



Q3 2025

Investment Outlook:

Will Confidence Crack?



Macro Environment



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Confidence is everything, until it's not. This past quarter was a textbook example of how investor confidence can endure in the face of mounting contradictions.

To close the quarter, equities pushed to all-time highs and investment grade credit spreads retested multi-decade tightness. Yet underneath the surface, fault lines in fiscal policy, global capital flows and economic data began to widen. While the emerging cracks have not yet eroded market confidence, the challenge ahead is that confidence rarely erodes gradually. Rather it tends to fall off a cliff.

Fiscal policy

US fiscal policy is back in the headlines. Deficits are running at levels typically associated with wartime or recession, despite unemployment near record lows. If growth doesn't accelerate meaningfully into the 3%+ range, the sustainability of this path becomes questionable. Goldman Sachs recently noted that just to cover interest expense, the US may need to run a structural primary surplus of 1–3% of gross domestic product (GDP). That's not a political opinion, it's arithmetic.

Markets have so far shrugged in response, thanks in part to hopes of an AI-driven productivity boom. If the US can grow its way out of this bind, perhaps today's fiscal largesse is tomorrow's smart bet. But if those gains prove elusive, then sooner or later the market will be forced to care.

Global capital flows

Zooming out, an important question is who will fund US deficits in the coming years. Foreign demand for Treasuries is not what it used to be. After the second-quarter tariff turbulence, there's anecdotal evidence that some Asian investors are reallocating to Europe. Hedging costs are part

of the story, as on an FX-hedged basis, US fixed income looks unattractive, with the Federal Reserve on hold while other countries are well into cutting cycles. But currency matters too. A weaker dollar might eventually restore appetite, but trade policies complicate that picture.

Tariffs, by design, tend to strengthen the dollar and reduce the trade deficit. This in turn lowers the capital account surplus, meaning less foreign capital flowing in. With less foreign investment, the US would have to rely more on domestic savers to fund government borrowing. Given the American consumer's notorious predilection for spending over saving, this implies one thing: higher yields. A key question is how high yields would need to rise in order to compel US citizens to save?

For now, investors appear unfazed by tariff risks. Survey data suggest that investors firmly expect the effective US tariff rate to stay below 15%. But political theater could upend that stability. With President Trump aiming to reassert credibility ahead of the August 1 deadline, the stage is set for tough talk and possibly tougher action. Market participants are caught in a catch-22. By ignoring tariff risks they enable and embolden Trump to proceed with highly punitive tariffs, but as we saw in April, a sharp selloff can prompt an abrupt reversal in both Trump's policies and market prices.

Economic data

Meanwhile, the domestic economy continues to defy the skeptics. Growth estimates for 2025 have ticked up from sub-1% in May to the 1–1.5% range. Several tailwinds are helping. The April uncertainty shock is fading, the recently passed One Big Beautiful Bill Act (OBBBA) adds fiscal thrust worth roughly 1% of GDP, and the US consumer has remained resilient. Perhaps most remarkably, the US has imposed elevated tariffs without triggering meaningful retaliation.

Still, cracks are emerging. In the short run, there are growing signs of economic deceleration. Soft data—surveys and sentiment—have bounced, but hard data are starting to wobble. Labor market demand data have softened, aside from headline non-farm payrolls, which (already infamous as a lagging indicator) have become even more lagging due to low response rates prior to revisions. Housing is softening. Private payroll growth is underwhelming. And immigration (perhaps the key growth engine missed by many economists in recent years) faces potential headwinds. The OBBBA allocates funding to scale up deportations, potentially turning net migration negative. Markets aren't pricing this in, likely because the economic impact hasn't been felt yet. But if labor supply tightens further, growth expectations may need to be revised.

The Federal Reserve, meanwhile, finds itself increasingly reactive. If labor market weakness broadens, the case for rate cuts will build. The Fed seems prepared to act if needed but is otherwise satisfied to remain on hold until inflation proves sufficiently contained. The committee seems to believe inflation expectations are well anchored, especially given how mild the pass-through from tariffs has been so far. That leaves the door open to rate cuts later this year. But the Fed's capacity to act is constrained, especially compared to other central banks.

