Hamilton Lane

# Private Equity and Private Credit Have a Competitive Edge During Times of Inflation

**August 2023**

## What You Should Know:

- Historically, private equity has done well across most market cycles compared to public equity.
- Private credit has demonstrated greater consistency of returns than public credit in times of inflation.
- Based on our historical data and past performance, we believe both private equity and private credit will continue to outperform public markets in the years to come.

Private markets have experienced explosive growth over the past two decades, accumulating nearly $10 trillion in AUM by the close of 2022. While this growth story has translated into intense interest in the asset class, there's also been a healthy dose of skepticism among advisors and investors, particularly as we enter a more challenging and uncertain macroeconomic environment. While the performance of private assets to date has been enticing, many investors are wondering whether the end of accommodative monetary policy, the outlook for lower global growth, and inflationary headwinds could erode the ability of private assets to outperform publicly-listed assets.

To explore this question, we turned to our proprietary private markets dataset, which tracks the behavior of thousands of private market investments over the past 50 years. We merged that private assets data with data on inflation and gross domestic product (GDP) growth to study how the performance of the private markets changes during different inflationary and growth environments relative to public markets.

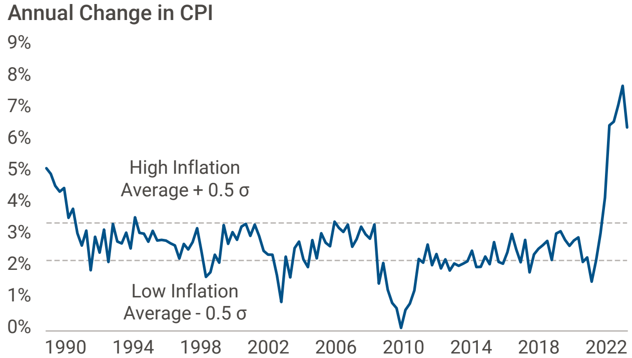
## Methodology

Our analysis focuses on private equity and private credit, which have the longest-dated and most robust sample sets. Performance is examined across nine inflationary and growth environments:

1. High inflation
2. High inflation / low growth
3. High inflation / average growth
4. High inflation / high growth
5. Low inflation
6. Low inflation / low growth
7. Low inflation / average growth
8. Low inflation / average growth
9. All

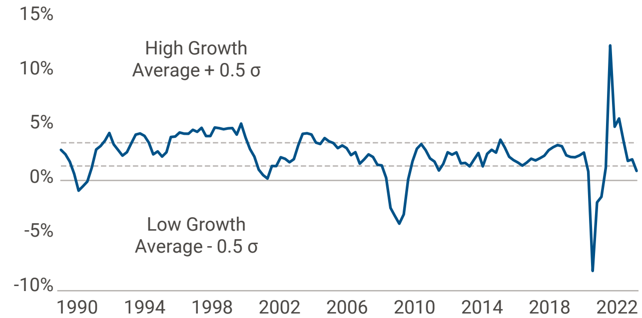
The analysis uses quarterly economic and private markets data stretching back as far as 1990 (the earliest period sufficient private markets data is available). We use the U.S. Consumer Price Index (CPI) as a measure of inflation and U.S. real GDP growth as a measure of economic expansion. That economic data is segmented into high, low, and average buckets based on a 0.5 standard deviation to their averages from 1990 to 2022.

