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Principal Investment Grade Private Credit

Principal Asset Management®



PART 2

The private premium

Pricing the value of investment grade private credit

AUTHOR



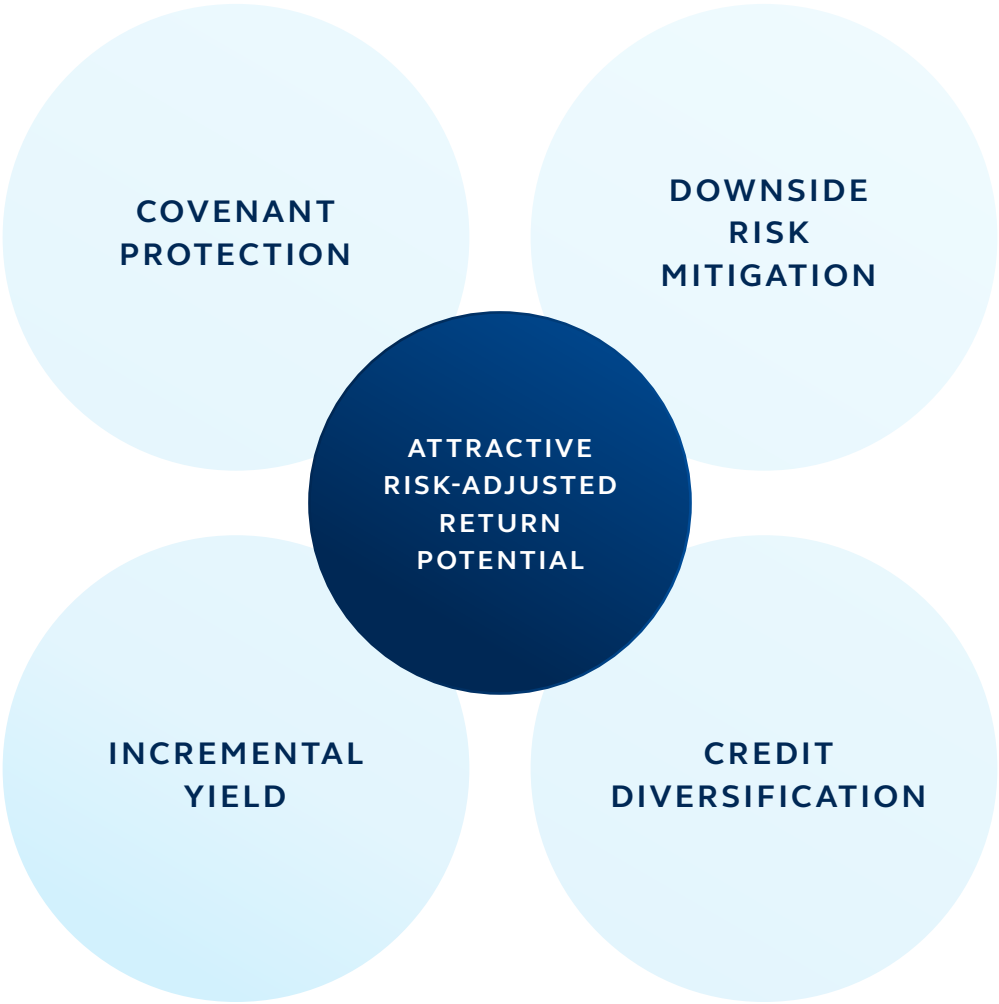
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EXECUTIVE SUMMARY

The first paper in this Investment Grade Private Credit series highlighted the increased focus institutional investors have recently placed on investment grade private credit and identified the spread premium to public bonds, negotiated covenants, structural flexibility, and diversification as the four core pillars of investment grade private credit's value proposition. This second paper in the series examines the premium more closely: what it is, why issuers are willing to pay it, and how much it offers historically and today.

