Private Markets House View

Latest outlook – H1 2023

abrdn.com

Contents

Private Markets House View Summary

Sector preference key: Non-attractive · Less attractive · Neutral · Attractive · Very attractive

Private Equity

Sector preference

Consumer · IT · Financial

Industrial · Healthcare · Business services

Return expectations (IRR)[1]

12-13% — Private equity Buyout

13-15% — Private equity Venture Capital

Private Credit

Sector preference

Consumer · IT · Financial

Industrial · Healthcare · Business services

Return expectations (Yield to Maturity)[1]

7-12% — US Middle Market

Infrastructure

Sector preference

Social · Transport · Utilities

Renewable energy · Communication · Specialised

Return expectations (IRR)[1]

10-12% — Direct/Co-investments

12-13% — Value Add

Real Estate

Sector preference

Office · Hotel/ Leisure · Retail

Residential · Logistics · Specialised

Return expectations[1]

3-6% — Direct

7-13% — Closed ended fund investments

Natural Resources

Sector preference

Agriculture · Timber

Mining % minerals · Energy

Return expectations (IRR)[1]

15-25% — US Energy

[1] range across regions.

Projections are offered as opinion and are not reflective of potential performance. Projections are not guaranteed and actual events or results may differ materially.

Private Market Outlook

Given the entrenched inflation and sustained rate rises we have witnessed over the last year, this edition of the Private Markets house view considers the impact the economic environment will have on market valuations and what we may expect over 2023, providing investors with a view on where current valuations are in the context of historic averages across asset classes.

Private equity

- The challenging economic environment requires focus on smaller companies and specialised/niche managers. Particular focus on managers with proven through-the-cycle returns and distinct operating/sector expertise with long-term trends is still giving investors the prospect of positive outcomes from investments.

Infrastructure

- In **the US** there is strong demand for infrastructure related assets characterised by long term stable revenues for example, key social and economic infrastructure with inflation-linked long tenor contracts with central/municipal government counterparties.
- Demand for digital and data infrastructure and energy-efficient technologies is strong. Infrastructure has a key role in the energy transition and in improving social outcomes. However, selectivity is key, given the backdrop of interest-rate hikes and high inflation.

Real Estate

- Within **the US** we have high conviction across last mile logistics and smaller footprint industrials across markets and residential assets in select sunbelt markets and gateway cities.
- Across **Europe** the focus is on logistics assets and also the private rented sector, both for core and value-add. We see some opportunities in alternative sectors and grocery/essential retail in the UK and Europe.
- In **APAC** logistics, there are further potential opportunities, especially the urban segment, in Korea and Australia, multifamily in Japan's winning cities, as well as offices in Seoul and Singapore.

Private Credit

- As economic conditions set to worsen, we expect an increase in defaults, given the rise in the cost of debt and the covenant-lite terms that have been agreed over previous years. The quality of deals remains crucial. We will look for assets that offer a good risk/reward balance and downside protection.

Natural Resources

- Will play an essential role in the global transition to lower-emission sources of energy. We see this as a space where the opportunity set will continue to evolve with the emergence of low-cost renewable power, growth of carbon markets and role of timber.

Political and economic outlook- H1 2023

1. United States

Recent banking stresses shouldn't become a systemic crisis, but they are a sign that rapid interest rate hikes are exerting a drag. We expect a recession starting in H2 2023. Headline inflation is now declining. Interest rates could be cut sharply during 2024 amid an economic downturn.

2. Mexico

A resilient economy will force Banxico to maintain a hawkish stance in the near term. Ultimately, tighter monetary policy and a deterioration in the US economy will see the economy contract and inflation recede more meaningfully in the latter part of the year.

3. Brazil

Growth will remain tepid as monetary policy stays tight given some stickiness in core inflation. The US recession will send the economy into contraction, bringing core inflation lower and giving scope for the Brazilian central banks to cut interest rates before year end.

4. United Kingdom

The UK economy has broadly stagnated at the start of 2023, and we expect recession-like conditions for much of this year as the full impact of monetary policy tightening feeds through. The combination of a sustained decline in real incomes, tighter financial conditions, and the spillovers from a US downturn will be headwinds to growth.

5. Europe

Energy prices have returned to pre-Ukraine invasion levels and a recession has been avoided for now. However, underlying inflation pressures are very engrained, keeping the European Central Bank in rate hiking mode. We think this tightening cycle will generate a mild recession later in 2023.

6. Turkey

Continued loose monetary conditions and pre-election stimulus will aggravate balance of payments pressures and weaken the lira. The election could lead to a contentious result and may see political instability, further dampening investment.

7. India

The domestic economy is strong, but core inflation is persistent, meaning the Reserve Bank of India has to maintain a tight policy stance through most of the year. Only once the US recession hits will the RBI see scope to begin easing.

8. China

The economy is rebounding rapidly as it belatedly re-opens post-Covid. Unlike elsewhere in the world, high inflation is not proving a problem. This may allow additional policy easing. That said, the recovery is domestic services orientated, rather than manufacturing and trade intensive. This will limit some of the beneficial international spillovers.

9. Japan

Japanese growth has been recovering, but the economy won't escape a broader DM downturn. Inflation is finally showing signs of more sustainability hitting the Bank of Japan's target. However, this is creating speculation about the future of extraordinarily loose monetary policy, which we expect to be incrementally tightened.

10. Australia

Contained wage growth, a pause in the monetary policy hiking cycle, and proximity to a rebounding China, give Australia a better chance than other DM economies of avoiding a recession this year.

● Developed markets ● Emerging markets

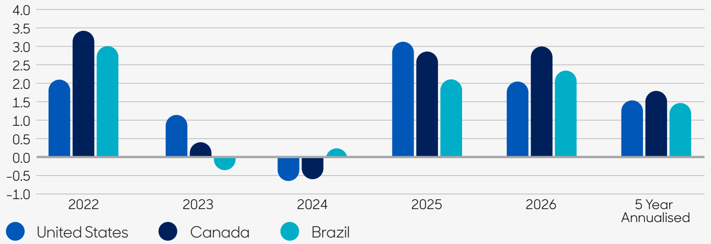
Full Q2 2023 Global Economic Outlook can be accessed here.

Projections are offered as opinion and are not reflective of potential performance. Projections are not guaranteed and actual events or results may differ materially.

Political and economic outlook- H1 2023

Americas

GDP forecast



Source: abrdn Research Institute and Oxford Economics.

