IQEQ

Private equity in the U.S.

January 2025

Introduction

Over the past year, marked by unprecedented developments, we witnessed notable macroeconomic shifts, including record-high inflation rates and aggressive monetary policy tightening across advanced economies.

These headwinds precipitated a global downturn, injecting significant uncertainty into markets. Private markets, in turn, faced substantial pressure, with some notable exceptions across strategies and regions.

As we enter 2025, a more optimistic economic outlook is emerging. Major economies are experiencing disinflationary trends and have entered a phase of easing interest rates. Central banks, including the Federal Reserve (the Fed), the Bank of England, and the European Central Bank, have implemented initial rate cuts, signalling the start of this cycle.

While global monetary policy is generally easing, some regional variations remain. For example, the Bank of Japan's decision to raise interest rates earlier in the year diverged from this trend. However, its broader impact on global asset prices has been limited, as initial market reactions have largely stabilized.

Optimism surrounding a more accommodative borrowing environment sets the stage for a potential resurgence in private market activity. However, broader uncertainty is expected to linger due to geopolitical tensions, the prospect of significant shifts in the global political order amid numerous elections in 2024, and persistent macroeconomic challenges.

Against this intricate backdrop, we examine how these conditions will influence the outlook for private equity markets in the U.S. in 2025. We aim to offer insights into how investors can navigate current market dynamics and leverage opportunities in private equity strategically to their advantage.

Macroeconomic overview

Macroeconomic conditions

New administration under President-elect Trump

Easing inflationary pressures

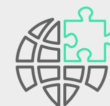
Regulatory compliance

Easing of the interest rate tightening cycle

Strong likelihood for soft landing

Elevated risk of default amidst tighter monetary policy in the near-term

Tech disruption and AI boom



Geopolitical realignment

Environmental challenges

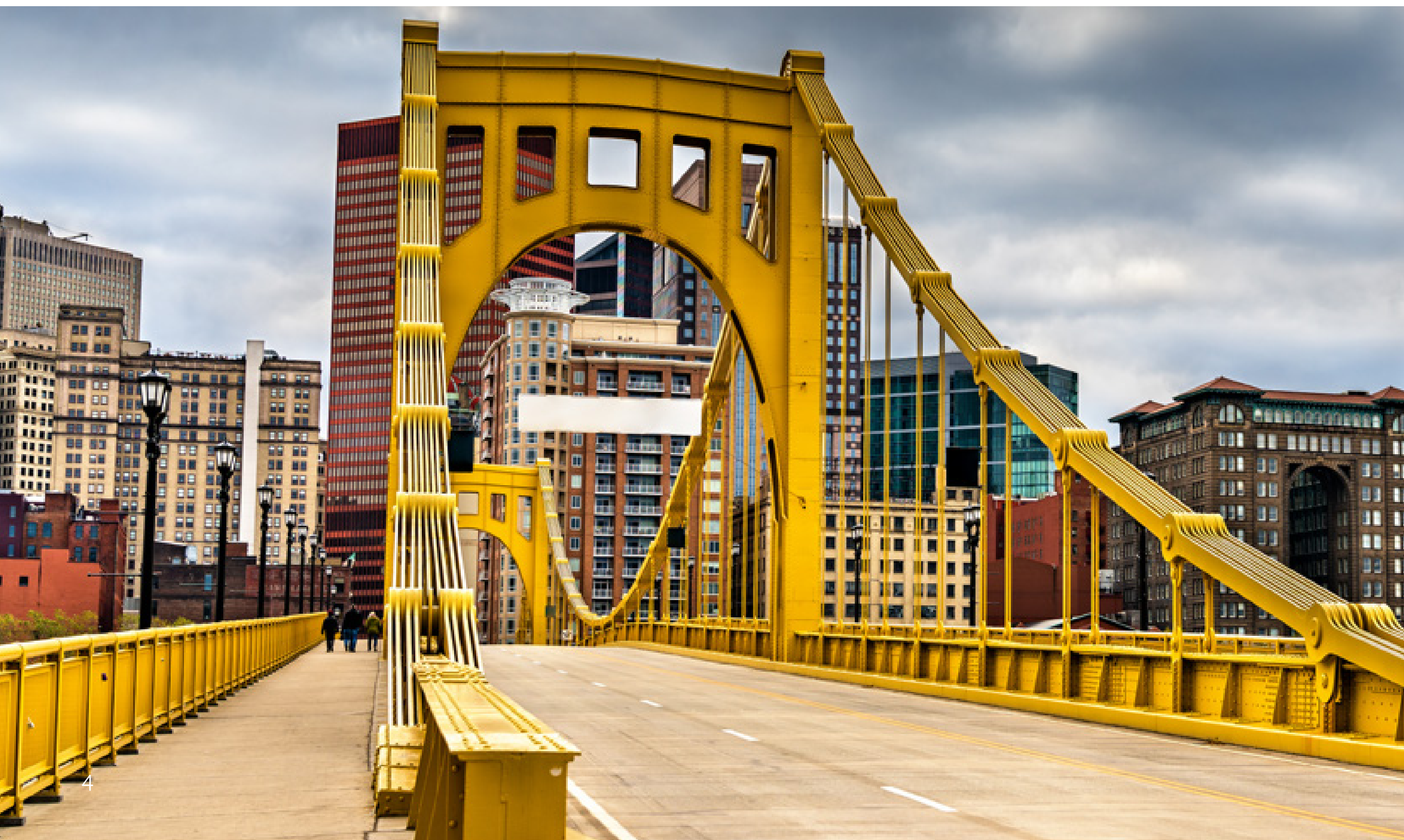
The U.S. economy grew at an annualized rate of 2.8% in Q3 2024, based on second estimates for quarterly GDP growth, reinforcing the notion of a soft landing and dispelling concerns about a potential recession.

