

STRATEGIC INTELLIGENCE REPORT

# The Fourth Turning

## & Private Equity

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*Kings of the Hill at the End of the Cycle:*

*Why Private Equity Is the Most Exposed Institution of the Unraveling Era*

The McPherson Group

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*This report is prepared for private equity professionals, limited partners, institutional investors, and corporate strategists whose portfolios or competitive environments intersect with PE-owned firms. It applies the Fourth Turning generational framework to the specific structural vulnerabilities of private equity as an institutional form — and argues that PE is the single institution most precisely optimized for the era that is ending.*

## Executive Summary

Private equity is the dominant financial institution of the American Unraveling — the era of roughly 1984 to 2008 and its extended aftershocks. Its rise was not accidental. The specific conditions of the Unraveling era — cheap and abundant debt, stable regulatory arbitrage, predictable institutional frameworks, and the cultural ascendancy of financial engineering as a legitimate form of value creation — were precisely the conditions under which the PE model generates superior returns. PE did not create those conditions. It was built for them.

The Fourth Turning thesis — the eighty-year generational cycle identified by historians Strauss and Howe — predicts that those conditions are not merely cyclical but structural. They end not because the business cycle turns but because the institutional order that produced them reaches the end of its useful life and undergoes crisis-level reconstruction. That reconstruction is, on the available evidence, underway.

This report makes a specific and uncomfortable argument: that private equity, precisely because it is so well optimized for the Unraveling era, is among the most exposed institutional forms to the Fourth Turning's disruptions. The same discipline that made it dominant — leverage maximization, short-duration return extraction, institutional arbitrage, and the elimination of organizational slack — becomes a liability when the institutional environment changes faster than investment theses can be refreshed.

The report identifies five structural vulnerabilities, five crisis scenarios with differential impact on PE returns and institutional survival, and a set of strategic postures for the PE firm that takes the analysis seriously.

### KEY FINDINGS

Private equity is the institutional avatar of the Unraveling era. Its core competencies — leverage, arbitrage, financial engineering, short-duration value extraction — are specifically products of the conditions the Fourth Turning ends. Five structural vulnerabilities are now converging: the leverage trap, the portfolio company fragility problem, the legitimacy target, the LP succession risk, and the regulatory reconstruction threat. The “Cheat the Prophet” dynamic — Chesterton’s observation that prophets fail by extrapolating the present forward rather than modeling discontinuity — is operating at scale: most PE firms are planning for linearity in an environment that the historical record suggests will not be linear. The firms that survive the Fourth Turning intact will not be the most optimized. They will be the most convertible — capable of redeploying their genuine competitive advantages (deal intelligence, operational capability, network depth) into the forms that the next era demands. The conversion option question — what could your firm become that would make it indispensable to the next institutional order — is the most important strategic question in PE right now, and the least asked.

## Section 1: Cheat the Prophet — Betting on Linearity

G.K. Chesterton opens *The Napoleon of Notting Hill* with a passage on prophecy that is directly applicable to private equity in the current moment. He describes a game he calls “Cheat the Prophet” — the tendency of human beings to listen carefully to all that clever men predict about the next generation, wait until those men are dead, and then go do something else entirely. The prophets are not wrong because their logic is flawed. They are wrong because they take something that is certainly going on in their time and predict that it will go on more and more until something extraordinary happens. They extrapolate the present forward. History refuses the extrapolation.

The Chesterton diagnosis of the prophets applies with uncomfortable precision to private equity today. PE has taken something that was certainly going on — cheap debt, stable institutions, financial engineering as a legitimate form of value creation — and built an entire industry around the assumption that it will continue. The clever men of PE have produced extraordinarily sophisticated models of how that continuation will unfold. What the Chesterton framework predicts is that the human race will, with cheerful indifference, go do something else.

Private equity’s extrapolation is the Unraveling-era institutional configuration: cheap debt markets, stable regulatory arbitrage, employer-sponsored workforce structures, predictable geopolitical order, and the cultural legitimacy of financial returns as a primary measure of institutional value. PE firms have not merely benefited from these conditions. They have built every element of their operating model — from fund structure to deal thesis to portfolio management to LP relationship — around their continuation.

***“The most dangerous position for a large organization in a Fourth Turning is to be optimized. The firms that thrive will be the ones that are convertible.”***

— The McPherson Group

The Chesterton problem in PE is not a failure of intelligence. PE attracts some of the most analytically capable people in American institutional life. It is a failure of imagination — specifically, the failure to model discontinuity rather than volatility. Chesterton’s prophets fail not because they are stupid but because they are too clever: they see the present with great precision and mistake its momentum for its destiny. Volatility is a temporary deviation from a stable equilibrium. Discontinuity is the end of the equilibrium itself. The Fourth Turning framework argues that what the current moment presents is the second, not the first.

