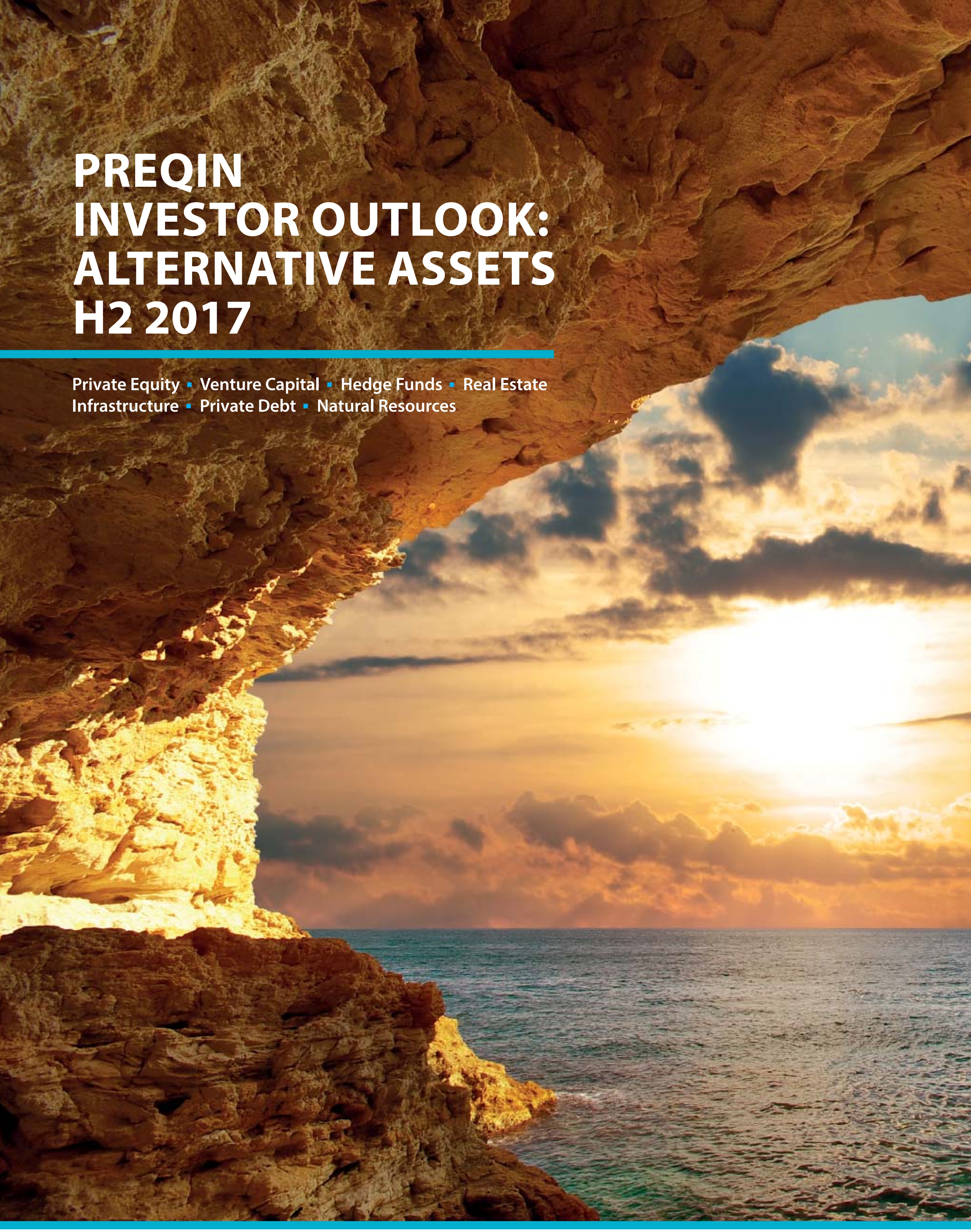

PREQIN INVESTOR OUTLOOK: ALTERNATIVE ASSETS H2 2017

Private Equity ▪ Venture Capital ▪ Hedge Funds ▪ Real Estate
Infrastructure ▪ Private Debt ▪ Natural Resources

preqin

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CONTENTS

DATA PACK FOR PREQIN INVESTOR OUTLOOK: ALTERNATIVE ASSETS, H2 2017

The data behind all of the charts featured in this report is available to download for free. Ready-made charts are also included that can be used for presentations, marketing materials and company reports.

To download the data pack, please visit:

www.preqin.com/investoroutlook

FOREWORD

The continued low interest rate policy around the world is one of the driving forces behind the increasing prominence of alternative assets in institutional investors' portfolios in recent years. The vast majority of institutions now commit to at least one alternative asset class, and the level of participation is particularly high across more established asset classes such as private equity, real estate and hedge funds. We are entering a period where alternatives are no longer 'alternative' in the eyes of many institutions, which bodes well for further expansion of the industry.

However, as we close in on the end of 2017, there are significant challenges in the market: Preqin interviewed 540 global institutional investors in June 2017, and the results show that investors are united in viewing high pricing for transactions as the key challenge across all closed-end private capital asset classes; for hedge funds, performance and fees are at the forefront of investors' minds. Major contributors to high valuations are the increase in competition, the strong performance and the corresponding effect of this success on fundraising totals and industry dry powder.

The counterpoint to high valuations is the creation of a strong sellers' market; this has helped vehicles to exit investments, and has also contributed to high distributions for some closed-end asset classes. The outliers – natural resources and hedge funds – are still contending with the hangover of recent poor performance, which has driven negative sentiment towards the asset classes. Results from our interviews with institutional investors indicate that the stronger returns seen over the past year have started to shift this viewpoint and, should they continue, may act as the catalyst for renewed interest in the years to come.

Investors are underweighted to alternatives – particularly considering funds have been distributing capital back at the levels seen in recent years – and now face the prospect of isolating the best candidates from a pool of more than 17,100 funds open to investment. For fund managers, standing out amid the unprecedented levels of competition is a challenging prospect, and the need for comprehensive data on the changing plans of institutional investors has never been greater.

Preqin's online services are indispensable fundraising and investor relations tools for any firm managing or looking to manage institutional capital. Thousands of professionals use Preqin every day to source new investors, access exclusive information on new RFPs and fund searches, monitor the market and track competing firms.

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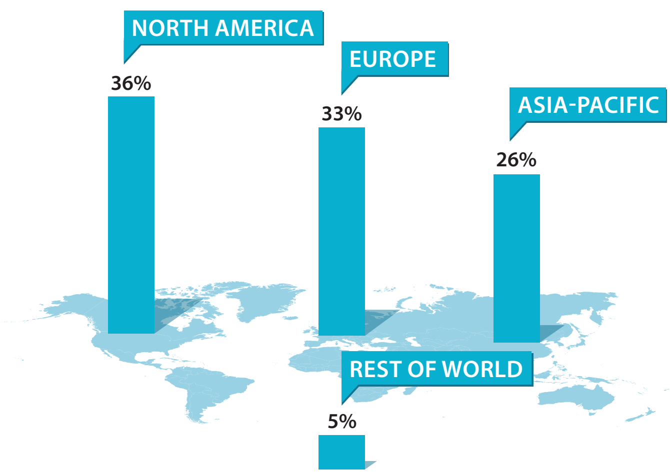
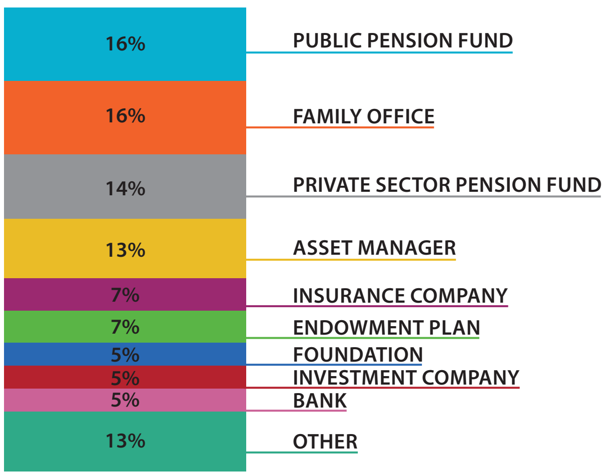
RESPONDENTS BY INVESTOR LOCATION



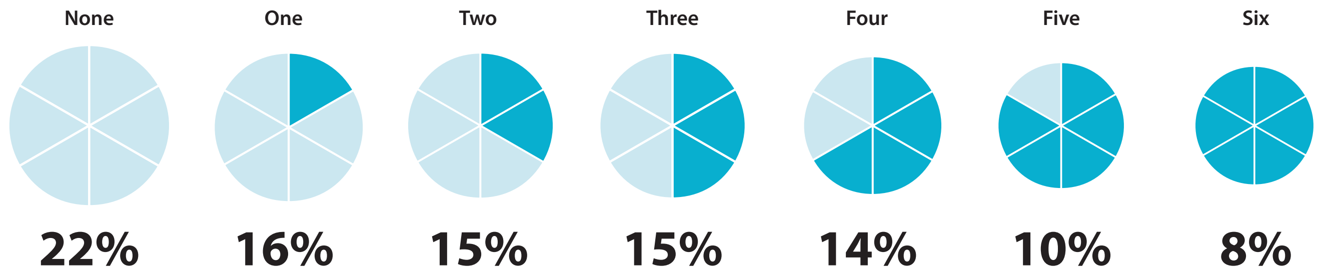
RESPONDENTS BY INVESTOR TYPE



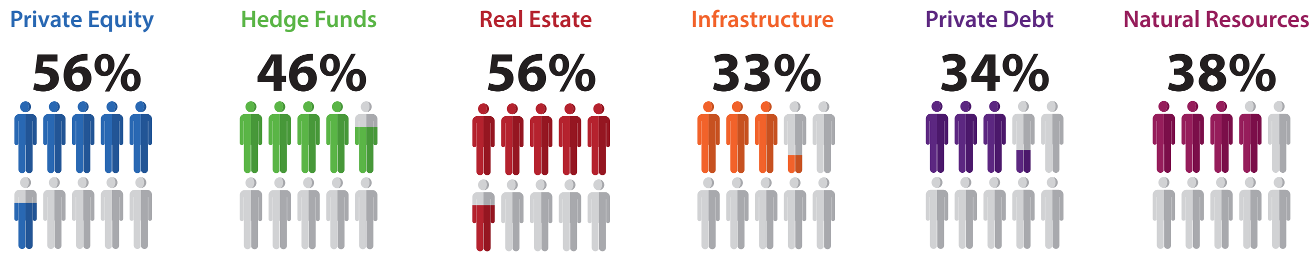
SECTION ONE: ALTERNATIVE ASSETS

PARTICIPATION IN ALTERNATIVE ASSETS

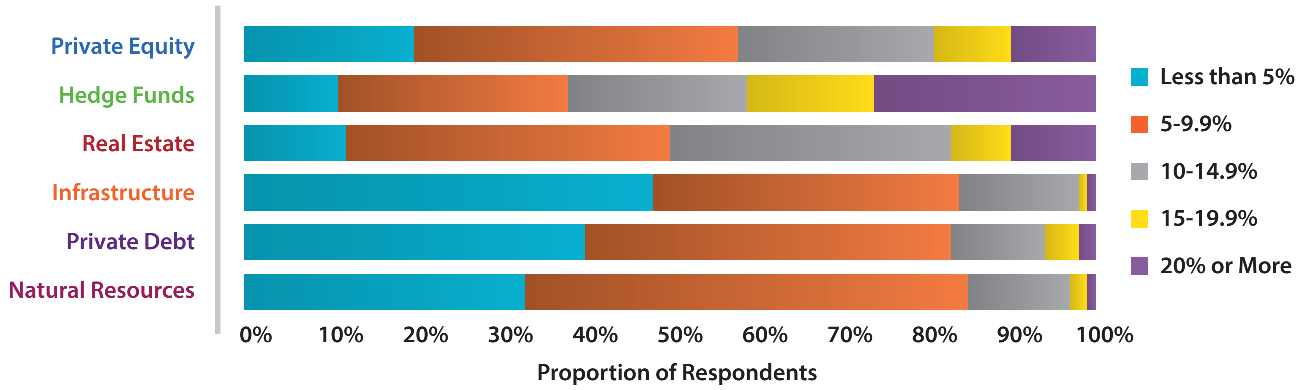
INSTITUTIONAL INVESTORS BY NUMBER OF ALTERNATIVE ASSET CLASSES INVESTED IN



PROPORTION OF INSTITUTIONAL INVESTORS ALLOCATING TO EACH ALTERNATIVE ASSET CLASS



INSTITUTIONAL INVESTORS IN ALTERNATIVE ASSETS BY TARGET ALLOCATION TO EACH ASSET CLASS (AS A % OF AUM)



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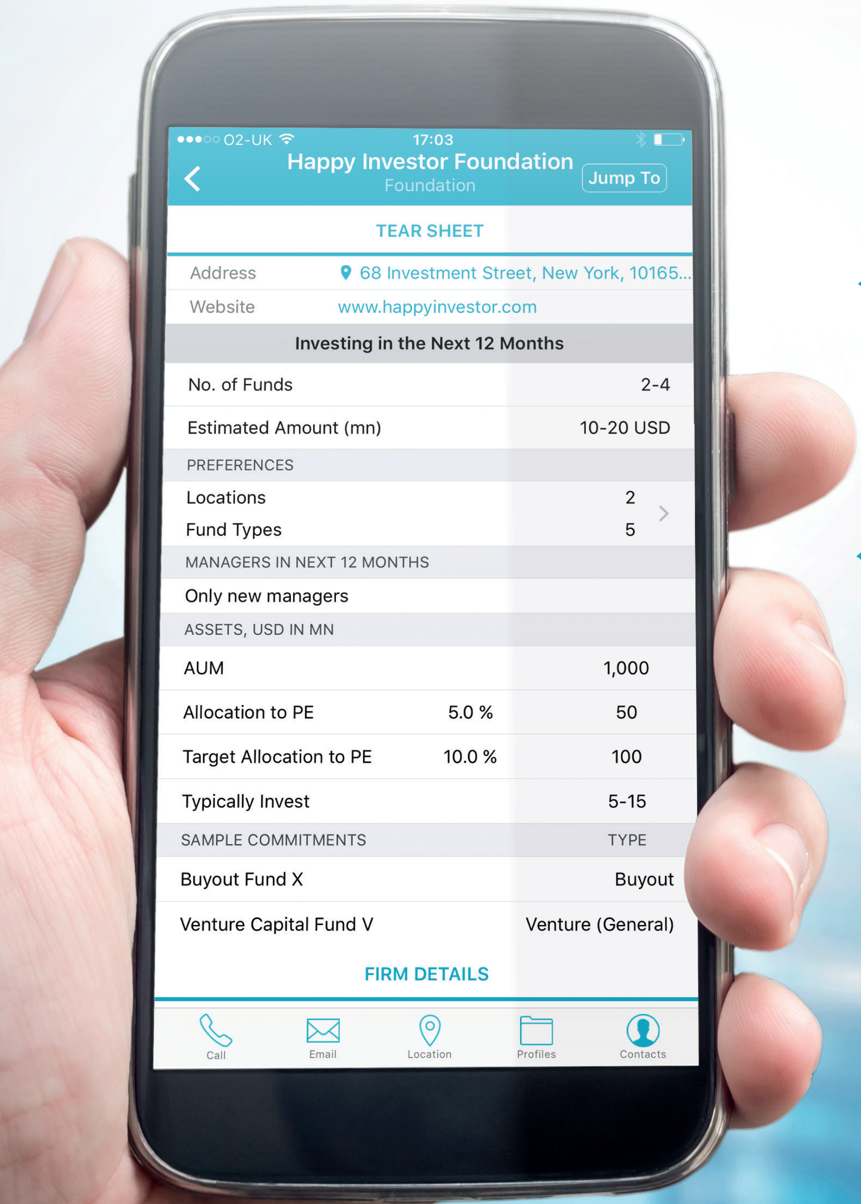
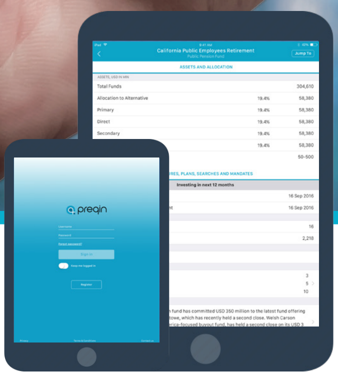


- Quickly prepare for meetings with investors or managers while on the road
- Easily access key investor or manager info during internal meetings
- Swiftly find key investor and manager information when putting together presentations



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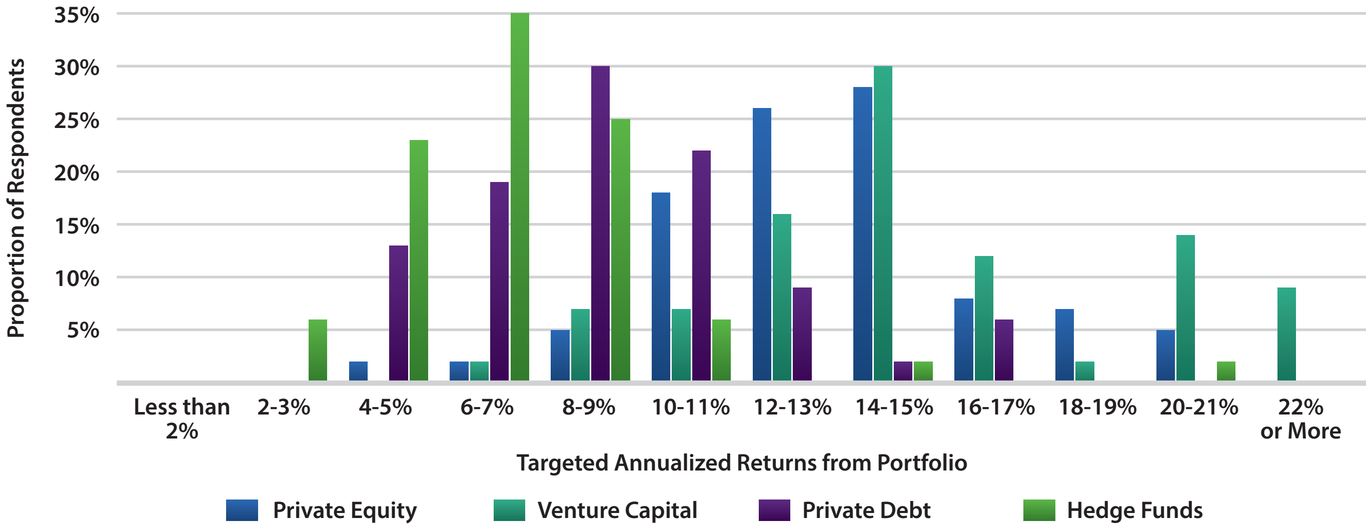
REASONS FOR INVESTING IN ALTERNATIVES

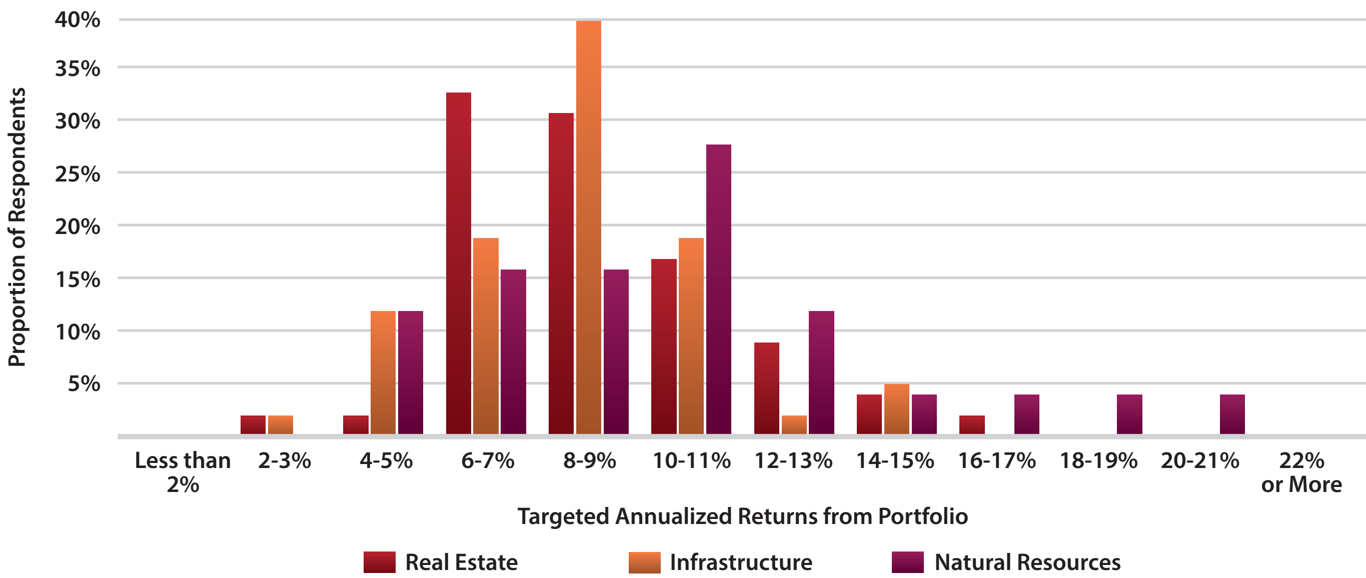
INSTITUTIONAL INVESTORS' MAIN REASONS FOR INVESTING AND TARGETED ANNUALIZED RETURNS

PRIVATE EQUITY	VENTURE CAPITAL	PRIVATE DEBT	HEDGE FUNDS
High Absolute Returns	High Absolute Returns	Diversification	Diversification
High Risk-Adjusted Returns	Diversification	Reliable Income Stream	Low Correlation to Other Asset Classes
Diversification	High Risk-Adjusted Returns	High Risk-Adjusted Returns	Reduce Portfolio Volatility



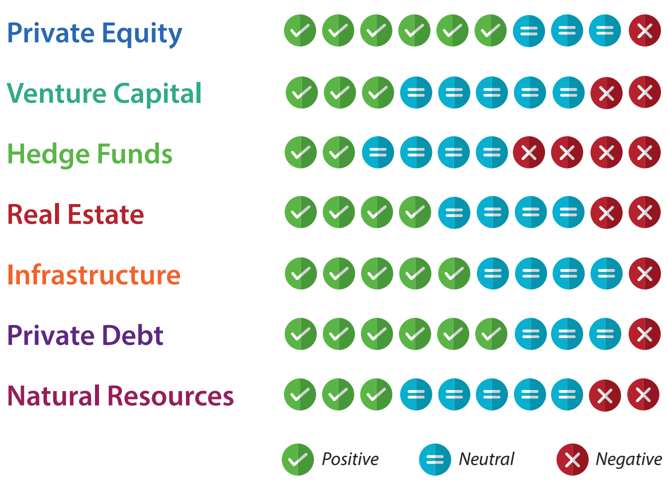
INSTITUTIONAL INVESTORS' MAIN REASONS FOR INVESTING AND TARGETED ANNUALIZED RETURNS

REAL ESTATE	INFRASTRUCTURE	NATURAL RESOURCES
Diversification	Diversification	Diversification
Inflation Hedge	Reliable Income Stream	Inflation Hedge
High Risk-Adjusted Returns	Low Correlation to Other Asset Classes	High Risk-Adjusted Returns

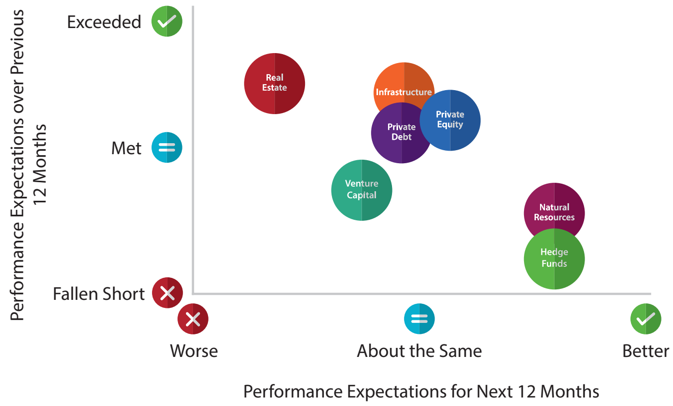


PERCEPTION AND EXPECTATIONS

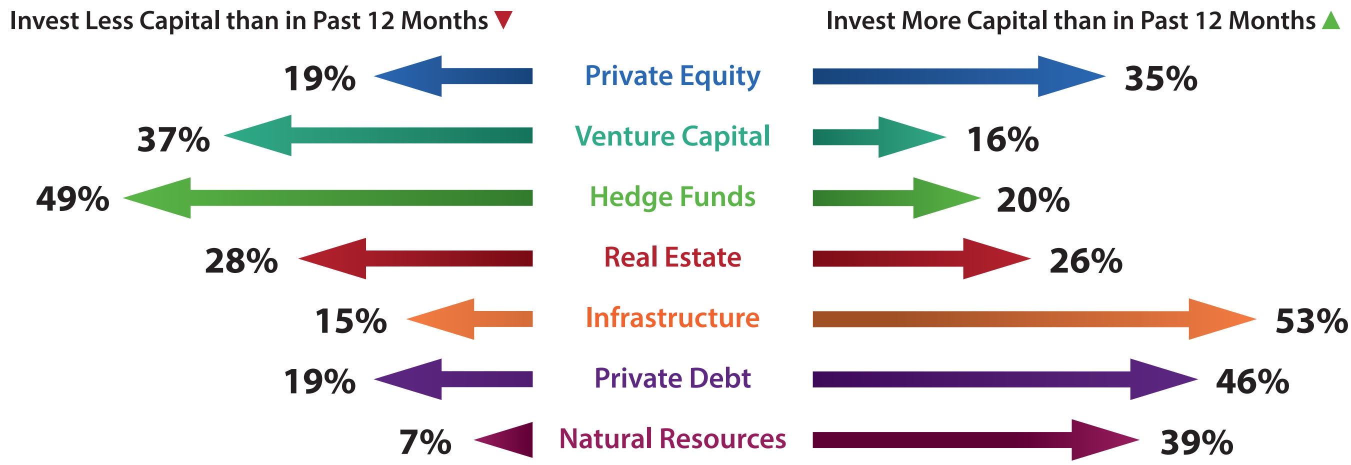
INSTITUTIONAL INVESTORS' GENERAL PERCEPTION OF ALTERNATIVE ASSET CLASSES



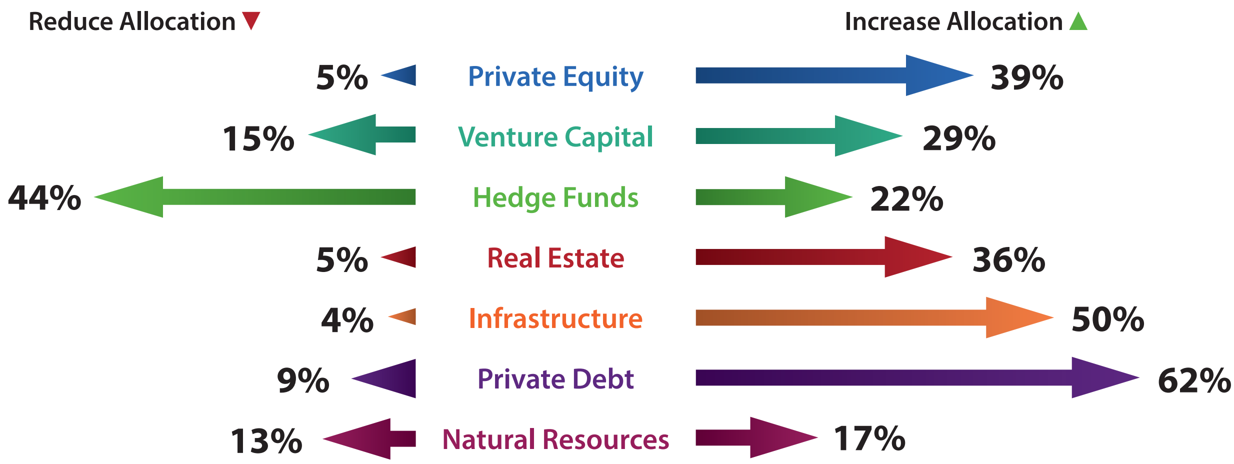
INSTITUTIONAL INVESTOR VIEWS ON ALTERNATIVE ASSETS PERFORMANCE



INSTITUTIONAL INVESTORS' PLANS FOR THE COMING YEAR



INSTITUTIONAL INVESTORS' PLANS FOR THE LONGER TERM



SECTION TWO: PRIVATE EQUITY

POSITIVE SENTIMENT DIPS BUT INVESTORS ARE SATISFIED

Investors surveyed by Preqin in June 2017 are less positive about private equity as an asset class than in previous surveys: the proportion of investors with a positive general perception of the asset class has fallen to 58% in June 2017 from 84% in December 2016.

