

The Red Thread

Our semi-annual insights into private markets

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Foreword

“Credit investors are typically focused on downside protection and as such are well positioned to weather the storm when it comes.”



Head of Unified Global Alternatives
– Private Credit

Joseph Sciortino

Dear readers

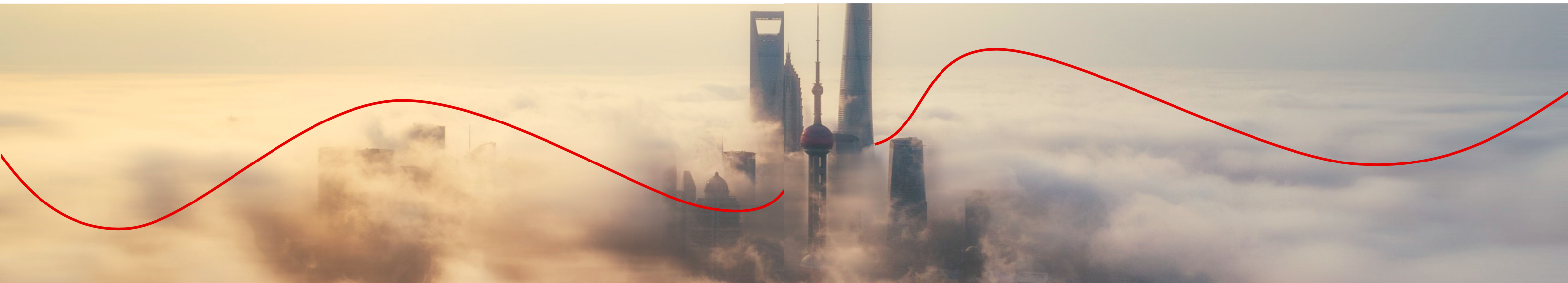
While the current market landscape remains fluid, increased macro uncertainty and unpredictable policy measures has led to heightened probability of a potential recession and turn in the credit cycle. Private credit markets are not immune to these challenges.

However, the robust structures and private nature of these investments can buffer investors from technical market sell offs. Further, the flexibility of these strategies gives managers ample tools not just to survive, but potentially thrive in a deteriorating economic environment. Credit investors are typically focused on downside protection and as such are well positioned to weather the storm when it comes.

Despite these concerns, higher rates offer attractive compensation for investors seeking yield in today's market. Additionally, private credit markets offer a wide and diverse set of opportunities for investment. Savvy investors who are able to evaluate these different markets and strategies have opportunities to outperform. While some areas of private credit market may be fairly priced there are certainly areas of the market that offer attractive yields for the given risk profile.

As we look further into 2025, our outlook for private markets remains optimistic. We invite you to delve into our comprehensive insights on how these macroeconomic trends are poised to influence private credit investments across the different segments of the market.

Global outlook



Market to pause and reflect

“On entering 2025, we expected a recovery in global real estate markets to gain momentum. The tariffs have created new uncertainty and will likely see a pause in transaction activity as investors take stock. We still expect positive returns this year, but slightly lower and driven by income. Residential looks most defensive and resilient.”

Fergus Hicks

**Senior Real Estate Strategist –
Unified Global Alternatives**



Tariffs blur the outlook for real estate

The 'liberation day' announcements on tariffs by US president Donald Trump created significant uncertainty and unpredictability across the global economy and financial markets. The proposals would take tariffs to their highest levels in 100 years and prompted the S&P 500 to fall 12%, the tech heavy Nasdaq to drop 13% and the FTSE EPRA Nareit Developed Index of global listed real estate to fall 10%. Markets subsequently rallied strongly when Trump announced a 90-day pause on reciprocal tariffs. In mid-May the US and China announced a truce and scaled back their bilateral tariffs significantly. Ultimately, the tariffs' impact will depend upon how they affect occupier demand and capital markets and heightened uncertainty remains.

The Fed paused US rate cuts in January to keep them in the target range of 4.25–4.5%. The tariffs are set to push US inflation higher, up from 2.4% in March, though the US-China truce may prevent it from hitting 4% in the coming months. Higher inflation could put the Fed in an awkward position as it attempts to battle both slowing growth and high inflation. Indeed, in mid-April it pushed back against market expectations for multiple rate cuts. Disinflation is still not fully taking hold in some countries and inflation remains above target. Eurozone headline inflation edged lower to 2.2% in March and, on the flash estimate, remained at that rate in April. UK inflation also edged down, to 2.6% in March from 2.8% in February.

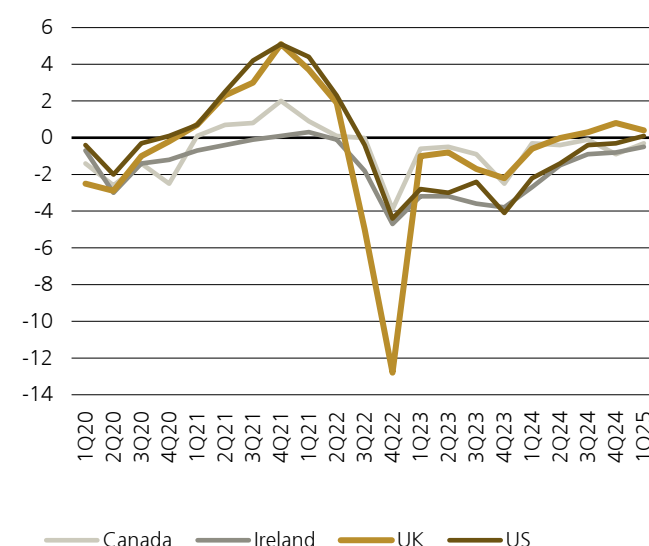
Policy rate cuts across other markets continued in 1Q25. The Bank of England cut rates by 25bps in February, held rates steady in March, and then reduced them by another 25 bps at its next meeting in May. After its 25bps cut in January, the ECB cut rates a further 25bps in both March and April, taking its deposit rate to 2.25%. The Bank of Japan raised rates to 0.5% in January, but kept them steady in March and April, remaining cautious due to uncertainty around US tariffs. However, we expect more rate cuts across Europe, in line with market expectations and as economic growth comes under pressure.

In 1Q25, eurozone GDP growth accelerated to 0.4% QoQ, with expectations over tariffs having little impact. In the US, on the other hand, GDP fell 0.3% on an annualized basis, reflecting a surge in imports as businesses stockpiled goods ahead of tariffs being implemented. South Korea, an economy highly dependent on trade, also experienced negative growth in 1Q25, with GDP falling 0.1% YoY and 0.2% QoQ, dragged down by exports and investment. China surpassed expectations for a second quarter, growing 5.3% YoY in 1Q25 and 1.4% QoQ. However, growth forecasts have been downgraded across countries to reflect the impact of the trade war. On the basis of the latest information, we don't expect a recession, but rather an economic slowdown.

Data from MSCI showed that, after allowing for seasonal effects, global transaction volumes slipped in 1Q25, following a steady recovery in 2024. This likely reflects uncertainty ahead of the implementation of tariffs and we expect some pause in market activity as investors assess their impact on real estate. According to MSCI data, global investment volumes were down 2% YoY in USD terms. Compared to 4Q24 investment volumes fell in the office, residential, industrial and hotel sectors, while retail was the only sector to see flat investment activity. Investment volumes were cushioned by the Americas, where retail and hotels respectively rose over the quarter, while APAC and EMEA were weaker and volumes slipped back across nearly all sectors.

Prior to 'liberation day,' we thought that global real estate values had bottomed in 3Q24 and upon entering the period of tariff uncertainty, confidence in the market had been building. According to data from CBRE, PMA and NCREIF on yields and cap rates across 290 city-sectors globally, yields fell in more markets than they rose in 1Q25, down in 25% of markets. They rose in 6% and were flat in the remainder. NCREIF reported US capital values flat QoQ at the all property level, while in the UK MSCI data showed them rising 0.4% QoQ (see Figure 1). On a total returns basis, at the all property level, performance was positive in both markets for a third successive quarter. We think that the tariffs could see the recovery stall, or even generate some renewed downward pressure on capital values. Overall, we have lowered our expectations for global real estate returns in 2025, but they remain positive, with significant uncertainty over the outlook.

Figure 1: All property capital value growth
(local currency, % QoQ)



Source: MSCI; NCREIF; UBS Asset Management, May 2025. **Past performance is not a guarantee for future results.**

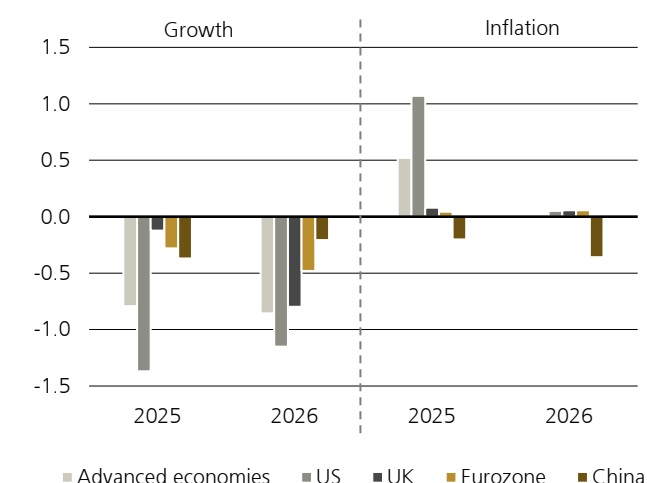
Residential looks most defensive and resilient

The announcements on tariffs from the Trump administration have created global trade tensions and heightened policy uncertainty. One of the consequences of the US policy shifts on the macro environment is an upward revision in US inflation forecasts. In general, tariffs result in a one-off rise in prices, though if inflation expectations increase as a result, inflation can stay elevated for longer.

In April, Trump enacted a 90-day pause on the harshest, reciprocal tariffs and in mid-May the US and China announced a 90-day truce, which will see the US's new tariffs on China slashed from 145% to 30% and those from China on the US drop from 125% to 10%. The remaining tariffs are expected to feed through to higher good prices in the US over the coming months. If the truce is enduring though, it may prevent US inflation from rising above 4% this year, which it was widely expected to do prior to the truce.

Inflation forecasts have been revised higher across regions, and in April Oxford Economics's forecast for the US for 2025 was over 1 percentage point higher than its January forecast (see Figure 2). We expect the US forecasts to be revised lower following the US-China truce. Higher inflation will likely restrain the Fed's ability to cut rates in the face of a slowing economy and could see other central banks remain cautious too if they also see inflation rise. We expect US rates to be stickier than in other regions and that there will be a bifurcation in policy. The Fed is expected to continue to hold off from rate cuts in the near term, despite some pressure from Trump, whereas further rate cuts are expected in Europe.

Figure 2: Change in GDP growth and inflation forecasts between Jan-25 and Apr-25 (percentage points)



Source: Oxford Economics; UBS Asset Management, May 2025.

Economic growth, a key driver of real estate occupier demand, is also expected to be impacted by the tariffs, with real income shocks and rising effective tariffs. Compared to January, Oxford Economics's April forecast lowered US GDP growth for 2025 by 1.4 percentage points, to 1.2% and China by 0.4 percentage points, to 4.1%. The short-term impacts of tariffs can already be seen, with the US economy contracting 0.3% on an annualized basis in 1Q25 due to greater imports. 2025 growth forecasts have been reduced globally, with weaker demand expected.

For the advanced economies, Oxford Economics cut its 2025 GDP forecast by 0.8 percentage points to 1.1%, driven by the US downgrade. The UK and eurozone suffered smaller downgrades, of 0.1 percentage points and 0.3 percentage points respectively, with 2025 growth now expected to be 1.1% for both (see Figure 2). The IMF also reduced its global growth forecast, to 2.8% and 3% for 2025 and 2026, respectively, a cumulative downgrade of around 0.8 percentage points relative to its January 2025 forecast. Despite this, global growth forecasts remain above recession levels.

The tariffs will impact real estate markets via their effects on economic growth and occupier demand, and also via their impact on the path of interest rates and risk premia for the asset class. They will also have indirect effects on real estate markets, for example, via higher construction costs and higher material prices, which could lead to delays in development projects or stymie them altogether, which could cushion rents. Moreover, the tariffs are likely to impact different parts of the real estate market in different ways, with some sectors more resilient and defensive than others.

The recovery in real estate pricing, which was starting to take hold, could see some stalling as the effects of the tariffs feed through. We started to see the bottoming of capital values in 3Q24, though capital value growth forecasts have been revised slightly lower, with significant uncertainty remaining. The outlook for capital values for 2025 is now weaker across regions and sectors, though we think the residential sector should show greater resilience. At the global all property level, we think that capital values will now be pretty flat in 2025, leaving investors reliant on rental income for returns. We think the office and industrial sectors may show some small capital value declines this year, with retail values pretty flat and residential values showing a modest uplift.

Global commercial real estate sentiment has also been affected by the uncertainty caused by the sharp shift in US policy and the impact of higher for longer interest rates. US volatility has caused some investors to seek a flight to safety and turn their attention more closely to European markets. Furthermore, the tariffs and economic outlook have created a downturn in consumer confidence, which may result in reduced consumer spending and could compound a tariff-induced slowdown in global trade. We think that lower trade volumes would impact logistics around transport nodes, including ports, airports and land borders and will likely weigh on rental growth and capital appreciation. US coastal logistics, which will face the brunt of the reduced international trade, looks more exposed, and will likely see the greatest pressure on occupancy, rents and property values.

Some logistics companies and related businesses are pausing expansion for industrial property and delaying decisions on new leases. However, in the short term, businesses have been stockpiling to avoid future tariff costs, which is driving temporary demand for warehouse space and pushing some rents higher. Trade barriers may encourage companies to shift manufacturing closer to home, driving longer-term demand for domestic industrial real estate. However, it may also cause trade diversion and the rerouting of trade via countries with lower US tariffs, particularly for Asia Pacific countries within reach of China, such as Malaysia and Vietnam.

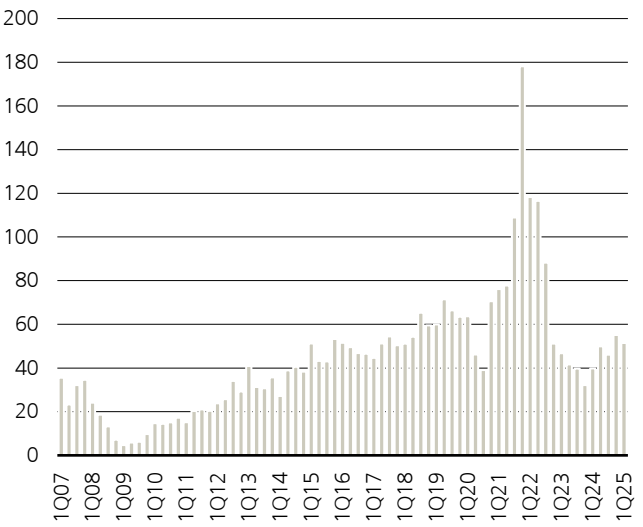
The attraction of the US as a destination for reshoring is supported by favorable tax policies for domestic producers from the Trump administration. Therefore, we may see a rise in demand for US manufacturing space as the domestic manufacturing sector is impacted by patterns of reshoring. In Europe, we expect to see onshoring and nearshoring, which could provide positive fundamentals for domestic logistics. Indeed, as companies diversify their supply chains, it may present new growth opportunities across Europe. The European market will also likely be impacted as the continent ramps up its defense spending, which is expected to boost demand for logistics properties and manufacturing facilities, though building up the European defense industry will take time.

The office sector faces downside risks too due to weaker business sentiment and as companies exercise caution when considering expansion or relocation plans, often putting them on hold. How defensive offices are depends on the type of tenants. Class A offices with tenants that are less vulnerable to economic changes will likely prove more resilient as return-to-office mandates broaden. We expect the pause by businesses to continue until they have better visibility on where policy is headed, as uncertainty leads to weaker business investment and hiring decisions. Overall, we now think that office capital values will show a small fall in 2025.

We already saw it as the weakest sector, strongly bifurcated between the best, prime offices, which have been in demand, aided by back-to-office mandates, and the rest, which account for a large portion of office space.

In contrast, we think that the residential sector is less exposed to the downside risks from the tariffs and is well positioned to be resilient due to strong fundamentals. Construction is likely to slow while demand holds strong and we’re increasingly optimistic on the sector. Indeed, global residential investment activity showed a steady recovery in 2024 (see Figure 3).

Figure 3: Global residential investment volumes
(seasonally adjusted, USD billion)



Source: MSCI; UBS Asset Management, May 2025. **Past performance is not a guarantee for future results.**

Elevated mortgage rates in the US are sustaining demand for rental apartments, supporting modest rental growth. We still expect global residential capital values to grow by around 2% this year.

Student accommodation outside of the US may also benefit from a redirection of international student flows away from US institutions towards other markets, such as Australia and Europe. At the same time, some countries are tightening student visa requirements, which could be a drag on student numbers. Other, more defensive asset classes include healthcare and life sciences, which are underpinned by demographics drivers, sectors and needs that are independent of the broader state of the economy.

Overall, uncertainty and unpredictability in policy make the impact of the tariffs on real estate markets hard to pinpoint. The uncertainty is weighing on business confidence and despite recent progress in trade deal negotiations, including the temporary reduction in US-China tariff rates, the current deals are neither formal nor permanent. The administration’s ability to make sharp policy shifts has caused investors to act with caution.

After a choppy 2025 so far, we think that 2026 has the potential to be more positive for real estate markets and for capital value growth to rebound. Furthermore, other policies from the Trump administration, including deregulation within real estate development and tax cuts, may provide a boost to the economy and provide a tailwind for real estate occupier demand. Investors will likely hold back on investments amid uncertainty, though necessity-based asset classes are expected to outperform.

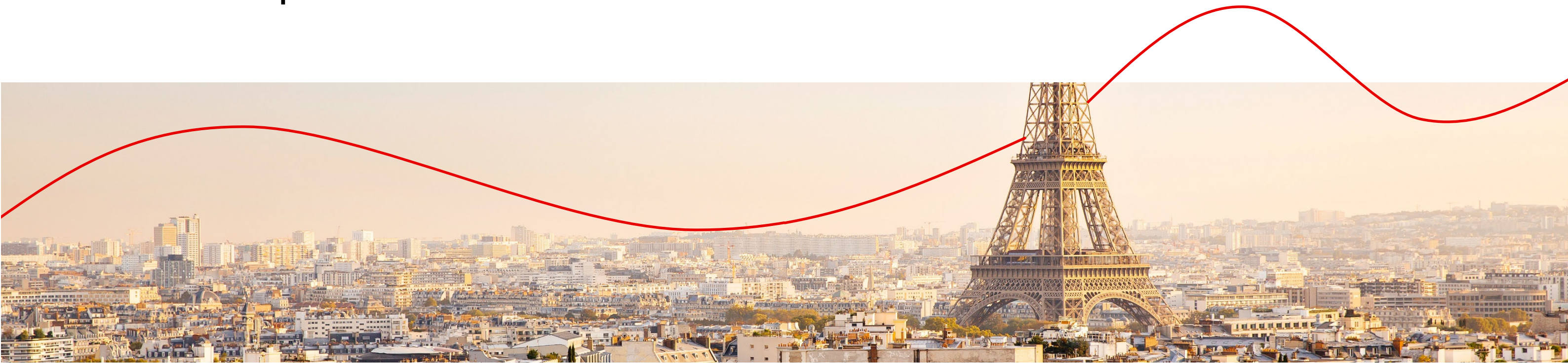
Moreover, real estate should provide protection against higher inflation. Against this backdrop, we think that investors should seek out the most resilient and defensive sectors, where they may find attractive opportunities and entry points. On the other hand, we think they should be more cautious about sectors and investments that are most exposed to the brunt of the tariffs. Above all, careful underwriting and evaluation of all potential deals is critical in this environment.