The slowdown in inflation, with only a minor uptick in October, provided the Fed confidence to cut interest rates twice in quick succession, bringing the base rate to 4.75%. These rate cuts are expected to further stimulate economic activity by making borrowing cheaper and encouraging investment.

However, the Fed is aiming to strike a delicate balance between cutting rates to boost demand while ensuring that upside risks to inflation are not realized. The effects of tighter monetary policy are starting to seep into the labor market, with cooling conditions and fewer job openings. Despite this, the unemployment rate has remained stable, and wages are recording only a marginal uptick, further supporting the notion of a soft landing in the broader economy. While the labor market shows signs of moderation, it remains resilient, with overall economic activity continuing to reflect the ongoing adjustments in response to the Fed's actions.

However, even with policy loosening, rates are likely to remain significantly higher than pre-pandemic levels. Consequently, borrowing costs and debt service payments are expected to remain at elevated levels for some time. This raises concerns about augmented default rates and poses risks to the banking sector. In turn, this adds uncertainty to financial markets, potentially having spillover effects on the private asset market.

The U.S. presidential election resulted in Donald Trump's re-election, bringing with it promises of tax cuts and deregulation. These policies, if fully implemented, could reduce burdens stemming from taxes on corporate earnings and capital gains, potentially encouraging greater deal activity and improving the investment climate for PE firms. However, much of the promised agenda remains shrouded by uncertainty, especially given the complexities of the current political landscape . At the same time, ongoing geopolitical tensions, such as the Russia-Ukraine conflict and unrest in the Middle East, continue to complicate the U.S. economic outlook. These tensions are likely to impact global economic dynamics, potentially driving volatility in energy prices, trade relations, and global supply chains.



Overview of the global private equity market

In 2023, the global PE market faced significant challenges, largely driven by elevated inflation and aggressive monetary tightening, which squeezed company operating margins and increased borrowing costs for leveraged buyouts (LBOs).

As a result, global deal value fell by 60% and deal count dropped by 35% compared to the peaks seen in 2021.[1] Notably, buyout investments, excluding add-ons, saw their total value decline to $438 billion, marking a 37% drop from 2022 and the lowest total since 2016.[2]

Exit activity proved to be even more challenging, with buyout-backed exits plunging by 44% in 2023, amounting to $345 billion.[3] This was exacerbated by higher borrowing costs, which forced potential buyers to pay more for reduced borrowing capacity relative to the purchase price and EBITDA multiples of the assets. This created a significant gap between buyer and seller expectations, particularly in the sponsor-to-sponsor channel, where PE firms sell assets to other PE firms.

