Q2 2024 Keystone Market Update

An update on the private markets ecosystem and Arctos' NOWCAST

June 2024

Q2 2024 Keystone Market Update Executive Summary

Key themes for both GPs and LPs based on this quarter.

GP Key Themes

- Even as we move into year three of the fundraising "recession," things may get worse before they get better. Plan accordingly
- Distributions are paramount in this environment. Taking liquidity, even at a discount to NAV, may help you stand out among LPs
- In an elevated rate environment, Credit (and specifically, Senior Credit) strategies are delivering double digit returns. Articulating your ability to generate repeatable, sustainable alpha will be more important than ever now that LPs don't need to extend further out on the risk curve

LP Key Themes

- The denominator problem is easing, thanks to a rebound in public markets. Yet, NAVs likely remain overvalued, leading to a persistent "numerator effect" and a continued backlog of PE exits
- Take a close eye to your GP's unrealized NAVs. Encourage your GPs to take liquidity on assets now vs. waiting to "grow into" the valuations paid during the COVID goldilocks era (at the expense of poor IRRs)
- Monitor underlying asset performance closely. Fundamentals are returning to pre-COVID levels, and higher interest rates and longer hold periods could pose risks in portfolios

SOURCE: ARCTOS

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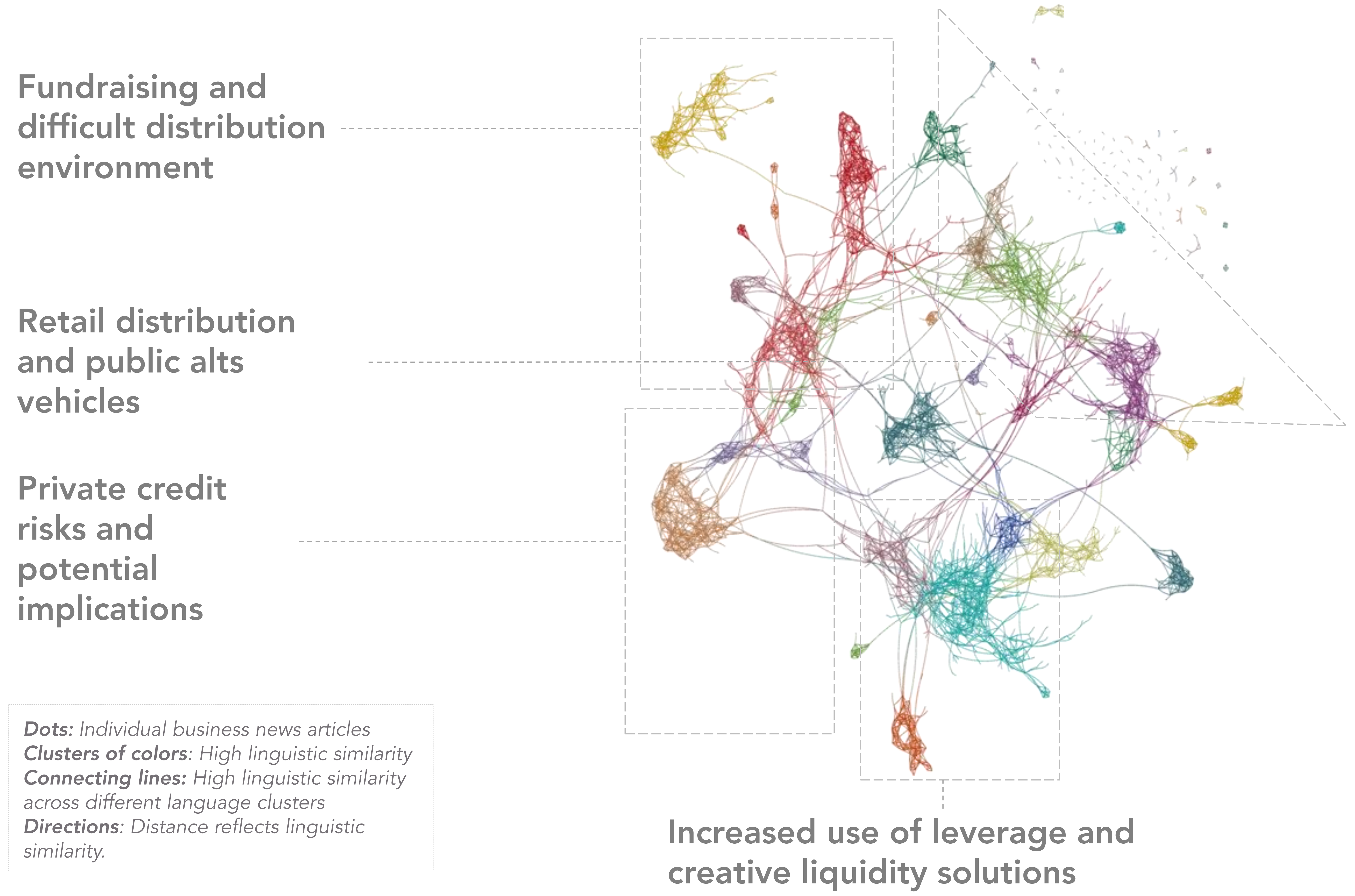
Current Private Markets NowNarrative Monitor (Q2 2024)

Our private markets narrative analysis highlights major trends, opportunities & risks in the linguistic data covering our markets and being delivered by its leaders



Dots: *Individual business news articles*
Clusters of colors*: High linguistic similarity*
Connecting lines: *High linguistic similarity across different language clusters*
Directions*: Distance reflects linguistic similarity.*

Q2 2024 NowNarrative Summary

There are two big opportunity narratives for private markets:

1. **Big Opportunity Narrative 1:** Distributions remain near multi-decade lows, but record dry powder and a thawing IPO market provides opportunity to generate at least partial liquidity in trophy assets.
2. **Big Opportunity Narrative 2:** Rising popularity of public alts and evergreen vehicles provides relief in an otherwise challenging fundraising environment. Outside of Real Estate, retail appetite for alts appears vey strong relative to demand from institutional LPs.

And there are two big risk narratives:

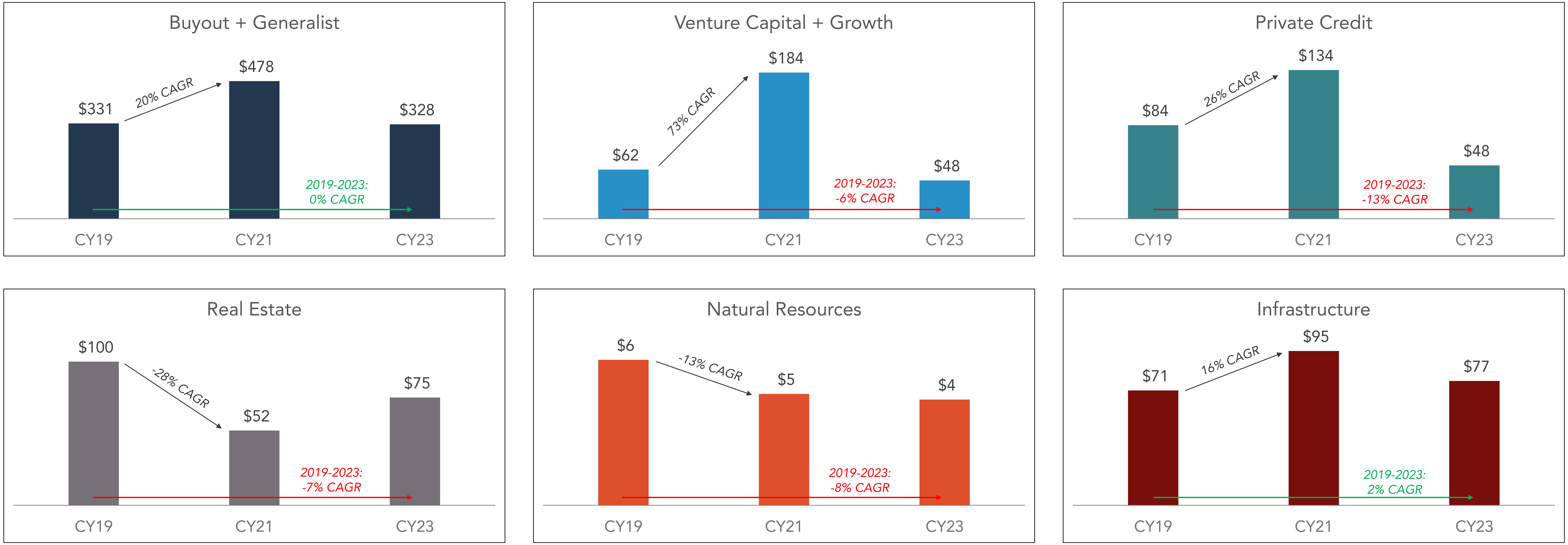
1. **Big Risk Narrative 1:** GPs are increasingly using leverage to generate liquidity for LPs, but LPs are taking notice and asking more questions.
2. **Big Risk Narrative 2:** The Private Credit boom presses on, but cracks are beginning to show as banks re-enter the fray and spreads continue to tighten. Are these cracks indicative of more widespread distress in private equity portfolios? What are the implications for unrealized NAVs?

SOURCE: ARCTOS

Fundraising Returned to Pre-COVID Levels in 2023…

Following a rapid increase in fundraising during a "goldilocks" period of heightened asset valuations and accommodative capital markets in 2021, most strategies settled near pre-COVID levels in 2023.

North America & Western Europe Fundraising Evolution Since 2019, By Strategy ($B)

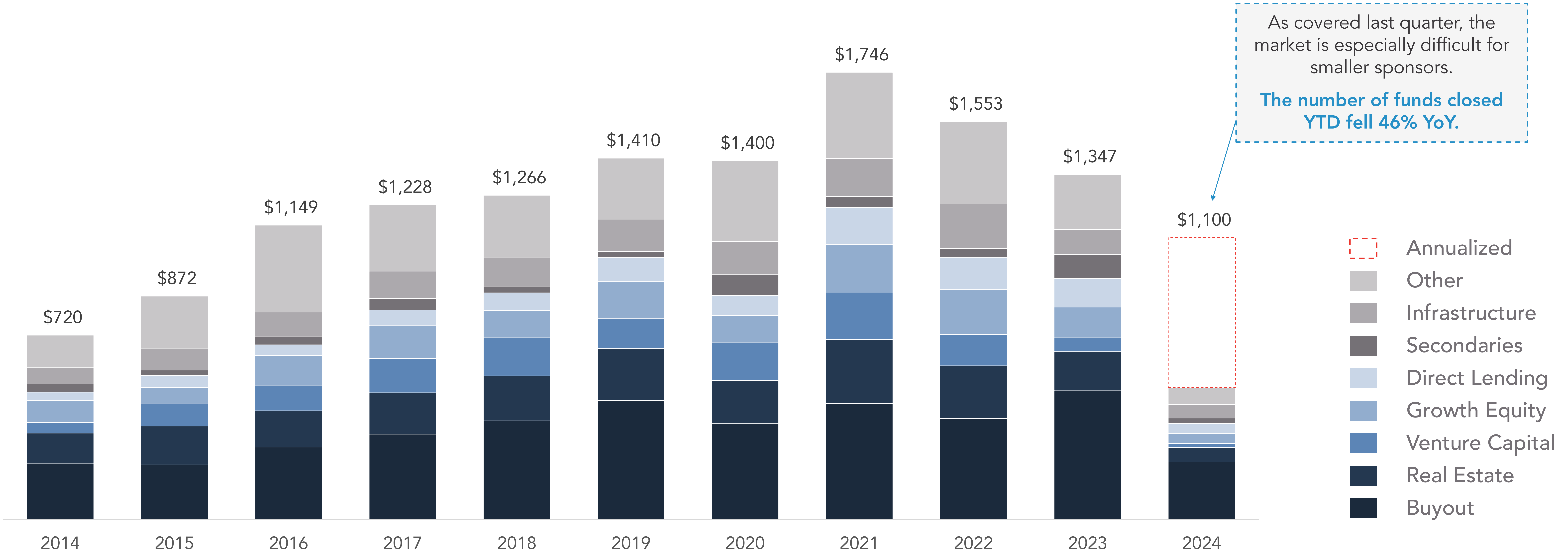


SOURCE: BURGISS, ARCTOS. AS OF MAY 2024. DATA ONLY INCLUDES NORTH AMERICAN, WESTERN EUROPEAN, AND GENERALIST FUNDS.

