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Round Table Discussion: Private Assets

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Editor´s Note...

Flavour of the Month

For many investors, the allure of private assets has steadily gained momentum over the past year´s and became somewhat of "the flavour of the month." As traditional markets experienced fluctuations and uncertainties, investors turned towards private equity, private debt, real estate, and other alternative investments seeking stability, diversification, and potentially higher returns. Now, as we reflect on the past and take a lookout of what may be in the future, it becomes imperative to dissect the performance, challenges, and future prospects of private assets.

The aim was not only to reflect on the journey of private asset investors over the last periods, but also to glean insights that could guide future strategies.

Over the past years, the landscape of investing in private assets has undergone significant transformations. Investors navigated through economic downturns, geopolitical tensions, and the unprecedented challenges posed by the COVID-19 pandemic. Despite these obstacles, private assets emerged as resilient pillars, offering unique opportunities and value propositions.

Private equity, for instance, witnessed remarkable growth, with investors increasingly recognizing its potential to generate alpha and outperform public markets. However, this growth wasn't without its challenges, as heightened competition, sky-high valuations, and concerns over governance and transparency posed persistent hurdles.

Similarly, the realm of private debt experienced a surge in popularity as investors sought yield in a low-interest-rate environment. Yet, as the market expanded, concerns regarding credit quality, leverage levels, and the potential for defaults loomed large, prompting investors to tread cautiously.

As our discussion unfolds, it becomes evident that the performance of investors in private assets has been a tale of resilience, adaptation, and opportunity. While successes abound, so too do cautionary tales, reminding us of the inherent risks and complexities involved in navigating these markets.

Looking ahead, uncertainties persist, from the specter of inflation to the dynamics of global trade and the implications of evolving regulatory frameworks. Yet, amidst these uncertainties lie opportunities for those adept at identifying and capitalizing on structural shifts, demographic trends, and technological disruptions.

As we embark on this journey of review, lookout and analysis, HedgeNordic´s round table discussion aims to uncover the lessons learned, the strategies that proved effective, and the pitfalls to avoid.

Joining us in the discussions and sharing their views from an allocators perspective were Ulrika Bergman, CIO at the Nobel Foundation, Magdalena Högberg, the Head of Strategic Asset Allocation and Quantitative Analysis at Swedish State buffer fund AP4 and Mikael Huldt, CIO at Swedish Insurance company Afa.

The asset manager side was represented by international experts in their field, and we were pleased to welcome Nadia Nikolova (Allianz Global Investors / AllianzGI), Raman Rajagopal (Invesco), Olivier Keller (PineBridge Investments) and Zeshan Ashfaque (Man Varagon) in Stockholm for the discussion which was lead by Jonas Andersson of Navare Invest.

We hope you enjoy this write up and summary!

KAMRAN GHALITSCHI
PUBLISHER, HEDGENORDIC

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PARTICIPANTS:

THE ROUND TABLE DISCUSSION TOOK PLACE IN STOCKHOLM, SWEDEN, ON JANUARY 31ST, 2024

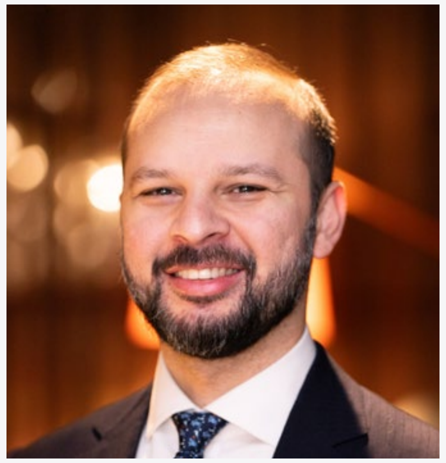
Ulrika Bergman

Chief Investment Officer

Ulrika Bergman, CFA, is the Chief Investment Officer of the Nobel Foundation since 2017 with responsibility for overseeing investments in the 6 bn SEK portfolio.

Bergman also serves on the board of Alfred Nobels Norske Minnestiftelse, Praktikertjänst AB:s Pensionsstiftelse, Sydholmarna Kapitalförvaltning AB and in the investment committee of Swedish Foundation for Strategic Research.

Previously she was CIO of the Global Equities Team at Skandinaviska Enskilda Banken AB, and before 2008 she held a position as Risk Manager at RPM.



Zeshan Ashfaque

Senior Managing Director and Senior Credit Officer

Zeshan Ashfaque is a Senior Managing Director and a Senior Credit Officer in the Underwriting & Portfolio Management group at Man Varagon.

Ashfaque has extensive experience investing in middle market credit and has originated, executed, and managed investments across a variety of structures, industries, and strategies, including stressed and distressed. Prior to Man Varagon, he worked in credit investing at Highbridge Principal Strategies, TPG Special Situations Partners, and Goldman Sachs Special Situations Group.

