

December 6th, 2022

Webinar Series

# Macroeconomic Outlook

*What lies ahead?*

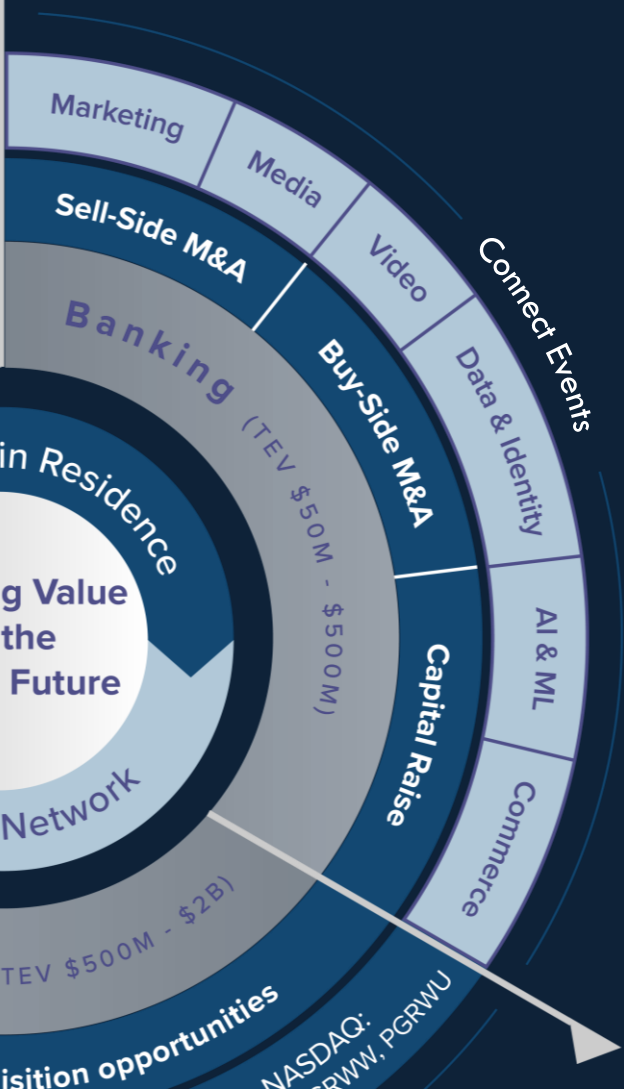
Hosted by

**Chris Legg**, Senior Managing Director, Progress Partners

**Adriaan Zur Muhlen**, Managing Partner, Progress Ventures

# Relevant experience

## Recently completed mandates



**Retargetly**

Has Been Acquired By

**EPSILON**

A PRIMEVUS GROUP Company

A principal of the undersigned in development of the company's strategic plan, served as exclusive financial advisor

**PROGRESS PARTNERS**

**MEDIA Radar**

Has secured strategic investment from

**THOMPSON STREET**

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**wwc GLOBAL**

Has Been Acquired by

**Command Holdings**

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**vi video intelligence**

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# Relevant experience

**Progress Ventures** is a sector-focused fund based on industry expertise investing in B2B advertising, marketing, and media technology companies, focused on four key areas of disruptive technology.

## Investment Themes



Data Management



Media Automation



AI & Machine Learning



Measurement & Analytics

## Current Portfolio – Fund 4



Connect Events



**Adriaan Zur Muhlen**  
Managing Partner

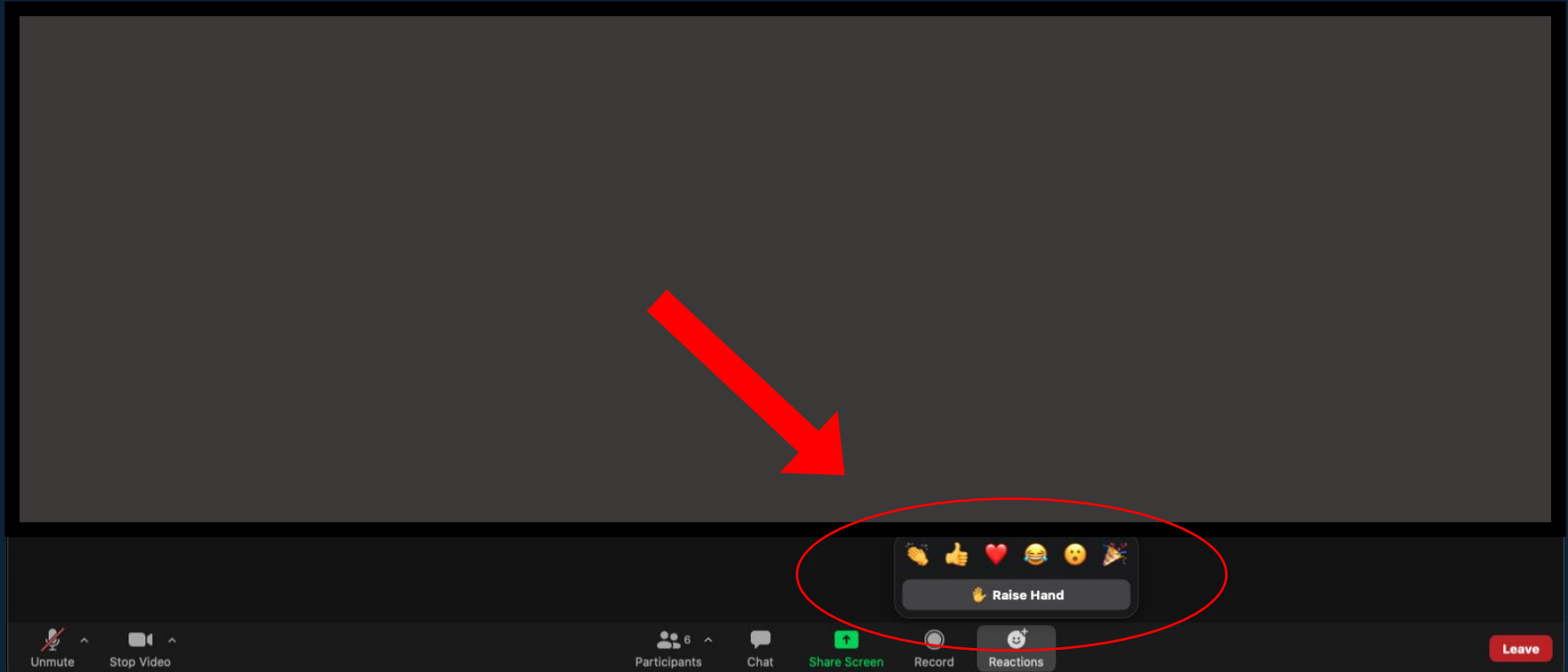
**Progress Ventures**



**Chris Legg**  
Senior Managing Director

**Progress Partners**

# Please Raise Your Hand!





# Macroeconomic Outlook

*What lies ahead?*

# Progress Macro Market Outlook

## Are we on the verge of seeing a reversal in market volatility and broader negativity?

- **Significant uncertainty in the market** makes planning difficult (trade flow disruptions, inflation & recession, geopolitical risk etc.)
- Fed is responding to inflation through **major interest rate increases** – a blunt instrument not without risk, but it appears to have started to have an impact
- Post-Covid market activity and valuations were a blip – it appears we are now **returning to pre-pandemic norms**
- **Geopolitical landscape remains challenged** and has continued to have negative effects on the global economy

### Glass Half Full

- US Recession will be light, if at all
- There will be an equity rally in 2023 as inflation cools
- Interest rates may stabilize (or decrease) sooner than expected

### Glass Half Empty

- The 30 year trend of increasing globalization may be ending
- Rest of World is more hurt / in a heavier recession
- Ukraine war will not resolve quickly



# Geopolitical Environment

*An Era of New Risks and Volatility*



# Global Instability

Fraying alliances and escalating tensions have caused uncertainty in the global order; surging inflation has only increased the pressure.



- Brexit fallout
  - Turmoil in Conservative Party
  - 3 Prime Ministers this year
  - 4 Chancellors in this year



- New tech export rules by US regulate flow of chips to China
- CHIPS and Science Act for domestic production



- Continued political polarization
- Focus on domestic production and turning away from globalized economy



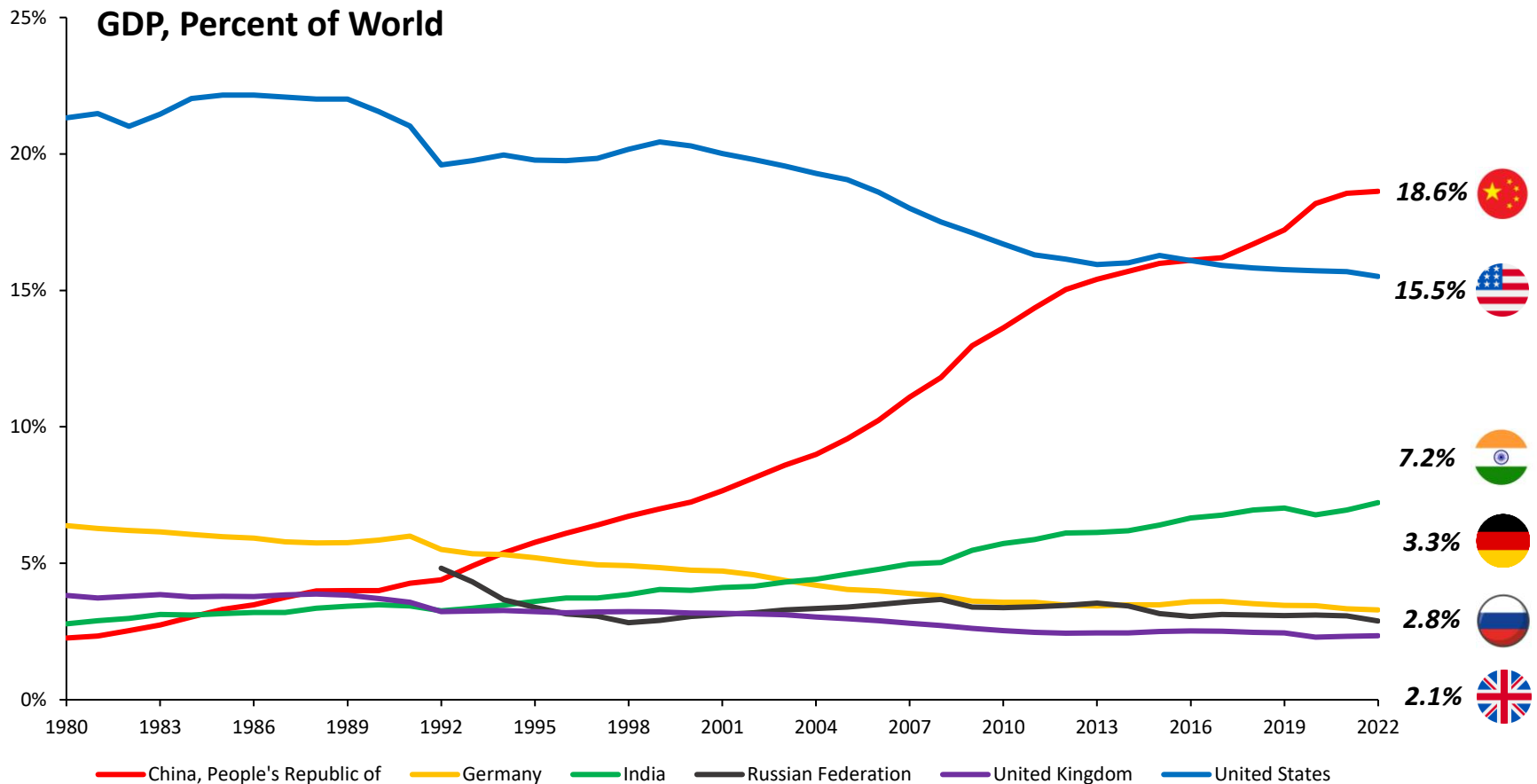
- OPEC+ defied Washington, cutting oil production and keeping inflation more persistent than expected



- Major war continues longer than expected with no end in sight
- Russian commodities being boycotted