Unlisted real estate sector performance outlook

	Negative		Neutral		Positive
US	Office	Industrial	Retail, residential, hotel		
Canada			Office, retail, industrial, residential	Hotel	
France		Residential	Office	Retail	Industrial, hotel
Germany			Office, retail, residential, hotel	Industrial	
Switzerland				Office, retail, residential, hotel	Industrial
UK		Office	Residential, hotel	Retail, industrial	
Australia			Office, industrial, hotel	Retail, residential	
Japan			Office, industrial	Retail, residential, hotel	
Singapore			Office, industrial, hotel	Retail	

Source: Oxford Economics; UBS Asset Management, Global Real Assets, May 2025.
Note: Classifications refer to expected total returns after currency hedging over the period 2025-27 versus global all property. **Classifications are not a guarantee for future results.**

Europe outlook



A paradigm change, or just noise?

“Real estate is a famously viscous asset class: it takes time to trade real estate. This increases its illiquidity, but it also shields it from short term market panics. Most real estate investors with a well-diversified portfolio enjoy restful nights while many equity investors may find the urge to stay up late or wake up early to see what the market on the other side of the world is doing.”

Olaf Margeirsson

**Head of Real Estate,
Research & Strategy – EMEA ex DACH,
Global Real Assets**



Keep calm and focus on asset and sector selection

Tariffs are no disaster for European real estate

The US administration, on 2 April, announced a new tariff structure between the US and the rest of the world, levying a 10% baseline tax on imports into the US with multiple countries facing additional (called ‘reciprocal’) levies. The tariffs’ level was higher than expected, causing volatility across multiple markets. Many economies retaliated, imposing tariffs on imports from the US. A week later (9 April), the US administration introduced a 90-day pause on the additional levies, with the aim of negotiating trade conditions between the US and individual countries. The 10% minimum levy remained in place; however, China was also excepted, effectively resulting in an import levy (tax) of 145% on imports from China into the US. China has retaliated with a tax of 125%.

There is, due to the ongoing trade negotiations, considerable uncertainty regarding tariffs, including their levels, timing, scope, exceptions, etc. Currently, countries in Europe face the 10% import levy but this may change as we edge closer to the 7 July deadline. Some agreements have already been largely hammered out, e.g. between the US and the UK.

Investing in direct real estate can be calming. As an example, the immediate impact from tariff changes for direct real estate investors in Europe is, in practical terms, non-existent. The listed real estate market, which is more subject to short-term behavioral factors, however, reacted immediately. Key sectors’ total return performance dropped by more than 10% in accumulated terms but that decline has since reversed as the outlook for trade negotiations improves (see Figure 1). Listed companies that focus on investing in European industrial assets are flat in terms of total return since the end of March. The residential sector, however, is up more than 13% over the same period – an important reason why is highlighted later.

In the long run, however, additional tariffs, if they are realized, are likely to shape the economy of Europe – and with it, its direct real estate markets. For one, economic growth is likely to suffer. The UK economy is e.g., expected to grow by only 1.1% p.a. over the next three years, below the 20-year average growth rate of 1.3%. The eurozone is looking at a similar growth trend. Much of that depends on access to energy though, and LNG imports from the US may be a part of any EU-US trade deal.

Weaker economic growth is a problem for cyclical sectors whose leasing demand depends on growing economic activity. This includes the industrial and office sectors.

Retail and residential are also not immune to weaker economic growth but the shortage of suitable stock is likely to shield the sectors from slower growth. The impact for direct real estate should therefore be considered in the context of supply-demand within each sector and location.

An important aspect is also the fact that slower economic growth is likely to push the Bank of England (BoE) and the European Central Bank (ECB) to lower policy rates. This would suppress risk-adjusted required returns for real estate assets, increase debt availability and support capital values. Indeed, we expect the BoE and the ECB to lower rates to 3.75% and 1.75% respectively, by the end of this year, as inflation should stay benign, being pushed downward by weaker economy. 5-year swap rates are also down for both the GBP (3.9%) and the EUR (2.2%) since the beginning of April. It’s this expected lower rate impact that has caused the residential sector to outperform amongst the listed real estate companies in Europe: the sector is relatively low yielding on the asset level, with lower rates bringing an important and outsized relief to capital values in the sector compared to others.



Source: EPRA; Refinitiv, as of 2 May 2025.

Overall, direct real estate markets in Europe are relatively shielded from higher tariffs between the US and Europe. This makes the asset class as important as ever in terms of building the optimal risk-adjusted portfolio.

Reconfirming its position in the portfolio

The downside protection of real estate

Repeatedly, the benefits of adding private investments, including real estate, to portfolios have been highlighted. Depending on the investment purpose, e.g. income generation or capital preservation, and the investment horizon, e.g. short- or long term, the allocation to private markets can lie somewhere between 10-40% (*The new 60:40 portfolio*). In practice, it may well be higher for many investors, e.g. if they own the home they live in. And from a pure risk point of view, one could argue the allocation should be even higher.

The allocation to real estate in a multi-asset portfolio is often justified from the standpoint of modern portfolio theory: maximizing the returns per unit of risk the portfolio is exposed to. ‘Risk’ in this case is usually defined as the annual standard deviation of the portfolio’s returns.

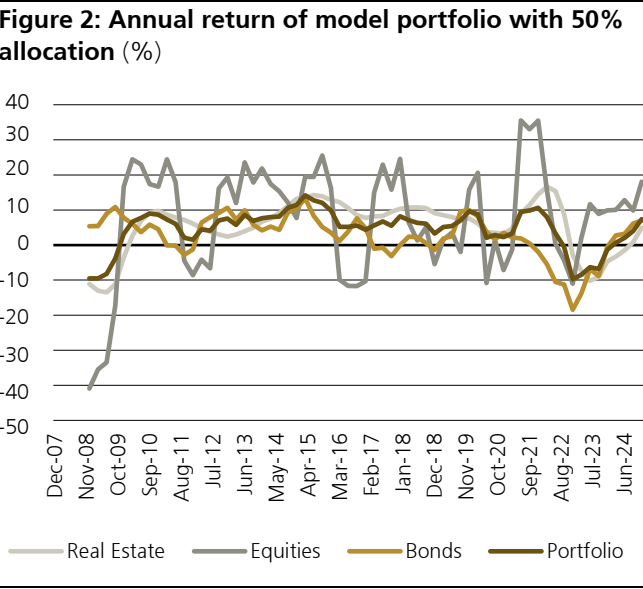
However, this has its downsides. The key issue is that investors’ preferences are biased towards avoiding downside risks, i.e. sharp drops in portfolio returns, while upside risks, i.e. sharp increases in portfolio returns, are welcomed. ‘Risk’ defined as standard deviation of returns, as per modern portfolio theory, does not consider this, as both upside and downside swings affect the standard deviation of returns in the same way.

Real estate is a famously viscous asset class: it takes time to trade real estate. This increases its illiquidity, but it also shields it from short-term market panics. Most real estate investors with a well-diversified portfolio enjoy restful nights while many equity investors may find the urge to stay up late or wake up early to see what the market on the other side of the world is doing. But fundamentals matter, of course, and real estate goes through cycles like any other asset class. The trick is to allocate enough funds to the asset class to enjoy restful nights, while having enough exposure to e.g., equities to enjoy the upside potentials there as well. The combined cycles of the underlying asset classes then merge into an overall portfolio cycle. Liquidity needs must also be considered.

Therefore, let’s consider the following case: an investor must allocate capital between real estate, equities and bonds while wishing to maximize the return per unit of risk, where risk is defined as the maximum drawdown in the portfolio returns. The investor also wants to have at least 50% of the portfolio liquid within six months. That means that the allocation to real estate is limited to 50%. We consider quarterly data from 4Q07 to 4Q24 relying on the total return of STOXX Europe 600, Bank of America Euro Government Index and MSCI’s Europe Quarterly Property Index, all denominated in EUR.

The outcome, ignoring potential fees, is shown in the graph below (see Figure 2). The allocation to real estate is 50% (maxed), 13% to equities and 37% to bonds. The annual total return is 4.2% with a maximum drawdown of 10.9% (in March 2009 and December 2023). In comparison, the maximum drawdown for each asset class over the period is 15.7%, 45.2% and 20.5% for real estate, equities and bonds, respectively. Annual total returns per asset class, in the same order, are 4.9%, 5.2% and 2.6%. A 60:40 equities/bond portfolio has a max drawdown of 26.6% and an annual total return of 4.5%. Many investors would sacrifice a 0.3% p.a. total return if they must only suffer a 10.9% drawdown instead of 26.6%.

One point to note: using modern portfolio theory, i.e. risk defined as standard deviation of returns, leads us to a 50%/3%/47% real estate/equities/bonds portfolio. Its maximum drawdown is 12.5% and annual returns 3.9%, i.e., underperforming the portfolio based on maximum drawdown. However, the returns per unit of risk are higher because a sharp increase in equity returns (such as in 2021) is interpreted as ‘risky’ – they increase the standard deviation of returns – even if the returns are positive. So, when constructing your portfolio, make sure you consider what ‘risk’ really means.



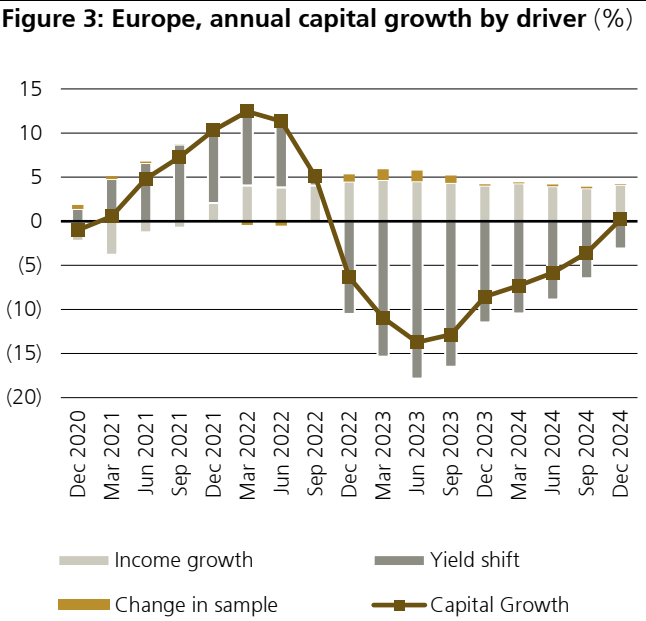
Source: Refinitiv, UBS Asset Management. May 2025. **Past performance is not a guarantee for future results.**

Every investor must accept some illiquidity if the decision is made to invest in private real estate. Many do so when they invest in the home they live in, often lacking the capital to invest further in real estate. But for investors with the firepower to do so, real estate can provide the downside protection that allows them to sleep at night.

More markets are showing yields falling than rising

The trough in capital values is here
Real estate is famously cyclical and prone to over- and underreacting due to latency in its responses to signals coming from the demand side. The key question, therefore, is: where are we in the cycle?

We've already entered positive territory in terms of all-property capital value development. As of December 2024, annual capital growth on the all-property level turned positive (0.2%), having been negative since December 2022 (see Figure 3). The residential sector (2.7% annual capital growth as of December 2024) outperformed other sectors, followed by industrial (1.4%) and hotels (0.4%). The retail sector was flat (0.0%) while offices (-1.9%) continued to see their values drop.

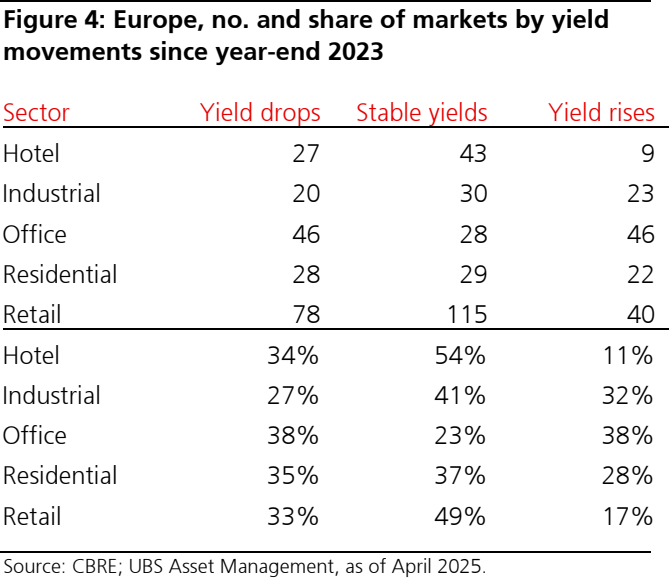


Source: MSCI; Refinitiv, as of May 2025.

In light of the challenges the European economy faces, it's natural to doubt that this development can continue to improve. However, we're not seeing negative pressures on capital values – rather the opposite, at least for high-quality assets.

The key reason why is very simple: interest rates and their development. Looking at how spreads have developed, we're increasingly confident that pricing at its current level is in 'fair' territory. Z-scores of yield spreads crossed into that territory around beginning of 2024, depending on the sector, and since then, yields have been predominantly (in 75% of available markets) stable or dropping. In fact, out of the ca. 600 markets we follow in terms of yields across Europe, a third has seen yields drop since year-end 2023, while a quarter has seen yields rise.

The distribution of those yield drops is also not limited to a specific sector: since year end 2023, 23% of industrial markets have seen yields decline, while 38% of office markets have seen their yields drop (see Figure 4). In fact, no other sector has seen so many, in relative terms, markets experience yield drops since 2023, but the residential sector is close with 35% of its markets seeing yields drop. Perhaps not surprisingly, given the bifurcation in the office market in terms of leasing demand (a topic we have repeatedly covered in the past), the office sector also ranks at the top in terms of share of markets where yields are rising (see Figure 4). Truly, sector and asset selection has seldom, if ever, been so important.



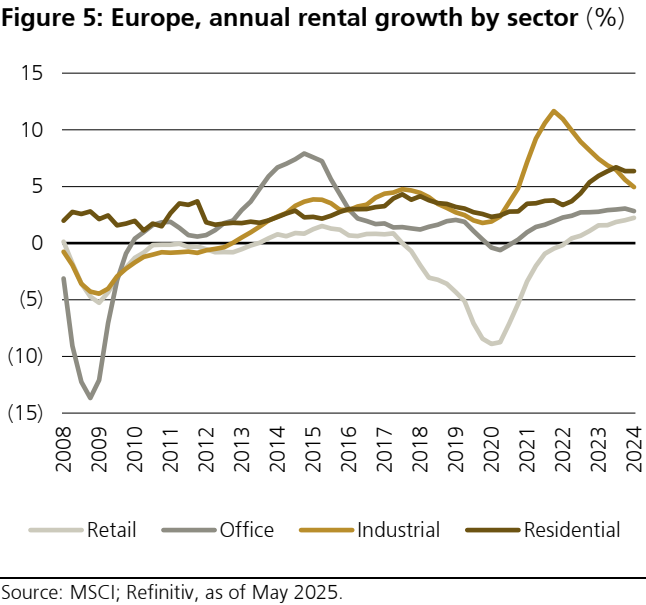
In this context, it's important to note that investment volume has begun to increase. MSCI reports that as of 1Q25, annual investment volume was EUR 213.9 billion, up 17% YoY. The residential sector, for the first time, topped the ranking in terms of investment volume with EUR 47 billion after an annual increase of 33%.

Furthermore, debt costs have dropped adequately to make the impact of leverage positive again at the income level for some assets. All-in costs on a well-leased prime office in the eurozone are around 4.0%, down nearly a percentage point over the last year. Meanwhile, prime Paris CBD offices are now trading close to 4.25%.

We've *previously highlighted* in one of our focus articles on the UK that significant yield compressions in the near future are unlikely. Despite the current outlook for lower policy rates, we see no reason to change this opinion of ours. Yes, yield spreads are likely to support pricing, but economic uncertainty weighs on the outlook, dampening our expectations for yield compression.

Keep an eye on Europe's demographics

Retail is staging a comeback
The fact that the residential sector came out on top in terms of capital growth in 2024 should not surprise anyone. From a leasing market perspective, the sector is under constant pressure from the demand side with inadequate supply. Consequently, rental growth has been strong across the region, with annual market rental value growth hitting 6.4% as of December 2024. The pace of rental increases in the residential sector is now faster than in the industrial sector (see Figure 5).



It's also worth highlighting the recovery in retail. In Europe as a whole, annual rental growth in the sector was 2.2% in 2024. That's the highest nominal rental growth the sector has seen since at least 2008. Rental growth in the sector has now increased for 16 consecutive quarters. Another point to highlight, is the fact that vacancy rates in retail warehouses in the UK have dropped to 3.2%, their lowest on record. Rents for this part of the market are up 2.1% YoY as of December 2024, at its highest since the summer of 2007. The same can be said about shopping malls, which saw their rents grow by 2.6% YoY as of December.

The recovery in retail is a good reminder of the cyclical nature of real estate markets. Retail had been largely ignored by investors since ca. 2017/2018, when the first signs of structural difficulties and the impact of fierce competition with the logistics sector (e-commerce) began to emerge. Now, the survivors in the sector have stabilized, with redundant retail space largely purged from the market. Consequently, rents are rising anew as supply and demand are in better balance than before.

Demographic shifts are coming, prepare accordingly
Offices are the next sector to undergo the cleansing process that retail has now endured. The sector continues to display the bifurcation trend that has been evident since 2020, despite some temporary rebound in office presence.

Fundamentally, the long-term issue that the sector faces is demographics. According to the United Nations, over the next 25 years, the population of 15-64 years olds in Europe will drop by ca. 13%. That means we'll have fewer working-age people to go to the office than today. There is a high probability that we're close to, or already at, the peak in terms of total stock of offices in multiple cities in Europe.

In the meantime, the office leasing demand that is in place flows towards 'prime' assets in 'prime' locations, where employees can find restaurants, cafés, entertainment and easy access to public transportation hubs. As a result, prime rents are rising, up more than 5% YoY as of 1Q25 in nearly 20 key European cities, including Brussels (6.7%), Prague (7.1%), Helsinki (14.0%), Paris (12.2%), Munich (11.5%), Milan (7.1%) and London (9.7%).

One point worth mentioning regarding Europe's demographic profile: over the next 25 years, the population aged 65 and older is expected to increase by ca. 50 million from ca. 150 million to 200 million individuals. For comparison, the total population of Spain is ca. 49 million.

The investment implications of this demographic change are profound. Many of these individuals, given current supply, will not be able to find a fitting residential unit for themselves and possibly their partner. The demand for one- and two-bedroom residential units that are old-age friendly is set to increase substantially over the next 25 years. Given how little attention this market segment has received, and the lead time in planning and building those units, many investors should seriously consider their allocation to this part of the real estate market.

Another often under-allocated segment is life sciences real estate (LSRE). Europe will need to build more LSRE assets in the next 5-10 years to meet the demand for healthcare services and outputs, including medicine, that 50 million more individuals will be looking for. The expiration of drug patents before 2030 is also edging closer, making the mid-term demand for labs and other LSRE assets for the pharmaceutical industry relatively robust. Trade reorganization is likely to affect selected parts of the European LSRE leasing market, especially in Ireland (a hub of exports to the US), but the mid- and long-term trends are surely pushing demand upwards.

Switzerland outlook



Back in the low-interest environment

“With lower interest rates, the recovery of the risk premium and the current high market volatility, interest in defensive Swiss real estate investments has significantly increased. Investors particularly favor residential real estate due to the continuously strong fundamentals and low dependence on the economic environment.”

