The Multi-Asset Era Demands a Public-Private Data Model

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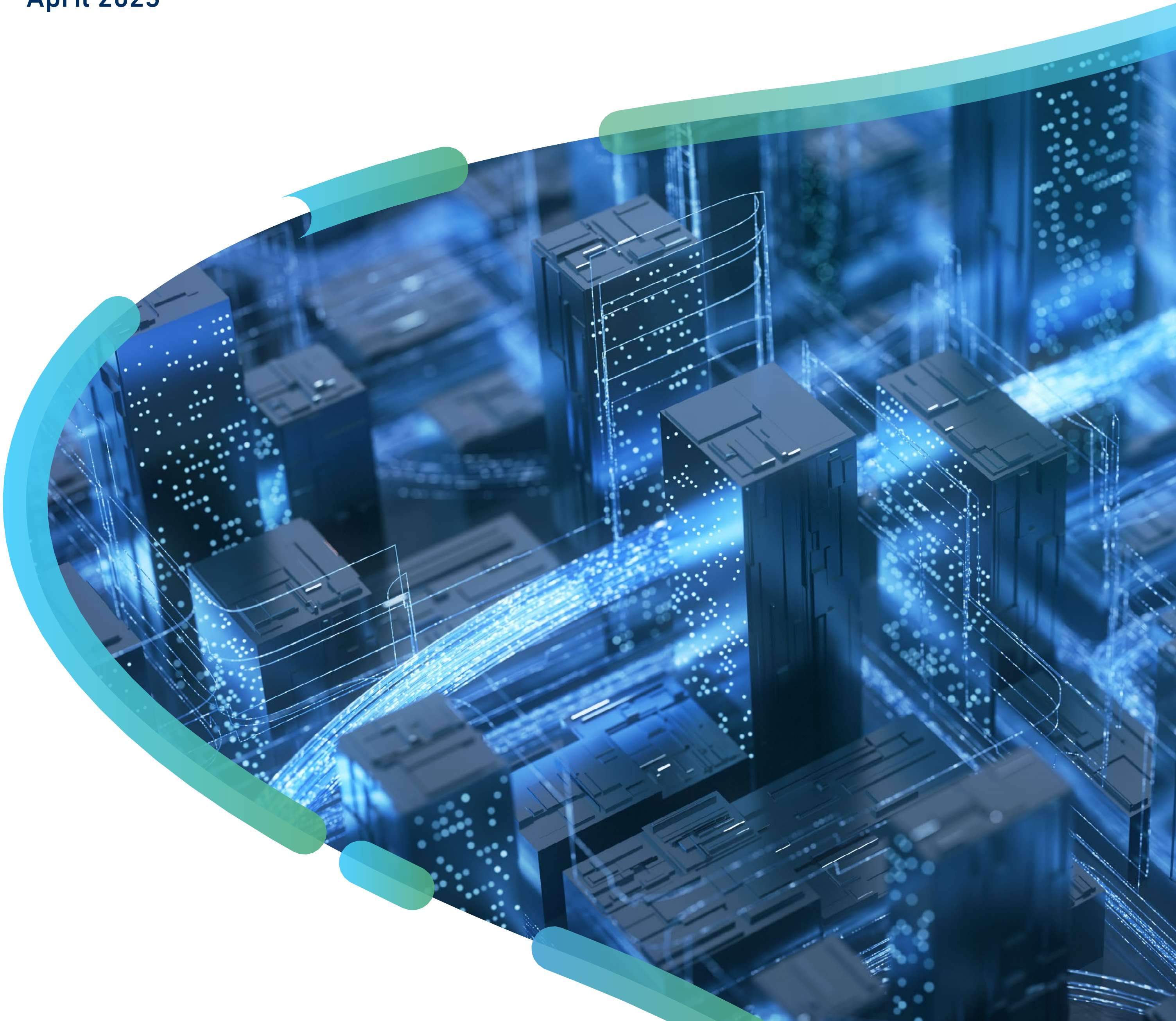

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As private markets assets move from a niche to a core portfolio holding for institutional investors, traditional data management approaches no longer meet the demands of the front and back office. It is time for a new data management model better suited for the multi-asset era.

