

PREQIN FUND MANAGER OUTLOOK: ALTERNATIVE ASSETS H1 2018

Private Equity ▪ Venture Capital ▪ Hedge Funds ▪ Real Estate
Infrastructure ▪ Private Debt ▪ Natural Resources

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DATA PACKS FOR PREQIN FUND MANAGER OUTLOOK: ALTERNATIVE ASSETS, H1 2018

The data behind all of the charts featured in this report is available to download for free. Ready-made charts are also included that can be used for presentations, marketing materials and company reports.

To download the data packs, please visit: www.preqin.com/research



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A blue-tinted background image featuring a silhouette of a woman in a business suit standing by a window. Her reflection is visible on the surface below. The window looks out onto a cityscape. The text 'SECTION ONE: PRIVATE EQUITY' is overlaid in white, bold, uppercase letters.

SECTION ONE: PRIVATE EQUITY

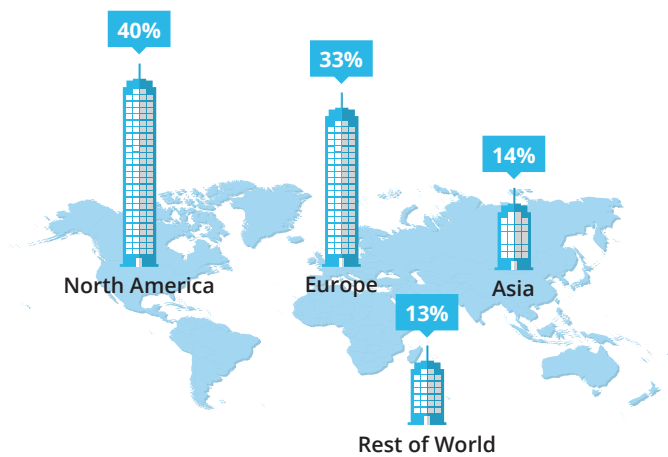
FOREWORD

The private equity industry continues to grow and evolve, presenting new opportunities and challenges for fund managers as they go into 2018. Preqin surveyed over 350 private equity fund managers in November 2017 to gauge their views on a wide range of topics, including the key issues affecting the industry, deal flow, the exit environment, investor appetite and future fundraising plans.

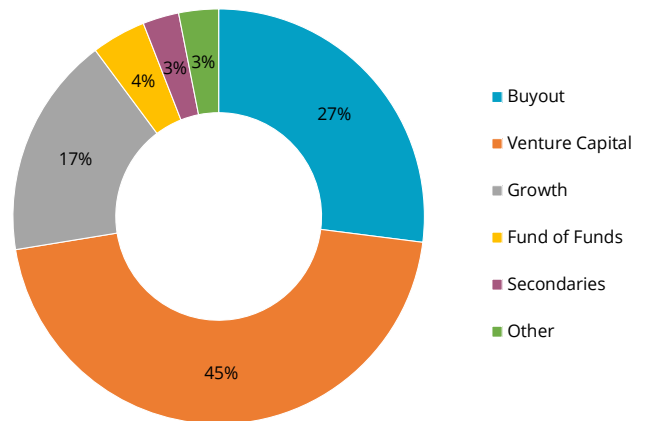
After years of rising prices, valuations remain the number one concern facing private equity fund managers. Fifty-eight percent of surveyed fund managers believe that pricing for portfolio companies is higher than 12 months ago and consequently 30% reported that they are finding it more difficult to find attractive investment opportunities. While many fund managers remain confident in their ability to innovate and find value, a significant proportion (36%) reported that they are reducing the targeted returns for their funds due to current valuations.

Despite these challenges, there remain many sources of optimism for GPs. Fund managers predict an improvement in the exit environment in the year ahead, with 39% expecting to see increased exit activity across the industry, while 56% expect their firm to make more exits than last year. Investor demand also remains as strong as ever, with 67% of fund managers noting an increase in investor appetite for private equity over the past 12 months. This is contributing to a strong fundraising environment and a healthy pipeline of funds coming to market: 24% of surveyed managers are already in market with their next fund, with a further 36% planning to begin raising new funds in 2018.

Survey Respondents by Headquarters Location:



Survey Respondents by Primary Investment Strategy:



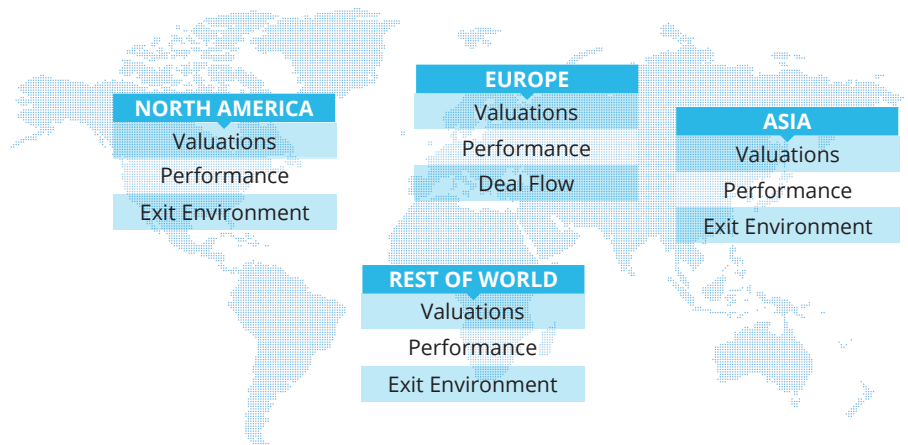


KEY CHALLENGES

The continued success of the private equity asset class in recent years, with strong returns and distributions to investors, has helped to drive increased investor interest in the asset class and growing levels of assets under management (AUM). It has, however, also brought its own challenges as higher levels of dry powder held by private equity firms have increased competition for assets and helped to drive up pricing.

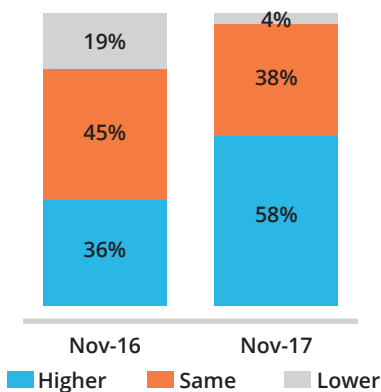
In November 2017, Preqin surveyed over 350 private equity firms globally to record their views on the key challenges facing the industry. For the third consecutive year, high company valuations were

Fund Managers' Top Three Issues for the Private Equity Market in 2018 by Fund Manager Location:



Source: Preqin Fund Manager Survey, November 2017

FUND MANAGER VIEWS ON PRICING FOR PORTFOLIO COMPANIES COMPARED TO 12 MONTHS AGO

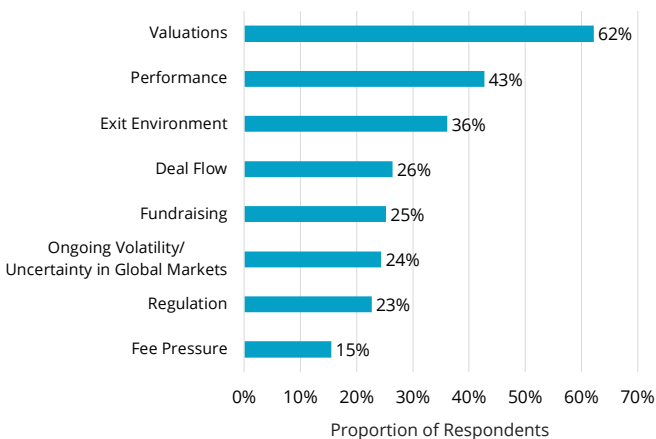


identified by the largest proportion of respondents as the biggest challenge in 2018 (Fig. 1.1), both globally and in each major region.

The raised valuations being paid for portfolio companies have become increasingly clear to fund managers over the past year. Fifty-eight percent of fund managers surveyed reported that pricing for portfolio companies had increased compared to 12 months ago – this is 22 percentage points higher than the recorded response in 2016’s survey. High valuations feed into the second

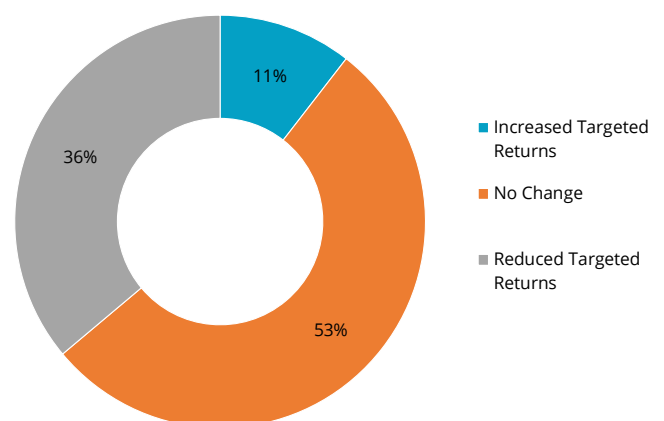
major concern among fund managers: performance. While rising valuations increase the likelihood that fund managers will be able to earn favourable returns on their current investments, they reduce the opportunity for firms to acquire new assets at sufficiently affordable prices to generate the high returns that investors have come to expect. Accordingly, 36% of fund managers reported that they are reducing their targeted returns for future funds due to high valuations in the market, compared to only 11% that plan to increase their targets (Fig. 1.2).

Fig. 1.1: Key Challenges Facing Private Equity Fund Managers in 2018



Source: Preqin Fund Manager Survey, November 2017

Fig. 1.2: Fund Manager Views on the Impact of Valuations on Targeted Fund Returns



Source: Preqin Fund Manager Survey, November 2017

DEAL FLOW AND COMPETITION

Distributions continue to outstrip capital calls, causing high LP liquidity and increased investor appetite for private equity investments, which in turn creates competition among managers. As Fig. 1.3 illustrates, 92% of respondents have stated that finding attractive investment opportunities is just as difficult or harder than 12 months ago – although the reality is that, regardless of competition, GPs will have to continue to put the record levels of accrued dry powder to work.

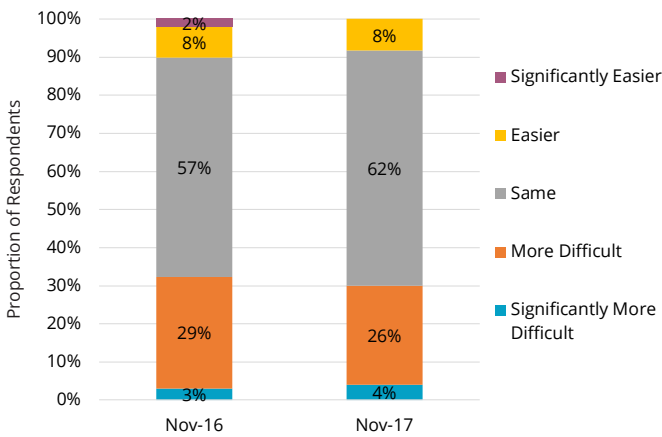
A side effect of the difficulties fund managers are facing when sourcing

attractive investment opportunities is the need to review more of them: 46% of respondents reviewed more opportunities per investment in 2017 compared to 2016 (Fig. 1.4). Furthermore, nearly half (49%) of fund managers have seen an increase in competition for transactions compared to 12 months ago (Fig. 1.5). An average of 49% of surveyed GPs saw an increase in competition across all stages of venture capital investment over 2017. However, a significant 12% and 13% of managers saw a decrease in competition for seed and late stage investments respectively. The majority (56%) of respondents cited

increased competition in growth funds, while just 4% noted a decrease. Mid-market buyout transactions appear to have experienced the highest level of increased competition of any investment type, as cited by 64% of managers.

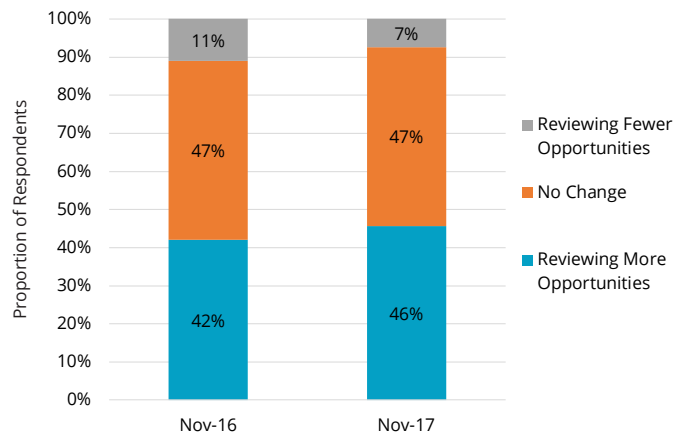
The majority of fund managers surveyed, irrespective of location, are planning to invest more capital in private equity assets in the year ahead compared to 2017 (Fig. 1.6). Notably, 86% of fund managers based in Rest of World regions are set to increase their investments in 2018, including 57% that will invest significantly more capital.

Fig. 1.3: Fund Manager Views on the Difficulty of Finding Attractive Investment Opportunities Compared to 12 Months Ago, 2016 vs. 2017



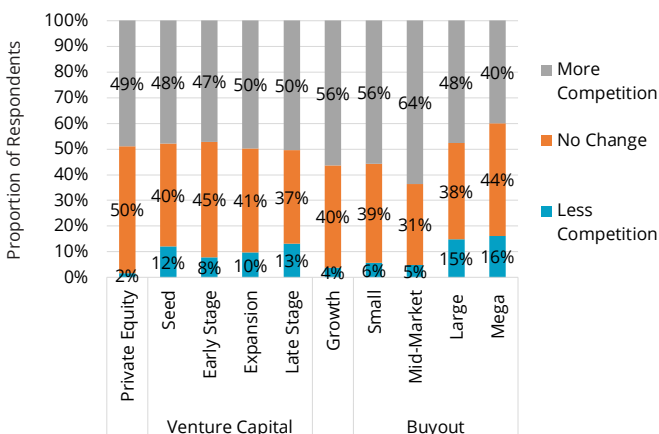
Source: Preqin Fund Manager Survey, November 2016 - 2017

Fig. 1.4: Fund Manager Views on the Number of Opportunities Reviewed per Investment Compared to 12 Months Ago, 2016 vs. 2017



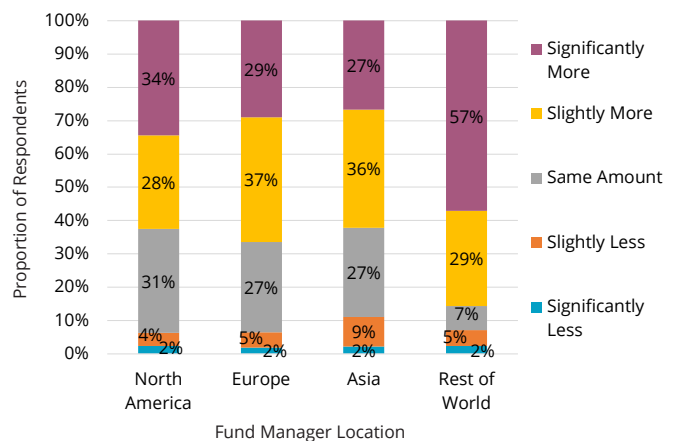
Source: Preqin Fund Manager Survey, November 2016 - 2017

Fig. 1.5: Fund Manager Views on the Level of Competition for Transactions Compared to 12 Months Ago



Source: Preqin Fund Manager Survey, November 2017

Fig. 1.6: Amount of Capital Fund Managers Plan to Deploy in Private Equity Assets in 2018 Compared to 2017 by Fund Manager Location



Source: Preqin Fund Manager Survey, November 2017



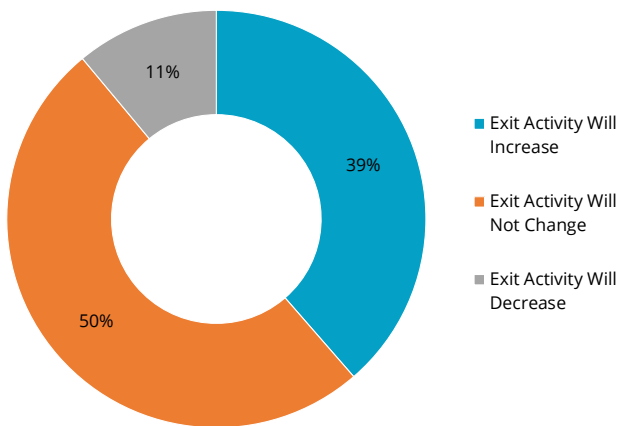
EXIT ENVIRONMENT

Although the number of buyout and venture capital exits has dropped in recent years, as shown in the **2018 Preqin Global Private Equity & Venture Capital Report**, our latest survey results show that fund managers surveyed by Preqin predict a strong exit environment in 2018. Thirty-nine percent of surveyed fund managers predict increased exit activity over the next 12 months, compared to only 11% that expect activity to decline (Fig. 1.7).

In terms of where these exit opportunities will come, fund managers predict increased activity across all exit types but particularly through trade sales: 51% of fund managers predict increased numbers of trade sales over the next 12 months, compared to only 4% that expect to see fewer (Fig. 1.8). In contrast, fund managers were split on the prospects for the IPO market in 2018, with 37% expecting to see more IPOs and 20% foreseeing a slowdown in IPO activity.

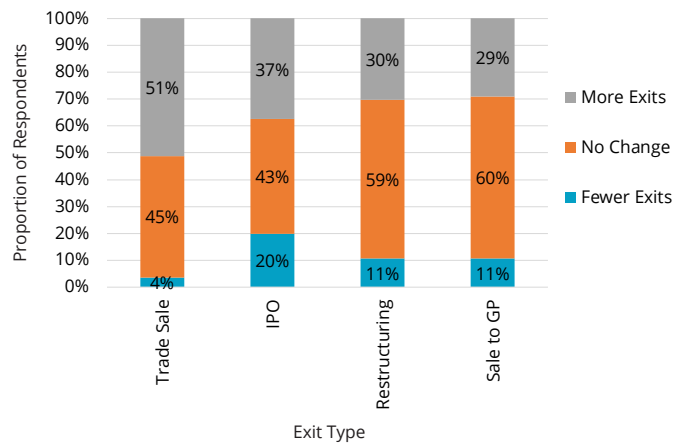
In terms of their individual firms, fund managers matched their broader predictions for the market as a whole, with 56% of fund managers planning to make more exits in 2018 than they did in 2017, including 8% that plan to make significantly more (Fig. 1.9). By comparison, only 9% of respondents foresee making fewer exits over the next year.

Fig. 1.7: Fund Manager Expectations for the Exit Environment in the Next 12 Months



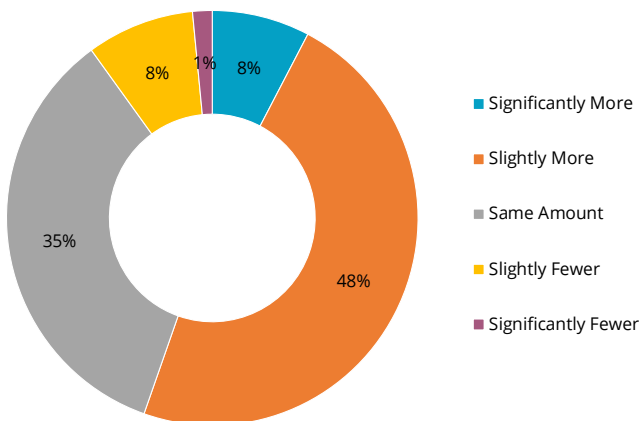
Source: Preqin Fund Manager Survey, November 2017

Fig. 1.8: Number of Exits Fund Managers Expect to See in the Industry over the Next 12 Months by Exit Type



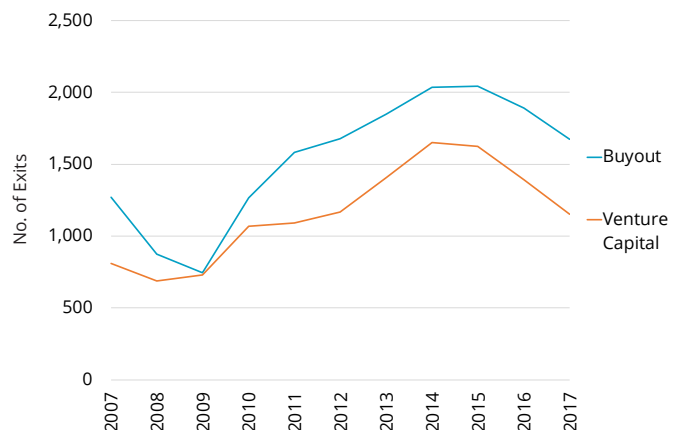
Source: Preqin Fund Manager Survey, November 2017

Fig. 1.9: Fund Managers' Planned Number of Exits in 2018 Compared to 2017



Source: Preqin Fund Manager Survey, November 2017

Fig. 1.10: Number of Buyout and Venture Capital Exits Globally, 2007 - 2017



Source: Preqin Private Equity Online

FUND MANAGER VIEWS ON INVESTOR APPETITE

The results of our latest fund manager survey indicate that investor demand for private equity has increased over 2017. Two-thirds of fund managers reported an increase in investor appetite – up nine percentage points on 2016 survey results – with just 8% of GPs reporting a decrease (Fig. 1.11).

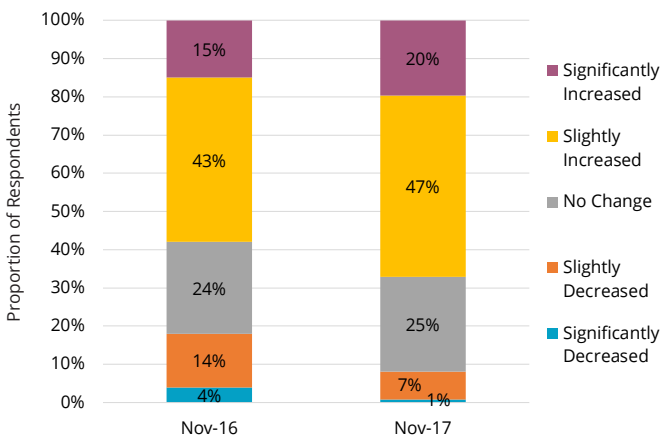
As in 2016, this increased demand has come from family offices in particular, as identified by 63% of fund managers (Fig. 1.12). GPs also reported a noticeable increase in demand from fund of funds managers (42%), asset managers (37%) and private sector pension funds (36%).

A significant proportion (20%) of fund managers identified banks as having shown a decrease in appetite – a direct impact of regulatory changes such as the Volcker Rule.

As the Asian private equity market matures, appetite from investors based in the region has increased: half of GPs identified an increase in demand from Asia-based LPs, the largest proportion of any region (Fig. 1.13). Even in the most mature private equity markets of North America and Europe, fund managers continue to see increased appetite from large proportions of investors.

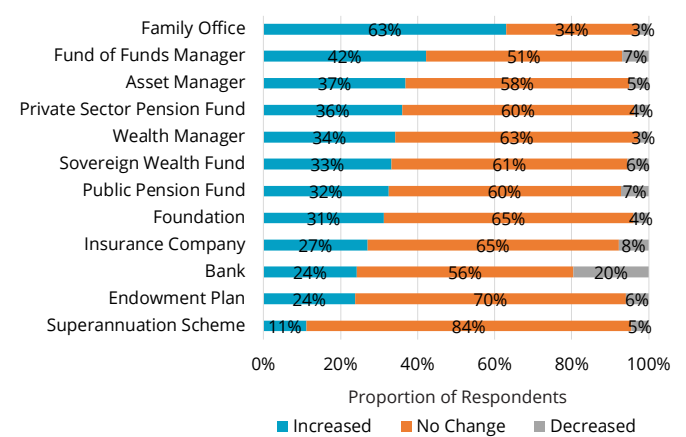
The continued growth in investor appetite will be welcome news to fund managers; yet, with a record 2,485 private equity funds in market (as at February 2018), competition for investor capital remains fierce. Seventy-three percent of GPs reported an increase in competition for investor capital over the past 12 months (Fig. 1.14). This level has remained consistent over the past few years; however, with 53% of investors interviewed by Preqin in December 2017 planning to increase their allocations over the longer term – the largest proportion recorded – it is likely there will remain opportunities to raise capital going forwards.

