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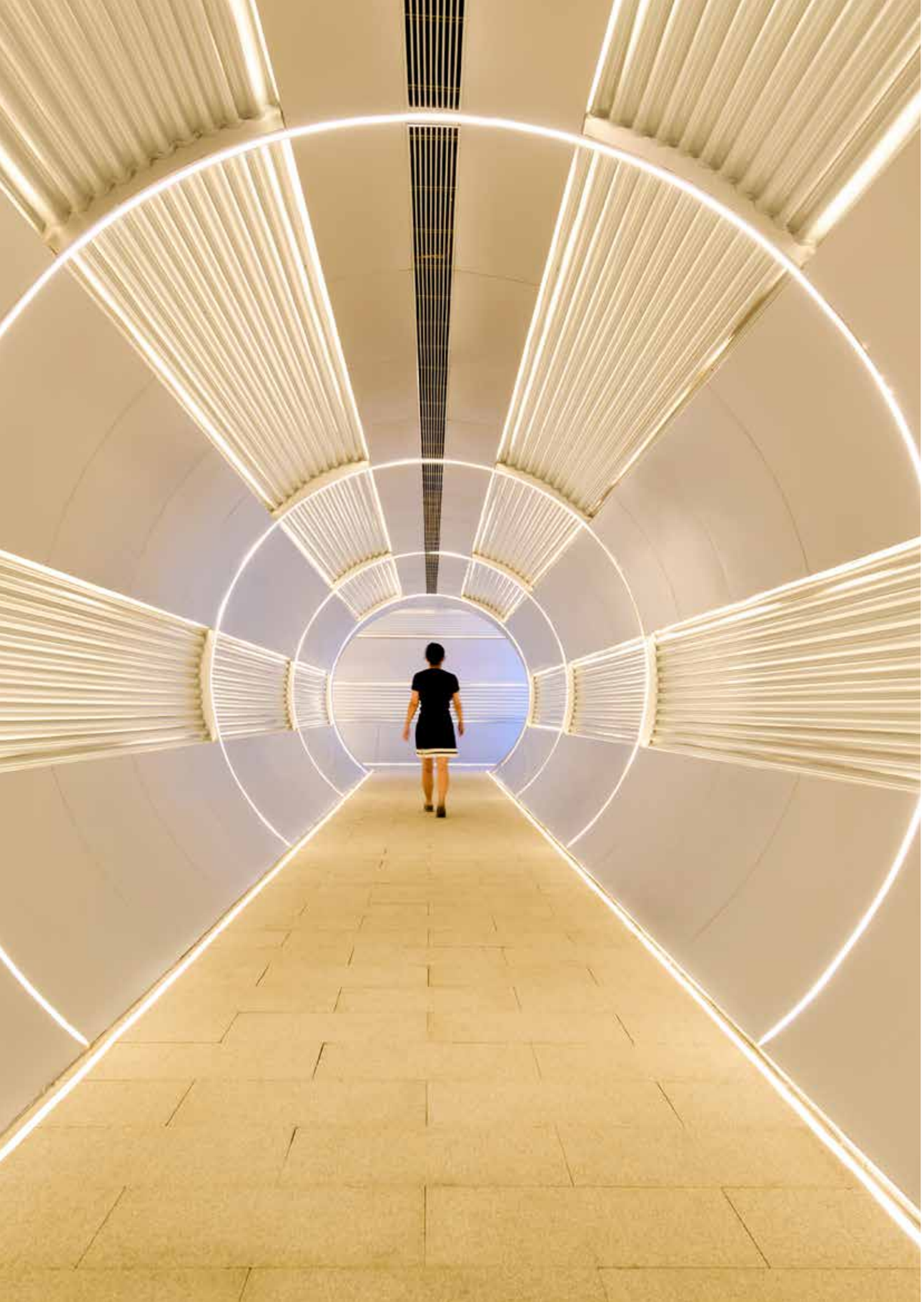
Evolution of corporate credit markets

An asset owner perspective

UBS



Executive summary

The corporate credit market is undergoing a fundamental transformation that is reshaping how investors approach their fixed income portfolios. This transformation is characterised by two major trends: the increasing integration between public and private markets, and the rapid expansion of alternative credit strategies.