EXHIBIT 1: Investment grade private credit value proposition



A significant component of value related to investment grade private bonds is the yield premium they offer vs comparable public bonds. This premium is often described as an illiquidity premium, but that is an oversimplification. First, private placements may be less liquid than public bonds, but that is not the same as being illiquid. Furthermore, the premium is also compensation for other factors, such as deal structures, complexity, and flexibility the private market offers issuers to meet their unique financing needs. Taken together, independent estimates place the average premium to spreads on comparable public bonds in a range of roughly 20 to 80 basis points, depending on segment and methodology.[*1][*2] Principal's own weighted average premium to publics over the past five years is just over 60 basis points, while reaching 90 basis points year-to-date in 2026.[*3]

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What is the premium to publics?

The premium to publics, also referred to as relative value, is the additional yield a private bond pays over a public bond of comparable rating, sector, structure, and maturity. It is best measured against actual comparable public bonds at current observed pricing in spread terms, not a generic index, since indices and stale pricing can misstate the true added yield. There is no industry-standard methodology for the calculation, which is one reason published estimates vary across managers and external sources.

A less liquid premium, not an illiquidity premium

While the market often labels this pickup an illiquidity premium, that framing overstates the case in two ways. First, investment grade private placements are not illiquid. Demand has risen significantly in recent years, with average oversubscription levels of approximately six times in 2025.*[4] Our own experience illustrates the competitive nature of the market for these limited availability assets: last year, for bids submitted on over $4 billion of bonds, we were allocated around $1 billion.*[3] That intense demand for these assets supports selling into an active secondary market, where a small group of specialist brokers acts as market makers. Other holders of the same private placements are typically the most liquid source of secondary buying. Selling a position generally takes longer than a public bond, and pricing is more negotiated, but this results in *lower* liquidity, where bonds can often be sold in days and weeks, rather than in the absence of it.

Second, liquidity is not the only reason for the premium. Federal Reserve Bank of Chicago research identifies two distinct components: compensation for the discount investors might face in a forced sale and a complexity premium that compensates them for non-standard deal structures or borrowing terms. For that reason, some practitioners prefer the broader term complexity premium to illiquidity premium, since it better reflects the range of factors – structural, timing, and informational – that drive the pickup over public bonds.

Why IG private placement issuers pay a premium

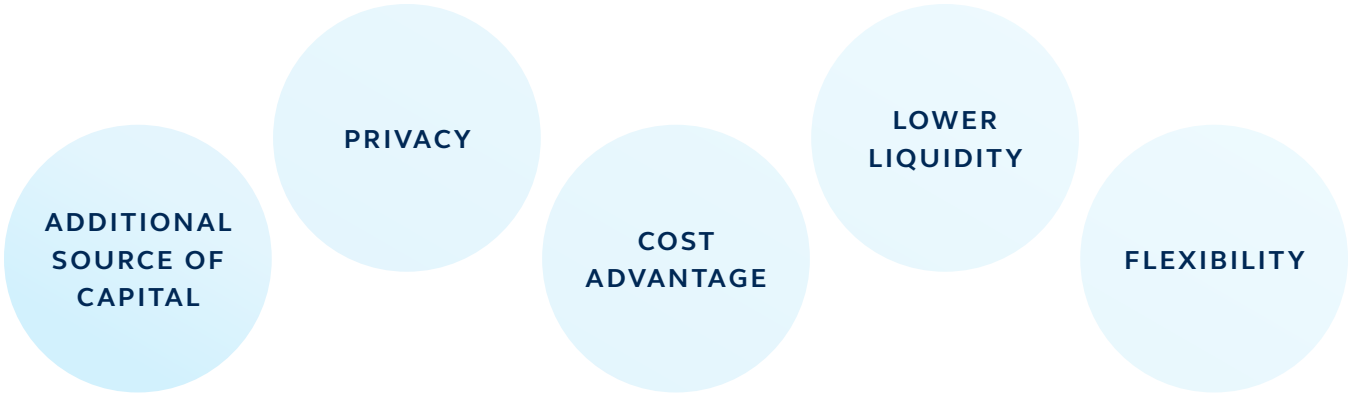
The premium exists because issuers are willing to pay for something the public market does not offer. Historically, the primary motivation was access: many issuers were too small to bring a cost-effective deal to the immense public bond market. As the IG private market has grown, other motivations have become equally important. Some issuers value confidentiality, preferring to share financial information with a small group of lenders rather than disclose it publicly on an ongoing basis. Others are large enough for the public market but want structural flexibility, such as delayed-draw or forward-starting funding that lets them lock in pricing today for capital drawn months later, or amortization schedules tailored to a specific cash flow profile.

