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PRIVATE EQUITY OUTLOOK · FEBRUARY 2026

The End of Easy Money: Private Equity's New Imperative

Why the decade of multiple expansions is over — and why the firms that can generate real operational alpha will define the next era of private markets.

EXECUTIVE SUMMARY

For the better part of a decade, from 2010 through 2021, private equity operated in a uniquely forgiving environment. Near-zero interest rates, abundant leverage, and expanding valuation multiples rewarded almost every deal, regardless of operational merit. Returns that looked like alpha were, in many cases, little more than beta dressed up in carried interest.

That era is over. The normalization of interest rates, compression of entry multiples, and slowdown in deal activity have fundamentally reset the conditions under which private equity creates value. Going forward, the managers who generate genuine, durable returns will be those who can identify businesses at the right price, operate them better, and exit to buyers willing to pay a premium for quality.

This paper makes four principal arguments:

- The decade of multiple expansion was an anomaly, not a template. Investors who benchmark future PE returns against the 2012–2021 vintage period will be systematically disappointed.
- Public market shrinkage is structural and accelerating. Meaningful equity diversification now requires deliberate private market exposure; there is simply no equivalent opportunity set in listed securities.
- Manager selection has never mattered more. The dispersion between top-quartile and bottom-quartile PE returns will widen materially over the next decade. Backing the wrong manager in this environment is far more costly than it was when the tide was rising.
- The most compelling risk-adjusted alpha is likely found in the lower middle and middle market. These segments offer better entry pricing, less efficient competition, and a natural exit premium as assets are sold up the market to larger sponsors.

I. A Decade Built on Borrowed Conditions

The Interest Rate Foundation

To understand where private equity stands today, one must first understand what made the prior decade so unusually profitable. From 2010 through 2021, the Federal Reserve held the federal funds rate at historically low levels — at or near zero for the majority of the period. The policy response to the Global Financial Crisis: sustained, extraordinary monetary accommodation, fundamentally altered the mathematics of leveraged buyouts.

Inexpensive leverage served as a multiplier for every aspect of the PE value creation equation. Sponsors could finance acquisitions at historically low all-in borrowing costs, often in the 4–6% range. With leveraged loan and high-yield markets wide open and bank credit conditions loose, deal teams could engineer capital structures that maximized equity returns with relatively modest operational improvement required to achieve target IRRs.

Consider the math: in a deal financed at 5x leverage at a 5% cost of debt, the annual interest burden on a $500M loan is approximately $25M on $100M of EBITDA. At a 3% cost of debt, that same structure drops annual interest expense to $15M - an immediate, structural improvement in free cash flow that requires no operational effort whatsoever.

> *"The era of easy money rewarded deal volume over deal quality. The next decade will reward exactly the opposite."*
>
> Chilton Trust Investment Committee

The Multiple Expansion Phenomenon

Perhaps the most important and underappreciated driver of PE returns in the prior decade was valuation multiple expansion. Between 2010 and 2021, the average entry EBITDA multiple paid in U.S. buyouts rose from approximately 7.5x to a peak approaching 12x. This secular re-rating of private company valuations, itself a direct consequence of low interest rates, which compress discount rates and inflate asset prices across all classes, created a powerful tailwind for PE returns.

The mechanism was simple: buy a business at 8x EBITDA, hold it for five years with modest EBITDA growth and modest debt paydown, and sell at 10x or 11x EBITDA. The exit multiple premium alone could generate 30–40% of the total equity return, independent of any operational improvement in the underlying business.

This phenomenon masked a great deal of mediocrity. Deals with modest or even negative operational improvement could still produce acceptable returns if held long enough to benefit from multiple expansion. In retrospect, what was often presented to LPs as sector expertise, operational transformation, or proprietary deal flow was, in material part, a beneficiary of broad-based re-rating.

The Debt-Fueled Acquisition Machine

Beyond the direct impact on individual deal returns, cheap capital enabled a broader structural shift in PE behavior. With leverage readily available and inexpensive, sponsors could justify higher entry prices by piling on debt. This dynamic pushed the average leverage multiple in U.S. buyouts from roughly 5x in the early 2010s to above 6x by the late 2010s, with many deals carrying 7x or more in total leverage.

