Private markets outlook – it's time for optimism

By Nils Rode

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Following a phase of very strong fundraising during the pandemic, 2023 marked a period of slower capital raising for many private asset classes. We now see private markets having largely reverted to pre-pandemic levels in terms of fundraising, investment activity, and valuations.

Source: Supplied. Nils Rode, chief investment officer, private assets, at Schroders.

However, noteworthy exceptions include large buyouts in private equity, where fundraising has remained vigorous - a concern as it results in higher dry powder and entry valuations.

Moreover, fundraising for infrastructure and venture capital has seen a significant downturn, and real-estate valuations have undergone strong corrections in some regions and market segments.

It is time for optimism

Developed markets have made remarkable strides in bringing inflation closer to policy goals, with a considerably lesser impact on growth, notably in the US, than markets had anticipated.

While potential uncertainties arise from geopolitical risks and muted growth expectations for 2024, we believe it's time to be optimistic about the potential for private market investments, given that private market conditions have largely normalised (with a few exceptions).

Private markets offer the advantage of diversification across risk premia, access to investments with defensive characteristics, and exposure to 3D Reset themes: deglobalisation, demographics and decarbonisation, as well as the AI revolution. Many of these trends will favour specific investment categories, including sustainability and impact-aligned investments, renewable energy, generative AI, and investments in India.

Simultaneously, some of these themes are inflationary, contributing to higher interest rates. Coupled with funding gaps created by regulatory capital limitations on banks, we anticipate this will generate appealing lending opportunities.

Capital flows: A contrarian indicator

Many private market strategies operate as closed systems where fundraising determines the amount of available dry powder, which subsequently influences entry valuations and ultimately investment returns.

Therefore, we favour strategies with stable fundraising dynamics, such as small/mid buyouts and see potential in strategies where fundraising has significantly deviated below its long-term trend, like infrastructure equity and venture capital.

We're also drawn to strategies with higher capital needs due to the retreat of traditional capital providers, such as real estate debt, insurance linked securities, specialty finance, microfinance, and private credit.

Selectivity remains key

Many current private investments involve "re-ups", or reinvestments with existing partners. The pandemic has amplified this trend as due diligence on new strategies and meeting new managers posed a challenge.

Considering the new market dynamics driven by the 3D Reset and the AI revolution, we believe it's crucial to question whether past successes can be replicated. Are existing partners and strategies well-positioned for today's trends (decarbonisation, deglobalisation, demographics, and the AI revolution)?

Are the fundraising and dry powder dynamics within the sub-sector healthy? Given the changes in market dynamics, it's likely that opportunity sets should also evolve.

Now, more than ever, it's vital to expand investments into opportunities that benefit from these transformative trends and policy changes, diversify a private allocation as it matures, and concentrate on areas with healthy fundraising dynamics that provide access to less efficient markets and opportunities.

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