Benefits and Pensions MONITOR Meetings & Events WEBINAR

PRIVATE INVESTMENTS BEYOND THE PANDEMIC

NORTHERN TRUST ASSET MANAGEMENT

The COVID-19 pandemic has created ongoing anxiety within society, which has had a downstream impact on financial markets. Economic impact and response have been sharp and swift and markets have reacted with extreme volatility. With the public markets taking it more directly on the chin, how are the lesser transparent private markets faring, asks Alice Fang, head of Northern Trust Asset Management Canada.

Asset owners – under pressure from declining plan assets, low rates, declining contributions, and higher payout – are reconsidering how to best invest to protect capital and improve returns during today's economic pause.

Alice discusses where private investments fit into this environment with Bob Morgan, managing director at 50 South Capital Advisors, a Northern Trust Asset Management affiliate, in the Benefits and Pensions Monitor Meetings & Events session sponsored by Northern Trust – 'Private Investments: Beyond the Pandemic.'

Alice Fang: *How does the COVID-19 Pandemic crisis compare to the global financial crisis (GFC) during 2008 and 2009?*

Bob Morgan: This time around more businesses were impacted because revenues just effectively stopped.

With the GFC, the issues were in the financial markets which took quite some time to work through. This time, the financial system is relatively healthy which is a positive sign. With COVID-19, everybody transitioned to working from home and most companies have operated really efficiently which is a testament to technology and business disaster recovery plans.

The big difference for private assets during the GFC was that no deals were being done.

Just before the pandemic hit, a lot of private equity firms were using credit facilities to fund acquisitions and sometimes these facilities had been out as long as a year.

When the pandemic hit, many firms had to call capital from limited partners (LPs) to repay these credit facilities. Needless to say it irritated some LPs because they were having to find liquidity in an illiquid environment to fund deals actually committed in 2019.

Fang: *How are the current conditions affecting managers?*

Morgan: On the venture capital side, a ton of money has been raised. For example, one of the firms we invest with raised $3.1 billion total in the last 12 months. If a firm with some insights takes advantage of these markets, it can pay off in this environment.

In the deal market, managers expect volume to slow down as was the case in 2008. Exits will probably slow down and it has become really hard to invest in new funds.

The concern now is for firms that have invested a lot of capital and have not yet exited because hold periods will lengthen and exits will slow down, affecting fund IRRs

Fang: *Have expectations changed in private assets?*

Morgan: Deal activity is definitely going to slow down. What happens in environments like this is you get a mismatch in buyer and seller expectations. If you own a business and you thought you could sell it for $100 million in December, if you are now offered $75 million, you are not likely to take it. It takes a little while for that valuation psychology to reset.

But when deals do get done, the returns can be attractive. We know that vintage year returns coming out of the 2001 to 2003 and 2009 through 2011 recessions were very strong. For firms that have cash available and are able to structure transactions, it should be a very attractive environment.

Acquisitions will be pretty prevalent as companies try to build their company cash flows. We're going to see a lot of private investments in public companies. Technology and growth will continue to grow quite significantly.

In credit, we are big believers in direct lending. From a risk/return perspective, it is an extremely nice place to be. It is a pure alternative to fixed income and, in a very low rate environment like we're in, if we can generate over 10 per cent current yield paid quarterly with what we believe to be very well-protected credit risk, we are very excited and that environment is only going to get better.

Fang: *What are some of the considerations now about allocations to private equity or private debt?*

Morgan: We are not big believers in trying to market time private markets.

Private equity firms are not really thinking about the next quarter. They're thinking long term: Where do I want my business to be in five years when I go to sell the company?

In addition to this long-term orientation, there is a real alignment among the different constituents – investors, LPs, GPs, lenders, the management teams – to do what's right for business.

No one knows what the future holds for sales price, but if you build a really solid company, you're probably going to get a nice price for it. BPM