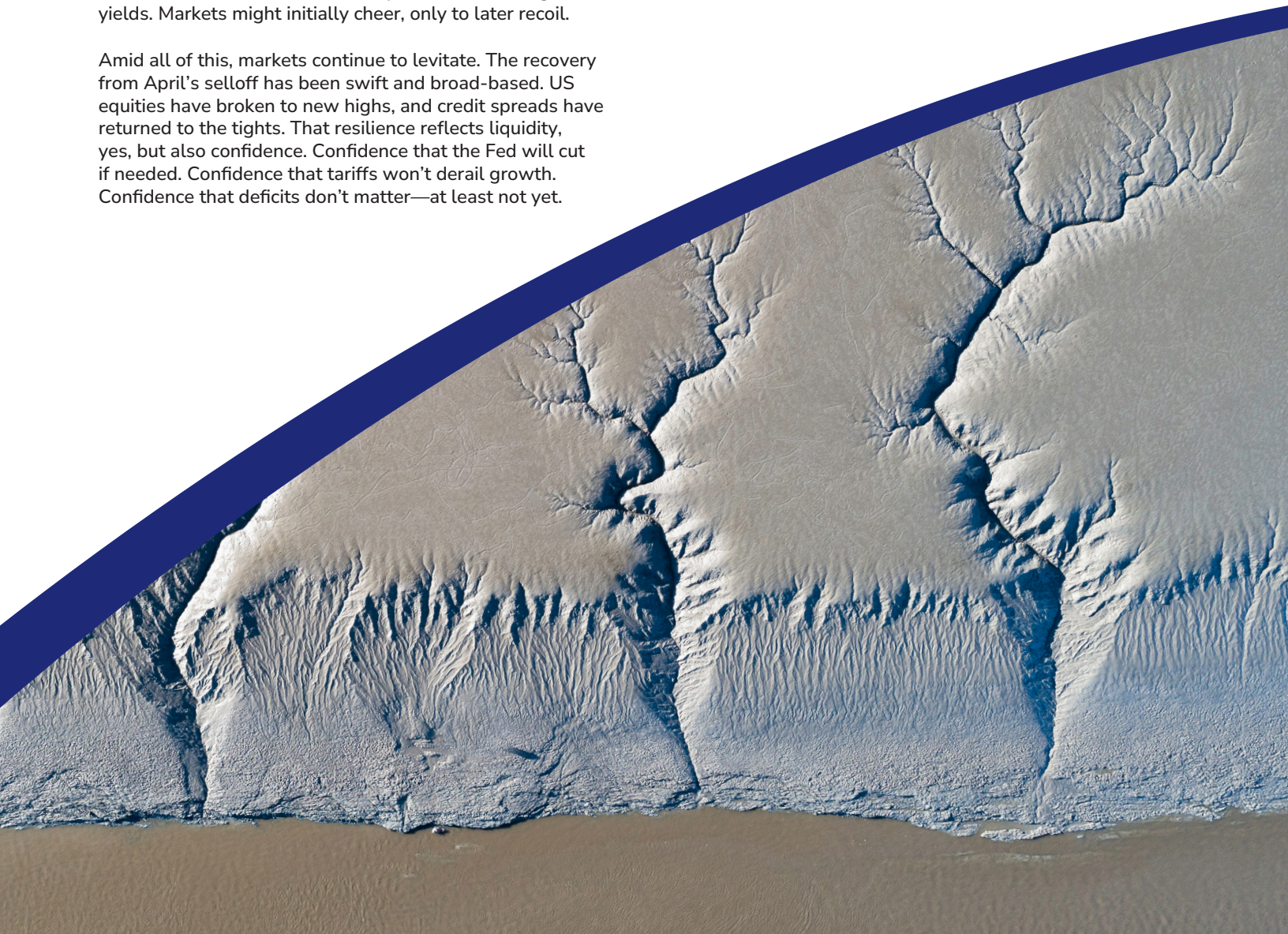
Complicating the picture is the looming question of who will lead the Fed next. President Trump is intent on nominating a new chair in 2026, with frontrunners including Kevin Warsh, Scott Bessent, Kevin Hassett and Christopher Waller. The prevailing expectation is that a new Fed chair might pursue aggressive "catch up" rate cuts to stimulate growth and reduce debt servicing costs. But such a move could trigger concerns about inflation, Fed independence and long-end yields. Markets might initially cheer, only to later recoil.

Amid all of this, markets continue to levitate. The recovery from April's selloff has been swift and broad-based. US equities have broken to new highs, and credit spreads have returned to the tights. That resilience reflects liquidity, yes, but also confidence. Confidence that the Fed will cut if needed. Confidence that tariffs won't derail growth. Confidence that deficits don't matter—at least not yet.

When confidence cracked

In the early 1990s, Japan reached a similar moment. Years of fiscal stimulus and easy money had kept the economy afloat, but eventually, investor faith eroded. Bond yields spiked, not because inflation was rising, but because confidence in the government's ability to sustain its debt path had faded. It wasn't about fundamentals—it was about belief.

The US isn't Japan. But the lesson still resonates: Confidence is an asset, and like all assets, it can depreciate. When markets begin to question the sustainability of policy—fiscal, monetary, or political—they tend to move quickly. For now, investors are riding high. But they would do well to remember that confidence, like credit, is easy to extend and harder to recall.



Pension Solutions Monitor¹



Chris Wroblewski, CFA
Co-head of Solutions Strategy

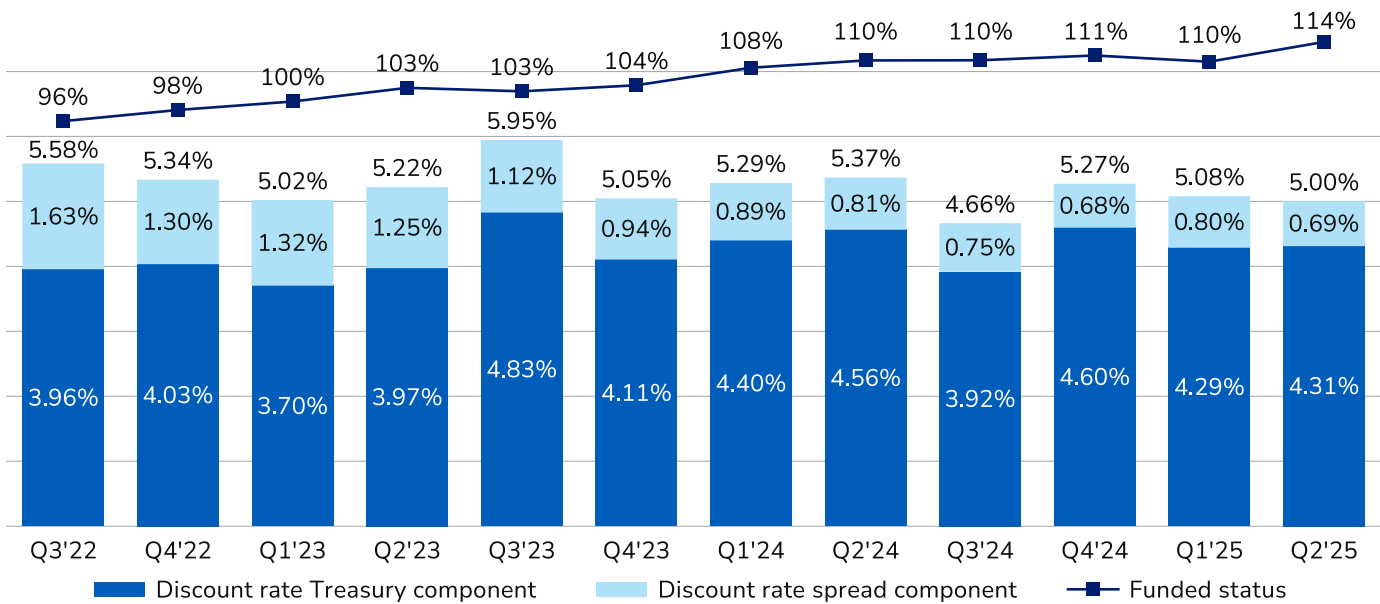
Our analysis of market movements impacting US corporate defined benefit pension plans leads us to estimate that pension funding ratios increased over the second quarter of 2025. Based on market movements, we estimate the average funding ratio increased from 109.6% to 114.3%.

