BAI Alternative Investor Survey 2019 – Preliminary Report

„Le roi est mort, vive le roi“ (The King is dead, long live the King!) – The interest rate environment is unlikely to change in the foreseeable future, even under the president-elect of the ECB, Christine Lagarde. Institutional end investors therefore continue to rely on alternative investments due to the lack of returns on traditional investment products.

BAI Alternative Investor Survey – Focus on Private Debt and ESG

BAI has now conducted the “*BAI Alternative Investor Survey”* for the sixth time. The aim of the survey is to determine the investment behaviour of institutional investors and to increase transparency in the alternative investment market in order to provide the industry with a better understanding of investors' needs. In addition, the annual survey serves as an important basis for the lobbying activities of the association, which is a major necessity in view of the newly elected European Parliament and initiatives such as the EU Commission's Sustainable Finance Action Plan.

Participants were exclusively institutional end investors, namely insurance companies, pension funds, pension funds, corporate investors, family offices and banks (Depot A/ proprietary trading).

Due to the "Sustainable Finance Initiative", the survey this year placed a special focus on ESG investments. The survey was also expanded to include a number of questions on private debt in order to build on the BAI study on corporate private debt published in April 2019. The survey is divided into the following chapters:

(1) General Information on the Participants
(2) Portfolio Allocation in Connection with Alternative Investments
(3) Chances, Expectations and Challenges
(4) Private Debt
(5) ESG-Investments
(6) Core Statements and Derivatives

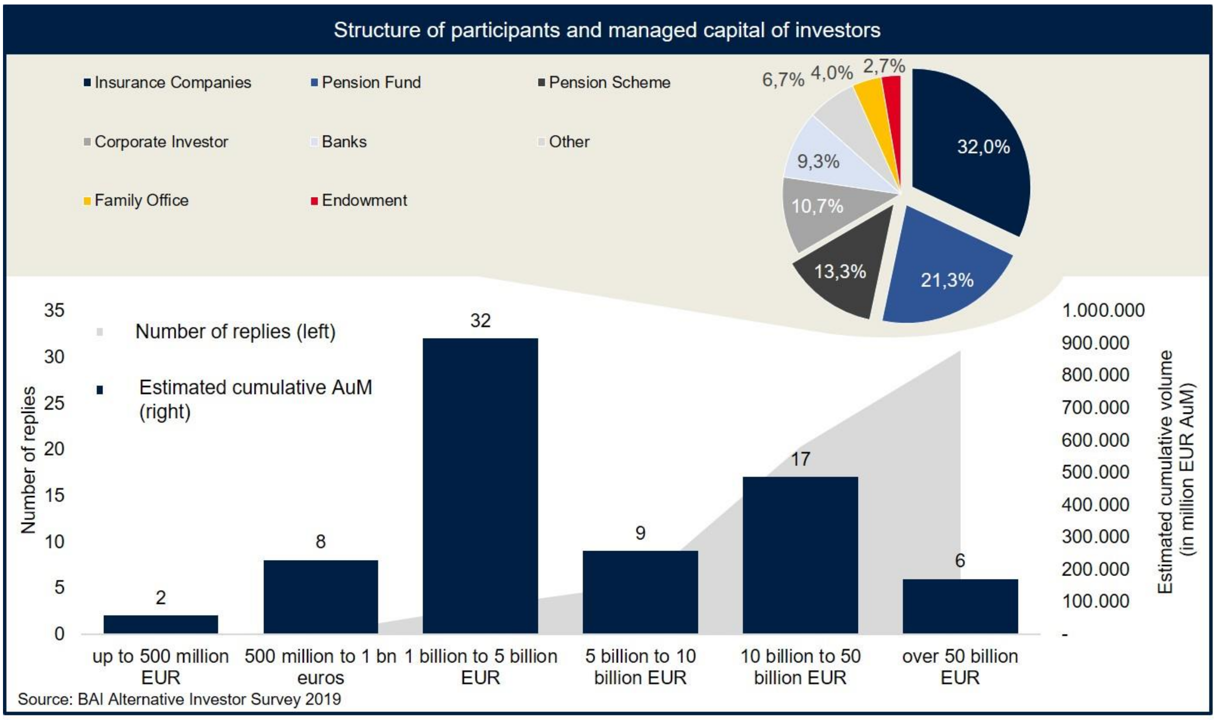
The survey covered the current alternative investments **Liquid Alternatives, Real Estate, Infrastructure, Private Equity, Private Debt** (with a focus on **Corporate Private Debt**) and **Commodities**.

