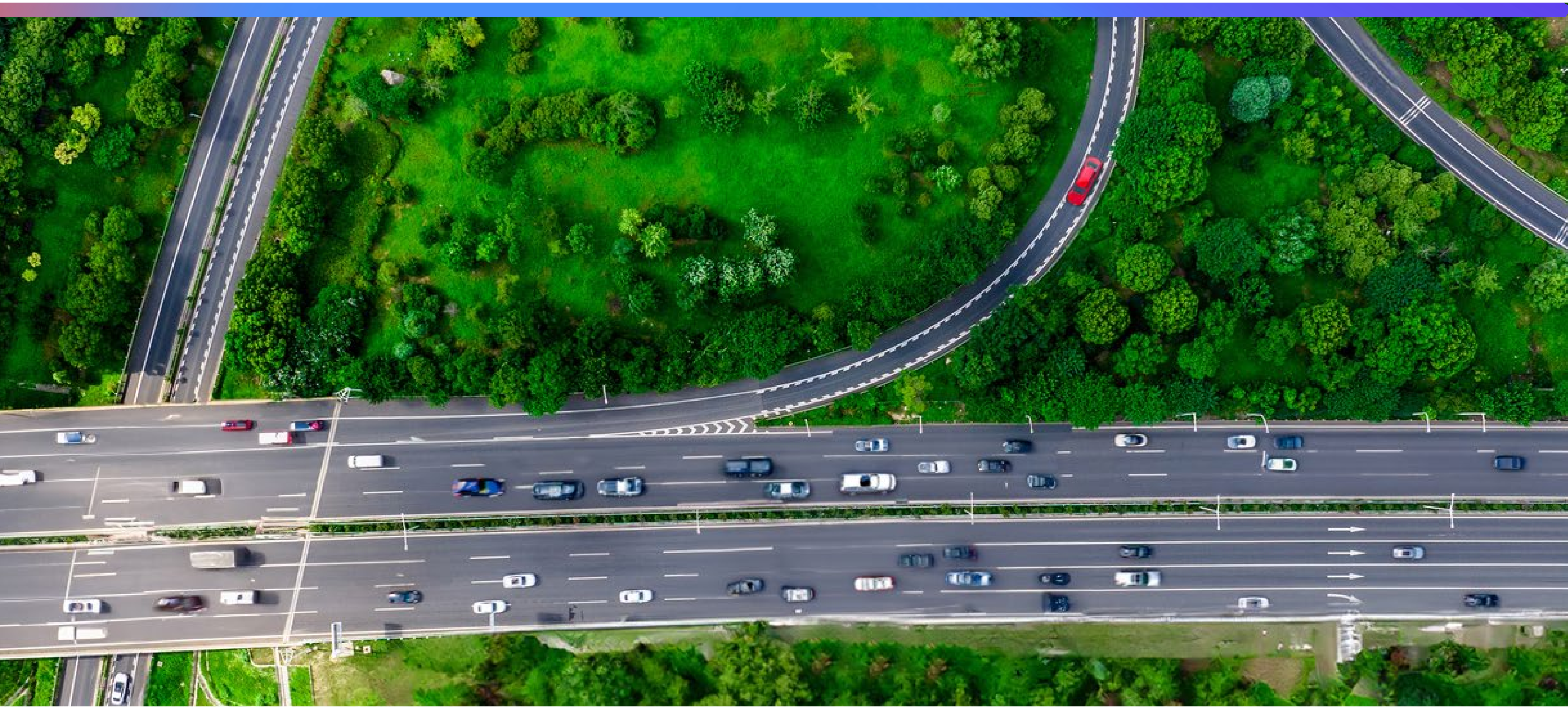
FRANKLIN TEMPLETON

2024 Private Markets Outlook

Compelling opportunities amid a liquidity crunch



Views expressed as of February 2024.

Overview

- 2023 can best be described as a surprising, slow-motion liquidity crunch across private markets. In stark contrast to other periods where we've seen more sudden market events resulting in financial crises, 2023 was a combination of factors that created a domino effect on liquidity and effectively froze portfolios with significant private investment exposure.
- Slowing exit activity and distributions, a much higher cost of capital, bank failures, and pessimism about macro uncertainty all combined forces to create a challenging outlook for financial markets during most of 2023. Investors who had been battered by the denominator effect in 2022, had to endure further hand-wringing as managers began to make capital calls, given the re-rating of valuations for private assets.
- Up until this point, investors had enjoyed the benefits of a low-rate environment which effectively resulted in private essentially being self-funding. However, the Fed's rapid tightening cycle exacerbated an already difficult liquidity and portfolio construction dilemma for asset allocators.
- While the public markets appear to have priced in several Fed rate cuts during 2024, we believe the "easy money" environment investors enjoyed before is over. Moreover, we believe that it will take some time for what is effectively a "liquidity queue" to work through the system as investors wrangle with very different assumptions in their investment underwriting theses than had been the case leading up to the 2022–23 period.
- As a result, investors who have the flexibility to be providers of liquidity or deploy additional capital may be able to take advantage of some compelling risk-return opportunities in 2024.
- **Private equity** is stuck in low gear. Exit activity which acted as the engine for many investors' private market allocations has slowed significantly. Furthermore, the private equity beta wave that supported this asset class the last few years looks to be over. In 2024, we believe PE portfolios made up of fewer, top tier companies that have a genuine exit plan in place will better fit the needs of institutions who not only seek long-term return potential, but also liquidity in their private market allocations.
- We envision a significant ramp in the use of **private equity secondaries** as a portfolio management tool as well as a growing marketplace to find compelling investment opportunities. Private market investments represent over $10 trillion in assets, yet annual secondary volume hovers around only $100 billion. With traditional exit activity slowing dramatically, we continue to see high-quality assets and portfolios of assets available for sale at attractive valuations.
- **Private credit** is ready for a resurgence as the new regime shifts negotiating power back in favor of private lenders. We think niche opportunities such as commercial real estate debt and US and European special situations investing are best positioned to benefit from the combination of looming maturity walls and the pullback of traditional bank lenders.
- While the "office apocalypse" has dominated most headlines, it's important to note that **commercial real estate** is comprised of a diverse set of property types. We believe industrial, multifamily, and alternative sectors like life sciences and self-storage represent attractive long-term opportunities that are positioned to take advantage of macro-thematic tailwinds.

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Private Investments
Franklin Templeton Institutional

"Franklin Templeton is pleased to share our 2024 private markets outlook, highlighting the different views across our $250+ billion alternative investment platform. Inside, we review the current landscape and what we see as the best opportunities for each asset class in the year ahead.

After a challenging 2023, we think that institutions who can be a provider of liquidity to others or have the flexibility to deploy additional capital may be able to take advantage of some unique and compelling risk-return opportunities in 2024."

Introduction

Private markets: A slow-motion, liquidity crunch

The 2022 hangover: A look back at 2023

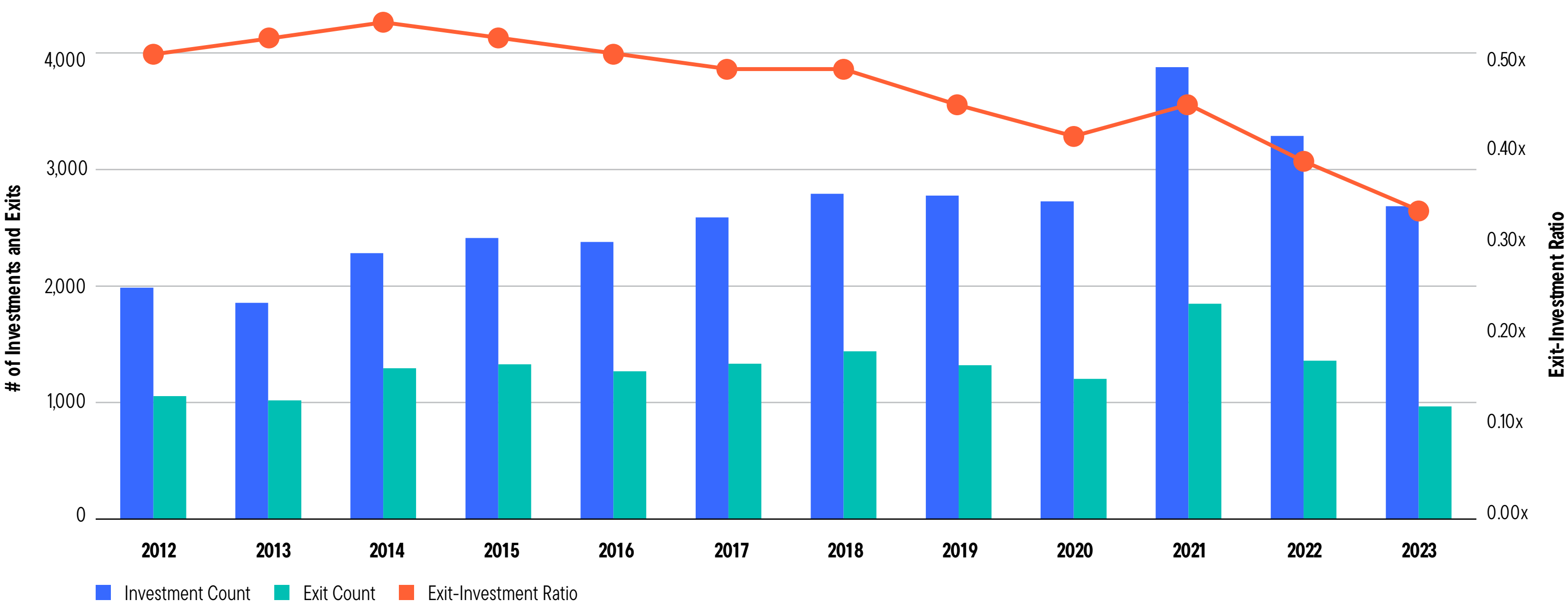
Investors were given little reason to be optimistic going into 2023. After a year of plummeting markets, spiking cross-asset correlations, rising inflationary pressures, and heightened geopolitical turmoil, few portfolios emerged from 2022 unscathed. Indeed, market volatility extended into the first half of 2023, as investors were dealt another blow with the largest banking collapses since the Global Financial Crisis (GFC), just as we were all finding our footing in the new investment regime.

