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FOREWORD

Early 2019 represents a pivotal point in time for the alternative assets industry. Having enjoyed a period of steady growth over the past decade, with total assets under management (AUM) at a record $9.44tn as of June 2018 (the latest data available), it is quite clear that this environment has begun to change.

In November 2018, we conducted a survey of over 400 investors to understand their current views on each asset class, the challenges they are facing and their plans for the next 12 months.

With asset valuations currently at record levels, fund managers and investors we spoke to largely agree that we are at the peak of the equity market cycle and are due a correction. Towards the end of last year, however, public markets were beginning to show signs of weakening. Alternative assets weathered the storm of the last recession well, though, and it is important to remember that investors allocate capital to alternatives for distinct reasons, beyond just sheer returns.

In private equity, high absolute and risk-adjusted returns are the priorities for investors, whereas for infrastructure and real estate they are seeking an inflation hedge and a reliable income stream. Investors in private debt are prioritizing high risk-adjusted returns and an income stream, and for hedge funds and natural resources the primary motivations for investing are diversification and low correlation with other asset classes.

Since alternatives clearly serve different purposes within an institutional portfolio, it is unsurprising that investors have built larger and more complex portfolios over time – and there are few signs of this subsiding in the near and longer term. Where an asset class had outperformed their expectations in recent years, most investors told us they were looking to increase their allocations in 2019. Even for the asset classes that have demonstrated sub-par performance – namely natural resources and hedge funds – investors are still planning to increase their allocations in 2019. Hedge funds in particular have the ability to offer capital protection during a market downturn, and we expect to see investors rebalance their hedge fund portfolios in the coming year as they position more defensively.

Although we expect the alternative assets industry to continue to grow, this will not be without challenges. Assets are priced at record levels, competition for capital and deals is intense and fund managers are under exponential pressure from investors to deliver in the current environment. Each individual asset class also has its own unique set of challenges, which we explore in more detail throughout this report.

Encouragingly, the alternative assets industry as a whole has demonstrated the ability to adapt to, and overcome, these challenges. Fund managers are evolving their strategies and routes to market to continue to create value, investors are becoming increasingly sophisticated at evaluating the current opportunity set, and advisors are frequently offering value-add services for their customers.

A key ingredient in these selective strategies – for fund managers, investors and advisors alike – is good information. We are honoured to be a partner and supplier for so many leading firms and professionals in the industry, and we continue to invest heavily to expand and improve our data and services. Alternative assets are our sole focus. We are grateful for your support, and we hope that you will find this report to be a helpful resource and support for your work.
The Home of Alternatives

Indispensable data, solutions and insights

Unlock the potential of alternatives
Access the industry’s most comprehensive private market datasets and tools.

Seamlessly build and manage your portfolio
Maximize performance with solutions to reliably compile portfolio company data, efficiently value investments and deliver effective, shareable investor reporting.

Master your domain
Enhance your point of view with publications, surveys and events that provide insider access to the largest global network of alternative assets experts.

Find out more: www.preqin.com

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PARTICIPATION IN ALTERNATIVE ASSETS

Institutional Investors by Number of Alternative Asset Classes Invested In

- NONE: 26%
- ONE: 18%
- TWO: 13%
- THREE: 13%
- FOUR: 11%
- FIVE: 10%
- SIX: 9%

Source: Preqin Pro

Institutional Investors Allocating to Each Alternative Asset Class

- PRIVATE EQUITY: 65%
- HEDGE FUNDS: 51%
- REAL ESTATE: 63%
- INFRASTRUCTURE: 33%
- PRIVATE DEBT: 33%
- NATURAL RESOURCES: 34%

Source: Preqin Pro

Institutional Investors by Target Allocation to Each Asset Class (As a % of Total Assets)

- PRIVATE EQUITY: 9.9% (Average target allocation)
- HEDGE FUNDS: 13.2% (Average target allocation)
- REAL ESTATE: 10.2% (Average target allocation)
- INFRASTRUCTURE: 5.5% (Average target allocation)
- PRIVATE DEBT: 6.3% (Average target allocation)
- NATURAL RESOURCES: 5.6% (Average target allocation)

Source: Preqin Pro
REASONS FOR INVESTING

Institutional Investors’ Main Reasons for Investing in Alternative Assets

- Diversification: 80%
- Low Correlation to Other Asset Classes: 70%
- Reliable Income Stream: 60%
- High Absolute Returns: 50%
- Reduce Portfolio Volatility: 40%
- High Risk-Adjusted Returns: 30%

Institutional Investors’ Targeted Returns for Their Alternative Assets Portfolios

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

Source: Preqin Investor Interviews, November 2018
EQUITY MARKET CYCLE

Investor Views on Where We Are in the Current Equity Market Cycle

- **Peak**: 61%
- **Recovery/Expansion**: 21%
- **Recession**: 5%
- **Trough**: 2%
- **Unsure**: 11%

Source: Preqin Investor Interviews, November 2018

Investor Views on How Their Outlook on the Equity Market Cycle is Impacting Their Private Capital Investments

- **Investing More Capital**: 26%
- **No Change**: 64%
- **Investing Less Capital**: 10%

Source: Preqin Investor Interviews, November 2018

Investor Views on How Their Outlook on the Equity Market Cycle is Impacting the Positioning of Their Hedge Fund Portfolios

- **Positioning More Defensively to Protect Assets as a Priority**: 40%
- **Positioning Has Not Changed**: 54%
- **Positioning More Aggressively to Accumulate Assets as a Priority**: 6%

Source: Preqin Investor Interviews, November 2018
INVESTOR ALLOCATIONS

Investors’ Expected Capital Commitments to Alternative Assets in the Next 12 Months Compared with the Previous 12 Months

Investors’ Intentions for Their Alternative Assets Allocations over the Longer Term

Source: Preqin Investor Interviews, November 2018
The definitive guides to private capital and hedge fund markets

In-depth review of 2018
Find comprehensive reviews of market performance, fundraising and deal activity over the year, in granular detail.

Expert predictions for 2019
Subject-matter experts from around the industry deliver key forecasts and discuss geopolitical and disruptive trends for the year ahead.

Navigate the cycle
An exclusive look at where institutional investors and alternative assets fund managers will put their money, their views on cyclical trends and performance, and their long-term plans. All taken from the results of the largest survey of alternative assets decision-makers you’ll find anywhere.

Get the full reports at www.preqin.com/reports
PRIVATE EQUITY

INVESTORS CONFIDENT IN PRIVATE EQUITY

Private equity is clearly delivering for institutional investors, providing strong returns that are meeting and often exceeding expectations.

The prospects for the industry as we move through 2019 and beyond are still positive, but there are likely to be bumps along the way. Net cash flow was negative in 2017 and, although still strong, fundraising slowed during 2018 in comparison to the record levels of 2017 as investors reduced the pace of new commitments. Pricing is at a record level and the majority of investors feel that this will be the key threat to return generation in the next 12 months.

Investors are, however, confident that private equity will continue to meet their portfolio objectives in future, with many looking to place more capital in the asset class over both the next 12 months and longer term. How long this continues, though, will likely be dependent on fund managers’ ability to not only put capital to work in the current climate but also to source suitable exit opportunities to continue to deliver to investors.

Key Survey Findings:

- **65%** of private equity investors target annualized absolute returns of 12% or more.
- **72%** of private equity investors believe asset valuations will be a key challenge for return generation in 2019, the largest proportion across all asset classes.
- **61%** of alternative assets investors believe we are at the peak of the equity market cycle.
- **39%** of private equity investors believe a market correction will occur within the next 12 months.
- **54%** of private equity investors feel small to mid-market buyout funds present the best opportunities in the current climate.
- **95%** of private equity investors plan to increase or maintain their allocation to the asset class in the longer term.
High absolute returns are one of the primary reasons why investors allocate to the asset class, as cited by more than half (51%) of private equity investors surveyed towards the end of 2018, a much larger proportion when compared to other alternative asset classes. As such, private equity investors also generally seek higher returns: almost two-thirds (65%) of investors target annualized absolute returns from their private equity investments of 12% or more.

The good news is that investors are largely satisfied with how their investments in the asset class have performed over the past year: 64% of investors felt performance had met their expectations, while more than a quarter (26%) said returns had exceeded expectations (Fig. 2.1). Across vintages 2011-2015, buyout funds have delivered a median net IRR of 16-21%, followed by venture capital (13-21%) and growth (10-18%) funds.

As concerns over high valuations and the ability of fund managers to successfully exit investments are potentially played out, however, the next 12 months may tell a different story: around a third of investors feel their private equity portfolios will perform worse than they did in 2018, up from 20% at the end of 2017 (Fig. 2.2). This reduced confidence is unsurprising considering that 10% of investors said the returns from their portfolios in 2018 did not meet expectations, up from 5% in 2017 and the largest proportion since December 2013 (11%).

