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PRIVATE WEALTH

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Private Equity in Perspective: Navigating Extremes and Unlocking Long-Term Value

Structural advantages and market shifts seem likely to support a return to form for this enduring asset class.

The last three years have been challenging for private equity investors, particularly for those newly introduced to the asset class. While private equity has long been celebrated for its ability to deliver outsized returns over time, recent performance reports have revealed a rare episode of underperformance relative to public market counterparts, particularly U.S. large-cap equities. Yet, as history has shown, periods of private equity weakness have often presented attractive entry points for investors with the patience and discipline to embrace long-term strategies.

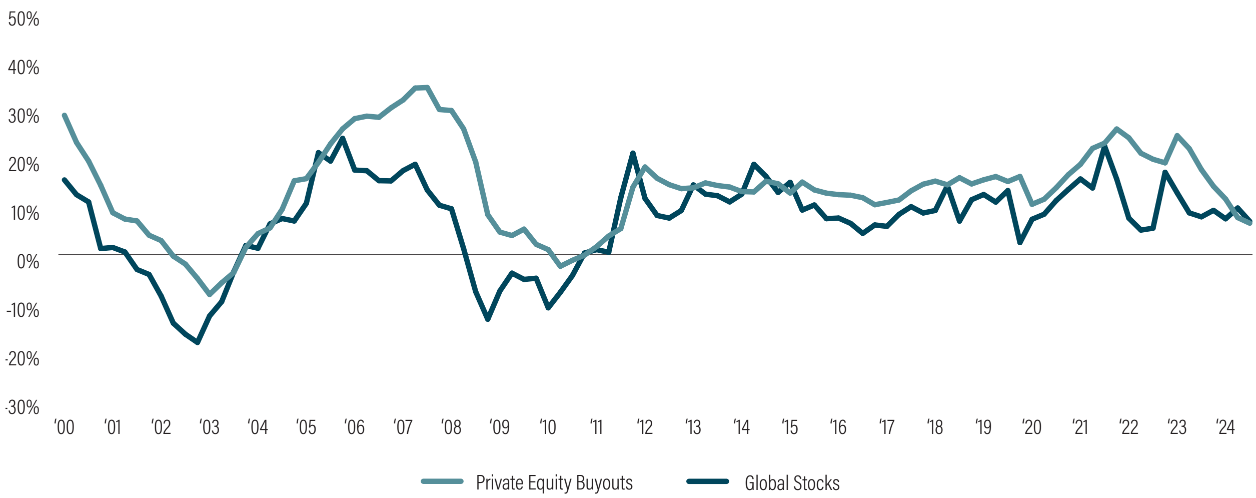
In this commentary, we explore the factors that have contributed to this underperformance, place the current environment in historical context, and outline what investors can expect from private equity over the long term. The key takeaway? Despite short-term headwinds, private equity remains a powerful tool for achieving long-term investment goals, supported by structural advantages that have rewarded patient investors time and time again.

A Tale of Extremes

The past three years have seen extremes across private and public markets—both for the economic fundamentals and market dynamics noted below—offering important context to understand the recent divergence in performance. As shown in the following display, rolling three-year returns reveal that public equities have recently outpaced private counterparts for the first time since 2015. However, history suggests that such an outcome is uncommon for long holding periods and has often been followed by periods of significant private equity outperformance.

PRIVATE EQUITY'S RECENT RELATIVE WEAKNESS IS A DEVIATION FROM THE NORM

3-Year Rolling Returns



Source: Burgiss and MSCI. Three-year rolling returns using quarterly data for the Burgiss Buyout and MSCI World indices. June 30, 2000 – September 30, 2024. Nothing herein constitutes a prediction or projection of future events or future market behavior. Historical trends do not imply, forecast or guarantee future results. Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed or any historical results. Investing entails risks, including possible loss of principal. **Past performance is no guarantee of future results.**

For private equity, the post-COVID environment began with a surge in activity. Record fundraising, robust dealmaking and strong investment performance were fueled by historically low interest rates, fiscal and monetary stimulus, and open capital markets. Yet, this momentum was interrupted in 2022 as central banks tightened monetary policy to combat inflation. Rising interest rates and persistent inflation created a more challenging environment for private markets; deal activity slowed, distributions to investors fell to their lowest levels since the global financial crisis, and fundraising moderated as liquidity constraints emerged. In response, private equity general partners focused on enhancing the value of their portfolio companies through operational improvements and longer holding periods, demonstrating discipline in navigating this transitional phase.

