WFF Autumn Macro Economic Round-Up

Women in Fund Finance ("**WFF**") is a sub-committee of the Fund Finance Association. WFF focuses on increasing the engagement, recognition and promotion of women leaders in the alternative investment fund finance industry. In this 'Macro Economic Round-Up', the European WFF Committee has reached out to market leaders to share their views on certain current affairs which are bound to have an impact on the macro-economic in the near future, and by way of default, which will also shape the fund finance market as we head into the fourth quarter of 2024.

Due to the looming US elections due in November of this year, this 'Macro Economic Round-Up' has focused on the US market and how the outcome of events there could influence the global economy. The European WFF Committee would like to thank all of the contributors for taking the time to participate in this publication. This '**WFF Autumn Macro Economic Round-Up**' will be the first in a series of macro-economic roundups, so please look out for future publications which will focus on different markets in turn. If you would like to learn more about WFF, please visit our website at www.womeninfundfinance.com.

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Interest Rates – The prevailing wisdom seems to be that we should get used to 'higher for longer', do you agree?

AA: We believe that inflation has levelled up and we will begin a rate normalization period. As outlined in the August edition of Moody's Ratings' Global Macro Outlook 2024-25, the Fed began rate cuts in September and we expect it to lower the fed funds rate another 150 bps by year-end 2025. Therefore, our forecast is 3.5% for the Fed Funds rates by year-end 2025 and 3% thereafter. More imminently, front-loaded policy easing is possible if the labor market continues to weaken. Other major central banks have already cut rates to align with economic realities and will continue to normalize their policy stances.

DDS: It is expected in the US that the Federal Reserve will begin easing its monetary policy this year as inflation is showing signs of moderating. The market has already projected and priced in anticipated rate cuts of ~100 bps, and most recent updated economic data accelerated the first rate cut amount to 50 bps. From my personal day to day experience inflation does not appear to be under control. Prevailing market data indicates lingering or continuing inflation, will be an ongoing influence that may mitigate the present rate cut mind set. The marketplace is in a fluid state subject to many less predictable influences such as our elections and the geopolitical climate worldwide.

Above said, companies, thanks to generally strong liquidity positions and balance sheet management, have proven resilient in the face of an elevated rate and borrowing environment which should be viewed as a helpful tailwind in avoiding recession conditions as rates decrease. The use of corporate revolvers, which is a leading indicator of financial stress in corporate balance sheets, has remained in normal utilization levels, 20-30%.

PD: The moderation in inflation and increasing concern about the full-employment side of the Federal Reserve's dual mandate means we expect it to follow up the jumbo 50 basis point (bps) cut it did in September with two more 25bps cuts this year and then 125bps of cuts next year. Chair Powell has argued that this "strong start" is a sign of the Fed's commitment to avoid falling behind the curve, suggesting the central bank will ease proactively as it attempts to secure a soft landing. Our work on equilibrium interest rates means we expect the endpoint of this cutting cycle to be just below 3% on the fed funds rate.

Recession / Growth – are you concerned that there may be a sustained recession (i.e. beyond a 'technical' one)? Or are you quite positive about growth prospects?

DDS: Although the US has had obvious signs of economic slowing with certain sectors struggling, we may not have met the technical parameters of recession. Considering technological innovations, strong consumer demand, and fiscal policies intended to stimulate the US economy, I believe prospects for growth remain positive, company liquidity has been helpful.

The outcome of the US elections will be consequential to our future.

PD: The US and broader global economy are clearly slowing. Consumers' savings stockpiles are almost depleted, interest rate-sensitive sectors such as manufacturing and housing are struggling, and the fiscal impulse is fading. Most concerningly, the US labour market is cooling and unemployment is rising. This has triggered the "Sahm rule", usually an indicator of impending recession.

However, at abrdn our baseline forecast remains for a soft landing, with US growth slowing from 2.6% in 2024 to 1.7% next year, but remaining positive, supported by material interest rate cuts. That's because the signal from rising unemployment is weaker this time around, given that it's being partly driven by rising labour supply from immigration and higher participation. Meanwhile, corporate profitability is still robust, mortgage delinquencies are low, and measures of household

net worth are close to record highs. In addition, the moderation in sequential inflation back to target-consistent rates should support sentiment and real income growth.

