Global Credit Outlook: 1Q2025

Cautiously optimistic

BlackRock.

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Authors

Amanda Lynam, CPA
Head of Macro Credit Research

Dominique Bly
Macro Credit Research Strategist

Key takeaways

- **Macro:** We expect monetary policy "normalization" in the U.S., as opposed to significant "easing." We see scope for deeper cuts from the ECB, given the weaker growth backdrop and trade risks. Pages 3 – 10.
- **U.S. consumer:** While bifurcated, aggregate household balance sheets have benefited from a large wealth creation boost. This should support resilient U.S. growth, if the labor market remains solid. Pages 11 – 15.
- **Liquid credit:** The strong performance of corporate credit in recent months has reflected a combination of above-trend growth, less restrictive monetary policy, solid corporate fundamentals, and favorable technical tailwinds. While this "warranted resilience" has pushed spreads to the tight end of the historical range, we still see a compelling all-in yield opportunity in 2025. Pages 16 – 28.
- **Private debt:** The multi-faceted growth trends behind private debt should gain further momentum in 2025, driven by its expanding addressable markets of borrowers *and* investors. We expect private markets will play a role in financing some long-term structural shifts in the global economy. The sponsor-related M&A rebound we anticipate should provide an opportunity to deploy capital. Pages 29 - 47.
- **Real estate debt:** The trend of "dispersion, but not disruption" remains in place. We see more downside for office valuations. Pages 48 – 51.
- **Risks to our view:** Significant policy shifts are on the horizon. A scenario of widespread tariffs coupled with retaliation could weigh on credit spreads. This could also cause corporates to lean more heavily on layoffs to protect margins, which is a risk to U.S. consumer financial strength.

Monetary and fiscal policy

Uncertainty, given significant policy shifts on the horizon

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Normalizing vs. easing monetary policy

Central banks took additional steps in 4Q2024 to reduce the level of restriction in monetary policy (Exhibit 1). Heading into 2025, however, uncertainty around the path of monetary policy in 2025 is elevated – in large part because of the potential for significant policy shifts following the U.S. election.

Clarity on the so-called "neutral" rate of interest – the rate that neither restricts nor stimulates growth – will be key to determining the ultimate destinations for these policy rates. Indeed, the distinction between monetary policy "normalization" and "easing" is important for corporate credit investors to monitor.

In our view, near-term policy *easing* (i.e., bringing rates to a level *below* the neutral rate) in response to a sharp growth downturn would likely be accompanied by meaningful credit spread widening. By contrast, policy rate *normalization* (i.e., bringing rates to, or slightly above, neutral) in response to improved inflation is a more supportive backdrop for credit (and largely what is priced into spreads, currently).

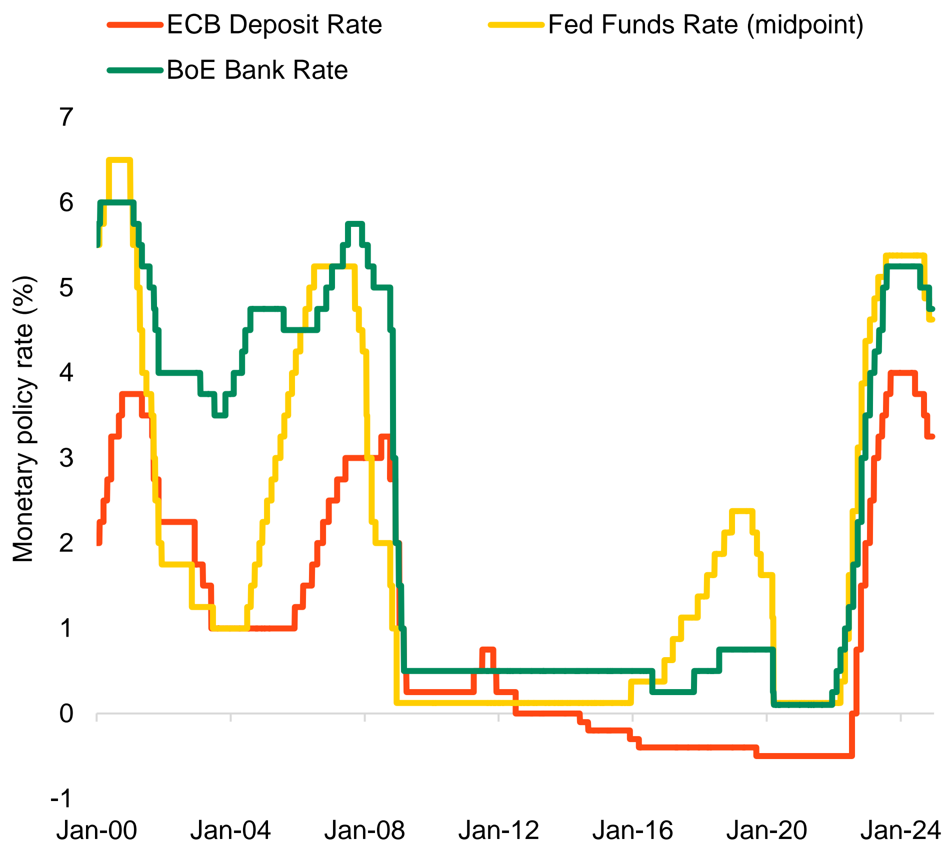
In the U.S., we believe the risks are skewed to a higher terminal policy rate relative to current market pricing, owing to above trend growth and the potential for upward pressure on inflation.

In Europe, given the weaker growth backdrop and progress on inflation, we view the risks as skewed towards a more aggressive cutting cycle relative to (1) the Federal Reserve, and (2) market pricing.

In the U.K., we expect a gradual interest rate cutting cycle, owing in part to the relative persistence of inflation in the region. That said, a soft economy may cause the BoE to cut more than market pricing anticipates.

Exhibit 1: The level of restriction in monetary policy has eased somewhat

Monetary policy rates for the European Central Bank (ECB), Federal Reserve (Fed), and Bank of England (BoE)



Source: BlackRock, European Central Bank, Federal Reserve, Bank of England, Bloomberg. As of December 10, 2024.

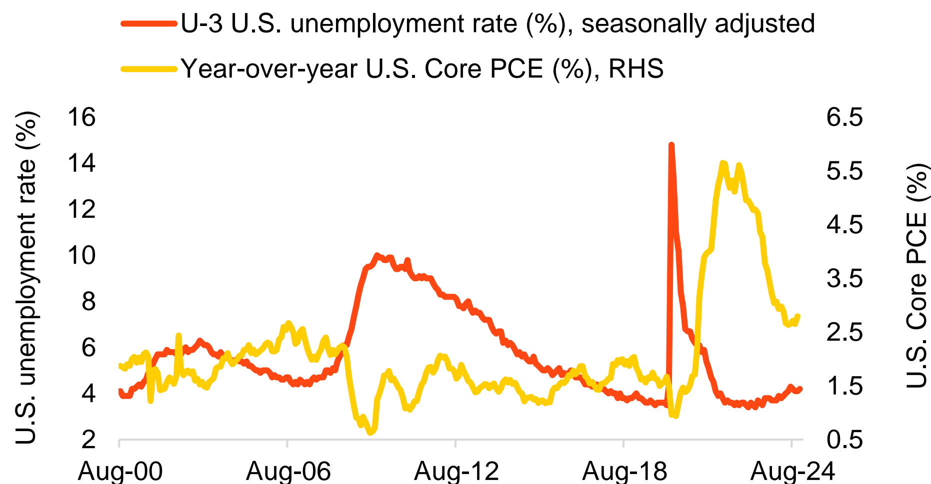
A “recalibration” cycle for the Fed

We expect structurally higher interest rates in this cycle, which stands in contrast to the ultra-low rates which prevailed for much of the post-financial crisis era. Indeed, the FOMC's September 2024 Summary of Economic Projections (SEP) showed the median member expected a longer-run Fed Funds rate of 2.9% - a figure that has gradually drifted higher over the past few quarters. We expect the December SEP (to be released December 18th) will show another increase to the longer-run Fed Funds projection.

Fed Chair Powell has referenced a desire to "recalibrate" monetary policy, now that both sides of the Fed's dual mandate (i.e., price stability and maximum employment) have moved into balance (Exhibit 2). But this does not foreshadow a deep rate cutting cycle, in our view. As shown in Exhibit 3, market pricing currently reflects approximately 90bp of additional rate cuts through January 2026, pointing to a terminal rate of approximately 3.7% (as of December 11th). For context, as recently as mid-September, market pricing was pointing to a terminal rate closer to 2.8%. Absent a sharp downturn in growth, we believe the risks are skewed to the Fed delivering *fewer* cuts than market pricing implies – but the path is highly dependent upon how the trade and other fiscal policies evolve.

Exhibit 2: The FOMC views the risks to its dual mandate as "roughly in balance"

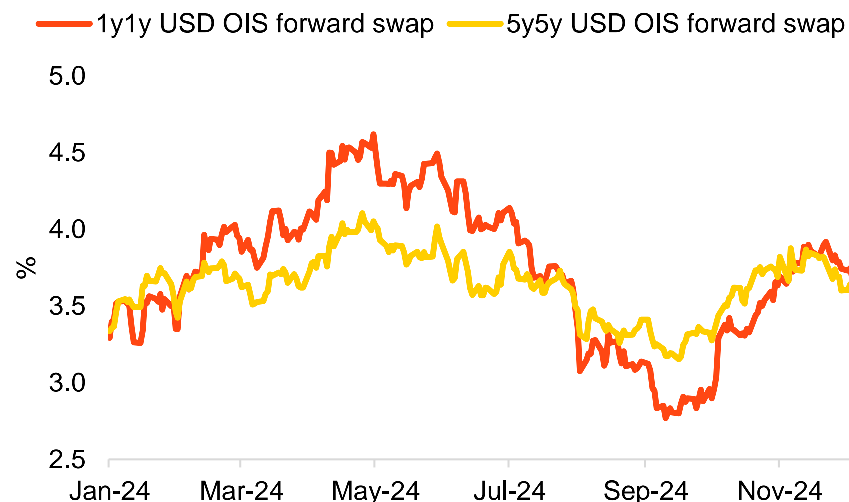
U-3 U.S. unemployment rate (%) seasonally adjusted, and year-over-year U.S. Core PCE inflation (%) seasonally adjusted, RHS



Source: Bureau of Labor Statistics, Bureau of Economic Analysis, BlackRock. Captures unemployment rate data through November 30, 2024, and inflation data through October 31, 2024 (most recent available as of December 10, 2024).

Exhibit 3: The market's pricing of the Fed's terminal and neutral rates has fluctuated

1y1y Overnight Indexed Swap (OIS) forwards, as a proxy for the terminal rate of this cycle, and 5y5y OIS as a proxy for the long-term neutral rate



Source: Bloomberg, BlackRock. As of December 11, 2024. **There can be no guarantee any forecasts may come to pass.**

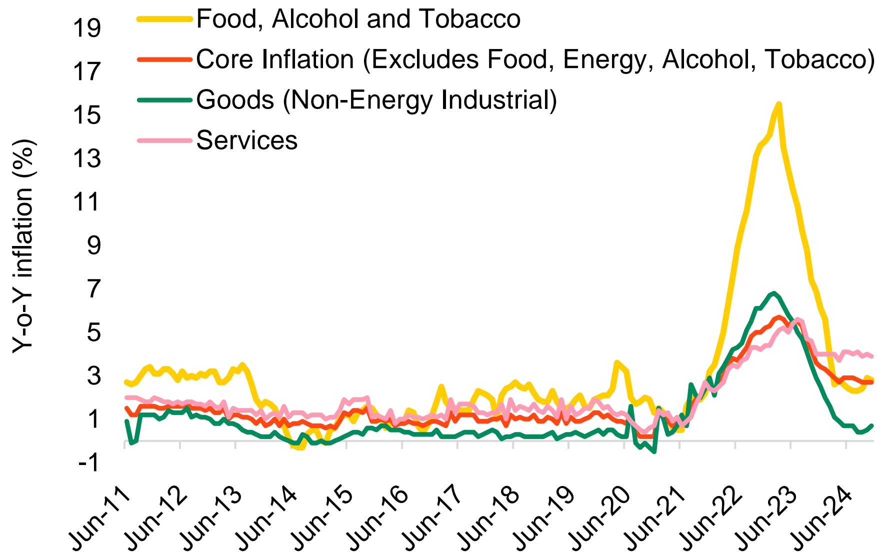
Potential for more aggressive cuts from ECB

Relative to the U.S., the growth-inflation mix in Europe is more challenging. Recent downside surprises in growth have been driven by a combination of contracting manufacturing activity, sluggish services activity and weaker exports (among other factors). ECB President Lagarde has characterized the risks to economic growth in the region as tilted to the downside, owing to a combination of factors including, (1) geopolitical risks, which could disrupt energy supplies and global trade (increasing energy and freight costs, for example), and (2) reduced demand for Euro Area exports, due to a weaker world economy or an escalation in trade tensions between major economies.

As downside growth risks have become more pronounced over the past few months, market pricing has implied a deeper rate cutting cycle from the ECB (Exhibit 5). Using Overnight Index Swaps, the market implied terminal rate is in the range of 1.6% by late 2025 (compared to 3.25% as of November 20th). Meanwhile, the Euro Area's most recent inflation print showed a continuation of elevated services inflation (Exhibit 4), partly due to the longer-term nature of wage adjustments in the Euro Area.

Exhibit 4: Services inflation has remained sticky in the Euro Area, while goods inflation declined

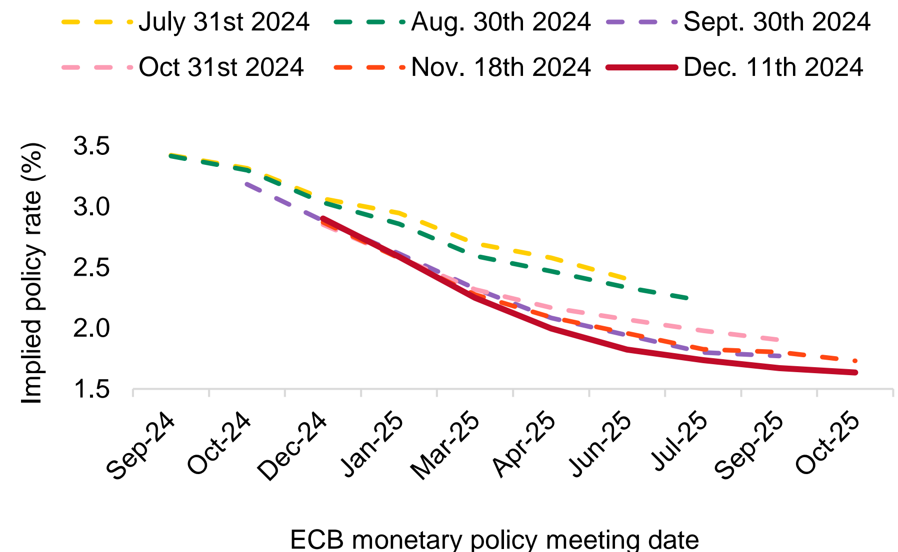
Year-over-year inflation (not seasonally adjusted) for Euro Area, by category



Source: BlackRock, Eurostat, Bloomberg, European Central Bank. Captures data through November 30, 2024 (most recent available as of December 10, 2024).

Exhibit 5: Market pricing points to deeper ECB rate cuts, relative to a few months ago

The ECB policy rate path implied by Overnight Index Swaps, at various points in 2H2024



Source: BlackRock, Bloomberg. As of December 11, 2024. **There is no guarantee any forecasts may come to pass.**

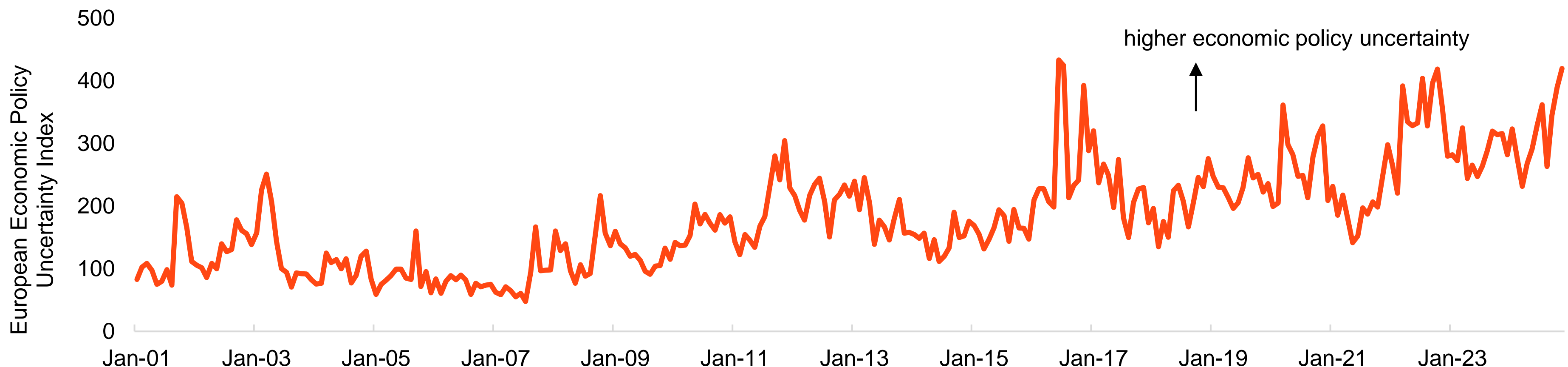
Europe: policy uncertainty is another risk

Elevated economic policy uncertainty also has the potential to weigh on investment in the Euro Area, as a recent analysis from the European Commission highlighted. Their analysis leverages the monthly Economic Policy Uncertainty Index developed by professors Scott Baker (Northwestern University), Nick Bloom (Stanford University) and Steven Davis (University of Chicago)[1], shown in Exhibit 6. They estimate that "an average-sized exogenous shock to uncertainty" reduces Euro Area real GDP growth by 0.45 percentage points. The European Commission's scenario analysis also included the following conclusions:

- If economic policy uncertainty reverted to the (lower) pre-pandemic levels (i.e., 1Q2009 to 4Q2019), this could provide as much as a 1.2 percentage point boost to real GDP for the Euro Area. The potential boost would be higher for investments (2.8 percentage points) and lower for consumption (1.0 percentage points), under this scenario.
- By contrast, if economic policy uncertainty increases by 50% relative to the post-pandemic levels (i.e., 1Q2020 to 2Q2024), this could provide a headwind to real GDP of as much as 0.6 percentage points. The potential headwind to investments would be more pronounced (1.4 percentage points) relative to the potential headwind to consumption (0.5 percentage points).

Exhibit 6: Economic policy uncertainty presents a downside risk to Euro Area investment

European Economic Policy Uncertainty Index



Source: Haver Analytics, Economic Policy Uncertainty Index developed by professors Scott Baker, Nick Bloom, and Steven Davis (more details on methodology can be found at: PolicyUncertainty.com). Captures data through November 30, 2024 (most recent available as of December 2, 2024). The European Economic Policy Uncertainty (EPU) Index is based on news articles from two newspapers from each of the five largest European economies: France: Le Monde, Le Figaro; Germany: Handelsblatt, Frankfurter Allgemeine Zeitung (FAZ); Italy: Corriere della Sera, La Repubblica; Spain: El Pais, El Mundo; UK: Financial Times, The Times of London. The number of news articles containing the terms uncertain or uncertainty, economic or economy, and one or more policy-relevant, such as policy, tax, spending, regulation, central bank, budget and deficit terms are counted. All news searches are done in the native language of the paper in question. Each paper-specific series is normalized to standard deviation 1 prior to 2011 and then summed. The series is normalized to a mean of 100 prior to 2011.

[1] Baker, S.R., N. Bloom, and S.J. Davis. (2016) "Measuring Economic Policy Uncertainty." The Quarterly Journal of Economics, Vol. 131, No 4, pp. 1593-1636.

Trade *uncertainty* precedes implementation

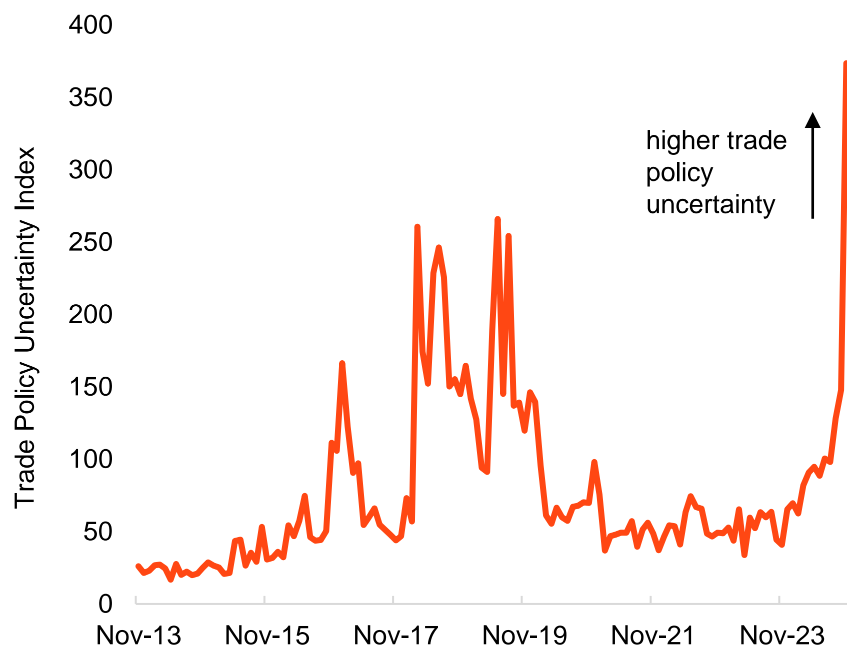
In recent months, the uncertainty related to trade, in particular, has notably increased. Exhibit 7 illustrates this using the Trade Policy Uncertainty (TPU) Index developed by Federal Reserve Board economists[2]. The historical precedent provides some perspective. A 2019 paper by Federal Reserve Board economists[3] found that the rise in trade policy uncertainty in 1H2018 (a period of escalating U.S.-China trade tensions and implementation of new tariffs) accounted for a 0.8 percentage point decline in the level of global GDP in 1H2019.

President Lagarde addressed the trade-related risks directly, during the Q&A in the October monetary policy meeting: "Any restriction, any uncertainty, any obstacles to trade matter for an economy like the European economy, which is very open...Any hardening of the barriers, the tariffs, the additional obstacles to that possibility to trade with the rest of the world is obviously a downside." Data from Eurostat (the statistical office of the European Union) shows that the U.S. represented approximately 20% of goods exported from the European Union in 2023.

For corporate credit investors, we see the most risk to fundamentals in a scenario of across-the-board tariffs (i.e., not targeted to specific countries or products), which may be accompanied by retaliatory tariffs. To the extent that such a scenario materializes, it has the potential to weigh on corporates' input costs and profit margins, beyond a "one time" upward price level shock. It may also shift consumer consumption patterns, based on the elasticity of the good. Depending on the severity of any input cost pressures, corporates may look to reduce headcount as tool to protect margins. So far, U.S. corporate layoff activity has been muted, as characterized by an unemployment rate which remains low by historical standards (4.2%) alongside similarly contained levels of jobless claims.

Exhibit 7: Trade policy uncertainty has moved higher following the U.S. election

Trade Policy Uncertainty Index (measured monthly)



Source: Haver Analytics, BlackRock. Captures data through November 30, 2024 (most recent as of December 10, 2024). The Trade Policy Uncertainty (TPU) Index is based on automated text searches of the electronic archives of seven newspapers: Boston Globe, Chicago Tribune, Guardian, Los Angeles Times, New York Times, Wall Street Journal, and Washington Post. The measure is calculated by counting the monthly frequency of articles discussing trade policy uncertainty (as a share of the total number of news articles) for each newspaper. The index is then normalized to a value of 100 for a one percent article share. Developed by Dario Caldara, Matteo Iacoviello, Patrick Molligo, Andrea Prestipino, and Andrea Raffo.

[2] Caldara, Dario, Matteo Iacoviello, Patrick Molligo, Andrea Prestipino, and Andrea Raffo, "The Economic Effects of Trade Policy Uncertainty," revised November 2019, Journal of Monetary Economics.

[3] Caldara, Dario, Matteo Iacoviello, Patrick Molligo, Andrea Prestipino, and Andrea Raffo (2019). "Does Trade Policy Uncertainty Affect Global Economic Activity?," FEDS Notes. Washington: Board of Governors of the Federal Reserve System, September 4, 2019, https://doi.org/10.17016/2380-7172.2445.

