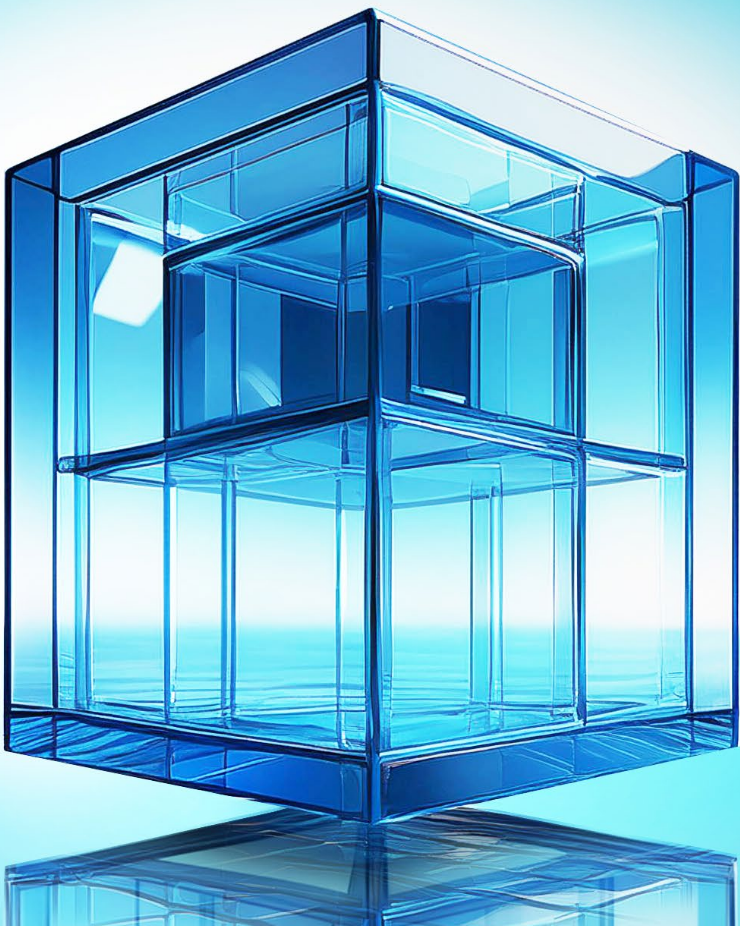
PGIM PRIVATE ALTERNATIVES

RESEARCH

WHAT'S YOUR ALTERNATIVE?

The view from investment decision makers in Europe and the Middle East



About PGIM

PGIM is the global asset management business of Prudential Financial, Inc. (PFI). In 42 offices across 19 countries and jurisdictions, our more than 1,400 investment professionals serve both retail and institutional clients around the world.

As a leading global asset manager, with $1.33 trillion in assets under management, PGIM is built on a foundation of strength, stability, and disciplined risk management.* Our multi-affiliate model allows us to deliver specialised expertise across key asset classes with a focused investment approach. This gives our clients a diversified suite of investment strategies and solutions with global depth and scale across public and private asset classes, including fixed income, equities, real estate, private credit, and other alternatives.

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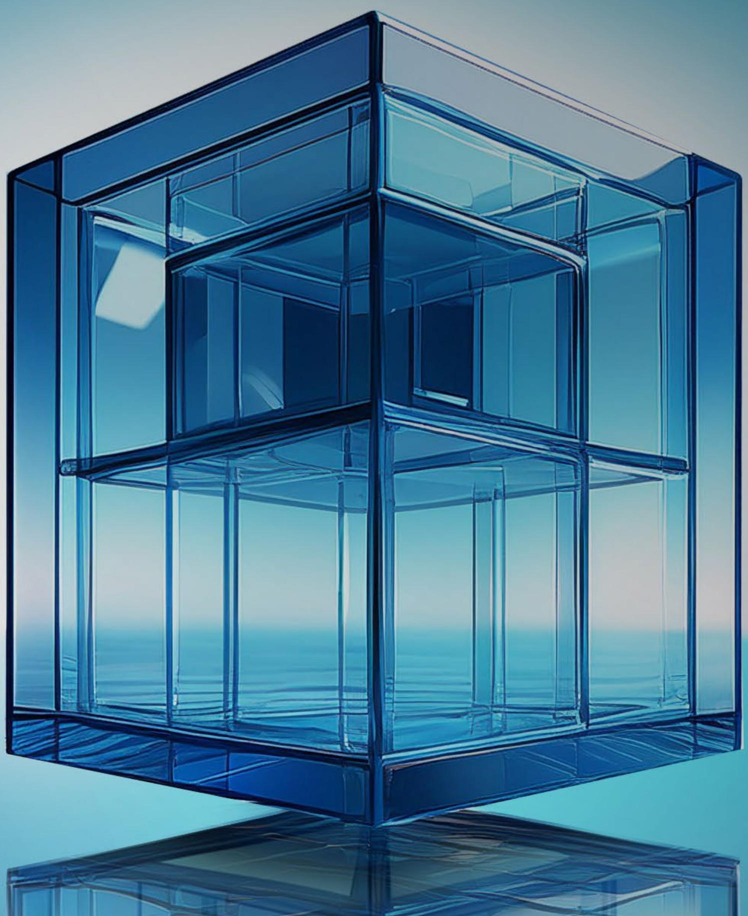

*PGIM is the investment management business of Prudential Financial, Inc. (PFI). PFI is the 12th largest investment manager (out of 411 firms surveyed) in terms of worldwide institutional assets under management based on Pensions & Investments' Top Money Managers list published June 2024. This ranking represents institutional client assets under management by PFI as of December 31, 2023. Participation in the P&I ranking is voluntary and open to managers that have any kind of U.S. institutional tax-exempt AUM. Managers self-report their data via a survey. P&I sends the survey to previously identified managers and to any new managers asking to participate in the survey/ranking. No compensation is required to participate in the ranking.

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INTRODUCTION

Private alternative assets are playing a greater role in institutional portfolios, driven by the pursuit of higher returns, diversification, and the increasing private market investment opportunity set. In a report published in March 2024, management consultancy McKinsey estimated that assets under management in global private markets totalled $13.1 trillion as of June 2023, and have grown nearly 20 percent per year since 2018.[1]

The post financial crisis era of low interest rates was a significant demand driver for private alternatives. But even in the recent environment of high interest rates, the muted volatility in private alternative assets offers a compelling proposition for institutional investors, delivering superior risk-adjusted returns. A study published by CAIA in 2024 found that annualised returns generated by private equity allocations from U.S. state pension funds outpaced returns from public equities over more than two decades.[2]

Large sophisticated institutional investors are allocating more to alternative assets."[3]

DAVID HUNT
President & CEO, PGIM

To examine the institutional use of private market assets, PGIM and Institutional Investor's Custom Research Lab partnered to survey more than 250 investment decision makers at institutions in Europe and the Middle East, representing approximately $10 trillion in assets under management. The results show that investors are committed to increasing their allocations in the coming years.

Respondents cite increasing geopolitical risks and declining correlations between public and private markets as major factors for increasing their target allocations to these categories of assets. By integrating private alternatives into their portfolios, investors seek to achieve a superior risk-return profile and mitigate the impact of market volatility.

Whilst these factors are consistent with reported trends, in this report we unveil the detail beneath the headlines. These results explore the building blocks within private markets and investigate how allocators are thinking about expanding and diversifying their holdings across private alternative assets.

1 McKinsey & Company (March 2024) Private Markets: A slower era. HYPERLINK "https://www.mckinsey.com/~/media/mckinsey/industries/private%20equity%20and%20principal%20investors/our%20insights/mckinseys%20private%20markets%20annual%20review/2024/mckinsey-global-private-markets-review-2024.pdf?shouldIndex=false"mckinsey-global-private-markets-review-2024.pdf" Accessed July 2024

2 CAIA Association (April 23, 2024) Long-Term Private Equity Performance: 2000 to 2023. HYPERLINK "https://caia.org/blog/2024/04/23/long-term-private-equity-performance-2000-2023"Long-Term Private Equity Performance: 2000 to 2023 | Portfolio for the Future | CAIA Accessed July 2024

3 PGIM (July 15, 2024) PGIM President and CEO David Hunt Talks Asset Management's Evolution. "https://www.pgim.com/interview/pgim-president-and-ceo-david-hunt-talks-asset-managements-evolution" Accessed July 2024

SURVEY METHODOLOGY

The 19-question survey was conducted over Spring/Summer 2024. Survey respondents represent large institutions in the United Kingdom, Continental Europe, and the Middle East. The breadth of the institution types surveyed provide a comprehensive view of investors' practices and aspirations across the EMEA region.

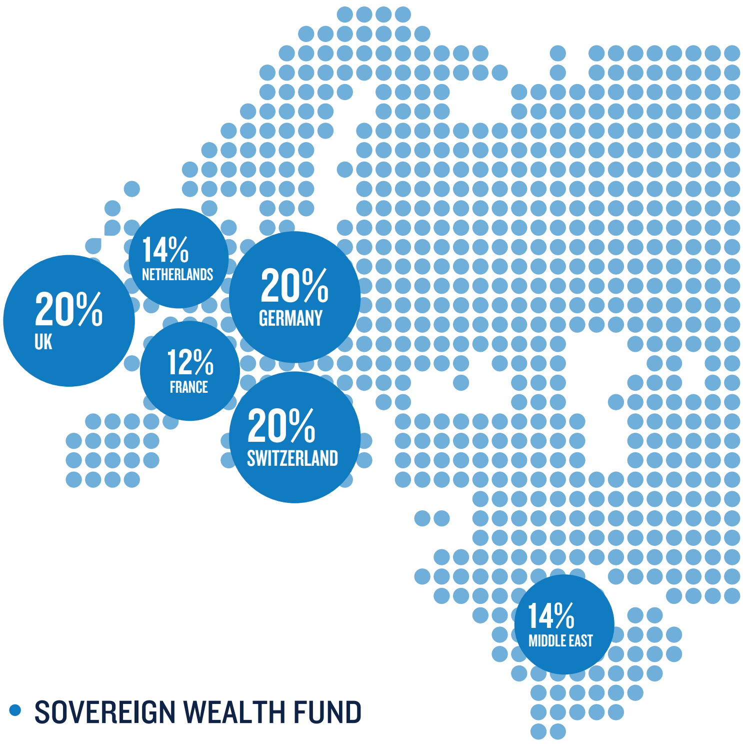
The survey explored three core themes:

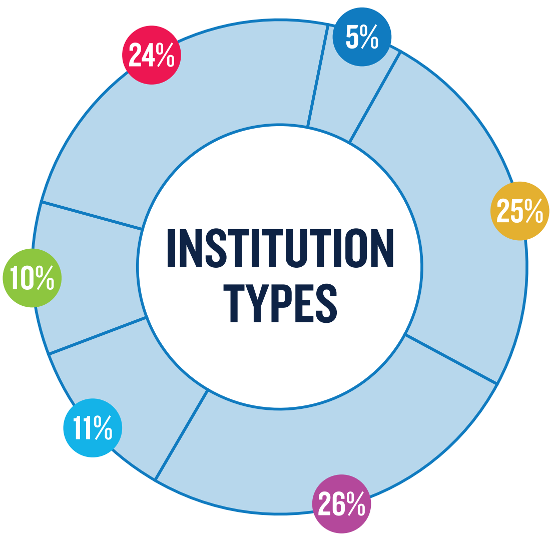
1. **Drivers and Holdings:** The main factors driving allocations towards private alternatives and the current state of play among institutional investors.
2. **Opportunity Set:** The most widely held asset classes among survey respondents, factors driving demand within the broader private alternatives' universe, and regional preferences.
3. **Routes to Market:** Investor preferences when partnering with asset managers to access markets and what characteristics are highly valued.