He earned a BBA from Emory University and an MS from The University of Virginia.

Olivier Keller

Managing Director, Private Funds Group

Olivier Keller joined the firm in 2005 and is a Portfolio Manager responsible for sourcing, evaluating, and executing private fund investments on a global basis. Before joining the Private Funds Group, Keller shared responsibilities for two listed investment vehicles in private equity and real estate. He also interned in the Private Banking Department of BBVA Privanza (Suiza) SA, Zurich.

Keller received a lic. phil. degree from the University of Zurich. He is a Chartered Alternative Investment Analyst (CAIA) charterholder and a FRM (Financial Risk Manager) charterholder.

In addition to English, Mr. Keller speaks German, Spanish and French.

Magdalena Högberg

Head of Strategic Asset Allocation and Quantitative Analysis

Magdalena Högberg, CFA is the head of Strategic Asset Allocation and Quantitative analysis at the Fourth Swedish National Pension Fund (AP4) in Stockholm.

Högberg leads a team of 18 specialists responsible for global equities, fixed income, hedge fund manager selection, portfolio analysis and asset allocation at AP4.

Högberg holds a Master of Science in Engineering Physics from The Royal Institute of Technology, Sweden and a Master of Science in Business and Economics from Stockholm University, Sweden.

Raman Rajagopal

Senior Client Portfolio Manager - Private Credit

Raman Rajagopal is a Senior Client Portfolio Manager for Invesco's private credit platform, which includes capabilities across broadly syndicated loans, CLOs, direct lending, and distressed credit.

Rajagopal joined Invesco in 2016. At Invesco, he has held roles focusing on private markets asset classes as well as in corporate strategy. Prior to joining the firm, he was a management consultant with Accenture, where he concentrated on wealth and asset management companies. Prior to Accenture, he worked in asset management roles with Oppenheimer & Co. and Morgan Stanley. He began his career as a corporate attorney with Paul Hastings LLP, where he focused on mergers and acquisitions.

Rajagopal earned a BS degree with university honors from Carnegie Mellon University and a JD from the University of Southern California Law School.

Nadia Nikolova

Lead Portfolio Manager Sustainable Private Credit

Nadia Nikolova heads the Development & Impact Credit strategies at Allianz Global Investors, currently managing over $4bn of commitments.

Nikolova joined AllianzGI over ten years ago originally as a portfolio manager in the Infrastructure Debt team and from 2016 has been focused on expanding AllianzGI's presence in sustainable investments including the infrastructure debt partnership with IFC (2017 & 2022), Emerging Africa Infrastructure Fund investment (2018), the introduction of Allianz Asia Private Credit strategy (2019) and the MIGA COVID-19 Response Program (2020), Emerging Markets Credit Insured Strategies and Export Credit Agencies (2021), SDG Loan Fund (2023).

PARTICIPANTS:

THE ROUND TABLE DISCUSSION TOOK PLACE IN STOCKHOLM, SWEDEN, ON JANUARY 31ST, 2024

Jonas Andersson

CEO & CIO

NAVARE INVEST

Jonas Andersson is the CEO / CIO of Navare Invest a single-family office investment company, active within tech, impact investing, real estate and private equity based in Stockholm, Sweden.

Prior to this position which Andersson has been servicing in since 2016, he had been working as a Senior Private Banker within the family office division at SEB for six years. Before that, he worked at Handelsbanken Regional Bank Mid Sweden as Group Head of Active Trading / Discretionary Asset Management.

Andersson holds a Bachelor of Business Administration (B.B.A.), Accounting from Uppsala University.

Mikael Huldt

Chief Investment Officer

afa FÖRSÄKRING

Mikael Huldt has spent the last two decades in portfolio management roles at large scale pension funds and insurance companies.

During his tenure he has been responsible for managing a variety of different asset classes on a global basis, but with a special emphasis on private market investments.

Huldt is currently the Head of Asset Management /CIO at Afa Insurance, a USD 23 billion institution with a 20% allocation to alternatives.

Kamran Ghalitschi

Publisher

Hedge Nordic

Kamran Ghalitschi is the founder and publisher of HedgeNordic, a media dedicated to bring news research and analysis to an audience of Nordic financial industry professionals with a focus on alternative investments and hedge funds.

Ghalitschi started his finance career in 1994 and worked in several positions as equity and options broker, in wealth management as well as in various marketing and sales roles for brokerage services and hedge funds.

