

Leveraging Opportunity in Change

Navigating the Trends Shaping
Private Markets in 2021 and Beyond



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About the Research and Acknowledgements

This report explores the long-term trends shaping private-market investors' decisions, and the strategies managers are deploying to continue generating returns despite growing global risks. The research is based on a survey, in-depth qualitative interviews and desk research, conducted by The Economist Intelligence Unit (The EIU) on behalf of Adams Street Partners.

The survey covered 110 limited partners (LPs)—specifically, investors that commit capital to private markets, including pension funds, institutional accounts, and investment and portfolio managers—in Asia, Europe and North America.

We would like to thank the following experts for their participation in the qualitative interviews:

- **Ingrid Albinsson**, Chief Investment Officer and Executive Vice President, Seventh Swedish National Pension Fund (AP7)
- **Paul Cavazos**, Chief Investment Officer, American Beacon Advisors
- **Hideya Sadanaga**, Senior Managing Partner and Head of Private Equity, Japan Post Bank
- **Antoon Schneider**, Managing Director and Senior Partner in the Principal Investor and Private Equity Practice, Boston Consulting Group

The report was written by Monica Woodley and edited by Monica Ballesteros.

A Note from Adams Street Partners

The covid-19 pandemic rapidly transformed life for individuals and institutions around the world. Profound changes in human behavior and consumption patterns moved quickly through global economies, creating tremendous uncertainty for governments, industries and company leaders. It remains to be seen what a post-covid world will look like, but it will undoubtedly be changed.

While macro-dislocations can be unsettling, they also create opportunities for investors who can maintain an even temperament and a long-term focus. We believe that private markets are well-suited to this mindset as they tend to be shielded from much of the volatility and short-term pressure faced by their liquid market peers. In fact, private markets have historically thrived during times of dislocation, change and growth.

Over nearly five decades of private-markets investing experience, Adams Street has observed three fundamental reasons why private markets may offer compelling opportunities during periods of disruption. First, management incentive systems are generally focused on long-term shareholder value, even if it comes at the expense of short-term profits. As a result, we have seen that private company managers may be less burdened than their liquid counterparts by the stress associated with creatively destructing old business practices in favor of a more innovative approach. Second, we believe that private markets have a superior governance structure that enables companies to adapt quickly to changes in the external environment. Finally, private markets tend to focus on sectors going through structural change and growth and thus may be more comfortable investing and operating in times of uncertainty.

In our view, the global pandemic has accelerated structural changes that were already underway, creating unique opportunities for private-market investors. Prior to covid-19, technology was already a disruptive force in many industries. Telehealth, online education, videoconferencing, secure mobile payments and automated customer engagement technology are all examples of products or services available before the pandemic that are seeing explosive growth.

The behavioral changes brought about by covid-19 and the accompanying shutdowns transformed these innovations into vertical growth strategies necessary for competitive success and survival. Companies that assume customers and workers will revert to their pre-pandemic approaches to conducting business may be at risk of extinction. We believe that successful companies will invest heavily in intuitive technology that enables customers and workers to interact at the time and place of their choosing.

The themes of innovation and growth are not confined to a single developed economy like the US—they are global in nature. In fact, we have seen many countries in Asia lead the way on consumer innovations, including the rise of mobile-first societies well before their western counterparts. In other areas, such as healthcare innovation and business-to-business software, the US and Europe remain ahead. In short, while regional differences exist, we believe the tailwinds are consistent.

We see private markets as well-positioned to be a driving force behind long-term innovation, job creation and growth on the global stage. As shown in the following research, investors are bullish about the ability of private markets to generate above-market returns compared to their public market peers. While risks remain, Adams Street anticipates high-quality private investments to be a cornerstone of a global investment portfolio in the years ahead.



Jeffrey Diehl
Managing Partner & Head of Investments



Executive Summary

2020 brought profound change that will continue to influence financial markets for years to come. The covid-19 pandemic hampered economies and exacerbated market volatility, and investors are still processing the short- and longer-term impacts. Geopolitical tensions and growth in anti-globalist policies are creating structural changes which investors must factor into their investment strategies. Despite increasing risks, however, investors are confident that private-market assets will continue to offer opportunities for long-term growth.

