Private Equity Institutional Investor Trends for 2015 Survey

Probitas Partners

probity (prō′bĭ·tē)
n. [from Latin probitas: good, proper, honest.] adherence to the highest principles, ideals and character.

On an ongoing basis, Probitas Partners offers research and investment tools for the alternative investment market to aid its institutional investor and general partner clients. Probitas Partners compiles data from various trade and other sources and then vets and enhances that data via its team's broad knowledge of the market.

Contents

The Private Equity Fundraising Environment

- Fundraising in 2014 slowed significantly in the third quarter, though a boom in fourth quarter fundraising, as happened last year, could bring the full-year total up to 2013's level.

- The trends that underlie the top line numbers in Chart I:

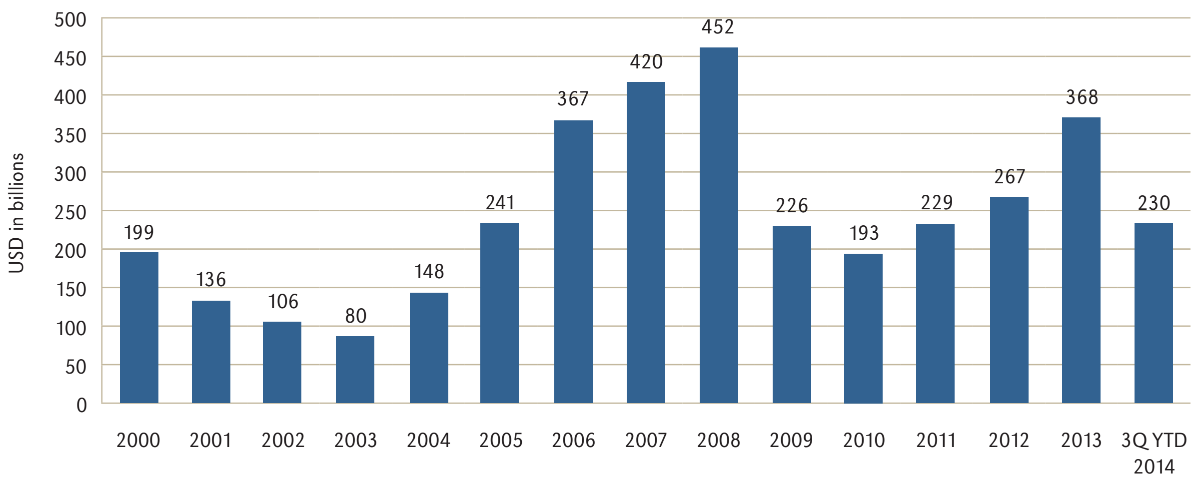
    - Funds targeting North America make up roughly 50% of all fundraising.

    - Mega buyout funds in the United States and Europe are raising large funds that are boosting overall commitments — but most of these funds are targeting smaller funds than they raised at the market peak.

    - In Asia, fundraising is rebounding from last year's lows, with interest in both China-focused and Pan-Asian funds increasing significantly.

    - The overhang of undrawn commitments has also increased over the last fifteen months as fundraising has swelled.

Chart I Global Commitments Private Equity Partnerships



Source: PREQIN, does not include funds-of-funds

Private Equity Institutional Investor Survey

Probitas Partners conducted its online survey in late September 2014, to gauge investor interest, opinions, and perspectives on investing in private equity. This survey is administered annually to identify emerging trends and to compare investors' changing views over a longer period of time. Ninety responses were received from senior investment executives globally, representing such institutions as public and corporate pension plans, funds-of-funds, family offices, endowments and foundations, and consultants and advisors.

Overview of Survey Findings

The following summarizes the top-line findings from the survey:

- **Steady interest in private equity.** Investors are focused on redeploying the large amounts of capital that have been returned to them over the last couple of years, freeing up their private equity allocations, though many of them are more focused on re-ups rather than increasing new fund manager relationships.

- **Continued focus on smaller buyout and growth capital funds.** Investors remain focused on smaller and middle-market buyout and growth capital funds in the United States and Europe to diversify portfolios and commit capital to strategies where managers can prove recurring added value.

- **. . . But many investors fear that purchase price multiples in these sectors are too high.** Even as investors express interest in the sector, they are concerned that the high prices now being paid will drive down future returns.

- **Interest in emerging markets rebounded slightly as China came back into favor.** The return of the IPO market in China has increased investor interest in China — though not to its previous highs of three or four years ago; political unrest or uncertainty in markets like Russia and Turkey muted interest in those geographies.

- **U.S. venture capital interest increased from last year's low point.** Increasing IPO activity caught investor attention, although the interest is mainly coming from North American investors; European and especially Asian investors remain unimpressed.

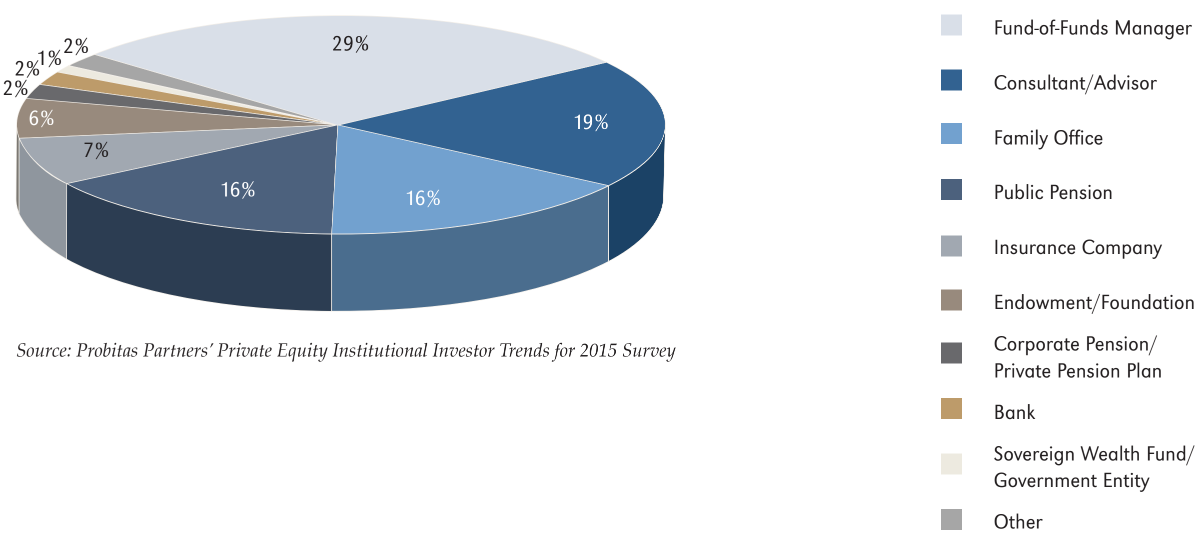
- **Investors are increasingly creating co-investment programs.** Investors are increasingly targeting co-investments in an effort to enhance overall and net returns, and say that they are devoting the resources to create internal co-investment programs; this is especially true of the largest investors.

Profile of Respondents

- There were 90 respondents to the survey; most respondents were from pension plans, funds-of-funds, insurance companies, and family offices (Chart II).
- Respondents were geographically diverse, with strong participation from the United States and Europe (Chart III).
- As Chart IV details, the large returns of capital that investors have been receiving have significantly increased room in their allocations — though many remain heavily focused on re-ups.
- Funds-of-funds are different — allocations are not really relevant as their ability to invest is driven by their ability to raise fund vehicles or separate accounts.

Chart II Respondents by Institution Type

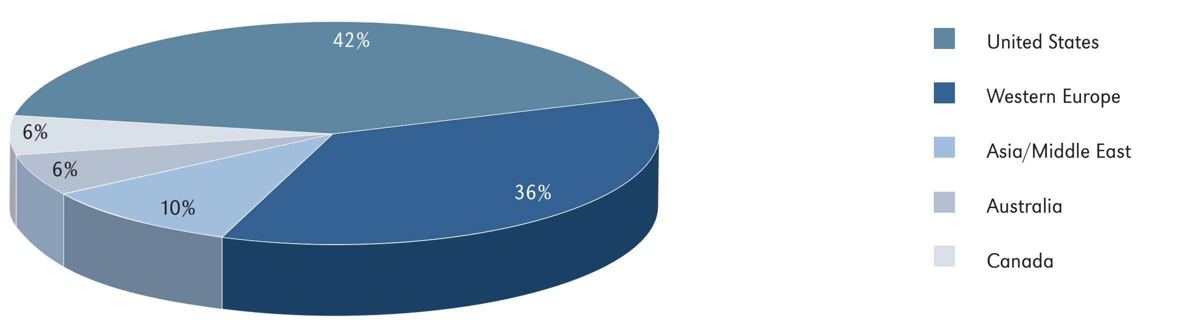
I represent a:



Source: Probitas Partners' Private Equity Institutional Investor Trends for 2015 Survey

Chart III Respondents by Firm Headquarters

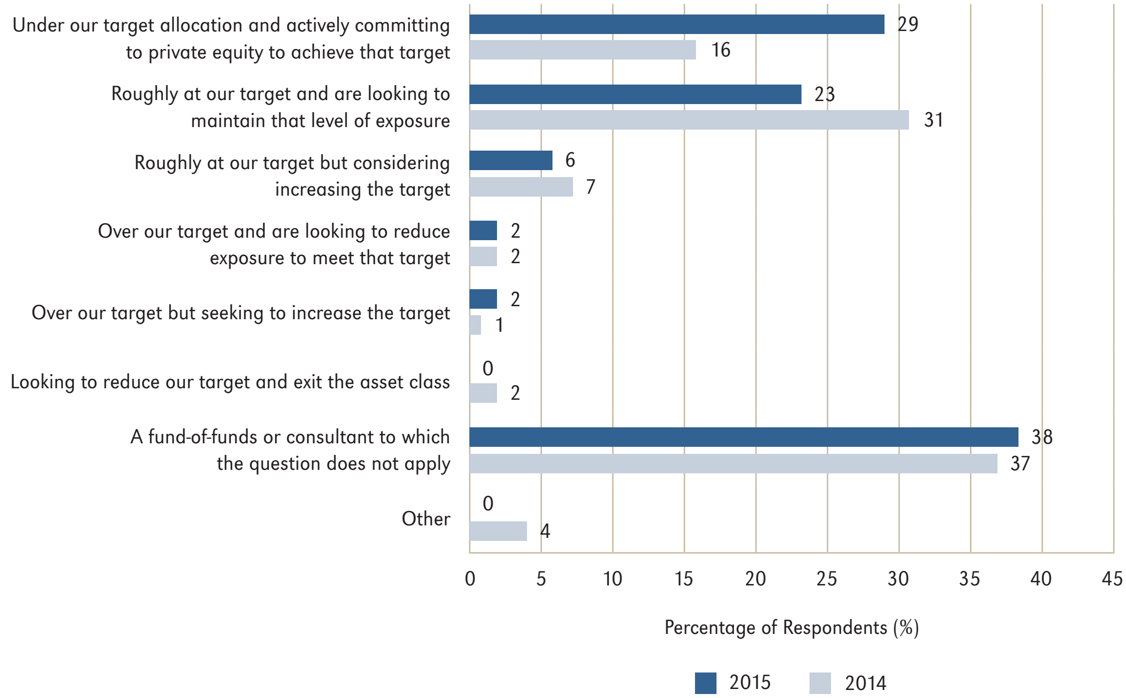
My firm is headquartered in:



Source: Probitas Partners' Private Equity Institutional Investor Trends for 2015 Survey

Chart IV Current and Target Private Equity Allocations

As far as our current private equity allocation, we are:



Source: Probitas Partners' Private Equity Institutional Investor Trends for 2015 Survey

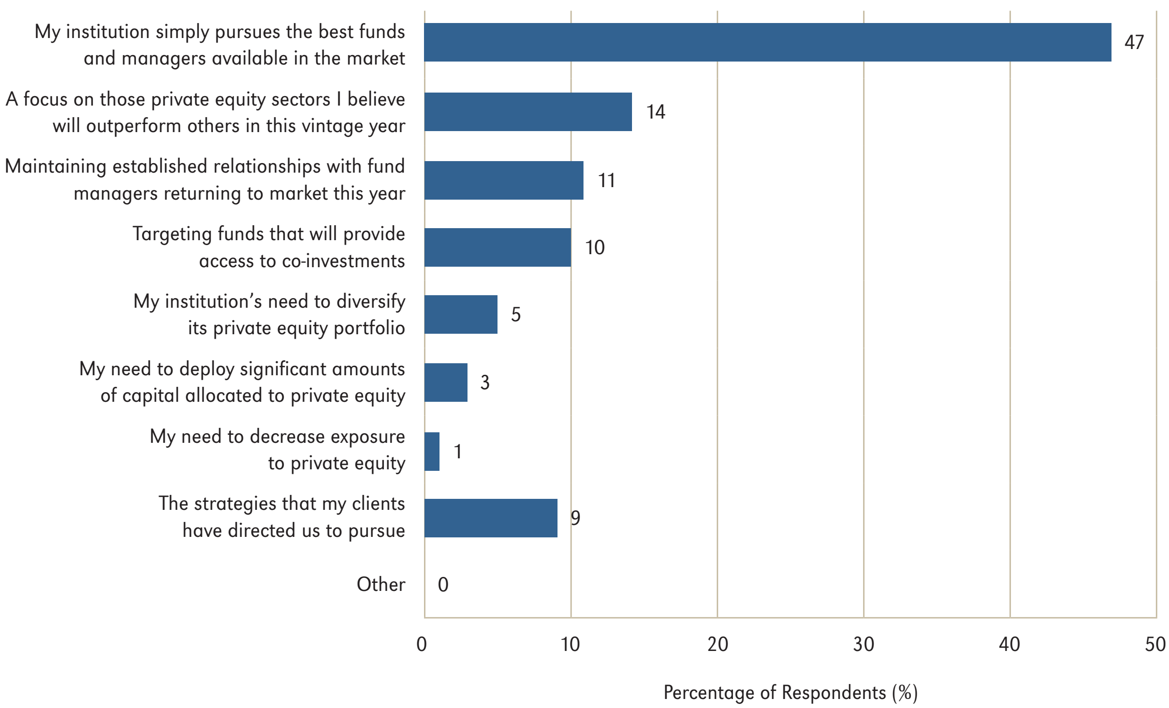
- What drives investors to invest? Consistent with Probitas Partners' past surveys, all other reasons are secondary to "pursuing the best available managers and funds," though the focus on best managers has become increasingly important to investors since the Financial Crisis (Chart V).