The evidence for discontinuity rather than volatility accumulates: institutional trust at historic lows and declining, geopolitical order fracturing faster than any post-WWII precedent, AI-driven workforce displacement accelerating beyond any historical analog, political pressure on concentrated financial power building across both partisan coalitions. These are not coincidental signals. They are, the Fourth Turning framework argues, causally related expressions of a single underlying dynamic.

### **Cheat the Prophet: The PE Version**

Chesterton writes that the prophets of the twentieth century “took something or other that was certainly going on in their time, and then said that it would go on more and more until something extraordinary happened.” The PE investor who recognizes the Fourth Turning risk and simply reduces leverage by 10% has committed exactly this error at one remove. They have taken the disruption itself as the new trend and extrapolated it forward modestly. They have made a volatility adjustment to a discontinuity problem. The human race, Chesterton notes, listens very carefully to the clever men — and then, once they are safely buried, goes and does something else entirely.

## Section 2: The Anatomy of PE's Unraveling-Era Advantages

Before stress-testing scenarios, it is essential to name the specific rent sources and competitive advantages that PE has built during the Unraveling era — and to assess each one's durability as the institutional environment shifts. The strategic analysis changes materially depending on which advantages are genuinely durable and which are artifacts of conditions that are ending.

Rent Source / Advantage	Durability	Fourth Turning Threat Vector
Cheap debt / leveraged buyout model	AT RISK	Rate environment normalization and credit market restructuring compress LBO returns structurally; not cyclically
Regulatory arbitrage (carried interest, fund structure)	AT RISK	Political pressure across both parties for tax and structural reform; Fourth Turning historically produces institutional reconstruction that closes arbitrage gaps
Information asymmetry / deal sourcing edge	MEDIUM	Democratization of financial data and proliferation of PE firms has compressed sourcing edges; still present but narrowing
Operational improvement capability	HIGH	Genuine operational value creation survives institutional change; this is the most durable PE advantage if genuinely present
Network and relationship capital	HIGH	Durable if built on genuine trust and demonstrated value; vulnerable if dependent on institutional access that regulatory change disrupts
LP relationship and capital raising	CONDITIONAL	Generational succession in LP organizations (endowments, pensions, sovereign wealth) is shifting evaluation criteria toward impact, governance, and long-duration return — not just IRR
Portfolio company cost optimization	AT RISK	The elimination of organizational slack — workforce reduction, deferred maintenance, supply chain concentration — creates fragility that is specifically punished in Fourth Turning disruption scenarios

### The Slack Elimination Problem

The most underappreciated structural vulnerability in PE-owned companies is the systematic elimination of organizational slack in the name of EBITDA optimization. Slack — redundant workforce capacity, excess inventory, geographic diversification, maintained community relationships, conservative balance sheets — is treated by PE financial engineering as inefficiency to be arbitrated away. The Fourth Turning framework treats it as resilience.

Every major crisis in American institutional history has punished organizations that had optimized slack out of their systems and rewarded those that maintained it. The Depression-era companies that had retained workforce depth, maintained community relationships, and avoided maximum leverage survived and often gained share. Those that had eliminated every redundancy in the name of efficiency discovered that the redundancy was doing something essential that was not visible until it was gone.

Cheat the Prophet, again — at the portfolio company level.

### **The Portfolio Fragility Audit**

A Fourth Turning-aware PE firm should conduct a systematic fragility audit of its portfolio companies: What is each company's debt service coverage at current EBITDA levels, and what happens if EBITDA declines 20%? What workforce capabilities have been eliminated that would be expensive to reconstitute under disruption? What supply chain concentrations exist that a geopolitical shock would break? What community relationships have been sacrificed for margin? The answers to these questions are the leading indicators of which portfolio companies are crisis-resilient and which are not.

## Section 3: Five Crisis Scenarios — 2025 to 2030

The following five scenarios are not mutually exclusive. The most likely outcome over the 2025 to 2030 window is a combination of elements from multiple scenarios, weighted by which macro forces accelerate fastest. The strategic value of scenario analysis in a Fourth Turning is not prediction but preparation — ensuring the organization has adaptive capacity across the widest range of plausible futures.

