INSIGHTS

JANUARY 2024



INVESTOR INTEREST

NEW EXPECTATIONS FROM A TRANSFORMING ASSET CLASS

EXECUTIVE SUMMARY

Asset managers are almost always at the mercy of investor priorities, which remain persistently unpredictable against a volatile macro-economic backdrop. Opinions are mixed about prospects of a recession in 2024, the timeline for interest rate stabilisation, and the overall deals landscape as a result. This report aims to provide a snapshot of investor priorities as we enter a new year.

The first section sets the scene – exploring the most concerning conditions for investors and gauging their risk appetite going forward. What are the three biggest trends to watch for in 2024? They might all have to do with a greater need for distributions among LPs.

Section two of this report drills down into the asset classes, investment strategies and innovations that are resonating most with LPs. No surprises that debt is in the spotlight, as are distressed assets. But how does private equity compare with other, more liquid strategies such as hedge funds in investors' eyes? Feelings are mixed here.

Looking ahead, we quizzed LPs about their attitudes towards business fundamentals that will make up the future – including artificial intelligence (AI), diversity, equity & inclusion (DE&I), and ESG performance. The clear majority of investors now pay attention to AI and ESG, as they make up core pillars of a future-ready business. Few, however, are paying attention to DE&I factors – something to explore further in coming months.

A new year does often bring a bounce, and the fact that GPs are sitting on record levels of dry powder bodes well – provided investor sentiment relaxes in the first quarter. Most will agree on the fact that something has to give this year in the private markets space – we'll keep you informed on all the ups and downs through the course of 2024.

AFTAB BOSE
HEAD OF PRIVATE MARKETS CONTENT

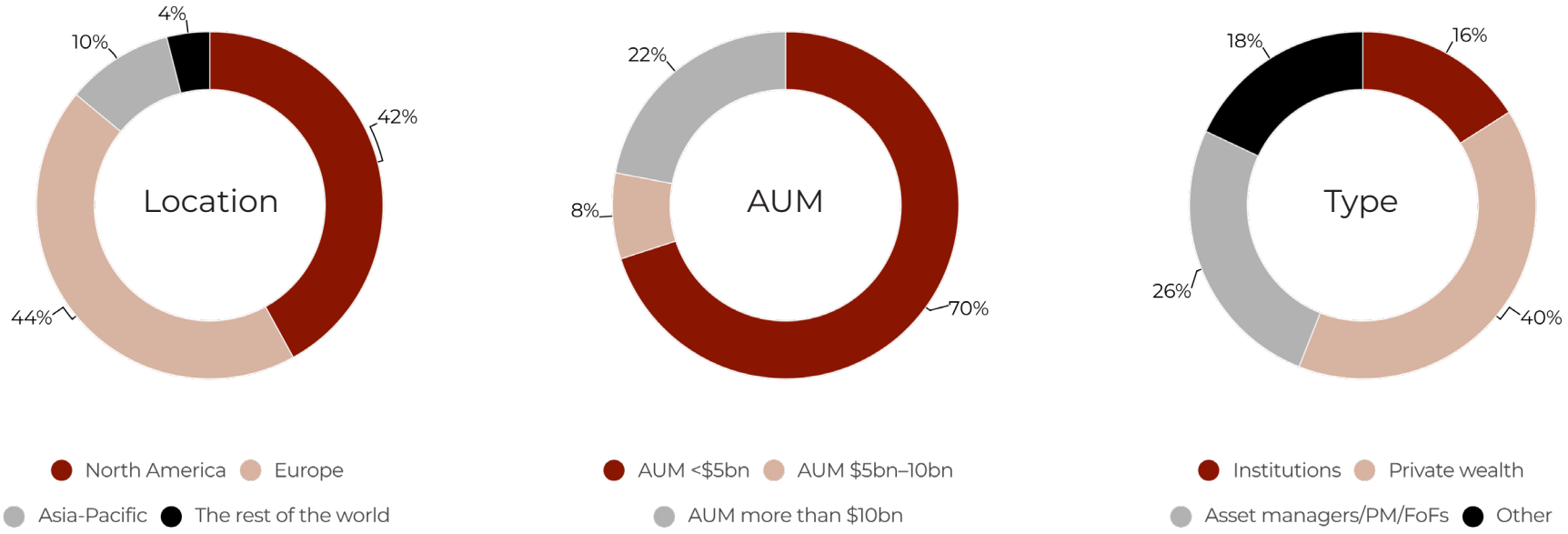
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ALLOCATION FOCUS

Breakdown of respondents to Private Equity Wire's 2024 Investor Survey by firm location, AUM, and type



METHODOLOGY

Analysis in this report is based on a Q4 2023 Private Equity Wire survey that gathered responses from C-suite, director-level and management professionals at over 50 LP organisations – including family offices and private wealth managers, public and private pension funds, insurance companies, and others. Commentary was gathered from industry professionals through qualitative interviews, while supplementary insight was gathered from a range of news and research sources, including Bloomberg, Financial Times, Reuters and others.

KEY FINDINGS

1

Recession on top

It's no surprise that the top three macro-economic concerns for investors have remained constant throughout 2023 – in June the list read interest rate hikes, recession and inflation, while Q4 saw a recession take the top spot. The inverted yield curve is among many indicators that a recession might be on the cards in 2024, though few expect it'll be a deep recession – the economy has proved more resilient than expected in recent years.

