Private Markets

Enhance your portfolio

Private markets and their benefits

Risk-adjusted performance

Inflation protection

Long term resilience

UBS

Wide-ranging benefits

Adding private markets to a portfolio can bring diversification benefits, improve risk-adjusted performance and more.

The main private markets investments are real estate, infrastructure, private credit and private equity. They encompass a wide range of assets, strategies and solutions for accessing them. In the long run, we expect portfolios which include private markets to outperform those which rely solely on traditional asset classes.

Private markets investments can be a powerful tool in helping investors create diversified portfolios with higher return expectations and better risk-adjusted performance. Traditional portfolios have tended to be split 60:40 between stocks and bonds. As interest rates rose sharply in the wake of the pandemic, stocks and bonds showed increased volatility and higher correlations. Adding private markets investments can lead to improved outcomes and portfolios which are more resilient over the long term.

Incorporating private markets enables investors to make investments which are unavailable in public markets. These investments can enhance income streams and provide good inflation protection. Private markets also allow investors to have a direct sustainability impact in decarbonizing the economy, along with opportunities to make positive social impact too.

Real Estate

Real estate involves investing in property, of which the main investment sectors are office, retail, industrial / logistics and residential / living property. Additionally, there are numerous other niche and emerging sectors, including hospitality, lab space, self-storage, student accommodation, retirement accommodation and other specialist types of real estate.

Real estate offers investors stability and predictability in income, with good inflation protection. It also offers investors the potential for long term capital growth. Although during downturns property values are also affected, the case for real estate as a portfolio diversifier remains. However, investors must be selective and focus on assets that benefit from strong fundamentals. Well-capitalized assets for which leverage has been secured at attractive fixed rates should remain somewhat insulated from any financing pressure.

Real estate can be accessed through private markets and by listed markets via public listed real estate companies. REITs (Real Estate Investment Trusts) are property companies which are listed on stock exchanges and receive certain tax benefits compared to the wider equity market. However, listed markets real estate investment typically show much more volatility in returns than private markets real estate investment and is subject to the influence of the wider equity market. Private markets real estate also allows investors to target the real estate sectors which are expected to outperform. Within private markets investors can access real estate directly at the asset level or via a number of other solutions such as funds and other investment structures.

Infrastructure

Infrastructure involves investing in facilities, services and businesses that are essential to the functioning of the economy. It covers sectors such as energy, transport, communication networks, water, waste and social infrastructure.

Infrastructure is a long term asset class that generally provides stable cash flows with strong risk-adjusted returns. Similar to other private markets investments, infrastructure can also be used to protect against inflation. Historical data shows that infrastructure has outperformed other asset classes such as equities when inflation is high.

We believe that infrastructure assets remain attractive, with a focus on those that benefit from secular tailwinds, government policies, inflation passthrough and have resilience against economic volatility. Infrastructure assets that benefit from robust, predictable and inflation-linked cash flows are less exposed to cyclical pressures and infrastructure showed a resilient performance in 2023.

Private infrastructure is not a homogenous asset class. At a high level, there are infrastructure equity, infrastructure debt and multi-manager strategies that investors can access to gain broad exposure. But even within these, there are significant variances from fund to fund. For example, strategies can target different geographies, deal sizes, sectors, cash flow profiles and different parts of the capital stack. The choice of strategy depends on an individual investor's risk tolerance, investment goals, diversification needs, current portfolio make-up and sector-specific views. Investors can also work with managers to develop bespoke mandates or separately managed accounts (SMAs) that are customized to their own needs.

Private Credit

Private credit is a broad catch-all category that describes credit investments that are not publicly traded, in contrast to public debt markets such as bonds, loans and other listed securities. While the most well-known private credit strategy is corporate direct lending, the private credit universe spans across corporate credit, structured credit, specialty finance and real assets. Within corporate credit, investors provide financing to corporate borrowers in some form, which may include classic direct lending, venture debt, distressed debt, hybrid / mezzanine strategies or special situations. Structured credit strategies focus on non-traded assets that may include asset backed securities (ABS) and similar structures, or commercial or residential real estate backed investments.