Kerstin Hansen

**Head of Real Estate,
Research & Strategy – DACH,
Global Real Assets**



Demand for real estate increases

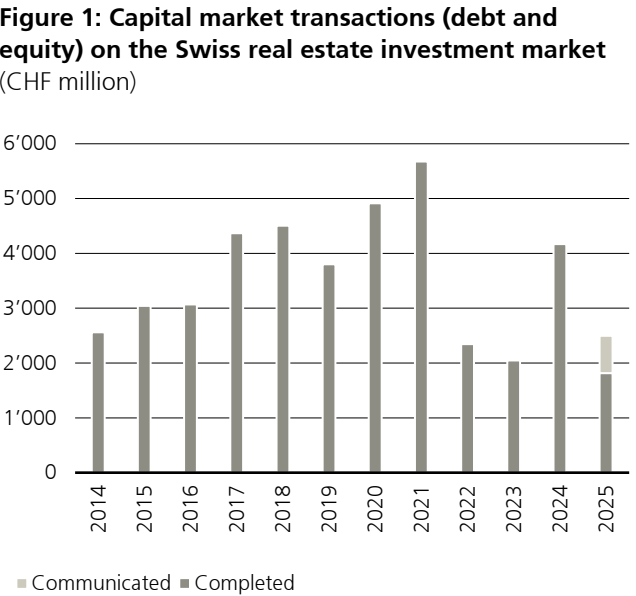
Swiss economy shows solid performance in 2024
Despite the global choppy waters, the Swiss economy was remarkably resilient in 2024, growing by 0.9%.¹ The weak foreign trade, which negatively affects the manufacturing sector, was offset by above-average growth in private consumption and thus strong domestic demand. However, the labor market cooled over the course of 2024 from previously high levels. After robust employment growth in 2023, the increase of 40,800 FTEs in 2024 flattened and fell short of the 10-year average. The unemployment rate rose from 2.4% in March 2024 to 2.9% in March 2025, particularly driven by job losses in manufacturing.

After a brief optimistic start to the year, the US government's high tariffs announced on 2 April and subsequent fluctuating announcements quickly dampened economic sentiment. The Swiss export industry would be significantly impacted by the announced tariffs. Should negotiations fail, exports to the US will face 31% tariffs starting in July 2025, initially exempting pharmaceutical products. In the short term, these tariffs are expected to have a limited direct effect on the Swiss economy, especially if pharmaceuticals, which make up the largest share of exports to the US, remain exempt. The greater concern is that uncertainty may deter company investments, potentially dampening global growth prospects. Compared to our earlier forecast of 1.5% growth at the beginning of the year, we now anticipate Swiss GDP growth of 1% in 2025.¹

Despite the particularly high tariffs on Swiss products, the Swiss franc (CHF) has appreciated substantially. This significantly increases the risk of inflation rate turning negative in Switzerland. In April, headline inflation fell to 0.0%. While some of the CHF appreciation may already be reflected, the full effect will likely take a couple of months to fully emerge. This development therefore justifies further monetary policy easing by the SNB in the form of interest rate cuts. We've revised our previous forecast, that the SNB would keep the interest rate at 0.25%, and now anticipate another 0.25 percentage point cut to 0% in June, with risks tilted towards negative interest rates. Swiss government bond yields have dropped significantly, due to reduced growth expectations and increased uncertainties following the US tariff announcements.

¹ The mentioned GDP figures are adjusted for sporting events. International sports organizations such as FIFA, UEFA and the IOC have their headquarters in Switzerland. The license income recorded in connection with major sport events is recognized as value added in the entertainment sector.

Attractiveness of real estate investments increased
The SNB's interest rate cut of a total of 150 basis points since March 2024 has already spurred greater interest in real estate investments (see our Outlook 1H25). Recent market movements are likely to further boost demand for Swiss real estate. After reaching a low of 15 basis points in 4Q22, the risk premium on Swiss direct real estate investments rose again to 180 basis points in 4Q24. The increased attractiveness is also evident in capital market transactions. After low momentum in 2022 and 2023, volumes increased significantly in 2024, surpassing the CHF 4 billion mark again. In the first four months of 2025, CHF 1.8 billion was raised and another CHF 700 million was announced (see Figure 1).



Source: J Safra Sarasin; UBS Asset Management, May 2025. Last data point: 2 May 2025.

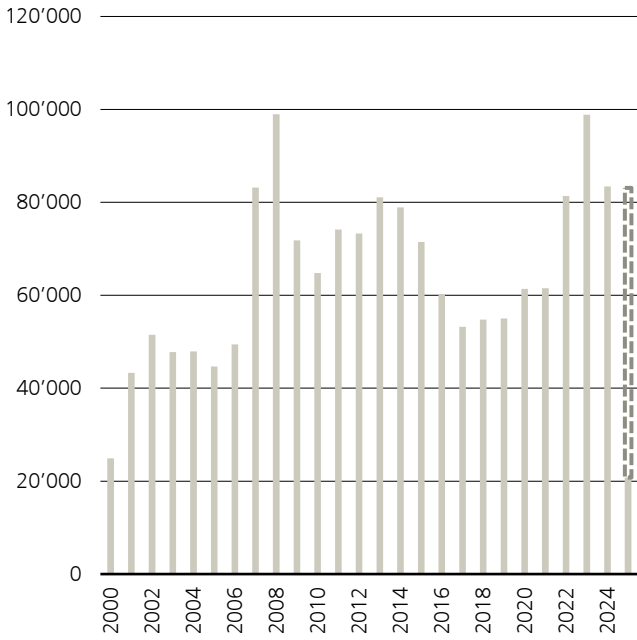
Besides the positive outlook for real estate investments due to lower interest rates, the defensive characteristics of real estate are becoming more prominent in the current volatile environment. Over the past 25 years, Swiss real estate funds have achieved an average return of 5.5%, just 90 basis points below Swiss equities. However, due to the high share of rental income in total returns, their volatility is significantly lower, driving the demand for real estate, especially in more turbulent times. This is particularly true for the residential segment, which is fundamentally strong in Switzerland and largely unaffected by any economic uncertainty arising from the current tariff development.

Given the moderate size of the Swiss economy, the value added generated by these sporting events is a noticeable quantity in the national accounts. Major sporting events usually take place every two years and only in certain quarters, leading to fluctuations in annual and quarterly gross domestic product (GDP). In order to make GDP rates comparable over the years, the State Secretariat for Economic Affairs (SECO) publishes sport-adjusted GDP.

Rental housing market with a lot of tailwind

Although net immigration declined slightly in 2024 compared to the record year of 2023, it reached 83,400, marking the third-highest level in the past 25 years, following 2008 and 2023. This growth means that Switzerland's permanent population has increased by around 375,000 people over the past five years. In the first three months of this year, net migration was 20,800, remaining at about the same level as last year (see Figure 2).

Figure 2: Net migration in Switzerland (total, permanent population)



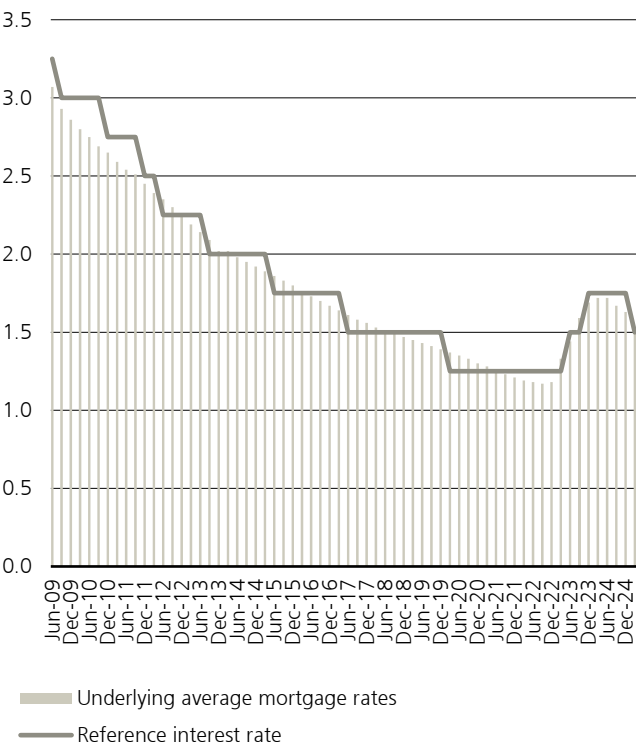
Source: State Secretariat for Migration; UBS Asset Management; May 2025; Last data point: March 2025; * 2025: Jan-Mar + extrapolation (dotted).

Despite the strong increase in demand, construction activity remains subdued, even though there was some improvement in 2024 due to interest rate cuts, better financing conditions, and the stabilization of construction prices. From 44,000 building applications at the low point at the end of 2022, the annual total rose to 49,000 in the first quarter of 2025. The number of approvals has also increased compared to the low point in 2023 but remains significantly below the long-term average. The widening gap between building applications and building permits likely indicates the increasing duration and complexity of approval processes. This means that construction activity and the completion of additional living space will remain subdued for some time, and price dynamics in the rental market are expected to stay strong.

According to figures from Wüest Partner, asking rents rose by an average of 4.7% in Switzerland in 2024, which is a record high for the past 25 years. This increase was also facilitated by the two reference interest rate hikes in 2023 that were reflected in in-contract rents in 2024. In 2024, the reference interest rate, and thus in-contract rents, remained constant. Due to the high proportion of fixed-rate mortgages in Switzerland, the decline in mortgage interest rates over the course of 2024 showed with a certain delay but became apparent in the reference interest rate published on 3 March 2025. As the underlying average mortgage rate dropped from 1.63% to 1.52%, the reference interest rate was lowered from 1.75% to 1.5% (see Figure 3).

As a result, in-contract rents that were at the reference rate of 1.75% are likely to decrease again in the summer of 2025. From this point forward, we expect a sideways movement. Asking rents, on the other hand, continued to rise in 1Q25, although the YoY increase of 2.3% is slightly weaker than in 2024.

Figure 3: Reference interest rate and underlying average mortgage rates (%)



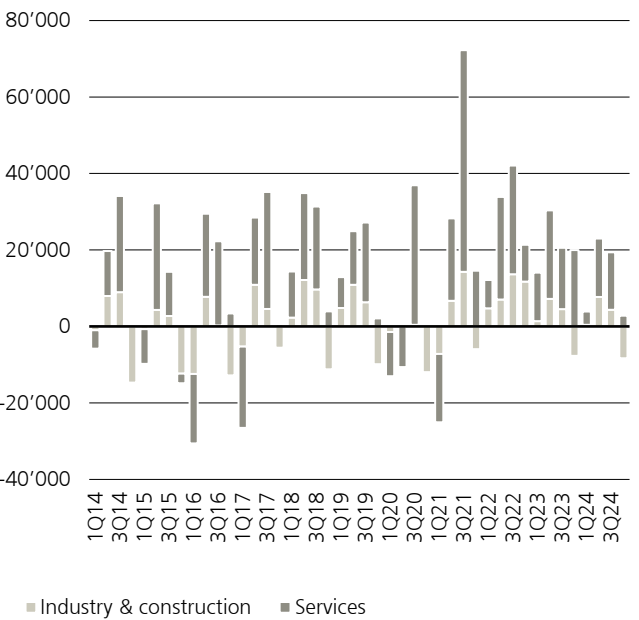
Source: Source: Federal Office for Housing; March 2025. Last data point: 31 December 2024.

Commercial real estate stable despite headwinds

Despite the expected economic slowdown posing a challenge for the commercial market, the Swiss real estate market finds itself in a favorable position, having maintained stable conditions up until now, despite the turbulences over the last five years.

While remote work and a sluggish global economy have impacted office markets worldwide, office vacancies have also risen in Switzerland. From 2019 to 2024, the average supply rate in the five major centers increased from 4.1% to 5%. This relatively moderate increase, in international comparison, is due to strong employment growth generating additional office demand in Swiss cities. Despite a significant slowdown compared to 2023, around 40,800 full-time equivalents were added in 2024 (see Figure 4).

Figure 4: Employment growth (FTEs)



Source: SECO, last data point: 4Q24.

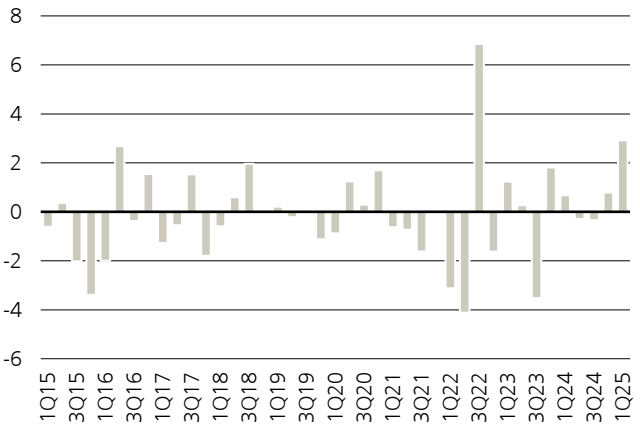
The uncertainty caused by the pandemic-related shift to remote work seems to be decreasing. According to the Wüest Partner Office Space Barometer, Swiss companies do not expect further increases in home office hours. On the contrary, more and more large companies are now enforcing 'return-to-office mandates.' The increased demand for quality and location is likely to persist, favoring very well-located, central, high-quality properties. Flexible concepts also remain popular. Sustainability is becoming increasingly important in renting, especially for larger companies. While demand for high-quality space has driven up prime rents over the past three years, average rents are also showing signs of recovery, with YoY growth of 3.4% in 1Q25.

Retail spaces have faced significant challenges from online shopping over the past decade, compounded by low consumer confidence in recent years. As consumer sentiment saw a slight uptick from very low levels and real wages got a boost from easing inflation in 2024, retail sales experienced a modest recovery. Following declining sales volumes in 2022 and 2023, a real-term increase of 1.4% was recorded in 2024.

Consequently, rents for retail spaces are also rebounding, with asking rents rising by 2.9% quarter-on-quarter in 1Q25 (see Figure 5). Properties anchored by food retailers have benefitted the most due to positive developments in the food segment.

However, consumer sentiment fell significantly again in 1Q25, as high uncertainty affected the outlook. Despite this, we expect private consumption to remain stable in Switzerland. Given its domestic market focus, Swiss retail should be less exposed to global disruptions and continue its recovery.

Figure 5: Asking rents growth for retail space (% QoQ)



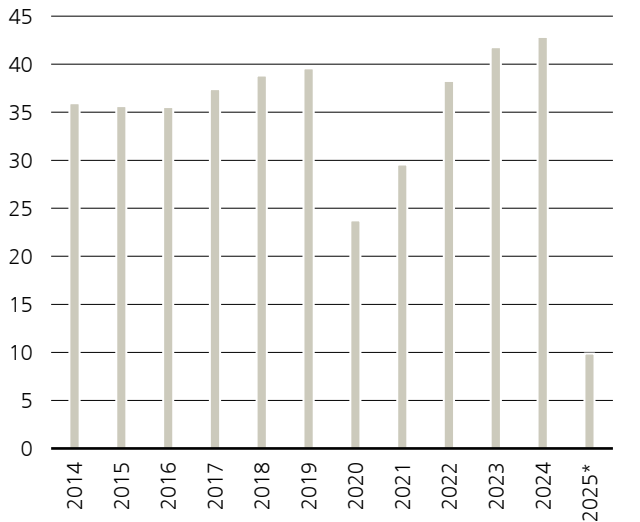
Source: Wüest Partner, last data point: 1Q25.

The logistics segment has been on the rise globally for years and is gaining traction in Switzerland as well. However, due to a high proportion of owner-occupancy, it remains a niche market, although demand for space is likely to keep growing. Alongside the continued growth of online trade, increasing protectionism may also support the domestic industrial and logistics sector as companies enhance the resilience of their supply chains. Export-oriented companies may face pressures, but with limited modern rental supply, prime rents are expected to continue to rise moderately.

Positive value growth as interest rates decrease

The Swiss hotel industry has defied the gloomy consumer sentiment both domestically and internationally, achieving another record year for overnight stays in 2024 – totaling 42.6 million (see Figure 6) – despite the strong Swiss franc. In the first three months of 2025, results matched those of the previous year. The recovery observed since the onset of the pandemic is broad-based. Contrary to many concerns, the hotel industry in city centers is thriving and setting new records. Although the USD depreciated significantly against the Swiss franc, potentially affecting arrivals from US tourists, who accounted for 8% of overnight stays in 2024, strong domestic tourism and major events like the ESC in Basel and UEFA Women's EURO suggest another robust year for Swiss hotels.

Figure 6: Number of overnight stays in the Swiss hotel industry (million)



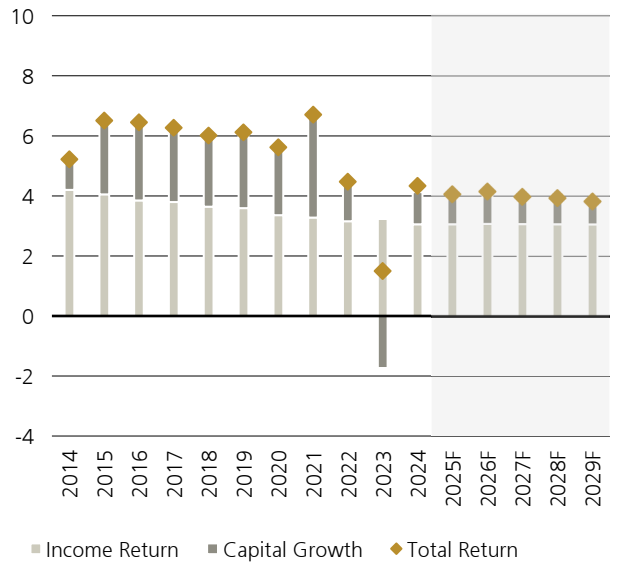
Source: Federal Statistical Office, UBS Asset Management, May 2025; * 2025: Jan-Mar.

Yield forecasts: upturn from interest rate cuts

Globally, real estate markets have experienced significant value corrections during the interest rate hike cycle. In Switzerland, the corrections in 2023 were relatively moderate. In 2024, the market as a whole recorded positive performance again, buoyed particularly by the residential market, which represents almost 0.5 of the Swiss index and saw capital growth of 1.8%. Offices appreciated slightly at 0.2%, while retail space grew by 0.6%. Logistics properties still registered slight depreciation in values of 0.2%, whereas hotel values, supported by above-average rental income growth in cities, increased by 2.2%.

The interest rate cuts have significantly boosted demand for real estate once again. We expect capital values to rise by around 1.6% in 2025 due to continued positive rental growth prospects in the residential segment and high demand given its low cyclical dependence and defensiveness. In the commercial segment, performance is expected to be more subdued due to the threat of an economic slowdown. These pressures make commercial properties with long-term leases more favorable, especially those with tenants focused on the domestic market and less growth-sensitive sectors.

Figure 7: Total return all-property Switzerland (% p.a.)



Source: MSCI/Wüest Partner; UBS Asset Management; March 2025; Last data point 2024. Past / expected performance is not a guarantee for future results.

APAC outlook



Brace for uncertainty

“Asia is bearing the brunt of the US tariffs. Macro could slow again. It’s still too early to cheer for faster rate cuts. We believe the impact will be varied across different real estate sectors. There are several relative safe havens to take shelter in, but ultimately, diversification will remain crucial, especially in an uncertain world.”