2

Safety first

While there are hints of optimism in investor sentiment – 20% of investors believe their organisation's risk appetite will increase in H1 2024, compared to H2 2023 – the majority (61%) expect their organisation's risk appetite to remain unchanged over the same period. The remaining 18% signal a nervy start to 2024 – reporting their business' risk appetite will shrink in the early part of the year.

3

Signs of the times

The safe haven of credit is drawing the biggest increase in allocations (50% of investors plan an increase in the next 12 months), while half of all investors plan to maintain their allocations in PE. Within PE strategies, the biggest focus is on distressed assets (48%), as investors look to capitalise on the economic pressures on portfolio companies. Equally reflective of market conditions is a strong focus on secondaries (45%), while buyouts (20%) don't even make the top three.

4

Future indicators in focus

Nearly two-thirds (62%) of investors ask their fund managers – current and prospective – about their approach to AI and ESG respectively, as most realise the value both factors bring in terms of competitive advantage and future-readiness. Indeed, 31% of allocators themselves use AI for various functions in their business, while another 36% are currently exploring the benefits. DE&I lags behind considerably as a priority.

WINDS OF CHANGE

Understanding investor attitudes towards a transforming private markets landscape.

Another year has rolled by without the much-anticipated, post-pandemic recession, though the prevailing sentiment in the investor community is that one might be around the corner.

Private Equity Wire surveyed LPs exposed to a range of alternative strategies twice this year – in Q2 and Q4 respectively. Having ranked second in June (cited by 73%) – behind only rising interest rates (77%) – recession has now taken the top spot with 78%, followed by interest rates (68%) and inflation (65%) (see Figure 1.1).

A range of factors are conflating. Susanne Forsingdal, Head of Americas Private Equity at Allianz Capital Partners says: "For one, there is geopolitical instability, which we might see more of going into 2024. Then there are economic indicators such as the output gap, where productivity hasn't quite met the levels of demand.

"Commercial real estate is another difficult area – the number of firms that are still grappling with challenges is quite high. And lastly, the inverted yield curve that we've had since mid-2022. All of these are strong indicators that we might be on our way into a recession."

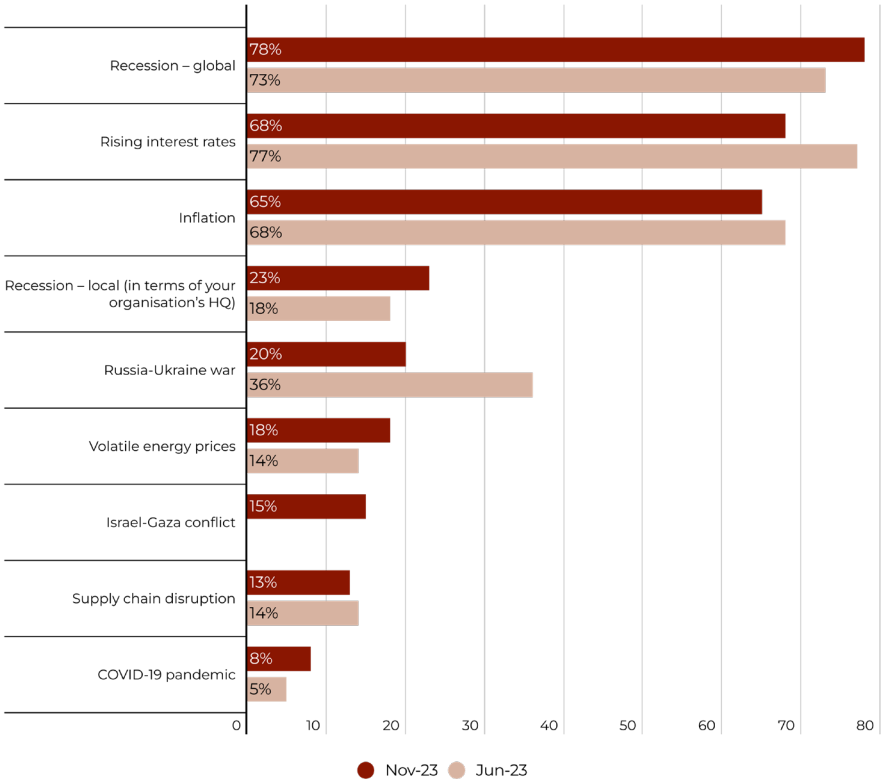
Still, analysts remain divided on the recession question, and Forsingdal suggests that despite these telling signs, the global economy has proven generally resilient in recent years. If a recession is on the cards, she feels it's unlikely to be a deep one.

STEADFAST STRATEGY

PE has been especially resilient, despite coming under siege this year. No doubt, some of the world's largest managers have had to revise their fundraising targets downwards in 2023 – only those with strong track records, operational stability and well-established relationships have bucked the trend. Leverage-reliant buyouts have been the hardest hit in many cases, while the safe haven of credit and opportunistic secondaries strategies have been in favour. Blackstone CEO Steve Schwartzman was among many



Figure 1.1 Alternative allocators' top macroeconomic concerns



Analyst note: *Survey respondents were asked in November 2023, In terms of the way your firm positions its portfolio, what are your three biggest macroeconomic concerns? (Please select three only). June 2023 data taken from the Private Equity Wire-Hedgeweek Mid-year 2023 Investor Survey*

Source: Private Equity Wire-Hedgeweek 2024 Investor Survey

leaders to laud the favourable conditions for credit this year, and many of the world's largest have made significant forays into the asset class this year. Still, those that have successfully raised buyout funds have done so emphatically. No better example here than CVC, which raised the biggest buyout fund in history in 2023 – at $29bn, closing in July, signalling the strategy is still a popular choice for many investors.