The uncertain macro environment in 2023 had a considerable impact on private markets. In the 2022 market downturn, equity and fixed income allocations shrunk in lockstep, leaving institutional portfolios over-allocated to private markets. Furthermore, lofty private equity valuations led many institutions to question whether the prices paid for investments during the 2019–2021 vintages might be overvalued.

The bid/ask spread between buyers and sellers in the private markets widened significantly, which along with the rising cost of capital created substantial headwinds that slowed exit activity in 2023. In fact, at the end of 2023, the US private equity exit ratio reached its lowest level in more than a decade.

Exit ratio lowest in a decade

US PE Investment-Exit Ratio

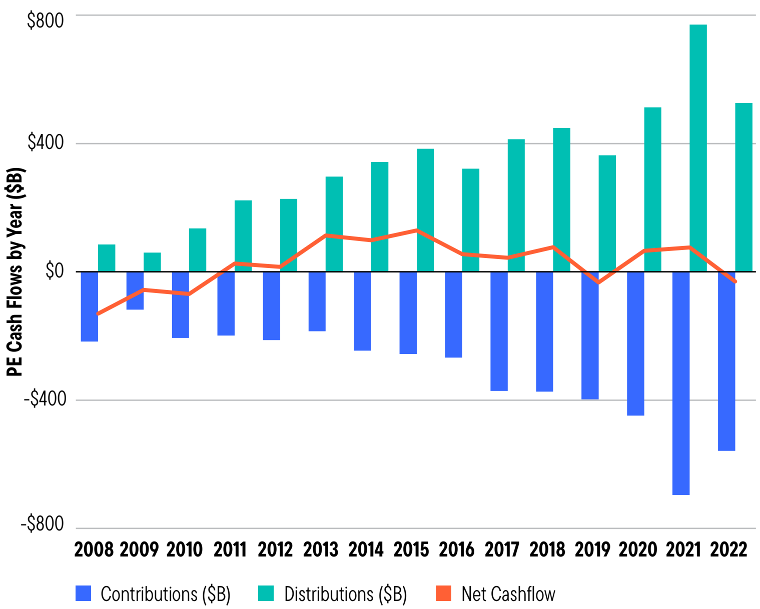


Source: PitchBook, as of 12/31/23. The investment/exit ratio tracks the number of PE exits in any given period against PE investments, excluding add-ons.

When exits slow, so too do distributions to investors. At the same time, capital calls have picked up amid tightening financial conditions. The combination of these two trends has created a punitive liquidity crunch for institutions. Amid the slow exit environment, PE cash flows turned negative for just the second time since the volatile period following the GFC, and venture capital (VC) cash flows did an abrupt U-turn after four years of trending toward positive territory.

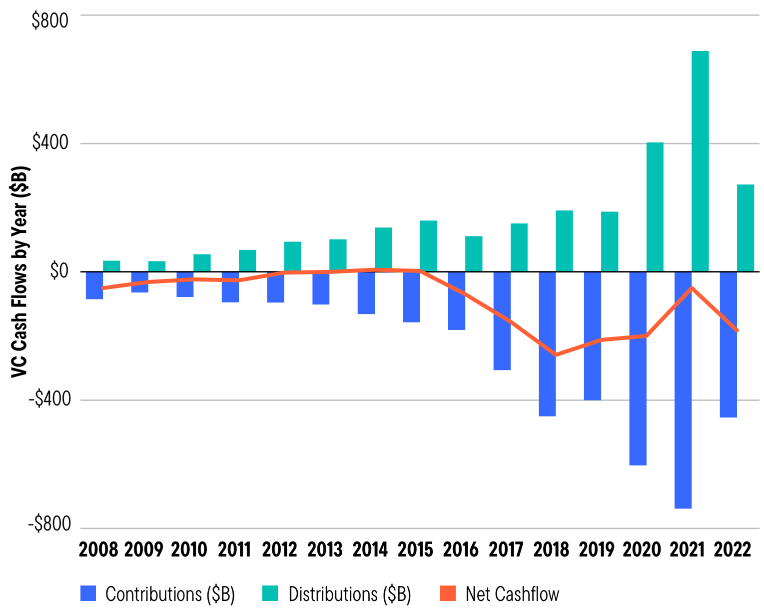
Slow exit environment means some private portfolios are no longer self-funding

PE Cash Flows by Year ($B)



Source: PitchBook, as of 12/31/22.

VC Cash Flows by Year ($B)



Source: PitchBook, as of 12/31/22.

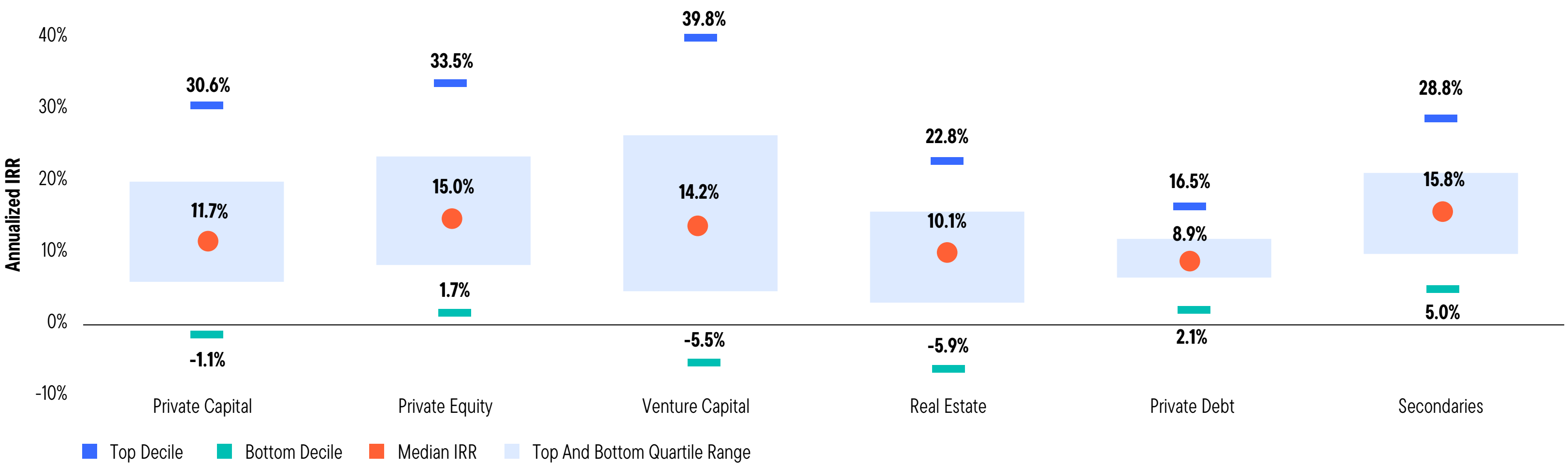
With respect to portfolio construction and liquidity management, in the post-GFC era many of these private market investments were effectively "self-funding," where capital distributions outpaced capital commitments, with many investors struggling to even keep pace with their target allocations. The result was a temporary masking of the illiquidity risk that can accompany private allocations. However, the reverse may now be true for some investors—requiring them to find different funding for capital commitments—setting up both a liquidity and portfolio construction dilemma.

Manager selection is paramount in the new regime

In the previous period of low rates, stable distributions, rising valuations, and robust exit activity, institutions could ride the private markets beta wave without seriously testing their assumptions about liquidity management, portfolio construction, value creation (sometimes known as "alpha"), and manager selection. But in the forward-looking regime, this is different. And as manager dispersion has historically been wide over full market cycles, manager selection in today's uncertain environment is essential.

Manager dispersion is wide over full boom-and-bust cycles

Fund IRR Performance Dispersion by Strategy (Vintage Years 2004–2018)



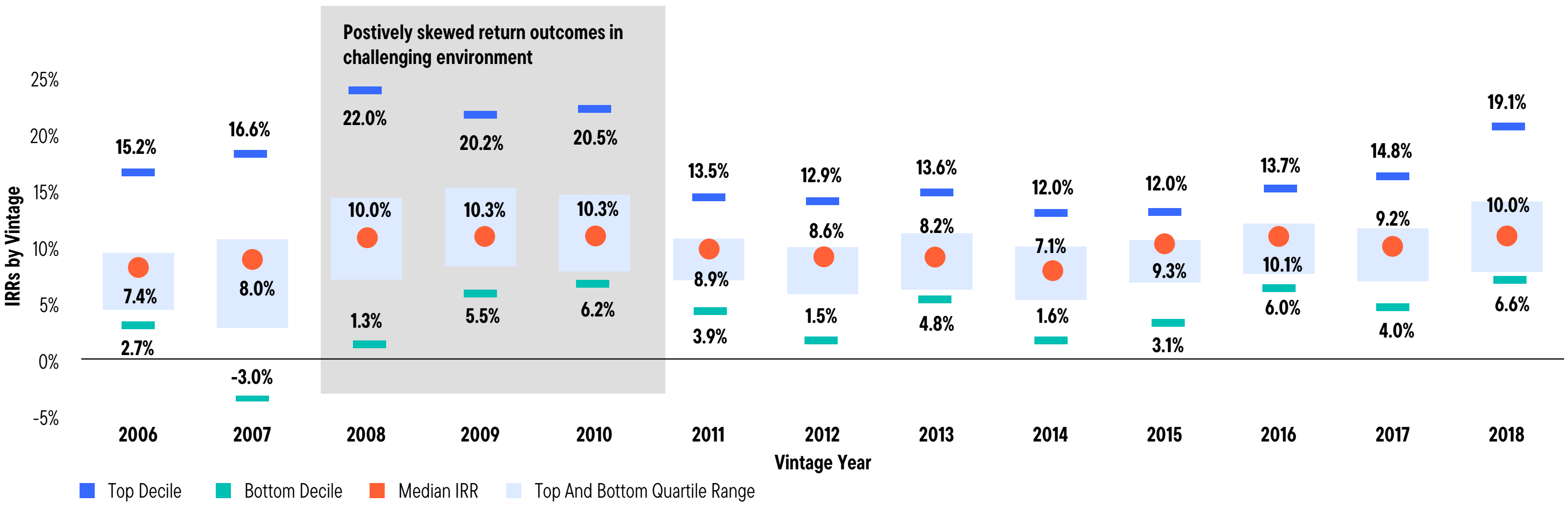
Source: PitchBook, as of 6/30/23.