Equity markets experienced positive performance over the quarter, with global equities increasing 11.7% and the S&P 500 increasing 10.9%.² We estimate plan discount rates decreased approximately 8 basis points (bps) over the quarter with the Treasury component increasing 3 bps and the credit component tightening 11 bps.³ Plan assets with a traditional “50/50” asset allocation increased 5.7%, while liabilities increased 1.3%. The positive asset performance outpaced the rise in liability values and resulted in a 4.7% increase to funding ratios over the second quarter of 2025.

Average funding ratios reached recent highs in the second quarter, driven by positive equity performance. As we enter the third quarter, investors continue to express demand for customized hedging strategies to lock in funded status gains. As fixed income allocations broadly rise, attention has centered on diversification objectives. The marginal dollar into fixed income is going more and more into strategies such as intermediate credit, investment grade private placements and shorter duration fixed income mandates. These fixed income strategies offer diversification benefits, the potential for enhanced yield and, ultimately, the chance for improved funded status outcomes. Looking further into 2025, we anticipate a continued emphasis on customization to target each plan’s unique objectives. For those with a primary focus of funded status preservation, custom credit portfolios that are managed in an annuity-aware framework and built benchmark agnostic could be a suitable approach.

The Pension Solutions Monitor assumes a typical liability profile using an approximate duration of 10 years and 50% MSCI AC World Total Gross Index / 50% Bloomberg US Long Government/Credit Index investment strategy. Our analysis incorporates data from L&G research, ICE indices and Bloomberg.

Figure 1: Discount rates



Sources: L&G – Asset Management, America, ICE indices and Bloomberg. Data as of June 30, 2025.

Pension funded status market summary:

- Equity markets delivered positive performance, with the S&P 500 and global equities up throughout the quarter.
- Plan liabilities increased due to lower discount rates.
- Funding ratio levels increased with the rise in assets outpacing the rise in liabilities.

Funded status risk	Q2 2025
Equities	↑
Interest rates	↑
Credit spreads	↓

Source: L&G – Asset Management, America, ICE indices and Bloomberg. Data as of June 30, 2025.

Fixed Income Markets



Anthony Woodside, CFA, FRM
Head of Multi-Sector Fixed Income & Investment Strategy

“Being right” is a universal ambition, but should one really feel validated if it is attained for the “wrong” reasons?

Market participants came into 2025 with an optimistic view on the outlook for the economy and risks assets, largely in anticipation of a more business-friendly Trump administration. While investors may feel content with equities currently at all-time highs and credit spreads near all-time tightness halfway through the year, the paradigm shifts in policy should also provoke some discomfort around a market seemingly priced for perfection.

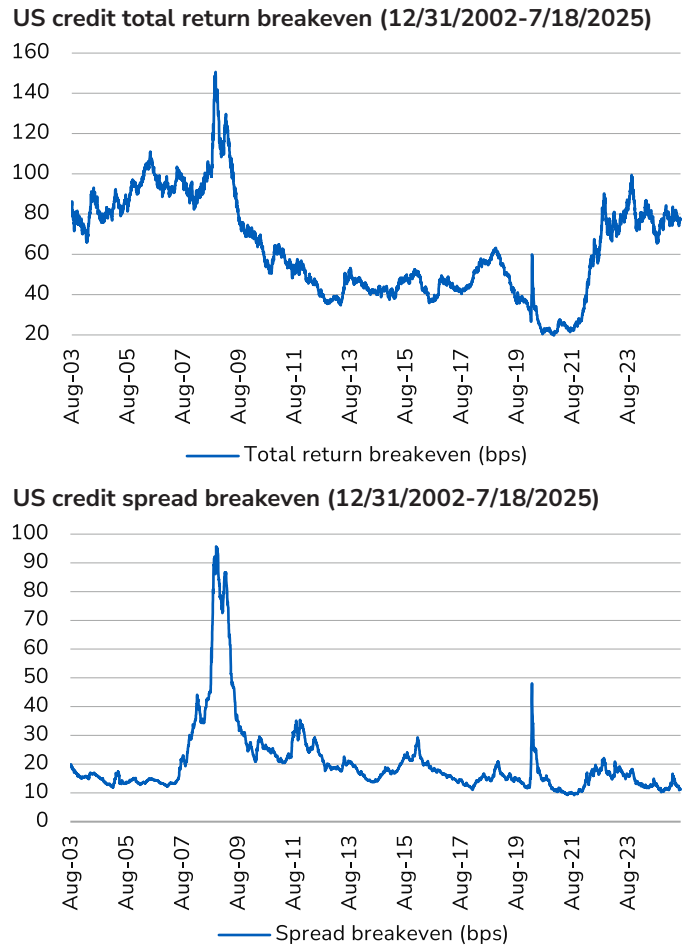
“Liberation Day” exposed the fragile accord between rich valuations and transformative challenges to the status quo, as risk assets came under immediate pressure. However, the subsequent pause in reciprocal tariffs and recent news flow around trade deals have proved sufficient to restore investor confidence—for now. Looking forward, amid elevated uncertainty and increasing downside risks to growth, we believe US fixed income markets currently offer a unique opportunity for investors to earn attractive levels of income in high-quality segments of the market.