…but Early 2024 Data Indicates There Could Be Further Downside

Given some of the funds raised in 2023 held meaningful closes before the fundraising downturn began in mid-2022, there is still some "noise" in the 2023 figures. Fundraising data through May suggests 2024 could see a further ~15-20% decrease from 2023.

Global Private Capital Raised ($B)

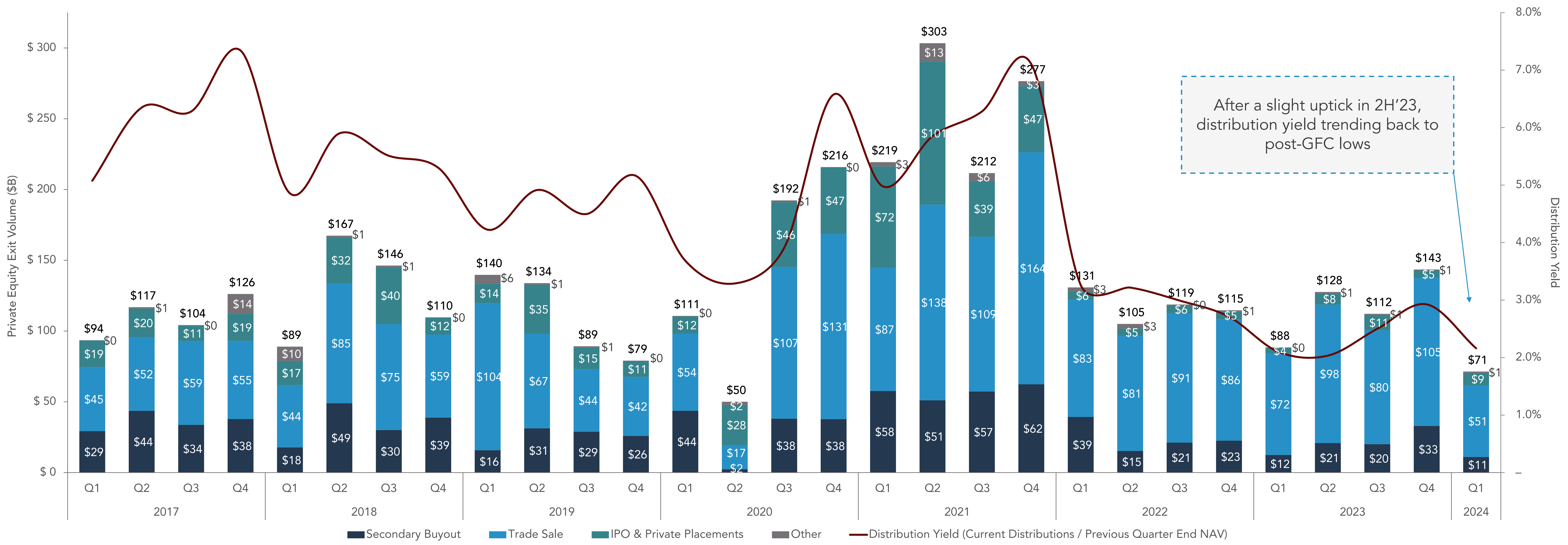


SOURCE: PREQIN, PITCHBOOK, BAIN, ARCTOS; AS OF MAY 2024. NOTE BUYOUT INCLUDES BALANCED, COINVESTMENT AND COINVESTMENT MULTIMANAGER FUNDS.

Distributions Are Paramount…and Decelerating

A rebound in fundraising will require a recovery in exit activity. However, global PE-backed exits declined to their lowest quarterly total in Q1 2024 since the onset of the COVID-19 pandemic. The dearth in exit activity occurred despite major public indices reaching all-time highs during the quarter.

Global Private Equity Exit Volume ($B)



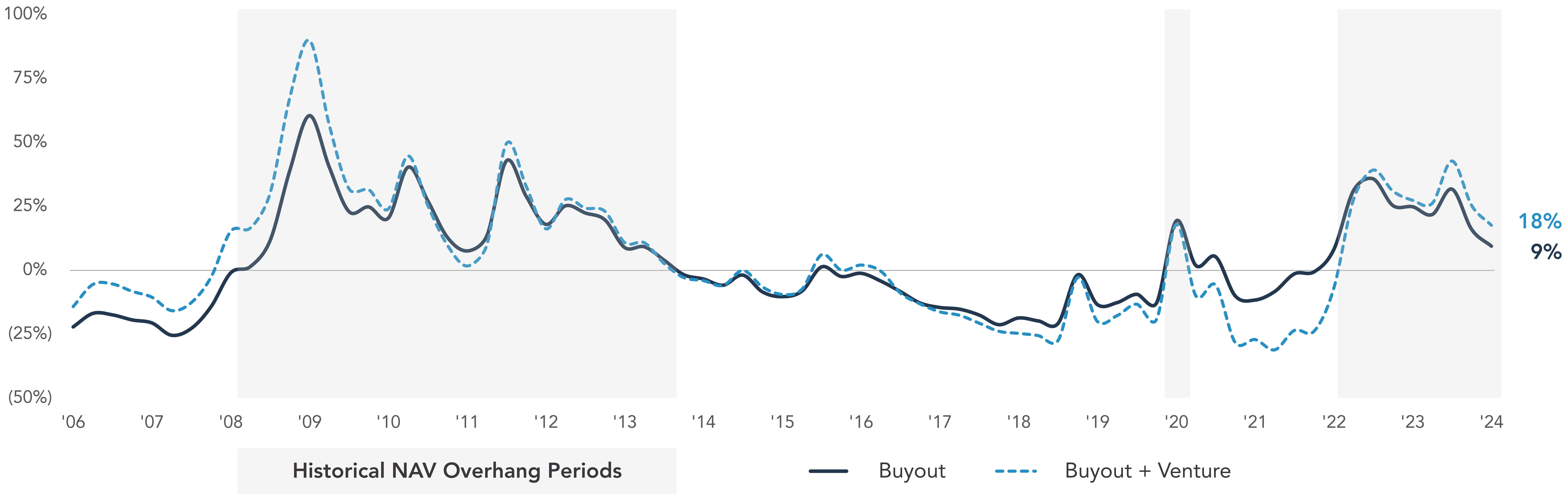
SOURCE: BURGISS

NAV Overvaluation Update

NAV overvaluation relative to public benchmarks has declined in recent quarters due to the public market rally. However, our models suggest that Buyout and Venture remain overvalued.

The Asset Class Remains Overvalued

Public-Private Proxy: North American Private Equity NAV Over- / (Under-) Valuation[1]



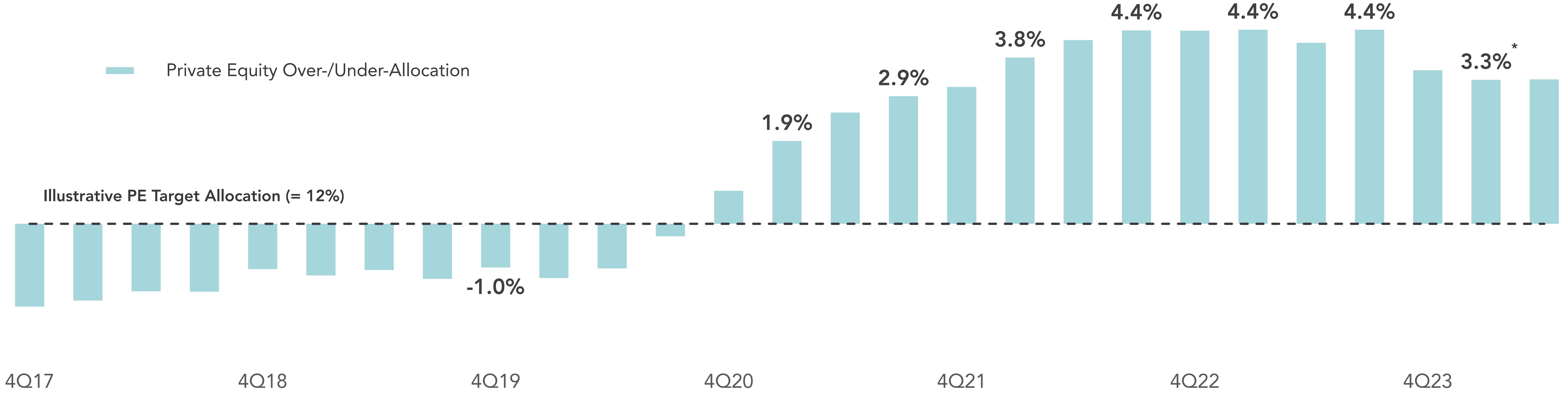
SOURCE: BURGISS, ARCTOS ANALYSIS; AS OF JUNE 2024.
(1) USES ARCTOS NOWCAST EST. OF NAV FOR Q1 '24 FOR NORTH AMERICAN BUYOUT AND ASSUMES 0% NAV GROWTH IN Q1 '24 FOR NORTH AMERICAN VENTURE.

Overallocation Burden Remains Strong

Pressure on private equity allocations remains high but has eased over the last three quarters due to (i) appreciation of the 60/40 portfolio, (ii) lower than expected NAV growth with only moderate NAV growth projected for Q1 and Q2 and (iii) higher than expected 4Q23 NCF activity

We Believe the Average Institutional Investor Is ~30% Overallocated to PE

Illustrative Pension Model: Assumes -1% Under Target Pre-COVID(1)



*Uses our nowcast est. of NAV and NCF for Q1-'24 and Q2-'24. Uses public market returns / prices as of 6/26/24.

