iConnections

iConnections Institutional Investor Outlook Survey 2024

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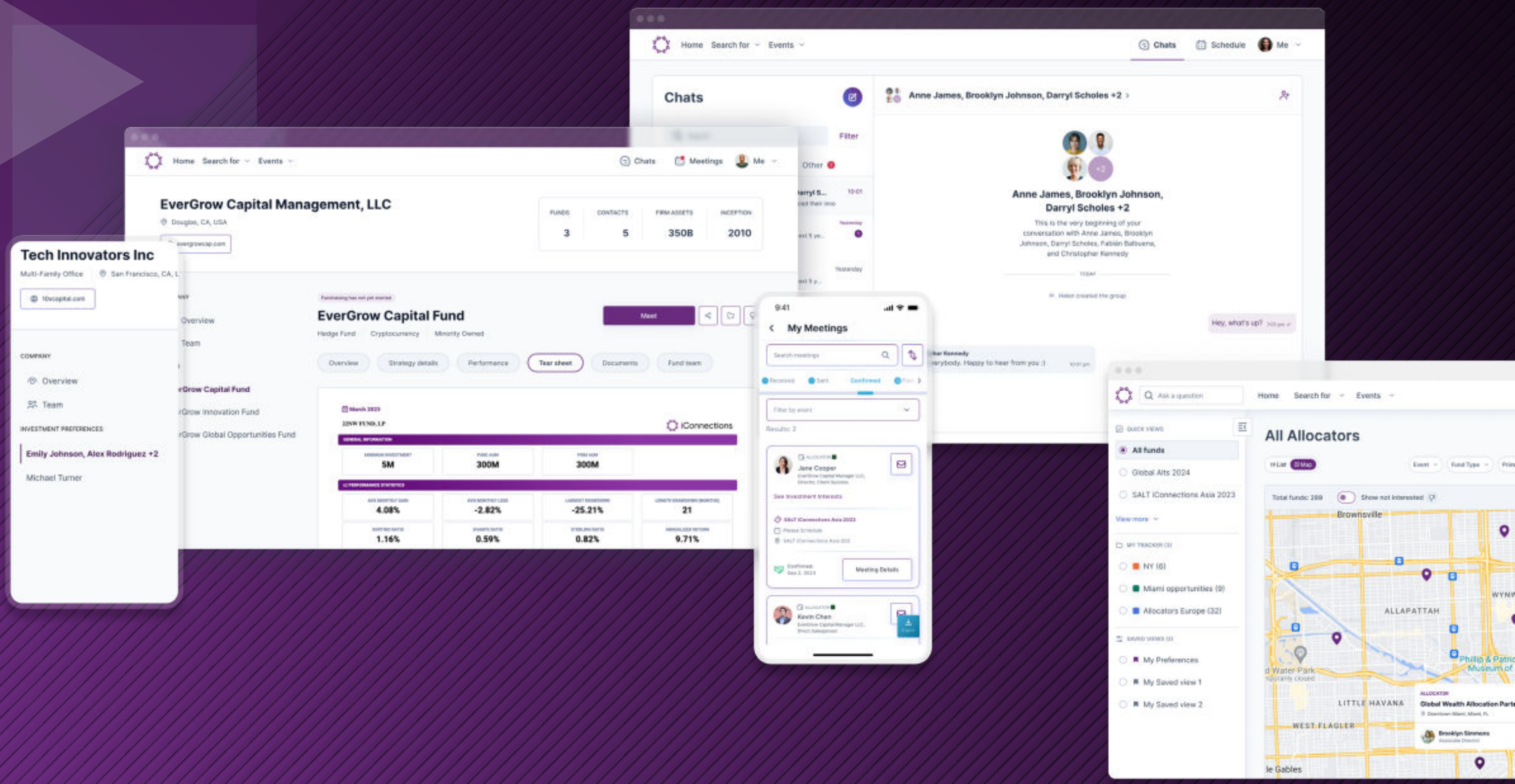


Survey Methodology

Alternative assets have grown to over $20 trillion in AUM as investors flock to private markets to capture attractive risk/return opportunities and tap into a universe of continued product innovation. Private equity, private credit and infrastructure are evolving at different speeds but collectively they offer investors an important diversification tool to compliment their exposure to more highly liquid hedge fund strategies.

With global megatrends (digitization, green energy) shaping the future of civilization, alternative assets should be ideally positioned to ride the wave of private investment over the coming years.

As evidenced in the iConnections Institutional Investor Outlook Survey 2024, LPs are broadly optimistic for the next 12 months, as they build their strategic asset allocations.

In February 2024, a total of 130 LPs were surveyed to find out how they would be positioning their portfolios in 2024.

Figure 1:
What type of firm do you work for?

From a size perspective, the largest representative group was institutions with assets under management of between **$1** billion and **$4.99** billion, accounting for 22% of the overall survey set.

