



2024 Private Markets Outlook

From headwinds to tailwinds

April 2024

Preface

There has been an abundance of media coverage and commentary around the private markets space in recent months. If you are to read one work on how the segment is shaping up in 2024 and beyond – including qualitative data that provides a big-picture view from institutional investors worldwide on topics like attitudes and allocations, opportunities and obstacles – we humbly submit that this report might be it.

What makes State Street’s third annual private markets report so distinctive? We believe it provides insights into manager and investor approaches to the asset class(es) not just at the macro asset allocation level but goes deep into the operational developments within those institutions to assess how they can compete in a future where private markets increasingly align with public ones on data standards and regulation.

As you’ll learn in these pages, the main themes that our research covers encompass: institutional investor sentiment toward near- and medium-term allocation and fundraising plans; how private markets investment does or doesn’t respond to our ongoing macroeconomic environment; and industry-wide implications of global government

and regulatory trends encouraging more domestic private markets investment, including making the segment more accessible to retail investors who had traditionally been excluded from this arena.

A significant high-level survey finding relays how, despite macro headwinds and a difficult private markets environment, institutional investors are largely digging in their heels, and committing to increasing their allocations in the near- and medium-term. This bullishness holds profound implications for the state of the broader investment landscape’s operational models, given another important survey takeaway: while clients suggest having outside growth ambitions in the private markets space, they recognize they cannot achieve these aspirations given current operational limitations and technology spend.

Poor quality and infrequent private markets data, challenges around interoperability, and impediments to achieving a whole portfolio view are persistent issues financial institutions are facing as they look to play more widely in the space. As private markets become more popular and accessible to investors, properly servicing this unique set of asset classes becomes keenly important.

With US\$3 trillion in private markets assets under custody and/or administration (AUC/A as of December 2023), more than 300 clients and 4,000 employees dedicated to the industry, we have made private markets a strategic priority and a growth driver for the business.

Survey pain points underscore how clients are seeking a consistent and connected platform with greater data transparency, insights to grow at scale, a streamlined and systematic approach to valuations, and reduction in manual processing to minimize operational risk.



Scott Carpenter

Global Head of Private Markets and Credit,
State Street

In other words, considering “smart sourcing” a holistic enterprise platform might present a sensible solution to investors with growing private markets goals, such as enabling more effective service provider oversight and compressing the private markets asset valuation cycle by bringing NAV finalization times down to make the private/public platform workable.

We will deep dive into that topic and more in future reports in this ongoing series about the changing dynamics in private markets.



Jesse Cole

Global Head of Private Markets Product,
State Street

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Survey methodology

In December 2023, State Street commissioned CoreData Research to conduct a survey of nearly 500 investment institutions worldwide, to understand their private markets investments and operations.

The respondents were C-suite and other senior, decision-making executives from a spread of traditional asset managers with private markets businesses, private

markets-only asset managers (including private equity, private debt, real estate and infrastructure), pension funds, insurance companies and other asset owners.

The key themes of the research were:

1

Near- and medium-term asset allocation and fundraising plans

2

Responses to the ongoing macroeconomic environment, in both immediate term investment strategies and long-term operational improvements

3

The global trend among governments and regulators towards encouraging more domestic private markets investment, including bringing retail investors into private markets

Key takeaways

Our third annual global survey of private markets shows that despite recent headwinds, institutional investors are digging in for the long haul and expect global regulatory developments to support sustained growth in demand for private assets. Key findings from our survey include:

- 1 The majority of institutions say they will increase their exposures to almost all private markets sub asset classes** (infrastructure, private debt, private equity and real estate) over the next two years and all of them over five years. Furthermore, institutions are likely to reduce public market allocations to fund increased private markets investment, with private markets set to make up nearly half of the average portfolio by 2028, according to private markets funds' managers.
- 2 There is a new demand for data platforms offering a 'whole-of-fund' view that allows institutional investors to see their private assets in line with the rest of their holdings.** As private markets holdings grow, institutions need to be able to view and analyze their exposure in the same way they analyze their public asset holdings. A quarter of respondents said the ability to do this would be 'transformational' for their private markets operations. This demand is leading organizations to challenge traditional obstacles to getting accurate and timely portfolio and holdings-level data for private assets.
- 3 We are seeing a new focus on better measuring risk in private markets assets.** Despite institutions seeing some respite from the macroeconomic headwinds of the past few years almost half (45 percent) said they were still struggling to justify relatively high-risk investments to investors who have leveraged themselves at higher costs than recently to access the asset class. Approximately, a third are seeking to take on less risk in their private markets portfolios in the future. Meanwhile, 19 percent are planning to increase risk in their private markets holdings to boost returns. Either way, the greater focus on portfolio data outlined above is tied to a strong focus on better measuring and assessing risk in private markets allocations. This is a significant impetus behind growing demand for improved access to data and technology.
- 4 Global legislative and regulatory developments will drive private markets demand by boosting government support for key industries and infrastructure priorities.** In particular, nearly half of respondents in North America and Europe expected legislations like the US Infrastructure Investment and Jobs Act and equivalent policies in the European Union and United Kingdom to boost private markets investment in their regions. Asian investors were less bullish but around a third said the same. Along with regulations targeted at growing high-net-worth retail and defined contribution investor bases for private markets funds through new fund vehicles, government interest in private markets is seen as a clear component of the planned portfolio growth.
- 5 A transformation is underway in private markets and across capital markets.** Private assets not only continue to take up portfolio share but are also treated more like public ones in how they are assessed, measured and even marketed to a broader range of investor types. This will have important implications for balance and liquidity in the global investment industry and for how companies raise capital. There will be an immediate impact in the investment that organizations will need to make in their private markets data and operations strategy, without which institutions may not achieve operational efficiencies to support their growth.

Introduction

In our 2023 Future of Private Markets Study,¹ respondents expressed strong concerns about the likelihood of an ongoing global economic environment in which high borrowing costs, fueled by inflation and low economic growth, made private markets investment more costly, difficult and risky, and arrested the rapid growth that private assets have seen over the course of the 21st century. The previous dataset painted a picture of an industry aware of the challenges it faced but uncertain about how to meet them.

A year later, the majority of both investors and their managers plan to continue growing their allocation to private markets.

The difference now is that they possess a clearer strategy for navigating these challenges, even as they anticipate the lingering effects of the difficult market conditions experienced in recent years to persist into the foreseeable future.

In our analysis, the data from this year's responses indicates a shift towards strategic, long-term planning in the face of an increasingly uncertain and challenging economic landscape.

This is the first report in a series based on our data that we will publish throughout 2024.

