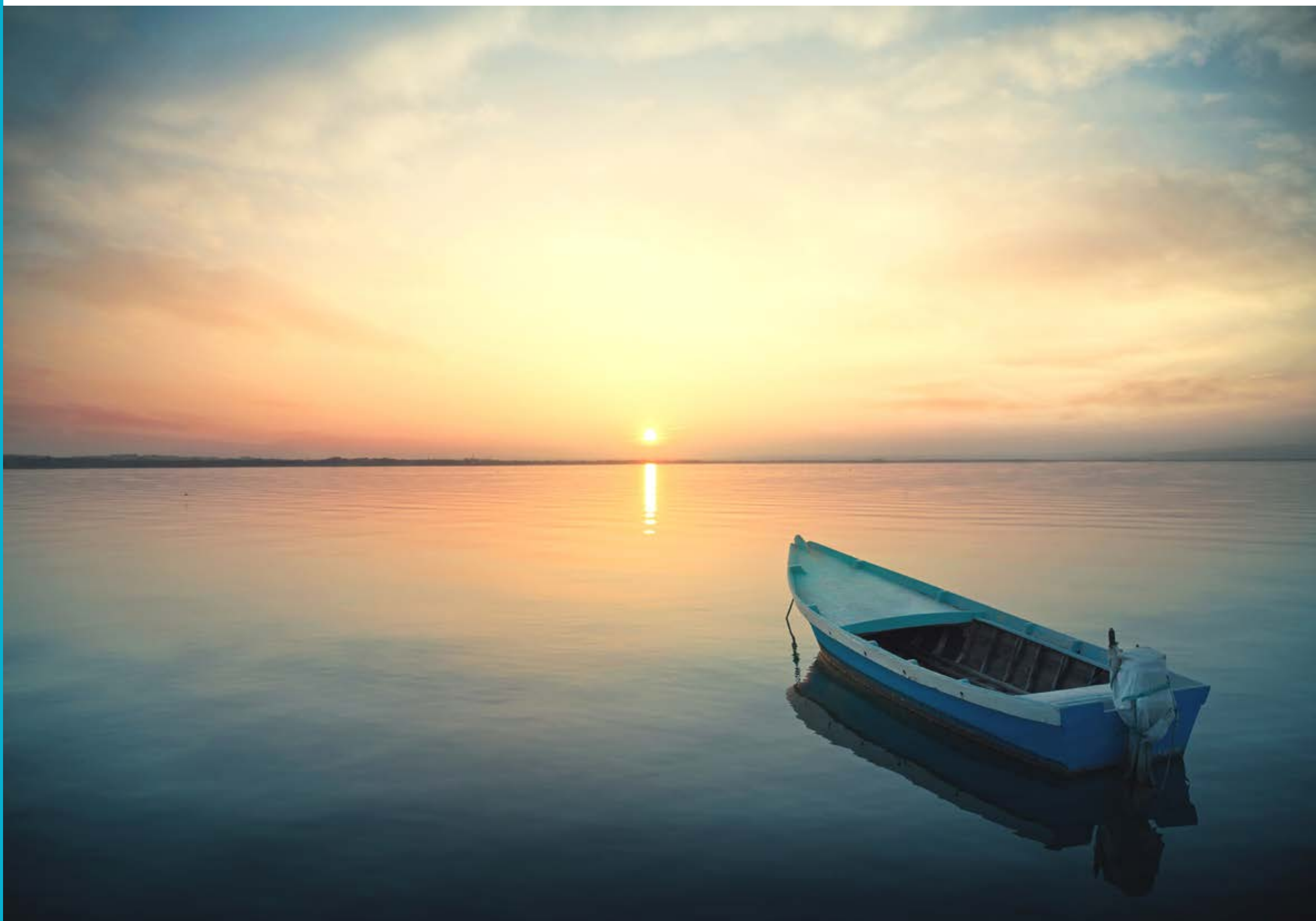
Preqin Investor Outlook: Alternative Assets
H1 2016



Private Equity | Hedge Funds | Real Estate | Infrastructure | Private Debt | Natural Resources

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Contents

Data Pack for Preqin Investor Outlook: Alternative Assets, H1 2016

The data behind all of the charts featured in the report is available for **free** in an easily accessible data pack. It also includes ready-made charts that can be used for presentations, marketing materials and company reports.

To download the data pack from Preqin's **Research Center Premium**, please visit:

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Foreword

The alternative assets industry continued to grow in size in 2015, with alternative assets fund managers now managing an all-time record $7.4tn, up $500bn from this time a year ago. This increase in assets has been driven by investor demand as institutions globally look to further diversify their portfolios to include an ever wider range of asset classes to generate strong returns, reduce volatility, act as an inflation hedge and deliver reliable income.

This report brings together the results of a series of in-depth interviews with over 460 institutional investors, conducted by Preqin's analysts for the latest editions of the **Preqin Global Alternatives Reports**. This has enabled us to provide detailed information on investors' portfolios, future plans, confidence in different asset classes, concerns for the future and more.

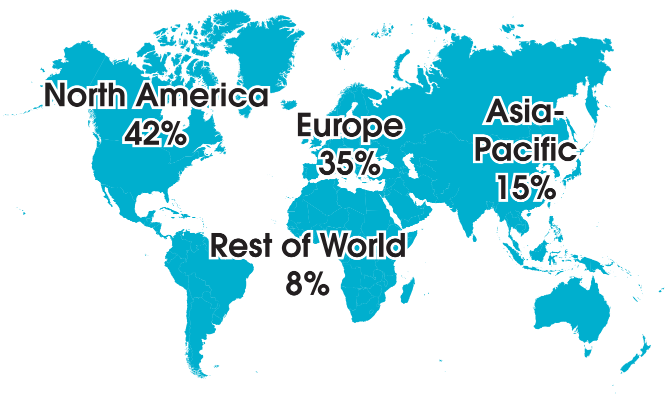
Real assets are becoming an ever more important part of most sophisticated investors' portfolios, and in addition to real estate and infrastructure, there is growing interest in energy, mining, timber and agriculture exposure. As a result of this surge in interest, **Preqin Investor Outlook: Alternative Assets, H1 2016** examines investors' views on natural resources for the first time, as well as their outlook for private equity, hedge funds, real estate, infrastructure and private debt.

In addition to chapters dedicated to institutional investors, the **2016 Preqin Global Alternatives Reports** cover fundraising, performance, deals, fund managers, secondaries, fund terms, placement agents, consultants, service providers and more across the private equity, hedge fund, real estate, infrastructure, private debt and natural resources asset classes. To get your copies of the reports, please visit: www.preqin.com/reports.

We hope you find this report informative and valuable, and would welcome any suggestions for future editions. To find out how Preqin's services can help your business in 2016, please do not hesitate to contact at us at info@preqin.com or at our New York, London, Singapore, San Francisco or Hong Kong offices.

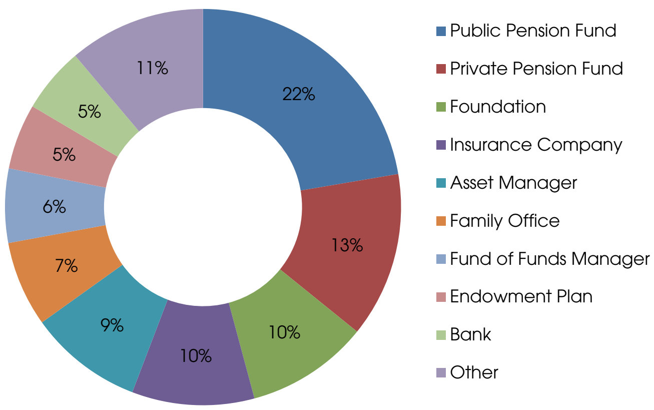
Breakdown of Respondents

Respondents by Investor Location



Source: Preqin

Respondents by Investor Type



Source: Preqin

2016 Preqin Global Alternatives Reports

The **2016 Preqin Global Alternatives Reports** are the most comprehensive reviews of the alternatives investment industry ever undertaken.

The Reports are an essential tool for anyone seeking to understand the latest developments in the private equity, hedge fund, real estate, infrastructure, private debt and natural resources asset classes.

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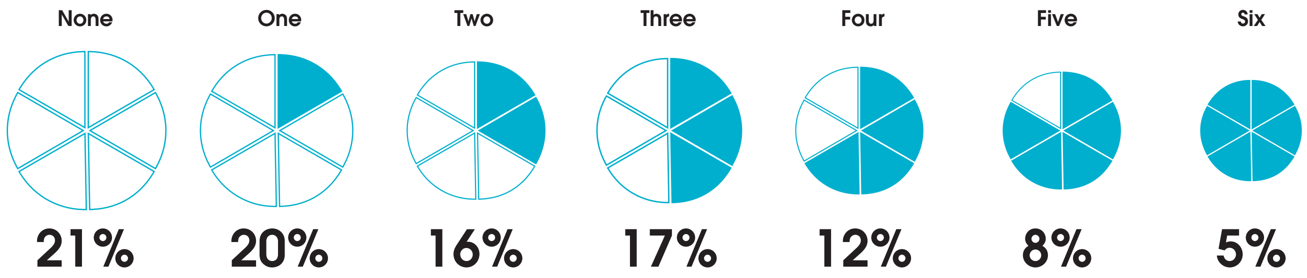
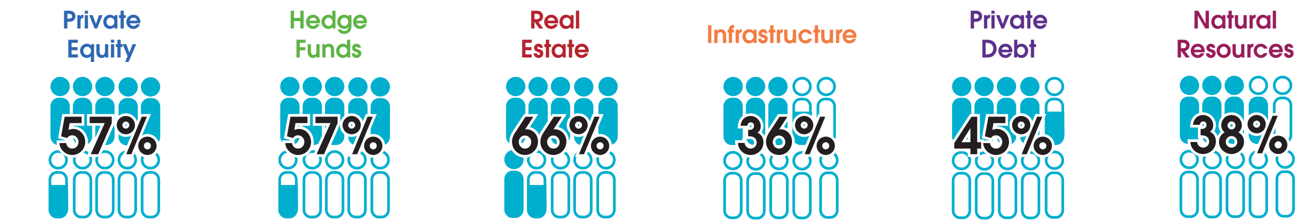
Participation in Alternative Assets

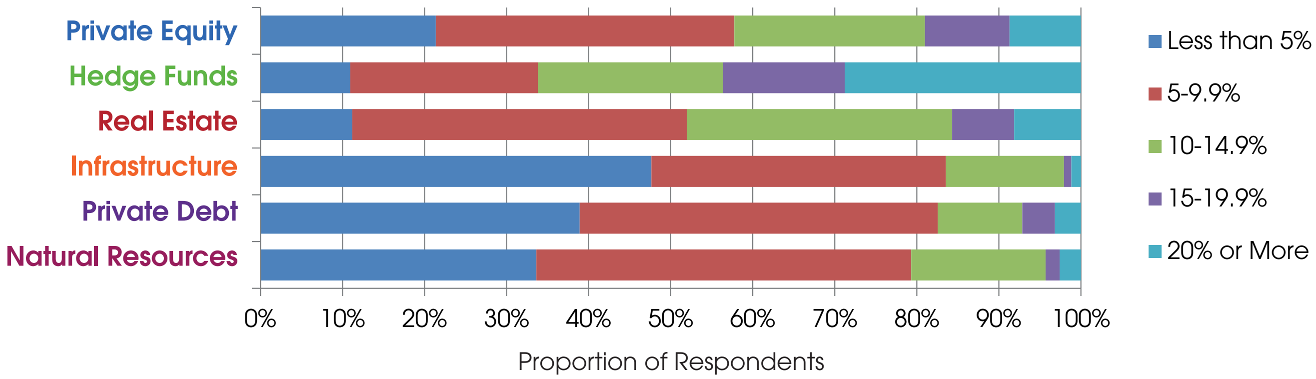
Institutional Investors by Number of Alternative Asset Classes Invested In



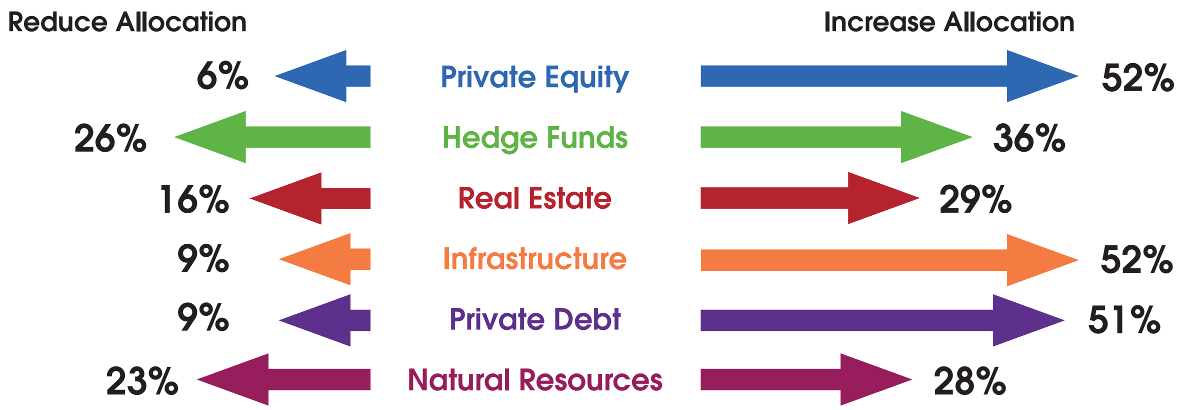
Proportion of Institutional Investors Allocating to Each Alternative Asset Class



Breakdown of Institutional Investors in Alternative Assets by Target Allocation to Each Asset Class (As a % of AUM)

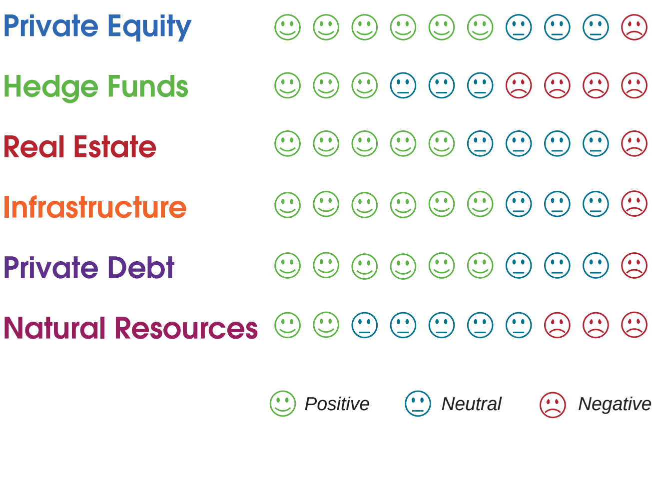


Institutional Investors' Plans for Allocations in the Longer Term

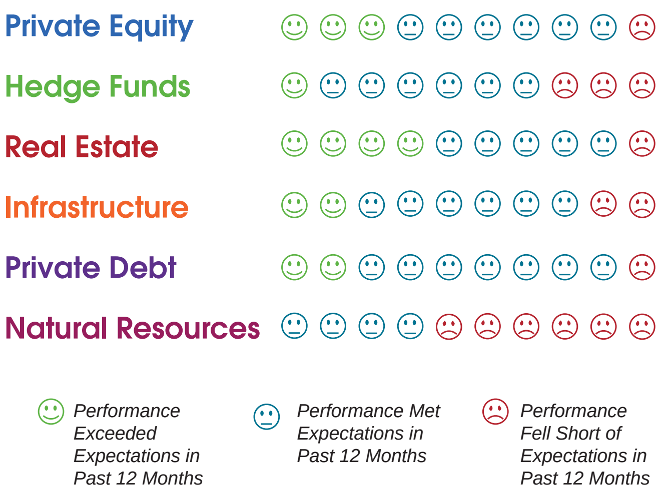


Views on Alternatives and Future Plans

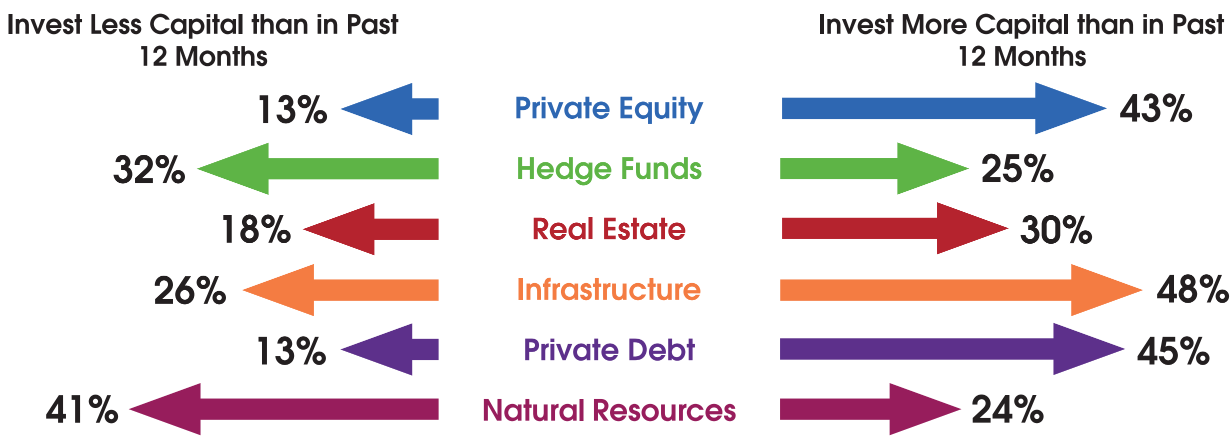
Institutional Investors' General Perception of Alternative Asset Classes



Institutional Investors' Perception of the Performance of Alternative Asset Classes



Plans for the Coming Year



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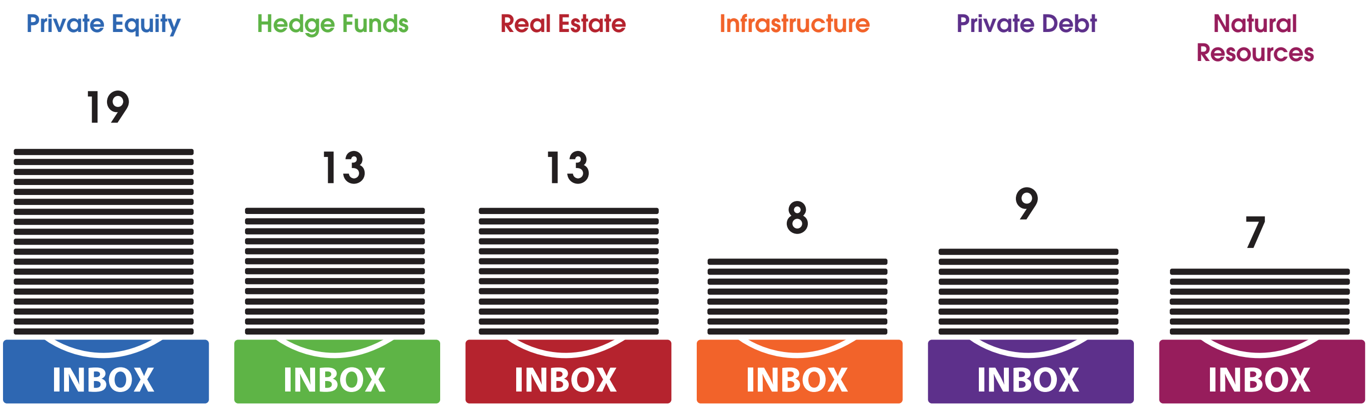
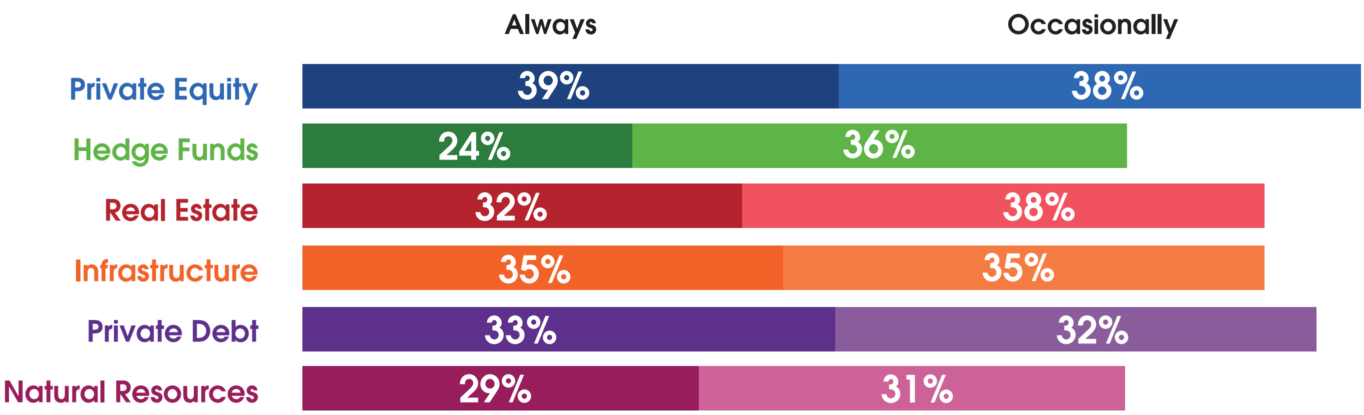
Alternative Assets Fund Sourcing

Average Number of Marketing Documents Institutional Investors Receive per Month



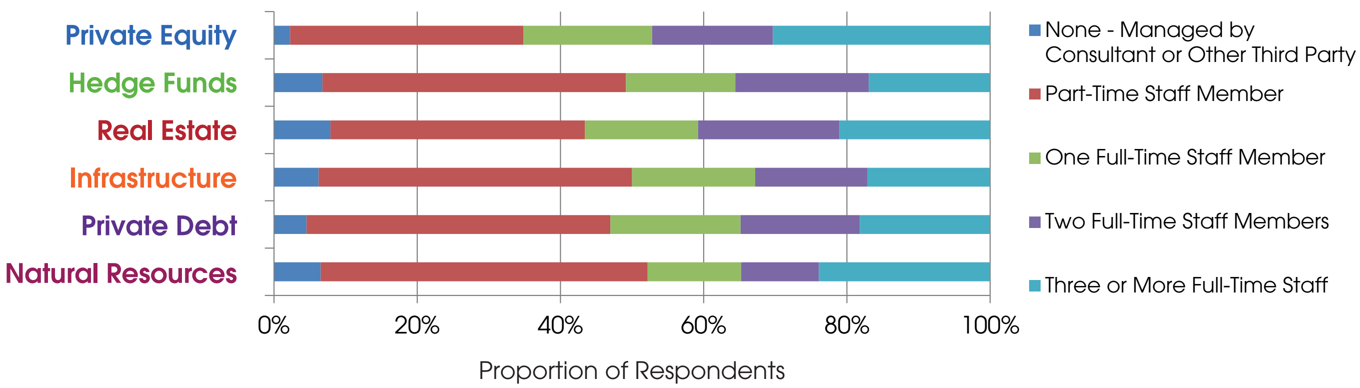
Average Number of Commitments Institutional Investors Make per Year

Proportion of Investors that Consider a Fund Manager's Environmental, Social and Governance (ESG) Policies

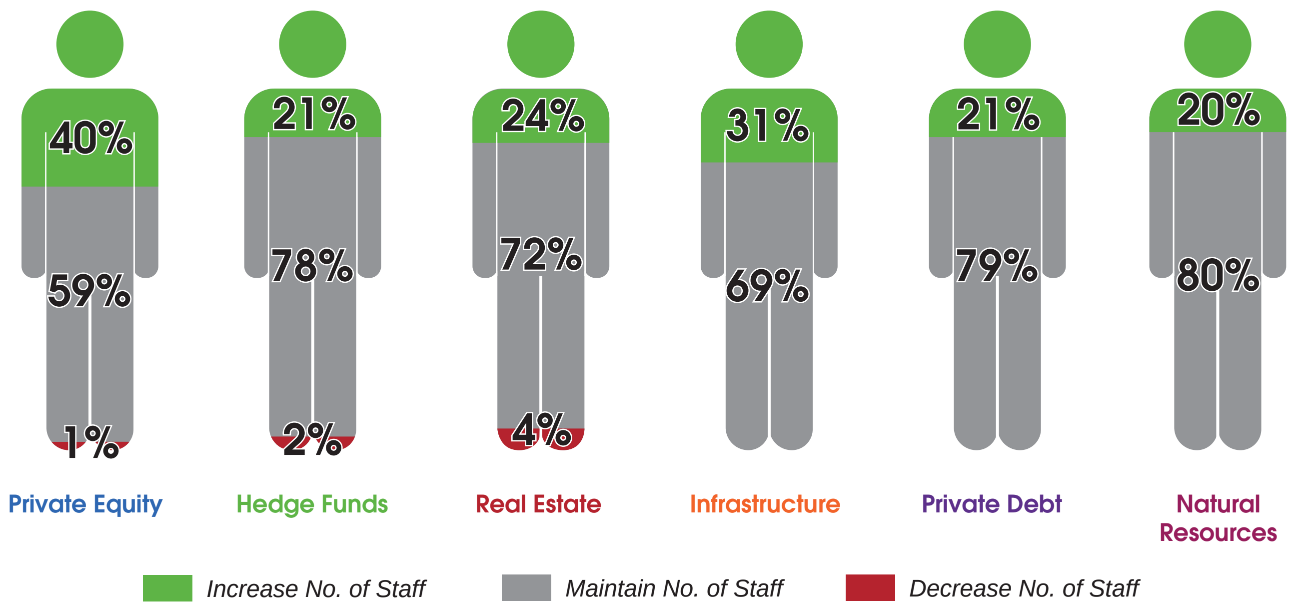


Staffing Levels

Staff at Institutional Investors by Asset Class



Plans for Staff Levels in the Next Two Years



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Private Equity

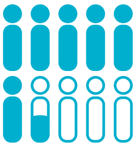
Distributions Driving Investor Satisfaction and Activity in Private Equity

As confirmed by Preqin's analysis of public pension fund returns, private equity continues to deliver superior returns compared to all other asset classes over the longer term. Furthermore, high distributions in recent years have significantly surpassed capital calls, driving institutional investor appetite for the asset class. As of June 2015 (the latest data available) $189bn was returned to investors from private equity funds* compared with $117bn in capital calls, continuing the momentum generated in 2014 when $475bn was distributed and $294bn called up from LPs. Consequently, 94% of the investors that Preqin recently spoke to felt that the performance of their private equity portfolios had met or exceeded expectations, compared with just 6% of respondents that felt returns had fallen short of their expectations in the past 12 months.

