December 2024

Asset Allocation Report – Private Equity

Context

In recent years, private equity has faced challenges, including slower capital deployment, fewer exit opportunities, and unexpected fundraising hurdles. Many deals completed during the peak years of 2020 and 2021 are now under pressure, as firms struggle to sell businesses at or above their purchase prices. The growing gap between buyer and seller expectations has significantly impacted exit activity (as evidenced by the increase in average holding times from 4.9 years in 2019 to 5.4 years in 2024, according to Pitchbook)— a vital process for limited partners to meet liquidity needs, rebalance portfolios, and reinvest.

Amid these challenges, recent changes in monetary policy present a potential opportunity for relief. The U.S. Federal Reserve has joined other central banks in cutting rates, a move that historically, when combined with economic growth, has created favorable conditions for private equity. By improving financing terms, boosting business performance, and narrowing valuation gaps, these shifts could support both investments and exits, potentially alleviating some of the current pressures.

While a few rate cuts won't completely resolve all market challenges, steady economic growth and a renewed appetite for risk are gradually fostering a more optimistic outlook. Dealmaking slowed considerably in late 2023 and 2024, but early signs of recovery are now visible. As inflation eases and central banks implement more accommodative policies, the prospects for exits and liquidity events in 2025 are improving, creating a more favorable environment for private equity.

North America Focus

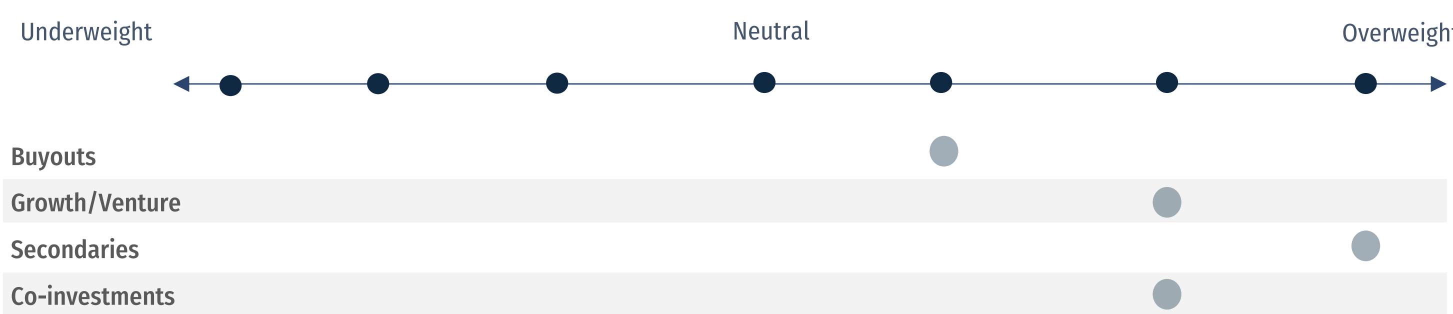
The United States plays a central role in the private equity industry, consistently leading in fundraising and deal-making. Its dominance makes it essential to examine how political and economic factors could shape the industry's future.

Although private equity firms are highly adaptable, the broader political, economic, and regulatory environment under the new U.S. government could influence deal-making, fundraising, and portfolio management. Key considerations include:

- **Deregulation:** the new government could benefit private equity firms by reducing compliance costs and easing acquisition barriers, particularly benefiting small and midsized businesses. Lowering these burdens could boost their growth and attractiveness.
- **Tariffs and Trade Policies**: Trade policies, such as tariffs or renegotiated agreements, may have a greater impact on manufacturing. However, most PE portfolios concentrate on sectors like technology, healthcare, financial services, and software, which are driven by intellectual property or services. This focus, along with diversification and strong operations, helps PE firms adapt effectively.
- **Economic Environment:** Policies like tax cuts, tariffs, and reduced immigration can drive inflation by increasing demand, raising costs, and tightening the labor supply, potentially leading to prolonged periods of high interest rates. While inflation poses challenges, private equity has demonstrated adaptability, as seen post-COVID when firms managed supply chains, protected margins, and grew EBITDA. The U.S.'s economic self-sufficiency helps mitigate some inflationary pressures, but prolonged high interest rates could delay improvements in exit opportunities.

Private Equity Views

The following summarizes the view in private markets based on a 12-month Outlook for each strategy. It is crucial to note that specific considerations will be addressed within these strategies in each of the following commentaries. This view cannot be generalized to all managers as each one is unique.