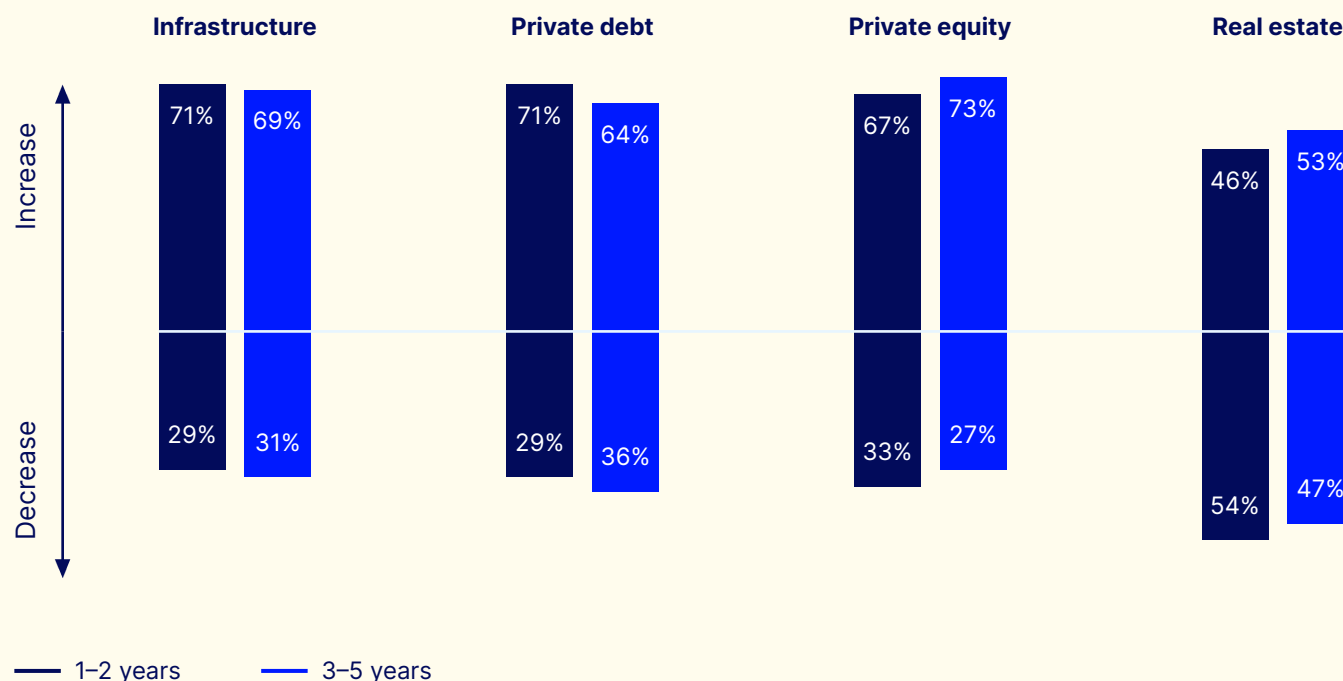
Demand grows despite macro headwinds

Growth of private markets asset classes has taken a hit so far this decade² due to the confluence of low economic growth and high inflation (and rising interest rates as a policy response to that inflation).

Our latest survey indicates institutions may view these macroeconomic pressures as easing, albeit with significant regional variations.

We also found that institutions expect the effects of the recent macro environment to continue to impact their ability to access private markets opportunities for the next few years, presenting challenges to their planned increases in allocations as shown in Figure 1 below.

Figure 1: Respondents expecting allocation increases to private market asset classes



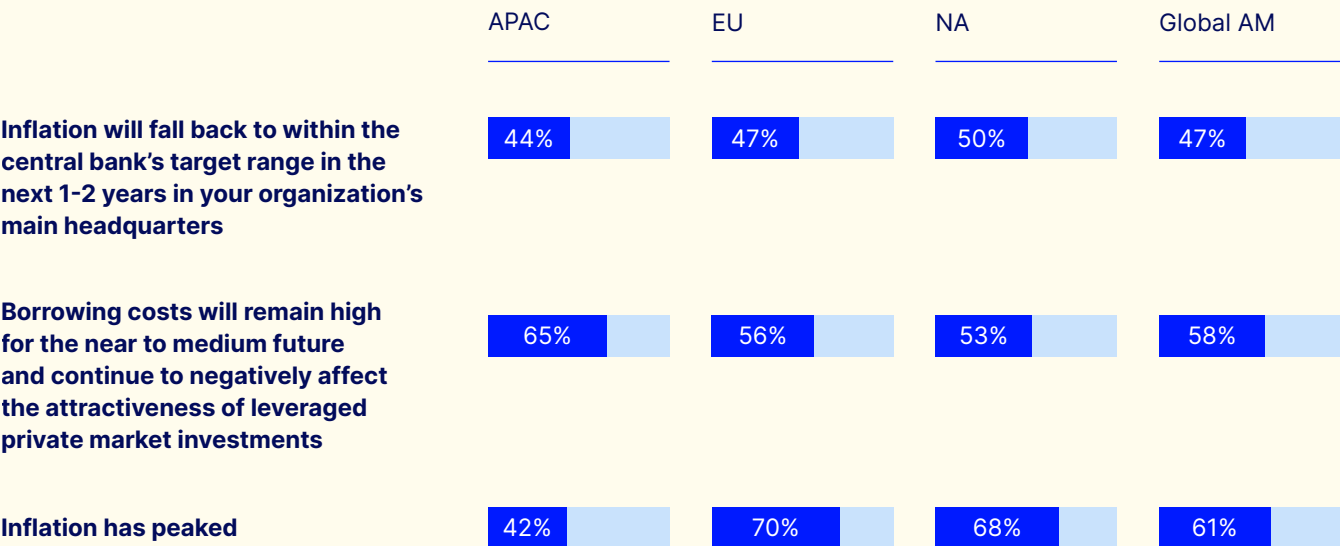
Source: State Street 2024 Private Markets Study

Globally, 61 percent of respondents said inflation in their regions had peaked, but fewer than half (47 percent) believed it would drop down to policy makers’ target levels within two years. Among organizations based in Asia Pacific (APAC), only 42 percent feel inflation has hit its peak. The majority of the respondents in all regions also agreed with the statement “borrowing costs will remain high for the near- to medium-term future” and this would “negatively affect the attractiveness of leveraged private markets investments” (see Figure 2 below).

Aligned with their perspectives on inflation, APAC respondents were significantly more bearish on rates than their peers in Europe and North America (65 percent expect

continued high rates, compared to 58 percent globally). APAC also represents the most diverse slate of national jurisdictions, as North America comprises only the United States and Canada, while European responses mostly come from the European Union (with the exceptions of the UK and Norway), which has a centralized monetary policy-making apparatus. Therefore, within APAC, there are more distinct differences in economic outlook, particularly in China (where only 10 percent believe inflation has peaked, and 30 percent believe it will be at target levels in two years). On the whole, Chinese respondents were considerably less inclined to believe that inflation would drop soon, than others in APAC.

