# Q3 2024 Keystone Market Update

## An update on the private markets ecosystem and Arctos' NOWCAST

September 2024

# Q3 2024 Keystone Market Update Executive Summary

Key themes we are actively monitoring for both GPs and LPs in 2024.

## GP Key Themes

- The fundraising market is improving on the margins, but concentration with big firms makes it feel really bad for everyone else.
- Continue to pursue "inorganic" distributions (i.e., via CVs), but with a critical eye on their possible negative impact on your franchise and brand with LPs.
- Our consolidation theme remains active and appears to be accelerating.

## LP Key Themes

- The numerator 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.
- Scrutinize unrealized NAVs. Reward GPs that mark their portfolios to market and seek liquidity (even if it means taking a discount). For GPs that deployed record amounts of dry powder in 2021, encourage them to "take their medicine" and move on quickly from deals they may have vastly overpaid for vs. waiting to grow into those valuations (at the expense of poor IRRs).
- The number of funds actively raising capital has decreased by ~70% in two years. This market provides an opportunity to strengthen core GP relationships.

SOURCE: ARCTOS ANALYSIS.
NOTE: CERTAIN INFORMATION HEREIN REFLECTS THE BELIEFS OF ARCTOS AND IS SUBJECT TO VARIOUS RISKS AND ASSUMPTIONS. THERE CAN BE NO ASSURANCES THAT ANY PLANS OR EXPECTATIONS WILL ULTIMATELY BE MET AS DESCRIBED HEREIN, IF AT ALL. THERE CAN BE NO ASSURANCE THAT HISTORICAL TRENDS WILL CONTINUE.

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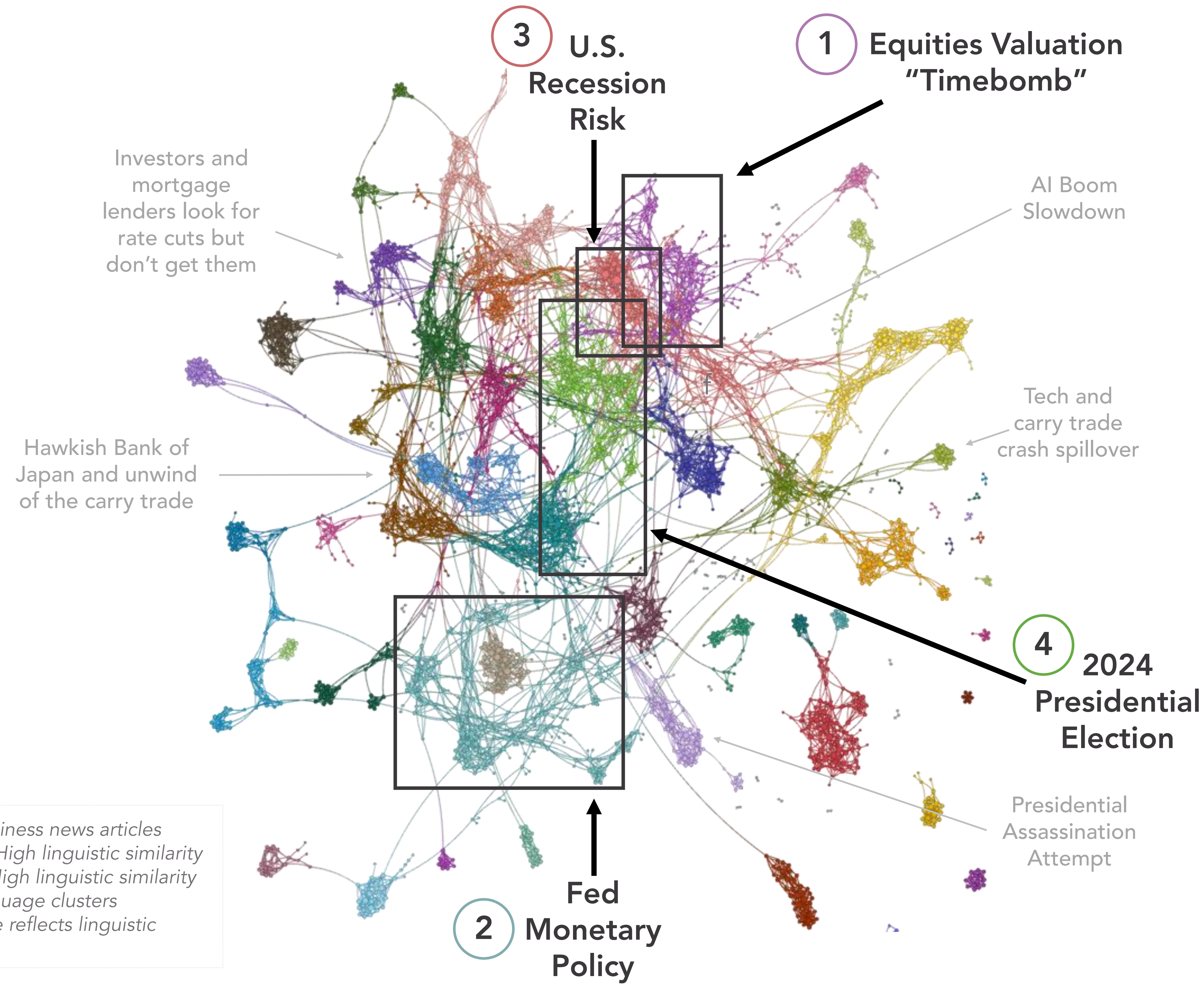
ARCTOS INSIGHTS

# Q3 2024 Now Narrative – U.S. Markets / Macro




***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.*

## *Narratives in Focus*

1. Equities Valuation "Timebomb"
2. Fed Monetary Policy
3. U.S. Recession Risk
4. 2024 Presidential Election



SOURCE: EPSILON THEORY. AS OF AUGUST 2024.
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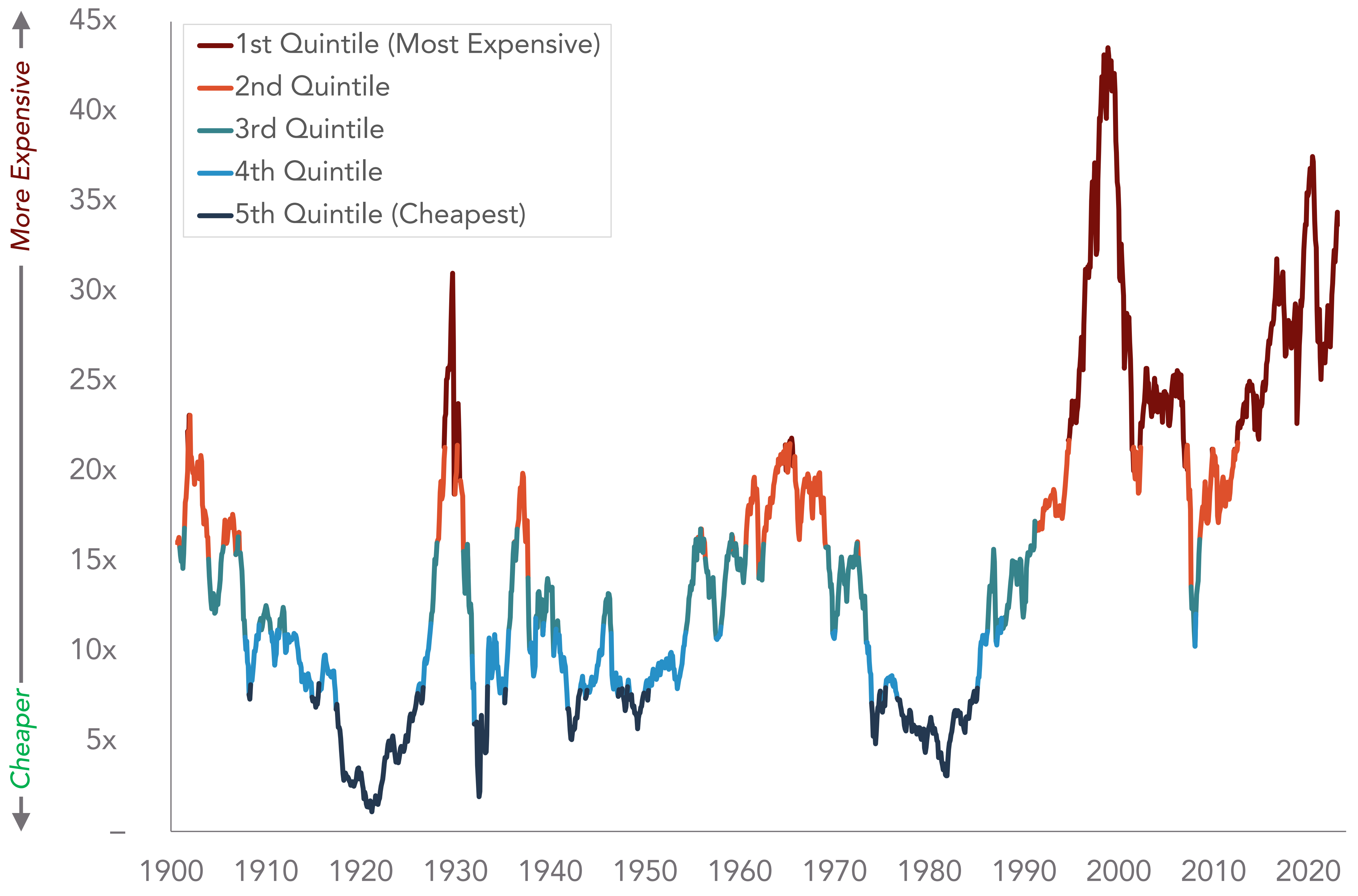
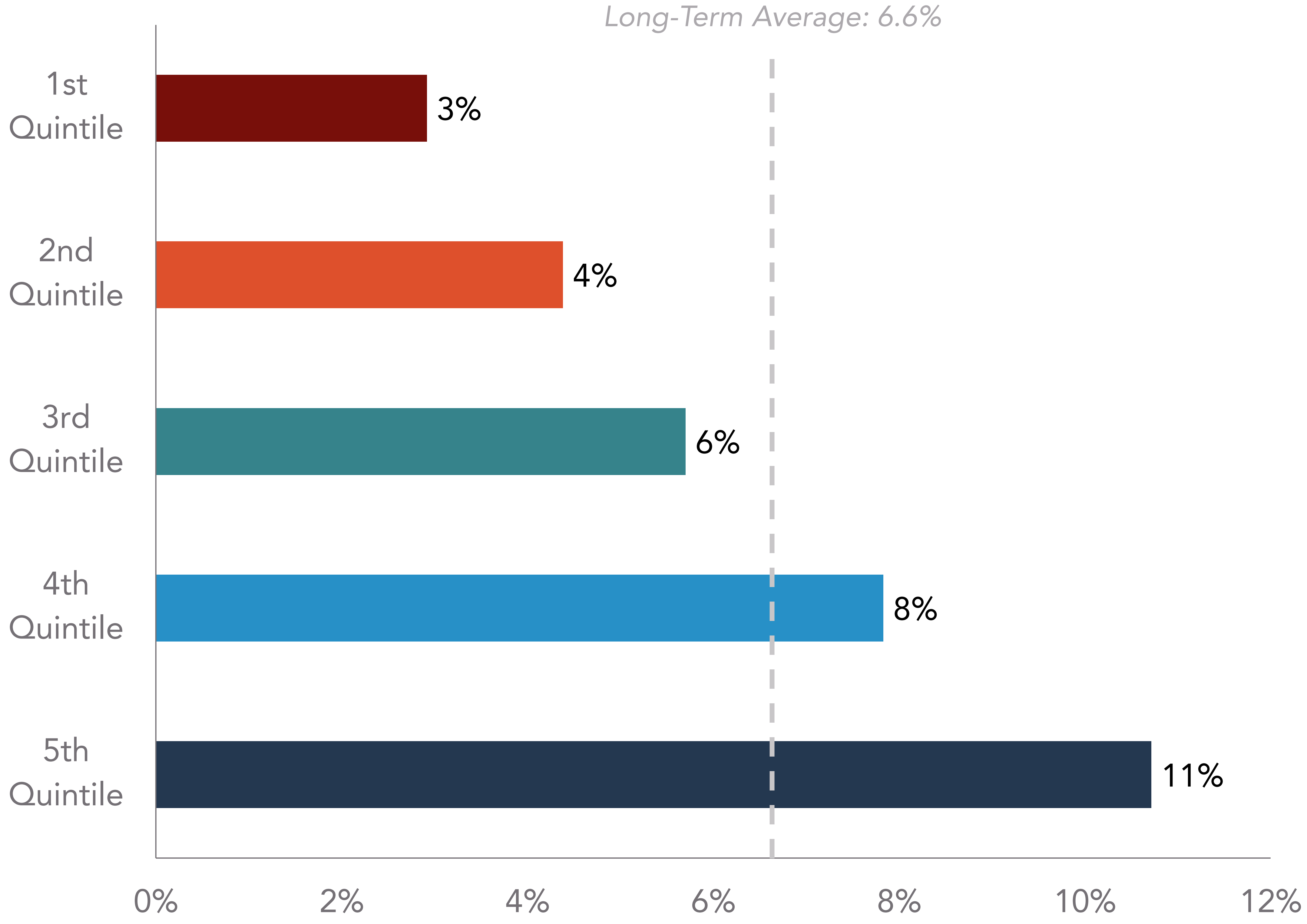
# U.S. Equity Markets Are Historically Expensive

Per the S&P 500 Shiller CAPE ratio, the market's current valuation remains in the most expensive quintile, falling in the ~97th percentile of valuations since 1900, suggesting long term equity returns will be below average.

