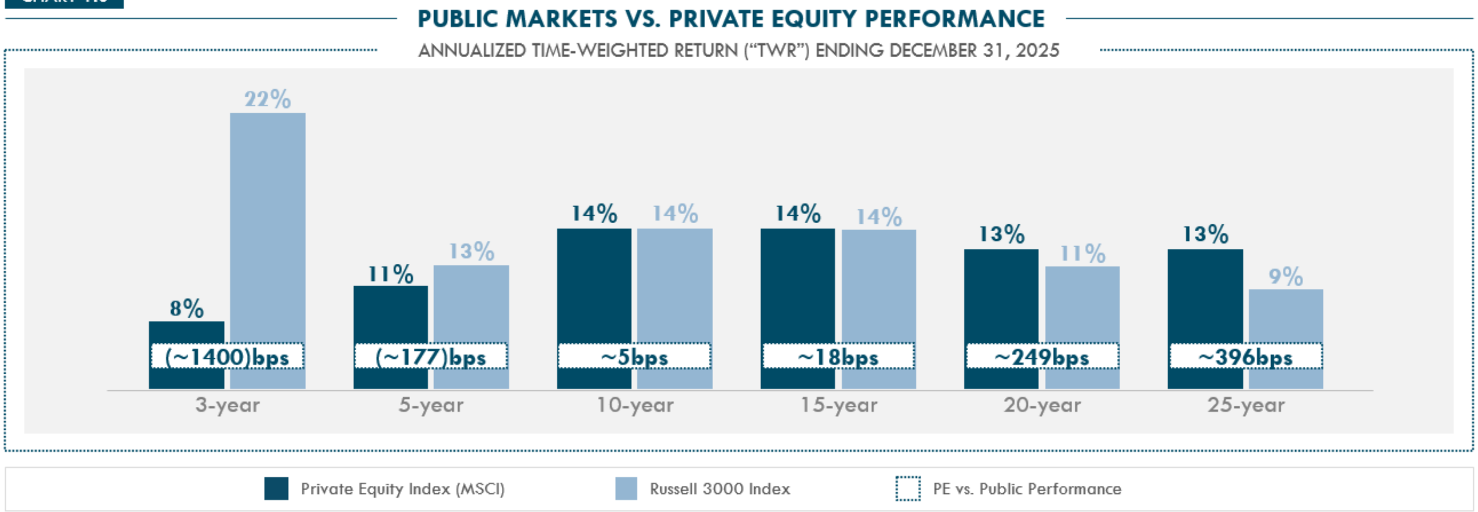
Part 2 of 3: Spotlight on Private Equity

The Evolving Role of PE in Portfolios

In recent years, private equity returns have moderated. After generating approximately 13% annualized net returns over the past 25 years, PE has moderated to returns of approximately 11% and 8% over the last five and three years respectively *(See Chart 1.0)*. More notably, PE has recently underperformed public equities, an unusual outcome relative to the experience of the prior quarter century. We believe this divergence deserves attention, but not extrapolation.

CHART 1.0



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Our analysis suggests that the recent underperformance of private equity is more likely temporal than structural. Underlying operating performance across PE-backed companies has remained resilient, while a significant portion of recent public market outperformance has been driven by expanding valuations and extraordinary performance from a relatively small number of mega-cap companies. The result is an unusual one: private equity returns are running below their long-term average despite continued double-digit underlying earnings growth, while public equities have generated returns substantially above their long-term average and now trade at a meaningful valuation premium to private markets.

This matters because periods of divergence do not necessarily represent permanent changes in relative return potential. They can also reflect differences in where markets are in their respective cycles.

In Part 1 of Dawson's Spotlight on Private Equity series, we examined what PE may need in order to generate attractive returns in the next era. Our analysis illustrated potential net returns ranging from ~8% under a multiple contraction scenario to ~16% as additional value-creation levers are introduced (*See Part 1 for more context*).

In this paper, we put those potential outcomes in a broader portfolio context. We believe PE continues to offer meaningful alpha potential if, as we expect, public and private market performance normalize. But our argument extends beyond returns alone. As the corporate universe has migrated toward private ownership and public markets have grown more concentrated, we believe private equity can play an increasingly important, almost necessary, role in giving investors access to a broader and more diversified opportunity set. All with the potential to generate more stable and resilient returns relative to public markets.

