



Asante Market Pulse

Q2 2025 – Rowing Downstream

In a market grappling with liquidity constraints, LPs are increasingly shifting their focus to the mid and lower mid-market, where agility, specialisation, and quicker return of capital offer a compelling counterbalance to sluggish exits and inflated valuations upstream. This issue explores the forces behind the downstream migration, the opportunities for alpha presented, and the capital solutions enabling investors to navigate this evolving landscape.

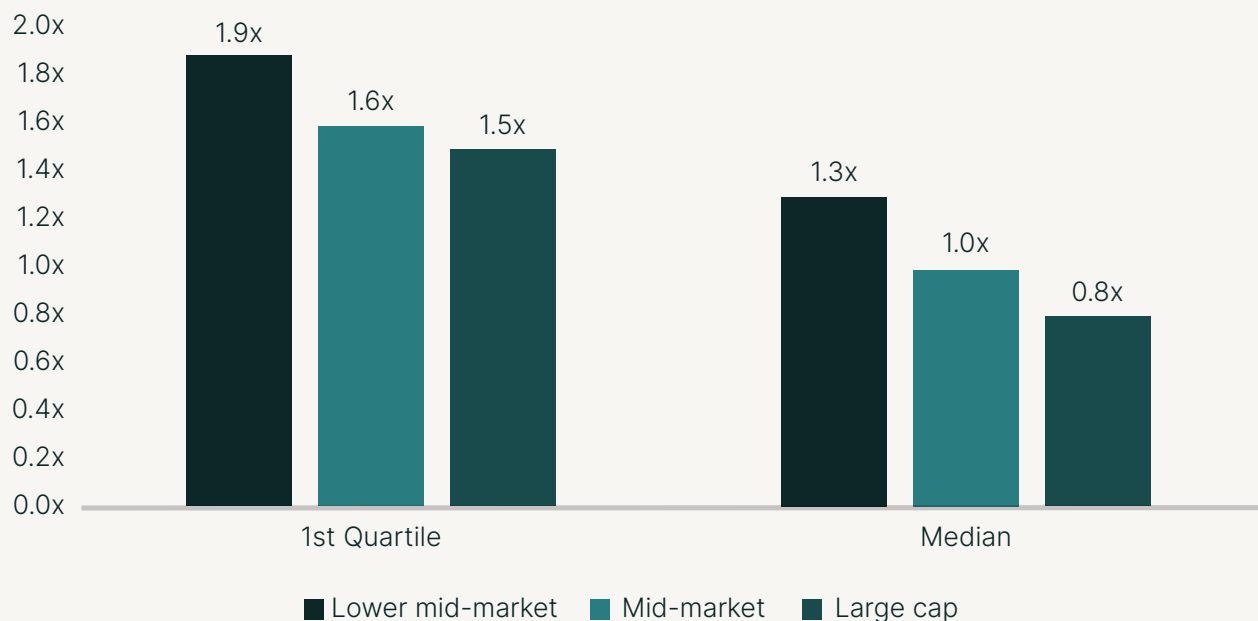


A spotlight on liquidity

In a period defined by muted exits and slower deployment, liquidity has become paramount for many LPs. According to McKinsey¹, more than twice as many LPs now cite DPI as the most important performance metric when compared to three years ago. Some reasons are obvious, others less so. It's clear that LPs are scrutinising their cash positions and forecasts now more than ever, and therefore recognise that a dollar today is worth more than a dollar tomorrow, especially in today's inflationary environment. Further, with more scepticism surrounding asset valuations, some LPs are placing less emphasis on the unrealised portion of GP portfolios, which can skew overall TVPI calculations. It's obvious that the reigning king is still cash.