Managers have found a way to sustain performance, too. Forsingdal says: "We've seen valuations continue to go up through Covid and after – GPs have been more creative in the way they work with companies to improve their performance. Leverage ratios have helped – during the Global Financial Crisis, leverage at some large managers went up to 70%, whereas this time around it hasn't climbed beyond 50%. More equity has offered protection from a potential crisis."

Among the more popular strategies being employed by managers with more stakes in value creation, Forsingdal says, are bolt-ons – investing in smaller businesses at lower multiples to generate value for a unified, platform company.

GAUGING APPETITE

Investors are aware of PE's resilience. Three-quarters (76%) of those surveyed by PEW in Q4 expressed confidence in the 12-month growth prospects of the PE industry, despite only 55% saying the same about the global economy and 51% about their local economy

KEY FINDINGS

Investors are cautiously optimistic as they enter 2024

Six out of 10 investors say their organisation's risk appetite remains unchanged



One out of five investors say their organisation's risk appetite with increase in H1 2024



INSIGHTS

(see Figure 1.2). When it comes to their own investment portfolios, growth confidence is nearly unwavering.

Confidence with caution is the overarching sentiment – 58% of investors surveyed confirmed an allocation to PE in Q3 2023, though 10% did also redeem funds from the strategy (see Figure 1.3). Asked about how their organisation's risk appetite will evolve going into 2024, the majority (60%) believe it will remain unchanged, while the rest are nearly split down the middle between those upping or moderating their risk appetite (see Figure 1.4).

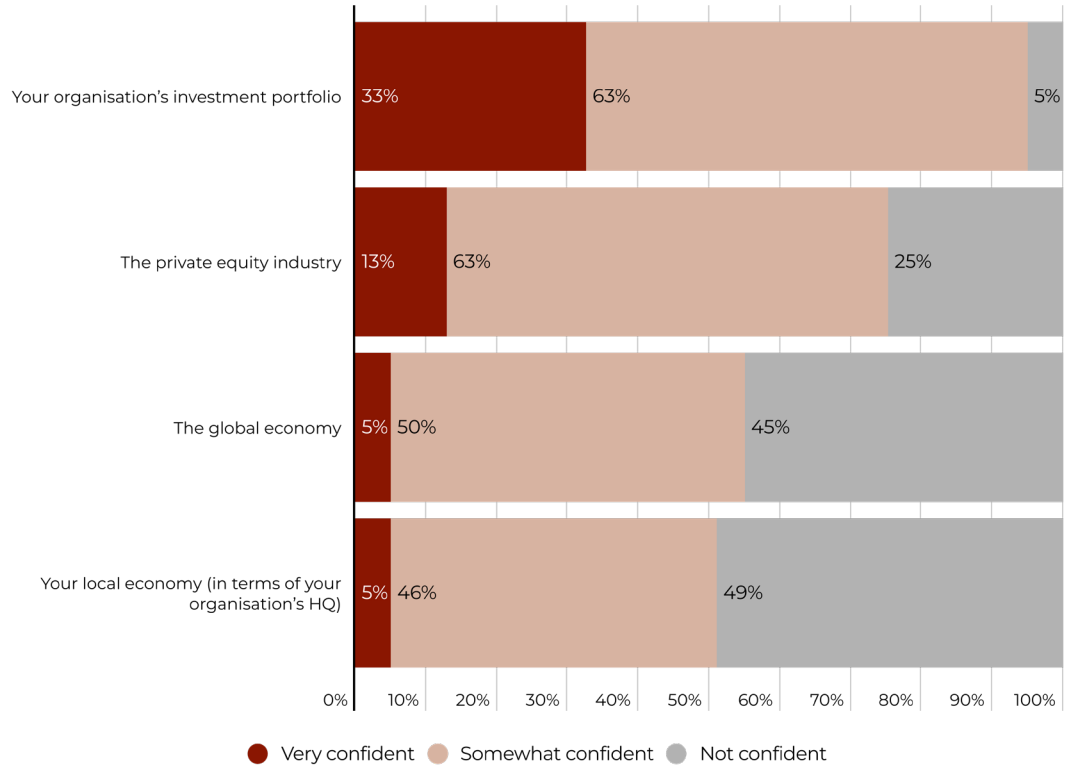
"I don't see this recovering fully soon," says Forsingdal. "Fundraising is taking longer. We were starting to see some bifurcation – with some funds able to raise new capital within expected timeframes. But we're also seeing many extending their periods and needing more time to close.

"The general picture is that many LPs are showing more restraint," she adds.

TRENDS TO WATCH

It's the time of year for predictions and forecasts, and PE's future as an industry in flux presents a true conundrum for commentators. Senior leaders at mega PE funds this year have declared the end of an era for PE, and large allocators worldwide have publicly initiated a shift to private credit.