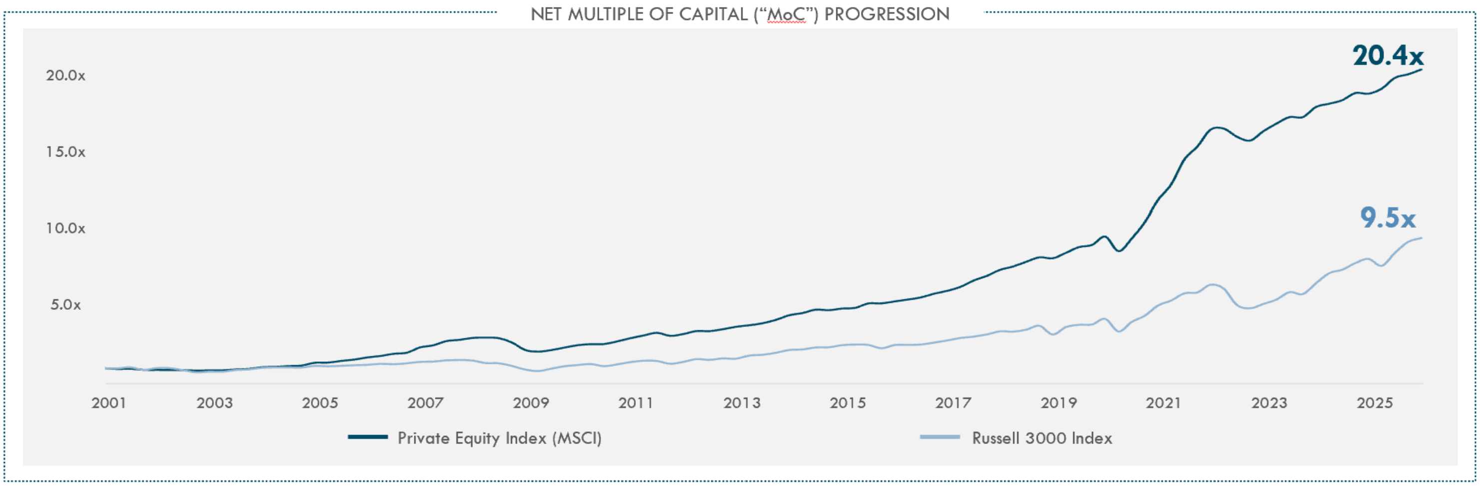
The evolving case for private equity, in our view, is about more than alpha. It is also about portfolio construction and the role that PE can play in investors' portfolios.

AN UNUSUAL PERIOD OF RELATIVE PERFORMANCE

Recent performance in both private equity and public markets stands in contrast with their longer-term records, with private equity currently trailing. Step back, though, and the picture reverses: over the past 25 years, private equity generated approximately 13% annualized net returns versus 9% for the Russell 3000. The difference compounded meaningfully: a dollar invested in private equity over that period would have grown to approximately 20.4x, compared with approximately 9.5x for the Russell 3000 *(See Chart 2.0)*.