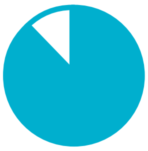
While the majority of LPs will be delighted with the returns they have received, many will now find themselves with more work to do in order to maintain their allocation. However, the strong performance of the asset class, the positive investor outlook and the large proportion of investors under-allocated to private equity means more capital will continue to flow into the asset class.

Concern over pricing and the impact it may have on returns is clearly at the forefront of investors' minds, with 70% of LPs believing valuations to be the biggest challenge facing the industry in 2016. However, the outlook is bright for private equity & venture capital in 2016. Fundraising should remain strong due to investor demand, although the challenge of identifying the best investment opportunities in a competitive market remains for LPs.

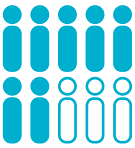
Investor Appetite



65%
Proportion of investors that have a positive perception of private equity.



88%
Proportion of investors that expect to commit more or the same amount of capital in 2016 as in 2015.



70%
Proportion of investors that feel pricing/valuations is the biggest concern in operating an effective private equity program.

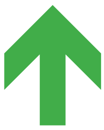
Make-up of Investors

35%
Proportion of capital originating from North America-based investors for funds closed in 2014-2015.

33
Average number of investors in private equity funds closed in 2015.

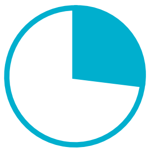
40%
Proportion of surveyed investors that intend to increase their number of GP relationships.

Evolution of the LP Universe



70%
Increase in sovereign wealth funds' average current allocation to private equity between January 2011 and January 2016.

30%
Proportion of aggregate capital currently invested in private equity accounted for by public pension funds.



27%
Average current allocation to private equity of family offices – the largest average of any investor type.

Data Source:

Preqin's **Investor Intelligence** database on **Private Equity Online** tracks in-depth data on over 6,200 active investors in private equity around the world. Search for investors based on their current allocation to private equity, location, investment preferences and much more.

For more information, please visit: www.preqin.com/privateequity

**Private equity refers to the core asset class centred on the buyout and venture capital industry, together with other closely related strategies, including growth, turnaround, private equity secondaries and private equity funds of funds.*

Satisfaction with Private Equity

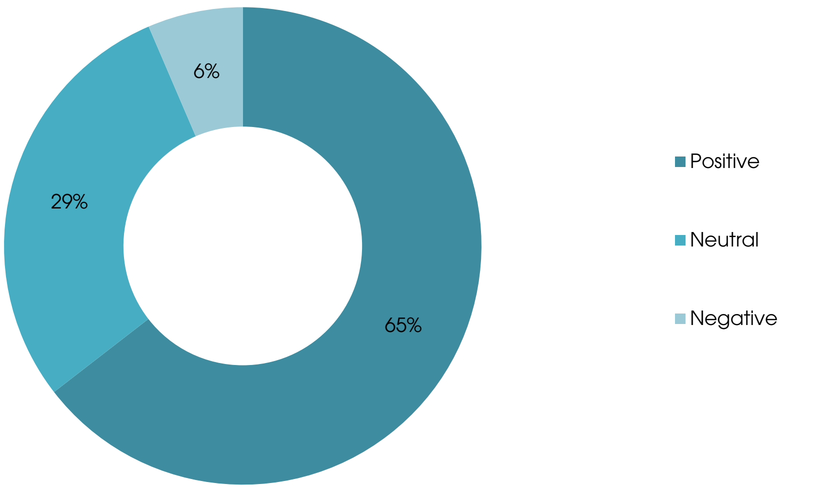
In December 2015, Preqin spoke with 100 LPs globally to determine their current appetite for private equity & venture capital and their future investment plans. The positive survey results suggest that investor appetite for the asset class will remain strong over 2016; the majority (65%) of LPs maintain a buoyant perception of the industry, while only 6% currently perceive it in a negative light (Fig. 2.1).

Investor Sentiment

Fig. 2.2 reflects this optimistic perception of and outlook for the private equity market. Sixty-four percent of investors stated their private equity portfolio had met their expectations in 2015, with an additional 30% feeling their investments had exceeded expectations.

Over the past five years investors have become increasingly positive in regards to their private equity fund investments, with the proportion that had their expectations surpassed increasing fivefold from 2011 to 2015. With record levels of distributions outstripping capital called, LPs are seeing more and more money returned to them, helping to explain the optimism.

Fig. 2.1: Investors' General Perception of the Private Equity Industry at Present

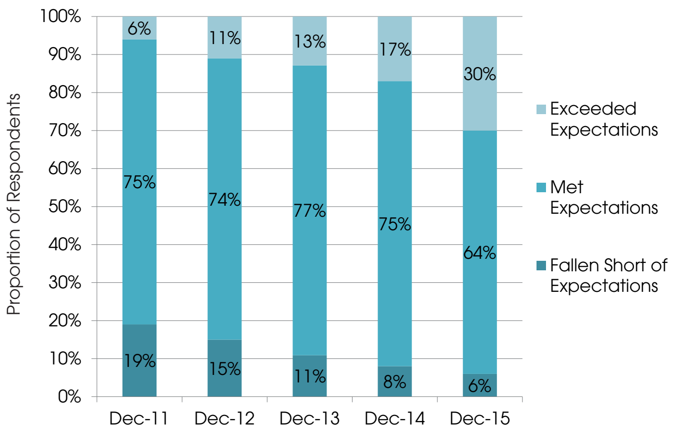


Source: Preqin Investor Interviews, December 2015

Return Expectations

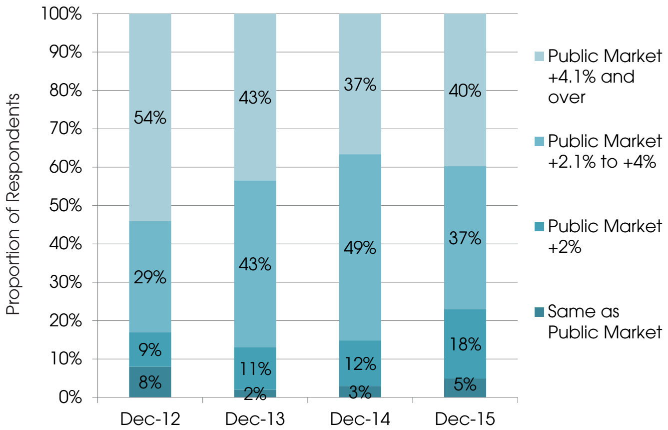
As shown in Fig. 2.3, 95% of investors surveyed expect their private equity portfolio returns to exceed public market returns, which is a marginal decrease from 97% in the corresponding 2014 survey. The proportion of respondents that are expecting to receive returns of more than four percentage points over public markets has decreased considerably from December 2012 to December 2015. This is perhaps a knock-on effect of recent pricing concerns and an illustration that while LPs still expect superior returns to the public market, their expectation about the degree of outperformance has reduced.

Fig. 2.2: Proportion of Investors that Feel Their Private Equity Fund Investments Have Lived up to Expectations over the Past 12 Months, 2011 - 2015



Source: Preqin Investor Interviews, December 2011-2015

Fig. 2.3: Investors' Return Expectations for Their Private Equity Portfolios, 2012 - 2015



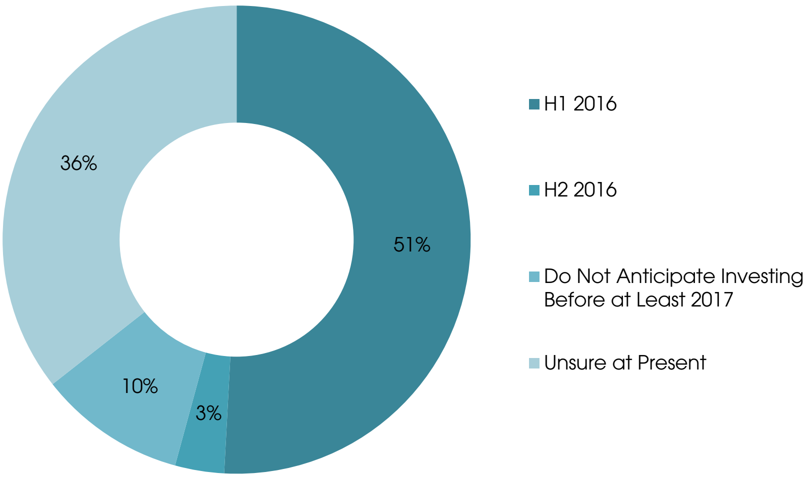
Source: Preqin Investor Interviews, December 2012-2015

Investor Activity in 2016

As shown in Fig. 2.4, 54% of investors interviewed plan to invest in their next fund in 2016 – the majority in the first half of the year. Thirty-six percent of investors were unsure as to when they would make their next commitment, but only 10% do not anticipate investing before at least 2017. This is an increase from the December 2014 survey results when 15% of LPs did not anticipate investing in the following year.

Many investors will increase their exposure to private equity over the next 12 months; 88% of surveyed investors expect to commit the same amount of capital, or more, to private equity over the next year compared to the previous 12 months (Fig. 2.5). In the longer term, over half (52%) of respondents will look to increase their allocation to private equity, with a further 43% maintaining their current level of exposure.

Fig. 2.4: Timeframe for Investors' Next Intended Commitment to Private Equity



Source: Preqin Investor Interviews, December 2015

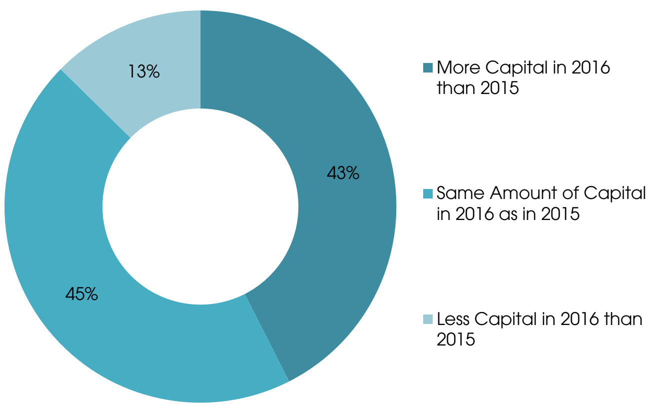
Re-ups and New Relationships

Forty percent of investors surveyed are looking to increase the number of GP relationships in their portfolio over the next two years, an increase of three percentage points from 2014. Furthermore, 45% of investors will look to maintain the same number of relationships, while 15% will look to decrease the number of fund managers in their investment portfolio.

The majority (78%) of investors surveyed will form, or will consider forming, new GP relationships over the coming year (Fig. 2.6). Twenty-two percent of LPs expect to only re-up with existing managers over the next 12 months, compared to 19% in the corresponding 2014 survey.

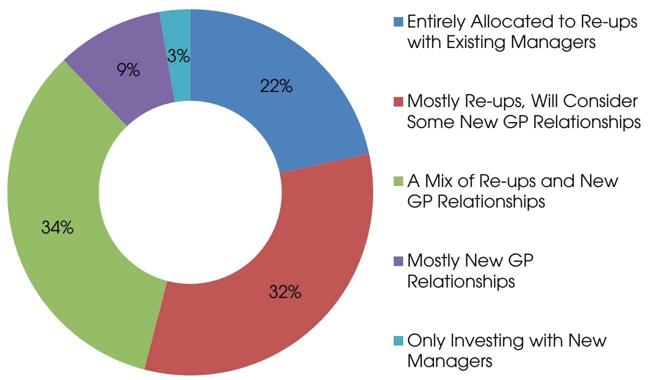
Thirty-four percent of LPs plan on investing in a mix of re-ups and new relationships in the coming year. This continuing trend suggests investors are looking to diversify the GP relationships they maintain in order to find the most attractive opportunities and the potential for the best returns, regardless of any previous relationship with the GP.

Fig. 2.5: Investors' Expected Capital Commitment to Private Equity Funds in 2016 Compared to 2015



Source: Preqin Investor Interviews, December 2015

Fig. 2.6: Investors' Intentions for Forming New GP Relationships over the Next 12 Months



Source: Preqin Investor Interviews, December 2015

Strategies and Geographies Targeted

Fund Types

It is evident from the survey results that small to mid-market buyout funds continue to be the most favoured fund type among LPs. Sixty-one percent of LPs consider these funds to present the best opportunities in the private equity market at present; 73% of investors are seeking to invest in these funds in 2016 (Fig. 2.7). Large to mega buyout funds are the second most favoured fund type by investors, with 36% looking to invest in 2016, a considerable increase from 12% in December 2014. Venture capital vehicles were viewed as attractive investment opportunities by 24% of investors, with 31% seeking to invest in the fund type in 2016, possibly linked to recent improvements in venture capital fund returns.

Fund of funds vehicles experienced the greatest loss of interest from investors of any fund type over 2014-2015. In December 2014, 15% of respondents believed funds of funds presented the best investment opportunities, compared with just 8% in December 2015. This echoes the survey results from December 2013, when 7% of respondents viewed funds of funds as presenting the best opportunities. This downturn in confidence may be a result of investors' increased expertise in investing directly in private equity partnerships, which generally enables an investor to avoid the double layer of management fees, thus increasing profits and total returns. Although current appetite for funds of funds has decreased, 19% of investors will seek to invest in funds of funds in 2016 as they look to take advantage of the diversification offered, as well as the potential for less risk than an individual private equity investment.

Preferred Geographies

North America has seen an 11 percentage point improvement in investor sentiment towards the region compared to 2014, with 71% of investors surveyed identifying the region as presenting the best investment opportunities in the current financial climate (Fig. 2.8). This suggests that LPs are looking to commit to established markets, and may in part be driven by the improving fortune of venture capital, with the vast majority of players in venture capital based in North America.

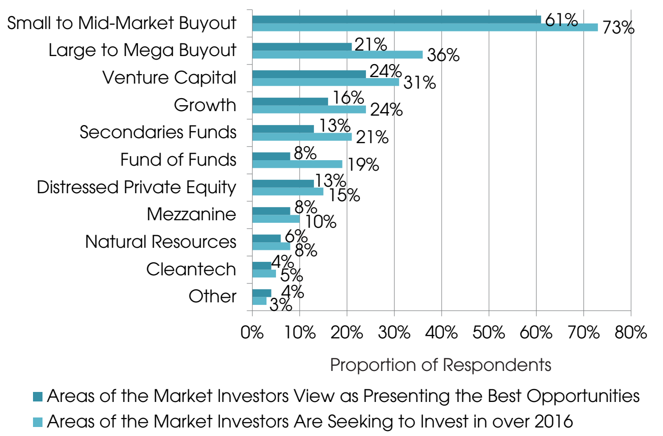
Surprisingly, despite recent economic troubles in China, investor attitudes towards Asia improved by one percentage point from 2014 to 2015. Economies outside North America, Europe and Asia (Rest of World) saw a one percentage point decrease.

Appetite for Emerging Markets

LPs are looking to remain committed to the established markets; in fact, only 8% and 6% of LPs surveyed indicated that they would avoid North America and Europe respectively due to the current financial climate. This is a small percentage in comparison to LP attitudes towards Asia and other regions. Thirty-three percent of investors surveyed will be avoiding investments in Asia altogether, with an additional 61% of LPs avoiding investment opportunities in economies outside North America, Europe and Asia in the year ahead.

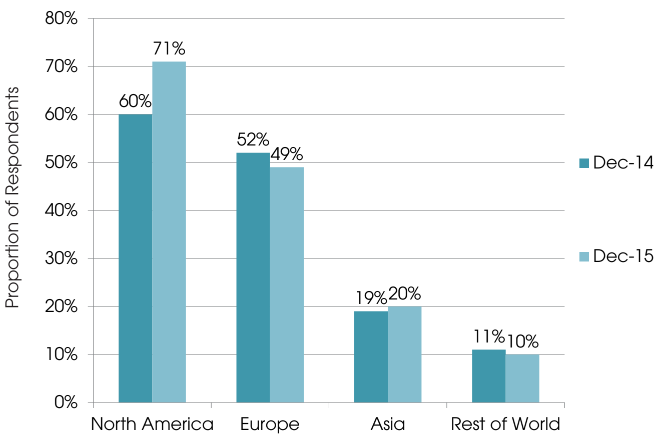
Although the majority of investors view North America and Europe to be the most attractive regions for private equity investment, many investors remain committed to emerging markets. According to the survey results, only 2% of LPs expect to decrease their allocation to investments in emerging markets over the coming year, as well as in the longer term. This is a considerable change from the corresponding 2014 survey, when 25% of respondents expected to reduce their allocations to emerging markets over the longer term. Thirty-three percent indicated plans to increase their allocations over 2016, with 65% stating their allocation would remain the same. Furthermore, 43% of LPs surveyed plan to increase their allocation to emerging markets over the longer term, with 55% intending their allocation will remain the same.

Fig. 2.7: Investor Attitudes towards Different Fund Types at Present*



Source: Preqin Investor Interviews, December 2015

Fig. 2.8: Regions Investors View as Presenting the Best Opportunities in the Current Financial Climate, 2014 vs. 2015



Source: Preqin Investor Interviews, December 2014-2015

**Fig. 2.7 - Respondents were not prompted to give their opinions on each region/fund type individually but to name those they felt best fit these categories; therefore, the results display the regions/fund types at the forefront of investors' minds at the time of the survey.*

Alternative Methods of Accessing the Asset Class

There are a variety of ways investors can access the private equity asset class aside from primary commitments to funds. Preqin's latest survey investigates investor appetite for direct investments, the secondary market, separate accounts and co-investments.

Direct Investments

As the limited partner universe becomes more sophisticated, direct investment is becoming an increasingly common way for investors to access private equity opportunities, gaining more governance in the portfolio company and insight into how their capital is being utilized. Nearly a quarter of surveyed investors will invest directly in companies on a proprietary basis, a reduction on the 33% that stated the same in June 2015. Nineteen percent of these direct investors are expecting to increase their activity in direct investments over the next year, whereas the majority (67%) are satisfied with their current level of direct investment activity, expecting it to remain the same (Fig. 2.9). Of the investors interviewed that currently co-invest, 94% are looking to increase or maintain their level of co-investment activity over the coming year.

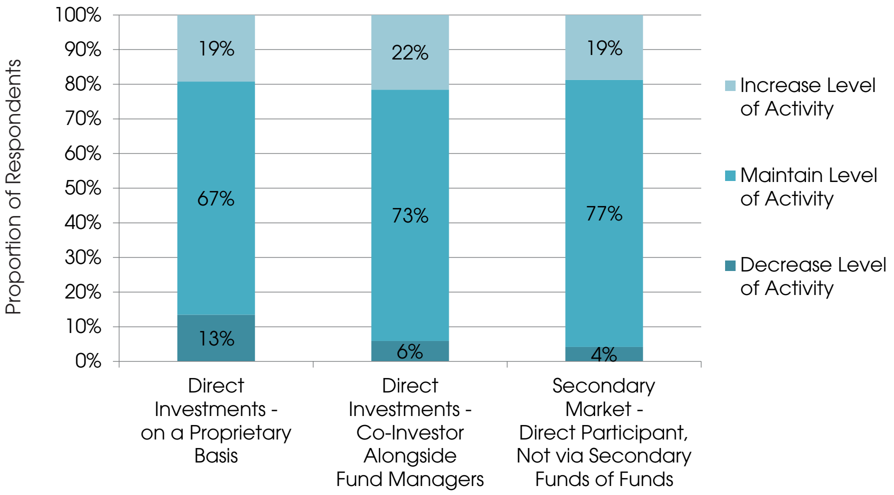
Secondary Market

Nineteen percent of investors surveyed expect their level of involvement in buying private equity fund stakes on the secondary market to increase in 2016, and the majority (77%) of LPs active in the secondary market believe they will maintain their current level of activity. This is unsurprising considering some of the benefits secondary investments can offer investors, including access to top fund managers and mitigation of the J-curve effect.

Separate Accounts

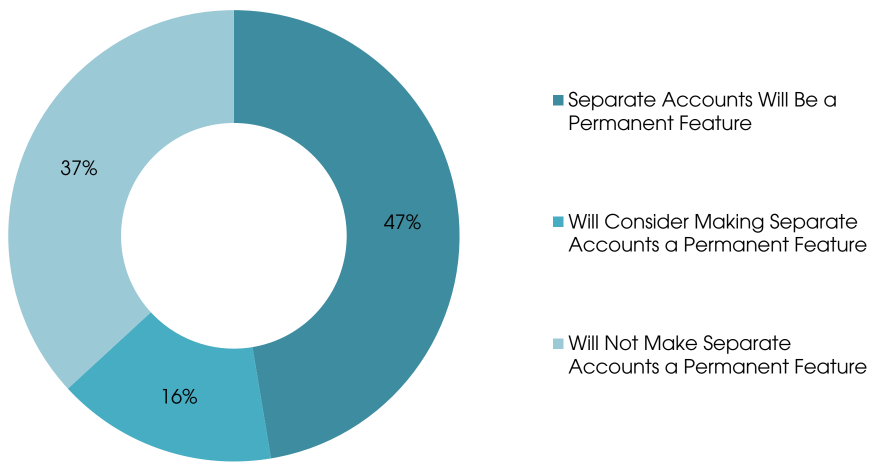
Sixteen percent of investors surveyed invest, or have invested, via separate account mandates with GPs. Separate accounts offer lower carried interest and management fees and a greater level of involvement regarding investment strategy. This allows the LP to form a closer relationship with the respective fund manager, creating a better position from which to negotiate future terms, as well as encouraging a greater level of reporting and communication from the GP. It is therefore not surprising that a large proportion (47%) of separate account investors surveyed will make it a permanent part of their investment strategy going forward (Fig. 2.10).

Fig. 2.9: Investors' Expectations of Their Direct Investment and Secondary Market Activity in the Next 12 Months



Source: Preqin Investor Interviews, December 2015

Fig. 2.10: LPs Investing in Separate Accounts: Proportion that Expect Separate Accounts to Be a Permanent Feature of Their Private Equity Portfolios



Source: Preqin Investor Interviews, December 2015

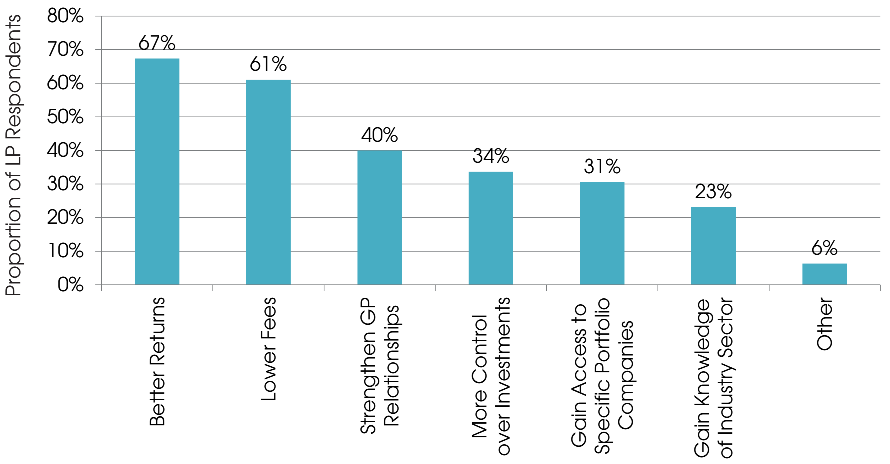
Co-Investments

Co-investments have been a topic of much focus within the industry of late. In order to find out more about this growing area of the asset class, Preqin surveyed 222 active LPs in September 2015 about co-investments to better understand the changing levels of participation among investors, and to find out their views on the perceived risks and attractions.

Half of all LPs are actively, or opportunistically, co-investing alongside private equity fund managers at present. This is in addition to 22% that are considering co-investing, having not done so before. This indicates that the vast majority of LPs have faith in co-investments and see the investment structure as an attractive way to access the asset class, with only 27% of LPs not looking to co-invest at the moment.

The potential for better returns and the attraction of lower fees seem to be the driving forces behind the majority of surveyed LPs deciding to opt for co-investments. As seen in Fig. 2.11, 67% of LPs believe that co-investing can lead to greater returns than those delivered by standard private equity fund arrangements. Additionally, 61% of investors are attracted to the prospect of lower fees charged on co-investment commitments. Interestingly, a third of LPs believe that co-investing provides them with more control over investments and 31% of LPs stated a desire to invest in a particular portfolio company, highlighting that institutional investors increasingly want to become more involved at portfolio company level.

Fig. 2.11: LPs' Perceived Benefits of Co-Investing



Source: Preqin Co-Investment Survey, September 2015

In contrast, among LPs that do not co-invest, and have no plans to co-invest, it seems that a lack of resources available to them is the prime reason for not accessing co-investment opportunities. Surprisingly, these responses are not solely from smaller sized LPs, with a number of respondents managing assets in excess of $10bn. Furthermore, almost a fifth of respondents stated that they do not look to co-invest as it would reduce their level of diversification, leaving them overexposed to certain deals by committing additional capital to the same portfolio company.

Performance of Co-Investments

For the majority of LPs that have seen co-investment positions produce positive returns, there has been a notable level of outperformance when compared to private equity fund returns. Eighty percent of LPs have acknowledged an outperformance, with 46% witnessing returns that are in excess of 5% greater than those in the standard private equity fund arrangements (Fig. 2.12). It is worth mentioning that many LPs stated that it was too early to tell in regards to co-investment returns.

Outlook

As shown in Fig. 2.13, LPs' involvement in co-investing is likely to rise further, with almost half (49%) of the LPs surveyed anticipating an increase in their co-investment activity in the future. This is in contrast to just 2% of LPs that are looking to decrease their co-investment activity, with almost a quarter (23%) aiming to maintain current levels. With record levels of dry powder and increasing concerns over valuations and returns, co-investments offer LPs a way to take more control of their portfolios.