Although many are wary that future returns may be eroded, investors are still confident that the asset class can meet their portfolio objectives over the coming year: 68% are just as confident that private equity will deliver in 2019 as they were in 2018, while 15% have more confidence in the asset class (Fig. 2.3).
PRIVATE EQUITY: CURRENT CHALLENGES

As has been the case for the past few years, asset valuations will be the key challenge for return generation within the private equity industry in 2019, as cited by almost three-quarters (72%) of investors (Fig. 2.4) – this is by far the largest proportion across all asset classes.

A significant 60% of investors believe pricing increased further throughout 2018 (Fig. 2.5), but for how long can it continue? Among all alternatives investors, 61% believe we are at the peak of the equity market cycle (Fig. 2.6). Thirty-eight percent of private equity investors believe that a market correction will occur within the next year, but 22% think it is still more than 12 months away (Fig. 2.7).

Aside from valuations, 32% of investors cite the ability of fund managers to successfully exit investments as a key challenge for return generation in the year ahead. Exit figures generally reflect this sentiment, as the aggregate value of private equity-backed buyout exits has been on a general downward trend since 2014, and the ratio of deal to exit value has been rising in recent years. That being said, the picture is still positive for the exit environment: the aggregate value of buyout exits was higher in 2018 ($326bn) than in 2017 ($297bn), and the total number of exits has remained consistently high in the past five years at close to or above 2,000.

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**Fig. 2.4: Private Equity Investor Views on Key Challenges for Return Generation in 2019**

<table>
<thead>
<tr>
<th>Challenge</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset Valuations</td>
<td>72%</td>
</tr>
<tr>
<td>Competition for Assets</td>
<td>40%</td>
</tr>
<tr>
<td>Rising Interest Rates</td>
<td>33%</td>
</tr>
<tr>
<td>Exit Environment</td>
<td>32%</td>
</tr>
<tr>
<td>Stock Market Volatility</td>
<td>23%</td>
</tr>
<tr>
<td>Geopolitical Landscape</td>
<td>20%</td>
</tr>
<tr>
<td>Deal Flow</td>
<td>17%</td>
</tr>
<tr>
<td>Regulation</td>
<td>7%</td>
</tr>
<tr>
<td>Currency Market Volatility</td>
<td>5%</td>
</tr>
<tr>
<td>Commodity Market Volatility</td>
<td>1%</td>
</tr>
</tbody>
</table>

**Fig. 2.5: Private Equity Investor Views on Portfolio Company/Asset Pricing Compared with 12 Months Ago**

- Higher: 60%
- Same: 28%
- Lower: 2%
- Unsure: 10%

**Fig. 2.6: Alternative Assets Investor Views on Where We Are in the Current Equity Market Cycle**

- Peak: 61%
- Recovery/Expansion: 21%
- Recession: 5%
- Trough: 4%
- Unsure: 11%

**Fig. 2.7: Private Equity Investor Views on Portfolio Company/Asset Pricing**

- Undervalued, Considerable Room for Further Price Rises: 39%
- Undervalued, Some Room for Further Price Rises: 25%
- Fairly Valued: 6%
- Overvalued, Correction More than 12 Months Away: 22%
- Overvalued, Correction Likely within Next 12 Months: 12%
- Overvalued, Correction Imminent: 1%
PRIVATE EQUITY: PLANS FOR NEXT 12 MONTHS

PROCEEDING WITH CAUTION
Between 2011 and 2016 investors were riding a liquidity wave as a result of positive net cash flows from their private equity portfolios, which in turn drove fundraising and global AUM to record levels. At $432bn, 2018 fundraising levels were still strong, just down on the 2017 high of $566bn, but the cash flow cycle appears to have reversed in 2017 with more capital being called up by fund managers ($500bn) than returned ($495bn).

As our survey illustrates, investors remain committed to private equity and the outlook for 2019 is positive. Investors expect to be highly active in the asset class going forwards: almost a third (31%) are planning to commit more capital than they did in 2018 and a further 57% are planning to commit roughly the same amount (Fig. 2.8). That being said, this reduction in LP liquidity combined with wider economic concerns and the potential for a market correction is likely to see investors proceed with caution. Investors will also be keen to avoid any repeat of the GFC and will likely be monitoring their private equity allocations, and their wider portfolio, for any potential overallocation arising from a denominator effect.

INVESTORS TARGET RE-UPS
The largest proportion (45%) of surveyed investors will be looking to make their new commitments via a mix of re-ups and new relationships with GPs with which they have not previously worked (Fig. 2.11). A third of surveyed investors are planning to commit to the asset class predominantly or solely via re-ups, which is unsurprising given the backdrop of capital consolidation in the industry – also concerned about a potential economic downturn, many investors are consolidating their private equity programs.

Fig. 2.8: Investors’ Expected Capital Commitments to Private Equity Funds in the Next 12 Months Compared to the Previous 12 Months, 2015 - 2018

<table>
<thead>
<tr>
<th>Year</th>
<th>Less Capital</th>
<th>Same Amount of Capital</th>
<th>More Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nov-15</td>
<td>43%</td>
<td>45%</td>
<td>13%</td>
</tr>
<tr>
<td>Nov-16</td>
<td>40%</td>
<td>49%</td>
<td>11%</td>
</tr>
<tr>
<td>Nov-17</td>
<td>37%</td>
<td>55%</td>
<td>8%</td>
</tr>
<tr>
<td>Nov-18</td>
<td>31%</td>
<td>57%</td>
<td>12%</td>
</tr>
</tbody>
</table>

Source: Preqin Investor Interviews, November 2015 - 2018

Fig. 2.9: Number of Private Equity Funds Investors Plan to Commit to in the Next 12 Months

<table>
<thead>
<tr>
<th>Number of Funds</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Fund</td>
<td>35%</td>
</tr>
<tr>
<td>2-3 Funds</td>
<td>22%</td>
</tr>
<tr>
<td>4-9 Funds</td>
<td>31%</td>
</tr>
<tr>
<td>10 Funds or More</td>
<td>12%</td>
</tr>
</tbody>
</table>

Source: Preqin Investor Interviews, November 2018

THE BEST OPPORTUNITIES
In line with previous years, the largest proportion (54%) of investors feel small to mid-market buyout funds are presenting attractive opportunities in the
current market (Fig. 2.12). Large to mega buyout funds, however, have slipped somewhat out of favour with investors over the past year: 18% believe this fund type presents favourable opportunities, down from 21% in December 2017. Growth funds have seen rising investor interest in recent years, and 29% of investors feel they present the best opportunities in the current environment.

**BREXIT A POTENTIAL DETERRENT**
Over the course of 2019, 36% of surveyed investors will exclusively target investment in developed markets, while 40% will focus predominantly on developed markets but may also allocate some capital to emerging markets (Fig. 2.13). Only a small proportion (8%) of investors will commit the majority of their capital to emerging markets in the year ahead.

Within developed markets, two-thirds of investors believe that the US presents the most attractive investment opportunities, followed by Western Europe (excluding the UK, 49%, Fig. 2.14). The UK specifically is viewed favourably by 28%; however, the market uncertainty arising from Brexit could deter investors, with one investor explaining they would not look to the UK until after Brexit. Certain markets within developed Asia are attracting

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**Fig. 2.11: Private Equity Investors’ Intentions for Forming New GP Relationships over the Next 12 Months**

- Only New Relationships: 13%
- Mainly New Relationships, Some Re-ups: 14%
- Mix of New Relationships and Re-ups: 7%
- Mainly Re-ups, Some New Relationships: 21%
- Only Re-ups: 45%

Source: Preqin Investor Interviews, November 2018

**Fig. 2.12: Investor Views on Fund Types Presenting the Best Opportunities in Private Equity**

- Buyout – Small to Mid-Market: 54%
- Growth: 23%
- Secondaries: 23%
- Buyout – Large to Mega: 23%
- Venture Capital – Early Stage: 14%
- Venture Capital – General: 13%
- Venture Capital – Late Stage: 14%
- Venture Capital – Seed: 9%
- Fund of Funds: 8%
- Venture Capital – Venture Debt: 3%
- Other: 16%

Source: Preqin Investor Interviews, November 2018

**Fig. 2.13: Private Equity Investors’ Intentions for Targeted Markets in the Next 12 Months**

- Only Developed Markets: 16%
- Mainly Developed Markets, Some Emerging Markets: 36%
- Mix of Developed and Emerging Markets: 16%
- Mainly Emerging Markets, Some Developed Markets: 36%
- Only Emerging Markets: 40%

Source: Preqin Investor Interviews, November 2018

**Fig. 2.14: Investor Views on Developed Markets Presenting the Best Opportunities in Private Equity**

- US: 67%
- Western Europe (Excl. UK): 49%
- Nordic: 28%
- Japan: 21%
- Canada: 11%
- South Korea: 10%
- Australia & New Zealand: 7%
- Singapore: 6%
- Other: 5%

Source: Preqin Investor Interviews, November 2018
interest: 11% of investors view Japan favourably, followed by South Korea (7%) and Singapore (5%).