Wai-Fai Kok

**Head of Real Estate,
Research & Strategy – Asia Pacific,
Global Real Assets**



From assembly line to firing line

Trade war in Asia

On ‘liberation day’, the US announced its most sweeping tariff increases in over a century. While this affected much of the world, Asia bore the brunt. From strategic rivals like China to long-standing allies like South Korea and Japan, countries across this region were hit with some of the steepest tariffs. This marks a clear shift from decades of trade liberalization and raises questions about what comes next for the global economy.

To understand how we got here, it’s worth recalling that the US has been a chief architect of globalization, leveraging its economic and military might to promote democratic ideals and free market principles. After World War II, it helped rebuild and develop countries, believing that stable, open economies would lead to a more peaceful and prosperous world. As part of this effort, the US supported the rise of Asia, including China and Vietnam, to become low-cost manufacturing hubs. This strategy delivered affordable goods to the world and lifted millions out of poverty. But it also led to persistent trade surpluses in Asia, driven not just by exports but also high savings rates. Now, under a renewed wave of economic nationalism, especially under the Trump administration, the US is forcefully challenging the very system it helped build.

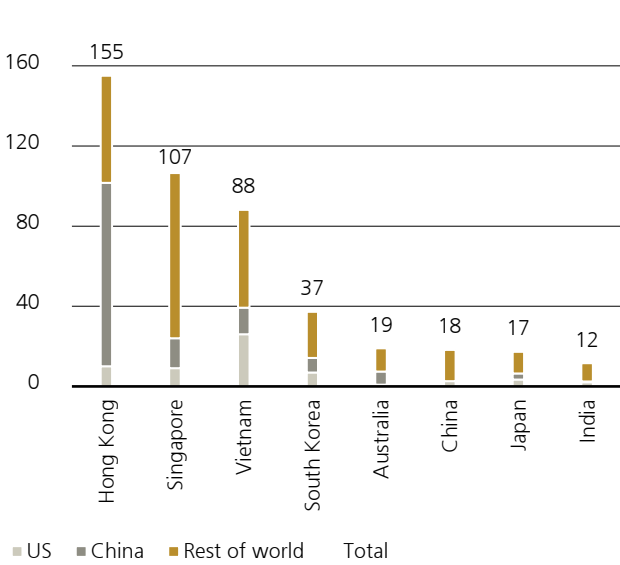
This is not to say the approach is inherently right or wrong as every country has the right to reassess its economic strategy. However, shaking the long-established foundation of global trade order in such an abrupt manner is bound to trigger a sharp backlash. For the larger nations, besides negative economic implications, their self-perceived global image may also be at stake. China, as a case in point, has responded forcefully with tit-for-tat escalations and shows little willingness to back down from a fight. The greatest concern is that this could spiral beyond trade into broader conflict, with unintended and potentially catastrophic consequences.

That said, it’s hard to determine the staying power of these tariffs, especially given the unpredictability of the Trump administration. There are already some signs of de-escalation with conditional tariff pauses, even towards the unrelenting China. That is good news, for now. Nevertheless, the damage has already been done. Based on official data releases so far for April, South Korean exports with the US fell 7% YoY, while China’s manufacturing PMI (-1.5pt) and Japan’s manufacturing future output index (-3.3pt) fell significantly. On unofficial data, various sources have also indicated a plunge in China-US shipping volume in April. Beyond the trade weakness, we believe there may also potentially be negative spillover into investment and consumption activities in the near future.

Assessing the full impact of this ‘trade war’ is challenging partly due to the erratic policymaking. Moreover, the economic repercussions extend beyond direct exposure to US exports. A more significant concern, driven by the complex web of global supply chains, is the indirect impact stemming from a slowdown in global growth. As countries export less to the US, they will most certainly also import less from their trading partners, exacerbating the tariff impact on overall trade. Take Australia, for instance, its exports to the US accounted for only ~7% of its total exports or 1.7% of its GDP. The impact may seem minimal at first glance. However, given the sweeping coverage of the US tariffs, Australia is also vulnerable to any deceleration in China, its largest trading partner (contributing ~33%), and other countries.

Given the chain reaction and far-reaching scale, evaluating trade in totality would likely provide a more appropriate risk gauge (see Figure 1). In the event of a global trade downturn, the more open and trade-reliant economies are expected to see a larger hit to GDP. This includes Singapore, Hong Kong, Vietnam and South Korea. Meanwhile, domestic-oriented countries will likely see smaller impact. In the scenario of a more isolated trade dispute, i.e. the US lifting its tariff on the world and targeting solely on China, countries that have higher trade exposure to China may be more vulnerable. Of course, this is hardly the full picture. There will also be various other factors that will come into play for the eventual economic outcome, including, but not limited to, supply chain reconfiguration as well as fiscal and monetary responses.

Figure 1: Goods exports as % of GDP (2024)



Source: CEIC, Oxford Economics, May 2025.

The cost of trade conflict

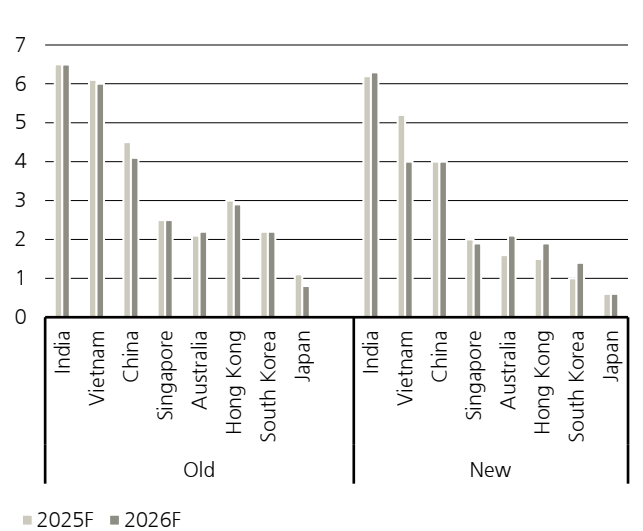
Slowest growth outlook in decades

IMF recently downgraded the GDP growth projection in Asia by 0.5ppt in 2025 and 0.3ppt in 2026 (see Figure 2). In this new set of forecasts, most countries are expected to slow but avoid a recession. China is projected to slow from 5.0% in 2024 to 4.0% in 2025 and 2026. While this is not too dissimilar from consensus, China’s outlook is likely to be a contentious one given a big range of variables such as tariff re-/de-escalation, fiscal stimulus and other market forces. This is reflected in the unusually wide range of Bloomberg consensus forecasts of 3.1-5.0% for 2025 by 67 forecasters. UBS Investment Bank estimated a GDP drag of over 2 percentage points (ppt) in the scenario of 145% US tariff but this was reduced to 1-1.5ppt based on the recent de-escalation to 30% tariff.

Outside China, IMF’s GDP downgrades broadly correlate with the respective nation’s exposure to external trade. Singapore, Hong Kong, Vietnam and South Korea are expected to see a larger hit to GDP to the tune of 1ppt or more. Australia and Japan would be more resilient at slightly more than half a percentage point damage. On the other end of the spectrum, India is forecasted to be among the least affected and grow the fastest among Asian peers at above 6% per annum.

Given the heightened uncertainty surrounding the US trade policies, we believe macro forecasts are likely to face more frequent revisions than usual in the near term. Therefore, a basic understanding of each country’s sensitivity to global trade is perhaps more crucial in this environment.

Figure 2: IMF GDP growth forecasts (April 2025)



Source: IMF, May 2025.

More interest rate cuts could ensue

While the US tariffs are expected to be inflationary in the US itself (supply shocks), it will potentially be a disinflationary force for the rest of the world due to softer demand, in the absence of meaningful retaliatory measures. In APAC, the risk of goods dumping could also exacerbate price pressure. Before the US tariff, disinflation was already well in advance and within the desired range across most countries. Any further downward pressure on prices is likely to accelerate interest rate cuts, a silver lining for income-focused investors, particularly those in real estate and bonds. The key question, however, is: to what extent?

Several central banks, including India, Thailand and the Philippines have jumped on the opportunity with a 25bps cut recently. However, Oxford Economics thinks the window for Asian central banks to cut their policy rates is small. Much will also depend on the health of the USD, which has been weak since the ‘liberation day’. The market is currently pricing in 75bps rate cuts in the US this year. In the event of fewer cuts, a strong USD may pose a restraint to central bankers in this region.

So far, APAC forecasters have added only ~1 additional rate cut compared to pre-‘liberation day’ baseline. The trajectory of ‘high-for-longer’ is not expected to change materially, at least for now. It’s likely also a result of limited data guidance. This could evolve over the course of the year depending on the development of the trade and macro outlook.

South Korea stands out as one of the more dovish ones, having already delivered 75bps in cuts since peak. Oxford Economics expects another 75bps of easing to 2.0% by end-2025. Australia began its easing cycle late in February with the market now expecting 3-4 more cuts for the rest of the year. Meanwhile, in Japan, consensus has largely pushed back their rate hike expectations but is divided on when the next hike will be. UBS Investment Bank is among the most dovish and forecast policy rates to stay flat at 0.5% until mid-2026 (mid-2027 before the US-China de-escalation announced on 12 May), while Bloomberg consensus is still expecting at least one hike in 2H25. In the past two years, we’ve been optimistic for Japan’s outlook of a renewed inflation era. We now believe the US tariffs could play spoilsport and potentially delay our thesis in the near term. To be clear, we think Japan’s economic normalization will continue, but take longer. We don’t think the shock is huge enough to bring back deflation.

Shelter from the trade storm

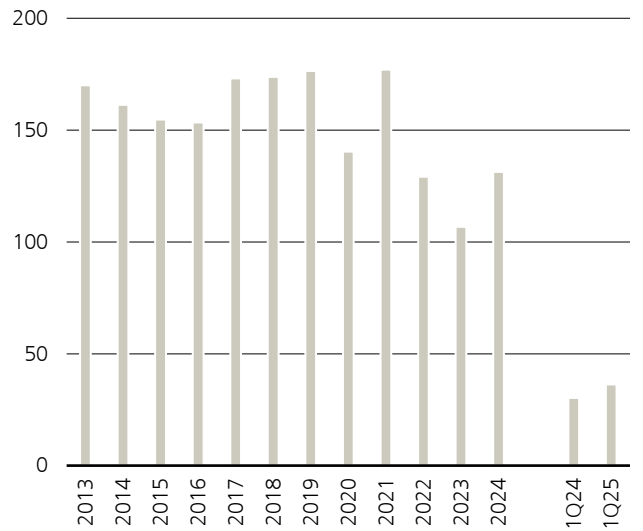
So far in 2025

The real estate transaction market in APAC started 2025 on a positive note. Volumes grew 20% YoY to USD 36.3bn in 1Q25, according to JLL's Capital Tracker (see Figure 3). Australia and South Korea continued to recover and grew 30% and 58% YoY, as investment yield spreads have improved meaningfully. Despite higher interest rates, Japan rose 20% led by foreign investors, indicating optimism on the inflation story. In China, activity remained muted (-33%) despite the recent recovery in listed market sentiment.

Cap rates were mostly flat to lower in 1Q25, except for Melbourne office, China and Hong Kong. The rise in the US 10-year Treasury yield, after the tariff announcements, caused some concerns initially. However, the movements in APAC bond markets have so far been benign with 10-year yields largely flat to lower. Most notably, Japan's government bond yield fell sharply by 30bps from the peak to 1.26% as of 5 May.

The occupier market was mixed in the first quarter. China and Hong Kong remained soft across almost all sectors. Outside these countries, leasing activity generally improved for the retail and office sectors with positive rental growth. Logistics picked up slightly after several quarters of softness. However, rental decline extended to more markets as new supply caught up. Leasing sentiment for this sector is also more vulnerable to global trade uncertainty.

Figure 3: APAC transaction volume (USD billion)



Source: JLL Capital Tracker, May 2025.

The road ahead

In our *December 2024 publication*, we noted a brighter path ahead for APAC real estate given a resilient macro backdrop, a favorable interest rate outlook and a bottoming out of capital values. This largely played out in 1Q25. Looking ahead, however, with the global trade order at risk, we think the increased uncertainty and market volatility are likely to temper investor confidence in the short term. Nevertheless, given massive repricing in the last two years (ex-Japan) and a potentially lower interest rate trajectory, we think any downside from here should be limited, barring an escalation in trade tensions or a severe economic recession. In our base case, we now expect a slower recovery in both transaction activity and investment returns.

Nevertheless, we think the recovery is less likely to be broad-based as the impact of a global trade slowdown varies across different sectors. Logistics is the most directly vulnerable to a trade slowdown, especially those assets located at port locations. This is followed by offices as an economic slowdown affects employment, space demand and corporate budgets. Retail is likely third in line as consumers curb spending with high-street and downtown assets underperforming neighborhood / suburban malls. Meanwhile, the residential sector would be the most defensive as historically demonstrated through the cycles. Geographically, Japan and Australia are likely better positioned economically, amidst the US tariffs, vis-a-vis other investible markets in Asia.

From an investment perspective, Japan offers stability, high yield spread and appealing cash-on-cash return. The potential delay in the BoJ's rate hikes may also provide a relief to earlier cap rate concerns. Meanwhile, Australia also has its own allures – significantly repriced valuations, strong population growth and supply constraints.

Japan – a good shelter

For a country that has seen interest rates and bond yields surging to the highest in almost two decades, Japan's real estate sure has held up exceptionally well. Despite the earlier expectations of further rate hikes, investors were still unfazed and continued deploying more capital each year. Capital values are still rising and cap rates remain steady as a rock. Its wide yield spread and cheap currency are compelling reasons. Fundamentally, its rental outlook has also been stronger than it has been in a long while.

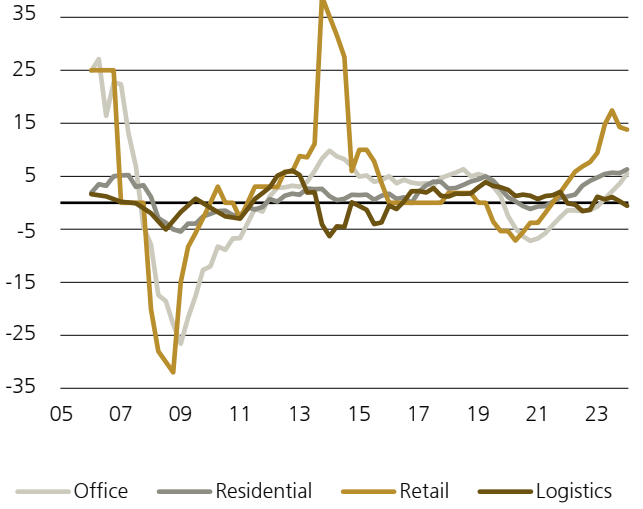
Almost all sectors, excluding logistics, are delivering strong rental growth. Tokyo's office demand is almost unrivalled in today's world with 2023-24 demand trending at double the pace of its prior decade. Prime rents have rebounded 8% from its trough in 2023 and PMA forecasts further uplift of 7% p.a. over the next three years, bringing it close to the peak just before the Global Financial Crisis period.

Meanwhile, the rents for high-street retail and average daily rates for hotels are also soaring to new heights thanks to the tourism boom. Even in the residential sector, where low but steady growth profile was a norm for decades, rental growth in Tokyo shot up to 6.1% YoY in 4Q24.

This is a drastic shift for the country. Before the recent bout of inflation, many people in Japan had probably forgotten how an inflationary environment felt like three decades ago. One in four people that grew up in Japan, or those below 30 years old, had probably not even experienced noticeable price increases in their lifetime. The long-ingrained deflationary mindset and habit, of the people and businesses, will have to change to thrive in this new environment, for the better or worse. For investors, this means renewed dynamism for the economy and optimism on growth. Who knew the pandemic would herald such generational change?

For now, the potential global trade slowdown is not expected to terminate this normalization. Instead, it may slow the process – by how much is anybody's guess and depends on how the external environment shapes up in the immediate future. We think the residential sector (multifamily) is the best positioned in this environment and has historically demonstrated low volatility in rents (see Figure 4) and occupancies through the economic cycles. There is also optionality on growth led by rising wages. Office has recently garnered more interests due to its early stage of upcycle but this sector has historically been more sensitive to economic cycles. Its lower cap rates may also make it more sensitive to interest-rate movements when the BoJ eventually resumes its policy normalization. While logistics holds promise for the long-term, its near-term fundamentals are dicey given the trade concerns and pockets of oversupply in Greater Tokyo.

Figure 4: Tokyo rental growth by sector (% YoY)



Source: PMA, May 2025. Past performance is not a guarantee for future results.

Australia – emerging opportunities

Office 'down under' has probably been one of the most unloved sectors in the last few years given its sticky work-from-home trend. Its vacancy rates are also among the highest in this region excluding China. The potential economic slowdown ahead is not good news for this historically cyclical sector, but it could also trigger urgency for workers to return to office as job security comes into doubt. It remains to be seen which of these will be a bigger driving force for the leasing direction. Usually, it's quite unlikely for bosses to sign off on space expansion when the outlook is uncertain, especially for larger companies.

Nevertheless, we think an investment case is emerging for this battered sector after a massive repricing in the last few years. That said, caution and selectiveness are still warranted – there is nowhere else in Asia that features a clearer bifurcation trend than Australia. So, focus on prime quality and central core locations with stronger supply-demand dynamics. Stay away from average quality, secondary locations and weak cities to avoid leasing headaches, as a broad-based recovery is not imminent.

Sydney is still the key gateway city where businesses want to be located. This year, net absorption for prime space in core locations more than doubled both YoY and compared to 10-year average. Net effective rent has grown for 11 consecutive quarters and is almost back to its previous peak in 2019. In Brisbane, the outlook is even rosier with higher cap rates at ~7%. Internal migration elevated the appeal of this state and its future Olympics hosting in 2032 could also keep the city busy for the next few years. The vacancy rates for prime assets here is the lowest in the country at 8% and net effective rent is running at 19% above 2019 levels. For the next five years, PMA forecasts net effective rents to grow at 5-6% p.a. for both cities.

We remain positive on the residential sector in Australia given its persistent undersupply situation which is unlikely to see any quick fix. Rental growth is slowing but still expected to stay elevated at around mid-single digits in the next few years. However, the build-to-rent sector is still nascent with limited completed stocks and pricing discovery, making it less accessible for core strategies. For now, more investors are opting to acquire living exposure through an alternative route in student accommodation, which has seen several successes of late.

Strategic viewpoint

The sectors highlighted in this article are opportunities that we think are relatively well positioned but by no means exhaustive. Ultimately, we think a diversification strategy is still crucial and likely to show its true benefits in this increasingly uncertain macro environment. Being selective on sectors is important as an overarching filter but it does not mean ruling out deals that have attractive attributes at the asset-specific level – such as value-add and opportunistic angles in pricing, under-renting, plot ratio optimization and area rejuvenation.

US outlook



Uncertainty overhang

"Uncertainty is high, but prices are still more attractive than they were at the peak three years ago. For investors who are able to take a longer-term view, 2025 may still be a good reentry point for the real estate market."

Tiffany B. Gherlone

**Head of Real Estate,
Research & Strategy – US,
Global Real Assets**

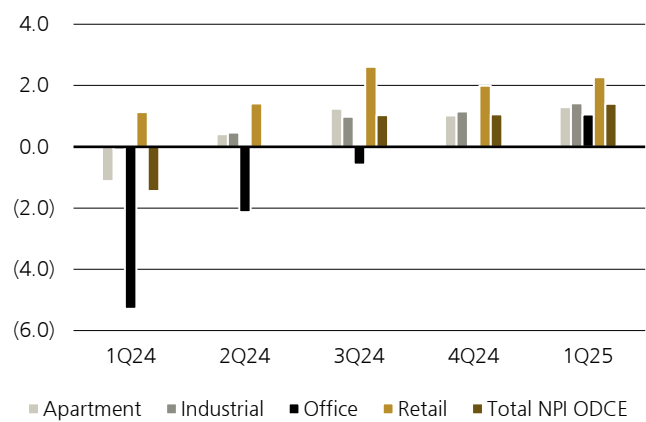


The uncertainty drag

Uncertainty is high. Higher uncertainty translates to higher risk. Investors will need to decide if and how much of a risk premium they may now require, which typically causes the market to pause and reassess. US real estate is likely in one of those reassessment phases right now, hoping to buy itself enough time for de-escalation of trade disagreements. In the meantime, transaction volume is probably not going to reach the highs we were hoping for in 2025. Leasing velocity may also be slower in 2025 than forecasters had hoped. Yet, real estate markets are in a good position with supply growth subsiding and staying low. Demand may be strong enough to weather some weakness.

