Private credit portfolio: Examining the efficacy of European opportunities

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This is the second of a four-part blog series on optimizing fixed income portfolios by incorporating private credit asset classes. In the first blog we unpacked the benefits of investment grade collateralized loan obligations (CLOs) and broadly syndicated loans. This blog evaluates the strategic case for European private credit and subsequent pieces will cover specialty finance and mezzanine debt, and distressed debt from a similar lens.

Overview
As volatility increases across public markets spurred by the ongoing trade dispute, private markets are becoming more relevant. Asian investors are reconsidering their asset allocation across geographies and sub-asset classes in light of this. Private markets have become a destination for global capital in motion given their potential for diversification and ability to enhance portfolio outcomes. Amidst a backdrop of a considerable accumulation of US assets, particularly across the private spectrum, we've also seen emerging demand for private market opportunities outside of the US. Among these opportunities, European private credit— particularly European direct lending and real estate debt –can act as effective diversifiers and yield enhancers within multi-alternative portfolios. This piece explores the strategic case for including European private credit in both dedicated private markets income sleeves and broader portfolio constructs.

By leveraging insights from Invesco Vision[1], we evaluate the role that European private credit can play in improving efficient frontiers, counteracting potential currency drag, and increasing risk-adjusted returns. Our analysis reveals that, when properly integrated, European private credit can offer tangible portfolio benefits – from higher yield and low correlation to macro-resilience and access to structural dislocations across direct lending and real estate markets.

Private markets as a structural allocation
Traditional fixed income strategies face headwinds from elevated interest rate volatility, uncertainty around Fed policy, and increased correlation to equities which has unfolded since the onset of escalated trade tensions and tariff announcements. In this environment, private markets have continued to gain traction, with a growing opportunity set in non-US markets. As discussed in a prior piece on real estate and infrastructure debt, private credit has evolved from a niche exposure to a staple in institutional portfolios and a rapidly growing category in wealth channels, driven by regulatory changes post the Global Financial Crisis, higher spreads versus public proxies, and diversification from public markets volatility. According to the latest Invesco Global Sovereign Asset Management Study ("IGSAMS"), close to 70% of global sovereign wealth funds (SWFs) plan to increase their funding to private credit, with the funding coming from a diversified array of asset classes (Figure 1 and 2).

1. Vision
Invesco Vision is a decision support system that combines analytical and diagnostic capabilities to foster better portfolio management decision-making. Invesco Vision incorporates CMAs, proprietary risk forecasts, and robust optimization techniques to help guide our portfolio construction and rebalancing processes. By helping investors and researchers better understand portfolio risks and trade-offs, it helps to identify potential solutions best aligned with their specific preferences and objectives. The Invesco Vision tool can be used in practice to develop solutions across a range of challenges encountered in the marketplace. The analysis output and insights shown in the document does not take into account any individual investor's investment objectives, financial situation or particular needs. The insights are not intended as a recommendation to invest in a specific asset class or strategy, or as a promise of future performance. For additional information on our methodology, please refer to our CMA and Invesco Vision papers.

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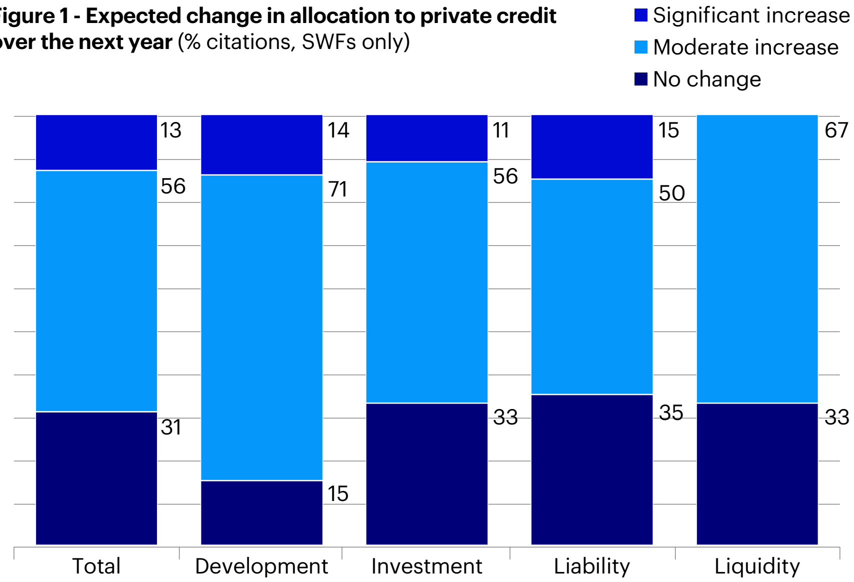
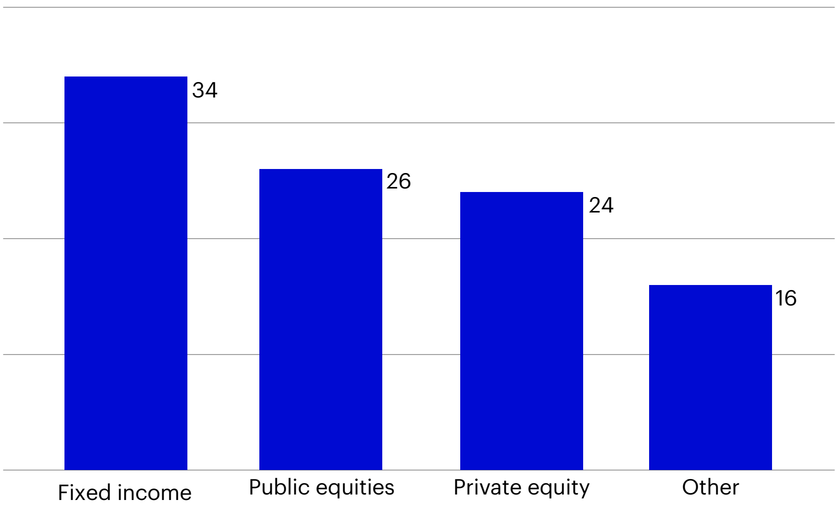
Figure 1 - Expected change in allocation to private credit over the next year (% citations, SWFs only)



