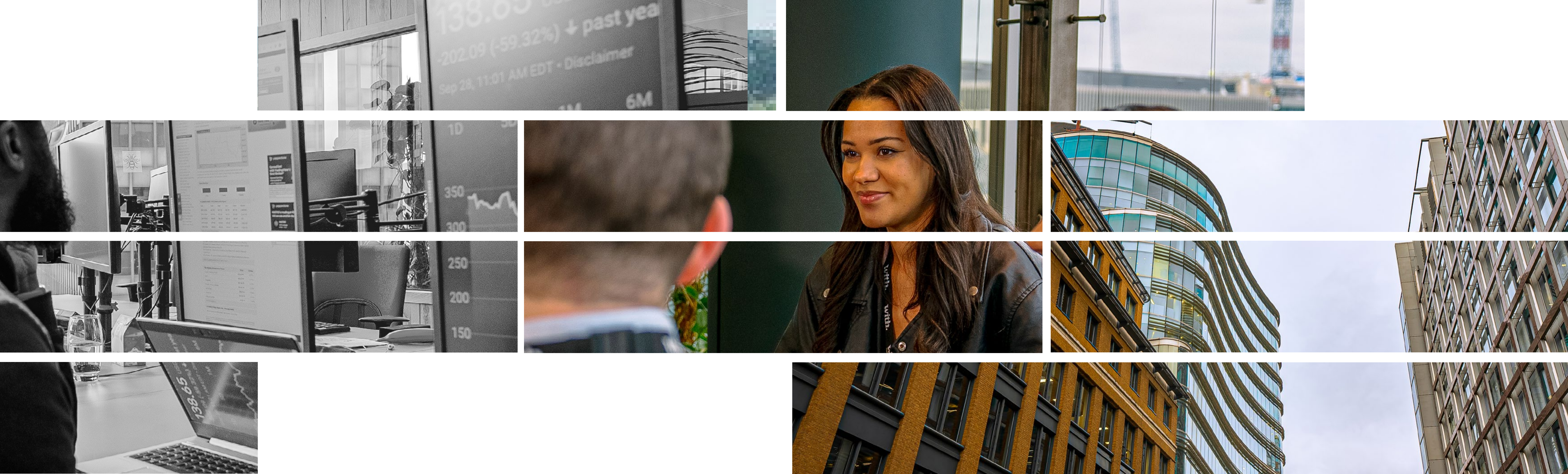
Private Markets Outlook 2025

PARTNERS GROUP

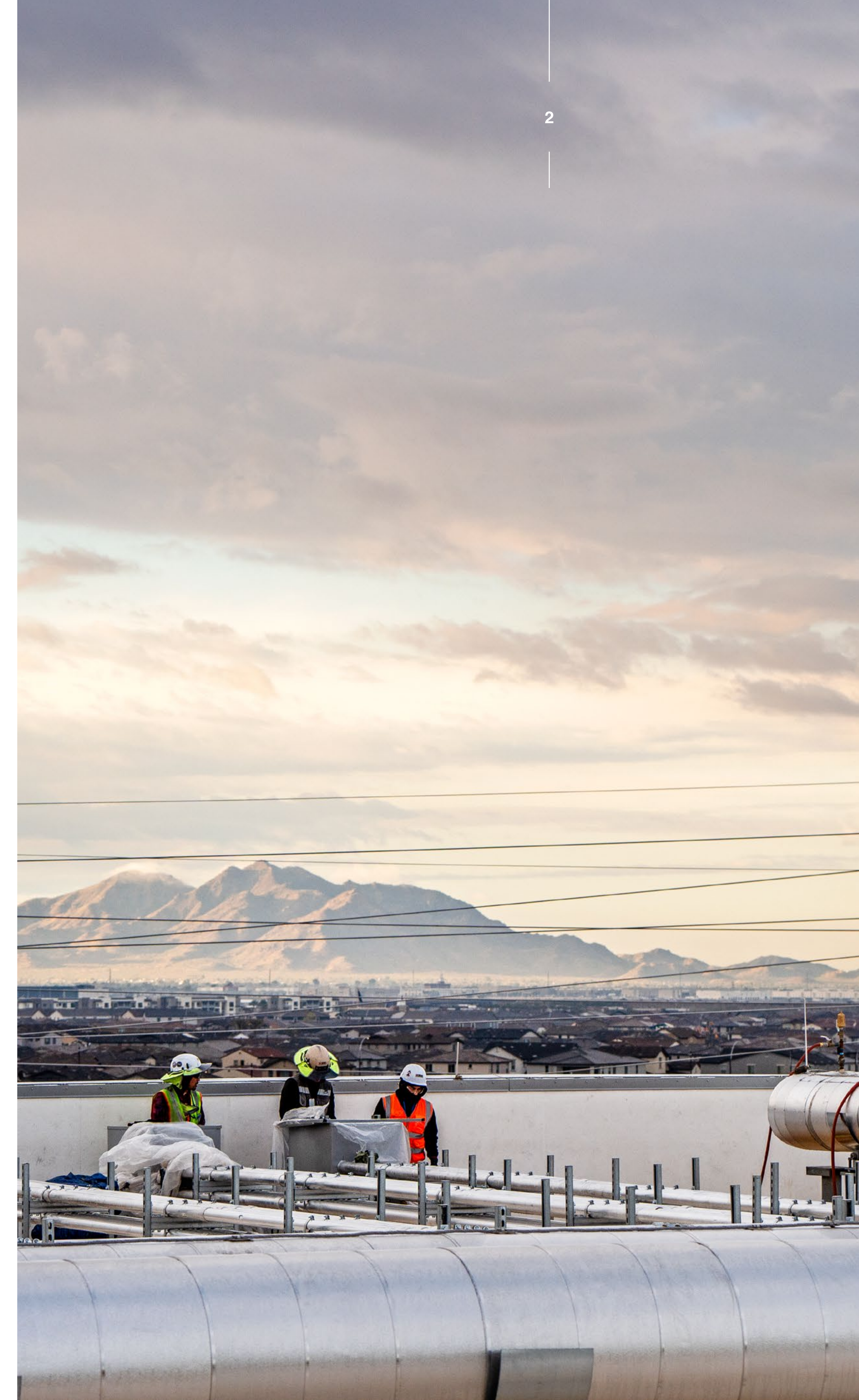
Building value in a 'brave new world'



Executive summary

- **Financial markets have entered an era of macroeconomic volatility and uncertainty. In this 'brave new world,' we emphasize the importance of value creation through asset transformation[1] and identifying themes supported by long-term secular trends.**
- **We expect major central banks to continue easing interest rates, but not to pre-COVID lows. In our view, the Fed is likely to implement four to five cuts in 2025, potentially reaching 2.5% over the next five years, while the ECB could reach 1-1.5% by end-2029.**
- **Private equity buyouts are poised to benefit from lower interest rates, as improved leverage conditions could spur transaction activity. However, the full impact on investment dynamics may take time to unfold.**
- **Despite the recent rate cuts, we expect private credit to deliver high single-digit returns, as base rates are unlikely to return to the post-global financial crisis lows. Lower borrowing costs may also result in more opportunities, particularly in the mid-market.**
- **In infrastructure, understanding the impact of volatile geopolitics is crucial. For instance, the underwriting processes in our decarbonization theme incorporate energy security and affordability, addressing a wider range of factors beyond carbon emissions.**
- **In real estate, property values appear to be stabilizing, except in offices. To navigate a prolonged high-interest-rate environment, we emphasize value creation and vertical depth in high-conviction sectors.**
- **Royalties – the new asset class in our platform – aim to offer portfolio diversification[2] and stability, with long-term capital preservation and upside potential[3]. Structured to withstand cost inflation, royalty investments tend to see revenues increase in tandem with inflation.**

1 The term 'transformation' may be conceptual and change over time. The concept of 'asset transformation' is subject to different interpretations and may vary differently. 2 Diversification does not ensure a profit or protect against loss.
3 There is currently no PG royalties fund offering in the US.



