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Midyear global outlook

Gravity defied – for now



Foreword

Even though many markets have recovered poise since the recent volatility spike, they remain vulnerable to further shocks and crucial long-term questions for investors persist.



Sonja Laud
Global Chief Investment Officer



Bill Hughes
Global Head of Private Markets

Of the various challenges involved in writing an outlook, two of the most prominent are: the possibility of having nothing new to say; and the risk of contradicting what you said only a few months earlier.

Unfortunately for investor nerves, the events of the first half of 2025 have given us plenty on which to opine. And we reiterate our core view that humility is more important than ever when navigating the challenging investment landscape this year, as markets clearly were mispricing a [host of risks](#) ahead of the tariffs-related [surge in volatility](#).

We have titled this midyear outlook ‘Gravity defied – for now’ because risk assets have recovered since the precipitous declines of early April, which rival some of the worst collapses in living memory. Yet even with the S&P 500 trading (at the time of writing) above its level at the start of the second Trump administration, and many other markets in positive territory for the year, crucial long-term questions for investors linger.

In this outlook, to which teams from across L&G’s Asset Management business have contributed, we address some of the most urgent and salient issues and questions for our clients across both public and private markets. These include:

- Have we reached the end of ‘US exceptionalism’?
- Is it true that there is no alternative (TINA) to US dollar assets?
- How to tackle concentration risk and market volatility
- The enduring strength of US Treasuries, the outlook for cash rates and how to navigate macro uncertainty across public and private markets
- How pension proposals could boost investment into private markets, bolstering economic activity and sterling assets
- The implications for emerging markets of evolving US-China relations

You will come across the word ‘diversification’¹ frequently over the coming pages. That’s because we believe the concept – whether at a stock, issuer, sector, geographic or asset class level – is a key instrument in the investor toolkit for dealing with market episodes such as the one we recently experienced. And for achieving long-term investment outcomes.

¹ It should be noted that diversification is no guarantee against a loss in a declining market.

A multi-polar world

As we enter the second half of 2025, further developments in government policy and geopolitics will shape the trajectory of growth, inflation and monetary policy, the key drivers of markets – alongside US dollar dynamics and the mounting burden of sovereign debt influencing investor perceptions of longer term fiscal and budget sustainability.

But [the decisive shift](#) away from the liberal, free-trading, post-war order towards a multi-polar world with a more complex international landscape will almost certainly have far greater implications over the coming years.

The tension in the Middle East, meanwhile, adds yet another layer of complexity and uncertainty to an increasingly complex global geopolitical landscape.

With foundations stretching back to 1836, at L&G we will face that future with humility, as we continue to seek opportunities and manage risk on behalf our clients.

Our ambition

Diversification also speaks to how we are seeking to fulfil our ambition as a business: to be a leading global investor, innovating to solve complex challenges for our clients, using the power of L&G.

To better meet our clients’ needs in a rapidly changing industry and macro landscape, we plan to build where we have existing expertise; partner where we have aligned purpose; and buy where we identify high-quality capabilities.

For example, the US, continental Europe and select regions within APAC represent key strategic growth areas for our private markets platform. They offer diversification for clients and expand our investment opportunity set in a number of subsectors that appear well positioned to benefit from favourable structural trends.

We will showcase over the coming months each of our capabilities in turn to highlight how they can play important roles in portfolios, at different points across our clients’ lifelong investment journeys.

“
We have just witnessed a decisive shift away from the liberal, free-trading, post-war order towards a multi-polar world.
”

An end to US exceptionalism?

The rebalancing to come, messy though it may be, could ultimately lead to a healthier equilibrium of capital allocation.



The US enjoys tremendous advantages with its enormous, c. \$30 trillion single market.² As investors reappraise their holdings in US dollar assets, can the world’s largest economy sustain the exceptionalism that has defined it in recent years?

Currently, the country’s free-market system encourages innovation and entrepreneurship, with deep capital markets providing funding and elite universities attracting top talent from around the world. It is the global technological leader and home to the largest companies in the world. In addition, the US has access to cheap abundant energy, which allows it to be self-sufficient; holds the global reserve currency; and has unmatched military power.

These features have historically allowed the US to attract strong capital inflows. However, there is an inherent paradox associated with being the issuer of the global reserve currency. As a matter of arithmetic, net capital inflows must be matched by a current account deficit and entail accruing liabilities to foreigners. That imbalance is a product of the inherent strengths of the US economy but, when sustained for long periods of time, creates a source of vulnerability.

The twin current-account and fiscal deficits in the US are borne out of its reserve currency status, but also risk undermining it if we are past the point of peak enthusiasm for US assets.

Recently foreign investors have become unsure of the direction of domestic policy. The Trump administration has a number of priorities, some of which are potentially in tension. For example, there is a clear desire to reduce the persistent US trade deficit, but tax cuts might boost demand, add to fiscal deficits and increase imports.

Similarly, are tariffs mainly a negotiating tool for more favourable trade deals, a mechanism to raise revenues or an attempt to onshore production? To restore US manufacturing competitiveness, import prices would likely have to rise

² Source: [GDP \(current US\\$\) - United States | Data](#)



significantly. This could trigger a broader increase in inflation and put upward pressure on interest rates. A manufacturing renaissance could crowd out private sector services, while higher interest rates add to concerns about public sector debt dynamics.

Investor questions

In addition, some foreign investors have begun to question US global leadership, its commitment to multilateral institutions and the architecture it has built over the last seventy years. There is also concern about the agenda to remove some of the constraints on executive authority and the erosion of the independence of US institutions. With Congress losing influence in the current political dynamic, the judiciary has a more central role in providing checks and balances. A recent ruling confirmed the independence of the Federal Reserve’s (Fed) leadership, which has helped reassure markets.

The US is a highly financialised economy. This is a great strength, but also makes it particularly sensitive to a deterioration in market sentiment. We have already seen an [adverse market reaction](#) which ultimately tempered the more extreme tariffs announced on ‘Liberation Day’. While the US has enjoyed tremendous flexibility to deploy fiscal policy to offset shocks, this might be reaching its limit.

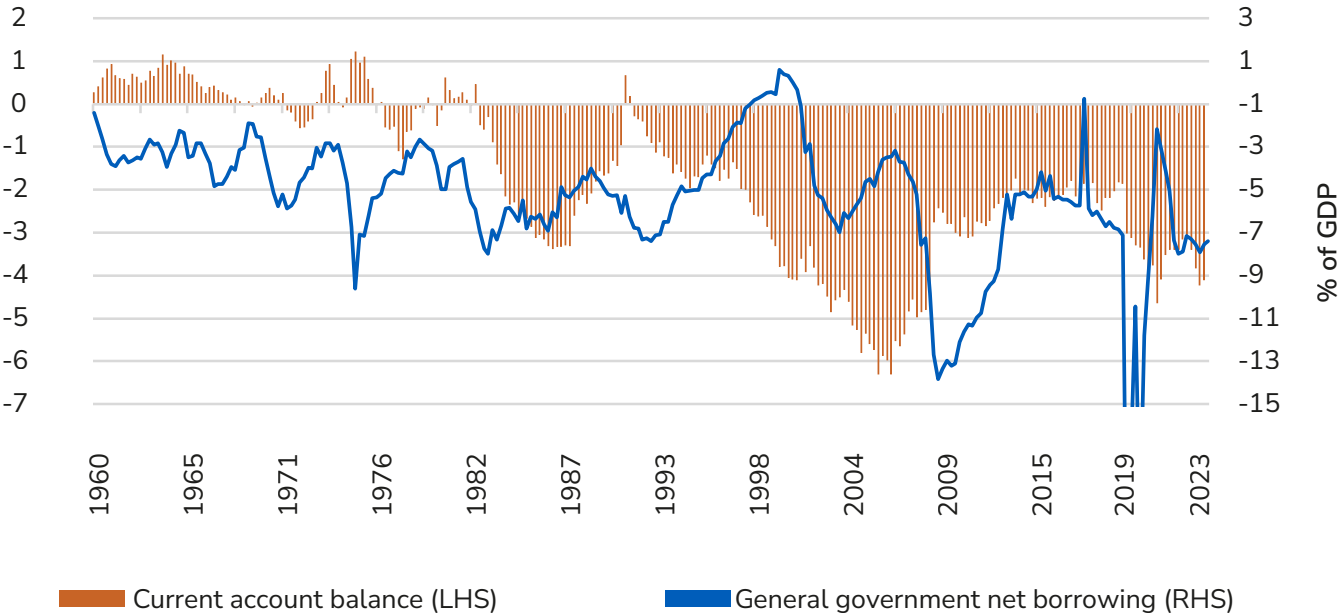
It is hard to know exactly when and what will be the trigger for the bond market to force discipline on Washington, but deficits of 6-7% of GDP³ in an economy at full employment is a weak starting point. Add in rising interest payments, and the pressure on mandatory spending from an ageing population, and it is clear fiscal policy is on an unsustainable path – with [Moody’s projecting debt to GDP](#) to rise from 98% last year to 134% by 2035.

