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WHO TURNED DOWN THE MUSIC?

"When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance." – Chuck Prince, former CEO of Citigroup, July 2007



The S&P 500 peaked three months later and proceeded to decline ~57% over the next ~17 months during the worst financial crisis since the Great Depression. We're extremely passionate about investing but don't get us wrong, it can be frustrating. Price can move against reality for long periods of time, often due to folks thinking like Mr. Prince (no offense to him) and dancing just because the music is playing. The fundamentals may no longer make sense and the economics are busted, but money is still flowing so stocks are bought, deals are made, money is spent, etc.

As frustrating as that can be, it is still one of the beauties of investing – the tragicomical irony that cycles repeat because human nature never changes. Every crisis unveils some modestly different iteration of financial sins committed while the music was playing. We can't help but to marvel at it. Well, what shenanigans did Wall Street pull now? Who was dancing just because there was music playing?

THE PRIVATE MARKETS PARTY

Private assets, as the name suggests, are assets that are not publicly traded on stock or bond exchanges and often require a cumbersome process to invest in. Given this fact, they are illiquid and difficult to transact in by nature. Private assets have been around as long as currencies themselves (any business is technically a private asset) but as a defined asset class, they gained popularity in the 1980's with the emergence of large and growing private equity firms.

The private market asset classes, now encompassing real estate/ hard assets, private credit, venture capital, hedge funds and more, are presented as a way to either enhance returns or enhance diversification via uncorrelated returns to traditional public stocks and bonds. Real estate and certain hedge funds certainly have long periods of uncorrelated returns. Venture capital, private equity, and private credit certainly showcase some examples of high returns that are difficult to match.

Even if modern portfolio theory would suggest private assets belong in a portfolio, there are undoubtedly drawbacks: lack of liquidity, opacity, lack of control / accountability, and in many instances, fundamentally higher risk. There has long been debate about whether or not private market assets generate sufficient returns to justify the drawbacks. In recent years, this debate has picked up steam as the lack of volatility private equity and private credit funds display during tumultuous times in the public markets is highly questionable. Given that these assets do not trade every day, there is not a natural mark-to-market function. This leaves a lot of discretion to fund managers on what to report for performance. Needless to say, many – not all – have taken liberties. Not only are quarterly returns difficult to verify, but the industry has also marketed the lack of daily marks and verifiable quarterly returns as a lower risk and/or uncorrelated alternative to publicly traded securities.

This utter nonsense, dubbed “volatility laundering” by critics such as Cliff Asness, has led us to view the industry with a cautious eye. The idea that equity privately held is less risky than equity publicly traded is silly. Equity is equity and always the tip of the risk spear – the lowest rung on the capital stack and thus the first loser when things go bad. Furthermore, the vast majority of private companies do not have access to liquid capital markets to raise cash when things do go bad. Most private companies are smaller with less diversified customers bases, less diversified supply chains, less diversified geographical exposure, etc. Not to mention, most private equity firms attempt to achieve their higher returns using large amounts of leverage! There isn’t anything illegal about leverage but suggesting a lower risk profile or less correlation when greater leverage is involved is disingenuous at best.



We want to be clear we are painting with a broad brush – not everyone in the private equity or private credit industry is guilty of putting lipstick on their pigs. But we write this newsletter as it is becoming clearer the financial sins committed are becoming too numerous to ignore:

1. Aggressively pursuing the wrong client base and creating a duration mismatch – retail and high net worth individuals who do not understand or align with partial liquidity rules. The investments these funds make are naturally long-term and it has become clear that many of their newer clients were not properly educated on this facet.

2. Growing too fast – often a sign of taking too much risk when growing too fast in finance, the private credit sector has experienced explosive growth over the past decade. This often leads to loose underwriting standards and poor outcomes. Several high profile fraudulent loan customers and sudden massive markdowns (volatility laundering exposed) have come to light over the past year.

3. Portfolio sector concentration – private credit funds have invested heavily in software. While it remains to be seen if AI is going to disrupt software, the private credit funds committed a cardinal sin in investing by failing to diversify appropriately.

4. Kicking the can down the road – the favorite dance of finance while the music plays, these entities are raising capital in new funds to buy assets from old funds in order to pay out clients that have been wondering when distributions would ever be made. These secondary or continuation funds reached $240 billion in 2025, staggering growth of 48% versus 2024.

5. Hidden leverage – These funds are now borrowing at the fund level, in addition to the portfolio company level. Net Asset Value (NAV) loans are small but growing at an estimated 30%+. Collateralized Loan Obligations (CLOs – made infamous during the Great Financial Crisis) are growing at similar rates. Furthermore, payment-in-kind holdings of the funds, in which the portfolio company cannot afford the interest payment and thus the interest payment is added to the total debt burden (giving the illusion of growing asset values for the funds), have doubled as a percent of income over the past few years.



6. Abusing misaligned incentives – the PIK and rapid growth in additional forms of leverage should be drawing scrutiny, right? Obviously, the clients in older vintages of funds have made their bed and are laying in it, but how do these fund managers keep raising capital and finding liquidity (aside from poorly targeted retail investors)? Herein lies perhaps the most eerie parallel to the Great Financial Crisis – several less-recognized credit rating agencies are the overwhelming majority of the ratings issued to private assets, allowing them to be purchased by a wider audience. Even better, several are owned by private equity firms!