CHART 2.0

PRIOR 25-YEAR PERFORMANCE: PRIVATE EQUITY VS. PUBLIC MARKETS



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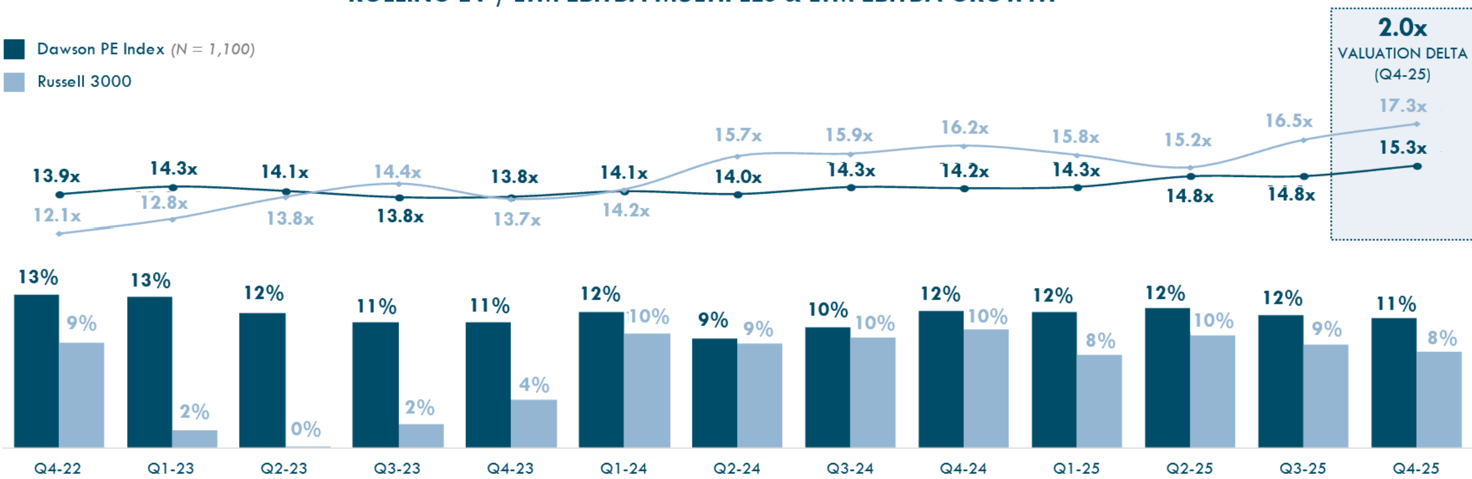
The question we ask, therefore, is not whether public markets have recently outperformed. They clearly have. The more important question is why. If recent PE underperformance reflects deteriorating businesses, weakening operating performance, or an impairment of the PE ownership model, then it could represent a structural change in the asset class's return potential; but our analysis suggests something different.

OPERATING PERFORMANCE TELLS A DIFFERENT STORY

While private equity investment returns have moderated particularly over the last three years, the operating performance of PE-backed companies has remained comparatively strong. During this same time, PE has continued to generate approximately 9-13% LTM EBITDA growth, outperforming public markets which has ranged from 0-10%. The growth has also been considerably more consistent than public markets *(See Chart 3.0)*.

CHART 3.0

ROLLING EV / LTM EBITDA MULTIPLES & LTM EBITDA GROWTH



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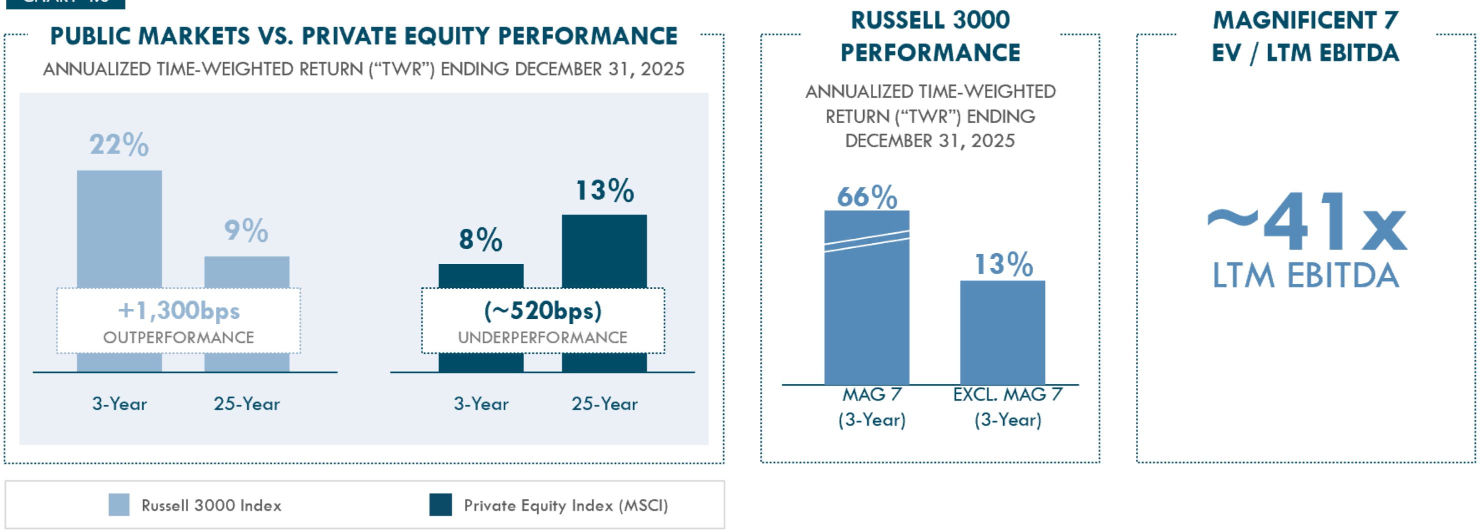
Said differently, recent PE underperformance has occurred despite outperformance of EBITDA. In our view, that makes it difficult to attribute the relative return gap solely to deterioration in the fundamental performance of PE-backed businesses. Instead, an important part of the divergence appears to lie elsewhere: valuations. At the end of 2025, the Russell 3000 traded at approximately 17.3x EV/LTM EBITDA, compared with approximately 15.3x for PE, representing a 2.0-turn premium for public equities *(See Chart 3.0)*. That gap persisted despite private equity's comparatively resilient EBITDA growth.

