SS&C Intralinks® Market Brief

Alternatives in the Age of COVID-19

July 2020

Data provided by PitchBook®

Editor’s Note

In the middle of June, the giant public pension CalPERS made headlines for confirming its commitment to allocate more to private equity and private credit. One of the largest and best-known limited partners (LPs) that has long invested in alternatives — primarily private equity (PE) and venture capital (VC) — CalPERS is hardly alone in its doubling down on investing in PE and VC fund managers, as firms flock to the asset classes due to their perceived outperformance and stability. However, in the COVID-19 pandemic era, both such attributes are thrown into stark relief. While the economic distress alone will cause performance to suffer, the duration and magnitude of the impact remains unknown. Due to the illiquidity of PE and VC, stability in fund metrics is almost assuredly greater than that observed in public markets, but opacity can also make fund investors more nervous. There are no signs of such unease yet; however, allocations to PE and VC funds remain more robust than might be expected.

The reason why is clear: Investors view alternatives as not only critical to a well-balanced portfolio but also increasingly important in hitting overall return targets. Despite concerns around performance over public equities steadily shrinking, alternatives’ lack of volatility, top managers’ rates of return and long time horizons all still outweigh concerns, as they have for some time. Allocations to PE and VC grew steadily throughout the 2010s, driven by the need for LPs to balance the growth in their public equity holdings and the allure of outperformance and stability. Such popularity also led to steady growth in the overall flow of commitments across the entire fundraising market, with LPs seeking exposure to smaller fund managers in search of outperformance as traditional arenas grew more competitive, while balancing investments in more established relationships to be mindful of overall risk. Such diversification occurred on both size and geographic bases, although North America tended to predominate because giant-fund managers simply established offices elsewhere for region-focused vehicles. Thus, as 2020 started, the decade-long trend of growth in fundraising culminated in record tallies for overall commitments by value to PE and VC funds — but clear trends were already beginning to emerge that the COVID-19 crisis only accelerated. In short, due to their own popularity, alternatives have had to adapt significantly, and as the post-pandemic era begins to slowly come into focus, investors and fund managers alike are trying to assess how they can not only evolve to suit the current environment but position for the long run.

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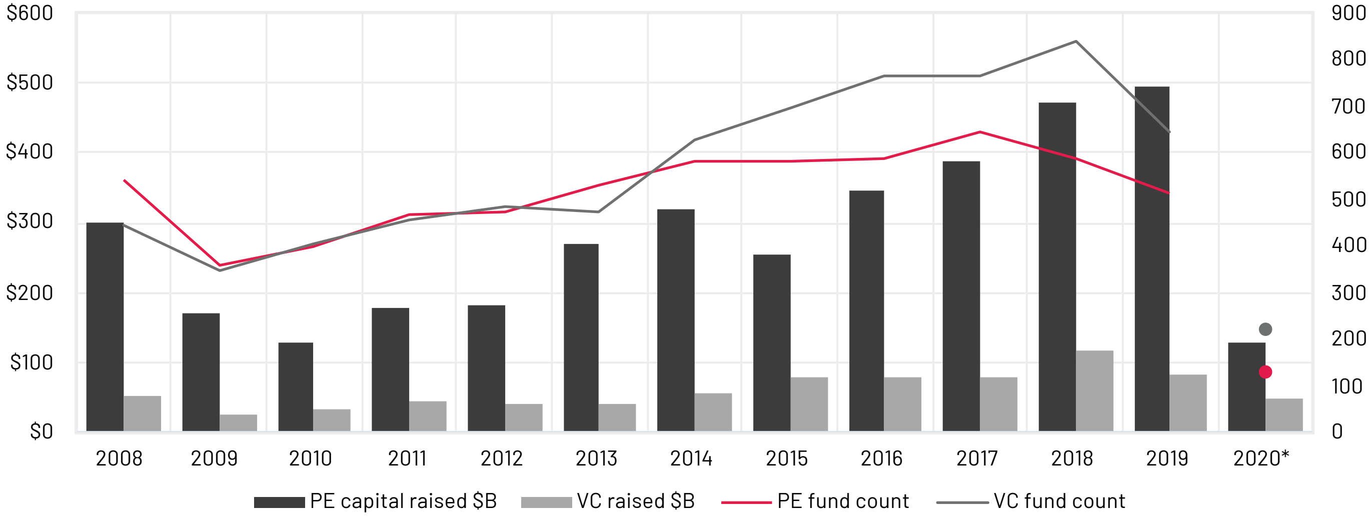
Strong growth in fundraising propels PE and VC to record dry-powder levels
Overall fundraising by year