Meanwhile, public markets experienced their own extremes. After the volatility of 2022, global equity markets staged a remarkable recovery in 2023 and 2024, led by a narrow group of U.S. mega-cap technology stocks—the "Magnificent Seven." These companies drove back-to-back 20%+ returns, creating a surge in public market performance, but the rally was highly concentrated, with much of the broader market lagging behind. When excluding the top-performing stocks, public market returns appeared far less compelling, underscoring the idiosyncratic nature of the recent outperformance.

Historical Context and a Shifting Backdrop: What Could Happen Next?

Instances of rolling three-year underperformance in private equity compared to public markets are exceedingly rare. Over the past several decades, these reversals have occurred only a handful of times. History suggests that such periods are often followed by meaningful private equity outperformance over subsequent three- and five-year time horizons. For example, following the prior episodes of three-year underperformance, private equity consistently outpaced public markets by significant margins, as shown in the table on page 3, which highlights the average return differences during these subsequent three- and five-year periods.

Average Annual Private Equity Outperformance
After Period of Relative Weakness

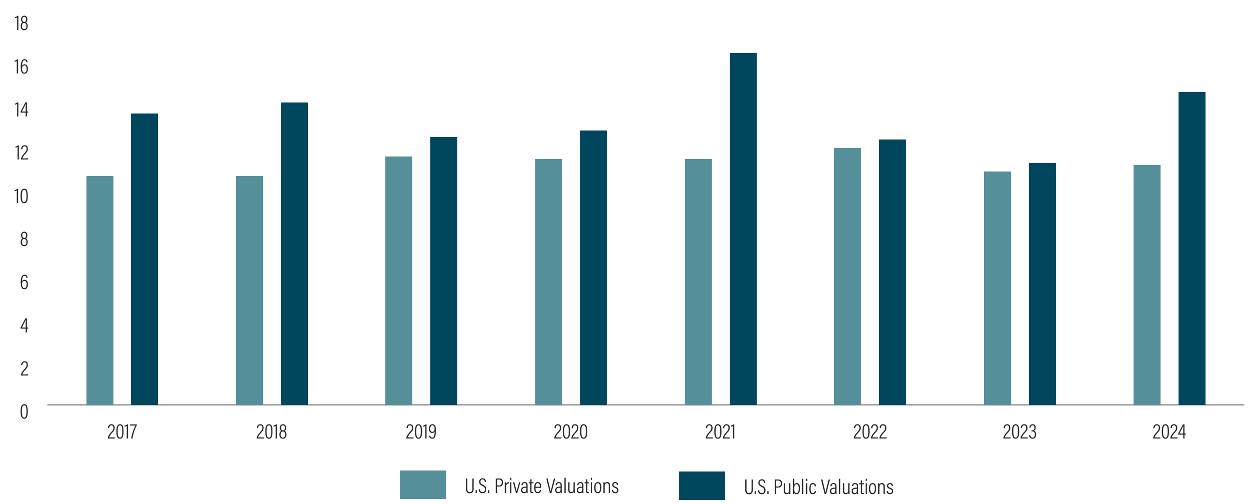
3-Year	5-Year
8.66%	**7.72%**

Source: Burgiss and MSCI. Three-year rolling returns using quarterly data for Burgiss Buyout and MSCI World indices. June 30, 2000 – September 30, 2024. Periods of underperformance defined as negative three-year rolling returns relative to MSCI World Index.

