The Tyranny of Dry Powder

THE LEAD | October 15, 2020

A recent note from our good friend at Bloomberg, Kelsey Butler, pointed to a study in *Astrobiology* highlighting 24 planets that could sustain life. Criteria for "superhabitability" include home stars younger than the Sun, Earth-like masses, and atmospheres with warmth and moisture greater than Earth.

All these planets are over 100 light years away – not ideal for COVID getaways. But for those who don't mind long trips with the kids, such conditions could mean more biodiversity and longer lifespans.

Our thoughts turned to things extraterrestrial as two of our content partners published findings on third quarter fundraising.

Preqin's Private Data report shows global fundraising off significantly at September 30 (see our *Chart of the Week*). Of the roughly $8.5 billion capital raised last quarter, about $4 billion was dedicated to direct lending. Next highest was mezzanine at $2.6 billion, followed by special sits and distressed.

This is dwarfed by the galaxy of debt funds in the market since 2015, which Preqin estimates at $300 billion. But this is a "targeted" number, not actually cash raised or deployed. How much is considered "dry powder?"

The volume of private credit raised, but not deployed, is about $100 billion – no small chunk. But compare that to the $400 billion for private equity. So for every four dollars of PE dry powder, there's only one dollar of debt.

PitchBook published their 3Q PE Breakdown showing "meager" fundraising so far this year. Roughly $130 billion has been raised in 167 funds versus $316 billion in 343 funds for all of 2019.

This performance is due less to COVID than the massive 2019 capital raise by mega-funds; a challenge to match this year.

While the motivation to put money to work is common among fund managers, PE dynamics differ somewhat. Managing company growth and operational improvements take time to show results, hence the J-curve effect lowering yields in the early years.

Many equity and credit funds are behind in their 2020 investing budgets, making the urgency to generate income-producing assets particularly acute. In recent years, this drive led some to deploy capital unwisely, resulting in vulnerable portfolios this year. Experienced managers resisted the temptation to jump into whatever deals floated into view, choosing to wait for better conditions.

Those have now arrived. Turning dry powder into good investments won't require galactic voyages, just sticking to credit fundamentals. LPs will be happier you stayed close to home.