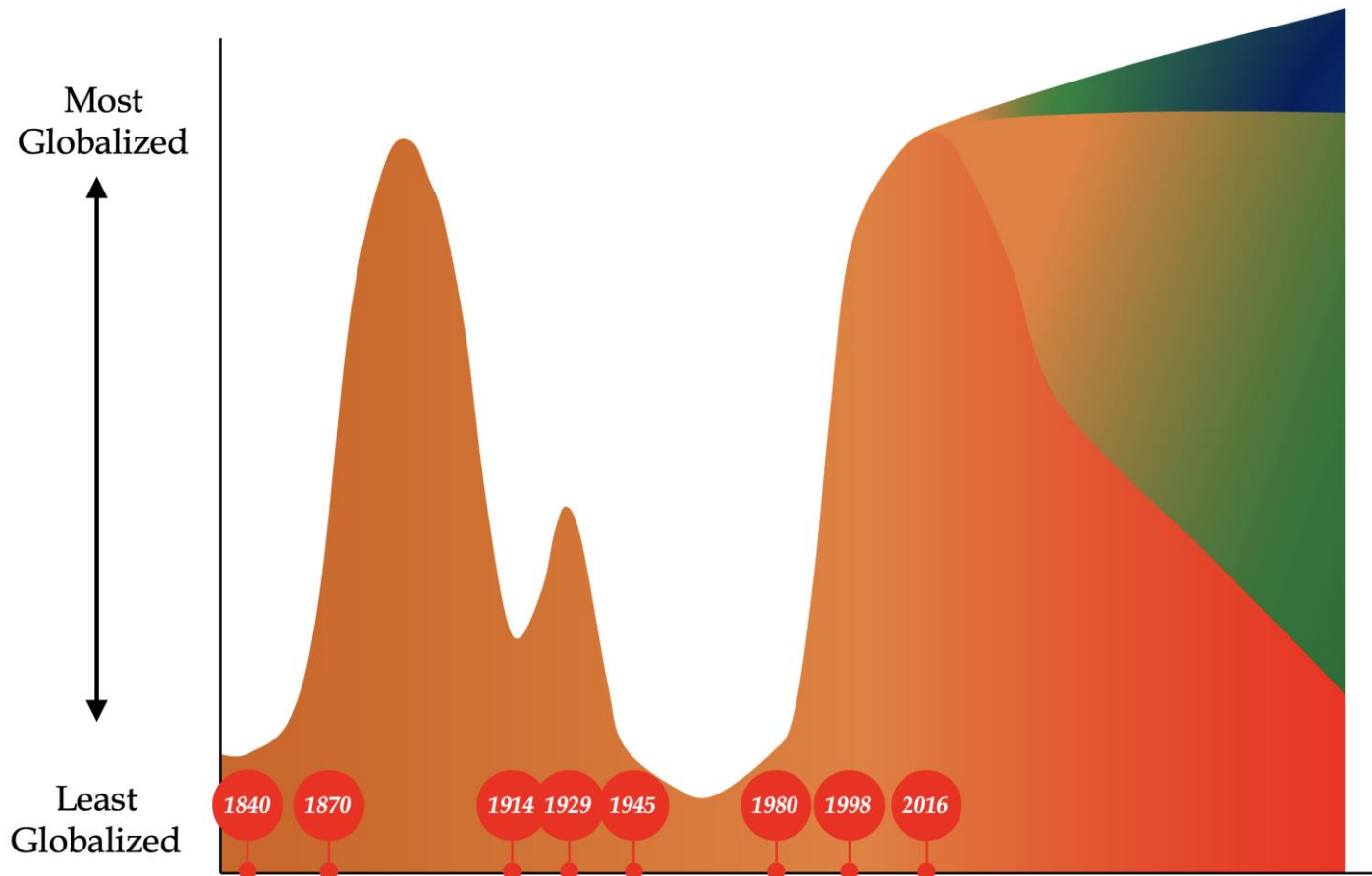
# Global Influence Changing

Global power changes over time. The world's economic gravity has been moving away from the US toward a more multipolar system with China as a major new challenger.



# Globalization's Cycles

Globalization has been the key driver of economic growth and prosperity. Are we at an inflection point?



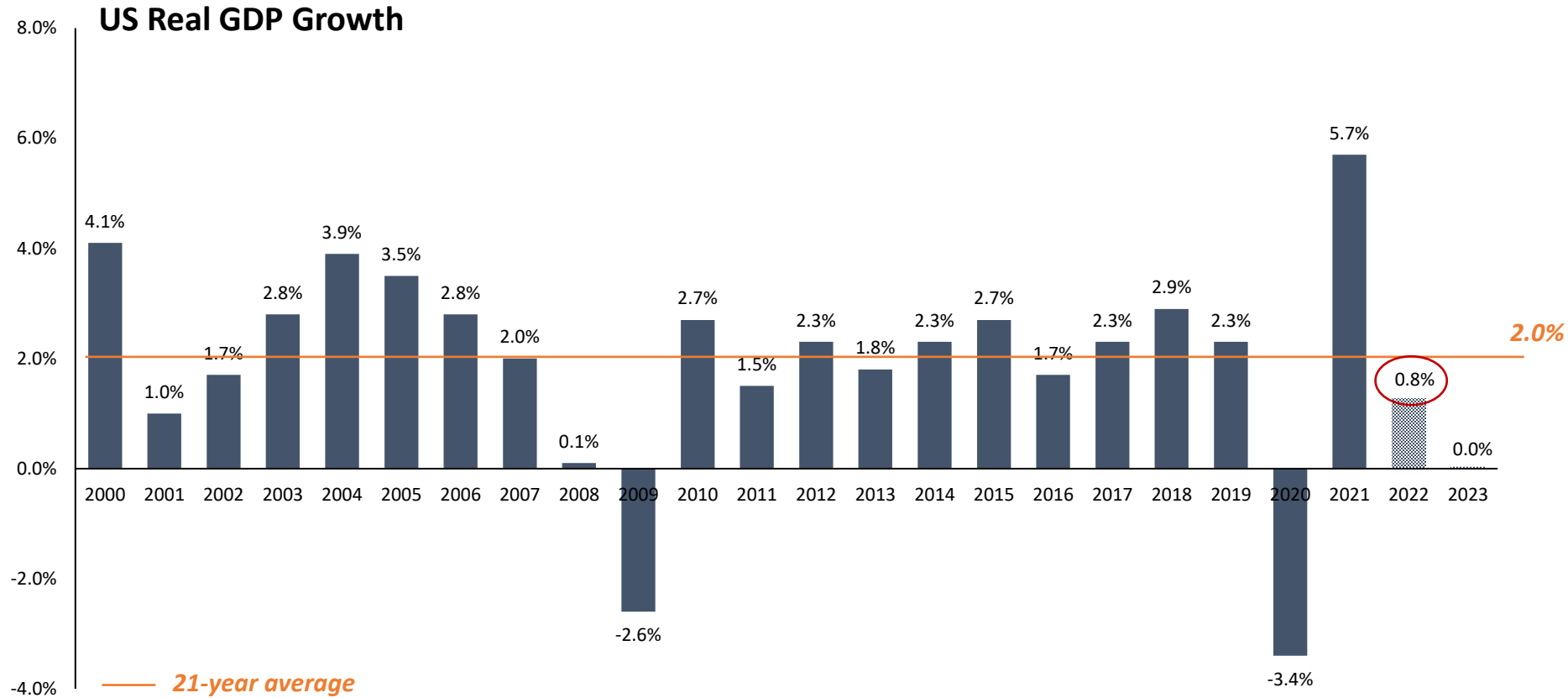
Source: Professor Rawi Abdelal

# US Macroeconomic Environment

*Conflicting Signals*

# US Real GDP Growth

US economic activity has remained strong but is projected to slow.



Source: Federal Reserve Economic; Conference-Board; Progress Analysis

# Major Factors Impacting US Economy

Unusual times as several challenges simultaneously face the US economy.

## Fed Monetary Policy



- We are reversing a 14+ year trend of overly favorable monetary policy
- After lowering the Fed Funds rate to 0.0% during the GFC, the Fed began using its balance sheet to make large-scale purchases of securities to further stimulate the economy
- This period of QE continued long after the GFC had ended, and further ramped during the Covid-19 Pandemic, increasing the Fed balance sheet to \$10T+AVE

## Covid-19 Pandemic



- Additional variants have caused virus-related headwinds to persist
- Labor pressure as a result of permanent workforce gaps from covid deaths
- Zero-covid policies from key countries such as China put additional pressure on manufacturing and supply chain

## Excessive Stimulus

- Covid recovery stimulus more than 8x GFC relief, increasing asset prices and inflation

## Supply Chain



- Low labor force participation and low unemployment create competition to populate supply chain
- Strong consumer demand has persisted and continues to pressure capacity restraints

## Russia and Ukraine



- Oil is the largest driver of inflation and has had rippling effects on other inputs of CPI and the supply chain
- Russia and Ukraine are responsible for exporting 24% of global wheat, 57% of sunflower seed oil, and 14% of corn

# US Government Debt & Stimulus

Did too much stimulus set the stage for longer-term structural problems?

## 9/11 Relief

\$15B

- Airline Worker Relief Act of 2002

## GFC Relief

Over 5 years

\$787B

- American Recovery and Reinvestment Act of 2009  
(includes Treasury's Troubled Asset Relief Program - TARP)

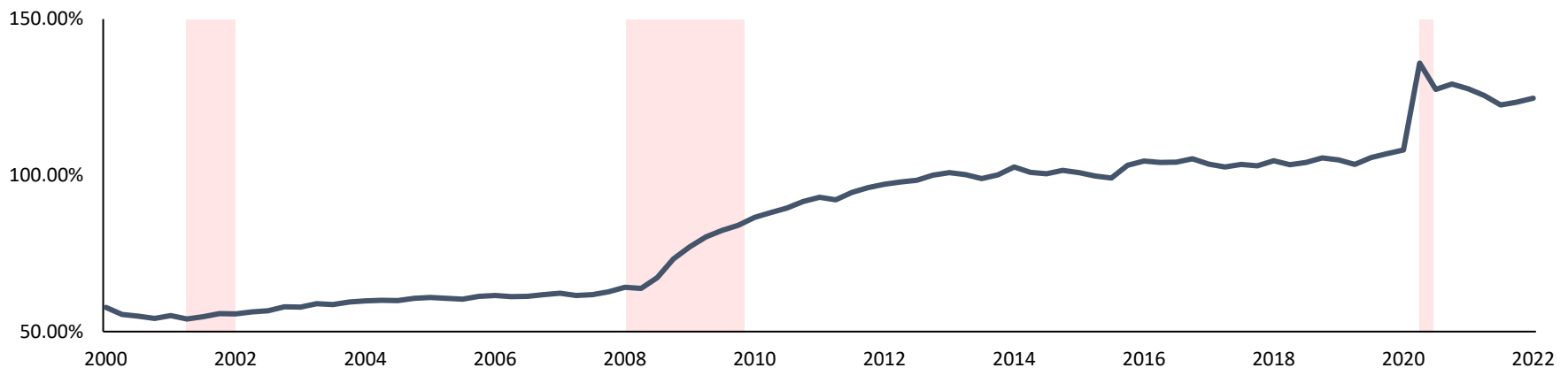
## Covid-19 Relief

\$5,700B

- CARES Act
- Paycheck Protection Program
- Consolidated Appropriations Act
  - American Rescue Plan

Source: Congress.Gov, Colliers, Business Insider, Progress Analysis

## Federal Debt: Total Public Debt as a Percent of Gross Domestic Product





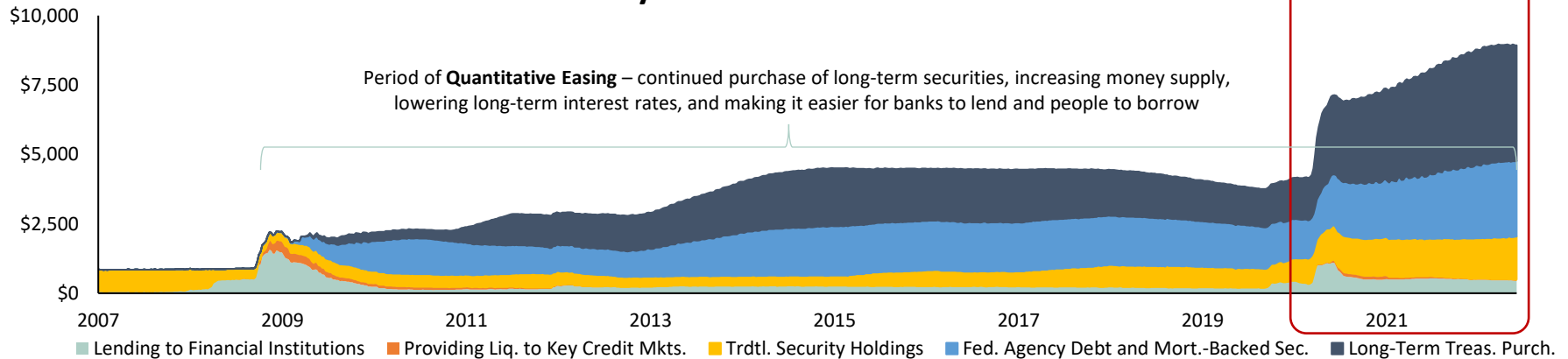
# Federal Reserve Today

Taming inflation expectations requires reversing several long-term trends.

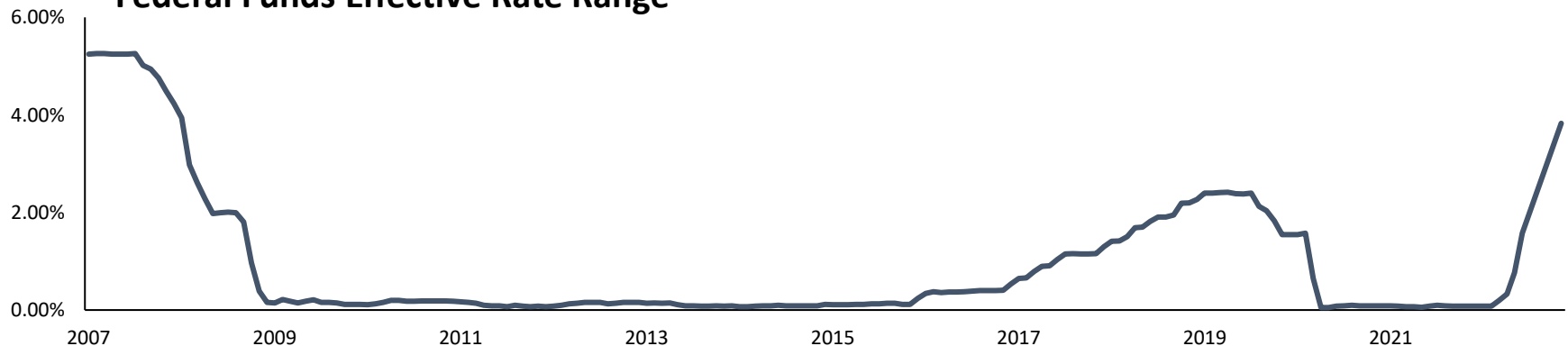
In September, the Fed began rolling-off by ~\$95B per month

## Federal Reserve Balance Sheet by Asset

Period of **Quantitative Easing** – continued purchase of long-term securities, increasing money supply, lowering long-term interest rates, and making it easier for banks to lend and people to borrow

