KEYNOTE INTERVIEW

Succeeding against a troubling backdrop

Despite wider macroeconomic headwinds, the secondaries market continues to see steady transaction flow, says AltamarCAM managing partner Miguel Zurita

Q What has been driving secondaries dealflow over the past 12 months, and what are you expecting to see in the months ahead?
The secondaries market is well positioned and has strong tailwinds. Global secondaries transaction volume hit a record high of more than $130 billion in 2021. And although volume in 2022 came in lower at around $110 billion, it was still the second-largest year ever in terms of value for the secondaries market.

If you take a step back, the secondaries market really is the liquidity provider in an illiquid asset class. And, as we have seen recently, liquidity needs are up. We've witnessed a slowdown in the level of distributions across the industry as a whole, and mature portfolio cashflows have turned negative, with funds asking for more money than they're distributing. This has not happened since the global financial crisis.

In this scenario, the demand for liquidity is higher. That's a great environment for secondaries buyers.

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Q To what extent has the wider economic picture impacted secondaries activity?
At the peak of the market, we sometimes saw premia being paid for access to high-quality portfolios. For several years now, secondaries have been trading at discounts; more recently, these discounts have become wider.

LPs that are selling want to accelerate liquidity, and sometimes that means sacrificing returns. It is worth bearing in mind, however, that private equity returns have been very strong, so LPs are sitting on very nice IRRs and can still come away with good returns, even if they have to sacrifice some upside.

It is also important to note that many LPs are selling so they can continue committing to new funds. Through the bull market, liquidity was abundant and the challenge was to gain access to the greatest funds. Now is a tougher period in which to risk capital, no matter who you are. Investors want to maintain relationships, and we have seen them sell funds to free up capital and keep committing to favoured managers.

Q What can be done to encourage further participation in the secondaries market?

The secondaries space remains a relatively small market with enormous potential to grow even further. If you look at other illiquid markets, like in certain illiquid corners of the real estate market, annual transaction volume will come in north of 3 to 4 percent of NAV every year. When it comes to secondaries, the figure is not even 2 percent.

If you think of secondaries as the primary source of liquidity in an illiquid market, it is still deploying only a fraction of what it could deliver. Secondaries growth is only going to move in one direction. There will be hiccups, and growth will not always be in a straight line, but the long-term trend is definitely upwards.

In terms of widening participation, this is still a buyer's market and the returns are strong. That is encouraging new investors into the market.

Buyers can afford to be highly selective, and the risk/return dynamics are very attractive. You can achieve returns that are very similar to what you get in the buyout market, but with a lot less volatility. It is much easier to pick the winners and avoid mistakes when you have more visibility of a portfolio. A secondaries strategy is also a good tool for accelerating or slowing deployment, as investment periods are shorter than that of a typical private equity fund.

It is true that there has been significant uncertainty as a result of inflationary and interest rate pressures, and there are secondaries deals that haven't proceeded because of the disparity in buyer and vendor pricing expectations. Nevertheless, looking ahead to the rest of this year and into 2024, I would expect to see sustained high levels of activity and another strong period for secondaries volume.

Q To what extent is the growth trajectory of the market driving manager differentiation? How are secondaries firms marketing themselves to stand out from their competitors?

The rapid expansion of the secondaries market has driven market segmentation. In its early years, secondaries was almost exclusively a distressed market. Investors sold here because they had no other options and were desperate for liquidity. That came at great cost, because when you approached the secondaries market as a seller, it was taken for granted that you were under some sort of pressure to sell. As a result, deep discounts were standard.

That has changed a lot, and the market is now one where there is fair pricing. You still see a few distressed sellers, but this is a very small portion of the market. Investors predominantly see secondaries as a tool to manage portfolios and manage liquidity. If you are an investor and want to reduce exposure to one region in favour of another, you have to go to the secondaries market to execute, or it will take seven to eight years if you just wait for it to happen.

> *"Funds [are] asking for more money than they're distributing. This has not happened since the global financial crisis"*

So, LPs are looking to sell for a number of reasons. As the market matures, you see specialisations emerging to provide LPs with more optionality: there are tail-end fund strategies, which are complex to analyse but offer opportunities to buy at deep discounts. There are also late primaries that offer some visibility on the assets in a portfolio, but also offer the opportunity to capture most of the value creation upside. Lastly, we have seen the emergence of GP-leds, which today represent close to half of the market.

We also see secondaries managers differentiating by asset class. The market was mostly private equity, but now there are real estate, infrastructure and venture capital-focused secondaries managers. Each segment has certain differentiating factors that provide a solution to the market on one side and an attractive investment opportunity for the investors on the other.

Q What has your experience been like navigating a market that is evolving and diversifying at such speed?

It is very difficult to try and do everything in the secondaries market. We've chosen an area where we believe we can find the greatest opportunities that play to our strengths, and where we believe we can find the alpha of the market.

We prefer GP-led transactions and smaller LP deals. We are comfortable with concentrated portfolios, and we also see less competition in this part of the market. We can hand-pick the assets we like and assess them thoroughly.

We are not the largest player in the market, and we don't have the firepower to buy portfolios worth several hundreds of millions. What we do have is a very strong primary business, so that makes us a preferred partner for many GPs. Most of our dealflow comes from existing relationships – quite often, from funds where we are already investors. ■