Looking at 2024, cautious optimism prevailed in light of policy loosening in the second half of 2023, providing a slight improvement in exit activity. Buyout-backed exits are projected to have risen to $361 billion, a 17% increase from 2023. However, this still represents the second-lowest exit value since 2016[4], reflecting a possible new normal of subdued activity within the PE asset class. Furthermore, exit pathways remain hindered by wide bid-ask spreads and selective offerings, which continue to create uncertainty regarding investment returns and could hinder future fundraising efforts.

On the fundraising front, global private equity raised $629 billion in 2023[5], an increase compared to the year prior. However, while this influx of capital may alleviate some exit pressures in the future, PE firms will likely need to adopt innovative strategies to return capital to limited partners (LPs) and maintain fundraising momentum.

Indeed, the first half of 2024 saw deal deployment outpace fundraising, reflecting a concerted push by general partners (GPs) to deploy existing capital. This resulted in a decline in dry powder, which dropped to $965 billion in 2024, down from its peak of $1 trillion in 2022.[6]

However, global undeployed capital, including dry powder and other committed but unallocated funds, still amounts to $3.9 trillion, with a significant portion in buyout funds approaching the later stages of their investment periods.[7] This creates increasing pressure for GPs to deploy this capital efficiently, particularly as they seek to meet investment commitments before their funds reach the end of their lifecycle. As GPs face mounting pressure to deploy funds, their focus will likely shift towards strategic investments that can generate optimal returns, while also managing the liquidity needs of their LPs.

While deal activity and exit values have exhibited a slight improvement, challenges remain, particularly with elevated borrowing costs and ongoing uncertainty regarding future exit channels.

However, the substantial dry powder, the growing age of capital, and the potential for further rate cuts provide optimism for increased investment activity.

Looking to 2025, the outlook for private equity remains cautiously optimistic. With interest rates expected to ease further, borrowing conditions for leveraged buyouts and deal-making are likely to improve. The fact remains, however, that borrowing costs are unlikely to return to pre-pandemic levels, potentially creating challenges for smaller, more highly leveraged transactions. While challenges such as high valuations and economic uncertainty are likely to persist given recent developments, 2025 could mark a year of gradual recovery for the private equity market, driven by strategic capital deployment and an improving exit environment.

Navigating fundraising and exit strategies in the U.S. amidst prevailing macroeconomic conditions

Similar to global markets, PE activity in the U.S. faced significant headwinds in 2023. Deal volume dropped to $248 billion, marking a 43% decline from the previous year[8] and a 53% drop from the 2021 peak of $528 billion.[9] This slowdown was largely driven by high borrowing costs, as syndicated loan yields edged closer to 11%, constraining traditional bank financing and making leveraged buyouts (LBOs) costlier.

Nevertheless, there has been a slight rebound in recent months. Deal activity in Q3 2024 reached $89 billion for transactions of $100 million or more, signaling renewed confidence among GPs.[10]

This surge in deal-making can be partly attributed to monetary policy loosening, which came to fruition in September 2024. The cuts, along with narrowing loan spreads, driven by both lower rates and rising competition between banks and private credit firms, reduced debt financing costs for GPs, fueling an uptick in LBOs, particularly in the technology sector.[11]

Meanwhile, fundraising in the U.S. in 2023 experienced an overall decline, and this slowdown persisted into 2024.[12] Preqin anticipated that North American fundraising would continue to decline in Q4 2024, though the region is expected to remain dominant in terms of its share of global PE capital raised.[13] Looking ahead, the decision to increase allocations will largely hinge on cash flow considerations however, as LPs express apprehension over unexited assets.

Indeed, the primary challenge facing the asset class is the accumulation of unsold assets, which in turn hampers exit opportunities. Buyout-backed exits plummeted to their lowest level in a decade in 2023, with the industry's major exit channels – corporate buyers and the sponsor-to-sponsor channel – both experiencing declines. Compounding this issue is the drop in the interest coverage ratio among buyout-backed firms in the U.S. to 2.4 times cash flow, the lowest level since the global financial crisis. In turn, such a development highlights potential vulnerabilities in firms' abilities to manage debt and signaling a need for strategic financial oversight in upcoming investment decisions.[14]

Though exit conditions remain challenging, optimism prevails due to anticipated moves by the Fed to further loosen policy. Further cuts will ease borrowing costs, particularly for LBOs, potentially revitalizing deal-making and improving exit conditions by narrowing the valuation gap between buyers and sellers. However, rates are still expected to remain above pre-pandemic levels, and smaller firms may continue to struggle with refinancing pressure.