250 RESPONDENTS

$10T AUM

19 QUESTIONS

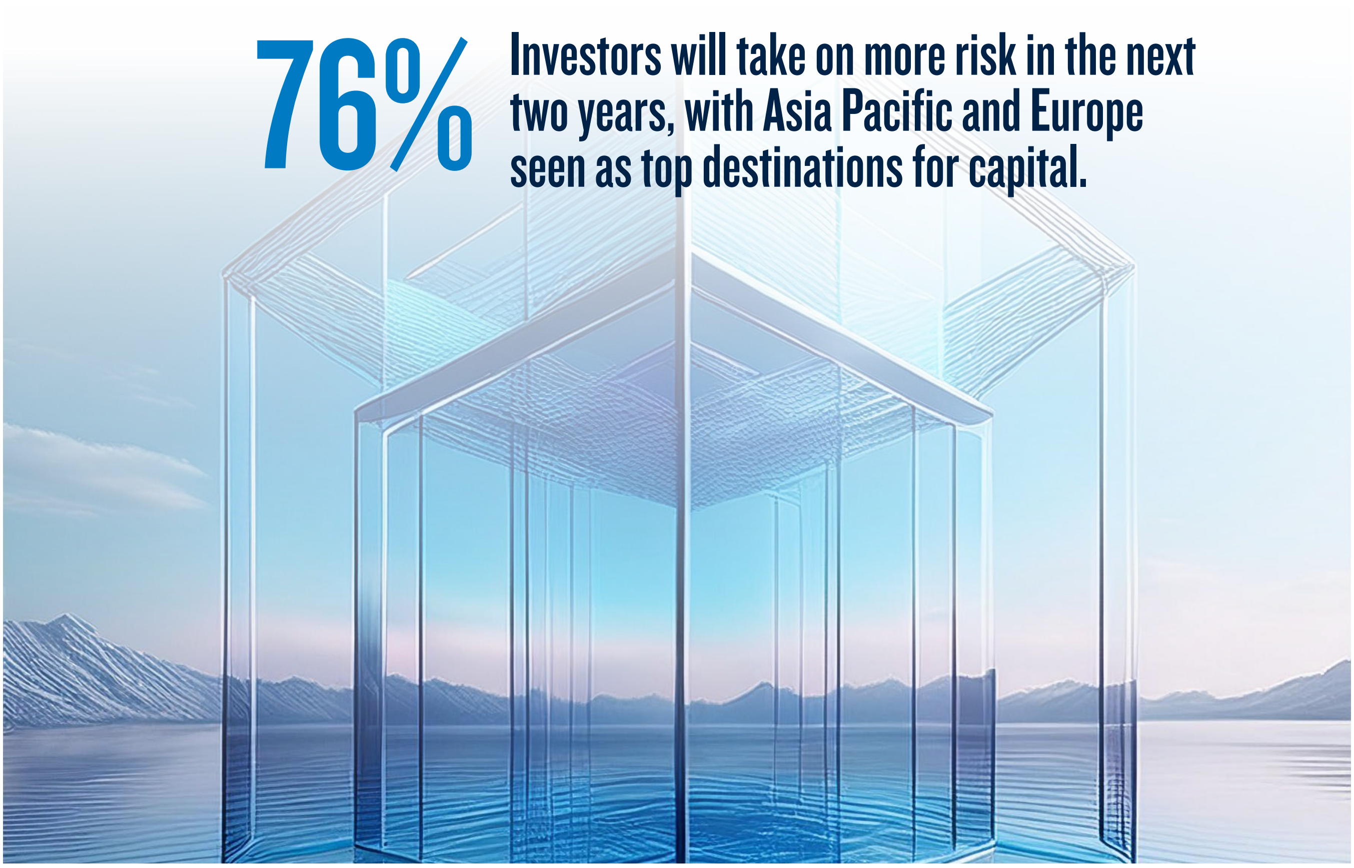




- SOVEREIGN WEALTH FUND
- INSURANCE COMPANY
- PENSION
- FOUNDATION/ENDOWMENT
- FAMILY OFFICE
- PRIVATE BANK

KEY TAKEAWAYS

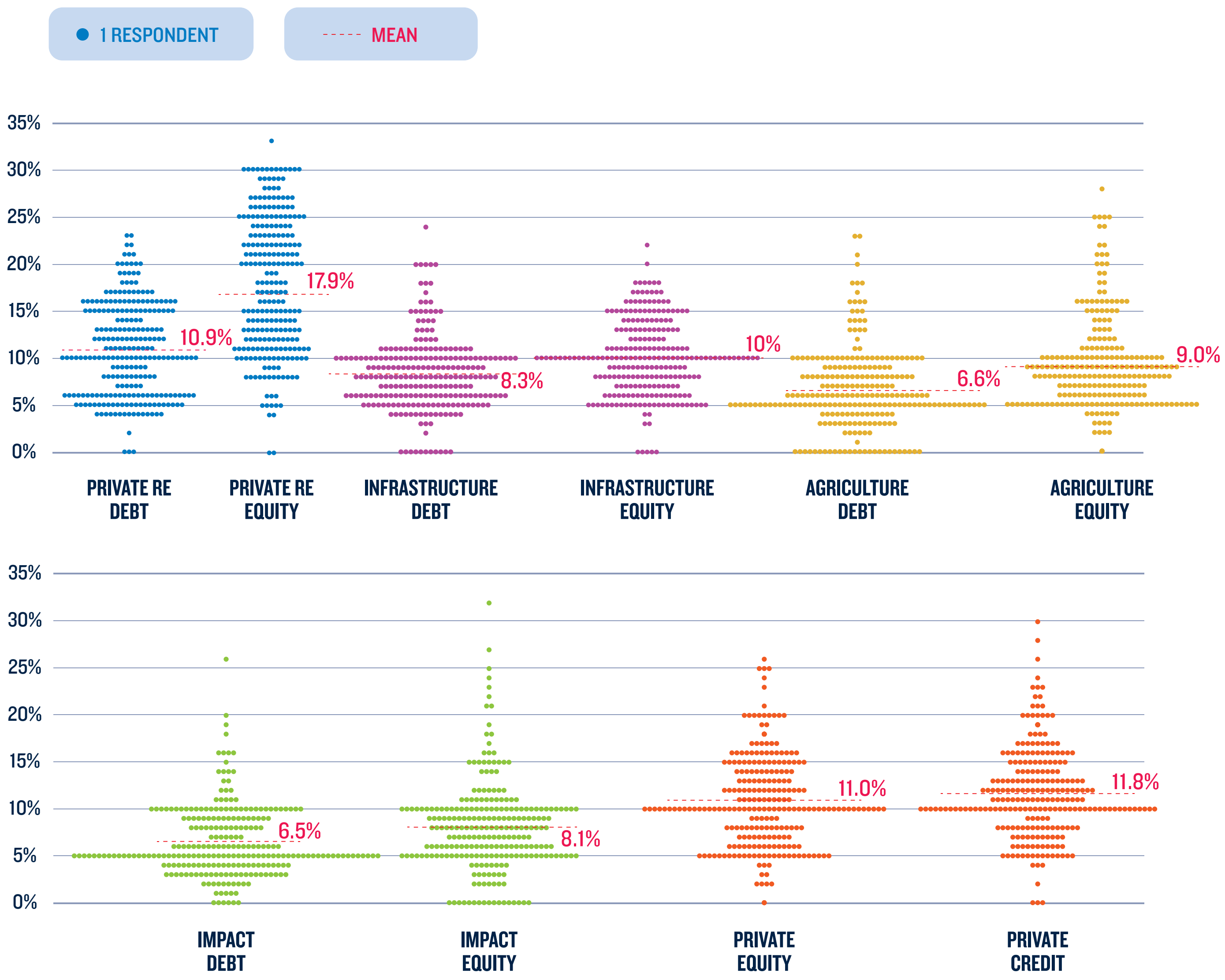
1. **Current Allocations:** Private alternatives make up approximately 25% of survey respondents' portfolios. Within this allocation, real estate equity (18%), private credit (11%), private equity (10%) and real estate debt (10%) are the most widely held asset classes.[4]
2. **Future Allocations:** Investors are most likely to increase holdings of private credit (44%), private real estate debt (42%) and sustainable equity (40%) over the next two years.
3. **Key Risk Areas:** Respondents foresee rising geopolitical risks (58%) and increased volatility in public markets (36%) fuelling demand for active strategies and private alternatives.
4. **Geographical Focus:** Developed Asia Pacific (64%) and Emerging Europe (59%) will attract more investments over the next two years. Latin America (8%) and China (26%) see declining investor appetite over the same period.
5. **Manager Outcomes:** Most respondents (52%) say their current asset managers have underperformed in providing access to liquidity via secondary markets. Nearly one-third of respondents (32%) say their current managers have fallen short of speed and timing expectations for exit transactions.
6. **Industry Partnerships:** Fully 62% of respondents prefer large, multi-line asset management firms with broad offerings and a local presence in multiple markets. Only 22% favour small boutiques that specialise in one or more private alternative assets.



4 Median estimates.

Exhibit 1: Approximately What Proportion of Your Private Alternative Allocation is Invested in the Following Asset Subclasses?

Real Estate equity, private equity, and private credit are the most widely held private asset classes



THE DRIVE FOR ALTS

Why are investors keen on
Private Alternatives?

THE DRIVE FOR ALTS: WHY ARE INVESTORS KEEN ON PRIVATE ALTERNATIVES?

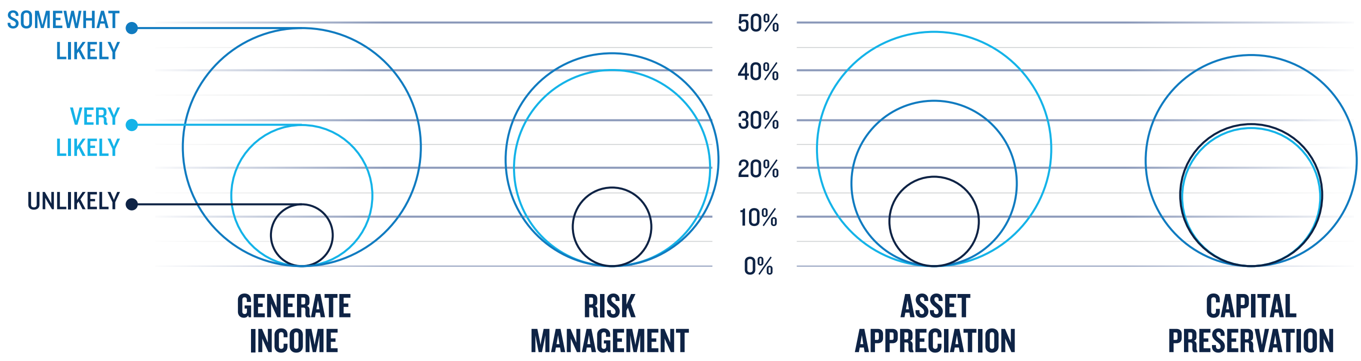
The flow of institutional funds into private alternatives has been larger than at any previous time in history. While this is partly due to the historically low interest rate regime following the global financial crisis, other factors have fuelled the growth of private alternatives in recent years.

The continued volatility in public markets is a key driver for the growing institutional appetite for private alternatives, and 36% of study participants anticipate market volatility will increase over the next two years.

The latest reminder of this was in August 2024 when the CBOE Volatility index – the VIX, Wall Street's closely watched gauge of investor anxiety in the US equities market – logged its biggest ever intraday jump, according

Exhibit 2: How likely is your institution to use private market alternative investments to meet the following portfolio objectives over the next two years?

Investors look to private alternatives for returns, income generation, and risk management



"

The banking sector has lowered its risk appetite for private real estate lending, leading to a structural funding gap that will require financing by institutional investors."

ANDREW RADKIEWICZ
Global Head of Private Debt Strategy and Investor Solutions
PGIM Private Alternatives

to Reuters.[5] In contrast, many investors prefer the lower frequency at which private markets are marked or repriced. Public markets price minute-to-minute and can be volatile – especially when risk appetite changes abruptly.

In contrast, private markets do not price as often and are less exposed to the sentiment-based gyrations (and potential overshooting) of public markets. The less-frequent pricing has the effect of smoothing valuations for private assets. During periods of market turbulence, this lagged repricing can reduce the swings in net asset values and funding ratios.

An overwhelming majority of survey respondents (88%) also value the income generating properties that private alternative assets offer. For instance, real estate and infrastructure investments can provide steady income streams through rents or usage fees. These assets thrived in the recent low interest rate regime when traditional fixed income assets investments failed to satisfy investors' income requirements.

Circa four out of five respondents (82%) also value the differentiated investment returns that private assets offer compared to public markets. Private equity, real estate, and infrastructure investments provide early exposure to high-growth companies and innovative technologies that are not yet available in public markets, offering substantial upside potential.

Meanwhile, once niche strategies such as agriculture are increasingly going mainstream, with investors trying to solve the trillion-dollar puzzle of feeding a growing world population with a dwindling amount of arable land due to climate change. As a result, the evolving landscape of agriculture and food production creates a range of investment opportunities.

> **Our private asset allocation is driven by the diversification benefits of the asset class as we are heavily exposed to equity market volatility in our portfolio. Moreover, there is a greater focus towards investing in income producing alternative assets in the last few years. ”**
>
> **DIRECTOR OF PENSIONS**
> **UK Pension Fund, £10 billion in assets under management**

5 Reuters (August 5, 2023) Wall Street 'fear gauge' logs record jump as investors bet on more turbulence. HYPERLINK "https://www.reuters.com/markets/us/wall-street-fear-gauge-posts-record-intraday-jump-stocks-slide-2024-08-05/" Wall Street 'fear gauge' logs record jump as investors bet on more turbulence I Reuters Accessed July 2024

STATE OF PLAY

The role of private alternatives in institutional investors' portfolios

STATE OF PLAY: THE ROLE OF PRIVATE ALTERNATIVES IN INSTITUTIONAL INVESTORS' PORTFOLIOS

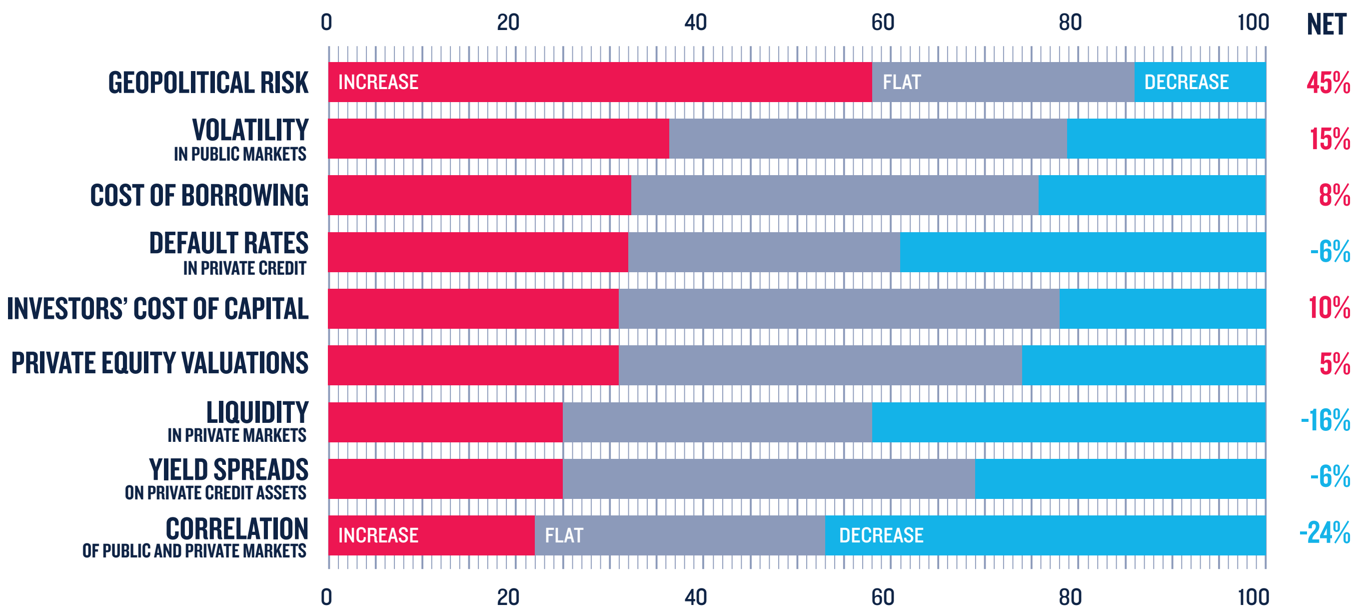
Private alternatives make up a quarter of the survey respondents' portfolios, and allocations to these types of assets are set to grow over the next two years. Investors' expectations for increased geopolitical risks and greater market volatility are likely to drive them toward active strategies.

Geopolitical risks have been a central focus for investors in recent months, with global tensions and election uncertainties continuing to affect markets. These concurrent tensions are contributing to an uncertain economic environment, with 58% of survey respondents expecting geopolitical risks to increase over the next two years.

Global markets have faced high volatility in recent years due to the double blow of high inflation and rising interest rates. Equity markets have swung sharply while government bond yields have climbed to multi-decade highs, with increasing divergences in central bank policy responses globally. Though equity markets are seen benefiting from a broader interest rate easing cycle led

Exhibit 3: What is your two-year outlook for the following investment factors?

Geopolitical risks and market volatility will increase



by major central banks, volatility is unlikely to subside. In total, 36% of survey respondents expect volatility in public markets to increase, while 42% expect volatility to remain at current elevated levels over the next two years.

Of the various categories of private alternative assets, private real estate equity, private equity and private credit comprise the most widely held assets among survey respondents' portfolios. Allocations to private real estate equity top allocations among respondents, with a median weight of 18% in their overall private alternatives' asset allocation. Real assets such as infrastructure and real estate have the potential to deliver long-term stable cash yields throughout various market cycles.

Of note has been the growth of private credit in investors' portfolios; this has been the fastest growing sub-asset class in the private alternatives space, accounting for a median allocation of 11% among survey respondents. The recent growth in the use of private credit is tied closely to changes in bank lending after the 2008 financial crisis, which has prompted commercial banks to retreat from corporate lending activities to hold more capital reserves.

We expect the private credit segment to see greater allocations from institutional investors over the next decade.

Call Back

The dispersion or the extent to which holdings were spread out around an average value among various kinds of private investments was the highest for private equity. Certain investor types, such as insurance companies, have regulatory limitations to invest in the asset class, while other institutions, such as endowments, typically have greater flexibility to invest in private equity.

THE ROAD AHEAD

Outlook for allocation trends in private alternatives

THE ROAD AHEAD: OUTLOOK FOR ALLOCATION TRENDS IN PRIVATE ALTERNATIVES

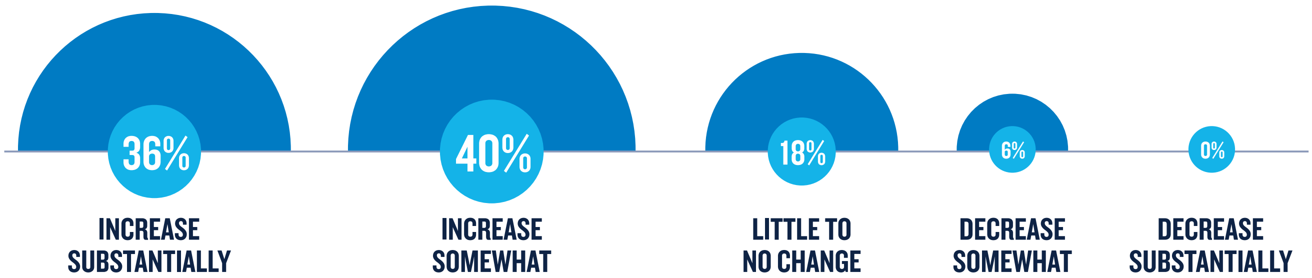
To make the case for increased allocations to private alternatives, investors need only to look back two years. 2022 was among the worst on record for a 60-40 portfolio, as stock/bond correlations jumped, readings spiked due to supply shocks to the global economy.[6] The increased correlations led to sizeable negative returns for portfolios, prompting a renewed push towards including assets that offer greater diversification.

Nearly half of the survey respondents (47%) expect correlations between public and private markets to decline over the next two years as the latter offers access to a wider range of assets and investment strategies than public markets, supporting their case for a greater push to include alternative assets in portfolios.

A recent study found that reallocating a theoretical 60/40 stock/bond portfolio to 40% equities, 30% bonds, and 30% alternatives increased its Sharpe ratio to 0.75 from 0.55 between 1989 to 2023.[7] Even adjusting for leverage, fees and spreads, the mean/volatility ratio for a buyout fund outpaced the U.S. equity market between 2005 to 2023.[8]

Exhibit 4: How do you anticipate your institution's risk appetite is most likely to change over the next two years?

An overwhelming majority anticipate taking on more risk in the next two years



76% Respondents expect their risk appetite to increase.

"

Infrastructure or real estate offer choices for long term providers of capital and generate a different pattern of returns which gives us diversification benefits from equities and fixed income."

CIO, UK PENSION FUND
£11 billion in assets under management

6 Reuters (April 11, 2024) Negative equity/bond correlation is positive for 60-40 portfolio. HYPERLINK "https://www.reuters.com/markets/europe/negative-equitybond-correlation-is-positive-60-40-portfolio-2024-04-10/" Negative equity/bond correlation is positive for 60-40 portfolio | Reuters Accessed July 2024

7 CFA Institute (December 21, 2023) The 60/40 Portfolio Needs an Alts Infusion. HYPERLINK "https://blogs.cfainstitute.org/investor/2023/12/21/the-60-40-portfolio-needs-an-alts-infusion/" The 60/40 Portfolio Needs an Alts Infusion | CFA Institute Enterprising Investor Accessed July 2024

8 PGIM (July 14, 2024) Uncovering the Unobservable: Have Private Assets Outperformed Public Assets? HYPERLINK "https://www.pgim.com/research/uncovering-unobservable-have-private-assets-outperformed-public-assets" Uncovering the Unobservable: Have Private Assets Outperformed Public Assets? (pgim.com) Accessed July 2024

More than 75% of the survey respondents anticipate taking on more risk in their portfolios over the next two years, with 36% expecting a substantial increase in risk appetite during that period. This "risk on" posture bodes well for the outlook for private alternatives to play a key role in delivering clients' key investment capabilities in their portfolio construction.

Tailored Solutions for Different Investors

This study categorises private alternative assets into private equity, private debt, real estate, impact investing, agricultural assets, and infrastructure projects.