A growing number of issuers use both markets, choosing whichever fits their needs at a given time, valuing an established private debt capital market relationship as a standing alternative source of capital if or when public market conditions turn unfavorable.



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EXHIBIT 2: The drivers of investment grade private credit premiums



How much premium?

The premium varies widely and depends on segment, structure, rating, and is further complicated by varying measurement approaches. Analysis by the Federal Reserve Bank of Chicago attributes an average premium of approximately 60 basis points (bps) to investment grade private placements relative to comparable public bonds, varying by segment: 39 bps for non-financial corporate placements and 78 bps for financial sector placements.[*1] The same analysis found private asset-backed securities carrying a considerably wider premium of approximately 156 bps over public asset-backed securities, a reminder that rating alone is not always a true basis for comparison across segments.[*1]

Sector matters within these ranges as well: utility issuers, whose private and public bonds tend to be structurally similar, typically command a narrower premium than both industrial and financial borrowers.[*1]

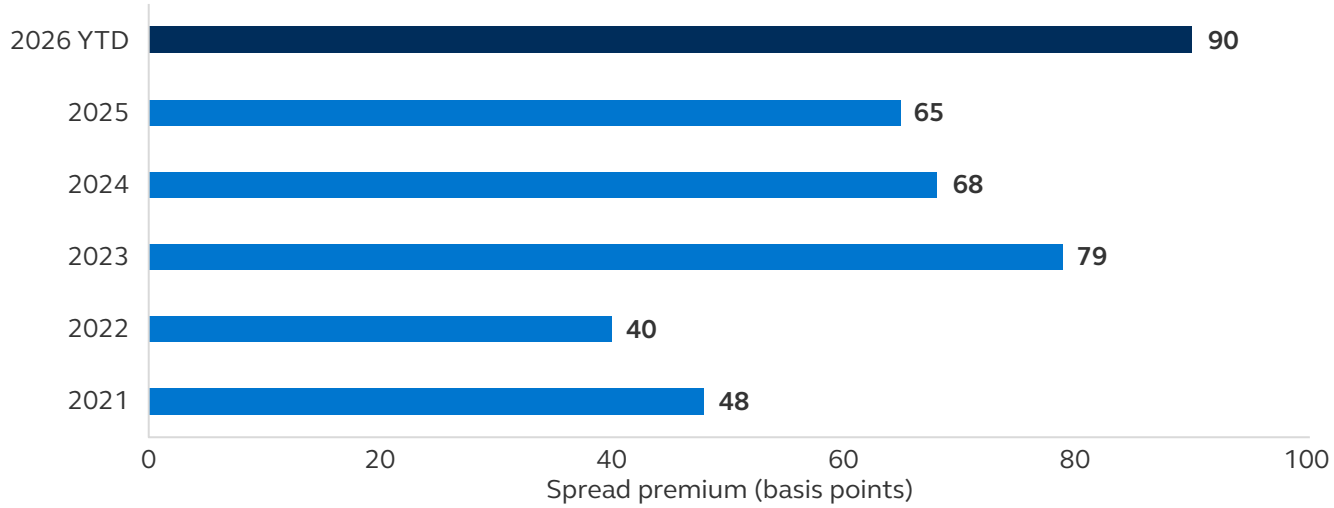
Our experience sits toward the upper end of these ranges. Across nearly $10 billion of investment grade private bond transactions completed over the five years to September 2026, the weighted average premium to publics was 62 bps.[*3] Year-to-date in 2026, the average is 90 basis points across a book with an average rating of A-minus and average life of ten years.

Importantly, our calculation of the premium is based on a conservative methodology. With the support of our public credit desk, our private credit analysts can access realistic pricing on each comparable public bond being used as it would trade today, rather than relying on a stale quoted price or a broad index. Our analysts typically, on average, identify approximately five comparable public bonds per private transaction to calculate an average spread.[*3] This relative value comparison is the final step in an intensive underwriting process, not the first: after assessing the company, industry, issuance structure, covenants, the proposed rating, and the maturity profile, if the resulting spread to comparable public bonds does not clear the threshold those combined factors require, we will likely decline the transaction regardless of how well the borrower scores on other credit metrics.

