10 ways private capital can banish its Nemesis in 2025

*As the year draws to a close **James Gow**, Group Managing Director, Markets, assesses the current challenges private capital must overcome and predicts how markets will evolve in the next 18 months and beyond.*

The interplay between the propensity of humans for hubris, and how Nemesis swoops in to restore balance, is a recurring theme in Greek tragedy. The over-estimation of one's abilities that leads to hubris often results in actions that defy the gods or the natural order. This is where Nemesis comes in. She is the goddess of retribution and revenge, but her primary function is to restore balance, dispensing and collecting dues as she wields her influence.

Over the last decade, a tug-of-war between these two forces has played out across global private capital markets. Following the global financial crisis (GFC) of 2008, the industry was primed with cheaper capital, fuelled by ongoing quantitative easing, leading to unprecedented growth across global markets.

This market hubris meant managers were able to leverage cheaper sources of funding for acquisitions and achieve significant growth in fundraising globally. Between 2008 and 2019, private capital expanded its AUM from $3.1 trillion to $10.2 trillion, and by mid-2023 AUM was $14 trillion. This 450% increase has led to a large and sophisticated global industry.

However, as the Classics warn us, a period of overarching ambition invites correction. Enter Nemesis in 2022 in the guise of a volatile macroeconomic climate resulting in higher interest rates and inflation. This in turn has led to the so-called denominator effect, with institutional investors' allocations rebalanced to reduce private fund exposure, leading to a slowing down of fundraising, deals, and exits for alternatives managers to grapple with, particularly those in the mid-market.

By the end of 2023, fundraising for private funds had dropped by 22% compared with 2021, with private capital fundraising for the year valued at $1 trillion, its lowest level since 2017, according to McKinsey's Global Private Markets Review 2024.

Global IPO markets have also been significantly impacted. In the first three quarters of 2024, we've seen a total of 870 IPOs, with a combined value of $77.6 billion. In 2022, the number of IPOs stood at 1,415, with a value of $184.3 billion, according to EY. It is unlikely Q4 of this year will rally enough to change the direction of travel for 2024.

However, 2025 may be the start of a more positive story for private markets fundraising, even if there are still macro factors that remain a concern for private fund managers, including:

1. Geopolitical instability – Uncertainty and risk driven by geopolitical instability is clearly impeding recovery. After a year described as the largest election year in history with around half of the world's population – roughly two billion people from more than 60 countries – eligible to vote in national elections in 2024, there has been much political uncertainty, not least in the UK, the EU and the U.S. A period of calm will hopefully prevail with the outcome in all three now known. However, conflicts in Ukraine and the Middle East, and rising tensions in Taiwan continue to keep markets jumpy. While the re-election of Donald Trump in the U.S. has given markets a short-term boost, there's no reliable way to know how markets will react once he returns to the White House.

2. Interest rates and monetary policy – It's expected that interest rates will continue in their current downward cycle, though they are not expected to return to the lows that followed the GFC. This will benefit private markets which was constrained by the higher interest rate environment. However, the same benefits can also be risks, as the IMF outlines, with investors possibly taking bigger risks as debt and leverage grow. The industry is preparing for a shift in monetary policy, with expectations of improved valuations and an uptick in IPO activity as interest rates normalize, but this may take time to kick in. Currently, it is predicted to take until 2026/27, which potentially means a difficult next 12 to 24 months.

3. Deals, exits and fundraising – The slowdown in exits means there are fewer deals being completed and so fundraising is weighed down. Exacerbated by the denominator effect, LPs aren't able to commit more capital as their existing positions remain locked up. However, while deal volume might be down, bigger funds are raising more as investors seek safe havens in an uncertain market, as this report notes. Meanwhile fundraising periods are taking much longer. At a recent client event, attendees who had recently completed a fundraise all said that their fundraising periods had increased, from an average of nine months in 2020/2021 to 18 months or more in the last three years.

4. Shifting sources of capital – Traditional sources of capital for GPs, for example pension funds, are under pressure to reduce some of their exposure to private markets. While the market is still forecasting double digit compound annual growth rates (CAGR) through new funds, the source of this capital is shifting towards sovereign wealth funds and larger family offices, particularly in the Middle East and Asia.

“The macro environment is supportive, but not great…” – Global Private Equity fund COO

While these headwinds are impacting private markets and will continue to do so, we predict several key trends will continue to shape the market in 2025 and beyond:

1. Continued out-performance in particular segments – while it has been a bumpy road for mid-market buyout, growth and real estate funds in particular, certain segments, like secondaries and infrastructure, are expected to continue to perform strongly. Preqin estimates that the fundraising environment may not fully recover until 2027, so GPs must continue to access alternative sources of capital through continuation funds, which allow them to extend the life of their investments and provide liquidity to existing investors. Within this environment we anticipate the Barbell Effect to continue, with larger managers and smaller, more nimble ones, able to outperform in a competitive market.

2. Exits will be a key KPI for investment professionals – as one Head of Investor Relations commented recently, “Rather than IRR being the key measure for investment professionals, perhaps it’s the ability to mobilise on exits.” Many in the industry have set up specialist exit offices or teams with the mandate to accelerate the exit timeline and return capital in an efficient way to investors, thus stimulating fundraising. Whilst it is likely that the IPO market will return as a key exit tool, it will not be the primary one.