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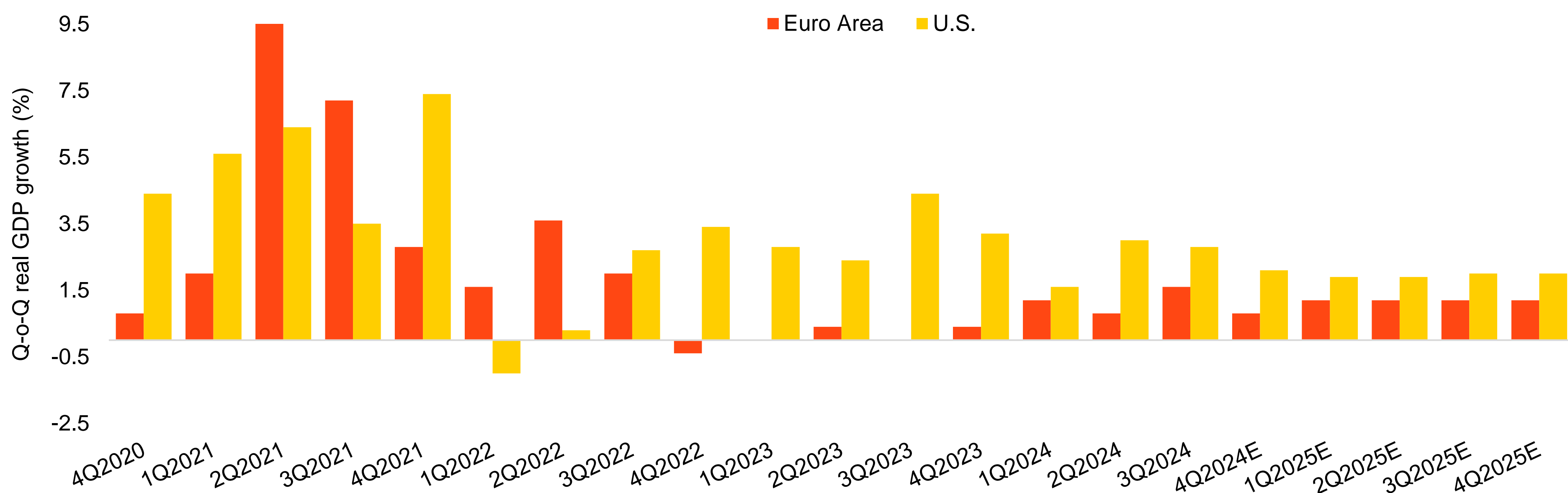
More divergence in U.S. vs. Europe growth

The elevated uncertainty related to economic policy (including trade) suggests the growth divergence between the U.S. and Europe is poised to persist into 2025 (Exhibit 8). According to the Atlanta Fed's GDPNow, U.S. real GDP is tracking at an above-trend pace of 3.3% (as of December 9th) and has increased (from 2.4%) since the November 5th U.S. election. Bloomberg consensus estimates (which capture a wide range of contributor estimates) call for the U.S. to grow 2.1% in 4Q2024 (quarter-over-quarter, annualized). Meanwhile, Bloomberg consensus growth estimates for the Euro Area are relatively more muted, at 0.8% (again, Exhibit 8), and have been roughly flat over the past several weeks.

The pace of above-trend growth in the U.S. has been key, in our view, to the resilience of corporate credit spreads for much of 2024 (and especially in the past few months). Maintaining a pace of trend growth (or, ideally, above trend) will be key to validating the current (tight) spread valuations (as highlighted later). That said, we are not bracing for significant underperformance in EUR credit spreads, because of the weaker growth backdrop. First and foremost, this is not a new pattern, as the growth divergence between the regions has existed for a while. And second, the ECB's residual support for the corporate bond market is likely a powerful technical tailwind, as we discuss next.

Exhibit 8: Supportive growth is key for continued USD credit spread resilience, in our view

Quarter-on-quarter real GDP growth (%), seasonally adjusted at an annualized rate



Source: BlackRock, Bureau of Economic Analysis, Eurostat. 4Q2024 – 4Q2025 forecasts use the Bloomberg Contributor Composite as of December 10, 2024. **There is no guarantee any forecasts may come to pass.**

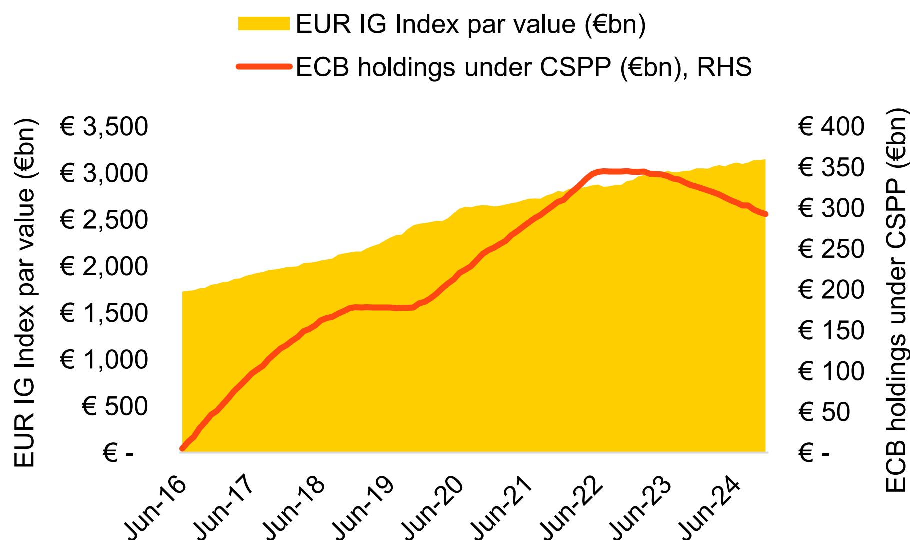
(Residual) ECB support for corporate credit

One notable reason for the resilience of the EUR corporate bond market, in our view, relates to the precedent that the ECB has set as a sizable purchaser of corporate bonds during periods of market volatility. For example, even though the ECB's most recent round of net purchases of corporate bonds under the Corporate Sector Purchase Programme (CSPP) ended in June 2022 (and reinvestments discontinued in July 2023), holdings remain sizable at €292 billion as of November 2024 (Exhibit 9). This has likely translated into a meaningful technical tailwind, reducing the amount of "available" bonds for investors to purchase, in a market that is already significantly smaller than the USD IG corporate bond universe. And while the ECB's corporate bond holdings are entirely IG-rated, the ownership has likely (indirectly) extended into the HY market, in our view, by encouraging investors to move down the rating spectrum.

While the Federal Reserve's pandemic era Secondary Market Corporate Credit Facility (SMCCF) purchased eligible ETFs and corporate bonds during 2020, its holdings were much smaller in absolute terms and relative to the larger size of the USD IG corporate bond market. For context, the SMCCF held $14.2 billion in holdings in early 2021, and all corporate bonds and ETFs were sold as of August 31, 2021.

Exhibit 9: The ECB still holds EUR IG bonds

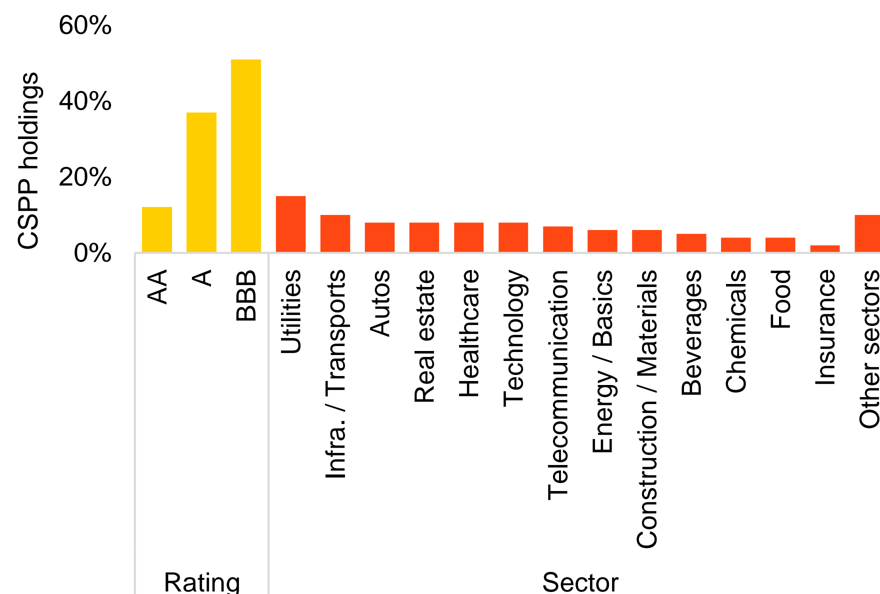
ECB CSPP holdings at amortized cost, and the par value outstanding of the ICE-BAML EUR IG Corporate Index (RHS)



Source: European Central Bank, ICE-BAML, Bloomberg, BlackRock. Captures data through November 30, 2024 (most recent available for CSPP holdings, as of December 6, 2024). Excludes corporate bonds held under the ECB's Pandemic Emergency Purchase Programme (PEPP).

Exhibit 10: The ECB's holdings are skewed towards BBBs

CSPP holdings by rating and sector, as of 1Q2024



Source: European Central Bank, BlackRock. As of 1Q2024 (most recent available, as of December 6, 2024).

U.S. consumer: the engine of the economy

Bifurcation is poised to persist, however

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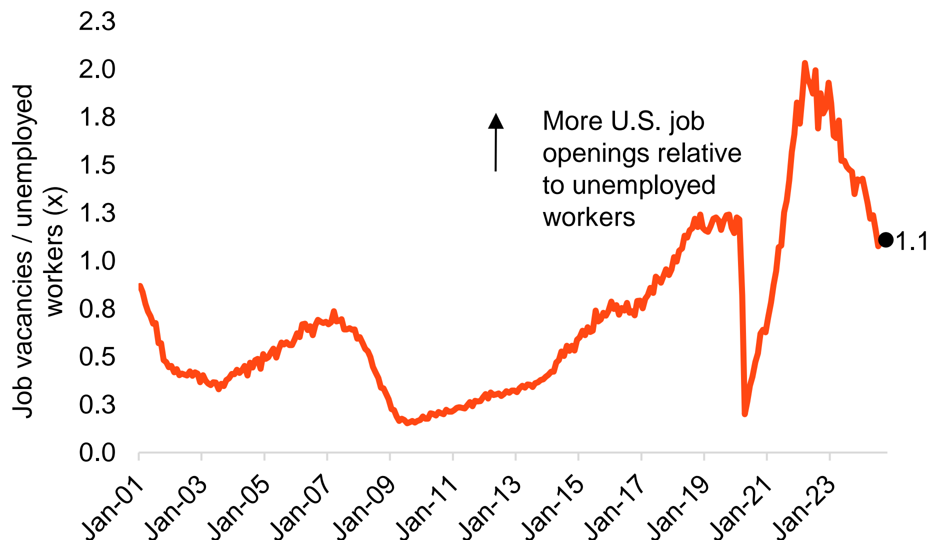
Testing the limits of the U.S. consumer

The resilience of the U.S. economy over the past several quarters is a direct reflection of robust consumer spending. Heading into 2025, a key question for corporate credit investors is whether the strength of the U.S. consumer can be sustained. This is important on two fronts, in our view. The first is the obvious read-through from the macro perspective, considering U.S. consumer spending generates 68% of U.S. GDP. The second is more micro-related, as sectors and issuers have varying degrees of direct exposure to consumer-facing sectors, which is likely to drive dispersion in 2025, in our view.

We believe the resilience of the U.S. consumer can extend into 2025, for two primary reasons. First, while the U.S. labor market has cooled (again, Exhibit 2), this has been driven by fewer job vacancies (Exhibit 11). Layoffs, which have the potential to be more damaging to consumers' financial strength (owing to the loss of an income), remain muted by historical standards (Exhibit 12). A key risk to maintaining this financial strength, in our view, is if corporates begin to use layoffs as a tool to protect profit margins.

Exhibit 11: The U.S. labor market has rebalanced to the pre-pandemic level

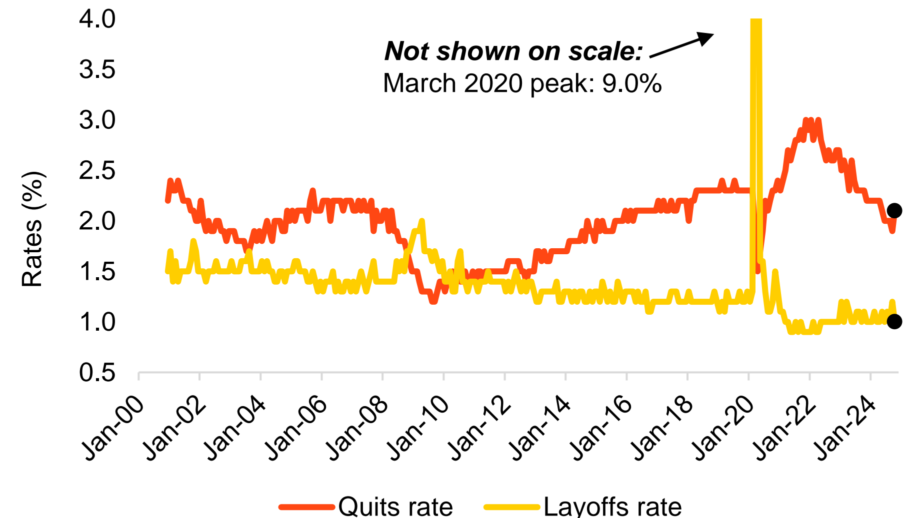
The ratio of U.S. job vacancies to U.S. unemployed workers, both seasonally adjusted



Source: BlackRock, Bureau of Labor Statistics. Captures data through October 31, 2024 (most recent available as of December 10, 2024).

Exhibit 12: Layoffs remain muted by historical standards

U.S. Layoffs & Discharge and Quits rates (%), both seasonally adjusted



Note: The Layoffs & Discharge Rate tracks involuntary job separations initiated by the employer, while the Quits Rate tracks voluntary job separations initiated by the employee. Source: Bureau of Labor Statistics, Bloomberg, BlackRock. Captures data through October 31, 2024 (most recent as of December 10, 2024).

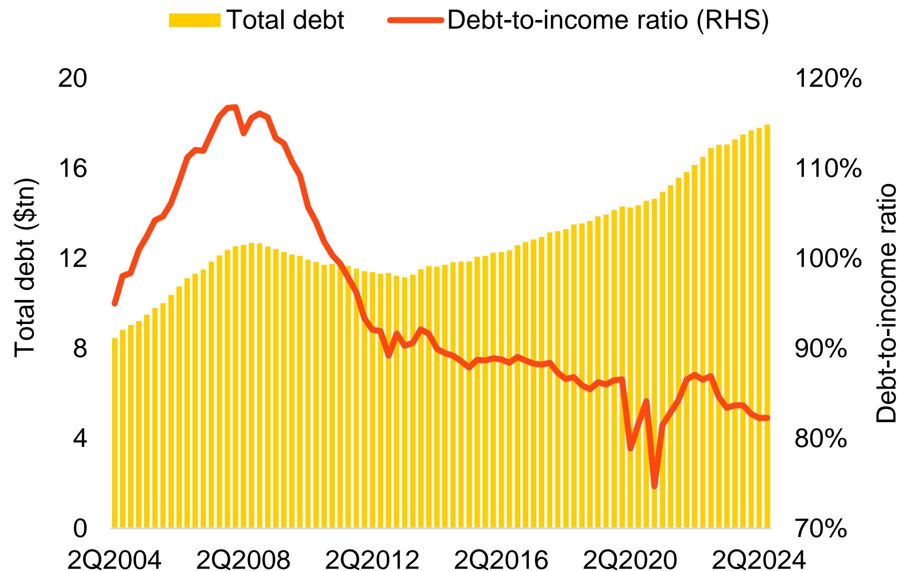
A boost to U.S. households' net worth

Second, U.S. consumer balance sheets are in solid shape. Indeed, in late September, U.S. personal income savings data was revised higher, indicating that households' financial strength may have room to run. Recent data from the Federal Reserve Bank of New York (NY Fed) reveals that while nominal total consumer debt levels *rose* in 3Q2024, the aggregate consumer debt-to-income ratio *fell*, suggesting that consumer income has grown faster than consumer debt over time (Exhibit 13).

The "wealth effect" has also been a strong support to aggregate U.S. consumer spending, in our view. Exhibit 14 highlights how two measures of U.S. household wealth creation have grown, reflective of gains in the equity and real estate markets. For context, the S&P 500 has increased 64% since the start of 2021, and the return for 2024 (year-to-date through December 10th) was 28%. And since the beginning of 2021 through September 2024 (most recent), the S&P CoreLogic Case-Shiller U.S. National Home Price Index was up 39%. Real wage gains (i.e., salary increases in excess of inflation) have also contributed.

Exhibit 13: The debt-to-income ratio has improved vs. pre-pandemic levels

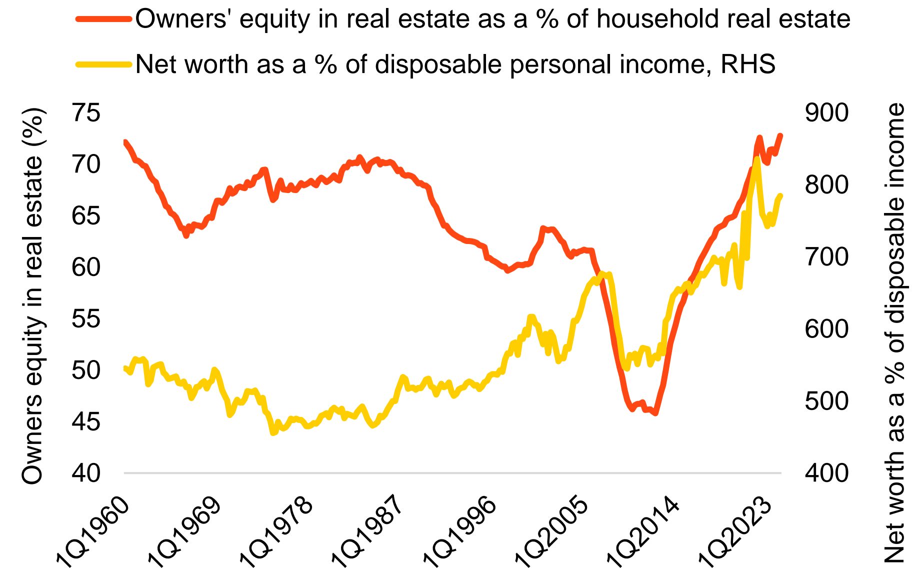
Total U.S. consumer debt and debt-to-income ratio (RHS)



Sources: New York Fed Consumer Credit Panel / Equifax; Bureau of Economic Analysis. As of 3Q2024 (most recent available as of December 10, 2024).

Exhibit 14: U.S. households' net worth has grown, owing to equity and housing market gains

Measures of U.S. households' net worth



Source: Federal Reserve Board, Haver Analytics, BlackRock. As of 2Q2024 (most recent as of December 10, 2024).

Bifurcation, under the surface

Of course, not *every* household has benefited from home ownership or participation in the stock market. This is reflective of the persistent pattern of bifurcation we have highlighted over the past few quarters.

As Exhibit 15 shows, only 44% of consumers in the bottom income quintile are homeowners. These lower income consumers, who are more likely to rent (again, Exhibit 15) and carry debt balances (credit cards, auto loans, student loans), have experienced headwinds from higher borrowing costs and elevated price levels (in absolute terms) in recent years – even though the *year-over-year* rate of inflation is improving.

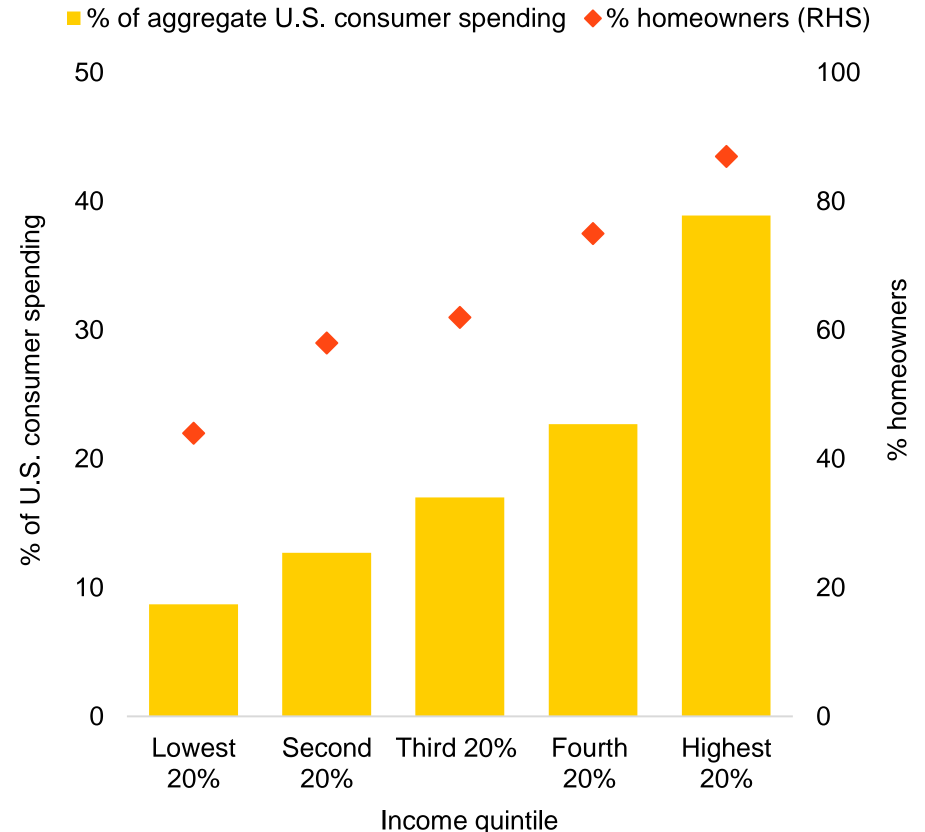
Indeed, in the most recent earnings season (November/December 2024), U.S. retailers commented on a consistent theme: value-seeking behavior. Certain consumer cohorts have looked to maximize their budgets to mitigate the cumulative impact of price inflation over the past few years. Spending is most cautious in discretionary categories.

Higher-income earners, by contrast, are more likely to own a home. And as Exhibit 15 also illustrates, these consumers generate a disproportionate amount of overall consumer spending. For example, earners in the highest 20% of the income distribution generate 39% of spending. And the top two income quintiles, combined, generate 62% of spending.

The key takeaway is that while the lower-income consumer has been under economic pressure, consumer spending *in aggregate* has been strong enough to support above-trend growth in the U.S. economy. In other words, the consumer weakness has been relatively contained. The labor market will be key to preserving this delicate balance in 2025.

Exhibit 15: The U.S. consumer is not "one size fits all"

U.S. annual aggregate expenditures by consumer income quintile, and share of consumers in each cohort that are homeowners (RHS)



Source: BlackRock, U.S. Bureau of Labor Statistics Consumer Expenditure Survey (released September 25, 2024; most recent annual survey, as of December 10, 2024).

Watching for an expansion of stress

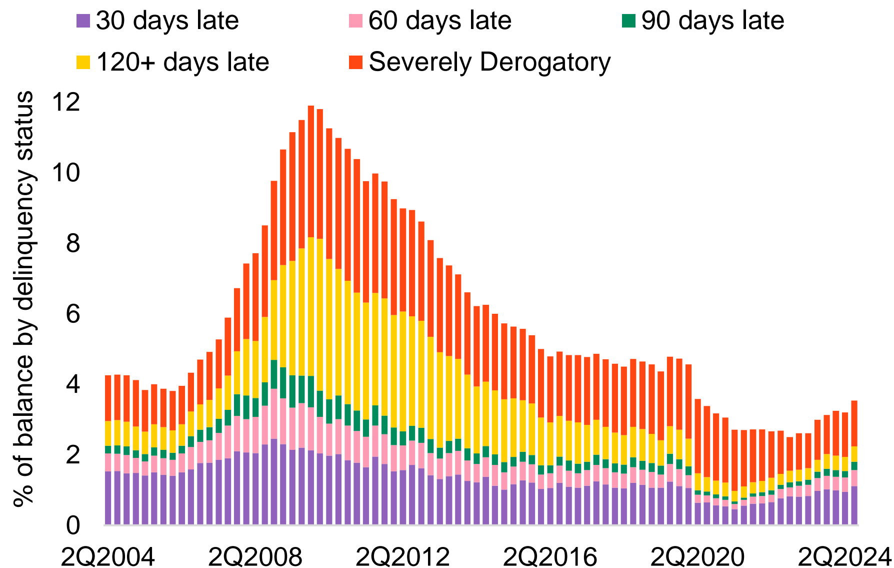
Similar to the distribution of U.S. consumer income levels, consumer debt and delinquency trends also illustrate a theme of bifurcation. For example, the financial situation of a higher-income household with debt in the form of a mortgage is different than that of a lower-income household with only non-housing related debts (such as credit card and auto loans, which do not build equity in an asset).

Consumer delinquency data sheds some light on such dispersion *within* consumer debt categories. For example, Exhibit 17 illustrates that credit card, "other" (i.e., retail cards and consumer loans), and auto debt categories have been the main drivers of the recent uptick in overall delinquencies (Exhibit 16). In contrast, delinquencies for housing-related debt remain near all-time lows – which likely reflects a consumer's desire to protect the equity they have built in their home, as it has appreciated in value in recent years.

Note that student loan delinquencies may be understated in the exhibits below. Such delinquencies resumed reporting to credit bureaus (following a grace period) after September 30, 2024, which is the endpoint for this most recent / available data.

