A photograph of a blue industrial building with yellow metal stairs and railings. The image is used as a background for the document.

February 6, 2025

# **Global Credit Weekly:**

Some rebuild of risk  
premia

**BlackRock**®

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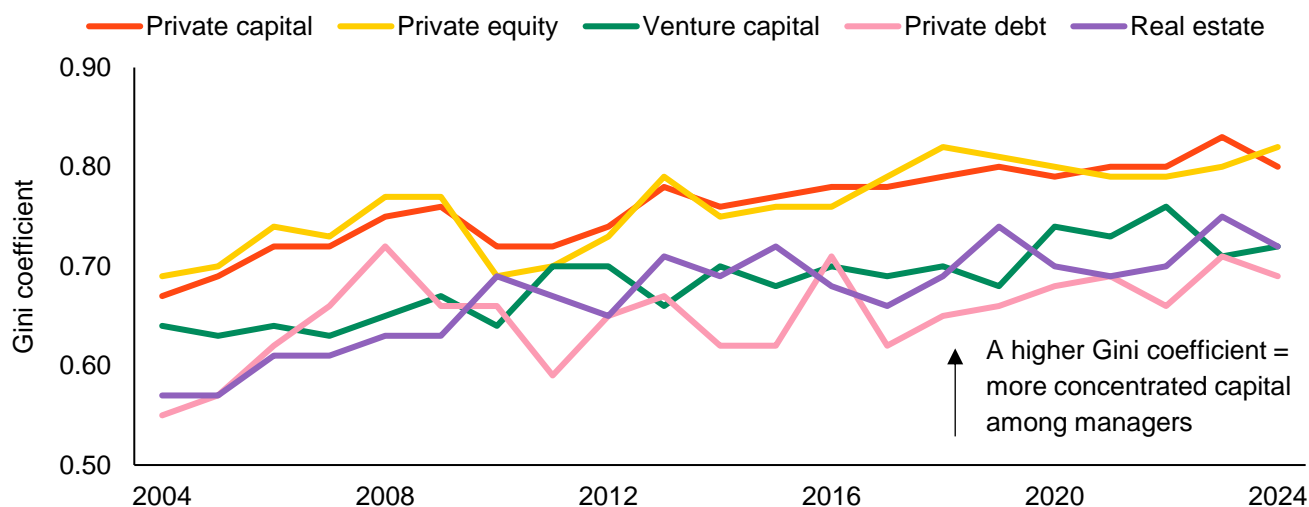
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## Key takeaways

- As our colleagues in the *BlackRock Investment Institute (BII)* highlighted earlier this week, recent U.S. tariff announcements mark a sharp escalation in trade protectionism. While the risk of tariffs had been well-telegraphed, until recently there was significant uncertainty related to their timing, scope and magnitude. Additionally, corporate credit valuations have largely reflected a risk of *targeted tariffs*, in our view. But as we highlighted in our *1Q2025 Global Credit Outlook*, a scenario of broad tariffs with potential retaliation would likely present a mix of headwinds for credit.
- With the trade-related data points from the past few days in hand, we now see risk for more extensive tariffs impacting USD and EUR corporate credit – beyond a targeted approach. We believe this warrants some rebuild in risk premia, and moderately wider spreads over the next few months. That said, the widening we expect is still relatively modest and will leave spreads well below the long-term averages of the post financial-crisis period, reflecting a mix of favorable fundamental and technical factors. Nonetheless, it underscores the importance of granular credit selection and structural protections for corporate credit investors, amid uncertainty.
- In such a dynamic investing regime, market participants have been focused on longer-term structural shifts in asset allocation trends. In this *Global Credit Weekly*, we take stock of some of the high-level patterns, including those involving the broader alternative asset universe. For example, we find that private capital concentration among managers has trended upward over a longer-term horizon (Exhibit 1). We also find that experienced alternative asset managers have captured a larger share of total capital raised in recent years, though to varying degrees across strategies. In our view, this underscores investors' preference for managers with underwriting and restructuring experience, and a broad set of capabilities. We see scope for allocations to private markets, including private debt, to grow further. This is driven, in part, by an expanding investor base, including among insurance and retail investors, as we discuss within.

### Exhibit 1: Allocators value breadth and depth of manager experience

Dispersion of capital across private capital asset classes by fund, measured by the Gini coefficient



Source: Preqin, BlackRock. 2024 is as of October 2024. Distribution of capital across strategies is measured by the Gini coefficient, where 0 is full equality of capital distribution among managers and 1 is where a single manager would have all the capital.

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## Recent tariff signals warrant a rebuild of credit risk premia, in our view

As our colleagues in the *BlackRock Investment Institute (BII)* highlighted earlier this week, recent U.S. tariff announcements involving Canada, Mexico and China (and suggestions of forthcoming tariffs on the European Union) mark a sharp escalation in trade protectionism. They also underscore that tariffs will be a key policy tool for the new U.S. administration. Our colleagues in BII believe 10% tariffs could be the new baseline for the U.S. to earn tax revenue, while 25% tariffs may be used as leverage in negotiations.

And while proposed 25% tariffs on Canada and Mexico were delayed for one month (as of February 3, 2025), the uncertainty overhang nonetheless persists. Also notable, in our view, were swift announcements from Canada and Mexico of planned retaliation, prior to the one month pauses.