Some less visible market dynamics at play include the fact that many mid-market and large cap GPs are still sitting on assets acquired at peak valuations in 2020-2021 and are unable to shift these today. The impact of this is twofold; the indigestion of the mid-market prevails, and performance suffers as valuations remain flat and hold periods increase. In contrast, the lower mid-market has shown more agility and taken advantage of constrained mid-market managers with pressure to deploy capital, providing a robust means of exiting and ultimately returning capital to LPs. Against today's backdrop, many LPs are assessing their portfolios and rethinking where liquidity resides, and are increasingly finding it further downstream.

DPI Performance of Private Equity Buyout Funds (Vintages 2003-2021)²



¹ Global Private Markets Report 2025: Braced for Shifting Weather, McKinsey (May 2025)

² Unlocking Liquidity: The Distribution Edge of Lower Mid-Market Private Equity, PGIM (2025)

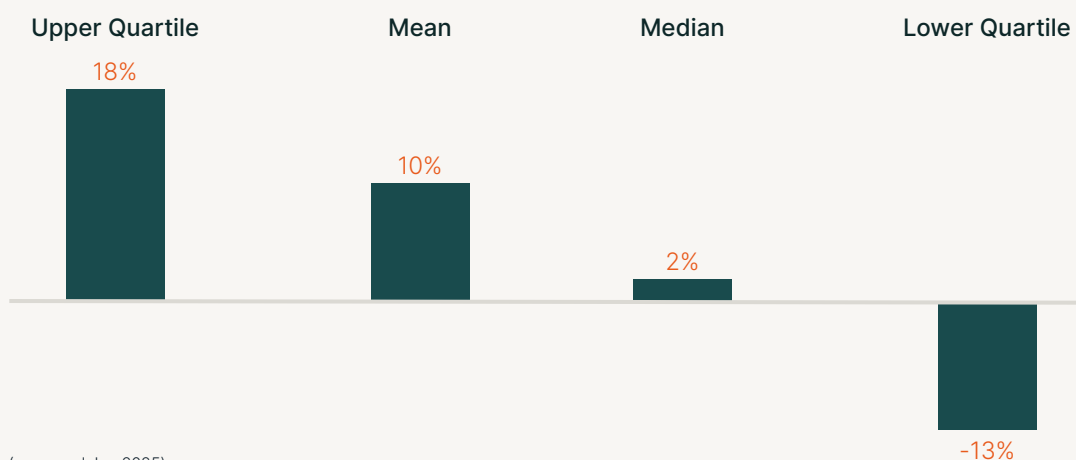
Where alpha still exists

The pursuit of liquidity is leading many LPs to double down or, in some cases, to rediscover the lower mid-market. As the Private Equity market matures, larger buyout strategies are increasingly resembling market indices, similar to those you can buy for 10bps via an app on your phone. These funds provide obvious benefit to sovereign wealth funds and pension giants who need to park capital at scale, but for more nimble LPs, alpha is top of mind, and the lower mid-market has been a fertile hunting ground.

Often, GPs in the lower mid-market bring deep specialisation in a sector or region, or are highly differentiated in their approach. In addition, they operate in less intermediated and less efficient areas of the market that are rife for exploitation. Crucially, lower mid-market assets are likely to be earlier in their development and institutionalisation, offering low hanging fruit to GPs with a hands-on approach from a value creation perspective. These easy wins are not available in assets that have been traded through multiple PE owners where the early bird has already caught the proverbial worm. While the upper end of the market wrestles with frozen IPO markets, prolonged holding periods and slowly falling returns, the lower mid-market continues to reward those who see the biggest risk of investing as not taking any risk at all.

While outperformance may appear modest upon inspection of the median returns delivered by a portfolio of lower and mid-market opportunities, relative to their large and mega-cap counterparts, the potential for outperformance for an investor with capacity to select funds becomes more apparent at the top quartile mark, with top quartile lower-mid market funds exhibiting an 18% higher IRR and 13% higher DPI than their larger competitors.