- Proven, top quartile managers can be difficult to access, and since funds typically only come to market every three to five years, many investors feel compelled to commit to these managers when they are available and open.

- Pension plans are more likely to target funds that will provide them access to co-investments, with 25% of them focused on this strategy.

Chart V Drivers of Sector Investment

Our sector investment focus in 2015 will be driven by:

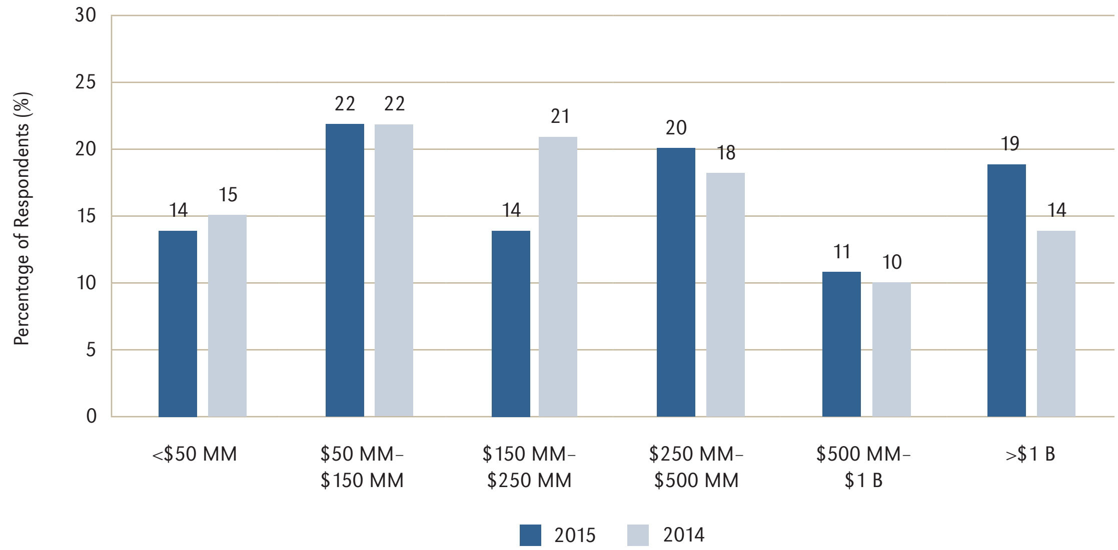


Source: Probitas Partners' Private Equity Institutional Investor Trends for 2015 Survey

- More respondents are looking to increase commitments as 2015 approaches, continuing the allocation rebound after the bottom of the fundraising market in 2009 (Chart VI).

Chart VI Private Equity Allocations

For 2015, we or the clients we advise are looking to commit across all areas of private equity (in USD):



Source: Probitas Partners' Private Equity Institutional Investor Trends for 2015 Survey

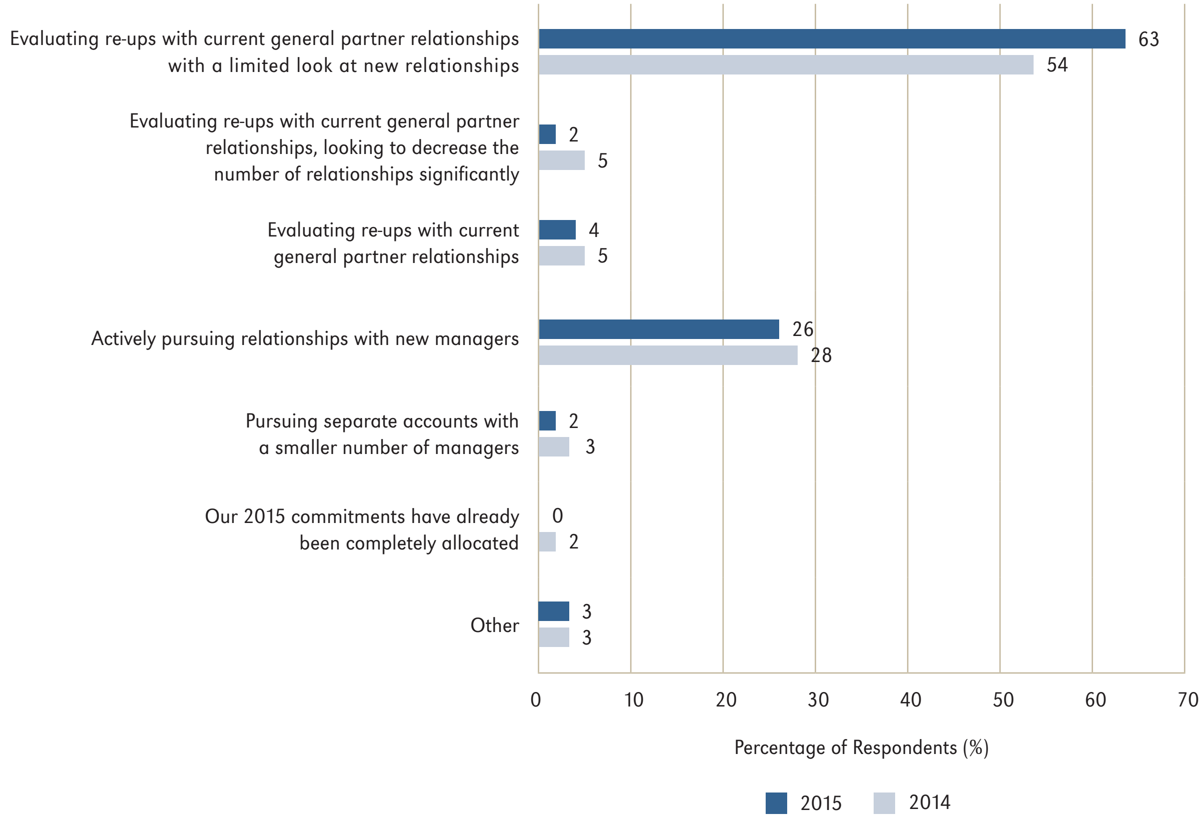
- There is even stronger focus this year on re-ups with a limited focus on developing new general partner relationships (Chart VII).

- Based on our discussions with investors, many are continuing to track sponsors that they began following post the Financial Crisis, looking to upgrade their portfolio quality by not re-upping with fund managers that had weak returns.

- Only 2% of respondents targeted separate accounts as their primary means of investing in private equity.

Chart VII Manager Relationships

During 2015, we would expect our primary focus to be:



Source: Probitas Partners' Private Equity Institutional Investor Trends for 2015 Survey

Sectors and Geographies of Interest

Chart VIII details the sectors of interest to investors for 2015:

- Middle-market buyouts and growth capital in the United States and Europe dominate interest, as has been the case in most of our previous surveys.

- Interest in Asian country-focused funds rebounded significantly from 19% last year to 33% this year with increased focus on China as their IPO markets re-opened.

- Interest in distressed debt surged from 20% last year to 35% this year, reflecting investors' fears of where we stand in the market cycle.

- Mega buyout funds continued to rank very low in expressed interest by investors though they continue to attract substantial capital in the market.

Table I compares the top-ranked areas of interest from our 2007 survey (the one immediately before the Financial Crisis) and the current survey.

- The latest survey contained more options than the 2007 survey, but it is still dominated by middle- and small-market buyout funds.

- U.S. venture capital ranked third in 2007 and only tenth in 2015, though that ranking is actually a significant rebound from fifteenth place in 2014. Among North American investors, venture capital in 2015 ranked third, with 46% targeting it.

- Distressed debt was just off the 2015 chart in the sixth position — but as a percentage, more investors were interested in the sector than were interested in 2007.

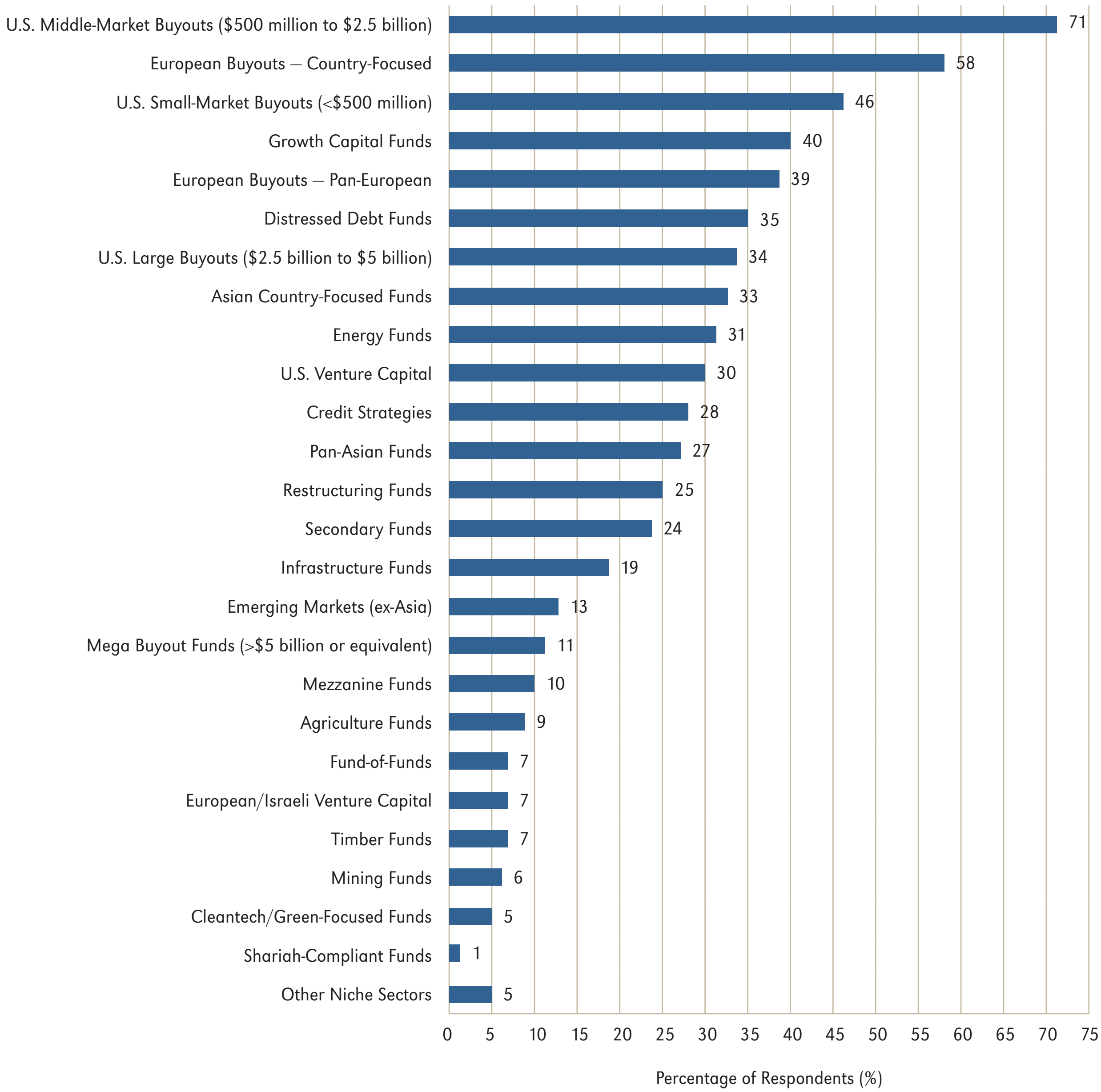
Table I Institutional Investors Focus of Attention Among Private Equity Sectors
Top Five Responses:

2007		2015	
Sector	**% Targeting**	**Sector**	**% Targeting**
U.S. Middle-Market Buyouts	49%	U.S. Middle-Market Buyouts	71%
European Middle-Market Buyouts	42%	European Middle-Market Buyouts — Country-Focused	58%
U.S. Venture Capital	34%	U.S. Small-Market Buyouts	46%
Distressed Debt	30%	Growth Capital Funds	40%
Asian Funds	25%	European Buyouts — Pan-European	39%

Source: Probitas Partners' Private Equity Institutional Investor Trends for 2007 Survey and 2015 Survey

Chart VIII Private Equity Sectors of Interest

During 2015, my firm or my clients plan to focus most of our attention on investing in the following sectors (choose no more than five):



Source: Probitas Partners' Private Equity Institutional Investor Trends for 2015 Survey

U.S. middle-market buyouts' top ranking in the survey reflects, in part, the fact that 48% of the respondents were from North America. This trend is driven by the fact that most investors prefer local funds and strategies when building core portfolios, and then extend their portfolios geographically as they gain knowledge and experience, and seek greater diversification. Charts IX and X, respectively, provide a look at the private equity world through the eyes of European and Asian/Australian/Middle Eastern respondents.

