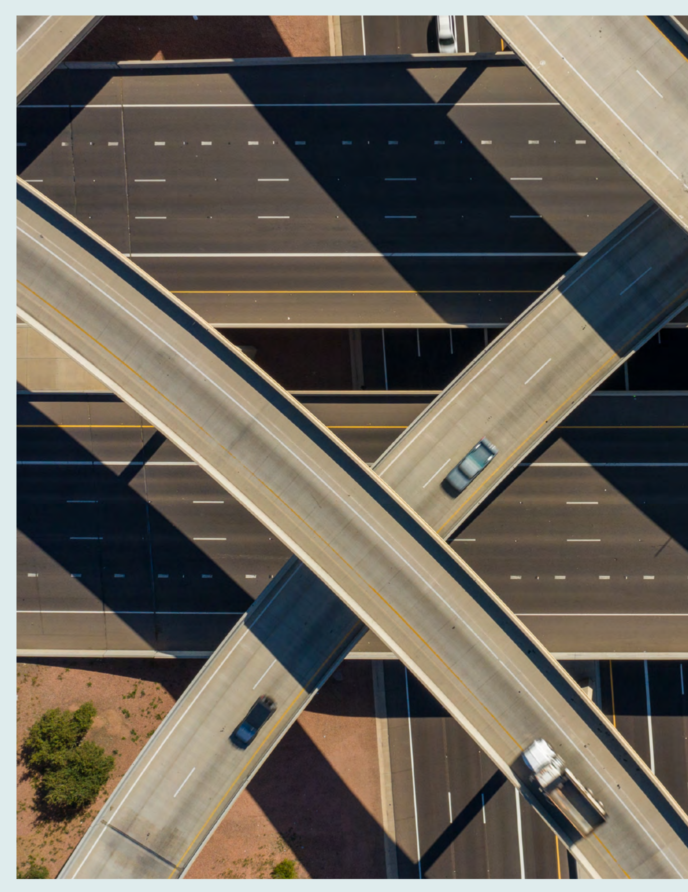
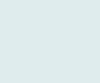
2024

Global Investment Outlook





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A letter from Steve Peacher

There's almost always a difference between expectations and reality, and in 2023 we saw that ring true for investing just as it does for any other aspect of life. Market sentiment had suggested expectations of a U.S. recession for the past year, which did not happen – although for other economies, such as Canada, the United Kingdom and the eurozone, the growth picture has been less rosy. We also saw the broader market's interest rate projections shift throughout the last 12 months, sometimes even running counter to the statements from central banks themselves.

As we begin 2024, sentiment indicators and expectations continue to be a focus for investors, especially as discussions over potential peak interest rates heat up and impact market volatility. It's certainly valuable to monitor the financial news flow, but I believe it's just as important to not get too caught up in the daily bobbing and weaving of financial market projections, and view events through a more comprehensive lens instead.

As SLC Management passes its 10-year milestone, we're reminded how important it is to maintain this kind of longer-term perspective, one that we seek to pass on to our clients through our 2024 Global Investment Outlook. Since our company's inception we've been committed to providing quality solutions, service and insights. And a key part of that commitment is utilizing the expertise of our diverse investment specialists to offer a deeper dive into what the indicators are really telling us. We consider what today's economic developments could mean in a historical context and what the specific outlooks are for different asset classes and different investors – from public and private fixed income, infrastructure and real estate to pension plans and insurance asset management.

Our twice-yearly global outlook is when we get to garner all of these insights in one place, featuring views from SLC Management and our specialty asset managers BGO, InfraRed and Crescent Capital. In the following pages we tackle some of the tough questions we all might face in the year ahead. Are there going to be further economic slowdowns in 2024? Are central banks done with rate increases, and are rate cuts on the horizon? What direction are fixed income markets heading? Will we see a pickup in private credit volumes, regaining of ground in real estate, and/or further global expansion of infrastructure? And what strategic positioning should various institutional investors adopt for the months ahead?

Over the past decade, it's been a privilege to help our clients achieve their long-term investment goals, and we look forward to continuing to do so in the months and years ahead. We hope this outlook can help you see past the crowd, view the short- and longer-term implications of shifts in the economy and engage your own stakeholders with these insights as we head into a year of change, challenges and opportunity.

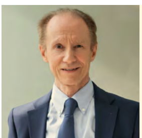
Regards,

Steve Peacher

President, SLC Management

Macroeconomic outlook

A resilient 2023 shifts expectations to pockets of weakness over systematic challenges in coming year



Dec Mullarkey

Managing Director, Investment Strategy and Asset Allocation, SLC Management

Global economy switching to lower gear

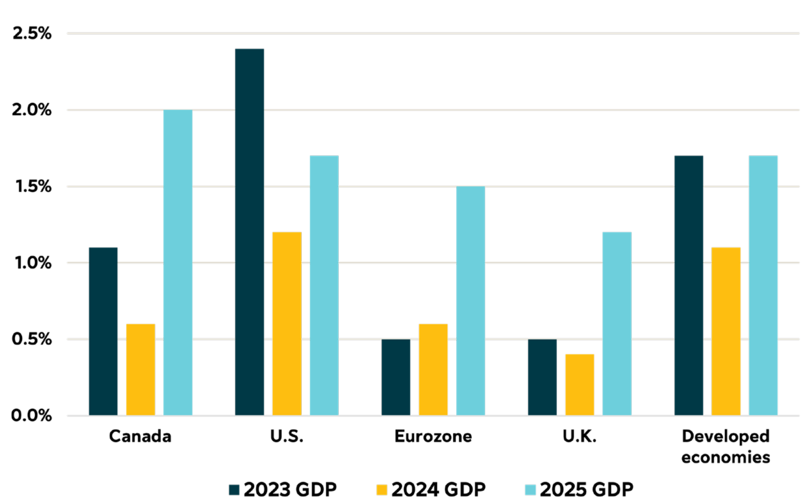
Over the last 18 months, most economists have been warning that a major global setback was right around the corner. The alarm was defensible. As central banks tightened at an historic clip, the reflex view has been that something will surely break. But the big surprise has been the resilience. Households and corporations are still in good shape. Jobs are plentiful and wages remain high. Rising rates are having little effect on companies that have locked in fixed rates years ago and on mortgage holders that are in the same camp.

