PRIVATE EQUITY & VENTURE CAPITAL

Many investors continued to increase allocation to private investments in Q1. While knock-off effects of SVB's collapse are yet to be seen, the role and fate of the venture capital (VC) and private equity industry are closely intertwined. SVB serviced nearly 50% of the tech and life sciences startups in the United States, and the VC industry will feel a long-term impact as the cost of funding increases and capital becomes scarcer. Venture-backed fintech companies like Brex and Mercury have stepped in to fill some of the gaps left in the wake of SVB, but as highlighted by Brex CEO Henrique Dubugras, while the operational infrastructure – wires, automated clearing house, and payments – may go to fintechs, deposits will likely be concentrated with the large US systemically important banks.

Away from the SVB collapse, private markets were relatively quiet. Venture activity remains tepid amid a slowing fundraising environment. Following a record-breaking $154 billion of fundraising in 2022, preliminary data from Crunchbase shows that total venture funding fell 53% YoY to $76 billion in the first quarter of 2023. Unlike previous quarters where the funding slowdown was most acute at the later stage, every funding stage was down 44%-54% YoY. Further, the IPO window remains closed around the world, with funds raised from first quarter listings dropping over 60% YoY.

Despite the slowdown, there is cause for optimism as venture firms still hold record amounts of dry powder, which will likely be deployed at lower valuations across all stages. Although the primary market has slowed, the market for secondaries has picked up. Many funds marked down their valuations by 20-30% in 2022 and investors are becoming more comfortable with current marks. Recent buyouts, which often traded at a premium to net-asset-value over the last several years, are now trading at 5-10% discounts, and discounts for many VC funds are in the 50-70% range. Investors are becoming more strategic in how they manage their PE portfolios and have begun selling strips of their recent commitments in order to reinvest in newer vintages with higher expected returns.

Another emerging trend is the ongoing reshoring of US manufacturing, which has two key tailwinds. First, the semiconductor industry received a boost with the Chips Act driving an increase in government funding to solidify the US's supply chain. With labor shortages and increasing focus on productivity and safety, there has been significant investment in automation. This, coupled with the drive to the Internet of Things and the electrification of almost everything we do, means there is a considerable need for chips. Second, there is a trend more broadly in manufacturing on how the US can reinvest in its own supply chains across a variety of sectors from downstream oil & gas to cold chain to food & beverage.

Within the venture industry, many note periods of slowdown can be the best opportunity set for company creation. Historical data shows that tech downturns lead to some of the best VC vintages as funds enter at lower valuations, companies are forced to grow more capital-efficiently, and talent is more readily available. While late-stage valuations surged in 2021 and fell just as quickly in 2022, seed stage valuations and activity have been the least-impacted through the 2022 reset. Entering the second quarter, we expect early-stage venture will continue to attract investment dollars as LPs bet that 2023 and 2024 vintages will be some of the best performing in recent memory.