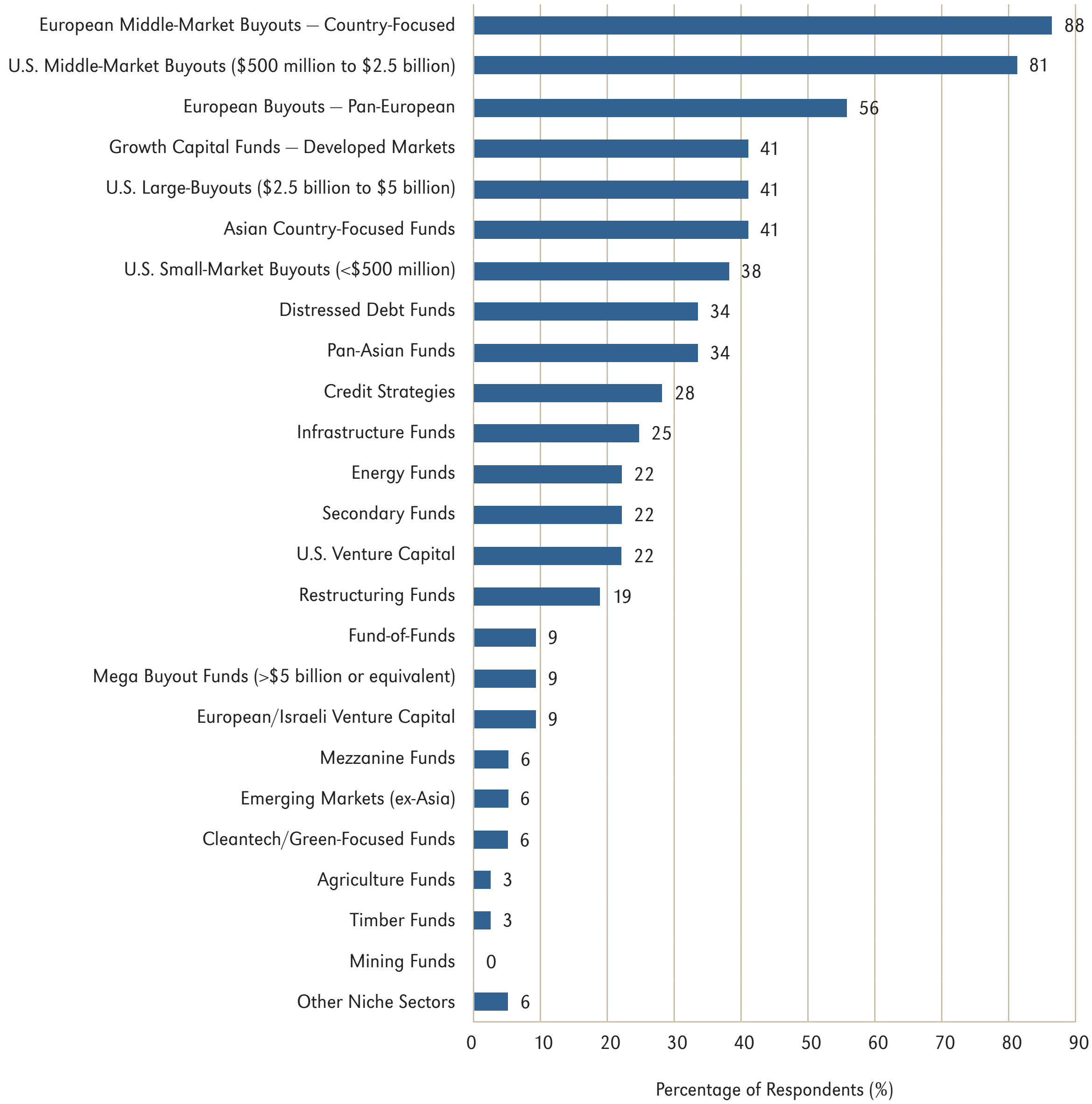
- Not surprisingly, Chart IX shows European country-focused middle-market buyouts as the top ranked interest for European investors while Pan-European funds were also a major focus.

- U.S. middle-market buyouts were also of interest to Europeans; distressed debt and credit strategies also scored well.

- U.S. venture capital was of much less interest than it was to North Americans — though it did outscore European venture capital.

Chart IX Private Equity Sectors of Interest; European Respondents

During 2015, I plan to focus most of my attention on investing in the following sectors (choose no more than five):



Source: Probitas Partners' Private Equity Institutional Investor Trends for 2015 Survey

- As shown in Chart X, Asian/Australian/Middle Eastern investors look on their home markets more favorably, though European country-focused funds and U.S. middle-market buyouts are also major sectors of choice.

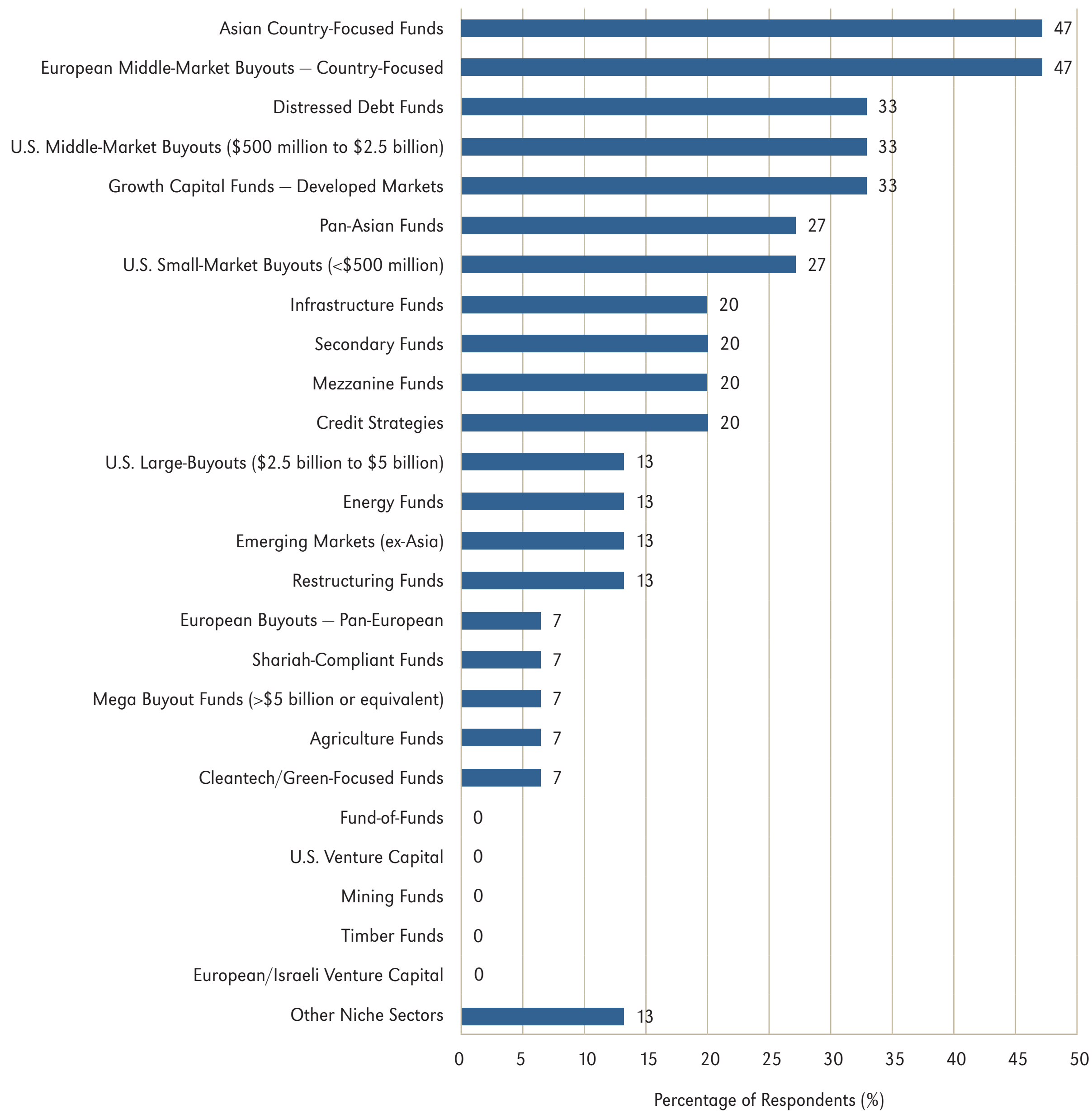
- As with other investors, focus on distressed debt funds increased this year driven by worries regarding the market cycle.

- Even as interest in U.S. venture capital surged in North America, it fell from low levels in 2014 to no interest looking towards 2015.

- The interest in Shariah-compliant funds came from Middle Eastern respondents.

Chart X Private Equity Sectors of Interest; Asian/Australian/Middle Eastern Respondents

During 2015, I plan to focus most of my attention on investing in the following sectors (choose no more than five):



Source: Probitas Partners' Private Equity Institutional Investor Trends for 2015 Survey

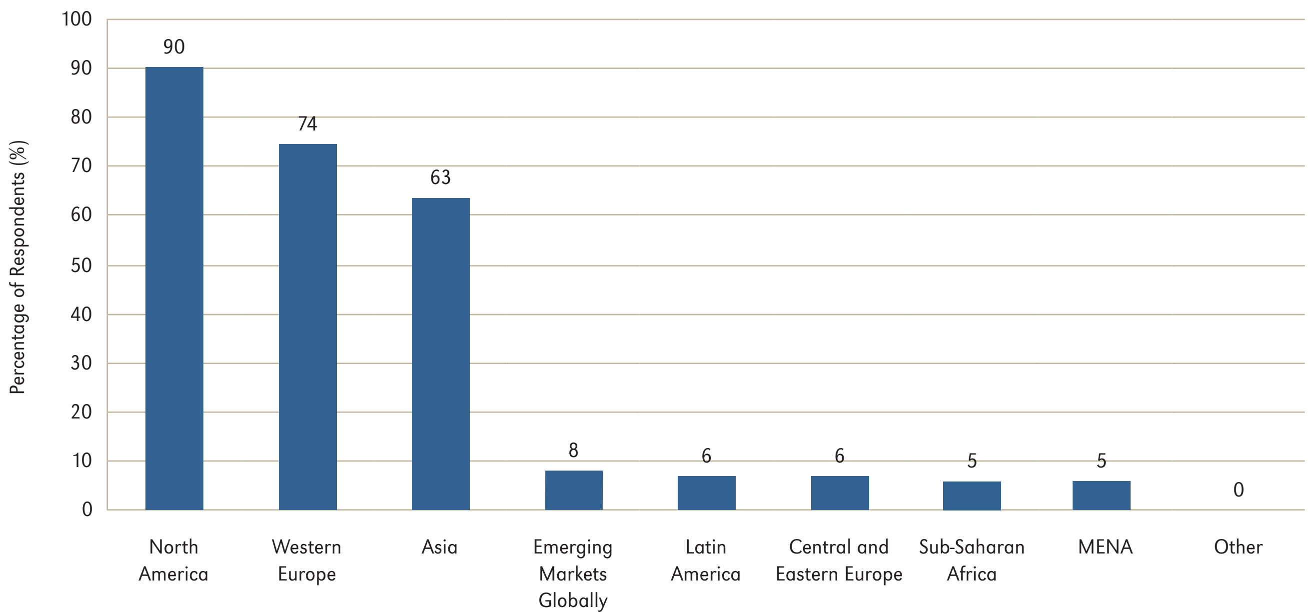
- As far as general geographic interest, the three major geographies of North America, Western Europe, and Asia continue to dominate investor interest (Chart XI).

