KEYNOTE INTERVIEW

Secondaries widens its net

As the secondaries market matures, the private wealth channel is increasingly likely to embrace its potential, says Shane Feeney, global head of secondaries at Northleaf

Q Where are the best opportunities in the secondaries market right now?
It's multifaceted at the moment; we're seeing attractive opportunities across a range of different deal types. The secondaries market is acting as an important relief valve for an industry that's out of equilibrium. If you look at the run-up in private equity NAV between around 2018 and today, it has been almost a supersizing cycle – that, combined with the paralysis we've seen in underlying exit activities, is creating a lot of favourable tailwinds for secondaries.

As we look at our pipeline and investment activity, we're seeing an abundance of opportunity across all transaction types – whether it be GP-led or LP-led transactions, innovative NAV lending or preferred equity opportunities. All of this is driven by secondaries acting as a solution to an industry that has cycled out of balance over the past couple of years. That will eventually correct itself – but in the meantime, the secondaries market is benefitting from strong activity levels.

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Q What are the key trends you would highlight within GP-leds?
For more than 20 years, Northleaf has focused on the mid-market opportunity set, although we do see larger-cap dealflow as well. The flow across both segments is very strong: transaction volumes were healthy in the first half of 2024, and we are likely on track to see a record year. Specifically, GP-led volume is expected to near the record levels reached in 2021.

If you go back four or five years, GP-led continuation vehicles largely had a singular objective: to retain ownership over companies that still had room to run from a value creation perspective. Now you have a dual objective on the part of some GPs that are using these transactions as a way to generate distributions for their LPs. This has led to a more mixed-quality opportunity set from GPs, so underwriting experience and assessment of GP motivations is critical in today's market.

The mentality in the market today is quite different from a couple of years ago. There's broad acceptance now among participants that these GP-leds are a useful tool to help multiple parties achieve their objectives and are here to stay.

My view is we will see more capital coming into this segment of the market. It's natural that with the passage of time, and with the track record on GP-leds starting to materialise, we'll see more capital formation. Part of that will come from larger capital allocators that have mainly been sitting on the sidelines watching – we could see more direct initiatives focused on GP-leds coming from pension funds and sovereign wealth funds, globally.

As I look over the next two to three years, I think we'll continue to see the market widen. At an industry level, that doesn't concern me; there's enough inventory to sustain more dry powder in the GP-led segment because it's largely been a mid-market phenomenon to date. When you start getting into large-cap funds that might want to use this tool, the amount of capital that's required becomes much more significant. It will require wider capital formation.

Q What about in LP-leds?

The LP-led market, again, had a very strong first half of the year. We saw selling activity really pick up across the board in terms of the types of sellers in the market, as well as more funds of funds coming to market trying to generate DPI on some of their older funds.

We've seen pricing move up in the first half of 2024, and this reflects how people have gotten more comfortable with their underwriting inputs and assumptions.

This pricing movement has definitely incentivised more sellers to come out. Certainly, in the mid-market, we've seen a healthy amount of selling activity and deal volume without distressed selling taking place. This again comes from the industry being out of equilibrium, and a widespread need for liquidity.

I don't think this is a one-quarter issue – it will probably take a correction period of 18-24 months to get the industry back into balance. I expect we'll continue to see some very attractive deal volume on the LP-led side for the foreseeable future.

Q What's needed for the secondaries market to continue its growth over the longer term?

One of the interesting trends we're seeing is a pretty significant adoption of semi-liquid or evergreen vehicles in secondaries. That's particularly interesting for the penetration of secondaries into the private wealth channel: there's obviously a lot of focus on the private wealth channel right now across all the private markets, and the secondaries industry is in the thick of that.

When you look at the inherent attributes that secondaries funds and transactions provide – diversification, lack of J-curve, a more predictable and consistent liquidity profile, and so on – a lot of these attributes really play well to open-end vehicles, and particularly the private wealth channel. That will be a really interesting theme for secondaries over the next couple of years as this continued push into private wealth gains momentum. I view it as one of the biggest potential game changers for the secondaries industry over the next three to five years.

"The secondaries market is acting as an important relief valve for an industry that's out of equilibrium"

To make the most of this, we need to educate the private wealth community on the benefits of these products and what they provide and what they don't provide. We also need to continue innovating on fund structures that are more private-wealth-friendly: for example, the introduction of open-end funds.

What's really exciting is that the growth in secondaries is a win-win for the private markets more broadly. As the secondaries market matures, it will facilitate more entrants into private markets. It provides a solution when investor objectives change, and I think that's particularly pertinent in the private wealth channel.

Q What are the main challenges facing the market?

Across all elements of private markets, including secondaries, there are still signs of a widened bid-ask spread. I don't think any markets are immune to that, even though prices have moved up. There are different views and expectations for when exit activity will pick up, when distributions off a portfolio will come back to a buyer, and how to price all that in.

On that note, secondaries can be a very effective countercyclical strategy. Macroeconomic uncertainty can be helpful for the secondaries market, to the extent that it puts more stress in the system around underlying cashflow and distribution activity, and it can create denominator effect issues for institutional investors. So, in an odd way, some of these uncertainties can actually drive secondary transaction demand. ■