Fig. 1.11: Fund Manager Views on How Institutional Investor Appetite for Private Equity Has Changed over the Past 12 Months, 2016 vs. 2017



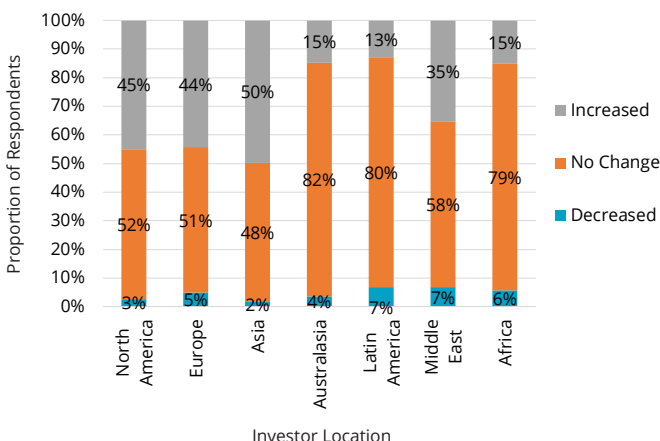
Source: Preqin Fund Manager Survey, November 2016 - 2017

Fig. 1.12: Fund Manager Views on How Institutional Investor Appetite for Private Equity Has Changed over the Past 12 Months by Investor Type



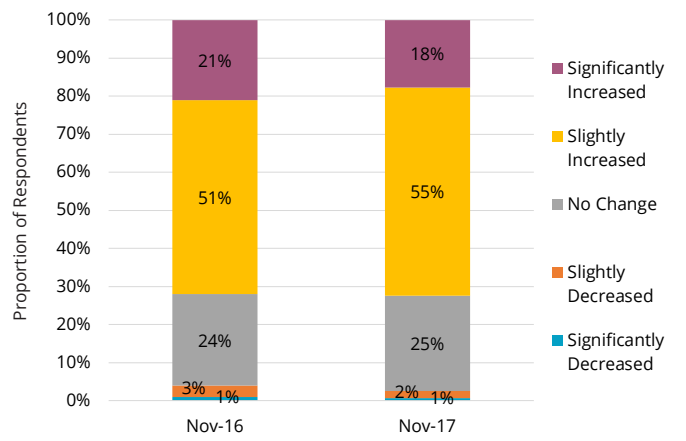
Source: Preqin Fund Manager Survey, November 2017

Fig. 1.13: Fund Manager Views on How Institutional Investor Appetite for Private Equity Has Changed over the Past 12 Months by Investor Location



Source: Preqin Fund Manager Survey, November 2017

Fig. 1.14: Fund Manager Views on the Level of Competition for Institutional Investor Capital Compared to 12 Months Ago, 2016 vs. 2017



Source: Preqin Fund Manager Survey, November 2016 - 2017

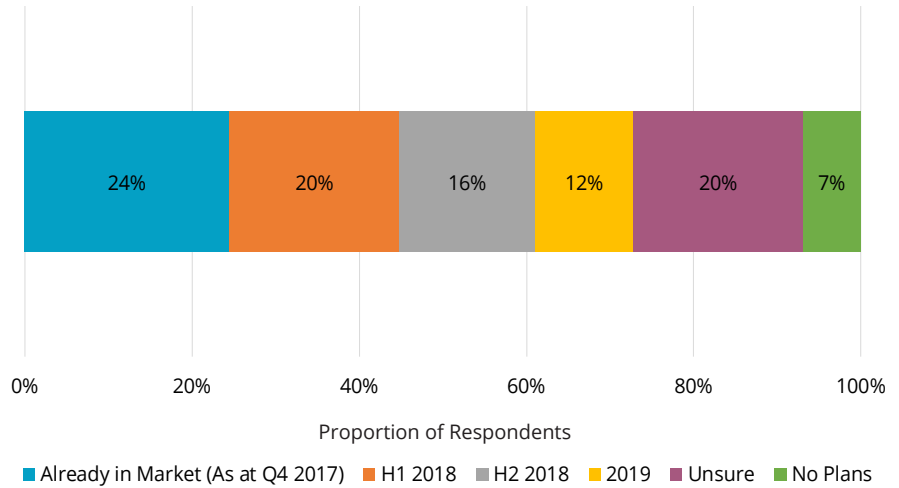


FUTURE PLANS

The rapid growth of the private equity fund market looks set to continue in 2018, as fund managers continue to bring new vehicles to market. At the time of the survey (November 2017), close to a quarter (24%) of fund managers were already in market with their next fund, while a further 36% were planning to begin fundraising in 2018 (Fig. 1.15).

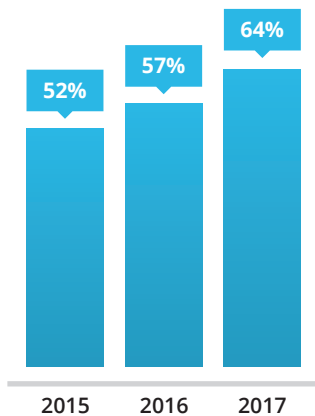
Fund managers are not just planning traditional commingled funds, but are also increasingly offering alternative structures to investors – a direct response to an increasingly sophisticated investor universe looking to maximize returns and reduce costs. Co-investment use, in particular, has increased rapidly in recent

Fig. 1.15: Timeframe with Which Fund Managers Intend to Launch Their Next Private Equity Fund



Source: Preqin Fund Manager Survey, November 2017

FUND MANAGERS OFFERING CO-INVESTMENTS



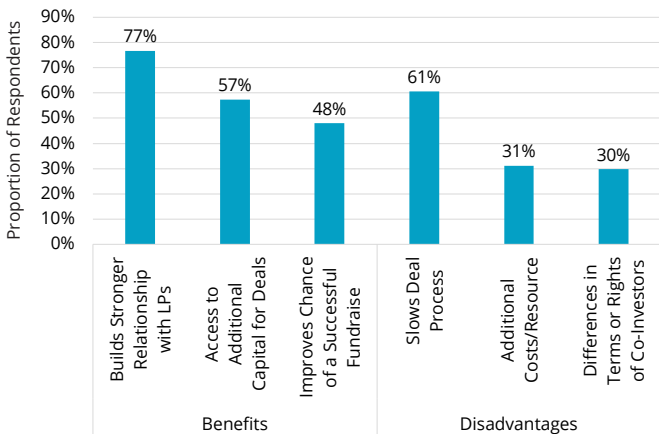
years: of fund managers surveyed, 52% offered co-investment opportunities in November 2015, while 64% do so as at November 2017. For many fund managers, the benefits, such as building a stronger relationship with investors and gaining access to additional capital for deals, can help outweigh the costs, such as difficulties that may arise in executing deals (Fig. 1.16).

Thirty-seven percent of surveyed fund managers plan to offer more co-investment opportunities in the next 12

months than they have over the past year, compared with just 4% that plan to offer fewer (Fig. 1.17). In addition, 18% of fund managers plan to offer more separate accounts over the next 12 months, and 15% intend to offer more joint ventures.

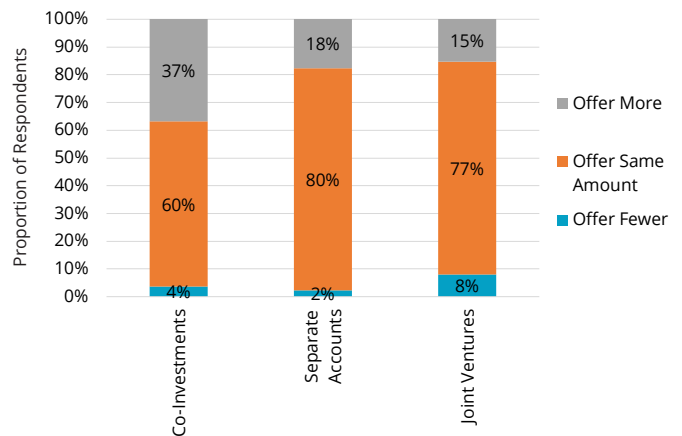
As investors continue to request means to adjust their portfolios to their specific risk/return preferences, demand for these vehicles is likely to increase, and their use likely to become more commonplace as fund managers seek to satisfy investor demand.

Fig. 1.16: Fund Managers' Perceived Benefits and Disadvantages of Offering Co-Investment Rights



Source: Preqin Fund Manager Survey, November 2017

Fig. 1.17: Fund Managers' Plans to Offer Alternative Structures to Investors in the Next 12 Months Compared to the Past 12 Months



Source: Preqin Fund Manager Survey, November 2017



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SECTION TWO: VENTURE CAPITAL



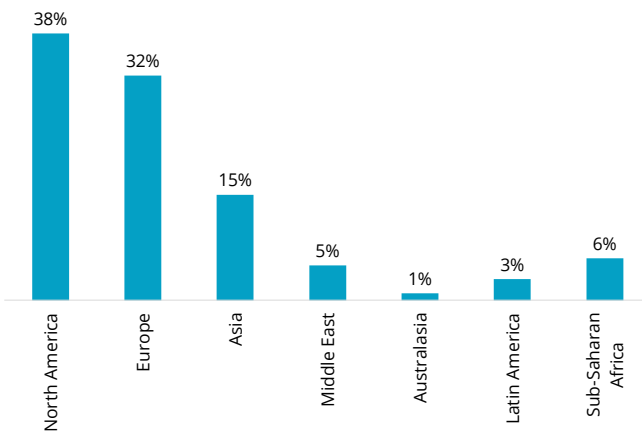
FOREWORD

Venture capital is a unique strategy with characteristics that differentiate it from buyout, growth equity and other foundational categories of private equity, so much so that some consider the strategy to be an asset class on its own. As the sector with the largest share of private equity fund managers, capital commitments to the space have grown in recent years, with venture capital appearing more commonly in institutional portfolios.

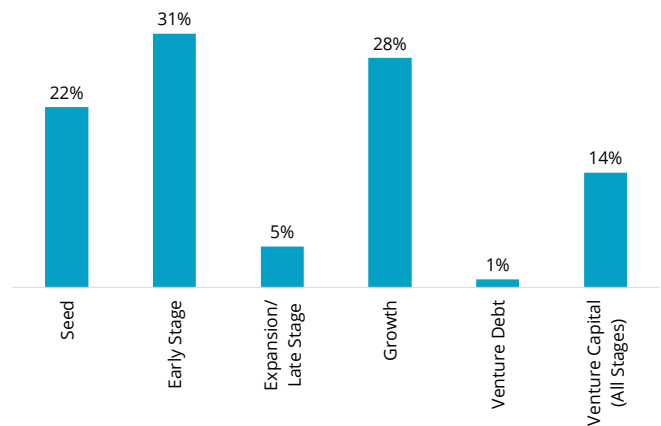
However, concerns remain among venture capital managers regarding performance, the current exit environment and deal pricing/valuations in 2018. Valuations are a common concern in all areas of alternative assets, with public markets at or near all-time highs. Performance is also likely to remain a concern given that deals have become increasingly expensive in the space.

Of the venture capital managers Preqin surveyed for this report, 38% are headquartered in North America, 32% in Europe and 15% in Asia, with the remainder located in Australasia, Latin America, Sub-Saharan Africa and the Middle East. Early stage is the most prevalent primary strategy among respondents (31%), followed by growth (28%) and seed investing (22%). More than 58% of respondents manage less than \$100mn in assets, while 7% manage more than \$1bn.

Survey Respondents by Headquarters Location:



Survey Respondents by Primary Venture Capital Investment Strategy:





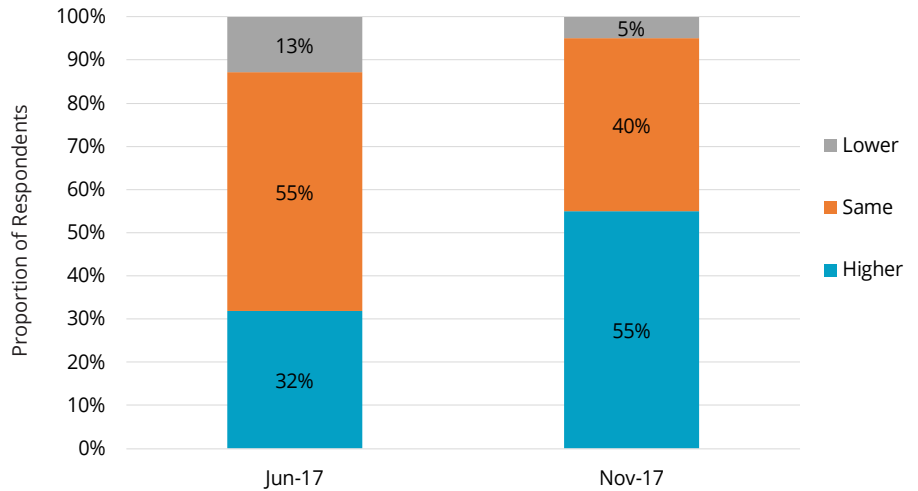
DEAL FLOW AND COMPETITION

Competition among managers, cheap financing and a global bump in venture capital fundraising are just a few of the reasons why asset valuations have increased steadily in recent years. It is unsurprising that 55% of GPs surveyed at the end of 2017 reported higher pricing for portfolio companies compared to 12 months prior, up 23 percentage points from the proportion surveyed in June 2017 (Fig. 2.1).

“Fund managers are confident that the exit environment will continue to gain momentum in 2018

Managers are under increasing pressure to keep pace of deal flow and produce the high absolute returns that have historically attracted them to the industry. A larger proportion (17%) of GPs surveyed cited deal flow as a key industry challenge in 2018 compared to 2017. Nearly all managers (98%) stated that the level of competition for transactions is either the same or greater than 12 months ago (Fig. 2.2). The US remains the most competitive marketplace for venture capital, with

Fig. 2.1: Fund Manager Views on Portfolio Company Pricing Compared to 12 Months Ago, June vs. November 2017



Source: Preqin Fund Manager Survey, June - November 2017

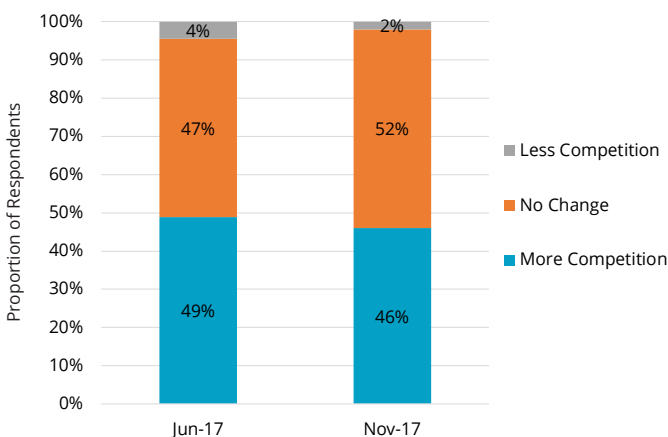
the West Coast the main hub for both managers and activity.

High valuations coupled with increased competition have resulted in a larger proportion (27%) of managers finding it more difficult to source attractive investment opportunities compared to 12 months ago (Fig. 2.3). Just 11% of GPs reported that it was now easier to source deals, while 62% cited no difference in the market. In efforts to consistently find enticing opportunities, fund managers

are having to review more investment proposals: the largest proportion (47%) of GPs are reviewing more investment opportunities now than they were 12 months ago (Fig. 2.4).

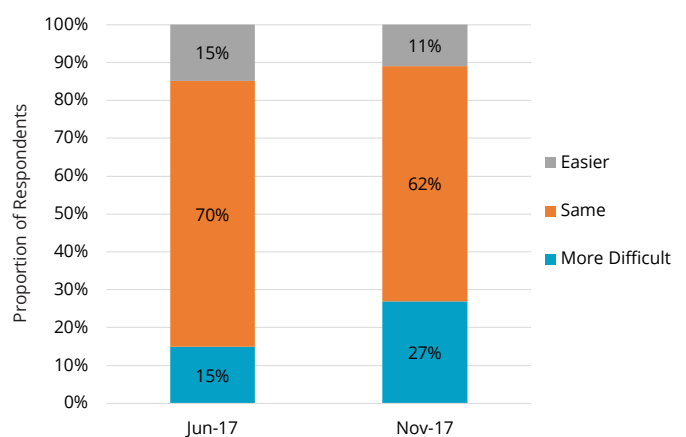
Fund managers are confident that the exit environment, which recovered over the course of 2017, will continue to gain momentum in 2018. The majority (61%) of respondents expect to exit more investments in 2018 compared with 2017, while another 29% expect to

Fig. 2.2: Fund Manager Views on the Level of Competition for Transactions Compared to 12 Months Ago, June vs. November 2017



Source: Preqin Fund Manager Survey, June - November 2017

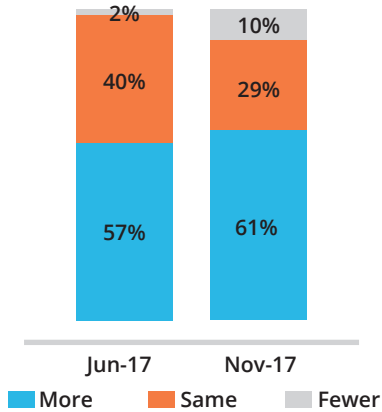
Fig. 2.3: Fund Manager Views on the Difficulty of Finding Attractive Investment Opportunities Compared to 12 Months Ago, June vs. November 2017



Source: Preqin Fund Manager Survey, June - November 2017

exit a similar number. However, despite managers' increasing confidence in the exit environment, a greater proportion (10%) of respondents plan to exit fewer investments in the coming year than those surveyed in June 2017 (2%).

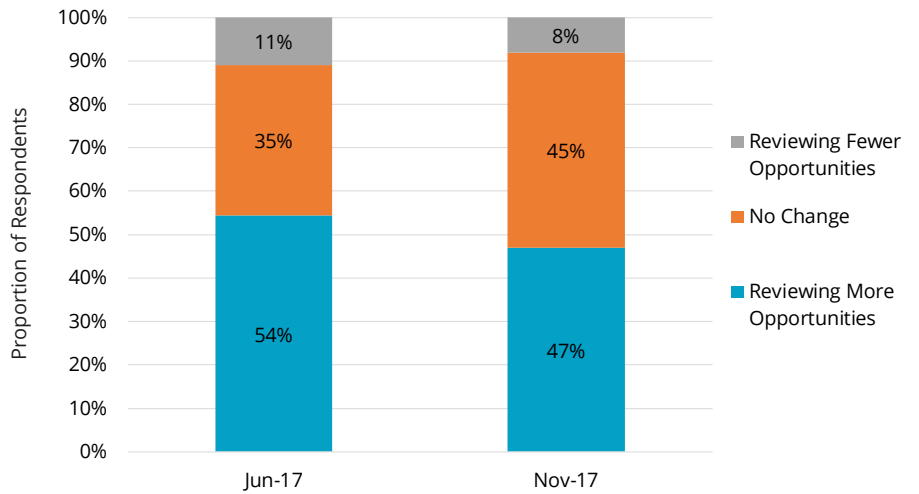
FUND MANAGERS' PLANNED NUMBER OF EXITS IN 2018 COMPARED TO 2017



Fund managers were also asked about levels of competition for transactions at each distinct venture capital investment stage, as shown in Fig. 2.5. For each stage, the largest proportion of managers saw an increase in competition over the past 12 months, led by 52% for seed investments and 50% for growth transactions. The largest proportion of managers that reported less competition for transactions was 12% for later stage investments, although this proportion remains relatively small.

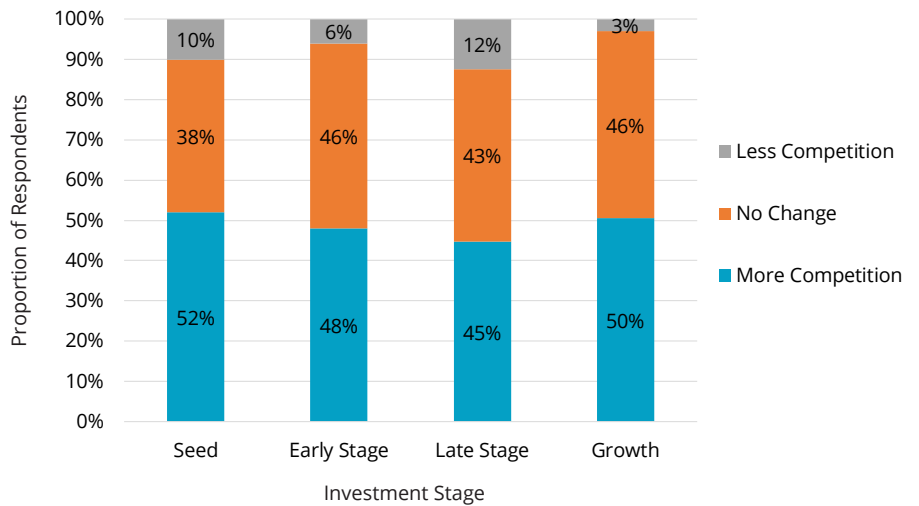
The proportion of fund managers that feel debt financing terms for acquirors have improved has increased by 15 percentage points from those surveyed in June 2017, yet it is still the case that the majority (54%) of fund managers have seen no change in terms (Fig. 2.6). The cost of debt has played a strong part in the proliferation of alternative investing in a low interest rate environment in recent years. Although interest rates have increased over the course of 2017, just 14% of fund managers feel debt financing terms have worsened in the past year.

Fig. 2.4: Fund Manager Views on the Number of Opportunities Reviewed per Investment Compared to 12 Months Ago, June vs. November 2017



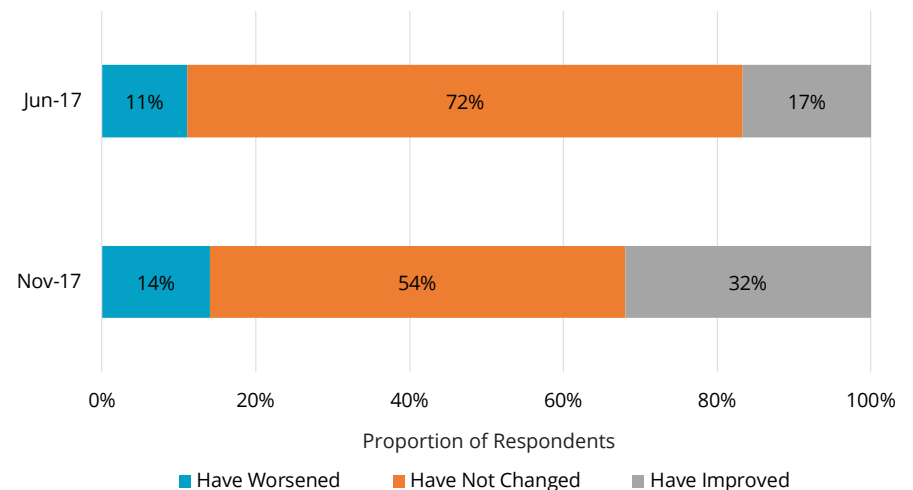
Source: Preqin Fund Manager Survey, June - November 2017

Fig. 2.5: Fund Manager Views on the Level of Competition for Transactions Compared to 12 Months Ago by Investment Stage



Source: Preqin Fund Manager Survey, November 2017

Fig. 2.6: Fund Manager Views on How Debt Financing Terms for Acquirors Have Changed over the Past 12 Months, June vs. November 2017



Source: Preqin Fund Manager Survey, June - November 2017



FUND MANAGER VIEWS ON INVESTOR APPETITE

A favourable fundraising environment is likely to continue in 2018 as the majority (60%) of GPs surveyed noted an increase in investor appetite for venture capital over the past 12 months, up six percentage points from June 2017 (Fig. 2.7).

The investor type from which the largest proportion (61%) of GPs noted an uptake in interest is family offices (Fig. 2.8). In addition, large proportions of fund managers also noticed increased appetite from fund of funds managers (41%), asset managers (37%) and wealth managers (35%)

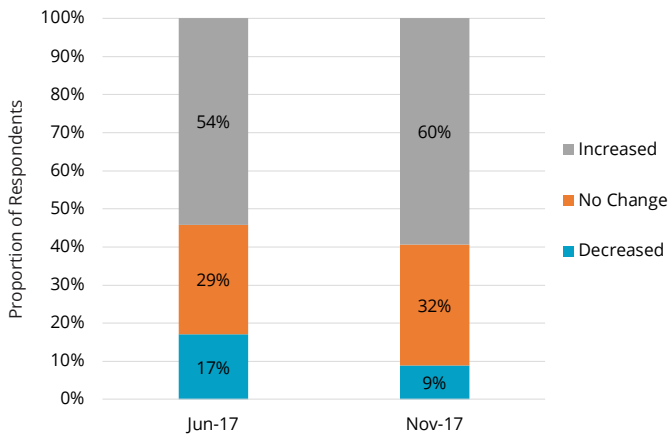
(35%). In contrast, the largest proportion (20%) of fund managers experienced a decrease in appetite for venture capital from banks.

When asked about investors' behaviour by location, 58% of fund managers reported an increase in appetite from Asia-based investors, while just 1% felt their interest had declined (Fig. 2.9). Considerable proportions of fund managers feel that demand for venture capital has increased from investors based in Europe (46%), North America (41%) and MENA (39%) over the past 12 months. In contrast, the

majority (78%) of fund managers have seen no change in venture capital interest from Australasia-based investors, with just 17% having seen an increase in appetite.