The practical consequence was that many portfolio companies entered PE ownership with limited balance sheet flexibility. Debt service consumed a substantial share of operating cash flows, reducing investment capacity for organic growth, R&D, and talent. The model worked so long as interest rates stayed low and refinancing windows remained open. When rates normalized, the fragility embedded in these capital structures became apparent.

Today, a significant portion of the PE portfolio universe is being stress-tested for the first time. Companies acquired between 2018 and 2022 at elevated multiples with maximum leverage are now facing materially higher interest costs at refinancing, slower revenue growth in a more cautious consumer and enterprise spending environment, and an exit market that is unwilling to pay the multiples at which they were acquired.

II. The New Landscape: Skill Over Structure

The Rate Normalization Reckoning

The Federal Reserve's rate hiking cycle, which began in March 2022 and took the federal funds rate from near zero to above 5%, represented the most rapid monetary tightening in four decades. For private equity, the consequences were immediate and multi-dimensional.

First, the cost of leveraged buyout financing rose dramatically. Leveraged loan spreads widened, and the base rate (SOFR) itself increased from near zero to over 5%, taking all-in debt costs from the 4–6% range to 8–11% or more for syndicated deals. This fundamentally altered return modeling: a deal that worked at 5% cost of debt often did not pencil at 9%, forcing either lower entry prices, reduced leverage, or both.

Second, the discounted cash flow math that supports exit multiples shifted against sellers. As risk-free rates rose, required returns increased, and the valuation multiples buyers were willing to pay compressed accordingly. The same business that sold for 12x EBITDA in 2021 might command 9x or 10x in 2024 - a 20–25% reduction in enterprise value with no change in underlying operating performance.

Third, the denominator effect in institutional portfolios reduced LP appetite for new PE commitments as public equity valuations fell in 2022, leaving many allocators temporarily overweight private markets and constrained in their ability to fund new capital calls.

What Value Creation Looks Like Now

The practical implication of this environment is that the PE managers who will generate superior returns in the coming vintage years are those who genuinely know how to build better businesses, not those who were adept at accessing leverage and timing exits.

Genuine operational value creation takes several forms, and the best managers in today's environment are demonstrating real competence in these areas:

- **Revenue Growth Engineering:**

Going beyond financial engineering to actually grow the top line through market expansion, new product development, pricing strategy, and go-to-market improvements. This requires sector depth and operating partner capabilities that many PE firms claim but few truly possess.

- **Margin Improvement Execution:**

Systematically reducing cost structures through operational efficiency, procurement leverage, technology adoption, and organizational rightsizing — without degrading the customer relationships or product quality that underpin enterprise value.

- **Buy-and-Build Platform Creation:**

Acquiring a platform company and executing a disciplined add-on acquisition strategy to build scale, geographic coverage, and competitive positioning. When done well, this can manufacture multiple expansion by growing a business into a more attractive buyer universe — even in an environment of flat broader multiples.

- **Management Team Transformation:**

Identifying businesses with strong underlying economics but weak management execution, then installing better operators. This is genuinely difficult to do and requires real human capital networks and organizational change capabilities.

- **Technology and Process Modernization:**

Applying operational technology — including AI tools, ERP systems, and data infrastructure — to improve business unit economics in ways that translate into durable EBITDA improvement rather than one-time cost cuts.

Entry Price Discipline: The New Alpha

In an environment where exit multiples are uncertain and leverage is expensive, the single most controllable variable in any private equity investment is the entry price. Buying a business at 7x EBITDA provides substantially more cushion for error — operational, macroeconomic, or timing-related — than buying the same business at 11x.

The best managers in today's environment are demonstrating genuine discipline in walking away from deals that do not meet their return thresholds, even when competitive pressure from other sponsors pushes prices above their comfort zone. This requires LP alignment on IRR expectations, a pipeline deep enough to maintain selectivity, and the organizational confidence to be patient.

