



In Quest for Diversification, Institutional Investors Take a New Look at Private Markets



NALAKA DE SILVA
Head of Private Market Solutions
Aberdeen Standard Investments

Institutional investors have long thought of private markets primarily as a means to boost returns, but challenging economic conditions this year have many rethinking the role that private market investments can play in their portfolio.

In particular, they're increasingly relying on private markets to enhance the diversification of their portfolios. This shift reflects two trends: a rise in correlated movement among public debt and equities; and a growing awareness of the opportunity to diversify within private markets. In addition, regulatory changes have cleared the way for some retail investors to enter the space through their 401(k) plans or other means.

"Private markets used to be this dark and opaque space, but it's emerging as a big landscape that includes real estate, infrastructure, natural resources, private equity and private credit," said Nalaka De Silva, head of private market solutions at Aberdeen Standard Investments. Investment into "private markets has become a broad spectrum of activity, including growth-oriented assets, such as venture capital and growth equity, and income-generating assets across real estate, infrastructure and natural resources.

"Investors had started exploring these things over the past decade, but in a COVID environment, those trends have really accelerated," he said.

What's more, this trend is emerging against the backdrop of a rapidly expanding venture capital arena, in which the cost of building and running a company has gotten much cheaper. With multibillion-dollar initial public offerings by tech giants like Alibaba, Snapchat and Facebook, it's clear that there's a massive opportunity for value creation in private hands before companies even reach the public markets.

That opportunity exists at various levels, allowing for investment from institutional investors looking to buy into riskier startups, as well as those who want to hold more mature companies. Even before the pandemic, private companies were staying private for longer, a trend that's unlikely to change in the current environment, according to De Silva.

PRIVATE INCOME

On the private income side, there's been an influx of high-quality infrastructure projects that previously may have been funded via government bonds. As investment bankers had begun to securitize the infrastructure funding, the space has blossomed to a much larger opportunity set, allowing for private

investment in schools, hospitals, roads and other projects essential to local economies.

"The only way to get exposure to those opportunities in the past was to buy municipal bonds, but the muni market is tightly priced and doesn't offer much yield," De Silva said. "This is another way to get the same type of exposure to government-backed, high-quality credit investments."

The world of private income investments has also expanded as capital-constrained banks pulled back on some lending following a spate of regulations in response to the global financial crisis of 2008 to 2010. That allowed entry from other capital providers who could offer specialty financing, working capital for specific situations and turnaround capital for larger organizations.

"People used to think of the private markets as just private equity, but you have this big, private capital debt market that's growing now," De Silva said.

COVID and the unprecedented global economic challenges of 2020 have created disruptions that further private market opportunities for investors in areas such as real estate and supply chains. There's also opportunity in the tech tools that have enhanced work-from-home productivity and allowed for the delivery of virtual education and healthcare, De Silva said.

"In terms of what the pandemic means longer term, dealing with technology and healthcare issues, for example, we are going to see a lot more emphasis on remote working, which spans a whole range of industries," he said. "What does that mean for real estate in terms of how people manage their space, what does it mean [for] residential property and how people live and work and play? I think that creates opportunities in real estate, opportunities in private equity through the supply chain and opportunities in terms of how we finance some of these transactions as a result of how capital flows work. The pandemic will definitely provide [more] investment opportunities."

Private markets also provide an opportunity for institutional investors who are focused on environmental, social and governance factors and looking to use their capital in a more impactful way. As direct owners of a private investment, investors have more say over environmental policies and stakeholder management.

"In that way, ESG becomes more embedded in the business," De Silva said. "When you're management, you can make oper-

ational changes looking at the environmental footprint, diversity, social aspects. You can look at the supply chain more carefully and be cognizant about fair living wages."

ENSURING LIQUIDITY AND OUTCOME

According to De Silva, there's broad and growing recognition among investors about how minimizing ESG factors today can create material issues later, which can create regulatory scrutiny or reputational risk. Private companies that can be as transparent as possible around their approach to such issues will have an advantage raising capital and growing their value to investors.

Even as their interest in private markets grows, institutional investors remain acutely aware of the importance of portfolio liquidity and their ability to meet cash flow needs for benefit payments, rebalancing or other capital obligations as necessary. The evolving and growing private market has eased this concern somewhat, since there are more players looking to buy, sell or trade at any given time.

De Silva said he tends to look at private market liquidity with a horizon of seven to 10 years, although to provide more flexibility to institutional investors who want to rebalance their investment more quickly, Aberdeen Standard Investments offers private market products that include a 20% allocation to more liquid assets. He added that despite the recent evolution of private markets, many institutional investors are still underweight in the class, partly due to implementation issues.

"Now, when they are looking at all of the different buckets in the private markets, they are probably underweight private equity or infrastructure on either the debt or equity side," he said. "But since you can't go and price it and trade it overnight, you need to have people that understand the assets and the complexity around them. You need lawyers, accountants, financiers. That's a big hurdle for people to be able to allocate to it effectively."

More clients are getting past that hurdle, however, turning to providers like Aberdeen Standard, which offer "one-stop solutions" to investing in private markets. De Silva said he expects the trend toward more private market investing to continue, as institutional investors continue to take an outcome-based approach to their portfolios.

"They've been forced to think about how to generate their returns and meet their objectives, and they're seriously looking at how to deploy effectively right now," he said. "The answer is, often, in the private markets." ■

www.pionline.com/aberdeen_privatemarkets20

FOR PROFESSIONAL INVESTORS ONLY. NOT FOR USE BY RETAIL INVESTORS.

Alternative investments involve specific risks that may be greater than those associated with traditional investments; are not suitable for all clients; and intended for experienced and sophisticated investors who meet specific suitability requirements and are willing to bear the high economic risks of the investment. Investments of this type may engage in speculative investment practices; carry additional risk of loss, including possibility of partial or total loss of invested capital, due to the nature and volatility of the underlying investments; and are generally considered to be illiquid due to restrictive repurchase procedures. These investments may also involve different regulatory and reporting requirements, complex tax structures, and delays in distributing important tax information.

The information contained herein is intended to be of general interest only and does not constitute legal or tax advice. ASI does not warrant the accuracy, adequacy or completeness of the information and materials contained in this document and expressly disclaims liability for errors or omissions in such information and materials. ASI reserves the right to make changes and corrections to its opinions expressed in this document at any time, without notice.

The above is for informational purposes only and should not be considered as an offer or solicitation to invest in any product.

Some of the information in this document may contain projections or other forward-looking statements regarding future events or future financial performance of countries, markets or companies. These statements are only predictions and actual events or results may differ materially. The reader must make his/her own assessment of the relevance, accuracy and adequacy of the information contained in this document, and make such independent investigations as he/she may consider necessary or appropriate for the purpose of such assessment.

Any opinion or estimate contained in this document is made on a general basis and is not to be relied on by the reader as advice. Neither ASI nor any of its agents have given any consideration to nor have they made any investigation of the investment objectives, financial situation or particular need of the reader, any specific person or group of persons. Accordingly, no warranty whatsoever is given and no liability whatsoever is accepted for any loss arising whether directly or indirectly as a result of the reader, any person or group of persons acting on any information, opinion or estimate contained in this document.

In the United States, Aberdeen Standard Investments is the marketing name for the following affiliated, registered investment advisers: Aberdeen Standard Investments Inc., Aberdeen Asset Managers Ltd., Aberdeen Standard Investments Australia Ltd., Aberdeen Standard Investments (Asia) Ltd., Aberdeen Capital Management, LLC, Aberdeen Standard Investments ETFs Advisors LLC and Aberdeen Standard Alternative Funds Limited.