Blackstone

Essentials of Private Markets

Private Credit

PRIVATE WEALTH SOLUTIONS

Need to Know

01

Growing Demand

Privately held companies **focused on growth** and transformation have increasingly turned to private credit as a source of capital. Working with non-bank lenders, these companies are seeking to meet their capital needs more efficiently through **direct loans.**

02

Defensive Income

Private loans are typically **senior secured** with meaningful cushion below in the form of junior debt and equity. Also, they typically offer floating rate coupons. These features aim to provide investors with principal protection and **high income potential.**[1]

03

Core Allocation

When added to a traditional balanced portfolio of stocks and bonds, private credit can offer **meaningful diversification** and improve risk-return potential.[2]

Basics of Private Credit

Private credit can offer companies a more direct and efficient way to access capital. Private credit managers raise funds directly from investors and lend to corporate borrowers in transactions that often involve a private equity firm. This direct approach—with no bank in the middle—can result in greater efficiency, confidentiality, certainty in execution, and flexibility in terms of structure for the borrower. For the investor, it can lead to stronger documentation, protection, and ultimately more attractive returns.

Particularly for investors looking beyond the 60/40 portfolio of stocks and bonds, private credit can represent an attractive core holding.

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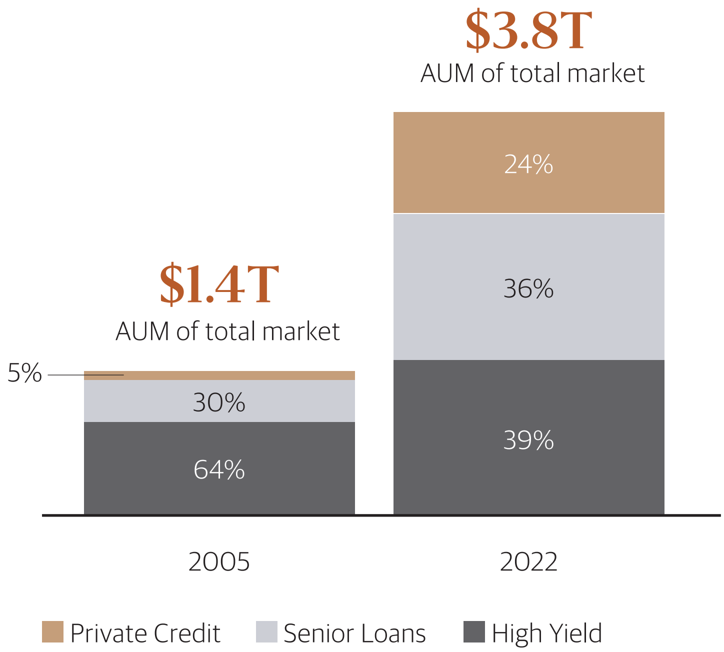
1. Capital is at risk and investors may not get back the amount originally invested.
2. Diversification does not ensure a profit or protect against losses.

Private credit has expanded rapidly for years, in part due to bank consolidation and regulatory change in the aftermath of the Global Financial Crisis. Today, private credit represents more than 20% of the US market for below-investment-grade credit, up from 5% in the mid-2000s (Exhibit 1), and plays an important role in financing large transactions.[3] This trend has been largely driven by private equity activity and companies that are seeking more flexible capital solutions.

EXHIBIT 1: The Growth of Private Credit[3]

US Below-Investment-Grade Credit Market



3. Source: Preqin, Credit Suisse, as of September 30, 2022. The total US below-investment grade credit market is defined as the aggregate of the US high yield bonds, US leveraged loans and North American private credit markets. Leveraged loans refer to broadly syndicated loans.

Why Investors Allocate

Historically, private credit has outperformed traditional credit segments such as high yield bonds and leveraged loans (Exhibit 2), in part reflecting the premium that borrowers pay for the efficiency, confidentiality, and flexibility of private capital. Private credit also has defensive characteristics, such as seniority in the capital structure. Much like a mortgage with repayment priority, private credit investors are paid before junior debt and equity holders (Exhibit 3). High income potential is another feature. Private credit typically consists of floating rate loans, so investors may benefit as income can increase with rising interest rates, and base rate floors can help protect against falling rates.