Introduction

Financial markets are adjusting to a new era defined by macroeconomic volatility and elevated uncertainty. We call it the 'brave new world'. In this new regime, investors can no longer solely rely on high levels of real growth or low interest rates to drive returns. For private markets, this shift emphasizes the importance of value creation through asset transformation[4] and identifying investment themes supported by long-term secular trends. In this paper, we examine the factors influencing our perspective on the evolving macroeconomic landscape and individual asset classes, which inform our relative value investment strategy in this 'brave new world'.

Our views on the economy

A 'brave new world' shaped by macrovolatility and regional differences

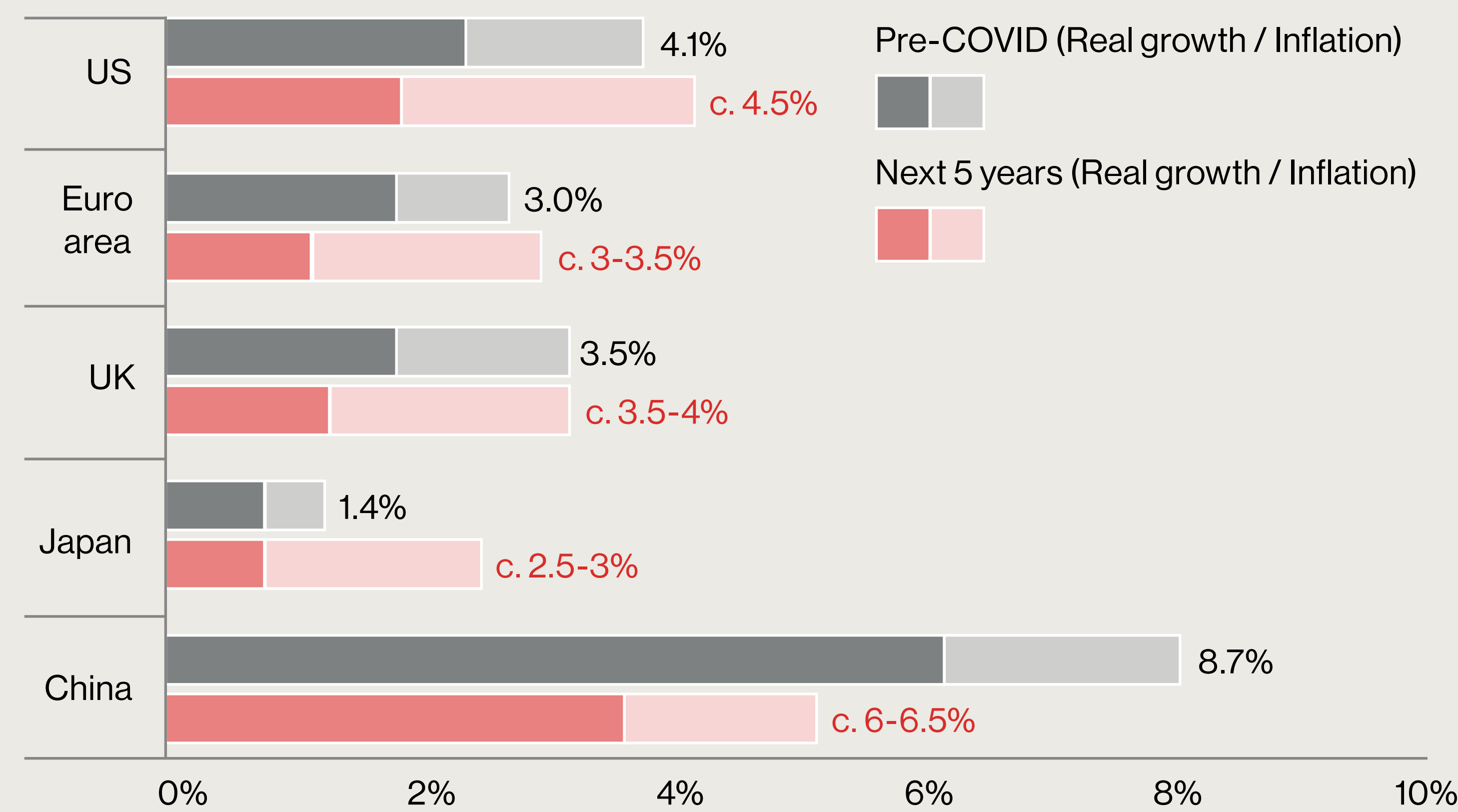
Our outlook for the next five years is characterized by macroeconomic volatility in a world of elevated uncertainty. With the exception of China, we expect slightly higher nominal growth across key economies compared to the pre-COVID period, driven by elevated inflation, which is likely to translate into a higher interest rates environment. Disinflation has made good progress over the last two years, but vulnerability remains with inflation risk not over. This is particularly evident in the US following the decisive victory of president-elect Donald Trump, who could bring in policies such as higher tariffs and stringent immigration controls, but also across key developed markets, due to tight labor markets and supply chain fragilities. Politics are also increasingly polarized and will further add to macroeconomic volatility. On the fiscal side, public debt loads are at very high levels, raising concerns over the sustainability of public finances, which may hinder fiscal support during future downturns.

This 'brave new world' will likely also be defined by regional differences. For example, while structural forces such as ageing demographics are expected to dampen growth across major economies, the adoption of AI technologies is likely to benefit the US significantly more. Europe, in turn, has fallen behind on technology development and is burdened by over-regulation – a clear contrast to the US, where Trump has been vocal about pushing for deregulation.

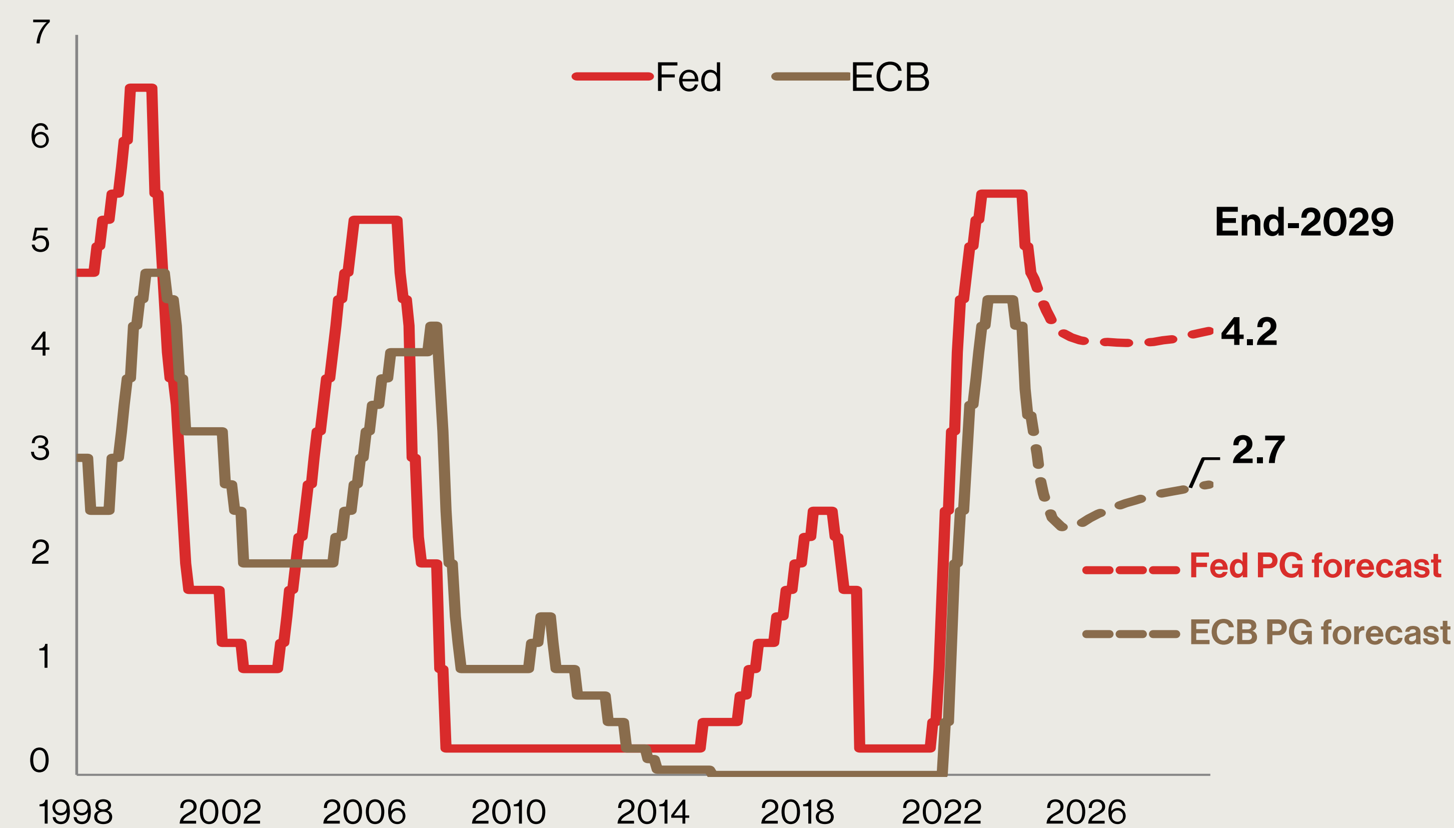
China should continue to outperform other major economies, but factors such as rising debt, shifting demographics, diminished opportunities for productivity gains, and the potentially adverse effects of tariffs are expected to put the country's growth on a slower trajectory.