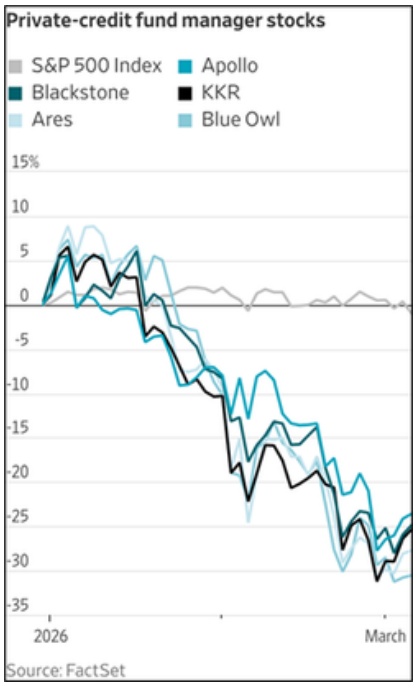


7. Circular financing – readers may recall the warning we issued on the tangled web of circular financing that was building in the AI industry. Invoking a similar response as hearing "golden age" or "supercycle", we tend to run in the other direction when we see evidence of circular financing. Certain players in the private markets are dancing and weaving with the Life Insurance and Annuity industry. Private equity and private credit companies have bought insurers who in turn buy the private assets that these companies underwrite. There are even emerging allegations of improper reinsurance deals with serious financial holes, but the opacity is too great to confirm or deny the allegations at this stage.

We have generally avoided private assets for clients as we have been skeptical that the lack of liquidity, lack of transparency, and frequently higher risk approach is appropriately compensated for with returns. But we want to reiterate this doesn't mean everyone operating in these industries is committing these financial sins and dancing just because the music is playing. There are plenty of good actors and alarmingly, the sins seem to be concentrated with the largest players in the industry.

WHAT DOES THIS MEAN FOR PORTFOLIOS?

The problems emerging in the private markets have been going on for months, and it was tempting to focus the newsletter on the drum beats of war rather than the dimming music in private assets. Ultimately, the oil shock – if sustained – is more important to the markets. However, many higher risk areas within the market showed signs of struggle before the oil spike. The weakness was spreading beneath the surface, including in the stocks of several private asset managers. As we finish writing this newsletter on April 9, the S&P 500 has already staged a partial rebound from the March oil shock lows and only sits ~3% from its highs in January.



A 3% drop in the market given the conditions seems paltry. It's difficult to even guess how the war will turn out – us finance folks do not do well pricing in geopolitics, especially when the other side may be highly irrational. While we do not feel compelled to always believe the market (just because others are dancing doesn't mean we have to), we certainly listen to it and pay close attention to what goes on under the surface.

It is clear to us that someone turned down the music even before a massive oil shock. Thus, we view a sustained oil shock as – pardon the pun – gasoline being poured on embers. We have played the same old song for most of the past three years now: (1) valuations at the index level are too high but opportunities still exist under the surface, and (2) valuations are not timing tools so stay invested, but high valuations do amplify downside risk so remain disciplined in asset allocation.

We are starting to change our tune. Not all boxes are checked for a stock market top (contact us if you'd like to review), but a majority are and more will be checked if oil prices go higher. As we highlighted in our previous newsletter, the denominator piece of stock returns (earnings expectations) was starting to get stretched. We remain skeptical of the two-year compound growth numbers assumed by Wall Street, and the war now presents reason to be worried about this year's earnings expectations. As we said before, capitalizing high valuations on high expectations is a recipe for serious pain.

Even if we are becoming increasingly concerned about the market, we will never take our eyes off the prize: helping clients reach their goals!

Sincerely,

Your First Bankers Trust Team

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CHART APPENDIX

Sources: Financial Times, S&P Global, Goldman Sachs, Bloomberg, FBT Research, JP Morgan Research, Bank of America Research