Scenario	Mechanism of Harm to PE	Severity	Strategic Response
The Leverage Trap	Rate environment remains elevated or rises further; credit markets tighten; LBO model generates structurally compressed returns; portfolio company debt service coverage breaks at scale	HIGH	Reduce portfolio leverage proactively; develop longer-hold, lower-leverage return models; build operational value creation that does not depend on financial engineering
The Legitimacy Reckoning	Political realignment produces structural reform of carried interest, fund taxation, and portfolio company labor practices; institutional legitimacy of PE model is challenged in both parties	HIGH	Build genuine operational value creation narrative; engage proactively on governance reform rather than reactively; diversify LP base toward impact-tolerant capital
Portfolio Company Fragility Cascade	Geopolitical or economic shock breaks supply chains and demand structures simultaneously; PE-optimized companies with thin slack are disproportionately exposed; distress sales compress returns across asset classes	SEVERE in shock scenario	Conduct portfolio fragility audit now; prioritize slack restoration in highest-risk holdings; develop distressed asset capability as a return opportunity, not just a risk
LP Succession Risk	Generational transition in endowments, pensions, and sovereign wealth brings millennial CIOs with different return criteria; ESG, governance, hold duration, and community impact become evaluation factors alongside IRR	CONDITIONAL	Map LP succession timelines; develop impact and governance narrative that is genuine, not cosmetic; build relationships with successor CIOs before they control allocation decisions
AI-Driven Portfolio Disruption	AI displacement restructures workforce and demand in PE portfolio companies faster than investment theses anticipated; value creation plans built on human labor arbitrage are obsolete	HIGH as structural force	Audit AI exposure across portfolio; identify companies with durable human-intensive value propositions versus those dependent on labor cost structures that AI will compress

## Scenario 1: The Leverage Trap in Detail

The leveraged buyout model is not merely a financial strategy. It is a bet — specifically, a bet that the cost of debt will remain low enough relative to asset returns that the spread generates attractive equity returns. That bet has been available at scale for roughly forty years, with the exception of specific stress periods, because the Federal Reserve's post-1982 disinflationary regime created a structural environment of declining real rates.

The Fourth Turning framework does not predict a specific rate environment. It predicts that the institutional order that produced the post-1982 regime — including the specific monetary policy consensus, the global trade architecture that suppressed goods inflation, and the geopolitical stability that allowed capital to flow freely across borders — is under the kind of structural pressure that produces reconstruction, not just adjustment.

A PE industry that has built its fund structures, its return models, and its LP promises around a specific rate environment is exposed not to a cyclical correction but to a structural shift. The distinction matters enormously: a cyclical correction is a temporary deviation that a patient investor can hold through. A structural shift means the equilibrium itself has moved, and the model that was built for the old equilibrium does not work in the new one.

## Scenario 3: The Legitimacy Reckoning in Detail

Every previous Fourth Turning in American history has produced a political reckoning with concentrated financial power. The pattern is consistent: the Unraveling era generates significant wealth concentration through financial sophistication; the Crisis era produces the political will, the catalyzing events, and the institutional reconstruction that restructures the relationship between financial institutions and the broader public.

The 1930s analogue is instructive. The Senate Banking Committee's Pecora Commission hearings of 1932 to 1934 exposed the practices of the major financial institutions of the Unraveling era — the 1920s banking and securities complex — with the specific effect of generating the regulatory architecture of the New Deal: the Glass-Steagall Act, the Securities Exchange Act, the Investment Company Act. These were not incremental reforms. They were structural reconstructions of the institutional framework within which finance operated.

Private equity's specific vulnerability is the carried interest tax treatment, the fund structure that limits transparency, and the portfolio company practices — workforce reduction, debt loading, asset stripping — that have become visible political targets across both partisan coalitions. The political conditions for a Pecora-style reckoning with PE are more developed than at any point in the industry's history.

### The Bipartisan Vulnerability

Private equity's legitimacy problem is unusual in the current polarized environment in being genuinely bipartisan. The left objects to labor practices, wealth concentration, and tax structure. The right has developed a parallel critique centered on the acquisition of American assets by foreign sovereign wealth funds through PE intermediaries, PE's role in healthcare and housing financialization, and the carried interest preference as a tax advantage for the wealthy. A regulatory reconstruction that draws on both critiques simultaneously is more likely in a Fourth Turning than a conventional partisan reform.

## Section 4: Strategic Posture — The Convertible PE Firm

The Ford analogy that runs through the Fourth Turning framework is directly applicable to private equity. Ford did not survive World War II by being efficient. It survived by being convertible — by having the manufacturing capability, the workforce depth, and the organizational flexibility to redirect its productive capacity toward what the moment demanded. The bomber production lines that Ford ran during World War II were not a departure from Ford's identity. They were an expression of its genuine capabilities, deployed in service of the era's most urgent need.