Each category offers unique risk-return profiles and liquidity profiles, enabling institutional investors to customise their portfolios to meet specific investment objectives and enhance overall performance. The following sections take a closer look at the survey respondents' appetite for each individual asset class.

Real Estate: Emerging from cyclical headwinds

QUICK TAKE:

- **The ability of European investors to increase allocations to real estate is constrained.**
- **Europe faces long-term structural undersupply of real estate.**
- **Urban "densification" and growing demand for data centres highlight sector transition.**

Real estate markets have weathered a tough environment in recent years due to the aggressive monetary policy tightening campaigns by major central banks and post-pandemic economic uncertainty, leading to a major correction in pricing. This is most evident in Europe, where the decline in real estate values over the last two years has been acute. However, the appeal for the real estate sector remains intact in the long term.

From a demand perspective, the ability of European investors to increase allocations to real estate in the near to medium term is constrained. Many possess large real estate allocations and have to invest significant amounts of capital in their existing portfolios. This is reflected in the survey results, with respondents in Germany and France expecting to keep their allocations to real estate debt intact over the next two years.

Europe has some of the highest ESG standards in the world, and bringing properties up to these standards requires significant capital investments from owners over the coming years. The issue is particularly urgent in Germany where local investors – traditionally a reliable and dominant source of new capital – are now less able to make significant new capital commitments because of their large current real estate exposures and the funding requirements for those assets.

From a supply perspective, Europe suffers from a significant, long-term structural undersupply of real estate, as planning laws give preference to conservation over development. The supply deficit runs into millions of units for every large market and is becoming a significant societal issue.[9] The undersupply is key in larger metropolitan areas and in central core locations. They include larger urban centres in Europe for residential purposes and last mile logistics in urban clusters. At the other end, there is a surplus of secondary

> **"The future of core real estate is going to look very different from what we have seen in the past two decades."**
>
> **SEBASTIANO FERRANTE**
> **Head of Europe**
> **PGIM Real Estate**

9 PGIM (April 18, 2023) The Long-Term Funding Gap in European Real Estate. HYPERLINK "https://www.pgim.com/alternatives/long-term-funding-gap-european-real-estate" The Long-Term Funding Gap in European Real Estate (pgim.com) Accessed July 2024

Exhibit 5: Portfolio rebalancing, diversification, and favourable risk profile drive investments

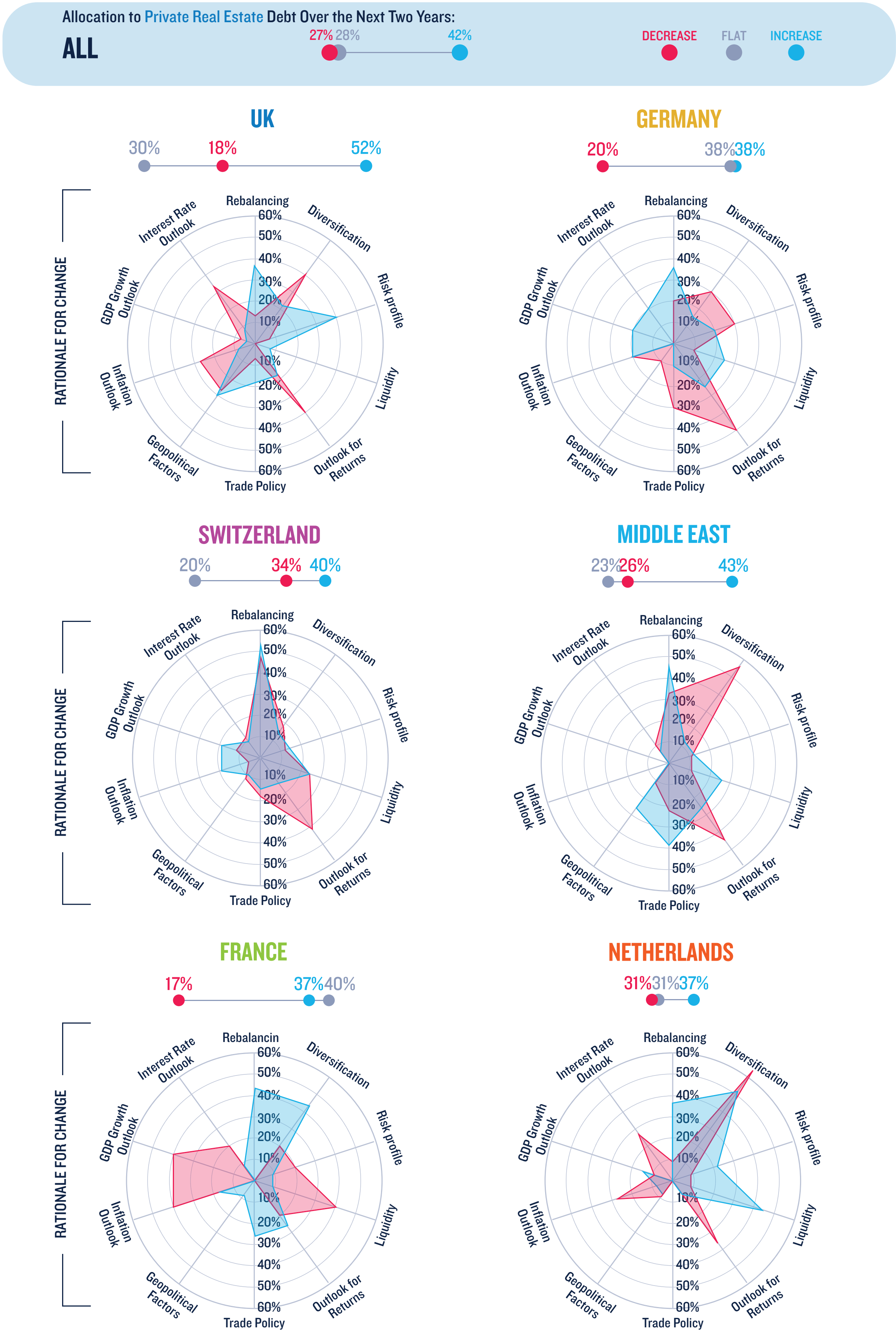
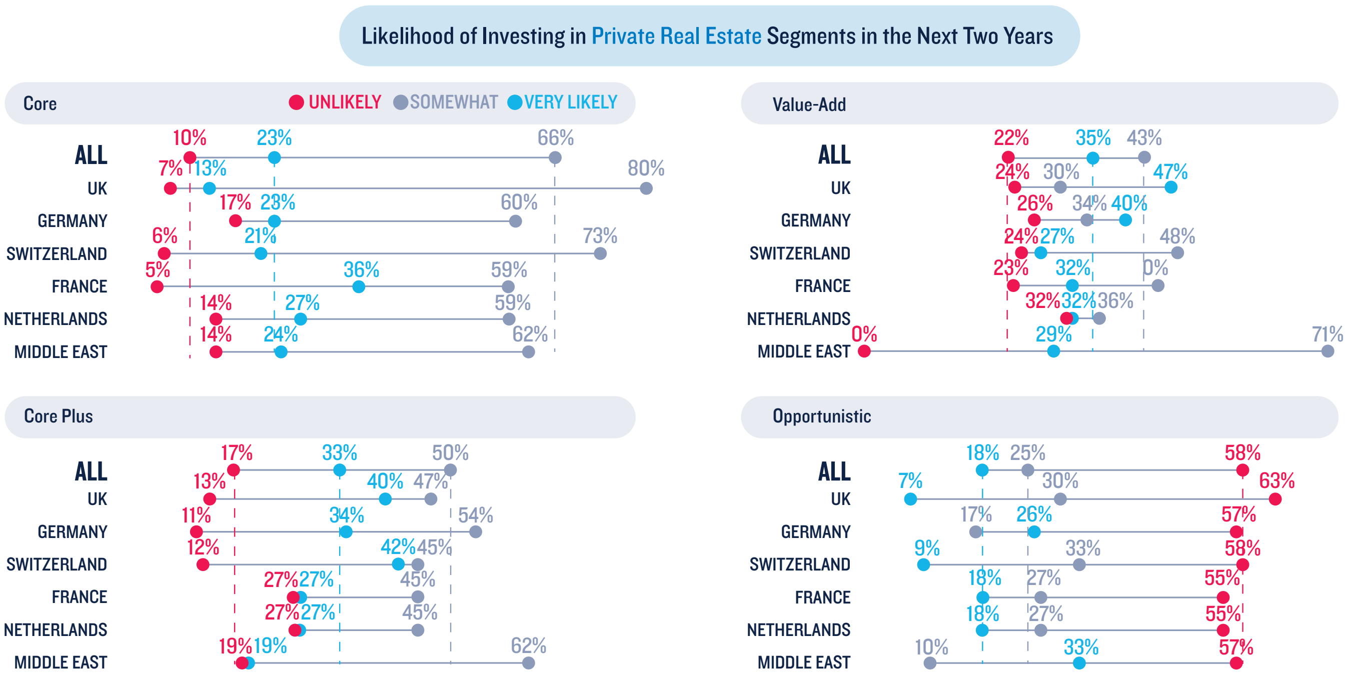


Exhibit 6: Investors seek risk, but avoid opportunistic segments

Likelihood of investing in Private Real Estate Segments in the next two years



office space, shopping malls and residential projects in low-density regions.

Elsewhere, offices - which traditionally comprise a large proportion of real estate - are facing structural headwinds from changing demographics, the evolution of working practices, and increased maintenance costs in an inflationary environment.

However, the changing macroeconomic backdrop is providing new opportunities. Unlike the previous economic cycle which was distinguished by low interest rates, quantitative easing and yield compression, the current regime in the real estate markets is marked by selectively investing in growth areas characterised by high net operating income (NOI) margins and income growth.

As a result, the real estate sector is transitioning from a distressed situation scenario to a growth-supporting environment. For example, the widening reach of mega-cap technology firms in the global economy signals growing demand for datacentres. Other areas for growth include a supportive housing and retirement environment for the aging population and the need to provide affordable housing solutions for the younger population in urban areas.

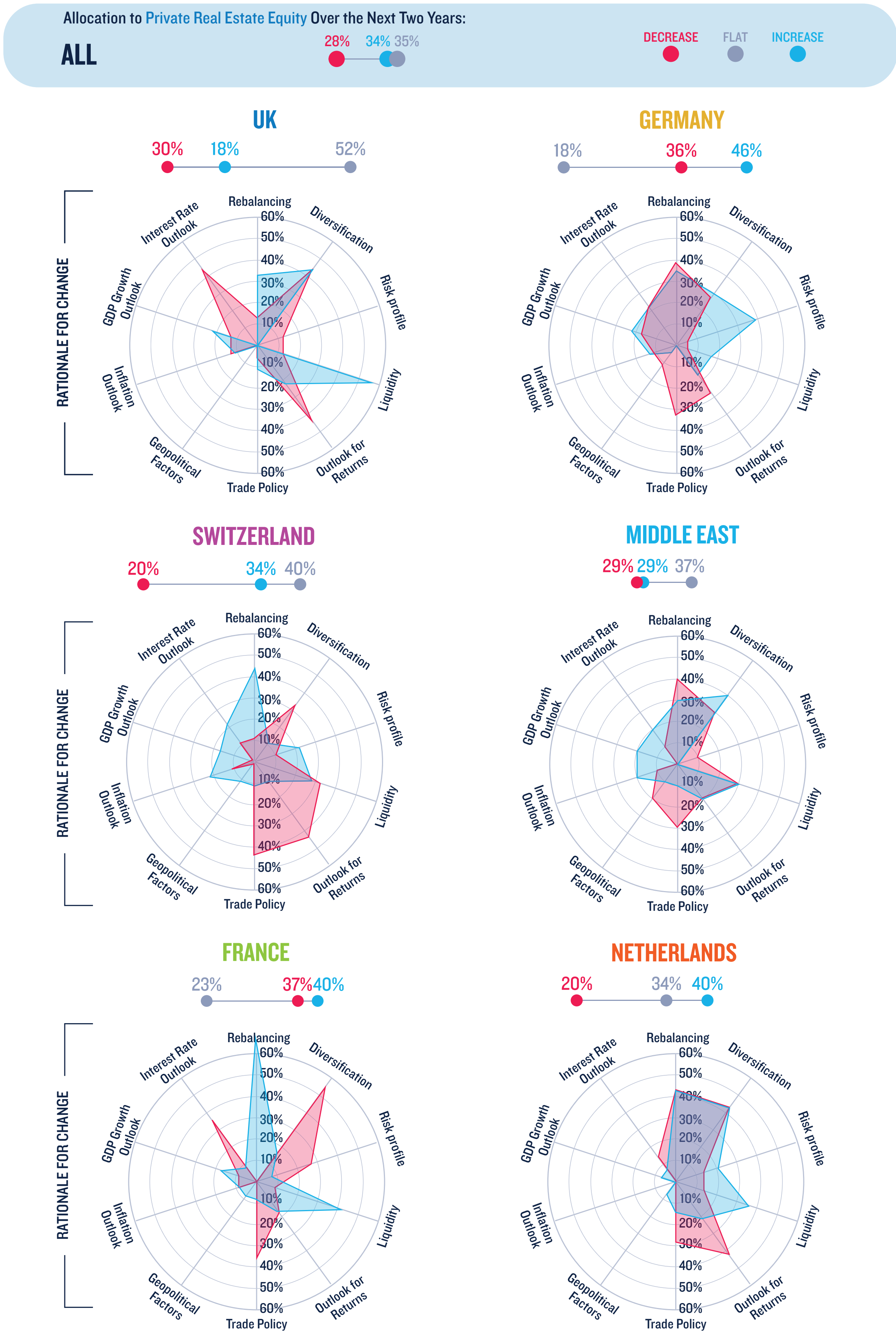
A third and an often-underappreciated factor is the keen interest which regulators are taking towards European banks to boost their capital reserves that is expected to create a shortage of loans towards this sector. CBRE expects a funding gap of more than $200 billion in European private real estate debt over the next three years.[10]

Among survey respondents, 42% say they are most likely to increase allocations to real estate debt investments over the next two years, with insurance firms leading the broader interest among investor types. Respondents – especially private banks and foundations, which forecast decreasing their allocations – are likely to base their decisions on the sector's uncertain outlook.

Within the real estate debt segments, respondents are the most optimistic towards increasing their allocations to core plus and value-add strategies over the next two years. Core plus strategies offer durable cash flows from

10 CBRE (December 13, 2023) The debt funding gap for European real estate. HYPERLINK "https://www.cbre.com/insights/reports/the-debt-funding-gap-for-european-real-estate" The debt funding gap for European real estate | CBRE Accessed July 2024

Exhibit 7: New investments driven by rebalancing, liquidity and diversification



high-quality properties using low to moderate leverage.[11] A third of respondents (33%) expect to increase their allocations to this sub-category over the period. At the other end, only 18% of respondents plan to increase their allocations to the opportunistic category signalling investors are cautious on undertaking higher risk investments.

From a demand perspective, real estate equity investments lagged their debt counterparts among institutional investors, with the slight majority of all respondents (34%) preferring to leave their allocations unchanged over the next two years due to the above reasons. Nevertheless, pension funds and family offices are the institutions most likely to make greater allocations to real estate equity over the next two years, according to the survey.

Either side of this majority, respondents were broadly divided between increasing and reducing their allocations to real estate equity; the graph above shows where regional and rationale nuances are influencing the overall figures. Investors who forecast a decrease in their real estate equity allocations based their decision on an uncertain outlook scenario while rebalancing portfolios was the major factor for increasing allocations to real estate equity investments.

The UK lagged the most among regional peers for making fresh allocations to real estate equity over the period, potentially due to recent supply chain issues for building materials, but that is likely to change as political uncertainty fades.

"

This is a historic time to potentially get double digit yields on senior secured loans in the backdrop of a favourable economic outlook."

ANTHONY MA
Principal
PGIM Private Capital

Private Credit: The rising star

QUICK TAKE:

- **Nearly half of survey respondents plan to keep private credit allocations unchanged.**
- **Sponsored offerings by PE-backed issuers remain industry benchmark.**
- **Family offices and private banks seen increasing allocations over the next two years.**

Demand for private credit has grown significantly in recent years, especially after the global financial crisis when greater regulation of commercial banks made it difficult for a wide swathe of borrowers to obtain leveraged loans. The International Monetary Fund estimated that the global private credit market topped $2.1 trillion globally in assets and committed capital in 2023, with approximately three-quarters based in the United States.[12]

Unlike bank lending, private credit solutions are tailored to meet borrowers' needs in terms of size, type, or timing of transactions. Today, it encompasses more segments of corporate lending, a wider range of real asset debt and a broader set of asset-backed loans including those backed by intangible assets such as music royalties and litigation finance. Furthermore, private credit markets are not only increasing in breadth but in scale as well.

