Themes

The following summary is based on discussions with both investors and investment managers. Each of the issues or ideas has been raised more than once.

We've referred to investors in the comments below but in most instances investors will be working closely with their consultants and you can infer that a reference to one is a reference to the other also.

- Many investors in Australia and New Zealand have been, and continue to be, focused on very portfolio specific issues, namely:
    - actual asset allocations relative to strategic benchmarks – falling listed equity market valuations have pushed private market exposures to the higher end, or above, long term strategic weights;
    - the required selling of liquid assets to fund currency hedge losses (as a result of substantial falls in the AUD and NZD against most other currencies), which has exacerbated the above.
- At some stage in 2009, the following factors should mitigate these circumstances:
    - some recovery in listed equity markets;
    - downward revaluation of private market assets; and
    - appreciation of the AUD and NZD
- Investors are starting to develop views that they have seen the bottom in listed markets and they are considering selective allocations for 2009. Areas of potential interest include:
    - global macro strategies – poor performance from active managers of equities and fixed income has focused attention on the importance of picking markets rather than stocks;
    - investment grade and non-investment grade debt (particularly bank loans given their position in the capital structure);
    - for control distressed debt strategies – however there is risk of capital overhang as evidenced by the large number of non-specialist distressed managers who have entered the market seeking to raise capital;
    - private equity (selectively) – small and mid-market buy-outs historically perform well out of recession years, also some opportunistic interest in secondaries but large and mega-buyouts and venture capital are not seen as compelling;
    - private investment in Asian and emerging markets - private equity projects generally preferred to infrastructure given political risk and the relatively longer exits; and
    - those strategies that incorporate elements of E, S and/or G as an alpha source – although these will not necessarily come cheap.

- Areas of concern to investors include:
  - hedge fund transparency (particularly in the case of FOF vehicles), as well as fees, hurdles and high-water marks, heavily leveraged funds are not attractive - investors are likely to wait for expected consolidation and a relaxation of terms and conditions before making significant investments;
  - an anticipated rise in default levels of corporate debt will delay investment in credit markets, investors will gain some comfort when the large, well-established distressed specialists begin to reduce cash levels in a significant way; and
  - real estate is off the agenda for most institutional funds until downward valuations slow – although some niche strategies are attracting attention.
- Other observations:
  - mega institutional funds are increasingly opting for direct exposures to private markets (property, infrastructure and private equity), reflecting their often substantial in-house investment capabilities but there is interest in co-investment vehicles and the possibility of strategic partnerships, smaller and medium sized funds generally favour well-diversified funds and FOF exposures (for their private equity allocations);
  - however, investors are making very definite choices in relation to the stage of investment in private equity – preferring buyout and distressed over venture capital**;**
  - there has been a trend towards specialist advisers rather than generalist asset consultants in the alternatives space; and
  - fund manager fees remain a hot topic in this region – whilst there is some debate regarding return versus cost (and whether minimising MER is a false economy), there is almost universal agreement that fees should continue to trend downwards