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High Five – 2025 Outlook (Fifth of a Series)

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Number three of our five themes for 2025: "*Default position: Discipline and careful portfolio construction will keep portfolios clean.*"

There are clear reasons for a more bullish sentiment to take hold in private capital investment in the year ahead. A more certain macro backdrop, a decisive election result, US companies reporting above-expectation results, and the S&P 500 building on a strong 2023 by rising more than 25% in 2024, are building optimism.

Adding to this is the benign default environment for managers that structured deals appropriately in previous low-rate years. Proskauer's private debt payment and bankruptcy default rate stood at just 0.70% in Q3 2024 (see our *Chart of the Week*). This compares favorably with the 4.47% BSL default rate reported by Fitch. The slight increase seen since mid-2023 comes from a low base and remains well below large caps.

With 26% of global buyout dry powder four or more years' old by the end of 2023, per Preqin and relatively low M&A activity last year, pressure to invest could intensify in 2025. However, prudent investors recognize that today's investments form the bedrock for tomorrow's portfolio health.

To keep portfolios clean, successful private capital investors will:

- Maintain discipline during what looks to be a strong vintage. That means sticking to successful strategies, focusing on fundamentals and cash flow generation, allowing for a margin of error in earnings and valuations, and building multiple ways out. If needed, walk away. One of private markets' biggest advantages is that owners can control their exits. Investing for the long haul are vital for both equity and debt providers.

- Build all-weather portfolios that perform well regardless of macros. Diversification is essential for all private capital investors, but especially in credit – by sector, position size, deal structure, leverage, and sponsor. Our average position is less than 1% across the portfolio, minimizing the impact of any one problem. Successful managers also construct their portfolios for different, less buoyant, environments, running detailed performance sensitivity analyses according to a variety of scenarios.

- Be active and proactive capital providers supporting value creation in businesses you back. Be also prepared to course-correct on existing investments when necessary. Experience and lessons learned help investors see around corners to identify potential opportunities and preemptively move as new risks emerge. Decisiveness will win out in a fast-moving market.

- Work with trusted partners who have been through cycles and are closely aligned. Lenders and sponsors with strong relationships can work collaboratively through good and bad times to build and protect value in the portfolio.