³ Source: [Federal Surplus or Deficit \[-\] as Percent of Gross Domestic Product \(FYFSGDA188S\) | FRED | St. Louis Fed](#)

In the near term, we expect underlying growth to slow as price rises from tariffs squeeze real incomes and policy uncertainty undermines business investment. However, the consensus among economists is that the US should be able to [skirt recession](#). Medium-term potential growth is likely to be lower as immigration policy slows labour supply.

Sustaining American exceptionalism – both in terms of economic outcomes and asset price performance – will likely require the US to adopt and embed the use of artificial intelligence as a labour-augmenting (and potentially labour-replacing) innovation. The US seems best placed to embrace that technological leap forward; whether it will be enough to counterbalance the offsetting downward pressures on growth is the pivotal question going forwards.

US current account and government deficits



Source: Macrobond, as at June, 2025.

A new equilibrium

Whether the US can remain the preeminent worldwide destination for global capital remains to be seen, particularly as some members of the current administration have argued that too much foreign capital has been chasing too few US assets, for too long.

These policymakers are not only aiming to reduce trade deficits and by extension the capital account, but had been threatening to pursue direct taxes on foreign capital. Section 899 has now been removed from the ‘Big Beautiful Bill’. This still leaves uncertain consequences from this and future attempts to fundamentally reshape global capital flows at a time of large fiscal deficits.

There is no doubt that foreign investors are beginning to think carefully about their US exposure as a consequence of the last six months. Already, US exposure in global equity indices presents an over-concentration challenge at 60-70%.⁴ That said, there is evidence that total holdings of US assets by foreigners is substantially lower, at an average of 10-20%.⁵

⁴ Source: US weighting in [MSCI World index](#) is c. 71% as of May 2025.

⁵ See, for example, J.P.Morgan report ‘Do foreign investors hold too much of US assets?’, May 2025.

“Sustaining American exceptionalism will likely require the US to adopt and embed the use of AI as a labour-augmenting (and potentially labour-replacing) innovation.”

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Still, global allocators of capital will likely take a more cautious approach to increasing their US exposure, at the very least. Structurally, the EU and UK seem most likely to be key beneficiaries at the expense of the US, particularly as increased [defence spending](#) increases deficits and thus the need for capital inflows.

For US markets, the suggestion is that a relative minor shift in the marginal buyer of various US assets could result in higher risk premiums and a reduction in the – admittedly difficult to quantify – uplift that US markets have enjoyed relative to the rest of the world. If so, the rebalancing to come, messy though it may be, could ultimately lead to a healthier equilibrium of capital allocation – one where capital and returns are more evenly shared.

Riding out regime change in fixed income

We assess how public and private credit investors can navigate macro volatility, while questioning the enduring strength of US Treasuries and the outlook for cash rates.



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Head of Global Bond Strategies – Unconstrained



Ross McDonald
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Head of Cross-Asset Research, Private Markets



Matthew Rodger
Emerging Market Economist

At the beginning of the year, the one constant we expected from the new US administration was volatility. That expectation was more than met in the first half of the year.

We do not anticipate any meaningful falls in volatility or uncertainty for the remainder of the year, given that the outlook for trade, fiscal policy and the economy remains unusually murky. So, for investors in public credit markets, we believe it's increasingly important not to become wedded to a particular view on inflation or recession, and to retain flexibility over asset allocation decisions.

During periods in which the market grows concerned about inflation upswings, we would expect to see upward pressure on interest rates. Worries about recessionary conditions would have the opposite impact. However, both inflation and recession worries can be triggered by supply-side restrictions (arising from tariffs, immigration restrictions or oil supply concerns). Benign pricing means that we generally prefer shorter-duration positioning, but the market's attitude is in flux as concerns oscillate between those twin implications of the same set of shocks.

For credit allocation decisions, the second half of the year may increasingly be a 'stock' picker's market. We will be relying on our integrated research team of credit, equity and investment stewardship analysts to guide us through the murk. They will be assessing which companies can better cope with the volatile environment, or whether you are being paid for the company's particular risk profile.

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Spreads can remain range-bound for a long period of time, with the higher yields in fixed income remaining the main source of return.
”

Investors should also continue to focus on the strength of technicals in fixed income, in our view: buyers in search of yields rather than spreads have dominated flows, resulting in spreads remaining at tight levels on a historic basis. Thus, spreads can remain range-bound for a long period of time, with the higher yields in fixed income remaining the main source of return.

This analysis of technicals will then include the key question surrounding the apparent lack of US exceptionalism – and the willingness of foreigners to continue investing in US markets. We think there will be increasing interest in non-US credit markets from Asian investors as they look to diversify their exposures – but they cannot abandon the American market altogether. Therefore, the relative valuation differential between US and European credit will remain a key area of focus for us.

European IG credit spreads after subtracting US IG spreads



Source: Bloomberg as at 12 June 2025.

Private credit props

A prolonged higher-for-longer rates regime is supportive for private credit returns, in our view. Sub-IG direct lending yield (c.10% currently)⁶ remains high in absolute terms, although only average relative to history. IG private credit yields (c.5-7%)⁷ are pricing towards the top of the historical range, offering potentially attractive returns.

Similar to public markets, private credit spreads are relatively tight – although the illiquidity premium has been stable so far in 2025. We are seeing increasing dispersion, with borrowers insulated from tariff volatility experiencing limited effect on pricing, while those more impacted or of lower credit quality need to offer wider spreads to attract lender demand. We prefer to be defensive in the current environment – non-cyclicals over cyclicals – and focus on diversification.

We view private credit as relatively sheltered from the recent macro volatility – at least in terms of direct tariff impact.

⁶ Source: L&G as at May 2025.

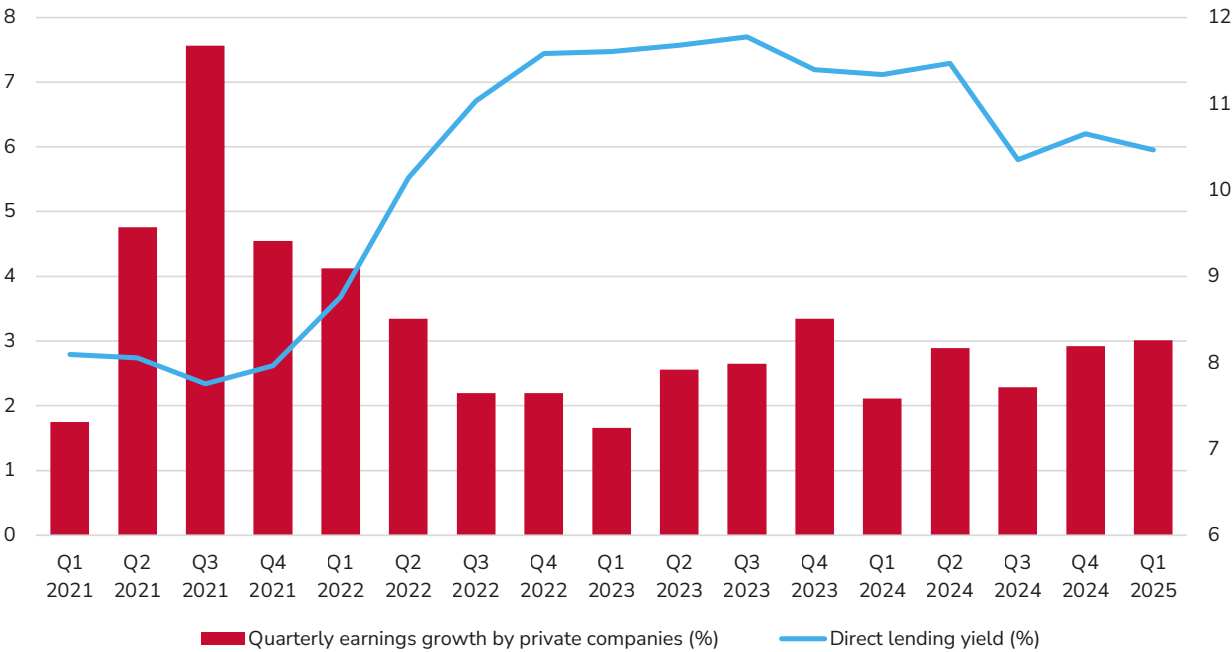
⁷ *ibid.*

A large chunk of investment grade private credit is infrastructure, utilities and real estate issuers, all of which are supported by highly predictable cashflows. Sub-IG borrowers, meanwhile, are concentrated in companies with domestic operations and service-based revenue, rather than goods-based. Direct exposure to tariff impact has been estimated at around 10%⁸

Fundamentals have been robust, with earnings growth capable of managing leverage in a higher rate environment so far. But prolonged trade tensions and fiscal concerns will have a broader influence and add to overall risk for the asset class.

