Credit Selection

MaxCap Group Research – June 2025

Credit selection

An evolving landscape. The investment market landscape is looking more challenging again in 2025, as a global trade war threatens the outlook with softening economic growth, rising price inflation and elevated uncertainty. Consistent returns are getting harder to find.

On credit selection. Institutional investors are looking broadly across credit markets – public and private, here and abroad – to find suitable exposures, at a time of increased volatility and decreased transparency in global equity markets, but credit selection is not easy.

Perusing the menu. There are numerous options across credit markets, which offer vastly different risks and returns exposures. That said, historical returns have been modest across a range of public credit market benchmarks, given periodic and sizeable drawdowns.

Making the grade. Within specific credit market segments, there are more nuanced choices up and down a familiar risk-return curve. In this context, we can position segments like commercial real estate debt, which has historically offered consistent returns, with low volatility.

Seeking diversification. Meanwhile, we have seen a concerning lack of diversification across different asset classes, following correlated dips in equity and credit returns in 2022, and potentially again in 2025. For now, commercial real estate debt returns remain lowly correlated.

Taking credit where credit is due. In a challenging world with elevated uncertainty, diminishing growth and volatile returns, there is a keen push to support portfolio returns and improve diversification, with private credit well positioned to deliver on both fronts.

A changing landscape

The **investment landscape** is looking more challenging in 2025. An unresolved trade war between the US and the rest of the world is dramatically reshaping the global trade network and driving a marked slowdown in economic activity in the near term.

- Meanwhile, **capital market volatility** has lifted dramatically, with sharp pricing movements in both equity and bond markets, particularly in the US. The synchronised nature of this correction is of particular concern, as investors are no longer getting the expected benefits of portfolio diversification from allocating across traditional stocks and bonds.

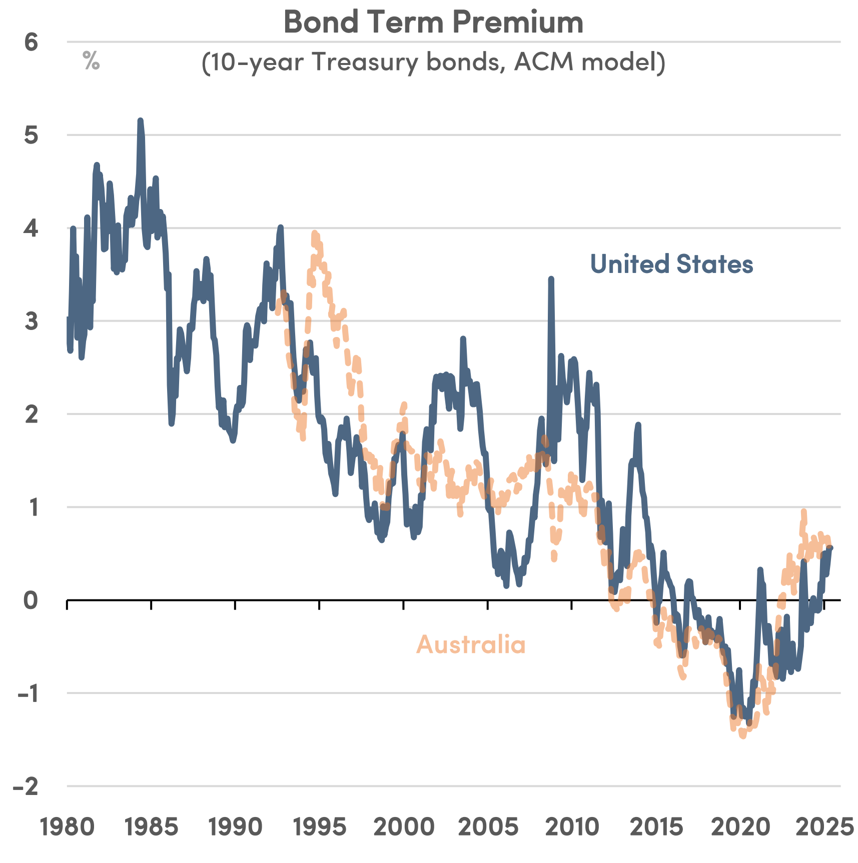
With this dislocation, investors are revising their **perceptions of risk**.