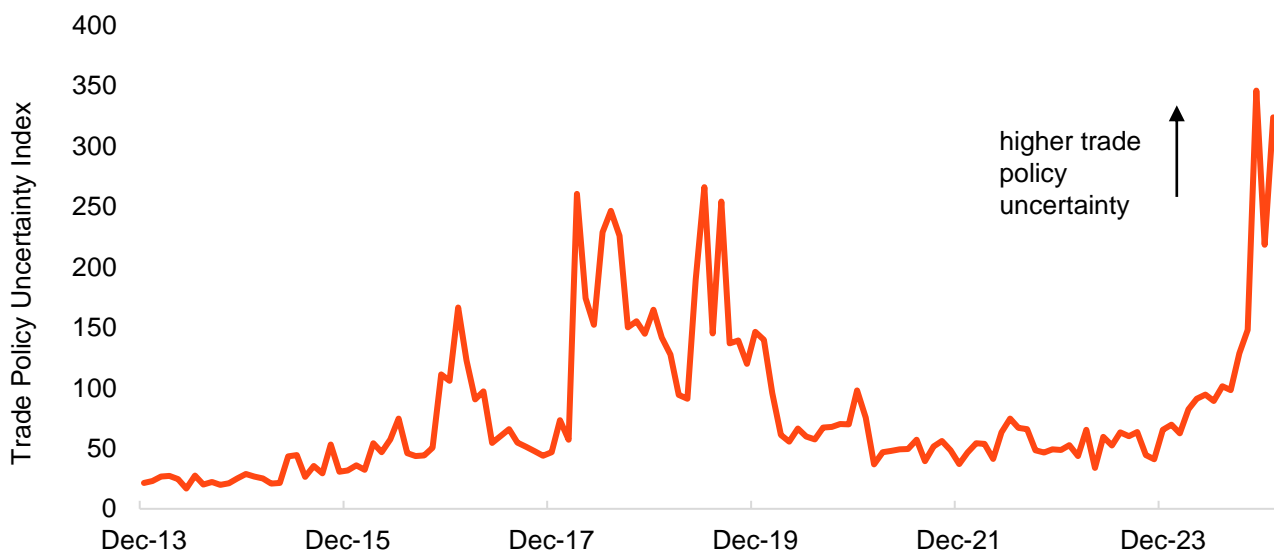
Prolonged, sizable tariffs have the potential to weigh on U.S. and global growth, alongside corporate and investor confidence. They may also add to U.S. inflation, which has already struggled to return to the Federal Reserve's 2% target. This could have a negative impact on USD and EUR corporate credit valuations, and, in our view, warrants some rebuild of credit risk premia, as we discuss later. That said, the ultimate impacts will be highly variable and will depend on any specific product exclusions, elasticity patterns in each category, and any available substitutes. The net impact will also need to be considered in the broad context of other policy priorities, which may influence the growth backdrop.

The risk of tariffs had been well-telegraphed, owing to the policy priorities highlighted by the new U.S. administration over the past few months. That said, until recently there was significant uncertainty related to their timing, scope and magnitude. Additionally, corporate credit valuations – which still feature index-level credit spreads at the tight end of the historical ranges (Exhibits 4 and 5) – have largely reflected a risk of *targeted tariffs*, in our view. Indeed, as we wrote in early January, corporate credit valuations for tariff-exposed goods sectors were not reflecting a material risk of across-the-board tariffs. Also noteworthy has been the robust activity in the USD IG and HY corporate credit new issue markets this week, despite some asset and headline volatility.

With the trade-related data points from the past few days in hand, we now see risk for more extensive tariffs impacting corporate credit markets – beyond a targeted approach. And as we highlighted in our 1Q2025 Global Credit Outlook, the risk of broad-based tariffs accompanied by retaliatory tariffs – if such a situation were to materialize – poses a unique set of downside risks to corporate credit.

### Exhibit 2: Trade policy uncertainty has moved higher following the U.S. election

Trade Policy Uncertainty Index (measured monthly)



Source: Haver Analytics, BlackRock. Captures data through January 31, 2025 (most recent as of February 5, 2025). The Trade Policy Uncertainty (TPU) Index is based on automated text searches of the electronic archives of seven newspapers: Boston Globe, Chicago Tribune, Guardian, Los Angeles Times, New York Times, Wall Street Journal, and Washington Post. The measure is calculated by counting the monthly frequency of articles discussing trade policy uncertainty (as a share of the total number of news articles) for each newspaper. The index is then normalized to a value of 100 for a one percent article share. Developed by Dario Caldara, Matteo Iacoviello, Patrick Molligo, Andrea Prestipino, and Andrea Raffo.

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A potential scenario of large, sustained, and broad tariffs – coupled with retaliatory tariffs – could weigh on corporates' input costs and profit margins, beyond a “one time” upward price level shock. It may also shift consumer consumption patterns, based on the elasticity of the good(s) affected.

Depending on the severity of any input cost pressures, we see a risk that some corporates may look to reduce headcount as a tool to protect margins. So far, U.S. corporate layoff activity has been muted, as characterized by an unemployment rate which remains low by historical standards (4.1% as of December 2024) alongside similarly contained levels of jobless claims. This low layoff activity has helped keep aggregate U.S. consumer spending resilient.

But if layoffs were to accelerate, the weakness in the U.S. consumer – which is currently confined to the low-income cohort – has the potential to expand more broadly. And because consumer spending represents two-thirds of U.S. GDP, a deterioration in consumers' financial health has the potential to weigh on U.S. economic activity. Credit spreads – which are sensitive to the growth backdrop – could move wider as a result, depending on the severity of any economic decline. Dispersion is also likely to remain elevated in such an environment.