⁸ Source: KBRA and Fitch.

Fundamentals remain robust as private credit borrowers managed through higher borrowing costs



Source: Q1 2025 Lincoln Private Market Index as at April, 2025.

We believe that cost increases, lower demand and more uncertainty for business planning will likely hit earnings growth, leading to weaker borrowers breaching debt covenants. We see smaller companies as disproportionately impacted, due to limited pricing power and revenue diversification. Another source of risk is the 2021-2022 vintage of loans – originated when yields were low and leverage high. They are coming up for refinancing in 2025-26 and could struggle due to higher debt costs and a weak M&A market.

All these factors raise concerns of an increase in defaults and represent a big test for the covenant-loose loans that have dominated direct lending issuance in recent years.

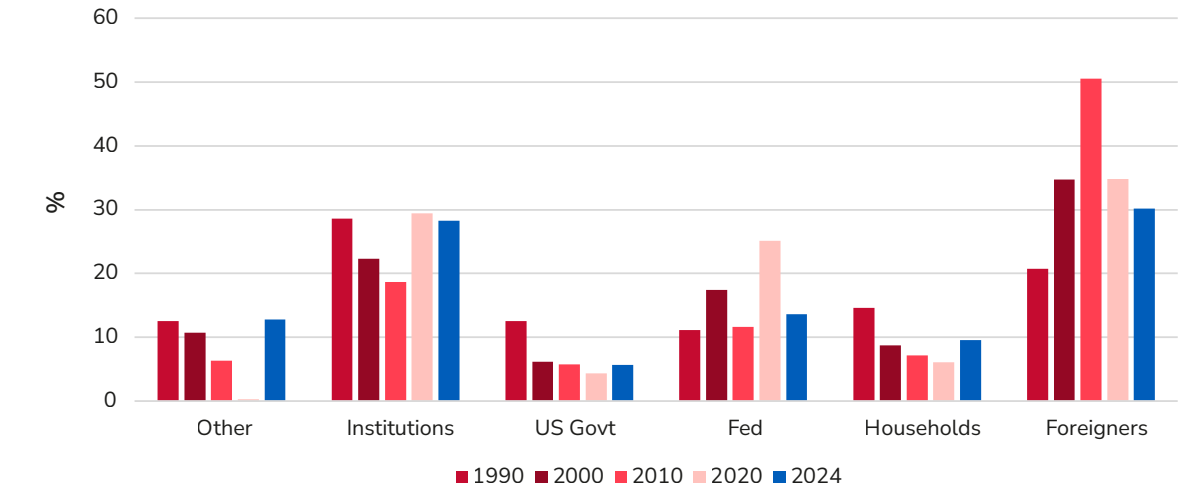
Three reasons why Treasuries are here to stay

In recent months, policy changes emerging from America have led to anxieties around the US Treasury market. Amid the disruption of the ‘Liberation Day’ tariffs, the US dollar weakened and government bond yields jumped – the opposite of what conventional wisdom would have expected.

Observers since have speculated that this portends ill for the dominance of the US Treasury market.⁹ However, despite investor heartburn, we see risks to US asset dominance as more modest than extrapolation suggests for three reasons.

- 1. The threat of mass selloffs of Treasuries from foreign actors, ominously speculated about in early April, carries less weight than before.¹⁰ The mid-2000s saw discussions of the “balance of financial terror” between the US and offshore Treasury holders.¹¹ Since then, though, US debt ownership has become substantially indigenous, with the foreign share of Treasury holdings falling from 55% in 2008 to around 30% today.¹² This blunts the threat of an external effort to dethrone the dollar-Treasury nexus.

Proportions of US Treasury holdings



Source: Macrobond as at 2 June, 2025.

- 2. While debates in Congress make it clear policymakers are relaxed about deficit reduction,¹³ it’s likely demand exists to absorb new issuance. Externally, International Monetary Fund forecasts of surpluses among major creditor countries suggest a trajectory of accumulation of new assets outpacing Treasury issuance.¹⁴ Domestically, the Fed is mulling slowing its shedding of Treasury bills,¹⁵

and there is talk of regulatory change to make it easier for banks to hold US debt.¹⁶ We think all these actions will supplement demand for Treasuries, and offer them some ballast despite a more erratic policy environment.

9 For example: <https://www.mirabaud.com/es/the-view/detalle-de-la-noticia/article/the-end-of-dollar-dominance>

10 Source: <https://www.cnbc.com/2025/04/15/us-treasurys-selloff-what-happened-and-why.html>

11 Source: <http://www.perjacobsson.org/2004/100304.pdf>

12 Source: Macrobond as at 2 June 2025.

13 Source: <https://www.semafor.com/article/05/22/2025/senate-leans-toward-preserving-much-of-trumps-big-beautiful-bill>

14 Source: <https://www.imf.org/external/datamapper/BCA@WEO/OEMDC/ADVEC/WEOWORLD>

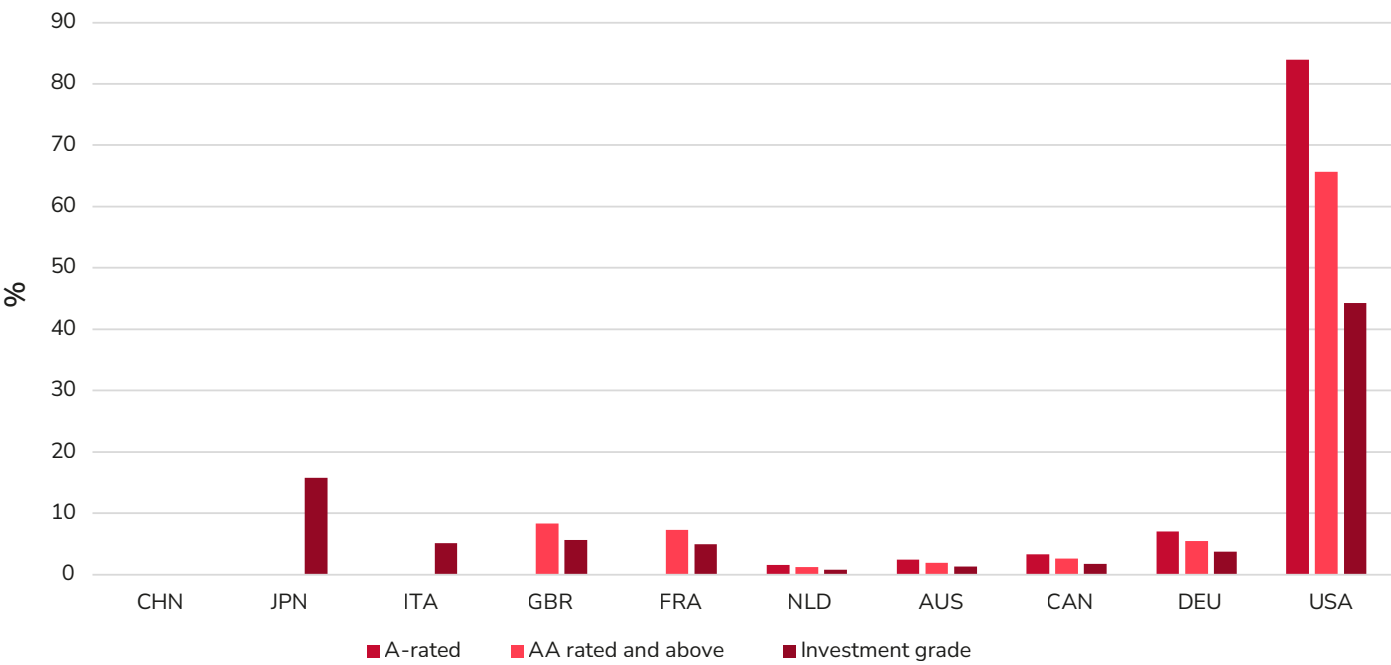
15 Source: <https://www.reuters.com/markets/us/feds-says-will-slow-balance-sheet-runoff-process-2025-03-19/>

16 Source: <https://www.reuters.com/business/finance/us-poised-cut-capital-requirements-banks-ft-reports-2025-05-15/>

3. Lastly, there exist meagre alternatives to US asset dominance. China, the US's greatest rival by GDP, maintains capital controls, limiting outbound investment and stunting its ability to serve as a competitor. Europe's debt has neither the scale nor the internal cohesion to challenge US hegemony. Unorthodox alternatives such as gold or cryptocurrency could be touted as alternatives, but neither produce income – nor are universally accepted as collateral like US Treasuries. US government paper remains the unavoidable global asset, and there's little evidence this will change much in future, in our view.

