Article

# The case for private equity in downturns

Private equity's model and form of ownership has demonstrated resilience in times of elevated inflation and muted economic growth.

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# What gives private equity *the edge*

## Record amounts of dry powder

Private markets dry powder—raised but yet to be spent capital— totalled a record US$3.7 trillion at the end of 2022.[1] This war chest can help managers to shepherd existing portfolio companies through market turmoil, either through the provision of additional capital support, or by backing "buy-and-build" acquisition strategies that expand earnings and market positioning.

## Taking advantage of lower valuations

With valuations tracking lower in 2023, managers can deploy their dry powder at much more attractive entry multiples. Target companies, on the other hand, have to accept lower prices as inflationary pressures and the possibility of a recession slows earnings. As of April 2023, purchase price multiples paid by private equity buyers are in "full correction mode", according to Pitchbook.[2]

## Access to essential companies

Many buyout fund managers actively target companies that are market leaders or provide critical goods and services without having to sacrifice order volumes. This makes these businesses more resistant to inflationary pressures as they can pass on higher input, labour or supply costs to consumers.

## Adopting new levers of value creation

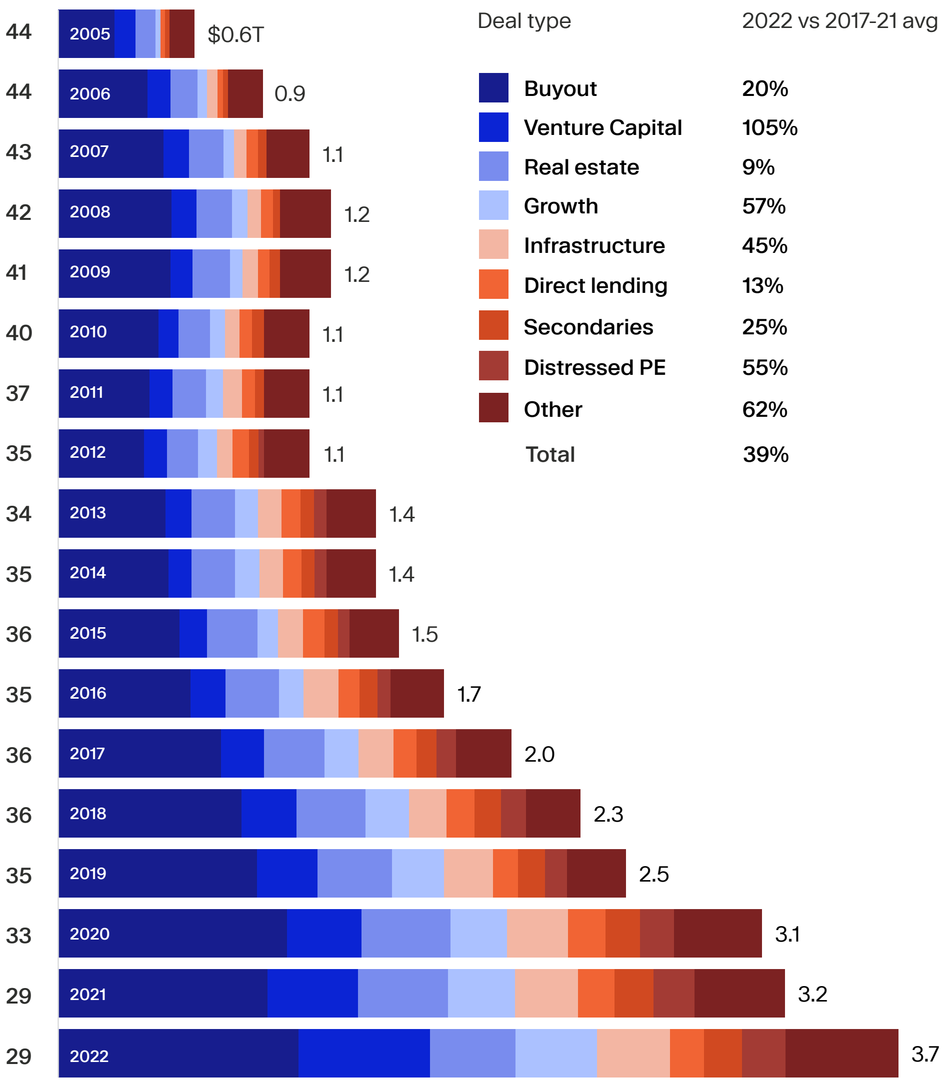
To respond to rising prices and interest rates that constrain multiple expansion, private equity firms can also turn focus to operational improvements to create value. They apply their deep industry expertise to uplift revenue, improve operational efficiency, retain talent, or increase the bottom line before selling upgraded companies for a higher multiple than they were acquired for.

