INSIGHTS

DECEMBER 2022



INVESTOR INTEREST

PRIVATE EQUITY'S FUNDRAISING SQUEEZE

EXECUTIVE SUMMARY

It's a striking contradiction: the largest investors in private equity funds have never been more positive on investing in the asset class, yet at the same time, never more constrained in being able to do so. Institutional investors in particular have faced two mounting challenges to their private equity allocations this year, both the result of greater uncertainty in the public markets. First, the imbalance between public and private market valuations has left many pension funds overweight to private equity in relative terms. Second, with fewer IPO exits possible, some managers have been less able to return cash to their investors, making those same investors more worried about putting money back into the asset class.

The result, for managers, has been a scramble to lock down these investors' allocations for next year, while at the same time strategically pushing into new fundraising markets – whether that be oil-rich sovereign wealth funds or private wealth investors. Some are much further ahead on this than others.

But while investors generally remain positive on private equity managers with strong track records and differentiated fund strategies, these new investor groups have additional requirements – from evergreen fund structures with more up-to-date valuation marks, to strong governance and co-investment rights. Larger managers with multiple fund offerings and the ability to market these funds effectively will win the race. The losers, ultimately, will be newer managers that fail to adapt before the macroeconomic outlook shifts again.

COLIN LEOPOLD
HEAD OF RESEARCH & INSIGHT

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METHODOLOGY

Approximately 50 investors and LPs were surveyed by Private Equity Wire during November 2022 for their views on asset allocation and investment plans over the next 12 months. They included a mix of institutional investors, asset managers and private wealth investors.

KEY FINDINGS

1

The 2023 race has already begun

At least half of all allocators surveyed by Private Equity Wire plan to increase their exposure to private equity over the next 12 months – making it the most popular asset class in the survey. However, in the short-term, institutional investors are being squeezed by the denominator effect and lower distributions. Allocations for next year are being locked down quickly by fund managers, making 2023 likely to be an even tighter market for new fund launches.

2

Crisis-hardened US managers in focus

Uneasy global investors are favouring US-based funds over European managers, as the Ukraine war continues, but the strategies and sectors they want exposure to have changed little since the pandemic. In our survey, buyout, venture and secondaries remain popular for almost all investor types. Among institutional investors, 50% want to increase their exposure to sustainability and impact funds – more than any other strategy. LPs also want to see a track-record of performance through previous crises.

3

Chosen few are tapping Middle East

Larger private equity managers such as Blackstone and BlackRock have been playing the relationship game in Abu Dhabi and Dubai to tap growing private equity allocations from oil-rich sovereign wealth funds, which are now less restricted by the denominator effect. The supersized fund commitments that follow can also come with stringent fee and co-investment requirements, however, and favour sectors such as infrastructure and healthcare.

4

Managers try to make private wealth sticky

A marketing push over the past two years has allowed some more established fund managers to raise up to 40% of total capital in recent periods from private wealth. This fundraising opportunity has been described as a “big white space” and will become increasingly competitive as allocations from these investors grow. The next challenge for managers will be educating and diversifying this customer base to limit the risk of fund redemptions during periods of crisis or instability.

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FUNDRAISING 2023: THE BIG SQUEEZE

Private equity remains the most popular asset class for investors in our survey but – facing pressure from the denominator effect and lower distributions – their fund commitments next year will be hotly contested

The long-term outlook among private equity investors may be positive but, in the short-term, fund commitments are slowing, reducing or going to a smaller group of managers.

Most institutional LPs have been crippled by the denominator effect and many are worried about lower distributions from their GPs. According to research and interviews conducted by Private Equity Wire, both trends are likely to carry into 2023, warping the fundraising environment for most of the year ahead.

Global private equity fundraising is currently the slowest in more than 20 years, according to data from Preqin in November. While almost all fund closures this year are still hitting target, they are taking longer to do so on average – 25% longer than pre-pandemic in fact. The amount of capital flowing into funds has also dwindled as this year has progressed: 2022 is set to be the first year on record where the total raised by closed funds has fallen in every quarter.

Brand name managers including Blackstone, Carlyle, KKR and Apollo reported record inflows up to Q2 this year, but the mood music among many of their large institutional LPs was already starting to change as public market volatility forced many to look at the relative value of their private market portfolio. Other factors are weighing down on these LPs too. Europe-based GPs have been facing more difficulty fundraising, as the implications of the Ukraine war have scared many investors from outside the region.

“When we’re talking to groups about how they want to implement a global portfolio, we are seeing enhanced appetite for more US-heavy portfolios with Europe becoming an increasing concern,”

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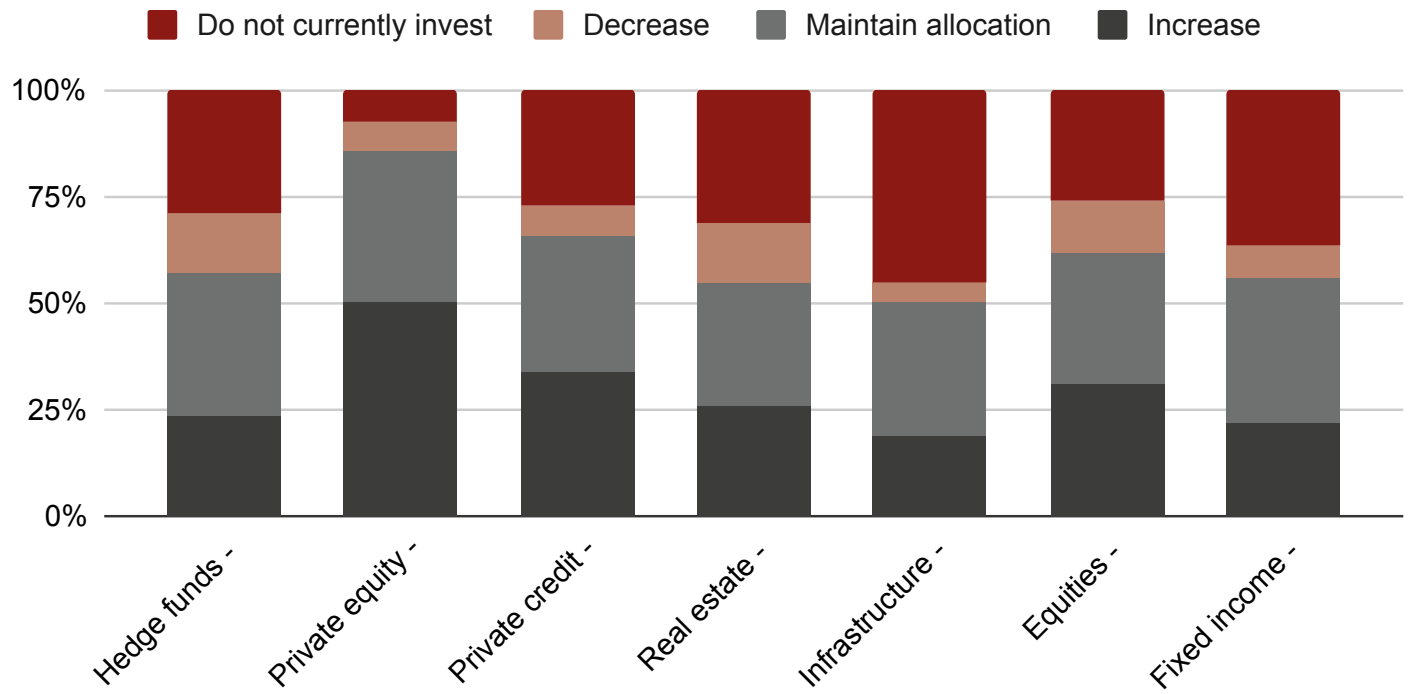
says Anna Morrison, senior director, private markets at Bfinance. European fund closes slowed notably in the second half of the year. Aside from Nordic Capital – which in October closed Europe's largest this year at €9bn – the region's 15 largest fund closes all took place before the summer and all, bar one, were below €3bn in size. Furthermore, only one of the 15 was a first-time fund – proving that LPs are pivoting to existing manager relationships or GPs that can show a track-record of investing through previous crises. At the end of October, Nordic Capital's managing partner Kristoffer Melinder told Financial News that LPs are over-allocated, under-resourced and "definitely going for lower risk in what they're doing".

Globally, funds which haven't reached final close in the second half of this year will now almost certainly stretch into next year, to capture fresh LP allocations budgeted for 2023. A placement agent who declined to named said in September that every one of the funds of their books will remain open for fundraising the first quarter of 2023.

"There will be a land rush in the first quarter of next year," says Clay Deniger, CEO of Capstone Partners. "The lesson learned is you've got to lock down commitments in the first half, and increasingly the first quarter, so it will be extremely competitive in Q1. If you're at a standing start on January 1, you're probably in trouble."

At least half of every investor type surveyed by Private Equity Wire in November plans to increase their exposure to private equity over the next 12 months – making it the most popular asset class in the survey – but

Figure 1.1 Survey asked allocators 'How do you expect to change your exposure to the following asset classes over the next 12 months?'



Private Equity Wire Investor Interest survey, November 2022

“There will be a land rush in the first quarter of next year. If you’re at a standing start on January 1, you’re probably in trouble.”

