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# Tipping points

## Investment Outlook 2025

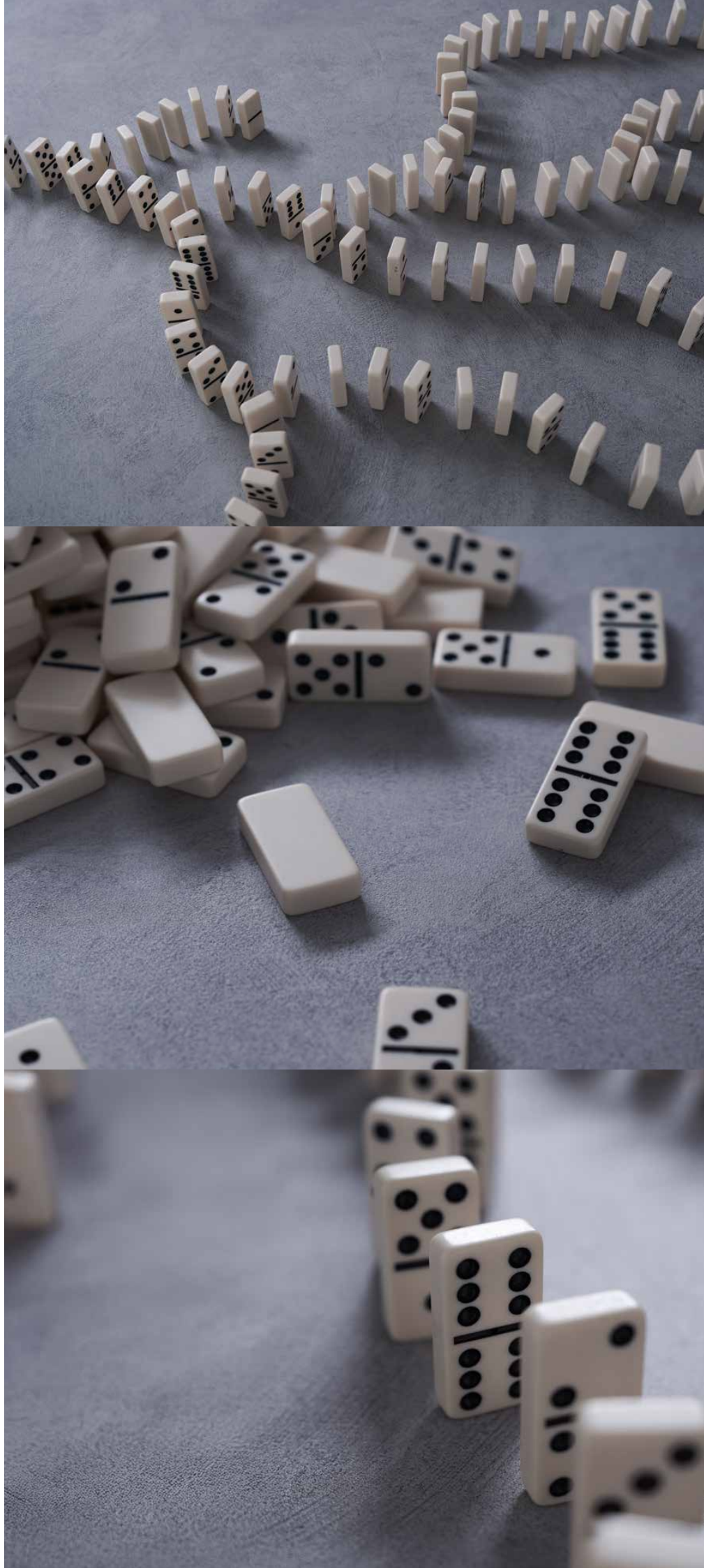


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# Introduction

In spoken language, the terms tipping point, inflection point and turning point are often used interchangeably when, in fact, they label rather different phenomena. A tipping point refers to a threshold beyond which an initially slow transformation accelerates, often with incisive and irreversible consequences. Without a doubt, we have already witnessed the crossing of a few tipping points in recent years. In the first section of our investment outlook, we outline those tipping points with potentially disruptive impacts that could still lie ahead and explain how investors can best prepare for an uncertain future.

In addition, we take a deep dive into the segments of the alternative investment landscape, where LGT Capital Partners has been active as a principal investor for over two decades. We share our observations and assessments on private equity, private credit, emerging market sovereign debt, real estate and infrastructure, as well as hedge funds and insurance-linked strategies. We also highlight recent trends, current challenges and attractive future investment opportunities. Finally, we provide an update on pertinent issues related to impact investing.

We hope that you will find this publication to be both insightful and informative and we invite you to share your views and ideas with us.

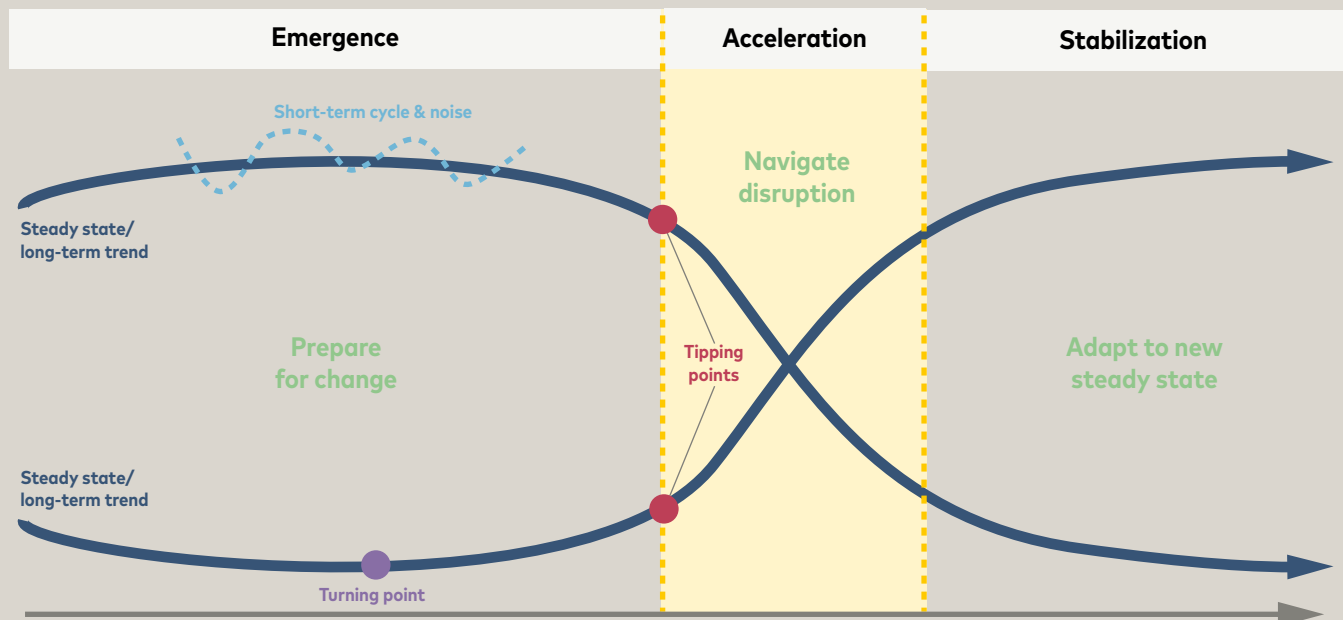


# Tipping points – Investment Outlook 2025

## What is a tipping point?

A tipping point is a critical threshold in a process or system beyond which a specific development accelerates. That change often becomes unstoppable at that point and the process cannot easily be reversed thereafter. Consequently, when approaching tipping points, small nudges can materially disrupt old equilibriums, speed up new trends and transform entire systems.

Climate science often uses the concept of tipping points, but the term also appears in other fields of social science, such as research into phenomena in mass psychology or the study of network effects in economics. Making popcorn is another popular example of a process that starts slowly before accelerating and becoming unstoppable.



### Seven trends nearing tipping points

1. Emerging technologies and rising productivity
2. Electricity demand and energy transition
3. Global fragmentation and economic nationalism
4. Long-term interest rates and debt sustainability
5. Market concentration and leadership rotation
6. Democratization of private markets
7. De-dollarization in emerging markets

### Accelerating beyond tipping points

- Global warming
- Generative AI (artificial intelligence)
- Geopolitical instability
- Aging societies
- ...

Source: Sustainability Science (2023), Springer Nature, LGT Capital Partners

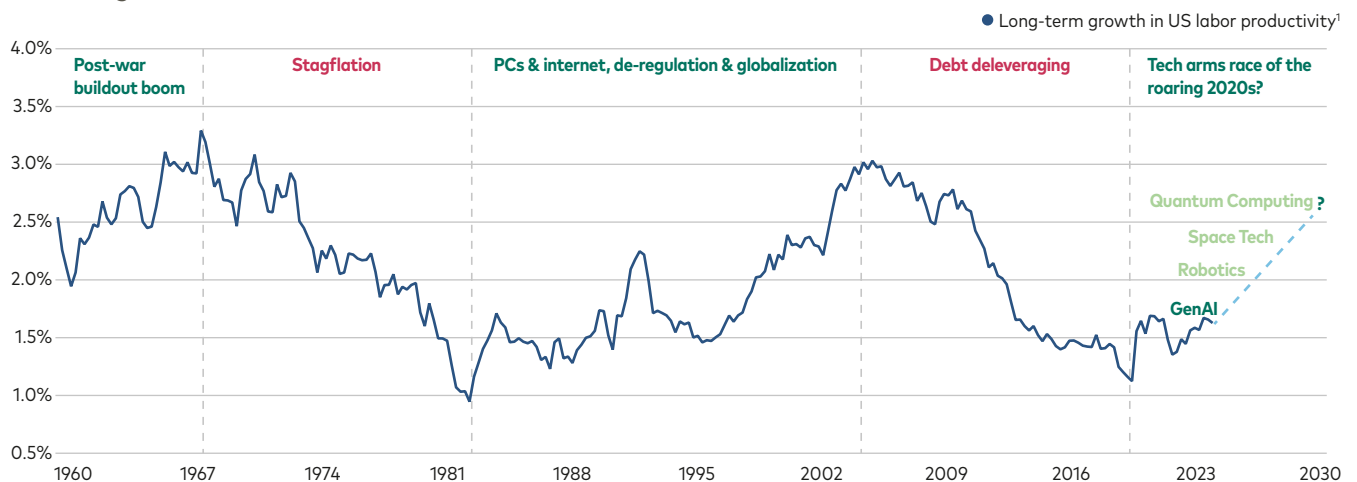
# Seven trends moving towards tipping points

Technology is an area that lends itself well to the analysis of tipping points. Innovations often emerge slowly at first but then start to spread swiftly as applications and user numbers multiply. Generative AI is a recent example that has already crossed its tipping point in terms of diffusion and adoption.