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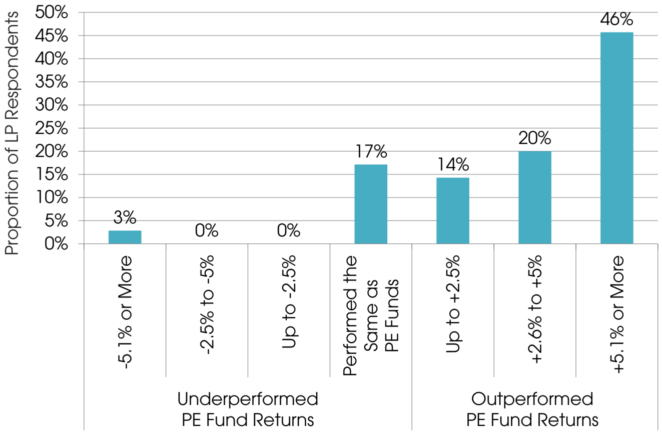
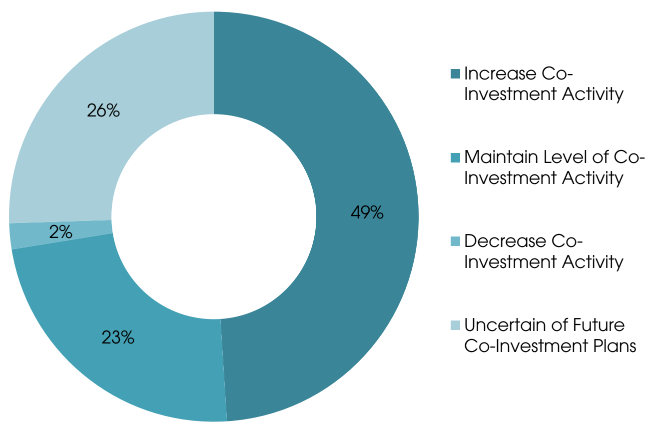
Fig. 2.12: Performance of Past Co-Investments Compared to Private Equity Fund Returns



Source: Preqin Co-Investment Survey, September 2015

Fig. 2.13: LPs' Future Co-Investment Plans



Source: Preqin Co-Investment Survey, September 2015

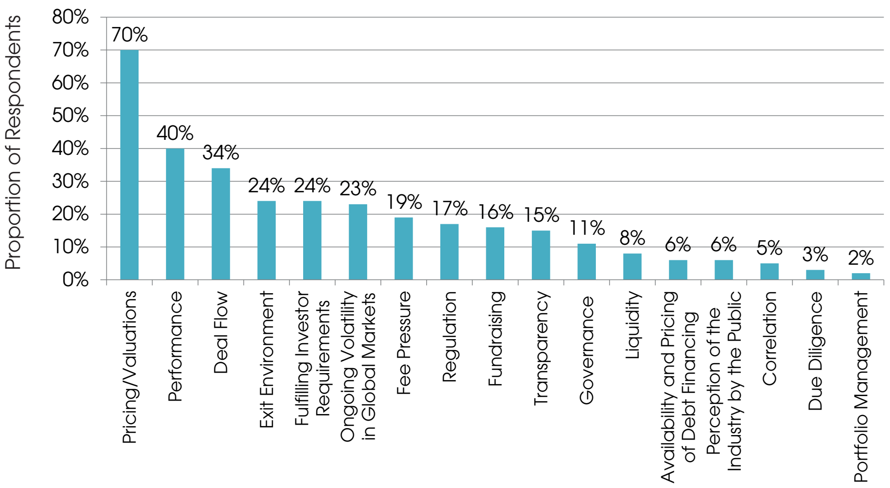
Key Issues and Regulation

Caution over the prevailing high valuations of private companies and a lack of transparency as to how they are being priced remain legitimate concerns for investors, acknowledged by the majority (70%) of LPs as the biggest challenge in operating an effective private equity program in 2016 (Fig. 2.14). Rising from 21% of investors surveyed in 2014, 40% believe that fund performance, linked intrinsically to valuations, is also a key concern for 2016.

Deal flow is another challenge that 34% of respondents feel could hinder their private equity program in the coming year, with investors concerned about whether their GPs can find deals at attractive entry valuations. This is likely interrelated with LPs' concerns over the current market environment and the purchase price multiples that are paid for companies; high valuations invariably make it more difficult for a GP to deliver high returns. With a finite number of economically viable deals and increasing competition among GPs for assets, investors are worried about less lucrative deals. Uncertainty is leaving LPs apprehensive about the quality and quantity of deal flow in 2016.

Just under a quarter of LPs each named the exit environment and fulfilling investor requirements as key challenges for 2016. Further to continued concern over fees and other fund terms, LPs identified increased transparency at fund level and the amount that GPs are committing to funds as areas in need of improvement. The desire from LPs for greater transparency is evident: 15% of respondents indicated that lack of transparency is a worry when looking to operate an effective program in the coming year.

Fig. 2.14: Biggest Challenges Facing Investors Seeking to Operate an Effective Private Equity Program in 2016

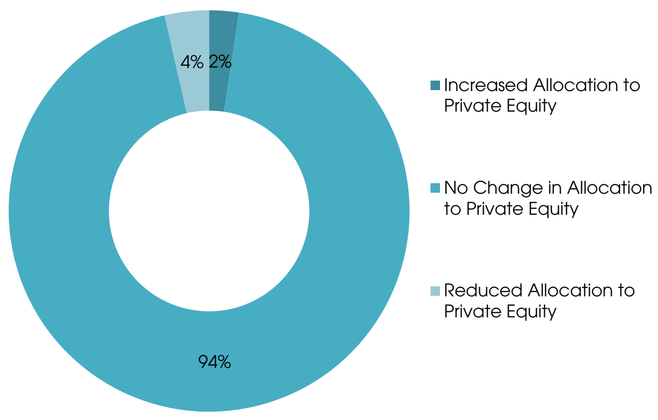


Source: Preqin Investor Interviews, December 2015

Regulation

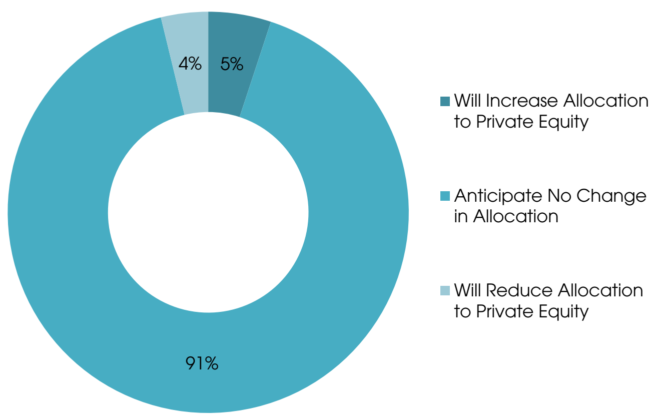
The proportion of investors that have indicated regulation is a key issue has fallen from 21% in December 2014 to 17% in December 2015. However, with several delays and much uncertainty surrounding the implementation of various reforms including the AIFMD, Solvency II, Dodd Frank and Basel III in recent years, the impact on private equity allocations is yet to be seen. While these regulations place restrictions on particular investor types, the vast majority of surveyed LPs have not changed their allocation to private equity as a result (Fig. 2.15) and a similar proportion (91%) anticipate no change to their allocations in the future (Fig. 2.16).

Fig. 2.15: Impact of Recent Regulatory Changes and Proposals on Investors' Private Equity Allocations



Source: Preqin Investor Interviews, December 2015

Fig. 2.16: Expected Impact of Recent Regulatory Changes and Proposals on Investors' Private Equity Allocations in 2016



Source: Preqin Investor Interviews, December 2015

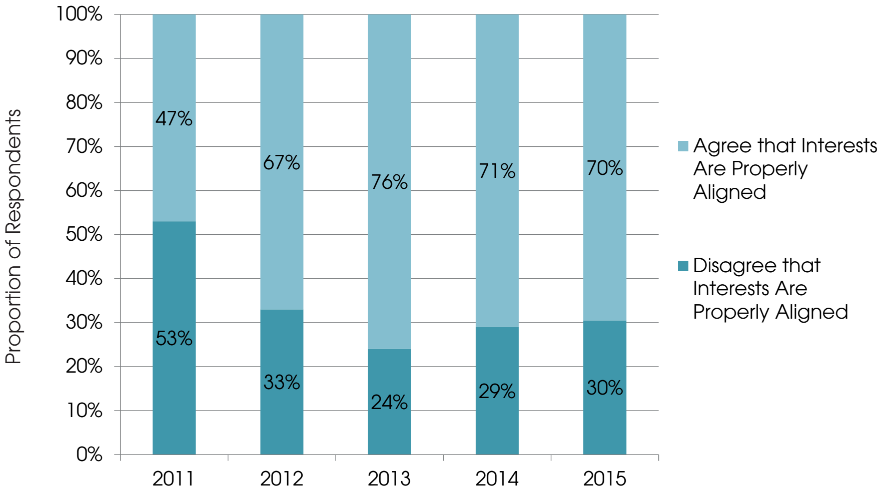
Fees and Alignment of Interests

Private equity fund terms and conditions have come under greater scrutiny from LPs over recent years. It is likely that the maturing investor base will exercise its increased negotiating power to question the validity of the traditional private equity fund fee structure, given the significant evolution of the investment landscape since the asset class's formative years.

For the fourth consecutive year, the majority (70%) of LPs interviewed agreed that LP and GP interests are properly aligned (Fig. 2.17); this represents just a one percentage point fall from 2014 and a six percentage point fall from 2013. It remains clear that the general consensus among LPs is that their interests are aligned to those of GPs.

Preqin asked investors that expressed dissatisfaction with fund terms and conditions what could be done to improve the LP/GP relationship. Sixty-four percent of respondents named management fees as a major issue (Fig. 2.18). This seems to be a recurring concern, one that has seen a four percentage point increase from the previous year. While 63% of respondents saw a change in management fees over the past six months, it is clear there is still work to be done to meet investors' expectations of the fees they are charged. Forty-seven percent of respondents expressed their desire for more transparency at fund level, with one US-based investor saying: "GPs will call you 100 times a day to convince you to commit…once you commit you don't hear from them ever again".

Fig. 2.17: Extent to Which Investors Believe that Fund Manager and Investor Interests Are Properly Aligned, 2011 - 2015



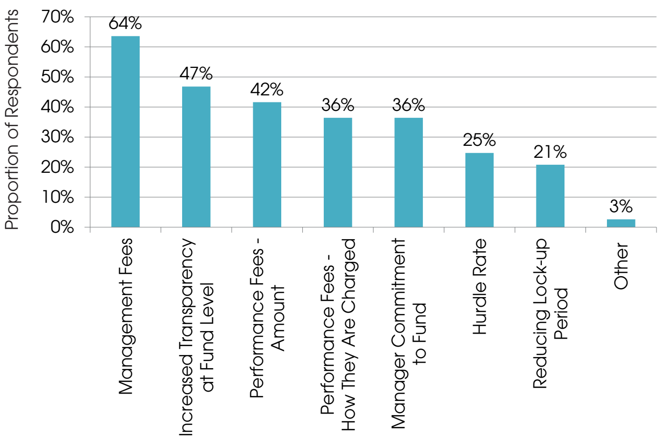
Source: Preqin Investor Interviews, December 2011-2015

Fund terms regarding performance fees are seen as problematic in two ways by LPs: 42% of respondents indicated that the amount charged needed to be improved and 36% stated that the method by which they are charged required amendments. Thirty-six percent of LPs believe managers should be committing more to their own fund, while hurdle rates and reducing lock-up periods were less common answers, cited only by 25% and 21% of LP respondents respectively.

When we asked LPs how permanent they felt recent shifts in prevailing fund terms and conditions would be, half of the respondents conveyed a sense of uncertainty, more than double the proportion that stated the same in December 2014, reflecting the increased sense of ambiguity felt among investors regarding changes in fund terms.

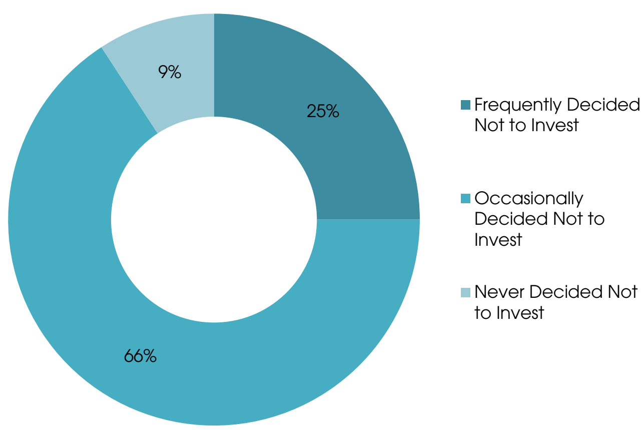
Fig. 2.19 illustrates the extent to which a misalignment between GPs and LPs has an effect on whether an LP will invest in a fund. Two-thirds of respondents stated that they occasionally decide not to invest in a private equity fund because of the proposed terms and conditions. A quarter of investors frequently decide not to invest if unattractive terms are offered.

Fig. 2.18: LPs' Views on Areas of Fund Terms and Conditions Where Alignment of Interests Can Be Improved



Source: Preqin Investor Interviews, December 2015

Fig. 2.19: Proportion of Investors that Have Previously Decided Not to Invest in a Fund Due to Proposed Terms and Conditions



Source: Preqin Investor Interviews, December 2015

Hedge Funds

Fundraising Becomes More Challenging in 2016

The spotlight continues to be focused on institutional investment in hedge funds. A year ago, in our **Preqin Investor Outlook: Alternative Assets, H1 2015**, the industry was examining the impact of the recent high-profile exits of California Public Employees' Retirement System (CalPERS) and Netherlands-based PFZW. A year on, the flood gates have in fact not opened to widespread further departures from the asset class; instead we continue to see more institutions than ever investing ever-growing portions of their total portfolio in the asset class and creating increasingly sophisticated portfolios of funds. However, there have been some changes in appetite from investors in 2016 compared to previous years; notably more investors reported to Preqin that they will reduce the size of their hedge fund portfolios than will increase their exposure. This is something that we have never seen before in the eight years that Preqin has been conducting annual surveys of investors; in previous years, the data always indicated that a larger proportion of investors will put more money to work in hedge funds than cut back. What does this mean for the industry?

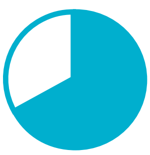
Firstly, fundraising is likely to become more challenging, particularly for small or emerging funds. However, investors remain interested in these funds in the year ahead: 54% of investors looking for funds in 2016 said they would either invest or consider investing in an emerging fund in 2016. In fact, as some of the largest funds reach capacity or close to new investment, we may see some smaller funds pick up new mandates as investors seek to put more capital to work in hedge funds in 2016.

Secondly, the performance of the sector is likely to come under even more scrutiny. A year ago, we noted that investor satisfaction with the performance of their hedge fund portfolios had declined from the end of 2013 to the end of 2014, and that 2015 would be a year for hedge funds to show what they are worth. For many investors, this was not proved: 33% of investors reported that their hedge funds had not met expectations in 2015, compared to 35% that reported the same in 2014. However, despite the Preqin All-Strategies Hedge Fund benchmark adding just 2.02% in 2015, its lowest level since 2011, in many ways, the value of hedge fund investment is becoming more evident in light of recent events in traditional equity and fixed income markets. Hedge funds outperformed many global indices in 2015, such as the S&P 500, MSCI World and Barclays Capital Global Aggregate Bond Index, and the turbulence in leading markets has continued into 2016. In the current environment, if hedge funds can prove their value as a product that can help preserve assets, reduce portfolio volatility and provide a risk-adjusted return stream, then maybe those investors that are currently taking a cautious approach to the asset class may reconsider their outlook on hedge funds.

Following a year in which performance remained a point of concern for many investors, the calls for hedge funds to reconsider fee structures continues to grow. Therefore, all fund managers – both emerging and established – will need to be able to pinpoint those investors looking to put more capital to work in hedge funds, prove their value in choppy markets and continue to listen and respond to investor demands over the course of the year in order to attract capital in 2016.

Preqin conducted interviews with over 150 institutional investors in December 2015 in order to gauge their outlook on industry issues such as performance and fund terms, as well as their appetite for hedge funds in 2016. Here, we present a detailed analysis of the key topics affecting hedge fund investors in 2015, using results taken from the **2016 Preqin Global Hedge Fund Report**.

Performance



67% Proportion of investors that believe hedge fund returns met or exceeded expectations in 2015.

35% Proportion of investors that believe performance is the key issue for hedge funds in 2016, the most commonly cited issue.

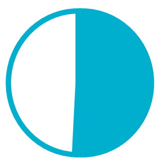
Exposure to Hedge Funds

25% of investors expect to increase their exposure to hedge funds over 2016.

32% of investors plan to decrease their exposure to hedge funds over 2016.

Terms and Conditions

46% Proportion of investors that want to see an improvement in the level of management fees charged in 2016.



51% Proportion of investors that have negotiated their fund terms and conditions over the course of 2015.

Satisfaction with Hedge Funds

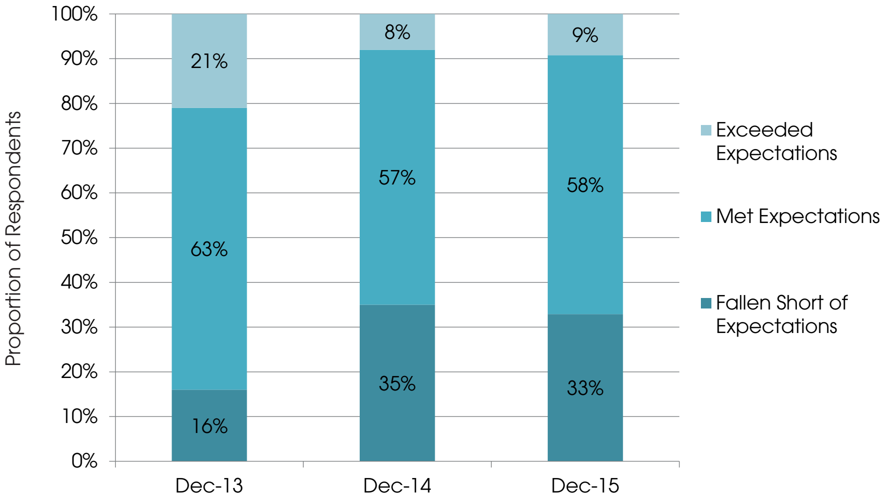
With periods of uncertainty impacting global markets in 2015, hedge fund managers have had to navigate volatile market conditions in order to deliver positive returns. As Fig. 3.1 demonstrates, investor satisfaction with the performance of hedge funds in 2015 remained at a similar level to 2014's survey. Fifty-eight percent of investors reported returns had met expectations in 2015; a further 9% reported returns had been exceeded. Although a significant proportion (33%) of investors stated that their hedge fund investments fell short of expectations, on the whole, investors' outlook on performance has not worsened since 2014, despite a particularly turbulent period between June and September 2015 leaving the benchmark more than two percentage points below the 2014 return. However, we did see a drop in investor satisfaction with the returns of hedge funds from 2013 to 2014, and the low, single-digit benchmark return of 2015 has done little to win over the 33% of investors that are sceptical about the performance of the sector.

Fig. 3.2 shows for investors in each particular strategy whether returns met or fell short of expectations during 2015. Relative value strategies were rated highly by investors: 78% of those surveyed stated that the strategy had met expectations. With high volatility in equity markets, the market-neutral characteristics of relative value strategies saw them deliver smoother returns than other strategies; the Preqin All-Relative Value Strategies benchmark ranked as the top performing strategy of 2015, coupled with the lowest volatility.

CTAs made a promising start to 2015, but the strong performance in Q1 was effectively wiped out during Q2 and the strategy subsequently experienced a difficult year. Despite this, managed futures/CTAs retained positive sentiment among investors with 69% viewing the strategy favourably. This represents a turnaround in the perception of CTAs, with surveys in both 2013 and 2014 showing that dissatisfied investors outnumbered the satisfied, perhaps as investors reassess their performance expectations from these funds.

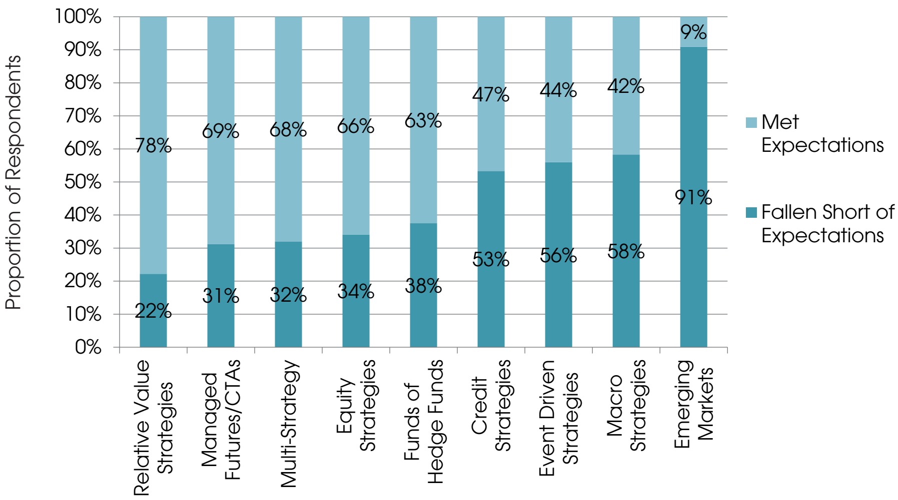
Sixty-eight percent and 66% of investors in multi-strategy and equity strategies funds respectively had their return expectations met over the course of 2015. Fund of hedge funds, for which 63% of investors in these funds felt their return expectations had been met, completes those strategies where more investors believed their return objectives had been fulfilled in 2015 than unfulfilled. At the other end of the spectrum, event driven and macro strategies funds struggled to meet the expectations of the majority of institutional investors, with 56% and 58% of investors expressing dissatisfaction with these strategies respectively. Emerging markets funds were the most poorly viewed during 2015, with just 9% of investors satisfied with the returns generated over 2015.

Fig. 3.1: Hedge Fund Portfolio Performance Relative to Expectations of Institutional Investors, 2013 - 2015



Source: Preqin Investor Interviews, December 2013-2015

Fig. 3.2: Hedge Fund Portfolio Performance in 2015 Relative to Expectations of Institutional Investors by Strategy



Source: Preqin Investor Interviews, December 2015

Data Source:

Preqin's **Hedge Fund Online** provides detailed information on over 5,000 institutional investors, including manager requirements, current and target allocations to hedge funds, target returns, future plans and much more.

For more information, please visit:

www.preqin.com/hfo

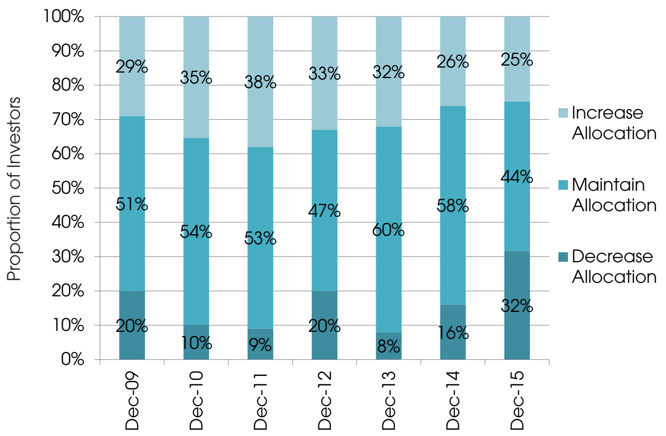
Investor Activity in 2016

Hedge funds have had a second year in which performance has disappointed a large number of investors (see the **2016 Preqin Global Hedge Fund Report**). These concerns have led to signs that fundraising could become extremely challenging in 2016; more investors have indicated that they intend to invest less capital in 2016 than in 2015 (Fig. 3.3), an early sign there may be net outflows over the year. Although investors recognize the long-term benefits of hedge funds within their portfolios, in the short term, if fund search activity declines, finding and gaining the attention of those investors looking to make new investments will be vital if fund managers are to accumulate fresh assets over 2016.

Coupled with an increasing number of investors indicating they will reduce the size of their hedge fund portfolios in 2016, the investors that have fresh investment planned have indicated that they will invest smaller sums and in fewer funds than in previous years. Fig. 3.4 shows that 65% of investors will be investing less than $50mn of fresh capital in hedge funds in 2016, an increase from the previous year (54%). In addition, the proportion of investors investing $250mn or more has decreased from 15% over 2015 to 8% in 2016. Forty-two percent of fund searches planned for 2016 are for one or two funds (Fig. 3.5). Again, this highlights that 2016 could potentially be a challenging one for fund managers looking to grow as institutional investors have indicated that they will be placing smaller sums of capital in the hands of a smaller number of hedge fund managers.

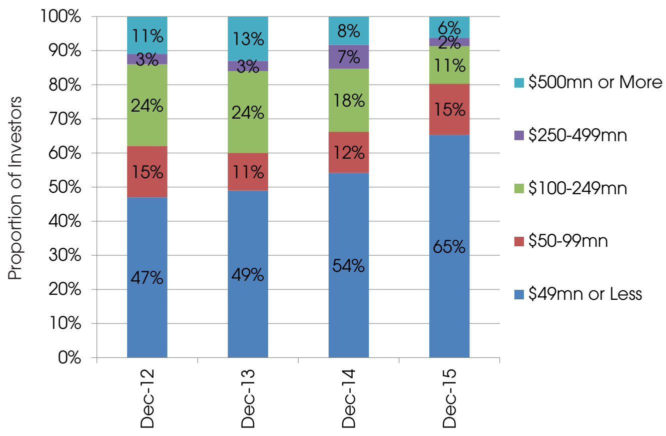
The more liquid strategies are the most attractive to investors in 2016; equity strategies, macro strategies and managed futures/CTAs all look set to see the largest inflows in 2016 (Fig. 3.6). At the other end of the spectrum, a larger proportion (15%) of all investors in credit strategies plan to reduce their exposure rather than increase or add these funds (4%) to their portfolios over 2016 (Fig. 3.6).