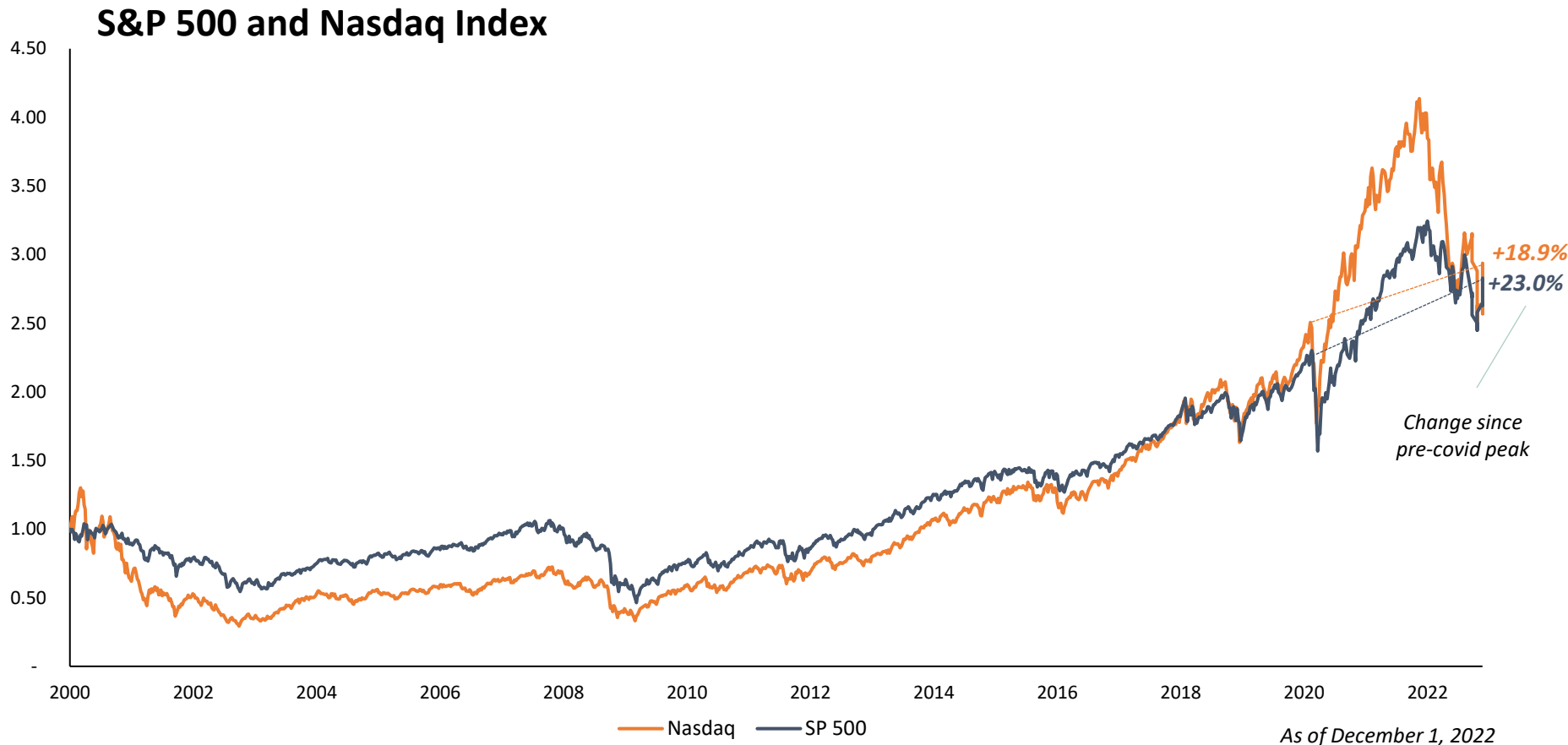


## Federal Funds Effective Rate Range



# US Public Markets Since 2000

Public markets are not far from pre-pandemic growth trajectories; the largest pullbacks have been in unprofitable technology growth stocks.

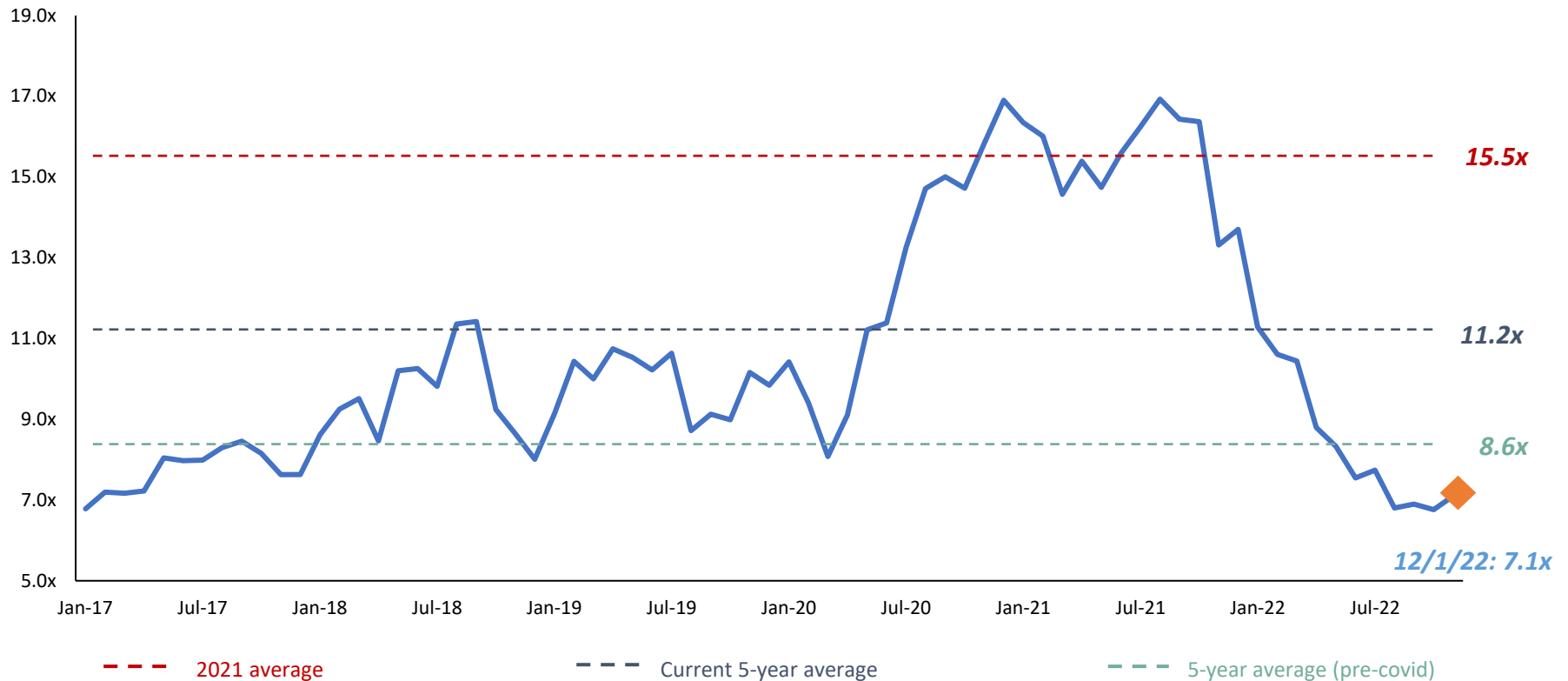


# SaaS Index

Public SaaS multiples have corrected from extremely high levels, but is it a potential over correction?

## B2B SaaS Valuation Multiples (ARR / TEV)

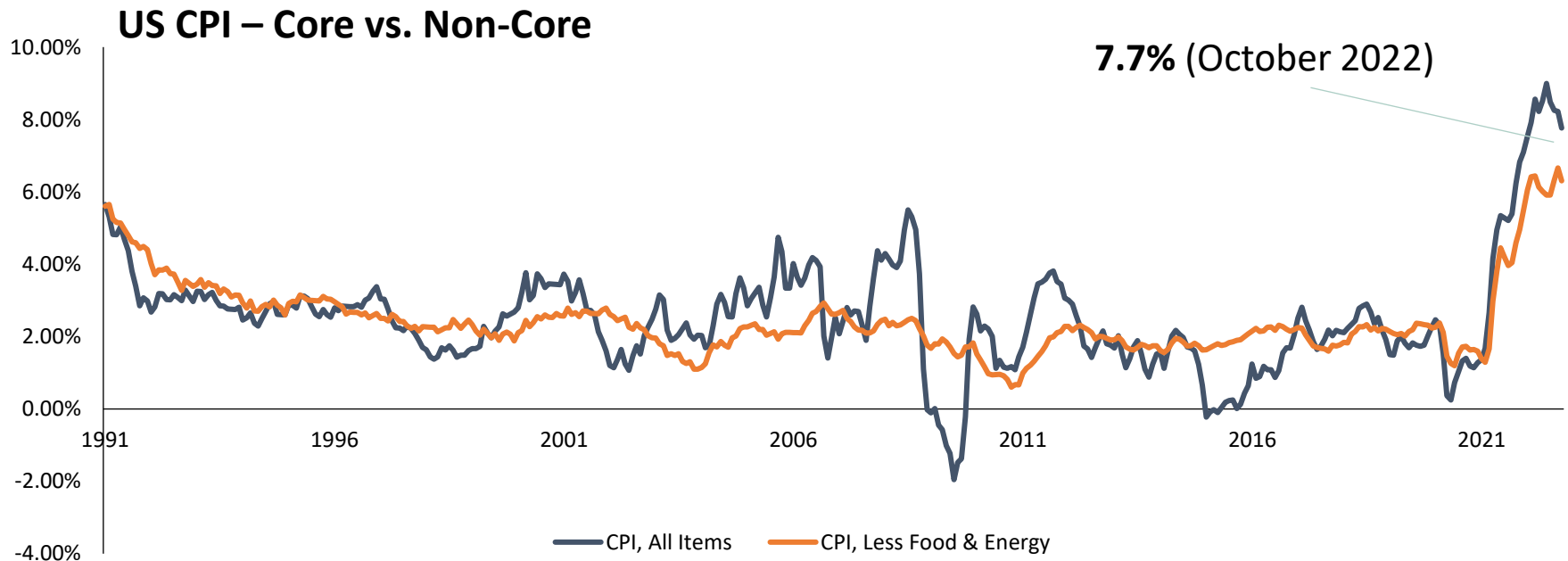
*Index of 91 public B2B SaaS companies with ARPU of \$500<*



# US Consumer Price Index

Inflation has continued to be worse than expected, but core goods have cooled as the supply chain pressures are easing.

- **Services inflation** has increased, a reflection of the labor market – restaurants, airlines, and hotels continue to rise and have far fewer workers than pre-pandemic.
- **Shelter prices** are now the largest driver of services inflation, but is a lagging indicator (rent lags behind housing prices).

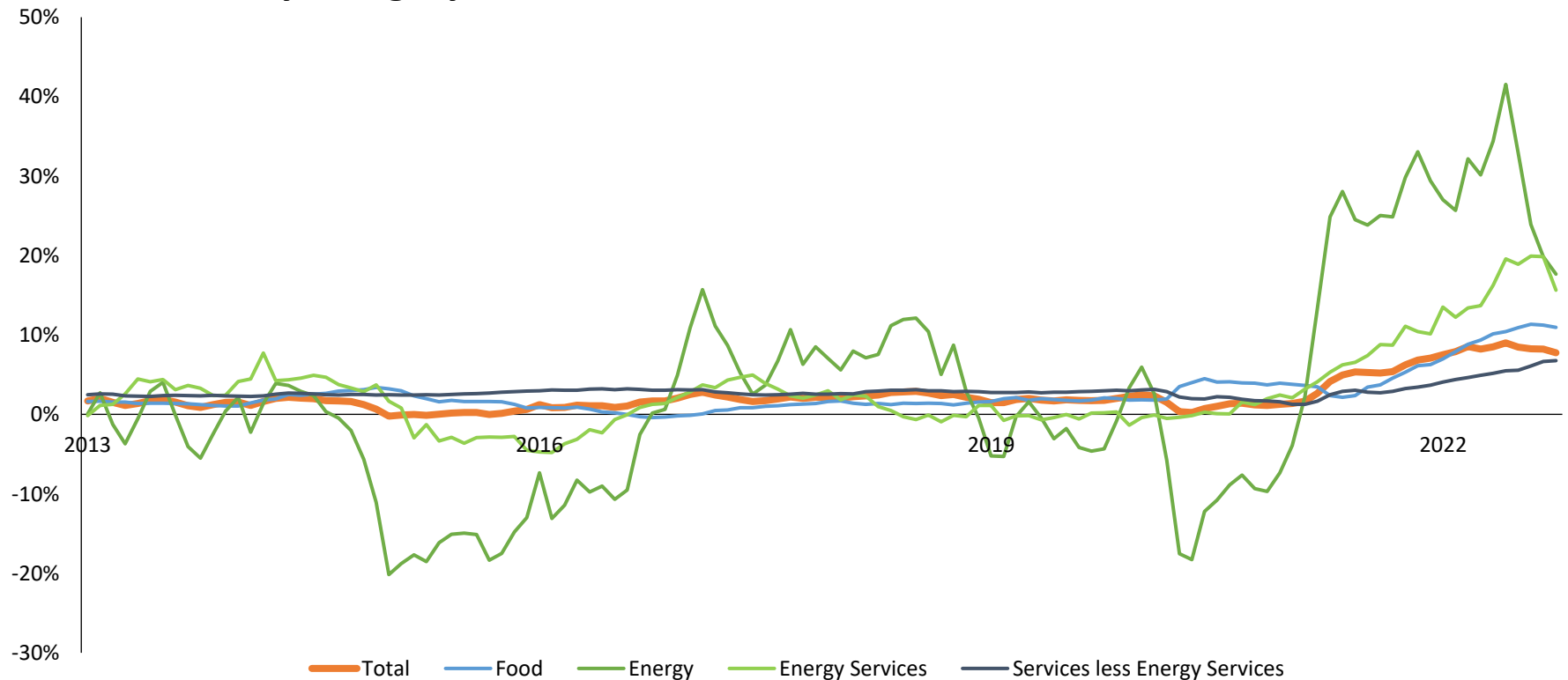


*Graph shows US CPI Percent Change since 12 months before.*

# US Consumer Price Index, Change by Type

Services less food and energy continue to inflate, suggesting that changes in the energy situation, and not the Fed's rate changes, have been the driver of a falling inflation rate.