December 2024

Asset Allocation Report – Private Equity

Buyout

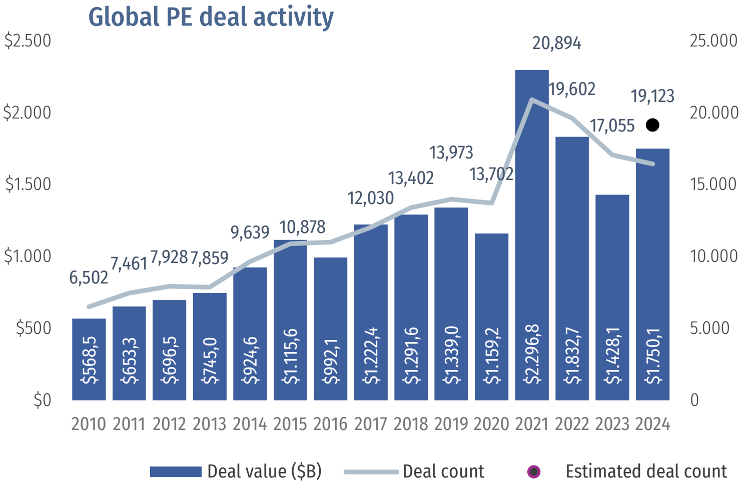
As 2025 approaches, the private equity buyout landscape is poised with both challenges and opportunities. To achieve historical returns, firms must focus on value creation by enhancing operations to drive organic revenue growth and profitability. This approach is particularly relevant in the **middle-market segment**, where revenue growth has consistently been a key driver of returns. Moreover, middle-market companies often provide greater scalability for value creation initiatives and offer a wider range of attractive exit opportunities.

Success will depend on firms' ability to adapt, excel in operational execution, and capitalize on emerging opportunities, enabling them to navigate challenges and unlock sustainable long-term value.

Tailwinds

Increasing Deal Activity: Lower capital costs for strategic and financial buyers, along with improved access to financing, are fueling a rebound in deal activity. According to Pitchbook, six-month deal values are now aligning with long-term trends for the first time since 2022. These favorable conditions have reduced transaction barriers and improved deal economics, supporting increased private equity activity while aligning buyer and seller expectations.

Global PE deal activity

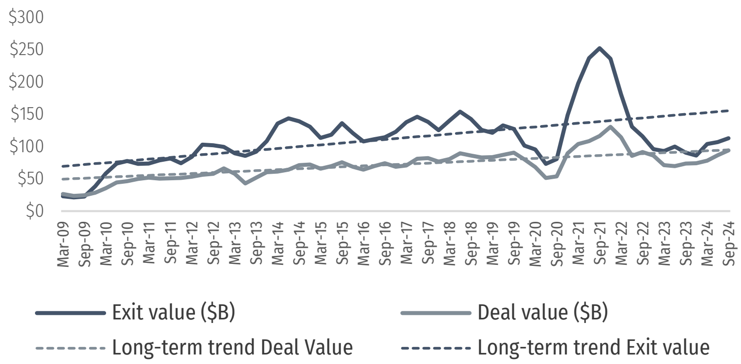


Source: Pitchbook, as of December 2024

In this context, the middle market is also poised to thrive in 2025, supported by its lower reliance on leverage and a strong emphasis on operational improvements, which create a favorable environment for investment. In Europe, the high concentration of founder-led businesses, combined with opportunities for growth through product diversification and geographic expansion, further enhances the prospects for deal activity in this segment.

Recovery in Exits: Improved exit conditions, including higher valuations and growing buyer interest are enabling private equity firms to return capital and attract investors. As reported by Pitchbook, PE exits are recovering, with 2,939 deals totaling USD 807.1 billion in 2024. While below 2021 levels, steady quarterly growth signals renewed confidence in the exit market.

Trailing six-month US PE buyout deal and exit values relative to long-term



Source: Pitchbook, as of September 2024

Middle-market companies are also well-positioned to capitalize on the resurgence in exit activity. Their size makes them appealing targets for both strategic buyers and private equity firms. Additionally, their limited access to IPOs often makes acquisitions the preferred exit route, aligning with current market trends favoring M&A activity.

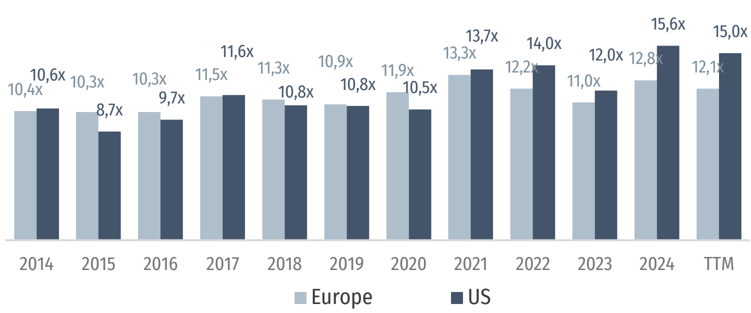
Dry Powder: In 2025, dry powder emerges as a tailwind for buyouts, supported by favorable market conditions that create an ideal environment for private equity firms to deploy capital effectively. With substantial reserves, these firms are well-positioned to act swiftly and decisively on emerging opportunities. According to Preqin, buyout funds held USD 1,015 billion in dry powder as of November 2024.

Headwinds

Stock Market Dynamics: In 2024, PE valuations have risen, influenced by multiple factors, including improved market sentiment and a catch-up with public markets. If interest rates decline, valuations may rise further, benefiting firms exiting investments through higher realizations. However, managers pursuing new deals must carefully assess entry multiples to avoid overpaying.

Despite this, interest rates may potentially remain high for longer, and strong economic fundamentals, including robust employment and earnings, continue to underscore the market's resilience and upside potential.