As investors adjust to changing market conditions and debt markets thaw, buyers should find more opportunity to get deals funded. Despite some interest rate volatility, Treasury rates ended the first quarter below where they started, and lenders have fresh capital to put out in 2025.

Figure 1: NCREIF property sector total returns (ODCE properties, quarterly total return, %)



Source: NCREIF Property Index filtered for Open-End Diversified Core Equity (ODCE) properties as of March 2025. **Past performance is not a guarantee for future results.**

After a 40% increase year-over-year in the fourth quarter, 1Q25 transactions volume was 10% above 1Q24 at USD 98 billion. In 1Q25, real estate returns rose across the board (see Figure 1), marking the first quarter of unanimous good news since 2022. Increased debt availability and slowing construction pipelines should help create some optimism among real estate investors this year, despite the cloud of economic uncertainty.

Prices are still more attractive than they were at the peak three years ago, and for investors who are able to take a longer-term view, 2025 may still be a good reentry point for the real estate market. Slowing construction pipelines should tilt lingering supply-demand imbalances in landlords’ favor over the next several years (see Figure 2).

When demand outpaces supply, rents should rise across sectors. Ultimately, prospects for rising rents and growing investment income will help unthaw real estate capital markets.

Uncertainty clouds economic expectations

The US economy shrank by an annualized 0.3% during the first quarter of 2025, its first contraction since 1Q22. This decline was largely driven by a record trade deficit, as businesses stocked up on imports ahead of the anticipated tariffs. The surge in imports reduced GDP by 4.8%. Consumer spending, which makes up approximately two-thirds of GDP, moderated to a 1.8% increase. Business investment stayed strong, primarily due to companies temporarily stockpiling inventory to avoid higher costs from tariffs. Although the US economy contracted during the first quarter, the labor market remained solid. Monthly nonfarm payrolls averaged 132,000 during the first quarter and recently came in above consensus at 177,000 in April. The unemployment rate was unchanged at 4.2%.

Fed’s Next Moves

The US economic outlook has become increasingly uncertain, as escalating geopolitical tensions disrupt trade, fuel market volatility and cause inflationary pressures. The Fed has taken a more cautious approach to policy decisions in light of these growing uncertainties. During the latest meeting in May, the Federal Open Market Committee (FOMC) decided to maintain the federal funds rate at 4.25% to 4.5%, as they wait for clearer signals on how inflation, unemployment and economic activity are shifting.

One of the key metrics the Fed monitors to gauge inflation is the core Personal Consumption Expenditures Price index (PCE), which although moderated to 2.6% in March, is expected to pick up as retailers raise prices to offset higher costs driven by import tariffs. Between the macro economy and inflation data, FOMC members are projecting a median of two rate cuts by the end of 2025. All else equal, the impact of lower interest rates will improve values, as the cost of borrowing becomes less expensive.

Expectations for 2025

Over the course of 2025, we expect growth to continue to moderate. Higher US tariffs and increased uncertainty will likely put pressure on GDP growth in the second quarter. However, an improved trade deficit will partially offset some of this drag. The trade deficit’s projected to improve in the second quarter, due to an expected steep decline in imports after their recent sharp surge. Although the level and duration of tariffs remain uncertain, markets are anticipating a partial rollback of tariffs, similar to the recent adjustment made with the UK Moody’s Analytics expects GDP to grow by an annualized 1.3% in 2025, a notable slowdown from 2024’s 2.8% growth. However, the effects of tariffs will continue to be a key factor in shaping future economic expectations.

Easing supply pipelines

The apartment sector

US apartment demand outpaced completions during 1Q25, as markets moved beyond the peak of the recent supply surge (see Figure 2). At a little over 70,000 units delivered, first quarter completions were 47% below 3Q24’s peak. During this period, just over 100,000 units were absorbed, driving vacancy down. The vacancy rate fell 20bps over the quarter to 4.8%, the lowest level since 2Q22. Despite tighter market conditions, rents increased marginally by only 0.9% YoY.

Transaction volume for the quarter was 35.5% higher than 1Q24 levels, suggesting that buyers are taking advantage of the possibility of acquiring at a discount despite economic uncertainties. The ODCE NPI apartment sector delivered an annual total unlevered return of 4.0% in the year ending March 2025.

The industrial sector

Industrial demand continued to soften in 1Q25, with postponed expansion plans amid economic uncertainty contributing to the slowdown. Although completions outpaced demand during the quarter, the pace of new deliveries slowed significantly – down 51.7% from 2Q24’s peak. Availability increased 30bps over the quarter to 8.9%, the highest national availability rate since 3Q15. Industrial rents were flat year-over-year, as elevated availability weighed on rental increases.

Despite softening fundamentals, transaction activity picked up slightly. Transaction volume for the quarter was 24.4% higher than 1Q24 levels. Industrial values rose for the third consecutive quarter, contributing to an ODCE NPI annual total unlevered return of 4.1% in the year ending March 2025.

The office sector

At the end of 2024 we warned that, “Office fundamentals improved for the first time in three years, but the sector is far from recovery.” Unfortunately, a decline in tenant demand during 1Q25 proved this point. Downtown Class A properties marked the only subsector with positive demand, while Suburban locations and mid-to-low quality office buildings struggled. For the fifth consecutive quarter, office vacancy hovered near 19.0% nationally, supported mainly by slowing supply growth. During 1Q25, two million sqft of office delivered in the US, representing the lowest level of new supply since 2011.

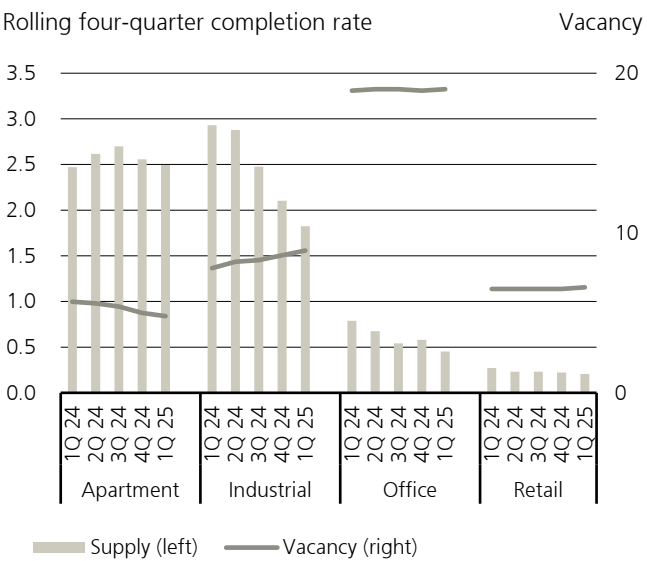
Transaction activity was mixed. Sellers lost momentum in suburban locations with transactions down 33% over the year. However, downtown office transactions increased 25% during the same period. For the first time since 2Q22, the NPI ODCE Office return was positive, increasing by 1.1% during the quarter, bringing the one-year total return to –1.7%. While the worst of the downturn may be over for the office sector, a return to pre-pandemic performance will likely take many years.

The retail sector

Retail outperformed other major real estate sectors during the first quarter, though looming economic risks make the sector’s continued dominance less certain. The retail sector delivered an ODCE NPI total unlevered return of 8.5% in the year ended 1Q25, outperforming the industrial, apartment and office sectors. Retail sales rose 4.5% year-over-year in 1Q25 supported by low unemployment and a temporary boost, as retailers built up inventory ahead of tariff increases.

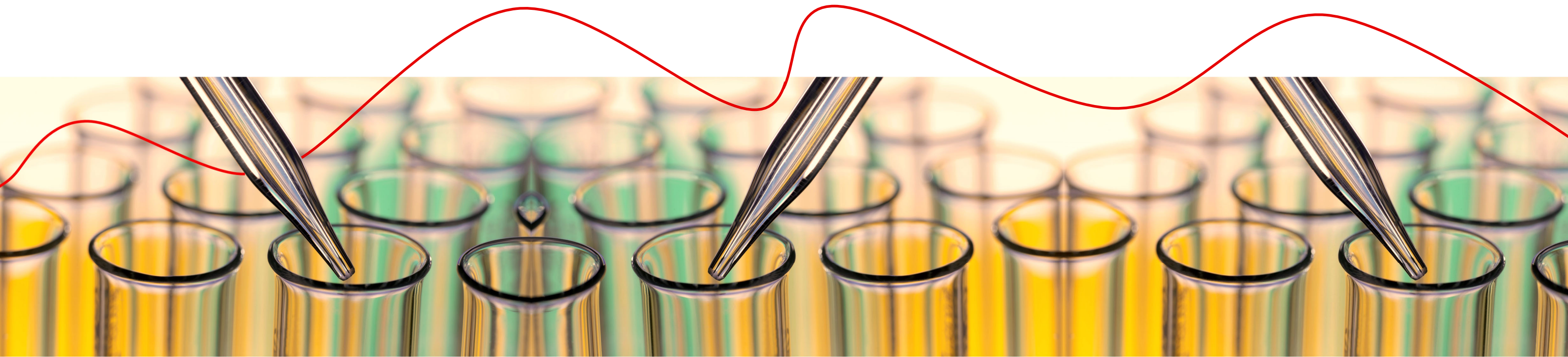
Leasing demand at neighborhood, community and strip shopping centers fell during 1Q25 for the first time since 2020, but low levels of construction helped keep the vacancy rate at 6.6%. Retail transactions for the quarter were up just 2% compared to 1Q24, a sign that buyers are not yet rushing to the table in response to retail’s strong fundamentals. Improving capital market conditions should support more activity once underwriters can factor in more clarity on the economy.

Figure 2: Sector fundamentals (%)



Source: CBRE-EA, as of March 2025, Note: Completion rates shown are the total supply delivered over four-quarters as a percentage of inventory. **Past performance is not a guarantee for future results.**

Life Sciences



Building the future of innovation

“Investing in cities that already have established life sciences real estate assets provides several strategic advantages. These locations offer a proven track record of collaborative success, reduced developmental delays, and a supportive and established supply chain ecosystem.”

Olaf Margeirsson

**Head of Real Estate,
Research & Strategy – EMEA ex DACH,
Global Real Assets**



Selecting cities for life sciences real estate in Europe

A deep dive into selecting cities for life sciences real estate in Europe

In the rapidly advancing realm of biotechnology and pharmaceuticals, life sciences real estate is more than bricks and mortar – it’s the enabler of innovation. Investors venturing into this specialized asset class are essentially betting on ecosystems that need real estate to grow. Think of it as the skeleton that keeps the muscles in place and the body as a whole standing. There are certain strategic parameters that can be used to select the right European cities for life sciences real estate investments. This must then be woven in with external push and pull factors that are forcing companies in the life sciences sector to adjust when it comes to their real estate footprint.

The nexus of development: educated workforce, financing and companies

At the heart of life sciences innovation lies a robust, interdisciplinary talent pool with access to financing supported by company leadership. Cities with a high concentration of graduates in biotechnology, medicine, data science, and engineering give life sciences companies the human capital needed to thrive.

Universities’ role in life sciences goes far beyond teaching; they serve as catalysts for collaboration, driving industry-academia partnerships, and facilitating technology transfer. Cities renowned for their academic institutions, such as Paris or Cambridge, are uniquely positioned to foster a dynamic and sustainable innovation ecosystem.

Higher education institutions also provide vital research infrastructure. They offer laboratories, collaborative research centers, and incubators that attract venture capital, public funding, and international academia-industry partnerships. For instance, universities known for their research in molecular biology and personalized medicine often work closely with established pharmaceutical companies, accelerating everything from early-stage R&D to clinical trial execution. The University of Oxford works with Novo Nordisk, Freie Universität Berlin works with Bayer and Pfizer.^{1,2}

Many other academia-industry partnerships exist, they are the standard rather than not. Companies seek this out as well. As companies respond to demand forces for their products, they look for the educated staff that has the knowledge needed to develop said products. Working with and providing leadership to research institutions and universities is a crucial funnel which directs the brainpower of an educated workforces into the right direction.

Companies also have the balance sheets and the network needed to access vast amount of financing across the capital stack, ranging from venture capital funding to private equity to debt.

Combine these three factors – an educated workforce from top-level universities, access to financing and companies providing leadership – and you create the cluster effects that support the life sciences ecosystem that a real estate investor wants to build the skeleton for.

The cluster effect and real estate

In the realm of life sciences, ‘location, location, location’ goes beyond traditional real estate value – it extends to the creation and enlargement of clusters that rise around the aforementioned nexus. The cluster effect occurs when companies, research institutions, and support services are co-located, creating a self-reinforcing ecosystem that amplifies innovation and efficiency. Cities like Oxford, Cambridge, London, Paris or Berlin exemplify this phenomenon, where the presence of long-established pharmaceutical giants has spurred the development of research parks, specialized industrial units, and top-tier laboratories.

Investing in cities that already have established life sciences real estate assets provides several strategic advantages. These locations offer a proven track record of collaborative success, reduced developmental delays, and a supportive and established supply chain ecosystem. Existing facilities mean that companies facing the imminent expiration of key patents can quickly repurpose or scale operations without the prolonged lead times required to construct new, compliant spaces. As a result, investors can leverage historical performance data and an established network – all of which reduce risk and enhance the likelihood of resilient leasing demand for labs and related real estate space.

Furthermore, the presence of mature clusters attracts additional investment. Ancillary businesses – from logistics and specialized consultancy firms to regulatory compliance experts – gravitate toward these hubs. This self-reinforcing network effect means that a city’s attractiveness as a life-sciences innovation center continues to grow over time, making it a veritable magnet for both public and private capital.

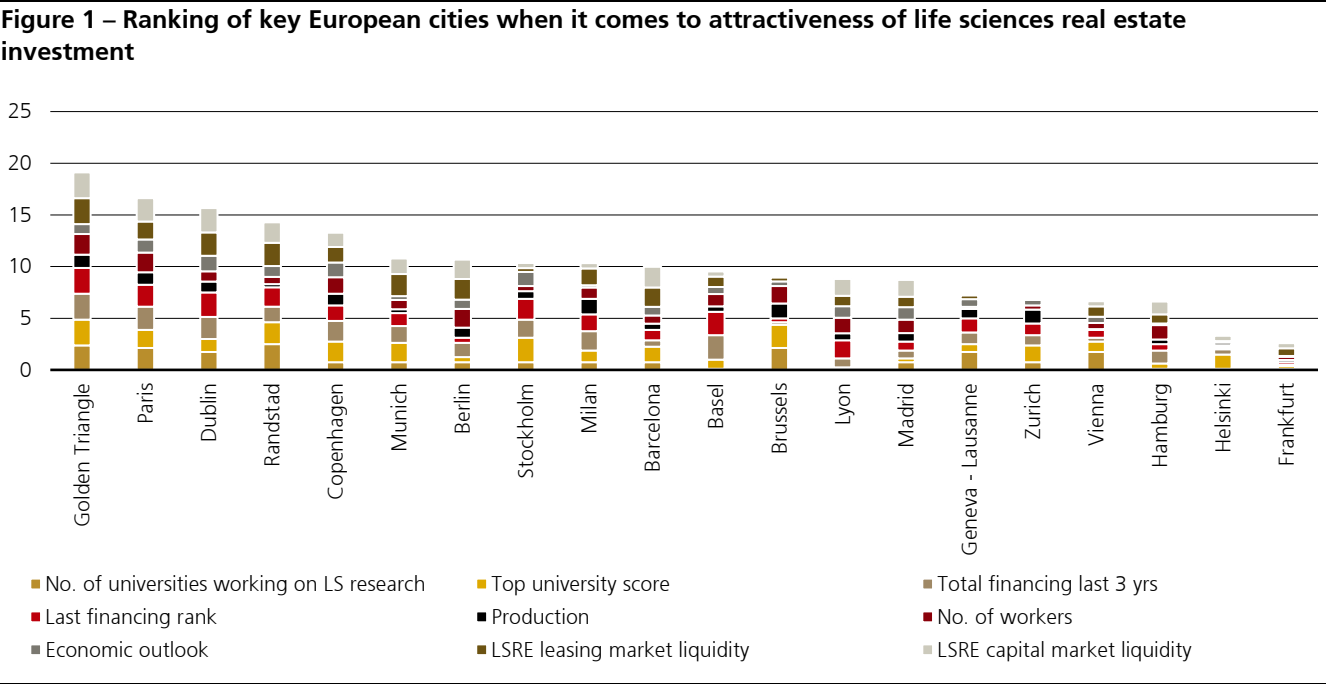
Putting it to practice

We can use these insights to screen and prioritize cities to invest in when it comes to life sciences real estate. Various different indicators should be considered but the key ones are:

- the university landscape, especially with regards to life sciences research and quality of universities;
- life sciences real estate activity, including leasing and investment deals;
- access to and flow of financing;
- amount of pharmaceutical and related production;
- and number of workers and the local economic outlook.

Relying on those factors yields the following ranking of key cities that should be strongly considered as destinations for life sciences real estate investment (see Figure 1). The Golden Triangle in the UK, consisting of Cambridge, Oxford, London and neighboring and related cities, sits at the top, followed by Paris and the Randstad region. A second cluster of rising hubs, consisting of e.g. Berlin and Barcelona, follows the established key centers.

Those rising hubs are driven by increased activity from companies in the industry reflected in leasing and capital market activities with life sciences real estate (LSRE) assets. But this activity, within Europe, may be about to shift.



Source: UBS Asset Management, April 2025.

Reciprocal tariffs can redefine firms’ location choices

Recent shifts in global trade dynamics – most notably, the imposition of tariffs – will likely reshape the strategies of multinational life sciences companies. These tariffs, which increase the costs of exporting to another market, have a profound impact on market access strategies.

If US companies face higher tariffs when exporting finished products to Europe, many are likely to opt for horizontal foreign direct investment (FDI) instead of traditional trade approaches. Horizontal FDI involves establishing production and R&D facilities within the target market – in this case, Europe. This strategy circumvents the tariff impediments while simultaneously taking advantage of local tax incentives and established innovation networks.

This would allow the investing company to access, tariff-free, an economic block that is on par with that of the US: EU’s GDP in purchasing power parity terms was USD 26.4 trillion in 2023, compared to USD 27.7 trillion for the US. Likewise, however, EU pharmaceutical companies may choose to move production capabilities to the US if tariffs on imports are high.

