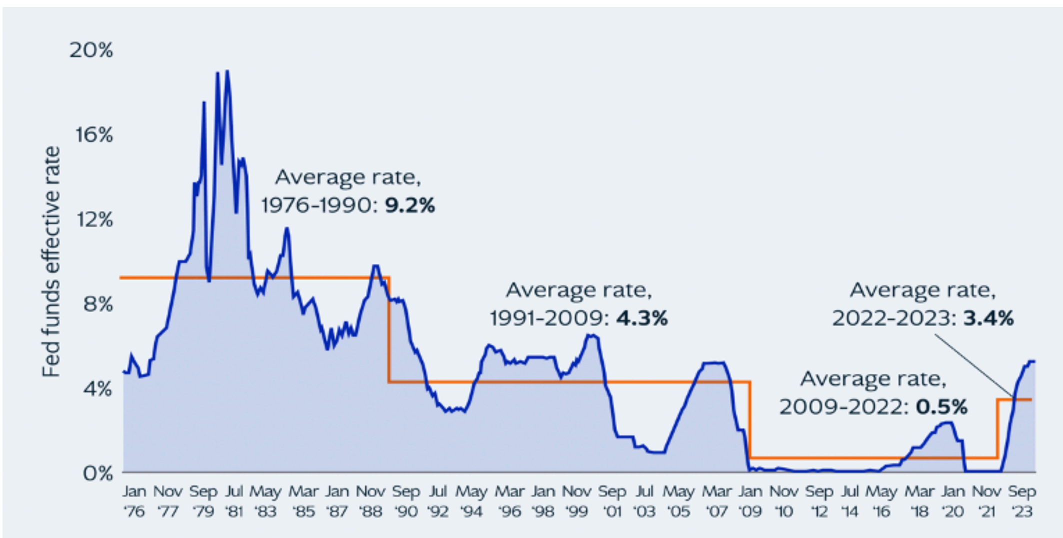
Can Private Equity thrive in a “higher for longer” interest rate environment?

Many investors have questions regarding the potential for private equity to keep delivering high returns in a higher interest rate environment. Four factors may help determine PE’s ability to continue their outperformance.

Though interest rates are high, they are below historical averages

Current rates feel high due to the near zero rates that we saw during the years following the global financial crisis. From 1976 – 2023, the average effective funds rate was 4.66%. Over the past two years, the average rate has been 3.35%. Despite negative sentiment, rates are slowly showing signs of returning to normalized levels, not unprecedented highs.



Leverage levels are lower

Private Equity managers have been able to use less leverage than in the past. In 2013, debt was about 60% of total capital structures. Today, that number is closer to 35%. Managers have become far more skilled at managing the cost of capital and decreasing the amount of borrowing during these times. Furthermore, many managers have been able to refinance debt when rates are lower.

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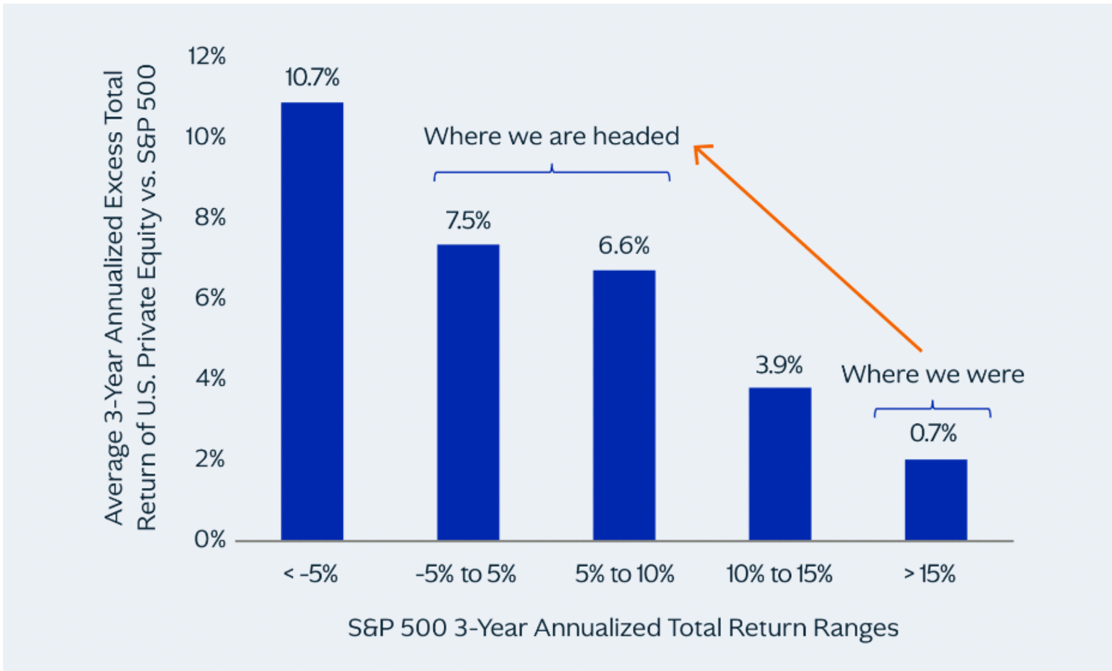
Private equity managers capitalize on inflationary stocks

Higher interest rates can lead to lower multiples and discounted good assets. Over the course of history, private equity has a strong performance when public securities falter. As the public market falters, there is a direct correlation to the private market excelling.



Private equity returns are dependent on value creation

Ultimately, private equity returns are contingent on value creation. Value is created by partnering with great companies and creating value. Strategies to create value include M&A, increasing efficiency, implementing new hiring tactics, and expanding businesses into new geographic locations.

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