Clay Deniger, CEO, Capstone Partners

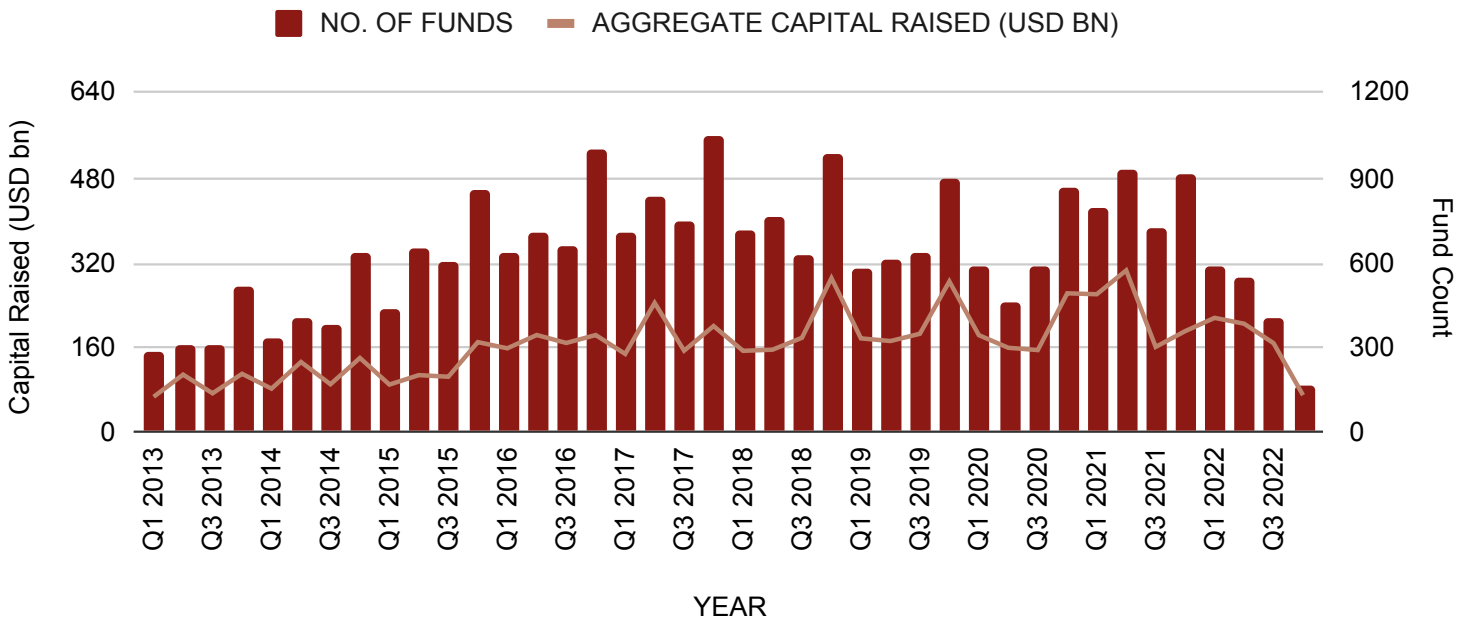
their commitments will be hoovered up quickly and may not stretch far into 2023.

Investment consultants and placement agents are keen to point out that fund commitments have slowed rather than stopped and have not slowed for every fund manager. “The re-ups have been coming but the re-ups have often been smaller and more delayed,” says Andrew Bentley, partner at Campbell Lutyens in London. “New commitments have been much more challenging and generalist buyout funds have never been more at risk.”

New fund launches early in 2023 may face pressure too. “Funds that are looking to fundraise without a particularly strong track record in this market will find it difficult,” says Leigh Webb, head of private equity sponsor coverage at finnCap Cavendish, “so this sort of slight market downturn will flush out some of those that have had mediocre performance over the last three to five years, and they will struggle to raise funds again. Those who have delivered good returns for their investors will continue to attract backers in the market.”

Although the number of GPs actively fundraising has fallen from the peaks of the pandemic, there is still an oversupply of managers chasing capital. The best mid-market managers fundraising this year are still “slicing through the market”, says Bentley, but he believes that 2024 will be just as tough for everyone else if the denominator effect drags on. “Once the [public market] bottoms out and distributions kick up again, things will correct but is it a nine-month problem or a two to three-year one? LPs are happy to be in the asset class, but they have to ration their capital. Nothing’s broken, it’s just a squeeze

Figure 1.2 Private equity fundraising across all strategies since 2013, by quarter



Source: Preqin

and probably a protracted squeeze".

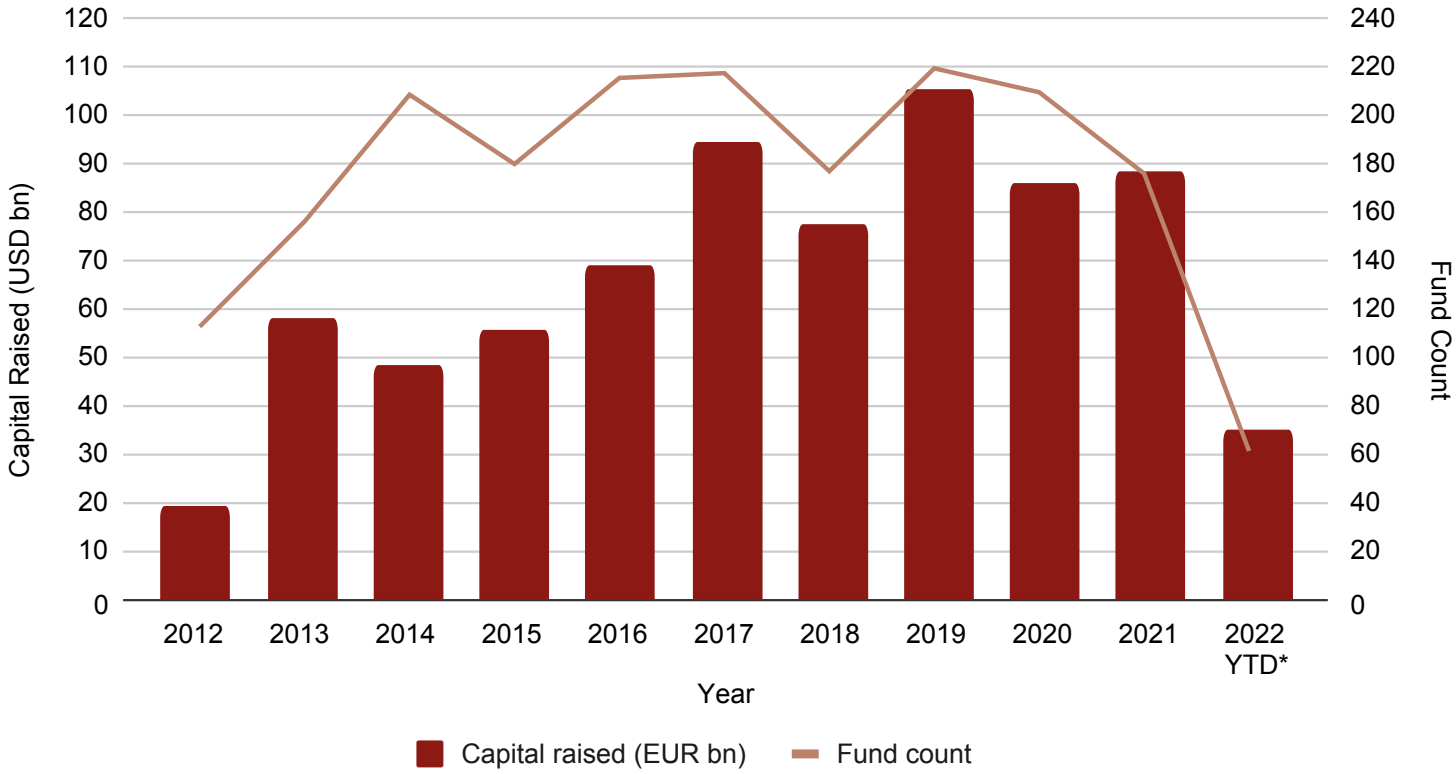
Although private equity tends to experience increased investor interest in a recession, allocators are nervous about 2023. Eight out of ten surveyed by Private Equity Wire in November believe the health of the global economy will not have improved in 12 months' time. The majority (56%) believe it will be worse, with asset managers the most pessimistic and institutional investors the most optimistic. Rising interest rates are the chief concern.

Investors are also watching distributions and have been reluctant to commit capital to GPs with large amounts of dry powder on their books. A measure of LP liquidity by placement agent Rede Partners fell to its lowest on record in November, indicating that LPs on average expect to reduce commitments to new funds over the next 12 months. More than eight out of 10 LPs surveyed by Rede see lower capital distributions over the next year as the main reason for them dialing back.

A person close to US-based Ridgemont Equity Partners, which announced closing its fourth flagship fund in October, said their strong Distribution to Paid-In Capital (DPI) track-record had been a key selling point to investors during the fundraising. Others involved in fund closes this year claim that distributions are becoming a more frequent talking point among LPs.

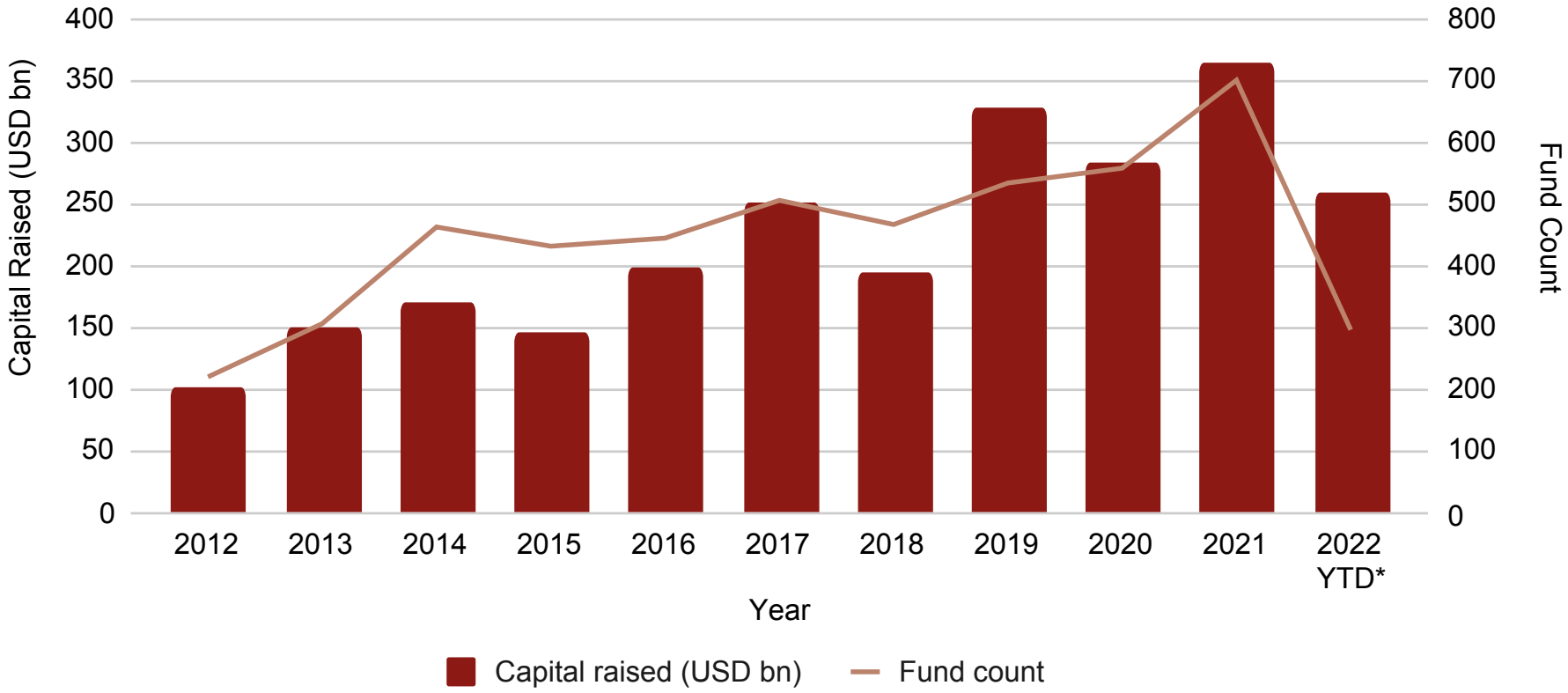
"Four years ago, I can't remember answering a questionnaire about DPIs," says Laura Hill, partner and head of investor relations in North America for Corsair Capital. "The current macro environment has provided a forum for LPs to be extremely vocal about