- 80% of respondents agreed that private markets are less susceptible to short-term volatility than public markets.
- 85% of respondents expect private markets to continue to outperform public markets in the long term.
- Respondents expect Asia-Pacific to offer the best private-market investment opportunities in 2021, followed by North America.
- Respondents expect the financial services, technology and healthcare sectors to offer the best private-market investment opportunities in 2021.
- Respondents plan to invest in companies with multiple growth strategies, and in funds with experienced general partners for risk mitigation.
- Respondents anticipate that the following risk scenarios will have the greatest impact on their private-market investment strategies in 2021: the continued spread of covid-19 and vaccine distribution issues; and growth in anti-globalist policies, such as trade barriers and tariffs.

Private Investments: An Alternative to Volatile Public Markets

Financial markets often diverge from reality, as 2020 demonstrated. While the covid-19 pandemic had killed more than 1.8m people around the world and left millions unemployed by the end of the year, the Dow Jones Industrial Average and the S&P 500 finished 2020 at record levels.^{1,2} Stock markets around the world showed mixed results (mainly down in Europe and up in Asia) but the contractions were smaller and less prolonged than what might have been expected considering the pandemic’s extreme impact on economies. Global fixed income also benefited from a strong performance in 2020, with credit spreads near their lowest point in ten years.³ However, performance came at a price: volatility. In March 2020 the Chicago Board Options Exchange’s Volatility Index (VIX) surged by 43% to a record high of 82.69, surpassing levels seen during the global financial crisis (GFC) in 2008.⁴

For investors looking for more consistent returns, those surveyed believe that private-market assets offer an alternative to the volatility of public markets. “I think they are less susceptible to volatility in that valuations do tend to be more static,” explains Hideya Sadanaga, senior managing partner and head of private equity at Japan Post Bank. “They didn’t move around as much during the March-June timeframe. Last year, our private-equity portfolio went down by as much as 10%, but public-market equity declines were much more severe.” Investors surveyed by The EIU share this view, with eight in ten agreeing that private markets are less susceptible to short-term volatility than public markets. Nearly nine in ten (88%) believe that this is because private-market investors can actively manage portfolio companies to diagnose and mitigate problems in real time.

The expansive monetary policies and lower interest rates have also contributed to a growing tolerance for risk according to Ingrid Albinsson, chief investment officer and executive vice president of AP7. “The private market has gained ground because of the low-return environment which has increased the acceptance of risk,” she notes. “The expansionary policy we are in has reduced the demand for a risk premium in a way and has encouraged holding riskier assets.”

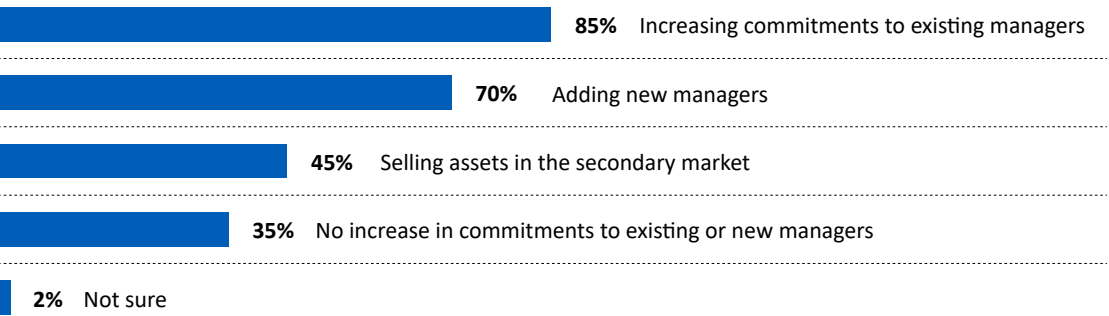
Ms Albinsson also attributes the expansion of private markets to the need to find diversification strategies and the long-term orientation of asset managers. “The investment horizon [of private-market investments] is a bit longer and the opportunity to create long-term value is more harmonized with the horizon of those investments,” she says.

