Beautiful in Their Own Way

Stockholm (HedgeNordic) – Faced with an ultra-low and "lower for longer" interest rate environment, institutional investors have increasingly turned to private markets to offset their lower-yielding bond portfolios. "This is a very prominent explanation and it is very often highlighted that institutions are going for private markets due to the interest rate levels," says Christoph Junge, Head of Alternatives at Danish pension provider Velliv. But he believes that that is only part of the explanation for why the private assets space has become an increasingly attractive market for institutional investors. The more mature operational processes within private markets have equally facilitated investment in the space.

"Institutions have been investing in private equity or real estate for at least the last 20, 30 years," Junge tells HedgeNordic. "Some asset classes have been becoming more mature during the last ten to 20 years. Many alternative asset classes were not mature enough and the deal volumes were not what they are today," he continues. "The energy transition with a lot of projects coming to the market during the last ten years certainly helped drive investor interest towards private markets." With these asset classes becoming more mature and the private assets space becoming ever larger, allocating capital to the space is a no brainer for long-term oriented investors. "For us, institutions and pension funds with a very long investment horizon, it is a natural fit to invest in long duration assets and take on some liquidity risk to get higher returns in return."

"For us, institutions and pension funds with a very long investment horizon, it is a natural fit to invest in long duration assets and take on some liquidity risk to get higher returns in return."

Heterogenous Space and Roles

The private assets space is highly heterogenous, and each alternative asset class from this space is heterogenous in its own way. Velliv, the third largest pension company in Denmark, is allocating about one tenth of its DKK 280 billion under management to a range of alternatives, including private equity, alternative credit, infrastructure, timberland and liquid alternatives. "Private equity and private debt are the largest building blocks and then comes infrastructure and then a smaller allocation to timberland and liquid alts," says Junge.

"The role of the private assets space in a portfolio really depends on the asset class we are speaking."

Each alternative asset class plays a different role in Velliv's portfolio. "The role of the private assets space in a portfolio really depends on the asset class we are speaking," Junge tells HedgeNordic. "Investing in private equity, for instance, is all about having higher returns than on public equities," says Velliv's Head of Alternatives. "There are only minor diversification benefits from private equity as it is the same macro factors driving returns in both listed and unlisted markets. But given that the majority of companies in the world are not listed, you get a much broader investment universe by investing in private equity," says Junge. "The markets are also less efficient, so you'll have better possibilities to create value or alpha," he continues. "Investing in public equities is like taking the passenger seat in the car. When investing in private markets, you literally take the driver's seat because you (or the manager) normally buy into controlling stakes, or even a hundred percent of the companies."

"Investing in public equities is like taking the passenger seat in the car. When investing in private markets, you literally take the driver's seat."

"Each alternative asset class, therefore, is attractive in its own way."

"Private credit is also about higher returns than the liquid counterparts," continues Junge. "In infrastructure, on the other hand, we are targeting stable returns," says the Head of Alternatives. "We are not aiming for returns in the range of 15 to 20 percent from infrastructure investments. That is not why we are investing in infrastructure," he highlights. "It is stability and inflation hedge that is relevant for infrastructure investments as they add stability to our portfolio," says Junge. "Then there is all the liquid alternatives space where we expect to get some crisis alpha. Each alternative asset class, therefore, is attractive in its own way."

Outsourced Investments

With a team of five focused on alternative investments, Velliv delegates the majority of their alternative investments to external managers. "We tend to say that we are specialists in selecting specialists, so that is our philosophy," argues Junge. "This is what we are good at and honestly, I don't think that we are better in sourcing deals in the U.S. or in Australia than people with boots on the ground who have an established network in these parts of the world," he continues. "Last but not least, of course, we get much better diversification by investing in alternative investments through funds. It takes some quite big tickets to invest directly."

"We get much better diversification by investing in alternative investments through funds. It takes some quite big tickets to invest directly."

Velliv cooperates with BlackRock and Nuveen for private equity investments outside Denmark. "We are only taking care of private equity in Denmark and BlackRock is covering Europe and Asia Pacific and Churchill Asset Management, an investment-specialist affiliate of Nuveen, is covering North America," explains Junge. "We have set up a fund of one with each of these, where they allocate two thirds to primary investments and one third to co-investments," he continues. "Co-investment is an important building block to bring down the overall fee load."

The manager selection process "starts with the investment strategy, analyzing whether it is a good fit for what we need," explains Junge. "But then we are focusing on the team in terms of both size and location," he continues. "We prefer boots on the ground, as we believe it is key to be present in the local markets to be able to source the best deals." Junge and his team at Velliv also "want to see a replicable and clearly-defined investment process or investment strategy, which is following a fixed playbook or framework." Last but not least, the team scrutinizes the track record. "The returns speak for themselves. We would like to see more consistent returns instead of one or two really high-flying deals leading in the front and then a couple of write-offs," says Junge.

"I like the private assets space and see a lot of compelling things in the asset class, but then there are, of course, other aspects we need to take into consideration."

Future Allocations

"I like the private assets space and see a lot of compelling things in the asset class, but then there are, of course, other aspects we need to take into consideration," Junge tells HedgeNordic. "It is a more expensive asset class as you can get listed equities nearly for free, and then there is illiquidity risk, so it has to be a balanced approach," he continues. Velliv, therefore, does not plan to significantly increase the percentage allocation to alternatives. "Our portfolio construction team is doing the asset allocation, but as things stand today, we are not going to change the percentage allocation," says Junge. "But given that we are having more inflows than outflows, it is natural that our dollar amount invested in this asset class will grow over the next years."

This article featured in HedgeNordic's "Private Markets" publication.