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Amanda Hale

Hi, I'm Amanda Hale, welcoming you back to episode two of our Industry Perspectives podcast series, where we explore the latest themes shaping financial services.

To recap, in episode one we had a conversation on the latest developments in the private markets space.

Where amongst other things, we discussed what opportunities had arisen for unlocking capital and driving value,

How this can differ depending on the jurisdiction in which business is being done, or the asset class being invested in,

The next wave of market innovation, and

What market structures could look like in the short term.

In episode two we are rejoined by our industry guests, Viral, Michael, Daniel and Rajiv.

In this episode, we expand on what market structures could look like in the next five years,

Opening-up alternatives to retail investors, exploring both the potential benefits and risks,

And whether the high returns experienced in the private equity space are now behind us.

Let's get straight back into the conversation...

Longer term, what are your thoughts on what market structures could look like in the next five years?

01:15

Daniel Pietrzak

I mean, I'm happy to start, but I don't, at least on our side, I'm not expecting what I call necessarily a lot of change as it relates to structures. I think there could be a broadening of the types of things that could get invested in. I mentioned before, I think you're seeing more of a maybe desire on the credit thing to go beyond just direct lending to include asset-based finance. I think Mike hinted at this pretty well. I think diversification is most investors like friend, right? Especially in a credit business where it is more focused on downside protection. You're not playing for the upside. I think you could see pools of capital that are investing in almost anything that we might be doing on the private credit side versus a narrow vertical that's one or the other, maybe even broader than that. But I think it's more about structures look the same, maybe just additional asset classes from a diversification perspective.

02:10

Rajiv Amlani

Just maybe one thing we talked a little bit about retail, but institutionally, the one thing we're seeing as a bank is that access point is changing structurally in terms of you used to traditionally have just LPGP co-mingled funds. And now you have tailored SMAs, you have ways of getting exposure via rated feeders and CFOs and principally protected structures. And I think that is maybe the innovation in the institutional side that we haven't necessarily talked much about. But that will probably continue to evolve depending on the capital requirements and the regulatory regimes in various different countries. And we're seeing a lot of education going on in that regard as well.

02:54

Daniel Pietrzak

I think the one thing that's been interesting there is you've seen more and more institutional investors building out what I'd call dedicated allocations to private credit. If you go back 10 years ago, probably even seven years ago, if we were raising a flagship fund on the institutional side, most people did not have a private credit allocation. So, they're actually going into their private equity bucket and pulling from there because it's the only place where they had long duration assets that they could invest into. And arguably, that didn't make a lot of sense, right, because private equity firms were trying to make much higher returns than what the credit funds were doing. But now you fast forward to today, not only does everyone have dedicated allocations to private credit, but they've also generally been increasing over time. So, I think that's the big story of why the industry has grown. It hasn't happened overnight. It's been a long journey. But I think that is an important part of the story here.

03:53

Michael Dryden

And just furthering down on what you were mentioning, like one of the things that I always think about is that if you look at most banks, they're all set up in the investment banking side for the most part. And Raj can comment on this further if Citi is changing this as well. But you have the equities division and the fixed income division, similar to most institutional LPs. The dance point, they had an equities allocation and they had a fixed income allocation. And one of the real evolutions that we're seeing is folks looking at dedicated allocations, but importantly, looking at that risk adjusted return spectrum and that there is really a spectrum from fixed income all the way to public equity. So, you have obviously private equity. You've got private credit. You've got asset-based finance. And you've got all these different points along the curve. And how do you be able to really sort of look at that curve to be able to drive better returns? And I think that we're seeing that. One thing that I would say is part of the reason for that also has been interest rates, I believe, at least. I think if you were to look at it in a low-rate environment, you almost do have to sort of barbell a portfolio depending upon the returns that you're looking for, because so much of your return was in sort of assets that actually were below any type of sort of benchmark you were looking to achieve. But as interest rates have become a little bit more elevated, you do have that ability to be able to create that curve. And I think that's something that is going to continue to be evolving over time where you have folks really looking at trying to be more precise as it relates to like what that risk adjusted return profile is.

