U.S. exceptionalism: At a crossroads

Examining the status of U.S. economic exceptionalism, identifying its historic underpinnings, and investigating how seismic global shifts could fundamentally change its application in markets.

FS INVESTMENTS®

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Much ink has been spilled on the topic of U.S. exceptionalism. Is it alive and well, or at risk of being dethroned? Our crystal ball works just as well as the next investor's but there is no debate that seismic shifts in geopolitics, technology and economic policy are redefining the global order.

At FS Investments, our job as investors is to navigate today's challenges while anticipating tomorrow's in order to deliver differentiated outcomes for our clients over the long term. As we see it, investors face two urgent questions today.

The U.S. has been the preferred destination for capital for years, and our economy remains the envy of the world: Could a new era of deglobalization and fragmentation change that paradigm? And if the U.S. remains economically exceptional, how can investors express this in markets?

Our research helps provide some answers:

- **The U.S. is an aggregator of global talent and capital** with a culture of innovation that drives scientific, technological and economic advancements. We enjoy one of the most sustainable economies in the world with food and energy independence, strong relative population growth, dynamic labor markets, a dominant global currency and deep capital markets. The U.S. is also best poised for resilience among major countries in the face of economic and geopolitical upheaval.
- **The U.S. public equity market is historically expensive.** A few large cap technology stocks—aka the Mag 7—have driven 40% of the S&P 500's performance over last decade. Meanwhile, the ability for investors to access differentiated economic exposures in public markets has deteriorated. The number of public companies has been nearly halved in the past three decades, and within the Russell 2000 (ostensibly meant to track innovative small and midsize U.S. firms) over 40% of members have zero or negative earnings.

So how can investors exploit an economy as productive and self-reliant as the U.S. but reach beyond the scope of what public markets offer?

We believe the private U.S. middle market, comprised of over 200,000 companies that make up one-third of private gross domestic product (GDP) and employ nearly 50 million Americans is the best way of exploiting a new era of U.S. exceptionalism. These companies represent the "sweet spot" of domestic dynamism—growing revenues and earnings faster than the S&P 500 while offering 35% lower valuations.

Capitalizing within this new era requires not just investing in the U.S. (effectively all that was needed in the prior era) but partnering with sponsors and asset managers with the experience and relationships to unlock opportunities in this fragmented market. With over 30 years of middle market investment experience, we believe we offer compelling investment strategies to exploit these new opportunities for our investors.

As we navigate this new, uncertain environment, a Peter Drucker quote comes to mind: "The greatest danger in times of turbulence is not the turbulence—it is to act with yesterday's logic."

We hope you find this research insightful, and we welcome the opportunity to discuss it further.

Regards,

Mich J Kelly

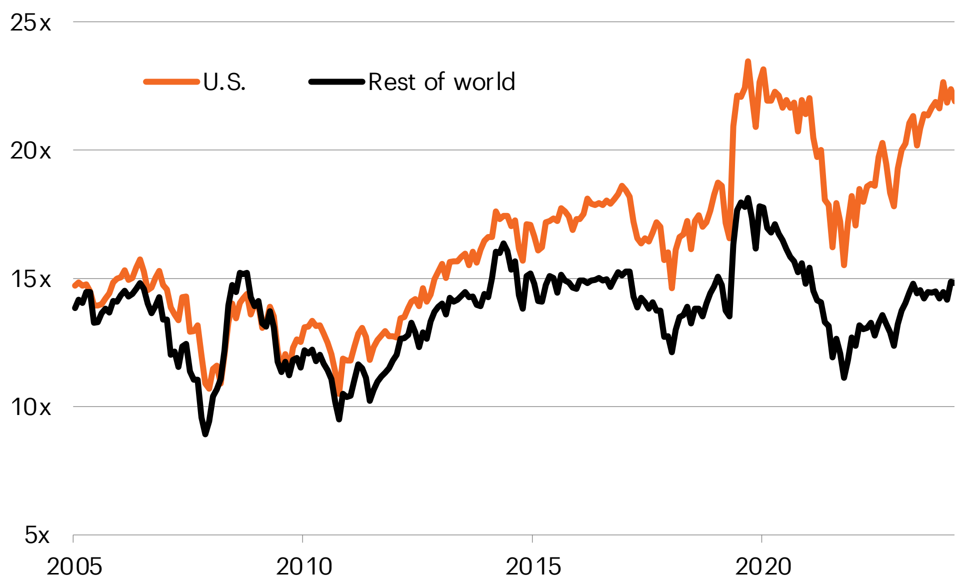
Mike Kelly
President and CIO, FS Investments

Core market thesis

Can U.S. exceptionalism survive the geopolitical and technological transformations of our time? In this report, we analyze the underpinnings of American economic exceptionalism, weigh its resilience and provide a playbook for investing in a new era.

1. Public markets have already priced in U.S. exceptionalism

GLOBAL EQUITY FORWARD P/E RATIOS



Source: MSCI, Bloomberg Finance, L.P., as of February 28, 2025.

The valuation premium for U.S. stocks is near an all-time high, leaving no doubt about the market's view of U.S. exceptionalism.

The U.S. remains the most productive and structurally resilient economy in the world—a distinction we believe will withstand today's pervasive global uncertainties. Yet with the S&P 500 priced at 21x earnings, U.S. stocks aren't just pricey; they're historically stretched compared to both global peers and their own past. While the Magnificent 7 capture headlines, nearly every U.S. sector carries a premium that signals a broad belief in U.S. dominance. This creates the urgent market conundrum of today: Investors must find a way to capture upside from U.S. exceptionalism when the public markets already treat it as a foregone conclusion.

Key findings

The private U.S. middle market offers investors the greatest way to exploit a new era of U.S. exceptionalism—and find growth at a reasonable price.

The structural conditions that drove U.S. economic exceptionalism for decades remain firmly in place—from self-sufficiency to an innovative culture.

As global instability rises, U.S. strength is likely to be compounded. However, the essence of U.S. exceptionalism is changing.

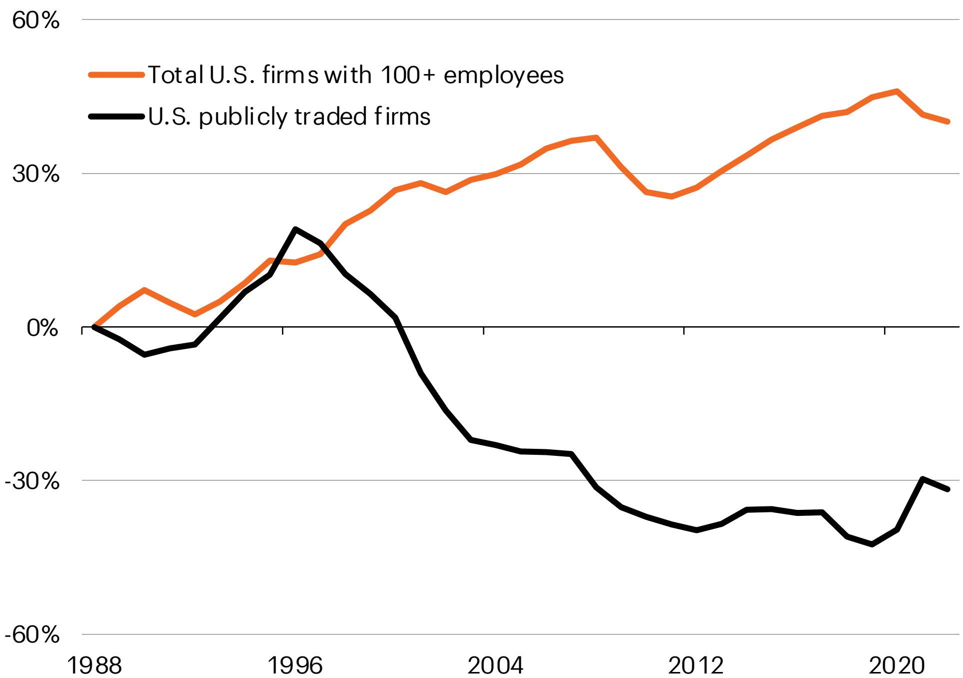
U.S. dominance is priced into public markets. Investors are exposed to historically high valuations and a highly concentrated market, unreflective of the real economy.

Investors are increasingly herding into the largest strategies, but today's changes offer a compelling catalyst to refocus on the core middle market.

Investors must find a way to capture upside from U.S. exceptionalism when public markets already treat it as a foregone conclusion.

2. Private markets are funding U.S. dynamism

GROWTH IN NUMBER OF U.S. COMPANIES



Sources: World Bank, U.S. Census Bureau, as of YE 2022.

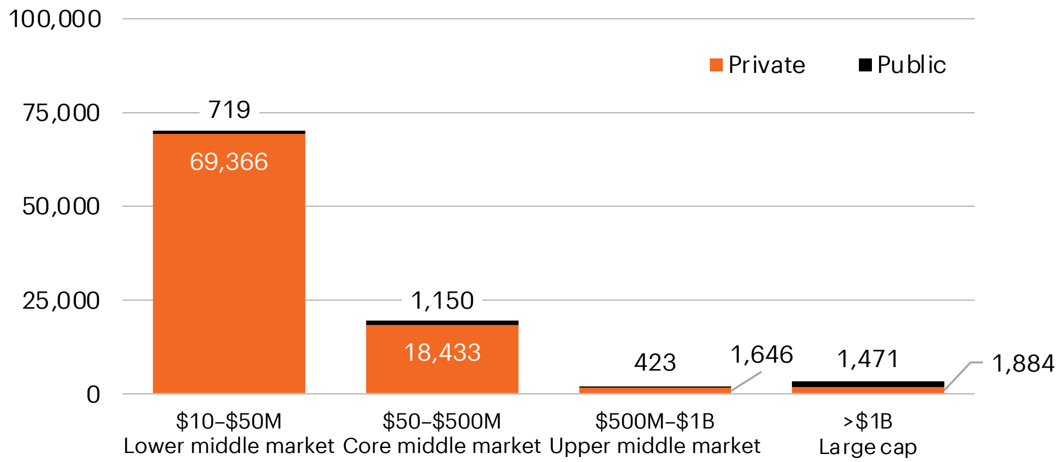
Private markets will be a necessity for accessing the full breadth of U.S. economic exceptionalism going forward.

Public markets have become an arena for the big to get bigger, while private markets fund the engine of the U.S. economy.

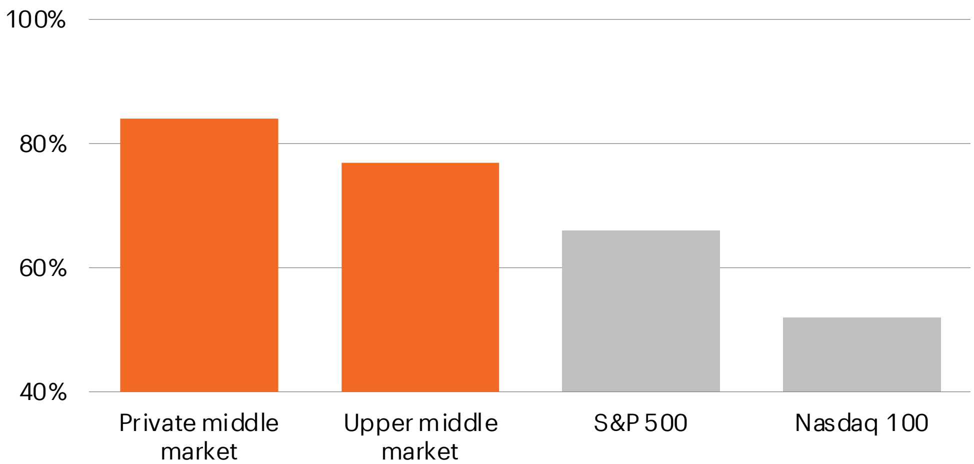
U.S. public stocks aren't just expensive—they've become a distorted reflection of the economy they claim to represent. Companies are staying private longer, creating a reflexive cycle in which a shrinking public market is increasingly dominated by a handful of giants, while a long tail of lower-quality firms lingers at the margins. This setup has worked for investors over the past 15 years, but with public markets increasingly disconnected from the broader economy, the task for investors is clear: Utilize private markets to access the full breadth of U.S. economic exceptionalism going forward.

