

Running the Right Race in 2025:

Taking Advantage of Different Starting Points

As investors size up opportunities in the new year, we believe that they need to be mindful of the recent history of each asset class and how that sets the stage for 2025. Fixed income has experienced two years of positive excess returns, weathering the high interest rate environment quite well. We expect that demand will remain in place as yields remain attractive, and economic growth is forecast to continue next year. However, with historically tight credit spreads and potential policy changes from the upcoming Trump administration having [sub-sector implications](#), we believe credit selection will be paramount in 2025.

Meanwhile, 2023 and 2024 were years of underwhelming activity in both commercial real estate (CRE) and some areas of private equity (PE) as higher interest rates adversely impacted these asset classes more so than fixed income. However, PE investors have experienced a pickup in exit activity and signs of a fundraising thaw, driven by lower interest rates, and we expect those areas of the market to pick up in 2025. Although the resetting of Office is still ongoing in CRE, we anticipate the solid fundamentals of the other four major property types to remain in place next year. We expect opportunities to be abundant in both asset classes, but investor due diligence will remain critical as interest rate uncertainty still remains a risk.

2025 Outlook: US Investment Grade



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KEY TAKEAWAYS

- > With credit spreads at multi-decade tights, credit selection will likely be paramount for 2025
- > We anticipate strong underlying demand to remain in place as yields remain historically attractive
- > Political appointees and increased M&A are expected to lead to an acceleration in sector differentiation

With the Fed beginning its rate cutting cycle in September along with a pre- and post-election rally in most US risk markets, momentum is positive as we end 2024. Economic growth remains strong; the job market is balanced; earnings growth is healthy; volatility is low; and inflation is close to the 2% mandate.¹ However, risk assets appear to be priced accordingly with investment grade (IG) credit spreads at multi-decade tights.² As such, we believe credit selection will be vital in 2025.

Fixed income yields remain attractive on a long-term basis, especially versus the equity market, and we expect elevated demand to continue across the IG market. But that demand has also led to spread compression across all credit rating buckets, reducing the risk-adjusted return. As a result, we feel now is the time to get closer to home risk-wise and wait for opportunities to deploy capital. The good news is that we expect those opportunities to come, with a heightened focus on political impacts and a more aggressive M&A landscape.

Politically, investors are eager to see how campaign trail rhetoric translates into real policy changes. We expect those policy changes to inject some volatility into markets. Deregulation and lower taxes (both corporate and individual) would most likely be tailwinds for performance.

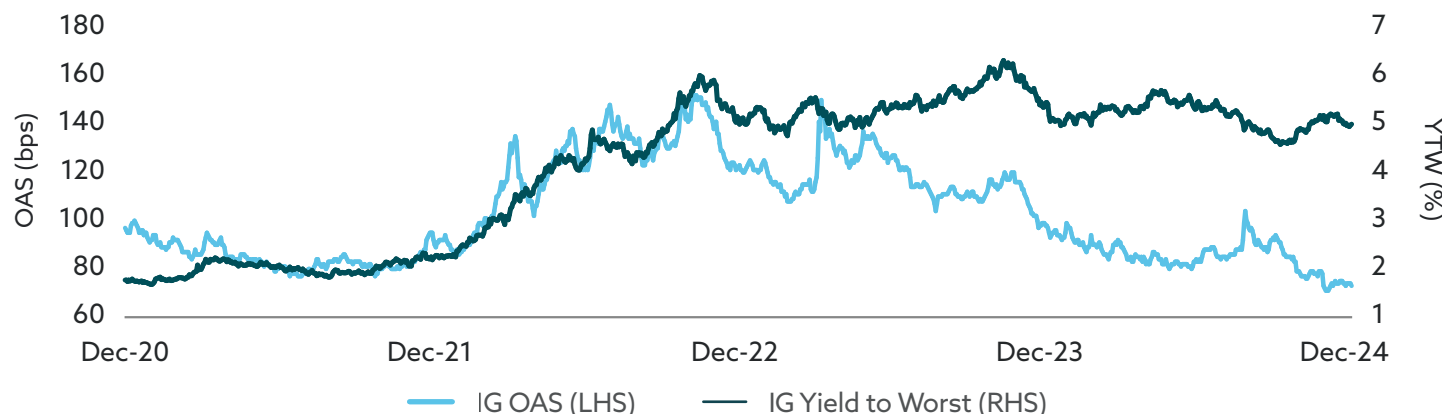
However, an increase in tariffs and a change in immigration policy would most likely have a detrimental impact on pockets of the IG market. For example, an uptick in deportation may lead to an increase in employee costs for those sub-sectors that rely on immigration for labor. Additionally, higher tariffs could harm pricing in certain sectors while also hampering the Fed's ability to ultimately bring inflation down to the 2% target.

