

KEYNOTE INTERVIEW

Not all evergreens are created equal



*Ensuring capital is effectively deployed while also meeting investors' liquidity demands is a challenge that requires expertise and scale, say StepStone Group's **Neil Menard** and **Miguel Sosa***

Q What evolutions are you observing in the so-called 'democratisation' of private markets, and how are these allocations sitting within retail investors' broader investment portfolios?

Neil Menard: I like to think of the evolution as the 'institutionalisation' of retail private markets, because – at least in our case – investors in evergreen vehicles are now obtaining access to exactly the same deals as large and sophisticated institutional investors, at the same time as and as part of the same transaction. They are effectively getting a true institutional experience.

SPONSOR
STEPSTONE GROUP

Against this backdrop, there is no doubt that allocations to private markets are increasing. Morgan Stanley recently revealed that private markets allocations among wealth clients have reached 7 percent, up from 5 percent a few years ago. That may not seem like much, but it is significant growth on a relative basis, and it shows that investors are starting to see the benefits that private markets can offer in terms of returns, lower volatility and enhanced diversification.

Public markets today are being driven by memes, media and momentum, and in that kind of volatile environment, private markets have become the ballast for investor portfolios. Even so, there is still a long way to go on education, as retail investors and financial professionals are still grappling with where these investments fit within their broader portfolios, and what they need to liquidate in order to meet these allocations. For example, is private equity a hedged equity allocation?

The private markets industry has done a decent job to date, but we need to continue to educate, educate, educate to ensure that investors understand

what they are investing in, and that financial professionals understand what they are putting in clients' portfolios.

As part of this need, we launched StepStone Academy, which we designed to introduce financial professionals to private markets. It offers a practical learning experience through webinars and structured modules, and has been a valuable resource for those looking to learn more.

Q What kind of mix is proving most popular with retail investors?

Miguel Sosa: Venture capital is understandably attracting a lot of attention. It is an exciting space and is at the forefront of some amazing technological developments, including but not limited to AI. Private equity is also proving popular, given its focus on larger, more established companies that continue to see robust growth, are cashflow positive and excel in their particular industry.

Another strategy that is increasingly garnering interest is infrastructure. Historically, infrastructure may have been viewed as somewhat uninspiring, but today it is at the epicentre of some of the biggest themes that are shaping our economies, including the shift to onshoring, the energy transition and, of course, the move to a more digital world. A whole backbone of infrastructure is required to support these trends, which brings a whole host of private equity opportunities alongside that.

NM: Just to add to that, I would say private credit has so far proven to be a popular kicking-off point for retail investors, because it's an asset class that they can readily understand. There has been a proliferation of private credit funds since the global financial crisis, when banks started retrenching from lending to private companies, and investors are benefiting from that trend.

Private equity then constitutes the next wave of evolution, as investors build their exposure to private markets, followed by venture capital and



Q Are you seeing increased appetite from institutional investors for these evergreen structures?

NM: We have definitely started to receive inquiries from some of our largest institutional investors. They are interested in using our evergreen funds to get allocated more quickly, with these vehicles acting as a way to get their cash deployed and 'in the ground' while they wait for capital calls. They are building this into their pacing models and their allocation policies.

We are seeing that interest from large institutions around the globe, and we are seeing it across all the private markets asset classes – private equity, venture capital, real assets, infrastructure and private credit.

MS: Private markets were historically available primarily to institutions because the barriers to entry were high, whether that was due to high investment minimums or investor accreditation rules. Many of these barriers have been lowered or removed with the advent of evergreen structures, creating real advantages for retail investors, but advantages for institutional investors too. Institutions can use evergreen funds to ensure immediate deployment and diversification, so I think we will see more interest in future from institutional investors when it comes to evergreen strategies.

infrastructure, if we were to put the asset types on a continuum.

Q What are the fund structures of choice when it comes to retail investors accessing private markets?

NM: It depends on the jurisdiction. In the US, 40 Act interval funds and 40

Act tender funds are dominating right now, while in Europe it's the ELTIF 2.0. The rationale behind these structures, of course, is to make products more convenient, efficient and transparent for investors, removing some of the challenges and barriers that have prevented retail investors from accessing private markets in the past.

In Europe in particular, however, it means the decision around structure has now become more important than the strategy itself. Distributors ask about the structure before asking about the investment thesis. We saw the same thing in the US when the shift towards interval funds began back in the mid-2010s. But we believe this will pass, and the investment thesis will ultimately be back at the heart of decision-making, as it should be.

Q These structures may be providing easier access for wealth investors, but what challenges do they present for managers?

NM: When an asset manager launches a closed-end institutional fund, they are having to solve for two things: risk and return. Semi-liquid vehicles, however, have to solve for risk, return and liquidity, or what we would call duration. Typically, they offer liquidity on a quarterly basis – up to 5 percent of fund NAV in some cases. What you don't want, as a manager, is to hold cash in anticipation of investor redemptions, as this cash drag can reduce performance. This is in part what happened during the early days of alternatives investing.

Managers need to be able to structure a portfolio in such a way that ensures investors' capital is deployed in the relevant asset classes, while still being able to meet liquidity demands.

Scale is also important when it comes to evergreen funds, because you need access to dealflow in order to put invested capital to work every month. Otherwise, you are going to end up holding too much cash. It's a challenge, and not all evergreen GPs are created equal. As a wealth investor or financial professional, you must do your investment diligence and make sure you understand who you are doing business with.

MS: I would add that it's not only a question of ensuring you have the necessary liquidity available during those windows in which fund investors can

“It isn't simply a case of putting private markets strategies into an evergreen fund, offering a window of liquidity and walking away”

MIGUEL SOSA

“The really interesting evolution is private markets' move into defined contribution plans”

NEIL MENARD

access their capital; it's also about managing the cashflows of the underlying investments. If an evergreen fund is making investments in long-duration private markets assets, it matters when the cashflows, or distributions, of those underlying assets occur.

Managers need the resources and the analytical tools to make sure that any proposed investment is at the right point of its cycle of commitments and distributions relative to the needs of the evergreen fund. That means scale and analytics are important.

Finally, not only do you need the resources available to manage those timings, you also need to be diversified across different types of private markets investments: primary investments

for times when the fund needs to be able to meet capital calls, and secondary investments for times when exposure can be deployed much more quickly. After all, it isn't simply a case of putting private markets strategies into an evergreen fund, offering a window of liquidity and walking away. A lot of thought and resources go into managing these evergreen vehicles.

Q How do you see evergreen and closed-end strategies co-existing in the long term?

NM: I think evergreen funds will continue to play a role in both the wealth and institutional worlds, but closed-end funds aren't going away either. Institutional investors have different time horizons and goals relative to retail investors, and so I believe that evergreen and closed-end strategies will continue to co-exist.

The really interesting evolution that is now underway in both the US and the UK, meanwhile, is private markets' move into defined contribution plans. Our private equity and private credit funds, for example, have recently been added to Aviva's pension scheme. These pension markets are worth trillions of dollars, and so that adoption process may prove transformative over the next two to three years.

At the same time, wealth allocations are only going to continue to grow. Morgan Stanley's client base is allocating to alts at 7 percent. More widely, the wealth channel is probably still only at 5 percent. The average institution, on the other hand, has a 30 percent allocation to private markets. Given the benefits that private markets offer in terms of minimising volatility while maximising diversification and returns, we think it is inevitable that the gap between these two allocation targets will narrow. ■

Neil Menard is a partner and president of distribution at StepStone Private Wealth Solutions, and Miguel Sosa is a managing director and senior investment strategist