PORTFOLIO INSIGHTS

Private equity

Despite competition, opportunities remain for the skilled and disciplined

July 2018

IN BRIEF

- Global private equity (PE) fundraising saw another sizable advance in 2017.
- Companies with strong growth potential and reasonable valuations are challenging to source, yet we believe there are ample opportunities.
- In the growing secondary PE market, we see opportunities in general partner (GP)-led transactions. In mergers and acquisitions, we see potential for PE buyout firms in the small to mid-size market.
- Venture capital deployment has accelerated, propelled by unrelenting technological innovation; opportunities have opened in areas such as e-commerce, cybersecurity and life sciences.
- As investor demand fuels fundraising and intensifies the competition to put capital to work, we advocate partnering with an investment manager that has experience, prudence and skill, and has achieved returns over multiple cycles.

AMID STRONG INVESTOR SENTIMENT, A SEARCH FOR RETURN

Private equity investor sentiment is strong. Global private equity fundraising, continuing an uptrend that began in 2010, saw another sizable advance in 2017. Modest long-term return expectations for traditional investments—J.P. Morgan's 2018 Long-Term Capital Market Assumptions see a roughly 5% average annual return on a 60/40 stock-bond portfolio over the next 10 to 15 years—are leading investors to alternative markets, such as private equity, to help them achieve their return targets.[1]

Additionally, private equity fundraising is highly correlated with public equity market performance (**EXHIBIT 1**). As public equity valuations rise and private equity distributions occur, investors tend to increase their private equity allocations to maintain their PE targets.

Several years of solid fundraising have added to the industry's store of dry powder. In fact, four of the largest private equity firms (Carlyle Group, Blackstone, TPG Capital and KKR & Co.) raised an aggregate of USD247 billion in 2017.[2] This strong private equity fundraising environment has led to a record amount of uncommitted capital. The increased demand for return-enhancing deals has driven average purchase price multiples to about 12.5x Ebitda in the U.S. and raised leverage ratios to over 5.0x Ebitda[3]—exceeding the previous all-time highs reached prior to the global financial crisis.

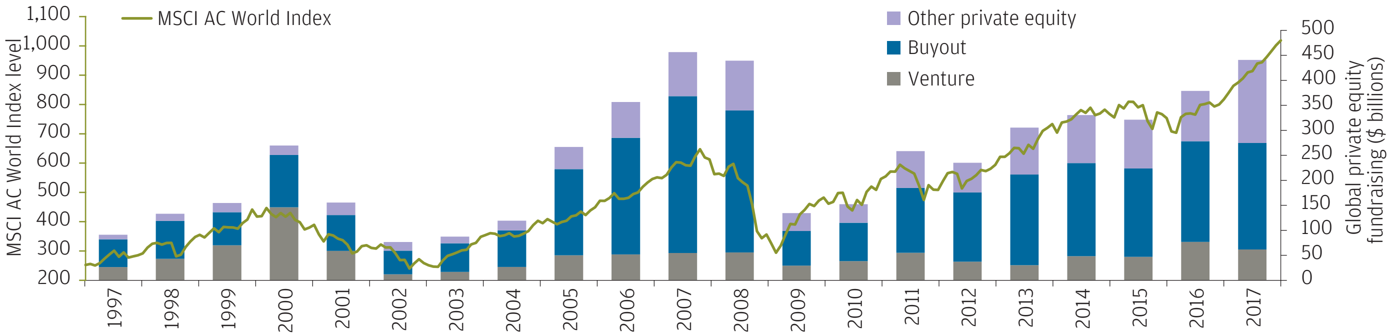
FOR MORE INFORMATION

Please contact your local J.P. Morgan Asset Management or Private Equity Group representative with any questions, or email PEG_Questions@jpmorgan.com

1 Return assumptions are for a 60% global equity, 40% U.S. aggregate bond portfolio, in USD terms. J.P. Morgan Asset Management, 2018 Long-Term Capital Market Assumptions.
2 Davies, Paul J., "How Gargantuan Can Private Equity Get?" *Wall Street Journal*, February 22, 2018.
3 Pitchbook, March 31, 2018.

Global private equity fundraising has continued trending up, correlated with public equity market performance

EXHIBIT 1: PRIVATE EQUITY INVESTOR SENTIMENT 1997–2017



Source: FactSet, Thomson ONE; data as of December 31, 2017.

The challenge will be identifying managers with the demonstrated skills and experience, access to opportunities and disciplined, consistent investment approach to put committed capital to work. For those managers, we believe there are ample opportunities to help investors realize their PE return objectives.

OPPORTUNITIES TO MEET INVESTOR DEMAND

In the market today, we are seeing more attractive opportunities in small to mid-market partnerships and direct investments, including leveraged buyout, venture capital and growth equity investments. In the secondary private equity market, we are finding the best return opportunities through general partner-led transactions rather than increasingly competitive auctions.

