BLUE OWL

Pulse Check:

2024 Market Outlook

Foreword

Reflecting on our initial market outlook for 2024, we are pleased that our views across the capital markets and broader economy were accurate as the underlying themes we highlighted have remained constant.

We are not macroeconomists, yet through our vantage point of over 400 portfolio companies, we were less convinced that inflation was at a level the Federal Reserve would feel comfortable embarking on a looser monetary policy in an aggressive manner.

Our natural skepticism of groupthink, informed by decades of experience underwriting alternative investments, ensured we were well-positioned for the contrarian market environment of higher rates and a stable U.S. economy that has characterized 2024 so far.

With more than two quarters of investment data behind us, we continue to see healthy earnings growth and stable credit ratings across our investment platforms. Capital inflows across our institutional and private wealth channels remain robust despite a more challenging fundraising environment.

Looking to the latter part of the year, the Fed will likely execute the first round of interest rate cuts. As we wrote at the start of the year, as the cost of capital eases even modestly, the floodgates of M&A may begin opening as private equity firms seek to deploy a record amount of dry powder.

Certain factors such as a divisive U.S. Presidential Election and various geopolitical conflicts still present potential headwinds.

From Blue Owl's perspective, our products and solutions focus on income generation and capital preservation, two areas investors tend to prioritize during times of uncertainty.

Regardless of the macro-environment, we remain laser-focused on serving as the go-to solutions provider to our users of capital while delivering strong, risk-adjusted returns to our investors.

With all that said, we invite you to read our updated thoughts on our three investment platforms. We hope these insights will provide a helpful framework for how we think about our business and the markets in which we operate.

We wish you the best for the remainder of 2024.

Doug Ostrover
Co-Chief Executive Officer

Marc Lipschultz
Co-Chief Executive Officer

BLUE OWL

Pulse Check:

2024 Credit Outlook

Craig W. Packer
Co-President, Head of Credit

Introduction

The first half of 2024 illustrated the difficulty of economic forecasting and the benefits of an all-weather asset class that is resilient amidst changing conditions. Entering the year, the prevailing market outlook for the U.S. economy was optimistic. GDP growth continued at a steady pace and there seemed to be few signs of an upcoming recession. Additionally, upwards of six interest rate cuts were expected by year-end from a Federal Reserve that seemed to have successfully tamed inflation while orchestrating a soft landing. This "Goldilocks scenario" would have seen borrowing costs ease alongside a growing economy, likely facilitating a rebound in dealmaking. However, a series of higher-than-expected inflation prints in the first several months of the year curtailed rate cut expectations, with some questioning if any easing would occur before year-end. Meanwhile, the U.S. labor market continued to prove resilient, further reducing the impetus for the Fed to cut rates. Recently, however, a bout of economic uncertainty, moderating inflation and softening payroll data revitalized calls for interest rate reductions - an indication the Fed may now be behind the curve and a soft landing may prove more elusive.

Despite this mixed backdrop, direct lending portfolios performed well in 1H24 and current market conditions augur further strong performance into year-end. Elevated base rates remain supportive of all-in yields and fund returns. This has reinforced the outperformance of the direct lending asset class relative to traditional fixed income and public credit markets. The resilience borrowers have consistently demonstrated amid a historic rate hiking cycle has been equally notable and credit stress remains low. While M&A activity has not rebounded as quickly as anticipated thus far in 2024, scaled direct lenders with differentiated platforms and substantial capital continue to see good opportunities and remain active.

In this piece, we revisit some of the themes and perspectives shared in our 2024 Credit Outlook published earlier in the year. Rather than offering new perspectives, however, we have provided updates on the topics continuing to define our market.

New deal activity remains light, but we continue to find attractive investment opportunities

As noted, entering 2024, market participants were generally expecting a rebound in deal activity following a slowdown in M&A volumes over the prior 18 months. While we continue to expect a resurgence in deal flow, it has not yet come to fruition as the higher-for-longer rate cycle persists, and valuation gaps remain between buyers and sellers.

Against the backdrop of light deal activity, public loan markets were significantly more active than they were last year, with the U.S. leveraged loan market registering a record $405 billion of issuance in Q2.[1] Many borrowers sought to take advantage of the supply-demand imbalance by refinancing loans in the public market, marking a reversal of the dynamic seen in 2023 when many broadly syndicated loans were refinanced in the direct lending market.[2] Importantly, we believe this give-and-take is a natural market dynamic in which the public and private credit markets co-exist. At times, the public credit market can pull back and private credit can step in to serve as the primary capital provider, as was the case in 2022 and 2023. Other times, deal flow to public and private markets can be more balanced.

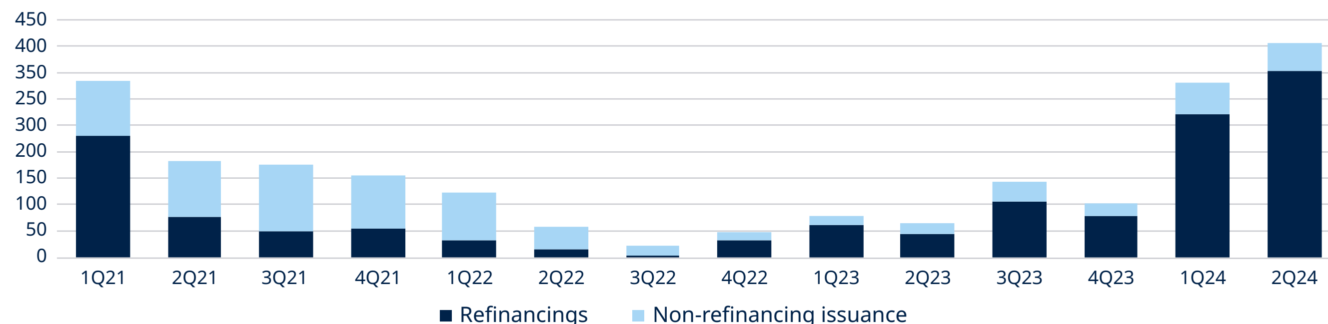
Despite a more active leveraged loan market, we believe the longer-term secular trend of private equity sponsors gravitating toward direct lending remains intact. Notably, refinancing transactions, rather than new supply, constituted the vast majority of recent broadly syndicated loan issuance, with over 87% of leveraged loan activity related to refinancing transactions in Q2.[2]

> Meanwhile, direct lending continues to appear to be the preferred financing solution for LBOs, with over 85% of leveraged buyouts financed with private credit in the first half of 2024. (Figure 2).

This highlights that while public markets are robust in the current environment, new financing opportunities stemming from leveraged buyouts – the 'bread-and-butter' of direct lending – continue to overwhelmingly favor private capital solutions. Therefore, we believe direct lending can largely benefit from an eventual increase in deal activity. As we look ahead, there are early signs of a rebound in dealmaking, with private equity deal activity through the first half of 2024 outpacing the first half of 2023 by approximately 12%.[3]

Figure 1

U.S. institutional loan activity ($B)

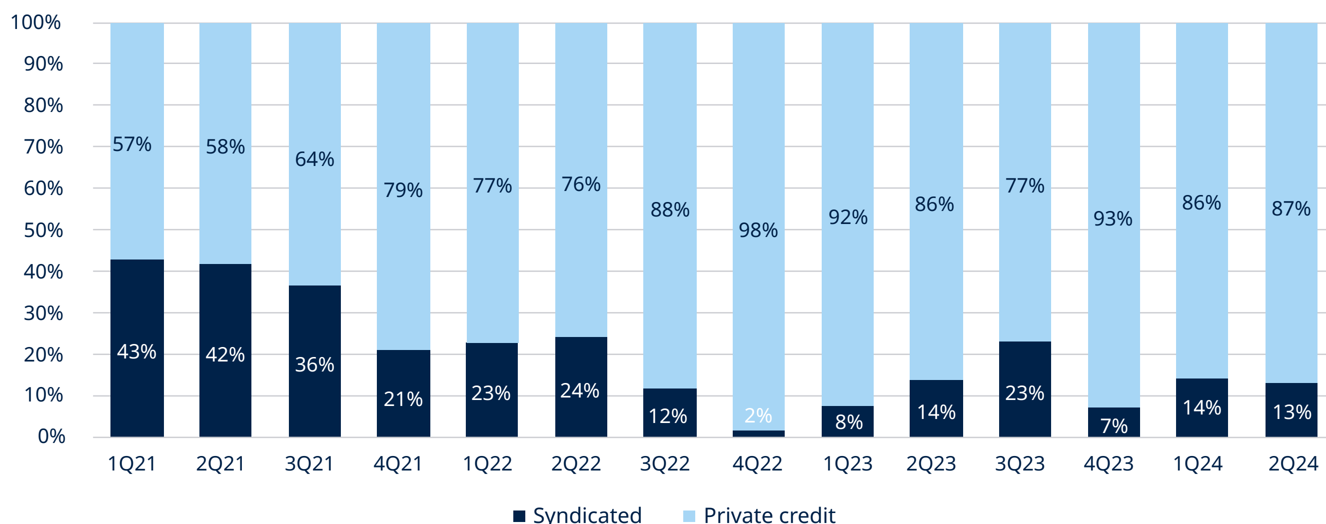


Source: Pitchbook US Credit Markets Quarterly Wrap Q2 2024. Refinancings includes Repricing and Extensions.
Past performance is not a guarantee of future results. There can be no assurance that historical trends will continue.