The premium can vary month to month depending on the mix of deals completed and market conditions. Furthermore, it should be read as an average across a range of mandates rather than a single number for every investor. Clients focused on maximizing relative value and willing to accept lower deal volume as a result can potentially capture premiums toward the upper end of that range.

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EXHIBIT 3: Premium to publics: Principal Asset Management weighted average, 2021–2026 YTD



Source: Principal Asset Management, internal investment data, September 2026.

For additional context, the market's longer-run average premium sits closer to 30 bps, underscoring how far current pricing has moved above history.[*2] Ratings play a role as well, albeit imperfectly: single-A and higher-rated issuances typically command a narrower premium than BBB-range paper, although the relationship can invert occasionally depending on which deals happen to price and the market environment.[*3] There is also a relationship between the weighted average life (WAL) of the bond and the premium, where a short WAL typically demands a lower premium.

Additionally, corporate, infrastructure, and asset-backed premiums each reflect different scales, and blending them into a single average can distort comparisons. For that reason, long-term GIPS-compliant composite returns, which we will cover in more detail in the final paper in this series, can serve as a reliable basis for comparing managers in addition to the headline premium figures.

The widest available premium does not automatically make it the right bond to buy. A wider spread can reflect significant complexity or a level of risk an investor may not wish to take, while a narrower premium can still be the appropriate choice when a transaction offers scarce exposure, strong structural protection, or a close match to an investor's liabilities. The premium, therefore, should be seen as one input into a broader underwriting and portfolio-construction decision rather than a standalone objective.

Market conditions and timing

The premiums in investment grade private debt deals have not been static over time and tend to lag the public market. When public bond spreads widen sharply, private market pricing typically takes a quarter or so to catch up, temporarily compressing the premium available on new deals during that period. The reverse is true when public spreads tighten quickly.

Across a full cycle, the effect tends to even itself out, but investors evaluating the premium at a single point in time should account for if and how the public market has recently moved, not simply the spread on offer that week. In addition, more stable, well-subscribed markets tend to see premiums trend toward the lower end of the historical range; more volatile conditions tend to widen them.

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Structured corporates

The premium to publics is increasing in our portfolio for another reason. As the market has focused more on private debt overall in recent years, originators, agents, and lenders have become more creative in deal design to better meet the needs of borrowers.

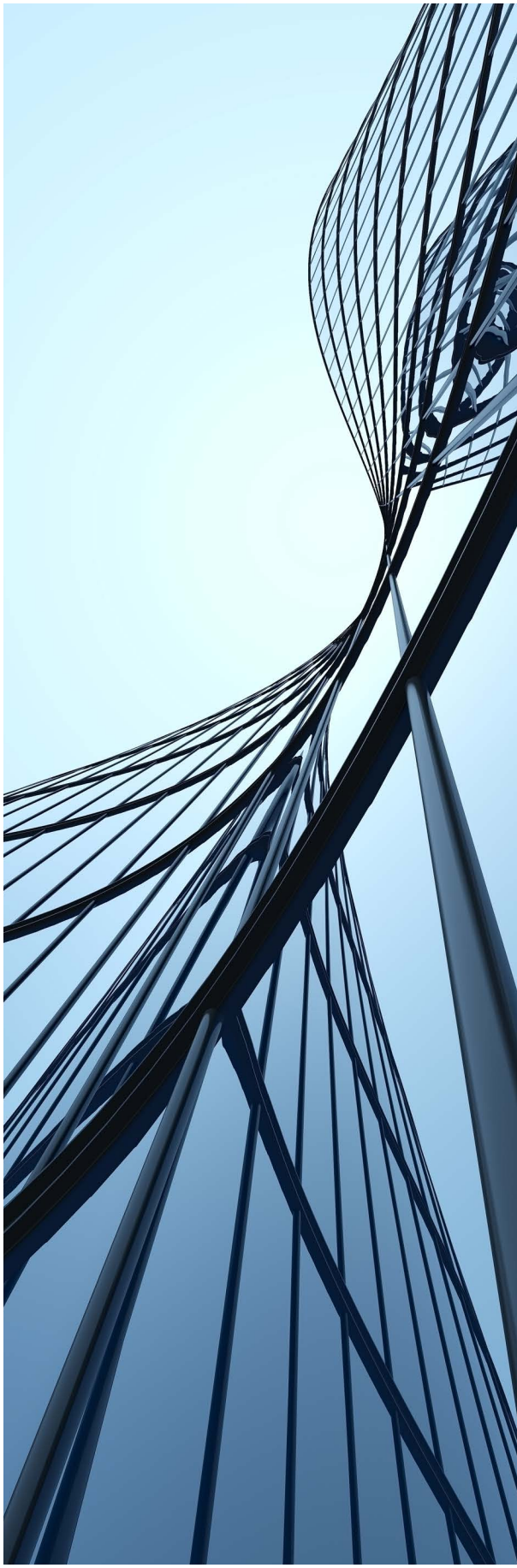
Distinct from investment grade private asset-backed deals, these new designs are often referred to as "structured corporates". A deal is considered a structured corporate when an identifiable, investment grade corporation, or similar entity, is ultimately responsible for the scheduled debt payments and/or repayment of the borrowed funds.

