# Three Myths of Private Market Valuations (First of Three Parts)

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In our special series last month on why private debt valuations should not be viewed through the same lens as those of public debt ("Glasses Half-Full"), we dug into the various characteristics of illiquid loans that make them particularly attractive in the current market.

Now our friends at Lincoln International have published a timely report on the matter, "Three Myths Regarding Private Market Valuations." The report sheds further light on how these valuations are determined, and how they are distinguished from their peers in broadly syndicated loans. We spoke this week with Ron Kahn, Lincoln's head of valuations about their findings:

Ron, your first myth is private valuations should mimic public ones. Why is that view held?

"There's natural skepticism on why private equity funds are holding their value given this phase of continued market volatility," he told us. "This gap exists because managers of those funds invest in companies in defensive sectors with consistent and predictable cash flows. The broad public market indices are comprised of more cyclical borrowers with sensitivity to consumer spending or exogenous headline risk.

"As a measure of this relative volatility, our Lincoln Private Market Index of private equity owned portfolio companies had total weighting in energy and consumer-facing sectors of less than 15%. The S&P 500 in contrast was almost 25%."

Isn't there also a major difference in the way private capital funds itself that impacts prices?

"For sure," Kahn replied. "Liquid loans move with CLO formation and mutual funds flows. Cash can move quickly in and out of those vehicles based on retail sentiment. Loan valuations can swing wildly with interest rate worries or GPI numbers as managers make portfolio allocation decisions sometimes unrelated to borrower performance."

He continued. "In contrast, private managers are supported by locked-in, long-term capital – almost $300 billion of dry powder, by some estimates. Those investments are generally not redeemable until funds mature, sheltering private companies from day-to-day market moves."

Nevertheless, we said, all credit markets – public and private – share some vibrations.

"Yes," said Kahn. "Some macro trends like high rates eventually migrate to private markets. But historic data shows private marks don't get hurt in the same way as publics. Of course those values don't typically lead to the higher returns CLO managers can orchestrate opportunistically.

"Our index and the S&P 500 diverge and converge over time," he concluded [see our *Chart of the Week*]. "Over four years of mostly periods of divergence, these prices at the end of 2022 ended up converging to only a 3%

difference.”