Exhibit 16: Total delinquent debt is increasing, but remains modest relative to history

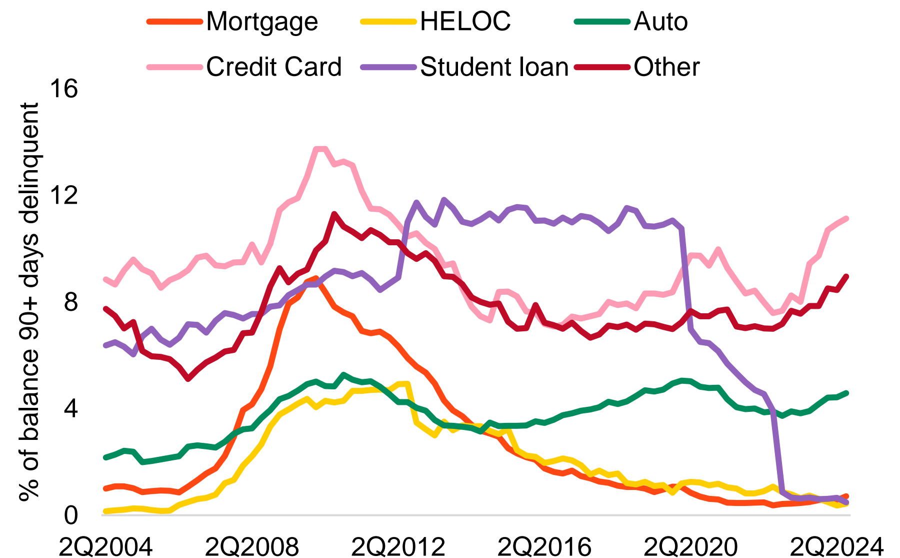
Total U.S. consumer debt balance, by delinquency status



Source: New York Fed Consumer Credit Panel/Equifax, BlackRock. As of 3Q2024.

Exhibit 17: Housing-related delinquencies remain modest

Share of debt balance 90+ days delinquent, by loan type



Source: New York Fed Consumer Credit Panel/Equifax, BlackRock. As of 3Q2024.

Liquid credit: USD and EUR

Focus on all-in yields

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We place more emphasis on all-in yields

USD corporate credit spreads reached new, post-financial crisis era tights in 4Q2024, fueled by a combination of above-trend growth (as outlined earlier), solid corporate fundamentals, and technical tailwinds. Notably, even the lowest-rated cohort of the USD HY market – CCCs – participated in the tightening (Exhibit 33), after having lagged the tightening in the broader index earlier in the year. At the time of this writing, spreads have bounced off their new local tights but remain at the low end of the historical range (Exhibit 18). That said, all-in yields are still attractive by historical standards (Exhibit 19).

We see scope for spreads to remain in this tight, narrow range in 1Q2025 – although we acknowledge the opportunity for material, absolute spread tightening is constrained given the starting point for valuations. Because we are not expecting a significant rate cutting cycle from the Federal Reserve, we place the most emphasis on the income and carry (yield) components of USD corporate credit total returns. By contrast, we place less emphasis on the potential total return from duration exposure, which would benefit fixed rate bond total returns, mechanically, if/when rates decline and/or spreads tighten. Floating rate exposures can also offer an important element of portfolio diversification, in this regard (as we outline later).

Exhibit 18: Spreads are tight...

Option adjusted spreads (OAS, bps) for the Bloomberg USD IG and HY Corporate indices

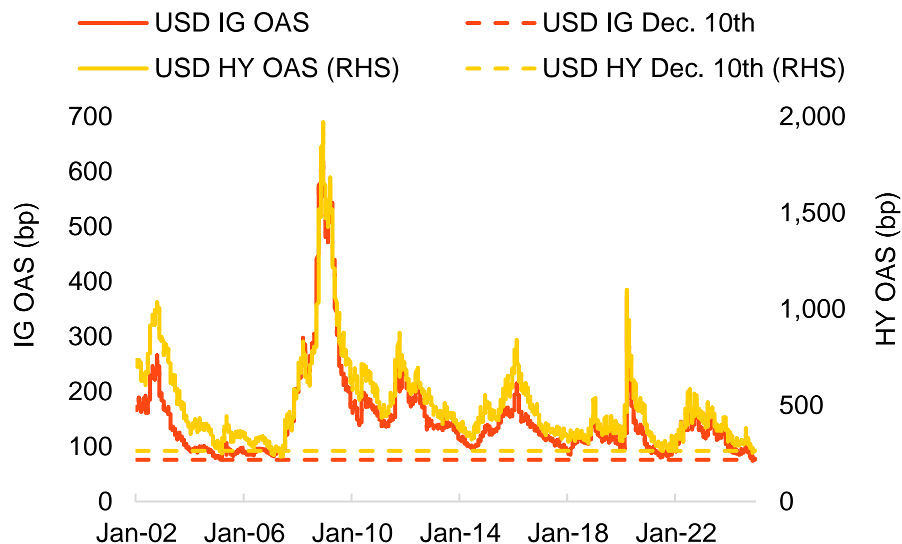
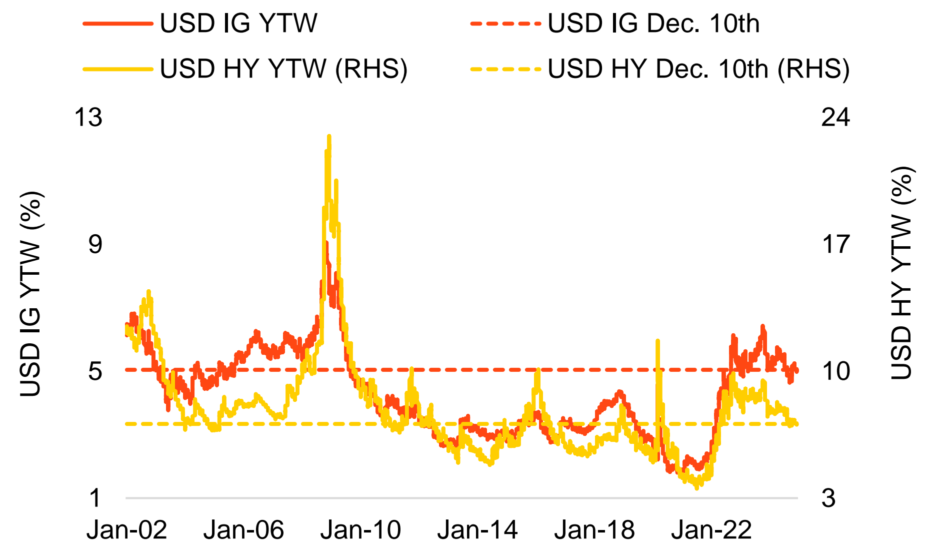


Exhibit 19: ...but yields are still elevated

Yield-to-worst (%) for the Bloomberg USD IG and HY Corporate indices



For both charts: Source: BlackRock, Bloomberg. As of December 10, 2024. **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index.

Spread vs. yield "tug of war"

Exhibits 20 and 21 illustrate the spread vs. yield relative value "tug of war" dynamic across various subsets of the global corporate credit market, using the percentile rankings of daily spread and yield measures. As Exhibit 20 shows, most pockets of USD credit spreads are trading at the richest levels of the post-financial crisis era and are also trading tight relative to their EUR peers. And again, even CCC-rated bond spreads are trading at a level near the tighter (i.e., richer) end of the range. But as Exhibit 21 highlights, the yield measures of most subsets of USD and EUR credit are much more attractive, by historical standards.

We expect this spread vs. yield relative value dynamic to persist into 1Q2025. As discussed earlier, we expect structurally higher interest rates, which should continue to support demand for corporate credit from yield-based buyers. And our base case of above-trend growth and *normalizing* monetary policy should leave corporate fundamentals well positioned to navigate this structurally higher cost of capital. Given the significant amount of pre-funding and refinancing already completed by speculative-rated firms in 2024, we view a payment shock as unlikely. Instead, the key risk, in our view, is policy-related (for example, across-the-board tariffs, with retaliation from other countries).

Exhibit 20: USD spreads trade tight relative to their EUR peers...

Percentile rank of daily index-level corporate bond option adjusted spreads, since January 1, 2010

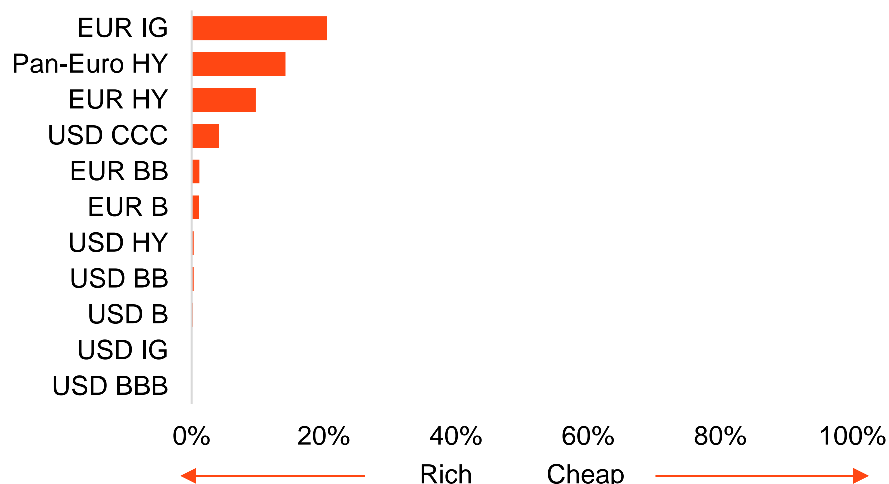
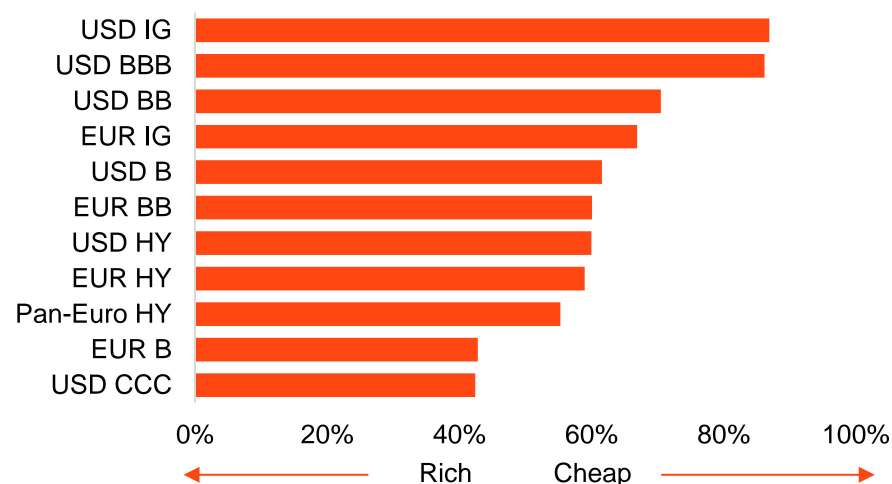


Exhibit 21: ...but the yield differentials are not as pronounced

Percentile rank of daily index-level corporate bond yield-to-worst levels, since January 1, 2010



For both charts: Source: BlackRock, Bloomberg, ICE-BAML. As of December 10, 2024. **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs, or expenses. Indices are unmanaged and one cannot invest directly in an index. We exclude USD AAA, EUR AAA, and EUR CCC due to their small size.

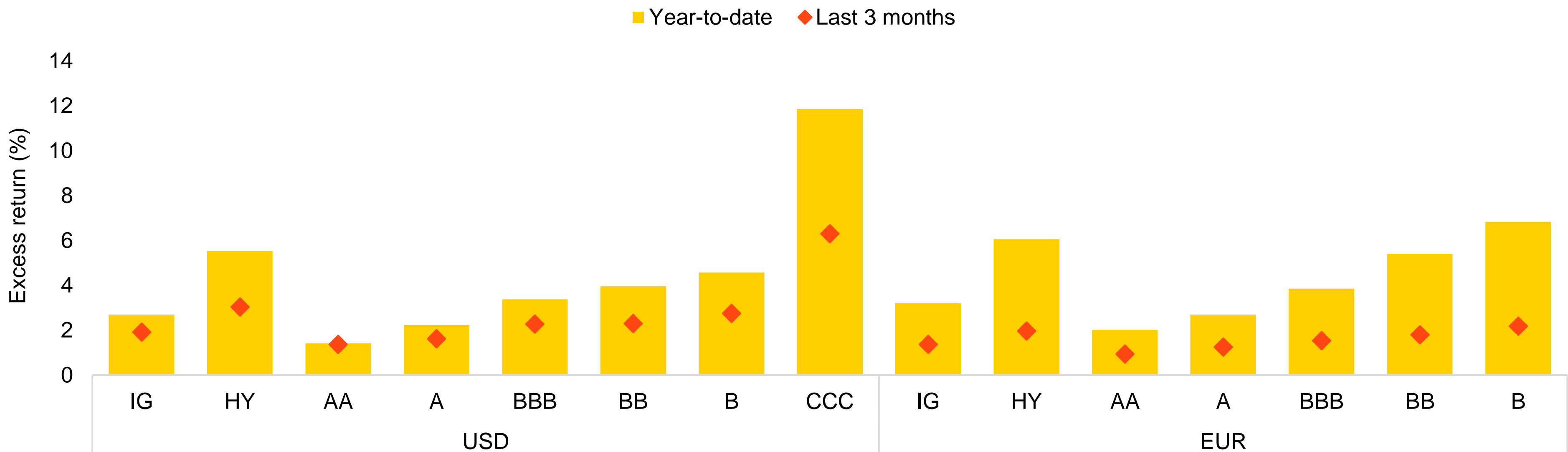
Lower-rated credit leads in performance

One of the defining characteristics of corporate credit performance so far in 2024 – across the USD and EUR markets – has been the outperformance of lower-rated subsets. In our view, this illustrates the opportunity cost of being underweight credit risk in a backdrop of resilient growth. It also coincides with the constructive signaling sent from other risk markets, such as small-cap equity indices, which appear to reflect decreased concerns around recession risk. The Russell 2000 Index is up 18% year-to-date, through December 10th.

Exhibit 22 illustrates this pattern using excess returns for the Bloomberg USD and EUR Corporate indices (which, unlike total returns, exclude the performance impact from interest rate fluctuations). The takeaway is clear: corporate credit did not reflect concerns about growth in 2024, as lower-quality credit (which tends to be much more sensitive to economic fluctuations, relative to its IG peer) outperformed its higher-rated cohort. We see scope for the outperformance of lower-rated credit to continue into 2025, albeit to a more moderate extent, given the starting point for valuations. The key factor underpinning this expectation is our view on the growth backdrop. A trend pace of growth (or, ideally, above trend) should keep risk premiums range bound, default risk contained and would likely continue to support investor demand for lower-rated credit (given its higher, available all-in yields).

Exhibit 22: We expect the trend of lower-rated credit outperformance to continue into 1Q2025

Excess returns for the Bloomberg USD and EUR Corporate indices



Source: Bloomberg, BlackRock. As of December 10, 2024. **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs, or expenses. Indices are unmanaged and one cannot invest directly in an index. We exclude USD AAA, EUR AAA, and EUR CCC due to their small size.

Higher rates: the velocity matters

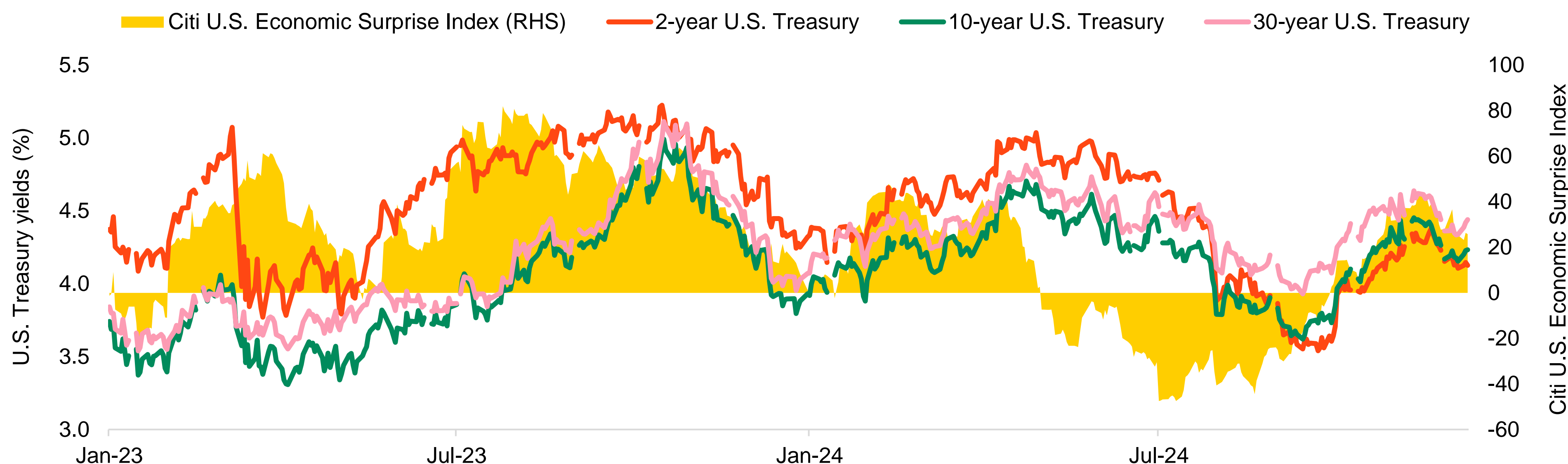
As our colleagues in the *BlackRock Investment Institute* (BII) outlined in their *2025 Global Outlook*, interest rates (and inflation) are expected to remain above pre-pandemic levels. For corporate credit investors, a backdrop of structurally higher interest rates can be a technical tailwind, as it tends to spur demand for corporate credit from yield-based buyers.

The risk, however, is if the increase in sovereign yields is volatile and disorderly – and not gradual. This underscores the importance of monitoring the *drivers* of interest rate fluctuations. For example, if higher sovereign yields are driven by concerns related to the U.S. deficit, or investors' pushing inflation expectations higher, that can be a negative backdrop for corporate credit sentiment. By contrast, if higher sovereign yields are reflective of improved economic growth, that is a much more supportive environment for corporate credit.

This has important implications for curve positioning. For example, in the U.S. Treasury market, our colleagues in BII tend to favor intermediate maturities, which are less vulnerable to potential increases in term premium (as investors may demand additional compensation for holding longer-term U.S. Treasuries, owing to persistent budget deficits and geopolitical fragmentation).

Exhibit 23: Treasury yields have moved higher, alongside stronger economic data

On-the-run 2-year, 10-year, and 30-year U.S. Treasury yields vs. the Citi U.S. Economic Surprise Index (CESI). A positive reading on the CESI means data releases have been stronger than expected and a negative reading means data releases have been worse than expected.



Source: Bloomberg, Citi, BlackRock. As of December 10, 2024. **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs, or expenses. Indices are unmanaged and one cannot invest directly in an index.

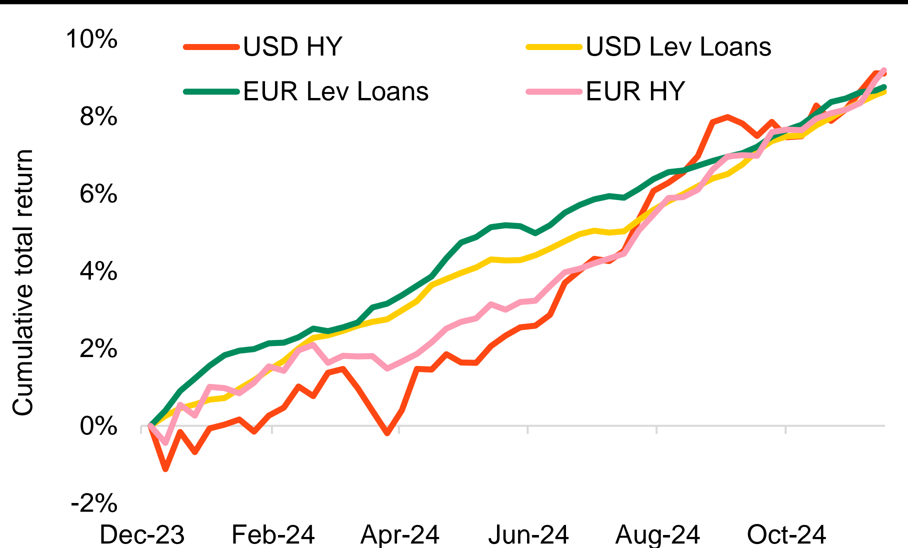
The floating vs. fixed decision

A structurally higher inflation and interest rate backdrop in the U.S. also supports the case for allocations to floating rate assets, in our view. Such exposures could take a variety of forms across the risk spectrum, ranging from floating rate IG notes, leveraged loans, collateralized loan obligations (CLOs), and various subsets of the private debt market (as discussed in a later section).

Exhibit 24 illustrates how total returns across USD and EUR HY and leveraged loans have converged in recent months despite notable dispersion earlier in the year (when interest rates were rising and acting as a negative headwind to fixed rate total returns). In our view, adding floating rate exposures can offer investors opportunities to introduce some diversification and a partial hedge against inflation and higher rates, while remaining "pro-risk" as our colleagues in BII have recommended. And as demonstrated in Exhibit 25, the yield "pick-up" that USD leveraged loans offer vs. USD HY bonds (when controlling for ratings) is elevated, vs. the historical pattern.

Exhibit 24: Fixed rate bonds lagged earlier this year, when rates were rising

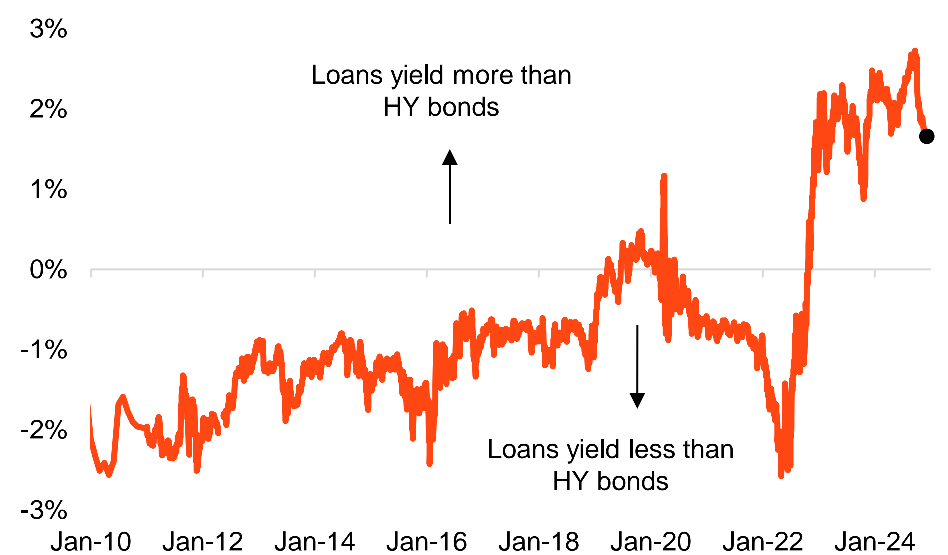
Cumulative year-to-date total returns for the Bloomberg HY Corporate and Morningstar Leveraged Loan indices (USD and EUR)



Source: Bloomberg, Morningstar/LSTA, BlackRock. As of December 10, 2024.

Exhibit 25: USD leveraged loans offer a yield "pick-up" vs. similarly rated HY bonds

Yield differential (%): B-rated leveraged loans minus B-rated HY bonds



Source: Pitchbook LCD, BlackRock, Morningstar/LSTA, ICE-BAML. As of December 6, 2024.

For both charts: The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results. Index performance returns do not reflect any management fees, transaction costs, or expenses. Indices are unmanaged and one cannot invest directly in an index. Uses weekly return data.

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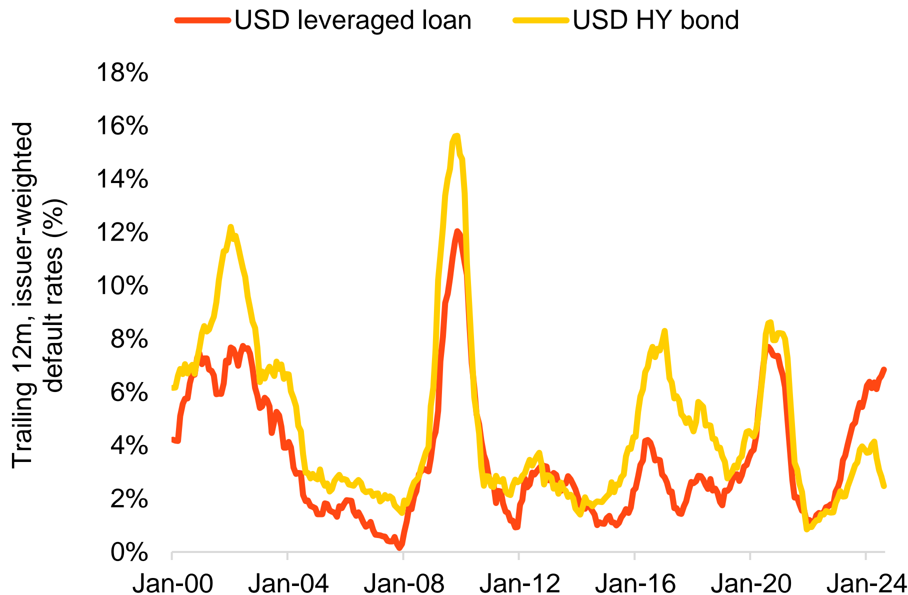
Defaults: the loan vs. HY gap should narrow

While the Fed and ECB have officially embarked on rate-cutting cycles, market participants are still watchful for signs of additional deterioration in corporate credit fundamentals in the liquid market. To track this, we turn to the Moody's issuer-weighted, trailing 12-month default rates, which include distressed exchanges. (Note: we cover liquid loss rates in a later section, when we discuss private debt losses).