Figure 1.3 European private equity fundraising since 2012, annual



Source: PitchBook
*Analyst note: as of Sept 30, 2022**

Figure 1.4 US private equity fundraising since 2012, annual



Source: PitchBook
*Analyst note: as of Sept 30, 2022**

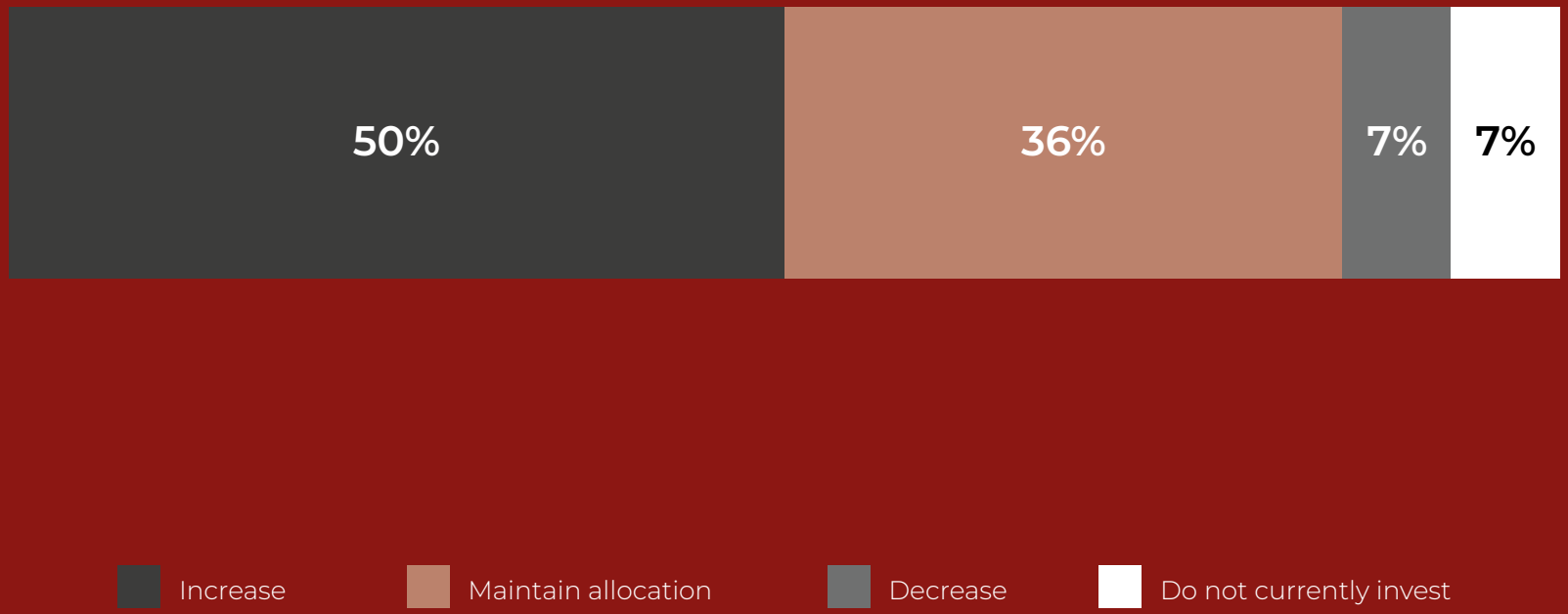
> The current macro environment has provided a forum for LPs to be extremely vocal about liquidity

Laura Hill, partner, Corsair Capital

KEY FINDING

Private equity is the most popular asset class for investors

86% of investors surveyed plan to increase or maintain their exposure to private equity during 2023



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liquidity. Yes, PE is illiquid, but every GP knows that they need to be exiting a certain number of deals per year and returning capital with the hope that some of that comes back to them (in new fundraising)."

Not surprisingly, new and faraway pools of LP liquidity are growing in significance, particularly for larger managers with the reach to tap them. North American managers including Apollo and KKR have said they are increasingly targeting investors from outside the US (see chapter 3) and a wider push into private wealth is also evident among others (see chapter 4).

It is worth noting that listed private equity houses can be more exposed to a weaker fundraising environment as their share price is typically a reflection of the fees they can earn from growing assets under management. The Financial Times reported in November that slower fundraising at Carlyle has led to a 2% decline in AUM in Q3. Carlyle's share price has fallen by almost 50% since the start of the year.

What can be done? More generally, GPs have been turning to the secondary market to preserve or return LP money, for example through continuation funds, strip sales or fund financing. Doing so can provide liquidity to their LPs allowing them to more easily commit to new funds.

According to Bentley, GPs may find also they will have to be even more flexible on their offering to LPs in 2023, for example by twinning co-investment or secondary opportunities with primary raises. Anecdotally, fees seem to have remained relatively static with only some reductions "around the edges", he says. This could shift through 2023. In Private Equity Wire's survey, fees were ranked as the top priority for institutional investors and the second highest priority for allocators in general, behind ESG.

"We think that soon, or at least eventually, the private equity market is going to become more competitive on fees; particularly when the weight of new capital is coming from DC rather than DB pension funds," says Stephen O'Neill, head of private markets at UK-based National Employment Savings Trust (Nest). It is estimated that around two-thirds of DC schemes in the UK do not currently invest in illiquid assets, while the remaining third invest less than 7 per cent. As such new investor groups are targeted by fundraising managers, further concessions may need to be made.

KEY TAKEAWAY

GPs – Fundraising deadlines have been extended into next year meaning launches in 2023 will be competing for a limited pool of capital



LIQUIDITY FEARS FAIL TO DAMPEN PENSION FUND APPETITE

Healthcare and technology have not gone out of fashion for institutional investors, but these investors are looking to a small number of managers to deploy their capital, and ones that are crisis-hardened too

At a board meeting in September held by the largest pension fund in the US, Nicole Musicco – the CIO of CalPERS – described the period between 2009 and 2018 when CalPERS was under-allocated to private equity as a "lost decade", costing it an estimated $11 billion to $18 billion in returns.

CalPERS currently allocates 12% to private equity and must commit at least $15 billion annually to reach its target. Like many other pension funds and institutional investors around the world, it is now reluctant to pull back.

At the SuperReturn North America conference in New York in October, other US pension funds discussed how they wanted to stay committed to the asset class in a volatile market, despite being stretched past their current allocation targets by the denominator effect.

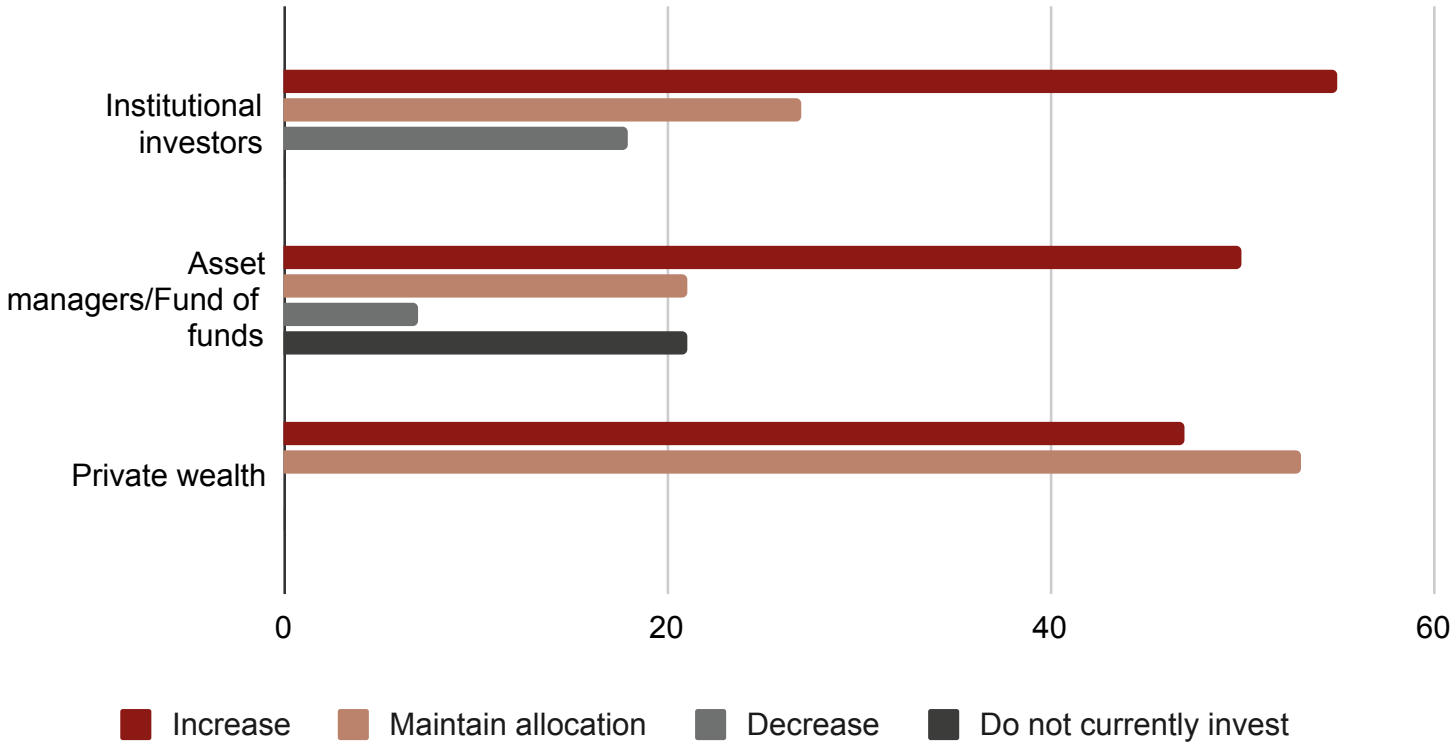
The solution for each appears to be quite different. While CalPERS has sold around $6bn worth of private equity fund stakes this year to free up capital for new commitments, Oregon Investment Council and others have been advised to lift their target range for the asset class to accommodate the current mismatch in public and private valuations.