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Participants (left to right): Magdalena Bergman (AP4), Jonas Andersson (Navare Invest), Nadia Nikolova (AllianzGI), Kamran Ghalitschi (HedgeNordic), Raman Rajagopal (Invesco), Olivier Keller (PineBridge), Zeshan Ashfaque (Man Varagon), Mikael Huldt (Afa Insurance), Ulrika Bergman (Nobel Foundation)

ROUND TABLE DISCUSSION

PRIVATE ASSETS

THE ROUND TABLE DISCUSSION TOOK PLACE IN STOCKHOLM ON JANUARY 31ST 2024. ALL REFERENCES TO DATES, TIMELINES, PERFORMANCES, NEWS AND EVENTS ARE TO BE SEEN FROM THAT POINT IN TIME.

Private markets have experienced significant momentum since the depths of the 2008 global financial crisis, driven by a decade of low interest rates and abundant credit availability. However, the landscape began to shift in the first half of 2022, as central banks responded to inflationary pressures by rapidly raising interest rates. While this adjustment did not completely stall momentum, the music slowed down in many corners of the private markets universe. Despite facing challenges posed by elevated interest rates and geopolitical tensions, certain corners within the private markets demonstrated resilience and continued to perform well in 2023.

Tale of Two Cities in Private Markets

"2023 for private markets was a tale of two cities, with some segments experiencing the best of times while others faced the worst of times," summarizes Mikael Huldt, Chief Investment Officer at Swedish insurance company Afa Försäkring. Private debt emerged as a

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standout performer during this period. "We observed a lot of positive fundamental tailwinds, including higher base rates, increased spreads as well as more lender-friendly documentation, driven by supply-demand dynamics," elaborates Huldt. "We had a couple more banks last year this time, which, combined with a risk-off environment and reduced accessibility to bond markets, drove a lot of interest to the private credit market."

Magdalena Högberg, Head of Strategic Asset Allocation and Quantitative Analysis at Fjärde AP-fonden (AP4), echoes Huldt's observations, noting that "While our unlisted portfolios performed as expected across the board, the private credit side stood out as the outstanding allocation within the unlisted segment of the portfolio." Ulrika Bergman, who has been steering the Nobel Foundation in her role as Chief Investment Officer since 2017, concurs with both Huldt and Högberg, affirming, "I have to agree with the other asset allocators at the table. Our allocation to private credit was definitely the best-performing private asset for us."

On the flip side, the private equity space as a whole faced challenges. "If you look at the more mature strategies such as buyouts, they suffered from low M&A activity,"

"We haven't seen it all yet. There's more to come depending on the sectors you are in."

Mikael Huldt, Afa


Mikael Huldt, Afa


Ulrika Bergman, Nobel Foundation

Huldt explains. The venture capital space was not spared either. "The introduction of a discount rate for future profits put forward real challenges for the venture capital model," he emphasizes. "Additionally, the hopes of quick flip IPOs were also turned on its head and was damaging for the market."

Ulrika Bergman, who has been building exposure in private equity at the Nobel Foundation over a number of years and is still in the portfolio-building mode, observed flat performance from the private equity allocation in 2023. "It was expected that 2023 would be more muted for the private equity allocation, given that it didn't give back anything in 2022 either," says Bergman. "However, given the extraordinary performance leading up to the end of 2021, the private equity space has still shown strong performance over the three-year or five-year period."

Magdalena Högberg and her team at AP4, who consider private equity as an equity allocation by ignoring the listing form and looking through the underlying exposure, experienced similar performance from the private equity allocation in 2023. "Private equity is something that we

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Ulrika Bergman, Nobel Foundation

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are deep in the J-curve of rebuilding. We have increased the allocation heavily in the last couple of years," says Högberg. "Even though the portfolio of private equity investments wasn't the largest contributor, there were few signs of negative performance," she emphasizes.

In the real assets segment of the private market space, infrastructure had a relatively strong year, while real estate faced a more challenging environment. "After observing stable valuations in real estate in 2022 despite negative trends in listed markets, I anticipated some adjustments in the unlisted side as well," notes Högberg. "As expected, we saw some revisions in our real estate investments throughout 2023."

Mikael Huldt observed similar downward pressure on real estate valuations. "With real estate coming out of a pandemic with the trend towards remote work and its impact on office spaces, we observed cap rates [a property's net operating income by its asset value] being way below interest rates levels, which affected valuations," explains Huldt. He concurs with Magdalena Högberg, stating, "We haven't seen it all yet." Huldt believes "there's more to come depending on the sectors you are in."

On the other hand, infrastructure assets flourished in 2023, as noted by Huldt. "Infrastructure comes in various shapes and forms," points out Huldt. "Yet, if you define infrastructure as being truly real assets often linked directly to the Consumer Price Index (CPI), significant increases in cash flows were observed, making this asset class appealing from a return standpoint," he explains. Reflecting on the entirety of the private markets landscape, Huldt metaphorically remarks, "as the tide went out, it became evident who was wearing paddock trunks and who was not."