In part, the decline in positive sentiment may relate to concerns about whether the recent strong performance of the asset class can be maintained at a time of high valuations: 86% of investors cite this as a key issue facing the industry, up from 70% in December 2016. Although high valuations may be beneficial to fund managers that are able to exit their investments at current prices, 45% of investors believe that valuations will lead to lower returns over the longer term, compared to only 25% that believe returns will increase.

Despite these concerns, investors have been satisfied with the performance of their private equity investments in recent years: 38% of investors reported that their private equity investments over the past three years had exceeded expectations, the largest proportion of all asset classes.

As a result, investors expect to commit significant amounts to private equity, not only over the next year, but also in the longer term. Among investors planning to make new commitments to private equity in the next 12 months, 51% are planning to invest $100mn or more, compared to 38% of those surveyed in December 2016. Over the longer term, 39% of investors plan to increase their allocation to private equity and 56% plan to maintain it at current levels, with just 5% intending to reduce their allocation.

KEY ISSUES

86%

of investors consider valuations to be one of the key issues facing the private equity industry at present.

57%

of investors believe it is currently harder to find attractive investment opportunities compared to 12 months ago.

INVESTOR SATISFACTION

58%

of investors have a positive perception of private equity, down from 84% in December 2016.

38%

of investors reported that their private equity investments over the past three years had exceeded expectations.

FUTURE PLANS

35%

of investors plan to commit more capital to private equity funds over the next 12 months than the past 12 months.

39%

of investors plan to increase their allocation to Europe-focused vehicles over the next 12 months.

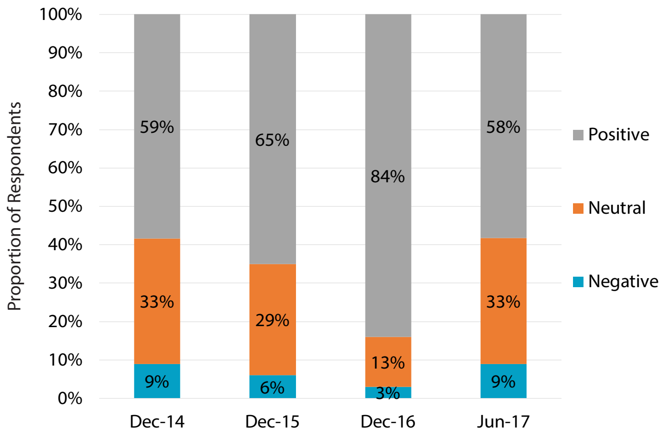
SATISFACTION WITH PRIVATE EQUITY

The proportion of institutional investors that regard private equity positively fell noticeably in H1 2017: 58% of investors surveyed by Preqin in June 2017 had a positive view of the asset class, compared with 84% in December 2016 (Fig. 2.1). Despite this, however, private equity remains the most highly regarded asset class among alternatives, with the smallest proportion (9%) of investors across alternatives holding a negative viewpoint.

In terms of performance, 22% of surveyed investors felt that their portfolios had exceeded expectations over the past 12 months (Fig. 2.2). This proportion has fallen slightly from the figure in December 2015 (30%) and December 2016 (24%) but remains the second largest proportion among alternative asset classes, after real estate (25%). Moreover, investors are also content with their private equity portfolio performance over the longer term. Thirty-seven percent reported that the performance of their portfolios exceeded expectations over the past three years, while just 8% felt that performance fell short (Fig. 2.3).

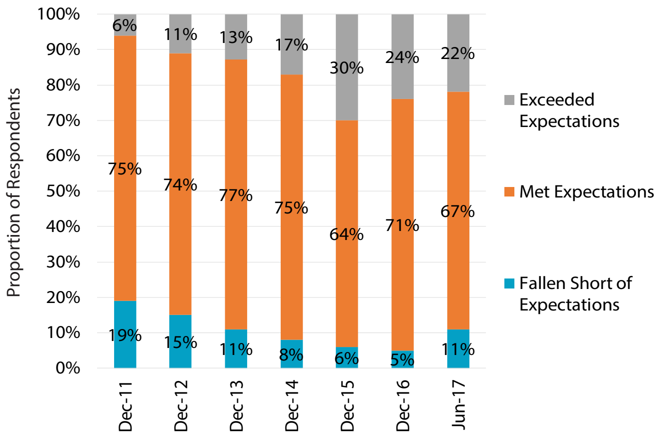
With portfolio company valuations high and deal flow becoming more of a challenge for the industry (see page 12), some investors are concerned about the possible impact of these developments on their portfolios. Over the course of the past three years, increasingly large proportions of survey respondents are losing confidence in the ability of private equity to perform portfolio objectives (Fig. 2.4). Correspondingly, the proportion of investors with increased confidence in the asset class has fallen from 18% in 2015 to just 6% in 2017.

Fig. 2.1: Investors' General Perception of the Private Equity Industry, 2014 - 2017



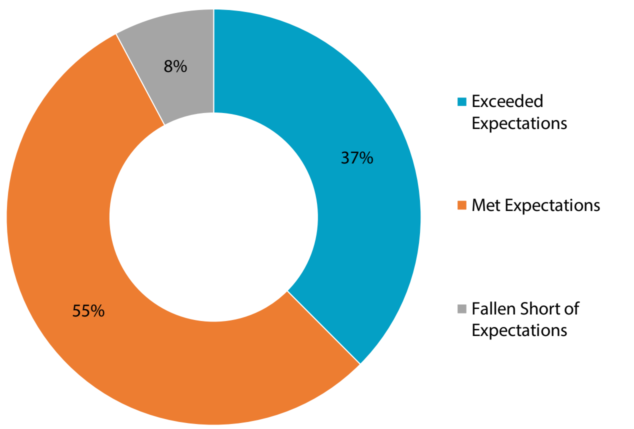
Source: Preqin Investor Interviews, December 2014 - June 2017

Fig. 2.2: Investor Views on Private Equity Portfolio Performance over the Past 12 Months Relative to Expectations, 2011 - 2017



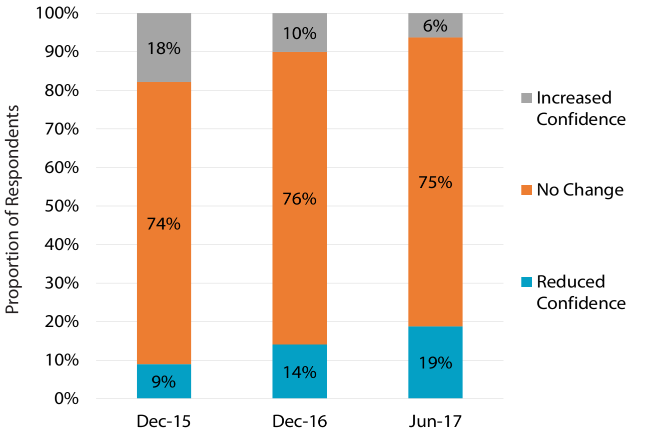
Source: Preqin Investor Interviews, December 2011 - June 2017

Fig. 2.3: Investor Views on Private Equity Portfolio Performance over the Past Three Years Relative to Expectations



Source: Preqin Investor Interviews, June 2017

Fig. 2.4: Investors' Change in Confidence in the Ability of Private Equity to Achieve Portfolio Objectives over the Past 12 Months, 2015 - 2017



Source: Preqin Investor Interviews, December 2015 - June 2017

KEY ISSUES IN 2017

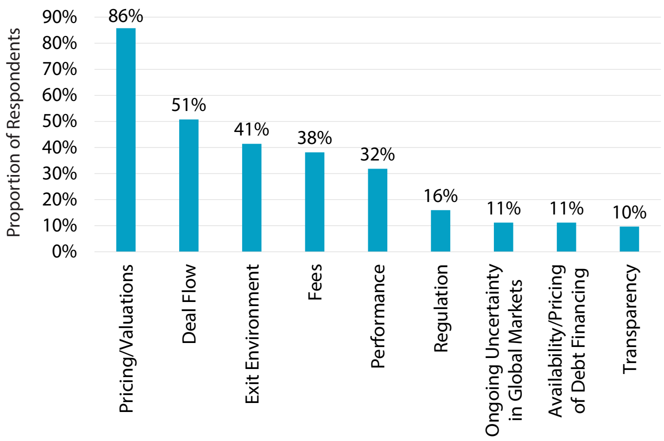
High valuations remain the leading concern of institutional investors in private equity, with 86% of those surveyed identifying it as one of the key issues facing the industry at present, up from 70% in December 2016 (Fig. 2.5). High valuations have made it harder for private equity fund managers to find attractive portfolio companies at reasonable prices.

Deal flow has therefore risen up investors' list of concerns, cited by 41% of respondents in December 2016 and 51% in June 2017. As a result, it is becoming increasingly difficult for investors to identify attractive investment opportunities at present, with 57% stating that it is more difficult than a year ago, the largest proportion among all alternative asset classes (Fig. 2.6).

Investors were split about the impact that valuations would have on portfolio performance in the short term, with equal proportions believing that they would improve returns as would reduce them (Fig. 2.7). This disagreement was reflected in investors' return expectations for the upcoming year, with similar proportions predicting that their portfolios would perform better (18%) as those that expected them to perform worse (21%, Fig. 2.8).

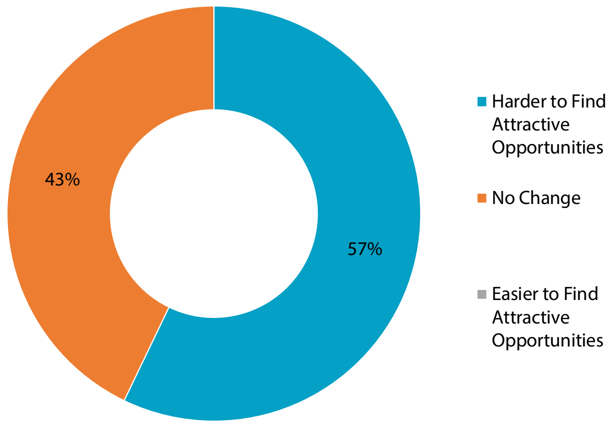
However, over the longer term, a significant proportion of investors believe that high valuations will have a negative impact on their private equity portfolios. Forty-five percent of those surveyed think that high valuations will lead to lower returns, as opposed to only 25% that believe they will lead to higher returns.

Fig. 2.5: Investor Views on the Key Issues Facing Private Equity in the Next 12 Months



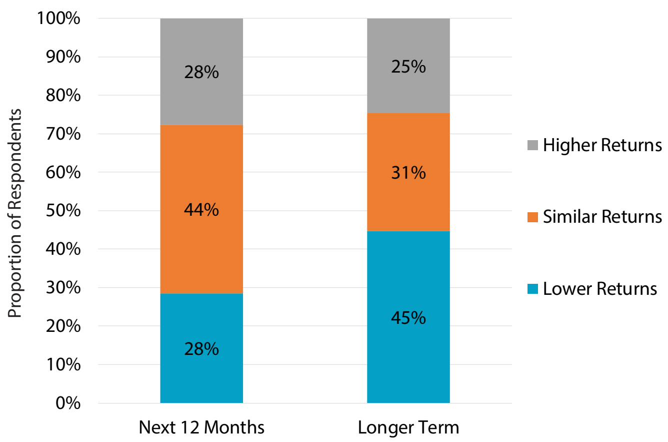
Source: Preqin Investor Interviews, June 2017

Fig. 2.6: Investor Views on the Difficulty of Identifying Attractive Private Equity Investment Opportunities Compared to 12 Months Ago



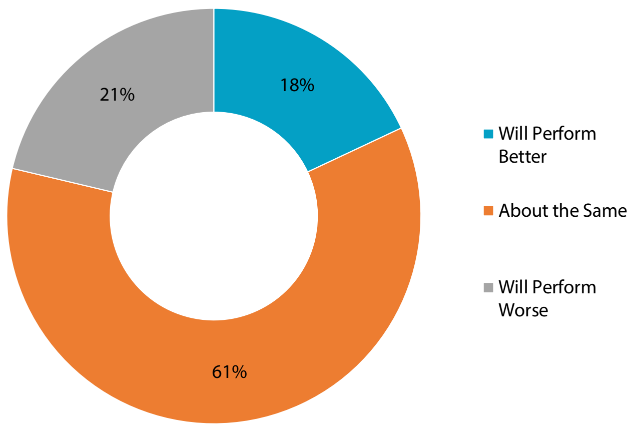
Source: Preqin Investor Interviews, June 2017

Fig. 2.7: Investor Views on the Impact of Portfolio Company Valuations on Private Equity Portfolio Returns



Source: Preqin Investor Interviews, June 2017

Fig. 2.8: Investors' Return Expectations for Their Private Equity Portfolios in the Next 12 Months Compared to the Previous 12 Months



Source: Preqin Investor Interviews, June 2017

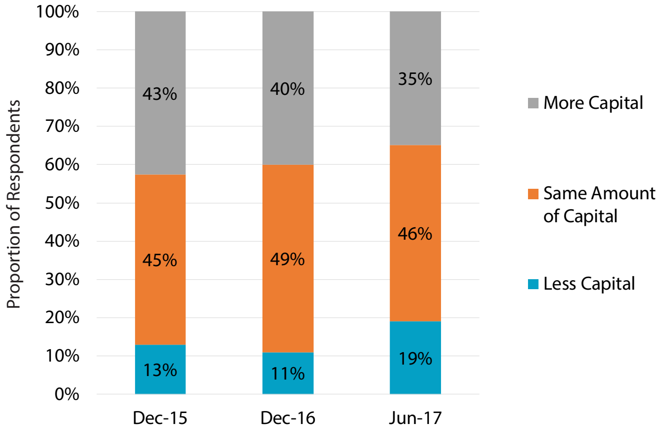
INVESTOR ACTIVITY IN THE NEXT 12 MONTHS

Investors continue to plan substantial investments in private equity for the year ahead. Over a third (35%) plan to invest more capital in the next year than in the past 12 months, while a further 46% will commit the same amount of capital as last year (Fig. 2.9). Although the proportion of investors planning to invest less capital in private equity has increased by eight percentage points from the end of last year to 19%, this remains lower than the corresponding figure for hedge funds, venture capital and real estate.

This is in contrast to the growing proportion of investors planning to commit larger sums of capital to the asset class. Among the investors on Preqin's **Private Equity Online** database planning new investments in the next 12 months, 51% are planning to invest $100mn or more, an increase of 13 percentage points from those surveyed in December 2016 (Fig. 2.10). The proportion of investors that plan to commit to seven or more vehicles in the next 12 months has increased over this period from 29% to 36%, although the proportion planning to commit to between one and two vehicles has also increased (from 26% to 33%, Fig. 2.11).

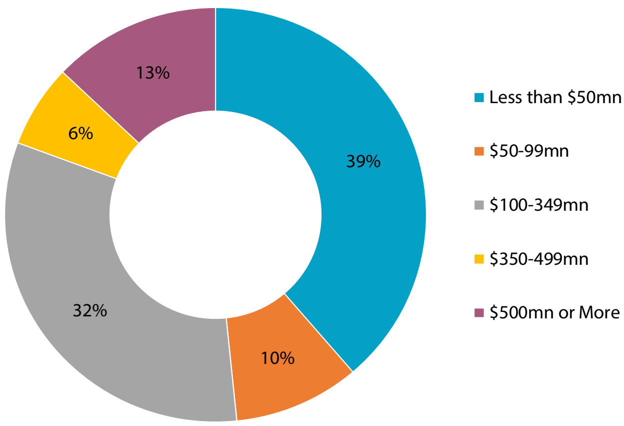
Over the longer term, prospects for further growth in private equity allocations remain strong, with 39% of surveyed investors intending to increase their allocation to private equity and 56% planning to maintain theirs at current levels, compared with only 5% that plan to reduce it (Fig. 2.12).

Fig. 2.9: Investors' Expected Capital Commitments to Private Equity Funds in the Next 12 Months Compared to the Previous 12 Months, 2015 - 2017



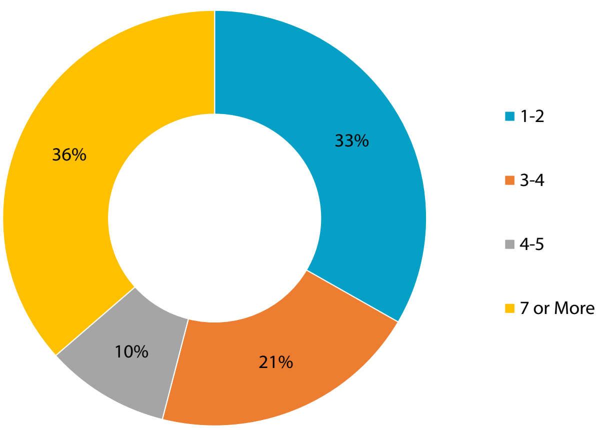
Source: Preqin Investor Interviews, December 2015 - June 2017

Fig. 2.10: Amount of Fresh Capital Investors Plan to Invest in Private Equity Funds over the Next 12 Months



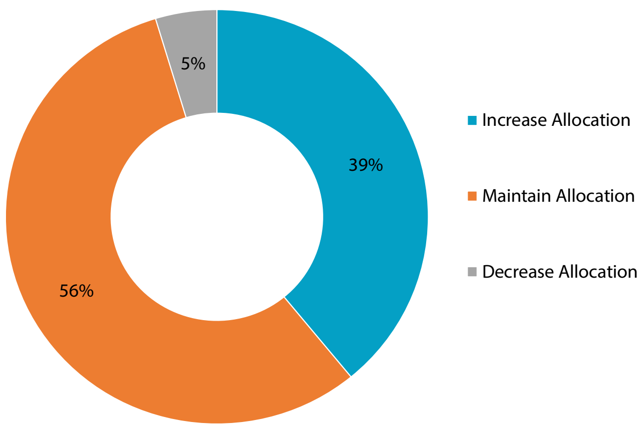
Source: Preqin Private Equity Online

Fig. 2.11: Number of Private Equity Fund Commitments Investors Plan to Make over the Next 12 Months



Source: Preqin Private Equity Online

Fig. 2.12: Investors' Intentions for Their Private Equity Allocation over the Longer Term



Source: Preqin Investor Interviews, June 2017

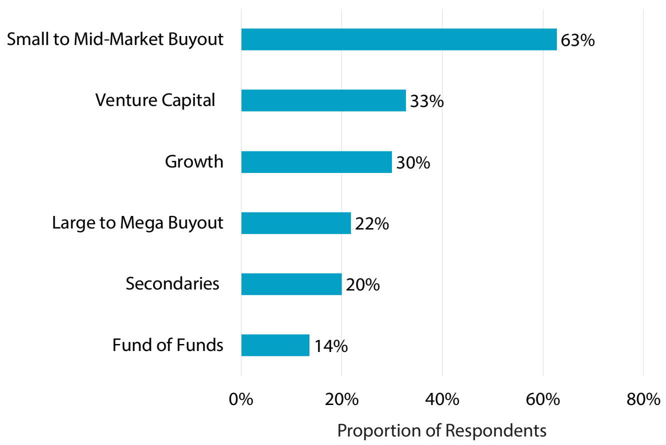
STRATEGIES AND GEOGRAPHIES TARGETED

As they look to commit more capital in the year ahead, investors in private equity continue to target small to mid-market buyout funds. Sixty-three percent of LPs surveyed identified these funds as currently presenting the best opportunities, up from 58% in December 2016 (Fig. 2.13). The greatest increase has been among growth funds: 30% of LPs named it as the fund type presenting the best opportunities, up from 18%.

North America continues to be the most favoured region among investors, with 69% viewing it as presenting the best opportunities, followed by Europe (50%) and Asia (30%), while only 10% believe emerging markets present the best opportunities at present (Fig. 2.14). Among investors targeting emerging markets, China was identified as the most promising region, cited by 38% of investors, followed by Emerging Asia (35%, Fig. 2.15). India saw the greatest increase, from 20% of respondents in December 2016 to 31%.

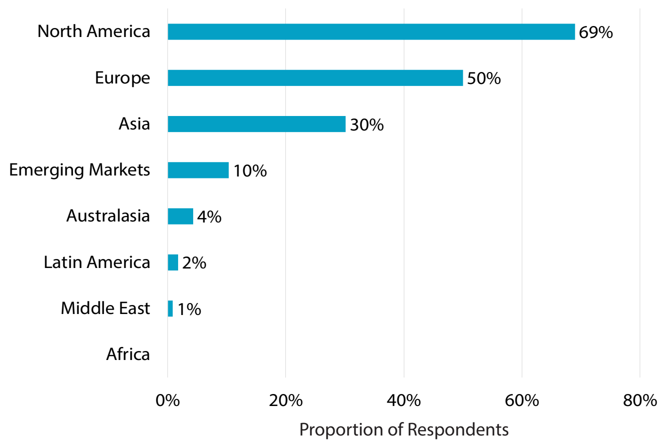
The greatest proportions of investors plan to increase their allocation over the next 12 months to Europe (39%) and Asia (32%, Fig. 2.16). Latin America is the only region to which more investors are planning to decrease (15%) than increase (11%) their allocations, although the majority of investors will maintain their allocations at current levels (74%).

Fig. 2.13: Fund Types* that Private Equity Investors View as Presenting the Best Opportunities



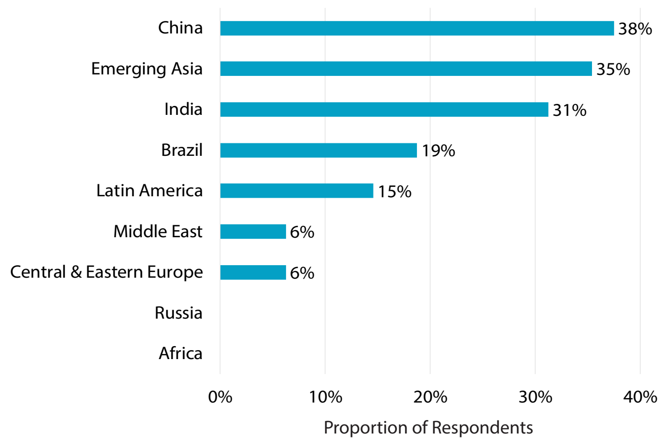
Source: Preqin Investor Interviews, June 2017

Fig. 2.14: Regions* that Private Equity Investors View as Presenting the Best Opportunities



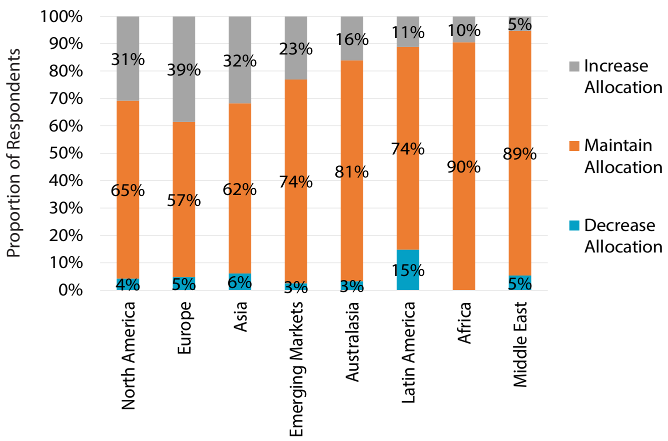
Source: Preqin Investor Interviews, June 2017

Fig. 2.15: Countries and Regions* within Emerging Markets that Private Equity Investors View as Presenting the Best Opportunities



Source: Preqin Investor Interviews, June 2017

Fig. 2.16: Investors' Plans for Their Private Equity Allocations over the Next 12 Months by Region



Source: Preqin Investor Interviews, June 2017

**Respondents were not prompted to give their opinions on each category individually but to name those they felt best fit these categories; therefore, the results display what was at the forefront of investors' minds at the time of the survey.*

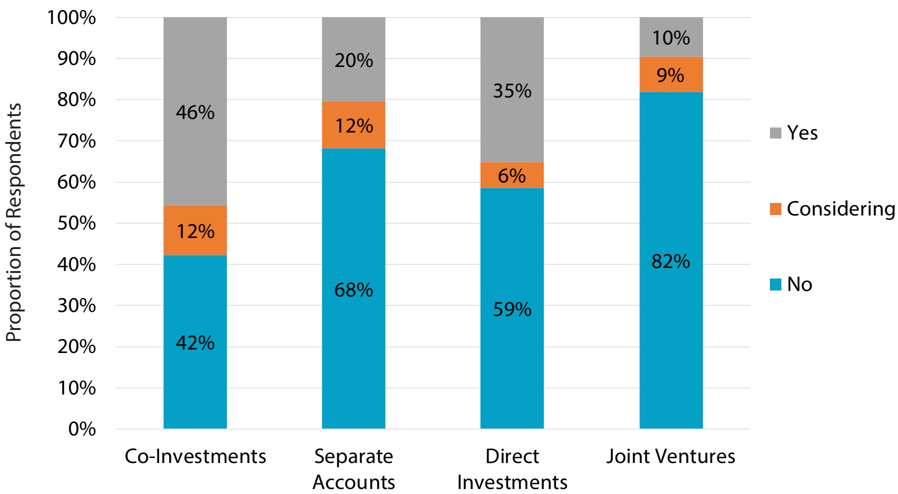
IN FOCUS: ALTERNATIVE STRUCTURES

In recent years, investors have increasingly made use of alternative structures beyond the traditional commingled fund structure, as they seek to improve the alignment of interests with GPs and access a wider range of opportunities. As Fig. 2.17 shows, many of these methods are now well established among investors, with almost half (46%) of surveyed investors co-investing and 35% investing directly in the asset class.

> ***Almost half (46%) of surveyed investors co-invest and 35% invest directly in the asset class***

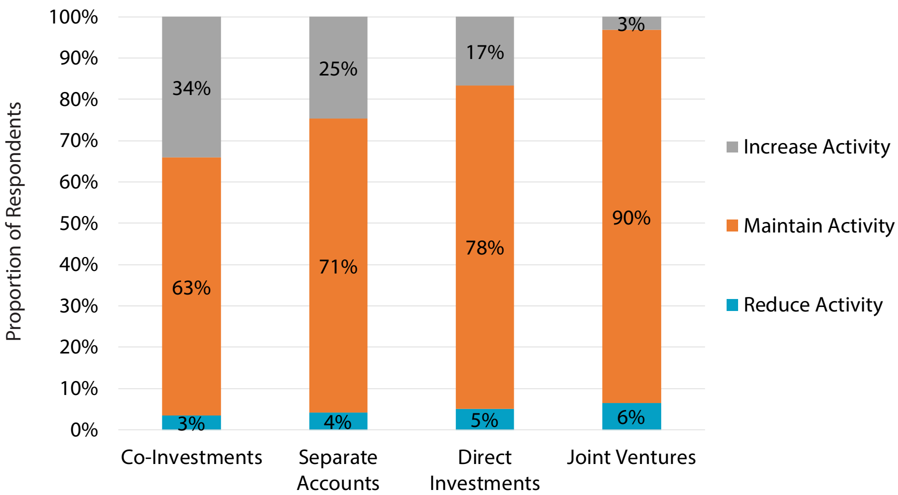
Over the longer term, co-investments are likely to become more prominent as 34% of surveyed investors plan to increase their co-investment activity, with only 3% intending to reduce activity (Fig. 2.18). Although separate accounts currently have less uptake than co-investments or direct investments, 25% of LPs plan to increase their activity in this area, with only 4% looking to reduce activity over the longer term.

