Blackstone

The Connection

Joe Zidle — Chief Investment Strategist, Private Wealth Solutions

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“Work the Problem”

In the 1995 movie *Apollo 13*, NASA Flight Director Gene Kranz tells his team, “Work the problem.” Instead of fixating on what **should** have been — a routine moon mission — they focused on the **reality**. A landing was off the table due to damage caused by a ruptured oxygen tank. They couldn’t change the circumstances, but they could adapt and find a way to get their astronauts home safely, which they did (with some “artistic liberties” in the movie). The phrase has since become a problem-solving mantra: Systematically break down the problem rather than get stuck on assumptions, distractions, or even asking the wrong questions.

Investors need to take the same approach and adapt to a new reality. The old investment playbook relied on ultra-low yields, traditional public 60/40 portfolios, and central banks stepping in as backstops. We’re now in a world where real rates are meaningfully positive, inflation is slower to recede, and economic resilience is keeping policy tighter for longer.

The US Economy Is on Solid Footing

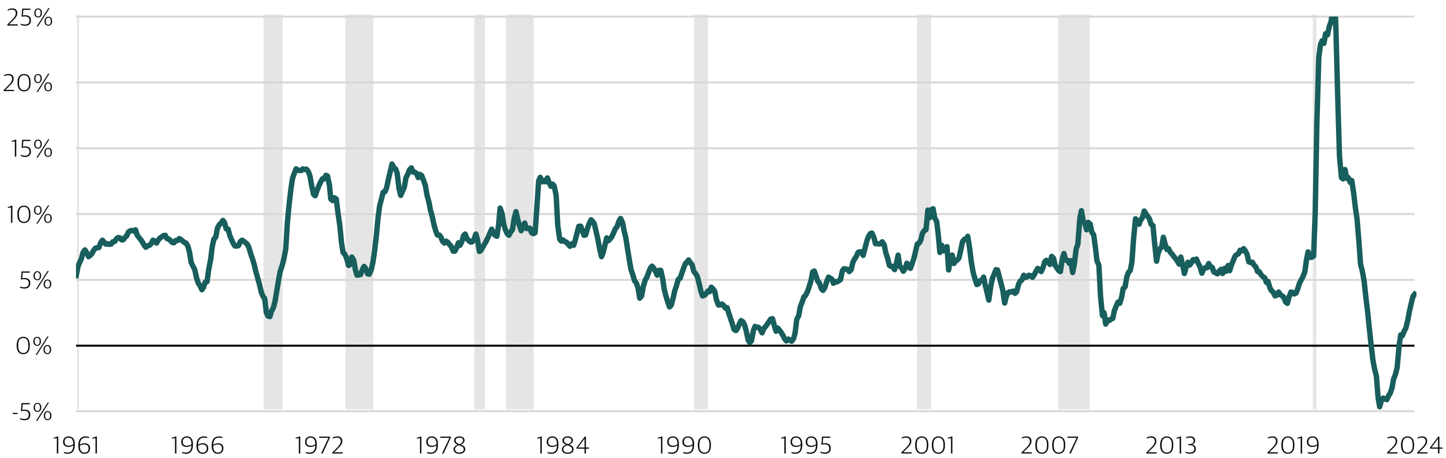
The Q4 2024 GDP report showed robust consumption growth at the strongest pace since early 2023 (+4.2% quarter-over-quarter, annualized).[1] Add to that strong household and corporate balance sheets, full employment, and easing credit conditions, and you have an economy that remains in solid shape.

While initial jobless claims remain low, the ratio of job openings to unemployed persons has declined, along with the quits rate — signaling a cooling, yet balanced labor market where finding a job has become more challenging. Within Blackstone’s private equity portfolio, we are also seeing a normalization of the labor market, with only 40% of US company CEOs reporting hiring challenges, the lowest percentage of the post-COVID-19 era, down significantly from the 76% peak.

Improving this stable picture is an increase in liquidity with more lending from private credit pools and banks, and money supply growth turning positive, rising nearly 5% year-over-year (see Figure 1).[2] With this backdrop, policymakers hit pause on further rate cuts, and now, with stronger economic data, market expectations have shifted from four cuts in 2025 to one.[3]

Figure 1: M2 Money Supply Growth

(% YoY)



Source: Macrobond and Federal Reserve, as of December 31, 2024. M2 money supply includes M1 (currency, demand deposits, and liquid savings deposits) plus certificates of deposits and money market funds. Grey bars represent NBER defined recessions.