05:25

Matthew Cherrill

So, over the past few years, we've seen the development of semi-liquid funds such as interval, tender offer, and evergreen funds in the US, VCCs and developments in open-ended long term investment funds in Singapore, the EU, and the UK. In Australia, ASIC has outlined a roadmap to unlock opportunities and tackle emerging risks by embracing new capital flows and technologies, keeping pace with evolving investor needs and making it easier for business and growth capital.

For private markets in particular, the roadmap outlines that the regulator needs better tools from government for effective supervision of funds.

So, within this constantly evolving landscape, opening up alternatives more widely to retail investors may create new opportunities for product development and innovation, but could also present risks.

What are your views on this?

06:15

Viral Patel

Well a few things, I guess. Like I think, you know, anytime you open up a market to a new investor group, you have questions around suitability, questions around risk could come up. And I think it's incumbent on all parties, frankly, the managers who are creating product, the financial advisor community that are working with clients and then ultimately the clients themselves to make sure that education is a big piece of the process. We're, in at least in my opinion, I think we are in the very early stages of a pretty large secular shift of capital flowing into this sector. And I think as we do that, you really have to be mindful of how these products are being set up. I mean, we've been at this for a while now.

I think we first took in capital from individual investors into our drawdown funds well over 20 years ago. We launched a dedicated private wealth business in 2011. And today we manage close to 290 billion just in the private wealth channel.

And I think a big piece of what we're spending time on is that education side of things. Right. And so we do these things called Blackstone University, where we bring financial advisors and individual investors together to actually get an introduction on all to get exposure to how to think about these asset classes. And so there's no doubt that when you create new products, there's going to be risk that potentially could come about. I think it's really just educating the market on what those risks are, frankly, how one should be managing them and how appropriate or not, how to size those risks for an individual investor is an important aspect as well. But, you know, I think while the risks are there, I think the benefits are incredibly exciting for investors. And so it's just a matter of managing it.

08:07

Daniel Pietrzak

I think Viral said a bunch of things in there that was spot on. I do go back to the, I mean, yes, there has been some of this, you know, quote unquote, innovation, but I think that's been more about getting, you know, kind of access.

We as well are spending a lot of time on the investor education. We call ours KKR academies. But again, it's bringing, you know, kind of the advisor and the investor community sort of in. We're trying to provide a fair amount of consistent research or sort of thought pieces out there.

You know, I think if there's one thing that the industry is looking to be mindful about is on that education piece, not just educating people on the underlying, but the way these structures sort of work. And the majority of the market out there is maybe even more than the majority set up is more the semi-liquid structure. So it's not intended to be a structure that's purely liquid. It would have some amount of sort of caps on a quarterly basis, but there is kind of that redemption sort of feature. I think those caps are there to protect all investors because one of the big reasons you're getting this excess return is the illiquidity of the underlying. And I think you need to be mindful about setting up these structures that can manage through periods of volatility.

And we do kind of manage on our side these pools of capital differently than we would manage a regular way drawdown fund. Like as a drawdown fund, you wouldn't have any concept of redemptions. You wouldn't have arguably any liquid assets or sort of cash in there. But here you do to manage that. Right. But it's that education piece about the underlying, the portfolio construction, the mechanisms of the structure that I think are really important. And I think the industry has done a very good job of that thus far and will continue to do so.

09:58

Michael Dryden

And maybe just complimenting both of what was said because I think it's very much aligned. Clearly, I don't think anyone disagrees that this market is here and going to continue to grow as it relates to having more retail investment into this phase. I think really to Dan's point, what we're constantly focused on is what is the structure of that of those vehicles? Because, again, the liquidity or lack of liquidity of these different structures and the perception of what that liquidity is or the illusion of what that liquidity is at some point in time, we always think they're really important. In addition, the structure, obviously, design create outcomes as well. If you think about it, if capital comes in and it's required to be invested, people invest. And you want to be able to understand how to think about investing a time when there is market dislocation versus investing a time where there's excess liquidity and what does that do from a supply demand perspective as well. And so I really we always think of ensuring how do you think about structure of these different vehicles, not just on sort of as Dan mentioned, of the liquidity profile on the way sort of out of a vehicle if folks are looking to monetize, but also on the structure on the way into vehicles as well. Because you want to be in a position of actually not being forced into investing at different points in time and really looking at being able to time when you're looking to invest into markets and being in a time where you actually think markets may be priced out and you don't want to be investing. And so I think, again, structure of these

vehicles is going to be of paramount importance to be able to get people the access that they're looking for.

