Credit Market Outlook and Strategy
By Werner Gerber, Group Head of Investment Solutions, Skybound Capital

How do you see the current credit cycle evolving over the next 12–24 months?
We expect modest late-cycle credit tightening and rising refinancing pressure to push defaults slightly higher, especially in weaker or cyclical sectors. Even so, overall fundamentals remain sound and there is still ample private credit capital in the market. This should keep the cycle manageable and create attractive investment opportunities as conditions stabilise into 2025 and 2026.

Where are you finding the most compelling risk-adjusted returns in credit markets right now?
We see the strongest risk-adjusted returns in the less crowded private-credit niches, such as asset-backed lending, trade and structured finance, and selectively in high-quality mid-market or speciality loans. In these segments, floating-rate, senior secured structures and limited competition make it possible to earn meaningful illiquidity premiums while still maintaining strong collateral and protections.

How are higher-for-longer interest rates changing your investment strategy?
Higher-for-longer rates reinforce our focus toward floating-rate, short-maturity credit, stronger borrowers, tighter structures, and prudent leverage. This helps us to preserve income, manage borrower stress proactively, and maintain discipline while staying flexible to redeploy as conditions evolve.

Are there sectors or regions where you see mispriced risk or unusual opportunities?
We see attractive mispricing where fear, regulatory retreat, or structural constraints have pushed yields well above true credit risk. This includes trade finance, select emerging-market and niche consumer loans, asset-backed financings, and discounted bank loan portfolios. By contrast, we are avoiding areas such as certain commercial real estate and legacy low-rate-era loans where spreads still fail to reflect mounting risks.

How do you balance yield and liquidity in your credit fund?
We balance yield and liquidity by matching fund redemption terms to the illiquid nature of private loans. We keep a liquidity buffer to manage redemptions in an orderly way, and we set investor expectations upfront so that they can earn the illiquidity premium without exposing the portfolio to forced sales.

What's your approach to credit risk assessment in private vs. public credit?
In private credit, we must "dig deeper" through full-bank-style underwriting, scrutinising cash flows, collateral, covenants, and management character, and structuring protections to compensate for limited transparency. By contrast, public credit relies more on market data, ratings, and relative-value analysis, making private credit a more bespoke, hands-on, and proactively managed risk assessment process.

How do you stress-test your portfolio for potential macro shocks (eg recession, geopolitical risk, rate volatility)?
We use comprehensive scenario and reverse-stress testing, including recessions, rate shocks, geopolitical and commodity disruptions, borrower covariance, covenant breaches, and liquidity crunches, to ensure the portfolio can absorb severe but plausible losses and to guide proactive de-risking and communication with investors.

How do you manage duration risk given the current yield curve environment?
We manage duration risk primarily by avoiding it, maintaining a floating-rate, short-tenor loan portfolio with matched or hedged fixed-rate exposures. This approach allows yields to adjust quickly, keep asset values stable across yield-curve shifts, and keep our focus on credit spreads rather than interest-rate bets.

How has competition among private lenders affected deal terms and returns?
Competition and capital inflows have made private credit more borrower-friendly, tightening spreads, loosening covenants, increasing PIK features, and pressuring lender protections. As a result, we focus

on proprietary or complex deals where we can still secure strong terms and appropriate illiquidity premiums.

What’s your view on the sustainability of private credit growth relative to traditional bank lending?
Private credit’s growth is structurally durable, driven by bank retrenchment, investor demand, and refinancing needs. While growth may moderate as markets normalise, it is becoming a permanent, complementary pillar of global lending with long-term expansion supported by deep borrower demand and ample private capital.

How do you evaluate borrower quality in a less transparent, private market?
We assess borrower quality in private markets through intensive, hands-on diligence, requiring detailed information, meeting management, analysing cash-flow resilience, collateral and covenants, using independent and alternative data, and maintaining ongoing reporting and engagement. This approach allows us to underwrite with confidence despite limited public transparency.