[1] Source: Pitchbook US Credit Markets Quarterly Wrap Q2 2024.
[2] Source: Pitchbook Private Credit and Middle Market Quarterly Wrap Q2 2024
[3] Source: Pitchbook 2024 US Private Equity Outlook Midyear Update.

Figure 2

Percent of LBOs financed in BSL vs private credit markets

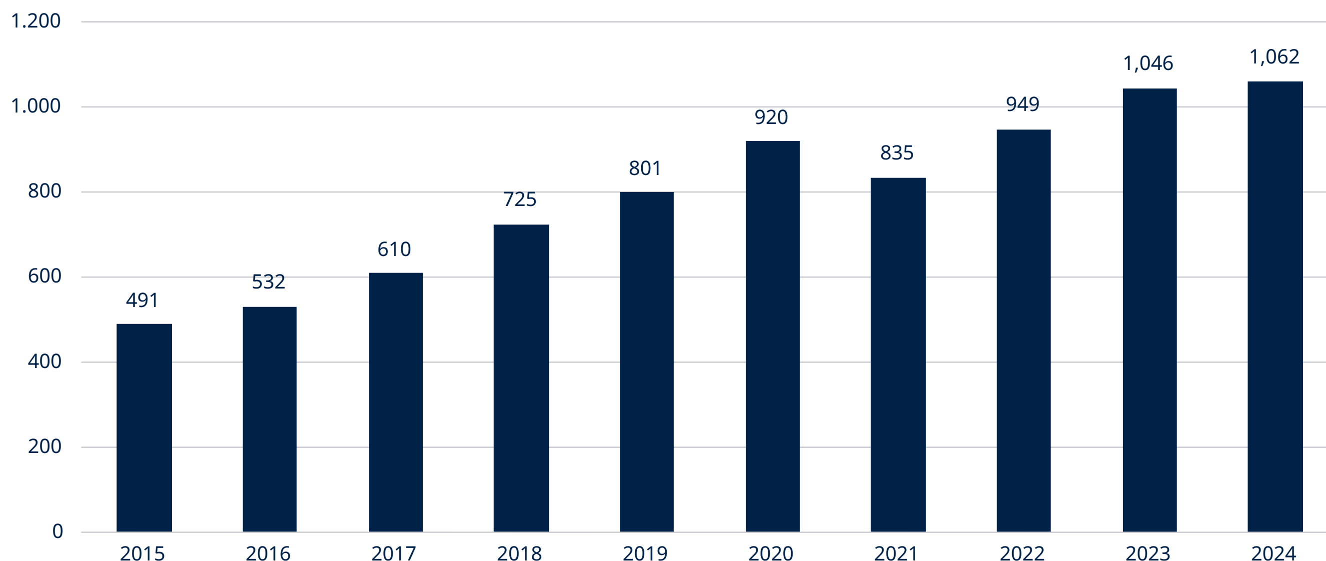


Source: Pitchbook as of June 30, 2024.
Past performance is not a guarantee of future results. There can be no assurance that historical trends will continue.

Furthermore, we believe pent-up demand for M&A continues to increase as private equity sponsors look to exit investments, deliver capital back to investors and deploy dry powder in new funds. The pressure to return capital to investors is particularly acute, with the median holding period of private equity-owned companies expected to maintain its all-time high of over 5 years in 2024.[1] Additionally, dry powder at buyout private equity firms reached an all-time high of nearly $1.1 trillion in mid-2024 (Figure 3). Once private equity sponsors begin to deploy their significant capital commitments in earnest, the direct lending industry will likely see a deal environment markedly different from recent periods.

Figure 3

Buyout private equity dry powder ($B)



Source: Preqin as of May 31, 2024.
Past performance is not a guarantee of future results. There can be no assurance that historical trends will continue.

[1] Source: Pitchbook 2024 US Private Equity Outlook Midyear Update.

The combination of active public loan markets, relatively light deal activity, and robust fundraising across the direct lending industry resulted in competitive pressures in the first half of 2024. Nonetheless, we have continued to find attractive investment opportunities in large, high-quality companies. Deployment across the Blue Owl Credit platform remains robust, with approximately $28 billion of gross originations in the first half of 2024. Deployment was primarily led by tack-on M&A as well as refinancing and repricing activities. Notably, over 45% of originations in the first half of the year were sourced from existing or past borrowers, which is above our historical average since inception. This highlights an increasingly important source of deal flow that accrues to Blue Owl as a function of our increasing scale and broad relationships across the sponsor and borrower community. Borrower credit quality also remains attractive, and we consistently secure appropriate structural protection in our credit documentation.

Overall, we believe it continues to be an attractive environment to deploy capital and a welcomed pick-up in financing activity will likely serve to shift market dynamics in favor of direct lending.

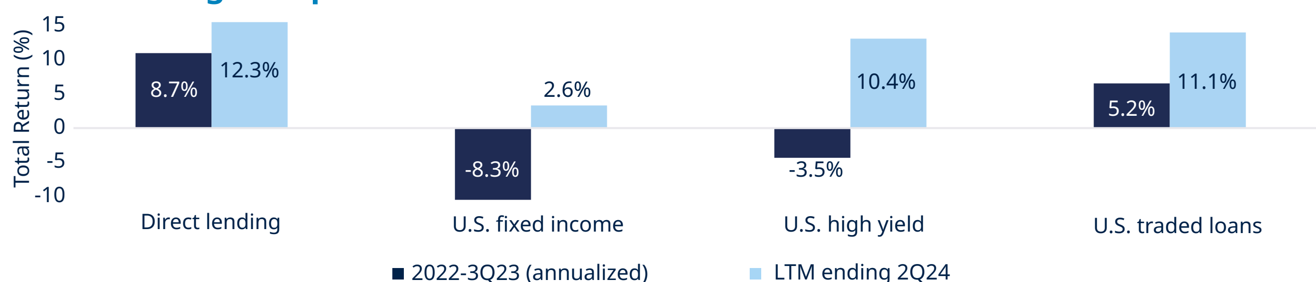
The current environment in direct lending continues to be one of the best in recent history from a returns perspective

Despite a more competitive deal environment resulting in tightening spreads, performance within direct lending remains strong. With the Fed leaving interest rates unchanged thus far in 2024, direct lending has continued to benefit from an elevated rate environment which has more than offset tighter spreads and helped to deliver attractive returns on both an absolute and relative basis. Indeed, we are observing all-in unlevered yields on newly originated loans currently of approximately 11%, presenting an attractive rate of return for senior secured credit risk.

In contrast to traditional fixed income instruments, the floating rate nature of loans translates to an increase in performance as rates rise. During the hiking cycle that began in early 2022 and ended in Q3 2023, direct lending significantly outperformed fixed income and public credit indices. (Figure 4) As the Fed has held rates constant, direct lending has continued to outperform, returning +12.3% in the twelve months ending June 30, 2024, compared to +2.6% for traditional fixed income, +10.4% for high yield credit, and +11.1% for traded loans over the same period.

Figure 4

Direct lending's outperformance



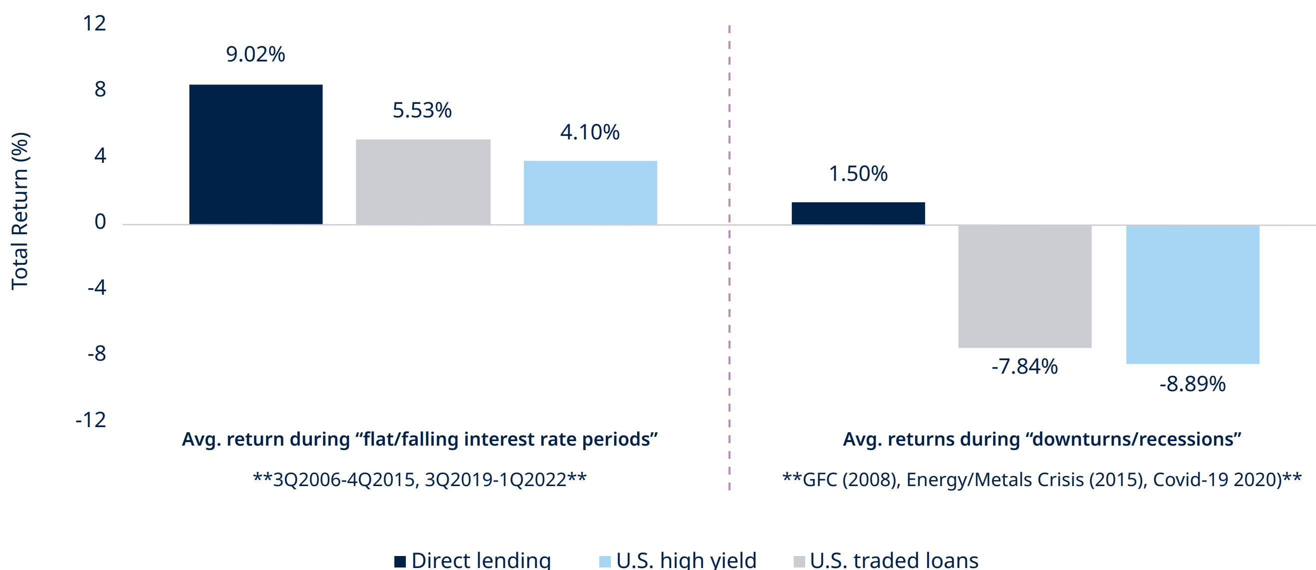
Sources: Bloomberg, Cliffwater as of June 30, 2024. U.S. Direct Lending represented by the Cliffwater Direct Lending Index, U.S. Fixed Income represented by the Bloomberg U.S. Aggregate Index, U.S. High Yield represented by the Bloomberg Barclays U.S. High Yield Index, U.S. Traded Loans represented by the Morningstar LSTA Leveraged Loan Index.

