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Secondaries Whitepaper

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Welcome to CAMRADATA's Secondaries Whitepaper

If uncertainty is the enemy of objective-led portfolios, flexibility is its antidote and a growing trend in private assets has enabled funds and investors alike to better manage their holdings in changing times.

Secondaries, or the buying or selling of non-virgin assets, has quietly revolutionised private markets. Allowing investors or fund managers to exit positions before the end of a pre-determined tenure has diluted concerns about portfolio illiquidity, while enabling rebalancing or a change of direction.

For investors, buying into secondary funds may allow better visibility into the assets – while also benefitting from an extra layer of others' due diligence – and avoid having to wait around to see how assets perform. The trend has enabled smaller players to enter a once highly elitist market, too.

Unsnaring assets from primary funds may also work out for the portfolio companies themselves, which are endowed with new owners to work through a different part of an economic cycle.

While the annual growth rate of private assets since 2017 has been 20%, taking values to $11.7 trillion as of June 30, 2022[1], secondaries have kept up the pace.

In 2021, the total volume of secondary deals hit a record high of $132bn — far surpassing the previous record of $88bn, set in 2019.[2]

An additional twist has come from who is driving the deals.

Previously an action guided by LPs, recent years have seen a significant increase in GP-led transactions, with the total value hitting $68bn in 2021[3]. This doubled the value of the previous year, and amounted for more than half the total value of secondary fund transactions.

Yet, swapping out players mid-game needs careful consideration to ensure standards and expectations are aligned. With private market dry powder continuing to stockpile, we will look at how this delicate balance might be achieved.

1 https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/mckinseys-private-markets-annual-review#at-a-glance
2 https://pitchbook.com/news/articles/continuation-funds-GPs-secondaries-private-equity
3 https://lionpointgroup.com/insights/a-secondary-wind-why-the-secondary-market-is-surging-in-private-equity/

Meet the Team

Natasha Silva
Managing Director, Client Relations

Amy Richardson
Managing Director, Business Development

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Associate, Business Development

Secondaries Roundtable

The CAMRADATA Secondaries Roundtable took place in London in September 2023

Secondaries funds play a key role in private markets, overcoming the issue of investing for a set period in a potentially volatile economic environment. But do they offer investors an attractive entry point?

Private market funds have been playing an increasingly important role in institutional investor portfolios over the past decade, offering higher expected returns than those available in public markets. The growth of the asset class was supported by the development of a secondaries market, providing greater liquidity to an otherwise fundamentally illiquid asset class.

Secondaries play an important role in private markets, providing LPs with the chance to enter and exit during the set lifecycle of funds rather than being constrained to set start and end dates. This attribute has been particularly beneficial during periods of more challenging market conditions. And, for new investors seeking exposure, the market for secondaries potentially offers attractive entry points for high-quality assets.

Whilst primary funds continue to play a key role in private market portfolios, investors are increasingly complimenting with an allocation to secondaries given their considerable benefits, says Antony Anastasiadis, principal for secondary investments at private markets investment manager Hamilton Lane.

"The secondary market has evolved to play a vital role in enabling institutional investors to actively manage their portfolios," he says. "For instance, in a capital constrained environment, LPs are thinking through how to free up capital to be directed into their highest conviction managers moving forward."

Anastasiadis notes that for many investors secondaries are an important building block in their private market portfolios. "We would argue that the current supply demand imbalance and historically low dispersion of returns make a compelling argument for investing in secondary strategies" he adds.

Nicolas Schellenberg, managing director at Cambridge Associates, adds: "In the early years, secondaries were sold as a great option for investors starting to build a private markets portfolio because they got vintage diversification and skin in the game immediately, all at a discount to the current net asset value (NAV) of the underlying assets.

"But neither discounts nor the benefits of secondaries when initiating a private investment portfolio should really be in the focus. Investors should look at the compelling risk-return profile of secondaries, which makes it a great core for any private investment portfolio."

> ***"Investors should look at the compelling risk-return profile of secondaries, which makes it a great core for any private investment portfolio."***

The growth of GP-led deals

One of the most significant recent trends in the secondaries market has been the move towards a greater proportion of transactions being GP-led, with managers seeking to offer a liquidity solution to their LPs while continuing to hold, in many cases, their most promising assets for longer.