Moderate real growth and no return to zero-rates

GDP growth broken into real growth and inflation



Historical and forward pricing for central bank rates (%)



For illustrative purposes only. Actual figures and events may differ and may vary significantly. Pre-COVID era is 2014-2019 to allow for more comparable data across the US and euro area for instance to exclude the sovereign debt crisis period that affected Europe. Nominal GDP growth is computed as the sum of real GDP growth rates and headline CPI inflation, for the respective period. The Fed fund rate is the upper bound and the ECB rate is the one on refinancing operations.
Sources: Partners Group, Bloomberg (11 Nov 2024), IMF (Oct 2024 WEO).

The implications for private markets

We believe investors can no longer count on real growth, nor on record low interest rates. The emphasis must be on what we build and on deploying capital behind investments that stand to benefit from long-term secular themes.

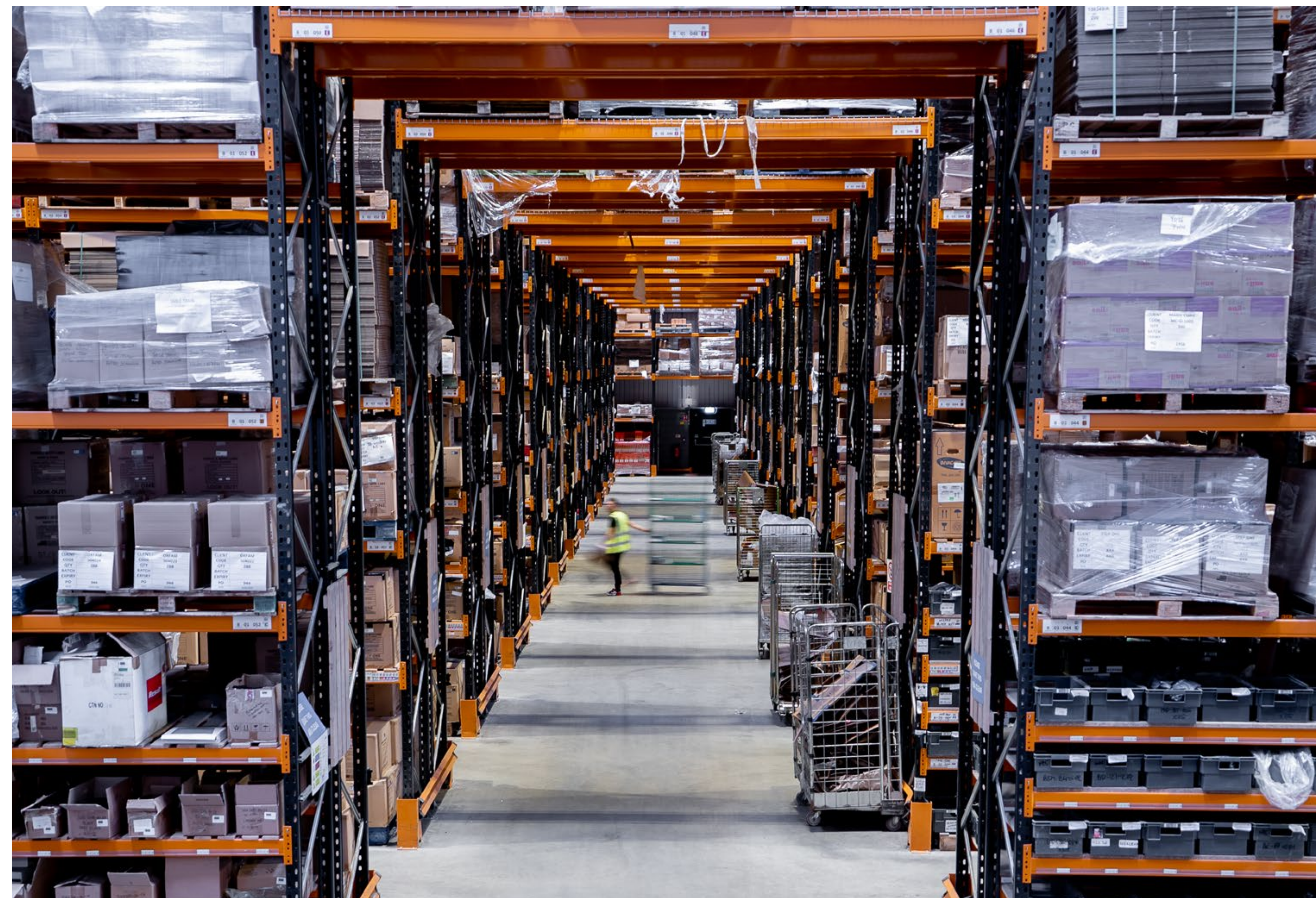
The rising political polarization is likely to drive regulatory changes and shift fiscal priorities. As such, we closely monitor regulatory developments and are watchful of the reliance on governments' agendas when considering prospective investments.

We also emphasize the importance of our asset testing approach, which incorporates alternative macroeconomic scenarios during the underwriting of prospective investments. Although the likelihood of runaway inflation reminiscent of the 1970s stagflation era has significantly decreased since last year, we remain cautious about potential supply shocks that could de-anchor inflation expectations and trigger a self-fulfilling cycle.

4 The term 'transformation' may be conceptual and change over time. The concept of 'asset transformation' is subject to different interpretations and may vary differently.

Moderate growth likely to prompt more rate cuts, but inflationary risk remains

Our near-term outlook for 2025 is that the US economy will moderate as household consumption slows. This slowdown should support further inflation moderation and therefore allow the Fed to continue gradually easing in 25bps increments. We forecast four to five cuts in 2025 and see the Fed rate at 2.5% in five years' time. This view is substantially lower than what markets are currently pricing (c. 4%). Risks to our Fed forecast are to the upside as we view policies from the incoming US administration as potentially inflationary (e.g. strict immigration control affecting labor supply and higher tariffs). In Europe, sluggish growth has allowed for faster moderation of price increases, with headline inflation already close to the 2% target in recent readings. Coupled with our view that growth will only gradually recover, this should allow the European Central Bank to implement a series of cuts, potentially five reductions of 25bps in 2025, resulting in a rate in the range of 1-1.5% by end-2029. As a result, we now anticipate lower cycle lows in this upcoming cycle than we had expected.