Reasons for optimism in 2024

With the hangover that was 2023 now easing, many investors are hitting pause and rethinking their allocations for 2024. While private markets investing is a very long-term game, there are certain periods where additional risk taking may be warranted, even if the investment environment appears unhospitable. For example, looking back at the historical returns of private credit funds by vintage year shows that the asset class had the highest level of returns with a significantly positive skew in return outcomes during the GFC years—possibly one of the most difficult macroenvironments in a generation.

2024: A short-term window for long-term opportunity?

Private Credit Funds IRRs by Vintage



Source: PitchBook, as of 6/30/23.

There are reasons for optimism in 2024. While some asset classes like private equity and venture capital may still be on the path to recovery, others are likely to thrive. Investors on the buyside of the private equity secondary market may benefit from a multiyear period of greater supply hitting the market as more LPs and GPs work together to seek liquidity solutions. Private credit is an asset class that has historically proven to be hardwired for hard times. Commercial real estate, while certainly troubled in areas like office, has numerous secular tailwinds propelling specific property sectors and geographies.

After a challenging 2023, we think that institutions who can be a provider of liquidity to others or have the flexibility to deploy additional capital may be able to take advantage of some unique and compelling risk-return opportunities in 2024. In the following pages, we outline the key risks, opportunities, and portfolio implications investors need to know to thrive in today's environment.

Asset class outlooks

Private equity: Stuck in low gear

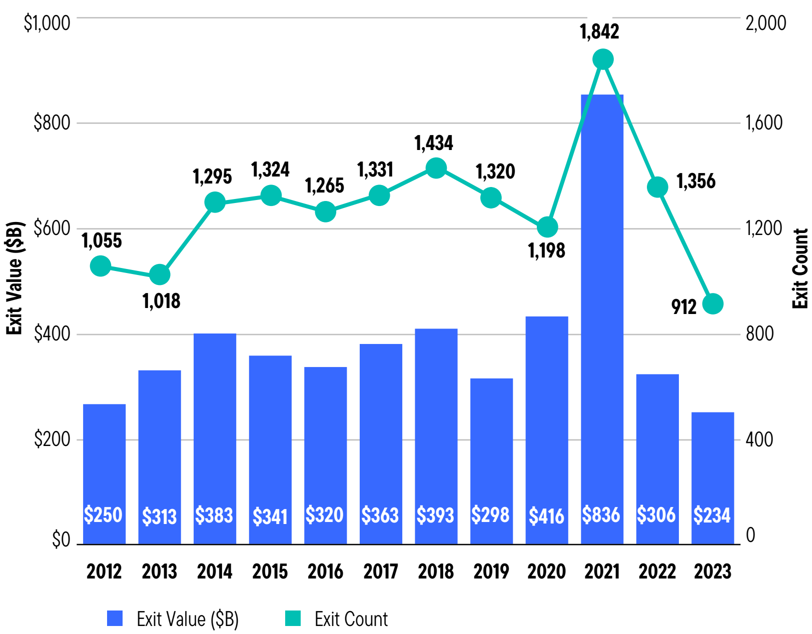
The private market engine slows down

As noted in our 2023 outlook, private equity exits slowed dramatically in 2022, and this trend has since continued. Exit activity is arguably the most important link in the PE chain of capital formation and an indicator of the health of the overall PE market. Exits fuel fundraising and the investment of capital. They also impact the allocation or reallocation of capital across institutions.

Similarly, private equity valuations are just starting to see a retrenchment from their 2021 highs. While lower valuations may create some short-term pain, we believe the combination of more reasonable valuations and the recent recovery in public markets will help spur the IPO and M&A market in 2024.

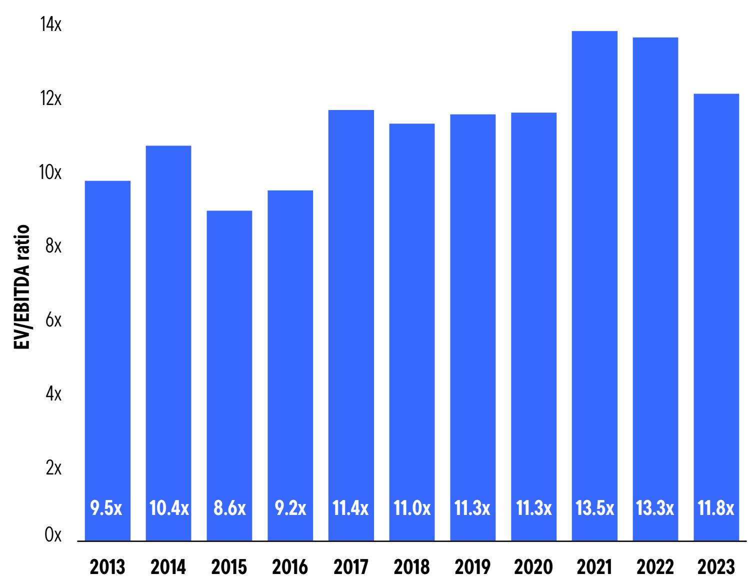
Exit activity has stalled

US PE Exit Activity by Year



Valuations turning over

Median North America PE Buyout EV/EBITDA Multiples



Source: PitchBook, as of 12/31/23.

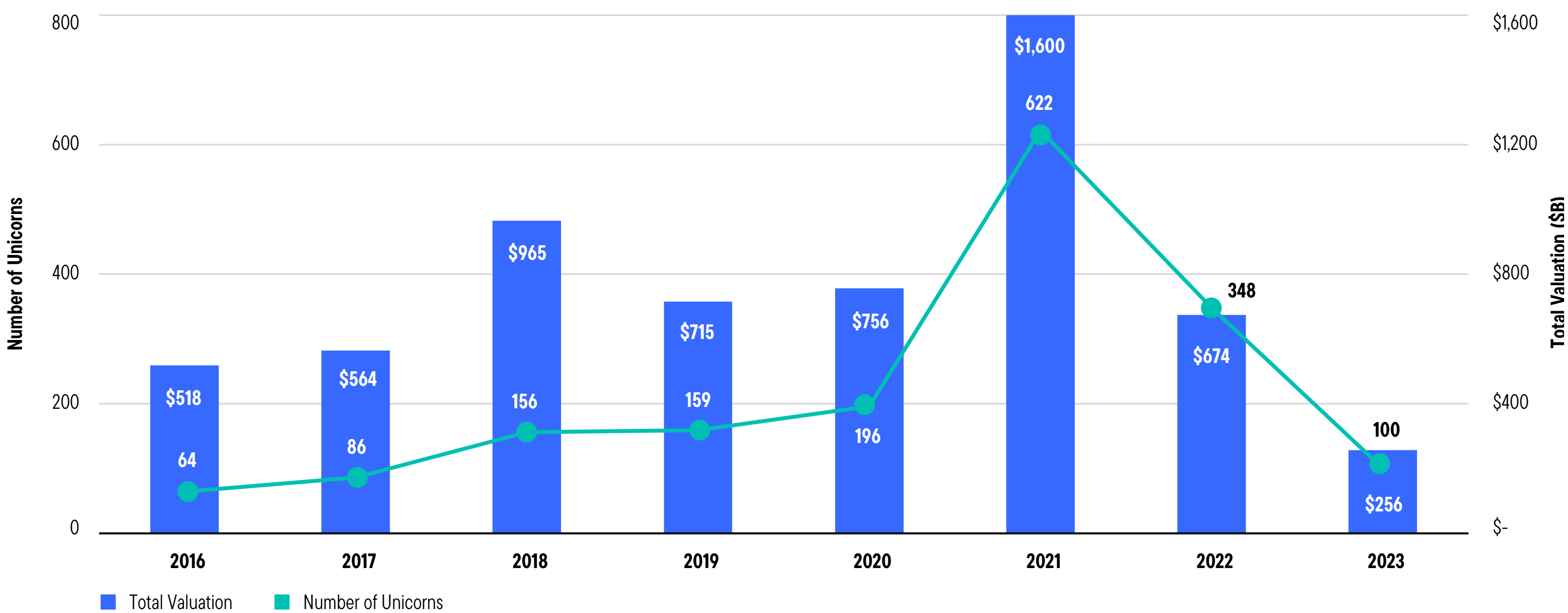
Refocusing on high-conviction ideas when private market beta wanes

The sudden disappearance of new "unicorns," or venture-backed companies valued at more than $1 billion, demonstrates there is a need to reevaluate approaches to venture capital investing. We believe that many asset allocators have built venture portfolios that essentially deliver private market beta because they are allocated to hundreds, sometimes thousands, of companies across industries with the hopes that a few will become unicorns and be able to realize that value through an exit event. In an investment climate where M&A activity and the IPO market are firing on all cylinders, that works quite well, but that is certainly not the case today. The good times of valuation steady markups driving VC portfolio returns have been replaced by markdowns and a more challenging exit environment, leaving asset allocators stuck with limited liquidity.

As in previous environments, and especially in this one, we have maintained that it is critical to gain access to, and build portfolios of, "tier zero" companies. We view tier zero companies as those that are clear leaders in their respective verticals and have a legitimate line of sight to an exit plan. With fewer companies in a portfolio, a VC fund manager can focus on fewer investments and work to become a strategic capital partner that helps in the maturation and pre/post IPO process.

Unicorns are now as rare as... well, unicorns

Pitchbook Unicorn Company Tracker



Source: PitchBook Unicorn Company Track, as of 12/31/23.