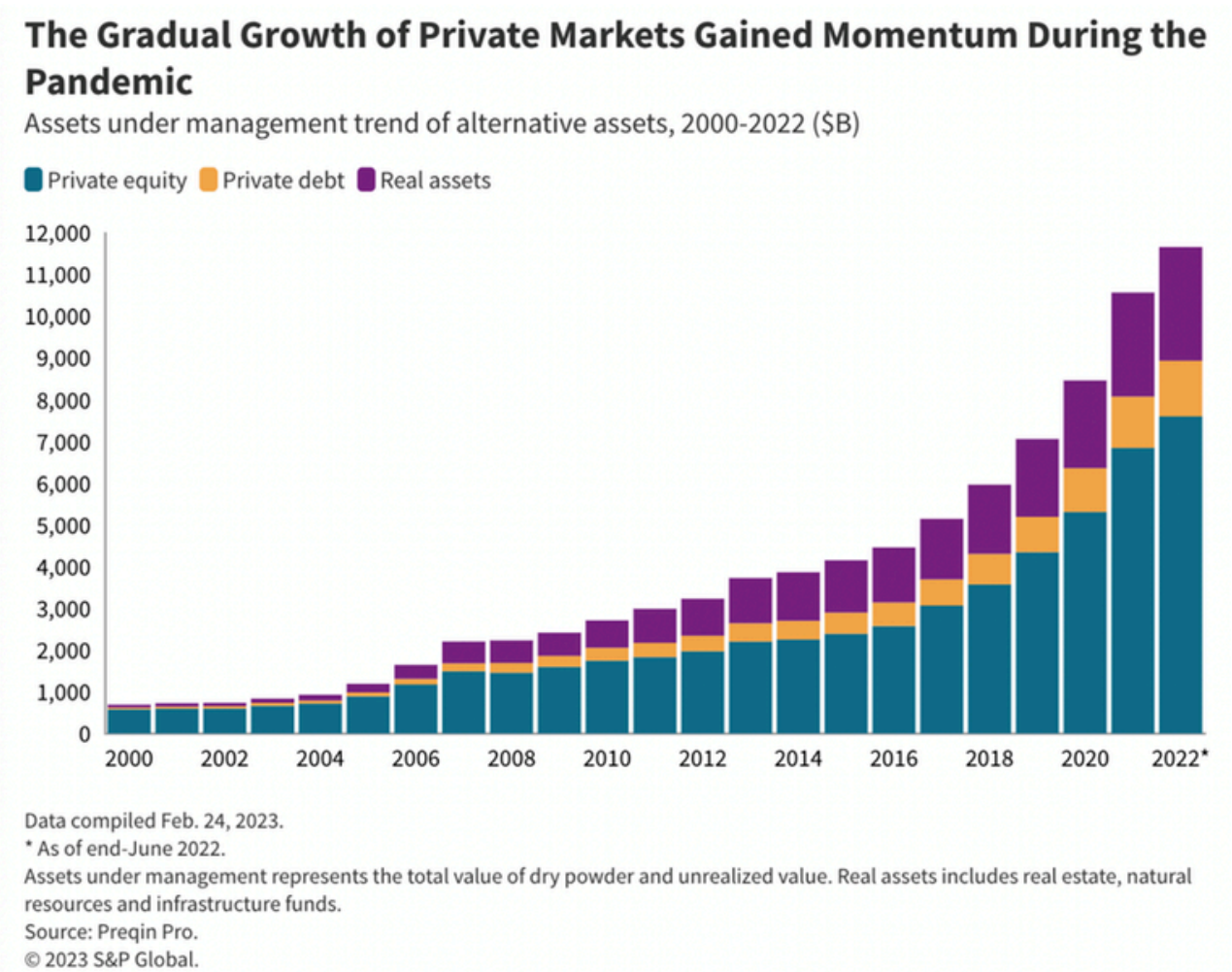
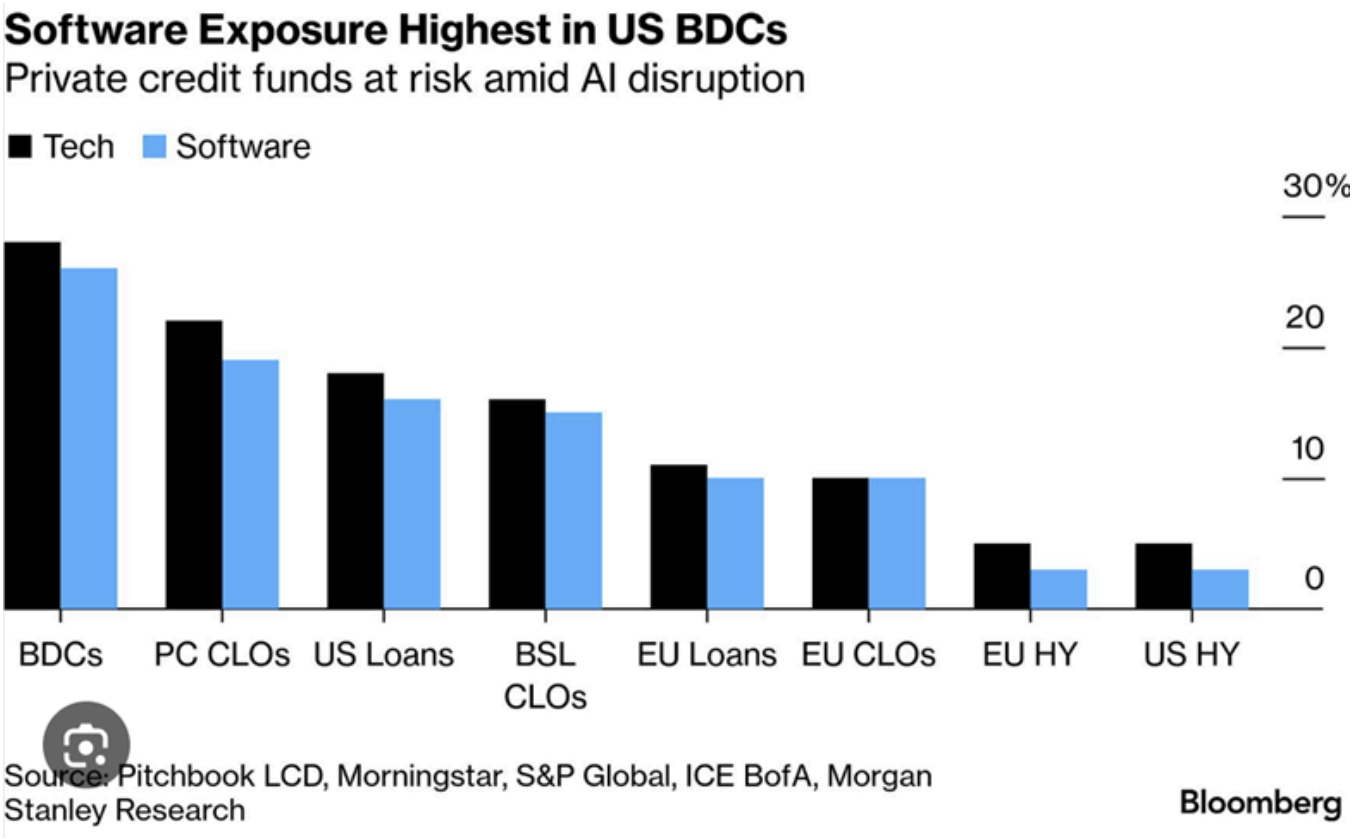