The PE firm that survives the Fourth Turning intact will not be the one that most efficiently extracts value from the Unraveling-era model. It will be the one that can identify its genuine competitive advantages — the capabilities that are real and durable independent of the institutional configuration that originally generated them — and convert those advantages toward what the next era demands.

### Strategic Imperative 1: Separate Genuine Capability from Institutional Arbitrage

The most important diagnostic question for a PE firm in the current moment is: which of our returns are generated by genuine operational value creation, and which are generated by institutional arbitrage that may not survive the Fourth Turning?

Genuine operational capability — the ability to identify underperforming businesses, recruit management talent, improve operational systems, build strategic adjacencies, and create durable competitive positions — is durable across institutional configurations. A PE firm that genuinely does this well has a competitive advantage that does not depend on cheap debt, carried interest treatment, or regulatory arbitrage.

Institutional arbitrage — returns that depend on specific tax treatment, specific regulatory gaps, specific debt market conditions, or specific LP information asymmetries — is vulnerable to precisely the kind of institutional reconstruction that the Fourth Turning produces. A firm that cannot separate these two sources of return cannot assess its own vulnerability honestly.

### Strategic Imperative 2: Conduct the Portfolio Fragility Audit

Every PE-owned company in a firm's portfolio should be stress-tested against the Fourth Turning's specific disruption scenarios: sustained elevated rates, geopolitical supply chain shock, AI-driven demand and workforce restructuring, and regulatory change in the company's sector. The audit is not a prediction. It is a preparation — identifying which companies have the organizational slack, the balance sheet strength, and the competitive positioning to survive disruption and which are fragile.

- Map debt service coverage at current, minus-10%, and minus-20% EBITDA across the portfolio. Identify which companies break and at what threshold.
- Audit workforce capability that has been eliminated in optimization efforts. What would it cost to reconstitute it if needed? What competitive capability has been permanently lost?
- Map supply chain concentration risks — geographic, vendor, and logistics — against geopolitical disruption scenarios.

- Assess community and regulatory relationship quality in each major market. PE-owned companies with genuinely poor community relationships are disproportionately exposed to regulatory targeting in a Fourth Turning legitimacy environment.

### Strategic Imperative 3: Map the LP Succession Timeline

The generational succession of investment decision-makers at endowments, pension funds, and sovereign wealth funds is as consequential for PE capital raising as the generational succession of HR buyers is for EAP vendors. The Millennial and Gen X CIOs now ascending to capital allocation authority bring materially different evaluation criteria than their predecessors.

Duration tolerance, governance transparency, impact measurement, and community accountability are moving from nice-to-have to threshold criteria for a growing segment of the LP universe. PE firms that have built their LP relationships around the previous generation of evaluators — and their evaluation criteria — are building toward a contract renewal problem at institutional scale.

### Strategic Imperative 4: Ask the Conversion Option Question

The conversion option question, as framed in the broader Fourth Turning corporate strategy work, is: what is the one thing your organization could become that would make it indispensable to the next era's most durable demand?

For PE firms, the answers worth taking seriously are not cosmetic. They involve genuine reorientation of the firm's competitive identity:

- The operational transformation specialist — a PE firm whose genuine competitive advantage is the ability to help companies navigate discontinuity, build adaptive capacity, and convert disruption into competitive advantage. This is a real capability that the next era will urgently need and that very few PE firms can genuinely claim.
- The domestic industrial rebuilder — a PE firm that has positioned itself ahead of the reshoring and domestic manufacturing investment wave, with the operational capability and sector expertise to build genuine manufacturing competitive advantage. The Fourth Turning's geopolitical disruption is creating demand for this capability at scale.
- The workforce transition investor — a PE firm that has built genuine expertise in businesses that help organizations navigate AI-driven workforce transformation. This is a structural demand tailwind that will outlast the current PE cycle.
- The long-duration value builder — a PE firm that has explicitly restructured its fund model around longer hold periods, lower leverage, and genuine operational value creation, positioned to attract the LP capital that is moving away from the classic LBO model.

#### The Antifragile Portfolio Company

Nassim Taleb's concept of antifragility — things that gain from disorder rather than merely surviving it — is the operative standard for Fourth Turning portfolio management. An antifragile portfolio company is not merely resilient to disruption. It has built the adaptive capacity, the organizational slack, the community embeddedness, and the workforce depth to convert the disruption into competitive advantage that its more optimized competitors cannot replicate. PE firms that can identify and build antifragile companies will generate the returns that the next era rewards.

