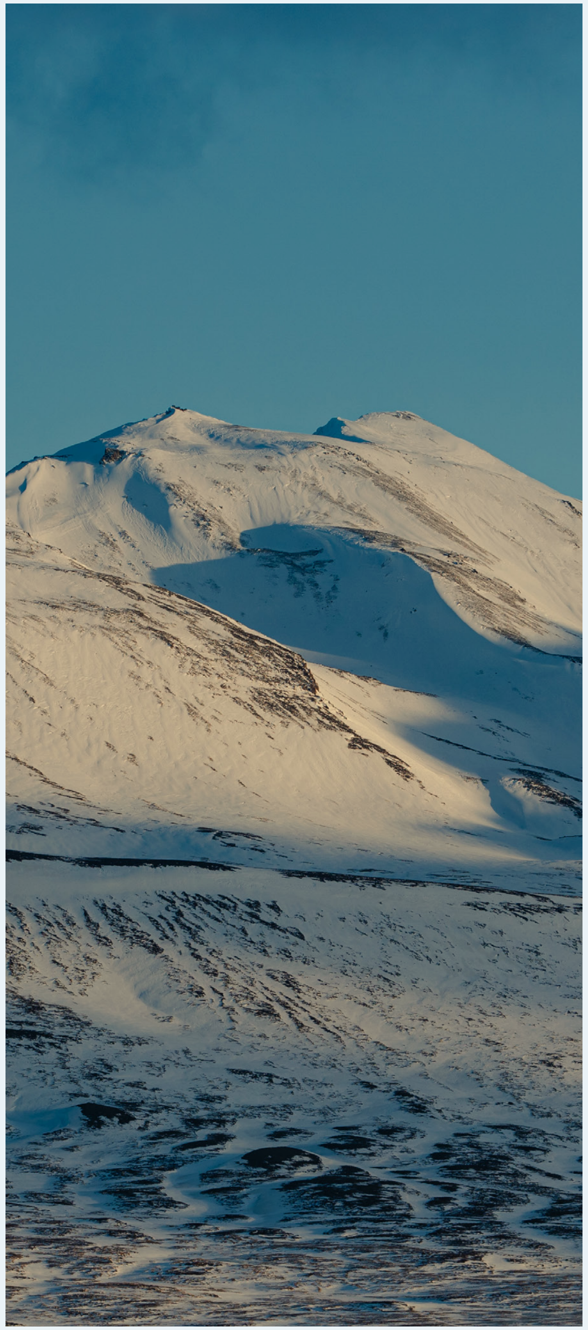
# 2025 Global Investment Outlook



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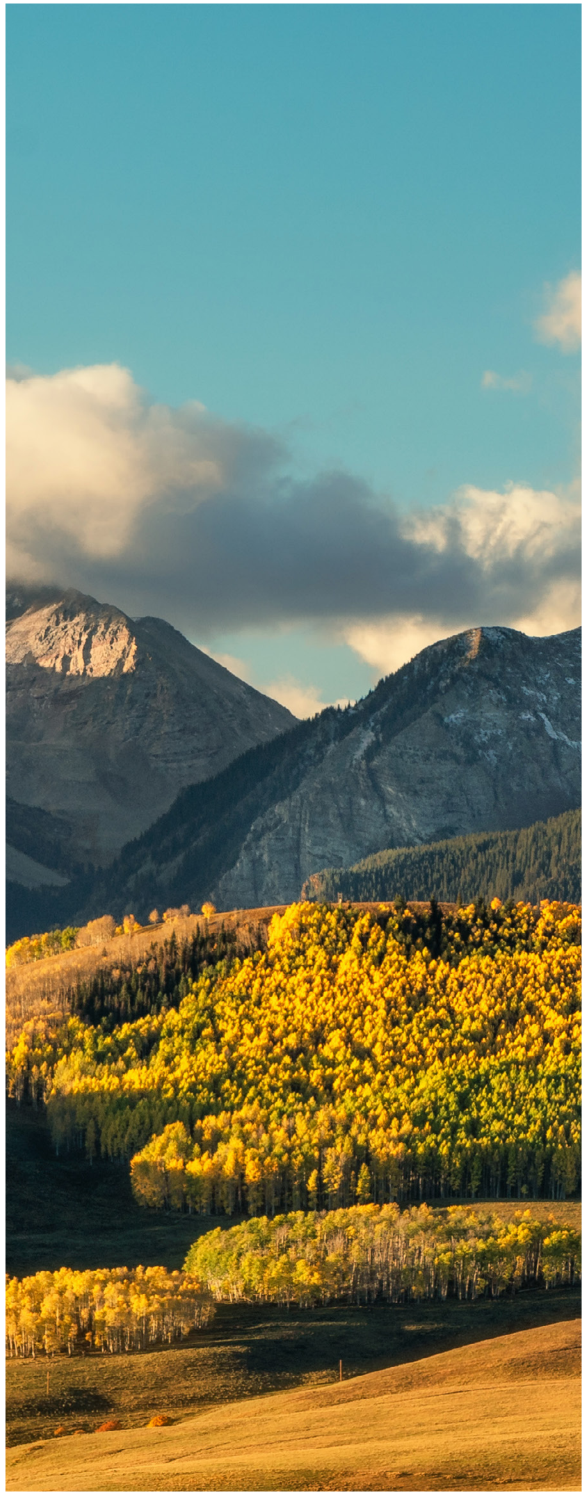


# A letter from Steve Peacher

Our 2025 Global Investment Outlook comes at a time of great change, uncertainty and opportunity across the world. In the previous year, we saw major shifts in the macroeconomic environment. In the U.S., Canada and other major markets, the conversation shifted from moderating inflation to buttressing economic growth. Central banks across the world went into easing mode, from the U.S. Federal Reserve to the Bank of Canada and European Central Bank.

On a geopolitical front, the globe also grappled with the grave consequences of armed conflict, several closely watched elections and the economic and human costs of significant weather- and climate-related disasters. At the same time, 2024 brought investors robust returns from a wide range of markets, including many fixed income asset classes.

However, several sources of uncertainty remain prevalent as we head deeper into the new year. These include those of a political nature, with an incoming U.S. administration raising expectations of both growth-friendly initiatives and the more sobering impact of tariff talk. The risks of ongoing global conflicts escalating even further remain top of mind as well. And observers are watching central banks closely, for signs of policymakers settling into a neutral rate or adopting a more stimulative mindset.

Consequently, questions remain as to what direction markets take from here. Will the above uncertainties translate into spread volatility in bond markets? Could the evolving rates environment affect market activity and volumes in public and private fixed income? Will we be seeing major shifts in other asset classes, such as real estate and infrastructure? What will be the impact on insurers and plan sponsors? And overall, where will asset managers be looking for opportunities in the months ahead?

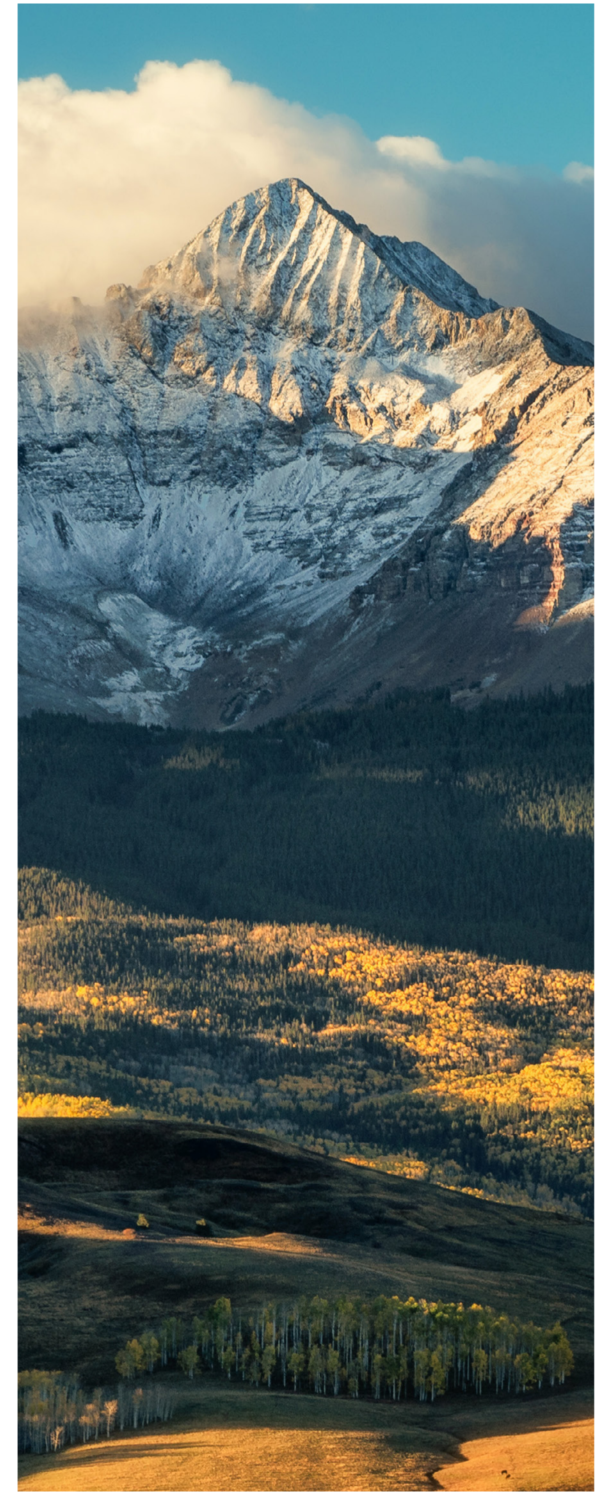
That the events of 2025 could have varying effects on different investment types highlights the importance, in my view, of gathering the diverse views of our investment teams into one place. In the following pages, our specialists from SLC Management, BGO, InfraRed and Crescent Capital will share their perspectives. I hope you will find useful insights in our 2025 outlook, which can serve as a valuable tool for framing your investment and business strategies, engaging stakeholders and gauging what investors may be most concerned about in the new year.