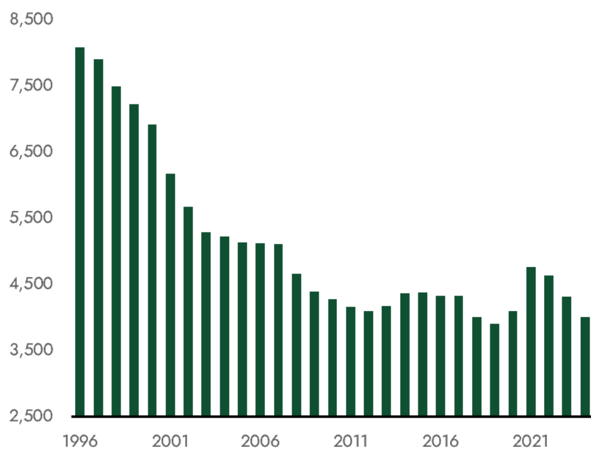
For LPs evaluating managers, entry price discipline is one of the clearest and most observable signals of quality. Managers who consistently buy at premium multiples and explain it away with narratives about quality, moats, or add-on potential should be scrutinized carefully, particularly in a market where those narratives must ultimately be validated by operational outcomes rather than favorable exit markets.

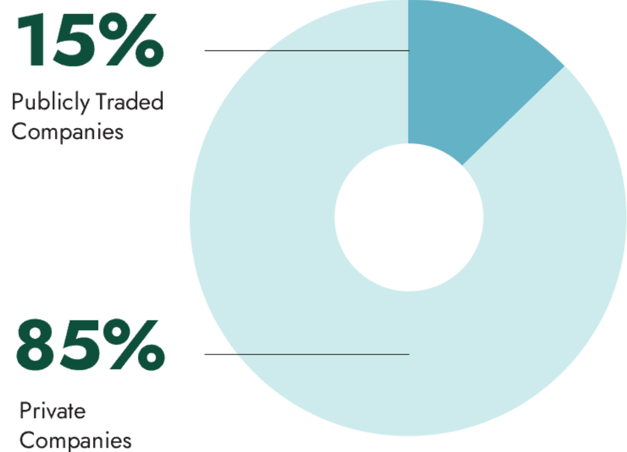
III. The Shrinking Public Markets Imperative

The Great Listing Decline

One of the most consequential structural shifts in modern capital markets, and one of the most underappreciated by traditional asset allocators, is the dramatic contraction of the U.S. public equity universe. At its peak in 1996, there were approximately 8,000 companies listed on U.S. stock exchanges. By 2024, that number had fallen to roughly 4,300, a decline of nearly 46% over three decades.

This contraction reflects several converging forces. Regulatory compliance costs (particularly post-Sarbanes-Oxley and Dodd-Frank) have made the public listing burden prohibitive for smaller companies. The availability of private capital, from PE sponsors, growth equity funds, and venture capital, has extended the duration over which companies can grow while remaining private. And the rise of the private secondary market has given early investors liquidity options that reduce the urgency of a public offering.





What Public Investors Are Missing

The practical consequence of this listing decline is that a growing share of economic activity is simply not available to public market investors. The majority of companies driving innovation, employment growth, and economic value creation in healthcare services, software, industrial technology, business services, and consumer sectors are, by an increasing proportion, privately held.