A supportive backdrop for high-quality credit

As the macro section highlights, growth forecasts have climbed higher in recent weeks as the consensus expectation for the effective tariff rate fell below 15% after initially surging to well over 20% on “Liberation Day.” However, while recession odds have been revised lower, forecasts remain notably above the unconditional probability of recession in a typical year.

Despite economic disruptions from tariffs and burgeoning signs of slowing growth, the typical flight to quality trade

Figure 2: US credit total return breakevens are near post-GFC highs, while spread breakevens are near post-GFC lows



Source: L&G – Asset Management, America, Bloomberg. Data as of July 18, 2025.

was largely muted in rates markets in the second quarter. Although 2- and 5-year yields rallied roughly 16 and 15 bps respectively, 30-year yields increased by 20 bps during the quarter.

Conversely, total returns for investment grade credit were positive in the second quarter, with market and long credit indices finishing up 1.8% and 1.3%, respectively. Excess returns were also positive, aided by spreads tightening 9 and 14 bps, respectively. Moreover, high yield credit posted total returns of 3.5%, with spreads tightening by over 50 bps, falling below the 300-bps spread threshold.

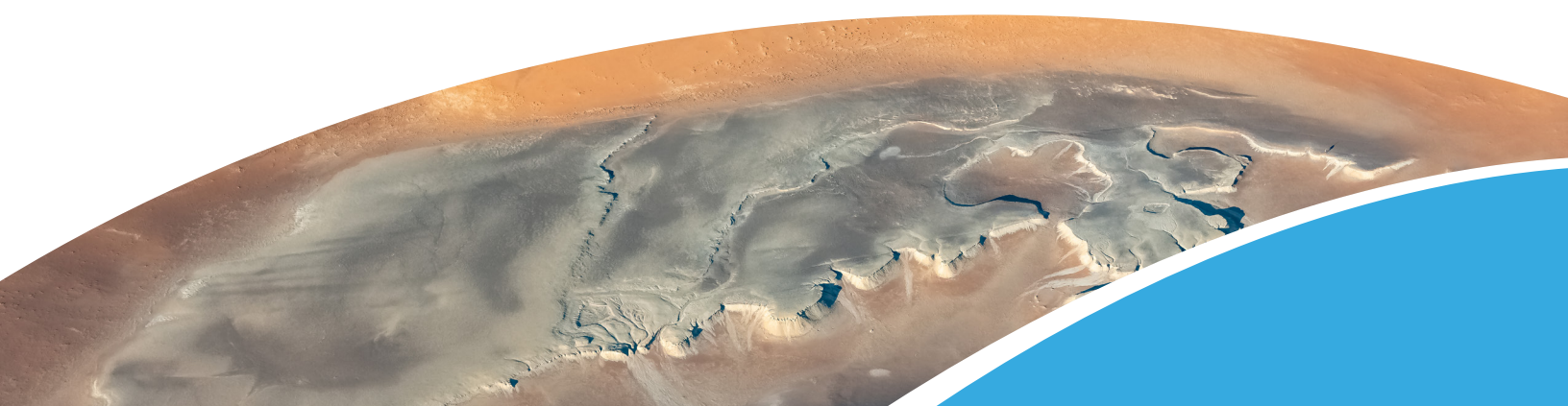
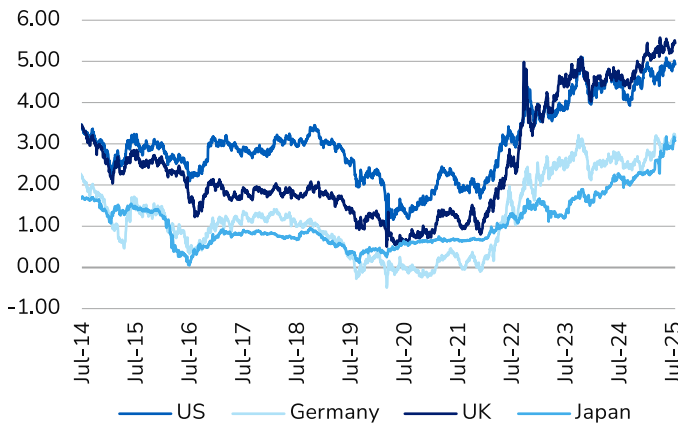
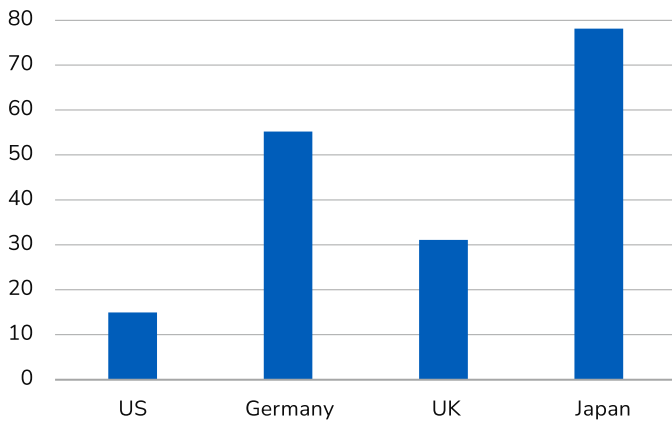


Figure 3: There has been a synchronized selloff in G4 long-term debt

G4 30-year yields (12/31/2011-7/18/2025)



G4 30-year YTD change in bps



Source: L&G – Asset Management, America, Bloomberg. Data as of July 18, 2025.