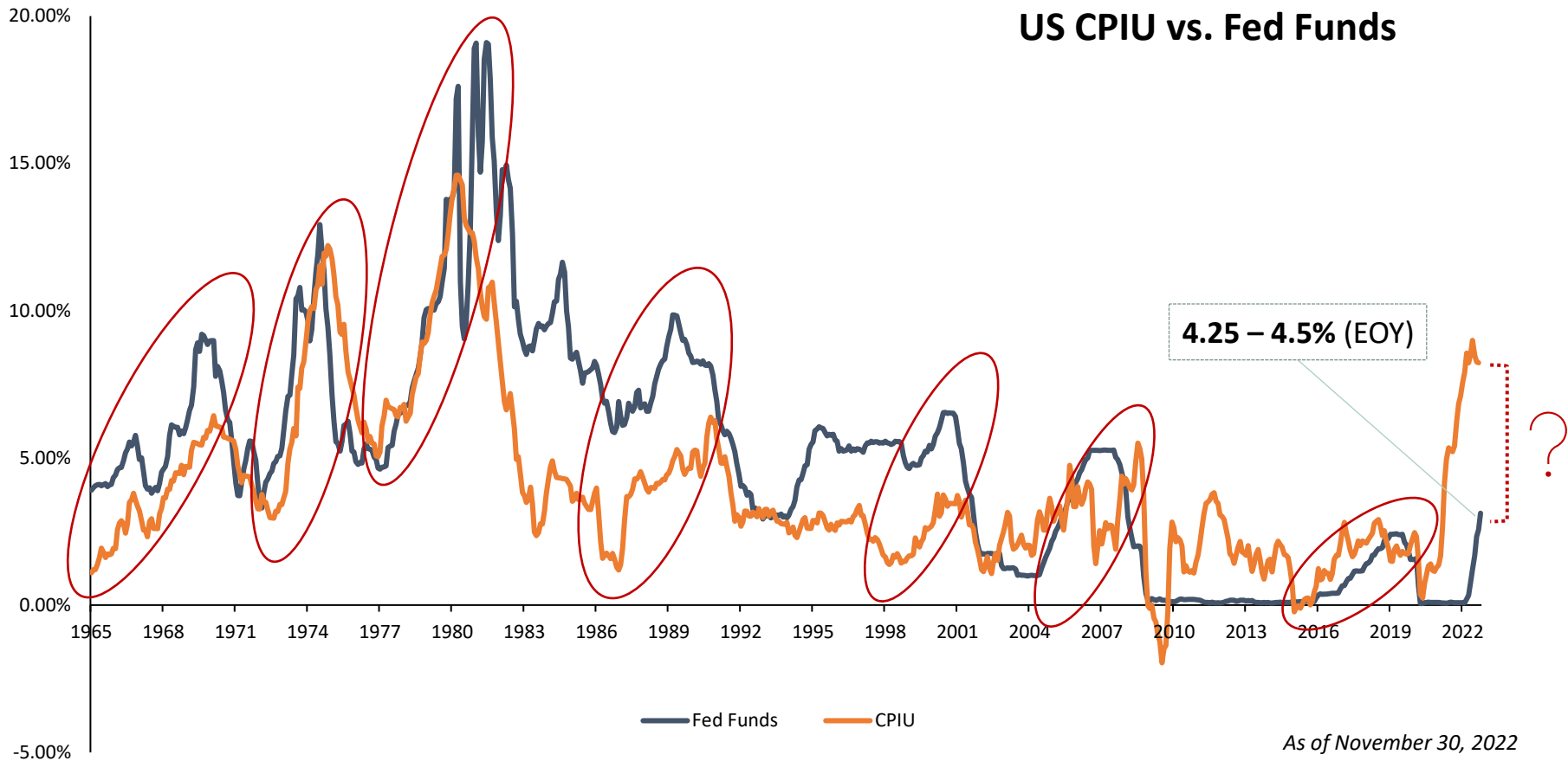
## US CPI by Category



Graph shows US CPI Percent Change since 12 months before.

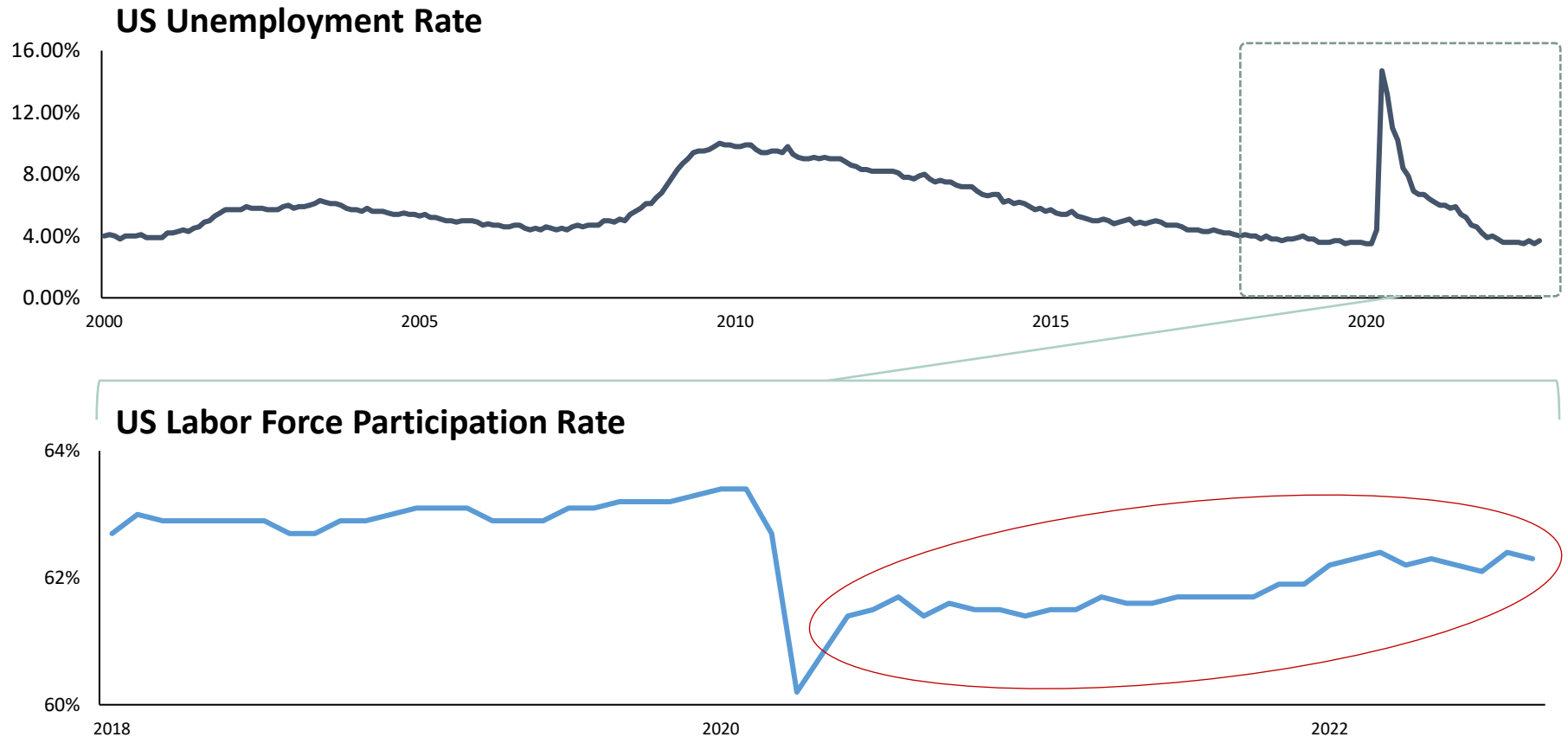
# Inflation and Fed Funds Rate

The Fed Funds rate has been the primary tool to control inflation; it remains well below CPIU, but how high does it need to go to bring inflation under control?



# US Employment

Unemployment remains at healthy levels and has yet to see a material effect from Fed intervention. Labor force participation is beginning to creep closer to pre-pandemic levels.



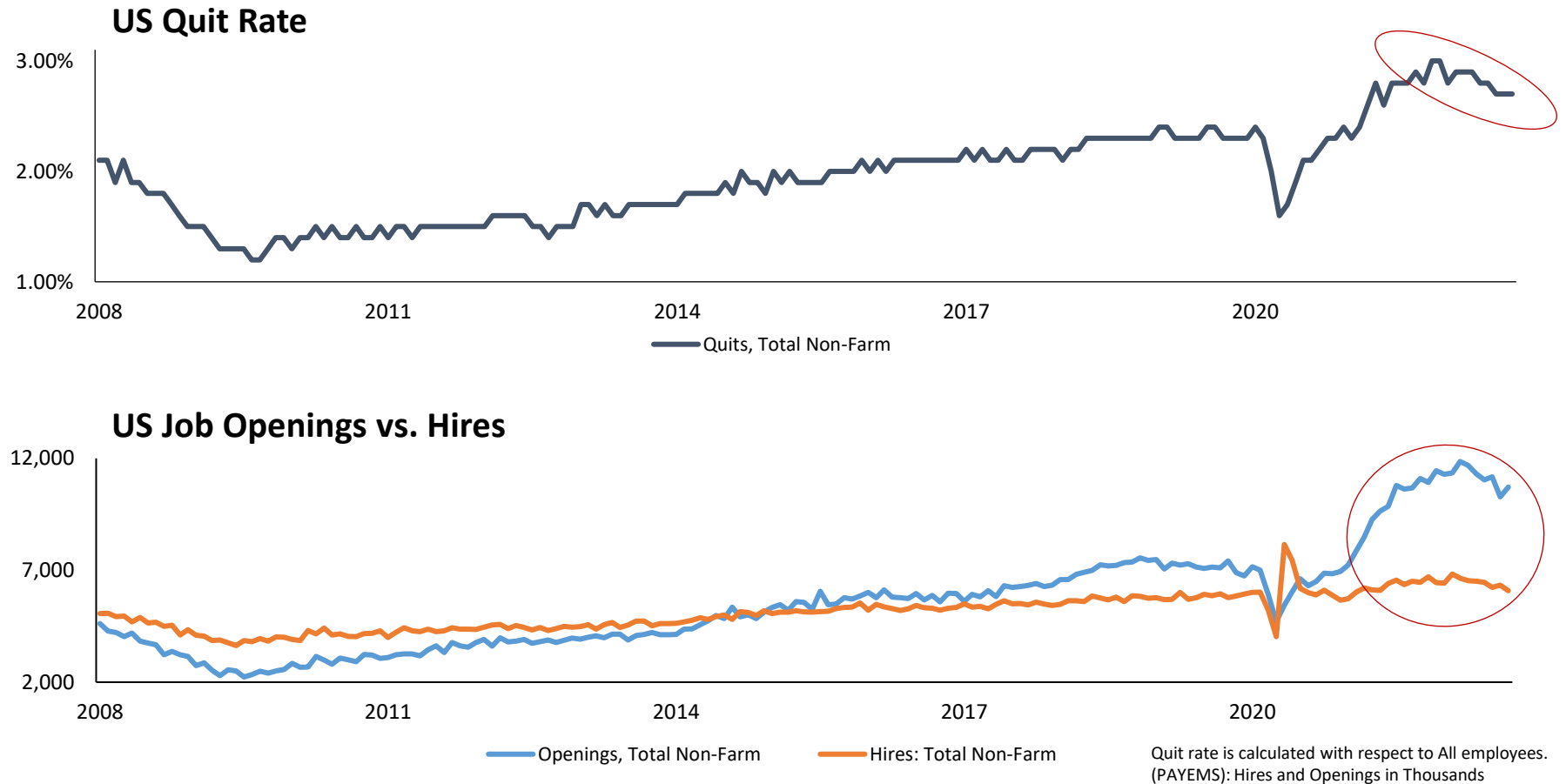
Source: Federal Reserve Economic; Progress Analysis

As of November 30, 2022



# US Employment (continued)

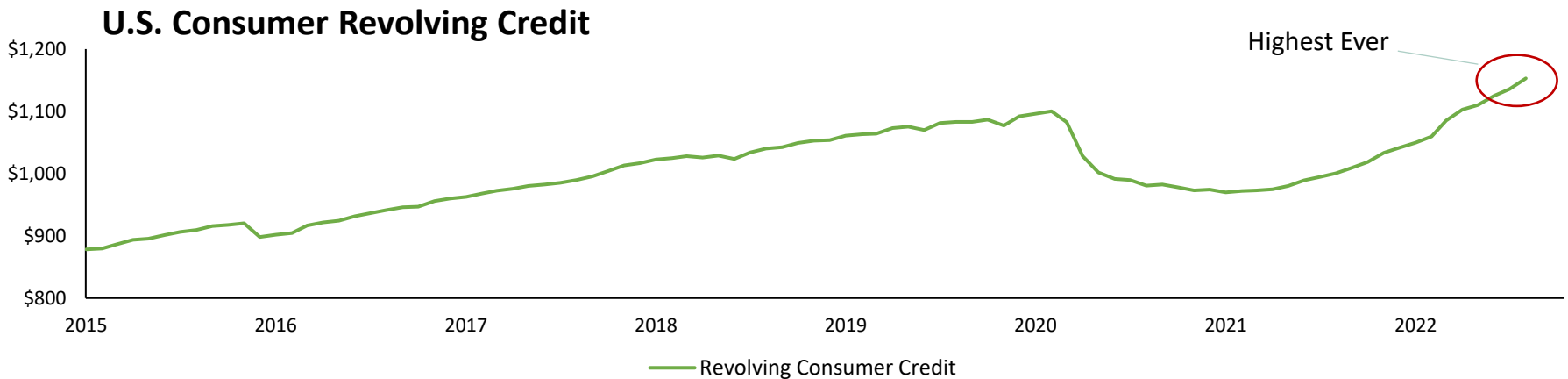
Quits have slowed, potentially signaling an end to the Great Resignation. However, the disparity between job openings and hires remains large.