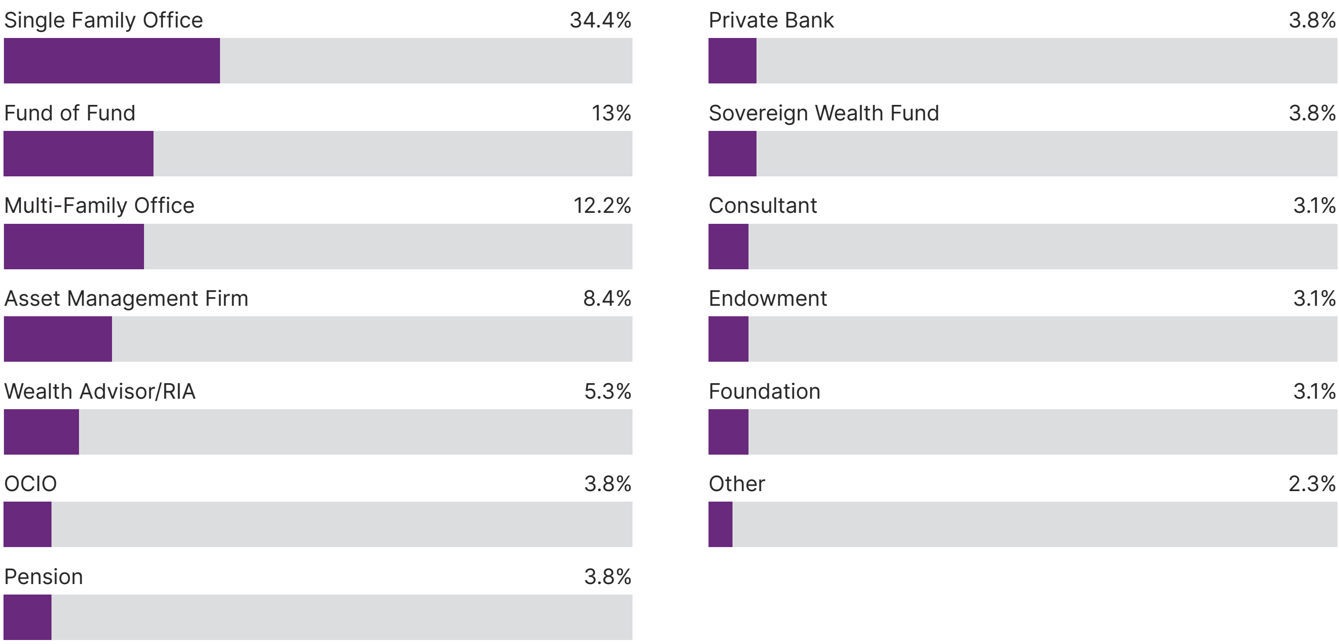
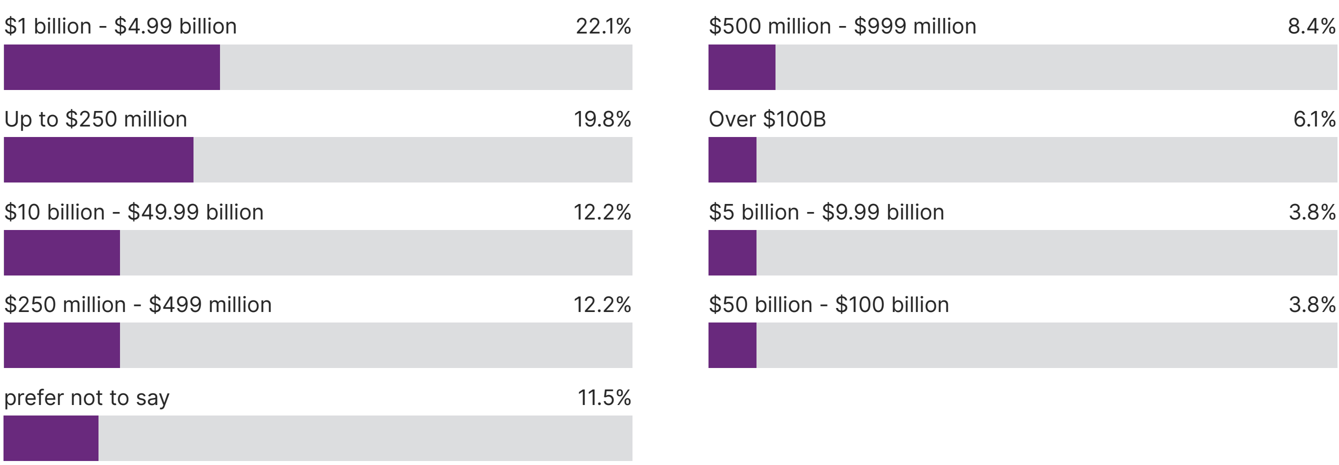


Figure 2:
What are your institution's assets under management/advisement?



Asset class positioning

Allocators have to weigh up a myriad of factors when determining their investment objectives. This is no less true when the world is experiencing a period of significant instability, as regional conflicts and changing power dynamics blur the lens through which they look at their asset class mix.

When asked what their 2024 outlook is for hedge funds, private markets and digital assets, the highest level of optimism was reserved for hedge fund strategies, at 53%, compared to 46% for private markets. It is worth noting that this figure is slightly higher than in last year's survey report, where 37% of respondents were optimistic on private markets. Year-on-year, sentiment towards hedge funds remains largely unchanged.