Median PE buyout EV/EBITDA multiples



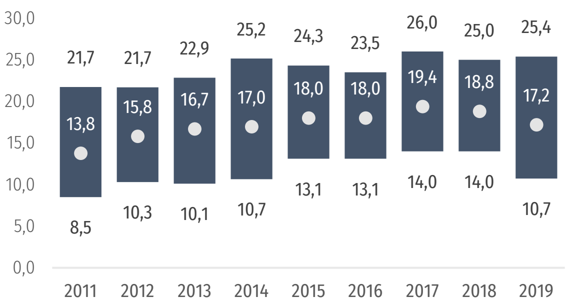
Asset Allocation Report – Private Equity

Geopolitical Uncertainties: Geopolitical tensions and economic challenges may affect investor confidence and market stability. Political strains, a potential slowdown in China's economy, persistent inflation, and the shift toward de-globalization could heighten uncertainty and disrupt trade and investment flows.

Increased Competition: A crowded market, with many firms competing for a limited number of high-quality assets, may continue to drive higher purchase prices, potentially reducing returns and making it more challenging to identify attractive investments..

Although elevated valuations could make exceptional returns harder to achieve, private equity has the potential to remain competitive by focusing on value creation through operational improvements and strategic growth, helping to address the challenges posed by narrowing long-term risk premiums, which have reached their lowest levels in over a decade.

Buyout Net IRR (vintage 2011-2019)



Vintage	KS-PME
2011	1.03
2012	1.09
2013	1.04
2014	1.2
2015	1.18
2016	1.14
2017	1.22
2018	1.09
2019	1.13

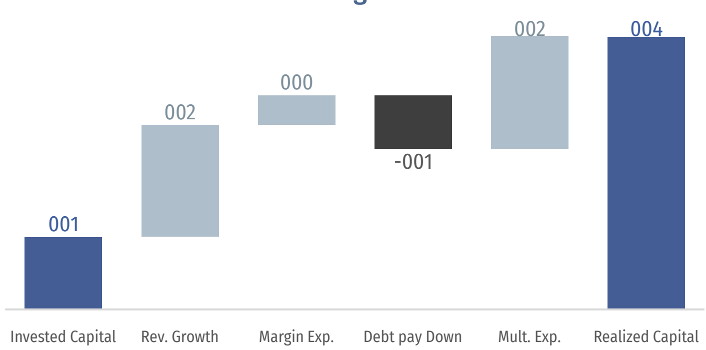
Source: Preqin, as of the most recent data available on November 15. PME: Pitchbook, as of Q2 2024.

Areas of Focus

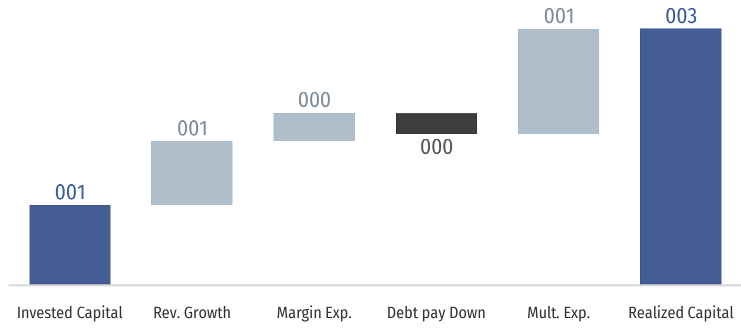
GPs' Focus on Alpha and Middle Market Opportunities: The 2025 outlook emphasizes the importance of GPs prioritizing alpha generation through operational value creation over beta-driven returns from multiple expansion.

Middle market managers are particularly well-positioned to capitalize on this environment due to their flexibility, scalability, lower entry multiples, and more modest leverage. Their focus on founder-led or family-owned businesses further provides diverse pathways for value creation, enabling tailored strategies that drive growth and enhance returns.

Valuation Bridge Mid-Market



Valuation Bridge Large Buyout



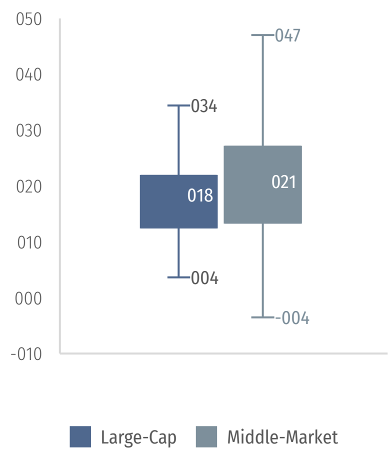
Source: Preqin. Middle Market refers to enterprises with an EV of less than USD 1 billion, while Large Buyouts refer to those with an EV greater than USD 1 billion. Data covers 2006–2019, all regions, and all industries. Middle Market constituents: 429; Large Buyouts constituents: 214.

	Mid-Market	Large Cap
Entry EV/EBITDA Multiples	11.2	12.7
Entry Leverage Ratios	4.3	6.0
Uplift in Exit MOIC	46.4%	26.4%

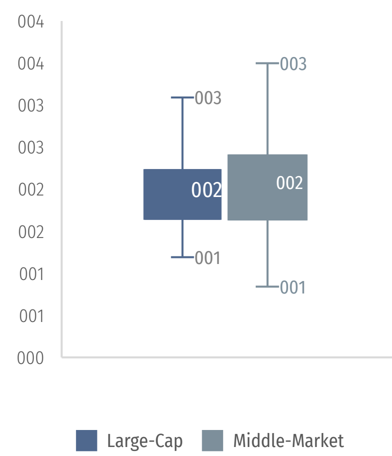
Source: Pantheon

The advantages of the middle market are reflected in its strong performance. An analysis conducted by HMC, focusing on managers specializing in middle-market and large-cap transactions—particularly industry leaders and those serving regional pension funds—revealed that middle-market managers generally achieve higher returns. However, this segment also exhibits greater return dispersion, underscoring the critical importance of meticulous manager selection to capture the full potential of middle-market opportunities.

