Middle market update

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Somewhat predictably, middle-market PE activity got off to a healthy start this year. About $54 billion was invested in Q1, down from a very strong Q4 2017 (almost $87 billion). First quarter numbers often decline from fourth quarter finales as investors look to wrap up any lingering deals by the end of the year. The typical year sees stronger activity levels as the year progresses, and 2018 is expected to see another strong showing in the middle market. Whether we see another record in 2018 is an open question, as 2017 set new marks by both counts and total value. We wouldn't be surprised to see a new record if it happens, though, given the swollen fundraising market and the fact that each of the last four years have seen at least 180 new MM funds totaling at least $125 billion per year. Market froth is a headache but not a dealbreaker, and the funds have to be put to work at some point.

Valuations are high but so is optimism. The middle market presents one of the best sources of deals in the US. Several factors are contributing to the middle market's success: low interest rates and high dry powder levels are the main drivers, but additional tailwinds include a healthy (and still improving) economy, which means more MM companies are making more money today than in the past. When business is doing well, investors tend to be more active, and those investors have more capital at hand today than they ever have. Even more broadly, the middle market is going to see sustained interest from PE firms as the Baby Boomer retirement wave really gets going. About 10,000 Baby Boomers retire every day (according to Google, *caveat emptor*). One paper estimated that most Boomers will retire within a 15-year timeframe, which is just beginning—it won't be until 2029 or so until nearly all Boomers will be retired. That presents an almost self-sustaining market for PE buyers, who will find new deal sourcing opportunities from smaller, family-owned businesses for at least a decade. One of the newest middle-market firms around is Brightstar Capital Partners, which closed its inaugural fund at $710M in Q1. They said in a recent interview that now is a good time to launch a MM fund, "against the backdrop of what will most likely be the greatest generational transfer of wealth ever seen." They cited an estimated $10 trillion of wealth transference in the US alone over the next decade, and upwards of $30 trillion over the next 25-30 years. If that turns out to be true, it helps put today's frothy market in perspective.

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