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The appeal of private assets in 2024

KEY TAKEAWAYS

- While interest rates and inflation may have peaked or plateaued in many major economies, they are expected to remain at elevated levels in 2024. At this stage of the cycle, concerns remain about the pace of economic growth.
- In the higher-for-longer rate environment, private market assets — infrastructure, private credit, real estate and natural capital — can offer attractive risk-adjusted returns, income, diversification and potential for inflation hedging.
- Government policy and regulations that encourage energy security and the transition to a low-carbon economy provide further support to these asset classes.
- Experienced managers of alternative assets will continue to develop investment vehicles that allow private investors to access the benefits of private markets.

SUPPORTIVE MACROECONOMICS AND STRUCTURAL TRENDS

The macroeconomic environment in 2024 will likely spur demand for private assets from all types of investors in our view. Over the last year and a half, most major global central banks focused on fighting inflation. The U.S. Federal Reserve, European Central Bank and Bank of England have each raised policy rates between 450 and 525 basis points, from near-zero to multi-decade highs. With the inflation outlook improving, we anticipate an end to the overall hiking cycle. A few outliers may emerge, such as high odds of a rate hike from the Bank of Japan and Australia and/or Sweden following suit.

But for most central banks, attention will now shift from “how high” to “how long” rates will stay at elevated levels. A pivot by central banks will require evidence such as inflation consistently trending lower, economic growth slowing or the labour market weakening.

Fiscal incentives from many governments around the world will also support private market assets, notably policies encouraging energy security and the transition to a low carbon economy. In the U.S., the Infrastructure Investment and Jobs Act and the Inflation Reduction Act are estimated to channel trillions of dollars into these areas. Similar policy measures are being enacted in Europe, with

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Repower EU and the Green Deal Industrial Plan. Countries in Asia — Australia, South Korea, Japan — also have clean energy policies supporting the development of the clean energy industries.

These policies will help drive capital to the sectors in which many private markets operate, and we expect them to remain a focus through 2024 and beyond.

INCREASING INVESTOR ACCESS

Previously considered the preserve of institutional investors, we expect a key theme in 2024 to be greater access to private markets for other investors. As more capital is needed to fund these attractive investment opportunities, asset managers are creating and adapting investment vehicles that aim to meet the needs of smaller-scale investors.

With opportunity comes risk, however. Investors need to understand the risks involved with these assets and the role they play in portfolios. Liquidity risk is more significant in private markets than public, and private assets should be considered a long-term investment.

Working with an asset manager with experience and expertise in private markets will help investors understand and manage some of these risks.

ASSET CLASS OUTLOOKS

Infrastructure

Infrastructure should benefit from still-high inflation and looks well positioned for resiliency in the face of slowing economic growth.

Often these assets provide essential services such as power generation, water and waste management, roads, bridges, communication networks and data centres. Steady demand for their services coupled with limited competition due to their size and capital-intensive nature makes the assets less sensitive to economic cycles and changes in market conditions. They are also a stable source of income with cash flows generated from long-term contracts, which often adjust for inflation or a higher cost of capital, providing a further protection in challenging economic environments.

PRIVATE ASSETS: INVESTMENT CHARACTERISTICS

In this higher-for-longer environment, private assets could continue to be a compelling source of risk-adjusted returns, income and diversification. Private assets are not traded on public exchanges. They can include debt, equity, real estate, infrastructure, farmland and timberland. While covering a broad range of asset types, they share similar investment characteristics in many instances:

- **Stability:** Private market pricing helps avoid public market noise, reducing volatility.
- **Return and income potential:** Limited liquidity has often been viewed as a limitation, but that same illiquidity creates opportunities. Private markets are perhaps best known for their high return potential compared with similar public assets.
- **Resilience:** Long-term cash flows are a feature of many private real assets often with contractual payments that adjust for inflation.
- **Diversification:** Private real assets generally have low or negative correlations with listed equity and bonds, and bring additional sources of alpha to a portfolio.

The government incentives mentioned above to facilitate the energy transition and decarbonize economies will continue to create a wealth of opportunity in the infrastructure sector. We expect these measures will help drive capital to projects for grid electrification, solar and wind power, as well as battery storage in the coming years.

Along with changes in energy production and transmission, we see a broad range of investment opportunities as society adapts, including mass transportation and electric vehicles, more energy-efficient buildings, and the scrapping and recycling of necessary metals and minerals.

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Private credit

Private credit has proven its resiliency in 2023's high-rate and high-inflation environment, and we expect this to continue in 2024. In our view, such challenging fundraising conditions can be the best time to invest.

The technical aspects of deal making have improved from a lender's point of view. Higher base rates equate to higher yields. And higher interest costs alongside more conservative capital structures mean new deals are being structured with lower leverage multiples and covenants that are often more favourable to lenders.

Given the macro challenges for borrowers, diversification and selectivity are critical. We favour market-leading companies with stable, recurring cash flows in non-cyclical industries, making them well placed to service interest payments and pay back loans. We continue to focus on more resilient areas of the market — such as health care, software and business services — all of which, we believe, are relatively well-positioned to withstand economic downturns.