"The advent of GP-led transactions has changed the secondaries landscape," says Benjamin Baumann, partner and global head of secondaries at Mercer Investments. "In the old days, most secondary transactions were LP-led and the situation for secondary investors was totally different. GPs, on the other hand would have passed on strongly performing investments to their peers rather than managing them longer to capture more of the growth momentum and the few GP-leds were more focused on orphaned assets.

"Over the past three to five years, GP-led transactions have picked up significantly and probably now account for 40% of overall volumes. The focus has completely changed as well, as now the objects of GP-led transactions are often trophy assets within a specific fund and the GPs don't want to give away the fruits of what they had planted. It shows that they will likely be a part of the market going forward."

Mercedes Fernandez Elias, managing director – Private Equity Secondaries at Morgan Stanley Investment Management, says the trend for GP-led deals experienced a significant growth during the global financial crisis as portfolio value creation agendas and traditional exit routes, such as IPOs or M&A, were affected. This meant partners already had to hold onto assets for longer, but then GP-led sales, especially single-asset deals, really took off during the Covid-19 pandemic.

"After the global financial crisis, GPs were left managing billions in assets and needing more time and in some cases more capital to maximise value while LPs wanted liquidity," she says. "During the pandemic, single-asset GP-led transactions grew rapidly as GPs were reluctant to sell their prized assets in a depressed environment. These deals allowed LPs to have the option to take liquidity while GPs could continue managing their best-performing assets.

"It has taken time for some GPs to understand that a sale by an LP is not necessarily a negative outcome. Many GP managers historically would not engage – and the legal set-up of funds did not permit sales when GPs were unwilling to interact," adds Anna Morrison, managing director at consultancy bfinance. "Now we have seen a greater willingness to accept LP sales, and most view this as a potential opportunity."

"What GPs did not like about the secondary market was that some LPs were selling their investments without GPs hearing about it until the last minute

> ***"LPs need to understand that LP and GP led secondaries have very different target returns, risk dispersion and cash flow profiles. It is something that comes up quite regularly with our clients. They might be more hesitant about GP-led secondaries, so you must sit down and discuss how they are different."***

and without having any control," says Cambridge Associates' Schellenberg. "During the global financial crisis, GPs started to realise that LP Secondaries can offer the potential to select and attract new LPs with capital, to support the current portfolio as well as future funds."

It is important that investors distinguish between GP-led and LP-led secondary investments as they offer very different risk-return profiles, liquidity profiles and diversification benefits, says MSIM's Fernandez Elias.

"As the market matures – we are still in the early days of GP-led secondaries – we will see much more disaggregation in fund offerings and investors will be able to choose among getting exposure to LP-, GP-led secondaries, or both because what they would be investing in is very different," she says.

"The industry needs to provide a little bit more education on these differences because LPs need to understand that LP and GP led secondaries have very different target returns, risk dispersion and cash flow profiles," says bfinance's Morrison. "It is something that comes up quite regularly with our clients. They might be more hesitant about GP-led secondaries, so you must sit down and discuss how they are different."

MSIM's Fernandez Elias adds: "Single-asset GP-led secondaries funds provide access to alpha and have the potential to generate buy-out returns – but with lower risk because you are investing in top managers and their trophy assets, which they have invested in for years.

"We believe GP-led secondaries are lower volatility, and that is getting investors interested."

Secondaries in the ESG age

Another challenge for secondaries investors is the widespread adoption of ESG principles across the investment industry. Stakeholders – whether they are shareholders, pension scheme members or employees – increasingly demand institutional investors demonstrate their positive impact.

While secondaries investors' involvement comes later in an investment's life cycle, they will still be able to exercise some stewardship, says Mark Wilgar, head of manager research & selection at global non-life legacy and run-off insurance consolidator, RiverStone International.

"Half of the battle is asking the right questions," he says. "If they see that you are asking about things that are important to you and your investors, then the GP will probably try to do something about it. But you do have to be pragmatic – you won't always be able to have a big impact."

