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# The Private Markets in a Downturn

*By Mario Giannini, CEO* | **April 30, 2020**

At the time of this writing, it will have been almost five full months since the first case of COVID-19 was confirmed in Wuhan, China in mid-November. Four months later, on March 11, the World Health Organization (WHO) declared it a global pandemic. Two days prior to that declaration, market-wide circuit breakers were triggered for the first time in 20 years. The markets have been on a wild, and generally downward, ride since. And just last week, on April 20, oil prices dropped into negative territory for the first time ever.

That's a lot to digest, particularly over the span of just a few short months. Suffice it to say (though it feels almost trite to actually say it), the COVID-19 pandemic has had – and will continue to have – a profound impact not only on the global economy, but across every facet of our lives. While people around the world are attempting to adjust to the "new normal" of social distancing and self-quarantining, for investors, the market downturn is a worrisome concern piled atop a heap of other unknowns.

As investors around the world seek to get a handle on this latest downturn and implications for their portfolios, we are reprising an excerpt from our latest **Market Overview**, from the Fall of 2019, in which we offer some considerations as to why the private markets (perhaps unsurprisingly) are generally well-prepared to withstand a downturn. Keep in mind that these thoughts were published prior to the current global health crisis.

**We are in an odd spot, aren't we?** There is an uncomfortable likelihood that we are facing the first real downturn that major economies have experienced in 12 years. Yet, looking at several of the private market indicators, we don't see peak behavior. We don't have money being spent by general partners at frenzied levels. We don't see limited partners chasing down allocation targets by committing vast amounts of capital.

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So, what do we make of that? We make of it that the private markets are entering this downturn, if it actually comes to pass, in far better shape than they entered the 2000 and 2008 downturns. That's a very good thing. The silver lining, as it were. What has us convinced that the private markets are in better shape? We've already touched upon a number of reasons:

- Money has been coming back to limited partners in buckets (another technical term of measurement used in the private markets);
- General partners have exhibited none of the signs of greed with respect to the pace of investing that occurred in prior cycles; and
- Limited partners have not thrown gobs of money at funds, causing fundraising to spike to record levels.

Sure, co-investments are scary and multiples are high, but that is all manageable and probably confined to individual companies and LP portfolios. It does not appear to be a systemic risk as we saw in 2000 and 2008.

But let's come back to the larger question at hand. What if there is no downturn? What if we're still on the runway to a peak, but, assuming a downturn is bearing down upon us, we make bad decisions and become our own worst enemies? We've seen from prior cycle behavior that private markets practitioners have a propensity to act as irrationally and emotionally as those in the public markets. How do we prepare for an environment that is either ready to turn down or not at all? How do we choose transactions or general partners in this environment? Where should we focus our efforts and our portfolios?

Observations from prior paths to peaks provide some guidance. (Sigh, alliteration makes everything sound better. Remember Bowie's brilliant, "wish upon, wish upon, day upon day"?)

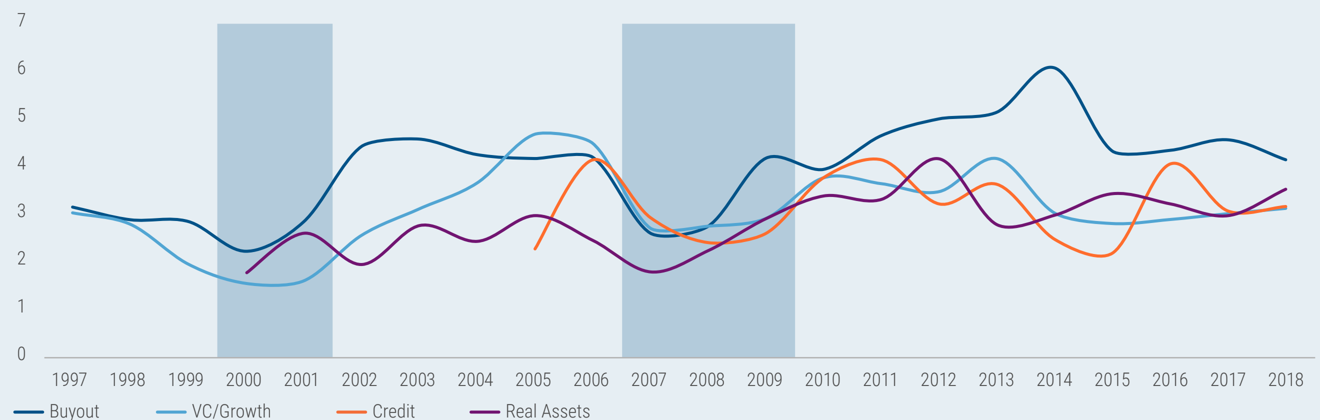
## GP's (lack of) Greed

Another sentiment indicator, and one of our favorites for its indication of the collective greed on general partners' parts, is in firmly neutral territory (Chart 63).