- Certainly, **country risks** are being actively re-assessed, with Australia still being well regarded as an island of stability, with good transparency and strong rule of law, which will draw greater capital inflows from other markets over coming years.
- At the same time, **asset class risks** are being re-adjusted in real time. Indeed, term premia for Treasury bonds – the default 'risk-free' asset that forms the bedrock of the global financial system – have risen clearly since 2020, and especially for the US in 2025.

All of this is occurring amid a broader **structural portfolio reallocation** for investors, from public to private markets, and from equity to debt.

- In this context, investors are seeking more guidance on **credit selection**, to understand the structure of each credit market segment and the potential drivers of credit returns, in order to work out which market segment best suits their portfolio needs.
- Amid this market landscape, investors need to distinguish the various **credit market options**, whether that is across well-established public markets, or the opportunities coming out of private markets.

In an uncertain market, bond investors in Australia and the US are seeking higher yields to compensate for risks over time, even for the most defensive assets like 10-year sovereign Treasury bonds



Source: AOFM, NY Federal Reserve, MaxCap Group (June 2025)

Perusing the menu

In scanning the diverse suite of opportunities across the global credit market, investors are quite spoilt for choice, with many **potential credit options** up and down along the risk-return curve.

- Certainly, at the bottom of the risk-return spectrum, we find the massive **sovereign bond market**, which encompasses public government debt issuances and forms the risk-free benchmark for other asset classes. Returns have been modest over the past decade.
- Further along the curve, we have different **asset-backed securities**, which collect income flows from aggregated asset pools like credit cards, leases and receivables (ABS), residential mortgages (RMBS) or commercial mortgages (CMBS). Overall, returns have been soft over prior decades, weighed down by drawdowns after the Great Lockdown and especially after the Global Financial Crisis.
- At the same time, there is a sizeable segment of **corporate lending**. While there are public- and private-market versions of this strategy, the public market benchmarks are more readily observable. In this context, the reported returns have been similarly modest over the past decade, not just in the prime investment grades, but all the way down to the sub-investment grades.
- It is in this diverse market landscape that we can position private credit segments like Australian **commercial real estate debt** (CRED). Over a long historical timeframe, CRED returns have been relatively consistent across the economic and interest rate cycles, absent the big drawdowns or capital losses that weakened public credit returns.

Meanwhile, there are **interesting differences in maturities**. Sovereign bonds and corporate loans may average out to a 10-year timeframe, while asset-backed securities may run a little shorter, at 4 to 8 years. Australian CRED loans only run to around 2 years, providing a higher degree of natural turnover, especially compared to other credit market segments.

Across the global credit market landscape, there is a broad range of well-defined segments, all with notable differences in terms of historical yields and spreads, as well as market depth and duration

Global Credit	Returns (USD, %, 10y average)	Market Cap (USD, Bloomberg benchmark)	Maturity (years)
Sovereign	0.1%	$39 trillion	9 years
Corporate	2.1%	$13 trillion	8 years
AAA grade	1.6%	$123 billion	13 years
AA grade	1.2%	$1 trillion	10 years
A grade	1.8%	$6 trillion	8 years
BAA grade	2.5%	$6 trillion	8 years
BA grade	4.3%	$1 trillion	5 years
CAA grade	5.1%	$182 billion	4 years
ABS	1.8%	$140 billion	4 years
MBS	1.1%	$7 trillion	8 years
CMBS	2.4%	$458 billion	5 years
AAA grade	2.3%	$306 billion	4 years
AA grade	2.4%	$129 billion	5 years
A grade	3.1%	$15 billion	4 years
AU CRED FM	12.7%	--	2 years

Source: Bloomberg, MaxCap Group (June 2025). Past performances are no guarantee of future returns. ABS: Asset-backed securities. MBS: Mortgage-backed securities. CMBS: Commercial mortgage-backed securities. AU CRED FM: Australian Commercial Real Estate Debt – First Mortgage