Figure 1.2 Alternative allocators' confidence in the prospects of their portfolios, alternatives markets, and the global economy



Analyst note: *Survey respondents were asked in November 2023, How confident are you in the 12-month growth prospects of the following.*

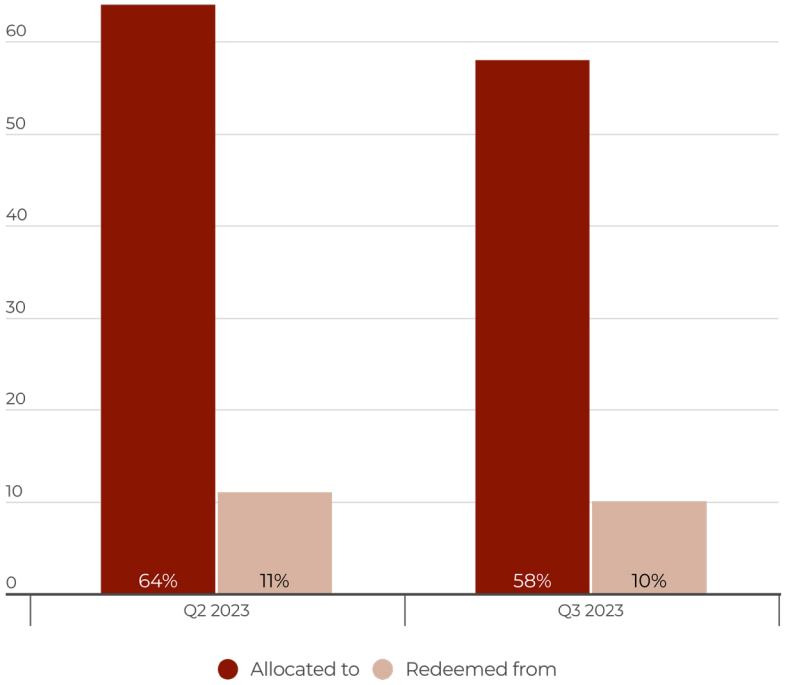
Source: Private Equity Wire-Hedgeweek 2024 Investor Survey

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The general picture is that many LPs are showing more restraint

Susanne Forsingdal
Head of Americas Private Equity, Allianz Capital Partners

Figure 1.3 Proportion of alternatives allocators surveyed allocated to or redeemed from private equity in Q3 and Q2 2023



Analyst note: *Survey respondents were asked in November 2023, During the previous calendar quarter, did your organisation allocate to or redeem from a private equity fund manager?*

Source: Private Equity Wire-Hedgeweek 2024 Investor Survey

Some have predicted consolidation as a result of the strain on PE, the most notable of these being Partners Group CEO, David Layton – who suggested the number of active PE players in the market could drop from 11,000 to 100 over the next decade, speaking to the Financial Times earlier this year. In a separate interview with Bloomberg TV, the firm's Chairman, Stefan Meister, predicted PE dealmaking would return to record levels in the next year or so.

The world's largest asset manager, BlackRock, released its 2024 Private Markets Outlook in December – highlighting infrastructure's resilience and energy transition potential and private debt's favourable juxtaposition with public financing as reasons for high performance in those two asset classes.

For PE, the firm observes a period of "adjusting to a new era", though there are factors to suggest deal activity will make a strong comeback. Among them: hints of better borrowing conditions, more carve-out activity, public market turbulence and a growing demand for returns and liquidity.
According to Forsingdal, one central trend will determine much of the activity in the PE space through 2024 – LPs' need for more distributions.

"Three factors will drive an increase in distributions. One is that banks will likely show more willingness again to lend to either strategic or larger PE buyers. Secondly, fundraising might pick up, which will give PE funds new pools of capital to invest.

Vintage success

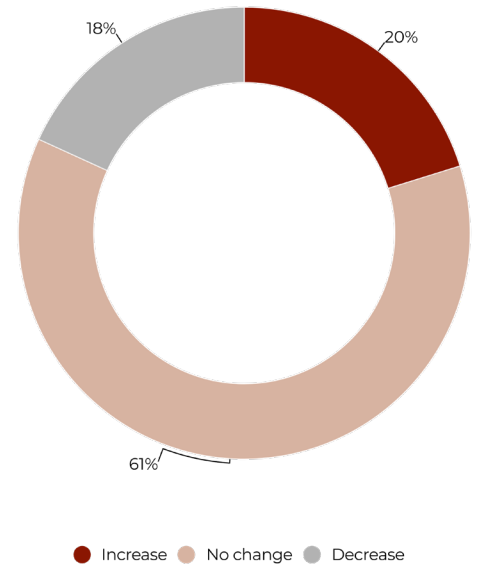
Crisis vintages do tend to perform better – the biggest example of this came in the post dot-com bubble era. Bloomberg's analysis of median fund IRRs since inception by PE vintage shows 2001 to be one of the best vintage years in the last two decades.

A similar spike came in 2009, while the zero-interest environment of the 2010s has brought about a steady incline since. In 2022, Cais juxtaposed vintage performance with the S&P's price-to-earnings index to show an inverse relationship between economic conditions and PE fund success.

Earlier this year, Vista's Founder and CEO, Robert Smith, spoke to Buyouts Insider about how his firm had held back from deployments amid the post-pandemic valuation peak, and is now looking to up its deal activity.