EXHIBIT 2: Private Credit's Strong Historical Performance[4]

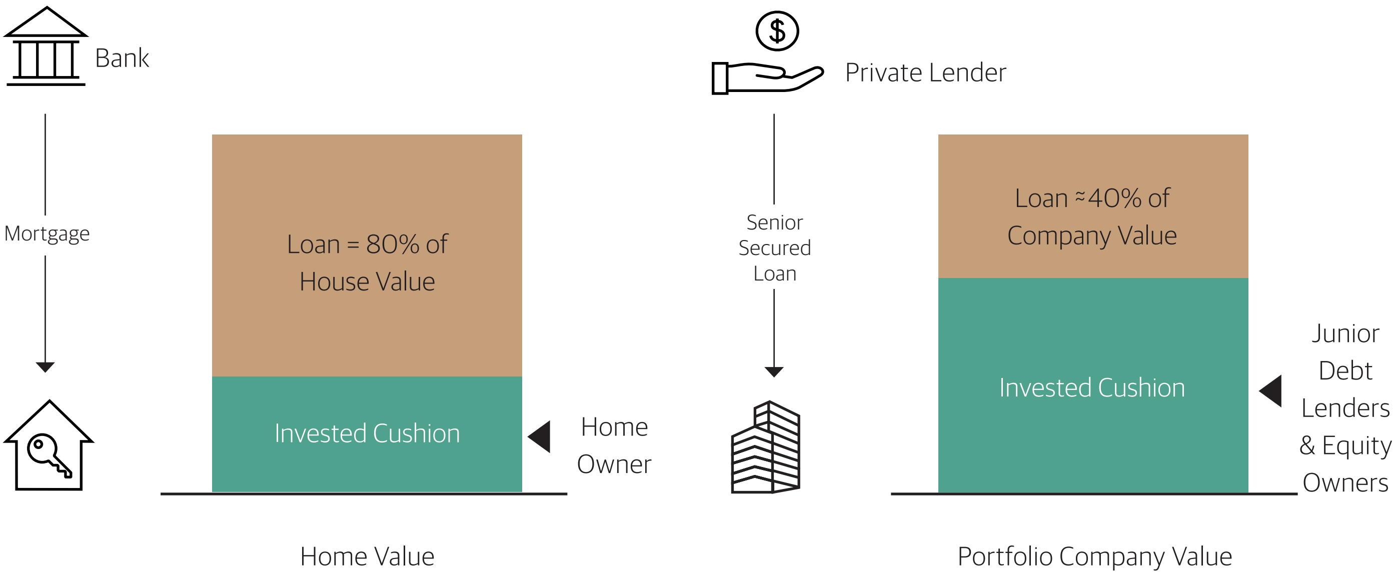
2016	2017	2018	2019	2020	2021	2022	Total Return
17.1% High Yield	**8.6%** Private Credit	**8.1%** Private Credit	**14.3%** High Yield	**7.5%** Investment Grade Bonds	**12.8%** Private Credit	**6.3%** Private Credit	**8.8%** Private Credit
11.2% Private Credit	**7.5%** High Yield	**1.8%** 1-3 Month T-Bill	**9.0%** Private Credit	**7.1%** High Yield	**5.3%** High Yield	**1.5%** 1-3 Month T-Bill	**5.0%** High Yield
10.2% Leveraged Loans	**4.1%** Leveraged Loans	**1.4%** Treasuries	**8.7%** Investment Grade Bonds	**5.8%** Treasuries	**5.2%** Leveraged Loans	**-0.8%** Leveraged Loans	**4.4%** Leveraged Loans
2.6% Investment Grade Bonds	**3.5%** Investment Grade Bonds	**0.4%** Leveraged Loans	**8.6%** Leveraged Loans	**5.5%** Private Credit	**0.0%** 1-3 Month T-Bill	**-0.8%** Treasuries	**1.0%** 1-3 Month T-Bill
1.1% Treasuries	**1.1%** Treasuries	**0.0%** Investment Grade Bonds	**5.2%** Treasuries	**3.1%** Leveraged Loans	**-1.5%** Investment Grade Bonds	**-11.2%** High Yield	**0.9%** Investment Grade Bonds
0.3% 1-3 Month T-Bill	**0.8%** 1-3 Month T-Bill	**-2.1%** High Yield	**2.2%** 1-3 Month T-Bill	**0.5%** 1-3 Month T-Bill	**-1.7%** Treasuries	**-13.0%** Investment Grade Bonds	**0.6%** Treasuries

Managing Risk

As is true of other segments of the sub-investment grade credit market, private credit carries default risk -- how lenders manage it is key to delivering strong risk-adjusted returns. Since private lenders own loans and the corresponding default risk directly (versus risk being traded in public markets), private credit managers typically adopt a highly defensive investment approach. Managers such as Blackstone focus on being senior secured lenders to scaled businesses that are in sectors with strong secular tailwinds and having the right structures in place to protect their investors – a combination which in Blackstone's view is central to delivering attractive risk-adjusted returns.