Through research conducted in partnership with NMG Consulting, we gathered insights from 90 institutional investors and retail gatekeepers managing over USD 8 trillion in assets to understand how asset owners are adapting their strategies to navigate this evolving landscape. Our findings highlight shifts in portfolio strategy and implementation as asset owners respond to an increasingly complex credit environment.

Key findings

The growing integration between public and private credit markets is creating new opportunities for relative value assessment, enabling asset owners to capture pricing inefficiencies across similar risk exposures while balancing liquidity needs with return objectives.

Asset owners are expanding their alternative credit allocations to capture benefits unavailable in traditional fixed income. These include enhanced yields through illiquidity premiums, stronger downside protection via customised covenants, and improved portfolio resilience through exposures with lower correlation to public markets.

The response to increased market complexity varies across institutions – larger organisations are building specialised internal capabilities, while others pursue strategic partnerships with external experts to access credit expertise and co-investment opportunities.

The emergence of an integrated credit landscape

Fixed income remains central to asset owner portfolios, with average allocations increasing from 38 to 41 percent over the past two years (Figure 1). This growth reflects higher yields and the expanding opportunity set created by the increasing integration between public and private markets.

Several key factors are driving this market integration, with changing borrower behaviour leading the transformation. Companies today are more sophisticated in how they obtain financing, regularly moving between different types of credit: publicly traded bonds, broadly syndicated loans (BSLs), and private credit. This fluid approach to accessing capital markets has created a more interconnected credit ecosystem where borrowers optimise their funding sources based on pricing, structure, and market conditions.

As part of the evolution private credit has emerged as an integral component of the credit landscape, functioning alongside rather than separate from traditional public markets. This integration has accelerated as institutional investors allocate substantial capital to private lending strategies, creating an environment where financing solutions span the public-private spectrum.

The broadly syndicated loan (BSL) market exemplifies this integration trend, functioning as a strategic middle ground between traditional public bonds and direct private lending. BSLs are initially arranged between a borrower and lead banks before being distributed to a wider group of investors. While they offer more liquidity than traditional private credit due to their tradability, BSLs typically maintain stronger covenant protections than public bonds, though these protections are generally less comprehensive than those in direct private lending arrangements. Asset owners highlighted how this hybrid nature allows them to balance liquidity needs with structural protections, providing a flexible component within their credit allocation.

Traditional investment grade bond markets have adapted to this new competition by offering more flexible terms and competitive pricing, particularly in areas where private lenders have become more active, such as lending to medium-sized companies. Similarly, the high yield bond market has evolved in response to competition from both BSLs and private credit, with changes including new pricing approaches and development of hybrid securities that combine features of bonds and loans. These adaptations across all parts of the credit market provide borrowers with more options while ensuring each segment remains attractive to investors.

Benefits for investors

While this evolution clearly benefits borrowers, the asset owners in our sample emphasised how it works to their advantage as well. The blurring lines between public and private credit enables them to extract the most favourable elements from each market segment, fuelling the growth of multi-asset credit strategies that span the entire credit spectrum. Investors revealed how they look to actively construct allocations balancing public market liquidity with the enhanced lender protections and potentially higher yields characteristic of private transactions.

Respondents also highlighted their growing capability to identify relative value opportunities by comparing equivalent credits across different market segments. Credit teams are increasingly capturing pricing inefficiencies between public bonds, BSLs, and private credit that represent fundamentally similar risk profiles, meaningfully improving risk-adjusted returns across their portfolios.

Notably nearly half (44 percent) of survey respondents indicate that the growth of private credit is causing them to reconsider their public fixed income allocations (Figure 2). This shift reflects growing recognition that success in today's credit markets requires a more integrated approach to portfolio construction. Asset owners are developing more sophisticated frameworks for evaluating opportunities across market segments, incorporating factors such as relative value, liquidity requirements, and portfolio diversification needs.