3. The core middle market balances fragmentation, growth and resilience

DISTRIBUTION OF U.S. FIRMS BY SIZE
Number of firms within revenue range



PERCENT OF REVENUE SOURCED FROM THE U.S.
Trailing four quarters



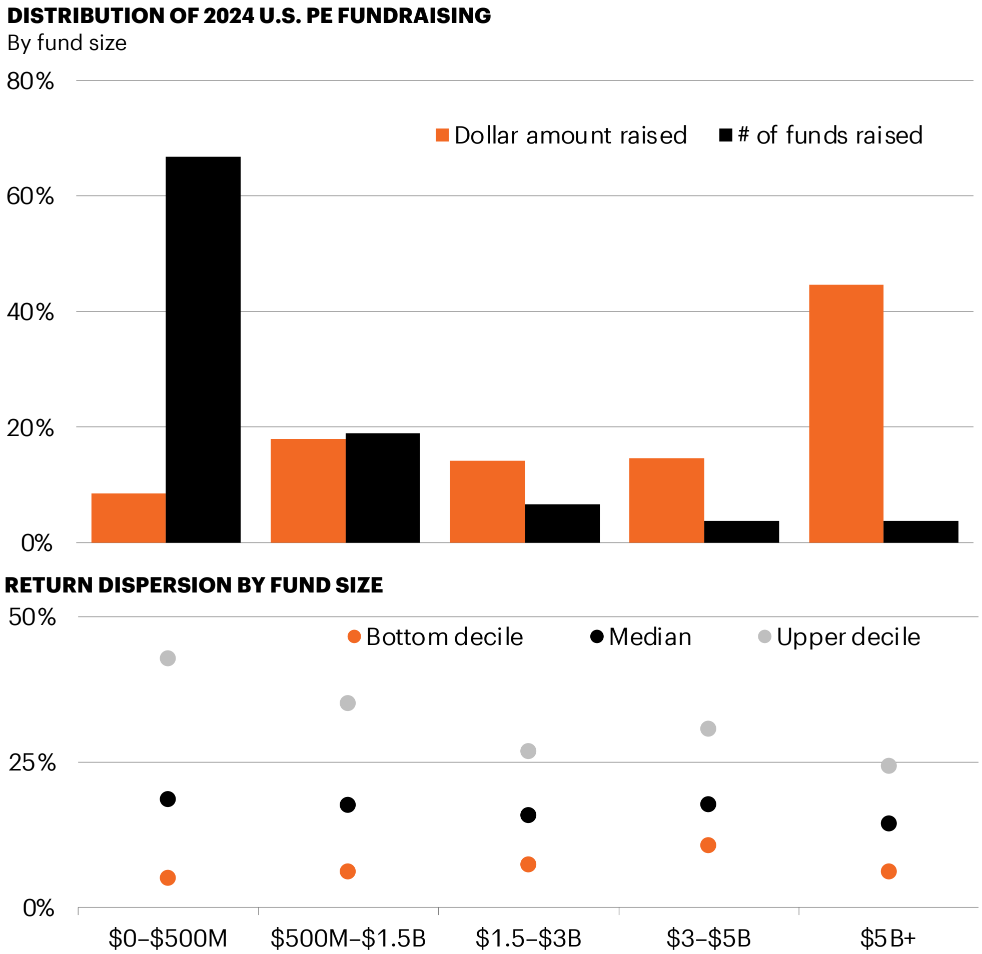
Source: World Bank, U.S. Census Bureau, as of YE 2022.

As the free trade consensus dissipates, the core middle market offers investors a unique combination of growth and domestic-focused resilience.

The core U.S. middle market is the optimal investment expression of the ongoing shift in the meaning of U.S. exceptionalism.

As the global order fragments and uncertainty grows, the meaning of U.S. exceptionalism is set to shift—from outward projection to inward strength. Rising trade protectionism carries the risk of upending complicated global supply chains, hitting the beneficiaries of globalization. The core middle market is a diffuse opportunity set of nearly 20,000 firms—mostly private—who get 84% of revenues from the U.S. As the free trade consensus dissipates, the core middle market offers investors a unique combination of growth and domestic-focused resilience.

4. The middle market is the "sweet spot" in private markets—and an opportunity to access GARP



Source: Pitchbook, Preqin, as of December 31, 2024. Return dispersion uses IRRs for U.S. PE buyout fund vintages 2012-2021.

Middle market PE funds have higher median returns, higher potential for outperformance and lower downside risk than megafunds.

As investors herd into the largest strategies, we see compelling alpha potential investing in the true middle market.

Investors should carefully analyze strategies to ensure they are targeting the most attractive segments of private markets. Last year, 4% of private equity funds raised almost half of all PE capital, which will flow toward a relatively small number of firms in the upper middle market and large-cap segments. Funds targeting the core middle market represent the sweet spot of private equity, marrying scale with fragmentation. Performance bears out the benefits—middle market funds have higher median returns, higher potential for outperformance and lower downside risk than megafunds.

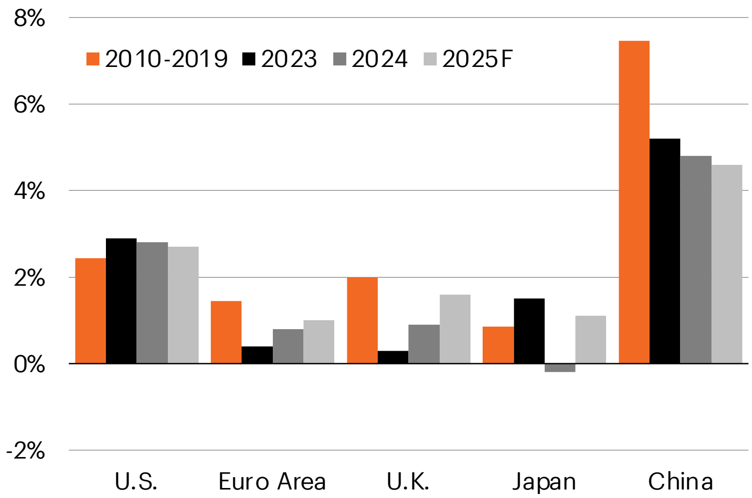
The state of U.S. dominance

"The U.S. has gone from strength to strength in recent history, leveraging structural advantages to create the world's dominant economy. Geopolitical and economic preeminence has filtered into the profitability of our companies and, ultimately, financial markets, generating a flywheel we call U.S. exceptionalism."

–Andrew Korz, SVP, Investment Research

Economic exceptionalism: U.S. outpaces the world

REAL GDP GROWTH BY COUNTRY/REGION



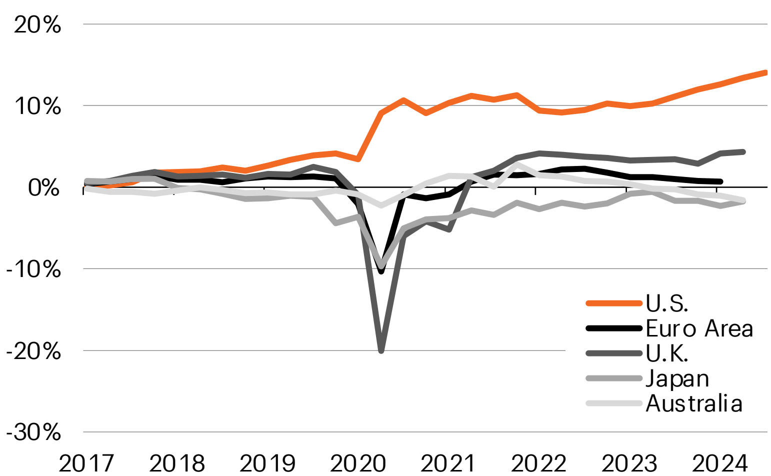
Source: IMF World Economic Outlook, January 2025.

The U.S. has consistently outperformed post-COVID

- Economic growth in the U.S. has lapped that of its developed market peers since the COVID pandemic, and especially over the past two years. Combined with economic challenges in China, the growth delta between the world's two primary economic powers has narrowed substantially.
- The International Monetary Fund (IMF) expects U.S. economic outperformance to continue in 2025 with real GDP growth of 2.7%.

CUMULATIVE LABOR PRODUCTIVITY GROWTH

Since YE 2016



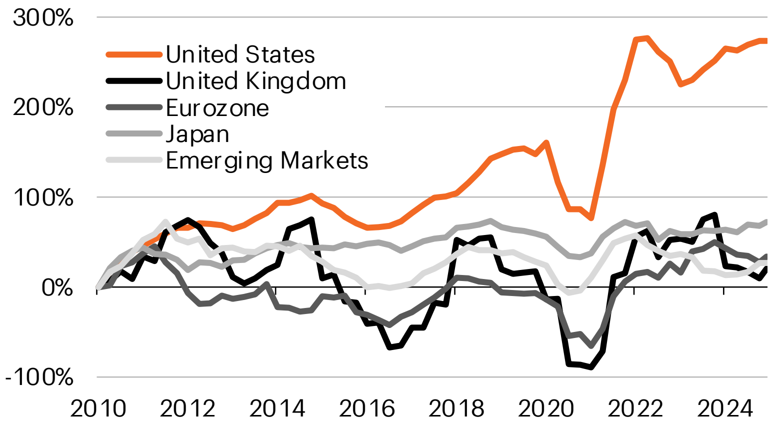
Source: OECD, latest data as of January 2025.

Productivity growth has powered the U.S. economy

- Economic growth comes from three sources—increases in the number of workers, the efficiency of those workers and innovation/technical progress.
- The secret sauce for the U.S. has been its labor productivity, which has increased by 14% since 2017 while productivity in its developed market peers has languished. In a world challenged by demographics, productivity will be the pivotal ingredient for growth in the future.

Corporate exceptionalism: A decade of dominance

CUMULATIVE EARNINGS PER SHARE (EPS) GROWTH
Since Q1 2010



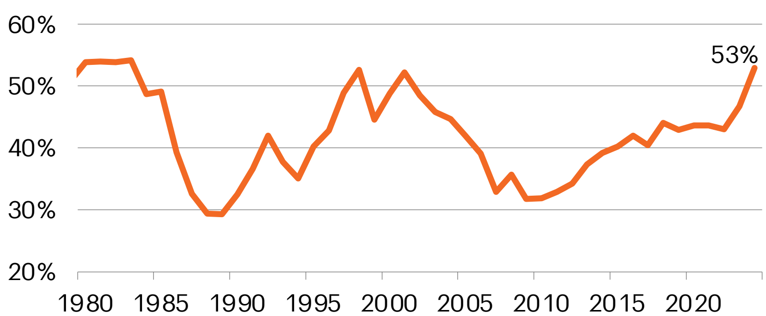
Source: Bloomberg Finance, L.P., FS Investments, as of February 7, 2025.

The profitability of U.S. firms far exceed that of firms in other regions of the world

- The profitability of U.S. firms has far outstripped that of its global peers since the aftermath of the Global Financial Crisis. Earnings per share of the S&P 500 have risen almost 300% since 2010 while that of European and Asian markets have flatlined.
- As is generally the case over the long term, fundamentals have been destiny—U.S. stocks have outperformed those in the rest of the world in 12 of the past 15 years.
- U.S. firms—and especially those in the technology and communication services sectors—have masterfully mined globalization to grow their consumer bases. This has allowed U.S. corporations to consistently grow revenues faster than the country's nominal GDP.

Financial exceptionalism: Dominating market share

U.S. PUBLIC EQUITY MARKET CAP, % OF GLOBAL

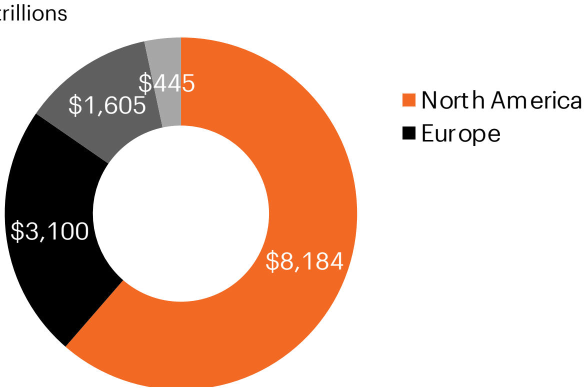


Source: NYSE, Nasdaq, World Bank, as of January 31, 2025.

U.S. comprises more than half of global traded equity value

- The outperformance of the U.S. economy and the dominance of its large tech firms has driven its share of global equity market capitalization above 50%, from just 32% 15 years ago.
- The U.S. equity market share doubles that of its GDP, which is only about 26% of the world's total.

REGIONAL COMPOSITION OF PRIVATE MARKETS AUM
$ trillions



Source: Preqin, as of December 31, 2024.

North America is more than 60% of private markets AUM

- More than 60% of global private capital, which totals more than $13 trillion, is invested in North America. This includes a diverse set of asset classes from private equity, to private credit, to real assets.
- The depth and breadth of U.S. capital markets give the country's firms better and cheaper access to capital.