11:31

Amanda Hale

We've seen commentary about the good old days of high returns in private equity being behind us.

I'd be very keen to get your views on that.

11:40

Viral Patel

Look, I think a couple of things. If you look at returns across the private equity industry, they continue to actually be quite strong. I'd say what is behind us are the good old days of how, maybe I don't even know how good they were, but how the way in which private equity may be made, made its money. You know, if you went back 30, 40 years, it was the leverage buyout business, right? You were taking businesses, putting more leverage on them and making a lot of return that way. I think today's private equity is very, very different than that. I think today's private equity industry is much more about navigating choppy markets, picking the right sectors of the economy to invest behind, but then almost more importantly, transforming our businesses through a significant amount of operational resource and value add that we bring to the company, right? We're not typically buying a company and just letting it do what it was doing before. We're thinking about, you know, is this, are we opening it up to a new market? Are we driving new product lines within it? Are there management changes that need to be done, efficiencies, and how they run the business? So there's a lot that we actually think about to drive returns. And if you look at returns today, more return is coming from those value add initiatives than it is from, you know, multiple expansion or leverage. And I think as the industry matures and continues to mature, I think the managers that are able to bring that sort of expertise and value add resource to the table are going to be the ones that benefit the most. Frankly, it's part of the reason why, you know, the private credit market has gotten so interesting for private equity managers because the private credit market affords us a lot more flexibility in order to actually execute on the strategies that we want to go after, right? Private credit can be a little bit more of a partner to us versus the syndicated markets, which are a bit more opaque and harder to work with. And so I think the returns in private equity will continue to be strong for those managers that focus on driving, you know, value add initiatives in their businesses. But you can't just be, you know, you can't be a potted plant and just watch your avenues. That's not going to work.

13:52

Daniel Pietrzak

Exactly right about kind of the before and sort of what is today in terms of the value creation plans. But and we're seeing this all the time as well. There are just different, you know, the industry sort of changes, right? I would say, Viral, the roll up strategies were a big thing for the longest time. Now you are seeing Japan as a big theme. You're seeing public to private happening again. You're seeing other sort of forms of carve out. So I think, you know, I think it'd be unfair to say that the good days of high returns are behind the industry.

14:23

Michael Dryden

Maybe one thing to add, and I'm not going to comment specifically on private equity, but I think what Viral and Dan were saying, I think is very important because I don't think we've actually talked about it yet here, is really dispersion. I think if you really sort of think about it, I think the next sort of number of years dispersion of different managers' performance, we think is going to continue to sort of expand. And the reason for that is if you really look at it in private equity and frankly, in some of these other asset classes, including like real estate. If you look at really like the last four years, it's been a one way trade of interest rates from like the mid 80s until sort of a couple years ago. And so that one, you know, direction view of interest rates actually really covered a lot of, sort of, potential mismanagement or just not great management. And people still had good returns just simply because if you bought something that had a decent amount of duration and interest rates went down, you sort of won. And so I do think to Viral's point, like dispersion and how that comes about, it's going to continue to exacerbate clearly in the private equity world. But I think across all these different areas. And so I think that what we're going to see here is less about sort of our high returns behind us. It's more the fact that the ability for everybody to generate high returns may be behind us. And it's going to be more something where we're going to be dispersion amongst different managers. And that would then value add to the table or really bring asset selection to the table or bring out an inclusive table or differentiated them sort of a directional view of that.