Figure 1: Allocation to fixed income, %

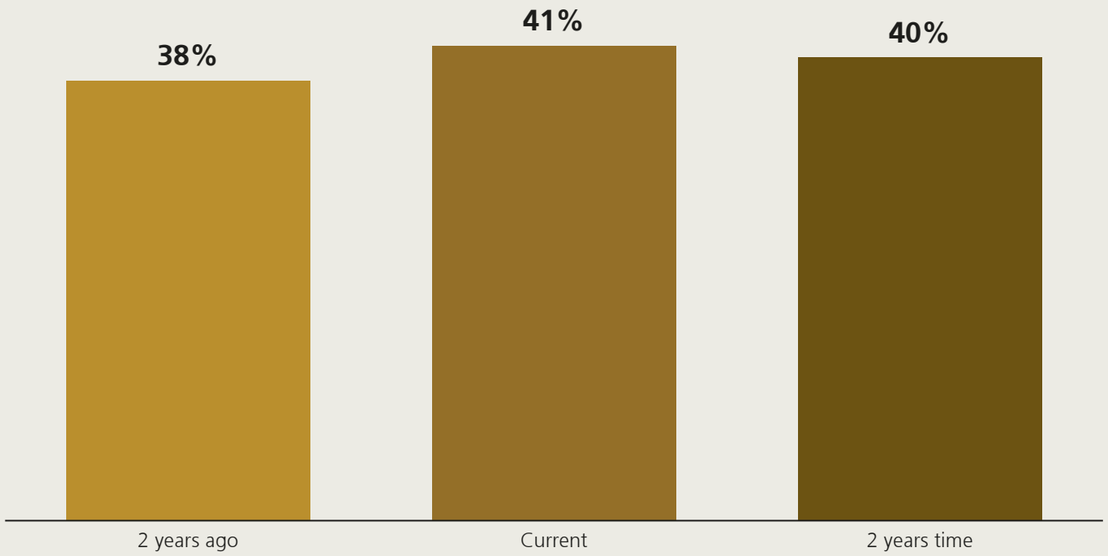
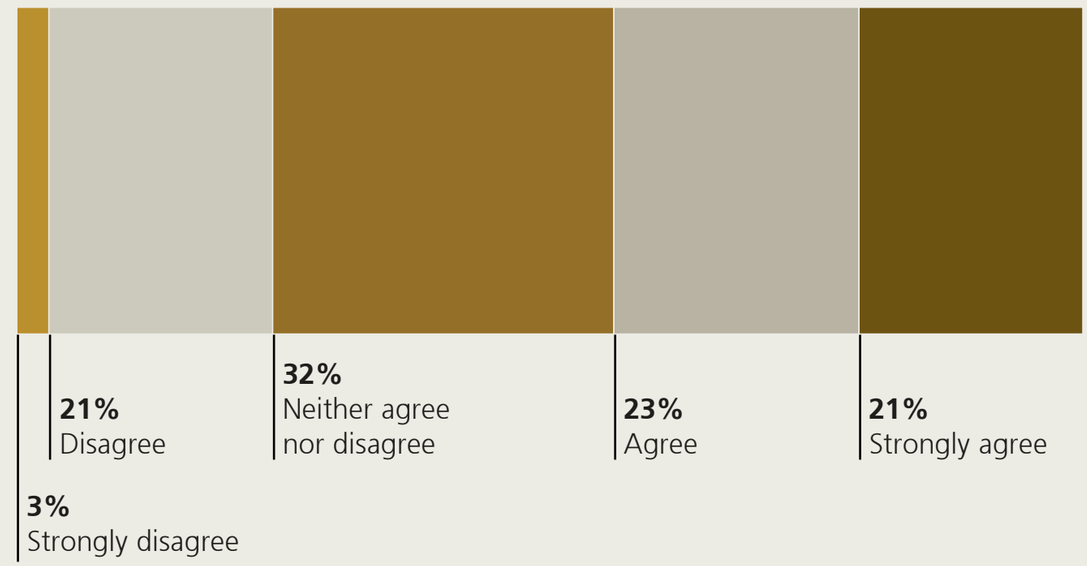


Figure 2: Growth of private credit markets is causing us to reconsider our allocation to public fixed income markets, % citations



Expansion into alternative strategies

While core fixed income investments such as government bonds, investment grade corporate debt and municipal/ agency bonds still form the foundation of most portfolios (73 percent), alternative strategies have grown to account for a significant 27 percent of fixed income allocations (Figure 3).

