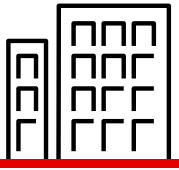


IPM monthly blog

Our monthly **insights** into **private markets** – **July/August 2024**

Real estate



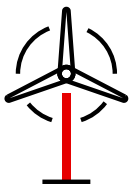
Reaching recovery

Commercial real estate markets are in a funny kind of limbo. During the first quarter, the number of deals under offer that failed to close spiked in Europe and the UK, which was likely the last gasp of a down market. Buyers may be holding out for cheaper debt, while sellers are in no hurry to trade at today's prices if yields move lower. Indeed, it's hard to argue with that logic. The European Central Bank dropped rates by 25bps in June. The Bank of Canada cut a total of 50bps so far in 2024, and the UK cut by 25bps in early August. With slowing job growth numbers and a downward trend in inflation, the US is expected to begin reducing rates in September.

Given the pre-rate cut jitters, it is not surprising to see continued weak trading volume. In Asia Pacific, sales were down -13% in the year ended March 2024. EMEA and the Americas saw sales -20% lower during the same period. Cross-border acquisitions are at their lowest level since 2010.

Even though capital market pressures are stunting values, net operating income is growing, which leaves us optimistic for wide-spread increases in transaction volumes and returns in the second half of 2024. Income growth is the main reason cited by investors when adding real estate to their portfolios. If an investor can catch the market at a time when income is growing and prices are poised for recovery, all the better.

Infrastructure



A positive mid-year health check

Earlier this year, we highlighted that we are seeing a return of 'animal spirits' in the infrastructure asset class, a healthy level of risk-taking and market buzz that was absent in 2023. Now that we have more than passed the halfway mark of the year, data points continue to be supportive of this view.

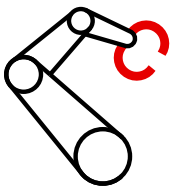
For example, according to Preqin, infrastructure fundraising in the first half of 2024 was USD 56 billion, more than twice the amount raised in the first half of 2023. Fundraising tends to be quite seasonal and most of the action usually happens in the fourth quarter. However, after a slow 2023, the current positive momentum on fundraising is welcome news.

Sentiment remains relatively positive. According to Infrastructure Investor's 1H24 Investor Report, 46% of LPs remain under-allocated to infrastructure. Preqin also reported that over 30% of investors plan to increase their commitment to infrastructure in the next 12 months – a figure that has not changed much since 2021 (usually hovers between 30–40%). This shows that last year, many LPs were on the sidelines. Not because they soured on the asset class, but because they took a wait-and-see approach given the challenging macro environment.

The increase in interest in infrastructure clearly shows that investors have clearly been satisfied with the results. Risk appetite has therefore increased, with Preqin reporting in its recent Investor Outlook that over 50% of respondents in their investor survey see 'core-plus' strategies as the most attractive (highest level in 5 years), while lower risk 'core' strategies only received votes from around 30% of respondents, down from 40% a year ago.

Deal volume is one area that still lags behind. According to Inframation, global infrastructure deals closed in 2024 August YTD is around USD 577 billion (USD 866 billion annualized), which falls short of the USD 997 billion of deals closed in 2023. We remain optimistic – as central banks around the world continue to cut rates (even if gradually), it should become easier for investors to underwrite transactions, especially when underlying infrastructure fundamentals remain strong. A stabilizing macro environment combined with a recovery in fundraising should spur more deals in the future.

Private equity



Performance stable, nascent recovery in venture

Private company performance has been stable into 3Q24. The question of whether financial performance can be sustained will depend on the consumer, where some cracks are beginning to show as companies try to push their own cost pressures downstream. Consumer spending will heavily influence the trajectory of privately held companies in the quarters ahead.

Interest rates are still the biggest question mark for private equity; even a small rate cut could directionally signal the beginning of a better market environment with cheaper leverage boosting returns. Conversely, today's environment with elevated rates (in a post-GFC context) will keep investor and sponsor sentiment sober.

Venture capital (VC) is showing nascent signs of a recovery, as Pitchbook reported 4Q23 as the first period of positive value gain in over two years for VC funds. The environment remains challenging, and companies with positive unit economics and a clear path to profitability are best positioned to raise capital.

An increasing number of co-investments and GP and LP-led secondary transactions are coming to market as sponsors look to stretch their capital further. Buyers currently have their choice of many attractive deals, and we expect this to remain the case in the coming quarters as sellers have limited exit options for private companies.



Rate cuts on the horizon?

As the later stages of the credit cycle play out, investors are looking to understand the potential impacts that looming rate cuts and continued corporate deterioration could have on return expectations for private credit.

The first order impacts of a rate cut will first flow through to any floating rate or spread products. Managers will likely see a linear step down in any credit product with a benchmark and floating rate, such as direct corporate loans. While managers have sought to get ahead of this potential impact, typically by locking in wider spreads or interest rate floors, investors should expect floating rate investment returns to correlate to changes in benchmark rates. A potential second order impact might be felt in fixed rate products. As markets digest rate cuts (and rates rally), investors could potentially bid spreads tighter on fixed rate investments or see spread tightening leak from public to private credit, as investors look to lock in attractive returns.

Further, when looking at overall spreads across private credit, the rally across public corporate investment grade (IG) and high yield (HY) over the course of 2024 has to some extent leaked through to more trafficked areas of private credit, such as upper middle market direct lending. For instance, middle market lending spreads have gone from ~650bps to ~550bps at the high end over this year. However, more niche pockets of private credit have historically shown less correlation to broader interest rate changes and corporate credit, with more consistent spreads or fixed rate contractual return dynamics. Areas such as asset-based lending, asset-backed financing and lower middle market direct lending have seen limited spread compression. Additionally, asset-based lending and other niche strategies also typically benefit from being able to secure higher interest rate floors.

Similarly, upper middle market direct lending portfolio company fundamentals have to some extent followed the deteriorating credit performance seen in the syndicated loan market, where defaults have picked up to ~3.28% with severities in the low to mid-50s. However, more esoteric segments of private credit have shown significant resilience due to strong creditor protections / structuring and overcollateralization. Niche lending strategies (not corporate based) have generally experienced limited fundamental deterioration to date.

Though private credit returns and credit performance will have some correlation to broader rates and economic performance, the asset class appears better positioned than public IG and HY, given enhanced structuring and credit protection, as well as collateral where performance is generally uncorrelated to corporate credit.

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