Within emerging markets, Asia is viewed most favourably (Fig. 2.15). Almost half (49%) of respondents named China specifically, while 30% cited India. Twenty-seven percent of investors feel other regions within Emerging Asia are presenting attractive opportunities.

**CO-INVESTING UPTAKE**

Pooled, single-manager funds will remain the structure of choice for private equity investors in 2019, with almost three-quarters of investors planning to commit capital to the asset class via this method (Fig. 2.16). A notable 35% of investors plan to co-invest alongside fund managers in the near future as they look to take advantage of opportunities for more favourable fees and greater control.

**OUTLOOK FOR 2019**

Despite investors’ concerns over the performance of the asset class amid rising valuations, they remain committed to private equity as they seek to take advantage of the strong risk-adjusted returns the asset class has delivered, as well as the other benefits on offer. Almost all surveyed investors are planning to maintain or increase their allocation to private equity over the longer term, which is a similar level to previous years (Fig. 2.17).
2018 was a challenging year for hedge funds: a difficult Q4 for performance, coupled with a net $34bn being withdrawn from hedge funds, resulted in AUM dropping over the last six months of the year to $3.45tn as at December 2018. However, the industry is still 3x the size it was a decade ago, as investors recognize the ability of hedge funds to act as a portfolio diversifier and risk mitigator.

Following the Global Financial Crisis (GFC), faced with the prospect of not meeting long-term liabilities, many institutional investors turned to hedge funds and capital flowed into the asset class. Over the second half of this decade, however, capital entering the asset class has slowed and there are signs industry AUM may have begun to plateau. The rush to build up portfolios has slowed as many investors have reached their desired level of exposure. Our results reveal that four out of five investors plan to maintain or increase their exposure to hedge funds in 2019. We also expect investors to redeem and rebalance in favour of less correlated strategies to ensure capital is protected in the event of a downturn.

The outlook for 2019 is therefore nuanced. While the slowdown in growth may indicate a lack of activity, beneath the surface we expect high levels of movement of capital. Whether hedge funds can deliver this for investors will be crucial in 2019, and managers must recognize the specific needs of each investor and be able to adapt to them.

Key Survey Findings:

- **55%** of hedge fund investors were disappointed with the performance of their portfolios in 2018.
- **42%** of hedge fund investors believe stock market volatility is the biggest threat to return generation in 2019.
- **61%** of alternative assets investors believe we are at the peak of the equity market cycle.
- **79%** of hedge fund investors plan to increase or maintain their allocation to hedge funds over the longer term, the largest proportion since December 2013.
- **40%** of hedge fund investors are planning to position their portfolios more defensively in the year ahead.
- **29%** of hedge fund investors are looking to increase their exposure to macro strategies over the next 12 months.
Back at the end of 2017, investor satisfaction with the performance of hedge funds was at its highest level since the end of 2013; following 12 consecutive months of positive returns, the Preqin All-Strategies Hedge Fund benchmark ended the year on +11.99%. Fast-forward one year, however, and investor sentiment has changed following a turbulent year for both hedge funds and the wider global economy. Hedge funds lost 3.41% over 2018, and more than half (55%) of surveyed investors told us the performance of the asset class fell short of their expectations (Fig. 3.1).

However, high absolute returns are not the primary motivation for investing in hedge funds for the majority of investors, and many look to hedge funds to provide downside protection in times of market volatility. While returns were down, the losses were not as severe as those seen in equity markets, and the volatility of hedge funds (4.28%) was much lower than that of the S&P 500 PR Index (15.30%). With this in mind, over half (57%) of investors remain confident in the ability of hedge funds to meet their portfolio objectives; over the past year, 16% of investors have become more confident in the asset class (Fig. 3.2), up slightly from 14% that said the same at the end of 2017.

Looking ahead, 37% of investors believe the performance of their hedge fund portfolios will improve over the course of 2019, while only 17% think performance will be worse than in 2018 (Fig. 3.3).
Investor sentiment is turning increasingly bearish towards equity markets; the volatility that bookended 2018 is at the forefront of institutional concerns. The largest proportion (42%) of investors believe that equity market volatility will continue into 2019 and will be a key challenge to hedge funds’ capabilities in generating returns (Fig. 3.4).

This very volatility may prove to be the wind in the sails of many hedge fund strategies, though, many of which are designed to thrive in times of market turbulence. Numerous hedge fund managers have blamed the extended growth and calm across markets as a hindrance to performance in recent years.

A growing pool of investors think we are at the top of the equity cycle and, with this in mind, are looking to position their hedge fund portfolios more defensively in the event of a market crisis or correction (Fig. 3.5). Although hedge funds as a whole were caught out by the volatility at the end of 2018, many have reduced their long-only exposure in recent months and other strategies show negative or no correlation to market direction. As a result, we may see investors rebalance portfolios in favour of hedge funds in 2019, especially less correlated strategies.

Fig. 3.4: Hedge Fund Investor Views on the Key Challenges for Return Generation in 2019

Fig. 3.5: How Hedge Fund Investors Intend to Position Their Portfolios in Response to the Equity Market Cycle

Fig. 3.6: Alternative Assets Investor Views on Where We Are in the Current Equity Market Cycle

Source: Preqin Investor Interviews, November 2018
HEDGE FUNDS: PLANS FOR NEXT 12 MONTHS

Over the next 12 months, a significant 79% of investors plan to invest the same amount, or more capital, in hedge funds as they did in the previous 12 months – this is the largest proportion we have seen since the end of 2014 (Fig. 3.7).

MACRO STRATEGIES FAVOURED

A notable 29% of investors are planning to increase their exposure to macro strategies in the coming year, the largest proportion across all strategies (Fig. 3.8). With investors generally looking to rebalance their portfolios in 2019 in favour of defensive strategies, those with less correlation to market beta such as macro strategies, systematic CTAs and market neutral strategies may see inflows.

US LEADS FOR INVESTORS

Sixty-nine percent of surveyed investors plan to predominantly target developed markets over the next 12 months, whereas just 6% intend to place the majority of their 2019 capital in emerging markets, and a quarter will take a mixed approach (Fig. 3.10).

Over three-quarters (77%) of investors feel the US presents the best opportunities, the largest proportion across all alternatives (Fig. 3.11). Western Europe (excluding the UK) was cited by 37% of investors, while the UK specifically was named by 24%. Japan is viewed favourably by 22% of investors.

Among emerging markets, Asia is likely to receive the most hedge fund capital in 2019. China was the emerging market named by the largest proportion (47%) of hedge fund investors as presenting favourable investment opportunities (Fig. 3.12). India and other regions within Emerging Asia were each named by 25% of investors.

UPTICK IN MANAGED ACCOUNTS

Pooled vehicles remain the preferred route to market, targeted by 70% of investors in the year ahead, as they typically meet investors' needs and allow for a diverse portfolio of investments.

Fig. 3.7: Investors’ Expected Capital Commitments to Hedge Funds in the Next 12 Months Compared with the Previous 12 Months, 2013 - 2018

Fig. 3.8: Investors’ Intentions for Their Hedge Fund Allocations in the Next 12 Months by Top-Level Strategy

Fig. 3.9: Number of Hedge Funds Investors Plan to Commit to in the Next 12 Months, 2017 vs. 2018
However, greater control over investments is increasingly important; using the latest Form PF data, hedge funds’ aggregate value in parallel managed accounts has grown from $619bn at the end of Q2 2016 to $770bn at the end of Q1 2018.

**OUTLOOK FOR 2019**

The market volatility endured at the end of 2018 will be at the forefront of investors’ minds as we move through 2019. Investors were largely unsatisfied with performance of their hedge fund portfolios over the course of the past 12 months, and in previous years this would likely have led to large outflows. However, it is the benefits that a hedge fund portfolio can offer for capital protection going forwards, rather than poor returns in the past, that will drive investors’ plans in 2019. Beyond 2019, a significant 29% of investors plan to increase their allocation to the asset class over the longer term, the largest proportion since 2015 (Fig. 3.13); on the other hand, 21% of investors plan to reduce their hedge fund allocation, which is the smallest proportion we have seen since 2013. Attracting investor capital will of course still be challenging and fund managers must understand each individual investor’s needs in order to win capital.
Master your domain
Enhance your point of view with research, multimedia and events that provide insider access to the largest global network of alternative assets experts.

Interactions that create opportunities
Meet face-to-face with industry thought-leaders at industry events and conferences. Build your own network and uncover best practices.

Know where you are
Accurately compare yourself against the competition so you can outperform your peers. Access private and public benchmarks, surveys and exclusive compensation and fund terms benchmarks.