Net IRR (Vintage 2000-2019)



Net TVPI (Vintage 2000-2019)

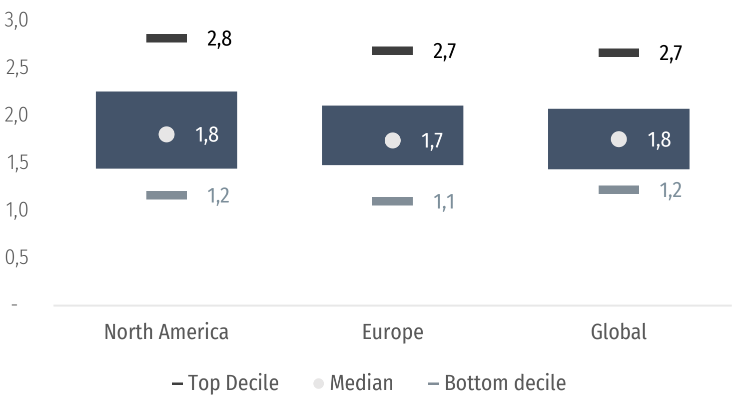


In terms of geographic focus, data indicate minimal variation in performance among managers targeting North America, Europe, or Global opportunities. Both median and top-decile metrics across key performance indicators appear comparable, suggesting an equal distribution of opportunities regardless of geography.

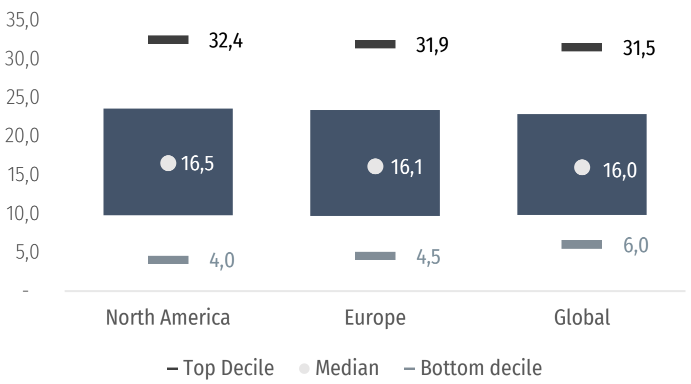
Asset Allocation Report – Private Equity

This consistency highlights the potential for investors to achieve similar outcomes across regions, provided they maintain a disciplined approach to manager selection and strategy alignment.

Net TVPI (Vintage 2000-2019)

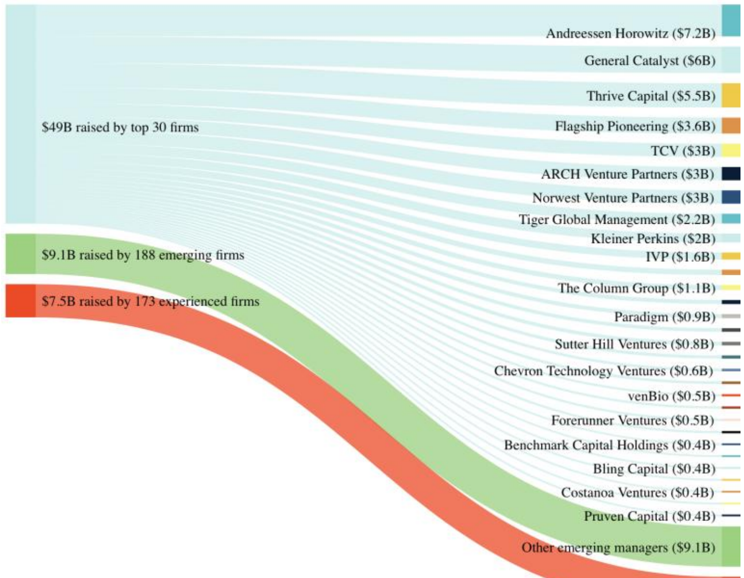


Net IRR (Vintage 2000-2019)



Source: Preqin, as of the most recent data available on January 9. North America includes 826 funds, Europe 510 funds, and Global 152 funds.

The top 30 VC funds raised 75% of all venture capital in the US this year



Source: Pitchbook, As of Dec. 4, 2024.

Venture and Growth

While venture capital and growth segments remain in a period of constrained liquidity and selective investment, AI-driven innovation and improving valuations for the top-performing private companies signal a methodical rebound, which is poised to accelerate if exit activity continues to recover in 2025.

However, outside AI, investors have prioritized quality over quantity, conducting rigorous due diligence and focusing on stronger companies with profitability potential. Insider rounds and bridge financing are helping companies maintain operations, but fewer new investors are entering the market.

Against this backdrop, there has been a clear flight to quality as fundraising activity is increasingly concentrated among larger/well-established managers. While total capital raised in 2024 is expected to return to pre-pandemic levels, fund counts remain near decade lows.