Our research indicates that the appeal of lower volatility, diversification and strong long-term performance has led to significant growth in private-market investing. According to the latest McKinsey & Company Global Private Markets Review, assets under management grew by \$4trn (170%) between 2009 and 2019.⁵ Survey respondents plan to add to that growth: 85% are considering increasing capital commitments to existing managers, and 70% are adding new managers to their portfolios (Figure 1).



Figure 1. Expected Private-Market Commitments for 2021⁶

Which of the following describes the top considerations for private-market commitments in your portfolio for 2021?



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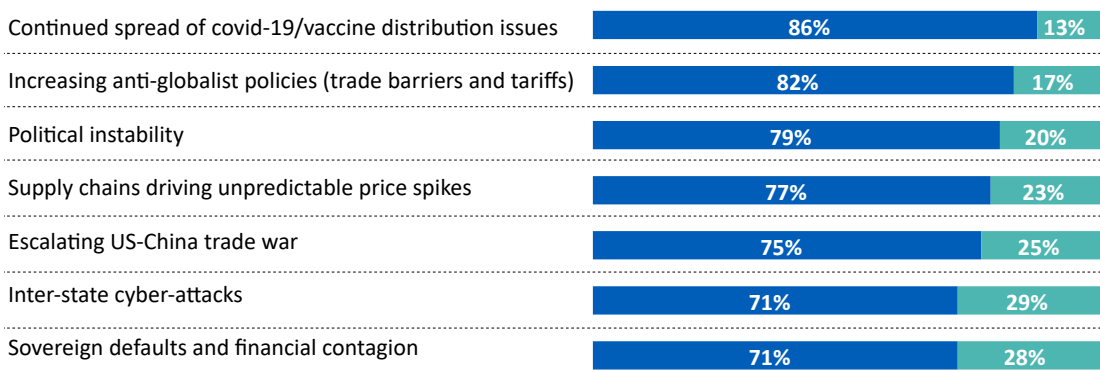
This may be fuelled by a desire to invest ahead of the expected economic rebound. While The EIU expects global GDP to rebound by 4.5% in 2021—after contracting by 4.3% in 2020—global GDP will not recover to its pre-covid level before 2022.⁷ More than eight in ten respondents (83%) believe that funds which deploy cash following a crisis perform better than funds that deploy cash in late-cycle peak economic growth—a key lesson learned from the GFC. “We didn’t stop investing last year,” explains Paul Cavazos, chief investment officer of American Beacon Advisors. “It’s not like we didn’t think about it, but we believe in vintage diversification and we often find that it’s at these inflection points that you have a greater opportunity to have some good risk-adjusted returns going forward.”

While many investors continue to invest, they are carefully considering the risk landscape to differentiate between long-term structural disruptions and temporary shifts. Survey respondents anticipate that the following risk scenarios will have the greatest impact on their private-market investment strategies in 2021: the continued spread of covid-19 and vaccine distribution issues; and growth in anti-globalist policies, such as trade barriers and tariffs (Figure 2).

Figure 2. Expected Impact of Risk Scenarios on Private-Market Strategy in 2021⁶

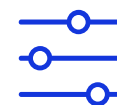
To what degree do you expect the following risk scenarios to impact your private-market investment strategy in 2021?

■ Major impact ■ Low impact ■ Not sure



“For the short term it is a question of the virus and the economic and expansionary policies coming this year to supporting growth,” explains Ms Albinsson. “But we also have this long-term structural trend which is the challenge of globalization. Geopolitical tensions and increasing focus on sustainability and climate risks are changing growth dynamics.” Mr Sadanaga worries about the impact of the combination of these issues. “We’re already seeing anti-globalism in terms of vaccine distribution and that type of ill will does worry me in terms of the long-term global economy,” he notes. “That might take a couple points off of global economic growth.”

The pandemic and the rise of anti-globalist sentiment have influenced respondents’ assessments of which geographies and sectors will provide the best opportunities for 2021. Most respondents



While many investors continue to invest, they are carefully considering the risk landscape to differentiate between long-term structural disruptions and temporary shifts

(93%) consider that dependency on markets with geopolitical risks is important when assessing private-market opportunities. However, investors are also considering how long-term trends such as digitisation might influence these dynamics. Eighty-nine percent of respondents consider the degree of digitisation of a prospective company is important given the long-lasting impact it has had on several sectors, including the rise of telemedicine and remote work.