Source: IGSAMS 2024. Note: How do you expect your allocation to private credit to change over the next year? Sample size: 45.

Figure 2 – Source of additional allocation to private credit
(% citations, SWFs only)



Source: IGSAMS 2024. Note: Where does an increased allocation to private credit typically come from? Sample size: 38.

Why European credit matters now
European private credit markets – especially direct lending and real estate – offer a unique confluence of benefits. Regulatory pressure on European banks has constrained traditional lending channels, creating attractive return premia for private credit due to a fragmented and underserved market. These assets are also less correlated to US-focused private credit strategies, thus offering diversification. Given the recent uncertainty around US policy, we believe demand for US private credit remains strong but has also created tailwinds for non-US exposure.

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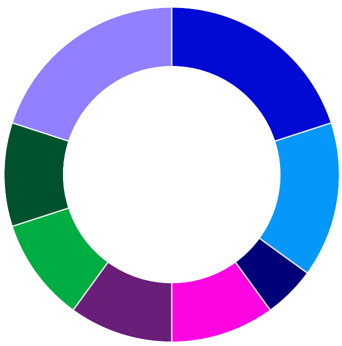
The Asian investor perspective: Currency hedging and local yield drag
For Asian investors, the inclusion of European private credit is not just an income enhancement strategy – it's a source of currency diversification. In the current global regime, US interest rates remain significantly higher than most Asian economies, creating a currency hedging cost that materially erodes local currency returns for USD-based assets.

The implementation of a large-scale tariff program as alluded to by the Fed chair could drive increased inflation in the US, putting the central bank in a challenging position regarding interest rates. This would keep hedging costs high and create further uncertainty around USD positions across Asia, making diversification into currencies such as the Euro a potential haven against a more uncertain backdrop.

When looking at portfolios on a de-smoothed risk basis, in non-USD terms, the value of USD exposure becomes less apparent than with USD-pegged exposures. As an example, in Singapore Dollar terms, US and European direct lending have roughly the same volatility (6.8% de-smoothed).[2] When considering this and coupled with policy uncertainty from the US, the idea of diversifying into Euro-denominated assets has merit. Given the large scale and scope of US public and private capital markets, we fully understand that while the US dollar will be the anchor currency of any portfolio, our objective here is to examine how marginal steps toward diversification can yield benefits in this unique environment.

Constructing the portfolio
When constructing a diversified private markets income sleeve, the case for European credit becomes apparent. We've constructed a representative allocation to a private markets income portfolio with meaningful weights to senior corporate lending, alternative credit, mezzanine, infrastructure, and both US and European private credit exposure (Figure 3). The sample exposures to European direct lending and real estate are 15% and 10%, respectively. This structure balances liquidity, geography, and sector exposure while enhancing return. The combination of assets below still maintains a similar return target to US direct lending of SOFR (Secured Overnight Financing Rate) + 600 bps, but with less risk (4% versus 5% de-smoothed, from Invesco Vision). This shows how a robust exposure, complemented with European private credit, can help to diversify the portfolio and still generate strong income.

Figure 3 - Sample private markets income allocation



	%
U.S. Direct Lending	20
European Direct Lending	15
Broadly Syndicated Loans	5
Mezzanine Debt	10
U.S. Real Estate Debt	10
European Real Estate Debt	10
U.S. Infrastructure Debt	10
Alternative Credit	20

Source: Invesco Solutions

While US exposure remains foundational in the portfolio (roughly 75%), the elevated concentration risk in sponsor-backed lending and correlated macro exposures has prompted many allocators to diversify geographically and structurally. European private credit offers several key advantages: different monetary policy cycles, strong creditor protections in certain jurisdictions, and secured exposure to real assets in income-generating sectors. The post-Brexit landscape has also introduced greater return dispersion, creating a rich field for income and return enhancement and portfolio diversification.