While digital assets have shown signs of improvement, led principally by Bitcoin's 200% price rally over the last 12 months, which has seen it rise from $20K to $67K (at the time of writing), investors remain broadly neutral on the asset class.

Figure 5:
What is your 2024 outlook for:

	Very Optimistic	Optimistic	Neutral	Pessimistic	Very Pessimistic
Hedge Funds	12.2%	53.4%	31.3%	3.1%	0%
Private Markets	12.2%	45.8%	34.4%	6.9%	0.8%
Digital Assets	2.3%	18.3%	51.9%	17.6%	9.9%

As to how this sentiment will influence their positioning in 2024, one third of the survey's respondents plan to increase their allocations to hedge funds and private market funds by up to 5%. What is noteworthy is that a higher percentage (35%) expect to increase their allocation to private market funds by 10% or more, signalling continued interest in the asset class as investors look to tap into illiquidity premia opportunities. It is also worth noting that 42% of LPs plan to make modest increases to digital assets, despite their broadly neutral view.

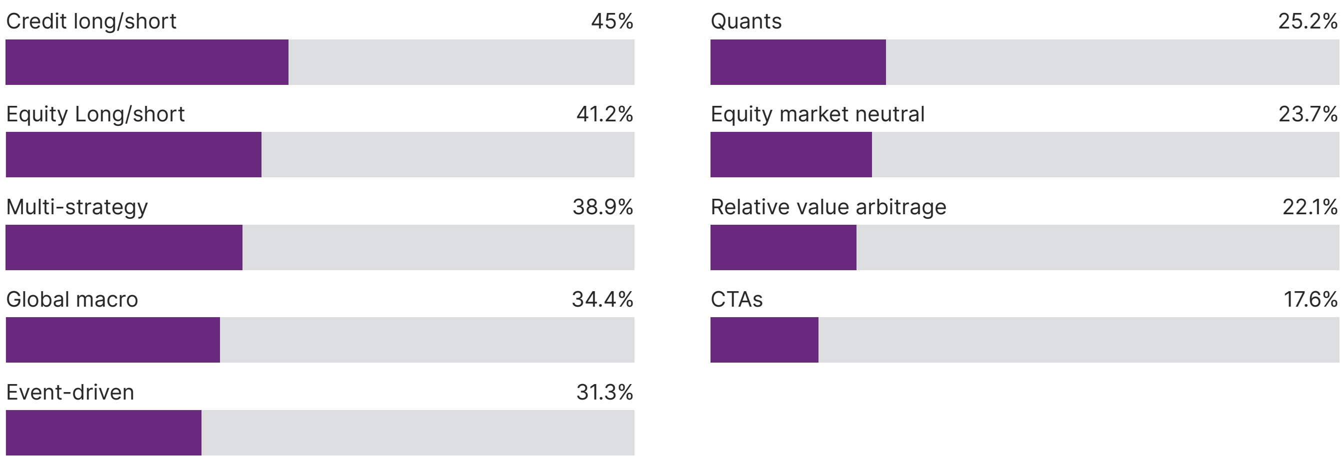
Figure 6:
What are your planned changes to net positions in 2024:

	0- 5%	5-9%	10% or more	0 to -5%	-5 to -9%	-10% or more
Hedge Funds	35.9%	19.1%	25.2%	12.2%	2.3%	5.3%
Private Markets	35.1%	13.7%	35.1%	14.5%	0.8%	0.8%
Digital Assets	42%	2.3%	7.6%	42.7%	0.8%	4.6%

Respondents were given the opportunity to select more than one option when asked what hedge fund strategies they would be favoring over the next 12 months. Credit long/short and equity long/short came out on top, suggesting that investors see the current market volatility as a good opportunity for active managers to generate alpha. As reported by Reuters, equities and credit-focused strategies were the best performers in 2023, with the industry at large generating average returns of 5.7% through November.

Multi-strategy, global macro and event-driven rounded out the top five strategies. CTAs were regarded as the least preferred strategy.

Figure 7:
Which hedge fund strategies will you be favoring in 2024?



Within private equity, lower and middle-market buyout funds were chosen as the clear preference, representing 63% of responses. This was followed by growth equity funds, which typically involve taking minority stakes in venture-backed companies to fund expansion into new markets and acquisitions.

Large-cap buyouts were found to be the least preferred strategy. This could be for numerous reasons: accessibility, capital commitment size, a slower M&A market and a lack of IPO activity, which was down 21% on the previous year.

Figure 8:
What private equity strategies will you be favoring in 2024?

