CADWALADER

The Times They Are A-Changin’

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Fed decision week delivered the next 75 bps ratchet up in short-term rates to 3.25% at the top end of the target range, but also an upwards revision in the **dot plot** to now show a median expectation of a 4.4% fed funds rate by year-end moving to 4.6% at the end of 2023.

As financial conditions tighten, the private market is receiving its fair share of media coverage. Regular *FFF* readers know the script: A 10% or greater sell-off in the S&P 500 triggers an alert somewhere to trot out the stories on the denominator effect and the lag in private fund valuations.

These stories are not entirely misguided: Private fund asset valuations will generally have to move lower, consistent with the public markets, and future returns may be downgraded. Too often, however, important points are often left out.

For one, seasoned vintage funds on the whole have built up significant value appreciation in recent years, and any forecasted valuation decline has to be assessed in the context of those embedded gains. (Newer vintage funds, on the other hand, have an opportunity to deploy capital at reduced prices.)

Also, the lag in private fund valuations serves as a ballast in performance in investors’ portfolios when public market volatility ticks up. The private fund structure is intentionally designed to facilitate and reward long-term decision making, which is why immediate recognition of high-frequency price changes may not be desirable.

With that editorial, here’s a round-up of notable reports that caught our attention in recent days:

- Bloomberg: ***Buyout Firms in Denial About Valuations, Tikehau Co-Founder Says***
  Buyout funds need to face the reality of lower valuations, according to comments made by Mathieu Chabran, co-founder of the €36.8bn AUM private fund manager Tikehau Capital SCA. Trends that dominated over the past few years − lower interest rates, multiple expansion, and cheap funding − are reversing and will show up in forward returns, according to Chabran.
- FT: ***Private Equity May Become a ‘Pyramid Scheme’, Warns Danish Pension Fund***
  Mikkel Svenstrup, Chief Investment officer at Denmark’s largest pension fund, ATP, raised concerns about the reported 80% share of portfolio company sales that traded to other buyout or continuation funds in ATP’s portfolio. The implication, according to Svenstrup’s comments, will be lower forward returns.
- Bloomberg: ***Private Equity Fees at Risk as Continuation Funds Lose Luster***
  Investor interest in continuation funds is evaporating, according to a Bloomberg article citing data from private markets advisory firm Campbell Lutyens & Co. Lagging valuation markdowns is driving the lackluster interest from investors. According to Campbell Lutyens, continuation fund closings in the first half totaled $19 billion, down 32% from a year earlier. Funds in the market haven’t declined meaningfully, but overall secondaries closings are hitting a pause. Short due diligence timelines for continuation funds, in the context of valuation uncertainty, may also be playing a role.
- WSJ: ***Citrix Debt Deal Prices With Large Losses for Banks***
  The $4.0 billion secured bond component of the Citrix Systems Inc. debt package cleared this week at a steep

discount, with the $4.1 billion loan component also selling at a significant discount. The transaction is emblematic of the changing environment in which levfin financing will become more costly and less available.