Leveraged buyouts

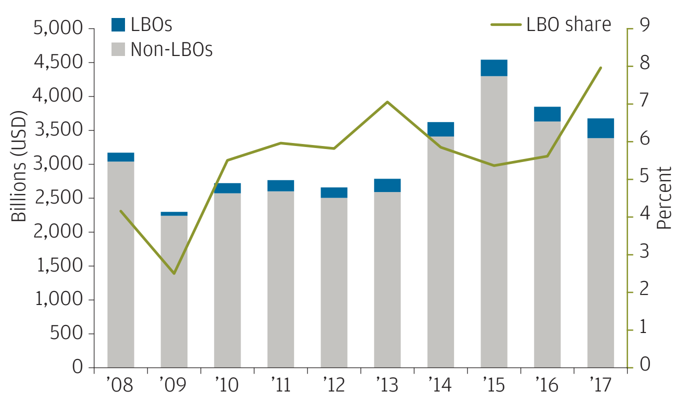
Merger and acquisition activity has been strong, and the role of private equity buyout firms has grown significantly since 2009. LBOs accounted for 8% of M&A activity in 2017 (**EXHIBIT 2**), double their 2008–09 level. An increasing volume of PE-firm-to-PE-firm transactions (called secondary buyouts) may also lead to attractive exit opportunities, especially for smaller mid-market companies that can be sold "up the chain" to large and mega-size private equity firms. A low rate environment, combined with the increasing availability of covenant-lite and second-lien loans, has reduced financing costs and increased competitive bidding among PE firms and corporate buyers. While this is driving exit prices higher, it is also raising the price of entry, particularly in the larger end of the market. For that reason, disciplined investing will be critical. We see tremendous potential in the small to mid-size market, where the number of opportunities is greater, transactions are generally less leveraged and valuations are less likely to be stretched.

Venture capital and growth

In recent years, companies with strong growth potential and reasonable valuations have been challenging to source as valuations have moved higher across all asset classes. Venture capital and growth-stage investments remain sought-after in the market. Capital has been deployed at an accelerated pace, propelled by unrelenting technological innovation and adoption—developments that are not only improving efficiency but

M&A activity has been strong and PE buyout firms' role has grown, potentially improving exit opportunities

EXHIBIT 2: GLOBAL M&A ACTIVITY AND THE SHARE OF LBOs 2008–17



Source: Dealogic; data as of October 3, 2017.

Shifts in fundamentals have opened opportunities in areas such as e-commerce, cybersecurity and life sciences

EXHIBIT 3: TITLE: DISRUPTIVE TRENDS AND THEIR IMPACTS

Rise of millennials	Explosion of devices	Artificial intelligence	Industrial renaissance	Blockchain
Millennial % of workforce	Global devices	AI products & services market	Industrial IoT market	Cryptocurrency market
75%	50 billion	USD37 billion	USD150 billion	USD2.9 billion
by 2025	by 2020	by 2025	by 2020	by 2023
vs.	vs.	vs.	vs.	vs.
32%	25 billion	USD643 million	USD95 billion	USD540 million
today	today	today	today	today
Shifting consumer preferences	Storing, managing and utilizing data as a top priority	Innovation across all industries	Full digital value chain	Economic innovation

Source: March Capital Partners, IDC, Business Insider, Technavio, Cisco IBSG, Top 500 List as of December 2016; Cryptocurrency: Business Wire as of October 18, 2017.

disrupting businesses, industries and everyday forms of communication (**EXHIBIT 3**). Due to these growth-stage businesses' disruptions in the market today and the burgeoning levels of dry powder, valuations in the late-stage venture capital space increased 19% in Q1 2018 compared with Q1 2017 levels. We see particular opportunities in areas such as e-commerce (where retail fundamentals are being upended by the ability to sell directly to customers online), technologies to combat the growing number of cyberattacks, and technology-enabled life sciences.

The secondary market

The private equity secondary market allows for the sale and purchase of investors' existing PE interests in buyout and venture capital investments, making it possible for investors to achieve liquidity from their PE assets and proactively manage their portfolios. The secondary market's benefits have led to a record amount of capital being raised for secondary investments and, with that, a compression in returns. The 10-year bull run in the public equity market, combined with the record amount of capital waiting to be deployed, has pushed secondary prices near all-time highs. In fact, the average corporate finance secondary interest was sold at 99% NAV (as of December 31, 2017), vs. 68% NAV in 2009. Venture capital assets were purchased at an average price of 83% NAV (as of December 31, 2017) vs. 59% NAV in 2009. During these times of relatively high prices, information and assignment advantages (derived from investment relationships). in addition to GP-led secondary transactions, have proven to be paths to compelling investment opportunities.

REALIZING OPPORTUNITIES THROUGH A BOTTOM-UP FOCUS

Realizing private equity objectives calls for investing with the best on a consistent basis—especially when investor demand is fueling fundraising and intensifying the competition to put capital to work. This requires joining forces with managers that can deliver meaningful private equity returns over multiple and varied investment cycles, and provide access to top-tier funds—even those funds where available allocations for new investors are scarce. It means partnering with managers that exhibit the discipline and insight to make solid investment decisions, and that raise capital based on the opportunity to deploy it prudently.

Fundraising has been strong, dry powder is plentiful, and there are reasons to be cautious. But ample opportunities are available for investors who are skilled, disciplined and experienced.

J.P. MORGAN ASSET MANAGEMENT—PRIVATE EQUITY GROUP

The J.P. Morgan Asset Management—Private Equity Group (PEG) is one of the longest-standing and most successful private equity firms in the industry. We have been active investors in the private equity market since 1980, investing broadly across geographic regions. We believe that successful private equity investing involves having access to best-in-class investment opportunities and managers; conducting objective, rigorous and thoughtful due-diligence; and making disciplined investment decisions that consistently generate attractive returns over time.

PEG is part of J.P. Morgan Global Alternatives, the alternative investment arm of J.P. Morgan Asset Management. With more than USD132 billion in assets under management and over 350 professionals, we offer strategies across the alternative investment spectrum, including real estate, private equity and credit, infrastructure, transportation, liquid alternatives and hedge funds.

As of March 31, 2018.

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