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Revisiting blockchain venture investing

While artificial intelligence start-ups have captivated investors' attention recently, the long-term transformational potential of blockchain technology remains strong. Despite the volatility and drawdowns in cryptocurrency markets, blockchain continues to capture attention across multiple industries for its potential to revolutionize how data is stored, verified, and transferred. Potential use cases extend beyond the familiar realm of cryptocurrencies into a multitude of sectors including finance, healthcare, and supply chain management. Futhermore, blockchain may become a vital complement for the adoption of other growing technologies such as artificial intelligence and other business applications of cryptography.

While venture valuations have receded from their 2021 highs and crypto venture deals have slowed dramatically, data suggests the blockchain VC category is on a rebound. Blockchain companies represented 4.7% of total venture deal volume (vs 6.8% at peak) in 2023's depressed market.[1] As such, rather than a demonstration of technological fragility, we see the current market correction as an opportunity to invest at attractive multiples, whereas previous vintages were forced to deploy capital at unsupported and unsustainable valuations.

Blockchain: At the intersection of AI and cryptography

Major Investment Opportunities

1	2	3	4
Regulated traditional finance adopts blockchain Potential to optimize exchanges, clearing, settlement, and payments. Opportunity to modernize banking operations including enterprise software, customer attribution, lending, privacy, and run-time security.	**Responsible super applications** Blockchain becomes the foundation for a more responsible version of emerging super applications. This enables users to control who sees their data, allowing them to monetize it, while suppliers of services retain access to a repository of human activity enabling them to build optimized models.	**AI is scalable learning and blockchain is scalable trust** Blockchain is the key solution to the growth of generative AI. Blockchain services will enable verification and distribution of source, ownership, and economic rights.	**Disruption of centralized cloud computing** Blockchain and AI are leading to an increasingly federated compute and storage architecture. This move-away from centralized cloud computing will result in the creation of new software services.

Investment implications

Private equity is stuck in low gear. Exit activity which acted as the engine for many investors' private market allocations has slowed significantly. Furthermore, the private equity beta wave that supported this asset class the last few years looks to be over. In 2024, we believe PE portfolios made up of fewer, top tier companies that have a genuine exit plan in place will better fit the needs of institutions who not only seek long-term return potential, but also liquidity in their private market allocations.

PE secondaries: Shifting into high gear

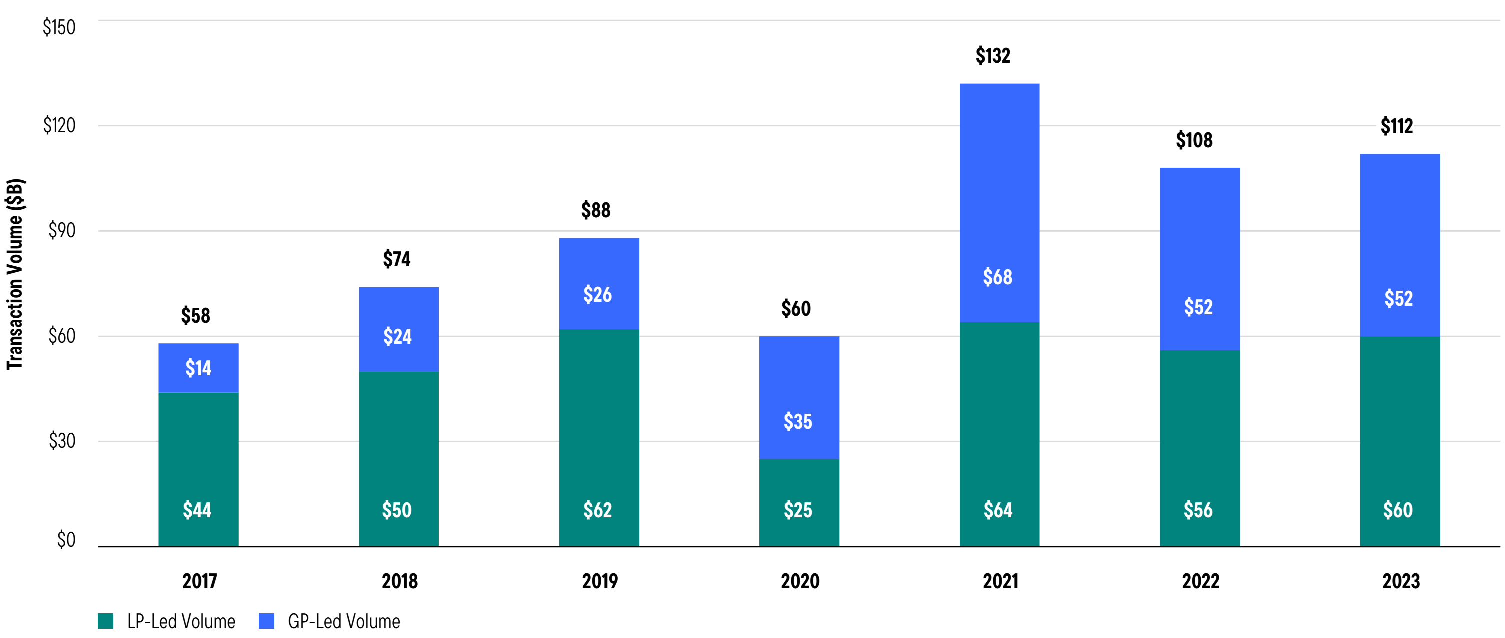
Secondaries activity boosted by slowing exit environment

While PE deals and exits have slowed, secondaries activity has remained robust. 2023 was the third consecutive year in which secondary volume surpassed $100 billion. We expect that the global secondary market will continue to experience significant growth in the years ahead due to the substantial amount of capital committed to private market funds and LPs increasingly embracing the secondary market as an effective portfolio management tool. In addition, the trend of fund sponsors seeking liquidity solutions for their LPs through organized transactions is expected to continue to contribute to significant secondary deal flow.

During times of economic uncertainty and slowing portfolio company exits, the secondary market can be an important release valve to provide liquidity to investors. We believe we're in the early stages of a generational secondary buying opportunity in private markets that will take multiple years to play out.

Secondaries activity remains robust and may be poised to accelerate

Secondaries Transaction Volume ($B)



Source: Jefferies 2024 Global Secondary Market Review, as of January 2024.

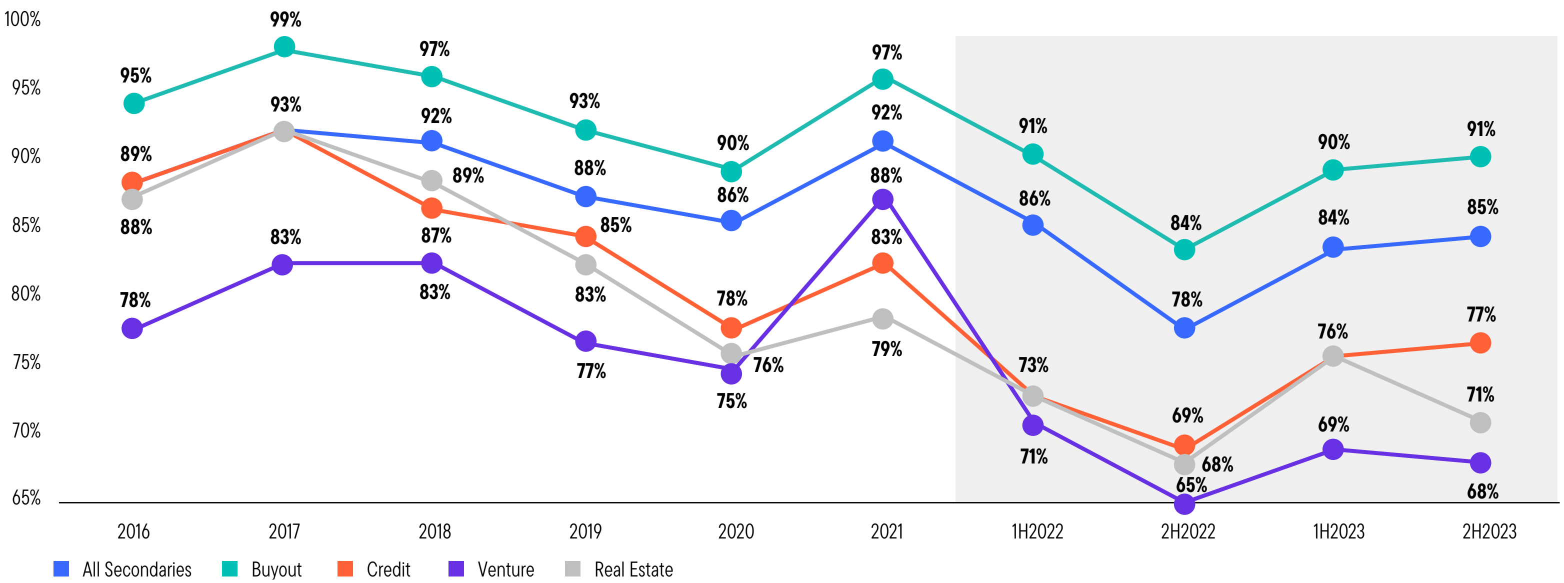
Supply-demand imbalance enables buyside selectivity

In 2024, we think secondary managers will benefit from significant inventory and institutional demand for liquidity—enabling them to choose from broad pools of assets to acquire attractive investment interests at favorable pricing. Given a rise in supply, managers may have greater ability to selectively diversify across stages of development (e.g., VC, growth equity, and buyout), geography, industry, and vintage. With the flexibility to purchase assets closer to their harvest stage, secondary managers can help mitigate the effects of the J-Curve, offering the potential for investors to receive distributions sooner. They can also selectively seek quality, avoiding troubled assets and deploying capital to prized assets.

2022's plunge in secondary pricing provided many opportunities to acquire companies at a deep discount, but it also potentially depressed activity as sellers waited for better timing. In 2023, prices rebounded, leading to increased deal flow. In 2024, we expect volumes to continue to rise but we still believe we will see high-quality assets available at a discount as more favorable pricing lures more sellers back to the market. However, the discounts in the secondary market should not overshadow the quality of the underlying asset being acquired. Secondaries, while typically more mature assets, still need a long time horizon to realize their full value. Discounts are certainly additive to total returns, but we believe they should be viewed as a potential source of short-term downside protection, rather than the long-term reason for acquiring an asset.