Looking ahead, despite recent volatility, the current macroeconomic backdrop appears increasingly supportive of a recovery in private equity activity: Healthy economic growth and stable inflation could provide a solid foundation, public equity valuations remain elevated, central banks are signaling a friendlier outlook, the return of banks to the leveraged lending market further injects much-needed liquidity and a potential pullback in regulatory activism, particularly in the U.S., may reduce dealmaking friction and create a more conducive environment for activity in private markets.

Another factor supporting the private equity outlook is its relative valuation advantage. While public equity markets have rebounded sharply, private equity valuations have remained relatively steady. As shown below, private market opportunities often trade at a discount to their public counterparts, with valuation multiples for private equity in the U.S. remaining compelling on a relative basis. This valuation gap offers private equity investors the opportunity to deploy capital into high-quality businesses with strong growth potential.

PRIVATE VS. PUBLIC EQUITY VALUATION MULTIPLES



Source: Pitchbook LCD and S&P Capital IQ. Data as of 3Q 2024. Valuation multiples are enterprise value/earnings before interest, taxes, depreciation and amortization. U.S. public equity multiples are those of the Russell 2000 Index. Nothing herein constitutes a prediction or projection of future events or future market behavior. Historical trends do not imply, forecast or guarantee future results. Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed or any historical results. Investing entails risks, including possible loss of principal. **Past performance is no guarantee of future results.**

Together, these dynamics suggest that private equity investors may soon benefit from a more robust pipeline of opportunities, supported by a macroeconomic environment that encourages both new investments and successful portfolio company exits.

The Long Game: Why Private Equity Remains a Cornerstone

While the recent underperformance of private equity may give some investors pause, it's important to remember that private equity is a long-term asset class by design. Over longer holding periods, private equity has consistently outperformed public markets, driven by its structural advantages in driving value creation away from the markets. The chart below illustrates the enduring strength of private equity returns compared to public benchmarks over various time periods.

Percentage of Time Private Equity Has Outperformed Over Rolling Periods

3-Year	5-Year	10-Year
85%	**94%**	**100%**

Source: Burgiss and MSCI. Based on quarterly returns for Burgiss Buyout and MSCI World indices, June 30, 2000 – September 30, 2024.

In addition to strong absolute and relative performance, private equity can serve as a key diversifier given the backdrop of private markets expansion and increasingly concentrated public equity indices.

In today's environment of full valuations and higher-for-longer interest rates, manager selection could be critical. We believe top-tier private equity managers with a proven ability to create value through operational improvements, strategic acquisitions and disciplined capital allocation will likely continue to outperform. Gaining access to these high-quality managers should be a top priority for allocators aiming to capitalize on private equity's long-term potential.

Conclusion: A Turning Point for Private Equity?

The recent underperformance of private equity relative to public markets may be unsettling for some investors, but we view it as an opportunity rather than a cause for concern. The macro backdrop is improving, relative valuations remain attractive, and in our view the long-term advantages of private equity are as compelling as ever. For investors with a disciplined approach and a long-term horizon, the current environment offers an appealing entry point to build or expand allocations to this enduring asset class.

As always, we believe success in private equity requires thoughtful portfolio construction, access to top-tier managers, and a commitment to the long game. For those who can embrace these principles, private equity remains a powerful tool in seeking to achieve long-term investment goals.

The Burgiss Buyout Index tracks the performance of closed-ended private equity buyout funds in the Burgiss manager universe. The index includes over 2,600 funds with $3.7 trillion in total capitalization.

The MSCI World Index captures large and mid-cap representation across Developed Markets countries. The index covers approximately 85% of the free float-adjusted market capitalization in each country.

The benchmark performance is presented for illustrative purposes only to show general trends in the market for the relevant periods shown. The investment objectives and strategies of each fund in the benchmark may be different than the investment objectives and strategies presented herein, and may have different risk and reward profiles. A variety of factors may cause this comparison to be an inaccurate benchmark for any particular strategy and the benchmarks do not necessarily represent the actual investment strategy of a fund. It should not be assumed that any correlations to the benchmark based on historical returns would persist in the future.

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