The GDP outlook has now shifted from recession scenarios to one of modest growth. The lagged effects from rate hikes are expected to cool activity and pinch expansion plans. North America was a standout last year but is expected to downshift and deliver 1% GDP growth this year.

Meanwhile the eurozone barely avoided recession last year as it managed its energy supply dislocations well. This year will feature some of the same challenges but improvements in real wages and household incomes are expected to help deliver modest growth.

China suffered its worst housing downturn last year but still posted average growth as economic activity bottomed over the summer – and is entering 2024 with more momentum as government economic policy has turned more friendly.

GDP growth outlook for major economies



Source: Bloomberg monthly survey, SLC Management, 2023. The above forecast is based on estimates and there is no guarantee that the estimate will be achieved.

Unsynchronized sector adjustments

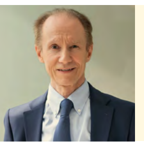
As we look to understand and characterize the current economic cycle, particularly in the U.S., it looks more like a series of unsynchronized sector adjustments or a "rolling recession" – which is a version of a soft landing where you have pockets of weakness but not a systematic downturn.

For instance, after a major correction in 2022 within technology, firms trimmed staff but started to recover as AI enthusiasm picked up. Housing prices dropped from cycle highs but are recovering as inventory remains low. U.S. manufacturing has been in contraction territory for over a year but is edging up from last summer's lows as supply chains heal and demand for goods stabilize.

Regional banks after recent failures have been shoring up their balance sheets as new regulatory capital requirements are proposed. Their stock valuations have taken a hit but seem to have reached a floor as markets cautiously assess risks from commercial mortgage holdings.

The biggest concern within real estate is the office sector. With the future of office still uncertain, office real estate investment trusts (REITs) are trading at significant discounts as the market worries about rent durability. High yield companies that pay floating rates are still performing relatively well. With the dramatic increase in rates over the past year, stress in this sector is still fairly contained with defaults rising slowly.

Macroeconomic outlook (cont.)

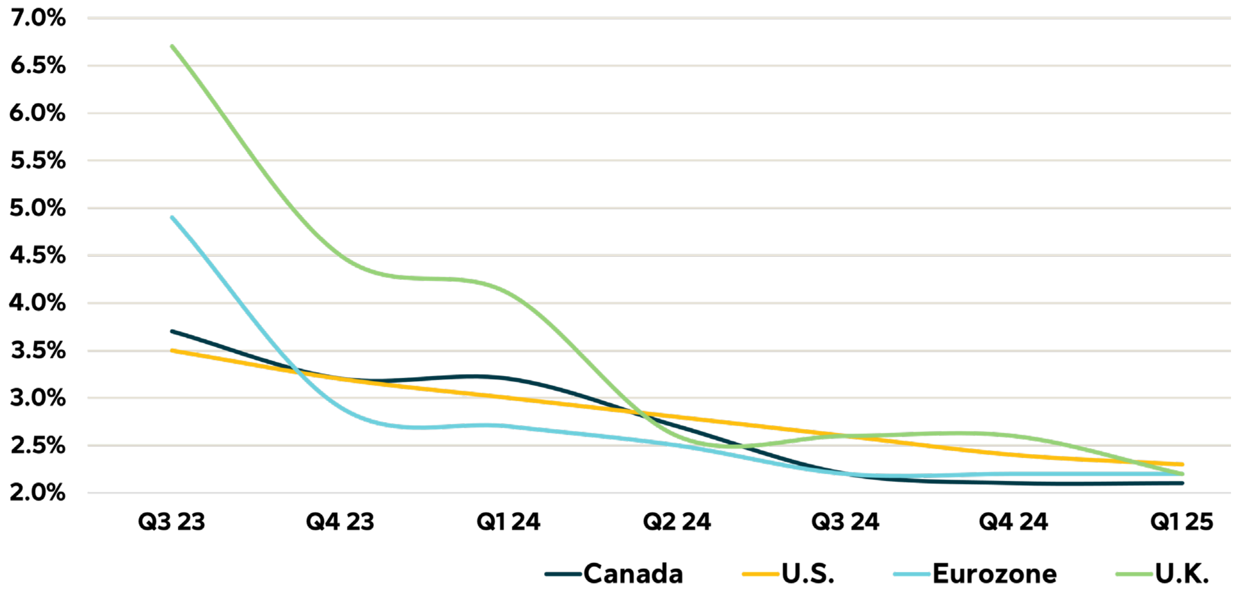


Dec Mullarkey

Managing Director, Investment Strategy and Asset Allocation, SLC Management

Therefore, through the lens of a rolling recession, technology and housing have seen stress and worked through it. Manufacturing is still in a prolonged but relatively mild contraction, and the outlook is improving. Regional banks have stabilized at a significant discount while markets assess how asset risks are evolving and how much consolidation may need to occur. In a similar fashion, the office sector is still in discovery mode on its ultimate level of utilization. Meanwhile companies with floating rate debt are holding up but could provide an early alert to the intensity of corporate debt stress.

