



PARA BELLUM ADVISORS

FAMILY OFFICE · PRIVATE CREDIT ALLOCATION

Alternative Lending Hedge for a Private Debt Portfolio

SCENARIO TYPE	Family Office – Private Credit Allocation
ASSET CLASS	US Middle-Market Direct Lending (Illiquid) with Synthetic Credit Hedge
RISK FOCUS	Unhedgeable credit exposure, mark-down risk, liquidity asymmetry, basis risk, governance survivability
PRIMARY OFFER	Structuring-as-a-Service™
RELEVANT SERVICES	Synthetic hedge architecture · Governance design · Hedge ratio calibration · CDS + TRS execution design · Monitoring framework

THE SITUATION

A US-based multi-family office built a meaningful private credit sleeve to solve a practical problem: income. Traditional fixed income was no longer carrying its weight. Direct lending filled the gap – senior secured loans, floating rate, double-digit yields. On paper, the most sensible part of the portfolio.

The problem was not performance. The problem was irreversibility.

Eighteen months after deployment, the office held dozens of private loans across multiple managers – all illiquid, all untradeable, all marked quarterly, all exposed to a deteriorating credit cycle. When public markets sold off, there was nothing to sell. When spreads widened, there was nothing to hedge directly.

The exposure was behaving like credit. The controls were behaving like hope.

HOW THE TRAP FORMS

Private credit looks benign on entry. Early returns are smooth. Income arrives on time. Marks are stable. Governance relaxes because nothing is visibly broken. Then conditions turn.

Public credit reprices immediately. Private credit reprices later – and then all at once. The lag creates a false sense of control long enough for exposure to become psychologically anchored.

At that point, three constraints lock in: there is no secondary market that clears at anything resembling fair value under stress; there is no single-name CDS for middle-market private borrowers; and broad index hedges do not line up cleanly enough to be relied on.

The portfolio is no longer diversifying income. It is a block of credit risk that cannot be reduced, transferred, or explained away.

WHAT TYPICALLY BREAKS

Direct CDS unavailable

No CDS market exists for private borrowers. The hedge instrument most people reach for first simply does not exist at this end of the credit spectrum.

Index hedges mismatch

Broad high-yield and leveraged loan indices hedge something – not enough of the right thing, and not reliably when it matters most.

Secondary sales are punitive

Forced secondary sales clear at material discounts. The market exists – it just does not clear at anything a sensible investor would accept voluntarily.

Governance fatigue kills execution

The real failure mode is not basis risk alone. It is losing confidence in the hedge at precisely the wrong moment and abandoning it before stress resolves.

THE STRUCTURAL INSIGHT

Private credit is not unhedgeable. It is multi-factor.

Most portfolios behave as a blend of leveraged loan beta, sector-specific credit risk, broad spread risk, and idiosyncratic borrower outcomes. Trying to hedge all of that with a single index is what creates disappointment.

Once the exposure is decomposed properly, a different design becomes possible – not to eliminate loss, but to compress drawdowns into something survivable. The difference between living with private credit and being trapped by it.

The structure was sized to behaviour, not theory. Hedge ratios were deliberately imperfect but stable. Costs were explicit. Rebalancing rules were limited and pre-defined. Governance was designed alongside the structure – not as an afterthought.

INTENDED OUTCOMES

- ▶ Drawdowns compressed to a level that did not force behavioural mistakes – losses became paced rather than clustered.
- ▶ The office retained the ability to wait out stress rather than react to it, preserving the illiquid positions through the cycle.
- ▶ Governance shifted from 'we hope this recovers' to 'we know how this behaves' – trustees understood exactly what they were paying for.
- ▶ In recovery phases, the hedge dragged as expected. That drag was priced and accepted. The structure remained durable.

WHERE THIS APPLIES

Most relevant where private credit represents a meaningful, illiquid portfolio sleeve; secondary liquidity is effectively unavailable in stress; investors want drawdown control rather than precision hedging; and governance needs to survive uncomfortable periods.

Less relevant where private credit exposure is small or opportunistic, investors are comfortable riding full credit cycles unhedged, or active trading or fund-level risk transfer is available.

TYPICAL ENGAGEMENT PATH

Structuring-as-a-Service™ – Synthetic Credit Hedge design and governance framework.

Secondary: hedge governance design, counterparty structuring, execution support, monitoring framework.