As shown in Exhibit 26 below, default rates for USD HY bonds have been on the decline since May 2024. But default rates for USD leveraged loan issuers have yet to plateau and remain divergent vs. HY. This reflects the swifter transmission of monetary policy for floating rate issuers, which have been contending with higher debt servicing costs since the start of the Fed and ECB hiking cycles in 2022, assuming no rate hedges (Exhibits 28 and 29, next page). Borrowers with fixed rate debt, by contrast, only began to encounter higher debt costs if and when they chose to refinance lower-coupon debt into a higher rate environment. That said, as Exhibits 28 and 29 highlight, incremental declines in floating rate debt costs are now materializing. This, coupled with supportive growth (especially in the U.S.), should allow the USD leveraged loan default rate to plateau in the coming months, in our view.

Exhibit 26: Loan defaults have yet to plateau

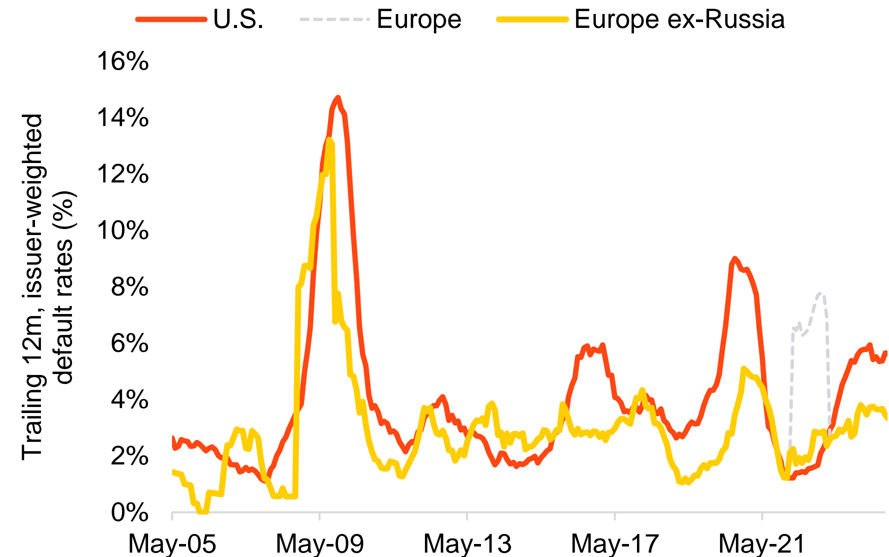
Trailing 12-month, issuer-weighted default rates for the universe of USD HY bonds and USD leveraged loans tracked by Moody's



Source: BlackRock, Moody's. As of October 31, 2024 (most recent available as of December 10, 2024).

Exhibit 27: USD defaults have outpaced EUR

Trailing 12-month, issuer-weighted default rates for USD and EUR HY and leveraged loans (combined) tracked by Moody's



Source: Moody's, BlackRock. As of October 31, 2024 (most recent available as of December 10, 2024). The increase in defaults in the EUR market in early 2022 reflects the defaults of Russian issuers following the onset of the Russia-Ukraine war.

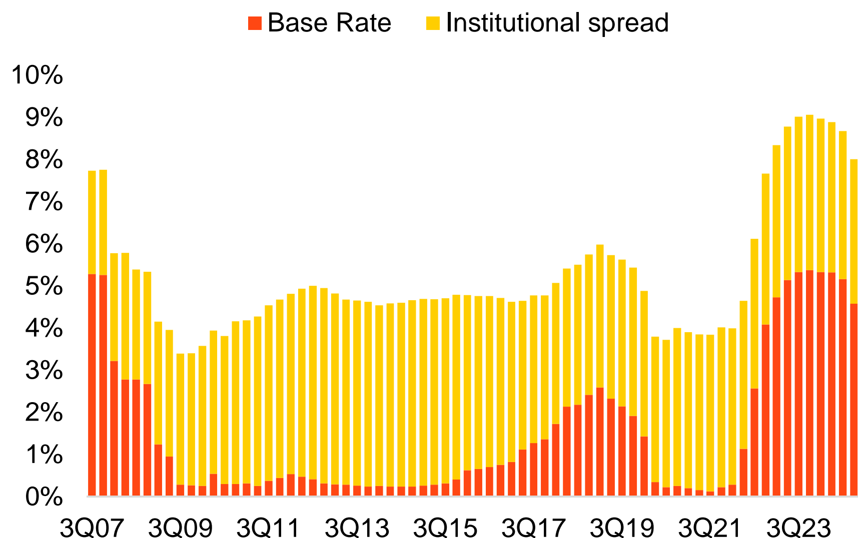
Some modest, incremental rate relief

Our review of fundamental data for the subset of issuers in the Morningstar/LSTA USD Leveraged Loan Index with publicly available financials is encouraging on this front. It shows that average EBITDA growth for 3Q2024 was 4.6% and has been consistently increasing since the local trough in 3Q2023 (1.8%). Average and weighted average leverage metrics have also improved modestly, since that time.

Notably, the higher rate of defaults among leveraged loan issuers hasn't been enough to derail performance (again, Exhibit 24). This, in our view, suggests the borrowers which defaulted in 2024 were anticipated by the market and likely already priced for the outcome. Leveraged loan performance has also been supported by a robust backdrop for CLO creation. 2024 is on pace to set a new annual record, with $193 billion of CLO volume priced through December 6, 2024, per data from Pitchbook LCD. CLOs are the largest buyer of leveraged loans in the primary market, absorbing nearly two-thirds of issuance at one point, per historical estimates from Pitchbook LCD.

Exhibit 28: All-in coupons remain elevated for the USD Leveraged Loan Index…

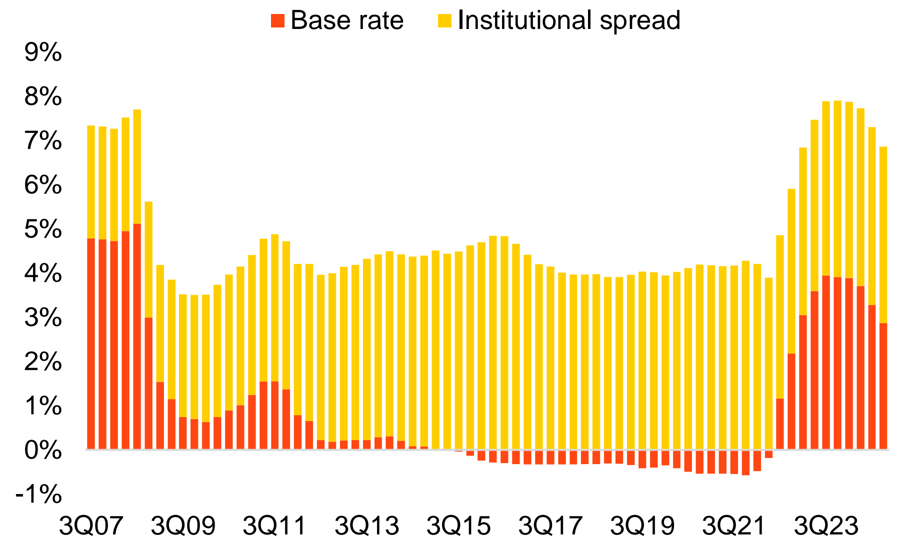
All-in coupon (%) for the Morningstar/LSTA USD Leveraged Loan Index



Source: BlackRock, Pitchbook LCD, Morningstar/LSTA, Markit. The base rate represents an average of all outstanding 1- and 3-Month LIBOR/SOFR contracts tracked by Markit. 4Q2024 is as of December 6, 2024. Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index.

Exhibit 29: …and the EUR Leveraged Loan Index

All-in coupon (%) for the Morningstar EUR Leveraged Loan Index



Source: BlackRock, Pitchbook LCD, Morningstar. 4Q2024 is as of December 6, 2024. Base rate is 3-month EURIBOR. Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index.

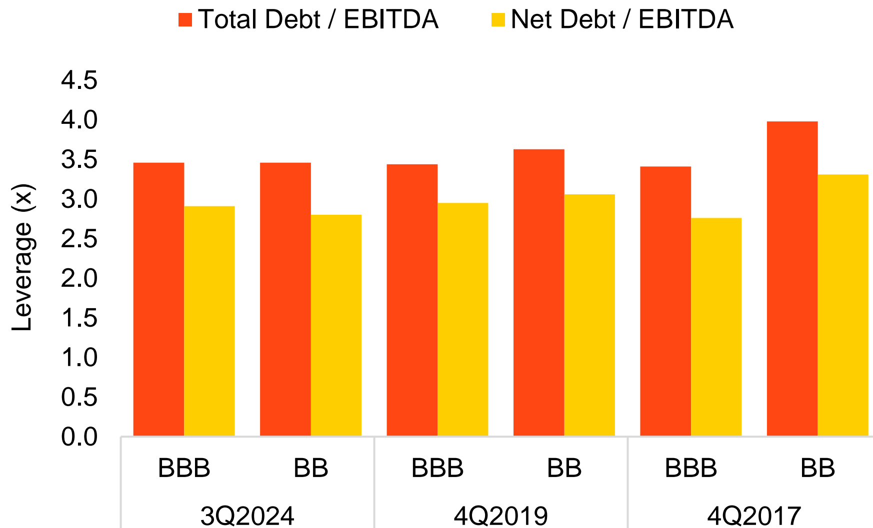
USD HY: warranted resilience

Over the course of the past several months, many market participants have expressed a view that the tight absolute levels of USD HY spreads offered only minimal compensation for credit risk. While difficult to argue with the absolute spread levels being tight, as we have outlined, there are a few reasons why this resilience is *warranted*, in our view.

These include the following factors, many of which we expect to persist into 1Q2025: (1) a "supportive enough" macroeconomic backdrop; (2) an up-in-quality ratings skew within USD HY, over the past several years; (3) some valuation and fundamental convergence (Exhibit 30) between the high-end of the USD HY rating spectrum (i.e., BBs) and the low-end of the USD IG rating spectrum (i.e., BBBs); (4) support from yield-based demand; (5) a strong tilt towards refinancing activity (Exhibit 31) which has led to limited net issuance; (6) a higher proportion of secured issuance in recent years, and (7) a technical tailwind from reinvesting higher coupons. Also, notable: in 3Q2024, trimmed mean net leverage levels for BBB borrowers (IG) slightly *surpassed* those of BB borrowers (HY; again, Exhibit 30), demonstrating, in our view, the fundamental convergence between these two cohorts.

Exhibit 30: BB and BBB leverage metrics have moved closer together, over time

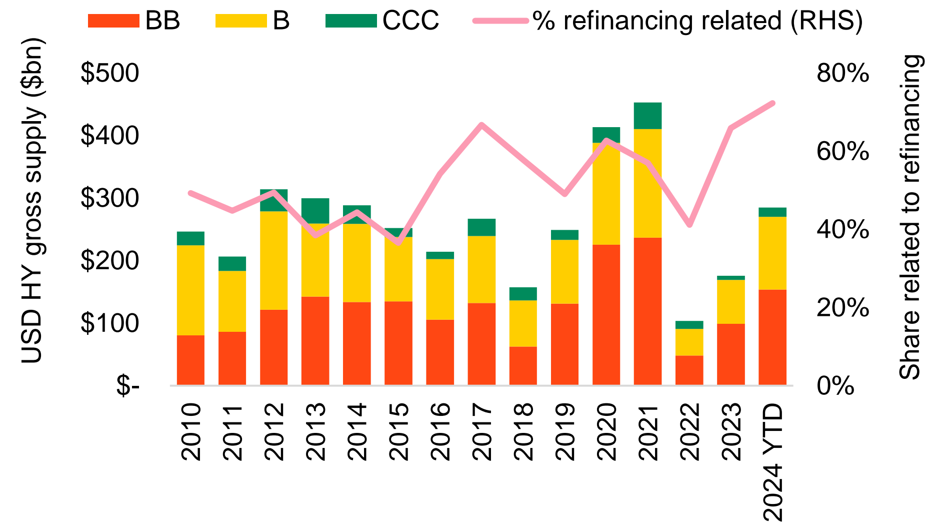
Trimmed mean (excludes top / bottom 10%) leverage, for the last twelve months ended 3Q2024, 4Q2019, and 4Q2017. Captures issuers in the Bloomberg USD BB and BBB Corporate Index.



Source: Bloomberg, BlackRock. Captures data through 3Q2024 (most recent).

Exhibit 31: USD HY gross supply – heavily weighted towards refinancing

USD HY gross supply by Dealogic "Effective Rating at Launch," and share earmarked for debt repayment or refinancing (as captured by Dealogic's "primary use of proceeds"), RHS



Source: Dealogic (ION Analytics), BlackRock. As of December 10, 2024.

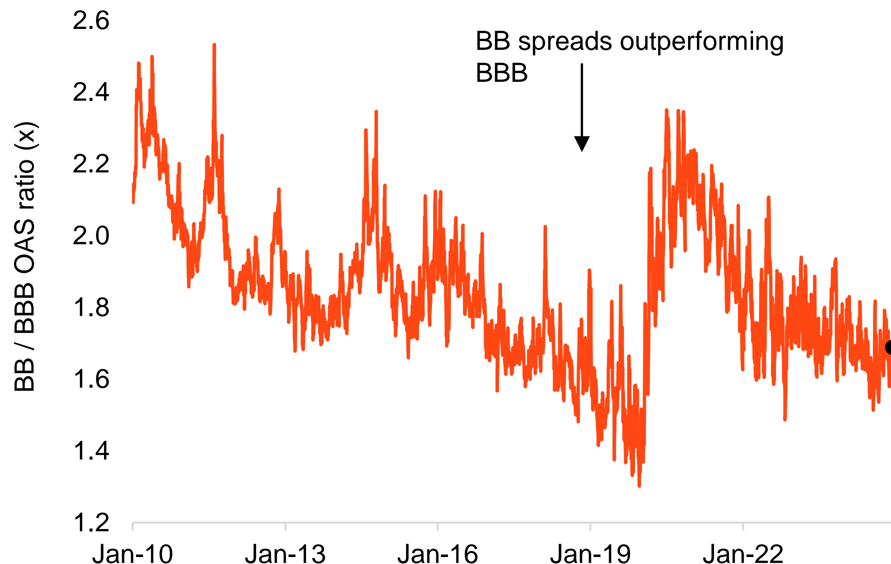
Some *modest* scope for added compression

The USD IG and HY markets are distinctly different asset classes in terms of investor participation and market conventions (trading, issuance, documentation). That said, we see a greater degree of fluidity between the two markets in recent years, as several large capital structures have moved from IG to HY, and back again (note: many of the initial "fallen angel" downgrades to HY occurred following the immediate onset of the pandemic). Indeed, there is no longer as stark of a divide between HY and IG, in our view.

At the index level, we see some modest scope for BBs to continue to compress vs. BBBs (Exhibit 32). And presuming the U.S. growth backdrop continues its pattern of resilience, we believe that CCCs can further narrow (incrementally) the residual "underperformance gap" vs. its higher-rated B and BB peers (Exhibit 33). That said, this is a highly idiosyncratic universe of CCC-rated firms, with a wide degree of variation in fundamentals and valuations. As a result, granular credit selection is especially critical within this segment.

Exhibit 32: We see some additional room for BBs to tighten vs. BBBs

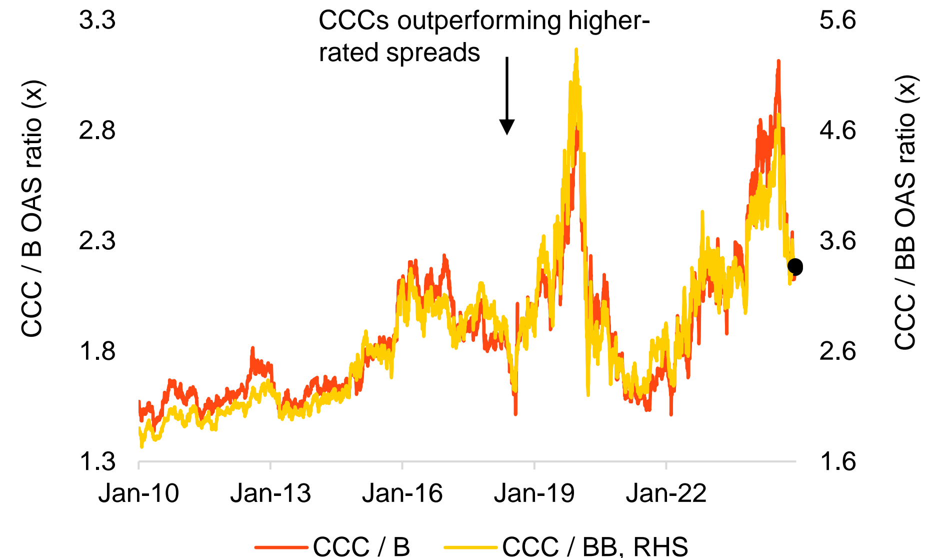
Option adjusted spread (OAS) ratios for the BB and BBB subindices of the Bloomberg USD IG and HY Corporate indices



Source: Bloomberg, BlackRock. As of December 10, 2024. **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index.

Exhibit 33: CCCs should also be able to narrow their underperformance gap

Option adjusted spread (OAS) ratios for the CCC, B and BB subindices of the Bloomberg USD HY Corporate Index



Source: Bloomberg, BlackRock. As of December 10, 2024. **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index.

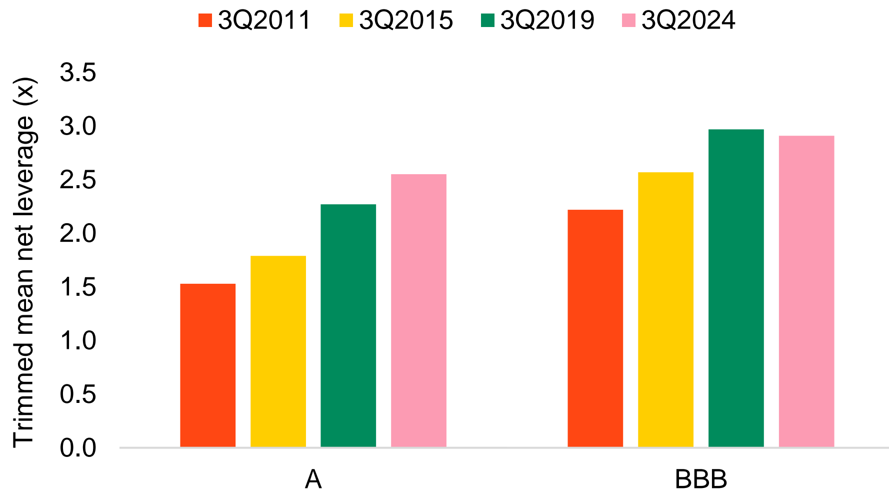
USD IG: move down-in-quality

Relative to its USD HY peer, the recent tightening in USD IG spreads is even more notable. This is because the rating distribution of the asset class has moved *lower* as it has grown substantially over the past several years. For example, in January 2010, the Bloomberg USD IG Corporate Index was $2.6 trillion in market value, with a rating distribution of: 1% AAA, 16% AA, 46% A, and 37% BBB. As of November 2024, it totaled $6.9 trillion, and was 1% AAA, 7% AA, 44% A, and 48% BBB.

Beyond moving “down-in-rating” over the past several years, leverage *within* a given rating has also increased (Exhibit 34). As of 3Q2024, the trimmed mean net leverage for the A-rated Index was 2.6x, compared to 2.9x for the BBB-rated Index (again, Exhibit 34). We view this as a modest difference in leverage relative to the additional spread provided by BBBs, as well as the potential that higher-rated firms are more likely to *utilize* their debt capacity. As a result, within IG, we are still comfortable moving down-in-quality into the BBB-rated cohort of the market. We see scope for the BBB/A OAS ratio (Exhibit 35) to compress, given our constructive macro base case.

Exhibit 34: IG borrowers’ net leverage, on average, has been increasing

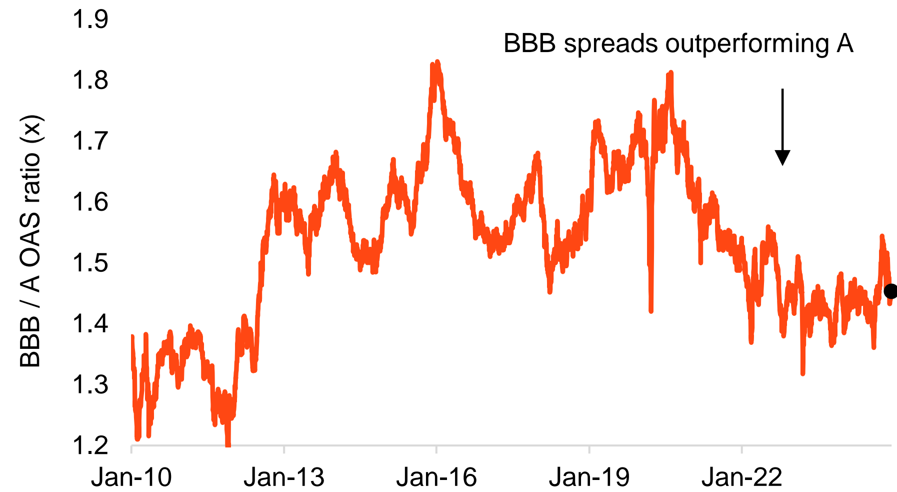
Trimmed mean (excludes the top 10% and bottom 10%) net debt to EBITDA for the universe of borrowers captured in the Bloomberg USD A and USD BBB Corporate indices



Source: Bloomberg, BlackRock. Captures trailing 12-month leverage through 3Q2024 (most recent available as of December 10, 2024). We exclude the AA cohort due to its much smaller size, relative to the A and BBB cohorts.

Exhibit 35: We see some potential for BBB spreads to tighten vs. their higher-rated peers

Option adjusted spread (OAS) ratios for the BBB and A subindices of the Bloomberg USD IG Corporate Index



Source: Bloomberg, BlackRock. As of December 10, 2024. **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index.

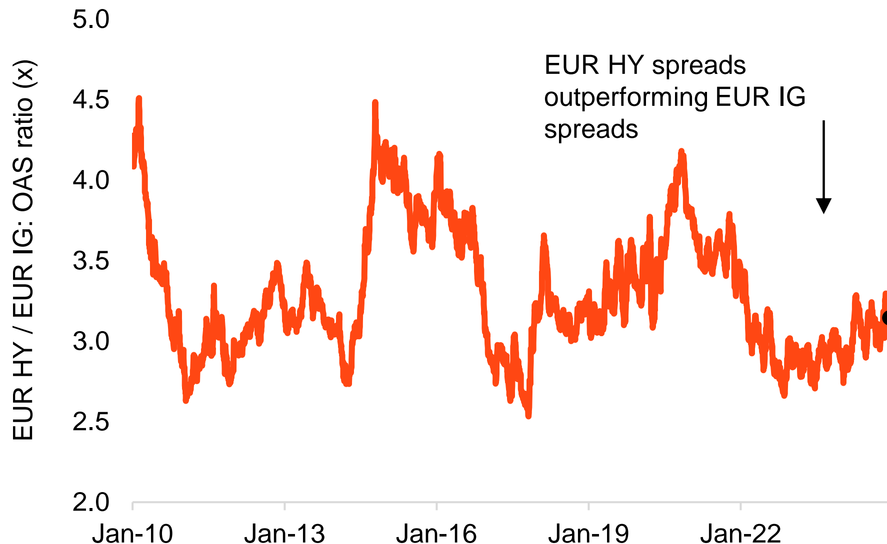
EUR credit: not reflecting growth concerns

As we outlined earlier, elevated trade policy uncertainty has the potential to weigh on investment in the Euro Area and extend the pattern of growth divergence relative to the U.S. But the performance of EUR corporate credit has not reflected a weaker Euro Area growth backdrop. For example, the (lower-rated) EUR HY market has outperformed its (higher-rated) EUR IG peer so far this year, on an excess return basis (again, Exhibit 22). EUR HY spreads have also only slightly underperformed EUR IG this year (Exhibit 36).

We attribute the relative resilience of the EUR credit market to a few factors. For example, as Exhibit 37 shows, the EUR HY Corporate Index has an "up-in-ratings" tilt that is visible, relative to its USD HY peer. While ratings are not a perfect proxy for quality, the differential is notable at the very high end (BB+, BB) and low end (all notches of CCCs) of the rating distribution.