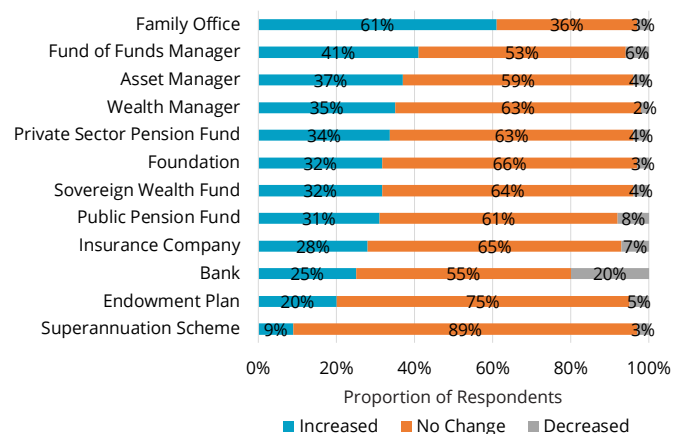
Although GPs reported a slight improvement in the level of competition among fund managers from six months ago, as seen in Fig. 2.10, the ongoing fight for investor commitments will likely intensify in 2018. Just 26% of investors surveyed by Preqin expect to increase their allocation to venture capital over the long term, which will, in turn, slow the growth of available investor capital.

Fig. 2.7: Fund Manager Views on How Investor Appetite for Venture Capital Has Changed over the Past 12 Months, June vs. November 2017



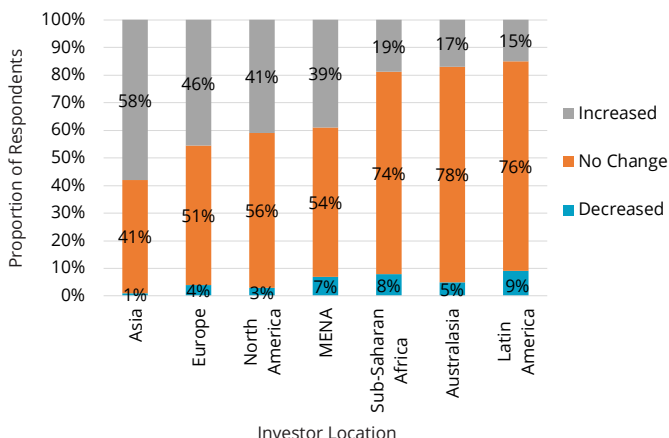
Source: Preqin Fund Manager Survey, June - November 2017

Fig. 2.8: Fund Manager Views on How Investor Appetite for Venture Capital Has Changed over the Past 12 Months by Investor Type



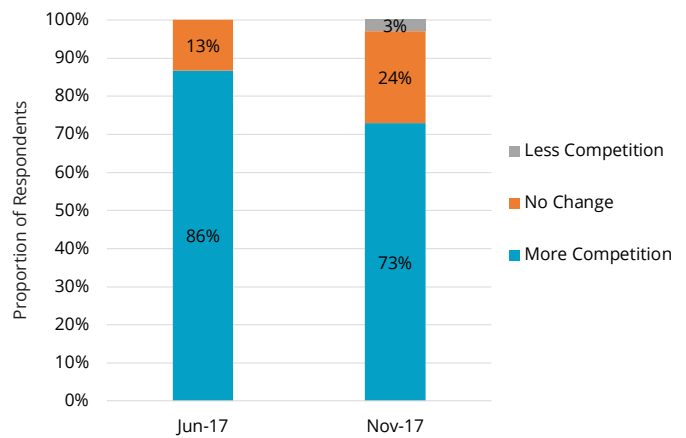
Source: Preqin Fund Manager Survey, November 2017

Fig. 2.9: Fund Manager Views on How Investor Appetite for Venture Capital Has Changed over the Past 12 Months by Investor Location



Source: Preqin Fund Manager Survey, November 2017

Fig. 2.10: Fund Manager Views on the Level of Competition for Investor Capital Compared to 12 Months Ago, June vs. November 2017



Source: Preqin Fund Manager Survey, June - November 2017

IN FOCUS: ESG

An increasingly competitive environment coupled with evolving LP preferences have pushed GPs to further distinguish themselves in order to successfully fundraise. A significant proportion (58%) of GPs stated a unique fund strategy is most important in differentiating themselves from other managers. With a rising population of LPs concerned with the impact and sustainability of their investments, the importance of environmental, social and corporate governance (ESG) policies is greater than ever.

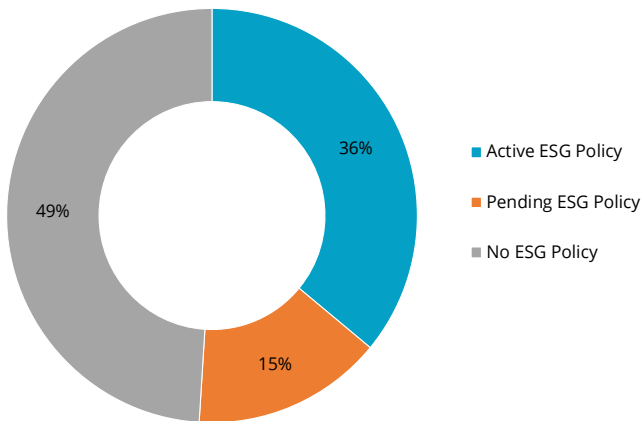
The majority (51%) of fund managers surveyed either have an active ESG policy or have one pending (Fig. 2.11). Yet, just under a third (31%) of GPs require portfolio companies to report on ESG or responsible investment activity (Fig. 2.12). The largest proportion (67%) of managers do not track ESG metrics, while just 13% of GPs report ESG metrics to investors quarterly or more frequently (Fig. 13).

As seen in Fig. 2.14, Europe-based managers are most likely to consider ESG factors: 61% of respondents either maintain an ESG policy or have one pending, while nearly the same proportion (62%) of North America-based GPs do not

consider ESG factors. Under a third of Asia- and North America-based managers have an active ESG policy.

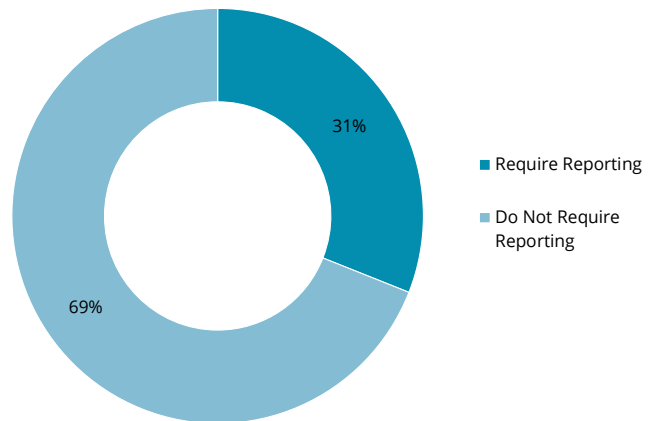
Although a significant proportion of managers consider ESG factors as part of their investment strategy, only a few actively collect and report on ESG metrics. A window of opportunity exists for managers to further differentiate themselves by employing more granular ESG objectives such as mandatory reporting, active engagement with portfolio companies, integration of ESG initiatives with fund strategy, and timely communication with LPs, among others.

Fig. 2.11: Fund Managers' Policies Regarding ESG Investment



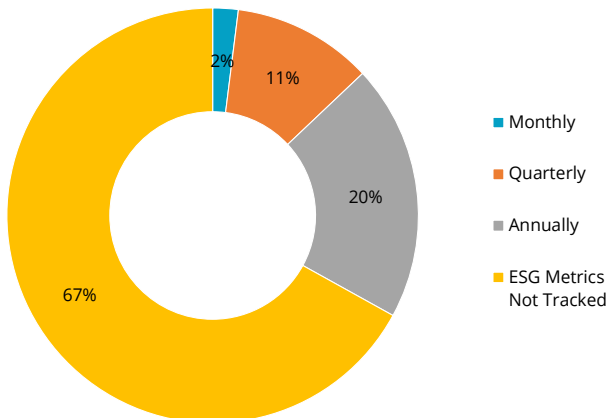
Source: Preqin Fund Manager Survey, November 2017

Fig. 2.12: Fund Managers that Require Venture Capital Portfolio Companies to Report on ESG Factors



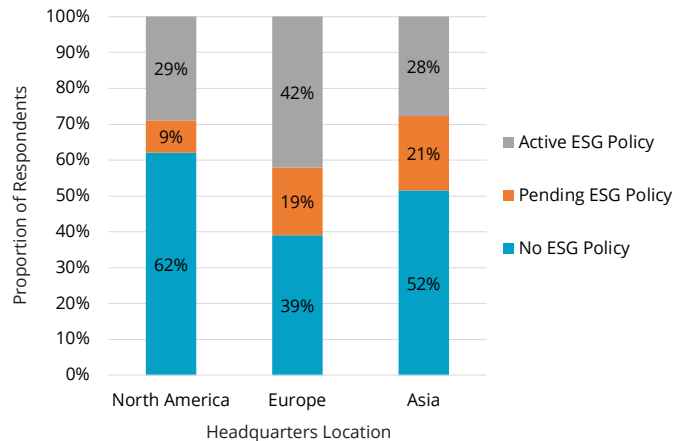
Source: Preqin Fund Manager Survey, November 2017

Fig. 2.13: Frequency with Which Fund Managers Report to LPs Regarding Their Venture Capital Portfolios' ESG Metrics



Source: Preqin Fund Manager Survey, November 2017

Fig. 2.14: Fund Managers' Policies Regarding ESG Investment by Headquarters Location



Source: Preqin Fund Manager Survey, November 2017



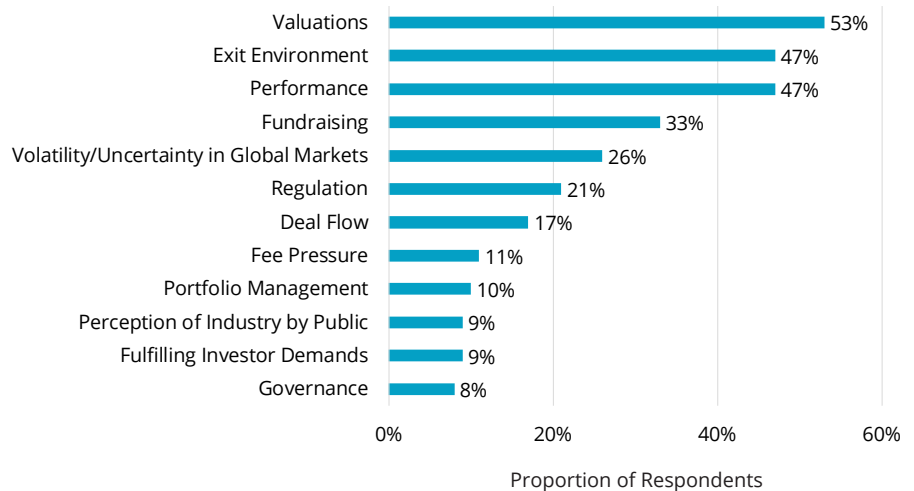
OUTLOOK AND FUTURE PLANS

Deal pricing, the current exit environment and performance are at the forefront of managers' concerns in 2018. The majority (53%) of fund managers cited deal pricing as one of the biggest challenges facing the industry in the coming year (Fig. 2.15), up 18 percentage points from our survey six months ago. The current exit environment and fund performance follow closely behind, both cited by 47% of GPs as key challenges in the next 12 months.

With the majority (62%) of GPs expressing no concern over their ability to source promising investment opportunities, it is no surprise that 66% of fund managers surveyed expect to deploy more capital in the next 12 months than in the previous year, including 36% that expect to commit significantly more (Fig. 2.16).

Valuations remain a key industry issue: 46% of GPs have altered their targeted returns for their latest fund launches. Likewise, a greater proportion of GPs surveyed have altered their investment strategies due to increased competition in the space compared to six months ago, although this figure represents just over a quarter of managers surveyed.

Fig. 2.15: Key Challenges Facing Venture Capital Fund Managers in 2018



Source: Preqin Fund Manager Survey, November 2017

Over the next 12 months, 40% of fund managers plan to offer more co-investment opportunities to limited partners in their funds (Fig. 2.17), up 10 percentage points from June 2017. The majority of managers plan to offer the same amount of separate account and joint venture rights to limited partners, as reported by 82% and 76% of respondents respectively. When asked about the expected timing of their next venture capital fund launch, over a quarter of fund managers currently have a fund in market as at Q4 2017. A further 38% plan to launch a fund in the first half of 2018.

FUND MANAGER VIEWS ON WHETHER VALUATIONS HAVE ALTERED TARGETED RETURNS FOR THEIR LATEST FUND LAUNCHES

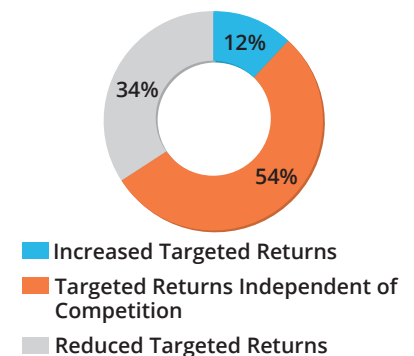
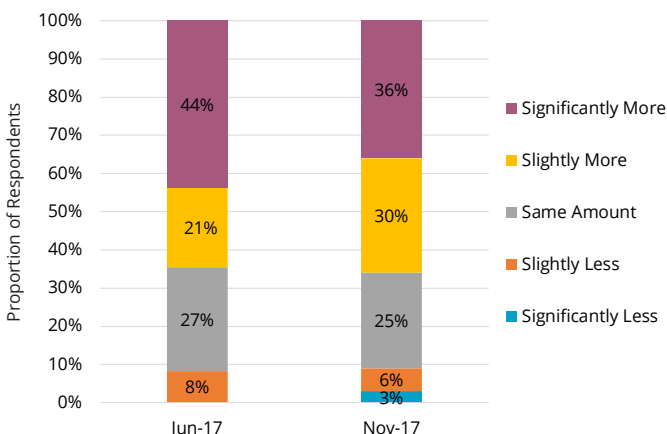
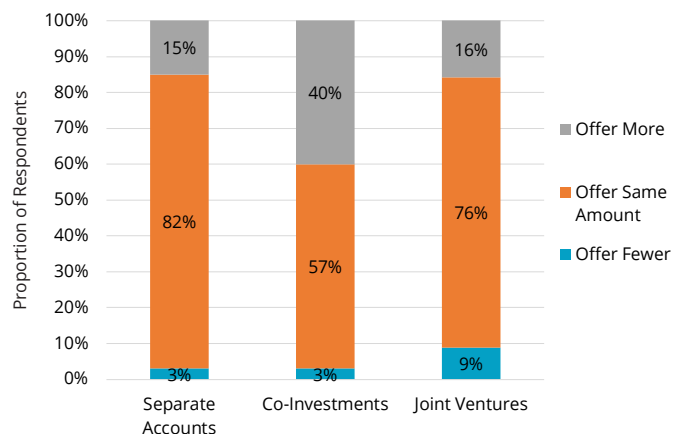


Fig. 2.16: Amount of Capital Fund Managers Expect to Deploy in the Next 12 Months Compared to the Past 12 Months, June vs. November 2017



Source: Preqin Fund Manager Survey, June - November 2017

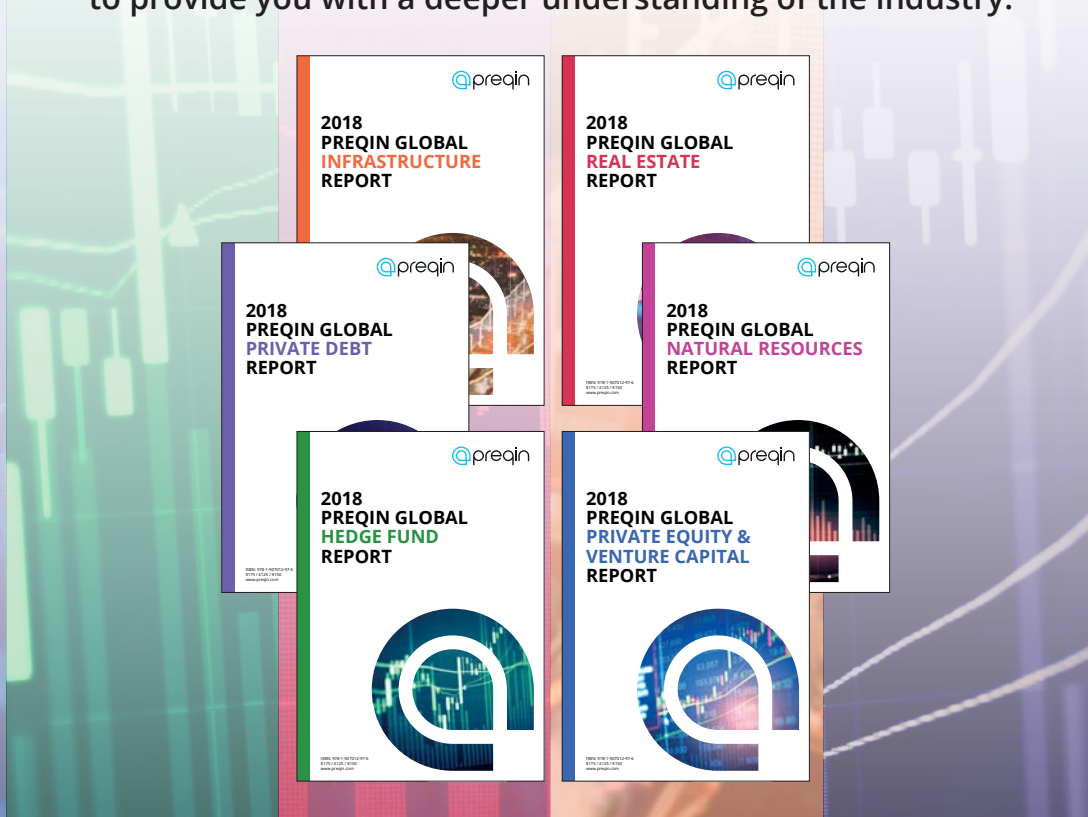
Fig. 2.17: Fund Managers' Plans to Offer Alternative Investment Structures to Investors in the Next 12 Months Compared to the Past 12 Months



Source: Preqin Fund Manager Survey, November 2017

THE 2018 PREQIN GLOBAL ALTERNATIVES REPORTS

The Reports analyze our market-leading global data and recent survey results to provide you with a deeper understanding of the industry.



Featuring extensive data and insights on fundraising, investor appetite, performance, deals, fund terms and more, the Reports provide a valuable indication of activity in 2018.

The series of six covers the following asset classes:

Private Equity & Venture Capital ■ Hedge Funds ■ Real Estate ■ Infrastructure
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In 2017, over **60,000** Reports provided individuals with an up-to-date understanding of alternatives, and **95%** of readers surveyed rated the quality as **good** or **excellent**.

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The background image is a landscape photograph with a green color overlay. It shows a winding asphalt road that curves through a valley. In the distance, there are rugged mountains with some snow or light-colored patches. The sky is filled with soft, white clouds. The overall scene is serene and scenic.

SECTION FOUR: HEDGE FUNDS

FOREWORD

In November 2017, we surveyed 360 hedge fund managers from across the globe. Our study looks at fundraising and performance in 2017, hedge fund fees and an outlook for new products and capital raising in 2018. Here we present some of the key findings of our study:

Improved Performance

The performance of the hedge fund industry has been called into question in recent years, particularly in light of the extended bull run in equity markets. However, 2017 represented a return to form with hedge funds adding 11.41% over the course of the year, its highest return since 2013. This industry-wide uptick in returns was reflected in the results of our survey with fund managers: more fund managers reported that their return ambitions had been met in 2017 than in 2016.

Fundraising Challenges Eased and the Industry Reached Record-High AUM

Following a challenging 2016, 2017 was a better year for the hedge fund industry with net inflows of \$44bn. In turn, the results of our survey show that fund managers have found that fundraising challenges have eased over the course of 2017, and that retaining capital is also easier than the year before. These inflows, accompanied by growth in assets as a result of stronger performance, has led to the hedge fund industry reaching record-high AUM of \$3.55tn.

However, Fees and Performance Remain Key Challenges in the Industry

Despite indications that investor appetite is improving, leading to inflows, coupled with stronger returns, key challenges around performance of the industry and fees remain. Fund managers are responding with new products to better align interests with their investors and counter concerns from allocators.

We hope you find this report useful, and welcome any feedback you may have. For more information about Preqin and our services please visit www.preqin.com or contact info@peqin.com.



ABOUT THIS SURVEY

Preqin conducts two surveys of hedge fund managers per year. Survey recipients are selected from Preqin's database of 6,000+ hedge fund managers and the respondents are representative of the wider industry. Fund managers participate in the survey on an anonymous basis.



360

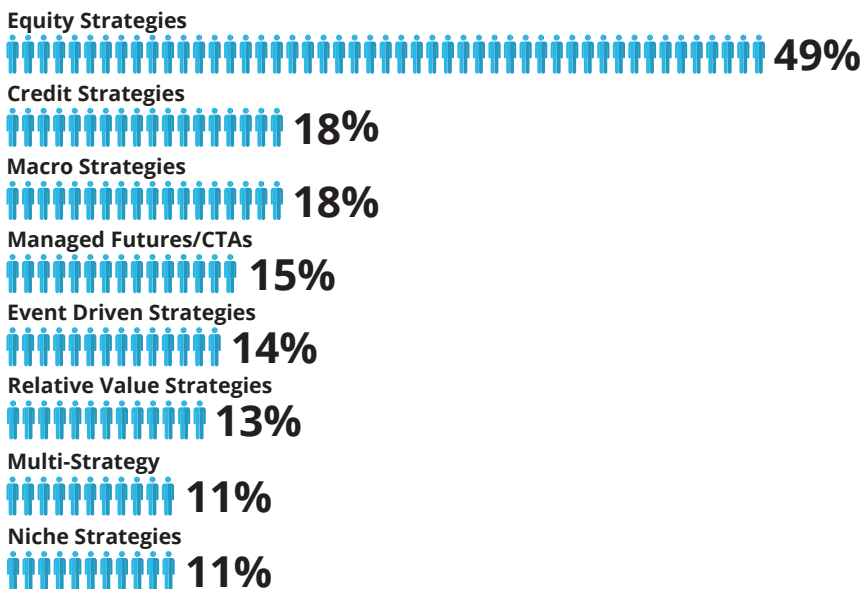
No. of hedge fund managers surveyed.



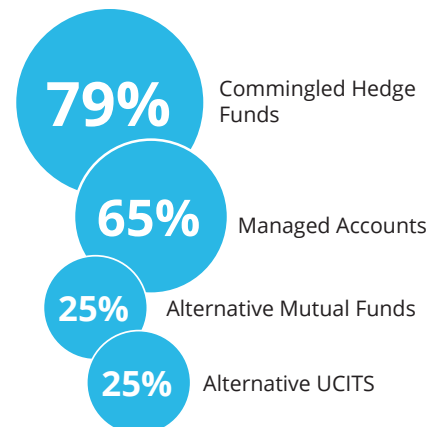
\$210bn

Total assets under management of hedge fund managers surveyed.

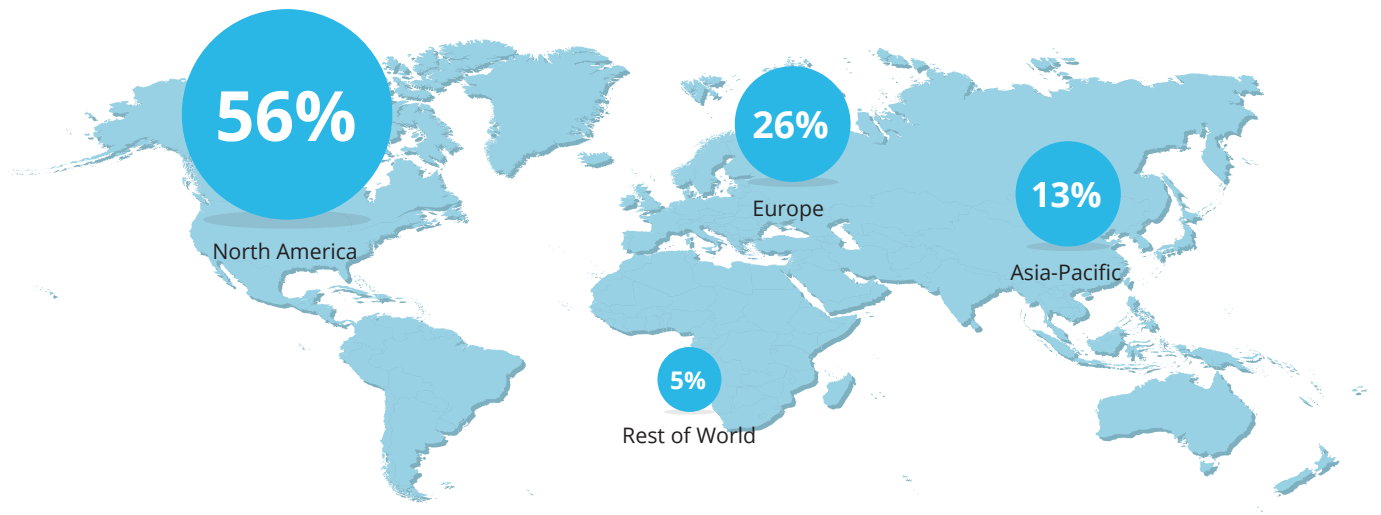
STRATEGIES OFFERED BY RESPONDENTS



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INVESTING AND THRIVING IN VOLATILITY

- Fabio Bretas, Phy Capital Investments



The hedge fund sector has had a challenging few years, particularly as investors questioned the value of these funds regarding performance and fees. We saw outflows in the latter half of 2015 and 2016. However, 2017 represented somewhat of a reversal of these trends with money coming back in and investor appetite improving. What is your outlook for 2018 – do you think the recovery will continue?

