

## Overview

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Private Equity turns 50 this year. The industry was built on a simple model: buy companies, improve them, sell them, return the proceeds. For decades, that's exactly what happened.

Then came the flood.

PE's prolonged success transformed a specialist craft into a \$10 trillion dollar industry. Scale doesn't just make complex systems bigger. It reorganizes them around new priorities. In PE, scale shifts emphasis away from performance-driven carried interest and toward AUM-driven enterprise value.

Rising rates have exposed what this incentive shift already set in motion: firms are holding onto companies longer and longer. The resulting distribution drought—and a recent stretch of uninspiring performance—have PE under fire. The strain is real. But it's not universal.

Just like not every 50-something buys a Porsche, not all of PE is in crisis. What you see in the headlines focuses on the behavior and circumstances of the largest firms. But their story isn't the whole story.

The original model is still working. If you know where to look for it.

### Who Is This For?

This paper is written for anyone—advisors, allocators, investment committees, and investors of any stripe—evaluating Private Equity investments, or for anyone trying to figure out what's signal and what's noise in the ongoing conversation about PE's future.

### Reading Time

Parts I & II: 15 minutes each

## Part I: The Asset Gatherers

**“The key to our business is consistency. Consistency of buying and consistency of selling. That is the key to our business and the key to the Private Equity industry, in general.”**

- Orlando Bravo (October 2025)

Orlando Bravo built Thoma Bravo into one of the largest Private Equity firms in the world. The consistency he described built the industry. PE firms bought companies, improved them, sold them, and returned the proceeds to investors. If they did it well, they earned the right to do it again. This virtuous cycle of consistent buying, selling, and reinvesting propelled PE from a specialist craft to a \$10 trillion industry.

In 2022, that rhythm stopped. And it has yet to resume.

The resulting distribution drought is now in its fourth year, longer and more severe than we’ve seen in modern PE—including the GFC<sup>1</sup>—and the backlog of unsold companies keeps growing. The headlines tell the story:

### Private-Equity Fundraising Slump Deepened Through September

The Ivies Are Having Second Thoughts About Investing in Private Equity

### Why Private Equity Is Suddenly Awash With Zombie Firms

### Investors Warn of ‘Rot in Private Equity’ as Funds Strike Circular Deals

### Private Equity Has More Housecleaning to Do in 2026

### Leaning Into the Turbulence: Private Equity Midyear Report 2025

### Leave Private Equity? More Buyout Professionals Are Considering It

Private equity logjam hits record as firms struggle to sell

### Once Wall Street’s High Flyer, Private Equity Loses Its Luster

Source: New York Times, Wall Street Journal, Financial Times, Forbes, Bain & Co.

They’re not wrong. But they’re not the entire story, either.

## The Streetlight Effect

Press coverage of PE skews towards the biggest firms. Many of them are now public companies themselves, so they are the easiest to follow. Meaningful data on most PE firms is very hard to get your hands on. So, thousands of firms—the vast majority of the industry—operate far below the media’s radar. The net effect is that media coverage of “Private Equity” is usually coverage of the firms visible to reporters. Science journalist David H. Freedman dubbed this the “Streetlight Effect”.<sup>2</sup>

The Streetlight Effect determines where most reporters can look, and Narrative Bias tends to determine what holds their readers’ attention. Vivid stories that resonate emotionally will outcompete boring facts that don’t. For example, the midlife crisis cliché endures not because it’s the norm—studies suggest only 10-20% of 50-somethings actually

<sup>1</sup> According to Bain & Company’s Global Private Equity Report 2026, Distributions as a percentage of NAV have lagged historical averages for the fourth consecutive year: “a new record for the modern private equity industry.”

<sup>2</sup> The Streetlight Effect takes its name from an old joke: A police officer finds a drunk man searching for something under a streetlight and asks what the drunk has lost. He says he lost his keys and they look under the streetlight for a while. After a few minutes, the officer asks if he’s sure this is where he dropped them. The drunk says no, he probably lost them in the park. The policeman asks why they aren’t searching there and he replies: “Because the light’s better over here.”



experience it<sup>3</sup>—but because stories about impractical sports cars and impulsive decisions are vivid. And the fear of turning into your parents definitely resonates.

The distribution drought is real. The backlog is real. The frustration is real. But the current narrative around PE leaves two specific things out.<sup>4</sup> First, PE has become a very big tent. “Private Equity” now encompasses tens of thousands of firms managing many trillions of dollars.<sup>5</sup> The streetlight doesn’t reach them all. Not even close. And just as plenty of people make it through their 50s without a regrettable tattoo, there are segments within PE where the model is still working the way it was designed—companies are being sold and capital is being returned to LPs.<sup>6</sup>

Second, even for the large cap firms described in the headlines, “rates went up” is an incomplete explanation. The deeper cause—the one that headlines don’t address—operates more slowly, more quietly, but unrelentingly: **scale**.

For decades, Private Equity has marketed itself in conscious contrast to its traditional asset management “parents”—firms paid on AUM<sup>7</sup> rather than on outcomes. They argued that carried interest and meaningful GP commitments represented stronger alignment, with more accountability around performance. The argument was compelling, because for a long time it was true. But it’s becoming harder to make.

Because scale—like age—has a way of changing behavior.

No one sets out to become their parents. But for many PE firms, the resemblance is getting harder to ignore.

## Private Equity at 50

Clayton Christensen<sup>8</sup> spent his career studying how and why successful companies eventually ran into trouble. The pattern was consistent: the very things that made them great—listening to their best customers, optimizing for what was working—are ultimately what expose them to disruption. Your most important customers, naturally, want product improvements and new features that cater to their needs. Often, that comes at the expense of everyone else’s.

Physicist Geoffrey West<sup>9</sup> found the same pattern from a different angle. Studying how organisms, companies, and cities scale, West showed that growth doesn’t just make systems bigger—it reorganizes them. When systems cross thresholds of scale—what Malcolm Gladwell popularized as a “tipping point”—they develop different priorities, different constraints, and different metabolisms. Christensen saw it in corporate boardrooms. West found it in biology and physics and pretty much everywhere else: scale reorganizes complex systems.

Both would recognize what’s happening as PE turns 50.<sup>10</sup> Through most of its history, carried interest—compensation contingent on performance—was the endgame. Firms and their teams got rich by selling companies at a profit and the system organized itself around that concept.

<sup>3</sup> Frank J. Infura et al, 2020.

<sup>4</sup> This is where we acknowledge that “the media oversimplifies complex topics” is not a particularly novel insight. But headlines drive narratives and narratives can drive decisions in the real world.

<sup>5</sup> Commercial databases such as Preqin track on the order of 30,000 active private equity and venture capital firms worldwide, while McKinsey estimates that private equity accounts for roughly half of the approximately \$13 trillion in global private markets AUM.

<sup>6</sup> “Limited Partner” or “LP” is a legal term. In a PE fund structure, the General Partner (“GP”) manages the fund and makes investment decisions. LPs contribute capital but have no role in day-to-day operations. Throughout this piece, LP, investor and allocator are used interchangeably to refer to those who commit capital into PE funds. PE Firm, Manager, Sponsor and GP will be used interchangeably to refer to those who raise the funds and make the investment decisions.

<sup>7</sup> Generally, traditional long-only equity fund managers, mutual fund complexes, and institutional asset managers that charge fees based on assets under management (“AUM”) with little or no performance-based compensation.

<sup>8</sup> Harvard Business School professor and author of “The Innovator’s Dilemma,” (1997) “The Innovator’s Solution,” (2003) and “Disrupting Class” (2008)

<sup>9</sup> Former President of the Santa Fe Institute and author of “Scale: The Universal Laws of Growth, Innovation, Sustainability, and the Pace of Life in Organisms, Cities, Economies, and Companies” (2017).

<sup>10</sup> Buying and selling private companies has been around as long as there have been private companies. Here we are referring to the founding of KKR in May 1976 as the “birth” of the modern PE industry, because KKR was the first firm to institutionalize the raising of a series of commingled, blind-pool funds explicitly dedicated to leveraged buyouts (“LBOs”) and created a template for the repeatable, fund-based model that defines today’s PE industry.



## But success brought scale, and scale has reorganized the system.

A PE firm with \$1 billion of AUM pulls in around \$15 million<sup>11</sup> per year in management fees. That's enough to run the business, but not enough to make everyone rich.<sup>12</sup> At \$5 billion, those annual fees might be more like \$70-80 million. Overhead is higher than at \$1 billion, but not five times higher. So, there is a tipping point—it varies by cost structure and product mix—where the management fee stream becomes large and durable enough to fund the firm's growth on its own. At this tipping point **Investors** tend to evolve into **Asset Gatherers**.

A firm that can sustain itself on fixed fees alone still has financial upside if they perform. But when carried interest is no longer load-bearing, the decision-making calculus changes. The constraint that once made selling non-negotiable-return capital or lose the franchise—doesn't completely disappear, but it loosens.