Lower Mid- and Mid-Market IRR Outperformance vs Large and Mega-Cap Funds (2018-2023)³



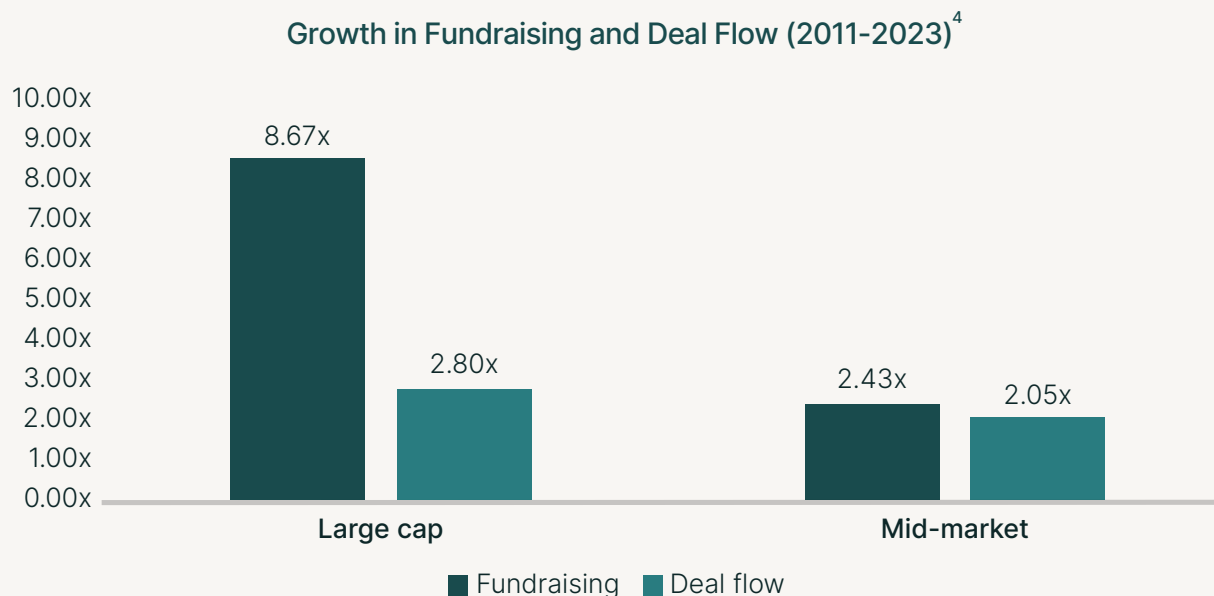
³ Preqin Data (accessed Jun 2025)

Why LPs are moving downstream



Our view is that the flight downstream isn't a fad; it's a clear reflection of the pendulum shifting and changing realities as the market matures. Whilst buying gold and investing in mega caps still define "flight to quality", there is a resurgence in appetite for funds down market with more perceived risk but much higher actual return potential. As investors chase differentiation, specialisation and liquidity, the lower mid-market is becoming a meaningful part of investors' portfolio construction.

Lower mid-market GPs are seeing higher volumes of actionable deal flow, generally at lower entry valuations due to less competitive and intermediated processes, which is perhaps unsurprising when one reviews the extent to which fundraising has outpaced deal flow growth in the large-cap market. This provides more clearly achievable value creation initiatives and therefore puts alpha generation firmly in the hands of the GP, preferable to relying on market tailwinds that seem to have stopped blowing. LPs have also recognised that specialisation is viable and preferable at the lower end of the market, where GPs can clearly define their circle of competence without having to stretch mandates.



There are, of course, still challenges, including but not limited to scaling down ticket sizes, accepting less co-investment, and navigating less visible track records. But for LPs willing to do the work, the rewards are clear - greater alignment, better performance, a more attractive segment of the market, and ultimately quicker return of capital.