We expect demand from small- to medium-sized businesses will continue to be strong given the limited sources of funding since banks withdrew from direct lending after the global financial crisis. And more investors are willing to supply capital, attracted by the asset's characteristics — an alternative source of income; inflation protection from floating rates; low or negative correlations with public markets; and lower volatility.

As the asset class continues to flourish and larger deals come to direct lenders, we believe managers with size, scale, proven track records and deep industry networks will be best positioned with access to a steady flow of opportunities from high-quality companies.

Real estate

We see common themes across the global real estate landscape: inflation is moderating but sticky, interest rates remain elevated, value losses are subsiding, investment volumes are near 10-year lows and transactions arising from distress have remained muted despite pressures. However, we also see a lot of variation within markets and sectors, underscoring the potential benefits of a diversified global portfolio in 2024.

In the U.S. office market, for example, just 12 of the country's 50 largest office markets have vacancies below their long-term average. In Europe, half of markets still have vacancies below long-term average.

Another source of variation is the significance of climate risk and environmental, social and governance (ESG) factors in investment decision making varies by region. European and Asia Pacific investors are more unified in their approach to this than their U.S. counterparts. Despite the differences, the structural drivers towards the decarbonization of real estate continue to increase, with market bifurcation between 'brown' and 'green' buildings already observed in some.

We expect retail will be a quiet outperformer. Years of negative sentiment have driven down values, creating a more attractive entry point for new investors. The alternatives sector, including self-storage, manufactured housing and outpatient care facilities, is positioned for future resilience and outperformance in our view. Their fundamental drivers rely less on economic growth and more on demographics, technology and health care. Affordable housing is another attractive sector, with demand outstripping supply in many parts of the world.

Natural capital

Natural capital's inflation-hedging characteristics should serve investors well in 2024 with rates and inflation likely to remain elevated. Many of the outputs from farmland and timberland, such as food and building materials, are often components of inflation measures. Higher inflation reflects higher prices for these goods. In the near term, these higher prices improve performance by increasing cash yields. Over the long term, higher prices can also increase the capital appreciation component of return as they are incorporated into asset valuations.

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But looking beyond current macroeconomic factors, long-term structural trends will likely transform the asset class from a niche investment to a core, resilient component of a long-term portfolio.

Investing in sustainable timberland and farmland is a fundamental way to benefit from growing worldwide demand for resources and supporting environmentally friendly and socially responsible food, fibre and timber production systems.

Furthermore, timberland and farmland's respective, sustainable, low carbon production systems and the capacity to generate verified carbon credits are increasingly valued as climate action ramps up. As an asset class, natural capital investments, such as timberland and farmland, have the lowest average carbon intensity — or net CO_2 emissions per dollar invested — among both alternative and traditional asset classes.

For more information, please visit nuveen.com.

Endnotes

Sources

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A word on risk

All investments carry a certain degree of risk and there is no assurance that an investment will provide positive performance over any period of time. Equity investing involves risk. Investments are also subject to political, currency and regulatory risks. These risks may be magnified in emerging markets. Diversification is a technique to help reduce risk. There is no guarantee that diversification will protect against a loss of income. Investing in municipal bonds involves risks such as interest rate risk, credit risk and market risk, including the possible loss of principal. The value of the portfolio will fluctuate based on the value of the underlying securities. There are special risks associated with investments in high yield bonds, hedging activities and the potential use of leverage. Portfolios that include lower rated municipal bonds, commonly referred to as "high yield" or "junk" bonds, which are considered to be speculative, the credit and investment risk is heightened for the portfolio. Credit ratings are subject to change. AAA, AA, A, and BBB are investment grade ratings; BB, B, CCC/CC/C and D are below-investment grade ratings. As an asset class, real assets are less developed, more illiquid, and less transparent compared to traditional asset classes. Investments will be subject to risks generally associated with the ownership of real estate-related assets and foreign investing, including changes in economic conditions, currency values, environmental risks, the cost of and ability to obtain insurance, and risks related to leasing of properties. Investors should be aware that alternative investments including private equity and private debt are speculative, subject to substantial risks including the risks associated with limited liquidity, the use of leverage, short sales and concentrated investments and may involve complex tax structures and investment strategies. Alternative investments may be illiquid, there may be no liquid secondary market or ready purchasers for such securities, they may not be required to provide periodic pricing or valuation information to investors, there may be delays in distributing tax information to investors, they are not subject to the same regulatory requirements as other types of pooled investment vehicles, and they may be subject to high fees and expenses, which will reduce profits. Alternative investments are not appropriate for all investors and should not constitute an entire investment program. Investors may lose all or substantially all of the capital invested. The historical returns achieved by alternative asset vehicles is not a prediction of future performance or a guarantee of future results, and there can be no assurance that comparable returns will be achieved by any strategy. Impact investing and/or Environmental, Social and Governance (ESG) managers may take into consideration factors beyond traditional financial information to select securities, which could result in relative investment performance deviating from other strategies or broad market benchmarks, depending on whether such sectors or investments are in or out of favor in the market.

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