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What Ted's Thinking

WTT: When Will Private Markets Normalize?

Could 2025 be the year private equity fund flows return to normal? No. Not yet.

The supply and demand for private funds remains significantly out of balance. The mismatch started in 2019, driven by three key factors:

First, private equity managers (GPs) raised funds faster and in larger sizes from 2019 to 2021 than previously. Their investors (LPs) funded aggressive GP deployment by trimming assets in public market strategies. As allocations to private strategies exceeded long-term targets, this created a ‘numerator effect,’ effectively pulling forward future demand for private investments.

Second, the dramatic slowdown in GP exits since 2021 has trapped capital in private investments, further straining portfolio allocations.

Third, weak public market returns in 2021 amplified these challenges through the ‘denominator effect,’ further increasing private market allocations in institutional portfolios.

Time has not yet fixed the problem. Recent public market strength reversed the denominator effect, but not the pre-existing structural challenges. LPs will need distributions to consistently exceed contributions to rebalance their portfolios to long-term targets.

The Path Forward

Today’s fundraising reality is stark. While managers hope allocators will return before their current funds are depleted, most are adjusting expectations. Maintaining a fund size in a successor vehicle is considered a big win. Flat is the new up.

Though 2025 may bring more favorable exit conditions, GP expectations require tempering. Innovative liquidity solutions, including continuation vehicles, secondaries, and even SPACs (I’m on the Board of one - Newbury Street Acquisition Partners II), will help return capital to LPs, but this won't immediately translate to new commitments.

Many GPs misinterpret this dynamic, seeing the return of capital as a catalyst for renewed LP interest. Instead, LPs will initially direct exit proceeds toward public market strategies. This rebalancing must continue until the excess commitments from the boom years work through the system - like the proverbial pig through a python. My conversations with CIOs indicate that the pendulum will swing back in the other direction favoring public markets even more than before 2021, as LPs reassess the illiquidity premium available in today's environment.

New Frontiers

This reality explains why GPs are aggressively exploring new capital sources. Private wealth, Middle Eastern sovereign wealth funds, and insurance companies are all increasing their private market allocations, offering fundraising opportunities beyond traditional institutional LPs.

Yet the core message remains: while fund flows from mature LP portfolios will eventually normalize, that timeline extends far beyond current GP expectations.