Macroeconomic Commentary

The second quarter of 2022 proved challenging, with rampant inflation, rising global interest rates, geopolitical conflict in Ukraine, and persistent supply chain and labor concerns impacting investor sentiment and negatively affecting performance across multiple asset classes. Inflation, caused by a myriad of factors and stubbornly at 40-year highs, along with the Fed's tightening monetary policy were main concerns for investors as fears of a potential resulting recession increased. Moreover, elevated commodity prices and a labor shortage, due for the most part to a wave of COVID 19 infections and low unemployment in general, led to business disruptions and further complexity within the broader economy. Through H1 2022, the S&P 500 declined 20.6%, which represented the index's largest decline during the first half of a year since 1970, while the MSCI AC World Index declined a comparable 20.9%. The technology-heavy NASDAQ exhibited even heavier losses, at nearly 30%, as valuations for higher growth businesses continued to be disproportionately impacted.

Unlike past quarters, where private equity and venture capital activity may have appeared to be less affected from broader financial market conditions, impacts were felt by most practitioners in H1 2022. Fundraising across all strategies, for the most part, remained robust, although many of the fundraising processes commenced earlier in the year and conditions have softened materially as of this writing]. Despite the appearance of significant dry powder across the industry, year-over-year investment activity across all strategies slowed given the uncertain valuation environment and lack of clarity regarding the economy and financing markets for buyout-oriented transactions. For much of the same reasons, private equity and venture-backed distribution activity has also declined materially after a record 2021.

U.S. Private Equity

U.S. private equity firms raised $176.0 million across 191 funds in H1 2022, an amount that was largely comparable to the first half of last year. However, fund count continued to lag recent years with institutional investors appearing to continue to prioritize their existing manager relationships, which led to the raising of fewer, but larger funds. Notably, there has been an apparent slowdown in fundraising subsequent to the first half of 2022, driven primarily by investor allocation constraints and the frenetic pace during H1. At this time, it seems that capital raised during the balance of the year will likely decline.

Deal activity over the first half of 2022 remained elevated compared to historical levels, though significantly below the record levels of 2021. U.S. PE managers invested $529.2 million which represented 43% of total deal value for the full-year 2021 and 70% of total deal value for the full-year 2019, the next highest year in terms of dollars invested after 2021. Dollars invested in Q2 declined meaningfully from Q1, which was notable, and we believe

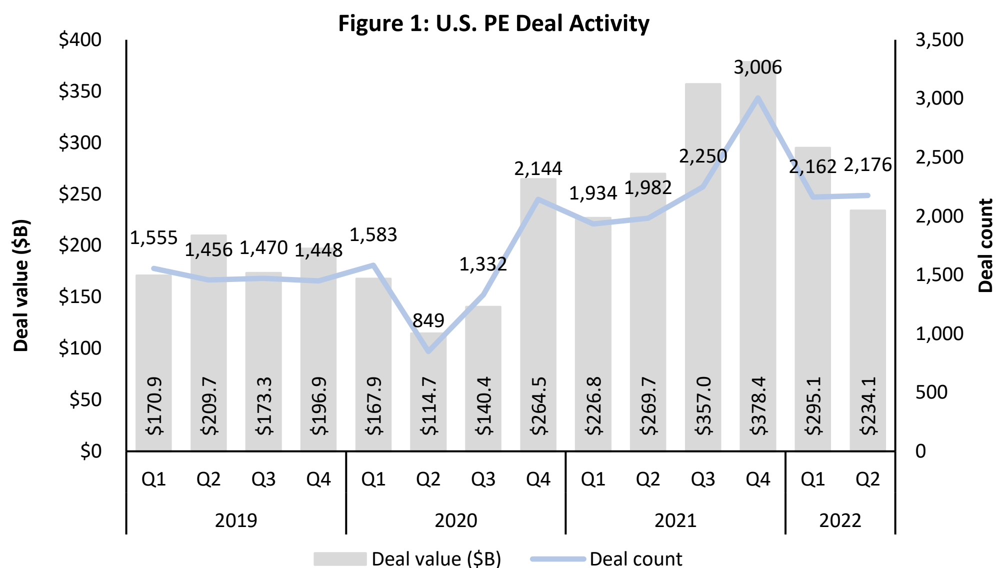

Figure 1 Data Source: PitchBook's 2022 Q2 US PE Breakdown; Q3 2021 – Q2 2022 includes estimated deal activity. Q1 and Q2 2022 includes estimated deal values.