1. Bureau of Economic Analysis, as of December 31, 2024.
2. Federal Reserve, as of December 31, 2024.
3. Bloomberg, as of February 13, 2025. Represents Federal Reserve funds futures contracts.

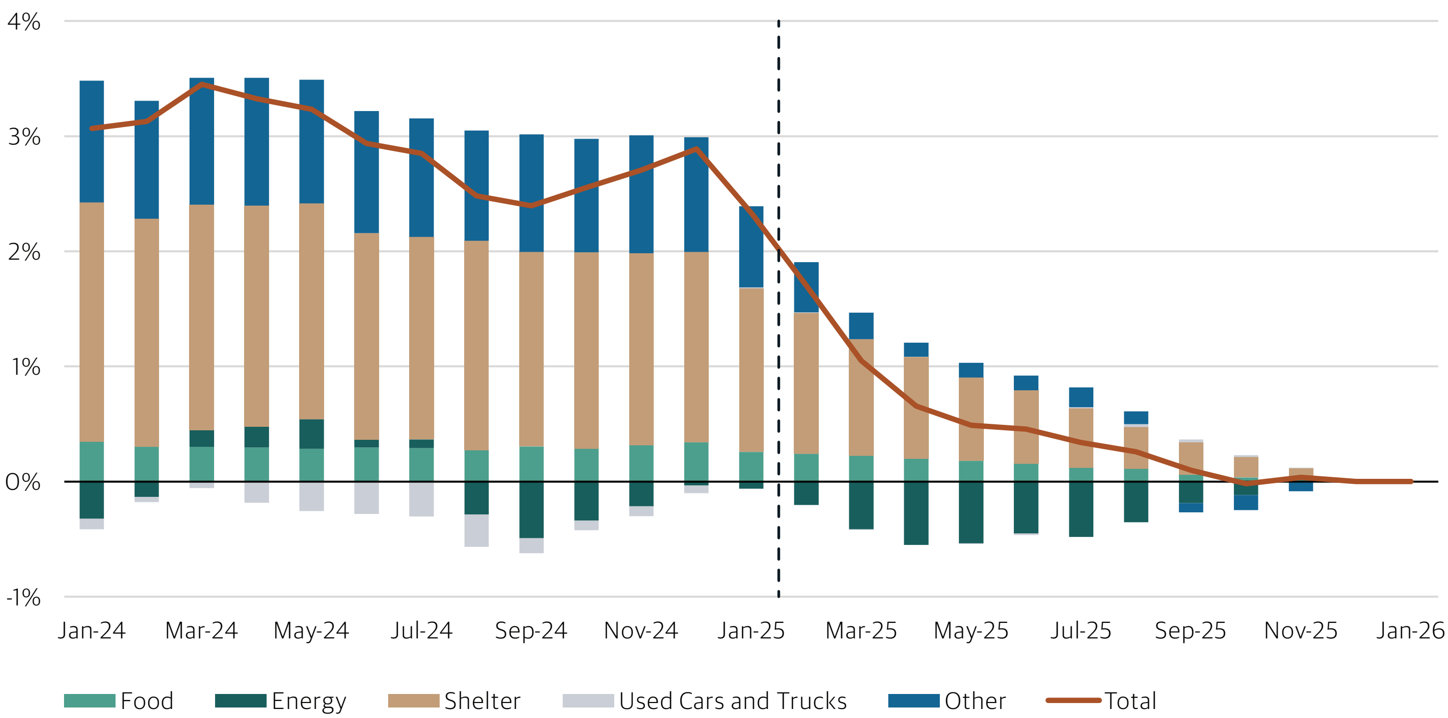
A Closer Look at Inflation And Interest Rates

The path of disinflation is slowing; however, our analysis indicates that government data continues to overstate shelter inflation, a significant component of CPI, comprising around one-third of the overall index and more than 40% of core CPI.

The latest CPI report had shelter increasing by 4.4% year-over-year.[4] However, after reconstructing the Bureau of Labor Statistics' (BLS) methodology and incorporating real-time rent data from Blackstone's multifamily and single-family rental portfolios alongside industry figures, we find that shelter inflation is running around 2% year-over-year. Adjusting these inputs suggest inflation is much closer to the Fed's target.