> 58% of investors surveyed confirmed an allocation to PE in Q3 2023, though 10% did also redeem funds from the strategy

Figure 1.4 Alternative allocators' risk appetite compared now to six months ago



Analyst note: *Survey respondents were asked in November 2023, How would you say your organisation's risk appetite will evolve going into H1 2024 compared to going into H2 2023?*

Source: Private Equity Wire-Hedgeweek 2024 Investor Survey

"And the third most prominent trend that I would be interested in tracking, one that has arisen out of the need for liquidity, is the rise of continuation funds. We'll find out in 2024 whether these were just relevant for this particular moment in time, or if we're going to see further evolution and innovation in the types of continuation funds that arise."

Commenting on the overall PE environment going forward, Patricia Miller Zollar, Managing Director of Neuberger Berman reiterated the need for resilience among sponsors. "It's important for managers to go deeper into specialisations they know best. Times of uncertainty often make for the best vintage years, and firms will not want to end up on the sidelines." ■

KEY TAKEAWAY

New and innovative vehicles that allow LPs to access more distributions could come in sharp focus, as foundations for a new-look PE landscape.



SCOPING STRATEGIES

How are LPs thinking about different private market strategies as we head into 2024?

After booming in the post-crisis era of zero rates and soaring valuations, an environment turbocharged by monetary and fiscal pandemic policies, the PE outlook has darkened.
The rapid increase in interest rates has hit valuations and deal-making hard, and liquidity-hungry LPs are exploring different options.

But it is not just in PE that the outlook confronting investors has been upended. The outlook in real estate, particularly commercial, has been hit by post-pandemic flexible working practices, while venture capital is firmly out of favour. The opposite is true for private credit, the one booming area of private markets, as lending to under-pressure companies creates opportunity.

Despite the wholesale change in the macro outlook, explored in section one, allocators remain heavily exposed to private market strategies, with 86% in PE and the same percentage in private debt/credit, compared to 52% in hedge funds (see Figure 2.1).

MAPPING ALTERNATIVES

Private credit/debt, which can serve as a hedge against rising interest rates, is the clear preferred asset class, with 50% of allocators planning to increase their investment. Just 5% plan a decrease, with the rest holding steady.

Infrastructure is the second most popular alternative asset class, with 30% planning an increase in the space, which will benefit from interest rates being higher as LPs seek a guaranteed long-term return.
Next was PE, with 20% planning an increase and 18% a decrease, followed by hedge funds

(16% and 7%, respectively). But if you strip out the investors not currently active in the respective strategies, sentiment on hedge is more positive than PE. For hedge funds, 26% of LPs are planning to increase their investment and just 11% to decrease.

Industry members say hedge funds are seen as more attractive for their active trading qualities and liquidity in an era where cash access, given its improved return potential and an unstable macroeconomic environment, is more important than ever.

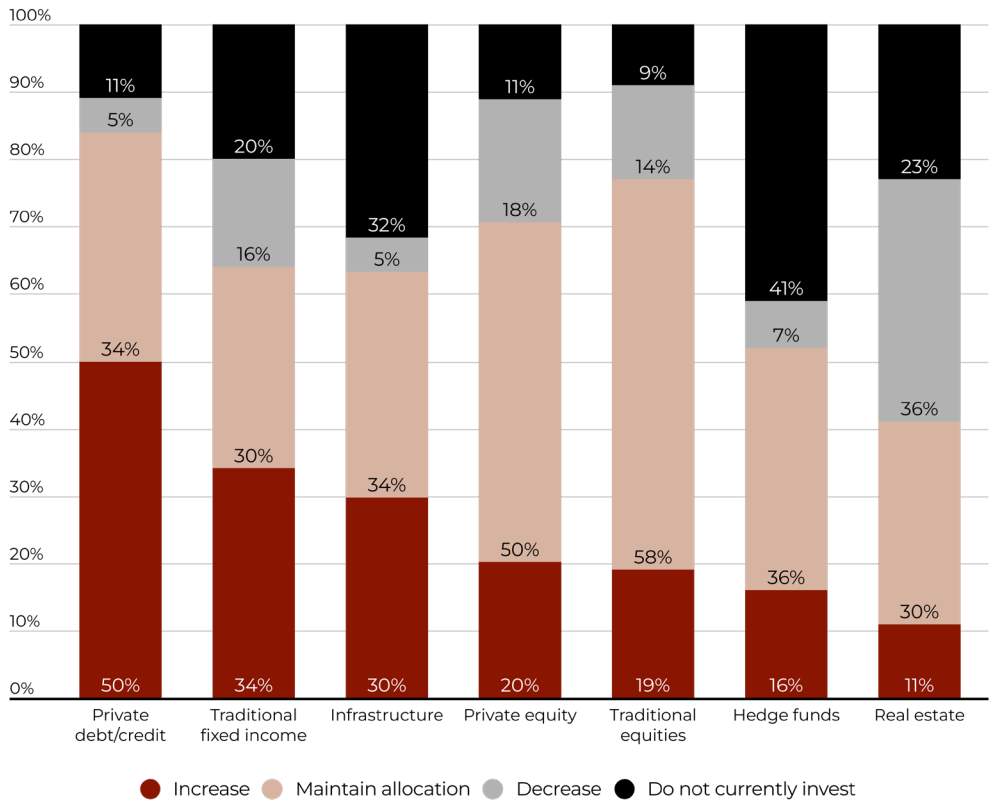
"After being out of favour, I think liquid strategies have become more attractive on a relative basis," said James Medeiros, President at Investcorp-Tages.