On behalf of SLC Management, I wish you all the best in 2025.

Regards,

Steve Peacher

Executive Chair, SLC Management



# Macroeconomic outlook

## Market expectations caught between potential business-friendly initiatives and trade policy challenges

Dec Mullarkey
Managing Director, Investment Strategy and Asset Allocation

### Unknowns heading into 2025

U.S. policy uncertainty is running high. A new president, whose party controls both branches of Congress, is championing an ambitious agenda. It contains the prospects of stimulus from tax cuts and lighter regulation. But it also comes with potential frictions and offsets from tariffs and an immigration crackdown.

That mix is hard to handicap, as some of the details remain vague, but markets are betting that growth will be prioritized and the net effect will be market friendly. The prospects of tax breaks and lighter regulation have already ignited a rally in equities. The potential for increased mergers and acquisitions has also led to an improved outlook for certain companies and sectors.

Nevertheless, the threat of tariffs, which typically lead to higher prices, could pinch consumers. Immigration reform is another issue that could prove inflationary, particularly if it materially shrinks labor supply. Undocumented immigrants comprise 40% of the agricultural work force, while in construction it is 20%. Both sectors struggle to attract domestic workers.

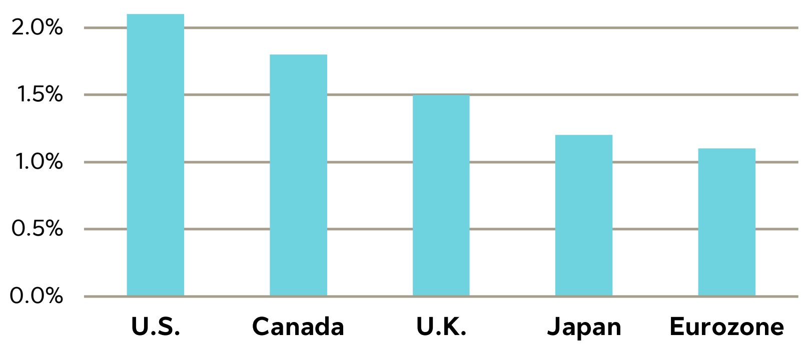
The market's confidence that President Donald Trump will be business friendly is supported by some of his cabinet recommendations. His nominees to lead the U.S. Department of the Treasury and U.S. Department of Commerce are both Wall Street veterans that can ably advise on crafting policies to avoid adverse market reactions. Opting for experienced hands from within the system certainly shows pragmatism. Similarly, he has nominated an industry CEO to lead the U.S. Department of Energy.

### What are economists and markets expecting?

While the U.S. political backdrop certainly matters, the business cycle is generally more critical in the longer run. And right now, employment is expected to remain strong. This in turn should fortify consumer spending. Productivity is up, while business and residential spending is expected to be solid. Inflation continues to decelerate, and absent some trade or policy shock the U.S. Federal Reserve should continue to normalize rates. The Bloomberg consensus estimate for U.S. GDP growth is for above 2% this year.

Across Canada, inflation is quickly receding, and rates are dropping. After two years of subpar growth, Canada is rebounding. The Bank of Canada, after a rapid rate hiking cycle, has been one of the most aggressive in cutting rates. This is having a material impact on Canadian households, whose debt to income is the highest amongst G7 peers. With rates dropping, floating rate mortgage holders in particular are catching a break. While the Canadian economy has struggled to grow beyond 1% over the last few years, this year it is expected to get closer to 1.8%.

**2025 GDP growth outlook for major economies**




Source: Bloomberg monthly survey, 2024. The above forecast is based on estimates and there is no guarantee that the estimate will be achieved.

China has struggled to find its groove over the last several years. A housing slump that has lasted four years has resulted in a large number of unfinished properties and bad loans. Credit growth has slowed, and weak consumer confidence has sapped activity. Policymakers, worried about deflation, have been cutting rates. The market keeps waiting for some large bouts of fiscal stimulus while the government instead rolls out targeted programs. Faced with the threat of uncertain tariffs the government seems to be holding off until it can assess the full impact.

Any tariff reaction from China will likely be some mix of retaliation, currency adjustments, rate cuts and fiscal support. Fortunately, the country has the fiscal and monetary capacity to help buffer its economy from some trade disruption. Markets still expect the government to stimulate and deliver GDP growth levels, albeit below target, of 4.5%.

The eurozone is expected to deliver 1% GDP growth this year. Germany, usually the manufacturing engine for the region, has been flat as demand from China has been weak. Meanwhile France and Italy have also been in the slow growth lane as they need to bring fiscal spending under control. However, activity is picking up. Employment is growing, and wage growth is outpacing inflation. The European Central Bank (ECB) is expected to keep cutting rates and should continue to help the region recover.

A big shock to this baseline economic outlook would be U.S.-initiated universal tariffs. In particular, North America's cross border supply chains are very integrated. This makes it very difficult to quickly relocate and retool. While China and Europe have dealt with and adapted to U.S. tariffs before, every new episode invariably brings the risk of overreach and subsequent rounds of retaliation that could derail trade and economic growth.

# Macroeconomic outlook (cont.)

Dec Mullarkey

Managing Director, Investment Strategy and Asset Allocation

## Market expectations caught between potential business-friendly initiatives and trade policy challenges

### Inflation calming down

Global inflation is returning to manageable levels. However, it is settling at different levels across regions. In the U.S., it is running a little hot, while Canada is right at target. The eurozone is also circling around target while China is at risk of seeing deflation.

Such divergences affect the pace of rate cuts. This in turn impacts exchange rates. The Fed has the luxury of time, delaying as needed. Meanwhile, Canada is trimming rates at a brisk pace. In Europe, as growth stays subpar, markets expect the ECB to continue to cut rates at a decent clip over the first half of the year.

Meanwhile, China needs more stimulus to arrest sluggish growth, stabilize housing and invigorate confidence. Looming tariffs are complicating that adjustment. The picture should become clearer as the new U.S. administration further cements its position.

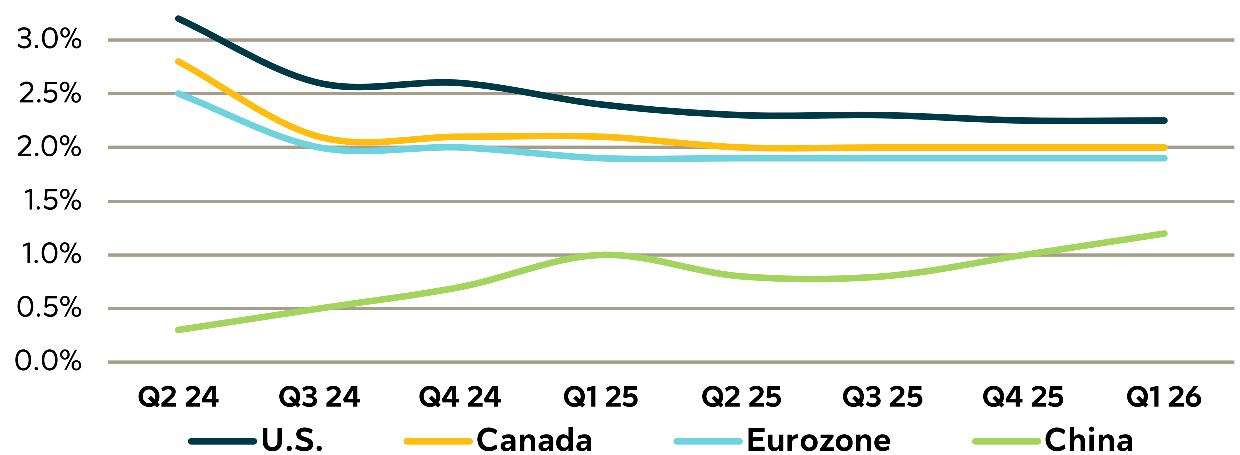
### Landing on the neutral rate

One important question central bankers need to settle is that of their neutral rates. In other words, under stable conditions, at what level should they stop cutting rates to ensure their economies operate at a sustainable pace?

