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High Five – 2025 Outlook (Last of a Series)

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This week we conclude our series on the private capital outlook for the year ahead with our fifth theme: "*A breath of fresh air: Investing and fundraising in 2025.*"

As private capital's virtuous cycle sets in motion, 2025 should present plenty of attractive investment opportunities across the capital stack. For senior debt investors, the direct lending climate will continue to be constructive as the reduced but somewhat higher for longer rate environment persists. We expect public debt spreads to continue compressing, leading to the relative risk-reward and income rewards increasingly skewing towards private debt.

Financing conditions should support higher leverage and a closer alignment between buyer and seller price expectations, which will accelerate M&A flow. This increased activity will put the brakes on spread compression in the traditional middle market, allowing structures and terms to strike a favorable balance for issuers and investors.

Meanwhile, we expect high demand for junior debt and structured capital. Sponsors and issuers are increasingly seeking flexible financing options to free up capital for growth and acquisition opportunities. Lenders providing these fixed-rate solutions benefit from downside protection while investors in floating rate assets get an interest rate hedge.

In private equity there are clear signs of optimism. A recent survey found 38% of LPs expect performance to exceed benchmarks this year, the highest share since 2021. Nearly half (45%) plan to increase their allocations to the asset class in the next 12 months. As the PE ecosystem evolves, investors can access a broader spectrum beyond traditional buyout portfolios.

Fresh from record activity in 2024, secondaries are seeing brisk deal flow. GPs turn to continuation funds to extend the value creation runway for their trophy assets, allowing LPs to crystallize returns. LPs sell portfolios to fine-tune their exposures and generate liquidity. GP stake investments are also on the rise. These offer investors consistent cash flow from management fees and upside from a share of managers' carried interest.

The vicious cycle of fewer exits, leading to fewer distributions and fewer available LP dollars is shifting to a more virtuous cycle. Easing borrower costs should draw out more buyers, enhancing competition for new deals. Greater demand for assets helps sellers achieve desired returns on assets they bought in a low-rate environment. As surveys show, appetite for private capital remains robust, so better distributions should result in new manager commitments.

Private equity fundraising has been the most impacted by LP liquidity issues, so we expect it to rebound first. Shortly afterwards we will see private debt fundraising improve, as the middle market opportunity set continues to expand. Yet, as we highlighted in our series, LPs are more discerning in their manager selection. Improved fundraising conditions will therefore favor the best performing managers with scale and proven capabilities through previous cycles for investing consistently, safely and profitably.