KEYNOTE INTERVIEW

An individual education

With demand from individual investors on the rise, fund managers should curate their investor base with due care and attention, say Partners Group's Rob Collins and Christian Wicklein

Individual investors are becoming increasingly attracted to private markets as they look to diversify their exposure and enhance their returns. However, catering to these investors' needs is far from straightforward. Rob Collins and Christian Wicklein, co-heads of private wealth at Partners Group – a firm that has been managing evergreen private markets offerings for more than 20 years – understand this predicament well.

Private Equity International caught up with the pair to discuss what individual investors need to know about private markets, whether growing contributions from this group may affect returns, and how to manage some of the complexities inherent in offering products suitable to individual clients.

SPONSOR
PARTNERS GROUP

Q What are the most important things that less experienced investors need to know about private equity?

Christian Wicklein: They need to know how dispersed private equity returns are between managers, and therefore how important it is to select the right managers. In public markets, this matters less: in exchange-traded funds (ETF), for example, the returns are very similar [between high and low performers]; in private markets, there can be a difference of up to 20 percent between the best and worst performers.

Investors need to choose carefully, especially in a more challenging economic environment where returns dispersion increases even further. Some groups haven't yet lived through a crisis and so the jury is out on how well they will do when the market turns.

Diversification is also a key point. It can be very tempting for private individuals to choose themes that are familiar to them – business owners investing in a sector they know well, for example. While that can be a nice add-on, you really want a well-diversified core position. That includes vintage-year diversification, because you need a long-term view: you can't time the market in private equity and hold back when times are tough, because you will likely miss out on some of the best opportunities.

Rob Collins: There are quite a few considerations that people take for granted in public markets investing that they can't in the private markets. In public markets, you can decide to invest and have immediate exposure; this is easier said than done in private markets. Investors need to understand the challenges involved in getting – and staying – invested in a diversified private markets portfolio.

Another consideration is operations – the critical middle – and back-office functions that many investors in public markets take for granted. For example, accurate and timely valuations: does the manager have the requisite process and tools for doing this in private markets?

So, it's complex, but there is a great opportunity for investors to diversify. In the US, for example, 85 percent of companies with revenues of $100 million or more are private. If investors want access to these foundational, proven businesses, they will have to go via private markets. Some of the most promising companies in the world are not, and never will be, public.

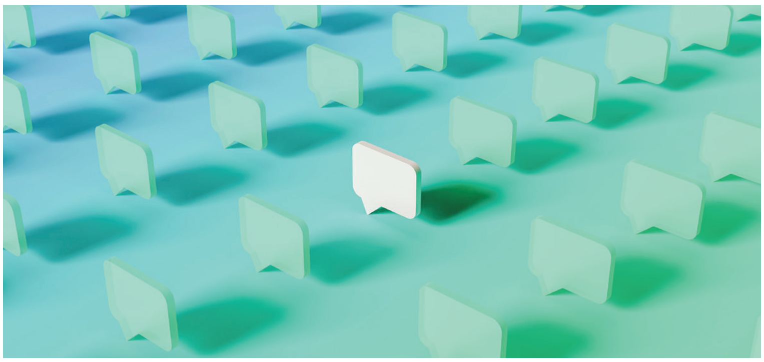
Q What challenges do managers face when dealing with an influx of individual investors seeking liquidity?

Christian Wicklein: Part of this is about attracting the right investors by educating them about product features such as liquidity limitations. We make this very clear in our communications. If you are running an evergreen fund, you want to make sure that you are purposefully building a client base as well as the underlying private markets portfolio.

It's worth saying that some of our institutional investors also like these structures because they offer straightforward exposure to private markets, so evergreens don't only attract individual investors. However, institutional capital can have the effect of concentrating the risk on the client side, especially when you have discretionary mandate positions – they can move larger amounts of capital in a day. That's why we feel it's important to be broadly diversified across thousands of individual investors accessing our funds via the right advisers and ensure tight controls on single-investor concentrations.

Yet it's also about vintage-year diversification in the portfolio. You need a balance between younger investments and those that are more mature and closer to exit and return crystallisation.