Asset owners described their alternative credit strategies as serving distinct portfolio objectives beyond traditional fixed income. High yield credit, at 8% of allocations on average, reflects investors' desire for enhanced yield with maintained liquidity. This category encompasses both high yield bonds and BSLs, with bonds offering flexibility to reposition when market conditions change, while BSLs provide floating-rate exposure and typically include stronger covenant packages. Together, these instruments allow investors to participate in sub-investment grade credit while balancing their needs for liquidity, yield, and structural protections.

Structured products (6 percent of allocations on average) appeal to investors seeking yield enhancement combined with specific risk factor exposures. Many highlighted how these instruments offer access to consumer credit, real estate, and other specialised sectors that complement their broader fixed income positions, while aiming to deliver favourable risk-adjusted returns.

Private credit investments (5 percent of allocations on average) attract asset owners primarily for the combination of yield premium and stronger structural protections unavailable in public markets. Many cited the importance of direct lender control rights and security packages in providing downside protection alongside returns that compensate for illiquidity.

Real estate debt (2 percent of allocations on average) represents a distinct but related strategy that shares characteristics with private credit while offering exposure specifically to property-backed lending. Asset owners value this segment for its collateralisation by physical assets, relatively stable cash flows, and the potential for inflation protection.

The remaining specialised strategies including EM debt and distressed debt reflects investors' desire for diversification through exposures with lower correlation to traditional markets. These allocations often serve as portfolio differentiators that can perform well in specific market environments, particularly during periods of dislocation or sector-specific stress.

The growth of private credit

Private credit has demonstrated remarkable momentum as an asset class and this is reflected in allocation trends in our research. Two-fifths of asset owners have increased their private credit allocations over the past two years and a third plan to increase allocations over the next two years (Figure 3). This sustained growth trajectory reflects both the asset class's evolution into a diverse opportunity set with multiple entry points and the attractive risk-adjusted returns it has delivered through market cycles.