More Nuanced On-the-Ground Views

While asset allocators possess a 'helicopter view' perspective on private market dynamics, on-the-ground managers can offer more nuanced insights into the evolving landscape.

Private Credit

"Overall, 2023 was a very good year for private credit investors," affirms Raman Rajagopal, Senior Client Portfolio Manager for Invesco's private credit platform, echoing earlier observations made by institutional allocators. "In direct lending on new issuance, we saw spreads go up, along with other other improving credit metrics such as lowering levels of borrower debt and lower levels of loan-to-value – all positive signs," says Rajagopal. "This is also the time when lenders have been able to negotiate for tighter documentation." Consequently, new issuance became more attractive

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Zeshan Ashfaque - Man Varagon

amidst these expanded economics. "Direct lenders have been particularly enthusiastic as they could offer underwritten yields exceeding eleven to twelve percent for senior secured positions of performing companies."

Of particular interest in the private credit arena in 2023 was the combination of a rise in base rates and widening spreads. "Floating rate instruments are pegged off a base rate in the United States," explains Rajagopal. "Traditionally, you do not see a rise in base rate accompanied by spread widening. However, this was the case in 2023."

Nevertheless, the challenge throughout the year in this asset class across the industry was deploying a significant amount of capital. With transaction volumes down materially, "it was very difficult to deploy a lot of capital last year," points out Rajagopal. "While from our perspective it was great to find high-quality assets with very attractive situations, the process was undoubtedly more difficult for those aiming to deploy substantial capital," adds Rajagopal. "I expect particularly impacted were those managers seeking to deploy large-scale vehicles. Smaller, more nimble strategies likely benefitted more from the market opportunity."

Despite operating in an environment characterized by higher base rates and spreads, Zeshan Ashfaque and his team at U.S. private credit manager Man Varagon chose to aim for similar, if not slightly higher, returns

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> Raman Rajagopal - Invesco

while assuming less risk. Reflecting on the dynamics of private credit, especially in U.S. sponsor-backed direct lending, Ashfaque recalls a time prior to the pandemic when lenders were taking on significant risk to achieve attractive returns. "We prioritized maintaining discipline," he emphasizes. "During periods of market dislocation, when spreads widened, our approach was not to chase additional yield at the expense of potential additional risk from an uncertain market outlook. Instead, we focused on preserving or slightly enhancing the yield we typically generate while reducing risk."

Ashfaque emphasizes that his team at Man Varagon held a fundamental belief that a base rate of one percent was not sustainable in the long term. "We anticipated that rates were more likely to rise than to fall, so we opted for managing the debt load in our portfolio," states Ashfaque. While the increase in the base rate contributed significantly to the rise in returns within their asset class, Ashfaque acknowledges the impact of this increase on the debt load across their portfolio.

"When base rates go from zero to one and then to five and a half, the debt load more than doubled, imposing a big burden on credit portfolios," he acknowledges. "This scenario favors those who have maintained prudent and appropriate leverage structures for borrowers, and made good choices regarding the types of companies to invest in." According to Ashfaque, "you have to be cognizant of the implications of this debt burden and which borrowers can sustain it." Ashfaque finds it intriguing to observe "how portfolios perform throughout an entire cycle of rates within this five-percent range."

Raman Rajagopal notes that the struggle of businesses to manage higher debt levels can lead to special situations. "There has been significant corporate borrowing in previous years, resulting in levels of indebtedness that are not sustainable at higher rates," says Rajagopal. "As a result, many capital structures become unsustainable in the medium term amidst a prolonged environment of higher rates," he elaborates. Borrowers facing near-term or medium-term maturities are grappling with their options. "This presents ample opportunities for special situations investors who can fix the capital structure, while targeting high equity-like returns while often staying in debt-like scenarios."

Private Equity

Olivier Keller, a Portfolio Manager overseeing sourcing, evaluation, and execution of private fund investments at PineBridge Investments, underscores that higher interest rates were a central talking point in credit and private equity. Keller echoes Mikael Huldt's observations regarding the private equity landscape's struggle with low M&A activity. "Overall volumes were down substantially, largely driven by interest rates," notes Keller. "Whether it is the absolute increase in rates or the uncertainty about how high they would ultimately go, this environment created a divergence in price expectations between buyers and sellers, leading to significantly lower activity, and thereby a reduction in distributions to private equity investors."