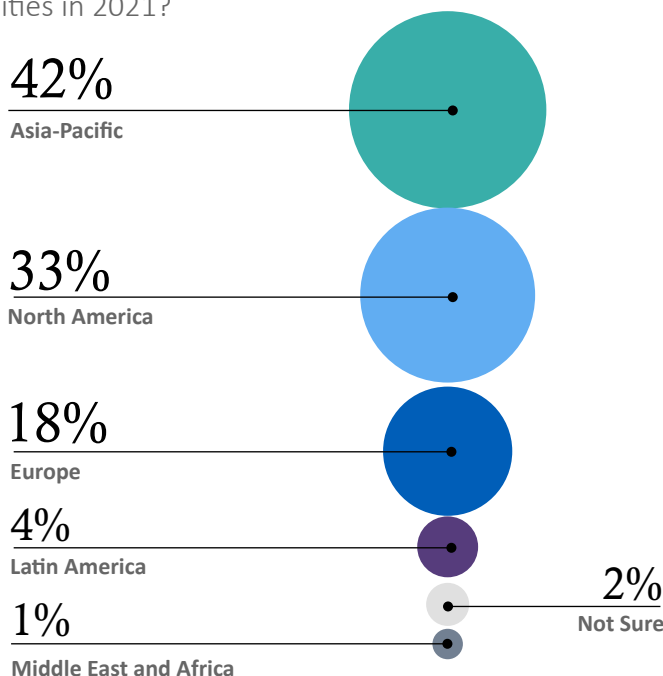
A Look Towards Asia-Pacific

Survey respondents expect Asia-Pacific to offer the best private-market investment opportunities in 2021, based on the quick economic rebound seen in China and other Asian economies as a result of their rapid coronavirus responses (Figure 3). China is the only G20 country that recorded growth in 2020 and has positive growth prospects in 2021. Other countries in the region, such as South Korea and Indonesia, also have positive growth prospects in 2021.



Figure 3. Geographic Regions with the Best Private-Market Investment Opportunities in 2021⁶

Which geographic regions do you expect to offer the best private-market investment opportunities in 2021?



Based on the quick economic rebound seen in China and other Asian economies as a result of their rapid coronavirus responses, respondents expect positive growth prospects in Asia-Pacific

While many investors in public markets favour China, the pandemic has exacerbated existing strains in the US-China relationship, forcing private-market investors to consider the potential long-term implications of further strategic divergence. “We don’t have a big exposure to Asia, but we could absolutely see that growing over time,” explains Mr Cavazos. “However, you have to be mindful of certain investments from a regulatory point of view, like with China. We’re being prudent about jumping in, in a sizeable manner.”

Instead, Japan—which has not been a big focus for public-market investors for decades—is showing promise in the private-market space. “Japan has a big industrial economy and lots of industrial conglomerates that need to ‘deconglomeratise’, and there’s so much to come from that,” notes Mr Sadanaga. “We also have not an ageing but an aged population, and therefore lots of companies that have succession issues. Those are ripe for transactions.” Private-market funds are able to influence the strategies of portfolio companies that are undergoing these types of transformations to promote greater growth.

“We are still US-heavy but in the past number of years, we’ve been intentionally spreading that out, principally to developed markets in Europe, particularly in the buyout middle-market space.”

– Paul Cavazos, Chief Investment Officer, American Beacon Advisors

In contrast to Asia’s optimistic prospects, euro-zone countries recorded an historic collapse in 2020, due to severe initial lockdowns that hit their services- or tourism-oriented economies. Renewed lockdowns will cause a double-dip recession in some of these countries in 2021. Brexit is another variable that is likely to weigh on growth in 2021, following the end of the UK’s transition period in late 2020.⁷

However, as the uncertainty of Brexit begins to clear, investors will be able to develop better forecasts, according to Antoon Schneider, managing director and senior partner in the principal investor and private equity practice at Boston Consulting Group. “The UK was out of favour for a while, but I think there’s now enough certainty around Brexit,” he says. “Never mind whether it’s good or bad, people know what to expect and private equity can price the asset.” Mr Cavazos is also looking to Europe for diversification: “We are still US-heavy but in the past number of years, we’ve been intentionally spreading that out, principally to developed markets in Europe, particularly in the buyout middle-market space.”