4. Source: Morningstar, Cliffwater. Represents the annual returns for the respective calendar year, ranked in order of performance. The asset classes presented are based on the following indices: Clifffwater Direct Lending Index for Private Credit, Bloomberg U.S. Corporate High Yield Index for High Yield, Bloomberg U.S. Aggregate Bond Index for Investment Grade Bonds, Morningstar LSTA US Leveraged Loan Index for Leveraged Loans, Bloomberg U.S. Intermediate Treasury Index for Treasuries, Bloomberg U.S. Treasury Bill 1-3 Month Index for 1-3 Month T-Bill. Past performance is not necessarily indicative of future results. There can be no assurance any alternative asset classes will achieve their objectives or avoid significant losses. The volatility and risk profile of the indices is likely materially different from that of a fund. The indices employ different investment guidelines / criteria than a fund and do not employ leverage; a fund's holdings and the liquidity of such holdings may differ significantly from securities comprising the indices. The indices aren't subject to fees / expenses and it may not be possible to invest in the indices. The indices' performance has not been selected to represent an appropriate benchmark to compare to a fund's performance, but rather is disclosed to allow for comparison to that of well-known and widely recognized indices. A summary of the investment guidelines for the indices is available upon request. See "Important Disclaimer Information," including "Index Comparison." Total return is calculated over the period 1/1/2016-12/31/2022.

EXHIBIT 3: Similarities between Home Mortgages and Senior Secured Loans



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Why Borrowers Turn to Private Credit

Aside from the benefits private credit offers to borrowers (Exhibit 4), with the right lending partner, borrowers can also benefit from the lender's scale and the resources of its platform and network.[5] As is the case with Blackstone Credit, the result can be a deeper relationship than is possible with a bank, one that may create value for borrowers beyond the initial loan.

EXHIBIT 4: Blackstone's View: Key Reasons Borrowers Select Private Lending

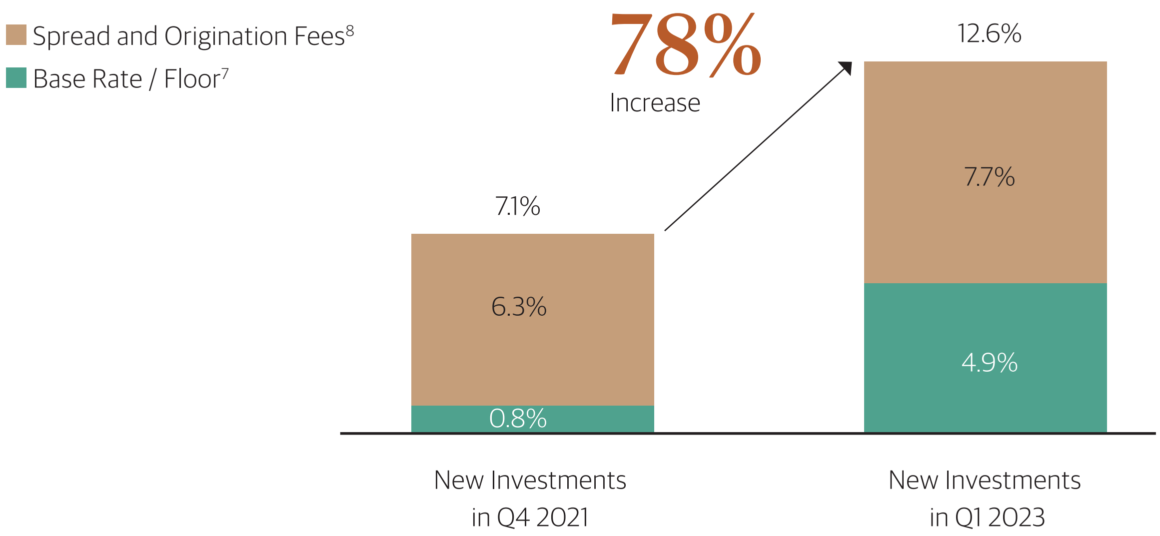
- Efficiency of execution
- Flexible structuring
- Maintenance of confidentiality
- Greater certainty of terms
- Fewer public disclosure requirements

5. Any investment involves a high degree of risk and should only be made if an investor can afford the loss of the entire investment. There are no guarantees or assurances regarding the achievement of investment objectives or performance and you could lose some or all of your investment. Investment performance may be volatile. An investment should only be considered by sophisticated investors who can afford to lose all or a substantial amount of the investment. Fees and expenses may offset or exceed profits. See also "Considerations Before Allocating" on page 7.