Fig. 2.17: Investors' Use of Alternative Private Equity Structures at Present



Source: Preqin Investor Interviews, June 2017

Fig. 2.18: Investors' Plans for Use of Alternative Private Equity Structures over the Longer Term



Source: Preqin Investor Interviews, June 2017

SECTION THREE:
VENTURE CAPITAL

GROWING COMPETITION FOR THIS UNIQUE ASSET CLASS

Venture capital remains one of the most prominent private equity strategies, but is also in a unique position to exist as an asset class unto itself. The characteristics of venture capital investing are what set up the strategy for explosive return potential in the right situations. Investors that target venture capital strategies do so for specific reasons, the most telling of which is high absolute returns. Sixty-seven percent of venture capital investors surveyed by Preqin target an absolute annualized return of 14% or more from their investments.

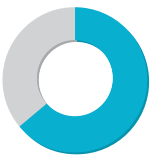
More than half (58%) of investors in venture capital are currently finding it more difficult to identify attractive opportunities than 12 months ago. Even so, 29% plan to increase their allocation to the strategy over the coming years, with one-quarter expecting to make seven or more investments in the next 12 months. So far in 2017, fund managers of North America-focused funds have benefitted the most from positive investor sentiment, with $26bn in aggregate capital raised.

First-time venture capital fund managers moving into the second half of 2017 will continue to face challenges in the fundraising space, as experienced managers with track records of success are more often targets of institutional investors in the asset class.

INVESTORS AT PRESENT

67%

of investors target an absolute annualized return of 14% or more from their venture capital investments.



64%

of investors cite high absolute return potential as their main reason for investing in venture capital.

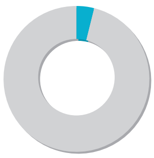
$26bn

Amount of capital raised by North America-focused venture capital funds in 2017 YTD (as at July 2017).

KEY ISSUES

58%

of respondents are currently finding it more difficult to identify attractive opportunities than 12 months ago.



4%

of investors state that ESG policies are a key consideration in their investment decisions.

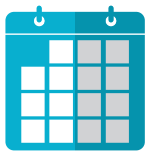
73%

of investors view pricing/valuations as a key issue facing venture capital in 2017.

FUTURE PLANS

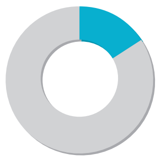
29%

of investors plan to increase their venture capital allocations in the long term.



25%

of investors plan to make seven or more venture capital investments in the next 12 months.



16%

of investors expect their venture capital portfolios in the next 12 months to outperform the previous 12 months.

SATISFACTION WITH VENTURE CAPITAL

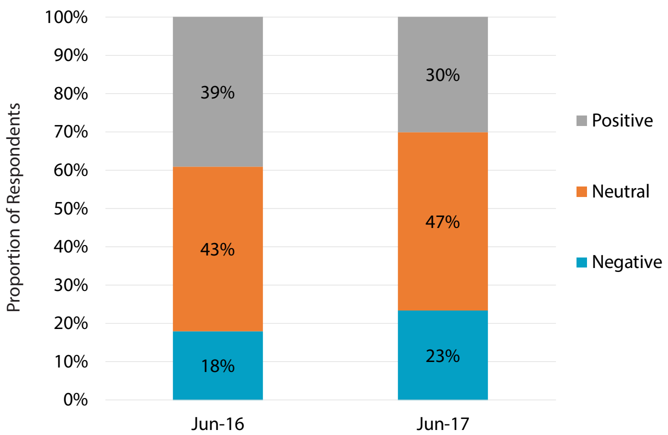
Among institutional investors interviewed by Preqin in June 2017, the general opinion of the venture capital industry has worsened compared to a year prior. Nearly a quarter (23%) of investors expressed a negative perception of the industry, up slightly from June 2016 (18%), while the share that reported a positive perception declined by nine percentage points over the same period to 30% (Fig. 3.1). However, the largest proportion (47%) of respondents continue to hold a neutral view of the asset class.

The majority (76%) of investors reported that their venture capital portfolios performed as expected or better over the past 12 months, including 17% for which performance had exceeded expectations (Fig. 3.2). At 24%, a marginally greater proportion of investors were disappointed by the performance of their venture capital investments than this time last year (22%).

Investors appear to be more satisfied, however, with venture capital performance over the longer term. Almost twice as many investors stated that their investments had exceeded their expectations over the past three years compared with the past 12 months: 32% reported that their venture capital portfolios have outperformed expectations (Fig. 3.3). For a further 45% of investors, performance has met expectations.

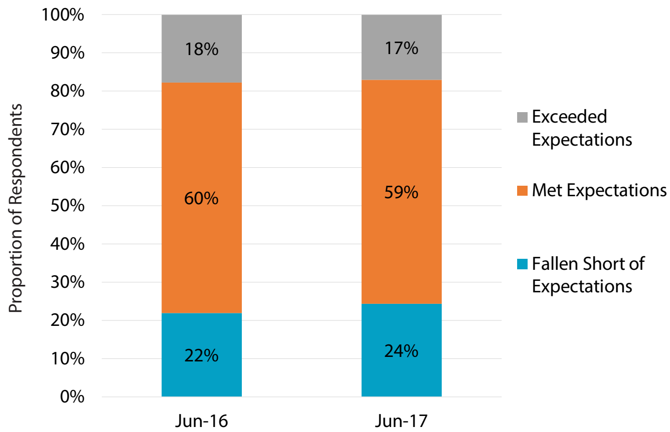
Nearly three-quarters of respondents have remained equally confident in the ability of venture capital to achieve portfolio objectives over the past year as in the previous year (Fig. 3.4). However, only 4% of investors have increased confidence in the asset class, down from 10% in June 2016, while the proportion reporting decreased confidence has grown to 21%. This is likely due to lingering concerns over mounting competition for deals and a sluggish exit environment.

Fig. 3.1: Investors' General Perception of the Venture Capital Industry, 2016 vs. 2017



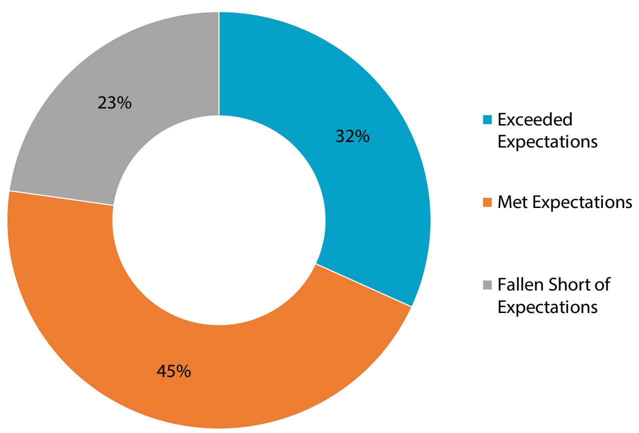
Source: Preqin Investor Interviews, June 2016 - 2017

Fig. 3.2: Investor Views on Venture Capital Portfolio Performance over the Past 12 Months Relative to Expectations, 2016 vs. 2017



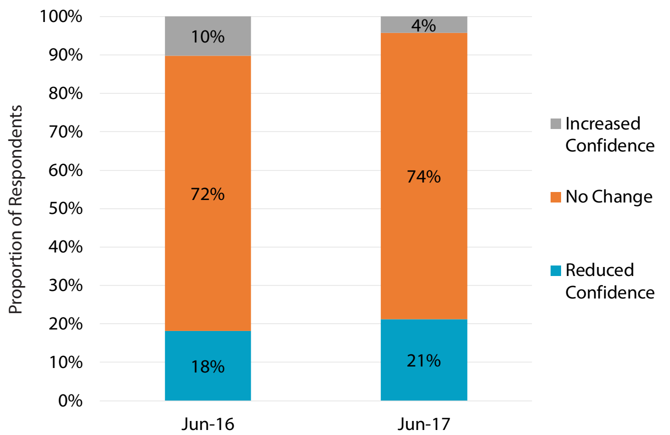
Source: Preqin Investor Interviews, June 2016 - 2017

Fig. 3.3: Investor Views on Venture Capital Portfolio Performance over the Past Three Years Relative to Expectations



Source: Preqin Investor Interviews, June 2017

Fig. 3.4: Investors' Change in Confidence in the Ability of Venture Capital to Achieve Portfolio Objectives over the Past 12 Months, 2016 vs. 2017



Source: Preqin Investor Interviews, June 2016 - 2017

KEY ISSUES IN 2017

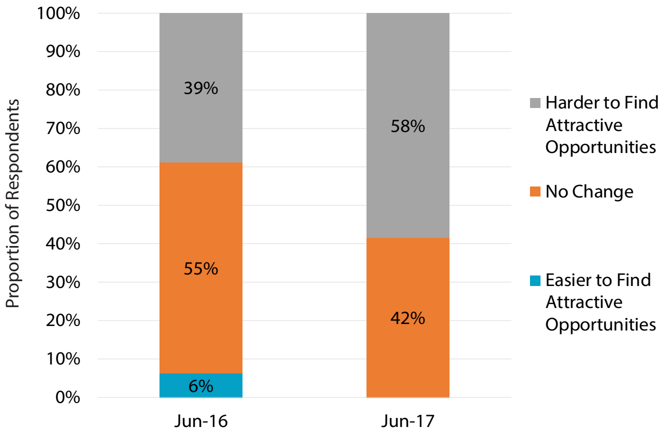
As seen in Fig. 3.5, 58% of venture capital investors interviewed by Preqin have found it more difficult to find attractive investment opportunities over the past year, with none finding it easier.

A year ago, pricing/valuations was the key issue for the majority (52%) of investors in venture capital; while this remains the most prevalent concern among investors, this figure has now increased to 73%, representing by far the largest year-on-year increase (Fig. 3.6). The state of the exit environment remains the second most prominent issue, cited by 51% of investors. Likely a result of the slowdown in both deal and exit activity towards the end of 2016, 45% of investors are concerned with fund performance. However, aggregate deal value is up 66% in H1 2017 compared to H2 2016, as is the number of large exits which, anchored by the Snap Inc. IPO, may be helping to ease investors' concerns.

Investors' return expectations for their venture capital portfolios in the next 12 months have positively shifted from this time last year: the proportion (16%) of investors that expect returns to improve over the next 12 months has increased by six percentage points since June 2016, with a further 47% expecting returns to remain stable (Fig. 3.7).

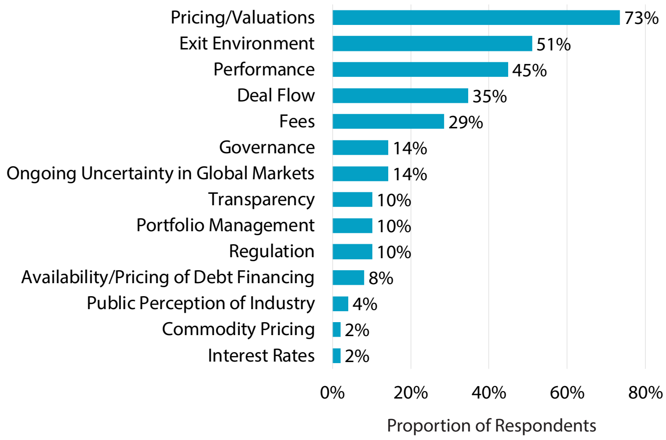
Social impact investing is on the radar across alternatives and has become an increasingly frequent discussion topic at industry events. Social impact, or ESG (environmental, social and governance), policies are taken into account by over half (57%) of venture capital investors when conducting due diligence, 4% of which regard ESG factors as key considerations (Fig. 3.8). Forty-two percent do not consider ESG factors when investing in venture capital funds.

Fig. 3.5: Investor Views on the Difficulty of Identifying Attractive Venture Capital Investment Opportunities Compared to 12 Months Ago, 2016 vs. 2017



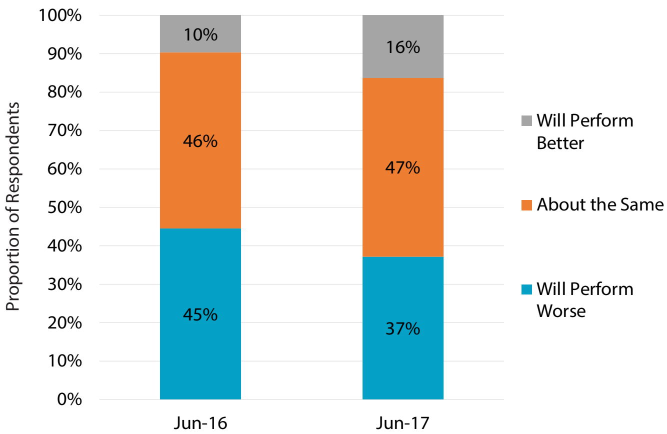
Source: Preqin Investor Interviews, June 2016 - 2017

Fig. 3.6: Investor Views on the Key Issues Facing Venture Capital in the Next 12 Months



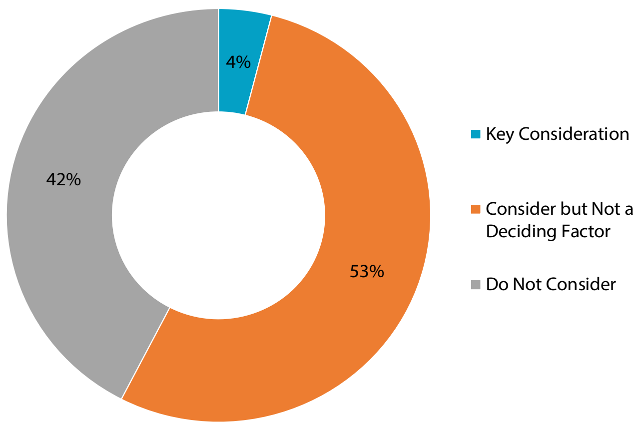
Source: Preqin Investor Interviews, June 2016 - 2017

Fig. 3.7: Investors' Return Expectations for Their Venture Capital Portfolios in the Next 12 Months Compared to the Previous 12 Months, 2016 vs. 2017



Source: Preqin Investor Interviews, June 2016 - 2017

Fig. 3.8: Investors that Consider ESG Factors when Investing in Venture Capital



Source: Preqin Investor Interviews, June 2016 - 2017

INVESTOR ACTIVITY IN THE NEXT 12 MONTHS

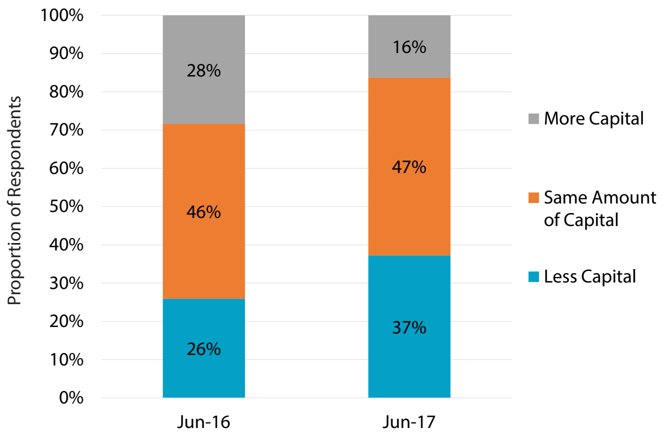
There are indications that investor sentiment towards venture capital may be shifting in the short term. The proportion (63%) of investors interviewed in June 2017 that expect to maintain or increase capital commitments to the asset class in the next 12 months compared to the previous 12 months has declined from June 2016 (74%); furthermore, 37% of investors intend to commit less capital to venture capital funds in the next 12 months, a significant increase from 26% of investors interviewed this time last year (Fig. 3.9). Still, 47% of investors plan to invest the same amount of capital over the next year.

Investors in venture capital are looking to spread their investments across multiple funds, with 42% planning to commit to five or more funds over the next 12 months (Fig. 3.10). Thirty-seven percent of investors intend to make just one or two commitments in the next year.

The majority (61%) of investors plan to commit less than $100mn in fresh capital to venture capital in the next 12 months, and a further 30% expect to commit $100-499mn (Fig. 3.11). While just 9% of investors are looking to commit $500mn or more, the aggregate capital committed by this small group could exceed the other 91% of investors' aggregate commitments in the year ahead.

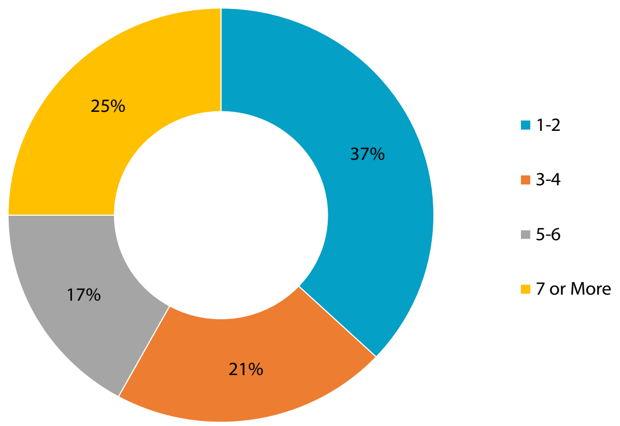
Investors appear to have a more positive outlook for venture capital over the longer term compared with the next 12 months: 29% plan to increase their allocation to the asset class over the next three years, in addition to 56% that will maintain their current allocation (Fig. 3.12). Just 15% of investors plan to decrease their venture capital allocation, marking an increase of two percentage points from this time last year.

Fig. 3.9: Investors' Expected Capital Commitments to Venture Capital Funds in the Next 12 Months Compared to the Previous 12 Months, 2016 vs. 2017



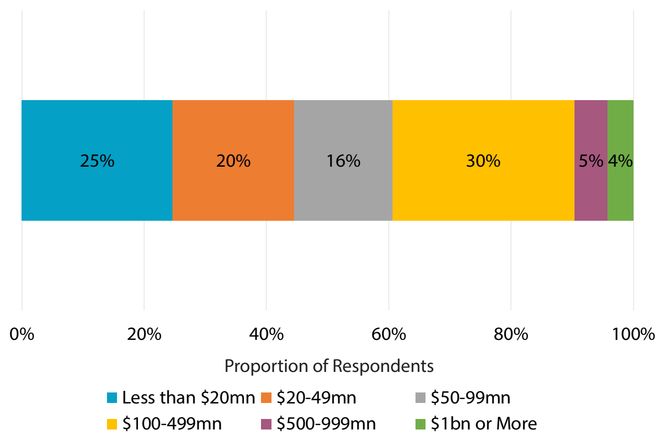
Source: Preqin Investor Interviews, June 2016 - 2017

Fig. 3.10: Number of Venture Capital Fund Commitments Investors Plan to Make over the Next 12 Months



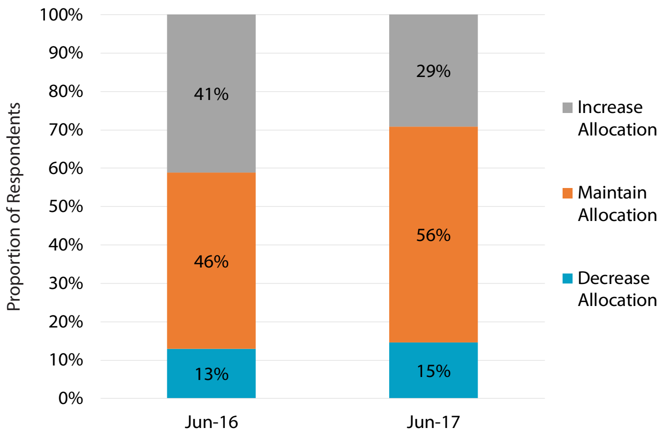
Source: Preqin Investor Interviews, June 2017

Fig. 3.11: Amount of Fresh Capital Investors Plan to Invest in Venture Capital Funds over the Next 12 Months



Source: Preqin Investor Interviews June, 2017

Fig. 3.12: Investors' Intentions for Their Venture Capital Allocations over the Longer Term



Source: Preqin Investor Interviews, June 2016 - 2017

STRATEGIES AND GEOGRAPHIES TARGETED

For the coming year, the broader mandates of general venture capital and growth funds continue to appeal to the largest segments of investors in the asset class (68% and 63% respectively), as seen in Fig. 3.13.

Early stage strategies are each targeted by just over half of venture capital investors at the start of H2 2017, and expansion/late stage funds by 50%. The niche strategy of venture debt is targeted by the smallest proportion (3%) of investors.

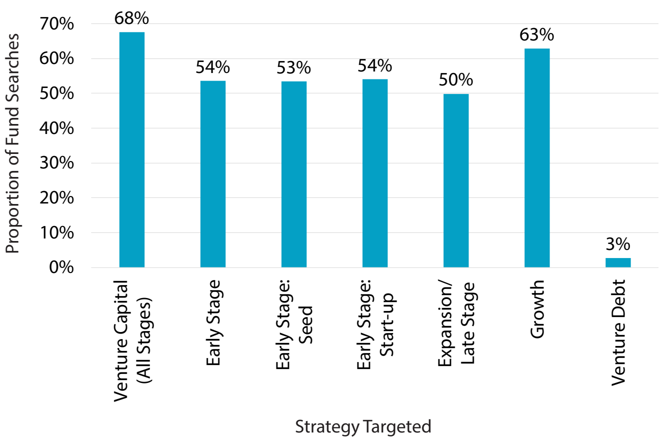
2016 was a record fundraising year for Europe-focused venture capital: 104 funds collectively raised over $22bn, with an average fund size of $237mn (Fig. 3.14).

> ***2016 was a record fundraising year for Europe-focused venture capital: 104 funds collectively raised over $22bn***

Aggregate capital raised was more than double that of the previous year, while the average fund size represents a five-year peak. Total funds raised for North America-focused venture capital, while significantly greater than that of the European market, decreased by $20bn from 2015.

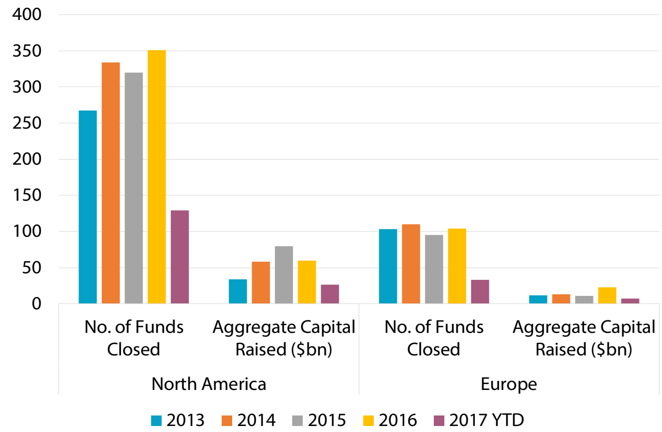
Investors across all regions tend to commit to funds targeting their domestic region, as seen in Fig. 3.15. North America-based investors are the most likely to invest in funds focused elsewhere, as 58% and 51% have a preference for Europe- and Asia-focused funds, respectively. An equal proportion (66%) of investors will target opportunities across North America as across Europe in the coming year, while 47% will pursue Asia-focused funds (Fig. 3.16). While too early to tell if recent trends indicate a lasting shift in geographic preferences, investors' attitudes towards venture capital investment in Europe indicate that the market should continue to mature.

Fig. 3.13: Strategies Targeted by Venture Capital Investors in the Next 12 Months



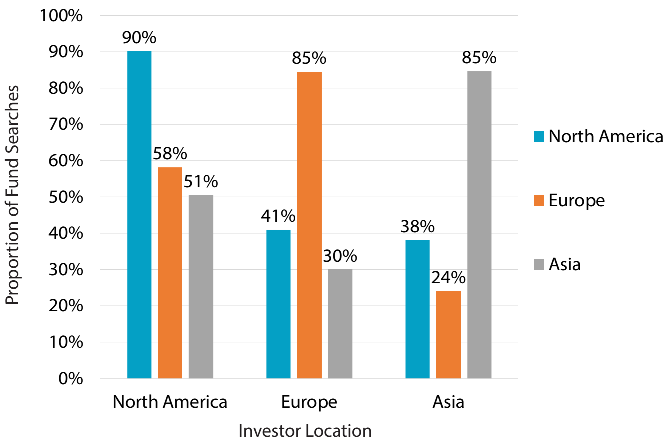
Source: Preqin Venture Capital Online

Fig. 3.14: North America- vs. Europe-Focused Venture Capital Fundraising, 2013 - 2017 YTD (As at June 2017)



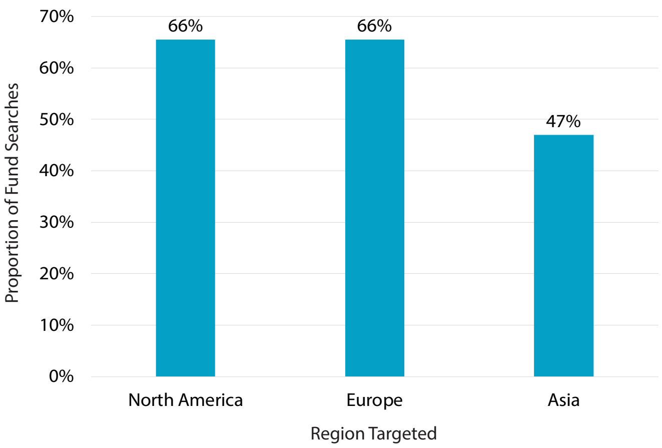
Source: Preqin Venture Capital Online

Fig. 3.15: Regions Targeted by Venture Capital Investors in the Next 12 Months by Investor Location



Source: Preqin Venture Capital Online

Fig. 3.16: Regions Targeted by Venture Capital Investors in the Next 12 Months



Source: Preqin Venture Capital Online

IN FOCUS: INVESTING IN VENTURE CAPITAL

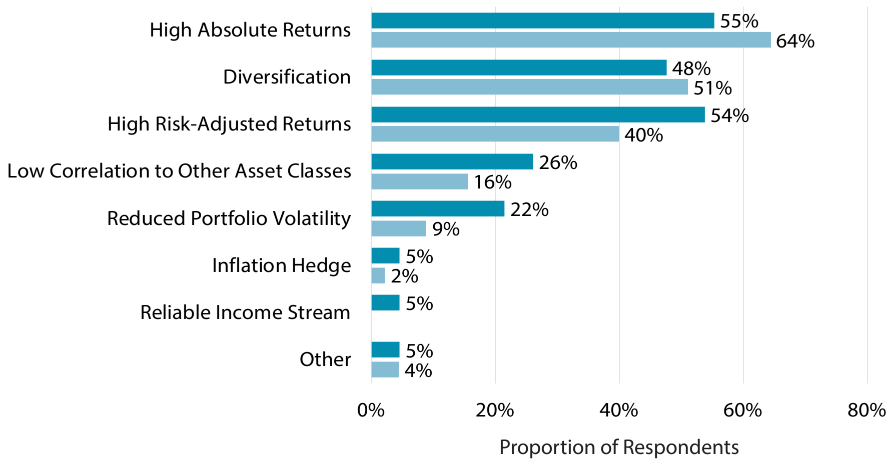
While Preqin continues to include venture capital fund types within its analysis of the wider private equity asset class, we also recognize the unique characteristics of the strategy, allowing it to exist as an asset class unto itself. Among the 6,600+ active private equity investors tracked by Preqin, 65% also actively invest in venture capital. In addition, there are more than 100 unique investors active in venture capital with no intention to invest in other private equity strategies – such investors oversee $3.4tn in AUM between them.

> ***Among the 6,600+ active private equity investors tracked by Preqin, 65% also actively invest in venture capital***

Investors highlighted three primary reasons as to why they invest in venture capital: 64% of respondents identified high absolute returns as the main reason they invest in the asset class, compared with 55% of the private equity investors surveyed (Fig. 3.17). Just over half of venture capital investors stated diversification as their primary objective, while 40% cited high risk-adjusted returns.