William Martinez, senior vice president for investment advisory at Apex, adds: "Sustainability and stewardship are strong trends, and many managers have adopted them as part of their investment process. So, as the universe of investable secondary opportunities expands, there will likely be an element of indirect incorporation, and some secondaries managers may decide not to invest in funds that are controversial to their client base.

"Reporting is an important consideration for our clients and investors generally, but it will remain hugely challenging for dedicated secondaries strategies, and clients will have to accept that there will be instances where you do not have a full look-through."

Wider adoption of ESG and LPs' interpretation of related issues present significant challenges for intermediaries in the secondaries space, as each investor will have their own approach.

"Given the different transaction profiles within the secondary market, we are presented with a range of potential engagement models to integrate thinking about material ESG risks into investment processes" says Hamilton Lane's Anastasiadis.

Solving the industry's tech problem

As in many other parts of the investment universe, data and technology are crucial to helping investors make more informed decisions in the secondaries market.

"It's one thing to have a lot of data – it's an entirely different thing to disseminate that data with purpose-built technology in ways that lead to better investment results," says Hamilton Lane's Anastasiadis. "We are consistently asking ourselves how do we automate? How can we identify information alpha?

"Within our industry, a notable challenge is the digital transformation of data. For example, it's no longer acceptable to allocate significant hours of resources to manually transpose the most recent EBITDA figures from PDF documents to Excel spreadsheets."

Anastasiadis says many market participants are investing in technology to make trading in secondaries more efficient, but not every investor has access to the same resources.

"Many technology solutions are currently being cultivated internally and will serve as a wellspring of competitive advantage within the secondary sector. We believe that the entities constructing tools and solutions that harness extensive GP ecosystems will emerge as the top performers of tomorrow." he says.

New technologies such as artificial intelligence (AI) might help to solve some of the industry's issues, says Cambridge Associates Schellenberg, but there are several hurdles to overcome.

"Some people are using AI and language models, but because of the issues around data entry, quality and amount of data, rigorous human oversight and analysis is still required and full automation is a big step away," he says. "If you can automate data entry, you already gain a lot of efficiency. However, true automation with real-time data solutions and analysis supporting investment decision-making on a higher level, will need a rigorously tested 'model' behind it, built from a large amount of quality data."

Participants note that other new technologies, such as blockchain, may also have a transformative effect on the secondaries market.

"Imagine a world where you can open an app and make a commitment to a close ended private equity fund. On this app, there exists your profile, tax documents, KYC, and other pertinent information that eliminates administrative burdens," says Anastasiadis. "Oh, did I forget to mention, you can also trade in and out of that fund in the secondary market, hypothetically and technically. This is where the world is going, and we are excited to be on the forefront of backing technology companies that will allow us to get closer to this type of turn-key solution."

While manual data entry and model construction is laborious and time-consuming, it has traditionally fed into the training of junior associates within GPs, helping them to learn about the businesses they invest in, says Cambridge Associates' Schellenberg. However, automation will likely mean that fewer juniors are needed – which could have a knock-on effect on building experience in the industry.

"If everything is automated and juniors are not needed for data entry, modelling and analysis, what learning process will there be for them to become senior and, at some point, experienced investors?" he asks. "We will have to think about how to train the seniors of tomorrow."

Looking ahead

The secondaries market has played a crucial role in helping primary investors make early exits, whether it be to completely liquidate positions or rebalance their portfolios. Incoming investors could potentially benefit from missing the early stage of the so-called J-curve pathway, bypassing the early years characterised by low or negative returns while plans are implemented, before companies start generating positive cash flows.

"Secondaries are a critical part of the private markets landscape," says bfinance's Morrison. "They are a key part of portfolio construction, and there has been an incredible rise in the range of options and product types over the years."

Apex's Martinez adds: "There will be more entrants in the secondary market, including some high-quality players with differentiated capabilities and expertise.

But you will also see some offerings not faring as well, and there will be differentiation in this space. So, it will grow, and there will likely be some great stories but also some much less compelling ones. In terms of underlying asset classes, the spectrum of accessible opportunities via the secondary route is progressively increasing to encompass areas such as private debt and infrastructure for example."

As the market for secondaries grows, more specialised strategies are likely to emerge, following the specialisation seen in primary markets, says Cambridge Associates' Schellenberg.

