Public vs. Private Credit: Finding Their Lanes in 2025

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Key Takeaways

- Private credit's role continues to evolve, with a focus on specialized and complex transactions, as public market conditions stabilize and traditional financing options regain traction.
- Despite higher-risk borrowers, default rates in private credit are converging with those in public markets, reinforcing private credit's maturation as an asset class and a viable fixed income alternative.

Private credit has been one of the most talked-about segments in fixed income markets over the last few years, with investors increasingly looking for ways to understand its role in portfolios. In a recent conversation on the *Basis Points podcast*, I spoke with Vishwanath Tirupattur, Chief Fixed Income Strategist at Morgan Stanley, about where private credit stands today, how it competes and complements public credit, and what investors should expect in 2025.

Understanding Private Credit

While many investors are familiar with public credit markets—investment-grade corporate bonds, high-yield bonds and syndicated loans—private credit remains less understood. Vishy described private credit as an umbrella term, but in its most common form, it refers to direct lending by non-bank lenders. Unlike public debt, private credit is not syndicated, lacks public ratings and does not trade in open markets, meaning valuations rely on third-party assessments. However, it typically offers stronger lender protections and customized loan agreements, making it an attractive alternative in certain situations.

The Competitive Landscape: Public vs. Private Credit

One of the key takeaways from Morgan Stanley's recent report, *The Road Ahead for Private Credit in 2025*, was how improved funding conditions have fueled intense competition between public and private credit. As Vishy explained, the dynamic has shifted significantly over the past few years:

- In 2022 and early 2023, heightened macroeconomic uncertainty and aggressive Federal Reserve rate hikes made deal execution in public credit markets less predictable. This created an opening for private lenders to step in and gain market share.

- By 2024, as public market conditions stabilized, some deals that had previously been financed in private credit returned to public markets. However, instead of eroding private credit's role, this evolution helped each market define its own space.
- Larger, more standardized deals have trended back toward public markets, while private credit has focused on more complex, specialized transactions—such as smaller deals, distressed situations or issuers with unique financing needs.

This competition has led to a degree of convergence in spreads and covenant structures, particularly in higher-quality transactions. However, private credit continues to offer a unique advantage for issuers who may not find a strong public market bid, creating a complementary relationship between the two segments.

Default Trends: Public and Private Convergence

With any discussion of credit markets, defaults are always top of mind. While private credit typically involves lower-rated borrowers—often the equivalent of B- to CCC in public credit—Vishy noted that default trends across private and public credit markets have been converging. Though measuring private credit defaults is inherently more challenging due to varying definitions and reporting standards, current conditions suggest:

- Leverage ratios have stabilized, and interest coverage metrics have improved at the margin.
- Earnings growth expectations remain positive, which should support credit fundamentals.

This convergence further reinforces the idea that private credit is maturing as an asset class and becoming more integrated into the broader fixed income landscape.

What about Returns?

A critical driver of investor interest in private credit has been its yield advantage over public markets. Private credit carries an illiquidity premium, as investors must accept the lack of daily pricing transparency and potential difficulty in exiting positions.

For investors willing to accept the trade-offs, private credit remains an attractive source of yield enhancement within a diversified portfolio.

Final Thoughts

As we look ahead in 2025, private credit and public credit are not simply competing but coexisting in a way that enhances the overall efficiency of credit markets. While private credit's share of deal flow may ebb and flow depending on macroeconomic conditions, its role as a solution for complex or illiquid transactions remains firmly in place. The WisdomTree Alternative Income Fund (HYIN) offers access to higher-yielding private credit strategies in a tradable ETF format, allowing investors to gain exposure to this growing asset class while maintaining liquidity. As credit markets continue to shift, understanding these options can help investors refine portfolio positioning for the year ahead.

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