Confidence fuels momentum in any industry. According to AIMA/Preqin research¹, about 32% of all hedge funds produced double-digit returns in 2017. My belief is that capital inflows will continue in 2018 across hedge funds, propelled by this inertia in performance, cash availability and the lack of new and different investment products in the global market. I also believe volatility will be back on a wide scale, and we should expect allocations to shift towards more defensive strategies. Although the hedge fund industry is very mature, it is also an ecosystem that is rich in 'fund-diversity' – specifically in discretionary or systematic trading strategies. Not all funds will have similar risk attributes or performance objectives and therefore should not all be placed in a general context.

What are the major trends you foresee playing out over the year?

Inflation and volatility are likely to be back, which we believe may positively impact our strategies and the investment management industry broadly. We also believe markets' over-valuation, macroeconomic contractions and geopolitical instabilities will affect all corners of the globe. This is a scenario we are very passionate about! So, we expect 2018 to be a year with market conditions that grant for defensive and volatility-specialist strategies.

Why have you decided that now is a good time to launch a new fund? What current market factors have contributed to your timing?

Major market events observed over longer timeframes occur approximately every eight years. The crises of the 1980s, 1990s and 2000s are clear and unarguable. However, other seemingly minor events can be just as harmful and create volatility, which can be amplified by economic and geopolitical short-term instabilities. We see these types of events beginning to surface more often and in some shorter-term intervals, creating sharp price movements, or "spikes". Many traditional and passive strategies are not designed to deal with these types of market behaviours.

We believe that this volatility, combined with the high level of global liquidity and the lack of innovative strategies, provides advantageous conditions for Phy Capital's investment strategy. Our quantitative investment strategies were initially forged in Brazil – a place where disruption, inflation and instability are very much a part of our day-to-day operations and where one must adapt and learn how to capitalize under extreme market conditions replete with price spikes. Our success in developing a robust investment process that aims to generate alpha in volatile environments provides us with what we believe is a true edge at a time when conditions are becoming more challenging across global markets. Our strategy is designed to thrive in inhospitable markets. Volatility is our sandbox.

Can you tell us more about your strategy?

Phy Capital operates two different investment strategies: a global quant macro strategy and an Asian quant macro strategy. Both strategies deploy our proprietary quantitative models. Our global strategy trades in carefully selected volatile futures contract instruments. The dedicated, active portion of the portfolio aims to generate alpha; again, volatility and liquidity are always at the forefront of our strategies.

These trades flow through developed, emerging and exotic markets day and night – literally. For that, our company is well equipped with highly skilled electronic traders, data monitoring and data screening specialists to effectively navigate through those environments. The remaining portion of assets under management not used to generate alpha is allocated in money-market instruments.

Our Asian-themed strategy offers the exact features as the global, differing only on the geographic focus in various markets across Asia. From the asset allocation perspective, the investment strategy seeks to capitalize on highly intense volatility and liquidity levels experienced in the more active Emerging Markets around the world. In this investment strategy, the portfolio will consist of commodity interests listed mainly on the Asian futures exchanges. It will also provide investors in the Western Hemisphere with the opportunity for Asian exposure to an alpha component to their overnight cash available. To accomplish this, the fund maintains round-the-clock operations six days a week.

The added complexities to make that happen are well worth our efforts and investment. For that, we have built a robust operational and risk management protocol.

What do you think will be your top challenges of 2018, and how will Phy Capital look to overcome them?

Our main challenge rests in our ability to express to investors how our model differs from all others in our market. Connecting with the right investors to present our unique qualities in the US and global markets will remain our focus. Regulations will also continue to be a growing pressure in the asset management industry. To stay ahead of these concerns, we have invested to build a solid compliance and risk management

¹<https://www.aima.org/article/press-release-hedge-funds-have-outperformed-stocks-and-bonds-on-risk-adjusted-basis.html>



platform that covers all angles of our business: financial, technological, operational and reputational risks. I also developed a proprietary mathematical risk model that aims to specifically oversee modelling risk and has the autonomy to stop and clear all opened positions in real time in the fund portfolio and seeks to mitigate mathematical model malfunctions under some market conditions.

Why should investors consider a fund that uses “scientific methods to develop advanced investments systems”? What would they expect to gain from such exposure? In what ways does investing in volatility, as opposed to stable markets, contribute to your overall strategy?

Indeed, our investment process is based on a scientific method. Historical patterns have confirmed time and time again that displacing human emotion from investment decisions is inarguably a wise approach. In our case, we developed a program based on astrophysics, not coincidentally my original field of expertise.

Our proprietary system has its origins in 1988 when I was researching the stars by quantifying noise patterns coming from the cosmos. The method gives us the discipline to not take anyone’s word for granted. The scientific method is the common language with which I communicate with other scientists. This framework allows us to test our strategies in historical and simulated market conditions to find where the alpha really is.

Our roots in volatile markets give us even more discipline in our investment process and alpha discovery. Even though the bulk of our alpha still comes from emerging markets, it is not necessarily our only source of returns. We have developed our model so that it is positioned to take advantage of different volatile and highly liquid environments.

How have you found fundraising so far? What methods have you employed to attract institutional capital?

Our product is certainly not for every investor. Our focus has been on institutional investors and high-net worth

individuals. And to that end, we have covered all bases in any investor’s due diligence process today. Phy Capital has carefully selected and engaged the most reputable service providers known in the US market today: from our hedge fund administrator, prime brokers, law firms, data feeders, risk management tools, compliance consultants and public relations advisors to our industry-specific marketing agency. We have a deep and seasoned executive team and a very solid infrastructure business environment, and this way we are confident that investors will be drawn to our investment strategy, which we believe is well positioned to generate alpha across markets using our proprietary quantitative investment approach.

Combining all of what we have done so far with a uniquely engineered founders’ share class being offered to investors in the US makes us very confident of our success.

FABIO BRETAS

Fabio Bretas is the Founder and Emeritus Chairman of Phy Capital Investments. Prior to forming Phy Capital, he was the Founder and CEO of Brazilian-based investment company called Phynance, a quantitative mutual fund. A leading Brazilian quantitative investor, Fabio is a specialist in developing proprietary technology to trade in volatile markets. He created a systematic software to manage futures contracts investments from January 2011 and March 2016 for a portfolio of the Phy Global Opportunities FIM IE fund and other accredited investors.

Prior to founding Phynance in 2005, Fabio was a Senior Portfolio Manager on BankBoston’s quantitative investment fund, Boston Eagle Quant FIM. Before joining BankBoston, a Bank of America company, he worked at Ibmec Educational as an Associate Coordinator. Fabio holds a degree of Science (PhD A.B.D) from the Universidade de São Paulo and a master’s in science from the Brazilian Institute for Aeronautics. He also holds his Certificate in International Management from the University of Toronto, Rotman School of Management.

PHY CAPITAL INVESTMENTS, LLC

Founded by Fabio Bretas, a leading Brazilian quantitative investor, Phy Capital Investments is a US-based quantitative investment firm that seeks to generate strong, risk-adjusted absolute returns. The firm operates two investment strategies: Global Quant Macro and Asian Quant Macro, which deploy proprietary quantitative futures trading models initially developed for Phynance in Brazil.

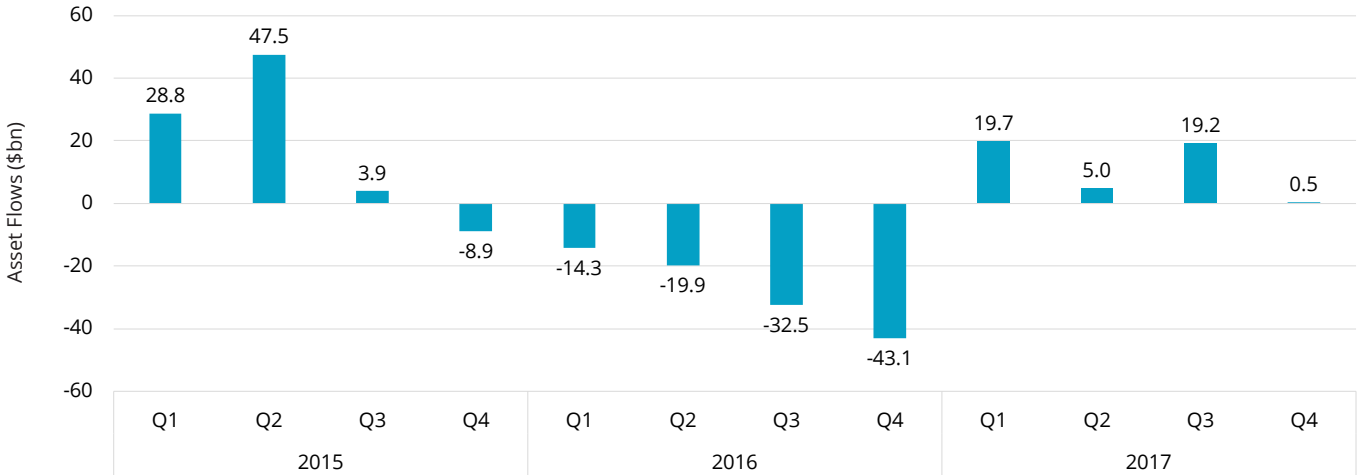
The firm’s strategies invest in highly liquid physical commodity and currency futures contracts, and index futures contracts. Phy Capital’s 20-person team includes, programmers and data scientists, investment professionals, and operations personnel. The company operates 24 hours per day, 6 days per week in an effort to provide trading coverage in all corners of the globe.

www.phycapital.com

This information is provided for informational purposes only, and does not constitute investment advice or an offer to buy or sell any security. The statements and opinions above are based on Phy Capital Investments’ (“Phy Capital”) opinions and market estimates each of which contain a number of assumptions. Phy Capital makes no representations regarding the reasonableness of such assumptions or the likelihood that any such assumptions will coincide with actual market conditions or events. There can be no assurance that any investment fund or investment strategy managed by Phy Capital will achieve its investment objectives or that substantial losses will not be incurred. Investing in futures and other financial instruments involves risk of substantial loss, including loss of principal. There can be no guarantee that any investment objectives will be achieved.

FUNDRAISING IN 2017

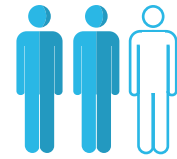
Fig. 1: Quarterly Hedge Fund Asset Flows, Q1 2015 - Q4 2017



Source: Preqin

Following a challenging year for fundraising in 2016, the hedge fund industry had a better 2017, with investor inflows of \$44bn. This return to positive flows from investors coupled with superior performance drove asset growth to record highs: total assets under management (AUM) of the hedge fund industry now exceeds \$3.55tn. The majority of fund managers enjoyed some of this positive growth: two-thirds of respondents experienced growth in AUM over 2017.

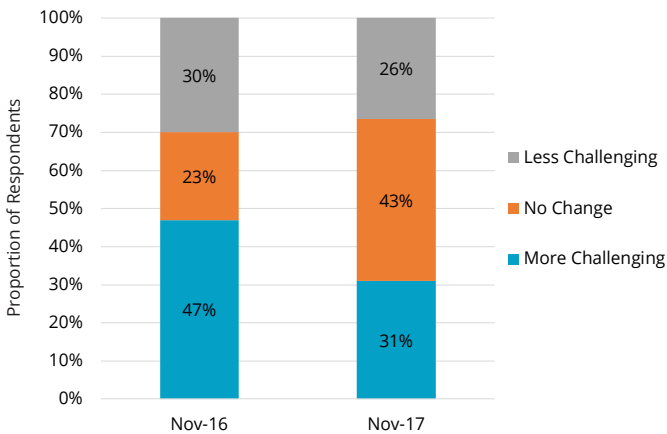
In light of investor inflows, and many managers reporting positive growth in AUM, our survey of fund managers reveals that fewer managers are finding fundraising more challenging in comparison with a year ago (Fig. 2), and more managers are finding it easier to retain capital (Fig. 3), again reflecting the improved environment in 2017.



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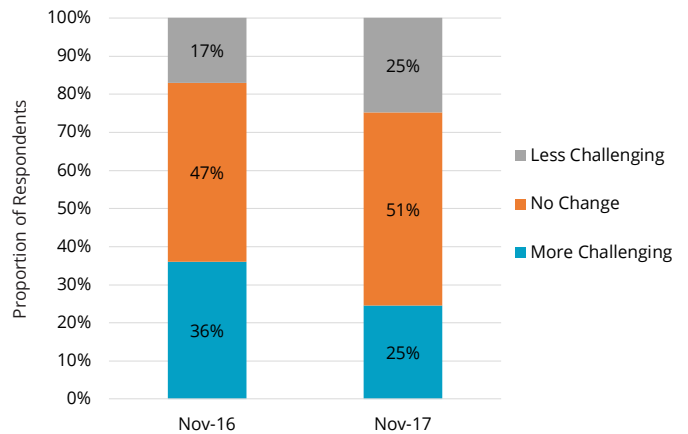
fund managers surveyed experienced growth in assets under management over 2017.

Fig. 2: Fund Manager Views on How the Fundraising Environment Has Changed over the Past 12 Months, 2016 vs. 2017



Source: Preqin Fund Manager Survey, November 2016 - 2017

Fig. 3: Fund Manager Views on How Retaining Assets Has Changed over the Past 12 Months, 2016 vs. 2017



Source: Preqin Fund Manager Survey, November 2016 - 2017

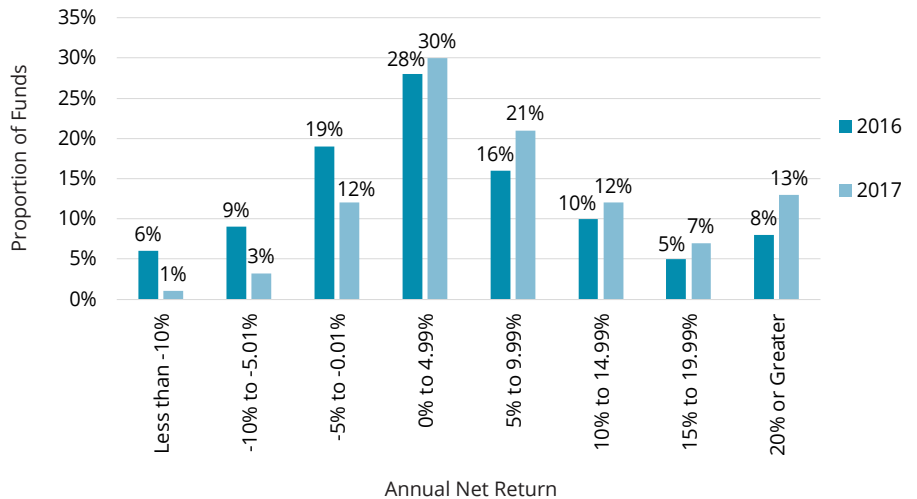


PERFORMANCE IN 2017

The Preqin All-Strategies Hedge Fund benchmark returned 11.41% in 2017, surpassing the return seen in 2016 (+7.67%) and recording the highest annual return since 2013 (+12.72%). Following this strong performance, 74% of respondents reported that their return goals had been met or exceeded over 2017 – a significant improvement from Preqin’s survey at the end of 2016, when 59% of respondents reported the same (Fig. 6). This corresponds to a wider shift in the industry towards better performance on a fund-by-fund basis. In 2016, less than a quarter of funds generated returns of 10% or more (Fig. 4). In comparison, in 2017, one-third of hedge funds added 10% or more over the course of the year. At the other end of the scale, 34% of funds were underwater in 2016; in 2017 just 16% of funds failed to generate returns above zero.

President Trump, following his election success in November 2016, had one of the largest positive impacts on hedge fund performance throughout 2017, as seen in Figs 7 and 8. In the first half of the year, the so-called “Trump Bump” – the US market rally in the immediate aftermath of the presidential elections at the end of 2016 – had a positive impact on the returns of 61% of hedge funds surveyed in June 2017. Trump’s reform proposals – in particular the “Tax Law and Jobs Act” which was passed in December 2017 – also had a

Fig. 4: Distribution of Hedge Fund Returns, 2016 vs. 2017*



Source: Preqin

significant positive impact on hedge funds: 49% and 44% of managers reported these added tailwinds to performance in H1 and H2 2017 respectively.

Low volatility – in both equity and bond markets – and the low interest rate environment had the largest negative impacts on performance in 2017. However, with several central banks, especially the Fed, moving to increase rates in 2017, which along with other factors has led to increased volatility in equity markets at the start of 2018, the industry may see better performance in 2018. However, with many hedge funds seeing their

January 2018 returns wiped out following a choppy February, this increase in volatility has proved troublesome at the start of this year. The uncertainty surrounding how market movements will impact performance in 2018 is reflected in Fig. 9: fund managers are almost perfectly split in their views as to how the industry will perform in 2018, with equal proportions predicting better and worse performance. This mixed view emphasizes the uncertainty in the market and the potential for challenging market conditions in 2018 to help or hinder returns in the hedge fund space.

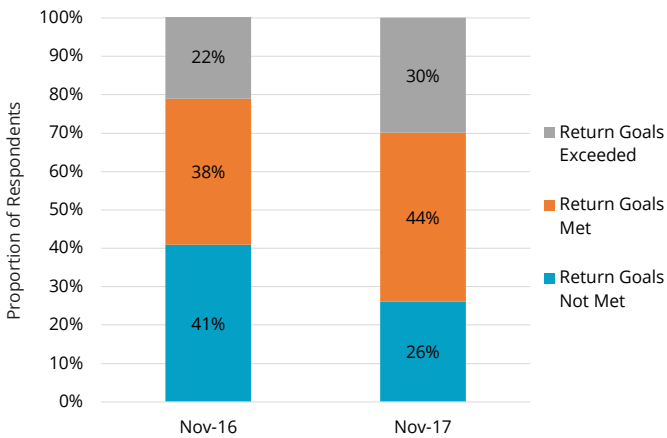
Fig. 5: Hedge Fund Performance by Top-Level Strategy (As at December 2017)*

Q1 2017	Q2 2017	Q3 2017	Q4 2017	2017
Equity Strategies 4.46%	Multi-Strategy 2.16%	Equity Strategies 3.88%	Equity Strategies 3.87%	Equity Strategies 15.01%
Event Driven Strategies 3.49%	Equity Strategies 2.04%	Event Driven Strategies 2.78%	Event Driven Strategies 3.23%	Event Driven Strategies 11.71%
Multi-Strategy 3.22%	Event Driven Strategies 1.73%	Multi-Strategy 2.51%	Multi-Strategy 1.85%	Multi-Strategy 10.09%
Credit Strategies 2.75%	Credit Strategies 1.53%	Macro Strategies 2.27%	Macro Strategies 1.74%	Credit Strategies 7.61%
Macro Strategies 2.13%	Relative Value Strategies 0.54%	Credit Strategies 1.73%	Credit Strategies 1.40%	Macro Strategies 5.57%
Relative Value Strategies 1.62%	Macro Strategies -0.65%	Relative Value Strategies 1.39%	Relative Value Strategies 0.70%	Relative Value Strategies 4.31%

Source: Preqin Hedge Fund Online

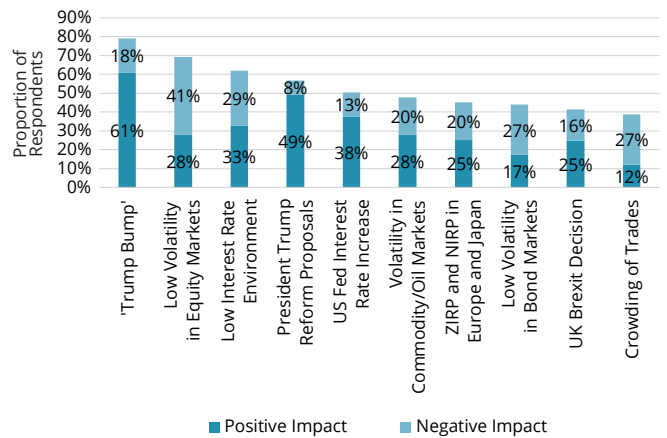
*Please note, all performance information includes preliminary data for December 2017 based on net returns reported to Preqin in early January 2018. Although stated trends and comparisons are not expected to alter significantly, final benchmark values are subject to change.

Fig. 6: Fund Manager Views on Returns in the Past 12 Months Relative to Objectives, 2016 vs. 2017



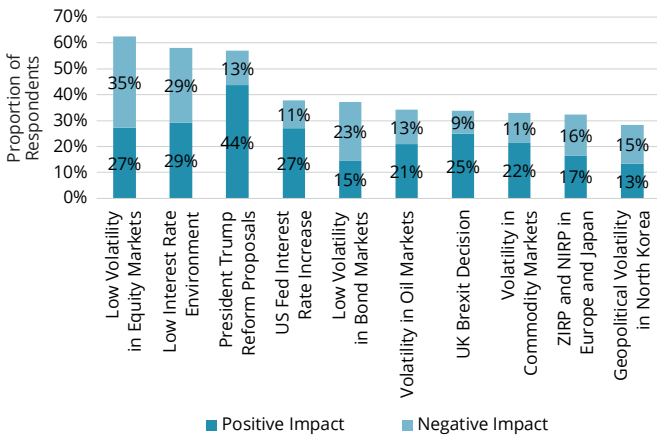
Source: Preqin Fund Manager Survey, November 2016 - 2017

Fig. 7: Fund Manager Views on the Key Macro Factors that Impacted Hedge Fund Performance in H1 2017



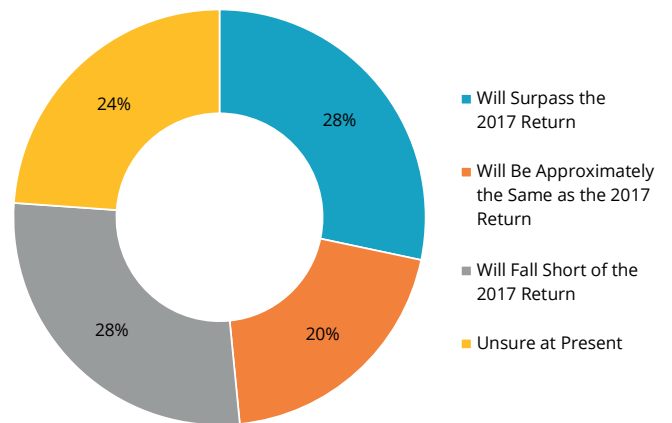
Source: Preqin Fund Manager Survey, June 2017

Fig. 8: Fund Manager Views on the Key Macro Factors that Impacted Hedge Fund Performance in H2 2017



Source: Preqin Fund Manager Survey, November 2017

Fig. 9: Fund Manager Predictions for the Performance of the Preqin All-Strategies Hedge Fund Benchmark in 2018 Compared to 2017



Source: Preqin Fund Manager Survey, November 2017

PREQIN SPECIAL REPORT: TOP PERFORMING HEDGE FUNDS IN 2017

This report takes a closer look at those funds that reached the top of the performance ranks in 2017. Using data taken from Preqin's online platform, we examine the top performing hedge funds over a one- and three-year basis, as well as those funds that have been performing consistently well over the past three and five years.

