

Why Private Markets Still Reward Selectivity: An Investor's Case for the Lower Middle Market



By **PACE KESSENICH**
Managing Director, Private Investments

Private markets are not monolithic. The opportunity set spans private equity and venture capital, private direct lending, and private real estate, but the common thread is that outcomes are shaped less by broad market movements and more by access, underwriting, and manager skill. For families evaluating how private investments fit into a long-term portfolio, where you invest in the market matters as much as whether you invest at all.

Private Investments are a “Mutual Handshake”

One of the biggest differences between public and private markets is that private investing is fundamentally relationship-driven. In public markets, any investor can buy a security. In private markets, capital providers and capital users choose one another. This dynamic creates what I think of as a mutual handshake: the entrepreneur or business owner is not just seeking capital, but the right partner.

The best private companies often want more than the lowest cost of capital. They want value-add capital — investors who can help recruit talent, open doors to customers, strengthen operations,



support mergers and acquisitions, and bring a relevant industry network. That tends to matter most in businesses that are still professionalizing and scaling, where strategic support can accelerate growth.

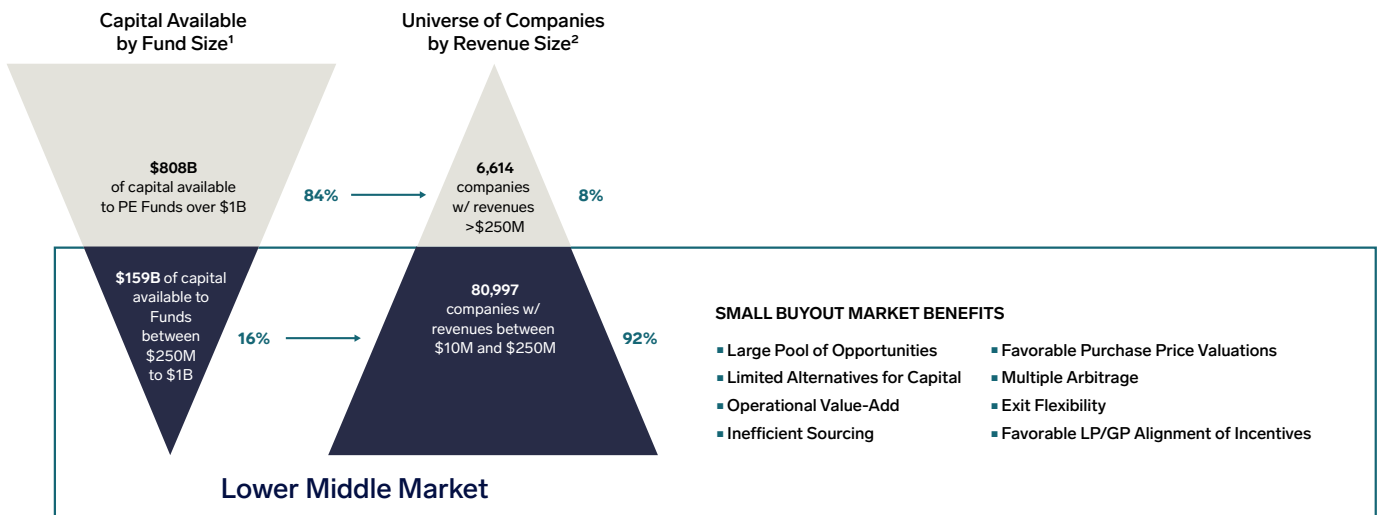
This distinction is particularly important when comparing larger and lower-middle-market companies. Management teams tend to be more established in larger, upper-middle-market companies, and the focus often shifts toward financial optimization rather than on building the business. In the lower middle market, however, the quality of the partnership between investor and management can still be a meaningful competitive advantage. As a result, manager selection is critical: the most sought-after private investors are often those that founders actively choose to partner with.

Why the Lower Middle Market Stands Out

At Pitcairn, we continue to see the lower middle market as one of the most compelling areas in private investing. Broadly speaking, this is the portion of the market where businesses generate less than roughly \$50 million in profit. It is also where the market is often less efficiently intermediated, with less capital chasing a deeper set of opportunities.

That imbalance matters. When too much capital competes for a smaller number of larger deals, pricing tends to become more efficient, and future returns are pressured. In the lower middle market, by contrast, managers can still find more proprietary opportunities, purchase businesses at lower valuations, and create value through hands-on execution rather than relying on financial engineering.

Small Companies Dominate Market Supply with Significantly Less Capital in Pursuit



Sources: This graphic was originally created by RCP Advisors. Data in the graphic is from PitchBook and S&P Capital IQ. 1. PitchBook: Capital available to invest by fund size represents U.S. private equity overhang for vintage years 2017-2024. U.S. PE Funds includes buyout, growth, co-investment mezzanine, diversified PE, energy, and restructuring. As of 6/30/24. 2. S&P Capital IQ: Commercially active businesses in the U.S. All subsidiary and business establishment data are combined. Additionally, public sector entities are excluded. As of 2/13/25.



Private Equity

In private equity, this can translate into more attractive entry valuations and more levers for value creation. Experienced managers can help professionalize a company by building out the finance function, upgrading systems, strengthening go-to-market capabilities, and executing add-on acquisitions. In our view, that combination of lower purchase multiples and a broader toolkit for operational improvement is a powerful recipe for long-term compounding.

Private Direct Lending

In private direct senior lending, the lower middle market can offer stronger lender protections and more disciplined underwriting. We often see better covenants, higher contractual yields, and lower leverage than in larger, more competitive parts of the market. That matters because leverage is one of the clearest predictors of resilience through a cycle. More conservative capital structures can support lower default rates, stronger recovery values, and returns that depend less on broader capital-market liquidity conditions.

Private Real Estate

In private real estate, the lower middle market can provide access to smaller, less-followed assets that are occasionally mispriced. Skilled operators can improve value through leasing, repositioning, renovation, and operational upgrades, then potentially create additional upside by assembling assets into a more attractive portfolio. The opportunity is not simply to own real estate, but to execute a clear value-creation plan in segments where institutional capital is not always as dominant.

Venture Capital

In venture capital, scale has increasingly delayed the path to the public markets, making manager breadth and selectivity even more important. We believe exposure to a diversified, highly skilled venture platform such as StepStone has been especially valuable in an environment where companies are staying private longer, and outcomes are increasingly concentrated in the best managers and the strongest companies.

The Implication for Investors

Private markets often offer an illiquidity premium to investors who are patient and have a long-term investment horizon. However, the case for private markets is not simply that they are private. With the right partners, private market managers provide access to businesses and assets where skilled investors still have an edge. The lower middle market is one of the clearest examples of that inefficiency, but it is also an area where dispersion between top and average managers is wide. Access, diligence, and alignment remain critical.

For families with long horizons, the most important question is not whether private markets are attractive in the abstract. It is where the opportunity set is still differentiated, and which managers are best positioned to convert that opportunity into durable results. For patient investors, private markets can be an effective way to pursue those themes through specialist managers with domain expertise.



PITCAIRN

PITCAIRN.COM | 215.887.6700

Philadelphia
161 Washington Street
Suite 801
Conshohocken, PA 19428

New York
1270 Avenue of the Americas
Suite 2503
New York, NY 10020



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