Volatile secondary pricing expands the investment universe

Secondary Pricing for LP Portfolios (%NAV)



Source: Jefferies 2024 Global Secondary Market Review, as of January 2024.

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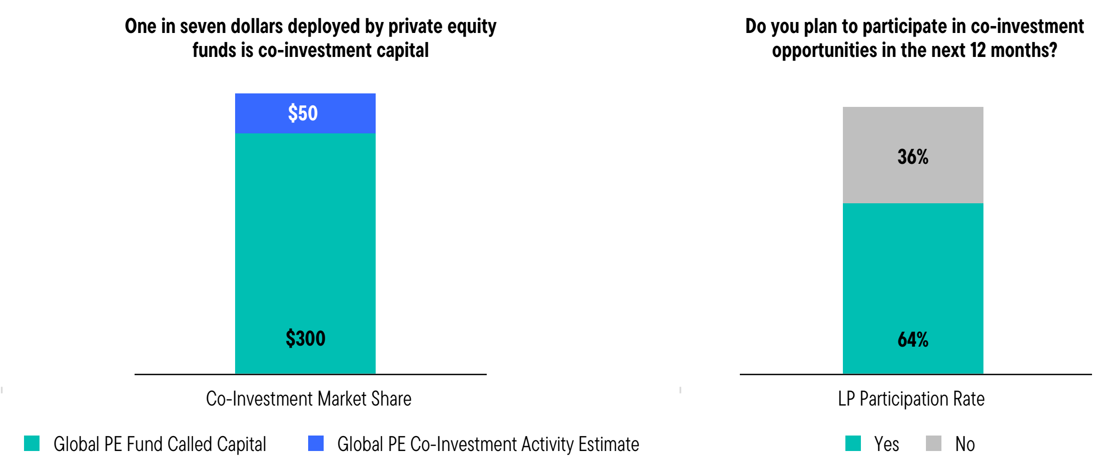
The expansion of the co-investments market

Approximately one in seven dollars deployed by private equity funds is co-investment capital. A co-investment is a passive, minority equity investment in a company made directly by an LP alongside a PE fund investment, which helps the LP save fund fees on a portion of the capital committed. Co-investments are usually done by the largest institutional investors that have strong GP relationships and staff with industry and dealmaking expertise. In 2024, we expect growing interest in co-investments from both well-resourced institutions and from a broader universe of institutions with less experience in co-investing.

Increasingly we have seen interest in the co-investment "club" approach, where a group of LPs partner together with an investment manager to build a portfolio with shared stakes in a number of co-investment opportunities. Collectively, the club of LPs can use the resources of the experienced investment manager to negotiate and deploy capital for co-investments, help expand their GP relationships, and access a higher volume of deal flow. Furthermore, the investment manager can help access a wider spectrum of investment options beyond merely mega caps—where co-investments have been concentrated historically—but also from mid and small cap opportunities that can improve the liquidity and diversification profile of the co-investment portfolio.

Co-investments are growing in popularity

Co-Investment Market Size and LP Participation Rate



Source: Cambridge Associates, Private Equity International's LP Perspectives 2024 Study.

Expect more innovation as the secondary market evolves

Like other private market asset classes, the secondary market has continued to evolve as more institutions have become active in the space. Over the past several years there has been a stratification in secondary markets into three primary types of transactions: LP-led, GP-led, and structured equity. While traditional LP-led activity will likely grow, we believe the slowing exit environment presents an opportunity for secondary managers to innovate in both GP-led continuation and structured equity transactions.

In GP-led continuation transactions, the GP leads the sales process that can benefit both the LP and GP. Essentially, the LPs need liquidity and want to raise funds from the asset, and GPs want to continue to manage the asset to fully realize the value of their portfolio company. For secondary managers, this presents an opportunity to acquire high-quality assets that are essentially "trapped" in fund vehicles, selecting only the individual assets they want, not a share of the broader PE portfolio.

In hybrid solutions, like structured equity transactions, secondary managers can target the best-in-class assets and source and structure the transaction to provide liquidity to LPs without the LPs having to potentially sell their assets at a loss like in a traditional LP-led transaction. Structured solutions can come in many different forms and include a variety of custom credit and equity agreements. For example, a secondary manager employing a structured equity approach may offer LPs the opportunity to transfer their private market portfolio into a new vehicle. In this arrangement, the LP maintains ownership from the GP's perspective, but the secondary manager pays the LP a portion of the assets' net asset value (NAV). The secondary manager takes over the administration and capital calls of the funds going forward and retains the distributions from the acquired assets until it achieves a minimum return. Once the secondary manager reaches the minimum return, the LP will then participate in the remaining upside of these assets. Furthermore, the secondary manager also receives an equity share in the assets, providing them with further upside as well.

Investment implications

We envision a significant ramp in the use of **private equity secondaries** as a portfolio management tool as well as a growing marketplace to find compelling investment opportunities. Private market investments represent over $10 trillion in assets, yet annual secondary volume hovers around $100 billion—creating substantial potential for further growth. With traditional exit activity slowing dramatically, we continue to see high-quality assets and portfolios of assets available for sale at attractive valuations.

Private credit: A resurgence in a new rate regime

Rates reset sets the stage for a new growth cycle

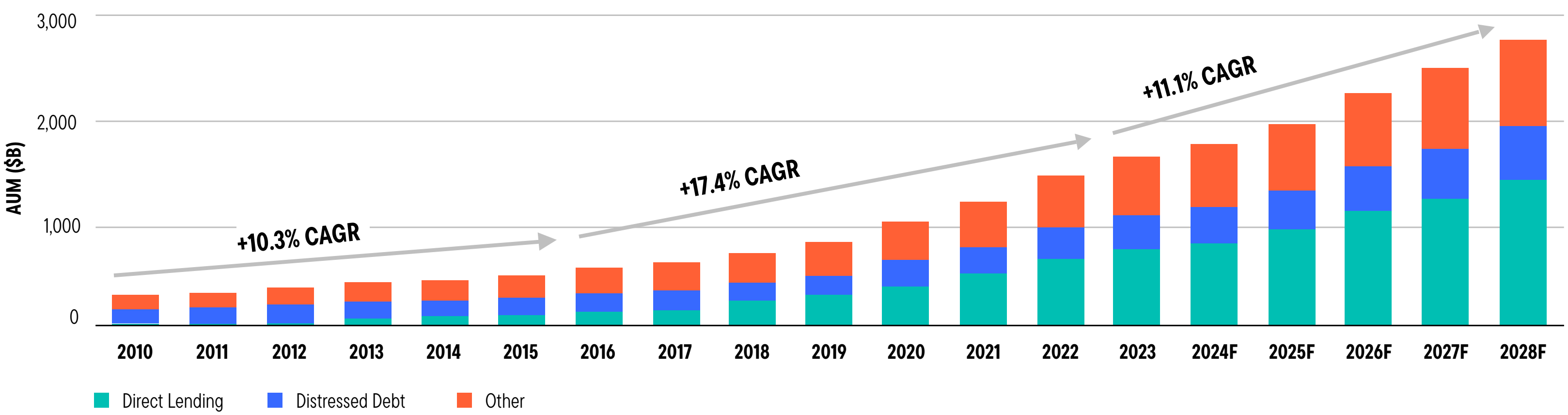
After a prolonged regime of cheap debt and loose lending standards, 2023 saw a shift in negotiating power from borrowers back in favor of private lenders. Adding to lender power was the dramatic pullback in traditional banks' liquidity in the middle market, as the collapse of Silicon Valley Bank and other regional banks reduced their appetite for risk taking. At the same time, higher base rates, even those that settle back down to the 2-4% range, may have a profound impact on middle market corporate borrowers. Over the past decade, many were playing the "amend and extend" game, where refinancing with cheap debt kept their businesses operating without the need to address long-term debt issues. But that may no longer be the case, as debt loads can no longer be rolled over so cheaply.

In 2024, we believe these new macro dynamics will set up the private credit market for growth for many years to come. At the end of 2023, private credit investments accounted for more than $1.5 trillion in assets under management (AUM). Looking longer-term, Preqin expects private credit to be one of the fastest growing private asset classes over the next 5 years, reaching $2.8 trillion in AUM by 2028 and growing 11% per year.

While current market dynamics should benefit the entire asset class, we also think there will be a resurgence in more niche private credit sectors outside of the dominant direct lending space. Smaller, more opportunistic strategies that thrive in distressed lending environments like special situations and commercial real estate lending may see fertile opportunity sets as many debt-saddled companies and properties need solutions.

Private credit could grow to $2.8T by 2028

Global Private Debt AUM by Strategy Type



Source: Preqin, 2024 Preqin Alternatives in 2028, as of January 2024.

Special situations investing and the need for capital solutions

A pullback of traditional lenders comes at a time when a $1.3 trillion wall of debt is scheduled to mature in the next four years. Furthermore, higher base rates will make the typical "amend and extend" process that was common in the ultra-low rate environment no longer an option for some companies coming under stress.

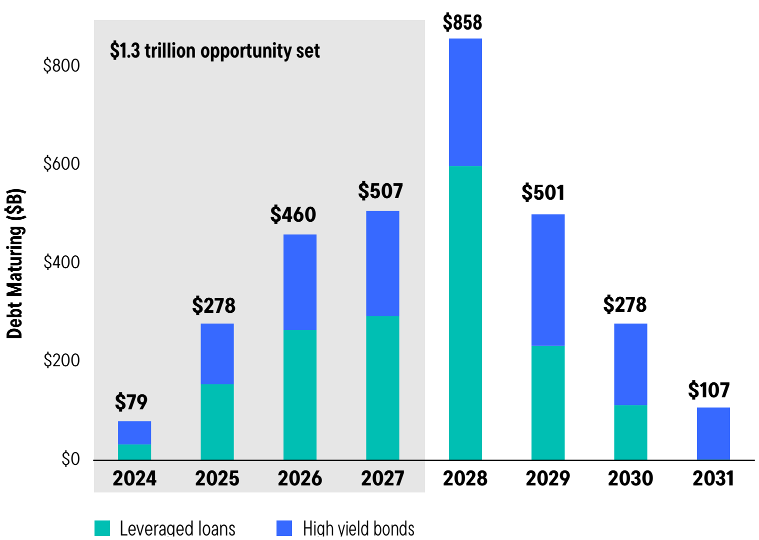
Many challenged middle market companies must go down a different path to extend their runway and avoid the value-destroying process of bankruptcy in this environment. This opens a new avenue for private lenders to provide creative capital solutions to "good companies" with "bad balance sheets" in a market where these types of opportunities were previously scarce.