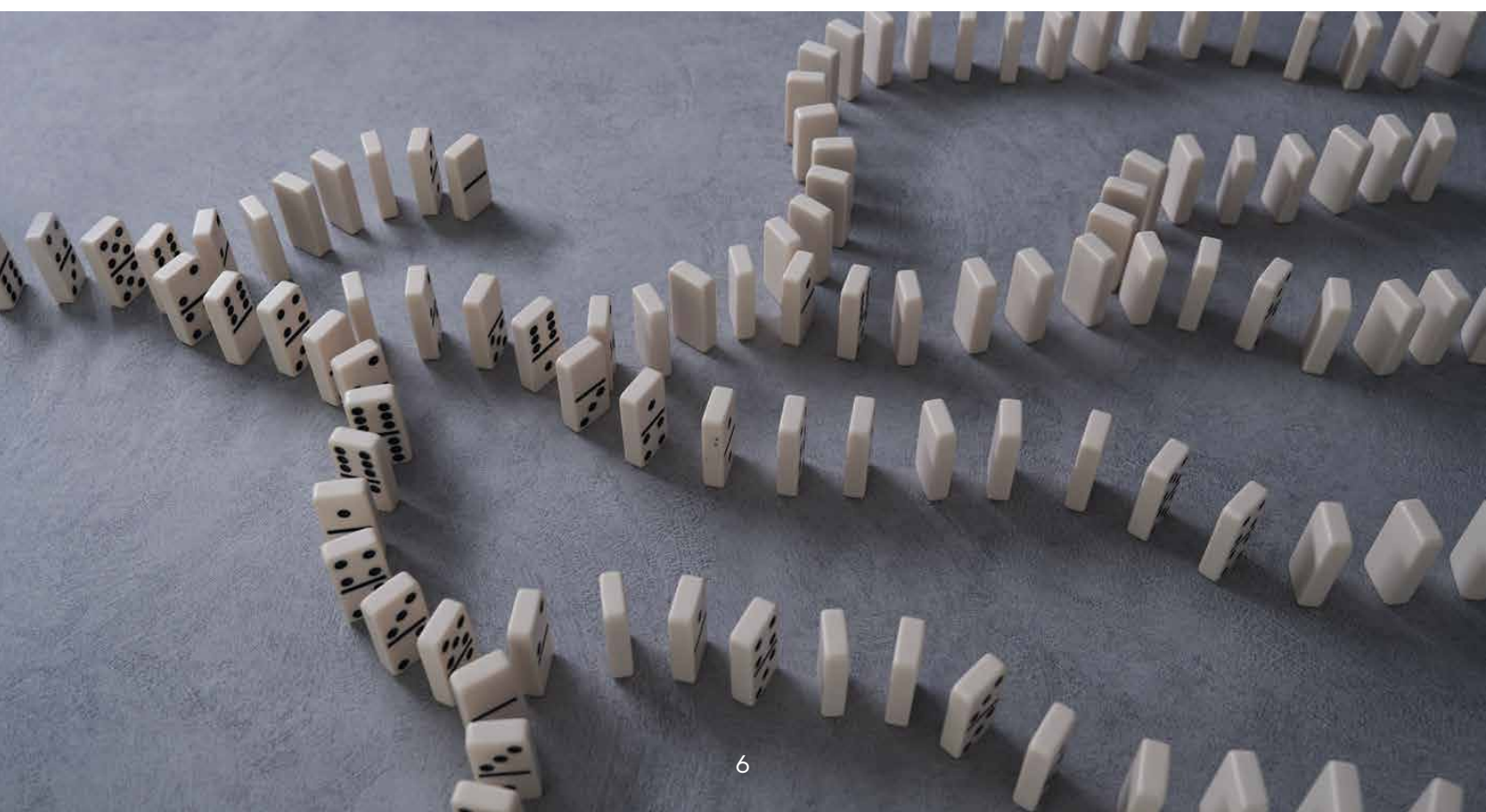
The hype around AI may be somewhat exaggerated and may end up disappointing in the short term. But in the long run, this breakthrough technology is bound to boost productivity. In addition, there is a very exciting pipeline of potential future innovations. Quantum computing, to name just

one, may be in its earlier stages, but once fully operable, it will revolutionize problem-solving. We are undeniably in an age of rapid innovation that is further fueled by an "arms race" among private companies and sovereign states. In our view, this bodes well for economic growth over the coming years.

## Cascading innovation



¹ US labor productivity (output per hour worked); 10-year annualized rate of change. Source: Macrobond, LGT Capital Partners

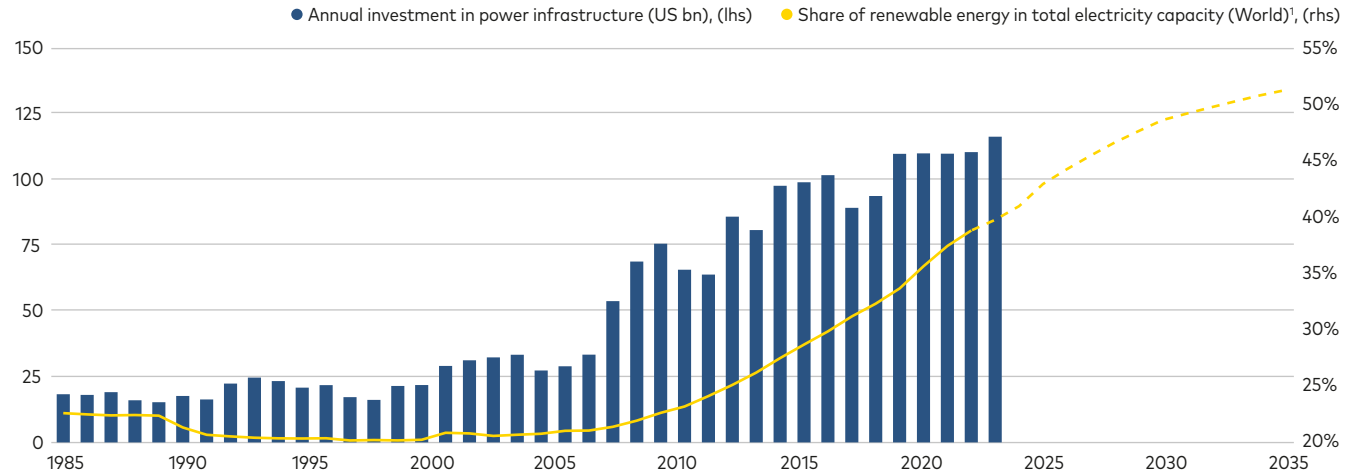


Moving beyond tipping points can also cause a system to break down. Over-usage of electric power grids is an example that we are seeing more frequently these days. Digitalization in general, and AI applications in particular, boost electricity demand and place a strain on existing grids. Moreover, climate change, with its

severe weather events, is adding to power disruptions globally. Modernizing and expanding the electricity infrastructure is thus a top priority and a core building block of the ongoing energy transition. Incidentally, many renewable energy technologies have swiftly come down in costs. Wind and solar are

now competitively priced power sources in many regions and are no longer in need of heavy subsidies. That is why for 2025 and beyond, we expect to see a continuation of the build-out push, driven by investments in renewable energy, novel technology, national security and economic resilience.

### Power play



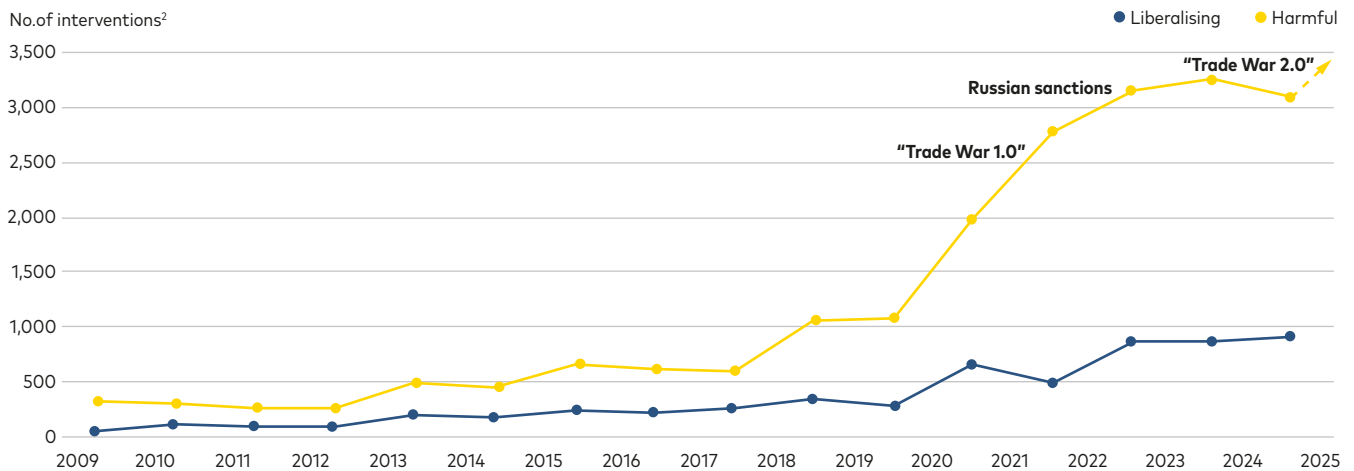
<sup>1</sup> Based on EIA International Energy Outlook. Source: EIA, Macrobond, LGT Capital Partners

The results of the US elections last year have clearly demonstrated that economic nationalism is not a fad but rather a structural trend. In 2025, we are likely to see a "Trade War 2.0" unfold—on top of all the restrictive measures already introduced over the last few years. Many observers believe that this will be temporary and

only serve as a means for the US to obtain concessions from its trading partners. Perhaps that will be the case. But the short-term noise is masking underlying trends that are of much greater concern: political polarization and global fragmentation are increasingly driving economic policies and business decisions—and therefore

also impacting investment choices. Nowadays, political ideology often supersedes economic rationale. The result is that access to markets and financing are weaponized and used to inflict harm on others, which in turn triggers retaliatory measures. Unfortunately, this process is accelerating—not only between China and the US but also globally.