Past performance is not a guarantee of future results. Indices listed do not represent benchmarks for the funds but allow for comparison of a fund's performance to an Index. An investor cannot invest directly in an index. Index performance does not reflect fees and expenses.

Even with the Fed now expected to begin easing this year, potentially as soon as this month, base rates are likely to remain well above their levels prior to the recent hiking cycle. Indeed, the most recent Fed projections called for the Fed Funds Rate to fall by 0.25% in 2024 and 1.00% in 2025, implying a 3-month SOFR rate that remains above 4.0%, which is expected to continue to bolster returns in direct lending.[1]

Figure 5

Direct lending's historical resilience in a variety of environments



Sources: Bloomberg, Cliffwater as of June 30, 2024. Direct lending represented by Cliffwater Direct Lending Index (CDLI), U.S. High Yield represented by Bloomberg Barclays U.S. High Yield Index, and U.S. Traded Loans represented by the Morningstar LSTA Leveraged Loan Index.

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[1] Source: Federal Reserve Summary of Economic Projections June 2024

Borrowers continue to perform well in the current environment

Taking stock as we draw closer to year end, our borrowers have remained resilient as expected, delivering strong credit performance with consistent year-over-year revenue and EBITDA growth. Top-line growth has been supported by stable demand, while moderating input costs and cost management measures have contributed to improved margin profiles. Given higher borrowing costs, we have been particularly focused on monitoring interest coverage and liquidity. At the beginning of the year, we anticipated interest coverage ratios across our portfolios to trough at a reasonable level in 1H24, which we have now seen, and we expect a gradual improvement in coverage metrics on the back of expected easing from the Fed later this year.

Importantly, we have not seen any signs of broad credit stress across our portfolio, nor has there been a material increase in non-accruals or defaults. Sectors that had previously encountered headwinds – such as healthcare companies facing labor shortages and wage inflation or industrials facing weakness from customer destocking – have generally returned to growth. The limited number of challenged names in our portfolio are isolated and idiosyncratic instances which we continue to closely monitor. Importantly, in the select instances in which borrowers have encountered meaningful stress, our credit documents have functioned as intended in our positioning.

While the strong performance of our borrowers is partly due to the strength of the broader economy, we believe our focus on scaled, high-quality and sponsor-backed companies has also been a key factor in our results. With an average EBITDA across our direct lending platform of over $200 million, we believe these businesses are better positioned than smaller middle market companies by virtue of their diversification, strategic significance, and ability to withstanding unforeseen cost pressures and economic headwinds.

Blue Owl is well-positioned in the current environment

Disciplined investment strategy and credit underwriting process

Highly selective	%Senior-secured	%Sponsor-backed	% of deals Blue Owl is the lead
~5%[1] closed	~90%[2]	~90%[2]	~85%+[1] of closed deals
Portfolio company EBITDA	**Portfolio company EV**	**Portfolio company LTV**	**Annual loss rate since** inception
~$231M[3]	~$4.5B[3]	~$39%[2]	7 bps[4]

[1] As of June 30, 2024. Excludes add-ons, syndicated transactions, equity only deals, and transactions for existing borrowers.
[2] As of June 30, 2024 based on Fair Value.
[3] As of June 30, 2024. Borrower financials are derived from the most recently available portfolio company financial statements, have not been independently verified by Blue Owl, and may reflect a normalized or adjusted amount Accordingly, Blue Owl makes no representation or warranty in respect of this information.
[4] Average annual loss rate based on total annual net realized losses across direct lending platform divided by the average aggregate quarterly cost of investments. The loss rate is based on the average loss rates in each year since inception from 2016 through the report date of the Blue Owl direct lending platform.

Conclusion

In closing, we believe the overall outlook is favorable and long-term market dynamics may continue to favor direct lending for the balance of 2024 and beyond. With easing financial conditions and significant pent-up demand among private equity sponsors for M&A, we anticipate an increase in deal activity that could help alleviate the current supply-demand imbalance that has resulted in competitive pressures within leveraged finance markets.

Importantly, we believe the secular shift to direct lending remains intact as sponsors and borrowers have come to appreciate the value proposition that private solutions offer. Scale, certainty of execution and flexibility provide borrowers and sponsors a compelling alternative to public leveraged finance markets, which we believe can continue to drive growth of the asset class over the long term.

As a scaled, well-established platform, we believe Blue Owl can be a key beneficiary of the continued growth of direct lending. We believe we are well positioned to succeed given our deep origination capabilities, strong sector specialized underwriting expertise, in-house portfolio management, and workout and fund financing capabilities. Because we can write large checks and are strategically relevant, we believe we can typically receive better access to deal flow and can be highly selective on credit selection and deal terms. Above all, we believe Blue Owl will continue to deliver attractive risk-adjusted returns to our investors, by virtue of our broad origination footprint, prudent asset selection, conservative structuring and focus on capital preservation.

Craig W. Packer
Co-President, Head of Credit

BLUE OWL

Pulse Check:

2024 GP Strategic Capital Outlook

Michael Rees
Co-President, Head of GP Strategic Capital

Sean Ward
Senior Managing Director

Great expectations:

A half of two quarters

As we entered 2024, global public markets priced in (1) accelerating global growth and corporate earnings, (2) declining inflation, and (3) expected significant central bank rate cuts. Dealmakers were primed for an uptick in activity, and the market saw strong rallies across tech and other "risk-on" assets, including many listed alternative asset managers, with several hitting all-time price highs in the fourth quarter of 2023 and early 2024.[1]

Contrary to these expectations, at the time of writing, central banks have generally left rates unchanged and, although the first weeks of January heralded some jumbo M&A announcements, both deal and exit activity levels have remained subdued. This situation resulted in mixed share price performance for the listed alternative asset managers in the second quarter and a growing expectation that meaningful distributions may be delayed to 2025 and 2026, perhaps reflecting the outlook for private market activity as a whole.

The tech sector continues to boost the public markets and the S&P 500 hit record levels no fewer than 30 times during the first half of 2024,[2] tempering the notion that the "denominator effect" of public market underperformance was weighing on investors' portfolios. The "Magnificent Seven" (i.e., Alphabet, Amazon, Apple, Meta Platforms, Microsoft, NVIDIA and Tesla) now account for over 30% of the S&P 500's value in aggregate.[3]

What's more, nearly 50% of U.S. publicly listed companies are loss-making and almost half of the assets tracking global public equity markets are now passive.[4] So, as a public market stock picker, your choices may now be limited to investing in Big Tech or likely underperforming your benchmark.

By contrast, we remain confident in the continued diversification and broadening of private markets, which today represent a mere 4.4% of the total current investing universe.[5] We believe the pursuit of diversified exposure to growth in the real economy should be a key driver of continued demand for alternatives and that sustainable returns are achievable within a growing investable ecosystem.[6]

Our GP Strategic Capital platform continues to provide innovative, long-term minority equity and financing solutions to leading private capital managers. Below are a few key themes we believe may be driving the private capital industry and specifically the GP Stakes market for the remainder of 2024.

[1] Capital IQ, Goldman Sachs Global Investment Research
[2] Bloomberg
[3] Capital IQ, accessed September 28th, 2024
[4] Compustat, Goldman Sachs Global Investment Research
[5] Preqin State of the Market H2 2024
[6] Preqin State of the Market H2 2024

Fundraising trends

Structural trends in the rapidly evolving alternative asset management industry give us confidence that some of the largest and most sophisticated managers will likely continue to be the primary beneficiaries of inflows to private markets. U.S. private equity fundraising continued to surprise on the upside at $155 billion in the first half of the year, helped by so called "megafunds" ($5 billion+ fund size) which accounted for 47.3% of capital raised.[1] The second quarter saw some significant fund closes, meaning the total capital raised in the second half of the year is expected to drop slightly.[2] This data reflects two things, in our view: (1) fundraising is a lagging indicator and the largest funds that closed in the first half have been in the market, in some cases, for two years, and (2) following a period of volatility or disruption, investors naturally fly to quality and size. This latter trend tends to unwind somewhat when the environment normalizes and, as a result, we would expect to see mid-sized funds increase their share of the total capital raised through the balance of the year.

