Morgan Stanley
INVESTMENT MANAGEMENT

How Morgan Stanley's David Miller dealt with stress

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Private Debt Investor

David Miller, Morgan Stanley's global head of private credit and equity, knows a thing or two about managing a big portfolio, particularly during times of stress.

As chief investment officer of the $ 700 billion Troubled Asset Relief Program—which the US government set up in 2008 to help steady the country's financial system—David Miller went through trial by fire navigating the global financial crisis, which also helped create the environment for the robust private credit universe that exists today.

"It was a fascinating and very scary time," Miller says of his work in Washington, which began in October 2008, in the eye of the storm. He joined a small team as director of investments under Treasury secretary Hank Paulson, and then became chief investment officer of a larger team under Treasury secretary Tim Geithner.

"I was a good investor before I went to Washington, but it was not really about how to generate the highest investment returns—although we were focused on protecting taxpayer capital—but more strategic in terms of how to stabilize the financial system," says Miller, who had been a portfolio manager at HBK Investments and before that, a vice-president in the special situations group at Goldman Sachs.

"Trying to create an incredibly complex strategy and execute on it while trying to fend off bank and market failures was incredibly chaotic," say Miller, who oversees a growing $50 billion portfolio that is roughly equally split between private credit and private equity.

Although his current mandate is significantly less fraught, the lessons Miller learned in Washington, including the importance of working with "tremendously dedicated and talented people", have likely served him well in running his business, which is part of a $230 billion alternatives platform within the $1.5 trillion of AUM of Morgan Stanley Investment Management.

The division has helped firm become the top valued bank in terms of price to tangible book value, and Miller aims to keep the momentum going, with a goal of doubling the private credit section to $50 billion in the next few years.

Risk management first

He will undoubtedly draw on his experience at the Treasury to achieve that goal. "The biggest thing that stays with you as an investor is your role to first be a risk manager with a credit mentality and being aware of what could go wrong, and being able to think outside the box," Miller says.

"Although the financial system is much safer today than in 2008, with the interconnectedness of the banks and the capital markets, you have to pay attention to what's going on from a macro perspective, which will inform some of your decisions as an investor."

That includes "the importance of diversifying your funding sources, particularly if you're employing leverage, and having the right structures with matching assets and liabilities, which allow you to be invested in longer-term illiquid assets that are not usually appropriate for a bank."

Miller does not believe there's systemic risk in the burgeoning private credit ecosystem. That is because equity contributions by sponsors in deals today, at about 50-60 percent, are "far superior" to those in 2008. "The vast majority of private credit is housed in appropriate fund structures that are either unlevered or levered at one to two times," he says. That compares with the 10-12 times leverage typical in bank lending.

"Private funds, including private credit funds, that did not need to sell assets in 2008 and 2009, and were able to be patient because clients couldn't withdraw money during the panic, tended to perform pretty well," Miller says. "So, while there could be a default cycle in the next few years—and we don't expect anything like 2008—we think private funds with good managers and the right structures should perform just fine."

The asset class offers other benefits. "Having asset managers be owners and providers of credit that may be too risky to be on a bank's balance sheet generally de-risks the overall system," he says. "At the appropriate time, rates will come down as inflation comes down."

When they do, M&A transactions, which rose 25 percent across the mid-market in Q1 2024 compared with Q1 2023, according to early data Miller has seen, will increase. "We're pretty constructive on growth, and we think M&A is going to pick up materially," he says, noting that Morgan Stanley's buyout teams are seeing 30-40 percent increases in M&A in the mid-market where private credit plays.

Intentional about growth

That should support Miller's goals to double the credit business, which he expects to achieve organically, for now. Private credit growth will come from areas Morgan Stanley already operates in: for the US, that includes senior secured direct lending, capital solutions (mezzanine/hybrid/opportunistic credit) and specialty finance, as well as venture growth and media royalties. In Europe, he plans to add capital solutions to the direct lending business.

"We don't view the growth profile as particularly heroic," says Miller, who joined Morgan Stanley in 2016 after a stint as chief executive officer of Silver Bay Realty Trust Corp, a publicly traded REIT he co-founded in 2011. "We have been very intentional about our growth," he says, noting the importance of having the scale to support top talent and a sophisticated platform, and the infrastructure to compete within any sizeable deal.

"We don't want to be so big that we are forced to do the marginal deal," he says. Amid the strong growth in the asset class, Miller is focused on maintaining a balance, saying that "the most important thing to us is our fiduciary responsibility to our clients".

Those clients skew about 60 percent towards institutional investors such as sovereign wealth funds, for which the manager creates structures such as separately managed accounts and funds of one. But the platform is increasingly turning to other vehicles such as public, as well as non-traded, perpetual-life business development companies like its North Haven Private Income funds, which serve institutions, and the platform's remaining 40 percent retail and high-net-worth clients. To that end, the business took its Morgan Stanley Direct Lending fund public in January. The BDC, launched in 2019, invests in subordinated debt.

Miller does not have any near-term plans to grow the business through acquisitions, although he does not rule out the possibility in the future. Right now, "we feel really good about the organic opportunities, and believe that most of private credit is in the relatively early innings."

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