## Proven performance in difficult markets

Recessionary periods have historically been some of the strongest vintages for private equity returns. This is driven in part because fund managers continue to deploy capital through cycles, and can therefore selectively acquire businesses at lower valuations in more challenging times. Indeed, private equity generated some of its best performing vintages during the dot-com crash of 2001 and the 2008-2009 global financial crisis (GFC).[3]

**Global private capital dry powder, by fund type ($T)**

Buyout's share of total (%)

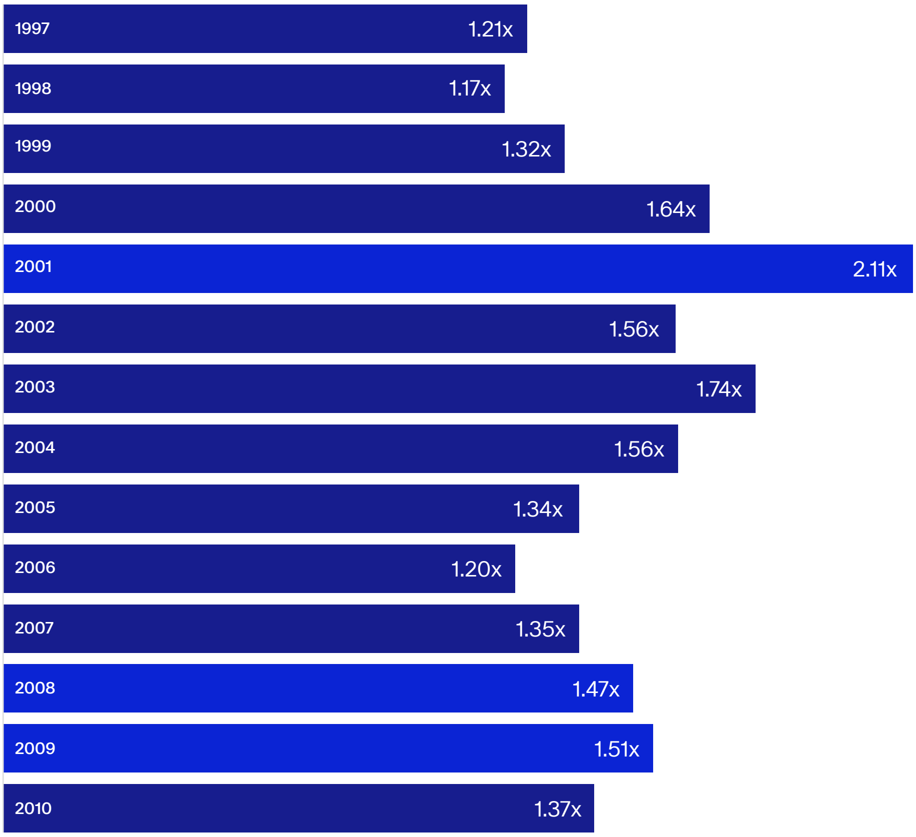



| Deal type | 2022 vs 2017-21 avg |
|---|---|
| Buyout | 20% |
| Venture Capital | 105% |
| Real estate | 9% |
| Growth | 57% |
| Infrastructure | 45% |
| Direct lending | 13% |
| Secondaries | 25% |
| Distressed PE | 55% |
| Other | 62% |
| Total | 39% |

Notes: buyout category includes balanced, coinvestment, and coinvestment multimanager funds: other category includes fund-of-funds, mezzanine, and hybrid: discrepancies in bar heights displaying the same value are due to rounding.
Source: Prequin

[1] https://www.bain.com/insights/private-equity-outlook-global-private-equity-report-2023/
[2] https://pitchbook.com/news/reports/q1-2023-us-pe-breakdown
[3] https://files.pitchbook.com/website/files/pdf/Q2_2020_Private_Market_PlayBook.pdf