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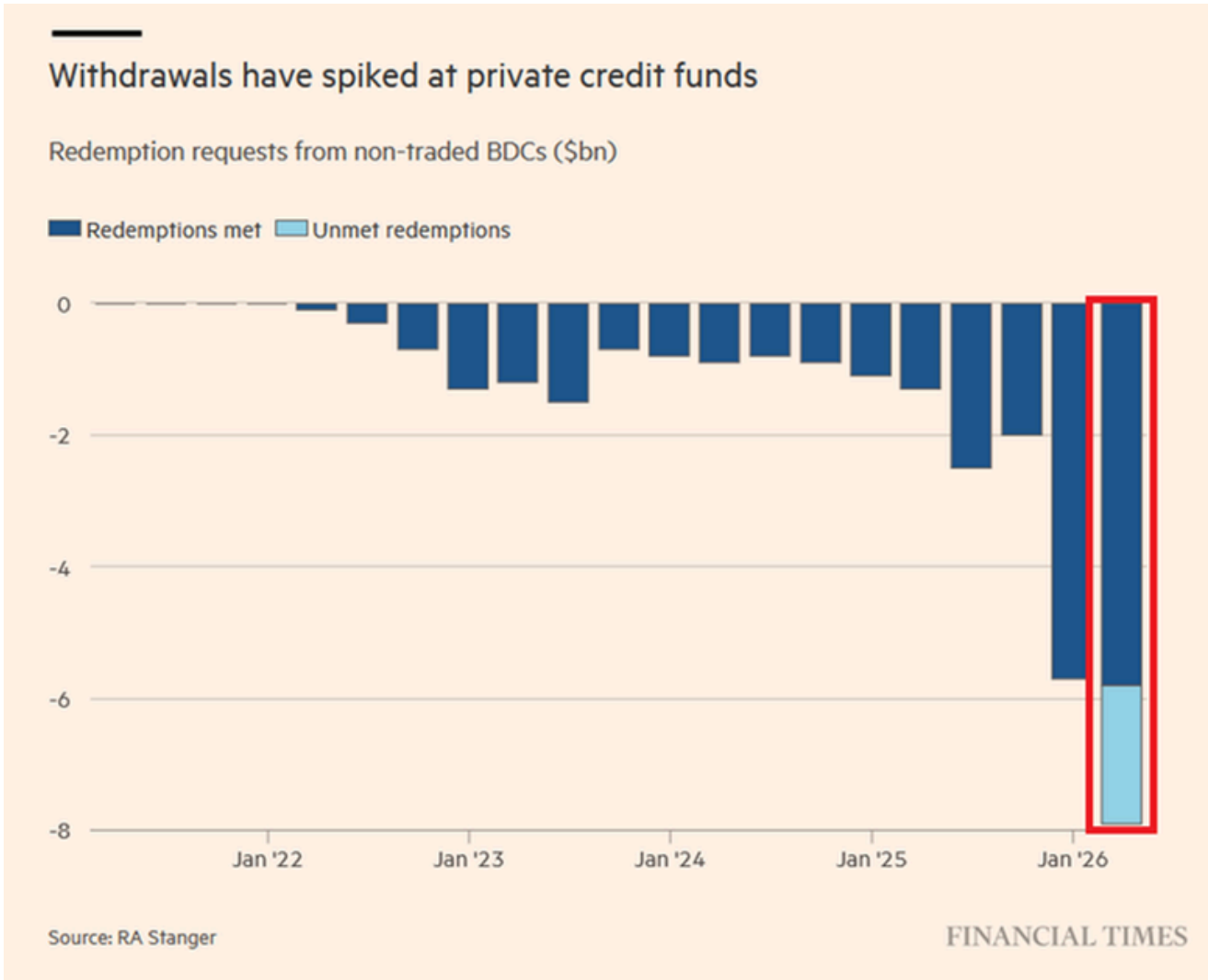


