Crème de la crème

NBPE is well placed with exit-ready companies.

Update
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The US Federal Reserve continued its slow but steady interest rate cutting cycle in September, reducing the Fed Funds Rate from 4.5% to 4.25%, the fourth reduction it has implemented since rates peaked in mid-2023. It may follow suit with its fifth rate cut in December.

Interest rate cuts spark plenty of discussion about which sectors will benefit. Many investment trusts, particularly those within alternative asset sectors, were hit hard by steep rate hiking cycles, so, the theory goes, rate cuts should provide a tailwind of equal magnitude.

Conventional wisdom assumes, for instance, that falling and lower interest rates are the main driver of private equity performance because they raise private company valuations and lower the cost of leverage. Hence, private equity returns should be closely correlated with interest rates.

However, as with most assumptions, there are nuances. Indeed, recent research carried out by Neuberger Berman (NB) found that private equity returns depend less on interest rates alone and a lot more on the general economic backdrop.

NB found only small, statistically insignificant correlations between private equity returns and four distinct measures of interest rates between 1985 and 2023. This suggests that private equity returns and distributions are primarily driven by the state of the economy, rather than by the level of interest rates.

NB said that the relationship between rates and private equity returns and distributions were "complex", noting a notable change in dynamics around the global financial crisis (GFC) of 2008/09.

The more tangible findings of NB's study is, in our view, on the correlation between interest rates and the dispersion of performance among private equity funds (that is, the difference in performance of the best and the worst funds).

Here, the overall finding is that the best-performing private equity funds are better able to capitalise on the favourable conditions that lower rates necessarily bring.

Main Street versus Wall Street

In short, NB's research found a negative correlation between private equity returns and the spread between the two-year and ten-year Treasury yields prior to the GFC, but this more reflects the spread's role as a bellwether of the economy.

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Post-GFC, there is a negative correlation between returns and the ten-year Treasury yield, but this is heavily influenced by the Covid-19 pandemic and the subsequent inflation shock; excluding this period results in insignificant correlations with the two.

Similar is the case with private equity distributions, which are cash payments made back to the fund's investors as the underlying investments are sold and profits are realised.

Before the GFC, distributions are negatively correlated with the yield curve spread, but after the GFC that negative correlation moves to the ten-year Treasury yield, as well as the benchmark short-term interbank lending rate (three-month LIBOR/SOFR), though this time that correlation persists irrespective of the Covid period.

Even still, NB concludes that the results suggest both returns and distributions are primarily driven by the state of the economy than by the level of interest rates, bond yields or loan spreads in themselves.

Sure, lower interest rates will help sentiment towards certain sectors. All things equal, lower interest rates should mean lower bond yields and lower interest on savings accounts, in theory encouraging more consumers to move to risk assets.

Lower interest rates should also be good for general stock market sentiment, meaning IPO activity should ramp up, providing more exit opportunities for private equity funds.

However, fundamentals almost always matter more than macro-economic machinations over the long term, and it is the real economy that determines the actual growth rate of companies that are more important for unrealised private equity valuations.

The best versus the rest

The final factor that NB explored was whether lower rates benefit the most skilful private equity managers disproportionately than the less skilful. To measure this return dispersion, NB looked at the returns of the 75th percentile and the 25th percentile of the Burgiss US Private Equity database.

The headline results showed negative correlations here, which suggests that the better funds do tend to pull away from the laggards more substantially when rates are low and leveraged loan spreads are narrow. Importantly, this correlation is consistent during both the pre- and post-GFC periods.

Wider dispersion in the second quartile of funds tends to be due to the cut-off for the 75th percentile rising further than the median, while wider dispersion in the third quartile tends to be due to the median rising further than the cut-off for the bottom 25th percentile. Put simply, this suggests that the higher dispersion is due to the better performers making even better use of favourable economic conditions, rather than poorer performers getting worse.

We think that all of this bodes well for **NB Private Equity Partners (NBPE)**, particularly the last point about the better private equity managers outpacing the worse ones when interest rates are low.

NBPE runs a co-investment model, investing directly into private companies as minority investor partners with some of the world's leading private equity managers, instead of investing into private equity funds.

This model gives management full control over investment decisions – allowing the team to start and stop investment activity whenever they deem it appropriate. By contrast, many of its fund-of-fund peers are often forced to do periodic, follow-on investments, even when it may not be in their best interest.

It also allows NBPE's managers to focus on investing alongside the best private equity managers possible. To do this, they make sure that every investment the trust makes is made alongside a manager in their core area of expertise, ensuring their partners have real, deep knowledge and experience in that specific sector. So, if NBPE wants to invest in a software company, for instance, it will invest alongside a software specialist private equity manager.

Financial flexibility

In addition, we suspect that NBPE will be even less dependent on interest rate cuts to deliver attractive returns moving forward. That's especially true since its investments are generally sourced from the mid-market section of private equity, where most realisations happen by selling portfolio holdings to trade buyers, or other private equity firms.

The fact that the IPO window is reopening is a benefit – and provides an extra avenue to realise value – but it's not the be all and end all for NBPE. In fact, despite a subdued exit environment, NBPE generated $68m in realisations during the first half of 2025, and has announced a further $97m of realisation at an aggregate uplift of 17% to carrying value, with the potential for further realisations in the latter part of the year.

Given the flexibility of NBPE's co-investment approach the company has prioritised balance sheet strength in recent years amid a more uncertain exit. As of 31/10/2025, NBPE has $312m of available liquidity which includes $93m in cash and liquid investments, reflecting a strong cash position. It effectively has no future investment commitments, so it is not compelled to raise cash to make new investments at inopportune times.

This puts it in a strong position to weather any slowdown in the pace of realisation activity and provides the financial flexibility to pursue new investments, maintain dividend payments and fund an increasing level of share buybacks without compromising balance sheet stability.

The findings of NB's research are unsurprising to us and suggests that while lower interest rates will be favourable to the market backdrop and should buoy listed private equity funds, investors should put more emphasis on the US economy achieving a soft landing. Such an outcome could be a tailwind for near- to mid-term returns from US private equity.

Taken together, a combination of soft landing and an interest rate cutting cycle would certainly provide a constructive backdrop for private equity. NBPE has a number of high-quality, exit-ready companies, positioning it well, in our view, to take advantage of any improvement in the exit environment. While the c. 30% discount to NAV is broadly in-line with peers, it could represent attractive absolute value for investors who can take a long-term view.

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