Q3 may decline further given Abbott's experience of current investment activity and commentary regarding deal flow from many PE firms]. From an industry perspective, deal activity remained highest across the IT and B2B services sectors, which contributed a combined 56.5% of U.S. PE deal value. Notably, technology deal activity did not see a significant dip in H1 and despite market and valuation concerns, and the sector remained a key focus of many PE investors given the expectation of long-term growth potential and perceived business model resilience.

Similar to fundraising and deal activity, U.S. private equity-backed exit activity slowed in H1 2022. Realizations totaled $189.9 billion across 577 exits, which includes estimated exits and exit value, which is noticeably lower than record full-year 2021 totals, but largely on trend with COVID-impacted 2020 levels. The pull back in exit activity was likely driven by a number of factors, particularly falling valuations and the resulting misalignment of buyer and seller expectations. Further, U.S. private equity-backed IPOs were virtually non-existent as stock market volatility persisted through the first half of the year.

European Private Equity

The European private equity fundraising environment weakened in H1 likely as a result of public market declines, limited partner allocation concerns, diminishing economic confidence, and inflationary pressures across the Continent. As a result, in H1 2022, only €27.9 billion was raised across 40 vehicles, which puts the fund count for European Private Equity on pace for the lowest number of funds raising capital in the last 10 years, and the lowest capital raised figure since 2014. Given the market dynamics, fundraising timelines have been elongated and it is likely that fund size growth expectations should be more modest going in the near-term.

Figure 2: Europe Private Equity Fundraising Activity

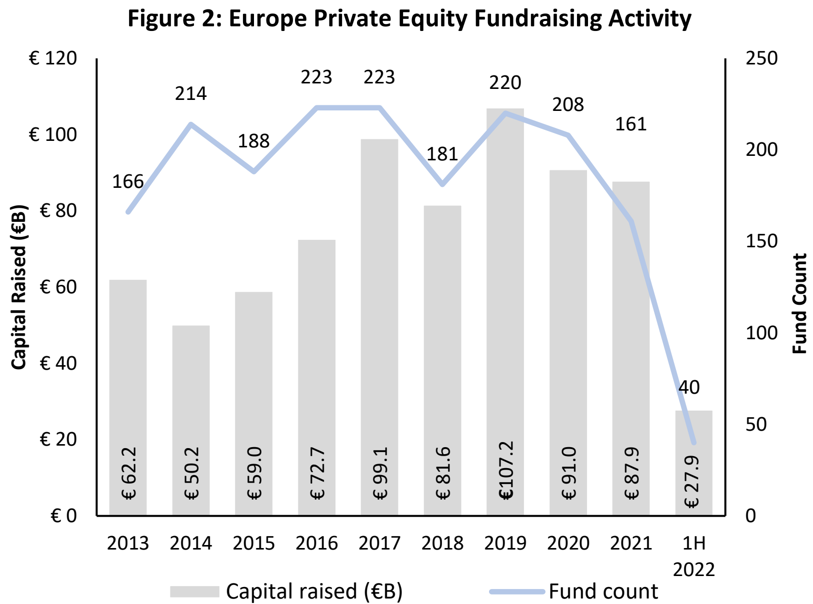

Figure 2 Data Source: PitchBook's Q2 2022 European PE Breakdown

Despite challenges within the broader European market, particularly the continued conflict in Russia/Ukraine and resulting energy prices crisis, European private equity investment activity was resilient in H1 2022. In the first half of the year, 4,053 deals worth an estimated €463.5 billion closed, marking YoY increases of 16% and 35%, respectively. The increase may be attributed mostly to significant amounts of private equity dry powder in the ecosystem that sought new investment opportunities.

