Private Equity Outlook

Diligent manager and asset selection will be crucial to success in the current market cycle

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In Brief

- The long-term outlook for private equity remains broadly attractive, offering potential opportunities to enhance portfolio return and reduce volatility.
- Last year's slowdown in deal activity reduced upward pressure on valuations.
- In the current landscape, secondaries and co-investments appear to offer compelling investment opportunities.
- On the buyout side, we continue to favor the small mid-market given generally lower entry multiples, greater value creation potential and broader exit avenues.
- Return dispersions are likely to expand even more in the current cycle, making diligent manager selection even more critical to capture top-quartile returns.

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Private Equity Outlook 2024

Private equity (PE) strategies offer investors an opportunity to diversify their portfolios and the potential to enhance return and reduce volatility. Historically, the asset class has consistently outperformed public equity markets across a variety of market environments. It also presents a much broader investment opportunity set, representing roughly 85% of the total equity investment universe[1]. Therefore, investing only in public equities limits investors' exposure to just 15% of the market.

While the asset class faced fundraising challenges and declines in deal activity in the last year, the long-term investment potential of the market remains favorable. However, diligent manager and investment selection remain critical when seeking top-quartile returns.

Slower fundraising and higher interest rates shaped investment dynamics

After reaching record transaction volumes between 2000 and the first half of 2022, last year saw a notable slowdown in PE deal activity. Declines began to unfold in the second half of 2022 and continued through 2023 due largely to two major market shifts.

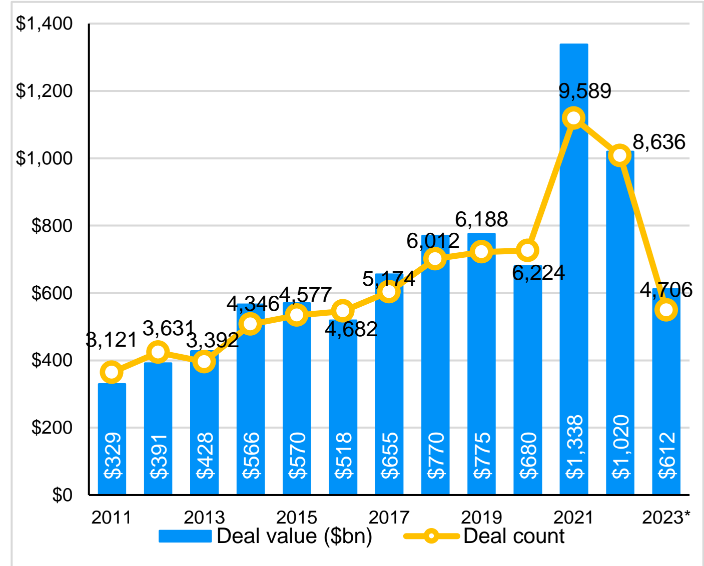
First, the runup in interest rates made debt more difficult and expensive to access. This had a more material effect at the large end of the buyout market, where most deals are executed using leverage.

Second, the broad declines posted by traditional public equity and fixed income markets across much of 2022 created a denominator effect – investors became overallocated to private markets as the value of their public portfolios declined. As a result, many limited partners (LPs) slowed down their commitment pace or stopped committing to illiquid asset classes altogether. This dynamic continued to dampen fundraising in 2023.

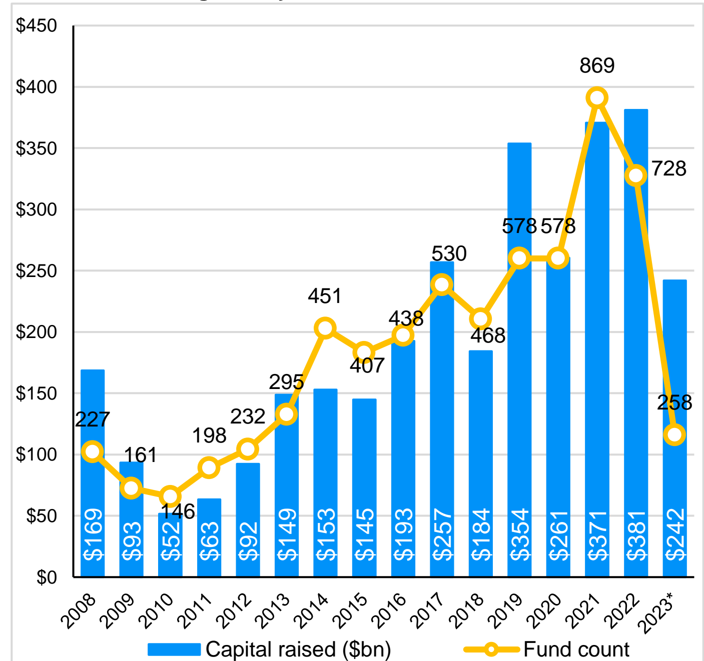
Muted deal activity may continue into 2024 given that the interest rate environment remains uncertain. However, at the same time, these dynamics have created a number of attractive entry points for those with dry powder to invest.

