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Chief Investment Office GWM
Investment Research

Private equity

CIO View: Private equity

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- Private equity (PE) sponsors have demonstrated an ability to adapt to changing market dynamics, to support underlying portfolio companies in periods of stress and to proactively deploy capital in dislocations.
- Historically, crisis vintages have been associated with higher returns. As investors balance short-term worries versus long-term opportunities, we think the strategic appeal of private equity as a source of differentiation and return enhancements remains valid.
- Our positioning remains intact. We continue to favor managers with a proven track record in value creation with a special eye on complex transactions such as carve-out and divestitures. We also still like secondaries, which could see a renewed supply of discounts as investors seek liquidity.

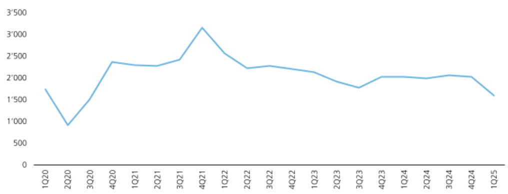
Source: Getty images

Private equity in the current environment

- 1Q25 has been characterized by increased uncertainty in public and private markets amid change in the US administration and policy shifts on tariffs and global trade. "Liberation Day" and the following announcement of US trade tariffs on all its major partners on 2 April have brought additional challenges and uncertainty PE investors will have to deal with in the short to intermediate term. The last quarters of 2024 indicated a pickup in private equity momentum (exits, acquisitions, and valuations). 2025 is now set to experience a change in trend.
- This is already visible in 1Q25 data. Pitchbook indicates that completed PE deals in the US are running ~20% slower in 1Q25 compared to 1Q24. Early in the year, sponsors adopted a wait-and-see approach, delaying decision-making until more clarity is shed on the new operating environment. They are now focused on assessing first- and second-order effects of tariffs on underlying businesses, while seeking alternatives to potential supply chain dependencies. This means both acquisitions and realizations will likely remain on pause and the spread between buyers and sellers could widen again. Distribution delays may extend until meaningful interest rate cuts, combined with President Trump's next phase of policy rollout (deregulation and lower taxes), incentivize more transactions.
- As for public markets, tariffs and their potential to slow down the global economy are negative for private company profit margins, cash flows, and earnings. The extent to which private companies will be affected will be dependent on their sector of activity, the lasting impact of tariffs, and the resilience of the economy and the US consumer. Private equity assets, however, can be more domestically orientated and less geared to import- and export-reliant industries, providing some offset to the

Fig. 1: Private equity deal counts declined amid uncertainty

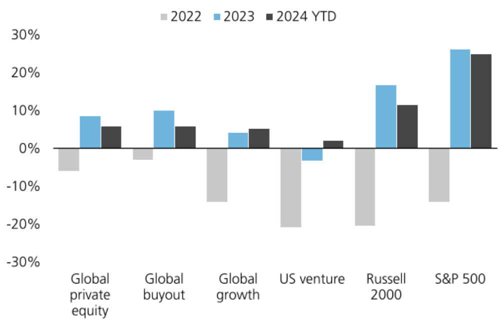
US private equity deal value in USD bn (lhs) and deal count (rhs)



Source: Pitchbook, UBS, April 2025

Fig 2: Compared to public markets, private equity valuations have remained mostly stable over the last 24 months

Private vs. public market returns, full-year 2022 and 2023, and year-to-date through 3Q24



Source: Cambridge Associates Private Equity Benchmarks, Bloomberg, UBS, April 2025 tariff hits. For instance, businesses focused on physical consumer goods are more at risk than those generating revenues from mission-critical enterprise services.

