Top 10 with...

Markus Benzler on Multi-Managers Private Equity | March 2023

Key facts:

1997

business established[1]

USD ~12.6bn

total commitments invested to date[1]

130+ GPs

with

450+ funds

invested to date[1,2]

[1] Source: UBS Asset Management, Real Estate & Private Markets (REPM); January 2023. Note: figures as of 31 December 2022 includes joint venture assets with UBS WM.
[2] Includes secondaries and co-investments

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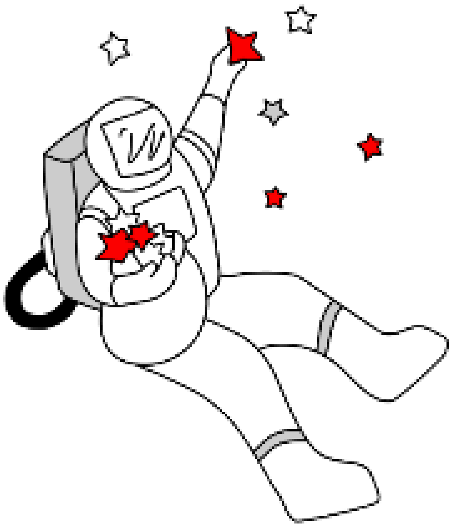
Markus Benzler, Head of Multi-Managers Private Equity

Exciting times ahead

Can investing into private equity be attractive in the current macro-economic environment? While caution, education and a solid strategy are imperative before venturing the market, the diversification and attractive features private equity can offer make it an appealing choice to investors. Markus Benzler, Head of Multi-Managers Private Equity (MMPE), shares his insights into unlocking possibilities in this asset class in the current environment.

1

What can MMPE offer to clients?

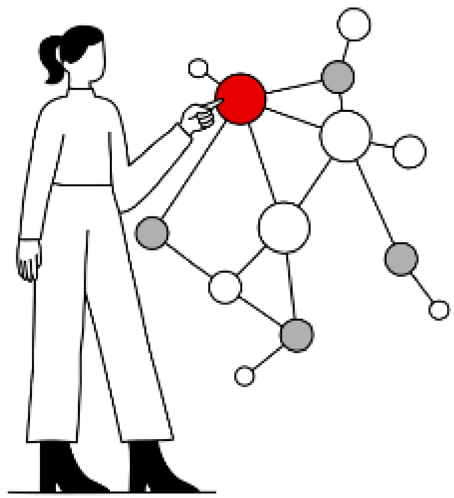


The MMPE business has developed into a core capability of the Real Estate & Private Markets (REPM) business.
It offers extensive private equity expertise to institutional investors such as pension funds, family offices, insurances and sovereigns. MMPE's offering comprises both individually tailored and managed accounts as well as illiquid and semi-liquid private equity investment strategies that typically invest globally into primaries, secondaries and co-investments.

Thereby, we closely support our clients during the build-up and maintenance of their private equity allocation, offering broad diversification benefits and the ability to generate growth while fine-tuning their total-expense ratio, portfolio build-up, risk/return and portfolio allocation targets through secondaries and co-investments.

2

Why access private equity through a multi-manager?

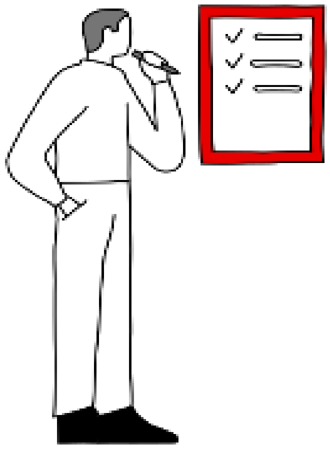


There are basically three ways to access private equity. One could think that the simplest approach is to invest directly into privately held companies. However, this requires a strong level of for example transactional, managerial and sectoral expertise, especially for non-institutionalized investors, as this increases the concentration and headline risk around single companies.

