IFM Investors

The Private Markets Macro Outlook:

Decarbonise, Digitise, Deglobalise

By Alex Joiner, Hiran Wanigasekera, Julio Garcia, Lillian Nunez, Rich Randall and Stuart Wardman-Browne

Outlook for 2025

Despite public markets having closed out 2024 near all-time highs, investors continue to face a number of uncertainties – most notably, the war in Ukraine and the ongoing conflict in the Middle East – that will impact global economic growth and investment opportunities in a range of ways.

Additionally, we are yet to fully understand what priorities President-elect Donald Trump will have upon his inauguration in January, but judging from his previous term and the Trump campaign's messages, we can make some predictions. A major question for many investors is whether the outgoing President Joe Biden's landmark Inflation Reduction Act (IRA), which offered billions in climate and clean energy subsidies, will be dismantled or altered.

We expect it is likely to be adjusted, pared back and, in some cases, rebranded. However, Trump's incoming administration has offered up views on federal funding for EVs, clean electricity and sustainable aviation fuel, and the outcomes achieved through the IRA have received bipartisan support, especially where projects have created jobs in areas heavily impacted by de-industrialisation.

The prevailing geopolitical risk informing most investment decisions will remain a consideration in 2025 regardless of investment destination, although these risks can be countered by allocations to countries understood to have established institutions and strong rule of law.

Alex Joiner
Chief Economist

Economic Outlook

By the end of 2024, macroeconomic conditions had allowed most major central banks to begin easing after earlier rapid and synchronous increases in interest rates, and their brief pause in contractionary territory, was largely effective in lowering inflation.

For 2025, we expect relatively modest global growth, with a slowing occurring across developed economies and in China. The US outlook is for growth slightly above trend, while Japan, UK and the Eurozone are expected to be distinctly at trend and China is expected to grow slightly below its current target. With inflation likely to be around target, central banks will have no cause to take policy to accommodative settings, despite a slightly negative fiscal impulse. But investors and policymakers will not only face economic risk, but political and geopolitical risk.

> **With inflation likely to be around target, central banks will have no cause to take policy to accommodative settings, despite a slightly negative fiscal impulse.**

Higher interest rates have elevated borrowing costs for many infrastructure assets over the past several years, which has put increased scrutiny over leverage levels from investors. The expectation that higher rates would be short-lived and economic uncertainty delayed new project investments. However, we have seen projects begin to move forward again, as central banks began cutting rates, coupled with a prevailing view that the future interest rate regime could be higher than the last. Infrastructure debt should benefit from macro and industry tailwinds including improving economic conditions, robust government spending and support for infrastructure, decarbonisation efforts, rapidly expanding electricity demand, and need for more and improved digital infrastructure. These projects often remain resilient during economic cycles due to their essential nature.

Infrastructure equity has similar tailwinds. Lower interest rates should also be supportive of valuations in the sector while also bringing about improving economic conditions. The sector also provides good inflation hedging properties – which may also come into play given the outlook for inflation following some of the early rhetoric of the incoming Trump administration.

2025 will likely see political and geopolitical risk awarded equal importance, as the world weighs up the impact of the incoming US administration on trade policy, but also the ongoing wars in Ukraine and the Middle East.

Aggressive tariffs on Chinese imports and 10% across all others will likely be an opening gambit potentially softened by negotiation, but they will still be impactful. China's response is equally important as it grapples with deflationary dynamics, low levels of consumption and a capitulated property sector. A weaker external sector is not what it needs and if faced with barriers to the US market China may seek to accelerate trade with both other advanced economies and its loosely-aligned BRICS-plus partners. How the US Administration deals with actual, as opposed to economic, conflicts – notably Russia-Ukraine and in the Middle East – will also inject uncertainty into the outlook.

More certain are the incoming administration's planned corporate tax cuts and the extension of household tax cuts, due to expire next year, that are expansionary and risk spurring inflation. Investors will need to consider the growth and inflationary implications of these (and other) policies collectively – an impossible task as it stands – and may simply be guided by what they know best - the new Trump administration is for growth, the 'deal' and for Americans to feel like they are becoming wealthier. These policies risk supporting rates at the long end of the curve and therefore valuations across asset classes.