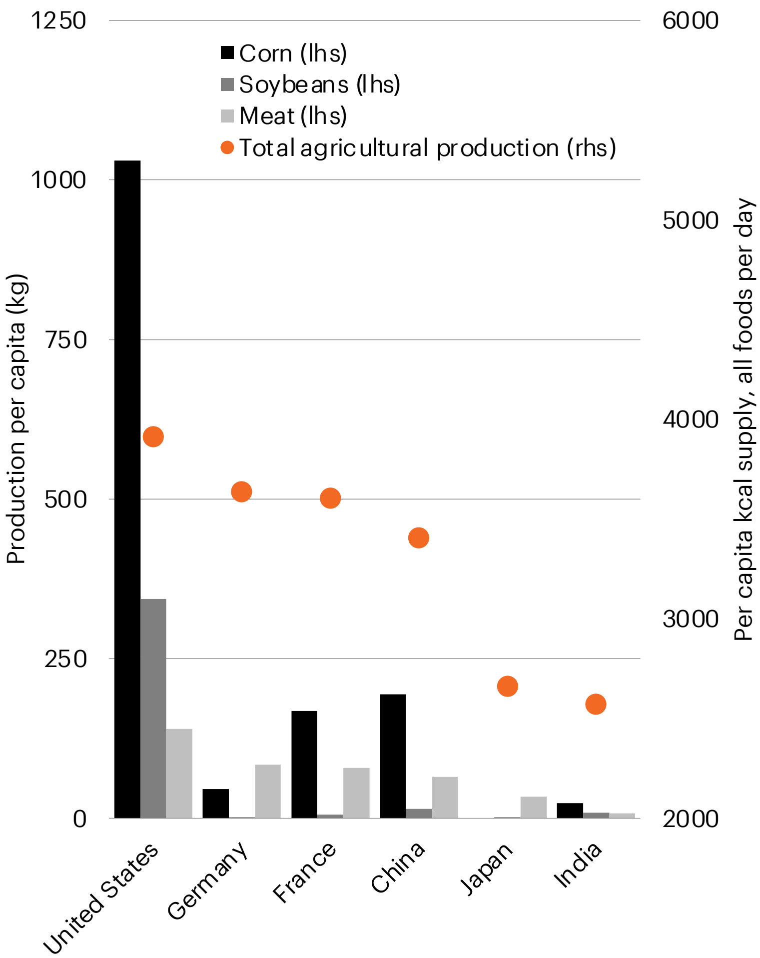
Underpinnings of U.S. exceptionalism

"U.S. exceptionalism isn't an accident—it's built on deep structural advantages that have endured for decades. From energy independence, to deep capital markets, to an unmatched culture of innovation, these foundations both explain dominance to date and lay the foundation for future resilience. Investors who understand these forces will be best-positioned for what comes next."

–Mike Kelly, President and CIO

Food self-sufficiency: Plenty to go around

AGRICULTURAL PRODUCTION PER CAPITA



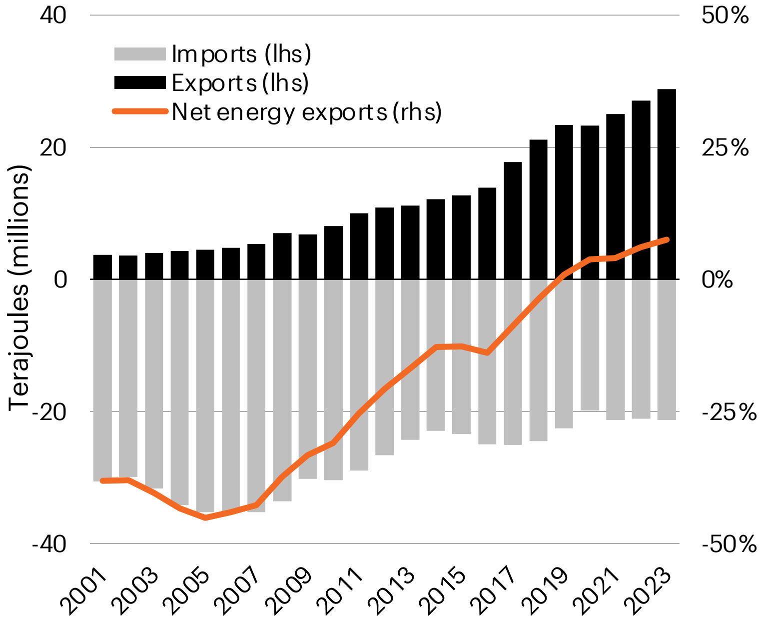
Source: UN Food and Agriculture Organization, as of 2022.

The U.S. ranks #1 in the world in food production per capita

- Since its founding, the U.S. has been an unbridled agricultural powerhouse. Our expansive geography and regional climate diversity support production of everything from Florida citrus, Idaho potatoes and California grapes to Missouri soybeans.
- The U.S. capacity to meet its caloric needs is unmatched. The U.S. ranks first in food production, with our abundant land yielding over 3,900 kcal per person per day. This is enough to feed every man, woman and child nearly two times over.
- Continued excess production has driven prices lower and helped contain food expenses as a share of U.S. household expenditures to just 7%, the lowest among large economies, and well inside China (20%) and India (32%).

Energy self-sufficiency: From importer to exporter

TRADE IN ENERGY, UNITED STATES

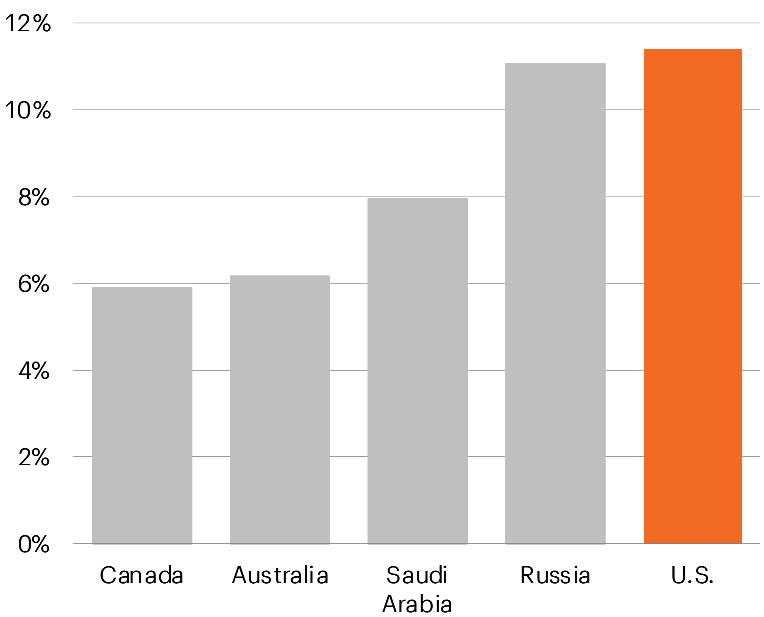


Source: International Energy Agency, as of 2023.

The U.S. has grown energy production immensely

- The U.S. has undertaken a remarkable transformation in energy production, reducing energy imports by 40% from peak (2006) to present.
- With greater self-reliance in meeting its energy needs, the U.S. economy is now far more resilient to supply shocks and coordinated price rigging by foreign adversaries.

SHARE OF GLOBAL ENERGY EXPORTS



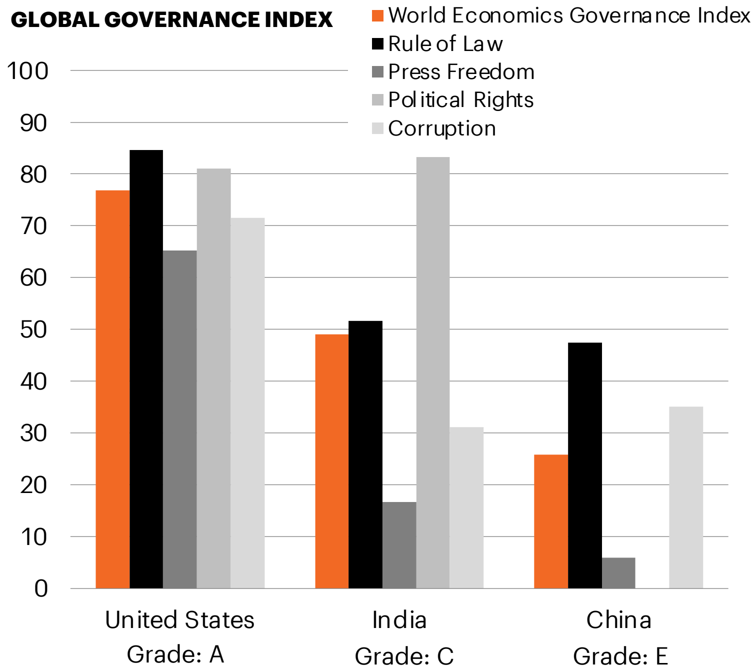
Source: International Energy Agency, as of 2022.

The U.S. ranks as the #1 energy exporter in the world

- In the 1970s and early 1980s, the risk of foreign energy dependence became obvious as the OPEC cartel held a stranglehold on oil prices, which spiked eleven-fold from 1970 to 1980. This was the primary driver of Fed Chair Volcker's fight against inflation, which drove the Fed funds rate as high as 20%—an economically crippling level.

Institutions: Laying the foundation

GLOBAL GOVERNANCE INDEX

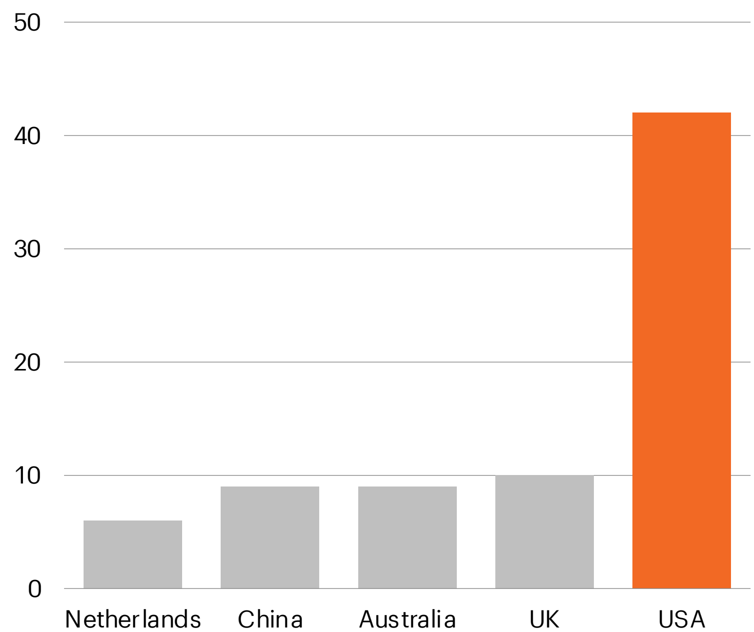


Source: World Economics, as of 2024.

EM has significant governance risk; China rated uninvestable

- Having legal, political and social institutions that are trusted and resilient is critical to the social, economic and capital infrastructure of a nation.
- Strong systems of governance provide the confidence necessary for entrepreneurs and investors to take risk and make long-term investments that drive innovation and job creation.

NUMBER OF TOP 100 GLOBAL UNIVERSITIES



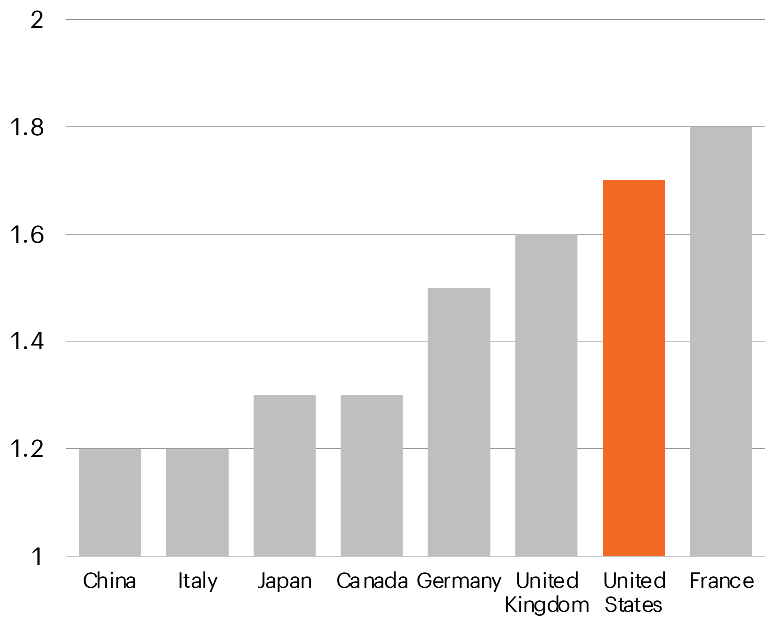
Source: U.S. News and World Report, 2023.

The world's think tank; attracting the world's best minds

- U.S. leadership in higher education is staggering, with more top 100 universities than the next five nations combined. They attract the brightest minds from around the globe and serve as hubs for research and innovation.
- Unfortunately, many U.S. educated foreigners leave the U.S. upon graduation. This is a missed opportunity to retain talent and grow the population of highly skilled individuals in the U.S. workforce.

Demographics: Stable population growth

FERTILITY RATE, TOTAL (BIRTHS PER WOMAN)

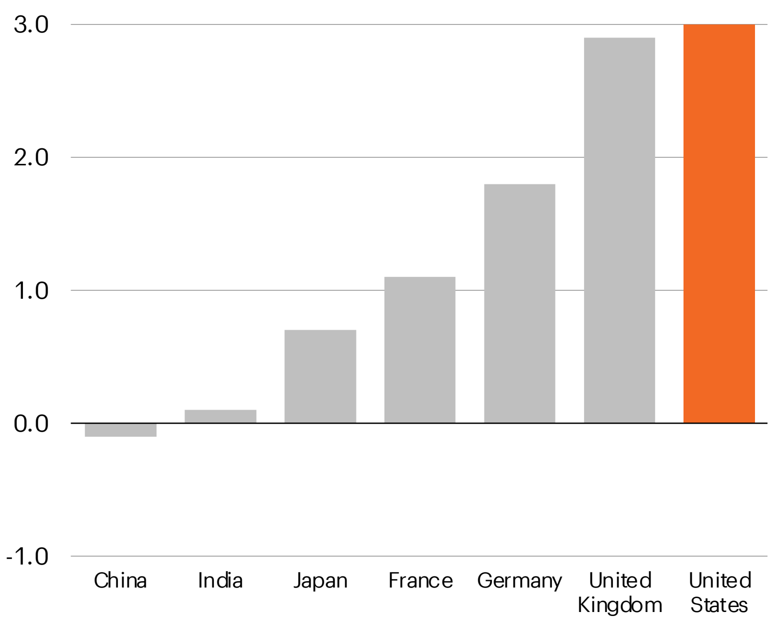


Source: United Nations and World Bank, as of 2022.