M&A may also provide numerous opportunities for capital deployment in 2025. High CEO optimism, more friendly regulatory bodies and equities near all-time highs should lead to a heightened M&A landscape where it will be particularly important to avoid the acquirers and own the acquirees.

While starting 2025 closer to home from a risk perspective, we have still found places to put money to work to start the new year. Specifically, we are overweight Banks as less regulation may lead to less issuance which should be beneficial for performance. We also see opportunities in select Utility and Food companies.

Overall, it is our view that credit and sub-sector differentiation will play a major role in performance next year with spreads at these tight levels. With our experienced analyst, trading and portfolio management teams, we feel PPM is well-positioned to help our clients by building consistently performing portfolios on a security-by-security basis.

TIGHT SPREADS AND HIGH YIELDS FAVOR CREDIT SELECTION²



(1) FactSet Earnings Insight. 6 December 2024. (2) FactSet. Daily spread and YTW for the Bloomberg US Credit Index through 10 December 2024. Forward-looking statements are subject to uncertainties that could cause actual developments and results to differ materially from the expectations expressed.

2025 Outlook: US Investment Grade Private Credit



LUKE STIFFLEAR, CFA
Head of Private and
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KEY TAKEAWAYS

- > By adding IGPC to fixed income portfolios, an investor can reduce risk through diversification and covenants while picking up yield over equivalent public corporate bonds; this relationship is expected to continue into 2025
- > Tailwinds such as limited bank capital, increasing institutional investor demand and growing issuance are all likely to continue

Investors in the Investment Grade Private Credit (IGPC) market are currently benefiting from several tailwinds that we expect to remain in 2025. Regulation continues to limit bank capital available for corporate lending, opening the door for institutional investors. Indeed, corporate pension funds and insurance companies are increasing exposure to the asset class. At the same time, issuance is growing as issuers look for a tailored debt solution outside of public markets (size, tenor, funding dates). Generationally tight spreads in public investment grade markets have caused private premiums to widen, making overall IGPC yields more attractive.

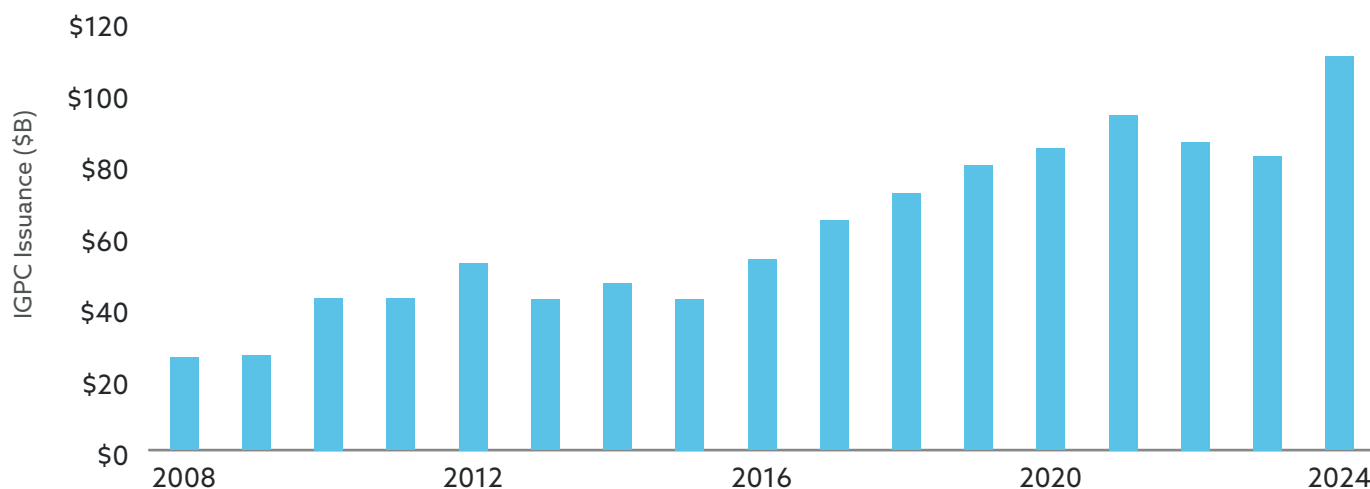
IGPC investing generally falls into four categories: corporates, infrastructure/project finance, credit tenant lease and asset-backed finance. We would note that asset-backed finance is expected to be the fastest-growing segment.