Unlike other distressed debt market cycles of the past, the current landscape is highly diversified and not dominated by the typical cycle-sensitive players like energy and industrial companies. In fact, many distressed issuers are in "defensive" industries, such as healthcare, technology, telecommunications, and cable/satellite.

The healthcare sector, for instance, presents an outsized opportunity in this space due to various pressures coming to head. The healthcare sector represents over $44 billion in distressed debt issuance. The industry saw aggressive private equity activity in staffing, home health, and hospice subsectors amidst the exuberance of the past several years. Now, profits and cash flows are being squeezed by higher financing costs, elevated fixed costs, rising wage pressures, and regulatory complications. Many companies are being temporarily challenged by these confluence of factors—further underscoring the need for near-term creative financing solutions.

A $1.3 trillion wall of debt coming due in the next 4 years

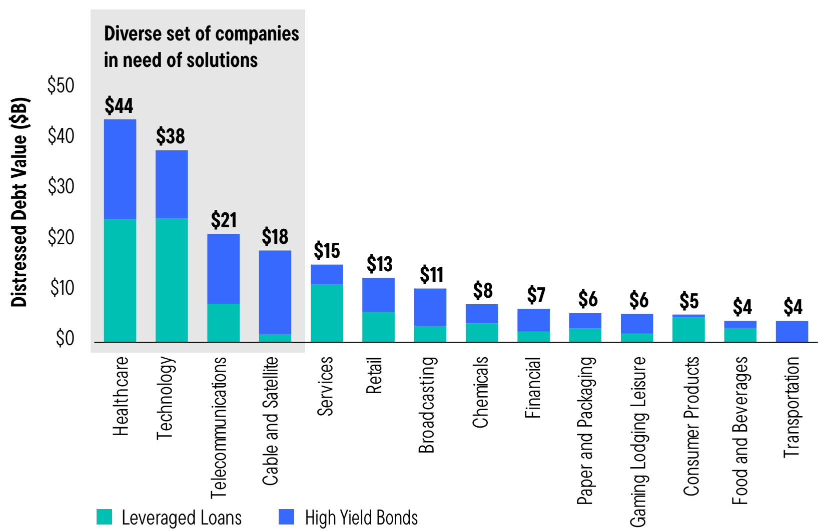
Value of High Yield and Leveraged Loan Debt Maturing by Year



Source: JP Morgan US High Yield and Leveraged Loan Strategy, S&P HIS Markit. As of October 10, 2023.

Many "good business, bad balance sheet" opportunities across sectors

Total Distressed Bonds and Loans Amounts by Industry



Source: JP Morgan as of October 2023. Distressed debt is defined as capital structures with high yield bonds or leveraged loans in excess of $100 million nominal value, trading at or above a 10% yield to maturity.

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Preserving value through capital solutions

There has been a major evolution in how to potentially generate value when capital restructuring is necessary. Previously, bankruptcy was seen as the standard procedure. However, the bankruptcy process has become an increasingly unattractive path for value preservation. It has become time-intensive, costly (bankruptcy legal costs have risen 40% in the last 7 years), recovery rates are near historic lows (only 40-65% for first-lien loans), and the reputational damage can be long-lasting.[2,3] In our view, creative capital solutions at early signs of potential distress can help companies preserve value and avoid the drawbacks of bankruptcy.

While some middle market companies may be able to negotiate with exiting lenders to refinance current debt agreements, others may need more creative solutions from new lending partners in the form of deleveraging through junior capital, enhanced collateral agreements, or liability management solutions.

For example, dropdown transactions can provide funding for a company by moving specific collateral into a new unrestricted subsidiary and raising capital that is secured by those assets. Priming capital transactions can have the company issuing new super senior secured debt to raise funds, with agreements from the majority of other lenders. Double DIP transactions can use the company's available debt capacity to provide a single loan with two separate claims against the creditors' assets. All these bespoke methods can help middle market companies avoid bankruptcy and extend their runway, while at the same time potentially providing equity-like returns for private creditors.

A new playbook in capital solutions

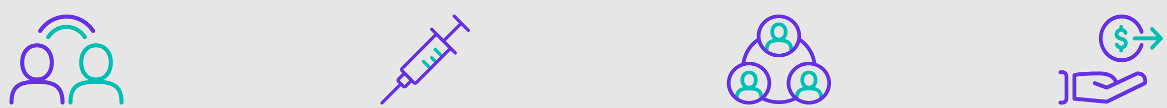
Examples of Private Credit Capital Solutions

1 Amend & extend

2 Junior capital

3 Enhanced collateral

4 Liability management



Negotiations with existing lenders

Sponsors injections
Third-party capital

Dropdown transactions
Priming capital
Double DIP

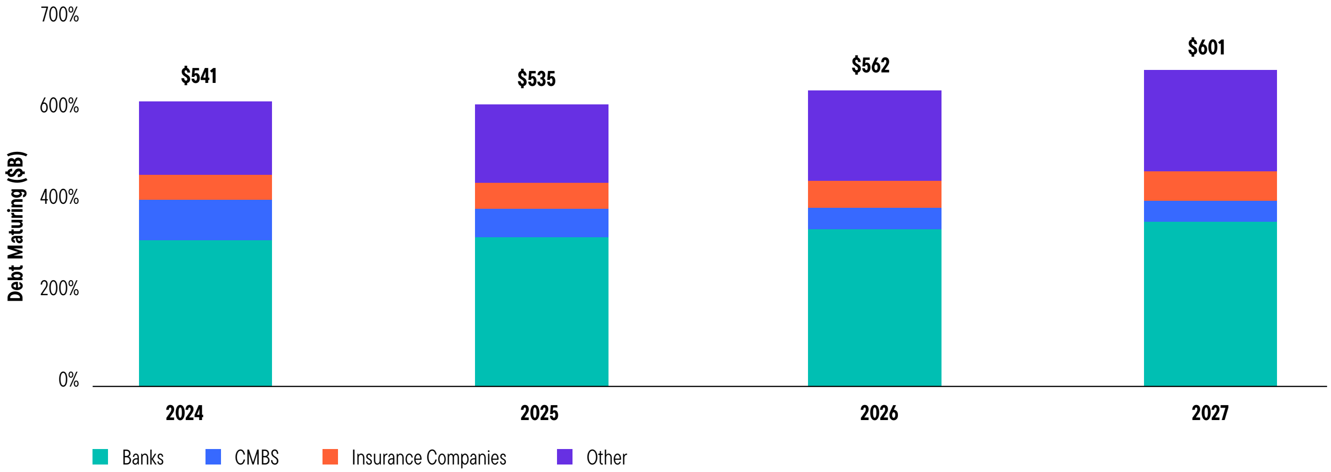
For illustrative purposes only.

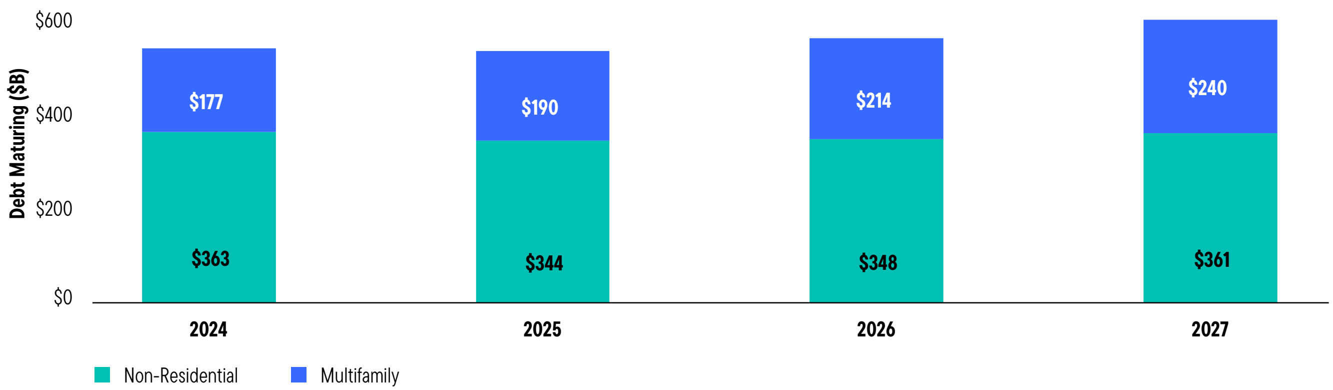
Commercial real estate debt hits a (maturity) wall

Investor sentiment toward commercial real estate is weak, attributable to a host of challenges. With $2 trillion of low-interest real estate loans set to mature over the next four years, borrowers will be required to refinance amid a higher rate environment. Regional banks have historically been large lenders to CRE, and in the face of increased capital reserve requirements, it is expected that they will significantly pull back, creating a large void for borrowers seeking real estate refinancing. Furthermore, other non-bank lenders, such as mortgage REITs, have slowed the deployment of capital as they are reserving capital for potentially troubled assets in the future, specifically for legacy office loans.

$2 trillion of real estate debt needs to be refinanced in next 4 years, but traditional lenders backing away

Total Commercial Real Estate Loan Maturities by Lender and Property Type ($B)





Source: Trepp, Q2 2023. Other category is primarily comprised of multifamily lending by Fannie Mae and Freddie Mac. This could also include finance companies (private debt funds, REITs, CLOs, etc.), pension funds, government or other sources.