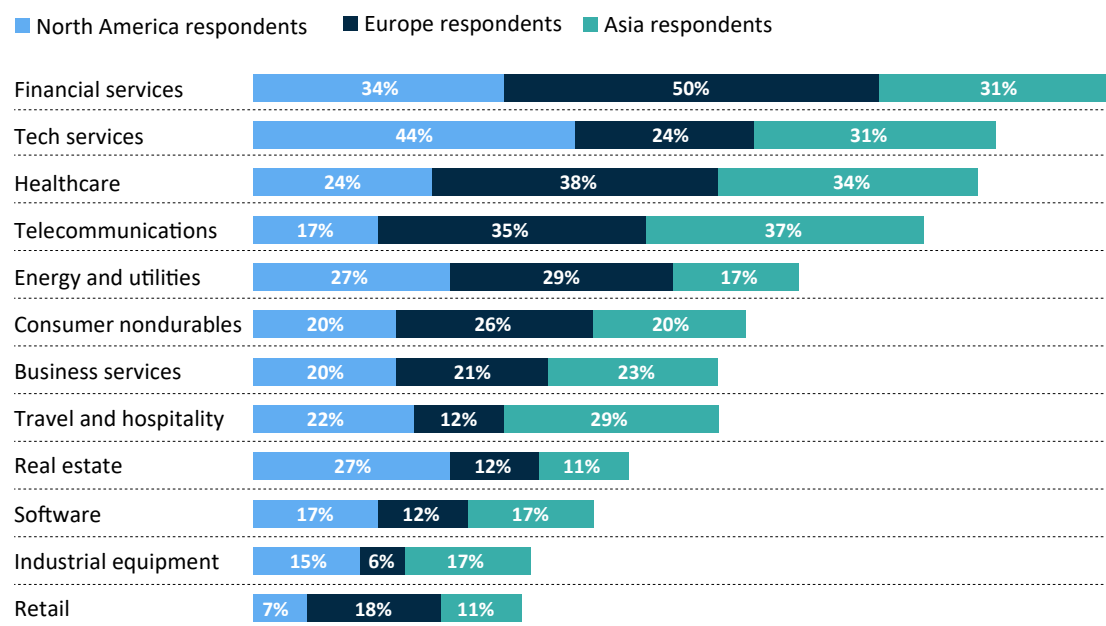
Sector Dislocation May Present Opportunities After Recovery

Survey respondents consider the top sectors for investment in 2021 to be those that have best weathered the pandemic: financial services, technology and healthcare (Figure 4). Greater competition in these sectors is already driving prices up for new entrants.



Figure 4. Sectors with the Best Private-Market Investment Opportunities in 2021 by Region⁶

Which sectors do you expect will offer the best private-market investment opportunities in 2021?



Top sectors considered for investment by survey respondents in 2021 are those that have best weathered the pandemic: financial services, technology and healthcare

Mr Sadanaga is wary of the high valuations he is seeing in technology: “Growth is getting very expensive because people who want to make an easy buck are coming into that space.” However, the continued trend towards digitisation is likely to impact other sectors beyond technology services. Mr Schneider sees how digitisation is already changing private equity. “Private equity is still looking to cut costs but now it’s with digital,” he explains. “How can we move our customers away from interaction with the sales force to a digital platform or how can we automate decisions? It’s about helping mid-sized companies to apply some of the tools that larger companies already may be using, like big data and AI [artificial intelligence].”

Investors in different regions are also focusing on potential gains from a temporary drop in valuation in sectors that will likely recover after the economic downturn. In North America, one-third of respondents are seeing opportunity in real estate, as investors consider whether remote work will be a temporary or structural change. In Asia-Pacific, the travel and hospitality sectors are expected to rebound after the pandemic. Mr Sadanaga is focusing on sectors that have been hardest hit by covid-19, such as entertainment, travel and hospitality: “If you can fund them until the end of the crisis, you can support these industries—there are companies in these sectors that deserve to live through this crisis and will flourish in the post-covid environment.”