Exhibit 36: Despite growth concerns, HY spreads have only slightly underperformed IG in 2024

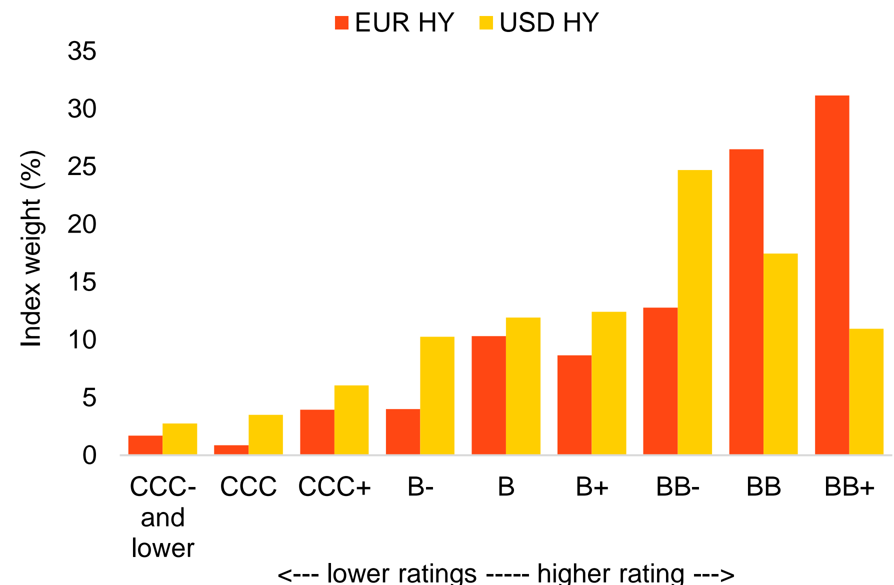
Option adjusted spread (OAS) ratio for the ICE-BAML EUR HY Corporate Index vs. the EUR IG Corporate Index



Source: ICE-BAML, Bloomberg, BlackRock. As of December 10, 2024. **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs, or expenses. Indices are unmanaged and one cannot invest directly in an index.

Exhibit 37: The EUR HY index has an average composite rating of BB-, while USD HY is B+

Rating weights for the ICE-BAML EUR HY and USD HY Corporate indices



Source: ICE-BAML, Bloomberg, BlackRock. As of December 10, 2024.

EUR credit: unlikely to materially lag USD

Other factors have also likely contributed to the resilience of EUR credit, including the previously-referenced historical precedent set by the ECB of intervening as a purchaser of corporate credit during periods of market volatility (again, Exhibit 9). The smaller sizes of the EUR IG and HY corporate credit markets, relative to their respective USD universes, have also likely translated into technical tailwinds.

One additional nuance to mention is that the EUR corporate credit markets are not exclusively reserved for European firms. As we recently outlined, roughly 10-15% of gross EUR supply in recent years has been generated by firms with a parent company incorporated in the U.S. This so-called “reverse Yankee” issuance has been a consistent source of supply in the EUR IG and HY primary markets over the past several years and is consistent with the trend of “Yankee” supply in the USD markets (i.e., debt issued by firms with a parent incorporated in Europe).

Given all of these “mitigating factors”, we are not bracing for material underperformance of EUR spreads, relative to its USD peer group – even considering the downside risks to growth in the region in 2025.

Exhibit 38: EUR IG spreads have been range-bound, relative to USD IG spreads

Option adjusted spread (OAS) ratio for the ICE-BAML EUR IG Corporate Index vs. the USD IG Corporate Index

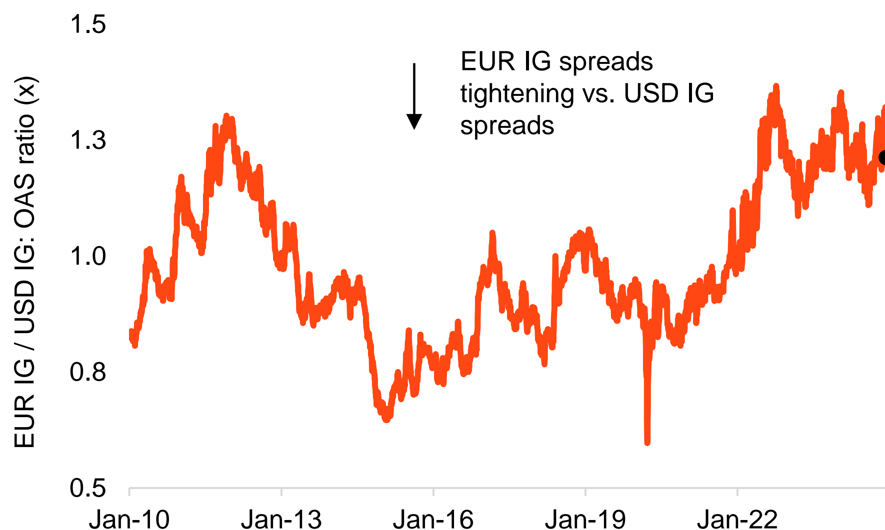
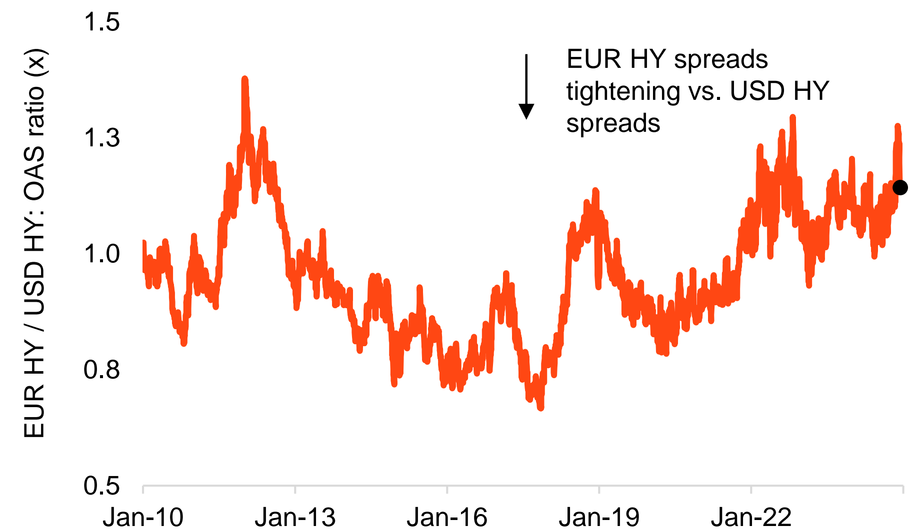


Exhibit 39: A similar pattern is evident for EUR HY spreads

Option adjusted spread (OAS) ratio for the ICE-BAML EUR HY Corporate Index vs. the USD HY Corporate Index



Source for both charts: ICE-BAML, Bloomberg, BlackRock. As of December 10, 2024. **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs, or expenses. Indices are unmanaged and one cannot invest directly in an index.

Private debt's structural growth

Expanding addressable markets of investors *and* borrowers

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Private debt's structural growth

One trend we expect to gain additional momentum in 2025 is the structural (and multi-faceted) growth behind the asset class of private debt. As we outline on the following slides, we expect private debt's addressable market of borrowers *and* investors to expand in 2025 (and beyond).

The concept of directly negotiated, bilateral lending is not new and has existed well before the global financial crisis. But over the course of the post-financial crisis era, private debt has established its status as a sizeable, scalable, stand-alone asset class for a wide range of investors.

While the private debt industry has experienced significant growth over the past several years, it is still modest in the context of the broader alternatives universe (Exhibit 40). We see scope for investor participation in the asset class to grow. And for those already invested, we see room for target allocations to move higher.

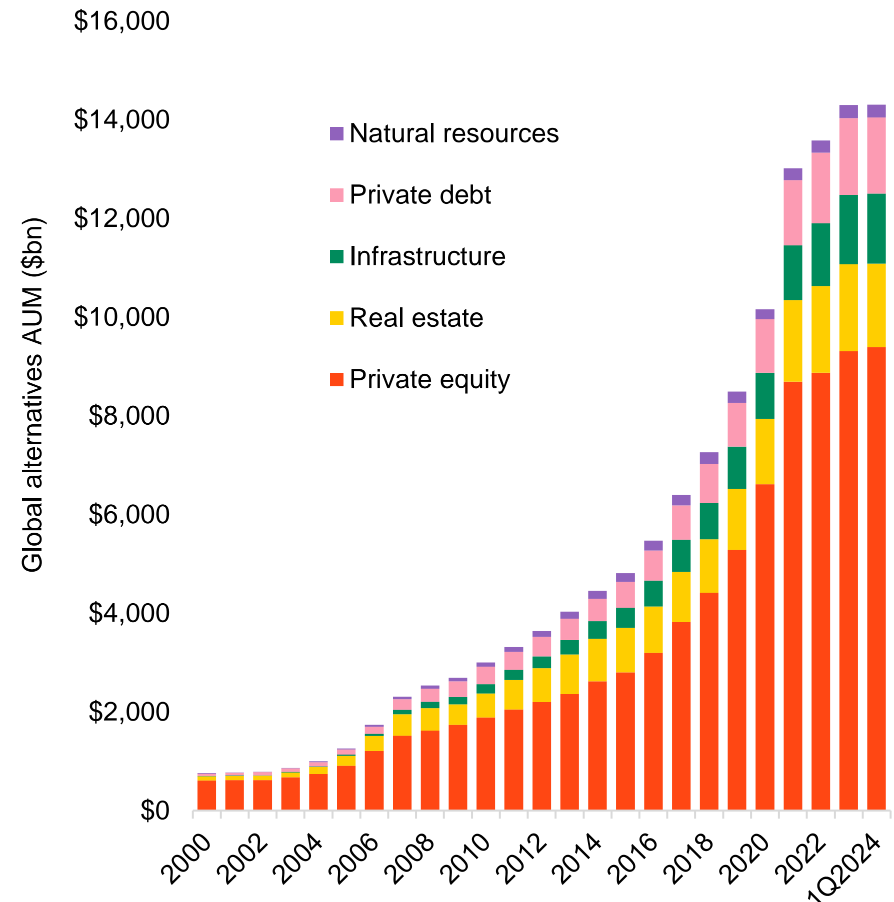
Outside of the "alternatives" designation, we increasingly see private debt considered as a fixed income substitute in a "whole portfolio" approach. Investors are increasingly combining public and private fixed income exposures to optimize for liquidity, yield and diversification.

And markets are increasingly looking to private capital as a financing solution to fund durable growth.

Additionally, over the course of the past two years, the definition of what the term "private debt" encompasses has also broadened, to include financing that can be originated, structured and held by a lender. This is a much wider definition relative to the "traditional" reference to middle market corporate lending.

Exhibit 40: We see ample scope for growth in private debt

Global alternative assets under management



Source: Preqin, BlackRock. As of March 31, 2024 (most recent available as of December 5, 2024). To avoid double counting of available capital and unrealized value, fund of funds and secondaries are excluded. Preqin's universe includes closed ended vehicles.

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Placing the avenues of growth in context

Market forces, technology and regulation are consistently moving financial activity to where it can be done most efficiently, leading to structural growth in the private debt asset class. Data from Pitchbook LCD estimates the global private debt market – focused on the historical definition of directly negotiated lending to middle market corporate borrowers – totaled $2 trillion as of year-end 2023, inclusive of dry powder.

As we discussed earlier this year, this represents only a portion of what we believe is the true total addressable market for private debt, which also includes lending to IG-rated corporates, as well as private asset-based finance (ABF). For context, an April 2024 analysis by Oliver Wyman[4] framed the U.S. specialty finance market at $5.5 trillion in size and estimated that private debt held only a 5% market share of that lending.

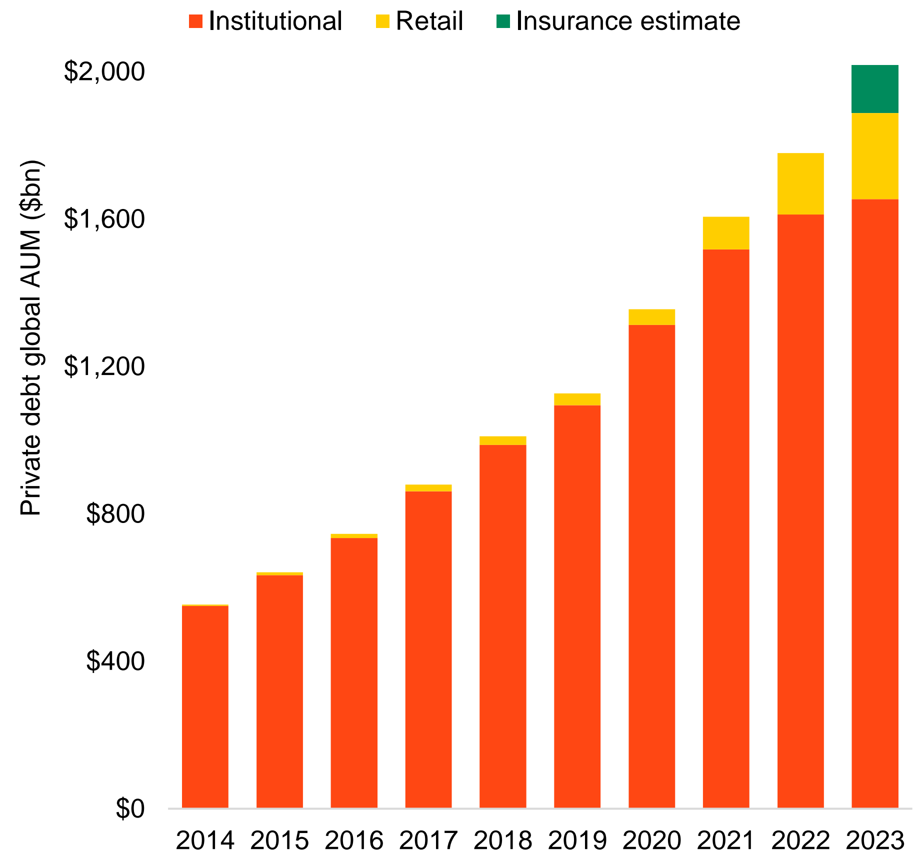
Even within the "narrow" definition of private debt, we still see scope for continued growth. This is driven by an expanding addressable market of investors in private debt, as well as broader utilization of private debt as a financing tool. Exhibit 41 frames how the insurance and wealth channels have evolved to be growing sources of capital for private debt lending. According to Pitchbook LCD, approximately $285 billion of private debt capital was raised by the seven largest public U.S. alternative asset managers in 2023. Of this amount, 52% was raised in the institutional channel, 40% was raised in the insurance channel, and 8% was raised in the wealth channel.

These market opportunities are substantial. For example, the U.S. insurance industry reported $8.5 trillion in total cash and invested assets at year-end 2023. And Federal Reserve data estimates U.S consumers' aggregate financial assets (inclusive of deposits, investments, pensions, etc.) totaled $117 trillion as of 2Q2024.

[4]"Private Credit's Next Act," April 2024 by Huw van Steenis and colleagues, Oliver Wyman.

Exhibit 41: The "traditional" definition of private debt captures roughly $2 trillion in global AUM

Global private debt AUM inclusive of dry powder; captures institutional capital as well as perpetual vehicles in the wealth and insurance channels



Source: Pitchbook LCD, BlackRock. As of December 31, 2023 (most recent available per Pitchbook LCD, as of December 8, 2024).

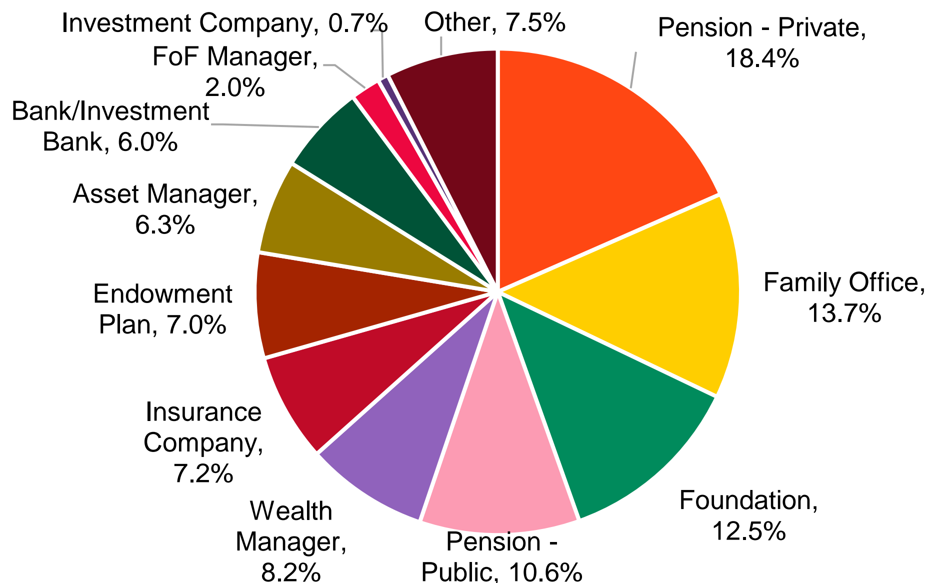
Wealth investor access is evolving

Exhibit 42 provides a snapshot of investor participation in the private debt market (by count, *not* AUM), using the universe tracked by Preqin. A common theme is evident: private debt investors are largely "buy-and-hold" with ample ability to invest in illiquid assets on a longer-term basis. As private markets – including private debt – continue to evolve, demand for simplified access to the asset class is growing. This includes innovation within structures, to allow retail investors access to private markets in a simple way. The goal is to reduce historical barriers, including large minimum investment sizes and high operational burdens (such as complex tax reporting requirements).

As we discussed recently, evergreen (perpetual-life) business development companies (BDCs) have helped broaden access to private debt investments, as these structures offer investors the ability to invest immediately and reach a target level of exposure more quickly (relative to waiting for capital calls from a drawdown fund). As Exhibit 43 shows, evergreen (perpetual-life) BDCs have been growing since the U.S. Securities and Exchange Commission (SEC) broadened the definition of "accredited investor" in 2020.

Exhibit 42: The private debt ownership base: largely long-term and "buy-and-hold" focused

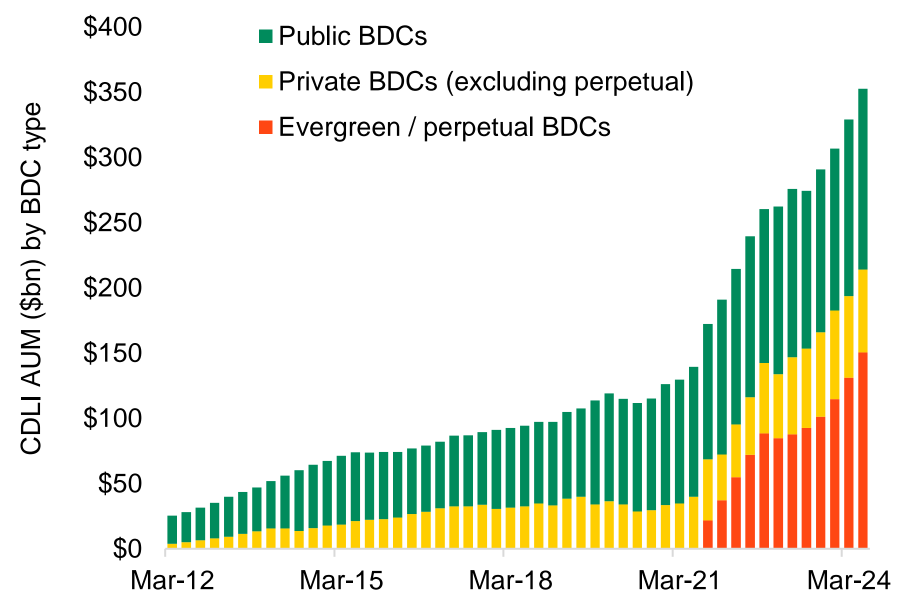
Proportion (by count) of private debt investors by investor type



Source: BlackRock, Preqin. As of June 25, 2024. The "Other" category includes Corporate Investor, Government Agency, Investment Company, Investment Trust, Sovereign Wealth Fund, and Superannuation Scheme. FoF = fund of fund.

Exhibit 43: BDC structures have evolved to meet demand from the wealth manager universe

Proportion (by count) of private debt investors by investor type



Source: Cliffwater Direct Lending Index, BlackRock. As of 3Q2024 (most recent available).

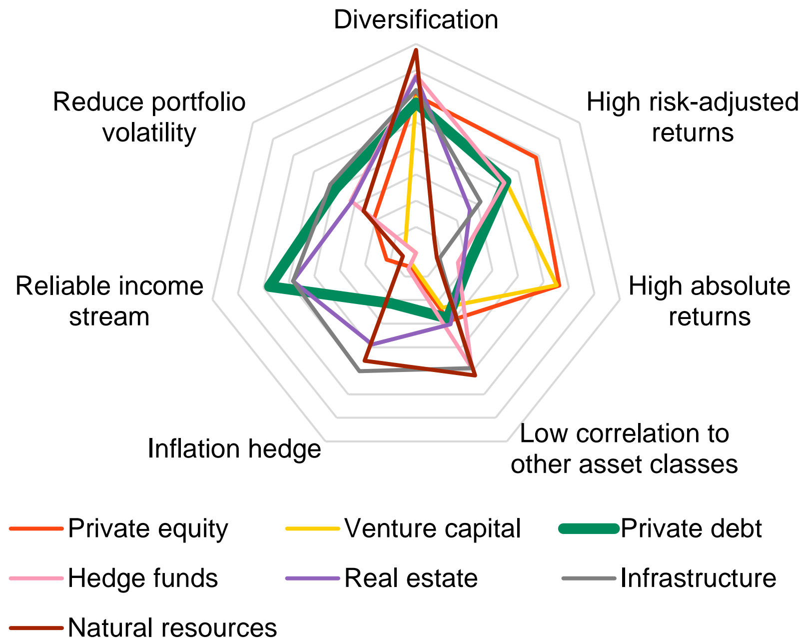
An expanding institutional investor base

On the institutional side, income and diversification are among the top reasons investors allocate to private debt (Exhibit 44), in the context of a "whole portfolio" approach. Others include an opportunity to introduce granular credit selection and structural protections (depending on the strategy). As we outlined recently and discuss later, we believe investors' increased familiarity and comfort with the asset class is also playing a role in its expansion – a trend we expect to carry into 2025.

As Exhibit 45 shows there is ample scope for investor participation and target allocations in private debt to expand, especially relative to other alternative asset classes such as private equity and real estate.

Exhibit 44: Income and diversification are sought by private debt investors

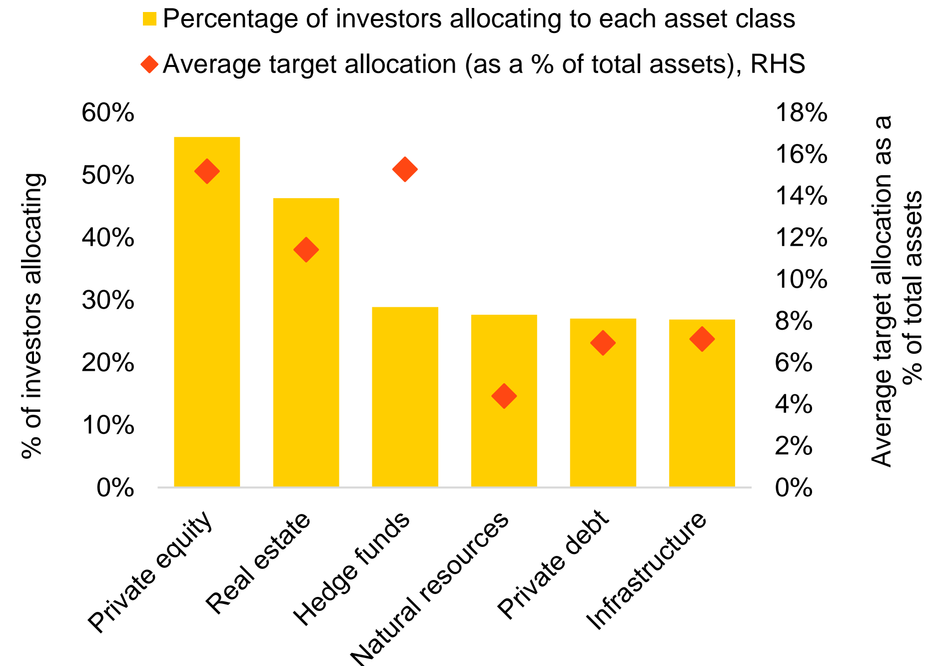
Institutional investors' main reasons for investing in alternative assets, per a June 2024 Preqin survey



Source: Preqin June 2024 survey, BlackRock.

Exhibit 45: Scope for allocations to increase

Percentage of Preqin June 2024 investor survey respondents allocating to each alternative asset class, and the average target allocation (as a percentage of total assets), RHS



Source: Preqin June 2024 survey, BlackRock. Venture capital is included in private equity. Percentage allocations include fund of funds.

