

Private Credit’s Evolution and Role in a Diversified Portfolio

Private Credit has become a core alternative investment for many investors seeking reliable income with compelling yields and diversification from traditional public markets. In this paper, we’ll explain what private credit is, what’s behind its growth, how it functions within an investment portfolio, and some of the risks investors should consider when allocating capital to the asset class.

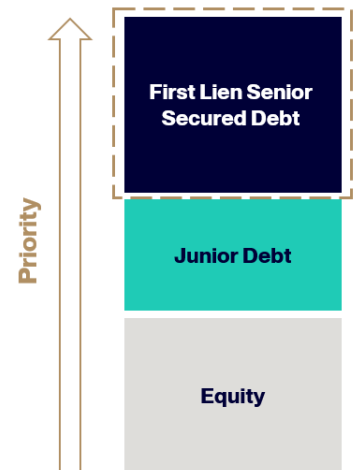
What is Private Credit

Private Credit refers to debt investments originated and held by non-bank lenders, typically through privately negotiated agreements. Unlike public bonds or syndicated loans, Private Credit investments are illiquid, customized, and often structured with strong lender protections.

Private Credit lending happens on a bilaterally negotiated basis where lenders work with borrowers to create bespoke solutions that address companies’ unique needs. By engaging directly with borrowers, Private Credit lenders have more flexibility to negotiate terms, covenants, and pricing, which can lead to better protections and higher yields for investors relative to traditional fixed income instruments.

The largest segment of Private Credit is Direct Lending, which focuses on senior secured loans to middle and upper middle-market companies. These loans typically feature regular cash interest payments and sit at the top of the capital structure, which means they hold the highest priority in the capital structure above other debt and equity.