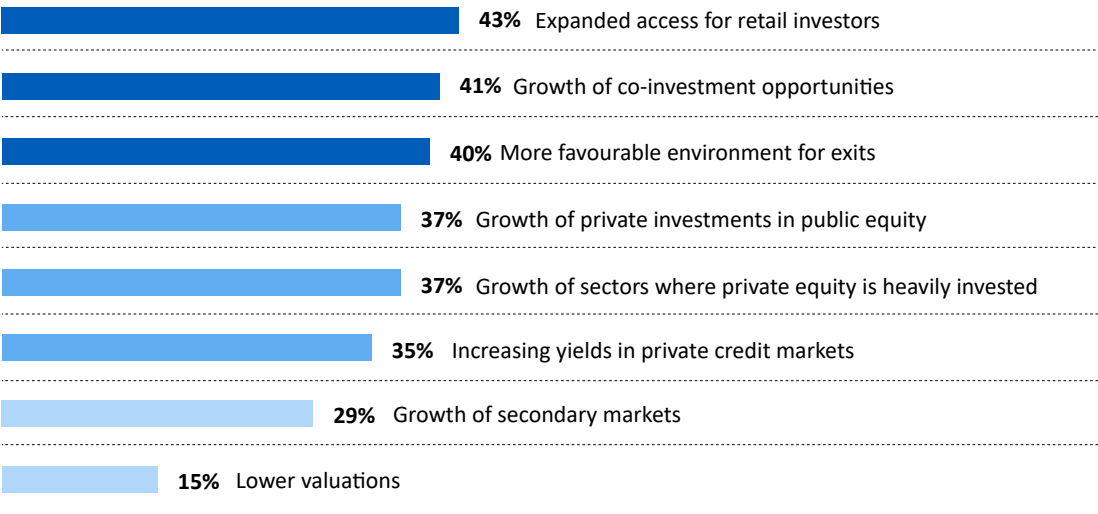
Where Investors are Seeing Opportunity

This year institutional investors are paying close attention to the impact that the potential expansion of access for accredited retail investors might have on private markets. They also see potential in the growth of co-investment opportunities, which reduce fees and can increase the net return of investments. Others are looking at the success of recent initial public offerings (IPOs) and the opportunity of more favourable exit environments (Figure 5).



Figure 5. Opportunities for Private-Market Deal-Making in 2021⁶

What do you anticipate will be the greatest opportunities for private-market deal-making in 2021?



Institutional investors are paying close attention to the impact of the potential expansion of access for retail investors to private markets and co-investment opportunities

Mr Sadanaga is excited about the prospects for exits: “2021 will be probably the biggest exit year we’ve seen in history.” However, he sees the expansion of access to private-market investments as a potential risk. “We’ve seen moves to democratise private equity, and I think there is a demand/supply issue in terms of money out there and the opportunity set available—the more money that comes in, the less likely it’s going to outperform,” he explains. “For 20 years private equity has been the best-performing asset, but those returns may come down if there are more market participants.”

When considering how they will protect their private-market investments against risk, survey respondents most frequently cited investments in companies with multiple growth strategies and in funds with experienced general partners (Figure 6).

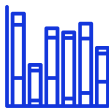
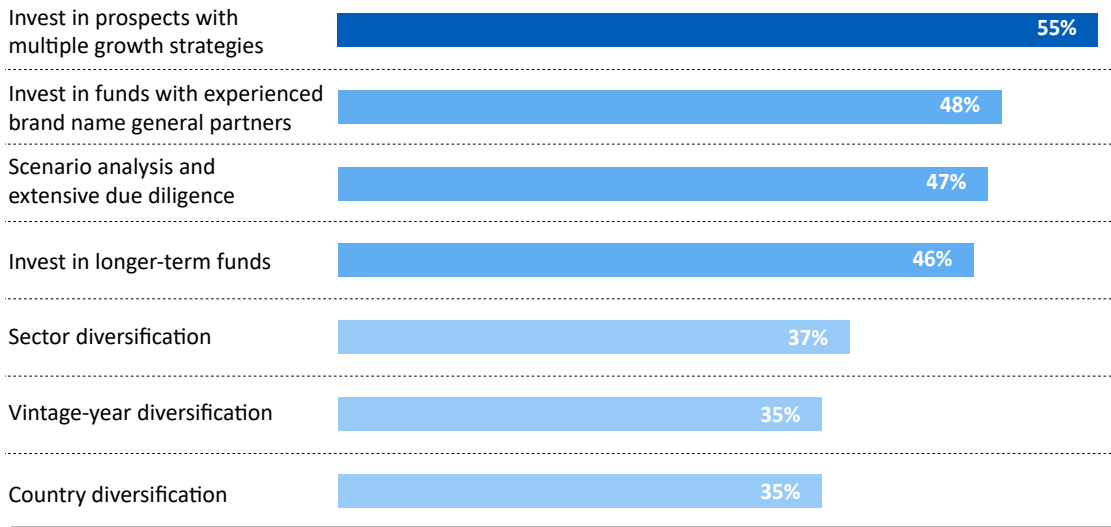