### Ideology trumps economics



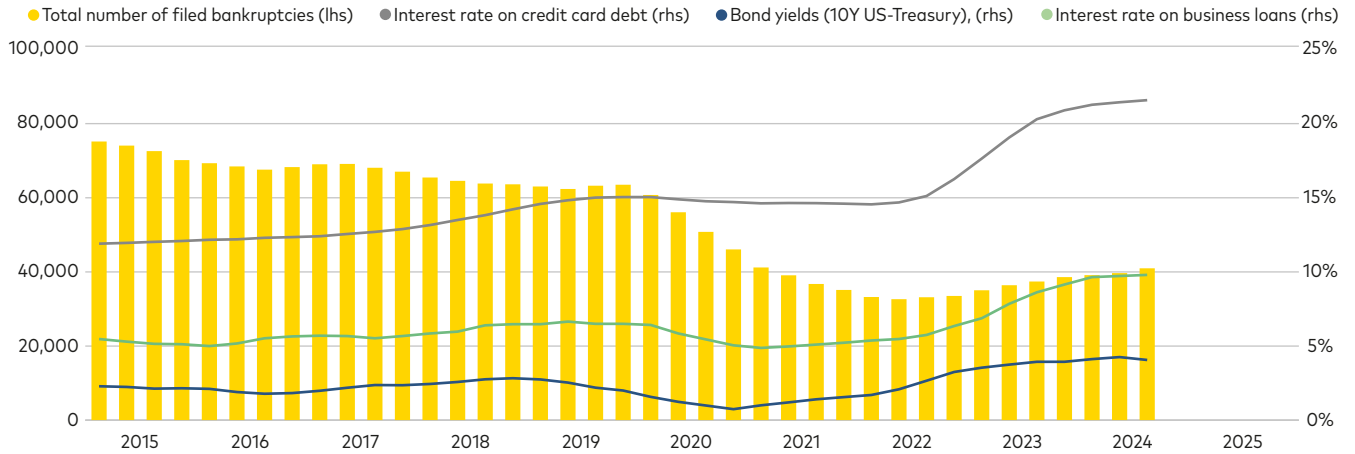
<sup>2</sup> Total number of G20 policy interventions recorded by November 1 of each year; classification by GTA. Source: Global Trade Alert (GTA), LGT Capital Partners

Interest rates are one area where we will likely refrain from moving beyond critical thresholds. Although the previous tightening of financing conditions has taken its toll on the economy, the outlook involving robust nominal growth and lower policy rates should alleviate fears of more pain. A cascade of corporate

defaults is therefore improbable considering the benign economic outlook but such a scenario remains an outlier risk, should interest rates climb even higher. Hence, debt concerns are not fully off the table given the trajectory of fiscal deficits and the possibility of yield spikes in bond markets. However,

policymakers will likely lean against such moves and lend support. Having brought inflation back under control, central banks can now fully focus on maintaining economic and financial stability. Conversely, calls for fiscal austerity are still quite muted but could gain momentum in the years ahead.

### Averting a tipping point in interest rates



Credit card debt: commercial bank interest rate on accounts with credit card plans, Business loans: actual rate paid on short-term loans by corporate borrowers. All series are for the US, quarterly smoothed data (1 year). Source: Macrobond, LGT Capital Partners

Profound and rapid innovation is accompanied by an ever-faster churn in the business world. Time-honored companies get replaced by newcomers that disrupt traditional business models. Add to that network effects and economies of scale, and these new firms can grow exponentially after having crossed

their respective tipping points. Today, a large chunk of equity market capitalization is made up of younger, technology-driven companies. These dynamics will likely linger. Market concentration can thus coexist with market rotation, as leadership can change quite often, even in a winner-takes-

all economy. In addition, anti-trust regulation is out to dismantle any unfair moats. For 2025 and beyond, we expect a broadening in equity market participation, where the benefits of recent technological advancements accrue not just with the innovators but also with adopters and implementors alike.

### The future belongs to the young



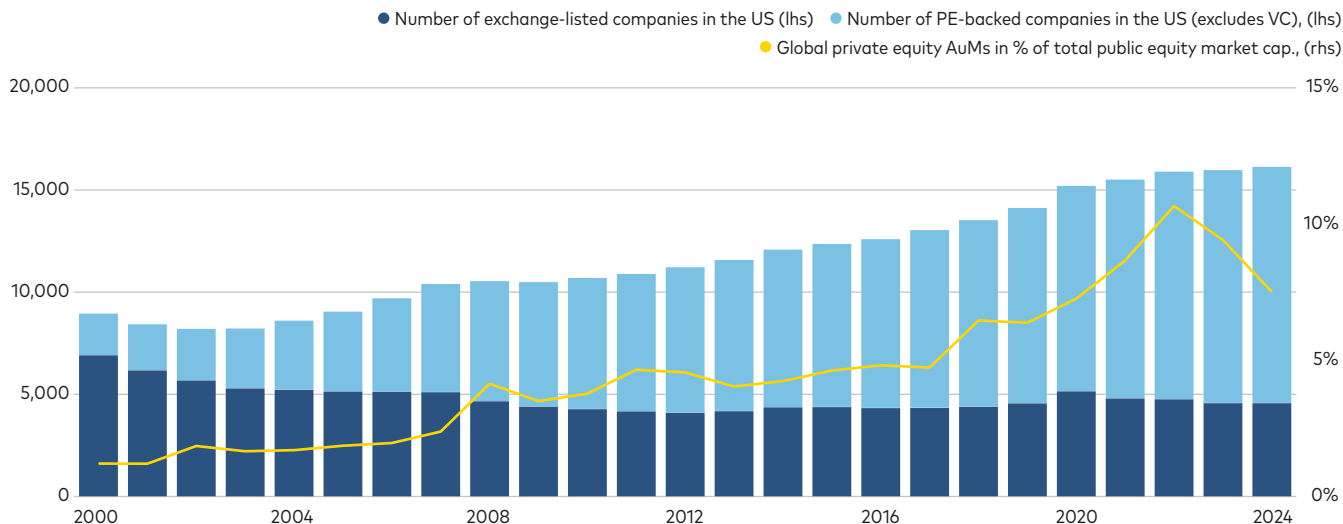
<sup>1</sup> From 1926 to 2024, weighted by market capitalization. Source: "The Geek Way" substack.com, Andrew McAfee, MIT, LGT Capital Partners

Private equity plays a key role in financing, as it often captures the two most profitable phases of a company's journey – its evolution from early-stage venture to mature firm, or the transformation from struggling business into an efficient competitor. Currently, the industry itself is at an inflection point with its

accelerating growth in assets and widening investor base. Today, the number of private equity-backed companies still only represents a tiny fraction of all existing companies. Moreover, in US dollar terms, private equity assets still pale in comparison to their counterpart in publicly listed equities. This relatively low base,

strong past performance and a "democratization" of private market investing are establishing a steep trajectory for future growth. But fast expansion brings its own share of challenges, and we continue to commit very selectively to best-in-class managers only.

### Plenty of runway for private equity



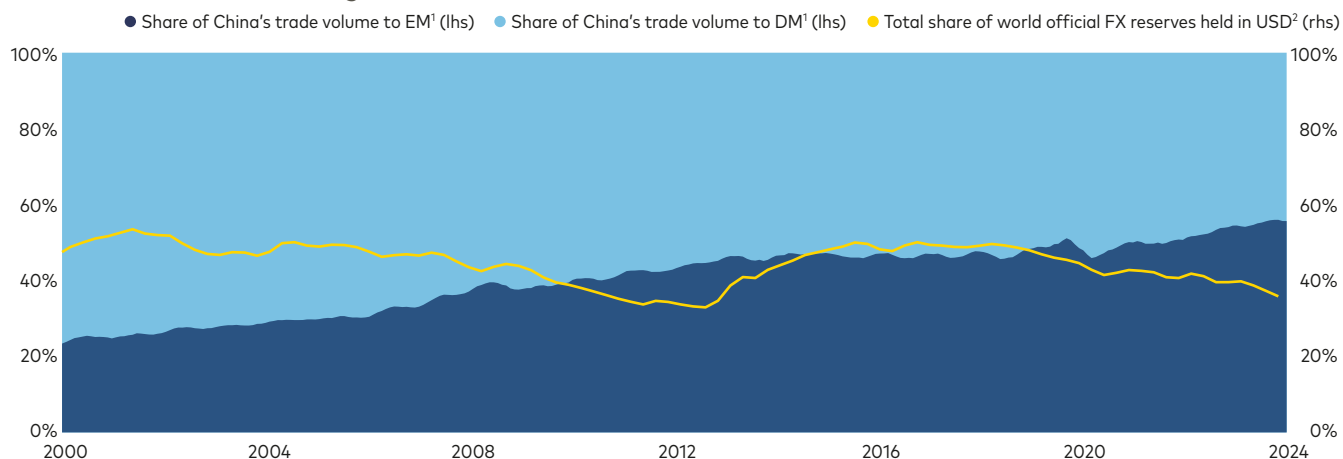
Source: Macrobond, Preqin, Pitchbook, LGT Capital Partners

Up until now, warnings of a "de-dollarization" had little credence. Yes, many countries have long started to diversify their foreign currency reserves away from the US dollar but so far, the move has been slow and gradual. That process may be about to shift gears. Driven both by economics and politics,

investment and trade flows have started to change direction. China's exports to other emerging markets already surpass its exports to the West and Asia-Pacific. The settling of trade deals in renminbi is on the rise, albeit from a low base. Sanctions imposed on Russia gave the process yet another jolt. Its exclusion from

dollar-based international payment systems put other sovereigns on high alert and official reserve holdings in gold rose sharply. At present, calling time on the US dollar's reserve currency status seems premature but we believe the development warrants close monitoring for future tipping points.

### De-dollarization in the making?



<sup>1</sup> China trade volume includes Hong Kong's exports. Regions based on IMF's Advanced economies and Emerging & Developing economies, but with Taiwan and South Korea counted as part of emerging economies; smoothed series (6M).

<sup>2</sup> Official world foreign exchange reserve holdings; share of claims in USD minus gold at market value.

Source: Macrobond, IMF, LGT Capital Partners

# Tipping points – preparing investment portfolios for the future

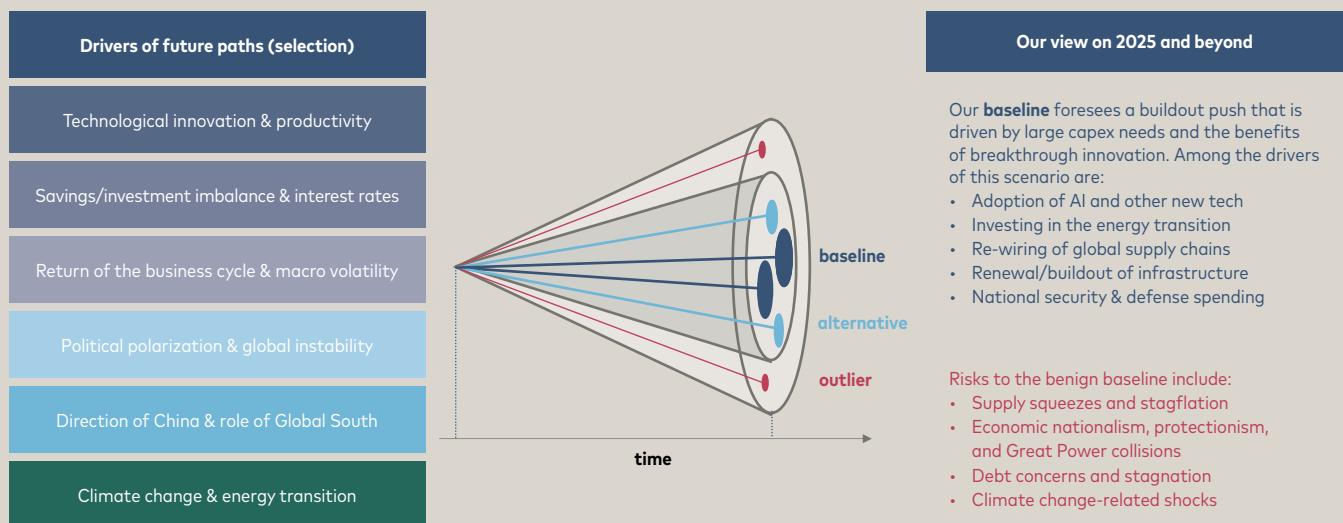
Tipping points are the thresholds at which developments accelerate—often with profound and irreversible consequences. For investors, it is therefore paramount to adjust to the rapid change that is taking place beyond tipping points that have already been crossed. Moreover, we need to prepare for nascent developments whose tipping points may lurk in the future. This is certainly no easy task. Our approach to managing current and future uncertainties in the asset allocation process is outlined briefly below.