In previous updates we detailed the ongoing dichotomy between elevated all-in yields and razor thin spreads in investment grade credit, noting the relative dominance of yield-focused buyers over spread sensitive investors in recent years. This trend remains in place as market participants have prioritized high total return breakevens over paltry spread breakevens, culminating in robust demand for the asset class (Figure 2). Supply dynamics have added to the supportive technical backdrop, particularly in long credit where new issuance is running well behind the typical pace. Consequently, new issue concessions are back near historical lows, while oversubscriptions are nearing historical highs.

Potential catalysts for credit market volatility

With credit seemingly stuck in an uncomfortable equilibrium, it is natural to look for potential catalysts to disrupt the relatively sanguine backdrop. Given our view that spreads have little room to run based on fundamentals, we believe the rate cycle will dominate the medium-term outlook for the asset class. Rates have been largely range bound over the past few months as the Fed continues to weigh increasing downside risks to growth with near-time upside risks to goods inflation. The central bank released its updated Summary of Economic projections in June, which showed its median dot continuing to signal two cuts in 2025, albeit

by a slimmer margin than in March. Additionally, inflation and unemployment rate forecasts were revised higher, while growth forecasts were revised lower. In our view, a deep cutting cycle or the Fed switching to a hiking bias are potential avenues for negative outcomes in credit.

While the evolution of the policy rate is certainly important, what happens further out the curve also matters for credit markets. Term premium remains near the highest levels in a decade as fiscal concerns continue to mount. The One Big Beautiful Bill Act did little to quell fears around the outsized fiscal deficit and onerous debt servicing costs, and bear steepening pressures have persisted. Yet fiscal largesse and waning demand for long-term debt are not merely US problems. They are also difficulties ensnaring developed market peers (Figure 3). We believe that long-end yields moving sharply above 5% on questions around fiscal sustainability would represent another formidable challenge for credit markets.

A further proliferation in trade tensions stands out as the most obvious source of volatility for credit in the near term. As the macro section postulates, President Trump may feel more emboldened from recent market moves—equities at all-time highs, historically tight credit spreads and a weaker dollar. However, we also deem it likely that a selloff in rates and/or a deterioration in macroeconomic data (specifically labor market data) could lead to the “Trump put” being swiftly exercised.

Opportunities to add value in fixed income

When surveying financial markets, it is tempting to conclude that the consensus was correct with respect to its investment thesis for 2025. Yet while current valuations are signaling the “all clear,” the events of the last few months suggest policy thunderstorms will remain in play over the medium term. The Trump administration has showed little fear of challenging the status quo, with business as usual being meaningfully upended in matters ranging from global trade to Fed independence. Such fragmentation lends itself to an increasingly multipolar world and poses a threat to continued US exceptionalism. While we do not dismiss the prospect for a goldilocks outcome to ultimately be achieved, we believe the pathway to such a destination appears narrower than it did coming into the year.

Nonetheless, there remain ample opportunities to add value in fixed income. From a total return perspective, elevated yields and the prospect for potential price appreciation from Fed cuts serve as strong tailwinds for the asset class overall. In spread markets, we prefer short-duration and intermediate maturities over longer-dated exposures, due to attractive carry and rolldown in the front-end of the curve. We advocate for building flexible and resilient portfolios by exploiting relative value opportunities across corporate credit, securitized credit and emerging markets. Moreover, we continue to stress the importance of prudent security selection, and we remain focused on allocating to companies with solid fundamentals that can withstand multiple quarters of heightened uncertainty. Finally, we believe a more dynamic approach to duration management is warranted in this environment, as historical correlations may prove unreliable amid a constantly evolving policy backdrop.

Equity Markets



Dave Chapman, CFA
Head of Multi-asset

The market is undeniably bullish toward the US across sentiment, positioning, flows, technicals and internal indicators. Yet all these factors sit uncomfortably with us.

Market confidence in American exceptionalism returned just in time for America's birthday, with the S&P 500 setting new all-time highs on July 3. Never mind the twilight's last gleaming on the tariff deadline nor the rampart of immigration policy affecting the labor market, one of the most anxiously observed macro indicators of the moment. Investors shrugged off these concerns, citing US equities as the best opportunity at the moment in a recent survey.⁴ Against this backdrop, here are a few observations on managing risk from here.

More cautious positioning

We initiated a tactical overweight position near the nadir of the initial tariff selloff that relied heavily on taking the other side of extreme negative sentiment and the unwinding of long positions across systematic and retail investors. After the rapid rebound and sentiment shift, though, we believed that remaining overweight was the home of only the bravest investors. Valuations are very stretched and well-telegraphed geopolitical and macroeconomic risks remain. Even more astonishingly, complacency around these risks is also well-telegraphed and seemingly accepted.