If we were at a market peak, you'd really expect that some part of the private markets universe would be spending quickly. None is.

**Chart 63: Time Between Fund Strategy**

Median Time to Next Fund in Years




Source: Hamilton Lane Data (October 2019)

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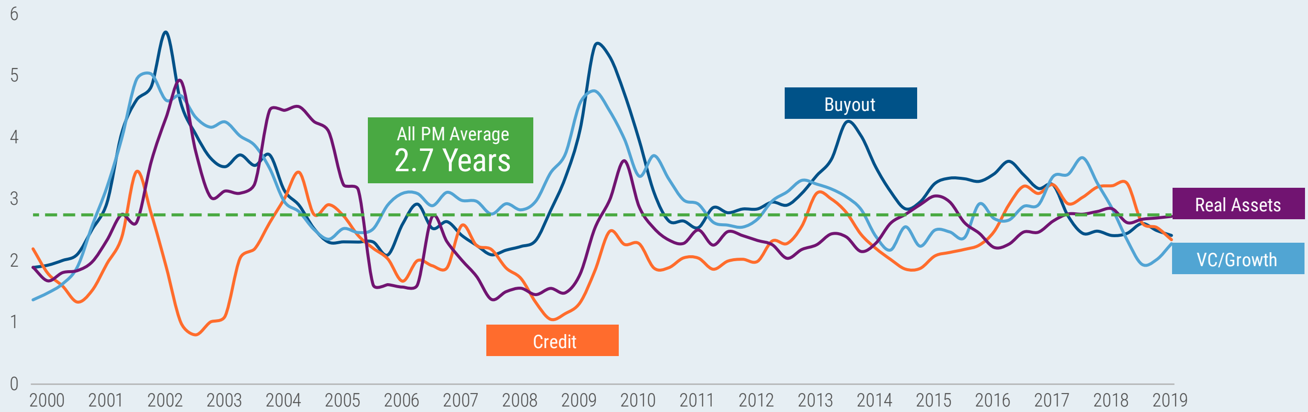
## Capital overhang

### Chart 31: Time to Deploy Capital Overhang

Years at LTM Pace



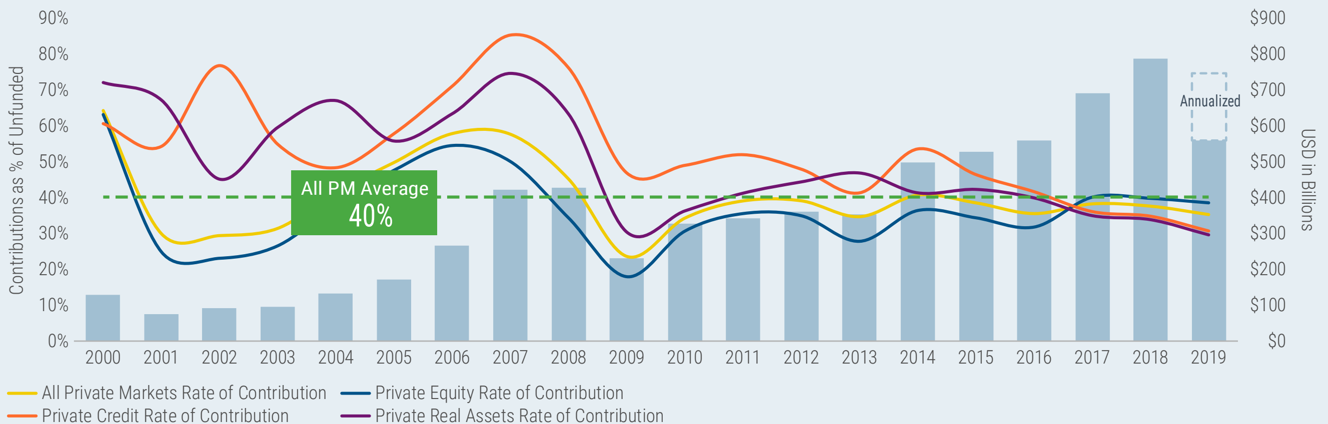

Source: Hamilton Lane Data (October 2019)

Now turn your attention to Chart 31, which, in our humble opinion, is really how we should be looking at the capital overhang. At current rates of investment, how much time will it take to spend the capital? We are right around average levels in all strategies other than venture, which, interestingly, suggests that more capital needs to go into that area. The other fascinating aspect of this chart is that the best times to invest are when the capital overhang is at its greatest. How is that for counterintuitive?

It's one of life's great paradoxes. It's largely because investment activity slows down in difficult times as sellers don't want to sell at low prices until they get used to those prices. Reality takes a long time to re-calibrate. Hell, in the case of the investors' view of the significance of the capital overhang, we're at 10 years and counting.