Looking ahead, favorable year-over-year comparisons could further support this trend. Figure 2 below illustrates if monthly CPI growth flattens to zero, the year-over-year inflation rate would still decline due to tougher base effects. All else being equal, shelter costs are coming down, while other components have been heating up.

Figure 2: CPI Projections Assuming Zero Growth in Underlying Components



Source: Bureau of Labor Statistics, as of as of January 31, 2025. Data after January 2025 are projections assuming zero growth in the underlying CPI components listed in the chart.

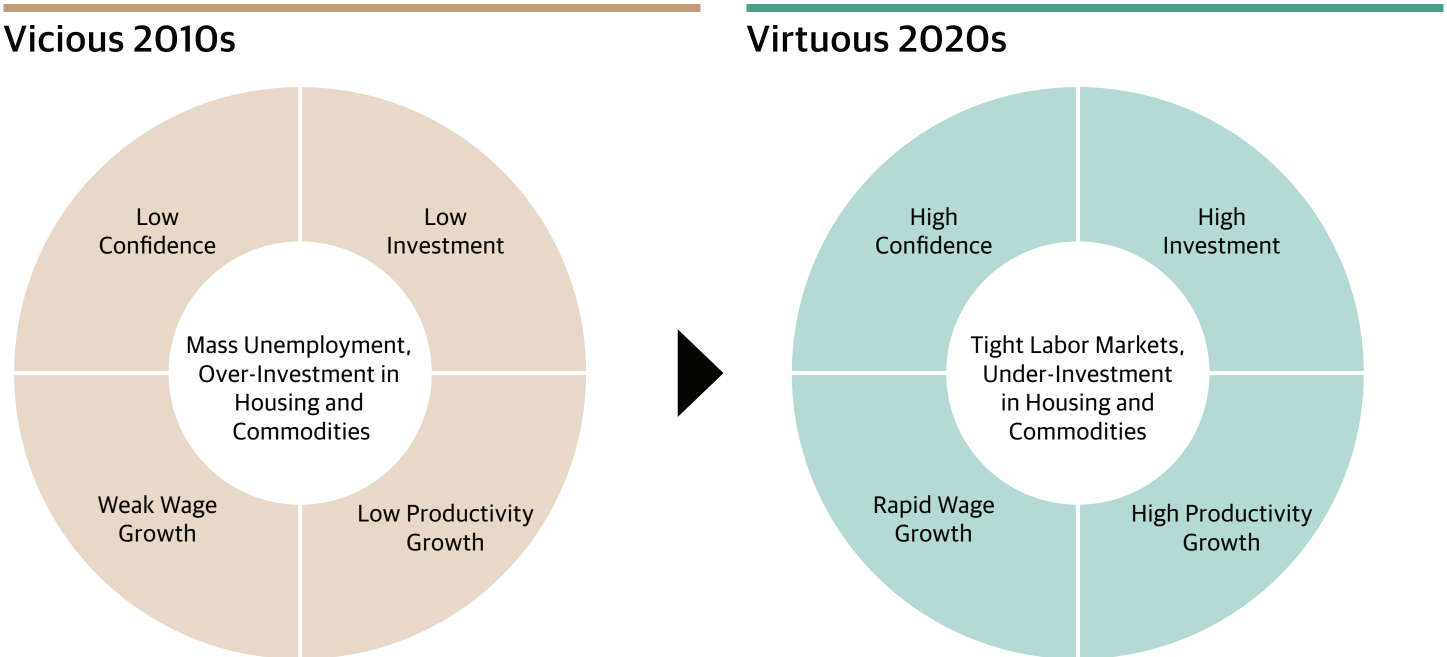
The Fed indicated in January its current policy is "meaningfully restrictive." But the real takeaway is how well the economy is performing in this environment.

Historically, strong productivity growth (think the late-1990s tech boom) coincided with rising rates, yet economic expansion continued. That raises two key questions: How much lower do rates need to go and at what point does the 10-year Treasury yield start to hinder growth? Recent years have shown that both the economy and financial markets can thrive even with higher rates.