Before the pandemic, the neutral rate for the U.S. and Canada was estimated to be around 2.5%. For Europe it was closer to 1.75%, as long-term growth expectations are lower. Based on futures markets, the implied neutral rates for the ECB and Bank of Canada are still in line with pre-pandemic estimates. However, in the U.S., it is expected to be in the 3.5%–3.75% range.

A big part of that bump up is the demand for capital is intensifying as the U.S. reorders supply chains, shifts to alternative energy and spends more on technology innovation. U.S. federal deficits also seem to be running higher on a persistent basis. All this suggests more activity, more borrowing and higher U.S. rates relative to pre-pandemic conditions.

**Headline inflation (consumer price indexes)**




Source: Bloomberg, 2024. Consumer price index (CPI) measures for Q4 2024 and after based on Bloomberg survey of economists. The above forecast is based on estimates and there is no guarantee that the estimate will be achieved.

### Key takeaways

- Overall policy uncertainty has been driven by potential tax cuts and lighter regulation on one hand and tough tariffs and immigration enforcement on the other.
- The U.S. is expected to remain in a robust stage of its business cycle.
- All eyes are on central banks, and where their neutral rates land in the new year.

Sources: Bloomberg, U.S. Federal Reserve, 2024–5.

# Fixed income: investment grade

Rich Familetti
CIO
U.S. Total Return Fixed Income

Linda Kong Ting
Senior Director and Credit Analyst, Asset Management

## "Goldilocks" scenario in 2024 puts 2025 on strong footing

### A sweet spot for fixed income

The 2024 calendar year was a near-ideal period for investment grade (IG) credit markets, as spreads remained extraordinarily tight. Despite geopolitical tensions, elevated rate volatility, a storied U.S. presidential election, other consequential political power shifts around the world and a narrowly averted currency crisis in Japan, spreads only nosed past 110 basis points (bps) once for the entire year. By contrast, spreads actually averaged 125 bps during 2023.

Strong GDP growth around or slightly below 3% in the U.S. since mid-2023 has certainly contributed to the strong performance in credit. However, this is definitely not the whole story. As U.S. IG credit spreads hit 20-year tights last seen in 2005, with high yield following a similar path, agency mortgage-backed securities remained significantly wider than their recent tights in mid-to-late 2021, due to a falloff in demand for this asset class by banks. This suggests that tight credit spreads owe a lot to technical dynamics.

Although 2024 gross issuance levels in U.S. IG fixed income are set to exceed the levels of the previous three years, the market remains well below the last peak during the zero-interest rate period in 2020. At the same time, demand for U.S. IG fixed income has risen significantly. The overall level of rates has certainly been a strong contributing factor, as all-in yields in investment grade of around 5% in the context of an average U.S. defined benefit pension funded status of 104%, plus high inflows into fixed income asset managers and insurance companies' annuity products, have driven extremely high demand. Furthermore, foreign flows have remained strong as weakening economies around the globe drive yields lower in the rest of the world. All of this has resulted broadly in a well-balanced "Goldilocks" environment for IG credit, and in credit products more broadly.

### Some risks amid sound fundamentals and technicals

What could disrupt this idyllic picture in 2025? Although there are still plenty of threats to markets, we continue to believe both the fundamental and technical pictures could remain supportive enough to keep spreads range bound in the first half of the year.

On the fundamental side, we note that most industrial companies have already implemented mitigation strategies against "known unknowns." These include potential tariffs under the second administration of Donald Trump and geopolitically driven energy price volatility, though we acknowledge the potential for surprises even on these issues. The outlook is even rosier for financial companies as they anticipate a looser regulatory environment, rising appetite for mergers and acquisitions, higher overall transaction volumes and continued yield curve normalization. We admit that some measured deterioration in credit quality is likely in the offing as some more aggressively underwritten 2021 loan vintages come due and lower-income borrowers continue to struggle. However, these pockets remain relatively contained and the pace of normalization to date has been manageable. We also observe that ratings volatility in IG fixed income has been very low in the past few years, as more companies have increasingly managed explicitly to an IG rating in the higher-rate environment.

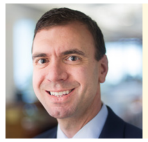
On the other hand, we expect greater supply in IG credit due to pent-up merger and acquisition transactions, in addition to the natural rising tide of organic issuance due to inflation and still-elevated rates as companies refinance pandemic-era debt. Any significant downdraft in rates may also result in spread widening, as yield-driven demand may decline enough to negatively affect market technicals. We also see some extant risk from a potential downturn in broader equity sentiment, even if this comes due to non-credit related concerns such as earnings moderation in semiconductor stocks.

### Key takeaways

- IG fixed income investors largely benefited from near-ideal conditions in 2024.
- Fundamentals and technicals could remain supportive for at least the first half of 2025.
- Many industrial companies have taken measures against "known unknown" risks heading into the new year.

Sources: Bloomberg, JPMorgan, 2024-5.

# Fixed income: non-investment grade



John Fekete
Managing Director and Head of Tradeable Credit

## Rate cuts in late 2024 could signal slower pace of easing for 2025; credit markets show growth

### Inflation still a Fed concern

The U.S. Federal Reserve cut interest rates by a quarter-point on December 18, 2024, as expected, amounting to a cumulative full-point since September 2024. Instead of celebrating, the market reacted like it received a lump of coal in its Christmas stocking as Chairman Jerome Powell telegraphed a slower and shallower rate cut narrative for 2025. The Fed had done a lot to support the economy over the last 90 days of 2024 and policymakers wanted to see more progress on inflation before reducing rates further. The updated Statement of Economic Projections (SEP) indicated only 50 basis points (bps) of cuts forecast for 2025. Inflation, as measured by the Personal Consumption Expenditures Price Index (PCE), is now forecast to be much higher at 2.5% in December 2025, up from 2.1% as previously thought, as disinflation has stalled out. Investors may need to wait until 2026 for inflation to approach 2%, pushing out by a year the timeframe for inflation to get back to target.

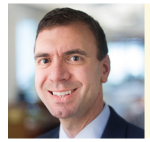
Fed rate cutting cycles typically drive Treasury yields lower, but that was not the case in 2024. Since September 18, 2024, the date of the first Fed rate cut, the 10-year U.S. Treasury yield has risen by 80 bps to 4.5%. This was because there had been no credible signs of an economic slowdown. The Fed deserves credit for executing a soft landing, in our view. Powell noted that "most forecasters have been calling for a slowdown in growth and it keeps not happening. There is no reason to think a downturn is more likely than it usually is."

### Healthy activity levels in credit markets

This contrasts with what is happening around the world, particularly in Europe, which is near a recession. As we predicted in our September public statements, the Fed's rate cuts have been accompanied by looser financial conditions and strong credit growth. This was evidenced by the near-record level of primary market issuance in the high yield, syndicated bank loan and collateralized loan obligation (CLO) markets. We believe that strong investor demand for income enabled syndicated loan and high yield bond investors to earn attractive returns in the range of 8%–9% year to date through December 18.[1]

[1] Indices used as asset class proxies: Credit Suisse Leveraged Loan Index and ICE BofA US High Yield Index, with performance range based on data as of November 30, 2024. Public and private credit indices shown are widely used market benchmarks to generally assess the relevant risk profile of a particular investment strategy. Future fluctuations in valuations and performance may occur as a result of changing market conditions, among other variables. The comparison indices and asset classes presented set forth herein are provided for informational purposes only and should not be relied upon as an indication of Crescent's investment strategy or as an accurate measure of comparison, as there may be differences between the relevant Crescent fund and such indices due to varying fund vintages and strategies. The comparisons contained herein have inherent limitations and qualifications, such as limited sample size, imperfect access to information and other considerations. There are significant differences between the types of securities and assets typically acquired by a Crescent fund and the investments covered by the applicable index or benchmark. Certain indices may or may not reflect the reinvestment of dividends, interest or capital gains. Moreover, indices are unmanaged and are not subject to fees and expenses.

# Fixed income: non-investment grade (cont.)



John Fekete
Managing Director and Head of Tradeable Credit

## Rate cuts in late 2024 could signal slower pace of easing for 2025; credit markets show growth

### The road ahead

Many investors are left to wonder what's next. Do we see 50 bps of cuts in 2025, or do we start the year with Treasury yields moving higher as they did in the first quarter of 2024? While many fear the new U.S. administration's policies could be inflationary, causing the Fed to stop cutting, new policies can take time to implement and work their way through the economy. We cannot help but notice the Fed cut rates by 100 bps within three months. As President-elect Donald Trump walks into the White House, the central bank may take a pause.

All this suggests Fed voters may be pre-emptively considering the impact of Trump's tariff, tax and spending proposals. Deregulation and tax cuts could potentially provide a boost to U.S. economic growth and benefit domestic companies, encouraging a risk-on environment for investing. For now, the economy remains resilient and labor productivity gains are providing a structural tailwind that supports growth. We believe this constructive fundamental backdrop, combined with a lack of material debt maturities for several years, should keep credit stress and default rates modest.