Tailwinds

Focus on Fundamentals: This is particularly evident in venture capital, where the focus has moved toward financial discipline, emphasizing profitability and efficient growth over unsustainable "growth at all costs" strategies. By aligning valuations with fundamentals, venture capital has regained investor confidence, reduced bubble risks, and encouraged more thoughtful, sustainable deal-making.

Platform-Based Value Creation in Growth: The growing adoption of platform-based strategies is enhancing the outcomes of growth funds. Companies with established operations and scalable models are driving value by executing add-on acquisitions, diversifying revenue streams, and entering new markets. This trend enables growth funds to unlock greater profitability through operational optimization and economies of scale.

Secular Growth Themes Driving Investments: Investment activity in venture capital has stabilized above pre-pandemic levels but remains far below 2021's record highs. AI has dominated the landscape, accounting for more than 25% of deal count and 35% of deal value. Secular growth themes driven by technological innovation – including AI, cybersecurity, FinTech, healthcare and others – continue to demonstrate transformative potential, even as venture and growth investors have been more selective in their deployment of capital.

Growing Interest by PE firms: Private equity firms are increasingly targeting VC and growth opportunities to capitalize on attractive entry points and long-term growth potential, allowing them to invest in companies with sufficient scale and extended private ownership. The technology sector, a core industry for both VC and growth, has shown particularly strong activity, accounting for 26.8% of Global PE deal value in Q3. PE firms leverage their expertise to drive business growth and offer alternative exit paths for venture and growth fund.

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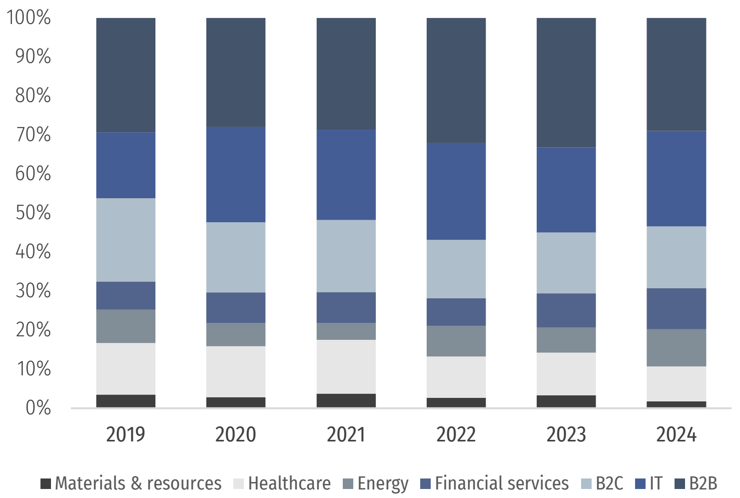
Share of PE deal value ($B) by sector



Source: Pitchbook, as of September 2024. Calculations by HMC based on private equity deal values in US and Europe (converted to USD using the exchange rate as of the last day of each month).

Secondaries: The prolonged lack of liquidity in the venture and growth capital segments, driven by a slowdown in IPOs and M&A activity, has created attractive opportunities in the secondary market. Investors can acquire secondary interests in funds at compelling discounts, offering mitigated J-curve effects and accelerated time to liquidity. Additionally, the secondary market provides visibility into the underlying portfolio and its key value drivers from day one, enabling informed decision-making and reducing uncertainty.

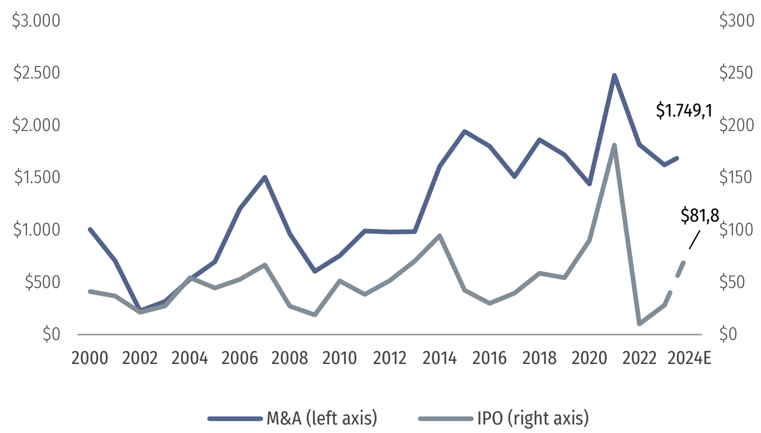
This dynamic positions secondaries as a strategic way to capitalize on high-quality assets in the venture capital space while managing risk and improving potential returns.

Headwinds

Limited Liquidity Options: A prolonged drought in exit activity for VC-backed/growth-stage companies continue to pose significant challenges for GPs and limited partners alike. This headwind is compounded by a growing backlog of late-stage startups, with nearly 40% of unicorns (private companies valued at USD 1B+) now held in portfolios for nine or more years according to Pitchbook. This liquidity crunch has reduced distributions to LPs, which are at decade-low levels of 5.2% of NAV, mirroring rates seen during the global financial crisis.

Nevertheless, the anticipation of future rate cuts has fueled optimism for a revival in exit activity. Lower borrowing costs could stimulate M&A transactions, creating a more conducive environment for VC-backed and growth companies to achieve successful exits. Rebounding IPO activity in 2024 and strong public markets could boost exits further in 2025. However, the pace and extent of rate cuts will play a critical role in determining how quickly the exit market fully recovers.