BAI moves closer to Investors - Significant Increase in Informative Value

With 75 participants, BAI set a new participant record this year and thus significantly increased the significance of the survey. The most strongly represented participant groups were insurance companies, pension funds as well as pension schemes.

The majority of participants (43%) manage fixed assets between EUR 1 and 5 billion. 17 investors (23%), more than half of them insurance companies, have AuM between EUR 10 and 50 billion.

Due to the broad spectrum of different investor types and the high number of participants, the survey covers a large part of the German investor landscape. In total, the participants manage an estimated investment volume of EUR 900 billion AuM. For comparison: the fixed assets of the German insurance industry amounted to EUR 1,351 billion AuM in 2017.[1]



Alternative Investments are not a Niche

For the majority of the participants, alternative investments are not an insignificant niche, but rather an established component of their portfolios. According to the survey, 82% of participants increased their exposure to alternative investments last year.

[1]Gesamtverband der Deutschen Versicherungswirtschaft e.V., 09.08.2019, https://www.gdv.de/de/zahlen-und-fakten/versicherungsbereiche/kapitalanlagen-24114

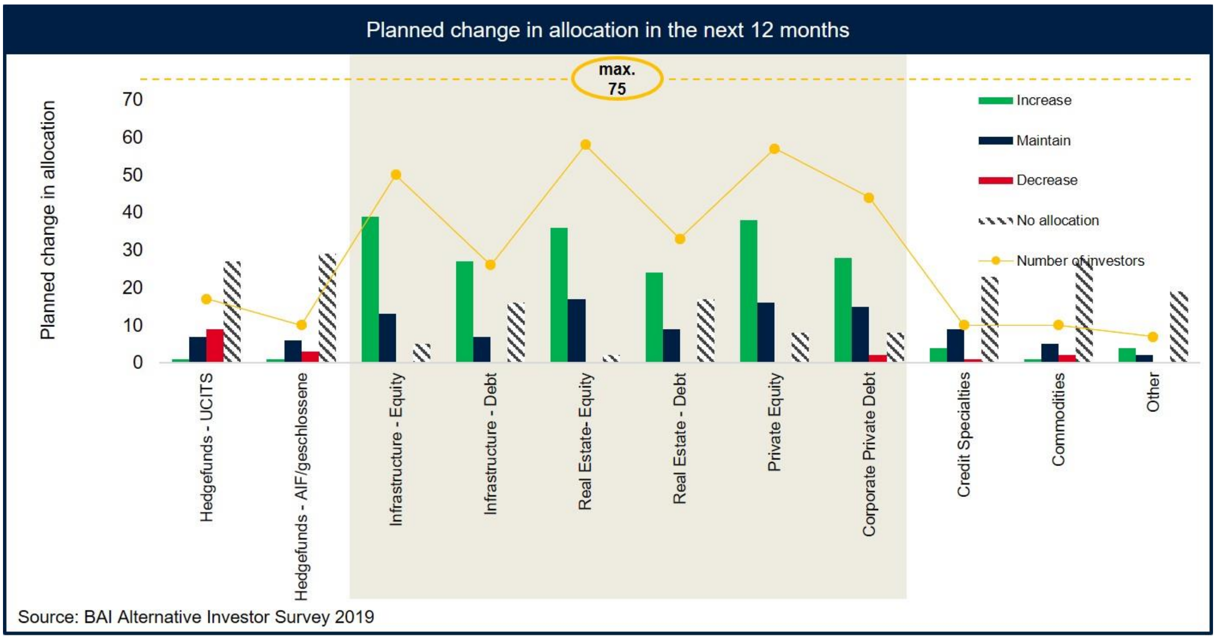
The asset classes **Real Estate**, **Private Equity**, **Private Debt** - including mainly **Corporate Private Debt** - and **Infrastructure** have proved particularly successful. For example, two thirds of the participants invest in infrastructure (equity), which significantly exceeds the value recently reported by the data service provider Preqin in its report "*Preqin Markets in Focus: Alternative Assets in Europe*".[2]

More than 77% of the participants stated that they invest in **real estate** (equity); 76% in the private equity asset class. It is noteworthy that in contrast to countries such as Great Britain or the USA, **liquid alternatives** - (both UCITS and AIFs) - are much less in demand in direct comparison with, for example, **private equity**.