In the UK, the recent LDI crisis has placed a spotlight on liquidity among pension funds there too. The FT reported in November that pension funds will have a reduced appetite for more illiquid holdings and some may look to sell their stakes in buyout funds. "The issue with private assets is that, in times of stress, they can't be mobilised," said Vincent Mortier, chief investment officer at European asset manager Amundi. "There will be some new thinking about liquidity management in order to avoid being trapped and having to sell things in a desperate way."

In Private Equity Wire's investor interest survey, liquidity ranked below both fees and ESG as a priority for asset managers and institutional investors in 2023 – the same as private wealth investors. According to Stephen O'Neill at Nest, most pension schemes keep ample liquid assets. "The far bigger challenge is that our overall risk exposure becomes imbalanced by the sticky valuations in private assets," he says.

While the current situation could send

Figure 2.1 How do you expect to change your exposure to private equity over next 12 months?'



Source: Private Equity Wire investor interest survey, November 2022

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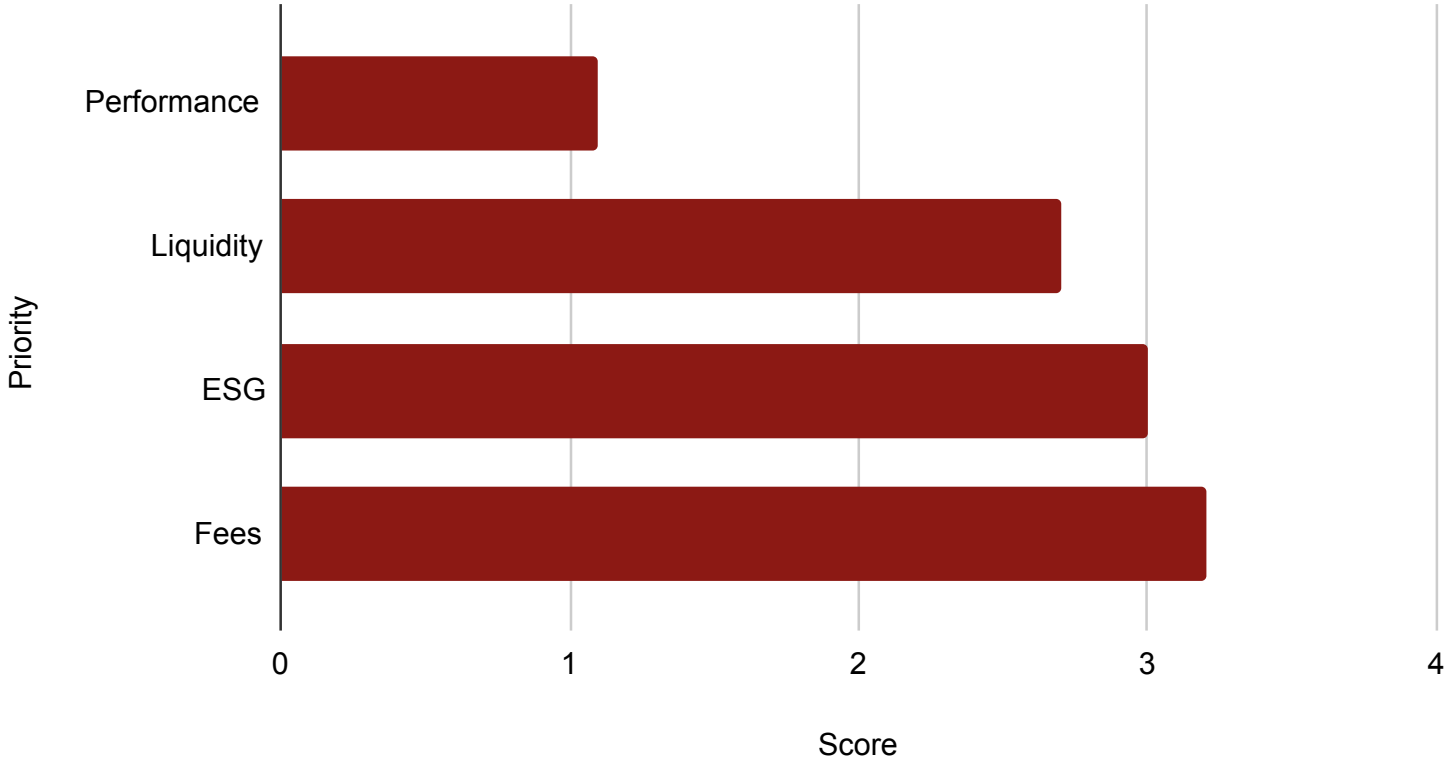
a significant amount of investor capital into equities that have fallen in value, O'Neill says Nest is unlike many others in that it is still in the ramp-up phase for private equity and is therefore "still committing more capital to bring [it] up to our strategic target weight". There are other examples of pension funds ramping up too. Laura Hill at Corsair Capital makes reference to a US corporate pension scheme with excess capital that will double the number of fund managers they are using next year, from five to 10.

For such LPs there is an opportunity to commit to high-profile managers that may have previously been out-of-reach. "Where maybe some LPs are now pulling back a little bit in terms of their allocations, this presents an opportunity for investors with capital to deploy like us to take advantage of this situation and potentially obtain greater access to more capacity constrained strategies," says Christian Dobson, portfolio manager at Border to Coast Pensions Partnership.

For institutional LPs above their target weight on private equity, GP relationships are being consolidated (see Chapter 1), yet the strategies and sectors they want exposure to have changed little since the pandemic.

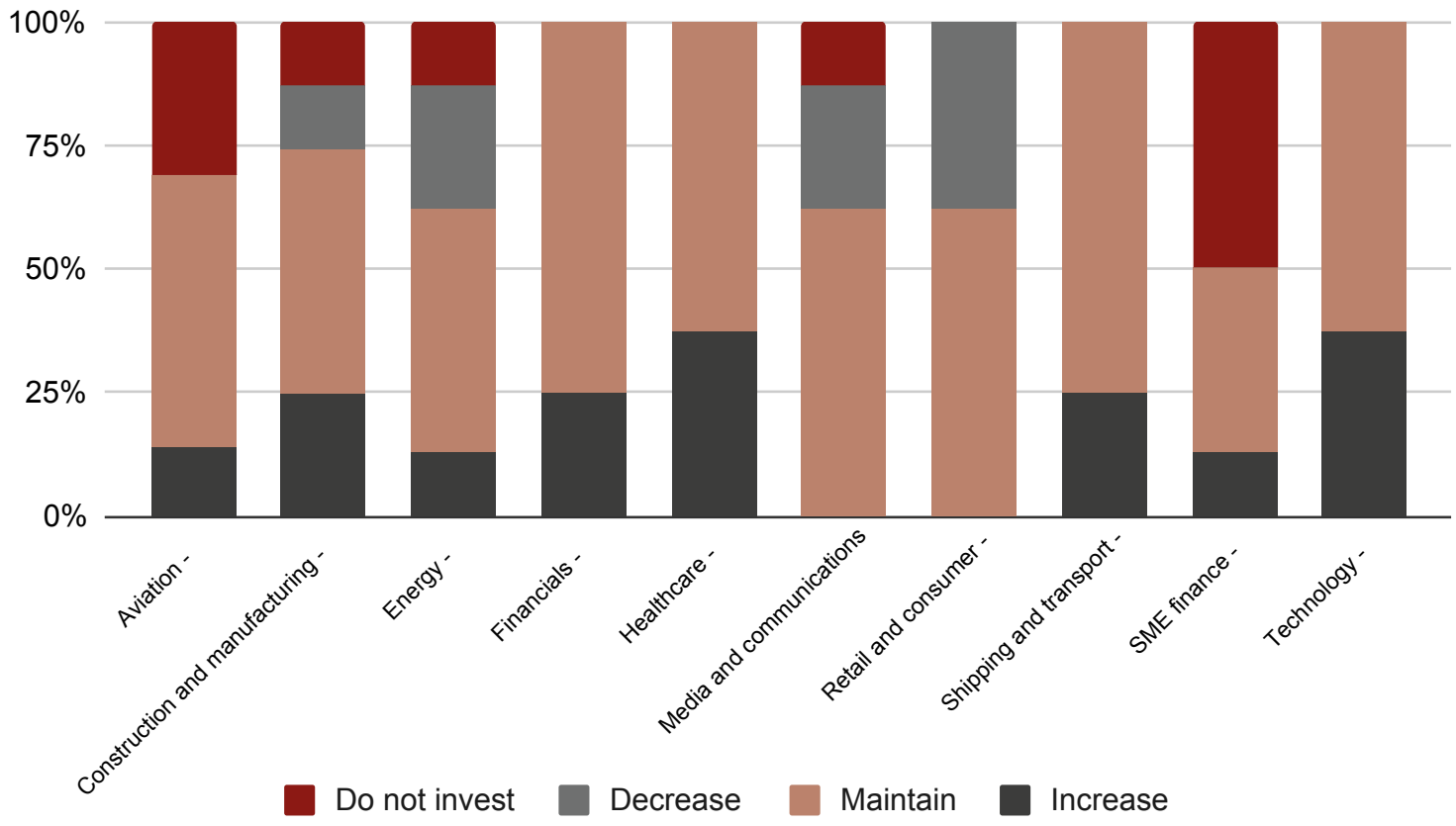
In the Private Equity Wire survey, buyout, venture and secondaries remain popular for almost all investor types but among institutional investors, 50% want to increase

Figure 2.2 Survey asked institutional investors 'How do you rank the following in order of priority?'



Source: Private Equity Wire investor interest survey, November 2022

Figure 2.3 Survey asked institutional investors 'How do you expect to change your exposure over the next 12 months?'