- Notably, interest in Asia rebounded significantly from 49% last year to 63% this year, approximately the level it reached three years ago.

- Interest in emerging markets outside of Asia remained scattered with no geography dominant.

Chart XI Private Equity Geographical Focus

During 2015, I anticipate that the three primary areas of geographical focus for our programs will be:



Source: Probitas Partners' Private Equity Institutional Investor Trends for 2015 Survey

- As far as European markets, interest in the United Kingdom surged this year, overtaking the Nordic Region which had led investor interest over the last eight years (Chart XII).

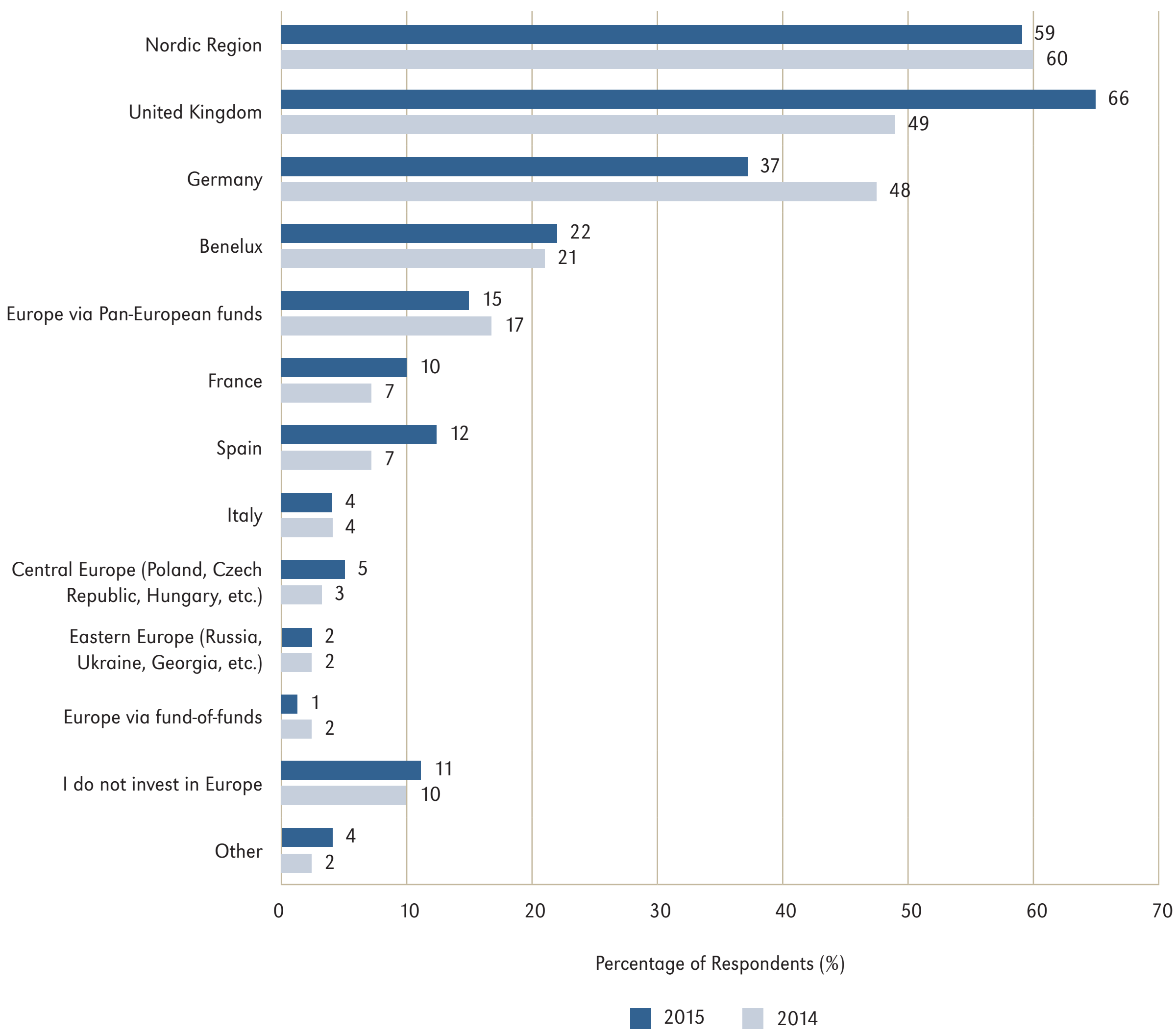
- Germany and the Nordic Region rounded out the top three geographies of interest, strongly leading the rest of Europe.

- France and Spain have rebounded slightly from last year, as both countries continued to deal with their macroeconomic issues.

- Interest in Eastern Europe remained at already low levels as the Ukrainian crisis roiled the markets, and continued to trail all other European geographies.

Chart XII Most Attractive European Markets

For European country/regionally-focused funds, I find the most attractive markets to be (choose no more than three):



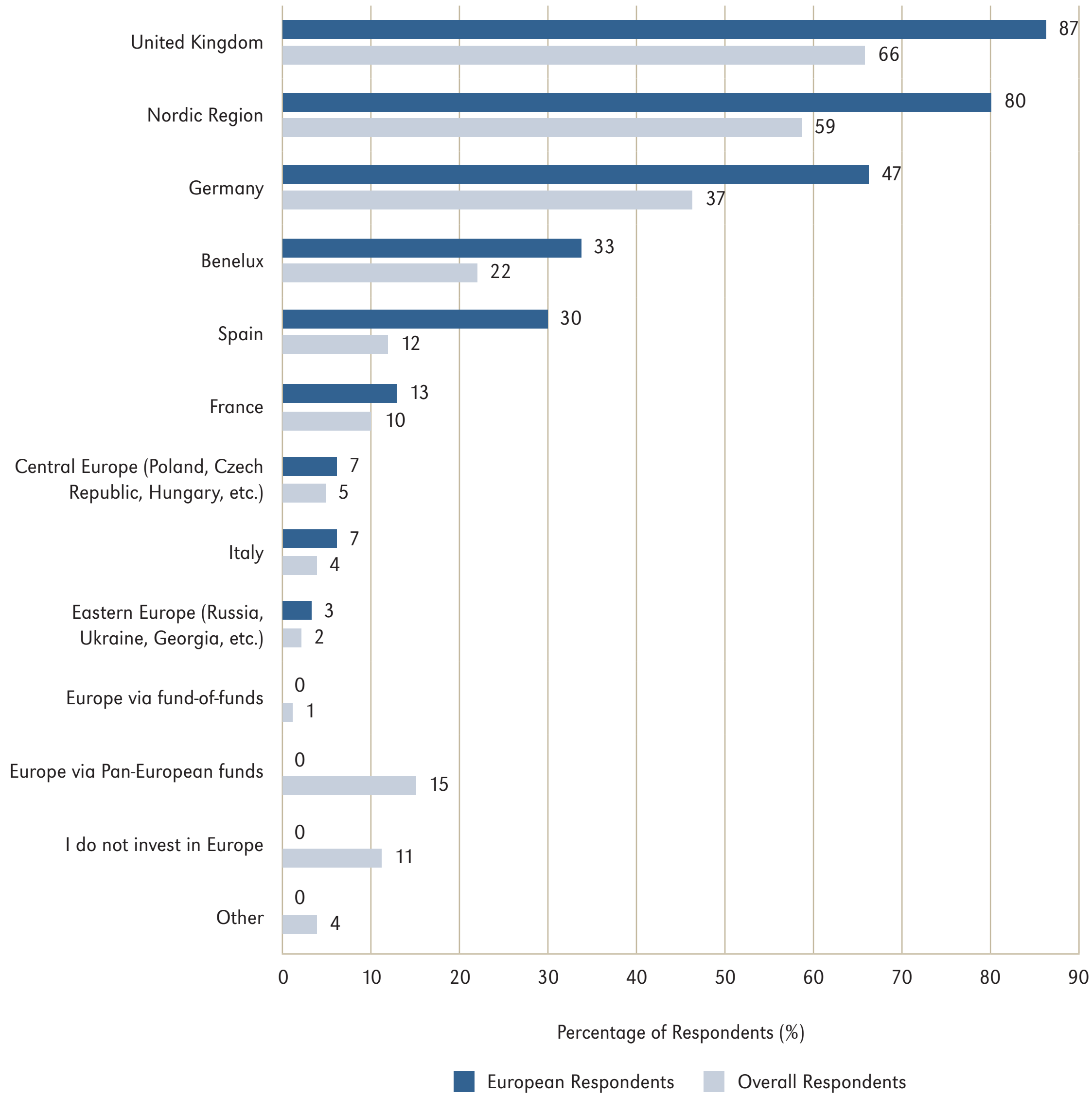
Source: Probitas Partners' Private Equity Institutional Investor Trends for 2015 Survey

- As Chart XIII highlights, European investors view their home market similarly to global investors in terms of greatest areas of interest, but with even more focus on the United Kingdom and the Nordic Region.

- The biggest difference between European and other investors is a much stronger interest in Spain and the Benelux, while interest in Eastern Europe remains very weak.

Chart XIII Most Attractive European Markets; European Respondents

For European country/regionally-focused funds, I find the most attractive markets to be (choose no more than three):



Source: Probitas Partners' Private Equity Institutional Investor Trends for 2015 Survey

Chart XIV highlights global respondents' interest in Asian geographies going into 2015.

- China remains the top Asian geography of interest among all parties. Interest rebounded from only 38% last year to 47% this year as China turned its IPO market back on.

- Interest in Japan surged from 9% two years ago to 22% last year on the back of the introduction of Abenomics — but renewed concerns dropped overall interest back to the 11% level this year.

- Among the biggest differences between Asian respondents and overall respondents is a much greater interest in Japan and Australia; however, there was a disproportionate number of Japanese and Australian respondents, skewing those results.

- The most notable difference between overall respondents and Asian respondents was that no Asian investor said it was targeting Southeast Asia while 25% of overall respondents did.

Table II highlights how investor interest within the Asian market changed over the last nine years.

- In 2007, China, India, and Japan enjoyed nearly equal investor interest. Since then, interest in both India and Japan has fallen significantly as investors grew increasingly concerned over a lack of exits and other macroeconomic issues.

- Interest in Southeast Asian funds has increased only over the last four years, driven in part by investors' desire to diversify away from China exposure. Australia benefits in this year's survey from a large number of Australian respondents targeting their home market.

- There are still a number of investors who do not invest in Asia — "I do not invest in Asia" would have been the fifth ranked answer in 2015 with 18% of responses.

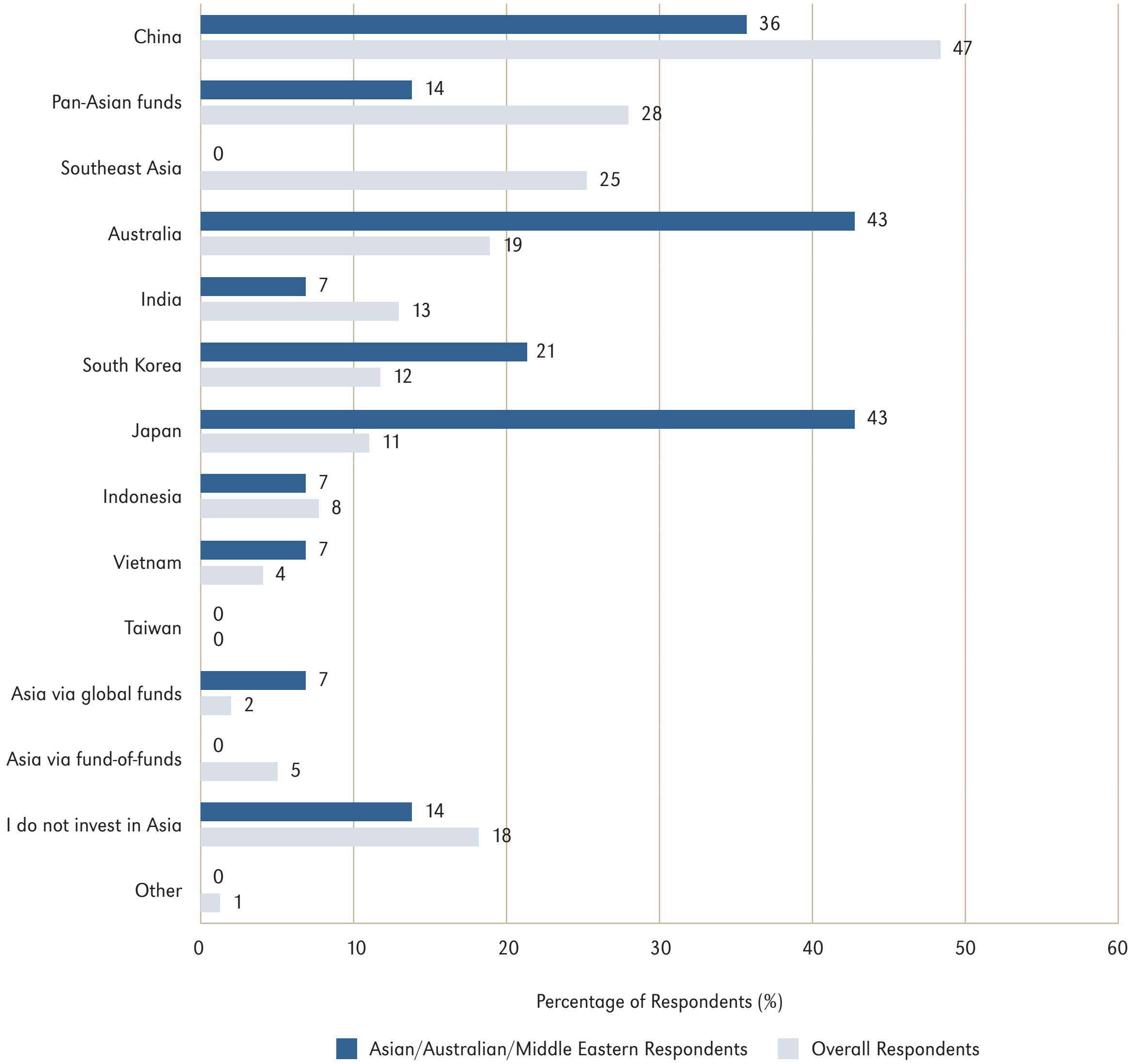
Table II Which Geographies in Asia Are of the Most Interest in Private Equity?
Top four responses:

2007		2015	
Country/Region	**% Targeting**	**Country/Region**	**% Targeting**
China	28%	China	47%
India	28%	Pan-Asian Funds	28%
Japan	25%	Southeast Asia	25%
I do not invest in Asia	25%	Australia	19%

Source: Probitas Partners' Private Equity Institutional Investor Trends for 2007 Survey and 2015 Survey

Chart XIV Most Attractive Asian Markets

Which Asian markets do you find most attractive at the moment (choose no more than three):



Source: Probitas Partners' Private Equity Institutional Investor Trends for 2015 Survey

- The percentage of investors not investing in emerging markets has been volatile over the last three years moving from a low of 18% two years ago, nearly doubling to 32% last year, then falling back to 25% this year (Chart XV).

- China and Brazil continue to lead investor interest in emerging markets, though interest in China increased significantly while Brazil stagnated amid economic difficulties and an uncertain Presidential election.

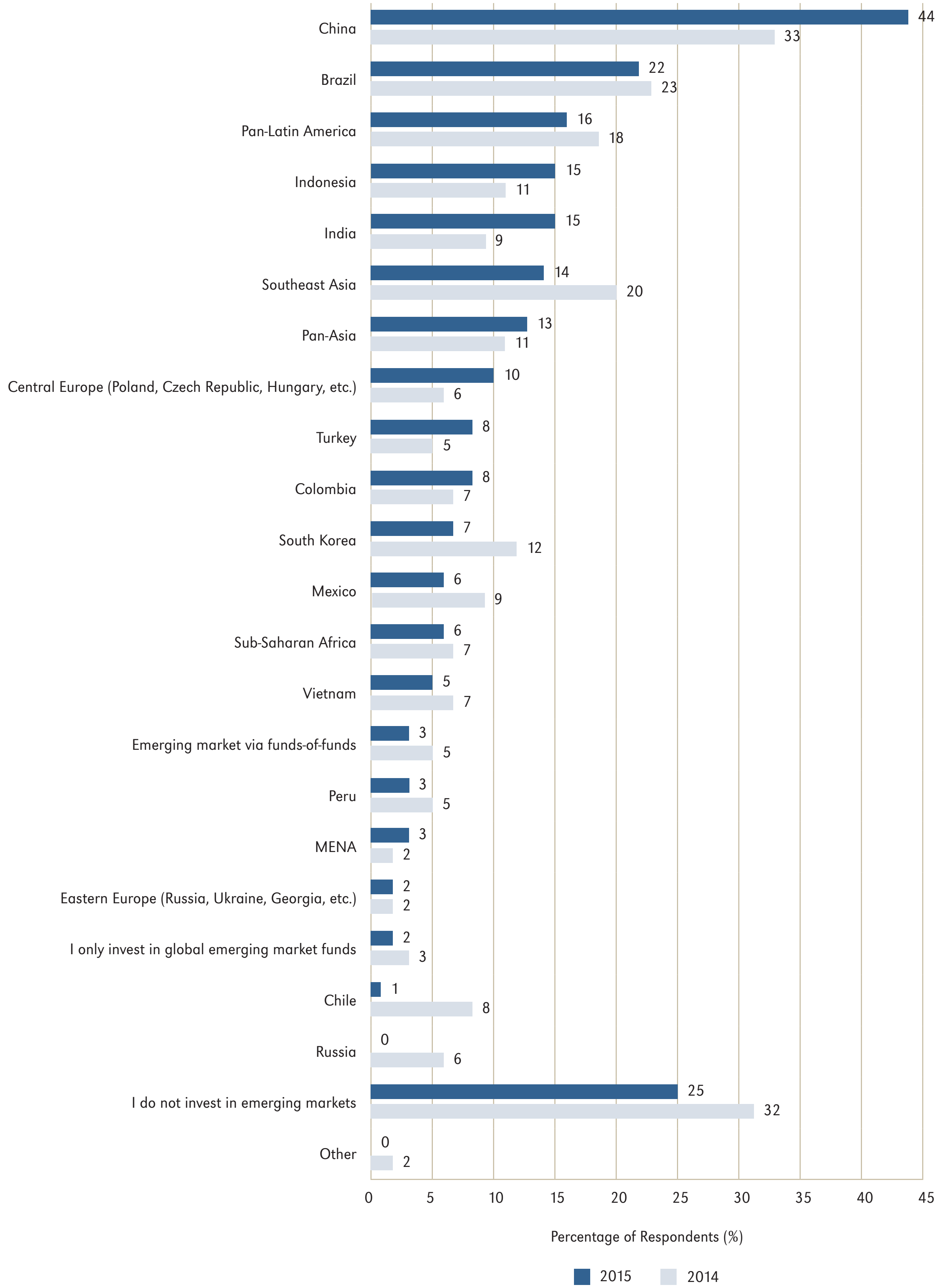
- With difficulties in Brazil, a number of investors have been looking to diversify their exposure; interest in Pan-Latin American funds increased significantly, and there was increased interest in Colombia and Peru as well.

- Though interest in India continued to be weak, as investors complain about the lack of exits from previous Indian funds they backed, there was an uptick on this year's survey related to the results of the recent Indian election and hopes for a better business environment.

- For the first time in our survey, the "other" BRIC country — Russia — attracted no investor interest as the Ukrainian crisis and economic sanctions continued to play out.

Chart XV Most Attractive Emerging Markets

Which emerging markets do you find most attractive (choose no more than four):



Source: Probitas Partners' Private Equity Institutional Investor Trends for 2015 Survey

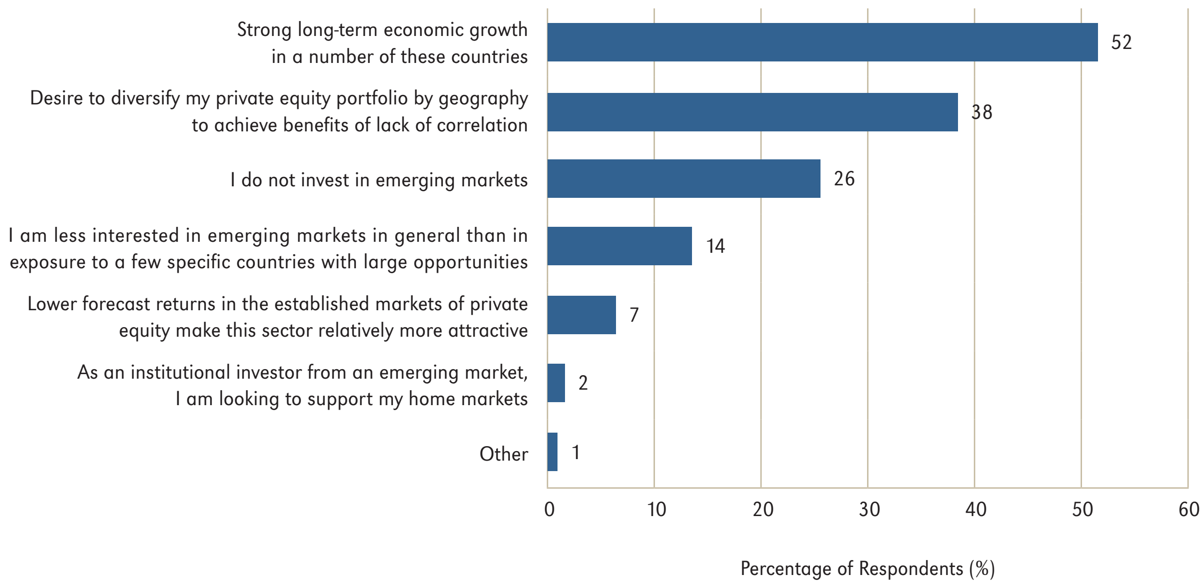
- The prospect of strong long-term economic growth that could positively impact returns drove investor interest in emerging markets. However, the number of respondents who felt compelled to invest in emerging markets on that theory dropped from 77% three years ago to 52% (Chart XVI).

- As it was last year, a desire to diversify their private equity portfolio was the second most popular reason to invest in emerging markets.

- The primary reason investors do not invest in emerging markets is their perception that the risk/return profile in developed markets is more attractive — a perception that increased dramatically from 40% last year to 62% this year (Chart XVII).

Chart XVI Interest in Emerging Market Private Equity

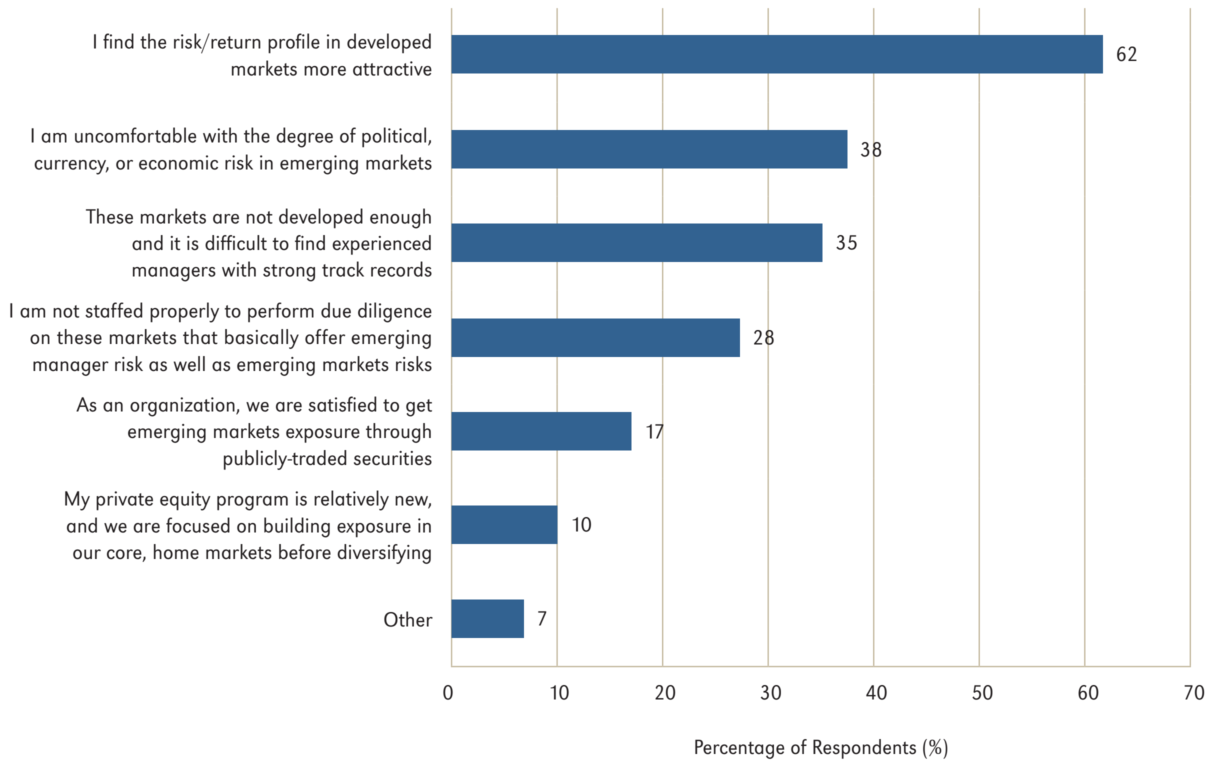
My interest in emerging market private equity is driven by (check all that apply):



Source: Probitas Partners' Private Equity Institutional Investor Trends for 2015 Survey

Chart XVII Disinterest in Emerging Market Private Equity

For those not interested in emerging markets, I am not interested because (check all that apply):



Source: Probitas Partners' Private Equity Institutional Investor Trends for 2015 Survey

U.S. Middle-Market Funds

- Fund managers in the large, homogeneous U.S. market are predominantly differentiated by investment strategies rather than geographic differences.