The U.S. population is stabler than other large economies

- Population trends are very sticky and take generations to reverse through public policy, yet the importance to long-term economic stability cannot be understated. A growing labor force and consumer base is the backbone of a developed economy.
- While the U.S. fertility rate is presently below the critical 2.0 replacement rate, it is far better than nearly all other large economies.

NET MIGRATION PER 1,000 POPULATION



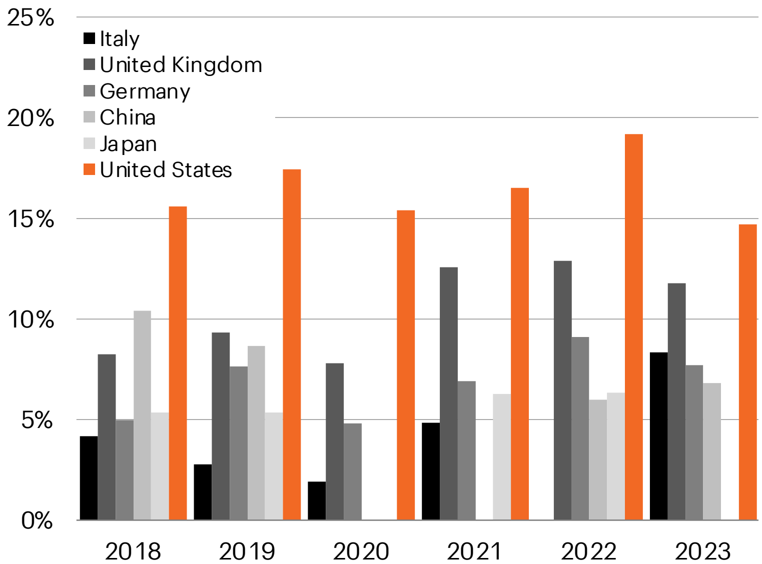
Source: CIA, estimate as of 2024.

Immigration also contributes to stable population growth

- More than offsetting its fertility rate, the U.S. has continued to grow from immigration, leading other large economies. Outside the U.S., developed nations are aging and dependents are increasing. This strains entitlements and creates intergenerational angst that spawns political instability.
- China faces both low fertility rates and negative immigration, portending an economically devastating population collapse over the coming generation.

Innovation: A culture of entrepreneurialism

TOTAL EARLY-STAGE ENTREPRENEURIAL ACTIVITY
% of 18–64 population who are either a nascent entrepreneur or owner-manager of a new business

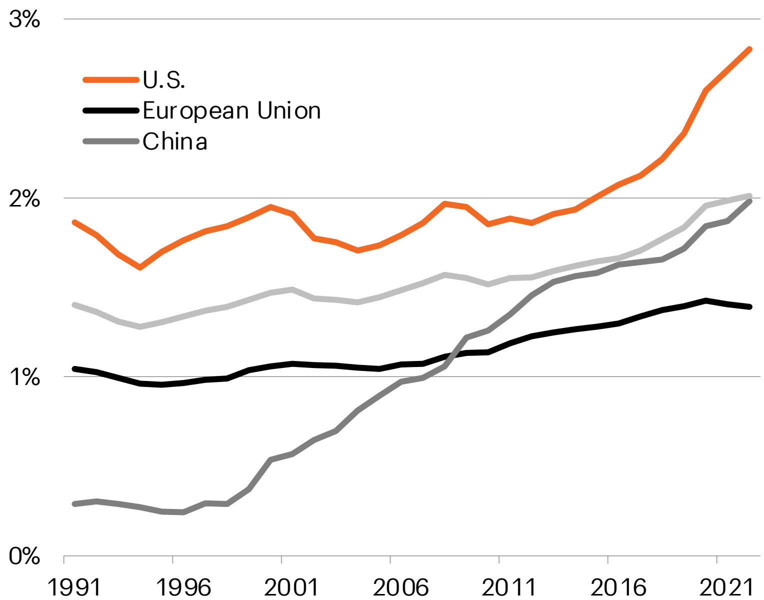


Source: Global Entrepreneurship Monitor, as of December 31, 2023. No data available for Japan in 2020 and 2023.

Americans are risk-takers

- Innovation, exploration and risk-taking have long been cornerstones of the American ethos. This trend has remained firm in recent years, as a higher percentage of U.S. workers are entrepreneurs or business owners than in any other country.
- Leadership in entrepreneurship not only lends itself to more innovation in the present but also fosters a culture in which talented people seek to settle here and invent in the future.

BUSINESS SPENDING ON R&D, % OF GDP
By country/region



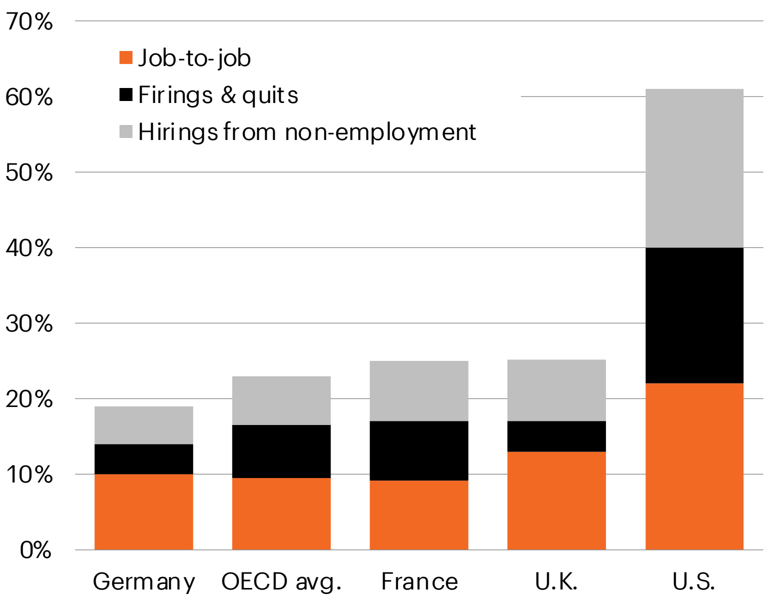
Source: OECD Main Science and Technology Indicators (MSTI), as of year-end 2022.

U.S. firms spend more on innovation than in other countries

- This dynamic has seeped into the U.S. corporate sector writ large, where spending on research and development as a share of the overall economy is higher than in competitor regions.
- This chart makes clear that the U.S. businesses have responded to the advent of new technologies and competition from China by spending more on innovation.

U.S. has the most dynamic capital, labor markets

LABOR MARKET TRANSITION RATES ACROSS COUNTRIES
Annual rates

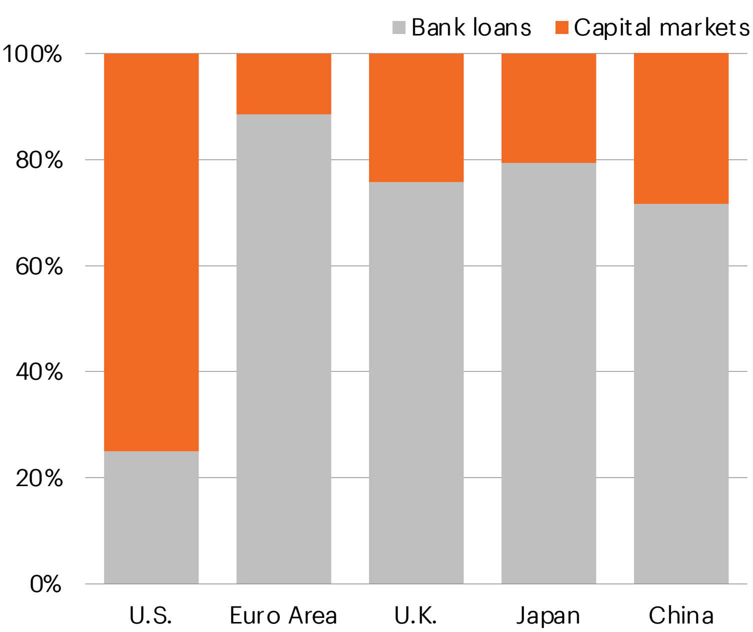


Source: OECD. Causa, O., N. Luu and M. Abendschein (2021), "Labour market transitions across OECD countries: Stylised facts, OECD Economics Department Working Papers, No. 1692, OECD Publishing, Paris.

Labor market dynamism is alive and well

- Economies are comprised of labor and capital inputs. The efficient allocation of these inputs is critical to the healthy functioning of any economy.
- The U.S. labor market demonstrates significantly higher levels of dynamism than its peers. The U.S. has much higher rates of job transitioning, suggesting better matching of skills and roles, lower regulations and higher geographic and occupational mobility.

COMPOSITION OF NON-FINANCIAL CORPORATE DEBT



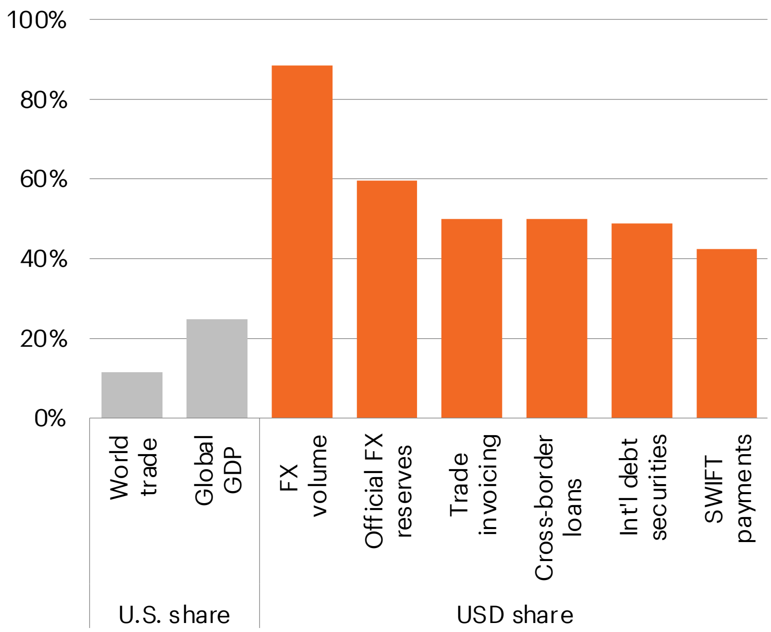
Source: SIFMA Capital Markets Outlook 2023.

Depth of capital markets is a key advantage

- The U.S. has the largest and deepest equity and credit markets in the world.
- While banks dominate lending in most countries, capital markets comprise 75% of credit extension in the U.S., giving its private sector a much more diverse set of funding sources.

U.S. dollar is (still) the dominant global currency

U.S. DOLLAR SHARE OF GLOBAL FINANCIAL ACTIVITY

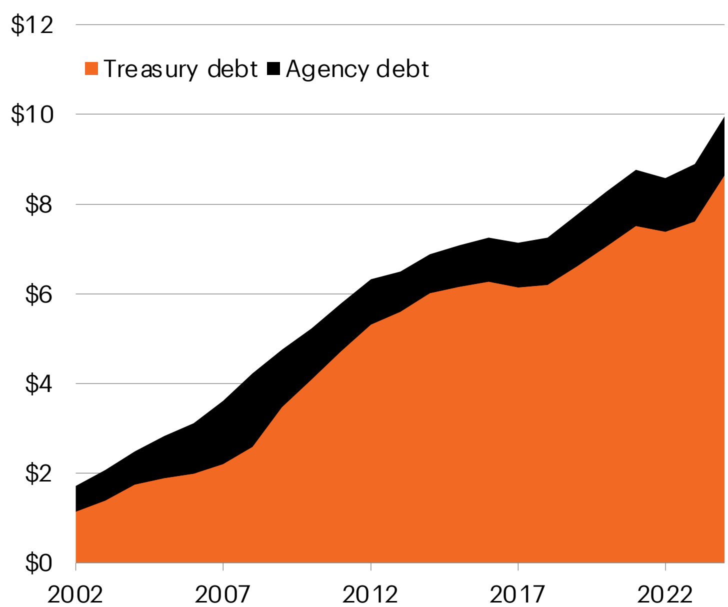


Source: Bank for International Settlements.

The dollar is ubiquitous across markets

- The Bretton Woods II system, borne out of the "Nixon Shock" of the early 1970s, has seen the U.S. dollar as the preeminent global currency due to its economic, financial and military strength.
- Despite the U.S. comparatively modest share of global GDP and trade, the dollar has an over 50% share of global forex volume and reserves, trade invoicing and cross-border lending.