Real asset lending strategies focus on private investments across segments such as infrastructure, energy and transportation. Specialty finance is an emerging area which captures other niche strategies such as asset-based lending, consumer lending, net asset value (NAV) financing, trade finance and litigation finance. Private credit offers investors the ability to access off-market credit investments that typically focus on income, with the added benefit of limited volatility and smoothed returns as positions are typically marked quarterly by third party appraisers, based on credit performance. Given the added complexity and illiquidity, investors typically enjoy a pricing premium over public market spreads, which may come in the form of a wider spread, entry, exit or amendment fees, original issue discount (OID) or even select equity participation.

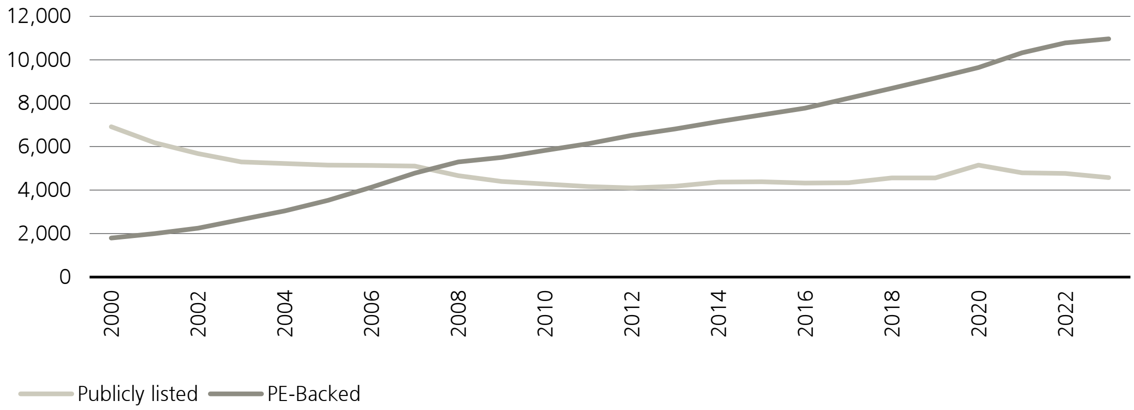
The private credit opportunity set continues to widen, as rising interest rates, tightening credit underwriting standards and continued retrenchment of traditional lenders has resulted in a fertile investment environment for private credit managers. It remains a lender's market, with managers able to secure attractive economics, strong structuring and lender protections. As regulatory requirements continue to force banks and traditional lenders out of private markets, private credit is expected to fill that vacuum and continue to evolve into a rich space with complex strategies and varied offerings.

Private Equity

Private equity involves investing in companies whose shares are not traded on public markets. The aim is to increase the value of a target company by taking majority control and overhauling its financial structures, day-to-day management and strategic direction. Private equity encompasses investments in different stages across a company life cycle, from early-stage venture capital to later-stage growth investing and leveraged buyouts of mature companies.

Private equity offers advantages over public equity, including extended holding periods, ability to align interests with company management, ability to actively participate in driving businesses, company specific selection and the ability to conduct intensive due diligence. The management team of a private company can undertake long-term initiatives without managing the company to quarterly earnings targets, which can be a focus for listed companies and result in a focus on the short-term.

Figure 1: Number of US firms by capital source



Source: PitchBook, UBS Asset Management, Real Estate & Private Markets (REPM), December 2023. Note: publicly listed = listed on NYSE or Nasdaq.