Fig. 3.3: Investors' Intentions for Their Hedge Fund Allocations in the Next 12 Months, 2009 - 2015



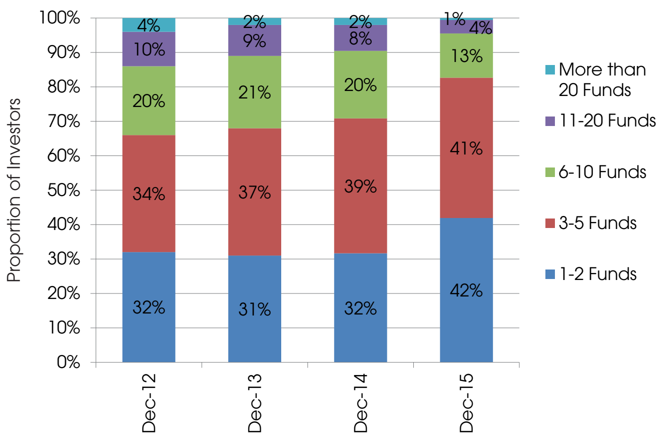
Source: Preqin Investor Interviews, December 2009-2015

Fig. 3.4: Amount of Fresh Capital Institutional Investors Expect to Invest in Hedge Funds over the Next 12 Months, 2012 - 2015



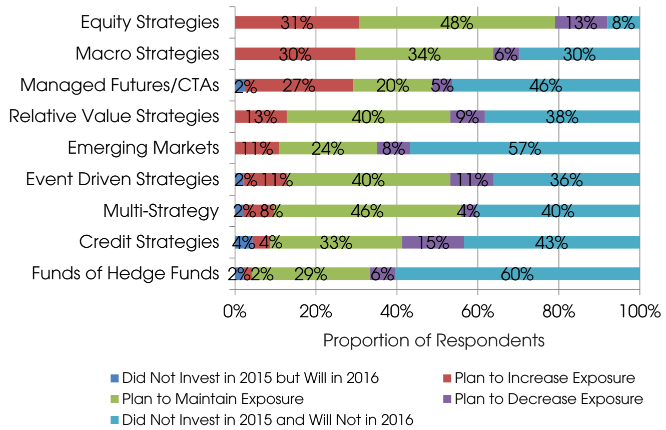
Source: Preqin Hedge Fund Investor Profiles

Fig. 3.5: Number of Hedge Funds Institutional Investors Expect to Add to Their Portfolios over the Next 12 Months, 2012 - 2015



Source: Preqin Hedge Fund Investor Profiles

Fig. 3.6: Breakdown of Investors' Allocation Plans for 2016 by Strategy



Source: Preqin Investor Interviews, December 2015

Attracting Investor Capital in 2016

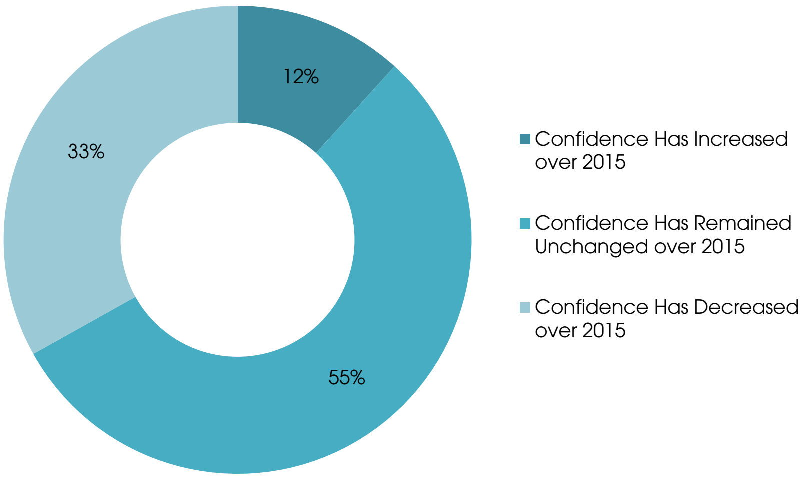
As 'Investor Activity in 2016' shows, fundraising could become more challenging in 2016, as investors take a cautious approach to investing in hedge funds. In fact, a larger proportion (33%) of investors reported that their confidence in hedge funds to perform portfolio objectives had reduced over the past year than those that reported it had increased (12%, Fig. 3.7), again highlighting the cautious outlook taken by investors towards hedge funds in 2016. With this in mind, Preqin turned its attention to how to attract investor capital in 2016 by looking at the key factors they use to assess hedge funds and their outlook on the key issues in the industry today.

Preqin's 2015 survey found that returns, highlighted by 53% of respondents, is the most prominent factor that investors consider when selecting a fund (Fig. 3.8). This represents an increase of nine percentage points from the corresponding proportion in Preqin's 2014 surveys. After a second year of disappointing performance for significant numbers of investors, it is unsurprising that investors are focusing more on the performance of a fund prior to investing.

Other than returns, fund manager experience is a key factor that investors consider when evaluating new opportunities (cited by 44% of respondents). This is closely followed by the source of returns/strategy and an established track record, each cited by 40% of investors. Although these figures are significant, they all represent a small decline from the previous year in contrast to the growing focus on returns. Other areas that have become more important to investors over 2015 are risk profile and fees, as well as liquidity, transparency and client service.

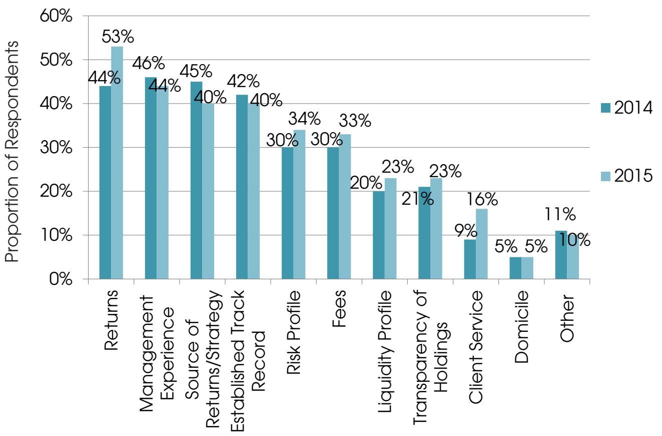
When looking at what investors rate as the key issue affecting the hedge fund industry in 2016, performance remains at the forefront of investors' minds: 35% of investors surveyed cited this as their leading concern in 2016 (Fig. 3.9). There has also been a significant increase in the number of investors stating that transparency will be a key issue: 21% of investors cited this as an important issue in the hedge fund sector going into 2016, compared with just 9% that stated the same a year earlier. Sustained performance difficulties and a growing need to understand the source of funds' performance – either good or bad – has highlighted for investors the increasing importance of transparency.

Fig. 3.7: Investor Confidence in Hedge Funds' Ability to Meet Portfolio Objectives



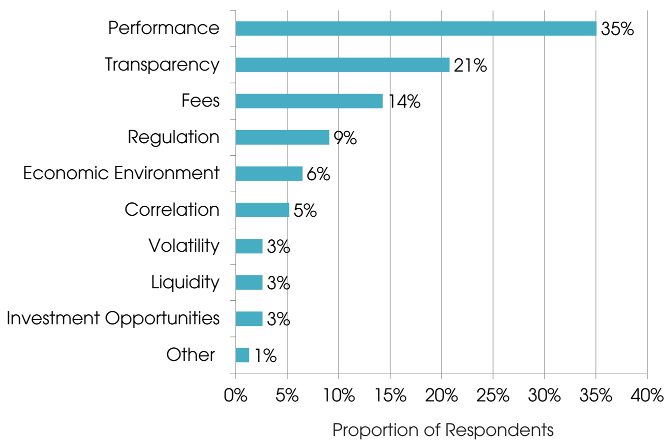
Source: Preqin Investor Interviews, December 2015

Fig. 3.8: Key Factors Investors Take into Account when Evaluating Hedge Fund Managers, 2014 vs. 2015



Source: Preqin Investor Interviews, December 2015

Fig. 3.9: Key Issue Facing the Hedge Fund Industry in 2016 According to Institutional Investors



Source: Preqin Investor Interviews, December 2015

Fees and Alignment of Interests

Fund terms and conditions are an important consideration for investors sourcing hedge fund investment opportunities. Central to these terms are the management and performance fees charged, which have long been a source of contention between investors and fund managers. In recent years the 2/20 fee structure, once synonymous with the asset class, has gradually given way to a wide range of terms of remuneration, reflecting the variety of fund types now available to investors in hedge funds and the high level of competition in the hedge fund market.

In addition to more appealing fee structures, investors have lobbied managers for increased transparency, appropriate liquidity and general improvement in the alignment of investor and manager interests. Given the vast amount of capital that institutional investors have at their disposal and the sustained appetite that many retain for hedge funds, managers are faced with balancing the demands of a progressively more sophisticated investor base with terms that are not detrimental to consistently generating returns or the long-term viability of their funds.

Sixty-nine percent of investors agree that investor and manager interests are aligned (Fig. 3.10). However, with 31% of investors disagreeing with this sentiment there is still clearly scope for the fund management industry to further address investor concerns.

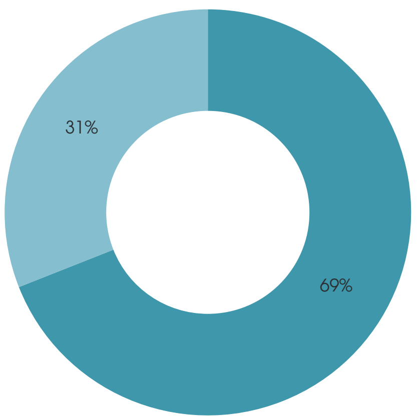
Approximately 14% of investors regard fees as the key issue facing the hedge fund industry going into 2016, making it the third most important issue behind performance and transparency (see page 20). Indeed, many of the more high-profile exits of institutional investors from the hedge fund space in recent years, most notably CalPERS in 2014 and Railpen in 2015, have cited the reason for their redemptions as the costs and fees incurred by investing in the asset class and therefore the perceived lack of value provided by hedge funds.

Many investors still see room for improvement in terms of fees. When asked which areas of fund terms had improved the most over 2015, management fees were most commonly cited (58% of investors, Fig. 3.11). However, management fees were also the most common answer when investors were asked which area of fund terms and conditions they want to improve further in 2016, as cited by 46% of investors. Similarly, although 35% of investors reported improvements in the level of performance fees, 42% would like to see performance fees reduced further over the coming year. This indicates that while there has been continued movement in the right direction for investors regarding the level of management and performance fees, there remains clear demand for further improvement over 2016.

Investors are also looking for improvement in how performance fees are charged. Thirty-five percent of investors have seen positive change in this area but 26% would like to see more progress in 2016. Understandably, many investors believe they should only be paying fees when it is justified by the performance of the fund, although managers can implement various conditions, such as clawback provisions, which can help to protect investors from sustained periods of sub-par performance. Furthermore, 14% of investors would like to see progress regarding the hurdle rates offered by managers, in contrast to just 12% of investors that have seen improvement in this area.

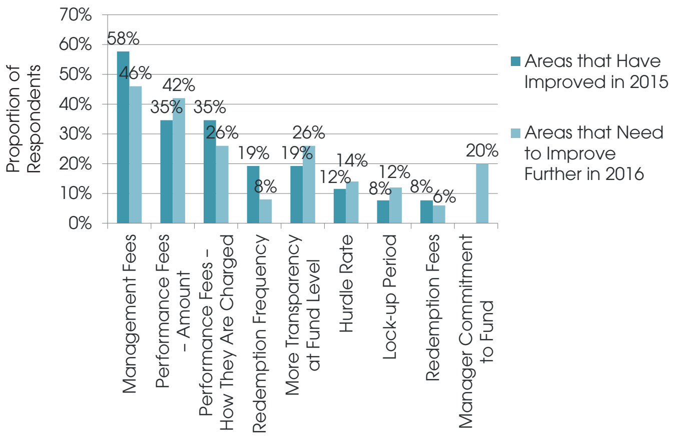
Along with fees, investors are also looking for fund managers to have more 'skin in the game' in terms of their own investment in their funds. No investor reported they have seen improvement on this front in 2015, and a fifth want their managers to improve on their level of investment in their own hedge funds. With performance proving difficult in 2015, investors want managers to put more of their own capital at stake in their hedge funds in order to better incentivize portfolio managers to generate positive performance in the future.

Fig. 3.10: Investors' Views on the Alignment of Interests between Investors and Fund Managers



Source: Preqin Investor Interviews, December 2015

Fig. 3.11: Areas of Fund Terms Investors Feel Have Shown the Most Improvement over the Past 12 Months and that Need to Improve Further in 2016



Source: Preqin Investor Interviews, December 2015

Investment Consultants

As institutional investors build increasingly large portfolios of alternative assets, there is a growing need for the use of alternative assets investment consultants to bridge the gap between investors seeking exposure to hedge funds and the fund managers that can best meet the portfolio needs of these institutions.

As a result, investment consultants can act as key intermediaries between investors and hedge funds, and understanding their outlook on hedge funds and their preferences for the year ahead can help in successfully raising capital in 2016, as well as finding the best investment opportunities. In this section, we present the findings of Preqin's in-depth surveys, conducted in November 2015, of 45 investment consultants and 150 institutional investors active in alternative assets, as well as drawing on data taken from Preqin's **Hedge Fund Online**.

Key Facts: Investment Consultants

319

Number of **investment consultants** globally that provide **advice** on hedge fund investments.

65%

Proportion of **institutional investors** that use a **consultant** to **advise** on their hedge fund investments.

Consultant Recommendations for 2016

Macro Strategies

CTAs

Liquid Alternatives

Recommend Increased Allocation

25%
recommend increased investment in hedge funds in 2016.

17%
recommend reduced investment in hedge funds in 2016.

Equity Strategies

Systematic Strategies

Funds of Hedge Funds

Recommend Decreased Allocation

Consultants' Views on Performance in 2015

73%
of investment consultants believe hedge fund **performance did not meet expectations** in 2015.

Leading Three Factors Assessed when Reviewing a Hedge Fund

At least one-year track record of the fund.

Transparency of the fund.

Experienced fund manager.

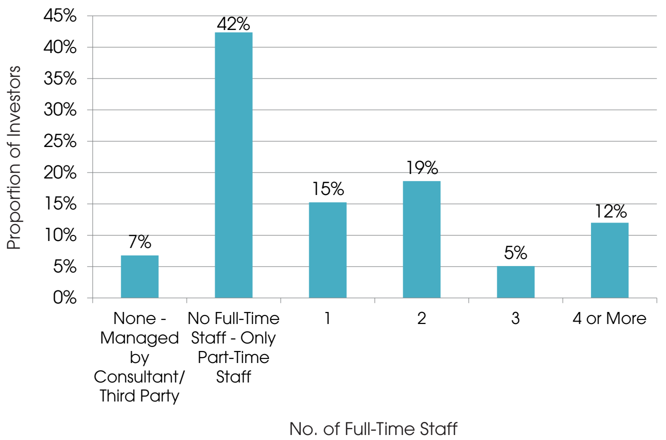
Hedge Fund Investment Teams

In our last Investor Outlook, released in August 2015, Preqin took a closer look at the process for institutional investors when it comes to sourcing and selecting hedge funds. The study revealed that investors face a difficult task in sifting through the proposals they receive – which on average amount to over 150 per year – and selecting the fund that matches their portfolio objectives. Perhaps more pressing on investors' time is maintaining their existing portfolios of funds. As investors seek funds to report more frequently and more transparently on the nature of the level of risk and strategy of their vehicles, this adds to the burdens they face when it comes to managing the incoming information regarding their hedge fund investments. With the challenge of selecting and maintaining portfolios of funds in mind, Preqin turned its attention to the investment teams at institutions with active investments in hedge funds.

As shown in Fig. 3.12, 7% of institutional investors reported they have no internal staff members working on their hedge fund portfolios and everything is outsourced to a consultant or another third-party firm. A much larger proportion (42%) have no specific hedge fund team in place to manage their portfolios of hedge funds, and instead, an individual or group of individuals spend part of their time managing and monitoring their portfolios of funds. Of the remaining investors with specific staff focused on their hedge fund investments, the majority either have one (15%) or two (19%) individuals looking after this area of their portfolio, although a not insignificant 12% of investors reported their internal hedge fund teams amounted to four or more individuals.

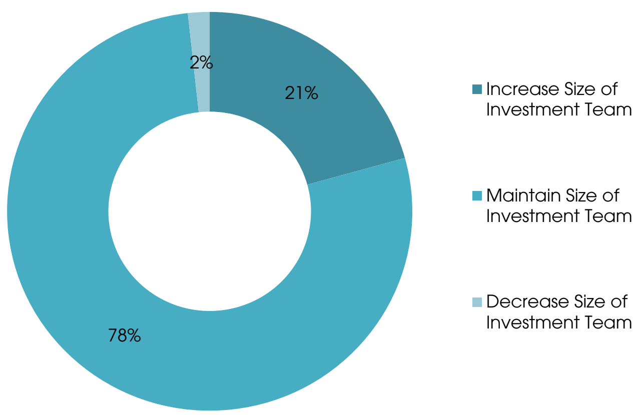
With most investors either not having specific individuals working on hedge funds full time, or having relatively small teams looking after this area of their portfolio, Preqin asked investors to discuss in more detail their plans for the future in regards to the size of their internal investment teams. Although 78% of investors have no plans to change the size of their hedge fund teams (or add new teams in cases where they do not already have them), over a fifth of respondents plan to increase their internal capabilities in managing this part of their portfolio, and just 1% will reduce the size of their hedge fund team over the next two years (Fig. 3.13). This indicates that although institutions retain relatively modest numbers of individuals to look after their hedge fund portfolios, we may see increased employment in this area going forwards as many investors begin to grow their own capabilities. The hedge fund sector is an ever evolving and complex asset class; often this area of an investor's portfolio may require increased attention in order to understand the complexities of these investments. As investors are becoming increasingly sophisticated when it comes to their portfolios of funds – not only increasingly managing portfolios of funds themselves rather than using funds of funds, but also looking for increased exposure to the asset class – there may be increased pressure to add to the numbers of staff working on this area of their portfolio.

Fig. 3.12: Number of Full-Time Staff Working on Hedge Fund Portfolios at Institutional Investors



Source: Preqin Investor Interviews, December 2015

Fig. 3.13: Investors' Plans to Change the Size of Their Hedge Fund Investment Team in the Next Two Years



Source: Preqin Investor Interviews, December 2015

Key Facts

The average investor receives **156** new hedge fund proposals each year.

It takes an average of **five months** to reach a decision on a fund proposal.

10

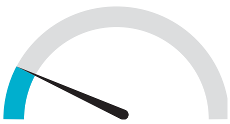
The average size of an investor's portfolio is 10 funds*****.

**Excludes funds of hedge funds.*

In Focus: Emerging Managers

Emerging managers have faced many challenges in recent years. Much of the inflows in 2015 went to the larger funds, which resulted in more funds with under $100mn in assets under management (AUM) seeing outflows over the year compared to those that saw inflows (53% vs. 41% respectively, as at 30 November 2015). New regulations and an increasingly sophisticated investor base demanding institutional-quality infrastructure, as well as lower fees, have led to smaller funds having to juggle spiralling costs while setting appropriate fees to remain competitive. However, although emerging managers face more barriers to entry and rising competition for capital, there are rewards still to be gained for launching a new hedge fund enterprise. Institutional investors retain an appetite for emerging managers and recognize the value that they can add to their investment portfolios. Those smaller hedge funds that can gain the attention of an institutional audience in 2016 may well be on the path from emerging to established manager.

The Emerging Hedge Fund Manager Landscape in 2016



17%
Proportion of fund managers established in the last three years.

60%
Proportion of funds that have $100mn or less in AUM.

5%
Proportion of industry capital invested in funds with $100mn or less in AUM.

Source: Preqin Hedge Fund Online

Investor Interest in Emerging Manager Hedge Funds

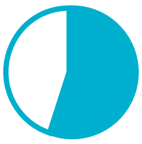
22% of investors invested in an emerging manager fund in 2015.

19% of investors will invest in an emerging manager fund in 2016.

35% of investors are considering investment in emerging manager funds in 2016.

Source: Preqin Investor Interviews, December 2015

Consultant Recommendations for Emerging Managers in 2016



45% of consultants do not recommend investment in emerging managers.

The remaining **55%** recommend the following in regards to exposure to emerging managers in 2016:

Source: Preqin Investment Consultant Survey, November 2015

Leading Three Reasons Investors Choose Emerging Managers

Potential for Higher Returns

Access to Unique Strategy

Emerging Managers Are More Nimble than Established Managers

Source: Preqin Investor Interviews, December 2015

Real Estate

Strong Performance Exceeds Investors' Expectations

Real estate has largely been performing well for institutional investors. Thirty-nine percent of investors interviewed by Preqin feel the performance of their real estate portfolios has exceeded their expectations in the past year, with just 10% saying it failed to meet expectations. Real estate funds have generated annualized returns of 16% in the past three years, while the 12.8% median return achieved by public pension funds' real estate portfolios in the 12 months to June 2015 is higher than any other asset class. Investors are seeing a lot of capital returned as a result. 2014 was a record year in terms of distributions from private real estate funds, with $187bn returned to investors, while $103bn was distributed to investors in the first half of 2015.

Driven by this strong performance and the confidence that it will continue to deliver, institutional capital will continue to flow into real estate in 2016. Eighty-two percent of investors expect to commit at least as much capital to real estate in 2016 as they did the year before. The longer term outlook is also positive, with 53% of investors below their strategic targets to real estate and many expecting to increase these targets in the medium to longer term.

There is no shortage of opportunities in the market; there are currently 497 private real estate funds being marketed, a record high, although fund managers must be aware of the concerns of investors if they want to secure commitments. With the majority of surveyed institutions citing high valuations of assets as their primary concern over 2016, investors face a difficult task in trying to separate the best managers that are adding genuine value from those that have simply benefitted from the rising market.

Investor Appetite

90%
Proportion of investors that feel their real estate investments have met or exceeded their expectations.

68%
Proportion of surveyed investors that feel that valuations are the key issue for the private real estate market in 2016.

52%
Proportion of surveyed investors that have a positive perception of real estate, up from 37% in December 2014.

Make-up of Investors

81%
Proportion of investors with under $10bn in assets under management.

$355bn
Total amount allocated to the asset class by the top 10 real estate investors.

$58bn
Estimated current allocation to the asset class of Abu Dhabi Investment Authority, the largest real estate investor globally.

Evolution of Investors

8.5%
Investors' average current allocation to real estate, below the average target allocation of 9.8%.

53%
Proportion of investors below their target allocation to real estate, the smallest in the period 2011-2015.

67%
Proportion of institutional investors that will not invest in first-time funds, the highest in the period 2009-2015.

Data Source:

Preqin's **Real Estate Online** contains detailed profiles of over 5,000 institutional investors actively or considering investing in real estate funds.

Information includes their plans for investment in the coming months, allocation information, full contact information for key decision makers, past investments and more.

For more information, please visit:

www.preqin.com/reo

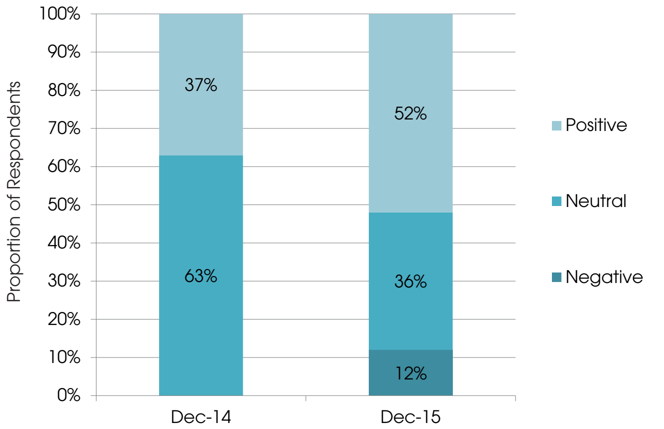
Satisfaction with Real Estate

Encouragingly, the majority (52%) of surveyed investors have a positive perception of the real estate asset class at present, indicating a large change in sentiment from the 37% that felt this way in December 2014 (Fig. 4.1). However, 12% have a negative perception, where none stated this at the end of 2014.

Furthermore, there is growing satisfaction among institutional investors with the returns they are seeing from their real estate portfolios. Fig. 4.2 shows that 39% of investors interviewed in December 2015 felt the performance of their private real estate fund investments had exceeded expectations in the previous 12 months, nearly three-times the proportion that stated this in December 2013. Investors remain confident in the ability of real estate to fulfil portfolio objectives, with 71% stating there had been no change in their level of confidence and 16% stating confidence had increased (Fig. 4.3).

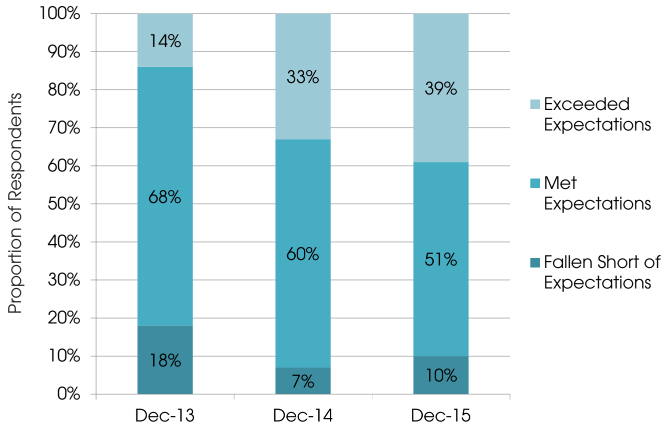
It is unsurprising therefore, that the majority (55%) of investors interviewed by Preqin will be looking to maintain their allocation to the asset class over the long term, although further growth in capital flowing to real estate is expected; 29% of investors plan to increase their exposure to the asset class, while just 16% will be shrinking their allocations (Fig. 4.4).

