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How private debt is developing and why investors are looking for quality

Nuveen's Laura Parrott explains why infrastructure credit is offering new opportunities, and how insurance companies are looking to lock in on higher rates

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What innovations are we seeing in private markets, and particularly private debt?
As the private credit market expands, both from capital flowing in as well as issuance that has traditionally been in the public market, we are seeing all sorts of new opportunities within private credit. Specifically, we are seeing innovation in infrastructure credit with new opportunities to help fund the energy transition and other infrastructure needs. There's quite a tailwind there, with innovative structures around infrastructure.

One of these strategies, which Nuveen has been a first mover on, is commercial PACE – or Property Assessed Clean Energy – an opportunity to invest in energy efficiency upgrades to commercial real estate. This is a credit product that can help financing within real estate, an example of an innovative credit solution for a specific area of the marketplace. As an investor, it is a good diversifier away from traditional corporate exposure, while having structural protections and collateral.

Why could private debt be an attractive asset class in a recession?
Whether it's in a recession or just in general, there remains a lot of market uncertainty, particularly geopolitical. Of course, we're seeing recessionary concerns. There is interest-rate volatility globally as central banks are starting or continuing to make moves, and institutional investors are starting to recognize that traditional portfolios might be a little too exposed to these types of risks.

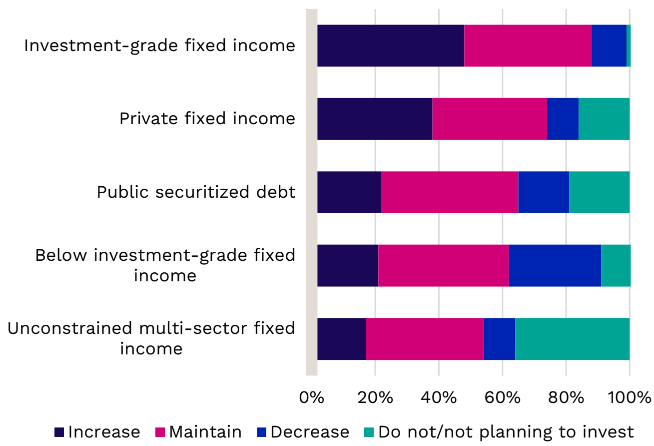
Private credit allows investors to diversify from those more traditional areas within your portfolio, but it can also serve as a ballast from the liquid markets where there could be more volatility. In the private markets, we generally don't see volatility in the same way because, for the most part, there are structural protections in these private credit instruments. And in infrastructure, there's oftentimes collateral that gives certainty of interest payments. All of this combined can provide more comfort going into a potential credit cycle or recessionary period, adding stability to your portfolio.

Why are investors placing a greater emphasis on quality?
In our surveys of Nuveen's institutional clients, there's an increased interest in investment grade opportunities (Chart 1). Part of this goes back to what we've talked about – in a period of potential global geopolitical instability, recessionary pressures and interest-rate volatility, having investment grade exposure can be a ballast to some of the more volatile areas.

The other argument would be that right now, investment grade is very attractive vis-a-vis what we're seeing for below investment grade credit. The delta between an investment grade yield and a below investment grade yield, isn't very significant given historically tight spreads. So now that we're out of the zero-rate environment and in a more historical norm from an underlying yield perspective, those investment grade exposures become more appealing to add back into your portfolio. Investors are not taking as much risk, but they're still enjoying an attractive yield. In private markets, investors also benefit from yield enhancement from the liquidity premium, so it's even more attractive.

For those reasons, we're seeing a lot more interest in the asset class and, when there is capital coming into an asset class, there is more issuance. Issuers recognize that there's capital there, and certainty of execution. When the two marry, that means the market in total is expanding.

Chart 1: How are institutional investors shifting fixed income allocations over the next two years?