## Cyclically Adjusted Price / Earnings Ratio




## S&P 500 Subsequent Annualized 10-Year Real Total Return



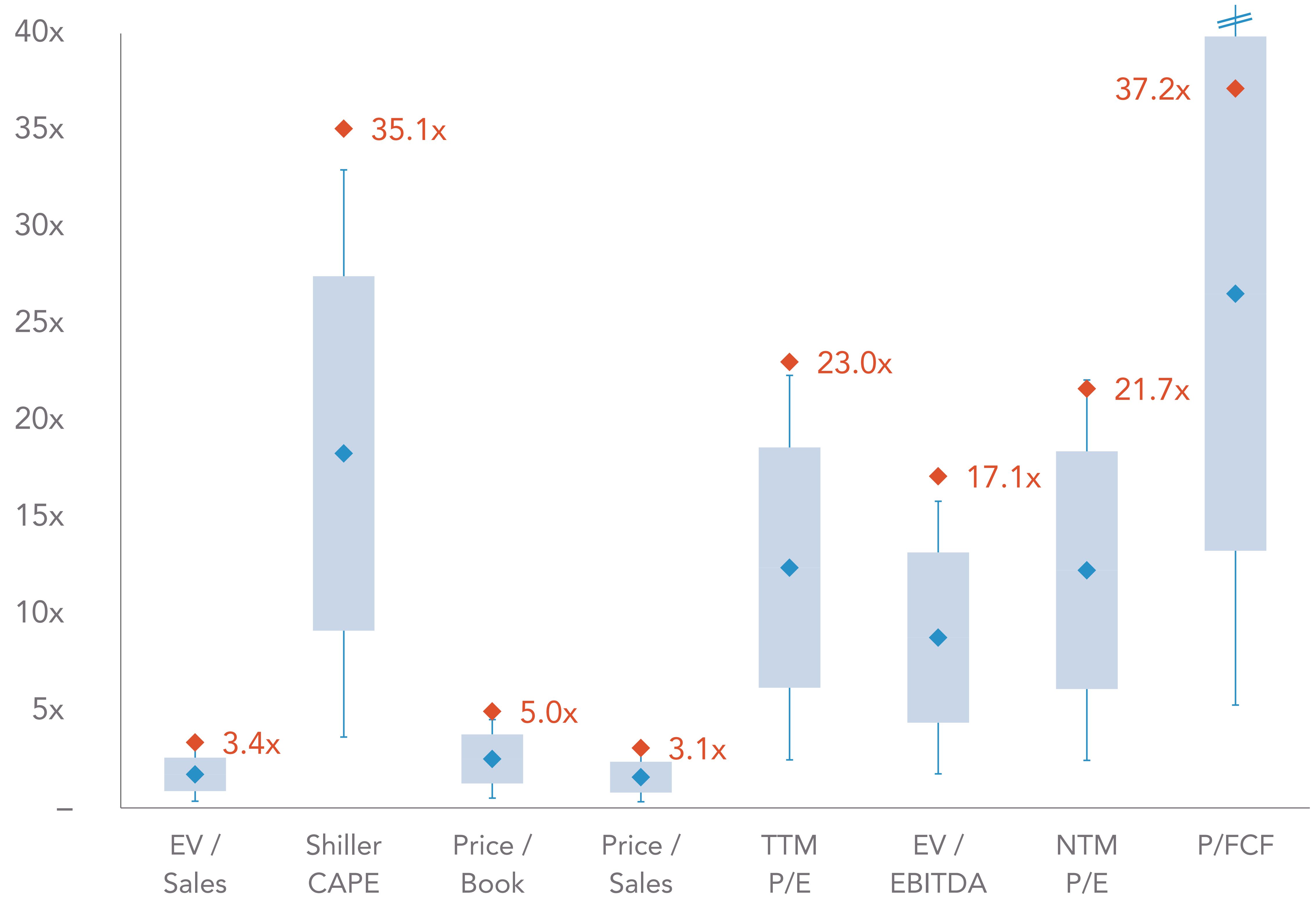



SOURCE: ROBERT SHILLER, YALE UNIVERSITY. AS OF AUGUST 2024.
NOTE: THERE CAN BE NO ASSURANCE THAT HISTORICAL TRENDS WILL CONTINUE.

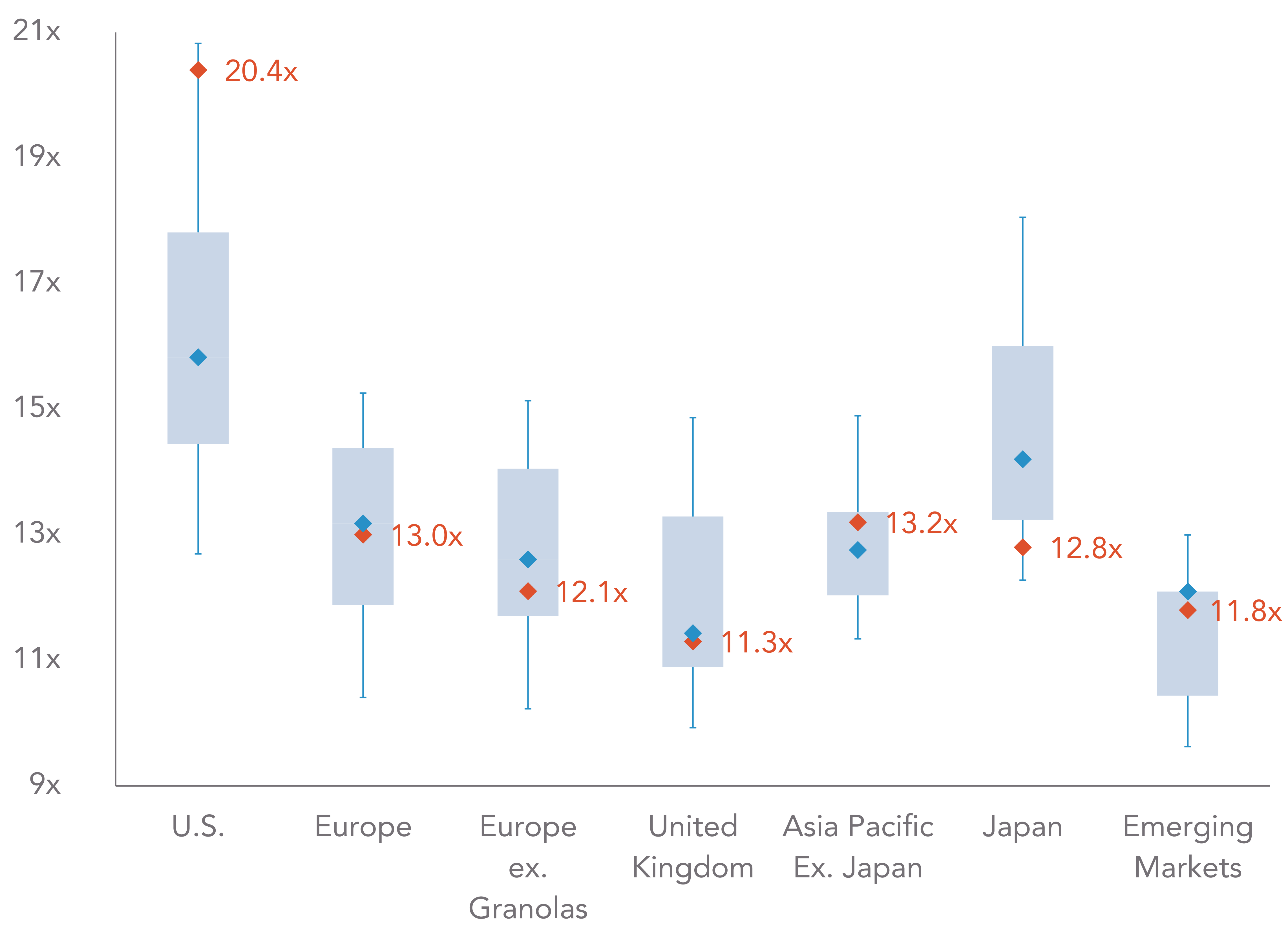
# How Expensive Are U.S. Public Markets?

The S&P 500 is currently near historical highs across most valuation metrics, remaining expensive relative to foreign equities and historical U.S. valuations.

## Current S&P 500 Valuation Multiples Relative to History




## 12 Month Forward P/E Multiples by MSCI Region (L20Y)




10th - 90th Percentile | 1st - 3rd Quartile Range | Current | Median

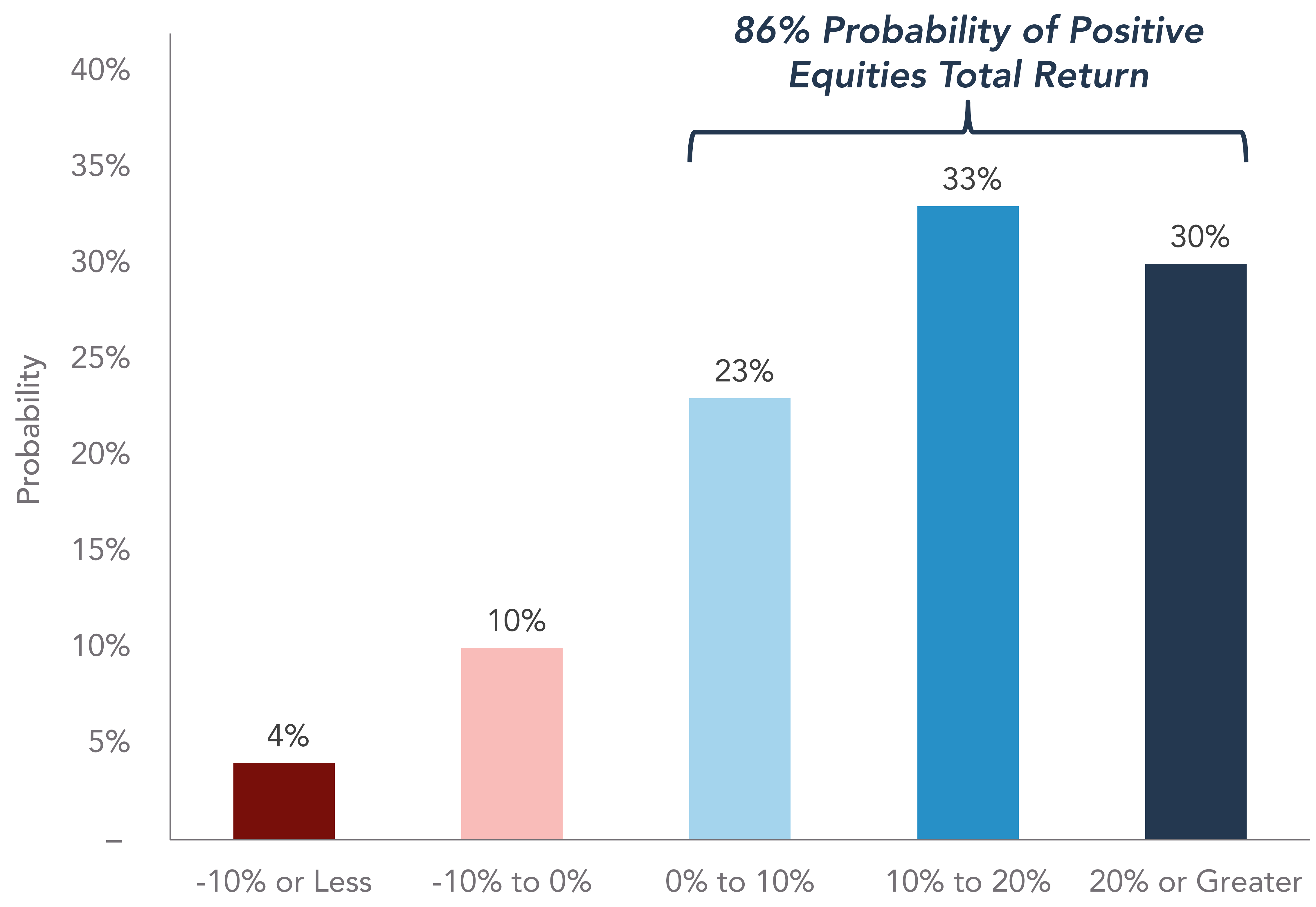


SOURCE: CAPITAL IQ, GOLDMAN SACHS, THE BAHNSEN GROUP. AS OF SEPTEMBER 2024.
NOTE: THERE CAN BE NO ASSURANCE THAT HISTORICAL TRENDS WILL CONTINUE.

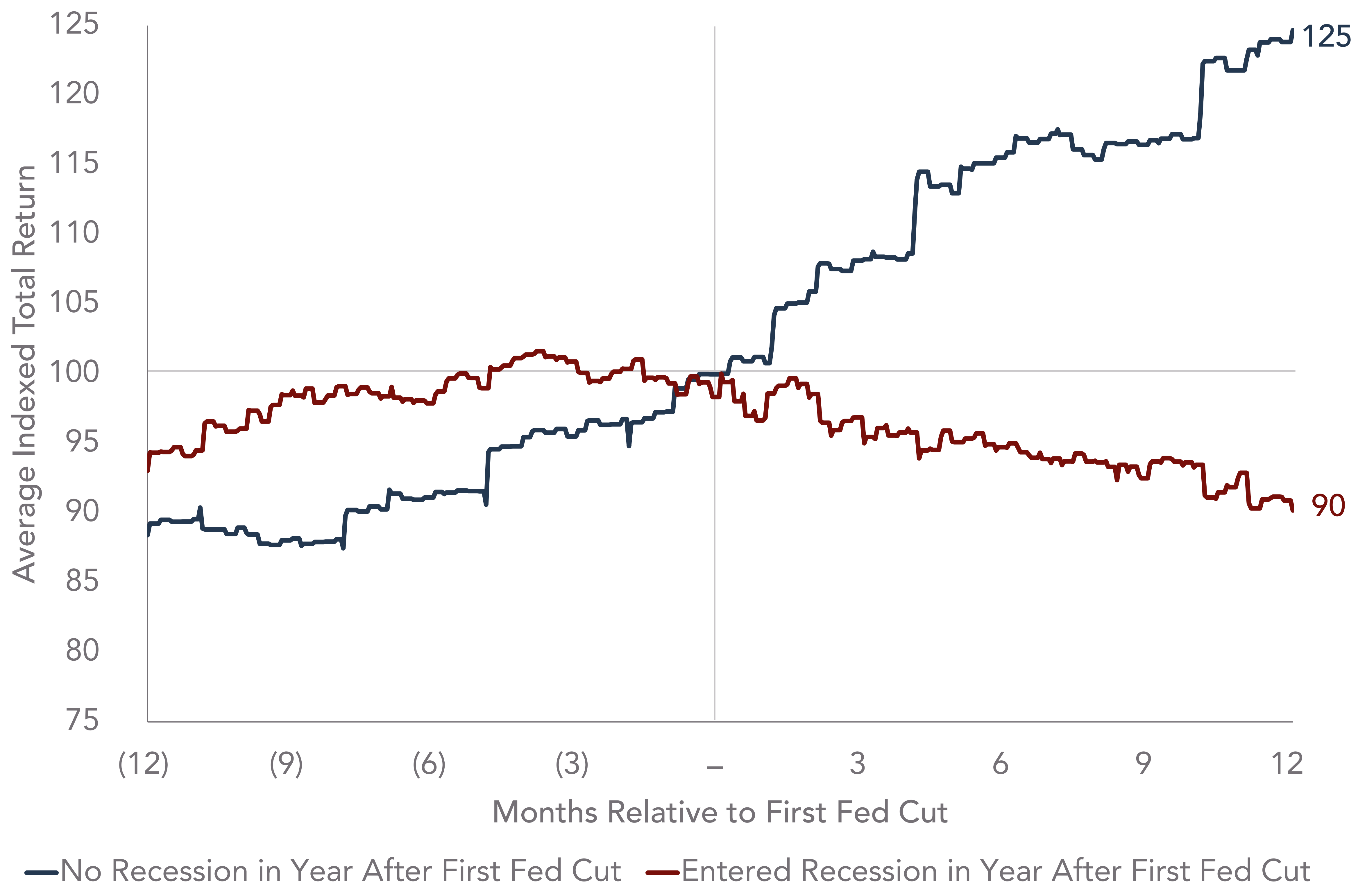
# But Strong GDP Growth and Dovish Fed Supporting Equities in Near-term

U.S. equities have delivered positive one-year returns ~86% of the time during periods of economic expansion, with initial fed rate cuts, during a rate cut cycle, amplifying the historical trend.