This shift in economic conditions underscores what I see as a broader transition — from the "vicious cycle" of the 2010s, characterized by higher unemployment and sluggish productivity, to a more "virtuous cycle" in the first half of the 2020s marked by tight labor markets, rising wages, and strong investment (see Figure 3). For investors, this change isn't just an economic backdrop, it's a call to rethink portfolio strategies.

4. Bureau of Economic Analysis, as of January 31, 2025. Seasonally adjusted year-over-year change.

Figure 3: From a Vicious to a Virtuous Cycle



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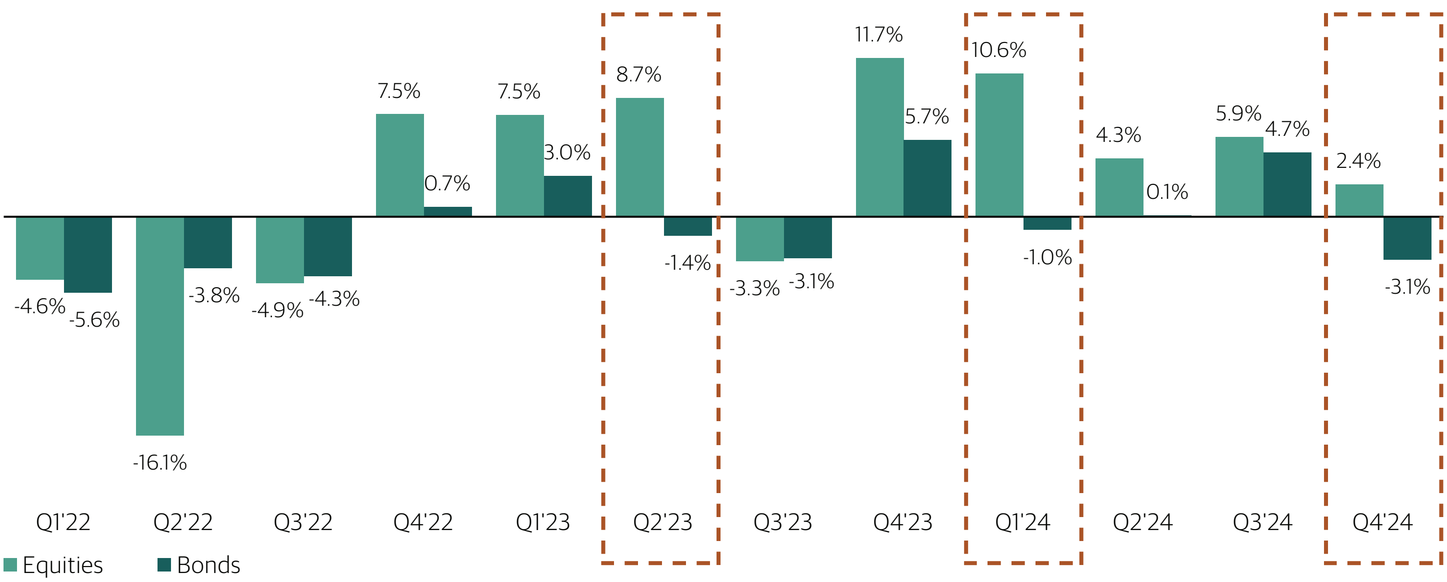
Asset Allocation In a Virtuous Cycle

So how do you allocate capital given that rates are, on average, higher than the previous cycle? Understand the problem, and then work the problem. Traditional public-only portfolios have long benefited from a reliably negative correlation between bonds and equities. However, this relationship has become unreliable, as seen in 2022 when both asset classes declined sharply, and in several subsequent periods. Since the first quarter of 2022, stocks and bonds have only exhibited a negative correlation 25% of the time (see Figure 4).

Figure 4: Total Return for US Stocks and Bonds
(% QoQ)

