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# PRIVATE MARKET OPPORTUNITIES IN A SHIFTING ECONOMIC ENVIRONMENT

How will private capital feature in portfolios in 2024?

Wednesday 13th March 2024 | 18:30pm
NoMad London

## Roundtable

# OVERVIEW

After 2023's slowdown in fundraising and dealmaking, many investors view the year ahead with cautious optimism for the economy and capital markets, despite ongoing geopolitical uncertainties. With many hoping for a 'soft landing' as interest rates come down, what does 2024 hold for private markets?

The role of private assets in a portfolio is becoming more crucial than ever, as many seek to take advantage of significant global trends. Despite its recent growth, private credit is still finding a place alongside traditional finance during times of economic fluidity. How is the market's approach to private credit changing? Can we anticipate more mergers among private capital players? Will we see more IPOs? How will the year's multiple elections across the world impact private markets' expectations for shifting regulation?

This roundtable discussion, hosted by the Financial Times in partnership with Clifford Chance, focused on the opportunities and challenges facing private markets. The roundtable gathered senior leaders from leading private capital firms in the market.

# KEY TAKEAWAYS:

1. There is growing optimism amidst uncertainty. Investor sentiment has shifted positively as markets begin to stabilise, suggesting a resilient outlook for private equity and credit amidst the current economic climate.

2. Geopolitical challenges and strategic shifts are affecting the evolution of private markets.

3. Private credit has performed well during a period of higher global inflation. However, competition within credit markets remains fierce, emphasising the need for strategic diversification and prudent risk management among investors.

4. Private markets are witnessing significant consolidation, with a few large firms dominating the landscape. This trend is squeezing out newcomers, especially in private credit.

5. The integration of AI into private markets is seen as a strategic enhancement rather than a replacement for human capital. As the industry evolves, embracing technology, regulatory adaptability, and international cooperation will be pivotal.

6. The next five years are poised to bring a more interconnected, accessible, and dynamic private market ecosystem, fuelled by the entry of US firms into Europe and an influx of retail money into the system.

# POINTS DISCUSSED

## How is the shifting macroeconomic and geopolitical picture impacting private markets' attractiveness?

Attendees agreed that the shifting macroeconomic and geopolitical landscape has subtly influenced the appeal of private markets. As a senior leader at a private equity firm pointed out, a year ago, uncertainty might have heightened nerves among investors. However, market sentiment has since shifted towards optimism as the macroeconomic situation stabilises and the outlook becomes more positive. On the other hand, the discussion underscored the uncertainty due to potential disruptions from upcoming elections that could affect both equity and credit markets. Two potential effects identified were decreased risk-taking by LPs and tighter regulation. However, attendees concurred that the change in governments worldwide is unlikely to have a major impact on private markets.

## The state of private equity

Participants were far from satisfied with the current state of the market. Over the past fifteen years, private markets have enjoyed unparalleled dominance. However, this landscape has undergone a significant shift in the past two years. In Europe, private equity is grappling with higher interest rates, which has made borrowing to finance investments more expensive. The LP investments have become increasingly polarised, reflecting divergent trends across geographical regions.

In the United States, there's a strong push towards ramping up investments in private equity, signalling a bullish outlook for returns. Meanwhile, in an effort to diversify, LPs are exploring commercial real estate debt, reflecting a strategic shift to mitigate risk while still targeting growth.

The attendees concluded that private markets are marked by their heterogeneity, driven by regional preferences, economic conditions, and strategic investment goals. The once cohesive dominance of private markets is giving way to a more nuanced, regionally specific tapestry of investment attitudes and strategies, highlighting the complexity of navigating global private equity in the current economic climate.

# POINTS DISCUSSED

## Private credit

On the other hand, private credit struck a more optimistic tone. The asset class has undergone a monumental shift over the past decade, transitioning from a niche concept to a staple within investors' portfolios. This transformation is largely attributed to the asset class's response to inflation, showcasing its value as a hedge and its ability to deliver consistent returns in a volatile economic environment. Despite this growing recognition, the average allocation to private debt remains relatively modest. This caution stems from intense competition within the credit sector, where private debt vies for attention and capital against other asset classes.

Sophisticated investors, particularly in Europe and the United States, now include both private credit and equity in their portfolios, reflecting a strategic approach to diversification and risk management.

## Exits, competition and return in private markets

As these markets mature, the focus shifts to the efficiency of capital deployment and exit strategies. The duration of investments, especially in private equity, where exit times can significantly impact overall returns, is a critical consideration. Investors are increasingly scrutinising how to balance the pursuit of high returns with liquidity needs and the time horizon of their investment strategies, indicating a sophisticated and nuanced approach to private market investments.