We suspect further gains in equity markets, which have run hard particularly in the US, will be far more measured in 2025. But in a relative sense being more exposed to equities remains preferable to bonds. Equities have seemingly priced in many of the pro-growth economic initiatives from the incoming administration, largely tax cuts, and less of those impeding it. This has resulted in US markets in particular having stretched valuations against most metrics and against current economic performance. At least to some degree earnings and economic performance will need to come through in 2025 to justify markets moving higher again.

Julio Garcia
Head of Infrastructure, North America

Infrastructure Equity

The end of 2024 saw inflation trending downwards in most advanced economies and gradually approaching central bank target bands. This offers central banks the opportunity to cut rates, albeit with some caution given potential inflationary risks. More certainty in the rates environment is expected to further support a deal market that is closer to equilibrium.

One key 2025 macroeconomic theme is potential upside in GDP growth, which will aid seaport, toll road and airport volumes.

Indeed, we believe global aviation will continue to perform strongly, benefitting airports and associated infrastructure, and despite recent high inflation and associated cost-of-living pressures, leisure travel will drive the growth in passenger volumes.

> **Data centres will continue to experience rapid growth and ongoing investment interest after a number of high-profile transactions over the last two years.**

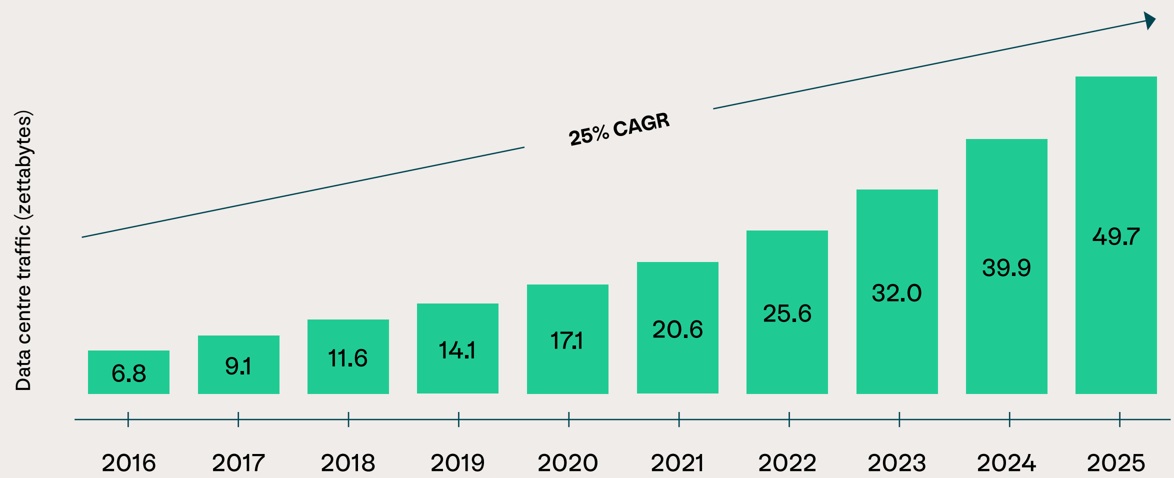
While we do not foresee a global recession, many infrastructure assets would still be able to offer investors downside protection, through mechanisms such as contracted revenues or regulation, and due to the low elasticity of demand prevalent in the sector.

Infrastructure investments also offer the opportunity to benefit from key megatrends – particularly decarbonisation and digitisation. As countries continue to decarbonise energy grids and transport, there will be growing opportunities to invest in the enabling infrastructure – such as electricity transmission, connecting renewable generation projects to the grid, and charging infrastructure for the growing number of electric vehicles on the roads.

Data centres will continue to experience rapid growth and ongoing investment interest after a number of high-profile transactions over the last two years. This theme was also reflected in our Private Markets 700 research, with 46% of respondents indicating that digital infrastructure will play an important role across infrastructure equity and debt markets in 2025. While recent data centre demand growth has been ascribed to the

FIGURE 1

STEADY GROWTH IN DATA CENTRES



Source: EY-Parthenon, Company Filings

growth in artificial intelligence applications, the sector has seen strong tailwinds for some time. Annual data centre traffic has been growing strongly for the last decade, equating to a compound annual growth rate of 25% (see Figure 1). Developers are aware of the challenges facing this growing market, such as sufficient land and energy supply, and have been proactively addressing these challenges in order to meet their construction pipelines.