Private markets boom shifts the dial on portfolio complexity

Asset owners have been moving away from traditional 60/40 portfolio allocation models, as demand for private capital rose in the wake of the Global Financial Crisis, and risk-return objectives have become a challenging task to achieve through publicly traded assets alone.

This shift towards private markets is expected to intensify in the future. With inflation climbing to multi-decade highs in many countries in 2022[1], the inflation-hedging attributes of private market assets have become attractive. Private infrastructure for example has historically outperformed in these conditions as it provides essential services, resulting in generally steady and reliable demand[2].

The inflation-hedging attributes of private markets will ensure the growth seen in sector allocations to date will continue.

Meanwhile, rising global action to address the climate crisis is providing another tailwind for private market allocations. For instance, BloombergNEF forecasts that annual investment in energy infrastructure will need to rise from around US$1.7 trillion per year today, to US$3.1-$5.8 trillion per year on average over the next three decades, if net-zero targets are to be met[3].

Data specialist Preqin's forecasts highlight the potential scale of private market growth: it expects global alternative assets under management to increase from US$13.7 trillion at the end of 2021 to US$23.3 trillion in 2027[4].

[1] Romei, Valentina and Alan Smith. "Global Inflation Tracker." Financial Times. www.ft.com (February 2023).

[2] Leung, Alex, Manisha Bicchieri, Alejandro Tapia, James Pilkington, and Joe Sciortino. "Private Markets Assess the Impact of Inflation." UBS Insights. www.ubs.com (July 2022).

[3] BloombergNEF. "Getting on Track for Net-Zero by 2050 Will Require Rapid Scaling of Investment in the Energy Transition Over the Next Ten Years." BloombergNEF New Energy Outlook. about.bnef.com (July 2021).

[4] Prequin. "Alternatives in 2023." Preqin Global Report 2023. www.preqin.com (January 2023).

For many asset owners, this implies that the traditional balanced portfolio is evolving from a 60/40 model, held in public equity and fixed income, to something closer to a 40/30/30-model, with private assets constituting a much bigger share.

As investors increase their private markets holdings, they are encountering more complex portfolio challenges.

Firstly, risk management is becoming increasingly complex. For instance, investors need to understand the indirect exposure their private markets funds may have to different sectors, companies and themes, and how this aligns with their wider, public markets portfolio. This demands far greater transparency from private markets fund managers, who often report only fund-level returns and metrics to investors.

Secondly, private markets are now attracting greater scrutiny from regulators. In the United States, the Securities and Exchange Commission (SEC) has proposed new disclosure rules for private funds that will require quarterly reporting on fees, expenses and performance metrics.[5] Similarly, the Australian Prudential Regulation Authority (APRA) will enforce guidelines that govern the way superannuation funds value unlisted assets, including valuation frequency and methodology.[6] These regulatory interventions are creating a strain on operations for asset managers, as many of them rely on multiple fragmented systems and processes to manage their private markets data.

The growth of investment in private assets has exposed challenges and complexities in the management of investment risk and regulatory adherence.

[5] US Securities and Exchange Commission. "SEC Proposes to Enhance Private Fund Investor Protection." US Securities and Exchange Commission. www.sec.gov (February 2022)

[6] The Inside Investor. "APRA Ups Scrutiny of Unlisted Property in Super." The Inside Investor. insideinvestor.com.au (March 2023).

Traditional data management models are running out of road

The final outcome of these shifts is that investors are losing momentum while using their present data management infrastructure. Current practices are not adequately meeting the growing demands of portfolio analysis, client reporting and regulatory requirements.

The challenges with the current scenario are multi-fold. The data management landscape in private assets is more complex than in public markets. The underlying assets across private equity, private credit, infrastructure and real estate are diverse, and the financial models needed to value them are often bespoke.