That said, we think that "hard landing" has replaced "no landing" as the key risk to the global cycle. While our quantitative recession risk models, which incorporate a broad range of US economic data, are not flashing red, they have been creeping up recently. This shift in the risk environment means the equity-bond correlation may start to turn negative once again.

AA: The US economy has outperformed its pre-pandemic trend. Normalization entails a deceleration to still-strong long-term trend growth rates, though recent downward revisions to employment suggest risks to the real economy are becoming more apparent. When we think about what could substantively scupper our baseline expectations, the most immediate issues that come to mind are the Fed's ability to engineer a soft landing and the outcome of the US presidential election in November. A sharp US slowdown would have significant negative spillovers to other regions including Europe, China and emerging markets through trade — including tourism — and financial channels.

Elections – can you summarise how elections in your jurisdiction this year have affected your outlook for Q4 and 2025? In the US Presidential Election, who do you think will win?

PD: Our baseline forecasts are conditioned on a Kamala Harris victory in the US presidential election, given her current lead in the polls. However, the race is close to a toss-up, and Trump still has a lead on perceptions of handling of the economy, and Republicans have a structural advantage in the electoral college given the national distribution of votes. So we are undertaking plenty of scenario analysis looking at the possible impact of a Trump presidency. One scenario could see tax cuts and reregulation give a boost to risk assets. However, another scenario could see Trump pursue growth-hurting inflationary policies such as tariffs, coupled with political interference at the Fed, which see risk asset sell off. A common through-line of these different versions of a possible Trump presidency is likely to be higher yields, more inflation, and a stronger dollar, than would otherwise be the case.

In the UK, the next big political event following the Labour victory earlier this year is the October budget. With fiscal space very limited, the budget will involve material tax increases. Having ruled out increases to the rate of income tax, national insurance, VAT and corporation tax, the government is likely to increase a number of smaller taxes, with an increase in capital gains tax, reductions in relief on pension contributions, and an increase in employers' national insurance all possible.

It's possible that these will become a headwind to growth and sentiment in time. The government is likely to tweak the way in which monetary operations interact with the fiscal rules to reduce the impact of Bank of England losses on the public finances, although we expect this to have a limited market impact.

AA: I will leave the election prediction to the pollsters. Regardless of the US election outcome, the new and future governments will need to deal with structural issues around substantial deficit funding and ensure our economy remains competitive for future generations. That is why both responsible fiscal policies, maintenance of free capital markets as well as constructive immigration and education policies are critical to maintain the U.S. as a leading economy and innovation hub of the world.

> Ana Arsov: "Regardless of the US election outcome, the new and future governments will need to deal with structural issues around substantial deficit funding and ensure our economy remains competitive for future generations"

DDS: In 2024, a series of local, national and supranational elections are already impacting the global marketplace and will have repercussions for years to come. Both promising and concerning are emerging technologies like AI, cryptocurrencies and unease with security, privacy, misinformation and the proliferation of "deepfakes". Complicating all these developments is the lagging regulatory environment straining to keep up.

As for US elections, the choices are stark with our presidential candidates. The first challenge for voters to overcome is to separate the personalities from the policies. It is plain to see the policies of the present administration are responsible for an atmosphere of inflation, an immigration crisis directly impacting crime and security in many cities throughout the country with commensurate economic consequences not yet fully appreciated. Many feel the policies of the current administration bear responsibility, in great part, for the atmosphere of global instability we are experiencing today.

The previous administration oversaw a period of economic vitality, low inflation, a controlled border and a more stable global environment. Of course, that is not to say there were not important issues and disagreements on policy choices, but each administration bears responsibility for what happens on their watch. The election outcome and its implications involve significant uncertainty around policy priorities and the potential for political and geopolitical stability.

AI – overall, do you think AI is a good thing? And where do you think it will have the biggest (positive or negative) impact in your field?