In other words, as of December 31, 2025, public market investors were paying approximately two additional turns of EBITDA for public companies while the operating performance of PE-backed companies remained comparatively strong. This suggests that public equities may have benefited largely from substantial re-rating of multiples. This can produce significant differences in investment returns even when the underlying private companies are generating more consistent and stronger EBITDA growth.

PUBLIC MARKET PERFORMANCE HAS BEEN EXTRAORDINARY BUT CONCENTRATED

The magnitude of recent public market returns is also important to place in historical context. The Russell 3000 has generated ~22% annualized returns over the past three years, compared with ~9% over the past 25 years. This outperformance is highly concentrated. The Magnificent Seven ("Mag 7"), which traded at ~41x LTM EBITDA, generated ~66% annualized returns over the most recent three-year period. Excluding those seven companies, the remainder of the Russell 3000 generated ~13% annualized returns *(See Chart 4.0)*.

CHART 4.0



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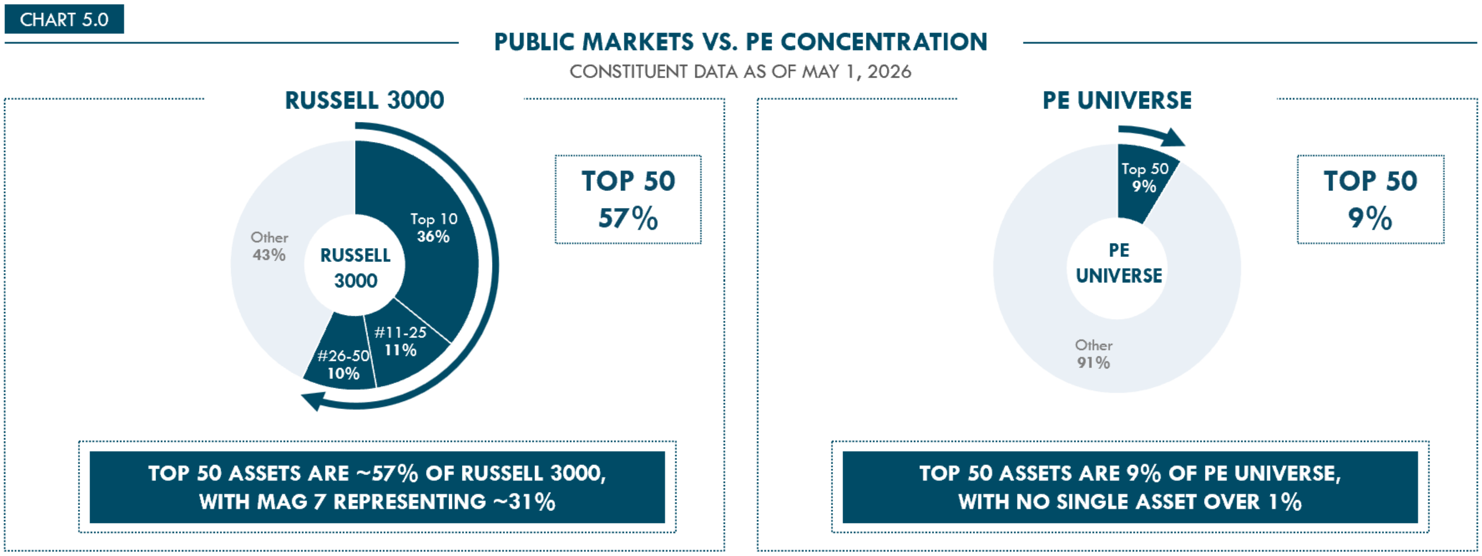
This is not a critique of those businesses. Their performance may ultimately prove justified by future earnings growth. But it reveals that recent public market outperformance has been heavily concentrated, with implications beyond just performance. Today, the top 50 companies represent ~57% of the Russell 3000's total market capitalization, with the Mag 7 alone accounting for ~31%. The comparable figures for private equity look very different: the largest 50 PE-backed companies represent ~ 9% of the private equity universe's enterprise value, with no individual company over 1% *(See Chart 5.0)*.