Focus on multifamily property lending

We believe this confluence of events adds up to a ripe opportunity in private real estate debt dealmaking. We are in the very early stages in the repricing of commercial properties that we think could take 18–24 months in total. While many troubled sectors like office will see the least competition from lenders, it should be approached with considerable caution, as their future valuations are highly unpredictable at this time. However, other healthier sectors like multifamily properties may see reduced financing options as well, opening the door for private lenders.

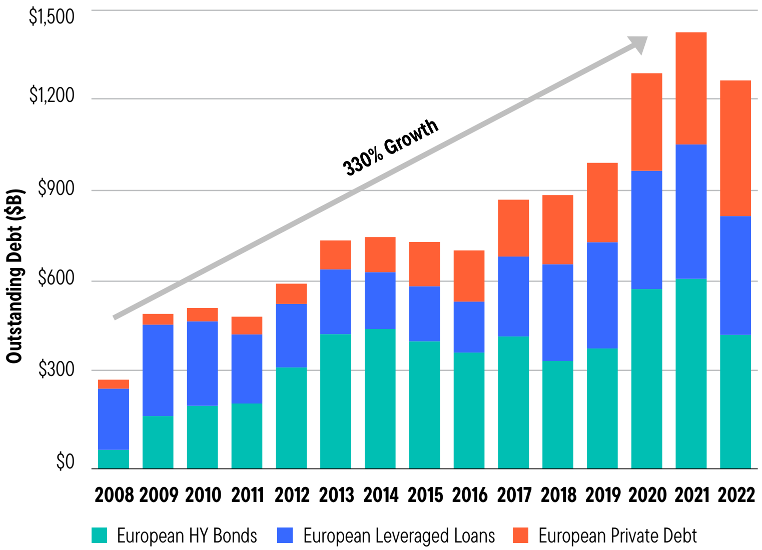
Furthermore, multifamily has some structural advantages over other commercial property types that make it more appealing during times of stress. In the US, because of the government mortgage agency model, there is additional built-in liquidity in the asset class that other sectors do not have. Additionally, in today's environment, we believe there is some embedded downside protection when investing on the debt side of commercial real estate. To build in a buffer against further market volatility, we favor underwriting multifamily properties that have already seen 10–20% decline from peak valuations and with approximately 70% loan-to-value.

Europe in 2024: The special (situations) guest of honor

We believe now is the time that investors should consider evaluating special situations credit investing in Europe. Like the US, the post-GFC era of ultra-low interest rates fueled an explosion of leveraged finance, with the European sub-investment grade market quadrupling in size to $1.2 trillion. Also similar to the US, this cycle's opportunity set is unique in that it is broadly diversified across a wide range of geographies and sectors. Furthermore, the distressed market size may be two times larger than any market we have observed since 2000. While market activity has been muted during 2023 across geographies, an attractive pipeline is building in 2024. We have seen activity pick up in sectors such as business services, TMT, financial services, and healthcare. This is occurring against a backdrop of lower bank lending across all regions.

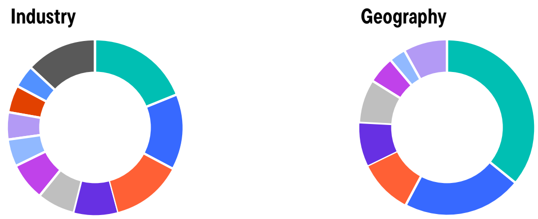
European sub-investment grade credit has quadrupled since GFC

Value of European Bonds and Loans



Distressed debt is diversified across sectors and 2x the average size since 2000

European Distressed Debt Breakdown



Industry	
TMT	19%
Financials	14%
Retail	13%
Real Estate	8%
Business Services	7%
Industrials	7%
Healthcare	5%
Technology	5%
Oil & gas	5%
Gaming	4%
Other	13%

Geography	
UK	36%
France	22%
Germany	10%
Netherlands	8%
Sweden	8%
Luxembourg	5%
Norway	3%
Other	8%

Source: Private Debt: Preqin, European Data retrieved as of December 2022. Private Debt includes Direct Lending (Senior, Unitranche, Blended/Opportunistic, Junior/Subordinated, Mezzanine), Private Debt Fund of Funds, Distressed Debt and Special Situations. Leveraged Loans: Market Value of Credit Suisse Western European Loan Index, High Yield Bonds: Market Value of ICE BofA Euro High Yield Bond Index. Distressed debt is defined as capital structures with high yield bonds or syndicated loans in excess of €100 million nominal value, trading at or above a 12% yield to maturity.

Why special situations is different in Europe: White lists

One of the key differences between European and US leveraged loan markets is the prevalence, in Europe, of white lists, which restrict the transfer of leveraged loans in the secondary market to a select group of buyers. The goal is to prevent lenders who are perceived to be borrower-unfriendly from entering syndicates, thereby reducing the likelihood of lenders seeking to take over companies. While white lists have been a feature of European loan documentation for some time, they've become more prevalent, broader and more restrictive in recent years, as a decade of benign credit conditions and ultra-low interest rates appeased the concerns of many lenders.

Today, as lending restrictions tighten, asset prices fall, and the credit environment grows more volatile, we believe the existence of white lists can limit market liquidity at exactly the wrong time, preventing incumbent lenders from exiting readily, and reducing the number of parties able to buy into deals. The effect is to artificially depress transaction prices and to prolong restructuring processes by adding complexity and, in many cases, making loans more illiquid. For those investors that appear on such white lists, the effect is to reduce competition for assets in the secondary market, and to lower the entry point into the deal.

Investment implications

Private credit is ready for a resurgence as the new regime shifts negotiating power back in favor of private lenders. We think niche opportunities such as commercial real estate debt and US and European special situations investing are best positioned to benefit from the combination of looming maturity walls and the pullback of traditional bank lenders.

Commercial real estate: Alternatives amidst the "office apocalypse"

A shifting landscape provides compelling and diversified opportunities

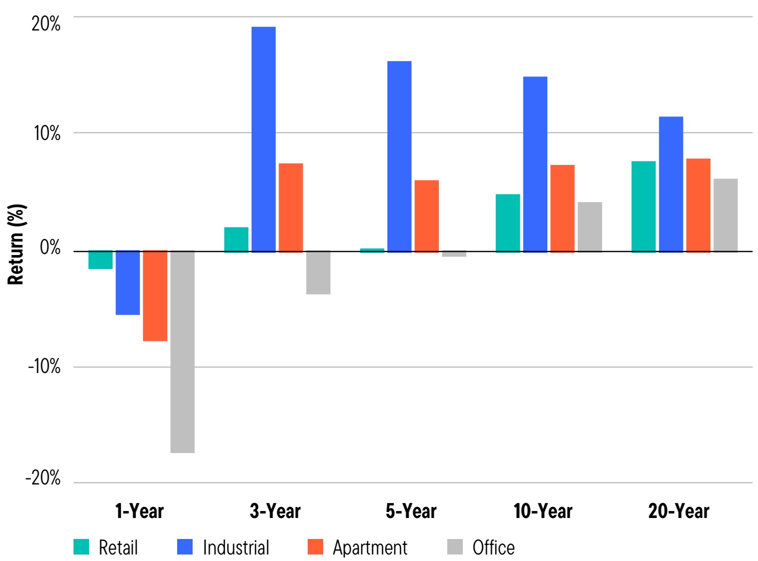
Commercial real estate (CRE) was in the headlines for much of 2023, with the office sector garnering most of the press. We believe the office sector's challenges will continue throughout 2024, but CRE is more than just office.

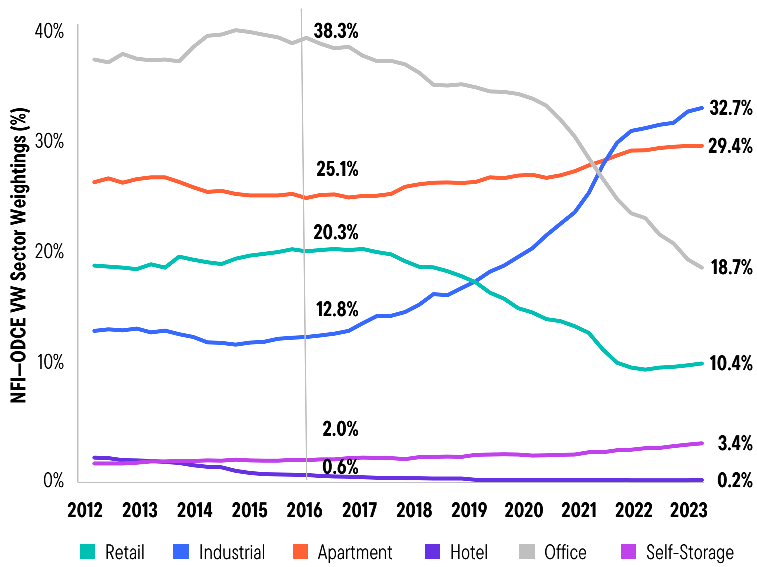
In fact, CRE portfolio allocations have shifted significantly over the years. Office, once the largest sector, has fallen sharply to 19% of the benchmark (down from nearly 40%); while industrial, a top performing sector is now up to 33%. Other property types like multifamily, self-storage, data centers, and student housing, for example, have become a much larger part of the real estate investable universe.

Looking ahead, we believe that certain themes and structural shifts will provide long-term investors with meaningful investment opportunities.

Sector performance dispersion has significantly changed CRE market composition

Sector Returns and Index Weights Over The Past 10 Years





Source: NCREIF, Clarion Partners Investment Research, as of Q4 2023.

Macro themes greatly influence investment potential

We believe there are five broad macro themes that will impact demand for CRE in the years to come: demographics, technology, shifting patterns of globalization, housing affordability/shortage, and resiliency. These will provide meaningful structural tailwinds for decades.

The industrial sector will be a large beneficiary of these themes. E-commerce sales are forecast to grow at 5–10% annually over the next decade, continuing to gain market share from traditional retail. More and more consumers will continue to buy goods online, leading to increased long-term demand for fulfillment centers. At the same time, Millennials are entering their peak spending years and rising (and tech savvy) Gen Z is now entering the workforce, which should also bode well for logistics demand.