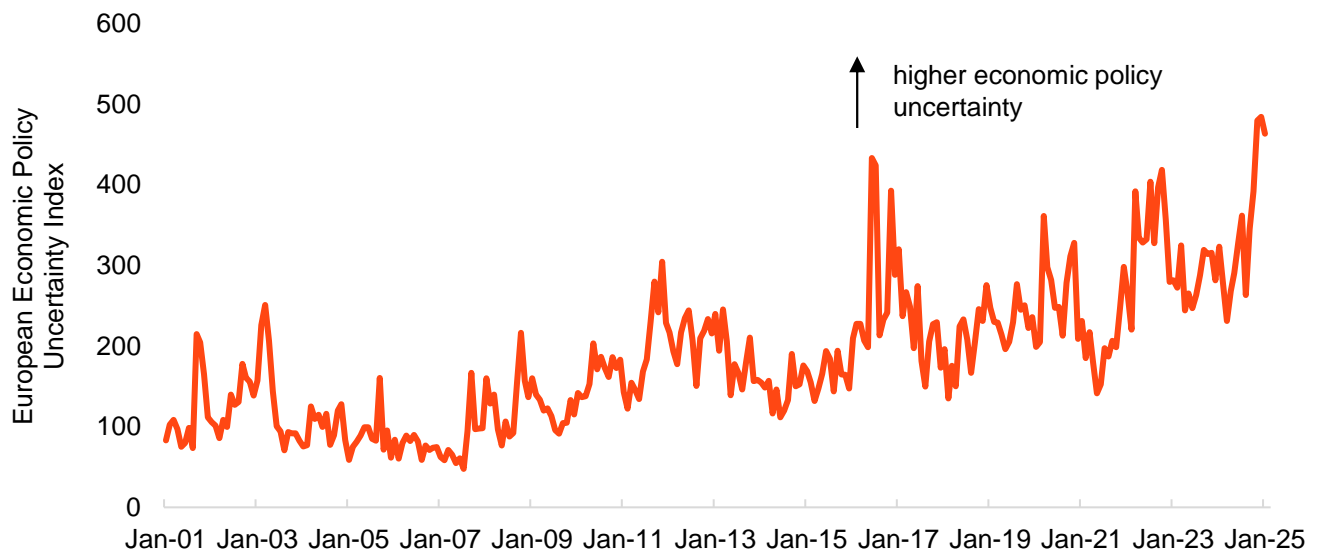
Additionally, and as we've also discussed previously, the mere presence of trade *uncertainty* – before the implementation of any actual tariffs – can also negatively impact business investment. This risk is especially relevant to monitor in export-oriented economies such as the Euro Area, as a November 2024 analysis from the European Commission showed.

### Quantifying the potential adjustment

As a result of these potential headwinds and the elevated uncertainty, we believe some rebuild of risk premia in USD and EUR corporate credit markets is warranted over the next few months, in the form of wider spreads. For the USD market, our base case is for approximately 10-15bp of spread widening in IG, and 30-40bp of spread widening in HY. This would bring index-level spreads to the 95-100bp and 300-310bp areas, respectively, using the ICE-BAML USD IG and HY Corporate indices. It would also keep the USD HY / IG option adjusted spread (OAS) ratio relatively constant, at 3.2x. Absent a sharp downturn in growth, we do not expect material decompression, owing to fundamental and technical factors.

### Exhibit 3: Economic policy uncertainty presents a downside risk to Euro Area investment

European Economic Policy Uncertainty Index



Source: Haver Analytics, Economic Policy Uncertainty Index developed by professors Scott Baker, Nick Bloom, and Steven Davis (more details on methodology can be found at: [PolicyUncertainty.com](http://PolicyUncertainty.com)), BlackRock. Captures data through January 31, 2025 (most recent available as of February 5, 2025). The European Economic Policy Uncertainty (EPU) Index is based on news articles from two newspapers from each of the five largest European economies: France: Le Monde, Le Figaro; Germany: Handelsblatt, Frankfurter Allgemeine Zeitung (FAZ); Italy: Corriere della Sera, La Repubblica; Spain: El Pais, El Mundo; UK: Financial Times, The Times of London. The number of news articles containing the terms uncertain or uncertainty, economic or economy, and one or more policy-relevant, such as policy, tax, spending, regulation, central bank, budget and deficit terms are counted. All news searches are done in the native language of the paper in question. Each paper-specific series is normalized to standard deviation 1 prior to 2011 and then summed. The series is normalized to a mean of 100 prior to 2011.