Illustrative Capital Structure

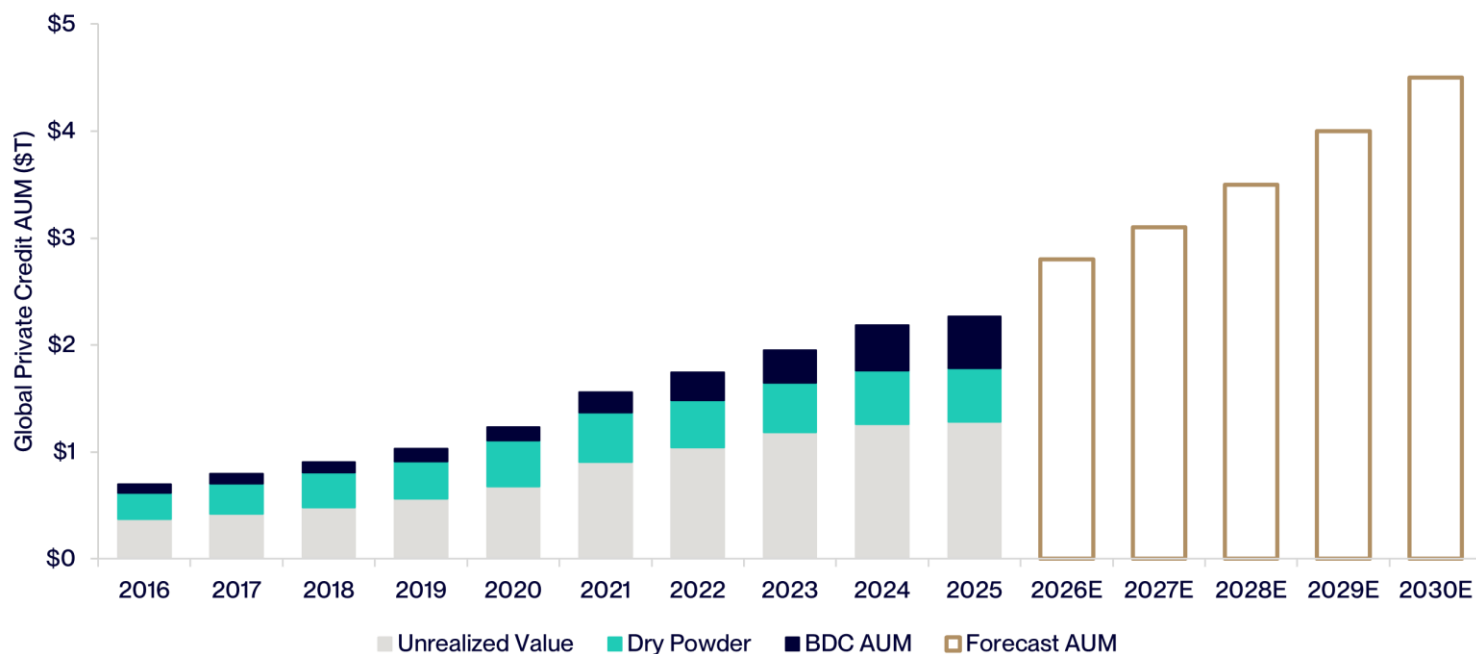


The Evolution of Private Credit

When a company needed a loan to finance operations, expansion or growth, it used to turn to banks. That changed in the last two decades, driven by a combination of industry consolidation and post-2008 financial crisis regulatory changes that made private, sub-investment grade loans economically unattractive holdings on bank balance sheets.

Banks’ remaining lending capital allocation has increasingly focused on larger companies with other revenue adjacencies. Mid-sized companies, generally those with up to \$1 billion in revenue, have simultaneously faced declining access to the two primary sources for Public Credit – broadly syndicated loans and high yield bonds – as both markets have gravitated toward larger offering sizes and bigger companies. Meanwhile, demand for private debt financing among middle-market companies have increased substantially, as companies stay private longer and the role of private equity investment firms continues to grow. Non-bank players such as Private Credit investment managers, insurers, and finance companies, have stepped in to fill the void, seizing on the opportunity to lend directly to middle market companies. As a result, Direct Lending has grown and matured significantly over the last two decades. The current Private Credit market is estimated to be more than \$2 trillion, surpassing the size of the leverage loan and high yield markets.¹ The Private Credit market is expected to continue to scale, more than doubling to \$4.5 trillion by 2030.¹

Private Credit Global Assets Under Management (\$T)¹



As Private Credit has grown, so has its importance in driving economic growth and business development. By providing financing to companies that may not have access to traditional bank loans or public debt markets, Private Credit can help businesses to hire, invest, innovate, and scale. This is particularly important for middle-market companies, which collectively represent one of the largest contributors to employment and economic output in the United States. Without access to Private Credit, many of these businesses could face significant constraints on their ability to grow, compete, and create jobs.

Private Credit’s Value Proposition for Borrowers

The attractiveness of Private Credit for potential borrowers is a key factor driving its growth. Both corporate borrowers and private equity sponsors have demonstrated a willingness to pay the generally higher costs of Private Credit relative to the public market alternatives in order to take advantage of what they perceive as several attractive relative characteristics, including:

Speed and Certainty of Execution. Public markets can be affected by macroeconomic volatility, causing dislocations and pull-backs in lending. Private Credit funding tends to be less affected, making it more available while providing less variation in terms throughout market environments. In addition, Private Credit deals are often executed more efficiently because they typically involve a single or small group of lenders compared to public markets, which could require input from hundreds of lenders.

Customization and Flexibility. Private Credit deals offer customized terms to meet the specific needs of a company rather than the standard terms offered by public markets. The flexibility to draw capital down over time and align capital with a company’s growth needs is an example of a potential key feature in Private Credit deals.

Heightened Degree of Confidentiality. Private Credit transactions are typically negotiated with a single or limited group of counterparties, resulting in enhanced confidentiality throughout the transaction process as opposed to public credit markets. Companies are often sensitive to public disclosure considerations and may pursue Private Credit solutions to achieve greater discretion and confidentiality.