15:54

Rajiv Amlani

And fundamentally, I think private equity is not going anywhere. Right. If you think about the number of publicly traded companies, it's dropped by nearly half over the last three decades. So companies are staying private for longer. There's significant dry powder to invest. I think there's been two recent very large take privates with EA, Electronic Arts, and Whole Logic as well. So the asset class isn't going anywhere. And to the points being made, it's going to be about the right managers backing the right managers and then finding a way to create value other than just by use of leverage, which, you know, in a low to zero interest rate environment, it was easier to get. And it's just much harder now. So the other thing I'd mention is if you do want access from an asset class perspective to transformative technologies, it feels like a lot of those are being funded within the private equity ecosystem and world. And so you probably still have scope to make good money, but it's just a little bit higher in a higher rate environment at the moment.

16:57

Matthew Cherrill

Different private market strategies could be seen as addressing different investor needs. For example, private credit strategies can offer insurers an attractive source of yield within insolvency constraints. While infrastructure, with its longer investment duration, could be said to be better suited to income generation.

Alternatively, one could also observe a blurring of the lines between pension funds, sovereign wealth funds, private equity, private credit and asset managers within the private market space. In terms of all these segments investing in the same way.

Is the space too crowded, perhaps changing the risk and reward metrics?

Rajiv, what are your thoughts?

17:33

Rajiv Amlani

I think from a coverage perspective, we definitively can see a blurring of the lines between all of the players you mentioned.

What was once a distinct investment domain for pension funds and sovereign wealth funds as capital allocators to GPs, they've now become, in some cases, direct participants in deals operating somewhat in the same way as the GPs that they provide capital to. Traditional asset managers are making a push into private markets, either via acquisitions or via joint ventures. And this is manifesting in increased competition for finite deal flows. So to the point around risk reward, it's potentially changing deal structures, covenants and pricing. So, yes, risk reward could be changing. At the same time, I think there's a lot to do in the private market space. It's a very broad space. And if you think about structural shifts that are happening, which will need to be funded via private markets, for example, energy transition, digital infrastructure expansion, I think that in combination with innovation that we talked about earlier should keep us all fairly busy for a long while to come within this space.

18:47

Amanda Hale

As we draw to a close can I ask your opinions on what's the single most important thing that listeners should take away from our discussion on private markets?

Daniel?

15:58

Daniel Pietrzak

Yeah, we covered a lot of ground, a bunch of different sort of things here.

For me, it's about the idea of this kind of whole idea of private markets or the things that are happening here is kind of not new. Like we've been talking about that for a long time in a bunch of different sort of formats, right? I mean, I think on the credit side specifically, private credit existed before the financial crisis. BDC's existed. GE, CIT had lending businesses, arguably every deal that we did at a bank that held it on its banks balance sheet and didn't syndicate it out with some form of private credit. And then there has been a lot of growth, but that growth has taken, let's call it 17 plus years since the financial crisis to get. And you go back to my points on institutional investors and allocations. And now I think we're providing this access for other sort of investors, i.e. wealth to sort of invest into. So, I think it's been a

long sort of story. I think if you do read some of the newspaper articles, you would think it started like two years ago. And that's kind of just not a correct sort of thing. So, I would focus on that and try to focus on the actual facts versus kind of the headlines.

20:14

Michael Dryden

Yeah. And just to compliment Dan's point, like the market has been evolving and budget structure will continue to evolve in general.

The ability to access on the asset side, the additional ways of being able to access investment in new assets is continuing to grow with technological enhancements.

And the ability for individual and institutional investors to be able to look at finding ways to invest across a capital structure, across the investment spectrum, we think will continue to grow as well. And there's evolution, that's going to continue to happen. And that's going to be that intersection between private markets and public markets will continue to evolve. And I think it will allow for people to be able to have greater access points rather than concentration amongst a handful of individual sort of either investors or individual business within their life.

21:07

Amanda Hale

Viral?

21:08

Viral Patel

Maybe to round that out, I guess what I would say is, you know, following on Dan's point about this being not new, you know, the private markets are where a lot of the opportunity for investing exists today. It's been that way for a very long period of time. And I think it's important for your listeners to understand that, right? You're seeing more companies, at least on the private equity side, more companies staying private for longer.