U.S. GOVERNMENT DEBT HELD BY FOREIGNERS
$ trillions



Source: U.S. Department of Treasury, as of December 31, 2024.

Demand for dollar assets remains strong

- The dollar's dominance gives the U.S. government immense power to dictate global economic and financial outcomes, although the system also coincides with the U.S. running large budget deficits.
- Despite some countries diversifying their reserves away from the U.S. dollar, demand for U.S. safe assets from foreigners remains quite strong.

Resilience in a changing world

"There are a number of geopolitical changes disrupting the post-WWII order in which the United States thrived. Still, the historic and continued resilience of the United States, our legal and political institutions, and the unparalleled ingenuity of our people will ensure we continue to lead in an increasingly uncertain and unstable world."

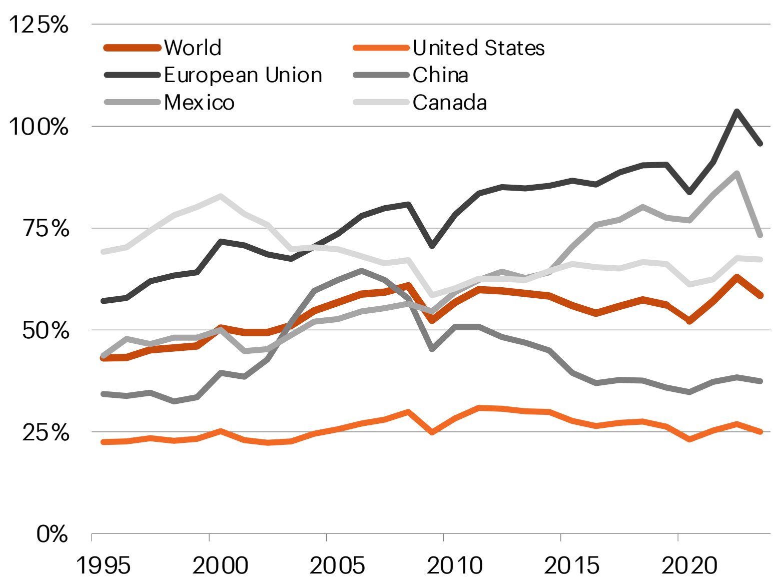
–Jason Cole, Head of Public Policy

The world is facing transformational change

Barriers to free trade	A populist backlash against the free trade consensus has gone mainstream in many parts of the world. Nations are increasingly focused on protecting domestic industry, especially in strategic sectors. This represents a tectonic shift in the economic landscape.
Turbulent geopolitics	Nationalism and populism are on the rise amid a backlash to the changes wrought by globalization. The incidence of conflict is increasing as countries compete economically and geopolitically. It appears the world has entered a new, more dangerous era.
Technological breakthroughs	New technologies such as artificial intelligence (AI) have the potential to fundamentally upend global structures. Popular uneasiness promises to contribute to these trends, and a "winner-take-all" view of the next tech revolution pits global powers in an existential race for supremacy.
Increasing debt levels	Debt levels have increased in most parts of the world after two economic shocks in the past two decades (the Global Financial Crisis and COVID). With aging populations posing risks to long-term growth, nations will need to make hard decisions to deal with public and private debt loads.

Trade: U.S. is the most insulated major nation

GROSS TRADE AS A % OF GDP
By country/region



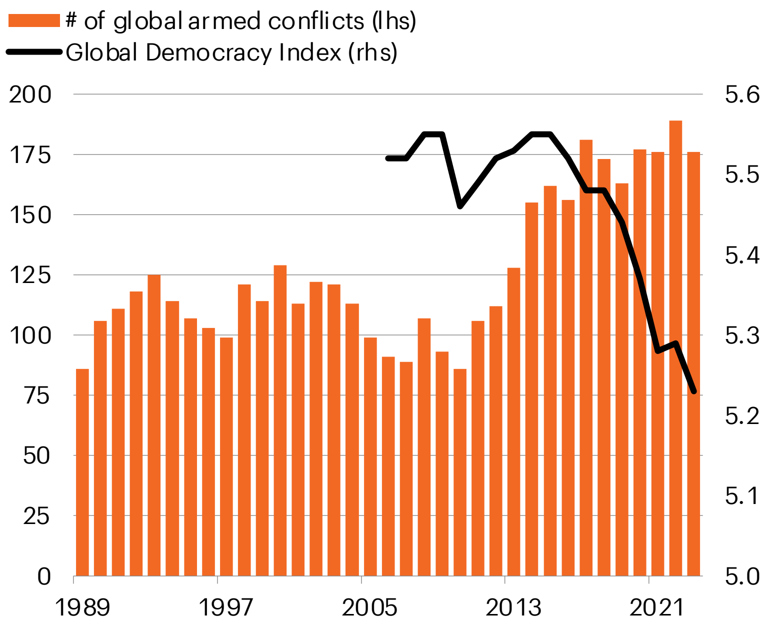
Source: World Bank, as of December 31, 2023.

The U.S. economy relies less on trade than any other major country, an advantage as globalization reverses

- Global trade as a percentage of world GDP increased for decades but peaked around 60% in 2008 and has declined slightly since—part of a broader trend toward deglobalization.
- A popular backlash against the post-1980s free trade consensus—and the economic dislocations it contributed to—has spread across much of the developed world.
- The U.S. economy is relatively well-equipped to handle the potential dislocations brought by changes in trade policy such as tariffs. Trade accounts for only 25% of GDP, the lowest among major countries.
- In addition, due to its size, the U.S. will own leverage in most trade negotiations in which it engages.

Geopolitics: Global reach in a fractured world

NUMBER OF ARMED CONFLICTS WORLDWIDE

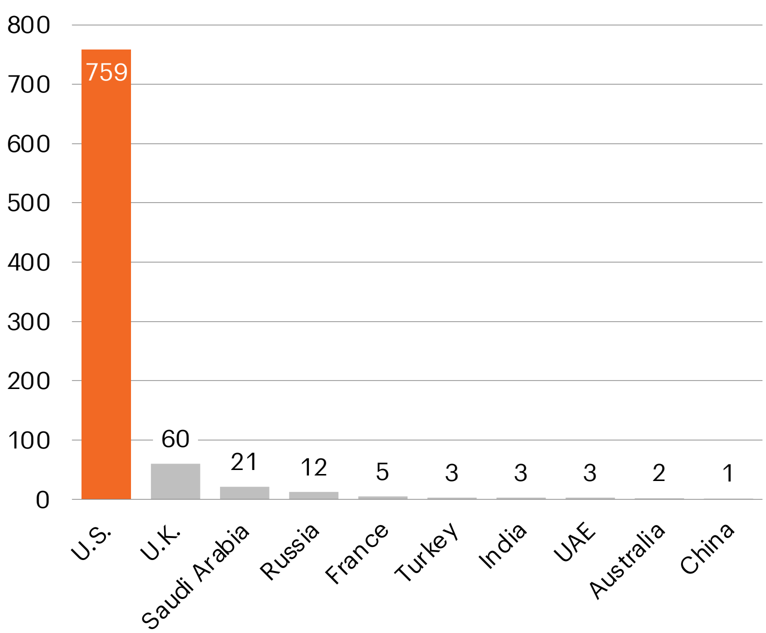


Sources: Our World in Data, Uppsala Conflict Data Program, Economist Intelligence Unit (EIU), as of December 31, 2023. EIU's Global Democracy Index is the average global score for all countries.

Democracy is down, conflict is up across the world

- The world has become progressively more dangerous and unstable over the past decade, with nearly double the number of ongoing conflicts today compared to 2010.
- This has unfolded alongside a growing global popular discontent—for example, just 22% of U.S. citizens trust the government, according to a Pew Research poll—and a concomitant decline in democracy around the world.

NUMBER OF FOREIGN MILITARY BASES, BY COUNTRY



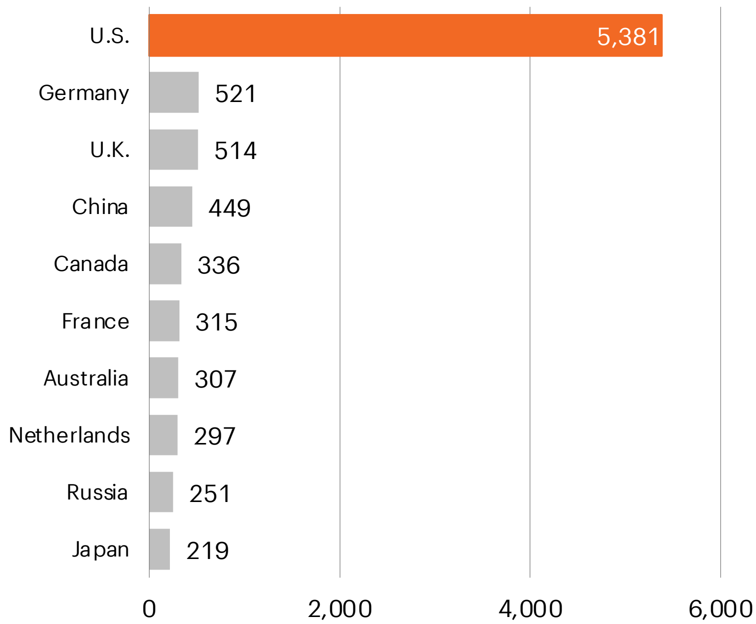
Source: World Population Review.

The U.S. has better global reach than anyone

- While we will refrain from commenting on U.S. foreign policy, the country is better-positioned than any to thwart threats from around the world.
- The U.S. spends more than $900 billion on defense, as much as the next nine countries combined, and operates a network of 759 military bases in more than 80 countries.

Tech: U.S. leads on revolutionary technologies

NUMBER OF DATA CENTERS BY COUNTRY

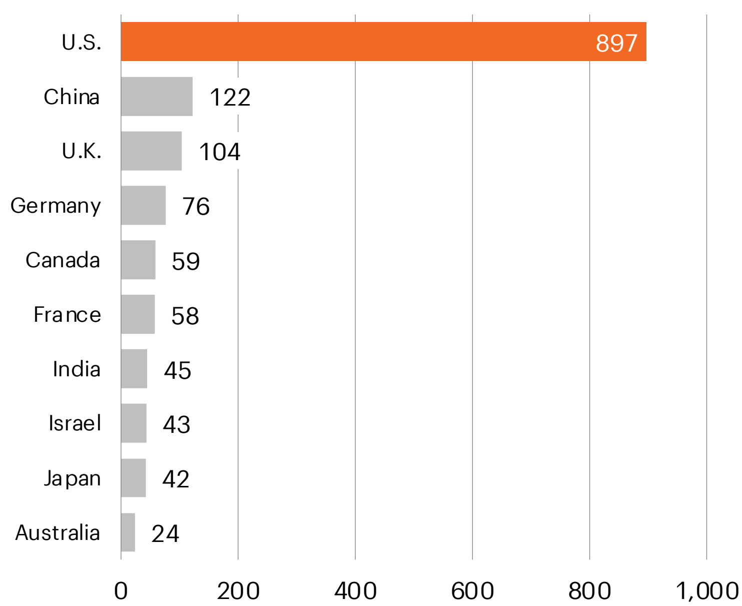


Source: Statista, as of March 2024.

U.S. has ten times as many data centers as any other country

- Burgeoning technologies such as artificial intelligence (AI), quantum computing and robotics have the potential to reshape life on earth in fundamental ways.
- Infrastructure buildout is critical to the growth and adoption of these technologies. The scale of compute and energy required to run AI workloads necessitates colossal buildout of data centers. The U.S. is currently home to more than 10 times as many data centers as the next closest competitor.

NUMBER OF NEW AI COMPANIES FUNDED BY COUNTRY
From 2017–2023



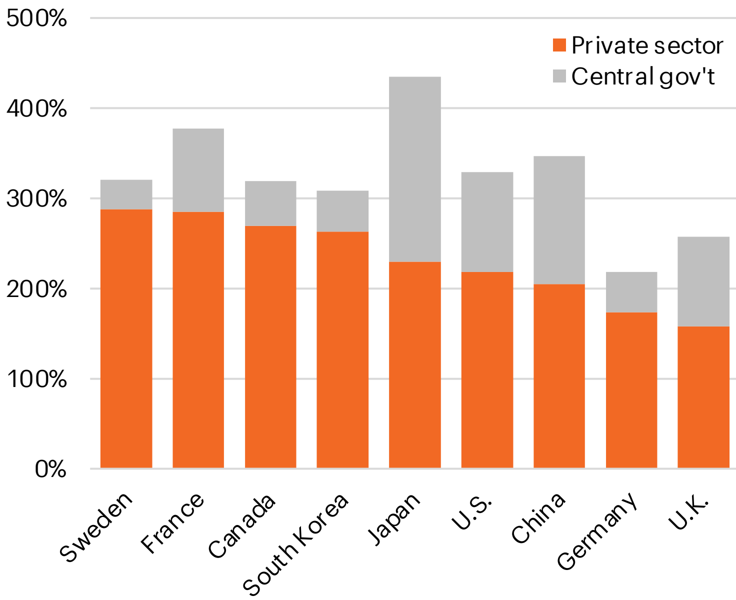
Source: Artificial Intelligence Index by the Stanford University HAI Center.