Figure 6. Opportunities for Private-Market Deal-Making in 2021⁶

How do you protect your private-market investments against global risk scenarios?



Investing in multiple growth strategies and in funds with experienced general partners was most frequently cited by survey respondents to protect against global risk scenarios

“Our strategies for mitigating risk are tenets that are always there—we start there and look back regularly,” says Mr Cavazos. “We want diversification—across strategies, vintages, geographies and sectors. We also want to make sure we are flexible, so we like products that can move up and down the market cap structure.”

The current environment has also made it even more important to work with strong partners. A large majority of survey respondents (85%) agreed that as competition increases, expertise will become more critical than ever. One of the characteristics they value most in a fund is deep sector and subsector expertise. For Ms Albinsson, sector-specific knowledge, particularly in sectors like fintech where regulation is rapidly evolving, is an important characteristic for value creation. “Sector-specific knowledge is always good,” she says. “To have a deep knowledge base, to understand how the value chain could be extended and to understand impending regulation and how it can hinder value creation is critical.”

Survey respondents also placed an emphasis on value creation over debt leveraging. Mr Sadanaga is happy to see this shift in thinking and a move away from the stereotype of “vulture” investors. “The problem with the vultures is they just rationalise and sell off—so no initiatives to grow companies, to make them better. If you just rationalise, or do quick fixes, you’re not getting the most from your investment,” he explains. “You have to find something that grows these companies and makes them more competitive. That’s something that many of our private-equity managers have done over the past decades, and that I really am happy about.”

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Environmental, Social and Governance Considerations Become an Imperative, with Promising Returns

As climate change and social unrest weigh on economic growth, the integration of environmental, social and governance (ESG) considerations into investment strategies is quickly becoming a requisite for investors and an avenue for continued growth. “When I joined Japan Post Bank in 2016, ESG was viewed by many as a cost—a cost that you had to pay to play,” says Mr Sadanaga. “We’re a public company and shareholders will ask what the ESG plan is and if you don’t have one, they won’t invest. That pressure has been rising.”

Mr Schneider agrees that ESG has quickly changed from a tick-box exercise. “Private-equity firms know the companies they invest in need an ESG rating or they will have trouble raising money, they worry people won’t touch the IPO,” he says. “People are taking ESG seriously at all levels—the LPs, the PE [private equity] firms, companies’ management. I’m amazed by how fast that has moved from lip service to a genuine concern.” Furthermore, the perception that ESG considerations come at the expense of returns is quickly dissipating: 85% of respondents now believe that the return value of an investment can be enhanced by incorporating ESG factors into the decision-making process.

Despite these shifting perceptions, there are still opportunities for growth in this area. Currently, just under half of survey respondents (46%) have strategies that include ESG restrictions, while another third (36%) take ESG considerations into account even though they are not restricted by them. According to Ms Albinsson, the challenge of incorporating sustainability considerations across industries is a potential area of growth for private markets across sectors, particularly in Europe. “[Sustainability] goes into the core of the traditional industry to find new solutions in production where there are a lot opportunities especially related to climate risk,” she says.