## The LGT Endowment’s approach

For the LGT Endowment, we make use of our proprietary methods of scenario planning and robust diversification to address uncertainties and complexities. The graph below depicts some of the fundamental drivers of future developments and our assumptions regarding potential paths in 2025 and beyond.

Our long-term investment convictions and the more immediate economic outlook have been implemented in the LGT Endowment (see also “How we invest our own money” on page 26). Some of these high-level views on portfolio positioning are listed below.

### Scenario planning as a method of dealing with uncertainties and complexities



Source: LGT Capital Partners

## Our investment convictions in making portfolios future proof:

### 1. No anchoring to the past

The environment in the wake of the Great Financial Crisis (GFC) and the distortions following the Covid-19 pandemic were historical anomalies that are unlikely to be repeated any time soon. The future will therefore look decidedly different to the

recent past. For instance, we believe that interest rates (real and nominal) will eventually settle at a higher equilibrium level—a factor that must be taken into account when allocating funds for the long term.

### 2. Tilted toward future growth

At present, we are most likely experiencing the early- to mid-stage of a secular upswing,

driven by increasing capex and breakthrough innovations. As such, we are putting our available risk budget to full use and are maintaining exposures to growth assets, both in public and in private markets, and selecting best-in-class managers that know how to profit from value opportunities and secular growth themes.

### 3. Robust portfolio construction

The exposure to risk assets needs to be diversified in an effective and prudent manner. Given that future shocks and crises can take many forms, we choose to go beyond traditional diversification with bonds and currencies. In particular, we bank on the flexible and uncorrelated nature of liquid alternatives, such as hedge funds, insurance-linked strategies, and a dynamic protection program.

### 4. Inclusion of inflation protection

While cyclical inflation continues to abate, the trend towards economic nationalism and future episodes of supply friction are likely to mean that inflation remains subject to high levels of volatility. Real assets, such as infrastructure, private real estate and inflation-linked bonds, can help to alleviate the

erosion of purchasing power in a nominal investment portfolio. Gold can also be considered but as it is a non-productive asset, we prefer to steer our allocation dynamically (see box below).

### 5. Preparation for anti-cyclical value opportunities

Tipping points are bound to create uncertainty and volatility. The ideal approach is to have a framework in place that can a) mitigate drawdowns (see point on robust portfolio construction), and b) capitalize on episodes of market stress. Setting up a monitor for deep value buy signals in listed assets, and already committing to private equity secondaries and distressed debt managers, are steps that go a long way in preparing for and profiting from future dislocations.

### 6. Currency hedging & US dollar diversification

In general, currencies mainly add to the volatility but not to the returns of an investment portfolio. Hedging foreign currency exposures can thus materially improve the risk-return profile—a principle we have implemented strategically for all our multi-asset portfolios. However, there are two exceptions: One, we leave open most emerging and frontier market currency exposures for the extra yield they bring. And two, we keep some US dollar exposure as it helps to diversify risk assets. In recent years, however, we have shifted part of that “safe haven” allocation from the US dollar to the Japanese yen.

## The case for and against adding gold

Gold is, to put it bluntly, a fickle asset that reacts to different factors at different times. In the past, it has often—but not always—shone in times of heightened geopolitical conflicts, rising inflation, low real interest rates and a weaker US dollar. More recently, it has also been supported by central bank buying, primarily by central banks in emerging markets seeking ways to diversify their reserve holdings. However, in periods of sharp market selloffs, gold has often suffered initial losses alongside equities and other risk assets. As such, it has been anything but a reliable hedge for portfolio risks. While we refrain from having a fixed allocation to gold, we gain dynamic and, at times, significant exposure to precious metals via our tactical overlays and our trend-following managers.

### Equity market drawdowns and gold performance (in USD terms)



<sup>1</sup> Large equity drawdowns: S&P 500 loses 10% or more.  
Source: Macrobond, LGT Capital Partners

# Private equity

## How private equity is navigating a challenging environment

The private equity industry was faced with challenging macroeconomic conditions at the start of 2024, with record-high interest rates, persistent inflation and heightened geopolitical uncertainty. Despite these challenges, private equity and venture capital owned assets continued to grow, with assets under management exceeding USD 11.0 trillion, driven by inflows, asset appreciation and limited exit activity to buyers outside the private equity ecosystem. Today, there is unprecedented dry powder totaling USD 2.7 trillion.<sup>1</sup> The rate cuts implemented in 2024 by the US Federal Reserve (Fed) and the European Central Bank (ECB), their first since 2020, marked the start of a new market regime.

Recent months have brought a solid recovery in deal-making sentiment in buyout markets, supported by stable financing markets and a clearer macroeconomic forecast. By the end of the third quarter 2024, total deal activity had reached USD 713 billion and was thus on course to surpass 2023 levels. Over 50% of these deals were in North America, with 30% in Europe and the remainder in Asia.<sup>2</sup>

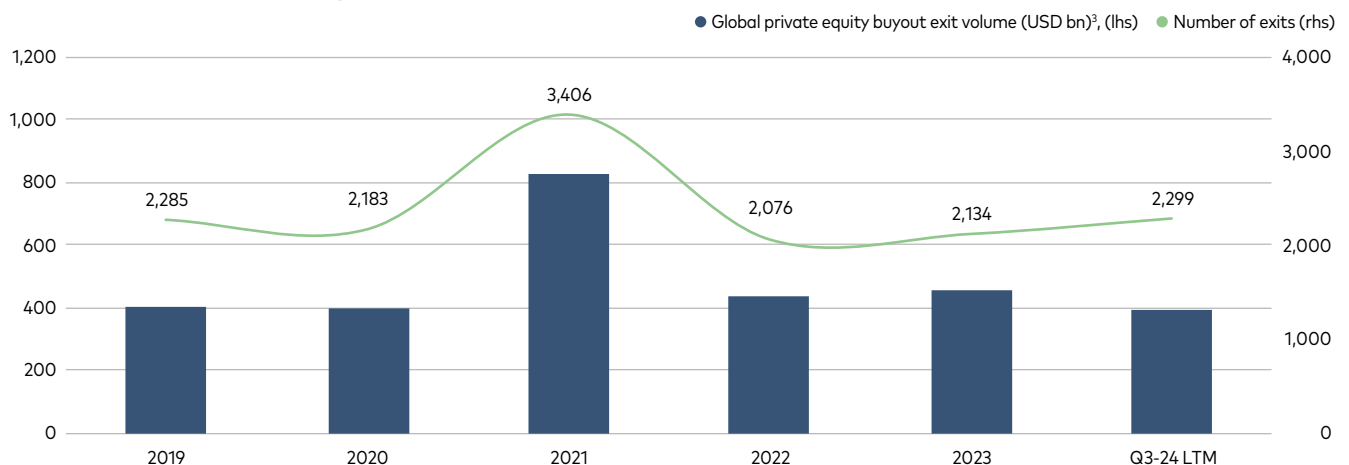
## Deal activity is picking up

Private equity managers currently own a historically large number of portfolio companies, with extended holding periods due to limited exit activity. Investor demand for distributions and the need for liquidity among funds could act as catalysts for deal activity in 2025.

With central banks poised to further cut interest rates, the cost of borrowing for leveraged transactions will ease, potentially driving higher transaction volumes and allowing general partners (GPs) to secure more favorable financing terms for portfolio companies. Lower rates would create a more favorable environment for refinancing existing debt and stabilizing interest coverage ratios of portfolio companies, which will allow for greater financial maneuverability for fund managers. This could provide another tailwind for deal activity.

Valuation gaps have narrowed as buyers and sellers increasingly find common ground. As financing becomes more accessible, both new investments and add-on acquisitions for existing portfolio companies are likely to increase. Selectivity will remain key, and investors should focus on assets with a clear strategic fit and strong fundamentals to ensure sustainable returns in an environment that remains complex.

## Exit volumes are in line with pre-Covid levels



<sup>3</sup> Private equity includes all categories under private equity as defined by Preqin. Data as of 30 September 2024 (data retrieved on 28 October 2024). Source: Preqin, Bain & Company, LGT Capital Partners

<sup>1</sup> Source: Preqin

<sup>2</sup> Source: Preqin

Competition for new capital remains significant, with a challenging fundraising environment over the last 24 months. However, there are early signs that conditions are improving. Among others, M&A activity is picking up, boosting exits and consequently also distributions, which in turn will support fundraising over the coming months. At the same time, private equity remains an integral part of asset allocation in the portfolios of institutional investors worldwide and continues to deliver competitive returns.

## Alternative liquidity solutions on the rise

While exit volumes in the sector have returned to pre-Covid levels, distribution yields remain subdued (see chart below). Alternative liquidity solutions are expected to continue to play an increasingly pivotal role amid slower exit activity. The secondary market has become an important tool for both limited partners (LPs) and general partners (GPs) to bridge the liquidity gap.

LPs are utilizing secondaries as a portfolio management tool to rebalance and create liquidity. GP-led transactions, on the other hand, allow managers to generate liquidity for existing LPs while retaining control of promising assets, representing a "win-win" for both GPs and LPs in such situations where interests are aligned. Beyond continuation funds, the GP-led market includes an array of tools, including tender offers and NAV financing. Follow-on capital will continue to be a crucial avenue for managers to pursue buy-and-build strategies and create value through operational

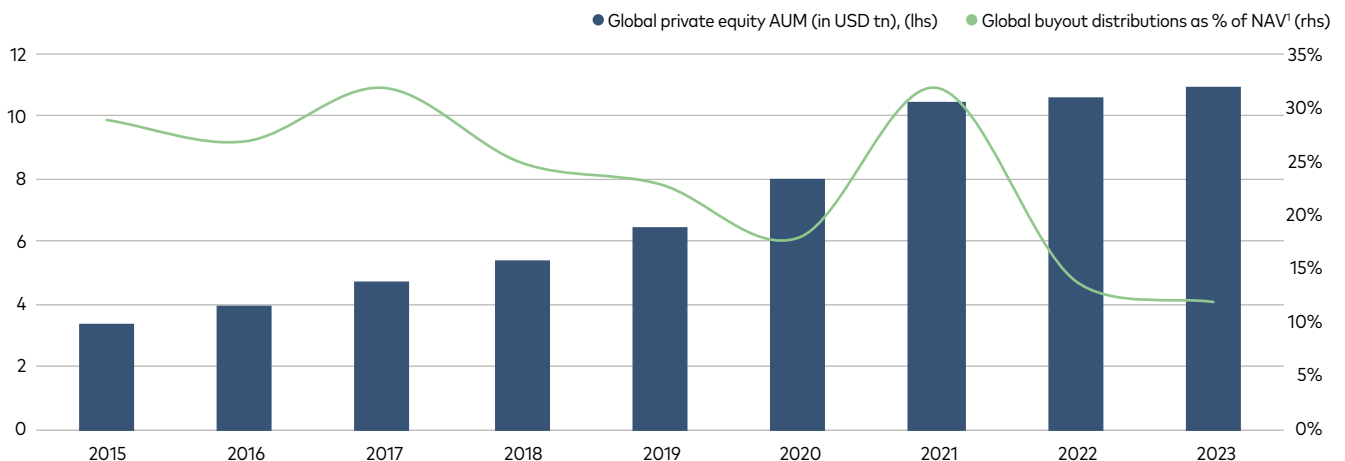
efficiencies and earnings accretion. For investors, this presents a chance to finance accretive add-ons with which they are familiar, while also gaining insight into their performance under existing ownership at favorable terms.