Private Equity and Infrastructure catch up with Real Estate

The following chart not only shows the current commitment of the participants, but also shows planned changes in allocation over the next twelve months.

The involvement in **infrastructure** (equity and debt), **real estate** (equity and debt), **private equity** and **corporate private debt** is to be further expanded among approx. half of the investors. The majority of investors do not envisage any allocation to **hedge funds** (both UCITS and AIFs), but rather the planned disinvestment outweighs the additional commitment.



The investment behaviour of different types of investors is generally alike. Insurance companies invest primarily in infrastructure (equity), real estate (equity), private equity and corporate private debt and infrastructure (debt).

[2] A key driver for different values may be the different definition of investors (Preqin, for example, counts FoF among the investors).

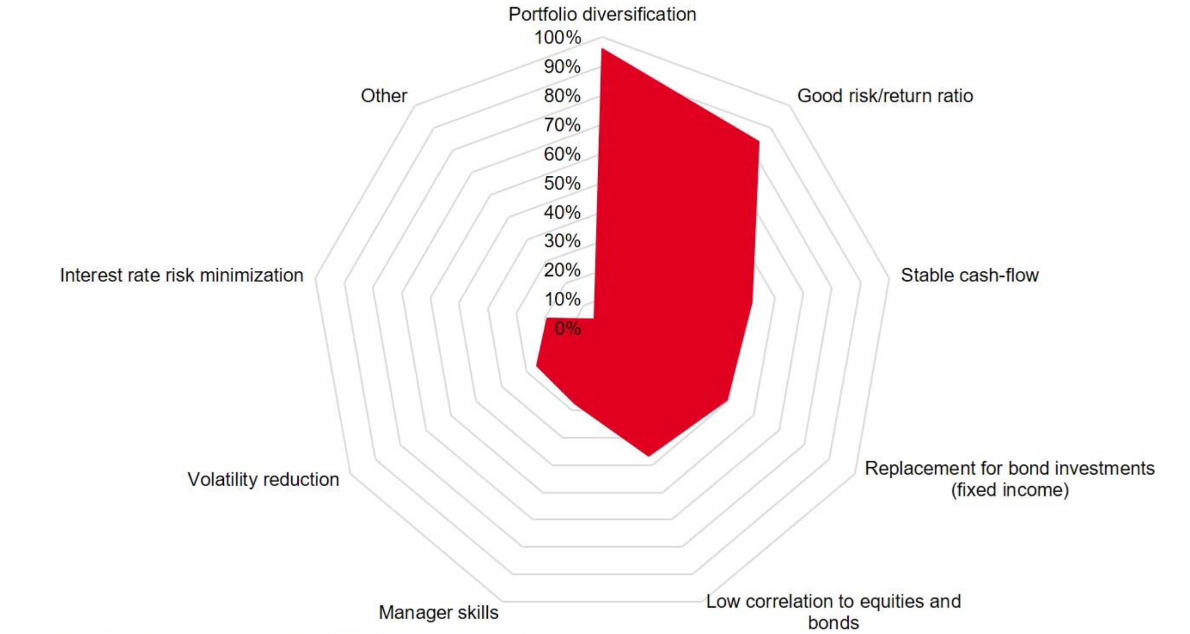
In contrast, the demand for liquid alternatives among corporate investors is above average at 75%. It is also noticeable that the asset class infrastructure (debt) is disproportionately popular with banks (Depot A) with 71%.[3]

Although **private equity** and **infrastructure** equity were able to catch up with the "top dog" **real estate** in terms of awareness, the planned shares in the target portfolios for **real estate** are - still - significantly higher. 26% stated that they had a target allocation of 3-5% for private equity; for real estate (equity) 17% of the participants reported a target allocation of over 15%.

Investors focus on Diversification

The main reason for investing in alternatives is the diversification effect; investors also appreciate a balanced risk/return ratio and a stable cash flow, which can be covered in particular by asset classes such as infrastructure or real estate. 27% of the participants stated that they invest in alternative investments on the basis of "*manager skills*".

Main reasons for investing in Alternative Investments*



Source: BAI Alternative Investor Survey 2019; * Multiple answers possible

AIF hedge funds better meet investors' expectations in terms of portfolio diversification, risk-return profile and correlation than UCITS funds; **infrastructure** (equity & debt) in terms of diversification effects through low correlation and the expansion of the investment universe. **Private equity** - as a widespread alternative investment - impresses due to its good risk/return ratio. The **real estate** asset class has particularly positive results in terms of diversification and stable cash flows.