With policy uncertainty once again surrounding the market in the new year, the covenants written into many IGPC bonds may provide investors with protection against credit deterioration. Examples of such structural enhancements include leverage covenants (debt/EBITDA) or asset sale restrictions, which may result in additional economics to investors through amendment fees and coupon bumps.

Acknowledging that the private bond market tends to be less liquid than the public, IGPC bonds typically offer a credit spread premium between 20 to 100 bps higher than comparable public investments.³ We expect this spread premium to stay at existing levels throughout 2025. In fact, the premium is ending 2024 at the higher end of that range.

Quickly on liquidity, demand historically outstrips supply, providing more market liquidity when making sales of IGPC debt. Specialty broker dealers that traffic in IGPC bonds are flourishing and new entrants are entering the market. Constricted allocations on new issues also leave investors demanding secondary purchases.

US IGPC ISSUANCE HIT A RECORD IN 2024³



(3) Unless otherwise indicated, private placement statistics may include issuance amounts, spreads and premiums that are aggregated and calculated by PPM based on compilation of transactions PPM observes in the private placement market. Sources of PPM data may include, but are not limited to, the investment bank or agent sponsoring a transaction, SEC filings, or other third-party data sources obtained by PPM in good faith and believed to be reliable, including the Private Placement Monitor. Data on public bonds used to calculate private placement premiums comes from Bloomberg. Forward-looking statements are subject to uncertainties that could cause actual developments and results to differ materially from the expectations expressed.

2025 Outlook: US High Yield



ADAM SPIELMAN

Head of Leveraged Credit



JOHN BROZ

Portfolio Manager



KARL PETROVICH

Portfolio Manager

KEY TAKEAWAYS

- > The high yield credit cycle benefits from positive trends in ratings, a lower distress ratio and a below average default outlook
- > Economic growth has been resilient, while we remain focused on any cracks in the labor market
- > We see value in natural gas-exposed Energy names, Financials and Telecommunications; leveraged loans still offer attractive income

We expect the supportive elements of the high yield credit cycle to continue in 2025. Economic and corporate profit growth are positive. The upgrade/downgrade ratio has stabilized and the distress ratio is well below long-term averages, signaling a benign default outlook.⁴

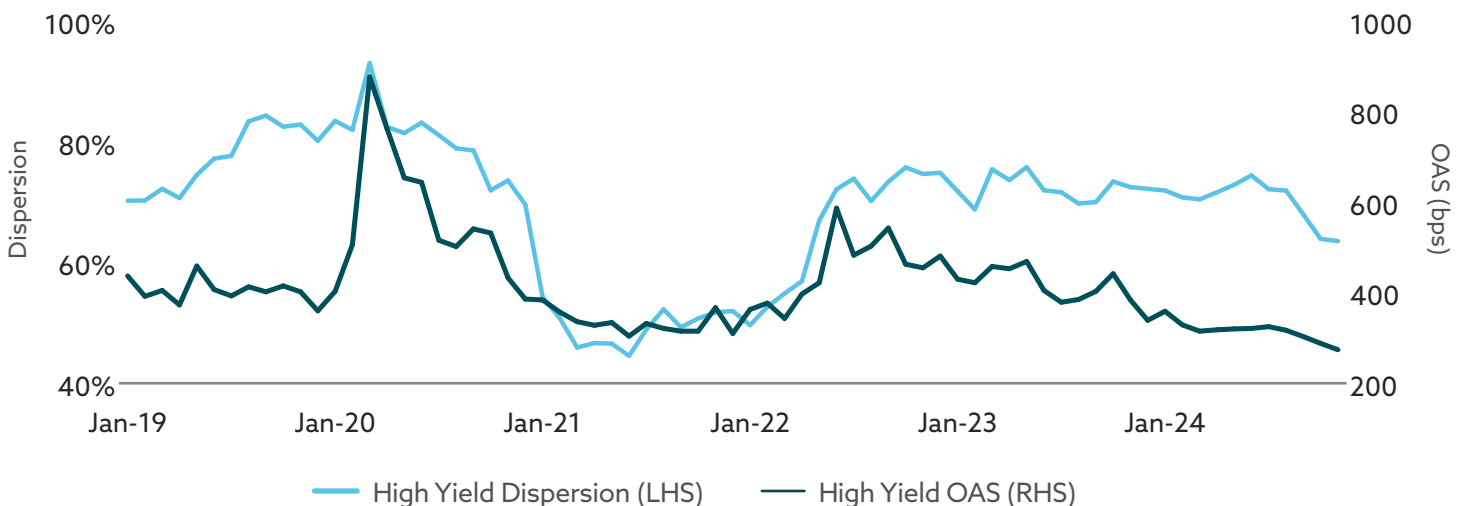
Valuations generate much debate with spread levels near multi-decade lows. Yield