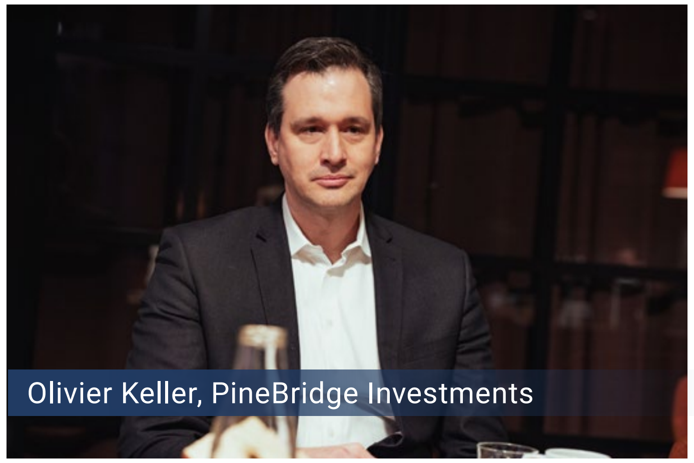
As a result, Keller also notes a sluggish pace of fundraising throughout 2023. "This should hopefully moderate dry powder levels somewhat, which are still at record levels in many markets," he observes. Additionally, Keller points out that "lower levels of distributions did not go in tandem with negative developments in asset value during 2023." Keller explains, "Many investors found themselves not affected much by the denominator effect [where the denominator is the total value of the investment portfolio] due to the solid performance of public markets. Instead, it was more of a numerator effect, where valuations did not decrease too much." Consequently, investors were more heavily allocated to this asset class than desired, increasing secondary volumes during the year.

Keller also notes the challenges faced by emerging managers in raising capital during 2023. "They were disproportionately affected by the lower fundraising levels. Getting something off the ground became much more difficult in such an environment." According to Keller, capital was predominantly allocated to established and perceived high-quality players in the larger-end of the market.

However, the struggle for emerging managers to raise capital prompted greater flexibility in incentivizing investors through alternative means such as deal-by-deal activity, co-investment opportunities, and fee structures. "Raising a first-time fund remains challenging in the current market environment, but there has been a general improvement in flexibility. There are many ways to achieve that and there is no silver bullet."

Impact Credit

Nadia Nikolova, a Lead Portfolio Manager with AllianzGI Development Finance specializing in impact investing in emerging and developed markets, has observed a less significant slowdown in private equity fundraising in the universe of impact investments. "In Europe, after years



Olivier Keller, PineBridge Investments

of growth in impact private equity fundraising, there is now a critical mass of dry powder, which drives the growth of impact private credit funds," notes Nikolova. At the same time, the deceleration of M&A activity has resulted in a trade-off between dry powder and available credit opportunities.

However, Nikolova highlights that "we are witnessing a game-changer through the adoption of blended finance techniques, where public capital is derisking private capital in order to increase inflows into emerging markets within the private credit space." The segment is still recovering from one of the largest capital outflows in 2021 and efforts have been made to redirect capital towards sustainable projects in emerging markets. "Entities such as the Net Zero Asset Owner Alliance and the Global Investors for Sustainable Development (GISD) Alliance have pledged substantial amounts of capital towards sustainable investments in emerging markets. However, despite these pledges, the capital is not yet flowing," acknowledges Nikolova. Nonetheless, she believes that COP28 marked a significant turning point, "acting as a catalyst for private capital to provide derisking solutions."

ESG Integration Across Private Markets

Reflecting on the private markets landscape through an ESG lens unveils a nuanced picture, believes Nadia Nikolova of AllianzGI. She argues that ESG considerations aren't universally embraced, emphasizing that the prioritization of ESG varies across different markets. "It depends on the markets we are discussing; some are more advanced than others," she notes.

Echoing Nikolova's sentiment, Zeshan Ashfaque from Man Varagon acknowledges that "ESG is still in its early innings in the U.S. and, frankly, has faced some negative movement, particularly due to political factors." He highlights challenges stemming from "a lot of noise that has moved things backward, and the scandals or news related to greenwashing." Despite this, Ashfaque remains optimistic about positive progress in the United States, albeit recognizing that it may not attain the same level of ESG integration as Europe.

Ashfaque underscores the disparity in data availability between public and private markets, posing a challenge for ESG integration. Specifically, he identifies the lack of data as the main challenge in ESG implementation in private markets. This challenge stems from the limitations of issuers and their constrained efforts in measuring ESG metrics. According to Ashfaque, "there needs to be a catalyst that compels issuers to improve their ESG measurement practices."

This catalyst could arise from broader market dynamics or initiatives originating within private equity firms, with which Ashfaque and his team collaborate in sponsor-backed lending arrangements. "As a lender, we do not own the company, which limits our ability to enforce changes directly," says Ashfaque. "However, we can encourage them by structuring deals and offering incentives, such as nominal pricing concessions upon achieving defined targets." With Man Varagon backed by Man Group, a global player with significant expertise in ESG considerations within public markets, Ashfaque and his team at Man Varagon are "actively working to leverage that knowledge and framework to apply it in a very disciplined and credible manner to private credit."