⁴ Returns In Focus - Value Creation Shines in the Lower Middle Market, CAIA (Aug 2024)

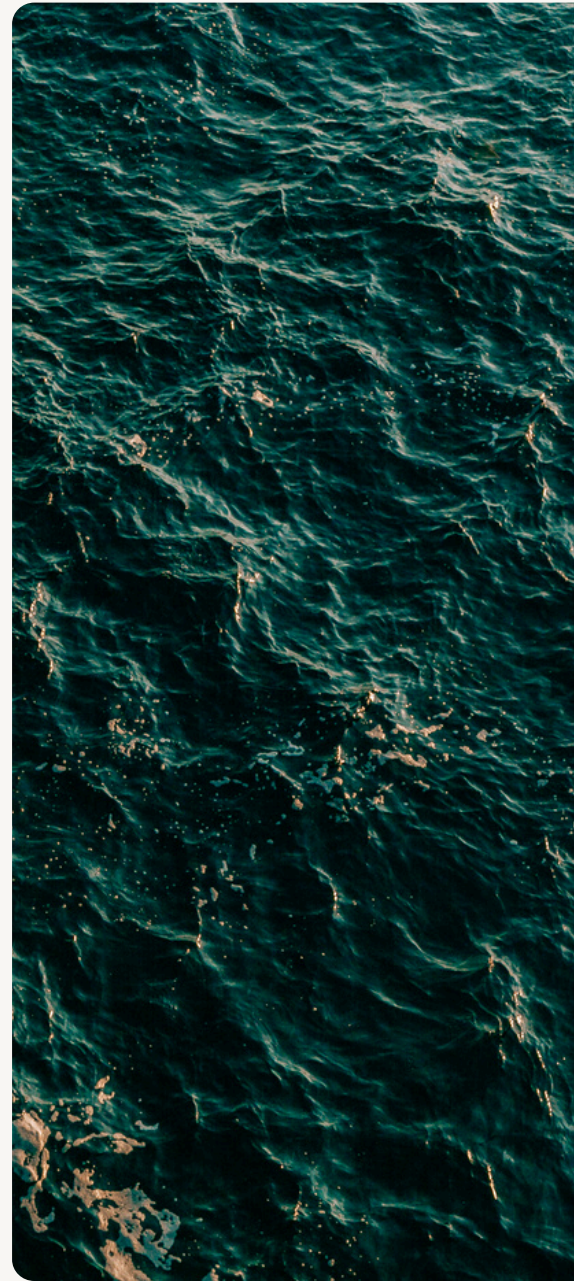


Challenges with smaller funds

As mentioned, the challenges that exist with smaller and particularly more nascent funds are not to be overlooked. First, they are often structurally unsuitable for the largest limited partners, such as sovereign wealth funds, public pensions, or insurance general accounts. These institutions typically require the capacity to deploy commitments well into the hundreds of millions, alongside expectations for consistent co-investment access, scalability, and limited breach of internal concentration limits. By contrast, smaller funds, often sub-\$500 million, struggle to accommodate such requirements without compromising strategy discipline or portfolio construction.

Another key challenge lies in visibility and verifiability of the track record. Many emerging managers are operating on the strength of prior experience at larger platforms, but attribution can be murky, and institutional investors are rightly cautious about backing a thesis that has yet to be tested across market cycles, team dynamics, or adverse conditions. The lower- and mid-markets offer greater return dispersion, meaning that the difference between a top and third quartile manager is often not incremental, but fundamental. Third quartile funds in these segments consistently underperform their large-cap counterparts on IRR, TVPI, and DPI - a stark reminder that selection risk is elevated when venturing off the beaten path. Greater risk for greater return.

Operational infrastructure can also lag in smaller firms. Lean teams, lighter compliance frameworks, and immature reporting capabilities may present further hurdles for institutional capital, particularly where governance and transparency are non-negotiable. As such, effective and intensive due diligence becomes not just a safeguard, but a prerequisite for success in this corner of the market. For those who get it right, the rewards are clear. But in the lower mid-market, alpha is earned - not assumed.