Uncertainty remains as we expect to navigate more volatility

		Base Case (Probability 55-60%)	Recession (Probability 30%)	Productivity boom (Probability 10%)	Stagflation (Probability 5%)
Characteristics		- Normalizing growth[3] (continued US outperformance vs Europe) - Continued (gradual) inflation moderation[4] - Continued gradual monetary policy easing	- Still tight monetary policy chokes the economy[6] - Demand destruction helps alleviate inflation faster - Abrupt tightening of financial conditions leads to surge in defaults[7]	- Technology enables productivity boom and drives investments - Strong growth puts a floor to inflation (contained; no spike) - Central banks save 'fire power' by leaving rates higher[8]	- Supply shocks[9] leading to a de-anchoring of inflation expectations - Inadequate monetary policy tools[10] - Stagnating (real) economic activity[11]
Key forecasts 5-year average unless otherwise specified	Real growth[1]	c. 2% US: c. 2% EU: 1-1.5%	c. 1.5%	2.5-3%	c. 1%
	Inflation[1]	c. 2.5% US: c. 2.5% EU: c. 2%	c. 2%	c. 2.5%	c. 3-4%
	Policy rate	Fed: c. 2.5% (in 5 years) (5y average: c. 3%) ECB: c. 1-1.5% (in 5 years) (5y average: c. 1.5%)	Fed: c. 1.5% (in 5 years) (5y average: c. 2%)	Fed: c. 3-3.5% (in 5 years) (5y average: c. 3.5%)	Fed: c. 4% (in 5 years) (5y average: c. 4.5%)
	Market valuation[2]	0-5% higher[5] (over 5 years)	c. 5% lower (over 5 years)	10-15% higher (over 5 years)	c. 20% lower (over 5 years)

The actual development of each scenario depends on many factors and may differ significantly. For illustrative purposes only. 1 NAV-weighted as per Partners Group's asset split across US, Europe, other advanced and emerging markets. 2 Market valuations refer to price-to-earnings ratios for public equities, enterprise value to earnings before interest, tax, depreciation and amortization for private equity, capitalization rates for private real estate and underwriting internal rate of return for private infrastructure. 3 Lower growth in the US vs 2023 over the forecast horizon, however, for Europe growth gradually recovers. Nonetheless, growth is expected to continue its structural decline. 4 Until a higher long-run inflation rate is reached (structural factors). 5 Supportive macro backdrop is expected to support valuations. 6 Emerges in the US with global spillovers. Fed maintains monetary policy too tight for too long which leads to a demand shock. 7 We may also see financial instability. 8 Stronger potential growth and higher price pressures versus the base case gives central banks comfort to leave interest rates somewhat higher but financial conditions remain relatively benign. 9 Geopolitical tensions would likely be the trigger. 10 Central banks respond by tightening monetary policy, however, they may do so too late or too little or may simply not have the necessary tools to address price pressures that emerge from supply issues. 11 Customers purchasing power gets eroded by inflation while corporates remain cautious with capex given the rising interest rate backdrop. Source: Partners Group (September 2024).

We emphasize the importance of our asset testing approach, which incorporates alternative macro scenarios during the underwriting of prospective investments.

Our views on private equity

Lower interest rates support pick up in exits, while reduced discounts in secondaries may benefit GP-leds

The reduction in interest rates should provide relief to the private equity industry, especially in the buyout space, where there is more reliance on leverage. This interest rate cutting cycle also comes at a time of robust economic activity (especially in the US), even though some moderation is anticipated. Corporate fundamentals are thus expected to remain healthy, and lower interest rate expectations are likely to enhance the overall outlook. We note, however, that it will take time for the full effect of lower rates to materialize within the buyout space. Entry multiples are slightly higher than average 2023 levels, but still below valuations from the pandemic-era when interest rates were at record lows. Therefore, while the gap between sellers' and buyers' valuation expectations is starting to narrow, it remains present.

In the secondaries market, the early signs of recovery in exit activity, combined with lower interest rates, has driven a contraction in discounts. However, recent earnings calls of publicly traded private equity firms indicate an intention to prioritize acquiring new portfolio companies before selling off existing ones. This trend may benefit GP-led secondaries strategies such as continuation funds, as sponsors leverage these vehicles to generate liquidity and hold quality assets for longer. Therefore, while we continue to see attractive opportunities, selectivity within the secondaries market is increasingly important. In addition to interest rates, political uncertainty has also weighed on the exit environment. However, we are beginning to see signs of recovery in the IPO market and the incoming Trump administration may create a more favorable climate for mergers and acquisitions.

Disciplined underwriting and focus on margin resilience amid uncertain scenario

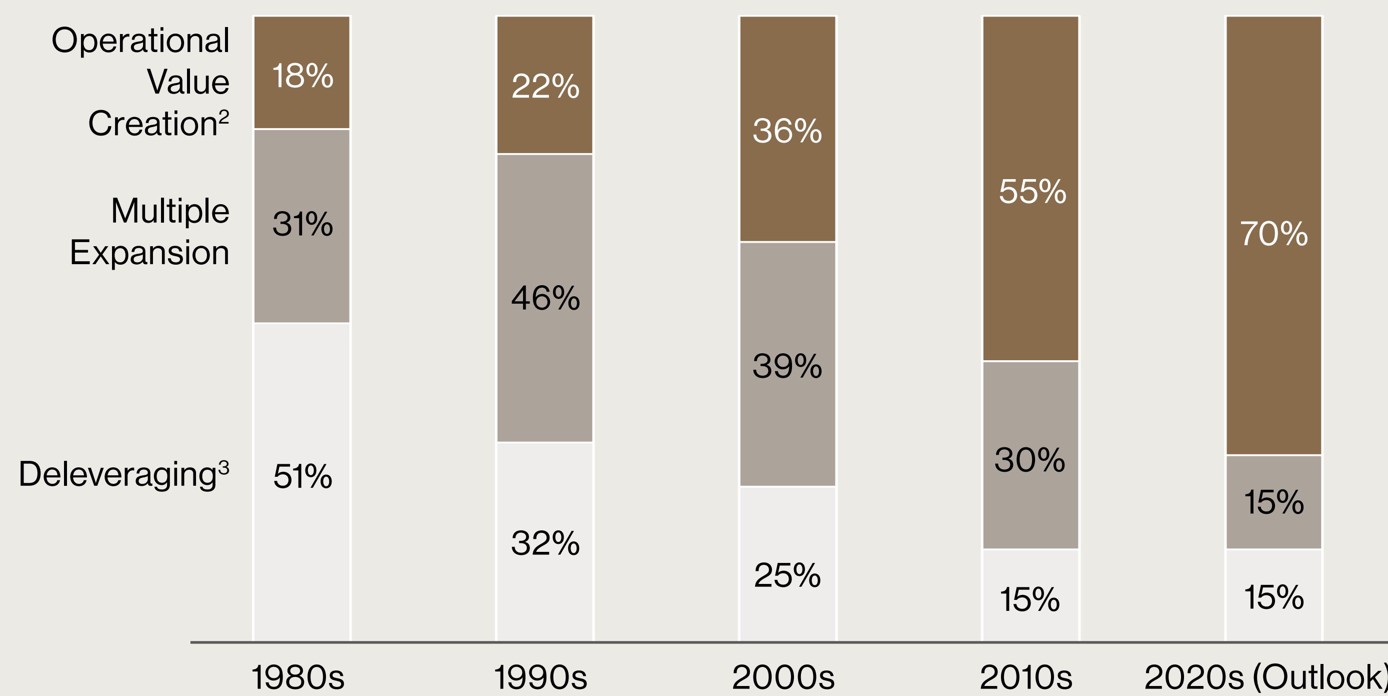
The 'brave new world' is synonymous with uncertainty and volatility. Therefore, while we are constructive about the near-term recovery in private equity activity and valuations, the longer-term outlook will present challenges. We anticipate navigating an investment landscape characterized by inflation and interest rate volatility, which will lead to fluctuations in valuations and cash flows. This situation reinforces the need for disciplined underwriting, with a careful approach to leverage as well as a focus on margin resilience. This anticipated volatility also highlights the value of having an investment platform with a diverse offering, as this provides flexibility to deploy across the various private equity segments according to evolving relative value attractiveness.