2.Source: Invesco Vision, data as of March 2025.

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Enhancing the broader portfolio
Adding European credit to global portfolios expands the diversification properties of a broader US-focused private credit portfolio, particularly when replacing a portion of traditional fixed income. As shown below, utilizing Invesco Vision we see the correlation of European private credit, both direct lending and real estate debt, have 0.6 and 0.35 correlations with their US counterparts, and low correlations across the entire opportunity set (Figure 4). In a macroeconomic backdrop with higher uncertainty, particularly around the stability of the US dollar, this diversification can provide considerable portfolio ballast, particularly for Asian investors with large overweights to USD assets but floating home currencies.

Figure 4 – Correlations of European private credit with various asset classes

Asset	Global aggregate	European senior direct lending	US real estate debt	US senior direct lending
European senior direct lending	0.16			
US real estate debt	0.18	0.32		
US senior direct lending	0.05	0.65	0.65	
European real estate debt	0.17	0.79	0.11	0.15

Source: Invesco Vision, data as of March 2025; Global aggregate = Bloomberg Global Aggregate Index, European senior direct lending = combination of Europe Mezz Debt private factor and public exposure from CS Western Europe Leveraged Loan Index, assuming no leverage , US real estate debt = combination of US Mezz Debt private factor and public exposure from Bloomberg Non-agency CMBS BBB Index, assuming no leverage, US senior direct lending = combination of US Mezz Debt private factor and public exposure from CS Leverages Loan Index, assuming no leverage, European real estate debt = combination of Europe Mezz Debt private factor and public exposure from Bloomberg Euro Aggregate Securitized Mortgage Index, assuming no leverage.

Several secular trends also continue to support European private credit. As discussed in my prior piece on real estate and infrastructure debt, the retreat of traditional bank lending across Europe mirrors US dynamics, creating a vacuum for private capital. As traditional financing options face increased headwinds, private capital is increasingly needed to finance sponsor-backed private equity transactions and growing sectors in the real estate space.

Opportunities in European CLOs
Even for investors with quality and liquidity constraints, there is still a highly viable pathway to accruing premia over traditional fixed income instruments through the private credit ecosystem, particularly high grade CLOs. As noted in our prior piece Private credit portfolio: Why investment grade CLOs and broadly syndicated loans?, CLOs are an attractive investment grade fixed income substitute. They offer observable complexity premia, like traditional private credit, while still meeting the needs of liquidity-sensitive investors. While the U.S. CLO market has grown substantially, we see an emerging opportunity for European CLO exposure, which capitalizes on the same trends discussed earlier such as diversified income and high risk-adjusted returns.

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In terms of the current European CLO opportunity set, we believe there is an attractive entry point as spreads are higher than in similarly rated U.S. CLOs. As an example, U.S. AAA CLOs maintain an average yield of around 4.8%, but European AAA CLOs (hedged to USD) offer an average yield of around 5.2% (source: Invesco Private Markets team). This 40 basis point spread, relative to the underlying low risk nature of CLOs, is a meaningful driver of risk-adjusted returns and serve as a complement to both traditional investment grade fixed income and U.S. CLO exposure. Additionally, like high grade U.S. CLOS, European CLOs have never experienced a default, adding quality and diversification in an increasingly uncertain macroeconomic backdrop.

Implementation challenges and platform considerations

Deploying capital into European private credit in much more than a theoretical exercise, it requires access to origination platforms, regional legal expertise, and robust operational capabilities. Differences in documentation, regulation, and execution timelines add complexity. Investors lacking this infrastructure may benefit from partnering with platforms that offer turnkey access and strongly embedded regional platforms with a long history of execution.

Conclusion: The strategic role of European private credit

We believe European private credit is no longer a peripheral allocation. It is now a core pillar in diversified private markets income strategies. It enhances yield, provides geographic and structural diversification, and offers a valuable hedge against volatility and FX drag – especially for non-USD investors. However, even for USD-focused investors, the current interest rate differentials allow European private credit exposure with a “yield pickup” to account for difference in higher U.S. interest rates. Regardless of which route an investor chooses to take, there can be effective pathways to implement this exposure efficiently.

In today’s complex and uncertain market, investors need to move beyond conventional asset class categories. The goal is no longer simply diversification for its own sake, but an outcome alignment. European private credit offers a powerful tool to achieve this goal, enabling investors to pursue income objectives with greater precision, resilience, and clarity.

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Investment risks
The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

When investing in less developed countries, you should be prepared to accept significantly large fluctuations in value.

Investment in certain securities listed in China can involve significant regulatory constraints that may affect liquidity and/or investment performance.

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