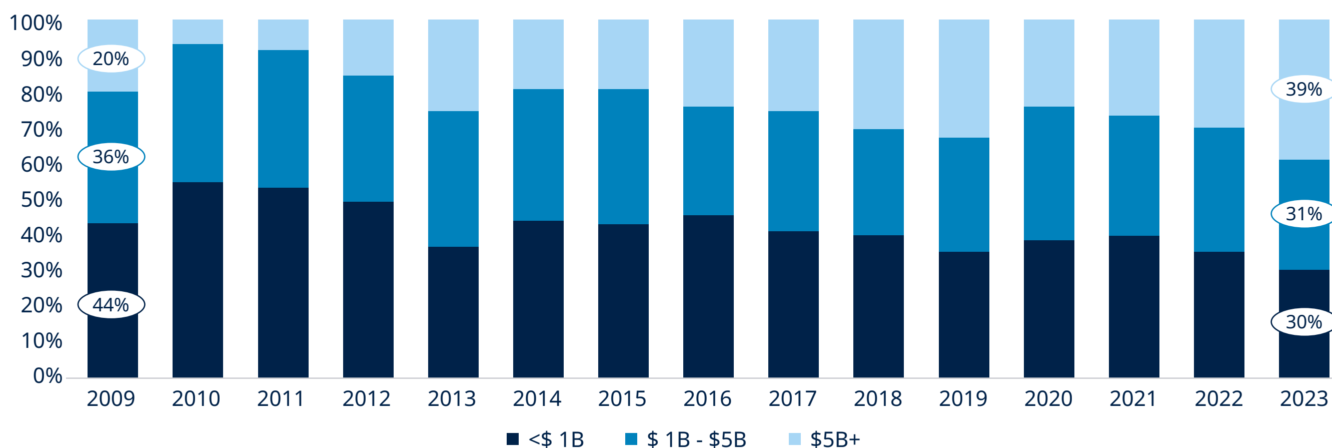
Global private equity and venture capital funds held $2.6 trillion of total uncommitted capital as of July 2024.[3]

> The 25 private equity and venture capital firms with the largest stores of dry powder collectively reported $556 billion of uncommitted capital—more than 21% of all private equity dry powder globally.[4]

The concentration of so much dry powder with a relative handful of firms reflects how the fundraising environment has favoured larger players. Given the lag in fundraising mentioned above, if we do enter a period of slower fundraising at the same time that deal and exit activity increases, funds with dry powder should be strongly positioned to take advantage of a wide range of opportunities.

Figure 1

Private capital raised ($B) by size bucket



Source: Pitchbook, Q1 2024 Global Private Market Fundraising

Past performance is not a guarantee of future results. There can be no assurance that historical trends will continue.

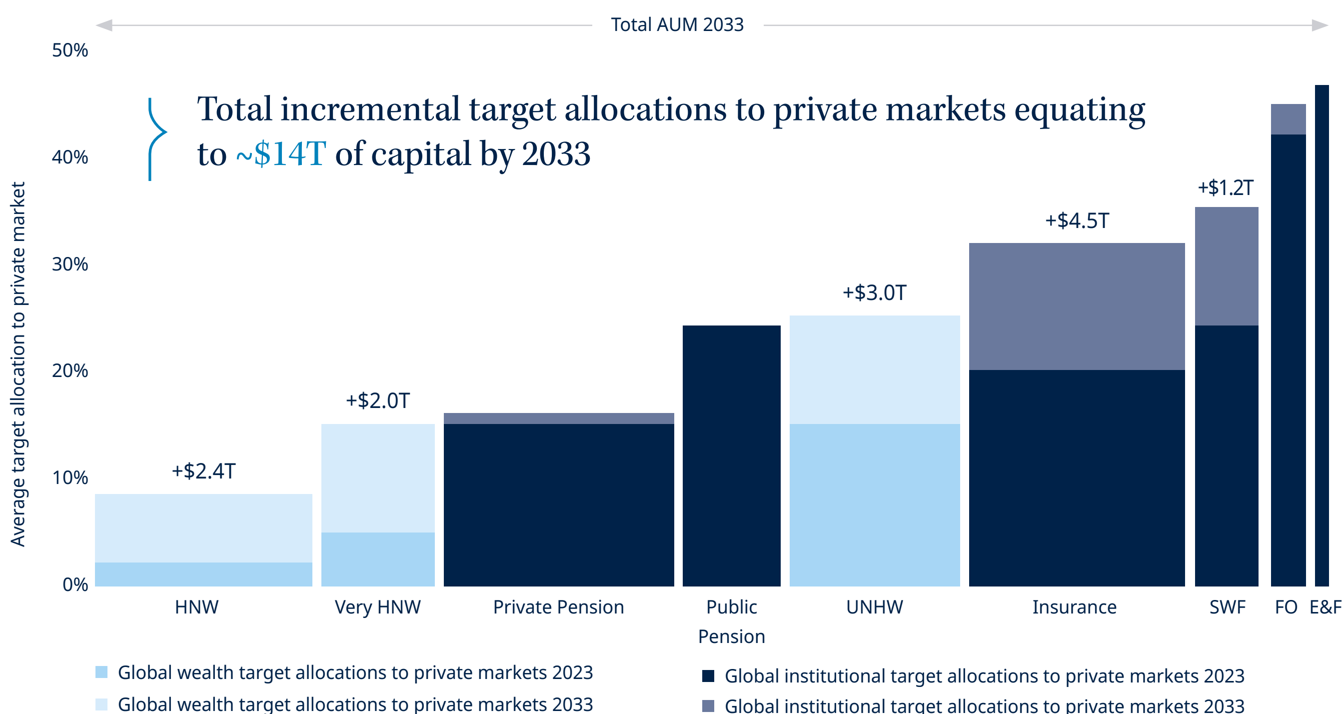
[1] Pitchbook Q2 2024 report
[2] Pitchbook Q2 2024 report
[3] S&P Global Market Intelligence
[4] S&P Global Market Intelligence

Under-allocation of client segments

With allocations from some of the earlier institutional adopters of private markets having doubled over the past decade,[1] GPs are seeking to enhance their distribution to relatively under-allocated investor segments, particularly select sovereign wealth funds, insurance companies and private wealth platforms.[2] Our proprietary analysis suggests that a total of ~$14 trillion could flow into private markets by 2033 as a result of the potential increase in target allocations, predominantly from newer adopters of alternatives. Our proprietary analysis target could include ~$7.4 trillion from wealth channels, $4.5 trillion from insurance funds and related products, and $1.2 trillion from sovereign wealth funds.

Figure 2

Under-allocation of client segments



The above information is provided for illustrative purposes only. This information is subject to change without notice as market and other conditions change. There can be no guarantee that historical trends will continue.

Data Sources: AUM Figures from Bain Capital Global Private Equity Report 2023 and held constant for 2033. 2023 and 2033 Private markets allocation figures for HNW, Very HNW from CapGemini World Wealth Report. 2023 Private markets allocation figures for Private Pension, Insurance, Public Pension, E&Fs from Preqin, Institutional Allocation Study 2024. 2023 Private markets allocation figures for UHNW from KKR Family Office Survey 2023. 2023 Private markets allocation figures for SWFs from Bain & CO Global Private Equity Report 2030. 2023 Private Market allocation figures for FOs from Forbes, "The Rise and Rise of The Family Office: An Analysis", January 11, 2024. 2033 Public Pension and E&F private market allocation figures are held constant. 2033 private market allocation figures for UHNW from CapGemini World Wealth Report 2033. 2033 private market allocation figures for Private Pension and E&Fs from Preqin (accessed June 2024). 2033 private market allocation figures for SWF from Global SWF Rankings and Categorisation (June 2024) and Global SWF Data Platform Annual Report 2024. 2033 private market allocation figures for Insurance from Allianz Global Insurance Report (May 2024) and KKR Insurance Survey 2024. 2033 private market allocation figures for Family Offices from Preqin and UBS Global Family Office Report 2024.

[1] Preqin's State of the Market, H2 2024.

[2] "How PE is paving the way for private wealth", Pitchbook. "Insurers Increasing Allocations to Private Markets", MarketsMediaGroup. Invesco Global Sovereign Asset Management Study, 2024.

Private wealth

We believe focus on the wealth distribution channel from private markets managers has noticeably accelerated and broadened beyond just the largest and first movers in the first half of 2024. With improved accessibility through continually evolving investment vehicles and market infrastructure, we believe this can provide a meaningful opportunity.