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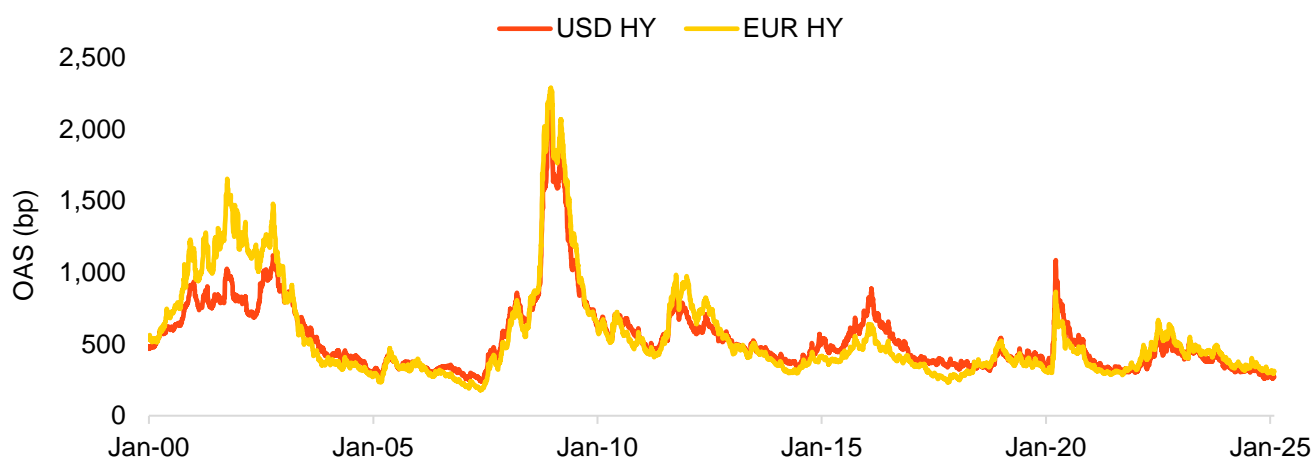
Notably, these base-case estimates of wider spreads would still leave USD IG and HY index-level spread metrics well below the post-financial crisis averages of 139bp and 467bp, respectively. This reflects our expectation that even if U.S. growth slows from the current level (2.9% as of February 5<sup>th</sup>) it will likely remain at or above trend. It also reflects the impact of the favorable technical backdrop in credit.

We see scope for incrementally more widening in the EUR IG and HY markets, owing to the region's more pronounced downside risks to growth (as the recent ECB press conference acknowledged). That said, and as we discussed in late 2024, a range of factors may keep the incremental widening – and any resulting underperformance relative to USD peers – contained. These include: (1) the European Central Bank's historical precedent of intervening as a purchaser of corporate credit during periods of market volatility; (2) the smaller size of the EUR credit market, relative to the USD universe, which has likely translated into a technical tailwind; and (3) an “up-in-ratings” tilt that is visible within the EUR HY index.

Additionally, EUR IG and HY credit already trades somewhat wide to its USD peer (Exhibits 4 and 5). For now, we are penciling in 15-20bp of widening for EUR IG and 45-55bp of widening in EUR HY. This would bring index-level EUR IG and HY spread metrics to the areas of 110bp and 360bp, respectively, while keeping the EUR HY / IG spread ratio at 3.2x. Here too, even these wider estimates for EUR IG and HY spreads would be below the post-financial crisis averages of 137bp and 445bp, respectively.

#### Exhibit 4: We see scope for 30-40bp of widening in USD HY spreads, from current levels

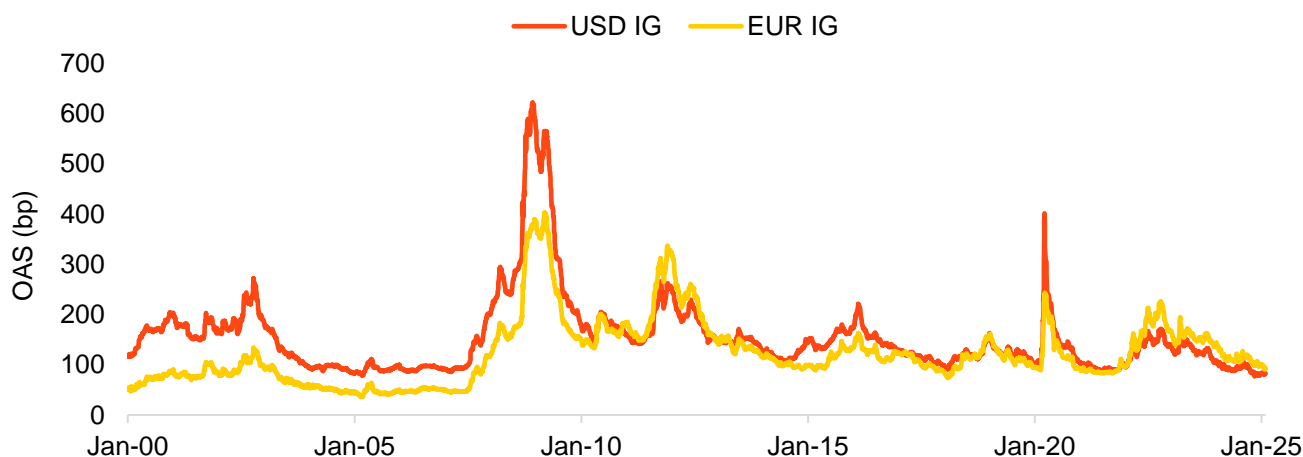
Index-level option adjusted spreads (bp) for the ICE-BAML USD and EUR HY Corporate indices



Source: ICE-BAML, Bloomberg, BlackRock. As of February 5, 2025. **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index.

#### Exhibit 5: We also expect some incremental widening in USD IG spreads, of 10-15bp

Index-level option adjusted spreads (bp) for the ICE-BAML USD and EUR IG Corporate indices



Source: ICE-BAML, Bloomberg, BlackRock. As of February 5, 2025. **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index.

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## Manager experience drives capital allocation across alternatives

In such a dynamic investing regime, market participants have been focused on longer-term structural shifts in asset allocation trends. In this *Global Credit Weekly*, we take stock of some of the high-level patterns, including those involving the broader alternative asset universe. We also discuss the expanding investor base for private debt, in particular.