Not that long ago, \$5 billion of AUM was rarefied air. Today, **several hundred firms**<sup>13</sup> have reached that scale. When only a handful of firms were at that level, they were exceptions. Now that hundreds do, the system has reorganized.

But it didn't happen overnight.

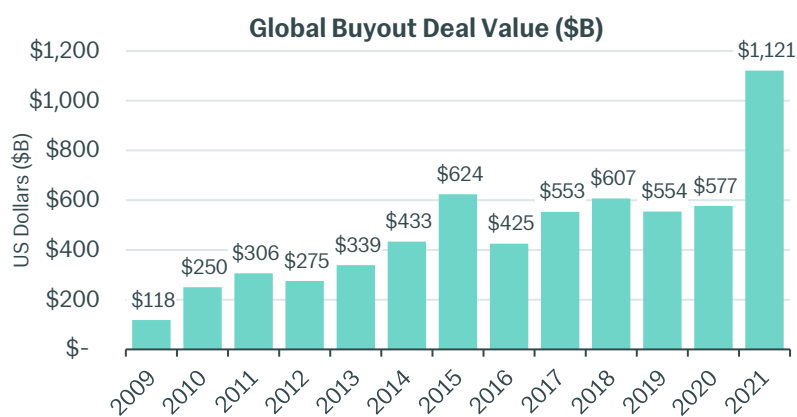
## Spinning Up the Flywheel

Private Equity stepped out of the Global Financial Crisis ("GFC") into ideal conditions. Central banks cut rates to near-zero, and lenders competed aggressively to put debt to work—often on borrower-friendly terms. PE firms could borrow cheaply, bid aggressively, and still make the numbers work. Finding a buyer on the other end was rarely a problem. Both strategic and financial buyers were hungry for assets. Even IPOs, while never Door #1, were a legitimate option.<sup>14</sup>

As a result, the PE flywheel—raise a fund, deploy it, realize gains, then raise a bigger fund—spun faster and faster. Global Buyout<sup>15</sup> AUM sat at \$1 trillion in 2008, grew to \$2 trillion by 2017, and exceeded \$5 trillion<sup>16</sup> by 2023. On an Aggregate U.S. Equity basis—adding together private and public equity—PE grew from only 1% of that total in 2000 to 8% by 2025.<sup>17</sup> Importantly, PE managers weren't pushing this flywheel on their own. Institutional investors starved for returns in a low-rate world were happy to lock up capital in PE structures in exchange for the promise of outsized results. Most kept turning up the dial on their PE allocations.

Some turned it as far as it would go.<sup>18</sup> Managers who backed healthy companies and kept them growing found a nearly endless supply of buyers at full market prices. The flywheel spun faster still.

So fast, in fact, that discipline became a liability. Managers who showed restraint on price or fundraising risked losing deals, losing talent, and eventually losing ground to firms who stayed aggressive.<sup>19</sup>



Source: Bain & Co. Global Private Equity Report 2022.

<sup>11</sup> PE firms generally charge a 2% management fee that steps down in the latter years of the fund. So for most firms, AUM will be a blend of newer funds charging the full fee and older, smaller funds where it's stepped down. That's why revenue is more like \$15 million than \$20 million.

<sup>12</sup> You probably have 15-20 full-time employees whose cash compensation runs close to \$10 million per year before office space, IT, etc.

<sup>13</sup> Private Equity International ("PEI") has been publishing "The PEI 300" since 2007. Firms are ranked based on the amount of capital they have raised over the last five years. If you raised \$5 billion - not ever, just since 2020 - you'd only come in at #154 on the 2025 PEI 300.

<sup>14</sup> From 2010 to 2021, there was a PE-backed IPO every ~8 days on average, compared to only 6 IPOs during 2022 and 2023 combined.

<sup>15</sup> Buyout is the largest category within Private Equity, representing ~60% of AUM. Growth Equity and Venture Capital are the other largest categories and experienced similar growth trajectories during this period.

<sup>16</sup> Bain & Co. Global Private Equity Report 2025.

<sup>17</sup> Mauboussin and Callahan, January 2026.

<sup>18</sup> In 2023, the average PE allocation among university endowments was 23%. For the twelve largest endowments, the average was more than 48%.

<sup>19</sup> We had more than a few candid conversations with managers during this period who took a more measured approach and expressed regret that they had. Yes, you read that right: asset managers telling their investors: "We're sorry for being so cautious." We don't hear that anymore.



## The Slowdown

When the Fed began hiking rates to combat inflation in March 2022, the pivot was decisive. Higher borrowing costs widened the bid-ask spread overnight—sellers were anchored to yesterday’s valuations, buyers were underwriting with today’s cost of capital, and deal activity slowed to a crawl. After more than a decade of acceleration, the flywheel lost its momentum.

That was four years ago. Since then, the conditions that froze the market have largely thawed. Inflation has moderated. Financing markets have stabilized. Corporate balance sheets are generally healthy. Public equity markets have rebounded with vigor. These are conditions that typically coincide with a surge in exit activity. The rate shock has passed.

What remains is a market that has adjusted to higher rates—and still isn't generating exits at the pace you'd expect.

Some of that is related to other market conditions. Geopolitical instability, trade wars, and the looming specter of AI have given buyers no shortage of reasons to stay defensive. And there are knock-on effects to a prolonged distribution drought. Fewer distributions back to LPs means less capital to allocate into new PE funds.

But now that the drought has been more severe than the GFC, it seems clear that something more is at work. LPs are clamoring for liquidity.<sup>20</sup> So the longer this drought continues, the more you would expect managers to sell at lower prices than they would have a year or two ago. Which raises the question: if they’re not cutting their asking price to get to an exit—what exactly are they doing?

Global Buyout Distributions as % of NAV



Source: MSCI via Bain & Co. Global Private Equity Report 2026. 2007-2024 as of year-end. Q3 2025 represents 12-month period from Q4 2024 to Q3 2025.

## The Iron Law Bends

For forty years, the math was simple: to raise a bigger fund, you had to return capital from prior funds. This was **the iron law of PE** because carried interest was how PE professionals got rich. Not salary. Not bonus. Carry. The only path to more carry was the next fund. The only path to the next fund was returning capital to your LPs so they kept coming back. That alignment was the engine that made the system go. It kept senior partners grinding and gave younger talent a reason to stay.

Then scale reorganized the system.

<sup>20</sup> SuperReturn is global PE conference held in Berlin. In 2024, a digital PE platform called Moonfare captured the mood when they had baseball caps printed up that read “IRR < DPI”.



Once a PE firm reaches its tipping point, it's a very attractive business to own: predictable and recurring revenues, high LTV customers, a capital-light business model, operating leverage,<sup>21</sup> attractive cash yield, and the \*carry\* on top: the asymmetric upside of uncapped performance incentives.

Now that this math works for hundreds of firms, dozens of **GP Stakes** firms have emerged that, to date, have collectively raised \$100 billion<sup>22</sup> to buy ownership interests in PE<sup>23</sup> firms. In a 2026 Dechert LLP survey of PE firms with at least \$2.5 billion of AUM, 77% of respondents reported plans to sell stake in their management company in the next 24 months. It's exactly the kind of emergent structure West would predict—a new metabolism arising to meet new needs.

Ownership stakes that transact routinely need to get priced, and DCF<sup>24</sup> math governs that pricing. Management fees are stable, recurring, and contractual. As a result, third-party valuation consultants typically discount them at 7-8%. Carried interest, by contrast, is lumpy, uncertain, and dependent on exit markets that can—as we have seen—freeze without warning for years at a time. The discount rate applied to carry reflects that: usually 25-30%. Through the lens of enterprise value, every dollar of fee revenue is worth three to four times more than a dollar of future carry. Therefore, every portfolio company sold shrinks the most valuable part of the business. And replacing it means paying more for something you know less about.

That spread always existed. But before, something more powerful took precedence. Under the old model, the cost of not selling was existential. Hold too long and LPs won't come back for your next fund. Lose enough LPs, you lose the next fundraise. Lose the next fundraise and you lose the franchise. Costs don't get higher than that. The DCF math was irrelevant because the governing constraint was survival.

In short, scale has facilitated a path to wealth for PE firms and their employees that is less reliant on carry and less hostage to the next fundraise. The iron law hasn't broken. But now it has some flex.

## Relief Valves

"Some flex" doesn't mean "anything goes". LPs accept illiquidity as part of the bargain, but as the distribution drought got worse, it risked testing the limits of even the most patient LPs. Scale loosened the constraint, but it didn't eliminate it entirely. Something had to give.

Enter the **continuation vehicle (or "CV")**. The mechanics are straightforward: when a GP's fund approaches the end of its term but still holds a company it doesn't want to sell, a CV offers a way out that isn't the door. Stand up a new fund vehicle, sell the asset into it at a negotiated price,<sup>25</sup> give existing LPs the choice to cash out or roll forward, and keep running the company—typically with reset fees and carried interest to align the GP with new investors. No third-party buyer required. No market-clearing price to accept.

