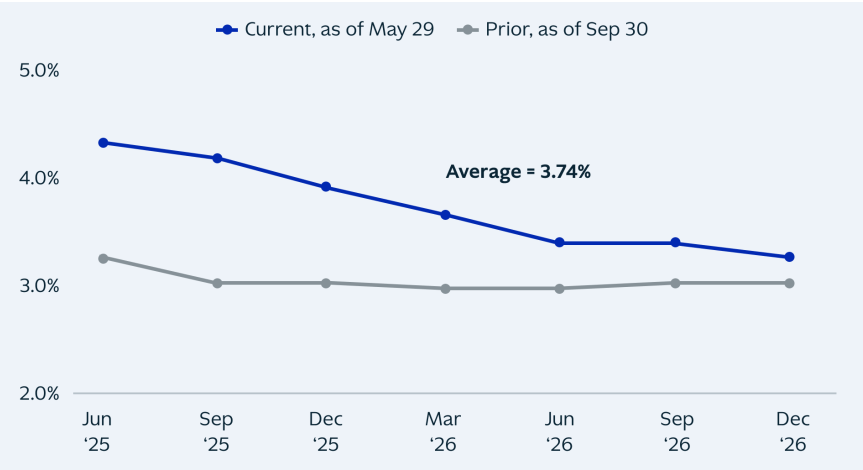
Exhibit 4: Spread to Maturity, Direct Lending vs. BSL Single B, Basis Points

Though It Has Narrowed Due to Recent Market Volatility, the DL Illiquidity Premium Is Still Robust

Data as at March 31, 2025. Source: KBRA DLD.

Exhibit 5: The Forward SOFR Curve, 2025 Current vs. 2024 Prior

A Higher for Longer Rate Environment Can Boost Floating Rate Yields



SOFR = Secured Overnight Financing Rate.
Data as at May 29, 2025. Source: Bloomberg.

Though Direct Lending has captured the most attention over the last several years, yields look even more attractive in ABF.

Inflation Hedging

The floating interest rates in Direct Lending are a clear hedge against inflation, but ABF can also play a role in fortifying investor portfolios when prices are rising. As mentioned above, many ABF loans are backed by tangible assets with an intrinsic value, and inflation is likely to increase the value of these underlying assets.

Diversification

ABF in particular offers investors a way to diversify the credit portion of their portfolios away from government securities and corporate risk and toward the broader economy. The assets underlying ABF loans vary widely: residential mortgages, auto loans, corporate accounts receivable, intellectual property such as music royalties, railroad cars, and for-lease aircraft. It's unlikely that any one economic trend would hit all of these different assets the same way at once. Even if they did, many of the sub-asset classes, such as residential mortgages or auto loans, consists of pools of hundreds or even thousands of individual loans.

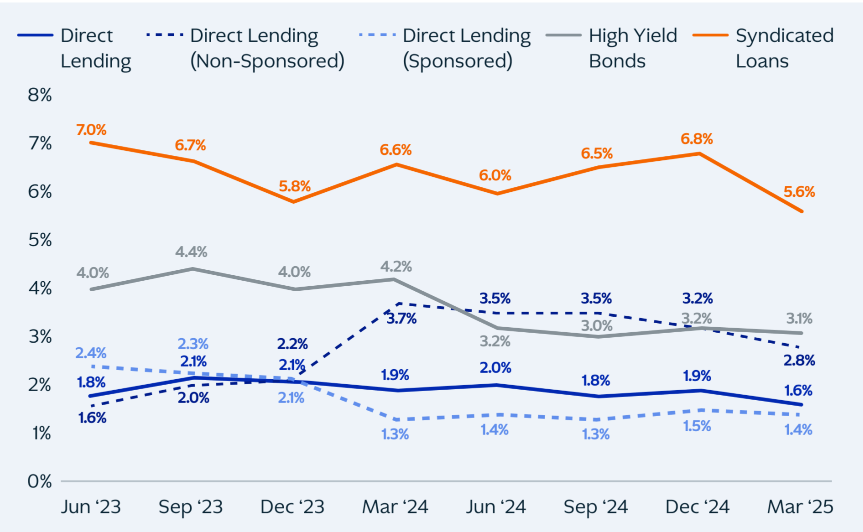
4. Is the concern around Private Credit risks warranted?