Figure 3: Allocations within fixed income portfolio, %

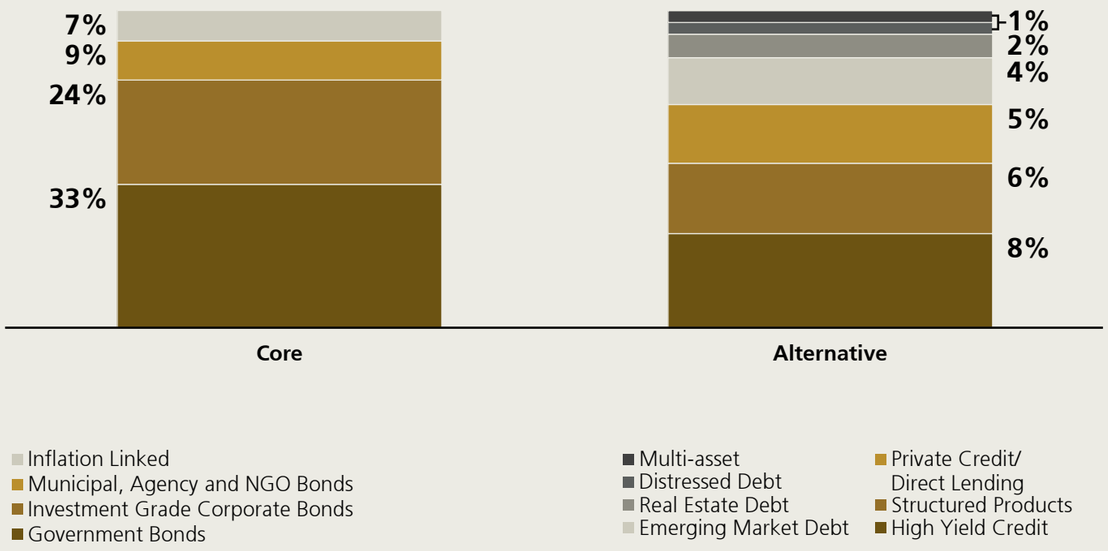


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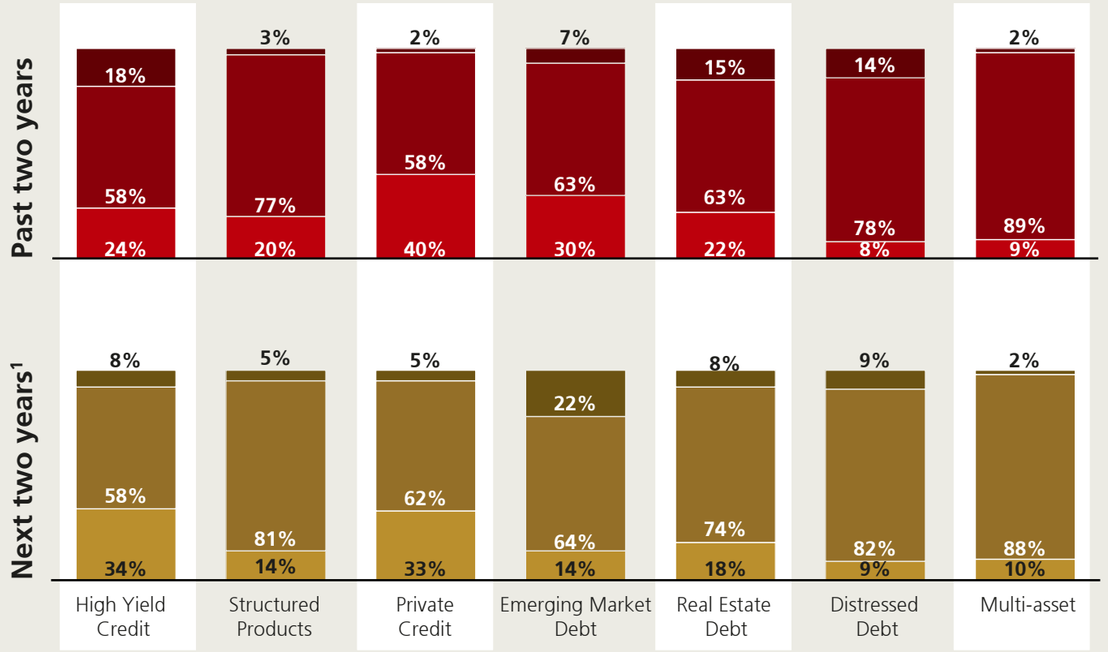
Figure 4: Changes in alternative fixed income allocations, % citations



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Asset owner adaptation

Most commonly investors have been building their private credit exposure through specialist direct lending funds, often committing to successive funds from the same managers to maintain consistent capital deployment. Respondents noted that they valued how the typical closed-end fund structure of 7-10 years aligned with their investment horizons, while regular income distributions supported portfolio cash flow needs. Unlike private equity where capital calls can extend over several years, many asset owners highlighted how private credit allows for more immediate deployment of capital, enhancing overall portfolio efficiency and reducing cash drag.

Beyond direct lending, asset owners have actively broadened their exposure across complementary strategies. Those seeking additional security favour asset-backed lending, while many had diversified through real estate debt to gain exposure to both income-producing properties and development projects. Liability-focused investors, particularly insurers and pension funds, highlighted their growing allocation to infrastructure debt, citing its long duration and often inflation-linked returns as particularly attractive for matching long-term obligations.

When discussing manager selection, asset owners consistently emphasised the importance of strong origination networks and proven discipline through market cycles. Many specifically scrutinise managers' monitoring capabilities and experience in managing loans through difficult situations, having learned valuable lessons from previous market disruptions. With the opportunity set expanding, investors told us they can now be increasingly selective, concentrating their relationships on managers with demonstrable expertise in specific market segments that complement their existing portfolio exposures.

Diversification and yield benefits

Asset owners emphasised how the expansion of alternative credit has created several advantages for their portfolios. They described how different strategies serve distinct investment objectives – with some providing higher yields, others offering more stable returns, and certain strategies delivering inflation protection. Many investors valued the expanded range of options that allows them to better match their specific portfolio requirements and liability profiles.

When discussing private credit specifically, asset owners highlighted several distinct benefits. They pointed to direct lending's higher yields compared to similarly-rated public bonds, attributed to both the complexity of structuring private deals and the illiquidity premium they receive. Investors particularly valued the stronger lender protections available through customised covenants and the closer relationships they can maintain with borrowers. Many also cited improved portfolio diversification, noting that private credit returns often demonstrate lower correlation with public markets during periods of volatility. This perceived stability stems partly from the absence of daily mark-to-market valuation in private credit, which can mask short-term volatility while also offering genuine diversification benefits through different underlying risk exposures and covenant protections.