For decades, these transactions were limited to extreme cases. On the positive end, the rationale was "we see such attractive return prospects here that it would kill us to let someone else earn this return and we'll do whatever it takes to not let that happen." That was such a high bar to clear with your LPs,<sup>26</sup> it happened very rarely. On the downside, CVs were a tool that managers would use to try to entice LPs in challenged funds to reset carry terms and/or create a path

<sup>21</sup> When most of your costs are fixed, so every extra dollar of revenue yields a progressively higher profit margin.

<sup>22</sup> When Petershill, a pioneer in the GP Stakes investment strategy launched their business in 2007, the institutional investors they were pitching "didn't know what we were talking about. GP stakes investing wasn't a recognized strategy or asset class."

<sup>23</sup> As well as private credit, private real estate, and private infrastructure firms who have similar business models.

<sup>24</sup> A discounted cash flow (or "DCF") model values a stream of future cash flows by converting them to present value. The higher the discount rate, the less a future dollar is worth today.

<sup>25</sup> Pricing assets in a CV is an awkward middle ground. It must be high enough that exiting LPs don't feel shortchanged, but low enough to attract new buyers and for GP to expect to make money on the next leg. If that strikes you as complicated and rife with potential conflicts, you're not alone.

<sup>26</sup> By definition, LPs were already looking at an outsized success – maybe something like a 4x or 5x ROI. To convince them that doubling down is the move when you've already "won" – that had to be a truly exceptional set of circumstances.



to earning fees and some additional capital to deploy when they were struggling to raise a new primary fund. It was a last resort.

But when rates rose and selling companies got harder, managers looked at the structure and saw a way to provide liquidity to LPs who wanted out—but without needing to sell the company to a third party at the market-clearing price. It was the solution to a problem everyone had. And it felt like everyone took advantage of it. In 2017, there were \$14 billion of GP-led secondary transactions, but that swelled to \$115 billion in 2025.<sup>27</sup> As of June 2025, 75% of the 50 largest global GPs had put the CV to use.<sup>28</sup>

CVs weren't the only structure that emerged to meet this need. **NAV loans**—credit facilities secured against the Net Asset Value (“NAV”) of a fund’s entire portfolio—offer a different path to the same destination. Instead of selling the assets, a GP borrows against them. The proceeds can fund follow-on investments, support portfolio companies struggling to access more debt, or—most often—generate distributions when exits are difficult.

Between 2019 and 2023, outstanding NAV loan balances grew roughly 30% annually, reaching an estimated \$150 billion<sup>29</sup>. In 2025, Partners Group estimated that the NAV loan market could grow to \$600 billion by 2030.<sup>30</sup> Total global buyout activity was around \$600 billion in 2024.<sup>31</sup> So even if only a fraction of that materializes, it represents another permanent structure that has emerged to allow GPs to avoid selling companies outright.

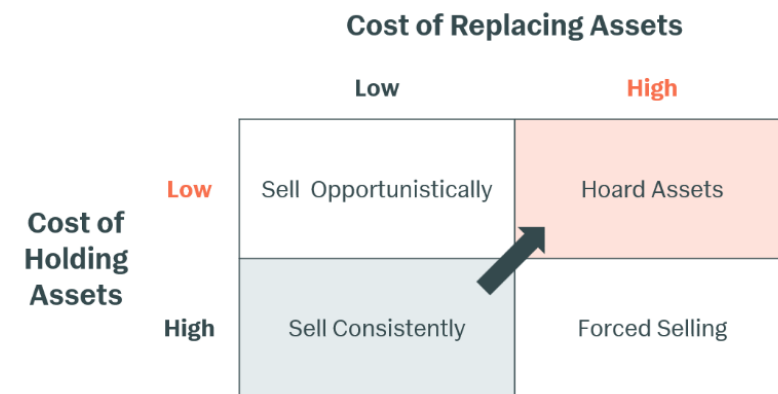
Both structures offer relief, but at a cost. In a CV, the GP is effectively both buyer and seller—a conflict that fairness opinions and LP advisory committee approvals can mitigate but not eliminate. It’s not hard to foresee hard feelings over perceived self-dealing souring LP relationships. NAV loans add leverage on top of leverage—and put a lender senior to LPs in the new capital structure.

New structures and new metabolisms also mean new risks. Adaptations emerge to solve the problem in front of them. They don't always anticipate the next one.

### The New Exit Game

The forces we’ve described don’t operate in isolation. They compound throughout the system. In the traditional PE model, every firm faced the same pressure to sell—which meant there was a steady supply of companies circulating in the sponsor-to-sponsor market. “Replacement” assets were relatively easy to come by.

But when more firms choose to hold, the supply of available assets shrinks. That drives replacement costs up, which makes holding even more rational for the next firm facing the same decision. Meanwhile, LPs who spent a decade ratcheting up their PE exposure are now above their target allocations—again, a direct consequence of PE’s own success—and can’t easily commit new capital even when they want to. That makes new capital harder to come by and creates more incentive to hold.



Source: LNW.

<sup>27</sup> van Mierlo, February 2026

<sup>28</sup> Jefferies H1 2025 Global Secondary Market Review (July 2025)

<sup>29</sup> With Intelligence, August 2024

<sup>30</sup> Bone, et al., January 2025

<sup>31</sup> Bain Global Private Equity Report 2026.



The loop is self-reinforcing. The more firms that hoard, the more expensive it becomes for everyone else to replace, which pushes more firms toward hoarding.

### The PE flywheel is now spinning in reverse.

These two forces—the cost of holding and cost of replacing assets—create four distinct positions in the matrix above:

**Sell Consistently:** The “Old” Exit Game. LPs expect their money back on a reasonably predictable schedule, and managers can easily find attractive new opportunities to invest. The flywheel spins smoothly: invest, sell, return capital, repeat. This was PE’s default mode for decades.

**Sell Opportunistically:** A comfortable position. You’re not under pressure to sell, but if a fat pitch comes along, you can jump on it. Replacement deals are plentiful enough that you’re not losing sleep over finding the next one.

**Forced Selling:** The quadrant of despair. Nobody wants to be here. You’re under pressure to return capital, but the market isn’t offering attractive places to redeploy. The options are all bad.

**Hoard Assets:** Where large managers increasingly find themselves. Some LPs want liquidity, but others are OK with holding out for a bigger exit on a co-investment or access to a continuation vehicle (CV) opportunity. Meanwhile, finding new deals is difficult and expensive. Holding is often the rational move at the margin. Keep the fee-generating asset, and let a CV provide liquidity for those who want it. Why sell a company you know to go buy one you don’t if the market isn’t going to punish you for it?

The arrow illustrates a shift that Arctos Partners calls “**The New Exit Game.**”<sup>32</sup> It encompasses the expanding toolkit GPs have developed to manage portfolios when profitable organic exits are tough to come by: continuation vehicles extend hold periods on winners without a third-party sale; NAV loans<sup>33</sup> manufacture LP liquidity without requiring a sale; GP stake sales monetize fee streams directly. The mechanisms are different, but underlying logic is the same: preserve the fee-generating asset, avoid the replacement cost, and find another way to satisfy the LP who wants liquidity. Sell the company and return the capital is still Door #1. But it’s no longer the only door.

Of course, GPs will present the rationale in any specific case as an effort, not to preserve fees, but to optimize outcomes for LPs. But the numbers don’t lie. What we observe in PE is a record-long distribution drought, record-high average holding periods, a record-high backlog of unsold companies—despite an economic backdrop that typically supports healthy distribution levels.

The New Exit Game is more than temporary response to a difficult market. The forces that produced it—scale, shifting incentives, new structures—are unlikely to reverse even if rates come down. It’s the product of a system reorganizing around different constraints and different priorities.

### Investors vs. Asset Gatherers

For most of its history, PE distinguished itself from traditional asset management through better alignment. Management fees were there to cover the overhead, but carry was the endgame. The path to wealth was through performance.

But now the management fees—and therefore the management company—have their own economic gravity. Vanguard founder Jack Bogle spent his career arguing that you can’t serve two masters—that the moment a

<sup>32</sup> “[The New Exit Game](#)”, Arctos Insights Whitepaper (December 2024).

<sup>33</sup> As the name implies, NAV loans are borrowings by fund managers collateralized by the Net Asset Value (“NAV”) of a PE fund. The financing is repaid from cashflows from the underlying diversified portfolio, for example the sale of a company. The lender receives seniority over distributions until repaid. Loan-to-value (“LTV”) ratios are typically conservative – 10-30% of NAV – and are another way that GPs can send money back to their LPs without selling companies.



management company's interests diverge from its investors', the management company wins. PE always claimed to be different. It's becoming harder to make that claim<sup>34</sup>.

When enterprise value overtakes carried interest as the primary decision-making lens, a firm has crossed from Investor to Asset Gatherer. That tipping point is structural—but it's not a neatly quantifiable event, and there won't be a neon sign that toggles from "Investor" to "Asset Gatherer". Culture or circumstance or storytelling skill can mask it for a time, which means the narratives the firm tells its investors (and itself) will tend to lag the behavior shift.