Source: Nuveen 2024 eQuilibirum global institutional survey
nuveen.com/equilibirum

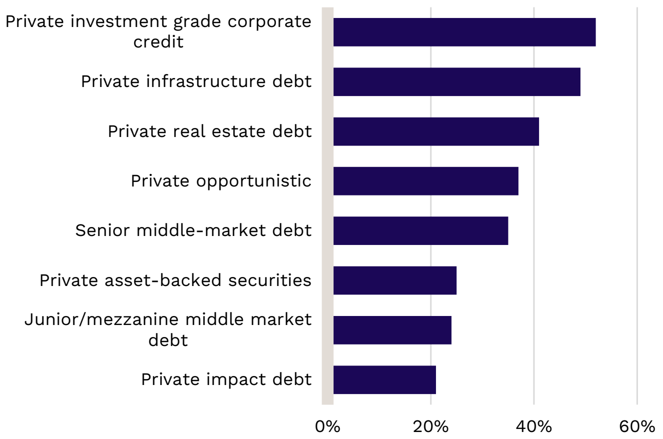
What other trends are you observing in alternative assets?
One of the other trends that we're seeing is infrastructure credit investing, in both the investment grade and the below-investment-grade context (Chart 2).

I already mentioned our commercial PACE product, which is a nascent market that's really starting to grow and a great investment opportunity in the investment grade securitization space.

Along those lines, I'd be remiss if I didn't mention the growth in the private asset-backed security market. It's an option for issuers wanting to move away from the public ABS market, and it's also an option to help finance more esoteric types of collateral pools. That has been an area of focus for us, and we've seen a tremendous amount of innovation within the ABS market.

The tailwind here is not just the capital coming in and issuers wanting the certainty of execution and access to that capital. We also have an environment where banks have been somewhat dislocated due to regulatory issues. So there simply is white space for other institutions to come in and capture that issuance, and we're seeing that in a significant way. That will remain a real source of growth for the private credit market, and we're excited about how we can participate and lead in that market.

Chart 2: Within private fixed income, where are institutional investors increasing allocations over the next two years?



Source: Nuveen 2024 eQuilibirum global institutional survey
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How is the role of insurance-based investors changing as new entrants forge their way in alternatives? Are you seeing any changes in the types of investor or sources or capital in the private debt market?
We're certainly seeing more interest in private capital, below investment grade but especially, as we discussed, in the investment grade construct. Nuveen conducts its Equilibrium Survey every year, where we survey 800 clients globally to gauge their desires, which helps us know where the market is going (Charts 1 and 2).

What we have found is that the majority of respondents are looking to increase their exposure to investment grade and private credit. And that's across our institutions. Insurance companies in particular are looking for ways to capitalize and lock in on the higher rates we've been enjoying over the past couple of years. Even with the rate cuts we've seen, we're still seeing attractive rates. So you can capture and lock them in for a longer duration and still enjoy the benefits that private capital provides. We mentioned structural protection, but the yield enhancement through the illiquidity premium and call protection are other features that that this market enjoys. These are all attributes insurance companies are interested in and so, we've heard firsthand from our clients that this is an area they're looking to expand their investment horizon in. As an investor focused on the market, this is something that we are experiencing in real time.

Laura Parrott is a Senior Managing Director and Head of Private Fixed Income at **Nuveen**, responsible for the growth and commercialization of private corporate credit, infrastructure debt, credit tenant loans, and private ABS. Laura also oversees the Nuveen Green Capital and the Energy Infrastructure Credit investment teams.

Nuveen and CoreData surveyed 800 institutions globally spanning North America (NORAM); Europe, Middle East and Africa (EMEA); and Asia Pacific (APAC) in October and November 2023. Respondents were decision-makers at corporate pensions, public/governmental pensions, insurance companies, endowments and foundations, superannuation funds, sovereign wealth funds, and central banks. Survey respondents represented organizations with assets of more than $10B (53%) and less than $10B (47%), with a minimum asset level of $500 million. The survey has a margin of error of ± 3.5% at a 95% confidence level. For more information visit
nuveen.com/equilibrium