One of the most notable trends in 2024 alternatives fundraising, in our view, was a continued and growing preference for experienced managers. Exhibit 6 demonstrates how the share of capital raised by experienced managers, defined as those with four or more funds, has increased over time. Also notable was the degree of variation across strategies, with the share of capital raised by experienced managers ranging from 62% to 98% of total capital in the first three quarters of 2024. (Note: for more detail on private debt fundraising, specifically, please see last week's note).

On the low end, venture capital fundraising by experienced managers was comparatively modest, at 62%, suggesting that manager experience may be somewhat less critical to allocators in venture capital than in other strategies. It may also reflect the unique nature of venture lending, which relies on strong relationships with entrepreneurs, industry specific expertise with emerging technologies, and knowledge of the startup landscape to source attractive investment opportunities. That said, the directional shift over the past few years (to favor experienced managers) within the venture lending category is clear.

At the high end, secondaries fundraising has been concentrated among experienced managers for quite some time, demonstrating the importance of a broad and established origination network for the strategy.

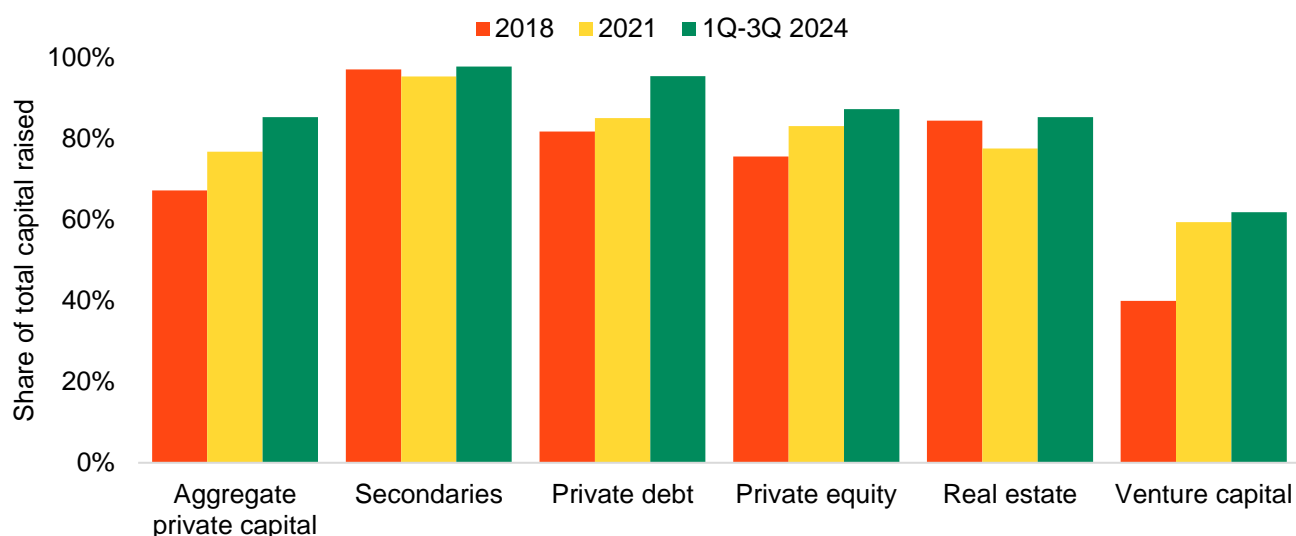
Other factors such as investor appetite for specific sub-strategies, and the macroeconomic environment, can inform these fundraising preferences as well.

Further, Exhibit 1 uses the Gini coefficient to measure dispersion of capital concentration across different private capital asset classes. A zero Gini coefficient indicates that there is full equality of capital distribution among managers, and a 1 indicates that a single manager would have all the capital. Over the last 20 years, as the alternatives space matured, the Gini coefficient for each strategy, and for aggregate private capital, has trended upward (albeit to varying degrees).

Private equity has largely maintained the highest coefficient among individual strategies. This, in part, reflects its relative maturity as a stand-alone asset class. Further, the elevated coefficient for aggregate private capital reflects the prominence of scaled asset managers with large, diversified offerings.

### Exhibit 6: Experienced managers are raising a larger share of private capital

Share of annual capital raised from experienced managers (defined as those with four or more funds, in aggregate), by strategy



Source: Pitchbook, BlackRock. Aggregate private capital includes data from private equity, venture capital, real estate, real assets, private debt, fund of funds, and secondaries. Captures data through 3Q2024.

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## Allocations have evolved in recent years

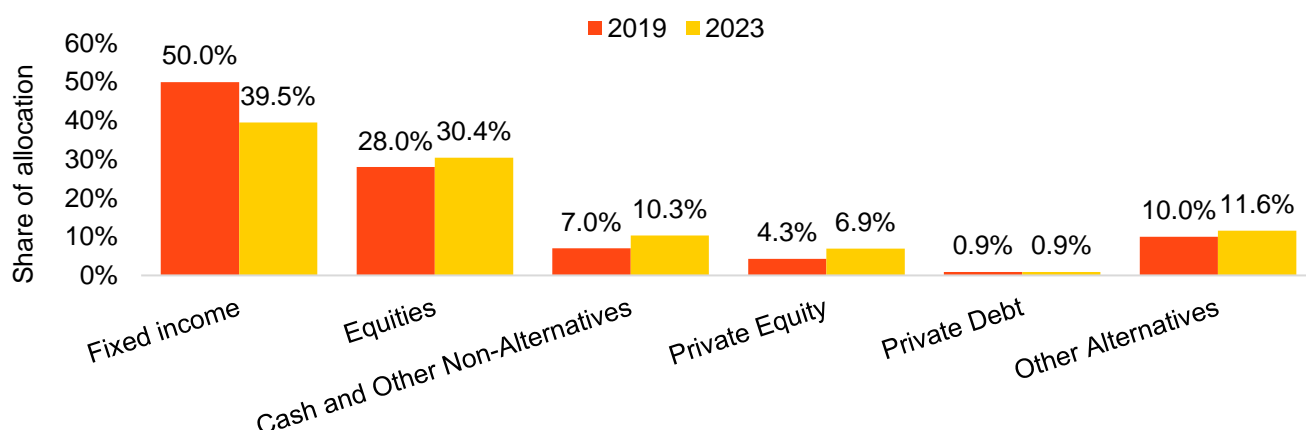
A comparison of institutional asset allocations from 2019 to 2023 – per a Preqin analysis published in January 2025 – demonstrates how exposure to alternatives has shifted over time, as strategies have grown and expanded (Exhibit 7). Importantly, this data reflects both changes in allocations *and* in market conditions.

