Private equity entry valuations decreased to 10.8x EV/EBITDA in 2023, presenting an opportunity for investors. (UBS)

It’s trick-shots to private equity, dude!

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We recommend investors include private equity within portfolios for diversification.

From trick-shots to new dreams for brand growth. Dude Perfect, the buddies from college who added their first trick-shot to YouTube in 2009 and became top influencers, announced plans to further expand their vision with the help of a "9-figure" private equity investment. This move comes at a time when private equity (PE) managers are navigating a complex landscape marked by high interest rates and a cautious approach to deal-making. Despite these challenges, the latter half of 2024 looks promising for PE, with expectations of a 13% recovery in US PE deals, according to EY-Parthenon Deal Barometer.

For investors, the addition of private equity to portfolios could enhance long-term returns, diversify sources of return, and stabilize portfolio performance. Private equity, which involves investing in private companies, has grown in popularity as more companies choose to stay private longer rather than access the public markets. This shift has led to a three-to-one ratio of private-equity-backed companies to publicly listed firms. Private equity investments offer diversification across asset class, sector, vintage, and geography, and are managed by General Partners (GPs) who raise capital from Limited Partners (LPs).

General Partners, responsible for fund management, have unlimited liability and receive a management fee and a share of profits. They actively work with portfolio companies to boost their success. LPs, on the other hand, provide capital without engaging with company management, have limited liability, and expect returns on their investments. They commit capital that is called upon over time by GPs.

Investors typically see returns when GPs sell portfolio companies, and capital is distributed back to LPs. Private market investments require long-term commitments, with investment periods often exceeding 10 years. Direct investments in private companies by individuals are possible but demand greater expertise and significant capital.

The PE market in 2023 saw private equity managers primarily focusing on operational improvements within their portfolio companies amid rising interest rates and macroeconomic uncertainty. This cautious approach led to a 30% drop-in US PE deal activity compared to 2022.

For 2024, we believe the current environment of high interest rates and expensive debt has forced managers to adjust to a new deal-making environment. Managers are prioritizing operational growth over financial engineering and multiple arbitrage, focusing on revenue and EBITDA growth, and positioning their portfolio companies to be in the best shape for exit when the window opens up again.

Private equity entry valuations decreased to 10.8x EV/EBITDA in 2023, presenting an opportunity for investors. Additionally, the private equity market is not oversaturated with cash chasing deals despite record levels of dry powder of $2.6 trillion in cash or liquid securities set aside to purchase new deals at the end of 2023. According to S&P Global Market Intelligence, this level of dry powder is below the historical average relative to assets under management.

The UBS Chief Investment Office recommends investors focus on private equity funds that have a strong operational performance record, as well as exposure to value-oriented buyouts, secondaries, or secular trends (including software, health, and climate-related solutions). Additionally, CIO's recommendations include private strategies that align with powerful long-term trends like digitalization and decarbonization (private infrastructure and thematic private equity funds).

Despite the inherent risks of alternatives, such as illiquidity, lock-ups, and high fees, they offer unique investment opportunities not available in public markets. Successful private equity managers will likely be those who can secure attractive valuations, excel in operational value creation, and leverage the secondaries market for liquidity solutions.

To read more, please refer to our report: Private markets (Quarterly private markets update).

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Non-Traditional Assets

Non-traditional asset classes are alternative investments that include hedge funds, private equity, real estate, and managed futures (collectively, alternative investments). Interests of alternative investment funds are sold only to qualified investors, and only by means of offering documents that include information about the risks, performance and expenses of alternative investment funds, and which clients are urged to read carefully before subscribing and retain. An investment in an alternative investment fund is speculative and involves significant risks. Specifically, these investments (1) are not mutual funds and are not subject to the same regulatory requirements as mutual funds; (2) may have performance that is volatile, and investors may lose all or a substantial amount of their investment; (3) may engage in leverage and other speculative investment practices that may increase the risk of investment loss; (4) are long-term, illiquid investments, there is generally no secondary market for the interests of a fund, and none is expected to develop; (5) interests of alternative investment funds typically will be illiquid and subject to restrictions on transfer; (6) may not be required to provide periodic pricing or valuation information to investors; (7) generally involve complex tax strategies and there may be delays in distributing tax information to investors; (8) are subject to high fees, including management fees and other fees and expenses, all of which will reduce profits.

Interests in alternative investment funds are not deposits or obligations of, or guaranteed or endorsed by, any bank or other insured depository institution, and are not federally insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board, or any other governmental agency. Prospective investors should understand these risks and have the financial ability and willingness to accept them for an extended period of time before making an investment in an alternative investment fund and should consider an alternative investment fund as a supplement to an overall investment program.

In addition to the risks that apply to alternative investments generally, the following are additional risks related to an investment in these strategies:

- Hedge Fund Risk: There are risks specifically associated with investing in hedge funds, which may include risks associated with investing in short sales, options, small-cap stocks, "junk bonds," derivatives, distressed securities, non-U.S. securities and illiquid investments.
- Managed Futures: There are risks specifically associated with investing in managed futures programs. For example, not all managers focus on all strategies at all times, and managed futures strategies may have material directional elements.
- Real Estate: There are risks specifically associated with investing in real estate products and real estate investment trusts. They involve risks associated with debt, adverse changes in general economic or local market conditions, changes in governmental, tax, real estate and zoning laws or regulations, risks associated with capital calls and, for some real estate products, the risks associated with the ability to qualify for favorable treatment under the federal tax laws.
- Private Equity: There are risks specifically associated with investing in private equity. Capital calls can be made on short notice, and the failure to meet capital calls can result in significant adverse consequences including, but not limited to, a total loss of investment.
- Foreign Exchange/Currency Risk: Investors in securities of issuers located outside of the United States should be aware that even for securities denominated in U.S. dollars, changes in the exchange rate between the U.S. dollar and the issuer's "home" currency can have unexpected effects on the market value and liquidity of those securities. Those securities may also be affected by other risks (such as political, economic or regulatory changes) that may not be readily known to a U.S. investor.