Country share in outstanding high-grade global assets

(Central government shares outstanding globally)



Source: Macrobond as at 2 June, 2025.

The second Trump administration is likely to continue offering markets a lot of disruption to digest. From trade and fiscal policy to geopolitics, we should expect a greater risk appetite than prior administrations. However, we believe the displacement of Treasuries will likely take bigger shocks and a more sustained push by rivals over a longer timeframe than we have seen.

What’s in store for cash?

Short-term cash rates will continue to be influenced by monetary policy decisions throughout the second half of the year. Across the US, UK and Eurozone, we expect central banks to continue with a data-dependent and gradual approach to cutting interest rates.

While our baseline expectation is for one or two cuts in each of these markets in the second half of 2025, increased market uncertainty amid the changing US policy agenda means we

could see either more or fewer cuts depending how economic data evolves. Should inflation pick up again, we could see central banks opt to maintain restrictive monetary policy, with rates on hold or only coming down very slowly for the remainder of the year. However, we do not expect to see an increase in interest rates.

In the event of a sharp deterioration in economic data, a faster removal of restrictive policy would be warranted through more aggressive rate cutting to support global economies, potentially up to three or four times depending on the speed and scale of any deterioration. While markets await clear direction in the data, we expect cash rates to remain attractive to investors for the remainder of the year.

How we tackle equity volatility

We chart a roadmap for uncertainty, covering concentration risk, factor-based investing and diversification¹⁷ via private markets.



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Andrzej Pioch
Fund Manager

In the final quarter of 2024, equity market concentration – which means a fall in a relatively small number of securities can have a large impact on overall performance – hit an all-time high. A few months later, volatility in stocks spiked to levels not seen since COVID-19.

While the trigger was the ‘Liberation Day’ tariffs, the two phenomena are clearly related. So how might investors look to overcome the risks inherent in a concentrated equity market and ride out future squalls?

Beyond 60-40

The following graphs show how a traditional 60-40 portfolio, made up of a market-cap weighted equity index combined with a global aggregate bond index, compares with a regionally diversified approach.

On the equity side a regionally diversified approach has resulted in a lower concentration risk in the Magnificent Seven, while still providing a meaningful allocation to high-growth equities through a combination of AI-themed companies and other NASDAQ 100 stocks.

¹⁷ It should be noted that diversification is no guarantee against a loss in a declining market.



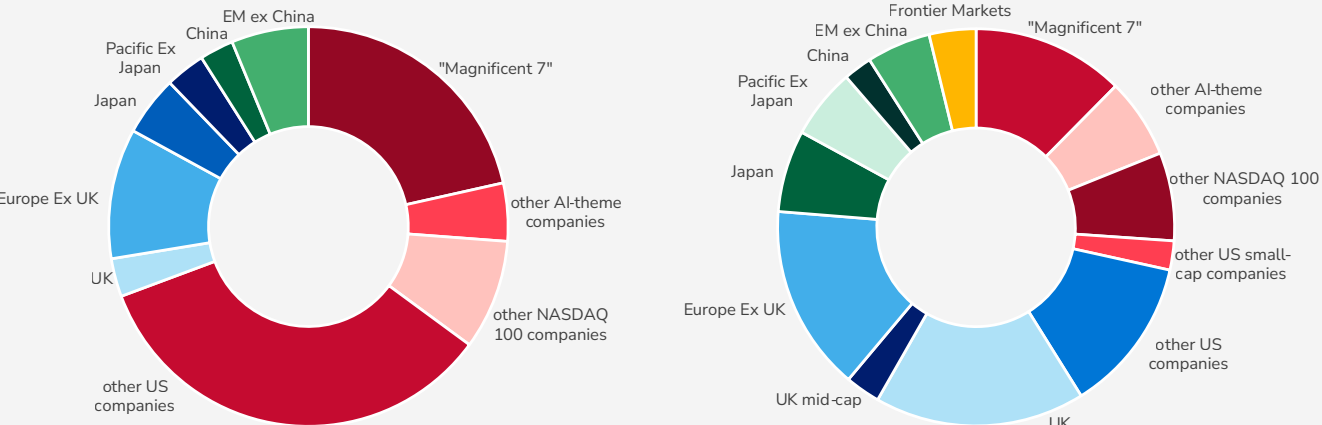
Fadi Zaher
Head of Index Solutions, EMEA

As well as being over-represented in market-cap weighted indices, these stocks could also feature in active funds given widespread excitement around the potential of AI.¹⁸ This ‘duplication risk’ across index and active holdings may further increase concentration risk.

In the year to date, regional diversification has been beneficial for investors, allowing them to capture strong equity market returns from Europe and Japan. This has resulted in better overall returns relative to a traditional 60/40 portfolio, as well as lower maximum drawdowns from a diversified portfolio.

¹⁸ Holdings of Nvidia as at the end of 2024 provide an illustrative example. M* data shows of 252 funds in the IA North America Sector, c. 95 don't hold the stock, c. 87 are market weight or overweight, and c. 70 are underweight vs the S&P 500. For illustrative purposes only. Reference to a particular security is on a historic basis and does not mean that the security is currently held or will be held within an L&G portfolio. The above information does not constitute a recommendation to buy or sell any security.

Market-cap weight (left) vs. a globally diversified portfolio (right)



Left-hand chart shows MSCI ACWI, right-hand chart shows an illustrative regionally diversified portfolio. It should be noted that diversification is no guarantee against a loss in a declining market.

Source: Bloomberg and L&G as at 31 December 2024.

A roadmap for uncertainty

Ultimately, it is impossible to predict exactly how things might look in 24 hours, never mind over a 20-year investment horizon. However, there are some simple principles we believe stand the test of time:

- **Diversify:** with so much geopolitical uncertainty, we favour avoiding overexposure to any specific region, sector or stock
- **Prepare, don't predict:** trying to accurately predict long-term outcomes at inflection points is impossible. We aim not to overcomplicate things and build portfolios that perform in a variety of different environments
- **Think long term:** we seek to avoid the short-term noise and remain invested. Achieving long-term returns requires consistent market exposure, even in difficult markets
- **Take your time:** acting gradually and following a robust and explicit process can limit behavioural biases, which are accentuated in trickier times with 24-hour news

The role of factors

Factor-based investing provides a way of tackling equity market volatility by diversifying the types of stocks to which investors are exposed. A factor strategy targets groups of stocks that share specific traits or ‘factors’ that have historically influenced performance.