Unlike directly issued private notes, for structured corporate deals, the deal structure puts the company on the hook for the debt. By contrast, in a securitized product (backed by credit cards, mortgages, etc.), repayment comes through asset pools with no ultimate backstop in the form of a corporate borrower. In corporate structured deals, responsibility for repayment can either be provided by or traced to a general obligation of the company (contractual) or via an assigned right to cash flows that are otherwise contractually due to the corporation/entity. These deals are becoming more commonplace and can offer a substantial premium to publics (even when compared to the same corporation in the structure when it has public debt outstanding). However, they require an investment manager with the expertise to parse the structure for viability and perform a thorough credit analysis.

Locking in yields

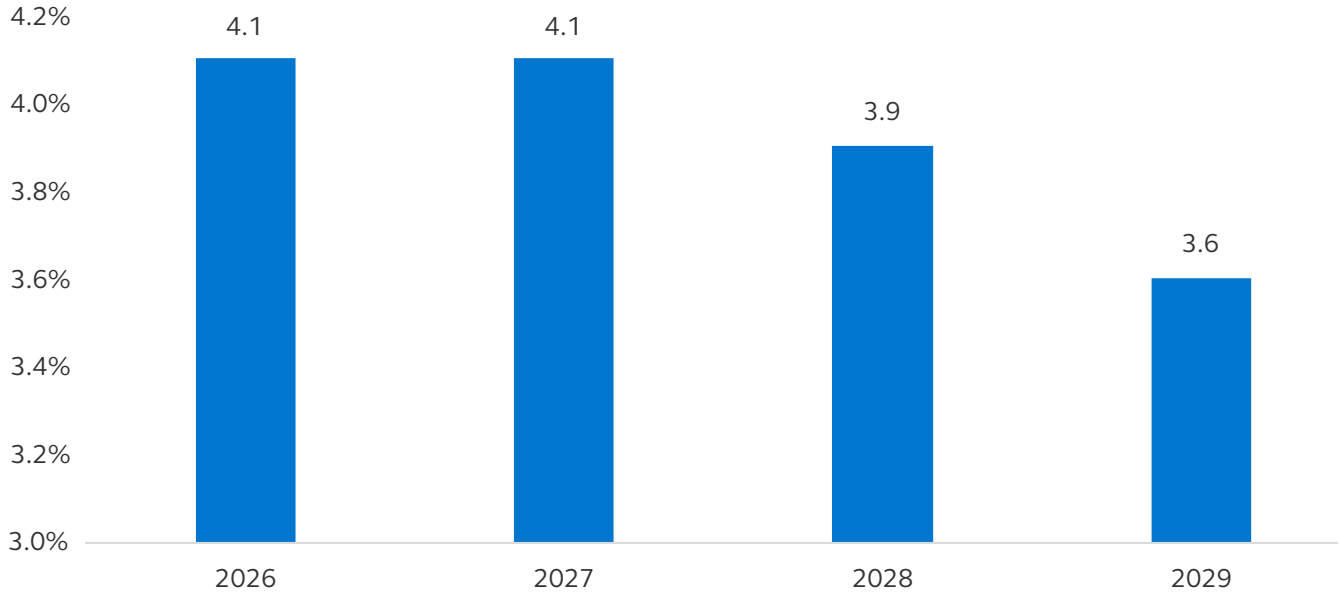
The premium is particularly relevant given where all-in yields sit today and what might happen to interest rates. While forward curves are pricing in at least three hikes over the next 12 months, implying an effective Federal Funds Rate of around 4.8 percent by next September,[*5] the Federal Reserve's own projections put the effective rate at 4.1 percent at the end of both 2026 and 2027, before falling to 3.9 percent in 2028 and 3.6 percent in 2029.[*6]