- On a positive note, high valuations are a lesser risk in private equity. While public markets rallied to new highs in the past 24 months in comparison, PE entry multiples have shown more stability. As of 3Q24, valuations were moderately improving compared to 2023 at around 12x but still well below public market multiples. Private valuations typically follow those of public market investments with a lag. If public equity markets remain depressed, downward adjustments should be expected, but the risks look more contained than what public markets experienced in the past few days.
- Our positioning remains intact. Entering 2025, we favored managers focused on middle-market companies where valuations looked particularly attractive and where leverage use is generally lower. This recommendation remains valid and could benefit from the next phase of Trump's policy rollout given the more domestic orientation of these businesses. Managers with a proven track record in value creation with a special eye on complex transactions such as carve-out and divestitures should also benefit from increased deal flow as companies review their strategic priorities and shed non-core assets to raise capital. Finally, secondary funds could see fresh supply of discounted deals prompted by some investors seeking liquidity solutions amid forced portfolio adjustment decisions ("denominator effect").
- Stagflation followed by an outright recession are key risks to monitor as part of CIO's downside scenario in the coming months. PE sponsors historically have demonstrated an ability to adapt to changing market dynamics, to support underlying portfolio companies in periods of stress, and to proactively deploy capital in dislocations. This time should be no different. Historically, crisis vintages have been associated with higher returns. As investors balance short-term worries versus long-term opportunities, we think the strategic appeal of private equity as a source of differentiation and return enhancements remains valid. They should nevertheless review their portfolios and seek to identify potential drifts in risk, expected returns, and tolerance for illiquidity.

Positive drivers

- **Resilient corporate fundamentals:** Private company earnings and revenues entering 2025 were solid overall. PE assets are often more domestically orientated and less geared to import and export reliant industries providing some offset to tariff hits.
- **Attractive valuations**: Compared to public markets, PE valuations have been stable over the past 24 months.
- **Fed rate-cutting cycle**: Lower interest rates would help ease funding costs and support transaction activity.

Negative drivers

- **Recession risks :** Tariffs have increased recession risks, which could negatively affect underlying portfolio company fundamentals.
- **Higher for longer:** Delays in rate cuts may limit the ability to support or finance deals.
- **Political uncertainty:** This is a drag on transactions and due diligence processes.
- **Exit environment:** A growing backlog of deals for sale, lengthening fund terms, and delayed exits may ultimately impact internal rates of returns (IRRs).

Considerations before investing

- When investing in alternative investments, investors must always be aware of the risks inherent to the asset class, such as a lack of liquidity, lack of control, limited disclosure, blind pool risk, uncertain cash flows, and the use of leverage.

Non-Traditional Assets

Non-traditional asset classes are alternative investments that include hedge funds, private equity, real estate, and managed futures (collectively, alternative investments). Interests of alternative investment funds are sold only to qualified investors, and only by means of offering documents that include information about the risks, performance and expenses of alternative investment funds, and which clients are urged to read carefully before subscribing and retain. An investment in an alternative investment fund is speculative and involves significant risks. Specifically, these investments (1) are not mutual funds and are not subject to the same regulatory requirements as mutual funds; (2) may have performance that is volatile, and investors may lose all or a substantial amount of their investment; (3) may engage in leverage and other speculative investment practices that may increase the risk of investment loss; (4) are long-term, illiquid investments, there is generally no secondary market for the interests of a fund, and none is expected to develop; (5) interests of alternative investment funds typically will be illiquid and subject to restrictions on transfer; (6) may not be required to provide periodic pricing or valuation information to investors; (7) generally involve complex tax strategies and there may be delays in distributing tax information to investors; (8) are subject to high fees, including management fees and other fees and expenses, all of which will reduce profits.

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In addition to the risks that apply to alternative investments generally, the following are additional risks related to an investment in these strategies:

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- Managed Futures: There are risks specifically associated with investing in managed futures programs. For example, not all managers focus on all strategies at all times, and managed futures strategies may have material directional elements.
- Real Estate: There are risks specifically associated with investing in real estate products and real estate investment trusts. They involve risks associated with debt, adverse changes in general economic or local market conditions, changes in governmental, tax, real estate and zoning laws or regulations, risks associated with capital calls and, for some real estate products, the risks associated with the ability to qualify for favorable treatment under the federal tax laws.
- Private Equity: There are risks specifically associated with investing in private equity. Capital calls can be made on short notice, and the failure to meet capital calls can result in significant adverse consequences including, but not limited to, a total loss of investment.
- Foreign Exchange/Currency Risk: Investors in securities of issuers located outside of the United States should be aware that even for securities denominated in U.S. dollars, changes in the exchange rate between the U.S. dollar and the issuer's "home" currency can have unexpected effects on the market value and liquidity of those securities. Those securities may also be affected by other risks (such as political, economic or regulatory changes) that may not be readily known to a U.S. investor.

Appendix

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