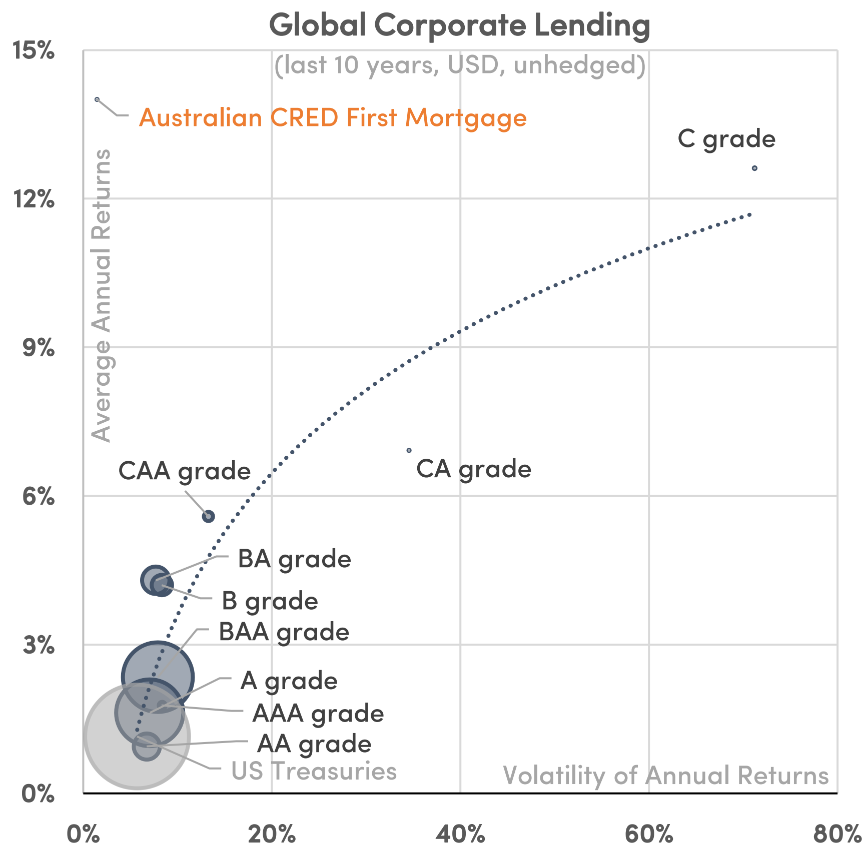
Grade assessment

For wholesale and institutional investors exploring their investment **options in credit markets** – public and private – there are numerous and nuanced strategic choices to consider.

- Take the **corporate loan market** as an example of these choices. Investors have to assess the investment risks arising from the borrowing counterparty, often encapsulated in a corporate credit rating, to determine their potential risk exposures, and whether that aligns well with their returns expectations.
- At one end of the spectrum, we have top-tier **AAA-grade borrowers**. While these higher-quality borrowers come with relatively low repayment risks and low levels of return volatility, the aggregate return profile is very modest, only slightly higher than sovereign bonds.
- At the other end of the spectrum, we have lower-tier **C-grade borrowers**, where returns are relatively more enticing – at double-digit levels – but they come with much higher degrees of repayment risks and volatility in returns. Certainly, this is a higher-octane strategy that is not necessarily well suited for many investors.
- In this context, we can use these public credit market benchmarks to position private credit strategies like **Australian commercial real estate debt**, where historical returns have been more comparable to C-grade corporate loans, with return volatility more comparable to AAA-grade corporate loans, even when we translate this from AUD to USD (with its added currency volatility on an unhedged basis).

Altogether, there is a wide array of historical credit market outcomes, in terms of market structure and total returns. **Australian commercial real estate** debt stands up well historically among these benchmarks, consistently demonstrated by delivering resilient returns across different parts of the economic and interest rate cycles.

Looking across the different grades of corporate loans globally, there is a familiar spread of historical returns and volatility, ranging from the prime investment grades to the sub-investment grades



Source: Bloomberg, MaxCap Group (June 2025)
Past performances are no guarantee of future returns

Seeking diversification

While there are clear historical differences in average returns across credit market segments, there is an equally important consideration in terms of **cyclical and synchronised return** trends, and what that means for investor portfolio diversification.