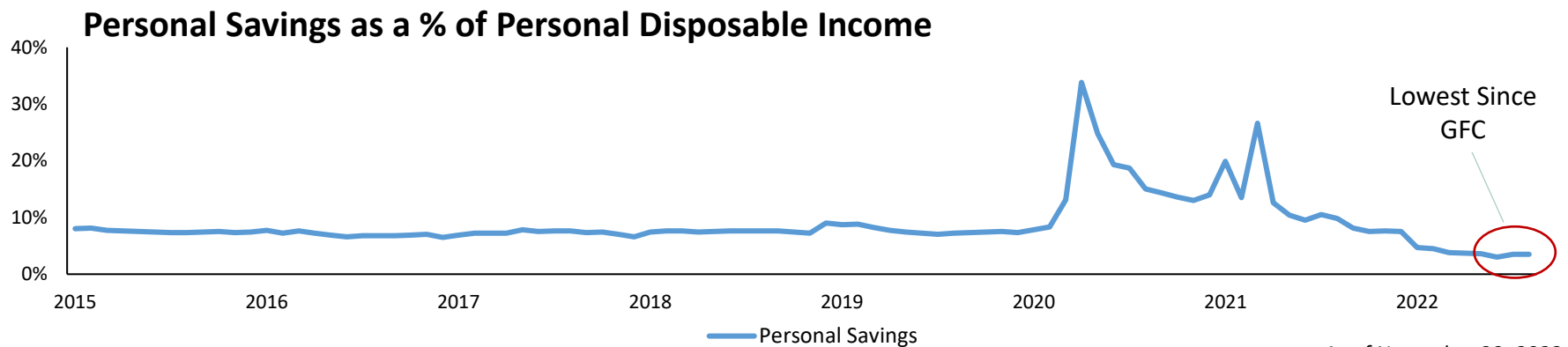
Source: Federal Reserve Bank of Minneapolis; Bureau of Labor Statistics; Progress Analysis

# Consumer Credit

Americans are leaning on credit cards and loans (while credit costs are spiking).



Source: Federal Reserve Bank of St. Louis; Progress Analysis



Source: Federal Reserve Bank of St. Louis; Progress Analysis

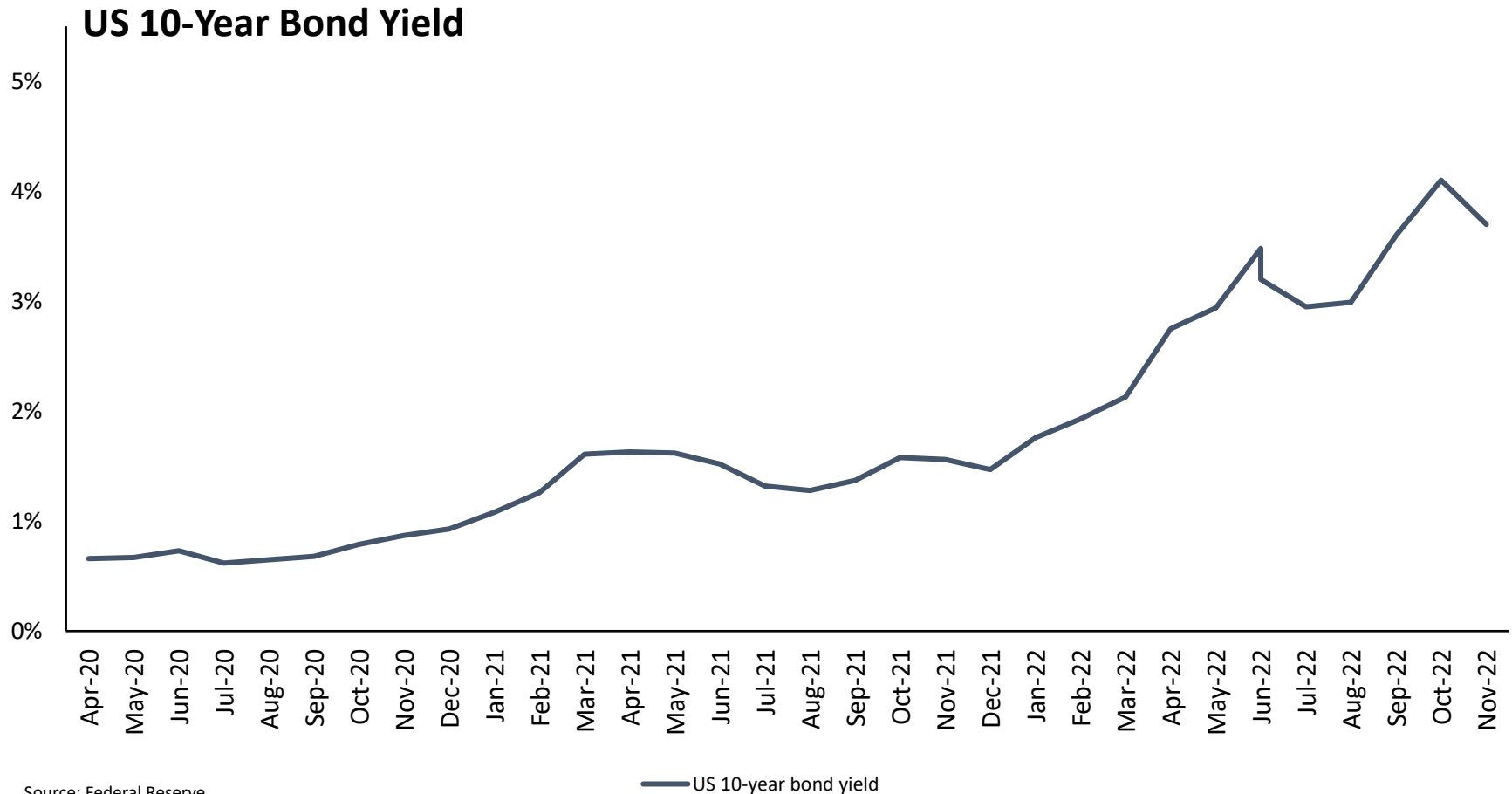
As of November 30, 2022

# Debt Markets

*Dramatic Changes*

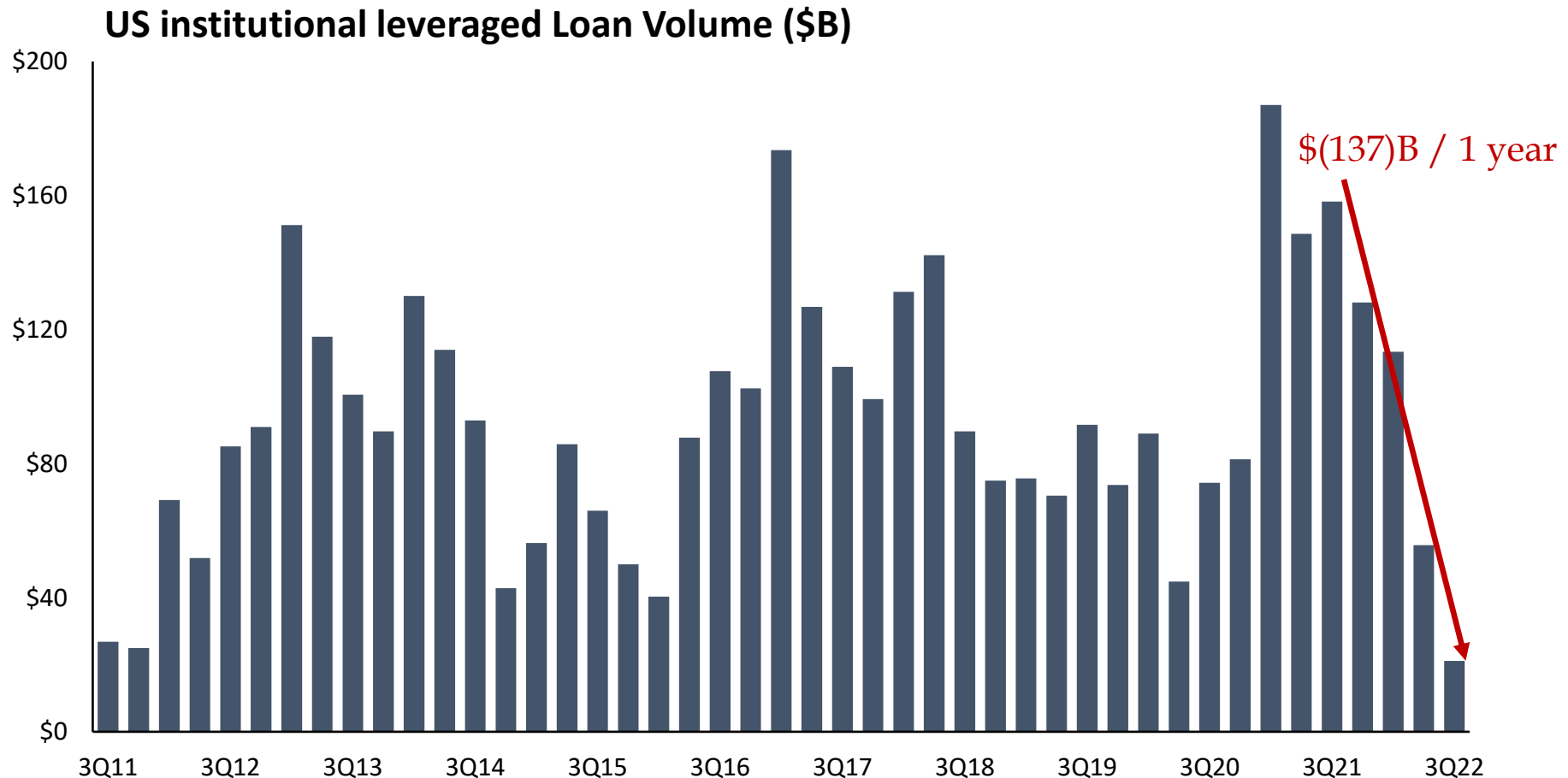
# Interest Rates

Borrowing costs have dramatically increased.



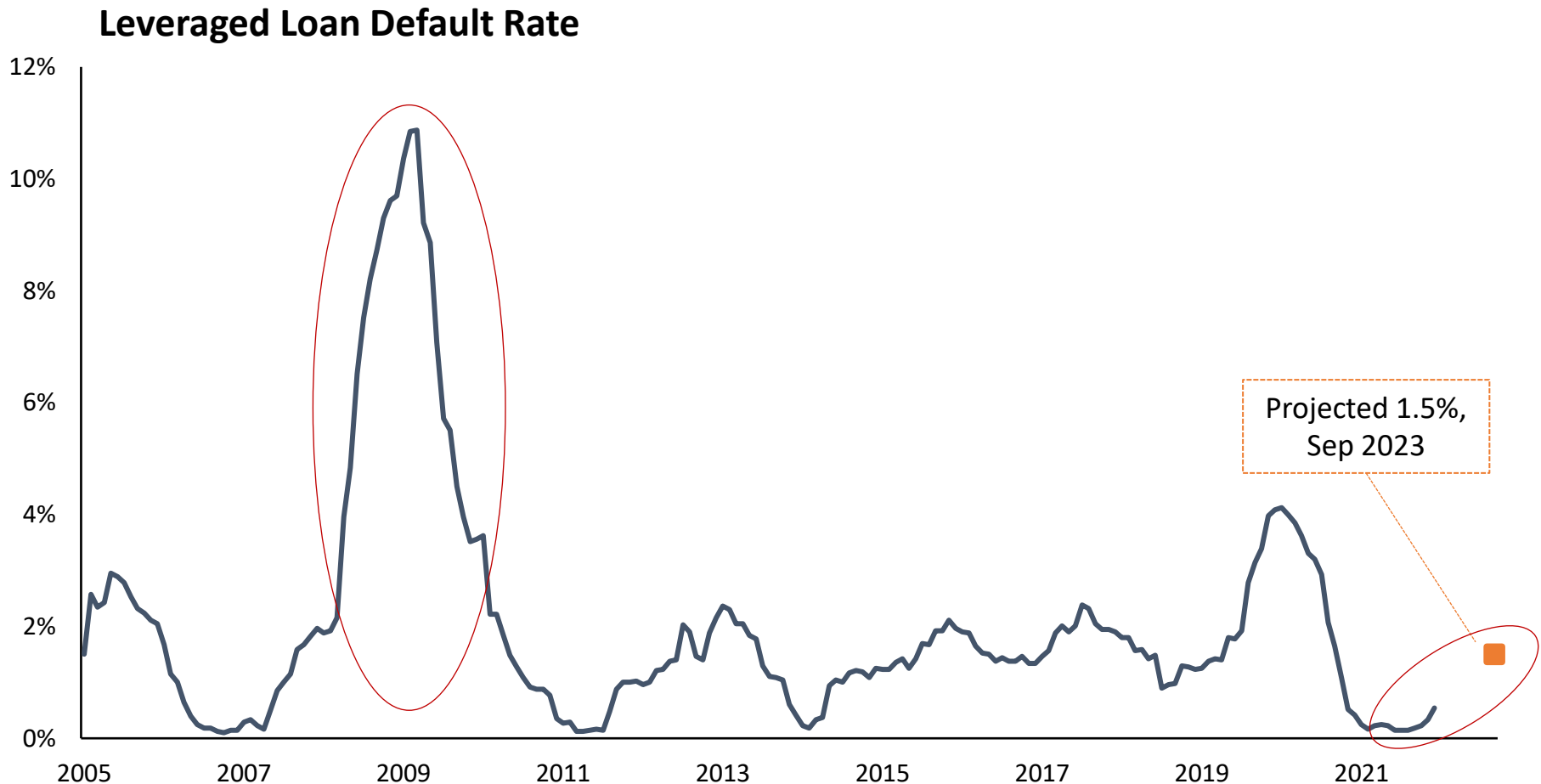
# Leveraged Loan Market

The leverage market has come to a halt as rate hikes challenge borrowers.



