Secondaries present unique attributes in the context of portfolio construction. (UBS)

Why are secondaries attractive in 2023?

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Three key reasons to invest in secondaries in 2023:

- Private equity valuations have yet to fully reflect current difficult market conditions. But secondaries are already showing meaningful discounts, allowing investors to invest in seasoned and quality assets at a bargain. As of December 2022, LP buyout secondaries deals were done at an average price of 87% of NAV (13% discount), compared to 97% one year ago. However, investors should note that further markdowns in the portfolio would erode the discounts attained.

- Secondary funds offer diversification benefits and defensive attributes that are valuable in the current macro environment, in our view. Managers typically acquire stakes in primary funds across geographies, strategies, and vintage years. Adding secondaries to a portfolio can also help reduce variability of outcomes. Historically, secondary fund return dispersion is narrower than that of buyout funds.

- Secondaries present unique attributes in the context of portfolio construction. Because they target more mature fund stakes and assets, secondary managers deploy capital quicker than a typical primary fund and thereby provide an accelerated exposure to private assets. Investors also receive a return in capital earlier than that of a typical primary fund investor. However, as the assets are more mature, there is also less growth potential in secondary funds. Secondary fund life is also typically longer than those of primary funds, meaning a longer lock-up of capital, which can also add a drag to the IRR performance.

Investment conclusion: Against a still-challenging macroeconomic backdrop in 2023, we recommend investors consider increasing exposure to secondaries to take advantage of price dislocations in the private market space. Doing so can increase portfolio diversification, reduce the variability of returns, and speed up distributions and capital deployment.

Content is a product of the Chief Investment Office (CIO).

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