Luke Stifflear

Episode 239: The Evolution of IG Private Credit: Insights from PPM's Luke Stifflear

GUEST Q & A

Stewart: Welcome to another edition of the InsuranceAUM.com Podcast. My name's Stewart Foley, I'll be your host. Welcome back, it's been a minute since we've done a podcast here, and I'm thrilled to be back with you. We're joined today by Luke Stifflear, who's a portfolio manager, head of investment grade private credit at PPM. Luke, thanks for joining us, thanks for taking the time.

Luke: Oh, it's a pleasure to be here today, thanks for having me.

Stewart: It is a hot one here in Texas today, I'll promise you, it's going to be about 100 degrees, and I know it's summertime in Chicago where you are as well. And looking forward, PPM is a storied firm in Chicago, and I want to learn a little bit more as we go here. But before we get going too far, I want to start this one the way we always do, which is: where did you grow up, and what was your first job? Not the fancy one.

Luke: That's always a tough question for me, coming from a very small town, but I grew up in a place about 20 miles south of Rochester, New York, it is definitely a very rural community. Everyone hears New York and they automatically focus on New York City, but it was definitely a Midwestern town. And then my first job, my very first job was, I was probably about 12 years old, delivering papers at 6:00 AM in the morning, I did that for about 4 or 5 years, until I moved on to being a dishwasher. So, all of those jobs made me go to school and study hard.

Stewart: Yeah, you are another in a long line of paper delivery personnel that we have had on this show of late, and I'm just very happy to have you as part of the team. I was a restaurant worker, which, you graduated to to dishwasher, I was full McDonald's regalia, but always good to get started there. And so, for those people who aren't necessarily from Chicago, or don't know PPM's story, it's a really interesting one, and I was hoping maybe you could start us off with just an overview of PPM, the founding, and how you got to where you are today as a company first.

Luke: Yeah. So, PPM started in 1990; we are the investment management arm for Jackson, we've been wholly owned subsidiary and had been primarily managing Jackson's money throughout the 1990s and into the early 2000s.[1] We have split out into managing third-party monies, which is focused primarily on the insurance channel. We now are a firm that has evolved into about $70 billion of assets under management, about half of that is for the Jackson general account, and the other half is for third-party investors.[2] As you look at our firm, we're split with about $23 billion of assets in public fixed income strategies, $22 billion in private market strategy, which, the investment grade private credit strategy that I manage makes up about $7 billion of that.[2]

(1) PPM America, Inc. (PPM) is an indirect wholly owned subsidiary of Jackson Financial Inc. Jackson Financial Inc. is a publicly traded company.
(2) As of June 30, 2024. AUM includes committed but unfunded capital for PPM's private equity and commercial real estate businesses.

Stewart: So, that's interesting because we've been talking about private credit a fair amount on the show, but we are focused today specifically on investment grade private credit, which is a little different animal. So, can you talk a little bit about the history and scope of PPM's investment grade private credit team, please?

Luke: Yeah. As you look back over the past 3+ decades for private placements or investment grade private credit, it's been primarily insurance company investors that have dominated the market, and that's changed, you and I'll probably get into that a little bit more in our conversation. But with PPM, we started investing in commercial or corporate bonds, corporate traditional privates, back in 1991. In 1992, we started investing in ABS, so developed an expertise there, and 1996 moved in and started doing our first credit tenant lease security transactions.

It's interesting, those deals are typically structured as 20 or 25 year deals, and we've had the opportunity now to see a lot of those roll off, and see how those have played out as far as a smaller segment of the asset class, and see how those have performed. And then, in 2012 we did the underwritings, did the white paper, and started investing in project finance infrastructure. So, as you look at our team now, we've got experience going back 30 years, back into corporate, 30+ years into ABS, a little under 30 years in credit tenant leases, and then about the past 15 years doing project finance and infrastructure. So, those 4 asset classes make up our investment grade private credit strategy.

Stewart: So, talk to me a little bit about what makes investment grade private credit attractive in the market today. There's a lot going on, it seems as though we're getting ready for rate cuts, I think that we saw a rapid... Well, I don't think we saw, we saw a rapid increase in interest rates into 2022, and it seems as though I, that creates some stress in private credit, or is about to, and it seems as though the Fed's getting ready to cut rates. So, can you talk a little bit about the investment grade private credit market right now, and how you would gauge that opportunity?

