Focusing on the sweet spots of the private markets

In our first blog we talked about the growth of private assets and the benefits an allocation to the asset class can provide to investors. Here, we look at the way we manage our private markets strategy at Kempen..

A one-stop shop for anyone looking for access to private markets

At Kempen we provide diversified exposure to private markets by investing in four distinct areas that would appear on the equity side of the balance sheet: private equity (buyout and venture), infrastructure, land (farmland and forestry) and real estate. These segments provide exposure to assets with characteristics that are generally difficult to find in the listed equity universe.

In private equity buyout we focus on investing in first-time private-equity-owned small- to medium-sized businesses that have considerable scope to professionalise, internationalise and diversify their client base. Private equity large- / mega-cap buyout investments, by contrast, are often large multinationals that have already been in the hands of multiple private equity investors and undergone several rounds of optimisation and restructuring, so there is limited scope to add value. They also tend to have higher valuations and more debt than smaller firms. The figures back this up: small buyout has historically outperformed large buyout . Venture capital provides exposure to innovative, fast-growing start-ups, often in technology, whereas listed equity provides exposure to more mature, bigger technology companies. A lot of ground-breaking innovation comes from start-ups, and they are staying private for longer. What's more, large corporates, and especially big tech firms, often have huge corporate venture capital arms to acquire breakout start-ups. This means that investors who want to capture the returns derived from technical innovation are increasingly turning to venture capital.

In infrastructure and real estate we tend to invest in small- to medium-sized assets, often in niche areas that are difficult to access in the listed universe, and that have scope for efficiency gains to be made.

Finally, we are able to source many attractive opportunities within the private forestry & farmland universe, whereas the listed market in this area is negligible.

Thanks to our unique combination of four areas within private markets, our strategy essentially represents a one-stop shop for investors looking to allocate to private markets.

Focusing on the sweet spots

Many of the flagship private asset funds in the market take a diversified approach to the areas they invest in – broad infrastructure or real estate funds, for example. But a benefit of our approach, in which we invest in four distinct areas within the private markets universe, is that we're able to concentrate our investments in what we perceive to be the sweet spots of each area without having an undue effect on our portfolio's level of diversification.

For example, within real estate we're currently focusing on residential properties, and may add logistics assets in due course. This means we have no exposure to retail and offices – areas that were already struggling prior to the pandemic, which only worsened their problems.

Similarly, we take a highly selective approach in infrastructure, generally focusing on themes benefitting from their link to multi-decade megatrends, such as renewable energy and communication.

Meanwhile, in private equity we focus on the smallest deals, where managers have much more scope to add value than in larger companies, for which lots of leverage is typically used to generate returns.

Finding the best partners

We invest in specialist private market managers' funds and also make co-investments, only choosing to work with the best partners based on our extensive due diligence process. And just like our selective approach to each of the four areas we focus on, we take a highly selective approach when choosing our managers, only investing in specialists in particular areas rather than with generalists.

For example, within venture capital we invest in a highly specialised biotech venture capital fund. This general partner has an investment team of around 20 people, 15 of whom have a degree or PhD in medicine, so they have in-depth knowledge of pharma. The firm has been around for nearly two decades and has been very successful in its biotech niche, which is benefitting from a number of fundamental growth drivers. At the same time, entry barriers for new investors are high.

Liquidity by design

Given the nature of their underlying investments it's very rare for private market funds to offer quarterly liquidity, which is what our strategy aims to provide in normal market conditions after an initial lock-up period of just three years[2].

This capability is fully embedded in the product's design: we invest in both open-ended and closed-end primary fund commitments as well as secondary fund investments and direct co-investments. We have balanced our allocation to each of the private market categories, targetting a 60% allocation to the so-called real asset categories of infrastructure, land and real estate and a 40% allocation to private equity. The strategy's cash conversion cycle of roughly five years means we should be able to offer a reasonable level of liquidity to our investors under normal circumstances. That said, investors in private markets need to have a long-term investment horizon to fully capture the return premium and should be prepared for scenarios in which liquidity is not readily available.

An experienced team able to obtain privileged access to some of the best funds

The five members of our team have 18 years of investment experience on average, over which time they've built up in-depth understanding of their areas of expertise. Our selective approach to investment enables them to concentrate on sweet spots rather than whole asset classes.

An additional benefit of our team's experience is that the members have established excellent relationships with investment partners in the market over the course of many years. In some cases, this means we can gain privileged access to funds that aren't accessible to many investors.

Tune into our webinar

To find out more about our how we run our private markets strategy and much more, please register **here** for our webinar on November 4th.

[1] Source: https://www.financialinvestigator.nl/nl/nieuws-detailpagina/2019/06/03/eFront-Small-buyout-funds-outperforming-mega-buyouts-3

[2] Source: There is no guarantee that withdrawals will be executed immediately due to the lower liquidity of underlying investments. The strategy is not obliged to sell an investment to facilitate a withdrawal.

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