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Private equity's moment in the limelight?

Private
markets, upon which everything from securities to real estate can be traded, are an increasingly popular avenue for investors seeking diversification and enhanced returns. According to McKinsey the total AUM across private markets has hit another all-time high of $6.5 trillion as investors continue to shift capital from public asset classes in search of lucrative investments in the "real" economy. Most notably, private equity, referring to ownership in a company that is not bought and sold on a public bourse such as the NYSE or the NASDAQ, has become a prominent fixture in global markets and we expect the sphere to continue growing - especially in the aftermath of the coronavirus pandemic. This piece discusses some of private equity's[1] strong points that could prove useful in the months ahead.

Active expertise

In the
eternal derby between passive versus active investing, it was assumed by many commentators that active management was fighting a losing battle (especially given the relentless growth in the ETF market). However, such a view may miss the point entirely. Private markets have been growing at twice the rate of ETFs, while it's commonly accepted that 60% of private returns are driven by active ownership channeled through the improvement and enhancement of assets. In the past, the perception was that private equity firms simply came in and ruthlessly cut expenses, severing flab from the business model. However, today, they bring real operational expertise to the table. PE firms with an active approach hire some of the best talent in the market and often have a metaphorical Filofax of industry contacts. Covid-19 has sent economic activity into the doldrums. The months ahead, as the global economy tries to regain its footing will be tough for businesses and "survival of the fittest" will be more relevant than ever. The business acumen of PE firms could serve as a lifejacket for the firms they invest in.

Dry powder

In any
crisis, liquidity is crucial – the balance sheet takes precedence over the income statement in assessing the strength of a firm. At the end of 2019, private investors were sitting on a record $1.5 trillion in cash, according to Preqin: the highest amount on record. Amid the simultaneous supply and demand shock caused by the pandemic, this means firms backed by private equity firms are better poised to weather the economic cessation than those without support from financial sponsors.

Having cash
at such a time can also be used to take opportunities. In the thick of the Covid-19 crisis, the governor of Saudi Arabia's sovereign wealth fund made headlines after saying: "You don't want to waste a crisis", referring to the attractive valuations and opportunities that a downturn can bring – if you have

the capital. Those who were active in the aftermath of the 2008 crisis are now reaping the fruits.

No stock market swings and a long-term approach

The past
months have been a white-knuckle ride for investors on public exchanges. Today, equities are on a relentless rise which
almost seems to good to be true in light of the current macroeconomic backdrop. Private equity investors are not waiting with baited breath for the next correction.

Moreover,
private firms are not subject to the same stringent reporting requirements and regulations as public firms. Many companies are growing fatigued by the paperwork and processes involved in being public, as well as the pressure of reporting quarterly earnings, a process which often fosters short-termism at the expenses of long-term value creation. Between 2000 and 2018, the number of private equity-backed companies in the US rose from around 2,000 to roughly 8,000. At the same time the number of publicly listed companies fell from 7,000 to c. 4,000. With more and more tech start-ups (who embark on high-risk, high-return projects) shunning IPOs, private share trading platforms which threaten to disrupt traditional exchanges are in the pipeline. Such new platforms should help tackle illiquidity, but in the end, constant communication and a close understanding of client expectations is still the best solution.

All in all,
it was already becoming clear that private assets are a core feature of the investment landscape for investors and entrepreneurs. The industry is shaking its reputation of being opaque, complex and niche, and is increasingly perceived as an attractive way to diversify an investment portfolio and achieve enhanced long-term return potential. Covid-19 will probably only propel the popularity of PE - especially if you consider that attractive alternatives are thin on the ground in the era of interest rates that are “lower for even longer” due to central bank measures to cushion the economic damage from the

crisis. In a market where investors have often felt that there was nowhere to run and nowhere to hide, private equity may, at times, be a useful cubbyhole.

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[1] For the purpose of this article, we focus on private equity firms who create closed-end funds for investing in private equity as well as other asset classes.

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