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Institutional Investing Insights

The Gallagher Investments Practice
2025 Research Forum Insights

The Investments practice recently held its 15th annual Research Forum, a day-long event where investment professionals from external organizations share their views on a range of timely economic, financial and investment topics. We seek to glean from these presentations useful knowledge and insights that may influence our ongoing research initiatives and inform our recommendations to clients. This paper provides a summary of the topics discussed at this year's Forum and key takeaways by our team. Please watch for further updates on these topics and trends throughout the year as our Gallagher team keeps a finger on the pulse of topics that impact our clients' portfolios and asset pools. Please reach out to your Gallagher Investments Consultant with any questions.

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1. Macroeconomic Update

Speaker: Joe Zidle, Chief Investment Strategist - Blackstone

- Mr. Zidle believes the US economic environment will be characterized by healthy growth and a stable labor market.
- Blackstone's portfolio company CEOs are notably optimistic, with a large majority expecting higher margins in 2025.
- Blackstone anticipates the Federal Reserve's upcoming easing cycle to be shallower and shorter than historical precedents, reflecting the economy's strength.
- Mr. Zidle believes the next cycle will have more volatile rates, which are higher on average compared to the last cycle.
- The S&P 500 index currently trades at a price/earnings multiple of 25x forward earnings estimates, implying modest returns ahead, while small and mid-cap companies may face greater challenges from higher rates but with valuations that are attractive relative to larger companies.
- A significant shift toward productivity-driven growth is emerging, supported by substantial investments in technology and AI. This is creating unprecedented infrastructure demands, particularly in power consumption, with the US power grid transmission queue now double the total installed capacity.

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- Despite concerns about the size of the US federal debt, America maintains key advantages through dollar dominance and leadership in innovation.
- Mr. Zidle believes we are entering a "virtuous 2020s" cycle, marked by high investment, strong confidence, tight labor markets, and potentially falling inequality – a stark contrast to the "vicious 2010s" cycle of low investment and modest growth.

Key Takeaway: Given the potential implications of stronger economic growth on interest rates, specifically a "higher for longer" rate environment, clients may want to consider modifying their fixed income portfolios' beta exposure from a core to an intermediate mandate.

2. **Opportunities and Risks in US Equities**
   Speaker: John Forelli, CFA, Head of Portfolio Research – Boston Partners

- Using the S&P 500 index as a proxy for the broad US stock market, US equities appear expensive by historical standards. As of year-end 2024, the forward price/earnings multiple of the S&P 500, 21.3x, far exceeds its historical mean since May 1995 of 15.9x. Contributing to the S&P 500's multiple expansion has been the strong performance of the "Magnificent Seven" stocks, which at year-end 2024 had a combined market capitalization comprising just over 33% of the S&P 500 and an average trailing P/E ratio approaching 40x.
- Certain segments of the equity market, however, including value stocks across various market capitalizations as well as small cap growth stocks, appear more favorable from a valuation perspective than large cap growth stocks, trading near or below historical P/E ratios as of Q3 2024.
- Looking at past periods when high levels of market concentration existed (e.g., 1998-99 and 1972-73), the S&P 500 eventually experienced a multi-year broadening of performance with 60% or more of index constituents outperforming the index itself. In those cases, market downturns produced particularly large corrections across stocks that had grown to a disproportionately large percentage of the market.
- Investors with passive exposure to the broad market today are facing similar concentration risk. Should the market broaden, active managers that have struggled in recent years to keep up with their respective benchmarks while striving to maintain a diversified portfolio may be well positioned for a period of positive relative performance.

- Despite a shift in investor preference towards more passive, value-agnostic exposure to equity markets (particularly in large cap stocks), active value managers across market capitalizations have been successful in outperforming their respective benchmarks over long-term trailing time periods. Additionally, active small cap managers, across styles, have broadly outperformed their benchmarks over time.

Key Takeaway: Clients may want to consider the concentration risks inherent in passive stock market allocations and consider increasing portfolio allocations to actively managed strategies and/or areas of the market that could benefit from a broadening of market performance, such as small capitalization and value-oriented stocks.

3. **US Direct Lending: Facts Versus Fears[1]**
   Speaker: Susan Kasser, CFA, Head of Private Credit - Neuberger Berman

- The private credit market has grown at a rapid pace over the last decade, with a significant increase in capital raised by private credit managers. This has raised concerns among some investors and observers that future returns may be impaired due to "hidden risks" in the market, such as weakening credit quality, rising defaults, and/or rising competition.
- Neuberger Berman discussed why it thinks these concerns are overblown in relation to direct lending, the largest subset of private credit, which involves issuing loans to private companies, predominantly for leveraged buyouts (LBOs) backed by private equity firms.
- Key points Neuberger Berman presented supporting this view included:
  - Default rates on direct lending have remained below those on broadly syndicated loans (i.e., publicly issued loans), one reason being that recent vintage LBOs have been consummated with higher proportions of equity capital financing versus debt financing, which lessens the risk for lenders.
  - The amount of capital raised for direct lending has been commensurate with the growth of capital devoted to LBOs.