Resilience Amid Volatility

Recent trends have served to underscore the role private credit can play in today's marketplace. As interest rates increased in 2022 and markets turned more volatile, the pace of issuance in US high yield bond and leveraged loan markets slowed, driving a larger share of overall deal flow to private credit. The result has been beneficial for both lenders and investors. Lenders have gained an edge in the negotiation process as capital from the public markets has become limited. Investors have received higher income due to the floating rate feature of private credit, which has allowed yields to increase as interest rates have risen.

EXHIBIT 5: Asset-Level Yields Have Increased[6]



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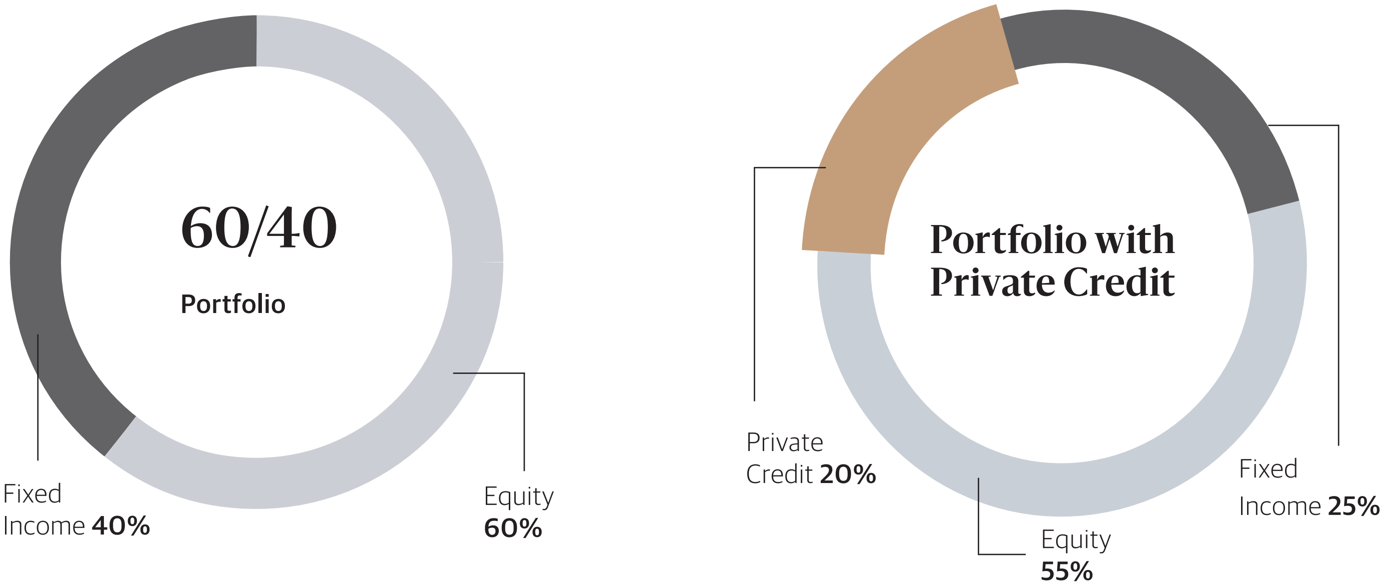
6. Includes all privately originated deals funded in respective quarters. Q4 2021 and Q1 2023 represent periods of contrasting baserates. Yields reflect average spread and origination fees or OID of private deals completed during respective quarters.
7. For "New Investments in Q4 2021", 3M SOFR as of December 31, 2021 was below the floor of 0.75%. For "New Investments in Q1 2023", base rate represents 3M SOFR as of March 31, 2023. For illustrative purposes only. There can be no assurance that rates will rise or at any particular pace.
8. Origination fees are amortized over an average hold of three years.
9. Bloomberg, Morningstar, as of 3/31/2023. Time period is based on earliest common inception. As commonly used in the industry, the 60/40 portfolio is 60% allocated to the S&P 500 Index and 40% is allocated to the Bloomberg US Aggregate Bond Index. Private Credit is represented by the Cliffwater Direct Lending Index. There can be no assurance that any Blackstone fund or investment will achieve its objectives or avoid substantial losses, or that alternative investments will generate higher returns than other investments. Annualized returns and volatility are calculated based on the quarterly returns over the period from October 2015 to March 2023. The yield on the portfolio with 20% private credit allocation was calculated using the annualized S&P 500 Dividend Yield, the annualized Bloomberg US Aggregate Bond Yield, and annualized Cliffwater Direct Lending Index quarterly income. The information herein is provided for educational purposes only and should not be construed as financial or investment advice, nor should any information in this document be relied on when making an investment decision. Opinions expressed reflect the current opinions of Blackstone as of the date hereof and are based on Blackstone's opinions of the current market environment, which is subject to change. Past events and trends do not imply, predict or guarantee, and are not necessarily indicative of, future events or results.
10. Please see "Important Disclosure Information" including "Case Studies."