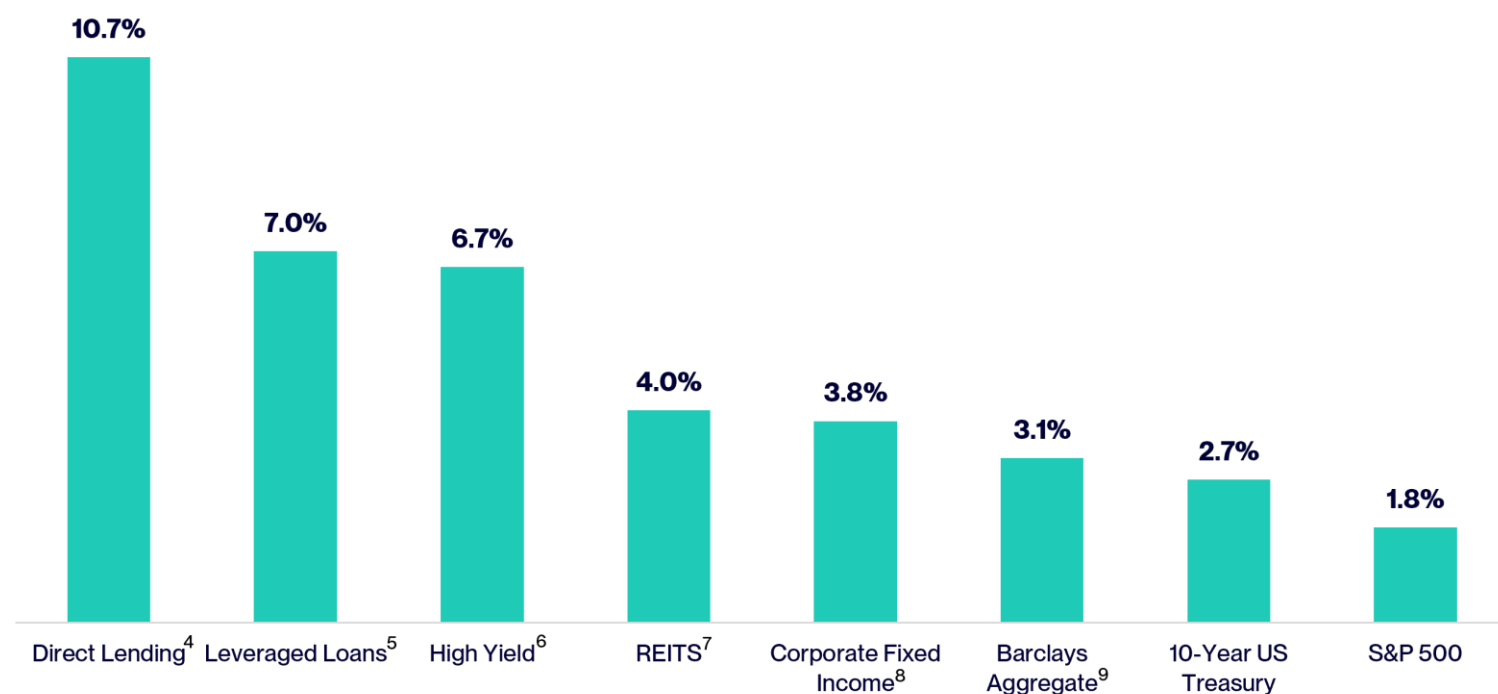
A Partnership-Oriented Lending Relationship. Deals with Private Credit managers come with access to their expertise, insights, and commercial network.