levels around 7% still offer intriguing long-term return prospects. The ICE BofA US High Yield Constrained Index – at over 50% BB and only 12% CCC – is also higher quality than in past cycles.⁵ We believe the key macro questions are around employment, inflation and interest rates. We continue to watch for any cracks in what has been a resilient US employment picture. Inflation is contained, in our view.

The technical picture remains robust. The asset class has experienced consistent inflows, while net supply has been moderate.⁶

Overall, we see value in the core of the market – spreads in the 200-400 bps range – across ratings. Dispersion in credit spreads declined in 2024 but still screens high relative to spread levels. Thematically, we like select BBB rated credits over higher-quality BB risk. Sector-wise, we favor natural gas-exposed credits in the Energy sector over oil-exposed names and are overweight Financials and Telecommunications. For clients that have the flexibility to own leveraged loans, we favor an out-of-index allocation to earn attractive current income.

DISPERSION DECLINED IN 2024, BUT STILL SCREENS HIGH RELATIVE TO SPREADS⁷



(4) Unless indicated, data sourced from BofA Global Research. 2 December 2024. (5) Rating data sourced from ICE Data Services and through 30 November 2024. (6) Flow data sourced from Morningstar and through 30 November 2024. (7) Dispersion defined as the proportion on a face value basis of the developed market USD HY Index marked +/-100 bps of the overall Index level. Forward-looking statements are subject to uncertainties that could cause actual developments and results to differ materially from the expectations expressed.

2025 Outlook: US Leveraged Loans



ADAM SPIELMAN

Head of Leveraged Credit



JOHN BROZ

Portfolio Manager

KEY TAKEAWAYS

- > Bank loans can offer investors attractive carry with yields over 8%; although prices are high, supportive fundamentals and technicals are set to continue into 2025
- > From a macro perspective, the three main areas of focus that could impact the bank loan market are employment, inflation and interest rates
- > Sector-wise, we favor midstream credits in the Energy sector and are overweight Food, Beverage & Tobacco and Healthcare

Our view is that the supportive elements of the bank loan credit cycle seen in 2024 along with positive economic and corporate profit growth should continue in 2025. Valuations have become less compelling in the loan market with over 2/3 of the market trading above par, more than doubling the average since 2014.⁸ However, loans still offer attractive carry with yields over 8%. We believe such conditions favor PPM's bottom-up, research-focused investment approach to find relative value on a credit-by-credit basis.

Fundamentally, we expect improvements in loan defaults and the upgrade/downgrade ratio over the next year. Loan defaults,