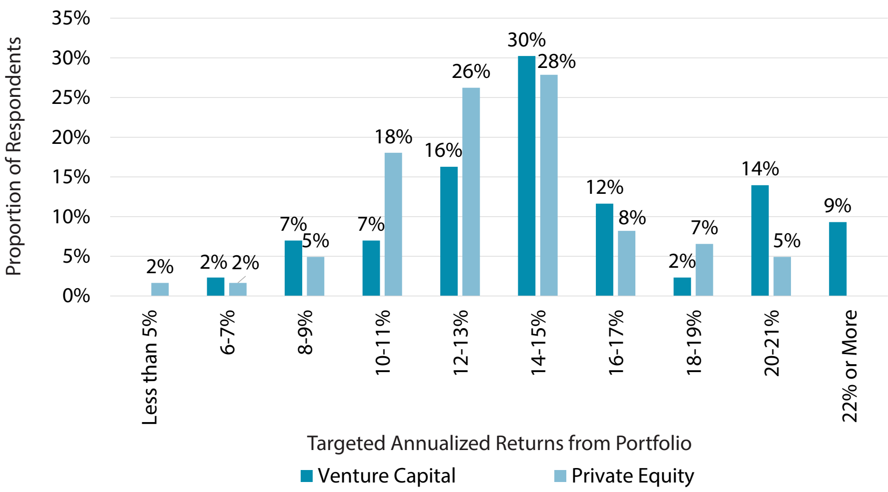
When asked for the absolute return values targeted from venture capital and private equity investments, investors clearly expect higher returns from their venture capital portfolios. Sixty-seven percent of investors in venture capital target absolute annualized return values of over 14%, including 23% that are seeking returns in excess of 20% (Fig. 3.18).

Fig. 3.17: Investors' Main Reasons for Investing in Venture Capital vs. Private Equity



Source: Preqin Investor Interviews, June 2016 - 2017

Fig. 3.18: Absolute Annualized Returns Targeted by Investors for Their Venture Capital vs. Private Equity Investments



Source: Preqin Investor Interviews, June 2017

VENTURE CAPITAL DATA AND INTELLIGENCE

Preqin tracks all aspects of the venture capital industry, with comprehensive data on institutional investors, fundraising, fund managers, fund terms and conditions, fund performance, deals and exits, service providers and more.

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SECTION FOUR: HEDGE FUNDS

INVESTORS REMAIN CAUTIOUS OF HEDGE FUNDS

A year ago, in our H2 2016 Preqin Investor Outlook, we reported that investors' concerns surrounding the performance of the industry had reached unprecedented levels. At that time, four out of five of the investors we spoke to reported that hedge funds had failed to meet expectations over the past 12 months. Fast-forward to this year and the proportion of investors stating that hedge funds have failed to meet expectations has fallen 24 percentage points to 55%. Although this is still a significant subset of investors, this indicates some cause for optimism. With a 12-month return of 10.78% to June 2017, more investors are, at least, recognizing that the sector has been adding more consistent gains over the past year or so.

Despite a double-digit 12-month return, and an improvement in investors' outlook on industry performance over the next year, the long-term performance of hedge funds continues to be questioned by institutional investors. Seventy percent of investors interviewed in June 2017 reported that hedge funds had failed to meet expectations over a three-year period. This disappointment with returns over extended periods is having a significant impact on the industry; the leading reason why investors decided to reduce their allocations to hedge funds in 2017 was dissatisfaction with the three-year performance of hedge funds.

The proportion of investors that have reported to Preqin that they plan to reduce their exposure to hedge funds has grown significantly over recent years (see page 29). This has been coupled with a shrinking pool of investors intending to increase their exposure to hedge funds, indicating that fund managers may find it more difficult not just to retain capital, but also to raise fresh funds. These difficulties look set to continue over the rest of 2017.

The twin issues of performance and the fees paid for returns persist as prominent concerns for investors. Although performance remains unsatisfying for more than half of the institutions we spoke to in June 2017, in fact, fewer investors are disappointed with the 12-month return compared to previous studies. This indicates that fund managers are increasingly answering investors' questions surrounding performance. However, concerns over fees remain, and managers may need to address such concerns if investors are to regain confidence in their hedge fund portfolios and be less cautious in their investment activity going forward.

INVESTOR SATISFACTION

45%

of investors reported hedge funds had met or exceeded return expectations over the past 12 months...

21%

...this is an increase from 21% that reported the same in our June 2016 study.

FUTURE PLANS

20%

of investors plan to increase their hedge fund exposure over the next 12 months.

49%

of investors plan to reduce their hedge fund exposure over the next 12 months

FEES IN FOCUS

50%

of investors are seeking changes to hedge fund fees.

56%

of investors are seeking fee changes because they do not seem justified in light of actual returns generated.

SATISFACTION WITH HEDGE FUNDS

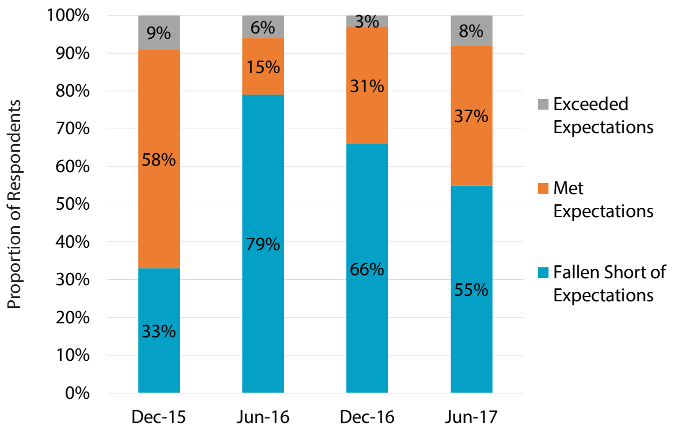
More than half (55%) of investors interviewed in June 2017 reported that hedge funds have failed to meet expectations in the past 12 months (Fig. 4.1). Although this is a large proportion, the level of surveyed investors reporting dissatisfaction with hedge fund performance has actually fallen from a high of 79% in mid-2016.

This reflects the improved performance of the hedge fund industry: the Preqin All-Strategies Hedge Fund benchmark has made only one monthly loss, and gained 10.78% over the past 12 months to June 2017. In comparison, the 12-month return of the benchmark in June 2016 was underwater at -0.61% following six months of losses in the previous year.

Although investors are increasingly recognizing the improved performance of hedge funds over a 12-month period, the longer-term performance of the sector is under question by many: 70% of investors surveyed by Preqin in June 2017 revealed that hedge funds have failed to meet expectations over a three-year period (Fig. 4.2).

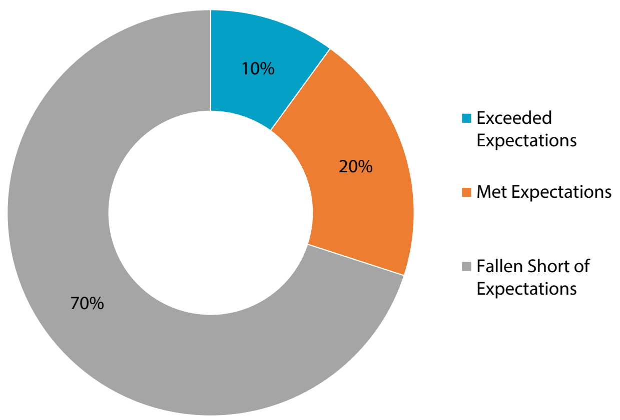
With widespread dissatisfaction with performance, nearly half (46%) of investors surveyed by Preqin relayed a negative perception of the industry (Fig. 4.3). Similarly, more than three times as many investors have reduced confidence in hedge funds' ability to achieve performance objectives than have increased confidence (37% and 12% respectively, Fig. 4.4). However, the level of investors losing confidence in hedge funds has also fallen since December 2016, similar to the trend seen in their satisfaction with performance.

Fig. 4.1: Investor Views on Hedge Fund Portfolio Performance over the Past 12 Months Relative to Expectations, 2015 - 2017



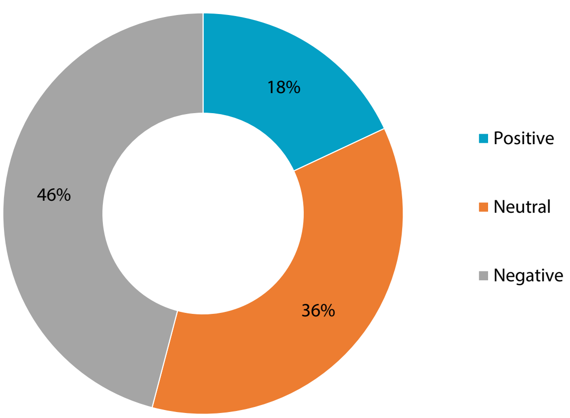
Source: Preqin Investor Interviews, December 2015 - June 2017

Fig. 4.2: Investor Views on Hedge Fund Portfolio Performance over the Past Three Years Relative to Expectations



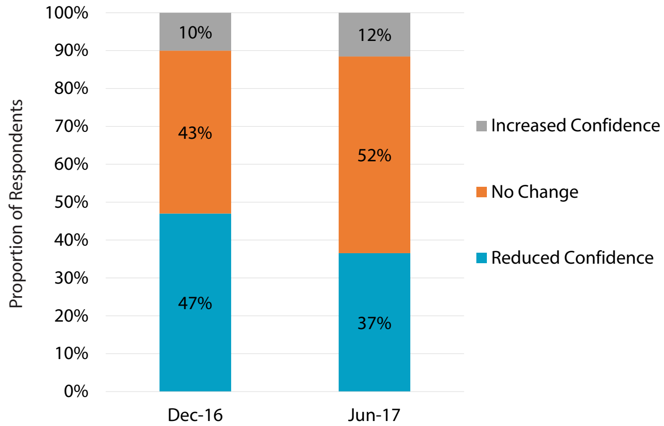
Source: Preqin Investor Interviews, June 2017

Fig. 4.3: Investors' General Perception of the Hedge Fund Industry



Source: Preqin Investor Interviews, June 2017

Fig. 4.4: Investors' Change in Confidence in the Ability of Hedge Funds to Achieve Portfolio Objectives over the Past 12 Months, 2016 vs. 2017



Source: Preqin Investor Interviews, December 2016 - June 2017

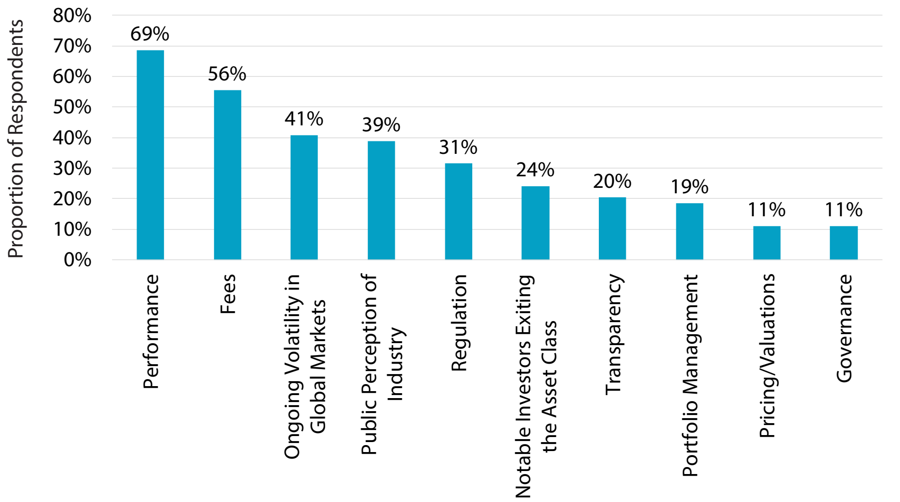
KEY ISSUES IN 2017

The twin issues of performance and fees continue to be at the forefront of investors' concerns in the hedge fund industry. Despite hedge funds being in positive territory in 2017 (+4.74% as at June 2017) and delivering strong returns over the past 12 months (+10.78%), performance remains the most high-profile issue for 69% of respondents within the asset class (Fig. 4.5). For further analysis on the disparity between investor opinion and recent performance, please see page 32.

As well as investors' general dissatisfaction with performance, a prominent issue facing the industry is the value that hedge funds offer institutions: 56% of respondents see fees as a key issue facing hedge funds – this is the third Preqin survey in a row in which fund charges feature as the second biggest issue. Contributing to the narrative are large public pension funds Illinois State Board of Investment and New York State Common Retirement Fund; both named high fees as a reason behind recent cuts to hedge fund portfolios. Moreover, half of investors are seeking changes to fees or fee structures (Fig. 4.6), citing factors surrounding the performance of hedge funds driving these demands for change. Inadequate actual returns (56%) and low risk-adjusted returns (29%) are the most common reasons for seeking out changes to fees (Fig. 4.7).

In an environment where the performance of the industry and the fees associated with this performance are under scrutiny, significant numbers of investors continue to issue redemption requests. Thirty-nine percent of respondents issued redemption requests in H1 2017, and 47% of those surveyed by Preqin at the end of 2016 said they had redeemed at least one fund during the year.

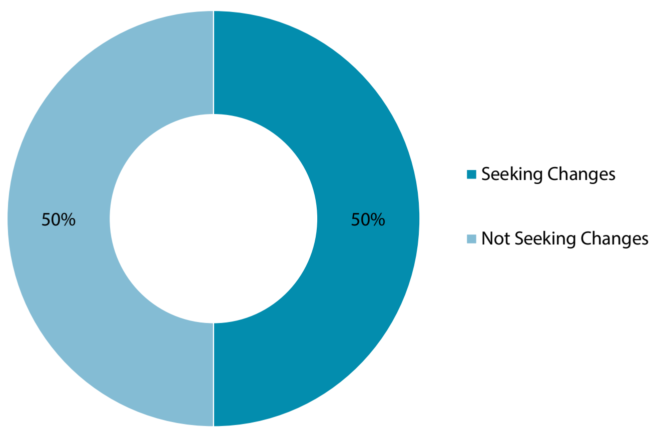
Fig. 4.5: Investor Views on the Key Issues Facing Hedge Funds in the Next 12 Months



Source: Preqin Investor Interviews, June 2017

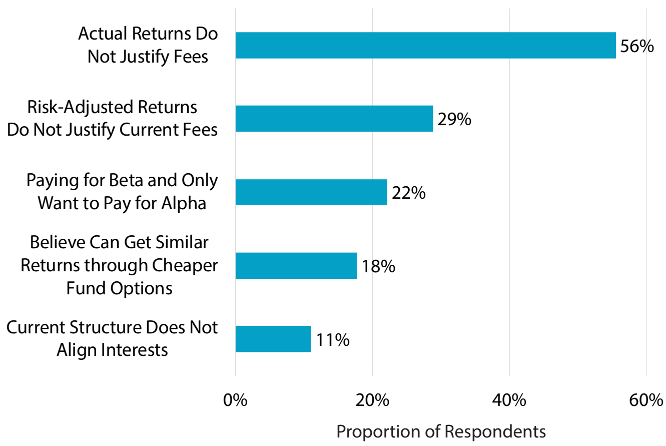
INVESTORS THAT HAVE ISSUED A HEDGE FUND REDEMPTION REQUEST

Fig. 4.6: Investors Seeking Changes to Fees Associated with Hedge Funds



Source: Preqin Investor Interviews, June 2017

Fig. 4.7: Investor Views on Why Hedge Fund Fees Should Change



Source: Preqin Investor Interviews, June 2017

INVESTOR ACTIVITY IN THE NEXT 12 MONTHS

Despite signs of an improving outlook on the performance of hedge funds, over half of all investors reported to Preqin that the asset class has failed to match their expectations over the past 12 months (Fig. 4.1, page 27). Forty-nine percent have indicated that they plan to decrease their allocation to hedge funds over the course of the coming year (Fig. 4.8). This is the largest proportion of investors planning to decrease their exposure to hedge funds, as well as the largest disparity between the level of investors planning to decrease rather than increase their capital allocation, on record.

Using data taken from Preqin's **Hedge Fund Online**, 74% of the investors currently seeking hedge fund opportunities plan to commit less than $100mn to the asset class (Fig. 4.9). However, the majority (58%) of investors plan to commit to three or more funds as investors continue to seek diversification of their hedge fund holdings (Fig. 4.10). A similar trend is seen in the longer term: twice as many investors plan to reduce their allocations than to increase them (44% vs. 22% respectively, Fig. 4.11).

Therefore, unless hedge fund managers can address the concerns of investors, the challenging fundraising environment that many fund managers have experienced since the second half of 2015 looks set to continue moving forwards.

LEADING REASONS INVESTORS WILL REDUCE ALLOCATIONS TO HEDGE FUNDS OVER THE NEXT 12 MONTHS

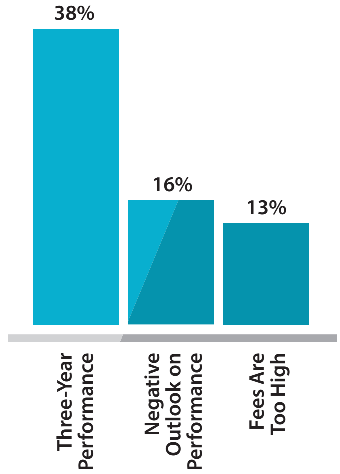
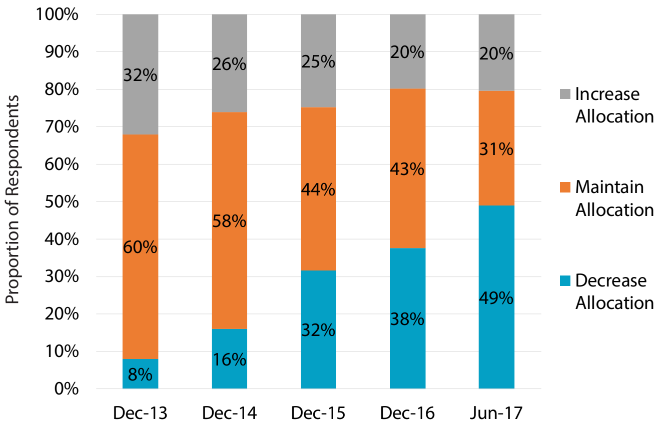
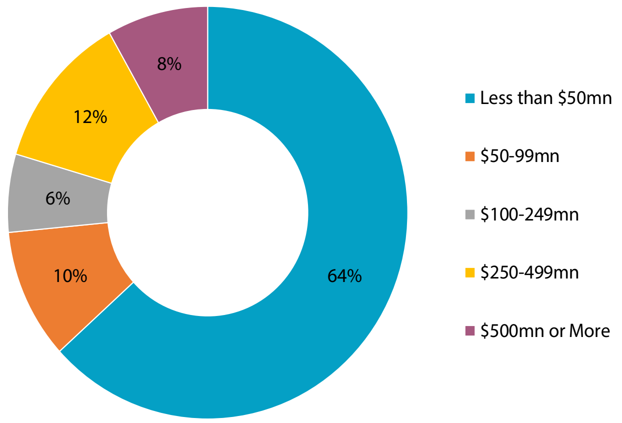


Fig. 4.8: Investors' Intentions for Their Hedge Fund Allocations in the Next 12 Months, 2013 - 2017



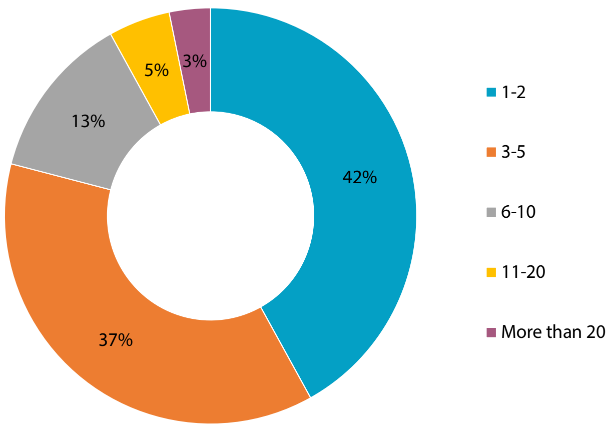
Source: Preqin Investor Interviews, December 2013 - June 2017

Fig. 4.9: Amount of Fresh Capital Investors Plan to Invest in Hedge Funds over the Next 12 Months



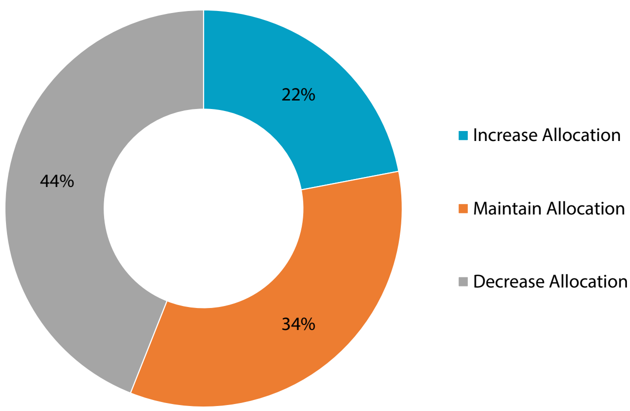
Source: Preqin Hedge Fund Online

Fig. 4.10: Number of Hedge Funds Investors Expect to Add to Their Portfolios over the Next 12 Months



Source: Preqin Hedge Fund Online

Fig. 4.11: Investors' Intentions for Their Hedge Fund Allocations over the Longer Term

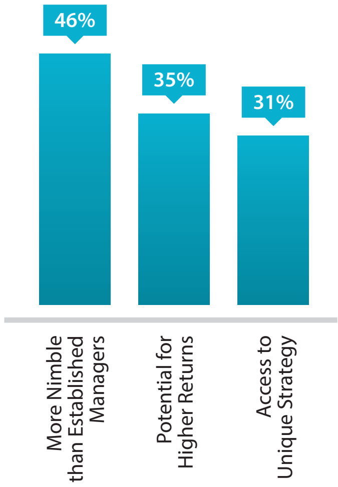


Source: Preqin Investor Interviews, June 2017

STRATEGIES AND STRUCTURES TARGETED

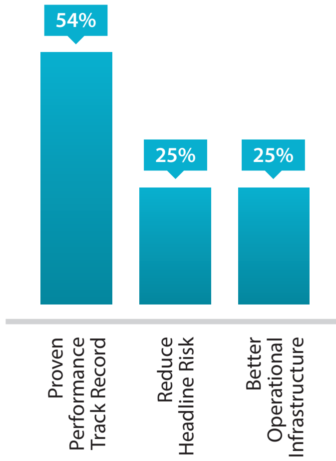
39%

OF INVESTORS ARE CONSIDERING SMALLER FUNDS IN THE NEXT 12 MONTHS



31%

OF INVESTORS ARE CONSIDERING LARGER FUNDS IN THE NEXT 12 MONTHS



Although almost half of investors plan to decrease their exposure to the hedge fund industry, there is likely to be significant activity over the next 12 months as investors look to alter their hedge fund holdings in the current market.

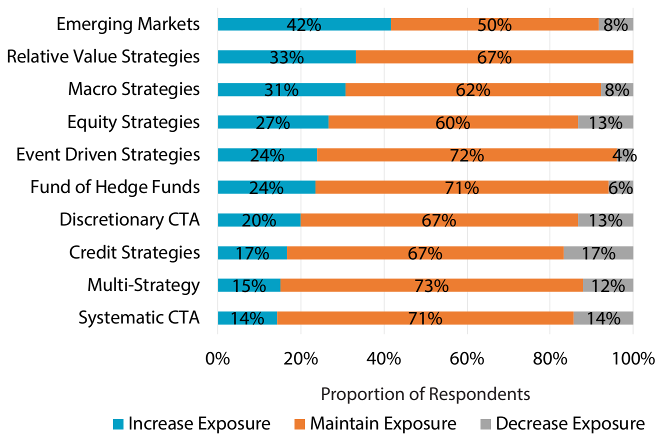
Forty-two percent of all respondents with exposure to emerging markets hedge funds plan to increase this exposure in the coming year, while one-third of investors in relative value strategies are also looking to up their allocations (Fig. 4.12). The Preqin All-Emerging Markets Hedge Fund benchmark has returned 12.88% in the 12 months to June 2017, outperforming the Preqin All-Strategies Hedge Fund benchmark by two percentage points. Investors may seek the potential for higher returns available in these regions as well as market diversification.

Forty-two percent of investors in separately managed accounts plan to increase their exposure to these vehicles in the coming 12 months (Fig. 4.13). In contrast, no investors in platform funds intend to increase their exposure to these vehicles and 29% plan to reduce their exposure. This indicates that although there is growing interest in managed accounts, investors are increasingly looking to access these directly rather than through platforms.

Thirty-nine percent of respondents will specifically search for smaller funds in the coming year; smaller funds are seen as more nimble (stated by 46%) and they offer the potential for higher returns (35%). Fewer investors (31%) are planning to look for larger funds in the next 12 months.

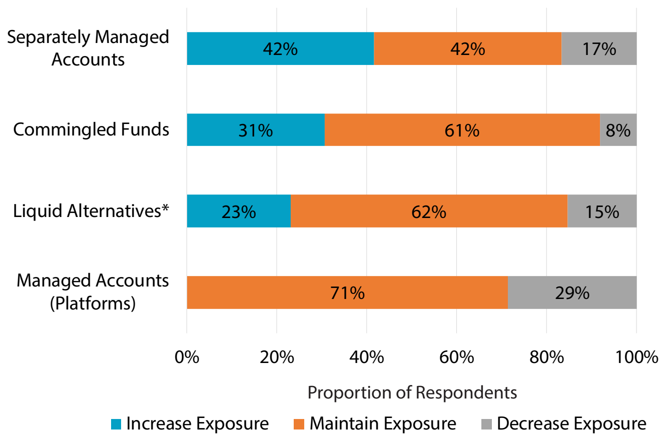
For more than half of these investors, the key driver is the proven performance track record of larger funds. With the vast majority (69%) of respondents identifying performance as a key issue facing the hedge fund industry, the ability to provide strong historical performance records could allow fund managers to differentiate themselves from their peers.

Fig. 4.12: Investor Allocation Plans for the Next 12 Months by Strategy



Source: Preqin Investor Interviews, June 2017

Fig. 4.13: Investor Allocation Plans for the Next 12 Months by Structure



Source: Preqin Investor Interviews, June 2017

**Alternative mutual funds and UCITS.*

IN FOCUS: PERFORMANCE

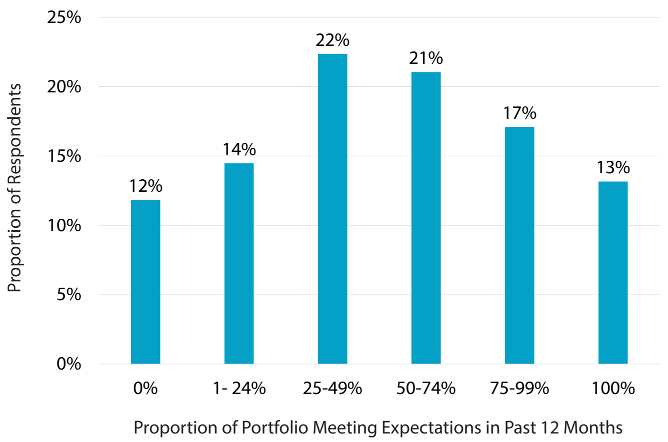
A leading concern among hedge fund investors over recent years has been performance, a major driver of investors' dissatisfaction with the asset class. However, with such a wide array of fund types, trading styles and markets to invest in, investors show differing levels of satisfaction across their portfolios. Just over half of respondents felt that 50% or more of their portfolio had met their performance expectations over the last 12 months, including 30% of investors seeing three-quarters or more of their portfolio meet expectations, while 12% found that none of their hedge fund investments met their requirements in the past year (Fig. 4.14).

Event driven strategies, equity strategies, relative value strategies, credit strategies and emerging markets all met the performance expectations of more than two-thirds of surveyed investors over H1 2017 (Fig. 4.15). Conversely, most respondents reported that macro strategies – the worst performing top-level hedge fund strategy in 2017 so far, at 1.18% as at June 2017 – as well as both discretionary and systematic CTAs (+0.44% and +0.72% respectively) had not met expectations.