Moving on from the capital overhang, what's the rate of spending out there? (Chart 32)

### Chart 32: Annual Private Markets Contributions




Source: Hamilton Lane Data via Cobalt (October 2019)

While the absolute pace of investing is high, that's only because the entire industry has grown. On a relative basis, investments have been at about average levels in the private equity world. Perhaps surprisingly, particularly given the press around the credit space, the pace of investing has been light in both credit and real assets. Why? The explanation is not unlike what we said about limited partners in the context of their fund commitment pacing: General partners have been relatively disciplined about investing during this entire

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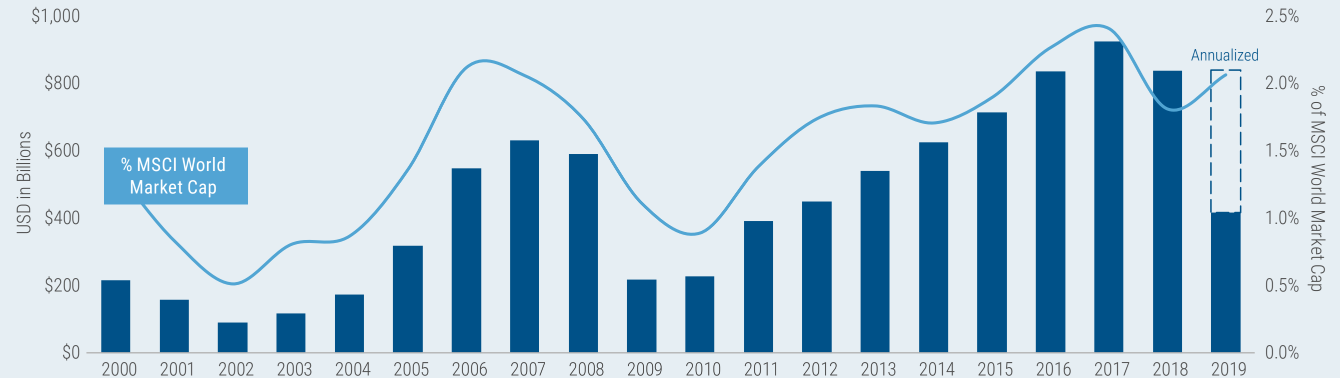
cycle. We have not seen the kind of exuberant behavior that took place at prior peaks in 2000 and 2007. If we are at a peak, if there is the beast of recession readying to jump out at us, then we would argue that private markets portfolios will be in far better shape than they were in the prior two downturns.

## Fundraising:

### Chart 22: Global Private Markets Fundraising




Source: Bison Data via Cobalt, Preqin, Bloomberg (October 2019)

If you're not going to cry for Eva Perón, then please don't cry for fund managers. Funds continue to gather substantial amounts of capital. Somewhat surprisingly, the numbers appear to have peaked, hovering around the same levels for the last few years (Chart 22). Why is that? One reason, we believe, is that the transaction volume is soaking up some of the capital that would otherwise, or formerly, have gone into funds. Another reason, again perhaps surprisingly, is that limited partners are exercising discipline around capital deployment. We're not observing the kinds of massive fundraising increases that characterized the run-up to the 2007 peak. That is an extremely positive, and overlooked, aspect of the current market environment.

## Conclusion

There you have it. What has us convinced that the private markets may be in better shape this time around? To recap (and with the dual caveat and reminder that the world looks and feels very different just a few months later): Money has been coming back to limited partners. General partners have not shown any of the signs of greed with respect to the pace of investing that occurred in prior cycles, and limited partners have exhibited discipline in their commitment levels, preventing fundraising from spiking to record levels. So while there are plenty of reasons to be kept up at night, let's take a collective deep breath and attempt to acknowledge the ways in which the private markets may be well-prepared for this downturn.

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**Index Definitions:**

**MSCI World Index** – The MSCI World Index tracks large and mid-cap equity performance in developed market countries.

**Strategy Definitions:**

**All Private Markets** – Hamilton Lane's definition of "All Private Markets" includes all private commingled funds excluding fund-of-funds, and secondary fund-of-funds.

**Corporate Finance/Buyout** – Any PE fund that generally takes a control position by buying a company.

**Credit** – This strategy focuses on providing debt capital.

**Mega/Large Buyout** – Any buyout fund larger than a certain fund size that depends on the vintage year.

**Private Equity** – A broad term used to describe any fund that offers equity capital to private companies.

**Real Assets** – Real Assets includes any PE fund with a strategy of either Infrastructure or Natural Resources. Real Estate funds are not included.

**VC/Growth** – Includes all funds with a strategy of venture capital or growth equity.

**Venture Capital** – Venture capital includes any All Private Markets funds focused on any stages of venture capital investing, including seed, early-stage, mid-stage, and late-stage investments.


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**As of April 27, 2020**