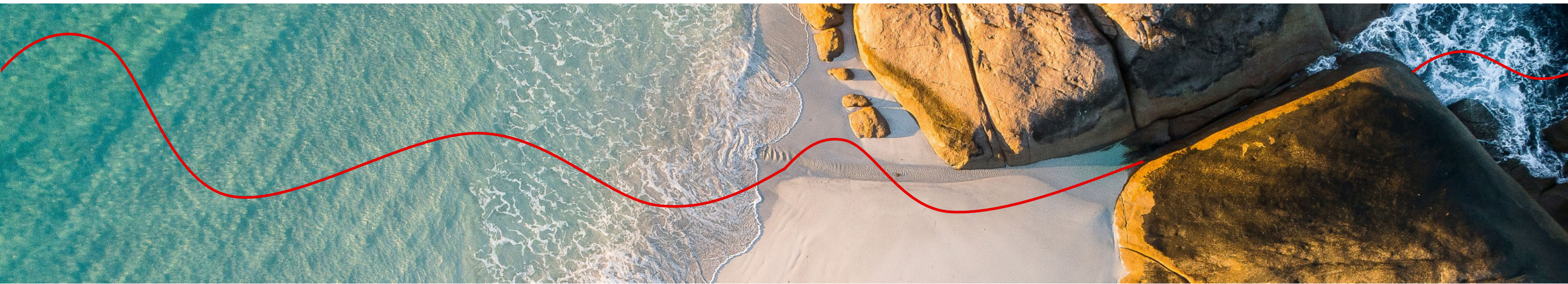
According to Eurostat, the key market in Europe that is exposed to this risk is Ireland. In 2024, the EU exported EUR 120 billion worth of medicinal and pharmaceutical

products over to the US. More than a third, EUR 44 billion, came from Ireland alone while Germany, which ranked second, exported less than two thirds (EUR 28 billion) of Ireland’s volume. Indeed, the growth of Ireland’s exports of those goods over to the US has been around 25% p.a. over the last decade, compared to ca. 14% p.a. for the EU as a whole. This is one of the key reasons why Dublin ranks so highly on Figure 1 but this is also a risk that investors must be aware off: ranking can change as markets shift.

If tariffs become a serious issue for the US-EU pharmaceutical trade, cities with adaptable, state-of the-art life sciences real estate assets stand to gain from this erection of trade barriers – see Figure 1. For these urban centers, the expectation would be that a number of US companies would choose to set up wholly owned subsidiaries or joint ventures, further reinforcing local clusters and accelerating innovation. Ireland, however, is likely to bear the brunt of the damage in the case of Europe’s access to the US market.

¹ University of Oxford, Medical Sciences Division (2025). “Key Partnerships”. Accessed 4 April 2025: <https://www.medsci.ox.ac.uk/about-us/partnerships-industry/key-partnerships>. ² Freie Universität Berlin (2025). “Wirtschaftskooperationen”. Accessed 4 April 2025: <https://www.fu-berlin.de/universitaet/kooperationen/wirtschaft/index.html>

First 100 days of Trump



Keep calm and carry on

"Infrastructure is viewed by many as a safe-haven investment. Its underlying investments provide essential services, are more defensive in nature, exhibit monopolistic characteristics, and have multi-decade useful lives. Infrastructure has consistently shown resilience during periods of economic uncertainty – and this time is no different."

Alex Leung

**Head of Research & Strategy –
Infrastructure, Global Real Assets**



Infrastructure as a safe haven

In our report *Infrastructure and the first 100 days of Trump*, we delve into the impact of Trump’s key policies on infrastructure and its main subsectors, shedding light on nuances that may be overlooked or misunderstood by investors. Below is an abridged version of the report.

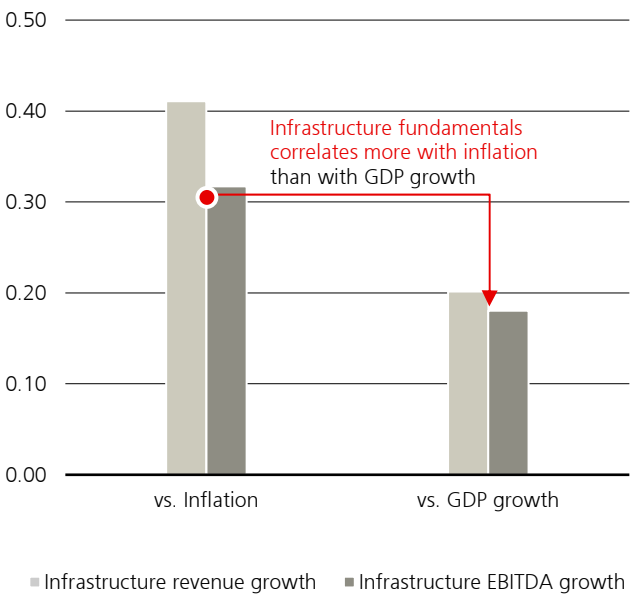
Infrastructure shines during stagflation

On 2 April 2025, President Trump announced tariffs that target US trading partners that far exceeded market expectations, causing a negative reaction around the world. Further retaliation from other countries also heightened investor anxiety. This led to downward revisions in GDP growth and upward revisions to inflation.

Overall, this combination is actually neutral if not positive for private infrastructure, as infrastructure tends to be more sensitive to inflation than to GDP.

For example, infrastructure has strong pricing power that allows it to pass on higher costs to customers, while the underlying business tends to be more defensive and less exposed to economic cycles. Looking at historical infrastructure revenues and EBITDA (relying on financial data from listed infrastructure), we found that infrastructure actually shows a significantly stronger relationship with inflation than with GDP growth based on correlations (see Figure 1).

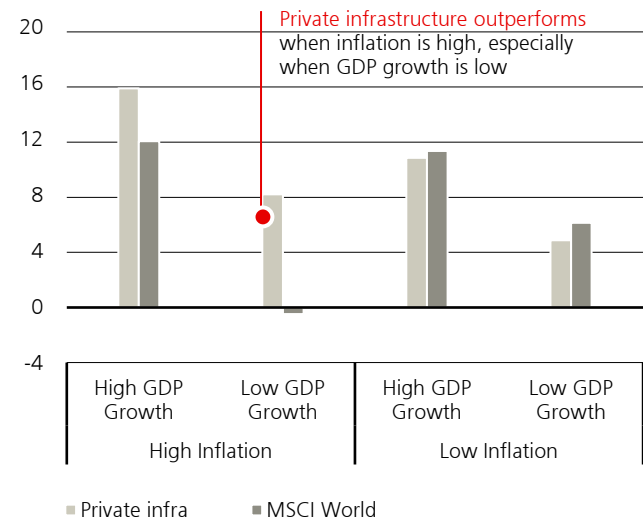
Figure 1: Private infrastructure correlation vs. GDP and inflation (R-Squared)



Note: Revenues and EBITDA based on S&P Global Infrastructure Index (USD) 2010-2024; GDP growth and inflation based on OECD historical data. Source: Bloomberg; OECD, April 2025.

This is consistent with our analysis of performance, which shows that private infrastructure benefits more from high inflation than from high GDP growth. In fact, private infrastructure actually outperformed public markets the most during a combination of low GDP growth and high inflation (see Figure 2).

Figure 2: Private infrastructure outperforms public markets the most during high inflation / low GDP growth (YoY performance, %)



Notes: Data based on quarterly YoY data; private infrastructure based on MSCI Burgiss data; GDP and CPI data based on OECD countries; threshold for high vs. low GDP and CPI are both ~2% (based on median quarterly data of observation period); Sources: Sources: Cambridge Associates; Bloomberg; MSCI; OECD, April 2025.

We’re not naïve enough to claim that infrastructure will not be affected by slowing economic growth and do expect some negative impact (e.g., sectors like transport are more GDP sensitive than others). However, historical performance data does suggest that a diversified private infrastructure portfolio benefits from ‘safe haven’ status, especially with the rise of stagflation risks.

Interest rates remain an uncertainty, as bond yields have recently increased due to the market volatility. President Trump has explicitly stated that lowering interest rates is a key policy goal, even going so far as to threaten the termination of Fed Chair Jerome Powell to achieve this.

Lower rates are unequivocally positive for infrastructure, as high rates were the number one concern for infrastructure investors in the last four years. However, even if rates remain elevated, it would simply be a continuation of the status quo, where infrastructure has already proven its relative resiliency.

Looking beyond direct impact and first order effects

Despite all the moving parts, we believe macroeconomic and market conditions are still largely aligned to benefit infrastructure. Some uncertainties persist – for example, investors are increasingly concerned about policies and geopolitics.

Our view is that we cannot look at each policy (e.g., tariffs, anti-renewables policies) in isolation. Through a broader lens, we also have to recognize that there had been positives – potential extension of tax cuts, deregulation, the push for US energy and technological (AI) dominance, and strong support for onshoring – all of which acts as tailwinds for infrastructure investments.

The same is also true across other regions around the world – as a reaction to Trump’s ‘America First’ policies, many countries are also looking to accelerate their own domestic investments. For example, Germany announced the creation of a EUR 500 billion infrastructure fund to support investments across energy, transport and digital infrastructure.

Looking at the YTD performance of listed infrastructure sectors gives us a good glimpse of how short-term sentiment for each sector has changed since the beginning of Trump’s presidency. Overall, listed infrastructure has outperformed broader equity markets.

However, sectors such as broadband and data centers have underperformed significantly. Meanwhile, more cash yield focused traditional infrastructure such as telecom towers, utilities and waste management have outperformed.

We summarize the outlook for various infrastructure sectors below based on Trump’s latest policies. Note that the table focuses on first order effects, although in reality, there are many second order effects that can complicate the outlook for these sectors. Please refer to our *report* for more details.

For example, despite the positive rhetoric by Trump on oil and gas, there is simply a limit to shale production volumes due to low commodity prices and geological limitations. Similarly, Trump has been a vocal supporter of data centers. However, there is also a lot of hype around AI, and investors needs to watch out for speculative behavior.

On the negative side, US energy transition seems to face the most headwinds under Trump. However, the industry is also highly resilient and has proven time after time that it can adapt to policy changes, especially given the strong demand for clean electricity around the world.

Overall, infrastructure enjoys strong pricing power and secular tailwinds, and should remain resilient despite the near-term policy uncertainties. Ultimately, risks can be passed onto customers in the long run, because there are simply no alternatives to the essential services that infrastructure provides.

Private infrastructure sector performance outlook

	Negative	Neutral	Positive
Europe	Oil & gas	Roads, ports, airports, logistics, conventional power, roads	Airport, railroads, fiber, telecom towers, utilities
US	Ports, logistics, airports	Energy transition, oil & gas, fiber, roads	Conventional power, data centers

Source: UBS Asset Management (UBS-AM), May 2025. Assessment informs top-down perspectives by sectors and regions. UBS-AM will weigh the perceived relative attractiveness using a scale of “positive”, “neutral” and “negative” ratings. The ratings do not reflect exclusionary or inclusionary investment screening but imply more risk premium to be applied to sectors with “negative” ratings and less risk premium for sectors with “positive” ratings, based on our latest views. These ratings are the opinion of UBS-AM and may not necessarily provide an accurate reflection of the ultimate success or potential return of a given strategy. **Past / expected performance is not a guarantee for future results.**

Renewable energy



When new energy meets old wires

“Energy storage not only mitigates the impact of grid congestion, but also provides a flexible and reliable solution to balance supply and demand. By storing surplus energy during periods of low demand and releasing it during high demand, energy storage projects help stabilize the grid, improve reliability, and supports the integration of more renewable energy sources.”

Alex Leung

Head of Research & Strategy –
Infrastructure, Global Real Assets



When new energy meets old wires

In a world where exciting infrastructure technologies that are becoming more efficient and innovative, the US electric grid remains objectively ancient. Much of the grid was built in the 1960s and 1970s¹, and it is struggling to keep up with the rapid growth of renewable energy. Investments in transmission lines have lagged behind investments in renewables in recent years (see Figure 1), resulting in congestion and inefficiencies across the entire system.

Figure 1: US transmission vs. renewables investments (USD billion)



Source: Edison Electric Institute, Rhodium Group/MIT, UBS Asset Management, February 2025.

This problem is exacerbated by the fact that renewable energy sources are often located far from demand centers. Since most of the grid was built half a century ago, it was not designed to support these new resources. Without new transmission lines, the full potential of renewables have been limited due to grid congestion, which leads to the curtailment of this cheap, clean and abundant energy source (where is essentially discarded or wasted).

In addition, rising popularity of electric vehicles and the broader electrification of industrial sectors have increased demand for electricity, adding further strain to the electric grid. Integrating smart grid technologies can enhance efficiency of these new sources of demand, allowing for real-time monitoring and adaptive responses to shifting demand patterns.

A modernized grid will not only connect more renewables and enable further industrial electrification, but also ensure resiliency and energy security in an era of rapid technological advancements.

Policies such as the Bipartisan Infrastructure Law aims to support grid investments, but progress remains slow. Despite billions earmarked for transmission improvements, bureaucratic and regulatory hurdles continue to stall projects.

Politics, permits, and procrastination

Transmission lines are more complicated to develop and construct than generation projects. They are spread across vast distances, requiring approvals from multiple counties, states, landowners, and regulatory agencies. Right-of-way disputes, environmental reviews, and local opposition further delay projects.

For example, the TransWest Express Transmission Project, a 732-mile line connecting Wyoming wind farms to Southern Nevada through Colorado and Utah, was proposed in 2005 but only broke ground in 2023 after 18 years of regulatory battles, and will be completed in 2028. Similarly, the 550-mile SunZia Transmission Project, which aims to transport wind energy from New Mexico to Arizona, took over 15 years to secure permits.

By contrast, renewable energy projects benefit from shorter development timelines and fewer regulatory hurdles, taking only 1-3 years to build once construction begins. There is also a structural business reason behind these bottlenecks. In deregulated electricity markets, upstream power developers can respond to price signals quickly, as they are motivated to lock in higher power prices (e.g. through long-term power purchase agreements).

In contrast, grid investments earn a fixed regulated return on equity (ROE), which means they lack the same urgency to build infrastructure as quickly, leading to timing discrepancies between generation and transmission.

Make electrons move again

So, what can help improve the grid congestion in the US? The federal and local governments can accelerate grid development by streamlining permitting, reducing regulatory delays, and offering better financial incentives.

Currently, many utilities would rather prioritize downstream distribution (and upstream generation for vertically integrated utilities) than transmission lines, since the former is easier to develop, and still generates similar ROEs. If the government can ease regulatory approvals, improve cost recovery, or take any action that lowers the cost of capital and project execution risks, developer would likely redirect investments back into transmission lines.

The government can also boost the regulated ROEs of transmission projects outright. When a new transmission line is built, it is often the upstream generators or the downstream consumers that benefit the most. The grid developer should arguably gain a larger share of the financial upside. While ROE incentive adders already exist, the qualification process is often politically contentious, so any reforms to this system would be highly beneficial. In our view, a combination of both financial incentives and regulatory reforms will be the most effective way of boosting new transmission project developments.

Outlook for electric grids in the age of Trump and AI

There is some early optimism for the electric grid under the Trump administration. Although Trump has been an ardent critic of renewable energy, his efforts in streamlining permitting and approvals is a positive for new transmission projects, which is often stuck in regulatory purgatory during the development process.

At the same time, the rapid rise of artificial intelligence (AI) and data centers, which Trump has been publicly highly supportive of, is driving electricity demand growth to levels not seen in decades. AI-driven data centers require enormous amounts of power, increasing strain on an already congested grid. Regardless of Trump’s policies on renewables, the sheer growth in electricity demand will necessitate more investment in both generation and transmission.

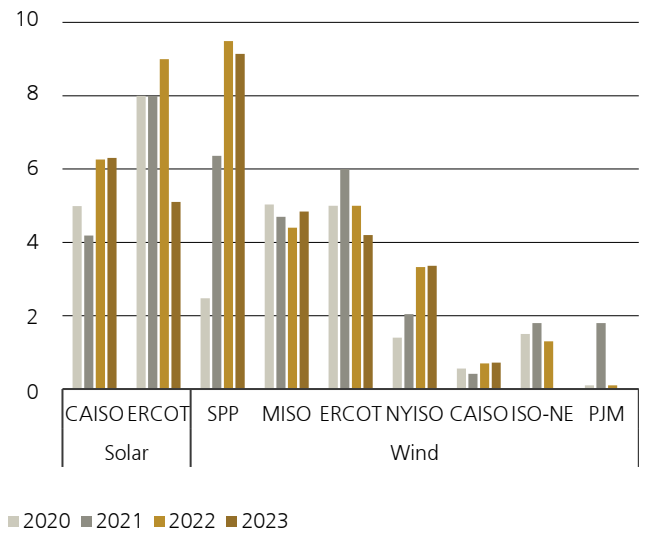
Finally, stabilization of the macro environment should improve the outlook for the electric grid in 2025. Higher interest rates and project cost inflation have been a headache for all types of large capital projects in the last few years. We should therefore see a pickup in new activity from developers.

A matter of location

So where should we invest? Grid bottlenecks vary significantly by region. Regulated markets tend to fare slightly better than deregulated markets, as vertically integrated utilities own both generation and transmission, allowing for better coordination.

Across the deregulated markets, those that have the highest renewable energy penetration also experience the most severe grid congestion issues. These include ERCOT in Texas (wind and solar), CAISO in California (solar), and SPP that covers states along the Northern and Central Plains (wind). These areas are prime locations for new transmission investments.

Figure 2: Curtailment as % of total generation



Source: ISO websites and annual report, UBS Asset Management, February 2025.

In addition to grid investments, investors can capitalize on these bottlenecks by investing in energy storage projects. Energy storage systems can absorb excess renewable energy that would otherwise be wasted in congested areas and store it for later use. When demand peaks, this stored energy can be sold back to the grid at higher prices, thereby reducing curtailment and enhancing grid efficiency.

Energy storage not only mitigates the impact of grid congestion but also provides a flexible and reliable solution to balance supply and demand. By storing surplus energy during periods of low demand and releasing it during high demand, energy storage projects help stabilize the grid, improve reliability, and support the integration of more renewable energy sources.

Conclusion

The US grid is struggling to keep pace with rapid changes in the energy landscape. While renewables, electric vehicles, data centers and industrial electrifications have expanded quickly, transmission development remains slow due to permitting delays, economic misalignments, and regulatory inertia.

However, the need for new infrastructure has never been clearer. AI-driven electricity demand, regional grid disparities, and shifting energy policies are creating new investment opportunities. Whether through transmission or energy storage, investors who understand the unique dynamics of power markets and regulatory reforms will be well-positioned to benefit from the grid’s inevitable modernization.

¹ Department of Energy, What does it take to modernize the US electric grid? October 2023. * Asset under management stated on gross asset values basis, reflecting values as at 30 Sept.2024, where available.

Energy transition



Accelerating the energy transition

"We believe the next big opportunities within the energy transition are transport and grid infrastructure. According to BNEF, transport will require between 5-8x the capital needed for renewables to 2050."

Declan O'Brien

**Client Portfolio Manager –
Energy & Transport Transition,
Global Real Assets**



Investment in low-carbon technologies

Beyond traditional wind and solar, where do you see the most attractive energy transition investment opportunities today and to 2050?

We believe the next big opportunities within the energy transition are transport and grid infrastructure. According to BNEF, transport will require between 5-8x the capital needed for renewables to 2050.¹ This is why our strategy dedicated to decarbonizing transport uses Proprietary Data Insight (PDITM) to identify the opportunities that are ripe for decarbonization based on: the cost competitiveness of the low carbon solution, the full lifecycle emission reduction and, whether the technology is commercially available.

We see the most immediate opportunities in the electrification of surface transport and near-shore maritime as these can already be decarbonized in an economic way using commercially available technologies. In the longer term, once these technologies mature, there will be significant opportunities to invest into maritime and air segments through the production, transport, and storage of low carbon fuels.

The energy transition will not be possible without grid infrastructure to enable the electrification of the economy. For example, energy storage and micro-grids can be considered attractive given they can be invested in as standalone opportunities. The challenge for investors is that these investments can often be difficult to access as they are highly regulated activities carried out by incumbent utilities.