Create a free account at www.preqin.com/insights
Sstellar real estate fund performance and significant levels of capital distributions have left investors largely satisfied with the asset class in recent years, resulting in consistently strong fundraising. Dry powder levels have increased to $295bn as of December 2018, although growth has been at a slower pace than previous years as fund managers put record amounts of capital to work, in spite of the challenging economic environment and record-high asset pricing. In 2018, 6,418 private equity real estate deals were announced or completed, for an aggregate value of $325bn – both record-high figures.

However, there have been early indications that the real estate market may be starting to slow, and the next 12 months will undoubtedly be challenging. Distributions, while still strong, have started to slow and deals in 2018 significantly outpaced exits. Investors largely believe we are at the peak of the equity market cycle, and will therefore be scrutinizing their portfolios more than ever over the next 12 months – whether that involves shifting strategies or reviewing fund manager relationships – to ensure they are well placed in the event of a downturn.

Over the longer term, however, notable proportions of investors will be looking to up their allocations to real estate as they continue to take advantage of the benefits the asset class can offer besides strong returns.

Key Survey Findings:

- 90% of real estate investors are satisfied with the performance of their investments over the past 12 months.
- 33% of real estate investors believe performance in 2019 will be worse than in 2018.
- 58% of real estate investors cited that rising interest rates are a key challenge for return generation in 2019, followed by asset valuations (54%).
- 61% of alternative assets investors believe we are at the peak of the equity market cycle.
- 37% of real estate investors feel each of core and value-added strategies are presenting the best opportunities.
- 36% of real estate investors plan to increase their real estate allocation over the longer term, with a further 54% looking to maintain their level of exposure.
Private real estate has been something of a star performer in recent years, with vintage 2005-2015 funds producing a median net IRR of 11.1%, outperforming most other private capital asset classes and public markets. As a result, 90% of investors told us that their real estate investments had met or exceeded their expectations in 2018 (Fig. 4.1), although investors feel this may not continue in 2019.

Despite the growing sense that returns may drop in the real estate sector, the confidence of most investors is undented. Almost three-quarters report that their confidence in the asset class to perform portfolio objectives has not changed over the past 12 months (Fig. 4.2).

What are investors’ expectations from private real estate? Forty-eight percent of real estate investors target annualized absolute returns of less than 10%, with many allocating to the asset class for reasons other than returns. Almost three-quarters of investors allocate to real estate for diversification purposes, while 39% seek a reliable income stream and 34% invest in real estate as an inflation hedge. High risk-adjusted returns and high absolute returns were cited by only 21% and 19% of investors respectively.

Concerns over rising interest rates, high asset valuations and competition for deals have led to a third of surveyed investors believing their real estate portfolios will perform worse over the next 12 months, a larger proportion than the 24% that said the same at the end of 2017 (Fig. 4.3). Just 7% expect better performance in 2019 than in 2018.
n contrast to the private equity asset class, the largest proportion (58%) of investors in real estate believe rising interest rates will have the biggest impact on return generation in 2019, above asset valuations (Fig. 4.4). This is in contrast to the end of 2017 when interest rates were ranked much lower among respondents (17%).

Despite this, pricing was still cited by more than half (54%) of surveyed real estate investors as a key challenge for return generation in the year ahead, and 56% believe pricing increased further throughout 2018 (Fig. 4.5). Across alternatives, the majority (61%) of investors feel we are at the peak of the equity market cycle (Fig. 4.6); yet it seems the timing of a potential market correction is much harder to predict. Almost a quarter of real estate investors believe a correction will occur within a year, while 20% feel a correction is due, but is more than 12 months away (Fig. 4.7). However, the largest proportion (46%) of investors believe real estate assets are fairly priced and that there is no correction on the horizon; this is a much larger proportion compared with private equity investors, where just a third believe that assets are fairly valued.

---

**Fig. 4.4: Real Estate Investor Views on the Key Challenges for Return Generation in 2019**

<table>
<thead>
<tr>
<th>Challenge</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rising Interest Rates</td>
<td>58%</td>
</tr>
<tr>
<td>Asset Valuations</td>
<td>54%</td>
</tr>
<tr>
<td>Competition for Assets</td>
<td>33%</td>
</tr>
<tr>
<td>Geopolitical Landscape</td>
<td>20%</td>
</tr>
<tr>
<td>Stock Market Volatility</td>
<td>10%</td>
</tr>
<tr>
<td>Deal Flow</td>
<td>9%</td>
</tr>
<tr>
<td>Exit Environment</td>
<td>9%</td>
</tr>
<tr>
<td>Currency Market Volatility</td>
<td>7%</td>
</tr>
<tr>
<td>Commodity Market Volatility</td>
<td>5%</td>
</tr>
<tr>
<td>Regulation</td>
<td>4%</td>
</tr>
</tbody>
</table>

Source: Preqin Investor Interviews, November 2018

**Fig. 4.5: Real Estate Investor Views on Portfolio Company/Asset Pricing Compared with 12 Months Ago**

- Higher: 56%
- Same: 22%
- Lower: 5%
- Unsure: 16%

Source: Preqin Investor Interviews, November 2018

**Fig. 4.6: Alternative Assets Investor Views on Where We are in the Current Equity Market Cycle**

- Peak: 61%
- Recovery/Expansion: 21%
- Recession: 5%
- Trough: 2%
- Unsure: 11%

Source: Preqin Investor Interviews, November 2018

**Fig. 4.7: Real Estate Investor Views on Portfolio Company/Asset Pricing**

- Undervalued, Considerable Room for Further Price Rises: 46%
- Undervalued, Some Room for Further Price Rises: 13%
- Fairly Valued: 9%
- Overvalued, Correction More than 12 Months Away: 11%
- Overvalued, Correction Likely within Next 12 Months: 5%
- Overvalued, Correction Imminent: 9%

Source: Preqin Investor Interviews, November 2018
REAL ESTATE: PLANS FOR NEXT 12 MONTHS

SLOWING DISTRIBUTIONS MAY AFFECT COMMITMENTS
Over the course of 2019, similar proportions of investors are looking to commit more capital (23%) to real estate funds as less capital (19%, Fig. 4.8). While real estate has delivered for investors in recent years, resulting in strong fundraising, distributions are slowing: the $212bn distributed to investors in 2017 was significantly lower than the $270bn in 2016, and $80bn was called up in the first half of 2018 against $100bn distributed. This, coupled with a volatile economic environment, may see some investors scale back the pace of their commitments in 2019.

OPEN TO NEW RELATIONSHIPS
Investors are largely open to forming new fund manager relationships in 2019, with only 22% of investors looking to commit capital solely via re-ups (Fig. 4.11). The largest proportion (38%) of investors are looking to invest via a mix of re-ups and fund managers they have not previously worked with, while a further 20% will mainly or solely look to place capital with managers that are new to them.

DEBT HOLDS LESS APPEAL
Core and value added are the top two strategies according to investors at present, with each cited by 37% as presenting the most favourable investment opportunities (Fig. 4.12). Other strategies that are likely to see capital inflows in 2019 include opportunistic and core-plus, which are viewed favourably by 29% and 27% of investors respectively. Debt as a real estate strategy had been growing in prominence in recent years; however, over the past year it appears the appeal of debt has declined slightly. At the end of 2017, 21% of investors we spoke to said debt was presenting favourable opportunities in the current climate, whereas this proportion compares to 15% of those surveyed at the end of 2018.

Fig. 4.8: Investors’ Expected Capital Commitments to Real Estate in the Next 12 Months Compared with the Previous 12 Months, 2015 - 2018

Fig. 4.9: Number of Real Estate Funds Investors Plan to Commit to in the Next 12 Months

Fig. 4.10: Timeframe for Investors’ Next Intended Commitment to a Real Estate Fund

Source: Preqin Investor Interviews, November 2018
INVESTORS LOOKING TO WESTERN EUROPE

Investors will be predominantly targeting developed markets in the year ahead: 63% will solely invest in funds focused on developed regions and a further 21% will primarily target developed regions with only some exposure to emerging markets (Fig. 4.13). Only 6% of investors will look to place the majority of their capital in emerging markets opportunities in 2019.

With investors appearing somewhat more risk averse, the stable economies of the US and Western Europe (excluding the UK) are likely where investors will place the majority of their capital in 2019: 56% and 45% of investors respectively feel these regions are presenting the best investment opportunities (Fig. 4.14).

Among those investors that are looking at emerging markets in 2019, the largest proportion (30%) feel Emerging Asia, aside from China and India, presents the best opportunities. Central & Eastern Europe is viewed as favourable by 29% of investors (Fig. 4.15).