Source: PitchBook Geography: Global
*As of May 29, 2020

North America still predominates, but geographic diversification grew throughout the 2010s
Overall fundraising by region (#)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020*
North America	431	275	325	354	441	559	736	806	866	886	960	759	224
Europe	306	239	227	251	232	261	257	235	248	283	240	206	67
Asia	167	125	193	251	214	121	161	163	160	162	162	120	30
Middle East	36	17	15	19	19	21	22	26	31	27	19	21	11
Africa	20	14	14	15	16	16	5	20	17	9	9	11	5
Rest of World	15	20	18	26	15	19	16	10	17	18	21	37	7
Oceania	14	12	9	7	18	9	12	16	16	20	12	5	2

Source: PitchBook Geography: Global
*As of May 29, 2020

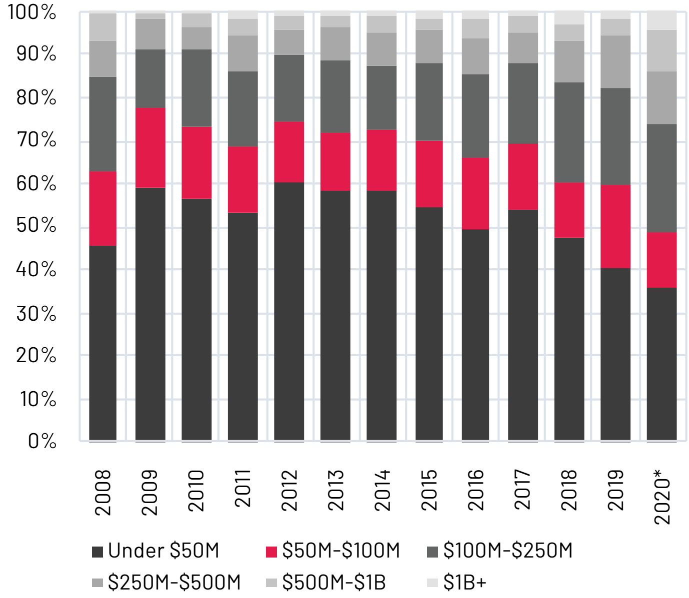
VC snapshot

Venture fundraising has also inexorably trended larger, and the incidence of mega-funds has risen significantly since 2015 in particular. At the macro level, these trends indicate the growing institutionalization of venture within LP portfolios. As successful funds were able to close on subsequent, ever-larger vehicles as LPs doubled down, the proportion of larger pools of capital grew over time. Mega-funds' rising frequency is driven in part by nontraditional investors, but primarily by the largest, truly global venture firms, as they scaled significantly. For larger LPs, this has enabled greater exposure to the venture-asset class, but smaller and/or newer investors looking to get into venture continue to propel overall volume as they allocate to midsized or smaller funds.

However, as can be seen from the 2020 data, the funds that have been able to close have tilted heavily toward more established, larger managers. Such risk aversion is clearly attributable to the unknown extent of the pandemic's impact on both newer and smaller fund managers, given their exposures can be riskier on average. Not all LPs can back the safest prospects in the fundraising market, but they still desire to either re-up or increase their exposure to VC, especially as times of distress can produce the strongest returns in the long run. More intense due diligence is occurring, as both LPs and general partners of funds try to find common ground. It's still too early to tell if the normal illiquidity of venture is going to be prolonged to problematic levels.

Fundraising has trended inexorably larger

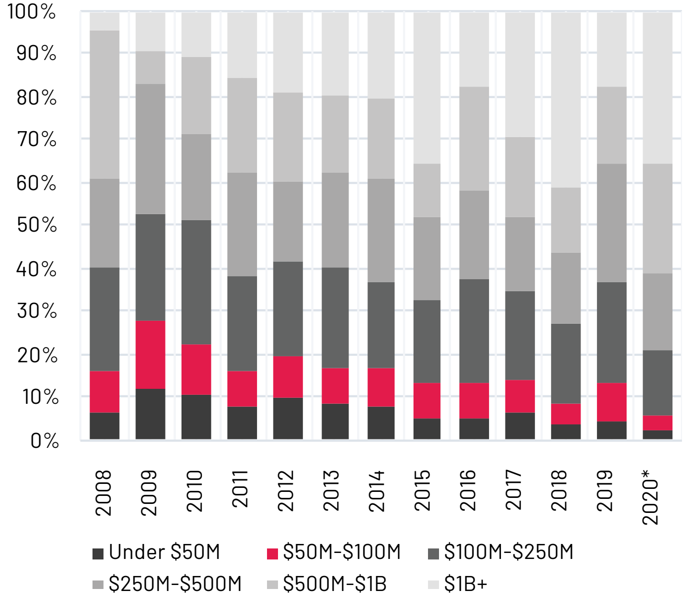
VC fundraising activity (#)