Thirty-nine percent of investors reported that the failure of funds to meet an internal benchmark was the leading reason why these vehicles had failed to meet expectations in the past year; 17% of investors were let down by poor returns over a longer three-year timeframe, and a further 17% did not believe that the low returns justified the fees paid (Fig. 4.16). However, not all investors felt that the manager was solely to blame; one institution cited external factors such as "low cash rates impacting returns", while another found it was due to their own choices when sourcing funds, stating they "picked some poor managers".

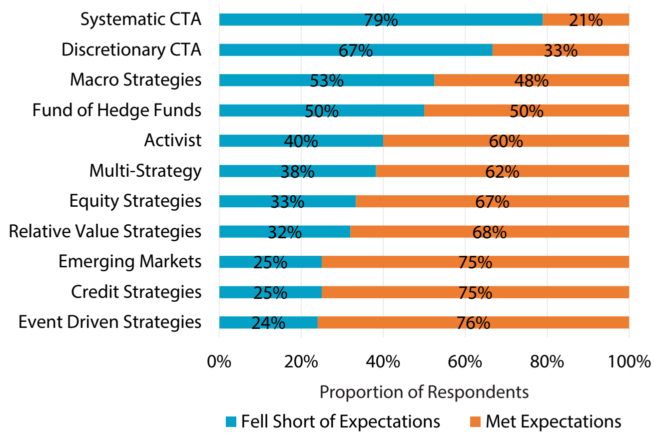
With performance generally improving over recent quarters, 94% of investors believe this return to better performance will continue or improve further over the next 12 months (Fig. 4.17).

Fig. 4.14: Investor Views on the Proportion of Their Hedge Fund Portfolio that Met Expectations in the Past 12 Months



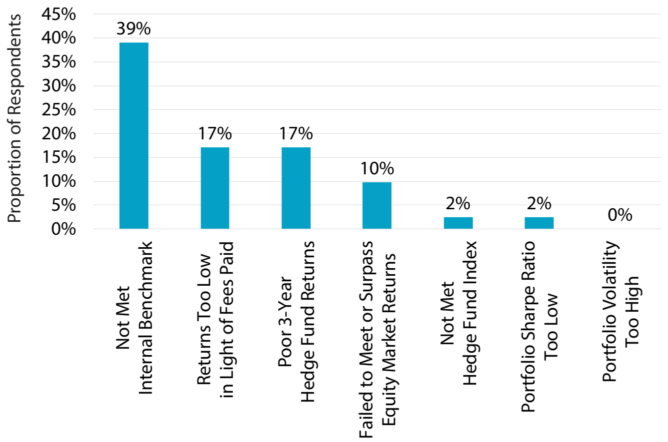
Source: Preqin Investor Interviews, June 2017

Fig. 4.15: Investor Views on Hedge Fund Portfolio Performance in H1 2017 by Strategy



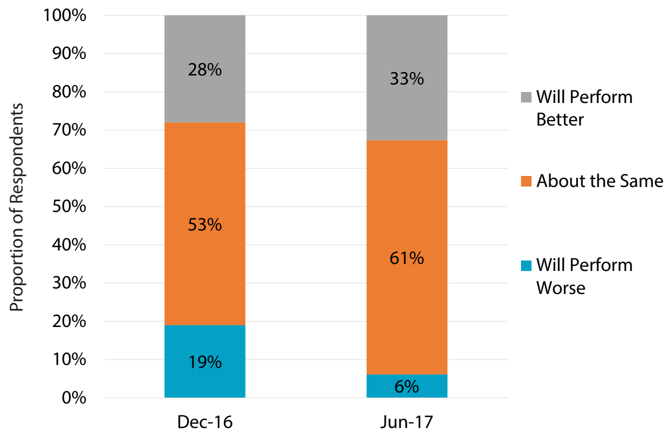
Source: Preqin Investor Interviews, June 2017

Fig. 4.16: Investor Views on Why Hedge Fund Portfolios Have Failed to Meet Expectations in the Past 12 Months



Source: Preqin Investor Interviews, June 2017

Fig. 4.17: Investors' Return Expectations for Their Hedge Fund Portfolios in the Next 12 Months Compared to the Previous 12 Months, 2016 vs. 2017



Source: Preqin Investor Interviews, December 2016 - June 2017

SECTION FIVE: REAL ESTATE

INVESTOR APPETITE REMAINS STRONG

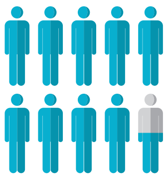
So far in 2017, significant geopolitical events have led to high levels of uncertainty in financial markets, with many players unsure of the likely impact on property valuations in both the short and long term. This is having an effect on institutional investors investing in real estate, whose wait-and-see approach may continue given that they expect their portfolio returns to decline in the year ahead.

Crucially for fund managers, though, institutional investors remain largely satisfied with their real estate portfolios, with almost all (95%) of those interviewed by Preqin in June 2017 stating that the performance of the asset class met or exceeded their expectations over the past 12 months. As such, the vast majority of respondents stated their intention to maintain or increase their exposure to real estate in the longer term, with just 5% looking to reduce their allocation.

As competition for assets continues to grow and push valuations higher, fund managers face the challenge of maintaining the high returns institutions have come to expect from the asset class.

As at September 2016 (the latest data available), real estate firms have continued that momentum with the PrEQIn Real Estate Index climbing to new post-crisis highs, and net IRRs for top-quartile funds in recent vintages pushing 20%.

INVESTOR SATISFACTION



95%

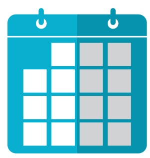
of investors feel their real estate investments have met or exceeded their expectations over the past 12 months.

CURRENT ENVIRONMENT AND FUTURE PLANS

53%

of investors feel it is harder to source attractive investment opportunities than 12 months ago.

EXPECTATIONS FOR H2 2017

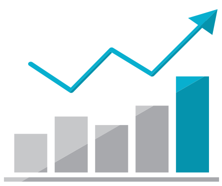


72%

of investors plan to maintain or increase their capital commitments to private real estate funds over the next 12 months.

36%

of investors plan to increase their allocation to real estate over the longer term, with 59% maintaining their allocation.



42%

of investors will target core-plus strategies over the next 12 months, an increase of 17 percentage points from June 2016.

72%

of investors see the pricing and valuation of assets as a key issue facing the industry in the next 12 months.

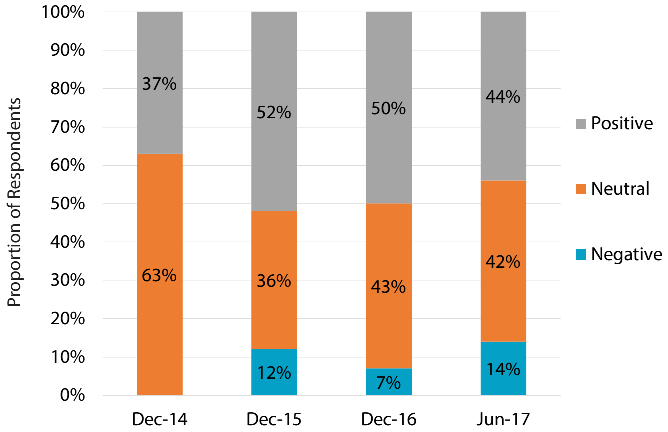
SATISFACTION WITH REAL ESTATE

Despite shifting slightly from the results seen in December 2016, institutional investor sentiment towards the asset class remains mostly positive. Forty-four percent of surveyed investors have a positive perception of the asset class, with just 14% holding a negative perception (Fig. 5.1). Driving this positive view is the opinion that real estate generally meets the performance expectations of institutional investors, as reflected by 95% of respondents that saw their real estate returns meet or exceed their expectations over the past 12 months (Fig. 5.2).

Investors' short-term views on performance appear to be closely aligned with their longer-term expectations, with 91% believing that the performance of their real estate portfolios over the past three years has met or exceeded expectations (Fig. 5.3).

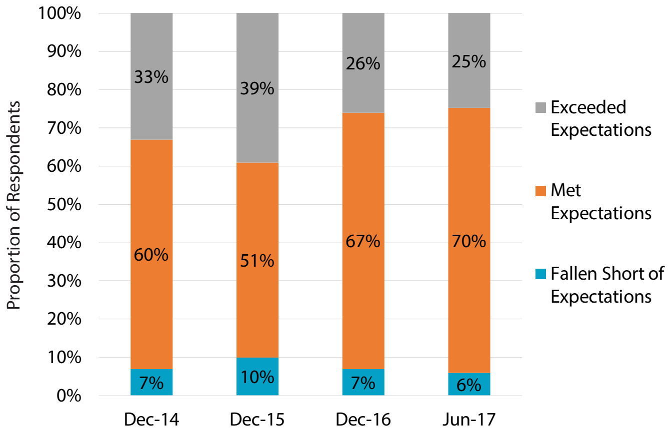
As such, there has been no drastic shift in investors' confidence in real estate to achieve portfolio objectives since December 2016, as seen in Fig. 5.4. However, there has been a very slight increase in the proportion of investors whose confidence in real estate has been adversely affected in the past 12 months.

Fig. 5.1: Investors' General Perception of the Real Estate Industry, 2014 - 2017



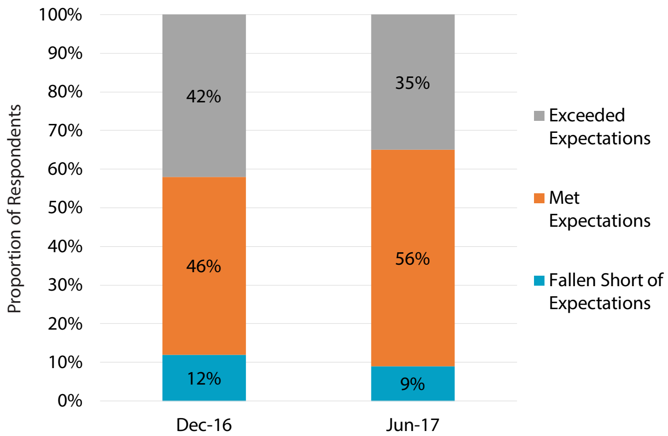
Source: Preqin Investor Interviews, December 2014 - June 2017

Fig. 5.2: Investor Views on Real Estate Portfolio Performance over the Past 12 Months Relative to Expectations, 2014 - 2017



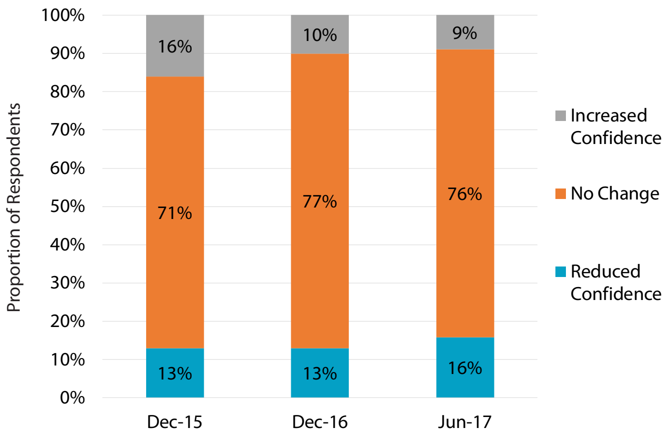
Source: Preqin Investor Interviews, December 2014 - June 2017

Fig. 5.3: Investor Views on Real Estate Portfolio Performance over the Past Three Years Relative to Expectations, 2016 vs. 2017



Source: Preqin Investor Interviews, December 2016 - June 2017

Fig. 5.4: Investors' Change in Confidence in the Ability of Real Estate to Achieve Portfolio Objectives over the Past 12 Months, 2015 - 2017



Source: Preqin Investor Interviews, December 2015 - June 2017

KEY ISSUES IN 2017

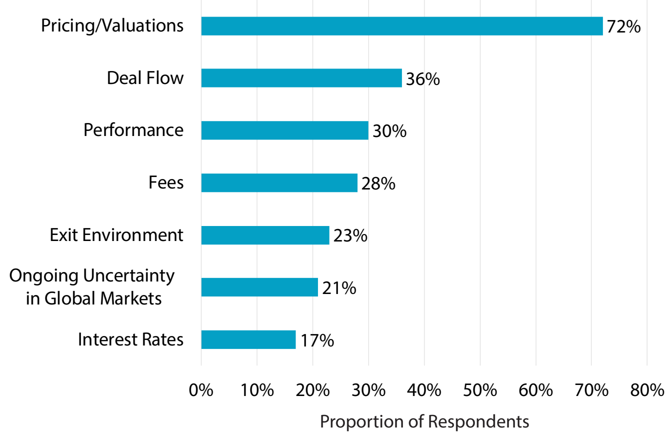
High property valuations are the single biggest issue concerning institutional investors in real estate, as cited by 72% of respondents (Fig. 5.5). In addition, 30% of respondents cited the eventual performance of private real estate funds as a prominent issue.

These concerns feature highly among North America-based respondents, largely driven by recent political events and the subsequent uncertainty within the industry (Fig. 5.6). Forty-six percent of Europe-based respondents identify concerns over fees, and the potential impact they may have on long-term returns in an already challenging and saturated market. In addition to asset valuations, Asia-based respondents view global market volatility as a significant issue, arguably a result of the slowdown in China's annual GDP growth rate. The largest proportion of investor respondents concerned by deal flow are based in Europe, which is unsurprising given the outcome of the Brexit referendum.

Competition among fund managers for investor capital has intensified over recent years, with the number of funds in market continuing to surpass previous records (standing at 557 at the beginning of Q3 2017). As such, investors are still having difficulty identifying attractive opportunities in the market: mirroring the results of December 2016, 53% of respondents have stated that it is harder to find attractive investment opportunities compared to 12 months ago (Fig. 5.7).

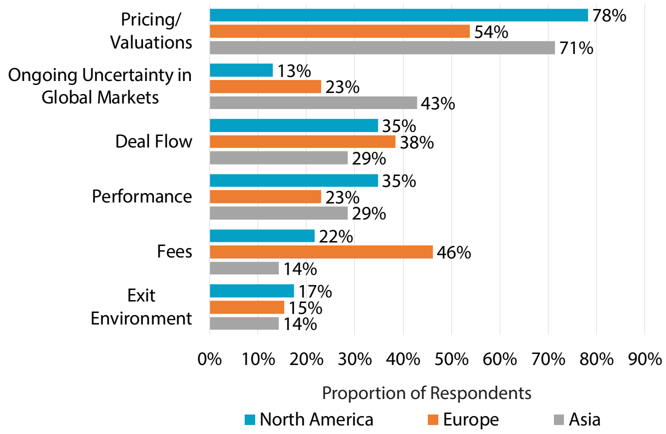
With these concerns in mind, as well as the strong returns that real estate has generated in recent times, institutional investors largely do not believe that fund managers will be able to surpass the returns they generated over the past 12 months, with 39% of investors anticipating that their portfolios will perform worse in the next year (Fig. 5.8).

Fig. 5.5: Investor Views on the Key Issues Facing Real Estate in 2017



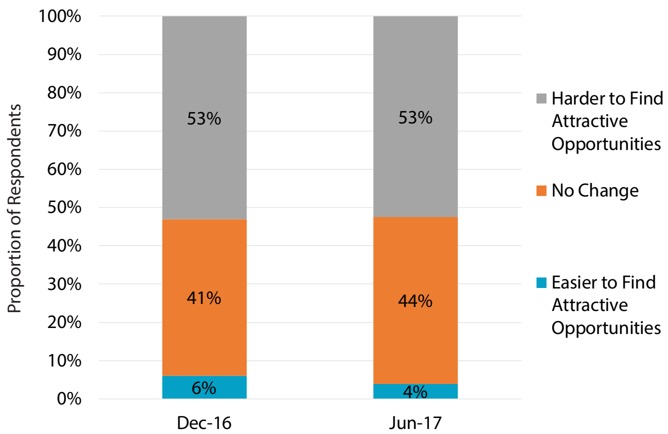
Source: Preqin Investor Interviews, June 2017

Fig. 5.6: Investor Views on the Key Issues Facing Real Estate in 2017 by Investor Location



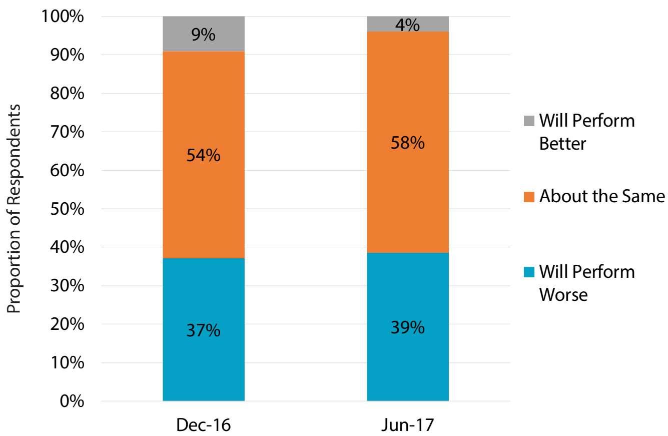
Source: Preqin Investor Interviews, June 2017

Fig. 5.7: Investor Views on the Difficulty of Identifying Attractive Investment Opportunities Compared to 12 Months Ago, 2016 vs. 2017



Source: Preqin Investor Interviews, December 2016 - June 2017

Fig. 5.8: Investors' Return Expectations for Their Real Estate Portfolios in the Next 12 Months Compared to the Previous 12 Months, 2016 vs. 2017



Source: Preqin Investor Interviews, December 2016 - June 2017

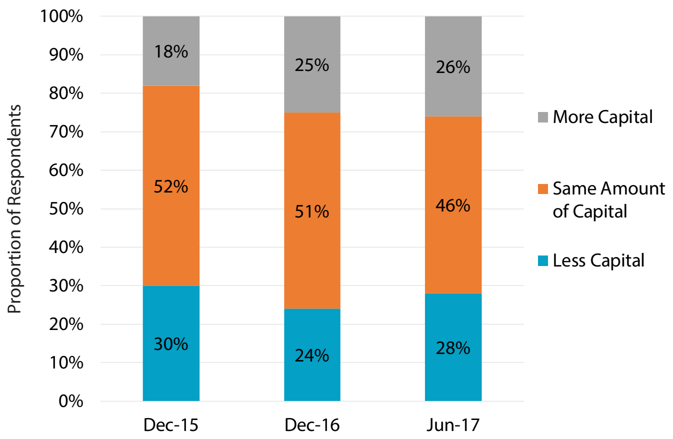
INVESTOR ACTIVITY IN THE NEXT 12 MONTHS

The issues discussed on page 36 have contributed to the view that fundraising is unlikely to see a significant increase over the rest of 2017. While there has been a slight shift in short-term investor appetite over the past six months, a greater proportion of surveyed investors plan to invest less (28%) rather than more (26%) capital than they did in the previous 12 months (Fig. 5.9).

As illustrated by the increase in capital concentration among a smaller pool of managers, fundraising has seen fewer but larger commitments made to real estate fund managers. Data on investor activity from Preqin's **Real Estate Online** shows that this could continue over the next year, with very little difference in the number of commitments investors will attempt to make (Fig. 5.10) or in the amount of capital they will put to work (Fig. 5.11) from the previous year.

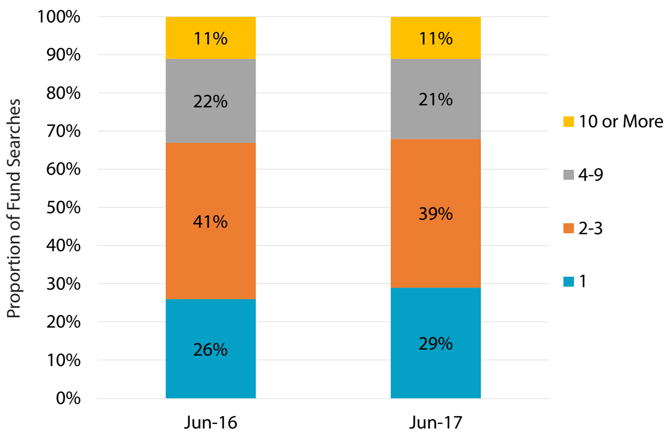
Despite short-term challenges, investors are encouraged by strong fund performance and the general ability of the asset class to meet performance expectations over both the short and long term. As a result, 95% of respondents will look to maintain or increase their allocations to the asset class over the longer term, and only 5% will seek to reduce their private real estate allocation (Fig. 5.12).

Fig. 5.9: Investors' Expected Capital Commitments to Real Estate Funds in the Next 12 Months Compared to the Previous 12 Months, 2015 - 2017



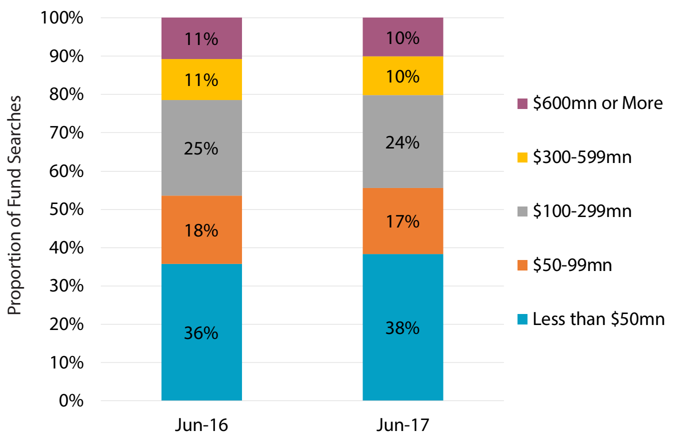
Source: Preqin Investor Interviews, December 2015 - June 2017

Fig. 5.10: Number of Private Real Estate Fund Commitments Investors Plan to Make over the Next 12 Months, 2016 vs. 2017



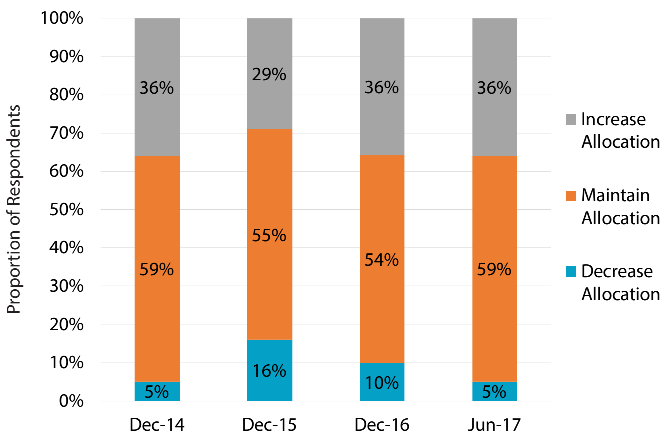
Source: Preqin Real Estate Online

Fig. 5.11: Amount of Fresh Capital Investors Plan to Invest in Private Real Estate Funds over the Next 12 Months, 2016 vs. 2017



Source: Preqin Real Estate Online

Fig. 5.12: Investors' Intentions for Their Private Real Estate Allocations over the Longer Term, 2014 - 2017

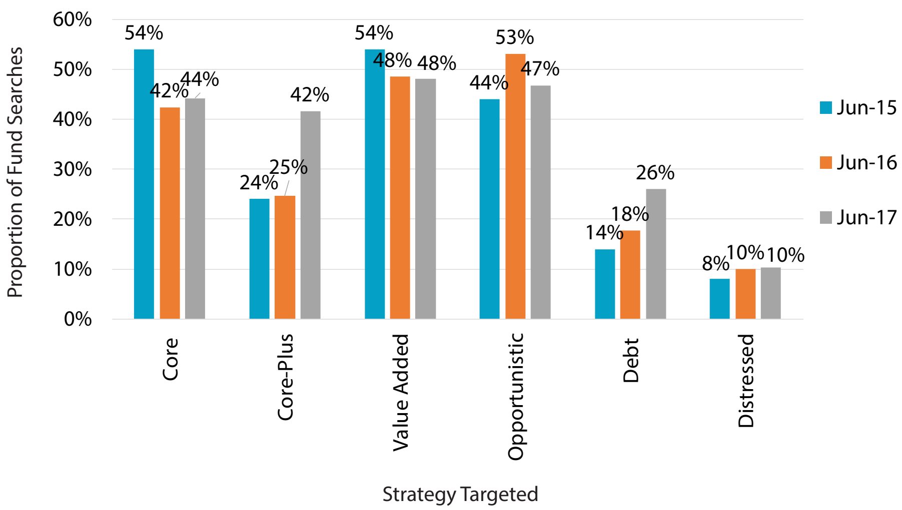


Source: Preqin Investor Interviews, December 2014 - June 2017

STRATEGIES AND GEOGRAPHIES TARGETED

As shown in Fig. 5.13, institutional investors continue to favour higher-risk over lower-risk strategies, although the difference is not as pronounced as in June 2016. The proportion of active investors targeting opportunistic funds has fallen by six percentage points since June 2016, whereas core-plus and debt funds saw a 17- and eight-percentage-point rise over the same period respectively. The concurrent fall for value added funds since June 2015 and opportunistic vehicles from June 2016 may be explained by investors' concerns over increased competition for deals among fund managers, and the resultant higher valuations for assets in these areas.

Fig. 5.13: Strategies Targeted by Private Real Estate Investors in the Next 12 Months, 2015 - 2017

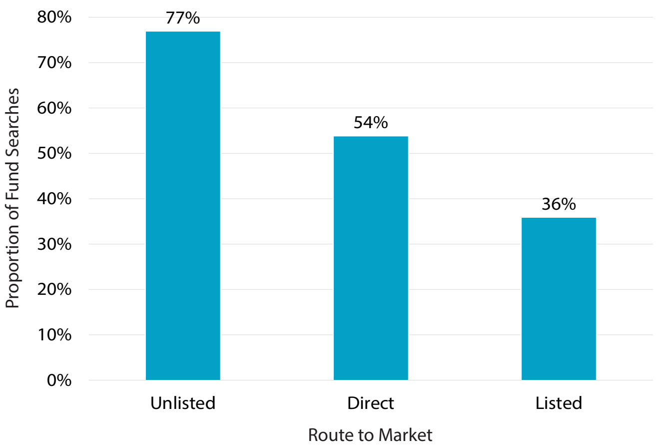


Source: Preqin Real Estate Online

Unlisted funds are the predominant route to market for 77% of active institutional investors making investments in the asset class in the next 12 months, while a smaller – but still significant – pool of 54% institutions will be targeting direct investments (Fig. 5.14).

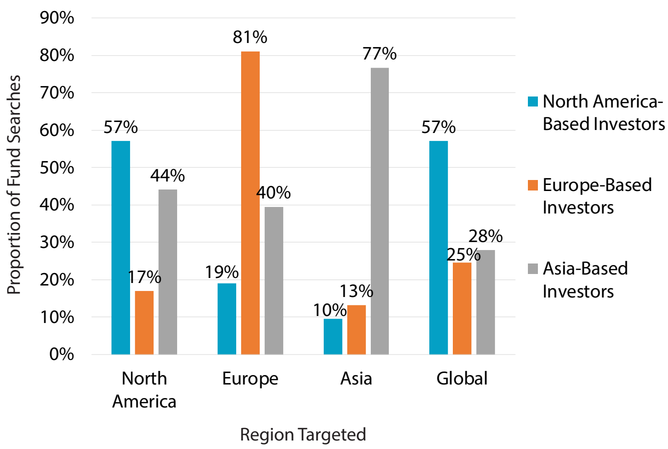
Domestic bias is characteristic of active investors looking to commit capital to private real estate funds in the next 12 months. This is more prominently seen in investors based in Europe and Asia than in North America. Over three-quarters of Europe- and Asia-based institutions are targeting domestic investment opportunities (81% and 77% respectively), compared to 57% of North America-based LPs (Fig. 5.15). North America-based investors prefer to gain access to foreign markets through the use of global vehicles. Asia-based investors also typically seek globally diversified investments, with over 40% specifically targeting funds focused on North America and Europe.

Fig. 5.14: Routes to Market Targeted by Private Real Estate Investors in the Next 12 Months



Source: Preqin Real Estate Online

Fig. 5.15: Regions Targeted by Private Real Estate Investors in the Next 12 Months by Investor Location



Source: Preqin Real Estate Online


SOURCE
new investors for funds and separate accounts
IDENTIFY
new investment opportunities
CONDUCT
competitor and market analysis
COMPARE
fund performance against industry benchmarks
DEVELOP
new business
Register for demo access to find out how Preqin's Real Estate Online can help your business:
www.preqin.com/realestate
preqin
alternative assets. intelligent data.