CHART 5.0



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An index containing thousands of securities can appear highly diversified based on its number of holdings while actually being concentrated based on economic exposure. As a relatively small group of companies grows to represent an increasingly large share of index value, investors become more dependent upon the performance, valuations and earnings expectations of an increasingly small subset of companies.

By contrast, private equity can offer a materially different exposure with a broader company universe and substantially less concentration at the top. And increasingly, that private company universe represents a part of the corporate economy that public market investors cannot easily access.

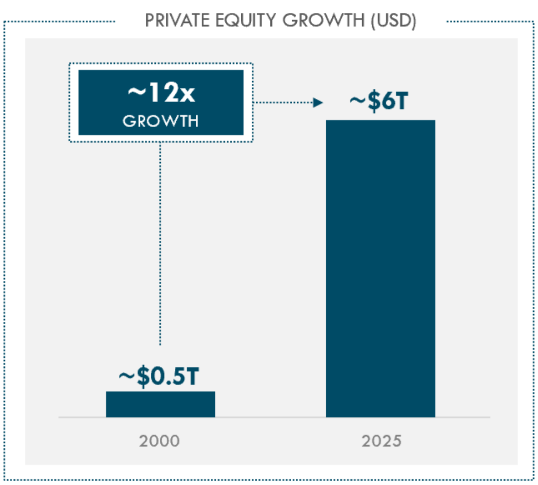
THE CORPORATE OPPORTUNITY SET HAS MIGRATED

The growth of private equity is sometimes viewed principally as a story about the growth of capital allocated to the asset class. We believe another structural development deserves equal attention: the corporate universe itself has changed.

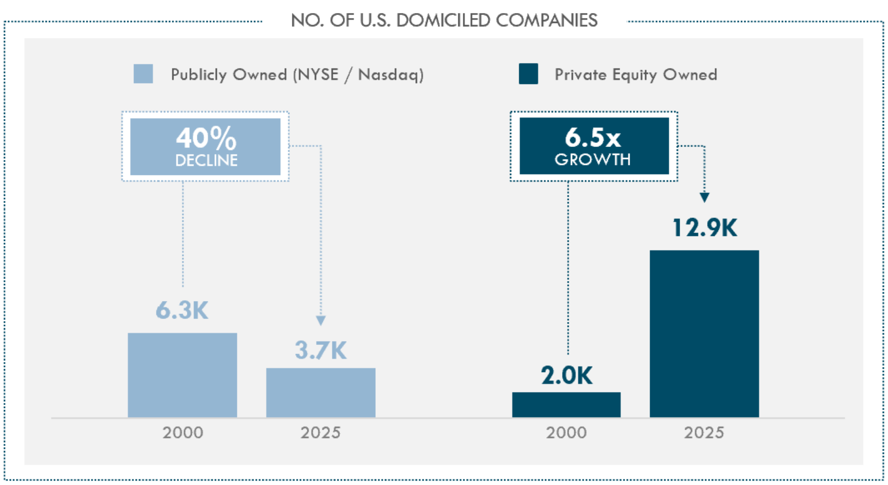
Over the past 25 years, the number of publicly listed U.S. companies has declined approximately 40%, from ~6,300 companies in 2000 to ~3,700 today. Over that same period, the number of PE-backed companies in the U.S. has increased approximately 6.5x, from ~2,000 to ~12,900, while private equity AUM has increased from ~$0.5 trillion to ~$6 trillion *(See Chart 6.0)*. When considered globally, the number of PE-backed companies exceeds 30,000.