Headline CPI inflation



Source: Bloomberg, SLC Management. Consumer price index (CPI) measures for Q4 2023 and after based on Bloomberg survey of economists. The above forecast is based on estimates and there is no guarantee that the estimate will be achieved.

Geopolitical risk remains a top concern

As the conflict between Israel and Hamas escalates and Russia's war in Ukraine continues, geopolitical risk continues to rise. Notwithstanding the human cost of the conflict, for now the spillover to financial markets has been contained. Oil prices are still trading within a tight range. One of the biggest concerns is if other parties enter the Middle East conflict, which would complicate any quick resolution.

Beyond Israel and Ukraine, the other big geopolitical tension is between the U.S. and China. As the U.S. seeks to contain China's technological sophistication, it is banning China's access to advanced U.S. chips and encouraging allies to follow suit.

The global trading system is reordering around a "China plus One" policy. The U.S. and others that relied on China for significant supply chain support are more actively diversifying into alternatives like Mexico, Vietnam, India, Indonesia and the Philippines.

Right now, the moves are more about diversification than decoupling. China remains a top destination for U.S. exports, but Mexico and Canada have moved into the top two, with China now a distant third.

Central bank policy to remain a critical market driver

While major central banks still warn the world that inflation is a threat, traders are ramping up their bets that rate cuts will be in vogue this year. It is surprising how quickly and consistently this shift has happened. Markets expect that the U.S. Federal Reserve, Bank of Canada, Bank of England and European Central Bank (ECB) will cut rates by 100 basis points or more this year.

After all, inflation is calming and central banks appear to be at peak rates as they stall and plan next steps. While most central banks suggest they are in no hurry, markets expect many will start cutting rates within the next six months. And the surprise in this outlook is that the ECB may lead the way should eurozone inflation recede to target much quicker than expected.

The market's conviction is that the cumulative effects of central bank rate hikes will have fully kicked in this year. This should pinch activity, force hiring to cool and excite central banks to be accommodative.

The key question is how much slowing do central banks need to see before they cut? And the tricky maneuver is that economic setbacks rarely proceed at a linear pace. Sometimes things look fine until they are not. However, for now markets believe central banks will stay alert for shifts in the data and react quickly to weakness to prevent too much of a self-enforcing downward spiral.

Source: Bloomberg, 2024.

Fixed income: investment grade

Rich Familetti
CIO U.S. Total Return Fixed Income

Markets eye the Fed's policy directions, but there are risks to following rate signals and predictions

Revised expectations range from soft landing to mild recession

The 2023 calendar year might be characterized by an expected recession that never was. The strength of the U.S. consumer helped both equities and credit spreads to shake off successive threats from inflation, geopolitical conflicts, three large bank failures and sectoral challenges in health care, cryptocurrencies and office properties.

As we enter 2024, most financial companies have leaned into predicting either a soft landing or mild recession, as the final vestiges of post-pandemic euphoria dissipate, combined with the hope that the U.S. Federal Reserve will be able to cut rates just in time. However, soft landings are historically rare, and all previous examples in the U.S. relied heavily on factors that may not exist today, such as heavy spending on the welfare state, strong foreign economies that provided external stimulus or major technological progress. Although the continued strength of the consumer suggests that recessionary forces could be forestalled until the second half of the year, we remain wary of potential geopolitical catalysts.

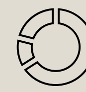
Implications of an end to the rate-hiking cycle

Whether or not the Fed and other central banks have hit peak rates and the timing of potential rate cuts that may be on the horizon remain a central question for 2024. It might be useful to see the current bond market's place in history in context, and how previous markets had behaved coming off past Fed tightening cycles.

In such scenarios, investors generally experience a decline in aggregate yields and a widening of spreads. However, while it might seem intuitive to assume that history will repeat itself, a similarly expected widening last year resolved itself with remarkable haste. A negative inflation surprise and/or increased strength in consumer spending could delay rate cuts or result in a higher-for-longer environment – which is not mutually exclusive to one or more rate cuts, as an absolutely higher level of rates provides flexibility for larger cuts when the time does come. Until then, it is worth recalling that the hiking cycle of 2004–2007 saw spreads meander even lower than current levels during a period of moderately high rates, similar to current conditions. While we are not anticipating this precise low-volatility outcome, it is not necessarily outside the range of possibility given supportive demand for investment grade credit from traditional duration buyers in pensions/liability driven investing and the potential return of foreign investors if hedging costs become less punitive.

Risk assets could see a strong 2024 – but with periods of volatility

Given data-driven lags and hindsight biases, it's quite possible that fundamental deterioration in traditional markers like GDP and unemployment may not be visible until the second half of 2024 or even later. As a result, the returns to risk assets may be driven more by geopolitical catalysts. While conflicts in Eastern Europe and the Middle East could remain serious concerns, dozens of nations around the world including the U.S. face elections in 2024. We are wary of potential event-related catalysts tied to inflation, energy and the U.S. dollar.



"We are wary of potential event-related catalysts tied to inflation, energy and the U.S. dollar."

In credit markets, we think spreads are currently on the tight side, but may well remain rangebound. In our view, supply/demand dynamics are reasonably balanced and corporate fundamental deterioration has been manageable so far in light of inflation-driven top line growth alongside stabilizing labor costs. Additionally, since spreads in financial names remain historically somewhat wider than that of non-financial companies, we believe stabilization in financials could contribute to keeping these spreads rangebound given that they should benefit from stabilization in interest rates in the context of increased reserves for both credit losses and uncertainty in commercial real estate.

Source: Bloomberg, 2024.