To download your free copy, please visit our Research Center:

www.preqin.com/rcp

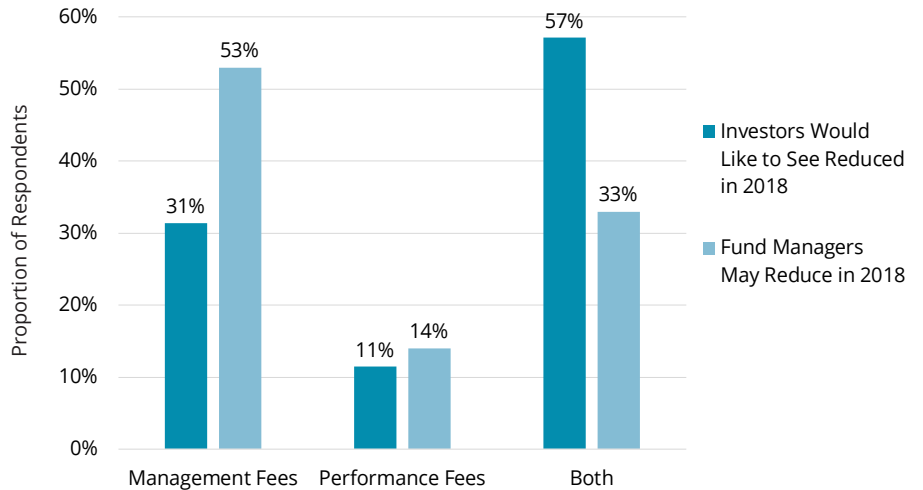




FEES AND OTHER TERMS AND CONDITIONS

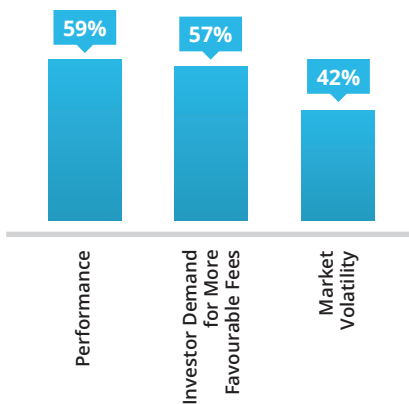
Investor demand for more favourable fees remains a top challenge in the industry today; 57% of fund managers surveyed felt this would be a key driver of change in 2018, behind only the performance of the industry (59%). Despite fund managers recognizing this demand, there remains some separation between what investors demand and what managers are willing to change. As shown in Fig. 10, although more than half of managers reported they would reduce management fees to attract investors, 57% of institutions we spoke to in December 2017 wanted managers to reduce both management and performance fees – something just a third of hedge funds reported they would do.

Fig. 10: Fee Structures Investors Would Like to See Changes to in 2018 vs. Fee Structures Managers Are Most Likely to Reduce



Source: Preqin Fund Manager Survey and Investor Interviews, November and December 2017

THREE LEADING DRIVERS OF CHANGE FOR HEDGE FUNDS IN 2018 ACCORDING TO MANAGERS

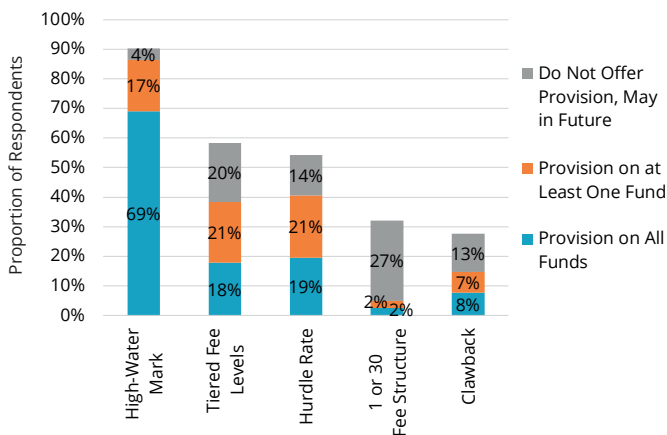


Despite this incongruity of investor demand and manager willingness to respond, we are seeing managers increasingly look for new ways to align performance incentives. High-water marks are used by the majority of managers (Fig. 11); just 10% of survey respondents do not have these in place, or have no plans to. Tiered fee structures and hurdle rates are also used by 39% and 40% of respondents respectively in at least one fund. Moving forwards, the '1 or 30' structure, developed by Albourne Partners in conjunction with Teacher Retirement System of Texas to better align interests, may be something

that gains traction; although only 4% of respondents already have this in place, 27% of managers are open to adding this structure in the future.

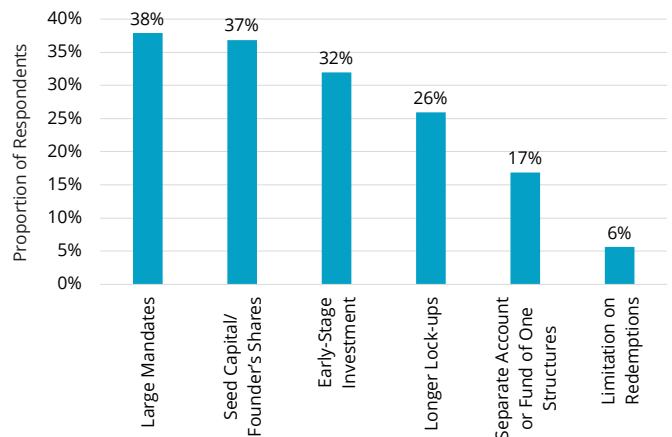
With investor demand for more favourable fees still a leading driver of change, managers are continuing to respond with concessions in return for certain investment conditions. Managers are most willing to offer fee concessions in return for a large or seed investment in a fund; 38% and 37% of respondents respectively reported they would reduce fees as a result (Fig. 12).

Fig. 11: Fee Provisions Provided by Hedge Fund Managers



Source: Preqin Fund Manager Survey, November 2017

Fig. 12: Reasons Why Hedge Fund Managers Have Offered Fee Concessions



Source: Preqin Fund Manager Survey, November 2017

OUTLOOK FOR 2018

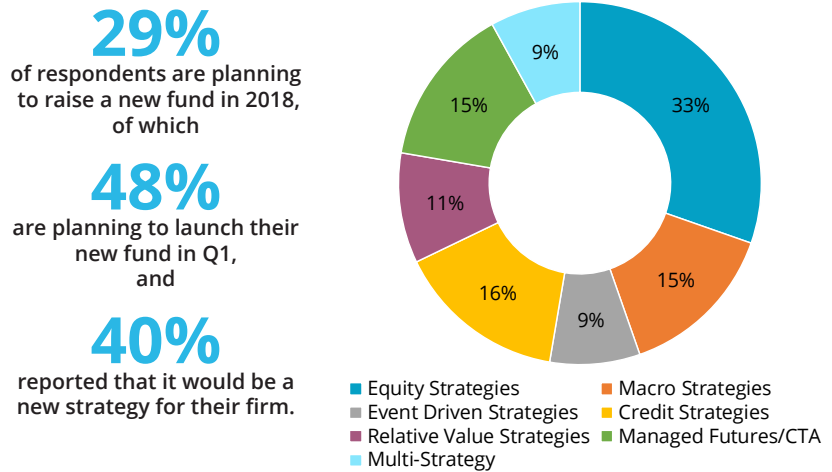
Nearly one-third of fund managers surveyed at the end of 2017 were planning to launch a new fund in 2018, of which nearly half (48%) intended to launch their new fund in the first quarter of the year (Fig. 13). Forty percent of these planned launches will represent a new strategy offered by the firm, as fund managers see new opportunities in a changing global marketplace. Equity and credit strategies account for the largest proportions of planned fund launches in 2018 (33% and 16% respectively).

Following a year of improved performance and net investor inflows, industry AUM increased 9.2% to \$3.55tn in 2017, and fund managers are predicting further growth in 2018. Almost two thirds (64%) of fund managers expect industry assets to continue to rise over 2018, with just 16% predicting a contraction (Fig. 14).

The majority (56%) of fund managers predicting growth in assets foresee both performance and investor allocations as the key drivers behind the increase (Fig. 15), similar to the drivers of growth in 2017. In isolation, performance is viewed as the factor to drive asset growth in 2018 by a greater proportion (26%) of respondents than allocations to the industry (17%).

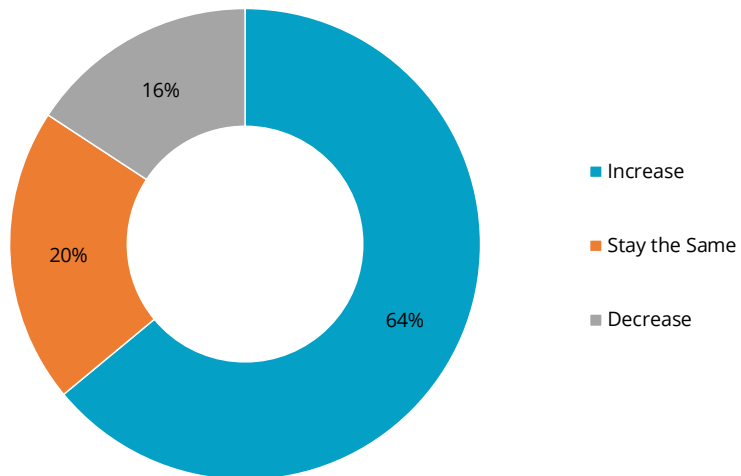
While fund managers went into 2017 with aims of reviving investor sentiment and reversing recent performance trends, managers have ended the year looking for more of the same in 2018: improved performance, asset growth and improving investor sentiment have shaped a positive year for hedge funds. Looking to 2018, uncertainty surrounds global equity markets and future hedge fund performance; however, managers remain optimistic, predicting industry growth and planning product expansion through new launches over the coming 12 months. If 2017 was a year for change, 2018 is one for consistency.

Fig. 13: Strategies Hedge Fund Managers Plan to Launch in 2018



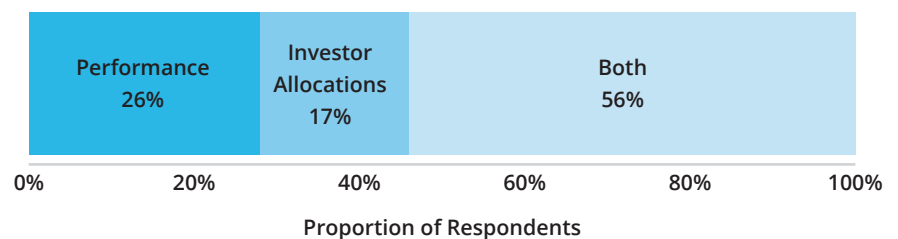
Source: Preqin Fund Manager Survey, November 2017

Fig. 14: Fund Manager Expectations for Hedge Fund Industry Assets under Management in 2018



Source: Preqin Fund Manager Survey, November 2017

Fig. 15: Fund Manager Views on the Key Drivers behind Expected Industry AUM Growth in 2018



Source: Preqin Fund Manager Survey, November 2017



NORTH AMERICA RESULTS

KEY FACTS



\$2.63tn

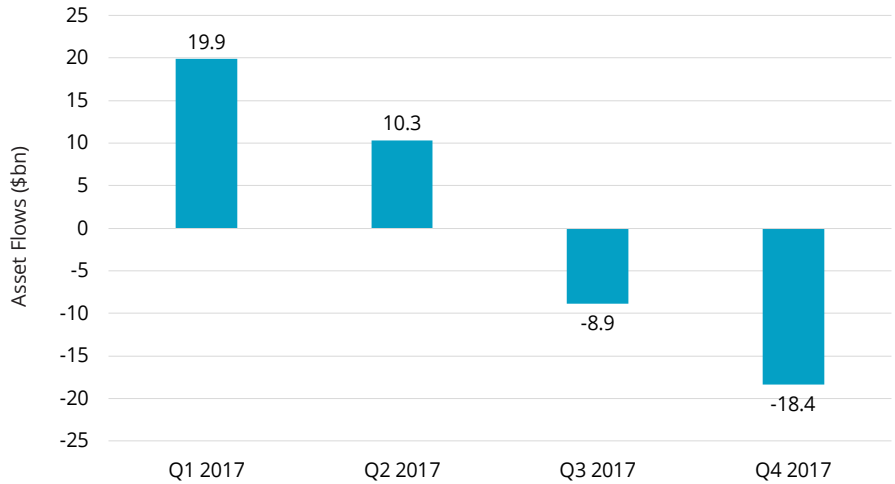
Total AUM of the North American hedge fund industry.



64%

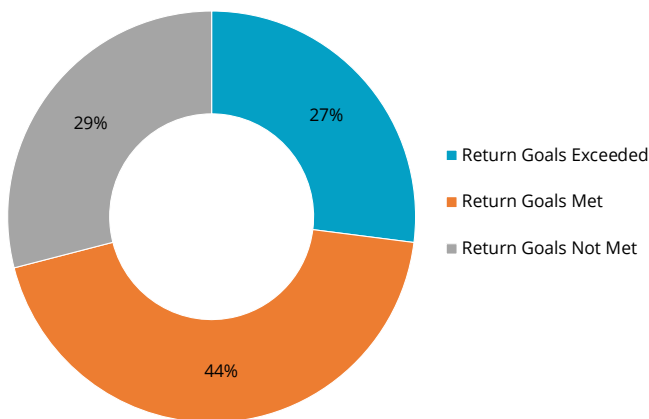
of North America-based hedge fund managers surveyed experienced growth in AUM over 2017.

Fig. 16: North America-Based Hedge Fund Quarterly Asset Flows in 2017



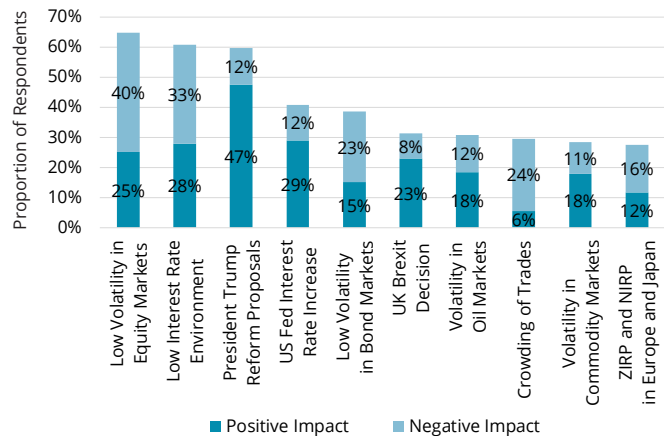
Source: Preqin

Fig. 17: North America-Based Fund Manager Views on Returns in the Past 12 Months Relative to Objectives



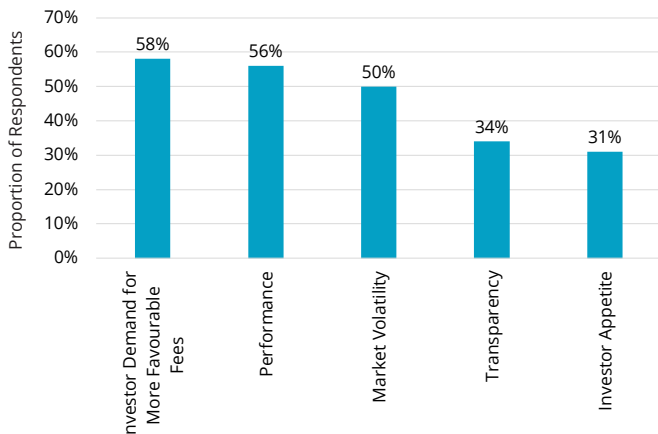
Source: Preqin Fund Manager Survey, November 2017

Fig. 18: North America-Based Fund Manager Views on the Key Macro Factors that Impacted Hedge Fund Performance in H2 2017



Source: Preqin Fund Manager Survey, November 2017

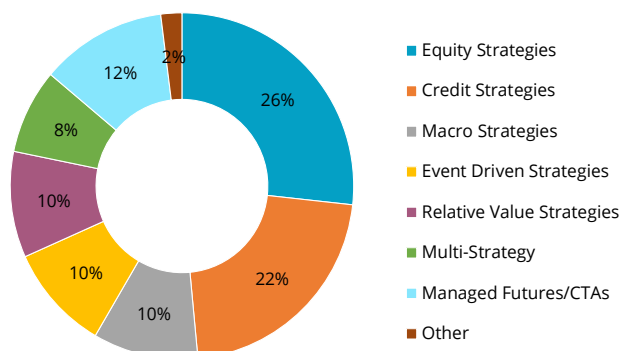
Fig. 19: North America-Based Fund Manager Views on the Leading Drivers of Change in the Hedge Fund Industry



Source: Preqin Fund Manager Survey, November 2017

Fig. 20: Strategies North America-Based Fund Managers Plan to Launch in 2018

23% of North America-based respondents are planning to launch a new fund in 2018. The strategies they intend to pursue are:



Source: Preqin Fund Manager Survey, November 2017

EUROPE RESULTS

KEY FACTS



\$731bn

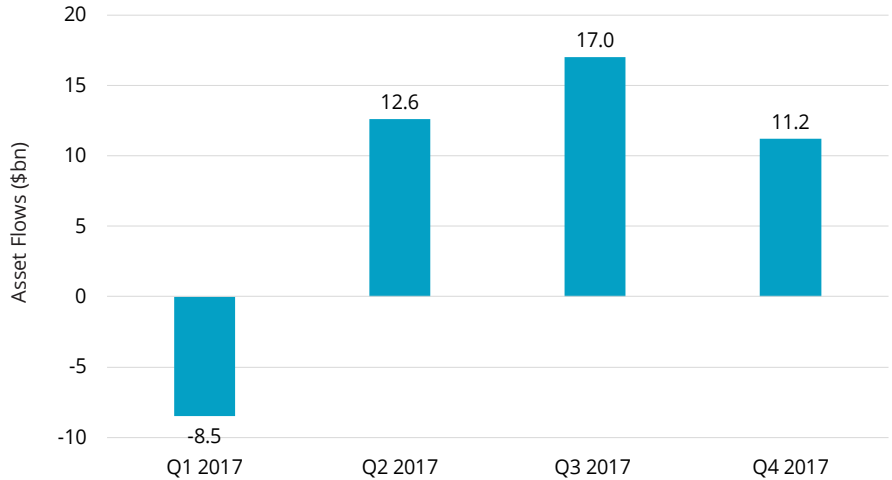
Total AUM of the European hedge fund industry.



64%

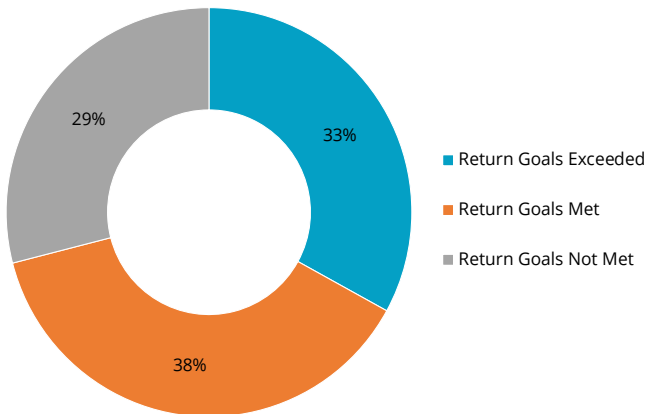
of Europe-based hedge fund managers surveyed experienced growth in AUM over 2017.

Fig. 21: Europe-Based Hedge Fund Quarterly Asset Flows in 2017



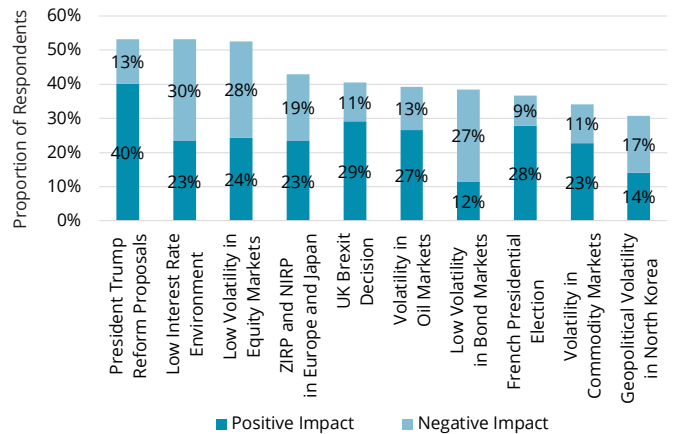
Source: Preqin

Fig. 22: Europe-Based Fund Manager Views on Returns in the Past 12 Months Relative to Objectives



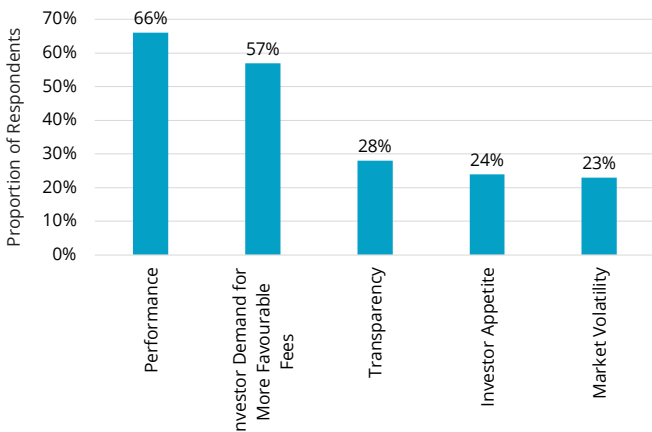
Source: Preqin Fund Manager Survey, November 2017

Fig. 23: Europe-Based Fund Manager Views on the Key Macro Factors that Impacted Hedge Fund Performance in H2 2017



Source: Preqin Fund Manager Survey, November 2017

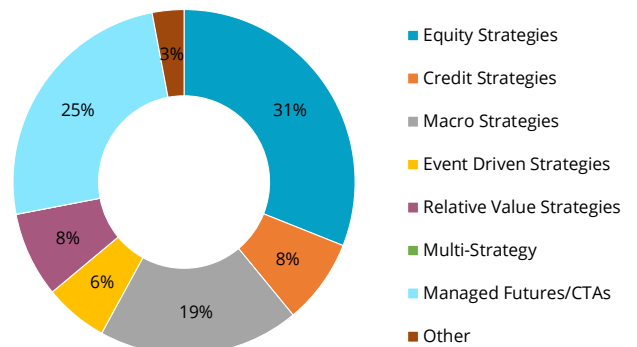
Fig. 24: Europe-Based Fund Manager Views on the Leading Drivers of Change in the Hedge Fund Industry



Source: Preqin Fund Manager Survey, November 2017

Fig. 25: Strategies Europe-Based Fund Managers Plan to Launch in 2018

39% of Europe-based respondents are planning to launch a new fund in 2018. The strategies they intend to pursue are:



Source: Preqin Fund Manager Survey, November 2017



ASIA-PACIFIC RESULTS

KEY FACTS



\$156bn

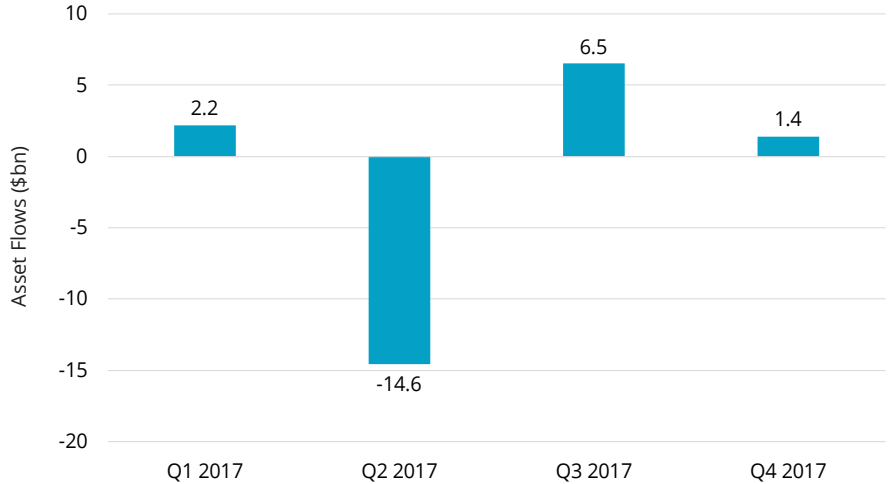
Total AUM of the Asia-Pacific hedge fund industry.



78%

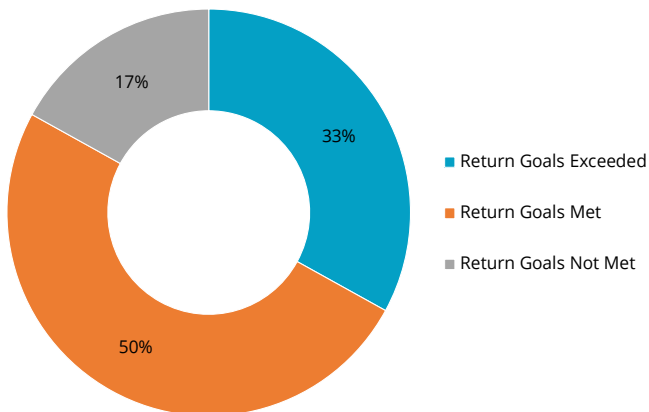
of Asia-Pacific-based hedge fund managers surveyed experienced growth in AUM over 2017.