The long-term outlook is also shaped by structural challenges and a growing embrace of technology, a trend we have been anticipating for several years. A good example is our investment in Emeria, a property management services provider based in France, where digitization has been a central strategic priority. Emeria has successfully transitioned from a paper-based operation to a digital platform, resulting in substantial improvements in EBITDA margins. More broadly, we proactively integrate technologies like AI across our portfolio companies. This approach not only enhances operational productivity but also ensures margin resilience in an increasingly competitive landscape.

The long-term outlook is also shaped by structural challenges and a growing embrace of technology.

Focus on transformation potential

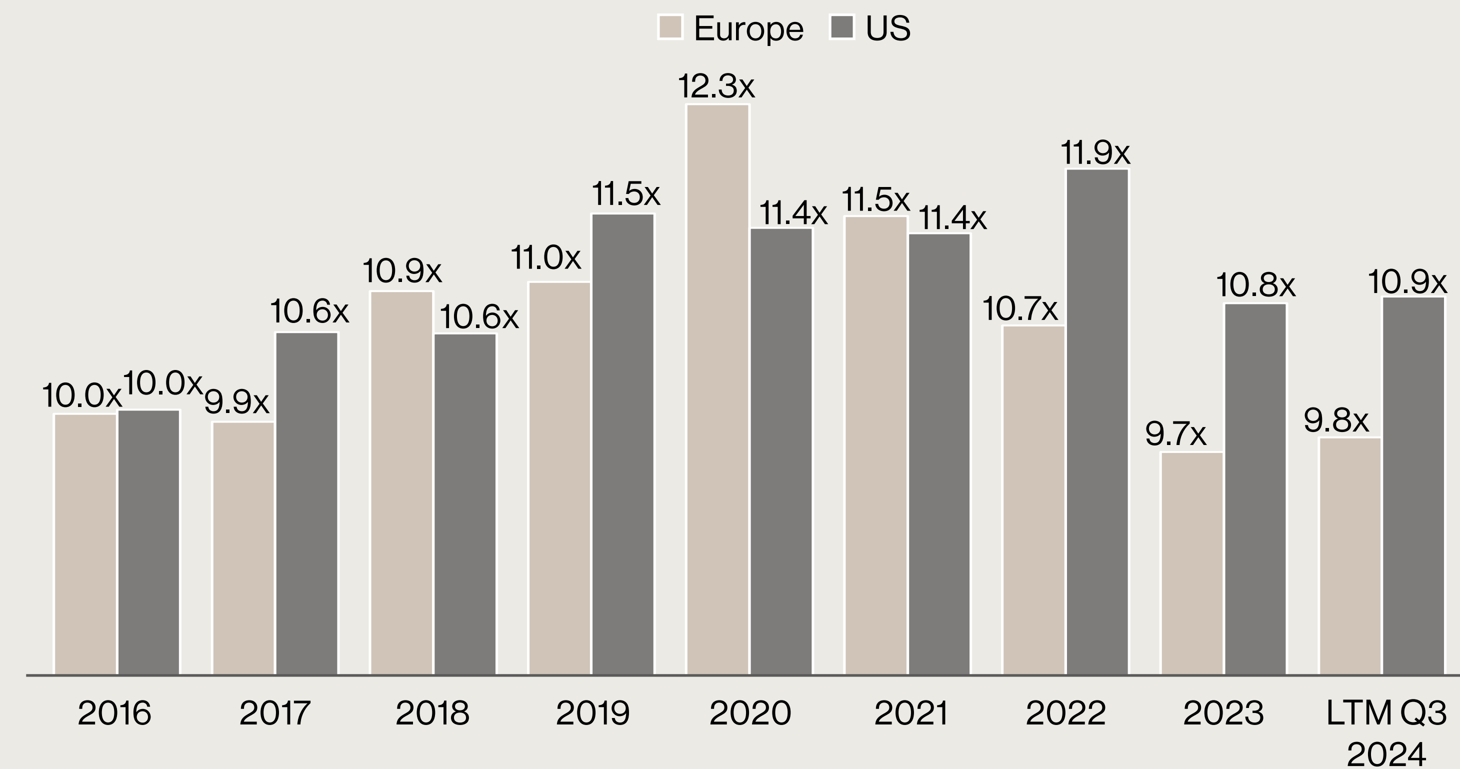
Evolution of private equity return contributors[1]



Past performance is not indicative of future results. For illustrative purposes only. There is no assurance that similar results will be achieved or that similar investments will be made. The term 'transformational' may be conceptual and change over time. The concept of 'transformation potential' is subject to different interpretations and may vary. 1 Source: Goldman Sachs, Pitchbook, BCG analysis (2021), Partners Group (2020s outlook). 2. Operational Value Creation measured by sales growth and change in EBITDA margin. 3 Adjusted for payouts during the holding period. Source: Partners Group (2024).

Valuations are slowly recovering

Private equity buyout entry valuations



Notes: average purchase price multiple of pro forma trailing EBITDA. Excludes platform acquisitions and other sponsored driven transactions. For illustrative purposes only. Past performance is not indicative of future results. There is no assurance that similar investments will be made or that the investment will be successful. Source: Partners Group (2024), Pitchbook (October 2024).

Our views on private credit

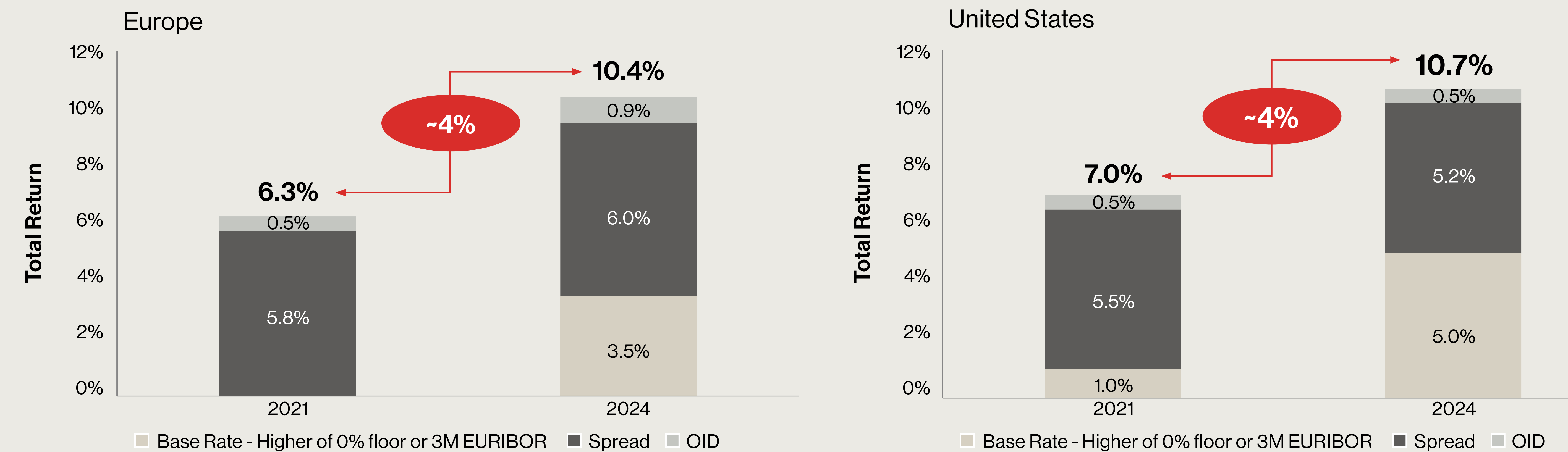
Relatively high base rates ensure private credit's appeal, while recent cuts provide tailwinds for the mid-market

Despite the recent cuts, base rates are still relatively high compared to just a few years ago, and we anticipate that they will remain elevated compared to the pre-COVID cycle. As a result, private credit investments are expected to continue to generate high single-digit returns overall. At the same time, rate cuts could also create some tailwinds for the asset class. Lower borrowing costs will have a positive impact especially on the mid-market, allowing businesses to take on more leverage. This positions private credit lenders more favorably compared to traditional lending banks, which are often limited in their ability to support high leverage. Additionally, lower rates can stimulate buyout transactions and create more opportunities for lenders.