Fig. 4.1: Investors' General Perception of the Real Estate Industry at Present, 2014 vs. 2015



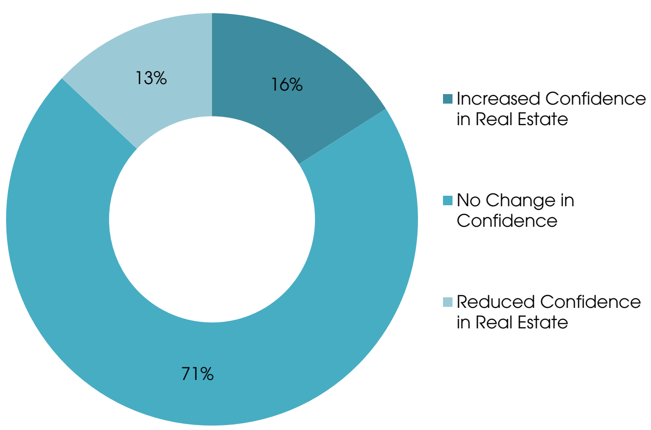
Source: Preqin Investor Interviews, December 2014-2015

Fig. 4.2: Proportion of Investors that Feel Their Private Real Estate Investments Have Lived up to Expectations over the Past 12 Months, 2013 - 2015



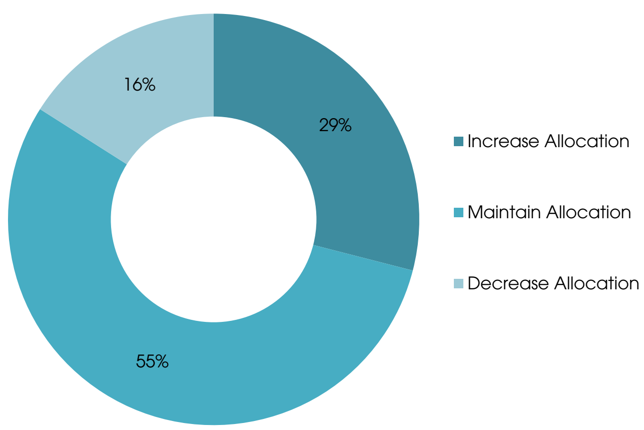
Source: Preqin Investor Interviews, December 2013-2015

Fig. 4.3: Investors' Change in Confidence in Private Real Estate to Achieve Portfolio Objectives in the Past 12 Months



Source: Preqin Investor Interviews, December 2015

Fig. 4.4: Investors' Intentions for Their Private Real Estate Allocations in the Longer Term



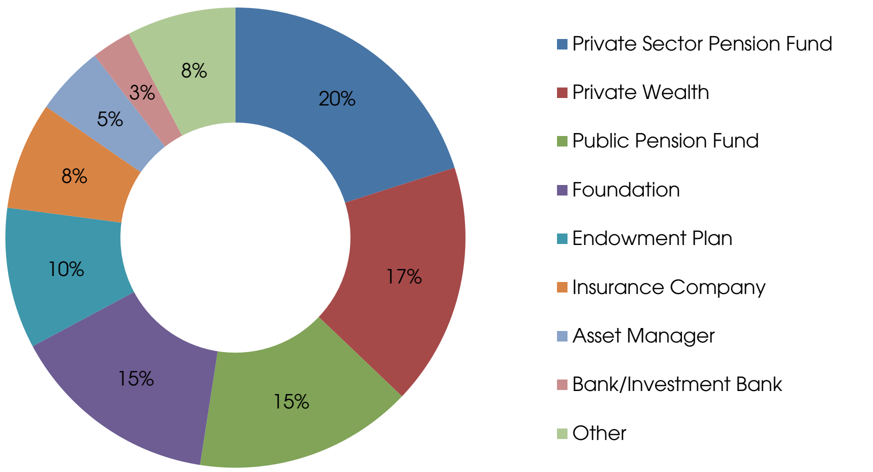
Source: Preqin Investor Interviews, December 2015

Evolution of the Investor Universe

Real estate remains an important part of many institutional investment portfolios, with 59% of investors maintaining an allocation to the asset class. Preqin's **Real Estate Online** features in-depth profiles for more than 5,000 institutional investors worldwide that are actively investing in real estate, including their preferences, past investments and plans for the next year, as well as contact information for key decision makers.

With most routes to real estate being illiquid, real estate investment is particularly suited to institutional investors with long-term investment horizons. Fig. 4.5 illustrates how pension funds account for over a third of real estate investors, with private wealth institutions, foundations, endowment plans and insurance companies collectively representing a further 50%. The population of active real estate investors has a wide range of assets under management (AUM), as illustrated in Fig. 4.6, with the largest proportions holding between $1bn and $9.9bn (36%) and less than $500mn (32%).

Fig. 4.5: Breakdown of Institutional Investors in Real Estate by Type



Source: Preqin Real Estate Online

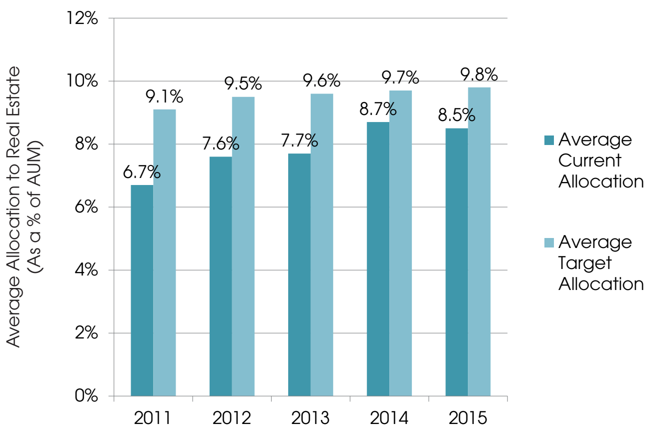
Allocations

The prominence of real estate within an institutional portfolio has increased over recent years, with the average current allocation rising from 6.7% of AUM in 2011 to 8.5% in 2015, while the average target allocation rose from 9.1% to 9.8% over the same time period (Fig. 4.7). Record distributions to investors from private real estate funds in 2014 may have contributed to the slight fall in the

Fig. 4.6: Breakdown of Institutional Investors in Real Estate by Assets under Management

Source: Preqin Real Estate Online

Fig. 4.7: Investors' Changing Current and Target Allocations to Real Estate, 2011 - 2015



Source: Preqin Real Estate Online

Download the Data Pack

View all the charts and tables featured in this report in our handy Excel data pack. It includes ready-made charts that can be used for presentations, marketing materials and company reports.

To download the data pack for **free**, please visit:

www.preqin.com/investoroutlook

average current allocation from 8.7% in 2014.

The top three investor types by average current allocation are all pension funds, of which public pension funds have the highest current and target allocations to real estate (Fig. 4.8). Sovereign wealth funds, which have long-term investment horizons, are also suited to investment in real estate, which is reflected in their relatively high average current and target allocations to the asset class.

In December 2015, the majority (53%) of investors were still below their target allocations to the asset class, as shown in Fig. 4.9. This proportion has steadily fallen from two-thirds of investors as of December 2011, as institutions have committed capital and more have reached their long-term strategic targets. Furthermore, 29% of investors are planning to increase their allocations to real estate over the longer term.

Private Wealth

Private wealth is an increasingly important source of capital to the real estate asset class, with wealth managers and family offices currently making up 17% of the real estate investor universe. The majority (51%) of private wealth firms are wealth managers, while multi-family and single-family offices constitute 25% and 24% respectively (Fig. 4.10). As global numbers of high-net-worth individuals increase year on year, the importance of private wealth as a source of capital for the real estate industry is set to grow. Fifty-eight percent of fund managers surveyed by Preqin stated they had seen more appetite for real estate from family offices over the past year, more than any other investor type.

Data Source:

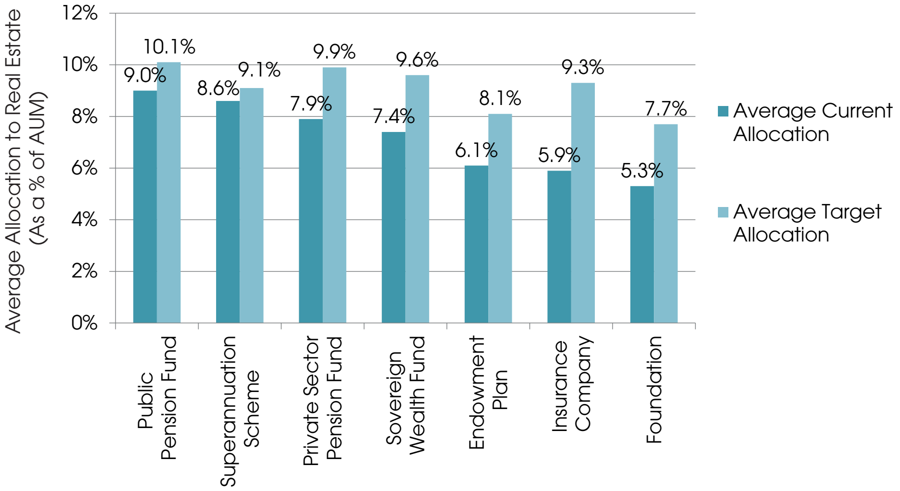
The **Fund Searches and Mandates** feature on Preqin's **Real Estate Online** is the perfect tool to pinpoint those institutions that are seeking new real estate funds for investment now.

Search for potential new investors by their current investment searches and mandates, including fund structure, fund strategy and regional preferences.

For more information, please visit:

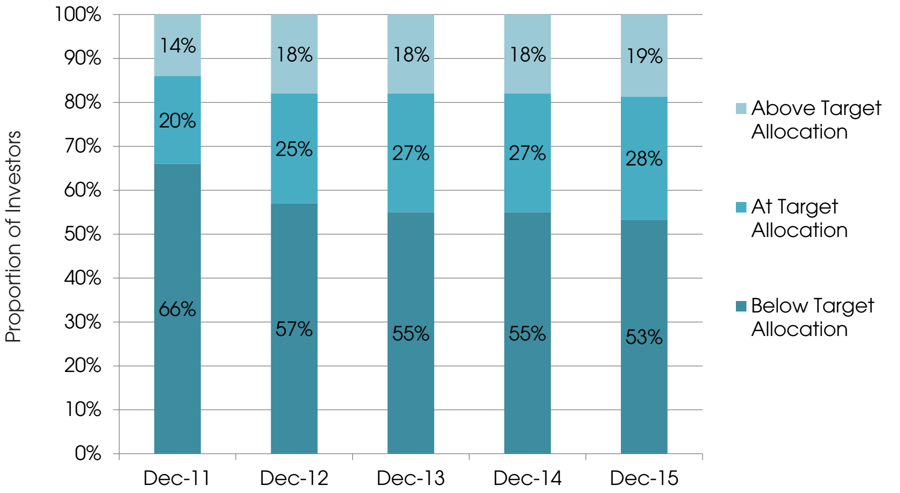
www.preqin.com/reo

Fig. 4.8: Investors' Average Current and Target Allocations to Real Estate by Investor Type



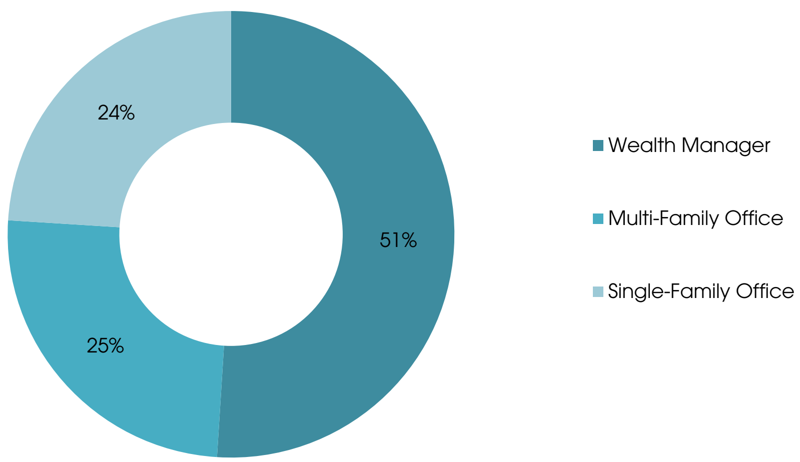
Source: Preqin Real Estate Online

Fig. 4.9: Proportion of Investors that Are At, Above or Below Their Target Allocations to Real Estate, 2011 - 2015



Source: Preqin Real Estate Online

Fig. 4.10: Breakdown of Private Wealth Investors in Real Estate by Type



Source: Preqin Real Estate Online

Investor Activity in 2016

Over 2016, 30% of institutions expecting to be active in the coming year are planning to deploy more capital in 2016 than they did in 2015, a larger proportion than that stated their intention to commit less capital (Fig. 4.11). The majority (58%) of active institutions plan to commit less than $100mn. Some investors, however, are looking to put substantial amounts of capital to work: 14% will invest $300mn or more in private real estate funds in 2016.

Strategies and Regions Targeted

Value added, core and opportunistic funds continue to be the most favoured strategies by those investors that plan to be active in the real estate asset class in 2016; 55%, 50% and 45% of investors are looking to commit to these strategies respectively (Fig. 4.12). Appetite for these strategies remains relatively unchanged from December 2014, suggesting investors are still targeting a diverse range of real estate exposure.

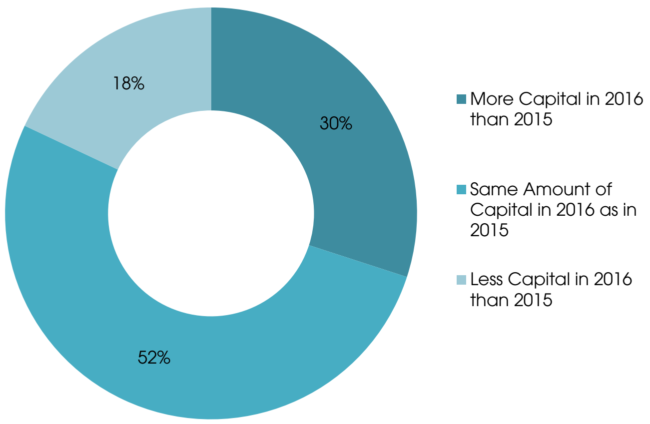
The majority of investors looking to make commitments in 2016 have a strong domestic bias, with investors much more likely to invest capital in the region in which they are based. However, Asia-based investors are less likely to target Asia than Europe- or North America-based investors are to target their domestic markets (Fig. 4.13).

Furthermore, North America- and Asia-headquartered investors are more likely than their Europe-based counterparts to have a globally diversified outlook.

Key Issues in 2016

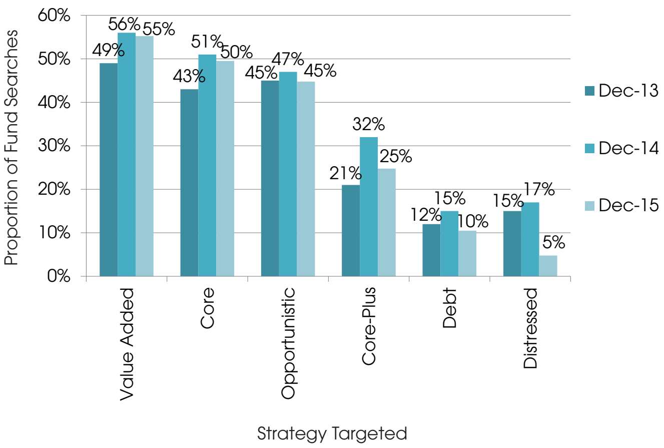
The pricing of real estate assets over 2016 is the primary concern of the majority of investors, which are concerned about the ability of fund managers to find opportunities at compelling valuations (Fig. 4.14). Two interrelated issues, the performance of real estate funds and fund managers' ability to source deals, are also cited as key concerns by notable proportions of respondents.

Fig. 4.11: Investors' Expected Capital Commitment to Private Real Estate Funds in 2016 Compared to 2015



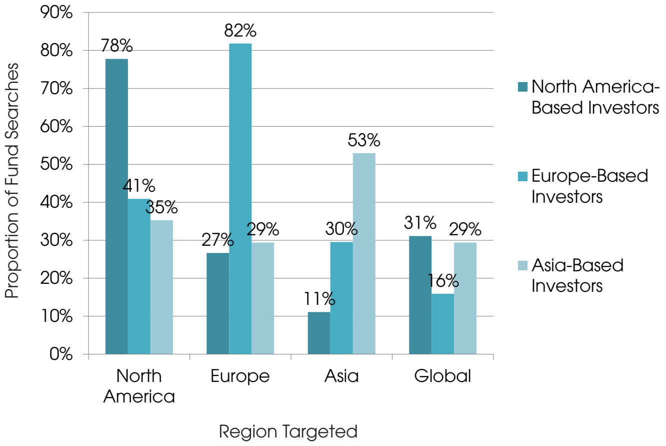
Source: Preqin Investor Interviews, December 2015

Fig. 4.12: Strategies Targeted by Private Real Estate Investors in the Next 12 Months, 2013 - 2015



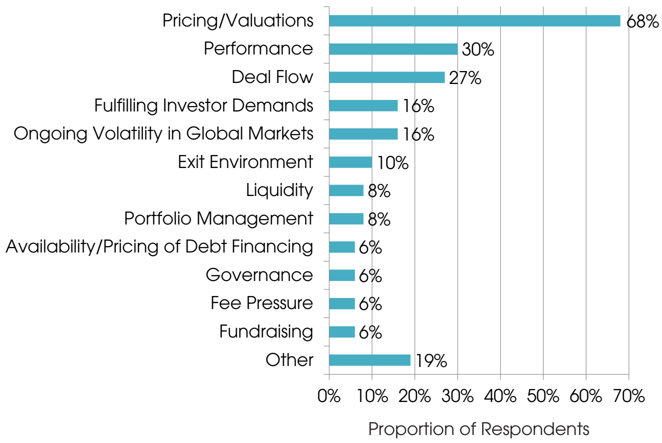
Source: Preqin Real Estate Online

Fig. 4.13: Regions Targeted by Private Real Estate Investors in the Next 12 Months by Location



Source: Preqin Real Estate Online

Fig. 4.14: Investors' Views on the Key Issues for the Private Real Estate Market in 2016



Source: Preqin Investor Interviews, December 2015

Appetite for First-Time Funds and Alternative Structures

Appetite for First-Time Funds

Investors are increasingly choosing to invest with more experienced fund managers that have a proven track record and consequently, approximately two-thirds of the investor population will not invest in first-time funds, a slight increase from 2013 and 2014, and a sizeable increase from 2009 (Fig. 4.15). There is a clear correlation between appetite for first-time funds and assets under management (AUM). Ninety-one percent of firms with AUM of less than $1bn will not invest in first-time private real estate funds, while 41% of firms with over $50bn in AUM will invest in new fund managers.

Appetite for Separate Accounts, Joint Ventures and Co-Investments

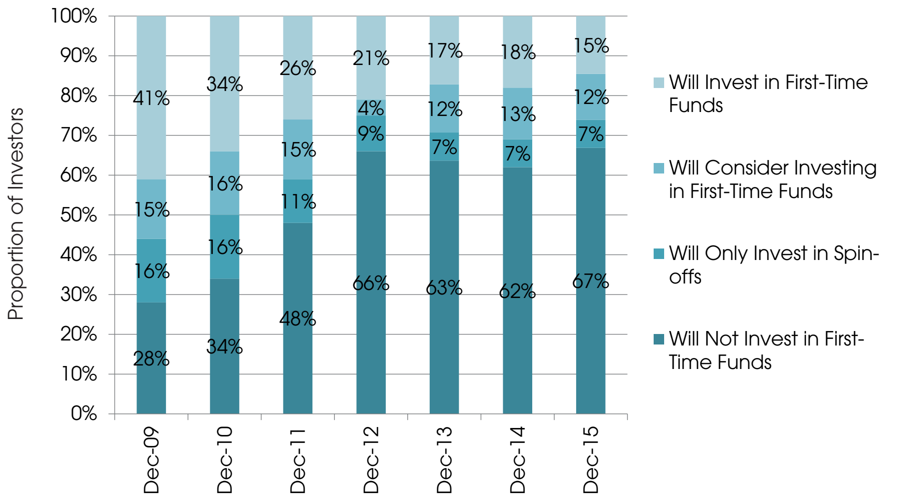
In recent years there has been an increase in investor appetite for exposure to real estate via alternative routes to market to traditional commingled funds. Structures such as separate accounts and joint ventures can offer institutions increased exposure to attractive assets, reduced fees, the opportunity to put large amounts of capital to work and a greater degree of control over their investment portfolio, while still accessing the skill and pipeline of deals of a third-party fund manager.

However, alternative structures come with high barriers to entry, often requiring large commitment sizes, making them accessible to only the largest of investors. Due to this, separate accounts, joint ventures and co-investments have been utilized by between one-fifth and one-third of real estate investors.

Fig. 4.16 illustrates that investor appetite for separate account mandates increased steadily between 2012 and 2015, before a small decline in 2016. This is supported by fundraising data, which shows a significant decline in the capital raised by separate accounts in 2015 from 2014. Fifty-two private real estate separate accounts were awarded in 2014 for $20.3bn, declining to 34 mandates awarded to fund managers for $12.9bn over the course of 2015.

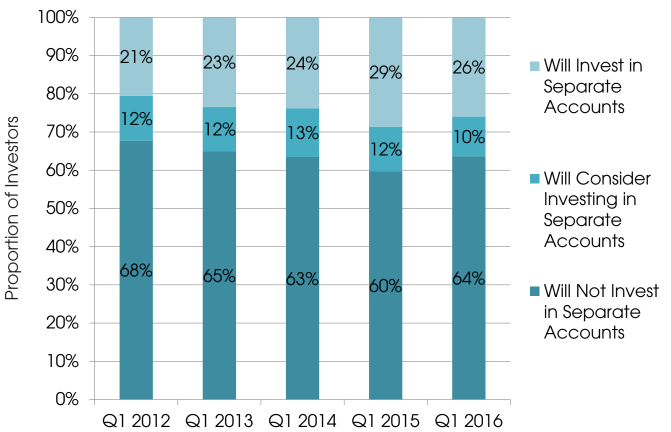
Investor appetite for co-investments has exhibited similar trends to the appetite for separate accounts, rising from 2012 until 2015, before declining slightly into 2016 (Fig. 4.17).

Fig. 4.15: Real Estate Investor Appetite for First-Time Funds, 2009 - 2015



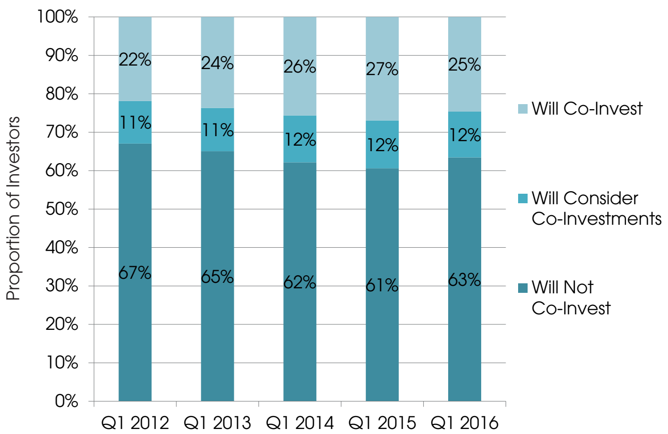
Source: Preqin Real Estate Online

Fig. 4.16: Investor Appetite for Real Estate Separate Accounts, Q1 2012- Q1 2016



Source: Preqin Real Estate Online

Fig. 4.17: Investor Appetite for Real Estate Co-Investments, Q1 2012- Q1 2016



Source: Preqin Real Estate Online

How Investors Source and Select Funds

How Investors Source Funds

61% through **internal investment team**

49% through **networking** and **peer recommendations**

36% through **direct approaches from fund managers**

34% after approach by **third-party marketer**

26% through **consultant recommendations**

20% through **fund databases**

The average investor receives **155** fund proposals each year.

The average investor sends **8%** of proposals through to a second round of screening.

The three most important factors investors consider when looking for a real estate fund manager:

- Past Performance
- Strategy
- Length of Track Record

The average investor makes **three** investments each year.

How Can Preqin Help Raise Funds?

> Find out which strategies investors are interested in with our dedicated **Fund Searches and Mandates** portal.

> Find out which consultants work with which investors and the key contacts at each group.

> Gain detailed insights into over **5,000** institutional investors to build tailored pitches to those investors looking for your fund.

> Over **7,800** investors are looking at funds on **Preqin Investor Network**. Ensure your details are accurate and up-to-date so investors can find you!

www.preqin.com/sharedata

Source: Preqin Investor Interviews, December 2015

Infrastructure

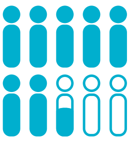
Will Infrastructure Deliver Returns in a Competitive Deal Environment?

Over three-quarters of respondents to Preqin's latest survey of institutional investors stated that the performance of their infrastructure fund investments over 2015 had met or exceeded their expectations. This, along with record distributions from infrastructure funds to investors in 2014, has seen appetite for the asset class rise among institutional investors: 74% of surveyed fund managers are seeing greater appetite from investors. With the majority of investors currently below their target allocation to infrastructure, capital should flow into the asset class in 2016 and beyond; almost half of respondents intend to commit more capital to infrastructure funds in 2016 than they did in 2015, while 52% intend to increase their allocation over the long term.

Despite the rising appetite, investors are often looking to commit capital to firms that have completed a full cycle of investments and exits. Notably, 2015 marked the first year in which the proportion of those investors not investing in first-time funds (44%) was greater than the proportion that consider such vehicles (42%), indicative of the challenges new firms will face in securing investor capital.

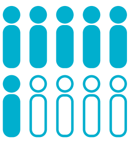
A more competitive deal environment is pushing up prices for infrastructure assets and affecting deal flow; as a result, the largest proportions of surveyed infrastructure investors feel these are the key challenges for the market in 2016. Only time will tell, however, whether today's asset prices will have an adverse effect on the strong, stable returns to which investors have become accustomed. Furthermore, investors face the challenge of identifying the managers that can truly deliver the returns they seek at an acceptable level of risk within an intensely competitive market. However, record distributions, rising appetite and the large proportion of investors underweighted to the asset class should see a continuation in the year to come of the strong fundraising figures seen in recent years.

Investor Appetite



77%
Proportion of investors that feel their infrastructure investments have met or exceeded their expectations.

38%
Proportion of surveyed investors that feel deal flow and valuations are the key issues for the infrastructure market in 2016.



60%
Proportion of surveyed investors that will target, or will consider targeting, co-investment opportunities.

Make-up of Investors

65%
Proportion of investors with under $10bn in assets under management.

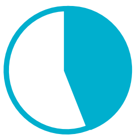
$99bn
Total amount allocated to the asset class by the top 10 infrastructure investors.

$15.5bn
Estimated current allocation to the asset class of Abu Dhabi Investment Authority, the largest infrastructure investor globally.

Evolution of Investors

4.3%
Investors' average current allocation to infrastructure, below the average target allocation of 5.7%.

63%
Proportion of investors below their target allocation to infrastructure, the largest in the period 2011-2015.



44%
Proportion of institutional investors that will not invest in first-time funds, the largest in the period 2011-2015.

Data Source:

See detailed profiles for over 2,600 institutional investors actively or considering investing in infrastructure funds on Preqin's **Infrastructure Online**, including their plans for investments in the coming months, allocation information, direct contact details, past investments and more.