In addition to these dominant megatrends of decarbonisation and digitisation, established infrastructure investors will be able to benefit from the need for continuous improvements across existing assets – and the need for expansion of others to meet growing demand for energy, transport, and delivery of essential goods like water.

As already mentioned, we anticipate a continued expansion across the aviation sector, which has largely already exceeded pre-COVID-19 passenger numbers in many parts of the world. To meet this growing passenger demand, airports will have to continue investing in new facilities including terminals and runways. For established infrastructure managers such as IFM Investors, the expansion and enhancement of existing facilities to meet growing demand present great opportunities for value-accretive investments that enhance the customer experience and support the growth of local economies.

Picture: Manchester Airports Group

Rich Randall
Global Head of Debt Investment

Infrastructure Debt

In infrastructure debt, similar themes will play a crucial role in 2025 as those in mind for infrastructure equity investors.

Across the globe, we expect a continued focus on decarbonisation to generate sustained growth in traditional renewables such as solar and wind projects as economies transition to net zero and consider other non-traditional power sources – aided, in part, by a continued reduction in the cost of renewables, especially solar.

We expect this to drive issuance in other sectors linked to the broader ecosystem of renewables, such as battery storage and interconnectors, with BloombergNEF previously predicting an annual growth rate of 21% by 2030 for the global energy storage market.[1] In addition, we expect to see more emerging technologies and alternative fuels seeking debt financing and continued, global adoption of successful biomass and biogas projects that can help support local power and energy supply.

In the US, we expect power demand to expand at a significant rate, with approximately 500 GW of new generation capacity expected to be connected to the grid over the next 10 years due to these needs, and the electrification of transportation to further heighten the demand for power. It is expected that renewables alone will not be able to keep up with that pace of demand, thus we expect traditional energy sources like natural gas fired power to expand to keep up with energy demand in the US. Often we are seeing the development and construction of newer more efficient gas fired power replacing older gas and even coal fired generation.

Additionally, since 2020, the number of transactions globally in the digital sector has increased by more than 30 percentage points, with it now accounting for around 17% of total transactions. We expect this trend to continue throughout 2025, particularly with respect to investment in fibre optic networks and data centres.

Finally, we anticipate social housing opportunities across Europe and Australia, as governments look to private capital to meet the growing demand for social and affordable housing, assisted living facilities and housing for key workers. This is reinforced by the findings of our inaugural Private Markets 700 research, which reveals that social, environmental and energy infrastructure are priorities for infrastructure investors, with 81% of respondents planning to increase their infrastructure debt exposure to social infrastructure.

Pricing trends and opportunities

Despite tightening corporate credit spreads, infrastructure debt spreads have remained relatively stable. We could see some spread compression following broader credit conditions over the next 12 months, particularly at the crossover space (debt that is on the edge between IG and sub-IG bond ratings, i.e. BB+ or BBB-).

For sub-IG grade opportunities, we expect to earn 350-600bps dependent on region and sub-sector, and 150-350bps for IG opportunities.

[1] Global Energy Storage Market Records Biggest Jump Yet | BloombergNEF

The derisked nature and outsized demand for traditional renewables such as wind and solar has resulted in tighter spreads for the sector, making it more challenging to find risk-adjusted relative value, but it can exist in more specialty financing situations.

Given the macro outlook, we expect interest rate and curve volatility to be an increasingly important consideration when lending to infrastructure assets. This can influence market dynamics, for example, in the UK market, swap spreads are becoming more negative (with gilt yields higher than swaps), driven primarily by a growing net supply of gilts due to subdued pension hedging activity. This has caused a shift in borrower behaviour, with many UK borrowers now opting to price over the Secured Overnight Financing Rate (SOFR) for fear of continued UK rate volatility.