While the integrated credit approach offers significant benefits, asset owners emphasised that successfully capturing these advantages requires substantial expertise and specialised resources. Respondent pointed to several key challenges including:

- Managing the trade-off between liquidity and higher returns
- Comparing mark-to-market public instruments with periodically valued private investments
- Maintaining selectivity and discipline in increasingly competitive markets
- Developing risk frameworks that can accommodate different reporting cycles and valuation methodologies

Our research revealed that leading institutions are fundamentally rethinking their approach to credit investing, developing sophisticated frameworks that span the entire market spectrum from public bonds to private loans. This evolution has driven significant changes in organisational structure, investment processes, and technological infrastructure as asset owners build the capabilities needed to evaluate opportunities holistically and capture relative value across previously siloed market segments.

External partnership models

Our research revealed distinct approaches to working with external managers emerging among asset owners as they navigate the integrated credit landscape. Each model reflects a strategic decision about which activities to handle internally versus externally based on institutional advantages and constraints.

Large pension funds, with their scale advantages, often combine internal teams handling liquid credit with strategic manager relationships for private markets. These investors have found they can cost-effectively manage more commoditised strategies internally, particularly in areas like investment grade corporate bonds and structured products, while leveraging specialist managers for more complex opportunities.

Insurance companies often focus their internal resources on investment grade private placements, where they have natural advantages in analysing long-duration assets that match their liabilities. For other segments, particularly higher-yielding strategies, they tend to rely more on external managers while maintaining strong oversight of credit quality and capital treatment considerations.

Many smaller institutions have developed focused approaches emphasising strong relationships with selected managers, supplemented by co-investment to enhance returns and reduce costs. Rather than trying to compete with larger institutions in building internal capabilities, they concentrate on developing deep relationships with managers who provide strong alignment through co-investment rights and favourable economic terms.

Building new capabilities

Asset owners described how success in today's complex market environment has required them to develop new capabilities. This includes the creation of frameworks for evaluating opportunities across public and private markets, implementing sophisticated risk management systems to monitor diverse exposures, and redesigning decision-making processes to act quickly when opportunities arise. Several institutions highlighted technology as a crucial enabler, detailing their investment in systems capable of providing portfolio-wide views across different credit market segments.

Respondents emphasised how the growing complexity of their credit portfolios has driven significant evolution in their risk management approaches. This includes the development of more sophisticated frameworks for managing liquidity, carefully balancing attractive illiquidity premiums with necessary portfolio flexibility. In some cases this has been achieved by implementing tiered liquidity structures that match different types of credit exposure with varying liquidity needs, allowing for the optimisation of returns while maintaining appropriate risk controls.

The expansion of co-investment activities emerged as a particular focus area. Asset owners detailed how they have established dedicated resources for evaluating co-investment opportunities and streamlined processes that maintain robust oversight while enabling timely decisions. Speed was consistently cited as a critical success factor - the most attractive co-investment opportunities are often available only briefly and to the first investors able to commit.

Asset owners highlighted the challenge of traditional governance processes when pursuing co-investment opportunities. Investment committee approvals that typically took weeks could result in missing attractive deals in fast-moving markets. In response, some investors have implemented streamlined approval processes specifically for co-investments, with several delegating authority within pre-approved parameters to dedicated teams to enhance their competitive positioning.

The full credit spectrum

Our research highlights a pivotal moment in corporate credit markets where traditional boundaries are dissolving, and investor approaches are evolving rapidly in response. Asset owners are not merely reacting to these changes but actively reshaping their fixed income frameworks to capitalise on them.

Investors are increasingly moving beyond the outdated public versus private credit dichotomy, instead viewing the credit spectrum as a unified opportunity set where relative value can be extracted across previously siloed segments. This integration is driving concrete changes - from restructured investment teams and enhanced technological capabilities to streamlined decision processes designed for a more fluid market environment.

Looking ahead, the distinction between market leadership and mediocrity will increasingly depend on an institution's ability to evaluate credit opportunities holistically, implement nimble execution frameworks, and balance illiquidity premiums with portfolio flexibility. Those who successfully navigate this transformation look well placed to not only enhance returns but fundamentally strengthen their position in an increasingly competitive environment.