Growth
Growth is positive for now, but we are forecasting a recession over H2 2023-H1 2024 as a result of the sharp monetary policy hiking cycle. Leading indicators and our recession risk models are already pointing towards this downturn.

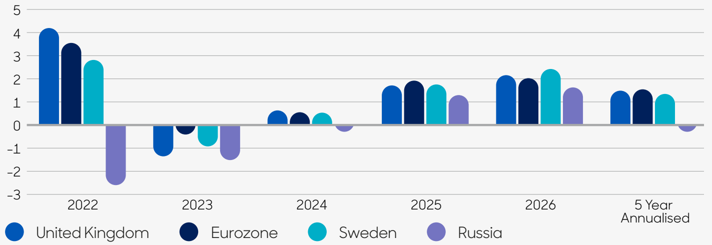
Inflation
Headline inflation is very high, but coming down as energy base effects turn negative. Core inflation is more persistent, but should decline if there is a recession.

Monetary policy
The Fed and other central banks have raised interest rates substantially over a short period of time. The historical norm is for big hiking cycles to trigger recessions. However, as the downturn hits, we are expecting a sharp interest rate cutting cycle, in excess of what futures markets currently price in.

Politics
In the near-term, US political attention will focus on raising the debt ceiling, with the x-date between June and September. We are expecting a short term extension to allow for longer negotiations, but with volatility along the way. Medium-term, focus is on the 2024 Presidential race.

Europe

GDP forecast



Source: abrdn Research Institute and Oxford Economics.

Growth
The Eurozone and UK economies are moving sideways, which is better than the deep recessions the energy crisis at one point suggested could occur. However, rate hikes and a US downturn will weigh on growth later this year.

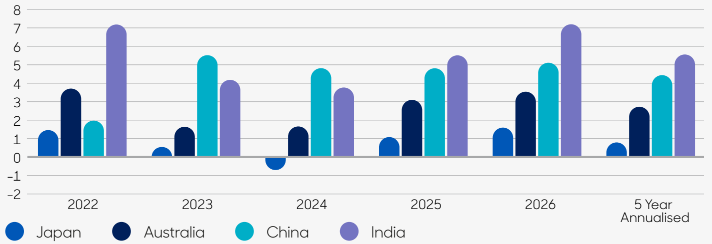
Inflation
Inflation is very high but declining across Europe. Core inflation is still rising, and it may take a recession to bring it under control.

Monetary policy
The Bank of England has probably finished it rate hiking cycle, but the European Central Bank may still raise interest rates a couple more times. That said, we expect both central banks to be in rate cutting mode during 2024.

Politics
European political leaders are focusing on utilising the loss of Russian gas to accelerate the green transition. But European fiscal reform and financing of new initiatives will be held up by internal divisions. The war in Ukraine remains a protracted conflict, with the outcome of summer offensives likely determining whether the two sides will be in a position to open negotiations this year.

Asia-Pacific

GDP forecast



Source: abrdn Research Institute and Oxford Economics.

Growth
Growth should be supported in the near term by China's reopening. However, tighter monetary conditions and an eventual US recession will prove drags and see growth slow in most countries.

Inflation
Inflation has peaked lower compared to other parts of the global economy and should ease back to target this year.

Monetary policy
Chinese policy will remain supportive, although we do not expect any substantial monetary easing as the economy rebounds. Elsewhere, policy will remain tight through the year as sticky core inflation and market pressures constrain central banks.

Politics
US-China relations continue to be the top political risk in the region, with both countries now entering into open competition over strategic assets and foundational technologies. Other countries in the region are likely to face pressure to pick a side as the US and China seek to deepen diplomatic alliances in exchange for security partnerships and inclusion in strategic supply chains.

Positive Neutral Negative

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Private Equity

Market Commentary

Throughout 2022, European and US private-equity deal activity differed. In both regions, technology valuations fell throughout 2022 with the business-to-business sector seeing the largest amount of activity as companies in the industry proved to be resilient. In terms of fundraising, 2022 was a challenging year.

Investor sentiment shifted as interest rates continued to increase and inflation moved higher. Just €53 billion of capital was raised across Europe and $343 billion across the US, the lowest in the last five years across both regions.

Market dynamics

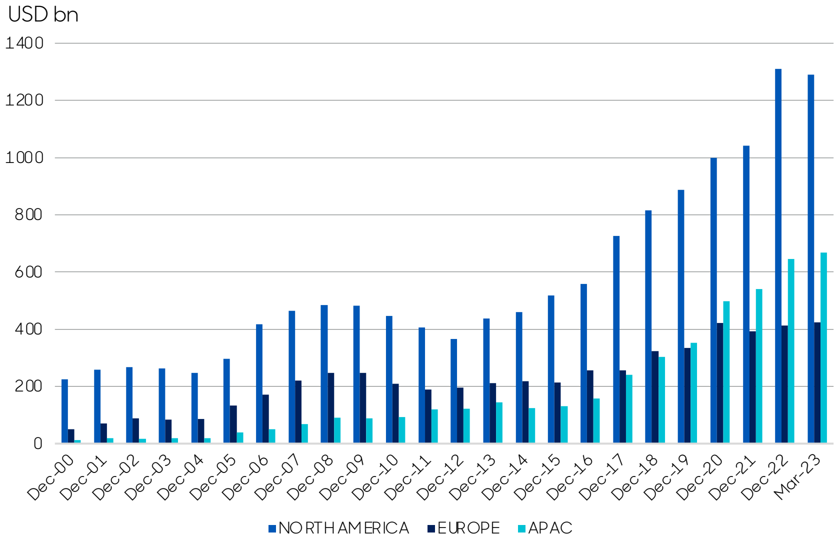
Deal Activity
Deal activity varied across regions. In Europe private equity continued to attract activity, with deal count increasing 13.1% and deal value up 1.4% year on year (YoY). While in the US, both deal count and value declined by 2.4% and 19.5% YoY, respectively.

Dry powder
Dry powder remains at record highs increasing to over $2trillion across all PE strategies globally. This will give managers the ability to react swiftly as opportunities arise.

M&A activity
Despite the challenging economic environment, M&A activity held-up well globally. IT, healthcare and financial services were particular resilient and saw the most amount of activity across 2022.

Source: Pitchbook, data as at 31 December 2022.

Private Equity Dry Powder – Global



Source: Preqin, data as at 31 December 2022.