What we can say with confidence is that the smaller and younger a firm is, the more tightly its incentives track those of its LPs. Decisions filter through two questions: does this improve investment performance? Does it help us raise the next fund? As firms scale, the stakeholder set broadens—outside investors in the management company, public shareholders, insurance affiliates, retail distribution partners—and there are more questions to answer. This isn't an argument that scaled managers are bad actors. It's an observation that their optimization problem is different. Charlie Munger told us: "Never, ever think about something else when you should be thinking about the power of incentives."

Another investing adage tells us to "concentrate to get rich, diversify to stay rich." The traditional PE model was built on the former, but scale pushes firms toward the latter.

**Investors get rich by selling companies. Asset Gatherers stay rich by accumulating them.**

### Summary

The current distribution drought was about more than a rate hike cycle. It's the rational outcome of a system that has reorganized around new constraints and new priorities. GP Stakes, CFs, and NAV loans are the structures that emerged to serve new needs.

Orlando Bravo invoked consistency as the key to PE: "Consistency of buying and consistency of selling." That consistency built the industry but hasn't scaled with it.

What PE was—aligned, disciplined, built on the primacy of performance incentives—still exists. For firms that haven't reached the tipping point, the incentives remain as they were originally designed. Scale hasn't reached them, so it hasn't complicated them.

We highlight where in Part II.

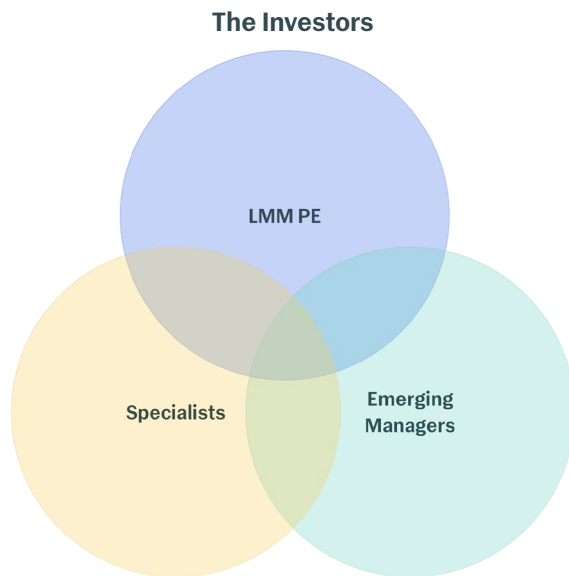
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<sup>34</sup> In *The Lessons of History*, Will & Ariel Durant write: "Nothing is clearer in history than the adoption by successful rebels of the methods they were accustomed to condemn in the forces they deposed."



## Part II: The Investors

### Look For The Investors



The New Exit Game isn't the only game in town.

The forces described in Part I—falling cost of holding assets, rising cost of replacing assets, and PE flywheel spinning in reverse—have pushed a large and growing segment of PE firms toward the “Hoard Assets” position in the matrix above. It's the rational position for many firms at scale.

But there is a specific cohort of firms for whom the original model—buy companies, improve them, sell them, return the proceeds—still holds. Because **the gravity of scale isn't acting on them yet.**

We will call this cohort of PE firms the “Investors”. Lower middle market PE (“LMM PE”) funds, Specialists, and Emerging Managers are overlapping groups with important commonalities. They tend to be **smaller**—usually managing funds below \$1 billion. They tend

to be **younger**—often with founders who recently left a steady and lucrative paycheck at an Asset Gatherer to bet on themselves as Investors. And they tend to be **specialists** who have built their practice around a single industry vertical or capital niche.

The relief valves available to larger managers are not available here. Smaller funds don't generate enough management fee income to sustain the firm independent of performance. Younger firms haven't yet earned the institutional permission to rely on CVs or NAV loans. Specialists can't get rescued from bad outcomes in one sector by heroic results somewhere else in the firm. They have nowhere to hide. Every deal is visible. Every deal matters. Therefore, **holding costs remain higher** than they are for scaled firms.

On the other side of our matrix, the Investors operate in markets where **replacement costs have stayed lower.** Founder and family-owned businesses in transition supply consistent deal flow more independent of macro conditions. Scale creates a coverage gap below roughly \$100M in enterprise value that larger managers structurally can't access. And Specialists have often been tracking companies for years before the generalists even get the call.

### Fishing Holes

The scaled firms that we call Asset Gatherers today—and the individuals who run them—didn't get there by hoarding assets. They are in those positions because at one point, they excelled as Investors. Then, rationally, they moved upmarket—bigger funds, larger deals, more stable fee income. Eventually they hit the tipping point to Asset Gatherer mode. That path is a no-brainer for them. But LPs need to consider if what's rational for them is optimal for you.

PE firms are very skilled at attributing their successes to something unique to them: proprietary edge, institutional knowledge, a secret sauce that comes from the name on the front door. Of course they are. Narrative backfilling<sup>35</sup> is the foundation of any good sales pitch. But the evidence suggests a more complicated story: that returns are a

<sup>35</sup> The retrospective construction of a coherent story to explain past events that tends to overweight the role of deliberate strategy and actions taken by the principal(s) and tends to underweight the role that luck, circumstance, or other forces outside of one's control had on the outcome.



product of both the fishing hole—what’s in the pond, who else is fishing there, and the structures beneath the surface—and the skill of the angler. Not either-or. Both.

PE firms generally can’t resist the pull of bigger ponds. So they move on. But the fishing holes stay where they are—ready for whoever steps in next.

Part II is about those firms: who they are, their structural advantages, and why these waters continue to produce the returns that built PE’s reputation in the first place.

## Structural Advantages

### Consistency of Buying

Lower replacement cost for Investors starts with where Investors fish. The deepest pool of opportunities in the lower middle market has always been family and founder-owned businesses that often come to market for reasons that are largely independent of economic conditions—succession, age, illness, or family circumstance. The opportunity set is large and constantly being replenished by entrepreneurship.

Smaller companies carry less acquisition leverage and entry prices reflect it. The smaller quantum of capital involved—for example, a \$40 million senior loan versus a \$500 million multi-tranche facility—means that borrowing costs and financial engineering matter less to the underwriting case. That means less financial risk as well as relatively less cyclicity and less sensitivity to rates from buyers, sellers and lenders than is found upmarket.

Fee economics also thin out the buyer pool. Investment banking fees, lending arrangements, transaction costs—most scale with deal size. The best-resourced talent and most competitive processes follow the fees. A sell-side advisor on a \$500 million transaction will earn between \$5 and \$10 million. The same advisor on a \$100 million deal might earn \$1.5 million. If you were a talented, capable investment banker, where would your eyes be?

This creates a coverage gap that works in the LMM buyer's favor. Below roughly \$100 million in enterprise value, sales processes are typically run by sector-focused or regional advisors, and many founder-owners opt for more targeted processes with a handful of buyers to balance confidentiality with competitive tension—particularly in environments where valuations feel uncertain.

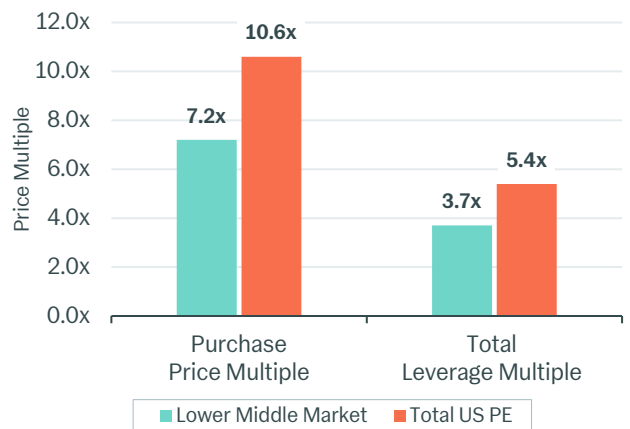
The larger a company gets, the more eyeballs it attracts—not only from potential buyers and bankers, but vendors, customers, employees, trade press, etc. More eyeballs means fewer secrets, and fewer secrets means fewer mispricings. More companies and fewer eyeballs in the LMM means mispriced opportunities can still be uncovered with some regularity.

U.S. Companies by Revenue



Source: NAICS.

LMM PE: Lower Prices & Less Leverage



Source: HighVista Strategies. Data from GF Data, LCD (2024). Purchase Price Multiple reflects Enterprise Value/EBITDA at entry. Total Leverage Multiple reflects Total Leverage/EBITDA at entry.



None of this guarantees bargains. But it does mean that LMM buyers are more likely to find favorable deal dynamics than PE firms up-market. That's a structural edge that doesn't require skill or luck. Below a certain threshold, fewer people show up. That's as reliable as gravity in the fee-driven M&A ecosystem.

But showing up and getting the look is only the first step. Capitalizing on it requires knowing what you're looking at. In addition to deep domain expertise, Specialists immersed in a single vertical have often been tracking specific companies long before they come to market. When they sit across from a seller, they're rarely meeting the company for the first time. In a world where AI tools erode analytical edge, the right relationships with the right humans—getting the first call—will only grow more valuable.