**S&P 500 One-Year Total Returns During US Economic Expansions (Since 1945)**




**S&P 500 Performance Following First Federal Reserve Rate Cut (Since 1945)**



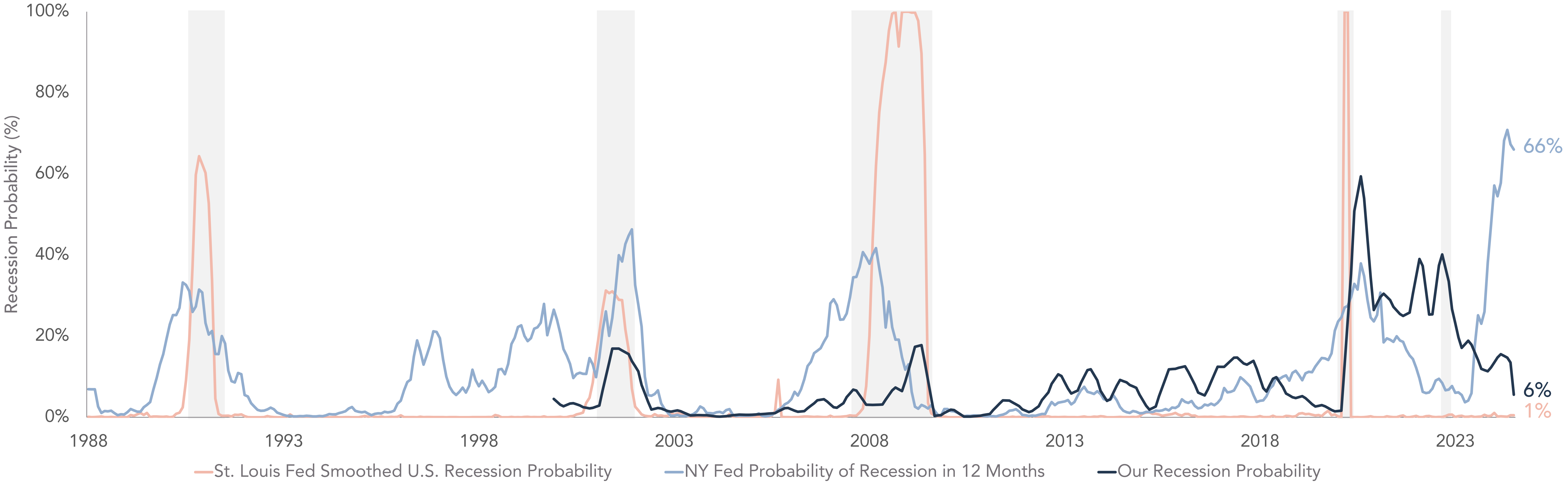



SOURCE: GOLDMAN SACHS, BLOOMBERG, CAPITAL IQ. AS OF AUGUST 2024.
NOTE: THERE CAN BE NO ASSURANCE THAT HISTORICAL TRENDS WILL CONTINUE.

# What Are the Odds of a U.S. Recession?

Traditional recession forecasting models vary widely on the probability of a near-term recession. Our model predicts a very low probability of a recession in the near-term.

## Current Recession Probability





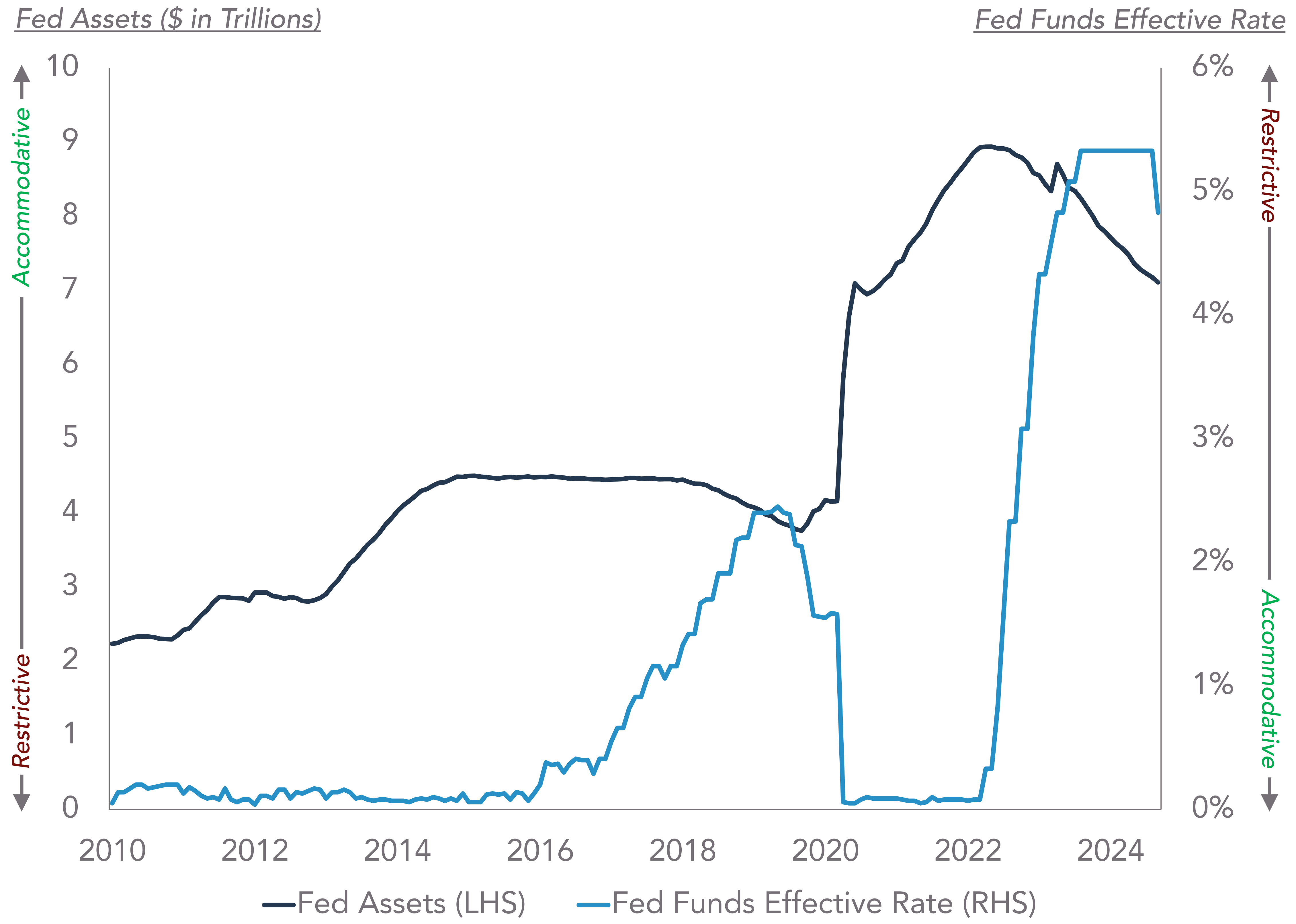

SOURCE: FEDERAL RESERVE BANK OF ST. LOUIS, FEDERAL RESERVE BANK OF NEW YORK, NAVEGA STRATEGIES. AS OF JULY 2024.
NOTE: THERE CAN BE NO ASSURANCE THAT HISTORICAL TRENDS WILL CONTINUE.

# Most Recessions Caused by Financial Crisis and/or Policy Errors

While open market purchases by the Fed have led to a historically large balance sheet, the Fed can manage recessionary risk via extensive room for rate cuts.

## U.S. Financial Stress Index


## Fed Policy Is Still Very Restrictive






SOURCE: FEDERAL RESERVE BANK OF KANSAS CITY, FEDERAL RESERVE BANK OF ST. LOUIS. AS OF SEPTEMBER 2024.
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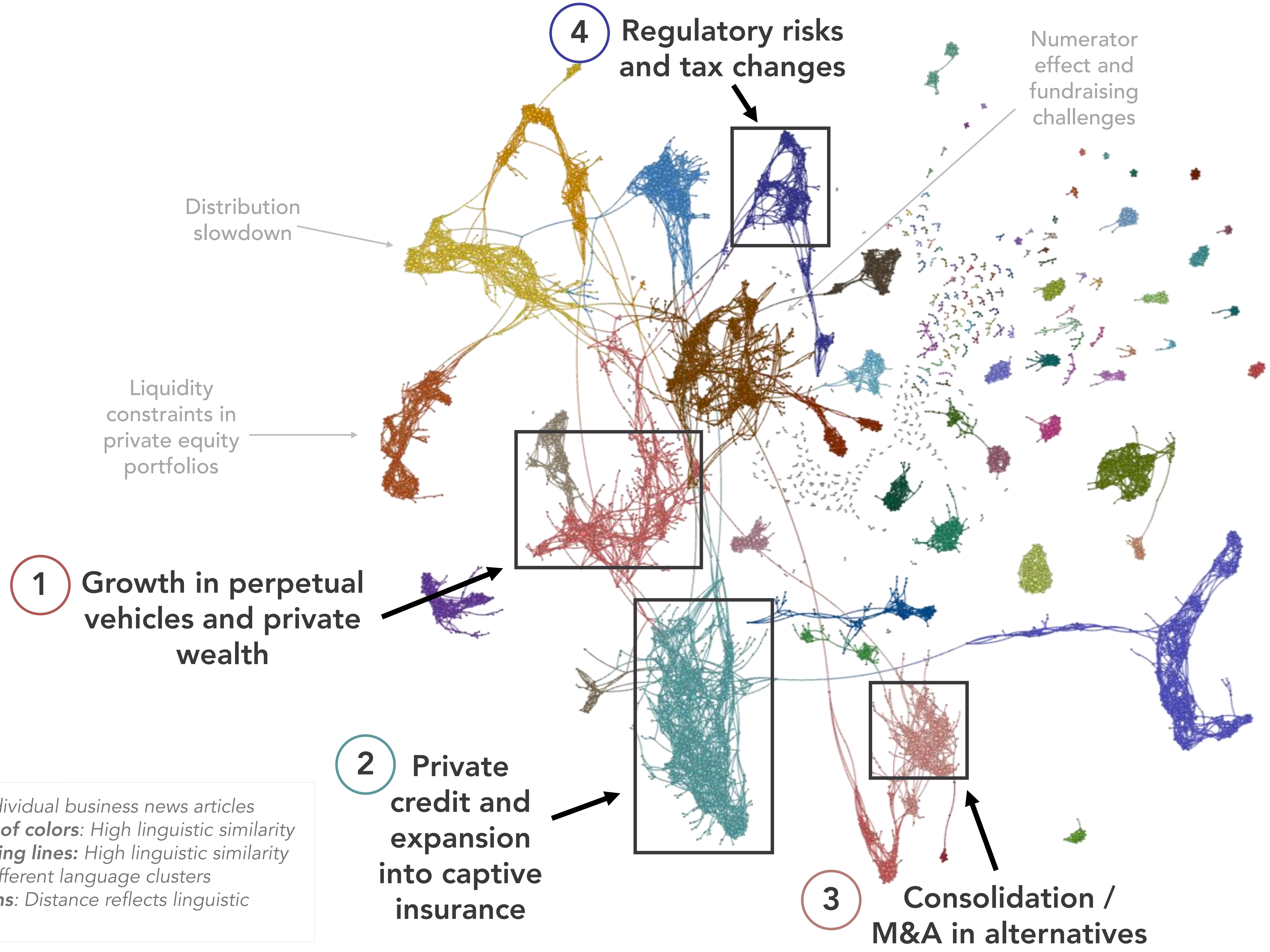
# Current Private Markets NowNarrative Monitor for GPs (Q3 2024)

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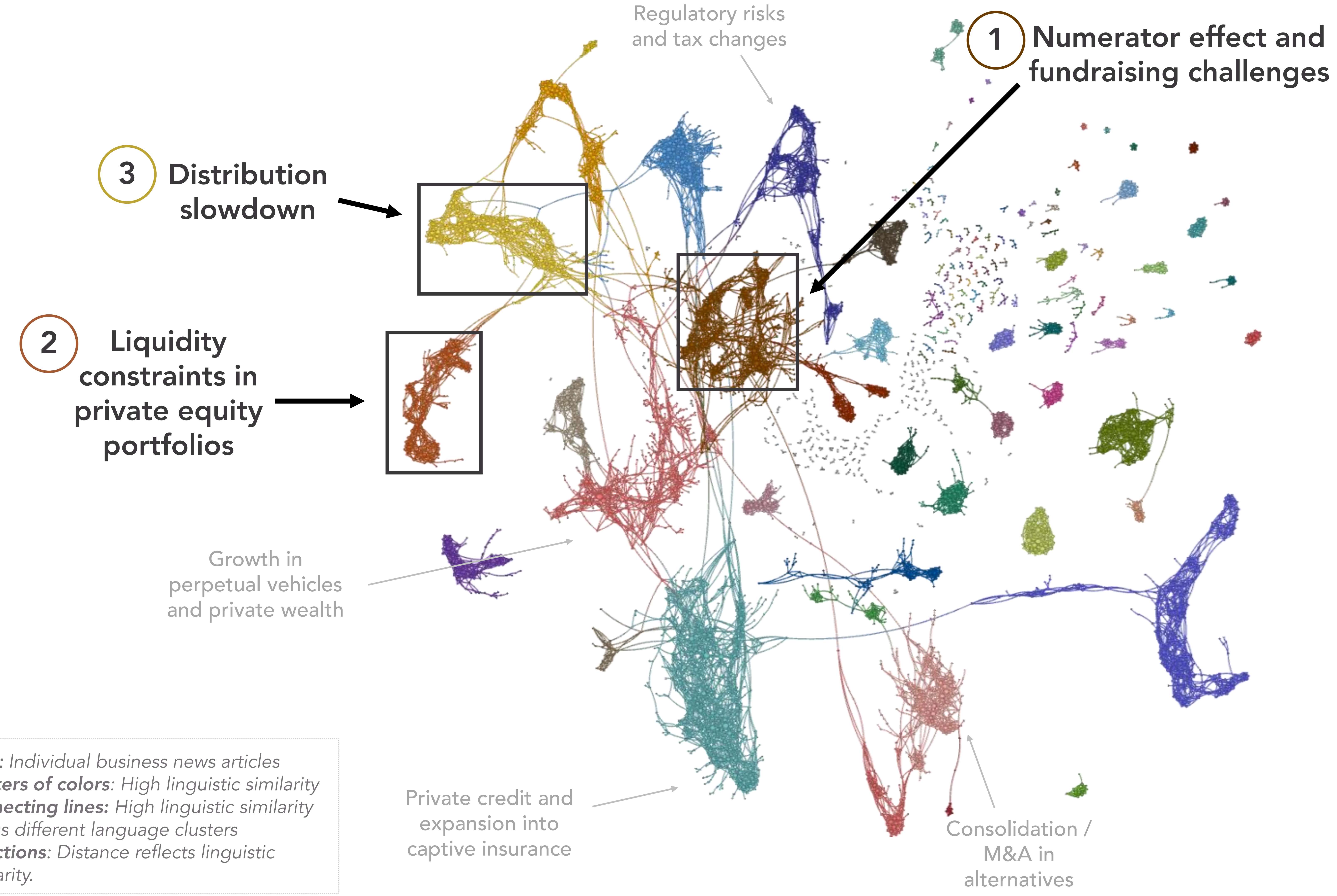
## *Narratives in Focus*

1. Growth in perpetual vehicles and private wealth
2. Private credit and expansion into captive insurance
3. Consolidation / M&A in alternatives
4. Regulatory risks and tax changes

# Current Private Markets NowNarrative Monitor for LPs (Q3 2024)

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## *Narratives in Focus*

1. Numerator effect and fundraising challenges
2. Liquidity constraints in private equity portfolios
3. Distribution slowdown

