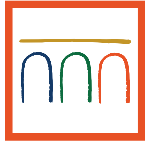


REYL
INTESA SANPAOLO

MARKET INSIGHT

FEBRUARY 2022

NICOLAS ROTH
HEAD OF PRIVATE ASSETS

"The timing is right to once again look at private markets and refresh asset allocation"

BUILDING PORTFOLIOS FULLY DEDICATED TO PRIVATE MARKETS

Private assets have often been considered the poor cousin of every asset allocation programme and have not received the adequate attention. Given how public markets behaved since the global financial crisis (GFC), this was not such a big issue and investors have been able to generate robust performance across public markets. But change might just be around the corner.

All the excess liquidity pumped into markets by central banks since the GFC has led prices of risky assets to melt up with excess leverage and easy borrowing. However, as it seems clearer now that the era of central bank support is over and tapering will become a reality, investors are bracing themselves for more material shocks in public markets. This new market dynamic can be supportive for investors looking to review their allocation to private assets, partially protect against market gyration and generate substantial performance. But before piling into private equity deals and asset-backed loans, there are a few elements worth being emphasised.

BUILDING PRIVATE ASSETS-ONLY ALLOCATIONS

Like public markets, private assets are showing a tremendous amount of granularity and should be considered as such when starting to invest. Portfolio construction matters, strategy allocation matters as well as asset and manager selection obviously. Portfolios can therefore be built along several guiding principles, including ones that can be borrowed from the public market approach. Most asset allocations are a collection of investments in fixed income, equities, commodities, and alternatives. For a client making a leap of faith into private markets, transposing the traditional and well-known liquid asset allocation framework into private markets can be soothing. Fixed income is mimicked with private debt, equities are replaced with private equity and alternatives can host illiquid alternatives and other private markets strategies. The caveat, however, is that it requires a solid financial surface to be executed and reach adequate diversification. But if this is within reach, then investors can enjoy privates to the full extent.

PRIVATE EQUITY RANGES FROM EARLY-STAGE VC TO PUBLIC COMPANIES BEING TAKEN PRIVATE

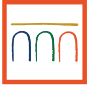
Private equity (PE) encompasses all strategies dealing with companies before their IPO. It starts with venture capital which consists of financing early-stage companies that may not yet have clients or products, but only a product or idea design. However, few companies can develop into successful cash flow generating businesses. Moving up the ladder, growth capital addresses companies that are more mature and are usually looking to expand but are lacking the required capital. Leverage buyout, one of the most popular strategies in PE, is about acquiring mature companies for control.

Private equity also has underexplored corners such as take-privates. This is often about identifying out-of-favour public companies with valuation disconnect and taking them private to allow management to focus on long-term goals. Diversification can therefore be built by investing in different points of the lifecycle of a company but also across industries.

GENERATING SOUGHT-AFTER INCOME WITH PRIVATE DEBT STRATEGIES

In private debt the opportunity set is staggering. The backdrop remains unchanged: banks are less active and less nimble when it comes to lending and have paved the way for a buoyant income generating non-bank lending market across various segments of the economy, from peer-to-peer lending to real estate financing. A niche area of the private debt space is the crossover strategy, dubbed growth debt or venture debt. The strategy is about financing growth companies through debt instead of equity raises. Lenders can negotiate attractive equity optionality via kickers and warrants while creating solid security packages for the loan. Few players are active in this field and, given valuation levels, not all founders are willing to look at debt, some are happier to prop up the valuation of their companies through equity rounds.

As alternatives, investors can look for hybrid and longer lockup strategies. Meanwhile, exit terms are becoming more "private equity-ed", allowing more managers to combine public and privates in their funds. Other strategies between debt and equity, such as workout of non-performing loans can also provide orthogonal source of returns and help diversify portfolios. The timing is right to look at private markets and refresh asset allocation once again. The opportunity set across private markets is extremely rich and the level of granularity justifies building bespoke private markets allocation instead of orphaned positions comingled in public assets portfolios.



REYL
INTESA SANPAOLO

IMPORTANT INFORMATION - This content is being provided by REYL & Cie Ltd or/and its affiliates (hereinafter referred to as "REYL") solely for information purposes and is not intended to be a solicitation or offer, recommendation or advice to buy or sell interests inany financial instrument mentioned in it, to effect any transaction, or to conclude any transaction of any kind whatsoever, in particular to any recipient who is not a qualified, accredited, eligible professional or institutional investor. It is intended for the sole use of the recipient and may not be forwarded, printed, downloaded, used or reproduced for any other purpose. It is not intended for distribution/offering to, or use by, natural or legal persons that are nationals of a country or subject to a jurisdiction of which the laws or regulations would prohibit such distribution/offering or use. Whilst REYL shall use reasonable efforts to obtain information from sources which it believes to be reliable, REYL, its directors, officers, employees, agents or shareholders assumes no liability regarding this content and give no warranty as to the accuracy, completeness or reliability of any mentioned data and thus assumes no liability for losses arising from the use of this content. The information, opinions and assessments contained in the present document shall apply at the time of publication and may be revoked or changed without prior notice. This content is intended only for recipients who understand and are capable of assuming all risks involved. Before entering into any transaction, recipients should determine if the relevant financial instrument mentioned in the content suits particular circumstances and should ensure that they independently assess (together with their professional advisers) the specific risks, the legal, tax, accounting consequences and eligibility requirements of any purchase, holding or sale of financial instruments mentioned in the content. REYL, its directors, officers, employees, agents or shareholders may from time to time have interests and/or underwriting commitments in the financial instruments described herein. REYL makes no representation as to the suitability of the mentioned information, opinions or securities and financial instruments. Historical data on the performance of the financial instruments or on the underlying assets are no indication for future performance. The present content has been compiled by a department of REYL which is not an organisational unit responsible for financial research.REYL is subject to distinct regulatory requirements and certain services and/or financial instruments may not be available in all jurisdictions or to all recipient types. Recipients are therefore responsible to comply with all applicable laws and regulations. There is no intention to offer services and/or financial instruments in countries or jurisdictions where such offer would be unlawful under the relevant laws and regulations.