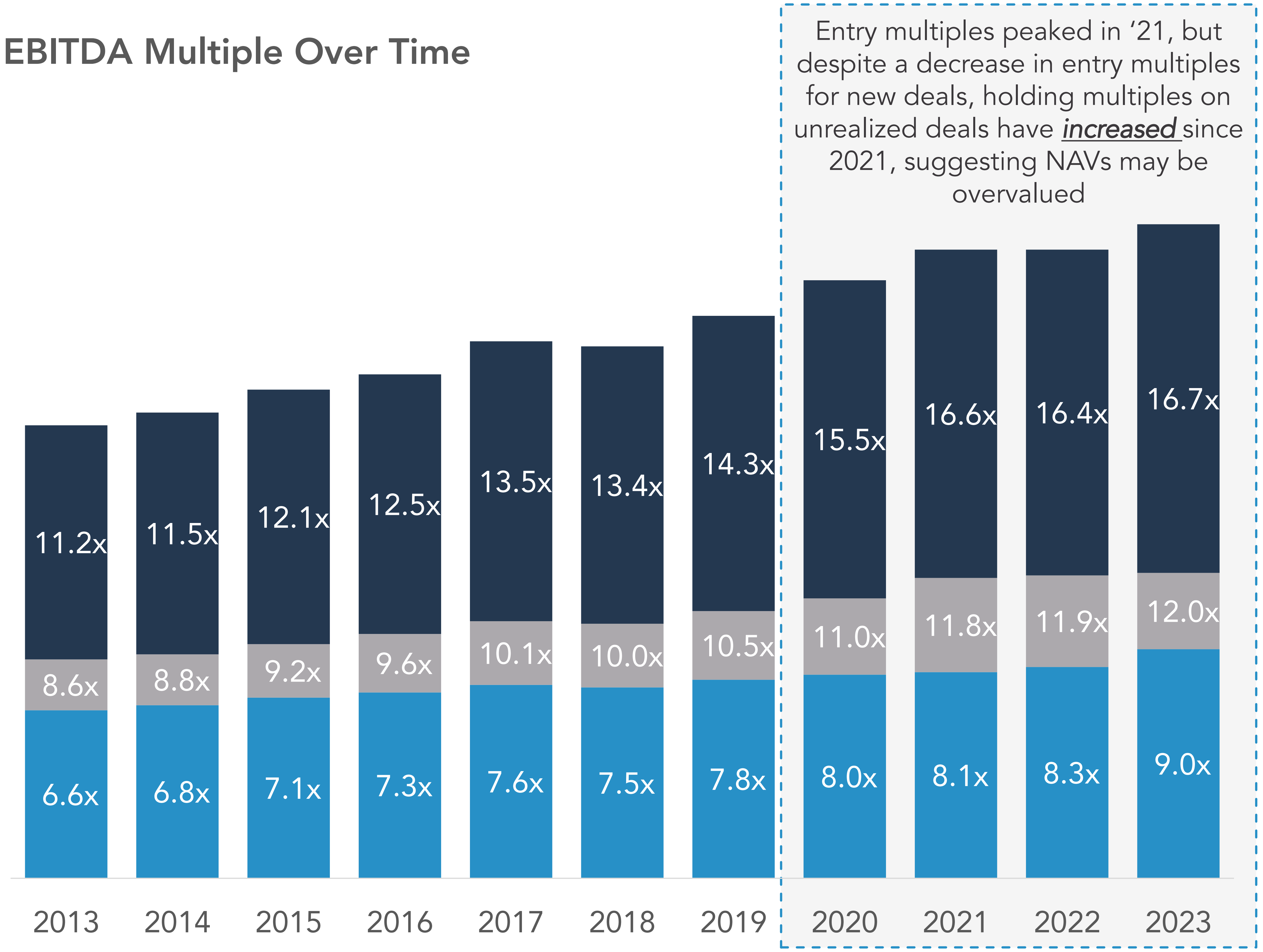
SOURCE: BURGISS, ARCTOS ANALYSIS; AS OF JUNE 2024. ST. LOUIS FED, ROBERT SHILLER (HTTP://WWW.ECON.YALE.EDU/~SHILLER/DATA.HTM; STOCK & BOND PRICES), ARCTOS ANALYSIS, AS OF JUNE 2024. (1) NORTH AMERICA AND WESTERN EUROPE BUYOUT, GROWTH, AND VENTURE CAPITAL (EQUITY), VIA BURGISS.
(1) ASSUMES 12% PE TARGET ALLOCATION.

Asset Level Performance Snapshot

Underlying assets must perform to "grow into" their entry valuations from 2021-2022, when purchase multiples reached post-GFC highs. Yet, following a period of inflationary growth, underlying performance seems to be normalizing to pre-COVID levels.

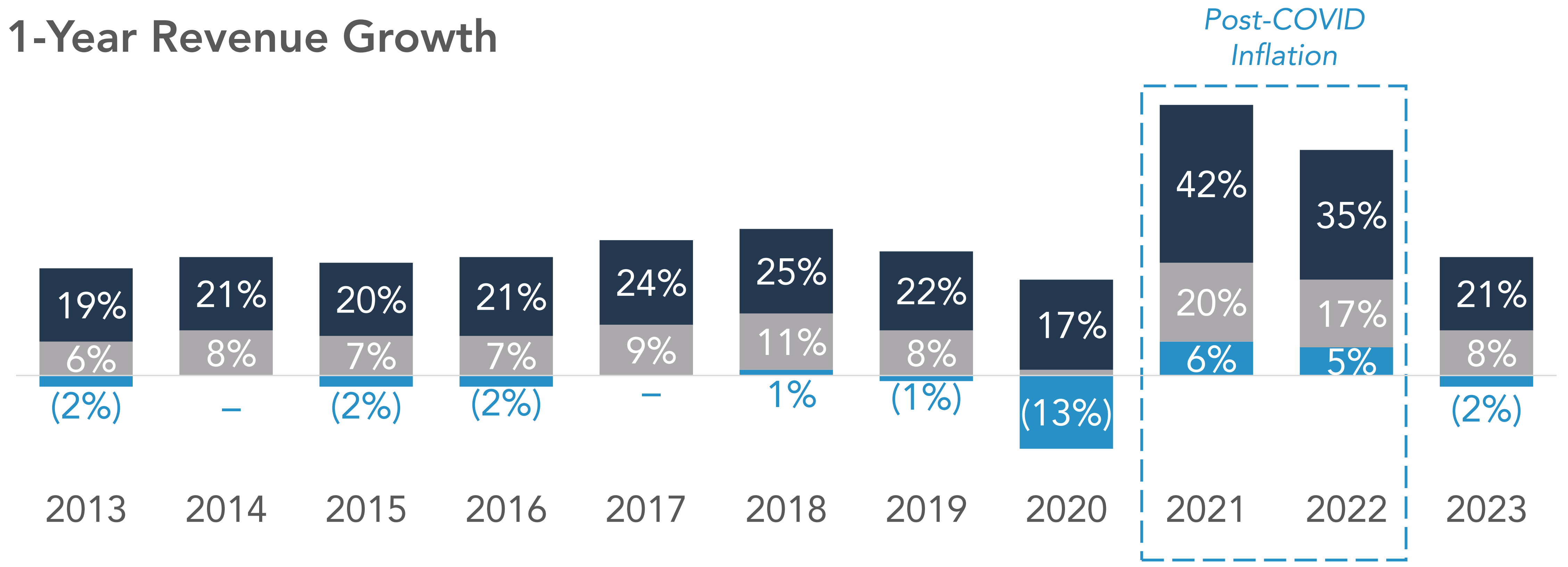
Holding Multiples Remain Elevated…

EBITDA Multiple Over Time

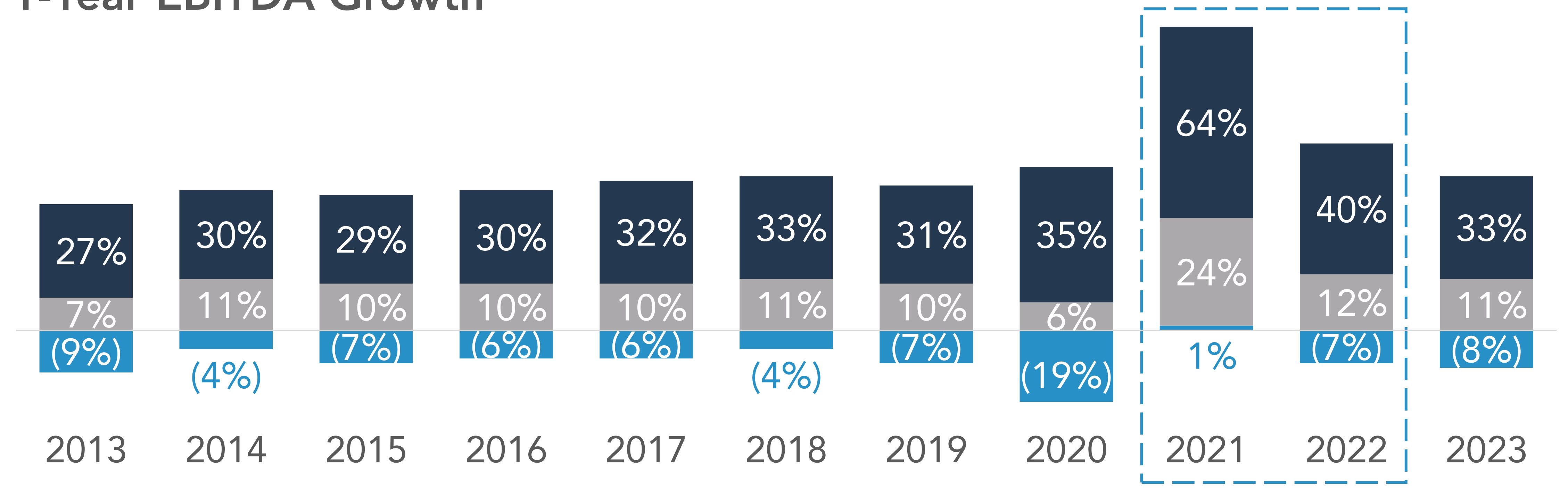


…as Performance Slows to Pre-COVID Levels

1-Year Revenue Growth



1-Year EBITDA Growth

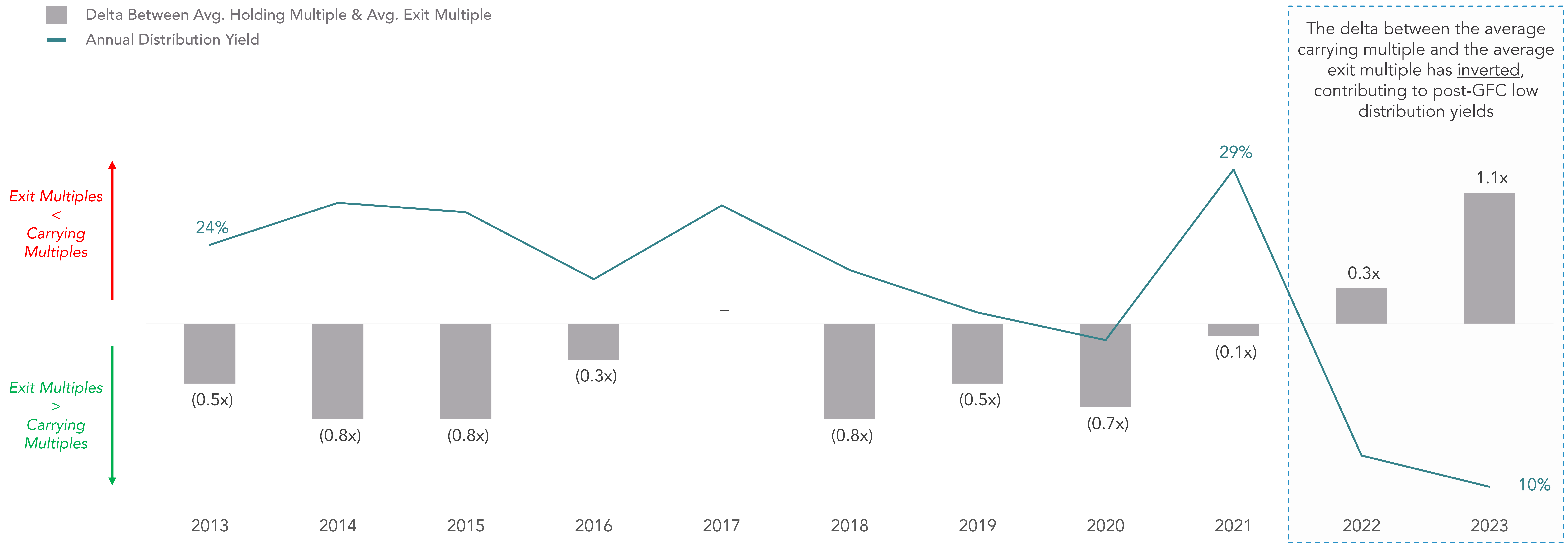


Percentile: 75th 50th 25th

Delta Between Carrying Values and Market Prices Driving Slowdown in Exits

For the first time in a decade, holding multiples are greater than exit multiples.