The central question in any transaction is "who is on the other side?" Specialists' domain expertise and networks give them much more actionable intelligence into a sellers' motivation, constraints, and worldview than even the most diligent generalists will have. In a world built on eking out small advantages, that's a pretty big one.

Specialists also tend to be the buyer of choice for companies closely held by founders or families who might care as much about how the next owner will treat their employees and customers<sup>36</sup> as the last dollar of purchase price. Similarly, when corporations divest non-core assets they are often optimizing for speed and certainty of execution.<sup>37</sup> If you already know the business, you might not need to win an auction to get the deal.

Non-economic sellers—those optimizing for something other than purchase price—aren't the norm. No honest manager would claim otherwise. But given the size, scope and diversity of the LMM, they do exist. Upmarket, they might as well be mythical creatures.

### Adding Value as Owners

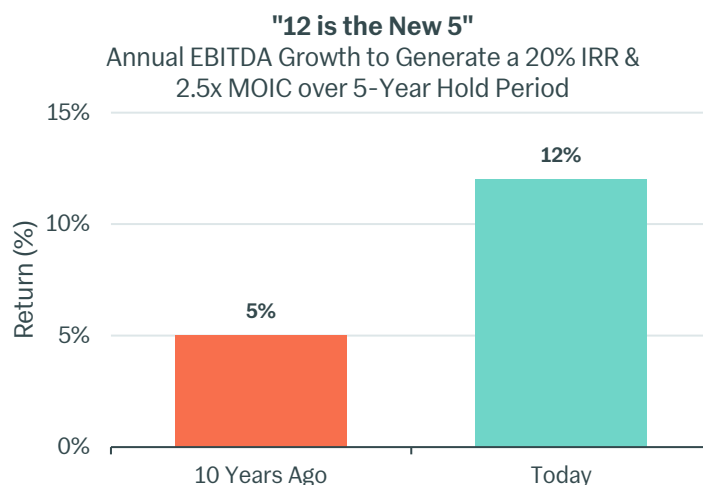
Most PE managers' minimum return threshold is 2.5x MOIC and 20-25% gross IRR. That math has gotten considerably harder for larger deals. A decade ago, cheap debt and rising prices meant that a typical large buyout needed only 5% annual EBITDA growth to hit a 2.5x return over a five-year hold period. Today—with borrowing costs nearly double, less leverage available, and purchase multiples near record highs—that same target requires 12% EBITDA growth.

To achieve 5% EBITDA growth in the ZIRP era, you needed to avoid screwing up. But to grow at 4-6x GDP, you need to make something happen. Value creation that substantial is more likely to come from a deep domain expert than a generalist.

In the lower middle market, the growth story starts from a friendlier place across the board. Lower purchase prices, less leverage, and a value-creation plan that is more about basic blocking and tackling than heroic execution: upgrade accounting and IT systems, fine-tune sales and pricing strategy, improve supply chains—generally, to bring basic best practices to businesses that haven't been run by professionally-trained managers.

<sup>36</sup> Who might include family, friends and neighbors.

<sup>37</sup> Certainty can mean trust that the buyer won't abandon the deal at the 11th hour. But it can also mean conviction that the buyer is a "safe pair of hands" that can execute on a business plan that won't blow up in 9 months - dragging that the corporate parent into a media fiasco or litigation when the whole point of a sale was a clean break.



Source: Bain & Co., Global Private Equity Report 2026. Illustrative example based on large US buyouts (EBITDA of \$50 million or more). Assumes a target 2.5x MOIC over a five-year hold period. 2015 assumptions: 6% borrowing cost, 50% leverage ratio, 10.0x entry / 12.5x exit multiple. 2025 assumptions: 8% borrowing cost, -36% leverage ratio, 14.0x entry / 15.0x exit multiple. Entry and exit multiples based on industry benchmarks for fully realized deals. Actual results will vary. Data from SPI by StepStone, Pitchbook, and Bain analysis.



The math also has implications that extend beyond the returns. At the larger end of the market, higher-leverage and more intense competition can push managers toward cost-cutting to squeeze out incremental points of margin—layoffs, benefit reductions, asset stripping, and other adverse outcomes for employees and customers. But when you’re starting at \$5 million of EBITDA and less than 4x leverage, you aren’t going to cut your way to the target return. You have to grow. This doesn’t make LMM firms saints, but the math dictates an emphasis on building great businesses over cutting, stripping, or carving out.

Larger companies start from a larger base, where the easy wins have already been captured. Scaling the cash flow of a larger, more sophisticated company requires executing more complex value-creation plans, in more crowded markets, against more sophisticated competition—maybe even against public competitors with a lower cost of capital. The more growth you need, the better a lower base starts to look.

**Consistency of Selling**

LMM companies are often sold to strategic buyers. Smaller acquisitions typically require fewer approvals and less corporate red tape, which makes deals easier to close. But there’s a second buyer pool that’s become increasingly important, it’s one we’ve already met. All that capital raised by Asset Gatherers up-market needs to go somewhere. The sustained growth of PE as an asset class has created a large pool of motivated buyers who are fiercely competitive with one another.

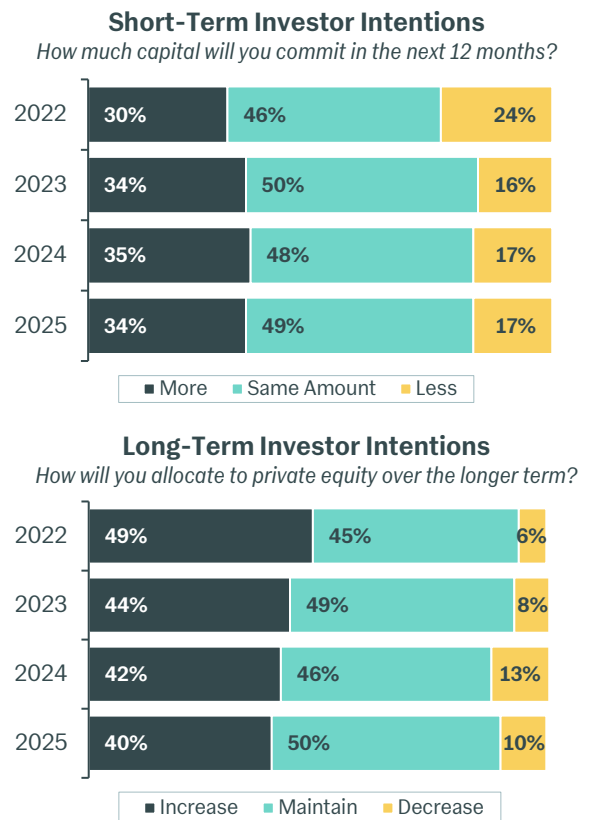
This may seem to contradict the argument made in Part I. If large PE has encountered structural liquidity and fundraising headwinds, are investors losing their appetite for PE? Recent evidence suggests not. Plans to maintain or increase PE allocations have remained remarkably stable through this extended downturn—nearly 90% in each of the last four years, with four times as many allocators planning to increase their exposure as decrease it. The capital may consolidate into fewer firms, but based on what allocators are saying today, it isn’t leaving the asset class.

On top of that, the “democratization of alternatives” is channeling retail capital into products managed exclusively by large Asset Gatherers—the only firms with the infrastructure to handle the reporting, liquidity, and regulatory requirements those structures demand. According to McKinsey’s 2026 Private Equity Report, semi-liquid PE funds pulled in over \$200 billion in 2025—double the amount raised in 2023.<sup>38</sup>

That capital is flowing into the same large and mega-cap managers (and their portfolio companies) that provide a natural exit path for LMM companies. The largest institutions don’t like it, because it crowds them out.<sup>39</sup> But for the LMM firms backing smaller companies and selling into this market, motivated, well-capitalized buyers chasing your assets is exactly what you want.

<sup>38</sup> McKinsey report quoted data originally sourced via Robert A. Stanger & Company.

<sup>39</sup> In the November 2025 WSJ article headlined: “Private Equity’s Embrace of the Mass Market Alarms Longtime Investors”, the pension managers who “want nothing to do with this new pool of retail money” quoted in the article manage \$277 billion (State of Florida) and \$221 billion (Texas Teachers) programs, respectively. Those managers cannot access the LMM and need the New Exit Game. Retail capital is a thorn in their side, but a tailwind for the LMM.



Source: Preqin Investor Outlook Surveys 2022-2025



## Alignment

We covered what happens when the iron law bends in Part I. For the Investor cohort, it still hasn't. The cost of holding too long—lose the LP, lose the fundraise, lose the franchise—is existential. Costs don't get higher.

Alignment isn't just about economic or legal terms on paper. It's also about the allocation of an investment manager's most important resources—their time and attention. Are they using it to generate returns for you today? Or managing the trappings of the returns they made in the past?

In Asset Gatherers, the senior team has a big enterprise to run and competing demands on their time—global fundraising, GP stake negotiations, resource allocation to different vertical or platform teams, sitting on multiple investment committees, managing a 100+ person organization. But at Investor firms, the senior team is spending most of their time investing—originating deals, leading diligence, crafting value creation plans, sitting on boards, and directly plugged into what's happening on the ground. Because the investment strategy is the business strategy and vice versa. There's precious little else to manage.