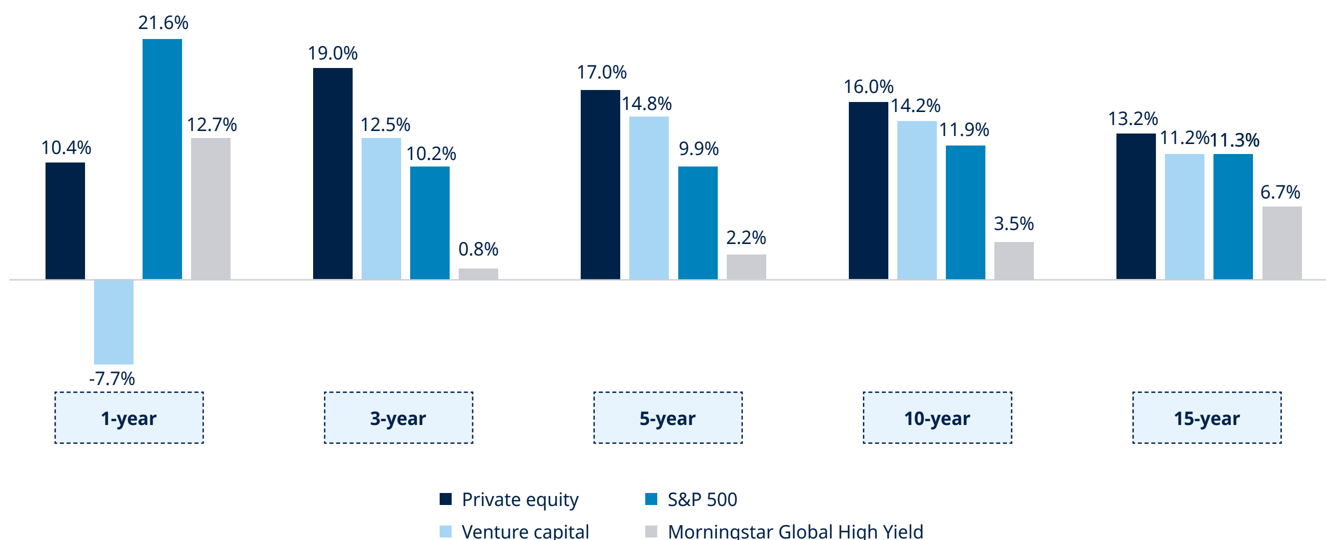
The private wealth space in alternatives was largely pioneered on the back of real estate-related products and grew with credit products, especially in the recent interest rate environment.[1] Now private equity and infrastructure retail products, where we are seeing fresh innovation, look poised to drive the next leg of growth in the space.

Some managers, including Blue Owl, identified the private wealth opportunity set early and have established broad-reaching retail platforms including all aspects of branding, product offerings and distribution. We believe the retail channel remains a scale and coverage game, requiring significant upfront investment in sales teams, product customization and bespoke content production.

Growing allocations to alternatives from private wealth reflect better investor understanding and the increasing accessibility of the asset class, a return gap versus traditional equities/fixed income in recent years, and the ability to diversify exposure with the introduction of growing sub-asset classes in the market. While wealth allocations to private markets have historically been more advanced in the U.S. and Asia versus Europe, we note that private wealth allocations are expected to grow across the board globally.[2] With bespoke regional market infrastructure under construction, we believe that the retail channel may be a key driver of the continued growth of private capital in the coming years.

Figure 3

Historical IRR by strategy



Source: Pitchbook Global Benchmark Report, data as of September 30. 2023. Note: All public index values are total return CAGRs. All private capital returns are net of fees and carry.

Past performance is not a guarantee of future results. There can be no assurance that historical trends will continue.

[1] J.P.Morgan, "Alternative Asset Management Private Wealth Tracker," July 9, 2024.
[2] J.P.Morgan, "Alternative Asset Management Private Wealth Tracker," July 9, 2024.

The pig in the python

The question on everyone's minds right now is "what will it take for the flow of distributions to restart?" Distributions can be a critical fuel to the capital formation flywheel and a key bellwether for the overall health of private markets growth.

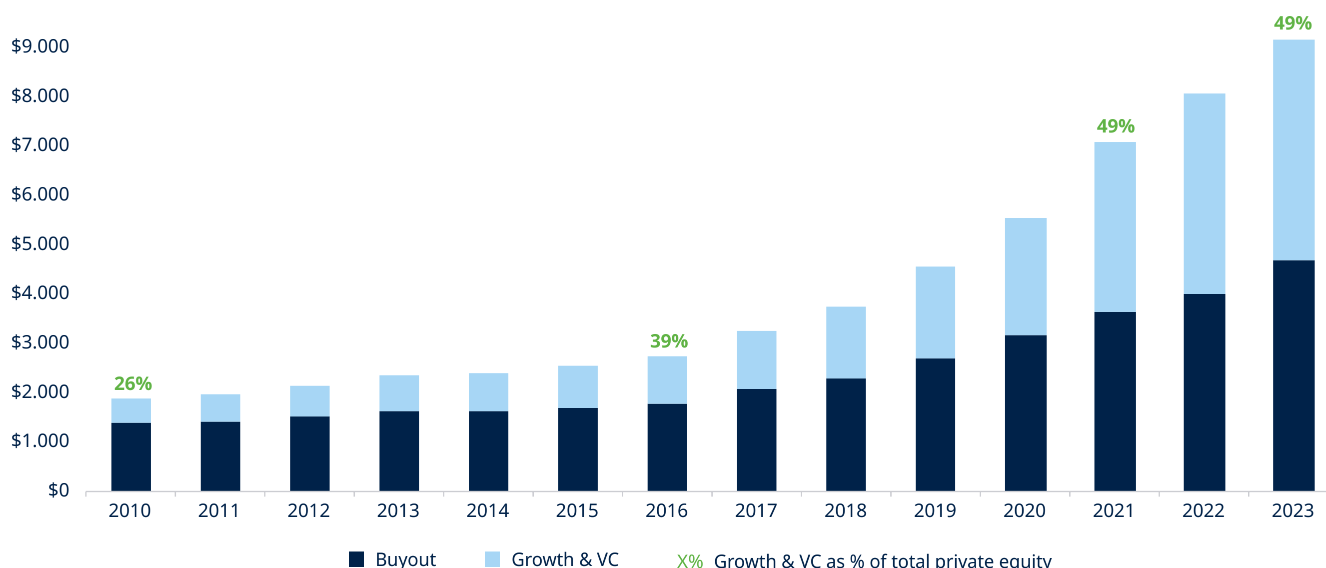
As the private equity market continues to evolve in response to macro conditions and investor appetite, it is becoming increasingly important to differentiate between the sub-asset classes. Between 2010 and 2021 the vibrant growth and venture capital market supported a higher capital velocity than buyouts, attracting both LPs and GPs to enter the space with AUM growing almost twice the annualized rate of buyout strategies.[1]

This trend accelerated when the market was flooded with trillions of dollars of global pandemic-related stimulus packages, resulting in seven "super quarters" of dealmaking, exit and fundraising activity between Q3 2020 and Q1 2022. However, despite record distributions across private equity in 2021 and 2022, net capital flow was only marginally positive for buyout and remained negative for growth and venture capital, due to the exceptional pace and quantum of capital deployment. In fact, we observe that the delta between capital called and distributions for growth and venture capital has been negative and getting wider since 2017.[2]

Figure 4

Global buyout + growth & VC AUM ($B) progression

	2010 AUM	2024 AUM	CAGR
Buyout	$1.3T	$4.3T	*9.8%*
Growth & VC	$442B	$4.1T	*18.7%*



Source: Preqin data accessed August 13, 2024.

Past performance is not a guarantee of future results. There can be no assurance that historical trends will continue.

[1] Preqin data accessed August 13, 2024.
[2] Preqin data accessed August 13, 2024.