America has the most robust AI ecosystem

- The U.S.'s thriving tech ecosystem—bolstered by a deep venture capital market—has positioned the country at the forefront of the AI race. Since 2017, nearly 900 AI firms have been funded in the U.S., far outpacing any other nation.
- The winner-take-most nature of technological innovation underscores the strategic importance of these sectors. While uncertainty remains, the U.S. is well-positioned to hold a leadership position for years to come.

Debt: U.S. is better-positioned than most

TOTAL DEBT TO GDP RATIO
Private and public sector; sorted by private sector

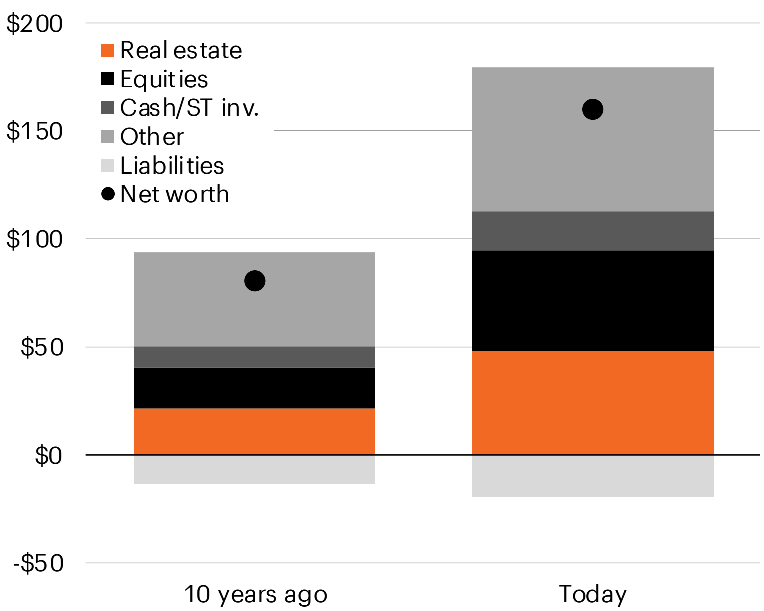


Source: International Monetary Fund.

Private sector debt is manageable

- Global debt to GDP has risen from 150% in the mid-1980s to around 240% today, an increase driven by both the public and private sector.
- The U.S. has debt concerns, especially at the federal government level, where total indebtedness has eclipsed 100% of GDP. However, private sector debt is manageable in comparison to global peers and does not represent a constraint on growth, in our view.

U.S. AGGREGATE HOUSEHOLD BALANCE SHEET
$ trillions



Source: Federal Reserve, as of Q3 2024.

U.S. household wealth has soared in recent years

- U.S. households sit in a better financial position than at any point in recent memory. Cautious borrowing following the Global Financial Crisis, combined with massive wealth gains, has driven the aggregate household leverage ratio (liabilities/assets) to 11%, the lowest since 1973.
- Today, U.S. households sit on more than $150 trillion in net worth, which they can use to fund future spending and spur economic growth.

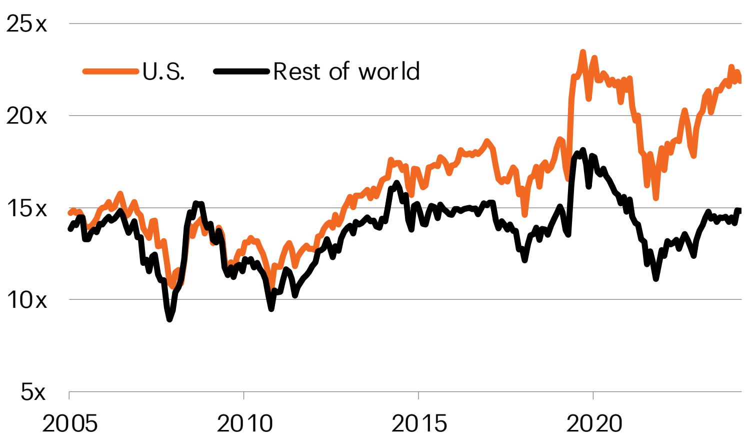
Investing in a new era of U.S. exceptionalism

"As the global environment changes, the U.S. remains the world's most compelling destination for capital. In these times of uncertainty, our investment team prioritizes companies that balance scale with domestic-focused resilience—traits that make the private core middle market the undeniable 'sweet spot' for future opportunities."

– Liz Campbell, CIO

Public markets already price U.S. exceptionalism

GLOBAL EQUITY FORWARD P/E RATIOS

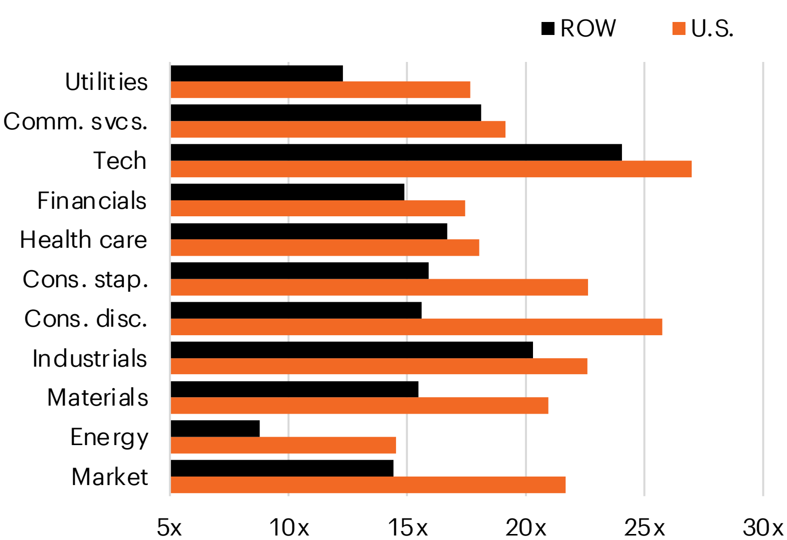


Source: MSCI, Bloomberg Finance, L.P., as of February 28, 2025.

Absolute and relative valuations are at multi-decade highs

- Markets, whose role is to price the future, are making one thing clear: hey expect U.S. firms and the economy to continue leading the world. U.S. equity valuations sit near a 25-year high and are 61% higher than those in the rest of the world.
- The only time in modern history in which valuations were steeper was the dot-com era, when forward price-to-earning (P/E) ratios peaked around 25x.

GLOBAL EQUITY FORWARD P/E RATIOS BY SECTOR



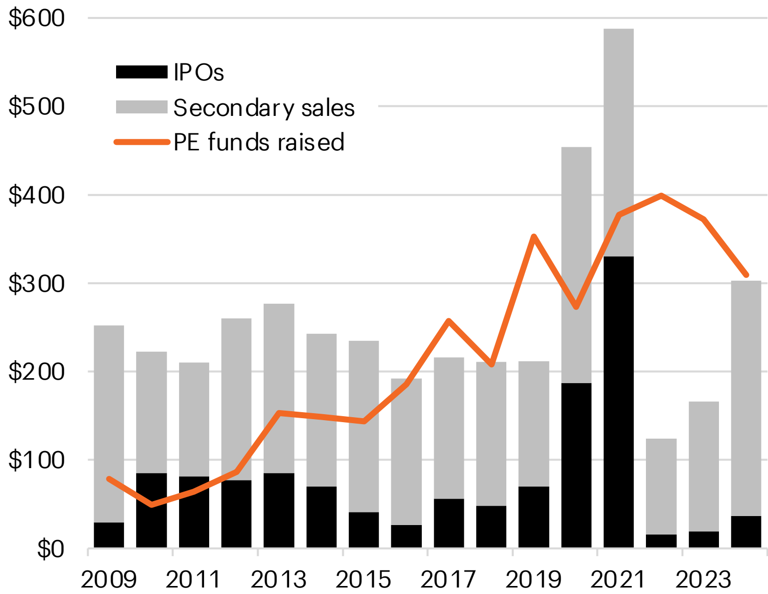
Source: MSCI, Bloomberg Finance, L.P., as of January 31, 2025.

It's not just tech; all U.S. sectors trade at a premium

- Contrary to popular belief, the current U.S. premium is not purely a tech sector story, though that is a critical factor. Valuations in nearly every equity sector are substantially higher in the U.S. than in the rest of the world, suggesting that sector composition does not fully explain the valuation premium.
- Public markets already price a broad view of U.S. economic exceptionalism. This will make beating expectations and driving future gains more challenging.

Funding dynamism: The shift to private markets

U.S. EQUITY CAPITAL RAISED BY YEAR
Public vs. private markets

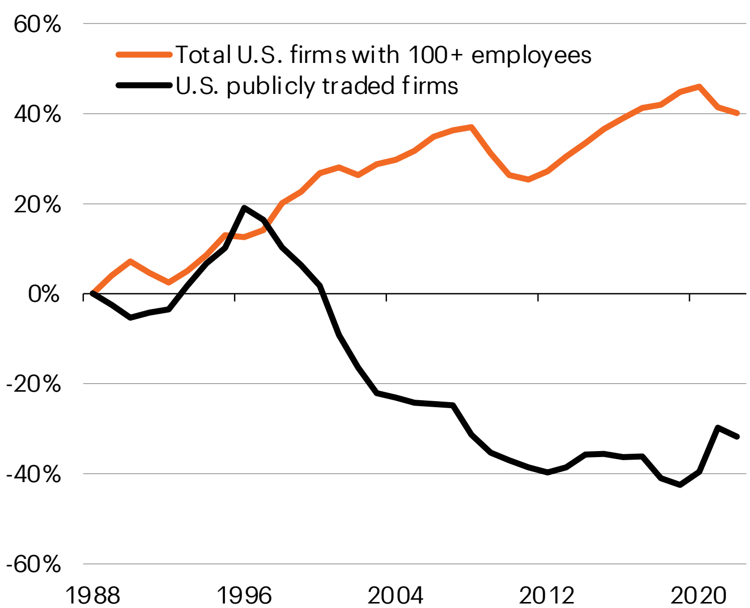


Sources: Bloomberg Finance, L.P., Pitchbook, as of December 31, 2024.

More money is raised in private vs. public equity market

- Even as public markets have enjoyed an epic bull run, their importance as a funder of American economic dynamism has waned.
- Robust private markets give firms the option to remain private longer—an option many have taken. Today, companies raise more money from private equity than from the public equity markets. In fact, when buybacks are considered, U.S. public equity markets are shrinking.

GROWTH IN NUMBER OF U.S. COMPANIES



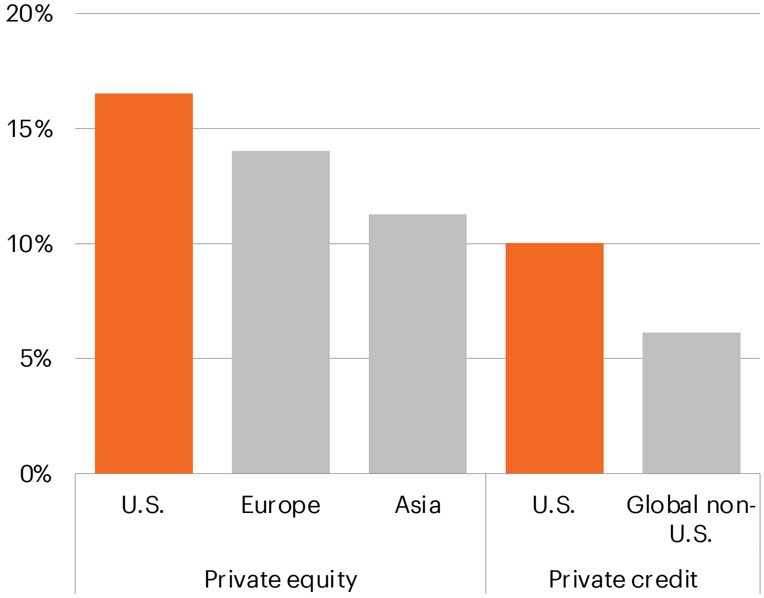
Sources: World Bank, U.S. Census Bureau, as of YE 2022.

The number of U.S. public companies has been cut in half

- A similar trend can be seen in credit markets, where private credit has grown its market share tremendously over the past decade at the expense of banks and public credit markets.
- Private markets are increasingly the dominant source of funding for American economic dynamism—and thus represent an increasingly vital set of asset classes for investors.

Allocating within private markets

GLOBAL PRIVATE CAPITAL PERFORMANCE
Annualized 15-year total return

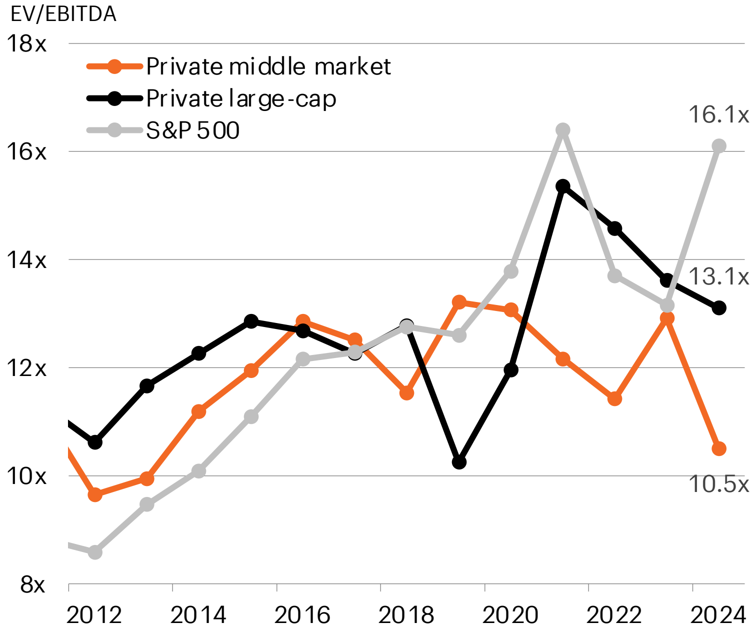


Source: Pitchbook, as of December 31, 2024.