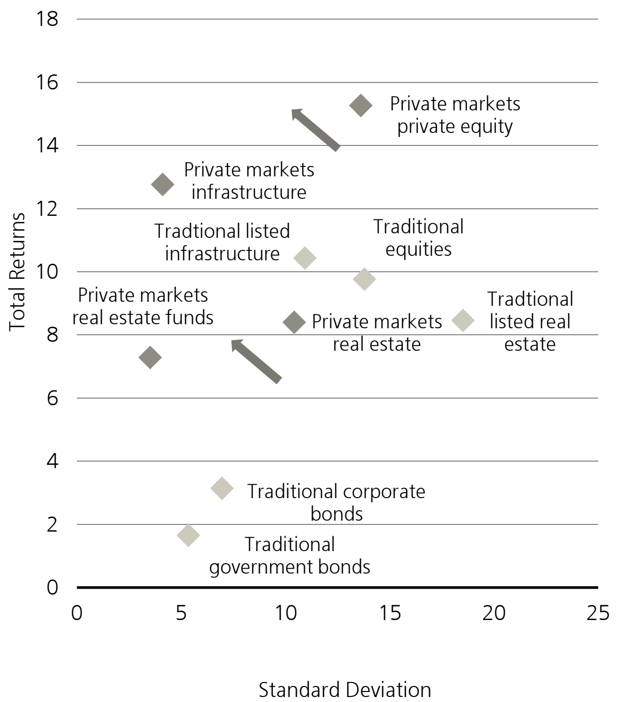
Investing only in listed equities limits investors' ability to gain exposure to fast-growing, upcoming companies which have not yet gone public. Innovation requires a significant amount of capital and private equity managers providing funding to companies at different stages of their lifecycle have a key role to play in building tomorrow's economy. Moreover, the number of PE-backed firms is increasing and reached nearly 11,000 in 2023, while the number of public listed firms is falling as companies remain in the private sector for longer and was just above 4,500 in 2023 (see Figure 1). This highlights the need for investors to consider exposure to private equity investments.

This broad pattern of companies delaying listings, or avoiding them altogether, is expected to continue. Hence, adding private equity into portfolios gives investors exposure to companies in their pre-public growth stages, in addition to their holdings in public markets.

The benefits of Private Markets

Improving the risk-return trade-off
Historically, private markets investments have exhibited both higher returns and lower volatility than traditional public markets investments (see Figure 2). This makes them attractive to investors who want to diversify their portfolios and use private markets to help reduce overall portfolio volatility. This is because private markets investments are not as strongly correlated with traditional asset classes as traditional assets classes are amongst themselves.

Figure 2: Global total returns and standard deviation
(13 years 2010 to 2022, local currency, % p.a.)

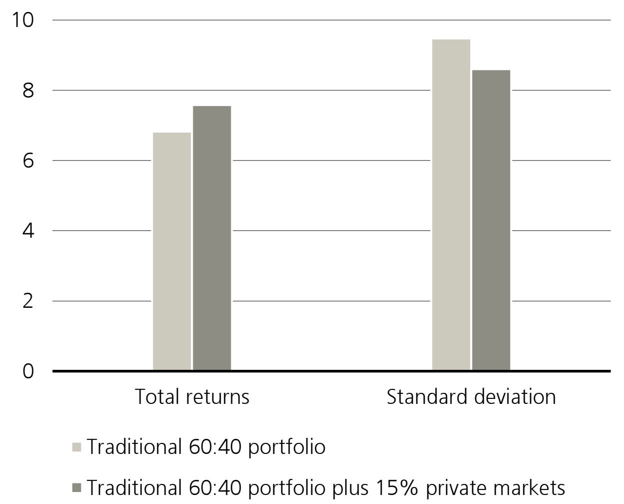


Source: MSCI; Global Listed Infrastructure Organisation; PitchBook; Refinitiv Datastream; UBS Asset Management, Real Estate & Private Markets (REPM), December 2023. Note: Private markets data is de-smoothed; private markets real estate refers to direct asset ownership; private markets real estate funds refers to real estate ownership via unlisted funds; standard deviation measures volatility in returns. **Past performance is not a guarantee for future results.**

Adding private markets investments to a traditional 60:40 equity-bond portfolio can enhance an investor's opportunity set and improve the risk-return trade-off, allowing investors to achieve a desired level of return for a lower level of risk (or a higher return for the same level of risk). In financial economics this possible opportunity set is referred to as the 'efficient frontier'.