We expect 2025 to be similar to 2024 – with growth at 2.0%–2.5%, inflation running close to 3% and the Secured Overnight Financing Rate (SOFR) base rate at or north of 4.0% – resulting in default rates remaining stable and concentrated in a small group of industries. We continue to favor floating rate assets such as syndicated bank loans and CLO liabilities, in which investors could earn high single-digit coupons that are more than 200 bps higher than the average coupon in the U.S. high yield market.

We see three tailwinds that should be favorable for syndicated loans and CLOs throughout 2025:

1. The resiliency of the U.S. economy.

2. Potential inflationary pressure from tax cuts and deregulation following the November 2024 Republican victory.

3. Attractive yields relative to other credit asset classes.

### Key takeaways

- The Fed executed a quarter-point cut in December 2024 as expected.
- Fewer cuts forecast for 2025 as inflation progress stalls.
- We are seeing attractive coupon income available for investors in syndicated loans and CLO liabilities.

Sources: Bloomberg, U.S. Bureau of Labor Statistics, 2024–5.

ABOUT CRESCENT CAPITAL

Crescent is a global credit investment manager with US$43 billion of assets under management as of September 30, 2024. For over 30 years, the firm has focused on below investment grade credit through strategies that invest in marketable and privately originated debt securities including senior bank loans, high yield bonds, as well as private senior, unitranche and junior debt securities. Crescent is headquartered in Los Angeles with offices in New York, Boston, Chicago and London with more than 220 employees globally. Crescent is part of SLC Management, the institutional asset management business of Sun Life. For more information about Crescent, visit www.crescentcap.com.

# Private credit: investment grade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## Robust activity, growing volumes could continue to drive markets in 2025

### Record year of volume in a competitive landscape

The investment grade (IG) private debt market had a record year of new investment activity in 2024. According to data from Private Placement Monitor, volumes surpassed the prior record of US$108 billion set in 2021. As at the end of October, year-to-date 2024 volume was US$113 billion and expected to close the year far above the US$120 billion mark. While a number of issuers took a "wait and see" approach in 2023 for non-urgent financing needs, there were a higher number of issuances in 2024 as we saw the start of interest rate cuts and an issuer base that had come to grips with the fact that cuts in the U.S. Federal Reserve's rates might not move longer duration Treasury rates much at all.

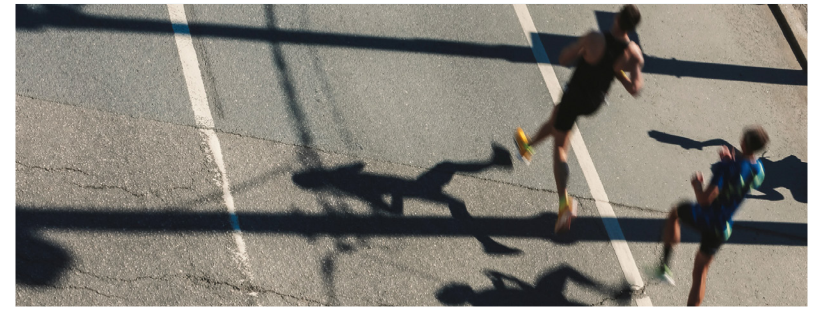
Volume growth in 2024 was driven by industrials, including several large investments in the manufacturing (e.g., chips and batteries) and energy (e.g., liquefied natural gas, pipelines) sectors, followed by the financial sector (e.g., asset managers, real estate investment trusts) and utilities. There were over 10 deals that raised more than US$1 billion, exceeding last year's number of large transactions. In addition, 2024 saw more transactions that were oversubscribed by multiple times, putting downward pressure on spreads throughout the year compared to 2023 as competition intensified, perhaps in part due to historically low spreads in public IG corporate bond markets. Nonetheless, investors generally remained disciplined in underwriting, with no material loosening on terms and covenants, demonstrated by several deals not getting circled this year due to credit or structural concerns.

### Our 2025 outlook: "building on the momentum"

Last year, our outlook for 2024 predicted a robust year of activity buoyed by an expectation of declining interest rates, lower inflation and pent-up issuer demand from the previous year. At the time of this writing, 2024 is slated to be a record year of activity, and we believe 2025 is poised to build on this momentum. Geopolitical risk remains a concern, and the new U.S. administration's policy impacts on regulation, tax cuts and tariffs remain uncertain. However, the continued cycle of interest rate cuts across multiple geographies and further cooling of inflation is expected to boost corporate investment, merger-and-acquisition activity and deal flow in 2025. Also, we expect to see a stronger pipeline of deals in January and early February, as some issuers delayed entering the market around the U.S. election cycle in the last quarter of 2024.

Sector leaders for volume in 2025 should continue to include industrials, energy and financials, in our view. Growth areas such as private asset backed securities (ABS) should also add diversification and boost relative value opportunities. Capital investment in fast growing sectors such as digital infrastructure (e.g., data centers, fiber optics), which is needed to accommodate the evolution of AI, will create further financing opportunities. Of course, the year could bring challenges. We anticipate sustained headwinds in real estate markets, which are seeking greater stability and return to pre-COVID trading levels. Other sources of uncertainty include impacts of changing government investment priorities in public infrastructure and regulatory landscapes.

A number of key trends in 2024 are expected to continue into 2025, including more large transactions (greater than US$1B), strong investor appetite and a very competitive market. Barring any unforeseen macroeconomic market disruptions, spreads on average are anticipated to see continued downward pressure in 2025 across IG private credit markets. Nonetheless, we expect relative value to public markets to remain in line with historic trends. The attractive risk-adjusted returns that can be generated by experienced investors with scale and deep sector expertise will continue to anchor the growth of IG private credit activity in 2025.



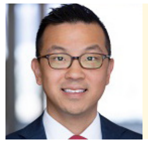
## Key takeaways

- IG private credit markets experienced robust volume growth in 2024.
- We believe 2024's positive momentum could carry into 2025.
- Growth in ABS and digital infrastructure investment could also drive markets.

Source: Private Placement Monitor, 2024–5. Investment grade credit ratings of our private placements portfolio assets are based on a proprietary, internal credit rating methodology that was developed using both externally purchased and internally developed models. This methodology is reviewed regularly. More details can be shared upon request. There is no guarantee that the same rating(s) would be assigned to portfolio asset(s) if they were independently rated by a major credit ratings organization.

# Private credit: non-investment grade


Chris Wright
President and Head of Private Markets


Chris Wang
Managing Director

## Cycle-tested values key to capturing today's attractive private credit opportunities

### Asset class well-positioned following the U.S. election

The private credit market remains highly attractive today, as its value proposition to both borrowers and investors remains clear and robust, in our view. Capital formation continues to shift on a secular basis to private credit as borrowers value the certainty of execution and ease of use that relationship lenders provide. Furthermore, investors continue to value the attractive yields, high current income and better lender protections in more conservative capital structures that can be found in private credit.

The asset class is poised to benefit from expectations of continued U.S. economic strength, lower taxes, market-friendly regulations and growth-oriented policies from a second Donald Trump presidency. These economic tailwinds, when combined with the significant amount of dry powder on the sidelines, aging private equity portfolios and a regulatory environment more conducive to dealmaking, are expected to create the conditions necessary for an attractive mergers-and-acquisitions (M&A) environment going forward.

At the same time, protectionist trade policies and immigration reform in an already-tight labor market should put upward pressure on inflation, likely resulting in a higher-for-longer rate environment. We view a higher rate environment as a positive for fundamental credit. President Trump's proposed economic policies are centered around driving economic growth in a more benign operating environment, which we expect to drive top-line growth across U.S. middle market companies.

It is important to remember that a higher rate environment can have a burdensome effect and pressure cash flows for borrowers, resulting in increased defaults and non-accruals. This potential for prolonged credit stress reinforces the importance of manager selection and the need for disciplined credit underwriting with a focus on capital preservation, strong free cash flow generation and robust debt service coverage. The growing dispersion of performance and returns across managers is expected to accelerate as rates stay elevated.

# Private credit: non-investment grade (cont.)

Chris Wright
President and Head of Private Markets

Chris Wang
Managing Director

## Cycle-tested values key to capturing today's attractive private credit opportunities

### Increasing importance, difficulty in evaluating private credit portfolios

Assessing the performance of private credit managers and their portfolios can be challenging. Most private credit managers have never invested through a cycle. This makes it difficult to underwrite how their investment returns, default rates and recovery rates would look through a recession or a prolonged period of elevated interest rates. Further compounding the issue is that default rates today may not reflect true underlying performance, as credit agreements can be amended to allow for payment-in-kind (PIK) interest or provide for a maturity extension before any default may occur.

Deteriorating underlying portfolio company performance can explain the increasing prevalence of PIK amendments and the growing presence of PIK interest income in private credit portfolios. For example, PIK interest represents on average 10.5% of investment income (and as high as 18.3% of investment income) for the largest publicly traded business development companies (BDCs)[1] today, up over 150 basis points from 8.9% just one year ago.