U.S. assets have materially outperformed

- U.S. assets have dominated performance in public markets in recent years, and the same can be said for private markets. U.S. returns in both private equity and private credit have significantly beaten those of other regions.
- Superior economic growth and higher yields have made the U.S. market the most attractive place to deploy capital.

MARKET VALUATIONS
EV/EBITDA



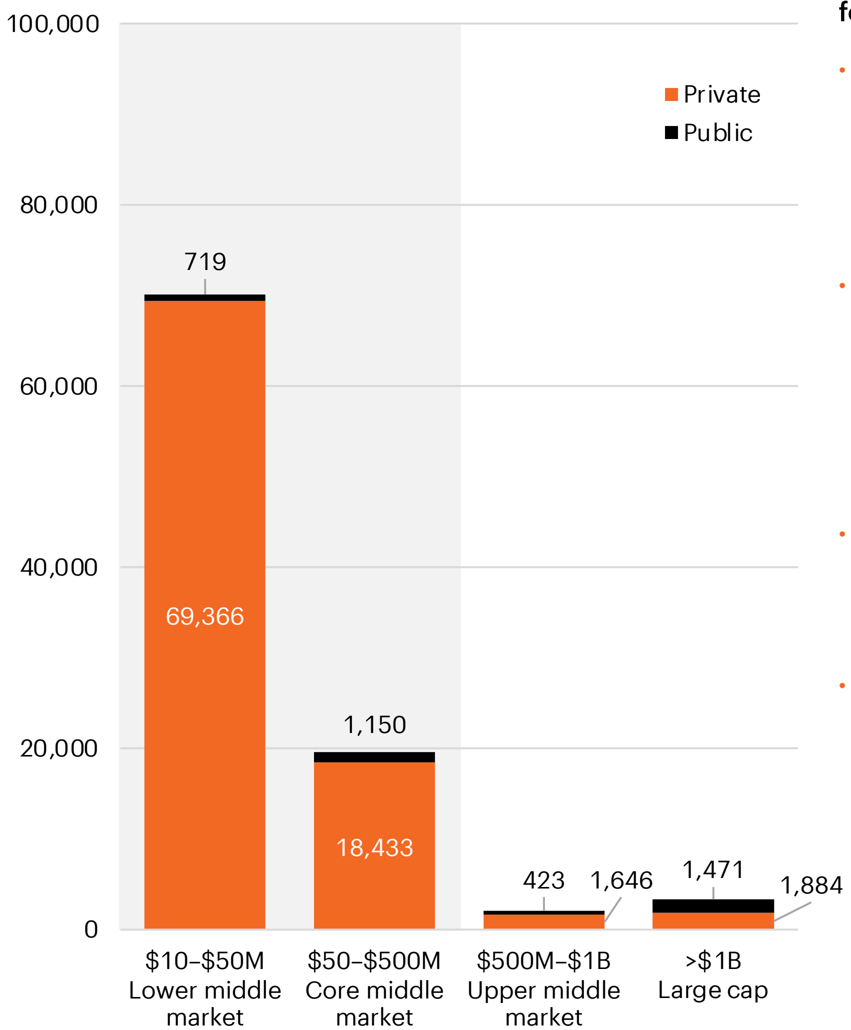
Sources: Pitchbook, Bloomberg Finance, L.P., as of December 31, 2024.

Within the U.S., middle market looks most attractive

- The logical next question is whether outperformance has led to the same valuation challenge in private markets as exists today in public markets. The answer is, partially.
- Large-cap private equity valuation, while below that of the S&P 500, are near the top of their historical range. Middle market PE, on the other hand, offers compelling entry valuations despite its historical outperformance.

Investing in the next era of U.S. exceptionalism

DISTRIBUTION OF U.S. FIRMS BY SIZE
Number of firms within revenue range



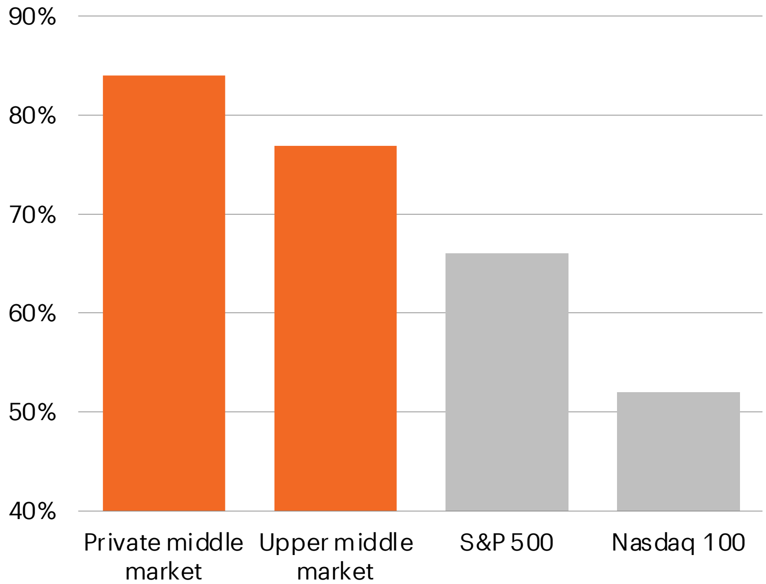
Source: S&P Capital IQ, U.S. National Center for the Middle Market (NCMM), Bloomberg Finance, L.P., as of December 31, 2024.

The core middle market represents a domestically focused sweet spot for investors

- The National Center for the Middle Market estimates there are more than 200,000 U.S. middle market firms with annual revenues of $10 million to $1 billion. Using S&P data, we were able to identify close to 100,000 of them, the vast majority of which are private.
- While the lower middle market contains the largest number of firms, many lack the scale or growth prospects for institutional investment. At the other end, the upper middle market and large-cap segments present challenges due to a more concentrated opportunity set and a more international scope.
- The core middle market represents a "sweet spot"—a fertile landscape of nearly 20,000 midsize firms, most of which are highly focused on the domestic market.
- Our view is simple: The core middle market will be the market expression of a new era of U.S. exceptionalism.

Middle market balances resilience and growth

% OF REVENUE SOURCED FROM THE U.S.
Trailing four quarters

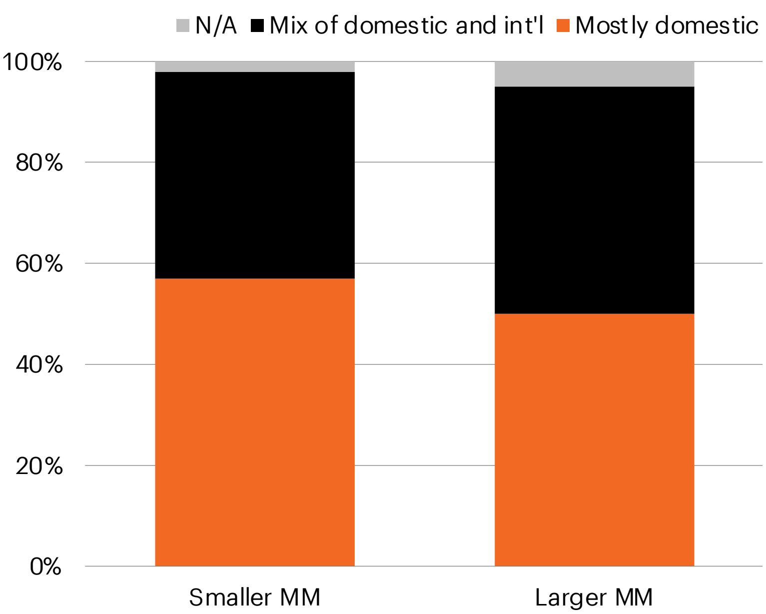


Sources: U.S. National Center for the Middle Market, Bloomberg Finance, L.P., as of December 31, 2024.

Middle market firms source 84% of revenues from the U.S.

- With trade protectionism rising across the world, the resilience of global supply chains will be tested. Margins that benefitted from globalization could come under pressure amid tariffs and higher costs.
- Most large companies today are truly global. The U.S. is the source of just two-thirds of S&P 500 revenue and only half of revenue from the tech-centric Nasdaq 100.

SUPPLY CHAIN EXPOSURE OF U.S. MM COMPANIES
Based on NCMM survey



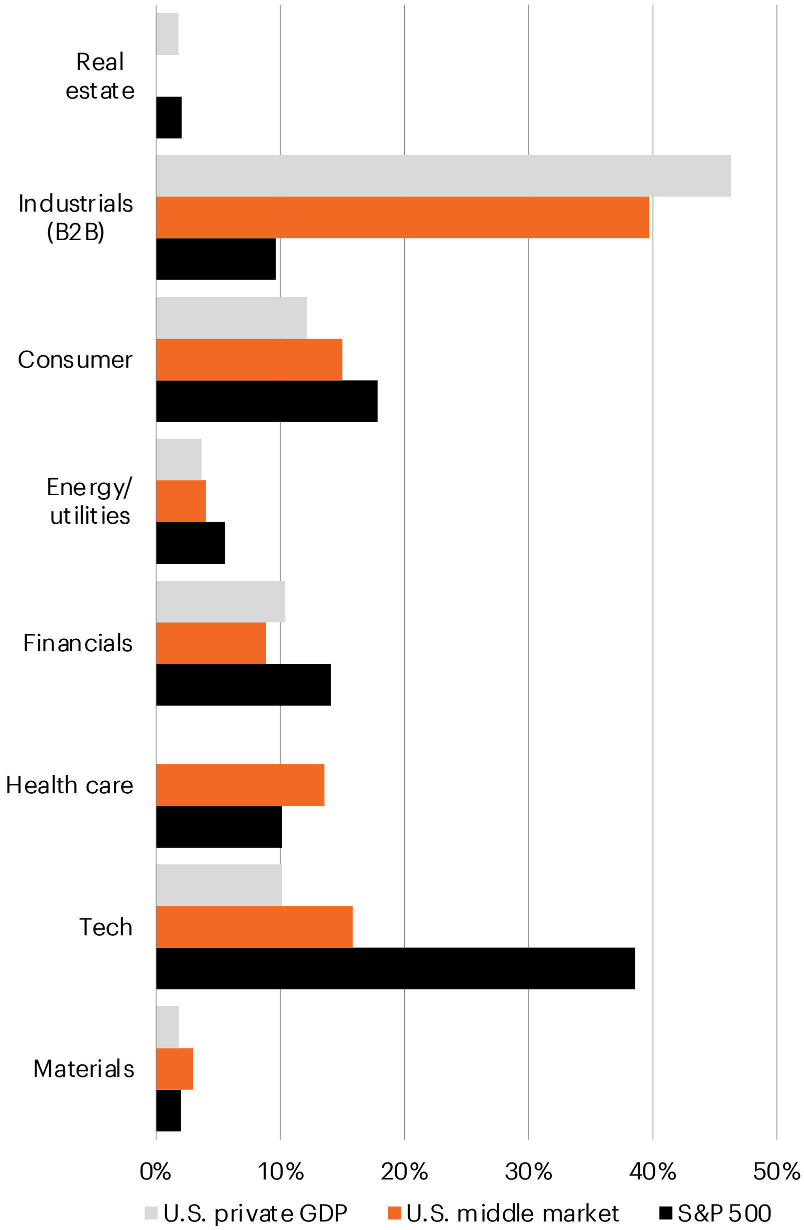
Source: U.S. National Center for the Middle Market, "Global Supply Chain Management and the Middle Market", May 2024.

Larger firms tend to have more globalized supply chains

- The private middle market mirrors the insular U.S. economy. 85% of revenues for private middle market firms come from the U.S. Even within the middle market, larger companies source more of their top line from abroad.
- Most middle market firms have a moderate level of international exposure in their supply chains, striking a healthy balance between scale and resilience.