Delta Between Avg. Holding Multiple and Avg. Exit Multiple



SOURCE: BURGISS

ARCTOS INSIGHTS

Private Credit (and specifically, Senior Credit) Outperforming

Senior Credit outperformed all other asset classes for the first time in the last decade in 2023. Typically, asset class outperformance rotates across strategies year to year. However, investors will likely rotate towards credit strategies over the near-term, further straining PE fundraising.

Burgiss Asset Class Returns – Global Private Capital Performance by Calendar Year

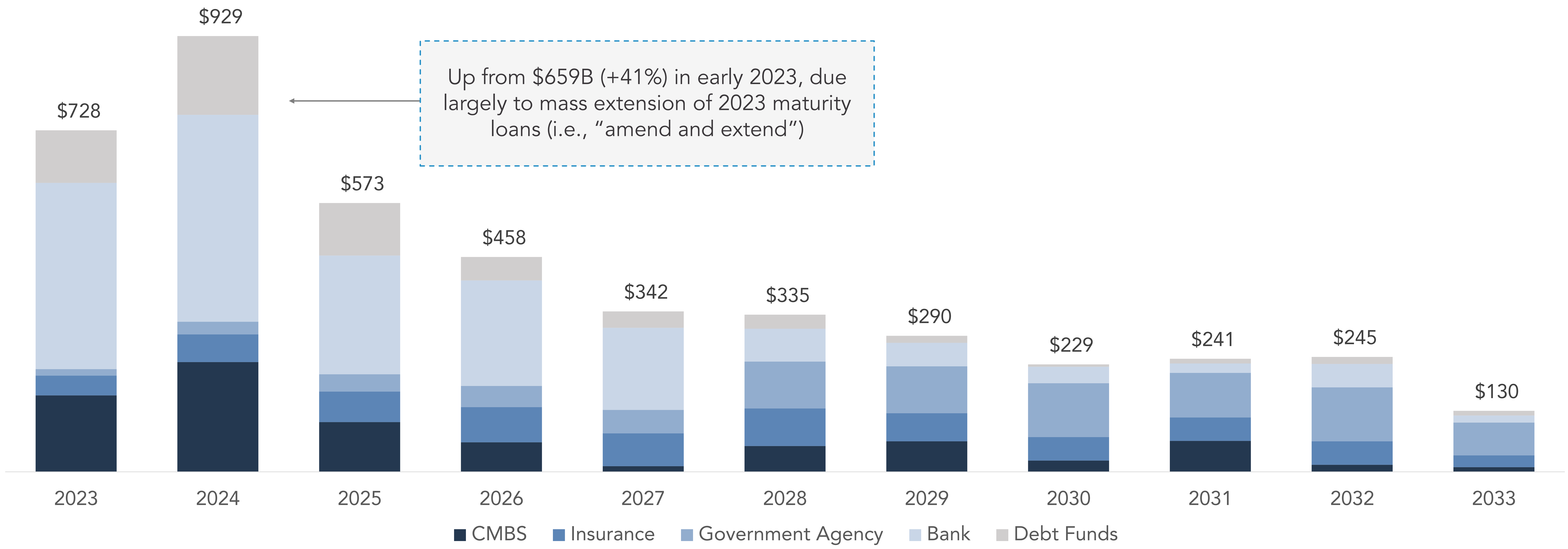
2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Venture Capital 26%	Venture Capital 15%	Natural Resources 22%	Buyout 23%	Venture Capital 21%	Venture Capital 20%	Venture Capital 58%	Venture Capital 50%	Natural Resources 22%	Senior 11%
Real Estate 13%	Real Estate 10%	Buyout 12%	Infrastructure 17%	Buyout 9%	Buyout 17%	Buyout 25%	Buyout 38%	Infrastructure 10%	Mezzanine 10%
Mezzanine 11%	Buyout 9%	Distressed 10 %	Venture Capital 15%	Infrastructure 8%	Mezzanine 9%	Expansion Capital 19%	Natural Resources 31%	Mezzanine 6%	Buyout 9%
Buyout 10%	Infrastructure 7%	Senior 8%	Real Estate 14%	Real Estate 7%	Real Estate 8%	Mezzanine 9%	Expansion Capital 28%	Senior 3%	Distressed 8%
Distressed 9%	Expansion Capital 5%	Mezzanine 8%	Expansion Capital 13%	Senior 6%	Infrastructure 8%	Infrastructure 8%	Real Estate 26%	Distressed 3%	Infrastructure 8%
Infrastructure 8%	Mezzanine 5%	Infrastructure 8%	Mezzanine 12%	Mezzanine 6%	Expansion Capital 8%	Distressed 8%	Distressed 22%	Real Estate 2%	Expansion Capital 4%
Expansion Capital 7%	Senior 3%	Expansion Capital 7%	Senior 12%	Distressed 3%	Senior 7%	Senior 8%	Mezzanine 16%	Buyout -1%	Natural Resources 2%
Senior 5%	Distressed -1%	Real Estate 7%	Distressed 10%	Expansion Capital 2%	Distressed 4%	Real Estate 1%	Infrastructure 14%	Expansion Capital -12%	Venture Capital -2%
Natural Resources 0%	Natural Resources -14%	Venture Capital 1%	Natural Resources 6%	Natural Resources -3%	Natural Resources -5%	Natural Resources -9%	Senior 8%	Venture Capital -21%	Real Estate -6%

SOURCE: BURGISS

Corporate Real Estate Maturity Wall Creeping Closer

LPs remain concerned about the pending CRE maturity wall. While evidence of distress has been more episodic to date (i.e., BREIT and SREIT redemptions, etc.), we may eventually see distress in CRE impact other private market asset classes.

Wave of Commercial Real Estate Debt Maturities ($B)



SOURCE: NEWMARK

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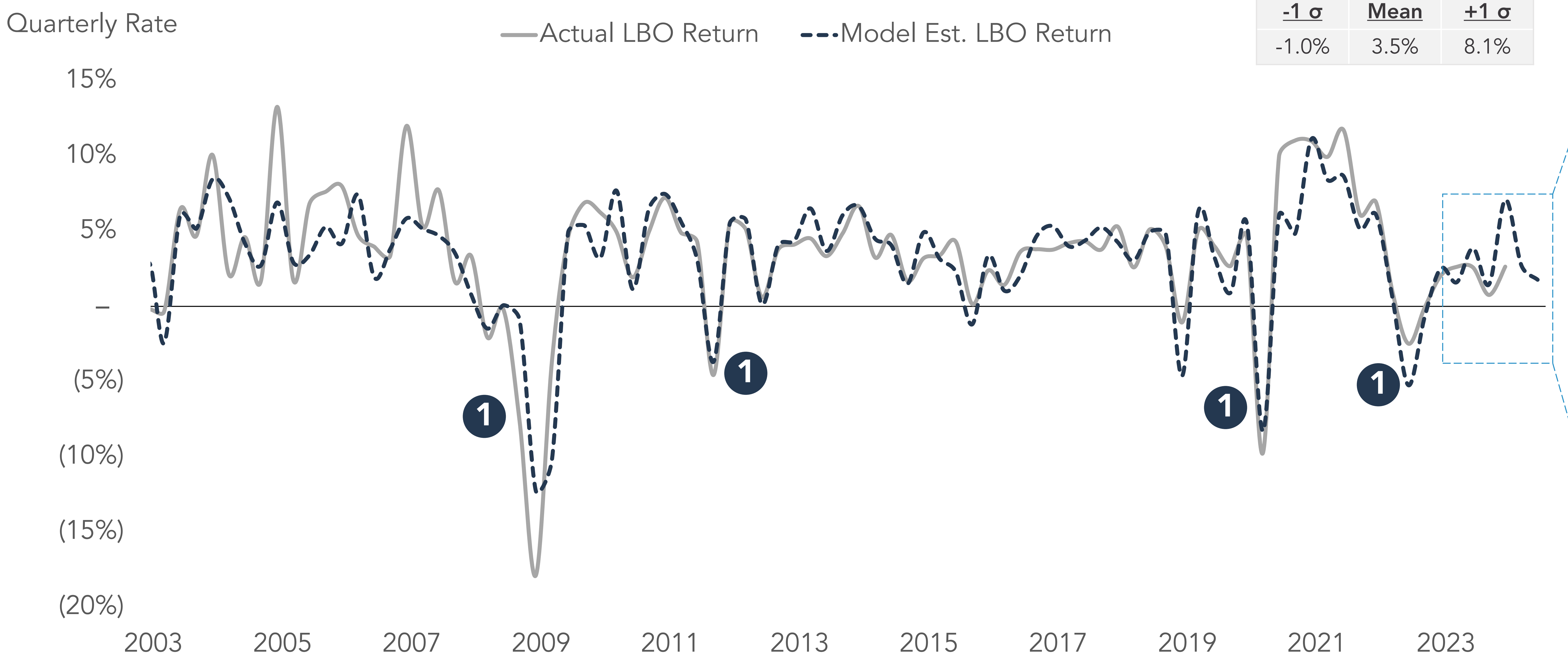
ARCTOS NOWCAST

Arctos NOWCAST Framework

- We use historical data and time series forecasting models to generate “nowcasts” – i.e., forecasts of current, and very near-term, activity for data that is released on a lag, as is common in private markets.
- Our proprietary models capture the interaction between past values of major macro, public market, and private market variables with current values of private market metrics we care about: NAV growth, contribution rates, distribution rates, cash flow activity, fundraising and secondary market value.
- Our goal is to build and regularly update an objective model of the present and near-future that we believe can help every investor and manager remain grounded and make better decisions, despite the “narrative noise” of the moment, which is often biased, momentum-driven, or influenced by a specific agenda.