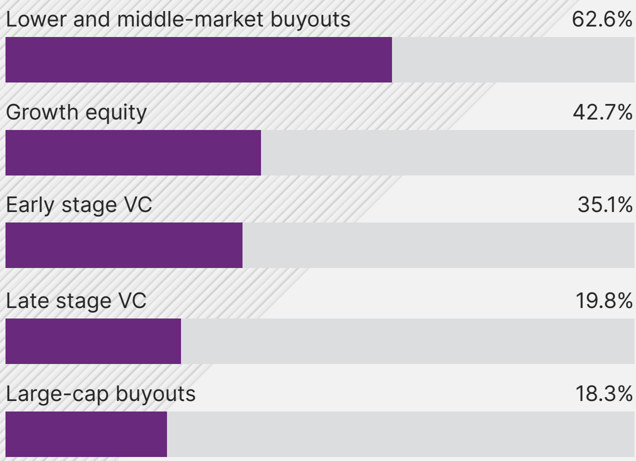
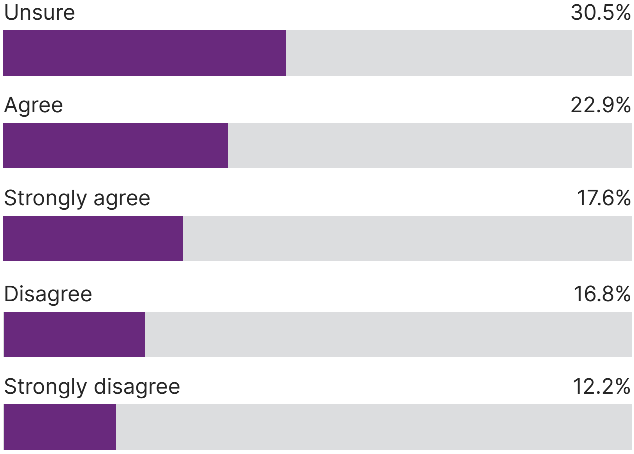


Figure 9:
Do you expect to use secondary markets to help manage liquidity for your alternative investment programs in 2024?



Last year, investors had to deal with the denominator effect in their portfolios. This happens when one portion of their overall portfolio (i.e. public equities) falls in value, leading to a higher weighting in non mark-to-market assets like private equity. As a result, it can push PE exposure beyond an investor's target allocation and reduce further fund commitments.

To overcome this, investors have increasingly turned to secondary markets, to free up liquidity and reduce their total exposure, giving them the opportunity to invest in new vintages: made all the more easier by the strong equity rally seen since October 2023.

Whilst the denominator effect is principally a pension fund-related issue, given their strict governance frameworks, the broader LP community has still come to recognize the benefits of PE secondary markets. Some 40% of survey respondents either 'agreed' or 'strongly agreed' that they expect to use them to manage their liquidity in 2024.

Private credit is an asset class that has enjoyed significant tailwinds in recent years, growing to $1.6 trillion. With Apollo's chief executive Marc Rowan noting that "debanking" is still in its infancy, the future growth trajectory of private credit appears strong.

As investment banks reduce leveraged loan volumes on their balance sheets, private equity sponsors are increasingly turning to private credit managers to finance buyouts.

With their floating rate component, direct lending funds have benefited from the higher interest rate environment. Although rates are expected to fall in 2024, investors are still optimistic with 35% confirming that direct lending opportunities still offer strong return potential.

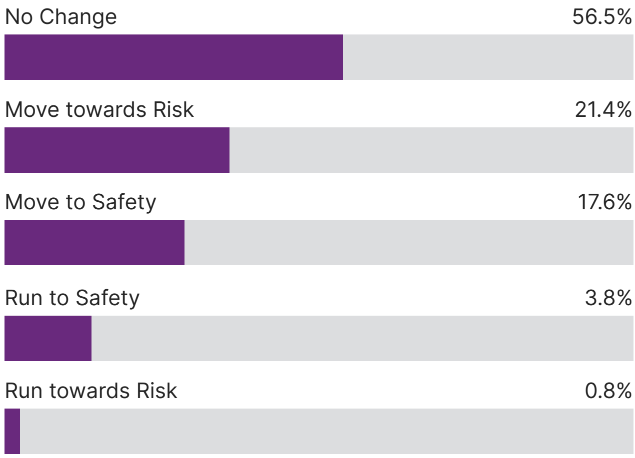
One in five respondents also see opportunities in distressed credit, as a wave of loan refinancing looms large.

Figure 10:
What would be your primary reason for feeling bullish on private credit in 2024?

Manager & Portfolio Insights

Portfolio construction considerations in 2024 remain a key priority, as allocators look to build new GP partnerships, whilst at the same time reinforcing existing ones. Getting access to the right strategies within alternatives requires a lot of strategic decision-making, blending strategies that can enhance the portfolio's risk/return profile. Despite the challenging macro environment over the last 12 months, 56% of respondents confirmed that their overall approach has remained unchanged. Only one in five said they had increased the risk profile of their portfolio, with 17% moving to safety.