"I'm not saying liquid investments will take over but there will definitely be more of a balanced approach and some money will move out of privates. Private credit could be the exception, which is still seeing a lot of interest."

Strip out investors not currently invested, and 23% of PE investors plan an increase and a fifth a decrease, the latter being double the rate of hedge funds. Lagging all other alternative asset classes is real estate, with just 11% planning an increase and 36% a decrease.

Fourteen percent of real estate investors plan to increase exposure in a difficult post-pandemic market for office rents and the all-consuming backdrop of tightening rates. For traditional asset classes, 34% plan to increase equity exposure against 19% planning

Figure 2.1 Alternative allocators' plans by asset classes over the next 12 months



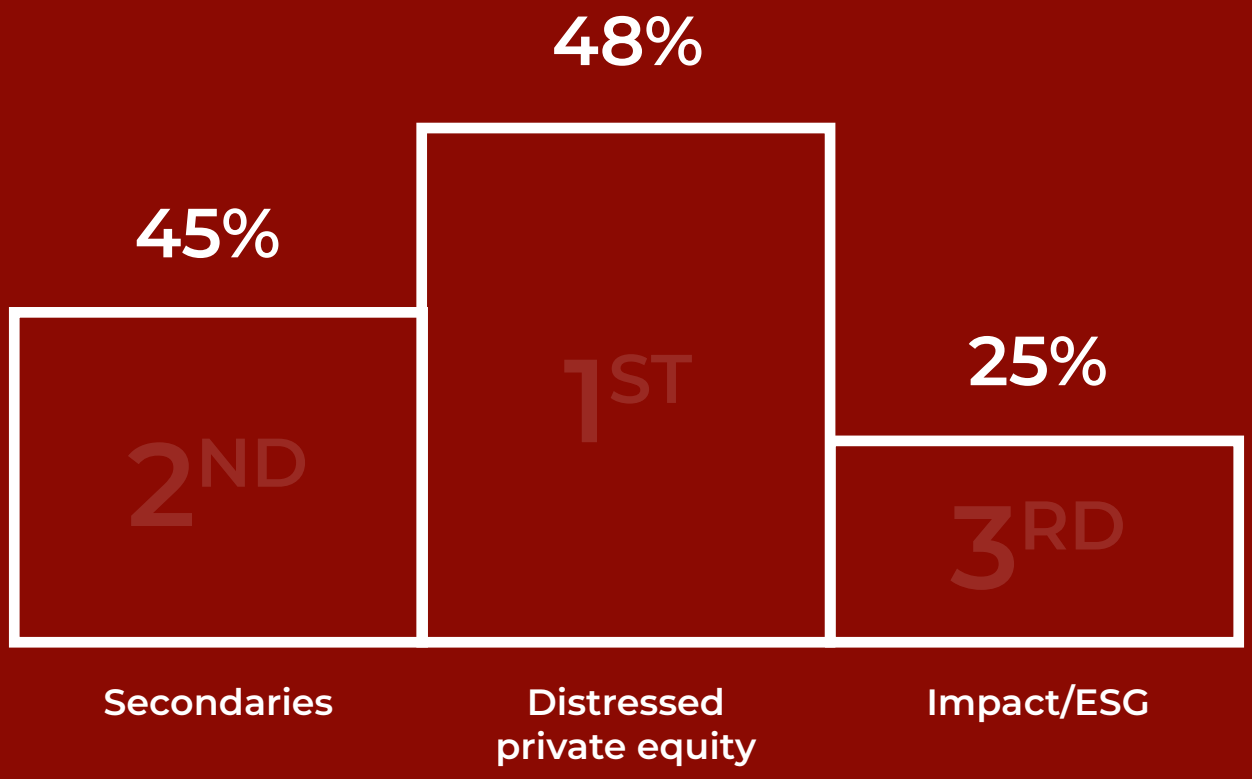
Analyst note: *Survey respondents were asked in November 2023, How do you expect to change your exposure to the following asset classes over the next 12 months?*