UPTICK IN DIRECT INVESTMENTS

Pooled single-manager vehicles remain the structure of choice among investors, with three-quarters planning to commit capital via this method in the

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**Fig. 4.11: Real Estate Investors’ Intentions for Forming New GP Relationships over the Next 12 Months**

Source: Preqin Investor Interviews, November 2018

**Fig. 4.12: Investor Views on Fund Types Presenting the Best Opportunities in Real Estate**

Source: Preqin Investor Interviews, November 2018

**Fig. 4.13: Real Estate Investors’ Intentions for Targeted Markets in the Next 12 Months**

Source: Preqin Investor Interviews, November 2018

**Fig. 4.14: Investor Views on Developed Markets Presenting the Best Opportunities in Real Estate**

Source: Preqin Investor Interviews, November 2018
near future (Fig. 4.16). Direct investments also continue to gain prominence in investors’ real estate portfolios: 29% are looking to invest directly in assets in 2019 and beyond, as the largest and most sophisticated investors take advantage of having the resources available to gain more control over their investments.

**LONG-TERM OUTLOOK POSITIVE**
Where the short-term outlook for investor commitments to real estate is nuanced, the long-term outlook is more positive: more than a third (36%) of investors are planning to increase their allocation to real estate as they seek to take advantage of the diversification benefits and reliable income stream that the asset class can provide (Fig. 4.17). Only 9% are planning to decrease their allocation, which is the smallest proportion in four years.

---

**Fig. 4.15: Investor Views on Emerging Markets Presenting the Best Opportunities in Real Estate**

<table>
<thead>
<tr>
<th>Emerging Markets</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Other Emerging</td>
<td>30%</td>
</tr>
<tr>
<td>Africa</td>
<td>20%</td>
</tr>
<tr>
<td>Central &amp; Eastern Europe</td>
<td>28%</td>
</tr>
<tr>
<td>China</td>
<td>18%</td>
</tr>
<tr>
<td>India</td>
<td>13%</td>
</tr>
<tr>
<td>Brazil</td>
<td>8%</td>
</tr>
<tr>
<td>Africa</td>
<td>8%</td>
</tr>
<tr>
<td>Other Latin America</td>
<td>7%</td>
</tr>
<tr>
<td>Middle East</td>
<td>7%</td>
</tr>
<tr>
<td>Russia</td>
<td>3%</td>
</tr>
</tbody>
</table>

Source: Preqin Investor Interviews, November 2018

**Fig. 4.16: Structures that Investors Expect to Utilize for Their Real Estate Investments in Future**

<table>
<thead>
<tr>
<th>Structures</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pooled Single-Manager Funds</td>
<td>75%</td>
</tr>
<tr>
<td>Direct Investments</td>
<td>29%</td>
</tr>
<tr>
<td>Co-Investments</td>
<td>21%</td>
</tr>
<tr>
<td>Pooled Funds of Funds</td>
<td>17%</td>
</tr>
<tr>
<td>Separate Accounts</td>
<td>12%</td>
</tr>
</tbody>
</table>

Source: Preqin Investor Interviews, November 2018

**Fig. 4.17: Investors’ Intentions for Their Real Estate Allocations over the Longer Term, 2014 - 2018**

<table>
<thead>
<tr>
<th>Allocation</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Decrease</td>
<td>5%</td>
<td>16%</td>
<td>10%</td>
<td>11%</td>
<td>9%</td>
</tr>
<tr>
<td>Maintain</td>
<td>60%</td>
<td>55%</td>
<td>54%</td>
<td>57%</td>
<td>54%</td>
</tr>
<tr>
<td>Increase</td>
<td>36%</td>
<td>29%</td>
<td>36%</td>
<td>32%</td>
<td>36%</td>
</tr>
</tbody>
</table>

Source: Preqin Investor Interviews, November 2014 - 2018
INFRASTRUCTURE DELIVERS WITH CHALLENGES AHEAD

The infrastructure asset class has generally delivered for investors in recent years. With a favourable risk/return profile, an ability to provide a reliable income stream and a low correlation to other asset classes, investors are largely satisfied with the performance of their infrastructure portfolios. Given the record distributions in 2017, and with cash flows edging towards positive territory in the first half of 2018 (the latest data available), the record-setting fundraising of the past few years is likely to continue. Over a third (35%) of surveyed investors are planning to commit more capital to infrastructure funds in 2019, the largest proportion across all alternative asset classes.

Despite this positive environment, asset prices are continuously rising, amid other challenges. Investors are largely expected to stick with the brand-name fund managers that have been receiving the majority of capital commitments in recent years, but some may look to shift capital to value-added strategies, which are currently viewed most favourably by investors.

Even with these challenges, the long-term outlook for infrastructure is extremely positive: half of investors plan to increase their allocation to the asset class, while a further 44% expect to maintain it, which is again the largest proportion among all alternative asset classes.

Key Survey Findings:

- 23% of infrastructure investors said performance in 2018 exceeded their expectations.
- 52% of infrastructure investors stated that asset valuations pose a key challenge for return generation in 2019.
- 73% of infrastructure investors allocate to infrastructure primarily for diversification.
- 35% of infrastructure investors are planning to commit more capital to the asset class in 2019 than they did in 2018.
- 35% of infrastructure investors believe value-added strategies are presenting the best opportunities at present.
- 50% of infrastructure investors plan to increase their allocation to the asset class over the longer term.
Infrastructure funds typically exhibit an attractive risk/return profile when compared to other private capital strategies; vintage 2005-2015 funds generated a median net IRR of 9.8% with standard deviation of 12.6%. This is in line with investors’ expectations: a significant 93% of investors target annualized absolute returns of less than 14%, which is the largest proportion of respondents seeking this level of return across all private capital asset classes. As a result, 84% of investors have had their return expectations met or exceeded by their infrastructure investments over the past year (Fig. 5.1).

Over the next 12 months, the majority (59%) of investors expect the asset class to perform about the same as in 2018, while just over a quarter (26%) expect the asset class to perform worse (Fig. 5.2). In this volatile economic environment where valuations are at record levels, investors are concerned about fund managers’ ability to find value and the impact this may have on returns. Exit activity was down significantly in 2018, with 1,290 unlisted infrastructure exits valued at an aggregate $139bn, compared with 1,671 in 2017 which were valued at an aggregate $194bn.

It is well known that investors do not allocate capital to infrastructure solely for high returns. In fact, high risk-adjusted returns and high absolute returns were cited by the smallest proportions of investors (21% and 20% respectively) as their primary motivation for investing in infrastructure.

The largest proportion (73%) of investors allocate to infrastructure for diversification. Other key attractions include the offer of a reliable income stream (44%), infrastructure’s low correlation to other asset classes (42%) and its ability to act as an inflation hedge (40%).
Infrastructure investors feel pricing is the biggest challenge for return generation in 2019, as cited by more than half (52%) of survey respondents, followed by competition for assets (37%), which is intrinsically linked to asset prices (Fig. 5.4).

Competition for assets is more intense than ever before and has pushed asset pricing to record levels; 46% of surveyed infrastructure investors believe that pricing increased further over the course 2018 (Fig. 5.5).

Sixty-one percent of alternative assets investors believe we are currently at the peak of the equity market cycle (Fig. 5.6). Among infrastructure investors specifically, it is clear that many believe a market correction is necessary – 47% of respondents stated that assets are overvalued – but are uncertain as to when it may occur. Twenty-eight percent of respondents feel a market correction is due within a year, while 19% predict it is further away than this (Fig. 5.7). That being said, a significant 53% of infrastructure investors do not believe that assets are overpriced, including 8% that feel they are undervalued, meaning that prices may inflate further in the near future.

Alongside pricing and competition, the other key challenges for return generation in 2019 according to investors are rising interest rates (36%) and the geopolitical landscape (30%).

**Fig. 5.4: Infrastructure Investor Views on Key Challenges for Return Generation in 2019**

<table>
<thead>
<tr>
<th>Challenge</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset Valuations</td>
<td>52%</td>
</tr>
<tr>
<td>Competition for Assets</td>
<td>37%</td>
</tr>
<tr>
<td>Rising Interest Rates</td>
<td>36%</td>
</tr>
<tr>
<td>Geopolitical Landscape</td>
<td>30%</td>
</tr>
<tr>
<td>Regulation</td>
<td>21%</td>
</tr>
<tr>
<td>Deal Flow</td>
<td>17%</td>
</tr>
<tr>
<td>Stock Market Volatility</td>
<td>13%</td>
</tr>
<tr>
<td>Commodity Market Volatility</td>
<td>12%</td>
</tr>
<tr>
<td>Exit Environment</td>
<td>11%</td>
</tr>
<tr>
<td>Currency Market Volatility</td>
<td>9%</td>
</tr>
</tbody>
</table>

**Fig. 5.5: Infrastructure Investor Views on Portfolio Company/Asset Pricing Compared with 12 Months Ago**

- Higher: 61%
- Same: 21%
- Lower: 8%
- Unsure: 2%

**Fig. 5.6: Alternative Assets Investor Views on Where We Are in the Current Equity Market Cycle**

- Peak: 61%
- Recovery/Expansion: 21%
- Recession: 5%
- Trough: 3%
- Unsure: 11%

**Fig. 5.7: Infrastructure Investor Views on Portfolio Company/Asset Pricing**

- Undervalued, Considerable Room for Further Price Rises: 16%
- Undervalued, Some Room for Further Price Rises: 10%
- Fairly Valued: 19%
- Overvalued, Correction More than 12 Months Away: 8%
- Overvalued, Correction Likely within Next 12 Months: 12%
- Overvalued, Correction Imminent: 44%
INFRASTRUCTURE: PLANS FOR NEXT 12 MONTHS

Unlisted infrastructure fundraising has been smashing records every year for the past four years, with $90bn secured by funds closed in 2018, and there are no signs of a slowdown ahead. A record $77bn was distributed to investors in 2017, and in the first half of 2018 (the latest data available) $33bn was returned to investors and $35bn was called up. This means that cash flows are edging nearer to positive territory, which has not been seen in the unlisted infrastructure industry since 2015. As a result, investors are likely to re-invest this capital in the near future: over a third (35%) of those surveyed are looking to invest more capital in infrastructure in 2019 compared to 2018, while 52% are looking to commit the same amount, which is roughly in line with the proportions seen at the end of 2017 and 2016 (Fig. 5.8).