Market dynamics key: Positive Neutral Negative

Sector preference


Consumer


IT


Financial


Industrial

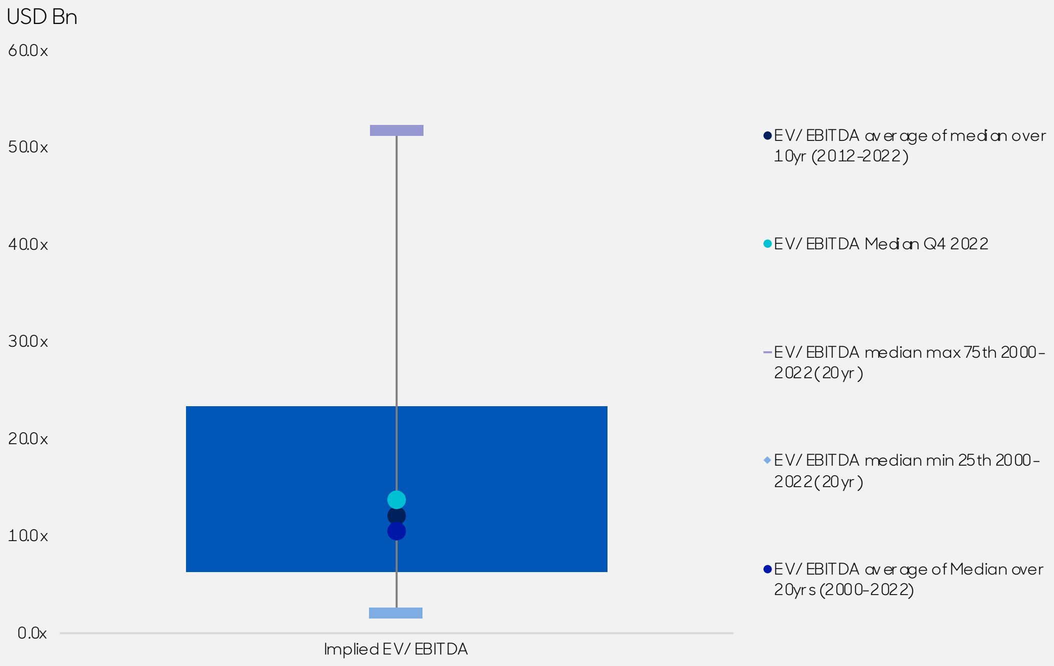

Healthcare


Business services

Sector preference key: Non-attractive Less attractive Neutral Attractive Very attractive

Private Equity

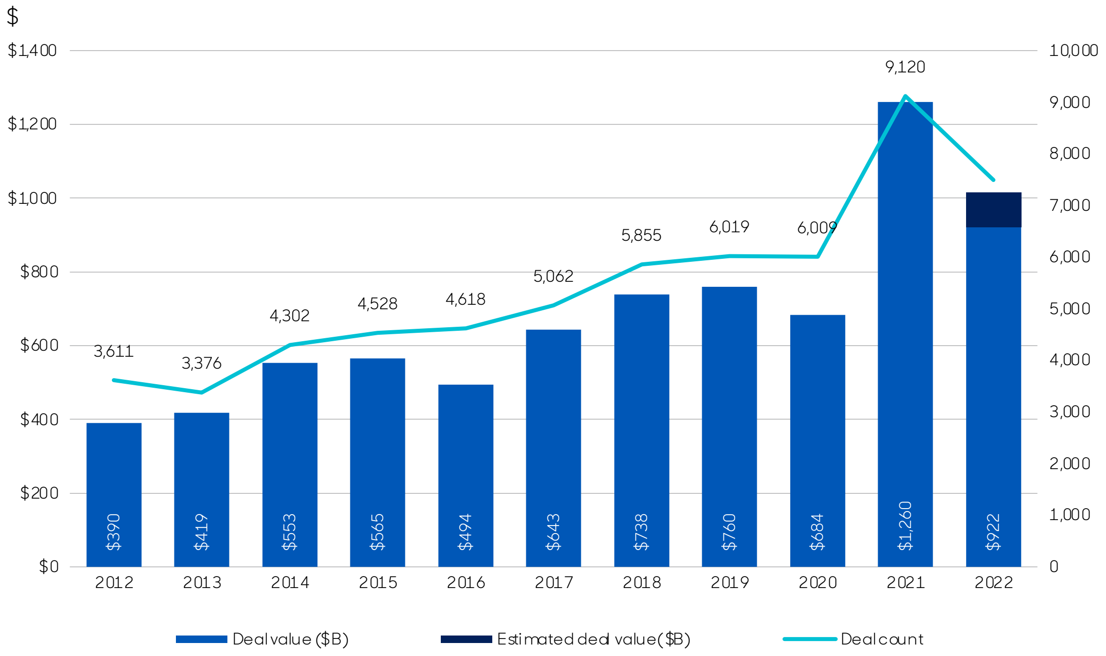
Market Valuations – US Private Equity Buyout



Source: Pitchbook, data as at 31/12/2022.

The Q4 2022 EV/EBITDA median suggests that current value is slightly higher relative to the median over 20yrs indicating that we may see valuation adjustments. We began to see a reset downward towards the end of 2022 and expect this softening to continue in 2023.

Deal Activity – Private Equity US



Source: Pitchbook, data as at 31/12/2022.

As highlighted in the above chart, despite deal activity remaining robust in earlier quarters in H2 we saw deal activity slow as most seemed to adopt the 'wait and see' approach in the tough economic environment. However, there were still some notable deals, such as Twitter, across 2022 demonstrating that despite challenging economic environment opportunities still exist, with long-term trends still giving investors the prospect of positive outcomes from investments.

Infrastructure

Market Commentary

Given the ongoing situation across **Europe**, we expect further increases in government infrastructure spending in the short to medium term. Specific opportunities are difficult to determine at this early stage but it is clear that there will be a number of areas of particular focus in the near future.

In the **US**, the 2021 Infrastructure bill has provided a meaningful boost to expectations as infrastructure spending remains a key strategic priority and significant resources are being committed to upgrading US infrastructure in the medium to long term.

