PRIVATE EQUITY INVESTING IN THE INFORMATION AGE

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What has made investing in private equity so attractive in the past 10-20 years?
First and foremost, the ability of private equity to outperform the public market over the past two decades. In my eyes, no other asset class has been able to outperform the public stock and bond markets so consistently over such a significant period of time.

More specifically, a key driver of investment in the industry over the past 10 years was the performance of the asset class over the course of the Global Financial Crisis (GFC). When the crisis hit, we saw many investors looking to liquidate their public holdings, but because of the structure of the private model, many LPs remained invested in private vehicles. And actually, when you look at private equity funds of vintages 2006-2008, they outperformed the public market and ended up delivering distributions to their investors.

Being able to return capital to investors after such a tough environment demonstrated the value that a private equity allocation can provide, and as such, drove investors to the market.

As the private equity environment improved post-GFC, more capital was distributed back to LPs and, in turn, we saw these distributions fuel growth as institutions sought to re-invest this capital in private equity, the market that had delivered such strong returns for them previously.

This outperformance and return generation led to a consistent flow of new investors entering the asset class as well as investors already active in private equity increasing their allocations.

With so many investors in today's market holding an allocation to private equity, what makes for a successful private equity portfolio?
There are several key factors to consider when creating or shaping a private equity allocation.

We are seeing more and more investors allocating in each of the three main regions: North America, Europe and Developed Asia-Pacific. Diversifying geographically allows investors to hedge against potentially uncertain economic environments; however, this is not without challenges: entering a new region requires understanding the market as well as operating in close proximity to its GPs.

Another factor to consider is allocating to a blend of strategies. We see a lot of investors active in buyout, venture capital and distressed debt, as well as some infrastructure assets within their private equity allocation. A mixture of risk/return profiles and asset diversification further de-risks portfolios.

Finally, many investors allocate through a range of vehicles such as co-investments and separate accounts. Accessing the industry through these vehicles allows for varying levels of exposure to the industry and more custom solutions to complement the holdings of a portfolio.

Once invested in private equity, how do you successfully monitor and evaluate your portfolio?
How investors monitor their portfolio is perhaps one of the areas of private equity that has changed the most over the past 10 years. The advancement of technology and increasing amount of information available to institutions has led them to create more rigorous processes and evaluation techniques.

Successfully benchmarking and evaluating a portfolio centres around managing the flow of information, and in turn processing that information into analysis.

Institutions receive data from their GPs on fund performance and the performance of underlying assets; they use public market data to evaluate their performance against stock and bond markets; LPs now have access to more data on private markets and can obtain Public Market Equivalent benchmarks for the private equity industry. Efficiently managing the wealth of data now available to investors is crucial to monitoring a portfolio and thereby the success of the investment strategy.

And what metrics or analysis are investors now creating from this data?
Information on cash flows is the first metric on the mind of investors. Monitoring calls and distributions and implementing forecasting models allows for investors to gain a better perspective on the current and potential future performance of their portfolio.

Risk measurement has also been an area of focus for investors for some time now. Implementing tools to derive risk metrics comparable with public assets allows for a greater understanding of the positioning of the portfolio.

Performance benchmarking is of course another key piece of analysis for investors. More LPs are creating historical benchmarks and implementing processes to allow data to transition more quickly from GP submission to evaluation.

How does implementing these processes benefit investment decision-making?
Creating processes and using software that streamlines and automates data analysis allows for several improvements, to name a few:

- Decisions can be made faster and with greater clarity.
- The risk of data error is reduced.
- Employees work from a centralized data source, increasing consistency across analysis and removing the need for creating metrics in Excel.
- The minds and time of investment professionals are freed up.

Alongside the benefits to investment decision-making, these processes also allow for greater transparency across LPs, especially important for investors with complex capital structures; a more in-depth understanding of an investor's GP relationships and the underlying assets they have exposure to; and clearer audit trails across the institution.

What will make for successful private equity investing in 2019? How do you see the processes we have discussed playing a part?
A lot of people in private equity are talking about cycles and the potential for a change in cycle phase. In times of a changing environment it is more important than ever to stay close and up to date on the market and your portfolio. An investor that focuses resources on technology and systems now will be better placed to react and make decisions for their portfolio in the future.

How do you see the private equity market developing over 2019?
First and foremost, we expect the performance of the private equity industry to remain strong, not only in terms of absolute returns but also as a diversifier to the public market. Private equity has previously shown its ability to outperform the public market in times of downturn, and we are confident that the asset class will remain strong in the event of a cyclical change.

If the market does enter a downturn then the secondary market will likely see more activity as investors look to rebalance their portfolio and potentially discounted shares become available. Being able to rapidly evaluate the changing dynamics within your portfolio will be of critical importance to successfully operating a private equity portfolio in this environment.

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