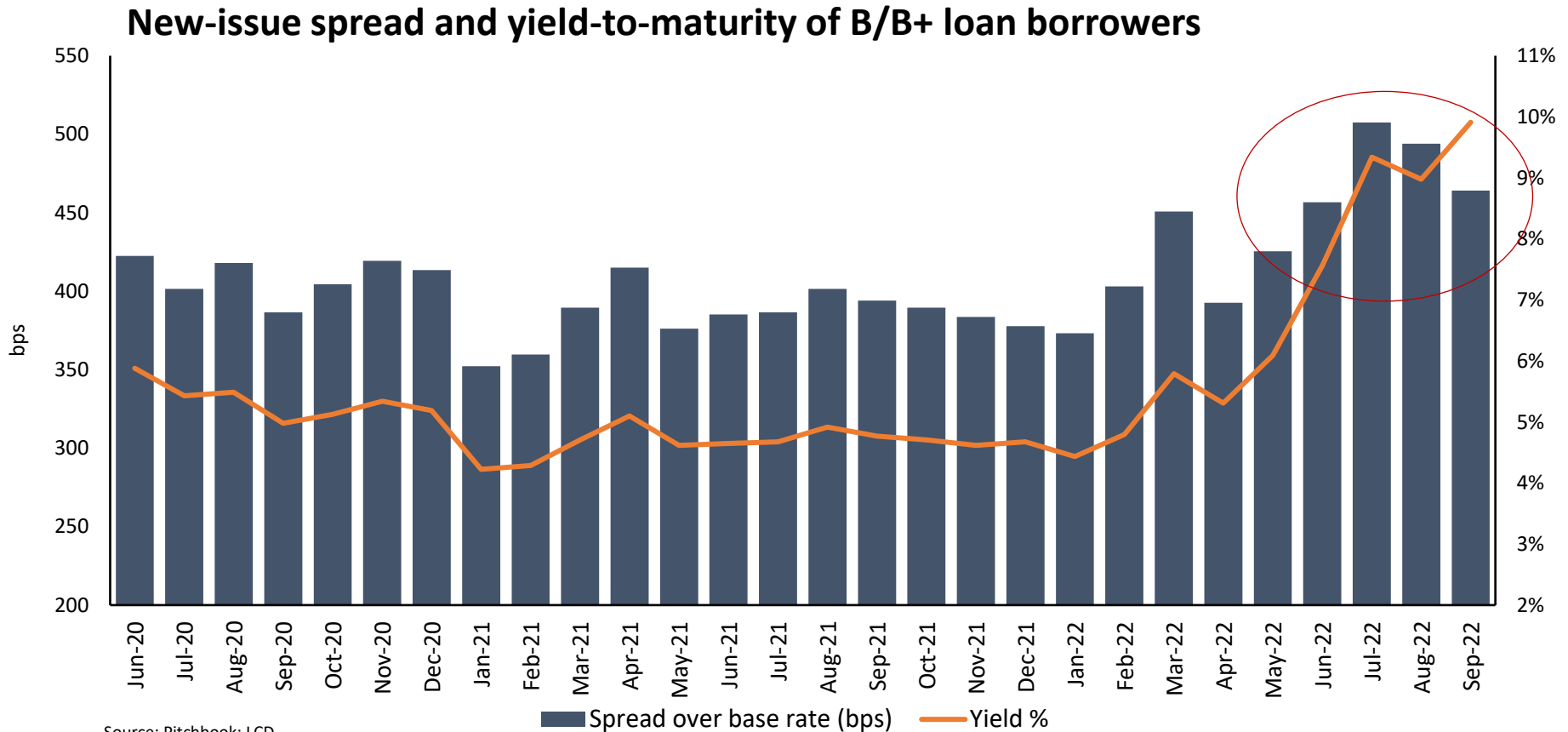
# Default Rates

However, default rates have not yet risen substantially and are not forecasted to rise to levels seen in previous recessions.



# High Yield Spreads

High yield spreads (difference between high yield and treasuries) have not expanded significantly yet.

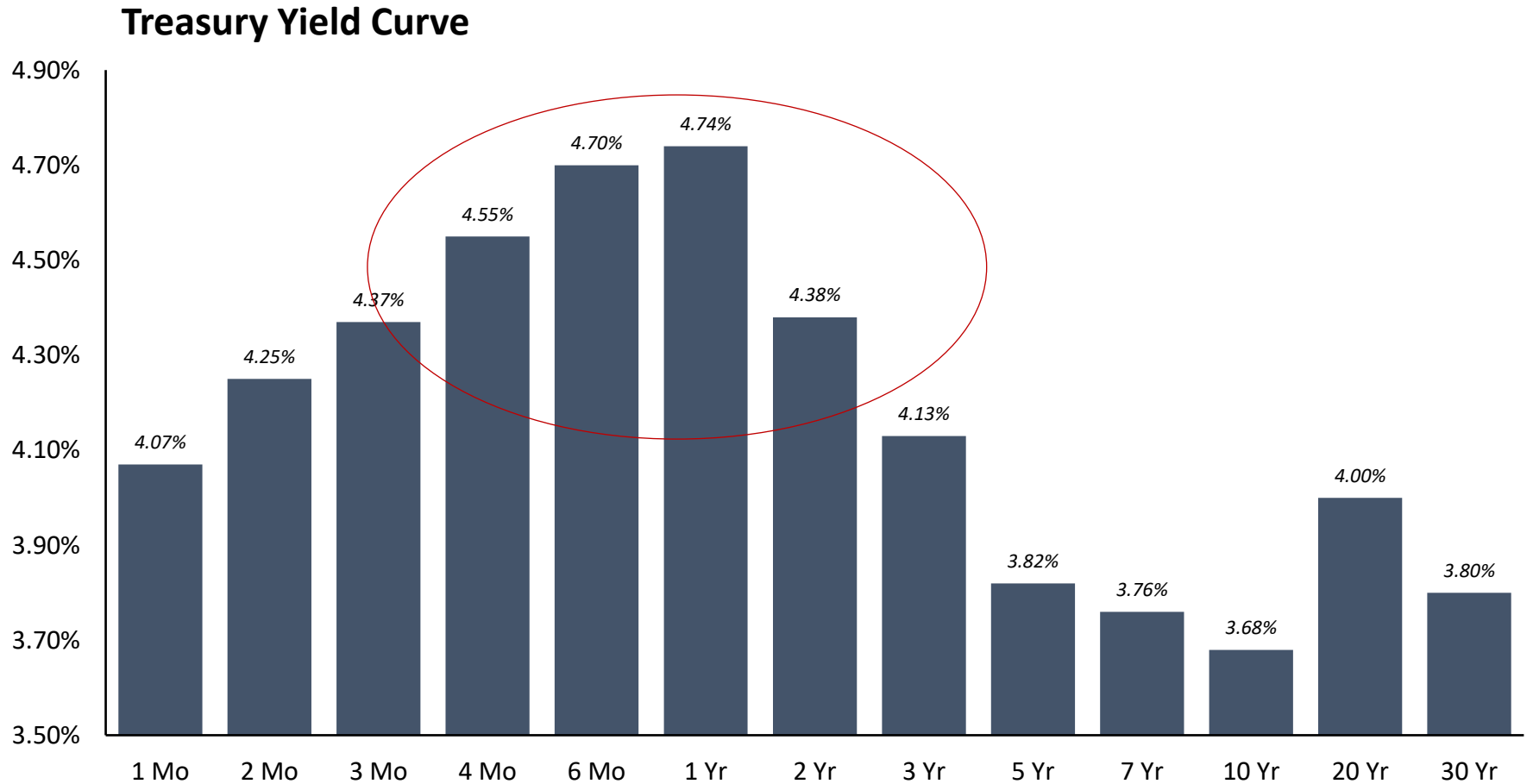


Source: Pitchbook; LCD



# Yield Curve Inverted

Yield curve's inversion reflects investors' bets on easing inflation and future rate cuts.



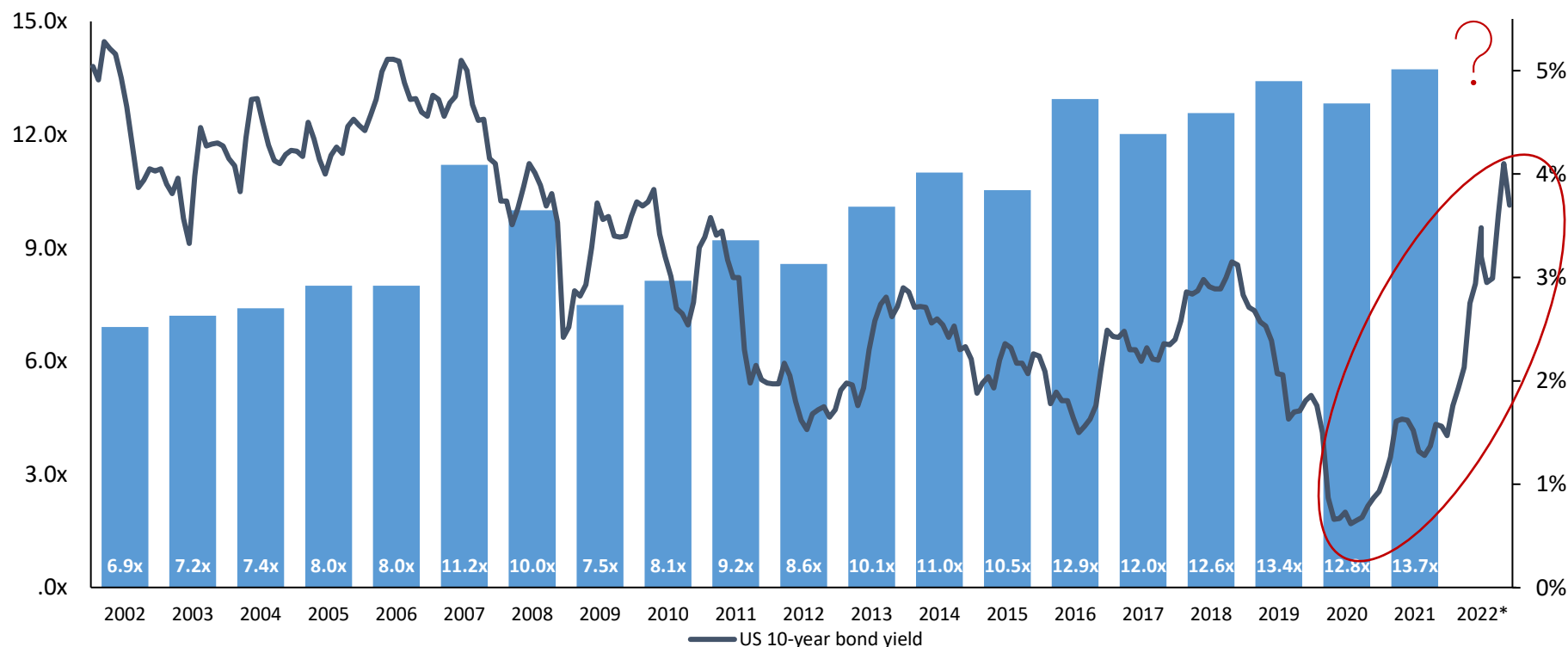
\*As of 11/30/2022

# Private Markets Outlook

# Returns Driven by Cheap Credit

Decreasing borrowing costs have helped push deal multiples to record highs. With yields reaching levels not seen in 10+ years, how will multiples react?

## US Median PE Buyout EV/EBITDA Multiples vs. 10-year US Bond Yield

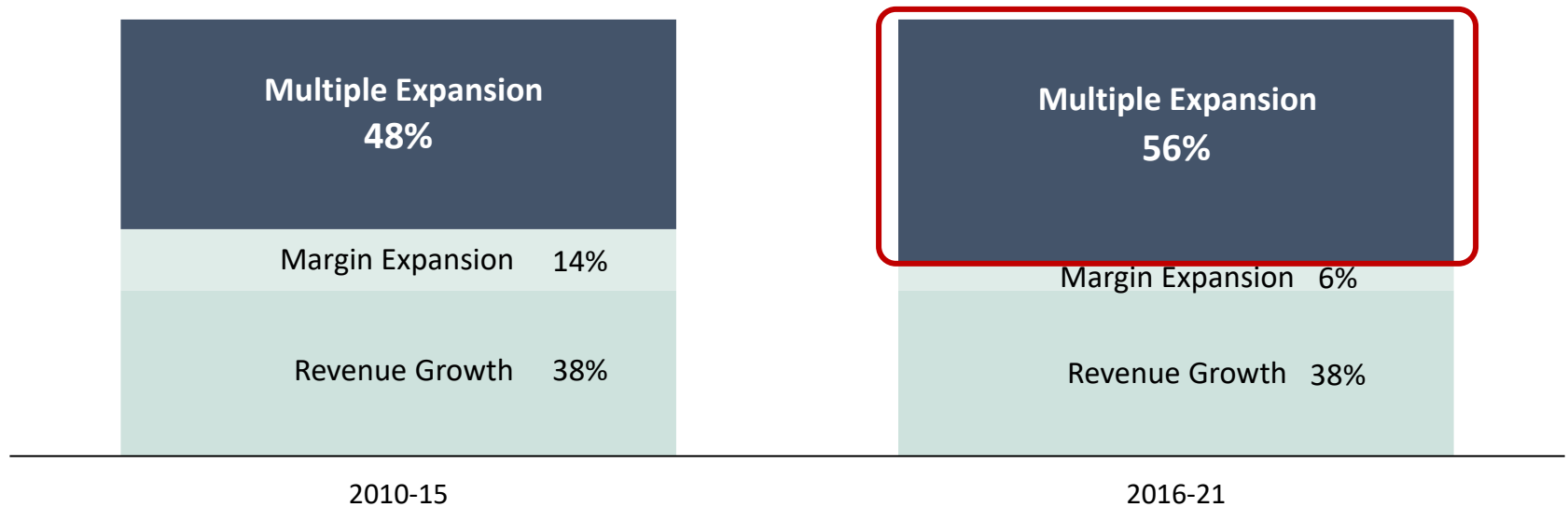


Source: CNBC; 2021 Annual Pitchbook US PE Breakdown; Bain Inflation Global Private Equity Report 2022; Progress Ventures Analysis based on Pitchbook, Leveraged Commentary & Data (LCD).