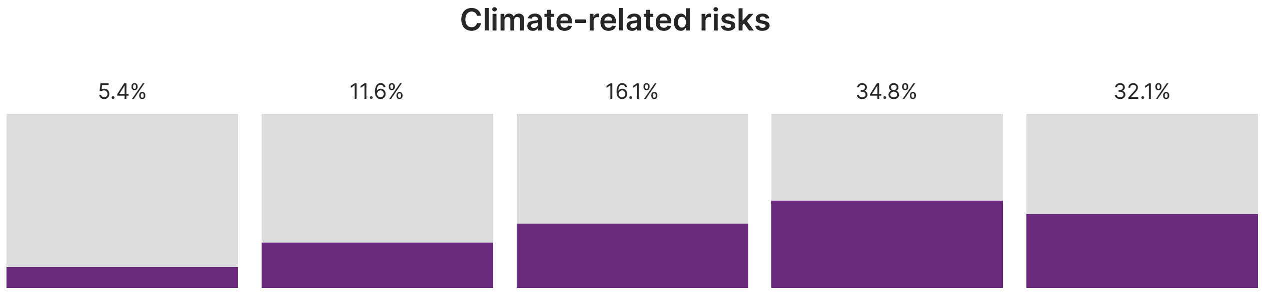
Figure 11:
Given the challenging macro environment, how has your investment strategy approach changed over the last 12 months?



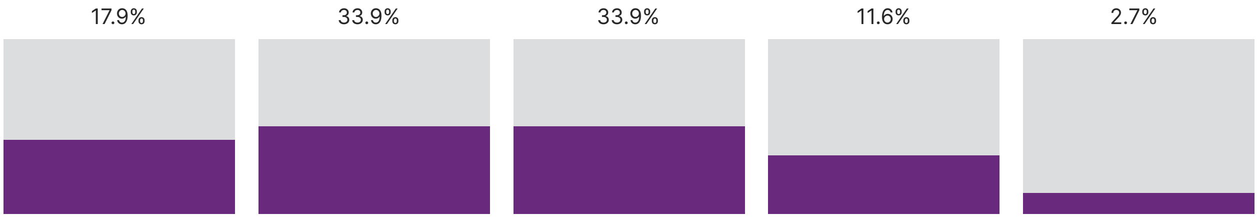
This is not to overlook the fact that investors are unconcerned by global instability, and what the economic growth prospects could look like going forward. In this year's survey, investors were presented with five options and asked to rank them on a scale of one to five, with one representing the highest impact.

Recessionary fears were cited as having the highest impact on portfolio construction (45%), followed by fund managers' ability to hit their hurdle rate (30%). Climate-related risks and blockchain-related investments were deemed to have the least impact on portfolio construction. Although the $1 trillion Infrastructure Investment and Jobs Act is expected to usher in a wave of new investment opportunities across the US, investors remain broadly neutral.

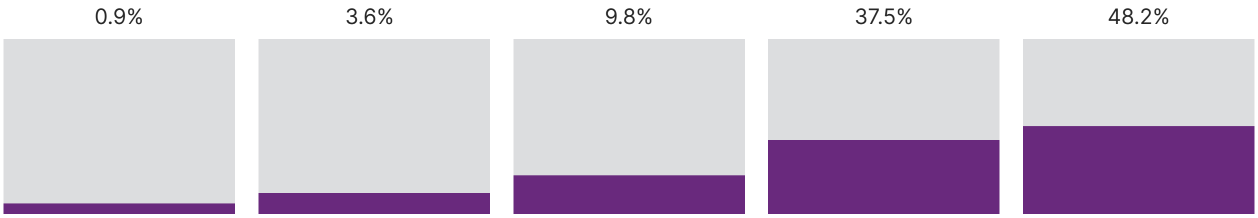
Figure 12:
What do you expect to have the biggest impact on portfolio construction?



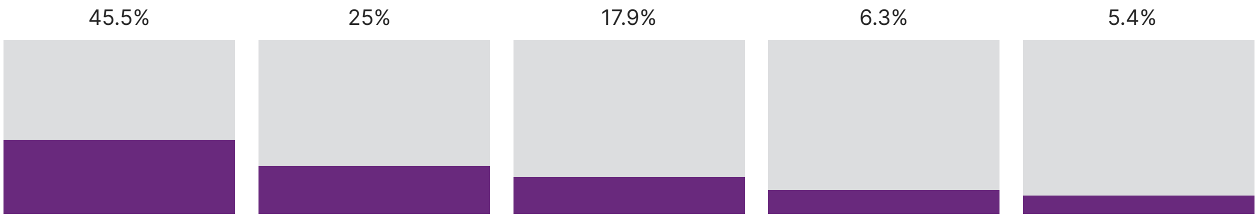
$1 trillion Infrastructure Investment & Jobs Act