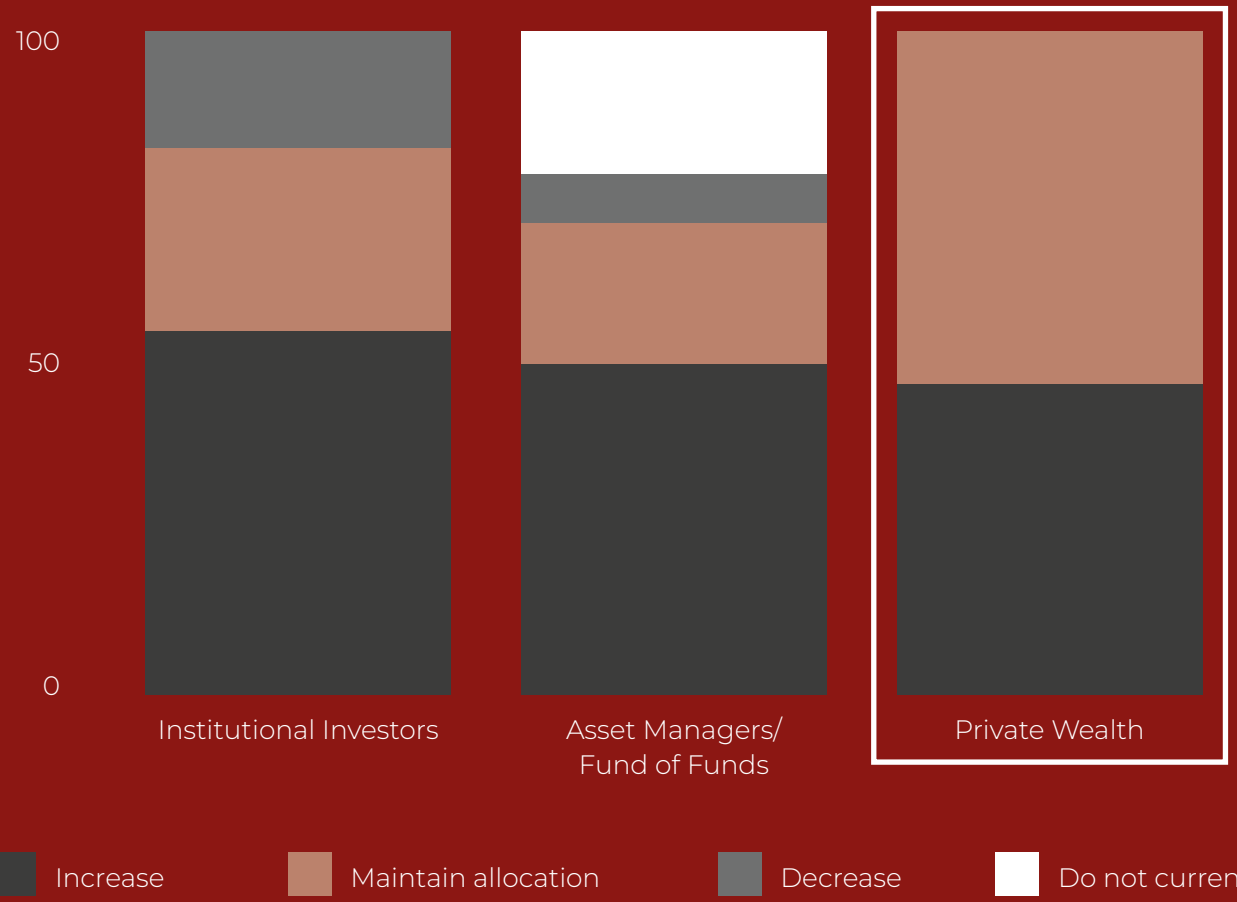
Source: Private Equity Wire investor interest survey, November 2022

> Where maybe some LPs are now pulling back in terms of their allocations, this presents an opportunity for investors with capital to obtain greater access to more capacity-constrained strategies

Christian Dobson, portfolio manager,
Border to Coast Pensions Partnership

KEY FINDING

The only investor group not decreasing exposure to the asset class next year is private wealth



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their exposure to sustainability and impact funds – more than any other strategy. This trend has been building among investors long before the pandemic but is more pronounced in a tighter fundraising environment. It is also likely to favour the impact funds launched or established by the larger, brand name managers over the past two years (see Private Equity Wire's February's Insight Report 'Creating Values').

Across all strategies, LPs are also showing more attention to managers that can demonstrate a track-record of performance through previous downturns.

"We are always conscious in building that diversified portfolio for partner pension funds," says Dobson. "We look for managers that have performed consistently through economic cycles and who we believe offer repeatable, executable strategies, rather than those dependent on a specific market environment and who present greater volatility of returns."

A recent investor survey by Montana Capital found that investors broadly have turned to resilient industries such as healthcare and business services, and investment strategies expected to be less impacted in a downturn, such as mid-market buyouts and secondaries. The survey found secondaries to be the number two long-term strategic preference of investors behind mid-market buyouts and ahead of growth capital, venture capital and private debt.

In terms of sector preference, healthcare and technology have not gone out of fashion for institutional investors in the Private Equity Wire survey, with financials and transport not far behind. The mid-market will be a favoured route here for LPs seeking to capitalise on lower valuations that may come in 2023. Around a third of LPs are planning to increase exposure to lower mid-market and mid-market buyouts over the next year, according to Rede's H2 Liquidity Index. It also found that 30% of LPs plan to increase deployment to healthcare-focused funds next year, and enthusiasm for sustainability and impact has overtaken technology.

Perhaps not surprisingly, retail/consumer and energy showed marked decreases in interest from institutions indicating a risk-off sentiment for 2023. In contrast, energy was the most popular sector for private wealth with 64% indicating an increased allocation and it being the second most popular sector for asset managers.



CHRISTIAN DOBSON, PORTFOLIO MANAGER, BORDER TO COAST PENSIONS PARTNERSHIP

This year has been as hectic as it has ever been from a fundraising perspective. However, public market declines and the subsequent denominator effect, and events such as the LDI crisis in the UK, may impact on some investors' ability to maintain private market commitment levels in 2023. A lot of managers have started to delay their fundraises and they're a little bit more focused on the existing portfolio and trying to find those final couple of opportunities before they have to raise again. There is going to be some caution from LPs around fund valuations as well. Trying to diligence funds at the moment is more challenging than it was at the start of this year because the full impact of public market declines has not yet come through into private equity funds.

KEY TAKEAWAY

LPs – Investors that are still ramping up their commitments to private equity now have an opportunity to access fund managers that might have been previously out-of-reach

TAPPING INVESTOR RESERVES IN ABU DHABI AND DUBAI

Sovereign wealth funds in the Middle East are flush with cash and less stretched than pension funds in Europe or the US. Their allocations are flowing to private equity, but they won't be captured by all



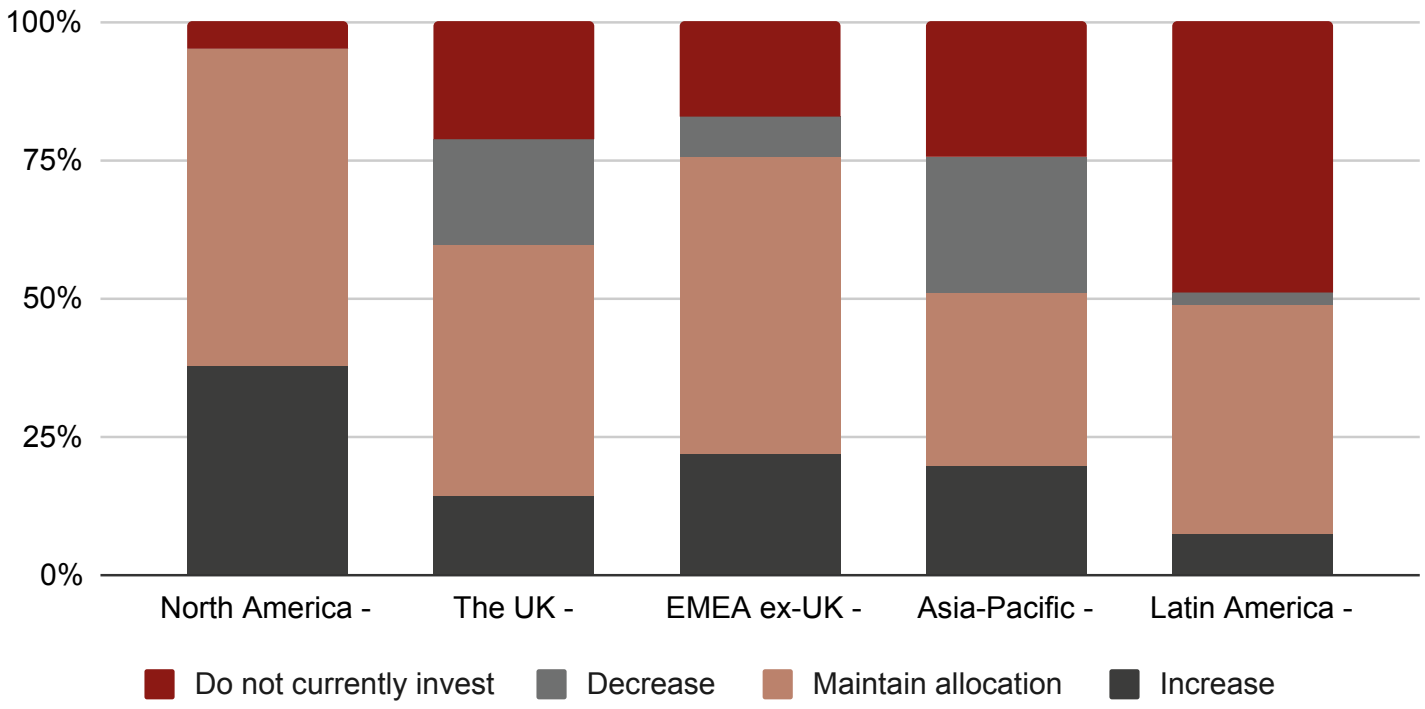
When rumours first emerged in early 2017 that Blackstone was raising $40bn for the world's largest infrastructure fund, many without knowledge of the plans balked at such an ambitious target.

Weeks later, opinions quickly changed when an anchor commitment of $20bn was revealed. It was to come from a Saudi sovereign wealth fund known as PIF, one of the largest wealth funds in the world.

"It was the deal that made people realise the financial firepower of these Middle East sovereign wealth funds," says an adviser to the fund.

In the five years since, private equity firms without any connection to SWFs in the region have been desperately trying to find one. And, in a higher oil price environment, these SWFs have even more financial firepower to commit, both as passive LPs

Figure 3.1 Survey asked allocators 'How do you expect to change your exposure by region over next 12 months?'



Source: Private Equity Wire investor interest survey, November 2022

and increasingly as co-investors.

Last month, Saudi's Public Investment Fund (PIF) was reported as one of the investors behind KKR and GIP's $15bn Vodafone towers acquisition and, separately, as an anchor investor in BlackRock's Middle East infrastructure strategy.