Rightsizing debt packages and legal terms even more crucial amid changing investment landscape

The changing investment environment requires a more disciplined approach to underwriting, especially as some market participants feel certain deployment pressure. Partners Group emphasizes the importance of modelling realistic forecasts that consider potential downside scenarios and their impact on businesses' ability to support a proposed credit package. For us, this prudent approach includes establishing appropriate protections not only in rightsizing debt packages but also in setting the appropriate legal terms in a lending transaction.

Direct lending can offer attractive investment potential



Source: Partners Group (2024). Original issue discounts (OIDs) are amortized over a 3-year period. For illustrative purposes only.

In terms of focus areas, we continue to prioritize businesses with recurring revenues, long-standing customer relationships, attractive profitability, and solid cash generation. In Europe, we leverage existing expertise we bring in sectors such as IT & software, logistics, semi-conductors, and manufacturing.

In the US, software businesses are also favored, but such assets are typically larger and lenders often act in a club setup, due to the market's depth and maturity. Overall, we believe that early conviction and the ability to leverage our existing industry knowledge are crucial, particularly in a bifurcated market where lower quality assets tend to struggle for attention but good businesses face intense competition.

Our views on infrastructure

A multi-faceted approach to decarbonization and staying ahead in digitization trends

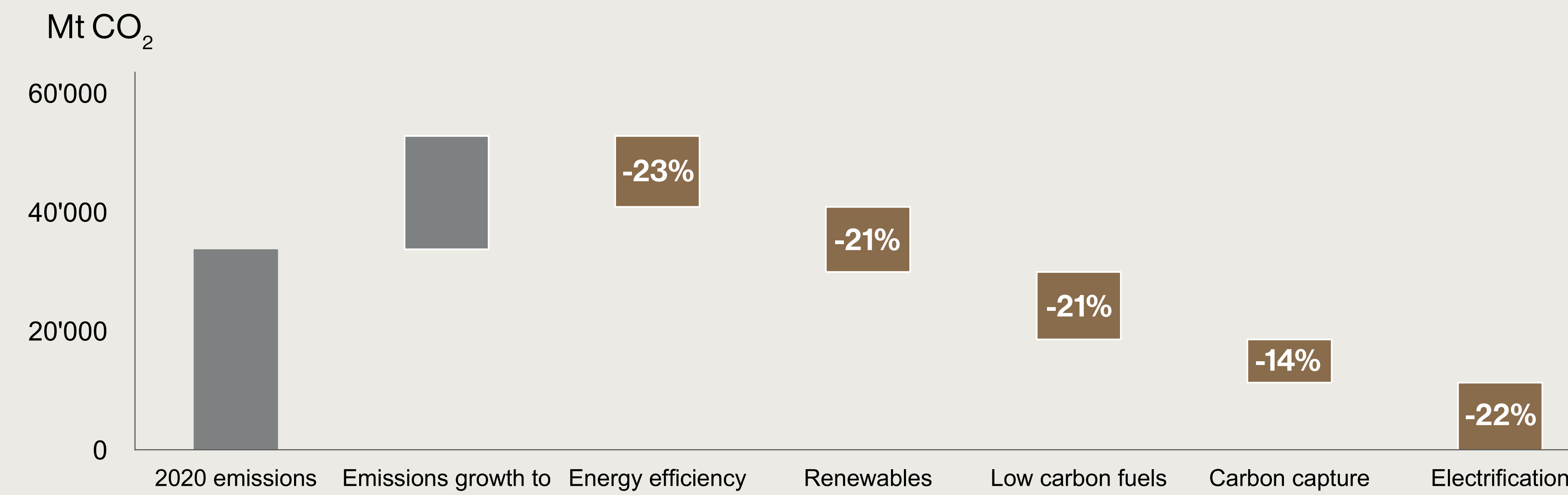
Our infrastructure strategy revolves around key themes such as decarbonization and digitization. For decarbonization, we recognize that there is no single solution to this global challenge. Therefore, we employ a multi-faceted approach that includes investing in companies focused on enhancing energy efficiency, supporting the transition from fossil fuels to renewable energy or sustainable fuel sources, implementing effective carbon capture technologies, and advancing electrification through innovations like heat pumps.

In digitization, Partners Group has been at the forefront of identifying and capitalizing on the rapid growth in cloud computing and data centers. We predict that the generative AI market will expand at a staggering 42% CAGR over the next decade, potentially reaching USD 1.3 trillion by 2032. Currently, the US accounts for 50% of global data center capacity, despite representing only 4% of the global population, suggesting that a significant rebalancing toward the Asia-Pacific region is likely to unfold over the next ten years.

It is crucial that new investments are economically viable even in the absence of strong decarbonization incentives.

We believe multiple solutions are required to reach net-zero

Share of CO_2 abatement

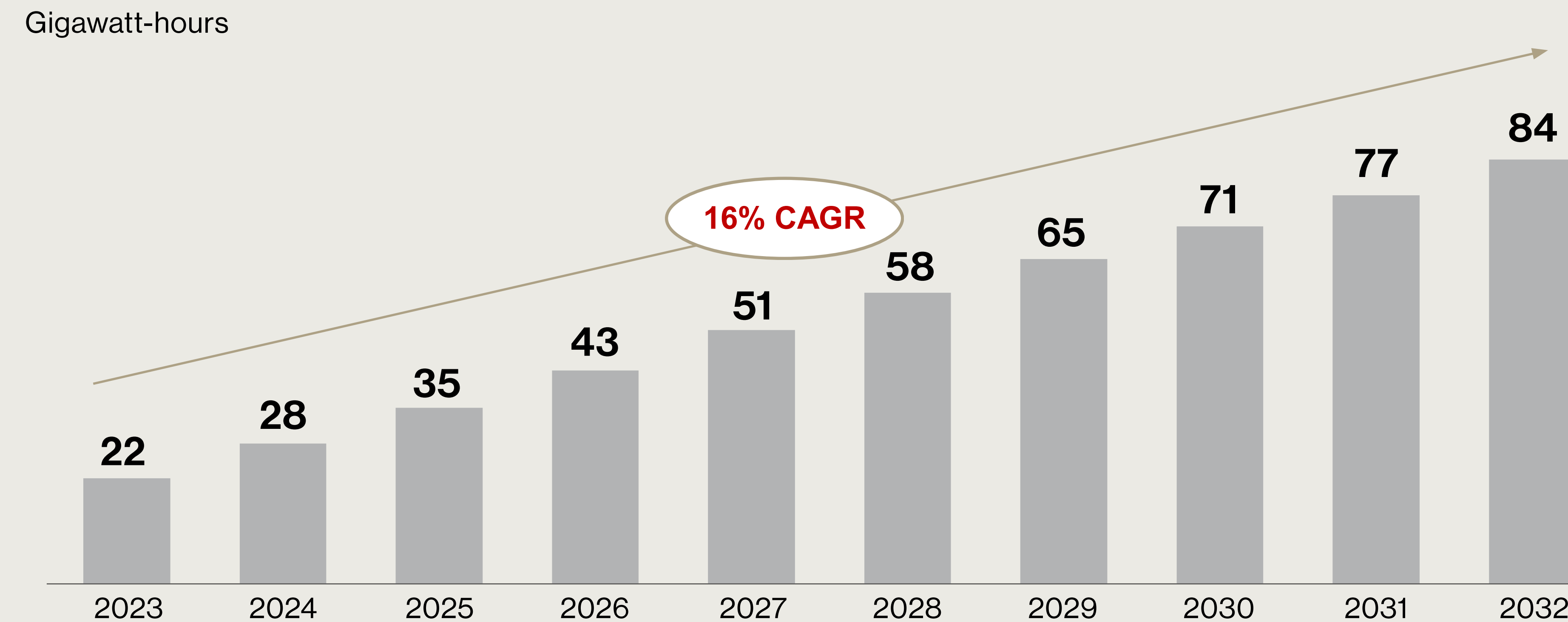


Sources: Partners Group (2024), IEA (2021), Net-zero by 2050.

