

## A WORD FROM CHURCHILL

# Positioning for what's next: Where we see opportunities ahead

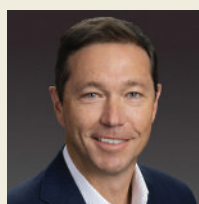
**Coming into 2026, many expected a pickup in deal and exit activity, but several factors have increased uncertainty and weighed on sentiment. What is your outlook for the remainder of the year?**

**Derek Fricke:** This has been the talking point for the last three to four years. Every year, there's been some exogenous shock, whether tariffs, a spike in rates, AI disruption, or geopolitical noise. Nonetheless, we had a record first half of 2026, driven by our focus on the core middle market, even as broader deal activity remained choppy. It's important to note that this activity hasn't come at the expense of taking on more risk. Our close rates in the first half sat near historic lows, meaning we're only closing on what we believe are the most attractive opportunities.

On AI specifically, we're not seeing disruption play out within our own portfolio. That's not to say we're dismissing the risk, as every new investment we make is subject to an AI evaluation framework, and it's also a topic of discussion at every one of our investment committee meetings. What we've found so far is that the service-oriented middle-market businesses we tend to underwrite are less exposed to AI-driven disintermediation. Across our conversations with our 130-plus middle-market sponsors, AI is overwhelmingly being used as a value-creation tool, lowering customer acquisition costs, improving margins, and making operations more efficient. We still view it more as a tailwind than the disruptive force the headlines suggest.

As we look ahead, we expect activity to pick up further in the back half of the year as some of these risks become more known quantities. There's still a significant backlog of portfolio companies ready to come to market, debt markets remain supportive even at a higher cost of capital, and investors are increasingly craving distributions. Buyers and sellers are also converging on what fair value looks like for top-tier, less flashy assets that offer steady growth. Barring another unforeseen shock, we're optimistic that activity will follow.

**Nick Lawler:** To Derek's point, the "haves" and "have-nots" dynamic holds true in secondaries as well. Top-quality assets with clean stories are trading at premium valuations and transacting competitively, while everything else has been stuck. What's notable in the GP-led secondaries market is that the vast majority of continuation



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vehicle (CV) assets are not troubled companies that couldn't find a buyer. They're precisely the opposite. They are the businesses a sponsor wants to double down on because they see years of compounding ahead.

That dynamic is starting to show up on the exit side too. We're seeing CV assets, after several years of additional value creation, sell to both strategic buyers and other sponsors. This further validates that CVs house some of the highest-quality companies in the PE ecosystem.

Their return profile and loss rate reflect the sponsor's deep familiarity with the business. Still, this is a young and growing part of the market: CVs represented only about 14% of sponsor-backed exits last year, up from roughly 5% in 2020.<sup>1</sup>

**Churchill has built its strategies around the core middle market. What are the structural advantages of investing there, and can the middle market still deliver the return profile investors want if rates stay higher for longer?**

**Fricke:** When we made the decision to focus on the middle market 20 years ago, it was for reasons that still hold true today. Middle-market sponsors use leverage as a tool for value creation, not as a driver of returns, so a higher cost of capital doesn't meaningfully inhibit their ability to deliver strong outcomes. These are generally smaller companies—call it \$10 million to \$100 million of EBITDA—that are often receiving their first institutional capital, which means there's substantial room for professionalization and operational improvement.

By the time a sponsor exits, the business typically looks materially different: more diversified, more stable, and with a stronger margin profile. Historically, that transformation has driven one to two turns of multiple expansion on its own. So, we have real confidence that tried-and-true value-creation strategies continue to work in the middle market, regardless of where rates settle.

There's also a supply-demand dynamic supporting this. There are 200,000 middle-market-sized companies in the US, with only a couple of thousand private equity firms competing for them. Within that universe, different end markets rotate in and out of favor, which means there are always pockets of high-quality opportunity for investors with a diversified, selective approach—in strong economic conditions and in more challenged ones alike.

**Lawler:** From the secondaries side, we define the middle market a bit differently—it's about companies that have grown and graduated beyond where we first invested in them, whether as a co-investor, lender, or fund investor. We're also seeing CVs move down market into this segment. Large-cap sponsors have widely adopted the strategy, but only about 40% of the middle-market sponsors we work with have executed a CV so far; this gap mirrors the same supply-demand dynamic Derek described and supports attractive returns as the strategy matures here.

**Given slower deal activity and rate uncertainty, which strategies are best positioned in this environment?**

**Fricke:** Investors are voting with their capital, and middle-market strategies—whether debt- or equity-oriented—continue to look attractive relative to more volatile, more publicly correlated parts of the market, like mega-buyout or venture. Within the middle market, it really comes down to what an allocator wants. Options range across the capital structure, from floating-rate senior debt to contractual junior capital to last-dollar equity exposure through co-investment or single-asset strategies. Each comes with a different return profile, and it's important for allocators to weigh that against their own risk tolerance.

Right now, though, we think two of our strategies are especially well suited to this environment. First, directs like equity co-investment and junior capital. Competition for high-quality assets has intensified, and we're increasingly seeing sponsors seek value-added, pre-syndication co-investors who can help right-size their equity checks so they can win the best businesses. We also are getting exposure to those same high-quality assets by offering a sponsor mezzanine or preferred capital, earning a contractual return in the process. Second, we continue to believe investing in emerging managers is an underappreciated strategy. These managers often bring more differentiated deal flow, and with so much of their own capital and reputation tied to fund performance, there tends to be greater alignment with investors. Given the wide divergence between top- and bottom-quartile managers in this space, it's important to partner with the right platform that has the capabilities to identify these managers early.

**Lawler:** On the secondaries side, both GP-led and LP-led transactions play important—but different—roles in a portfolio. LP-led secondaries have been remarkably consistent, with positive vintage-year returns dating back through both the dot-com bust and the global financial crisis. They offer strong diversification and cash flow. On top of that, the supply-demand backdrop right now is favorable. Dry powder relative to deal volume is near historic lows, which keeps pricing disciplined and continues to support attractive entry points, with many quality buyout funds still trading at discounts to net asset value.

Within GP-led transactions, we remain focused on top-quality single-asset deals. We're also starting to see an additional compelling use case emerge. It involves high-performing businesses in out-of-favor industries, where a sponsor wants to play offense and acquire weaker competitors at more attractive valuations. The distinction we draw is between temporary dislocation, which can create real opportunity, and secular decline, which we avoid.

## Source reference:

1. "Only McKinsey Perspectives," McKinsey & Company, Alex Panas and Becca Coggins, February 25, 2026.

## Important disclosure

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