The middle market mirrors the U.S. economy

SECTOR COMPOSITION OF U.S. PUBLIC AND PRIVATE EQUITY MARKETS, COMPARED TO THE U.S. ECONOMY



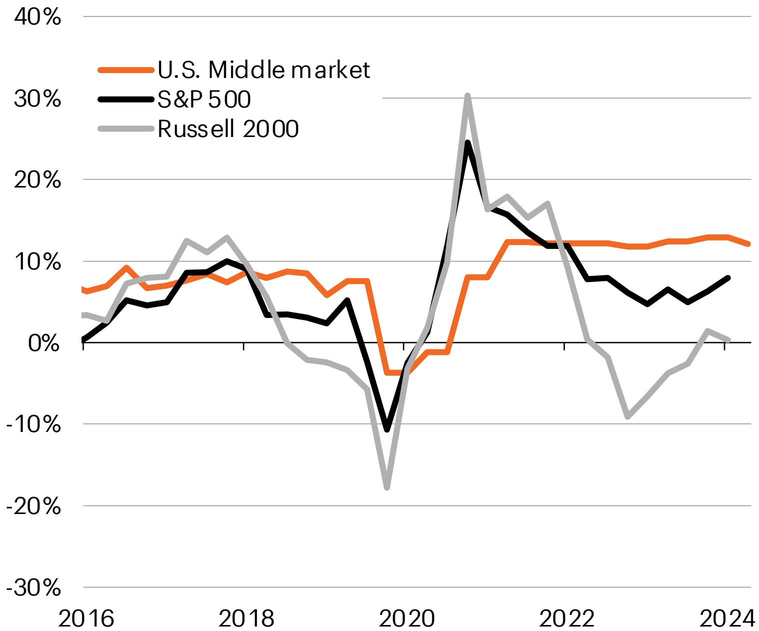
Source: Pitchbook, Bloomberg Finance, L.P., U.S. BEA, as of December 31, 2024. U.S. middle market is represented by the composition of deal activity over the past three years in Pitchbook's U.S. middle market PE database. Rental real estate excluded from private U.S. GDP calculation.

The middle market mirrors the makeup of the U.S. economy, in contrast to tech-dominated public markets

- The composition of public U.S. equity markets has strayed far from the underlying economy it is purported to represent. Today, nearly 40% of S&P 500 market cap lies in technology and media companies.
- This deviation is obviously a reflection of the historic scale and profitability of today's technology giants. But it also illustrates that successful companies in many industries are increasingly unlikely to go public.
- As the heart of the U.S. economy, it should come as no surprise that the middle market closely mirrors the composition of the U.S. economy.
- Industrials, which broadly include firms whose primary business is selling goods or services to other businesses, make up a plurality of the middle market. These companies may be less flashy than tech and media firms, but they tend to be consistent, stable performers.

Domestic strength powers middle market growth

MARKET REVENUE GROWTH, % Y/Y

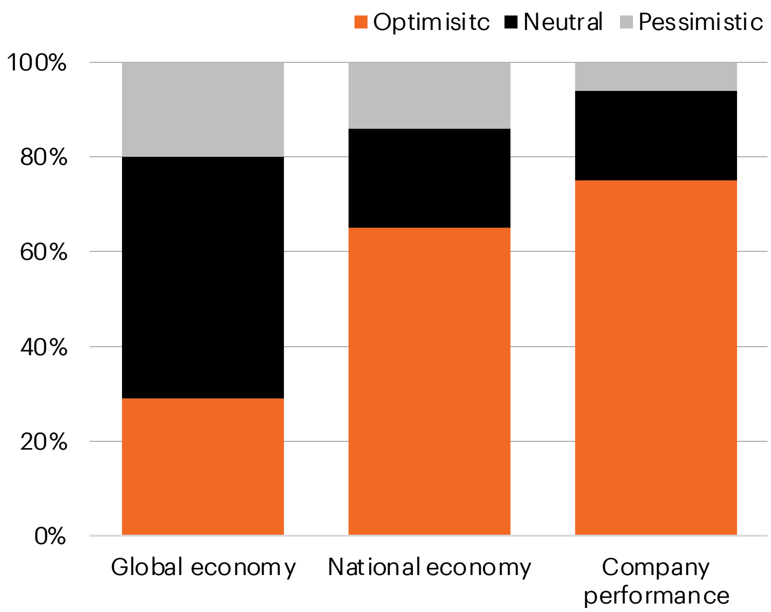


Source: U.S. National Center for the Middle Market, Bloomberg Finance, L.P., as of December 31, 2024.

Middle market revenues consistently outpace large-caps

- Middle market fundamentals have long been more stable than those of large-cap firms, due to their lower exposure to global developments and boom/bust industries.
- Since the COVID recovery, middle market firms have consistently grown revenues at around 12% per annum— well above that of the S&P 500. This speaks to their ability to capture the strength of the U.S. economy and mitigate disruptions associated with the pandemic.

U.S. MIDDLE MARKET LEADERS SENTIMENT
Outlook for 2025



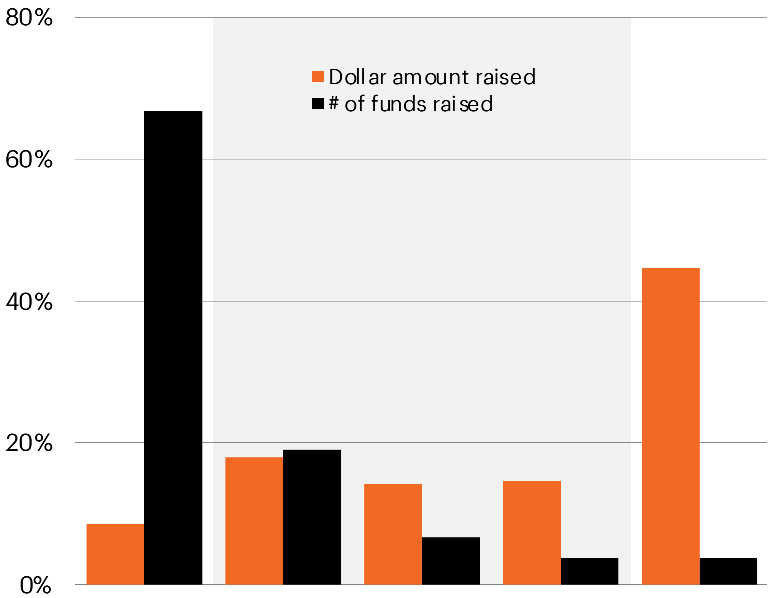
Source: JPMorgan 2025 U.S. Business Leaders Outlook.

Leaders are optimistic on the U.S., skeptical internationally

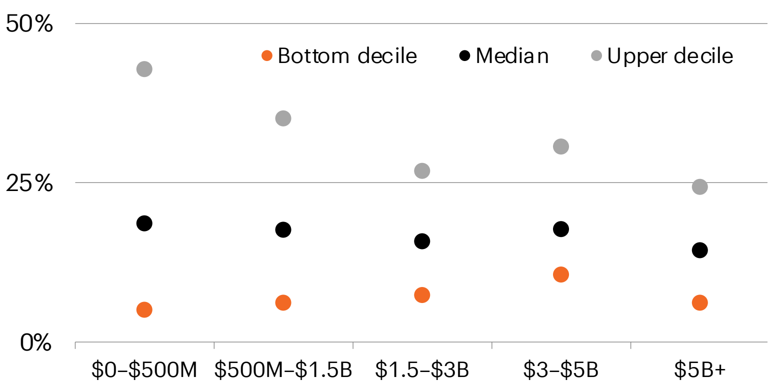
- This mix of stability and growth is impossible to find in public markets. Revenue growth in the Russell 2000, which ostensibly tracks firms of similar size, is 0% over the past year. More than 40% of its members have zero or negative earnings, speaking to the hollowing out of public markets.
- The right-hand chart brings into stark relief the chasm between global and domestic sentiment. Middle market executives are quite optimistic about the outlook for the U.S. economy and their own firms, but much less so about the global backdrop.

Private equity: The middle market sweet spot

DISTRIBUTION OF 2024 U.S. PE FUNDRAISING
By fund size



RETURN DISPERSION BY FUND SIZE



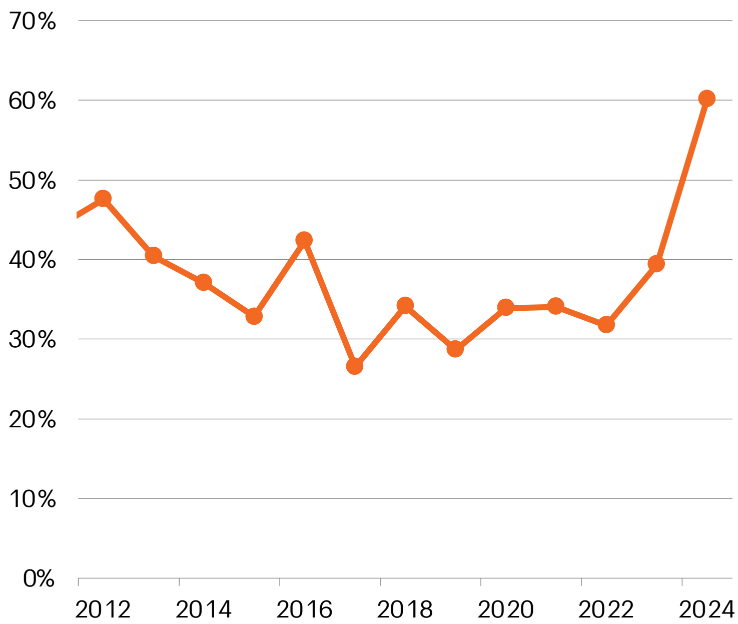
Source: Pitchbook, Preqin, as of December 31, 2024. Return dispersion uses IRRs for U.S. PE buyout fund vintages 2012-2021.

Increasingly concentrated capital flows highlight the opportunity in middle market funds

- The distribution of fundraising into U.S. private equity has become increasingly concentrated amid the emergence of so-called "megafunds." The largest PE funds accounted for just 4% of the total number of funds raised in 2024, but 45% of the capital.
- The long tail of small, sub-$500 million funds comprised two-thirds of the fund count but less than a tenth of the capital raised.
- Between these two extremes, the middle is where the largest opportunity lies. Pairing scale with fragmentation, these are the funds that target the 20,000+ companies we identified previously. Meanwhile, the mass of capital raised in megafunds is competing for deal flow in the much more concentrated upper middle market/large-cap segments.
- Performance tells the story. Median middle market returns sit in the high teens while retaining upside potential, with megafunds delivering lower median returns and much lower dispersion.

Private credit: Opportunities for alpha

% OF PRIVATE CREDIT FUNDRAISE GOING TO 10 LARGEST FUNDS

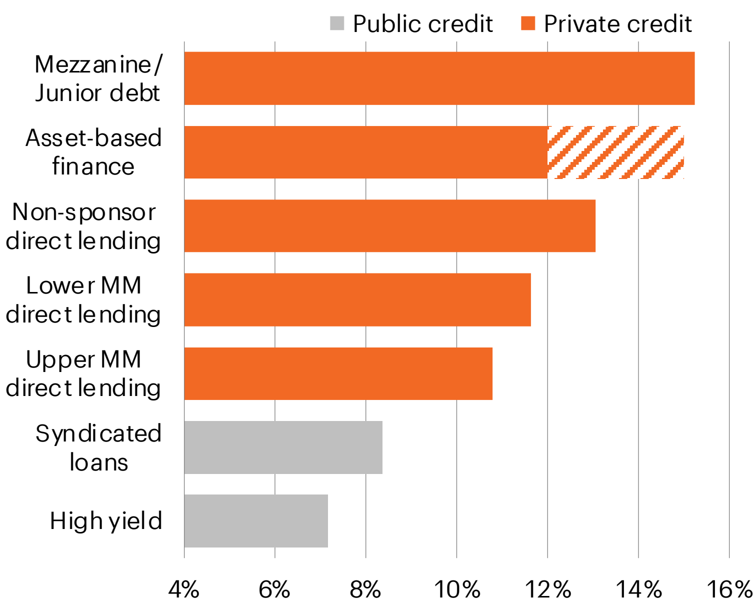


Source: Preqin, as of December 31, 2024.

Capital is increasingly herding into the largest funds

- Fundraising concentration is rising in the private credit space, as well. The proportion of global private credit capital raised that went to the ten largest funds was 60% in 2024, the highest on record.
- Herding behavior is nothing new, but almost always results in suboptimal outcomes. Investors appear to be addressing uncertainty by prioritizing brand name and perceived comfort over the best investment opportunities.

LEVERAGED CREDIT SUB-MARKET YIELDS



Source: J.P. Morgan. U.S. CLOIE Index, Bloomberg Finance, L.P., ICE BofAML U.S. High Yield Index. Pitchbook. Morningstar LSTA U.S. Leveraged Loan Index. Cliffwater, LLC, Cliffwater Direct Lending Index. KKR Credit, FS Investments. As of September 30, 2024.

Opportunities for alpha lie in less competitive segments

- The private credit market continues to grow in both scale and scope, offering compelling opportunities across various sub-markets.
- Lower middle market and non-sponsored direct lending offer investors the ability to go against the grain. As capital flows to the large-cap part of the market, these segments increasingly offer yield premium and lender-friendly terms.

Five implementation questions to ask

Implementation questions investors should ask when assessing opportunities

1	How do you define the middle market, and where are you positioned within the segment?
2	How are you ensuring that your capital raising ambitions don't dilute your ability to target the core middle market, where the best opportunities lie?
3	How much of your performance can be tied directly to earnings growth of the underlying companies?
4	What is your edge in sourcing deal flow in the fragmented U.S. middle market?
5	How do you think about international investing, and what is your target allocation to non-U.S. assets?