We believe cloud computing and rising AI demand require unprecedented data center capacity growth

Cumulative global data center deployment by the four largest tech companies

Gigawatt-hours



Source: Partners Group (September 2024), EY-Parthenon (2023). Includes demand from Microsoft, Google, Amazon, and Meta.

Additionally, we see the infrastructure secondaries market at an inflection point, with transaction volumes expected to increase three to five times by 2030. This growth is fueled by rising infrastructure assets under management and a broader acceptance of secondaries. The mid-market is the segment we believe presents the most compelling opportunities within secondaries, offering larger transaction volumes and less competition.

Net-zero targets remain prominent but are increasingly tempered by energy security and affordability concerns

We recognize that the increasingly volatile geopolitical environment carries implications for the infrastructure market. While we anticipate regulatory support for energy transition and energy security to remain strong, the current context introduces some nuances. Net-zero targets continue to be prominent, but they are increasingly tempered by concerns regarding energy security and affordability. As a result, investors focused on decarbonization infrastructure must broaden their investment criteria beyond greenhouse gas emissions reduction, taking geopolitical factors into account during the underwriting process.

When evaluating new investments, it is crucial that they are economically viable even in the absence of strong decarbonization incentives. This means scrutinizing aspects such as affordability and the security of supply. Our investment in Gren, a European district heating company, is a good example. The company provides the lowest cost of heat, sourced from local resources, which minimizes the reliance on imports. At the same time, it contributes to the decarbonization agenda by enhancing heating efficiency and using low-carbon fuels.

Our views on real estate

Greater emphasis on operational intensity, thematic sourcing and vertical depth

With interest rates expected to remain higher in this cycle than the pre-COVID experience, value creation needs to underpin returns as rent collection will not suffice. In addition to the need to deliver value creation, investors are also having to adjust to an industry that is evolving to become more operationally intensive to meet occupiers' changing needs and adapt to shorter lease contracts prevalent in the market.

In practical terms, this shift puts a greater emphasis on the importance of conducting thematic research to identify long-term secular trends, such as ageing demographics, supply chain disruption, and housing affordability.

It is also crucial to develop a deep understanding of local markets and employ on-the-ground management teams to deliver vertical depth and navigate the operational intensity of the market effectively.

Additionally, disruption in the occupier markets is creating significant bifurcation between sectors. The office sector, for instance, continues to face headwinds from factors such as remote working and AI. At the same time, the living and logistics spaces are benefiting from generally muted supply and robust demand underpinned by strong secular drivers.

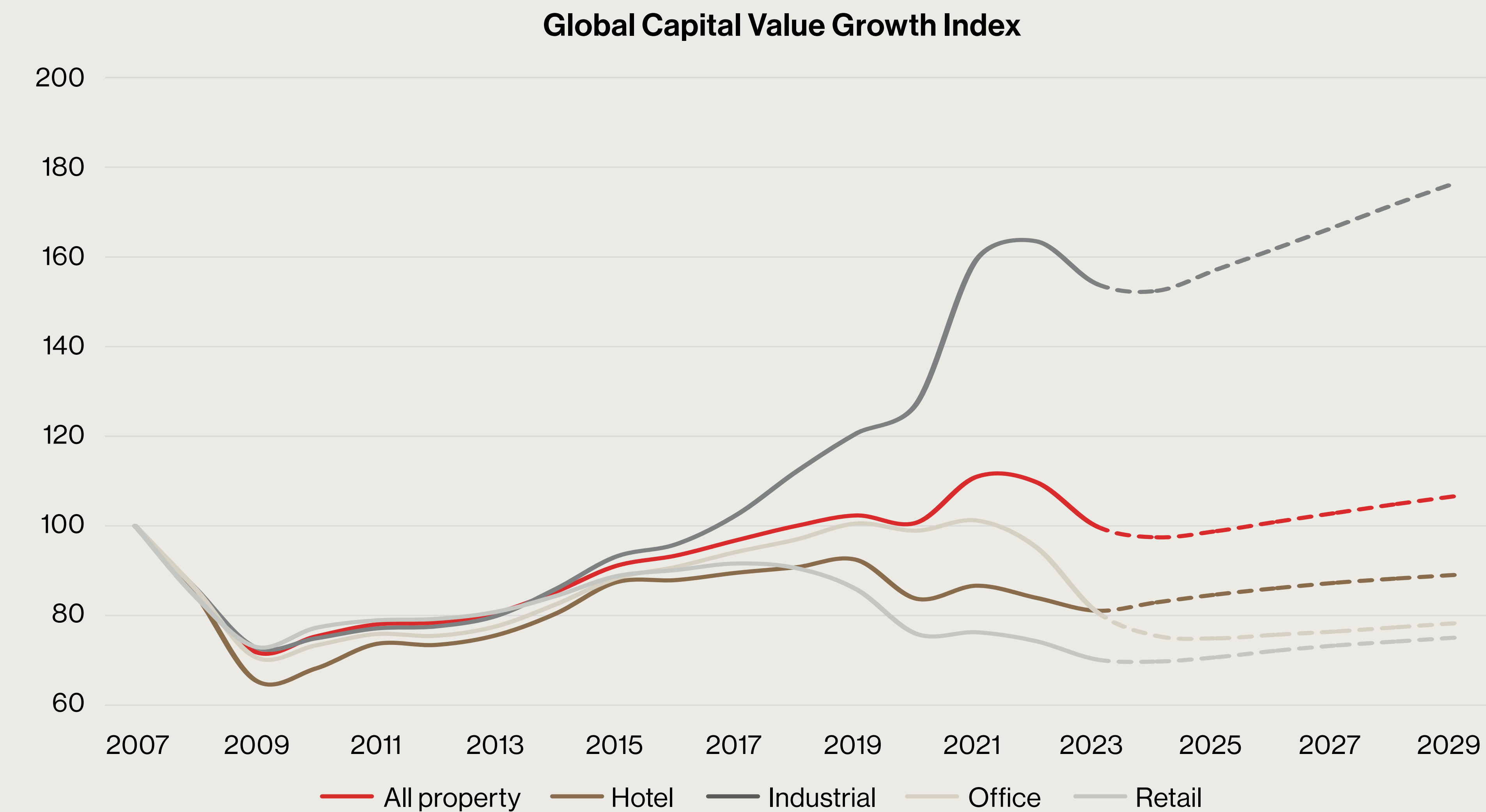
Strong pipeline of opportunities, with attractive vintage years expected to arise

The significant decline in 5-year swap rates – a key benchmark for real estate in both the US and Europe – is a strong indication that the recent interest rate cuts are providing support for real estate strategies. Such rate reductions are anticipated to lead to lower cap rates and discount rates within valuations. Recent market data, particularly regarding real estate investment trusts (REITs), suggests that property values have stabilized, although the office sector remains the notable exception.