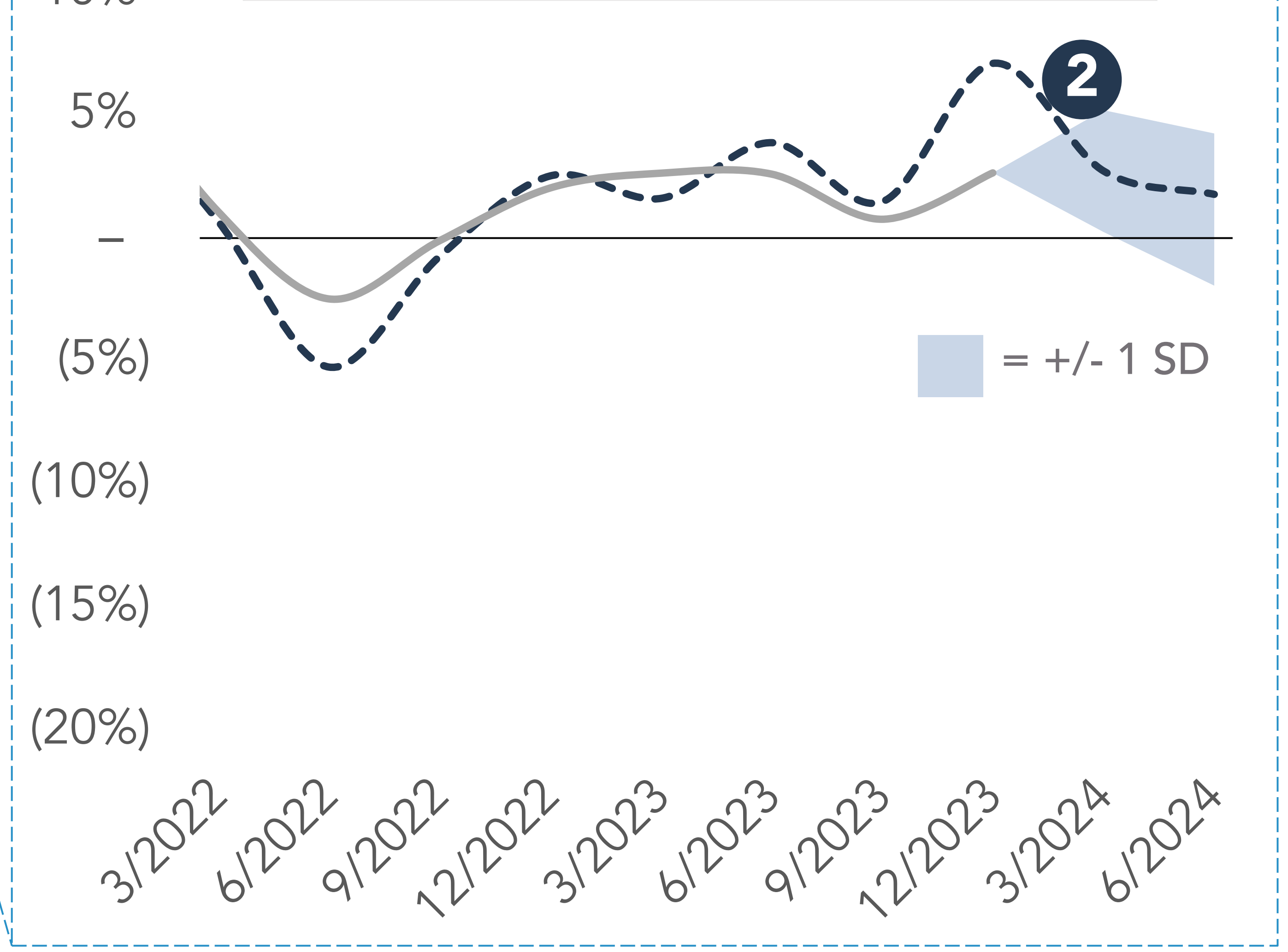
ARCTOS NOWCAST: NAV Growth

20-year Average		
-1 σ	Mean	+1 σ
-1.0%	3.5%	8.1%



NOWCAST

	Q4 '23	Q1 '24	Q2 '24
Actual	2.6%	n/a	n/a
NOWCAST Q4	6.4%	2.8%	n/a
NOWCAST Q1	**n/a**	**2.7%**	**1.8%**



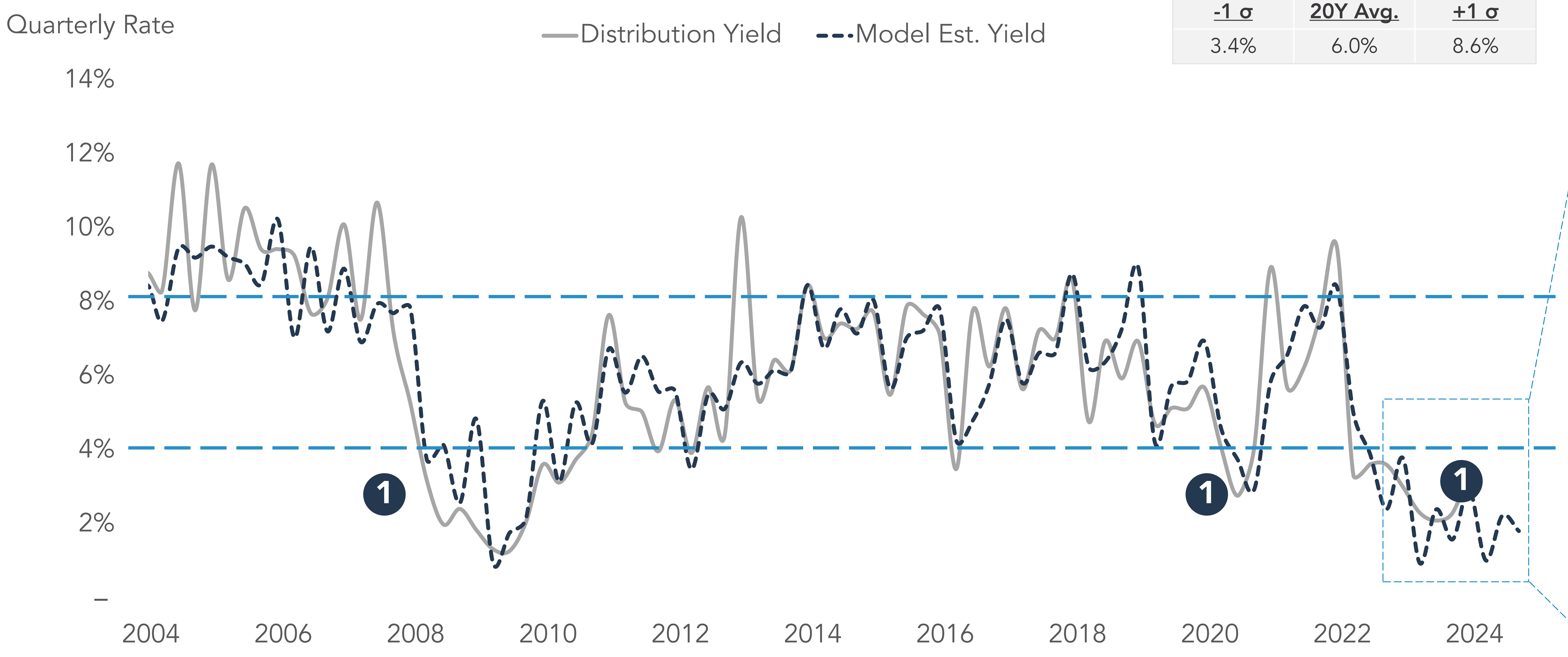
1 Long-term Trend: Unrealized NAV declines are exceptionally rare, as evidenced by the GFC, Euro Debt Crisis, COVID, and the 2022 meltdown.

2 2Q Observation: Despite strong Q4 2023 appreciation in both the S&P 500 (11%) and Russell 2000 (14%), private NAVs grew only 2.6% (below our NOWCAST prediction). We anticipate more moderate growth during the first half of 2024.

SOURCE: ARCTOS ANALYSIS.

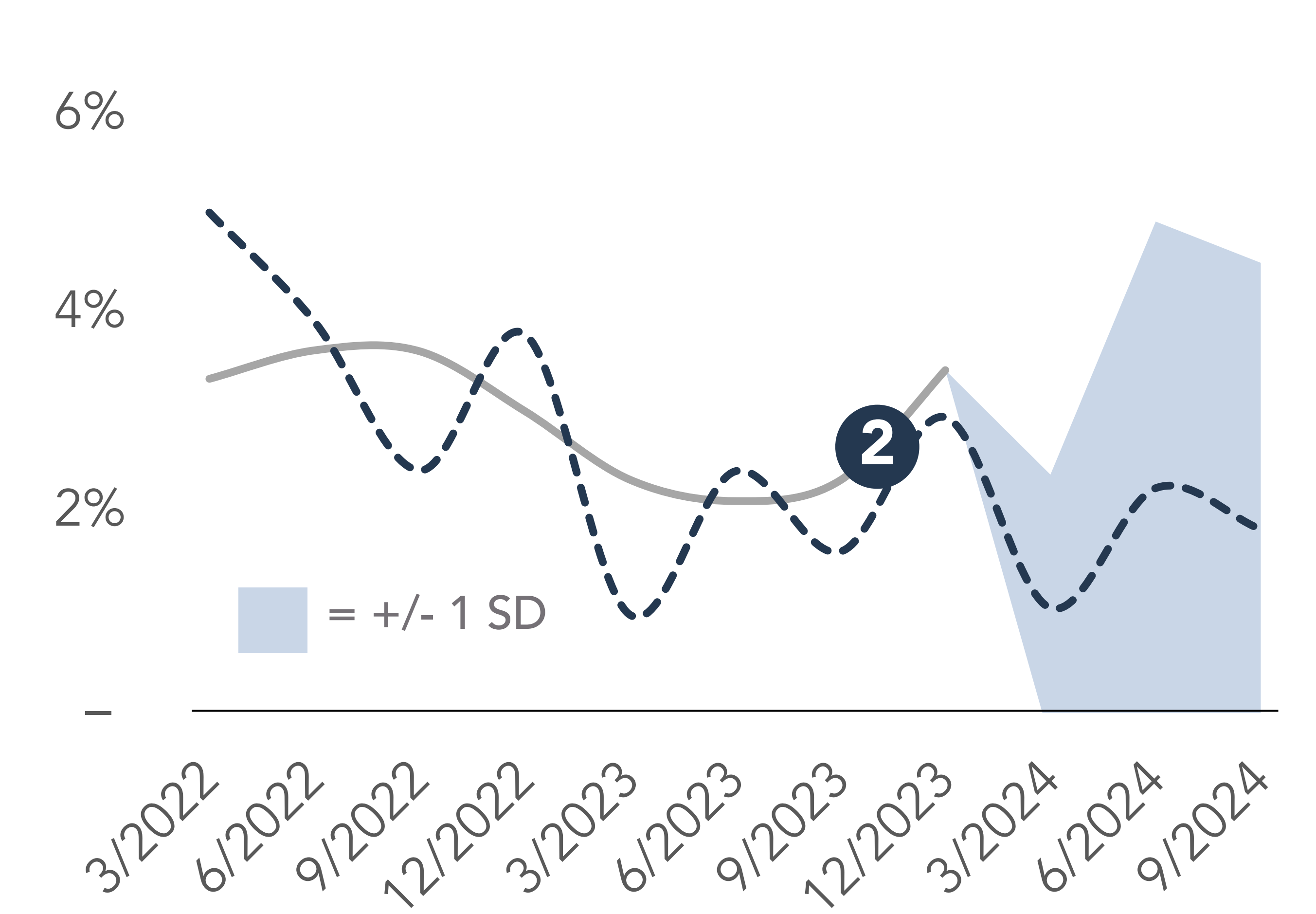
ARCTOS NOWCAST: Quarterly Distribution Yield

-1 σ	20Y Avg.	+1 σ
3.4%	6.0%	8.6%



NOWCAST

	Q4 '23	Q1 '24	Q2 '24
Actual	3.4%	n/a	n/a
NOWCAST Q4	2.6%	1.0%	n/a
NOWCAST Q1	**n/a**	**1.0%**	**2.2%**