A MIX OF FUND MANAGER RELATIONSHIPS

As with most other private capital asset classes, the largest proportion (41%) of infrastructure investors are looking to commit capital to the asset class in 2019 via a mix of re-ups with existing managers in their portfolio and forming new relationships with managers with which they have not previously worked (Fig. 5.11). While investors may largely prefer to continue investing with managers that they have a good relationship with, there will likely be times when they want to gain exposure to new industries or geographies or are perhaps looking to increase their allocations and therefore form new relationships.

VALUE-ADDED STRATEGIES ATTRACTIVE

Competition for infrastructure assets, particularly the more mature core and core-plus assets, may explain why investors are viewing higher-risk value-added strategies more favourably at present. Over a third (35%) of investors believe value-added strategies are presenting the most attractive opportunities at present (Fig. 5.12), up significantly from 28% at the
end of 2017. In contrast, 30% feel core strategies are offering the best opportunities in 2019, significantly down on 47% of investors surveyed the previous year.

**UK AND EMERGING MARKETS PROMISE**

The majority (70%) of investors plan to predominantly target developed markets over the course of 2019 (Fig. 5.13), with the US and Western Europe (excluding the UK) viewed most favourably (Fig. 5.14). Over a third (35%) of investors believe the UK specifically will present attractive opportunities in the year ahead, which is the largest proportion across all alternative asset classes.

However, as competition intensifies in developed markets, some investors will look to place capital in emerging markets over 2019, particularly in Asia. Thirty-four percent of investors feel India specifically is presenting attractive opportunities, followed by China (27%, Fig. 5.15), as both countries look to increase private investment across multiple infrastructure sectors, including energy and transportation, to attempt to fill the 'infrastructure gap'.

**Fig. 5.11: Infrastructure Investors’ Intentions for Forming New GP Relationships over the Next 12 Months**

- Only New Relationships: 19%
- Mainly New Relationships, Some Re-ups: 12%
- Mix of New Relationships and Re-ups: 12%
- Mainly Re-ups, Some New Relationships: 18%
- Only New Relationships: 10%

**Fig. 5.12: Investor Views on Fund Types Presenting the Best Opportunities in Infrastructure**

- Value Added: 35%
- Core: 30%
- Core-Plus: 27%
- Opportunistic: 24%
- Debt: 15%
- Secondaries: 9%
- Fund of Funds: 5%
- Distressed: 8%

**Fig. 5.13: Infrastructure Investors’ Intentions for Targeted Markets in the Next 12 Months**

- Only Developed Markets: 39%
- Mainly Developed Markets, Some Emerging Markets: 31%
- Mix of Developed and Emerging Markets: 19%
- Mainly Emerging Markets, Some Developed Markets: 5%
- Only Emerging Markets: 6%

**Fig. 5.14: Investor Views on Developed Markets Presenting the Best Opportunities in Infrastructure**

- US: 58%
- Western Europe (Excl. UK): 53%
- UK: 35%
- Nordic: 22%
- Australia & New Zealand: 17%
- Canada: 14%
- Japan: 11%
- South Korea: 9%
- Singapore: 7%
gap. Other regions within Emerging Asia were named by almost a quarter of investors.

Elsewhere, investment in Brazil is viewed favourably by 15% of investors, while 19% believe other regions in Latin America are presenting the best investment opportunities within emerging markets.

**POOLED VEHICLES MAIN ROUTE**

With many investors still relatively new to the asset class, it is little surprise that 79% plan to allocate capital to infrastructure via pooled single-manager vehicles (Fig. 5.16). Investing directly in infrastructure assets requires a large amount of capital and resource, which many investors do not possess, and only 16% plan to invest in the asset class directly in the near future. Examples of investors that do invest directly in infrastructure include OMERS, Abu Dhabi Investment Authority and CPP Investment Board.

**A POSITIVE OUTLOOK**

The infrastructure asset class has largely delivered for investors in recent years and this means the long-term outlook for the industry is considerably positive: half of investors plan to increase their allocation to the asset class, the largest proportion of investors across alternatives (Fig. 5.17). A further 44% plan to maintain their current level of exposure, meaning that growth of the industry is expected to continue.

---

**Fig. 5.15: Investor Views on Emerging Markets Presenting the Best Opportunities in Infrastructure**

<table>
<thead>
<tr>
<th>Region</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td>34%</td>
</tr>
<tr>
<td>China</td>
<td>27%</td>
</tr>
<tr>
<td>Central &amp; Eastern Europe</td>
<td>24%</td>
</tr>
<tr>
<td>Other Emerging Asia</td>
<td>24%</td>
</tr>
<tr>
<td>Other Latin America</td>
<td>19%</td>
</tr>
<tr>
<td>Brazil</td>
<td>15%</td>
</tr>
<tr>
<td>Africa</td>
<td>14%</td>
</tr>
<tr>
<td>Middle East</td>
<td>11%</td>
</tr>
<tr>
<td>Russia</td>
<td>5%</td>
</tr>
</tbody>
</table>

Source: Preqin Investor Interviews, November 2018

---

**Fig. 5.16: Structures that Investors Expect to Utilize for Their Infrastructure Investments in Future**

- Pooled Single-Manager Funds: 79%
- Co-Investments: 28%
- Pooled Funds of Funds: 21%
- Direct Investments: 16%
- Separate Accounts: 10%

Source: Preqin Investor Interviews, November 2018

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**Fig. 5.17: Investors' Intentions for Their Infrastructure Allocations over the Longer Term, 2016 - 2018**

<table>
<thead>
<tr>
<th>Year</th>
<th>Decrease Allocation</th>
<th>Maintain Allocation</th>
<th>Increase Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nov-16</td>
<td>53%</td>
<td>41%</td>
<td>5%</td>
</tr>
<tr>
<td>Nov-17</td>
<td>55%</td>
<td>41%</td>
<td>4%</td>
</tr>
<tr>
<td>Nov-18</td>
<td>50%</td>
<td>41%</td>
<td>6%</td>
</tr>
</tbody>
</table>

Source: Preqin Investor Interviews, November 2016 - 2018
Since the GFC a decade ago, the private debt asset class has gone from strength to strength, and investors have been reaping the rewards: among those interviewed at the end of 2018, over 90% were satisfied with how their portfolios had performed over the past 12 months.

Strong returns are, of course, not the primary reason investors typically allocate to private debt, with the asset class’s ability to offer downside protection in times of market turbulence a key draw – 2019 may therefore prove a pivotal year for the asset class. With over a third of investors believing a market correction will occur in the next 12 months, we have already seen signs that investors are reassessing their portfolios, and the fundraising market has begun to record strategy shifts. While fundraising has been strong – exceeding $100bn for the fourth year running in 2018 – the prominence of direct lending is decreasing, and investors are seeing more opportunities in distressed debt and special situations strategies.

Over the longer term, private debt will remain an important, and potentially growing, part of investors’ portfolios, with a significant 95% of investors planning to maintain or increase their allocation to the asset class.

Key Survey Findings:

- 91% of private debt investors felt their performance expectations were met or exceeded in 2018.
- 35% of private debt investors believe a market correction will occur within the next 12 months.
- 50% of private debt investors see rising interest rates as the biggest threat to return generation in 2019.
- 68% of private debt investors believe the US presents favourable opportunities, while 53% and 34% respectively cited Western Europe and the UK specifically.
- 44% of private debt investors believe that direct lending presents the best investment opportunities, followed by special situations (43%) and distressed debt (36%).
- 95% of private debt investors will be looking to increase or maintain their allocation to the asset class over the longer term.
Among investors interviewed, 92% feel their private debt investments have met or exceeded their expectations over the past year, compared with 90% of those surveyed one year prior (Fig. 6.1). On the whole, private debt is therefore delivering downside protection for investors; indeed, 81% are just as, if not more, confident in the ability of private debt to meet portfolio objectives compared with one year ago (Fig. 6.3).