3. Investor experience will be a key battleground – GPs will continue to raise capital, but the competition for finding available and appropriate pools of investors will continue to be intense. Investors are looking for a seamless experience from the point of onboarding, which should be straight-forward and painless. GPs and investors are facing several challenges around fragmented data and communications, inadequate onboarding processes, and a lack of transparency on fund management. There is a clear need for end-to-end digitized solutions for fundraising and investor journeys, from investor sourcing and onboarding, to fund set-up, to in-life fund management and wind-down.

An example of this is Aztec Invest, which provides streamlined investor sourcing and screening to managers, through an easily integrated and customizable platform. The tool then onboards suitable investors and manages all future investor communications through one seamless system.

4. Private Credit is here to stay – credit funds continue to outperform and according to Morgan Stanley, the private credit market is estimated to grow to $2.8 trillion by 2028. At the start of 2024 it was valued at around $1.5 trillion, up from $1 trillion in 2020. We continue to see an increased institutional appetite for Private Credit exposure motivated by the lower interest rates of the past and the search for higher returns. But even recently as rates have risen, Private Credit has proved to be a resilient and largely interest-rate-hedged investment. There is no doubt going forwards that regulatory developments will shape the Private Credit landscape, while higher interest rates and an adverse economic climate has the potential to increase the number of loan defaults. Notwithstanding this, all signs point to a continued evolution and ongoing growth of the private credit market, albeit with the need for stakeholders' heightened vigilance about potential risks.

5. Focus on cost and efficiency – with more pressure on returns, GPs will have a continued focus on cost and efficiency, continually reviewing and iterating operating models, while maximizing outsourcing arrangements across all functions of their business. This includes more innovative fee models to compete for investors' capital. For fund managers optimizing their operating model, remaining competitive will involve choices around in-house or outsourced processes to keep their cost base as stable as possible, while investor demands and regulatory requirements will become more prescriptive.

6. Investment in AI, data infrastructure and automation will continue to accelerate – increasing investment in digital capabilities will help firms make more informed decisions and improve client experiences. This includes enhancing products and offerings for LPs and investors. Technology is creating opportunities to reshape processes, harness data, and create revenue streams with new services and offerings. Tools such as Chat GPT and Microsoft CoPilot are revolutionizing the way people work. After something of a market splash earlier this year we are starting to see a consistent application across the industry. From deal support to administration, technology is helping managers do more with less.

"Our clients are looking for partners who can scale effectively as they themselves scale. We are investing heavily to meet these demands and retain our leading position in this market." Kathryn Purves, CEO Aztec Group

7. Increasing regulatory pressures – the direction of travel globally is towards more regulation of private markets, not less. For example, GPs active in the EU will need to check if they are in scope for the comprehensive Digital Operational Resilience Act (DORA) which comes into force from January 17, 2025. Other examples of incoming regulation is the tightening up of AML and CFT regulations in the U.S., with the new FinCEN rules, which take effect from January 1, 2026. While the markets might expect a lighter regulatory touch from the Trump Administration, in other jurisdictions regulations are tightening, and for globally active managers, this is an area that will continue to require close attention. Within the EU there is already increasing oversight of how sustainability is measured and reported, as well as how the crypto-asset landscape is regulated.

8. M&A between GPs will increase – with somewhat subdued performance in certain segments of the market, M&A between GPs and GP stakes investments will accelerate. While GP stakes have been around for over 20 years, activity has been somewhat flat in recent years. But we anticipate an increase in activity in

2025, coupled with pure play M&A of GPs, with lift outs of teams reshaping the landscape. Blackrock's acquisition of Global Infrastructure Partners this year is one of the largest examples in recent times, but there will be others as managers seek to add skill sets and diversify their offerings.

9. Demand for co-investment opportunities will remain high – while this demand will mainly be driven by investors looking for attractive co-investment deal flow, more and more GPs will utilize co-investment strategies to facilitate larger deals. The total capital raised for co-investments with private equity investment managers increased from $4 billion in 2010 to $10.3 billion in 2022. Moving forwards we expect these opportunities to continue to capitalize on a more depressed fundraising environment.

10. Use of NAV facilities and other debt structures will continue – last but certainly not least and perhaps one of the most topical, Aztec data shows a significant increase in the usage of NAV and debt facilities in recent years, as managers navigate their way through the lower fundraising environment. This approach is likely here to stay, even as the fundraising market recovers and capital is returned.

After private capital's unfettered years of hubris, and as its bruising encounter with Nemesis shows signs of abating, private fund managers are learning to weather the pendulum swings by employing innovative strategies. To support them, partners like Aztec are continuously investing in and building market-leading tools and systems to support the market's adaptations.

We're supporting clients through their next period of sustained growth, continuing to invest in advanced technology and automation, enhancing the investor experience through platforms like Aztec Invest, and expanding our geographic coverage into the U.S. and Ireland.

If you'd like to discuss any of the points raised in this article, please contact James directly.