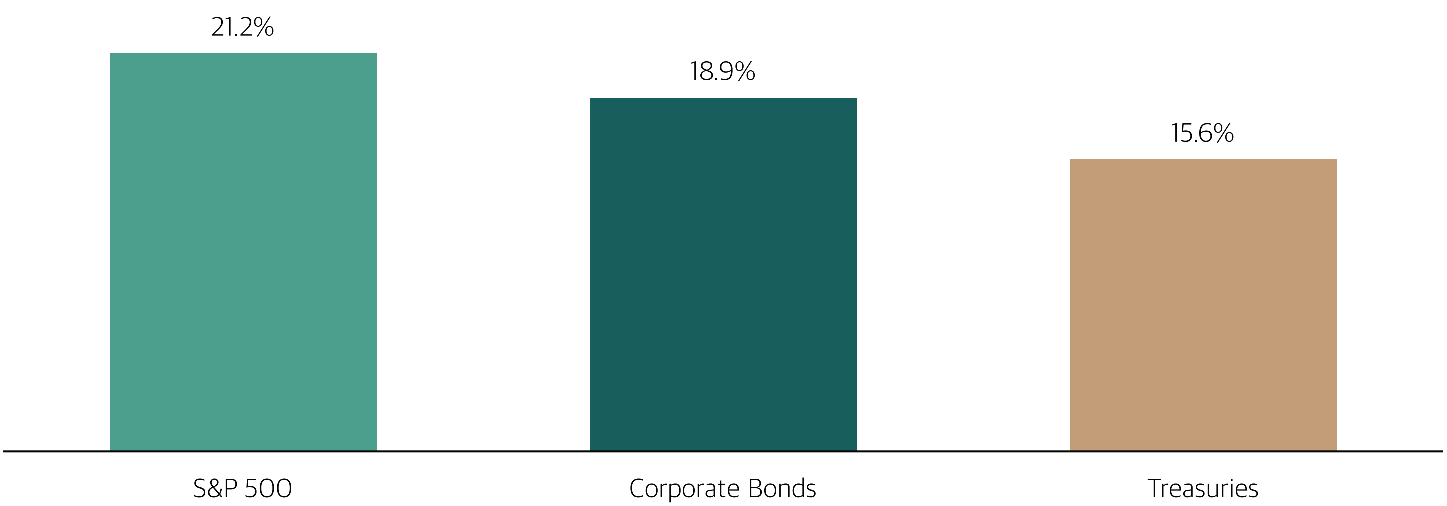


Source: Bloomberg, as of December 31, 2024. Equities reflect total quarterly returns for the S&P 500 Index. Bonds reflect total quarterly returns for the Bloomberg US Treasury Index. Red boxes represent quarters of negative correlation.

Given these conditions, we believe that private markets provide a more reliable avenue for investors to improve diversification and can enhance returns through:

- **Private equity** which has historically outperformed public market equities over the long run and currently offers more attractive valuations.
- **Private real estate and infrastructure** provide potential inflation protection and long-term compounding — crucial for portfolios across cycles.
- **Private credit** addresses risk and return challenges in public markets by offering high recurring cash flows, with most loans adjusting with short-term interest rates. While most asset classes suffered in 2022 as the US 10-year Treasury climbed over 200bps, private credit generated strong outperformance and diversification (see Figure 5).

Figure 5: Private Credit Excess Returns Over Various Asset Classes in 2022



Source: Bloomberg, as of December 31, 2022. Corporate bonds represented by the Bloomberg US Corporate Bond Index and Treasuries represented by the Bloomberg US Treasury Index. Excess return calculated over the period of December 31, 2021 to December 31, 2022 using quarterly returns.

In our Guest Column, Michael Zawadzki, Global Chief Investment Officer for Blackstone Credit & Insurance (BXCI), further outlines the attractive backdrop for private credit performance and the many ways to capitalize on the rapidly growing opportunity set across private credit strategies.

A Broader Toolkit to Capitalize on the Credit Opportunity

Michael Zawadzki
Global Chief Investment Officer for Blackstone Credit and Insurance

Much has been written about private credit's "Golden Moment," characterized by historically high rates and wide spreads. While some of this excess return has normalized, we believe the "Golden Moment" will endure into a "Golden Age," with an extended runway of growth and an addressable market that now exceeds an estimated $30 trillion.[5]

Secular tailwinds have driven a rapid expansion across private credit asset classes, creating the need for large-scale financing solutions across many of Blackstone's investing megatrends including digital infrastructure, power, and housing. The resulting emergence of asset-based finance, infrastructure credit, opportunistic credit, and other verticals provide broad options, or "tools" for investors in search of excess yield and portfolio diversification.

Scaled and experienced credit managers like Blackstone can use these tools to deliver clients flexible and dynamic multi-asset credit solutions to take full advantage of this massive market opportunity and aim to deliver attractive risk-adjusted returns through cycles.