[3] However, it should be noted that the number of responses from corporate investors and banks is comparatively low, which limits interpretability.

General challenges - Investment in geopolitical instability

Institutional investors are exposed to numerous uncertainties and challenges due to Brexit, trade conflicts and the continuation of Mario Draghi's heritage - the keywords being low interest rate environment. But which of these problem areas carries the most weight from the investor's point of view? Participants see inadequate returns, geopolitical risks and negative interest rates as the greatest issues when making investment decisions within the next twelve months. Over a period of three to five years, investors also see a lack of returns and geopolitical risks as core challenges. It is surprising that regulatory uncertainties remain a major challenge for investors in the medium term. This should give national and European legislators food for thought.

In view of the growing uncertainties, 74% of investors indicated that they would aim to increase their exposure to illiquid alternative investments over the next three to five years.

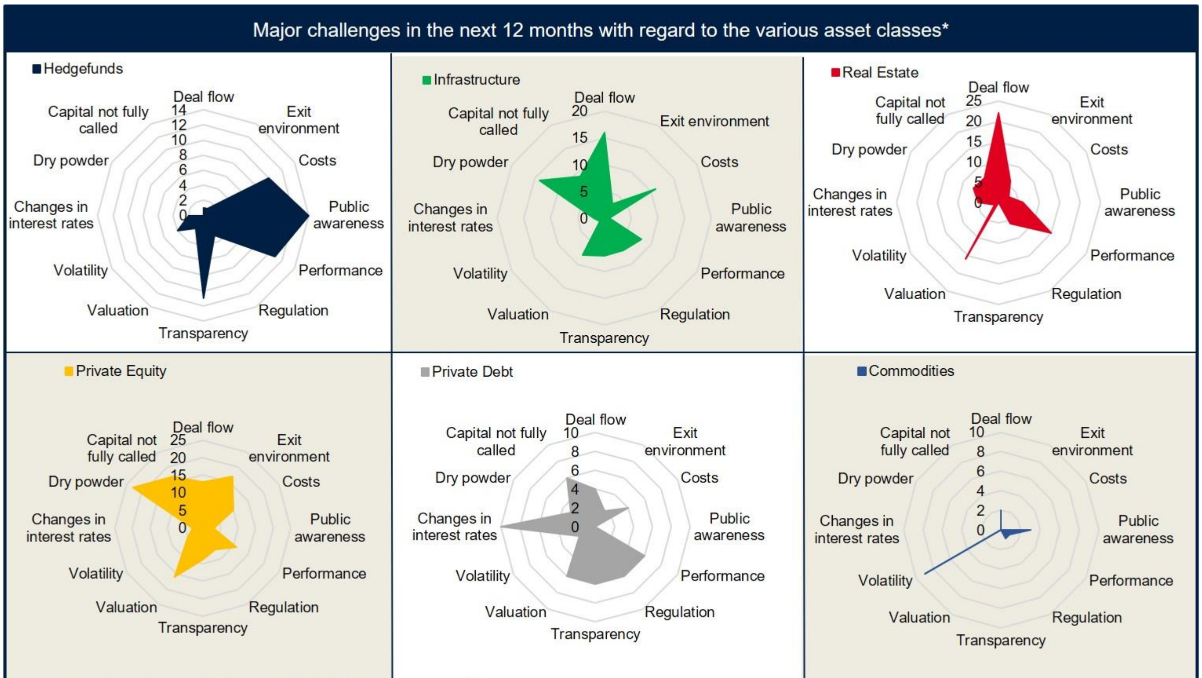
Specific Challenges - In Search of Stable Returns

Particularly in the low-interest environment - ten-year government bonds sometimes show a negative yield - there is a high demand for reliable investment opportunities, with each asset class confronting investors with very different challenges.

For **hedge funds**, public perception, performance and transparency are the main difficulties. It is astonishing that public perception is still - or once again - of great importance to investors, as these funds are now comprehensively regulated.

The high demand for **infrastructure investments** may result in a low deal flow; here the dry powder issue is a challenge, as expectations may not be met.

For many investors, **real estate** is a fixed component of portfolios, although real estate valuation is a particular problem. The same applies to **private equity** with the resulting risks for the exit if the economic environment changes; in addition - analogous to infrastructure - the slow capital call is a major challenge here.