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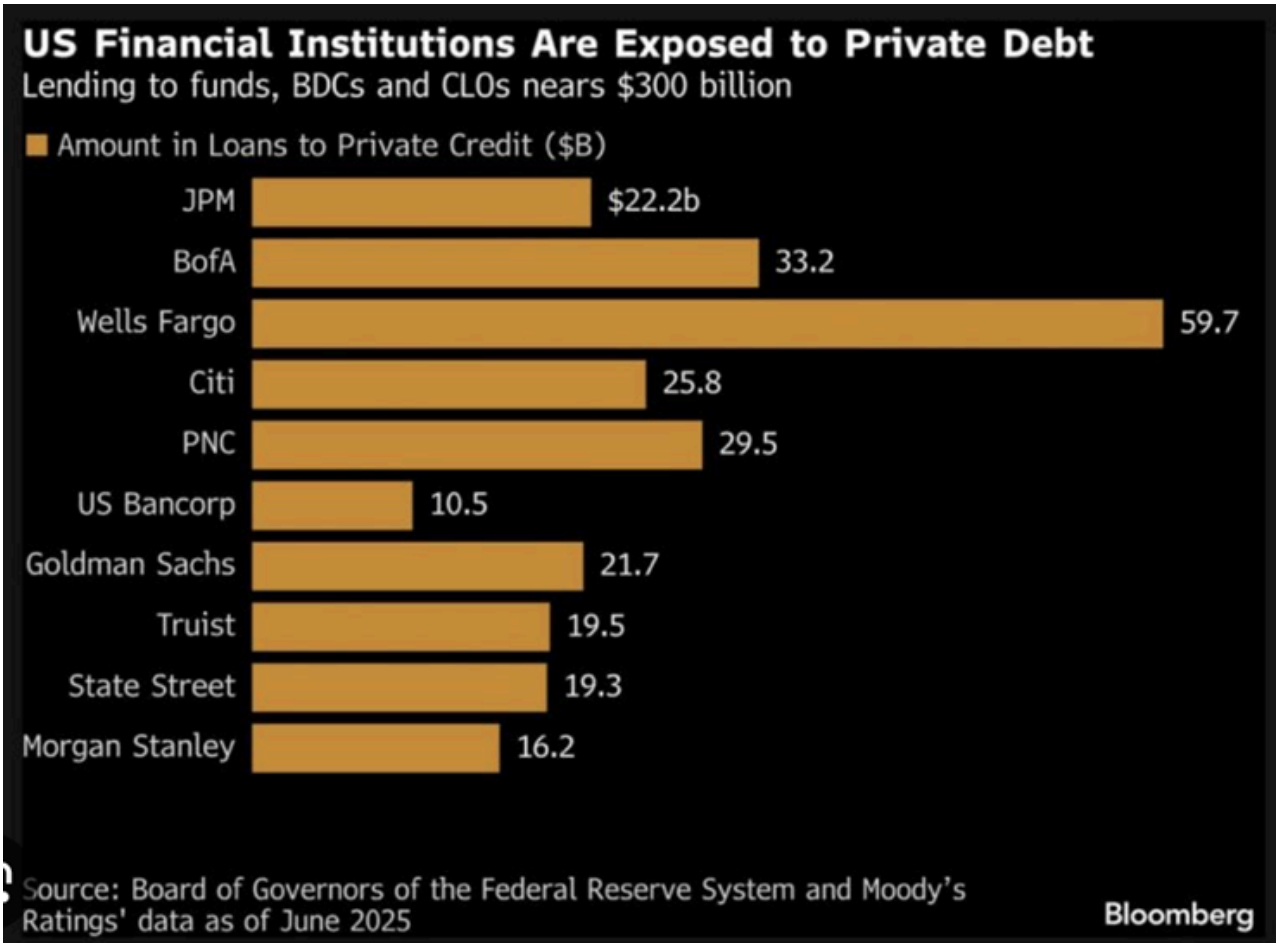
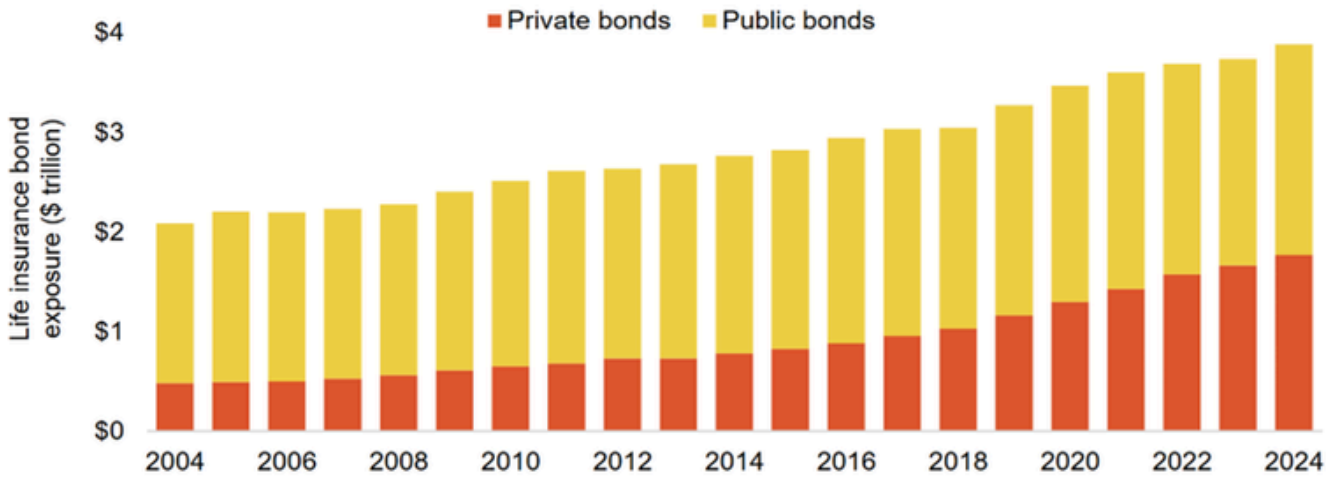


Exhibit 1: Life insurance industry exposure to private bonds has grown over time
U.S. life insurance industry bond exposure, by bond type, in $ trillions

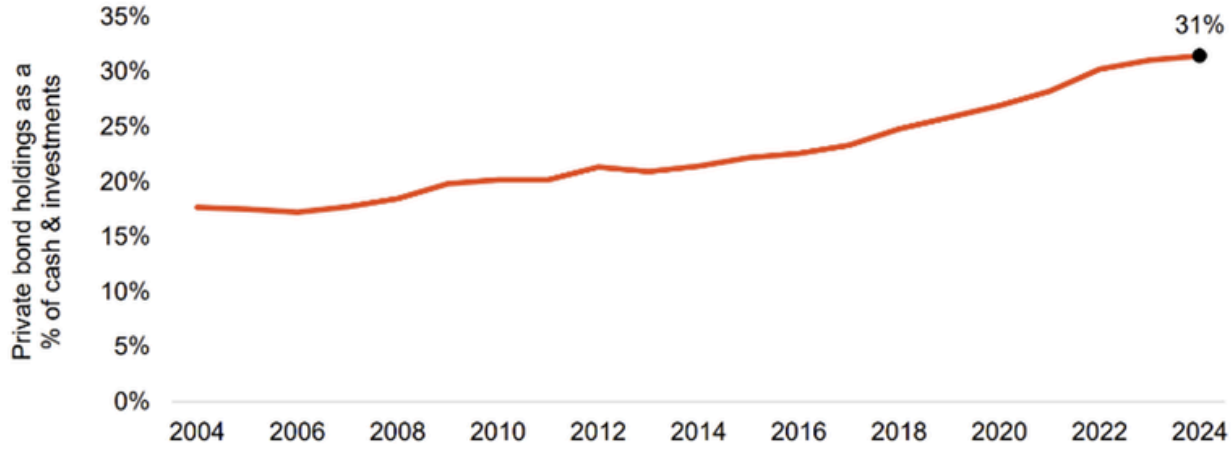


Source: S&P Capital IQ, BlackRock. As of year -end 2024 (most recent available as of October 20, 2025). Private bonds are broadly defined as bonds that are privately placed, or those that are qualified for resale under SEC Rule 144A or are freely tradable under SEC Rule 144.