Blockchain and a rising price in Bitcoin



Recessionary fears



Managers’ ability to hit their hurdle rate

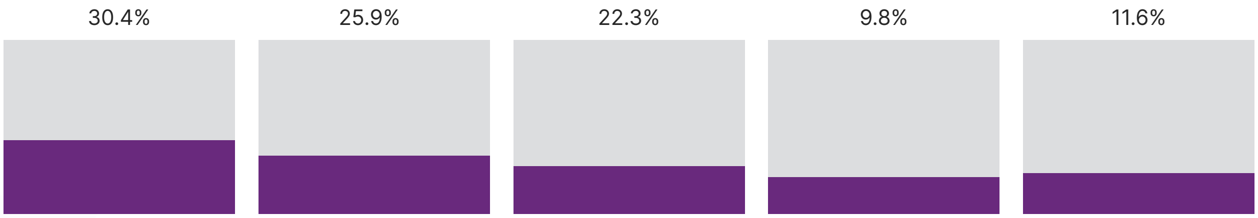
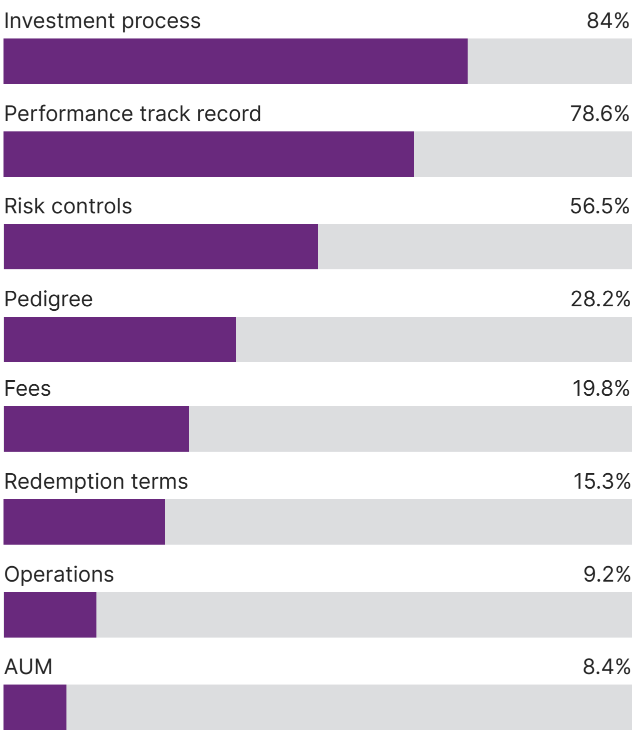


Figure 13:
What are the key drivers for evaluating fund managers?

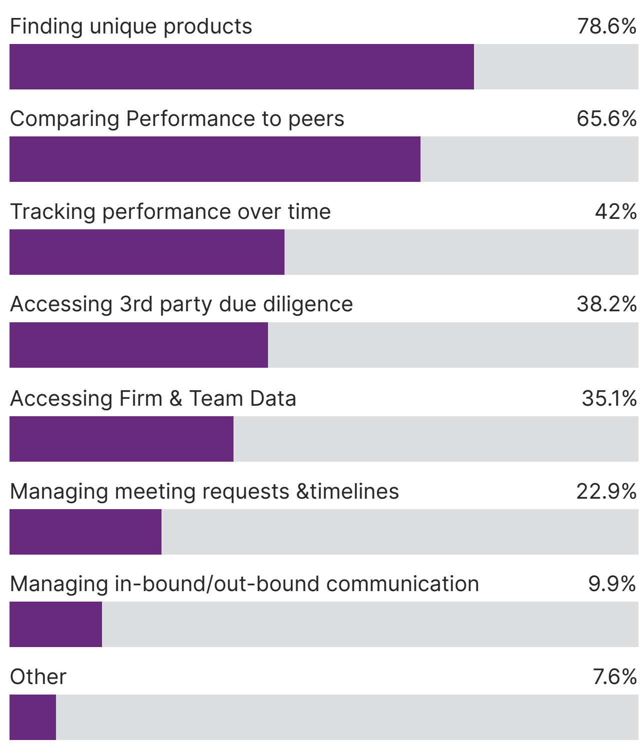


Survey respondents were asked to choose their top three factors for evaluating fund managers. Investment process was the single most important consideration. This underscores the importance of fund managers' ability to clearly articulate their value proposition; what is unique about their investment strategy? Investors want to know how managers think about differentiating their respective firms in today's marketplace; more so than track record, which came in as the second highest priority, followed by risk controls.

To further highlight the importance of the investment process, 79% of respondents said that finding unique fund products was the biggest challenge when evaluating new fund strategies. In a crowded market, investors are looking for fund managers to come up with original strategies that catch their eye; it is an important finding for managers to take on board, as they approach their fundraising process in 2024.

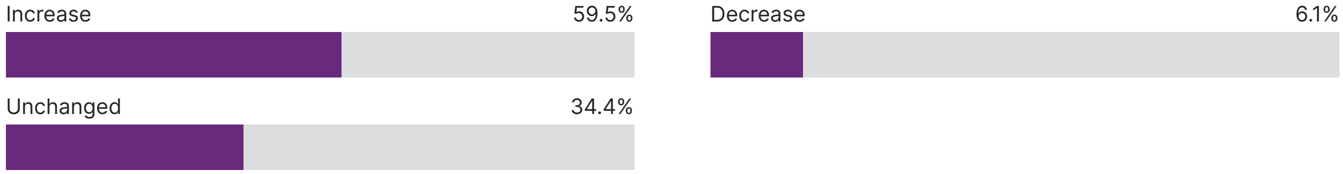
Benchmarking performance was cited as another key challenge, according to two thirds of respondents. This is potentially more of an issue in illiquid private markets, where fund data is more difficult to come by to assess peer groups, and determine best-in-class performers.