Source: PitchBook Geography: Global
*As of May 29, 2020

Mega-funds proliferate while smaller funds held strong until lately

VC fundraising activity ($)



Source: PitchBook Geography: Global
*As of May 29, 2020

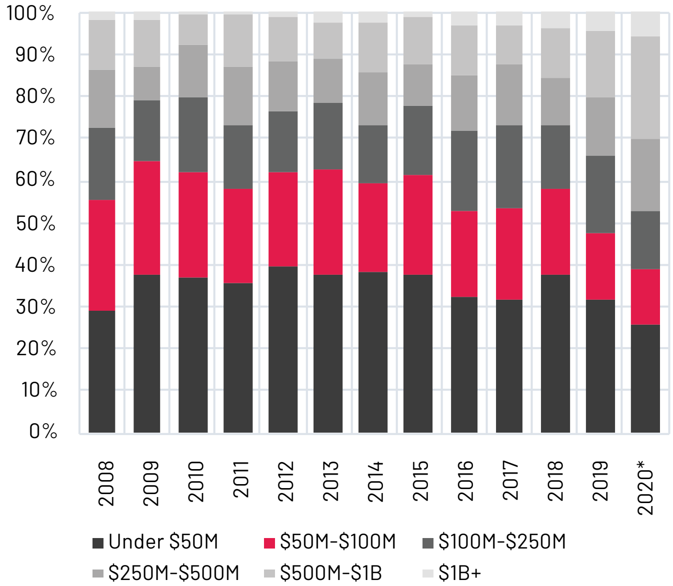
PE snapshot

PE volume has tilted toward larger funds. Capital committed to funds ranging from USD 500 million to USD 5 billion in size especially grew as of late, tellingly. The growing institutionalization of the largest PE firms enabled them to become much more opportunistic and targeted toward select vehicles dedicated to niches, such as specific nations in emerging markets. Meanwhile, a growing cohort of firms reached a degree of success and scale that enabled them to aim and achieve higher target sizes. Ensuing competition grew to such a pitch that, not only did funds at times have to scale up to compete, but large firms have focused on raising mid-market-targeting vehicles at a deliberate size to capitalize on select market niches.

Data from 2020 so far only shows an intensification of those trends. LPs face a similar quandary with buyout fund allocations: an appropriate balance of risk and exposure to a still-desirable yet illiquid asset class. However, the current environment does proffer opportunities for the PE funds that can capitalize on temporarily undervalued assets. Carveouts of corporate divisions are being considered more seriously than before; favorable terms for injections of capital into public entities offer another strategy. PE fund managers have options; as a result, LPs are still eager to commit to proven managers. PitchBook data shows PE managers in 2020 were still able to close at an accelerated clip; that may shift as time goes on, but for now, bodes well.

The top of the market steadily grows

PE fundraising activity (#)