This approach can reduce reliance on a few dominant stocks and spread risk across different types of companies. If an investor’s objective is to manage market volatility by increasing diversification in the medium to long term, two style factors may be particularly relevant:

1. **Quality:** companies with strong balance sheets and consistent earnings
2. **Low Volatility:** stocks that tend to fluctuate less in price

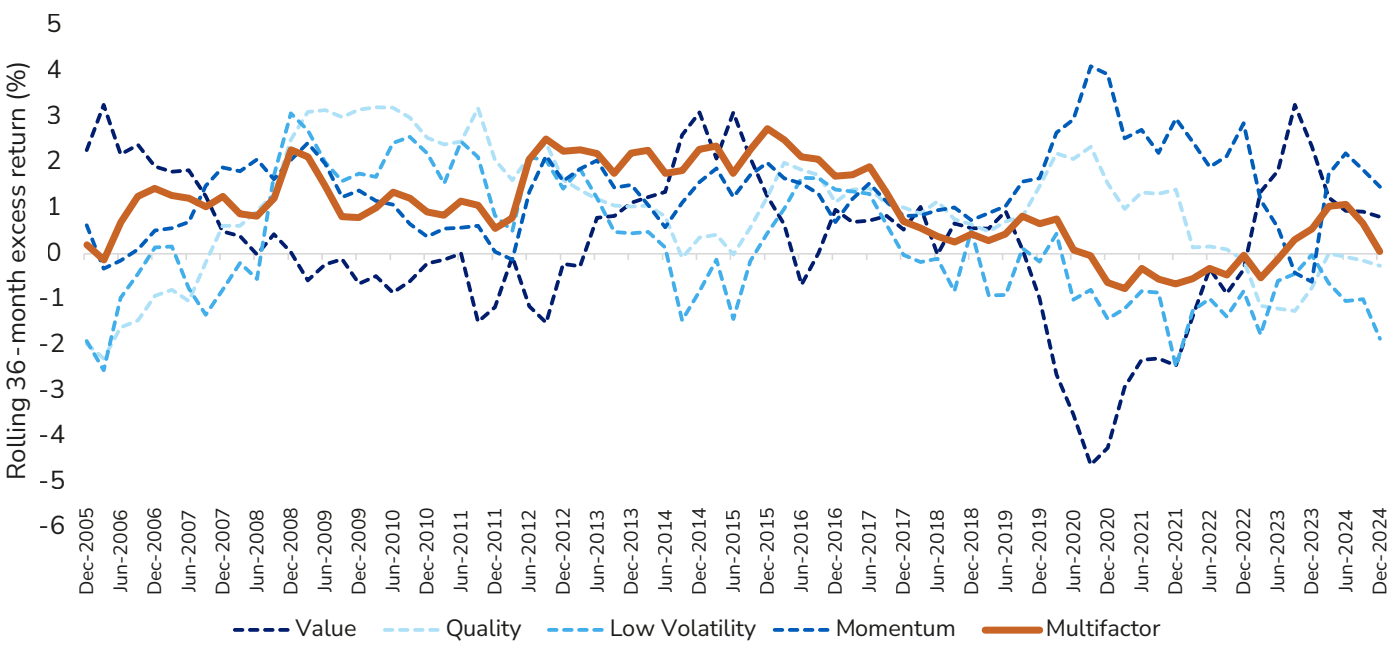
Other style factors often combined with the two lower-risk type factors include:

- **Momentum:** Stocks that have shown strong recent performance
- **Value:** Stocks that appear undervalued relative to fundamentals
- **Size:** Exposure to both large and smaller companies for broader diversification.

While these three factors can entail higher volatility than the Quality and Low Volatility factors, a combination of factors offers diversification across various styles and tends to smooth out the investment journey.

A multi-factor approach can mitigate the cyclicity of factor returns.

A multi-factor approach can mitigate the cyclical nature of factor returns



Source: STOXX. L&G. USD gross index returns. Rolling 36-month relative returns versus Stoxx World AC Index from December 2012 to December 2024. **Past performance is not a guide to the future.**

Equal weighting, examined

Adjusting how capital is distributed across a portfolio due to the way stocks are weighted is another potential way of reducing concentration risk.

The traditional approach of market-cap weighting gives more influence to the largest companies, which can increase volatility if those stocks underperform. One widely used alternative is equal weighting, where each stock gets the same allocation, regardless of size.

Compared with market-cap weighting schemes, equal weighting tends to result in small companies gaining a higher allocation, while reducing the concentration risk in largest stocks. This approach can reduce overexposure to mega-cap stocks and increase exposure to mid- and small-cap companies, resulting in improved diversification.

As such, several systemic approaches can be deployed to tackle market volatility. Selecting the right one ultimately depends on an investor’s goals, risk tolerance and overall investment strategy.

Going private

Public equity markets have historically generated strong, long-term returns overall. And yet as noted earlier, they have become concentrated in recent years – with the US dominating global indices, and a handful of tech stocks dominating the US market.

At the same time, the macroeconomic outlook is clouded, partly due to US policy uncertainty.

Private markets offer a further route to diversify and manage equity risk exposure. Some investors criticise the smoothing of

market-to-market volatility in private markets. But it offers a way to look through the daily noise of risk-on / risk-off in liquid markets for long-term investors who do not look for short-term liquidity.

As many global assets are privately held, and not available to liquid market investors, we expect some additional return pickup from their illiquidity and occasionally somewhat exotic nature.

“ Private markets offer a further route to diversify and manage equity risk exposure. ”

Return drivers

Outside of private equity, private markets further provide exposure to different drivers of returns, away from business cycle dependence. In private credit, the make-up of borrowers is significantly different to their counterparts in public credit markets. Beside large cap corporates (which are a relatively small component), lenders can gain exposure to hundreds of thousands of mid-market, privately held companies as well as asset-backed loans; for example, infrastructure and real estate.

In the real assets space, the demand and supply conditions which combine to deliver income and income growth do not correlate 1:1 with those in the public equity markets. And increasingly, investors have chosen to complement diversified exposure with targeted strategies to access specific characteristics within real estate or infrastructure. Residential property – for which there are an increasing variety of strategies available – generally sees demand being relatively insensitive to economic conditions. Digital infrastructure, and datacentres specifically, has seen a surge in demand for capacity in recent years, most recently to service the growing demand from AI.

Investment in the latter could be seen as an extension of the diversification away from the Magnificent Seven US tech companies; while these ‘hyperscalers’ procure a significant amount of datacentre capacity, demand is broader than AI and comes from a wide variety of users.

Complementing US exposure

Private markets also offer geographic diversification: the US accounts for about 53% of institutionally investible global private market assets, with Europe at 20% with APAC at 24%.¹⁹

This underscores the need to complement US exposure with assets in Europe and the rest of the world, in our view. As a result, it also requires an understanding of the different characteristics of each individual market.


For instance, regulation is a key factor in residential markets, where national governments, and regions and cities, are involved in rent-setting. In datacentres, digital sovereignty has been a key driver of increased investment outside of the US. Although many of the key drivers are global, encapsulated in [the 4D](#) (digitalisation, demographics, deglobalisation and decarbonisation) megatrends we believe are shaping the future of the asset class, detailed local market knowledge is an essential ingredient for investing with confidence in private markets.




¹⁹ Source: Preqin as at end 2024.

How pension proposals could power sterling assets


We assess the extent to which UK government plans might boost investment into private market assets and bolster economic activity.



Bill Page
Head of Real Estate Research



Mathew Webb
Head of Endgame Solutions



Martin Dietz
Head of Diversified Strategies

As global investors rebalance their geographical exposures, sterling assets may gain on the margin. But we believe the long-term trajectory of the UK economy will ultimately prove a far more potent factor in their performance.

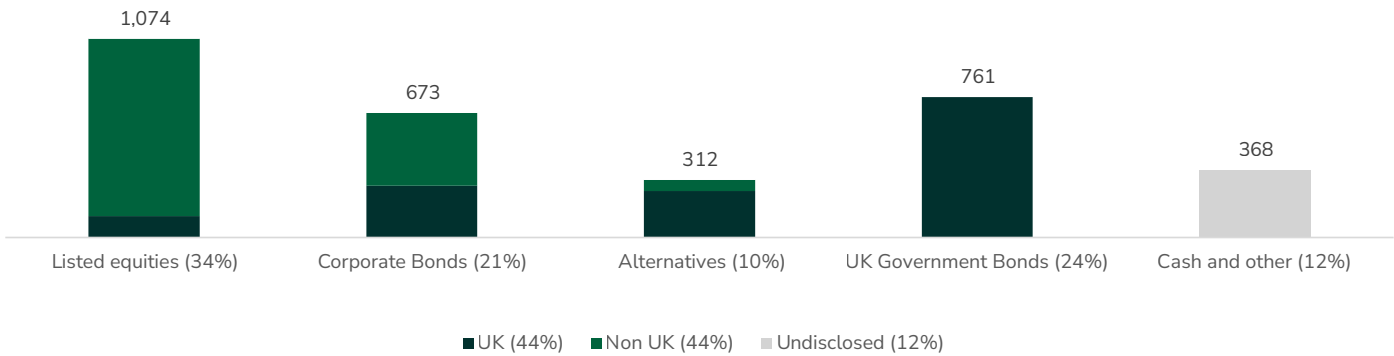
To this end, how might the UK government’s plans for pensions boost the country’s growth?