Market dynamics

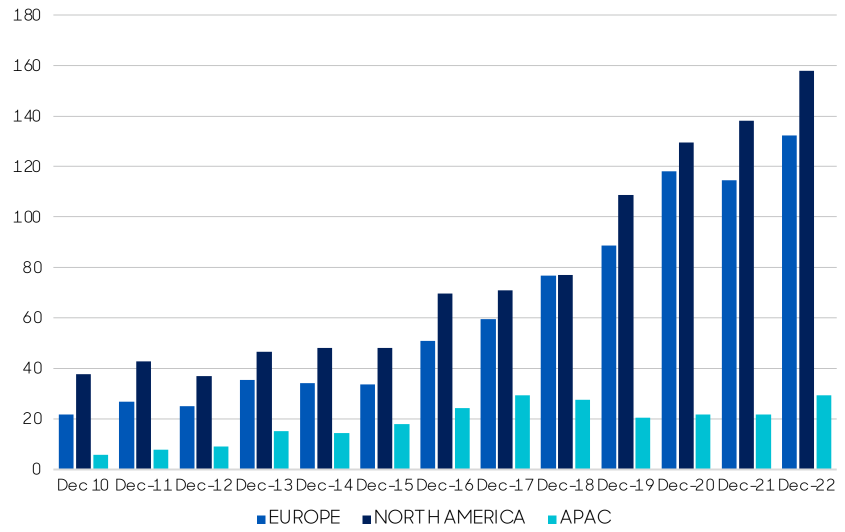
Deal Activity
Global infrastructure deal activity remained strong in 2022 despite economic challenges and uncertainty. Deal volume surpassed 2021 with more than $1.07tn and 3,369 transactions closing in 2022, compared to $1.04tn and 3,307 deals the previous year.

Dry powder
In the US, dry powder remains high, with $164bn as of March 2023. The same was seen across Europe with $128bn as of March 2023.

Political Outlook (near term)
Largely positive in the US with the signed infrastructure bill. Challenging in South America due to recent (and expected) electoral results. Across Europe the ongoing conflict in Ukraine continues to have a profound impact with long-term energy security now firmly a key strategic priority for EU member states and the UK.

Market dynamics key: Positive Neutral Negative

Infrastructure Dry Powder



Source: Preqin, data as at 31/12/2022.

Sector preference[2]

Social

Transport

Utilities

Renewable Energy

Communication

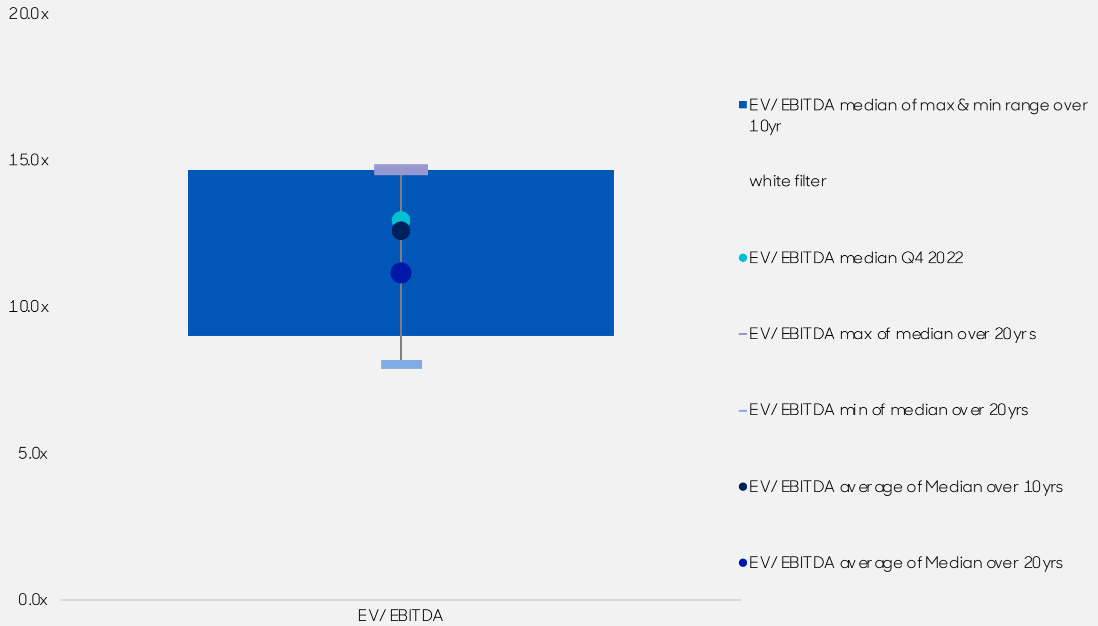
Specialised

Sector preference key: Non-attractive Less attractive Neutral Attractive Very attractive

[2] abrdn views, reflective of European direct infrastructure.

Infrastructure

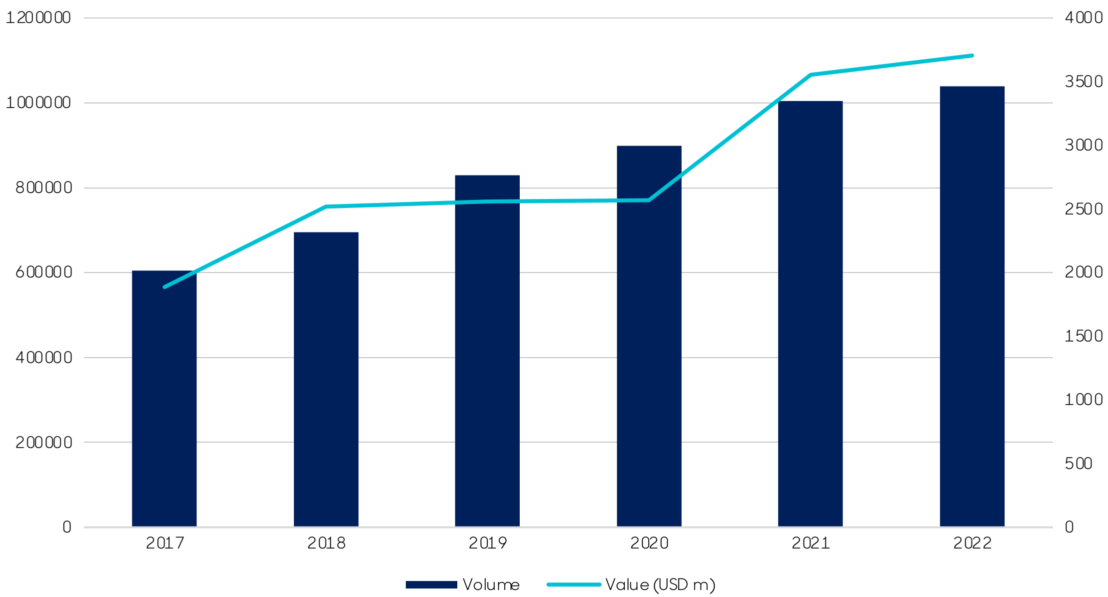
Market Valuations – Global Infrastructure (core plus)



Source: Pitchbook, data as at 31 December 2022.