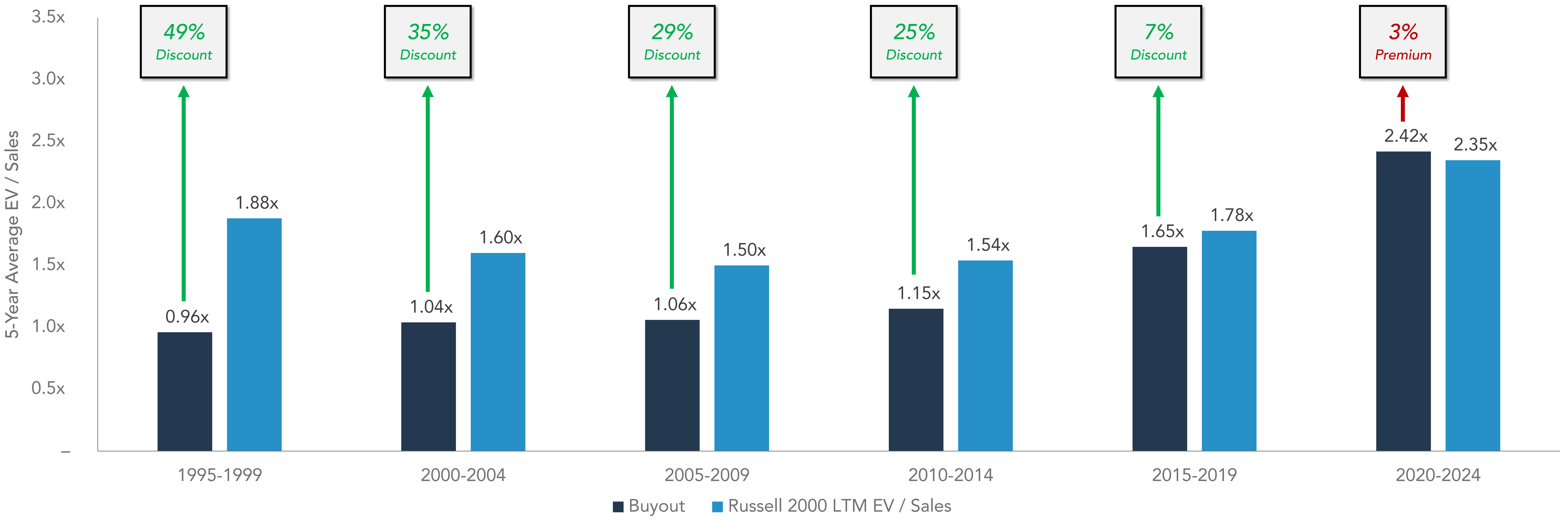


SOURCE: ARCTOS, QUID. AS OF AUGUST 2024.

# Private Equity Valuation Environment

Private equity buoyout multiples have increased over time at a greater rate than its public proxy counterpart.

## Private Equity Buyout Multiples vs. Public Proxy



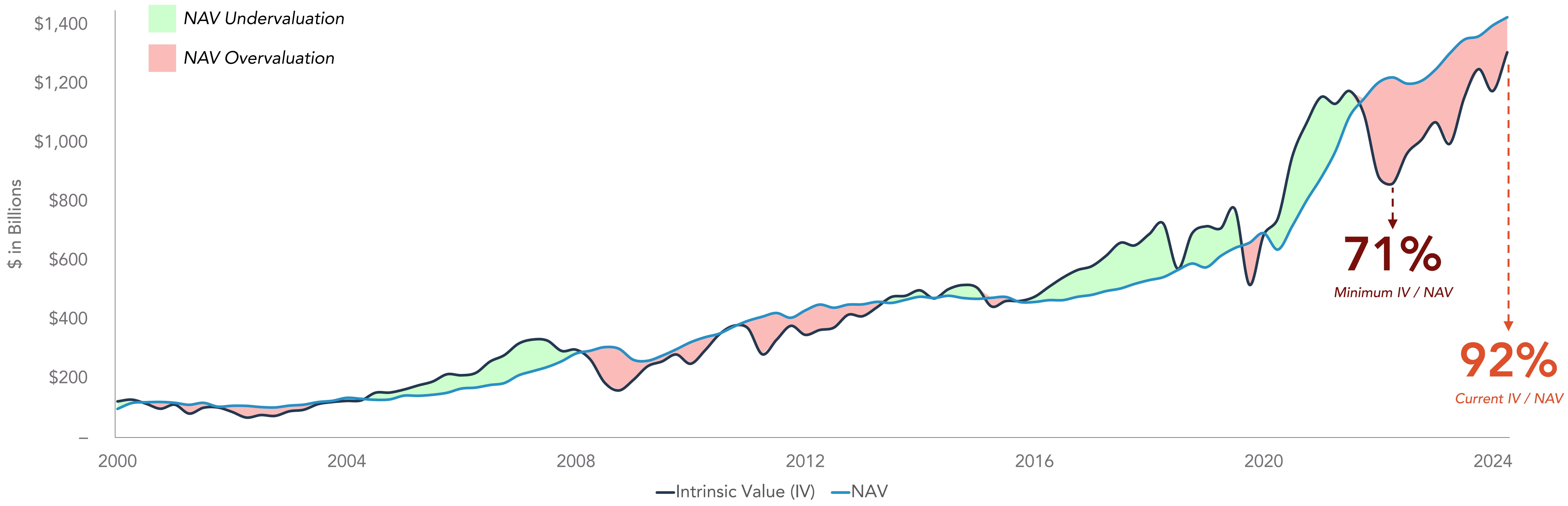



SOURCE: BANK OF AMERICA RESEARCH. AS OF Q2 2024.
NOTE: THE BENCHMARKS AND INDICES PROVIDED HEREIN WERE SELECTED BY ARCTOS FOR ILLUSTRATIVE PURPOSES ONLY. SELECTION OF SUCH BENCHMARKS OR INDICES IS INHERENTLY SUBJECTIVE AND OTHERS MIGHT SELECT OTHER BENCHMARKS OR INDICES BASED ON THEIR ASSESSMENT OF THE MARKET. ACTUAL RESULTS MAY DIFFER, PERHAPS MATERIALLY, FROM THE TRENDS PRESENTED HEREIN. THERE CAN BE NO ASSURANCE THAT HISTORICAL TRENDS WILL CONTINUE.

# Emergence of "NAV Valuation Overhang"

NAV valuation overhang, observed when private equity NAV is overvalued relative to underlying intrinsic value, has historically corresponded with weaker exit environments and the denominator effect. The current overhang is the result of record purchase price multiples paid during the post-COVID boom, and the lack of subsequent write downs.

## Buyout Private Equity: NAV Valuation Overhang






SOURCE: ARCTOS ANALYSIS, BURGISS, CAPITAL IQ. AS OF SEPTEMBER 2024.
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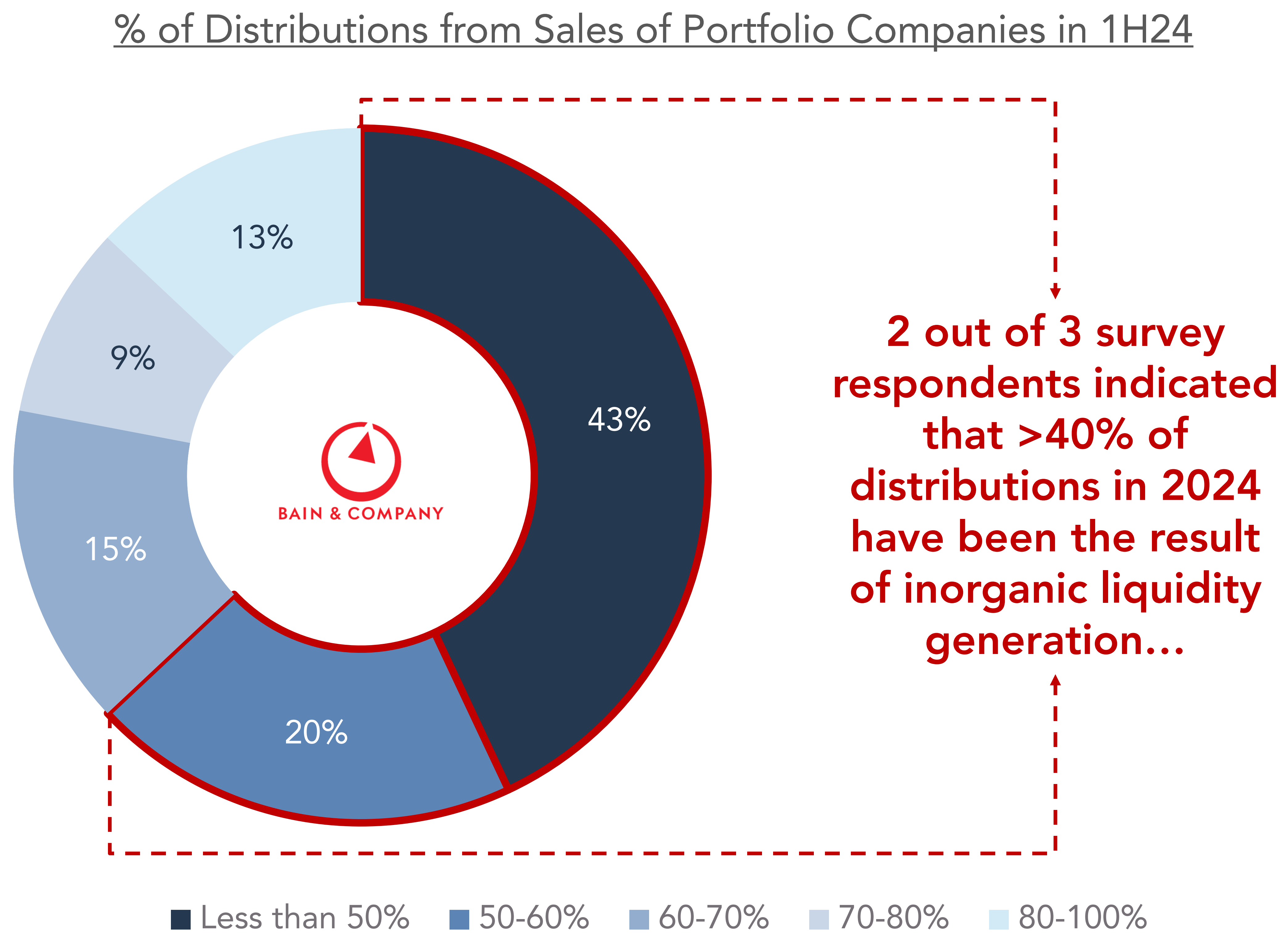
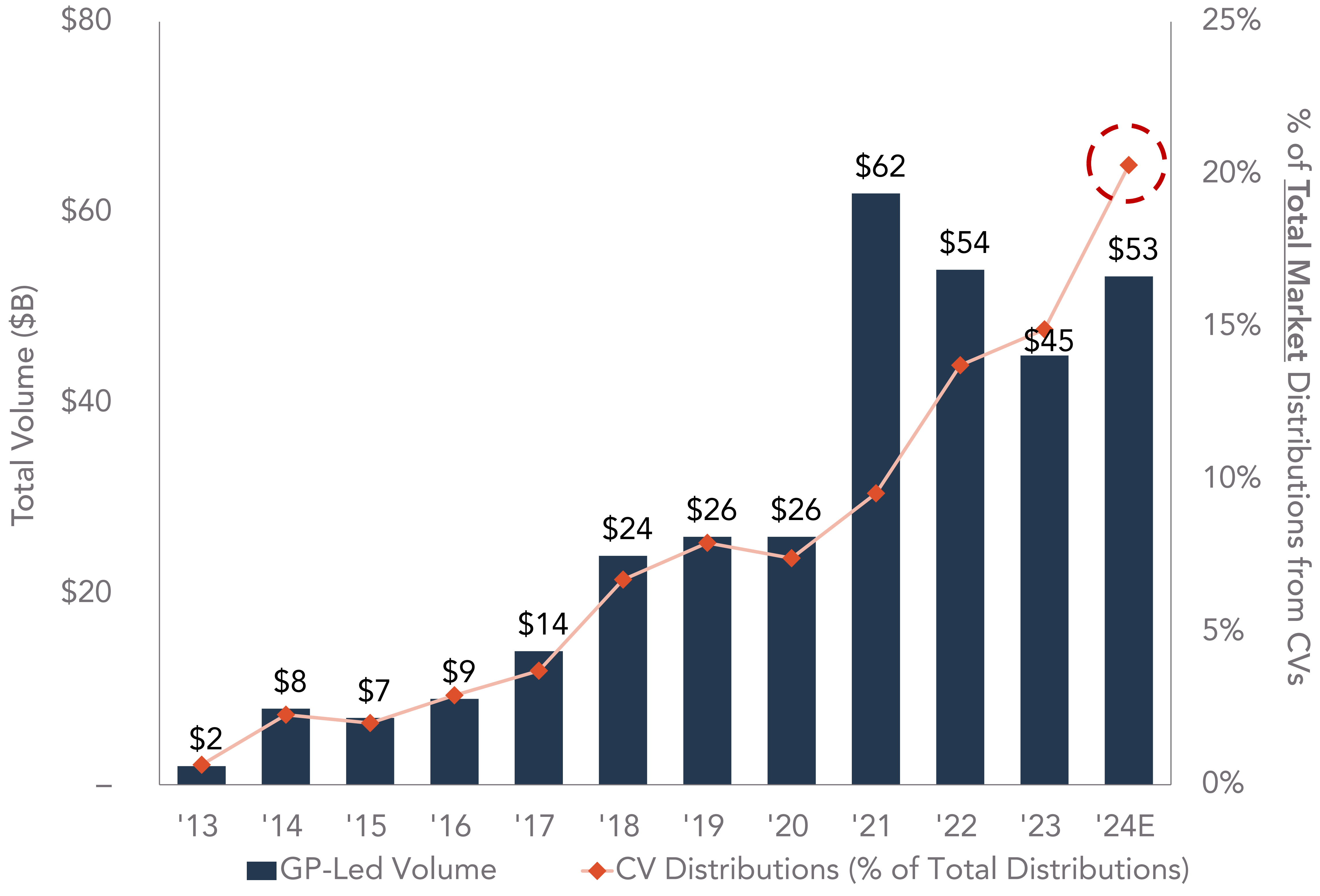
# Distributions Are Worse Than You Think

The NAV overhang problem has contributed to the lack of liquidity in the market, compelling GPs to pursue "inorganic" distributions. Managers utilizing continuation vehicles, NAV loans, and other tools to generate much-needed liquidity for LPs.