## Looking ahead

Looking ahead, 2025 offers both complexity and measured optimism for private equity investors. Though additional rate cuts are expected, positively impacting deal activity among others, it is improbable that rates will reach the historically low levels observed between 2010 and 2020. Geopolitical uncertainty and the uneven macroeconomic landscape in different regions will continue to present challenges. However, these periods can also present some of the most compelling long-term investment opportunities for discerning investors.

Private equity firms will need to remain disciplined in their underwriting approach by focusing on high-quality assets with strong fundamentals and controllable value creation levers. Liquidity solutions will remain essential tools in managing cash flow and meeting investor expectations, given softer distribution yields. These solutions not only address the immediate liquidity requirements of LPs but also empower sponsors to retain ownership and stewardship of the businesses in the portfolio. Investors who remain prudent, strategic and flexible will be well positioned to capitalize on the opportunities that lie ahead, ensuring continued success in an ever-changing market.

### Distributions lag behind industry growth



<sup>1</sup> Global buyout distribution rate is calculated as distributions as a percentage of net asset value. Data as of 30 September 2024 (data retrieved on 28 October 2024). Source: Preqin, Bain & Company, LGT Capital Partners

# Private credit

## Navigating the tipping point

In a volatile macro environment, private credit could be approaching a tipping point. The asset class is evolving from a fast-growing niche to a mainstream portfolio allocation for many investors. In recent years, the asset class has grown rapidly in volume but also in complexity as private credit moved beyond straightforward direct lending from closed-end funds to include areas such as structured credit, specialty finance, asset-backed lending and multiple options to access credit, such as secondaries and semi-liquid vehicles.

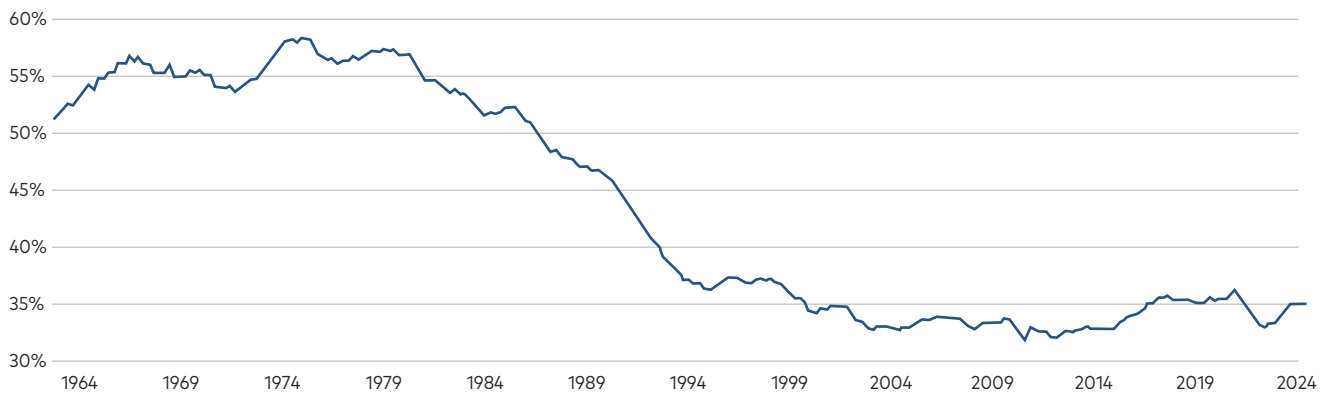
The fundamental driver of this market growth remains the retrenchment of traditional banks and the rise of alternative lenders to fill this space. This trend started in middle market leveraged buyout (LBO) financing in 2008, and a similar development on the asset-based lending (ABL) side has recently gained

momentum. Tighter bank regulation and the need for more adaptable and customized financing options in a dynamic macro environment are contributing to this development.

## The importance of active management

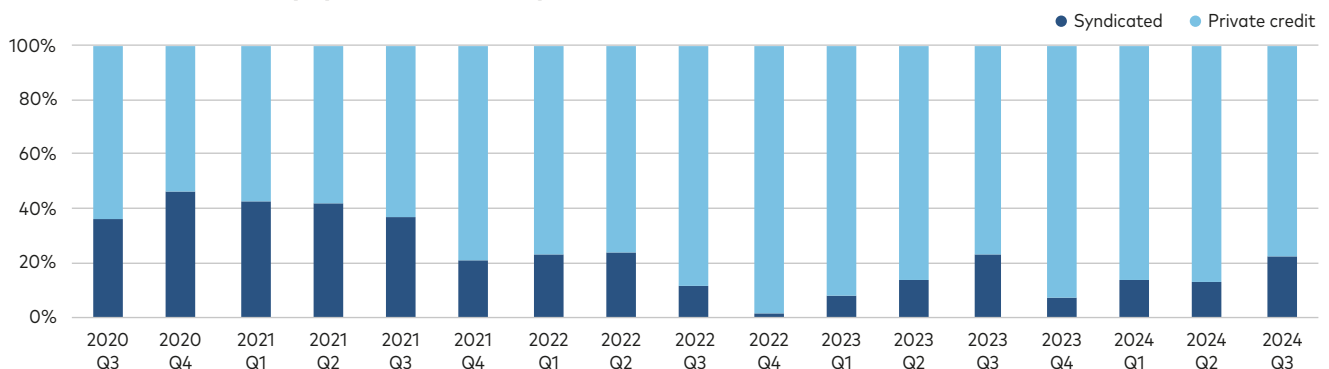
Given the complexity of the asset class, we believe the best risk-adjusted returns can be generated by a diversified, balanced and actively managed portfolio. At LGT Capital Partners, we continuously assess and adjust the value and risk of each credit sub-strategy, focusing on managing risks and analyzing cash flow profiles, duration, convexity, default risk and foreign exchange risk. Further, we use our market access to constantly evaluate manager development, key legal topics in loan documentation and the precedents set in restructuring outcomes.

Share of banks in total outstanding lending volumes<sup>1</sup>



<sup>1</sup> All bank to total loans to households and non-financial institutions in the US. Source: FRED, Oliver Wyman, LGT Capital Partners

Share of LBOs financed by syndicate banks vs private credit market<sup>2</sup>



<sup>2</sup> LBO: Leveraged buyout, data retrieved 18 November 2024. Source: Pitchbook, S&P LCD, LGT Capital Partners

Our preferred approach is to build portfolios with a core of lower-risk, yield-based strategies such as senior direct lending, while also capitalizing on market dislocations with higher-yielding, opportunistic strategies.

In the macroeconomic cycle, the market presents many opportunities but also certain challenges, especially: (i) the potential for higher default rates, (ii) a rapidly evolving restructuring environment, particularly in the US, and (iii) a possible consolidation of general partners (GPs).

First, higher defaults are a concern, particularly for a cohort of LBOs that were completed in the 2019–2022 vintage, when capital structures were built with the expectation of interest rates remaining at zero for the foreseeable future. These buyouts may struggle to generate enough cash flow to de-lever before refinancing, highlighting the importance of careful credit selection and risk management in private credit. Notably, default levels are not yet comparable to the global financial crisis, possibly due to underreporting of distressed exchanges, amend and extend transactions, and equity injections used to avoid public defaults.

Second, a number of sponsors have engaged in liability management exercises (LMEs) around more challenged LBOs, which were financed by broadly syndicated loans, exploiting weaker documentation to bypass protections for senior secured lenders. While these LMEs so far have not gained traction in private credit, a strong understanding of LBO documentation is crucial to achieve good returns.

Finally, not all managers will perform well and there may be a consolidation across market players, highlighting the importance of being closely entrenched in the asset class to navigate its dynamics.

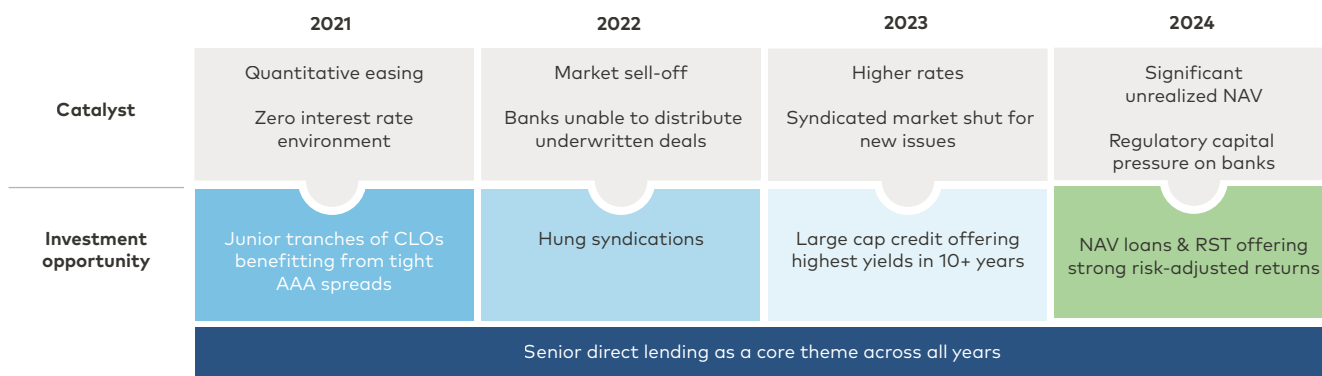
## Attractive outlook despite yield compression in large cap direct lending

2023 represented an outstanding opportunity for large cap direct lending as high spreads and limited competition provided an ideal environment for capital providers. However, market conditions have changed in the past 12 months in this section of the market. In particular, strong recent returns have led to significant capital inflows, impacting pricing and documentation.

Moreover, syndicated loans are regaining market share, driven by high demand from collateralized loan obligations (CLOs), which have rebounded after lower issuance in 2021-2023. Today, it is increasingly difficult to differentiate between loan documentation for syndicated loans and private loans in the large end of the market, with covenant-lite private loans increasingly prevalent. However, even with rate cuts, yields are in the high single digits and thus remain attractive. Additionally, the resilience of middle market spread levels and credit documentation is noteworthy. Meanwhile, the potential for other private credit sub-strategies remains highly compelling.

In summary, private credit is at a crucial juncture, with a continued shift from banks to alternative lenders and the asset class gaining importance in investors' portfolios, which benefit from a general expansion beyond pure direct lending. In our view, the best way to capture the opportunity set of this asset class is by building a core of globally diversified mid-market direct lending assets, complemented by more opportunistic and growing areas, including specialty lending (such as Net Asset Value financing and Risk Sharing Transactions), structured credit and asset-based lending strategies.