Source: BAI Alternative Investor Survey 2019; * Multiple answers possible

Private Debt – Popular despite Prejudices?

As mentioned at the outset, the survey took a closer look at the **private debt** asset class in order to follow up the BAI study *'Corporate loan financing by non-banks in Germany*'.

Corporate Private Debt enjoys great popularity across all investor types, whereby particularly good empirical values are available with regard to the diversification effect.

The results of the survey also show that the most important subclass of private debt in Germany is **corporate private debt**. The participants' demand is predominantly for so-called senior tranches. It is somewhat surprising to learn that investors regard the interest rate risk as the greatest challenge, especially for private debt, since credit funds mainly work with variable interest rates and thus protect investors from interest rate risks.[4]

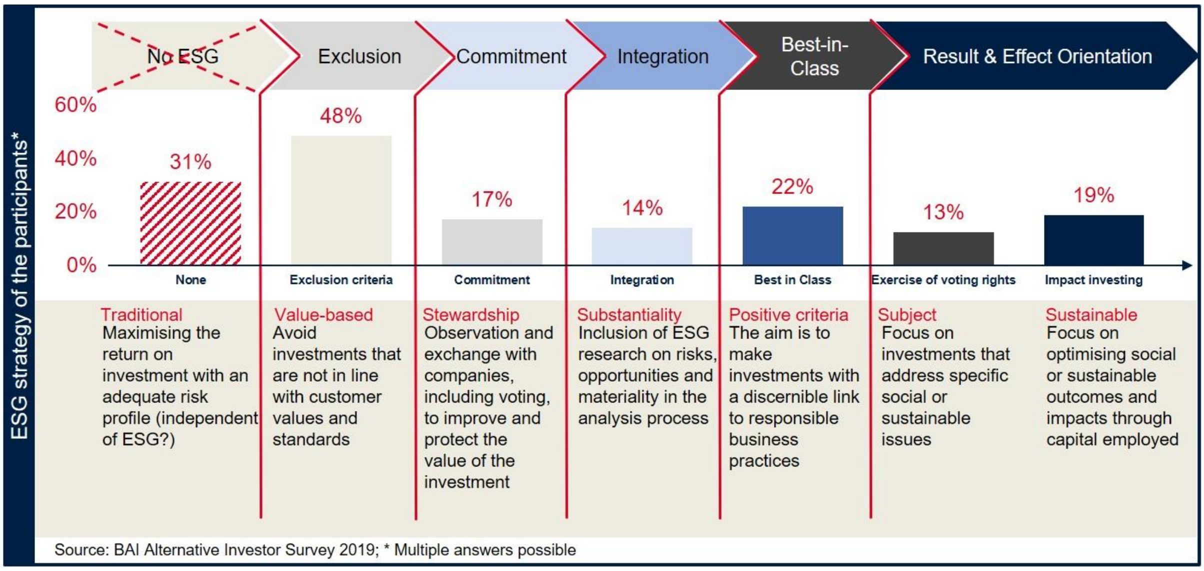
Time is running out - ESG has to be on investors' agendas

In view of the long-running discussion and the "*Sustainable Finance*" action plan announced by the EU Commission at an early stage, it is surprising that 31% of investors have not - or not

[4] For more information, see the BAI study *„Unternehmenskreditfinanzierungen durch Nicht-Banken in Deutschland", vgl.* Page 74 ff.; https://bvai.de/fileadmin/PDFs/DE/Publikationen/BAI-Studie_2019_-_Unternehmenskreditfinanzierungen_durch_Nicht-Banken.pdf

yet - integrated ESG into their investment strategy. Failure to take account of environmental, social and corporate governance aspects can have a considerable impact on the development of the portfolio.

The most popular - or currently most popular - integration option is the use of exclusion criteria, i.e. the avoidance of investments that are not in line with the base values and standards of stakeholders.



The EU Commission's "*Sustainable Finance*" action plan is generally supported by investors. However, 44% of investors demand more personal responsibility and describe the Commission's efforts as too bureaucratic.

The results of the entire survey will be available from September 2019 in our closed members' and investors' area.

Contact:

Bundesverband Alternative Investments e.V. (BAI)
Sven Gralla, B.Sc. Economics
Research Associate Market & Research
Poppelsdorfer Allee 106
53115 Bonn
+49 228 96987 0
gralla@bvai.de