US M&A value and IPO capital raised ($B)



Source: Pitchbook, as of October 2024.

Slow recovery in valuations: Valuations showing signs of recovery in 2024, with median pre-money valuations increasing across all stages, in some cases surpassing 2021 levels. However, these figures are heavily influenced by AI deals and startups that delayed fundraising after securing high valuations during the zero-interest-rate-policy era.

At the same time, the median time between funding rounds has significantly increased—now exceeding two years for late-stage companies—indicating slower value creation. Flat and down rounds now account for 26.6% of all VC deals, the highest level in a decade, reflecting ongoing market corrections based on company fundamentals.

While AI continues to drive outsized valuations, the broader market is experiencing corrections as valuations increasingly align with company fundamentals. Interest rate cuts may offer some additional support, further enhanced by disciplined underwriting practices and the application of lessons learned from past overpayments.

Areas of focus

Diversification: Diversification is vital in today's venture capital landscape, and FoFs offer an effective solution by pooling investments across funds to reduce risk and enhance resilience. They also provide access to emerging sectors like AI and leverage expertise to ensure a balanced risk-return profile and exposure to top managers.

In addition, Growth private equity funds that prioritize diversification across underlying investments are better equipped to navigate macroeconomic uncertainties. By avoiding overreliance on a few companies, these funds mitigate the risk of significant impacts from external factors.

These two approaches enable the capture of opportunities, specifically among top-quartile managers.

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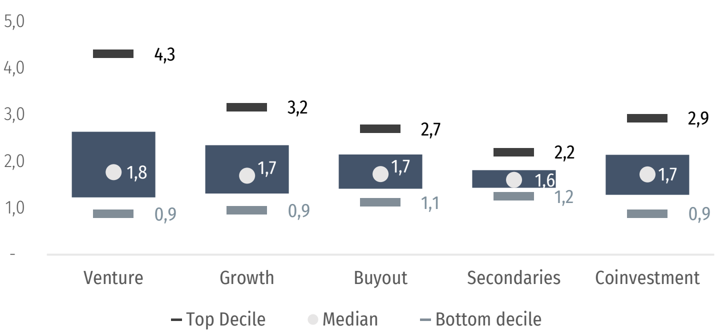
Net TVPI Dispersion (Vintage 2005-2019)



Source: Preqin, based on the most up-to-date data as of December 7, 2024.

Early-stage attractiveness: Early-stage strategies invest at less volatile entry valuations given the limited scale and market traction of startup companies. They also tend to be less impacted by immediate market conditions, as they prioritize companies pursuing long-term innovation, with the ability to become leaders in disruptive technologies and secular growth themes. With extended timelines for portfolio companies to grow and mature, these funds align well with the expected recovery in the exit markets.

Coinvestments

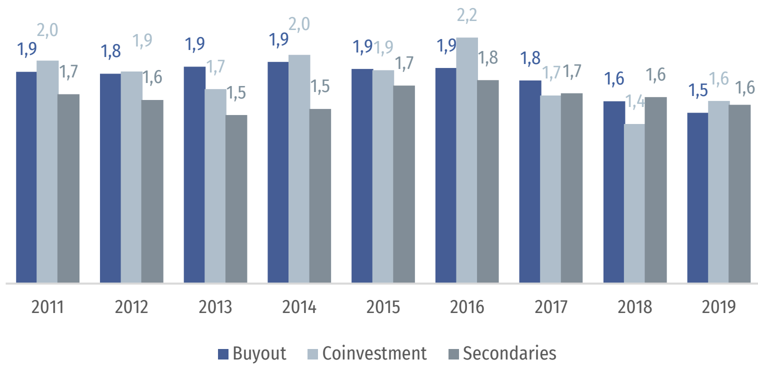
Co-investments remain a compelling option for private equity investors, benefiting from many of the same tailwinds that drive buyout strategies. This strategy is especially well-positioned in 2025, thanks to factors such as:

- With fundraising becoming more challenging, GPs may turn to co-investments to bridge funding gaps for larger deals or to secure the necessary capital for opportunities without exceeding their fund limits. This can create additional co-investment opportunities for LPs or lead to tailored solutions, such as SMAs or overflow vehicles.
- In a competitive deal environment characterized by elevated purchase prices—particularly for top-tier assets—and ongoing uncertainty, diversification is more critical than ever. Co-investments offer unique flexibility to achieve this, whether through direct investments alongside GPs or via commingled co-investment funds. These funds not only provide access to high-quality private equity opportunities but also enable a focused allocation to highly experienced managers with proven operational capabilities, further enhancing the potential for value creation.
- Furthermore, Co-investments has emerged as a flexible and cost-effective alternative for GPs to secure capital. They enable GPs to balance liquidity needs, support portfolio growth, and maintain control over their investments, aligning well with the current financial landscape.

In terms of returns, co-investments closely align with buyouts in terms of returns, highlighting their complementary nature and potential to enhance portfolio performance without significant deviations in risk-adjusted returns.

As shown in the following exhibit, the data underscores the attractiveness of co-investments as a strategy capable of delivering competitive—and occasionally superior—returns compared to traditional buyouts or secondaries.

Net TVPI (Vintage 201-2019)



Source: Preqin, based on the most up-to-date data as of January 9, 2025.

