Letter from London (Second of Two Parts)

THE LEAD | August 6, 2024

For a long-time practitioner and educator in the private capital space, there's nothing like engaging with sophisticated investors digging deep into nuances of the asset class. In London and the Midlands, these discussions centered around such questions as:

1. How will growth of private markets impact appetite in direct contribution plans and semi-liquid strategies?

2. Do investors have appetite for evergreen structures vs. term, levered vs. unlevered?

3. How should pension plans (and managers) incorporate sustainability into portfolios?

4. What are the fastest growing asset classes for UK investors?

5. What will the UK government's push into lending mean for privates?

We knew from previous visits that each investor has unique sensitivities and requirements. As with other jurisdictions, some plan managers like evergreen structures because they don't have to re-underwrite the same direct lenders with whom they are already comfortable. Due diligence is, after all, a laborious process. "It feels like just when we're wrapping up work on the previous fund, we're starting on the next one," one DC plan director told us.

Others appreciate the discipline of confirming their original assumptions. "We're very active with our managers," a client told us. "Things are always changing and having a new fund to consider affords us the chance to stay abreast of the latest developments and how they are impacting our managers."

Diversity is a critical element for pension funds. In private capital that means being able to invest in a wide range of assets. In the UK this also requires a balance between local and global concerns. According to a recent PLSA report, the government's emphasis on green transition and a national infrastructure plan is key to attracting new pension dollars.

Another active credit investor agreed, "Stable income with a sprinkling of sustainability is the key to public UK pensions. But we are here to pay the pensioner. Alts, infrastructure, and natural capital are very popular asset classes today. We like the stability of private credit. Being secured by the assets and cash flows is an upside relative to public credit."

What about fund structures? "We view our manager partnerships with an eye on alignment. Having more of a bespoke approach to funds is helpful. Does the manager originate unique assets more suited to our investment style? Can they be more flexible as market conditions change? Will they adapt their structures to us, rather than the other way around?"

Finally, one Midlands pension fund focused on the "private" nature of the asset class. "The illiquid premium is always helpful, and particularly now. Risk/reward makes a good deal of sense. Opportunities outside of public markets seem more numerous. And the role of an active manager in private credit can’t be overstated. You can achieve a steady income stream with relatively low volatility. In this market that’s very attractive.”