During this period, alternative asset allocations (including private equity, private debt and other alternatives), grew from 15% to 19.6%, driven in part by private equity, which grew from 4.3% to 6.9%. The factors behind the increased allocation are two-fold, in our view: (1) investors turning to private capital strategies for income, portfolio diversification and inflation hedges (among other factors), and (2) due to market conditions over this period. Indeed, while investor allocations to private capital *have* increased over time, the impact of the so-called “denominator effect” on target allocations and longer private equity hold times may overstate the degree of this growth.

And despite investor allocations to private debt remaining stable over the period, a 2024 Preqin investor survey noted 55% of investors intended to increase their allocations to private debt over the longer term – the highest of any alternative asset class (Exhibit 8). This is consistent also with the 2024 BlackRock Global Insurance Report, which captured the views of 410 insurance investors representing \$27 trillion in AUM. Indeed, 91% of respondents intended to increase allocations to private markets over the next two years. And within this cohort, 30% planned to increase exposure to investments in private debt.

### Exhibit 7: In aggregate, institutional investor allocations to alternatives have grown

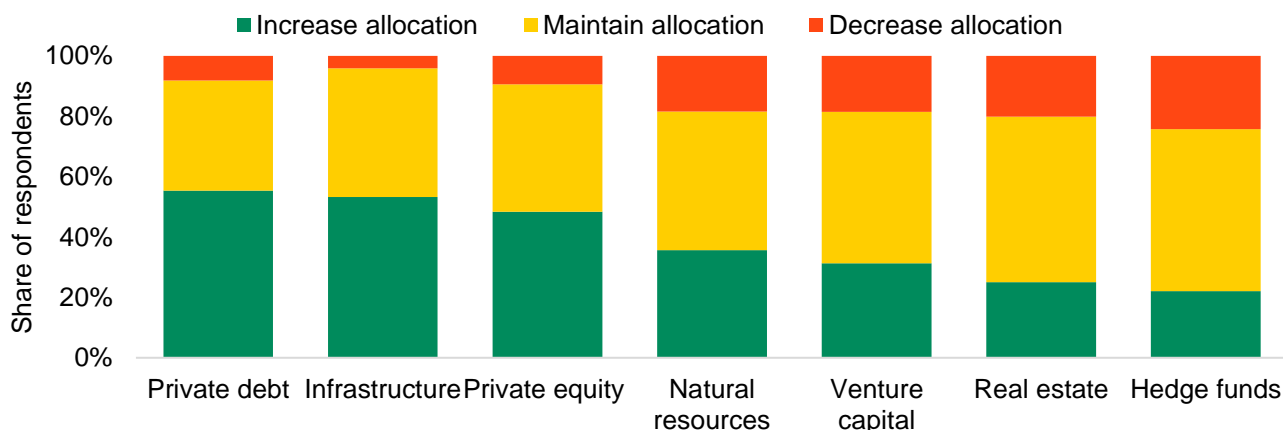
Institutional investor weighted average allocations in 2019 and 2023, per a Preqin survey



Source: Preqin Pro, Preqin Insights+ analysis published January 2025, BlackRock. Weighted average allocation as of December of each year. 2019 data includes 2,147 investors and \$13.5 trillion assets under management. 2023 data includes 4,255 investors and \$21.1 trillion assets under management. Private equity includes venture capital. Totals may not sum due to rounding. Other Alternatives includes hedge funds, real estate and infrastructure.

### Exhibit 8: 55% of investors surveyed expect to increase allocations to private debt

Investors' intentions for their alternative asset allocations, over the longer term, per a Preqin survey



Source: Preqin 1H2024 Investor Outlook, BlackRock. Captures responses from institutional investors.