Private Credit’s Value Proposition for Investors

Private Credit strategies offer several potentially attractive features to prospective investors, including:

Premium Yield and Returns. Private Credit has historically offered higher yields than other income-oriented investments such as traditional fixed income alternatives and high dividend-paying stocks. These higher yields have not historically been offset by higher realized losses. Private Credit has generated yields 3.7% higher than broadly syndicated loans and 4.0% higher than high yield, on average, over the last 10 years.^{2,5,6} In addition, Private Credit has achieved total annualized returns that are 3.6% higher than broadly syndicated loans and nearly 3% higher than high yield over the same period.^{2,5,6}

Competitive Yields across Assets (10-Year Average)³



Seniority and Security of Loans. Direct Lending predominantly focuses on senior secured loans. Investments are generally secured by the borrower’s cash flows, physical and financial assets, and tend to be very senior in the capital structure – ahead of equity and any subordinated debt. Loan amounts are typically only 30% to 60% of total asset value, creating a substantial cushion against any potential impairment.

Strong Contractual Protections. Private Credit loans also typically carry a robust set of contractual protections for the lender, called covenants. In addition to the contractual obligation to pay regular interest and repay loan principal on a set schedule, covenants often limit the total amount of debt a borrower can have outstanding and prevent the borrower from incurring additional debt that is more senior to the direct loans or reducing the collateral securing the direct loans. These types of protections can help to create downside protection while also functioning as early indicators of weakening borrower performance.

Floating Rate Structure. Floating rate loans – where the cash coupon of the loan is reset as interest rates change – typically account for most Direct Lending portfolios. This benefits investors in elevated interest rate environments and should better insulate investors in sustained inflationary periods compared to other fixed income instruments and equity. At the same time, these loans are often structured with reference interest rate floors that provide additional yield protection in very low interest rate environments. Investors interested in gaining exposure to Private Credit in their portfolios should consider evaluating the business development company (BDC) as a potential investment structure.

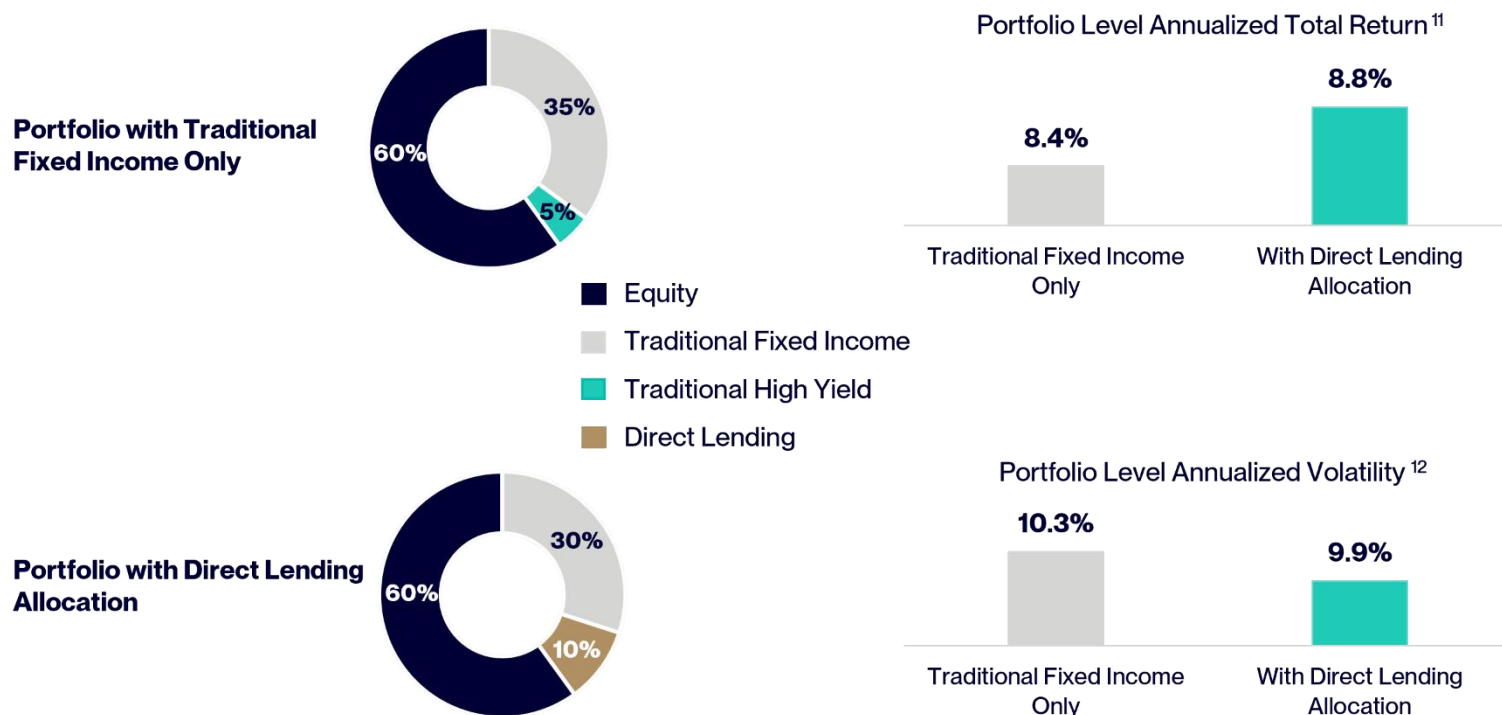
Private Credit’s Potential Fit in Investor Portfolios