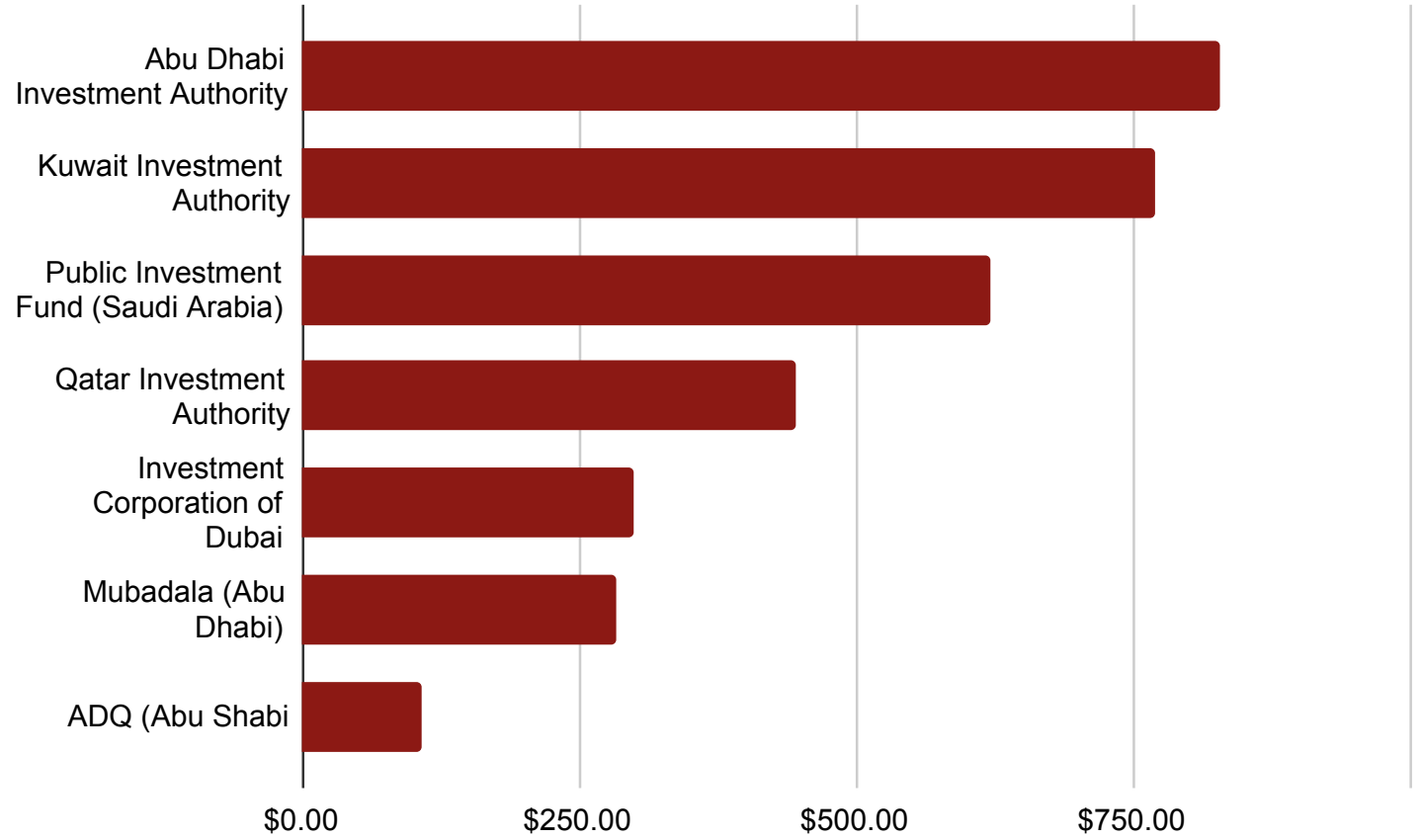
But while the commitments on offer can be jaw-dropping, those with experience of these SWFs say it can take years to build a relationship and their allocations can be so large that only a small number of GPs can accommodate them.

In total, there are 27 SWFs and 13 pension funds in the Middle East managing around $4.6trn in capital, close to the same level in Europe where almost twice as many institutional investors operate.

They have a reputation for secrecy and have historically played an outsize role in times of global economic uncertainty as during and after the Global Financial Crisis. But they are also modernising and growing fast. Assets held by Middle Eastern sovereign-wealth funds have appreciated by 20% so far this year, to about $3.75trn, according to Sovereign Wealth Fund Institute data. That increase follows the rising price of Brent crude, which has risen by about 23% this year to over $93 a barrel at the time of writing.

Reliable information on how much sovereign-wealth funds invest overall in

Figure 3.2 The largest Gulf wealth funds by AUM (USD bn)



Source: Global SWF

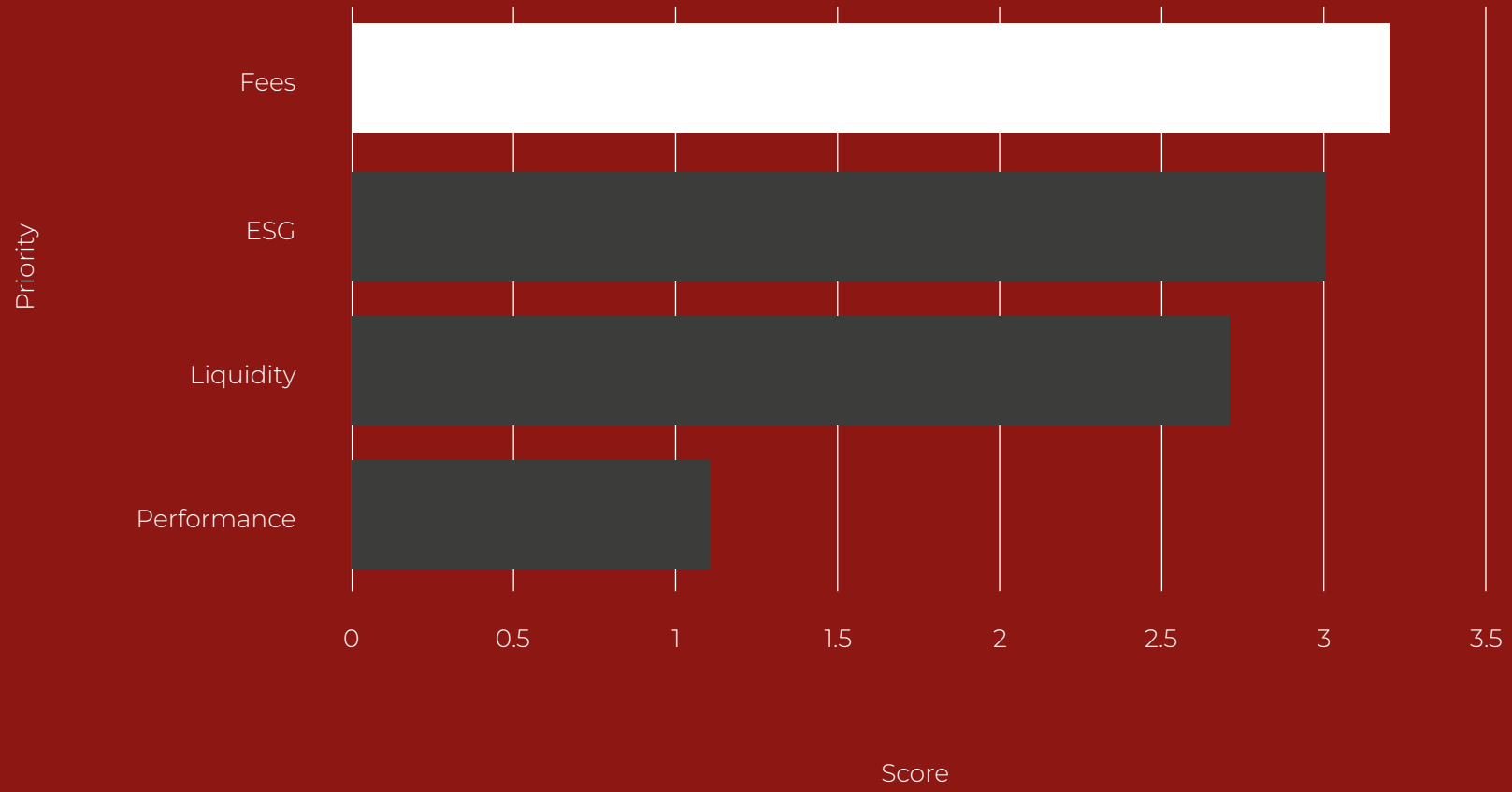
“There is a weighting to the US among Middle Eastern sovereign wealth funds. They tend to allocate on average around 30% to Europe, but 30% of a lot is still a lot”

Mike Preston, partner, Cleary Gottlieb

KEY FINDING

Fees are the top priority for institutional investors

An abundance of managers in fundraising mode is making some investors think about fees



INSIGHTS

private equity is difficult to find but according to a presentation on the Middle East by Preqin in November, their average allocation to alternatives doubled from 22% in 2021 to 44% in 2022. Even more noteworthy in the current fundraising environment is that these SWFs can be more flexible in the face of a denominator effect and often have fewer specific liabilities than large pension funds in the US or Europe.

As the examples above show, relationships between international private equity managers and Middle Eastern SWFs have traditionally hinged on infrastructure and real estate but between 2014 and 2019 there has been a steady shift away from real estate. In 2021, it was venture capital that dominated, as shown when Abu Dhabi's Mubadala Investment Co came in as a new investor in Klarna after its valuation plunged to $6.7 billion from $45.6 billion last year. For 2023, private equity is in the ascendency. Fifty per cent of SWFs in the Middle East plan to increase allocations to private equity, according to the Global Sovereign Asset Management Study 2022 conducted by Invesco in the first quarter of this year.

Of the 10 sovereign-wealth funds with the largest private-equity holdings, including both direct and fund investments, five are located in the Middle East, according to Sovereign Wealth Fund Institute data. The largest is Mubadala with about $97 billion in private equity assets, followed by the Kuwait Investment Authority with about $71 billion.

North America remains the most popular investment destination while Europe has declined in popularity due to the ongoing Russian-Ukraine conflict, according to Invesco's study. The trend reflects a wider preference among allocators going into 2023. In Private Equity Wire's Investor Interest survey, more investors plan to increase (35%) and maintain (60%) their allocation to North America than any other region.

This shouldn't dissuade European private equity managers from looking to the Middle East though, says Mike Preston, a partner at law firm Cleary Gottlieb who works with SWFs there. "There is a weighting to the US," he says. "SWFs tend to allocate on average around 30% to Europe but 30% of a lot is still a lot – it's not a small allocation."

In terms of sectors, infrastructure has been a mainstay for SWFs in the region but healthcare and medical technology are growing areas of interest, particularly as new mega cities and centres of excellence spring up. According to recent reports, Mubadala and PIF are investing heavily in artificial intelligence, biotechnologies and fintech.

The net zero ambitions of Norway's sovereign wealth fund – also built on vast oil reserves – provides a clue on future strategy too. The energy transition is becoming increasingly important to Middle Eastern SWFs as they try to "balance the other side of the equation", says the unnamed adviser.

Where they are investing indirectly, through private equity funds, typical commitments of between $100m and $300m require a manager with a fund of at least $1bn in size, but potentially much larger.

"There are two types of GPs that can raise from SWFs," said Dr Bhaskar Dasgupta, head of strategic development – MEA, Apex Group during the Preqin presentation: "Large funds where they have a relationship; and differentiated strategies that can meet specific SWF allocations [for a specific region or sector]. Smaller GPs will find it more difficult."