For more information, please visit: www.preqin.com/infrastructure

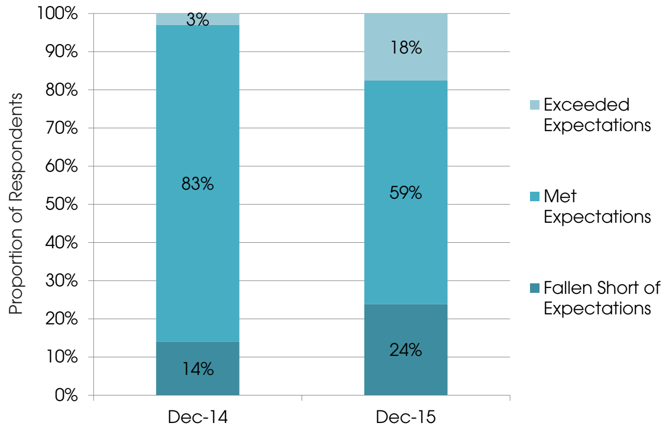
Satisfaction with Infrastructure

Fig. 5.1 shows that over three-quarters of surveyed institutional investors felt the performance of their infrastructure fund investments had met or exceeded expectations over 2015. This is encouraging and demonstrates that most investors appear satisfied with the performance delivered by the asset class. Notably, the proportion of investors that thought performance exceeded their expectations over the past 12 months increased from 3% in 2014 to 18% in 2015. However, almost a quarter of respondents felt their investments had fallen short of expectations, an increase from the 14% that stated the same in the previous year.

Furthermore, results from the survey show that 56% of institutional investors currently have a positive perception of the industry (Fig. 5.2). As investors become more experienced and familiar with the asset class, such positive sentiment could translate into larger allocations to infrastructure in future and is encouraging for the continued growth of the industry. Investors remain confident in the ability of infrastructure to fulfil portfolio objectives, with 64% stating there had been no change in their level of confidence and 23% stating confidence had increased (Fig. 5.3)

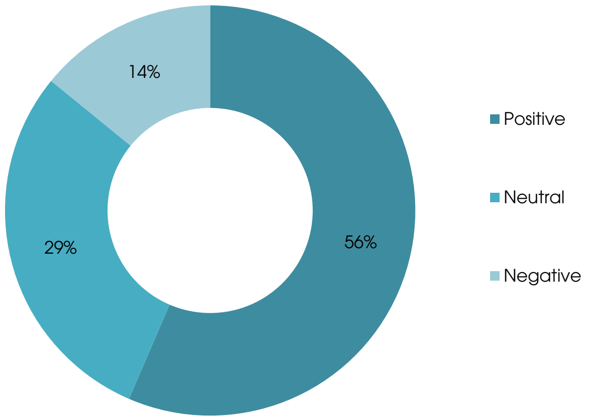
The outlook appears positive for the continued growth of the asset class, with the majority (52%) of investors stating that they intend to increase allocations over the longer term (Fig. 5.4). The average current allocation to infrastructure now stands at 4.3% of total assets under management, although as investors become more experienced and comfortable with the risks associated with investing in infrastructure, it is likely that allocations will increase. A further 39% of investors stated that they would maintain their current allocation to the asset class.

Fig. 5.1: Proportion of Investors that Feel Their Infrastructure Fund Investments Have Lived up to Expectations over the Past 12 Months, 2014 vs. 2015



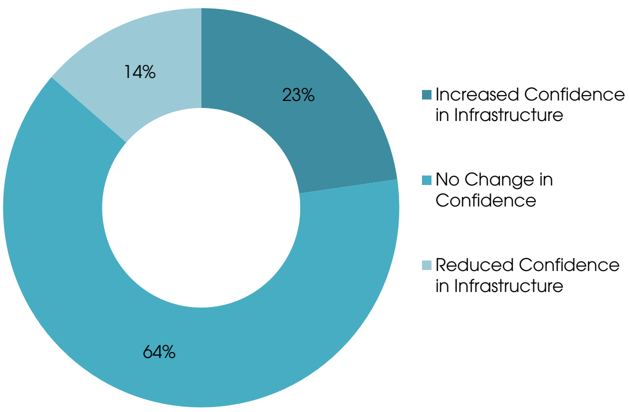
Source: Preqin Investor Interviews, December 2014-2015

Fig. 5.2: Investors' General Perception of the Infrastructure Industry at Present



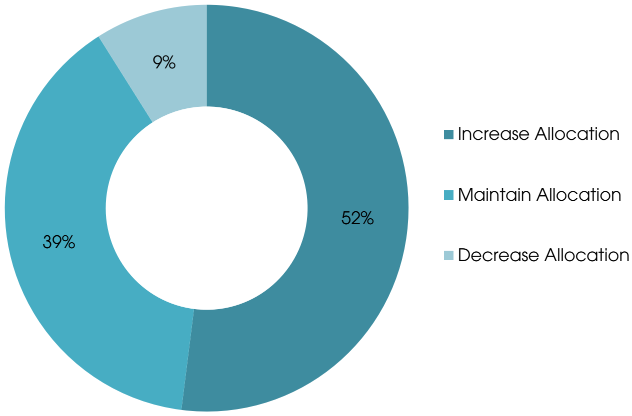
Source: Preqin Investor Interviews, December 2015

Fig. 5.3: Investors' Change in Confidence in Infrastructure to Achieve Portfolio Objectives in the Past 12 Months



Source: Preqin Investor Interviews, December 2015

Fig. 5.4: Investors' Intentions for Their Infrastructure Allocations in the Longer Term



Source: Preqin Investor Interviews, December 2015

Evolution of the Investor Universe

The number of investors entering the infrastructure asset class has increased over recent years. Today, Preqin's **Infrastructure Online** service features extensive profiles for over 2,600 institutional investors worldwide that are investing, or are considering investing, in the asset class. Compared to other alternatives such as real estate and private equity, infrastructure is a relatively young asset class in investor portfolios, with many investors still evaluating the best ways to maximize their relatively conservative exposure to the space.

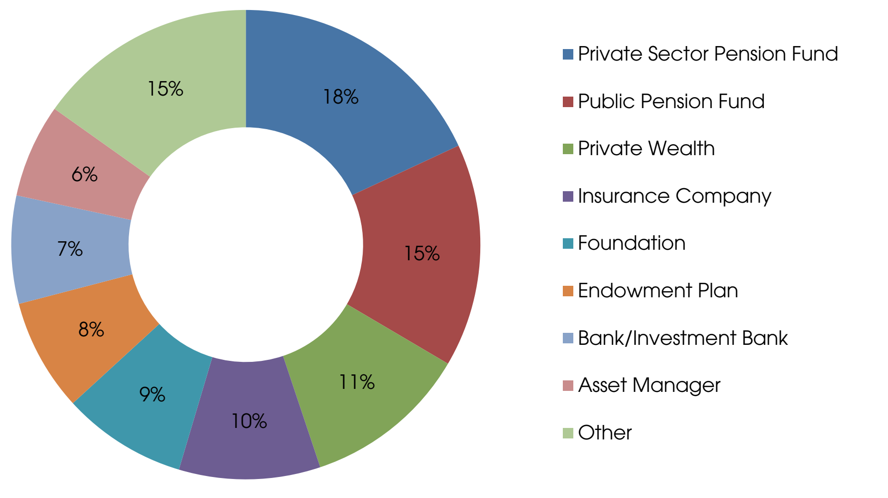
The long investment horizon and inflation-hedging characteristics of infrastructure assets are well suited to large institutional investors with long-term liabilities. For example, Fig. 5.5 illustrates that pension funds account for a third of infrastructure investors, with private wealth institutions and insurance companies representing notable proportions of the universe. Typically, it is the largest investors with bigger ticket sizes that invest in the asset class as Fig. 5.6 shows; nearly three-quarters (74%) of infrastructure investors have at least $1bn in assets under management (AUM) with a notable 15% of the universe holding $50bn or more in AUM.

Allocations

Investors are becoming increasingly familiar with the infrastructure asset class, as Fig. 5.7 demonstrates, mirroring the rise in prominence of infrastructure within investment portfolios over recent years. Investors' average current and target allocations to infrastructure (as a percentage of AUM) have generally risen since 2011. The youth of the asset class has meant that investors have historically allocated a relatively small proportion of their portfolio to infrastructure compared with other alternatives, with the average current and target allocations at 4.3% and 5.7% respectively for both 2014 and 2015. While these are still the highest percentage allocations seen since 2011, allocations in 2015 remain the same as the year before.

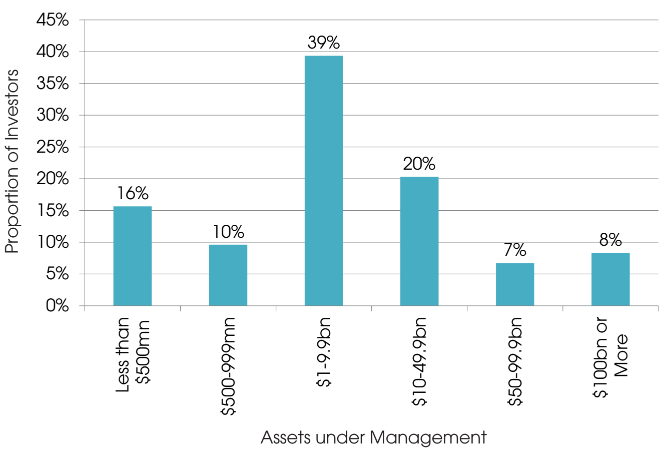
Further analysis reveals the most prominent investor types by their average current and target allocations to the asset class. The varying degrees of experience and individual portfolio objectives mean that investor types have different levels of exposure to infrastructure, as Fig. 5.8 shows. For example, superannuation schemes are typically based in Australia where there is a long history of infrastructure investment. As a result, their familiarity and expertise in the asset class mean

Fig. 5.5: Breakdown of Institutional Investors in Infrastructure by Investor Type



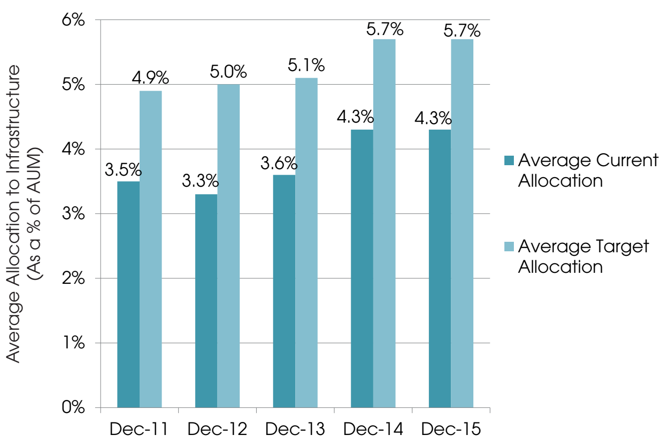
Source: Preqin Infrastructure Online

Fig. 5.6: Breakdown of Institutional Investors in Infrastructure by Assets under Management



Source: Preqin Infrastructure Online

Fig. 5.7: Average Current and Target Allocations to Infrastructure over Time, 2011 - 2015



Source: Preqin Infrastructure Online

that these investors maintain the highest average current and target allocations to infrastructure, at 6.6% and 8.7% respectively. The difference between public and private sector pension fund allocations has become more noticeable over 2015, with public pension funds generally more active in the asset class than their private sector peers.

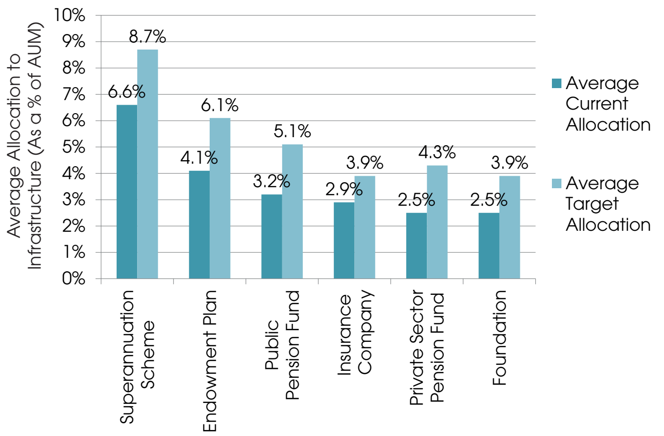
In December 2015, the majority (63%) of investors were still below their target allocation to the asset class, as shown in Fig. 5.9. This is encouraging for the long-term growth of the asset class, as investors will look to put more capital to work as they move towards meeting their strategic targets.

Dissatisfied with fixed income investment in a low interest rate environment, the inflation-hedging attributes, diversification and stable cash flows that infrastructure can offer has attracted growing numbers of private wealth entities (defined as wealth managers, multi-family offices and single-family offices) to enter the asset class; currently, private wealth investors make up 11% of the infrastructure investor universe. The majority of private wealth firms investing in infrastructure are wealth managers (52%), while multi-family and single-family offices constitute 25% and 23% respectively (Fig. 5.10). As global numbers of high-net-worth individuals increase year on year, the importance of wealth managers, multi-family offices and single-family offices to the infrastructure industry is set to grow.

With the greatest number of high-net-worth individuals based in North America, it is unsurprising that the region is home to the largest proportion (46%) of private wealth firms currently invested in infrastructure. Europe is home to 39% of private wealth firms, with the UK and Switzerland the most prominent locations for these firms.

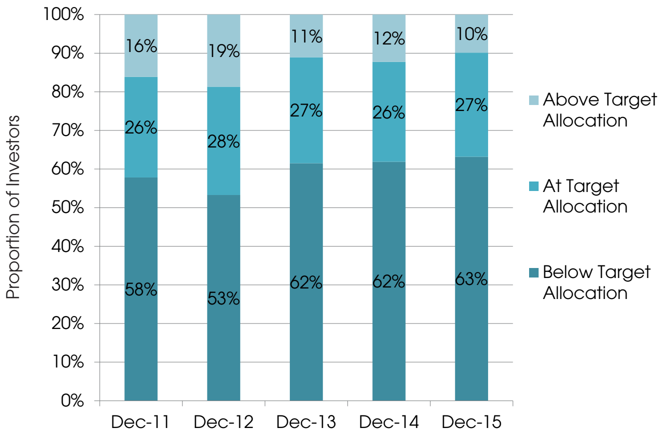
Approximately three-quarters of family offices and wealth managers invest through unlisted infrastructure funds. Family offices are more likely to access the asset class through direct investment: 46% invest in infrastructure directly compared with 22% of wealth managers.

Fig. 5.8: Average Current and Target Allocations to Infrastructure by Investor Type



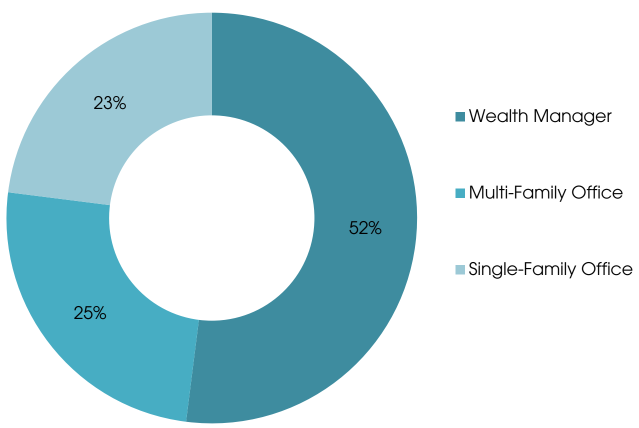
Source: Preqin Infrastructure Online

Fig. 5.9: Proportion of Investors At, Above or Below Their Target Allocations to Infrastructure, 2011 - 2015



Source: Preqin Infrastructure Online

Fig. 5.10: Breakdown of Private Wealth Infrastructure Investors by Type



Source: Preqin Infrastructure Online

Data Source:

The **Fund Searches and Mandates** feature on **Infrastructure Online** is the perfect tool to pinpoint those institutions that are actively seeking new infrastructure funds for investment now.

Search for potential investors by type and location as well as route to market, and regional and strategy preferences.

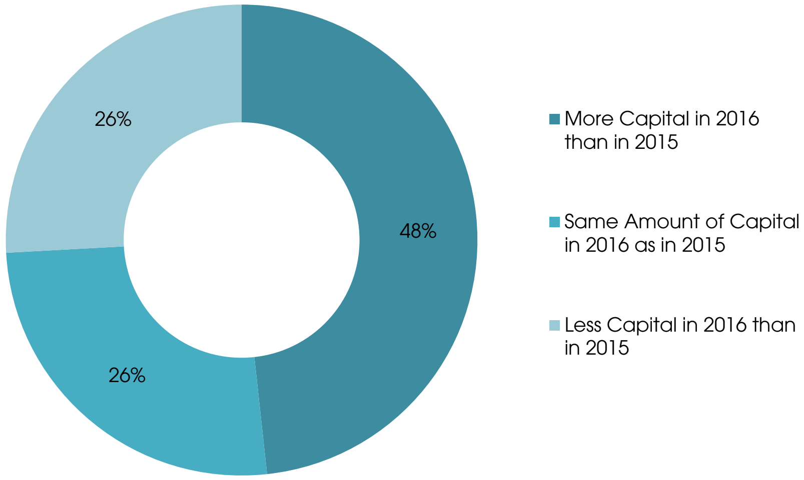
For more information, please visit:

www.preqin.com/infrastructure

Investor Activity in 2016

Almost half (48%) of investors surveyed intend to commit more capital to infrastructure funds in 2016 than they did in 2015 (Fig. 5.11), reflective of how investors are increasingly recognizing infrastructure's potential to generate stable returns and its inflation-hedging characteristics. While the majority of investors intend to commit more capital or maintain the same level of commitments over 2016, 26% of investors will look to reduce the amount of capital they invest in infrastructure over 2016. This could be a reflection of the potential impact on returns of rising valuations of assets and the limited availability of attractive investment opportunities.

Fig. 5.11: Investors' Expected Capital Commitments to Infrastructure Funds in 2016 Compared to 2015

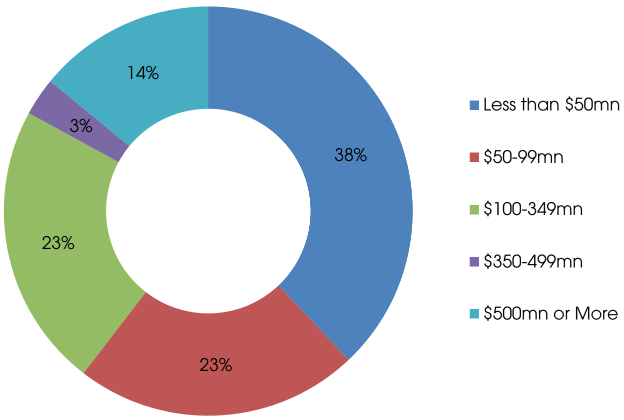


Source: Preqin Investor Interviews, December 2015

Preqin's **Infrastructure Online** tracks the activity and future investment plans of over 2,600 active investors in the infrastructure asset class. As shown in Fig. 5.12, 61% of investors that expect to be active in the next 12 months plan to invest less than $100mn in infrastructure over 2016. However, there are some investors that will make considerable commitments to the asset class in the coming year; 17% of investors that plan to be active intend to commit at least $350mn to unlisted funds in 2016. In terms of the number of investments, 41% of active investors plan to make three or more new fund commitments in the next 12 months, including 17% planning to invest in five or more vehicles (Fig. 5.13).

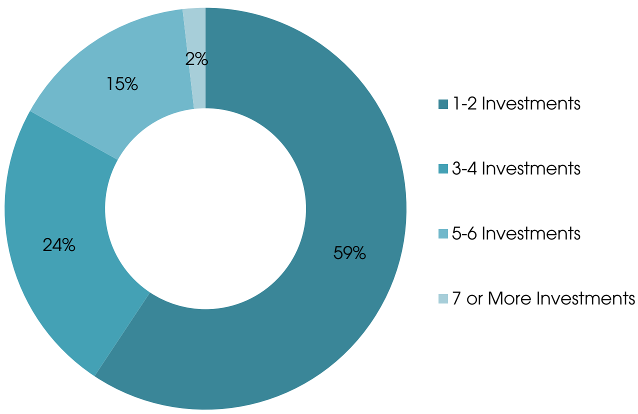
Fig. 5.14 shows the preferred route to market (direct investment, unlisted funds and listed funds) of infrastructure investors searching for new investments over the next 12 months in the period December 2012 to December 2015. The proportion of investors targeting unlisted funds fell from 91% in 2012 to 65% in 2014, while appetite for direct investment increased over the same period. Over 2016 however, 70% of investors will target unlisted infrastructure funds, while 48% will target direct investment, bucking the trends seen in the three years prior to this. Concerns over recent valuations for infrastructure assets and investors' ability to find assets at attractive

Fig. 5.12: Amount of Fresh Capital Investors Plan to Invest in Infrastructure over the Next 12 Months



Source: Preqin Infrastructure Online

Fig. 5.13: Number of Infrastructure Investments Investors Plan to Make over the Next 12 Months

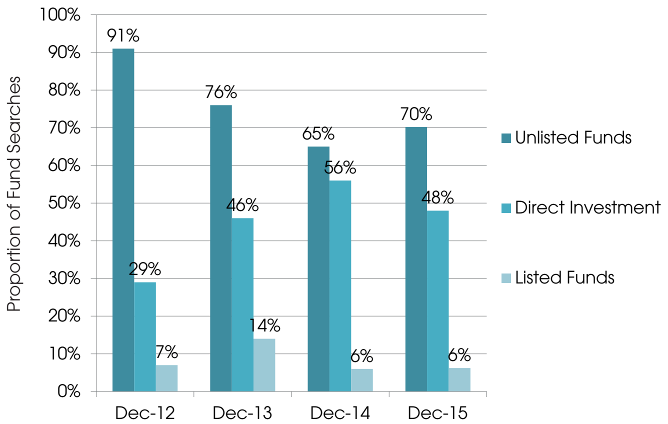


Source: Preqin Infrastructure Online

prices may have contributed to the slight decline in institutional appetite for direct investment, although the larger institutions with an established allocation to the asset class and the resources to build sizeable investment teams will most likely continue to be active.

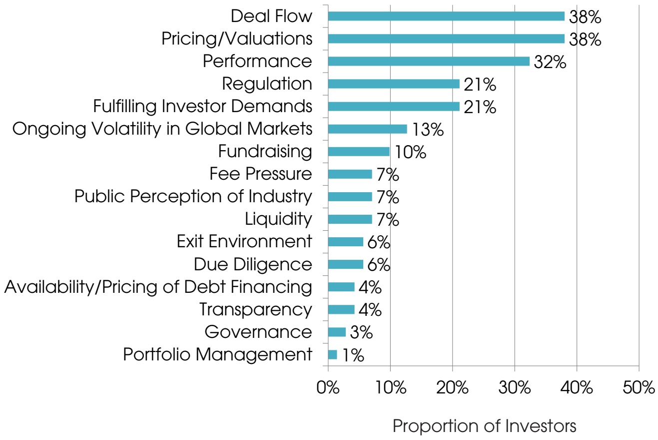
A number of issues will impact institutional investor appetite for infrastructure opportunities in 2016 and the general growth of the industry in the longer term (Fig. 5.15). A more competitive deal environment is pushing up prices for infrastructure assets and affecting deal flow; as a result, the largest proportions of surveyed infrastructure investors feel these are the key challenges for the market in 2016. Performance was cited as a key concern by nearly a third of investors, an issue that is associated with the difficulties pertaining to deal flow and high valuations.

Fig. 5.14: Preferred Route to Market of Infrastructure Investors Searching for New Investments in the Next 12 Months, 2012 - 2015



Source: Preqin Infrastructure Online

Fig. 5.15: Investors' Views on the Key Issues for the Infrastructure Market in 2016



Source: Preqin Investor Interviews, December 2015

Appetite for First-Time Funds and Alternative Structures

First-Time Funds

The proportion of infrastructure investors not investing in first-time funds has increased each year since December 2011 (Fig. 5.16). Notably, 2015 marked the first year in which the proportion of those not investing in first-time funds (44%) was greater than the proportion that will invest (42%). This may be indicative of a wider trend among investors seeking managers with a strong track record and previous experience when looking to place capital in unlisted infrastructure funds. Only 35% of funds in market are being raised by managers that have raised more than two infrastructure funds previously, reiterating how capital is likely to become further concentrated among a smaller selection of managers over the course of 2016.

Larger proportions of institutional investors target first-time funds than target other established asset classes such as private equity, where only 31% of LPs will target first-time funds. This reflects the relative youth of infrastructure; there is not the range of established managers seen in private equity. As the asset class matures, it would be expected that the proportion targeting first-time funds will fall.

Nevertheless, there is clear correlation between the appetite for first-time funds and an institutional investor's assets under management (AUM), as investors with larger assets are more likely to have the internal resource to conduct the necessary due diligence on new fund managers. Sixty-six percent of firms with less than $1bn in AUM will not invest in first-time infrastructure funds, while 63% of firms with over $50bn in AUM will invest with new fund managers.

Alternative Structures

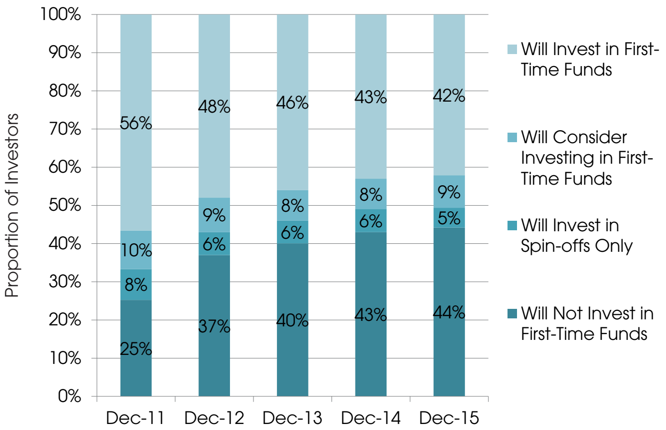
As institutional investors' expertise in the infrastructure market develops, some start to look for alternative structures and routes to market other than investing in pooled infrastructure funds. The benefits include greater control over the direction of their capital, more access to attractive assets and a greater ability to negotiate fees and other fund terms.

Appetite among infrastructure investors for separate accounts has declined over recent years (Fig. 5.17). At the beginning of 2016, the majority (52%) of investors will not invest through separate accounts, rising from 37% and 47% at the beginning of 2014 and 2015 respectively.