We believe rising defaults and non-accruals across private credit manager portfolios will also test the strength and quality of the underlying credit agreements that provide contractual rights and protections to the lender. Weak credit agreements lacking fundamental protections will expose investors to the possibility of liability management exercises, in which collateral and its associated value can be taken from the lender. Investors were stunned when one of the first sponsor-funded liability management exercises of a private credit-backed company occurred during a highly public faceoff between direct lenders and a financial sponsor over a private upper middle market annual recurring revenue (ARR) loan in 2024.

### Outlook for opportunities in private credit

In this extraordinary period of market transition, private credit can capture the opportunity arising from the economic strength in U.S. middle market companies and a resurgence in M&A activity, providing investors with opportunities for strong relative value and risk-adjusted returns.

We believe a higher-for-longer rate environment should result in rising credit stress across portfolios. Consequently, manager selection will be key as cycle-tested managers with robust origination capabilities, disciplined credit underwriting and hands-on portfolio management expertise will, in our view, have a higher likelihood of generating strong returns with reduced risk.

## Key takeaways

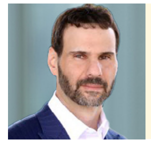
- Secular trends and expectations of a market-friendly U.S. administration have created sanguine conditions for private credit investment.
- We believe a higher-for-longer rate environment should result in rising credit stress across portfolios, underscoring the importance of manager selection.
- Private credit is poised to capture potential opportunities from strengthening U.S. middle market companies and increased M&A activity.

Sources: Bloomberg, Private Placement Monitor, 2024-5.

1. Ten largest publicly traded BDCs by market capitalization as of December 16, 2024, excluding 2024 IPOs: ARCC, BXSL, FSK, GBDC, GSBD, MFIC, NMFC, OBDC, PSEC and TSLX.

# Real estate

## CRE investment outlook the brightest in years



Ryan Severino
Chief Economist, Head of U.S. Research

### Economic backdrop remains resilient and supportive

Having endured the peak of cyclically high inflation and interest rates in the wake of the pandemic, the U.S. commercial real estate (CRE) market stands ready to benefit from significant changes in the broader environment. Space-market fundamentals continue to perform reasonably well. Where weak spots exist, they largely stem from too-robust supply, not collapsing demand. The U.S. Federal Reserve began cutting interest rates in the third quarter and continued into the fourth quarter of 2024. That has helped to heal CRE capital markets and should provide additional support in the coming quarters. That should not only enable the CRE market to close out 2024 in much better shape than it began, but it should also set the asset class up well to mount a further recovery in 2025.

### CRE market outlooks by sector

#### Industrial

Our outlook remains positive over the medium term. The supply pipeline should ease considerably, and demand should hold firm. Yearly rent growth should reaccelerate once the national vacancy rate stabilizes. The next business cycle should not look as favorable for space-market fundamentals, as measured by vacancy rate and asking rent growth, as the prior one. But we expect industrial to remain a favored property sector, especially as newer, more sophisticated properties – better equipped for modern supply chains – get developed.

#### Retail

While retail remains the tightest of the major property types (as measured by the national vacancy rate), it should remain in a strong position over the longer term. U.S. consumers remain very healthy, responsible for roughly 70% of GDP. Furthermore, they continue to do most of their shopping in physical centers. While ecommerce should continue to increase, most retailers are increasingly utilizing physical centers in a complementary way. Ecommerce is no longer viewed as a substitute for physical stores. The high barrier to development of new properties should remain entrenched, keeping the sector stable and healthy.

#### Multifamily

Supply and demand dynamics should remain favorable, even over the longer term, due to the structural housing shortage in the U.S. But improvement in the national statistics should occur gradually as the market digests some oversupply, concentrated in southern metros. The national vacancy rate should decline at a slow but sustained pace while national asking rent growth should hit a plateau. The rift between strong and weak markets should remain wide, even as the overall sector's outlook remains positive.

#### Office

This market faces a more interesting future over the medium term. We expect obsolete inventory to get razed or converted as the supply side of the market adjusts to the structural downward shift in demand. Ultimately, as the economy expands and employment increases, that should translate into more demand for office space, even if the utilization rate (space per worker) has structurally decreased. This process will take years to complete, potentially longer than one market cycle. But office could learn a lot from retail, a sector that many market participants once left for dead.

#### Emerging sectors

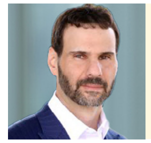
Favored emerging sectors typically require some particular expertise that lurks outside the bounds of typical CRE investment. Cold storage requires significant knowledge of both the technological specifications of the buildings themselves, but also the cold supply chain. Data centers similarly require knowledge of the structure of the properties themselves, including their sophisticated cooling systems. But they also require a solid understanding of the energy supply required to power such facilities. Medical office properties mandate a sophisticated knowledge of building specifications to meet the modern needs of health care professionals and systems. But they also require an understanding of demographics and health care consumption patterns.

#### Capital markets

Investment activity stabilized in 2024, as measured by volumes and cap rates. The market should continue to fare well as the federal funds rate drops ever closer to neutral and the cost of capital becomes less of an impediment to investment. The long end of the yield curve could remain volatile, which could provide some short-term disruptions; CRE remains incredibly interest rate sensitive. But rate cuts, plus a positive economic backdrop, could produce a run of solid returns in a manner unseen for decades.

# Real estate (cont.)

## CRE investment outlook the brightest in years



Ryan Severino
Chief Economist, Head of U.S. Research

Debt capital markets, across various metrics, should see significant improvement in almost all areas as monetary policy eases over the next two years as the Fed moves toward neutral. Underwriting standards should loosen as demand from borrowers increases. Aside from structural challenges, such as those in the office sector, most of the issues in credit markets involve problems of a more cyclical nature. Those should work themselves out over time, even if they do not save every loan issued when capital markets were booming just following the pandemic. And spreads should remain attractive to lenders, even if they compress along with risk premia.

## Shifting risks alter outlook

After many months, the key risk facing the CRE market is not monetary policy. With the Fed cutting rates and investor sentiment improving, the focus now turns to two other potential risks. The first is some random, idiosyncratic shock. Unfortunately, risk in the world is going up in many respects, not down. That increases the probability of something going awry. Second, other government policies (such as fiscal and regulatory) will warrant close inspection over the next 12–24 months. The wrong combination of policies could create notable headwinds. For now, with the economy carrying so much momentum and interest rates set to decline further, the CRE market has an almost ideal environment. If the economy and market can avoid the more negative scenarios, the CRE market could produce its best sustained performance in decades.

### Key takeaways

- Macro conditions and market fundamentals have put CRE in a prime position in 2025.
- An environment of policy easing should lead to significant improvement in debt capital markets.
- Idiosyncratic events and fiscal policy remain risk factors in the new year.

Sources: CoStar, RCA, Jones Lang LaSalle (JLL), 2024-5.

# Infrastructure

**Jack Paris**
Chief Executive Officer

**Edward Hunt**
Partner, Head of Core Income Funds

**Stephane Kofman**
Partner, Head of Capital Gain Funds

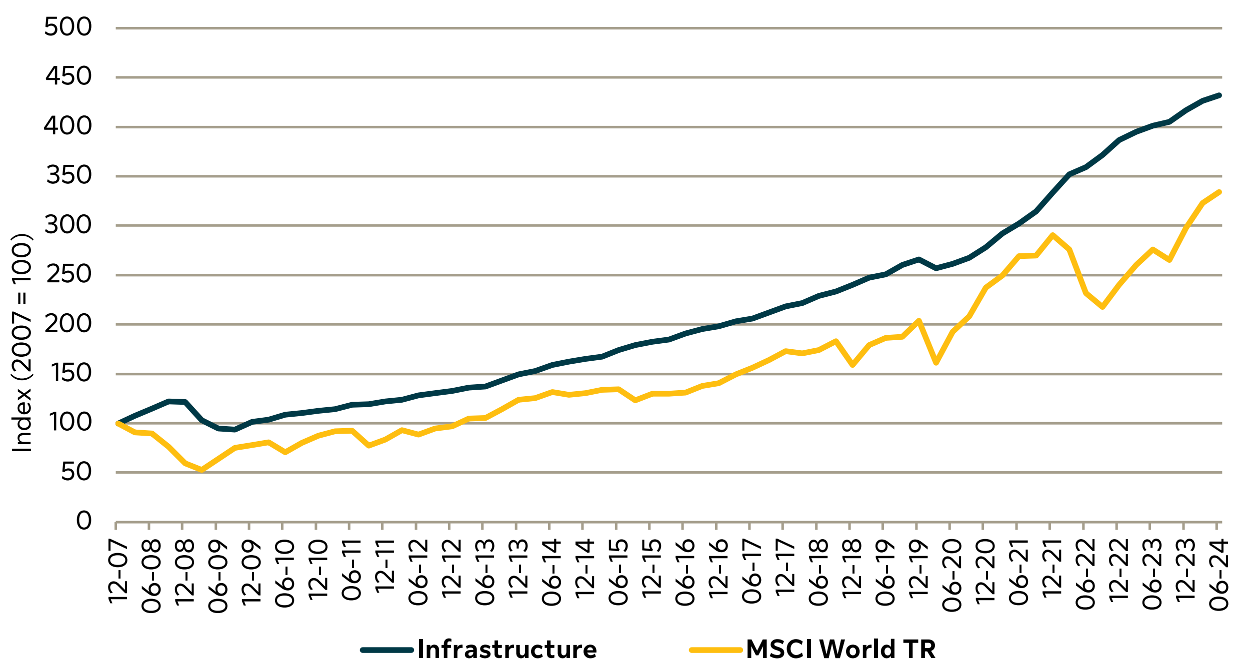
## Asset class proving resilient as market activity continues to recover; megatrends shape a growing mid-market

### Macro environment shaping near-term performance and valuations

In 2024, economic growth has proven more resilient than anticipated in North America, while the European economy has continued to show signs of weakness. Inflation trended lower than in previous years but remained stickier than anticipated, contributing to a steepening of the yield curve across Europe and North America, with short-term interest rates trending down amid central banks cutting rates and long-term government bond yields holding at higher levels due to persistent inflation uncertainties.