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## Expanding addressable market of investors, such as insurance and retail

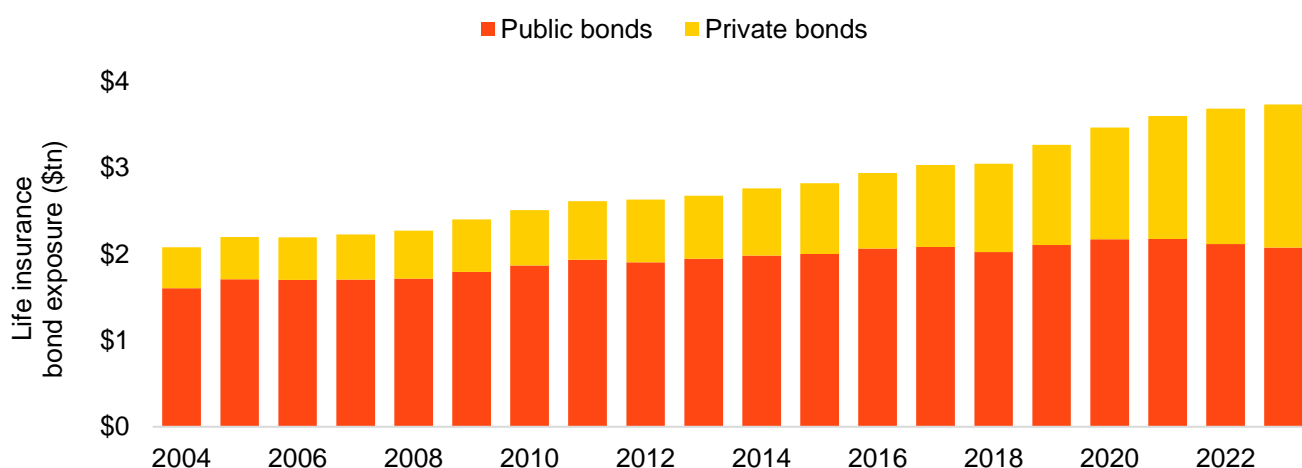
As we've discussed previously, an expanding addressable market of investors *and* borrowers has been an engine for private debt's continued growth. Among those categories driving this expansion on the investor side are insurance and retail.

The relationship between insurers and private debt lenders is evolving, with insurers increasingly turning to private debt to access more "capital-efficient yield." Private debt managers can often provide insurance with investment grade (IG) rated, structured investment opportunities that produce a higher yield than more liquid alternatives, due to the complexity and illiquidity premiums. This, coupled with insurers' objective of long-term asset-liability matching (i.e., pairing long-term investments with long-term liabilities, such as life insurance payouts), has led to increasing partnership between the two. Exhibits 9 and 10 demonstrate how private bonds have grown as a share of life insurance holdings.

Private bonds are broadly defined as bonds that are privately placed, or those that are qualified for resale under SEC Rule 144A or are freely tradable under SEC Rule 144. For example, these may include: issuer obligations, residential and commercial mortgage-backed securities, other loan-backed and structured securities, Securities Valuation Office (SVO) identified funds, affiliated and unaffiliated bank loans, and unaffiliated certificates of deposit (CDs). We see scope for insurance participation in private debt to increase, especially as private debt's addressable market of *borrowers* expands in parallel, including to capture more IG rated borrowers.

### Exhibit 9: Life insurance exposure to private bonds has grown over time

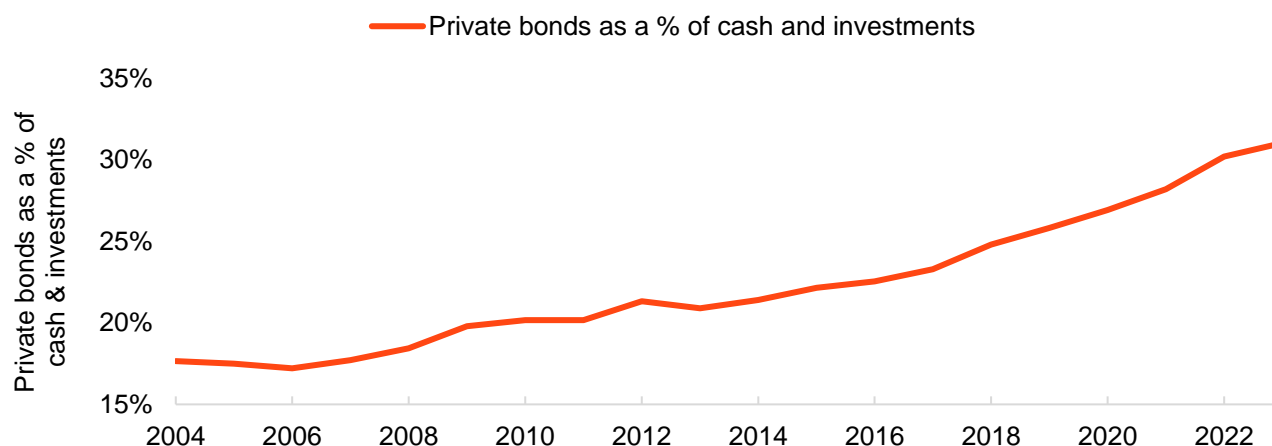
U.S. life insurance industry bond exposure (\$ trillions), by type from 2004 to 2023



Source: Capital IQ, BlackRock. As of year-end 2023 (most recent available as of February 5, 2025).

### Exhibit 10: Private bonds are growing as a share of total cash and investments

Private bond holdings as a share of total cash and investments for U.S. life insurance companies



Source: Capital IQ, BlackRock. As of year-end 2023 (most recent available as of February 5, 2025).