Figure 2: Inflation and interest rate expectations



Source: State Street 2024 Private Markets Study

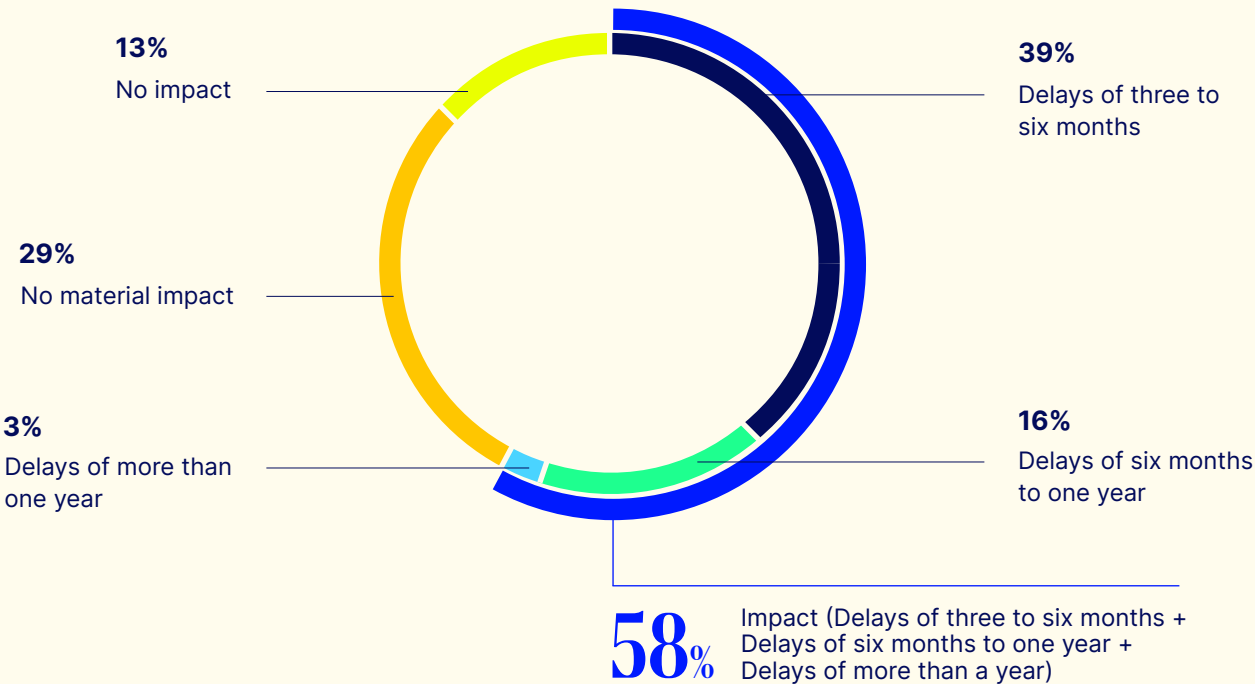
Furthermore, these economic conditions have had a material impact on the private markets industry, with more than half of respondents (58 percent) reporting average delays of at least three months to their deals (see Figure 3 below).

The effect on different asset classes was pronounced, with 100 percent of infrastructure-only managers suffering delays of three months or longer and 68 percent of private equity managers

saying the same. Meanwhile, only 50 percent of real estate and 42 percent of private debt managers reported material delays.

Despite this broadly pessimistic macroeconomic outlook, our research shows that institutional investors anticipate continuing short- and medium-term growth in their private markets allocations, with majority of respondents predicting increased allocations to almost all sub-asset classes (see Figure 1 above).

Figure 3: Impacts of market conditions on private market deals

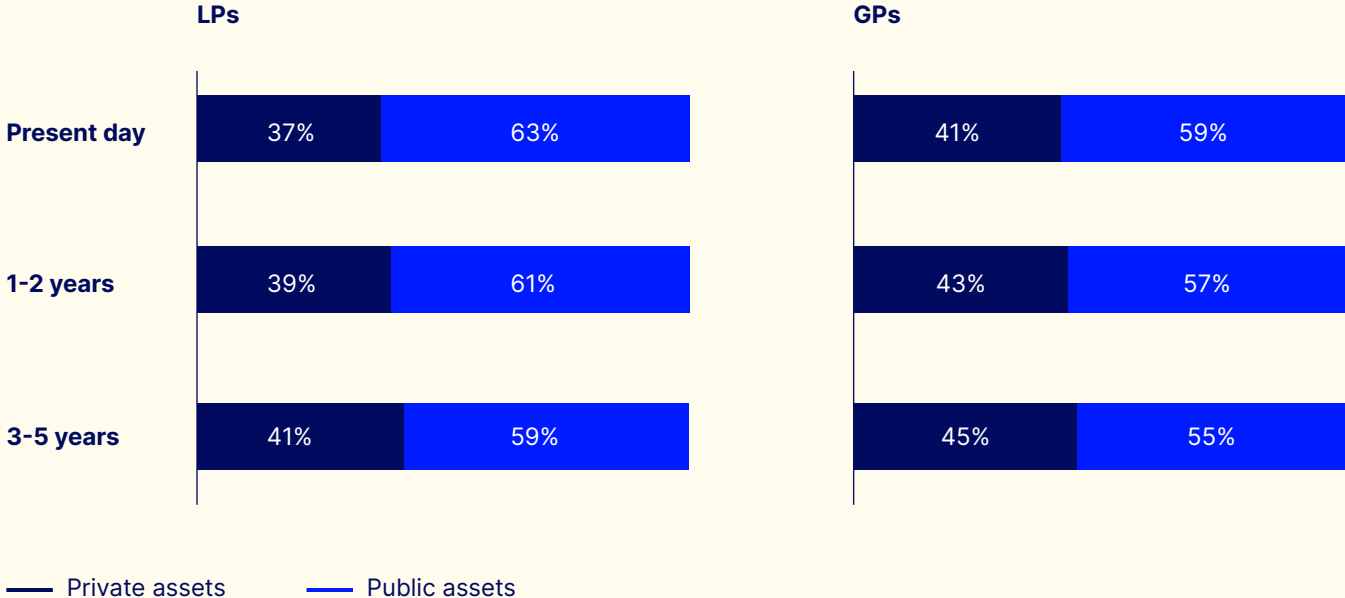


Source: State Street 2024 Private Markets Study

Respondents also anticipated this growth to continue to be at the expense of public markets allocations. Approximately, a third of respondents (36 percent) expect increased funding for private markets investments to come at the expense of reduced allocations to public markets assets, compared to just over a fifth (22 percent) who thought it would come from entirely new capital. Nearly a quarter (23 percent) expected a fairly equal combination of both decreased public holdings and new capital to account for their increases.

Both Limited Partner (LP) respondents assessing expected changes to their own portfolios and General Partner (GP) respondents considering their clients' allocations had a fairly consistent view of how private to public asset ratios are set to change over the near- and medium-terms, both expecting private markets to account for four percentage points more in the average portfolio (see Figure 4 below). However, GPs assessed the current level of private markets holdings in portfolios to be higher than LPs, leading them to predict that 45 percent of their portfolio mix would be allocated private markets investments within three to five years.