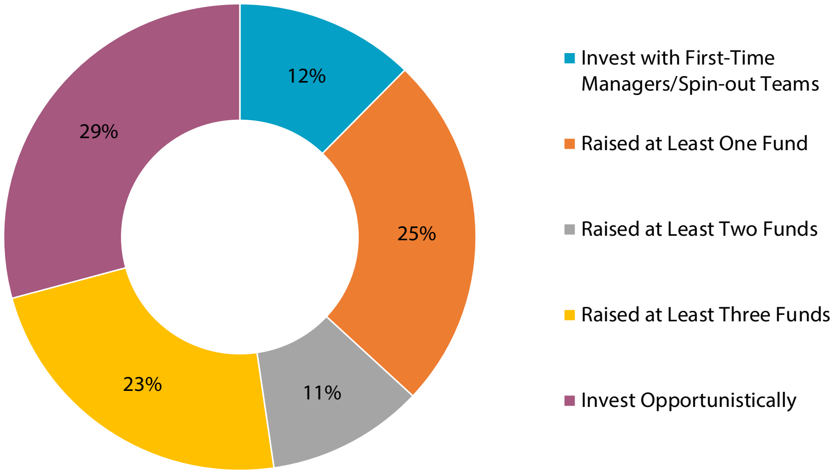
IN FOCUS: EVALUATING FUND MANAGERS

Understanding investors' requirements is becoming an increasingly important task for fund managers trying to raise capital in a congested market. Illustrated by recent trends in real estate fundraising, investors are placing a premium on track records: 59% of investors surveyed stated a preference for managers with prior experience in closing funds, including a significant proportion (23%) that will only invest with managers that have previously raised at least three vehicles (Fig. 5.16).

Only 12% of respondents indicated a willingness to invest with first-time real estate fund managers, which may struggle to raise sufficient capital in a crowded market. However, 29% of interviewed investors are investing opportunistically; therefore, first-time managers could still find appropriate opportunities to market their vehicles.

The majority (86%) of investors interviewed over the past year have not changed their strategy regarding the size of funds they will target, although more investors will seek smaller rather than larger funds (Fig. 5.17). Similarly, 61% of surveyed investors will not be changing the number of fund manager relationships they maintain in their portfolio; despite movements toward fewer, larger relationships, a larger proportion of surveyed investors will look to forge relationships with more GPs than will look to reduce that number in the next 12 months (Fig. 5.18).

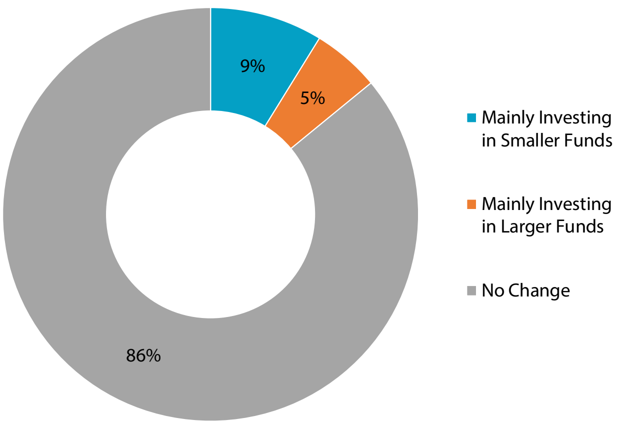
Fig. 5.16: Level of Fund Manager Experience Sought by Private Real Estate Investors



Source: Preqin Investor Interviews, June 2017

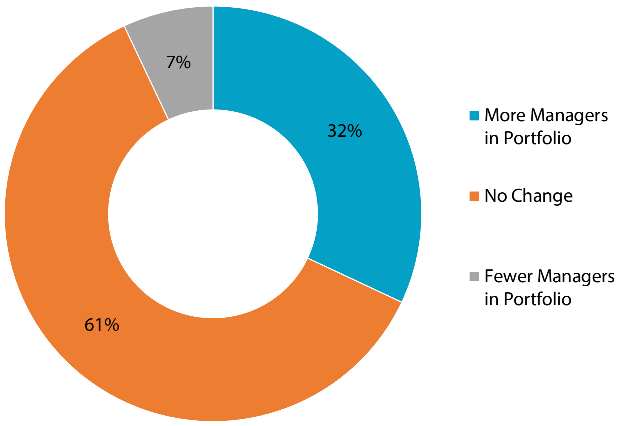
"Only 12% of respondents indicated a willingness to invest with first-time real estate fund managers, which may struggle to raise sufficient capital in a crowded market"

Fig. 5.17: How Private Real Estate Investors' Strategy Regarding Fund Size Has Changed over the Past 12 Months



Source: Preqin Investor Interviews, June 2017

Fig. 5.18: Private Real Estate Investors' Expected Change to the Number of Fund Managers in Their Portfolio in the Next 12 Months



Source: Preqin Investor Interviews, June 2017

SECTION SIX: INFRASTRUCTURE

INVESTOR POSITIVITY FOR INFRASTRUCTURE

Investor satisfaction with infrastructure has reached a three-year high: 89% of investors interviewed in June 2017 have either a positive or neutral view of the asset class, and 94% feel that their infrastructure investments in the past year have met or exceeded expectations. Investors continue to see strong risk-adjusted returns from their portfolios and remain committed to the asset class, with over half (53%) planning to commit more capital to infrastructure investments in the next 12 months than in the past year.

The infrastructure fundraising market has been strong in recent years, providing fund managers with large amounts of capital ready to deploy. With a limited supply of investable assets, competition has increased resulting in asset prices climbing higher – 59% of investors identified valuations as a key issue for the infrastructure asset class. This is having an effect on the number of opportunities available to fund managers, with half of investors surveyed citing deal flow as a key issue. A further 60% of investors feel that asset prices are expensive, and two-fifths are finding it harder to find attractive investment opportunities compared to a year ago.

Despite these concerns, investor appetite is strong: almost all (96% of) respondents plan to maintain or increase their allocation to the asset class over the longer term, with half of investors looking to make three or more investments in the next 12 months. Notably, significant proportions of investors are also looking to increase or maintain their allocations to co-investments, separate accounts and direct investments.

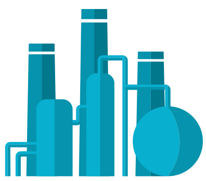
INVESTOR SATISFACTION AND CONCERNS

94%
of investors feel that their infrastructure investments over the past 12 months met or exceeded their expectations.

59%
of investors feel that asset pricing is a key issue in the industry.

CURRENT CLIMATE

40%
of investors find it more difficult to identify attractive investments than 12 months ago.



37%
of investors think conventional energy is the sector presenting the most attractive opportunities.

EXPECTATION FOR 2017 AND BEYOND

53%
of investors are looking to commit more capital to infrastructure in the next 12 months than in the past 12 months.

18%
of investors think their infrastructure portfolios will perform worse in the coming year, compared to 15% that think they will perform better.

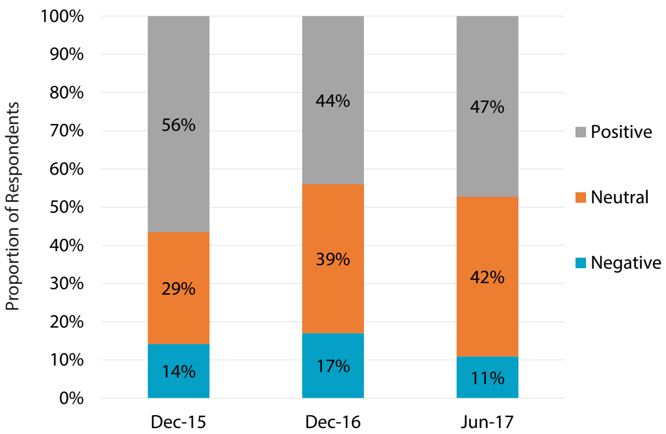
SATISFACTION WITH INFRASTRUCTURE

Encouragingly, institutional investors' general perception of the infrastructure industry has become more positive in the last six months: the proportion of respondents with a positive view of the asset class has risen from 44% in December 2016 to 47% in June 2017 (Fig. 6.1). Although this is not near the highs seen in 2015, the proportion of investors with a negative perception to the asset class has fallen to just 11%, the smallest in three years.

The infrastructure asset class has seen strong performance, consistently generating median net IRRs around the 10% mark since 2004 vintages. It is therefore unsurprising that the clear majority (94%) of institutional investors feel that their infrastructure investments have met or exceeded their expectations over the past 12 months, an increase from both 2015 (77%) and 2016 (89%, Fig. 6.2). Over the longer term, 21% of respondents feel their investments have exceeded expectations over the past three years, with only 12% of investors reporting that their infrastructure investments have fallen short of expectations (Fig. 6.3).

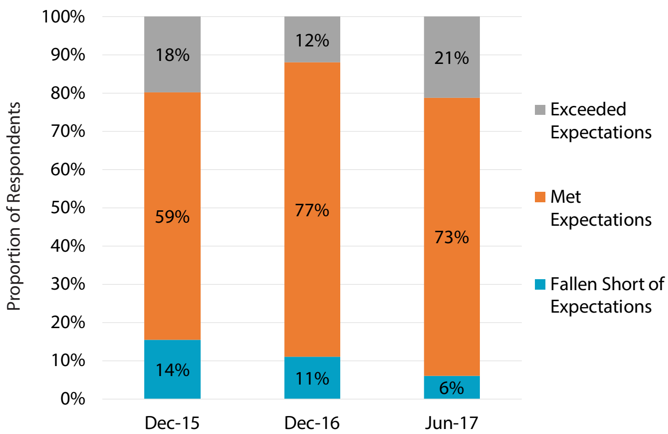
With record levels of dry powder ($150bn) in the asset class, some investors could be concerned over fund managers' ability to put capital to work; however, 91% of investors have the same or an increased level of confidence in the ability of infrastructure to achieve portfolio objectives in the coming year (Fig. 6.4).

Fig. 6.1: Investors' General Perception of the Infrastructure Industry, 2015 - 2017



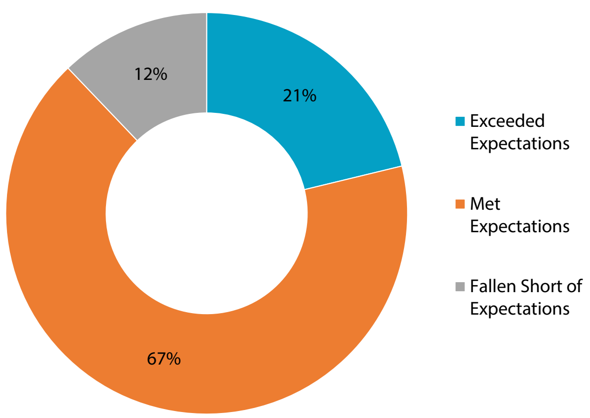
Source: Preqin Investor Interviews, December 2015 - June 2017

Fig. 6.2: Investor Views on Infrastructure Portfolio Performance over the Past 12 Months Relative to Expectations, 2015 - 2017



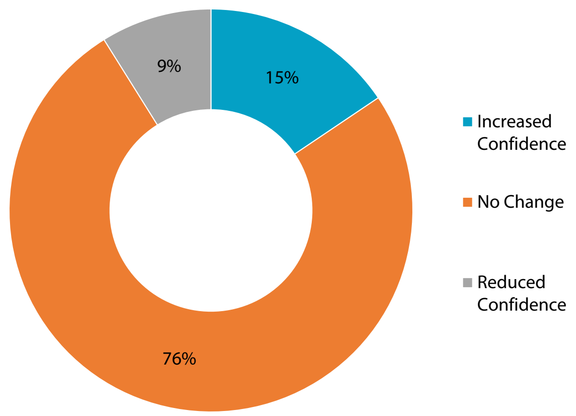
Source: Preqin Investor Interviews, December 2015 - June 2017

Fig. 6.3: Investor Views on Infrastructure Portfolio Performance over the Past Three Years Relative to Expectations



Source: Preqin Investor Interviews, June 2017

Fig. 6.4: Investors' Change in Confidence in the Ability of Infrastructure to Achieve Portfolio Objectives over the Past 12 Months



Source: Preqin Investor Interviews, June 2017

KEY ISSUES IN 2017

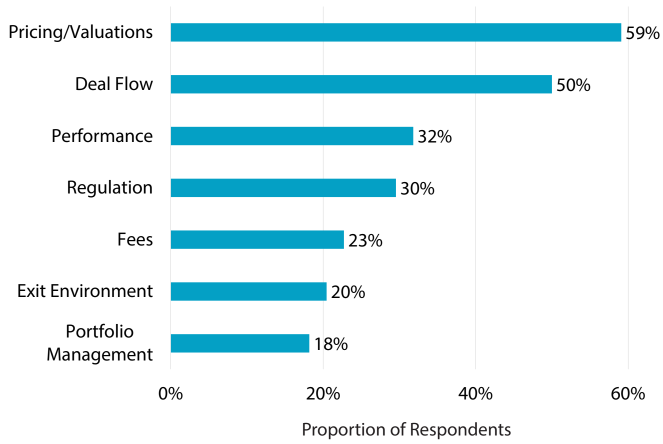
The biggest concern cited by infrastructure investors is the pricing of assets (Fig. 6.5), with one institution reporting that "most assets are overpriced" and that it is "better being a seller than a buyer at the moment".

The increase in competition for assets – driven by increased participation in the asset class from fund managers with large amounts of dry powder to deploy and institutional investors seeking direct investment – is putting pressure on valuations. Sixty percent of investors surveyed believe infrastructure asset prices are expensive, including 11% that believe assets are very expensive (Fig. 6.6).

Correspondingly, deal flow is the second biggest concern on investors' minds, with high valuations restricting the pipeline of available investments. These factors could have an effect on the eventual performance of unlisted funds, cited as a concern by 32% of respondents. Two-thirds of institutional investors expect their infrastructure portfolios to perform about the same in the next 12 months as in the past 12 months, although slightly more of those surveyed believe their portfolios will perform worse (18%) rather than better (15%) in the same period (Fig. 6.7).

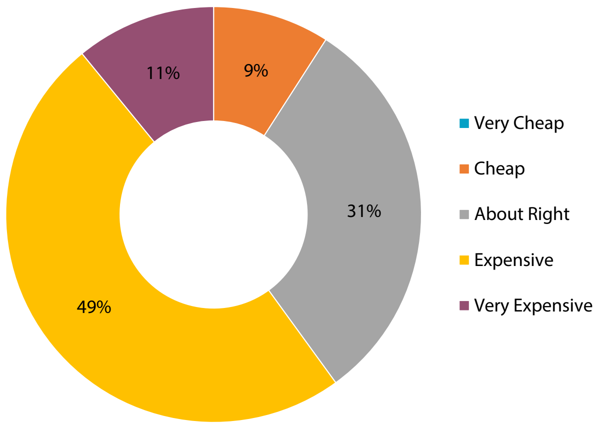
Despite there being large numbers of funds in market, there are encouraging signs for firms seeking capital: investors are reporting that it is easier to find funds to invest in compared to December 2016, with the proportion of respondents rising from 3% to 12% (Fig. 6.8). However, a sizeable 40% of investors believe it is more difficult than 12 months ago.

Fig. 6.5: Investor Views on the Key Issues Facing Infrastructure in the Next 12 Months



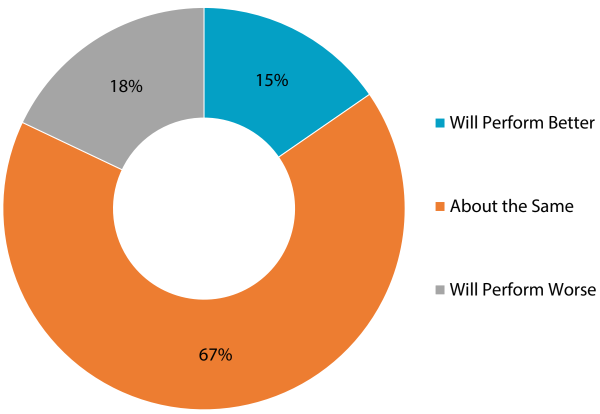
Source: Preqin Investor Interviews, June 2017

Fig. 6.6: Investor Views on the Pricing of Infrastructure Assets



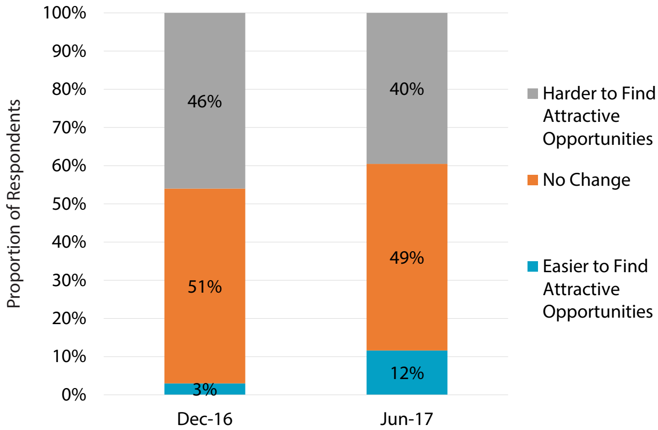
Source: Preqin Investor Interviews, June 2017

Fig. 6.7: Investors' Return Expectations for Their Infrastructure Investments in the Next 12 Months Compared to the Previous 12 Months



Source: Preqin Investor Interviews, June 2017

Fig. 6.8: Investor Views on the Difficulty of Identifying Attractive Infrastructure Investment Opportunities Compared to 12 Months Ago, 2016 vs. 2017



Source: Preqin Investor Interviews, December 2016 - June 2017

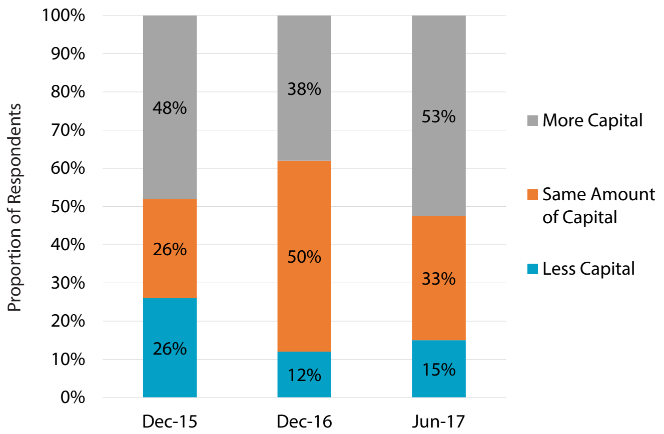
INVESTOR ACTIVITY IN THE NEXT 12 MONTHS

The proportion of institutional investors looking to commit more capital to the infrastructure asset class has increased significantly: over half (53%) of investors are planning to invest more in the next 12 months, an increase of 15 percentage points from results seen in December 2016 (Fig. 6.9). Over the longer term, institutions plan to remain committed to the asset class, with half of respondents looking to increase their exposure and a further 46% planning to maintain their allocation to the asset class (Fig. 6.10). The fact that only 4% are likely to reduce allocations in the long term is indicative of investors' confidence in the asset class to perform portfolio objectives.

Data on unlisted fund searches and mandates issued by institutional investors on Preqin's **Infrastructure Online** shows that investors are favouring fewer commitments in the year ahead, with half of active investors targeting just one or two investments. While just over half (51%) of active investors will commit smaller sums of less than $100mn, there remains a significant proportion seeking to commit more than $100mn to infrastructure funds in the year ahead, including 12% that plan to invest $350mn or more (Fig. 6.11).

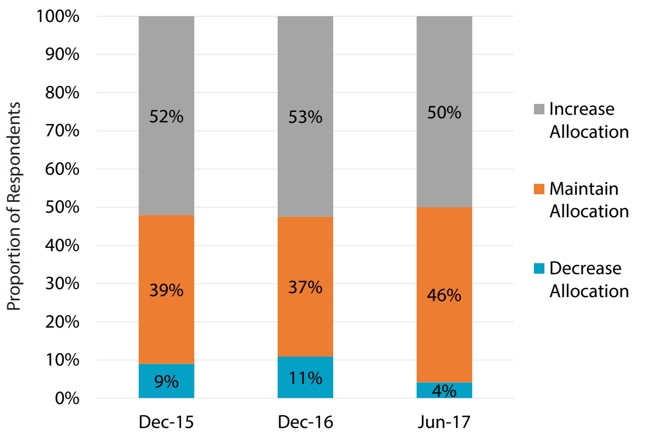
Institutional infrastructure investors are also looking for alternatives to the primary fund commitment model to gain exposure to the asset class. As Fig. 6.12 illustrates, significant proportions of investors are planning to maintain or increase their allocations to co-investments, separate accounts and direct investments in the year ahead.

Fig. 6.9: Investors' Expected Capital Commitments to Infrastructure in the Next 12 Months Compared to the Previous 12 Months, 2015 - 2017



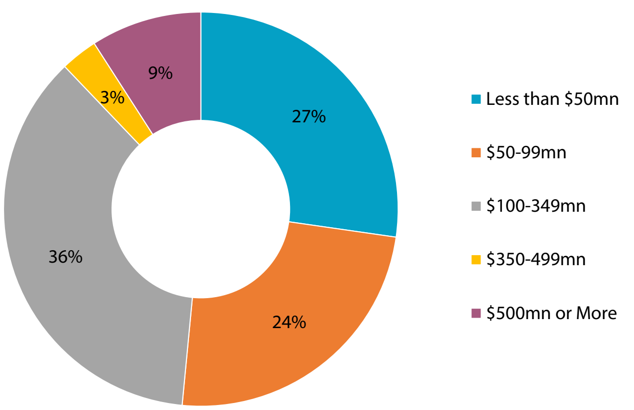
Source: Preqin Investor Interviews, December 2015 -June 2017

Fig. 6.10: Investors' Intentions for Their Infrastructure Allocations over the Longer Term, 2015 - 2017



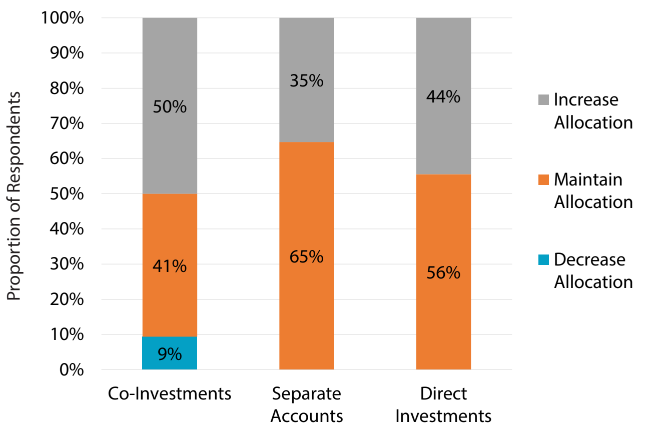
Source: Preqin Investor Interviews, December 2015 - June 2017

Fig. 6.11: Amount of Fresh Capital Investors Plan to Invest in Infrastructure over the Next 12 Months



Source: Preqin Infrastructure Online

Fig. 6.12: Investors' Intentions for Their Allocations to Alternative Infrastructure Structures over the Next 12 Months



Source: Preqin Investor Interviews, June 2017

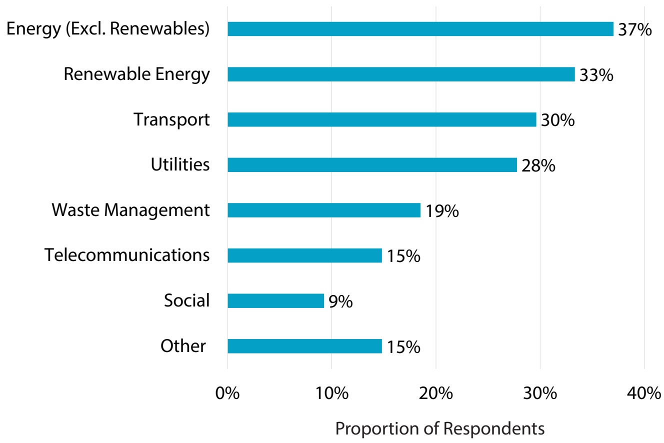
STRATEGIES AND GEOGRAPHIES TARGETED

Demand for energy is rising globally, and investor appetite for the sector is growing: 37% of investors identify conventional energy sources as offering the best opportunities, closely followed by 33% that see renewable energy as the most attractive strategy (Fig. 6.13). This is a reversal of the results seen at the end of 2016, when 64% identified renewables as the best option and 43% thought the same of conventional energy.

Despite 35% of investors reporting that core funds still present the best opportunities in the market (Fig. 6.14), the proportion of respondents favouring this strategy has fallen by 11 percentage points since the end of 2016, potentially due to the effect that growing demand has had on pricing. Furthermore, the proportion of respondents identifying opportunistic funds as the most attractive has more than halved from 42% in December 2016 to 17% in June 2017. When considering project stages, 44% of respondents believe greenfield offers the best opportunities at present (Fig. 6.15).

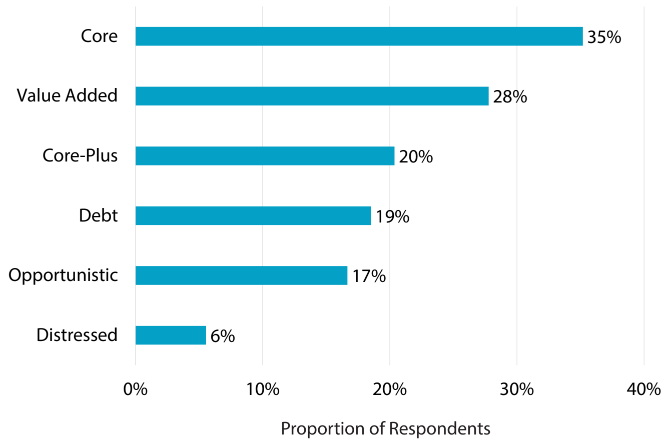
There has been no real change in investors' opinion of the most attractive markets since our interviews at the end of 2016. As shown in Fig. 6.16, North America remains the favoured destination for infrastructure investment, perhaps linked to the current US administration's plans to invest $1tn in infrastructure assets across the country.

Fig. 6.13: Industries* Investors View as Presenting the Best Opportunities



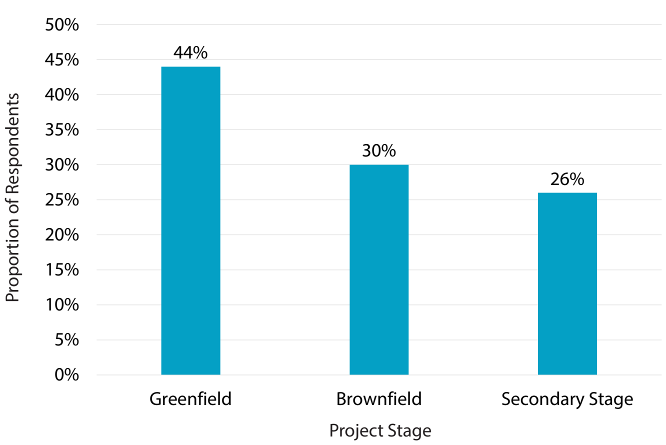
Source: Preqin Investor Interviews, June 2017

Fig. 6.14: Strategies* Investors View as Presenting the Best Opportunities



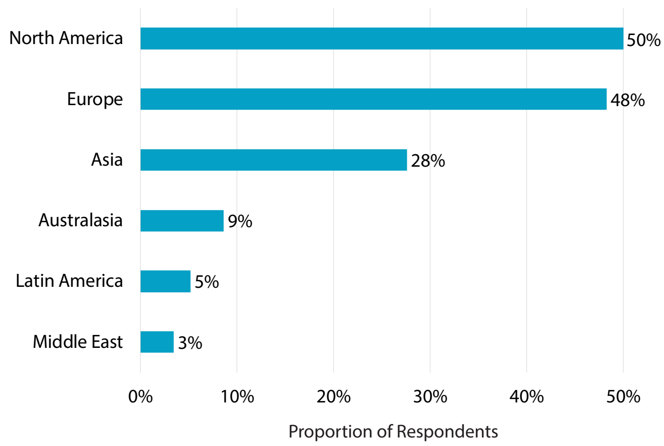
Source: Preqin Investor Interviews, June 2017

Fig. 6.15: Project Stages* Investors View as Presenting the Best Opportunities



Source: Preqin Investor Interviews, June 2017

Fig. 6.16: Regions* Investors View as Presenting the Best Opportunities



Source: Preqin Investor Interviews, June 2017

**Respondents were not prompted to give their opinions on each category individually but to name those they felt best fit these categories; therefore, the results display what was at the forefront of investors' minds at the time of the survey.*

SECTION SEVEN: PRIVATE DEBT

INVESTORS HAVE CONFIDENCE IN PRIVATE DEBT

Investor appetite for private debt remained strong in the first half of 2017; and the proof was in the fundraising, as more than $42bn has been committed to private debt funds closed globally since January. With more capital in the industry than ever before, investors surveyed by Preqin in June 2017 have appropriate concerns about deal flow, returns, valuations and global volatility heading into H2 2017. Still, 90% of respondents remain confident that their private debt investments will achieve portfolio objectives moving forward.