### Multi-strategy approach maximizes flexibility to adjust focus as market evolves



NAV: Net asset value; RST: Risk sharing transaction; CLO: Collateralized loan obligation.  
For illustrative purposes only and merely reflect the market observations and opinions of LGT Capital Partners.  
Source: LGT Capital Partners

# Emerging market sovereign debt

Emerging market sovereign debt comprises a very heterogeneous investment universe of more than 160 countries and different instruments, with hard currency as well as local currency bonds. The resulting return outcomes are strongly influenced by idiosyncratic and country-specific developments and by the various return drivers of the individual instruments.

## Signs of a turnaround in hard currency debt

An important development that drove investment returns and sentiment in this asset class were the various country defaults in the aftermath of the Covid-19 pandemic. Several countries are in financial distress due to increased debt levels and higher refinancing costs on the back of rising interest rates globally. However, 2024 marked a turning point, with no new sovereign bond defaults during the year and previously troubled countries (Ghana, Zambia, Ukraine) managing to successfully restructure their debt. These positive trends, in combination with a better financing environment, have strengthened market confidence. This, in turn, should lead to inflows into the asset class, not least as investor flows have already started to translate into positive return momentum. Selectivity will remain a key success factor for investment outcomes, and a focus on countries with credible and sustainable economic policies will be essential going forward.

## Improved outlook for local currency debt

High carry returns, supportive currency valuations and low historical foreign investor participation are supporting factors for the asset class going into next year. By focusing on markets with higher real rates and a positive outlook for governance and exports, very competitive risk-adjusted returns can be achieved.

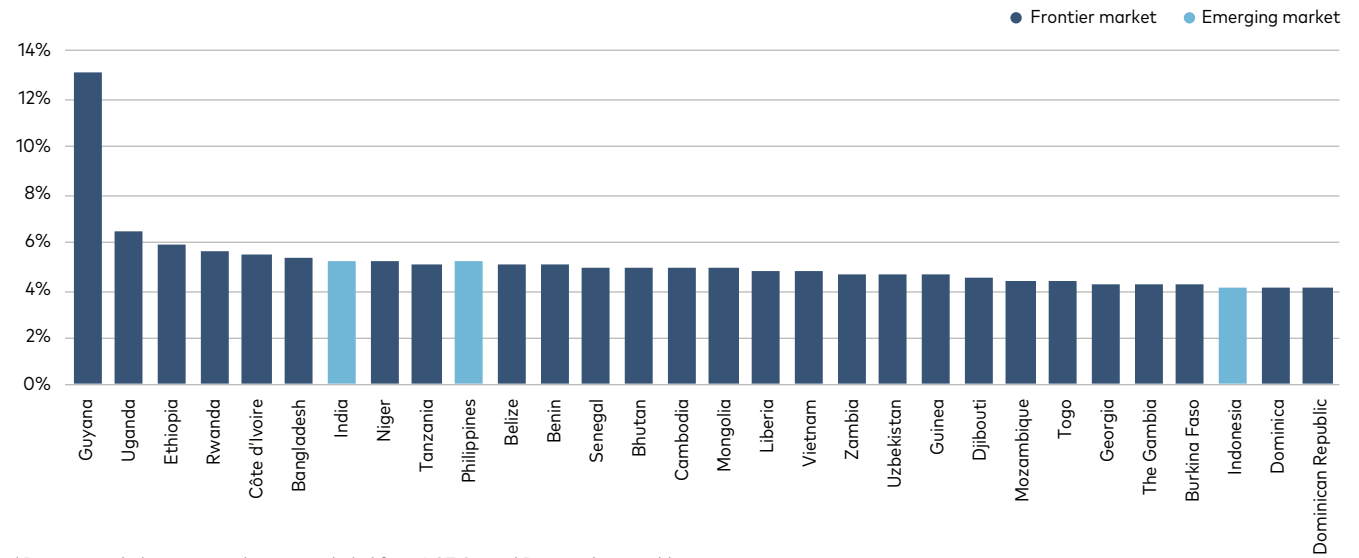
Most of the countries in the universe have sustainable external balances, which broadens the opportunity set. In general, lower risk-free rates in the US have the potential to support the asset class in terms of investor inflows and returns, as the relative value picture further improves and the hurdle rate for risky assets is lowered. An in-depth assessment of the different countries and regions in terms of fundamentals and valuations is indispensable as their absolute and relative attractiveness may differ significantly. Further, we believe there are considerable merits to expanding the investment universe beyond the narrower industry benchmarks, as this diversifies and enhances the return components of the asset class.

## Frontier market local currency debt with a distinct investment profile

During times of heightened global uncertainty, frontier market local currency debt has performed strongly against other asset classes, not least in terms of risk-adjusted returns. The performance of frontier sovereign debt instruments is mainly driven by their own idiosyncratic factors as well as the issuers fiscal and monetary policies. Further, these markets are dominated by local investors, significantly reducing flow-driven volatility due to foreign investors, which is often visible in other asset classes. Consequently, global drivers and uncertainty impact the asset class to a lesser extent, resulting in reduced volatility, low correlation and lower beta compared with other asset allocation components. During the last few months, many frontier market currencies experienced significant adjustments in the form of depreciation, providing an attractive starting point for the currency component going into 2025. At the same time, high nominal and real yields are expected to provide a steady income stream and buffer.



The 30 fastest growing countries<sup>1</sup> (expected real GDP growth p.a. 2024–2028)



<sup>1</sup> Does not include countries that are excluded from LGT Capital Partners' investable universe.  
Source: IMF WEO, LGT Capital Partners

# Real estate

## Valuation correction largely behind us

After two long years, disinflation is now prevalent across the globe, major rate increases are behind us and it appears that we are past what has been a text-book real estate market correction, with inflation up, the cost of debt up and rents up but values down (primarily due to the higher cost of debt). Real estate returns are now turning positive in many countries and deal volumes appear to have bottomed. While lenders still have difficult issues to work through with their existing loan books, there has been less new development financing, thus aiding the continuing positive story in real estate that supply/demand fundamentals are solid, if not strong, with the exception of the office segment and certain other markets.

## Compelling investment themes across sectors

The challenge for the market going forward is for transaction volumes to return to historic averages. Owners are reluctant to sell at depressed values and are mainly doing so in the face of hard loan maturity events, the end of fund lives or some other situation requiring sale proceeds—resulting in so-called “event-driven sales”. There is indeed some “normal” transaction activity, where owners are selling at values that have met business plan expectations, but overall transaction volumes remain below average. While the more positive interest rate environment is providing some relief to impending maturities in 2025, there is still a significant amount of real estate debt that needs to be refinanced at debt costs that are potentially still higher than the original cost of financing. Additionally, in certain cases, acquisitions are still subject to negative leverage.

As capital structures and pricing slowly reset to the new interest rate environment, investors with cash and access to debt are well positioned to enter the market at value points that are 20% off market peaks in some cases and are supported by strong fundamentals. Below are three broad but compelling investment themes for 2025 and beyond:



- 1. Residential supply-demand imbalance:** in both the US and Europe, there is an acute need for more housing. For example, in the US, supply delivery of new residential units will “fall off a cliff” in 2025 and 2026, with a shortfall of almost 5 to 6 million units compared to the number required.<sup>1</sup>
- 2. Re-engineering/refining industrial supply chains:** geopolitical tensions, national security interests and a desire for manufacturing alternatives will drive a shift in supply chain reshoring and the movement of production to friendly countries, all of which are positive drivers for industrial real estate demand.
- 3. Digital infrastructure:** advances in AI and technology are driving the increased need for digital infrastructure. Overall, the demand for data centers is expected to be around 2.5 times higher than the current supply by 2030, but bottlenecks in power infrastructure are holding back speculative development, with long queues (5–7 years) for electric hook-ups in prime markets.<sup>2</sup>

<sup>1</sup> Source: Green Street

<sup>2</sup> Source: Green Street



## More opportunities around the drive for specialization and distressed situations

In addition to these broad themes, there are numerous real estate asset class segments with healthy fundamentals that offer compelling opportunities as a result of the repricing investment environment. These include hospitality (e.g. extended stays and full-service), retail (e.g. 'fortress mall' or service retail) and alternative sectors (e.g. self-storage). There are also attractive opportunities in the net lease space across asset types. We continue to see the hyper-specialization of asset classes, leading to much more granular investment choices by type, location and size. Across all of these investment choices, the aforementioned event-driven sales are offering deep value opportunities for those able to transact quickly.

The office market remains the problem child of the industry, but to different extents, depending on the macro location (US vs. Europe vs. Asia), micro

location (downtown vs. suburb) and asset quality (modern vs. dated). In addition, the increased cost of debt, work-from-home models introduced in the wake of the Covid-19 pandemic and a recessionary environment in many markets have resulted in severe value adjustments. However, even in the office segment a gradual shift in perceptions is now underway as employers are increasingly requiring employees to spend more time back in the office with the goal of enhancing collaboration and performance.

Notwithstanding recent negative headlines about commercial real estate experiencing widespread distress or the office segment being impacted by work-from-home models, there are many positive trendlines in the fundamentals and many supporting arguments to invest across sectors. As such, our approach going forward is to be mindful of the forces shaping the real estate markets and to actively mine opportunities arising from capital structure resets, i.e. event-driven sales, and demand-driven business plans.

# Infrastructure

## The buildout of an asset class

The infrastructure market is experiencing rapid growth due to decades of underinvestment, aging infrastructure, and trends such as the adoption of digital technologies and the need to accelerate the energy transition. Against this backdrop, vast investments are required to build and upgrade infrastructure, resulting in a growing investment opportunity set and increasing investor interest in this asset class. Today, infrastructure assets under management (AUM) have reached more than USD 1.3 trillion, up from just over USD 250 billion in 2013, corresponding to a compound annual growth of around 20% over the last ten years. Going forward, AUM are projected to continue increasing by 15% annually until 2027.<sup>1</sup> Additionally, since 2017, the number of infrastructure funds on the market has increased threefold, driven mainly by new entrants and platform expansions, reflecting the vast opportunity that this asset class presents. Looking ahead, long-term growth prospects remain strong, underpinned by secular growth drivers connected to digitization, energy transition and demographic changes.

## Digitization: exponential rise in demand for data-related infrastructure

2024 saw a significant increase in digital infrastructure investments, driven by the growth and speed of AI adoption and the sustained demand for digital infrastructure assets. Data is the fastest-growing commodity, necessitating massive investments in the physical infrastructure behind processes such as transmission, hosting, data processing and manipulation. With the rise of generative AI, the data volume has increased by more than 130% since 2020.<sup>2</sup> Over 6,000 megawatt (MW) of new data center capacity will be required by 2026. In 2024 alone, there was increased deal flow in this space, reflecting strong demand from hyperscale companies with enormous compute, storage and networking requirements such as Amazon and Microsoft, which are looking to secure data center capacity in anticipation of future needs.