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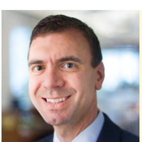
Fixed income: below investment grade



John Fekete

Managing Director and Head of Capital Markets, Crescent Capital Group

End of the rate hiking cycle leaves credit poised for stronger results

Below-IG markets pick up by end of 2023

Inflows to credit were light by volume throughout 2023, though they did see some pickup in the latter stages of the year as it became more apparent that a U.S. recession was not happening in the near term, giving way to expectations of a mild recession or soft landing in 2024 instead. A more sanguine outlook on the rate environment also helped drive volumes, with market sentiment reflecting the belief that central bank tightening may be at its peak.

We began to see more constructive below investment grade public markets in the final months of last year, particularly with respect to single-B rated credits. That has resulted in some tighter pricing in high yield and bank loan new issues, and there remains considerable potential for the market to further benefit from these tight conditions given the still-light volumes and significant demand from the collateralized loan obligation market.

Possible impacts of higher-for-longer rates

The high yield market itself has experienced some headwinds from rising rates, given the fixed rate nature of these bonds, but we expect returns from the asset class to improve in an eventual rate decline. One space in below investment-grade public markets garnering interest is that of broadly syndicated loans, which offer the benefits of floating rate structures. The debt securities in this sector that have been coming to market since late 2023 have been of higher quality and feature more conservative leverage structures, according to our analysis, amid a high-rate environment.

Solid ground ahead, but caution still required

In our view, the environment for credit in 2024 looks to be constructive. Credit fundamentals remain positive heading into early 2024, although some of this strength is expected to moderate as U.S. economic growth cools. We continue to expect most borrowers to exhibit revenue and cash flow growth going forward, resulting in stable leverage ratios. Coupons, or the rates borrowers pay, are likely to be at or near their peaks with the rate hiking cycle concluding in the U.S. While still-high interest rates may pressure certain borrowers, many have adequate liquidity and would benefit from private equity sponsor support, if needed. Credit defaults are relatively low and are likely to hover around their long-term average in 2024. With low recession risk, defaults at or below historical average and monetary policy leaning toward rate cuts rather than additional hikes, high yield bond and bank loan investors are likely to realize high single-digit returns in 2024.

Sources: Bloomberg, JP Morgan, 2024.

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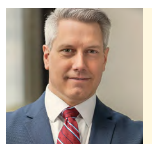
Private credit: investment grade

IG private credit volumes poised for a strong 2024 opening



Andrew Kleeman
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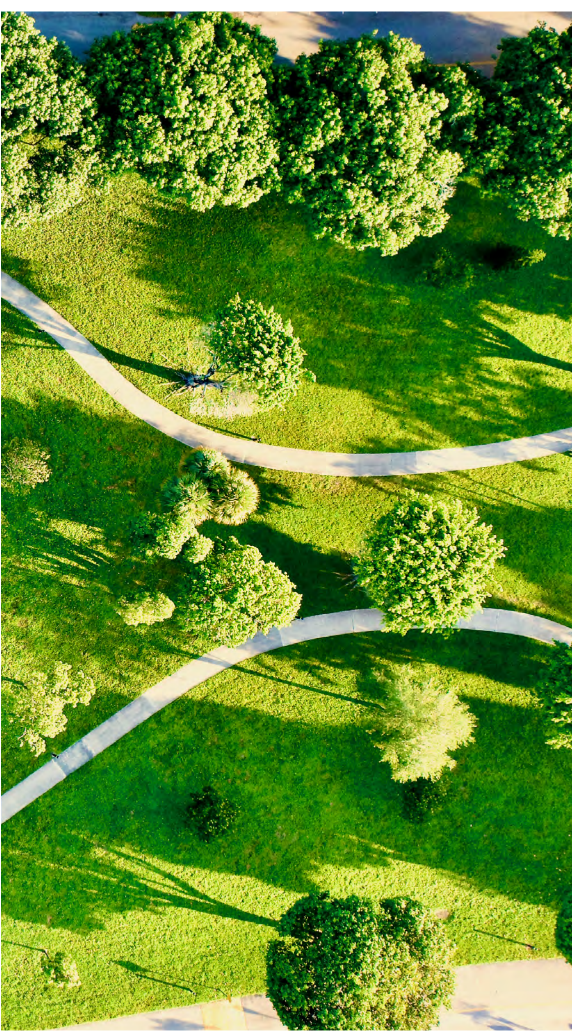
Capitalizing on opportunities

The total volume for investment grade (IG) private credit in 2023 was close to 2022's volume, a result of lower financial sector issuance (asset managers, business development companies and real estate investment trusts [REITs]) being offset by strong corporate and utility issuance. We believe that issuers came to market in 2023 because they had a reason to raise capital (an acquisition, capex or refinancing a debt maturity) and that higher coupons discouraged some "opportunistic" issuers who had taken advantage of the low interest rate environment of 2020 and 2021 to bolster liquidity.

When issuers did come to market it was often for short tenors, with a preference to not to lock in long-term rates. While overall volume was relatively steady in 2023 over 2022, the market in 2023 lagged 2022 for much of the year, but caught up with a strong final quarter. Q4 of 2023 was busy as issuers seemed to have come to terms with rates that could be "higher for longer." Steady supply was not bad news, however, because for much of 2023 the market experienced lower demand driven by investors who were either cash constrained or had lower product sales or higher redemptions, thereby tempering their demand. Despite lower market volume, many investors have been able to take advantage of reduced competition and to invest in IG private credit securities exhibiting attractive relative value and with good allocations.



2024's market outlook: "Steady as she goes"

We expect a solid start to 2024 for two reasons:

1. A number of deals were postponed that had been scheduled to launch in Q4 but, given the strong fall calendar, these deals were delayed as issuers and bankers were concerned about "shelf space" (i.e., getting investor's attention).