The Q4 2022 EV/EBITDA median suggests that current value is slightly higher relative to the median over 20yrs indicating that we may see valuation adjustments. Adjustments will vary across sector, based on demand for assets. For example, valuations across renewable energy are likely to remain stable as demand is robust.

Deal Activity – Global Infrastructure



Source: Infralogic, data March 2023.

Deal activity was strongest in the US across the year, however, Italy saw the biggest increase in deal value driven by a large transaction Atlantia. This was a take private of Milan based road operator. In terms of sector, globally the transport sector dominated, followed by energy and renewables, making it the most active sector since 2018.

Real Estate

Market Commentary

Cross-border capital flows were at a four-year high relative to total market activity in 2022. Of the capital that was raised, the vast majority may not be deployed for some time as pricing uncertainty has deterred many players from bringing assets.

Across the US, Industrial and Residential are the preferred sectors as structural demand headwinds for offices continues to spread from tech markets to gateway cities.
In Europe the market is moving quickly through a revaluation driven by higher interest rates and debt costs. Total office vacancy is rising, but prime remains constrained; residential, alternatives and logistics are still undersupplied and remain our preferred picks. Retail is still restructuring.

Market dynamics

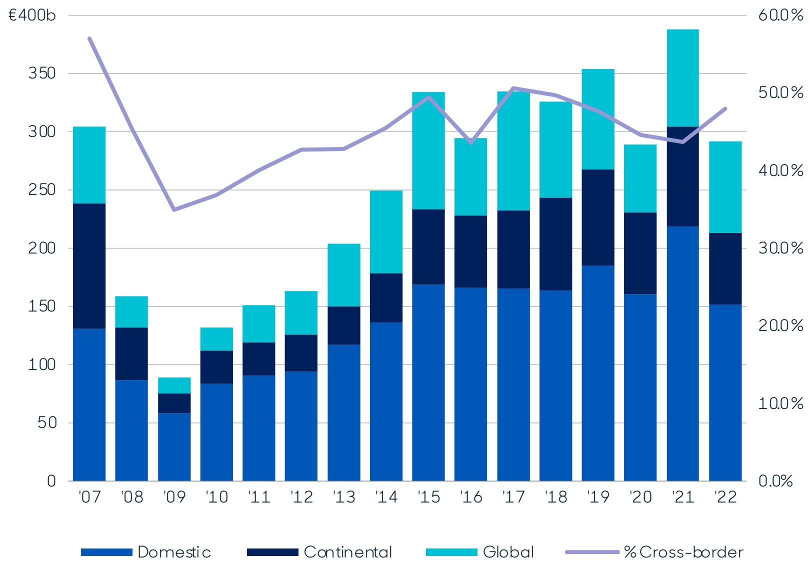
Margin over bonds
In the **US** yield spreads remain narrow, however, repricing continues for real estate and may see slight widening of the spread during the year. In **Europe** real estate looks poor value with spreads not fully allowing for illiquidity premia. However, we expect spreads to widen as real estate yields rise and fixed income yields peak through 2023.

Flow of capital
In the US Deal flow has slowed down considerably on the back of a strong USD but bid-ask spreads are narrowing which could lead to a recovery in deals. In Europe there is a sharp decline in liquidity as pricing correction evolves as investors wait to see where values land.

Listed Market Pricing
In the US, REITs have performed in line with the broader equity markets year to date. Rising private market valuations across most sectors have surpassed pre-Covid peaks (excluding office and lodging). Across Europe listed market valuation is attractive overall with a wide range by sector and countries driven by different fundamentals but also balance sheet strength/weakness.

Market dynamics key: Positive Neutral Negative

Real Estate – European Capital Flow



Source: RCA, March 2023

Sector preference[3]

Office Hotel/leisure Retail Residential Logistics Specialised

Sector preference key: Non-attractive Less attractive Neutral Attractive Very attractive

[3] abrdn views, reflective of European direct real estate.

Real Estate

Looking across the sectors globally, the ranges of yield of the last 7 years have narrowed significantly compared to the equivalents of the last 15 years.

At a sectoral level, industrial and apartment have witnessed the yield compression across US and Europe as Q4 2022 cap rates continue to be lower than the 7 years average despite interest rates increasing over the last 12 months. However, retail has seen yield softening when comparing average Q4 2022 cap rate to the 7 years average, which reflect the fundamental changes in those sectors with the impact of digitalisation of shopping in recent years. Yields of the office sector in Q4 2022 were broadly consistent with the 7 years and 15 years average, but we see increasing uncertainty surrounding valuation of the sector as work patterns evolve post the pandemic.

Similarly, we see the Q4 2022 cap rate was also lower than the 7yr average in China. There was a steep decline in industrial volume in the final quarter which suggests the extent to which the sector had overheated in 2021. With yields compressing, it is uncertain if this level of activity will sustain.

Market Valuations – US Real Estate Cap Rates

Sector	Min Cap rate (15yrs)	Q4 2022 vs 7yr average		Max Cap rate (15yrs)
		Q4 2022	7 year average	
Industrial	5.2%	5.4%	6.3%	8.5%
Office	6.2%	6.9%	6.6%	8.7%
Retail	6.2%	6.6%	6.5%	8.1%
Apartment	4.6%	4.9%	5.5%	7.1%

Market Valuations – Europe Real Estate Cap Rates

Sector	Min Cap rate (15yrs)	Q4 2022 vs 7yr average		Max Cap rate (15yrs)
		Q4 2022	7 year average	
Industrial	4.7%	4.7%	6.0%	8.3%
Office	5.4%	5.6%	5.8%	7.2%
Retail	5.2%	6.6%	6.2%	7.2%
Apartment	3.8%	4.2%	4.8%	6.2%

Market Valuations – China Real Estate Cap Rates*

Sector	Min Cap rate (9yrs)	Q4 2022 vs 7yr average		Max Cap rate (9yrs)
		Q4 2022	7 year average	
Industrial	2.9%	5.3%	5.3%	12.5%
Office	3.0%	4.1%	3.9%	6.1%
Retail	3.5%	6.3%	4.5%	6.3%

Q4 2022 7 year average

Source: RCA, March 2023

*China Office Q1 2007, Q1 -Q4 2008, Q3 2010, Q4 2018 data not available. Industrial- Q4 2013 to Q2 2015, Q2 2017, Q3 2018- Q2 2019 data not available. Retail- Q4 2012, q1 2014 to q4 2014, Q1 2016, Q2 2016, Q4 2018 not available. Due to data availability the time series for China is limited 9yrs.