Luke: Yeah, so first what I want to do is make sure the difference between private credit high yields, which are lending primarily to equity sponsors, which are highly leveraged transactions, typically floating rate, and generally anywhere from 3 to 5 years in tenor, versus the investment grade credit market, private credit market, which I'm talking about today, which are of companies or issuers that are of investment grade quality, they may not always have an investment grade rating from a rating agencies, but they are of investment grade quality. They're typically fixed coupon notes, and the tenor on those bonds are on average anywhere from 7 to 10 years. It's much different than when the general person talks about private credit, they're generally referring to equity sponsored transactions. The investment grade private credit market for decades has been dominated by insurance companies.

We have seen a shift over the past, what I would call probably 5+ years, to where other institutional investors are understanding the advantages to this asset class, and are beginning to allocate monies to the asset class, whether that's across pension funds, endowments, family offices. And one of the things to dispel about the asset class, as soon as you say private, a lot of allocators or third-party managers will want to put it into an alternatives bucket. I do not believe that it fits appropriately in an alternatives bucket, there is just simply not enough juice in this asset class, you're typically picking up anywhere from 75 to 125 basis points over like comparable public bonds, and really, this should be viewed as an alternative to an allocation of investment grade public corporate bonds.

Stewart: In your world, the way you're explaining this, that's where you should be benchmarked, right? It is comparable risk but a private transaction, and as a result it has a liquidity premium that you're calling somewhere between 75 and 125 basis points, but you're not giving quality here.

Luke: Absolutely. And conversely, you're picking up structure, and as I look at the advantages of this asset class, there's three primary advantages and I think these are, in the order of importance, the number one advantage you're picking up is an enhanced covenant protection, that is the primary criterion of why investors are allocating to the asset class. The second then is spread premium relative to comparable public bonds, everybody likes to get more spread. And then third, which generally is not talked about a lot, but as you get into large portfolios that have challenges putting money to work is the credit diversification and access to off-the-run tenors. We make a lot of investments in companies or in issues that simply aren't available in the public market. So, it adds to the diversification of a total portfolio.

Stewart: Is there a way, and I've never asked this, and if this is a dumb question, just tell me, could you pull out of the air an example that would be of a covenant that you would not get in a public bond?

Luke: Yeah.

Stewart: I'm not trying to put you on the spot, but just if you can do it would be good.

Luke: It's actually a great question, and I've got an example. The most common covenant, and I think the most important one that we typically see, is a debt to EBITDA covenant. That's a leverage covenant, which basically is generally set at anywhere from three and a half to four times, depending upon the industry, and what that debt to EBITDA covenant does is it really protects the debt investor from shareholder friendly activities. So, often if you're a public bond investor, you will see companies take actions that are more shareholder-friendly to the detriment of the bondholders, whether they're levering up to make a large acquisition, whether they're doing a great number of share buybacks, or whether they're doing large dividends and increasing the leverage, well, what that debt to EBITDA covenant does is it really protects you from those shareholder friendly activities, and ensures that your bond will stay of investment grade quality. It might go down to a BBB-, bordering down across border credit, but it generally is going to protect you from going down to below investment grade quality, from management actions that are not friendly to bondholders.

Stewart: That's super helpful. And so, when I think about the growth in private credit that you were talking about a moment ago, has investment grade private credit seen comparable growth, and what has been the trajectory there, and how has that market evolved?

Luke: Yeah. So, for our market, it has not grown as quickly as the low investment grade or private credit that lends directly to sponsors. I think the primary reason for that is you've seen the banks pull back much more quickly to those types of lending that they do to those companies, where they haven't pulled back in the investment grade arenas as much, although, I sense that they are beginning to do so as they continue to be very tight with their capital and capital allocations. But we are seeing in our market is we're seeing the banks pull back in some of the alternative structures, such as ABS, and I think that's why we're seeing a great deal of growth over the past 18 to 24 months in private asset-backed securities.

Stewart: Yeah, you make a great point. Let me try to see if I've got the dots connected right. So, we've heard a lot about bank pullback and creating opportunities for private credit, direct lending, and so forth, but what I hear you saying is, yeah, that's true, but that's a riskier part of the market. This is a less risky part of the market, they've pulled back less here, but they still have pulled back, but maybe not quite as much. And then, talk about the asset-backed or the ABS growth that you've seen, is that a result of bank pullback as well, or how do you see the growth in private structure, which is where I think a lot of it's coming right now.