Therefore, a lot of investors try to invest via fund managers into this space. The fund managers bring along the expertise and a certain level of diversification. Historically, we have seen that the best fund managers (usually in the top quartile) are capable of consistently outperforming, when measured against typical (listed) equity benchmarks. The issue with these types of managers is that they are usually not in need of additional capital as their strategies are only scalable to a certain extent (in comparison to more liquid asset classes).

Multi-manager platforms can solve the riddles arising from the aforementioned dynamics: a good multi-manager set-up can provide access to some of the best fund managers either via primaries or secondaries and can participate into direct deals as a co-investor. This provides solid diversification but also ensures quality and execution capacities that only professional private equity investors can deliver.

3 Why choose private over public equity?

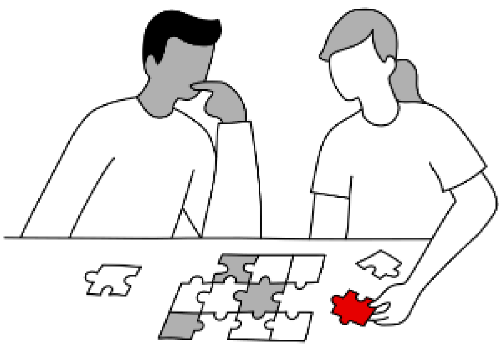


Firstly, it's worth mentioning that the drivers behind public equity are different from those behind private equity.
While the former is mainly driven by macroeconomic factors (such as interest rates, GDP, market sentiment, etc.), the latter is often underpinned by cutting-edge technology, innovative business models and favorable growth dynamics – in a good number of cases public market equivalents do not even yet exist. From our investors, we often hear that today they can achieve with private markets what they were able to achieve with small-cap public market investments some 10-20 years ago. In fact, a lot of the return potential from small-cap public markets has shifted to private markets.

These companies, usually unlisted, want to stay private to preserve their operability and incur less restrictions than public companies or are just simply too small to be listed yet. Typically, private equity investors are recognizing the strategic potential, and with active management, they can unlock their inherent value creation potential.

In addition, investors usually have plenty of choice in terms of strategies and investment styles to consider: small to medium-buyout, large buyout, mega buyout, seed stage, early stage and late-stage venture capital along with different growth strategies. Investors also can choose by region/country or how they want to enter depending on their portfolio targets and familiarity with the asset class: fund-of-funds, single funds, secondaries, co-investment or direct deals.

4 What makes private equity attractive when compared to other asset classes?



Private equity has been growing steadily for a number of years, providing on average higher returns than other asset classes (see Figure 1). According to McKinsey, private equity was the highest performing private markets asset class[3] in 2021, outperforming other asset classes.

Long term, returns have usually been higher than those generated by other asset classes, and investors are rewarded by this premium (illiquidity) for their sustained commitment. In addition, in times of market uncertainty, investors can benefit from market dislocation. The diversification potential I mentioned previously is also significant, which not only can improve overall portfolio returns, but also decrease volatility.

[3] McKinsey's Global Private Markets Review 2022, https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/mckinseys-private-markets-annual-review, March 2022.

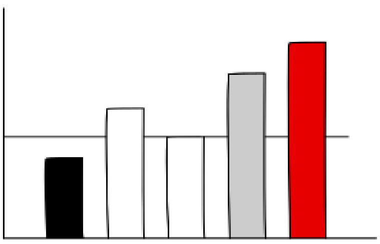
Figure 1: Average annual total return by asset class, 2001-2021 (USD)

Average risk p.a. (standard deviation of total return)

Private Equity Global	Direct Lending	Private Real Estate	Core Real Estate	Global Equities	Global Bonds
10.7%	3.6%	9.9%	4.7%	16%	5.7%

Source: UBS Asset Management, Real Estate & Private Markets (REPM); January 2023; Note: CAPE Global Private Equity Index, Cliffwater Direct Lending Index, Cambridge Real Estate Index, Global Real Estate Fund Index, MSCI AC World, Barclays Global Aggregate. Data covers period between 1 January 2001 and 31 December 2021. Past performance is not an indicator for future results.