Moreover, corporate and private credit issuers have noticed an increase in defaults since 2022 driven by the rising rate environment and more challenged growth/inflation combination. Infrastructure debt businesses are less cyclically sensitive and we have not seen a similar pickup in defaults, driven by the essential, strategic nature of the assets we lend to. We also see infrastructure assets being more resilient to inflation as they can either hedge input costs, or pass inflation on to end users via higher prices. We expect investors to continue to value these characteristics in the future, especially if the potential for geopolitical turmoil, protectionist trade policies, and labour market dynamics put upward pressure on inflation again.

Sub-IG infrastructure debt typically has tenors of four to 10 years and we typically focus on a floating rate exposure. IG debt tenors are typically 10-25 years with a prevalence of both fixed and floating rate transactions. As interest rates decline, we may see a preference for longer tenors from borrowers.

“In the US, we expect power demand to expand at a significant rate, with approximately 500 GW of new generation capacity expected to be connected to the grid over the next 10 years.

Diversified Credit

Lillian Nunez and
Hiran Wanigasekera
Co-Heads of Australian Diversified Credit

We enter 2025 with an environment for private credit that is much more attractive than many would have expected even 12 months ago. At the end of 2023 and during the early months of 2024, we were seeing interest rates rise and remain higher than initially forecast in an effort to address inflation, and many in the market were uncertain as to whether Australia would be able to execute a soft landing, instead anticipating a recession.

Instead, for 2025, we now predict a scenario where base rates will remain relatively high throughout the year, with the first rate cut not expected before May, allowing for an associated credit spread that will offer private credit lenders attractive returns. While the global central bank situation may see rates getting repeatedly cut, we do not see the Reserve Bank of Australia following suit, with inflation lurking around the corner. In that regard, it means that the Australian private credit market will potentially be able to offer returns not available in overseas jurisdictions, including the US, where the Federal Reserve has already cut rates by 100 basis points.

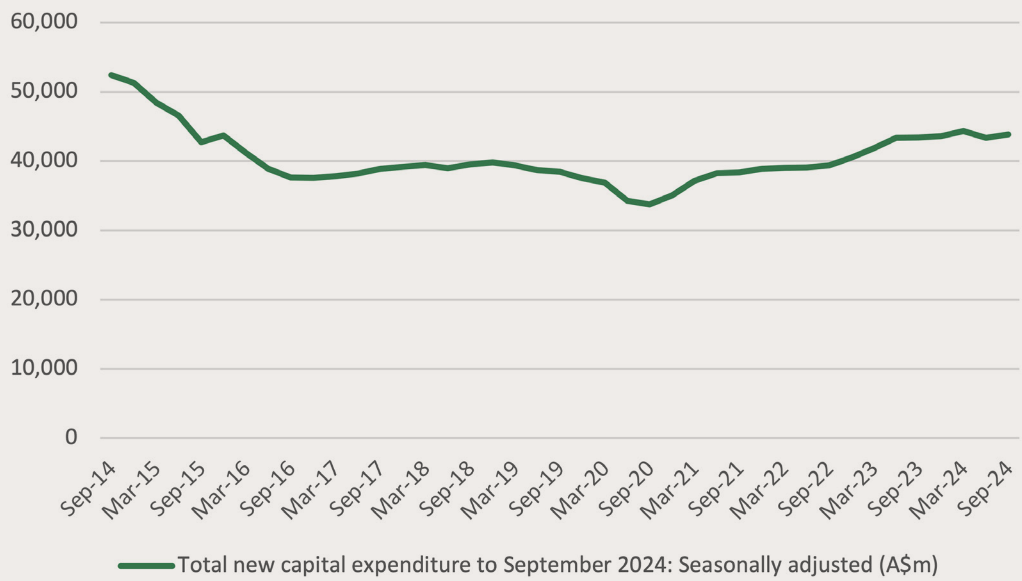
As a Diversified Credit team, we seek to invest across the Australian economy, so the improving economic outlook – one that sees a rising tide lifting all boats – is a positive, and will drive business confidence and see a greater number of corporates re-invest in their own growth. While some financing for such growth may come in the form of equity and a larger number of IPOs or capital raises, a significant portion will continue to be funded through debt.