## 1H 2024 featured significant inorganic distributions…




## …with continuation vehicle volume maintaining scale.



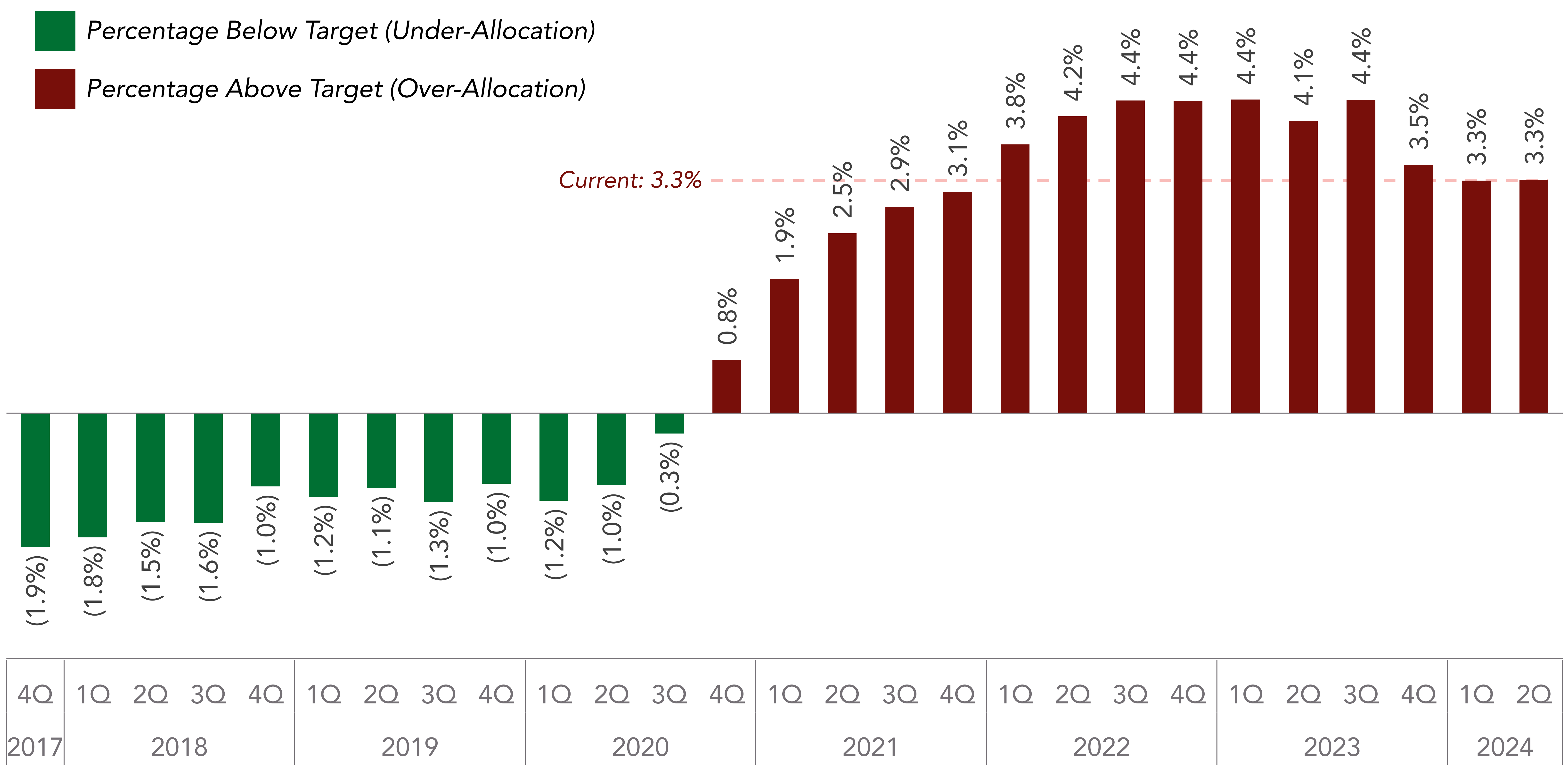



SOURCE: BAIN, 1H 2024 GREENHILL SECONDARIES MARKET REPORT, EVERCORE, JEFFERIES, BURGISS, ARCTOS ANALYSIS.
NOTE: THIRD-PARTY LOGOS INCLUDED HEREIN ARE PROVIDED FOR ILLUSTRATIVE PURPOSES ONLY. INCLUSION OF SUCH LOGOS DOES NOT IMPLY AFFILIATION WITH OR ENDORSEMENT BY SUCH FIRMS OR BUSINESSES. THERE CAN BE NO ASSURANCE THAT HISTORICAL TRENDS WILL CONTINUE. THIRD-PARTY LOGOS INCLUDED HEREIN ARE PROVIDED FOR ILLUSTRATIVE PURPOSES ONLY. INCLUSION OF SUCH LOGOS DOES NOT IMPLY AFFILIATION WITH OR ENDORSEMENT BY SUCH FIRMS OR BUSINESSES.

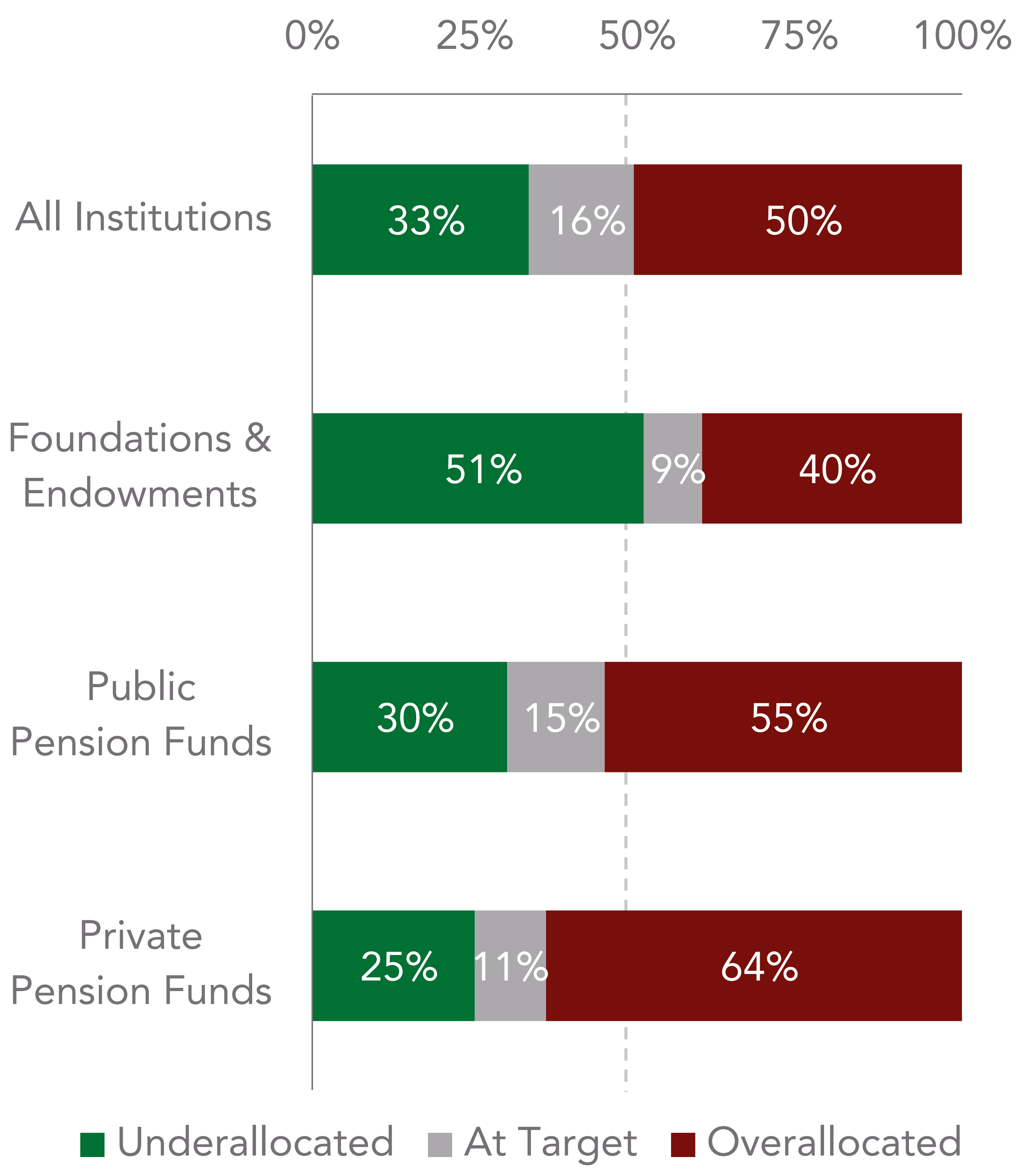
# Allocation Constraints Persist

Institutional LPs have been facing over-allocation since shortly after the onset of COVID-19, an issue that has been exacerbated by the current NAV valuation overhang seen in private equity.

## Arctos PE Allocation Constraint Model




## Constraint is Widespread



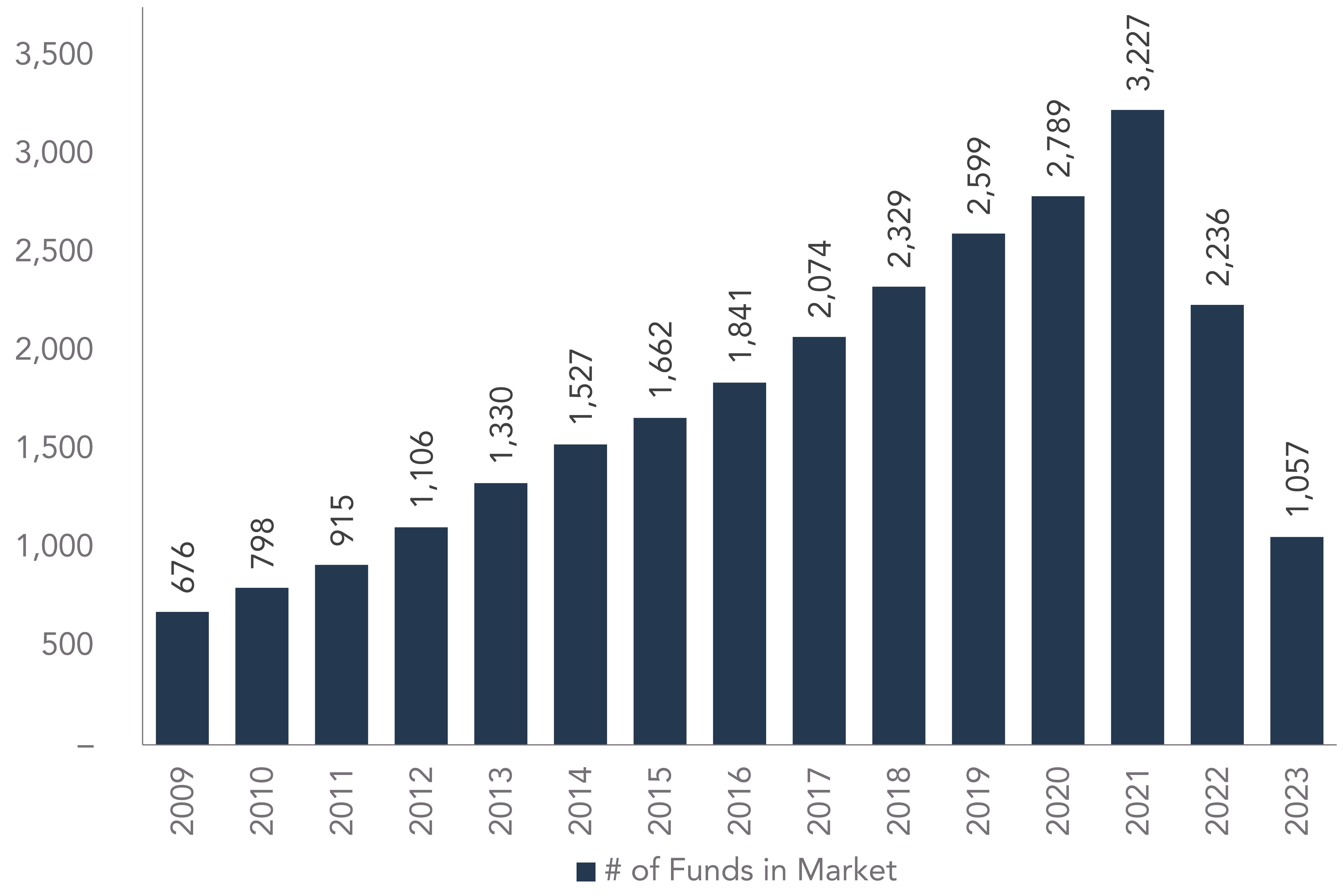



SOURCE: ARCTOS ANALYSIS, BURGISS, BUYOUTS INSIDER. AS OF JUNE 2024.
NOTE: "AT TARGET" INDICATED AS CURRENT ALLOCATION WITHIN 0.5% OF PRIVATE EQUITY TARGET. THERE CAN BE NO ASSURANCE THAT HISTORICAL TRENDS WILL CONTINUE.

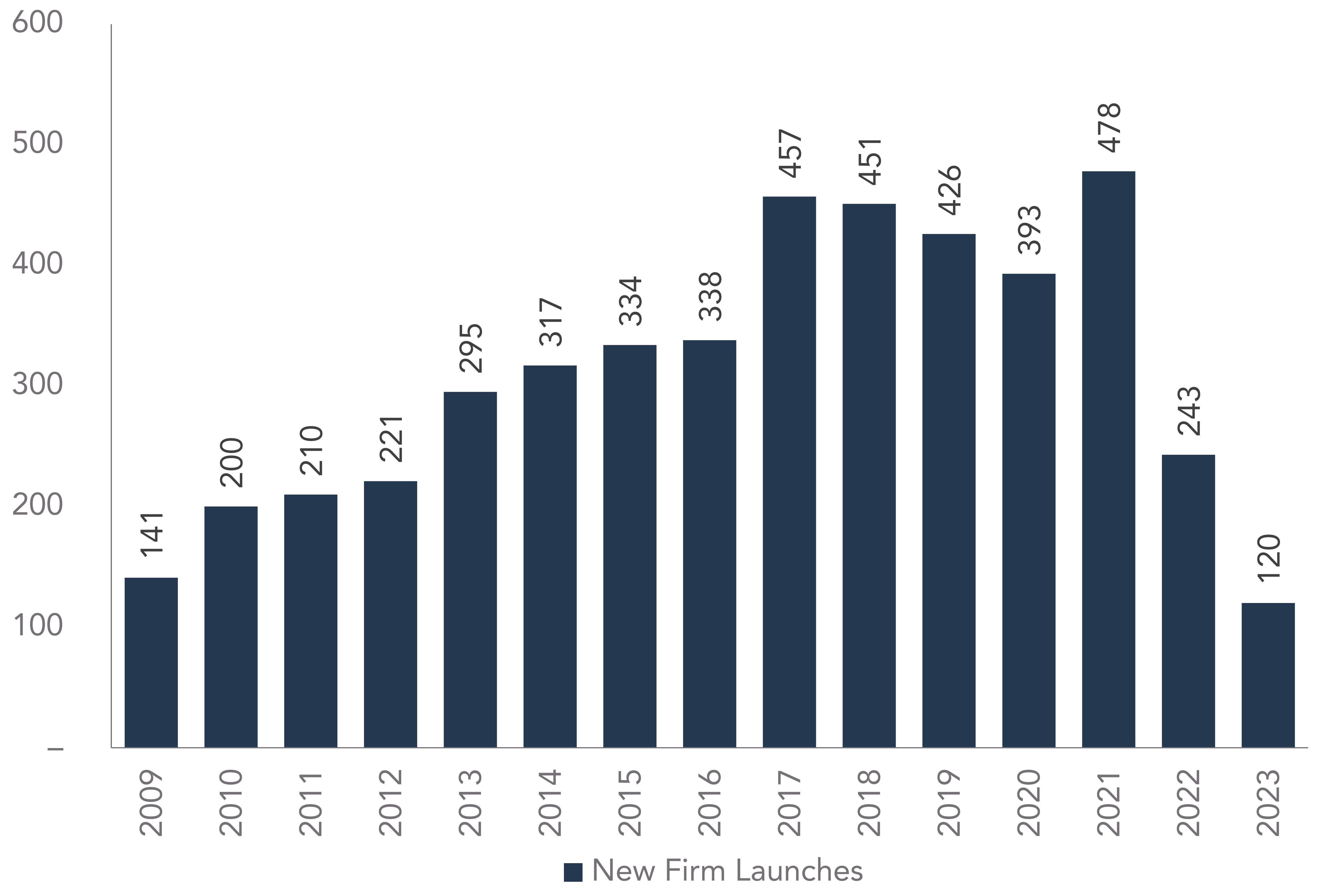
# New Fund and Firm Formation is Plunging…

Funds in-market have declined during a difficult fundraising environment, with accelerating consolidation creating an increasingly large barrier to entry for new managers.

