The Investment Podcast

M&G Investments

Episode 8: The democratisation of private assets
3 September 2021

Jo Waldron [00:00:33] Hello and welcome to The Investment Podcast. I'm Jo Waldron and I'm an investment specialist in the Private Assets Team. Today I've got William Nicoll, CIO of Private and Alternative Assets here at M&G, to talk to us about what he's seeing in his business. Private assets have been steadily growing in popularity in recent years. Preqin estimates that global alternative assets AUM you will have a growth rate of somewhere around 10% per annum and will grow from 10 trillion dollars at the end of 2020 to 17 trillion by 2025, which is being led by debt and private equity. William, the private and alternative assets business you run at M&G is pretty large. You've got over 500 people running 62 billion of AUM. With that many people in assets, your definition of private assets is very broad and reaches from Private Equity and Alternatives to Infrastructure and Real Estate with a large Private Debt business incorporating corporate Real Estate, distressed and both structured and consumer finance. That tells me that private assets are an important part of M&G's business. Why do you think that private assets are attractive to clients and why do you think there's been so much excitement about them?

William Nicoll [00:01:36] Hi Jo. I think that you've got a lot of different reasons why people are moving into private assets. One of the things we should think about is when we're talking about private assets, we're talking about assets that aren't public. So, you're talking about a lack of transparency and you're often talking about a lack of liquidity. You are talking about two things which are normally seen as not so good and so there have to be reasons to attract people out of things that are liquid and where you've got real transparency of markets for people to want to do that. You've got a lot more choice sitting in the private markets in terms of what you can do. So, there are, as you said, there are a large number of asset classes going all the way through from Infrastructure Equity and Private Equity ideas through to Real Estate and into the Private Debt discussion. You clearly have a large amount more diversification than you can get elsewhere. I think that is very attractive to large investors like pension funds and big institutional investors. You have the ability in the private markets to be much more bespoke with what you're doing. So, when you think about the protections that you can put on debt or the level of management interaction that you can have when you think about Private Equity, you then have a very different set of interactions and levers you can pull to start thinking about how to change your investment or how to make sure the investment works for you. I think when you think about the interactions that people are having with the companies or the projects that are involved, that also goes very neatly into ESG and impact. If you're able to have good, sensible, easy conversations with management because you have a close relationship with them, about ESG or the impact that they're having on various different areas of their business, it means that it's much easier for us as investors to show clients and show Institutional investors exactly where ESG and impact are coming from in their portfolios and where there might be issues and what we can do about it. We can normally do something about it in the private markets, which is not always so easy in all of the public markets.

Jo [00:04:48] I think that is interesting. You say that private assets are useful for portfolios and useful for our clients. So, why aren't we seeing more of them? Why don't we see the private asset funds in the industry best buyer list?

William [00:05:03] Yeah, I think that is a really good point. The answer comes back to the original discussion that when you're talking about private assets, they're not normally liquid and they're not as transparent. So, they're just more difficult to invest in. When you ally that to the fact that they're more difficult to invest in and you've got a very large number of different asset classes, it then becomes quite complicated. So, the way that we look at it, is that many investors will have very different requirements from their investment portfolios. You end up with something that looks very much like a modular approach, where you have a large number of asset classes that you can put into various different funds, each doing different things. So, for example, if you're looking at long lease property, then quite often that will have an inflation component. You might get 20 years of inflation linkage and that could be very interesting for certain pension schemes. Or you might be looking at something that is slightly shorter-dated, like speciality finance, where you might be getting a significantly higher return over the next seven or eight years. Again, that might be extremely interesting to a whole different set of investors, all the way through from high net worth and into a different sort of institutional investors. So, what we have found is that you have to build a modular approach to try and get access to the right assets of people. That means that you're asking people to understand quite a lot. You're asking your investors to understand how different markets work, and that takes a while. So, I think that we're still in the process where the private markets are developing and, therefore, you would expect, although there's a lot of interest in private markets, that it takes a while for that to feed through into portfolios. What we have also seen is that with the very largest asset allocators, there have been bigger allocations to private and that is through going through different clients and clients sizes. Over the last five years, you've seen much more interest in some of the smaller clients looking to get access to private markets. You then start hearing and seeing some of the difficulties in terms of making sure that there's enough education, that there's enough liquidity and access for these people to be able to get into the private assets they particularly want. I also think that it is worth saying that the scale of these markets and the number of people that you need for each separate market, means that you tend to get concentration towards the larger managers. Ideally, you wouldn't have as many people running private assets as we have because that is a huge resource that we're putting towards it. But you have to do that, in order to do it properly. Each market has its own conventions, and each market has its own way of looking at credit, returns or risks and this needs to be understood.

Jo [00:08:10] So, you've described a world where you've got lots and lots of different pockets that we're trying to put together. We are still only just starting to get towards the smaller clients. It's really dominated by larger clients and larger managers. Is there anything else that can be done to try and solve for the liquidity and the complexity problems?