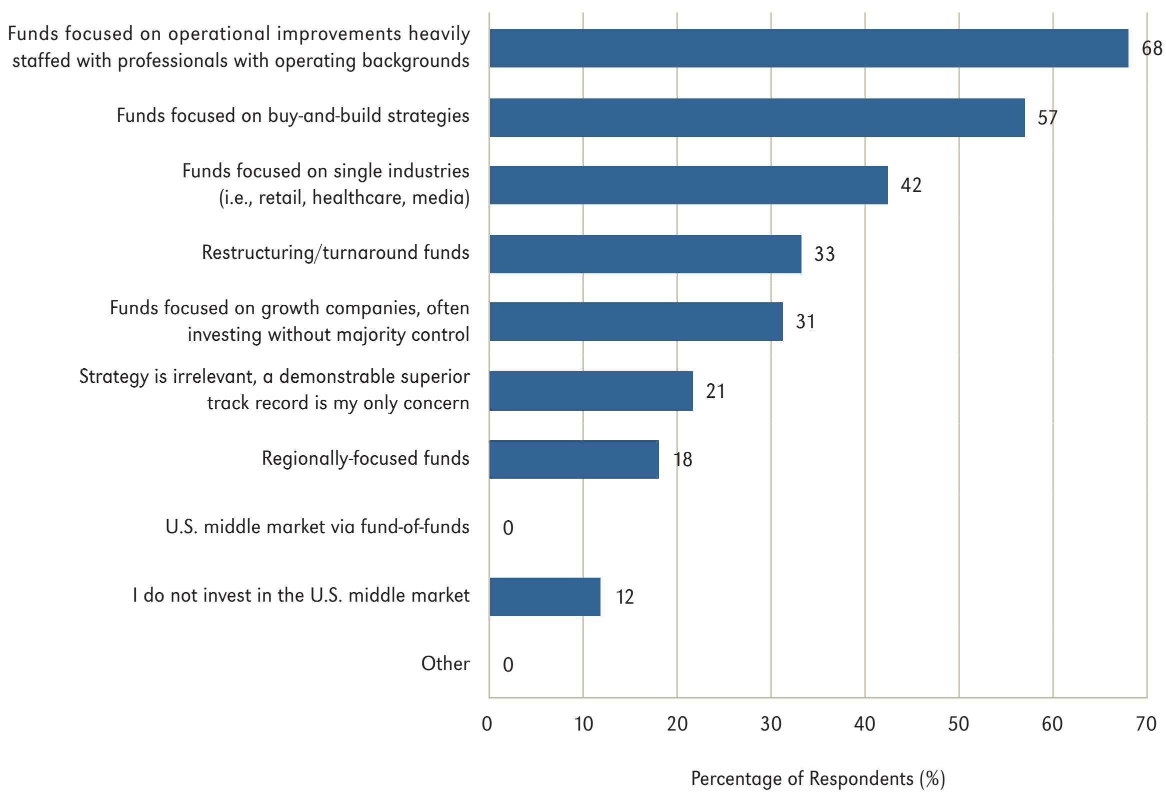
- The majority of respondents indicated a strong preference for funds that generated returns via operational improvements and that were staffed with operating professionals. This is consistent not only with past survey results but also across all investor types (Chart XVIII).

- There is a strong interest in buy-and-build strategies, with the least interest being for regionally-focused funds.

- Most European investors are interested in the sector but 43% of Asian/Australian/Middle Eastern respondents said they do not invest in the U.S. middle market.

Chart XVIII Most Attractive U.S. Middle-Market Sectors

Which of these sectors/strategies in the U.S. middle market do you find most appealing (check all that apply):



Source: Probitas Partners' Private Equity Institutional Investor Trends for 2015 Survey

Venture Capital

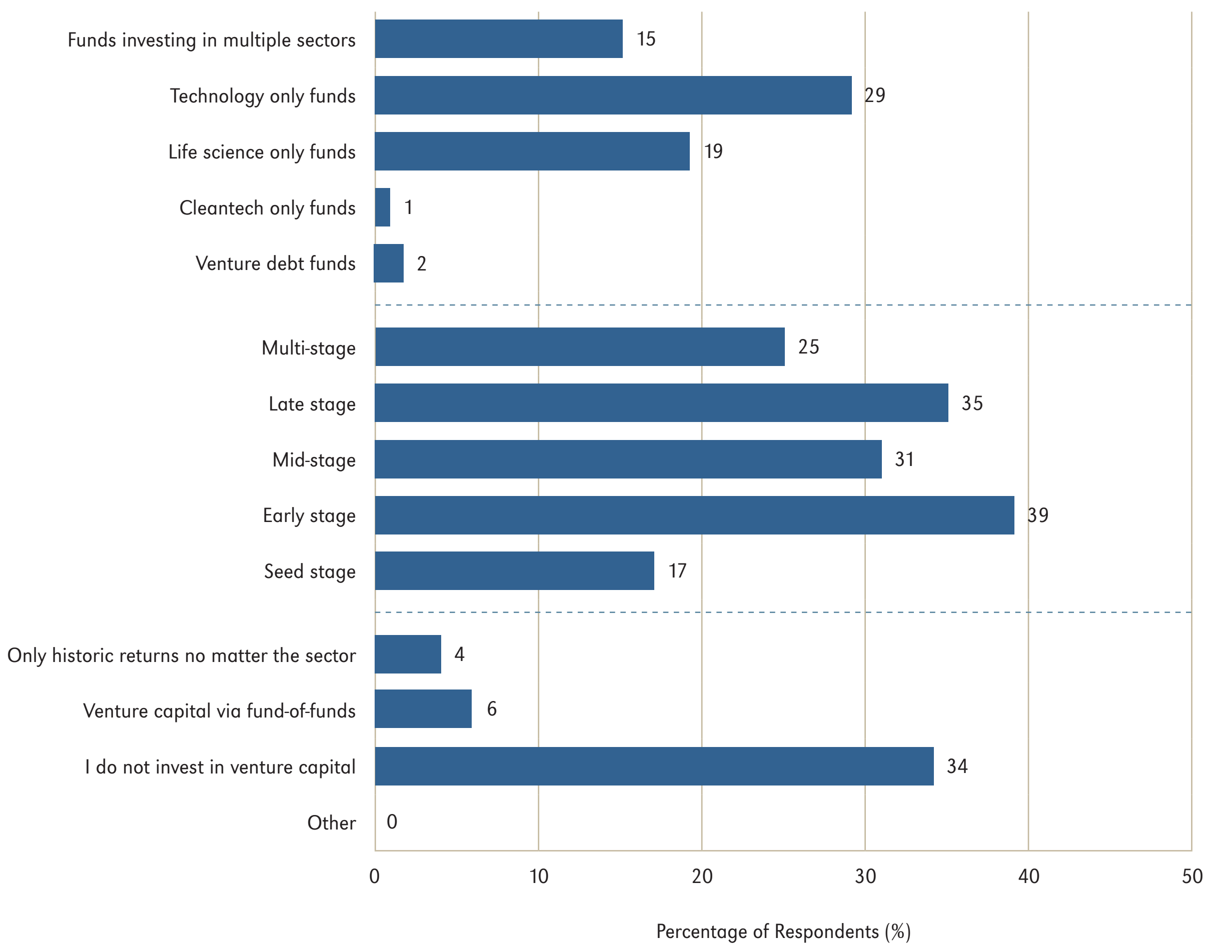
- Investor interest in technology only funds increased significantly this year, though interest in cleantech funds has continued to dwindle to a very low level (Chart XIX).

- Endowments and foundations remain much more active in venture capital than other investors and focused on early stage investments, with 80% of respondents targeting that stage.

- Since 2007, the number of respondents that do not invest in venture capital has doubled, from 17% to 34%, though this year it noticeably improved from 42% last year. Asian/Australian/Middle Eastern investors are the most negative on the sector, with 71% of respondents saying they do not invest in venture capital at all; only 24% of North American respondents say that they do not invest in venture capital. Endowments and foundations are the most positive, with all of those respondents targeting the sector.

Chart XIX Most Attractive Venture Capital Sectors

In venture capital, I focus on funds active in the following sectors or stages (choose all that apply):



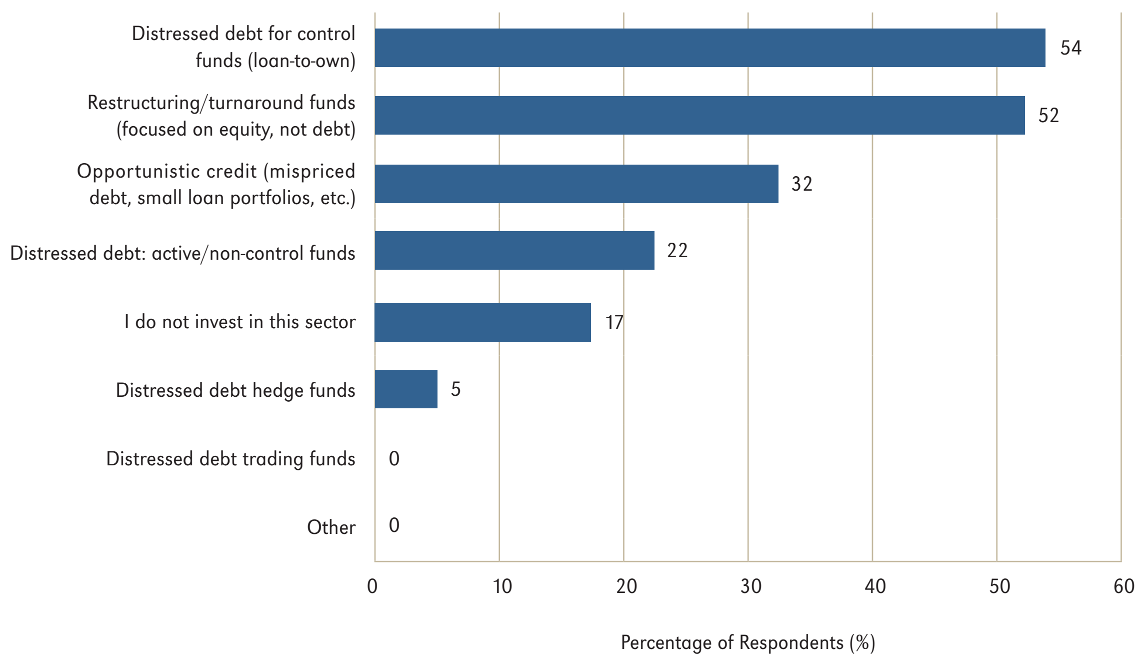
Source: Probitas Partners' Private Equity Institutional Investor Trends for 2015 Survey

Distressed Private Equity

- There are several distinct distressed strategies, but many fund managers pursue a combination of these approaches within the same fund.
- Most respondents prefer strategies with a value-added focus that generates higher multiples of return. In all our previous surveys, restructuring/turnaround funds and distressed debt for control funds have switched back and forth for the lead in the sector (Chart XX).
- Opportunistic credit funds (with a strong focus on assets other than corporate debt) are another area of focus for investors. While some investors have expanded their distressed debt category to include more credit strategies, others still consider it a straight credit or fixed income product, and therefore not in their alternatives allocation.
- For the first time in our surveys, interest in distressed debt trading has gone to zero.

Chart XX Distressed Investments

Within the distressed debt/restructuring sector, I am most interested in (choose no more than two):



Source: Probitas Partners' Private Equity Institutional Investor Trends for 2015 Survey

Credit Focused Funds

- Over the past four years, investors have been increasingly focused on the private credit sector as they look at opportunities created by the strained bank markets.