"Those (Middle East SWF) tickets take so much face time," says a fundraising source at a large US-based manager. "You can go there seven times and think you have a relationship. In one case it took two years to cultivate what we thought was a good relationship and we were told it will take another two years. So, you have to be really smart about how you spend your time, and very targeted."

According to Preqin data, 21% of LPs in the region expect a number of in-person meetings before committing capital while 66% expect a mix of in-person and virtual meetings. "There is a clear expectation that managers will need to build rapport to succeed in fundraising," said Preqin's analyst Alex Murray.

Setting up a local office can help – UAE's business capital Dubai has become a magnet for hedge funds while asset managers such as BlackRock and Franklin Templeton have opened offices in Saudi.

"It's not about timing the market, but 'time in' the market," said Laura Merlini, Managing Director, EMEA, for the CAIA Association on the Preqin webinar, later adding that smaller funds can also find a place if they "do their homework".

"SWFs can be quite diverse on their mission, mandate and regional restrictions," she added.

KEY TAKEAWAY

GPs – There are deep pools of liquidity among SWFs in the Middle East, but it can take years of relationship building and a large fund size to open the door to negotiations

GPS LOOK PAST ‘FAST MONEY’ IN PRIVATE WEALTH

Brand name managers have been expanding into private wealth to reach under-allocated investors. Now they are finding ways to ensure these investors stick with them for the long-term

With many institutional investors hung by the denominator effect, larger fund managers have been focusing on private wealth.

In its third quarter results, Blue Owl said it pulled in $3.6 billion from the investor segment between July and September – a 300% increase on the same period last year which pushes the proportion of retail capital raised at around 40% of their total. On their earnings call, the company described private wealth as “a very big white space”. A growing list of managers is about to draw all over it. Alongside Blackstone and Apollo, EQT and Partners Group are among those who are increasing their ambitions here. Currently about 8% of EQT’s client base is private wealth. Partners Group is targeting about a third, but says it is unlikely to go far above half of total capital committed.

“I expect [private wealth] allocations to increase irrespective of current short-term developments. By and large, we are nowhere in terms of allocations and I doubt that many of our underlying clients have similar problems like the institutions when it comes to the denominator effect,” says Christian Wicklein, global co-head, private wealth, Partners Group.

According to Private Equity Wire’s survey, private wealth was the only segment where all respondents intend to either maintain or increase their exposure to private equity.



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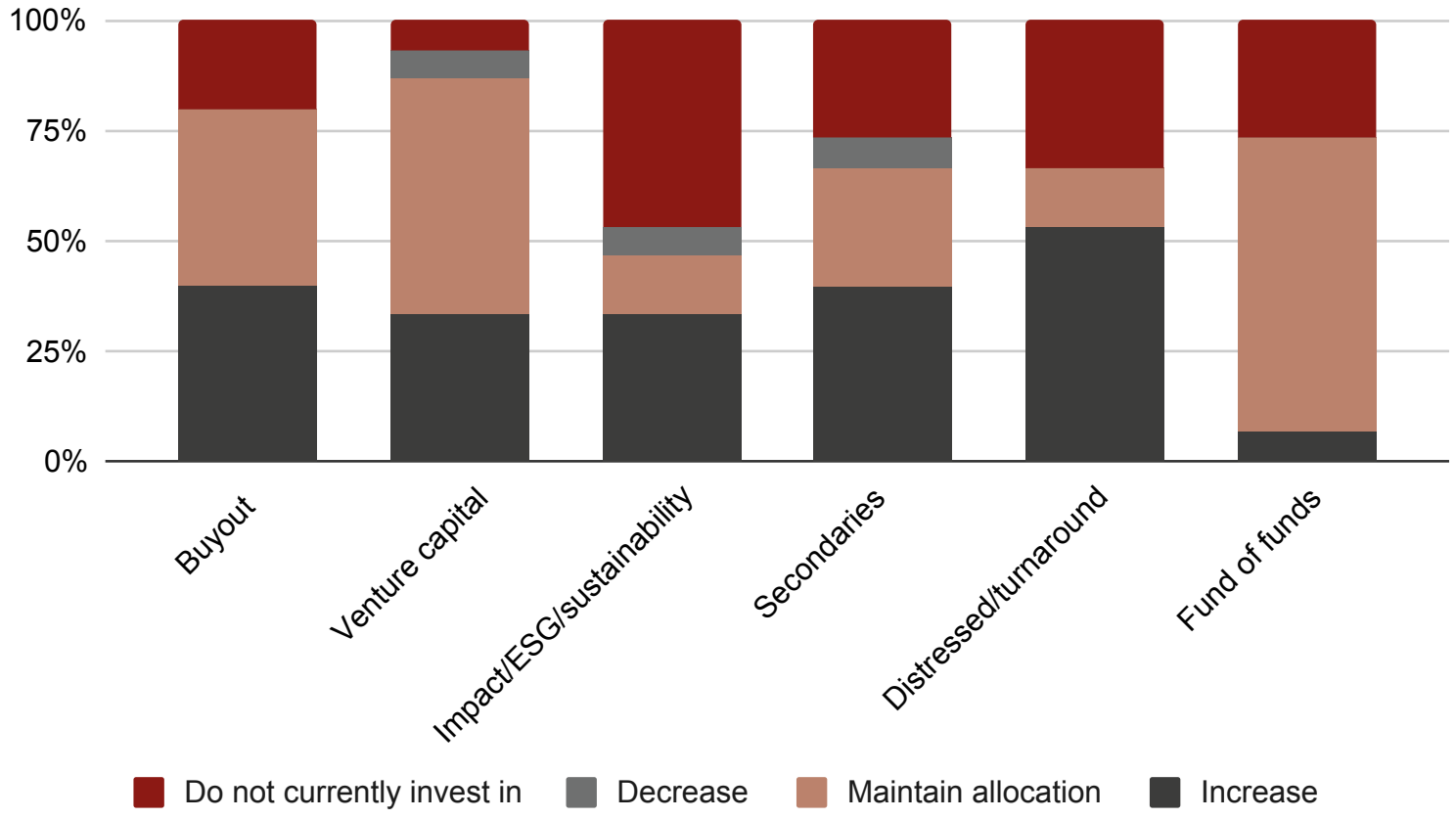
For institutional investors and asset managers, the proportion planning to reduce their exposure over the next 12 months is 18% and 7% respectively. Private wealth also appears comparatively more bullish than other investors on sectors such as financials and energy and fund strategies such as distressed/ turnaround and secondaries.

Not all private equity funds are in a position to capture these flows, however, and it is the larger franchise names that have been among the first to set-up shop and hire teams targeting the space. Some GPs have been acquiring or leveraging wealth management firms and, geographically, hoovering up demographic pockets of high-net-worth (HNW) individuals, for example in Asia and the Middle East. Looking forward, the "white space" described by Blue Owl might seem limitless as it overlaps with HNW retail investors – the average retail investor holds only around 2% in alternatives, according to consultancy McKinsey, with the potential to more than double over the next three years.

The perceived risk, for managers, is that these private wealth flows can be fickle in a more volatile market – they can be turned on and turned off, particularly by less sophisticated 'mom and pop' investors.

"Fast money's great when markets go up, but it can also bite you when things get a bit choppy," says one private wealth fundraising source.

Figure 4.1: Survey asked private wealth investors 'How do you expect to change your exposure to these private equity strategies over the next 12 months?'



Source: Private Equity Wire investor interest survey, November 2022

There are competing views on the 'fast money' hypothesis. Retail platform Moonfare said in November that "economic concerns have not significantly dented [their] investors' faith in private equity as an investment class" – 83% are still considering new allocations over the next 12 months as infrastructure, secondaries and private credit have come more into focus. A few weeks earlier Moonfare's CEO was even more positive, describing macro volatility as a turning point for private wealth, as individual investors "take refuge in private markets".

However, another survey released in the same month by RBC BlueBay Asset Management found that international wholesale investors do not expect to significantly increase their allocation to private markets over the next three to five years and just over half of expect public markets to outperform private markets in the same period.

Those close to the private wealth segment say using trusted intermediaries and finding diversification across investor type and region are key to avoiding knee-jerk outflows when markets are rocky.

"I don't think there's any feeling that it's like hot money, or it's 'here today, gone tomorrow,'" says Tarun Nagpal, founder and CEO at S64, an intermediary platform for private wealth. "Remember, the majority of the market is advised. And the banks themselves are putting a huge amount of resources into building these

Figure 4.2: Survey asked private wealth investors 'What are your biggest macroeconomic concerns?'