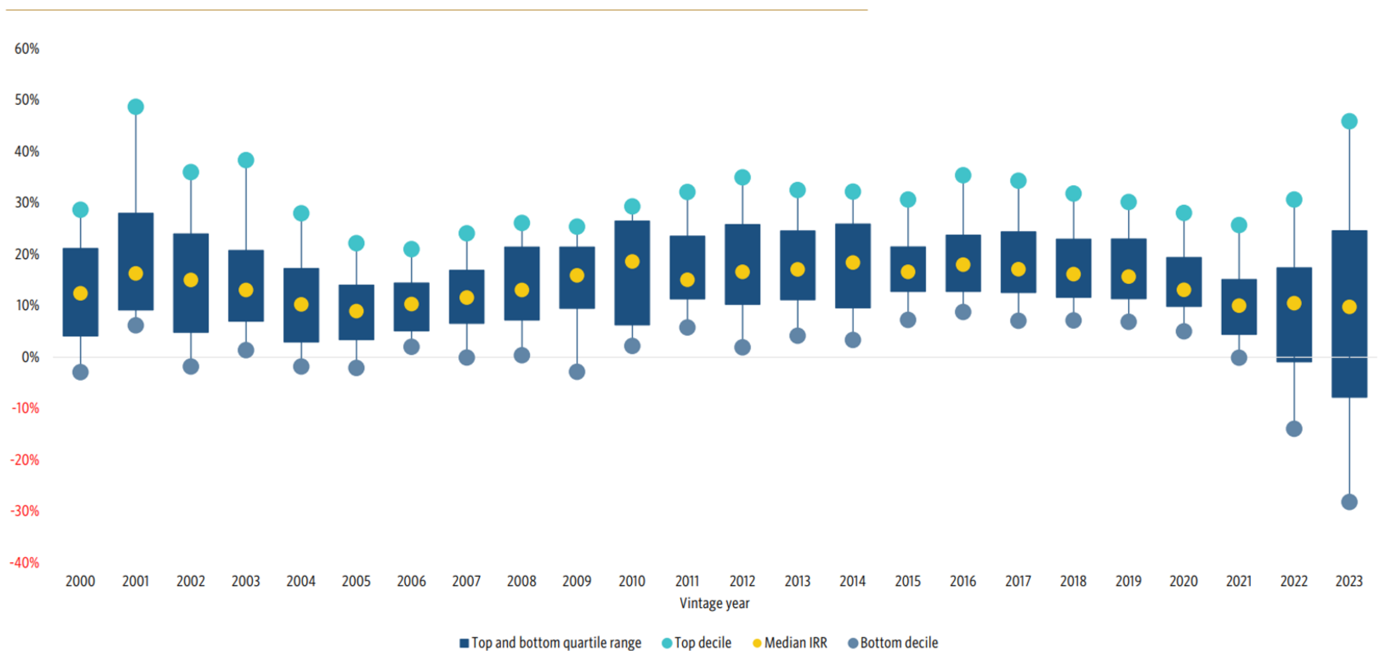
A traditional 60/40 or even 70/30 institutional portfolio that relies entirely on public equities for growth exposure is, by definition, underweight the sectors and stages of company development that generate the most distinctive risk-adjusted returns. This is not a theoretical concern, it is a structural gap that compounds over time as more high-quality businesses choose to remain private for longer.

Consider that a portfolio spread across 500 public companies may appear diversified, but if those companies represent less than 15% of the economic value-generating private sector universe, it is profoundly under-diversified in economic terms. True portfolio diversification in 2026 requires deliberate, considered private market exposure — not as an alternative sleeve, but as a core component of the equity allocation.

The Case for PE Exposure — Done Right

None of this should be construed as a blanket endorsement of private equity as an asset class or of any particular vehicle or structure. The case for PE exposure is contingent on accessing quality managers with the skills to generate genuine returns in the current environment and maintaining appropriate position sizing given the illiquidity inherent in these investments. Today, performance dispersion between the top quartile and the bottom quartile private equity funds is more significant than ever, underscoring the need for thoughtful and experienced diligence to uncover those managers capable of delivering true alpha in today's environment.

IRRs by Vintage



Source: PitchBook North American Benchmarks as of Q1 2025

IV. Where True Alpha Lives: The Middle Market Advantage

Market Segmentation: Not All Private Equity Is Created Equal

Private equity is not a monolithic asset class. The opportunity set spans a spectrum from the large-cap buyout market — transactions above $1 billion in enterprise value, dominated by mega-funds like Blackstone, KKR, Apollo, and Carlyle — to the lower middle market, where transactions are often sub-$100 million in enterprise value and are conducted by regional or specialist managers with limited LP brand recognition but often superior deal economics.

Understanding where along this spectrum the most compelling risk-adjusted returns are available — and why — is essential to building a well-constructed PE allocation.

Why the Lower and Middle Market Offers Structural Alpha

1. Less Competition, Better Entry Prices

The large-cap buyout market is intensely competitive. Mega-fund managers competing for a $2 billion EBITDA business will typically conduct a highly organized auction process involving 10-20 qualified bidders, investment banks running tight process timelines, and pricing pressure that compresses returns for every participant. The result is that large-cap buyouts are acquired in an efficient market, and the return premium for bearing illiquidity and leverage is correspondingly modest.