CHART APPENDIX

Exhibit 4: Private bonds have grown as a share of life insurers' total cash and investments

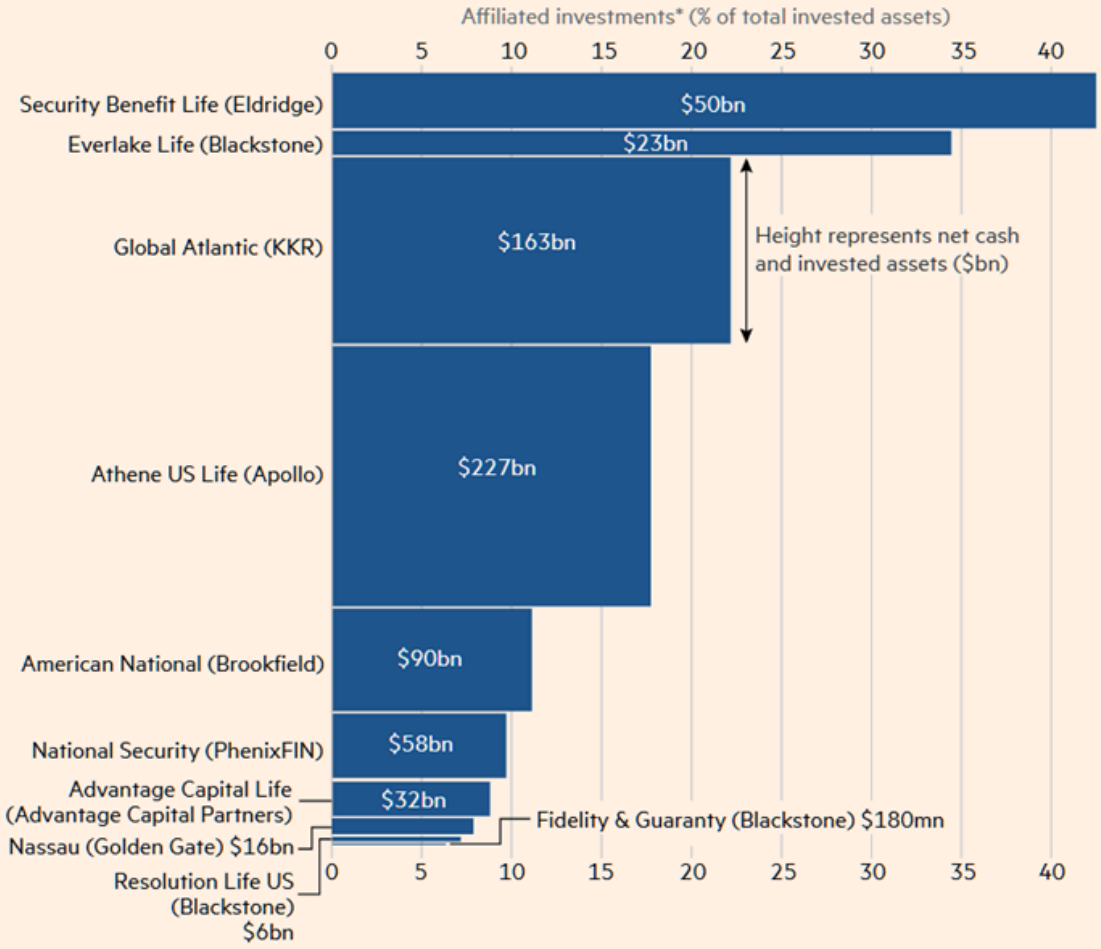
Private bond holdings as a share of total cash and investments for U.S. life insurance companies



Source: Capital IQ, BlackRock. As of year-end 2024 (most recent available as of October 20, 2025).

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Private capital-backed insurers make big allocations to private capital affiliates



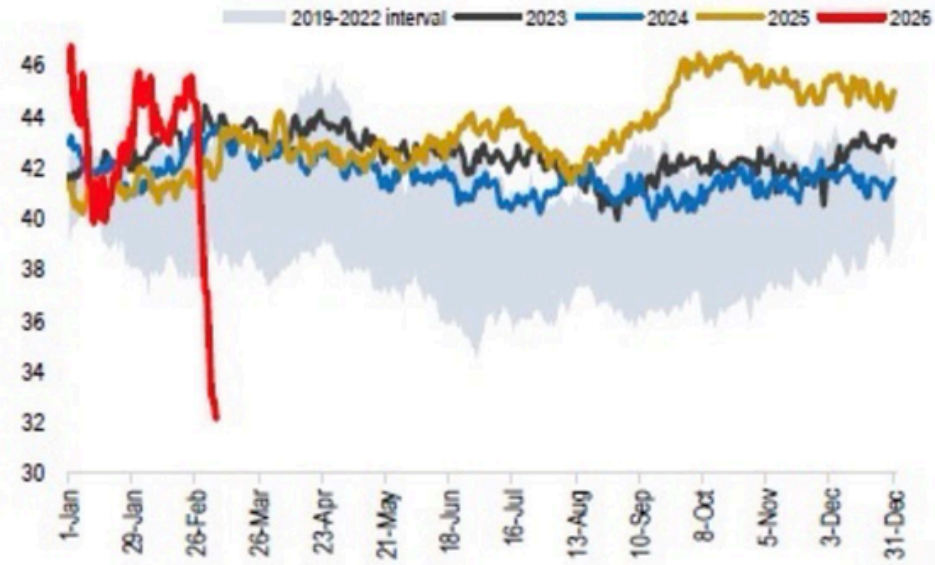
Source: AM Best • *Top 10 insurers with highest ratio of affiliated investments to capital + surplus, a measure of financial solvency, 2024. (Companies with >$500mn net admitted assets) data from US statutory filings