## Funds actively raising capital has decreased rapidly…




## …with new firm launches falling even further.



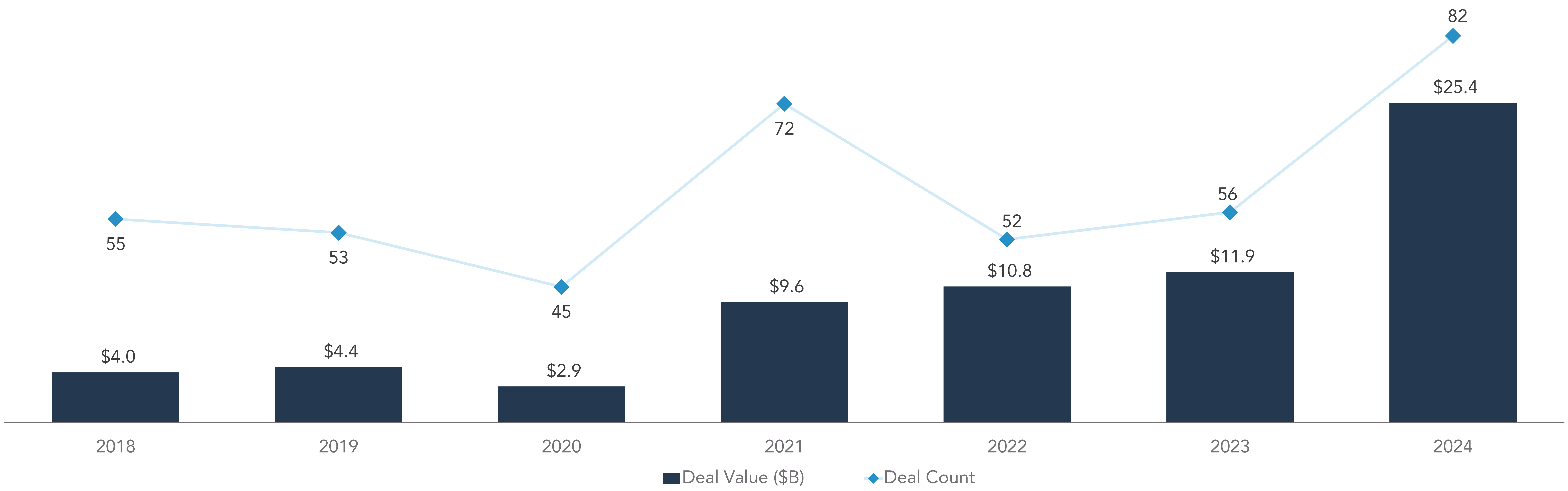



SOURCE: BURGISS, ARCTOS ANALYSIS. PUBLIC MARKET DATA AS OF 8/28/24.
NOTE: THERE CAN BE NO ASSURANCE THAT HISTORICAL TRENDS WILL CONTINUE.

# …As a Result of Unprecedented Consolidation

Firms are acquiring capabilities they lack, and solidifying market positioning, by acquiring other asset managers.

## Strategic Asset Manager M&A






SOURCE: PITCHBOOK. AS OF AUGUST 2024.
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# ARCTOS NOWCAST

## Arctos NOWCAST Framework

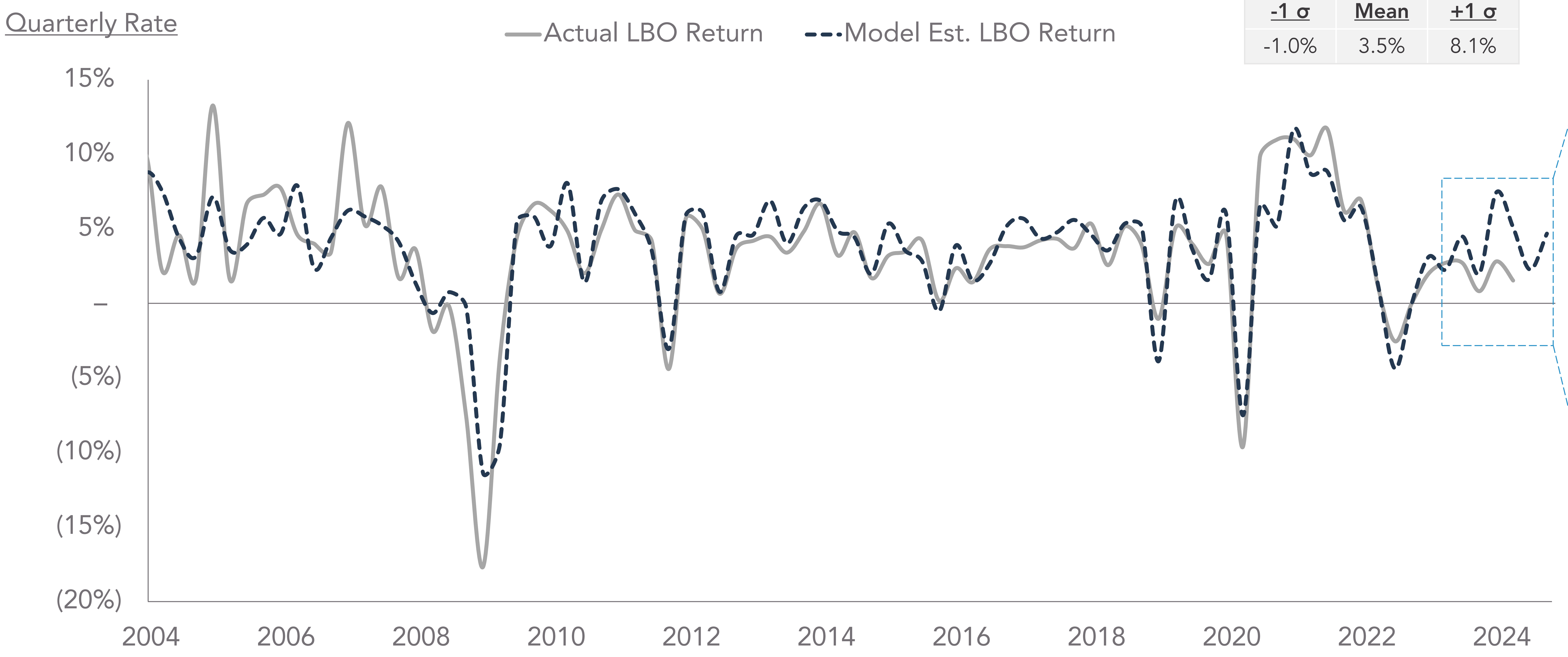
- We use historical data and time series forecasting models to generate "nowcasts" – i.e., forecasts of current, and very near-term, activity for data that is released on a lag, as is common in private markets.
- Our proprietary models capture the interaction between past values of major macro, public 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.

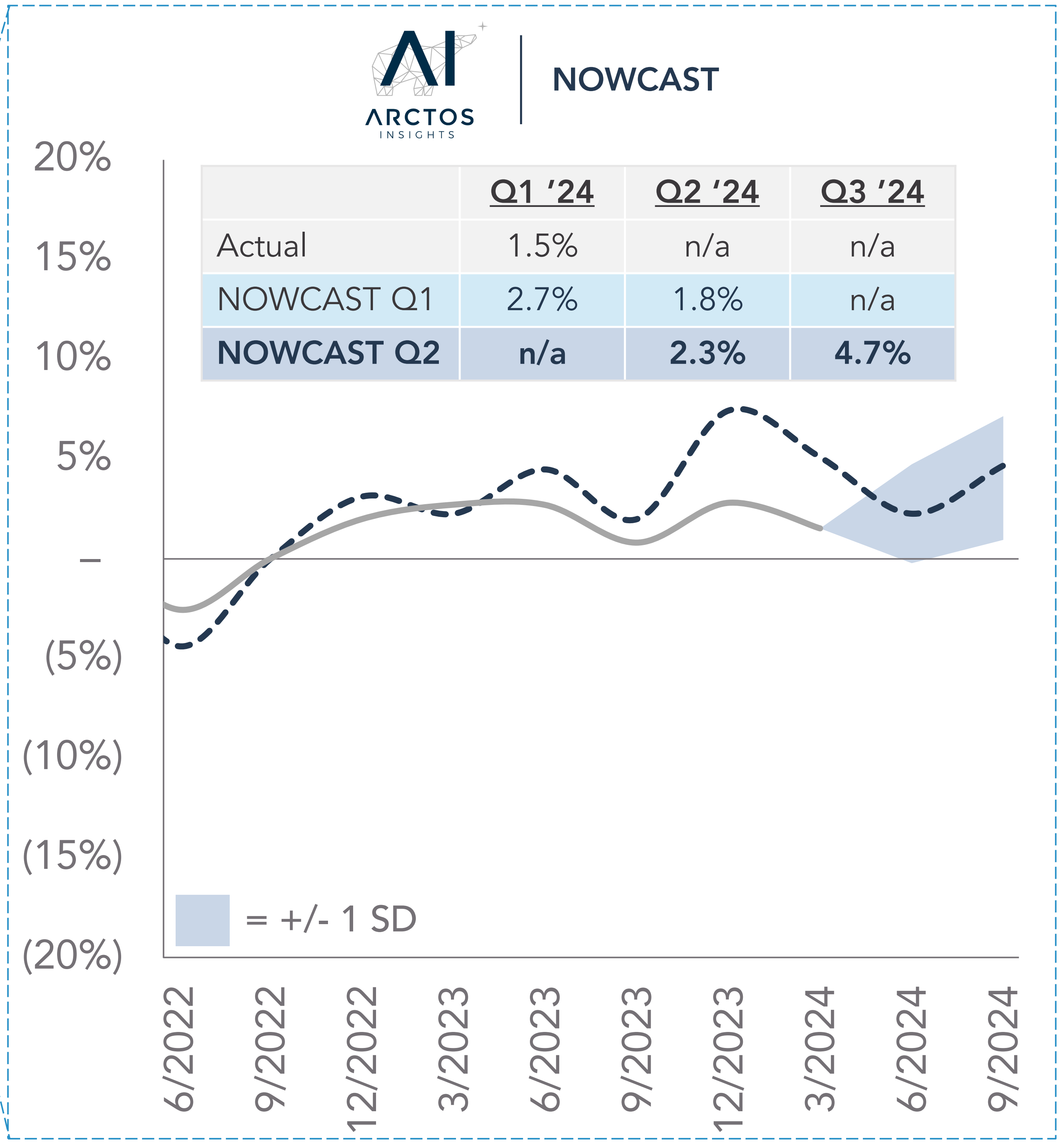
# Arctos NOWCAST: NAV Growth

Strong public equity market performance YTD (S&P 500 +22% through 9/30/24) should lead to strong NAV performance in 2H'24.

## Arctos Private Markets Valuation Model

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




| | Q1 '24 | Q2 '24 | Q3 '24 |
|---|---|---|---|
| Actual | 1.5% | n/a | n/a |
| NOWCAST Q1 | 2.7% | 1.8% | n/a |
| **NOWCAST Q2** | **n/a** | **2.3%** | **4.7%** |



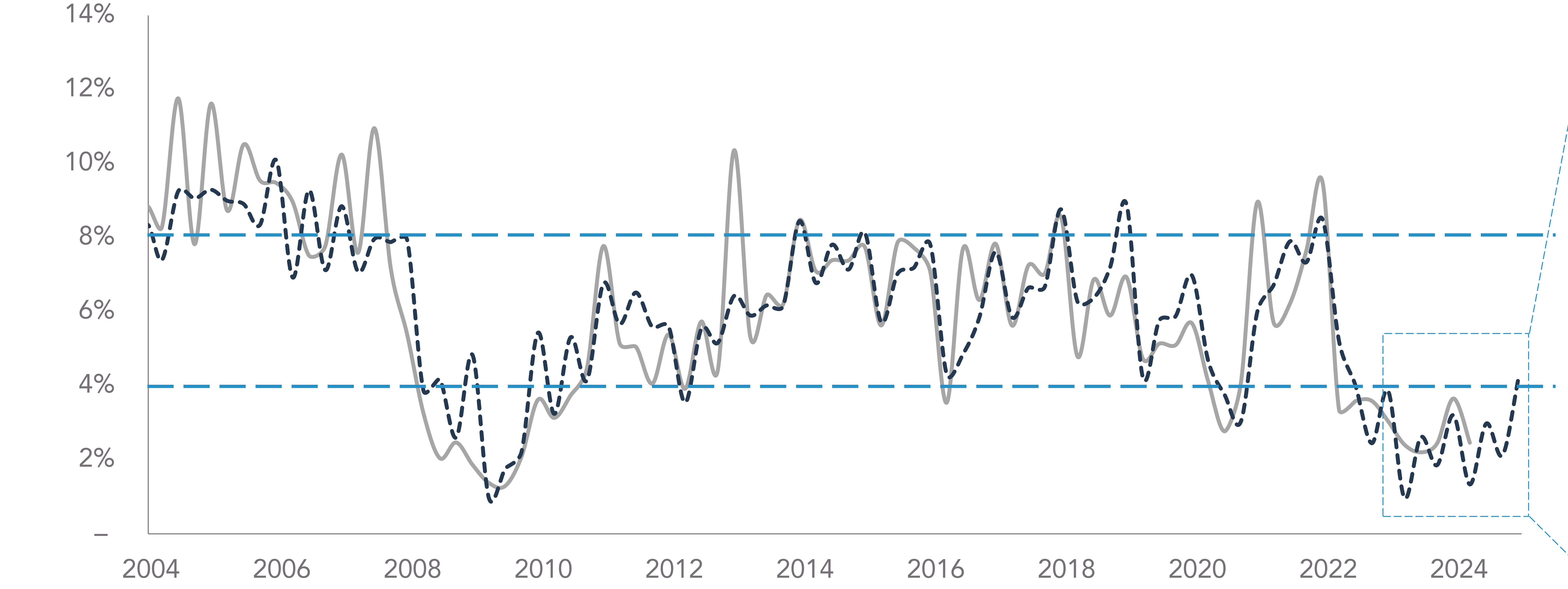
SOURCE: ARCTOS ANALYSIS.
NOTE: CERTAIN INFORMATION HEREIN REFLECTS THE BELIEFS OF ARCTOS AND IS SUBJECT TO VARIOUS RISKS AND ASSUMPTIONS. THERE CAN BE NO ASSURANCES THAT ANY PLANS OR EXPECTATIONS WILL ULTIMATELY BE MET AS DESCRIBED HEREIN, IF AT ALL. THERE CAN BE NO ASSURANCE THAT HISTORICAL TRENDS WILL CONTINUE.