Incorporating Private Credit into a diversified portfolio may improve overall income, reduce reliance on public market performance, and enhance resilience across economic cycles. For individual investors, this creates an opportunity to build portfolios that are not only return-oriented but also more balanced and durable. As a result, an allocation to Direct Lending may be worthy of consideration for investors who are:

- Focused on income and current yield
- Interested in portfolio diversification
- Concerned about the impact of elevated interest rates or inflation

For investors with a traditional 60% equity and 40% fixed income allocation, private credit can serve as a complementary component that enhances both return and risk characteristics. By introducing an asset class with a lower correlation to public equities and bonds, portfolios may benefit from improved diversification and reduced overall volatility. Looking at a long-term investment horizon of the last 20 years, portfolios that included a 10% allocation to direct lending outperformed and had lower volatility than traditional 60/40 portfolios.

Adding Direct Lending to a Diversified Portfolio Would Have Improved Return and Risk Efficiency¹⁰



In our view, the steady income, reduced mark-to-market fluctuations, and differentiated risk exposures create a more efficient portfolio with improved risk-adjusted returns over time.

Risks and Other Considerations

Investments in Private Credit strategies carry a number of potential risks. The investments of a Direct Lending fund have credit risk to the underlying borrowers, substantially all of which are sub-investment grade or not rated. These investments may be subject to mark down or loss of capital. In addition, most Private Credit funds have the ability to employ leverage that could ultimately result in the magnification of any potential investment losses.

The underlying investments of Direct Lending strategies are illiquid. Depending on the type of Private Credit fund and its terms, an investment in the fund may have limited or no liquidity; therefore, investors may not have the ability to liquidate their investment when desired or at all. As a result, Direct Lending is not a suitable investment for investors who cannot absorb losses or who require regular or immediate liquidity. Investments in Direct Lending funds are typically subject to fees and expenses, which lower the fund's investment returns to shareholders and are also subject to potential conflicts of interest.

Before making the decision to invest in a Private Credit strategy, investors should consult their financial, tax, and accounting advisors and read the fund's prospectus carefully for a full list of risks associated with an investment in the fund, as well as a description of any fees and expenses.

Conclusion

Private Credit is poised for further growth as an asset class. Historically, Direct Lending strategies have provided investors with attractive risk-adjusted returns, predominantly driven by high cash yield. We believe the historically consistent high-single digit returns, low relative volatility and correlation with traditional investments, and potential for relative resiliency in the face of elevated interest rates and / or sustained inflation make Private Credit strategies worthy of consideration as part of an income-focused investor's diversified investment portfolio.