An investor locking in today's yield for a ten-year private placement is not exposed to rate volatility in the way a floating-rate or shorter-duration instrument is, making the current entry point particularly attractive for long-term institutional allocators. That durability compounds over the life of a ten-year note: even modest further tightening in premiums over the coming years would leave an investor who locked in today's wider spread meaningfully better off than one waiting for a hypothetical improvement in relative value.



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EXHIBIT 4: FOMC median federal funds rate projections



Source: Federal Reserve Bank of St. Louis, FOMC Summary of Economic Projections for the Fed Funds Rate, Median, September 2026.

It is also worth noting how value is captured. Unlike public bond portfolios, where total return is often supplemented by active trading around fundamentals and relative value, private placements are largely a "buy-and-hold" allocation, also referred to as "buy-and-maintain". The premium is captured primarily at origination, and secondary trading among existing holders is not typically a meaningful source of additional portfolio return. That reinforces the importance of getting the initial underwriting and pricing discipline right.

Downside risk mitigation reinforces the case

The premium is not compensation for additional risk. Historical loss rates on private placements have historically run below those on comparable public bonds, a difference attributed to the covenant protections and closer lender engagement available in the private market.

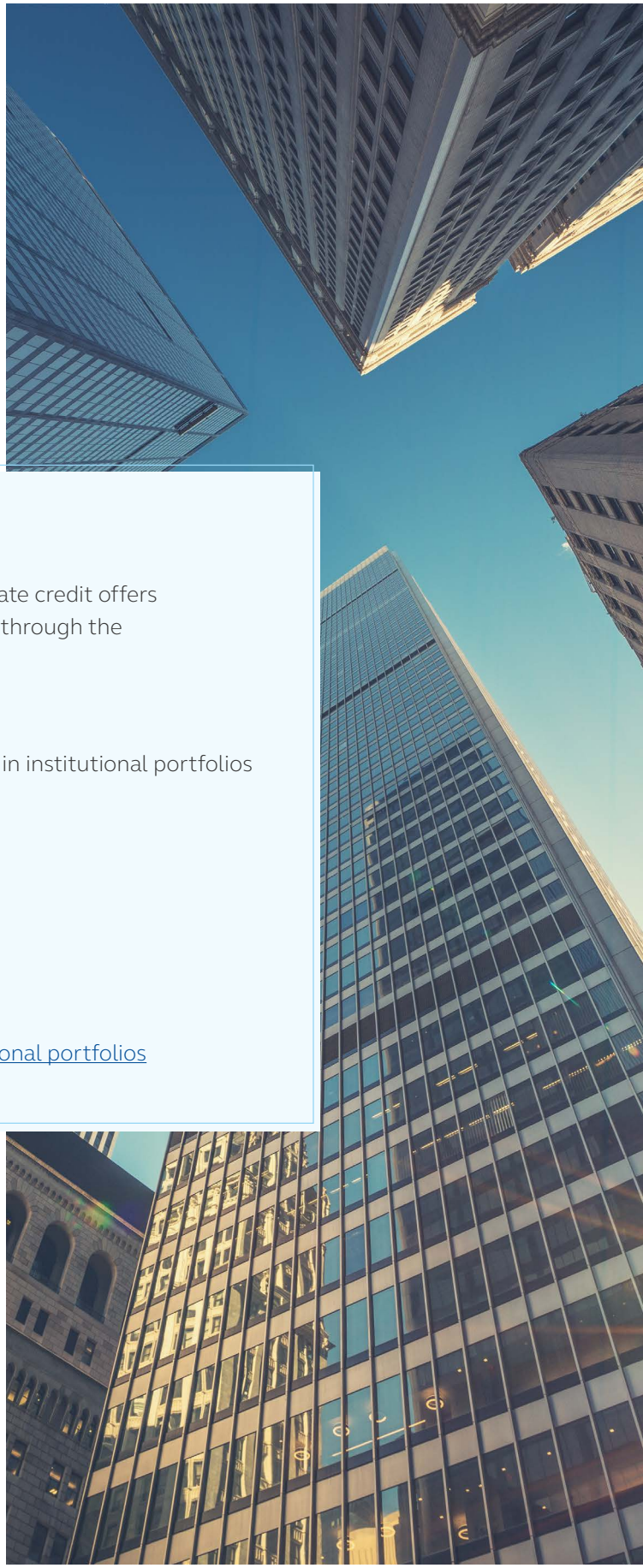
Federal Reserve Bank of Chicago analysis puts historical loss rates approximately 14 percent lower for private placements than for comparable public bonds, consistent with academic research showing that a smaller, more concentrated investor base makes negotiated restructuring easier and less costly than the alternative available to widely dispersed public bondholders.[*2] Combined with the diversification benefits detailed in the first paper in this series, historical data suggests the premium may contribute positively to risk-adjusted outcomes.