Co-investments enable investors to greatly increase their exposure to infrastructure by investing directly in an asset alongside a GP. Fig. 5.17 shows that appetite for co-investing has remained steady among investors over recent years, with the largest proportion of investors each year during the period 2014-2016 stating that they intend to target co-investment opportunities. With competition for investments limiting the number of infrastructure assets available to fund managers, investors may be keen to increase their exposure to what they deem a particularly attractive asset.

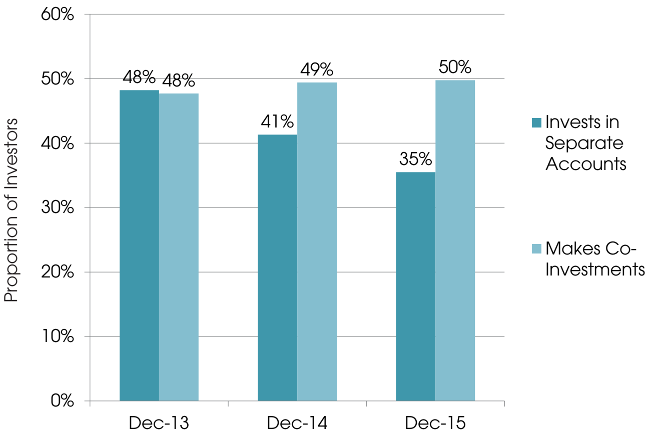
Due to the high barriers to entry, these alternative structures are typically only suitable for larger institutional investors. Often, these forms of investment require larger capital commitments and substantial human resource to carry out the due diligence and portfolio monitoring that accompany investment in separate accounts and co-investments. As AUM increase, investors become more likely to target both types of alternative structure; 47% of investors with AUM of $50bn or more will invest in separate accounts, while 70% of the same pool of investors will invest in co-investment opportunities. In comparison, only 6% and 29% of smaller institutions (less than $1bn in AUM) will target separate accounts and co-investment opportunities respectively.

Fig. 5.16: Infrastructure Investor Appetite for First-Time Funds, 2011 - 2015



Source: Preqin Infrastructure Online

Fig. 5.17: Investor Appetite for Separate Accounts and Co-Investments, 2013 - 2015



Source: Preqin Infrastructure Online

How Investors Source and Select Funds

How Investors Source Funds

57% through **internal investment team**

46% through **networking** and **peer recommendations**

39% through **direct approaches** from fund managers

34% after approach by **third-party marketer**

25% through **consultant recommendations**

23% through **fund databases**

The average investor receives **100** fund proposals each year.

The average investor sends **9%** of proposals through to a second round of screening.

84% of institutional investors have decided not to invest in a particular opportunity due to the proposed terms and conditions.

When conducting due diligence, **70%** of institutional investors will consider the fund manager's **environmental, social and governance policies**.

The average investor makes **two** investments each year.

Source: Preqin Investor Interviews, December 2015

How Can Preqin Help Raise Funds?

- Find out which strategies investors are interested in with our dedicated **Fund Searches and Mandates** portal.
- Find out which consultants work with which investors and the key contacts at each group.
- Gain detailed insights into over **2,600** institutional investors to build tailored pitches to those investors looking for your fund.
- Over **7,800** investors are looking at funds on **Preqin Investor Network**. Ensure your details are accurate and up-to-date so investors can find you!

www.preqin.com/sharedata

Private Debt

Can Private Debt Continue to Provide Strong Returns in the New Credit Environment?

Private debt as a comprehensive asset class has performed well for investors in recent quarters, with 18% of investors Preqin spoke to recently stating that their private debt investments have exceeded expectations in the past 12 months, while a further 68% feel their expectations have been met. Furthermore, overall investor sentiment towards the asset class is encouraging, with over half (54%) of investors relaying a positive perception of the industry at present, likely due to the current state of public and private credit being conducive to near and longer term success in private lending.

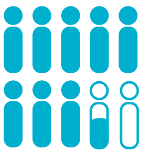
A diverse range of institutional investors continue to make up the private debt investor universe, with pension funds accounting for the largest proportion by number. Geographically, 62% of investors are based in North America, a region which continued to be a hub for private debt activity in 2015.

The fundraising outlook looks promising within private debt. Europe has overtaken North America as the region most sought after by investors, with 71% of investors planning to commit to Europe-focused funds in the next 12 months. Appetite for North America remains strong however, with two-thirds of investors planning to target the region in 2016.

Investor appetite for private lending has been the primary driving force behind successful fundraising cycles within the private debt industry. The past year saw direct lending continue its evolution into a viable fixed income alternative that has become an invaluable source of risk-adjusted returns for a growing number of institutional investors. Distressed debt has witnessed an increase in investor appetite over the last six months and it is clear that these two strategies, followed closely by mezzanine, will continue to form the bulk of fundraising and private debt activity in the near term. As the private debt landscape continues to mature in the near term, competition is likely to intensify with relative performance constantly being judged against expectations and lofty benchmarks set by early adopters.

Nearing the end of 2015, Preqin interviewed more than 100 global institutional investors that actively invest in private debt in order to gain insight into their current perception of the market, investment preferences and future plans for investment in the asset class.

Investor Appetite



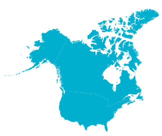
86%
Proportion of investors that feel their private debt investments have met or exceeded their expectations in 2015.

46%
Proportion of surveyed investors that typically make up to three new commitments per year.

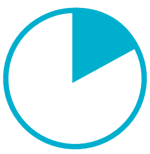
46%
Proportion of surveyed investors that plan to invest more capital in private debt in 2016 compared to 2015.

Make-up of Investors

$25.9bn
Estimated current allocation of TIAA-CREF, the largest private debt investor globally.



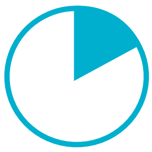
62%
Proportion of private debt investors that are based in North America.



17%
Proportion of respondents that intend to increase the number of staff working on private debt investments in the next two years.

Evolution of Investors

11%
Average current allocation to private debt of family offices, the highest of all investor types.



17%
Proportion of investors that would consider co-investing in a first-time fund.

20%
Proportion of investors that would consider co-investing alongside a fund manager.

Satisfaction with Private Debt

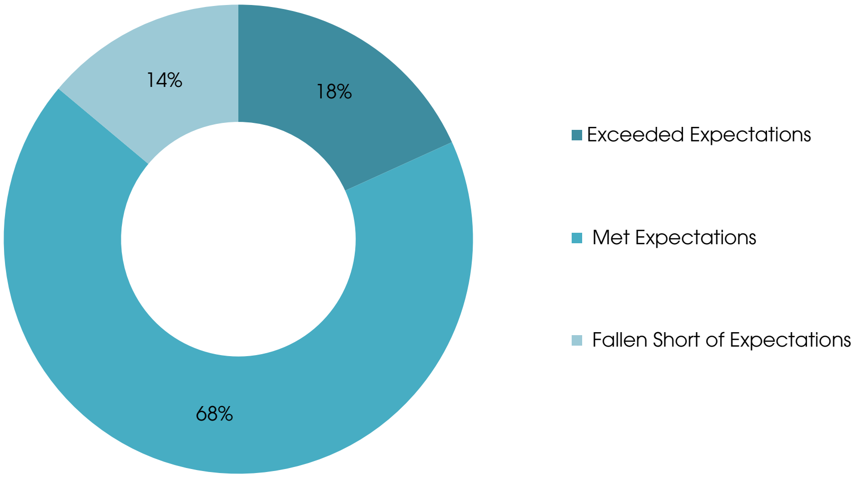
As shown in Fig. 6.1, the vast majority (86%) of investors surveyed are satisfied with the performance of their private debt investments, stating their expectations had been met or exceeded over the past 12 months. The proportion (18%) stating their expectations had been exceeded represents a four percentage point increase compared to December 2015.

This is particularly encouraging considering that a direct lending-type fund typically offers less scope for outperformance due to the coupon structure. Capital preservation takes precedence over outsized returns at the lower end of the risk/return spectrum, and a sizeable proportion of managers seem to have achieved that in 2015.

More than half (54%) of investors currently have a positive view of the asset class, far outweighing the 10% that currently have a negative perception (Fig. 6.2).

Furthermore, Fig. 6.3 shows that 26% of respondents have gained confidence in the asset class over the past 12 months compared with 7% that stated their confidence had dropped, indicating that investors are likely to remain committed to the asset class over the longer term.

Fig. 6.1: Proportion of Investors that Feel Their Private Debt Investments Have Lived up to Expectations over the Past 12 Months



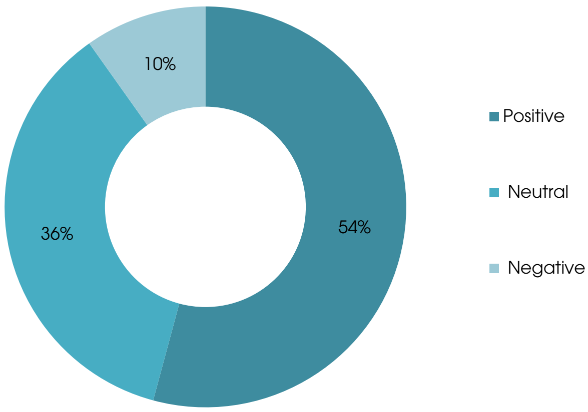
Source: Preqin Investor Interviews, December 2015

Data Source:

Private Debt Online is the leading source of data and intelligence on the growing private debt industry. This comprehensive resource tracks all aspects of the asset class, including fund managers, fund performance, fundraising, institutional investors and more.

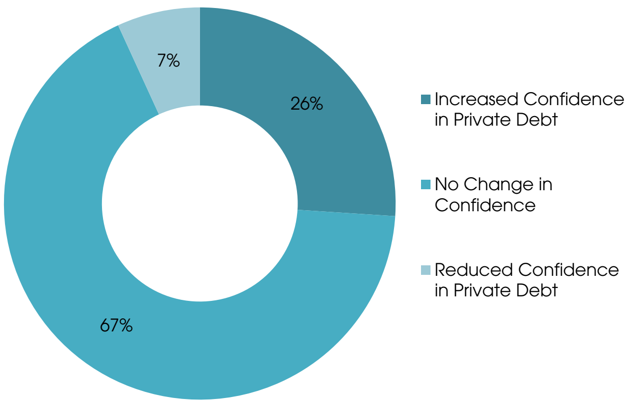
For more information, please visit: www.preqin.com/privatedebt

Fig. 6.2: Investors' General Perception of the Private Debt Industry at Present



Source: Preqin Investor Interviews, December 2015

Fig. 6.3: Investors' Change in Confidence in Private Debt to Achieve Portfolio Objectives in the Past 12 Months



Source: Preqin Investor Interviews, December 2015

Evolution of the Investor Universe

Institutional investors have largely increased exposure to the private debt asset class since 2009, and 2015 was another year in which private debt increased its prominence within portfolios. Preqin's **Private Debt Online** contains information on more than 1,800 institutional investors that are either actively investing in private debt opportunities or looking to make their maiden commitment.

Types of Active Investors

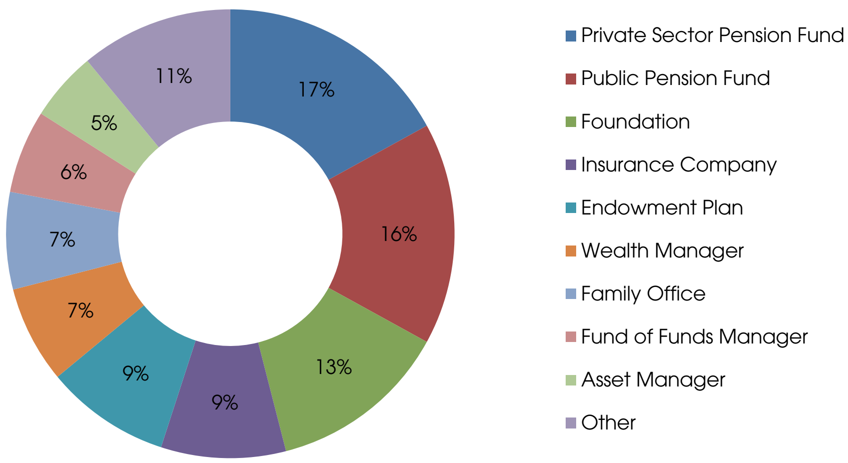
The perception of private debt as an asset class that can provide strong risk-adjusted returns explains the growing amounts of attention given to this industry. As shown in Fig. 6.4, public and private sector pension funds make up the largest proportion of all active investors in private debt, accounting for a third of investors, followed by foundations (13%). This group of institutional investors typically holds large amounts of capital, which enables them to allocate to growing asset classes.

Locations of Private Debt Investors

The location of investors within private debt is heavily skewed towards European and North American markets: 88% of all investors in private debt are based in North America and Europe (Fig. 6.5). Overall, 62% of private debt investors are based in North America, which is explained by the maturity of the market and opportunities in the region. Before the recent growth periods in private debt activity, North America-based investors had already participated in the lending space.

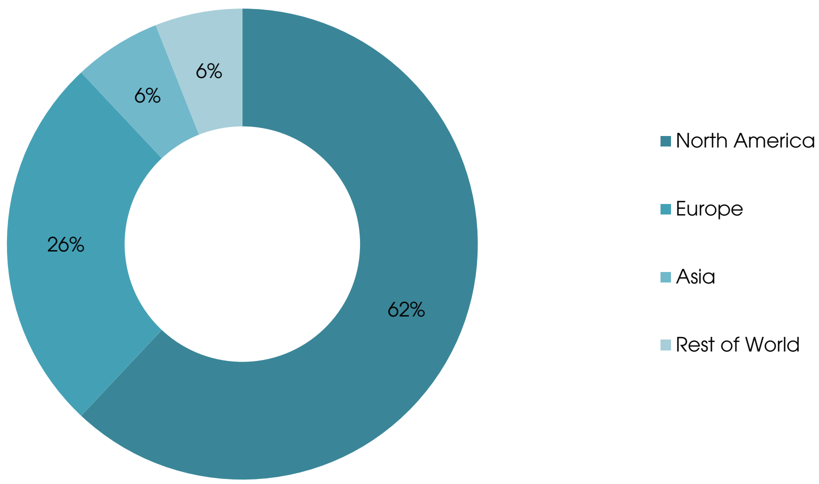
Europe accounts for 26% of private debt investors, with the remaining 12% based in Asia and other regions. Regulation fuelling the growth of private debt activity in Europe and North America would explain the prominence of these investors in the asset class, alongside the growth of private debt in the UK and France. In a general sense, investors hold a preference for investing domestically, where they have a greater understanding of the market and its nuances. Understanding of the regulatory and legal framework in a specific market is certainly a factor that could make investors more comfortable with exposure.

Fig. 6.4: Breakdown of Institutional Investors in Private Debt by Investor Type



Source: Preqin Private Debt Online

Fig. 6.5: Breakdown of Institutional Investors in Private Debt by Location



Source: Preqin Private Debt Online

Average Current Allocation by Investor Type

Examining average allocations to private debt by investor type provides an interesting insight into how the varying institutions perceive the asset class and what their investment intentions might be going forward. Fig. 6.6 shows that family offices and wealth managers have relatively high current allocations to private debt as proportions of assets under management, at 11.0% and 6.6% respectively. These investors typically prefer long-term investments with strong risk-adjusted returns. Foundations allocate 4.5% of total assets to private debt, closely followed by asset managers (4.4%) and endowment plans (4.0%).

Public pension funds and private sector pension funds have relatively lower average current allocations at 3.1% and 2.7% respectively. Nonetheless, this investor type typically has significantly larger AUM than endowment plans and foundations and is an important source of capital for private debt.

Source of Allocation

As we continue to see growth in the industry, how investors define, place and understand the asset class is evolving. One way is to examine which internal allocations investors use to invest in private debt.

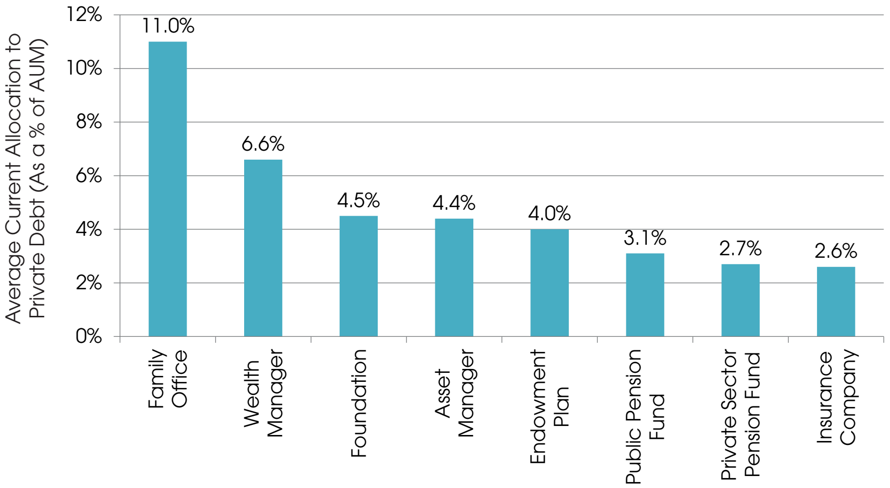
As shown in Fig. 6.7, more than half (53%) of all investors make investments in private debt through their private equity allocations. Comparatively, only 6% invest through a fixed income allocation. This indicates that the asset class is still very much viewed by a large number of investors as an alternative investment similar to private equity, with comparable characteristics such as illiquidity and low correlation with other markets.

At present, 11% of investors now maintain a separate allocation to private debt, up from 10% last year, suggesting that investors are gradually beginning to see private debt as separate from their fixed income or private equity investments.

Outlook

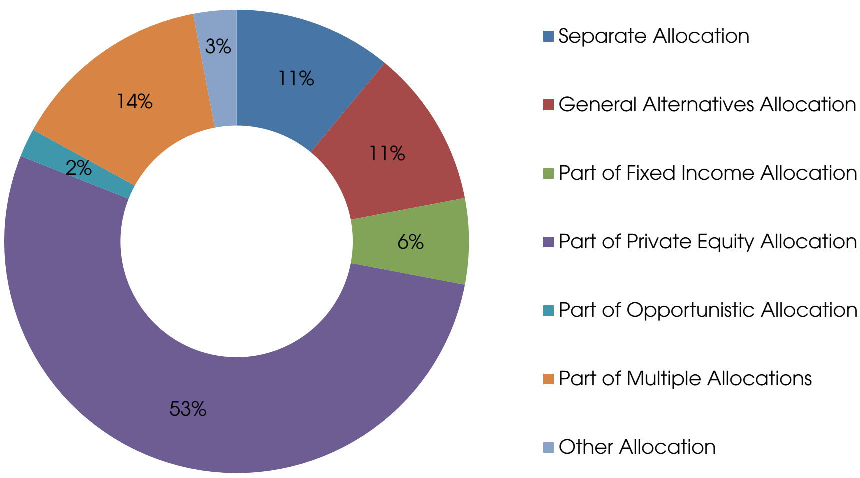
As more investors increase their allocation and carve out dedicated parts of their portfolio for private debt, the asset class will continue to see growth and mainstream acceptance providing consistent performance is maintained. The investor universe continues to diversify and expand beyond early adopters, as private debt establishes its place on the risk/return curve. With traditional fixed income prospects remaining bleak for the foreseeable future, we can predict growing interest among investors outside North America and Europe as well.

Fig. 6.6: Average Current Allocation to Private Debt by Investor Type (As a Proportion of AUM)



Source: Preqin Private Debt Online

Fig. 6.7: Breakdown of Investors in Private Debt by Source of Allocation



Source: Preqin Private Debt Online

Data Source:

Access comprehensive information on more than 1,800 investors in private debt worldwide with Preqin's **Private Debt Online**. Profiles include current and target allocations, strategic and geographic preferences, past investments, full contact information for key decision makers and more.

Plus, view detailed information on investors' future investment plans with the **Fund Searches and Mandates** feature. Search for potential new investors by their current investment searches and mandates, including fund structure, fund strategy and regional preferences.

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Investor Activity in 2016

Given the generally positive sentiment towards the asset class as a whole at present, it is expected that investors will be looking to maintain or increase their exposure to the asset class moving forward.

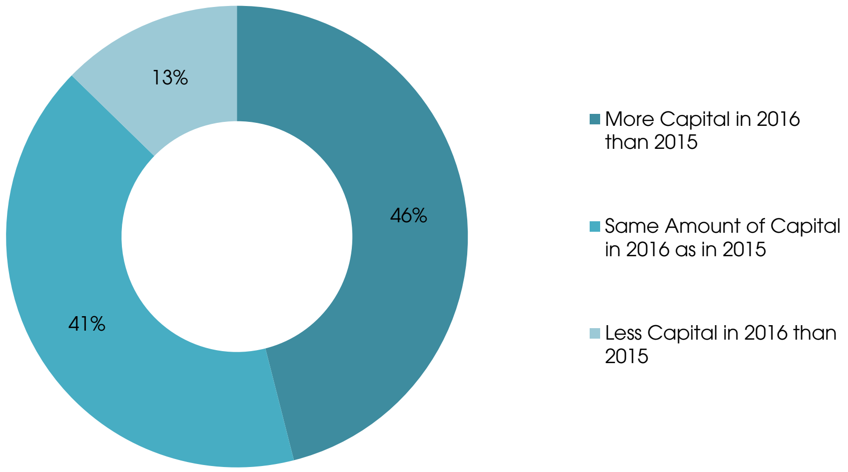
Forty-six percent of investors are planning to commit more capital to private debt opportunities in the coming year than they did in the last 12 months, while a further 41% plan to commit the same amount of capital (Fig. 6.8). This is encouraging news for fund managers that are likely to be seeking investor capital over the course of 2016.

The longer term outlook is also positive: a significant 92% of investors plan to increase or maintain their allocation to private debt over the longer term, suggesting that private debt is set to play an ever more prominent role within the portfolios of institutional investors (Fig. 6.9). Only 8% of investors plan to reduce their exposure to private debt over the longer term.

While the outlook for the asset class in the near and long term is generally positive, investors believe there are a number of key issues within the industry at present. As shown in Fig. 6.10, pricing and valuations were cited by the largest proportion (31%) of investors as a key issue, closely followed by deal flow (27%) and performance (25%). It is likely that volatility within the current economic climate could be concerning some investors in terms of pricing and valuations when monitoring a private debt investment, and this issue does seem to be the most pressing to allocators at the moment. Deal flow has certainly been a point of concern in the private debt industry for some time, as the concept of alternative lending (and borrowing) has had to develop largely in the blank space left by banks since 2008.

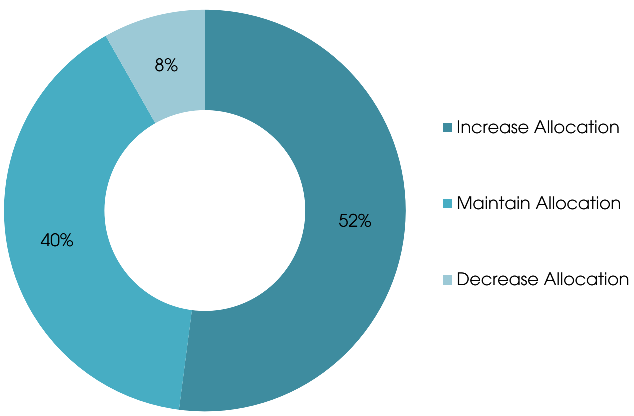
Performance is high on the list of concerns for all parties involved in private debt, as it is across most asset classes. However, on a risk-adjusted basis, the returns for most private debt strategies have been sufficient or better than expected for investors in past years, as previously discussed. Investors have continued to show confidence in the alternative lending industry over the course of 2015, and as we move into 2016, investor appetite is likely to continue to grow as private debt becomes an established part of the alternatives industry.

Fig. 6.8: Investors' Expected Capital Commitment to Private Debt Funds in 2016 Compared to 2015



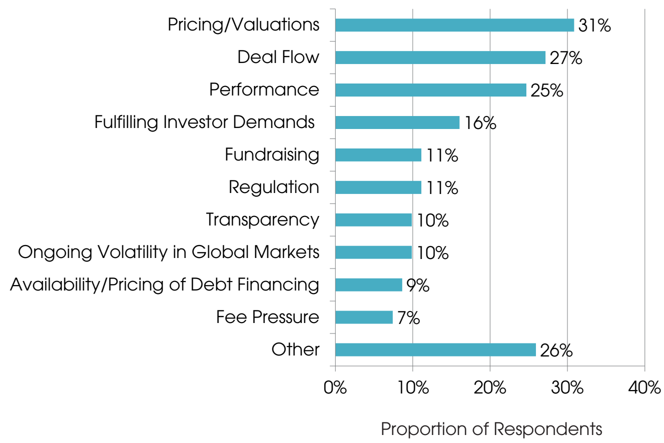
Source: Preqin Investor Interviews, December 2015

Fig. 6.9: Investors' Intentions for Their Private Debt Allocations in the Longer Term



Source: Preqin Investor Interviews, December 2015

Fig. 6.10: Investors' Views on the Key Issues for the Private Debt Market in 2016



Source: Preqin Investor Interviews, December 2015

Strategies and Geographies Targeted

Fund Type Preferences

According to Preqin's **Private Debt Online**, 64% of investors with active mandates in private debt are seeking to make at least one direct lending commitment within the next 12 months (Fig. 6.11). Direct lending accounts for the highest number of funds currently on the road and therefore fund managers should be encouraged to see this proportion of prospective investors remain consistent over the past year.

The highest amount of capital ($45bn) is being sought by distressed debt funds, with this fund type becoming increasingly important to investors over the past year; 64% of investors are expecting to target the strategy in the year ahead, up from 53% of investors in June 2015 and 30% in December 2014. As a result, fund managers have been motivated to raise mega funds, with the average target size of a distressed debt vehicle currently in market at $1.4bn, three-times larger than the average direct lending fund on the road.

Demand for mezzanine funds is also strong, with 60% of investors currently seeking to make a commitment to the strategy in the next 12 months. On the other hand, the proportion of investors seeking to make a special situations commitment in the next 12 months has fallen by four percentage points since June 2015 to 29%. Moving towards the more niche categories of private debt, the proportions of investors seeking to make fund of funds and venture debt commitments currently stand at 8% and 6% respectively, minor variations from the June 2015 figures.