Figure 5

Capital called and distributed to LPs ($B) – global Buyout strategies

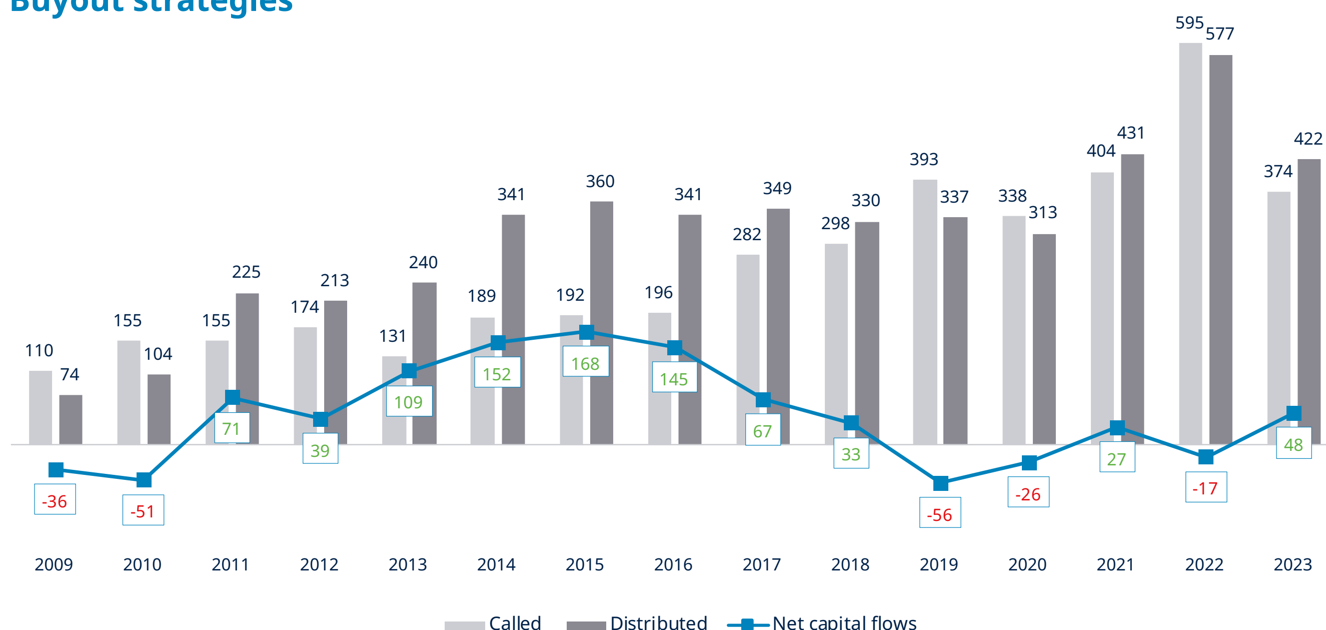
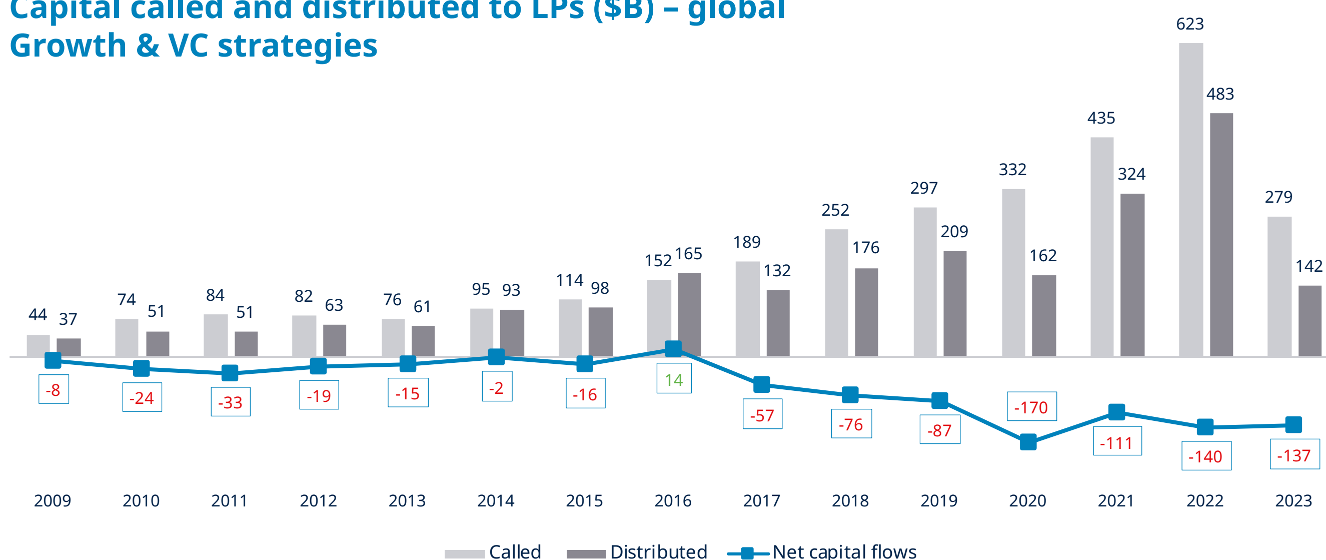


Figure 6

Capital called and distributed to LPs ($B) – global Growth & VC strategies



Source: Preqin data accessed August 13, 2024.

Past performance is not a guarantee of future results. There can be no assurance that historical trends will continue.

This has, unsurprisingly, led to a slowdown in appetite for growth and venture capital strategies as evidenced in the pace of capital raising vs buyout, which (as referenced above) has remained relatively resilient and enjoyed a "flight to quality", led by some of the largest mega-funds through 2022 and 2023. In stark contrast to 20.7% CAGR (2010-2021) in annual capital raised for growth and venture capital strategies, fundraising by value has fallen -31.1% CAGR since the peak of $513 billion in 2021 to 2023.[1]

[1] Preqin data accessed August 13, 2024.

So what will it take for the flow of distributions to restart?

The narrowing of the bid/offer spread between potential private market buyers and sellers, a re-rating of stocks outside of the “Magnificent Seven” and a clearer view on normalized interest rates can all be important catalysts for exit activity.

In the meantime, investors’ large-scale shift in focus away from future MOIC in favour of near-term DPI is compelling GPs to think more creatively about generating liquidity for LPs.[1]

We have observed across our Partner Managers a more rigorous and systematic approach to portfolio rationalization, with leading GPs differentiating themselves in a congested and consolidating market by taking decisive action on assets they believe are unlikely to grow into their originally underwritten exit valuations. These actions may include full or partial monetizations through traditional channels or minority stake sales, recapitalizations and a marked increase in the use, or at least consideration, of continuation vehicles.

We are also seeing early signs of capitulation on both sides of the bid and offer. Sellers are more motivated to realize positions as time goes on and, with spreads on financing very tight, largely due to a full reopening of the bank-led syndicated loan market, bidders are willing to push the envelope a little bit further on financing.[2]

We are told by investment bankers that their M&A pipelines have never been so full.[3]

While this pipeline is yet to translate into a meaningful uptick in deal activity, tentative green shoots from U.S. private equity exits have sprouted, increasing 15% YoY by value in the first half of 2024. The lag in deal activity, beginning in 2023, that contributed to record levels of dry powder, has also helped narrow the net deal-exit gap by $200 billion during the year, creating a dent in the massive $551 billion exit gap accumulated in 2022.[4]

The second quarter saw a pick-up in European private equity dealmaking, increasing 27.3% from the previous quarter, which was one of the worst in recent history.[5] Exit value was +90.3% QoQ in Q2 and, while it is too early to extrapolate any sort of long-term upward trend, it does feel like the first quarter of the year may have been the trough for European deals.[6] European exit value in the first half was heavily skewed to 23 mega-exits, which accounted for over half of total exit value.[7]

Federal Reserve Chair Jerome Powell’s latest statements laid the groundwork for the next phase of the Federal Reserve’s monetary policy during his Jackson Hole address in August, signaling he is ready to begin cutting interest rates at the September meeting.[8] While the direction of travel appears clearer, the pace of cuts still depends on incoming data. We believe one or two cuts in the second half of the year would be a helpful catalyst for exit activity to resume and could herald a return to growing net capital flows for LPs in buyout strategies.

[1] Altiva, “ DPI vs. IRR: The New Metric Shaping Private Equity Investment Performance”
[2] Wells Fargo H1 2024 Recap
[3] Global M&A Industry Trends: 2024 mid-year outlook, PWC.
[4] Pitchbook Q2 2024 US PE Breakdown
[5] Pitchbook Q2 2024 European PE Breakdown
[6] Pitchbook Q2 2024 European PE Breakdown
[7] Pitchbook Q2 2024 European PE Breakdown
[8] Chair Jerome H. Powell Speech at “Reassessing the Effectiveness and Transmission of Monetary Policy,” an economic symposium sponsored by the Federal Reserve Bank of Kansas City, Jackson Hole, Wyoming. Sourced from Federalreserve.gov

Through the cycle returns from a GP Stakes strategy

Perhaps the most obvious and important benefit of a GP Stakes strategy for investors is diversification. We continue to believe that GP Stakes as an asset class can provide investors a level of diversification—by strategy, asset class, geography, size and vintage—that would be difficult and perhaps impossible to match through any other single investment.

That being said, we believe the catalyst for GP Stakes becoming an established asset class has been investors' heightened focus on DPI, in addition to MOIC and IRR, as a key performance metric. In an environment where realizations have slowed significantly and have yet to rebound, a strategy that can return cash quickly through regular distributions has been considered an attractive hedge to more traditional private equity investments.

A GP Stakes investor typically participates in the earnings of the business alongside the founders or management company owners, including the economics of all funds that a manager currently manages and all funds that they will raise in the future.

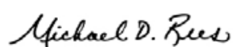
> By diversifying the portfolio across different private capital managers, a GP Stakes investor can participate in the success of multiple GPs, ultimately building a portfolio benefiting economically from underlying funds across vintages, portfolio companies, as well as many strategies and multiple geographies.

Conclusion

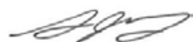
One of the biggest structural shifts in private markets over the next ten years is likely to be the composition of investor segments who drive the next wave of capital formation—namely the rise of private wealth, insurers and certain sovereign wealth funds. We continue to see enormous opportunity for both AUM growth and continued outperformance of private asset classes, supported by an expanding and diversifying investable universe. However, we also believe that current trends in consolidation of LP-GP relationships will accelerate, meaning these opportunities will no longer be universally accessible. GPs who wish to continue their historic growth trajectory will need to give equal focus to their distribution and business development capabilities as to their investment performance, thinking creatively and proactively about how best to satisfy investor demands, whether that be for distributions or thoughtful content.