That said, we will remain cautious when lending to companies within the services sector that may struggle with staff shortages, as Australia continues to see peak employment. As the tight labour market will continue to cause inflationary pressures, this will also impact the financial health of companies within the services sector and act as a key impediment to growth and investment.

As far as sectors of interest, all businesses that are linked to the current trends of digitisation and decarbonisation will be evaluated due to those sectors' predicted future growth, but as we maintain a diversified portfolio, we seek to be exposed to the economy as a whole, rather than specific sectors.

FIGURE 2

PRIVATE NEW CAPITAL EXPENDITURE AND EXPECTED EXPENDITURE IN AUSTRALIA HAS RISEN TO ITS HIGHEST LEVEL SINCE MID-2015



Source: Australian Bureau of Statistics

> **Greater confidence in valuations and asset prices will likely continue to lead to further transaction activity and encourage a greater number of investors to begin allocating to the sector again on a selective basis.**

Finally, while we do not believe that the real estate market has fully normalised, we believe we are at or nearing the bottom subject to the asset class and location. We anticipate we will see the beginning of a recovery as commercial office assets begin to experience stabilised valuations and inflation continues to feed through contracted lease revenues. While the recovery in the segment may be modest, demand for real estate, as evidenced by capital seeking opportunities, demonstrates a significant turnaround from the experience of the past few years. Greater confidence in valuations and asset prices will likely continue to lead to further transaction activity and encourage a greater number of investors to begin allocating to the sector again on a selective basis.

Crucially, while last year saw a tightening of pricing, as the demand for capital rises over the course of 2025, we expect this tightening to moderate. And while private credit pricing moderated, the changes are not as pronounced as in the public credit market – resulting in an improved premium in the private credit space compared to its public counterpart.

Stuart Wardman-Browne
Global Head of Private Equity

Private Equity

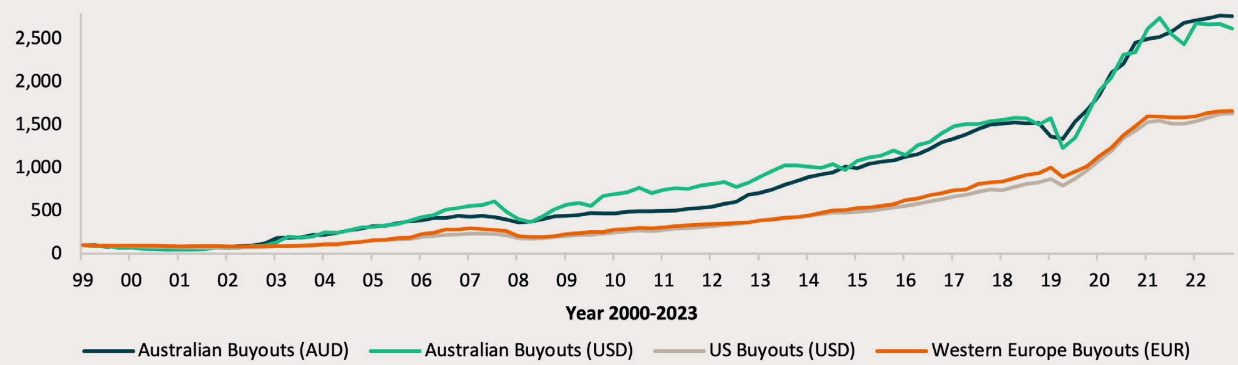
The Australia-New Zealand market has long been attractive for private equity investment. Data from the Burgiss Private IQ database[2] highlights that Australia has outperformed the US by around 70% since 2000.

We foresee more great opportunities over the next 12 months, particularly in the lower and mid-market where more Australian businesses are growing and innovating. Relatively speaking, there are far fewer private equity funds looking to invest in these businesses, and even fewer in the software, tech-enabled services and healthcare sectors of interest at present to IFM's business.