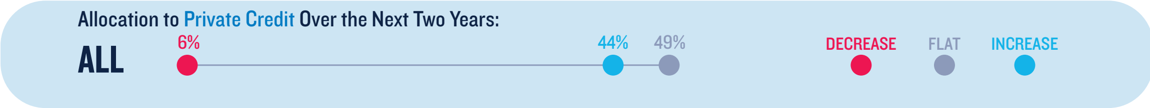
Nearly half of the survey respondents (44%) are likely to increase holdings of private credit over the next two years, thanks in large part to its healthy yields and favourable risk profile. These investments offer higher interest rates due to the illiquidity premium, with historical gross yields in direct lending trending in the low double-digit range (base floating rate plus 500 – 700 basis points of spreads).[13]

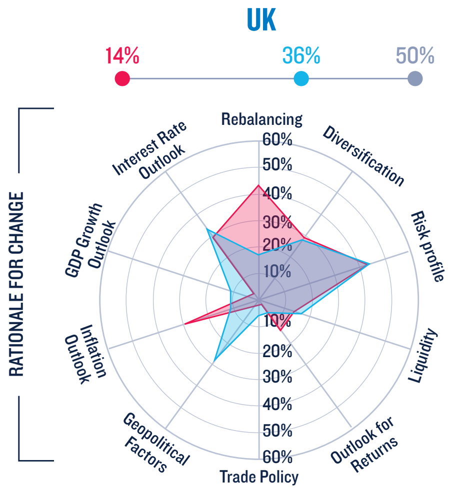
The environment of high interest rates in the wake of the global inflationary shock has also separated issuers with strong business models that have robust balance sheets and can support higher interest expenses from their less prosperous peers. As a result, senior secured lending currently offers the potential to capture unprecedented double-digit yields.

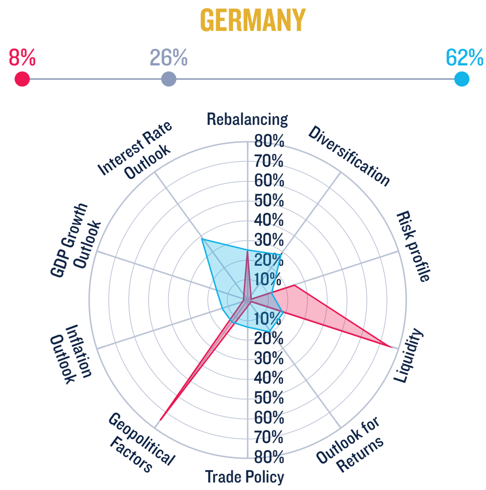
11 PGIM. Investing across the Real Estate Markets. "https://www.pgim.com/real-estate/investments" Accessed July 2024
12 International Monetary Fund. (April 2024) The Last Mile: Financial Vulnerabilities And Risks. HYPERLINK "https://www.imf.org/en/Publications/GFSR/Issues/2024/04/16/global-financial-stability-report-april-2024" The Last Mile: Financial Vulnerabilities and Risks (imf.org) Accessed July 2024
13 PGIM (May 1, 2024) In Conversation with IAS: Tony Coletta and Junying Shen. "https://www.pgim.com/interview/conversation-ias-tony-coletta-and-junying-shen" Accessed July 2024

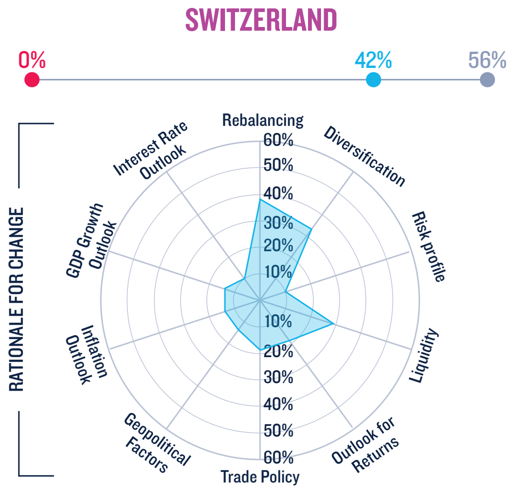
Exhibit 8: Healthy growth in allocations in search of diversification and rebalancing amid a relatively higher interest rate outlook

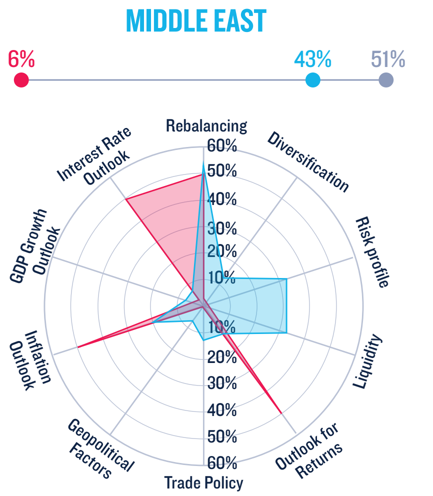
Germany is notably eager for new private credit investments, while Switzerland foresees no decrease

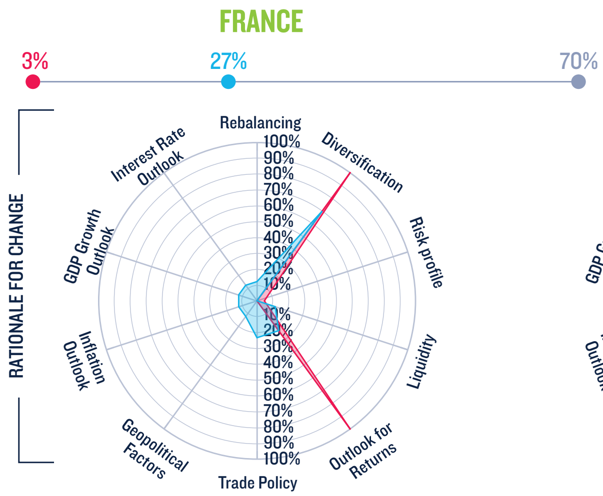


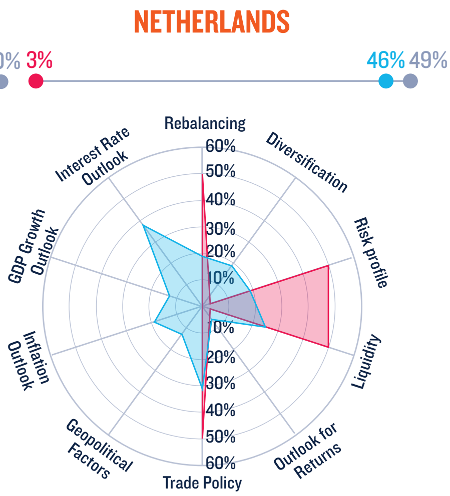












> **Private Credit is a safer asset class than it was about a decade ago.”**
>
> **TONY COLETTA**
> **Executive Director, Global Debt Solutions**
> **PGIM Private Alternatives**

Private credit can be more attractive than the equity route because senior debt repayments are prioritised over subordinated debt and equity holders. Private credit funds also have covenants that allow them to take protective measures if a company underperforms. However, private lending markets have yet to face an economic downturn, warranting some caution among investors.

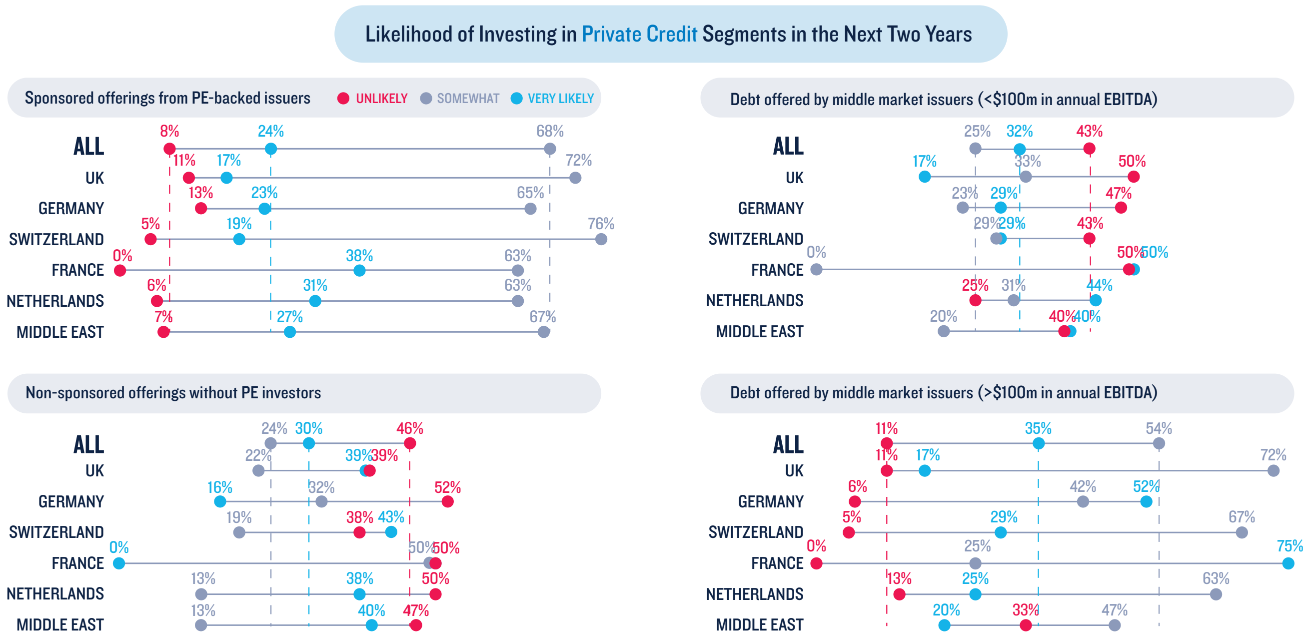
Looking to the investor segments in the respondent profile, family offices, private banks and foundations and endowments are most likely to increase their allocations to private credit over the next two years. However, taken together, most respondents in the insurance and pension sectors expect to keep their allocations to private credit intact over the same timeline, reflecting the institution-specific constraints on their holdings for the asset class. Moreover, the slowing pace of dealmaking activity due to the backdrop of high interest rates means that investor capital is engaged for the duration of the private credit investments and unavailable for recycling into fresh opportunities.

Geographically, the European private credit market is less developed than the U.S. with regards to size and degree of competitiveness in terms of the number of participants. However, the region's growth prospects will provide opportunities to close this gap, in particular for asset managers with a history and proven expertise within local markets. Moreover, managers are also diversifying their lending capabilities to include a broad new range of companies and asset types.

Investors show a clear preference for private credit offerings from private-equity-backed issuers. More than 90% of respondents say they are very or somewhat likely to invest in such sponsored offerings, while nearly half of respondents (46%) say they are unlikely to invest in private credit issues from unsponsored companies without PE backing.

Survey respondents also favour lending to issuers with more than $100 million in annual EBITDA, as capital preservation remains critical from a debt investor's perspective, and lending to larger companies is broadly viewed as having greater stability. However, 75% of survey respondents are also willing to lend to companies with less than $100 million in annual EBITDA, since deals with such smaller companies often have more creditor-friendly terms, stronger covenants, and relatively higher yields.

Exhibit 8: Private Credit investors favourable towards large issuers



Private Equity: Turning a corner

QUICK TAKE:

- **Demand is likely to catch up in some countries due to evolving regulations.**
- **Sovereign wealth funds and family offices most likely to increase holdings.**
- **Netherlands, Switzerland, and Middle East investors to increase allocations.**

Private equity (PE) is among the highest priorities for investors, with 38% of survey respondents earmarking this asset class for fresh allocations over the next two years. We expect evolving regulations to allow more flexibility in private equity investments for pension funds and insurance companies will boost appetite for the asset class.

The growing trend towards large deal sizes in recent years is also attracting institutional investors who see private equity as an "active approach" to invest in companies. Consequently, PE firms have evolved from the pure leveraged buyout shops of the 1990s into diversified private alternative conglomerates with extensive and sometimes interlinked interests across various sectors.

Though the uncertain economic environment and geopolitical turbulence has led to a challenging environment for exiting PE investments, investors see opportunities in the energy transition and digital infrastructure space.

Institutional investors are increasingly managing their portfolios due to reduced liquidity arising from the challenging exit environment. As a result, activity in the private equity secondaries market has improved as investors actively manage their portfolios and seek faster exits and shorter holding durations.

Geographically, institutions in the Netherlands (49%) followed by Switzerland (44%) and the Middle East (43%) are likely to increase their allocations to private equity over the next two years. Investors in these regions have traditionally invested less in private equity compared to their peers in the UK and the U.S. Demand for private equity in these countries may be driven by investors' desire to boost their historically lower target allocations.

In Switzerland, for example, the growing appetite among institutional investors to allocate more towards private assets has been in place for a decade. Demand for private equity investments is growing due to the prospect of better risk-adjusted returns and the opportunity to harvest illiquidity premiums among small and medium sized companies supported by changing regulations.

Exhibit 10: Private equity investors will seek growth opportunities

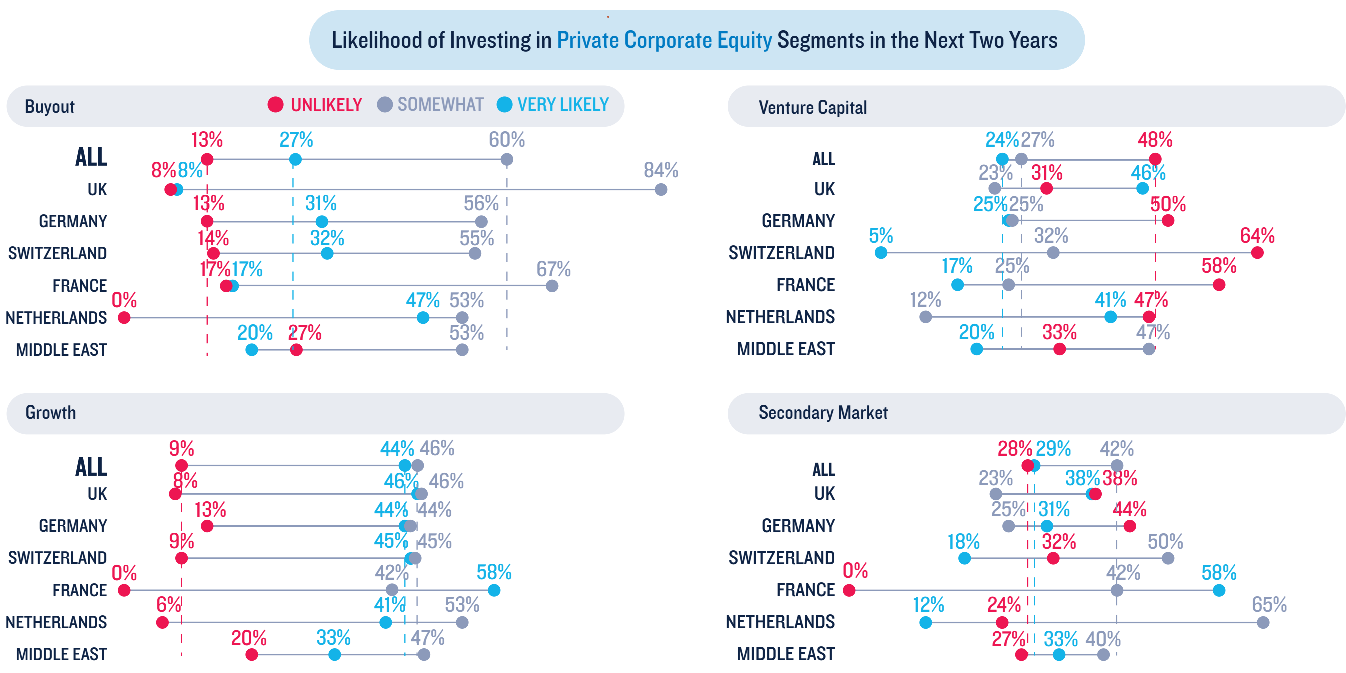
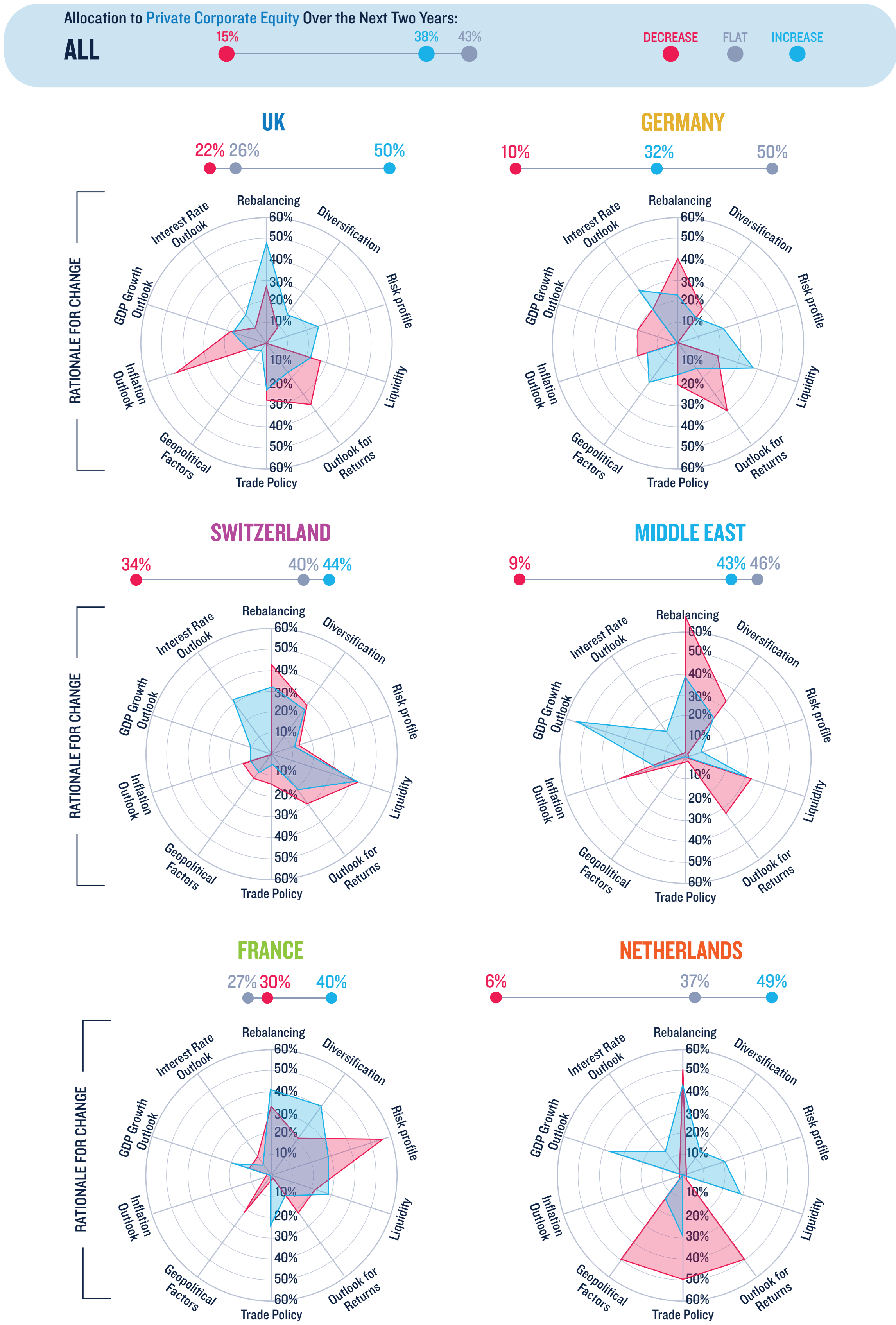


Exhibit 11: Rebalancing, favourable liquidity, and diversification benefits spur new allocations

Consistent support for increased allocations to private equity across geographic segments for common reasons: rebalancing and the availability of liquidity.