Fig. 26: Asia-Pacific-Based Hedge Fund Quarterly Asset Flows in 2017



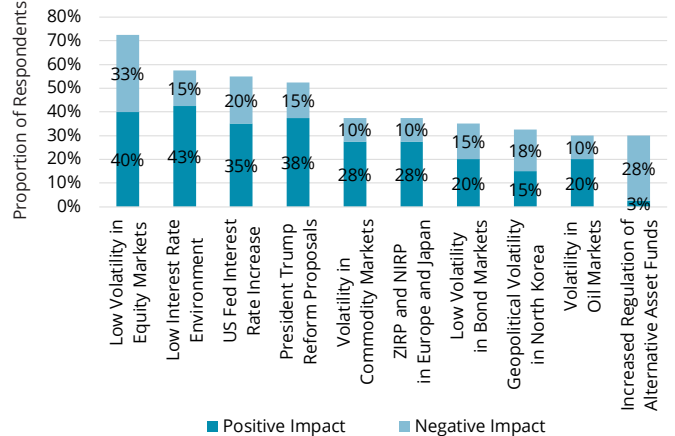
Source: Preqin

Fig. 27: Asia-Pacific-Based Fund Manager Views on Returns in the Past 12 Months Relative to Objectives



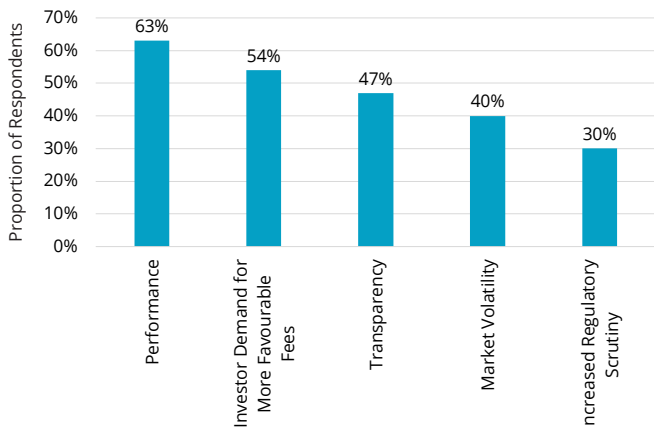
Source: Preqin Fund Manager Survey, November 2017

Fig. 28: Asia-Pacific-Based Fund Manager Views on the Key Macro Factors that Impacted Hedge Fund Performance in H2 2017



Source: Preqin Fund Manager Survey, November 2017

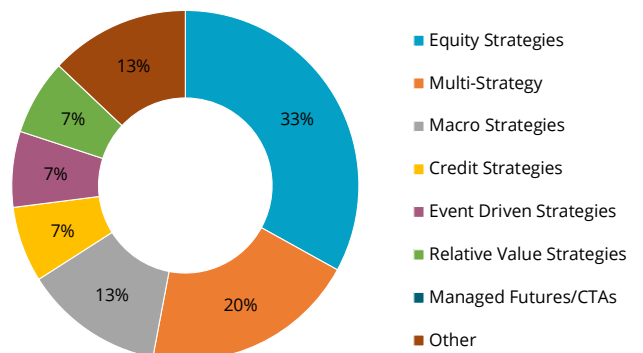
Fig. 29: Asia-Pacific-Based Fund Manager Views on the Leading Drivers of Change in the Hedge Fund Industry



Source: Preqin Fund Manager Survey, November 2017

Fig. 30: Strategies Asia-Pacific-Based Fund Managers Plan to Launch in 2018

33% of Asia-Pacific-based respondents are planning to launch a new fund in 2018. The strategies they intend to pursue are:



Source: Preqin Fund Manager Survey, November 2017

REST OF WORLD RESULTS

KEY FACTS



\$63bn

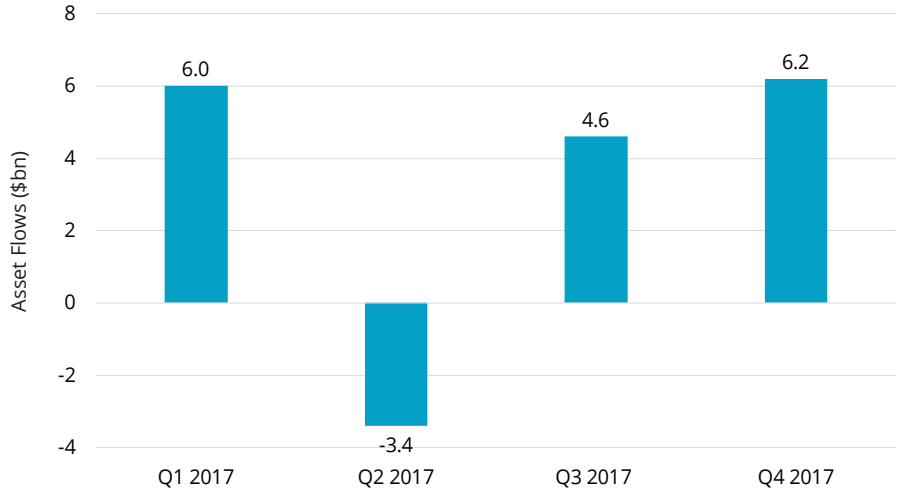
Total AUM of the Rest of World hedge fund industry.



69%

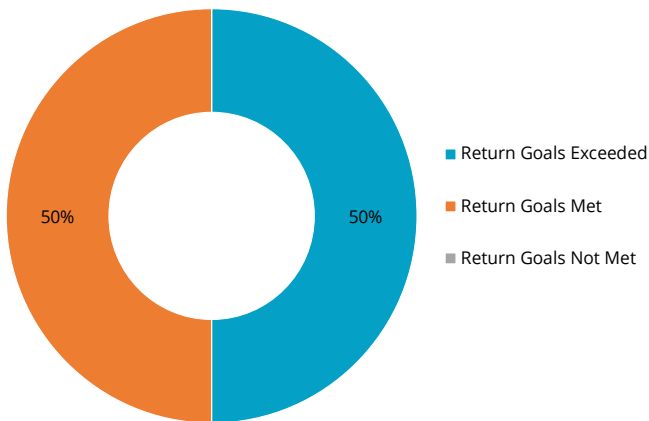
of Rest of World-based hedge fund managers surveyed experienced growth in AUM over 2017.

Fig. 31: Rest of World-Based Hedge Fund Quarterly Asset Flows in 2017



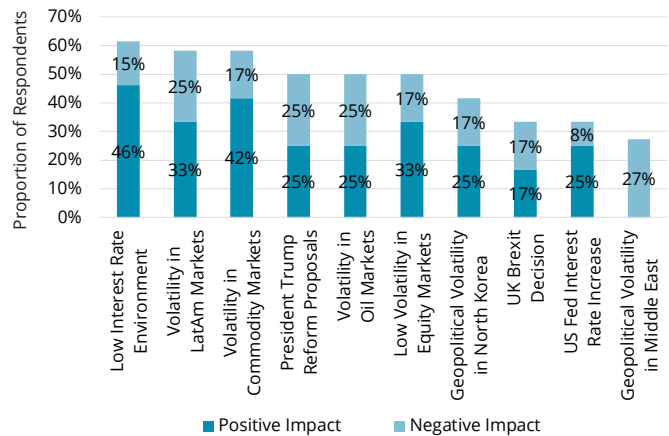
Source: Preqin

Fig. 32: Rest of World-Based Fund Manager Views on Returns in the Past 12 Months Relative to Objectives



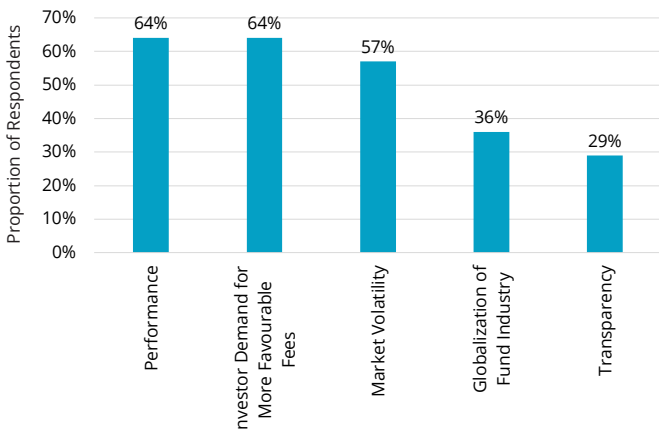
Source: Preqin Fund Manager Survey, November 2017

Fig. 33: Rest of World-Based Fund Manager Views on the Key Macro Factors that Impacted Hedge Fund Performance in H2 2017



Source: Preqin Fund Manager Survey, November 2017

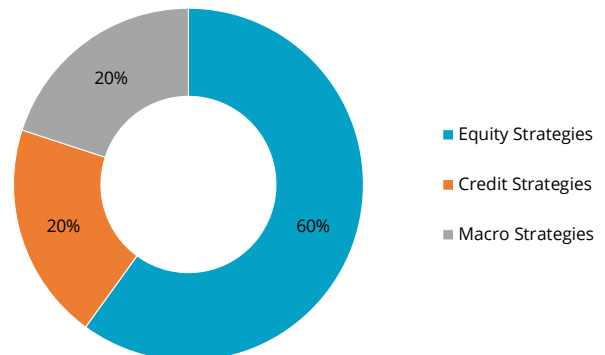
Fig. 34: Rest of World-Based Fund Manager Views on the Leading Drivers of Change in the Hedge Fund Industry



Source: Preqin Fund Manager Survey, November 2017

Fig. 35: Strategies Rest of World-Based Fund Managers Plan to Launch in 2018

37% of Rest of World-based respondents are planning to launch a new fund in 2018. The strategies they intend to pursue are:



Source: Preqin Fund Manager Survey, November 2017



SECTION FOUR: REAL ESTATE

FOREWORD

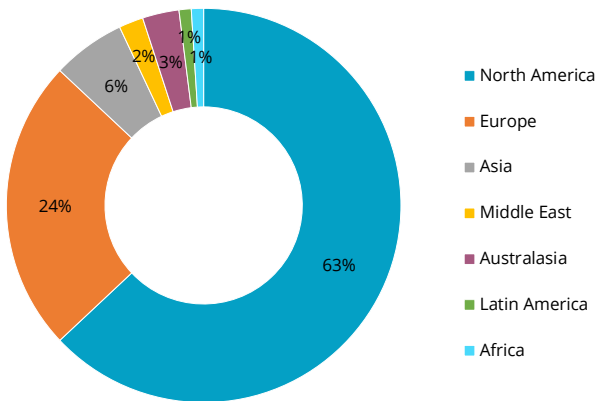
For firms utilizing a real estate investment strategy, it is a particularly challenging time. The concerns highlighted in our **H2 2017 Fund Manager Outlook** – namely pricing and competition for assets and investor capital – have intensified; now among these difficulties is the changing macroeconomic environment, with rising interest rates further complicating the operation of a real estate portfolio.

For firms raising capital, the market is very competitive, and it is obvious from the discrepancy between the numbers of funds closing and those being marketed that not all will achieve their goals. We are already seeing firms adapting their offerings in response to market conditions, either by taking on more risk, by expanding their strategy or, for 61% of firms surveyed that are bringing a fund to market, by reducing the targeted returns of these vehicles.

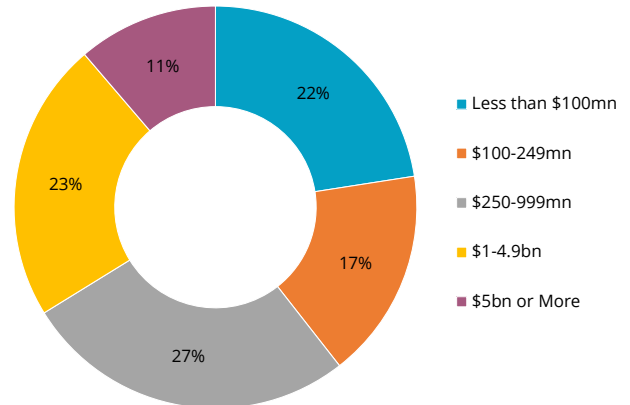
Despite such an environment, strong investor appetite prevails, backed up by a fund manager base that has generally delivered for investors in recent years. Distributions have been high, and target allocations need to be met. In a low interest rate environment, real estate continues to satisfy the desire for diversification, reliable income streams and attractive absolute returns. Fund managers able to express a unique value proposition and mitigate investors’ pricing concerns will likely be the recipients of capital commitments in 2018.

For this report, we surveyed 215 real estate firms to try and understand how these issues have evolved, and how robust they feel the real estate market is when it comes to withstanding these challenges.

Survey Respondents by Headquarters Location:



Survey Respondents by Assets under Management:





MARKET OVERVIEW

Real estate has seen many years of strong performance, with post-crisis vintages achieving consistent median returns at approximately 15% (Fig. 4.1). This has allowed fund managers to distribute capital back to investors at an unprecedented rate: since 2013 – the first year in which capital distributed exceeded capital called – nearly \$900bn has been returned from closed-end private real estate fund managers to investors (Fig. 4.2).

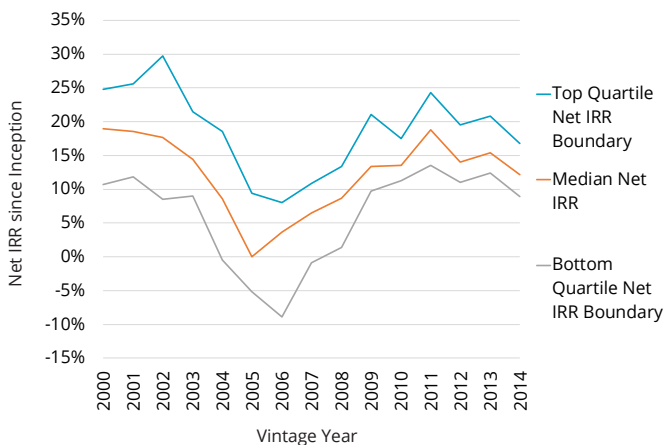
This has been the driving force behind the positive perception of the asset

class in recent years and has helped the fundraising efforts of real estate firms, with capital raised surpassing \$100bn annually for the last five consecutive years (Fig. 4.3). This in turn has fuelled a largely consistent year-on-year increase in assets under management (AUM) of the industry (Fig. 4.4).

However, examining the market in more detail shows that the landscape is beginning to change. Firstly, fundraising – while strong – is centred around commitments to some of the largest fund

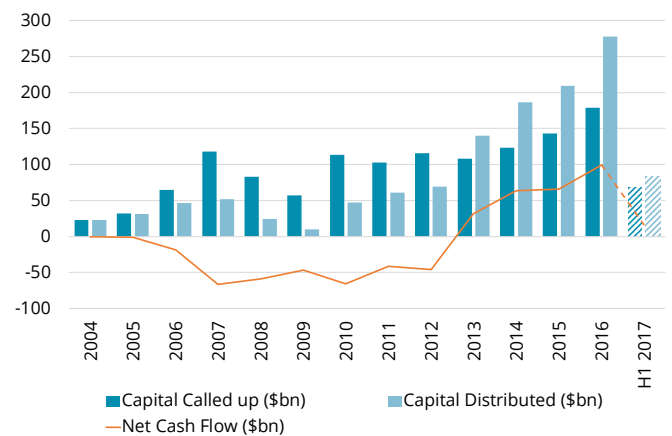
managers in the space, which has made fundraising intensely competitive for the remainder. Secondly, capital available to fund managers is close to record levels, which has helped fuel the rising valuations of assets and the growth in the unrealized value of portfolio assets. Lastly, the success of the asset class and the corresponding increase in investor appetite has brought more managers to the fore than ever before, which is increasing the level of competition for available assets and affecting valuations.

Fig. 4.1: Closed-End Private Real Estate Funds: Median Net IRRs and Quartile Boundaries by Vintage Year (As at June 2017)



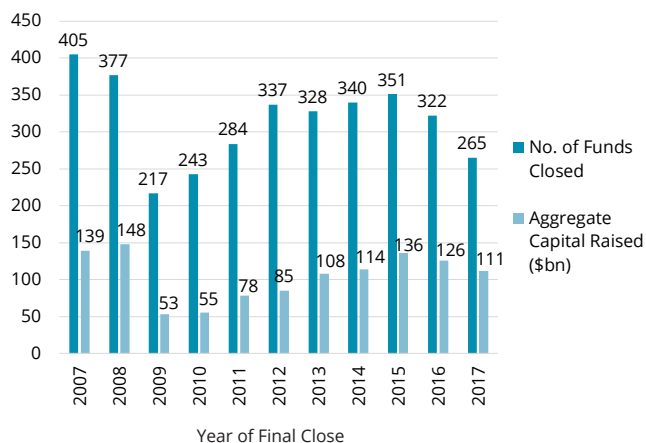
Source: Preqin

Fig. 4.2: Annual Capital Called up and Distributed by Closed-End Private Real Estate Fund Managers, 2004 - H1 2017



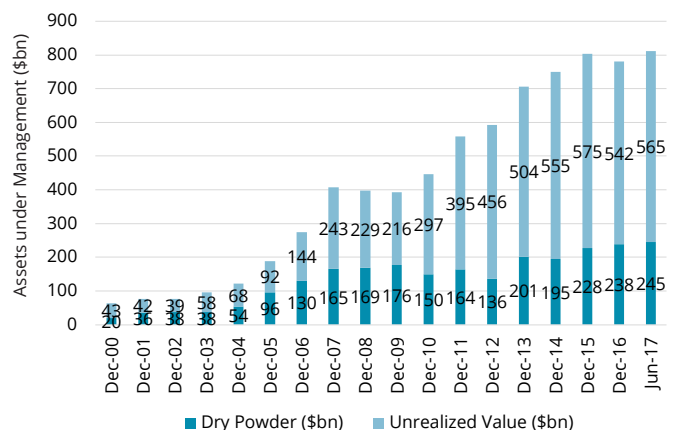
Source: Preqin

Fig. 4.3: Annual Closed-End Private Real Estate Fundraising, 2007 - 2017



Source: Preqin

Fig. 4.4: Closed-End Private Real Estate Assets under Management, 2000 - 2017



Source: Preqin

CHALLENGES AND KEY ISSUES

PRICING THE DOMINANT THEME

Globally, for the second year running, the pricing of assets has remained the key concern of private real estate firms, cited by 62% of respondents (Fig. 4.5). This proportion is 25 percentage points higher than the next biggest challenge for 2018, deal flow, which is intrinsically linked with valuations.

“Seventy-one percent of fund managers surveyed believe pricing for assets is higher than it was a year ago

However, as each regional real estate market is at a different stage of development and presents distinct opportunities to investors, the issues faced by firms differ across regions. Fund managers operating from the developed real estate markets of North America and Europe have mirrored concerns of valuations and interest rates, whereas fundraising is the key concern for Asia-based firms.

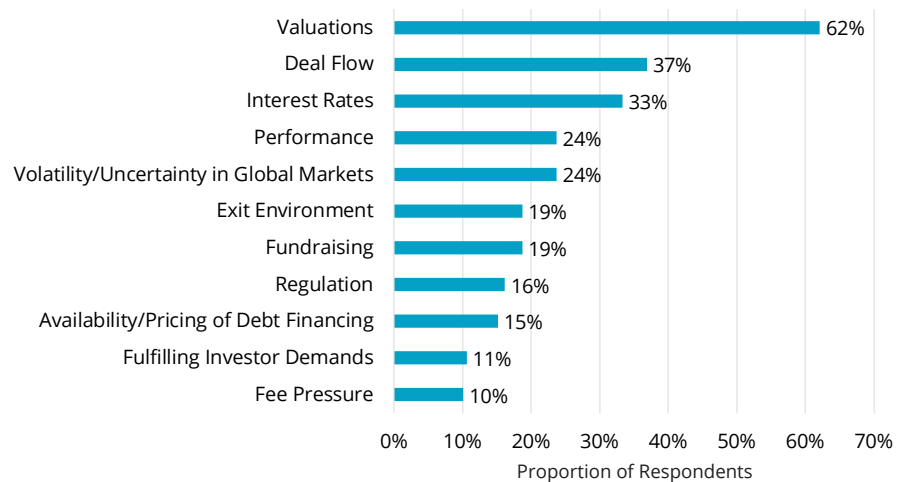
Seventy-one percent of fund managers surveyed believe pricing for assets is higher than it was a year ago. Driving this is the vast amount of capital at managers' disposal: \$249bn as at December 2017,

Fund Managers' Top Three Issues for the Real Estate Market by Fund Manager Location:



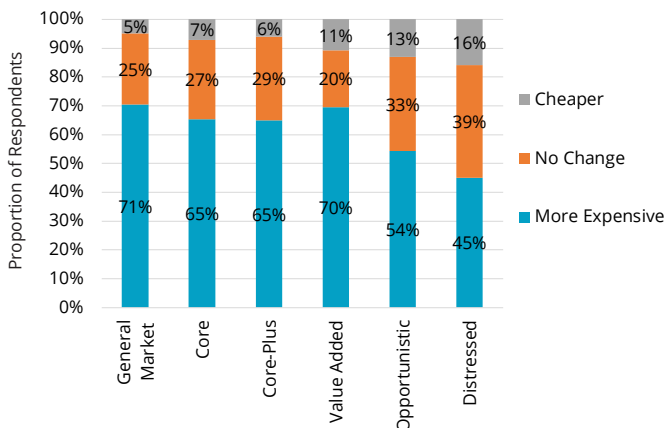
Source: Preqin Fund Manager Survey, November 2017

Fig. 4.5: Key Challenges Facing Private Real Estate Fund Managers in 2018



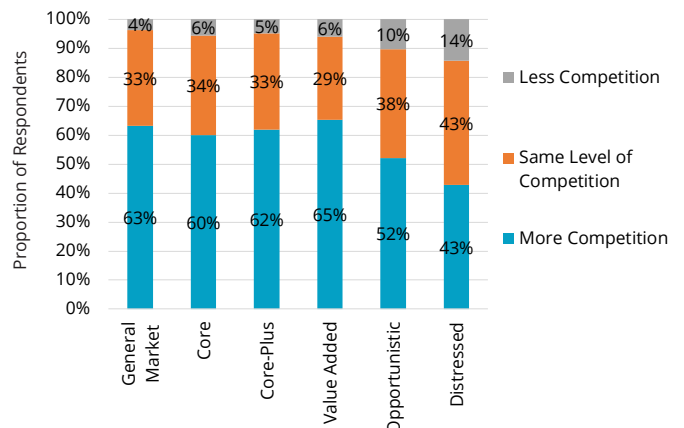
Source: Preqin Fund Manager Survey, November 2017

Fig. 4.6: Fund Manager Views on the Pricing of Real Estate Assets Compared to 12 Months Ago by Strategy



Source: Preqin Fund Manager Survey, November 2017

Fig. 4.7: Fund Manager Views on the Level of Competition for Real Estate Assets Compared to 12 Months Ago by Strategy



Source: Preqin Fund Manager Survey, November 2017

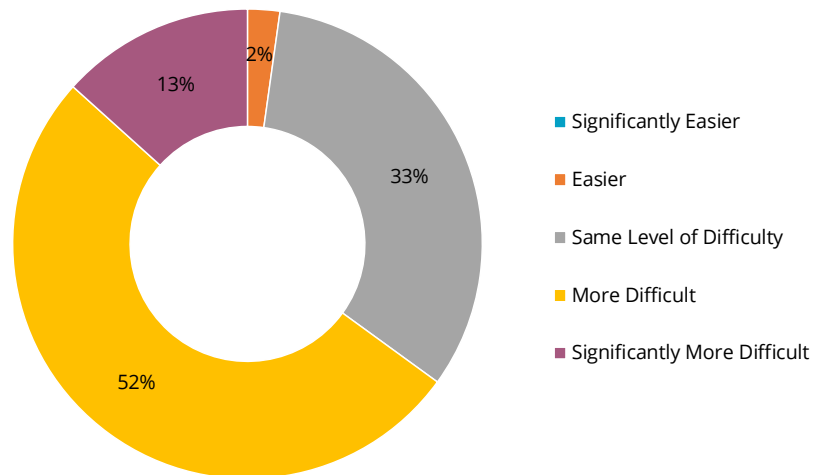


in conjunction with the increase in competition for transactions, not just from fund managers, but from institutional and strategic investors as well. One North America-based real estate fund manager stated that there is currently “higher investment demand than available deal placement”.