Areas of Focus:

The current market environment has underscored the appeal of "mid-life" transactions, which enable investments in established portfolio companies. These deals are particularly attractive as they often feature moderated valuations, less competitive bidding processes, and the potential for earlier cash distributions, helping to mitigate the effects of the J-curve. Furthermore, tighter credit markets and limited exit opportunities have shifted investor focus toward opportunities that provide greater visibility into a company's performance and value trajectory.

Co-underwrite transactions are also gaining traction in this environment. These deals allow to partner with GPs earlier in the investment process, often sharing in the due diligence and decision-making stages. This approach not only enhances transparency and alignment but also enables investors to access high-quality assets with favorable terms.

Together, funds focused on mid-life and co-underwrite transactions align with broader market trends, providing a practical approach to navigating the current market environment.

Secondaries

Secondaries will remain a crucial part of private markets in 2025, providing liquidity solutions, access to mature private assets at discounted valuations, and enhanced portfolio diversification.

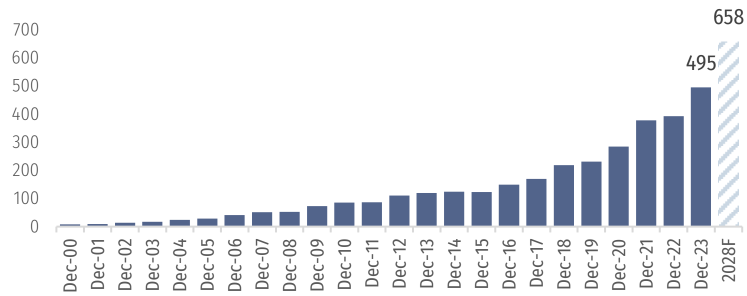
Asset Allocation Report – Private Equity

It is poised for significant growth in the coming years, driven by structural tailwinds, evolving deal structures, and expanded participation from a broader range of investors. In a soft-landing scenario, secondaries and private equity as a whole are well-positioned to benefit from stabilized valuations and access to high-quality assets, delivering strong risk-adjusted returns.

Tailwinds

Market Expansion and Maturity: The secondaries market has experienced rapid growth, with transaction volumes reaching USD 68 billion in 2024, representing a 58% year-over-year increase. According to Preqin, AUM in secondaries is projected to exceed USD 600 billion by 2028. This growth is driven by rising allocations to private markets and an increasing demand for liquidity, as this strategy is viewed as a vital tool for portfolio rebalancing.

Secondaries Assets Under Management

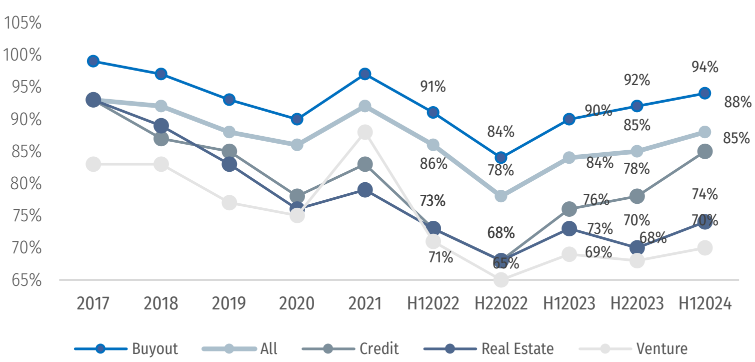


Source: Preqin Pro

Discounted Entry Points: In 2024, discounts to NAV averaged around 12%, allowing secondary investors to access high-quality, mature portfolios at attractive valuations. Although narrower than historical peaks, these discounts remain meaningful, providing compelling opportunities for LP-led strategies to mitigate J-curve effects and enhance returns.

For GP-led transactions, current pricing enables innovative liquidity solutions like continuation funds, allowing sponsors to retain top assets while providing investor liquidity. In H1 2024, continuation funds represented 90% of GP-led volume, highlighting its demand. The surge in GP-led deals, reflects a shift toward structured solutions and serves as a tailwind for secondaries.

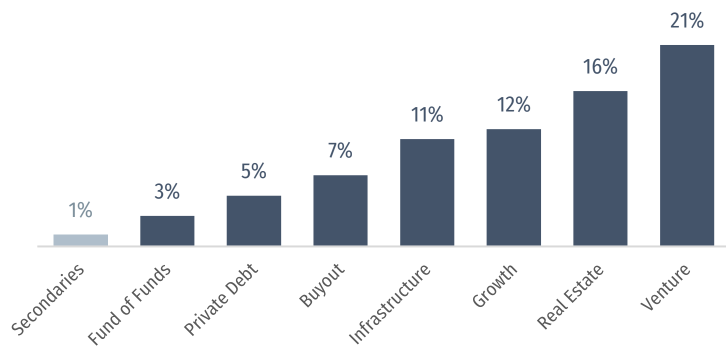
LP Portfolio Pricing (% of NAV)



Source: Jefferies, H1 2024 Global Secondary Market Review

Defensive Nature of Secondaries: Secondaries have become increasingly attractive to investors for their defensive profile and strong capital preservation, particularly in uncertain and volatile markets. They show a significantly lower proportion of funds with net multiples below 1.0x compared to other private capital strategies, highlighting their resilience and reduced downside risk.