Attractive Backdrop as Credit Enters 2025

2024 delivered robust performance and the environment remains favorable for credit in 2025 for several reasons. Corporate balance sheets have held up despite the higher rate environment and earnings growth has allowed for a reduction in leverage compared to pre-COVID-19.[6] Loan-to-values remain at historically low levels,[7] and more help is on the way as recent rate cuts work through the system, the new administration implements likely pro-growth policies and healthy capital markets facilitate maturity extensions. We also expect a strong rebound in M&A activity from a 30-year low,[8] which should yield increasing financing opportunities.

The US consumer is similarly healthy, well supported by record home equity, declining debt-to-disposable income, and higher real wages.[9]

Today's base rates are supportive of elevated all-in credit yields. As shown in Figure 6, bonds currently offer their highest premium compared to the S&P 500 earnings yield since 2003.

Figure 6: Credit Yields Remain Historically Attractive[10]
US BBB Bond Yield Less S&P 500 Earnings Yield

5. McKinsey & Company, The Next Era of Private Credit, September 2024.
6. JPM, as of 2Q24. Historical Avg. Debt / EBITDA represent the year-over-year credit statistics of the loan-only portion of the JPM Leveraged Loan Index; broader issuers of the JPM High Yield Index.
7. PitchBook Data, Inc., as of September 30, 2024. Equity Contribution only reflects contributed equity for all LBOs.
8. Morgan Stanley Global Equity & Credit Research Report as of November 11, 2024. Dealogic, Morgan Stanley Research.
9. Blackstone views and beliefs, October CMF Takeaways, as of October 24, 2024.

Of course, against this broadly supportive backdrop, we are closely monitoring increased interest rate volatility, tight spreads in traditional fixed income assets, and geopolitical uncertainty that may drive increased performance dispersion.

A Growing Universe of Private Credit Strategies

We continue to see accelerated growth in the private credit markets, with private lenders stepping in to fill the void left by constrained bank balance sheets.

While private credit has historically been associated with middle-market corporate direct lending, a significant expansion of strategies is underway across the industry, including financings for physical assets, infrastructure, residential and commercial real estate, and fund portfolios.

But that's just the start. In our view, there's a long runway ahead that opens up a massive addressable market that exceeds $30 trillion.[11]

In what we call "financing the real economy," managers have the ability to directly originate or partner with banks to provide capital to all the assets that make the economy run.

These tailwinds are fueling the need for large-scale solutions to finance the significant secular growth underway across many of Blackstone's high-conviction investment themes. From AI and data centers to power and energy transition, we believe that private credit has become essential financing for the infrastructure of the future.

Figure 7: Investible Credit Universe Continues to Expand[12]

Traditional Corporate Credit	Corporate Bonds	Leveraged Loans	CLOs	Direct Lending	Opportunistic	
Financing the Real Economy	Data Centers	Digital	Energy Transition	Residential	Commercial Real Estate	
Structured Risk Transfers	Lender Finance	Aviation	Fleet	Equipment	Credit Cards	
Utilities	Inventory Finance	GP Lending	NAV Lending	Road Infrastructure	Containers	

Read more: Asset Based Finance: The Oldest "New Industry in Finance"

The Multi-Asset Credit Solution

We believe that allocating to a dynamic multi-asset credit (MAC) strategy enables investors to capitalize on this expansive opportunity set across the broader landscape. By using the tools in the enhanced toolkit, managers can build diversified and resilient portfolios, overweight higher relative value strategies, and navigate shifting opportunities and obstacles in the market.

A comprehensive MAC portfolio combines high-quality assets across an extensive range of liquid, private, structured and real asset credit strategies. Managers with capabilities in all these areas have numerous asset allocation levers to pull to drive investment performance, beyond simply credit selection.

10. Bloomberg, as of July 30, 2024.
11. See Endnote 5.
12. Represents Blackstone Credit & Insurance views and beliefs, as of November 2024. For illustrative purposes only.

Figure 8: Broad Opportunity Set Exists Across the Full Credit Spectrum[13]

Illustrative Asset — Level Yield

- By tapping into diversified sources of credit spread, a manager can navigate a range of macro environments, reducing risk and volatility while enhancing performance. For example, focusing on shorter duration assets amidst today's high and volatile interest rates.

- A manager can tactically adjust allocations to optimize portfolios to changing market conditions and capitalize on dislocations whenever and wherever they arise.