Across the whole market, 63% of respondents have seen more competition for assets compared to the previous year (Fig. 4.7). Fund managers were invited to provide insight on the level of competition in distinct parts of the market:

- **Core/Core-Plus:** transactions involving stabilized assets in major gateway cities often capture media attention for large deal sizes, and as such it is unsurprising that competition has continued to increase.
- **Value Added:** the largest proportion (65%) of surveyed fund managers reported greater levels of competition for assets slightly higher up the risk/return spectrum. This could be in response to high valuations for core/core-plus assets, with one Europe-based manager stating they are “moving away from prime [assets]”, while another said they will be taking on “more risk”.
- **Opportunistic:** while the majority (52%) of respondents have noticed more competition in this area of the market, the proportion is markedly smaller than that for value added property.
- **Distressed:** the distressed real estate market is smaller than others and so it is therefore unsurprising that

Fig. 4.8: Fund Manager Views on the Difficulty of Finding Attractive Real Estate Investment Opportunities Compared to 12 Months Ago



Source: Preqin Fund Manager Survey, November 2017

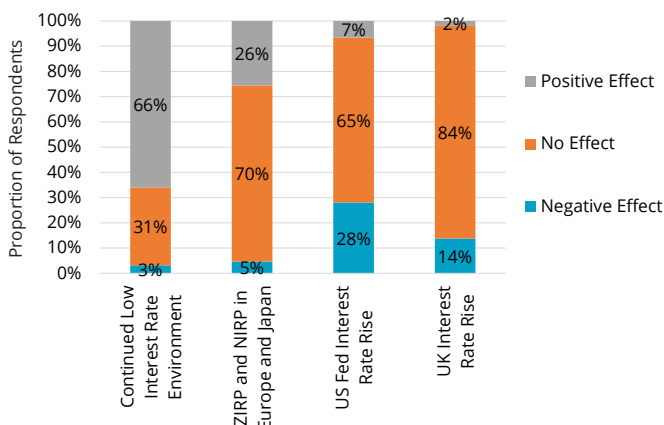
the strategy recorded the smallest proportion (43%) of respondents that feel there is greater competition and the largest proportion (14%) that feel there is less.

Competition has had various effects on the operations of real estate firms. Sixty-five percent of respondents believe it is now harder to source attractive assets than a year ago (Fig. 4.8), and as a result, over a third are having to review more opportunities in order to find investments. For those looking to bring a fund to market, three out of five are having to reduce their targeted returns from levels they would otherwise have set if valuations remained steady. Others are looking at more creative ways to extract value by adapting their investment strategies, and some are looking towards other geographies or niche property types.

ANOTHER FACTOR TO CONSIDER – INTEREST RATES

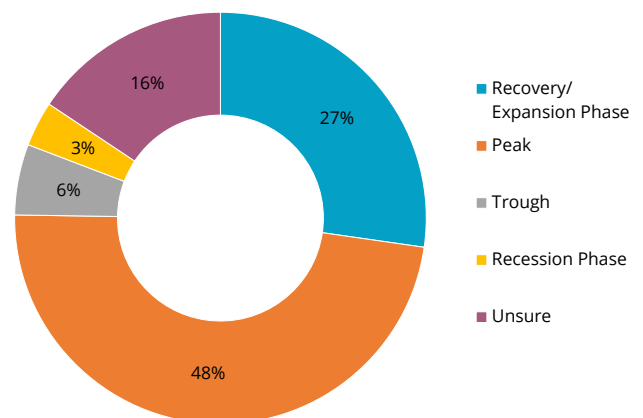
On the back of US and UK interest rate rises in 2017, and with further rises planned, concerns have been raised that we may be coming to the end of the historically low rate environment that has benefitted real estate investment and the growth of the asset class post-crisis. As seen in Fig. 4.9, greater proportions of real estate firms felt that fund performance was positively rather than negatively impacted by the continuation of the low rate environment and also by the interest rate policies enacted in Europe and Japan respectively. While the majority experienced no effect from rate rises in the US and UK, more respondents felt it had a negative effect on their 2017 real estate investments, with this proportion likely to rise over time alongside the Fed’s and the BOE’s planned policies.

Fig. 4.9: Fund Manager Views on the Impact of Interest Rate Policy on Real Estate Fund Performance over 2017



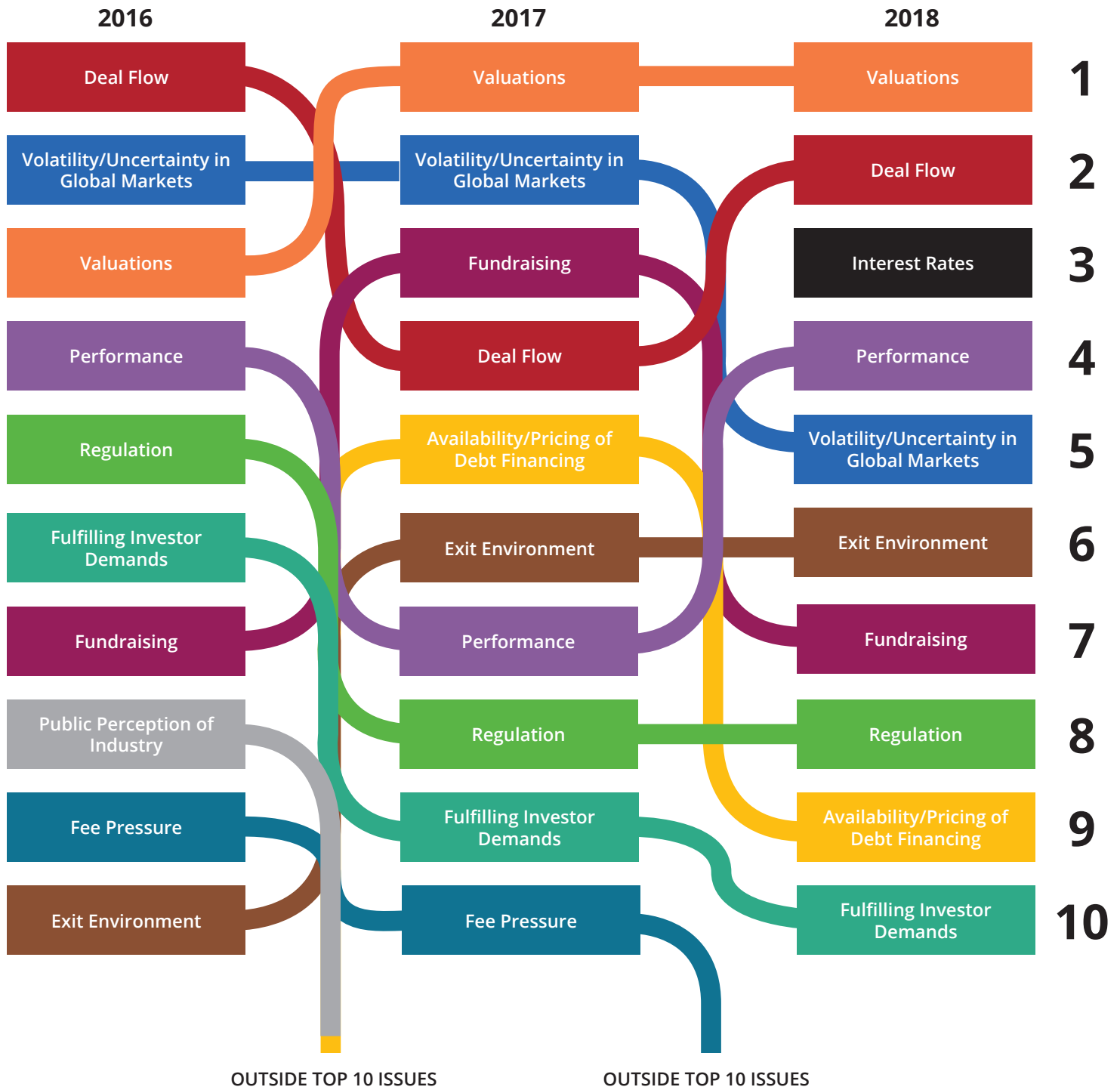
Source: Preqin Fund Manager Survey, November 2017

Fig. 4.10: Fund Manager Views on where Real Estate Is in the Current Market Cycle



Source: Preqin Fund Manager Survey, November 2017

FUND MANAGER VIEWS ON THE KEY CHALLENGES FACING THE REAL ESTATE MARKET



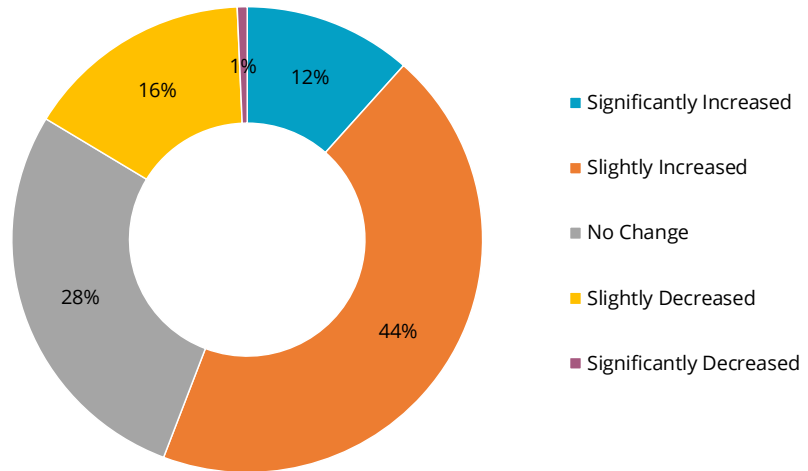
Source: Preqin Fund Manager Surveys, November 2015 - 2017



FUND MANAGER VIEWS ON INVESTOR APPETITE

Three-quarters of the 215 real estate managers surveyed by Preqin in November 2017 experienced an increase in competition for institutional capital over the past 12 months. The sheer number of vehicles seeking capital (a record 573 as at January 2018) makes it a significant challenge for firms to stand out from the crowd. However, despite these difficulties, firms looking to raise capital in 2018 are approaching an investor base that appears to be satisfied with the asset class: 56% of managers surveyed reported an increase in investor appetite for real estate in the past 12 months, including 12% that cited a significant increase (Fig. 4.11).

Fig. 4.11: Fund Manager Views on How Institutional Investor Appetite for Private Real Estate Has Changed over the Past 12 Months



Source: Preqin Fund Manager Survey, November 2017

Across all investor types, more fund managers have seen an increase in investor appetite for private real estate in the past 12 months than a decrease. The largest proportions of fund managers noted increased appetite from asset managers (39%), insurance companies (36%), private sector pension funds (36%) and, interestingly, retail investors (35%, Fig. 4.12). The transition to real estate investment for retail investors could be due to the yields on offer relative to fixed income where returns remain low.

Firms are seeing greater appetite across all regions, with the largest proportion (45%) of surveyed firms witnessing increased

appetite from North America-based LPs (Fig. 4.13). However, the proportions reporting increased appetite from Europe- and Asia-based investors are not far behind at 38% and 40% respectively.

Despite the apparent increase in competition for capital, fund managers are likely to continue to see opportunities as institutional investors work towards their target allocations: 32% of investors interviewed by Preqin in December 2017 plan to increase their real estate allocations over the longer term.

FUND MANAGERS REPORTING MORE COMPETITION FOR INVESTOR CAPITAL IN 2017

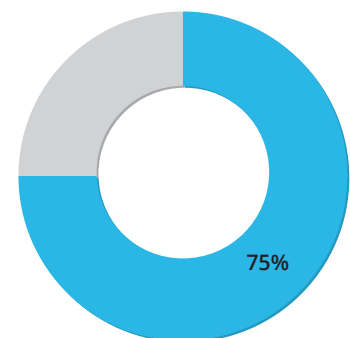
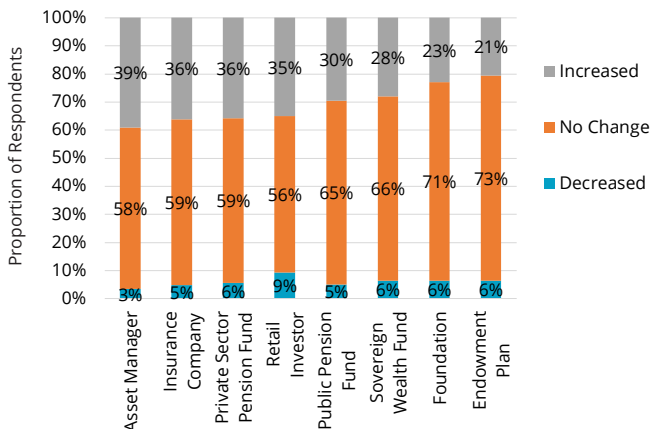
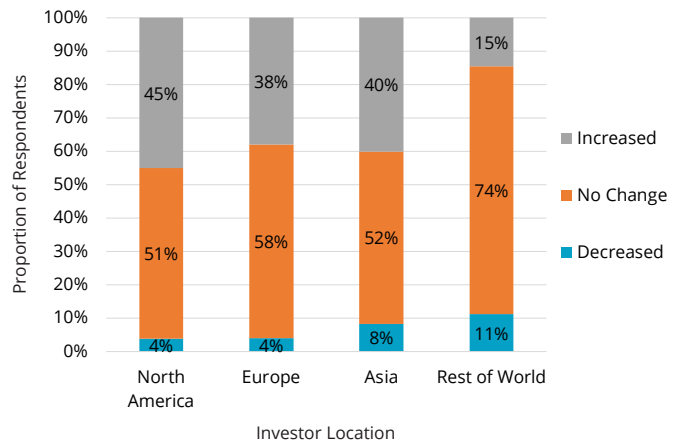


Fig. 4.12: Fund Manager Views on How Institutional Investor Appetite for Private Real Estate Has Changed over the Past 12 Months by Investor Type



Source: Preqin Fund Manager Survey, November 2017

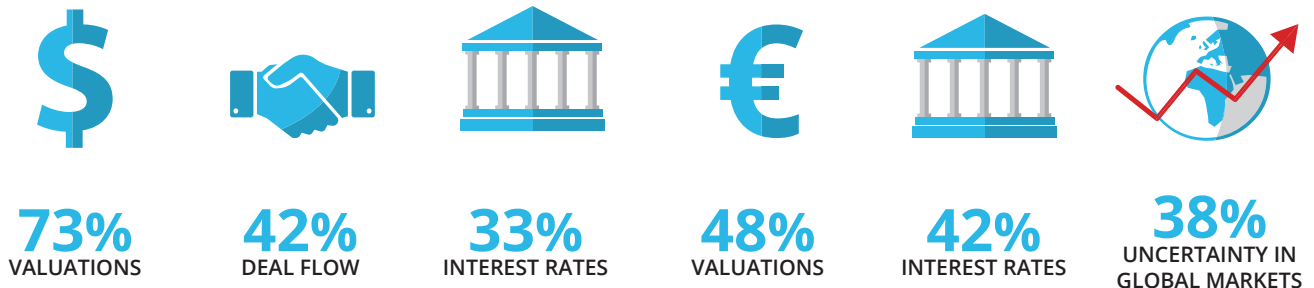
Fig. 4.13: Fund Manager Views on How Institutional Investor Appetite for Private Real Estate Has Changed over the Past 12 Months by Investor Location



Source: Preqin Fund Manager Survey, November 2017

NORTH AMERICA AND EUROPE

KEY CONCERNS CITED BY NORTH AMERICA- AND EUROPE-BASED REAL ESTATE FUND MANAGERS FOR 2018:



NORTH AMERICA

EUROPE

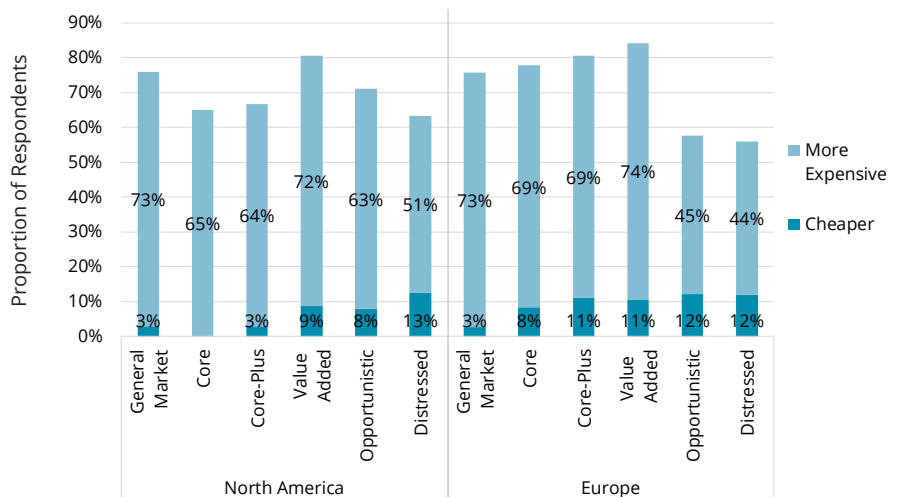
The emerging trends in the world's more traditional real estate markets are relatively similar to one another, however the differences appear in terms of scale. North America is the largest and most developed real estate market in the world, capturing the majority of investor capital commitments, and is the leading market for deal flow globally. As such, many of the global trends seen in this report are the trends of North America, and its challenges are the global fund communities' challenges.

Capital flows into Europe – which still account for a significant proportion of global fundraising – do not match the totals seen in North America. However, the growth in capital commitments from post-crisis levels to the highs seen in 2015 echo the fundraising pattern seen in North America.

“North America-focused funds hold more than \$150bn in dry powder, while Europe-focused funds hold close to \$60bn

With strong fundraising across both regions, dry powder has continued to rise; North America-focused vehicles hold more than \$150bn in available capital, and funds targeting European investment, hold close

Fig. 4.14: North America- and Europe-Based Fund Manager Views on the Pricing of Real Estate Assets Compared to 12 Months Ago by Strategy



Source: Preqin Fund Manager Survey, November 2017

to \$60bn. With high amounts needing to be invested in a limited timeframe, and the overall rise in competition for assets across all sectors in these markets, pricing pressure has continued to intensify in the past 12 months.

PRICING PRESSURE

High valuations are the main issue across both North America and Europe – however, this is not restricted to just one area of the market. Real estate fund managers based in each region have seen more expensive assets in 2017 relative to the general market a year prior, which is also apparent across the risk/return spectrum of assets available for acquisition (Fig. 4.14). As such, the prevailing view from

managers operating out of these regions is that we have reached the peak of the cycle, although the level of uncertainty is higher for Europe-based firms than their counterparts across the Atlantic.

Can this continue? Sixty-three percent of North America-based and 56% of Europe-based real estate firms plan to deploy more capital over 2018 than they did in 2017, with only 5% and 12% respectively planning to commit less. Couple this with the fact that competition for assets – not just from other firms, but also among institutional investors – has continued to rise across the board in both regions and we could see further rises in pricing over 2018. Most firms do not believe that there



will be a significant correction in the next year, and in fact, approximately two-thirds of North America- and Europe-based managers believe that industry assets will continue to grow over the next year.

However, if this environment continues, it will become more difficult than it is currently to source attractive assets, with firms having to conduct more thorough due diligence per investment to ensure it has the right characteristics for their portfolio and strategy. Only 1% of North America-based respondents found it easier to find attractive opportunities over 2017 than they did in 2016, with 71% finding it more difficult; in Europe, no firms found it easier and 61% found it more challenging (Fig. 4.15).

INTEREST RATES

The low interest rate environment has been a major factor in the growth of the asset class in North America and Europe, and has made real estate particularly attractive for institutional investors. However, with inflation starting to rise, and economies performing strongly in the US and many countries in the eurozone, central bank policy is starting to shift. The end of 2017 saw the Federal Reserve and the Bank of England increase interest rates,

along with a general tightening of the ECB's loose monetary policy which we have seen in the years following the Global Financial Crisis.

Thirty-seven percent of real estate managers in North America believe that the Federal Reserve's rate rise will have a negative effect on fund performance, while only 9% believe it will have a positive effect. In Europe, rate rises seem to be having less of an effect, with 93% and 81% of firms headquartered in the region predicting that rate rises in the US and UK respectively will have no effect on fund performance.

“ Without a significant correction in pricing many of the trends that have prevailed in recent years will continue to intensify ”

OUTLOOK

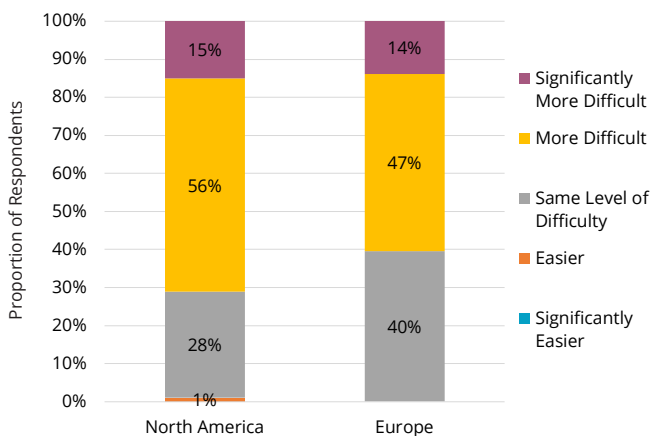
Without a significant correction in pricing, many of the trends that have prevailed in recent years will continue to intensify. While this means that investment in some

areas of the more traditional markets will become more challenging, the options available to fund managers in North America and Europe mean that firms have many opportunities to pivot their focus, whether it be to less saturated sectors or to different markets within each region.

Europe has its own issues to contend with: the region is not immune to the political uncertainty surrounding the future of the UK – one of the biggest real estate markets in Europe – and its future relationship with the EU. Many in the industry are still waiting for some indication of what the future holds in terms of inbound and outbound investment and whether regulations will be altered.

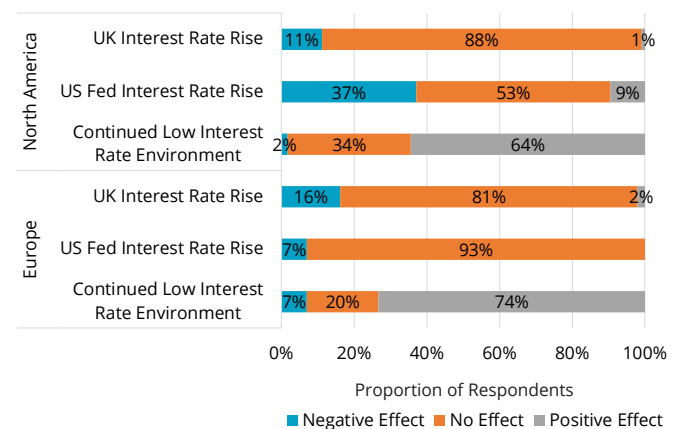
In times of uncertainty, investors are looking to place their capital in relative safety; when we interviewed 244 real estate investors at the end of 2017, most cited North America or Europe as presenting the best opportunities in the current market. However, they now face the challenge of having to find a way to isolate the best performers in an incredibly competitive fundraising environment.

Fig. 4.15: North America- and Europe-Based Fund Manager Views on the Difficulty of Finding Attractive Investment Opportunities Compared to 12 Months Ago



Source: Preqin Fund Manager Survey, November 2017

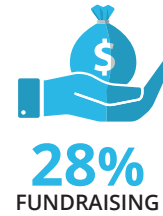
Fig. 4.16: North America- and Europe-Based Fund Manager Predictions for the Effect of Interest Rate Policy on Fund Performance in 2018



Source: Preqin Fund Manager Survey, November 2017

ASIA & REST OF WORLD

KEY CONCERNS CITED BY ASIA & REST OF WORLD-BASED REAL ESTATE FUND MANAGERS FOR 2018:



The fundraising markets outside North America and Europe are far smaller than their more traditional counterparts. Fundraising has never truly recovered from 2008 totals, and the levels of capital raised annually in recent years have remained stagnant. However, the crisis did create opportunities for local firms, which started to secure capital commitments when international capital dried up in the aftermath. The community has placed a premium on local knowledge of property markets, and those firms that have the experience and relationships to source assets and navigate the varied regulatory landscapes.

CHALLENGES

As with North America and Europe, valuations are the biggest issue for Asia & Rest of World-based (ROW) real estate firms at present; however, when focusing on just Asia-based respondents, fundraising remains the dominant issue, and pricing ranks third. This is a notable change for these managers, where pricing

has not historically been a major concern. Fig. 4.17 shows how pricing has shifted in both the general market and across the risk/return spectrum for Asia & ROW-based respondents. The prevailing view is that assets have become more expensive in 2017 relative to 2016; however, there are exceptions, particularly in capital appreciation strategies like opportunistic and distressed real estate, where assets are considered cheaper than a year ago.

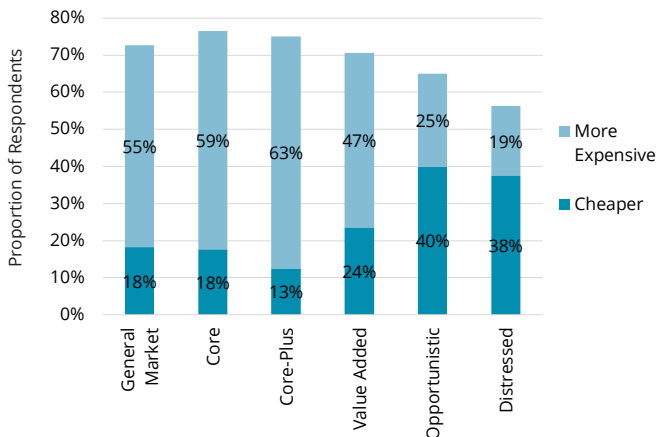
Despite this, Asia & ROW-based managers have reported more competition for transactions – especially for core and core-plus assets. Furthermore, contrasting with managers in the traditional markets, less than a quarter of Asia & ROW-based managers feel the real estate cycle has peaked. As such, they are more bullish regarding their activity in 2018: 84% plan to increase the amount of capital they deploy in assets relative to 2017 totals, including 56% that will significantly increase this total.