AA: Artificial intelligence (Al) usage among financial institutions is not novel. Major banks have been using it to enhance their compliance and other operational tasks where large data sets are required to help in monitoring for suspicious activities. Quantitative trading firms deploy high and medium frequency trading strategies trained using large language models. The advent of generative Al has enabled a wider use. For example, institutional investors are increasingly leveraging Al to enhance their day-to-day investment processes, and usage will likely soar as the technology advances.

However, harnessing Al is fraught with technical and organizational challenges and requires close collaboration among multiple stakeholders. It needs executive support, significant capital investment, and highly skilled teams, giving tech-savvy, deep-pocketed investors a decisive advantage.

Although Al's role will likely grow, it will augment rather than replace human judgment. Some of the risks is that all Al models, whether generative or traditional, typically perform well in situations similar to those they have encountered during their training and they struggle with novel or unusual circumstances. For example, an algorithm trained solely on data gathered during a period of economic stability is unlikely to perform well during a financial crisis.

Al models will also malfunction if they are fed with incorrect or fake data. Specifically in the field of credit analysis and loan underwriting, Al can help process data faster and achieve better operating efficiency, but the ultimate judgment call, particularly in complex corporate transactions, will be subject to human touch and analytical layover for foreseeable future.

DDS: Overall, I believe that AI is a value add to our future. It is also commonly understood that there are significant risks of misuse in the development and management of AI technologies.

Dramatic positive impacts are already realized in efficiencies and automation, enhanced analytics, innovation and personalization of the user experience. From my industry vantage point, I see AI applications including credit risk assessment, fraud detection, compliance administration, enhanced deal sourcing, due diligence and other operational efficiencies. These benefits apply broadly to the alternative sector, banking, law, private equity, credit, real assets and more. An important overall benefit is the ease of increased transparency across all disciplines. AI is going to influence talent planning in all sectors.

PD: We are cautious optimists on AI's eventual productivity and labour market impact, but also think it will have widespread implications for distributional outcomes, regulation, and even geopolitics.

AI has the hallmarks of what economists call a "general purpose technology" - pervasiveness, continuous improvement, and innovation spawning. The lack of a measurable macro-level productivity impact thus far is not a good reason to downplay its potentially transformative effect, because previous general purpose technologies have taken time to raise productivity.

Economic history suggests that job creation and productivity enhancement from technological change more than outweigh job destruction over the long run. That said, one risk is that the scope of job types under threat from AI means this time is different.

Certain sectors will be outsized beneficiaries from AI. In the near term, these are 'enablers' like chip manufacturers, 'scalers' such as platforms, and 'early adopters'. In the long term, those with large numbers of knowledge workers and lots of administration, such as finance, education and the law, are the biggest beneficiaries from the perspective of capital, but potential losers from the perspective of labour.

Governments and regulators face a pacing problem whereby the rate of innovation is so rapid that policy struggles to keep up. We anticipate a wave of AI regulation, focused on human oversight, accountability of decision making, privacy, and bias.

Finally, AI hardware and software will become a new locus of geopolitical competition. Export bans of leading edge graphics processing units are already part of the arsenal of US-China rivalry. The values embedded in AI decision making, and its dual-use military and commercial applications, raise the prospect of a cyber arms race.

Conflicts – do you expect the conflicts in Ukraine, Gaza and between China and Taiwan to continue into 2025? Do you think approaches to these wars has had a material impact on voters in your jurisdiction?

DDS: Sadly, I do expect these conflicts to continue along with the anxiety and insecurity levels factored into all societal decisions and behaviour. I do feel approaches to the current wars and other current conflicts around the world which are escalating have a material impact on US voters.

PD: In Ukraine, our base case is for a continued ongoing conflict, with fairly limited global macro and market implications. But much depends on wavering and uncertain Western support for Ukraine. Even under a supportive US President, US political divisions are preventing military aid being delivered, with direct consequences for Ukraine's war outcomes. A Harris presidency would likely continue current support, though the political environment in Congress will determine whether aid requests would be fulfilled. The election of Donald Trump would make policy more unpredictable and affect the cohesion of the pro-Ukrainian international coalition. Trump has pledged to end the war, effectively enshrining Russia territorial gains. His eventual foreign policy advisors will be key to determining whether he follows through on this pledge.