Understanding alternative investment risks

01 Limited regulatory oversight

Since alternative investments are typically private investments, they do not face the same oversight and scrutiny from financial regulatory entities such as the Securities and Exchange Commission ("SEC") and are not subject to the same regulatory requirements as regulated investment companies, (i.e., open-end or closed-end mutual funds) including requirements for such entities to provide certain periodic pricing and valuation information to investors. Private fund offering documents are not reviewed or approved by the SEC or any US state securities administrator or any other regulatory body. Also, managers may not be required by law or regulation to supply investors with their portfolio holdings, pricing, or valuation information.

02 Portfolio concentration; volatility

Many alternative investments may have a more concentrated or less diversified portfolio than an average mutual fund. While a more concentrated portfolio can have good results when a manager is correct, it can also cause a portfolio to have higher volatility.

03 Strategy risk

Many private credit funds employ a single investment strategy. Thus, a private credit funds may be subject to strategy risk, associated with the failure or deterioration of an entire strategy.

04 Use of leverage and other speculative investment practices

Since many hedge fund managers use leverage and speculative investment strategies such as options, investors should be aware of the potential risks. When used prudently and for the purpose of risk reduction, these instruments can add value to a portfolio. However, when leverage is used excessively and the market goes down, a portfolio can suffer tremendously. When options are used to speculate (i.e., buy calls, short puts), a portfolio's returns can suffer and the risk of the portfolio can increase.

05 Valuations

Further there have been instances where hedge fund managers have mispriced portfolios, either as an act of fraud or negligence.

06 Past performance

Past performance is not necessarily indicative and is not a guarantee of a hedge fund's future results or performance. Some private credit funds may have little or no operating history or performance and may use hypothetical or pro forma performance that may not reflect actual trading done by the manager or advisor and should be reviewed carefully. Investors should not place undue reliance on hypothetical or pro forma performance.

07 Limited liquidity

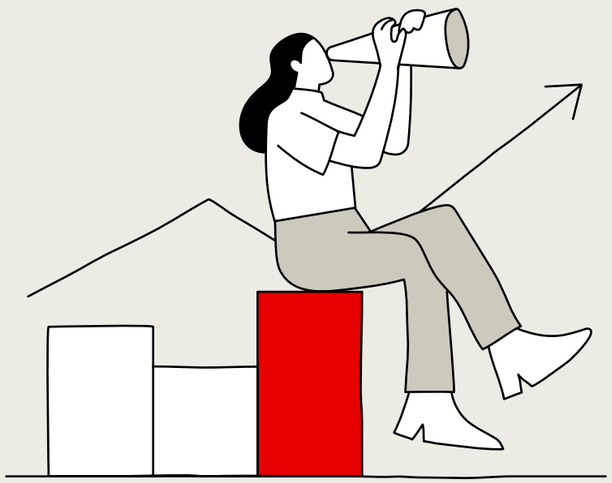
Investors in alternative investments have limited rights to transfer their investments. In addition, since private credit funds are not listed on any exchange, it is not expected that there will be a secondary market for them. Repurchases may be available, but only on a limited basis. A private credit fund's manager may deny a request to transfer if it determines that the transfer may result in adverse legal or tax consequences for the private credit fund.

08 Tax risks

Investors in certain jurisdictions and in alternative investments generally may be subject to pass-through tax treatment on their investment. This may result in an investor incurring tax liabilities during a year in which the investor does not receive a distribution of any cash from the Fund. In addition, an investor may not receive any or only limited tax information from private credit funds may not receive tax information from underlying managers in a sufficiently timely manner to enable an investor to file its return without requesting an extension of time to file. In certain jurisdictions a lack of tax information may result in an Investor being taxed on a deemed basis at an adverse rate of tax.