## Decarbonization: energy transition moving beyond its tipping point

In 2023, global annual renewable energy capacity additions increased by nearly 50% to 510 gigawatt (GW), the fastest growth rate in the past two decades. In 2024, global investment in clean energy is expected to reach almost double the amount going into fossil fuels, with an expected investment of USD 2 trillion in CO<sub>2</sub> abating technologies such as renewable energy, electric vehicles and nuclear power (see chart next page).<sup>3</sup> Further, the growth in data center electricity use, which is expected to double by 2026, has emphasized the urgent need to direct capital towards renewable energy sources, grid infrastructure and battery storage solutions to combat the intermittency of wind and solar power generation. In 2024, Microsoft signed a global framework agreement with Brookfield to deliver over 10.5 GW of new renewable power capacity by 2030, while Amazon signed an agreement to develop nuclear small modular reactors as part of its planned transition to carbon-free energy.

## Resilient past, attractive future

The infrastructure asset class has proven resilient and has performed well throughout market cycles due to its low correlation to other asset classes, stable valuations, consistent yields and inflation protection characteristics. Moreover, structural trends like digitization, decarbonization and demographic change will play a critical role in the future development of the asset class and will require more capital investment. As it navigates this environment and the vast opportunity set, LGT Capital Partners remains focused on building a well-diversified portfolio of investments that can provide essential services, benefit from structural growth drivers and preserve capital in market downturns.

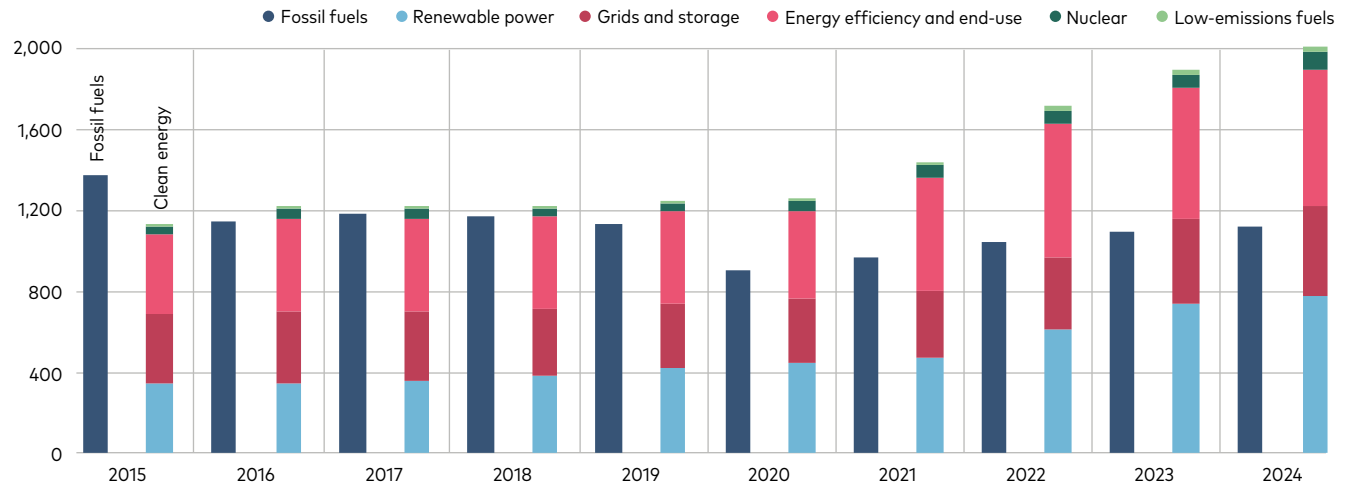
<sup>1</sup> All numbers according to Preqin

<sup>2</sup> Data growth worldwide from 2010 to 2020, with forecasts from 2021 to 2025; statista.com

<sup>3</sup> Renewables 2023 – Analysis and forecast to 2028; IEA



### Global investments in clean energy and fossil fuels (USD bn)



Source: IEA, LGT Capital Partners

# Hedge funds

## A valuable building block

We invest across a broad range of discretionary and systematic hedge funds for the LGT Endowment. On the discretionary front, this includes long/short equity, event-driven and relative value strategies. The systematic component features strategies such as quantitative macro, trend-following, short-term trading, quantitative equity, market-neutral and AI/machine learning. The overall allocation to hedge funds aims to deliver absolute returns across market cycles with strong downside mitigation, as well as diversification against traditional asset classes.

For 2025 and beyond, the outlook remains positive in our view, with elevated interest rates and divergent central bank policies, plus increased macroeconomic volatility, creating opportunities for hedge funds to generate alpha.

## Elevated interest rates and market dispersion to persist in 2025

Discretionary long/short strategies are benefiting from elevated dispersion and single-security volatility in both equity and credit markets, which provide attractive investment opportunities. The increased focus on sector-specific stock pickers targeting universes traditionally characterized by these dynamics is expected to drive opportunities, regardless of market direction.

For credit-oriented and convertible arbitrage managers, liability management exercises are expanding the opportunity set. With interest rates still elevated, both high- and low-grade firms are working to manage borrowing costs by refinancing bonds set to mature over the next few years. As the US Fed and the ECB enter

easing cycles, management teams see opportunities to refinance existing debt at lower rates and to raise new capital, opening up investment opportunities.

Following the US presidential election, increased clarity around the political and regulatory landscape could also spur M&A activity, resulting in attractive opportunities for merger arbitrage strategies.

## Innovative systematic hedge fund strategies

In an environment of heightened market uncertainty, actively traded systematic strategies also thrive. Their diversified and adaptive asset class allocations allow them to seize opportunities simultaneously across various asset classes and thousands of markets.

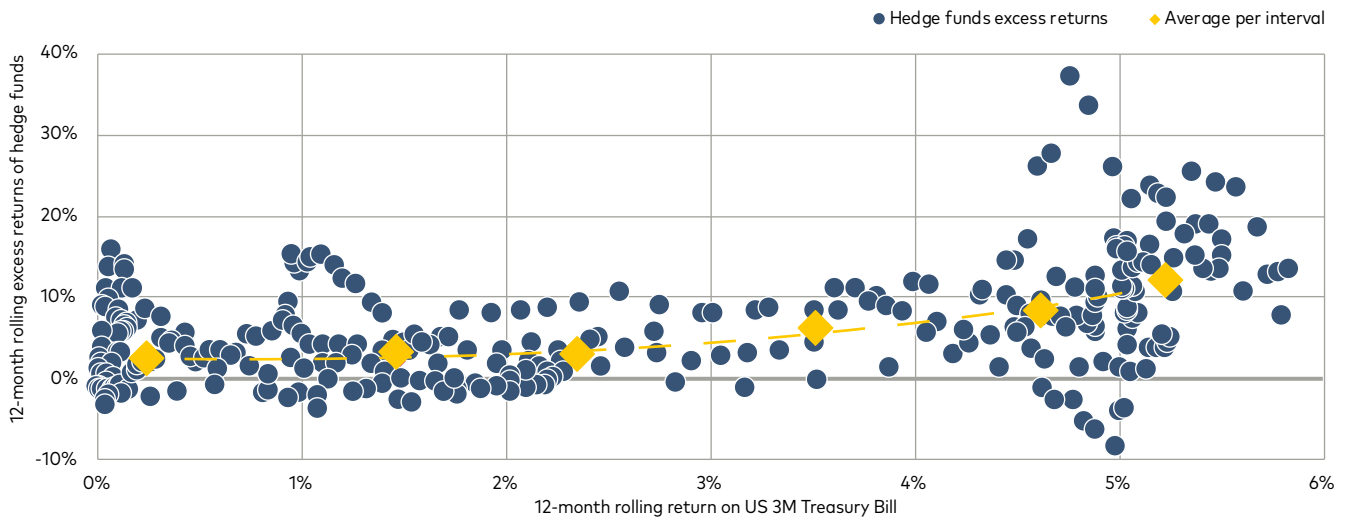
Moreover, these systematic hedge funds are both dynamic and innovative and they use sophisticated machine learning strategies, thus leading the way in developing new investment techniques.

## Stable returns and diversification for a traditional portfolio

Overall, hedge funds can offer attractive returns and new sources of performance, as well as enhancing overall portfolio resilience due to their diversifying nature. In the current environment of market volatility and economic uncertainty, these strategies can navigate *challenges and seize opportunities that traditional investments might miss*. Their ability to adapt quickly to changing market dynamics makes them a valuable investment, helping investors to mitigate risks while pursuing performance growth in a complex financial landscape.

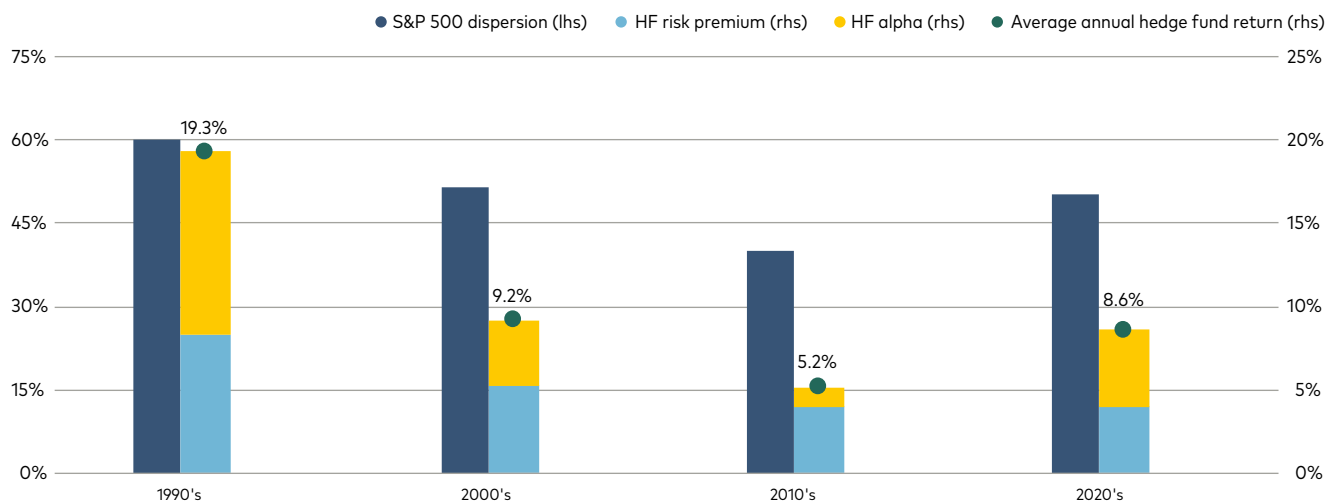


### Hedge fund excess returns in different interest rate regimes<sup>1</sup> (in USD terms)



<sup>1</sup> Hedge fund excess returns are calculated using trailing 12-month returns of HFRI Fund Weighted Index and subtracting the respective 12-month rolling returns of the MSCI World NR Index Hedged adjusted for equity beta of HFRI Fund Weighted Index; data used from October 1994 through October 2024. Source: LSEG, HFRI, LGT Capital Partners

### Hedge fund returns and dispersion within the S&P 500 Index per decade<sup>2</sup> (in USD terms)



<sup>2</sup> HFRI Fund Weighted Index decomposed into risk premia and alpha components using proprietary LGT CP factor models; S&P constituents' cross-sectional dispersion of the quarterly returns was estimated per decade. Data as of 30 September 2024. Source: LSEG, HFRI, LGT Capital Partners

# Insurance-linked strategies

## Strong demand for insurance capacity after loss-heavy years

2024 was a year of attractive return momentum for investors in insurance-linked strategies (ILS), despite significant hurricane activity in the North Atlantic late in the season. The asset class already experienced a fundamental increase in pricing and return characteristics in the course of 2023, and ILS markets were able to maintain this strong price momentum throughout 2024. While last year's performance for ILS investors was in line with expectations, the overall market environment for primary insurers remains under pressure: the level of attritional losses from so-called secondary perils such as local floods, hail, tornadoes and wildfire events remains high. The continued inflationary pressure is also resulting in higher potential losses in the stress test scenarios of the insurance industry, which in turn leads to an increase in regulatory capital requirements. Factoring in the impact of extreme single catastrophe events during 2024, such as the earthquakes in Taiwan and Japan earlier in the year, the heavy rainfall and flood events in Europe in the summer, and the hurricanes affecting the US mainland in September and October, the combined effects of losses and regulatory pressures have resulted in continued strong demand for additional reinsurance and ILS capacity.