The [Pension Schemes Bill 2025](#) released in June is aimed at building scale in the industry by encouraging various forms of consolidation. It also seeks to stimulate UK investment, in the expectation that larger pools of capital will be more easily able to invest in longer-term private market assets.

Of the estimated £3.2 trillion of UK pension assets (as at September 2024), some 44% are already invested in sterling assets, predominately UK Government bonds. Only about 10% are in invested in alternatives (property, private equity, private credit and infrastructure), albeit with an already high 80% allocation to the UK²⁰:

20 Source: [20250604-pension-scheme-assets-2025-final.pdf](#)

£3.2trn of UK pension assets: Asset allocation by asset type



Asset Allocation is subject to change.
Source: L&G analysis as at June, 2025, based on data from the [Pensions Policy Institute: Pension scheme assets – how is asset allocation changing and why?](#)

In order to increase the overall allocation to private markets (i.e. the Alternatives category in the charts), the bill proposes:

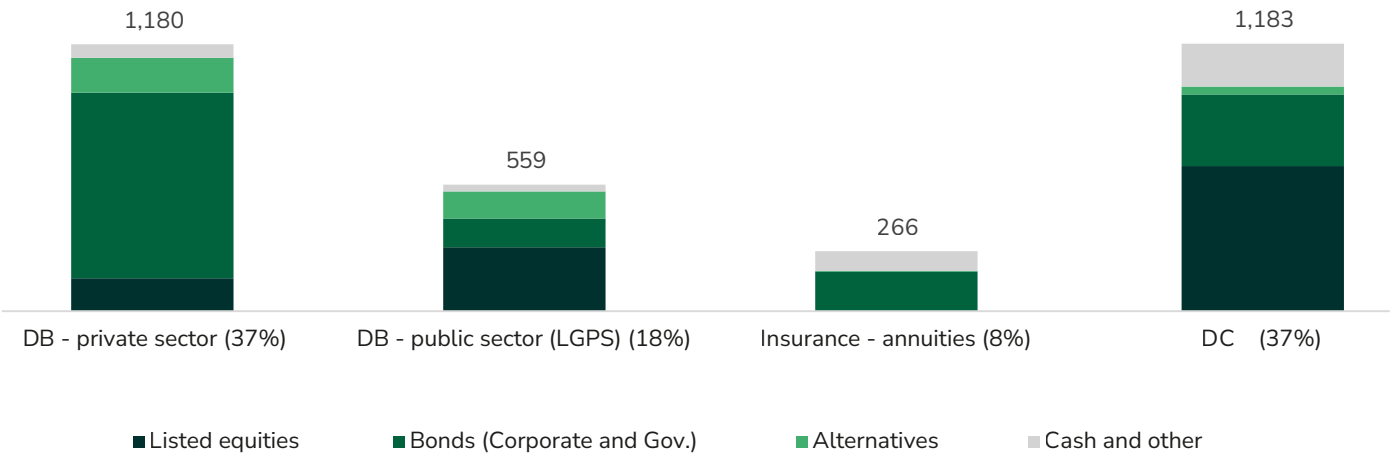
- DB – private sector:** making it easier for trustees of well-funded Defined Benefit pension schemes to release money back to employers and their scheme members, [when safe to do so](#), unlocking some of the £160 billion surplus funds to be reinvested across the UK economy and boost business productivity and deliver for members.²¹ There is the potential for some of this surplus to be invested for growth in private markets.
- DB – public sector:** consolidating and further professionalising the Local Government Pension Scheme (LGPS), with assets held in six pools that can invest in local areas infrastructure, housing and clean energy. There is the potential for the existing allocation of larger LGPS schemes to private markets to be taken up more broadly by the larger pools.
- DC:** new rules creating multi-employer DC scheme ‘megafunds’ of at least £25 billion, so that bigger and better pension schemes can drive down costs and invest in a wider range of assets. Together with the voluntary [Mansion House Accord](#) (to invest 10 percent of their workplace portfolios in assets that boost the economy such as infrastructure, property and private equity by 2030, at least 5 percent ringfenced for the UK) this has the potential to increase private market allocation within DC.
- Insurance – annuities:** insurance companies are already investors in private market assets to back their insurance liabilities, albeit with a focus on cashflow generating assets. This is [set to continue](#) as well funded private sector DB schemes select buyout as their endgame strategy and will increase as [Solvency UK](#) and consultation on the [Matching Adjustment Investment Accelerator](#) seeks to expand the range of assets that insurers can invest in.

We wait to see how this legislation will change the current asset allocation across these investor types (see chart). Each will have different risk, return, liquidity and regulatory objectives and, importantly, different expected growth rates.

21 Source: [Government response: Options for Defined Benefit schemes - GOV.UK](#) as at May 2025.

“ We see sterling assets as a beneficiary given expected inflows from the wider DC market, which is poised to play a more significant role in financing UK-led projects. ”

£3.2trn of UK pension assets: Asset allocation by investor type



Asset Allocation is subject to change.
Source: L&G analysis as at June, 2025, based on data from the [Pensions Policy Institute: Pension scheme assets – how is asset allocation changing and why?](#)

However, what is clear is that the government’s intention is to increase interest in UK private market assets across the entire domestic pensions market, thereby also catalysing economic growth, by setting policy and through defining framework in legislation.

It is up to the market to take up this call to action – both in terms of demand for UK private market opportunities, but also in supply, to kickstart growth in the government’s plan for change.

For investors more generally, this growing focus on UK private market assets [may present an opportunity to invest](#), albeit amid with some risk of being crowded out if demand outpaces supply.

DC deep-dive

As the global economic landscape evolves, UK pension schemes – particularly DC funds – face both opportunities and challenges in navigating their sterling-denominated assets. While UK DC pension schemes traditionally relied on public markets, DC investing is evolving beyond a singular focus on low fees, shifting toward value-driven funds and defaults that prioritise long-term outcomes for savers.

Historically, private markets were kept at the margins of DC investing – deemed too complex, too illiquid. But these asset classes offer the potential for enhanced long-term returns through exposure to high-growth assets and sectors, including venture capital, infrastructure, clean power and affordable homes.

As noted elsewhere in this report, the current push towards private assets can provide further diversification, seeking to mitigate volatility linked to global financial cycles.

In July 2024, L&G was one of the first asset managers to launch a private markets strategy range designed for UK pensions and DC savers. By incorporating private markets, our funds seek potential enhanced returns through high-growth assets. Our approach strikes a balance between global opportunity and a UK focus – offering strong market access and creating a differentiated engagement opportunity for DC savers.

Our new DC and multi-asset approaches enabled us to be one of 17 UK asset managers to sign the updated Mansion House Accord,²² cited earlier. Further pension reform, such as the Pensions Investment Review, encourages greater allocation to private markets.

We see sterling assets as a potential beneficiary given expected inflows from the wider DC market, which is poised to play a more significant role in financing UK-led projects. As this policy shift not only aims to enhance retirement outcomes, but strengthen domestic investment capacity, bolstering the UK economy.

As UK assets are influenced by macroeconomic forces – global inflationary pressures, central bank policies, and geopolitical uncertainties, the priority remains clear though: looking to help safeguard DC savers while aiming to secure sustainable, long-term growth.

We believe that by keeping the focus on what is best for our members, UK pensions can navigate uncertainty to help future-proof retirement outcomes, while supporting domestic investment in critical projects.

22 As at May 2025.

Real estate reallocation?

We have seen anecdotal evidence of US investors considering capital allocations outside their domestic market. So far, however, this has been contained within a few surveys or ‘shows of hands’ at industry conferences.

Any reallocation would most likely, in our view, focus on continental Europe as well as the UK – but UK real estate values were marked down significantly in 2022 and 2023. At a market level, despite some recent value appreciation, valuations remain -21% lower than their recent peak. This is slightly more than the US and significantly more than Europe ex UK, where values were lower by a more modest -14%²³. The UK offers investors scale and transparency. It is the third-largest institutional real estate market globally and the second-largest developed market after the US. It is the largest market in Europe²⁴. According to JLL, it remains the most transparent real estate market in the world – offering strong legal protections, robust data availability, and high liquidity.

Putting UK real estate in a broader private markets context shows that real estate yields, based on a spread to risk-free, are screening relatively strongly – a reflection of the fact that real estate globally has repriced more quickly than private equity and infrastructure.