As investor sentiment continues to be the main driver of fundraising success, the largest segments within private debt are seeing strong support, as well as fierce competition for allocations within the industry, as more and more vehicles come to market in hopes of successful closings. With assets so highly contested, the differentiation, scope and terms of a fund will be vital for fund managers looking to secure investor commitments to private debt in 2016.

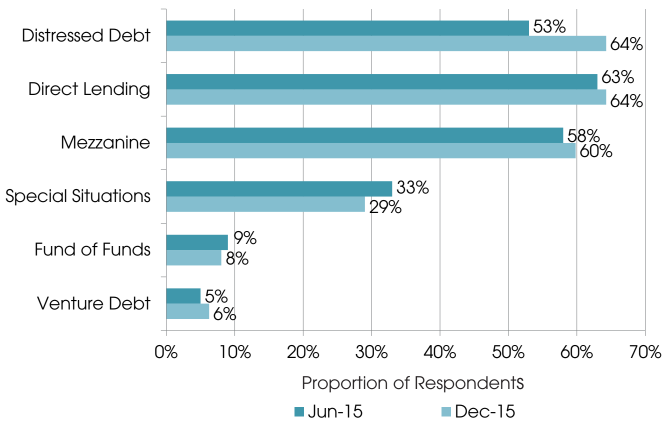
Geographic Preferences

An interesting trend is emerging in private debt: for the first time, more investors are planning to commit to Europe-focused funds than North America-focused vehicles. A shown in Fig. 6.12, 71% of investors expect to commit capital to funds focusing on Europe in the year ahead, up from 65% in June 2015. In comparison, 67% of investors plan to commit to North America-focused funds in the year ahead, up from 65% six months ago.

Both of these regions have traditionally attracted strong investor interest, but only in recent years has regulation, alongside other favourable changes, caused a recognizable growth in investor appetite for exposure to European private debt instruments. There are currently 120 funds in market with a focus on North America, compared with 69 with sights set on Europe across all strategies. A further breakdown reveals that the shift could be driven by a specific strategy; there are 37 Europe-focused direct lending funds in market, seeking an aggregate $22bn, whereas 42 North America-focused direct lending funds are seeking $18bn.

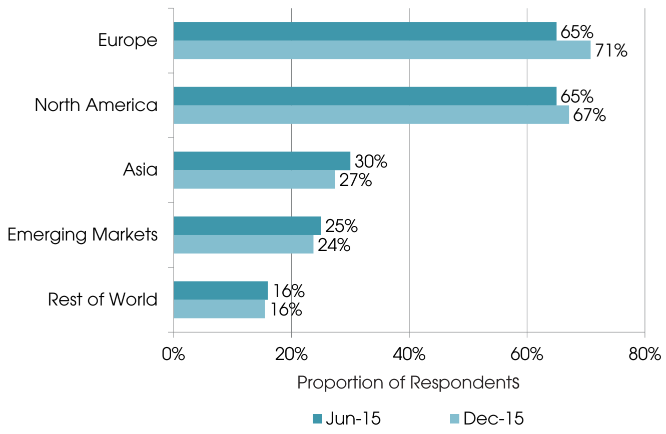
Investor appetite for geographies outside North America and Europe has remained relatively stable throughout the second half of 2015 and beginning of 2016, with 27% and 16% of investors seeking opportunities in Asia and Rest of World respectively.

Fig. 6.11: Strategies Targeted by Private Debt Investors in the Next 12 Months, June 2015 vs. December 2015



Source: Preqin Private Debt Online

Fig. 6.12: Regions Targeted by Private Debt Investors in the Next 12 Months, June 2015 vs. December 2015



Source: Preqin Private Debt Online

Natural Resources

Investors Concerned about Performance but Expecting to Maintain Allocations

2015 was a challenging year for natural resources, with low commodity prices dominating the headlines. This has perhaps unsurprisingly led to concerns among investors about the performance of their natural resources portfolios, with 62% of those surveyed stating that performance had fallen short of expectations in the last 12 months.

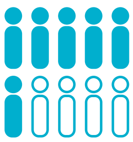
Despite challenging conditions however, investors plan to continue putting capital to work in the asset class in 2016, with 59% expecting to commit the same amount or more capital to natural resources in 2016 compared to 2015. In the longer term, investors plan to continue to be active in the natural resources asset class: 28% expect to increase the size of their natural resources portfolio, compared to 23% that are planning a long-term decrease.

The two most targeted natural resources strategies for the year ahead are energy, sought by 87% of investors, and metals & mining (38%). These are the two sectors that have been the most affected by recent price declines, possibly suggesting that investors are attempting to take advantage of opportunities created as energy and mining companies offload assets under financial pressure.

Despite concerns, investors have generally reported satisfaction with fund terms and conditions: 88% of investors either believe that interests between fund managers and investors are well aligned or have a neutral view of the issue. However, 83% of investors have decided not to invest in a fund due to the proposed fund terms and conditions, indicating that fund managers need to ensure that their fees are close to market rates or that they can effectively justify the fees they charge in order to make sure these issues are not an obstruction in securing investor commitments.

In 2016, investors are, unsurprisingly, concerned about ongoing volatility and uncertainty in global markets, with 61% of survey respondents naming this as a key issue; performance was cited by 43% of respondents. How fund managers address and mitigate these concerns could be a key factor in determining fundraising success in a competitive environment.

Perception of Natural Resources

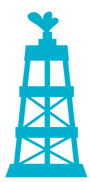


62%
Proportion of investors that feel their natural resources investments have fallen short of expectations in the past 12 months.

61%
Proportion of investors that believe volatility and uncertainty in global markets is a key issue for the natural resources industry in 2016.

Investor Appetite

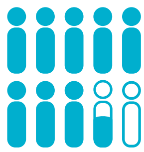
59%
Proportion of investors that expect to commit more or the same amount of capital to natural resources in 2016 compared to 2015.



87%
Proportion of investors active in natural resources that will be targeting energy strategies in 2016.

Fund Terms and Conditions

34%
Proportion of investors that have seen a change in the balance of fund terms and conditions in favour of investors.



83%
Proportion of investors that have decided not to invest in a fund due to the proposed terms and conditions.

Data Source:

See detailed profiles for over 1,500 institutional investors actively or considering investing in natural resources funds on Preqin's **Natural Resources Online**, including their plans for investments in the coming months, allocation information, direct contact details, past investments and more.

For more information, please visit:

www.preqin.com/naturalresources

Satisfaction with Natural Resources

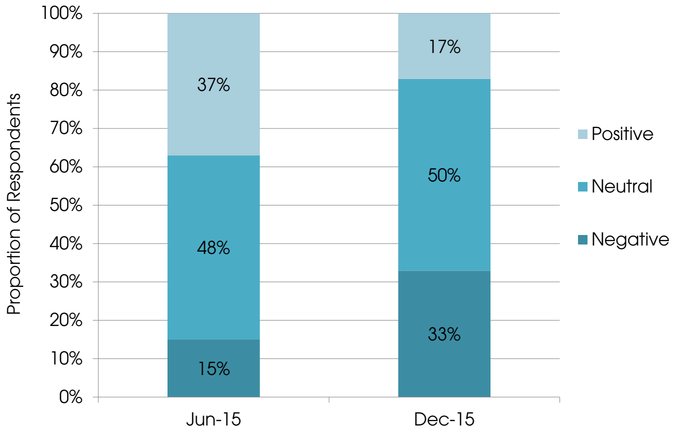
In the current economic climate it is perhaps unsurprising that only 17% of investors surveyed had a positive perception of the asset class, compared with a third that had a negative view of natural resources (Fig. 7.1). In comparison to an earlier survey of investors, this is a markedly more negative position: in June 2015, 37% viewed the asset class positively and only 15% negatively.

It seems that part of this change in mood can be attributed to investors' disappointment with their own investments in the asset class, possibly combined with the realization that the difficulties in the sector may last longer than initially assumed. When asked about the performance of their own investments over the past 12 months, 62% of investors reported that it had fallen short of expectations (Fig. 7.2). By comparison, only 2% felt that their investments had exceeded expectations.

Nevertheless, it is important to note that while investors reported disappointment with their investments in 2015, for the majority this does not seem to have changed their longer term plans for the asset class. Fifty-eight percent of investors reported that their confidence in the ability of their natural resources investments to perform portfolio objectives had not changed over the past 12 months; 15% reported that their confidence had actually increased during this time (Fig. 7.3).

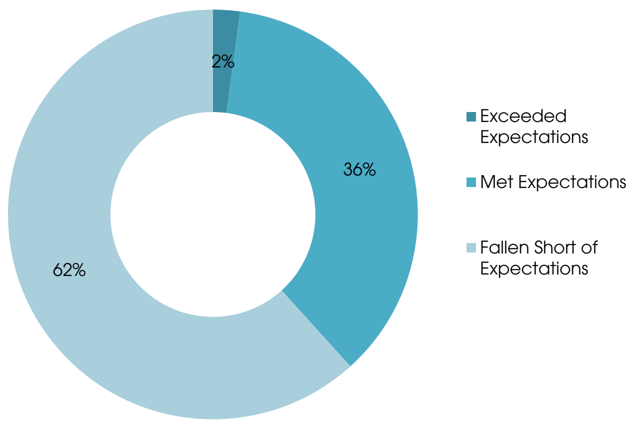
As shown in Fig. 7.4, two topics dominated investors' thoughts when considering the key issues for natural resources in 2016, with 61% of investors citing the ongoing volatility and uncertainty in global markets and 43% naming performance as key issues for the industry in the year ahead. Some of the other issues flagged by investors included concerns about pricing and valuations (16%), deal flow (15%) and whether fund managers are sufficiently responsive to investors' requests (13%).

Fig. 7.1: Investors' General Perception of the Natural Resources Asset Class at Present, June 2015 vs. December 2015



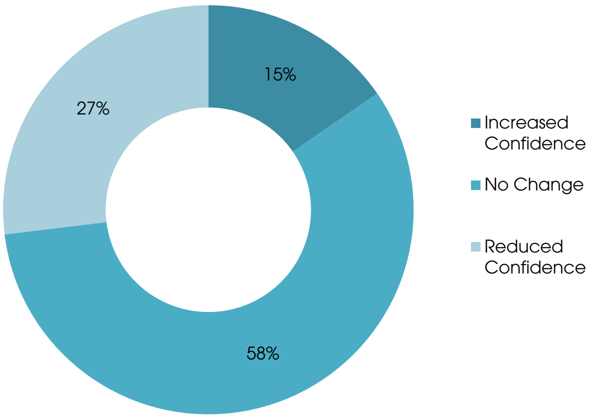
Source: Preqin Investor Interviews, June 2015 - December 2015

Fig. 7.2: Proportion of Investors that Feel Their Natural Resources Investments Have Lived up to Expectations over the Past 12 Months



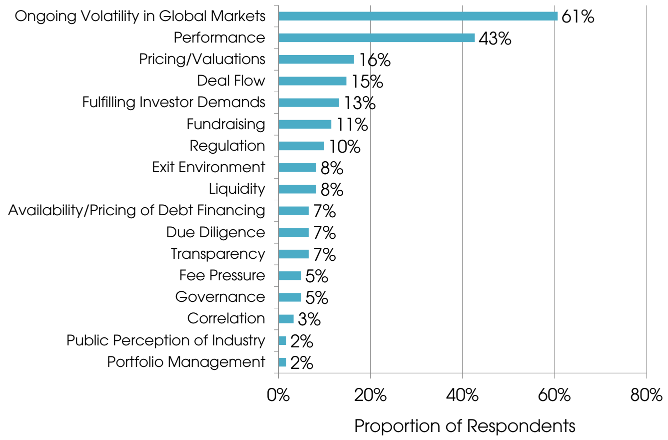
Source: Preqin Investor Interviews, December 2015

Fig. 7.3: Investors' Change in Confidence in Natural Resources to Achieve Portfolio Objectives in the Past 12 Months



Source: Preqin Investor Interviews, December 2015

Fig. 7.4: Investors' Views on the Key Issues for the Natural Resources Industry in 2016



Source: Preqin Investor Interviews, December 2015

Investor Activity in 2016

Given the current challenging environment for natural resources investments, a number of investors appear to be adopting a cautious approach towards their natural resources allocations in 2016. Fig. 7.5 shows the level of capital investors expect to commit to natural resources in 2016 compared to 2015: 41% are planning to invest less capital in the asset class, compared with 35% that plan to invest the same amount of capital and 24% that are looking to invest more.

Nevertheless, while a number of investors may be allocating less capital over the next 12 months than they did in 2015, fewer investors are changing their overall long-term plans for the asset class. As shown in Fig. 7.6, over the longer term the majority (77%) of investors surveyed intend to maintain or increase their allocations to natural resources.

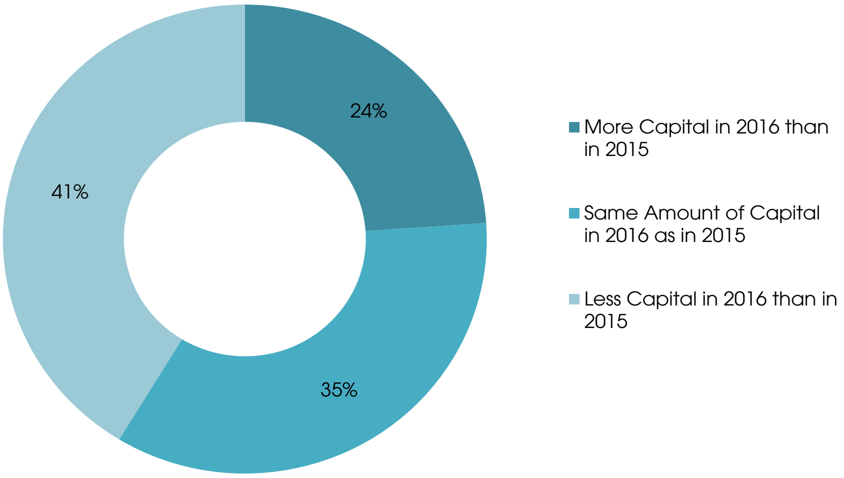
As shown in Fig. 7.7, the majority (64%) of investors that are planning to make additional commitments to natural resources over the next 12 months intend to invest less than $50mn in fresh capital. Eighteen percent plan to invest between $50mn and $99mn and 15% plan to invest between $100mn and $299mn. Only 3% plan to invest $300mn or more in natural resources in 2016.

Energy remains the most commonly sought strategy, with 87% of those investors planning investments in natural resources over the next 12 months seeking energy funds (Fig. 7.8). While this partly reflects the dominance of energy funds in the natural resources market, it may also be the result of investors seeking to take advantage of buying opportunities created as existing energy firms offload assets under financial pressure.

Despite the difficulties caused by low metals and minerals prices over the past year, metals & mining remains the second most commonly sought natural resources strategy, with 38% of investors seeking investment in the sector. The remaining three strategies – agriculture/farmland, timberland and water – are each sought by approximately 30% of investors.

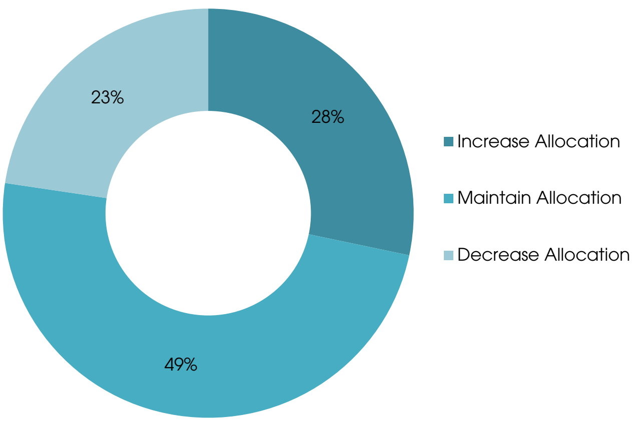
Fifty-nine percent of investors indicated that they were seeking investments in funds with a global remit (Fig. 7.9). In comparison to other alternative asset classes, natural resources funds tend to be much wider in their geographical focus as the location of suitable resources for extraction or cultivation can, to a large extent, dictate where

Fig. 7.5: Investors' Expected Capital Commitment to Natural Resources Funds in 2016 Compared to 2015



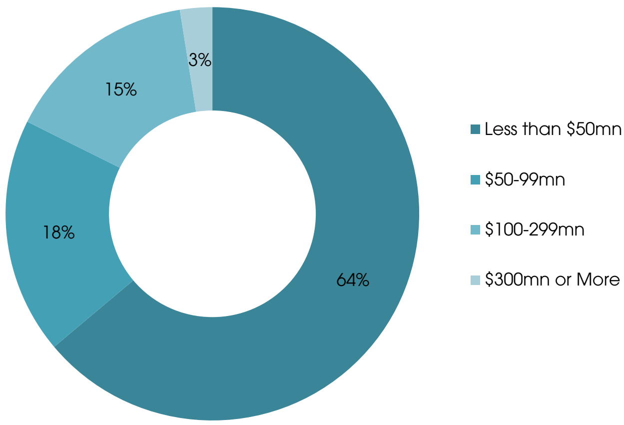
Source: Preqin Investor Interviews, December 2015

Fig. 7.6: Investors' Intentions for Their Natural Resources Allocations in the Longer Term



Source: Preqin Investor Interviews, December 2015

Fig. 7.7: Amount of Fresh Capital Investors Plan to Invest in Natural Resources over the Next 12 Months



Source: Preqin Investor Interviews, December 2015

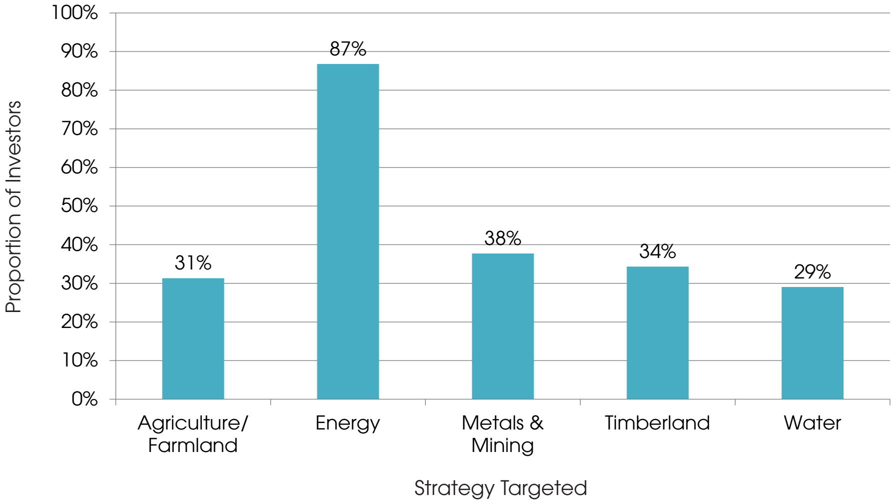
funds invest. With regard to individual regions, 37% of investors are seeking funds with a particular focus on North America, 31% on Europe and 12% on Asia. Twelve percent are seeking investment outside these regions.

Outlook

Given the widely recognized disruption in the natural resources sector caused by falling commodity prices over the past year, it is hardly surprising that this should have had some impact on investors' sentiment towards the asset class as they go into 2016. However, reassuringly for the natural resources fund industry, the majority of investors seem to be taking a long-term attitude towards the asset class rather than pulling back in the face of relatively short-term commodity price fluctuations.

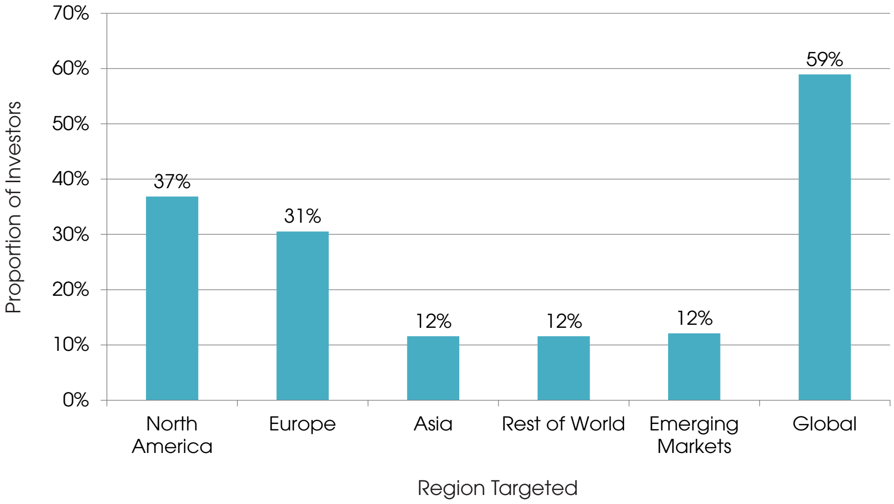
While investors seem to be planning their investments carefully for the coming year, opportunities remain for fund managers to attract funding even in areas heavily affected by the current difficulties, such as energy and metals & mining. With a large proportion of investors retaining interest in the potential benefits of natural resources investment, any substantial improvement in commodities prices could see the asset class continue to grow over the coming year.

Fig. 7.8: Strategies Targeted by Natural Resources Investors in the Next 12 Months



Source: Preqin Natural Resources Online

Fig. 7.9: Regions Targeted by Natural Resources Investors in the Next 12 Months



Source: Preqin Natural Resources Online

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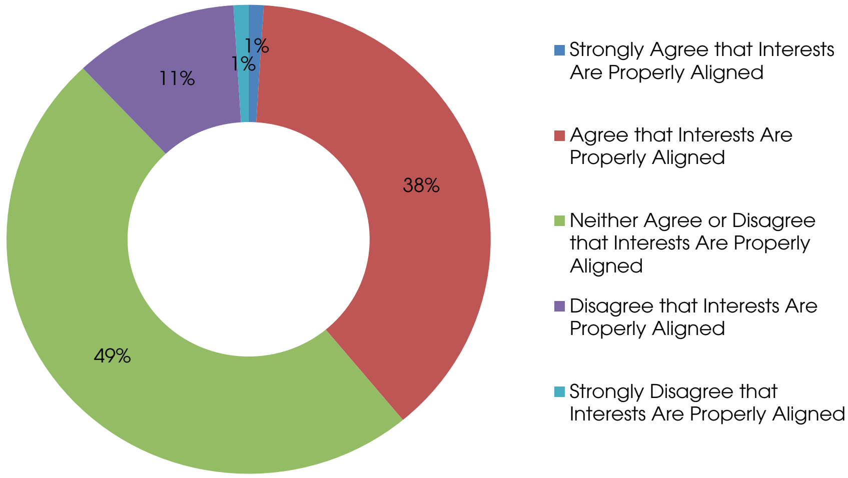
Fees and Alignment of Interests

Fund terms and conditions are one of the key considerations for investors looking to put capital to work in the natural resources asset class; across all alternative assets investors have increasingly sought favourable terms, especially in return for early or large commitments. These efforts seem to be having an effect, as shown in Fig. 7.10. Thirty-nine percent of investors feel natural resources fund manager and investor interests are properly aligned, with a further 49% stating that they had neutral feelings on the subject. Despite this, 12% of investors felt there was a misalignment of interests, suggesting that while investors are generally satisfied with fund terms there is still room to build on relations between the two parties.

As well as their overall view on the alignment between fund manager and investor interests, investors were also asked which way they felt the balance of interests was moving. As shown in Fig. 7.11, the majority of investors feel fund terms have either not changed (59%) or changed in favour of investors (34%). Just 7% of investors believe that fund terms have gone through a change in favour of fund managers over the past 12 months.

With investors reporting that they generally consider fund terms and conditions to be properly aligned, it is perhaps surprising that many investors surveyed stated that they have previously decided against investing in a particular opportunity within natural resources due to the proposed terms and conditions. In fact, 83% of respondents claim that they occasionally or frequently decide not to invest in a particular opportunity for this reason (Fig. 7.12). Although investors have reported fund terms evolving in their favour over the past 12 months, there are evidently still occasions when investors decide against allocating to a fund due to the terms and conditions.

Fig. 7.10: Extent to Which Investors Believe that Fund Manager and Investor Interests Are Properly Aligned



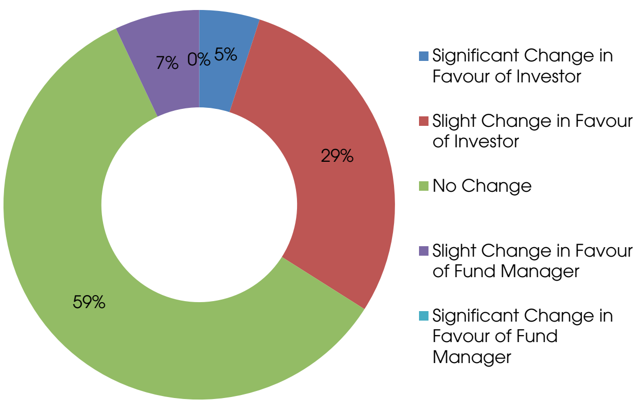
Source: Preqin Investor Interviews, December 2015

Data Source:

The **2015 Preqin Private Equity Fund Terms Advisor** is the ultimate guide to fund terms and conditions, containing analysis, benchmarks, listings of funds and their terms (on an anonymous basis), investor opinions and more.

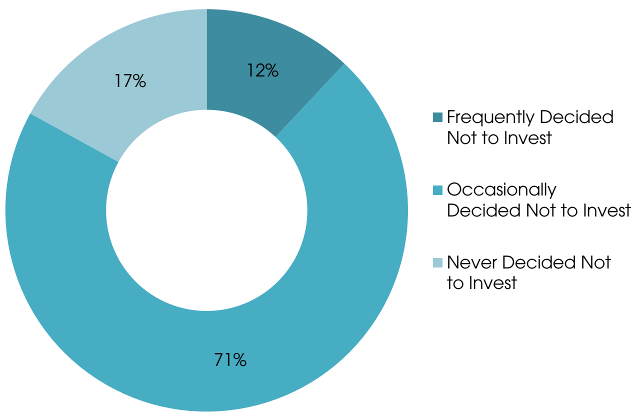
For more information, or to purchase a copy, please visit: www.preqin.com/fta

Fig. 7.11: Proportion of Investors that Have Seen a Change in Natural Resources Fund Terms and Conditions over the Last 12 Months



Source: Preqin Investor Interviews, December 2015

Fig. 7.12: Proportion of Investors that Have Previously Decided Not to Invest in a Fund Due to Proposed Terms and Conditions



Source: Preqin Investor Interviews, December 2015

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