Insurance industry interest in private debt

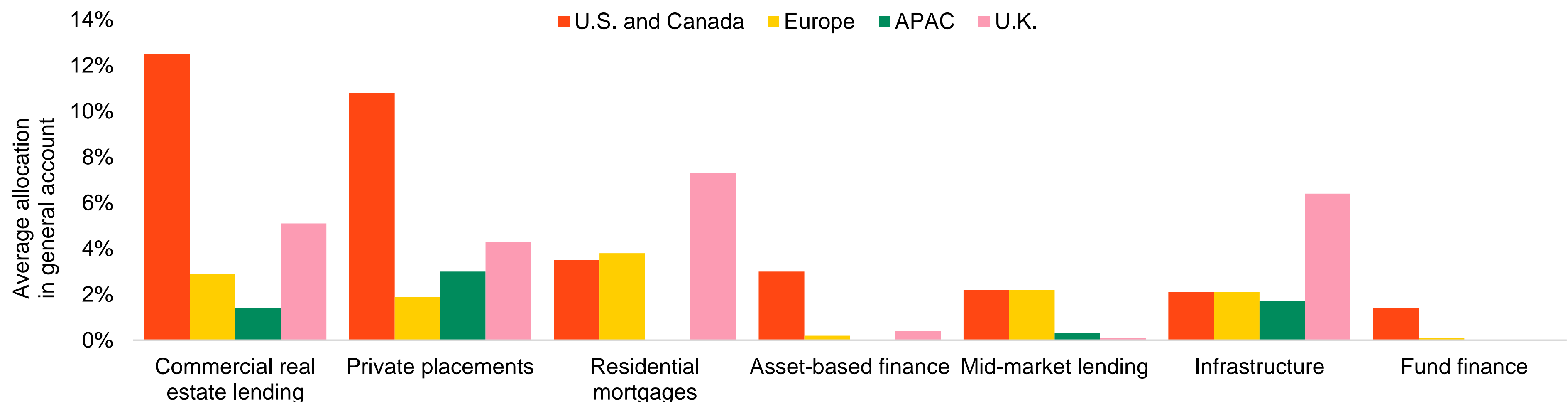
Private markets' increasing overlap with the insurance sector is another trend we expect to gain additional momentum in 2025. As we outlined in late October, insurers are increasingly focused on generating "capital efficient yield." In many instances, this has incorporated broadening the investment universe to include IG private, less liquid, and structured investments to improve "yield per unit of capital." Life insurers' asset-liability matching approach is well suited to deploy capital into less liquid assets given the long-term nature of their liabilities (i.e., life insurance policies are paid years into the future).

A June 2024 Moody's survey – which captured responses from 30 of the largest global insurers with combined total investments of $5.3 trillion – found that nearly 80% of those surveyed planned to increase holdings of at least one class of private debt over the long term. Moody's cited several benefits for insurers, including potential for additional spread earnings (owing to an "illiquidity premium"), an opportunity for detailed due diligence, diversification from other asset classes, and the potential for stronger covenant protections. Exhibit 46 illustrates the allocations to various private debt segments, per the survey.

This is consistent with the 2024 BlackRock Global Insurance Report (released October 14, 2024), which captured the views of 410 insurance investors representing $27 trillion in AUM. 91% of respondents intend to increase allocations to private markets over the next two years. And within this cohort, 30% plan to increase exposure to investments in private debt.

Exhibit 46: Insurers' exposure to the various categories of private debt varies by region

Per a June 2024 Moody's survey of 30 global insurers: Average allocations as a % of general account investments



Source: Moody's ("Insurers' private credit holdings will grow, with benefits outweighing risks," June 4, 2024), BlackRock.

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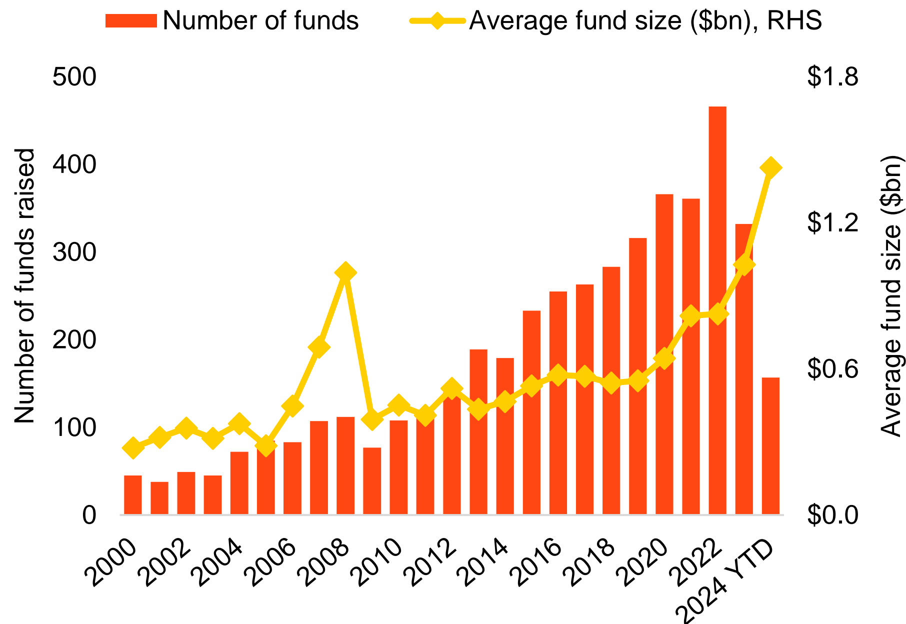
An expanding borrower base

Having already discussed the "supply" of private debt (i.e., investors' allocated capital into private debt funds), we now turn to the "demand" side of the equation: borrowers' utilization of private debt as a financing tool. Put simply: private debt is no longer reserved for niche, small financing opportunities, as was the case more than a decade ago.

Indeed, average private debt fund sizes have increased alongside growth in overall AUM (Exhibit 47, and again, Exhibit 41). This has allowed private debt to compete in areas where it previously could not. For example, private debt is increasingly financing deals that are large enough to be serviced in the public (syndicated) markets, as shown by a higher frequency of "jumbo" financings (Exhibit 48). So far in 2024 (through December 5th), there has been $82 billion of "jumbo" volume in the U.S. sponsor-backed market, according to data compiled by KBRA DLD – a new record. The average jumbo financing size for this year stands at $1.9 billion – above the previous record set in 2023 ($1.8 billion), per KBRA DLD.

Exhibit 47: Larger private debt fund sizes

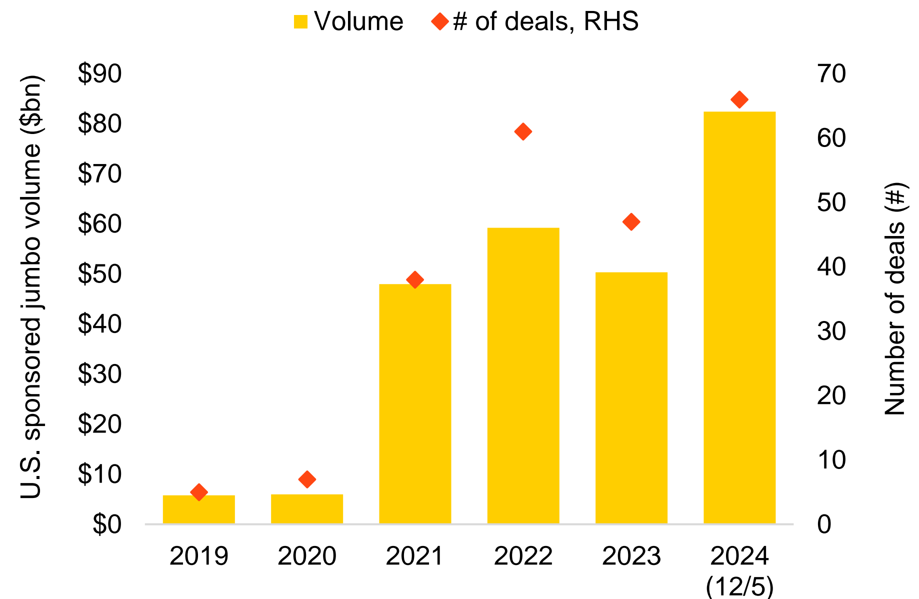
Global private debt fundraising (number of funds and average fund size, on RHS). Captures the "final close date."



Source: BlackRock, Preqin. As of December 10, 2024.

Exhibit 48: More "jumbo" private debt deals

U.S. sponsored jumbo volume (direct lending deals greater than or equal to $1 billion)



Source: KBRA DLD News, BlackRock; Includes new-issue incremental amounts to existing loans greater than or equal to $1 billion. KBRA data for this series begins in May 2019. 2024 captures transactions through December 5, 2024 (most recent available as of December 10, 2024).

Public vs. private financing "mix-shift"

Notably, private debt is also servicing borrowers with *demonstrated* access to the public debt markets – including refinancing publicly traded debt outstanding (i.e., HY bonds and leveraged loans) with private financing (Exhibit 49). This is important, in our view, as it helps disprove a common myth in private debt: that this sort of financing is reserved for companies without any better options. The data shows instead that the overlap of borrowers between the two markets is much more fluid.

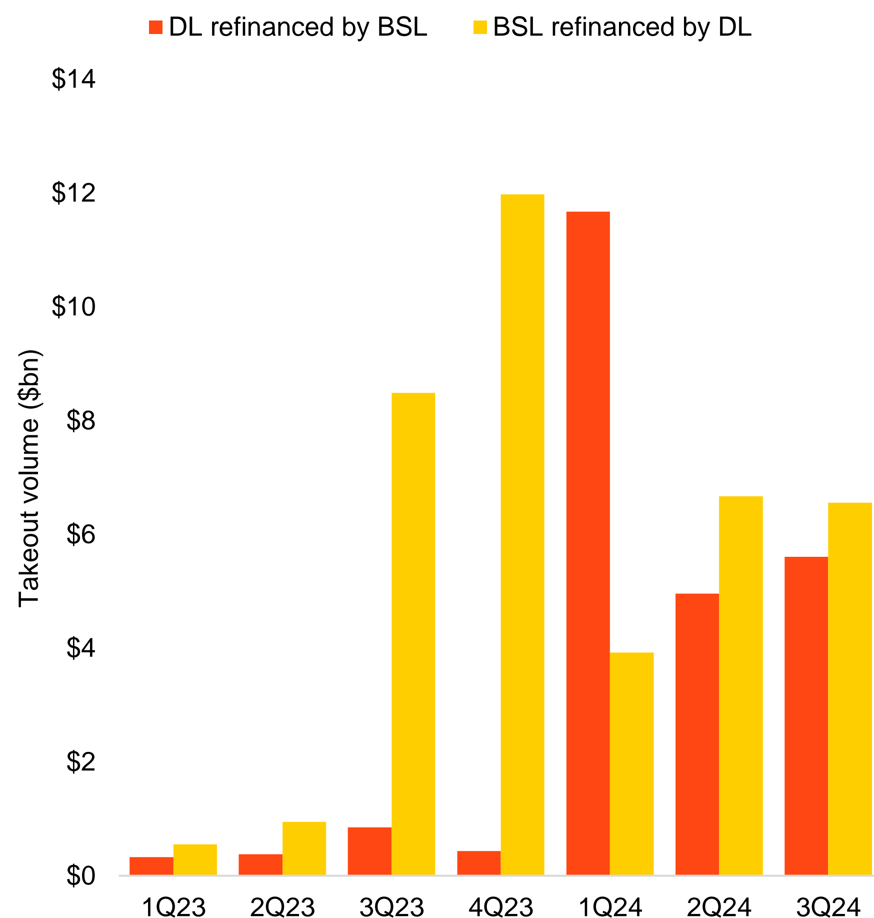
Exhibit 49 illustrates that even as leveraged finance syndicated markets have been receptive to lower-rated firms over the past few quarters, the value proposition of private debt remains attractive for a range of borrowers. In our view, this is driven by factors such as certainty of execution/pricing and customization. Data from Pitchbook LCD shows that of the 37 borrowers that refinanced their syndicated loans into private debt in 2024 (through October 31st), only four had more than $1 billion in debt outstanding. The median amount of debt refinanced from those borrowers was $450 million.

We expect the financing "mix-shift" between public and private debt refinancings will vary based on factors such as borrower-specific circumstances, macroeconomic volatility and the willingness of syndicated markets to refinance lower-rated borrowers. That said, we expect the markets will "coexist peacefully" and largely complement one another. Indeed, we view the growth of private debt as a viable financing option for a wide range of companies as a net positive for financial stability.

Moreover, private debt's appeal has not been limited to speculative-grade firms. More recently, and as discussed on the next page, some IG-rated borrowers have been turning to private debt for financing – despite having access to the USD IG new issue market (an extremely large, liquid and deep financing market).

Exhibit 49: The private vs. public "mix-shift" will ebb and flow, depending on market conditions

New issue broadly syndicated loans (BSL) and direct lending (DL) takeouts



Source: Pitchbook LCD, BlackRock. As of 3Q2024 (most recent available). Historical data is subject to change as LCD collects more information.

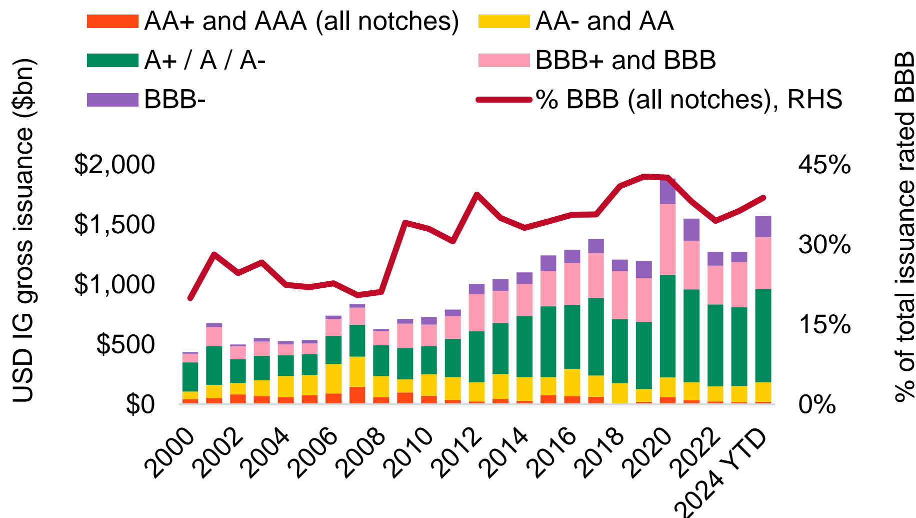
Private credit's appeal to *IG-rated* borrowers

As we discussed earlier, the USD IG universe has shifted lower in ratings, and higher in leverage, as it has grown. We believe this pattern reflects corporate CFOs' views that the cost of debt capital was likely better optimized at a higher leverage level, so long as the rating remained comfortably within IG territory (at BBB). Exhibit 50 illustrates the structural shift towards BBB-rated debt financing following the 2008 global financial crisis.

At this stage, some of the outstanding USD BBB capital structures are quite large (Exhibit 51). Many of these issuers have already tapped *global* IG debt markets (EUR, CHF, GBP, JPY) to diversify funding sources. With such a large amount of publicly traded debt outstanding, these borrowers may be approaching investors' issuer concentration limits, and/or the "upper bound" for IG-rated leverage at the holding company level. In such instances, the use of private debt for future financing may provide a more optimal and customized solution, especially for IG-rated borrowers with asset-rich subsidiaries (where value may be unlocked with secured financing). While the decision to access such private financing is nuanced, we see the potential for this opportunity set to grow, over time.

Exhibit 50: BBB-rated debt has captured a larger share of new issue activity

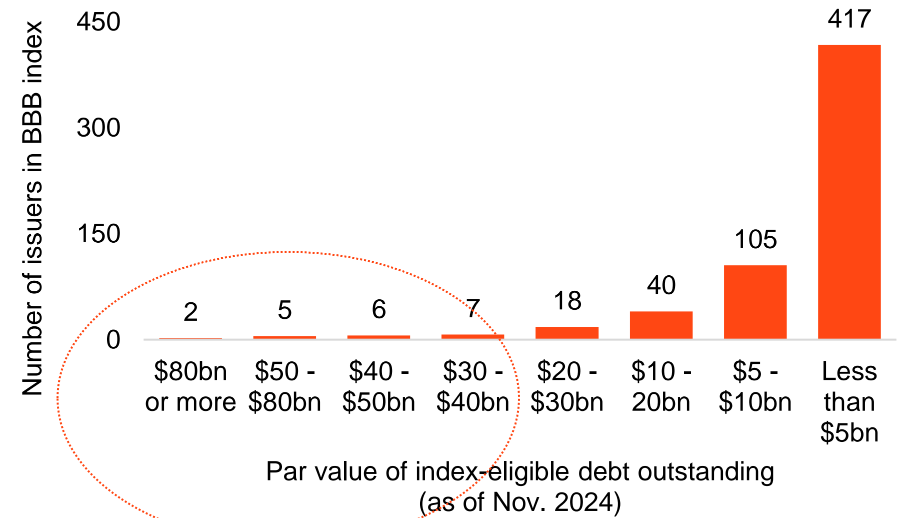
USD IG gross issuance by Dealogic "Effective Rating at Launch," and the share rated BBB (across all three notches), RHS



Source: BlackRock, Dealogic (ION Analytics). As of December 5, 2024.

Exhibit 51: Some USD BBB debt structures are now very large

Number of issuers in the Bloomberg USD BBB Corporate Index by index-eligible debt outstanding (ticker LCB1TRUU)



Source: BlackRock, Bloomberg. As of November 18, 2024. Excludes issuers that are not index-eligible.

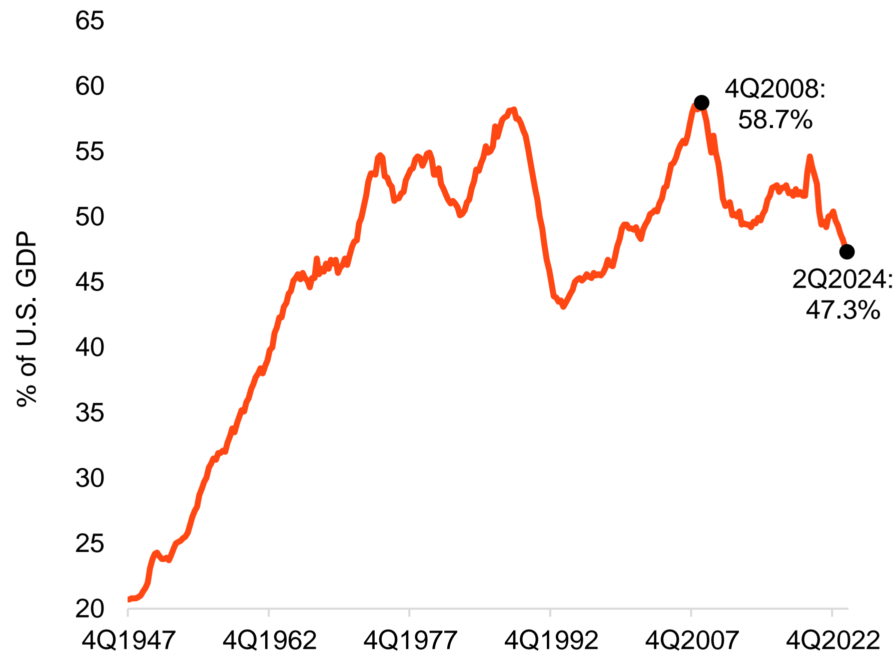
Evolving bank lending, capital markets

Also related to the "demand" side of private debt is the ongoing evolution in both bank lending and debt/equity capital markets. For example, long-term shifts in the global economy, such as the build out and expansion of artificial intelligence (AI) capabilities, will require significant capital investment and financing (some may require multiple rounds of funding).

As our colleagues in the *BlackRock Investment Institute* recently highlighted, private markets are pivotal in building the transformation we see ahead. They estimate that spending on AI-related infrastructure (data centers, chips, and power systems) could exceed $700 billion *per year* by 2030. Cumulatively, investment could total $3 trillion by 2030. With banks seeking to deploy their balance sheet capital in the most efficient way, and government spending constrained by elevated fiscal deficits, we see a critical role for the capital markets – including the private markets – to mobilize the required capital. This presents an opportunity for investors, in our view.

Exhibit 52: Banks' share of lending has declined

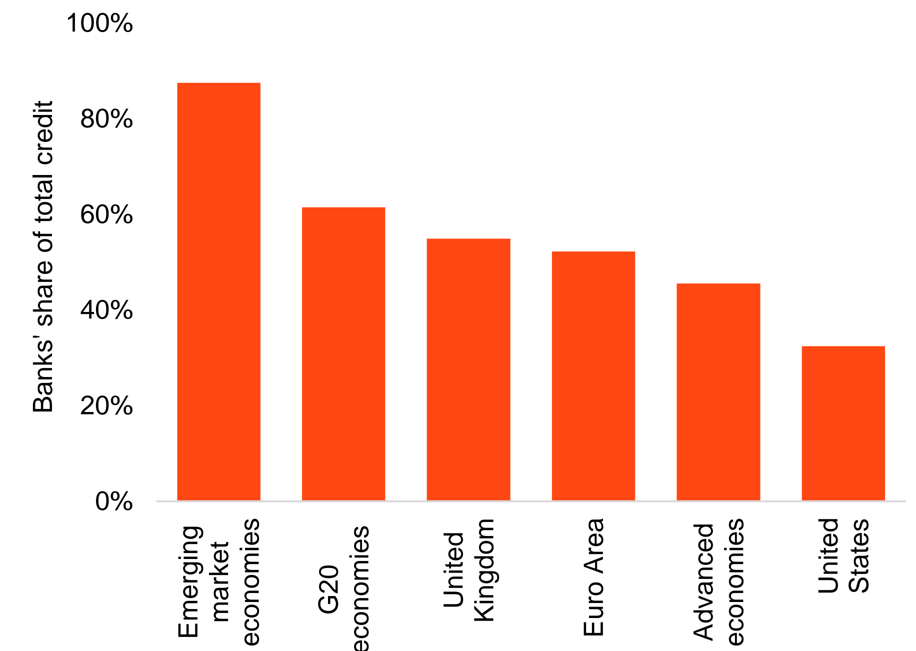
U.S. bank lending to the domestic private non-financial sector (at market value), as a percentage of U.S. GDP



Source: BlackRock, Bank for International Settlements. As of 2Q2024 (most recent as of December 10, 2024).

Exhibit 53: Reliance on bank lending varies

Banks' share of total credit provided to the private non-financial sector - select regions



Source: Bank for International Settlements, BlackRock. As of 2Q2024 (most recent available as of December 10, 2024).

Increasing partnerships

The trends related to long-term AI financing (among other "mega forces") are occurring in addition to other structural forces in bank lending. In September, we noted banks' more selective approach to lending, especially in areas such as commercial real estate and subprime consumer. This was evident in bank lending surveys – from the U.S. and Europe – released over the past several quarters.

At the same time, scaled asset managers have grown their access to longer-dated, more permanent capital, as seen by the growing number of private equity-owned insurers in the U.S. This has left sourcing and origination capabilities as a key differentiator for private debt managers.

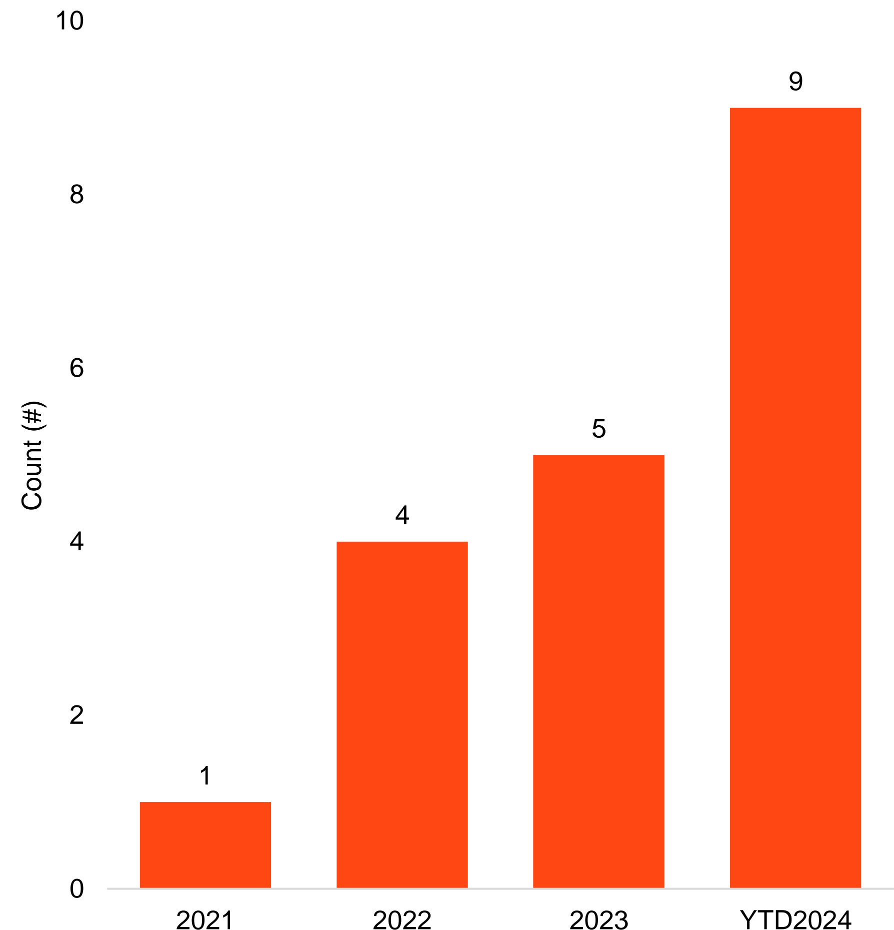
So, as the financing ecosystem has evolved, banks and asset managers have, too. A November 2024 research paper co-authored by Oliver Wyman and Morgan Stanley Research identified 19 origination-focused partnerships formed between banks and private debt managers from 2021 through 2024, with some participants forging multiple partnerships (Exhibit 54).

While a variety of partnerships have been announced, their analysis highlights that many focus on leveraging the banks' vast origination and distribution networks, while moving select assets *from* bank balance sheets *to* managers with more permanent capital. We frame this as having moved banks away from a model whereby they *originate, lend, and hold a loan on their balance sheet*, to a model of *origination and connection with a lender*. This newer model would still allow banks to preserve client connectivity and servicing in other areas.