From an institutional perspective, sovereign wealth funds (SWFs) (58%) expect to increase their allocations to private equity, followed by those in the foundation and endowments segment (43%) and pensions (42%) over the next two years.

SWFs and foundations have historically invested a significant portion of their portfolio in private equity to benefit from the risk-return benefits of the asset class. Since these long-term investors are less constrained by governance and regulatory requirements, they can avoid the elevated market volatility of public debt and equity markets and continue to invest in private equity for the long term. Similarly, well-funded pension funds are often able to invest a portion of their assets in very long-term, stable private investments. Accordingly, they are likely to increase their holdings in private equity assets.

In aggregate, 43% of respondents do not expect to make any change to allocations to private equity, with only 27% of respondents from France likely to maintain their PE allocations and 30% anticipate lowering them. This is driven by the so-called “denominator effect” in portfolios, via which lower valuations of fixed income and equity investments in 2022-23 increased the relative proportion of private equity in portfolios overall, pushing PE towards the maximum allocation ranges within portfolios by asset allocators.

In addition, investors may face liquidity pressures due to lower distributions in portfolios and therefore are likely to maintain their private equity allocations or engage in the secondary market to sell holdings to rebalance portfolios.

Impact debt and sustainable equity: No longer niche

QUICK TAKE:

- **Broadening demand for sustainable investments remains intact.**
- **Portfolio reporting metrics remain challenging.**
- **Impact investing via equity more favoured than through debt.**

A large section of survey respondents earmark impact investing among their top three categories of assets for scaling up investments over the next two years with 40% of survey respondents expecting to increase allocations. While demand for sustainable assets is expanding among institutional investors, acquiring and analysing high-quality data – e.g., greenhouse gas emissions and social and environmental impact metrics – on current and prospective sustainable investments remains a persistent constraint on investors in this asset class.

Money managers continue to increase renewable assets in their portfolios. However, they struggle to package them into separate investment vehicles due to disparate reporting requirements. For example, Britain’s new framework for using ESG labels, which is widely seen as a major step towards fighting greenwashing, appears to be off to a slow start, as asset managers take a cautious approach.[14]

Nearly half of survey respondents from insurance companies and pension funds are keen to increase their sustainable equity investments, followed by private banks and sovereign wealth funds. Their plans to increase allocations is driven by their desire to rebalance their portfolios, with the growing liquidity in the impact investing sector also supporting incremental demand.

Demand for impact funds waned after the pandemic as robust oil and gas stocks and higher interest rates made it harder for such investments to outperform. However, as the global economy recovers, demand for such products is increasing. Institutional investors are also keen to invest in diversified products that include engagement strategies, rather than simply exclude certain assets based on ESG and sustainability criteria.

Sustainable equity investments recorded most interest, with 40% of survey respondents expecting to increase their allocations over the next two years. UK investors expressed greater demand than their geographical peers. The demand from UK investors stems from the nation’s eagerness to catch up to its European counterparts in their investment allocations to sustainable private assets. From a regulatory perspective, the proposed pension sector reforms aimed at consolidating the industry is also a driver, as impact investing is often integrated with infrastructure investments.

14 Financial Conduct Authority (Feb 2, 2024) Sustainability disclosure and labelling regime. HYPERLINK “https://www.fca.org.uk/firms/climate-change-and-sustainable-finance/sustainability-disclosure-and-labelling-regime” Sustainability disclosure and labelling regime I FCA Accessed July 2024

Exhibit 12: Consistent support for increased allocations to impact/sustainable equity across geographic to support rebalancing and favourable liquidity.

New investors seek rebalancing, liquidity, and diversification

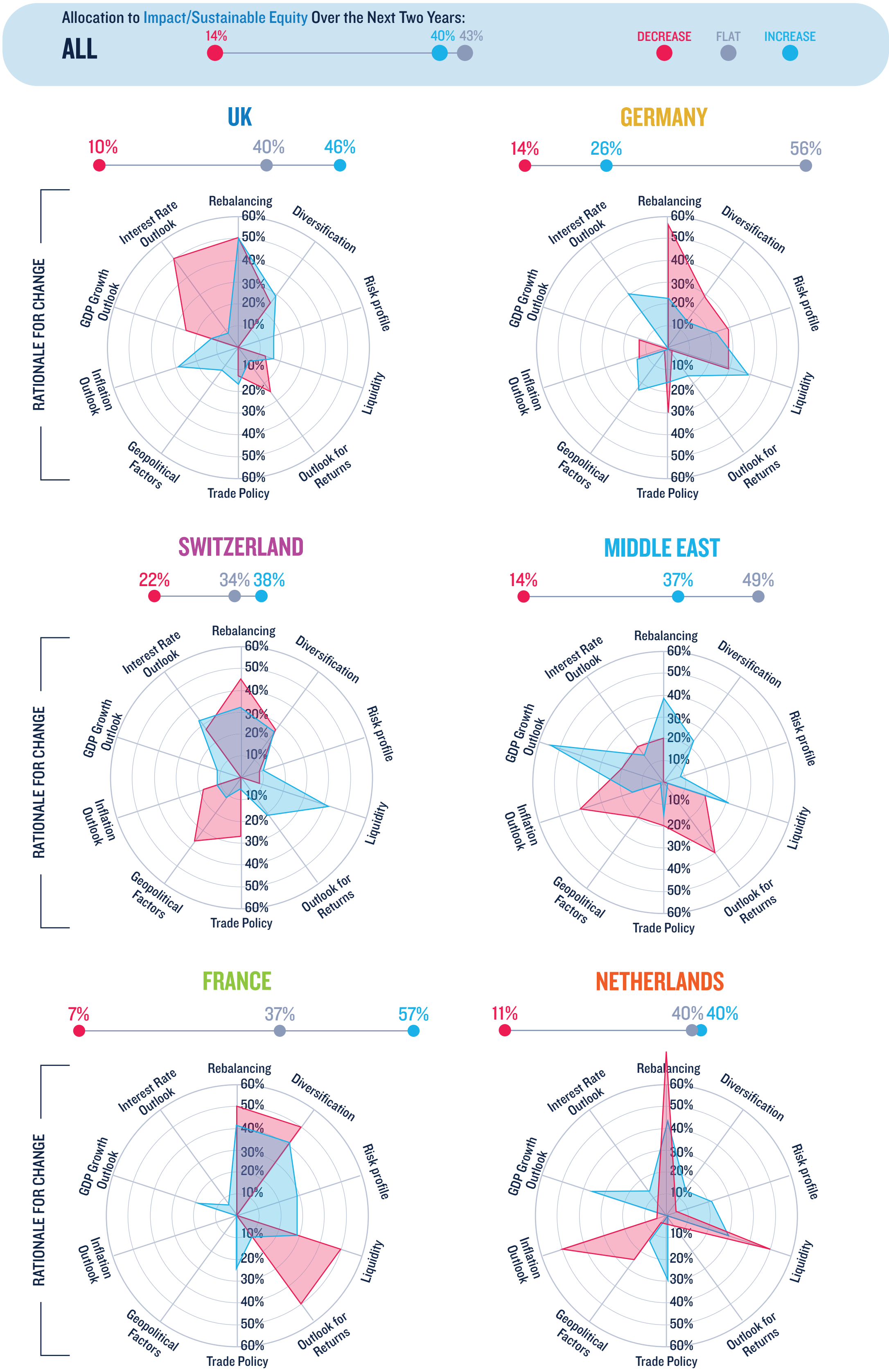


Exhibit 13: UK respondents are eager to increase allocations to impact/sustainable debt to rebalance holdings and take advantage of inflation outlook.

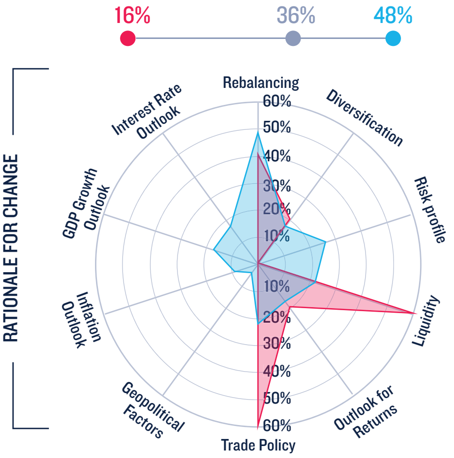
New allocations driven by rebalancing, diversification, and favourable liquidity outlook

Allocation to Impact/Sustainable Debt Over the Next Two Years:

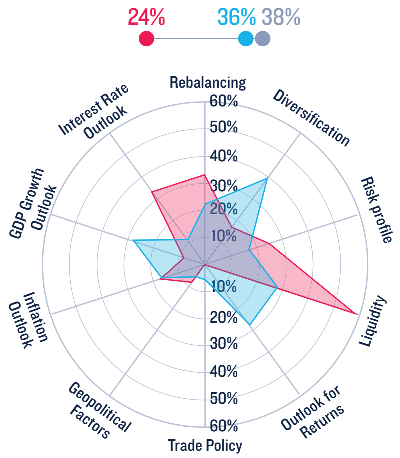
ALL — 22% · 34% · 40%

DECREASE · FLAT · INCREASE

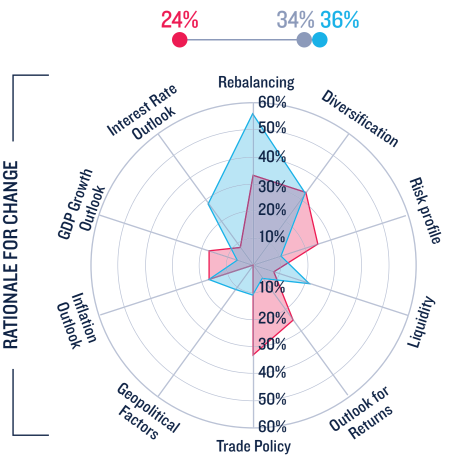
UK



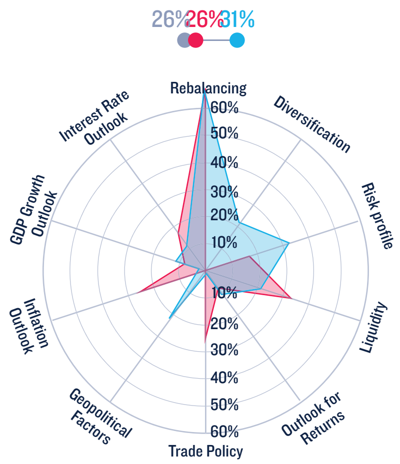
GERMANY



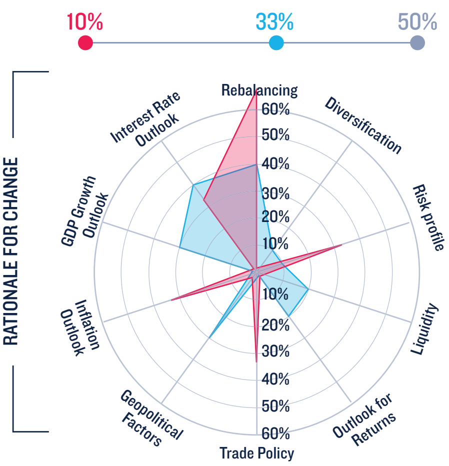
SWITZERLAND



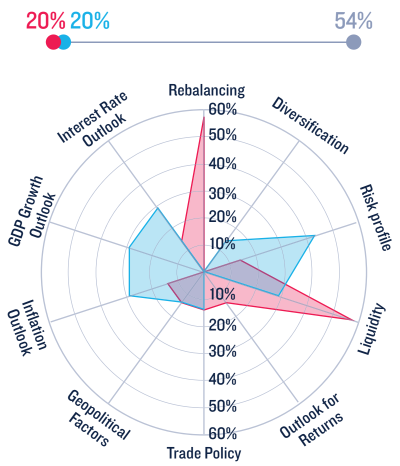
MIDDLE EAST



FRANCE



NETHERLANDS



The appetite for sustainable debt investments trailed equity slightly, with 34% of all survey respondents expecting to increase their allocations to the asset class over the next two years. However, UK investors are especially eager to increase their allocations to sustainable debt. Investors' marginally weaker appetite for sustainable debt instruments potentially stems from the consensus view that impact investing is best executed via equity investments which allow investors to have a more direct influence on portfolio companies' operations to improve sustainability; for example, turning around a factory with a poor emissions record. In comparison, investors prefer debt investments in assets that are further along the sustainability journey, such as forestry or affordable housing.

Across the EMEA region, 40% of survey respondents said they will retain their current allocations to sustainable debt. However, family offices are the most bullish about the asset category, with nearly half of survey respondents expecting to increase their allocations in the asset class over the next two years.

Sustainable Finance Disclosure Regulation characteristics: A higher calling

QUICK TAKE:

- **Relatively high interest rate environment is benefiting Article 8 products.**
- **Article 8 funds are seen as more focused on sustainability issues than Article 6 peers.**
- **More than two-third of respondents expect to use SFDR data in the investment decision-making process.**

Survey respondents are eager to consider hybrid SFDR designations when making investment decisions. The survey showed most respondents have shifted their

Exhibit 14: To what extent does your institution consider the following designations under the Sustainable Finance Disclosure Regulation (SFDR) when making investment decisions?

Investors are eager to consider Article 8 designations

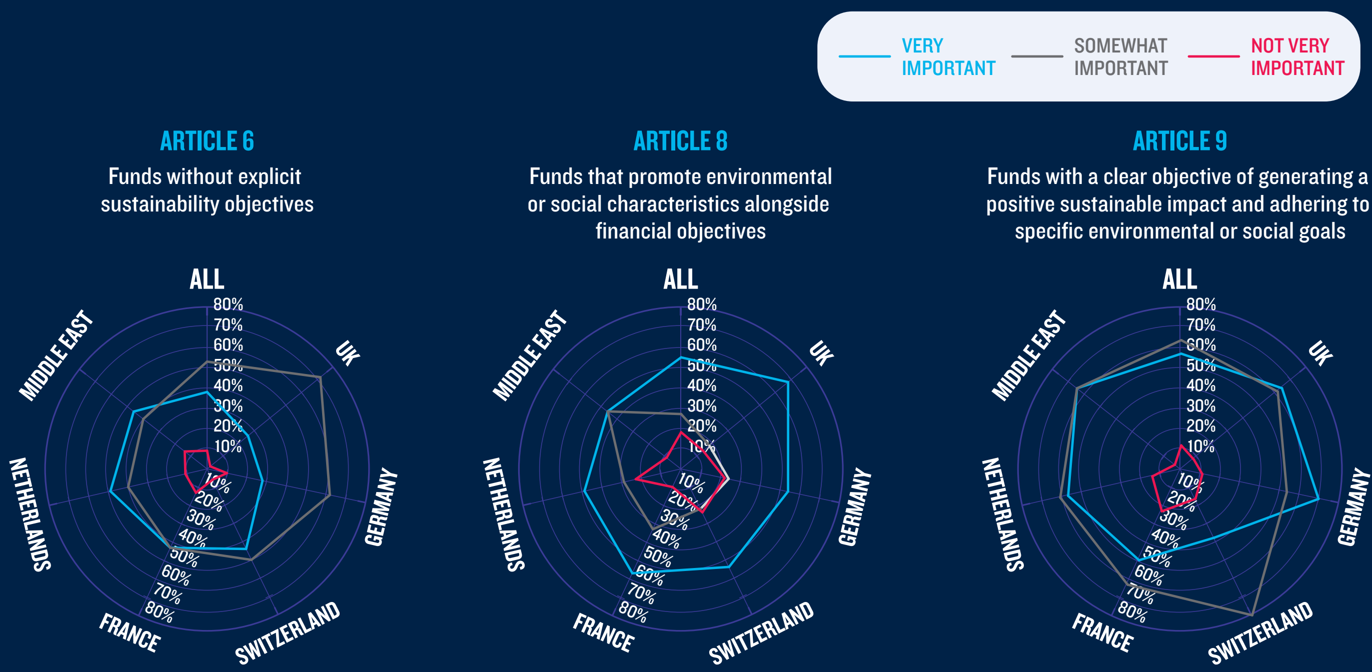


Exhibit 15: Investors are looking to increase analysis of SFDR data

Looking to the future, do you anticipate your institution will...

baseline preference to products having an Article 8 designation. More than 55% of respondents said they consider Article 8 designations as very important when making investment decisions.