Private Credit

Market Commentary

The volume of transactions across middle market slowed in 2022 vs 2021, however, it still proved to be an attractive way to borrow in the midst of turbulent market conditions as private credit continued to overtake syndicate loans volumes.

Dislocation in the market is creating good opportunities and lenders are in a position to demand stronger covenants and execute details at attractive risk-adjusted returns.

Selectively remains key and with signs of distress and increasing default rates high quality deals is vital.

Market dynamics

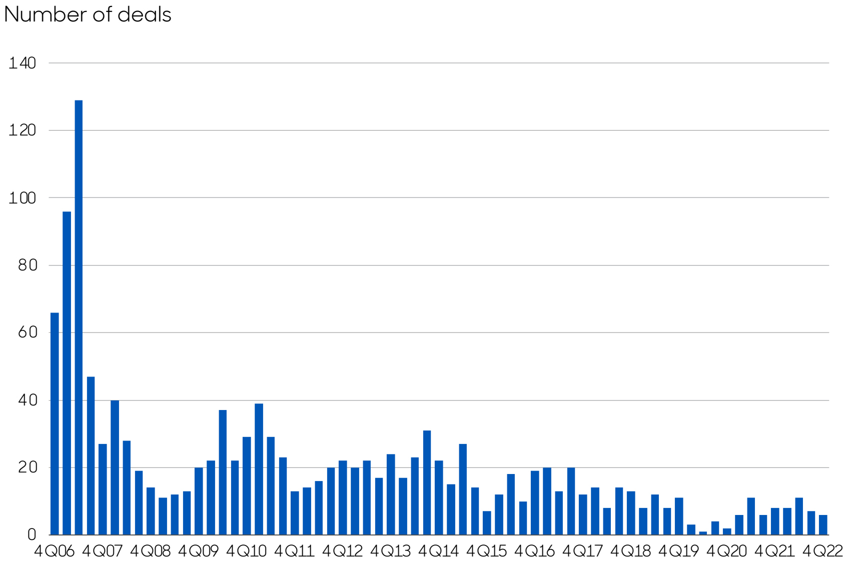
Financial Covenants
As markets have become more risk-averse, and with spread on lower middle market loans widening, recently covenant packages within this space have tightened giving lenders greater protection and early warning about operational challenges.

Inflation
Sticky inflation remains a problem for central banks and the return of hawkish messaging from central banks has increased volatility.

Default rates
As interest expenses increase, private credit is not exempt from borrower stress. The Proskauer Private Credit Default Index revealed an increase in default rate to 2.06% in Q4 2022 which is a 0.5% increase from the previous quarter.

Market dynamics key: Positive Neutral Negative

Deal Activity – Middle Market Deal Volume



Source: Pitchbook, LCD. March 2023.

Sector preference[4]


Consumer


IT


Financial


Industrial


Healthcare

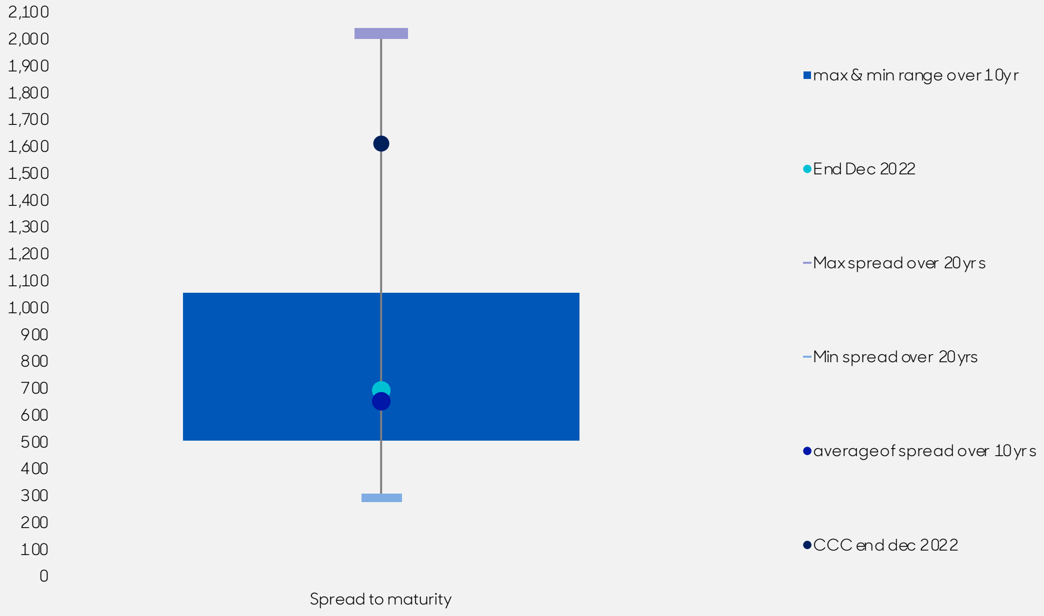

Business Services

Sector preference key: Non-attractive Less attractive Neutral Attractive Very attractive

[4] abrdn views, reflective of US Middle Market.