Beyond these partnerships, the analysis noted other opportunities for banks to participate in the evolving private debt ecosystem, including (1) servicing private debt funds and loans, and (2) financing private debt managers.

Exhibit 54: Partnerships are a way for banks to participate in private debt's growth

Count of bank and private debt manager partnerships announced, by year



Source: Oliver Wyman, Morgan Stanley. See "Extending Credit: The Evolving Role of Wholesale Banks in Credit Markets," for more. YTD2024 is as of November 20, 2024.

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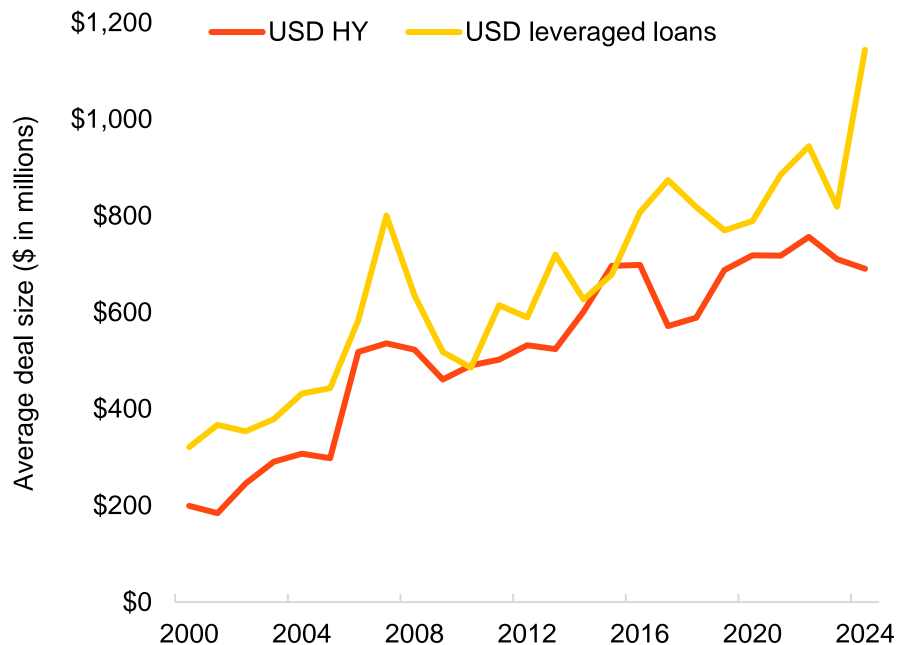
Larger debt markets, and “private for longer”

Other structural shifts in the debt and equity capital markets are also important to monitor in 2025. Starting with Exhibit 55, the average deal size in the USD leveraged loan market increased significantly in 2024, owing in part to a large wave of refinancing and repricing activity. And while the USD HY bond market’s average deal size didn’t set a new record, it remains sizable, at $690 million. For most middle market firms, such average deal sizes are prohibitively large. And issuance of a smaller deal size would likely render it illiquid (and possibly, not index eligible) in the public markets. This is another reason why a firm may opt for a more customized financing solution in private markets. In the equity market, the structural decline in the number of public companies outstanding has continued through 2024 (Exhibit 56). Here too, this has provided an avenue for private debt lenders to participate in the earlier stages of companies’ growth.

Exhibit 55: Larger average deal sizes in the public debt market

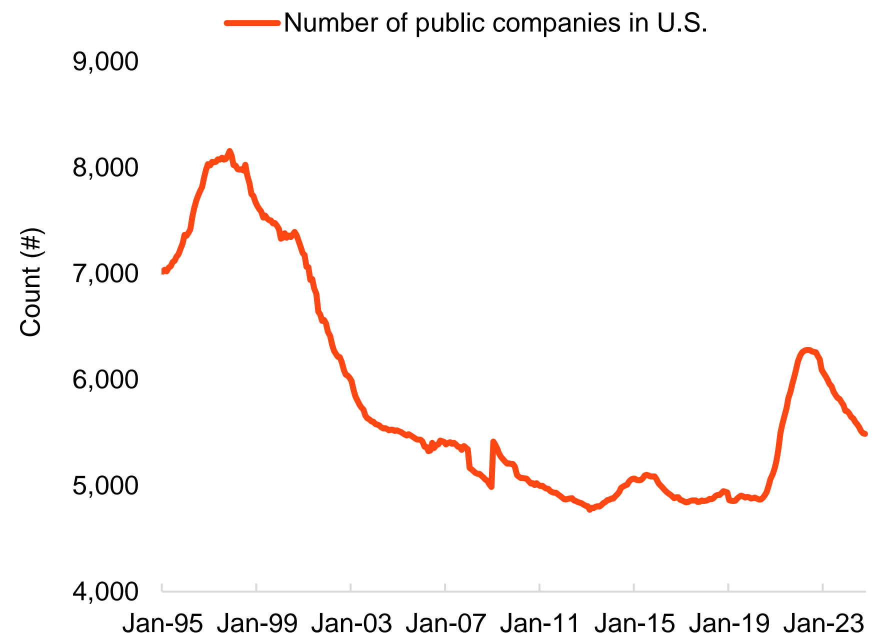
Average deal sizes ($ millions) in the USD HY and USD leveraged loan primary markets



Source: Dealogic (ION Analytics), Pitchbook LCD, BlackRock. As of December 6, 2024. We include leveraged loan institutional and pro-rata issuance, as well as issuance for all uses of proceeds across HY and leveraged loans (including refinancing).

Exhibit 56: Companies are staying “private for longer” in the U.S. equity market

Number of Public Companies in the U.S. based on NASDAQ and NYSE



Source: BlackRock, World Federation of Exchanges, Haver Analytics. As of October 31, 2024 (most recent for both as of December 6, 2024).

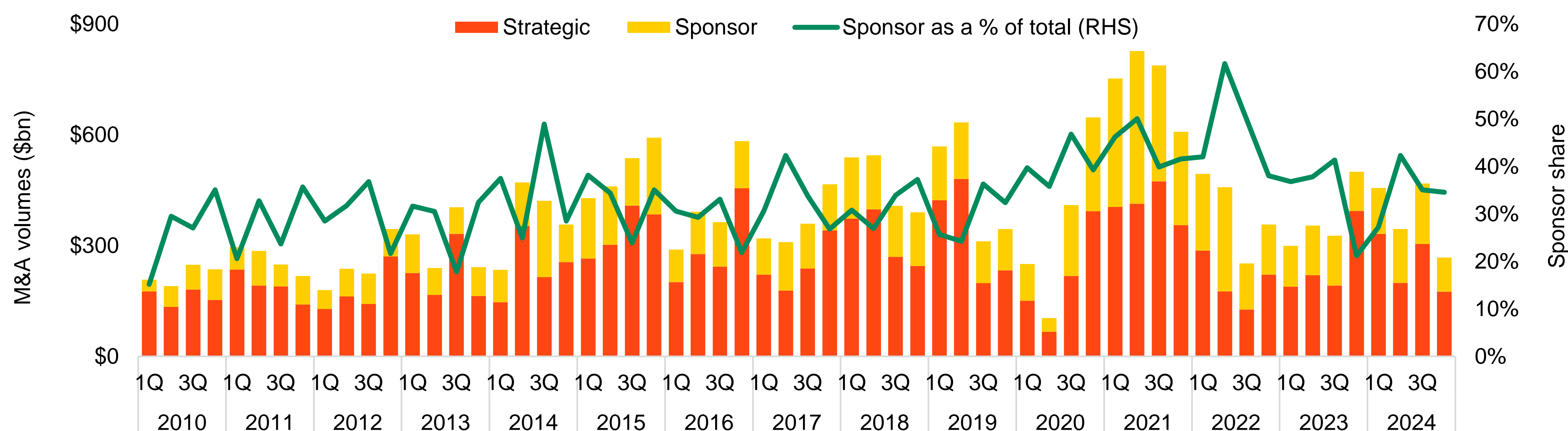
Clarity should drive an uptick in M&A

The U.S. election outcome has provided "directional" clarity, though important details regarding many of the incoming Trump administration's policies (i.e., trade, taxes, among others) have yet to be finalized. This point was recently noted by Fed Chair Powell, when he outlined a list of uncertainties related to the impact of potential tariffs. Nevertheless, the combination of this "directional" clarity, normalizing monetary policy, and supportive growth sets the stage for a potential rebound in M&A in 2025, in our view.

The scope for a recovery in deal making is especially pronounced on the sponsor-related side, relative to strategic transactions (Exhibit 57). Using data compiled by Dealogic, year-to-date (through December 8th) announced M&A by North American *strategic* acquirers (for deals valued at $100 million or more), is tracking 2.5% below the five-year average of 2019-2023. By contrast, transactions involving a financial sponsor (either as a seller, or a buyer) are 25% below the five-year pace. For corporate credit investors, there are two implications. First, the funding mix (i.e., debt vs. equity) can significantly impact credit fundamentals. So far this year, 58% of strategic M&A has been funded solely with cash (which, in practice, can often be replaced with debt). This ranks at the high end of the range over the past several years (although is notably behind 2022's "cash only" share). Second, for investors in private debt markets, a recovery in sponsor related volumes should provide an opportunity for capital deployment (as discussed on the next slide).

Exhibit 57: Sponsor-related M&A has room to rebound

Announced sponsor and strategic M&A deals in North America and sponsored volume as a share of the total (RHS). Captures deals valued at $100 million or more, at announcement. Excludes canceled and withdrawn deals.



Source: Dealogic (ION Analytics), BlackRock. As of December 8, 2024. Sponsor related transactions are those that include a financial sponsor on either side (as buyer or seller).

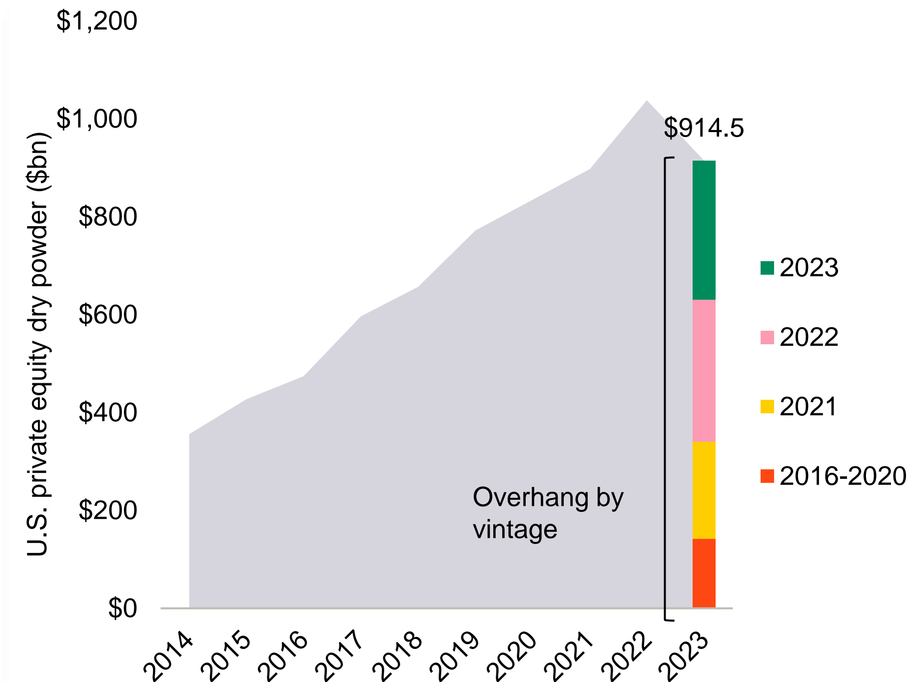
PE exits should accelerate from here

As shown in Exhibit 58, dry powder in private equity (PE) funds is elevated, although it has declined from the peak levels of 2022. Moreover, PE firms' aggregate inventories are bloated and include some notably aged positions, as illustrated in Exhibit 59. This has been driven by a sharp decline in the number of PE exits relative to investments (which decreased two-thirds vs. the 2021 peak, per Pitchbook LCD data).

The swift interest rate hiking cycle that began in 2022 resulted in a sharp misalignment of buyer and seller expectations – especially for deals that may have been formed in a much lower interest rate environment. With recession risk notably lower than a year ago, monetary policy normalization under way, and the outcome of the U.S. election known, we see scope for additional activity within PE portfolios, as sponsors look to exit/monetize positions and distribute capital to investors. Moreover, as the PE industry sources new deals, private credit lenders focused on sponsor-backed opportunities will have additional opportunities to deploy capital.

Exhibit 58: PE dry powder is elevated

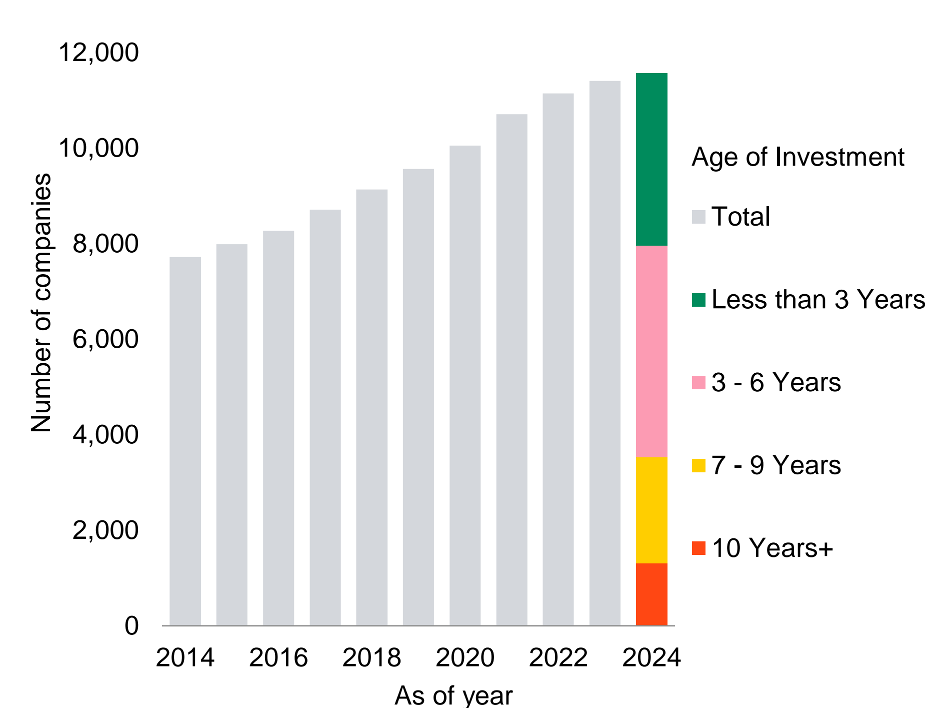
U.S. private equity dry powder, by vintage



Source: Pitchbook LCD, BlackRock. As of December 31, 2023 (most recent).

Exhibit 59: PE inventory is aging

U.S. private equity-backed company inventory, by deal year



Source: Pitchbook LCD, BlackRock. As of September 30, 2024 (most recent).

Experience matters

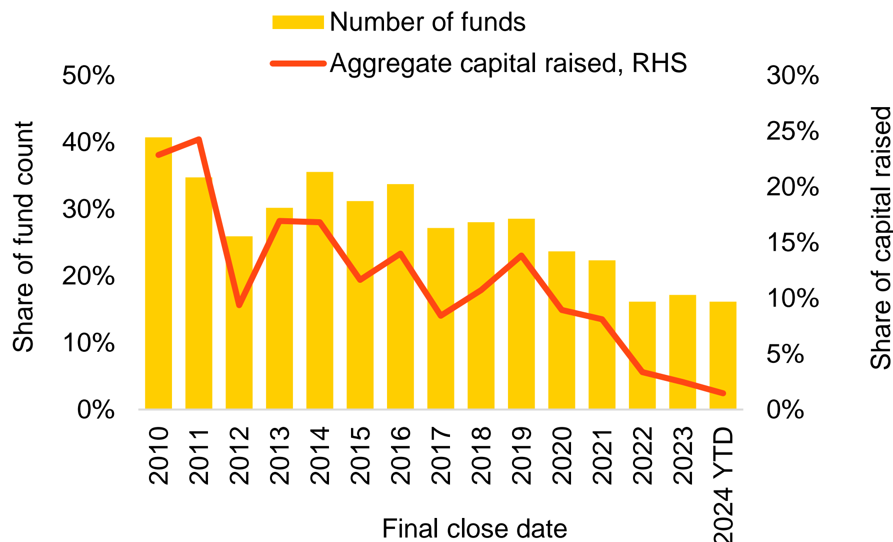
Earlier, we commented on investors' growing familiarity and comfort with the private debt asset class, relative to even just a few years ago. But this has not extended to *all* private debt managers, across the experience spectrum. Indeed, investors have been discerning as to where they allocate capital.

Exhibits 60 and 61 illustrate this by tracking private debt fundraising (using the Preqin universe) by manager experience level. First-time private debt funds have captured, on average, 2.4% of total capital (per year) since 2022, well below the 2019-2021 run rate of 10.3%. Similarly, established private debt managers (i.e., those raising their fourth fund or later) have raised 86% of capital, on average, since 2022, compared to an average of 72% from 2019-2021.

We believe a higher interest rate environment has encouraged investors to favor more experienced managers, who typically benefit from restructuring and workout expertise. We also believe this is reflective of some investors' desire to streamline the number of private debt managers with whom they work. As a result, those with breadth and depth of expertise are likely best positioned, in our view.

Exhibit 60: First-time private debt funds have raised only minimal amounts of capital

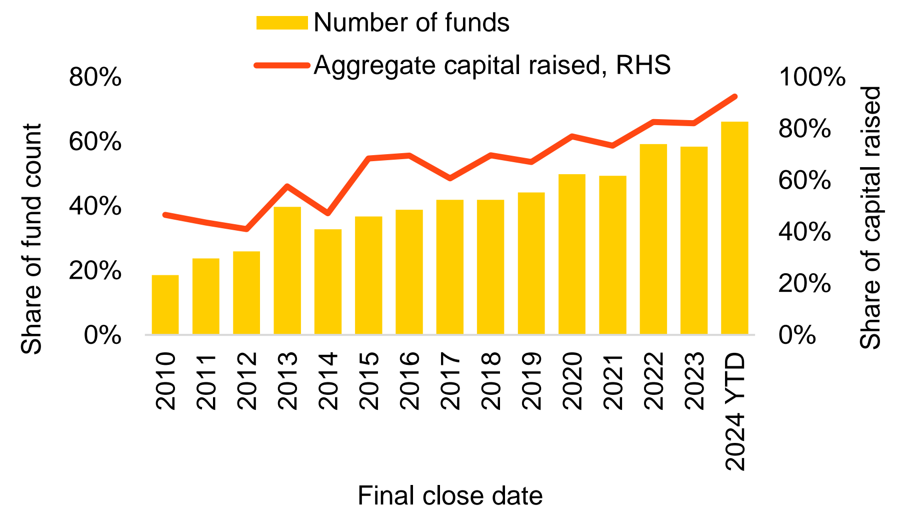
First-time private debt fundraising as a proportion of total funds and aggregate capital raised (RHS)



Source: BlackRock, Preqin. Captures data as of November 1, 2024 (most recent).

Exhibit 61: Experienced private debt managers have raised the lion's share of capital

Fourth fund or later private debt fundraising as a proportion of total funds and aggregate capital raised (RHS)



Source: BlackRock, Preqin. Captures data as of November 1, 2024 (most recent).

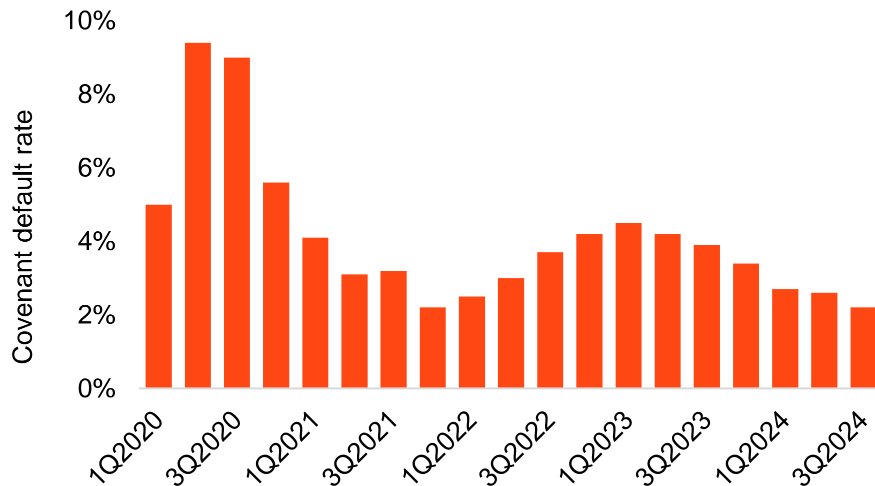
Resilient fundamentals should persist

Private debt fundamentals have shown notable resilience in the higher interest rate environment, owing to the long-term relationship between the lender and borrower. With rates poised to further normalize and given our expectation for supportive growth (especially in the U.S.), we see scope for fundamentals to show ongoing improvement into 2025.

For example, Lincoln International's private debt, size-weighted covenant default rate declined for the *sixth consecutive quarter* in 3Q2024 (Exhibit 62; although this somewhat masks the elevated default rates of firms in the lower middle market, as we have previously highlighted). Further, size-weighted fixed charge coverage ratios for borrowers in the U.S. and Europe increased in 3Q2024, suggesting that interest rate relief has started to support fundamentals. On a pro-forma basis, Lincoln International estimates that coverage ratios will continue to improve in the coming quarters (Exhibit 63). However, we continue to view future rate cuts as more likely to be a *normalization* (vs. easing), so additional rate relief may be limited if economic resilience persists (especially in the U.S.).

Exhibit 62: The covenant default rate declined for the sixth consecutive quarter

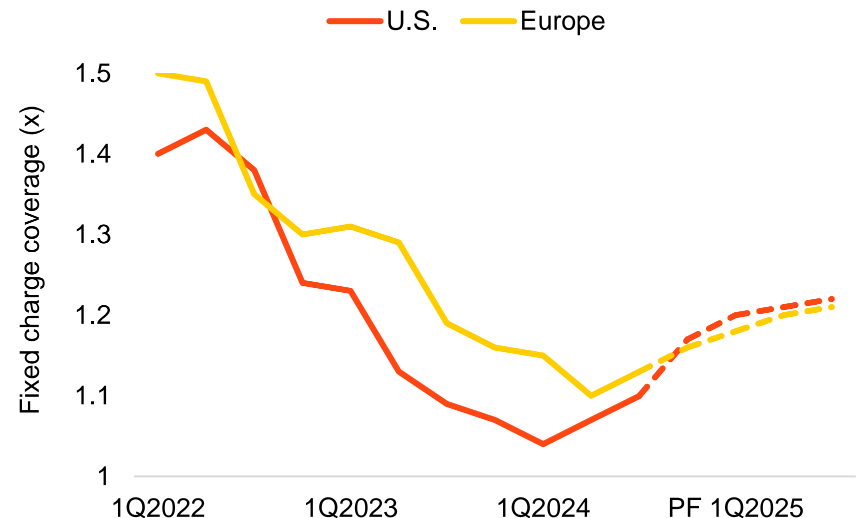
Aggregate size-weighted covenant default rate for the U.S. portfolio companies tracked by Lincoln International



Source: Lincoln International Valuations & Opinions Group Proprietary Private Market Database, BlackRock. As of 3Q2024. A default is defined by Lincoln as a covenant default (not necessarily a monetary default). The calculation is size-weighted and considers the total net debt balance for each of the portfolio companies that had a defaulting security in the respective quarter. © 2023 Lincoln Partners Advisors LLC. All rights reserved. Used with permission. Third party use is at user's own risk.

Exhibit 63: Fixed charge ratios may have troughed

Size-weighted and pro-forma (PF) fixed charge coverage ratios for the universe of U.S. and European firms captured by Lincoln International (and per Lincoln's PF estimates)



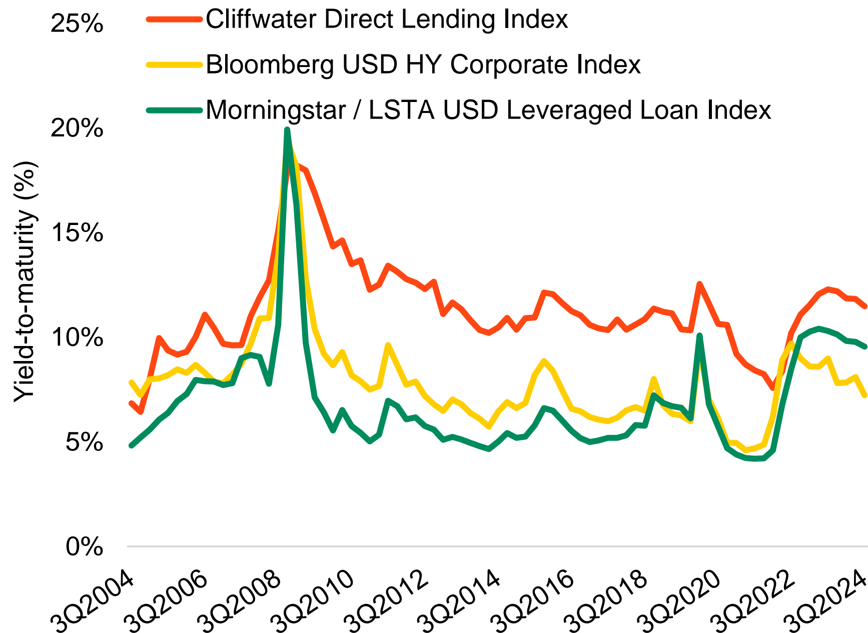
Source: BlackRock, Lincoln International Valuations & Opinions Group Private Market Proprietary Database. Captures data as of 3Q2024. Calculation: (EBITDA – Taxes – Capex) / (Interest Expense + 1% Debt Balance). © 2023 Lincoln Partners Advisors LLC. All rights reserved. Used with permission. Third-party use is at user's own risk. For U.S., respective SOFR rates represent a trailing 4 quarter average.