Hydrogen and nuclear are also generating a lot of interest but we see more limited opportunities in the short term. However, they could be attractive for the long term if they can scale and become more cost competitive.

How should investors within the energy transition account for geopolitical risks related to renewable energy supply chains (e.g., rare earth metals, solar panels)? How do you address these risks?

We believe the key to investing into the energy transition is to ensure that investments are truly sustainable on a holistic basis. Thinking back to the biofuels rush in the early 2000s, there were negative consequences not fully considered at the outset e.g., deforestation and the impact on land use.

As part of PDI™, we've developed (in-house) a lifecycle assessment tool which aligns with the fundamental requirements of the ISO 14044:44. This gives us the full view of the well-to-wheel emissions profile before we consider making an investment.

As electrification is a major component of our strategy, we pay close attention to the supply chain of battery providers. We observe that the industry is evolving with several positive elements from the growth of LFP batteries (which do not use cobalt, which is an industry that historically had severe human rights issues in some sourcing locations such as DRC) to increasing the percentage of critical minerals that can be recycled at the end of a battery's life.

Additionally, we target some of the most reputable manufacturers and will either seek information on policies or request for representation from its partners and major suppliers covering the UN Global Compact principles.

What do you consider your biggest challenges in the energy transition?

The biggest challenges in the energy transition are finding the trillions of capital required, and investing it in a way that delivers the best outcomes for the planet. Rising interest rates and inflation have increased costs, reducing the viability of many energy transition projects.

At the same time, the funding pool for investments where the technology risk is less proven, or the economics are not showing a trajectory to cost parity with conventional technologies, has declined.

The availability of quality data around emerging energy transition technologies is another obstacle. Policy makers and investors are making decisions without access to the detailed information around the cost and emission profiles of the various energy transition technologies. Better data would allow capital to be allocated where it will have the biggest bang-for-buck reduction in Co2 emissions.

This is why we created PDI™, our total cost of ownership (TCO) models, which helps the team to identify which parts of the transportation sector can be decarbonized in an economic way, leading to an efficient use of capital to reduce emissions. We believe this approach is consistent with a just transition and makes the strategy less exposed to the changing political environment and a reliance on future subsidies.

Our life cycle assessment (LCA) models allow us to understand the impact of our investments in avoiding carbon emissions. For example, it shows that investing in transport in developed markets (where the grid is relative clean) has a higher Co2 avoided per dollar invested than renewables. Whereas in developing markets, renewables tend to have more impact than transport as the grids typically have a higher emission intensity.

For some of the emerging energy transition sectors, investors know they need to take a long-term view and can take comfort from the cost declines seen in renewables and battery packs experience over the past decade. However, a greater understanding of the current and projected cost and emission profile, and a clear direction from policy makers, would make financing more plentiful and available at a lower cost.

How do you assess the concept of 'stranded assets' within the transportation industry?

The energy transition is at a stage where there are multiple technologies being presented as climate solutions. Not all these technologies will succeed. Through our PDI™, our investment team can identify the areas of transport where the low carbon option generates lower lifecycle emissions and is cost competitive with the legacy fossil-fueled equivalent.

We believe that PDITM is an essential toolkit to avoid stranded asset risks as it can assess the cost and emission profile vs. legacy technology and whether the technology is proven and fit for purpose. For example, if you look at containerships, the industry has yet to coalesce around a low carbon technology, with some looking to e-methanol while others are looking at ammonia and LNG. In just 5 years, the industry prospects of LNG as a decarbonization fuel have changed significantly as costs fluctuated significantly while the full lifecycle emission benefits are being scrutinized more carefully. This creates a high risk of a stranded assets and that uncertainly makes financing challenging.

Is there a quantitative approach to measuring impact?

Many investors grapple with where their investment can have the most impact. We present an Impact Return Metric which provides a quantitative assessment of the CO2-eq avoided per dollar invested (CO2/USD).

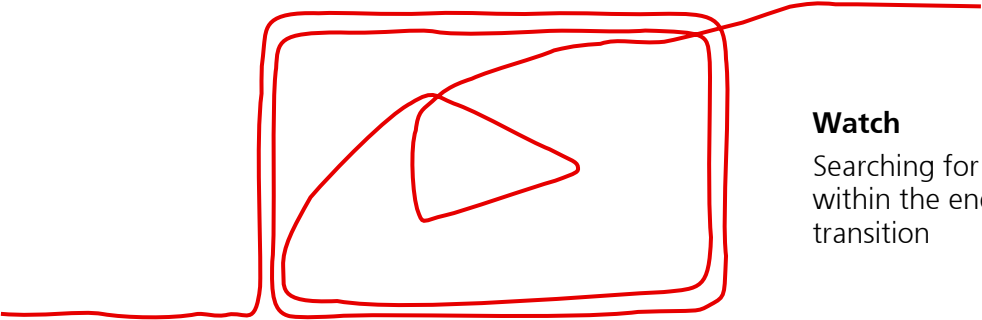
We've compared transport and renewables across different geographies. Our analysis shows that electrified transportation can have a higher impact return vs. renewables in countries where the grid is already relatively clean.

For example, in countries with low grid emissions such as Sweden (~10 gCO2 / kWh), the Impact Return for transport can be up to 25x² higher than for new investments in wind, while in Poland (~720 gCO2/ kWh), investing in wind power can deliver 7x higher impact return than transport, illustrating the importance of considering grid emissions when assessing Impact Return for transport.

The continued growth in renewables is essential as an enabler for the decarbonization of the grid and wider electrification programs. As grids further decarbonize, the Impact Return for the electrification of transport will grow against renewables.

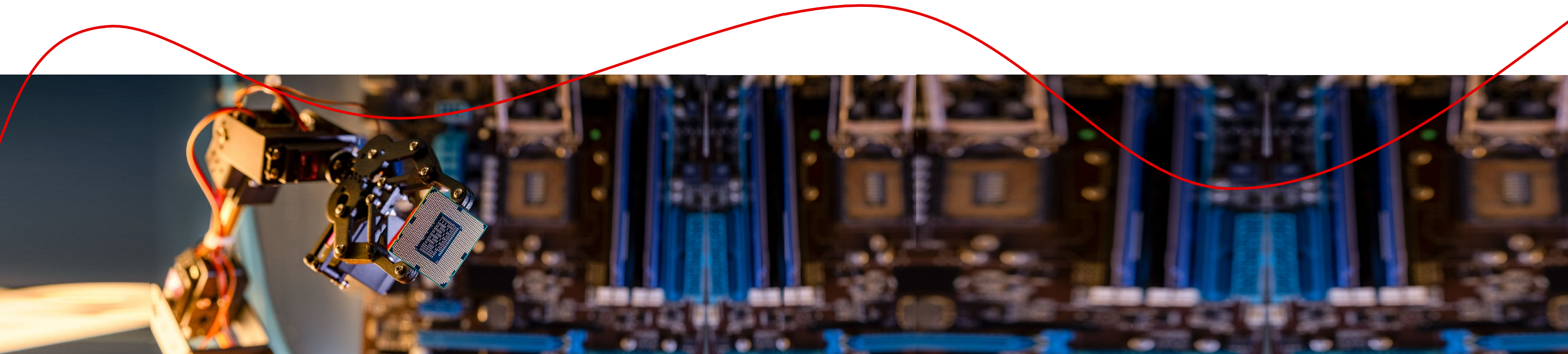
Metric such as Impact Return help outcome focused investors who want to allocate their capital towards the investment that has the most impact in terms of emissions avoided per dollar invested.

Sources: **1** BNEF has modeled multiple scenarios for how the energy transition may unfold over the next three decades. **2** In Sweden, the max for transport application is 9.7kg Co2/USD (baggage tractor) and max for wind is 0.38kg Co2/USD (onshore wind). In Poland, max for transport application is 5.47kg Co2/USD (baggage tractor) and max for wind is 36.2kg Co2/USD (onshore wind).



Watch
Searching for impact within the energy transition

Is it for the long haul?



Responding to tariff uncertainty

"We believe the current market favors larger, market-leading companies which are exposed primarily to their respective domestic markets. The sponsors best positioned to succeed today are those employing modest leverage, driving operational improvement, and maintaining a clear sense of risks and opportunities within their current portfolios."

James Pilkington

**Portfolio Manager, Private Equity –
Unified Global Alternatives**



Balancing risk and opportunity

Tariff uncertainty in focus

Private equity investors have had a busy 1H. The US administration’s 2 April tariff announcement took investors by surprise, leading to a global equity markets selloff as trade war fears intensified. The subsequent rollback of the tariff announcement also surprised equity markets, which rallied significantly on news of a pause. As with the 2022 tech-led selloff, private equity tends to lag the public markets, but is not immune from a turbulent market.

The most immediate effects are to portfolio valuations, which are linked directly and indirectly to public comparables; these have, in hindsight, been modest since equities recovered quickly. Second-order impacts relate to forward expectations, including liquidity: public markets are a key exit path for privately held companies, and hopes of an active 2025 M&A market have effectively been dashed by the market uncertainty (though were already looking likely to underperform optimistic expectations going into the year).

This will exacerbate the cycle of longer holding periods for private companies, fewer distributions to investors, and a poor fundraising environment. Uncertainty has also played a role in the US central bank’s decision to keep rates unchanged at elevated levels, which is less favorable for creating private equity returns through borrowing.

Fundraising is especially challenging for new managers because smaller investor budgets are often allocated to re-ups with existing managers and a general risk-off sentiment. This caution may not be fully warranted in an asset class that typically has a 5-10 year return horizon.

In terms of investment strategy, we believe the current market favors larger, market-leading companies which are exposed primarily to their respective domestic markets.

The sponsors best positioned to succeed today are those employing modest leverage, driving operational improvement, and those who have a clear sense of risks and opportunities within their current portfolios. Dry powder also helps – both to support existing portfolios and capitalize on emerging opportunities. While cautious on the macro, which includes a weakening US consumer, uncertain times have also produced some of the strongest vintages of private equity funds. Today’s market does present risk, but also opportunity.

Venture capital

While facing plenty of uncertainty of their own, venture backed companies are largely insulated from tariff pressures, as they tend to produce few tariff-exposed products. The negative IPO sentiment does hurt late-stage companies with public aspirations, but the outlook has been dim for a while, and the investment cycle has become so long that fewer companies are affected than would have been in the past.

Investors are now ‘in it for the long haul’ and looking toward the next golden era of venture capital, with most investors focused on AI-related investments. These hold plenty of promise, but are in early innings and will probably take years to show true results.

Within AI, investments which enhance application and broaden economic potential appear better positioned than model development and those focused on interface/user adoption (following recent trends that have abandoned unprofitable user growth).

The dynamics of the post-2021 venture capital hangover are still slowly resolving, with gains largely remaining on paper, exits being rare, and distributions even rarer. Selective investment behind top funds and the most promising up-and-comers continues to be the strategy for most investors.

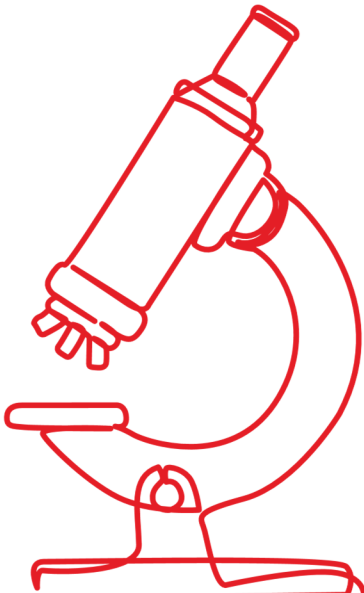
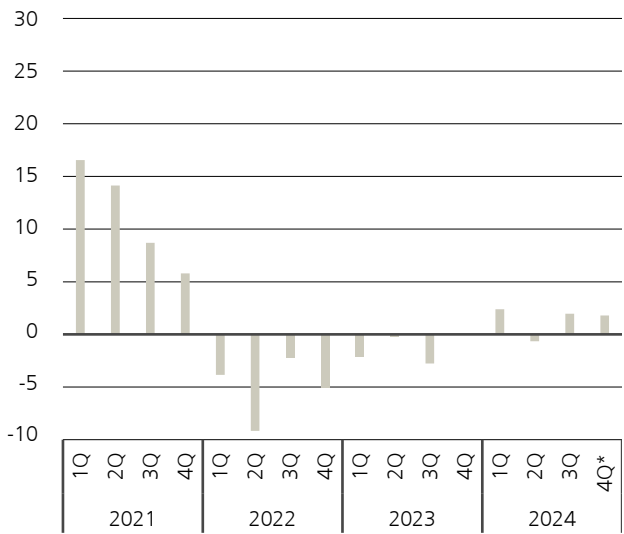
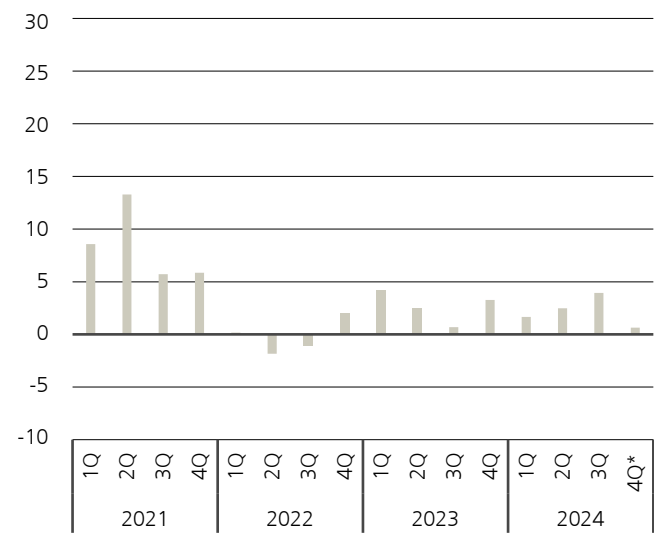


Figure 1: Venture capital quarterly fund returns (%)



Source: PitchBook, April 2025. (* denotes preliminary data). **Past performance is not a guarantee for future results.**

Figure 2: Private equity quarterly fund returns (%)



Source: PitchBook, April 2025. (* denotes preliminary data). **Past performance is not a guarantee for future results.**

Private equity sector performance outlook

	Negative	Neutral	Positive
Americas		Venture capital	Growth equity, buyouts Secondaries
Europe			Venture capital, growth equity, buyouts Secondaries
Asia		Venture capital	Growth equity, buyouts Secondaries

Source: UBS Asset Management (UBS-AM), May 2025. Assessment informs top-down perspectives and strategy allocation. UBS-AM will weigh the perceived relative attractiveness of these strategies using a scale of “underweight”, “neutral” and “overweight” ratings. These ratings are the opinion of UBS-AM and may not necessarily provide an accurate reflection of the ultimate success or potential return of a given strategy. **Past / expected performance is not a guarantee for future results.**

Navigating the storm



A bridge over troubled water?

"Navigating the credit market, especially during turbulent times, requires a cautious approach – but with careful asset selection and strategic positioning, investors can find attractive opportunities."

Joseph Sciortino

Head of Unified Global Alternatives –
Private Credit



Uncharted waters ahead

“When you're down and out
When you're on the street
When evening falls so hard,
I will comfort you
I'll take your part.”

– Paul Simon

The first one hundred days of the second Trump administration has been eventful to say the least. The announcement of impending tariffs on Mexico, Canada and China raised concerns of global trade war increasing the risk of recession. Some strategists have gone so far as to say a recession in the US is now a 90% probability. Naturally, this has investors on edge and private credit’s not immune to this speculation.

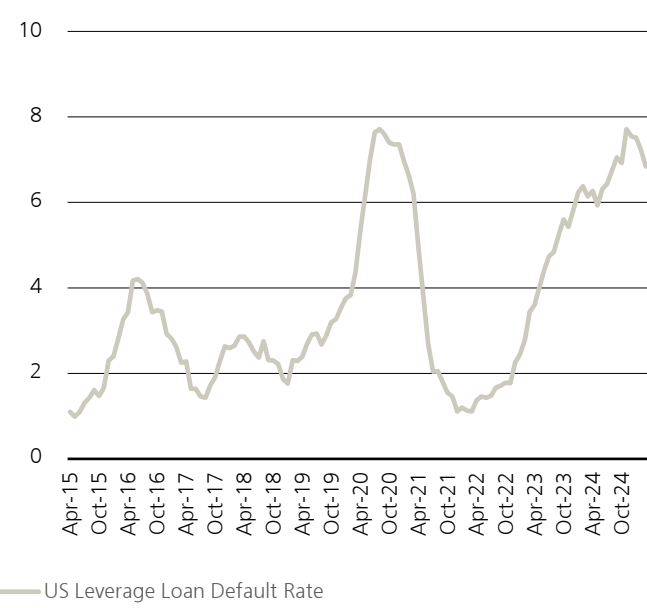
Corporate credit

Much has been written about the hidden risks among the direct lenders. Countless articles about the percentage of payment-in-kind (PIK) loans within business development company (BDC) portfolios predict doom. The truth is PIK loans are not all created equal. Private lenders often use PIK features as an attractive way to build in flexibility for a company that is looking to grow. Furthermore, from what we observe the large private BDCs have a lower percentage of PIK loans than the public BDCs the articles are quoting. Further, the vast majority of these loans are what we would call the ‘good’ kind of PIKs.

Instead, we focus on other fundamental metrics like interest coverage ratios, non-accruals and leverage. Interest coverage ratios are lower today compared to 3 years ago given the rise in interest rates and the resulting increase in borrowing costs for private credit borrowers. However, the revenue growth and EBITDA trends have been stable. Furthermore, there are no immediate signs of financial stress in the sector as the leverage profile has been consistent and the non-accrual loan percentage have remained low for our investments. Granted, these operate in a lag as fundamentals deteriorate but we’ve seen no negative trends emerge as of yet.

Despite what the market spreads are signaling, we believe a long drawn-out credit cycle has already begun. With the rise in rates due to ‘transitional’ inflation post-COVID-19, we began to see an increase of default activity in the broadly syndicated loan market (see Figure 1). To date, the increase in defaults and default exchanges is primarily limited to poor documentation and liability management exercises but the default rate will accelerate if growth slows as more companies will fall under pressure.

Figure 1: Issuer-weighted speculative-grade US bond vs. US loan default rates (%)



Source: Moody’s Ratings, March 2025.

However, the flexibility of private lenders can be a significant advantage over the public markets in difficult times. In fact, we’ve seen a number of companies opt for the private market to fund their companies citing this flexibility despite the higher cost of capital.

While the direct lending strategy is exposed to a default cycle, we believe the funds we’re partnered with have robust portfolios and talented teams that will be able to weather the storm and come out as strong as ever. In fact, we would characterize the ability of our lenders to provide borrower flexible solutions as an opportunity, not a risk. Lenders able to look through the storm and back high- quality companies during rocky times will profit. You could even call these lenders a bridge... over troubled waters (corny, I know).

In fact, after many years of a mild opportunity set, special situations strategies in corporate credit could be heading for a comeback. Over the past decade and a half, the holders of public market debt (high yield and leveraged loans) have shifted dramatically. Mutual Funds, ETFs and collateralized loan obligations (CLOs) have no ability to hold stressed or distressed debt, never mind execute actual workouts. If a recession does emerge and the default rate continues to climb, new capital focused on special situations and capital solutions investing will finally find themselves back on top of the performance tables. It may still be early but we’re keeping an eye on these opportunities.