Compounding this theme is increased competition within private markets, driven by higher returns. This competition can drive up the cost of entry, yet the potential for greater returns continues to attract a broad spectrum of investors.

Such dynamics underscore the nuanced balance between risk and reward in private market investments. Amid these conditions, a large range of investment outcomes is anticipated across the private markets. This dispersion signifies that while some sectors and strategies will yield substantial returns, others may struggle to meet investor expectations due to the uncertain exit and pricing environment. The performance difference will be clear, showing how well different assets and investment strategies can handle the current market challenges.

### Geopolitics

Geopolitics is a major theme for private market professionals, with a particular focus on China.

The possibility of global sanctions against China raises profound questions for funds with exposure to Chinese markets or investments. The scale of Chinese LP participation in private markets is substantial, making the implications of such sanctions far-reaching for global investment dynamics. The segmentation between funds with and without Chinese involvement is not just a matter of investment strategy but also a reflection of broader shifts in international relations where economic ties with China are increasingly scrutinised and, in some cases, severed, not only at the investment level but also among individual shareholders.

The global effort to lobby against regulations like the Foreign Investment Risk Review Modernisation Act (FIRRMA) from overly affecting funds underscores the investment community's concern about being caught in the crossfire of geopolitical disputes. Such regulations, while designed to protect national security interests, can inadvertently constrain the free flow of capital and complicate international investment strategies.

Sensitive industries, particularly those with significant technological or strategic importance, such as those covered under regulations similar to the Sectoral Foreign Direct Investment Screening (SEFE), are at the forefront of these considerations. The uncertainty surrounding which sectors might be deemed sensitive and thus subject to stricter scrutiny or outright investment bans adds another layer of complexity to fund management and investment decisions.

European countries are strengthening regulations against foreign investment, with the notable exception of the UK.

# POINTS DISCUSSED

## Implementation of AI in private markets

The integration of Artificial Intelligence (AI) into the business of private markets is steering towards enhancing decision-making processes, and portfolio management rather than focusing solely on replacing the people power. This strategic approach acknowledges the potential of AI to complement and augment the capabilities of investment teams, enabling more efficient analysis, risk assessment, and identification of investment opportunities. By leveraging AI, firms can harness vast amounts of data to derive insights that were previously inaccessible, improving the accuracy of their investment decisions and operational efficiencies.

AI adoption is not without its challenges. Its vast potential application can be overwhelming. Firms are faced with the daunting task of determining how best to deploy AI technologies within their operations without being bogged down by the hype or the myriad possibilities that AI presents.

A practical approach is needed, focusing on specific, achievable goals that directly enhance business outcomes and provide the most value, rather than dispersing resources across a broad spectrum of potential applications.

In essence, the journey towards embracing AI in private markets is about striking a balance between ambition and practicality.

## Market consolidation

The landscape of private markets is undergoing a phase of significant consolidation, marked by a series of notable deals over the past year.  A smaller number of large firms continue to assert their dominance, while newcomers face formidable challenges in carving out a space for themselves. The competitive pressure is exacerbated for firms that adopt aggressive fee structures or make desperate strategic moves, with many unable to sustain their operations and eventually exiting the market.

This consolidation is not evenly distributed across all market segments. It is particularly pronounced in areas with high entry barriers and where scale and reputation play critical roles in securing deals and investor trust. The presence of 5-6 firms that continue to dominate the market underscores a reality where size and established track records offer significant advantages, including access to larger deals, more substantial fundraising capabilities, and the ability to leverage economies of scale.

For newcomers, especially in the private debt sector, the challenges are even more daunting. Unlike equity investments, where investors can demand higher returns for taking on greater risk, debt investments typically offer fixed returns. This structure means that for private debt firms, particularly those just entering the market, the ability to compete on risk-adjusted returns is constrained.

They face the dual challenge of proving their ability to manage risk effectively while also navigating a market environment that does not compensate for higher risk with proportionately higher returns. This dynamic makes it difficult for new entrants to attract investors, especially when competing against established players with proven track records and more conservative risk profiles.

### What do the next five years hold for private markets?

As these trends come together, private markets are on the verge of significant change, as US firms continue to dominate the European market, and the asset class opens up to retail investors.

Regulators, industry players, and investors will have to adjust to this changing environment, seeking growth while also focusing on stability and protecting investors. In the next few years, we're likely to see a private market ecosystem that is more interconnected, open, and dynamic. Technology, regulatory insight, and cooperation between different market participants will be equally crucial in this period of transition.

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