5 You mentioned volatility. How is the current macro-economic environment impacting private equity?



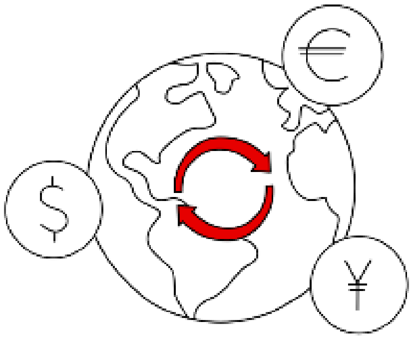
In general, the global economy is facing a time of major distress, geopolitical unrest, record-high inflation and volatility. Although the 2008 GFC was different from the current scenario, at the time, the majority of strategies with 2008-09 vintages delivered strong returns in spite of market volatility and outperformed the public market. This was due to lower valuations and depressed operating performance of the companies back then, of which after a few years, have recovered leading to strong return levels. We believe the current market environment will ultimately result in a very similar outcome.

Investors' interest towards private equity continues to be strong, although at lower levels than in 2021 for example. There are three main reason for this: with higher interest rates there is additional competition for investors' money from the fixed income sector.

Secondly, investors continue to be cautious given the overall market environment and the uncertainty regarding the direction the global economy.

Thirdly, a number of larger investors do face the denominator effect, i.e. they are overallocated to private equity as returns have fallen slower than on the public market side, and therefore there is less or no money to be deployed. We believe now is a good time to invest, due to the relative undersupply of capital compared to previous years. Still, the current economic scenario requires caution and prudence.

6 How is private equity settling with inflation?



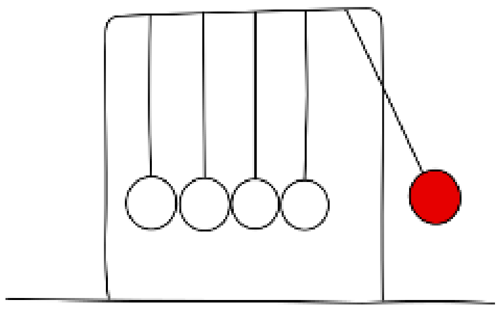
The good thing about private equity at the moment is that the key drivers of inflation, e.g. energy or food, are typically not sectors where a lot of private equity capital flows in to. However, for many private companies especially in the industrial sector, inflation brought along higher labor and goods costs.

Sponsors can mitigate the effects of inflation in their portfolios by closely following the input prices and reacting or even proactively managing anticipated price increases for their products. Short to mid-term on the new investment side, supporting companies with strategies that are essential to customers' lives and businesses is very important. This will employ increased pricing power with the ability to pass higher costs onto their customers.

Also, companies with contractual or recurring-revenue models have more predictable cash flows, less customer churn, and can help to create a portfolio with more predictable operating performance for sponsors pursuing these strategies.

Finally, a portfolio diversified by geography and industry remains a key mitigant to inflationary pressure and a core component of private equity portfolio management.

7 What differentiates UBS from competitors in this space?



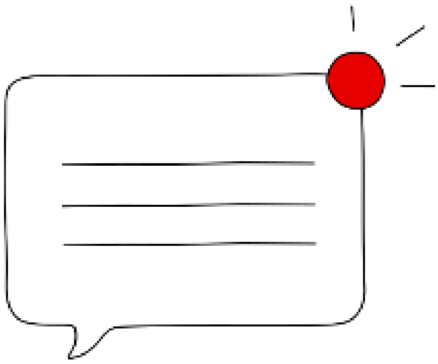
Firstly, experience: by European standards, MMPE is highly experienced and tested through many cycles having been active in the industry for over 20 years. Only a few of our European peers have been active longer than us and we have a long track-record of delivering private equity returns in the upper quartiles. We have always invested in technology, especially, IT and life sciences venture and growth capital across North America, Europe and APAC and believe we are one of the most experienced teams in the broad technology sector globally.

Secondly, our broad skill set. Today we have an equally strong skill set investing into primaries, secondaries and co-investments which allows us to tailor our approach to customer needs, particularly for mandates. Our strategies typically have high transactional content (secondaries and co-investments) minimizing the j-curve and the total expense ratio for the benefit of our investors.