[1] *Note: the views and opinions expressed herein reflect those of the author/speaker and may not reflect those of Neuberger Berman or the firm as a whole.*

- Direct lending has taken market share in recent years from the broadly syndicated loan market, as borrowers favor direct lenders' ability to offer certainty of closing, faster execution, and greater flexibility.
- Yield spreads on direct lending investments over those offered on broadly syndicated loans have remained consistent.

- Neuberger Berman also noted, however, the importance of effective manager selection of direct lending strategies, as underwriting standards and risk management practices vary widely across managers.

Key Takeaway: Direct lending fundamentals remain solid, and the asset class continues to provide attractive risk-adjusted returns for clients that don't need immediate liquidity. Gallagher remains focused on identifying reputable direct lending managers that have competitive track records and high-quality sourcing, underwriting, risk management, and monitoring/workout capabilities.

4. Evolution of Target-Date Funds

Speaker: Lucian Marinescu, CFA, Head of Investments for Retirement - Morningstar

- The target-date fund (TDF) landscape is shifting toward streamlined product lineups, as exemplified by Vanguard's single target retirement series approach.
- Index-based TDF series account for the largest market share due to their lower fees (0.27% average versus 0.79% for active funds).
- There has been a strong shift toward using Collective Investment Trusts (CITs) as investment vehicles, especially among larger providers, due to their lower cost structure and customizability.
- Personalization trends are emerging through target-date plus features, including quarterly automatic rebalancing and data feeds from recordkeepers. However, guaranteed income and annuity integration remain limited to larger plans due to implementation challenges and low adoption rates.
- The inclusion of private equity as an investment option faces significant headwinds in the defined contribution space, primarily due to litigation risk, regulatory uncertainty, and high fees conflicting with the trend toward lower costs.
- The market is gravitating toward solutions that balance innovation with cost-effectiveness, emphasizing the need for clear value propositions and fee justification.

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- Success in this evolving landscape requires focusing on scalable, cost-efficient personalization while carefully evaluating more complex solutions for sophisticated clients.

Key Takeaway: Adoption of income-based annuities, private market investments and portfolio personalization within 401(k) plans has thus far been limited by plan sponsors given higher fees of such options and potential litigation. Additional challenges of providing such options include educating participants on these unfamiliar and somewhat complex topics.

5. **2025 Inside Real Estate Outlook: Poised for Growth**
   Speakers: Darren Kleis, Portfolio Manager, and Art Jones, Director of Commercial Real Estate - Principal Asset Management

- Commercial real estate markets have repriced lower over the past three years in response to higher interest rates and, in the case of office, weak fundamentals.
- Principal believes that this repricing cycle is complete for most property sectors except for the office and life sciences sectors, and that economic strength will support space demand, tenant stability, and transaction activity in the commercial real estate asset class going forward, even if interest rates remain elevated.
- Principal believes commercial real estate has entered a recovery phase, with stabilizing valuations and improving debt and equity capital flow.
- Principal's outlook on key sectors is as follows:
    - Data Centers: Principal's highest conviction sector, with AI-driven demand and rent growth between 15-30%, although the recent DeepSeek AI developments may briefly delay leasing decisions while the market digests the implications.
    - Residential: Demand remains strong as homeownership affordability challenges extend rental cycles.
    - Industrial: Tenant demand is resilient and rent growth has normalized. Tariff uncertainty may shift supply chains more domestically and can be a tailwind for the sector.
    - Retail: Selective opportunities, favoring high-quality tenants—a stock pickers market. It remains a stock pickers market in that not all retail will perform well. The highest quality centers and necessity (grocery anchored) retail will see the highest occupancies and rent gains.

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- Office: Significant distress continues, with capital markets hesitant to re-engage; conversions and demolitions are expected to accelerate. The flight to quality that is underway will continue.
- Healthcare & Senior Living: Long-term demographic tailwinds exist, but facilities are challenged by escalating labor costs and persistent operational inefficiencies that complicate their growth and profitability.

Key Takeaway: Clients with underweight allocations to private real estate may want to consider increasing their exposure to the asset class through closed-end private equity or debt-based investments. Gallagher is in the process of reviewing investment strategies that could be available to clients in the coming year.

6. **Artificial Intelligence**

Speaker: Dillon Edwards, AI Strategist – J.P. Morgan Asset Management

- Like many other industries, the investment management industry is trying to harness the potential efficiency gains of artificial intelligence (AI).
- At a simplistic level, the advancement of large language models (LLM) has allowed anyone, not just programmers, to effortlessly access and process large amounts of data.
- A basic use case for investment managers is using AI systems to summarize data quickly. For example, a research analyst covering a utilities company may utilize an internal LLM to distill an annual earnings report into its key themes or generate a bulleted summary of the company's key revenue drivers. Using AI in this way allows research analysts to allocate their time researching more specific questions that arise from this summary and/or cover a wider range of companies.
- Another potential differentiator is the ability to feed proprietary data into models that can provide unique insights.
- To have a secure and private system, an investment manager will need to spend potentially large amounts of money to develop their own proprietary LLM models.

Key Takeaway: Gallagher will continue to refine its evaluation of how investment managers employ AI in their research process. One question Gallagher will seek to address through its ongoing manager due diligence is how smaller, less capitalized firms will compete with the AI capabilities of firms with larger budgets and proprietary data sets. Gallagher is also testing potential uses of AI applications for its own manager research activities.

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