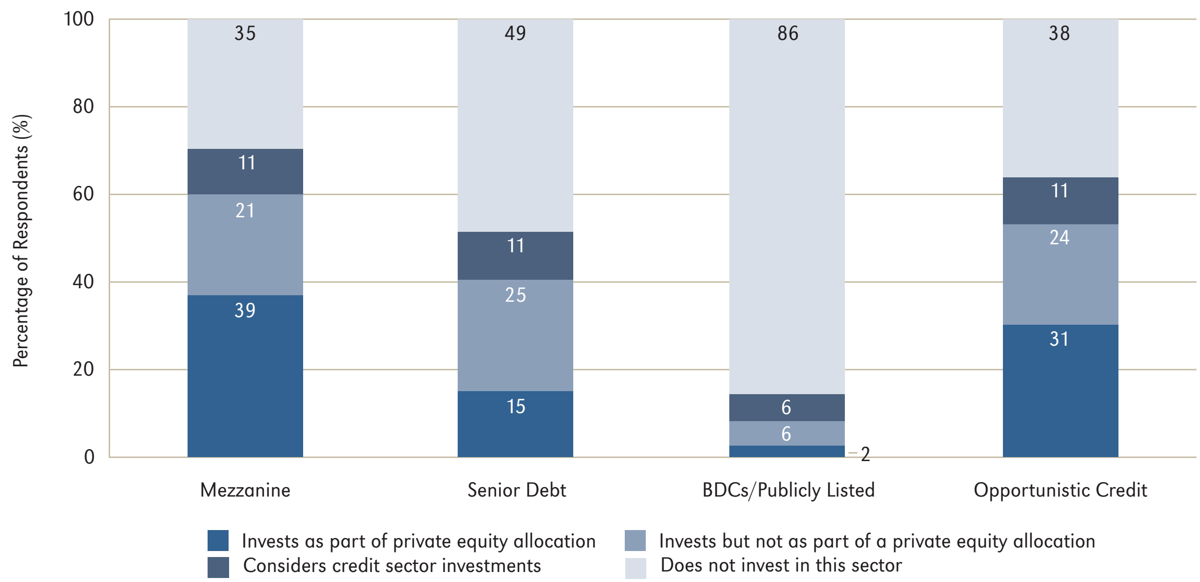
- Respondents to the survey are more focused on the mezzanine, opportunistic credit, and senior credit sectors, though a number of investors make their commitments to these strategies outside their private equity allocations (Chart XXI).

- European investors are more likely to invest in senior credit out of their private equity allocations than other investors.

- Few respondents to the survey were interested in business development companies or other publicly listed vehicles.

Chart XXI Credit

In the credit sector, my firm:



Source: Probitas Partners' Private Equity Institutional Investor Trends for 2015 Survey
Note: Some sectors total greater than 100% as a few investors had multiple responses

Real Asset Funds

Interest in real assets has been growing among sovereign wealth funds and pension plans with significant long-term liabilities and a desire to pursue strategies that could be resilient in times of high inflation. For the first time, our survey asked about interest in real assets.

- Oil & Gas was the only sector that attracted strong interest where the bulk of the investments made were coming from private equity allocations (Chart XXII).

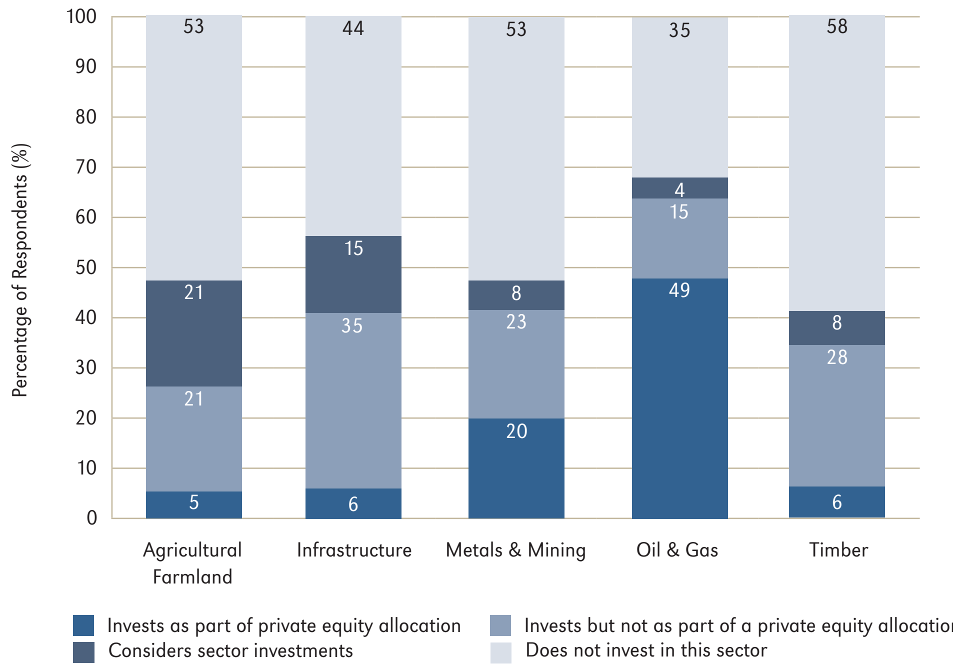
- However, the other sectors also attracted interest from either general real asset or inflation hedging allocations, or from specific allocations in sectors such as infrastructure or timber.

- Notably, 21% of respondents are currently considering an allocation to agricultural farmland.

- Large investors (those seeking to commit $500 million or more to private equity in 2015) are much more interested in real assets while family offices are much less interested in the sector.

Chart XXII Real Assets

In the real asset sector, my firm:



Source: Probitas Partners' Infrastructure Institutional Investor Trends for 2015 Survey
Note: Some sectors total greater than 100% as a few investors had multiple responses

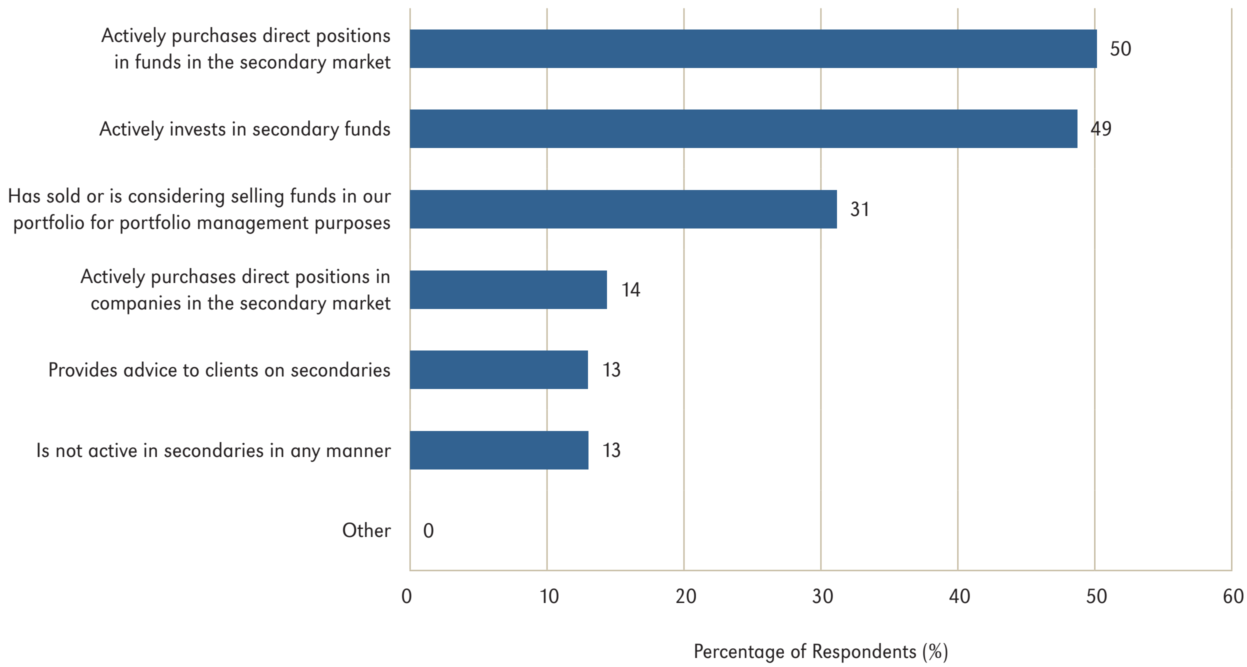
Secondary Market

- The number of investors who are active in the secondary market increased across the board; those purchasing direct positions increased from 38% last year to 50% this year, while those investing in secondary funds increased from 45% last year to 49% this year (Chart XXIII).

- The secondary market is clearly maturing. The percentage of investors who have sold or are considering selling funds from their portfolio reached an all-time high this year, while the percentage of respondents who are not active in secondaries in any manner is at an all-time low.

Chart XXIII Secondary Market Investments

In the secondary market, my firm (choose all that apply):



Source: Probitas Partners' Private Equity Institutional Investor Trends for 2015 Survey

Co-Investments and Direct Investments

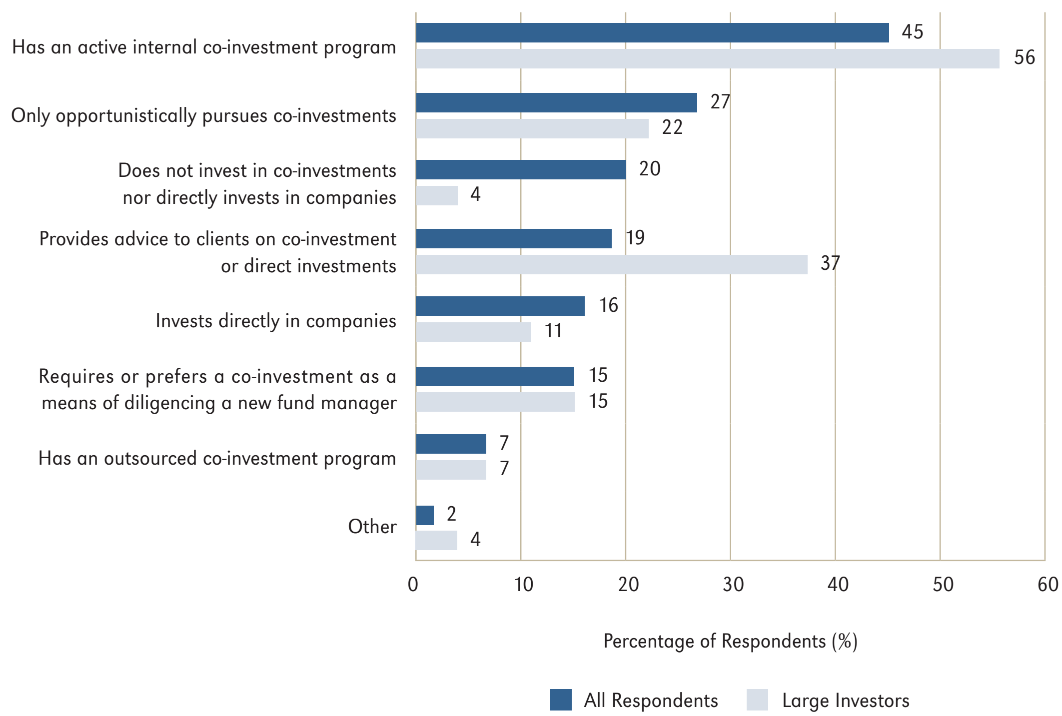
- Interest in co-investments increased significantly. Last year 35% of respondents stated that they had an active internal co-investment program, while this year 45% of overall respondents and 56% of large investors said that they had these internal programs in place (Chart XXIV).

- Only 4% of large investors said that they did not pursue co-investments or direct investments at all.

- Family offices are more likely to invest directly in companies, with 30% of them targeting that strategy.

Chart XXIV Directs and Co-Investments

Regarding directs and co-investments, my firm (choose all that apply):



Source: Probitas Partners' Private Equity Institutional Investor Trends for 2015 Survey

Note: "Large Investors" denotes those survey respondents who plan to commit $500 million or more to private equity in 2015

Fund Structures and Key Terms

- As with most of our past surveys, the level of general partner financial commitment to a fund remains the most important term for investors as it is a key factor in assuring alignment of interest between limited partners and general partners (Chart XXV).

- European investors were most focused on the distribution of carried interest among senior investment professionals, with 59% of respondents focused on that attribute. Asian/Australian/Middle Eastern investors ranked the overall level of management fees and carry distribution waterfalls as tied at second on their list of most important terms.