Multifamily is another growth opportunity, supported by record high for-sale housing prices, household formation, and a healthy labor market outlook. Over the long run, we expect steady demand for rentals due to the ongoing shortage of housing stock overall. Strong pent-up demand from Gen Z and Millennial households is expected to support more institutional-quality rental housing stock. An estimated "extra" five million young adults are now living with their parents because many cannot presently afford a home.[4]

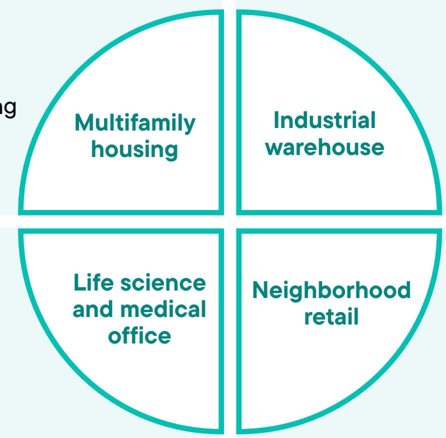
We also believe there is significant opportunity in alternative real estate sectors. Life sciences and medical office properties continue to benefit from aging demographics and innovation, particularly, MedTech. Over the past decade, self-storage has also reported outsized appreciation and net operating income (NOI) growth due to secular demand.[5]

Long-term, high-conviction opportunities overlooked by the "office apocalypse" narrative

Macro Themes Driving Real Estate Sector Performance

Demographics	Technology	Deglobalization	Housing	Resiliency

- Millennials & Gen Z driving differentiated housing demand / next gen cities
- Retiring boomers driving age targeted housing
- Historic low affordability pushing households to renting



- E-commerce growth = warehouse demand
- Higher earning wave of Millennials / Gen Z are driving consumption
- Shifting trade patterns leading to nearshoring and onshoring of manufacturing

- Innovation industries are expanding to new locations
- Aging population drives life science and medical office
- Need for health technology, health informatics, precision medicine

- Millennials / Gen Z entering prime earning and spending years
- Resiliency of grocery & necessity formats
- Technological advancements in omnichannel retail driving demand near consumers

Based on the views of Clarion Partners Investment Research, as of January 2024.

IN FOCUS

Retail is dead, long live retail

Even as Amazon becomes more dominant in logistics, about 80% of retail sales still occur in-store.[6]

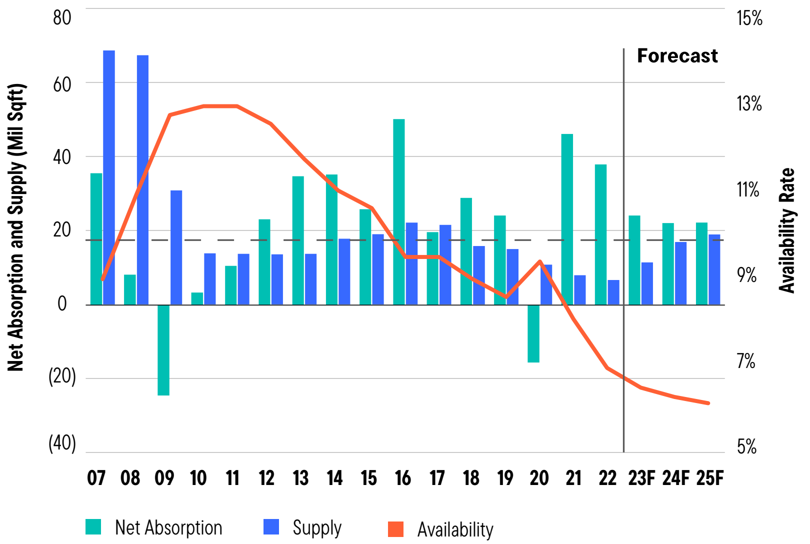
Over the past decade or so, brick and mortar retail has in fact evolved and re-invented itself for the better. Many well-located centers have been re-purposed into open-air and mixed-use formats, which have boosted foot traffic. Also, the right tenant mix is key; in 2023, retailer store openings surpassed closings.

Critical mass, demographics, and location are key factors in retail investor asset selection. We expect that necessity-anchored and lifestyle centers in top trade areas with high levels of spending power and supply constraints will outperform.

Due to the migration of many high-paid workers to more affordable Sun Belt states and other fast-growing secondary metros, "necessity" and grocery-anchored neighborhood retail has seen increasing occupancy since 2020, helping to push rents higher.

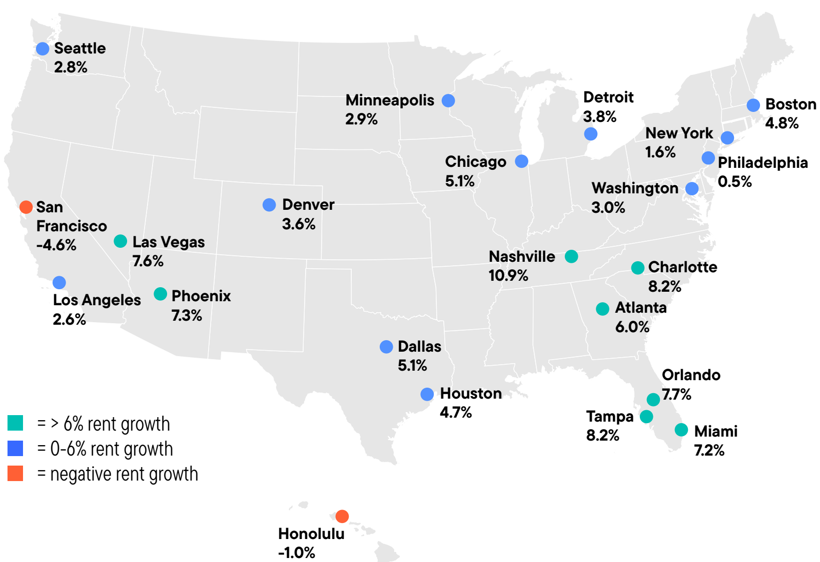
Neighborhood retail has performed surprisingly well

US Neighborhood Retail Net Absorption, New Supply, and Vacancy



Geography matters

Non-Mall Retail Annual Asking Rent Growth



Source: CBRE-EA, Clarion Partners Investment Research, Q3 2023.
Note: Forecast was provided by Clarion Partners Investment Research as of June 2023. Forecasts have certain inherent limitations and are based on complex calculations and formulas that contain substantial subjectivity and should not be relied upon as being indicative of future performance. Past performance is not indicative of future results. Please see the important disclosures at the end of this presentation.

Keeping real estate cycles in perspective

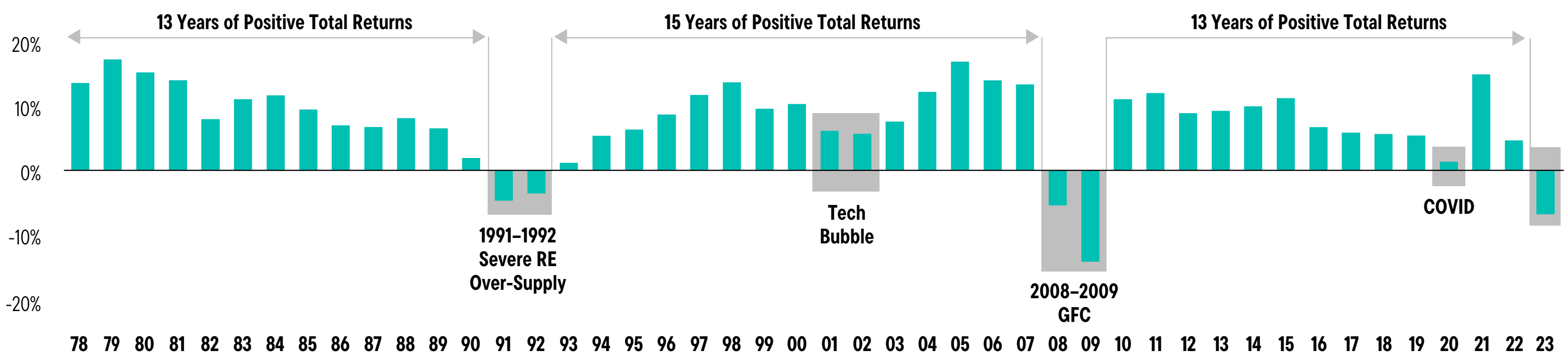
While 2023 was a challenging year for CRE, it is important to maintain a long-term perspective. Over the past 46 years, U.S. institutionally held real estate has produced 41 years of positive returns while averaging approximately 9.0% annually.

Looking ahead, we do expect credit conditions and investment sales activity to improve. Debt capital markets are likely to ease particularly with respect to well-leased, "in-favor" property types. We do expect the outlook to vary by property type, a function of each sector's ability to take advantage of some of these structural tailwinds.

At these inflection times, a thematic approach becomes even more useful in charting enduring long-term investment strategies.

Another bump in the road for long-term commercial real estate investors

NCREIF Property Index (NPI) Total Return by Calendar Year



Source: NCREIF, Bloomberg, Clarion Partners Investment Research, Q4 2023.

Investment implications

While the "office apocalypse" has dominated headlines, it's important to note that **commercial real estate** is comprised of a diverse set of property types. We believe industrial, multifamily, and alternative sectors like life sciences and self-storage represent attractive long-term opportunities that are positioned to take advantage of macro-thematic tailwinds.

Sources and endnotes:

1. Source: Morgan Stanley Research Venture Vision, as of 2023.
2. Source: TheLegal500, ReOrg. Includes data on Delaware and SDNY only. Represents legal costs of top 15 corporate restructuring firms. Average hourly rate for the bankruptcy department of representative firms across all associates, partners, and counsel.
3. Source: JP Morgan Investment Research, Pitch Book, Bloomberg Finance, S&P / HIS Markit; Moody's Investors Service, as of 2023.
4. Source: Census Bureau, Real Page, Moody's Analytics, Clarion Partners Investment Research, as of Q2 2023.
5. Sources: NCREIF, Self-Storage Almanac, Clarion Partners Investment Research, as of Q2 2023.
6. Source: National Retail Federation, 2023 State of Retail and the Consumer Study.

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