The lower middle and middle market is fundamentally different. A family-owned business in the $10—50 million EBITDA range may have three to six viable acquirers, a founder who prioritizes cultural fit and management continuity over price maximization, and no investment bank orchestrating the process. This market inefficiency is real and persistent — and it translates directly into lower entry multiples, more attractive leverage terms relative to enterprise value, and a higher probability of purchasing genuine value rather than paying for the consensus. Further, deals in the lower middle and middle market are often "first institutional capital" for owners of family-owned businesses. High quality deals will often include a rolling of equity into the deal by the seller, a strong indication of alignment of interests and "skin in the game" for continued company success.

2. Greater Scope for Genuine Operational Improvement

A $50 billion company like a publicly traded industrial conglomerate has almost certainly been exposed to decades of public market scrutiny, activist shareholders, and management consulting engagements. The easy operational wins have been harvested. What remains is genuinely difficult to execute.

A $50 million EBITDA specialty manufacturer that has been owner-operated for 30 years can be ripe with opportunity for operational improvements: it has likely never implemented enterprise resource planning software, conducted a systematic pricing analysis, built a professional sales organization, or explored adjacent market opportunities. The opportunity to professionalize and scale is substantial — and the skill required to execute it, while real, is more accessible to a focused, sector-experienced PE team than the marginal improvement opportunities available in large-cap situations.

3. The Natural Exit Premium: Selling Up the Market

Perhaps the most structurally compelling aspect of lower and middle market PE investing is the built-in exit premium that arises from selling to larger buyers. When a lower middle market manager acquires a business at 6–7x EBITDA and grows it — through organic improvement, add-on acquisitions, and management team development — to a scale and quality that makes it attractive to a large-cap sponsor or strategic buyer, the exit multiple expansion is driven not just by macro conditions but by the fundamental re-rating of the asset itself.

A business with $8 million of EBITDA that trades at 6x in the lower middle market has a very different buyer universe than the same business grown to $40 million of EBITDA. At $40 million, the company is now accessible to mid-market PE funds paying 9–10x, to strategic acquirers willing to pay control premiums, and to public company buyers pursuing bolt-on transactions at synergy-adjusted multiples. This structural step-up in the buyer universe, often referred to as "selling up the market", is a durable, strategy-specific source of multiple expansion that does not depend on favorable macro conditions.

4. Fragmented Sectors with Platform Creation Opportunity

Many of the most attractive middle market segments: specialty healthcare services, industrial distribution, veterinary care, environmental services, wealth management, home services, remain highly fragmented, with no dominant national or regional player. This fragmentation creates natural platform-building opportunities for PE sponsors who can execute a disciplined buy-and-build strategy: acquire a strong regional operator, professionalize the management team and systems, and consolidate smaller competitors as add-ons.

When executed well, this strategy generates multiple expansion by transforming a $10 million EBITDA local operator into a $60 million EBITDA national platform - a business that is not only three times larger in earnings, but commands a meaningfully higher multiple by virtue of its scale, diversification, and institutional quality. The IRR contribution from this engineering, done properly, can approach that of the original investment thesis, effectively doubling the value creation opportunity.

The Manager Paradox: Capacity vs. Alpha

There is an important structural tension embedded in any discussion of middle and lower middle market alpha: the managers who generate it are constrained by fund size in ways that do not apply to mega-fund peers. The strategies that work best in the lower middle market are fundamentally incompatible with $20 billion funds; the deal sizes are too small, the execution requires too much attention per company, and the market cannot absorb capital at scale.

This means that access to genuinely alpha-generative middle market PE managers is a meaningful constraint for large institutional investors who cannot accept the J-curve impact of small fund commitments relative to total portfolio size. For HNW investors and family offices, however, this constraint works in their favor; the minimum commitment requirements that are prohibitive for a $50 billion endowment are entirely manageable at the appropriate scale.

V. Manager Selection in the New Environment

What to Look for — and What to Avoid

In the current environment, the markers of genuine PE quality are both more important and more observable than they were during the multiple expansion era. The following framework reflects our views on the characteristics that distinguish managers likely to generate top-quartile returns from those likely to disappoint.