Despite the macroeconomic challenges outlined, such as the potential impact of a new US administration's economic reforms and the ongoing conflicts in Ukraine and the Middle East, we are typically more focused on the dynamics at the micro level impacting our individual investee companies or prospective new investments. Every business has its own, often very specific challenges to navigate. Typically, we

FIGURE 3

AUSTRALIAN BUYOUTS HAVE OUTPERFORMED US AND EU BUYOUTS OVER THE LONG TERM[2]



Past performance does not guarantee future results. Data as at 30 June 2023.

[2] Burgiss Private IQ database, https://www.msci.com/our-solutions/private-capital

help our investee companies to work through challenges they may have scaling their businesses, such as having the right business systems in place or attracting the necessary talent.

The pace of technology change can bring both challenges and opportunities so ultimately, we will need to continue to be vigilant for risks and help our companies to be agile enough to take advantage of opportunities.

The sectors which we deem inherently high growth in the coming year are software, tech-enabled services and healthcare, where we seek attributes that demonstrate the businesses are both proven and have actionable growth, such as those that have demonstrated a great market fit for their products or services and whose unit economics work.

For a private equity team surveying the market, the ability to exit a company at an opportune moment is as crucial as our ability to source new opportunities. 'Exit-ability' is all about thinking through who the most likely buyers are in the future for the asset in which we are investing. We look to find businesses where, if our investment thesis plays out, there will be many motivated trade buyers in the future.

And despite recent highs in public market valuations and the likelihood that the growth trend will continue in 2025, we do not assume that going public is a likely exit path for our investments and instead want to consider the field of potential buyers ahead of our investment. This allows us to be confident that there will be several interested parties when we come to exit and enables us to engage with these potential buyers early to build the demand.

> **The pace of technology change can bring both challenges and opportunities so ultimately, we will need to continue to be vigilant for risks and help our companies to be agile enough to take advantage of opportunities.**

Important Disclosures

The following disclosure applies to this material and any information provided regarding the information contained in this material. By accepting this material, you agree to be bound by the following terms and conditions. The material does not constitute an offer, invitation, solicitation, or recommendation in relation to the subscription, purchase, or sale of securities in any jurisdiction and neither this material nor anything in it will form the basis of any contract or commitment. IFM Investors (defined as IFM Investors Pty Ltd and its affiliates) will have no liability, contingent or otherwise, to any user of this material or to third-parties, or any responsibility whatsoever, for the correctness, quality, accuracy, timeliness, pricing, reliability, performance, or completeness of the information in this material. In no event will IFM Investors be liable for any special, indirect, incidental, or consequential damages which may be incurred or experienced on account of a reader using or relying on the information in this material even if it has been advised of the possibility of such damages. Certain statements in this material may constitute "forward looking statements" or "forecasts". Words such as "expects," "anticipates," "plans," "believes," "scheduled," "estimates" and variations of these words and similar expressions are intended to identify forward-looking statements, which include but are not limited to projections of earnings, performance, and cash flows. These statements involve subjective judgement and analysis and reflect IFM Investors' expectations and are subject to significant uncertainties, risks, and contingencies outside the control of IFM Investors which may cause actual results to vary materially from those expressed or implied by these forward-looking statements. All forward-looking statements speak only as of the date of this material or, in the case of any document incorporated by reference, the date of that document. All subsequent written and oral forward-looking statements attributable to IFM Investors or any person acting on its behalf are qualified by the cautionary statements in this section. Readers are cautioned not to rely on such forward-looking statements. The achievement of any or all goals of any investment that may be described in this material is not guaranteed. Forecasts are based on reasonable assumptions and are provided for informational purposes as of the date of this material. Such forecasts are not a reliable indicator of future performance and are not guaranteed to occur.

Infrastructure investment risk

An infrastructure investment is subject to certain risks including but not limited to: the burdens of ownership of infrastructure; local, national and international economic conditions; the supply and demand for services from and access to infrastructure; the financial condition of users and suppliers of infrastructure assets; changes in interest rates and the availability of funds which may render the purchase, sale or refinancing of infrastructure assets difficult or impractical; changes in environmental and planning laws and regulations, and other governmental rules; environmental claims arising in respect of infrastructure acquired with undisclosed or unknown environmental problems or as to which inadequate reserves have been established; changes in energy prices; changes in fiscal and monetary policies; negative economic developments that depress travel; uninsured casualties; force majeure acts, terrorist events, under insured or uninsurable losses; and other factors beyond reasonable control.