With respect to realizations, much like in the U.S., activity was slow during the first six months of the year. In H1 2022, 739 PE-backed companies exited for a cumulative value of €157.8 billion, marking a YoY decrease of 25% in exit value. The sharp decline in exit value is likely a result of perceived near-term risks that the European economy faces including geopolitical conflict in Ukraine, continued persistent inflation, public market volatility, and Continent-wide monetary tightening.

Venture Capital

U.S. venture capital funds raised $121.5 billion in H1 2022, compared with 2021's $138.9 billion full-year total, continuing the strong momentum of the recent past and tracking towards a record year. The $121.5 billion raised

across 415 funds surpassed the $74.1 billion raised across 338 funds over the same period last year. As observed in prior letters, name-brand, billion-dollar-plus funds continued to command the lion's share (nearly 64%) of H1 2022 commitments. More specifically, in H1 2022, 30 funds have closed on at least $1 billion, an increase over 2021's full-year figure of 22. Venture capitalists have also continued to raise capital at an accelerating pace – the average interval between U.S. venture fundraises has steadily dropped to 2.02 years, down from 3.12 years a decade ago. The success of these large funds and the shortening gap between fundraises have created an especially crowded field from which allocators must choose managers, posing challenges to newer and lesser-known venture outfits.

The robust fundraising has, concerningly, occurred amid the darkening backdrop of floundering (technology) stocks, a shuttered IPO market, and plateauing or declining start-up valuations. Venture and growth investing appear to be correcting from a frenetic 2021, a year in which there was more capital invested than in the prior two years combined. The impact of the slowdown has varied across the venture funding stages; globally, late-stage (i.e., Series C and later) rounds have suffered a 38% YoY decline (Q2 '21 to Q2 '22) in deal value, while early-stage (i.e., Series A & B) declined by 9%[1].

The weakness of later stage activity and earlier stages' relative strength can, in part, be attributed to investors mitigating against the moribund exit market. Approximately 831 exits representing $48.8 billion in value among venture-backed companies were recorded in the first half of the year, positioning 2022 to fall well short of 2021's full-year figure of $777.4 billion. 2022's first half exit activity is a reversion to levels not seen since 2017/18. There has been a particular lack of IPO issuances, which are slated for their worst year in decades. Only 42 venture-backed companies went public in H1 2022, compared to 298 in 2021 and 143 in 2020. Some late-stage companies may be reluctant to become public given volatile conditions, necessitating a focus on profitability as capital availability constricts. SPACs, an alternative to traditional IPOs that experienced a popularity surge in 2020 and early 2021, also appear to have fallen out of favor.