Rob Collins: It really goes back to ensuring that investors are well educated about private markets. You want to make sure your investors have a long-term perspective and that they understand the specific features of your fund and its value proposition.



Q How do you approach valuations at Partners Group?

CW: We have been running evergreen vehicles for decades because they offer investors a very convenient way to access private markets. We recognise the importance of accurate valuations, as our evergreen vehicles offer a degree of liquidity while investing alongside our closed-end funds. This means we have to ensure there is no arbitrage opportunity between the two access points, and we have to put ourselves in the shoes of the remaining investors.

We have to build a bridge from what is in the public domain and what the sector-adjusted equivalents are in our portfolio. Individual investors need to understand this, as we have different sector exposure and different growth rates compared with the public markets. For instance, for our direct equity control portfolio, we've seen average revenue growth rates of around 11 percent in recent years versus roughly 4 percent or 5 percent in public markets. That's why our valuations may differ from those in public markets.

Q How important are financial advisers and other intermediaries in a democratised environment, and how much education do they need on private markets investing?

CW: Our individual investor products are only available via carefully scrutinised intermediaries, so they are very important to us. We run academies and other educational formats for financial advisers from our distribution partners in the US, Europe and Asia-Pacific. These are centred on topics as diverse as portfolio construction, asset class features, what is happening in private markets and even what the role of an investment committee is. We want people to build a solid understanding of the content as well as product structures; this ultimately helps to align interests and build a long-term investor base.

The market is broadening for individual investors in private markets, and we welcome the growing marketplace. We all need financial advisers and intermediaries to be well informed on how private markets investments work to ensure products are appropriate for these investors. That also means tailoring education initiatives to different knowledge levels among intermediaries.

RC: Doing this right takes a lot of resources – we have client services and relationship teams fully dedicated to private wealth, for example. The type of education and topics of interest are different for individuals when compared to what is required for institutional investors, and we need to meet the idiosyncratic needs of this segment. In many ways, this is more complex than for institutional investor solutions. We need to ensure financial advisers are well equipped to have the right conversations with investors.

Q How could a wave of capital from private wealth affect private markets?

RC: I don't see the amount of capital from private wealth fundamentally changing return expectations for private markets. The opportunity set is so large among private companies, and it's getting larger. The economy continues to shift from public to private.

It's also true that certain large institutional investor segments, such as defined benefit pension plans and banks, have been on the decline. Defined contribution plans and private wealth investors are simply replacing some of the capital that used to come from them.

Q How can private markets manage this increased interest from individual investors?

RC: You have to think very carefully about this newer segment of investors so that you get off to the right start. We need to ensure we are creating the right products in the first place and positioning them correctly so that we fulfil the expectations of this newer investor base. For this reason, we don't see a mass retail opportunity in the near term; we remain focused on meeting the needs of high-net-worth clients, where we take on the complexity and in return offer a simple, meaningful solution.

"You can't time the market in private equity and hold back when times are tough, because you will likely miss out on some of the best opportunities"

CHRISTIAN WICKLEIN

"You have to think very carefully about these newer segments of investors so that you get off to the right start"

ROB COLLINS

CW: In the meantime, there seems to be broad agreement across the private markets industry that the private wealth segment represents one of the biggest opportunities today. It could be very tempting to get carried away.

It may be easy to raise more capital, but we believe private markets firms need to take a measured approach and be sure to attract the right kind of investor – people who understand what they are investing in and are 'sticky'. The industry also needs to recognise that we don't have to partner with everyone. We have walked away from partnerships with financial intermediaries because we haven't been happy with the level of advice provided to underlying investors, or because the fees charged by a distributor would be too high to leave end investors with an appropriate net return.

We have also restricted inflows of capital for more than five years now so that we can deploy capital in a reasonable manner and achieve a healthy vintage-year diversification. Managing an evergreen fund is complex – you have to manage cashflows on the portfolio level as well as subscriptions and redemptions on the investor level. And this is an area that is often neglected when talking about liquidity; people tend to think about it on the way out, but they don't consider how quickly and efficiently capital is deployed and how that can impact vintage-year diversification. These are important aspects that can have an impact on returns. ■