June 15, 2020

Private equity's moment in the limelight?

Private
markets, upon which everything from securities to real estate can be traded, are an increasingly popular avenue for investors seeking diversification and enhanced returns. According to McKinsey the total AUM across private markets has hit another all-time high of $6.5 trillion as investors continue to shift capital from public asset classes in search of lucrative investments in the "real" economy. Most notably, private equity, referring to ownership in a company that is not bought and sold on a public bourse such as the NYSE or the NASDAQ, has become a prominent fixture in global markets and we expect the sphere to continue growing - especially in the aftermath of the coronavirus pandemic. This piece discusses some of private equity's[1]
strong points that could prove useful in the months ahead.

Active expertise

In the eternal derby between passive versus active investing, it was assumed by many commentators that active management was fighting a losing battle (especially given the relentless growth in the ETF market). However, such a view may miss the point entirely. Private markets have been growing at twice the rate of ETFs, while it's commonly accepted that 60% of private returns are driven by active ownership channeled through the improvement and enhancement of assets. In the past, the perception was that private equity firms simply came in and ruthlessly cut expenses, severing flab from the business model. However, today, they bring real operational expertise to the table. PE firms with an active approach hire some of the best talent in the market and often have a metaphorical Filofax of industry contacts. Covid-19 has sent economic activity into the doldrums. The months ahead, as the global economy tries to regain its footing will be tough for businesses and "survival of the fittest" will be more relevant than ever. The business acumen of PE firms could serve as a lifejacket for the firms they invest in.

Dry powder

In any crisis, liquidity is crucial – the balance sheet takes precedence over the income statement in assessing the strength of a firm. At the end of 2019, private investors were sitting on a record $1.5 trillion in cash, according to Preqin: the highest amount on record. Amid the simultaneous supply and demand shock caused by the pandemic, this means firms backed by private equity firms are better poised to weather the economic cessation than those without support from financial sponsors.

Having cash at such a time can also be used to take opportunities. In the thick of the Covid-19 crisis, the governor of Saudi Arabia's sovereign wealth fund made headlines after saying: "You don't want to waste a crisis", referring to the attractive valuations and opportunities that a downturn can bring – if you have

the capital. Those who were active in the aftermath of the 2008 crisis are now reaping the fruits.

No stock market swings and a long-term approach

The past months have been a white-knuckle ride for investors on public exchanges. Today, equities are on a relentless rise which almost seems to good to be true in light of the current macroeconomic backdrop. Private equity investors are not waiting with baited breath for the next correction.

Moreover, private firms are not subject to the same stringent reporting requirements and regulations as public firms. Many companies are growing fatigued by the paperwork and processes involved in being public, as well as the pressure of reporting quarterly earnings, a process which often fosters short-termism at the expenses of long-term value creation. Between 2000 and 2018, the number of private equity-backed companies in the US rose from around 2,000 to roughly 8,000. At the same time the number of publicly listed companies fell from 7,000 to c. 4,000. With more and more tech start-ups (who embark on high-risk, high-return projects) shunning IPOs, private share trading platforms which threaten to disrupt traditional exchanges are in the pipeline. Such new platforms should help tackle illiquidity, but in the end, constant communication and a close understanding of client expectations is still the best solution.

All in all, it was already becoming clear that private assets are a core feature of the investment landscape for investors and entrepreneurs. The industry is shaking its reputation of being opaque, complex and niche, and is increasingly perceived as an attractive way to diversify an investment portfolio and achieve enhanced long-term return potential. Covid-19 will probably only propel the popularity of PE - especially if you consider that attractive alternatives are thin on the ground in the era of interest rates that are “lower for even longer” due to central bank measures to cushion the economic damage from the

crisis. In a market where investors have often felt that there was nowhere to run and nowhere to hide, private equity may, at times, be a useful cubbyhole.

---

[1] For the purpose of this article, we focus on private equity firms who create closed-end funds for investing in private equity as well as other asset classes.