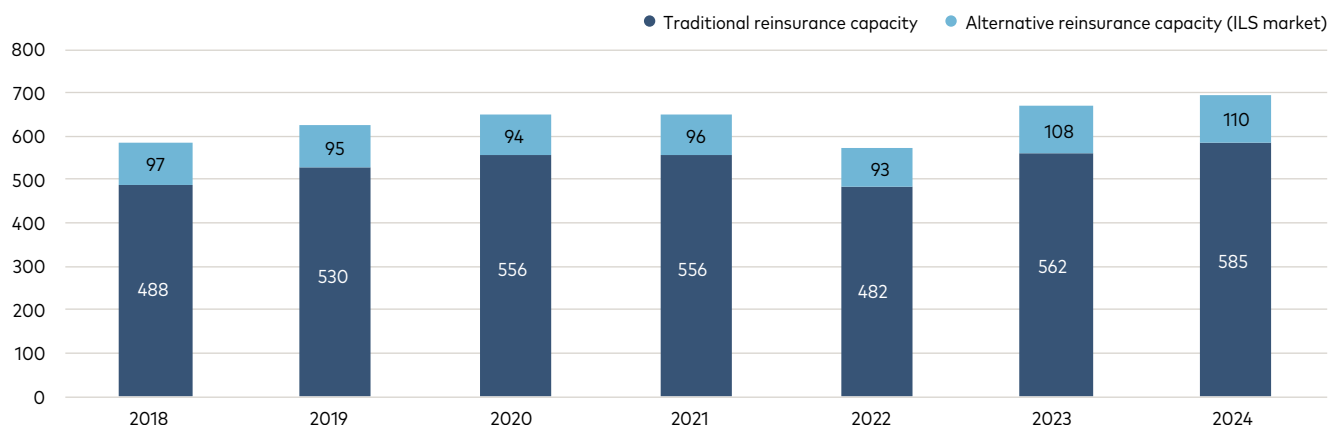
The outcome of the 2024 North Atlantic hurricane season is clearly once again playing a vital role in determining the ultimate performance of the asset class as well as the rate environment. Earlier in the

year, key research institutes forecasted an above-average hurricane season. This assessment was driven by high sea surface temperatures in the Atlantic and Gulf regions at the end of the first quarter. However, the high concentration of Saharan dust in the Atlantic basin led to drier and more stable atmospheric conditions, and the late shift of El Niño/La Niña conditions helped to keep windshear over the main storm development region above its climatological average. As a result, the season started late and lasted much longer than in previous years. Ultimately, event activity—with several hurricanes making landfall on the US mainland—underlines the importance of prudent portfolio management in ILS investing, with a clear focus on limiting downside risk.

## Supply and demand to find a higher balance in 2025

While the combination of increased regulatory capital requirements and above-average event activity should now lead to a continued strong price environment, this high demand for protection purchases is also meeting an increased supply of capacity. This growth in available capital is partially driven by the positive returns of ILS managers and reinsurers, who are reallocating their retained earnings. Another important source of fresh capital is the wealth management segment, where we are seeing a continued interest in liquid ILS (cat bond) allocations. We therefore expect to see further growth in the ILS market and attractive allocation opportunities as we move into 2025.

### Development of global reinsurance capacity (USD bn)



Data per 30 June 2024  
Source: Gallagher Re, LGT ILS Partners

# Impact investing

## A heightened sense of urgency

The need to transition to a more impactful capital allocation process is becoming increasingly urgent as the world's environmental and social challenges continue to mount. Climate change and severe weather events, as well as inflationary pressures, rising (geo)political tensions and armed conflicts are all contributing to growing social inequality and political polarization in many regions of the world.

Investors are increasingly responding to these global challenges by viewing capital as a force for good and adopting impact investing strategies. According to the Global Impact Investor Network (GIIN), there are now close to 4,000 organizations that collectively have a total of over USD 1.5 trillion of impact investing assets under management (AUM) worldwide. This means that the impact investing market has expanded at a compound annual growth rate (CAGR) of 21% since 2019. Translating investor assets and commitments into actions can prove challenging, particularly for emerging impact managers. While impact standards and frameworks remain fragmented, best practices are emerging and becoming more widely adopted. Ensuring that capital is invested effectively and in accordance with good market practices is crucial to preserve the integrity of impact investing activities.

## Expansion of capabilities in impact investing

At LGT Capital Partners, we have been consciously growing our impact investing activities for more than a decade and we have integrated the impact dimension with a focus on environmental and social outcomes into our impact investment processes. We are proud to see the positive results of our impact investments, along with the growing interest from our clients in deploying capital with both return and impact objectives.

Over the last year, we have further expanded our impact activities in private equity and private debt with closed-end funds and significant mandates, all focusing on achieving positive impact. In addition, we have developed a best practice guide for private equity impact managers to illustrate some of the key elements of impact investing, highlighting tangible examples from some of the world's leading investors.

We have also taken a more ambitious approach to investing in climate solutions and impact investing within the LGT Endowment. Our clear intention is to invest in attractive new opportunities arising from the green transition, while mitigating the associated risks. In the coming months, we will further define our priority areas and refine our ambition level.

## A growing set of opportunities

The opportunity set comprising proven profitable and scalable businesses that are responding to critical environmental and social challenges is rapidly expanding. Innovations in the areas of energy transition, decarbonization, healthcare and fintech will all meaningfully shape the investable landscape for private equity investors. At the same time, many highly experienced investors that have built track records within conventional private equity firms are now launching impact or thematic funds with a sustainability and/or social focus.

In addition, biodiversity is now featuring more prominently on the agendas of corporations, investors and global organizations, and new standards are emerging to measure and integrate biodiversity into business decisions.

In our view, this growing range of promising investment opportunities will attract strong private equity investors into this space and lead to the further institutionalization and expansion of impact investing in 2025 and beyond.

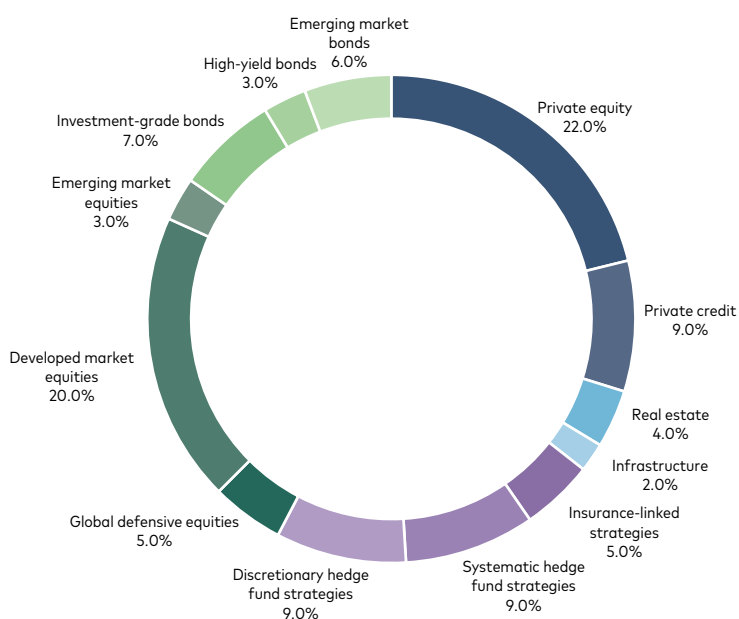
# How we invest our own money

LGT Capital Partners has been managing and investing a combined portfolio of traditional and alternative investments, the LGT Endowment, for over 25 years. Today, this strategy exceeds USD 20 billion in assets under management,<sup>1</sup> with around USD 2.5 billion of capital from LGT's sole shareholder and substantial sums of capital from key investment professionals at LGT Capital Partners. This drives the strong alignment of interests between the firm's owner, our investment team and our investors.

The LGT Endowment's investment mandate is to achieve sustainable long-term asset growth with moderate volatility. To this end, we developed our proprietary strategic asset allocation methodology. Its core components—scenario planning and robust diversification—help us to build an investment portfolio for an uncertain future and changing market environments with the ambition of generating attractive risk-adjusted returns over the long run.

## Tipping points—preparing investment portfolios for 2025 and beyond

Our latest adjustments to the strategic asset allocation include a slight increase of equity beta, a shift from high-yield bonds to private credit, and a strengthening of our allocation in local-currency denominated frontier market debt. As before, the growth tilt of the portfolio is complemented with diversifying strategies, namely systematic and discretionary hedge funds and a dynamic protection strategy. In addition, our foreign currency hedging strategy is geared towards reducing overall portfolio risk.



### Private markets

The owner-manager structure of private equity holdings, together with long investment horizons, allows for active value creation over a full cycle. In private credit, contracts are individually negotiated in close consultation with counterparties.

Carefully selected infrastructure and real estate deals offer the potential for inflation-resilient income yield and capital growth.

### Hedge funds and liquid alternatives

Alternative investment strategies are a source of uncorrelated returns found in the systematic harvesting of alternative risk premia or the generation of alpha from high-quality discretionary managers.

Insurance-linked strategies also focus on generating returns that are independent of the overall market direction. The dynamic protection strategy is specifically designed to cushion market drawdowns in the portfolio.

### Specialized equities and fixed income

When selecting publicly traded securities for our multi-asset portfolios and individual mandates, we maintain a strong focus on sustainability and quality. Value-add through active management is another cornerstone of our public market strategies. In addition, we participate in attractive niches such as global inflation-linked bonds or emerging market debt in local currencies.

<sup>1</sup> Assets include shareholder, staff and client investments. The LGT Endowment is not available for investment by US investors. The quotas above represent the long-term, strategic asset allocation. The actual, invested asset allocation can deviate significantly from these numbers for tactical and portfolio management reasons. Please note that the portfolio has 4% leverage and that the 2% allocation to the dynamic protection strategy is an overlay strategy and is thus not added to the overall sum of assets allocated.

Source: LGT Capital Partners

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