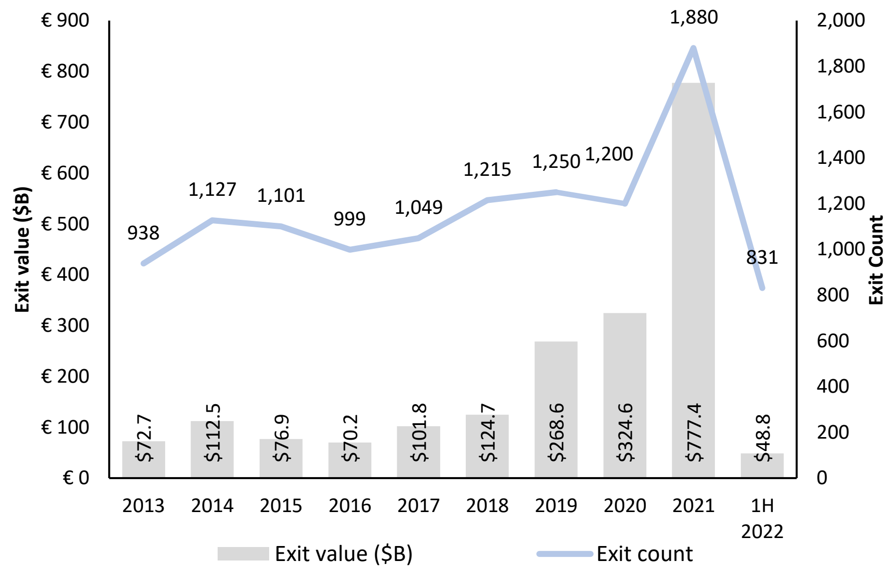

Figure 3 Data Source: Q2 2022 PitchBook-NVCA Venture Monitor; 2021 and 1H 2022 includes estimated exit activity

The nonexistent IPO market may underscore a significant disconnect between venture backed and richly-valued, privately-held companies and sinking public technology stocks. High-flying start-ups hoping to raise cash via these offerings are now confronting the prospect of raising capital at flat or slashed valuations. "Flat" rounds could become increasingly accepted as a palatable outcome, should the exit and IPO drought persist. Start-ups and their management teams, as well as their venture backers, are having to contemplate a departure from a breakneck growth mentality to one which is grounded in durability.

[1] https://news.crunchbase.com/venture/global-vc-funding-falls-q2-2022-monthly-recap/

However, there is some room for optimism. According to the Wall Street Journal, U.S. venture-backed companies raised ~$330 billion in 2021, nearly double the previous record set in 2020[2]. Additionally, the abundance of venture dry powder, which currently totals $290.1 billion, could help cushion current portfolios.

Secondaries

The first half of 2022 set yet another record for the secondary market. According to Jefferies, secondary market volume of $57 billion surpassed the previous high-water mark in H1 2021 of $48 billion, a 19% increase. Much of this increase was a result of strong momentum carried over from 2021, with a robust supply of both GP-led deals and LP portfolio sales. Many LPs were motivated to bring portfolios to the market as a result of a perceived overallocation to private equity. This resulted in LP secondary volume growing by 74% in H1 2022 when compared to the same period in the previous year, driven in part by the largest secondary LP sale in history – a $6 billion portfolio deal. Yet, as public markets experienced downward volatility, the outlook for the rest of the year has become more muted. Buyers in general appear to be increasingly selective in what deals they will consider. Going forward, a potential widening bid/ask spread for companies and portfolios may cause total volume for 2022 to ultimately undershoot the record $132 billion achieved last year.