Potential interest rate cuts in the fall and early 2025, could trigger a more benign exit environment that will be important for sentiment. Growing net cash flows to LPs, at least in buyout strategies, feels achievable in the next 12-18 months. The amount of NAV that needs to be processed in growth and venture capital strategies, and their historic reliance on public markets as an exit route, leads us to believe that it will take all but the highest quality operators within these strategies longer to deliver positive DPI.

We have an established track record in partnering with the highest quality GPs globally and we are confident that our market position and value proposition continues to be attractive to existing and prospective managers alike. The deep embedded structural drivers in private markets support sustainable, multi-year growth and GP Stakes is a great way to capture the growth of the most successful managers, through a diversified, cash-flow oriented strategy with solid downside protection. Blue Owl's GP Strategic Capital platform continues to be a partner of choice for both investors and managers.



Michael Rees
Co-President



Sean Ward
Senior Managing Director

BLUE OWL

Pulse Check:

2024 Real Estate Outlook

Marc Zahr
Co-President, Head of Real Estate

Introduction

Commercial real estate investors endured an extremely challenging market environment in 2023, much of which continued into the first half of 2024. All time fundraising lows combined with elevated inflation and higher-for-longer interest rates have left many investors' pencils down. As we enter the last part of the year, market participants likely remain cautiously optimistic that a market turnaround is in sight as we near the bottom of the cycle and may be eager to find ways to create value amid the disruption. While it appears interest rates have peaked, investors and managers seem to have become incredibly selective and creative about which opportunities to pursue. It will be an interesting period as we await the results of the U.S. presidential election and the subsequent impact on the U.S. and global economy.

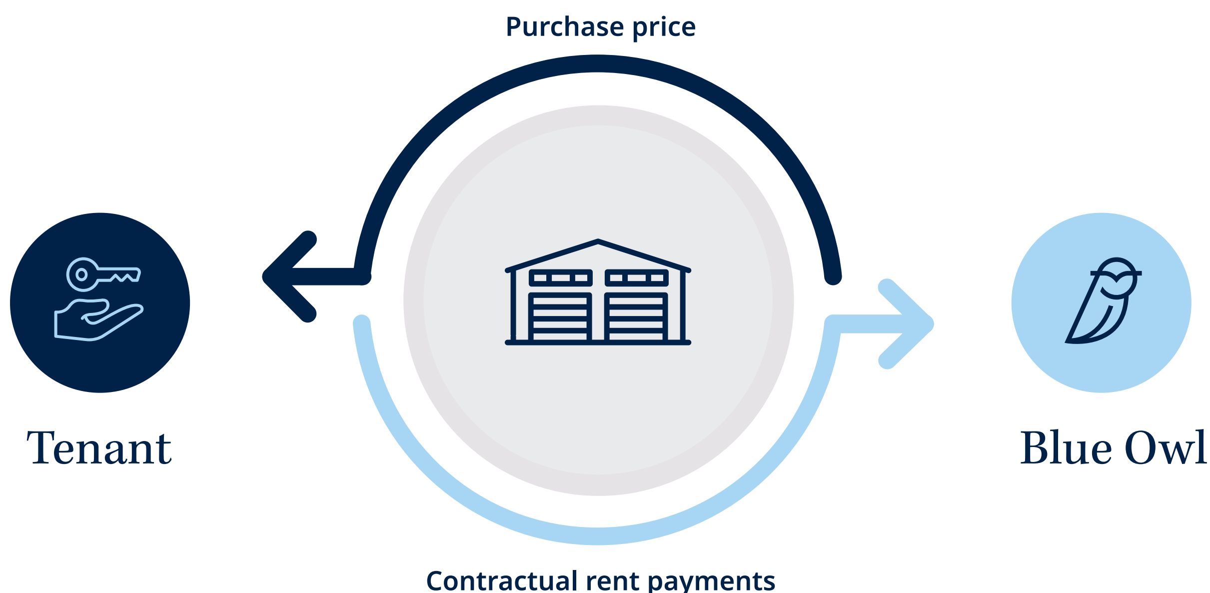
Despite the many economic challenges present in the broader market, Blue Owl Real Estate maintained its steadfast vigilance, remaining poised to act on the potential buying opportunity that would emerge this year, especially in the net lease market. Because the tenant assumes the expense risk in a net lease structure, landlords such as Blue Owl Real Estate can depend on predictable, consistent income that is largely unaffected by external market forces such as inflation. Economic uncertainty and diminishing sources of traditional capital are likely leading many companies to consider alternative funding such as sale-leasebacks to optimize their balance sheet and enable future growth. We believe net lease investments continue to offer investors stability, diversification, and downside protection – key attributes investors seek in today's market which continue to translate into meaningful demand for net lease real estate investments.

Buyer's market:

Putting money to work in a shifting environment

Throughout the first half of 2024, elevated interest rates continued to impact firms' ability to access liquid borrowing markets to fund working capital for operations. As a result, firms of all sizes and capital structures—including investment grade companies—are increasingly utilizing sale-leaseback transactions as a viable capital raising alternative. In addition, we are seeing companies move towards a build-to-suit sale-leaseback model for new developments as they have become more focused on efficient cash flow management and reducing large capital expenditures where possible. Firms are drawn to providers of flexible, creative solutions who can transact at scale, and move with speed and certainty of execution to deliver a holistic result that both optimizes efficient use of capital and creates considerable value within a business.[1] We are often seeking to solve different problems for different companies, and our ability to provide flexible and innovative solutions that help meet each company's needs can allow us to dictate pricing and terms.

Recently, we partnered with several financial institutions to assist in offsetting unrealized losses in their securities portfolios with the gain generated from our sale-leaseback proceeds. In another transaction, a gas and convenience store operator utilized proceeds from a programmatic partnership with Blue Owl Real Estate to pursue M&A activity, allowing the operator to drive earnings and growth. Lastly, a large discount retailer sold us a portion of their industrial footprint, enabling the firm to pay down outstanding debt which added incremental liquidity to their balance sheet and in parallel improved their credit rating. These dynamics allow Blue Owl Real Estate to put considerable dollars to work in pursuit of delivering attractive risk-adjusted returns to our investors.



In executing a sale-leaseback with a corporate tenant, Blue Owl becomes a partner of the company, unlocking the value of an asset that is already on the balance sheet

[1] Source: PERE Net Lease Report May 2024

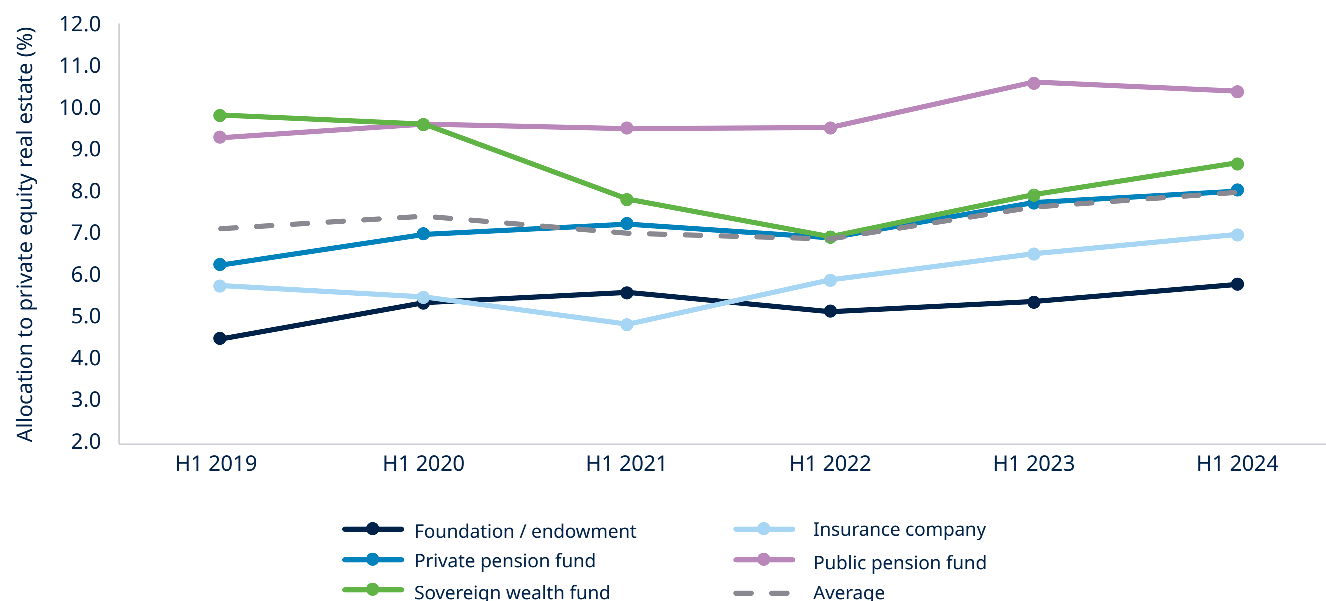
> When reviewing our transactions executed in the first half of 2024, a trend emerges—we have been able to negotiate terms better than those observed in recent history—making one point clear: we believe we are in the midst of the best buying opportunity in Blue Owl Real Estate's history.