2. The annual Private Placements Industry Forum, which is usually scheduled for January, occurs later in 2024, resulting in some issuers coming to market in advance of the conference rather than waiting until mid-February.

As we enter 2024, the U.S. economy is still doing well, but shows signs of slowing and it appears that the U.S. Federal Reserve and central banks are inclined to be accommodative in order to stave off any more tempering of economic growth from the 2022/2023 rate hikes. The oft-used term "soft landing" comes to mind. With that backdrop, we expect the IG private credit market to be steady. Considering the uncertainties we had in front of us at this time last year when we prepared our 2023 "cautiously optimistic" outlook (high inflation, midway into aggressive rate hikes and a chance of a recession), combined with the U.S. bank turmoil led by Silicon Valley Bank in March 2023, our outlook for 2024 is no less constructive. While we do not expect the financial sector to drive volumes as it did in 2020 and 2021, we do expect that it will anchor new issuance and provide ample refinancing opportunities in the near term given the bulge of issuance in the past few years. More stable interest rates should benefit all asset classes, from infrastructure and structured finance to corporates. REITs and real estate issuance are still in search of a bottom.

A wild card on the demand side is investor appetite, which for much of 2023 was a bit muted due to the reasons mentioned previously. The stronger investor demand, as evidenced by price tightening and deal over-subscriptions we have seen at times in the fall of 2023, could signal a more competitive market in 2024.

If there are economic, political or market headwinds that change the playing field and make for less constructive markets, private credit activity could still be strong as the private market has been viewed by investors as a safe haven where issuers seek certainty of execution. During those times investors are often rewarded for proving liquidity. We believe that investors who retain a "steady-as-she goes" perspective might find it beneficial in such an environment.

Source: Private Placement Monitor, 2024.

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Private credit: below investment grade

Chris Wright
Managing Director & Head of Private Markets, Crescent Capital Group

Chris Wang
Managing Director, Crescent Credit Solutions, Crescent Capital Group

Attractive yields and conservative structures can create a compelling vintage in private credit

Delivering value to both investors and borrowers

We believe private credit will continue to deliver tangible value. Today, investors have benefited from the higher returns, consistent cash flows and steady income distributions that private credit can provide while delivering lower volatility. At the same time, borrowers have appreciated the partnership that a private credit manager can provide with certainty of execution and no market risk for the borrower due to the committed capital and contractual commitments that underlie such financings. These factors increasingly make private credit borrowers' lender of choice.

Capital formation is changing and shifting to private credit

In our view, private credit continues to benefit from favorable market dynamics and secular tailwinds. Capital formation is changing, and it is shifting toward private credit on a secular basis.

Banks continue to retrench from middle market lending with private capital providers filling the void. Record levels of investible capital amassed by private equity sponsors, as well as the growing volume of refinancings, growth capital and dividend recapitalizations, continue to drive demand for private credit. Finally, we have observed that borrowers have increasingly turned to private credit for refinancing solutions to help solve the upcoming maturity wall of loans and bonds that were underwritten in a zero-rate environment. This includes seasoned public issuers that have utilized the private credit markets to address their pending maturities.

In our view, this secular shift is occurring against a backdrop of more conservatively structured loans with lower leverage levels, higher equity cushions and greater lender protections in credit agreements.

Flexible capital to deliver sought-after solutions

We expect borrowers to increasingly look to private credit to provide flexible capital solutions across both senior and non-senior structures to meet their specific financing needs in today's market.

For example, creative senior solutions and non-senior structures could be critical in helping companies transition and right-size their capital structures, which may have been put in place during a significantly lower interest rate environment. Non-senior debt has the flexibility to be structured with cash or non-cash (payment-in-kind) returns, allowing borrowers to access incremental growth capital without increasing their cash interest burdens. This growth capital can be used to generate liquidity, retire cash-paying debt or make accretive acquisitions. Non-senior debt can also be a cost-efficient tool for sponsors to raise capital without repricing existing senior debt or triggering existing most-favored-nation (MFN) provisions, whether such debt is structured with a cash or non-cash return.

Finally, we believe flexible capital solutions represent a compelling value proposition to borrowers and can subsequently provide investors with the opportunity to earn higher risk-adjusted returns.

Implications for investors considering private credit

In a benign credit environment, there are low default rates and little dispersion in returns among managers. In fact, managers that took on more risk have been typically rewarded with more return. But we are no longer in a period of benign credit. Higher rates are a double-edged sword: the higher returns due to lenders must be paid for by the borrower. And the risk of a recession is top of mind for investors and managers alike, with concerns over earnings pressure and a potential increase in defaults.

Investors considering private credit today should consider a manager's experience investing across multiple credit cycles (including through prior high interest rate environments and periods of economic weakness), strength of sourcing platform, consistent discipline in underwriting and portfolio management expertise.

We believe that with the right manager, the attractive yields and conservative structures today should create the conditions for a compelling vintage in private credit for 2024.

Sources: Bloomberg, Private Placement Monitor, 2024.

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Real estate

Future policy moves, post-pandemic market reality expected to steer sector's performance

Ryan Severino

Chief Economist, Head of U.S. Research, BGO

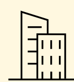
CRE adjusting to new market landscape

Heading into the home stretch of the year, the U.S. commercial real estate (CRE) market endured a year of transition. Industrial and apartments are settling back into pre-pandemic environments after a few years of outsized demand, followed by a period of excess supply. Retail has quietly transitioned to its tightest market in history, as measured by CoStar's national vacancy rate. Office is still transitioning to its post-pandemic equilibrium. And CRE capital markets are transitioning from a period of rising interest rates and negative returns to a period of stable to declining interest rates and a swing back to positive returns.