Commercial real estate

Through the storm of volatility and headlines, commercial real estate pricing increased slightly in the first quarter after nine consecutive quarters of declines. Commercial real estate faces dual challenges related to the move in interest rates – higher borrowing costs and higher cap rates. Both of these factors, coupled with select fundamental pressures, can ultimately lead to property-specific challenges when it comes to refinancing existing loans or servicing debt. However, unlike corporate where equity remains near all-time highs in valuation, commercial real estate (CRE) has already repriced following the increase in rates post-COVID-19. The only outlook that is certain for CRE is uncertainty. As always it comes down to location. We expect continued dispersion by region, sector and property.

Similar to the theme in corporate credit we believe this could be a great opportunity for opportunistic strategies. Lenders with fresh capital have a large and diverse market of assets various states of stress. Finding quality properties with bad capital structures in need of fresh capital is a theme we expect to focus on in our opportunistic private credit investment strategy. Given the adjustment in CRE valuations mentioned above, lenders can originate new loans at compelling loan-to-values (LTVs) with significant downside protection.

On the income side, we continue to focus on short duration strategies. We’ve expressed this theme for years now. During times of uncertainty and volatility shifting your duration down the curve can protect investors looking to earn safe, secured income. We continue to focus on high quality sectors and particularly multifamily property. Overall, property fundamentals have been generally improving. The multifamily vacancy rate declined in the first quarter for the first time in three years. While new supply in multifamily continues to come to market, new multifamily housing starts have declined significantly over the last few years, which should ultimately help create a more favorable supply/demand dynamic in the future as the existing new development supply is worked through.

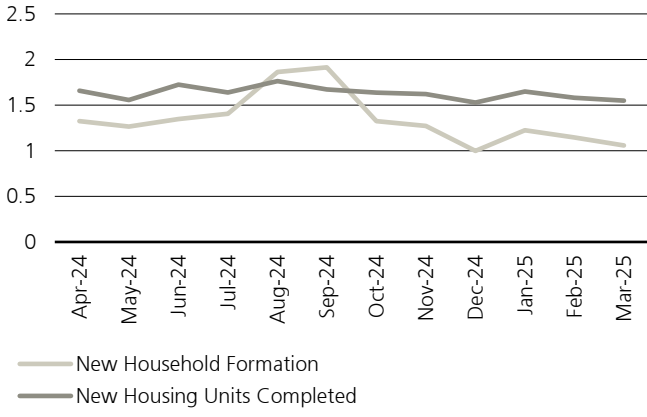
Additionally, post the Silicon Valley Bank (SVB) collapse, regulatory pressure on regional banks has reduced competition significantly, particularly in construction lending which continues to be a core component of our short duration strategy.

In addition to construction lending, multifamily bridge-to-agency remains another core component to our short duration strategy. We’re always looking for investments where we believe the yields don’t reflect the real risk profile. As such, we’re always on the lookout for strategies that take advantage of non-economic players like government sponsored entities who adhere to strict guidelines while executing their mandate. We believe the credit and refinancing risk in our bridge-to-agency strategy is very low compared to the high yields we’re earning.

Residential real estate

For the past 15 years, we’ve been extoling the virtues of residential real estate as a sector for lenders. The main reason was the fundamental supply/demand imbalance created by the gap between new household formation versus and new home creation (see Figure 2). Today, these statistics are more in line with monthly home creation consistently ranging higher than household formation over the past 12 months.

Figure 2: US household formation



Source: US Census Bureau and US Department of Housing and Urban Development, New Residential Construction, 17 April 2025.

While a more balanced supply demand picture doesn’t provide the tailwinds it has in the past, we maintain the view that residential real estate remains one of the most attractive credit profiles available in the market. Consumer balance sheets are well positioned as homeowners have built a large cushion of equity in their homes and have very manageable debt service costs. While the prevailing mortgage rates are near the highest levels over the past 15 years, the vast majority of the US housing stock either has no mortgage or has a mortgage the was originated prior to 2022. As a result, most homeowners with a mortgage are benefiting from having a fixed borrowing cost that are relatively low.

Negatively, high current mortgage rates have stretched affordability to an unsustainable point which could lead to modest declines in home prices if rates don’t come down. Additionally, increase supply in certain metropolitan statistical areas (MSAs) could put pressure on home prices. These markets have typically been the benefit of high demand strong home price appreciation (HPA) over the past few years.

Overall, we believe investors need to be more discerning than in the past. Strategies that were more heavily reliant on HPA growth could produce disappointing results going forward. We remain focused on short duration residential real estate credit strategies that perform well in most forward-looking home price environments, not strategies that rely on rising home prices to achieve target returns.

Specialty finance

Specialty finance is a bit of a catch all for everything that doesn't fit neatly into corporate credit and real estate. Most investors immediately think of consumer lending, but the definition encompasses everything from corporate receivables to litigation finance to health care royalties. As this covers diverse areas of assets and strategies, it's very difficult to have an outlook on the space.

Overall, we believe there are areas that will continue to produce attractive uncorrelated yields and others that will be highly susceptible to a downturn in the economy. We're being cautious in the consumer and small business lending space favoring a more senior position in the capital structure and a shorter duration profile where the portfolio velocity is higher allowing investors to recycle more capital into periods of widening spreads.

Additionally, we're able to source more niche strategies that while not as scalable can produce very attractive yields with limited credit risk. Many of these strategies are complex and have others risks investors need to evaluate such as origination capacity, execution risk, etc. We'll continue to look to expand our stable of these strategies going forward.

Reinsurance

While pricing for collateralized reinsurance is off the highs of late 2023 / early 2024, it's still quite attractive in a historical context.

While the expectation is that pricing for mid-year contracts (which largely reference US wind-related losses) will modestly soften, there is anticipated to be a notable amount of dispersion with more remote contracts seeing more material price reductions. Less remote and recently loss-affected contracts are less likely to see significant price declines (and will likely see price increases in select cases).

January's California wildfires are likely put a floor under pricing for many contracts, but are not likely to have a major impact on pricing (perhaps because of a perceived greater likelihood of some recoveries via subrogation to the local utility company).

The hurricane season is expected to be fairly 'normal' in contrast with the more active than usual season that we witnessed in 2024. Sea surface temperatures in the main development region (MDR) of the eastern Atlantic have cooled markedly since last summer. This should be a mitigating factor in hurricane development and intensification.

Cat bonds still offer reasonable value from a historical perspective, but to a lesser degree than collateralized reinsurance. Both risk-free rates and cat bond spreads are lower than at the same time last year, while expected losses have remained fairly static. As such, loss-adjusted yields are projected to be in the high single digits vs. the low teens at this time last year.

In conclusion

As a credit investor I can attest we're a negative lot. Credit is a negatively convex asset class, meaning we primarily face downside risk. As such, credit investors focus on potential risks when underwriting investments, which often leads us to hold a more cautious view than the market. We operate with the mindset that a recession is always just around the corner.

Ironically, when the market starts to share our concerns and focus on risk, we often feel more at ease, even in a deteriorating environment, because that's what we've anticipated. I'm not suggesting that credit performance will be immune to a recession, but I don't think investors should panic. If you've been a prudent investor, and we believe we have, the downside is probably manageable.

Additionally, investing in credit when the water is the choppiest can be the most rewarding. We believe the current environment is a favorable one for our strategy. Even in a recession, where overall credit markets deteriorate, we believe our asset selection can shield investors from credit losses, while elevated interest rates can deliver attractive carry for investors. Being positioned short duration and at the top of the capital structure has its privileges and this is never more valuable than when a storm approaches.

Private credit sector performance outlook¹					
	Negative		Neutral		Positive
Corporate credit			Direct lending	Special situations	
Structured corporate credit			CLO equity	CBO equity	CLO warehouses
Commercial real estate	Stabilized lending		Transitional lending	Construction lending	Opportunistic bridge-to-agency
Residential real estate	Buy-to-rent			Transitional Lending	Construction Finance
Specialty lending	Consumer		Small business	Working capital	Niche ABL
Reinsurance				Cat bonds	Collateralized reinsurance

¹ Source: UBS Asset Management (UBS-AM), May 2025. Assessment informs top-down perspectives as well as bottom-up strategy and manager selection. UBS-AM will weigh the perceived relative attractiveness of these strategies using a scale of "underweight", "neutral weight" and "overweight" ratings. These ratings are the opinion of UBS-AM and may not necessarily provide an accurate reflection of the ultimate success or potential return of a given strategy. **Past / expected performance is not a guarantee for future results.**

Diversified Alts



Beyond the 60:40 portfolio

"Private equity, private credit, real assets and hedge funds are no longer viewed solely as niche allocations. Instead, they are increasingly considered components of a broader, more resilient portfolio framework. Among these, hedge funds may deserve renewed consideration – not only for their diversification characteristics but also for their potential to navigate complex market conditions with greater flexibility."



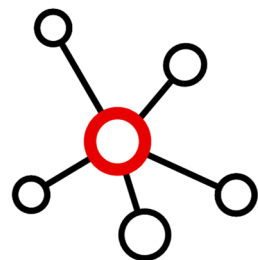
Fergus Hicks

**Senior Real Estate Strategist –
Unified Global Alternatives**



Karim Cherif

**Head of CIO Alternatives –
Global Wealth Management**



Building resilience through diversified alternatives

For decades, the 60:40 portfolio – 60% equities and 40% bonds – was the cornerstone of most investors. Yet, the traditional model is facing significant headwinds. Changing macroeconomic conditions, inflation uncertainty, and shifting equity-bond correlations have all questioned the reliability of this approach. In this context, alternative investments are gaining attention as an appealing complement to traditional strategies.

Private equity, private credit, real assets, and hedge funds are no longer viewed solely as niche allocations. Instead, they are increasingly considered components of a broader, more resilient portfolio framework. Among these, hedge funds may deserve renewed consideration – not only for their diversification characteristics but also for their potential to navigate complex market conditions with greater flexibility.

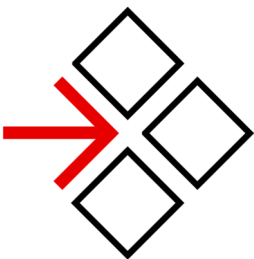


Rethinking diversification: the rise of alternatives

Alternatives are not a monolith – they include a diverse spectrum of investment types that may behave differently from traditional asset classes. Each type can serve a distinct role:

- **Private equity** targets high-growth companies, often inaccessible through public markets.
- **Private credit** may offer stable income through direct lending and bespoke financing.
- **Real assets** like infrastructure and real estate, can act as a hedge against inflation and contribute to portfolio diversification.
- **Hedge funds**, long overlooked by private investors, might offer both diversification and liquid flexibility – particularly in volatile or uncertain markets.

While private equity and credit typically require long-term capital commitments, hedge funds can offer more liquid exposure and may respond more dynamically to changing market environments. A carefully constructed allocation across these segments could support improved portfolio resilience over time.



Building an alternative allocation: a three-part framework

1. Define your strategy

Constructing an alternatives portfolio begins with clear intent:

- **Return focus:** Seeking growth, income, or absolute returns?
- **Risk appetite:** How much volatility and drawdown can you withstand?
- **Liquidity profile:** Are you prepared for illiquid investments – or do you need tactical flexibility?
- **Time horizon:** Are you thinking in decades or in business cycles?

Allocations vary from investor to investor, and highly depend on personal objectives, appetite for risk and tolerance for illiquidity. As a general rule, holding up to 20% of a liquid portfolio in alternative should enable investors to avoid running short of cash, including in periods of market stress. This allocation may rise up to 40% if an investor have modest cash flow needs from their portfolio and can draw on liquidity from another source.

2. Combine illiquid and liquid alternatives thoughtfully

A diversified portfolio may benefit from a blend of long-term strategies and shorter-term flexibility:

Segment	Role	Liquidity	Return profile
Private equity	Long-term growth	Low	Higher volatility
Private credit	Income generation	Low	Moderate risk-return
Real assets	Inflation sensitivity and income	Low	Cyclical exposure
Hedge funds	Tactical flexibility and stability	Medium	Strategy-dependent

Some investors may choose to implement this through a core-satellite structure, combining broadly diversified strategies with select, higher-conviction opportunities.

Use a *core-satellite* structure:

- **Core:** Multi-manager platforms or diversified funds of funds for stability.
- **Satellite:** High-conviction single-strategy funds for opportunistic exposure.

3. Stay committed for the long term

Private markets require careful pacing. Capital is often deployed gradually, and distributions may occur years later. Without continued reinvestment, exposure can decline. A long-term capital plan may help mitigate vintage concentration and maintain consistent exposure.

Hedge fund allocations, in contrast, may offer more liquidity and flexibility. Some investors adjust allocations tactically – scaling exposures to directional or diversifying strategies based on changing macro conditions.

For private markets, commitment pacing is crucial:

- Capital is deployed gradually (over 3-5 years).
- Distributions return capital later – so without reinvestment, exposure declines.
- A programmatic commitment cycle ensures compounding and mitigates vintage risk.

In contrast, hedge funds can play a more dynamic role:

- Tactically increase allocations during volatility.
- Rebalance into or out of directional strategies depending on macro trends.
- Maintain consistent exposure to diversifiers for structural portfolio support.



Why hedge funds now?

In today's market environment – characterized by shifting macro regimes and stretched valuations – hedge funds may offer several potential benefits to an alternatives portfolio:

1. Diversification with downside protection

Certain hedge fund strategies are designed to perform independently of market direction. Strategies such as equity market neutral, multi-strategy, and macro trading have demonstrated the ability to reduce portfolio drawdowns during market sell-offs. Historical analysis shows that incorporating hedge funds into a traditional portfolio not only smooths performance but accelerates recovery from drawdowns.

Example: In one illustrative scenario, a 20% hedge fund allocation in a 60:40 portfolio, sourced equally from equities and bonds, historically reduced volatility from 9.2% to 8.5%, and improved annualized returns from 5.7% to 5.9% (UBS, HFRI, 1997-2024).

2. Flexible exposure in shifting markets

Hedge funds are unconstrained vehicles with access to tools beyond the reach of most long-only managers. This includes short positions, derivatives, and structured instruments. That flexibility enables them to capture opportunities and mitigate risk across asset classes, regardless of market direction.

Styles like:

- relative value (exploiting pricing inefficiencies);
- macro (positioning across global themes);
- event-driven (capitalizing on corporate actions);
- equity hedge (long/short equity strategies).

3. Substitute or complement? Both.

Depending on the strategy, hedge funds may act as a complement to or a substitute for traditional assets.

- **Diversifiers** (e.g. systematic CTAs, macro multi-strategy) act as low-correlation stabilizers – ideal bond or equity complements.
- **Substitutes** (e.g. equity hedge, convertible arbitrage) offer targeted exposure with better risk-return dynamics than traditional asset classes.

Hedge funds have historically shown upside participation during up markets, while helping to protect capital in drawdowns – a combination that may support more stable long-term return compounding.



How endowments have led the way

Large endowments and institutions have played a pioneering role in allocating to alternatives. Yale and Harvard paved the path decades ago:

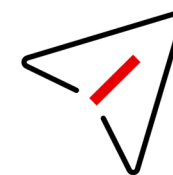
- holding 30-50% of assets in alternatives;
 - diversifying across vintages, managers, and geographies;
 - using hedge funds not just to generate alpha – but to reduce portfolio fragility.
- While private investors may not fully replicate this model, the core principles – diversification, discipline, and manager selection – are broadly applicable. They adopt similar principles using structured programs, evergreen funds, and guided solutions, depending on their individual circumstances.



Risks and considerations

Alternative investments offer attractive long-term benefits – but they also come with distinct risks:

- Illiquidity: Many alternative strategies, particularly private equity and credit, require long lock-up periods.
- Leverage: Some hedge fund and credit strategies use borrowing to enhance returns, which increases downside risk.
- Transparency: Information on fund holdings and strategy shifts may be limited.
- Operational complexity: Manager selection, risk oversight, and governance structures vary widely.
- Performance dispersion: Within each style, outcomes can differ significantly by manager. Indices are not directly investable and may not reflect actual portfolio performance.



The future of portfolio construction

The traditional 60:40 model may no longer provide the same level of diversification or downside mitigation as it once did. For investors looking to navigate today's more complex market environment, a broader approach – including private equity, private credit, real assets, and hedge funds – may offer added resilience and potential long-term benefits.

While alternative investments are not suitable for all investors, those who can accommodate the unique risks and characteristics may find value in constructing a thoughtfully diversified alternatives portfolio.

Green footprints?



Navigating nature-related risks in real estate

“Incorporating nature-related risks into real estate strategies can help to protect assets from increasing environmental challenges and new regulatory demands. This approach not only supports ecosystems but also offers long-term competitive benefits by creating appealing spaces for tenants and investors, while meeting potential regulatory requirements.”

Allee Zhang

**Sustainability Specialist –
Global Real Assets**





Navigating nature-related risks in real estate

Nature-related risks, including biodiversity loss and climate change, are growing concerns for real estate investors. These risks have the potential to affect property values, development and operating costs, tenant demand, and adherence with emerging regulations and initiatives.

As the built environment is a significant contributor (30%) to global biodiversity decline,¹ the real estate sector holds both the responsibility and opportunity to drive change through nature-positive strategies.

Nature and real estate

Real estate has both direct and indirect impact on biodiversity through asset design, development, operation and supply chain dependencies. There is also a dependency on nature to create desirable, resilient locations; for example, green spaces could strengthen climate adaptation, reduce environmental impacts, and enhance tenant appeal.

According to the taskforce on Nature-Related Financial Disclosures (TNFD), nature has been defined as the 'natural world', with an emphasis on the diversity of living organisms, including people, and their interactions among themselves and with their environment.² It's fundamental to the long-term health of our social and economic system.

More recently, nature has been framed as the construct of four core realms: land, ocean, freshwater, and atmosphere.³ The four realms provide an entry point for understanding how organizations and people depend, and have impacts, on nature. Given the complex role nature plays, real estate investors should integrate nature-related risks and opportunities into their investment decisions.

Assessment and integration

To navigate these risks, real estate investors can leverage frameworks such as the TNFD to understand and disclose nature-related dependencies and risks, much like TCFD does for climate.

A preliminary risk assessment can be conducted on the current and projected dependencies of real estate investments on natural capital (e.g., water usage, pollution) using a materiality assessment tool such as ENCORE.⁴ The material nature risk factors can be integrated into investment decision making, across the stages of a property's lifecycle, as each can have an influence on biodiversity and ecosystems.

For example, during design and development, decisions made on land use could influence the level of impact on nature, such as effects on natural habitat and ecosystem disruptions. During a building's operational phase, usage of energy and water contributes to GHG emissions and pollution while poor waste management can degrade soil and biodiversity.

At an asset level, nature baseline analysis, such as carrying out an ecology survey to determine the species and habitats present in a specific area, can help to evaluate the effects on ecosystems, and develop appropriate nature strategies. Certain actions will require a collaborative approach with multiple stakeholders such as local government / councils, tenants, and local communities. Changes in biodiversity should be monitored over time, potentially with the support of expert ecologists, ensuring that the data collected is both accurate and meaningful.



Final thoughts

The integration of nature-related risks into real estate strategies is part of future-proofing assets from rising environmental concerns and emerging regulatory demands. For the real estate sector, taking a nature-related risk approach not only protects ecosystems, but also creates long-term competitive advantages by creating spaces that appeal to tenants, investors, and fulfill potential regulatory requirements alike. By embracing these strategies, real estate investors can contribute to a resilient, sustainable future that aligns financial success with environmental stewardship.

¹ World Economic Forum, 2020.

² The Taskforce on Nature-related Financial Disclosures.

³ The TNFD Nature-related Risk & Opportunity Management and Disclosure Framework.

⁴ ENCORE (Exploring Natural Capital Opportunities, Risks and Exposure) is a business assessment tool, developed by UNEP-WCMC, SECO and MAVA Foundation, to understand how environmental changes might impact businesses and the wider economy.

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