- Certainly, we have seen considerable **cyclicality in returns** in recent years. The combination of higher interest rates and cost inflation was very detrimental to investment returns in 2022, across a broad range of public and private asset classes.
- Specifically, there were broad and adverse **credit market impacts** as well, with synchronised losses across most credit segments, from sovereign to high-yield bonds. That said, commercial real estate debt continued to deliver resilient returns, without a similar drawdown.
- For now, there are **similar concerns for 2025**, as persistent uncertainty over trade tariffs drive another round of diminished economic growth, increased price inflation and elevated capital market volatility, with predictable impacts for both equity and credit returns.

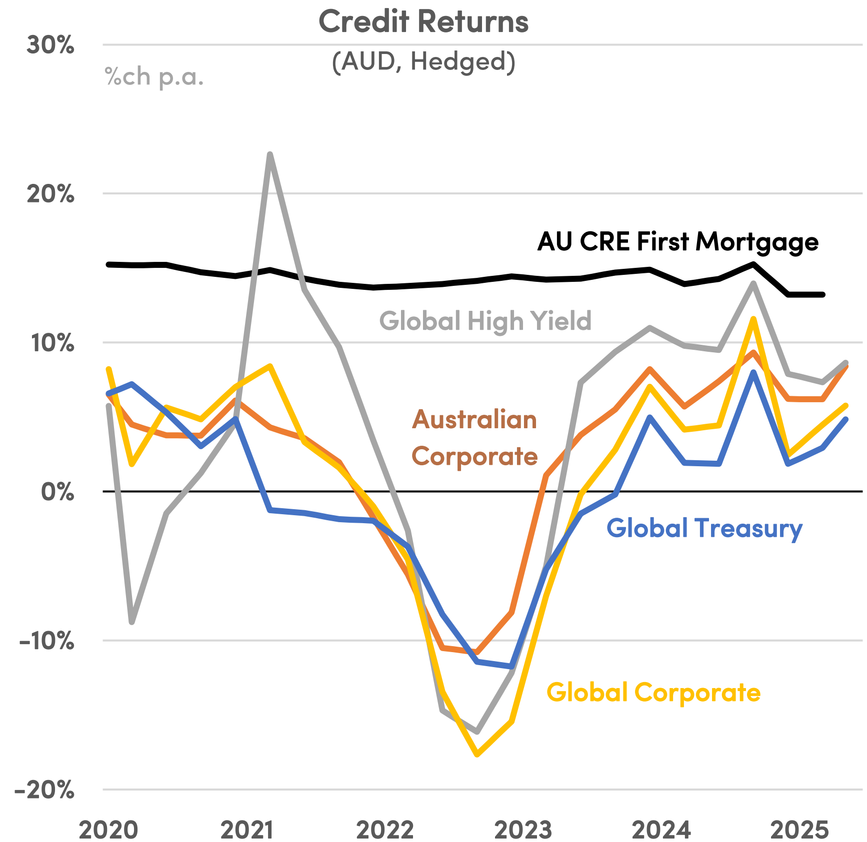
This **lack of diversification** across asset classes is greatly concerning.

- Indeed, after the synchronised pullback in returns in 2022, and rising risks of another stagflationary episode in 2025, investors are urgently seeking **lost diversification benefits** for their portfolio, with asset classes that offer more consistent and less correlated returns.

Meanwhile, the market outlook continues to work **in favour of private credit** segments like Australian commercial real estate debt.

- While the external outlook for the **Australian economy** is set to soften on the back of disrupted global trade flows, market expectations of further rate cuts in 2025 will go some way to support domestic demand, particularly for interest rate-sensitive sectors like housing construction, especially amid a persistent shortage of housing.

Many credit market segments have seen significant degrees of cyclicality in returns over time. The high degree of returns correlation across these segments points to a concerning lack of diversification



Source: Bloomberg, MaxCap Group (June 2025)
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