Examining real estate by its components

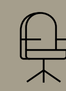
Looking ahead, 2024 will likely see a continuation of the aforementioned trends. We continue to foresee compelling investment opportunities ahead and our outlook has brightened over the last quarter. Yet each key component of the CRE market faces critical circumstances heading into next year.

Industrial: Despite recent increases in construction, industrial holdings remain in a favorable position. As the property sector continues to transition from a "box to store other boxes" to a sophisticated, technologically oriented part of the integrated global supply chain, its economic value is increasing. That is supporting the structural increase in real rent levels, even as rent growth slows.

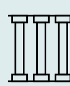


Apartment: Recent apartment construction will not come close to fixing the housing shortage in the U.S. This shortage has built up over the last 14–15 years, and it will take more than a temporary increase in high-end apartment construction in a limited number of markets to alleviate it. That should keep space market fundamentals attractive over the medium run.

Retail: This sector is becoming more efficient over time. Once derided as "overbuilt and under-demolished," retail has fixed its inventory problems over the last 15 years. And despite wildly hyperbolic claims of a "retail apocalypse" no such thing has occurred. Consequently, retail inventory is now incredibly efficient, generating sales per square foot that hover near record highs. Such strength is why the national vacancy rate is at a record low while asking rents are at record highs.



Office: The future of office will not get decided soon. That process is going to play out over a longer period as office contends with the exogenous shock of the pandemic. Nonetheless, pockets of strength exist in the highest-quality space. But our industry has a propensity to overreact to situations like this. At some point, likely in the next year, opportunities for office investment will increase, especially for the more risk-tolerant investors and portfolios.



Capital markets: Investors may be nearing a significant shift. The key event that should ultimately bring about a resumption of positive CRE returns is the end of U.S. Federal Reserve tightening. Rate cuts aren't necessary, but the market needs to believe that the Fed has finished. Once that occurs, returns should shift back into positive territory. And we are inching ever closer to that point. Over the last four quarters, returns have been gradually improving, yet remain negative. Our modeling and the futures market believe that the Fed is done hiking. If so, positive returns will almost certainly follow, sooner rather than later.

Performance could depend on policy direction

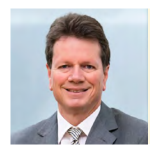
After a challenging 12 months, we believe CRE is inching closer to more fertile ground. The path forward appears more positive than any point since the Fed began its tightening cycle in March 2022. Yet, the next few quarters could prove bumpy. Space market fundamentals should continue to support income returns. Therefore, total returns will hinge on appreciation and, relatedly, Fed policy. If the Fed has finished hiking, returns should stabilize and then accelerate, especially if the Fed begins cutting rates in 2024, as we and the futures market expect should occur.

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

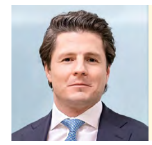
Infrastructure

Shifting long-term thematics support the case for infrastructure investment

Jack Paris
Chief Executive Officer, InfraRed



Richard Crawford
Partner, Head of Energy Income Funds, InfraRed



Edward Hunt
Partner, Head of Core Income Funds, InfraRed

Stephane Kofman
Partner, Head of Capital Gain Funds, InfraRed

Characteristic resilience in times of volatility

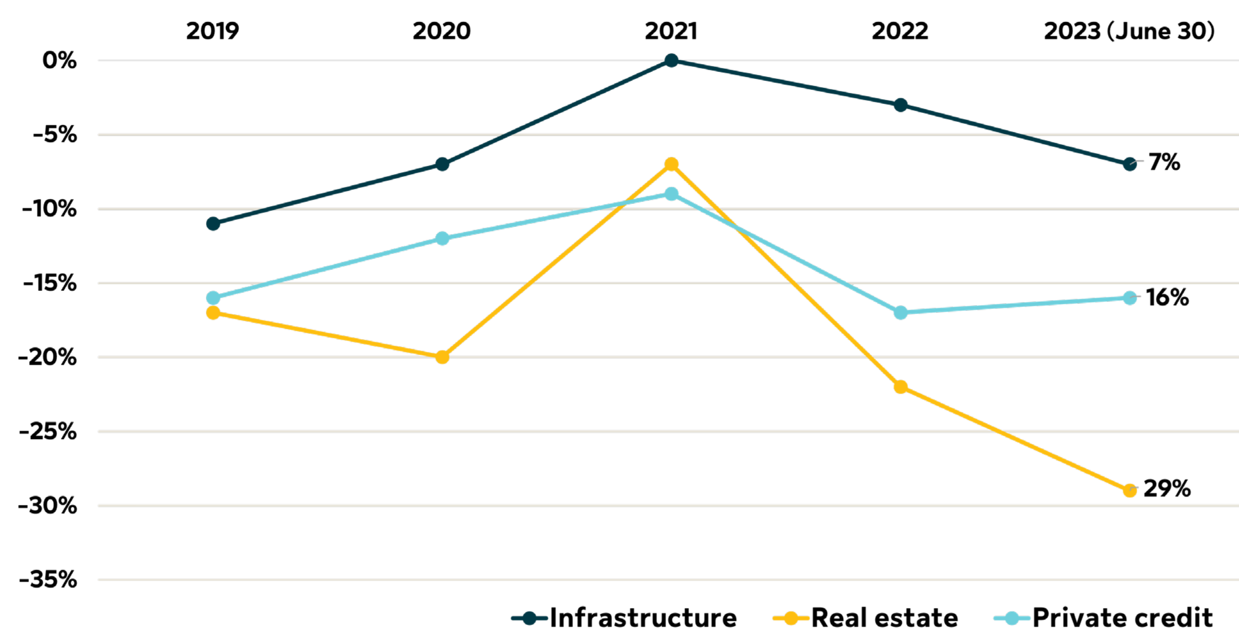
Looking at the infrastructure asset class, either in the context of the past year or for the outlook ahead, might be best done through two distinct lenses. Both the near- and long-term perspectives offer their own set of insights into the potential risks, opportunities and challenges ahead for infrastructure investors.