Ashfaque stresses that the integration of ESG considerations is still in its infancy in their market and should be carefully balanced with returns, as overlooking

Nadia Nikolova, AllianzGI

> "In Europe, after years of growth in impact private equity fundraising, there is now a critical mass of dry powder, which drives the growth of impact private credit funds."
>
> Nadia Nikolova - AllianzGI

this aspect could potentially result in diminished returns. As a direct lender, the team at Man Varagon primarily "view ESG first and foremost as a risk assessment framework, where we are looking at how matters that fall under E, S, and G impact the returns on the investments and the capital of our clients." Aside from pursuing an exclusionary approach in certain sectors or types of companies, assessing ESG aspects is integrated as part of the broader due diligence approach. "We try to blend all of that together while making credit decisions."

Raman Rajagopal of Invesco's private credit platform, agrees with Ashfaque, noting that "some of the strategies that have been employed in the public markets weren't able to be ported over to the private markets." Rajagopal highlights the challenge of limited coverage by third-party vendors, which was particularly sparse when they began focusing on this aspect eleven years ago. Given Invesco's scale of their participation in corporate senior loans globally, they decided to build a proprietary framework to underwrite E, S, and G considerations in a tool that was adaptable to the sectors in which

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companies participate.

"The focus of that framework was originally in the liquid loan space, targeting major issuers syndicating loans," recalls Rajagopal. "We sought to apply the same principles used for larger companies across our broader platform to underwrite middle-market businesses," he continues. "Beyond the exclusionary considerations, we see value in identifying opportunities for our borrowers for ESG improvement."

Allocator Views on Impact Investments

Although integrating ESG considerations in private markets may present challenges for managers, this aspect is of paramount importance for institutional allocators during manager selection. "ESG in general is part of our DNA," says Magdalena Högberg of AP4. "We are required by law to be exemplary in how we invest and being mindful of sustainability is part of that," she explains. "It's not merely a procedural checkbox; much more, it is a conviction that drives returns for us. Sustainability risks and opportunities are closely linked to financial performance and we address ESG in order to enhance long-term returns. We evaluate ESG themes across all aspects of our investment strategy and make investment decisions accordingly."

> "ESG in general is part of our DNA. We are required by law to be exemplary in how we invest and being mindful of sustainability is part of that. It's not merely a procedural checkbox; much more, it is a conviction that drives returns for us."
>
> Magdalena Högberg - AP4


Magdalena Högberg, AP4


Raman Rajagopal, Invesco

Impact investing holds a prominent position on AP4's agenda. "Impact investing has been perceived as sacrificing returns, but I don't believe that's necessarily the case anymore," asserts Högberg. "I like our thematic approach, where we identify significant themes where we can channel investments," she continues. "We can generate very good returns while also contributing to a sustainable planet for years to come. It is a really important focus area for AP4."

Mikael Huldt, the Chief Investment Officer at Afa Försäkring, stresses the importance of quantifying and reporting the impact of impact investments. "If you aim to create any meaningful impact, it needs to be measurable and clearly defined. Otherwise it's a bit opaque and merely words without substance," emphasizes Huldt. "Moreover, the benefits from impact investments should not result from unintended consequences. It needs to align with a specific strategy from the outset and undergo consistent evaluation," he continues. "Managers should not be making these reporting and data points up along the way."

Huldt's perspective resonates, especially considering the backdrop of numerous greenwashing scandals in 2023, as noted by Nadia Nikolova of AllianzGI. "Investors have grown more skeptical about what the industry means by 'green' and what we define as Article 8 or 9 in the European context, as well as impact investing," she argues. Given the prevalent concerns surrounding greenwashing and impact washing, Nikolova and her team at AllianzGI have taken additional measures to safeguard their approach to impact.

"We hired an independent impact strategy team defining and measuring impact, and monitoring impact performance on the underlying portfolio," explains Nikolova. The team designed a framework that runs in parallel with the investment process. "We do the same credit assessment and credit due diligence as we do on the impact side," she elaborates. "For us, impact means that companies, through their products and services,

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must generate positive, measurable, and significant impact that solves the society's and the planet's largest challenges." The KPIs in the financial documentation also align with this framework.