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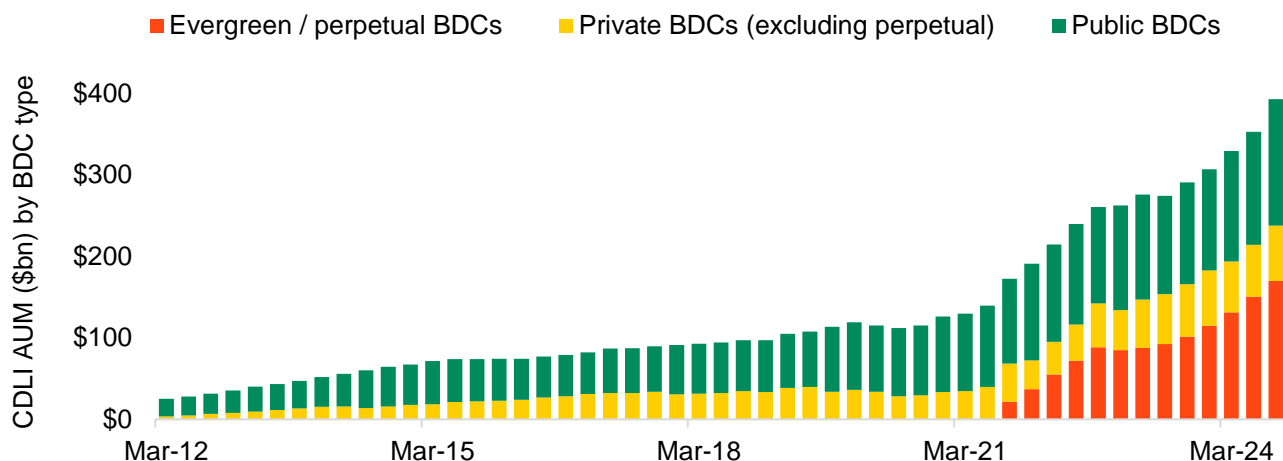


Further, increasing participation by retail investors represents another potential growth tailwind for private debt, in our view. The creation of the evergreen / perpetual business development company (BDC, Exhibit 11), and the broadened definition of “accredited investor,” have expanded retail access to private debt in recent years. But growth in the retail space has more room to run, in our view, especially as private debt offerings and access continue to evolve.

The retail opportunity is vast and even a modest increase in retail allocations to private capital could provide a meaningful tailwind. For example, the most recent UBS Global Wealth Report outlines \$450 trillion in total global wealth, with more than 22 million people qualifying for millionaire status in the U.S., alone. Further, the Investment Company Institute notes that there is nearly \$28 trillion in U.S. individual retirement accounts (IRAs) and defined contribution plans as of 3Q2024 (Exhibit 12). The majority of this value is held in liquid assets, despite longer term investment horizons. To put this opportunity set in context, global assets under management in the broader alternatives universe totaled \$16.8 trillion as of 2Q2024, per Preqin. Further innovations and expansion of private capital (including private debt) offerings will likely continue to make private markets more accessible to retail investors. In our view, this growth will likely favor larger, more established managers, that have the capabilities, offerings, and resources to innovate with products and accommodate retail investors. Educational efforts will also be key, in our view.

### Exhibit 11: BDC structures have evolved to meet demand from the wealth manager universe

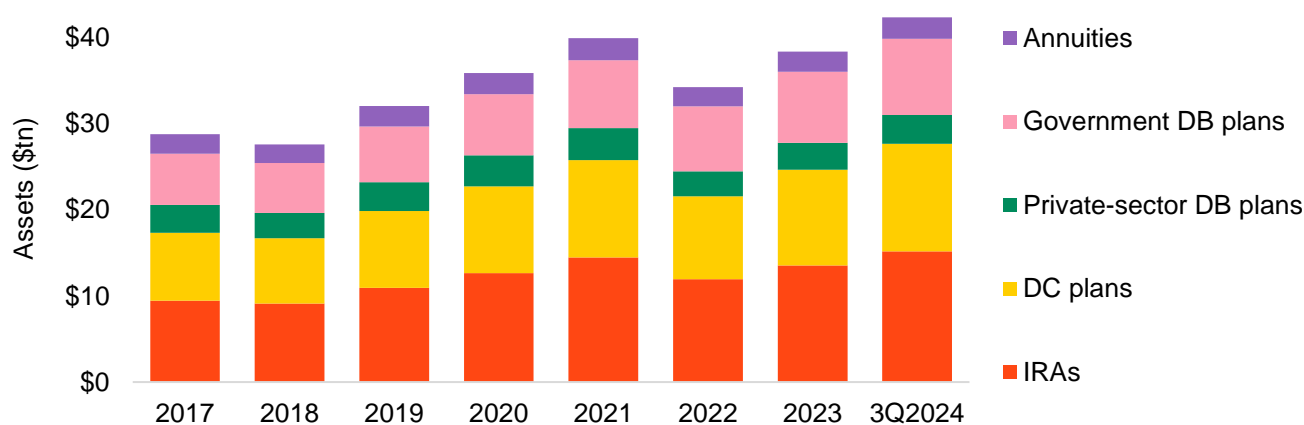
Cliffwater Direct Lending Index (CDLI) assets under management (\$ billions), by BDC type



Source: Cliffwater Direct Lending Index, BlackRock. As of 3Q2024 (most recent available as of February 5, 2025).

### Exhibit 12: U.S. retirement assets could present an opportunity for private capital to expand

U.S. total retirement assets (\$ trillions), by plan type



Source: Investment Company Institute, BlackRock. Annual data as of year end, 3Q2024 data as quarter end. DB is defined benefit, DC is defined contribution, IRA is individual retirement account. Defined contribution plans includes private employer-sponsored DC plans (including 401(k) plans), 403(b) plans, 457 plans, and the Federal Employees Retirement System (FERS) Thrift Savings Plan (TSP). Government defined benefit plans included federal and state and local government plans. Annuities include all fixed and variable annuities held outside of retirement plans and IRAs.

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**Unless otherwise stated, all reference to \$ are in USD.**

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