Some have argued that Private Credit is in a bubble, but we see a different picture. Private equity firms are currently sitting on approximately $1.6 trillion of dry powder, up from about $660 billion in 2015. As this capital gets deployed, the need for flexible financing will only grow — and Private Credit will be critical to meeting that demand. The rapid growth of the asset class has also raised questions about the transparency of Private Credit portfolios and even the potential for systemic risk. While market volatility always brings a higher likelihood of defaults, we think experienced Private Credit managers have ways to manage this risk and that the systemic risk may be lower than many people realize.

The goal of every credit investor is two-fold: first, to lend to borrowers who seem unlikely to default, and second, structure loans that preserve the lender's capital in the event of default. Private Credit does this well. In fact, average default rates in the asset class over the past two years have been lower than in both Syndicated Loans and High Yield bonds. Along with lower default rates, tighter covenants in Direct Lending have also historically resulted in higher recovery of capital in instances of defaults, leading to overall lower loss rates.

Exhibit 6: Default Rates, %

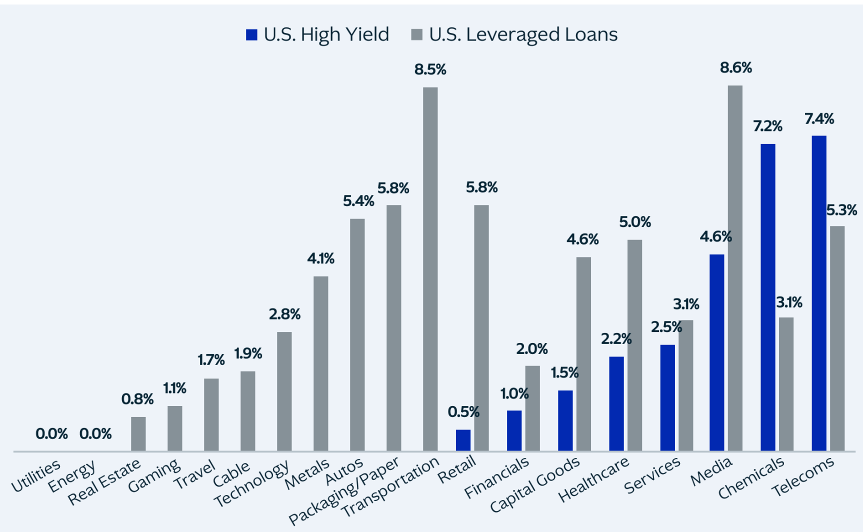
Historically, Default Rates for Direct Lending Have Been Low



Scope: 1,800 US sponsored borrowers, 500 non-sponsored borrowers Direct Lending deals from BDC reports ($175 billion); Calculation: TTM # of Defaulted Issuers/Total # of Issuers; Definition: Payment defaults, bankruptcies, distressed debt exchanges/ restructurings, distressed exits, excludes covenant breaches. Data as at March 31, 2025. Source: KBRA.