Within this macroeconomic environment, infrastructure performance has proven resilient, with robust earnings growth across transport, energy and digital infrastructure, underpinned by the ability of the asset class to recover inflation costs and the structural support of secular tailwinds accelerating demand. These factors contributed to largely offset the effects of a higher interest rate environment on valuations. In a slower economic environment anticipated for 2025, we anticipate infrastructure to continue offering a resilient proposition for investors across strategies.

**Infrastructure's long-term performance, total return, 2007–H1 2024**




Source: Preqin, Private Capital Quarterly Index rebased to 31 Dec 2007, as of June 30, 2024. Past performance is not indicative of future returns.

### Capital flows and deal activity recovering

Infrastructure allocations remain below historical peaks with investors focusing on managers with a proven track record, but rebounding demand from investors drove a 91.2% year-on-year increase in commitments to private infrastructure fundraising the first nine months of 2024[1]. Transaction volumes are showing signs of recovery. With long-term rates stabilizing, valuations in the core infrastructure space are becoming more attractive, and we expect stronger deal activity in this segment.

Simultaneously, the value-add segment is entering a "supercycle" with a meaningful increase in opportunities coming to the market, underpinned by megatrends, including energy transition and digitalization, and an increased emphasis on selective dealmaking. In 2024, the number of transactions under US$250 million accounted for over two thirds of total market activity.

North America and Europe remain the most attractive geographies from an allocation perspective, and account for over 66% of total transaction volumes in 2024 year to date (as of September 30), underpinned by supportive policy environments driving decarbonization, increased demand for infrastructure modernization and strong deal pipelines ahead.

[1] Realfin, State of the Market – Global Infrastructure Q1-Q3 2024, October 2024.

# Infrastructure (cont.)

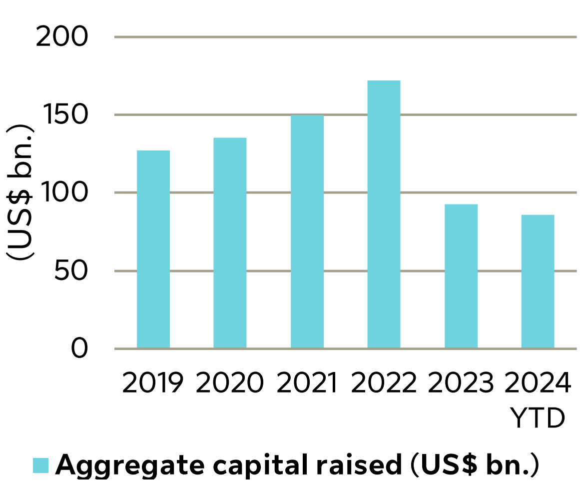
Jack Paris
Chief Executive Officer

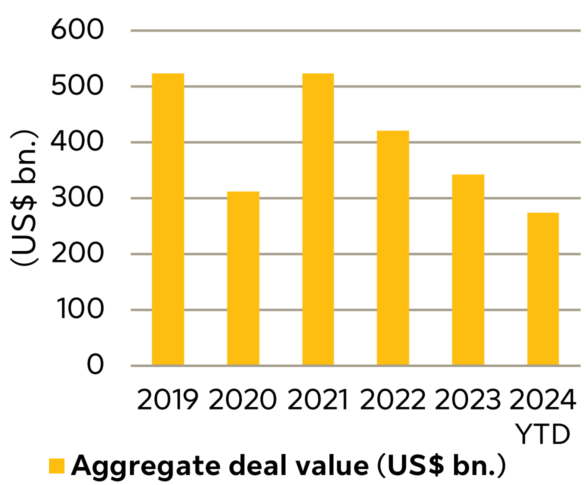
Edward Hunt
Partner, Head of Core Income Funds

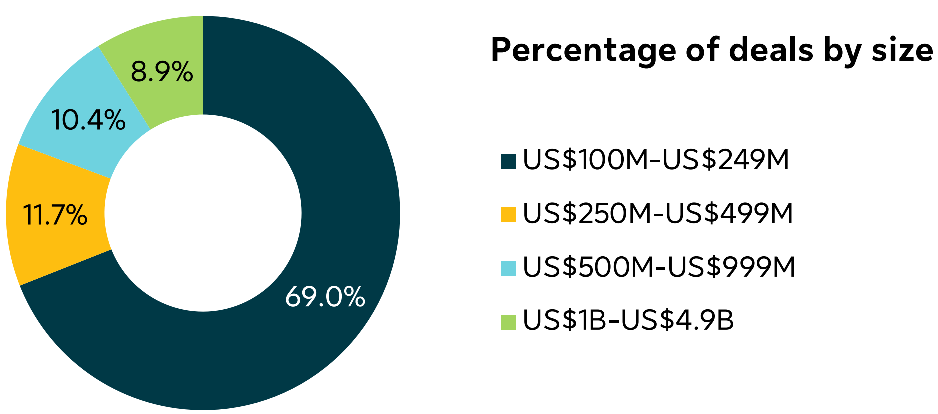
Stephane Kofman
Partner, Head of Value Add Funds

## Asset class proving resilient as market activity continues to recover; megatrends shape a growing mid-market

**Infrastructure fundraising and transaction volumes (US$ bn.)**




Source: Preqin, as of November 2024. Past performance is not indicative of future returns.

### Megatrends continue to shape the future of infrastructure

The pillars of decarbonization, digitalization, demographics and deglobalization continue to shape the long-term outlook for infrastructure and drive investment opportunities. The topics of energy security and affordability continue to shape the European policy debate amid sluggish economic growth and high energy prices. In the U.S., a new administration may implement some policy changes, including increased emphasis on oil and gas and lower funding to the electric vehicle sector. Despite fluctuating global policies, investment in energy transition remains a strong trend, with renewable capacity and battery storage anticipated to continue growing as electrification of transport and heating continue to drive power demand.

Moreover, the surge in global power demand, driven by new data centers and AI-related infrastructure, highlights the growing overlap between digitalization and the energy transition, and is further strengthening the case for investment in renewable energy and grid enhancements, reinforcing infrastructure's critical role in enabling the global transition to a sustainable, data-driven economy.

Amid rising trade barriers, and the new trend of "slowbalization," or the slowing of globalization, we see re-shoring of production capacity as a theme boosting demand for improved logistics infrastructure across North America and Europe. We also see a renewed public policy focus on leveraging public-private partnership models to support investment in new infrastructure and the modernization of existing, critical infrastructure, as public budgets remain tight amid historically high public deficit levels.

### Long-term asset class growth

As macroeconomic uncertainty persists, we anticipate continued interest from both policymakers and private investors in infrastructure, making the sector integral to addressing global challenges. We therefore continue to believe that the asset class is positioned for long-term growth, underpinned by its resilience across market cycles and the structural need for long-term investment.

## Key takeaways

- Infrastructure performance has proven resilient amid 2024's global economic uncertainty, underpinned by its inflation-hedging characteristics.
- Increased market activity, with core infrastructure valuations comparatively attractive, and the mid-market provide a continuous flow of new deals with solid return potential in the value-add space.
- Megatrends continue to drive the outlook for the asset class, as digitalization and decarbonization increasingly overlap.

Sources: Realfin, Preqin, 2024–5.

# Insurance asset management


Peter Cramer
Senior Managing Director, Head of Insurance Portfolio Management & Trading


Nitin Chhabra
Managing Director, Head of Insurance Solutions


Louis Pelosi
Managing Director, Client Solutions

## Plenty of ways to navigate through regulatory, economic and geopolitical risks

### External factors critical for insurers

It has always been the case that managing investment portfolios for insurance companies requires careful consideration of many external factors that do not impact other types of investors, with one such factor being regulatory capital impact. That is especially true today, as the growth of private asset classes has driven numerous initiatives leading to potentially higher capital charges for certain investments.