# Private Equity Buyout Returns, by Type

Multiple expansion has been the largest driver of PE returns over the past decade.

## Drivers of Private Equity Buyout Returns (2010-2021)



### Revenue, median CAGR by year of exit



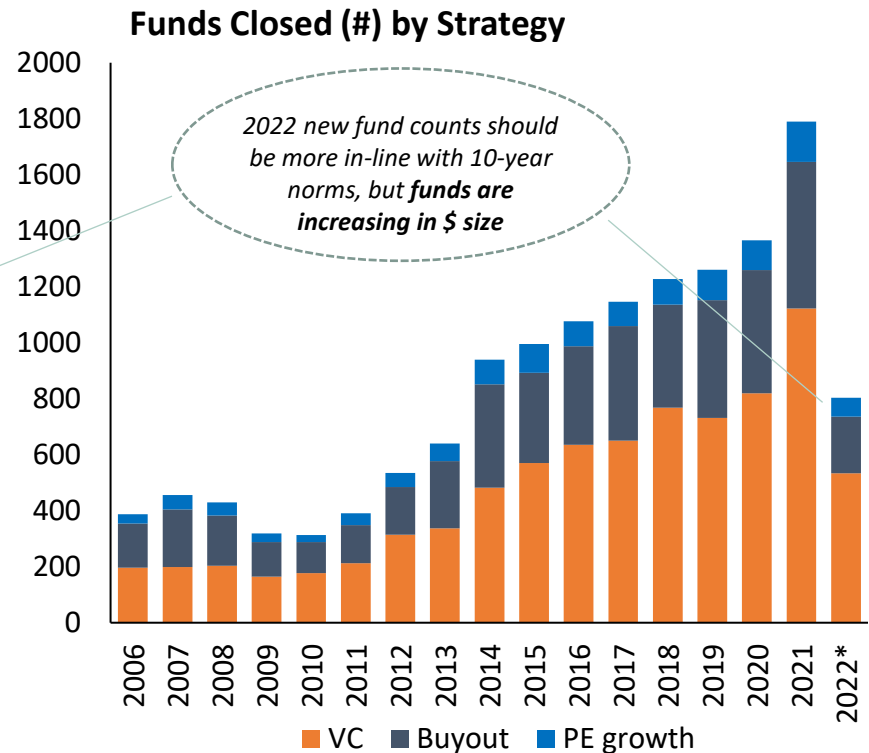
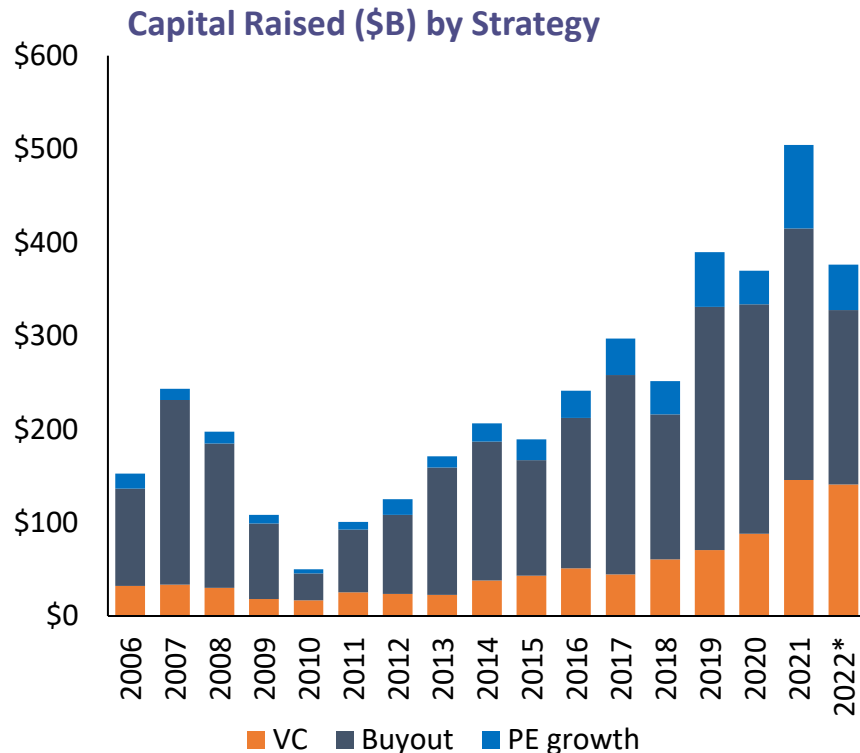
### EBITDA margin, estimated median CAGR by year of exit



# Capital Raised and Funds Closed

2022 fundraising momentum in PE and VC has continued.

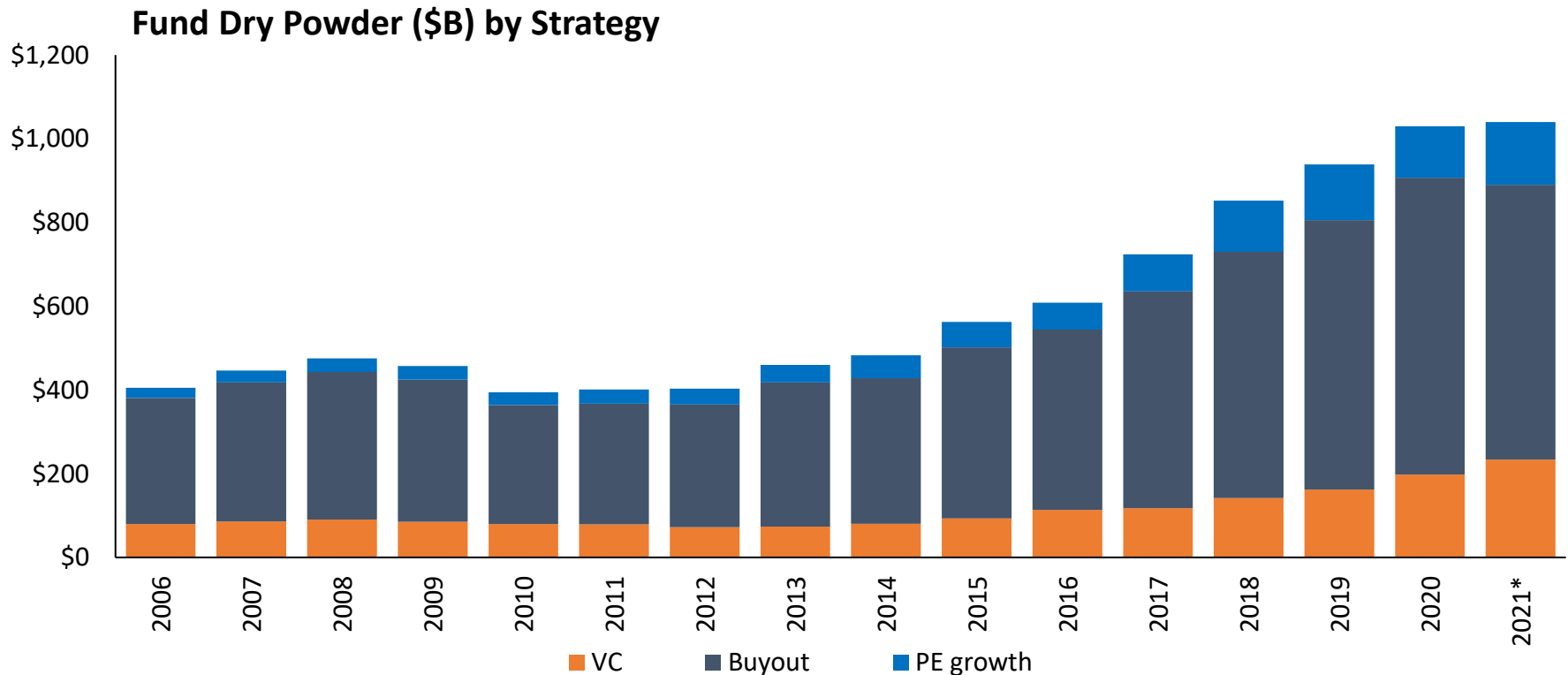
- Many of these commitments come from recycling 2021's record distributions, but some managers are beginning to be over-indexed in their PE and VC allocations as liquidity has slowed and book values remain high.



# Capital Overhang Growing

Record fundraising in recent years has led to record dry powder.

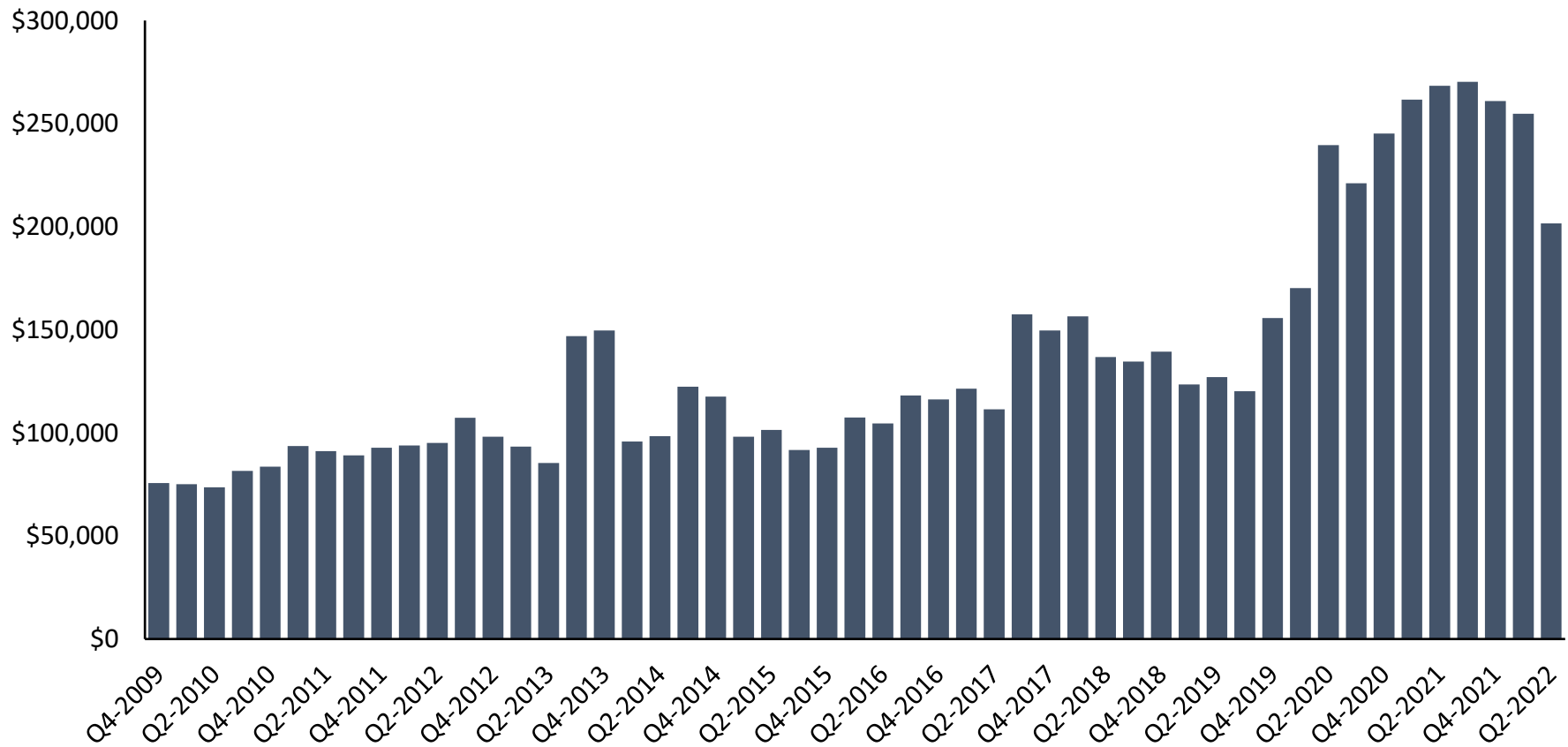
- Capital will need to be put to work in order to meet traditional investment periods.
- VC and PE will need to face valuation corrections as the economy moves out of a 0 interest rate environment.



# US Corporate Cash

US corporate cash remains elevated and provides opportunity for growth.