The outlook for private debt is positive, perhaps even more so than in recent years: 92% of investors feel their private debt investments over the past 12 months have met or exceeded their expectations – this is a larger proportion than in both June 2015 and June 2016 – and 90% remain confident that their private debt investments will continue to achieve portfolio objectives moving forward.

North America and Europe remain the primary regions for private debt activity, as investors and managers continue to see opportunity across the board from senior lending to distressed debt in both regions. All of the five largest funds closed thus far in 2017 have been either distressed debt or direct lending vehicles focused on the US or Europe, proving that there is yet to be much diversion from historical norms in the asset class. However, after Digital India Fund achieved a final close of $2bn, Cheekotel has cracked the top 10 largest funds with a vehicle focused on mezzanine opportunities within India. There are 66 funds in market seeking nearly $18bn for private debt opportunities in Asia & Rest of World as at July 2017.

A record proportion (91%) of investors plan to maintain or increase their private debt allocations over the longer term. Compared with one year earlier, when 16% planned a long-term decrease in allocation, that figure now stands at only 9%, in what may perhaps be the most telling investor statistic. Long-term confidence continues to be a driver in the industry, as the low interest rate environment persists and investment in new regions continues to grow. As long as managers continue to provide strong risk-adjusted returns and investors see a steady flow of deal activity, investors are likely to remain committed to the asset class.

INVESTOR SATISFACTION

94%

of investors feel their private debt investments over the past three years have met or exceeded their expectations.

11%

of investors are now less confident in the ability of private debt to achieve portfolio objectives than they were 12 months ago.

FUTURE PLANS

46%

of investors plan to increase their allocation to private debt in the next 12 months.

62%

of investors plan to increase their private debt allocation over the longer term.

EXPECTATIONS FOR H2 2017

56%

of investors believe Europe currently presents the best investment opportunities in the asset class.

48%

of respondents believe direct lending currently has the best risk/return profile among private debt fund types.

SATISFACTION WITH PRIVATE DEBT

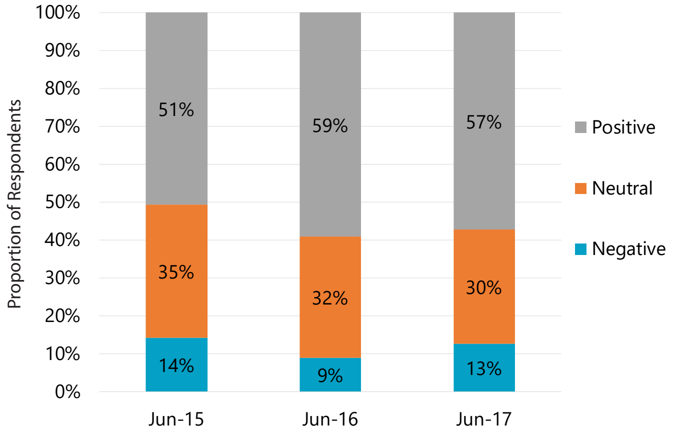
Investors' positive perception of the private debt industry remains strong moving into H2 2017, as cited by more than half (57%) of survey respondents (Fig. 7.1). Potentially more telling, however, is the consistently low reports of any negative perception from investors. When combined, the proportion of investors reporting positive or neutral attitudes towards the private debt asset class has remained at or over 86% since our 2015 study.

Reflecting on the year to June 2017, investor respondents are more satisfied with private debt performance than ever before. As investors become increasingly familiar with the maturing asset class, significantly more are reporting that their portfolios have met expectations over the preceding 12 months, with 80% having responded in this way in H2 2017 compared to 52% just two years earlier (Fig. 7.2). A further 12% of investors reported their private debt investments exceeded expectations over the past 12 months.

Looking back on the past three years, investors' views on private debt performance are even more positive: 21% have seen the asset class outperform expectations and just 6% signalled that their allocations have fallen short of expectations (Fig. 7.3).

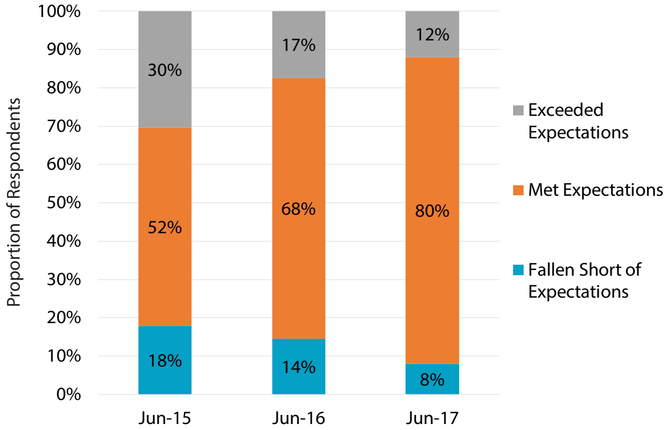
As shown in Fig. 7.4, investors over time have become increasingly confident in private debt's ability to meet portfolio objectives. Only 11% of investors reported that their confidence in the asset class has decreased over the past year, down from 16% of investors interviewed in June 2016 and 19% in June 2015.

Fig. 7.1: Investors' General Perception of the Private Debt Industry, 2015 - 2017



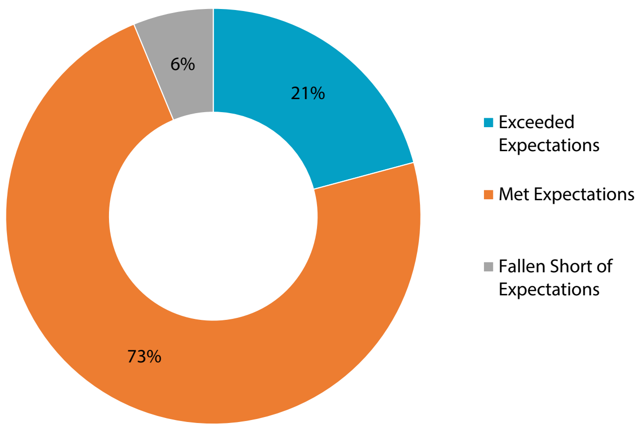
Source: Preqin Investor Interviews, June 2015 - 2017

Fig. 7.2: Investor Views on Private Debt Portfolio Performance over the Past 12 Months Relative to Expectations, 2015 - 2017



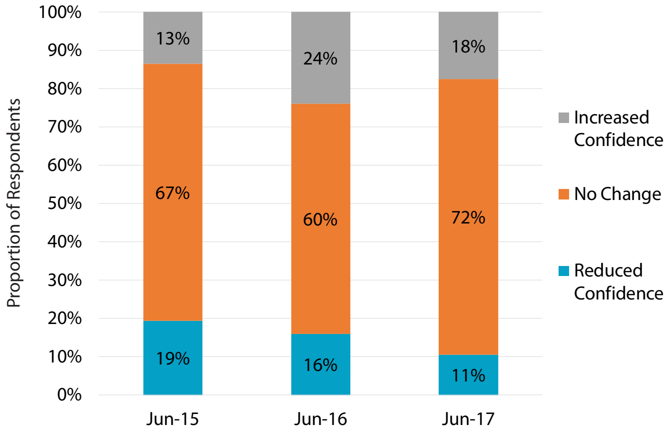
Source: Preqin Investor Interviews, June 2015 - 2017

Fig. 7.3: Investor Views on Private Debt Portfolio Performance over the Past Three Years Relative to Expectations



Source: Preqin Investor Interviews, June 2017

Fig. 7.4: Investors' Change in Confidence in the Ability of Private Debt to Achieve Portfolio Objectives over the Past 12 Months, 2015 - 2017



Source: Preqin Investor Interviews, June 2015 - 2017

KEY ISSUES IN 2017

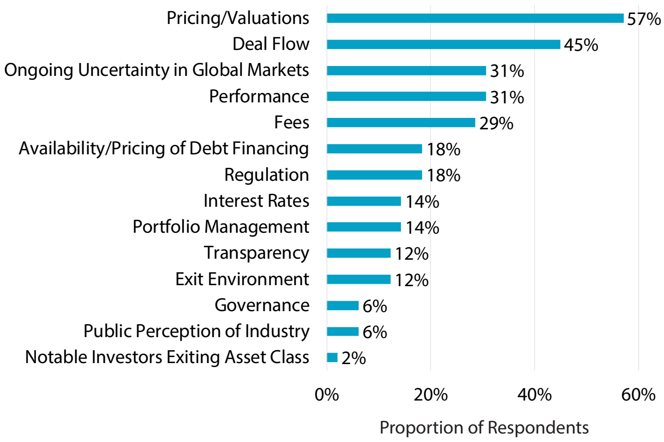
When asked about the key issues facing private debt this year, the majority (57%) of investors interviewed in June 2017 cited pricing and valuations as their key concern, followed by deal flow (45%) and performance (31%, Fig. 7.5). With near record-high levels of private debt capital available, it will be vital for managers to maintain robust deal flow and competitive pricing and valuation standards moving forward. Managers' efforts in recent years to improve transparency have appeared to quell concerns, as this ranks notably low among investors' concerns.

The level of education investors receive from managers and consultants regarding private debt has come to the forefront of discussion in recent years, as new products have emerged in the constantly changing regulatory and interest rate environments surrounding private lending. As at June 2017, nearly half (48%) of private debt investors are satisfied with the education that they have received, with an additional 21% rating it as fair (Fig. 7.6). Conversely, 15% of respondents stated education was poor, while 17% had no opinion on the matter.

The majority (55%) of investors foresee interest rates having no effect on their private debt portfolios in the next 12-24 months (Fig. 7.7). However, 29% of respondents expect a positive impact. Diverse outlooks could be a result of investment in a variety of regions or different levels of capital seniority depending on an investor's appetite for interest rate risks.

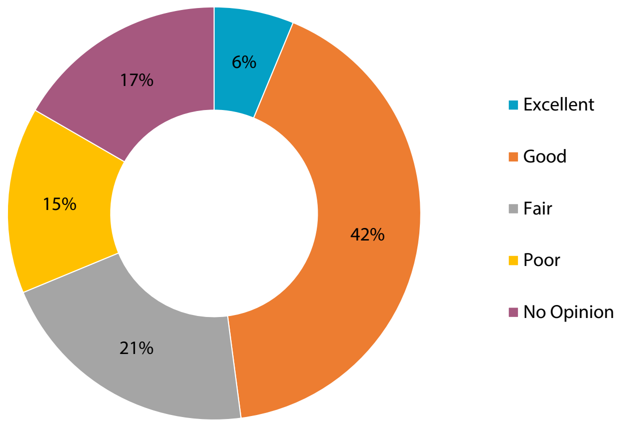
The bulk (61%) of private debt investors expect returns to remain about the same in the coming year as the previous year (Fig. 7.8). On the upside, 17% of investors expect improved performance over the next 12 months, while 22% are expecting worse performance from their private debt funds.

Fig. 7.5: Investor Views on the Key Issues Facing Private Debt in 2017



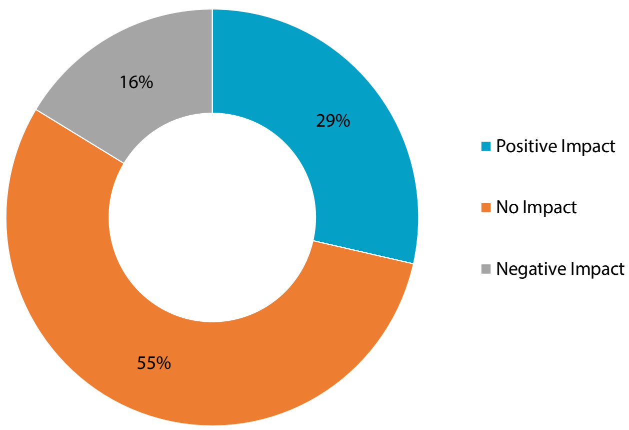
Source: Preqin Investor Interviews, June 2017

Fig. 7.6: Investor Views on the Quality of Education Received from Fund Managers and Consultants Regarding Private Debt



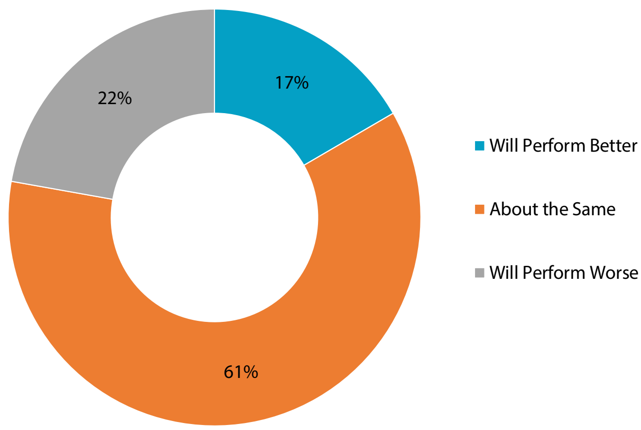
Source: Preqin Investor Interviews, June 2017

Fig. 7.7: Investor Views on the Expected Impact of Interest Rates on Their Private Credit Portfolios over the Next 12-24 Months



Source: Preqin Investor Interviews, June 2017

Fig. 7.8: Investors' Return Expectations for Their Private Debt Portfolios in the Next 12 Months Compared to the Previous 12 Months



Source: Preqin Investor Interviews, June 2017

INVESTOR ACTIVITY IN THE NEXT 12 MONTHS

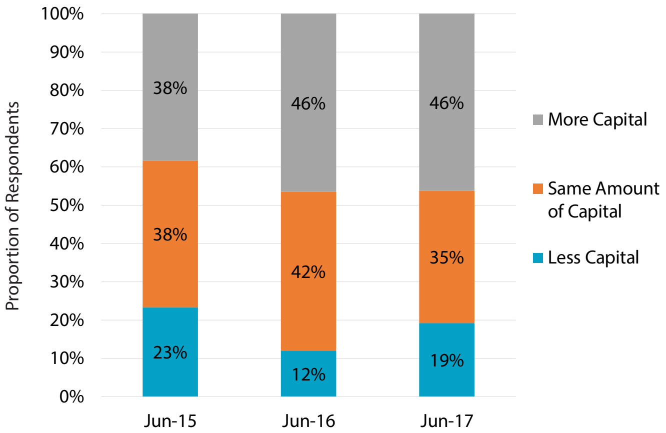
Nearly half (46%) of investors interviewed heading into the second half of the year plan to commit more capital to private debt in the next 12 months than they have in the past 12 months, and a further 35% are expecting to commit the same amount (Fig. 7.9). The smallest proportion (19%) of investors expect to reduce their exposure to the asset class in the coming year, up from 12% of investors interviewed one year earlier.

Seventy-seven percent of active investors plan to make between one and five new commitments to private debt in the next 12 months (Fig. 7.10). A smaller proportion (16%) of investors are looking to make 6-10 commitments in the next year, followed by 7% that are planning to make more than 10. Commitments can certainly vary in size, so the number of commitments by a given investor can lean considerably on the diversity of strategies targeted in their private debt portfolio.

Almost a third (31%) of investors plan to commit under $20mn in total to private debt funds in the next 12 months, followed by 24% and 19% targeting total new commitments of $20-49mn and $50-99mn respectively (Fig. 7.11). At the higher end of the spectrum, 27% will look to commit capital in excess of $100mn in the next year, including 5% that intend to commit $1bn or more.

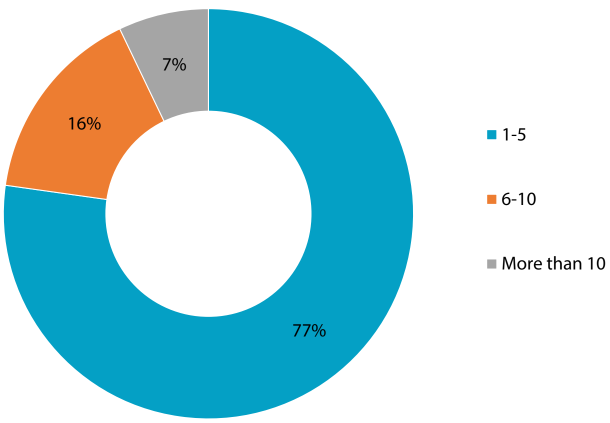
Looking ahead to the longer term, 91% of investors intend to either increase or maintain their private debt allocations (Fig. 7.12). Just 9% reported plans to decrease allocations over the longer term, with those planning to increase allocations remaining at 62% from the previous year.

Fig. 7.9: Investors' Expected Capital Commitments to Private Debt Funds in the Next 12 Months Compared to the Previous 12 Months, 2015 - 2017



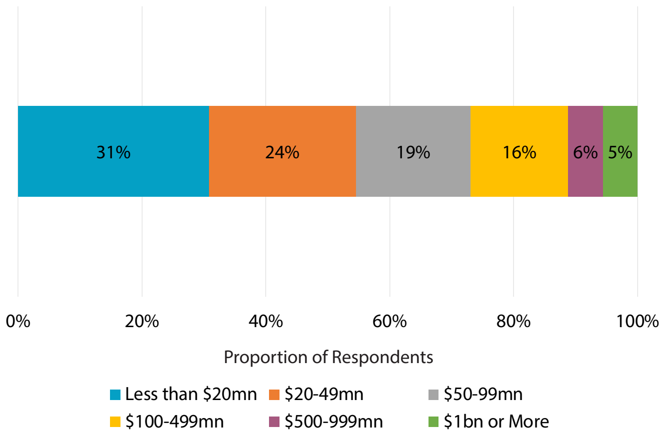
Source: Preqin Investor Interviews, June 2015 - 2017

Fig. 7.10: Number of Private Debt Fund Commitments Investors Plan to Make over the Next 12 Months



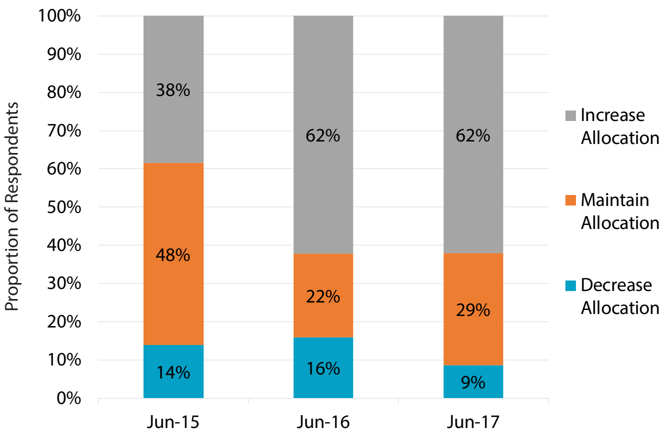
Source: Preqin Investor Interviews, June 2017

Fig. 7.11: Amount of Fresh Capital Investors Plan to Invest in Private Debt Funds over the Next 12 Months



Source: Preqin Investor Interviews, June 2017

Fig. 7.12: Investors' Intentions for Their Private Debt Allocations over the Longer Term, 2015 - 2017

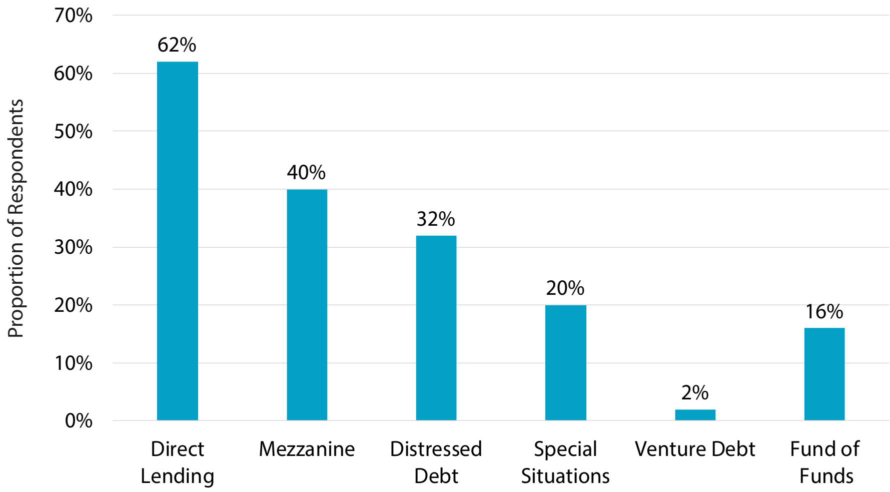


Source: Preqin Investor Interviews, June 2015 - 2017

STRATEGIES AND GEOGRAPHIES TARGETED

As investor sentiment towards private debt becomes more and more positive, certain strategies are emerging as particularly attractive to investors at present. The majority (62%) of investors interviewed believe direct lending currently presents the best opportunities, as the fund type and underlying strategies have increasingly become mainstream components of investor portfolios (Fig. 7.13). Forty percent of respondents see great opportunity in mezzanine funds, while 32% and 20% look favourably on distressed debt and special situations funds respectively. Only 2% of investors believe venture debt funds present the best opportunities in the asset class.

Fig. 7.13: Fund Types* that Investors View as Presenting the Best Opportunities



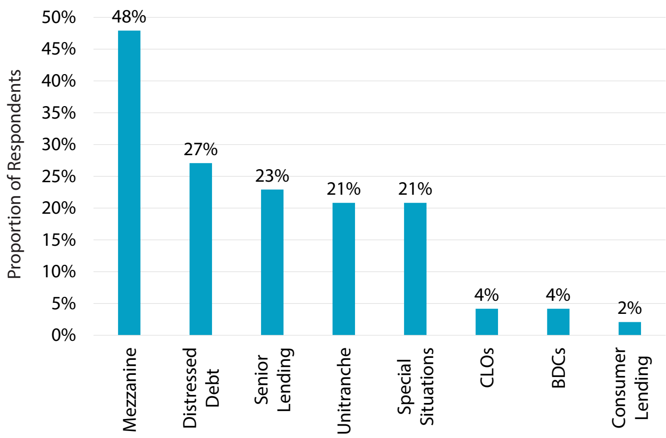
Source: Preqin Investor Interviews, June 2017

> ***Direct lending and its underlying strategies have increasingly become mainstream components of investor portfolios***

As seen in Fig. 7.14, the largest proportion (48%) of respondents believe mezzanine offers the best risk/return profile among private debt fund strategies heading into H2 2017. Senior lending (23%), special situations (21%) and unitranche (21%) sit behind distressed debt at 27%. CLOs and BDCs make the list at 4% each, followed by consumer lending (2%).

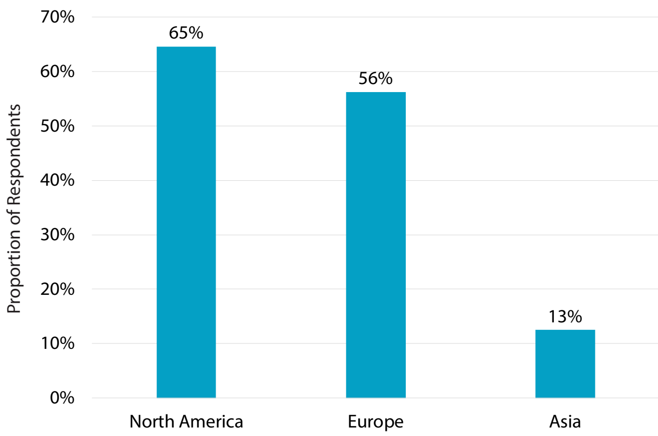
North America remains the region in which investors see the best private debt opportunities, as endorsed by 65% of respondents (Fig. 7.15). Not far behind, Europe is considered to offer top-tier private debt opportunities by 56% of investors interviewed; the region has seen a significant increase in private debt activity in recent years, along with a growing fundraising market, both of which signal potentially strong opportunities on the horizon. Finally, 13% of respondents believe Asia presents the best opportunities for private debt investment, as private lending activity steadily grows in the smaller marketplaces throughout the region.

Fig. 7.14: Strategies* that Investors View as Presenting the Best Risk/Return Profile



Source: Preqin Investor Interviews, June 2017

Fig. 7.15: Regions* that Investors View as Presenting the Best Opportunities



Source: Preqin Investor Interviews, June 2017

*Respondents were not prompted to give their opinions on each category individually but to name those they felt best fit these categories; therefore, the results display what was at the forefront of investors' minds at the time of the survey.

IN FOCUS: FUND TERMS

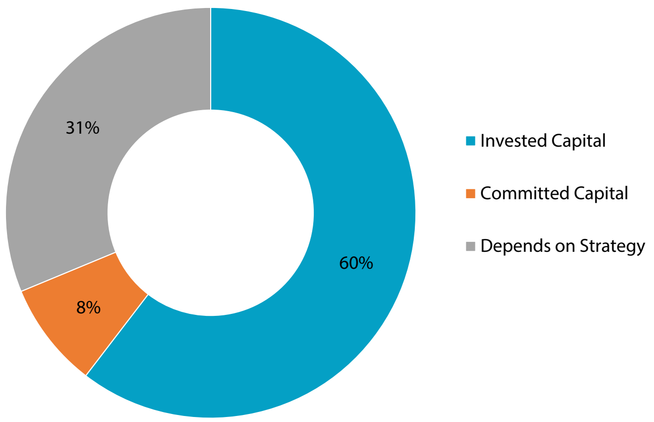
When referring to private debt in general, 60% of investors interviewed by Preqin in June 2017 expect to pay management fees on invested capital rather than committed capital (8%, Fig. 7.16). This opinion certainly varies based on where in the capital stack the manager operates, as 31% of respondents indicated that it would depend on the strategy employed by a fund.

Focusing solely on direct lending reveals a slightly larger proportion (62%) of investors that expect to pay fees only on invested capital; however, the level of respondents that expect to pay fees on committed capital is also higher at 13% (Fig. 7.17). As a further 24% of respondents acknowledged that the capital basis for management fees depends on the specific manager, this divergence could be due to a number of factors that can be leveraged to arrive at more aggressive fee structures, such as operating in niche specialties, proprietary deal flow or historically strong track records.

Direct lending funds most closely mimic the characteristics of traditional fixed income products, with their lack of liquidity one of the most noteworthy differences. However, investors are typically compensated for this illiquidity over the life of a fund in the form of a return premium versus liquid products with a similar risk profile. Among investors interviewed, 67% expect this premium to fall within 101-300 basis points (Fig. 7.18).