## Section 5: Action Checklist

### Immediate (90 Days)

- Conduct the portfolio fragility audit across all active holdings. Prioritize by debt service coverage ratio and supply chain concentration.
- Map LP succession timelines across your top 20 LP relationships. Identify which are controlled by decision-makers who will transition within the next fund cycle.
- Separate genuine operational capability from institutional arbitrage in your return attribution. Be honest about which returns survive a structural shift in the institutional environment.
- Brief your investment committee on the five crisis scenarios and their differential impact on your specific portfolio. The goal is not consensus on the prediction — it is shared understanding of the range of plausible futures.

### Near-Term (6 to 18 Months)

- Develop a genuine operational value creation capability narrative — one that is honest about where the firm adds operational value and where it does not. This narrative will be the primary LP retention tool when financial engineering returns compress.
- Engage proactively on governance and tax reform rather than waiting for regulatory reconstruction to force it. The firms that shape the new regulatory framework will fare better than those that resist it until it arrives.
- Identify one or two conversion option candidates — fund or portfolio strategies that position the firm for the next era's most durable demand — and begin building the capability or portfolio thesis now, before the disruption makes it obvious.
- Build or deepen relationships with the successor generation of LP decision-makers at your most important capital sources. The relationship that is built before the allocation decision is made is worth ten times the relationship built during the fundraise.

### Strategic Horizon (2 to 5 Years)

- Restructure at least one fund offering around a longer-duration, lower-leverage, higher-governance model designed for the LP capital that is moving away from the classic LBO structure.
- Make a specific, visible, genuine commitment to organizational slack restoration in the portfolio companies most exposed to Fourth Turning disruption scenarios.
- Develop government-sector and public-private partnership capabilities that activate in the disruption scenarios where commercial returns are most compressed.
- Build the outcomes measurement and impact reporting infrastructure that the next generation of LP evaluators will require — and that will distinguish the firms that are genuinely converting from those that are performing conversion.

## Conclusion: The Kings of the Hill Problem

Chesterton's "Cheat the Prophet" passage from *The Napoleon of Notting Hill* ends with an observation directly applicable to the current position of private equity: the players listen very carefully and respectfully to all that the clever men have to say about what is to happen in the next generation. They then wait until all the clever men are dead and bury them nicely. They then go and do something else. The PE industry has produced extraordinarily clever men with extraordinarily precise models of how the Unraveling era continues. The human race, with its characteristic cheerful indifference, is preparing to go do something else.

The Fourth Turning framework does not suffer from this problem in the way that a specific market prediction does. It does not predict that PE returns will decline in Q3 2026 or that carried interest reform will pass in the next Congress. It predicts that the institutional configuration that made PE dominant — the specific combination of cheap debt, regulatory arbitrage, cultural legitimacy of financial engineering, and stable geopolitical order — is at the end of its eighty-year cycle. That prediction is structural, not tactical.

The firms that read this analysis and make a volatility adjustment — reduce leverage by 10%, extend duration by a year, add a governance slide to the LP deck — have not responded to the structural challenge. They have made a tactical adjustment to a strategic problem. They are, in Chesterton's terms, the clever men producing one more careful prediction before the human race buries them and goes and does something else.

The firms that take the analysis seriously will ask a different question: not how to optimize the current model for a more volatile environment, but what their genuine competitive advantages are and what those advantages could be converted to serve in an era whose demands are fundamentally different from the one that built the industry.

Private equity has genuine competitive advantages that are not artifacts of the Unraveling era: the ability to identify underperforming assets, recruit and deploy management talent, think across industry structures, move capital with speed and conviction, and build complex institutional relationships. These capabilities do not disappear in a Fourth Turning. What disappears is the specific institutional configuration that channeled those capabilities into the LBO model.

The PE firm that can answer the conversion option question honestly — what could we become that would make us indispensable to the next era — is not a victim of the Fourth Turning. It is a beneficiary of it. The disruption that destroys the optimized will create the opportunity for the convertible.

### THE BOTTOM LINE

Private equity is the most precisely optimized institution of the Unraveling era. That optimization is its greatest vulnerability in the Fourth Turning. The firms that recognize this early enough to ask the conversion option question — and to answer it honestly — will be the category winners when the next High arrives. The firms that treat the current disruption as elevated volatility rather than structural discontinuity will not.

## About the Author

James McPherson is a strategy and operations practitioner, educator, speaker, and coach. He holds a B.A. in Classics with honors from Johns Hopkins University, studied leadership under pressure in Homer’s Iliad as a Fulbright Scholar at the University of Lausanne, Switzerland, and completed his M.B.A. at Duke University with a concentration in Strategy & Decision Science. He is the founder of The McPherson Group, which advises leaders, institutions, and communities on navigating large-scale disruption with clarity and purpose.

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