Based on independent forecasts, a market-weighted sector average of ‘prime’ real estate in the UK is expected to outperform global averages with an average annualised return of 7.5% p.a. to 2029²⁵. Part of this is supported by structural shortages of supply in many real estate segments following a period of significant construction price increases. This, and continuing friction in achieving planning permission, is supporting rental tension in areas of the market with resilient demand such as multilet industrials, many parts of the residential market and high-quality offices.

In a global context, the case for UK commercial real estate is not about turning away from the US; we see it as about building resilience and enhancing returns through diversification. With elevated yields, a favourable policy backdrop, and strong sector-specific opportunities, the UK offers a timely and tactical complement to US exposure.

23 MSCI quarterly data to Q1 2025.
24 MSCI valuation data, end 2024.
25 Property Market Analysis (PMA), spring forecasts 2025.

A good time for UK innovation



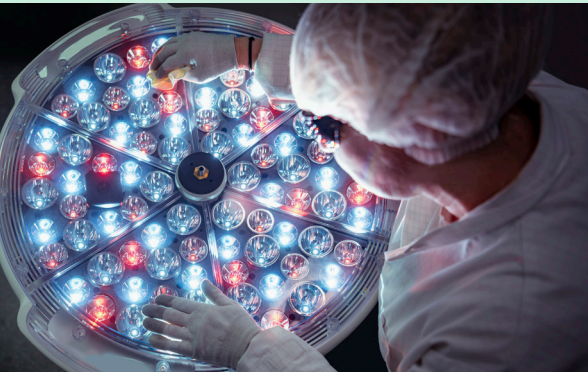
Alastair Stewart
Head of Investments,
Venture Capital

We continue to view UK innovation as a compelling investment opportunity, with the sector likely to benefit from government support and policy volatility in the US.

The UK government recently reaffirmed its focus on science and technology with [£86bn of spending](#) by the end of this parliament, as part of a broader set of measures to support key UK innovation ecosystems. In comparison, US research funding across both government institutions and universities is under threat, as evidenced by the [\\$4bn cuts](#) to the National Institutes of Health that were announced in February this year.

In an ever-competitive global race for technological superiority, there is now a risk that US technological progression slows and top academics start to reconsider where best to base themselves and their research. We see this as a near- and long-term opportunity for the UK and its world-leading universities, to attract talent and build on key technological areas of national interest such as quantum computing, AI, clean energy and healthcare.

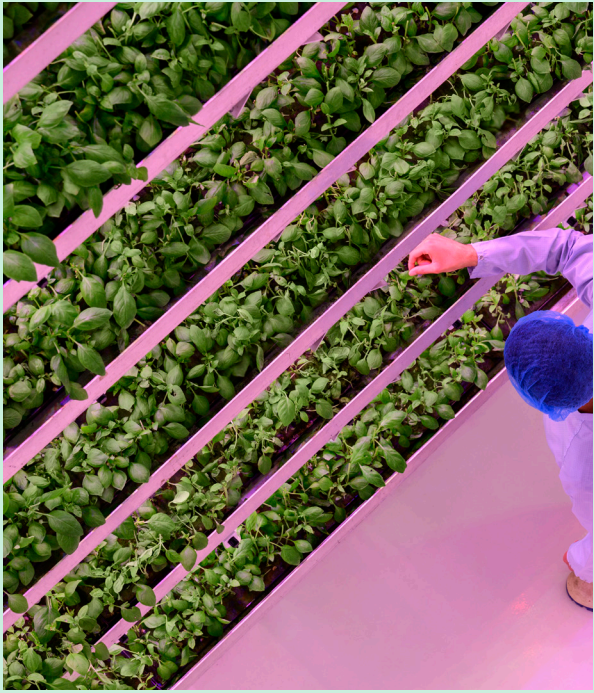
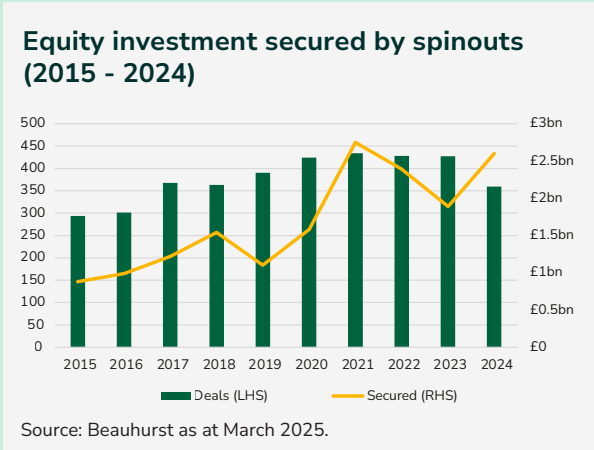
Within the broader UK venture capital market, the university spinout asset class continues to grow with [£2.6bn invested in 2024](#), a level almost in line with the approximately £2.7bn invested in the peak of 2021, albeit overall valuations have continued to normalise.²⁶ On top of targeted government support, private sector initiatives such as the Mansion House Accord are likely to act as positive market drivers over the coming years. In contrast, the overall venture capital fund raising market continues to face challenges as low public markets activity hinders exits, resulting in lower liquidity for LPs to redeploy.



26 Source: Beauhurst as at March 2025.

At a transactional level, we continue to see key companies being funded with significant round sizes and including a broad range of UK and international investors. Recent examples include a \$600m round for [Isomorphic Labs](#), a company using AI to develop new drugs and a \$200m round for Cambridge based [CMR Surgical](#), a developer of surgical robotics.²⁷

However, capital gaps remain, and we continue to see opportunities for investors to access high quality investments, at sensible valuations, at the early-commercialisation stage as they look to build scale. In addition, the UK technology market has for many years benefited from lower-entry valuations compared to the US. Combining these factors: positive policy tailwinds, identifiable capital gaps and lower relative valuations suggest now is likely a good time to be investing in UK innovation, in our view.



²⁷ Source: Isomorphic Labs and CMR Surgical company announcements from March 2025 and April 2025 respectively.



Evolving US-China ties: EM implications

While we expect emerging market resilience, we are relatively cautious in our public market EMD positioning – and see an increasing role for private capital.



Erik Lueth
Emerging Market Economist



Amie Stow
Head of Private Market Credit
Investment Specialists

The ongoing global trade hostilities are probably less consequential for emerging markets²⁸ than many investors might have expected.

One key reason for this is that China has a significant amount of leverage in trade issues. Another is that US tariffs tend to weigh on the dollar, which is a boon for emerging economies and assets. Ironically, the biggest risk for emerging markets are US policies and initiatives that could push the world’s biggest economy into recession.

In contrast to the 2018 trade war, China has matched US tariffs one-to-one. By doing so, it appears to have prompted a reprieve of the most egregious levies until at least mid-August. China’s strength is its manufacturing prowess. It makes the US too dependent on Chinese goods and China less dependent on US goods.

While the outcome of the US-Sino trade conflict remains highly uncertain, we forecast China to get close to its 5% growth target this year. Tariffs, if they were to return in force, can be buffered by rerouting and fiscal stimulus. Also, tentative signs of property market stabilisation are showing. If sustained, this would remove a major drag on growth.

28 Investments may be made in countries where investment markets are considered to be less developed. This means that investments are generally riskier than those in developed markets because they: - may not be as well regulated; - may be more difficult to buy and sell; - may have less reliable arrangements for the safekeeping of investments; or - may be more exposed to political and taxation uncertainties. The value of investments can go up or down more often and by larger amounts than investments that invest in developed countries, especially in the short term.



Raza Agha
Head of Emerging Market Sovereign Strategy

Other emerging markets (excluding Mexico) have been hit by a 10% universal tariff and could face additional reciprocal levies of 11%-50% if no trade deal is reached by mid-July.²⁹ However, the trade war is weighing on the greenback, providing financial loosening for emerging markets just when it is needed. In addition, the waiver on reciprocal tariff may be extended, as trade deals with 60 countries remain elusive.

In a scenario where the US enters recession – either by disregarding economic orthodoxy or through the creeping effects of uncertainty – emerging economies and emerging assets are likely to fare poorly, in our view.

Over the medium term, we think the impact of US tariffs on globalisation should be minimal. That is because the US accounts for just 13% of global trade (inter-EU trade not counted). Moreover, the world tends to move on when the US turns more inward.³⁰

In the last three years of Donald Trump’s first term as president, the rest of the world signed more regional trade agreements than ever before.³¹ While the share of imports in US GDP has been falling since 2013, it continues to rise strongly in the 36 next largest economies.³²

29 Source: <https://www.ft.com/content/2c473393-35fb-479d-8bba-236a1a98087c>
30 Source: IMF and Macrobond as at June 2025.
31 Source: WTO as at June 2025.
32 Source: Macrobond as at June 2025.