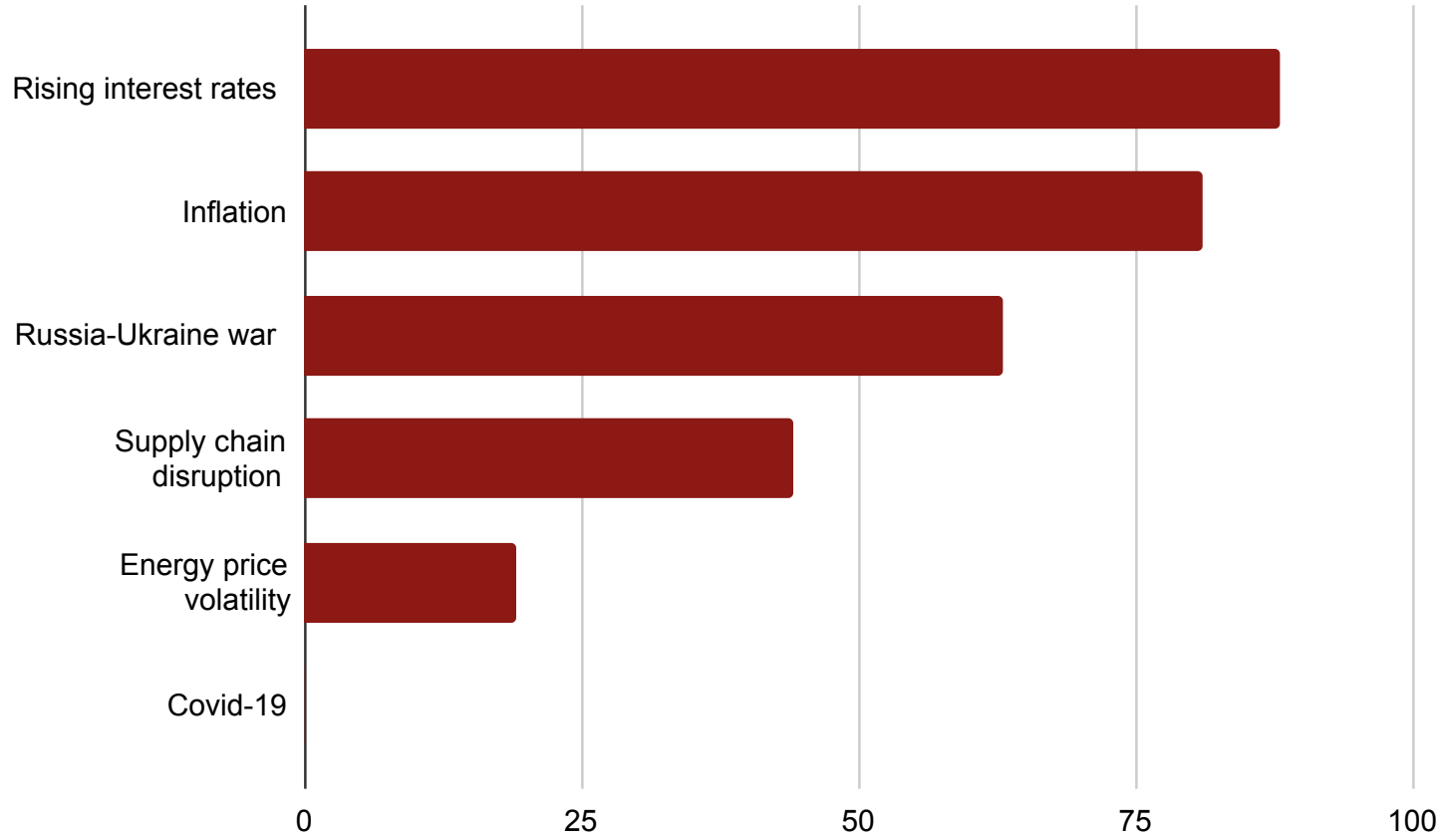
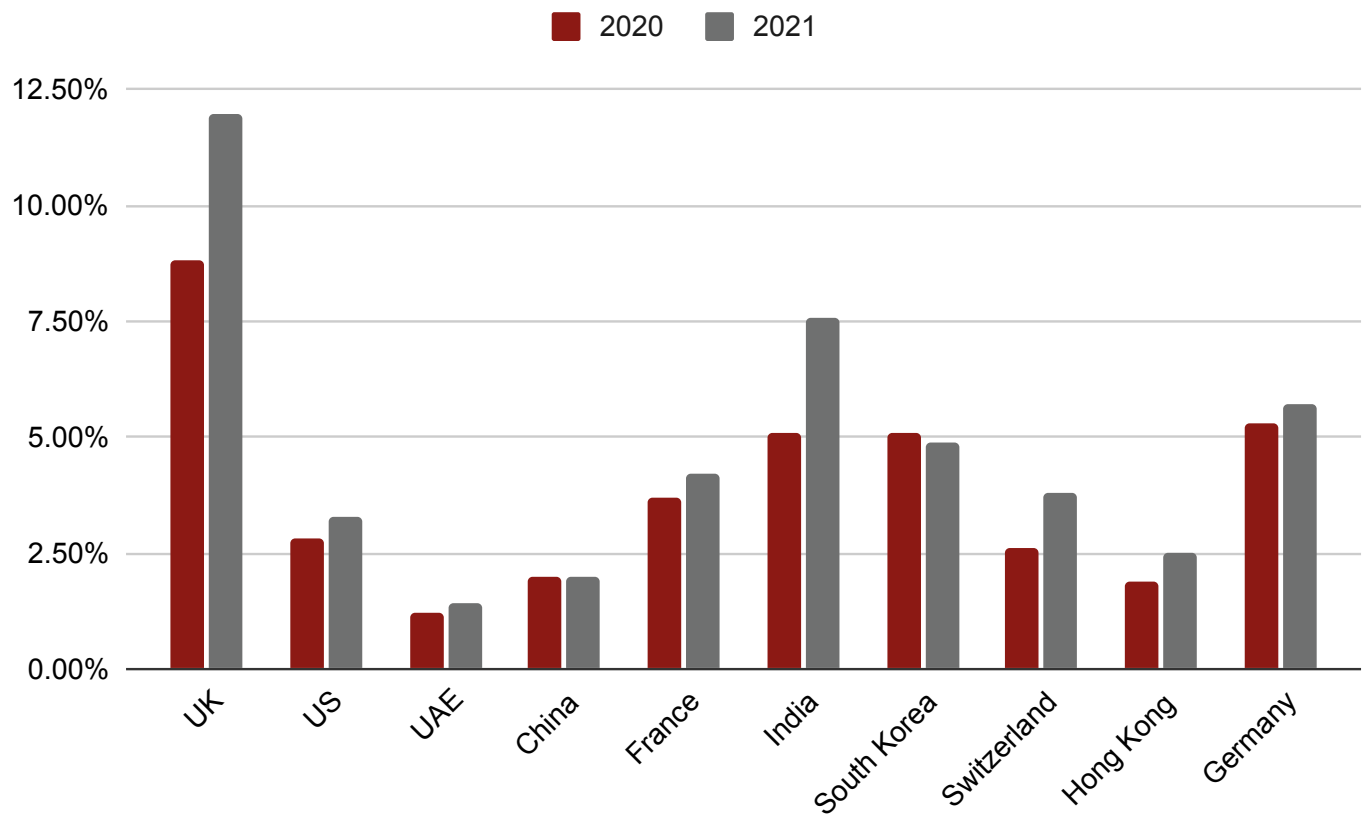


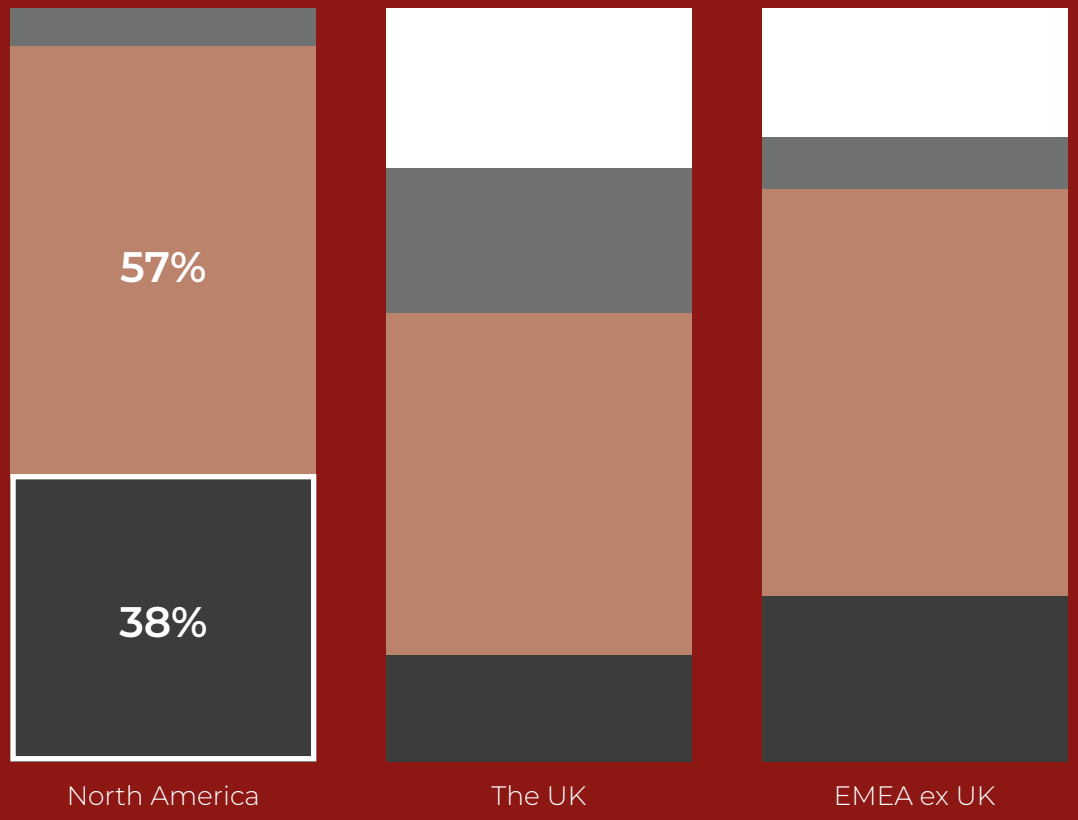
Figure 4.3 How high-net-worth investors allocate to private equity, by country



Source: GlobalData, 2020

KEY FINDING

Investors are looking to North America more than ever



INSIGHTS

private markets franchises so they have to do the right job in advising clients for the long-term."

On the same Blue Owl earnings call, the company was keen to point out it had "virtually no" redemptions in the second and third quarter but added "we all want the flows to be very consistent and every quarter up to the right. But... that's just not how markets work."

Partners Group says it provides a liquidity window on its evergreen funds which is around 5% of the total fund size per quarter but says that education and building awareness is what really helps to ensure the allocations are long-term and sticky.

"If you want to be successful, and really scale globally, you need to have multi-currency funds, local language materials and teams and do much more differentiated outreach and marketing than a few years ago when the whole space was still new," says Wicklien.

This is how fund managers are preparing for the next leap in private wealth: matching their offering more closely to the needs of their individual investors. The next trend is expected to be customised mandates where private investors can allocate to a GP across a number of strategies, for example on a defensive or dynamic basis.

According to Moonfare, illiquidity, fees and the long-term investment horizon of private equity are the biggest hurdles to new private wealth allocations. But perhaps it's actually private wealth's investment priorities, rather than flows or allocations, that are faster moving.

Institutional investors have taken the lead in sustainability, particularly in Europe, but in the Private Equity Wire survey, private wealth respondents ranked ESG as a much greater priority – and more than liquidity, fees or performances.

KEY TAKEAWAY

GPs – Fund managers are diversifying and educating their investor base in private wealth to mitigate the risk of outflows



CHRISTIAN WICKLEIN, GLOBAL CO-HEAD, PRIVATE WEALTH, PARTNERS GROUP

Private wealth, on a relative basis, is in a strong position and investors are still trying to get to their desired allocation target. Irrespective of short-term developments, there are opportunities for good managers who can create some alpha over traditional portfolios. Stable returns are shining through again and vintage diversification has been coming up in conversations, along with customized mandates which combine certain modules from our funds. Valuations also need more consideration in the evergreen fund structures [that private wealth investors tend to invest in]. You need to make sure that you adjust your valuations under fair value principles because if clients can go in and out on a monthly or quarterly basis, you have to ensure that you don't offer investors an arbitrage opportunity, so we are proactive and close to the truth with our fund valuations.

“I expect private wealth allocations to increase, irrespective of current short-term developments”

Christian Wicklein,
global co-head, private wealth,
Partners Group

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