Ratio of funds with a Net TVPI below 1.0x (Vintage 2000-2019)



Source: Preqin, using the most recent data available as of December 8, 2024. Calculations by HMC based on the performance of over 8,200 funds.

Sustained Appetite for investors: Secondary funds are highly appealing in an environment where DPI is a top priority, offering quicker returns and earlier distributions than primary funds. This makes them essential for investors prioritizing realized performance.

Additionally, the market is attracting non-traditional players, including retail investors through feeder funds and evergreen structures, diversifying the investor base and deepening the market.

Headwinds

Increased competition: The growing popularity of secondaries has intensified competition among institutional investors, particularly for high-quality deals in established markets like the U.S. and Europe. This increased demand risks compressing discounts and reducing potential returns.

While there is no objective data to confirm a clear advantage, managers with extensive track records have often navigated a range of macroeconomic environments, which, in some cases, have influenced their overall performance and median metrics, unlike newer managers whose track records are more limited.

Firms with extensive experience hold significant advantages through their established relationships, deep market knowledge, and strong reputations. These managers are well-positioned to leverage lessons learned from navigating diverse economic cycles, allowing them to refine strategies and maintain a competitive edge in an increasingly dynamic landscape.

December 2024

Asset Allocation Report – Private Equity

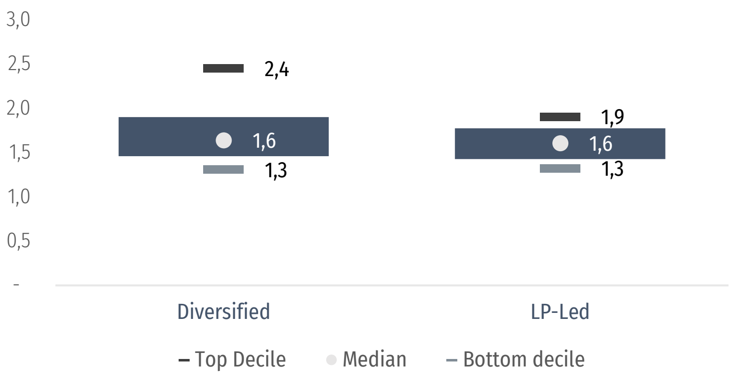
Area of Focus

Strategic Diversification: investors should focus on secondary funds that are well-diversified across strategies to capitalize on various trends, such as venture secondaries and the opportunities arising from both LP-led and GP-led transactions.

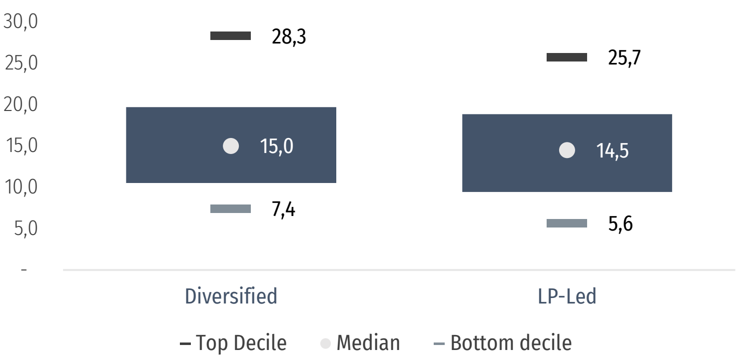
Additionally, funds specializing in GP-led transactions hold strong appeal, as this segment continues to evolve beyond traditional continuation funds. Single-asset deals, for instance, have gained significant traction, comprising 64% of GP-led volume in H1 2024. These deals allow sponsors to retain "trophy assets" while providing liquidity to investors. GP-led transactions overall reached USD 28 billion in H1 2024, reflecting a 56% year-over-year growth compared to H1 2023, and accounted for 41% of total secondary market volume.

As shown in the following exhibits, the median performance of secondaries funds with diversified strategies (combining GP-led and LP-led transactions) is comparable to that of LP-led focused funds. However, diversified funds exhibit slightly greater dispersion, suggesting that with careful selectivity, investors have the potential to achieve higher returns. Nevertheless, secondaries as an asset class continue to benefit from very low overall dispersion, which remains a key advantage in terms of risk mitigation, providing investors with more predictable outcomes compared to other strategies.

Net TVPI (Vintage 2000-2019)



Net IRR (Vintage 2000-2019)



Source: Preqin. HMC analysis based on data available as of January 9, 2025. Diversified includes the analysis of 74 funds, and LP-Led includes 111 funds.

AI

Artificial Intelligence is rapidly influencing private markets. These technologies are revolutionizing processes such as pricing, deal sourcing, and operational efficiency, enhancing transparency, improving risk assessment, and optimizing transaction outcomes. By streamlining workflows and enabling data-driven strategies, AI is reshaping how value is created and managed across various sectors, paving the way for more efficient and effective market dynamics. Therefore, key areas include:

Emerging Investment Opportunities: AI-focused companies are attracting significant attention from private equity investors. Funds specializing in AI technologies offer exposure to high-growth sectors such as machine learning, natural language processing, and autonomous systems. Allocating a portion of the portfolio to such funds can capture the upside of this transformational trend.

Enhanced Due Diligence and Risk Management: Fund managers are increasingly adopting AI tools to analyze historical data, identify trends, and uncover hidden risks. These tools also support investor decision-making by providing deeper insights into fund performance and portfolio diversification.

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