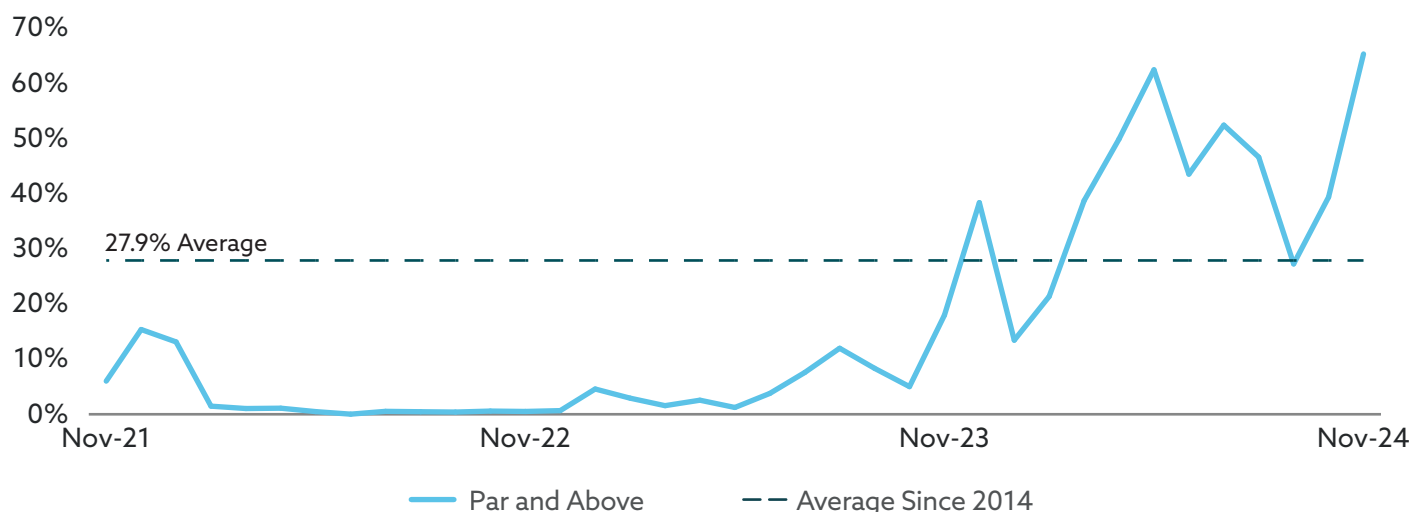
including liability management exercises (LMEs), are currently at a 46-month high, but forward looking indicators such as the distress ratio imply a lower default rate in 2025.

The technical picture of the loan market should remain robust with CLO creation, inflows into the asset class, and moderate net supply continuing into 2025. To illustrate the currently supportive nature of loan technicals, CLO issuance, a major driver of demand, is up 72% from the year-ago period.

From a macro perspective, the three main areas of focus are employment, inflation and interest rates. The US job market has held up admirably in this elevated interest rate environment, but we are looking for any signs of softening. We believe inflation has been restrained, but the interest rate story is still playing out as markets await the policy impacts of the upcoming second Trump administration.

As for investment opportunities, we continue to focus on investing in core performing credits in the loan market to capture the carry. Sector-wise, we favor midstream credits in the Energy sector and are overweight Food, Beverage & Tobacco and Healthcare. We consider some of our Healthcare holdings to be post-LME success stories, with names that have improved their capital structure since the COVID downturn. For clients that have the flexibility to own corporate bonds, we favor an out-of-index allocation to provide price convexity.

LOAN VALUATIONS HISTORICALLY HIGH TO END 2024⁸



(8) Unless indicated, data sourced from LCD, a part of PitchBook. 2 and 9 December 2024. Forward-looking statements are subject to uncertainties that could cause actual developments and results to differ materially from the expectations expressed.

2025 Outlook: US Private Equity



CHAMP RAJU

Head of Private Equity



CRAIG RADIS

Senior Partner



MARK STAUB

Senior Partner



RAY ZHANG, CFA

Partner

KEY TAKEAWAYS

- > US PE investors have experienced a pickup in exit activity and signs of a fundraising thaw, driven by lower interest rates; we expect those areas of the market to improve in 2025
- > We also believe deal flow will remain robust, especially for co-investments
- > Despite market expectations for a strong year, underwriting and due diligence will remain paramount as inflation, geopolitics and macroeconomic uncertainty remain risks

With the Fed beginning a rate cutting cycle in September and a Republican government taking over in January, the market consensus is for a bright 2025 for US PE. We agree, but we also believe times of exuberance are not times to forgo extensive underwriting and due diligence.