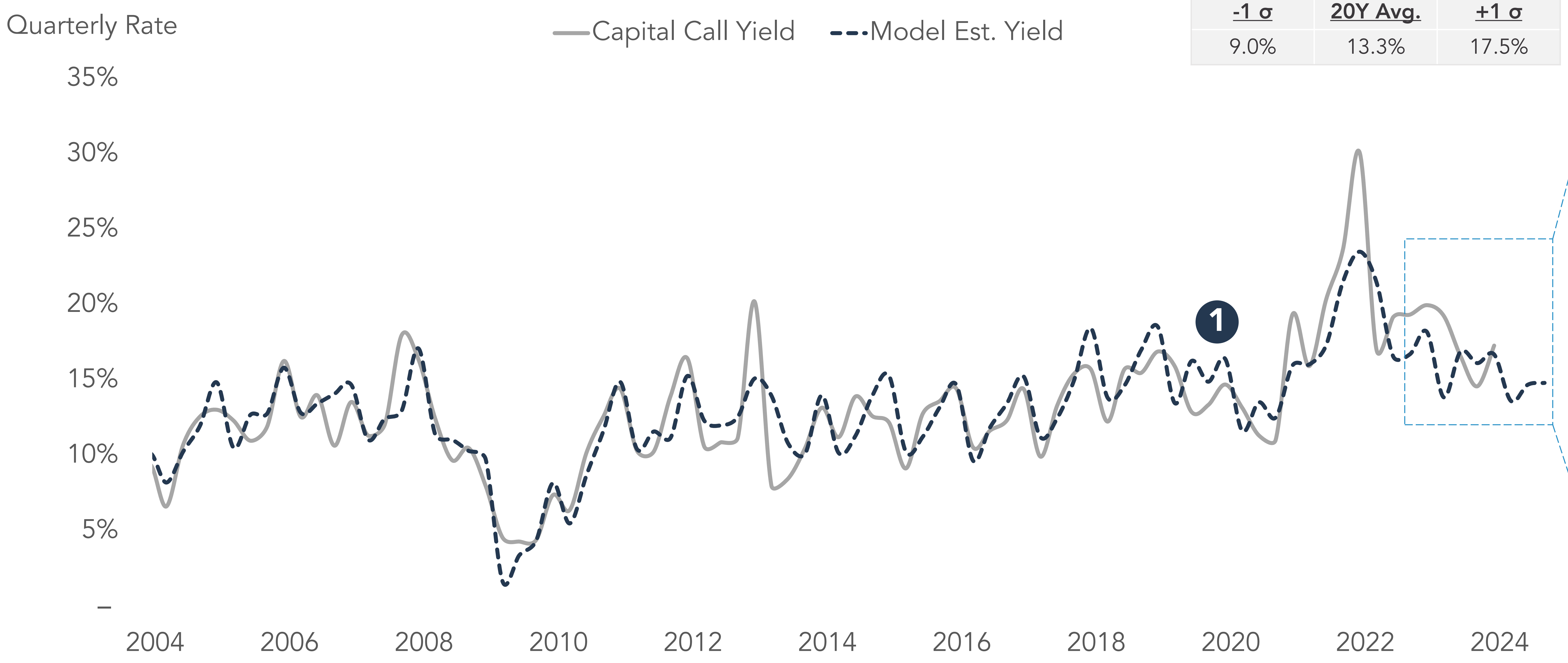


1. Long-term Trend: Quarterly distribution yield of 4-8% has been remarkably stable for two decades, except for one quarter in the depths of the pandemic, three years post GFC and right now. **The exit market is broken and overwhelmed by unprecedented unrealized value.**

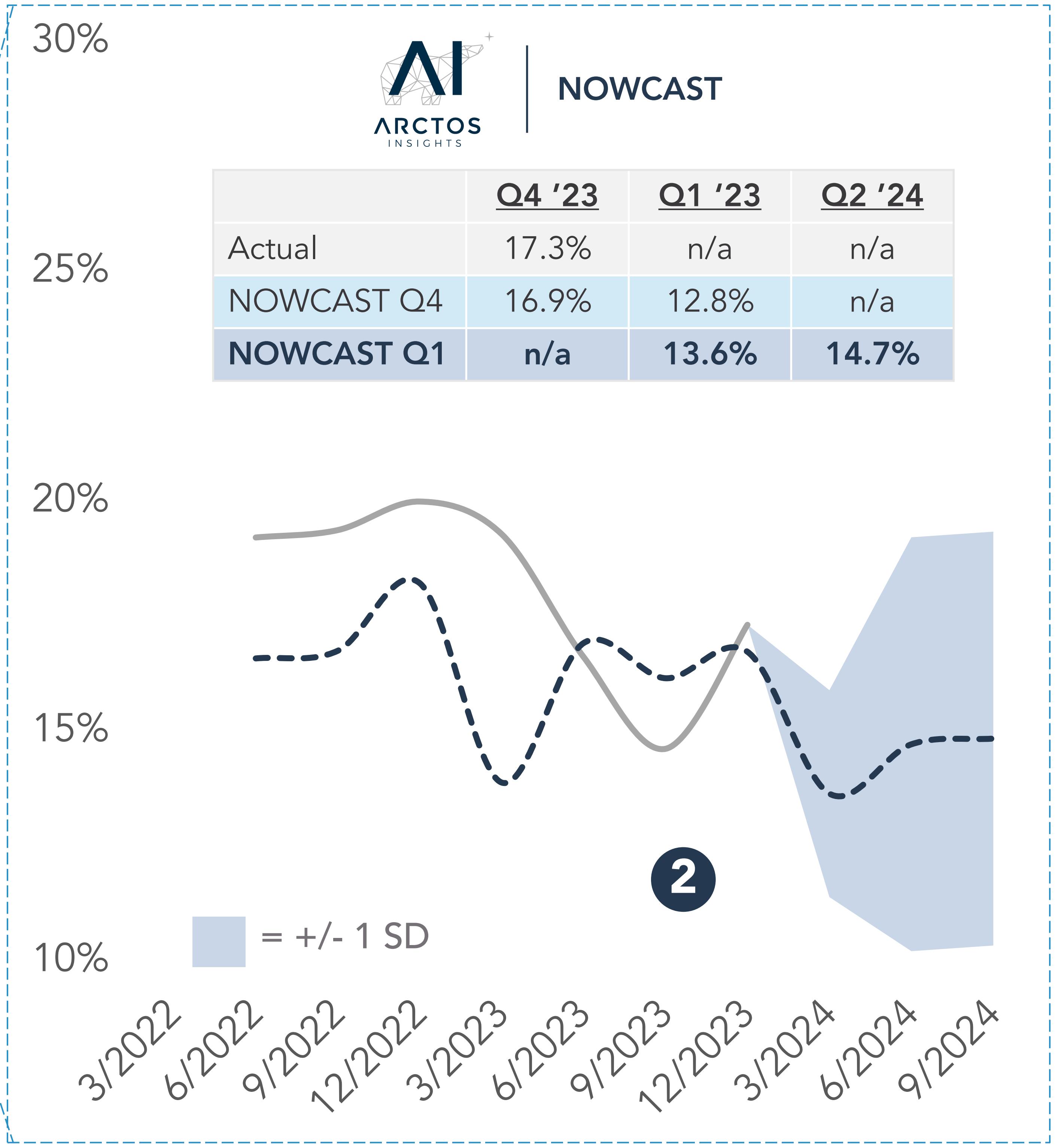
2. 2Q Observation: We expect very weak distribution yield to continue through 2024. The sheer scale of unrealized NAV (>$4T) masks this with a historically "average" dollar distribution amount. Private equity is currently much more illiquid than normal.

SOURCE: ARCTOS ANALYSIS.

ARCTOS NOWCAST: Quarterly Contribution Yield



-1 σ	20Y Avg.	+1 σ
9.0%	13.3%	17.5%

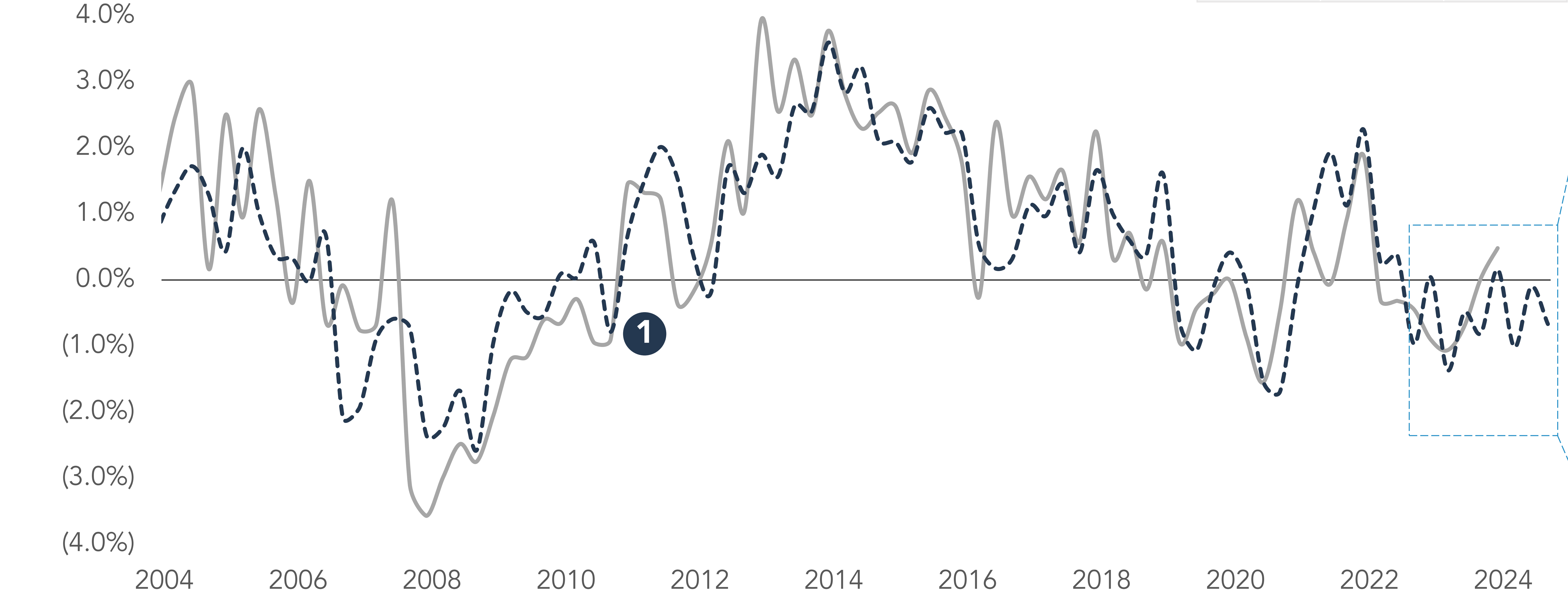


	Q4 '23	Q1 '23	Q2 '24
Actual	17.3%	n/a	n/a
NOWCAST Q4	16.9%	12.8%	n/a
NOWCAST Q1	**n/a**	**13.6%**	**14.7%**

1. Long-term Trend: Weirdly, quarterly contribution yield was stable during very active investment years (2016-21) but jumped to abnormal levels during 2021-2023, despite low deal activity. We suspect this is explained by fund line of credit utilization whipsaw, highlighted in our prior analyses here and here.
2. 2Q Observation: We anticipate contribution metrics will return to their long-term averages in 2024.

SOURCE: ARCTOS ANALYSIS.

