Private assets' role in a diversified portfolio

Private assets are an increasingly important source of returns and diversification. Shaniel Ramjee, senior investment manager, Multi Asset, takes us through the opportunities private markets offer, as well as the risks they pose.

Shaniel Ramjee
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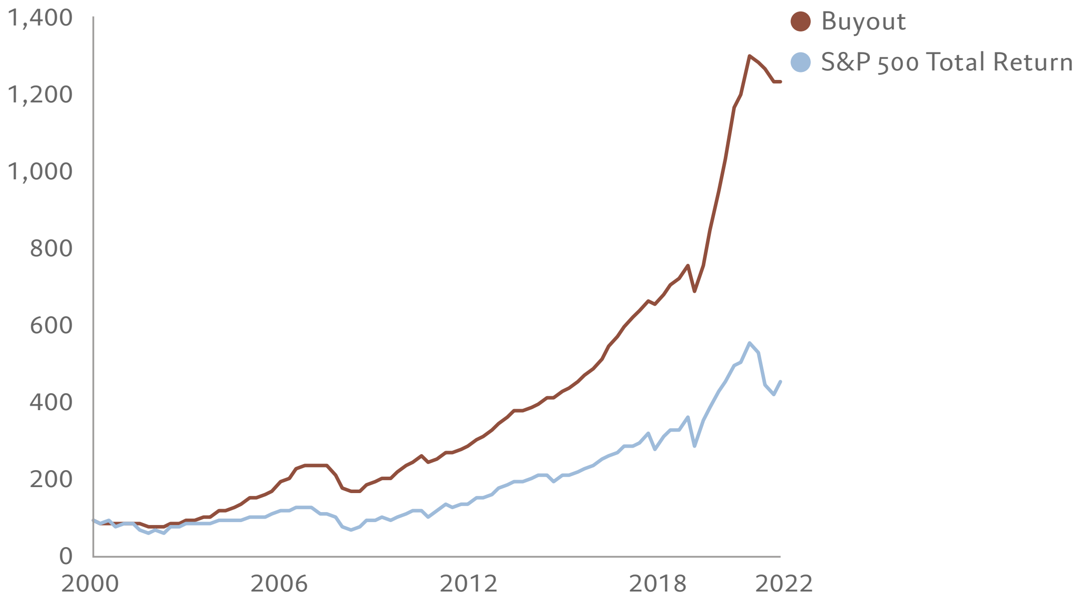
Fig. 1 - Private trumps public
Performance of Private Equity Buyouts vs S&P 500, rebased Dec 2000 = 100



Source: Prequin Pro, Pictet Asset Management. Data covering period 01.12.2000-31.12 2022

Q: Why private equity?

A: There are many reasons why companies might choose to remain private. They might be family owned, or not want to be subject to the administrative burden of public listing, or to the short-termism imposed by quarterly reporting. Typically they are in a different part of their lifecycle – usually at an earlier stage – from publicly-traded firms. They might have just found their niche in the world of business and are starting to grow. It's at a stage where a lot of exciting things happen to some of these companies. And where a bulk of their returns is often generated. So for investors to be able to access investments at this stage is particularly interesting.

Q: Does it make any difference being a Europe-based private equity investor?

A: Europe has a long history of private companies, many of which have been in existence for decades and controlled by a founding family. But we see with increasing frequency in these companies that younger generations are less involved in the business, or indeed, a first round of professional managers have stepped into the business hoping to expand or grow it.

Private equity can be one of the ways in which they do that without relinquishing family control. Private debt becomes important here too – historically, these companies were much more dependent on bank loans, but these can be relatively inflexible compared to contracts that can be struck with private lenders.

Q: Have rising interest rates altered the landscape for private equity?

A: I think it's an important question because the frothiness of markets that we saw at the end of the last cycle, especially in growth markets, meant that price-to-earnings multiples in private equity also expanded quite substantially. Now it's important to understand how best to finance companies in a world where interest rates are higher as we have now.

As for private debt, the risks of volatility means it makes sense to focus on defensive sectors – healthcare, education, business services and software. These are naturally cash generative and have low correlations to the wider market. This makes it easier for them to generate profits even in uncertain times. It also becomes even more important to structure contracts with suitable covenants, particularly on interest cover and maximum leverage – and then assessing these metrics frequently.

Q: Rising interest rates have clearly been a wider risk for the markets, but are there any risks that are specific to private assets?

A: Due diligence is crucial. We know that, on the face of it, these companies are slightly less transparent than those in the public markets. Vintage diversification – holding a spread of investments in private equity companies, coming due in different years – is extremely important because we know once we're invested, we are invested for quite a long time. Exits are also important. When conditions for initial public offerings (IPOs) are robust, taking private companies public becomes more likely. But in some market environments this is more difficult. In those circumstances, expertise in trade sales becomes necessary.

Q: As an asset manager, does it make a difference to you that the firm you work for is also privately held?

A: Absolutely. I think at Pictet we understand uniquely what strength private structure gives us: the ability to think long term; to invest long term; to be able to be contrarian at times; and to think about what truly matters in terms of growth. It is always about the quality of that growth, not just the quantity or the speed. And we appreciate that.

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