The smaller fund sizes in the LMM naturally skew toward Emerging Managers or “Challengers”<sup>40</sup>—typically defined as those raising their first, second or third institutional fund. Even among the broader universe of the LMM, these managers are especially well-aligned with their LPs. Founders are high-performers who have left a lucrative seat to go all-in on themselves. It's a career-defining move. They are committing materially all of their personal net worth to those early funds, and, when you only have a handful to speak of, every deal's outcome is life-or-death for the firm.

In software, “technical debt” refers to taking a shortcut that solves today's problem while creating a larger, less visible obligation that compounds quietly in the background. PE firms struggling to generate exits are accumulating something similar: **talent debt**. The New Exit Game falls hardest on younger professionals who haven't yet seen a big carried interest check. GP stake investors want to buy stable, growing fee streams, and stability and growth both require a deep, talented and cohesive team. PE has historically been one of the stickier career paths in finance, as the promise of future carry payouts kept ambitious people in their seats. But every non-paying vintage pushes the expected value of carry further out-of-the-money for professionals who haven't yet collected. If the drought runs long enough,<sup>41</sup> carried interest delayed becomes carried interest denied. Golden handcuffs require gold.

Finally, for investment decision-makers, there is elegance in simplicity. With an Emerging Manager, what you see is largely what you get. The team is small enough to get to know and evaluate directly. The incentive structure is clean—there are no competing business lines, you don't have to worry about GP stake sale,<sup>42</sup> there are no continuation vehicle mechanics to parse.

Simplicity doesn't eliminate risk, but it allows allocators to focus analysis on the question that matters most: can this team find, buy, and improve companies in their niche? That exercise is hard enough.

## Diversification

Start with the most basic portfolio construction question: does a PE allocation actually diversify your portfolio? Many allocators—most, apparently—would say yes. In Prequin's latest Investor Outlook Survey<sup>43</sup> the number one answer to

<sup>40</sup> “Emerging Managers” is the generally accepted industry term. But John-Austin Saviano of High Country Advisors argues that the term Emerging Managers “diminishes the experience and accomplishments of extraordinarily talented investors” and proposes “Challengers” as an upgrade – to “underscore the ambition of newer entrants while also reminding established firms (and the allocators who back them) that innovators and competitors are always close at their heels.” We think he's onto something.

<sup>41</sup> Carried Interest is calculated net of the preferred return. The longer a fund holds without distributing, the more the preferred return accrues—and the higher the return hurdle the fund must clear before carry kicks in.

<sup>42</sup> The firm's not worth anything yet. The tipping point to Asset Gatherer mode is likely 10+ years out.

<sup>43</sup> Republished within Bain's Global PE Report 2026



“What are your main reasons for investing in Private Equity?” was: “Diversification” at 64%—slightly ahead of higher risk-adjusted returns at 61%.

It’s worth pausing on that. Whether it’s private or public, equities are claims on businesses operating in the same economy, subject to the same interest rates, the same consumer spending, the same credit cycles, etc. The null hypothesis shouldn’t be low correlation—it should be substantial correlation. The question shouldn’t be “why is PE so correlated with public markets?” but rather “why do so many allocators believe it isn’t?”

The answer is an artifact of imperfect measurement. As we know, PE returns are reported on quarterly valuations while public equities reprice daily. The lag suppresses measured correlation mechanically—the data series are out of sync, so PE looks less correlated than it likely<sup>44</sup> is. In 2023, Man Group measured the correlation between PE and public markets total returns back to 1997.<sup>45</sup> Even using smoothed data—which understates the true figure—they still found 76%. On a rolling four-year basis, that number reached 90% in recent years.

That makes sense. PE firms value assets using public company comparables. It’s difficult to meaningfully decorrelate two asset classes when one prices itself off the other. On top of that, take-private transactions—buying public companies and de-listing them—were the fastest-growing deal category in 2025, up 72% year-over-year.<sup>46</sup> When a PE fund owns what was, until recently, a public company, the diversification argument gets hard to take seriously.

But this high correlation does not apply equally across PE. Companies in the lower middle market carry less acquisition leverage—around 3-4x EBITDA versus 6-7x for deals over \$1 billion<sup>47</sup>—which means less of the return is driven by changes in cost of capital and more by what actually happens inside the company. Academic studies on PE as a diversifier at asset class level is plentiful, but research on diversification by segment within PE is not.

Partners Capital tried to fill this gap by using de-smoothed<sup>48</sup> returns. Their findings are striking: Specialist LMM strategies showed a correlation to the S&P 500 of just 0.38 compared to 0.74-0.79 for broad PE indices—and a beta of 0.26 versus 0.58-0.84. The further down-market you go, the more diversification you’re getting.

**Private Equity Volatility & Beta Estimates from De-Smoothed Performance**

Private Equity Index	Proxy for:	Average Return (2001 - 2020)	Standard Deviation	De-Smoothed Standard Deviation	Ratio of De-Smoothed Std Dev to S&P 500 Std Dev	Correlation to S&P 500 (R2)	Beta to S&P 500
State Street Private Equity Index	Overall PE	8.4%	9.6%	16.8%	1.12	0.74	0.83
Preqin Private Equity Index	Overall PE	9.2%	8.4%	15.9%	1.06	0.79	0.84
Preqin Buyout - Large Index	Large Cap Buyouts	10.5%	8.4%	11.1%	0.74	0.78	0.58
Preqin Buyout - Small Index	Specialist LMM Buyouts	11.4%	7.4%	10.3%	0.69	0.38	0.26

Source: Partners Capital. Sample set is March 2001 to January 2020 for PE indices and uses quarterly data. De-smoothed standard deviation adjusts for the serial correlation of Private Equity returns. If a sample has more serial correlation, this adjustment increases the standard deviation. There are multiple techniques for this adjustment. Partners Capital use an AR(1) adjustment. Beta is calculated as the ratio of the de-smoothed Standard Deviation for PE indices over the S&P 500 SD (15%) multiplied by the correlation to the S&P 500.

This makes intuitive sense given everything above. Less leverage means less of the return is driven by changes in cost of capital. More operational value creation means return drivers are more company-specific and less market-dependent. When it comes to diversification, your mileage will vary based on where within PE you are invested.

<sup>44</sup> The torchbearer for this point of view is self-professed “gadfly of the PE industry” Cliff Asness of AQR, who coined the term “volatility laundering” in 2023.  
<sup>45</sup> Simple return correlation of Cambridge Associates US Private Equity Buyout Index and Russell 2500 Index using quarterly returns for indices noted from first quarter of 1997 (the first quarter currently available for the Cambridge Associates index) through the first quarter of 2022.  
<sup>46</sup> Owing largely to the \$55 billion take-private of Electronic Arts announced in September 2025.  
<sup>47</sup> Source: Ninepoint Partners, November 2025. Data from JPMorgan, Pitchbook.  
<sup>48</sup> Because PE valuations are reported using appraisals rather than market prices, the reported return stream appears far smoother and less volatility than it would if the companies actually traded on an exchange. De-smoothing applies a statistical correlation to remove this serial correlation, producing a return series that better reflects the true economic volatility of owning the assets.



## The Returns

Below we present how these structural advantages translate into returns. But first, a note on the return data itself.

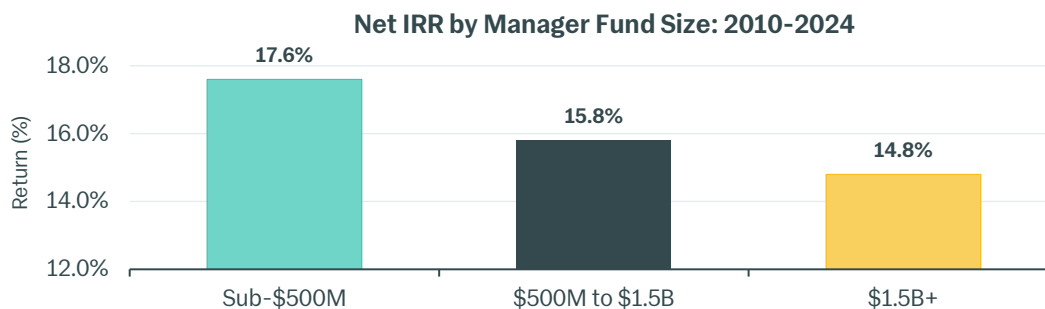
There is no requirement that PE funds report their performance to any data provider. No central registry exists, no regulatory mandate compels disclosure, and no provider can guarantee comprehensive coverage. Different databases have different gaps: self-reported databases skew toward larger, more institutionally prominent managers, while LP-reported databases capture smaller funds more systematically. A fund that quietly winds down without returning capital may simply disappear from the record—and because that outcome is more likely to happen in the LMM than in larger segments, survivorship bias is a relevant caveat to the evidence that follows.