- Identifying asset classes that are undercapitalized can drive sustained outperformance. For example, the significant growth of data centers, power and energy transition combined with the balance sheet constraints of banks is creating a uniquely favorable supply/demand mismatch in asset-based finance.

- Expanding the toolkit means accessing more complex opportunities that may provide excess return. For example, structured credit asset classes such as collateralized loan obligation (CLO) securities and commercial mortgage-backed securities (CMBS) currently offer spreads that are far more attractive in their historical context compared to other parts of the liquid credit market.[14]

- Perhaps most importantly, through direct origination a manager can generate excess yield by providing customized solutions and eliminating the friction of intermediaries and syndication processes. As shown in the chart below, investors can potentially earn an additional 200 basis points of yield for equal or less risk in the private markets.[15]

13. For illustrative purposes only. Yields represent asset yields at origination. The yields presented are not to be interpreted as a measure of performance, rather, an indication of potential yields that investments in the fund could achieve at origination utilizing current market data. Performance at the fund level will be separately calculated as an IRR. Estimates / Targets: IG Bonds: Bloomberg, as of October 30, 2024. Infrastructure Debt: Blackstone Private Credit data. Assumes 2%-4% spread and 3.7% base rate. Base rate represents 7Y UST, as of October 2024. IG Asset Based Finance: Blackstone Private Credit data. Assumes 2%-4% spread and 4.1% base rate. Base rate represents 4Y UST, as of October 2024. High Yield Bonds: Bloomberg, as of October 30, 2024. Leveraged Loans: JP Morgan LL Index, as of October 30, 2024. Real Estate Lending: Blackstone Private Credit and Real Estate data. Assumes 3%-6% spread and 5.3% base rate. Base rate represents 3M SOFR, as of October 2024. Senior Direct Lending: Blackstone Private Credit data. Assumes 4%-7% spread and 5.3% base rate. Base rate represents 3M SOFR, as of October 2024. HY ABF: Only includes ABF residuals. Blackstone Private Credit data. Assumes 7%-10% spread and 4.1% base rate. Base rate represents 4Y UST, as of October 2024. Opportunistic Credit: Blackstone Private Credit data. Assumes 8%-11% spread and 5.3% base rate. Base rate represents 3M SOFR, as of October 2024. CLO Equity: Bloomberg, as of October 30, 2024.
14. CLO BB spread data relative to LL B spreads. LL B data point represents JPM B-Rated Loan Index; CLO BB represents JPM CLO Primary: USD - CLO BB Spread to 3M Term SOFR, both as of November 22, 2024. Real Estate CMBS BBB spread data relative to Corp BBB Index, both as of Bloomberg, as of February 11, 2025.
15. Public IG represents the Bloomberg US Agg Corporate Avg OAS, as of November 22, 2024. The Bloomberg US Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by US and non-US industrial, utility and financial issuers. Private IG data, as of November 22, 2024, based on BIS spread data, Blackstone. B Liquid Loan New Issue is sourced from LFO, Bloomberg, Blackstone representing BSL B Loan New Issue (B2 Moody's / $1 billion+). Direct Lending New Issue is sourced from Lincoln Private Credit Report and Blackstone's Europe DL Pipeline and US DL Pipeline.

Private Credit Offers Excess Yield Compared to Public Credit[16]

Figure 9: Investment Grade Yields[17]