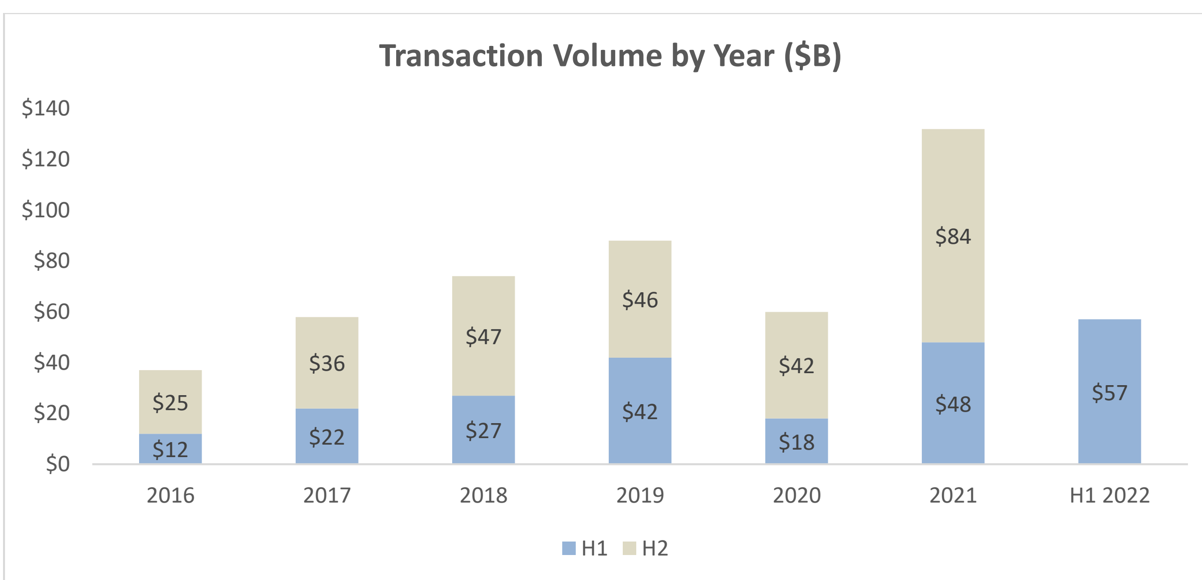

Figure 4 Data Source: Jeffries: Global Market Secondaries Review – July 2022

GP-led transactions, after accounting for 60% of all secondary transactions in H1 2021, cooled off somewhat in H1 2022, accounting for only 42% of total volume, at $24 billion. Continuation vehicles continue to dominate, representing 80% of the GP-led market, with buyers indicating a strong preference for buyout deals. Single asset deals accounted for the majority of continuation vehicles, even as buyers expressed their desire for greater diversification. Jefferies noted that the average maturity for GP-led deals decreased from approximately six years in H1 2021 to roughly five years in H1 2022. This may be a reflection of the increasing acceptance amongst GPs of continuation vehicles as an accepted exit path, with their ability to provide liquidity to investors, while also retaining exposure to the upside.

After a strong improvement in 2021, secondary pricing fell across the board in H1, with average pricing for all strategies falling by 600 basis points to 86% of NAV in H1 2022. As public markets declined and market uncertainty increased,

[2] https://www.wsj.com/articles/ipo-market-faces-worst-year-in-two-decades-startups-11661181427?reflink=integratedwebview_share

buyers likely became increasingly skeptical of dated valuations, resulting in steep discounts. Hit particularly hard was the venture market, with average prices falling by 1,700 basis points to 71% of NAV. Buyers witnessed weakening IPO markets and the significant rerating of some public trading multiples. On the buyout side, prices fell by 600 basis points, with buyers expressing a strong preference for North American exposure. Newer funds continued to price the strongest, with an average price of 94% of NAV for funds 2018 or younger. In contrast, funds 2011 or older priced the weakest, at 75% of NAV. The weighted average vintage of all funds sold was 2014 (~8 years old), which was slightly older than during H1 2021.