This preference is also seen in industry data, with Article 8 funds holding a majority market share over Article 6 and Article 9 counterparts, according to Morningstar.[15] Among factors driving inflows into Article 8 funds is the relatively high interest-rate environment that favours investment-grade debt issues, which tend to make up ESG-oriented portfolios. Given that article 8 funds have stronger sustainability criteria than article 6, fewer (38%) survey respondents view Article 6 designations as a very important factor whilst making investment decisions.

Meanwhile, Article 9 funds also garnered strong interest from respondents, with 43% citing this designation as an important factor in asset selection. However, the relatively limited pool of investable assets in this category remains a mitigating factor. But with investor interest growing in sustainable investing, the pool of Article 9 funds is expected to increase in the future with a bias towards private alternatives, as they are seen as an investment category where products can be created to address the demand gap.

More than two-thirds of survey respondents (68%) say they plan to increase the use and analysis of SFDR data in the investment decision making process. Approximately 60% of the survey respondents said they will seek investments that are directly aligned with the European Union's SFDR taxonomy of sustainable investing while a similar share of respondents said they will benchmark asset managers' offerings using SFDR criteria.

"

Article 8 products have become the new baseline in the ESG market for funds."

EUGENIA JACKSON
Global Head of ESG, PGIM

15 Morningstar (June 5, 2024) What You Need to Know About SFDR Article 8 Funds HYPERLINK "https://www.morningstar.com/business/insights/blog/esg/sfdr-article-8-funds" SFDR Article 8 Funds: Requirements, Outflows, and ESG Risks I Morningstar Accessed July 2024

Private Infrastructure Debt and Equity: Investing in the future

QUICK TAKE:

- **AI related workloads and growth in traditional cloud services are powering demand.**
- **Pensions and sovereign wealth funds' assets are most likely to increase infrastructure allocations.**
- **Infrastructure equity transactions squeezed due to higher rates environment.**

Following the recent global monetary policy tightening cycle, investment returns from infrastructure debt investing offer similar returns to equity investments, with the added benefit of downside protection due to strong covenants.

Infrastructure equity valuations have been squeezed due to higher interest rates, rising energy prices and supply chain disruptions, leading to less dealmaking in the space. The number of infrastructure deals declined by a fifth in 2023 compared to the previous year, according to a report by the Boston Consulting Group.[16]

However, signs of activity are starting to emerge in the infrastructure equity investing space. A multi-billion-pound stake in Edinburgh Airport purchased by a French infrastructure group signalled growing activity in the sector recently.[17] Infrastructure investing is not completely immune from the global economic cycle and another downturn may weigh on dealmaking activity. Debt investing is also at a similar phase of the investing cycle, with investors starting to allocate capital in some sectors after staying sidelined around the pandemic.

Investors also gain an early-mover advantage by investing in assets that signal powerful structural changes. Data centres is one such example.

The demand for storage and computing capacity is likely to grow exponentially due the broad adoption and integration of digital services throughout all sectors of modern commerce, leading to double-digit revenue growth over the next few years.

The growth of traditional cloud services – the largest driver of data centre requirements – was already creating some imbalances between supply and demand for these services. The growing adoption and integration of artificial intelligence in business operations has accelerated the impact of an existing fundamental disequilibrium between unbridled demand growth and constrained supply. [18]

Regulatory change is also encouraging infrastructure investments as governments seek to build out national projects. The new UK government removed a ban on onshore wind farm investments, fueling a rush by companies to move ahead with new onshore projects which will require large investments by institutional investors.[19]

"

Infrastructure equity investors benefitted from a favourable environment in the pre-pandemic world due to low interest rates, but that world has changed dramatically, requiring a greater focus on operational improvements."

FEDERICO CHIARAMONTE
Principal
PGIM Private Capital

16 Boston Consulting Group (March 18, 2024) A Bump in the Road: Private Equity Infrastructure Investment Set to Rebound Following Slowdown in 2023. HYPERLINK "https://www.bcg.com/press/18march2024-private-equity-infrastructure-investment-set-to-rebound" A Bump in the Road: Private Equity Infrastructure Investment Set to Rebound Following Slowdown in 2023 (bcg.com) Accessed July 2024

17 Sky News (April 17, 2023) VINCI Airports buys majority stake in Edinburgh Airport as part of billion-pound deal. HYPERLINK "https://news.sky.com/story/vinci-airports-buys-majority-stake-in-edinburgh-airport-as-part-of-billion-pound-deal-13117135" VINCI Airports buys majority stake in Edinburgh Airport as part of billion-pound deal | UK News | Sky News Accessed July 2024

18 PGIM (Feb 27, 2024) Morgan Laughlin Sees a "Generational Opportunity" in Data Centres. HYPERLINK "https://www.pgim.com/ucits/article/morgan-laughlin-sees-generational-opportunity-data-centres" Morgan Laughlin Sees a "Generational Opportunity" in Data Centres (pgim.com) Accessed July 2024

19 Earth.org (July 9, 2024) New UK Labour Government Lifts Onshore Wind Ban, Commits to Doubling Wind Power by 2030. HYPERLINK "https://earth.org/new-uk-labour-government-lifts-onshore-wind-ban-commits-to-doubling-wind-power-by-2030/" Labour Lifts UK's Controversial Onshore Wind Ban | Earth.Org Accessed July 2024

Exhibit 16: Increase in allocations driven by rebalancing, diversification, and liquidity

Increasers outnumber decreasers notably in Germany, France, the Netherlands, and the Middle East

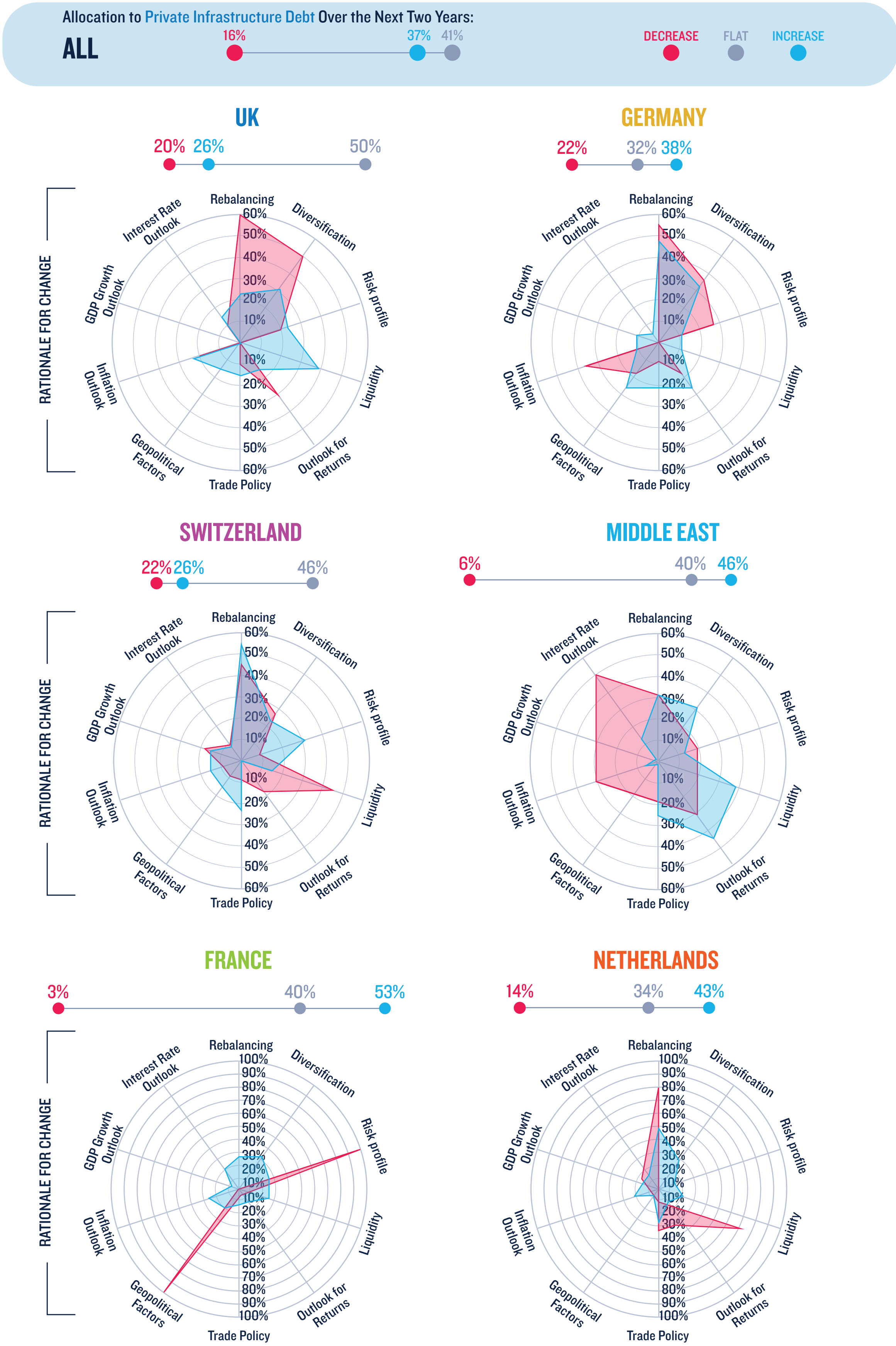
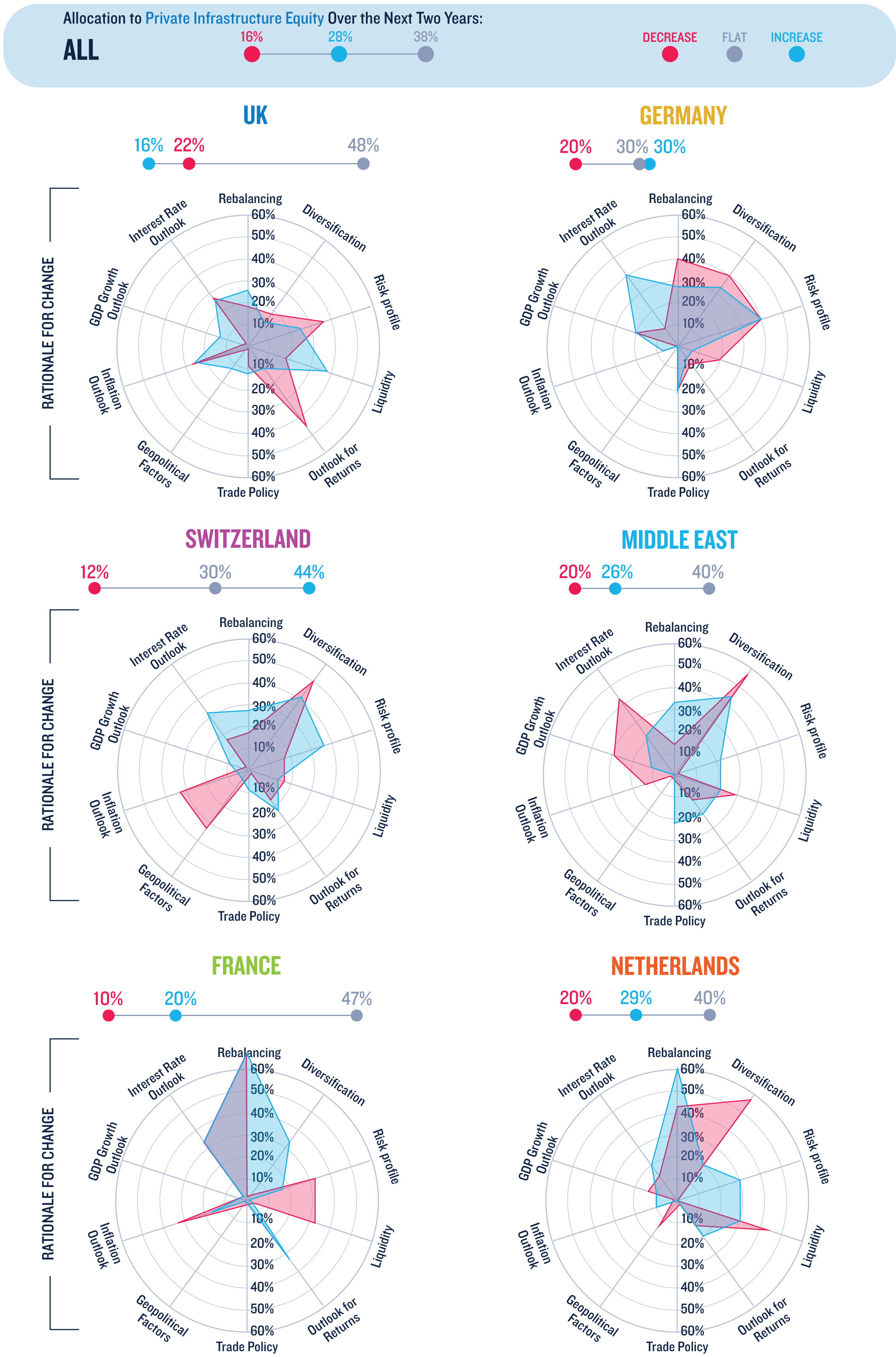


Exhibit 17: New investments spurred by rebalancing, diversification, and asset risk

Switzerland is eager for infrastructure equity due to diversification, risk, and interest rate outlook



In aggregate, 37% of survey respondents expect to increase their allocations to private infrastructure debt over the next two years. From a debt perspective, there is low volatility in cash flows, a key factor for institutional investors.

Middle East investors are the most inclined to make allocations towards infrastructure debt in the next two years driven by the economic boom in the region. A large focus for investors from the region is renewables and energy investments such as pipelines and liquefied natural gas (LNG). UK respondents lag the broader interest, as the investment market is further along the privatisation journey than its geographical peers, with debt transactions returning to pre-COVID levels driven by investment and refinancing needs.

Investor enthusiasm for the private infrastructure equity space is more restrained than its debt counterpart, with 28% of survey respondents expecting to increase allocations over the next two years. In the pre-pandemic world, return on equity investments declined to single digits for the core segment. While those expected levels of returns have climbed as interest rates have increased, the deals market remains challenged. However, some recent large fund-raising activities in the market indicate the landscape to raise infrastructure equity financing is improving.

Transportation, logistics and communications infrastructure top investors' preferences. The transportation sector underwent a structural change in investors' mindsets during the pandemic as transportation businesses limited investments and preserved cash. The strong focus now for the sector is a reversal of that underinvestment trend during the pandemic.

Meanwhile, communications infrastructure moved into the limelight as businesses moved online during the pandemic, and subsequent hybrid models have been adopted. In recent times, the shift to electric vehicles and adapting to newer technologies has boosted appetite for these sectors. In contrast, utilities infrastructure recorded the least interest, with only 25% of survey respondents likely to increase their allocations over the next two years. Recent adverse headwinds in the sector are keeping investors sidelined.

Agricultural investing: inherent value

QUICK TAKE:

- **Capital preservation is a key driver and valued by survey respondents.**
- **Equity investments are more attractive to survey respondents than debt investments.**
- **Respondents from Germany, France and Netherlands see increasing allocations.**

Investors see agricultural investing as an asset type with long-term income predictability and inflation protecting characteristics. There is a high degree of inflation sensitivity for agricultural assets, as commodity prices track price changes alongside low correlations to public markets and even real estate investments.[20]

Only between 1 per cent and 3 per cent of the $4.3 trillion U.S. farm asset market is owned by investment funds according to industry estimates, with family-owned and operated businesses accounting for 95 per cent of all U.S. farms, according to data from the U.S. Department of Agriculture.[21]

We have a growing world population and a shrinking supply of arable land. Food will become increasingly valuable over the long run."