The data are presented deliberately as a mosaic. We present multiple providers and methodologies because no single authoritative source exists. We present multiple time periods because the market conditions that shaped returns in any given period by not resemble what comes next. When multiple imperfect datasets converge on the same conclusions over multiple time periods, that convergence should carry more weight.

With that context established, the data points consistently in the same direction: these advantages have translated into outperformance by the Investor cohort.

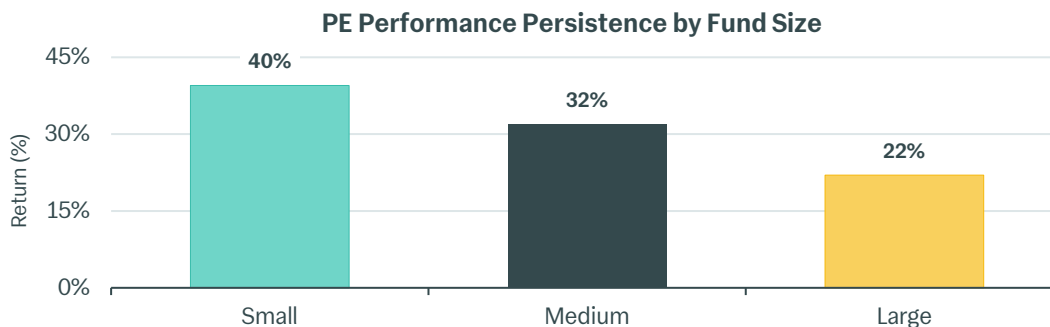
## LMM Funds

First, on a pooled basis, the sub \$500 million fund size cohort has outperformed the \$1.5 billion-and-up fund size cohort by nearly 300 basis points since 2010:



Source: HighVista Strategies. Data from Burgiss as of 12/31/2024. US Buyout Vintages 2010-2024 Median Returns by Fund Size. Past performance may not be indicative of future results.

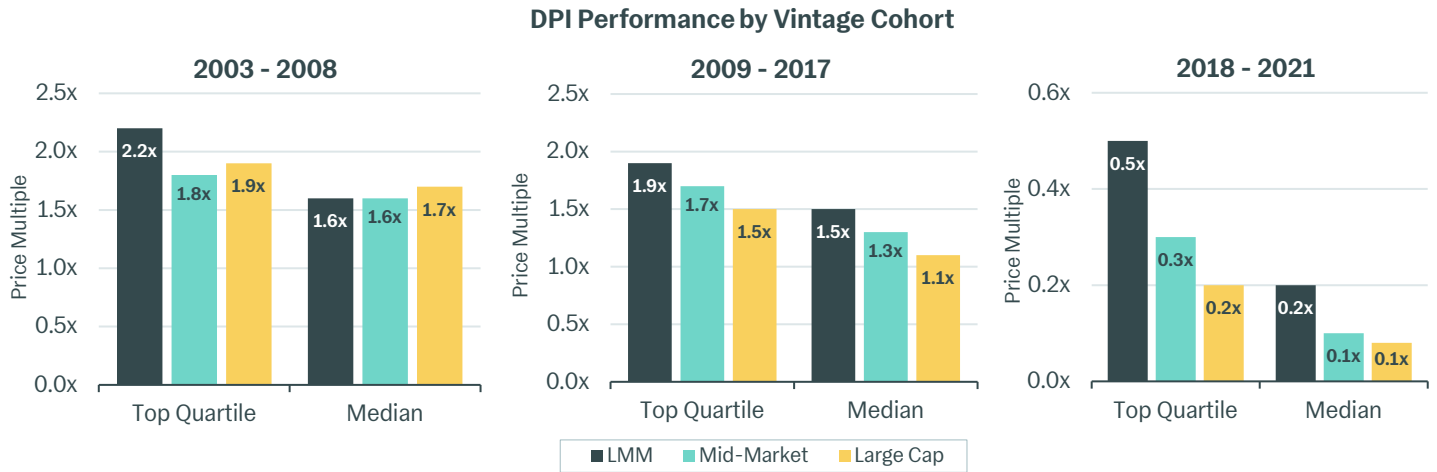
There is also evidence of **stronger performance persistence**—measured by the frequency at which a top quartile fund’s successor fund is also top quartile—at the smaller end of the market:



Source: Schroders, 2022. Based on analysis of 3,512 private equity funds in Preqin database since 1980. Only GPs with at least two funds are included and only funds at least seven years hold are included. Performance quartile based on internal rate of return (IRR) and multiple of invested capital (MOIC) returned to LPs. Funds smaller than \$500 million are “Small”, \$500-\$2 billion are “Medium” and \$2 billion and above are “Large”.



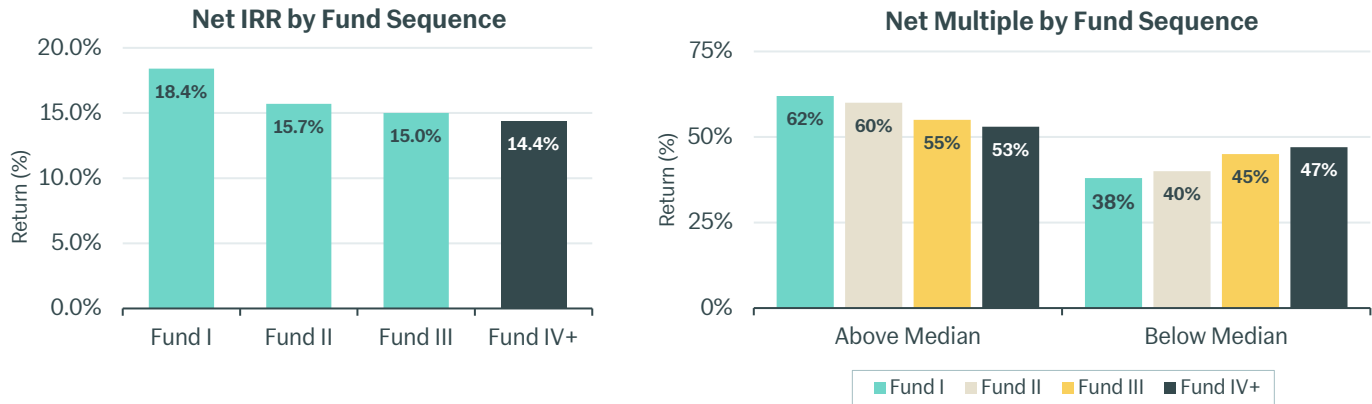
Greater consistency of selling can be observed in the form of **more distributions** in the LMM vs. larger segments across a variety of economic environments:



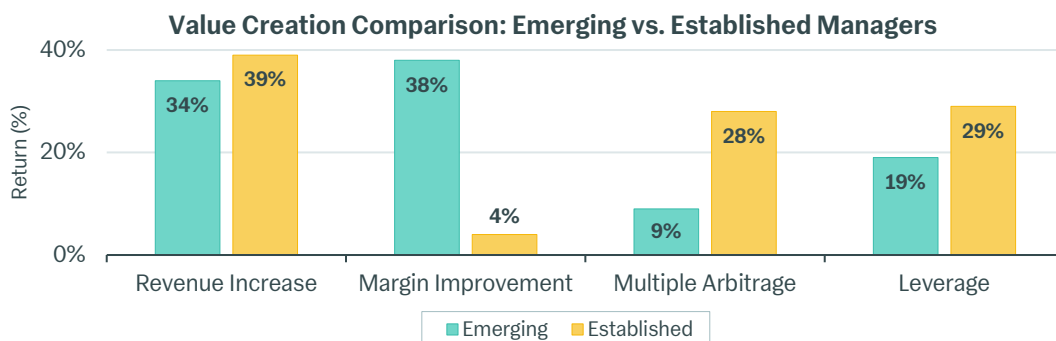
Source: PGIM Global Asset Management. Data from Prequin as of March 31, 2024. The analysis includes 2003 to 2021 vintage year buyout funds across N. America and Europe. Vintages from 2003 to 2008 include funds that invested during the Global Financial Crisis ("GFC"). Vintages 2009 to 2017 include funds that invested during the post-GFC bull market, and vintages from 2018-2021 include funds that invested during the Covid-19 pandemic and subsequent economic volatility. DPI represents Distributed Capital relative to Paid-In Capital.

## Emerging Managers

**Funds I, II and III have outperformed** Funds IV and older over the last two decades with **returns driven more by operating improvements** than financial engineering or market cycle tailwinds:



Source: SPI by StepStone and Burgiss. Data as of June 30, 2025. For Buyout funds with Vintages 2001-2020. Net IRR chart includes 2,090 funds. Net Multiple chart includes 2,069 funds.