In the near term, throughout 2023 we saw a continuation of several macroeconomic themes that have been playing out over the course of the year: higher inflation, elevated interest rates and the resultant market volatility. Infrastructure assets are historically more resilient to these factors than other types of alternative investments, and infrastructure's performance during bouts of pressure in 2023 were consistent with this characterization.

It is important at this point to be reminded of the characteristics of infrastructure investments that help them maintain their resilience amid uncertainty. We expect that high-quality infrastructure investments may be more insulated from the broader economy and policy landscape given both their long-term and conservative debt structures, which are generally less sensitive to rate fluctuations, and often contracted revenues, that may be correlated to inflation.

The following graph shows that the discount to net asset value (NAV) in the private secondary market for infrastructure held up better in the volatile first half of 2023 compared to other alternative asset classes.

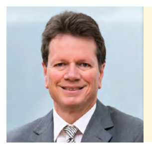
Infrastructure holding up well during volatility
Discounts to NAV in the private secondary market



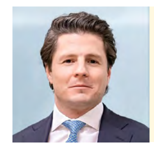
Source: Greenhill Secondary Market Review, H1 2023. Market data based on Greenhill transactions and other known transactions as reported in the source. For more information, visit www.greenhill.com.

Infrastructure (cont.)

Jack Paris
Chief Executive Officer, InfraRed



Richard Crawford
Partner, Head of Energy Income Funds, InfraRed



Edward Hunt
Partner, Head of Core Income Funds, InfraRed

Stephane Kofman
Partner, Head of Capital Gain Funds, InfraRed

Macro concerns could lessen, but likely to remain

We have seen some stabilization in the macroeconomic environment, though we also caution that some risk factors remain, such as further escalations in geopolitical conflicts. Moreover, market volatility and underlying inflation and rate uncertainty could continue to affect asset pricing and investor demand in 2024.

With respect to inflation, our observations of market sentiment suggest some confidence that we are at, or perhaps even past, the point of peak rates. However, we also see evidence that even if inflation comes off its highs, it will likely remain sticky and range-bound for the near term.

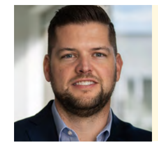
An evolution in thematics

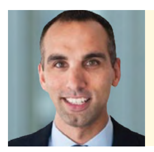
Shifting to the longer-term lens, while we believe the thematic megatrends that we have identified in previous discussions (such as decarbonization, digitalization and demographic changes) should continue to drive markets, 2023 saw some changing dynamics that could further shape infrastructure demand. The greater role of public policy within megatrends such as decarbonization – through initiatives like the Inflation Reduction Act in the U.S., the European Green Deal and the COP 28 agreement on transitioning away from the use of fossil fuels – had an increasing impact in the past year and into 2024.

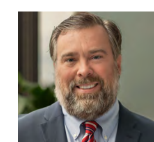
These policies have created an environment of intensified competition between countries for infrastructure investment capital and expertise. Coupled with numerous geopolitical security concerns around the world, we are seeing evidence of a "deglobalization" effect around infrastructure investment. A growing number of distinct regions are seeking to attract more of what may be a finite amount of available capital in a given thematic sector, for example, in opportunities arising from onshoring the supply chain in logistic facilities, intermodal transportation and other operational enhancements. This represents a considerable tilting of the demand–supply balance, and we expect such developments to serve as a medium- to long-term positive driver of infrastructure investment.

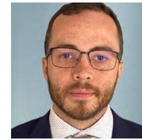
Source: Greenhill, 2023.

Insurance asset management


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


Nitin Chhabra
Managing Director, Head of Insurance Solutions


Thomas Klem
Managing Director, Head of Institutional Client Experience


Louis Pelosi
Managing Director, Client Solutions

Opportunity continues to exist to lock in reliable, income-driven returns despite pullback in rates

Ongoing market volatility underscores insurers' need for reliable income

In most years, investment income is the largest and most important component of earnings for an insurance company, and the importance of that stable source of earnings is amplified when underwriting and investment markets are volatile. On the property and casualty side, while several consecutive years of insurance rate increases have restored pricing adequacy, concerns surrounding the increased frequency of severe weather events, potential reserve deficiencies and rising reinsurance costs paint an uncertain and volatile forecast of underwriting results. On the life side, the higher investment leverage the industry operates with leads to a greater hit to investment portfolios when prices decline.

For these reasons, all types of insurers tend to favor the reliable, high-multiple earnings represented by investment income, and the current higher interest rate environment continues to provide investment income growth opportunities in both the core and alternative fixed income markets.

All-in core fixed income yields remain attractive despite recent pullback in interest rates

In 2023, many investors took advantage of a strategy called "loss harvesting," which entails selling low yielding bond holdings at a loss and reinvesting the proceeds in the higher yielding bonds that are available in the market in order to lock in those attractive yields before they disappear. The downside of this strategy is having to realize losses – which flows through income – but the benefit is that the portfolio will likely generate more investment income going forward. At the same time, if those losses can offset gains taken elsewhere in the investment portfolio, the tax burden is reduced. A common strategy in 2023 was for insurers to realize losses in bonds, offset those losses by taking gains in equities and reinvest those funds all in fixed income at these higher yield levels. Many insurers have experienced significant appreciation in their equity allocations, and this represents an opportunity to scale back closer to a long-term allocation, which may prove prescient if the U.S. does enter into a recession in 2024.

