

Markets Insight

Private credit isn't the problem – concentration is

Diversification is the foundation of good investing

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Every market cycle has a focal point of worry. For many, the current preoccupation is private credit.

Critics warn that it is opaque, illiquid and vulnerable to a sudden loss of confidence. Some argue that because private credit funds impose limits on withdrawals, retirement savers and individual investors should be kept away from private markets altogether.

But private credit is not inherently dangerous. Concentration is.

History shows that financial trouble rarely stems from the existence of a particular asset class. It arises when investors treat any one source of return as a substitute for a properly built portfolio.

Consider the guaranteed investment contract, or GIC. By the late 1980s, GICs had become the default “safe” option inside many 401(k) plans. They offered principal protection, paid a steady rate and were issued by large, highly rated insurance companies. They seemed uncontroversial. Almost boring.

Then Executive Life Insurance Company collapsed in 1991 after loading its balance sheet with junk bonds to enhance returns. Some retirement plans with significant exposure to its GICs faced withdrawal restrictions and uncertainty. The failure wasn't the GIC structure. It was the combination of insurer-level risk and concentrated exposure, where too much capital depended on a single provider rather than being diversified across issuers and strategies.

This pattern repeats with remarkable consistency. In one decade the worry is junk

bonds. In another, technology stocks. In 2008, it was structured credit. Each episode triggers debate about whether the asset class itself should exist in mainstream portfolios. Each time, that debate misses the point.

Assets don't fail in isolation. Portfolios do. Private credit is not a monolith. It includes senior and junior lending, sponsor-backed and direct corporate loans, asset-backed finance, special situations and secondaries. Risk varies widely depending on underwriting discipline, sector exposure, leverage, structure, geography and, most importantly, manager and investor behaviour.

Lumping all of that together may be convenient for headlines, but it obscures rather than clarifies risk. Concentrating capital in narrow strategies, over-allocating to a single manager or assuming that one source of yield will perform well in all environments has always been a risky proposition. When those bets go wrong, the asset class becomes the scapegoat.

Public markets learned this lesson long ago. Few institutions or advisers would recommend owning a single stock, or even a single stock fund, as a complete equity portfolio. Investors diversify across large, mid, small, growth and value stocks because experience taught them to.

My firm is a manager of private assets but we would argue private credit and equity investing, in general, deserve the same treatment.

Another common critique is that private markets investing's limited liquidity makes it unsuitable for most investors. But liquidity

is not inherently good or bad. It is a design choice. The relevant question is whether the liquidity profile of an investment aligns with an investor's time horizon and overall portfolio construction.

Pensions and endowments have used private markets for decades, not because they expected calm markets, but because those assets – properly diversified – can help portfolios endure turbulent ones. Those programmes are built across managers, strategies and vintage years to reduce dependence on any single market outcome.

The problem arises when access expands without discipline. As private markets move into defined contribution plans and the broader wealth channel, the margin for error shrinks. Investors have different liquidity needs, risk tolerances and levels of experience. That does not argue against access. It argues for applying institutional standards of diversification, transparency and prudence, consistently and honestly.

There will always be another asset class under suspicion. Private credit will not be the last. When the next one comes under fire, it would be worth remembering the lesson of the GIC: don't ask whether the instrument failed. Ask whether the portfolio holding it was built to survive when conditions changed.

Markets evolve. Cycles turn. What doesn't change is this: diversification is not a feature of sophisticated investing. It is the foundation of it.

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