"There will still be the traditional strategies probably with more specialisations – such as geography, size, GP- or LP-led – but there will also be more complex and completely new products emerging," he explains. "For example, there may be pure ESG or sustainability-focused secondaries funds, whereas today there is not sufficient depth in the market for those types of concentrated niche strategies."

RiverStone International's Wilgar says greater consolidation between players in the primary and secondary markets will likely occur as opportunities increasingly overlap.

"It does not strike me as very sustainable that you could run a dedicated secondaries fund without also having a primaries business that will get you on the panel with many of the GPs," he says. "I would be surprised if there are many dedicated firms in a decade that only exists to invest in secondaries."

Another potential change for secondaries will be the entrance of more retail investors as regulators remove restrictions preventing them from holding certain types of alternative investments.

"One of the big drivers of private markets in the next 10 years will be the entry of retail capital into private markets," says Mercer's Baumann. "Obviously, retail investor capital will focus on more liquid strategies, so secondaries will play a vital role."

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Roundtable Participants

Antony Anastasiadis

Principal, Secondary Investments

Personal Profile

Antony is a Principal based in the London office where he is part of the global Secondary team and leads our sourcing and institutional limited partner origination efforts. He is responsible for conducting due diligence and leading the execution of secondary investments.

Prior to joining Hamilton Lane in 2017, Antony was an Associate with Setter Capital where he focused on all aspects of secondary market transactions from sourcing, coordinating and execution of transactions on behalf of institutional investors.

Antony received a Bachelor of Honours degree in finance from the Asper School of Business at the University of Manitoba.

Company Profile

Hamilton Lane (Nasdaq: HLNE) is one of the largest private markets investment firms globally, providing innovative solutions to institutional and private wealth investors around the world. Dedicated exclusively to private markets investing for more than 30 years, the firm currently employs over 600 professionals operating in offices throughout North America, Europe, Asia Pacific and the Middle East.

Hamilton Lane has nearly $818 billion in assets under management and supervision, composed of $117 billion in discretionary assets and approximately $701 billion in non-discretionary assets, as of June 30, 2023. Hamilton Lane specializes in building flexible investment programs that provide clients access to the full spectrum of private markets strategies, sectors and geographies.

For more information, please visit www.hamiltonlane.com or follow Hamilton Lane on LinkedIn: https://www.linkedin.com/company/hamilton-lane/.

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Mercedes Fernandez Elias

Managing Director, Morgan Stanley Private Equity Secondaries

Personal Profile

Mercedes is an Investment Committee member and Partner for the Morgan Stanley Private Equity Secondaries team and has 17 years of industry experience. Prior to her current role, Mercedes headed the MS Private Equity Solutions investment platform in Europe, working across primaries, co-investments, and secondaries.

Previously, Mercedes was on the investment team at MCH Private Equity, where she was responsible for screening, analyzing and monitoring private equity investments.

Mercedes started her career as a management consultant at KPMG, advising private equity funds and corporations on strategy, mergers and acquisitions and operational issues.

Mercedes received a B.S. and MSc. with highest honors in industrial engineering from Universidad Politecnica de Madrid and an M.B.A. with honors in finance and management from the Wharton School of the University of Pennsylvania.

Company Profile

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Established in 1975 as a subsidiary of Morgan Stanley Group Inc., Morgan Stanley Investment Management has provided client-centric and risk management solutions to investors and institutions for more than 45 years.

Morgan Stanley
INVESTMENT MANAGEMENT

Roundtable Participants

William Martinez CFA CAIA

Senior Vice President, Investment Advisory

Personal Profile

William is a Senior Vice President and Team Leader in the Investment Advisory team. His role includes investment research, manager selection, investment and operational due diligence of alternative investments. This includes private markets (private equity, private credit, infrastructure and real estate), hedge funds and alternative risk premia.

In his previous role as Investment Specialist at Aberdeen Standard Investments, William covered multi-asset investment solutions across a broad range of asset classes and strategies including public markets and listed alternatives, discretionary and quantitative portfolio components. There he contributed to the design of proposals and bespoke investment mandates for institutional clients. Prior to that William worked as an Investment Analyst at IV Capital Limited, focusing on hedge fund and global asset allocation strategies. His previous roles included working at Goldman Sachs International and BNY Mellon.