Nikolova also highlights the dual dimensions of impact, stating, "One aspect is the actual activities of the company – is it an impact generating business? As an example: investing in a Danish offshore wind project doesn't generate significant impact given the country's already high reliance on renewable energy. Our marginal Euro of investment in that case makes little difference," she emphasizes. However, Nikolova contrasts this with investing in a renewable energy project in Uzbekistan, an investment that "has a very different additionality component. Therefore, we monitor not only what we are investing in but also the contribution of our capital. In emerging markets, the latter component holds much greater significance." This is where blended finance plays a crucial role, reducing risk for investors while attracting capital to emerging markets.

Futures Prospects for Private Markets

With over two and a half decades of experience in private markets, Mikael Huldt, now the CIO at Swedish insurance company Afa Försäkring, shares insights on navigating market dynamics. "While it is very hard, if not impossible, to time market swings and market cycles,

> "…the focus will have to go back to the fundamental value creation opportunities that private equity offers through its governance model and maturity ownership."
>
> Olivier Keller - PineBridge

identifying paradigm shifts and structural trends is key," says Huldt. "Private credit is an excellent example," he notes, "where a void created by retrenching banks was filled by other alternative solutions." According to Huldt, recognizing such long-term trends gives investors a better chance at "trying to time those and at least not to be late to the party."

Private Equity

A notable structural shift is observed in private equity, which experienced subdued deal activity in the past year due to factors such as expensive debt financing and increased risk awareness. The combination of rising interest rates, inflationary pressures, economic and geopolitical uncertainties, along with a correction in the broader public equity markets, has contributed to a slowdown in deal-making. Olivier Keller, specializing in sourcing, evaluating, and executing private fund investments at PineBridge Investments, anticipates an increase in M&A activity and distributions in 2024, driven by the stabilization of interest rates. However, Keller underscores the improbability of returning to the same market environment observed over the past decade. "Everyone expects some cuts, but does that mean that we will be back in the same environment that we had for the past ten years? It's very unlikely."

Given the likelihood of sustained higher rates, the pertinent question arises: "How does private equity justify its existence and deliver a premium over public markets in the coming years?," asks Keller. He suggests that a renewed emphasis on differentiated sourcing and operational value creation could shield private markets from external headwinds. "This means that the focus will have to go back to the fundamental value creation opportunities that private equity offers through its governance model and maturity ownership," explains Keller. "It involves sourcing attractively priced deals, identifying the right growth catalysts, and reducing reliance on capital markets, with operational efficiency assuming greater importance," he elaborates. "That will have to come to the foreground over the coming years for private equity to continue to deliver as it should."

This 'higher-for-longer' interest rate environment underscores the importance of careful manager selection in private equity. "Everything revolves around the skill set. Manager selection is all about finding managers who can perform under these circumstances, possess the appropriate sourcing channels, operational and sector-specific capabilities, as well as exit plans to continue generating value," argues Keller.

Private Credit

Private credit is expected to perform in the current environment amid high interest rates and a decrease

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in bank lending. Even with potential interest rate cuts on the horizon, private debt is anticipated to remain an attractive option for investors given the high income profile with significant potential for downside mitigation. Raman Rajagopal, a Senior Client Portfolio Manager for Invesco's private credit platform, argues that a moderate reduction in interest rates would be more sustainable for private credit markets.

Rajagopal cautions on the increasing divergence among private credit portfolios. The higher base rate today is likely to impact sectors and firms differently, influenced by their pricing power, business resilience, and capital structure management. This backdrop will be an important driver of dispersion, not disruption, across sectors and issuers. "Each manager will possess a unique set of credits that's inherently different. Therefore, the return outcomes could vary widely," explains Rajagopal. "Manager selection is likely to matter much more in periods of heightened credit losses."

Distressed Opportunities

Rajagopal also contends that the escalating default rates could broaden the opportunity set for distressed investments. "The opportunity set tends to ebb and flow quite significantly with the overall market default rate." Zeshan Ashfaque from Man Varagon concurs with Rajagopal, asserting that "these windows for distressed investments close rapidly." Ashfaque points out that "a lot of capital had been raised in distressed over the last decade, but opportunities were limited." Ashfaque emphasizes the need for swift action and agility, noting that "everyone is poised to seize upon any signs of market dislocation."

> "Emerging markets tend to be the most affected, not only in terms of performance but also due to capital outflows. For those considering impact investing, being countercyclical is essential."
>
> **Nadia Nikolova - AllianzGI**

Raman Rajagopal of Invesco also points out that "while opportunities in large cap distressed opportunities tend to fluctuate significantly, opportunities in small capitalization distressed credit and special situations tend to be far more consistent." Rajagopal further points out that "since Covid, we have seen a material expansion in small capitalization distressed credit and special situations opportunities that continues through today, given the increased burden of rising rates on heavily levered small cap corporate borrowers."