Historically, private credit has helped to enhance returns, reduce volatility, and improve the income potential of traditional investment portfolios (Exhibit 6). For investors seeking defensive positioning with return potential in the face of interest rate volatility, inflation, and continued uncertainty in public markets, these characteristics may be attractive.

EXHIBIT 6: Reshaping the Risks and Returns of Traditional Portfolios with Private Credit (2015-2023)[9]



60/40 Portfolio

Annualized return	8.3%
Annualized volatility	11.0%
Current yield	2.9%

Portfolio with a 20% Private Credit Allocation

Annualized return	9.2%
Annualized volatility	10.2%
Current yield	4.3%

Providing More Than Just Capital[10]

CUSTOM INK

When Blackstone partners with a borrower, its role is to act as more than just a provider of capital. The **Blackstone Value Creation Program** aims to provide borrowers with the resources needed to increase efficiency and accelerate growth. At Blackstone, more than 90% of borrowers introduced to the Value Creation team actively participate in the program.

In May 2019, Blackstone Credit provided a $280 million direct loan to Custom Ink, an innovative customized apparel brand in the US. Key benefits of private lending, in addition to speed and greater certainty, included the value-add of partnership. By partnering with Blackstone, Custom Ink gained access to the Blackstone Value Creation Program and a breadth of opportunities to cross-sell to other portfolio companies. The goal: accelerate Custom Ink's growth and take its business to the next level.

Patient Capital

From the perspective of the manager, private investing means active value creation, versus passively holding stocks and bonds, which are very "liquid" and can be sold at any time. Private investing involves long-term commitments because value creation generally takes time. This gives rise to the concept of the "illiquidity premium," meaning the return that investors seek to offset the risk of holding a non-liquid asset. This potential return can be pursued in private asset classes through funds with long-term capital lockups as well as those with semi-liquid structures which offer the potential, but not a guarantee, to redeem capital at regular intervals.

Some of the methods used by private market managers include:

- Informational Advantage
- Operating Intervention
- Strong Governance
- Customized Terms

Considerations before Allocating

Manager selection can be important when allocating to private credit. Investors should be aware of considerations such as credit selection and the acumen of the managers conducting borrower due diligence.

Liquidity and time horizons can also be key considerations. The compounding power of private credit returns typically requires a medium- to long-term investment horizon.[11] Investors should carefully consider their liquidity needs within the context of their overall portfolio to determine whether and how much to commit to private credit.

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11. "Medium- to long-term" defined as a horizon of multiple years, for instance 5+ years.

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Index Definitions

Bloomberg US 1-3 Month Treasury Bill: The index measures the performance of public obligations of the US Treasury with maturities of 1-3 months, including securities roll up to the US Aggregate, US Universal, and Global Aggregate Indices.

Bloomberg US Aggregate Bond Index: The Bloomberg US Aggregate Bond Index is an index of US dollar-denominated, investment-grade US corporate government and mortgage-backed securities.

Bloomberg US Intermediate Treasury Index: The index measures the performance of public obligations of the US Treasury with maturities of 1-10 years, including securities roll up to the US Aggregate, US Universal, and Global Aggregate Indices.

Bloomberg US Corporate High Yield Bond Index: The Bloomberg US Corporate High Yield Bond Index measures the US dollar-denominated, high yield, fixed-rate corporate bond market.

Cliffwater Direct Lending Index: The Cliffwater Direct Lending Index (CDLI) seeks to measure the unlevered, gross of fee performance of US middle market corporate loans, as represented by the asset-weighted performance of the underlying assets of Business Development Companies (BDCs), including both exchange-traded and unlisted BDCs, subject to certain eligibility requirements.

Morningstar LSTA US Leveraged Loan Index: The Morningstar LSTA US Leveraged Loan Index is designed to deliver comprehensive, precise coverage of the US leveraged loan market. Underpinned by PitchBook | LCD data, the index brings transparency to the performance, activity, and key characteristics of the market.

S&P 500 Index: The index measures the performance of 500 widely held stocks in the US equity market. Standard and Poor's chooses member companies for the index based on market size, liquidity and industry group representation. Included are the stocks of industrial, financial, utility, and transportation companies. Since mid-1989, this composition has been more flexible and the number of issues in each sector has varied. It is market capitalization-weighted.