PRIVATE MARKETS INVESTING: 4 TRENDS SHAPING THE FUTURE

Private markets investing continues to move towards the mainstream of the funds industry – with intense competition, investor appetite and digitisation helping drive efficiency and innovation throughout the financial ecosystem, says **Clive Bellows**, at Northern Trust.

Northern Trust's role as asset servicer to global fund managers and asset allocators provides us with a first-hand view of key developments shaping the evolution of the investment industry including ongoing regulatory and market structure changes, shifting asset allocation trends and technological advances.

Among these trends, growth in private markets investing – in private equity, private debt, real estate, infrastructure, and other specialist asset classes – is a distinctive shift of the past 20 years. It continues to gather pace: the value of private markets is projected to reach more than $15 trillion by 2025, and over $18 trillion by 2027, up from $7.4 trillion in 2020[1].

Readers will be familiar with the reasons – returns on private markets investing have been shown to be greater than traditional asset classes[2] through factors including managers' ability to identify undervalued opportunities and proactively manage investment outcomes through direct ownership.

Private markets have demonstrated inoculation to broader conditions through both bull and bear markets through managers' focus on targeting sustainable growth, over long-term holding periods. Allocators are increasingly looking to these investments to help match their liabilities to assets over long-term horizons.

Market conditions are also driving new behaviours as fund managers seek to access fresh sources of funding and allocators seek to maximise value on investment. These pressures are also driving innovations in fund structures, technology, and operating models.

Here are four significant trends we observe as private markets investing continues to move towards the mainstream of the funds industry – all with broad-reaching ramifications.

1 Investors are demanding heightened transparency and technology. For years, asset allocators have leveraged private investments for portfolio diversification, but many struggled with their relative opaqueness as illiquid asset classes, and the associated transparency and valuation issues.

Allocators are now seeking heightened transparency, and for many this means a consolidated view of their fund's exposure across both traditional and private investments, along with confidence that the data is timely and representative of real-time scenarios. Today's solutions make it possible to integrate data and portfolio analysis for private and public assets and close the transparency gap between private and traditional investments.

Tools that were passable when a small percentage of a portfolio was dedicated to private markets are obsolete, as today's technology solutions can transform this experience. For example, we are seeing successful AI-driven automation initiatives, from automating the capture of investor statements off web portals to leveraging machine learning techniques that transform them into usable data.

New technology is also helping automate and digitise the cumbersome processes on which managers of private market funds have long depended, such as manual checks for order confirmations or to confirm investor onboarding details. Solutions such as digital portals make these obsolete by accelerating lifecycle processes, smoothing administration, and providing secure channels for data exchange.

Market entrants without robust operating models and technology infrastructure, or the support of suitable partners to assist, will likely find it more challenging to launch funds and retain clients.

2 Semi-liquid funds are in the spotlight. Private assets' shift to the mainstream of the funds industry is driving demand for products to deliver private market exposure with a measure of liquidity. 'Semi-liquid' funds – investing in a hybrid asset mix of public and private assets and offering redemption facilities through open-ended funds or limited liquidity vehicles – are rising in prevalence as a result.

This trend is being led by investor appetite but also by how governments are viewing semi-liquid funds as a solution for some of the financial, economic and infrastructure challenges facing their countries – to channel money into sustainable infrastructure and contribute to achieving public policy objectives.

Europe is experiencing strong interest: in the EU, semi-liquid funds are viewed as helping channel capital towards long-term investments that promote the European Green Deal in line with the EU's objective of achieving smart, sustainable, and inclusive growth. The UK Government's 2023 Mansion House Reforms[3] targeted for defined contribution pension providers to commit to allocating 5% of assets in their default funds to unlisted equities by 2030 – a commitment that is helping drive high volumes of fund launches.

Consequently, the EU's European Long Term Investment Fund (ELTIF) and the UK's Long Term Asset Fund (LTAF) fund regimes have been updated to broaden their reach and appeal as purpose-built entry points for investors in more illiquid assets. We see substantial interest from managers in using these vehicles to launch funds, and from institutional and retail investors in accessing them. In the US, structures such as interval and tender offer funds fulfil a similar role and may similarly come to the fore.

However, while these frameworks are in place, managers face the challenge of implementing their product ideas using vehicles and processes that in some areas have only been tested at limited scale. Operating an open-ended fund with limited investor redemption cycles also comes with the unique challenges, of providing investors with regular access to their holdings, while still trying to generate the premium associated with holding long-term illiquid assets.

3 Democratisation of ownership is looming. Growth in semi-liquid funds is part of a trend driving the evolution of private market investors. Today these largely comprise institutional and high net worth individuals but will likely evolve to include a broader community of public investors.

Traditionally, managers of private capital funds operate high-value, low-volume operations with small numbers of investors investing high values. 'Democratising' private markets potentially turns this on its head, instead bringing-in large numbers of investors committing smaller investment amounts.

This will present operational challenges for managers: for example, ensuring compliance with applicable regulations while managing higher volumes of investors than they may have traditionally been faced with while meeting the requirements of Know-Your-Customer and Anti-Money Laundering regulations or MiFID II appropriateness tests.

4 Tokenisation could drive significant benefits. Tokenising real-world assets also presents opportunity to unlock value in private markets. Tokenising assets can enhance their liquidity by enabling fractional ownership – helping replace many transfer-of-asset ownership processes using intermediaries between the seller and buyer. Benefits include realising illiquidity discounts and lowering management costs.

Real-world assets are increasingly being listed and traded on many blockchain platforms. For example, Northern Trust recently launched The Northern Trust Carbon Ecosystem™ to allow institutional buyers to digitally access carbon credits from leading project developers. Currently, most of these chains are isolated and operating on their own protocols, making it difficult to trade across different chains.

To scale digital asset trading and reach critical mass, our industry will need to enable interoperability across chains, to increase connectivity and partnerships across the financial ecosystem.

As ever, our role as our clients' asset servicer will be to help ensure investments are undertaken within appropriate regulatory and governance frameworks – while supporting their requirements for the safekeeping, process efficiency, transparency, and insight that they receive today.

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[1] S&P Global: Private Markets – A Growing, Alternative Asset Class; [2] BVCA: Private capital performance, September 2024; [3] UK Government: Mansion House 2023, 11 July 2023