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CHART APPENDIX

Figure 3: Global crude export

mbd; 2023-2025 4 weeks MA; 2026 - 10 days MA



Source: Kpler, J.P. Morgan Commodities Research

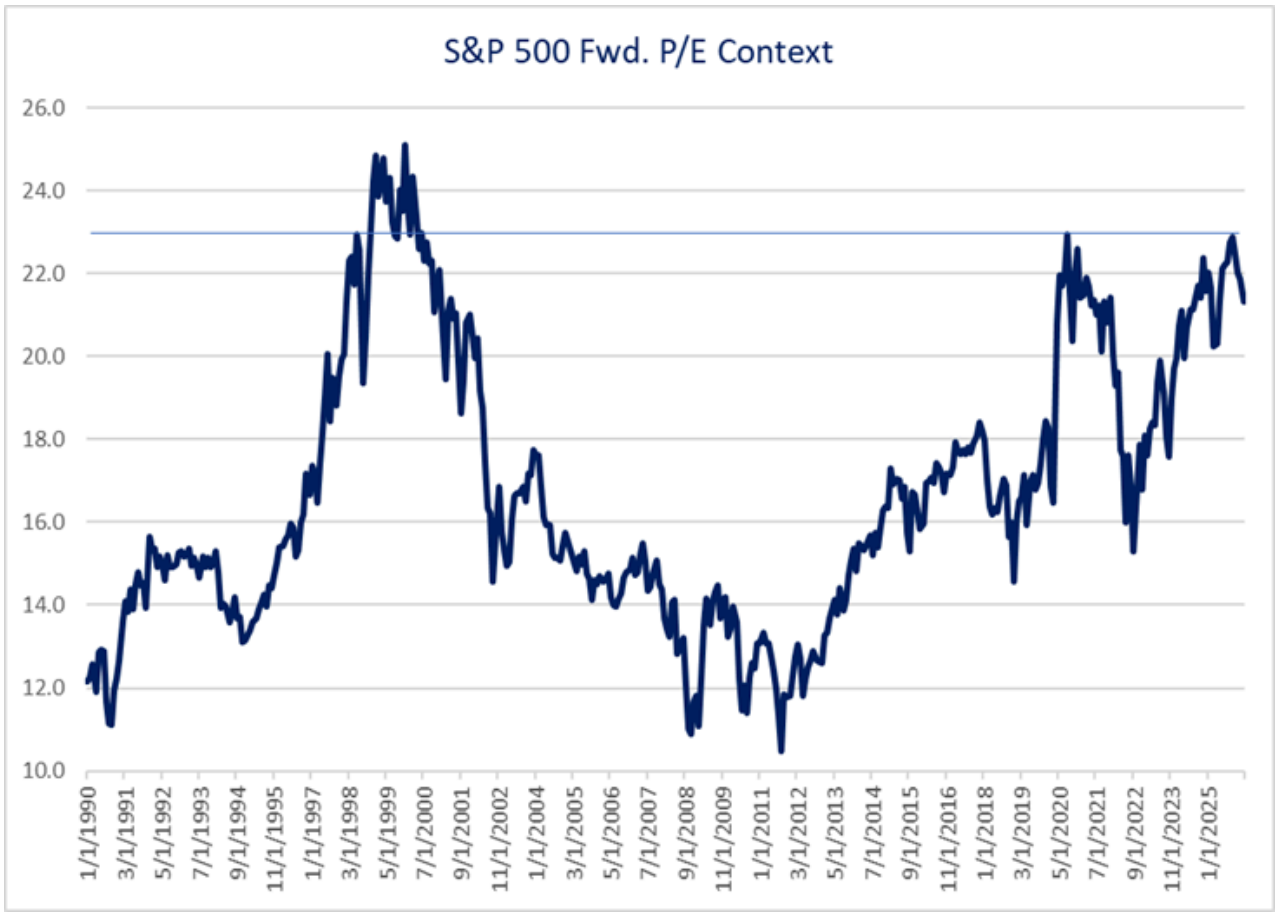


CHART APPENDIX

S&P 500 Bear Market History over Past 80 Years

Market High Date	Recovery Time (Days)	Recovery Time (Years)	
5/29/1946	1,472	4.0	
8/2/1956	783	2.1	
12/12/1961	630	1.7	
2/9/1966	449	1.2	
11/29/1968	1,193	3.3	
1/11/1973	2,744	7.5	← Nifty Fifty Valuation Bubble
11/28/1980	705	1.9	
8/25/1987	701	1.9	
7/16/1990	212	0.6	
7/17/1998	129	0.4	
3/24/2000	2,666	7.3	← Tech Valuation Bubble
10/9/2007	1,997	5.5	
2/19/2020	181	0.5	
1/3/2022	746	2.0	
Average	**1,043**	**2.9**	
Median	**726**	**2.0**	