Given the current market conditions and as the real estate sector approaches a turning point, 2024 and 2025 are anticipated to be attractive vintage years, especially in our high conviction themes. We see a strong pipeline of both direct and secondary opportunities, and irrespective of the investment type, our focus remains on thematic research and vertical depth in order to navigate the investment landscape.

We believe we are transitioning to a more favorable phrase in the real estate cycle

Property prices started to recover in 2024 selected sectors, with the exception of offices



Actual figures and events may differ and may vary significantly. There is no assurance that the above stated investment strategy will materialize. Source: MSCI Global Quarterly Property Capital Value Index, Oxford Economics forecasts (as of October 2024), Partners Group. For illustrative purposes only.

Our views on royalties

Partners Group's approach and the benefits of an allocation to royalties

Our team has been implementing this strategy for several years now and has observed that royalties serve as both a portfolio diversifier and stabilizer, while generating attractive returns with a focus on long-term capital preservation and growth. Firstly, royalties provide access to predictable and attractive income streams, and exposure to high-growth sectors.

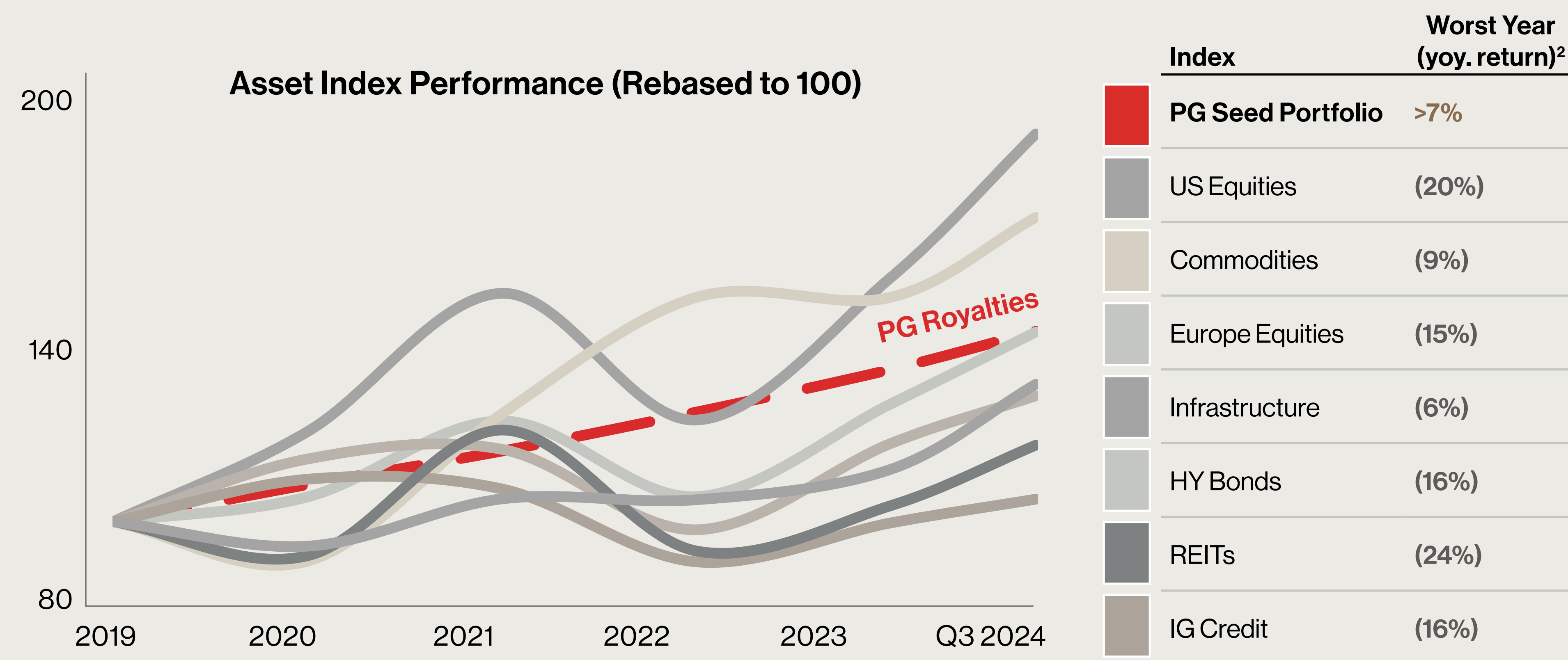
Additionally, the strategy can enhance portfolio diversification due to its low correlation with traditional asset classes, such as public markets and other strategies within private markets.

Typically, we see two common misconceptions about royalties: that they constitute a small market, and that they are merely a niche strategy, limited to just one or two sectors. However, Partners Group's approach demonstrates otherwise. We view royalties as a burgeoning asset class with an estimated market size of USD 2 trillion and considerable growth potential. Moreover, as relative value and thematic investors, we employ a cross-sector approach, which allows us to explore a broad opportunity set. This means we can focus on the top 5% of royalties globally while applying a relative value framework.

It is also important to highlight that, as a leader in evergreen funds, we can use these perpetual structures to align the lifetime of our investments with the typically long duration of royalty assets. This enables us to underwrite assets on a hold-for-life basis, allowing us to achieve our base case returns without depending on an exit. While we can capitalize on exits, they are not incorporated into our fund-level return targets and, therefore, can potentially provide an upside for our investors.

Royalties have the potential to deliver consistent returns with downside mitigation

Performance relative to other asset classes[1]



Index	Worst Year (yoy. return)[2]
PG Seed Portfolio	>7%
US Equities	(20%)
Commodities	(9%)
Europe Equities	(15%)
Infrastructure	(6%)
HY Bonds	(16%)
REITs	(24%)
IG Credit	(16%)

Source: Partners Group (2024). Past performance is not indicative of future results. For illustrative purposes only. There is no assurance that similar results will be achieved. There is currently no Partners Group royalties fund offering in the US. 1 Royalties reflects the annualized track record of the team investing at PG3 AG since inception in Q4 2020 until 30 September 2024. The data for the other indices has been sourced from BlackRock Investment Institute (accessed 11 November 2024) and reflects returns until 30 September 2024. Index returns total returns (income or dividends reinvested) in US dollars. Indexes or prices used: US Equities (MSCI USA Index), Commodities (Commodity Research Bureau (CRB) Index), Europe Equities (MSCI Europe Index), Infrastructure (S&P Global Infrastructure Index), HY Bonds (Bloomberg Barclays Global High Yield Index), REITs (S&P Global Real Estate Investment Trust Index), IG Credit (Barclays Global Corporate Credit Index). 2. Reflects worst performing year for each index over the last 5 years (on an annualized basis).

Effective mitigation for an inflationary environment and upside potential

We believe our approach to royalties positions us advantageously in an environment of volatile inflation. First and foremost, our royalty investments focus on the revenue side, effectively insulating us from cost inflation. This allows us to maintain our profit margins without being squeezed. Additionally, in the context of inflation, we typically observe increases in the prices of the underlying products or services that generate these royalties. While we do not view royalties as a direct hedge against inflation, we anticipate that our revenues will rise in tandem with inflationary pressures, which provides a level of inflation protection. However, it is also worth emphasizing that we do not incorporate inflation assumptions into our underwriting processes. This means that any inflationary developments can represent an upside for our investments, further enhancing our potential returns.

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Partners Group is one of the largest firms in the global private markets industry, with around 1'800 professionals and approximately USD 150 billion in assets under management (inclusive of all Partners Group affiliates). The firm has investment programs and custom mandates spanning private equity, private credit, infrastructure, real estate, and royalties. With its heritage in Switzerland and its primary presence in the Americas in Colorado, Partners Group is built differently from the rest of the industry. The firm leverages its differentiated culture and its operationally oriented approach to identify attractive investment themes and to build businesses and assets into market leaders.

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