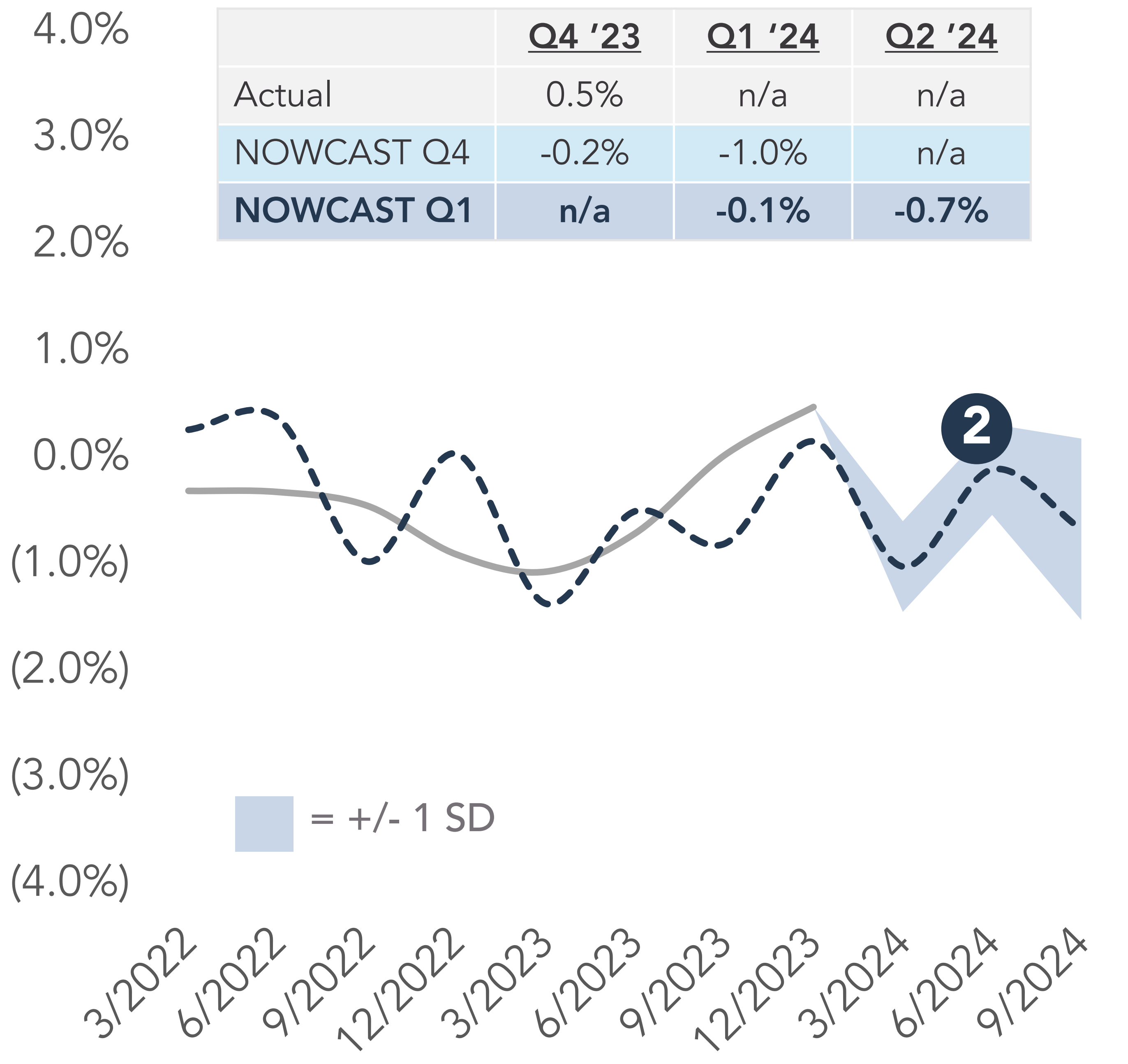
ARCTOS NOWCAST: Net Cash Flow Forecast



-1 σ	20Y Avg.	+1 σ
-1.1%	0.5%	2.2%

NOWCAST

	Q4 '23	Q1 '24	Q2 '24
Actual	0.5%	n/a	n/a
NOWCAST Q4	-0.2%	-1.0%	n/a
NOWCAST Q1	**n/a**	**-0.1%**	**-0.7%**

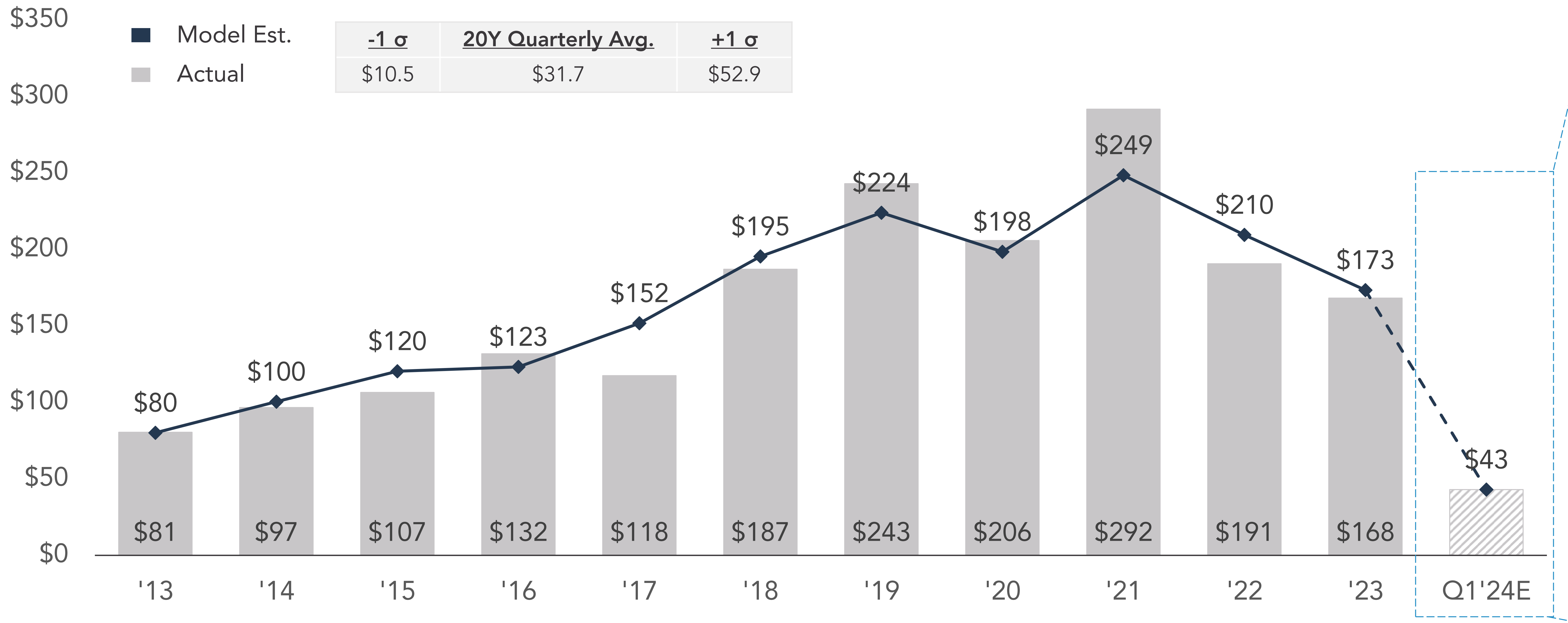


1. Long-term Trend: After a decade of almost constant aggregate positive net cash flow, developed market private equity has entered a period of liquidity consumption in 2022 similar to 2007-2011.
2. 2Q Observation: Q4 saw higher than anticipated distribution activity, yielding positive NCF for the second consecutive quarter. We expect NCF to remain near breakeven until robust exit activity resumes.

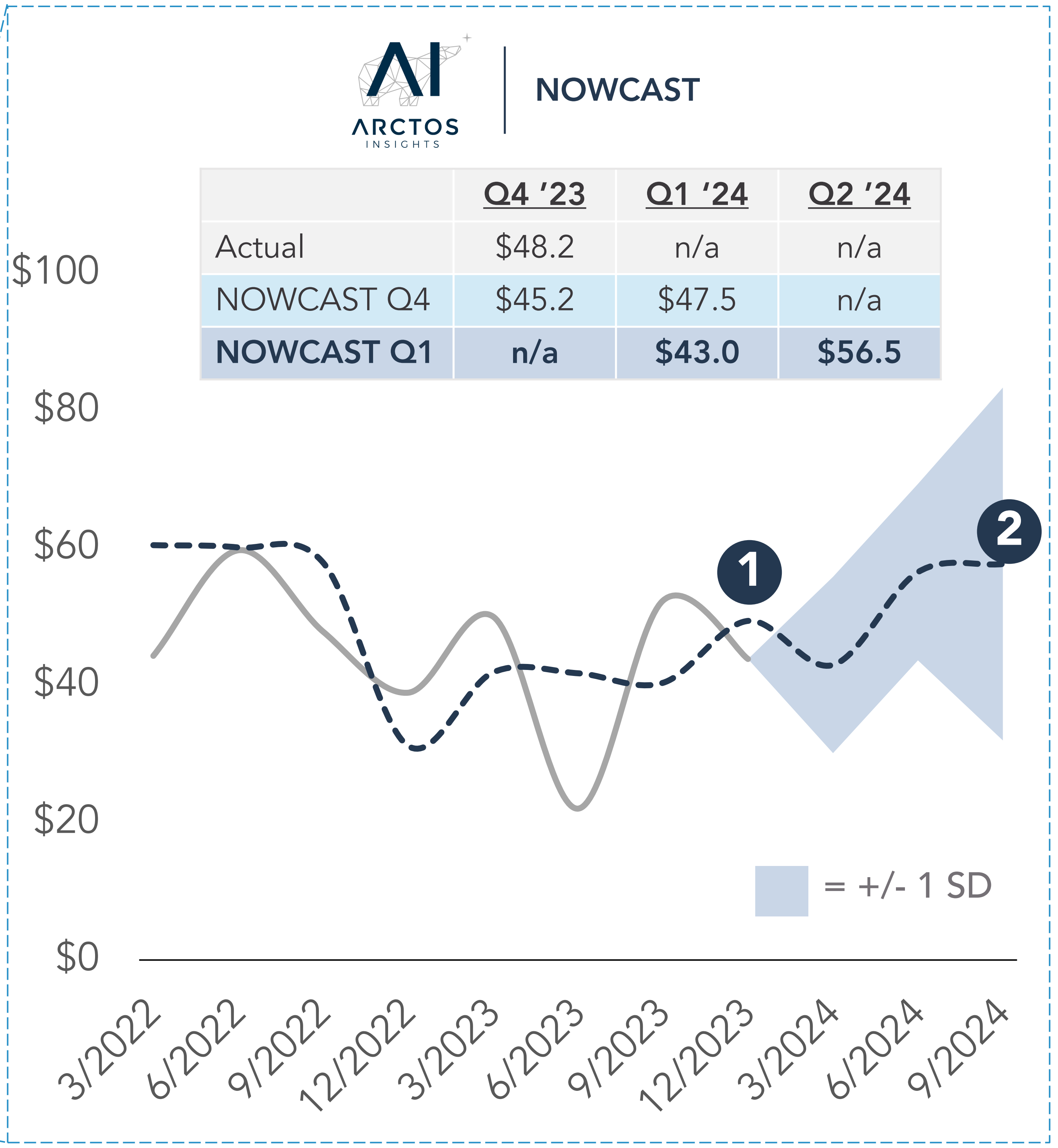
SOURCE: ARCTOS ANALYSIS.