As such, we are now neutral on equities and underweight risk on a cross-asset basis, expressed primarily through an underweight to credit, where valuations are even more challenging. We fully acknowledge the dynamics that can continue supporting equity levels. The aforementioned sentiment, positioning, technical and other indicators mean that, more commonly, new highs lead to new highs. Additionally, record buybacks are providing a consistent bid to the market, although they may be in lieu of capital expenditures amid uncertainty about economic and trade policies. Any resolution to macro risks, even with current complacency, would clearly be welcome. The news is so bad, its good.

Hedging at the top

We are hearing this bullish sentiment from clients, as well. No one wants to hedge at the top. The reasons are common and understandable: outright hedging is expensive, capping

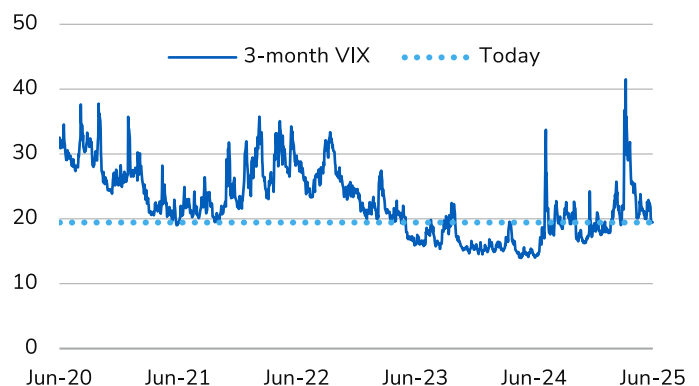
upside with a collar has too much opportunity cost, and diversification is a free lunch. Interestingly, though, this bullish sentiment may be reflected in equity volatility markets in subtle but opportune ways.

Yes, equity volatility is carrying poorly. The spread between 3-month at-the-money volatility and recent realized volatility is in its 83rd percentile over the last five years, meaning markets are charging a relatively high premium for at-the-money hedges. However, exposure to convexity (i.e., exposure to deeper out-of-the-money options or more extreme price swings) is relatively inexpensive, which we believe may underappreciate the magnitude of concurrent tail risks already identified. For example, the VIX 3-month future is only in its 36th percentile over the same period, as seen in Figure 4. In other words, the market might be underestimating the risk of significant price swings.

What are the implications? First, new equity highs and resilient fixed income markets mean that portfolio values and pension funded status are very robust. Protecting year-to-date gains or setting a floor on funded status outcome might only require a deeper out-of-the-money option, i.e., one that is more convex in its profile, has a lower premium outlay and is currently a better relative value. Second, pricing on zero-premium collars through the end of the year remains surprisingly attractive. Investors would cap their calendar year gains at a little over +15%, which is in about the top third of annual returns over the past 65 years.

Finally, diversification is free but fickle. We are spending more time on our own portfolios considering contingent options. An example of a contingent option is a 95% put on the S&P 500 that only pays off if rates rise 10 bps more than expected over the same horizon. The implied correlation cheapens the hedge materially while protecting the outcome that challenges total return portfolios most.

Figure 4: 3-Month VIX (6/30/2020 to 6/30/2025)



Source: L&G – Asset Management, America, Bloomberg. Data as of June 30, 2025.

Equity Solutions: MSCI Rebalancing Predictions



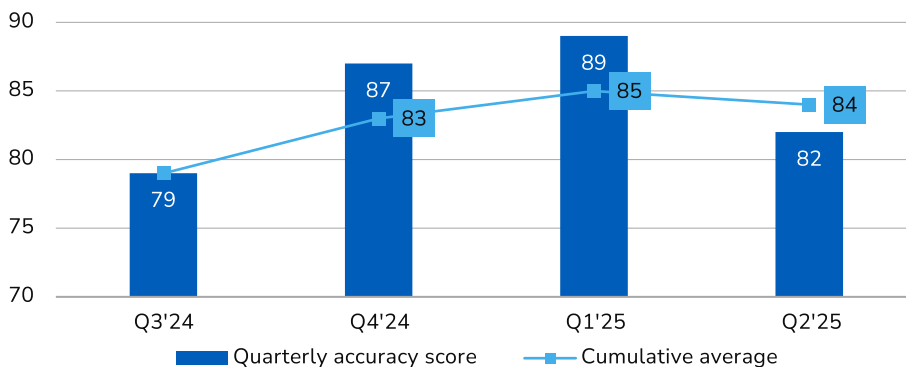
Dave Barron, CFA, CAIA
Head of US Equity Solutions

The second-quarter rebalance occurred in a uniquely challenging environment given market turmoil.

Demonstrating accuracy and reliability

Now in its fifth edition, this outlook continues our effort to track and assess the accuracy of our MSCI World rebalance predictions. In this quarter's review, we look back at the second quarter of 2025 and evaluate our performance amid a uniquely volatile environment.

Figure 5: MSCI rebalance prediction history



Source: L&G – Asset Management, America. Data as of June 30, 2025.

In the second quarter, MSCI announced 11 adds and 39 deletes in the MSCI World Index, for a total of 50 constituent changes. We correctly predicted 46 of the 50, and after accounting for five incorrect predictions, our Rebalance Accuracy Score came in at 82.

While this represents a modest decline from our first quarter score of 89, the event window for the second-quarter rebalance, spanning April 15 to April 30, followed the introduction of “Liberation Day” tariffs on April 2—a catalyst for significant market volatility and shifts in investor positioning.

Maintaining an accuracy score of 82 under these conditions reflects the strength and adaptability of our methodology. Additionally, with only 50 constituent changes in the second quarter, each incorrect prediction had a greater statistical impact on the final score. By contrast, quarters with higher event counts—like the first quarter—naturally dilute the effect of individual misses.