Figure 4: Current and expected private vs. public markets allocations (LPs vs. GPs)



Source: State Street 2024 Private Markets Study

54%

Majority of respondents said they would be reducing allocations over either assessed timescale

64%

APAC respondents expect to grow real estate holdings over the medium term, likely anticipating a return to growth in the Chinese real estate market

52%

Most North American investors still expect to divest from the asset class over the longer timescale

Closer analysis of the results shows there will be clear sub-asset class winners and losers within private investments as these portfolio holdings grow. In particular, real estate is the only asset class the majority of respondents (54 percent) said they would be reducing allocations over either assessed timescale. Even though this leads to 53 percent planning to increase allocations on a three-to-five year view, that number is largely explained by nearly two thirds (64 percent) of APAC respondents expecting to grow real estate holdings over the medium term, likely anticipating a return to growth in the Chinese real estate market, which has suffered from contractions in liquidity and construction.³

Most North American investors (52 percent) still expect to divest from the asset class over the longer timescale, while European investors were split 50-50 on increasing and decreasing.

The relatively low desirability of real estate is not surprising. It is a highly leveraged asset class and consequently susceptible to the concerns about longer term high borrowing costs expressed above. Real estate also faces a variety of endemic structural problems, in addition to the problems in China mentioned earlier, which have knock-on effects for other real estate markets.⁴

Despite numerous people returning to office post COVID-19, workplace attendance remains significantly lower than before the pandemic.⁵ Additionally, the physical retail space continues to be squeezed by a long-term trend towards online⁶ shopping, which was further exacerbated by the pandemic.

Infrastructure and private debt were the biggest winners. In the case of private debt, the larger than average percentage increase globally is partly a reflection of the relatively small size of the asset class to begin with, but also a sign of its growing importance among the private markets family?

Infrastructure, meanwhile, has become the beneficiary of a growing trend towards governments legislating to drive investment into their national infrastructure priorities. Examples include the US Infrastructure Investment and Jobs Act,⁸ the UK Mansion House Reforms⁹ and legislation to create

wrappers to enable more defined contribution and mass affluent retail investment into private markets, such as the EU's European Long-Term Investment Fund (ELTIF) and the UK's European Long-Term Investment Fund (LTAF).¹⁰

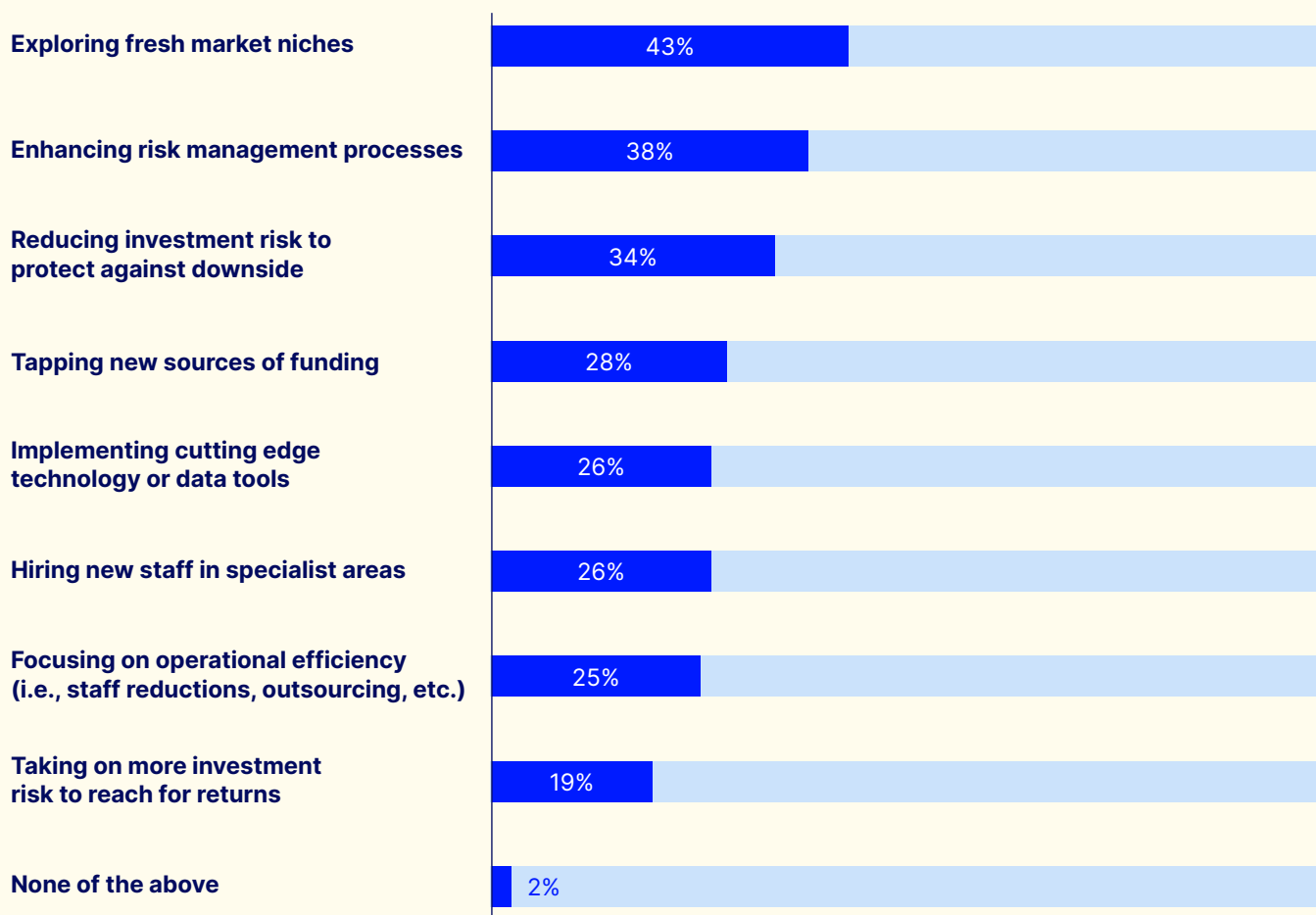
Given the real impact global economic conditions have had on private markets investments so far in the 2020s, and the expectation that these problems will persist into the medium term, government intervention is not going to be enough to enable institutions to achieve their stated portfolio growth ambitions. And, based on their responses, our survey participants recognize this. In their responses, they outlined clear plans to improve investment selection opportunities using targeted strategies for better data gathering and analysis.

New strategies for growth

Portfolio risk looms large in institutions' responses to the market and economic headwinds they face. More than half of respondents (53 percent) are deliberately either reducing or increasing the risk in their portfolios, with nearly twice as many de-risking than up-risking (see Figure 5 below).

A further 38 percent are enhancing their risk management processes and the most popular response (exploring fresh market niches, 43 percent) involves asset allocation adjustments with implications for portfolio risk.