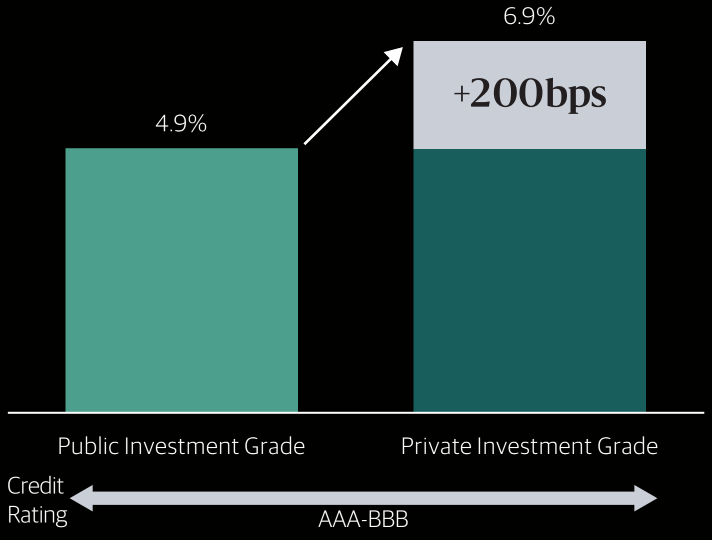
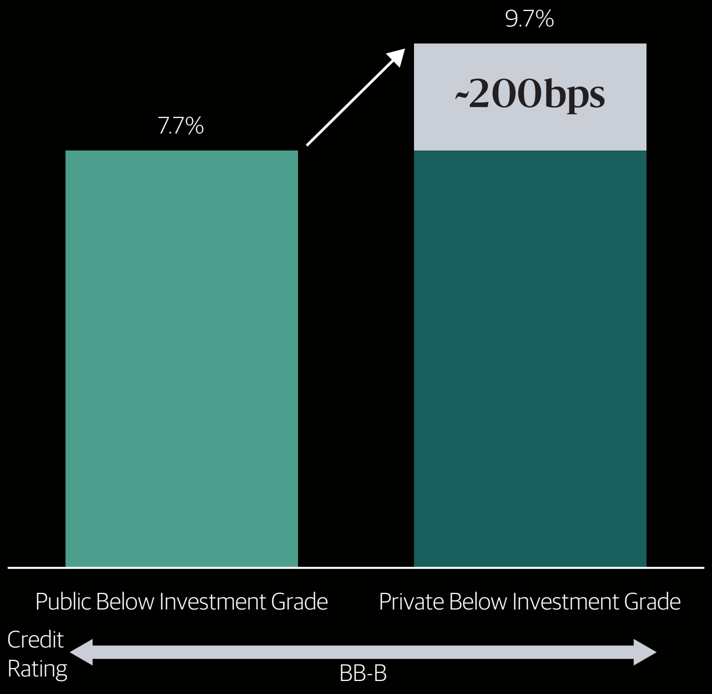


Figure 10: Below Investment Grade Yields[18]



In addition to these return drivers, a MAC portfolio can serve as a powerful risk mitigant. Investing across multiple strategies enables managers to find the proper balance of risk and return, current income and appreciation, and liquidity and origination premium, all while benefitting from the lower correlation and volatility that comes with asset class diversification.

Bringing It All Together

We believe that managers with scale, flexibility and a fully integrated platform have a strong competitive advantage in credit when it comes to executing on the breadth of strategies and the opportunity set ahead.

At Blackstone, we benefit from our market-leading credit business that spans over 4,750 borrowers and 20 distinct strategies. We believe that our leading franchises across the credit spectrum and geographies position us to assess risk return through a broader lens and capitalize when opportunities present themselves. Critically, Blackstone's global footprint encompasses leading private equity, real estate and infrastructure platforms. The insights that come from this vast library of financial and operating data, real-time CEO surveys, and human capital help us make better decisions on underlying credits and portfolio positioning.

Bringing it all together is our nearly 100-person Office of the CIO team. This team serves as the "central nervous system" of Blackstone's credit investing apparatus, leveraging dedicated expertise in areas including underwriting, asset management, value creation, portfolio insights, asset allocation, and data sciences. This integrated approach allows us to harness the power of our data to connect dots and spot trends earlier and hone our decision-making processes from Investment Committee to asset-allocation forums.

The combination of the attractive credit market opportunity, a growing range of investment strategies, and the ability of a manager to wield a deeper and more sophisticated toolkit makes multi-asset credit a great way for investors to capitalize on an enduring Golden Age in credit.

16. Represents Blackstone's view of the current market environment as of the date appearing in this material only, which is subject to change.
17. As of December 31, 2024. Public Investment Grade is represented by the Yield-to-Worst of the Bloomberg U.S. Aggregate Bond index. Private Investment Grade is represented by BXCI's ABF spread premium to IG corporates.
18. As of December 31, 2024. Public Below-Investment Grade is represented by the Yield-to-Worst of the Bloomberg US Corporate High Yield Index and Spread-to-Maturity of the Morningstar LSTA US Leveraged Loan Index plus the 3Y SOFR swap rate. Private Below-Investment Grade is represented by the excess spread of Lincoln's Senior Direct Lending index.

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