INVESTORS TURN TO PRIVATE ASSETS IN SEARCH FOR DIVERSIFICATION

Authored by: Kris Richmond - London & Capital

As investors have sought diversified sources of return, alternative assets have benefited. Private equity in particular has seen strong growth over the last decade. But how has this come about?

The growing attraction of private assets

An unprecedented period of loose monetary policy has supported global economies since the onset of the pandemic. It has also helped financial markets soar to new heights by the end of 2021. With elevated public market valuations, low fixed income yields, and the outlook from here looking increasingly uncertain, it is little wonder that investors are increasingly turning their attention to alternative investments to diversify their portfolios.

Private assets in particular allow investors to obtain an illiquidity premium over the long term and add additional sources of return to their portfolio.

Private equity, venture capital, infrastructure and other private assets have seen inflows explode over the last 12-18 months as asset allocators increasingly tap into these different portfolio drivers.

Why private equity?

The search for diversification has been one of the key reasons for the attraction. Public businesses tend to already be at a certain stage of maturity. In contrast, private equity and venture capital have been able to offer investors access to businesses at an earlier stage of their growth trajectory.

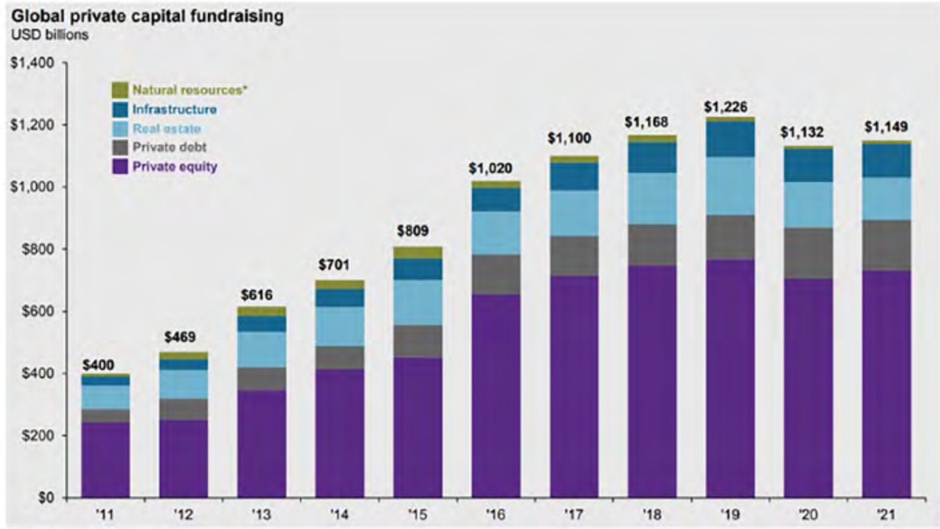
For investors, this means exposure to areas that is not easily attainable through traditional investments.

These alternative vehicles seek companies with different business models, often with new technology or targeting untapped markets. Disruptive technology in private equity companies have long been grabbing headlines.

Some of these have listed in the last few years, including well-known businesses such as Uber, Airbnb and Spotify. As was evident from the share price performance of these companies, most of the investment gains were made prior to their listings. There are many more highly interesting industries to be accessed through private markets.

Some examples include:

- **Blockchain is continuing its ascent to help transform many businesses and processes. Essentially a secured, shared database, blockchains store information in blocks that arranged in a chain. While cryptocurrency may be the most famous blockchain application, it can do far more than just this.**
- **Artificial intelligence (AI) is increasingly popular to help streamline business operations in numerous industries. This includes healthcare, financial services and education. By the first half of 2018, nearly 12% of global private equity investments went to AI businesses – a substantial growth from 2011 when it represented 3%.[1]**



Source: Preqin, J.P. Morgan Asset Management.

As these investments are often in more niche areas of the market, they have been particularly attractive to investors who wish to be more selective about their areas of market exposure. Added to this, alternative assets often carry an illiquidity premium, due to their more specialist nature. This offers extra compensation for long-term investors seeking additional reward in the face of rising inflation.

A strong runway

Throughout 2021, fund flows, dealmaking and exits all remained at elevated levels and on many metrics hit historic records for the year. Fundraising activity for private debt, real estate and infrastructure has also remained robust.

These significant fund flows have led cumulative dry powder in private markets to accelerate to around $3.3tln according to Pitchbook. This locked-in capital indicates a bright future for the private equity industry as money is put to work over the next few years, supporting the businesses and technology which will drive the future of the global economy.

While alternatives are showing strong growth and healthy potential, it is still a specialist area of the market. Like any other asset class, it requires thorough analysis to find the opportunities that offer the best value, while complementing the other assets in an investment portfolio.

1 https://www.oecd-ilibrary.org/sites/3abc27f1-en/index.html?itemId=/content/component/3abc27f1-en#:~:text=AI%20now%20represents%20over%2012,start%2Dups%20focused%20on%20AI.