JAMIE SHEN
Head of Agriculture
PGIM Real Estate

20 PGIM (July 8, 2024) Agriculture Landscape: July 2024. HYPERLINK "https://www.pgim.com/real-estate/commentary/agriculture-landscape-july-2024" Agriculture Landscape: July 2024 (pgim.com) Accessed July 2024

21 U.S. Department of Agriculture, Economic Research Service. (2024, September 5). Farm Sector Income & Finances: Assets, Debt, and Wealth. HYPERLINK "https://www.ers.usda.gov/topics/farm-economy/farm-sector-income-finances/assets-debt-and-wealth/" USDA ERS - Assets, Debt, and Wealth Accessed July 2024

Exhibit 18: Liquidity, rebalancing, and risk profile drive new investments

Respondents from Germany, France, and the Netherlands, and Middle East show more enthusiasm for Agriculture equity.

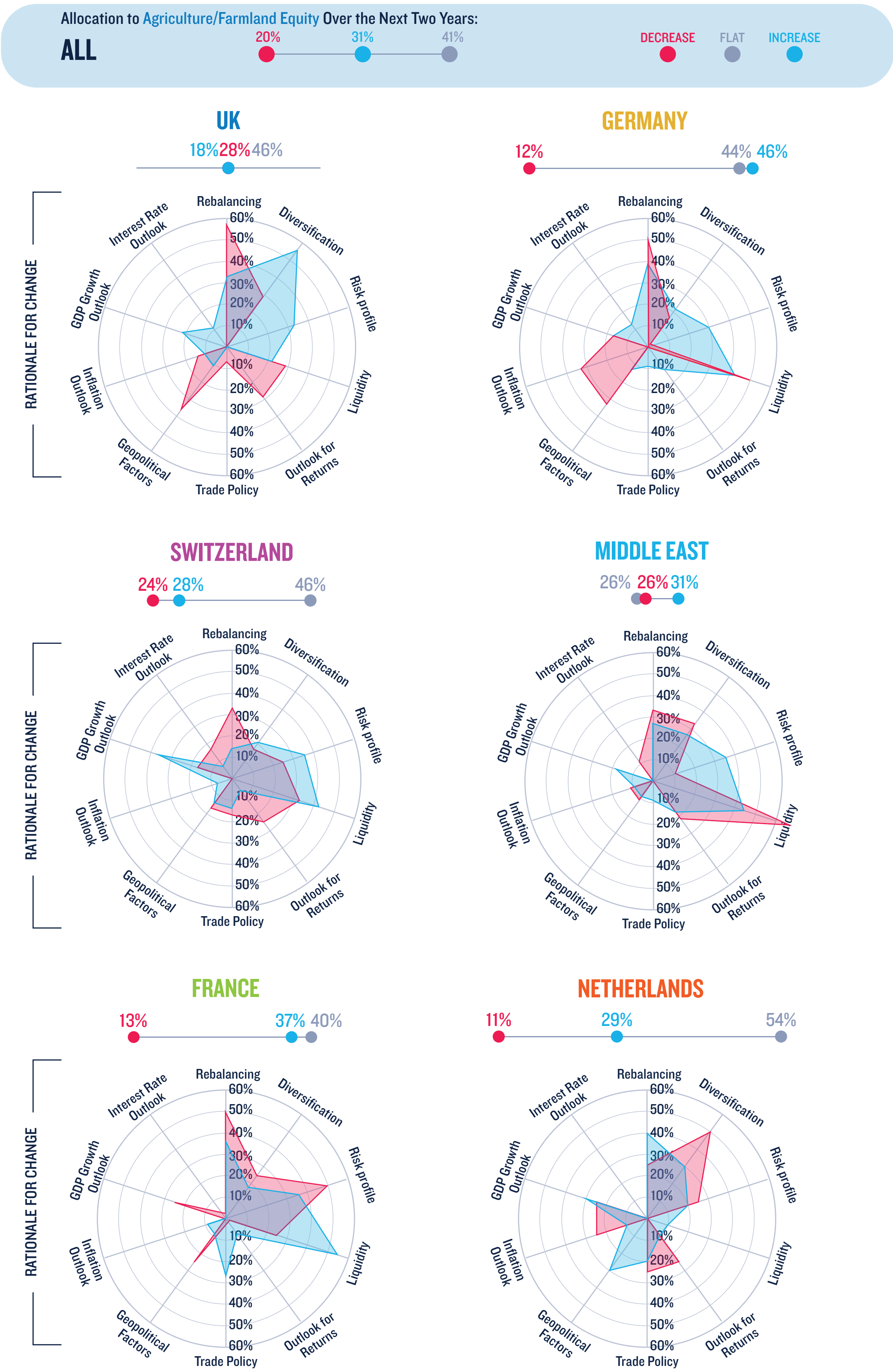


Exhibit 19: Rebalancing, trade policy, and diversification drive new allocations

Decreasers outnumber increasers in most geographic segments

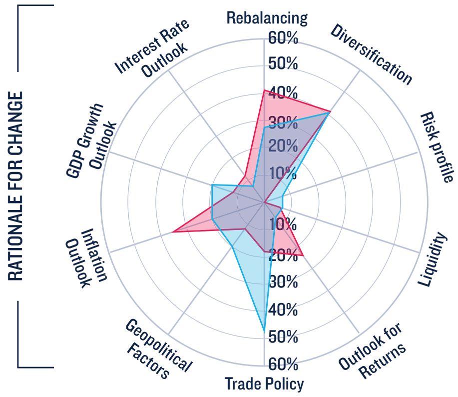
Allocation to Agriculture/Farmland Debt Over the Next Two Years:

ALL 22% 31% 35%

DECREASE FLAT INCREASE

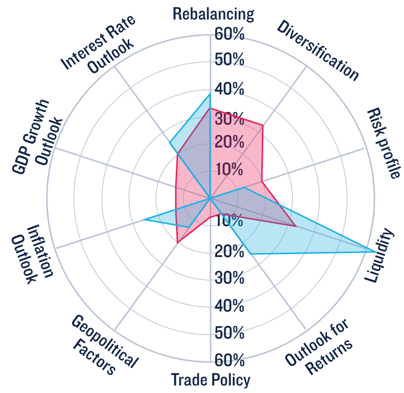
UK

30% 30% 34%



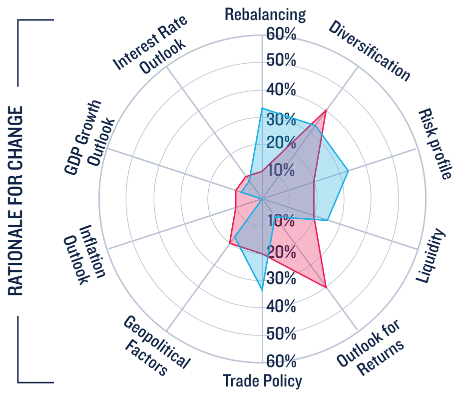
GERMANY

30% 30% 38%



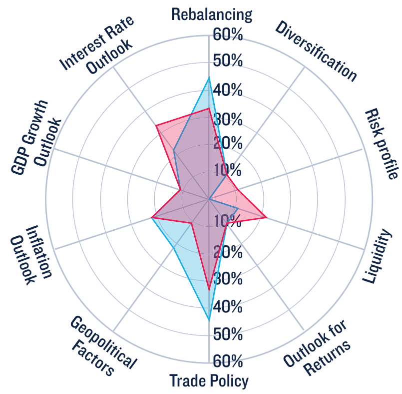
SWITZERLAND

20% 24% 46%



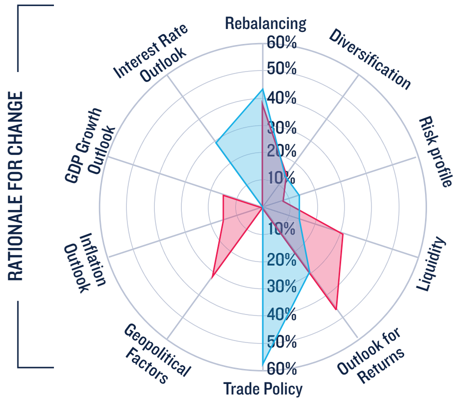
MIDDLE EAST

26% 26% 29%



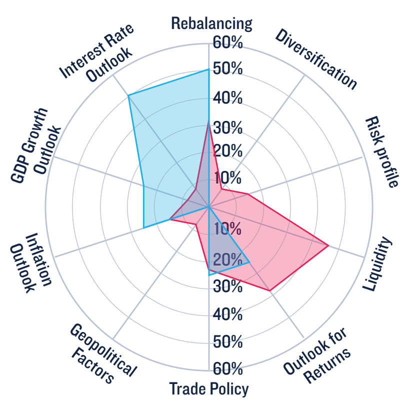
FRANCE

23% 27% 43%



NETHERLANDS

11% 37% 37%



The agricultural opportunity set is predominantly based in the U.S. from an institutional investor's perspective, though Australia and Canada have emerged as attractive destinations in recent years. In the latter's case, favourable regulatory developments, and the growing appetite of large domestic institutional investors for investing in real assets is driving demand.

Yields for agricultural assets are likely in the mid-single digit ranges for the various commodities, including blended products. Over the long term, risk-averse capital preservation requirements are seen contributing to investment allocations in agricultural assets compared to other private alternative assets. Broadly, 71% of survey respondents say they are likely or very likely to use private alternatives to meet their capital preservation objectives.

Technological advancements addressing challenges in labour and renewable energy are powerful demand drivers for agricultural assets. Fuel producers need land on which to grow crops for biofuel inputs; similarly, solar and wind power generators need suitable sites for photovoltaic panels and wind turbines. Agriculture and farmland owners are uniquely positioned to take advantage of the growing demand for such sites.

Headwinds that may attenuate investments include the cyclical nature of commodity prices and regulations that, for example, require tracing and documentation of the origin and ownership of food production.

Survey respondents are eager to increase their asset allocations towards agricultural equity investments over the next two years due to the potential higher returns compared to the debt channel, and greater awareness about investing via the equity route. Agriculture-focused private capital funds have returned an average net internal rate of return of 7.4%, over the past five quarters, according to data provided by Preqin.[22]

Family offices are the keenest to increase allocations to agricultural investments followed by private banks and pension funds. A key demand driver is the recent volatility around inflation that has made investors more sensitive towards including inflation-protected assets such as agriculture in their portfolios. Growing awareness among long-term investors that current agriculture systems exceed global capacities is also encouraging demand.

Geographically, respondents in Germany, France and Netherlands are the most likely to increase their allocations over the next two years. Allocations by investors from these regions are seen from a sustainability perspective, with Dutch institutional investors among the leaders in this category.

Institutional investors' appetite for investing in agricultural debt lagged equity, potentially owing to lesser awareness in the asset type and more limited investment options. Survey respondents are more likely to reduce or continue their allocations over the next two years.

Among investor types, foundations and endowments are the only category of investors which bucked the overall trend of steady or declining allocations. These investors expect to increase their allocations over the period, driven by the objective to diversify portfolios.

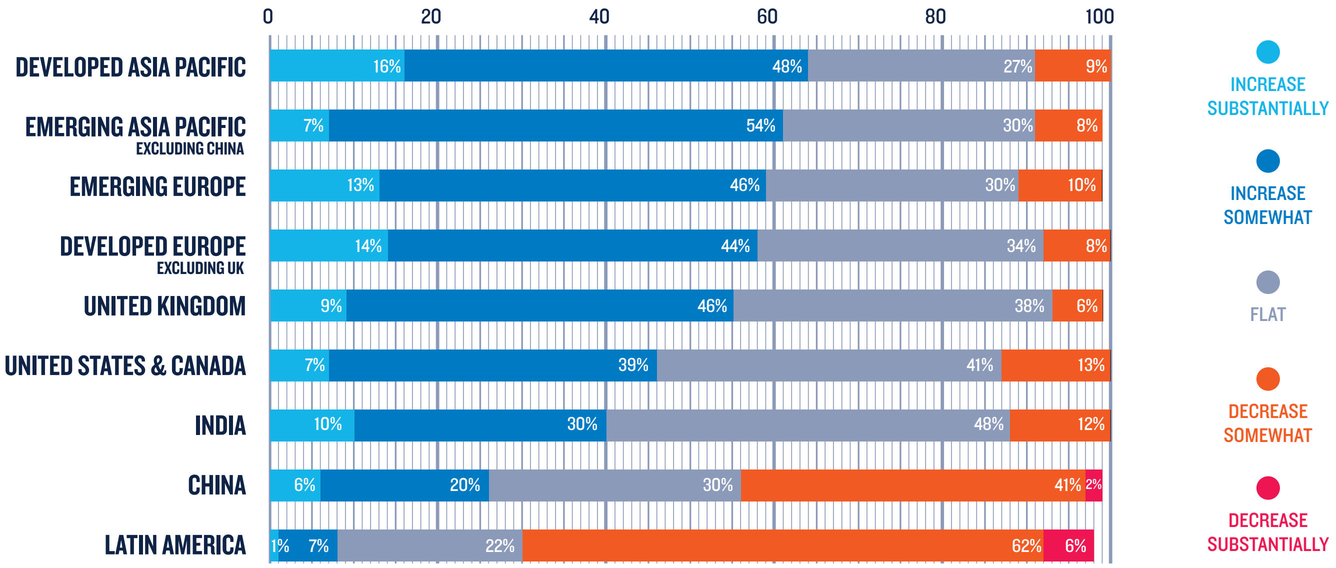
22 Chief investment officer (July 31, 2024) CalSTRS Achieves 8.4% Return in 2024 Fiscal Year. HYPERLINK "https://www.ai-cio.com/news/calstrs-achieves-8-4-in-2024-fiscal-year/" CalSTRS Achieves 8.4% Return in 2024 Fiscal Year (ai-cio.com) Accessed August 2024

LOCATION MATTERS

LOCATION MATTERS

Survey respondents say the developed economies in Asia and Europe are their preferred destinations for private alternative investments in the next two years. In aggregate, 64% of respondents anticipate increasing holdings in the developed markets of Asia Pacific, and 16% expect such growth to be substantial during this period. A solid majority of respondents – 61% – expect to augment holdings of private assets in the emerging markets of Asia Pacific.

Exhibit 20: Asia Pacific and Europe are preferred destinations for capital, while investments in LatAm and China is likely to wane in the next two years.



Asia Pacific has increasingly become a magnet for institutional investors in private alternatives due to its high economic growth potential and strong demand for infrastructure funding. According to the Asian Development Bank, infrastructure financing requirements in developing Asia Pacific will exceed $22.6 trillion through 2030, representing a gap of $1.7 trillion a year to maintain economic productivity.[23]

This funding shortfall is unlikely to be filled by public financial markets and offers further potential opportunities for institutional investor participation through private debt and equity placements.

Survey respondents are also bullish about investing in Europe, with nearly 60% of respondents planning to increase their allocations substantially or somewhat in the emerging and developed economies of Europe over the next two years.

The United Kingdom also ranked among the top destinations for private alternatives for investors, as 55% of survey respondents expect to increase their allocations over the next two years.

At the other extreme, respondents said they are likely to decrease investments in China and Latin America during the period. Across the full sample, 43% of respondents expect to reduce their holdings in China. Investors' reduced appetite for Chinese assets is likely due to the recent economic slowdown in the country, the nation's sustained trade tensions with the U.S. and growing anxiety about the prospect of conflict between China and Taiwan.

The following sections highlight country-level preferences for alternative investments:

23 Asian Development Bank (February 2017) Meeting Asia's Infrastructure Needs. HYPERLINK "https://www.adb.org/publications/asia-infrastructure-needs" Meeting Asia's Infrastructure Needs | Asian Development Bank (adb.org) Accessed July 2024

Exhibit 21: Allocation increases – Geographic highlights

How is your institution's allocation to the following private alternative assets likely to change over the next two years?

(Percentage of respondents anticipating an increase in allocation in next two years, by geography)

The Netherlands

The Netherlands provided 14% of the survey responses with a combined assets under management of more than $1.5 trillion. Unlike its counterparts elsewhere in Europe, respondents indicate a greater appetite to increase their allocations to private equity over the next two years. Private infrastructure debt also scored highly among Dutch investors, likely due to greater demand for private alternative investments from domestic institutional investors in the wake of recent pension reforms.

