Chart of the Week

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How to Launder Your Volatility

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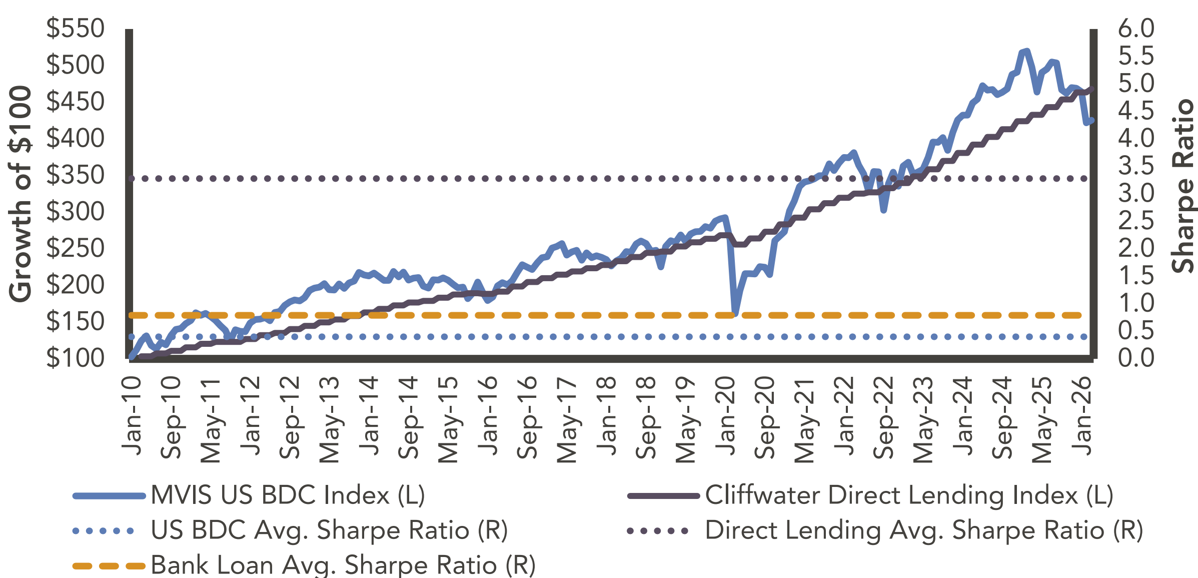
Private credit's seemingly superior risk-adjusted returns are partly a result of infrequent valuations that smooth reported volatility, rather than inherently lower underlying asset risk



Source: Bloomberg, Cliffwater as of March 31, 2026. Cliffwater Direct Lending Index data measured quarterly.

Hi, James Torgerson here! Volatility can be an unsightly blemish on portfolios and lead to inferior risk-adjusted returns. Private credit is just the thing investors need to launder away the pesky volatility that drags down Sharpe ratios! Those looking for an easy way to remove the stains of volatility from their portfolios should look no further! Call the number at the bottom of your screen now! Smoother portfolio returns await!

While the above may sound like a cheesy infomercial, an allocation to private credit can indeed provide numerous benefits, including an income premium, stricter covenants, and attractive long-term returns. Additionally, the frequency with which private credit portfolios are marked (primarily monthly or quarterly) can lead to smoother headline volatility and higher risk-adjusted returns when compared to public credit.

While there is no publicly traded private credit index, listed Business Development Companies (BDCs) can be used as a proxy for the asset class. Listed BDCs are exchange-traded investment vehicles that hold private loans to small-to-mid-sized companies and can offer insights into the differences between the stated volatility of public and private credit portfolios. The chart above shows the cumulative returns for both the publicly listed MVIS US BDC (which is valued on a daily basis) and the Cliffwater Direct Lending (which is valued on a quarterly basis) indices. Additionally, the chart shows the Sharpe ratios (i.e., risk-adjusted returns) for these

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indices, as well as that of bank loans, which are often used as another proxy for direct lending. While the cumulative returns for the BDC and direct lending indices are directionally similar, the publicly traded BDC index exhibits significantly more volatility than the private index (even though the underlying assets are relatively similar in terms of credit risk). Further, when measured from the beginning of 2010 through the end of March, the Sharpe ratio of the direct lending index is 3.3, while the publicly traded BDC and leveraged loan indices show Sharpe ratios of 0.4 and 0.8, respectively, for that time period. Clearly, by listing privately and employing a valuation lag, private credit is able to launder away a significant percentage of a portfolio's volatility.

To be clear, private credit likely has a place in many institutional portfolios, and it is important to remember that the asset class is comprised of much more than just direct lending. However, as the asset class continues to grow and retail investor participation increases, readers should be aware that lower private credit fund-level volatility does not necessarily mean lower volatility of underlying assets.

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