Our executed transactions carried a weighted average entry cap rate of 8%, lease terms of 15 years, and average annual rent escalations of 2.5%. Further, when comparing terms for transactions executed in the first half of the year to transactions currently under letter of intent ("LOI") or contract, entry cap rates are nearly 70 basis points higher, annual rent escalations are 30 basis points higher, and lease terms are one year longer on average, which serves as evidence that the attractive buying opportunity is not behind us.

In parallel, the size of our investment pipeline has reached a new high, standing at approximately $65 billion. Year-to-date, we have acquired or have under LOI/contract to potentially acquire more than $18 billion of real estate. At the same time, we have generated nearly 120 basis points of cap rate compression for the assets we have sold this year in a challenging market, further highlighting the persisting demand for net lease assets despite the ongoing higher interest rate environment. We remain optimistic a turnaround for the commercial real estate industry is in sight as investor allocations have started to rebound in the first half of 2024.

Figure 1

Historic average private real estate allocation, by institution type *(in %)*



Source: PERE Investor Report – H1 2024

Past performance is not a guarantee of future results. There can be no assurance that historical trends will continue. Please see Important Information herein for important information on estimates, projections and forward-looking statements.

Continued momentum in digital infrastructure

As more of our daily lives become reliant upon technology, the need for sufficient quantities and sheer scale of data centers continues to increase. This heightened demand is fueled by well-known trends such as Artificial Intelligence, the Internet of Things, and increasingly more common remote work – all of which rely upon this sophisticated infrastructure to process, store and effectively manage massive amounts of data.[1]

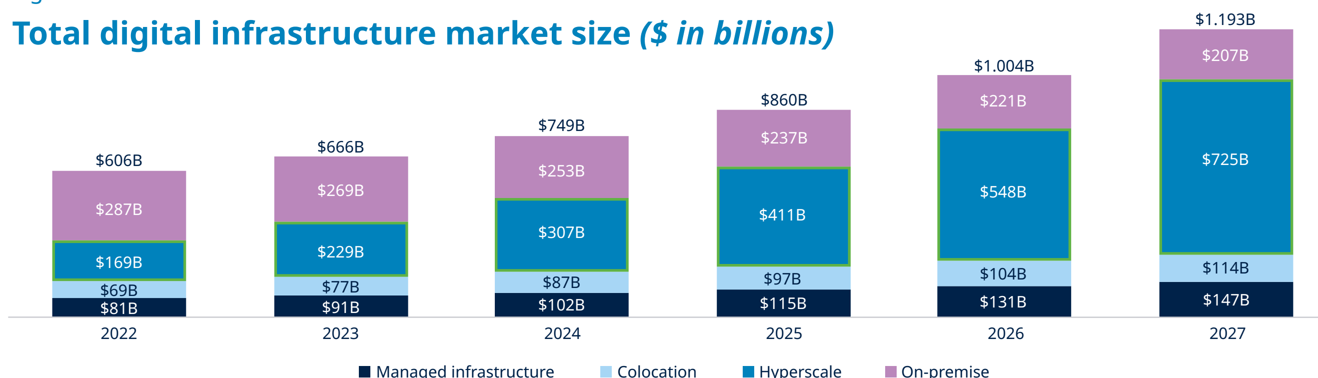
Leading cloud service providers such as Google, Meta, Amazon, and Microsoft are eager to continue meeting consumers' need for expanded data and latency capabilities but are encountering a data center marketplace with limited supply and increased demand. In addition to supply-demand issues, increased construction and power costs lead to delayed, over-budget projects often requiring further customization and modifications to suit the needs of the eventual end-user. To enable their ability to efficiently construct mission-critical assets to meet consumer demand, firms are moving towards custom-built facilities they control.

Blue Owl Real Estate's expertise is centered around problem solving and presenting solutions to company decision makers with the goal of helping them optimize their balance sheets and utilize their own capital more efficiently. While the data center industry is nothing new, industry tailwinds have shifted these types of deals into our area of expertise. Given the relatively higher interest rate environment and the increased demand for capital providers, data center development deals now fit squarely in our investment parameters. The explosive growth of cloud services has led to an exponential increase in hyperscale data centers, representing a new and attractive near-term opportunity set for our team. We currently have over $35 billion worth of data center deals in our pipeline (approximately 50% of the total pipeline), with over $13 billion closed/under contract. Advancements in AI are anticipated to significantly drive future data center demand and we believe our opportunity set in this industry will continue to grow.

Given the economic scale and significance of these hyperscale projects, often in the billions of dollars, we believe there are few market participants capable of providing the speed, capital, and depth of partnership to compete with Blue Owl's Real Estate platform. Blue Owl Real Estate's history of success over the last 15 years combined with billions in dry powder positions us to act on these opportunities.

Figure 2

Total digital infrastructure market size *($ in billions)*



Source: Structure Research, Altman Solon. August 2023.

Past performance is not a guarantee of future results. There can be no assurance that historical trends will continue. Please see Important Information herein for important information on estimates, projections and forward-looking statements.

[1] Source: PERE: "Opportunity knocks for build-to-suit data centers" – Published September 2024

Net lease remains well-positioned for the road ahead

Across the global marketplace with constantly evolving economic conditions, net lease investments have been viewed as a safe haven for certain market participants. Seeking to offer stability, inflation protection, and diversification, net lease investments may present compelling opportunities for investors to build portfolios with the potential for predictable, long-term returns.

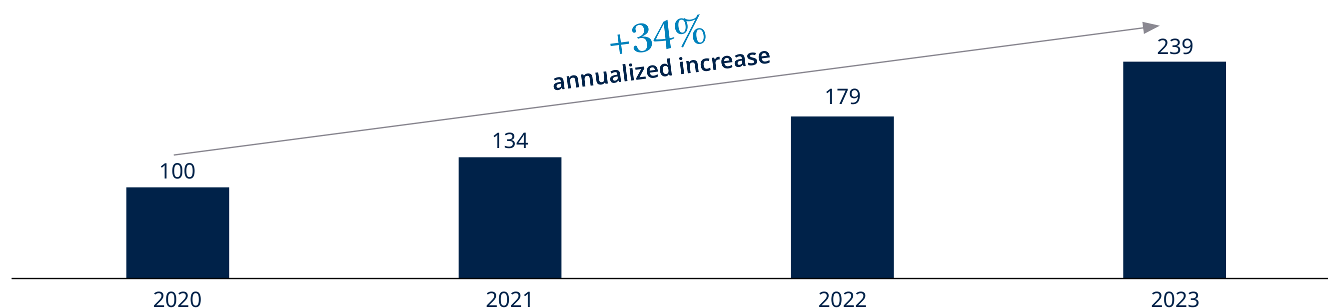
As consumers, we have all experienced the material impact of the highest recorded levels of inflation in the last 40 years, whether it be at the grocery store, the gas station, or the overall increase in the cost of goods. The same holds true for the commercial real estate industry where we've seen property insurance costs, taxes, and the cost of labor and materials skyrocket in recent years.[1]

While some commercial real estate investment strategies are negatively impacted by these market dynamics, Blue Owl Real Estate looks to avoid these pitfalls. Our investment thesis centers upon triple net lease structures and fixed rate financing—attributes seeking to enhance the predictability of our risk-adjusted returns, and further differentiating our strategy from our competitors. Further, Blue Owl Real Estate's portfolio averages an annual net rent growth of 2% providing an additional hedge against inflation throughout nearly any economic cycle.

The same macro trends we are observing in the United States are also present overseas. Although the international net lease market is less mature when compared to the United States, the emerging European and Asian markets present similar opportunities driven by comparable dynamics: rising demand for alternative finance, increasing amounts of M&A activity, and notably less competition amongst our peer group.[2] As a result, we expect many investors will likely increase their exposure to net lease investments in the near future.

Figure 3

Insurance costs – US commercial real estate *(Indexed to 100)*



Source: Marsh– US Insurance Market Pricing Q4 2023 – February 5, 2024.

Past performance is not a guarantee of future results. There can be no assurance that historical trends will continue. Please see Important Information herein for important information on estimates, projections and forward-looking statements.

[1] Source: PNC: "Inflation and Interest Rates Continue to Impact Commercial Real Estate" – Published August 2024
[2] Source: PERE Net Lease Report May 2024

Conclusion

Despite the uncertainty present in today's markets, we believe this economic environment continues to be the most attractive buying opportunity for net lease real estate strategies we have seen in over two decades. Our differentiated sourcing and ability to transact off-market can allow us to take advantage of these rare, fruitful opportunities. Our strategy was designed to perform in varying economic conditions and seeks to deliver predictable income and downside protection to our investors.

We strongly believe Blue Owl's Real Estate Platform is well positioned to continue this positive performance of delivering attractive risk-adjusted returns in any market environment.

Marc Zahr
Co-President, Head of Real Estate

Important information

Unless otherwise indicated, the information referenced herein is as of August 31, 2024.

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