William is a CFA and CAIA charterholder and a member of the CFA Society of the UK. He has a BSc in Economics from the University of Lausanne, Switzerland and an MSc in Theory and History of International Relations from the London School of Economics. William also holds the CFA Certificate in ESG Investing.

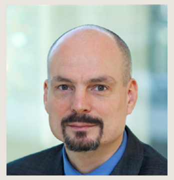
Anna Morrison

Managing Director

Personal Profile

Anna leads the coverage of Private Equity clients and services at bfinance, joining the team in October 2020. Anna is an experienced institutional investor within the private equity asset class and has an extensive fund investing track record covering the US, Europe and Asia.

Anna joined from IFM Investors, where she spent nearly 20 years managing globally focused fund of funds programmes with over USD 1.5bn in commitments. Anna received a Bachelor of Economics from the University of Tasmania and a Masters of Applied Finance from the University of Sydney.



Nicolas Schellenberg

Managing Director

Personal Profile

Nicolas is a Managing Director at Cambridge Associates and has over 20 years of experience in the investment and financial services industry. He is based in the firm's London office and is a senior member of global Secondaries team. He is overseeing due diligence on secondaries opportunities and secondary funds. Previously, Nicolas led CA's EMEA Manager Research team for Private Equity, Growth and Venture Funds.

Before Nicolas joined Cambridge Associates, he worked at Macquarie Investment Management, in the Private Equity Fund of Funds team in London, where his responsibilities included the due diligence and quantitative analysis of primary, secondary and co-investments, as well as portfolio management. Prior to this, Nicolas was with the Merger & Acquisition Advisory Teams of Lazard & Co. and ABN AMRO in London.

He also worked at the life insurance company Deutsche Herold Lebensversicherung AG in Bonn, Germany.

EDUCATION - MBA, University of Cologne
LANGUAGES - Native in German

Benjamin Baumann

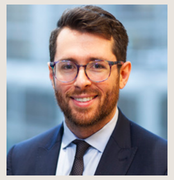
Partner - Global Head of Secondaries

Personal Profile

Benjamin Baumann is a Partner and Global Head of Secondaries at Mercer Investments, and Chief Investment Officer of Mercer Alternatives AG, the delegated Investment Manager of all Mercer's Alternatives solutions implemented in Luxembourg. In his portfolio management role, he is also a member of various Alternatives portfolio construction groups, Rating Review Committees, and Investment Committees.

Prior to joining Mercer in 2015, Benjamin worked at Strategic Capital Management AG. He holds a Master's degree in Finance and Economics from the University of Zurich, studied economics at the University of Santiago de Compostela, and is a CAIA Charterholder.

Moderator



Mark Wilgar
Head of Manager Research & Selection

Elizabeth Pfeuti
Chief Client Officer

Personal Profile

Mark is responsible for leading investment research and due diligence on external asset managers as part of the investment team at RiverStone International, a leading global non-life legacy and run-off insurance consolidator.

Prior to joining RiverStone Mark worked as Senior Investment Director in the Credit Investment Group for Cambridge Associates in London, responsible for researching and advising large institutions on credit and alternatives investment strategies across the liquidity spectrum. Between 2009 and 2013 Mark worked for P-Solve Investments Limited (now part of Schroders Solutions) in client reporting, investment, and operational functions on behalf of the £6 billion UK pension fiduciary management portfolio.

Education and Professional Credentials
• Investment Management Certificate (IMC) – 2012
• BSc Engineering and Business, Warwick Business School, 1st Class (Hons) - 2009

Personal Profile

Former Dow Jones staffer Elizabeth Pfeuti is Rhotic's Chief Client Officer and a member of the Rhotic Media executive leadership team. A highly-decorated journalist, Elizabeth has been in financial journalism for around 15 years. At Dow Jones, she covered the asset management, investment banking and investor services beats for Financial News, where she also wrote on a wide range of regulatory themes

She was previously the European Editor for CIO Magazine and boasts an exceptional contact book of buy-side and in-house institutional CIOs and asset management executives. More recently she has worked on corporate briefs for pension consultants, investment banks and asset management groups.

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