Figure 14:
What is the biggest challenge when evaluating a new fund strategy?



Despite the complexities of evaluating managers and building asset class exposure, six out of 10 survey respondents remain committed to expanding the number of GP relationships in their respective investment universe, with one third choosing to maintain the status quo.

Figure 15:
Are you planning to increase or decrease the number of GP relationships in your existing portfolio?



With North America and Europe being home to many of the world's leading fund managers, we wanted to canvass LPs' views on Asia Pacific, and the Middle East's increasing rise to prominence; led by Abu Dhabi, with its strategic focus on becoming the 'Capital of Capital'. Indeed, hedge fund giants' TCI and Brevan Howard have set up offices in the UAE capital, as well as Ray Dalio's family office. Dalio recently referred to the UAE as a 'renaissance state'.

This is still early days, however, with the region far from being an established fund hub. Some 20% of respondents said they viewed the region as still important but were not expecting any material change to their allocation plans in 2024. Sixteen percent of LPs said the Middle East represented 'high' or 'considerable' importance. Asia Pacific remains, for now, a higher regional priority.

Figure 16:
How important are the following regions to your overall alternative asset allocation plans for 2024?

	High strategic importance	Considerable strategic importance	Still important but no material change	They are becoming less important	Low strategic importance
Asia Pacific	11.5%	19.8%	32.8%	9.9%	26%
Middle East	8.4%	8.4%	21.4%	9.2%	52.7%

Over half of this year's survey respondents said hedge funds were their preferred asset class in Asia Pacific. A similar percentage cited their interest in private equity/VC in both regions.

Figure 17:
Which of the following regional investment opportunities are you most interested in?

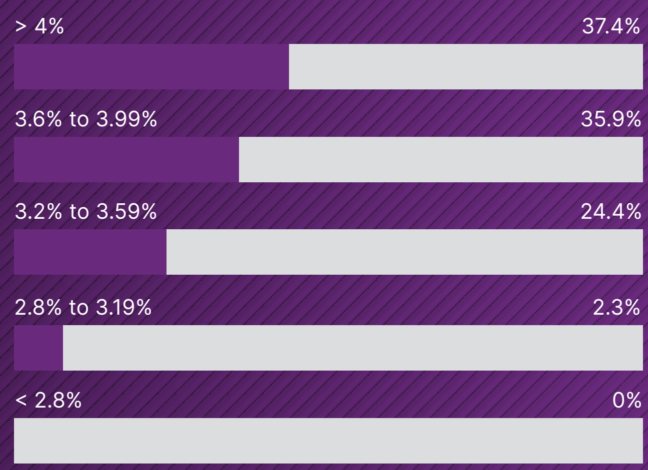
	Hedge Funds	Infrastructure	Real Estate	Private Equity/VC	Private Debt	Digital Assets
Asia Pacific	56.5%	23.7%	18.3%	33.6%	22.1%	4.6%
Middle East	35.9%	27.5%	17.6%	31.3%	11.5%	4.6%

Market/Economic Insights

It has been quite a rollercoaster ride for bond market investors in recent times. Last year, yields in US 10-year Treasuries reached their apogee when, in October, they hit 4.98%: a 16-year high. A Q4 rally then ensued, with yields ending the year at 3.8%. So far, in Q1 2024, bond yields have tended to trade between 4% and 4.3%, as the markets anticipate when the US Federal Reserve will make its first rate cut; expected "some time this year" according to Fed Chair Jerome Powell.

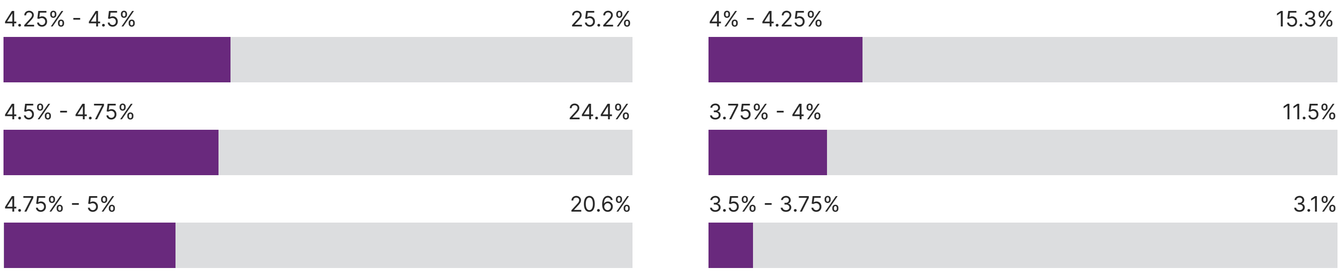
In light of this, respondents were asked to give their prediction on where they think the US 10-year bond yield will be at the end of the year. There was no clear consensus, with one third expecting it to be north of 4%, and one third expecting it to be between 3.6% and 3.9%.

Figure 18:
Where do you think the US 10-year bond yield will be at the end of 2024?