CHART 6.0

PRIVATE EQUITY AUM



PE BACKED VS. PUBLICLY OWNED COMPANIES



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While it is acknowledged that exit activity has slowed in recent years and longer holding periods have contributed to the number of companies currently owned by private equity, we believe it would be incomplete to interpret the growth of the private company universe simply as an inventory of businesses waiting to be sold. The longer-term data in our analysis suggests a potentially broader structural change: many companies' increasing desire to reside in private rather than public markets.

We believe the continued shift from public to private markets is partly driven by the advantages of the private equity governance model. More patient, sophisticated capital and aligned ownership can allow management teams to make decisions with a long-term horizon - investing through cycles, pursuing operational improvements and seeking to build durable value without the pressure of quarterly earnings expectations.

At the same time, private capital markets have developed to the point where businesses can grow and operate at significant scale while remaining private, making private ownership an increasingly viable and attractive long-term option for companies. As a result, the investable universe available through public markets increasingly represents only one portion of the broader equity opportunity set. We believe this changes the diversification discussion for investors: the question should no longer be simply whether private equity can outperform public equities, but also whether a portfolio invested exclusively in public equities provides sufficient exposure to the full breadth of the modern corporate economy.

NORMALIZATION IS A QUESTION OF FUNDAMENTALS

We believe today's relative performance should also be viewed against the longer-term experience and expectations of both asset classes.

Private equity has generated approximately 8% annualized returns over the past three years, compared to approximately 13% over the past 25 years. Public equities, by contrast, have generated approximately 22% over the past three years, compared with approximately 9% over the past 25 years. In our view, neither of the recent figures represents a durable run rate.

We believe public valuations already reflect earnings growth that has not yet been delivered. Public equities trade at an approximately two-turn EBITDA premium to private markets, with a narrow group of companies trading near 41x LTM EBITDA. While this growth may well arrive, we see it as having already been priced, and it must now be earned simply for current valuations to hold.

Private equity begins from a different position. Multiples have stayed within a comparatively narrow band, EBITDA growth has continued at approximately 9-13% over the last 3 years, compared to 0-10% for public comparables. This suggests returns have been generated primarily through operating performance rather than re-rating. Less of the future is embedded in today's marks.

Normalization, in our view, is therefore not a directional call. It is a question of whether returns remain anchored to fundamentals. On that basis, and with the operational levers (identified in Part 1 of our series) still available to sponsors, we believe the setup for private equity is constructive.

PUTTING PART 1'S RETURN SCENARIOS INTO A PORTFOLIO CONTEXT

In Part 1 of our series, we asked what private equity might need to generate attractive returns in its next era. Rather than assume a single outcome, we modeled several illustrative scenarios assuming a 5-year hold period.

Under a scenario in which valuation multiples contract by 2x from entry to exit, while other levers hold generally consistent with prior 25-year averages, the analysis generated an ~8.0% net IRR. With value-creation assumptions broadly consistent with private equity's prior 25-year experience, illustrative net returns were ~10.5%. Introducing approximately 365 basis points of EBITDA margin expansion increased the illustrative net outcome to ~13.4% (driven by AI adoption potential), lower financing costs to ~14.2%, and more active fund management to ~15.6% (*See Part 1 for more details*).

The downside case may be the most instructive. Even assuming two full turns of multiple contraction, an illustrative 8.0% remains broadly comparable to the ~9% generated by the Russell 3000 over the past 25 years, a period that itself includes the extraordinary 22% annualized performance of the most recent three years. Said differently, an adverse valuation environment for private equity can still produce an outcome in line with the long-term experience of public markets.

As additional levers are introduced, the illustrative outcomes move back toward private equity's own historical experience of approximately 13% annualized, and at the upper end above it. Importantly, none of that depends on multiple expansion, elevated leverage, or revenue growth above historical averages. It depends on margin expansion, financing costs and fund management, each of which in our view can be influenced by a sponsor.