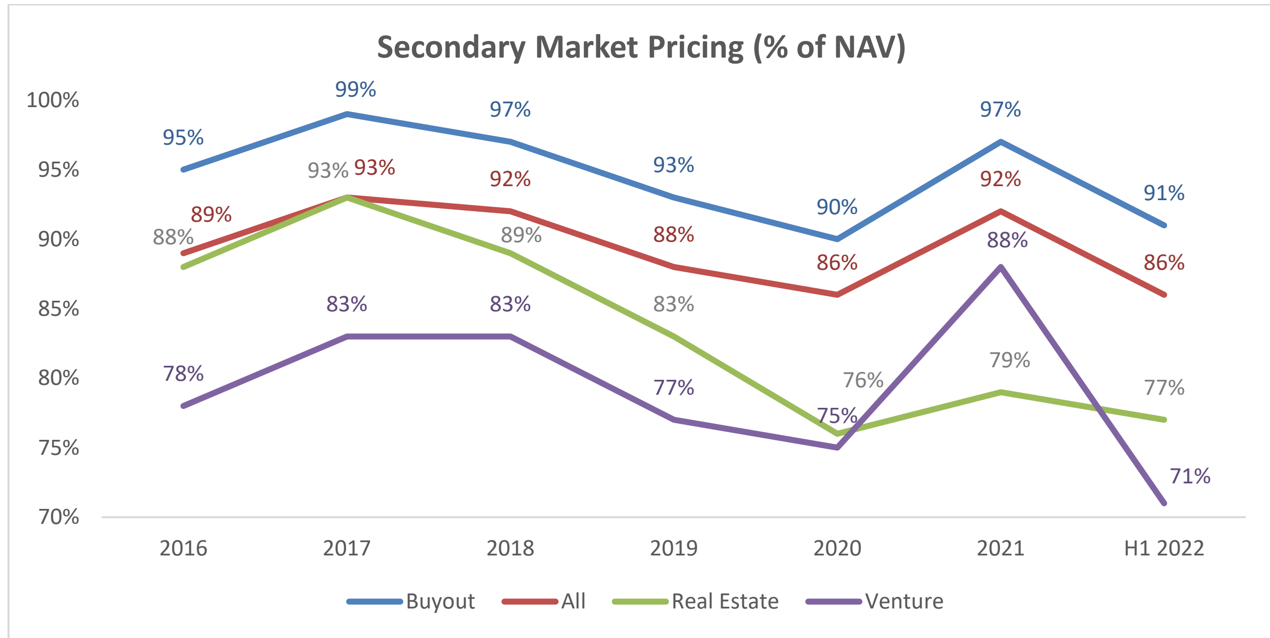

Figure 5 Data Source: Jeffries: Global Market Secondaries Review – July 2022

Outlook

The first half of 2022 proved challenging for investors on many fronts. Persistent inflation and rising global interest rate policies will likely have a material effect on asset prices, portfolio company performance, and ultimately investor behavior during the balance of the year. Transaction activity across the venture and private equity markets, both in terms of new investments and exits, is likely to be below levels witnessed during the first half of the years as investors across both strategies recalibrate pricing and growth expectations. Fundraising is also expected to slow, with many institutional investors already eyeing potential 2023 commitments after having allocated the majority of their 2022 allocations during the first half of the year. Moreover, should public markets continue to trade at current depressed levels, denominator concerns may become more pronounced, leading to difficult decisions regarding target allocations and 2023 commitment pacing. Investors will closely monitor venture capital and private equity quarterly valuations, which historically have been much smoother, both on the down and upside, than the public markets.

SOURCES

Unless otherwise noted, with respect to private equity information, data sourced through: PitchBook's Q2 2022 US PE Breakdown and PitchBook's Q2 2022 European PE Breakdown.

Unless otherwise noted, with respect to venture capital information, data sourced through: Q2 2022 PitchBook-NVCA Venture Monitor, Q2 2021 PitchBook-NVCA Venture Monitor

Unless otherwise noted, with respect to secondary investment information, data sourced through: Jeffries: Global Market Secondaries Review – July 2022.

IMPORTANT INFORMATION

Past performance is not a guide to future results and is not indicative of expected realized returns.

Copyright© Abbott Capital Management, LLC 2022. All rights reserved. This material is proprietary and may not be reproduced or distributed without Abbott's prior written permission. It is delivered on an "as is" basis without warranty or liability. Abbott accepts no responsibility for any errors, mistakes or omissions or for any action taken in reliance thereon. All charts, graphs and other elements contained within are also copyrighted works and may be owned by Abbott or a party other than Abbott. By accepting the information, you agree to abide by all applicable copyright and other laws, as well as any additional copyright notices or restrictions contained in the information.

The opinions and forecasts expressed are based upon market conditions as of September 2022 and are subject to change without notice. This publication does not form part of any offering memorandum and is not an invitation to subscribe for shares in a fund nor is it to be construed as an offer to buy or sell any financial instrument. This does not constitute a recommendation of the suitability of any investment strategy for a particular investor.

This material is for informational purposes only and is not an offer or a solicitation to subscribe to any fund and does not constitute investment, legal, regulatory, business, tax, financial, accounting or other advice or a recommendation regarding any securities of Abbott, of any fund or vehicle managed by Abbott, or of any other issuer of securities. No representation or warranty, express or implied, is given as to the accuracy, fairness, correctness or completeness of third party sourced data or opinions contained herein and no liability (in negligence or otherwise) is accepted by Abbott for any loss howsoever arising, directly or indirectly, from any use of this document or its contents, or otherwise arising in connection with the provision of such third party data.