Ashfaque further argues that an excess supply of capital for distressed managers might prompt them to broaden the definition of distressed. "Each investor has a unique mandate, and managers have a way to accommodate that. Distressed managers may consider a wider range of situations, some of which may be less distressed than what they historically focused on." Nevertheless, Ashfaque expresses less concern about Man Varagon's investments in private credit, since the private credit manager focuses on providing financing to healthy businesses backed by private equity firms.

During the pandemic, for instance, when some businesses faced closure due to regulatory restrictions, "we experienced our private equity sponsors supporting those businesses by putting in more money and seeing them through the other side, as we all viewed the closures as temporary disruptions," recalls Ashfaque. "While sponsor backing provides some reassurance, it's not a guarantee of credit performance. If the damage is severe enough, you can have a situation where your private equity sponsor backs away and says, here you go, take the keys and good luck. As a credit investor, you have to be ready for the worst-case scenario regardless of how strong the underlying business, its management team, and its owners are."

Rescue Capital in Impact

Nadia Nikolova of AllianzGI Development Finance emphasizes that in the impact universe, "we don't talk about special situations, we talk about rescue capital on our side of the table." With half of the world's population facing elections in 2024, some outcomes could lead to significant shifts, especially in emerging markets. "Emerging markets tend to be the most affected, not only in terms of performance but also due to capital outflows," says Nikolova. "For those considering impact investing, being countercyclical is essential."

For AllianzGI, it's not simply about their presence in these markets but rather about how to navigate them. "We engage in twofold partnerships with organizations that have demonstrated resilience during crises," says Nikolova. "These typically include development and multilateral development banks, which may have preferred creditor status and have relationships with governments," she elaborates. "The key questions are: who do we partner with, how are we protected behind them, and who bears the initial hit?" This is where AllianzGI's collaboration with development agencies comes into play, allowing investors to mitigate risks and ensure diversification.


Zeshan Ashfaque, Man Varagon

Manager Selection: "Rome was not built in a day"

While private markets can sometimes be perceived as a single investment option, this universe spans different asset classes, sectors, geographies, investment styles, and risk appetites. There is no one type of "private asset," necessitating an understanding of the distinctions within the private markets universe to anticipate the characteristics of individual asset classes. "Our team is constantly screening the markets. We assess portfolio needs from a top-down perspective, such as a desire to allocate to distressed opportunities," Magdalena Högberg explains how Fjärde AP-fonden (AP4) is looking for opportunities in private markets. "When the right opportunity arises, we leverage existing relationships that our private markets team has built out to invest."

While not necessarily taking on the risk associated with emerging managers when investing in private equity, Högberg highlights AP4's strategy of seeking niche opportunities. "We focus on going niche, exploring themes and parts of the market where we find a hub of excellence or something specific that can enhance our equity allocation to capture the equity risk premium more effectively," explains Högberg. "For us, private equity means seeking investments not readily accessible in listed markets, with thematic investing being a major focus for us in recent years." Högberg emphasizes that, as an allocator, investing in large generalist funds can resemble exposure to leveraged beta, which can be obtained more cost-effectively. Therefore, niche managers are preferred.

Ulrika Bergman at the Nobel Foundation also prioritizes existing relationships when venturing into private markets. "Given our cautious approach in recent years and our ongoing portfolio-building efforts, we have mostly invested with managers already in our portfolio," says Bergman. "Looking ahead, we are starting to meet with managers who may complement our portfolio in the future.

"Rome was not built in a day. It involves consistently monitoring the market and cultivating relationships before making allocations," concludes Mikael Huldt of Afa Försäkring. "For us, it is always about aligning identified portfolio needs with opportunities presented by managers we have engaged with over the years," he elaborates. "When they offer a product that matches our portfolio and our needs, then we press the button."

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> Mikael Huldt - Afa

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Nordic **Insights**

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The HedgeNordic series of round table discussions titled "Nordic Insights" aim to bring together industry professionals and experts in their field in a vivid discussion. The setup allows to look at and discuss a specific topic within the financial industry from various different angles, and hear of different opinions and approaches. The group would typically consist of a colourful mix of representatives from the financial industry. The combination of having a relatively small, intimate group of individuals for the discussion behind closed doors in combination with a wide circulation to a relevant audience in the Nordic region through a summary of the discussion in a convenient read-up paper combines the best of the two worlds of professional and personal relationship building and broad communication and branding.

The size of the group and format chosen, combining a casual lunch followed by the actual work session and discussion give an excellent opportunity to network and get to know the participants and organisations behind them in both a more personal and professional manner.

The Round Table Discussion is hosted without audience, behind closed doors. The moderated discussion will evolve around topics pre-defined in collaboration with the participants prior to the event. To insure a dynamic and lively discussion the specific questions that will be discussed are not disclosed prior to the get together.












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