The Dutch pension system (the largest occupational pension system in the euro area) is transitioning from a defined benefit (DB) to a collective defined contribution (CDC) model, following the Dutch legislature's approval of the Future of Pensions Act. This reform, which became effective in July 2023 with a transition period until January 2028, marks a significant shift in the Dutch pension sector and reflects a broader move towards more flexible and individualised pension planning.[24]

For plan managers, this regulatory shift may drive an increase in allocations to illiquid alternatives such as infrastructure equity, which not only provides potentially higher expected returns and portfolio diversification benefits but, for some investors, aligns with their environmental, social, and governance goals. Dutch institutional investors have called for ambitious policies from policymakers for the energy transition, and have offered to pledge billions to help support investments in the country's electricity grid.[25]

24 PGIM (July 31, 2024) Collective Defined Contribution (CDC) Schemes: Assessing Capacity for Alternative Investments. HYPERLINK "https://www.pgim.com/research/collective-defined-contribution-cdc-schemes-assessing-capacity-alternative-investments" Collective Defined Contribution (CDC) Schemes: Assessing Capacity for Alternative Investments (pgim.com) Accessed July 2024

25 Reuters (March 27, 2024) Dutch pension funds willing to invest billions in energy transition. HYPERLINK "https://www.reuters.com/business/dutch-pension-funds-willing-

United Kingdom

The UK generated 20% of the survey respondents with a combined assets under management of more than $1.6 trillion. UK respondents are most likely to increase allocations to real estate debt over the next two years. Recent policy initiatives have encouraged institutional investors to increase investments in private markets such as the Mansion House Act in 2023 and proposed pension reforms outlined in the legislative agenda of Prime Minister Keir Starmer in July 2024.[26]

The UK pension reforms seek to drive consolidation within the pensions sector. Institutional investments into private assets can help the government's objectives of attracting longer-term capital into the broader economy to fund key economic projects, such as the green energy transition. Real estate debt investments are also attractive to UK institutions as they are asset-backed in nature. The UK also scored the highest for potential investments in debt and equity investments focused on impact/ sustainable objectives. This eagerness may be related to the large local government pension pools' strong agenda to invest in local impact investments. With general partners (GPs) now offering open-ended fund structures, some of the illiquidity concerns are minimised and may encourage allocations to impact investments.[27]

Germany

Germany also generated 20% of the survey respondents with a combined assets under management of more than $1.6 trillion. In the survey, German respondents scored the highest among peers to increase holdings of private corporate credit over the next two years. German insurers have made a big push towards private credit in recent years due to the relatively higher interest rates available in this sub-asset class. For example, by mid-2022, private equity and private debt accounted for more than 9% of capital investments made by German insurers, doubling from end-2019, according to data from BaFin, the German financial regulator.[28]

While rising interest rates have cooled the appetite for private equity allocations due to squeezed valuations, demand for private credit is broadly intact due to diversification benefits, a factor that is cited by German respondents looking to increase investments to this asset class. Institutional investors in Germany also view private credit as an area where they can adopt a more active approach as banks have reduced lending to small and midsize enterprises in recent years. German investors also scored the highest across geographies for investing in agriculture equity investments due to their growing desire for sustainable investments.

Switzerland

Switzerland contributed 20% of the survey respondents with a combined assets under management of nearly $1.8 trillion. Swiss investors score the highest appetite for private infrastructure equity allocations across geographies in the survey. While Swiss institutional investors tend to have a higher allocation to tangible assets like real estate and infrastructure compared to other countries, recent regulatory changes have supported further infrastructure investments. In 2020, the regulator allowed Swiss pension funds to allocate up to 10% of their total assets under management to infrastructure and now recognise it as a stand-alone asset class.

Switzerland ranks the second highest among survey respondents for private corporate equity across countries. This is indicative of a broader appetite for private equity investments over the past decade due to diversification benefits, superior risk/return profiles to public equities, and integrating impact investing benefits. Regulators have made it easier for Swiss pension funds to diversify into private markets in similar legislation to infrastructure, and for institutional investors to access private markets in a new (L-QIF) fund category.[29]

France

France provided 12% of the survey responses with total assets under management of more than $1.2 trillion. French respondents rank dedicated impact/sustainable equity as the highest sector for increased allocations across geographies over the next two years. France has

invest-billions-energy-transition-2024-03-27/" Dutch pension funds willing to invest billions in energy transition | Reuters Accessed July 2024

26 PGIM (July 26, 2024) UK Pension Reforms: A New Horizon Awaits. HYPERLINK "https://www.pgim.com/article/uk-pension-reforms-new-horizon-awaits" UK Pension Reforms: A New Horizon Awaits (pgim.com) Accessed July 2024

27 HM Treasury (July 19, 2023) Mansion House 2023. HYPERLINK "https://www.gov.uk/government/collections/mansion-house-2023" Mansion House 2023 - GOV.UK (www.gov.uk) Accessed July 2024

28 BaFin: (29th March 2023) Complex Investments. HYPERLINK "https://www.bafin.de/SharedDocs/Veroeffentlichungen/EN/Fachartikel/2023/fa_bj_2301_illiquide_Anlagen_en.html" BaFin - Expert Articles - Complex investments Accessed July 2024

29 finma: (February 23, 2024) Limited Qualified Investor Funds: new fund category exempt from FINMA authorisation and supervision. HYPERLINK "https://www.finma.ch/en/news/2024/02/23240223-meldung-l-qif/" Limited Qualified Investor Funds: new fund category exempt from FINMA authorisation and supervision | FINMA Accessed July 2024

had a strong tradition of sustainability, both in public and private markets, and French investors are increasingly considering the importance of ESG in their investment decision making.

French regulators have implemented strong rules favouring ESG investments, and asset managers must report consistently on various ESG metrics.[30]

French investors also ranked infrastructure debt investments the highest across geographies for future investments. Their enthusiasm for infrastructure debt may be tied to such assets' ability to deliver financial returns and meet sustainability objectives with unified allocations.

Middle East

The Middle East provided 14% of the survey responses with a combined assets under management of nearly $1.8 trillion. Debt investments topped preferences among investors from this region, with private real estate debt leading asset preferences across geographies. Investing in private infrastructure debt is a high priority for Middle East investors, only ranking behind France among its geographical peers. The region's policymakers are increasingly looking to build up social safety nets for a relatively young population and infrastructure debt is viewed favourably from a returns perspective and improved liquidity profile.

While Middle East investors remain bullish about the outlook for private infrastructure debt, the so-called "denominator" effect is likely to counter-balance additional investments and perhaps limit further allocations. Overseas demand in the housing and hospitality sectors are major drivers for investors in the Middle East. In real estate debt, investors are more inclined to increase exposures to core and opportunistic real estate segments.

Broadly, Middle Eastern investors are likely to shift towards absolute return benchmarks, which will encourage larger allocations to private alternative assets due to stability in valuations compared to public markets. Private equity also remains a strong area of interest for Middle Eastern investors, ranking third across geographies behind the Netherlands and Switzerland. Diversification beyond the region's traditional industries – that is, oil and gas – is a powerful driver for the region's investment allocations to private equity in sectors such as fintech, life sciences and media.

30 Bloomberg: (Nov 7, 2023) France Restricts ESG Fund Labels to Target Fossil-Fuel Industry. HYPERLINK "https://www.bloomberg.com/news/articles/2023-11-07/france-restricts-esg-fund-labels-to-target-fossil-fuel-industry" France Restricts ESG Fund Labels to Target Fossil-Fuel Industry - Bloomberg Accessed July 2024

ROUTES TO MARKET

ROUTES TO MARKET

The final segment of the survey examines institutions' relationships with their asset management partners and measures how well their managers are performing against expectations. The majority of survey respondents (52%) said their current asset managers have underperformed in their ability to deliver access to liquidity to the secondary market.

Survey respondents say asset managers are more likely to underperform than exceed expectations on key metrics such as speed of capital deployment and exit transactions. While most respondents (58%) said their managers have met their expectations for the speed of capital deployment, a not insignificant 29% said their managers fell short of expectations for the speed of capital deployment.

More than 80% of the survey respondents are keen to consider investing in multi-asset solutions composed of several private alternative assets. Their enthusiasm stems from the growing availability and maturity of multi-asset alternative offerings from asset managers that are receptive to investors who seek varied alternative asset exposure through a single manager relationship.

A solid majority of respondents (62%) also said they preferred to work with a large multi-line firm with broad offerings and a local presence in multiple markets over small boutique firms that specialise in one or more private alternative investments.

Exhibit 22: How well have your current asset managers met your expectations for executing your private market investments?

Respondents lament lack of liquidity

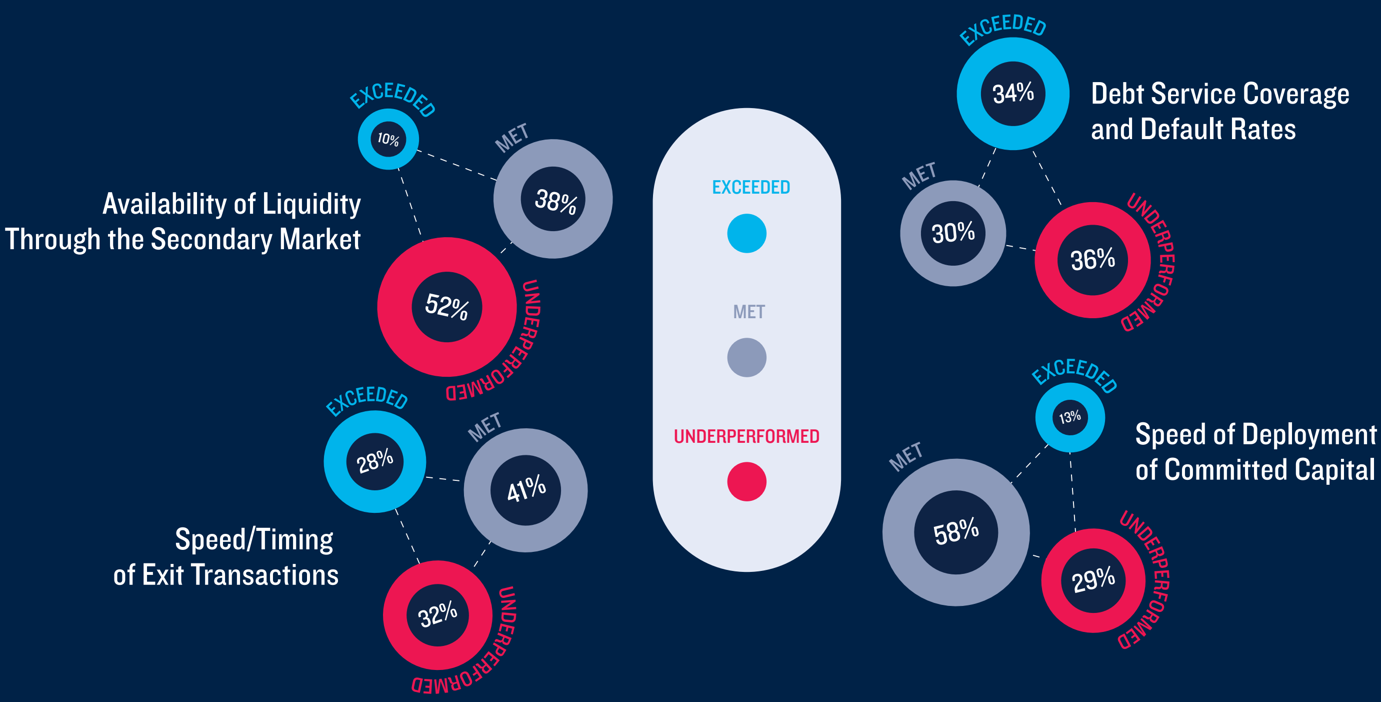
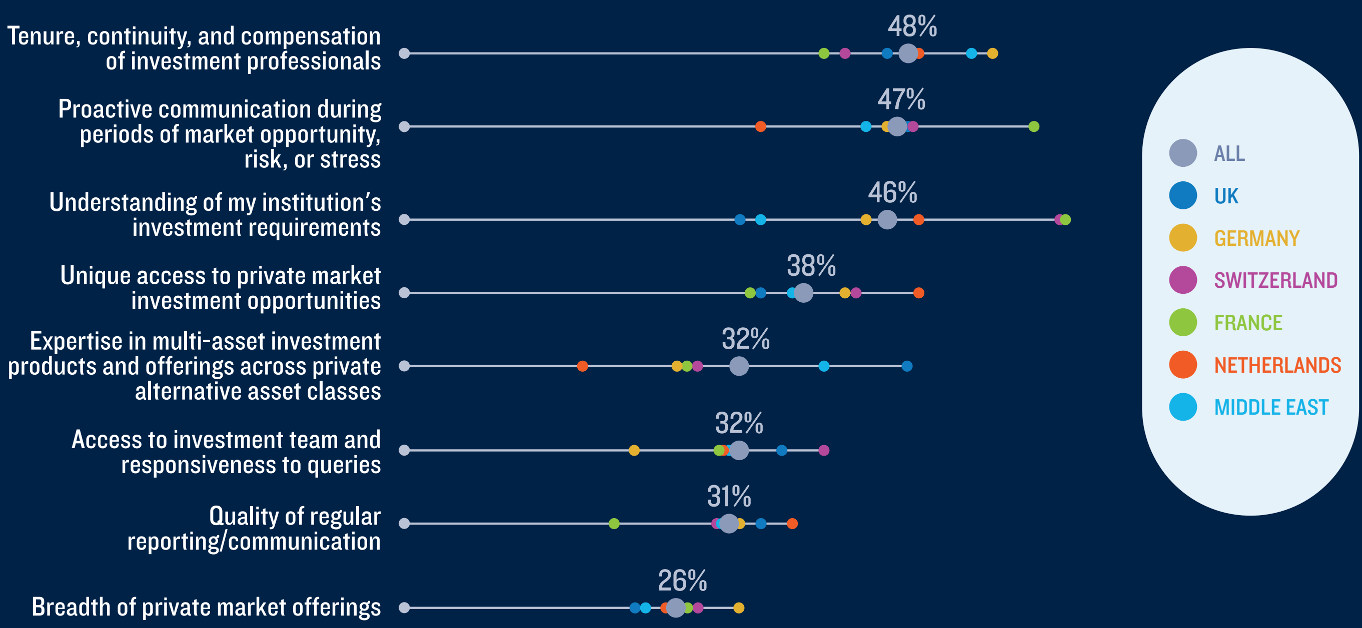


Exhibit 23: When evaluating prospective new asset managers for private alternative investments, which of the following types of firms are you likely to prefer?

Large, multi-line firms prevail over boutiques in private assets

Exhibit 24: Which of the following non-investment-performance factors are especially important to you when evaluating prospective new asset managers for private alternative investments?

Investors choose asset managers based on investment teams, proactive communication, and understanding of client needs



INVESTMENT IMPLICATIONS

INVESTMENT IMPLICATIONS

The fast-growing private alternatives sector is gathering increased interest from institutional investors in today's evolving macro and geopolitical landscape, according to the survey. Assets under management for alternative assets is expected to grow to $23.3 trillion by 2027, up by more than 70% from $13.7 trillion at the end of 2021, according to Preqin, a UK data firm.[31]

The top three considerations for using private alternatives in portfolios in the survey are to yield income, generate returns and risk management. Every category of private alternative assets discussed in the preceding pages include these elements to varying degrees.

Where might allocators look to meet these portfolio objectives?

Active approach

Private alternatives provide an opportunity to take a "hands on, direct engagement" approach with company management teams as investors can offer their expertise to help businesses become more profitable. Consider private equity investments where institutional investors can often take a "consulting" role with businesses they invest in, which can result in investment returns uncorrelated to public markets.

Turning to Debt

Investing in infrastructure debt or private credit offer predictable and relatively higher cash flows compared to government bonds or corporate debt. The yields that private credit investing offer help long-term investors, such as pension funds, who require alternative income streams when faced with aging populations or relatively lower public fixed income yields.

Sustainable Means

The green transition is a powerful investment driver. Investors are exhibiting a renewed appetite for responsible investments due to new sustainability guidelines from regulators and a greater understanding of private alternatives. Moreover, there is a structural funding gap for infrastructure projects that help economies become greener. Investor demand for such projects is stronger than ever, with institutions keen to participate in opportunities that satisfy not only their own return objectives but also the needs of a broader set of stakeholders.

The Next Stage

Regulation is powering the next stage of growth for private alternative investments as policymakers are

"

Small and medium sized businesses need finance to grow. We invest in private equity and private debt funds due to the two overarching objectives of providing jobs and boosting growth."

INVESTMENT OFFICER
UK pension fund, £30 billion in assets under management

31 Preqin: (October 5, 2022) Global Private Capital AUM to Double to $18.3tn by 2027. HYPERLINK "https://www.preqin.com/portals/0/documents/foa%20press%20release%20final.pdf" Accessed July 2024

increasingly mindful of the profound impact that private investors can have on local, regional, and even national economies. Governments are recasting rules to cultivate private investments that can fund economic activity to benefit voters.

Recent regulatory reforms in the UK, for example, encourage pension funds to increase their allocations to private alternatives. In Europe, the newly updated rules for investing in ELTIFs by EU regulators in early 2024 expand the pool of eligible participants in private markets and allow greater flexibility.[32]

Not a one size fits all approach

The survey also highlights how investment preferences differ across institution types and jurisdictions, as investors look to align their unique investment objectives with the growing universe of private alternative assets.

Despite the promising outlook, investors must navigate several challenges when allocating to private alternatives. These include fee structures, relative illiquidity, and the complexity of due diligence processes. Effective, thoughtful manager selection and robust governance frameworks are critical to mitigating these risks.

The competitive landscape is intensifying, with an increasing number of market participants jostling for attractive investment opportunities while numerous profitable businesses prefer to stay in private hands or delay their public listing plans.

In the years ahead, the tenure and the track-record of the investment teams in the private alternative sleeve and the ability of large firms to offer a wide swathe of assets on a single platform will become increasingly important to the success of institutions throughout Europe and the Middle East.

32 Reuters: (February 20, 2024) Exclusive: Top UK pension fund Nest expects to lift private assets to 30% of holdings. HYPERLINK “https://www.reuters.com/world/uk/top-uk-pension-fund-nest-expects-lift-private-assets-30-holdings-2024-02-20/” Exclusive: Top UK pension fund Nest expects to lift private assets to 30% of holdings I Reuters Accessed July 2024

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