Figure 5: Top responses to private market investment challenges

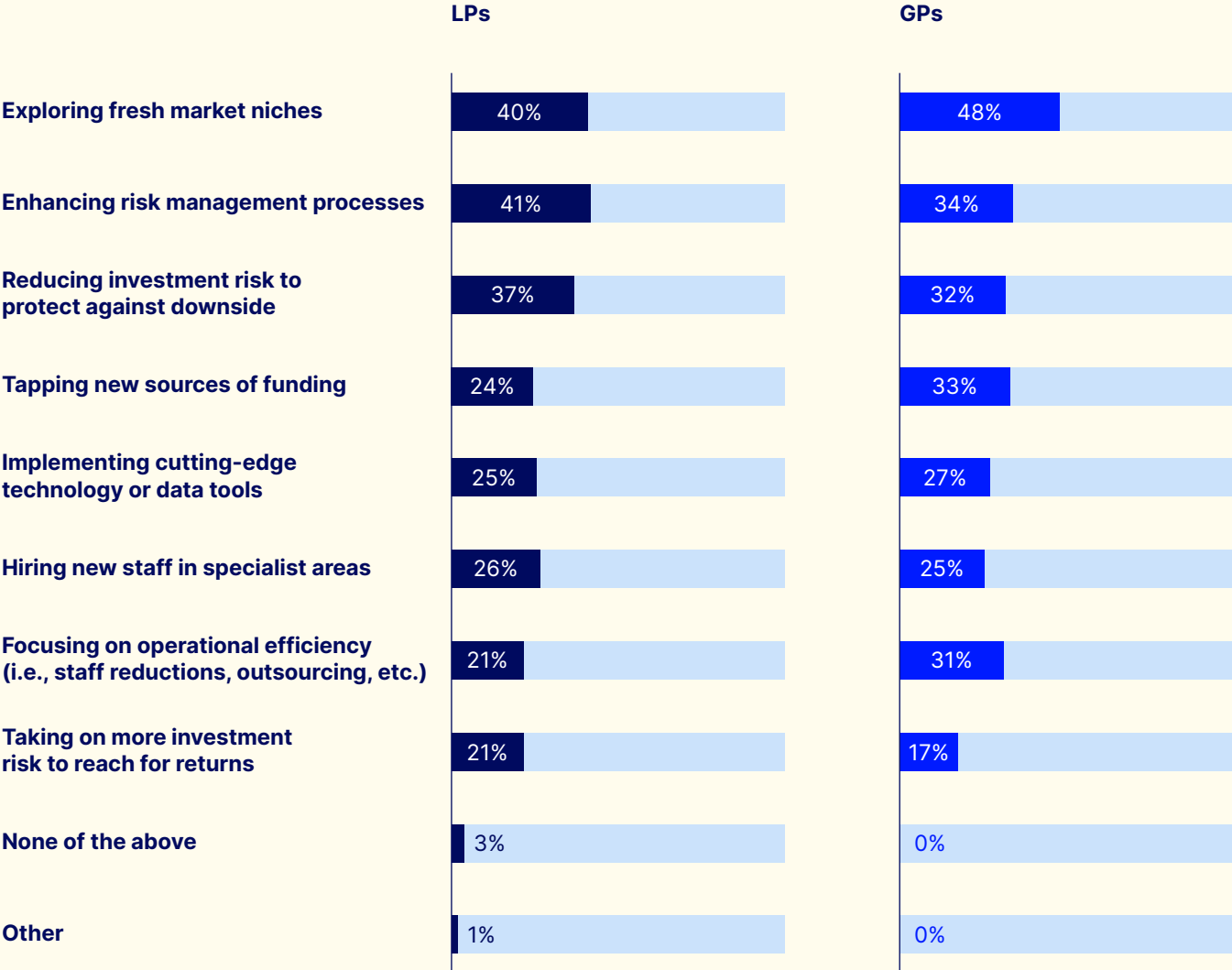


Source: State Street 2024 Private Markets Study

There were some nuances in the approach taken by GPs and their LP clients (unsurprisingly, GPs included broadening their fundraising sources as a top response),

but in their prioritization of assessing the risk in their private markets holdings and changing their allocations accordingly, they were quite consistent (see Figure 6 below).

Figure 6: Top responses to private markets investment challenges, GPs vs. LPs

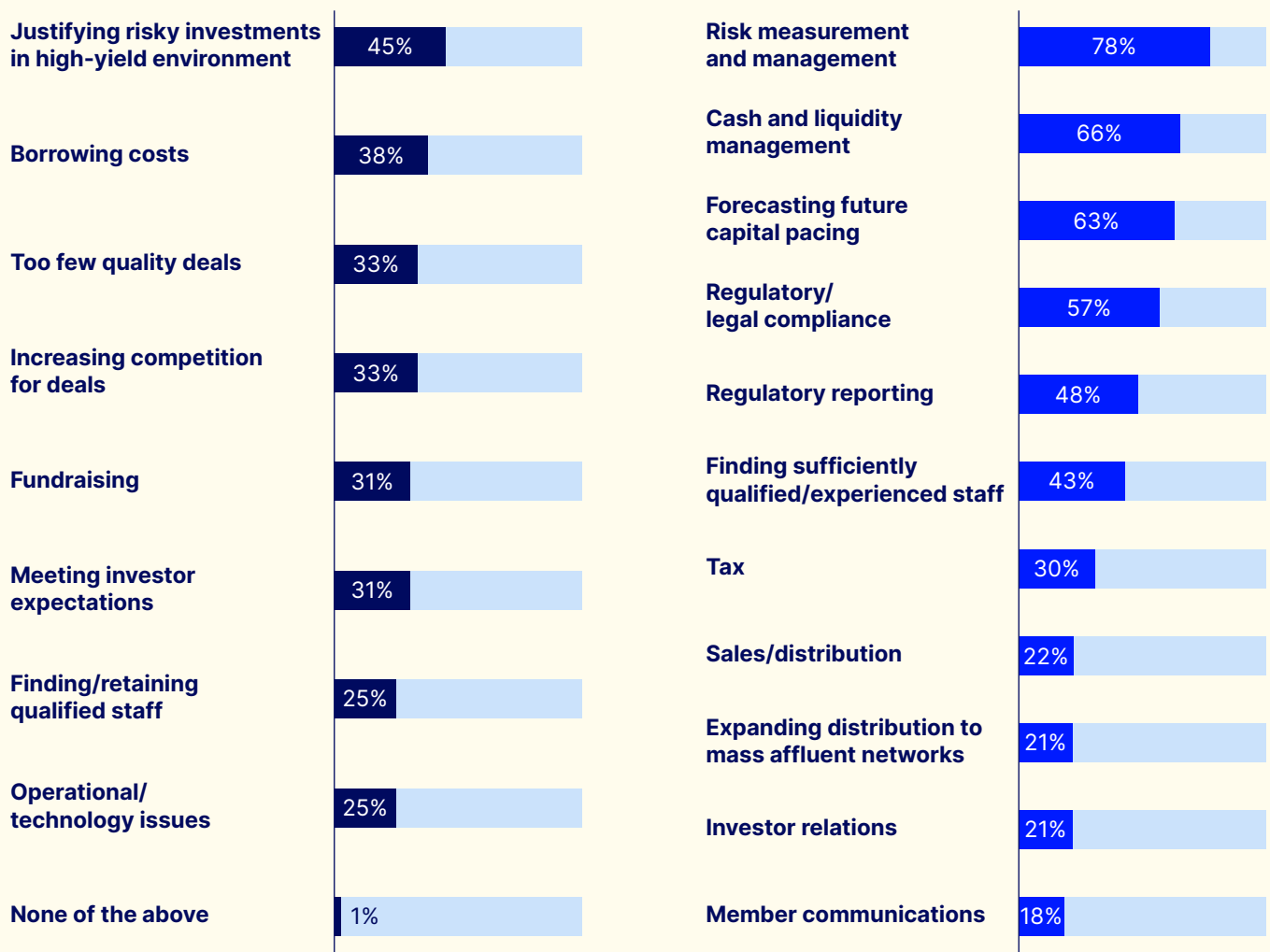


Source: State Street 2024 Private Markets Study

The biggest operational pain point for all respondents globally was risk measurement and management (78 percent). Almost half (45 percent) said justifying investment risk when the cost of leverage is high is their

biggest private markets investment challenge right now, higher than the cost of leverage itself and any other challenges (see Figure 7 below).