Private Credit

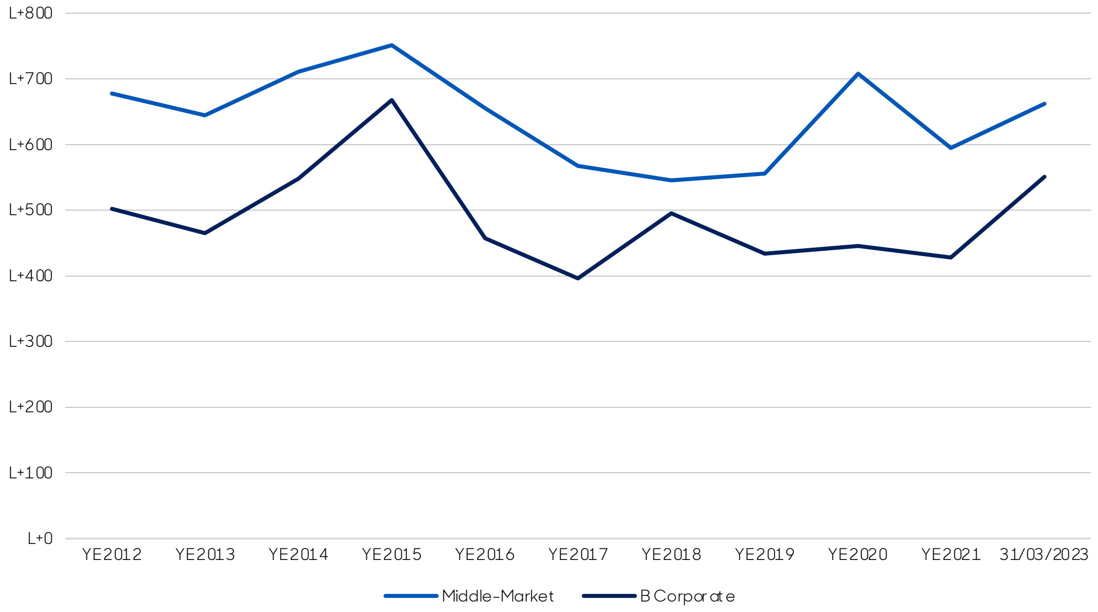
Market Spread – US Middle Market



Source: Pitchbook LCD, April 2023.

Middle market spread as at end December 2022 compared to the average over 10yrs suggests spreads have widened. There is an expectation these will continue to widen as we approach recession in 2023 and the potential for defaults to increase. The quality of deals is crucial, and it is important to look for assets that offer a good risk/reward balance and downside protection.

Middle Market – Spread premium



Source: Pitchbook LCD, April 2023.

Comparing middle market, which are illiquid, to B rated corporates, which are more liquid, over the last 10 years we can see that the spreads implies that middle market companies overall are of lower credit quality than B rated corporates. The average premium across 10yrs is between 100-150bps. When selecting deals across middle market, as the credit quality does differ, specialist knowledge is critical. The quality of deals is crucial, and it is important to look for assets that offer a good risk/reward balance and downside protection.

Natural Resources

Market Commentary

Across the US there is a strong demand for oil, leading to persistently high prices and strong producer cash flows. However, there is evolving political pressures on carbon-intensive sectors set to continue with the Biden administration. This stance has solidified with the 2022 Inflation Reduction Act. Meanwhile in Europe, sanctions imposed on Russian exports is continuing to impose pressures on domestic commodity supply and energy autonomy becoming increasingly necessary. There is continued government support to expand and invest in renewable energy.

Market dynamics

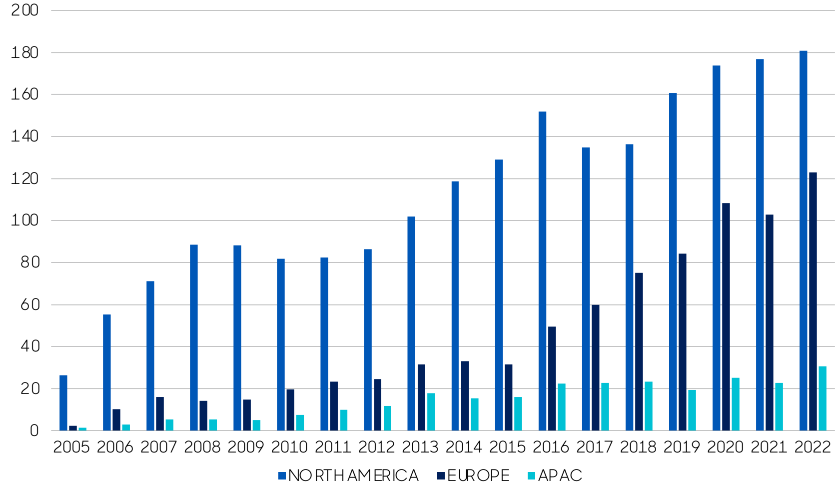
Regulation/Policy & Tax
Interest rate hikes expected to taper, and Inflation Reduction Act expected to provide strong tailwinds across energy and agriculture.

Dry powder
$180bn across North America, which is all-time high for the region , was ~$86bn in 2012. Followed by Europe, also at record high of $123bn.

Inflation
In the US, inflation is beginning to taper in response to sustained interest rate hikes, which is likely to continue through 2023. The EU energy crisis caused higher-than-expected inflation in 2022. This is likely to persist through 2023.

Natural Resources – Dry Powder

USD bn



Source: Preqin Pro, data as at Dec 2022

Market dynamics key: Positive Neutral Negative

Sector preference[5]

Agriculture

Timber

Energy

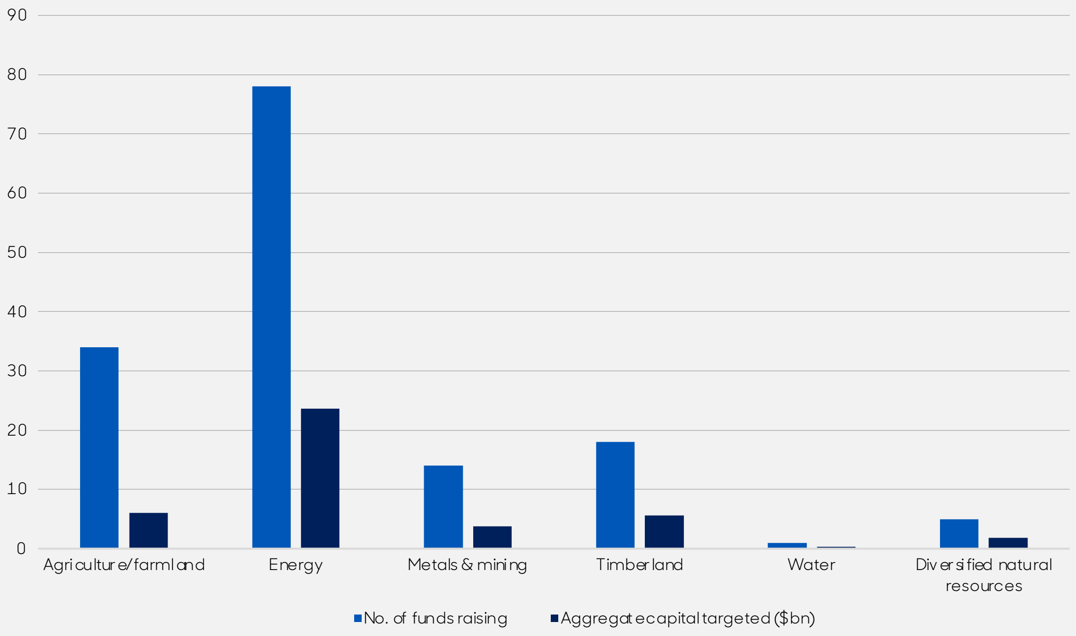
Mining & minerals

Sector preference key: Non-attractive Less attractive Neutral Attractive Very attractive

[5] abrdn views, reflective of US Natural Resources.