ARCTOS NOWCAST: Fundraising Projection

Annual North American LBO Fundraising ($B)



-1 σ	20Y Quarterly Avg.	+1 σ
$10.5	$31.7	$52.9



	Q4 '23	Q1 '24	Q2 '24
Actual	$48.2	n/a	n/a
NOWCAST Q4	$45.2	$47.5	n/a
NOWCAST Q1	**n/a**	**$43.0**	**$56.5**

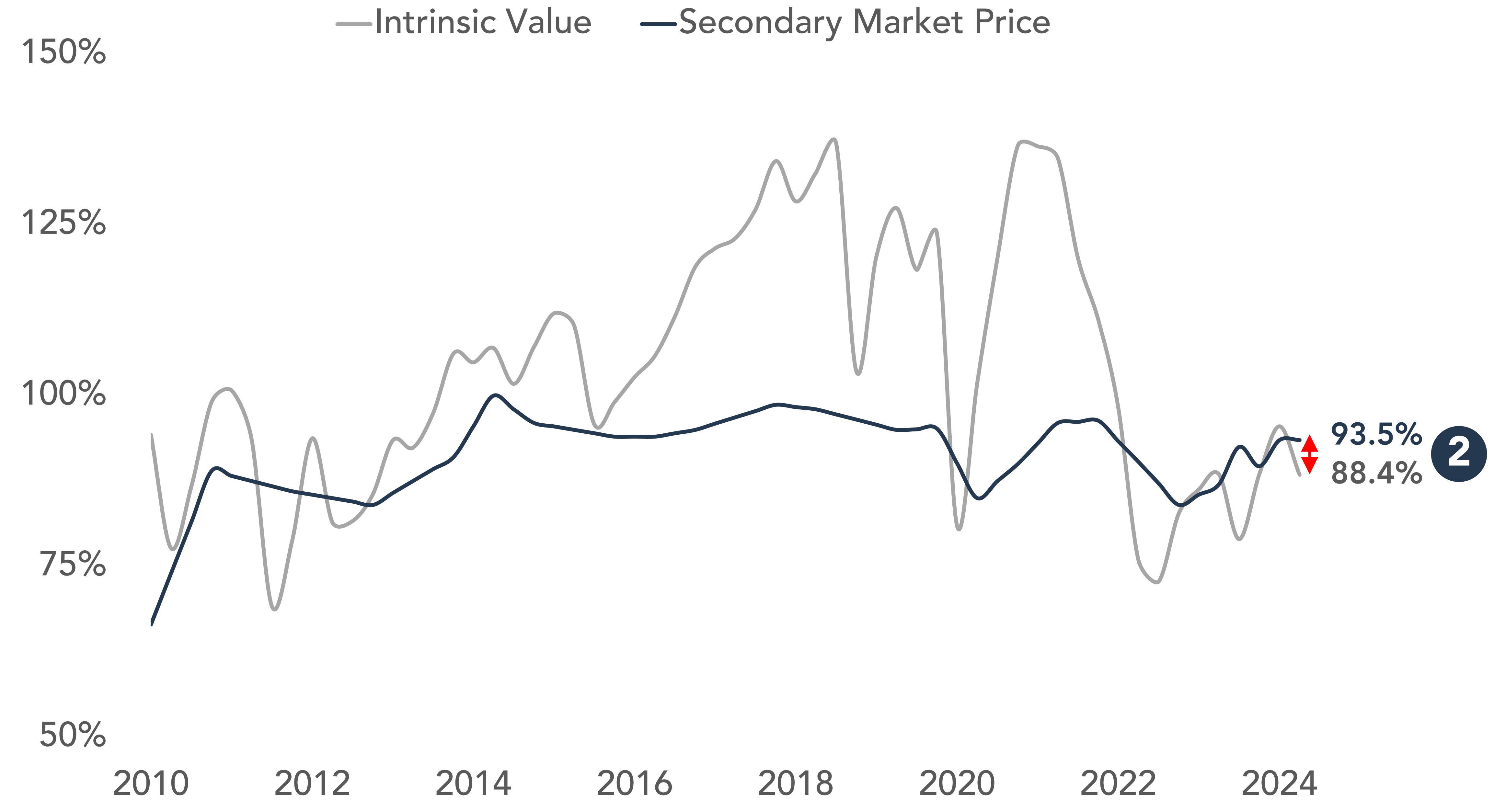
1. Long-term Trend: Q4 saw an appreciation in the 60/40 Portfolio and positive net cash flow activity (an improvement!), both of which are near-term positives for fundraising projections, although problems persist for private markets more broadly (as covered in the first section of this presentation).
2. 2Q Observation: Our model projects an increase in North American buyout fundraising during the early quarters of 2024, though we forecast it should remain below 2021 levels.

SOURCE: ARCTOS ANALYSIS.

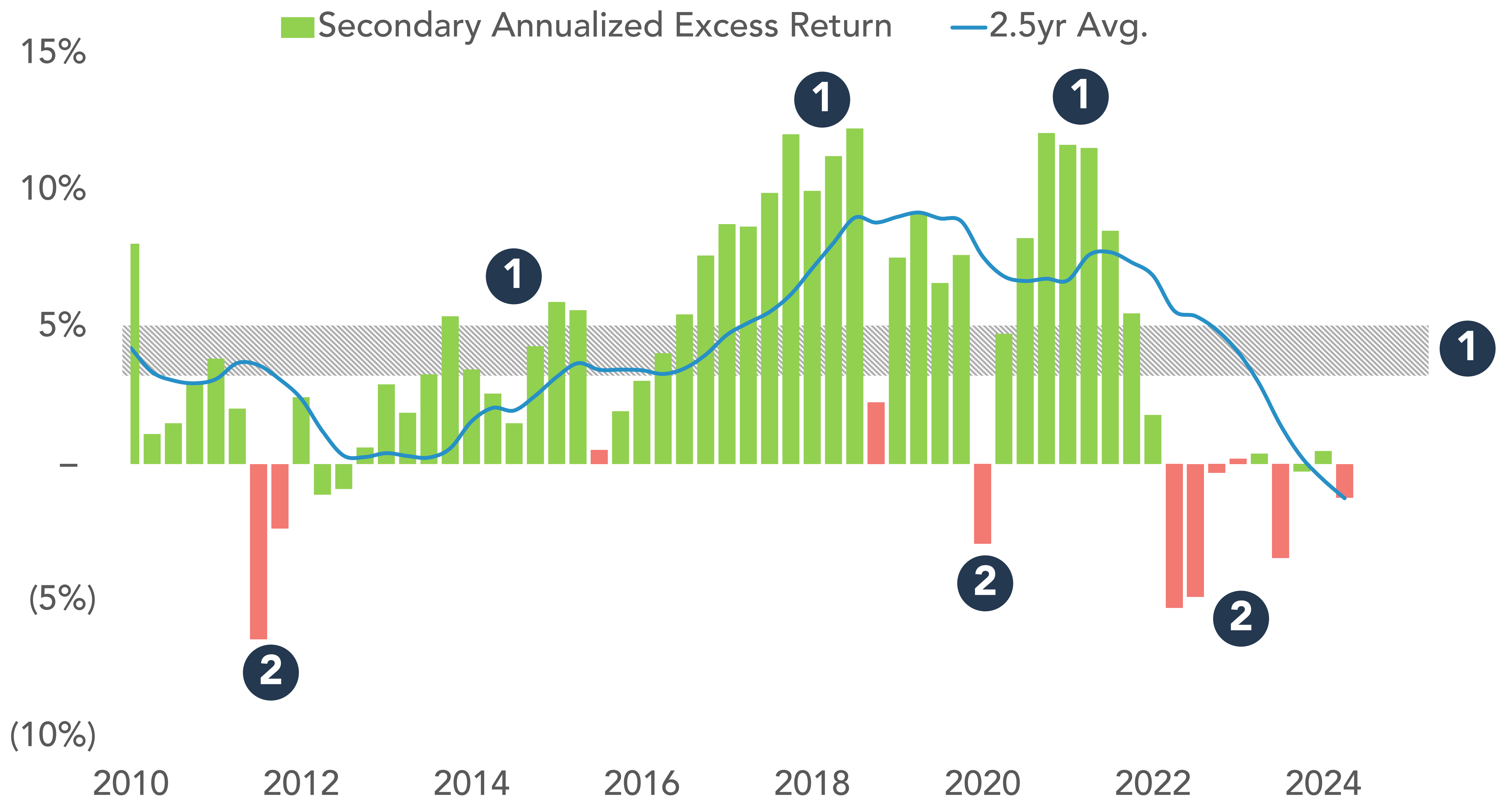
ARCTOS NOWCAST: Secondary Return Environment

ARCTOS INSIGHTS

Annual North American LBO Intrinsic Value vs. Secondary Market Price (%)



Annual Secondary Market Alpha Harvest (%)



1. Long-term Trend: The secondary market can harvest excess return by purchasing assets below intrinsic value and then harvesting that arbitrage quickly via realizations. The alpha harvest needs to exceed 4-5% annually to offset secondary fund fee and carry.
2. 2Q Observation: Despite the recent increase in intrinsic value, our models still suggest the secondary market, by paying roughly fair value, is still overpaying for beta during a period with historically low liquidity – not a great formula for alpha harvest. **This is a supportive environment for traditional LP secondary sellers.**

SOURCE: ARCTOS ANALYSIS. PUBLIC MARKET DATA AS OF 6/26/24

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Our Takeaways & Recommendations

*Thanks to a rebound in public markets, **we have shifted from a "denominator" problem to a "numerator" problem***

- ✓ The rebound in public markets has eased the denominator issues that began in 2022. That said, until the excess NAV problem is resolved (through an increase in net cash flow or decrease in NAVs), we expect fundraising to remain very challenging, especially for undifferentiated sponsors in the middle market.
- ✓ In a shrinking market, GPs will have to take share just to maintain current AUM levels. GPs should focus on bolstering LP facing functions and clearly articulating their ability to generate alpha through cycles. Capital is increasingly concentrating with the largest managers, and smaller GPs will have to more clearly articulate their "right to win" in the markets in which they operate.

*Until unrealized valuations normalize, we expect distribution activity and fundraising to remain near post-GFC lows. **Distributions will continue to be a key differentiator, even if it means taking a discount to NAV***

- ✓ We expect LPs to heavily scrutinize unrealized marks in this fundraising environment. We advise GPs to "take their medicine" and mark their books to market. Not only is it the right thing to do (which LPs will appreciate), but it will allow GPs to manage expectations and then look to sell assets at or even above NAV, further differentiating from the market (where overvalued assets may be "stuck" until they "grow into" their carrying values).
- ✓ We advise caution regarding novel structures like NAV loans. Continuation vehicles can be pursued opportunistically, but we believe LP sentiment here is shifting negatively. All else equal, LPs place a premium on organic liquidity, and GPs should be dedicating resources to "sourcing" exits.

If you would like to discuss any of the topics raised, please do not hesitate to reach out to us at info@arctospartners.com.

ARCTOS INSIGHTS

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Founded in 2019, Arctos serves as a catalyst for innovation and business transformation for its portfolio companies and its markets. The firm's proprietary approach is anchored by its unique quantitative research and data science platform, Arctos Insights.

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