Figure 7: Investment and operational challenges



Source: State Street 2024 Private Markets Study

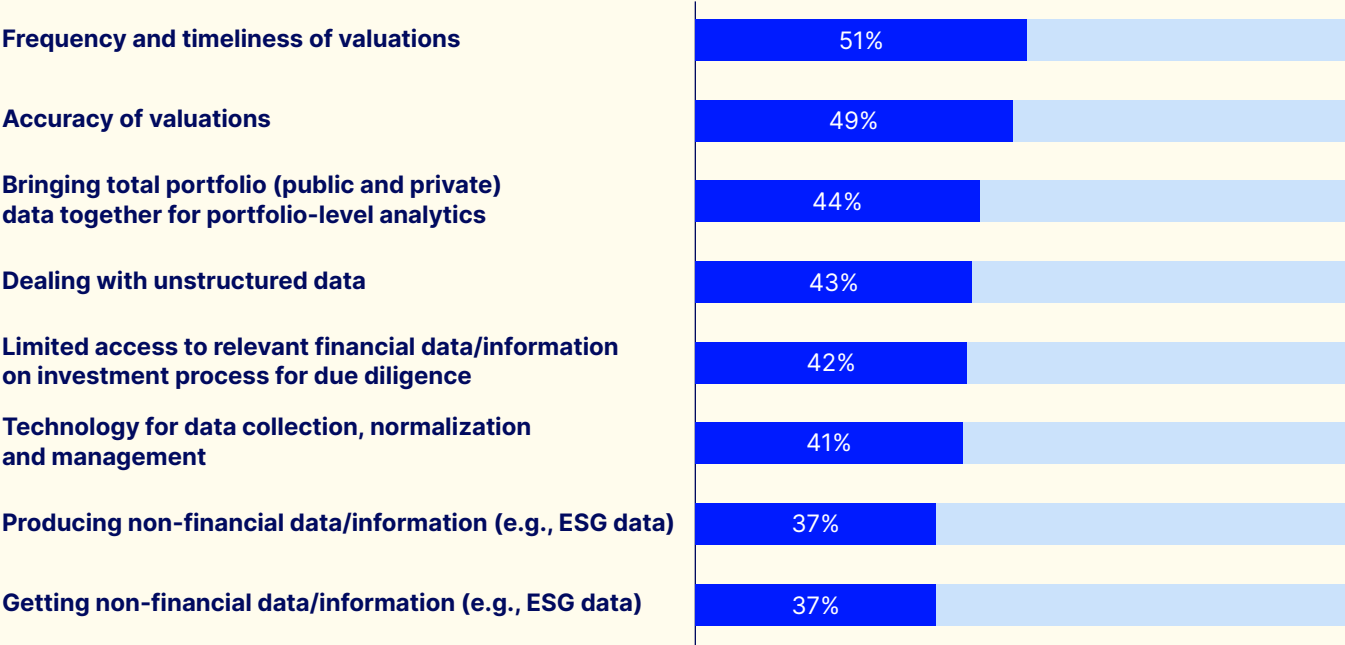
Both the investor client and manager sides of the market (as outlined in Figure 6 above) admitted to having trouble assessing private markets opportunities, presenting portfolio challenges from a risk perspective.

A significant minority (39 percent) of LPs did not rate their ability to perform due diligence on managers and deals as strong, while nearly half (49 percent) of GPs said the same of their ability to “find and access good private markets investment opportunities.”

In both cases, the data shows regional differences amongst respondents, with North American LPs and GPs indicating that they are more confident in their assessment capabilities than those in Europe or APAC. APAC respondents were the least confident, with a minority of GPs (48 percent) rating themselves as strong, along with only 55 percent of LPs.

Respondents were clear that data management is vital to making the operational improvements necessary for the portfolio adjustments and changes in investment style they are seeking to make.

Figure 8: Data challenges



Source: State Street 2024 Private Markets Study

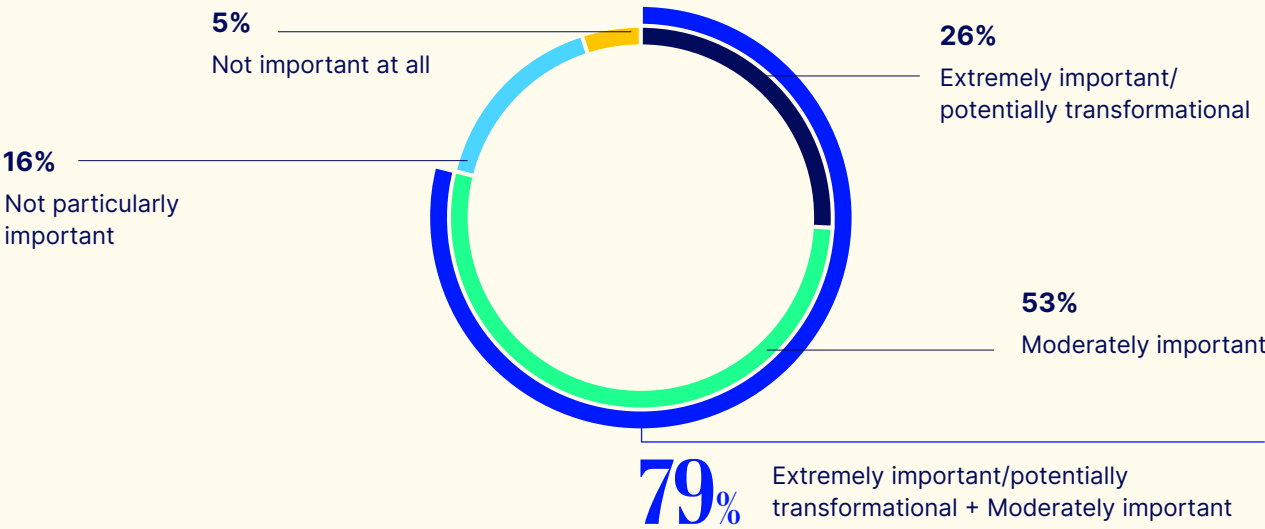
Challenges in acquiring good quality data with sufficient frequency are long standing in private markets. However, as the asset classes grow and governments attempt to bring more institutional investment into them, accurate and timely reporting is becoming increasingly scrutinized.

One thing that stood out from our research was that European respondents were less concerned about the frequency (42 percent called it a top concern) and accuracy (38 percent) of their fund valuations than the global average. They were, however, much more concerned with getting ESG and other non-financial data (52 percent in Europe, compared to 37 percent globally).