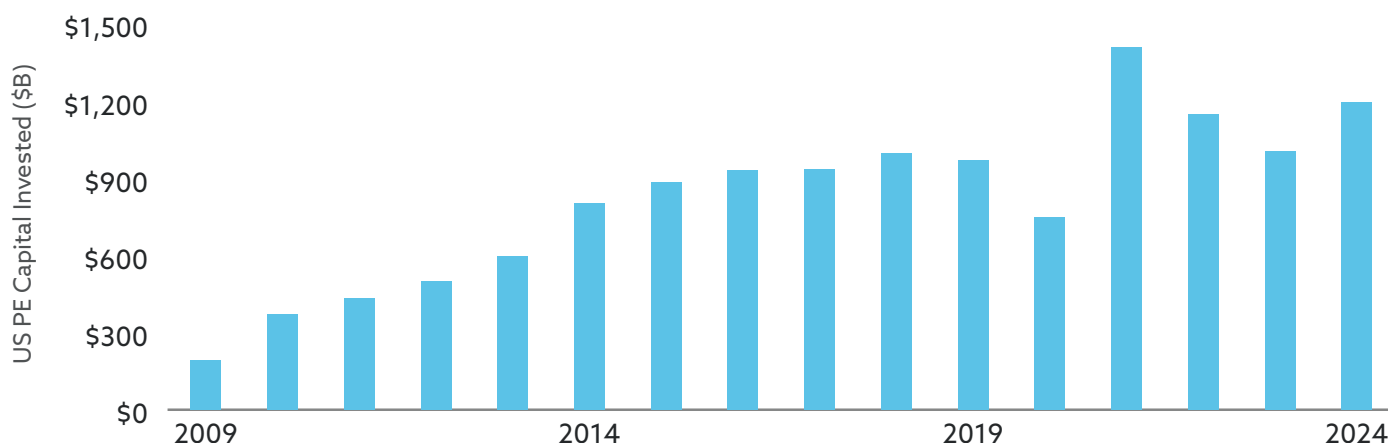
Since 2022, when the Fed's rate hiking cycle significantly raised interest rates, the PE market has faced headwinds. Exit activity slowed, led by a reduction in IPOs. However, 2024 brought a pickup in exit activity, which we expect to continue in 2025. There has been a surge in single-asset continuation vehicles, increasing distributions to limited partners (LPs). Given today's lower interest rate environment, some general partners are refinancing debt facilities and executing dividend recapitalizations to provide LPs with liquidity.

Fundraising activity had slowed for all but the biggest names, resulting in smaller dollar amounts raised amid longer time frames. We observed some thawing in 2024 and believe the fundraising market could improve next year. When the pace of asset sales increases, distributions back to LPs also increase, which can increase LPs capacity to commit fresh capital. Further, more recent PE vintages may be investing at better valuations.

Investment activity has already rebounded, and we expect robust deal flow again in 2025. This includes an area of focus for PPM – co-investment deals. Lower interest rates could bolster deal flow; however, cheaper borrowing costs may also lead to elevated valuations. The Technology sector has been a focal point for PE investors, and we expect it to remain so. AI and machine learning seem to be discussed at every meeting. These trends impact other sectors – maybe all sectors – given technology needs are embedded in most businesses.

The macro drivers we have discussed come with risks. The Fed's current cutting cycle is underpinned by the assumption inflation is under control, but it may not be. While we believe portfolio companies are better prepared to manage higher rates, an uptick in inflation could lead to slower growth and higher input costs. The economy has been supported by consumer spending, but that strength may ebb in 2025. Specific to PE, public equity markets have outperformed over the last two years, and continued outperformance could impact flows of future dollars into PE.

WE EXPECT DEAL FLOW TO REMAIN ROBUST, ESPECIALLY FOR CO-INVESTMENTS⁹



(9) PitchBook. As generated on 11 December 2024. Forward-looking statements are subject to uncertainties that could cause actual developments and results to differ materially from the expectations expressed.

2025 Outlook: US Commercial Real Estate



JOE BURKE, CRI, FLMI
Interim Head of Commercial Real Estate

KEY TAKEAWAYS

- > Setting aside Office, we expect occupancy levels in the other four major property types to remain healthy and rental growth to be steady in 2025
- > A rise in maturities in 2025 should provide ample opportunities for lending
- > However, long-term interest rates may have an outsized impact on not only lending activity but also valuations and property sales volume

As we wrap up 2024, we contend that investors are best served viewing the CRE market through two different lenses. Setting aside Office for a moment, fundamentals are stable to strong in the Multifamily, Industrial, Retail and Hotel property types as occupancy levels remain healthy and rental growth is steady. We expect this to continue into 2025 with marginal improvement possible.