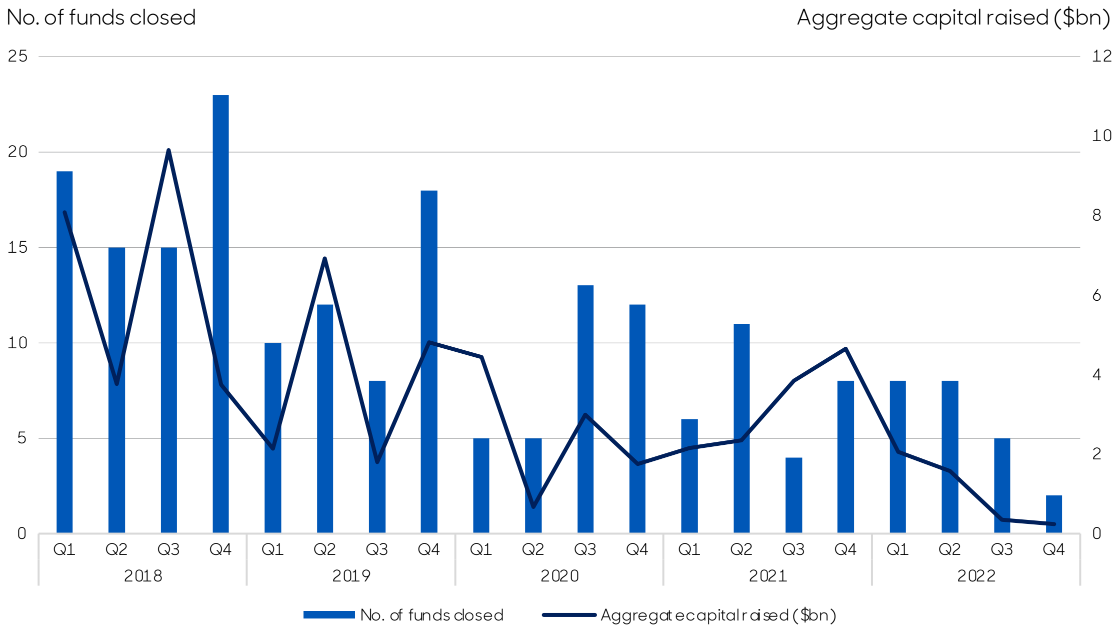
Natural Resources

Natural resources – funds in market by strategy



Source: Preqin Pro. Data as of Jan 2023.

Natural Resources – Global fundraising



Source: Preqin Pro. Data as of Dec 2022.

Global fundraising across infrastructure has slowed significantly as indicated above. However, as shown by capital raised across strategy, there was still notable flow into energy funds signalling that investor appetite for exposure to the energy transition and renewable energy investment is strong. There are investment opportunities across natural resources with the emergence of low-cost renewable power and growth of carbon markets, including the role of timber in the global transition to net zero and lower emissions.

Important information

Investment involves risk. The value of investments, and the income from them, can go down as well as up and an investor may get back less than the amount invested. Past performance is not a guide to future results.

The information contained in this document is of a general nature on the activities carried out by the entities listed below. This information is therefore only indicative and does not constitute any form of contractual agreement, nor is it to be considered as an offer or solicitation to deal in any financial instruments or engage in any investment service or activity. No warranty whatsoever is given and no liability whatsoever is accepted for any loss arising whether directly or indirectly as a result of the reader, any person or group of persons acting on any information, opinion or estimate contained in this document.

Please note that some of the investments referenced in this publication are not authorised for distribution in all of those jurisdictions in which we operate. For further information, please speak to your usual contact or visit our website **abrdn.com**

Investors should be aware that there are risks inherent in all investments and there can be no guarantee against loss resulting from investments in the Fund.

The key risk factors are described below:

Liquidity Risk

Private market assets are inherently illiquid. Selling private market assets can be a lengthy process, and the price at which assets can be sold may be uncertain.

Consequently, investors in the relevant Fund should be aware that they may not be able to sell their investment when they want to, and the Fund's performance may be adversely affected by the sale of assets to meet redemption demands. Redemption requests may from time to time be satisfied by the sale of more liquid assets which could adversely affect the liquidity profile of a Fund to the detriment of remaining investors.

Suspension Risk

In exceptional circumstance, the Directors of the Fund with the approval of the Depositary may temporarily suspend the issue, valuation, sale, purchase, redemption or conversion of shares in the Fund.

Private Markets Risk

Private market assets have certain characteristics which have associated risks. Because assets do not trade on public markets, valuation and pricing may be difficult to determine. Assets may be long-term projects which have development risk and uncertainty regarding their financial viability and overall the risk of default, bankruptcy or dilution of the value of a Fund's holding in individual assets is higher than for public market assets.

Risks of investing

Equities: Foreign securities may be more volatile, harder to price and less liquid than domestic securities. They are subject to different accounting and regulatory standards, and political and economic risks. These risks may be enhanced in emerging markets countries.

Fixed Income

Fixed income securities are subject to certain risks including, but not limited to: interest rate, credit, prepayment, and extension.

Real Estate

Investments in real estate may carry additional risk of loss due to the nature and volatility of the underlying investments. Real estate investments are relatively illiquid and the ability to vary investments in response to changes in economic and other conditions is limited. Real estate values can be affected by a number of factors including, inter alia, economic climate, property market conditions, interest rates, and regulation.

Alternatives

Alternative investments may engage in speculative investment practices; involve a high degree of risk; and are generally considered to be illiquid due to restrictions on transferring interests. An investor could lose all or a substantial portion of their investment. Investors must have the financial ability, sophistication/ experience and willingness to bear the risks of such an investment.

Diversification does not necessarily ensure a return or protect against a loss.

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