This is likely to be an effect of the EU’s Sustainable Finance Disclosure Regulation law, which came into effect last year.¹¹ This year the EU introduced rules governing ESG ratings agencies.¹²

One solution for data management that resonated with our respondents (see Figure 9 below) was integrating their private and public holdings data onto a consolidated platform for analyzing their portfolio as a whole, rather than treating private markets data as a discrete bucket. This would enable them to adjust for factors such as risk across all segments of their portfolios holistically.

Figure 9: Importance of a whole-of-portfolio view of private and public holdings data



Source: State Street 2024 Private Markets Study

More than three quarters (79 percent) of respondents described this as at least moderately important and around a quarter (26 percent) said it would be potentially transformational for their organizations. Within the private markets sub-asset classes there were differences, with extremely important/potentially transformational responses most common for real estate (33 percent) and private debt (27 percent), compared to 15 percent for private equity and 17 percent for infrastructure. The frequent complexity of unlisted credit arrangements and the legacy of infrequent and manually processed data in property may well account for this.

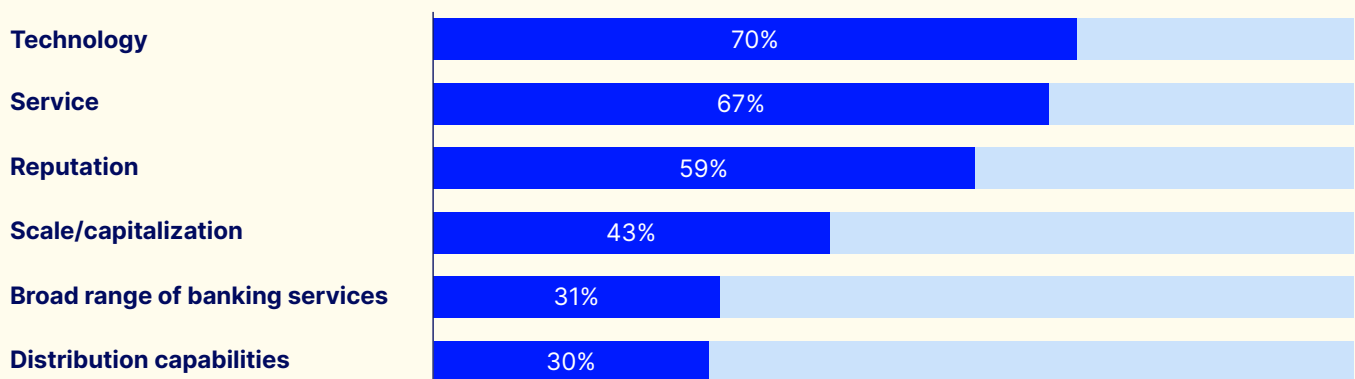
However, respondents conceded there are significant challenges in achieving this whole-of-portfolio view. More than half (54 percent) cited the relatively

poor quality of private markets data compared to public investments and 43 percent said insufficient timeliness was an impediment. A further 40 percent said these problems made normalizing the two datasets a major obstacle.

Whether they were looking for a whole-of-portfolio view of their holdings or to improve their ability to assess their private markets portfolios in isolation, one approach to improving access to and management of data that was popular with respondents was outsourcing. Nearly three quarters (72 percent) of respondents were either already outsourcing data management, or likely to outsource it in the next three to five years.

Technology was the most desirable quality in an outsourcing provider (see Figure 10 below), followed by service and reputation.

Figure 10: Most important considerations for outsourcing providers



Source: State Street 2024 Private Markets Study

Operational risk is the big story in private markets

Tim Buchner, Head of Private Markets, Charles River Development

It's insightful to learn that our research flagged the timeliness and frequency of valuations as one of the top challenges for private markets investors. Over the past several years, we have seen a considerable increase in how often managers require valuations of their underlying investments across their private markets portfolios. This is driven by heightened expectations and scrutiny from regulators and investors into valuations and overall risk management processes.

In the United States, for example, the Securities and Exchange Commission recently adopted new and amended rules that impose a broader set of disclosures, reporting and other obligations to advisers of private funds. As a result, regulators are demanding more frequency and greater oversight of valuations, more detailed performance reporting, and annual financial statement audits for each fund. These rules have significantly increased fund managers' administrative burden and most aren't ready for the influx across their people, processes or systems. Regulators are just the beginning, as managers are seeing a continuous ramp-up of similar expectations from their investors – from increases in reporting and ad-hoc requests.

This evolving environment is forcing managers to prioritize the workflow that's required to ensure timely, accurate and repeatable compliance for how data is collected, investments are valued and how risk management is checked. They need a system for valuing private companies based on a range of data and the ability to make valuations based on them. Such a system creates the need for data governance, which is key to this process and typically requires a technology solution to replace the manual and error-prone processes of yesterday.

The findings in this survey around the challenges associated with viewing the total portfolio also support this need for systematized processes. Being able to stress test risk as part of the overall private market's portfolio (or even the whole portfolio including public assets) is becoming much more important. There are various ways to assess an asset's risk and this ability is based on having a strong data model.

Operational risk is the big story in private markets, whether that's in valuations or in holistic portfolio monitoring and stress testing. If you don't have all your investment data in one place, it's very hard to assess that risk.

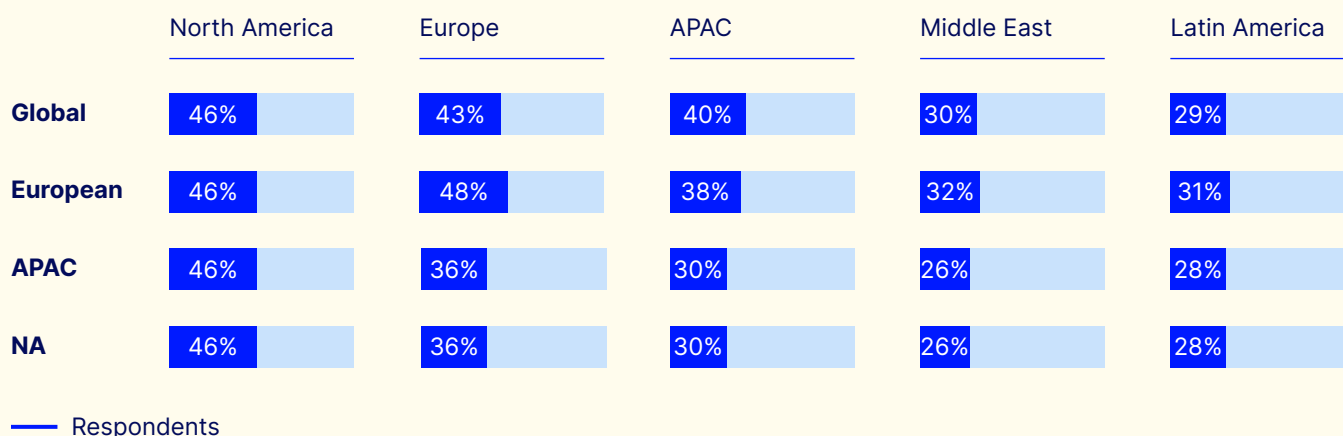
The impact of global regulations

As discussed previously, another significant driver of future private markets investment is likely to be legislation and regulation. In addition to private markets-specific laws and rules, like ELTIF or the US Private Fund Adviser Rule, governments are increasingly focused on driving capital markets investment into their political and strategic priorities, which typically benefits all private markets asset classes. Often, these priorities are national infrastructure, but governments are also increasingly interested in using policy to drive flows into companies that support strategic domestic industries like defense, emerging technologies and energy infrastructure, in particular green energy. This has resulted in increased

top-down industrial strategies in the US, EU and UK.¹³ China, which already has a more economically interventionist government, also announced new growth targets this year that focus on increasing investments in key, especially emerging, industries dubbed ‘New Productive Forces.’¹⁴