Technical tailwinds may also occur next year, as we anticipate new construction starts in Multifamily and Industrial to remain on the decline. Deliveries have begun moderating in the second half of 2024 due to the lack of available construction financing and the high cost to build.¹⁰ As such, a decrease in supply should have a positive impact on occupancy levels and rental growth.

Office, on the other hand, remains challenged. We have seen some green shoots as a handful of markets have had positive absorption.

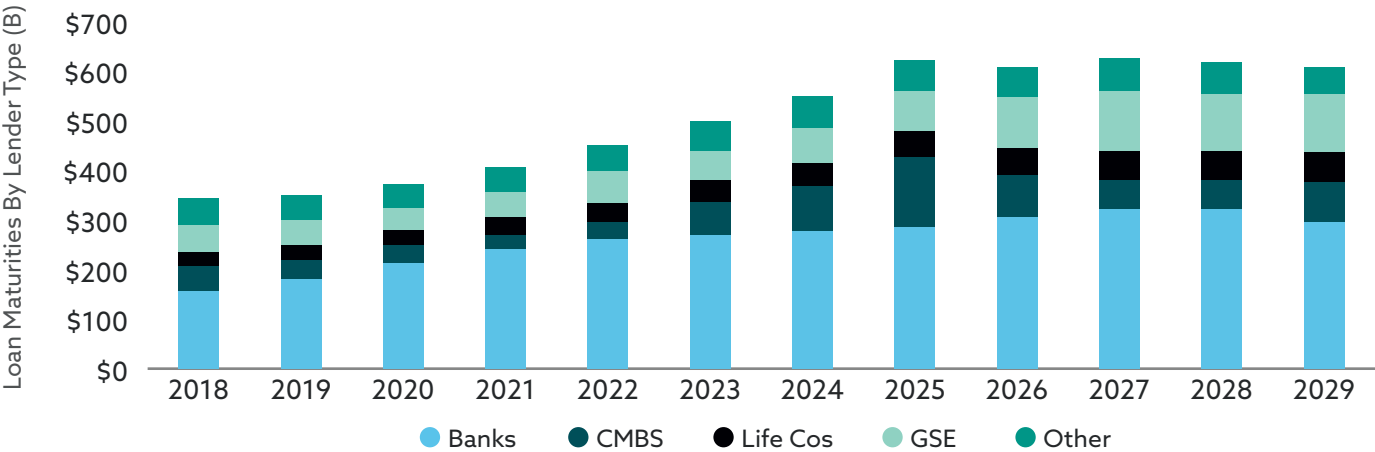
Certain companies such as Amazon are beating the drum for employees to come back to the office full-time, or at least close to full-time, which may help buck the work-from-home trend. Also, our base case is that Office valuations have stabilized with a bias to go upward. But, we believe some pain still is possible with Office loan maturities coming up and tenant lease expirations coming into play.

Looking at the CRE market as a whole, we feel that 2025 will be defined by two major factors: upcoming loan maturities and long-term interest rates. With a 13% rise in maturities from 2024, the coming year should provide ample opportunities for lending.¹¹ In fact, the MBA forecasts that total mortgage lending (originations and refinancing) should increase from \$539B to \$665B in 2025.¹²

Although much focus will be on how the Fed manages the rate cutting cycle in the new year, it is long-term interest rates that may have an outsized impact on not only lending activity but also valuations and property sales volume. Barring a run-up in the back-end of the Treasury yield curve, we expect most property types to appreciate and lending activity to meet estimated projections. This, in turn, should lead to demand for mortgage capital.

With this potential uptick in lending opportunities, our CRE team will continue to monitor all markets and major property types looking for relative value for our clients. We anticipate maintaining our historical focus on Multifamily, Industrial, and Necessity-Anchored Retail loans, which are considered more defensive property types.

MATURITIES IN 2025 MAY LEAD TO OPPORTUNITIES¹¹



(10) J.P. Morgan. Commercial Real Estate Update. 11 October 2024. (11) Trepp, Inc. Based on Federal Reserve Flow of Funds through Q2 2024. (12) MBA. Commercial Real Estate Finance Market Outlook. September 2024. Forward-looking statements are subject to uncertainties that could cause actual developments and results to differ materially from the expectations expressed.

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