Luke: So, there's two reasons why I think you're seeing growth in the ABS market, specifically with regard to private securities. One is the pullback from the banks, which we're all aware of and we've talked about, the second is the confidence that I have execution across the ABS private market, we're seeing deals get done more quickly, whereas they're getting done with a higher degree of confidence from what agents tell me. And issuers are able to access capital in a way that doesn't require them to go through the 144A or the public format, and they can issue in deal sizes or bond issuance that is not of a $500 million benchmark size. They may be able to do a $200 million deal and still get great execution on it. They may have to offer additional structural protections, but they don't have to do that large size, which investors on my side of the market have a great deal of demand for.

Stewart: You'd mentioned at the top of the show how long PPM has been in this space, can you talk a little bit about how that impacts deal flow? I think that it's worth noting that when you are a consistent provider of capital, you're going to get calls that perhaps newer entrants to the market may not get. Is that a fair assessment? And just help me out with that.

Luke: Yeah, it's a very fair assessment, and I would say it's not only the consistency, but it's also the feedback that we try to give to market participants. As I talk to bankers, obviously on a continual basis, they say what they hate to hear is a ‘no’ after looking at a transaction for 10 days. They'd rather hear a ‘no’ after 1 day. And one thing that we try and do is give very consistent feedback to all of our market participants. If I know that I'm not going to do a deal or purchase bonds from a very first phone call, I will say that, I'm not going to wait until the end of the marketing period in order to tell a banker that. But moving back to what you were mentioning, Stew, as far as consistency, and our tenor in the marketplace, we've been doing this for 30+ years, one advantage I think that we have also is we have a consistent appetite.

We're typically putting to work anywhere from one and a half to $2 billion per year in private placements, and that consistent appetite gives some confidence to the market participants, primarily the investment banks, that they'll be able to get transactions done, versus other market participants that may not have that consistency, or that consistent demand, or bonds, it makes it tough for the bankers to do because this is not as deep of a market as what you see, for example, in the public bond market, where there are many thousand participants or investors. We're looking at generally in this market, you've probably got somewhere between 65 and 75 investors.

Stewart: So, let's talk a little bit about, it's always on the mind of insurance companies, is liquidity. And there's a lot of talk about liquidity in private markets, which I think has largely just been, frankly, untested. I don't think anybody's got the right answer to that today. But can you talk a little bit about the state of current market liquidity in the IG private space?

Luke: Yeah. So, investment grade private credit by its name is categorized as an illiquid market, but what makes it illiquid is the lack of supply versus lack of demand. So, for example, if I get a mandate from an insurance company for, let's call it $100 million, it's going to take me several months to get that $100 million to work into a diversified portfolio, versus on a public mandate, you can go out and purchase that in the secondary market, there's not a liquid supply of secondaries where we can't construct portfolios, rather we're typically, or with 90% of the time, we're buying that through the new issue market.

But if you look at the other way, the demand is very, very strong. So, the illiquidity comes from a lack of supply, not of a lack of demand, but if you're in my position where you're looking to sell bonds, the liquidity is great, because you have a number of investors that are in a supply-constrained market, typically if you're selling bonds that are via a syndicated transaction, there's probably somewhere between 10 to 20 other investors that weren't allocated all of the bonds that they want, so they still have additional demand. We at PPM America are considered to be one of the more active secondary traders in the market, we will trade for a total return basis. And just this year I've sold greater than 10% of our portfolio, and we're typically selling though is anywhere in a 24 to 48 hour time period, what takes longer though is the settlement. The settlement of those bonds can take anywhere from 10 to 12 days.

Stewart: That's super helpful, it leads me to my next question though, which is, what trends are you observing in market issuance? And I don't know if I'm opening a can of worms that doesn't need to be opened, but it seems as though there is, over time, a growing amount of capital chasing high quality assets. Is that what you're seeing today and what's the impact been on spreads?