End Notes

¹ Source: Preqin, Cliffwater, BlackRock. Historical (actual) data from Preqin and Cliffwater as of each calendar year-end and June 2025 (most recent available for Preqin). 2026E to 2030E are BlackRock estimates. There is no guarantee any forecasts may come to pass.

² Source: Cliffwater, data as of December 31, 2025. Based on Cliffwater Direct Lending Senior Index returns from 2016 through 2025.

³ Source: As of December 31, 2025 (latest available for all constituents). All data other than Cliffwater Direct Lending Senior Index is sourced from Bloomberg. Yield is defined as dividend yield for equity, yield to maturity for loans, yield to worst for bonds, and yield to 3-year for Direct Lending. As noted, the yield metrics presented herein are derived using different methodologies across asset classes and, accordingly, are not directly comparable. Differing methodologies are utilized because comparable yield metrics may not be uniformly available or applicable across each asset class. These differing assumptions and calculation methodologies may result in certain asset classes appearing more or less favorable to others. Investors should consider the underlying methodologies and assumptions when evaluating such comparisons. **PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS.**

⁴ Source: Cliffwater Direct Lending Senior Index. It is not possible to invest in an index.

⁵ Source: LSTA Leveraged Loan Index. It is not possible to invest in an index.

⁶ Source: Bloomberg Barclays US High Yield Index. It is not possible to invest in an index.

⁷ Source: MSCI US REIT Index. It is not possible to invest in an index.

⁸ Source: Bloomberg Barclays US Investment Grade Index. It is not possible to invest in an index.

⁹ Source: Bloomberg Barclays US Aggregate Index. It is not possible to invest in an index.

¹⁰ Direct Lending is represented by the Cliffwater Direct Lending Index (CDLI). Equity is represented by the S&P 500 Total Return Index. Traditional Fixed Income is represented by the Bloomberg US Aggregate Total Return Index. Traditional High Yield is represented by the Bloomberg US Corporate High Yield Bond Total Return Index. The index information provided herein is included to show the general trend in the applicable markets in the periods indicated and is not intended to imply that Direct Lending is similar to any index in composition or element of risk. It is not possible to invest in an index, and the returns above do not represent the returns of HLEND.

¹¹ Represents the annualized total return of the indices (in the proportions set forth in the charts showing the "Portfolio with Traditional Fixed Income Only" and "Portfolio with Direct Lending Allocation") from September 30, 2005 through December 31, 2025 for all indices, where return is defined as gross income return, net realized gains (losses), and net unrealized gains (losses) and is prior to any fees and expenses.

¹² Volatility is defined as the standard deviation of quarterly index returns from September 30, 2005 through December 31, 2025 for all indices (in the proportions set forth in the charts showing the "Portfolio with Traditional Fixed Income Only" and "Portfolio with Direct Lending Allocation").