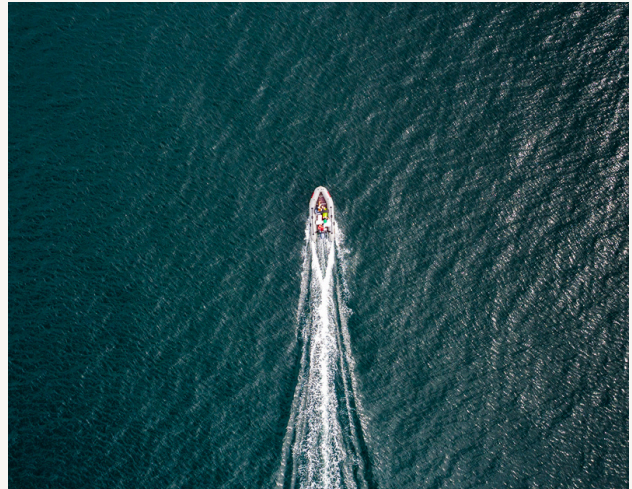




Global macroeconomic outlook and impact on smaller private market funds

It would be remiss not to at least reference the current economic outlook and its impact, though the nature of current volatility means that any specific analysis may become quickly outdated. In any case, geopolitical and economic uncertainty is the new normal - with the U.S. at the epicentre. From recent (albeit seemingly abated) interest rate whiplash and inflation volatility, to extraordinary global trade tension and geopolitical uncertainty, the macroeconomic backdrop continues to test the nerves of even the most seasoned asset allocators. While these conditions may have softened M&A activity and dragged on exits across the board, the ripple effects can be seen to play out quite differently across segments of the market.

For lower mid-market private equity managers, this environment presents both challenges and unexpected opportunities. On one hand, elevated borrowing costs and tighter credit conditions have made financing more difficult, particularly for smaller GPs who lack the balance sheets or leverage with lenders that their larger peers enjoy. Investor caution has also increased, adding pressure to fundraising efforts and lengthening decision cycles.



On the other hand, dislocation breeds opportunity. Lower mid-market managers are often more nimble, less dependent on leverage, and able to utilize lower hanging fruit, in terms of operational levers that drive value. Amidst market turbulence, many are capitalising on stressed sellers, bilateral deal opportunities, and valuation resets - all of which tend to appear first in the lower reaches of the market. Moreover, LPs seeking shelter from inflated valuations and frozen exit markets are increasingly prioritising opportunities with shorter duration, stronger liquidity potential, and clearer value creation. In short, uncertainty isn't just a hurdle - it's a catalyst for managers prepared to run towards the fire.



Implications for LP portfolios and the capital solutions available

As investor demand shifts downstream, the methods for accessing the lower mid-market are evolving. For many institutional LPs, the challenge is less about desire and more about access, with a growing set of capital solutions helping to bridge that gap.

Seeding strategies are gaining traction, allowing LPs to back promising first- or second-time funds with favourable economics, enhanced governance rights, and early access to differentiated managers. Warehousing structures, where LPs or intermediaries underwrite initial transactions pre-fundraise, are also enabling emerging GPs to build track records and demonstrate deal execution before coming to market.

Meanwhile, deal-by-deal (DbD) deployment is being used both tactically and structurally, giving LPs the ability to underwrite individual opportunities with greater control over timing, exposure, and downside protection.

Morgan Stanley alone has raised north of \$2.3bn for its largest co-investment fund dedicated specifically to the lower mid-market, in a bet that smaller private equity funds will generate outsize returns as a result of increased alignment to generate carried interest, relative to their asset-gathering mega-fund peers.⁵

These strategies also address practical constraints. Sub-scale fund sizes that may once have deterred large institutions are increasingly being absorbed through programmatic capital relationships or the support of fund platforms that aggregate exposure. For LPs willing to invest in access, the lower mid-market offers not just the prospect of returns, but genuine alignment with managers who are still hungry, disciplined, and focused. In many ways, it's not just about the fund - it's about forging the next generation of managers from the ground up.

⁵ Why Co-investment Matters for Smaller Deals, Mergers & Acquisitions (Apr 2025)



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