The re-election of President Donald Trump could influence the U.S. PE landscape. His campaign promises center around tax cuts and deregulation, though not targeted at the PE sector, could have significant indirect effects. Proposed corporate and personal tax cuts will likely foster a more business-friendly environment, which could encourage greater deal activity. Deregulation could also reduce compliance costs, freeing up resources for strategic investments and enhance portfolio returns.

However, Trump's historically unpredictable trade policies and confrontational international stance could introduce economic volatility and uncertainty, complicating long-term investment planning for PE firms. Sectors reliant on international trade or exposed to tariff risks, such as manufacturing, automotive, and green energy, might face significant headwinds, potentially impacting portfolio performance and exit strategies.

Given this uncertain landscape, GPs must focus on factors within their control. This includes implementing innovative strategies to generate distributions and maximize returns. By enhancing underwriting practices and boosting EBITDA across portfolio companies, GPs can build resilience. Proactively focusing on value creation, such as operational improvements and strategic cost management, which will be essential as firms navigate volatile market conditions.

To maximize returns and alleviate cash flow constraints, GPs should conduct thorough due diligence, leveraging all available tools at their disposal. Generative AI, in particular, has been underutilized and can play a crucial role in ensuring a comprehensive assessment of opportunities, enabling GPs to make informed decisions during the due diligence process.

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Degree of opportunity for private equity markets posed by macroeconomic conditions

Development	Degree of opportunity for asset class
Start of policy loosening cycle	
The U.S. has proceeded with monetary policy loosening, with the Fed having cut rates in two consecutive meetings. This development will provide relief to the private equity asset class in two key areas: easing financing conditions, particularly for leveraged buyouts, and facilitating exit strategies. This will be crucial, especially in light of the significant volume of unsold assets, offering some alleviation in liquidity constraints. Yet, it is important to note that interest rates are expected to remain in restrictive territory, implying that the easing in exit strategies will likely be moderate and primarily benefit larger funds.	✓ HIGH / MEDIUM / LOW
Resilient U.S. economy	
The U.S. economy has successfully defied recession fears so far, recording three consecutive quarters of GDP growth, with Q3 2024 growth amounting to an annualized 2.8% on the quarter. This positive economic outlook is expected to place upward pressure on investment activity, particularly in light of relatively poorer outlooks for other advanced economies. In tandem with the substantial dry powder accumulated in the U.S. PE sector, there is significant potential for deploying additional capital and driving growth within the asset class.	✓ HIGH / MEDIUM / LOW
VC investments in AI technologies	
Although overall investment appetite in VC remains subdued due to cautious investor sentiment, advancements in AI technologies are expected to serve as a key market catalyst, driving investment activity and funding commitments in the U.S. While the decline in fundraising during 2023 may raise concerns, the robust fundraising levels recorded in 2021 and 2022 have provided a significant pool of capital, which is likely to have supported fund investments in 2024.	HIGH / ✓ MEDIUM / LOW
AI as a value creation ally for both GPs and LPs	
AI is presenting LPs with compelling investment options and offering new ways for firms to enhance internal operations. For GPs, the trifecta of AI, big data and machine learning can be used to improve investor reporting, automate contract drafting and elevate the value proposition of their portfolio companies.	✓ HIGH / MEDIUM / LOW
Regulatory compliance	
Post-election changes in Securities and Exchange Commission (SEC) leadership could lead to notable shifts in regulatory priorities. A more lenient administration may ease compliance and reporting requirements, potentially alleviating the administrative burden on PE firms and fostering increased investment activity. On the other hand, a continuation or intensification of regulatory scrutiny could result in stricter oversight of valuation methodologies and fee transparency, posing additional challenges for fund managers. These contrasting scenarios underscore the importance of maintaining flexibility and readiness to navigate an evolving regulatory environment.	HIGH / ✓ MEDIUM / LOW

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