Luke: Yeah, that's exactly what we're seeing today, and surprisingly, the impact on spreads, the spread premium to public markets is held strong, there's a number of reasons for that. And I think the primary reason is, if you're not getting the spread premium, private investors such as myself, we just pivot to the public market, and we have our public portfolio managers pick up the risk that we need. So, it can be a mistake for investors, if they're seeking to make an allocation to the investment grade private market, but they don't have the ability to pivot back and forth to public markets. Because if the value's not here in the investment grade private credit market, you should be investing in publics.

Stewart: And I don't want to put words in your mouth here, but you run the investment grade private credit part of the shop, I'm assuming by the statement that you just made, that you work closely with the public folks, and you're making a relative value decision that says, hey, I'm not seeing the value in the private side, we should go to public, and vice versa. Is that a fair depiction?

Luke: Yeah, that's spot on. To give you a sense, I sit right outside of our public trading desk, we communicate on a daily basis, we have 8:00 AM meetings every morning to talk about new issuance in the public markets, where spread levels have been, activity that occurred overnight, and how spreads have moved from one day to the next. So, I think it's important as you look at this market, that you have a very strong relative value play versus publics.

Stewart: Very cool, I've learned a bunch, I really appreciate you being on. I've got a couple of fun ones for you on the way out the door, if you're so inclined. The first one is, you grew up in this small town, and I did too, and I can tell you that I didn't know beans from apple butter about investments at an institutional level, what it meant to be a portfolio manager, what a yield spread was, or anything else. And I honestly came home from my first semester in college, and I announced to my grandfather that I was going to open up a used car lot in the front lawn, because that's what everybody else did, and I would be just fine at that. And I still believe I would've been, it's true. But what advice would you give someone who's from a small town like you, in upstate New York, or anywhere else in the United States, who's interested in getting into this business and doesn't feel like they really know how or that they have that opportunity?

Luke: I would say rather than focusing on trying to get into the investment business, you should look at experiences that those that are in the business have, and try and replicate or follow a similar role. So, for example, I didn't end up in the investment management industry as my first job out of college, I started working for a bank and went through a credit training program. So, I think if I were talking to younger people, I would give them the advices of try to determine what type of experiences you need to get to where you want to be 10, 20, 30 years down the road, and accumulate those experiences rather than focusing on the job.

Stewart: That's perfect. Now, here, I've got a really fun one for you. So, you got lunch, it's you and three people, who do you want to most have lunch with, alive or dead? You're in Chicago, there's a lot of opportunities there, who do you want? You got anybody you want, it doesn't have to be three, it could be one, could be two, or up to three.

Luke: That's a good question. People aren't going to appreciate this, but I would say first off, it would be my mom, I lost my mom 2+ decades ago, so I'd like to share with her what's happened in our life, and maybe I've got a couple questions for her.

Stewart: She'd say, "Luke, I knew you'd make it. I knew you were going to do great." That's good.

Luke: Number two, given the division that we have in our country right now, I would say probably George Washington.

Stewart: Wow, there you go.

Luke: I'd want to ask him, when you were putting our country together, what did you envision, and bring our current life examples into what he was thinking at the time, and get his thoughts, I think that would be very valuable. And then, the third one's really easy for me, it would be Jamie Dimon.

Stewart: Wow, there you go.

Luke: I think not only is he a great leader, but as we look at his leadership that he's provided to JPMorgan Chase over the decades, it's just incredible from a stamina standpoint. He's had some health issues, and you look at most CEOs, they can't stand at the top of the ship for that long, it's just too hard of a job, but he's persevered. So, his perseverance, I admire a great deal.

Stewart: Wow, that's great. I can only imagine if you can just think about handing George Washington your iPhone, just handing it, and just go check this out.

Luke: Exactly.

Stewart: That would be crazy. So, I've really enjoyed talking with you, I've learned a lot today, and I want to thank you very much for being on today. I really appreciate it.

Luke: No, thank you Stew, I appreciate the opportunity.

Stewart: My pleasure. We've been joined by Luke Stifflear, who is the portfolio manager and head of investment grade private credit at PPM. Thanks for listening, if you have ideas for a podcast please shoot me a note at Stewart@insuranceaum.com. Please rate us, like us, and review us on Apple Podcasts, Spotify, Google Play, or wherever you listen to your favorite shows. My name's Stewart Foley, we'll see you next time on the Insuranceaum.com Podcast.