# Arctos NOWCAST: Quarterly Distribution Yield

Quarterly distribution yield of 4-8% has been remarkably stable for two decades, with few periods of exception. The current exit market is broken and overwhelmed by significant unrealized value.

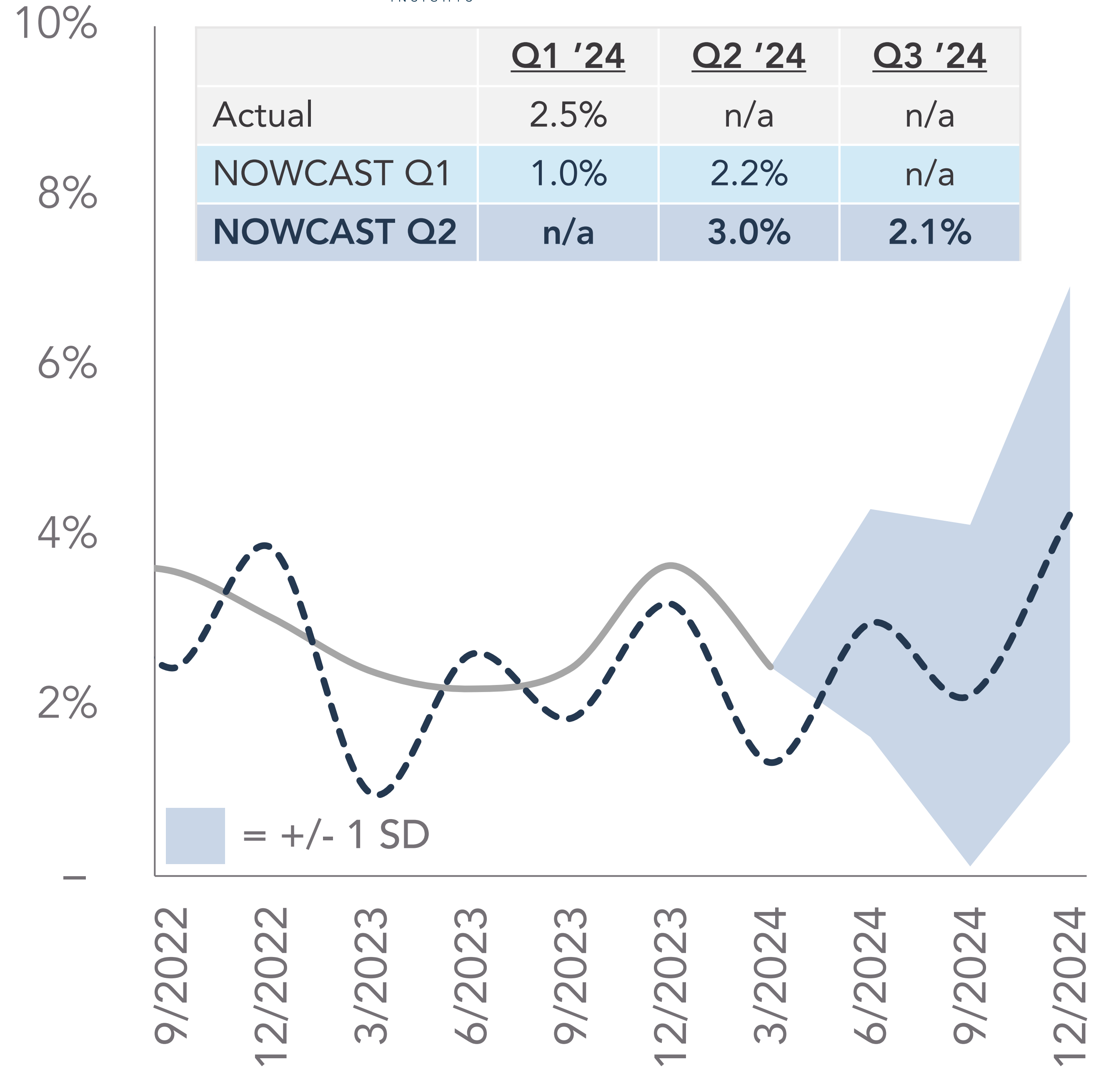
## Arctos Private Markets Distribution Model

| -1 σ | 20Y Avg. | +1 σ |
|---|---|---|
| 3.4% | 5.9% | 8.5% |




NOWCAST

| | Q1 '24 | Q2 '24 | Q3 '24 |
|---|---|---|---|
| Actual | 2.5% | n/a | n/a |
| NOWCAST Q1 | 1.0% | 2.2% | n/a |
| **NOWCAST Q2** | **n/a** | **3.0%** | **2.1%** |






SOURCE: ARCTOS ANALYSIS.
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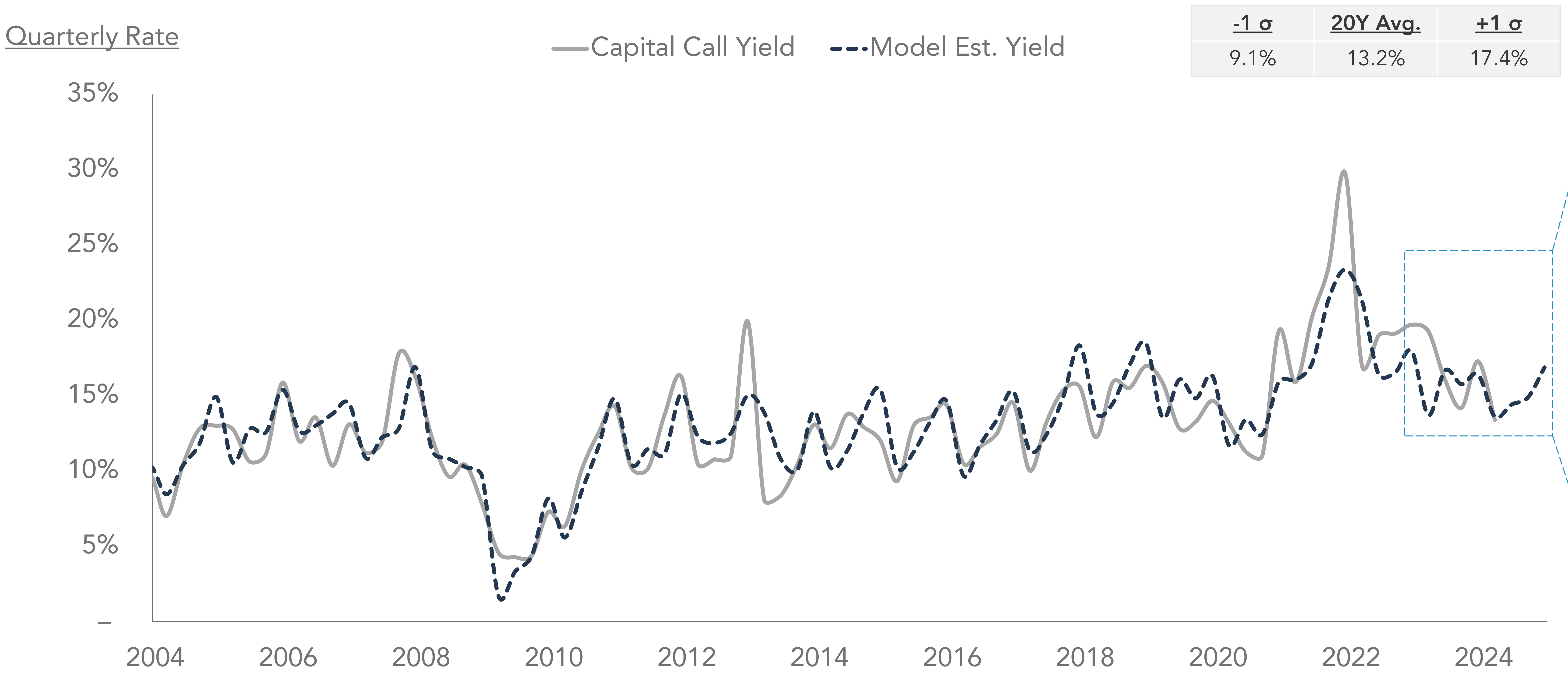
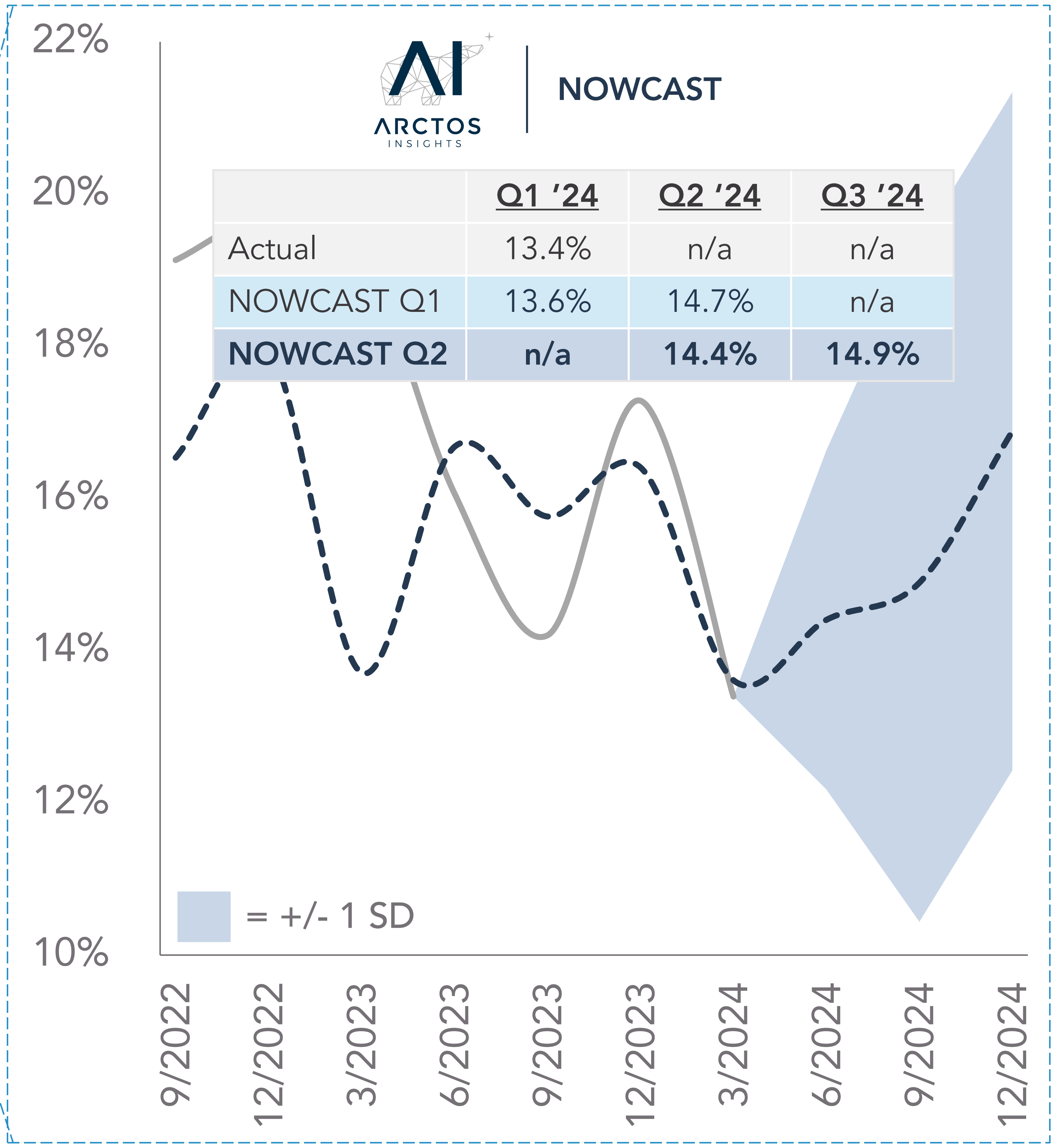
# Arctos NOWCAST: Quarterly Contribution Yield

Contribution yields were stable during active investment years but jumped to abnormal levels during ’21-’23, despite low deal activity. We suspect this is explained by line of credit utilization, highlighted in our prior analyses here and here.

## Arctos Private Markets Contributions Model




| -1 σ | 20Y Avg. | +1 σ |
|---|---|---|
| 9.1% | 13.2% | 17.4% |




| | Q1 ’24 | Q2 ’24 | Q3 ’24 |
|---|---|---|---|
| Actual | 13.4% | n/a | n/a |
| NOWCAST Q1 | 13.6% | 14.7% | n/a |
| **NOWCAST Q2** | **n/a** | **14.4%** | **14.9%** |

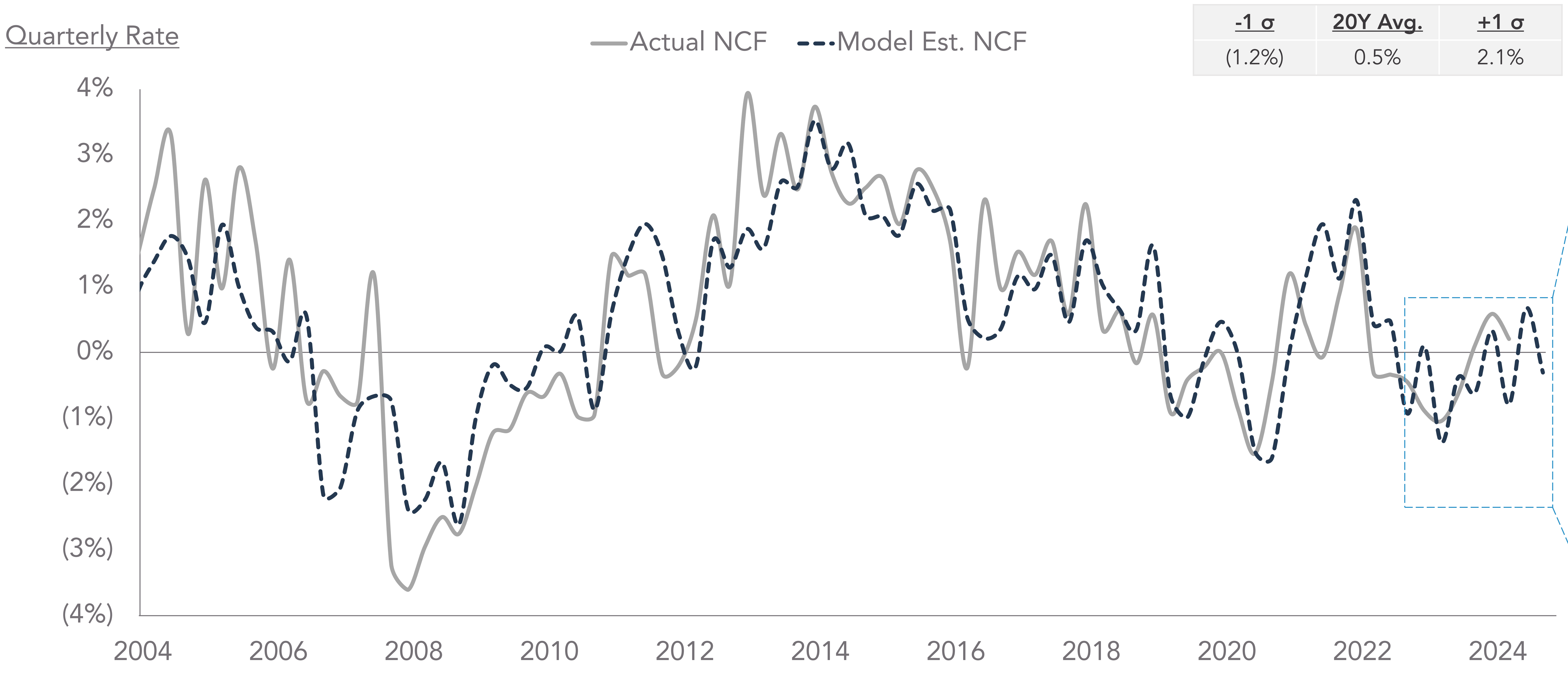


SOURCE: ARCTOS ANALYSIS.
NOTE: CERTAIN INFORMATION HEREIN REFLECTS THE BELIEFS OF ARCTOS AND IS SUBJECT TO VARIOUS RISKS AND ASSUMPTIONS. THERE CAN BE NO ASSURANCES THAT ANY PLANS OR EXPECTATIONS WILL ULTIMATELY BE MET AS DESCRIBED HEREIN, IF AT ALL. THERE CAN BE NO ASSURANCE THAT HISTORICAL TRENDS WILL CONTINUE.