In Gaza and the broader Middle East, we expect ongoing regional instability but not an escalation into full-scale regional conflict of a sort that would have big global macro and market implications. Nevertheless, that is the key risk scenario, which we use in stress tests. Iran and Israel have demonstrated a willingness to carry out direct military action against one another, while the conflict between Israel and Hezbollah in Lebanon is intensifying. In our risk scenario, Iran and its proxies and Israel become caught in an escalatory cycle, disruption to shipping through the Red Sea spreads to the Strait of Hormuz, and oil prices rise substantially, with spikes to $150 possible. Global central banks cannot look through the inflationary consequences, given the previous inflation overshoot, and the nascent interest rate cutting cycle returns to hikes.

Finally, we think the risk of a conflict over Taiwan is low but increasing. The US election outcome and broader policy approach to Taiwan represents the biggest risk to the status quo with China. Both Trump and Biden have made statements that undermine US strategic ambiguity. Should this become a persistent trend, it could lead to a meaningful shift in risks relating to cross-strait stability. China may become more emboldened over time to increase grey-zone actions and other

indirect attempts to further the cause of unification. In extremis, a blockade or invasion is plausible, if unlikely.

AA: Global economic and financial integration is at risk of stagnating. The ongoing and brewing conflicts in Europe, the Middle East and Asia add significant uncertainty to the macro-outlook. The unpredictability of geopolitical conflicts and difficulty in measuring their economic outcomes make geopolitical risks particularly tough to assess and plan for. Nevertheless, the funds and banks which will be winners in disrupted world, are the ones that stay vigilant and ensure ongoing and evolving risk and scenario analysis, avoiding concentration risks, while remaining well-funded and capitalized.

General Outlook – to end on a positive note, what are you most excited about in the world of (fund) finance for 2025?

PD: Cooling inflation, broadening interest rate cuts, and a soft landing in the economy can be a decent macro backdrop for a wide range of assets to perform, and to encourage investors to come on out of cash and into markets. There will be inevitable volatility in macro and markets over the next year, just as there has been over the previous year. But economies are in the early innings of a sustained rate cutting cycle, which increases the opportunity cost of sitting on the sidelines and supports the deployment of investor capital.

> Paul Diggle "economies are in the early innings of a sustained rate cutting cycle, which increases the opportunity cost of sitting on the sidelines and supports the deployment of investor capital"

AA: The strong growth momentum in the asset management industry means that its funding will become more complex and draw greater investor and regulatory scrutiny. At the same time, banks' ability to act as the traditional provider of funding and leverage will remain constrained due to the increasing and evolving capital and liquidity rules to de-risk their balance sheets. This will require the distribution of those risks among insurance companies and other asset managers.

Therefore, Moody's has a role to play for both investors and originators with its analysis and ratings. I am thrilled that we have a global, highly talented and experienced team that is focused on private credit and fund finance to stay on top of these developments with our thought leaderships and risk assessment expertise.

> Dee Dee Sklar "The number of rating agencies that are now willing to rate sublines and NAV facilities has increased over the past few years. This development will help many non-US lenders significantly as they look to navigate the new Basel requirements and will likely bring more lenders to invest in fund finance."

DDS: The outlook for 2025 is promising with expected resilience, innovation and continued availability of capital. The growth in structured products and the increased numbers and types of capital providers continues to support a robust marketplace for fund finance solutions. Continuing changes in the regulatory environment is a challenge that has, so far, been offset by non-bank lenders, insurance innovation, and capital market innovations often combining to create flexible alternatives. The number of rating agencies that are now willing to rate sublines and NAV facilities has increased over the past few years. This development will help many non-US lenders significantly as they look to navigate the new Basel requirements and will likely bring more lenders to invest in fund finance as it becomes a relatively short term, well rated and reasonably priced asset. The number of lead agents has increased over the past few years as has the number of participant banks, with several expanding their product suite beyond the traditional subscription lines. The large number of lead agents and participants in established markets will continue to increase.