**Annual Change in CPI**




Source: FRED (July 2023)

**Annual Real GDP Growth**



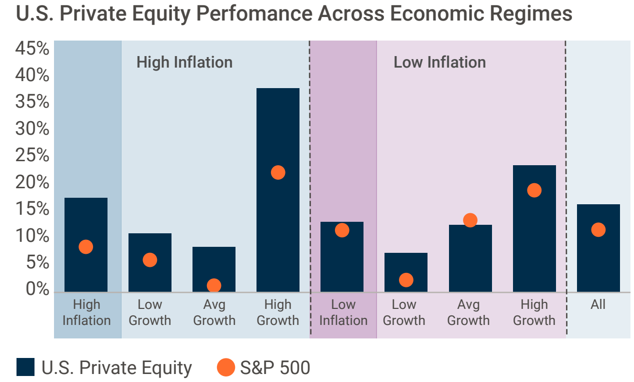

Source: FRED (July 2023)

We also calculated annualized rolling one-year time-weighted rate of returns (TWRs) for private equity and private credit. Meanwhile, we relied on the S&P 500 Index and the Bloomberg Barclays Aggregate Bond Index as benchmarks for public market performance.

## Private Markets Performance by Economic Regime

Private equity skeptics may be surprised by the results: Private equity bested public equity benchmarks in nearly every economic regime.

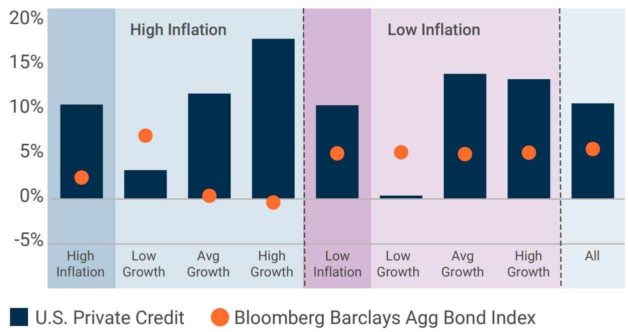
**U.S. Private Equity Perfomance Across Economic Regimes**




Source: Hamilton Lane Data, Bloomberg (July 2023)
Returns modeled using annualized 1 year returns from 1990 to 2022 on a quarterly basis. Past performance is not an indicator of future results.

But the story doesn't end there. On average, private equity historically outperformed public equity the most during times of high inflation. Meanwhile, if private equity returns begin to more closely resemble public equity in a low inflationary environment/low growth scenario, this could potentially reduce the spread between private equity and public equity returns.

**U.S. Private Credit Perfomance Across Economic Regimes**




Source: Hamilton Lane Data, Bloomberg (July 2023)
Returns modeled using annualized 1 year returns from 1990 to 2022 on a quarterly basis. Past performance is not an indicator of future results.

The picture for private credit is a bit more complicated. Our analysis shows private credit returns underperformed during periods of low growth regardless of the inflationary environment. Keep in mind that the low-growth periods were heavily influenced by the market volatility of the Global Financial Crisis when many of the low-growth observations occurred. The credit funds of that era were typically riskier (i.e., mezzanine and opportunistic credit) and had a higher correlation to public equities than the more senior credit funds (i.e., unitranche) that are prevalent today.

We should note that private credit had more consistent returns in all other environments, with especially wide performance spreads during high-inflation environments (e.g., high inflation and low growth).

Returning to the nine inflationary and growth environments, the average spread of outperformance across private equity and private credit is 600 bps. Both strategies saw the highest outperformance during periods of high inflation/high growth, with both exceeding 1,500 bps for that economic regime. During periods of high inflation, compared to low-inflation environments, the average spread triples for private equity and nearly doubles for private credit.

## We Believe Private Equity and Private Credit Will Continue to Outperform

In the analysis above, we narrowed our focus to U.S. economic indicators relative to private equity and private credit performance. This was intentional, as the U.S. market has the richest private market data set and uniformly observable GDP growth and inflation data. Further, when considering whether to use data from the broader global markets, we found that many of the growth/inflation combinations had relatively small sample sizes. These limitations notwithstanding, we still believe the data thus far suggests that private equity and private credit are likely to outperform public markets in most economic scenarios.

We are big believers in private markets, generally – but not only because of their potential for outstanding performance. In our estimation, private markets blend risk and return in the healthiest way. We've seen up markets, down markets, recovery from the Internet bubble, and the Global Financial Crisis; and private markets have outperformed public markets.