Genuine Operational Capabilities

The most important and difficult to verify characteristic of a quality PE manager is real operational capability. Many firms present operational consulting arms, operating partner networks, and sector specialization as differentiating features. Few have truly integrated these capabilities into their investment and ownership processes in ways that drive measurable EBITDA improvement.

Evaluating this requires going beyond GP marketing materials to interview portfolio company CEOs, examine hold period EBITDA bridges on realized deals, and understand the actual mechanism by which value was created. Managers who can demonstrate consistent, repeatable operational improvement across multiple portfolio companies over multiple vintage years are a rare and genuinely valuable commodity.

Consistent Entry Discipline

As noted above, entry price discipline is increasingly the single most consequential variable in PE return generation. Look for managers who have demonstrably passed on deals — who can articulate specific situations where competitive pricing drove them to the sidelines, and who did not succumb to the pressure to deploy capital at any price to stay relevant with LPs.

Be appropriately skeptical of managers whose deal pace accelerated meaningfully during the peak multiple environment of 2019–2021. The vintage year composition of a manager's portfolio is a useful signal: heavy concentration in 2020–2022 deals at peak multiples is a risk factor that deserves explicit evaluation.

Alignment of Interests

The fee and carry structure of a PE fund should reflect genuine alignment between GP and LP. Standard market terms of 2% management fee and 20% carried interest with an 8% preferred return hurdle remain reasonable for managers who generate consistent top-quartile returns. These terms become difficult to justify for managers who have consistently delivered median or below-median performance.

Pay particular attention to the GP's own capital commitment to the fund. A GP committing 1% or less of fund capital may have limited personal financial exposure to underperformance — an alignment gap that is especially concerning in funds pursuing higher-risk strategies.

VI. Portfolio Construction Guidance

Building a Private Equity Allocation for the Current Environment

For investors who are appropriately positioned to hold illiquid capital, the current vintage period — despite its challenges — may prove to be among the most attractive entry points for private equity in over a decade. Valuations are lower, competition is reduced, and the managers who survive this environment with strong track records will have demonstrated real skill rather than simply ridden a macro tailwind.

The following principles reflect our guidance for constructing a PE allocation appropriate to the current environment:

Prioritize Vintage Year Diversification

No investor can consistently call the optimal vintage year for PE commitments. A systematic commitment strategy that deploys capital across multiple fund cycles provides exposure to a range of economic environments and reduces the risk of heavy concentration in a single market cycle. Given our view that current and near-term vintages offer attractive entry conditions, investors who have been underweight PE through the 2022–2025 period may wish to accelerate their commitment pace modestly.

Emphasize the Middle and Lower Middle Market

For most HNW investors and family offices, the bulk of PE exposure should be oriented toward the middle and lower middle market, where structural inefficiencies, operational improvement opportunities, and "sell-up" exit premiums create a compelling long-term return opportunity that does not require favorable macro conditions.

Maintain Appropriate Liquidity Reserves

Private equity is genuinely illiquid. Capital called over the first three to four years of a fund's life is not accessible for 8–12 years in typical cases. Any investor in PE must ensure that their total liquidity profile — including liquid public equities, fixed income, and cash — is sufficient to meet all anticipated and unanticipated cash flow needs without requiring forced liquidation of private market positions.

VII. Portfolio Construction Guidance

Private equity is not going through a crisis, it is going through a correction. The correction was both inevitable and necessary. An asset class that had come to rely on central bank accommodation and multiple expansion as its primary value creation engines was not generating sustainable alpha; it was generating impressive-looking returns that obscured the mediocrity of the underlying operational work.

And herein lies the opportunity: the managers who will define private equity's next chapter are those who have always known how to build better businesses; they buy well, operate with rigor, and exit strategically. They exist at every level of the market, but their highest concentration, and their clearest natural advantage, is in the middle market and lower middle market, where competition is less intense, operational opportunity is greater, and the structural exit premium of selling up the market provides a durable source of multiple expansion that does not depend on favorable macro conditions.

For investors, the message is to be far more intentional about where that exposure resides. The dispersion between great managers and average managers in private equity has always been wider than in public markets. In the current environment, that dispersion is likely to widen further.

The end of easy money is not a reason to avoid private equity. It is a reason to be far more selective about which version of it you own.

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