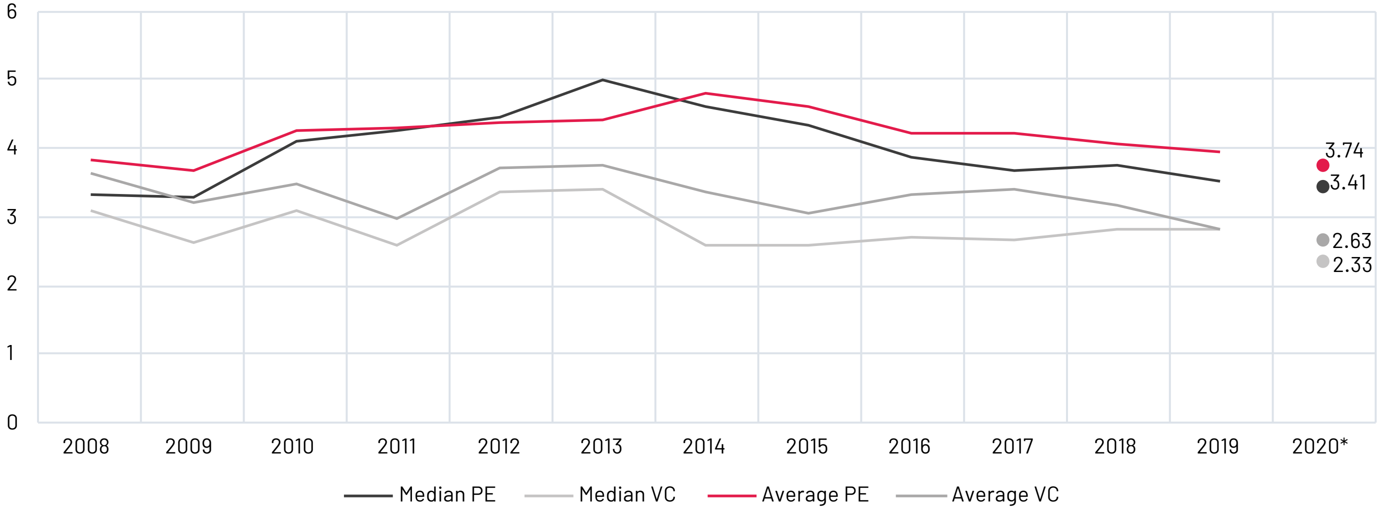


Source: PitchBook Geography: Global
*As of May 29, 2020

Looking forward

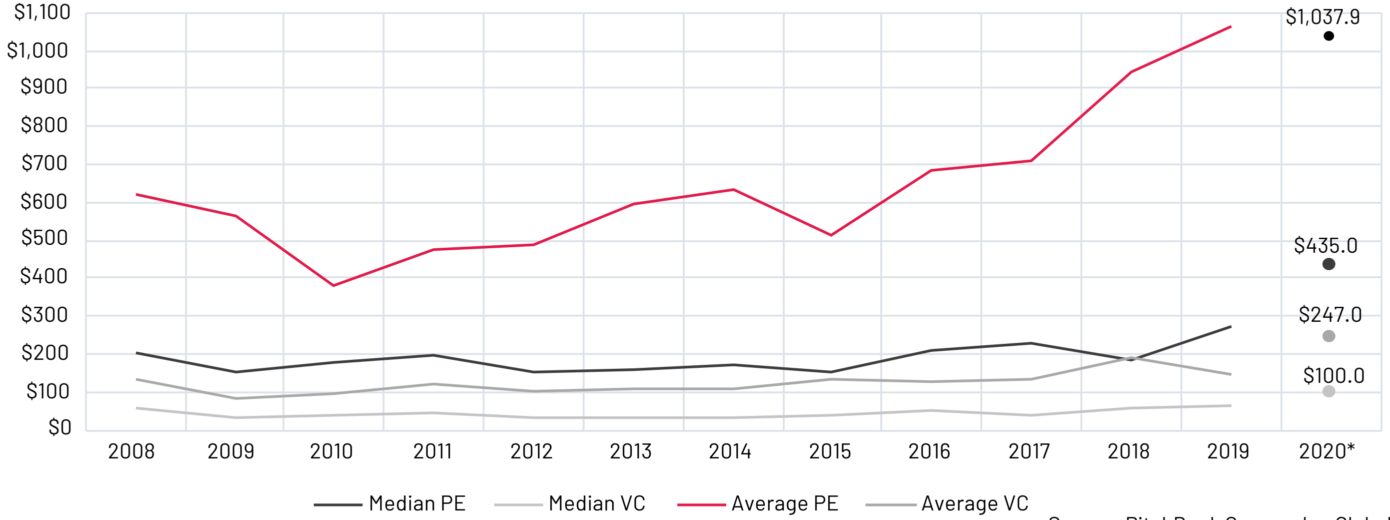
Given how strong fundraising has been for alternative fund managers, it may be reasonable to expect somewhat of a slowdown simply because LPs will have reached their target allocations. However, it remains to be seen how long it takes giant public pensions, asset managers at large and other types of LPs to gain their desired exposure to alternative strategies. Accordingly, it is likely that the trends toward larger, more experienced fund managers will only continue as the ramifications of the pandemic continue to unfold.

Fund managers are trying to raise and close at a faster clip
Median and average time between global PE & VC funds



Source: PitchBook Geography: Global
*As of May 29, 2020

New highs for fund sizes across the board
Median and average global PE & VC fund size ($M)



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