You know, Raj mentioned this, but there's so much value creation that's happening in the private markets. So we get very excited by all of the expanding access that's happening for individual investors today. You know, we talked a lot about the innovation and the opportunity ahead. And we are early innings of this secular shift in wealth management.

And all because I think that individual investors are starting to realize the benefits of this, of the private markets that our institutions have enjoyed for the past 20 plus years.

22:05

Amanda Hale

Rajiv?

22:07

Rajiv Amlani

I think my message would be that there is maybe a bit of a perception that private markets are risky. And that's just simply not true. There's a spectrum of risk, right? And we have that spectrum of risk being articulated on this call via Michael and Dan and Viral, right? You've got private equity, which you ultimately should be getting paid for because you are taking risk. And then you've got the investment grade part of the ABF world or the corporate world where you're taking less risk, being paid less, but still being paid an illiquidity premium by accessing the private part of the market rather than the public part. So I think that would be the message. It's a growth area. It's probably something that should be embraced in the right way in your exposure and in someone's exposure. But it depends on your own risk reward and your tolerance for that.

22:58

Amanda Hale

Rajiv, before we conclude, can you just touch on some of Citi's latest innovations in the private market space and how these are helping clients?

23:06

Rajiv Amlani

At Citi, we really try and find a way to differentiate ourselves. And even though it's a bit of a cliché, we pride ourselves on client service as a core offering and that includes superior coverage, structuring and distribution. So within Spread, where I sit, we've had a number of client mandates that have been given to Citi purely just for structuring roles, especially when it comes to large and complex trades. So we have the advantage of being a truly global bank, which means we see a lot and we can use that as a way of thinking about solutions for clients and innovating. On the banking side, we've grown the private credit origination effort and recently hired Aashish Dhakad to lead that for us. Within that business, we focus on advising corporate clients across investment banking, corporate banking and commercial banking to raise capital.

And the evolution of private markets has provided these companies with various different options and greater access to capital today than ever before. So I think Citi has a very important role to play in the private market ecosystem and we want to use our global footprint and our structural innovation to really bring interesting opportunities to our many investor clients like Dan and Viral and Mike, who are on the call with me today.

24:21

Amanda Hale

Thanks, and there are just a few other examples, such as Citi joining up with SDX as a custodian and tokenisation agent on the latter's digital central securities depository platform, bringing late-stage pre-IPO equities to institutional and eligible investors on the SDX platform.

Citi's collaboration with SDX unlocks access to digital private market assets for global issuers and also, investors.

Citi's also published some excellent thought leadership content covering the private market space. For example, the Create Research Citi survey report "Rebooting the Global Asset Management Industry" and then more recently Citi Institute's GPS private markets access innovation and new pathways to progress reports.

25:13

Matthew Cherrill

Citi also has global capabilities via its proprietary custody network, providing solutions to our clients to invest in, hold, and for us to service private market instruments using industry leading technology.

The shift of assets and investment to private market instruments is prolific, which brings unique levels of complexity at an asset, and geographic, level.

Hence Citi's model has been adapted to facilitate this growing asset class, whilst leveraging Citi's global transfer agency, and direct to transfer agency, business models also provides a frictionless subscription, settlement, and servicing capability to this non-standard global asset class.

25:51

Amanda Hale

I'd just like to conclude by issuing my thanks to all of our guests. So, Daniel, Michael, Viral and Rajiv, along with my co-host Matthew for joining the discussion today. Thank you, everyone.

26:03

Viral Patel

Well Amanda, Matt, thank you so much for having me. It's been a wonderful conversation, and I hope all your listeners got a good understanding of why we are so excited about what's happening in private markets today.

26:14

Michael Dryden

Thanks everybody for the time today was great to great to be part of this and Viral Daniel was great to join yourselves in this conversation. Thanks all.

26:23

Daniel Pietrzak

Well, thank you so much for having me on here today. I thought the conversation was great. Viral, Mike, I enjoy being with you. Hope all the listeners enjoyed the content here today. Thank you.

26:33

Amanda Hale

You have been listening to our Industry Perspective podcast series.

We look forward to you joining us for our next episode.