A notable 46% of investors in private debt are targeting an annual absolute return of 8-12%; yet, 27% of investors believe the asset class will perform worse in 2019 than in 2018, up from 20% that predicted worse performance for 2018 (Fig. 6.2). Most investors feel that rising interest rates are the key challenge that will affect returns in the year ahead.

![Fig. 6.1: Extent to Which Investors Feel Their Private Debt Investments Have Lived up to Expectations over the Past 12 Months, 2017 vs. 2018](source: Preqin Investor Interviews, November 2017 - 2018)

![Fig. 6.2: Investor Expectations for the Performance of Their Private Debt Portfolios in the Next 12 Months Compared with the Past 12 Months, 2017 vs. 2018](source: Preqin Investor Interviews, November 2017 - 2018)

![Fig. 6.3: Investors’ Change in Confidence in the Ability of Private Debt to Perform Portfolio Objectives over the Past 12 Months](source: Preqin Investor Interviews, November 2017 - 2018)
PRIVATE DEBT: CURRENT CHALLENGES

Half of surveyed investors believe that rising interest rates will be a key threat to return generation over the course of the next 12 months (Fig. 6.4). Pricing is also still a concern for investors, as cited by the next largest proportion (42%) of investors. Only 1% of investors felt that valuations dropped over the course of 2018, with almost half (47%) reporting that pricing had increased over the year (Fig. 6.5).

Sixty-one percent of alternative assets investors believe we are at the peak of the equity market cycle (Fig. 6.6). Among private debt investors specifically, over a third (35%) anticipate a market correction in 2019 (Fig. 6.7), which is on par with investors in the private equity asset class but much higher than other private capital asset classes including real estate, infrastructure and natural resources. A further 20% said a market correction is due but may not happen within the next 12 months.

Fig. 6.4: Private Debt Investor Views on Key Challenges for Return Generation in 2019

Fig. 6.5: Private Debt Investor Views on Portfolio Company/Asset Pricing Compared with 12 Months Ago

Fig. 6.6: Alternative Assets Investor Views on Where We Are in the Current Equity Market Cycle

Fig. 6.7: Private Debt Investor Views on Portfolio Company/Asset Pricing

Source: Preqin Investor Interviews, November 2018
PRIVATE DEBT: PLANS FOR NEXT 12 MONTHS

Following record distributions of $134bn in 2017, investors had significant amounts of capital to re-invest in the asset class in order to maintain their allocations, or as was the case with many investors, actually grow their allocations. The strong fundraising figures of 2018 reflect this: $110bn was committed to private debt funds closed in the year, and while down on the 2017 record of $129bn, this figure is still higher than both 2015 and 2016. 2019 could well be another strong year: just over half of investors plan to commit the same amount of capital to the asset class, while a further 32% will invest more capital, perhaps searching out counter-cyclical opportunities in the market in the event of a downturn (Fig. 6.8).

IMPORTANT OF TRACK RECORD

From our thousands of conversations with investors throughout the year, it is clear that investors continue to rank the track record of a fund manager among the most important attributes to consider when committing capital to the asset class. It is therefore unsurprising that 93% of investors plan to re-up with fund managers to some extent when making new commitments in 2019, including 23% that will exclusively be re-upping (Fig. 6.11). The largest proportion (40%) of investors expect to invest via a mixture of re-ups and new relationships with fund managers they have not previously worked with, and a further 20% will predominantly look to form new relationships in 2019. With private debt still a relatively new part of an investor’s portfolio when compared to more established asset classes, it is expected that investors are generally more open to investing with managers they have not previously worked with as they look to add to their roster and build up their portfolio.

EVIDENCE OF A STRATEGY SHIFT

Direct lending remains the most sought-after strategy among private debt investors, and 44% feel
it currently offers the most favourable investment opportunities (Fig. 6.12). However, there is evidence of a strategy shift occurring within the asset class, as investors perhaps look to alter their investment approach in anticipation of a market correction.

Over the next 12 months, special situations and distressed debt funds, which are counter-cyclical, are likely to attract increased amounts of investor capital, with these strategies growing in favour among investors over the past year: 43% and 36% of investors respectively believe these strategies are presenting attractive opportunities. On the other hand, appetite for direct lending has waned: direct lending funds closed in 2018 secured $45bn, significantly less than the $68bn secured by funds closed in 2017. As intense competition has compressed returns, many investors are seeking a better risk/return profile with other strategies such as mezzanine: mezzanine fundraising surged from $12bn in 2017 to $31bn in 2018 following the closure of GS Mezzanine Partners VII, the joint largest mezzanine fund ever raised.

**UPTICK IN EMERGING MARKETS INTEREST**

Since the general emergence of private debt as an established asset class, much of its growth has been...
centred around the established markets of the US and Europe. Sixty-eight percent of investors believe the US presents the best opportunities, while 53% and 34% respectively said the same about Western Europe and the UK (Fig. 6.14).

While this is likely to continue in the near future, there are signs that emerging regions are gaining traction. Thirteen percent of investors plan to commit all, or the vast majority, of their 2019 capital allowance to emerging regions (Fig. 6.13). While this may still seem a small proportion, it is larger than for all other alternative asset classes.

Within emerging markets, the largest proportion (33%) of investors feel China presents favourable opportunities, followed by other regions in Emerging Asia (23%, Fig. 6.15). Twenty-three percent of investors specifically named Brazil as presenting attractive opportunities, while 20% cited Central & Eastern Europe.

**TRADITIONAL FUND STRUCTURES**

Single-manager funds remain the structure of choice for private debt investors going forwards (Fig. 6.16). Other structures, such as separate accounts, co-investments and direct investments, are likely to be used less frequently for private debt investment compared with other private capital asset classes. However, with the private debt industry in a state of constant growth and investors developing more mature and sophisticated portfolios, we may see an uptick in the use of alternative structures in the coming years.

**A POSITIVE VIEW AHEAD**

The long-term outlook for private debt is noticeably positive: a significant 48% of investors plan to increase their allocation to the asset class, while 47% will maintain their current level of exposure (Fig. 6.17). Private debt will therefore remain a core part of investors’ portfolios as they look to reap the rewards that the asset class has the potential to offer, particularly in times of market volatility.
INVESTORS RECOGNIZE NATURAL RESOURCES BENEFITS

The natural resources industry has suffered from poor performance in recent years and investors are understandably disappointed with the returns they have received. That being said, high absolute returns are not investors’ primary motivation for investing in the asset class: portfolio diversification and low correlation to other asset classes rank higher in their priorities. This explains why investors will be sticking with natural resources in the year ahead, particularly considering the prospect of a market correction in the near future.

Performance woes aside, 2018 was a strong year for the asset class, with 91 funds securing a record $93bn, and the initial outlook for 2019 remains positive. Twenty-nine percent of surveyed investors are planning to commit more capital to the asset class in the next 12 months than they did in 2018. Investors will likely continue to focus on what they know best, with developed markets and energy strategies still the most favoured avenues for natural resources investment. However, investors are also open to forming new fund manager relationships, perhaps looking to new strategies and regions as they continue to build their portfolios, demonstrating the truly diverse nature of the asset class.

At the beginning of 2019, with 3x as many funds in market than closed in 2018 – and seeking twice as much capital as was secured in the year – the challenge of attracting capital from investors seems a huge task. However, given that investors are increasingly recognizing the benefits natural resources can offer, 2019 has the potential to be another successful year.

Key Survey Findings:

- 29% of natural resources investors were disappointed with the performance of their investments in 2018.
- 66% of natural resources investors allocate for diversification purposes, whereas 39% seek a low correlation to other asset classes.
- 74% of natural resources investors are open to forming new relationships with fund managers.
- 66% of natural resources investors believe that the US is presenting the best investment opportunities at present.
- 29% of natural resources investors are planning to commit more capital to the asset class in 2019 than they did in 2018.
- 89% of natural resources investors are planning to maintain or increase their allocation to the asset class over the longer term.
Investors were largely disappointed with the returns they received from their natural resources investments in 2019. Indeed, across vintage 2005-2015 funds, net-to-LP returns for natural resources funds have averaged just under 7% per annum, compared with 10-12% for other private capital asset classes. As is often the case in times of strong economic growth, commodity prices weaken and become more volatile, exercising a knock-on impact on the performance of natural resources investments.

That being said, the primary reasons why investors allocate to natural resources are to achieve portfolio diversification (cited by 66% of investors) and a low correlation to other asset classes (39%) – high absolute returns were named by only 28% of surveyed investors. Because of this, 81% of investors are just as, if not more, confident in the asset class to meet portfolio objectives over the next 12 months compared with 2018 (Fig. 7.3).