Exhibit 7: LTM Default by Sector

Leveraged Loan Default Rates Tend to Remain Low During Times of Economic Distress and Vary Meaningfully by Sector and When Compared to High Yield



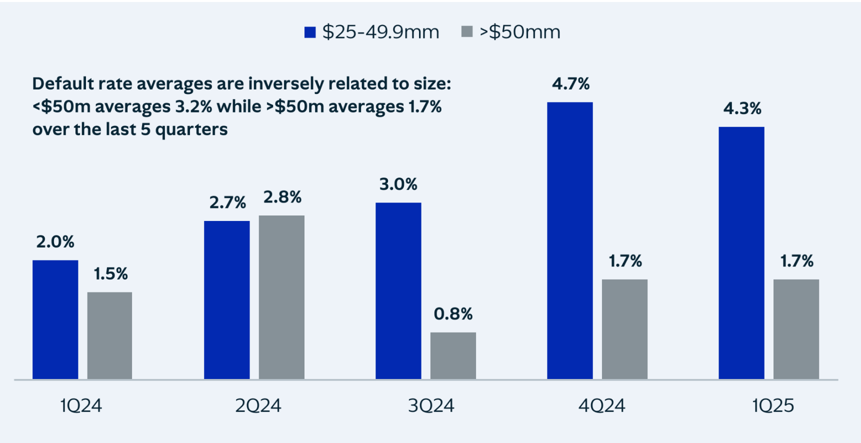
Data as at April 30, 2025. Source: JP Morgan Research.

We think the nature of the market's evolution has also helped the overall risk profile of the asset class Historically, borrowers turned to Private Credit because their credit profiles locked them out of syndicated markets or they needed bespoke financing that was unavailable in public markets. That is no longer the case. The retrenchment of banks since the GFC and the preference among some borrowers for greater speed and flexibility have brought larger, higher-quality borrowers to the Private Credit markets.

That being said, risk management is still paramount. The cumulative impact of a higher interest rate environment is an important consideration for asset allocators. We think optimal portfolio construction depends upon investor type, risk profile, and duration needs. In Direct Lending, our Private Credit teams tend to focus on the upper middle market and large corporations. These businesses have historically been more resilient than their peers (Exhibit 8), and covenant default rates tend to be inversely related to size, with smaller companies notching the most defaults. Larger companies tend to have more options to turn performance around or seek a capital infusion.

Exhibit 8: Average Private Credit Market Default Rates by EBITDA

At KKR, We Believe There Can Be Benefits (and Safety) in Larger, Market Leading Companies



Data as at March 31, 2025. Source: Proskauer 1Q25 Private Credit Default Index.

In ABF, our teams also conduct rigorous due diligence to understand the cash flow profile of assets in granular detail and value the underlying assets to try to determine the volatility of cash flows in a wide variety of scenarios, as well as the recovery potential. As a simple example, when our ABF team evaluates investments with exposure to consumer credit, they look for pools of loans in which the borrowers have relatively high credit scores and incomes.

The structure of loans is also critical in managing risk. In Direct Lending, covenants and other contract provisions can become very important in the event of a liquidity issue. In Asset-Based Finance, deal structures are typically created fresh for every new investment and depend upon the specific nature of the assets, cash flows, and associated risks. Managers with strong origination and diligence teams will have an advantage in mitigating portfolio risk.

Building on this point, we think performance among managers will vary significantly as Private Credit continues to expand and competition for high-quality borrowers increases. In Direct Lending in particular, the entrance of larger, more stable borrowers over the past several years has contributed to tighter spreads and borrowers pushing back on covenants built into loans to protect investors. Larger managers with scaled capital and strong track records are likely to be in the best position to manage this competitive pressure.

Conclusion

Private Credit is a mature market that can offer investors a stable source of attractive yield, with less volatility than Equities. In a higher-for-longer environment, the absolute yields and illiquidity premium available in Private Credit, make a strong case for inclusion in an individual investor's portfolio. At a time of high macroeconomic uncertainty, we also believe a balanced allocation between fixed- and floating-rate structures is wise. The asset class can provide this exposure, and its ability to generate stable income in both high- and low-interest rate environment make the asset class a valuable tool for navigating inflationary pressure. But as Private Credit becomes a permanent fixture in borrower toolkits, we would argue that the steady income, diversification benefits, and illiquidity premium available in all economic conditions make Private Credit a compelling permanent allocation that can help investors achieve their investment goals.

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