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Conclusion: Rethinking the Long Term

Global risks like the continued spread of covid-19 and increasing anti-globalist policies have continued to dominate the headlines in 2021 and will influence private-market investors' strategies in the long term. Investors surveyed are confident in the ability of the asset class to deliver strong, risk-adjusted returns which has led them to increase and diversify their allocations. Data from Preqin shows the consistency of performance over longer time horizons (Figure 7), and 85% of survey respondents expect private markets to continue to outperform public markets in the long term.

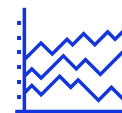
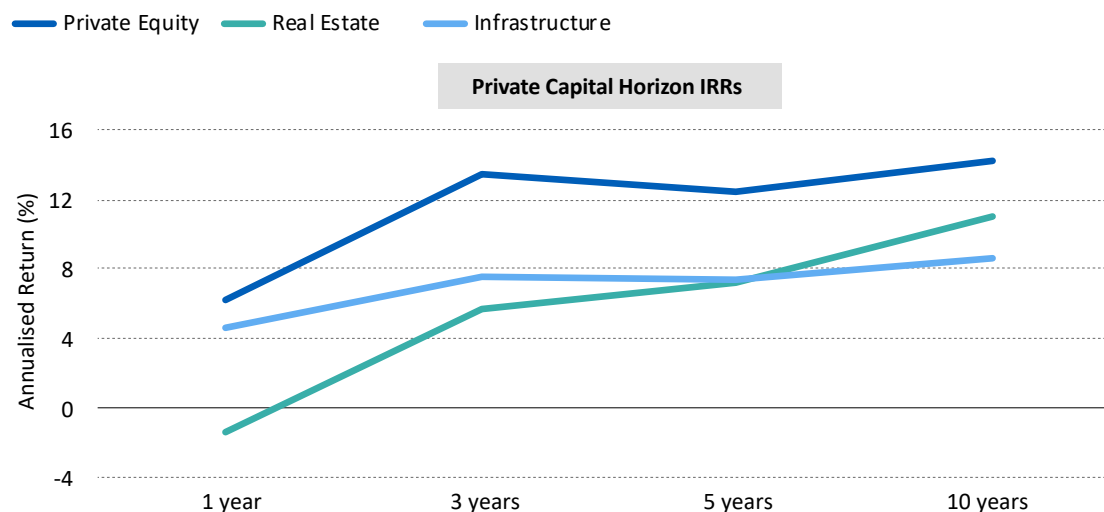


Figure 7. Private-Market Assets – Annualised Returns⁸



Investors are confident in the ability of the asset class to deliver strong, risk-adjusted returns which has led them to increase and diversify their allocations

However, broad private-market exposure is not sufficient to shield investments from global risks. As with every asset class, having the right investment strategy and partners is paramount to produce outperformance and strong, risk-adjusted returns. “We believe in private markets over the long term, which is why over the past three to four years we have increased our allocation,” Mr Cavazos says. “But that doesn’t mean that every GP [general partnership] is going to outperform, which is why it is of paramount importance that we are with the right ones. We’re bullish but that doesn’t mean that you don’t have to be careful.”

Investors surveyed recognize the need to rethink how global risks may impact the asset class in the long term and identify the opportunities that may emerge from these structural changes. They are actively managing their portfolios in the midst of a crisis, diversifying the geographic scope of their investments and capitalising on the opportunities that accelerating trends like digitisation are creating across multiple sectors. They must also calculate how structural changes should influence their investment strategy for the future. As greater concern about climate change, governance and social issues impact future economic prospects, the integration of ESG in the investment process is becoming even more vital to assess risks and find opportunity. This ability to foresee the dislocations brought about by global risks, and to identify the trends that emerge from these changes, is what will continue to create opportunities in private markets for years to come. ■

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1. Source: Johns Hopkins University of Medicine. "COVID-19 dashboard by the Center for Systems Science and Engineering (CSSE) at Johns Hopkins University (JHU)." [https://coronavirus.jhu.edu/map.html]
2. Source: Shaban, Hamza, and Heather Long. 2021. "The stock market is ending 2020 at record highs, even as the virus surges and millions go hungry." The Washington Post. [https://www.washingtonpost.com/business/2020/12/31/stock-market-record-2020/]
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6. Source: The Economist Intelligence Unit
7. Source: The EIU. 2021. "Global outlook February 2021."
8. Source: Preqin, data to June 2020

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