As we begin 2025, insurers will need to navigate through this heightened regulatory scrutiny alongside uncertainties related to central bank policy, economic growth, inflation and geopolitical tensions in a market that is seemingly priced for perfection. Fortunately, a favorable market landscape for income-oriented investors is providing numerous opportunities for insurers.

### Heightened regulatory scrutiny

Concerns by regulators surrounding the packaging of private assets into innovative structures by insurers, particularly those that are private equity backed, have driven them to embark on multiple initiatives aimed at improving transparency and better aligning the capital treatment of investments with their underlying risk. Key updates include:

1. The National Associations of Insurance Commissioners' (NAIC) Principles Based Bond Definition project, set to be implemented on 1/1/2025, which will see securities that don't meet the definition of a bond move to Schedule BA and incur significantly greater capital charges.

2. A proposal to grant the NAIC's Securities Valuation Office (SVO) the power to restrict the use of a private letter rating if the SVO believes the rating isn't reflective of the underlying investment risk.

3. An increase in the capital charge assigned to residual tranches of structured securities held by life insurers from 30% to 45% for year-end 2024 filings.

Despite the increased regulatory scrutiny, capital efficient vehicles such as rated notes continue to be potentially effective ways to gain exposure to alternative asset classes without incurring punitive capital charges, so long as the underlying assets are bond-like in substance. We've had many conversations with investors in private credit rated notes helping them gain comfort that their investments will continue to pass muster with the NAIC.

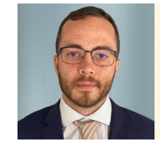
### Fixed income: tight spreads, but attractive all-in yields and areas of value

The U.S. Federal Reserve's concerns about the labor market caused it to ease the short-term Fed Funds rate over the back half of 2024. However, it is our belief that long-term rates will remain higher, driven by a strong economy, continued pricing pressures and the expected economic, trade and taxation agenda of the incoming U.S. administration. And while elevated base rates have resulted in all-in bond yields that continue to be at their most attractive levels in over 15 years, credit spreads are at or near historic tights. This means that in certain areas of the fixed income market in which spreads have compressed considerably, we are patiently waiting for better opportunities. Yet, there are other areas where we see strong relative value. One is investment grade (IG) structured credit, which has historically offered higher yields at higher ratings relative to IG corporates, making for strong capital-adjusted yields.

# Insurance asset management (cont.)


Peter Cramer
Senior Managing Director, Head of Insurance Portfolio Management & Trading


Nitin Chhabra
Managing Director, Head of Insurance Solutions


Louis Pelosi
Managing Director, Client Solutions

## Plenty of ways to navigate through regulatory, economic and geopolitical risks

### The varying role of insurance investments, and where we're seeing interest from investors

Our approach to strategic asset allocation begins with identifying the role of different types of investments in insurance company portfolios. Liability backing assets focus on high quality assets that provide stable income while matching liability characteristics. Return seeking assets offer higher return potential through growth, income or both, while also serving as portfolio diversifiers.

| | **Liability backing assets** | **Return seeking assets** |
|---|---|---|
| **Role:** | Match liability characteristics, aiming to provide stable income | Surplus growth, diversification |
| **Key asset classes:** | IG public fixed income, IG private fixed income, IG commercial mortgage loans | Non-IG fixed income, real estate, equities |

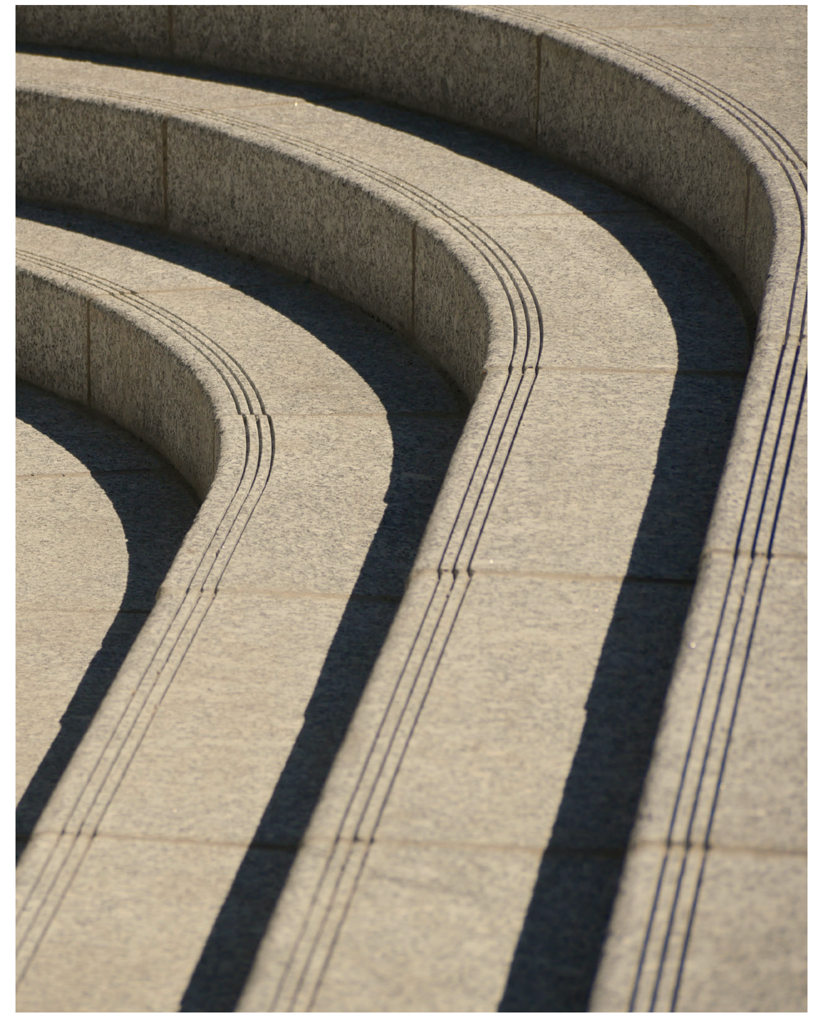
Within liability backing portfolios, investor interest in IG private fixed income remains strong due to its significant yield premium over comparably rated public bonds with no additional capital charge. We think this makes it an attractive asset class for those companies that have the capacity to trade liquidity.

Within return seeking portfolios, the focus of our conversations has been on direct lending and non-IG real estate debt. Both of these asset classes offer equity-like returns, can be accessed through capital efficient vehicles and benefit from supply/demand imbalances driven by continued pullbacks in lending by banks.

### Key takeaways

- Heading into 2025, insurers should be aware of higher regulatory scrutiny alongside numerous macro uncertainties.
- While all-in bond yields are at their most attractive levels in over 15 years, historically tight credit spreads have us taking a more patient approach within core fixed income.
- In liability backing portfolios, investor interest in IG private fixed income remains strong given its continued relative value over comparably rated publics.
- In surplus portfolios, we are seeing strong interest from insurance investors in direct lending and non-IG real estate debt.

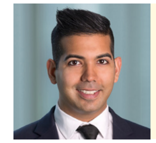
Source: Bloomberg, 2024–5.



# Retirement plan solutions

## De-risking appears attractive as yield curves normalize and equity valuations remain elevated

Tim Boomer
Senior Managing Director, Head of Client Solutions



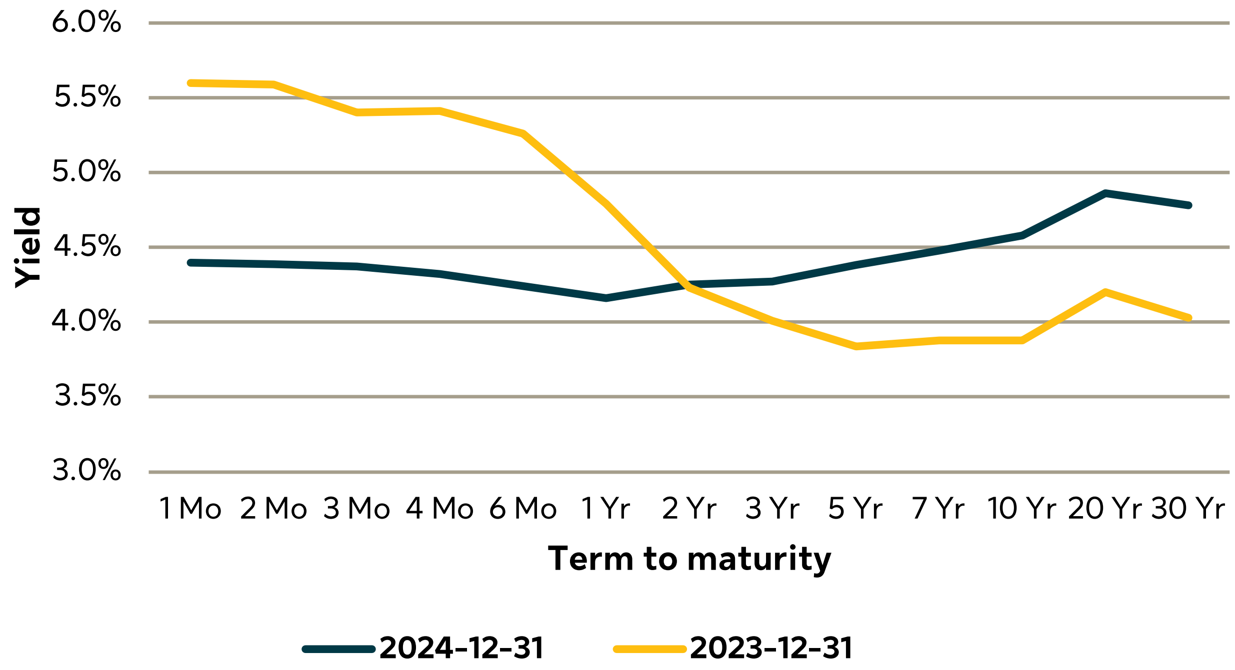
Ashwin Gopwani
Managing Director, Head of Retirement Solutions