Pooled TVPI seven years since inception by vintage year




Source: Pitchbook

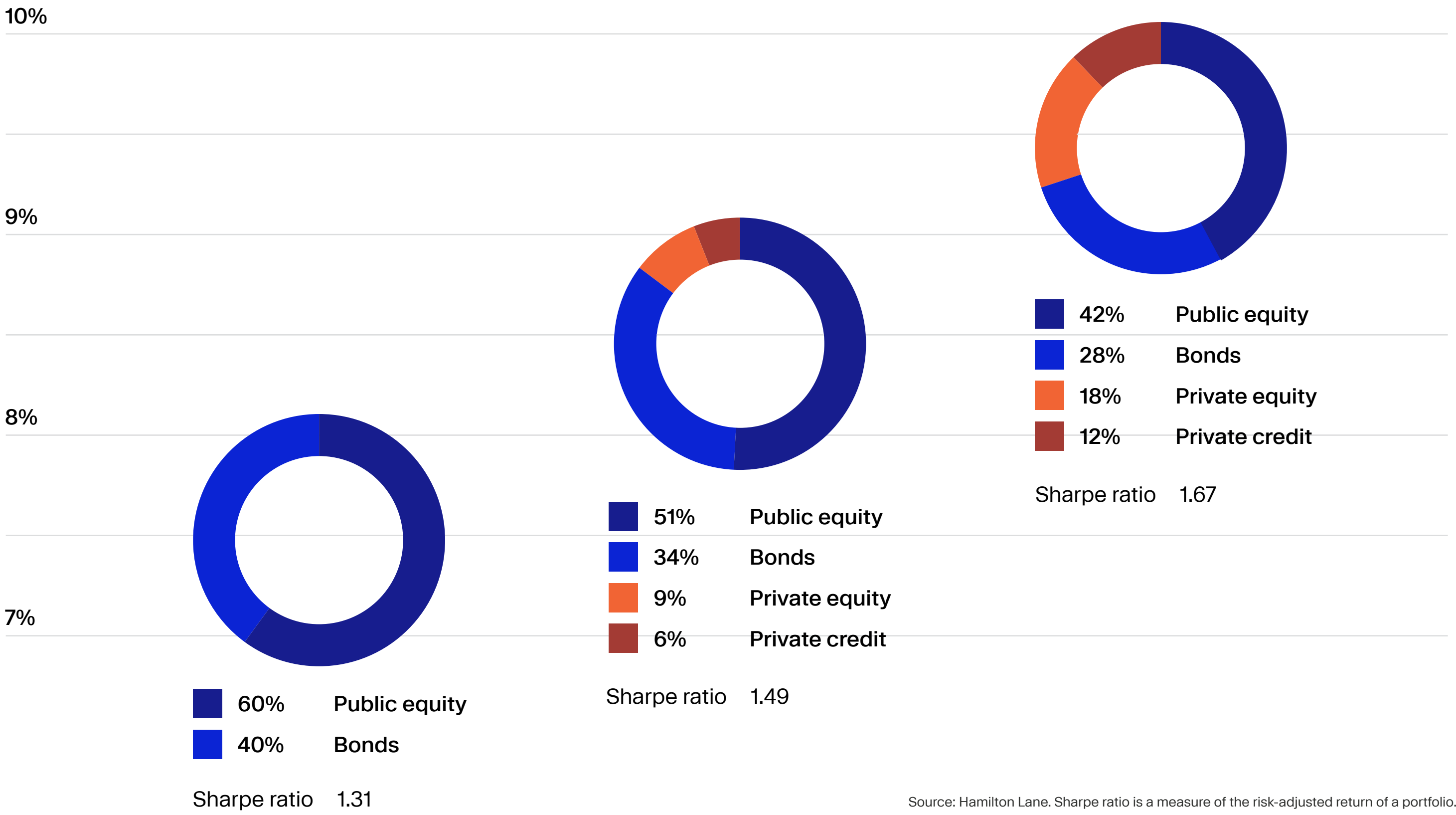
## Rethinking 60/40 models

High inflation, increasing interest rates and high uncertainty are destabilising the relationship between bonds and equities, weakening the impact of the 60/40 model where the majority of a portfolio consists of public equities and the rest, of bonds.

In an environment of lower returns from bonds and stocks, private equity's track record could prove highly beneficial. Between 2001 and 2021, private equity and private credit outperformed global public equity and credit markets in 19 of the 20 years.[4]

Adding private strategies to a traditional portfolio can therefore help bolster performance. For example, between 2000 and 2020, a rigid 60/40 portfolio offered annual returns of around 7.5 percent. However, a portfolio with a larger allocation to private equity and private credit offered annual returns of 9.40 percent.

A more diversified portfolio can help bolster risk-adjusted returns




Source: Hamilton Lane. Sharpe ratio is a measure of the risk-adjusted return of a portfolio.

[4] https://www.hamiltonlane.com/getattachment/37092cdf-c435-4142-bd9f-742a076ee5a9/hamilton-lane-beyond-60-40-allocating-to-private-markets-final.pdf

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