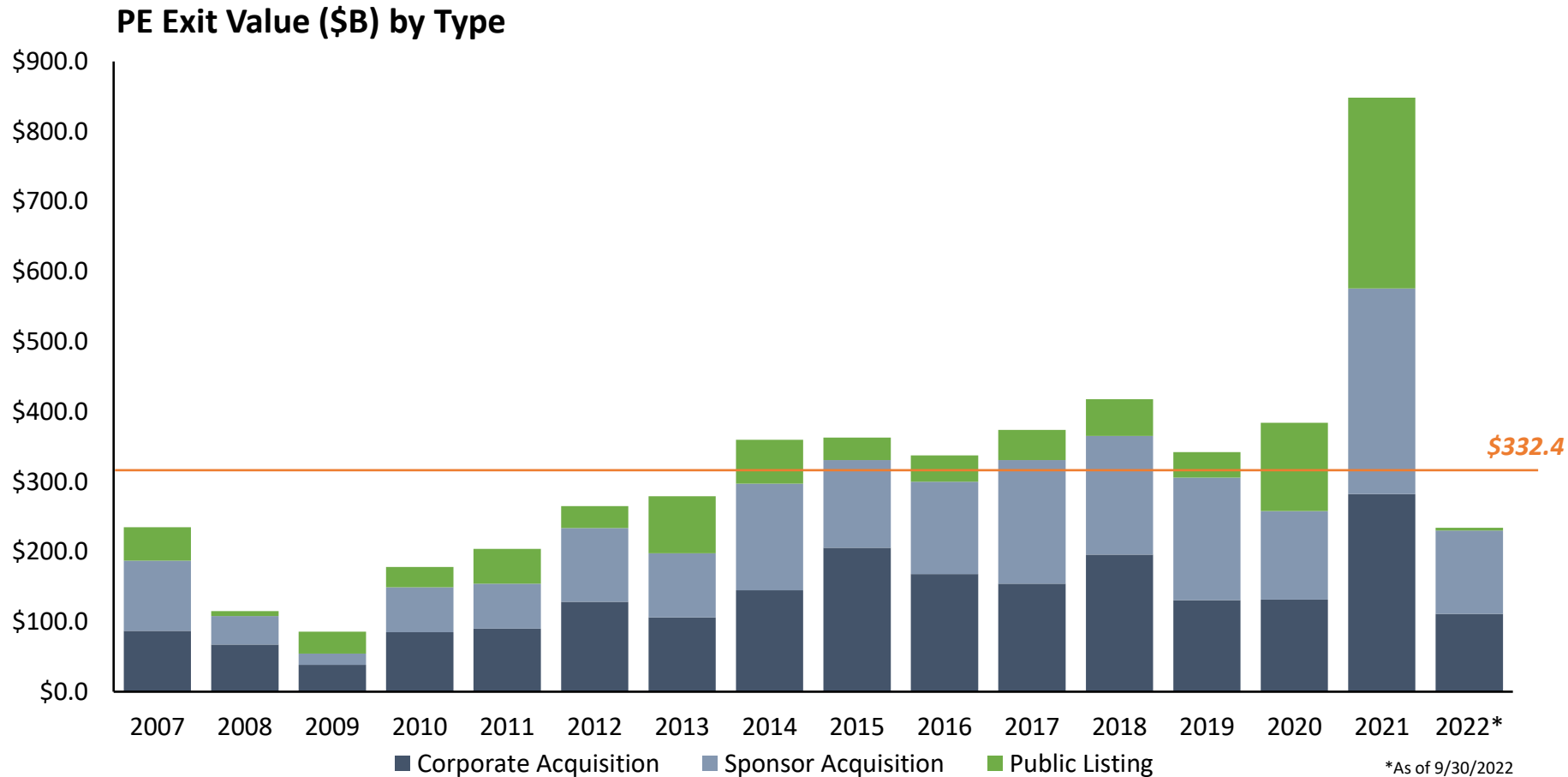
**US Corporations, Total Cash on Hand and in US Banks (\$M, Quarterly)**





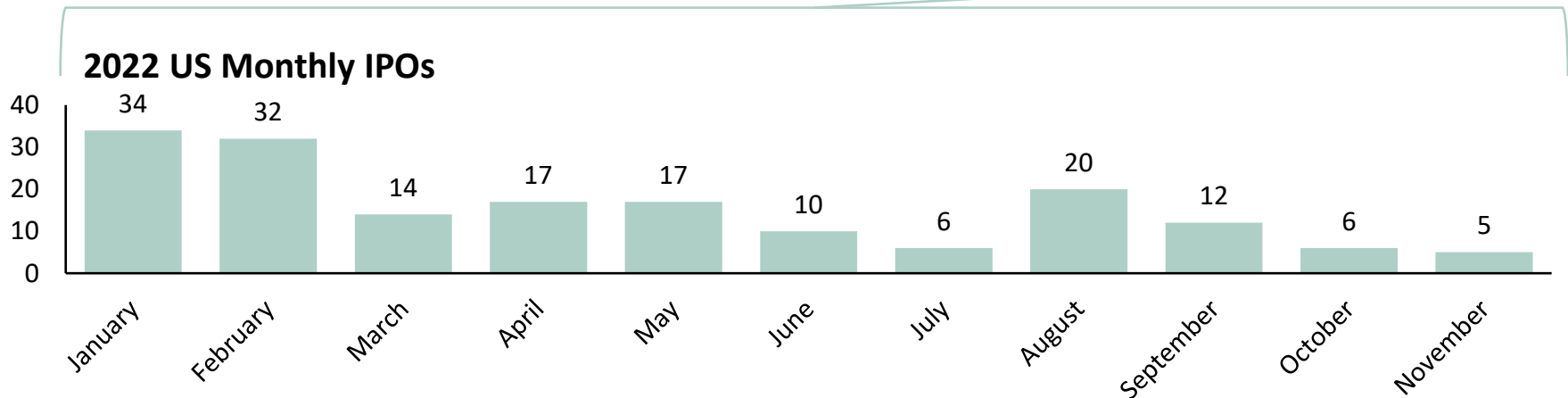
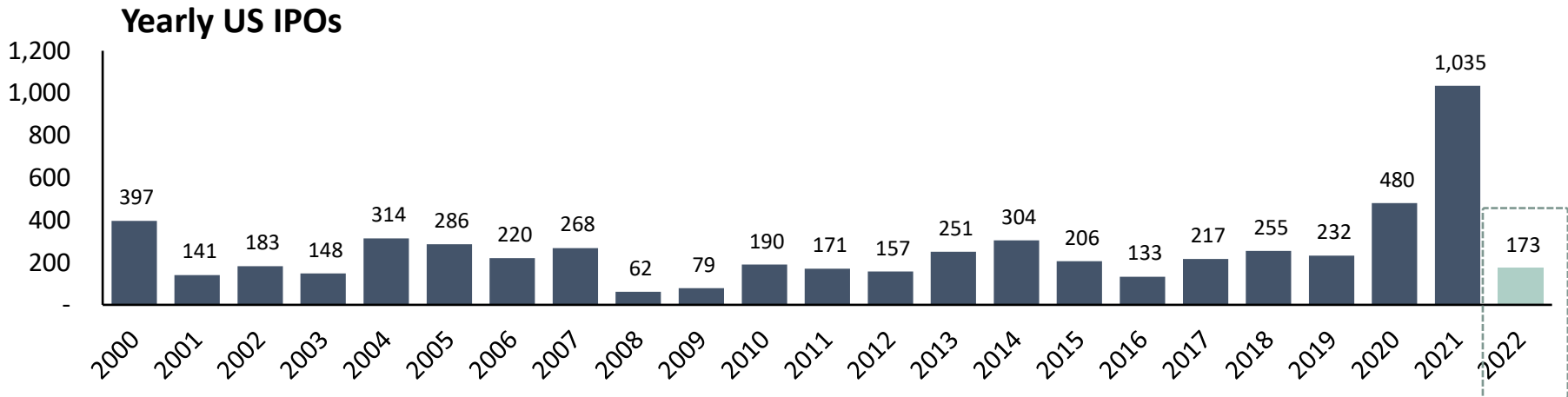
# Private Equity Exit Activity Slowing

PE exit activity feels depressed in the short-term lens but is returning to norms.



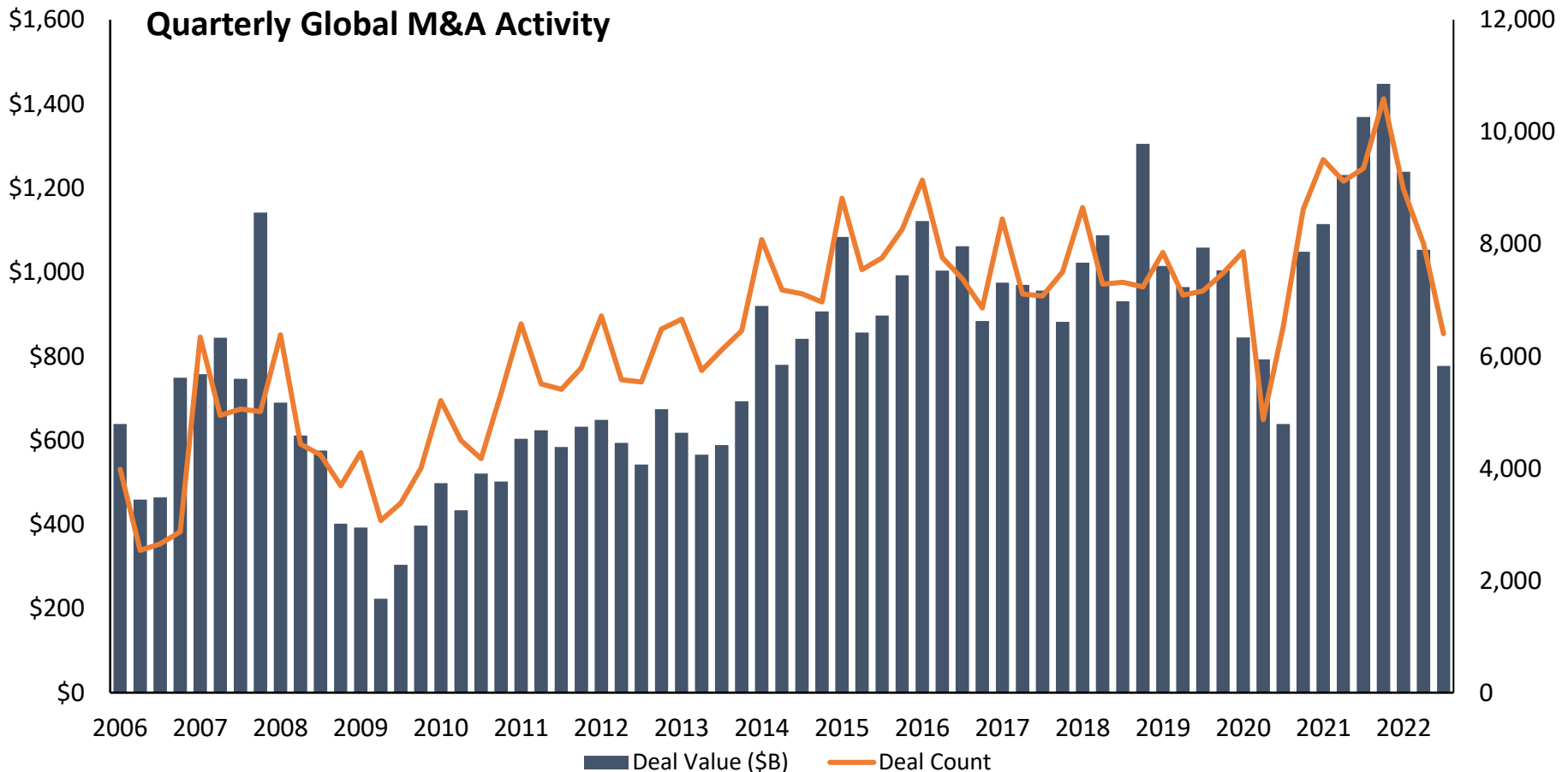
# IPO Activity Halted

The IPO market has come to a halt and has continued to slow throughout 2022.



# M&A Activity

Overall M&A activity has decreased sharply from last year but is not far from averages.

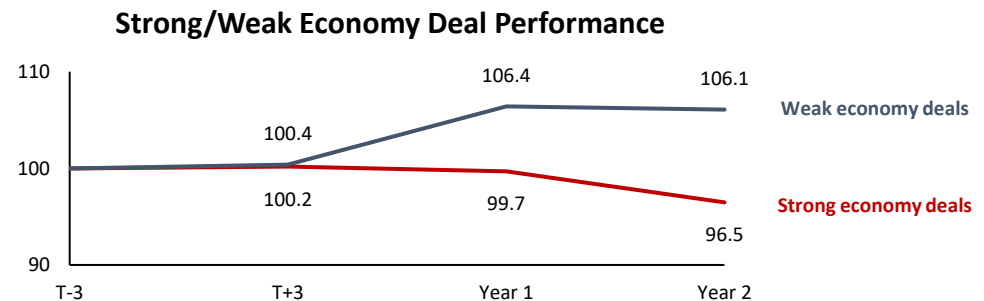


# Conclusion

# Progress M&A Outlook

We are optimistic about the current environment and see opportunity to capitalize.

- **Market valuations have returned to normal** – valuations are down from abnormal highs that are unlikely to return, and are really **returning to pre-covid healthy norms**; don't hang on to unrealistic valuations
- **Demand is strong** – over the last few years, many acquirers were priced out; **they return alongside newly raised funds** with hundreds of \$Bs of dry powder
- **Corporate cash** – while it has been shrinking since Q4-21, cash is still **higher than pre-pandemic levels** and strategic M&A is an **opportunity to escape mediocre growth**
- **Deals done in softer markets – reward dealmakers** and historically have outperformed transactions done in hotter markets
  - Opportunity for stock transactions and earn-outs
- **Downtowns spark innovation** – softer economic environments are better times to start companies – **companies and employees are more open to change**



# Conclusion

- We are returning from Covid outlier years to **historical norms**
- **Global instability** and moves away from a globalized economy have created additional pressures that may disrupt long-term growth
- **Inflation has continued to persist longer than expected**, but is starting to cool as the Fed's actions start to make an impact
- **Continuing to reduce consumer demand and moving the employment situation towards more balanced levels** should relieve supply-side pressure (and inflation as well)
- Rising interest rates have created **challenges in the debt market** not seen in years; leverage-sensitive parts of the economy will have to adjust to these changes
- **Deal activity has fallen sharply in the short-term lens**, but is in-line with historical averages; 2021 was an anomaly and its froth will likely not return for a long time
- Creating value in private markets that require debt will become more difficult going forward – **revenue growth and having valuation discipline** will be key (higher costs of debt will drive down purchase prices)
- **Private market fundraising remains very robust**, increasing overhang, and creating pressure to deploy despite economic fundamentals
- While economic downturns are challenging, they create **opportunity for those who navigate wisely** and are not afraid to act

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