If this global policy direction is looked at in competitive terms, North America looks to be the clearest winner. When asked which regions were most likely to benefit from their national or pan-national governments’ and regulators’ interventions to drive these investment flows, most respondents said North America, followed by Europe (see Figure 11 below).

Figure 11: Regions most likely to benefit from regional private markets investment legislation¹⁵

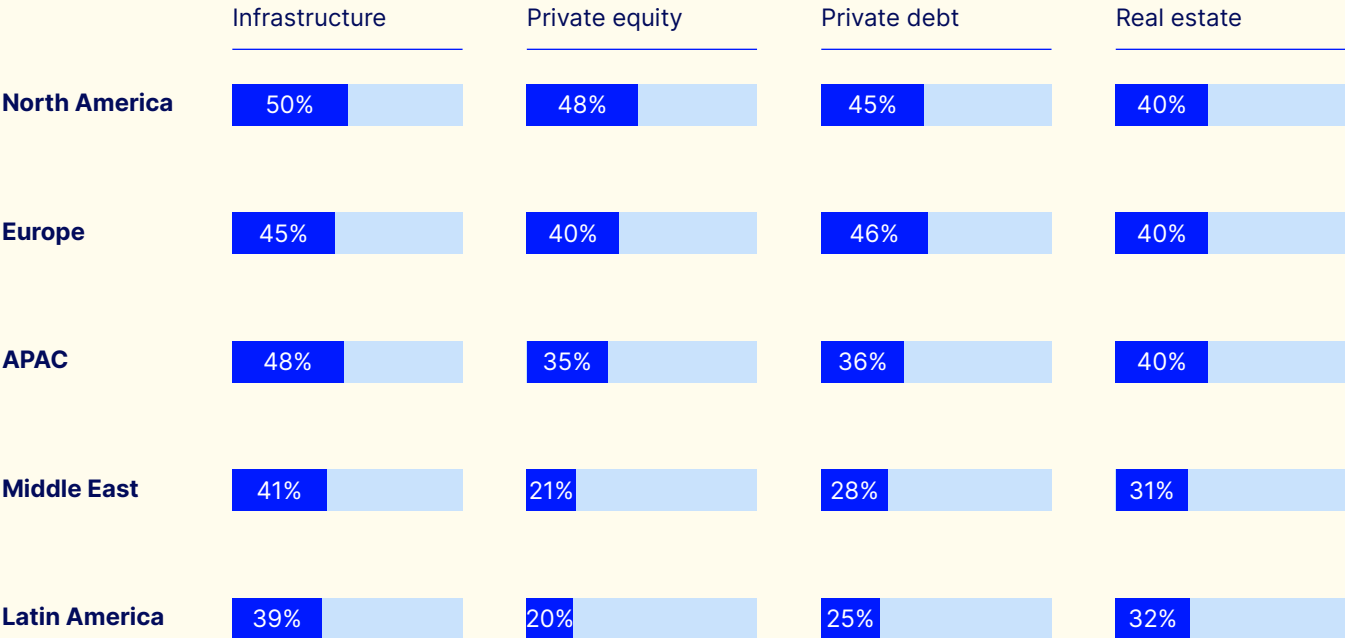


Source: State Street 2024 Private Markets Study

Nearly half (46 percent) of respondents in APAC believed North America would be a beneficiary of these policies, while only 30 percent of them thought the same about their own region. While European respondents were marginally more likely to pick their region than North America (48 percent to 46 percent), only 36 percent of both Asian and American respondents said the same.

North America’s expected dominance in boosting its domestic private markets through government policy was consistent across almost every sub-asset class where they came out on top or on joint top, everywhere except private debt. Respondents were bullish on European policy bolstering private debt – likely a reflection of the European Commission’s drive for a Capital Markets Union,¹⁶ which seeks to increase volumes and sources of non-bank, private sector lending for businesses through a formalized legislative framework for capital markets across the EU.

Figure 12: Asset classes most likely to benefit from regional private markets investment legislation



Source: State Street 2024 Private Markets Study

Respondents had a mixed response to the likelihood of new fund vehicles bringing more defined contribution and high-net-worth retail money into the asset classes. Most institutions (54 percent) agreed that there are not enough suitable products currently, while only around half (49 percent) felt there was strong demand from retail investors. A small minority (14 percent) thought that retail-like vehicles would account for a majority of private market investments in the next three to five years. On the other hand, the number who thought traditional fundraising would make up the majority was only 51 percent, while a third (33 percent) thought both modes of investment would take a roughly equal share of flows.

This indicates institutions see a future for the retail or quasi-retail private markets fund model, and responses to recent legislative developments in Europe bear this out.

Two thirds (67 percent) said they expected ELTIFs and LTAFs were likely to be successful in their intended objectives. Perhaps unsurprisingly, European respondents (75 percent) were most likely to feel this way. However, majority of organizations in all regions agreed. North Americans (56 percent) were the most skeptical while 64 percent of APAC respondents said the same.

In terms of the private markets assets most likely to benefit, infrastructure and private equity managers were the most bullish on legislation boosting their sectors, with 84 percent and 80 percent respectively saying both pieces of legislation were at least somewhat likely to be successful. Approximately two thirds (64 percent) of private debt managers agreed, along with exactly half (50 percent) of real estate managers.

Conclusion

Last year, the new market conditions were a shock. But with a return to the old environment unlikely for some years, private markets investors have adapted to their new reality.

With portfolio and operational risk taking center stage in their planning, their strategies for improved operations and data management are now geared towards clearer outcomes than in our last survey.

Additionally, governments and regulators continue to take an increasing interest in the space, with legislation and other top-down initiatives also becoming more tailored to the outcomes they seek to achieve. As we navigate this dynamic landscape, it is evident that proactive adaptation and strategic alignment will be key drivers for success in the private markets ecosystem.

We value your feedback.

Share your thoughts on this report. We promise it won't take more than a minute!

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Authors and contributors



Scott Carpenter
Global Head of
Private Markets and
Credit, State Street



Jesse Cole
Global Head of
Private Markets Product,
State Street



Tim Buchner
Head of Private Markets,
Charles River Development



James Redgrave
Global Thought
Leadership and
Editorial, State Street

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State Street Corporation
One Congress Street, Boston, MA 02114-2016
www.statestreet.com

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