As to where they think the Federal Funds Rate will be at the end of the year, this too elicited a range of responses. One quarter of LPs were quite bullish on how far the Fed would cut rates, choosing 4.2% to 4.5%. A similar percentage of respondents expect it to be within the 4.5% to 4.75% range, with one in five taking a more conservative stance, anticipating that it would be 4.75% to 5%.

Figure 19:
Where do you think the Federal Funds Rate will be at the end of 2024?



This relatively bullish sentiment on the US economy is further evidenced by LP expectations on where the S&P 500 will finish at the end of the year.

Presently, the S&P 500 is trading at 5,168 having rallied strongly since mid-October when the market was trading just above 3,500. Some 47% of survey respondents think the stock market will be between 5,000 and 5,500, with one third expecting it to be between 4,500 and 5,000.

One quarter of LPs believe the risks of a US recession will be less than 20%. A further 40% estimate the risk to be 20 to 40%, suggesting that overall sentiment – in this important Presidential Election year – remains upbeat.

This has certainly been helped by the AI revolution, as witnessed by the turbocharged price performance of Nvidia (up 283% over the last 12 months) and the overall performance of the 'Magnificent Seven'.

Figure 20:
Where do you think the S&P 500 will be at the end of 2024?

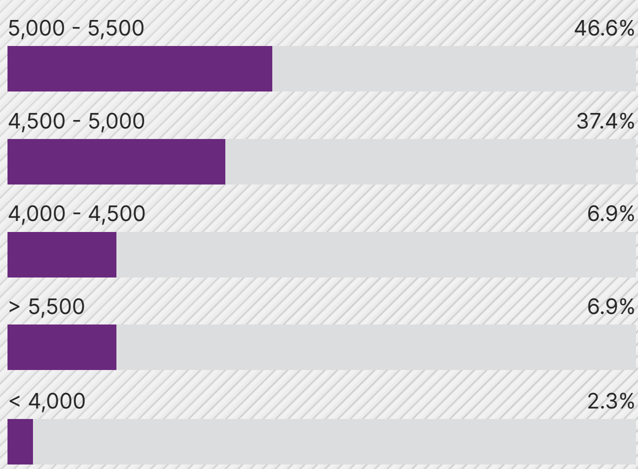
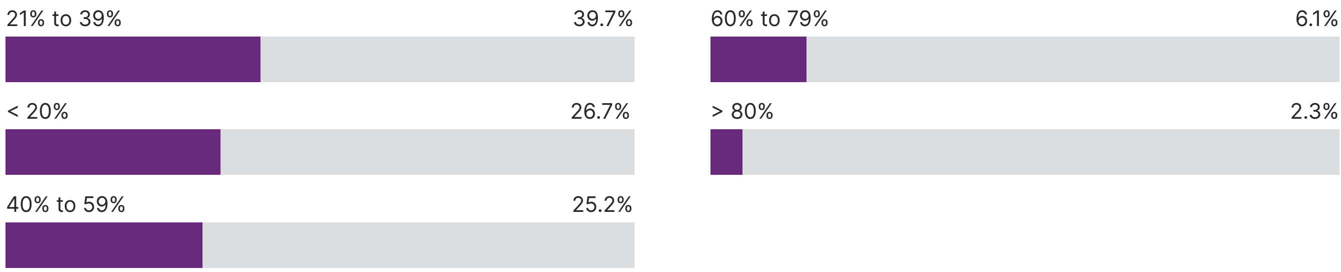


Figure 21:

In percentage terms, how likely do you think the US will experience a recession in 2024?



Conclusion

Looking at current market conditions, it is evident that allocators are navigating a complex terrain of global instability and shifting market dynamics. Despite this, optimism towards hedge fund strategies has notably increased, with a clear intention among LPs to bolster allocations to both hedge funds and private markets.

This suggests continued confidence in GPs within their investment programs to seek out alpha-generating opportunities, with LPs favoring credit long/short and equity long/short strategies. Furthermore, the rising prominence of private credit funds, coupled with the increasing utilization of secondary markets to manage liquidity, underscores a strategic flexibility among investors to capitalize on evolving opportunities.

Within private credit, direct lending strategies, distressed debt/special situations and asset-backed lending strategies are the most popular options, while in private equity, there is a clear demand for lower and middle-market buyout funds this year, over and above growth equity and large-cap buyouts.

As investors consider portfolio construction, it remains the case that GPs' investment process and track record are a high priority. Finding unique fund products is by far the biggest challenge for LPs, even though this year 60% of survey respondents confirmed they would look to increase the number of GP relationships.

With a broadly 'cautiously optimistic' view of the US economy for 2024, there are plenty of signs that investors remain convinced that alternative assets will have a vital role to play in meeting their long-term risk-adjusted return targets.

One final data point worthy of mention – and which points to the continued evolution of alternative assets – is the level of optimism among investors in terms of private wealth converging with private markets. As the figure below shows, 40% see it as a significant opportunity. Could this be a trend that continues to gather pace? It is something all GPs will doubtless be paying close attention to, as they think about future product development.

Figure 21:
How big an opportunity do you think private wealth investors will have to access private market funds, as the industry further democratizes?