Every rebalance is different. Event counts and index dynamics vary quarter to quarter, and the second quarter was especially unique given market turmoil. Against this backdrop, scoring in the low 80s reflects the robustness of our process. Over the last four quarters, our cumulative accuracy stands at 84, reinforcing the consistency of our approach even in the face of uncertainty.

Our latest predictions

Figure 6 highlights our predictions for the third quarter of 2025 MSCI rebalance. The key dates for this cycle are the following:

- 10 business day window: July 15 - July 28.
- Announcement: August 7.
- Implementation point: Close of Tuesday, August 26, but may be different for some markets (e.g., market holiday, exchange closures).

Prediction process

We have designed and implemented a low active risk approach to capture outperformance created by index micro inefficiencies. In our investment approach, we target a variety of opportunities, one being rebalance predictions, where we model widely followed approaches to predict index additions and deletions. This predictive capability provides an opportunity for us to optimize portfolio adjustments before official index announcements, potentially enhancing returns. Here's how it works for an MSCI rebalance:

- On a quarterly basis, MSCI will re-establish its market cap weighted index series using a publicly available methodology, which means it can be independently modeled with reasonable certainty.
- We identify which companies we believe will be reclassified between the Standard (Large + Mid Cap) indices and Small Cap indices.
- MSCI selects one of ten days at the end of the month prior to the actual rebalance to crystalize sizing classifications.
- A public notification of the changes happens approximately two weeks before the rebalance, with the

rebalance happening at the end of the month (February, May, August, November cycle).

After the rebalance period ends, we evaluate our predictions based on the following method:

- Correct prediction (i.e., True positive; 1 point)—We assign ourselves one point for every accurate add or delete prediction.
- Incorrect prediction (i.e., False positive; -1 point)—One point is deducted for every prediction that is not ultimately added or deleted by MSCI.
- No prediction (i.e., False negative; 0 points)—No points are assigned or deducted for an add or delete that was not originally predicted.
- We add up the total number of points and divide it by the total number of adds and deletes implemented by MSCI to determine the Rebalance Accuracy Score. While we do not expect to achieve perfect accuracy, our aim is to maximize correct predictions and minimize mistakes. Accurately predicting this information in advance is knowing what trillions of dollars are likely to do before they do it.

Figure 6:
Our MSCI predictions for Q3 2025

Benchmark	Country	Name	Prediction
World ex USA	Australia	REECE LTD	Delete
World ex USA	Canada	ATKINSREALIS GROUP INC	Add
World ex USA	Canada	BOMBARDIER INC-B	Add
World ex USA	Canada	QUEBECOR INC - CL B	Delete
World ex USA	Canada	WEST FRASER TIMBER CO LTD	Delete
World ex USA	Portugal	BANCO COMERCIAL PORTUGUES-R	Add
World ex USA	Switzerland	BELIMO HOLDING AG-REG	Add
World ex USA	Germany	HENSOLDT AG	Add
World ex USA	Italy	DIASORIN SPA	Delete
World ex USA	France	EURAZEO SE	Delete
World ex USA	Switzerland	TEMENOS AG - REG	Delete
World ex USA	Israel	NOVA LTD	Add
World ex USA	Israel	PHOENIX FINANCIAL LTD	Add
World ex USA	Japan	KAWASAKI HEAVY INDUSTRIES	Add
World ex USA	Japan	RYOHIN KEIKAKU CO LTD	Add
World ex USA	Japan	DENTSU GROUP INC	Delete
World ex USA	Japan	HOSHIZAKI CORP	Delete
World ex USA	Japan	RICOH CO LTD	Delete
World ex USA	United Kingdom	FRESNILLO PLC	Add
World ex USA	United Kingdom	CRODA INTERNATIONAL PLC	Delete
USA	United States	AFFIRM HOLDINGS INC	Add
USA	United States	ROCKET LAB CORP	Add
USA	United States	SOFI TECHNOLOGIES INC	Add
USA	United States	TAPESTRY INC	Add
USA	United States	AVANTOR INC	Delete
USA	United States	CONAGRA BRANDS INC	Delete
USA	United States	THE CAMPBELL'S COMPANY	Delete
USA	United States	LKQ CORP	Delete

Source: L&G – Asset Management, America as of July 21, 2025. For illustrative purposes only.

Private Credit



Dan Dreher
Solutions Strategist

We see reasons to have confidence that both major segments of the private credit market—investment grade (IG) and sub-IG—can continue to thrive.

Private credit—loans made by non-bank lenders outside the public markets—has exploded in size over the past decade. Global private credit assets swelled to roughly \$3 trillion in the second quarter of 2025. This rapid growth has led to criticism around the sustainability of the asset class. The fear is this growth has been accompanied by weaker underwriting—covenant-lite loans, high leverage and optimistic valuations are frequently cited along with press headlines warning that the sub-IG market is entering bubble territory. However, we believe these concerns are overblown.

Delineating between two distinct universes

Private credit's rise can be viewed as a structural shift: After the 2008 crisis, banks pulled back from lending to many businesses (due to regulation and capital rules), and private funds filled the void. Thus, much of the private credit AUM growth is simply the disintermediation of banks, not a speculative bubble on top of existing credit. Federal Reserve data point out that overall private-sector corporate indebtedness hasn't spiked in the last decade. Companies are borrowing, but not dramatically more than before; they're just borrowing more from private sources.

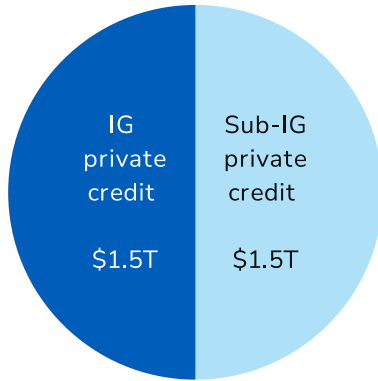
"Private credit," however, is not monolithic. It spans a spectrum from high-quality corporate loans (IG) to risky mezzanine debt (sub-IG), with IG and sub-IG private credit segments each having distinct characteristics.