Thirdly, our focus: we are a mid-sized player in our industry focusing on smaller and mid-sized funds and transactions which allows us to be highly selective and generally participate in less competitive transactions and we rarely face cut-backs in our allocation requests.

Lastly, MMPE is able to leverage the larger UBS franchise. This has benefitted us in accessing investment opportunities, but also how we select and deploy capital.

8 What advice would you give to investors approaching this asset class?

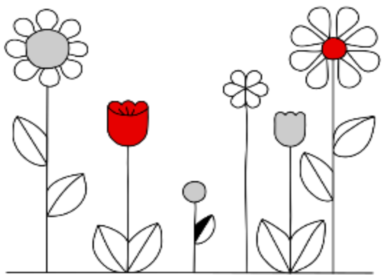


For new investors into this asset class: now can be a good time to enter. Valuations have dropped, many investment markets have changed from a sellers' to a buyers' market. We believe that technology and secondaries in particular are attractive on a global basis.

Illiquidity has been a key deterrent to those yet to invest into private equity, particularly the cost or risk in doing so. For those being hesitant, semi-liquid strategies can be an ideal starting point. MMPE, for example, launched a semi-liquid strategy last year that is exclusively focused on secondaries.

We believe offering quarterly liquidity to investors marries perfectly with investing in the most liquid sub-asset class of private equity, which is secondaries. Typically, secondaries are less risky, have a lower total expense ratio and provide much higher liquidity than other private equity offerings.

9 What's your view on integrating ESG factors into private equity solutions?



ESG and the recent SFDR regulations are certainly topics that are on everyone's mind. We have been integrating ESG aspects in our investment process since 2012. Together with our colleagues from Global Wealth Management, we launched a dedicated Impact Fund (UBS Oncology Impact Fund) in 2015. Since then, we have strengthened our commitment to acting as sustainable investors across other strategies and mandates.

Most recently, we launched the fifth generation of our private equity growth strategy which has a European sub-strategy which is SFDR Article 8 compliant. This sub-strategy will be one of the few Article 8 private equity offerings on the market (combining primaries, secondaries and co-investments) with a clear ESG angle. In fact, our latest private equity growth strategy has a strong focus on investing in companies that reduce their CO_2 footprint, increasing female participation and promoting ESG reporting.

10 What future developments impacting private equity could we expect over the next five years?

Capital supply: at the moment allocations to private equity are reducing on a global scale, especially as larger allocators are struggling with the denominator effect. This should lead to more attractive investments in the next couple of years with stronger returns a few years later, just as we have seen after the GFC.

Democratization of private markets and private equity: we expect there to be an ongoing secular trend which enables more investors to participate in private markets. We expect that trend to continue as more suitable offerings are hitting the market. This starts with dedicated suppliers (often labelled as FinTech), innovative offerings such as semi-liquid strategies, and regulatory development (e.g. the European ELTIF is currently being reformed leading to a much wider application range).

ESG: while Europe is leading with the recent SFDR regulation, North America and parts of APAC are following from a regulatory standpoint. This is supported by investors also demanding more innovation and progress in this area, beyond financial return measures. However, what is needed by regulators globally, is a consistent framework across countries and regions that allows global investors to integrate their efforts.

Technology: the more obvious developments are in blockchain and artificial intelligence (AI). More GPs are looking at the tokenization of fund shares. This means issuing the fund shares on a blockchain to make them more easily tradeable. A reason to do this is to bring down the minimum investment of funds. For example, a USD 5m fund commitment could be divided into 100 tokens worth USD 50k each. Another benefit of making private equity fund shares available on the blockchain is the ability to easily sell shares on the secondary market, further increasing the liquidity of private equity investments.

AI will continue to play a key role in how we approach and solve problems. I expect that in the coming years, our investment analysts will have new tools at their fingertips that will allow them to make faster and more holistic investment analyses. However, I believe that investment decisions will continue to be the domain of humans. No doubt that more developments will emerge, and as a technology investor, we have seen many surprises over the last 20 plus years.

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