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Conclusion

The premium available in investment grade private credit has historically existed over certain periods and may reflect a combination of factors including market structure, complexity, and liquidity characteristics. It also compensates investors for structural complexity, scarcity, and the flexibility issuers value, and varies depending on segment, WAL, rating, and market conditions.

While yields remain at elevated levels relative to the past decade, we believe the case for capturing that premium today and locking it in for a full market cycle looks as strong as it has in years.



Continue the series

This paper examined the premium investment grade private credit offers over public bonds, why issuers pay it, and how it holds up through the current rate cycle.

This is the second installment of a six-part series:

- The expanding role of investment grade private credit in institutional portfolios
- The private premium
- Understanding covenants
- Mitigating downside risk
- Diversification of fixed income portfolios
- Selecting an IG private credit investment manager

READ PART 1:
The expanding role of investment grade credit in institutional portfolios

[*1] Federal Reserve Bank of Chicago, Life Insurers' Private Credit Investments and Annuity Market Share Capture, April 2026.

[*2] Federal Reserve Bank of Chicago, Privately Placed Debt on Life Insurers' Balance Sheets, May 2024.

[*3] Principal Asset Management, internal investment data, September 2026. Five-year figures cover $9.5 billion of investment grade private investments; results reflect Principal's own investment experience and are not market averages.

[*4] JP Morgan Securities estimates, January 2026.

[*5] Federal Reserve Bank of Atlanta, Market Probability Tracker, September 2026.

[*6] Federal Reserve Bank of St.Louis, FOMC Summary of Economic Projections for the Fed Funds Rate (Median), September 2026.

Risk Considerations

Investing involves risk, including possible loss of principal. Past Performance does not guarantee future return. All financial investments involve an element of risk. Therefore, the value of the investment and the income from it will vary and the initial investment amount cannot be guaranteed. Private placements are subject to liquidity risk, credit risk, valuation uncertainty, and issuer-specific risks. Historical spread premiums, recovery rates, covenant protections, and loss experience may not be repeated in future market environments. The strategy's objective of downside risk reduction/protection may or may not be successful and as a result investors must be prepared to bear capital losses, including a loss of capital invested. Private credit involves an investment in non-publicly traded securities which are subject to illiquidity risk. Portfolios that invest in private credit may be leveraged and may engage in speculative investment practices that increase the risk of investment loss.

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