### Current markets suggest favorable conditions for de-risking

In Q4 2024, the U.S. Federal Reserve commenced its first rate cut cycle after four years, with a 50-basis point (bp) cut in September and a 25-bp cut in December, with further cuts expected in 2025. This has prompted many plan sponsors to contemplate the question: is now still a good time to make changes to reduce risk, or has the opportunity passed? In our view, reducing risk has become more compelling compared to recent history.

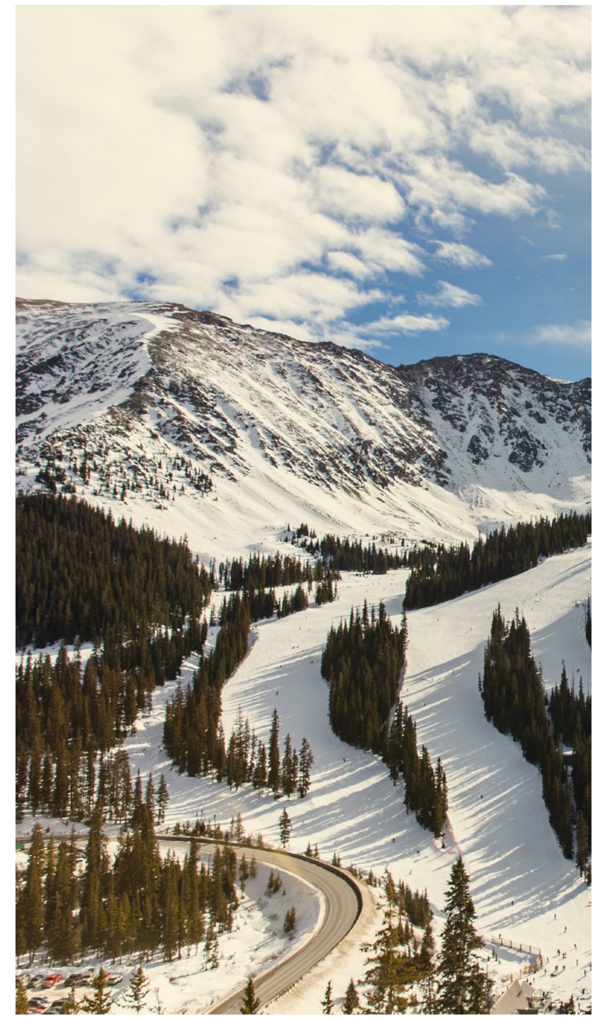
At year-end 2023, the yield curve was deeply inverted, with short rates significantly exceeding long bond yields. For plan sponsors using leverage to extend duration, this led to high carry costs. By the end of 2024, short rates were at a significantly lower point while longer-term yields were higher than year-end 2023. This steepening of the yield curve has positioned liability driven investing (LDI) portfolios for higher net yields, as these portfolios often receive longer-term yields as they seek to hedge long-dated liabilities. We are now seeing many plan sponsors consider increasing leverage within their portfolios.

### Steepening yield curve positioning LDI portfolios for higher net yields




Source: U.S. Department of Treasury, daily treasury par yield curve rates.

Long treasury yields are down from their peak in October 2023, but have not decreased at the same pace as short rates. In fact, long Treasury bond yields have experienced a net increase of approximately 76 bps over 2024, and are approximately 200 bps above their 10-year average level as of year-end 2024, suggesting an attractive entry point for longer-term fixed income.



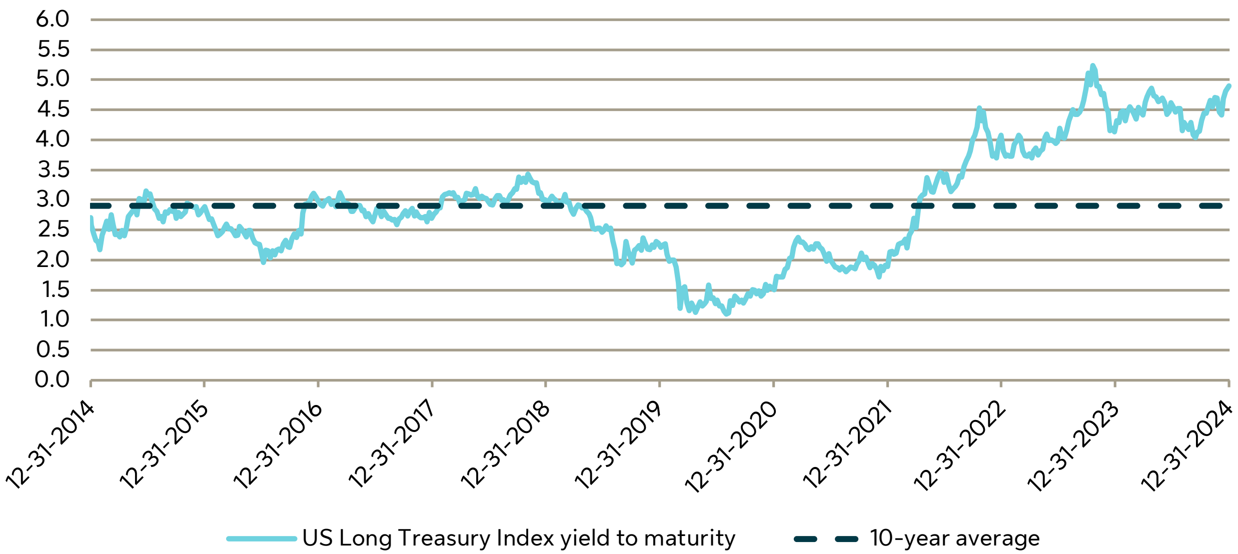
# Retirement plan solutions (cont.)

Tim Boomer
Senior Managing Director, Head of Client Solutions

Ashwin Gopwani
Managing Director, Head of Retirement Solutions

## De-risking appears attractive as yield curves normalize and equity valuations remain elevated

**Long bond yields significantly exceed long-term averages**




Source: Bloomberg, US Long Treasury Total Return Index, 2024.

### Plan sponsors seek further yield and diversification within fixed income portfolios

As funded statuses remain healthy and fixed income plays a larger role in many plan portfolios, plan sponsors are looking for ways to boost yields to keep up with liability growth and achieve sufficient diversification of credit exposure to mitigate default risks. Strategies that utilize investment grade private credit have seen increased interest from many plan sponsors as they seek to meet these objectives.

### As equity valuations remain high, plan sponsors look to lower-risk alternatives

Equity markets have persistently rallied since the start of 2024, hitting record highs. Concerns have been building as valuations far exceed forward earnings, meaning that equities appear expensive compared to historical standards. As a result of these concerns, many plan sponsors are considering reallocating from equities into less risky asset classes, while hoping to preserve some return potential. Real estate equity continues to garner interest from investors as an alternative asset class with a stable income profile and strong diversification potential. Non-investment grade private credit provides returns that rival other return-seeking asset classes, have low correlations to traditional asset classes and historically exhibit low default rates. Finally, narrowly syndicated credit offers some of the advantages of private credit with the liquidity that comes from publicly traded instruments.

### What does 2025 have in store?

While many pension plans were on track to close 2024 with strong funded positions, plan sponsors should remain wary of potential risks in the new year. For example, there remain many unknowns surrounding whether the Fed's policy will achieve a soft landing, how tariffs may impact economic growth and inflation, and whether the equity market rally will persist. We expect continued strong activity from plan sponsors in diversification and de-risking to protect their hard-earned gains from any adverse surprises.

## Key takeaways

- Short rates decreasing due to central bank rate cuts could be a potential tailwind for leveraged strategies as financing costs decline.
- Longer-term bond yields rising could provide an attractive entry point for mid- to long-duration fixed income.
- Equity valuations have hit new highs, reflecting a market consensus that equity markets are richly valued.

Sources: U.S. Department of Treasury, Bloomberg, 2024–5.

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Unless otherwise stated, all figures and estimates provided have been sourced internally and are as of December 31, 2024.

Unless otherwise noted, all references to "$" are in U.S.dollars.

All data are subject to change.



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