Disclaimer

All financial data and/or economic information released by this Publication (the "Publication"); (the "Data" or the "Financial data and/or economic information"), are provided for information purposes only, without warranty of any kind, including without limitation the warranties of merchantability, fitness for a particular purpose or warranties and non-infringement of any patent, intellectual property or proprietary rights of any party, and are not intended for trading purposes. Banque Internationale à Luxembourg SA (the "Bank") does not guarantee expressly or impliedly, the sequence, accuracy, adequacy, legality, completeness, reliability, usefulness or timeless of any Data. All Financial data and/or economic information provided may be delayed or may contain errors or be incomplete. This disclaimer applies to both isolated and aggregate uses of the Data. All Data is provided on an "as is" basis. None of the Financial data and/or economic information contained on this Publication constitutes a solicitation, offer, opinion, or recommendation, a guarantee of results, nor a solicitation by the Bank of an offer to buy or sell any security, products and services mentioned into it or to make investments. Moreover, none of the Financial data and/or economic information contained on this Publication provides legal, tax accounting, financial or investment advice or services regarding the profitability or suitability of any security or investment. This Publication has not been prepared with the aim to take an investor's particular investment objectives, financial position or needs into account. It is up to the investor himself to consider whether the Data contained herein this Publication is appropriate to his needs, financial position and objectives or to seek professional independent advice before making an investment decision based upon the Data. No investment decision whatsoever may result from solely reading this document. In order to read and understand the Financial data and/or economic information included in this document, you will need to have knowledge and experience of financial markets. If this is not the case, please contact your relationship manager. This Publication is prepared by the Bank and is based on data available to the public and upon information from sources believed to be reliable and accurate, taken from stock exchanges and third parties. The Bank, including its parent,- subsidiary or affiliate entities, agents, directors, officers, employees, representatives or suppliers, shall not, directly or indirectly, be liable, in any way, for any: inaccuracies or errors in or omissions from the Financial data and/or economic information, including but not limited to financial data regardless of the cause of such or for any investment decision made, action taken, or action not taken of whatever nature in reliance upon any Data provided herein, nor for any loss or damage, direct or indirect, special or consequential, arising from any use of this Publication or of its content. This Publication is only valid at the moment of its editing, unless otherwise specified. All Financial data and/or economic information contained herein can also quickly become out-of- date. All Data is subject to change without notice and may not be incorporated in any new version of this Publication. The Bank has no obligation to update this Publication upon the availability of new data, the occurrence of new events and/or other evolutions. Before making an investment decision, the investor must read carefully the terms and conditions of the documentation relating to the specific products or services. Past performance is no guarantee of future performance. Products or services described in this Publication may not be available in all countries and may be subject to restrictions in some persons or in some countries. No part of this Publication may be reproduced, distributed, modified, linked to or used for any public or commercial purpose without the prior written consent of the Bank. In any case, all Financial data and/or economic information provided on this Publication are not intended for use by, or distribution to, any person or entity in any jurisdiction or country where such use or distribution would be contrary to law and/or regulation. If you have obtained this Publication from a source other than the Bank website, be aware that electronic documentation can be altered subsequent to original distribution.

As economic conditions are subject to change, the information and opinions presented in this outlook are current only as of the date indicated in the matrix or the publication date. This publication is based on data available to the public and upon information that is considered as reliable. Even if particular attention has been paid to its content, no guarantee, warranty or representation is given to the accuracy or completeness thereof. Banque Internationale à Luxembourg cannot be held liable or responsible with respect to the information expressed herein. This document has been prepared only for information purposes and does not constitute an offer or invitation to make investments. It is up to investors themselves to consider whether the information contained herein is appropriate to their needs and objectives or to seek advice before making an investment decision based upon this information. Banque Internationale à Luxembourg accepts no liability whatsoever for any investment decisions of whatever nature by the user of this publication, which are in any way based on this publication, nor for any loss or damage arising from any use of this publication or its content. This publication, prepared by Banque Internationale à Luxembourg (BIL), may not be copied or duplicated in any form whatsoever or redistributed without the prior written consent of BIL 69, route d'Esch ı L-2953 Luxembourg ı RCS Luxembourg B-6307 ı Tel. +352 4590 6699 ı www.bil.com.