- IG private credit consists of private loans made to highly rated borrowers across widely diverse sectors and maturities. These are fixed rate products that carry a rating from a third-party agency—just like their public equivalents. One example: private placements.
- Sub-IG private credit includes loans to lower-rated, often middle-market companies (essentially an alternative to public leveraged loans or high-yield bonds). It encompasses direct lending, mezzanine financing and other types of higher-yielding private debt. These are floating rate products that are governed by custom / proprietary rating policies.



Each category is sizeable—on the order of ~\$1.5 trillion each in outstanding loans—but the segments have varying investor bases and risk profiles.

Figure 7: Both segments of the private credit market are sizeable



Source: L&G – Asset Management, America.

Assessing downside risks

IG private credit

Even if we suppose the bearish case that the sub-IG side of private credit enters bubble territory, this does not automatically mean the entire private credit market would collapse or spread turmoil broadly. Several factors compartmentalize risks, especially between the two segments of the private credit market:

- **Different borrowers, different risks:** The IG side is lending to high-quality companies, projects and financing facilities with strong balance sheets and predictable cashflows. The sub-IG side is funding highly leveraged companies often backed by private equity. Trouble in one cohort doesn't necessarily translate to the other. For instance, a wave of defaults in speculative B-rated retailers wouldn't imply anything about the ability of an AA-rated infrastructure project to pay its private placement coupons.
- **Different lenders, similar appetite:** IG private credit investors (for example, insurers and pensions) typically hold these loans to maturity, using them to match long-term liabilities. They are not mark-to-market traders, but neither are sub-IG investors. These investors do not tend to lean on their private credit allocations for liquidity.
- **Limited Interconnectedness:** One hallmark of the 2008 global financial crisis was interconnectivity. Banks and markets were linked by levered subprime mortgages. Private credit, by contrast, is more siloed. Loans are not broadly traded or held by leveraged intermediaries who lend to each other. Instead, they sit on the books of funds and insurance accounts that generally match them with long-term capital.
- **Structural protections in IG loans:** IG private loans typically have tight covenants and security packages. This means if a borrower's financial performance slips,

IG lenders can often step in early—often well before any payment default—to renegotiate terms, obtain additional collateral or even demand repayment.

Sub-IG private credit

The bearish case is not our base case. We do not expect that the sub-IG private credit segment will collapse given the following factors:

- **Private equity sponsor support:** A large portion of direct lending is sponsor-driven (for example, loans made to private equity owned companies). Sponsors are not passive bystanders. They typically have 30-50% equity invested in these companies.
- **Active management:** Private credit managers often tout their ability to be “partner lenders.” They stay close to the borrower with frequent reporting and board observation rights in some cases.
- **Diversification and dry powder:** The private credit universe itself is highly diversified—by sector, geography and borrower—unlike the loans that characterized the housing bubble. Additionally, many private credit funds still have undrawn capital commitments. In a downturn, that dry powder can be used to support portfolio companies or selectively buy distressed loans (providing a floor to valuations).

Conditions for private credit to thrive

Looking forward, we believe both IG and sub-IG segments have the opportunity to thrive under certain basic conditions. IG lenders must remain committed to third-party rating agency oversight to maintain rating standards. Sub-IG lenders, on the other hand, must stay focused on robust economic opportunities at measured risk levels and avoid non-economic performance objectives. Over the past twenty years, non-bank lenders have continued to offer unique and customized financing solutions to IG and sub-IG segments, as healthy capital markets require lenders in every rating category and across investment horizons.

Footnotes

1. For illustrative purposes only. L&G – Asset Management, America prepares the Pension Solutions Monitor data assuming a typical liability profile using an approximate duration of 10 years and 50% MSCI AC World Total Gross Index / 50% Bloomberg US Long Government/Credit Index. Our analysis incorporates data from LGIM America research, ICE indices and Bloomberg. Prior to January 2023 the funded ratio of a typical US corporate defined benefit plan was calculated using an approximate duration of 12 years and a 60% MSCI AC World Total Gross Index / 40% Bloomberg US Aggregate Index (“60/40”) investment allocation strategy incorporating data from LGIM America research, ICE indices and Bloomberg. The change to a “50/50” asset allocation reflects our understanding that most US corporate defined benefit plans have extended the duration of their fixed income as funded status has improved for the broader market. Furthermore, we believe that the duration of a typical plan’s fixed income portfolio is better represented by the Bloomberg US Long Government/Credit Index compared to the Bloomberg US Aggregate Index. As of March 2025, we began using an approximate duration of 10 years. These results are based on simulated or hypothetical assumptions that have certain inherent limitations. Unlike the results in an actual performance record, these results do not represent actual trading. Because these trades have not actually been executed, these results may have under- or overcompensated or the impact, if any, of certain market factors, such as lack of liquidity. Simulated or hypothetical trading programs in general are also subject to the fact that they are designed with the benefit of hindsight. No representation is being made that any account will or is likely to achieve profits or losses similar to these being shown.
2. “Global equities” as represented by the MSCI AC World Total Gross Index.
3. Discount rates are based on a blend of the Intercontinental Exchange Mature US Pension Plan AAA-A and Intercontinental Exchange Retired US Pension Plan AAA-A discount curves.
4. Source: L&G – Asset Management, America, Bloomberg. Data as of July 8, 2025.

Disclosures

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