Important Disclosures

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS. The data and information in this material, which has been prepared by HPS Investment Partners, LLC (“HPS”), are presented for informational purposes only. All charts, graphs and images are shown for illustrative purposes only. This material does not constitute an offer to sell or the solicitation of any offer to buy any interest, security, including any interests in any HPS managed funds or accounts, which offer can only be made by definitive offering documentation, which will contain material information with respect to any such interest or security, including risk factors relating to any such investment. All information provided herein is as of the date set forth on the cover page (unless otherwise specified) and is subject to modification, change or supplement in the sole discretion of HPS without notice to you. While this document expresses views as to certain investment opportunities and asset classes, HPS may undertake investment activities on behalf of one or more investment mandates inconsistent with such views subject to the requirements and objectives of the particular mandate. The investments and asset classes mentioned in this document can be highly illiquid, are speculative and may not be suitable for all investors. This document does not provide tailored investment advice and is primarily intended for distribution to institutional investors (as defined under (FINRA Rule 2210(a)(4)). Investing in such investments is only intended for experienced and sophisticated investors who are willing to bear the high economic risks associated with such an investment. Investors should carefully review and consider potential risks as well as their specific investment objectives and experience, time horizon, risk tolerance, and financial situation before making any investment decisions. Nothing contained in these materials constitutes investment, legal, tax or other advice nor is it to be relied on in making an investment or other decision. HPS makes no representation or warranty (express or implied) with respect to the information contained herein (including, without limitation, information obtained from third parties) and expressly disclaims any and all liability based on or relating to the information contained in, or errors or omissions (negligent or otherwise) from, these materials; or based on or relating to the recipient’s use (or the use by any of its affiliates or representatives) of these materials. This document may contain “forward-looking” statements. These are based upon a number of assumptions concerning future conditions that ultimately may prove to be inaccurate. Such forward-looking statements are subject to risks and uncertainties and may be affected by various factors that may cause actual results to differ materially from those in the forward-looking statements. Any forward-looking statements speak only as of the date they are made, and HPS assumes no duty to, and does not undertake to, update forward-looking statements or any other information contained herein. The success or achievement of various results and objectives is dependent upon a multitude of factors, many of which are beyond the control of HPS. The document may not be copied, reproduced, republished, posted, transmitted, distributed, disseminated, disclosed, quoted, or referenced, in whole or in part, to any other person without HPS’s prior written consent. Certain information contained herein, including indices and economic trends, is based on or is derived from information provided by independent third-party sources. HPS believes that such information is accurate and that the sources from which it has been obtained are reliable; however, it cannot guarantee the accuracy of such information and has not independently verified the accuracy or completeness of such information or the assumptions on which such information is based. Any index information provided herein is included to show the general trend in the applicable markets in the periods indicated and is not intended to imply that any investment product is similar to any index in composition or element of risk. The indices are not available for actual investment. No index is directly comparable to the investment strategy of any investment product. Moreover, independent third-party sources cited in these materials are not making any representations or warranties and do not guarantee the accuracy, completeness or availability of any information attributed to them and shall have no liability in connection with the use of such information in these materials, including for any errors or omissions (negligent or otherwise), regardless of the cause, or for the results obtained from the use of such content.

General/Loss of capital: An investment in the asset class or in investment vehicles that invest in the asset class described herein involves a high degree of risk. There can be no assurance that investors’ return objectives will be realized, and investors could lose up to the full amount of their invested capital. **Limited liquidity:** An investment in investment vehicles that invest in the asset class described herein may provide limited liquidity and interests in such vehicles may not be freely transferable or redeemable. There may be no secondary market for interests in such vehicles. **Dependence on Manager:** The manager of any investment vehicle that invests in the asset class described herein may have total trading authority over such vehicle. Decisions made by such manager may cause investors to incur losses or to miss profit opportunities on which they would otherwise have capitalized. **Volatility:** Investment techniques used by an investment vehicle that invests in the asset class described herein may include the use of leverage and derivative instruments such as futures, options and short sales, which amplify the possibilities for both profits and losses and may add volatility to such vehicle’s performance. **Regulation:** An investment vehicle that invests in the asset class described herein may not register as an investment company under the U.S. Investment Company Act of 1940 or similar laws or regulations. Accordingly, the provisions of such laws and regulations would not be applicable.

The foregoing risk factors do not purport to be a complete explanation of the risks involved in an investment in the asset class, or in investment vehicles that invest in the asset class, described herein. Investors in any security should read the entire offering materials of such security before making investment determinations.

Where applicable, this material has been distributed by HPS Securities LLC (“HPS Securities”), an affiliate of HPS and a broker/dealer registered with the U.S. Securities and Exchange Commission and member of the Financial Industry Regulatory Authority (“FINRA”) and the Securities Investor Protection Corporation (www.sipc.org). HPS Securities does not provide research reports.