The decrease in reinvestment yields in November and December 2023 may leave investors wondering if loss harvesting opportunities will still be available in 2024. We think so, as we believe the magnitude of the recent pullback in both rates and spreads was largely unfounded and higher rates will be around for longer. Given this extreme market reaction combined with still-prominent recessionary risks as the impact of higher rates flow through the economy, we believe promising opportunities exist in high quality sectors offering relative value, such as structured products. We also think the liquidity lever continues to offer considerable value within core fixed income, so sectors such as investment grade private fixed income may continue to make sense for companies that have the capacity to give up some liquidity.

Alternatives screen well from a long term strategic asset allocation view

With the rise in rates over the past couple of years, income-oriented alternative investments such as private credit and real estate can now potentially offer private equity-like returns with significantly less volatility. However, uncertainty surrounding the timing and pace of possible rate cuts has led to quickly changing market views on all asset classes, including alternatives, and can result in suboptimal long-term asset allocation decisions.

Fortunately for insurers, these types of decisions tend to proceed at a measured pace due to the accounting, tax and capital rules they are subject to. Consequently, asset allocations are less likely to be based on market timing and more likely based on which asset classes offer the best risk and/or capital adjusted expected returns over a long-term horizon. As we enter an uncertain 2024, many areas within private and public below investment grade credit, real estate and infrastructure offer attractive long term risk/return potential, can improve overall portfolio diversification and come with negotiated downside protection features.

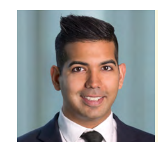
Source: Bloomberg, SLC Management, 2024.

Retirement plan solutions

Important decisions face pension plan sponsors as interest rates test lower levels

Tim Boomer

Senior Managing Director, Head of Client Solutions, SLC Management



Ashwin Gopwani

Managing Director, Head of Retirement Solutions, SLC Management

Rate impacts on liabilities could mean challenging choices ahead

The 2023 calendar year was a volatile period for interest rates, with historical highs and a significant rise in rates capped by a swift fall. We saw significant de-risking during the year, either in the form of increased interest rate hedging using fixed income and derivatives, or risk transfers to insurance companies.

We believe plan sponsors with remaining liabilities, hedged or unhedged, now face some important decisions to help ensure that their hard fought pension gains are not eroded. The prospect of falling rates could significantly impact the funded status of underhedged plans, while plans that have de-risked significantly face the challenge of building portfolios that can keep pace with liability growth over the long-term.

Rates begin to subside after historic highs

The average yield on U.S. 30-year Treasuries rose above 5% at the beginning of the fourth quarter of 2023 before declining sharply by over 100 basis points (bps) by year end. This steep decrease in interest rates over the final three months of the year can serve as an important reminder for pension plan sponsors that de-risking opportunities to protect recent funded status gains may be temporary given shifting and volatile market conditions.

100+ bps

A sharp decline in 30-year Treasury yields in Q4 2023.

Overall, the FTSE Discount Rate ended 2023 close to 20 bps lower than the previous year end. Despite this reduction in pension discount rates, positive performance by return-seeking assets continued to drive funded status improvements for many plan sponsors in 2023. Despite marginally lower rates, we continue to believe that this is an opportune time for plan sponsors to re-evaluate their investment strategy and consider taking risk off the table. Industry data suggest that many plan sponsors still carry outsized interest rate risk within their plans and we believe this risk budget is typically better allocated to areas where plan sponsors can be consistently rewarded for it.

Higher fixed income returns needed to keep up with growing liabilities

With fixed income increasingly making up a larger portion of pension plans' asset allocations, we see a renewed focus on ensuring that liability driven investing (LDI) portfolios keep pace with liability growth rates as well as hedging rate movements. Liabilities are immune to downgrades and defaults in the discount rate used to value them, so LDI portfolios typically need to either yield a premium over the liability growth rate or add additional alpha through active management. This has led to a strong trend toward "LDI plus" or "enhanced LDI," a strategy that retains the liability hedging characteristics of traditional LDI while also utilizing higher yielding fixed income asset classes like high yield bonds, bank loans, commercial mortgages and private credit.

In recent years many pension plan sponsors have looked to investment grade (IG) private credit in particular as a means of providing name diversification that is hard to access across public markets while still maintaining strong correlations to liabilities. IG private credit carries a yield premium to traditional public fixed income markets, reflecting the additional work to originate deals as well as some liquidity premium, while benefiting from covenants and collateral that protect holders in times of economic uncertainty.

Plan sponsors turning to new tools for hedging and diversification

Increased levels of funding and a volatile and more complex market environment have led to an increased interest in leverage as a solution to some of the challenges that pension plans face.

Large pension plans and insurance companies have been using leverage as a liability management tool for decades. Over the past few years, we've seen a marked increase in the number of small- to mid-sized plans willing to use long Treasury futures to extend duration, plus an increase in the number of mid-sized plans considering more bespoke leverage strategies to achieve a more targeted form of hedging.

While U.S. Separate Trading of Registered Interest and Principal of Securities (STRIPS) have historically been a viable option for most plans considering duration extension, there are some circumstances under which plans might be able to effectively use leverage to hedge interest rate risk while maintaining a higher allocation to credit. Any such approach, however, needs to be done in a way that does not compromise the plan's liquidity needs and ability to pay pension payments.

Sources: Bloomberg, Society of Actuaries, 2024.

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