Elevated yields, modest loss rates

As mentioned earlier, we are emphasizing the carry and yield opportunities across the corporate credit landscape in 2025. Relative to its closest peer in the syndicated market – USD leveraged loans – subsets of private debt still offer a notable yield "pickup." To show this, we use the Cliffwater Direct Lending Index (CDLI) – an asset-weighted index of approximately 17,000 directly originated middle market loans totaling $393 billion – as a proxy for U.S. middle market lending. As Exhibit 64 highlights, the CDLI yield as of 3Q2024 was 11.5%, compared to 9.5% for the USD leveraged loan index. A range of factors can contribute to private debt risk premiums, including a general "illiquidity premium" and borrower/deal-specific exposures. Further, Exhibit 65 highlights how the CDLI income compares to its modest loss rates over the past two years (despite the higher cost of capital for borrowers).

Exhibit 64: Direct lending has historically offered a yield "pick-up" vs. public markets

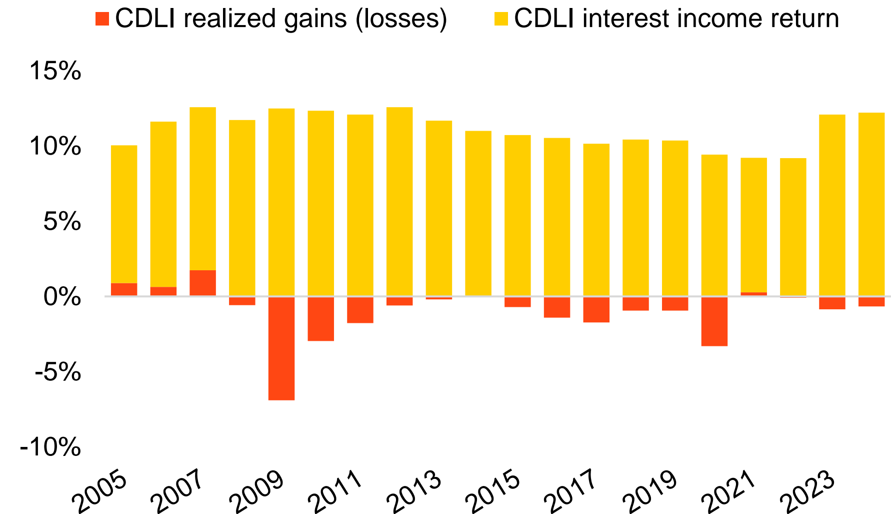
Average index yield-to-maturity levels



Source: Cliffwater LLC, Bloomberg, Morningstar / LSTA, Pitchbook LCD. As of 3Q2024 (most recent for CDLI).

Exhibit 65: Realized losses for the CDLI remain modest despite elevated rates

Trailing 12-month income return and realized gains (losses)



Source: Cliffwater Direct Lending Index, BlackRock. As of September 30, 2024. Realized gains can be driven by equity stubs, warrants, and gains on exited investments. These were more common in 2005-2007, when second lien and mezzanine loans were a greater portion of the CDLI. We exclude unrealized gains and losses in this chart. Long-term unrealized gains (losses) are approximately zero, as they either convert to net realized losses upon a credit default, or are reversed when principal is fully repaid.

For both charts: The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results. Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index.

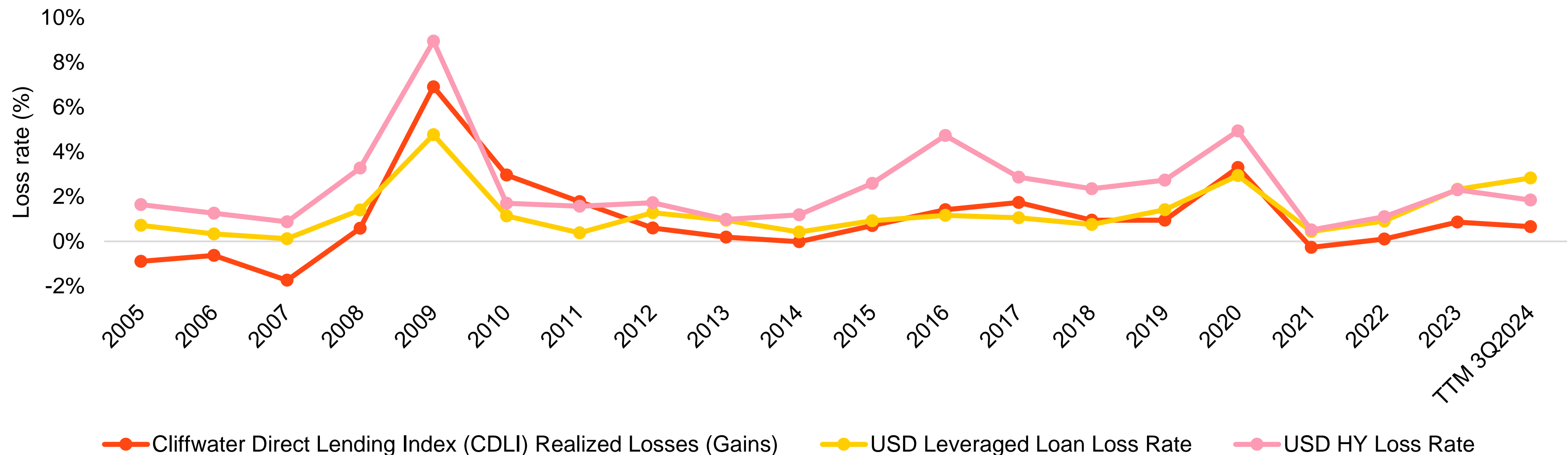
Loss rates compare favorably

Private debt's loss rates also compare favorably to its public market peers, as shown in Exhibit 66. In periods of financial market stress, such as the global financial crisis of 2007-2009, the energy sector disruption of 2014-2015, and the pandemic in early 2020, net realized losses for the CDLI were either similar to or lower than our estimates of loss-given-default in the USD HY bond and leveraged loan markets (again, Exhibit 66).

(Note: as we have outlined previously, when comparing public vs. private debt, we view loss rates as more informative than default rates, driven by the increased prevalence of covenants in private debt structures. For example, tripping a covenant provides private lenders the time and legal position to address issues in advance of a payment default).

Exhibit 66: Direct lending loss rates have compared favorably vs. public markets in recent years

Realized annual and trailing 12-month 3Q2024 loss rates for the Cliffwater Direct Lending Index, and trailing 12-month estimated loss rates for the universe of USD leveraged loans and HY bonds tracked by Moody's (calculated as the actual issuer-weighted trailing 12-month default rate per Moody's multiplied by one minus the average historical recovery rate)



Source: BlackRock, Moody's, Cliffwater LLC. For the CDLI, we show annual and trailing 12-month realized loss rate data for 3Q2024 (most recent available for the CDLI). We assume a 40% recovery rate for HY and a 60% recovery rate for leveraged loans (both in line with the historical average), to arrive at estimated loss rates given the Moody's issuer-weighted, trailing 12-month default data. The HY and leveraged loan loss rates reflect the universe of HY bonds and leveraged loans tracked by Moody's. **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index. Realized gains can be driven by equity stubs, warrants, and gains on exited investments. These were more common in 2005-2007, when second lien and mezzanine loans were a greater portion of the CDLI.

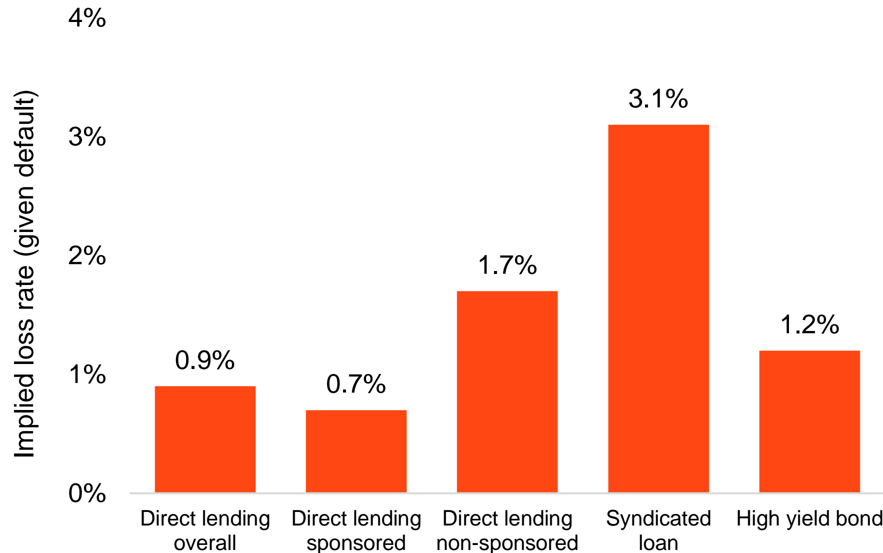
Loss rates reflect structural protections

Data from KBRA DLD and Solve paints a similar picture of relatively contained loss rates in direct lending (Exhibit 67). We attribute this to a few factors: (1) the due diligence and underwriting in the investment selection process; (2) structural protections, as the loans are generally senior secured in the capital structure, as well as covenants; (3) ongoing monitoring to help mitigate downside risk, and (4) having a strategic partner who can work collaboratively with the company to provide needed support over the long-term, if required.

This can often result in a more efficient process for negotiating amendments vs. what would otherwise occur in the syndicated public market, where a wide array of lenders would need to agree on a potential change (and some may push for a restructuring). That said, as we outlined in February 2024 – there is a wide degree of dispersion within the private debt landscape across a variety of dimensions, including: strategy, size, region, and sector. This is evident in the range of EBITDA growth experienced over the past few quarters (Exhibit 68), and we expect this trend of "dispersion but not widespread market disruption," to persist in 1Q2025.

Exhibit 67: Subsets of direct lending have among the lowest implied loss rates (given default)

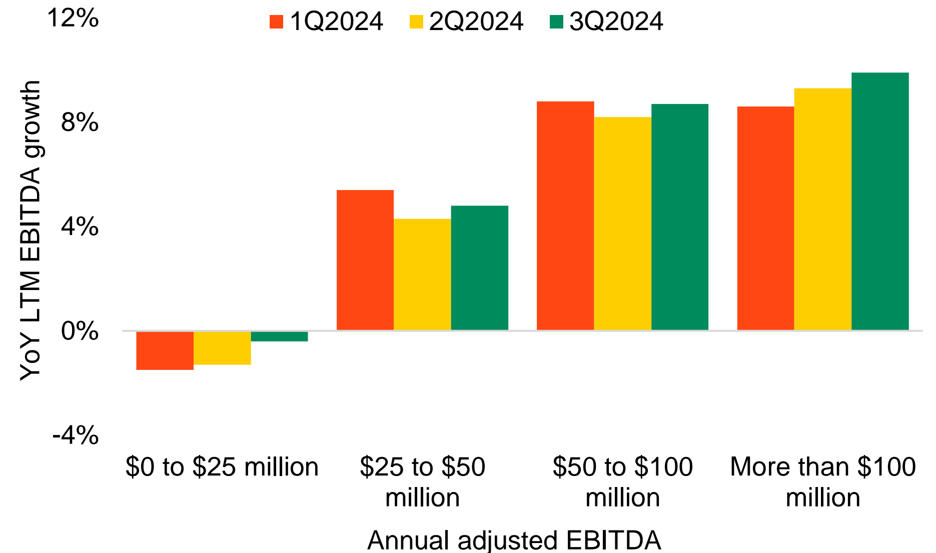
Trailing twelve-month implied loss given default rate, by issuer count



Source: KBRA DLD, Solve, BlackRock. Loss given default rate = default rate * (1 – implied recovery rate). Chart uses KBRA analysis completed in November 2024. **There can be no guarantee any forecasts will come to pass.**

Exhibit 68: Dispersion is evident

Year-over-year LTM EBITDA growth by company size (as measured by annual adjusted EBITDA), for companies in the Lincoln International Proprietary Private Market Database



Source: Lincoln International Valuations & Opinions Group Proprietary Private Market Database, BlackRock. As of 3Q2024. © 2023 Lincoln Partners Advisors LLC. All rights reserved. Used with permission. Third party use is at user's own risk. LTM = last twelve months.

Commercial real estate: watching for a bottom

Office weakness likely has more room to run

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CRE prices begin to stabilize, for some

Trends in commercial real estate (CRE) will be closely watched in 2025, due to its sensitivity to growth and interest rates, as well as its exposure to lingering post-pandemic structural shifts.

So far, a need for additional clarity on the macroeconomic landscape (and some interest rate volatility) has kept buyer and seller property price expectations somewhat misaligned, contributing to lower transaction activity. For example, year-to-date U.S. CRE transaction volume of $316 billion (as of October 2024) is in line with the prior year, but less than half of the transaction volume in the same period of 2022, according to Real Capital Analytics (RCA).

That said, we believe U.S. CRE transaction volumes may be nearing a trough as additional clarity on fiscal and monetary policy emerges, especially if economic growth and the labor market remain supportive (as many CRE categories are heavily influenced by the health of the labor market).

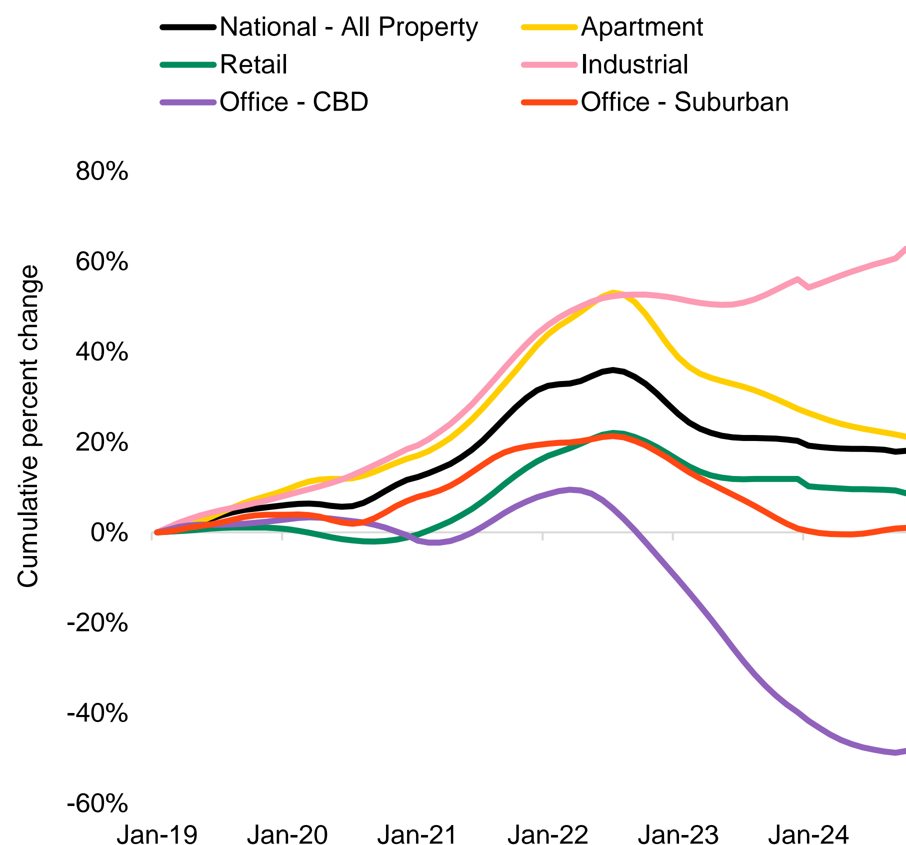
Recent stability in CRE pricing across most property types suggests that buyer and seller price expectations may be coming into better balance (Exhibit 69), a key input to transaction activity.

Still, the theme of “dispersion but not widespread market disruption” remains pertinent, as demonstrated by changes in property pricing over time (again, Exhibit 69).

Central business district (CBD) office properties are a notable exception to stabilizing values. The continued decline in pricing suggests that CBD office properties are further behind other property types in the recovery cycle, something we will discuss in more detail in the coming pages.

Exhibit 69: Pricing dispersion persists

Cumulative percent change in the level of the RCA U.S. Commercial Property Price Indices (CPPI) sector-specific indices since Jan. 2019



Source: Real Capital Analytics Commercial Property Price Indices National All-Property Index, BlackRock. Captures data through October 31, 2024. **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs, or expenses. Indices are unmanaged and one cannot invest directly in an index.

Office recovery is lagging other properties

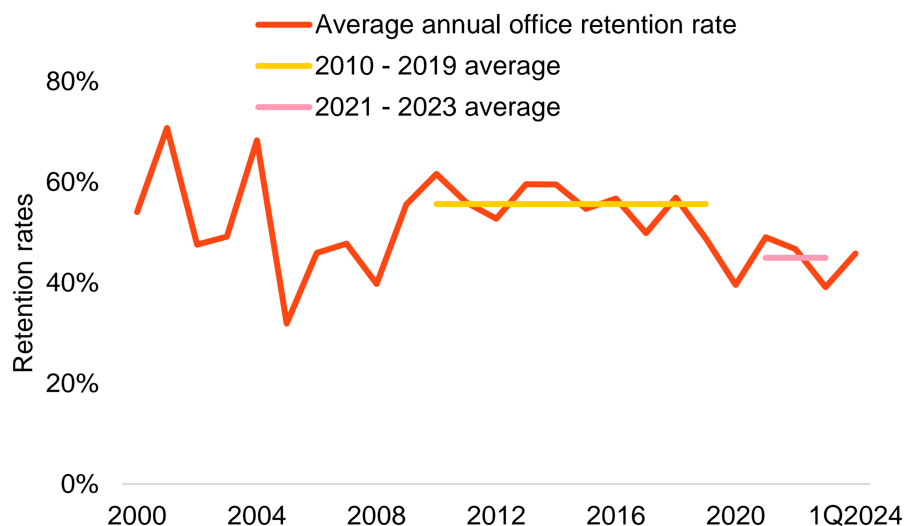
Office properties, which total an estimated $750 billion in outstanding commercial mortgage debt according to Moody's, have notably lagged in showing signs of recovery. Post-pandemic structural shifts, such as hybrid working and changing tenant preferences, continue to challenge performance, especially for central business district (CBD) office properties. Ongoing price declines suggest that the market's structural transformation is still unfolding (again, Exhibit 69).

An analysis by Green Street demonstrates how average annual retention rates for office spaces have fallen post-pandemic as tenant needs and preferences have evolved (Exhibit 70). Retention rates are critical to a property's profitability because of the costs associated with replacing a tenant. Sustained improvement in office property transaction activity will be key to recovery (Exhibit 71).

That said, there is meaningful dispersion *within* office properties. Green Street notes that Class A office properties (i.e., highest quality) tend to have higher rents and occupancy rates than market averages. These strong fundamentals have somewhat differentiated them from the broader office stress. For example, in recent months, there have been anecdotes of property owners receiving attractive property prices and refinancing terms for these newer, high-quality office properties.

Exhibit 70: Annual retention rates have fallen

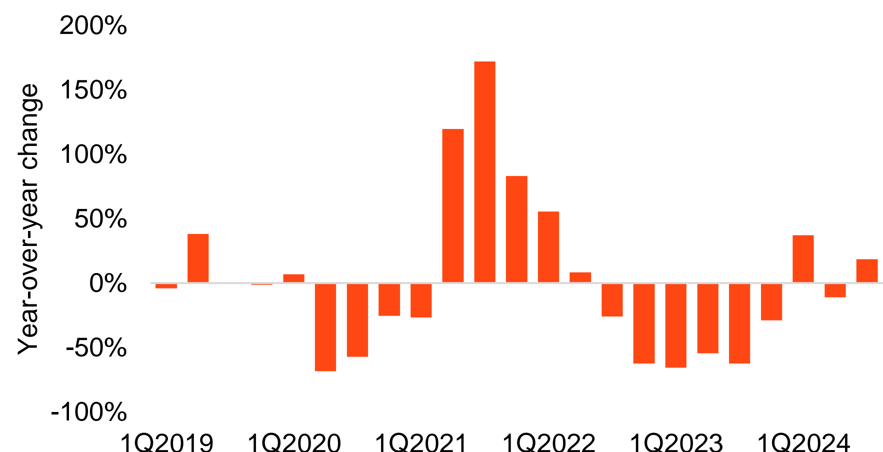
Historical average office annual retention rates, as reported by public company disclosures



Source: Company disclosures, Green Street, BlackRock. Not every office REIT discloses retention rates. This analysis is an average of retention rates from BDN, BXP, HPP, KRC.

Exhibit 71: Office property transaction volume is improving, but structural headwinds persist

Change in year-over-year (YoY) transaction volume for the RCA CPPI Office Index



Source: Real Capital Analytics Commercial Property Price Indices (CPPI) National Office Index, BlackRock. Captures data through 3Q2024. **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs, or expenses. Indices are unmanaged and one cannot invest directly in an index.

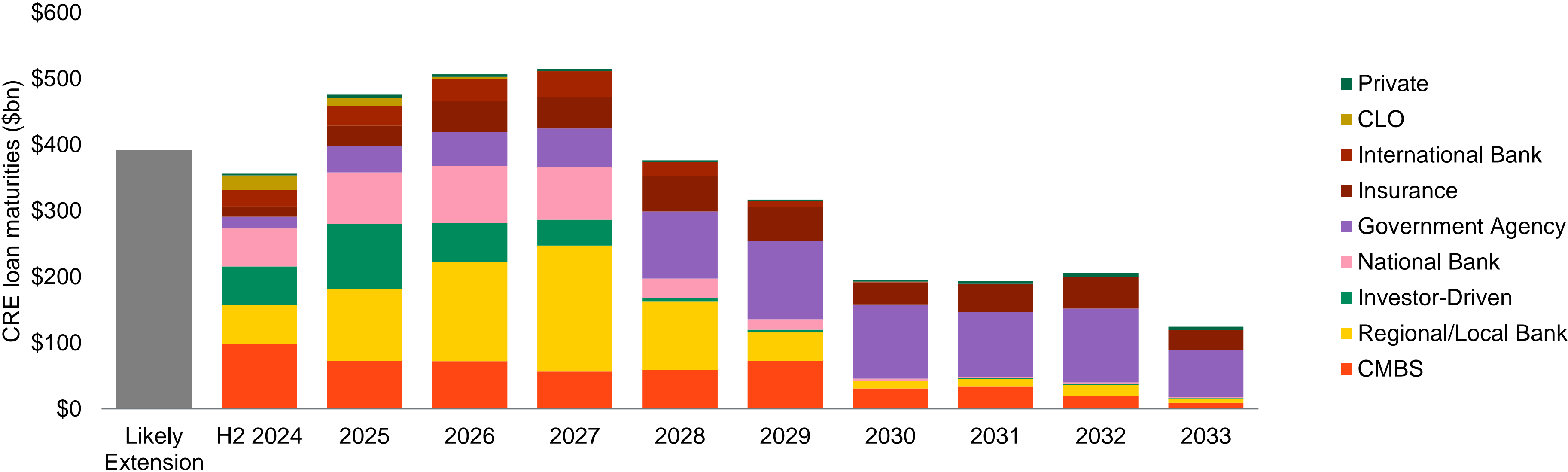
Upcoming CRE maturities are sizable

While there are signs of recovery for most property types, a wave of upcoming CRE loan maturities in the U.S. has focused market participants on the health of outstanding loans. Near-term refinancing of such outstanding loans may present challenges for existing CRE borrowers due to depressed valuations, tighter underwriting standards, and elevated rates – especially in areas facing structural challenges, such as office.

That said, banks, which hold 51% of CRE mortgage debt in the U.S. as of 2Q2024, according to data from the Federal Reserve, have shown a willingness to extend maturities on CRE-related debt. For example, an October 2024 Moody's analysis, which captured CRE loan modification disclosures from 39 U.S. banks, showed that the median share of modified CRE loans more than doubled in 1H2024 vs. 1H2023. Term extensions were the most common modification, according to the analysis. While it can be challenging to track loan extensions, data compiled by Real Capital Analytics (RCA) and MSCI Real Assets estimates that $397 billion of U.S. CRE loans maturing in 2023 and 1H2024 have been extended. Further, $360 billion and $480 billion of loans are expected to mature in 2H2024 and 2025, respectively (Exhibit 72). Given the upcoming maturity schedule, we believe this willingness to extend maturities will be key to watch going forward, until CRE transaction activity has more firmly recovered.

Exhibit 72: Apartments represent the largest share of maturing volume in the coming years

Volume of maturing commercial property loans, by property type



Source: Real Capital Analytics, BlackRock. Data as of September 24, 2024 (most recent available). RCA identifies a loan as "likely extended" if, based on their analysis, it was slated to come due in 2023 or 1H2024 and was not subsequently refinanced or the associated collateral was not sold.

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