Source: Bloomberg, FBT Research

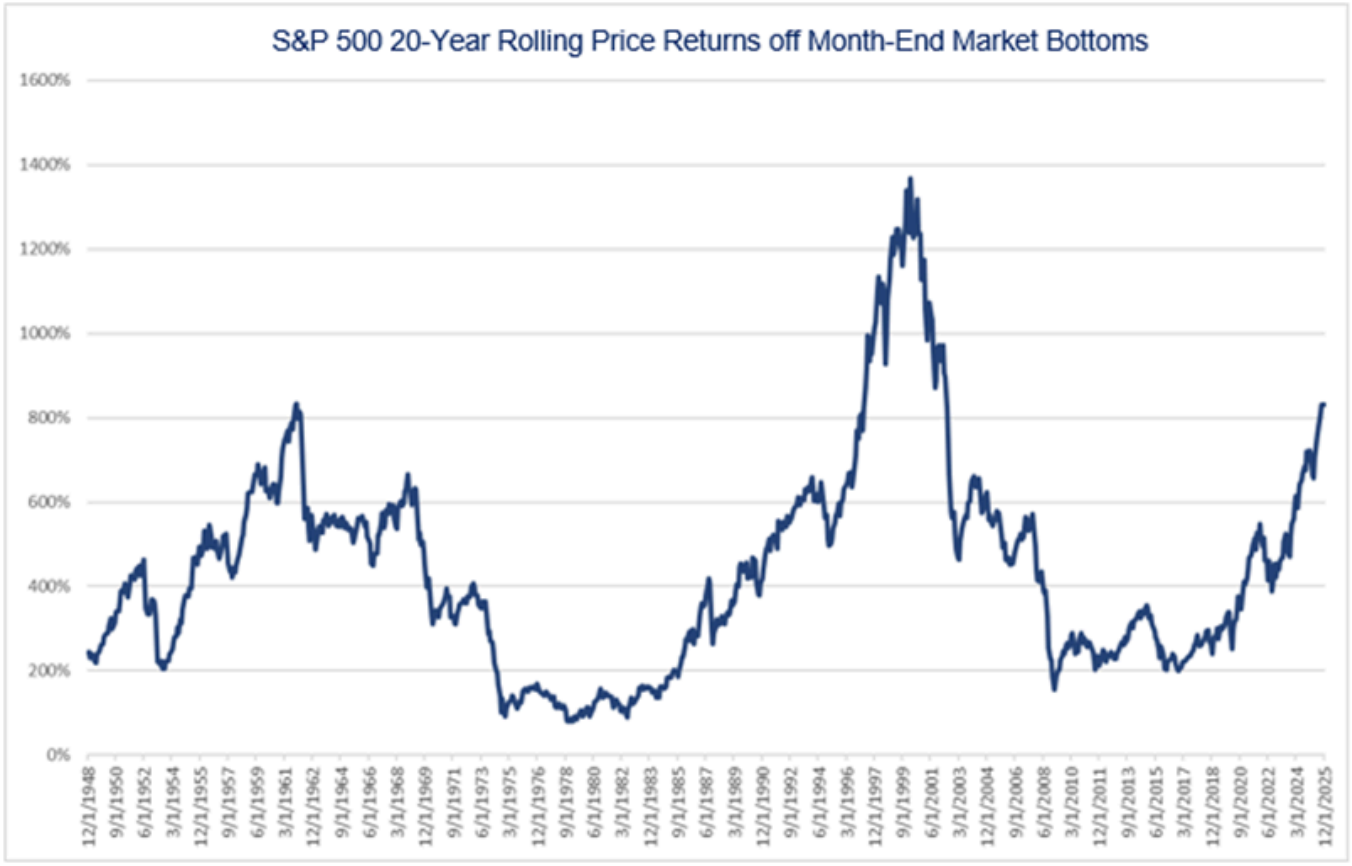
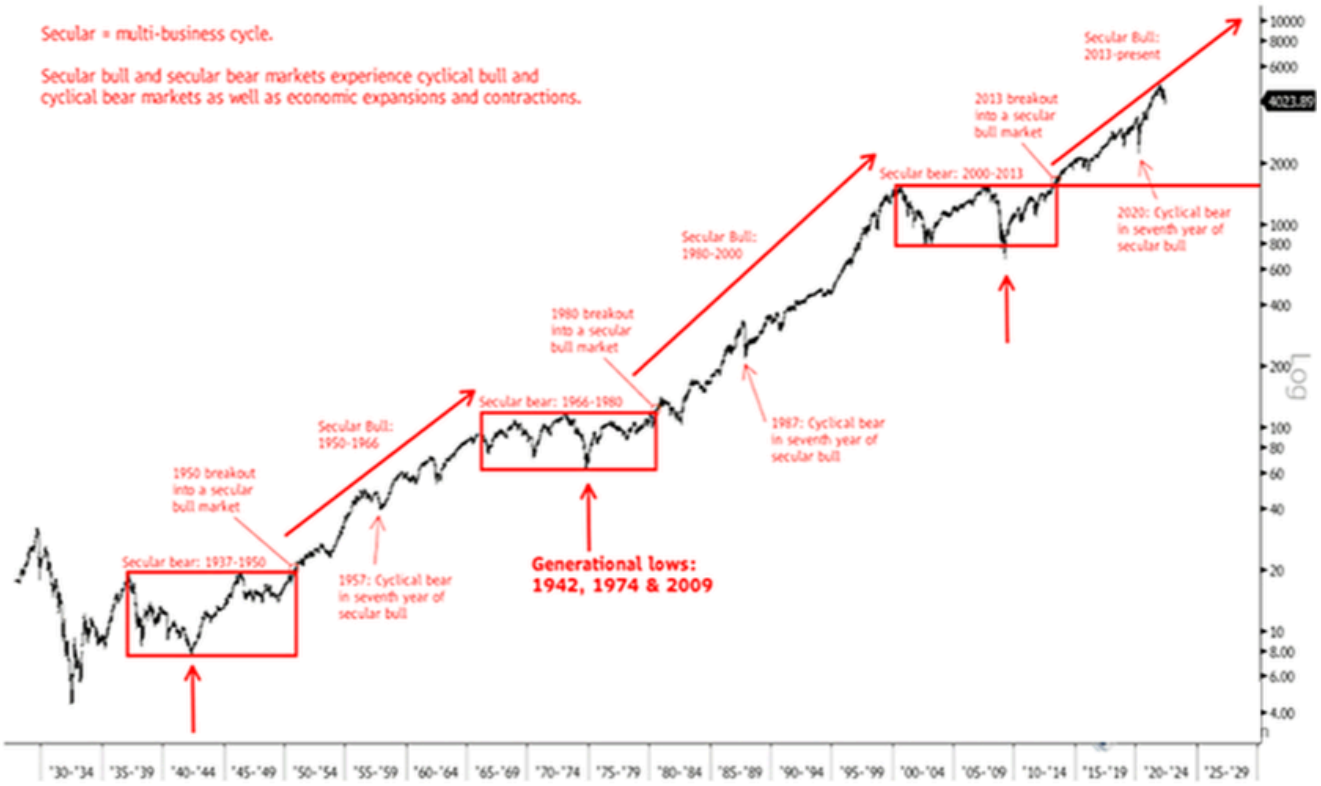


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Chart 1: S&P 500 secular bull market roadmap: Monthly log-scale chart
This chart shows secular bear markets from 1937-1950, 1966-1980 and 2000-2013 and secular bull markets from 1950-1966, 1980-2000 and 2013 to present.



Source: BofA Global Research, Bloomberg