This is why we believe recent relative performance should not be extrapolated indefinitely. Private equity does not need to recreate every tailwind of the past 25 years to potentially generate attractive returns relative to public markets.

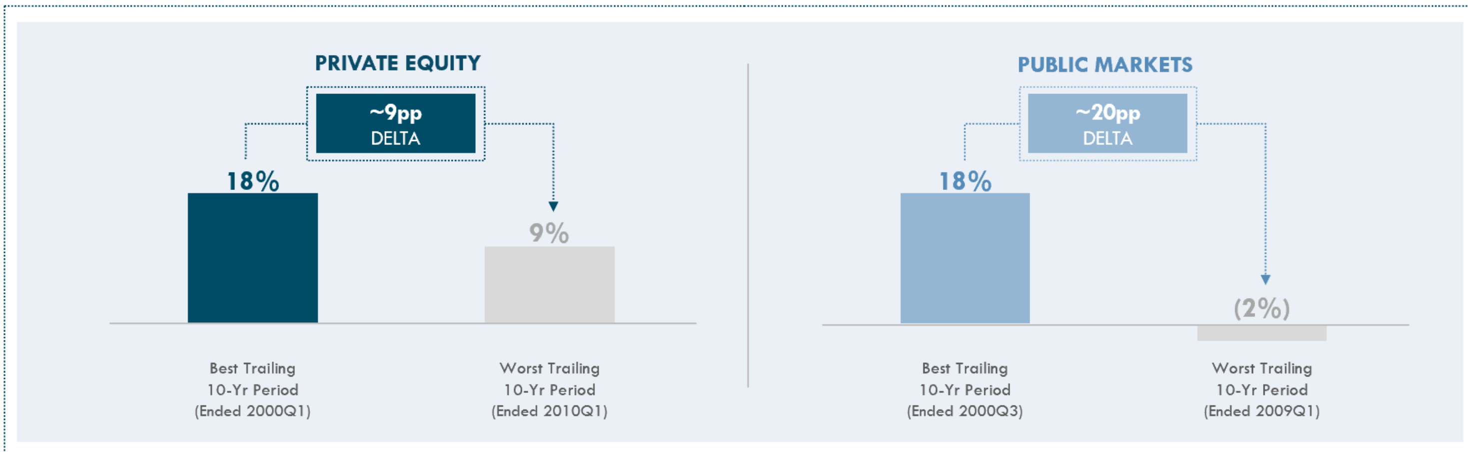
A MORE STABLE SOURCE OF EQUITY RETURNS

Potential alpha is only one part of the argument. Private equity has also exhibited a more muted range of outcomes than public equities. Case in point: the best trailing 10-year period for private equity generated ~18% annualized returns, while the worst generated ~9%, representing a 9-percentage-point spread. Public markets' best trailing 10-year period also generated ~18%, but their worst generated approximately negative 2%, representing a 20-percentage-point spread *(See Chart 7.0)*. Said differently, over the long-term, private equity has generated better returns with lower volatility. Some may conclude this as better risk-adjusted returns.