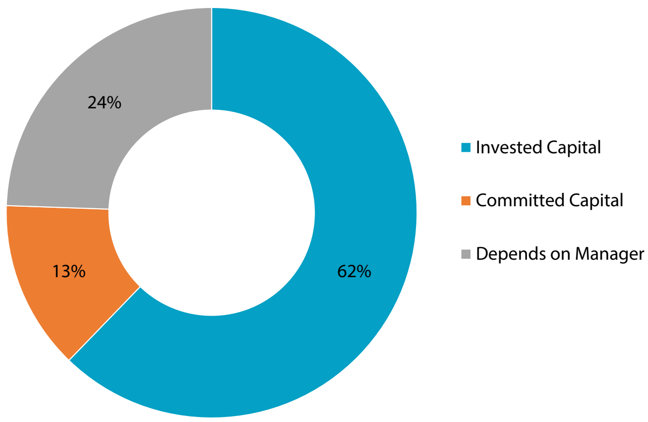
Forty-five percent of investors prefer a term of 3-5 years for a private debt fund, a lifespan just shorter than that of the average private capital fund, and 43% have a preference for funds running from 5-7 years (Fig. 7.19). However, it is important to note that since direct lending funds return value to investors earlier than the average alternatives strategy, the shorter preferred term length is not too surprising.

Fig. 7.16: Investor Views on whether They Expect to Pay Management Fees Based on Invested or Committed Capital when Investing in Private Debt



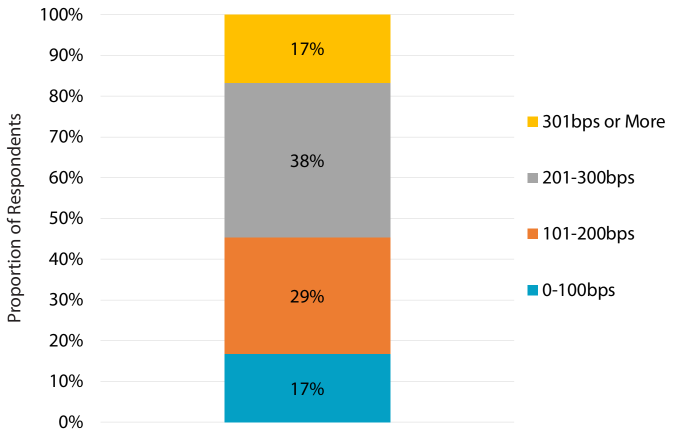
Source: Preqin Investor Interviews, June 2017

Fig. 7.17: Investor Views on whether They Expect to Pay Management Fees Based on Invested or Committed Capital when Investing in Direct Lending



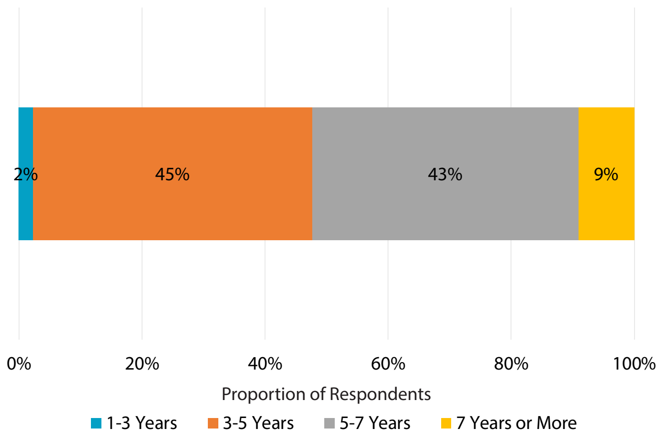
Source: Preqin Investor Interviews, June 2017

Fig. 7.18: Investors' Preferred Illiquidity Premium for Direct Lending Funds



Source: Preqin Investor Interviews, June 2017

Fig. 7.19: Investors' Preferred Private Debt Fund Term Length



Source: Preqin Investor Interviews, June 2017

SECTION EIGHT: NATURAL RESOURCES

IMPROVING SENTIMENT BUT LONGER-TERM CAUTION

For the first time in two years, since oil prices dropped, the majority (70%) of investors feel that their allocations to natural resources have met or exceeded their expectations; this is a significant increase from 46% at the end of 2016 and correlates with an improvement in the PrEQIn Natural Resources Quarterly Index over recent months. However, despite greater satisfaction with returns, investors continue to be wary of the asset class, with their overall perception of natural resources remaining relatively unchanged since December 2016. The vast majority (70%) are opting to maintain their allocation over the long term, rather than increase it.

Interestingly, investors' concerns surrounding the natural resources asset class have shifted significantly. In line with issues seen across closed-end alternatives, the pricing of assets has emerged as a leading issue among respondents. With increasing amounts of dry power to invest, investors are concerned about the ability of managers to purchase assets at a price that will allow for strong future returns. Performance and volatility in global markets remain major concerns, yet the number of respondents reporting this as a major issue has dropped, as investors' confidence in natural resources investments has also improved.

Looking forward, despite a few concerns that investors may have about the asset class, natural resources investors are looking to make fresh commitments, with 39% of investors looking to commit more capital than they did in the previous 12 months.

INVESTOR SATISFACTION AND ACTIVITY

30%

The proportion of investors reporting that their natural resources returns had fallen short of expectations decreased from 54% in December 2016 to 30% in June 2017.

39%

of investors plan to commit more capital to natural resources in the next 12 months than they did in the previous 12 months.

EXPECTATIONS FOR 2017 AND THE YEAR AHEAD

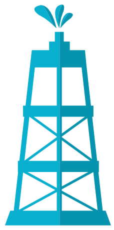
34%

of investors believe that pricing of assets and performance are the key issues in the asset class over 2017.

33%

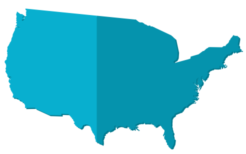
of investors believe their natural resources portfolio will perform better in the next 12 months, while 17% believe it will perform worse.

OPPORTUNITIES IN THE MARKET



70%

of investors believe conventional energy investments are currently presenting the best opportunities in the market.



65%

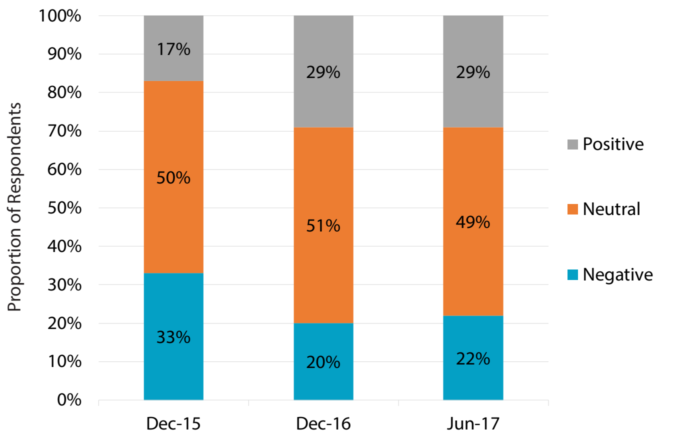
of investors believe North America is currently presenting the best opportunities in the market.

SATISFACTION WITH NATURAL RESOURCES

While the performance of unlisted natural resources vehicles continues to recover some ground over the second half of 2016, institutional investors' perception of the natural resources asset class remained static over H1 2017 (Fig. 8.1). Placed in the context of 2015, when the new normal for oil prices had begun to impact on the performance of the industry, and 62% of investors interviewed by Preqin were dissatisfied with their returns, this therefore signals a shift in investors' attitudes.

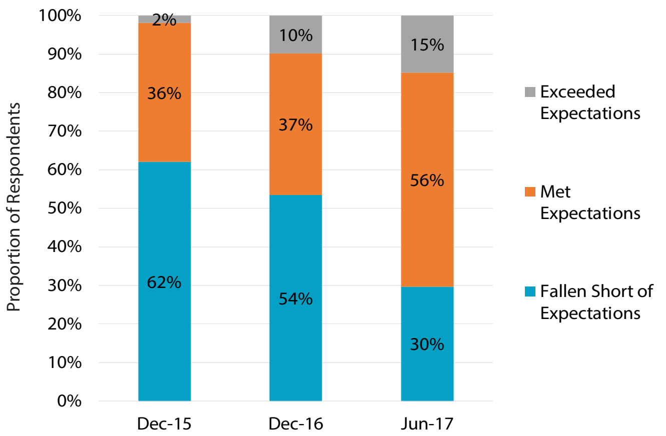
For the first time in two years, the majority of natural resources investors have found the performance of their natural resources investments have met or exceeded their expectations over the past 12 months (Fig. 8.2). Accordingly, the proportion of investors seeing investments fall short of their expectations dropped from 54% in December 2016 to 30% in June 2017, although this still represents the largest proportion seen across closed-end alternative asset classes. While there has been no discernible rise in the proportion of investors with increased confidence in natural resources performing to portfolio objectives, the proportion of respondents with reduced confidence has fallen from 27% in December 2015 to 13% in June 2017 (Fig. 8.4).

Fig. 8.1: Investors' General Perception of the Natural Resources Industry, 2015 - 2017



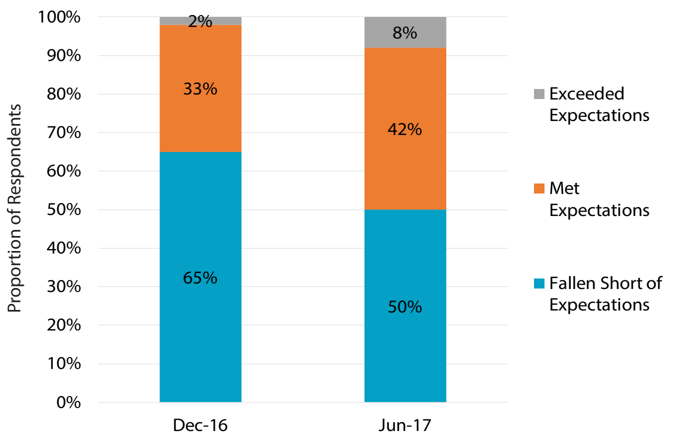
Source: Preqin Investor Interviews, December 2015 - June 2017

Fig. 8.2: Investor Views on Natural Resources Portfolio Performance over the Past 12 Months Relative to Expectations, 2015 - 2017



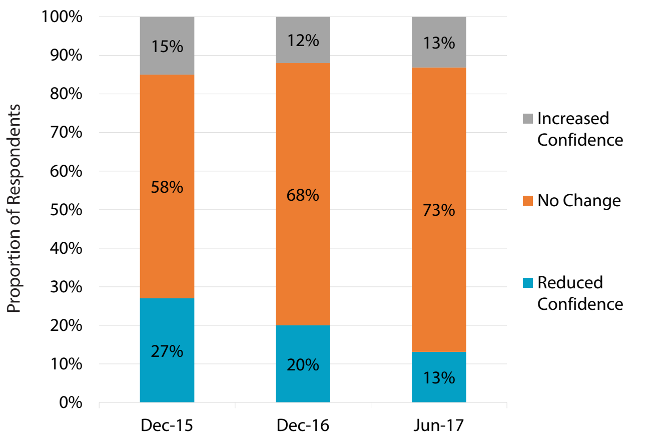
Source: Preqin Investor Interviews, December 2015 - June 2017

Fig. 8.3: Investor Views on Natural Resources Portfolio Performance over the Past Three Years Relative to Expectations, 2016 vs. 2017



Source: Preqin Investor Interviews, December 2016 - June 2017

Fig. 8.4: Investors' Change in Confidence in the Ability of Natural Resources to Achieve Portfolio Objectives in the Past 12 Months, 2015 - 2017

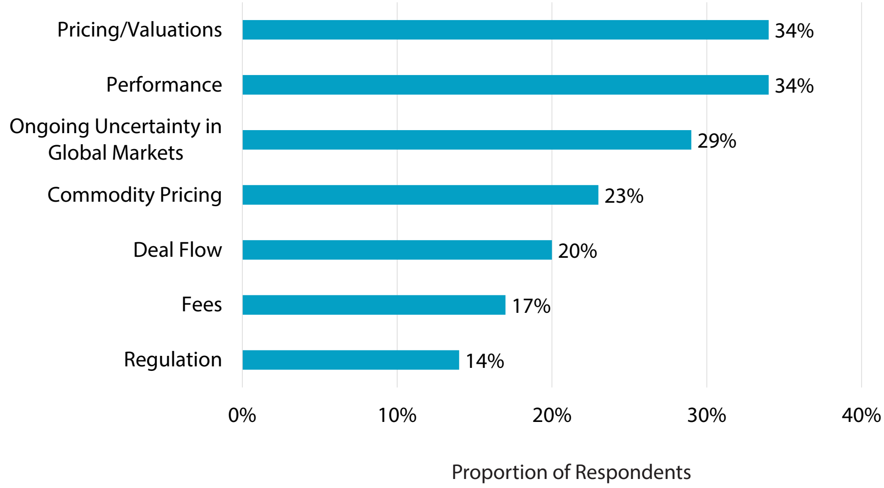


Source: Preqin Investor Interviews, December 2015 - June 2017

KEY ISSUES IN 2017

Since our last survey of institutions in December 2016, there has been a shift in investors' perception of the key issues facing natural resources. Similarly to issues seen across closed-end alternatives, the pricing of assets has emerged as the joint leading issue among respondents, cited by 34% (Fig. 8.5). Up from 23% at the end of 2016, the issue replaces volatility and uncertainty in global markets as the major concern for institutions. While performance (34%) and uncertainty (29%) remain at the forefront of investors' minds, both have declined in prominence since the 2016 survey, when they were each cited as key issues by 41% of investors.

Fig. 8.5: Investor Views on the Key Issues Facing Natural Resources in the Next 12 Months



Source: Preqin Investor Interviews, June 2017

PRICING

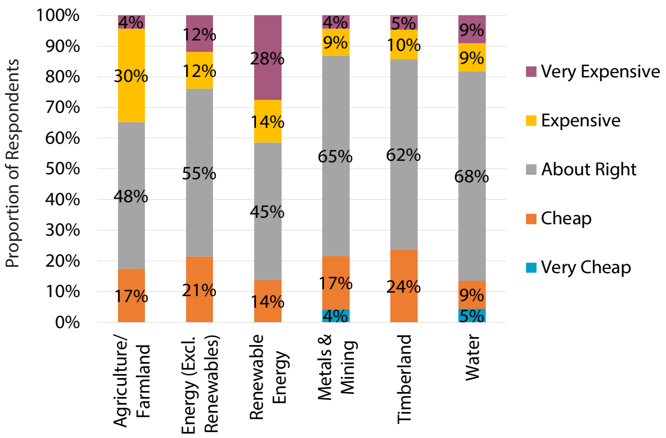
Higher valuations off the back of recent record fundraising totals have put pressure on an industry with a limited supply of projects for investment. However, the market does contain a wide variety of sectors; some are highly saturated with participants, such as energy, while others are less so, like water and timberland. Some conventional energy assets have been negatively affected by the fall in oil prices in 2015, and because of this, a relatively large proportion (21%) of investors believe that assets can be acquired at relatively cheap prices (Fig. 8.6). Conversely, in renewable energy where demand is high, 42% of respondents feel asset prices are expensive, including 28% that see them as very expensive.

PERFORMANCE

Unlisted vehicle performance is still the leading issue among natural resources investors, with many particularly concerned over funds that they invested in at the time of higher commodity and oil prices and how these will fare in the longer term. However, 40% of investors surveyed believe commodity pricing will have a positive impact on performance over the rest of the year, compared to just 18% that believe it will have a negative effect. Furthermore, more investors predict a positive impact on performance than when surveyed at the end of 2016, when 35% thought commodity pricing would have a positive effect and 21% believed it would have a negative effect.

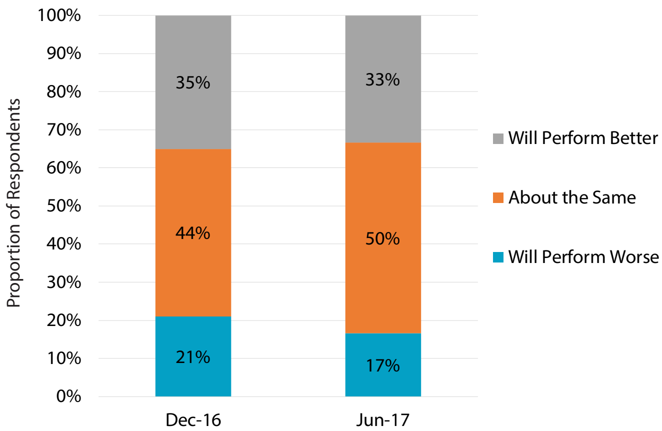
However, investors' performance expectations for the natural resources asset class in next 12 months have remained relatively unchanged from December 2016, with half of those surveyed expecting their portfolios to perform to the same levels as they have in the previous 12 months (Fig. 8.7).

Fig. 8.6: Investor Views on the Pricing of Natural Resources Assets by Strategy



Source: Preqin Investor Interviews, June 2017

Fig. 8.7: Investors' Return Expectations for Their Natural Resources Investments in the Next 12 Months Compared to the Previous 12 Months, 2016 vs. 2017



Source: Preqin Investor Interviews, December 2016 - June 2017

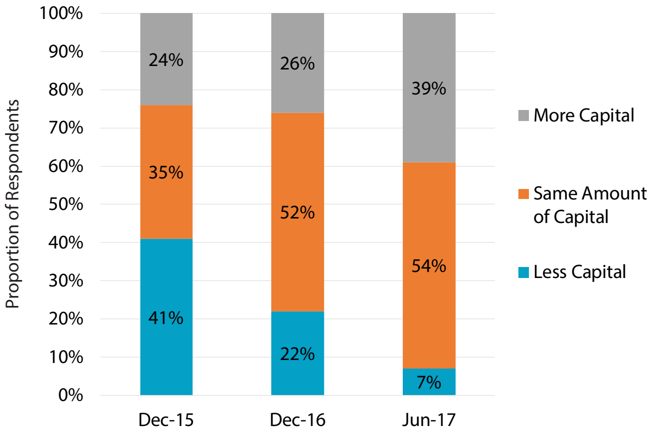
INVESTOR ACTIVITY IN THE NEXT 12 MONTHS

At the end of 2016, institutional investors were being cautious in their approach to investments in the upcoming year. However, natural resources investors surveyed in June 2017 are taking a more bullish approach to the next 12 months: 39% of respondents will commit more capital to natural resources in the year ahead, up from 26% in December 2016, Fig. 8.8. The proportion of investors looking to commit less capital has fallen from 22% in 2016 to just 7% in 2017. Short-term plans are heavily weighted to capital flowing into the asset class, while over the longer term, the majority of investors will maintain their natural resources allocations.

Data from Preqin's **Natural Resources Online** shows that the majority of forthcoming commitments will be smaller in size: 54% of active institutions are looking to invest less than $50mn in the year ahead, although there are still some investors that may well make larger commitments to the asset class (Fig. 8.10). In addition, these commitments are also likely to go to fewer vehicles, with 85% of active investors targeting just one or two fund commitments in year ahead.

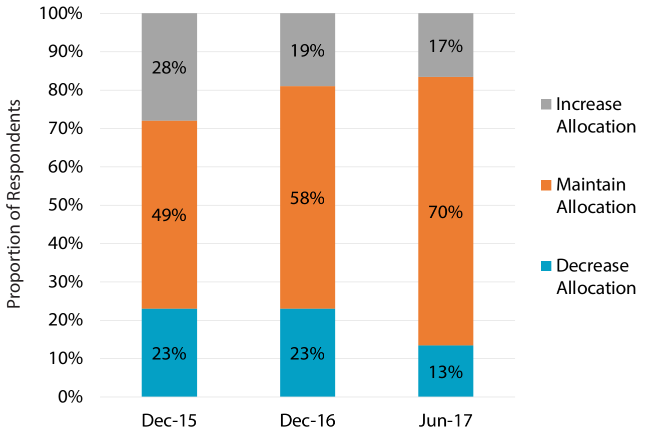
Alternative ways to access natural resources have been gaining traction in recent years, particularly with the adoption of co-investments. As such, a significant proportion of surveyed investors are looking to ramp up their investments in these areas over the next 12 months: 55% will increase co-investment allocations and 41% will increase their direct investments (Fig. 8.11).

Fig. 8.8: Investors' Expected Capital Commitments to Natural Resources Funds in the Next 12 Months Compared to the Previous 12 Months, 2015 - 2017



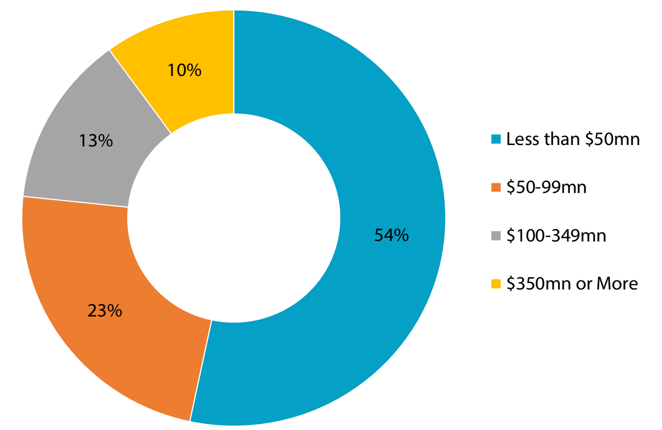
Source: Preqin Investor Interviews, December 2015 - June 2017

Fig. 8.9: Investors' Intentions for Their Natural Resources Allocations over the Longer Term, 2015 - 2017



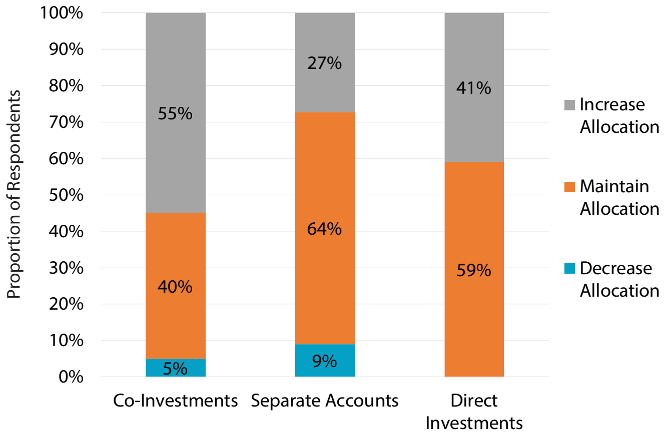
Source: Preqin Investor Interviews, December 2015 - June 2017

Fig. 8.10: Amount of Fresh Capital Investors Plan to Invest in Unlisted Natural Resources Funds over the Next 12 Months



Source: Preqin Natural Resources Online

Fig. 8.11: Investors' Intentions for Their Allocations to Alternative Natural Resources Structures in the Next 12 Months



Source: Preqin Investor Interviews, June 2017

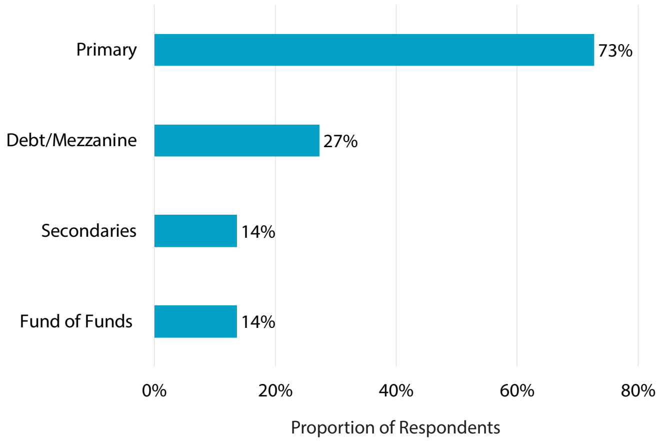
STRATEGIES AND GEOGRAPHIES TARGETED

With capital commitments to natural resources vehicles set to increase over the coming year (see page 59), primary funds are the strategy that investors identify as the most attractive for opportunities in the current market (73% of respondents, Fig. 8.12). This is followed by debt/mezzanine natural resources funds – a growing area within the unlisted natural resources space – which were cited by 27% of respondents.

Energy is by far the largest market within natural resources and is considered the most promising sector for natural resources investment (Fig. 8.13). Recent innovation has increased the efficiency of renewable energy technology to the point that it is economically competitive with conventional assets. Furthermore, there remains a strong international commitment to alternative sources of conventional energy production. As such, 55% of institutional investors believe that renewable energy presents the best opportunities in the current market.

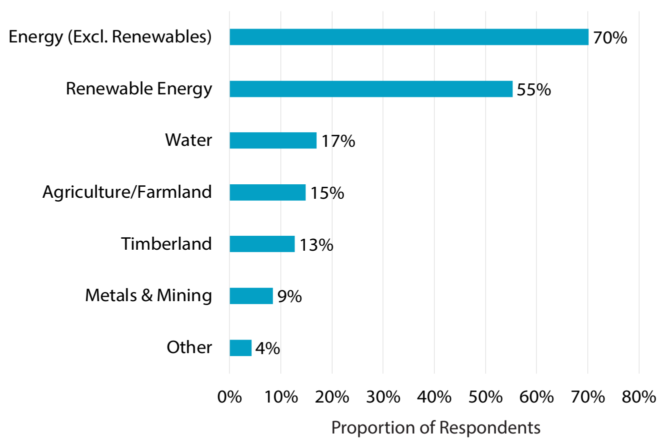
Regionally, North America is perceived as presenting the best investment prospects by 65% of respondents, followed by Europe (35%) and Asia (23%, Fig. 8.14). Emerging markets were only specified by a small proportion of surveyed investors; however, institutions are seeking to capture the opportunities for higher returns and a more globally diversified portfolio in the longer term. Twenty-seven percent of respondents plan to increase portfolio weightings towards emerging markets, while only 2% plan to reduce emerging markets exposure, and a further 8% currently have no allocation but expect to invest in the longer term.

Fig. 8.12: Strategies* that Investors View as Presenting the Best Opportunities



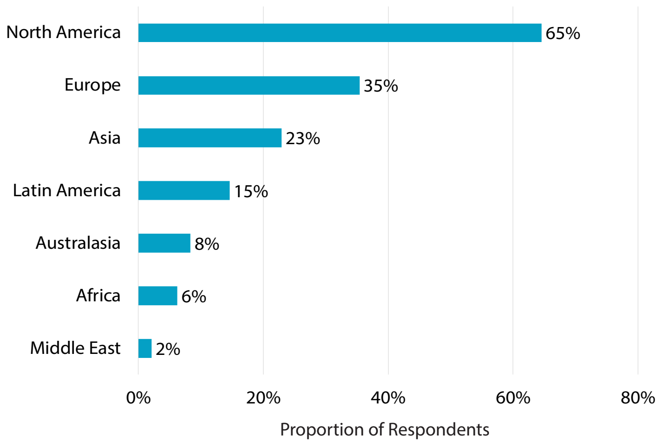
Source: Preqin Investor Interviews, June 2017

Fig. 8.13: Sectors* that Investors View as Presenting the Best Opportunities



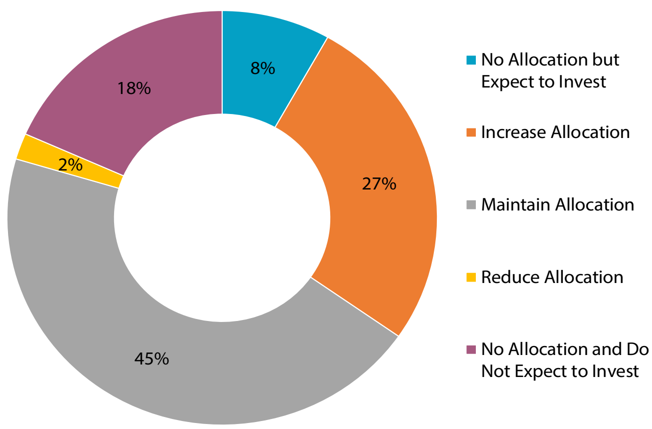
Source: Preqin Investor Interviews, June 2017

Fig. 8.14: Regions* that Investors View as Presenting the Best Opportunities



Source: Preqin Investor Interviews, June 2017

Fig. 8.15: Investors' Expected Change in Their Allocation to Natural Resources in Emerging Markets over the Longer Term



Source: Preqin Investor Interviews, June 2017

**Respondents were not prompted to give their opinions on each category individually but to name those they felt best fit these categories; therefore, the results display what was at the forefront of investors' minds at the time of the survey.*

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PREQIN INVESTOR OUTLOOK: ALTERNATIVE ASSETS

H2 2017

PREQIN

Alternative Assets Data & Intelligence

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