Fixed income securities investment risk

Investments in fixed income securities are subject to the risks associated with debt securities generally, including credit, interest rate, call and extension risk.

Private equity investment risk

Private equity investments are speculative, highly illiquid, involve a high degree of risk and have high fees and expenses that could reduce returns; they are, therefore, intended for experienced and sophisticated long-term investors who can accept such risks. Furthermore, restrictions on transferring interests in private equity funds may exist so prospective investors should be prepared to retain their investments in the fund until the fund liquidates. Private equity funds may borrow money or use leverage for a variety of purposes, which involves a high degree of risk including the risk that losses may be substantial. Lastly, the possibility of partial or total loss of a private equity fund's capital exists, and prospective investors should not subscribe unless they can readily bear the consequences of such loss. There can be no assurance that the private equity fund sponsor's or the fund's investment objectives will be achieved or that investors will receive a return of their capital.

Past performance does not guarantee future results. The value of investments and the income derived from investments will fluctuate and can go down as well as up. A loss of principal may occur.

This material does not constitute investment, legal, accounting, regulatory, taxation or other advice and it does not consider your investment objectives or legal, accounting, regulatory, taxation or financial situation or particular needs. You are solely responsible for forming your own opinions and conclusions on such matters and for making your own independent assessment of the information in this material. Tax treatment depends on your individual circumstances and may be subject to change in the future. This material is confidential and should not be distributed or provided to any other person without the written consent of IFM Investors.

United States Disclosure

This material is for use with institutions only and not for use with retail investors. The material, if presented in the US, is offered by IFM (US) Securities, LLC, a member of FINRA and SIPC.

Australia Disclosure

This material is provided to you on the basis that you warrant that you are a "wholesale client" or a "sophisticated investor" or a "professional investor" (each as defined in the Corporations Act 2001 (Cth)) to whom a product disclosure statement is not required to be given under Chapter 6D or Part 7.9 of the Corporations Act 2001 (Cth). IFM Investors Pty Ltd, ABN 67 107 247 727, AFS Licence No. 284404, CRD No. 162754, SEC File No. 801-78649.

Netherlands Disclosure

This material is provided to you on the basis that you warrant that you are a Professional Investor (professionele belegger) within the meaning of Section 1:1 of the Dutch Financial Supervision Act (Wet op het financieel toezicht). This material is not intended for and should not be relied on by any other person. IFM Investors (Netherlands) B.V. shall have no liability, contingent or otherwise, to any user of this material or to third parties, or any responsibility whatsoever, for the correctness, quality, accuracy, timeliness, pricing, reliability, performance, or completeness of this material.

United Kingdom Disclosure

This material is provided to you on the basis that you warrant that you fall within one or more of the exemptions in the Financial Services and Markets Act 2000 ("FSMA") [(Financial Promotion) Order 2005] [(Promotion of Collective Investment Schemes)(Exemptions) Order 2001, or are a Professional Client for the purposes of FCA rules] and as a consequence the restrictions on communication of "financial promotions" under FSMA and FCA rules do not apply to a communication made to you. IFM Investors (UK) Ltd shall have no liability, contingent or otherwise, to any user of this material or to third parties, or any responsibility whatsoever, for the correctness, quality, accuracy, timeliness, pricing, reliability, performance, or completeness of the information in this material.

Switzerland Disclosure

This Information is provided to you on the basis that you warrant you are (i) a professional client or an institutional client pursuant to the Swiss Federal Financial Services Act of 15 June 2018 ("FinSA") and (ii) a qualified investor pursuant the Swiss Federal Act on Collective Investment Schemes of 23 June 2006 ("CISA"), for each of (i) and (ii) excluding high-net-worth individuals or private investment structures established for such high-net worth individuals (without professional treasury operations) that have opted out of customer protection under the FinSA and that have elected to be treated as professional clients and qualified investors under the FinSA and the CISA, respectively.

IFM-17Dec2024-4091904