

Even as Possible Recession Looms, Prospects for Private Markets Look Strong

It is no secret that public markets are facing notable volatility. But from where I sit in the trenches of private market dealmaking, the near-term prospects for private equity remain strong.

Here's the reality: Funds have raised enormous amounts of capital that still needs to be deployed. That means private market M&A deals will continue to get done at good values, particularly for well-run companies that show consistent performance.

Investors Closely Track Recession Indicators

There is one question on the minds of all investors today: Will we enter a recession, and if we do, how deep it will be?

We cannot ignore the macroeconomic indications that a recession could be coming. Inflation hit 9.1 percent in June – a 40-year high, creating pressure on the Federal Reserve to continue rapidly increasing interest rates. Similar stories have emerged globally as central banks attempt to get inflation under control.

Private Markets Are a Safe Haven—But for How Long?

It's not surprising that public markets have already declined in anticipation of a downturn. Those markets run up more quickly in a strong economy, and tumble faster. Private markets are historically less volatile. We are hearing of LP investors asking private equity groups when portfolio company valuations will be marked down in accordance with the down public markets. But this is the wrong mindset. Portfolio company valuations aren't generally marked up when public markets are rising, and in turn shouldn't necessarily be penalized for public market volatility.

When we think about what to expect in the second half of this year and early next year, we are watching second quarter business performance as a harbinger of what's to come. There are certainly some companies suffering as consumers pull back in spending on products amid sharp increases in gasoline and grocery prices. But, based on corporate earnings to date, the impact hasn't been widespread.

Private markets have not been entirely immune from the current economic environment. Lenders and buyers are becoming a bit choosier. Dealmaking in cyclical businesses

But this is an odd time for the economy, and despite the indicators it's not at all clear that we will wind up in a recession. Labor markets are telling a far different story, with unemployment at historic lows. There's never been a recession when the jobs market looks like today's.

– which has been strong in recent years – may drop off a bit as there's less capital made available for those transactions.

What's more, we have seen some deals that already are in motion take longer to finalize than we expected. But we're not yet in a phase where those deals are falling apart.

For years, private equity has been an attractive component of a diversified portfolio for LP investors. Because of the low-interest rate environment we've been in, material funders of private equity – large institutional investors like pension funds, university endowments and insurance companies – have increased their allocations to alternative assets, including private equity, because the private market has provided great returns. If interest rates rise for an extended period, we could ultimately see less capital available for private equity as fixed income and other investments become more attractive. But that would take years to play out.

In the meantime, there is continued pressure to deploy the substantial dry powder sitting in private funds. That bodes well for activity in coming months.

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