Total returns for portfolios which include private markets investments have historically been slightly higher than those which do not, which sometimes creates the perception of risk among investors. However, volatility as measured by standard deviation in returns has been slightly lower for portfolios which include private markets due to their lower correlations with the 60:40 portfolio (see Figure 3).

Figure 3: Global total returns and standard deviation
(13 years 2010 to 2022, local currency, % p.a.)



Source: MSCI; PitchBook; Refinitiv Datastream; UBS Asset Management, Real Estate & Private Markets (REPM), December 2023.
Note: Private markets data is de-smoothed; private markets allocation is 15%, split equally between direct asset onwership real estate, infrastructure and private equity. **Past performance is not a guarantee for future results.**

Liquidity and valuation considerations

It is important to note that private markets investments are less liquid compared to the daily traded public markets in equities and bonds. Within private markets, liquidity varies from monthly for some real estate funds, to quarterly or annual for others, while capital can be committed to closed-end funds for ten years and more, depending on the asset class.

Accessing Private Markets

Accessing private markets requires a well-defined strategy, understanding the options available and how they can complement each other to meet overall investment objectives. It is important to consider the benefits of each private markets asset class individually, but also as a whole where their combined benefits can diversify portfolios.

Liquidity is also lower when investors hold assets directly rather than via a fund structure. Direct holdings of assets can take time to transact, and the ease of selling an asset can vary depending on market conditions. As such, investors in private markets typically have long term investment horizons and do not require the daily liquidity provided by public markets. In downturns it may not be possible to sell private markets investments, or only at a significant discount.

Another factor for investors to be aware of is how private markets are valued. Typically, private markets assets are valued by third party, expert appraisers, often based on the values of similar assets or companies which have recently traded. Valuations are normally released with a lag, unlike public markets which are daily priced.

This lag can lead to so-called "valuation smoothing", whereby valuations do not fully reflect actual transaction prices were an asset to be sold.

Over time a vast array of routes has been developed for investors to access private markets, allowing them to select the best option that meets their needs. These include direct asset ownership, club deals, funds, multi-manager or 'fund-of-funds' vehicles, separate managed accounts (SMAs), co-investments and other options. Multi-manager solutions allow investors to harness the expertise of specialist teams and get maximum global and sector exposure. SMAs allow investors to partner with specialist asset managers who can tailor actively managed solutions and strategies to meet their specific requirements.

Sustainability and Private Markets

Long term and specific measures with impact
Private markets have the potential for positive influence on both the environment and society, allowing investors to implement specific and impactful sustainability measures in ways they are unable to in public markets. Direct ownership of assets allows managers to take control of the direction of sustainability initiatives, which can also improve financial outcomes for investments. Moreover, many private markets investments are for the long term (10 years plus), which allows sustainability strategies (also typically long term) to be fully integrated into the life cycle of the investment and its strategy.

There are many areas in which private markets can drive sustainable outcomes. For example, driving decarbonization agendas in operation and construction of real estate. By providing energy infrastructure to manage the green transition to renewable energy sources is another area, with energy storage a key component of this. Decarbonizing transport systems is another way in which private market investment can contribute to the sustainability movement.

Life science real estate is key for the pharmaceutical industry in developing and manufacturing new treatments and drugs which improve people’s lives, a direct social impact. Cold storage is also critically important for delivery of perishable goods across the population, reducing food waste and impacting both environment and society. Another possibility is investing in private companies in climate tech or health tech. There are many opportunities in private markets which can allow investors to take on and shape ESG initiatives and to contribute positively towards a sustainability-led future.

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