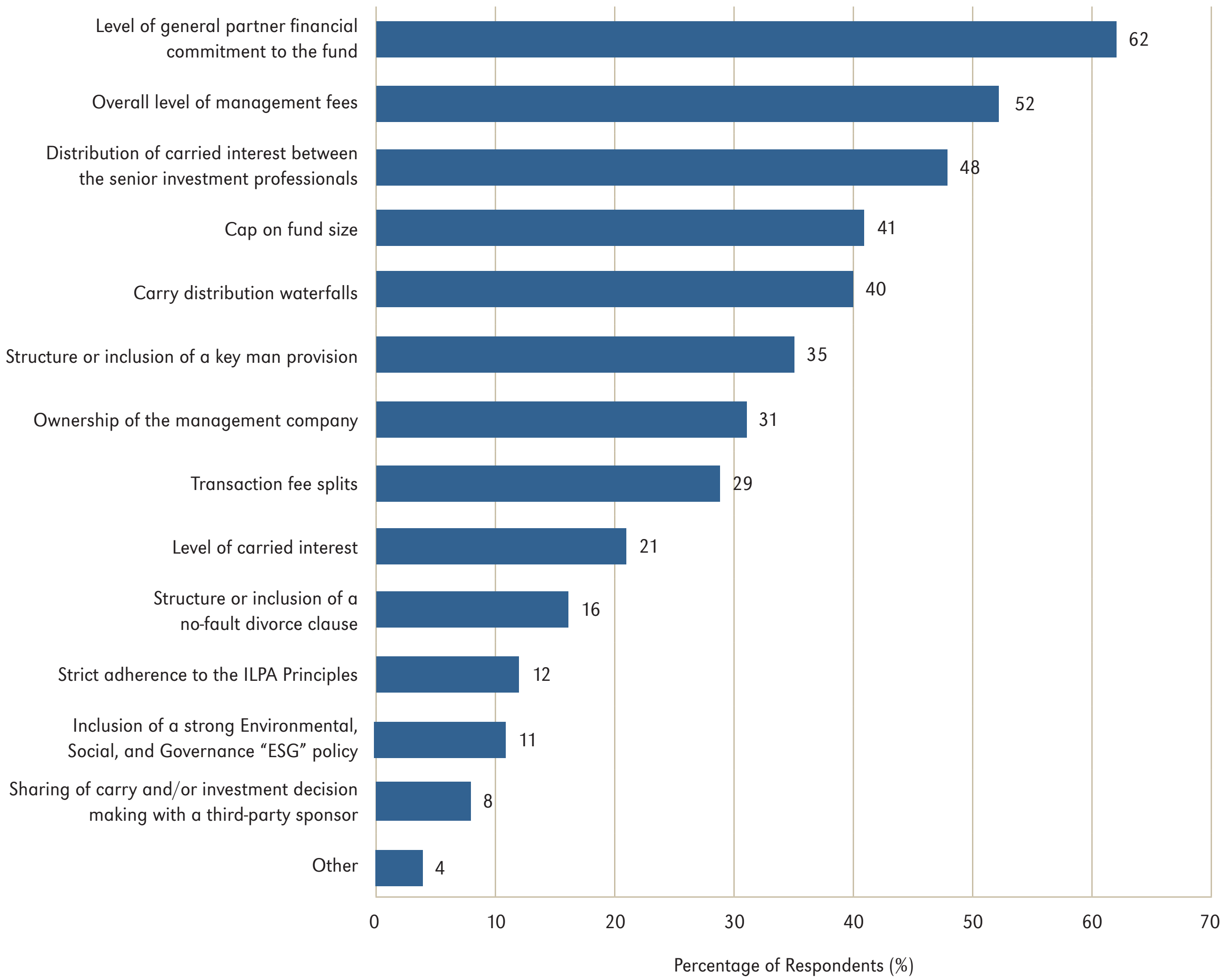
- Asian/Australian/Middle Eastern respondents were also much more concerned about sharing carry or investment decisions with third-party sponsors, with 33% of them targeting this as a concern.

- As far as strict adherence to the ILPA Principles or the inclusion of a strong Environmental, Social and Governance ("ESG") policy, neither of these issues ranked highly, though 33% of pension plan respondents targeted strict ILPA compliance and 19% of European respondents felt that strong ESG policies were important. None of the Asian/Australian/Middle Eastern respondents targeted ESG policies as an issue of focus and family office respondents were not focused at all on the ILPA Principles or ESG policies.

- In past surveys we asked investors in more detail about the ILPA Principles and found that, though few investors insisted on strict compliance, a majority of investors of all types used them as a starting point for terms negotiations.

Chart XXV Issues Regarding Fund Structure

The issues I focus on most when investing or advising a client as far as terms or structure of a fund are (choose no more than three):



Source: Probitas Partners' Private Equity Institutional Investor Trends for 2015 Survey

Investor Fears and Concerns

- The greatest fear of most private equity investors last year was that large funds are becoming generalized asset managers and are moving away from their key investment strengths. This year that fear fell to second place as investors focused more strongly on their perception that too much money was coming into all areas of private equity (Chart XXVI).

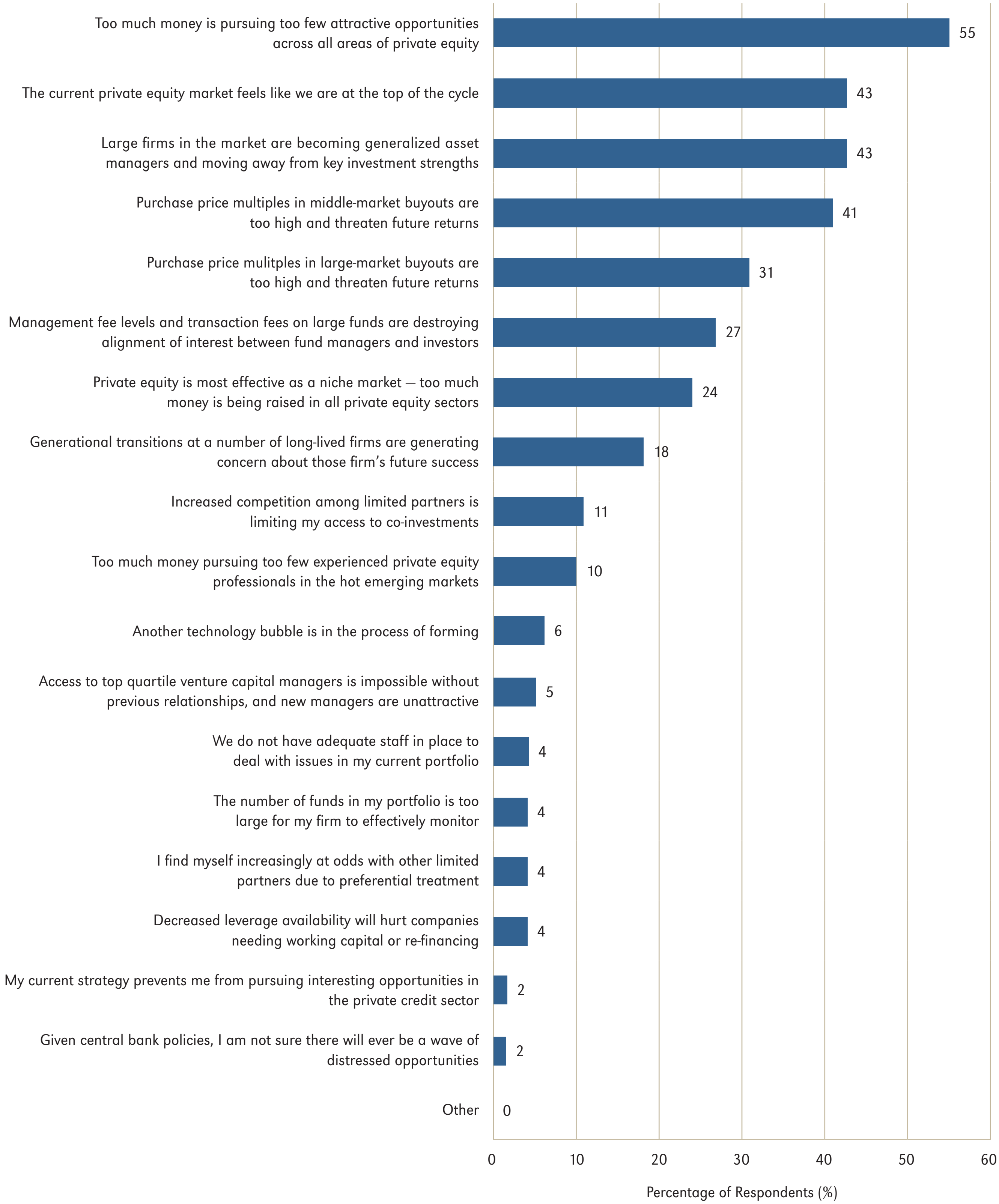
- Tied for second place among investors' concerns was the sense that the market may be at the top of a cycle — with the resulting risk of a decline in the offing. Notably, Asian/Australian/Middle Eastern investors were much less concerned about this, with only 8% perceiving it as a fear.

- Even though middle-market buyouts in North America and Europe were by far the area of strongest interest for investors (as was covered earlier), the fourth ranked fear of investors, at 41%, was that purchase price multiples for middle-market buyouts are too high and threaten future returns. This was actually the number one concern of North American limited partners, 50% of whom selected it.

- Venture capital is a smaller section of most investors' portfolios, but it is notable that fears particular to the sector — that another technology bubble is forming or that access to top quartile managers is too difficult and new managers are unattractive — are very low.

Chart XXVI Greatest Fears Regarding the Private Equity Market

My three greatest fears regarding the private equity market at the moment are:



Source: Probitas Partners' Private Equity Institutional Investor Trends for 2015 Survey

Table III highlights investors' concerns pre-Financial Crisis and compares them to their fears going into 2015.

- Concerns about too much money coming into the market were among the top issues in 2007 and 2015. In 2007 investors were very aware that there was too much debt and too much equity available in the buyout market and that the strong returns leading up to 2007 and beyond were unlikely to continue.

- Investors are now concerned that purchase price multiples for middle-market buyouts are too high and that we are at the top of a market cycle — leading to concerns for future returns.

- In the 2015 survey, a large number of respondents were concerned that large firms in the market were becoming asset managers focused on assets under management growth and were moving away from their key investment strengths — an issue that was not topical in 2007.

Table III What Keeps You Up at Night?
Top four responses:

2007		2015	
Issue	**% Targeting**	**Issue**	**% Targeting**
Management fee levels and transaction fees on large funds are destroying alignment of interest between fund managers and investors	51%	Too much money is pursuing too few attractive opportunities across all areas of private equity	55%
The amount of leverage in the buyout market is unsustainable, and over the next two years credit problems will hurt performance of recent vintage funds	48%	The current private equity market feels like we are at the top of the cycle	43%
There is too much money available in the large buyout market and this will dramatically impact future returns	39%	Large firms in the market are becoming generalized asset managers and are moving away from their key investment strengths	43%
Private equity is most effective as a niche market and too much money is being raised in all sectors of private equity	35%	Purchase price multiples in middle-market buyouts are too high and threaten future returns	41%

Source: Probitas Partners' Private Equity Institutional Investor Trends for 2007 Survey and 2015 Survey

Our View of the Future

Several key trends for 2015 emanate from the survey and our ongoing conversations with investors:

- **Fundraising globally in 2014 will roughly match 2013's total — but investor fears that we are at or near the top of a market cycle will increasingly affect fundraising.** As we move into 2015, investors are likely to become more conservative, either slowing their commitment pace or shifting their focus into areas like distressed debt, special situations, opportunistic credit, and restructuring. At the same time, investors are dealing with a surge of liquidity as fund managers are generating significant exits in the current environment and are under pressure to redeploy that capital back into private equity to maintain their allocations.

- **Separate accounts are becoming increasingly important to large investors.** Separate accounts — either specifically targeted at a particular strategy or giving the manager wide latitude to invest across strategies — are becoming increasingly important to very large investors, not only as a method to reduce costs but also as a way to effectively deploy large sums in capital-intensive sectors such as large buyouts and infrastructure. The largest private equity managers that are active in a number of alternative sectors are taking advantage of these investor desires to increase their assets under management.

- **Smaller investors and the "best of breed" approach.** Many smaller, sophisticated investors continue to take a different approach, targeting "best of breed" managers in narrower strategies such as middle-market industry-focused buyout or growth capital funds or middle-market distressed and turnaround vehicles, looking to generate alpha in inefficient sectors. This approach often requires both looking at new managers and moving away from established relationships with managers who these limited partners perceive have become too large for their strategies.

- **Leverage, banking regulators and private credit funds.** In the United States at least, bank regulators' current focus on limiting high-risk loans from commercial bank balance sheets seems to be finishing the process begun with Dodd-Frank of severely limiting commercial bank activity in most sectors of private equity. This is likely to continue the rebound in the CLO market, as well as spur the creation of more private credit funds that target middle-market companies not well served by the bond market. Some investors fear that the managers of these newer private credit funds lack experience in dealing with market crises.

- **At the large end of the deal market, sovereign wealth funds and the largest public pension plans are increasingly competing with fund managers for deals.** These institutions are becoming increasingly sophisticated direct investors and they often have longer-term investment horizons than many funds, giving them unique advantages in certain circumstances. A number of these investors also invest in funds, most often seeking co-investment deal flow or access to middle-market or niche sector exposures that are better targeted through funds. A number of them are also willing to join direct investment syndicates for particular deals — making them both competitors and partners to fund managers.

- **Increased interest in hard asset plays.** A number of sophisticated investors, worried about economic uncertainty and future asset shortages, as well as those seeking to match long-term liabilities, are increasingly turning to hard asset sectors such as oil & gas, infrastructure, agriculture, mining, and timber. Often these investments are made through separate inflation-linked allocations outside of their private equity or real estate allocations, and a number of large investors are pursuing transactions in these sectors through separate accounts or direct investments.

Notes

Notes

Private Equity Institutional Investor Trends for 2015 Survey

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