Public markets positioning

What does this mean for positioning in our emerging market debt (EMD) portfolios?

Economic growth is a key consideration for us – and the IMF Spring Meetings have led to a flurry of sobering updates to macro forecasts. The organisation has lowered its projections for global, advanced economy and emerging market economic expansion for 2025 by 50bps across the board. Despite our view that emerging markets should be resilient, the markdowns are driven by and concentrated in countries with the largest exposures to the US. These include Mexico, the only major emerging market to see a recession this year; China; emerging Asian economies; and the Middle East and North Africa, with the latter reflecting lower oil price forecasts.

However, the forecast downgrades are not significant, with headline growth levels flat to those seen in 2019 – and in line with post-COVID average. We also note that these forecasts were made in mid-April, at the peak of macro negativity, so there is room for upward revisions.

Notwithstanding uncertainties around the outlook, emerging market spreads have remained relatively contained, while issuance from sovereigns in the year to date is running close to record levels. This highlights strong market access for investment grade credits, while high yield countries continue to benefit from IMF support, which helps facilitate greater financial backing when needed.

Coupled with strong external buffers in the form of reserves, this means idiosyncratic risks in emerging markets are manageable, in our view. The principal risk is therefore global macro and markets, particularly the US.

As a result, we are relatively cautious in our positioning, running a moderate overweight via credits and countries more insulated from tariff impacts, focusing on the short end of yield curves and staying neutral on duration.

Mobilising private capital

Private capital is playing an increasing role in emerging markets. Debt Conversion bonds (previously known as debt-for-nature swaps) have been around in various guises since the 1980s. The structure has reemerged after COVID as developing countries external debt surpassed \$11.4 trillion in 2023.³³

We see these loans as presenting an opportunity for developing countries to restructure existing debt and use the savings to unlock funding for essential needs. To date, funding has predominately been used for conservation efforts but these instruments can also address other priorities. Since 2021, about \$6 billion of debt has been restructured.³⁴ Development Finance Institutions (DFIs) or insurers provide guarantees, which reduce default risk for investors and enhance the credit rating in-line with DFIs, typically AA / A-rated. The US Development Finance Corporation (DFC), set up during the first Trump administration, has been a key market participant over the last four years.

Looking ahead, we expect to see new entrants as well as the DFC continue to provide these guarantees across a host of priorities that will likely include nature, critical infrastructure, food or vaccination programmes.

Private capital needs to mobilise to support these transactions. To date, life insurers have predominately picked up the mantle, but a more diverse institutional client base will probably be needed in the years ahead, as the structure of these transactions becomes better known.

A handful of deals are likely before the end of the year, with the potential to restructure more than \$1.5 billion of emerging market debt.³⁵ African nations are likely to be dominant issuers in the near-term, but with high debt burdens across emerging markets, we anticipate a steady stream of issuance.

“Relatively contained spreads, even amid high issuance, suggest strong market access for investment grade credits.”

33 BloombergNEF: 'Debt-for-Nature Swaps: Conservation Collateralized', 12 May 2025.
34 Ibid.
35 L&G estimates according to current pipeline of transactions as at 1 June 2025.

The long (index) view



Lee Collins
Head of Index Fixed Income

The landscape for managing EMD index strategies has changed significantly since L&G launched its first such strategy in 2011. Over the past 14 years we have faced a number of challenging periods in markets, from the taper tantrum in 2013 to more recent events such as COVID-19 and heightened geopolitical tensions.

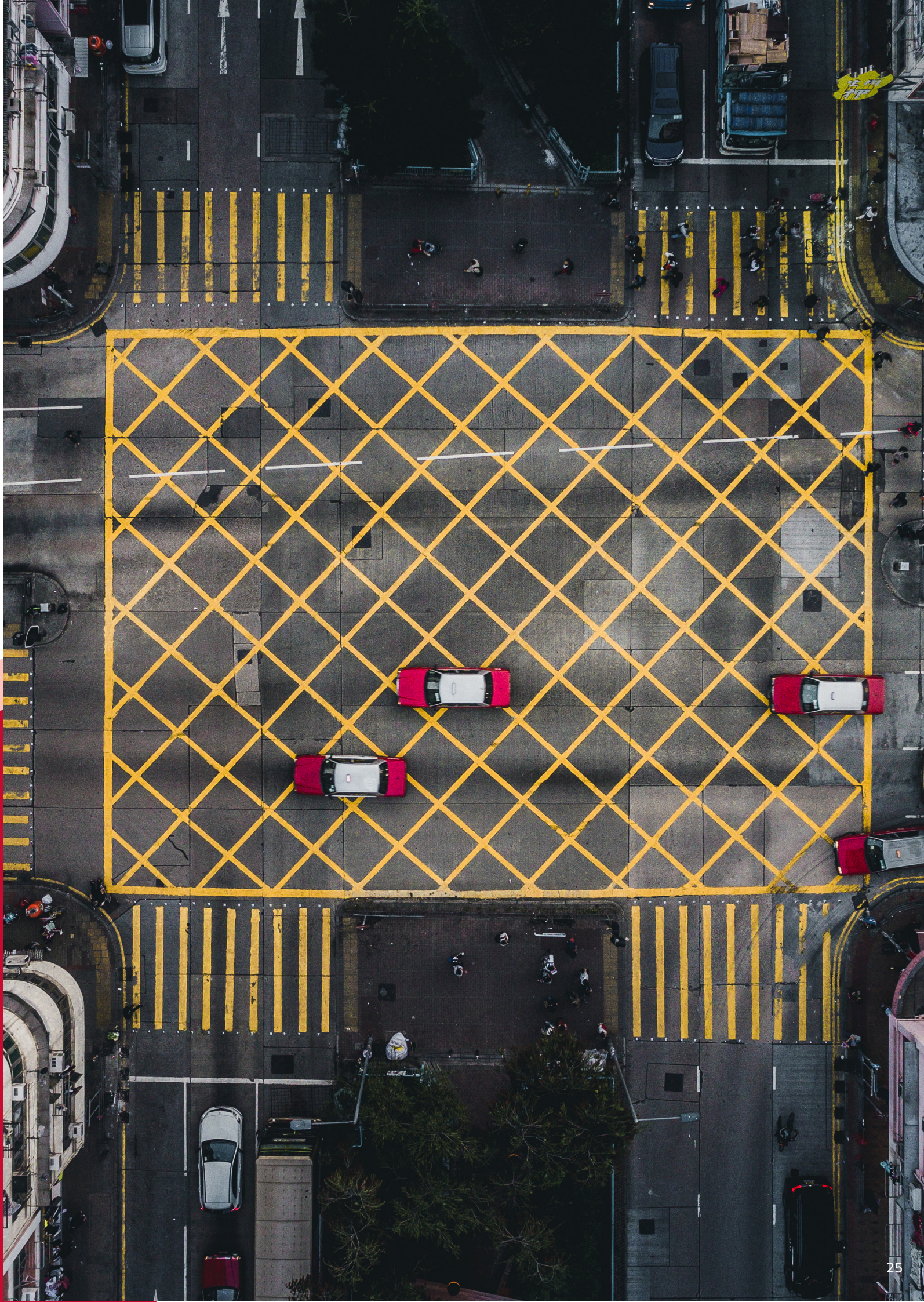
These have been good tests, demonstrating that index EMD strategies can still be managed to achieve their investment objectives with cost-efficient trading and sourcing sufficient liquidity.

In the local currency space, we have witnessed the universe of sovereign exposures change and expand materially through the inclusion of India and China, while also seeing the exclusion of Russia in 2022.

The trading ecosystem has also evolved significantly from the time when almost all local currency markets had to be traded via voice. Today, almost all the markets we operate in can now be traded more efficiently via electronic platforms. India remains an exception for now, but change is on the horizon here too.

In our view, EMD is not an asset class that can be managed in what many would describe as a traditional 'passive' manner. We believe it requires a proactive approach around things such as index events, new issues, corporate actions, and changes to accessibility and sanctions.

As the investment universe continues to expand in terms of size and complexity, we believe asset class expertise and constant innovation will become ever more important.



Contact us:

For further information about the Asset Management business of L&G, please visit am.landg.com or contact your usual L&G representative.



Key risk

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