Source: Private Equity Wire-Hedgeweek 2024 Investor Survey

KEY FINDINGS

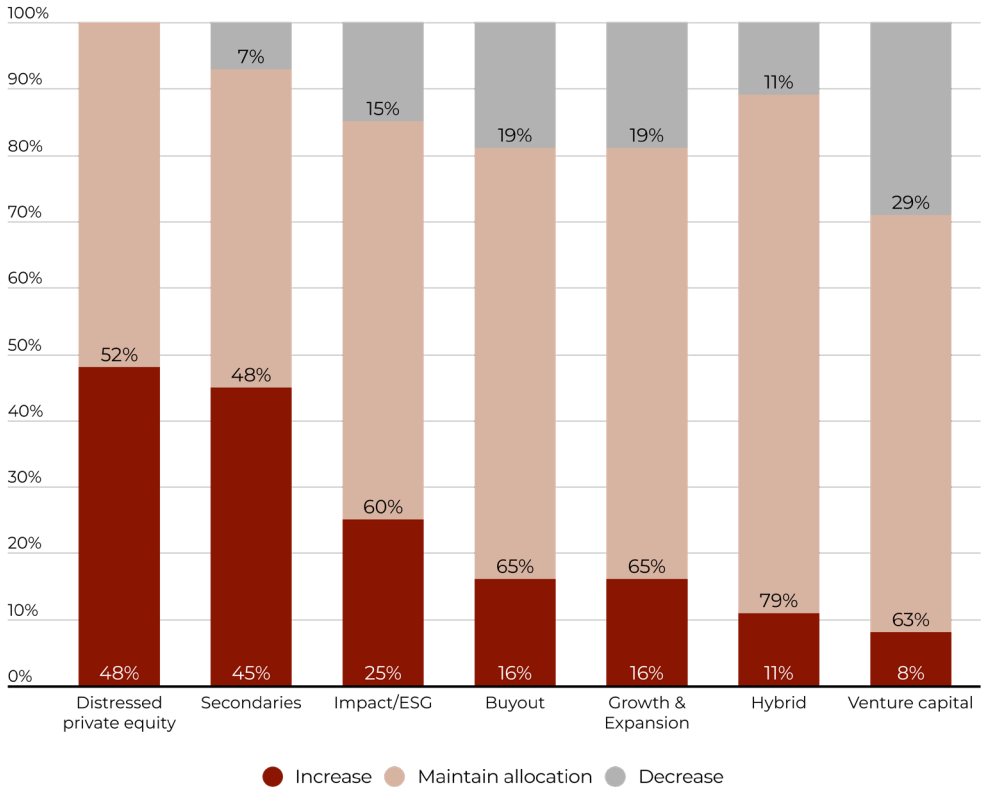
Buyout has fallen out of the focus private equity strategies

Private equity strategies that will see the biggest increase in allocations



INSIGHTS

Figure 2.2 Private equity investors' plans for their private equity allocations in 2024 – by private equity strategy



Analyst note: *Survey respondents were asked in November 2023, How do you expect to change your exposure to the following private equity strategies over the next 12 months?*

Source: Private Equity Wire-Hedgeweek 2024 Investor Survey

to decrease, with bonds offering attractive returns and stock markets volatile. Among current investors only, twice as many LPs plan to increase their fixed-income allocations as equity.

PRIVATE EQUITY

There are two clear preferences within PE: distressed PE and secondaries, with 48% and 45%, respectively, of respondents planning an increase (see Figure 2.2). Valuations within the space have slumped amid higher rates and the IPO exit route is far reduced this year.

That has all led to an increase in distressed PE transactions and better opportunities in this area, as well as a boom in the secondaries market as firms with multiple assets transact with PE peers in preference to more traditional exit routes. The PE findings suggest diversification is a key theme, with active investors keen to allocate across non-traditional areas.

Just 16% plan an increase in traditional buyout-focused PE, with a higher proportion (19%) planning a decrease and the remainder maintaining their allocation. Slightly more plan a decrease in growth & expansion (19%) than increase (16%).

But there was a significant gulf when it comes to venture capital, which benefited massively in the low-rate environment, which led to a boom in valuations and has declined markedly since the end of the easy-money environment. Less than a tenth of respondents (8%) plan

“

After being out of favour, I think liquid strategies have become more attractive on a relative basis

James Medeiros
President, Investcorp-Tages

to increase compared to 29% which plan a decrease.

PRIVATE CREDIT

If PE appetite has become more muted, the opposite has happened in private debt/credit. Interest in this area of alternatives is highest in distressed (44%) and direct lending (41%), followed by special situations and infrastructure debt (both 38%).

The fact that each of those four private credit segments are all expected to see an increased allocation from more than a third of LPs suggests the flows into private credit will not cease soon.

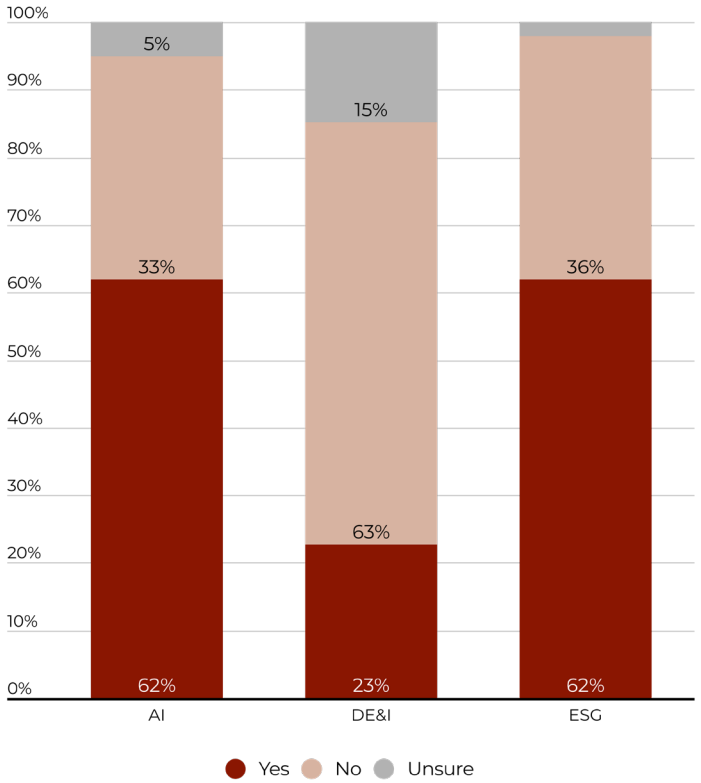
Michael Weinberg, a special advisor to the Tokyo University of Science Endowment who also serves as Adjunct Professor of Finance and Economics at Columbia Business School, is more positive on private markets strategies.