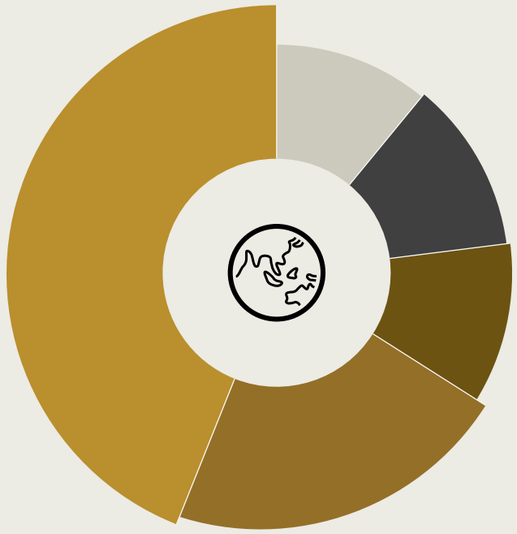
Methodology

This study draws on comprehensive interviews with 90 asset owners across the US, UK, Italy, Germany, and Switzerland, representing institutions with combined assets under management exceeding USD 8 trillion. The research, conducted in Q4 2024, gathered insights from a diverse range of participants including large institutional investors and retail gatekeepers. Our findings reflect input from senior decision-makers including CIOs, Heads of Strategy, Heads of Fixed Income, and Portfolio Managers, providing a thorough perspective on the themes shaping the fixed income market.



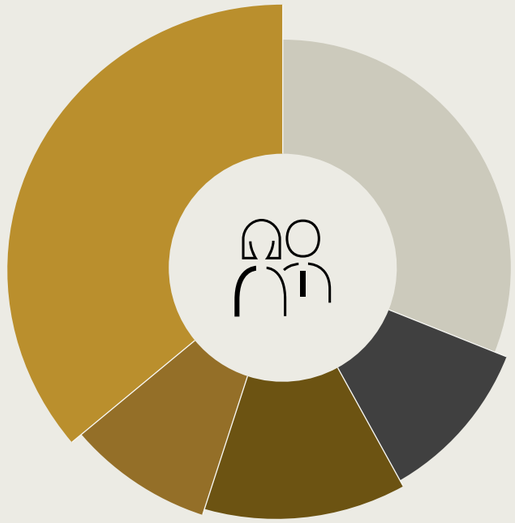
Study sample

Geographic exposure



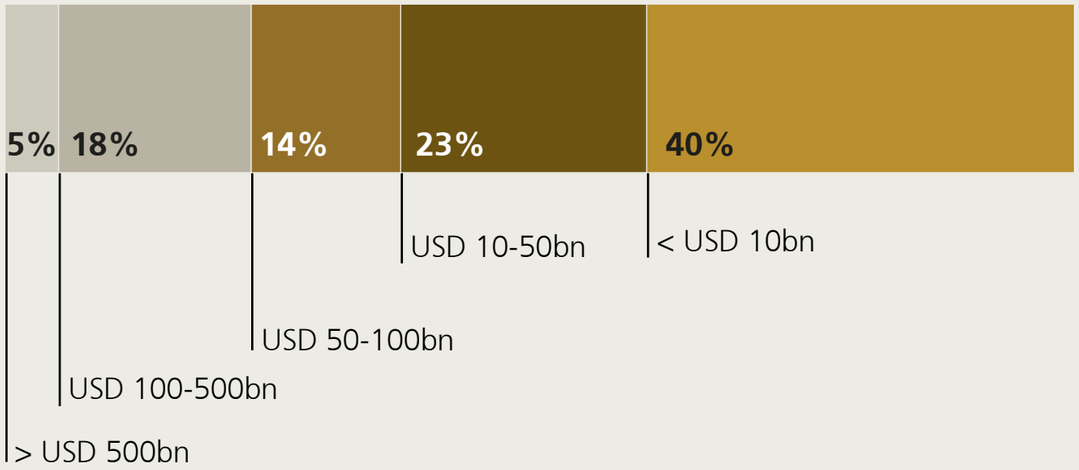
- **11%** Germany
- **12%** Italy
- **11%** Switzerland
- **22%** UK
- **44%** USA

Investor classification



- **31%** DB Pension
- **11%** DC Pension
- **13%** Insurer
- **9%** Sovereign Wealth Fund
- **36%** Wholesale

AuM distribution



Source: **For all data and charts (if not indicated otherwise):** NMG Consulting, Global Fixed Income Study 2024; Results from interviews conducted in September and October 2024.

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June 2025

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