In addition, there are several reasons why we believe private markets may remain resilient. For starters, private markets can benefit from better governance, whereby private companies have boards of directors who are real experts, who were put there by private equity sponsors, and are very involved with the companies. Private companies also tend to have management teams that are heavily incentivized by stock, which means that the alignment between management teams and the shareholders is very strong. And because so few companies are going public today, private equity is one of the best ways to access the large swath of the economic activity across the U.S. and other developed economies around the world.

DEFINITIONS

High Inflation: Includes any quarter from 1990 - 2022 where the annual U.S. Consumer Price Index (CPI) rate was above half a standard deviation to the historical average of annual CPI on a quarterly basis from 1990 – 2022

Low Inflation: Includes any quarter from 1990 - 2022 where the annual U.S. Consumer Price Index (CPI) rate was below half a standard deviation to the historical average of annual CPI on a quarterly basis from 1990 – 2022

High Growth: Includes any quarter from 1990 - 2022 where the annual U.S. real GDP rate was above half a standard deviation to the historical average of annual GDP on a quarterly basis from 1990 – 2022

Low Growth: Includes any quarter from 1990 - 2022 where the annual U.S. real GDP rate was below half a standard deviation to the historical average of annual GDP on a quarterly basis from 1990 – 2022

High Inflation / Low Growth: Includes any quarter that fell in both the high inflation bucket (CPI rate was above half a standard deviation to CPI historical average) and the low growth bucket (GDP rate was below half a standard deviation to GDP historical average)

High Inflation / High Growth: Includes any quarter that fell in both the high inflation bucket (CPI rate was above half a standard deviation to CPI historical average) and the high growth bucket (GDP rate was above half a standard deviation to GDP historical average)

High Inflation / Average Growth: Includes any quarter that fell in both the high inflation bucket (CPI rate was above half a standard deviation to CPI historical average) and had the GDP rate within half a standard deviation of the GDP historical average

Low Inflation / Low Growth: Includes any quarter that fell in both the low inflation bucket (CPI rate was below half a standard deviation to CPI historical average) and the low growth bucket (GDP rate was below half a standard deviation to GDP historical average)

Low Inflation / High Growth: Includes any quarter that fell in both the low inflation bucket (CPI rate was below half a standard deviation to CPI historical average) and the high growth bucket (GDP rate was above half a standard deviation to GDP historical average)

Low Inflation / Average Growth: Includes any quarter that fell in both the low inflation bucket (CPI rate was below half a standard deviation to CPI historical average) and had the GDP rate within half a standard deviation of the GDP historical average

All: Includes every quarter from Q1 1990 – Q4 2022

S&P 500 Index – The S&P 500 Index tracks 500 largest companies based on market capitalization of companies listed on NYSE or NASDAQ.

U.S. Private Equity: A broad term used to describe any fund that offers equity capital to private companies investing primarily in the United States

U.S. Credit: This strategy focuses on providing debt capital primarily investing in the United States

Bloomberg Barclays Aggregate Bond Index – Tracks the performance of U.S. fixed rate corporate debt rated as investment grade.

DISCLOSURES

This presentation has been prepared solely for informational purposes and contains confidential and proprietary information, the disclosure of which could be harmful to Hamilton Lane. Accordingly, the recipients of this presentation are requested to maintain the confidentiality of the information contained herein. This presentation may not be copied or distributed, in whole or in part, without the prior written consent of Hamilton Lane.

The information contained in this presentation may include forward-looking statements regarding returns, performance, opinions, the fund presented or its portfolio companies, or other events contained herein. Forward-looking statements include a number of risks, uncertainties and other factors beyond our control, or the control of the fund or the portfolio companies, which may result in material differences in actual results, performance or other expectations. The opinions, estimates and analyses reflect our current judgment, which may change in the future.