For example, if investing in a wind power project, valuation models might require hourly data sets on electricity generation, pricing data and operational expenditure, all projected for the potential lifespan of the asset. This often requires multiple teams to provide key inputs in separate files for different sections of the model.

Currently, the approach to managing data model inputs is highly unstructured. The majority of the industry uses spreadsheets to collate the different data sets they need and to run valuation models for each individual private asset, with a linked master sheet to provide a consolidated view. The task of updating these valuation models separately for each asset to reflect a change in market conditions is onerous and time consuming. Additionally, these updates are often facilitated by email, which combined can cause significant delays to front-office decision making.

Even sophisticated private markets investors who have moved beyond spreadsheets often use point solutions – siloed software tools to manage specific tasks across the investment lifecycle – that do not address the problem of delays and still are an inefficient use of resources. If you look at infrastructure for example, systems have evolved to understand how to capture and model specific types of assets, such as a toll road or an airport. However, the issue is that these developed data models have little in common and are not transferable across asset types.

These are huge challenges for private markets portfolios, even if investors were looking at them in isolation. However, as we have outlined, it is increasingly important for investors to obtain a holistic view of risk exposures across private and public allocations, and to be able to stress test portfolios at an aggregate level.

For this to happen, private markets data needs to be standardised, and moved from being held in multiple, fragmented systems, to a single platform that also holds public markets data and can scale as the business demands.

Private assets data is relatively unstructured and complex, with data often held in multiple fragmented systems, commonly requiring bespoke data models to complete the valuation process.

Getting data management fit for the future

How can investors use their data infrastructure as a competitive advantage?

In answering this question, we must bear in mind that private markets assets remain complex and idiosyncratic — the need for bespoke valuation models and specialised, best-in-class software tools is not going away.

What investors need is a data model that enables them to achieve a single source of truth, even as multiple point solutions are being used to manage the portfolio. This means implementing an enterprise solution that can connect seamlessly to different data systems being used by teams across the investment lifecycle for private and public markets assets without replacing those individual systems.

Investors need a solution that seamlessly connects different data systems being used across the investment lifecycle and encompasses all asset classes to help provide a single source of truth.

By centralising private and public markets data in this way, investors will be better positioned to respond to market events quickly. For instance, in the event of extreme market stress, investors would be able to obtain a real-time picture of their exposures across their public and private markets allocations. Consider the onset of the COVID-19 pandemic and its immediate impact on the hospitality and travel industries as an example.

With a public-private platform, investors can obtain a clear, aggregated and timely view of their exposure to different sectors all in one place. An integrated approach to position and transaction record-keeping will ensure that this data is accurate and up-to-date. This paves the way for faster, better-informed portfolio stress testing and multi-asset analyses.

An Integrated & Interoperable Platform

Data centralisation can also enable investors to move away from disconnected, inefficient accounting, fund administration and regulatory reporting workflows in the back office. This is critical if back-office teams are to cope with larger, more complex private markets portfolios and the rising level of transparency associated with them. For example, portfolio monitoring and performance reporting with legacy infrastructure is a time-consuming process. These systems often have inflexible reporting and data output capabilities and rely on spreadsheets for historical data. Such limitations make it inherently complex to structure fund accounting data into meaningful outcomes. As a result, ad-hoc analyses can take days to deliver.

The case for diversifying traditional 60/40 portfolios with private markets exposure has become widely acknowledged. However, even as investors rebalance their portfolios, they will realise the full potential of their allocation models only if their data infrastructure can deliver a holistic view of their entire portfolio.

Adopting a comprehensive front-to-back, public-to-private technology solution that combines modern, cost-effective and scalable software and services is the best way to obtain a clear picture of risk exposures across asset classes and to integrate workflows across the investment lifecycle. By taking this approach, investors can embrace the challenges and opportunities of the multi-asset era with confidence.

Centralising public and private markets data helps investors make timely and informed decisions in response to market events.

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