PE transactions have slowed from recent record highs

U.S. PE deal activity



U.S. PE fundraising activity



Source: PitchBook 3Q23 U.S. PE breakdown as of 9/30/2023. Includes estimated deal count and value as of 9/30/2023.

[1] S&P Capital IQ, as of 8/31/2022.

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Emerging opportunities in secondaries and co-investments

The current market environment has fueled significant interest in secondary transactions and co-investments. Both LP and general partner (GP) led secondary transactions are of particular interest for investors with dry powder. The overall market continues to see secondary interests priced at a discount to net asset values (NAVs), providing a favorable entry point for secondary buyers. LP buyout portfolios were priced at an average of 87% of NAV in 2022 and 90% as of the first half of 2023.[2] Given the significant slowdown in distributions across the market, selling PE interests on the secondary market has created liquidity for LPs. While discounts offer an added layer of immediate upside, secondary returns are primarily driven by asset appreciation. Thus, it remains critical to evaluate the underlying asset quality.

Co-investments – investments made directly into a single company alongside a GP – are also an attractive part of the market. These investments can generally be an opportunity for GPs and LPs alike. Amid fundraising challenges, GPs can offer co-investments to strategic partners to reduce their overall capital commitment, and staples are a way to entice LPs to future primary commitments. With co-investor capital, GPs can upsize their equity checks, and LPs can gain access to a potentially high-returning, targeted opportunity alongside a strategic partner. Further, many LPs are offered co-investments on a no fee-no carry basis as an added incentive.

Continued focus on small mid-market

On the buyout side, our view is that the small mid-market remains more attractive than the large and mega-markets given the segment's structural characteristics. Entry multiples tend to be more favorable, on average 1.3x lower for companies valued below $1 billion versus companies valued above $2.5 billion based on buyouts between 2010 and YTD 2023.[3] This is due to the fact that the small mid-market is relatively less competitive for investors and offers more room to find pricing dislocations.

The small mid-market segment offers higher return potential, with top-quartile performance data showing that smaller fund sizes outperformed larger funds by more than 200 basis points over 2010 to 2020 vintages.[4] Businesses in this segment are often still family- or founder-owned at the time of investment and can benefit greatly from enhancements in the form of organic and inorganic expansion and operational improvements.

The segment is less sensitive to current IPO headwinds, which have weighed heavily on the exit possibilities of large PE deals. Instead, the small mid-market has a broad range of exit avenues. In addition to IPO, small mid-market companies often also exit via strategic acquisition or acquisition by another financial sponsor. Strategic acquirers are typically larger, publicly traded or financial sponsor-backed companies looking to add or expand a specific business capability. Financial sponsors may also acquire small mid-market companies as platform investments in sectors of interest or areas where they feel they can optimize and enhance the business.

[2] Jeffries Report, as of August 2023.
[3] PitchBook. Median Transaction Value / EBITDA Multiples of US buyout deals occurring between 2010 and YTD 2023.
[4] MSCI Private I. Top quartile IRR of U.S. and European buyout funds with vintages between 2010 and 2020.

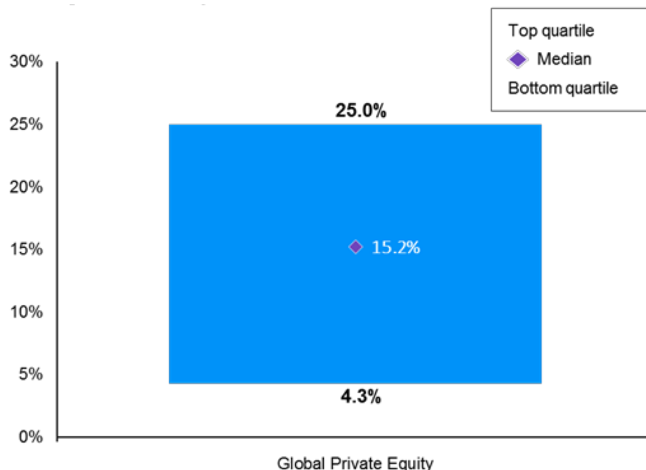
In summary: Asset selection remains key

Robust PE manager and asset due diligence will be crucial to success in the year ahead. The dispersion of manager returns in the asset class has always been relatively large across vintages over the years, especially in the small mid-market, and this dispersion may increase further given continued uncertainty in the market, emphasizing the importance of selecting top-quartile managers.

Despite recent volatility, PE continues to be a solid investment opportunity and has historically often been an outperforming investment following periods of dislocation. In this environment, we have seen earnings growth remain solid, continued technological advancements driving innovation and efficiencies across industries and pricing dislocations, which have created attractive opportunities. With this in mind, the outlook for PE remains favorable, and choosing the right partner will be critical to navigating the complexities and breadth of this compelling opportunity set.

The wide dispersion of PE strategy returns offers considerable opportunities for active management and manager selection

Top-quartile, median and bottom-quartile returns for 10-year period ended 1Q23



Source: Burgiss, J.P. Morgan Asset Management. Manager dispersion is based on the annual global PE returns as represented by the 10-year horizon internal rate of return (IRR) ending 1Q23. Data is based on availability as of 8/31/2023.

Next steps

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