

Continuing to allocate to Private Equity

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As we go into 2024, investors continue to be faced with many uncertainties, whether they come from geopolitics or the macroeconomic environment. As proven in past years and especially in 2022 and 2023, allocating part of an investment portfolio to private markets help improve the risk/return profile of the portfolio through diversification. For investors that can take the illiquidity risk, we recommend an 11% allocation to private markets in a medium risk portfolio.

Within private markets, given the higher inflation and higher interest rate environment, we especially favour allocation to private credit and direct infrastructure. And we recommend continuing to allocate to private equity. Private credit, and direct lending in particular, has performed well in 2023 and we expect that to continue in 2024.

Direct lending managers extend senior secured loans to private equity firms acquiring a company, or to companies directly.

With limited new bond issuances in capital markets and a syndicated loan market still recovering from a tough 2022, direct lenders benefit from a supply/demand imbalance which allows them to extend loans at attractive terms. Rates of those loans are floating and are currently negotiated at SOFR + 550bps to 650bps.

In addition, lenders are able to negotiate restrictive covenants providing them with better downside protection.

As we do not expect a hard landing in the US or Europe, default rates shall remain relatively low.

In addition, the loans being senior secured, recovery rates upon default are relatively high compared to other asset classes.

Direct Infrastructure is another asset class within private markets which benefits from long term tailwinds.

Whether it is decarbonisation and transition to net zero, whether it is deglobalisation and the relocation of supply chains, or whether it is digitalisation, those secular trends continue to require infrastructure investments.

By allocating to direct infrastructure, investors invest in often essential assets and benefit from long term stable cash flows, mostly inflation linked.

Lastly,

we expect private equity to continue to deliver outsized return compared to public markets, and investors who can bear the illiquidity risk will continue to allocate to the asset class to capture the illiquidity premium.

Manager selection remains more essential than ever, with dispersion between top quartile managers and bottom quartile managers very high. In a higher rate environment, those managers with a proven operational playbook and access to financing will benefit from better market conditions, with lower valuations and less competition.