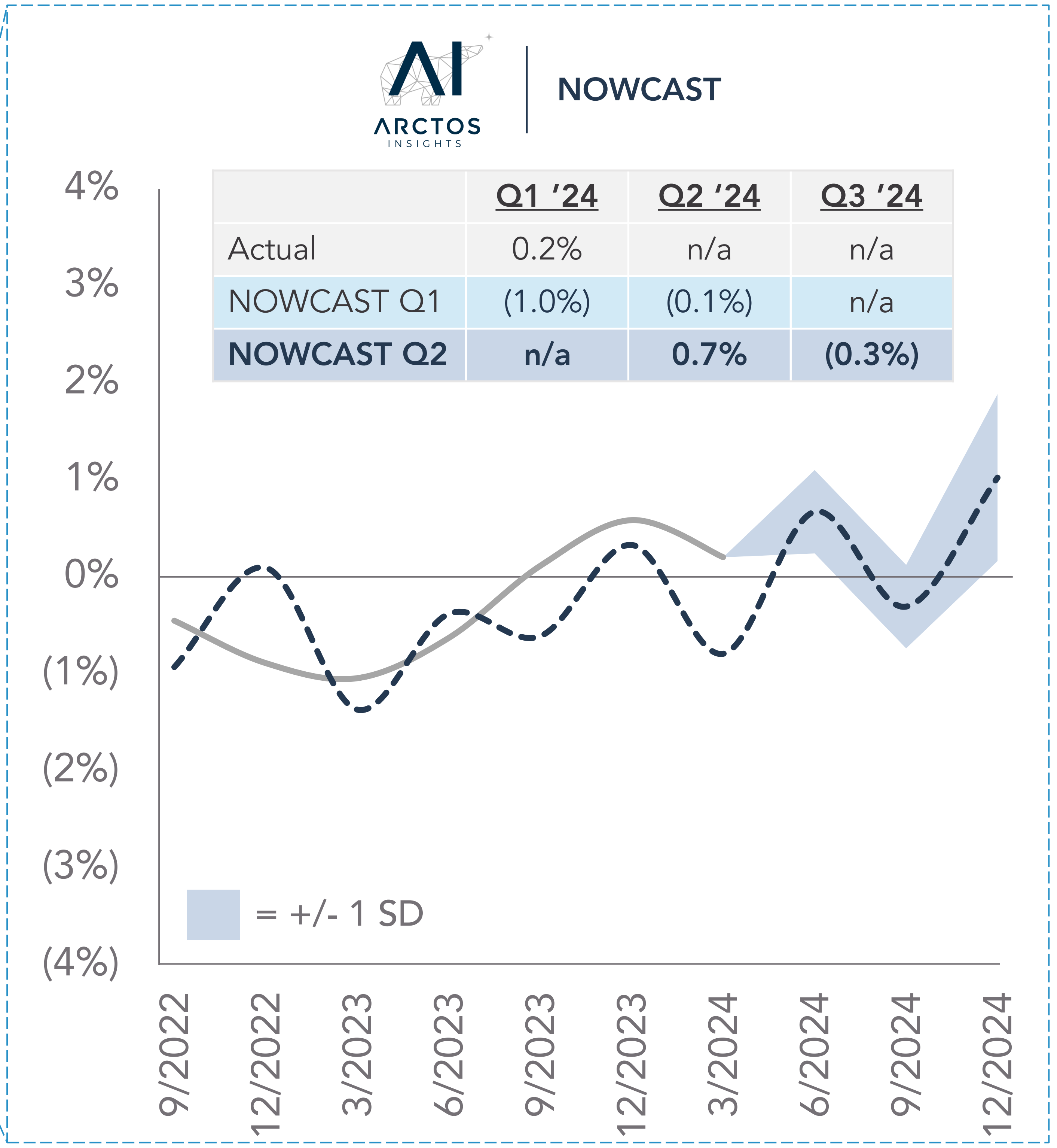
# Arctos NOWCAST: Net Cash Flow Forecast

After a brief period of capital consumption, Q1 was the third consecutive quarter of positive NCF in private markets. We expect NCF to remain near breakeven until robust exit activity resumes.

## Arctos Private Markets Net Cash Flow Model




| -1 σ | 20Y Avg. | +1 σ |
|---|---|---|
| (1.2%) | 0.5% | 2.1% |




| | Q1 '24 | Q2 '24 | Q3 '24 |
|---|---|---|---|
| Actual | 0.2% | n/a | n/a |
| NOWCAST Q1 | (1.0%) | (0.1%) | n/a |
| **NOWCAST Q2** | **n/a** | **0.7%** | **(0.3%)** |



SOURCE: ARCTOS ANALYSIS.
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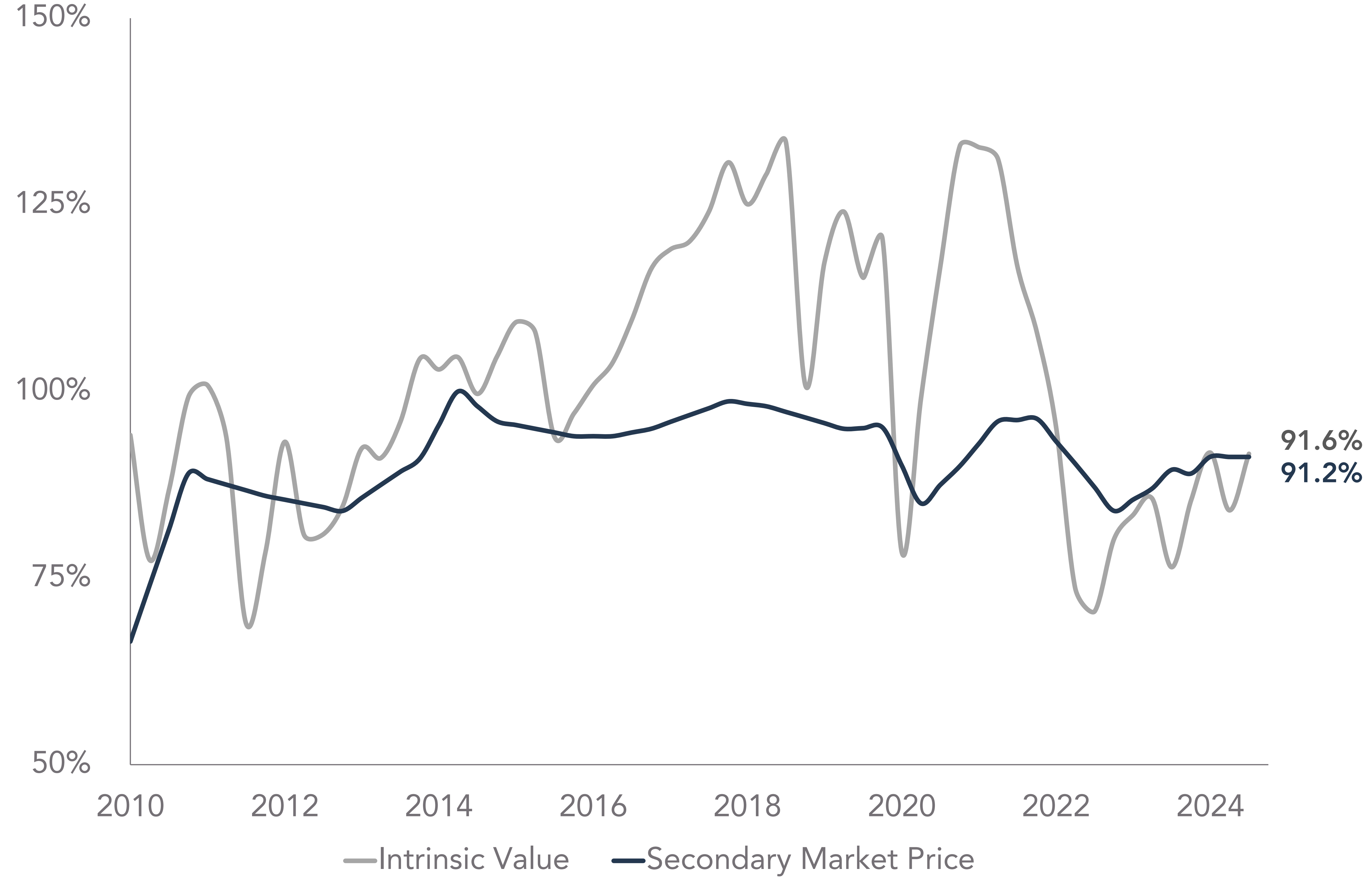
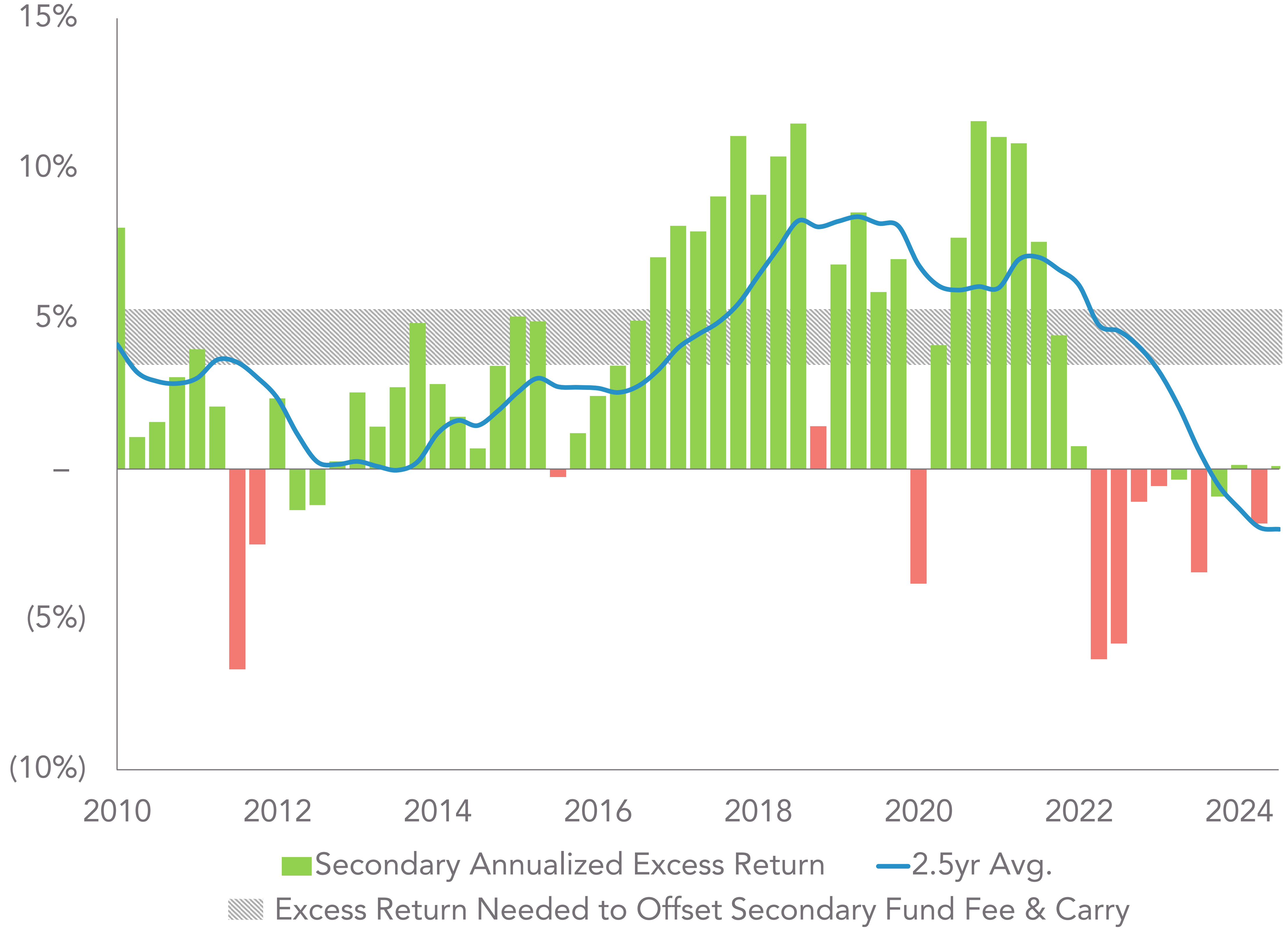
# Arctos NOWCAST: Secondary Return Environment

Secondary market alpha harvest needs to exceed 4-5% annually to offset secondary fund fee and carry. This is a relatively neutral environment for traditional LP secondary market participants.

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




## Annual Secondary Market Alpha Harvest (%)



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# Takeaways and Recommendations for GPs in 2024

1. We expect fundraising markets to remain difficult for most managers, outside of the very largest, multi-product firms (in our nomenclature: Level 9 and 10 firms).

2. Our consolidation theme that we have been tracking remains active and is, if anything, accelerating.

3. Negative sentiment around CVs will raise the cost of pursuing them. But interest in CVs will naturally remain high, in our view.

ARCTOS INSIGHTS

# Takeaways and Recommendations for LPs in 2024

1. The NAV overvaluation burden has lessened, but it remains active (our view: IV = ~90 cents of NAV).
2. The implied overallocation burden of this environment has not lessened nearly as much, due to low distributions and continued deployment momentum (industry-wide NCF at ~$0).
3. CVs are not going away. Given NAV overvaluation, some CVs likely represent great opportunities to exit at >IV in this market.
4. The number of active funds-in-market is down meaningfully (~70%). LPs have considerable leverage with their core GPs. And secondary markets offer a unique window to monetize non-core relationships without sacrificing alpha if you can accept a small discount to NAV.

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

## About Arctos Partners

Arctos Partners is a private investment firm that provides bespoke growth and liquidity solutions, differentiated thought partnership, and value creation advice to sports franchises (Arctos Sports) and alternative asset managers, their funds, and portfolio companies (Arctos Keystone).

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.

Arctos has a team of more than 50 investment and operational professionals with investment and operating expertise across industries, geographies and economic cycles. The firm is headquartered in Dallas, with office locations in New York and London. For more information, visit www.arctospartners.com or Arctos Partners' company page on LinkedIn.

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