What types of borrowers or deal structures are you avoiding right now?
We deliberately avoid high-beta or weakly protected borrowers, such as cyclical, highly leveraged, opaque, covenant-lite, PIK-dependent, structurally risky, or jurisdictionally uncertain, and instead reserve capital only to deals where we have strong downside protection and high confidence in resilience through a downturn.

How do you communicate liquidity risk and redemption terms to investors?
We handle liquidity communication by being exceptionally transparent; clearly explaining redemption terms, educating investors on the illiquidity–yield trade-off, providing regular updates on liquidity and stress scenarios, and proactively setting expectations so that investors fully understand the structure, risks, and rationale long before they consider redeeming.

How do you align incentives between fund managers and LPs?
We align incentives by committing our own capital, using LP-friendly fees and hurdles, employing a whole-fund waterfall with clawbacks, limiting fund size, offering fee-free co-investments, and tying team compensation to long-term performance, ensuring we win only when investors do.

What are the biggest misconceptions investors have about credit funds?
A key misconception is that private credit is a “low-risk, high-yield” asset with bond-like safety with equity-like returns. In reality, it carries real credit and liquidity risk, relies on mark-to-model valuations, can see defaults and stress in downturns, and requires clear expectations about illiquidity, volatility, and the limits of rate-driven return gains.

How do you differentiate your strategy from other managers in a crowded market?
We differentiate ourselves by specialising in underserved niches, such as consumer/financial services, credit and trade and structured credit, sourcing proprietary and bespoke deals that require deep domain expertise, structuring strong protections, and pairing this with high GP alignment, transparency, and nimble institutional execution. This creates a strategy that few generalists private credit funds can replicate.

How do you measure performance beyond yield or spread?
We evaluate performance holistically, considering net IRR, MOIC/DPI/TVPI, loss and recovery rates, yield-to-realised-return conversion, and risk-adjusted and benchmark-relative metrics. This approach ensures investors see not just headline yield but true, through-cycle value creation and underwriting quality.

What are your expectations for returns in credit funds over the next few years compared to historical averages?

We expect private credit funds to deliver high-single-digit to low-double-digit net returns, roughly in line with or slightly above long-term averages, benefiting from today's higher yields but tempered over time by eventual rate cuts, modestly rising defaults, and ongoing spread compression.

How do you approach valuation and mark-to-market adjustments for illiquid credit holdings?
We value illiquid loans through a disciplined fair-value process, regularly marking positions based on borrower performance, market spread movements, independent third-party checks, and credit events. This ensures our NAV reflects economic reality without resorting to "mark-to-myth" or unnecessary volatility.

How are technology and data analytics changing credit underwriting?
Technology is transforming our underwriting and monitoring by automating data ingestion, enriching analysis with alternative and real-time data, deploying AI-driven scoring and early-warning systems, and streamlining operations. This enables faster, more informed, and proactive credit decisions without replacing human judgment.

What's your view on tokenised credit or digital private market platforms?
Tokenisation is an early but promising innovation that could make private credit more accessible and efficient, enabling easier transfers, lower minimums, and smarter administration. We remain cautious, monitoring regulatory clarity, platform robustness, and real liquidity before adopting it selectively through pilot partnerships or tokenised share classes.

Are you incorporating AI or alternative data in your credit analysis?
We increasingly use AI and alternative data to enhance underwriting and monitoring, using machine learning, NLP, real-time operational data, and automated benchmarking to flag risks and deepen insight, while still keeping decisions in fundamental, human-driven credit judgment.

How do you see retail investor access to private credit evolving?
Retail access to private credit is set to broaden rapidly through interval funds, digital and tokenised platforms, and lower-minimum vehicles, bringing institutional-grade yields to a wider audience. Success will hinge on strong education, suitability safeguards, and responsible product design to avoid liquidity and risk mismatches.