All opinions, estimates and forecasts of future performance or other events contained herein are based on information available to Hamilton Lane as of the date of this presentation and are subject to change. Past performance of the investments described herein is not indicative of future results. In addition, nothing contained herein shall be deemed to be a prediction of future performance. The information included in this presentation has not been reviewed or audited by independent public accountants. Certain information included herein has been obtained from sources that Hamilton Lane believes to be reliable, but the accuracy of such information cannot be guaranteed.

This presentation is not an offer to sell, or a solicitation of any offer to buy, any security or to enter into any agreement with Hamilton Lane or any of its affiliates. Any such offering will be made only at your request. We do not intend that any public offering will be made by us at any time with respect to any potential transaction discussed in this presentation. Any offering or potential transaction will be made pursuant to separate documentation negotiated between us, which will supersede entirely the information contained herein.

Certain of the performance results included herein do not reflect the deduction of any applicable advisory or management fees, since it is not possible to allocate such fees accurately in a vintage year presentation or in a composite measured at different points in time. A client's rate of return will be reduced by any applicable advisory or management fees, carried interest and any expenses incurred. Hamilton Lane's fees are described in Part 2 of our Form ADV, a copy of which is available upon request.

The following hypothetical example illustrates the effect of fees on earned returns for both separate accounts and fund-of-funds investment vehicles. The example is solely for illustration purposes and is not intended as a guarantee or prediction of the actual returns that would be earned by similar investment vehicles having comparable features. The example is as follows: The hypothetical separate account or fund-of-funds consisted of $100 million in commitments with a fee structure of 1.0% on committed capital during the first four years of the term of the investment and then declining by 10% per year thereafter for the 12-year life of the account. The commitments were made during the first three years in relatively equal increments and the assumption of returns was based on cash flow assumptions derived from a historical database of actual private equity cash flows. Hamilton Lane modeled the impact of fees on four different return streams over a 12-year time period. In these examples, the effect of the fees reduced returns by approximately 2%. This does not include performance fees, since the performance of the account would determine the effect such fees would have on returns. Expenses also vary based on the particular investment vehicle and, therefore, were not included in this hypothetical example. Both performance fees and expenses would further decrease the return.

Hamilton Lane (Germany) GmbH is a wholly-owned subsidiary of Hamilton Lane Advisors, L.L.C. Hamilton Lane (Germany) GmbH is authorised and regulated by the Federal Financial Supervisory Authority (BaFin). In the European Economic Area this communication is directed solely at persons who would be classified as professional investors within the meaning of Directive 2011/61/EU (AIFMD). Its contents are not directed at, may not be suitable for and should not be relied upon by retail clients.

Hamilton Lane (UK) Limited is a wholly-owned subsidiary of Hamilton Lane Advisors, L.L.C. Hamilton Lane (UK) Limited is authorised and regulated by the Financial Conduct Authority (FCA). In the United Kingdom this communication is directed solely at persons who would be classified as a professional client or eligible counterparty under the FCA Handbook of Rules and Guidance. Its contents are not directed at, may not be suitable for and should not be relied upon by retail clients.

Hamilton Lane Advisors, L.L.C. is exempt from the requirement to hold an Australian financial services licence under the Corporations Act 2001 in respect of the financial services by operation of ASIC Class Order 03/1100: U.S. SEC regulated financial service providers. Hamilton Lane Advisors, L.L.C. is regulated by the SEC under U.S. laws, which differ from Australian laws.

Any tables, graphs or charts relating to past performance included in this presentation are intended only to illustrate the performance of the indices, composites, specific accounts or funds referred to for the historical periods shown. Such tables, graphs and charts are not intended to predict future performance and should not be used as the basis for an investment decision.

The information herein is not intended to provide, and should not be relied upon for, accounting, legal or tax advice, or investment recommendations. You should consult your accounting, legal, tax or other advisors about the matters discussed herein.

The calculations contained in this document are made by Hamilton Lane based on information provided by the general partner (e.g. cash flows and valuations), and have not been prepared, reviewed or approved by the general partners.

As of August 28, 2023