In 2023, the size of the SRT market was reported at $18.5 billion however the expectation is that 2024 volume is much larger and the increase in the number of counterparties has decreased pricing while increasing liquidity. SRTs are becoming a standard tool for banks. Geography has also been an interesting trend to watch as increased capital and lending participation is coming from the Middle East, Asia (ex-Japan), and the less traditional parts of Europe (Scandinavia, Spain etc). Product growth and innovation has been rapid for both fund leverage and capital raising solutions. Rated feeders, CFOs, NAV financings, and now by product; structures like Feeder CLOs and other structures are continuing to show the creativity and resilience of the market to effectively solve issues and to improve and expand traditional solutions.

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Ana Arsov is a Managing Director, co-heading the Global Financial Institutions rating franchise for Moody's Investors Service, and a Global Head of Private Credit for Moody's. In her role, Ana fosters analytical and issuer coverage for the growing private markets between financial institutions, leveraged finance, and securitization markets.

Ana joined Moody's in 2013, bringing experience in analyzing financial institutions and managing credit professionals. She served as the Global Co-Head of Banking from 2021-2023, previously holding the position of Managing Director overseeing global investment banks, securities firms, and specialty finance ratings. She co-authored Moody's rating methodologies for finance companies and securities firms and led the development of Moody's counterparty risk rating.

Before Moody's, Ana held executive roles in credit risk management at several prominent banks. At UBS Investment Bank, she was responsible for North American financial institutions. She served as Head of Global Portfolio Management-Credit Risk Management at Morgan Stanley, where she managed risks across trading and lending businesses and led key initiatives for Morgan Stanley Bank N.A. Starting her career at Lehman Brothers, she eventually led the North American Financial Institutions and Structured Finance team and later contributed to Lehman's bankruptcy resolution.

Ana holds a Master's Degree in Management from Boston University and a Bachelor's Degree in Business from Pace University, New York. Ana also holds a certificate in Board Governance from Harvard Business School.

Paul Diggle

Chief Economist
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Paul Diggle is abrdn's Chief Economist, leading the Global Macro Research team. He heads a team undertaking macroeconomic research and analysis, global economic forecasting, and political risk analysis, to drive better investment decisions. He has substantial experience as a market economist, and is a regular presenter with clients and the media. He also co-hosts a podcast discussing all things economics and politics called Macro Bytes.

Paul joined abrdn in 2015. He previously worked at Capital Economics, the leading macroeconomic forecaster, where he sat on the US and UK economics desks. He started his career at Volterra Partners, where he developed credit risk models for banks.

Paul graduated with an MA in Philosophy, Politics and Economics (PPE) from the University of Oxford, and went on to gain an MSc in Economics from Birkbeck, University of London

Paul is originally from Jersey, one of the Channel Islands which sit off France. He has also lived in Cyprus, Germany, and Ireland. After a stint in London, he is now settled in Edinburgh, Scotland, with his young family.

Dee Dee Sklar

Global Co-Head
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Dee Dee Sklar is a Board and Advisor Candidate. As a senior banking executive with global experience in banking and alternatives, she has managed global businesses providing financing and other solutions to private equity firms, portfolio companies, and asset managers across three international banks. Dee Dee retired from her role as Vice Chair, Subscription Finance (and prior Global Head) at Wells Fargo. She remains Global Co-Chair of Women In Fund Finance and is a part of the Fund Finance Association's business development initiatives.

Dee Dee is currently a Nuveen Churchill Private Income Fund (PCAP) Board Member, a Coller Capital Senior Advisor, and prior on Atalaya Capital Management Business Advisory Board (acquired by Blue Owl Capital); a prior a 17Capital Supervisory Board Member (acquired by Oaktree Capital). She has advised two women founded firms, The Artemis Fund and TealBook (through Series B) and served as a diligence advisor to two private equity sponsor acquisitions.

She started her career in finance with a real estate asset manager investing debt and equity in commercial real estate on behalf of Insurance Companies, moved into Securitization of multiple asset classes for two global banks, headed financial institutions Americas and seeing an opportunity in 2004 within fund finance solutions built a business acquired by Wells in 2012. Always an advocate for women and diversity is a founding member of KPMGs Women in Real Estate Steering Committee, a member of NYSE ICE, Committee of 200, PEWIN, WAVE, a 30% Coalition Advocate Member and a founding member of EWOB. She is a regular speaker and contributor to publications.