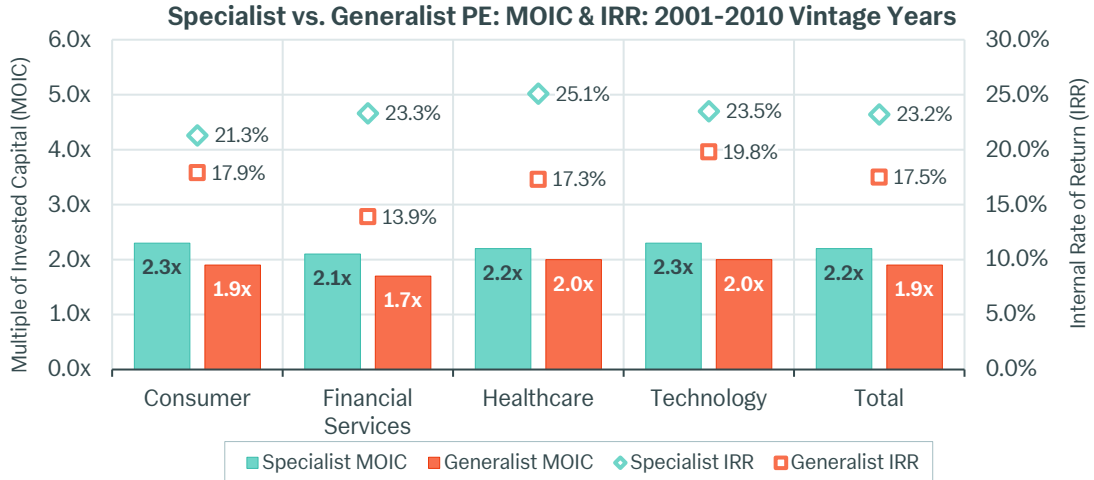


Source: Unigestion. Dataset includes 2,654 realized and unrealized transactions closed between 2000 and 2024.



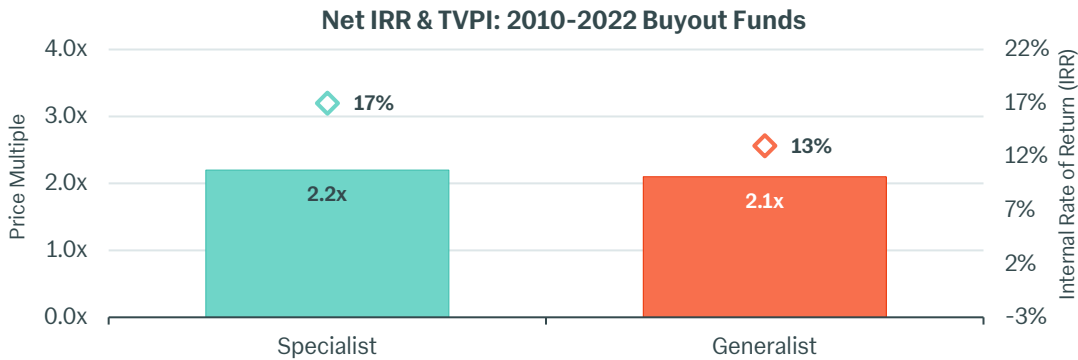
## Specialists

We see evidence across multiple periods and economic environments that **specialists tend to outperform generalists**. First, Cambridge Associates examined returns for vintage years from 2001 through 2010:



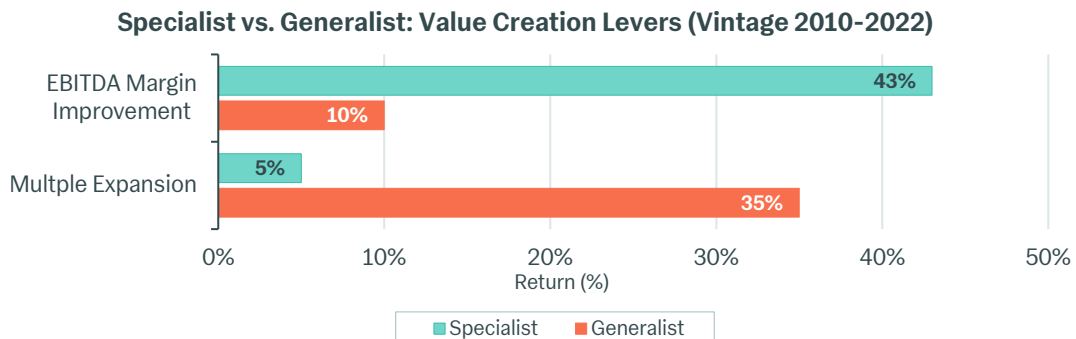
Source: Cambridge Associates. Data as of December 31, 2013. Measures performance of all US Buyout and Growth Equity investments across the four identified sectors with an initial investment in the year of 2001 to 2010.

McKinsey's 2026 Global Private Markets Report provided overall specialist vs. generalist performance for more recent vintages.



Source: McKinsey Global Private Markets Report 2026.

Specialists have outperformed, and again **driven by operating improvements** rather than financial engineering or market cycle tailwinds:



Source: McKinsey Global Private Markets Report 2026.



## Underwriting Considerations

None of this is a free lunch. We've highlighted the merits of LMM, but there are also risks that present more acutely in smaller funds vs. larger ones and require specific examination.

Smaller funds generally have shorter histories, so LPs must be comfortable underwriting track records from prior firms. Key person risk also tends to be more acute—smaller funds mean less fee income and carried interest to distribute, which means leaner teams. As a result, investment professionals carry heavier loads than counterparts at larger firms who have armies of junior staff, operating partners, and in-house consultants.

Smaller companies can also be more fragile and come with higher execution risk. Companies generally don't stay small on purpose. A smaller earnings base is an asset through the lens of generating the best multiple of invested capital, but it can make companies more exposed to economic headwinds, key person risk, mismanagement, or other bumps in the road. And if you're looking for global diversification, you usually won't find it here. The U.S. middle market sources 85% of its revenues domestically.<sup>49</sup>

Measures of risk and return profile are very sensitive to end points and peer universe groupings, but there have been periods where dispersion of returns<sup>50</sup> are higher for smaller and emerging funds vs. larger and more established funds. In other words, the best outcomes are better, but the worst outcomes are worse. This dispersion means that rigorous due diligence and manager selection skill are critical to capturing the structural advantages of the LMM.

The structural forces we've identified improve the base rate for LMM exits, but any individual exit still depends on asset quality, timing and execution. Macro capital flows don't guarantee that all LMM funds will outperform. Finally, investing in the LMM requires continuous vigilance, as the star performers inevitably graduate upmarket, with hungry upstarts taking their place.

Nothing here should be read as an argument that large managers can't deliver. Many will. Scale can bring real advantages that smaller firms cannot replicate. In specific types of transactions—for example, complex cross-border deals, capital-intensive sectors, heavily regulated or politically sensitive industries and certain types of secondary opportunities—scale might be a prerequisite. The point isn't that scale is bad in and of itself. It's that scale changes what a firm optimizes for—and LPs should be clear-eyed about the specific optimization problem their managers are solving for.

Finally, nothing is risk-free. If an edge were obvious and easy to access, it wouldn't exist. But on balance, we see the structural advantages—less efficient pricing, better diversification, a robust and competitive buyer universe, and superior alignment—tipping the scales in favor of the LPs who can access the Investor cohort and apply the right underwriting approach. These are not trivial conditions. The same features that create the opportunity—shorter track records, leaner teams, continuous manager turnover—make it hard to identify which managers will outperform. The resources, focus and underwriting skill required are what keeps the edge intact.

## Conclusion

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Investing is hard. The question for allocators, advisors, and their clients shouldn't be whether a perfect, foolproof strategy exists—it doesn't—but to what extent you can tilt the odds in your favor.

<sup>49</sup> Defined here as companies with annual revenues between \$10 million and \$1 billion. Source: The National Center for the Middle Market (2026)

<sup>50</sup> As measured by Inter-Quartile Range (or "IQR") which is obtained by subtracting the 3<sup>rd</sup> Quartile return from the 1<sup>st</sup> Quartile return. Wider ranges mean greater dispersion. Results vary depending on data provider and time horizon, but, on balance, smaller funds have tended to show a wider dispersion than larger funds over the long-term.



The forces we describe are unlikely to reverse. Christensen and West would both recognize the pattern: scale reorganized the industry around new priorities, and the New Exit Game—continuation vehicles, NAV loans, GP stakes, and whatever comes next—is the rational outcome.

But rational for them doesn't mean optimal for you. The structural conditions that preserve alignment—smaller funds, younger firms, narrow specialization—are the same ones that enable more consistent buying, more consistent selling, more robust diversification from public markets, and outcomes driven by operational improvements rather than financial engineering.

The industry spent decades distancing itself from its parents—traditional asset managers with a fixed-fee model. But at scale, PE looks more and more like them every day.

PE's midlife crisis is real. But it's not universal. The firms keeping the original promise—consistent buying, consistent selling, capital returned on schedule—are out there.

But the streetlight doesn't always reach them.

#### ABOUT THE AUTHOR



**Dan O'Donnell, CFA**, leads research and analysis within the private equity asset class. His work encompasses sourcing, underwriting, and monitoring the full spectrum of private equity strategies on behalf of LNW clients. His work also entails collaborating with LNW's Chief Investment Officer, members of the LNW investment team and client advisory teams to align private equity strategies with client needs and goals.



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