CHART 7.0

PE VS. PUBLIC MARKET PERFORMANCE

10-YEAR ROLLING ANNUALIZED TWR



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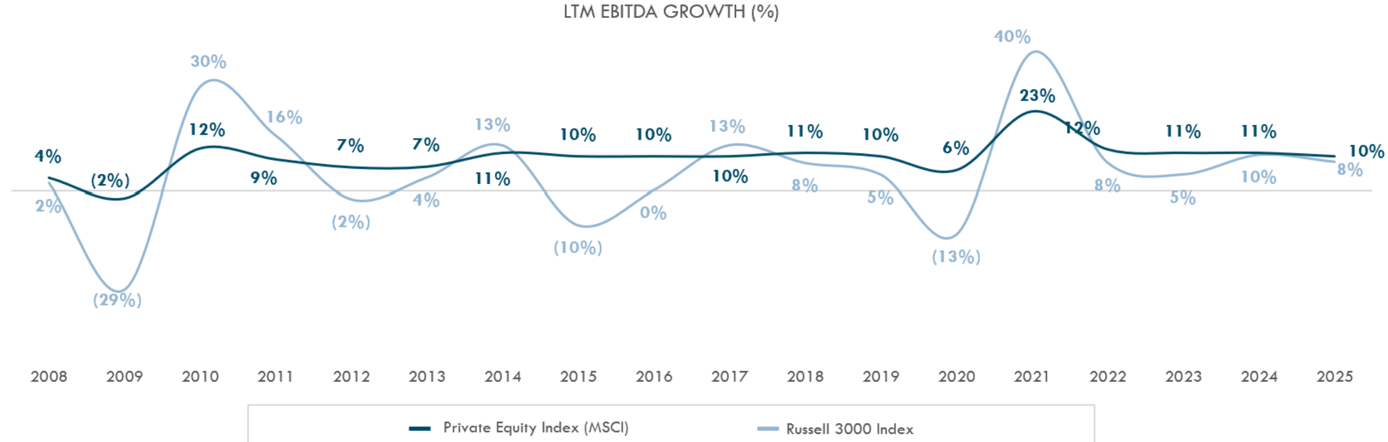
Some have argued that PE valuations are opaque and, at times, disconnected from public market reality; an argument that tends to become loudest when private company valuations do not move in lockstep with public market declines. We believe this critique can overlook a fundamental difference between the two ownership models. The enhanced governance, longer-term orientation and greater alignment more typical in private equity can contribute to more resilient underlying earnings and cash flows *(See Chart 8.0)*. To the extent that fundamentals are more stable, lower volatility in private company valuations may reflect differences in business performance and ownership structure, rather than simply differences in valuation methodology.

CHART 8.0

PE VS. PUBLIC MARKETS EARNINGS GROWTH

LTM EBITDA GROWTH (%)



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CONCLUSION: BEYOND ALPHA

Private equity has historically earned its place in institutional portfolios through its potential to generate alpha. We believe that opportunity remains intact.

While recent PE returns have moderated and have lagged public equities, the underlying evidence does not, in our view, suggest that the PE operating model has structurally deteriorated. PE-backed companies have continued to grow earnings ahead of public markets. Public market outperformance has instead coincided with substantial valuation expansion and extraordinary performance from a narrow group of companies, we believe leaving public equities at a premium that must now be earned through future earnings growth simply for current valuations to hold.

At the same time, Part 1 of our Spotlight on Private Equity series demonstrated the potential for private equity to generate a wide range of attractive outcomes without a return to the conditions that characterized prior eras. Even assuming two full turns of multiple contraction, if other levers hold generally consistent with prior 25-year averages, illustrative PE returns approach the prior 25-year return of public equities. As additional value-creation levers are introduced, those illustrative outcomes move back toward private equity's own historical experience, and at the upper end above it, without relying on multiple expansion, elevated leverage or outsized revenue growth.

But we believe the more important evolution in the case for private equity goes beyond just returns. The corporate opportunity set itself has changed. More companies have migrated toward private ownership while public indices have become increasingly concentrated, and private equity should therefore be evaluated not simply as an alternative to public equity, but as a complement to it. Both provide ownership in businesses. Increasingly, however, they provide ownership in different universes of businesses, with different concentrations, valuation dynamics and sources of return.

For investors with appropriate liquidity, time horizons and governance capabilities, excluding private equity means forgoing exposure to a growing portion of the corporate economy at a time when the public-market opportunity set has narrowed. Beyond its potential to generate alpha, private equity can expand the investable opportunity set, enhance diversification, reduce dependence on increasingly concentrated public markets, and contribute to a more stable overall return profile.

The question for many investors may therefore no longer be simply whether private equity will outperform public markets in the next three or five years. It may increasingly be whether a long-term equity portfolio can be considered truly diversified and resilient without private equity.

However, fully capturing that opportunity is not a given, and not all of private equity is created equal. In this new era, we believe the gap between winners and losers will become more pronounced and GP selection will matter more than it has in past cycles. The same may be true for LPs: positioning for the full potential benefits described in this paper may depend less on simply allocating to the asset class, and more on how that allocation is built and managed. **In our third and final paper of the Dawson Spotlight on Private Equity series, we will explore what we believe will be required of those managing and allocating to the asset class: the role of Active Management for both GPs and LPs**.