"Any future flows into alternatives are likely to be driven by private wealth, rather than institutional investors. Though even that will likely be to private markets, rather than to more complex and tax inefficient hedge fund strategies."

FUTURE FIT

LPs were asked whether they quiz fund managers about the latter's progress in the diverse and increasingly crucial spheres of AI, DE&I and ESG.

Figure 2.3 Proportion of alternative allocators that ask fund managers about AI, DE&I and ESG



Analyst note: *Survey respondents were asked in November 2023, Do you ask fund managers – whether current or prospective – about their approach to: ESG, DE&I, and AI?*

Source: Private Equity Wire-Hedgeweek 2024 Investor Survey

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More LPs are interested in asking GPs about their use of AI and ESG when compared to DE&I

Room for improvement

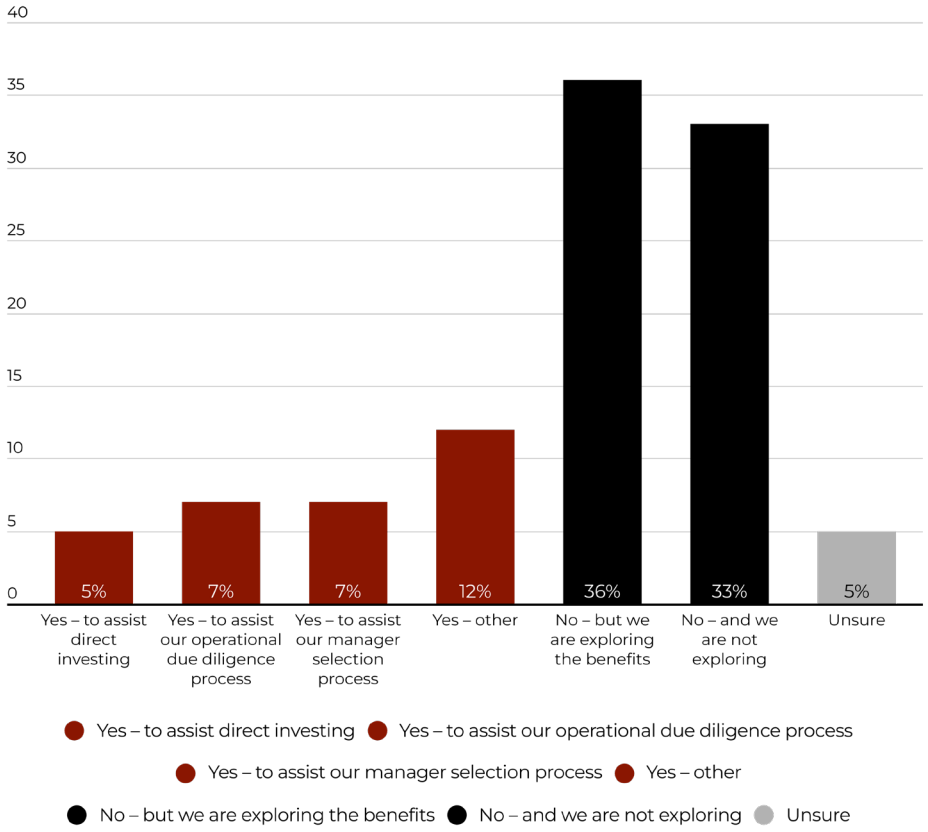
LPs are disappointed with the level of AI progress at the GP level, found the SS&C Intralinks 2024 LP survey of over 250 LPs, published in October in association with Private Equity Wire.

This is despite the fact that senior leaders in the PE space have been lauding the potential of AI for the financial world at public forums throughout the year – including but not limited to: Blackstone CEO, Steve Schwartzman at IPEM Paris and Silver Lake co-CEO, Greg Mondre at a Berlin conference.

But progress seemingly lacks behind expectation – LPs are more satisfied with GPs’ data security and governance measures; frequency of information flow; reporting tech capabilities and the overall digital experience than they were with AI proficiency.

Asked where they see the biggest potential for AI, a tenth of LPs said its ability to “scrape” pdfs for information was front and centre, though there are undoubtedly more opportunities to come in the future.

Figure 2.4 Proportion of alternative allocators that use AI to help run their investment portfolios



Analyst note: *Survey respondents were asked in November 2023, Does your organisation use AI/machine learning technology to run its investment portfolio? Please select all that apply*

Source: Private Equity Wire-Hedgeweek 2024 Investor Survey

More LPs are interested in asking GPs about their use of AI and ESG when compared to DE&I (see Figure 2.3). The former have become key sources of competitive advantage and future-readiness. Most (67%) allocators themselves are either already using AI or are exploring its benefits to help run their investment portfolios (see Figure 2.4).

As for ESG, it's inevitable that businesses need to pay attention. "The underlying trends that ESG is seeking to capture, however imperfectly under the acronym of E, S, and G, will continue to be important, and investors ignore them at their own risk," says Courtney Birnbaum of Corbin Capital Partners in New York.

"There is no doubt, for example, that climate change is having an impact on insurance or that wildfires are a real risk for utility companies." ■

KEY TAKEAWAY

Aside from the higher-risk distressed landscape, the secondaries space is set to be the hotspot of PE activity in 2024 – investors are taking a keen interest.

PRIVATE EQUITY WIRE

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