William [00:08:31] I think that there are a lot of things that we can try and do. Interestingly, of course, there's a lot of things that the regulators and various governments would also like to do because there is an understanding that because an asset is private, because it's illiquid, that doesn't necessarily mean that it's not suitable for pension schemes. If you think about long term infrastructure, that's extremely suitable for somebody's private pension scheme. If they're not going to be able to touch that for the next 20, 30 years, having something with a very long-time scale works quite well. So, what we are seeing is, interest from regulators, whether that's in continental Europe or in the U.K at the moment, with the idea of a long-term asset fund to allow people to get easier access to illiquid assets and to long term assets. Again, there is an education process that will have to go on with that in order to make sure that everybody understands that these things will be less liquid and to make sure that there are markets of some kind that allow us to either trade units in the fund or to easily change ownership of the particular assets or funds. That's going to be a movement away from the standard partnership structures where switching ownership around the place is a little bit more onerous to something that is one of these new structures, whether that's an LTAF, an LTIF or similar.

Jo [00:10:23] That's interesting. So, we think there are structures coming that allow us to see these assets being more accessible for individuals. One of the things that strikes me about having them as an individual investor is your ability to say it is going to be exactly that date when I want to come out of this asset - this is somewhat limited. So, being able to move the assets around within these structures becomes important. Is there any way that you think that we are going to be able to do that more easily because we don't see most of these assets trading very frequently?

William [00:11:05] Yeah, I suppose you need to come back to the idea of what do we mean by liquidity? If you think about publicly-listed shares, then you have a lot of regulations and a lot of rules about how you do that and how you show prices. In many cases, of course, you have very strong liquidity amongst the largest equities. In some of the smaller equities, liquidity is not instant, and I think that the people understand that. So, I don't think it's a point where the idea that everybody needs to have overnight immediate liquidity, I think it is a phase that the market went through in terms of funds. I think it feels like there is an understanding that is not necessary. So, as you say, the bit that's important is the idea that says 'in a couple of years, months or even a couple of weeks, I'll be looking to move these assets, therefore, how do I do that?' rather than the current state, which I think assumes that people at 11:30, can have a cup of coffee and decide that they're going to sell the whole portfolio and can do that by the end of the day. I think that understanding means that there is also an interest in how you transfer these assets. So, although it may take a little bit of time, you want to be able to have a system that allows for transferability. One of the reasonably obvious things that I think should come through the next few years is, is the idea of tokenization. If you think about the various different assets, art or other ideas that have been taken and put onto a blockchain, then there's no reason why you couldn't get a large asset and have that tokenised, allowing for much simpler transferability. I think as soon as you start solving the problem with transferability, you are then setting up the possibility of liquidity, because if everybody understands that to transfer what would have been something like half a building in Munich, for example, which previously, clearly, would take a large amount of work and either would require a whole fund to be set up or require a large amount of property legal diligence. If instead that can be tokenised and, therefore, switching the ownership of that, it becomes relatively simple, cheap, and quick, at that point, the concept of liquidity can follow in the same way that it does when you start to standardise how equities are traded or how government bonds are traded. So that sort of standardisation and that sort of understanding of everything being equal and the tokens being valid, in theory, non-corruptible, then I think you have an interesting idea where the underlying assets become much more possibly liquid. At which point you might see funds becoming much more liquid, which removes, almost immediately, the negative about investing in private assets. Therefore, you can go back to the discussion about diversification, extra yield, extra protections all being very attractive with very little downside. That is going to take a while now.

Jo [00:14:56] That sounds really interesting. So, you're essentially taking an illiquid and difficult to transfer asset and turning it into something digital and easily transferable in the same way that you transfer stocks or bonds in a cross-traded market.

William [00:15:17] Sure. I think we also have to remember that everybody grows up with this idea that the markets are they've been there forever and they're immutable and, of course, they're changing all the time. So, the idea that the Eurobond market, for example, I mean, the corporate bond market is a reasonably recent invention and the liquidity there is solely because it makes sense for the community as a whole to have the ability to be able to trade these bonds and people are willing to pay for that. So, it's the same discussion. As soon as you units that are feasible to trade, then I think you're much more likely to see liquidity. The difficulty at the moment is that there's clearly no possibility of trading things or being able to move things around the place which are so different, when you're talking on one side about a private company in the infrastructure world or a piece of asset-backed securities, mortgages. These things are wildly different, and you need to get a big enough market really to be able to drive liquidity. One of the ways that could happen, is through tokenization of some kind.

Jo [00:16:41] What's the regulatory backdrop to tokenization? Is that something that regulators are happy with or are looking at?

William [00:16:50] I think regulators are looking at it. I can't promise that I really know how far advanced they are and what they're looking at because it's very new. As I say, not that many assets have been tokenised yet and very few things have been done in Europe. It's going to be difficult for the regulator to lead on this because we need to start looking at how that works. For example, whether you use a public or private blockchain is an interesting discussion by itself, because a public blockchain means everybody can see what's happening and a private blockchain can solve the same sort of problems, but what you wouldn't is, you you wouldn't have the ability… you'd limit your market and therefore you'd be limiting your liquidity. So, from a regulator standpoint, I don't think it's yet at the stage where there are enough standard ideas on how to do things, to allow for sensible regulation to come through, beyond that which we already have. Clearly, we have a large amount of regulation already making sure that the transferability, etc. is there. So, I think to start with, this feels like something that will be for very large assets, for large, sophisticated investors, and then that will dribble down quite quickly. Certainly, that's the case if it ends up looking quite cheap and it ends up looking like an easier and cheaper way of transferring assets than we've had before.

Jo [00:18:33] It sounds like you really are at the cutting edge of trying to solve some of the inherent difficulties of investing in private assets. It's been really interesting talking to you today. So, thank you very much for your time and we will see you in the next podcast.

William [00:18:51] Thanks, Jo.

M&G Investments