As a result of the present volatility in commodity markets and the slump in oil prices, many investors feel that performance may dip even further in 2019. Almost a quarter (24%) of investors believe that their natural resources investments will perform worse over the next 12 months, compared with just 6% of those surveyed at the end of 2017 (Fig. 7.2).

It should also be noted that natural resources performance has improved and compares favourably with the public market: the PrEQIn Natural Resources Index reached a new high of 144.2 points as at June 2018 when rebased as of 31 December 2007, outperforming the S&P Global Natural Resources Index TR. As we move into 2019, while the proportion (70%) of investors that felt performance had met or exceeded expectations is smaller than the previous year, this figure is still positive and nowhere near as low as the figures seen at the end of 2016 (47%) and 2015 (38%, Fig. 7.1).
7. NATURAL RESOURCES

NATURAL RESOURCES: CURRENT CHALLENGES

The largest proportion (45%) of natural resources investors feel that asset valuations are a key challenge for return generation in 2019 (Fig. 7.4).

Among alternative assets investors, 61% feel we are at the peak of the equity market cycle (Fig. 7.6), and a third of natural resources investors feel that asset pricing is higher than 12 months ago (Fig. 7.5) – this is, however, the smallest proportion across all private capital strategies. Furthermore, 48% of investors feel that assets are fairly priced, and 19% even think assets are priced too low and that there is room for further price increases yet (Fig. 7.7), which is by far the largest proportion when compared to other private capital asset classes. While asset valuations are the biggest threat to return generation in the next 12 months, this demonstrates that the challenging environment is likely to continue for some time and prices may rise further in the short term.

Other challenges affecting return generation according to investors are the geopolitical environment (cited by 31% of respondents), rising interest rates (26%) and competition for assets (23%).
NATURAL RESOURCES: PLANS FOR NEXT 12 MONTHS

Capital distributions have been high in recent years, with a record $99bn returned to investors in 2017. This has helped to boost fundraising, with 2018 marking a new record: $93bn was raised by unlisted natural resources funds closed during the year, and there are signs this momentum will continue. In the first half of 2018 (the latest data available), cash flows entered positive territory for the first time in the past decade, with $49bn returned to investors compared with $48bn called up, with many investors looking to re-invest this capital going forward. A notable 29% of investors are planning to commit more capital in the next 12 months compared to the previous 12 months, whereas only 11% of investors were planning the same at the end of 2017 (Fig. 7.8).

INVESTORS STICK WITH EXISTING MANAGERS

Over a quarter (26%) of investors are looking to commit capital in 2019 exclusively to natural resources managers with which they have a previous relationship (Fig. 7.11), and this is the largest proportion across all alternative asset classes. Given the prevailing performance concerns, investors are likely to feel more comfortable allocating capital to managers they know well and with which they have experienced previous success. However, there will of course still be investors looking to form new relationships, including 12% that are exclusively looking to work with new managers. These investors are likely to be either new to the asset class, currently under-allocated, or perhaps looking to explore new strategies or geographies to further diversify their portfolios.

ENERGY TO RECEIVE LARGEST SHARE

Energy remains the dominant strategy in the natural resources sector and these funds will receive most of investors’ capital in 2019: 86% of investors

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**Fig. 7.8: Investors’ Expected Capital Commitments to Natural Resources Funds in the Next 12 Months Compared to the Previous 12 Months, 2016 - 2018**

<table>
<thead>
<tr>
<th>Nov-16</th>
<th>Nov-17</th>
<th>Nov-18</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less Capital</td>
<td>Same Amount of Capital</td>
<td>More Capital</td>
</tr>
<tr>
<td>22%</td>
<td>19%</td>
<td>17%</td>
</tr>
</tbody>
</table>

Source: Preqin Investor Interviews, November 2016 - 2018

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**Fig. 7.9: Number of Natural Resources Funds Investors Plan to Commit to in the Next 12 Months**

<table>
<thead>
<tr>
<th>1 Fund</th>
<th>2-3 Funds</th>
<th>4-9 Funds</th>
<th>10 Funds or More</th>
</tr>
</thead>
<tbody>
<tr>
<td>63%</td>
<td>30%</td>
<td>8%</td>
<td>0%</td>
</tr>
</tbody>
</table>

Source: Preqin Investor Interviews, November 2018

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**Fig. 7.10: Timeframe for Investors’ Next Intended Commitment to a Natural Resources Fund**

<table>
<thead>
<tr>
<th>Q1 2019</th>
<th>Q2 2019</th>
<th>H2 2019</th>
<th>2020 or Later</th>
</tr>
</thead>
<tbody>
<tr>
<td>39%</td>
<td>20%</td>
<td>16%</td>
<td>25%</td>
</tr>
</tbody>
</table>

Source: Preqin Investor Interviews, November 2018
feel energy funds present the most attractive opportunities (Fig. 7.12). Agriculture/farmland and timberland funds are viewed favourably by 27% and 25% of investors respectively, compared with 20% and 17% for water and metals & mining funds.

**OIL & GAS BOOSTS US PROFILE**

Developed markets look set to continue to dominate natural resources fundraising over 2019: 39% of investors plan to invest exclusively in developed markets and a further 20% will predominantly employ this approach but may also look for some exposure to emerging markets (Fig. 7.13).

Two-thirds of investors believe that the US is currently presenting the best investment opportunities (Fig. 7.14), likely a result of the continuing expansion of the oil & gas industry in the country due to technological advancement and more stable or even reduced drilling/extraction costs. Just over a quarter (26%) of investors feel Western Europe (excluding the UK) is presenting attractive opportunities, while 22% are positive about the UK. The developed natural resources market in Australia and New Zealand is still appealing to investors, and 16% believe it presents the best opportunities. The reasons for this are twofold: Australia is one of the

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**Fig. 7.11: Natural Resources Investors’ Intentions for Forming New GP Relationships over the Next 12 Months**

- Only New Relationships: 12%
- Mainly New Relationships, Some Re-ups: 26%
- Mix of New Relationships and Re-ups: 12%
- Mainly Re-ups, Some New Relationships: 43%
- Only Re-ups: 7%

Source: Preqin Investor Interviews, November 2018

**Fig. 7.12: Investor Views on Strategies Presenting the Best Opportunities in Natural Resources**

- Energy: 86%
- Agriculture/Farmland: 27%
- Timberland: 25%
- Water: 20%
- Metals & Mining: 17%

Source: Preqin Investor Interviews, November 2018

**Fig. 7.13: Natural Resources Investors’ Intentions for Targeted Markets in the Next 12 Months**

- Only Developed Markets: 39%
- Mainly Developed Markets, Some Emerging Markets: 30%
- Mix of Developed and Emerging Markets: 4%
- Mainly Emerging Markets, Some Developed Markets: 7%
- Only Emerging Markets: 26%

Source: Preqin Investor Interviews, November 2018

**Fig. 7.14: Investor Views on Developed Markets Presenting the Best Opportunities in Natural Resources**

- US: 67%
- Western Europe (Excl. UK): 26%
- Australia & New Zealand: 22%
- Canada: 16%
- Nordic: 10%
- Japan: 7%
- South Korea: 7%
- Singapore: 6%
- Others: 5%

Source: Preqin Investor Interviews, November 2018
leading minerals producers for industrial/commercial usage in China and the timberland and agriculture sectors are strong in both countries.

While developed markets will still receive the lion’s share of capital in 2019, emerging markets will not be far behind. Eleven percent of investors will entirely or predominantly target emerging regions for their natural resources commitments in the year ahead, and a further 30% will do so alongside developed markets, which is the largest proportion across all alternatives. Rich in a diverse range of resources such as fossil fuels, biofuels, minerals and timber, alongside the growth of renewable energy, emerging markets present prime opportunities for natural resources investment in 2019 and beyond.

Emerging Asia was cited by the largest proportion (32%) of investors as presenting attractive opportunities within emerging markets at present, followed by China specifically (28%, Fig. 7.15). Brazil and India are also viewed favourably by investors (each cited by 22%).

**SINGLE-MANAGER FUNDS FAVOURED**

Over three-quarters (76%) of investors will invest in natural resources in the near future using pooled single-manager funds (Fig. 7.16). Smaller, but still notable, proportions of investors are likely to invest directly in the asset class (16%) or co-invest alongside fund managers (18%).

**INVESTORS COMMIT TO FUTURE**

The outlook for the natural resources industry in 2019 is largely positive, with investors ready to place capital with fund managers when attractive opportunities arise. This is unlikely to change over the longer term, as a significant 88% of surveyed investors plan to increase or maintain their allocation to the asset class, a larger proportion than at the end of 2017 (82%) and 2016 (77%, Fig. 7.17). Investors clearly understand the benefits that a diverse investment portfolio can offer, especially in times of market volatility.