OUTLOOK

The difficulty for institutional investors targeting Asia & ROW markets is the different levels of development and the varied economic, social and regulatory environments which can make long-term investment challenging. However, there is also strength in this diversity, which fulfils institutions’ desire for portfolio diversification, and there is a chance for outsized returns due to the strong economic growth, which has been stunted in more developed markets in recent years.

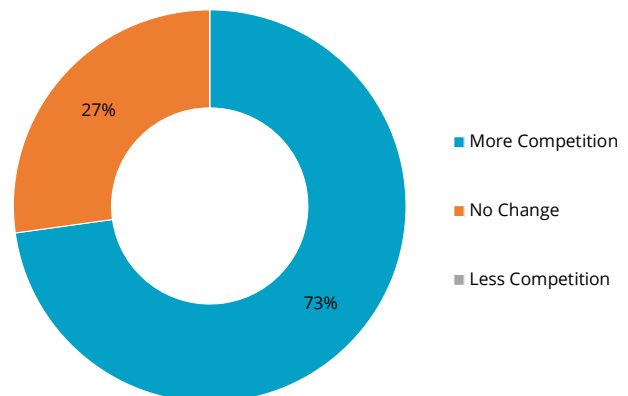
However, competition for investor capital is increasing: 73% of Asia & ROW-based fund managers feel there is now more competition for commitments than 12 months ago, while no respondents feel there is less (Fig. 4.18). Furthermore, they are facing the issue of trying to stand out from the crowd in an environment where investors are generally more risk averse, believing the best opportunities lie in North America and Europe.

Fig. 4.17: Asia & Rest of World-Based Fund Manager Views on the Pricing of Real Estate Assets Compared to 12 Months Ago by Strategy



Source: Preqin Fund Manager Survey, November 2017

Fig. 4.18: Asia & Rest of World-Based Fund Manager Views on the Level of Competition for Investor Capital in 2017 Compared to 12 Months ago



Source: Preqin Fund Manager Survey, November 2017



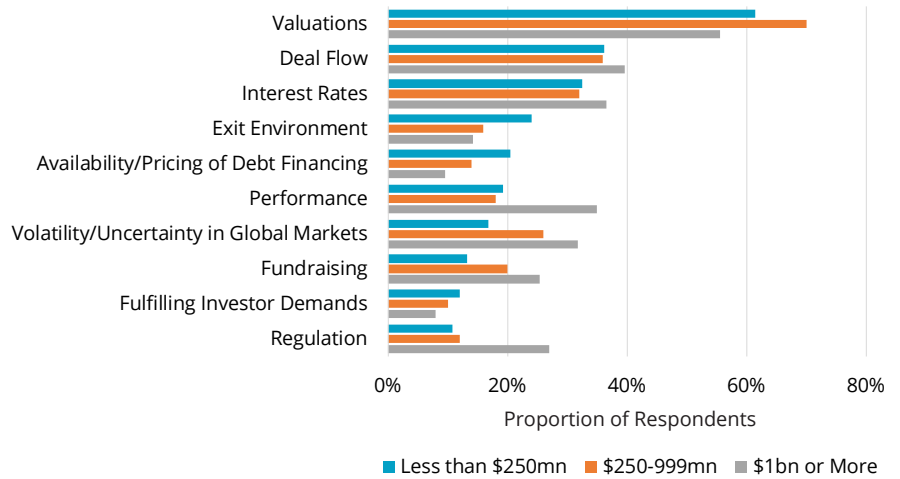
CHALLENGES OF SIZE

While fundraising has been relatively strong in the last few years – with five consecutive years of \$100bn or more being secured for closed-end real estate vehicles – the annual number of funds closed since 2015 has declined significantly (see page 34). Increasingly, capital is becoming concentrated among a select group of managers, typically those that have the longest and strongest track records. Illustrative of how concentrated the market has become, the 10 largest funds closed in 2017 secured a third of the total capital raised, while the top 20 funds captured half of capital commitments. As such, the challenges faced by smaller firms (those with less than \$250mn in AUM) can differ significantly from mid-sized (\$250-999mn) and large managers (\$1bn or more).

CHALLENGES

The top issues facing real estate firms are aligned for fund managers of all sizes – namely valuations, deal flow and interest rates (Fig. 4.19). Pricing is an issue for more small and mid-sized firms than large managers, and there is greater disparity in the proportions of respondents concerned by valuations than by deal flow. Interestingly, as AUM declines, more

Fig. 4.19: Fund Manager Views on the Key Issues Facing the Real Estate Industry in 2018 by Firm AUM



Source: Preqin Fund Manager Survey, November 2017

respondents are concerned with the exit environment, the availability and pricing of debt financing and fulfilling investor demands, while the reverse is true for uncertainty in global markets, fundraising and regulation.

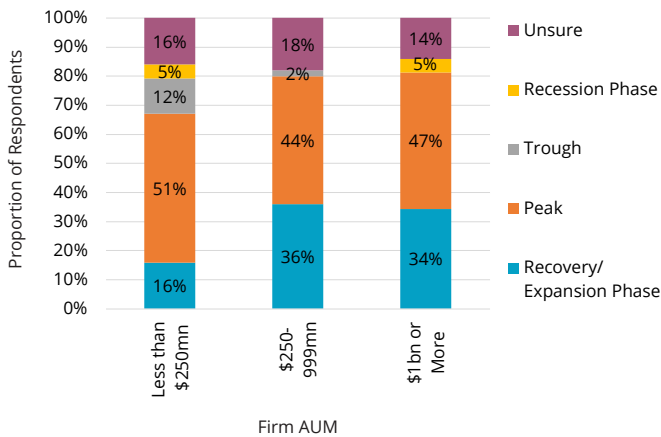
Asset pricing is becoming more expensive for managers of all sizes – in line with global trends across all strategies – while competition is also rising universally. As such, the prevailing view among managers

of all sizes is that we are at the peak of the real estate market (Fig. 4.20). However, more mid-sized and large firms believe there is still room to grow in the market than their smaller counterparts.

ACTIVITY

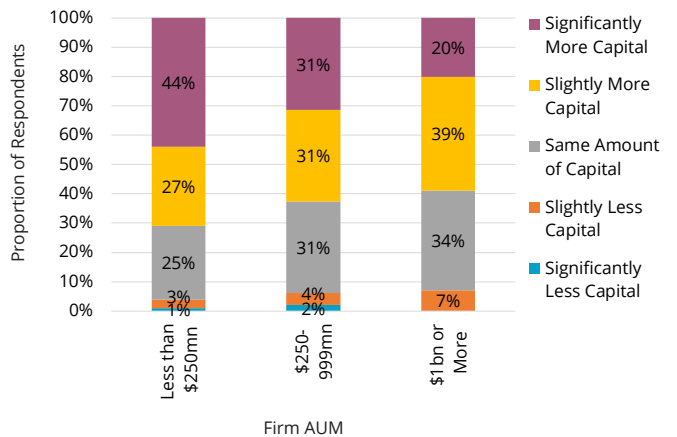
While all fund managers plan to deploy more capital in real estate in 2018 than they did in 2017, the proportion of respondents deploying more capital decreases as firm AUM increases: 71%

Fig. 4.20: Fund Manager Views on where Real Estate Is in the Current Market Cycle by Firm AUM



Source: Preqin Fund Manager Survey, November 2017

Fig. 4.21: Amount of Capital Fund Managers Plan to Deploy in Real Estate Assets in the Next 12 Months Compared with the Past 12 Months by Firm AUM



Source: Preqin Fund Manager Survey, November 2017

of the smallest firms plan to deploy more capital compared with 59% of the largest (Fig. 4.21). In terms of exits, more respondents are planning to increase their activity over 2018 relative to 2017 than to reduce this, particularly among smaller and mid-sized firms, as seen in Fig. 4.22.

INVESTOR APPETITE

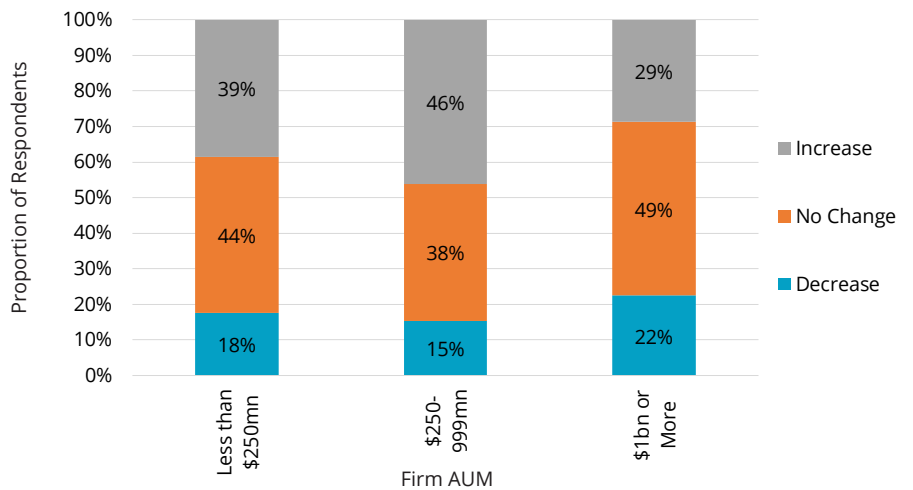
In line with the strong performance and high distributions of recent years, satisfaction with the real estate asset class is high, and as such managers have seen a rise in institutional investor appetite over the course of 2017. Furthermore, it is unsurprising to see that – in an environment where track records are key determinants of commitments – that the larger the firm, the more likely they are to have seen an increase in investor appetite for real estate over 2017 (Fig. 4.23).

With a record number of funds in market, surveyed fund managers have seen an increase in competition for capital over 2017. This is particularly apparent for those managers in the mid-market space – with the largest number of funds in market – where no respondents noted a decrease in competition for capital (Fig. 4.24).

OUTLOOK

Smaller funds have the capacity to generate higher returns than their larger peers and can often act faster than larger

Fig. 4.22: Fund Managers’ Planned Level of Exit Activity over the Next 12 Months Compared to the Previous 12 Months by Firm AUM

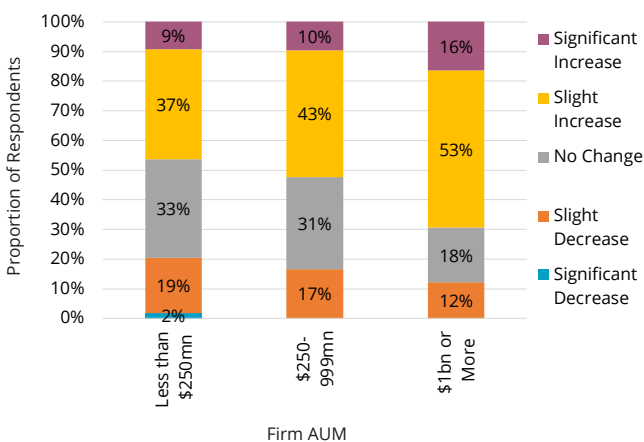


Source: Preqin Fund Manager Survey, November 2017

organizations. However, investors – with one eye looking to the challenges facing the industry – are lowering the risk tolerance in pursuit of managers that have the networks to maintain pipelines and a history of investing over difficult periods. As pricing pressure and capital competition intensifies it is expected that the established managers will continue to dominate the fundraising environment. This is evidenced by the fact that first-time funds – generally raised by smaller firms – constitute approximately a quarter of all funds in market, but just 13% of the aggregate capital targeted. Conversely, the most experienced managers (those that

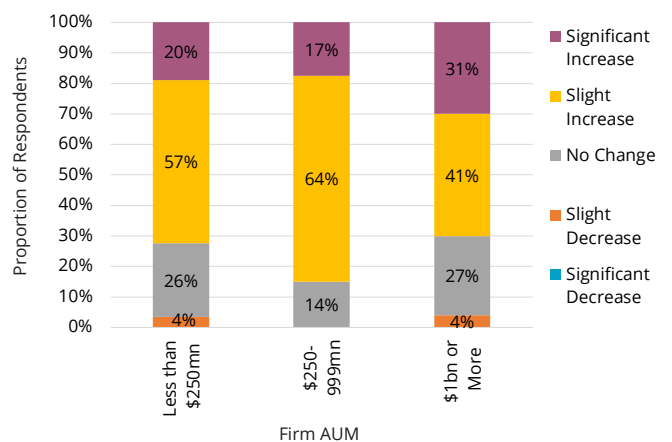
have raised nine or more funds previously) are seeking to raise just 13% of the number of funds in market yet 30% of all targeted commitments.

Fig. 4.23: Fund Manager Views on How Institutional Investor Appetite for Real Estate Has Changed over 2017 by Firm AUM



Source: Preqin Fund Manager Survey, November 2017

Fig. 4.24: Fund Manager Views on the Level of Competition for Institutional Investor Capital over 2017 by Firm AUM



Source: Preqin Fund Manager Survey, November 2017



THE YEAR AHEAD

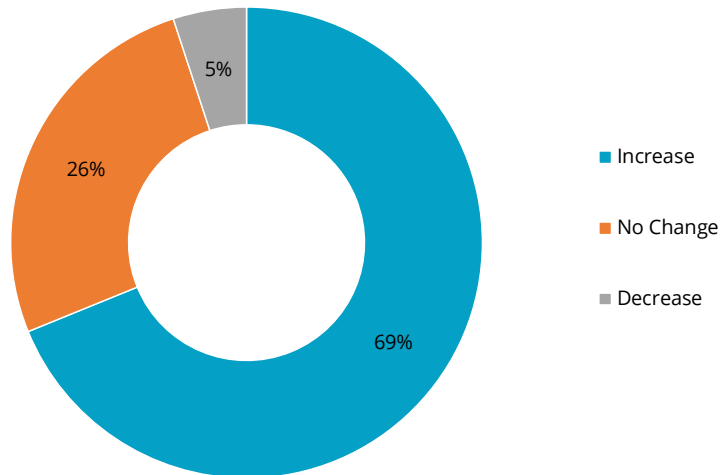
TIMING THE MARKET

The current environment has amplified concerns about where we currently are in the market cycle. Nearly half of private real estate firms surveyed believe we have reached the peak of the market. However, regionally, this proportion decreases as we move east from North America. Fifty-three percent of North America-based real estate firms feel we are now at the peak of the market, compared to 49% of Europe-based respondents and just 24% of Asia & ROW-based firms. Despite this, there remains a significant 30% of North America-based firms that feel there is still room to grow, while Europe-based respondents were more unsure.

“ Nearly two-thirds of surveyed firms intend to deploy more capital in 2018 than they did in 2017

However, real estate fund managers surveyed do not believe a correction is imminent, with 69% predicting that industry assets will grow over the next year (Fig. 4.25). Firms remain keen to put their capital to work, with 64% planning to deploy more capital in property over

Fig. 4.25: Fund Manager Predictions for the Size of the Private Real Estate Industry in the Next 12 Months



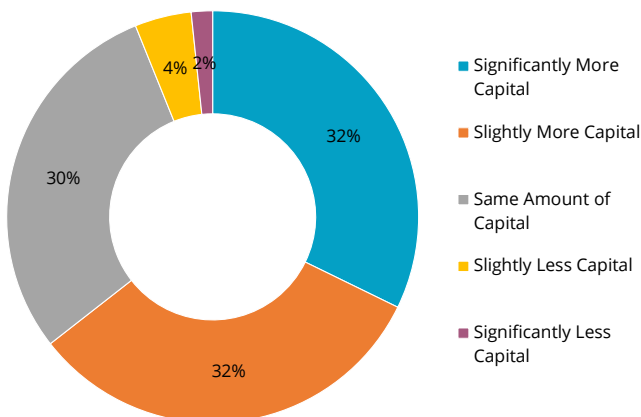
Source: Preqin Fund Manager Survey, November 2017

2018 than they did in 2017, while only 6% intend to invest less (Fig. 4.26). This includes nearly a third that expect to deploy significantly more capital over the next year.

What does this mean for 2018? Without a significant correction, the capital available to fund managers (approximately a quarter of a trillion dollars as at December 2017) means we are likely to see a continuation of trends that have persisted in recent years: a high level of competition for transactions and upwards pricing pressure. The other side of the coin is a continuation

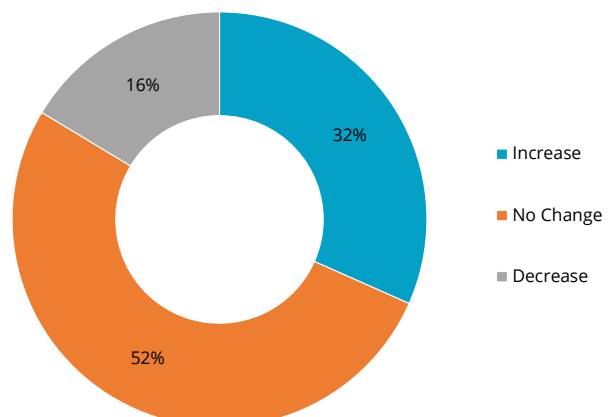
of the strong seller's environment – double the proportion of respondents plan to increase their exit activity over 2018 than reduce it (Fig. 4.27). However, fund managers are still confident that they can source attractive opportunities and deliver the level of performance that institutional investors have come to expect from the asset class.

Fig. 4.26: Amount of Capital Fund Managers Plan to Deploy in Real Estate Assets in the Next 12 Months Compared to the Past 12 Months



Source: Preqin Fund Manager Survey, November 2017

Fig. 4.27: Fund Managers' Planned Level of Exit Activity in the Next 12 Months Compared to the Past 12 Months



Source: Preqin Fund Manager Survey, November 2017

REASONS TO CONTRIBUTE DATA

BE SEEN

by thousands of investors and decision-makers around the world

ENSURE

that the data we hold for your firm and funds is correct

GENERATE

incoming leads from industry professionals seeing your profile

CONTRIBUTE

to industry benchmarks and help further research into this area

Contributing data is free and simple. For more information, please visit:

www.preqin.com/sharedata



An aerial, high-angle photograph of a large cable-stayed bridge spanning a body of water. The bridge's two massive pylons are visible, with numerous stay cables fanning out to support the deck. The bridge deck is a multi-lane highway. In the background, a dense urban landscape with various buildings and structures is visible under a hazy sky. The entire image is overlaid with a semi-transparent orange filter. Centered over the bridge deck is the text "SECTION FIVE: INFRASTRUCTURE" in a bold, white, sans-serif font.

**SECTION FIVE:
INFRASTRUCTURE**

FOREWORD

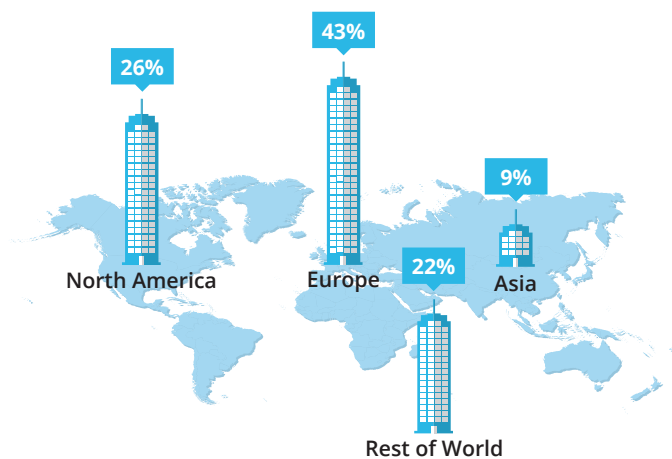
In November 2017, Preqin surveyed 65 infrastructure fund managers globally to determine their views on the key challenges facing the industry and the current level of competition for assets, as well as their outlook for the next 12 months. Valuations are at the forefront of fund managers' concerns at present. Against a backdrop of record levels of dry powder available for infrastructure investments, fund managers feel there is more competition for assets than 12 months ago and that, as a result, pricing is now higher.

Infrastructure fund managers have also observed an increase in appetite from institutional investors for the asset class. However, even with this increase the fundraising market remains highly competitive, with 176 unlisted infrastructure funds currently seeking capital. Those without a recognized brand will need to work hard to set themselves apart from the crowd.

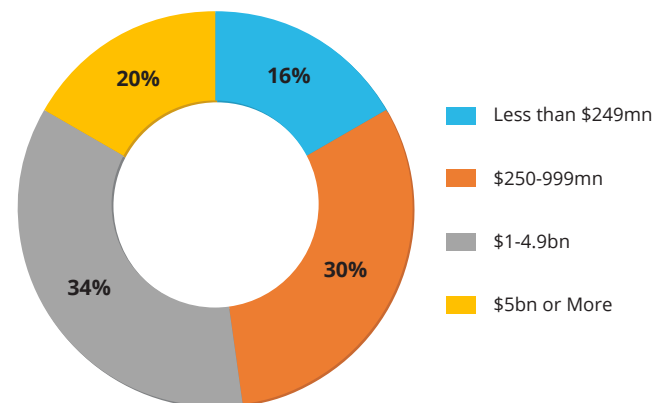
The infrastructure market is set to be very active in 2018 with the majority of fund managers expecting to deploy more capital in the year ahead. The high pricing environment will create more opportunities for attractive exits, and so the prospects are favourable for higher distributions to investors in the coming months.

We hope that you find this report useful and welcome any feedback you may have. For more information about Preqin and our services please visit www.preqin.com or contact info@peqin.com.

Survey Respondents by Headquarters Location:



Survey Respondents by Assets under Management:





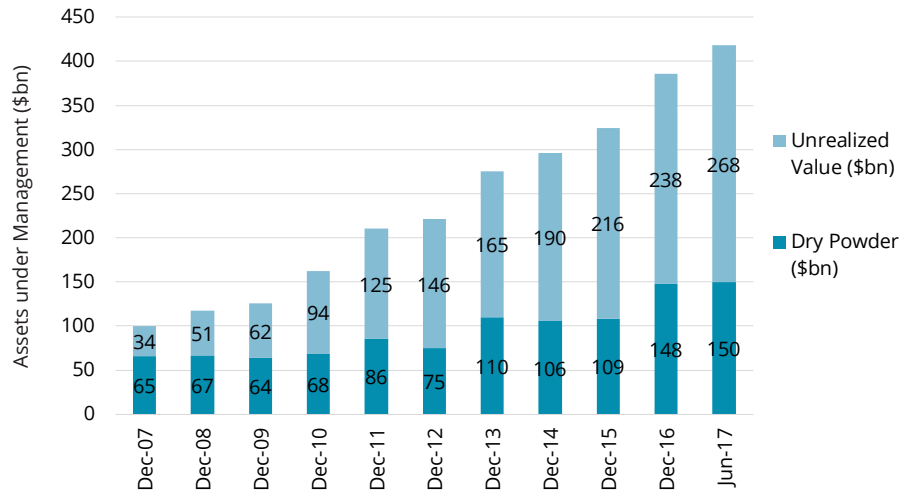
INDUSTRY OUTLOOK

The infrastructure market has grown rapidly over the past 10 years; many institutional investors have sought to diversify their portfolios by investing in infrastructure, which offers the prospect of steady, reliable returns with low correlation to other asset classes. As a result, the assets under management (AUM) held by infrastructure fund managers has quadrupled over this period, from \$99bn in December 2007 to \$418bn in June 2017 (Fig. 1).

However, the expansion of the industry has brought with it noticeable challenges, as the growing amount of capital allocated to infrastructure has created increased competition for deals and rising valuations. Valuations have yet again emerged as the number one concern among fund managers in our survey, with more than half (59%) reporting it as a key issue facing the industry at present (Fig. 2). Seventy-one percent of fund managers reported that pricing for infrastructure assets is higher now than it was 12 months ago, with just 2% believing it to be lower (Fig. 3). Rising prices were particularly noticed for core (71%) and core-plus (63%) assets.

Rising valuations pose a challenge as the need to deploy capital must be balanced against the risk of potentially over-bidding for assets. As a result, it may be difficult for fund managers to continue to generate

Fig. 1: Unlisted Infrastructure Assets under Management, 2007 - 2017



Source: Preqin

the returns that investors expect: 57% of fund managers reported that valuations are leading them to reduce the targeted returns of funds that they are bringing to market, compared to just 13% that think high valuations will increase returns.

Despite these challenges, infrastructure fund managers generally remain optimistic that the industry will continue to grow in the future. Among those surveyed, 94% reported that they expect industry AUM to increase further in 2018, with none expecting assets to decrease.

FUND MANAGER VIEWS ON HOW INDUSTRY ASSETS UNDER MANAGEMENT WILL CHANGE IN THE NEXT 12 MONTHS

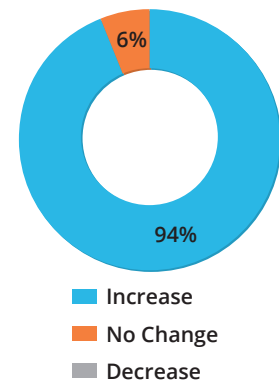
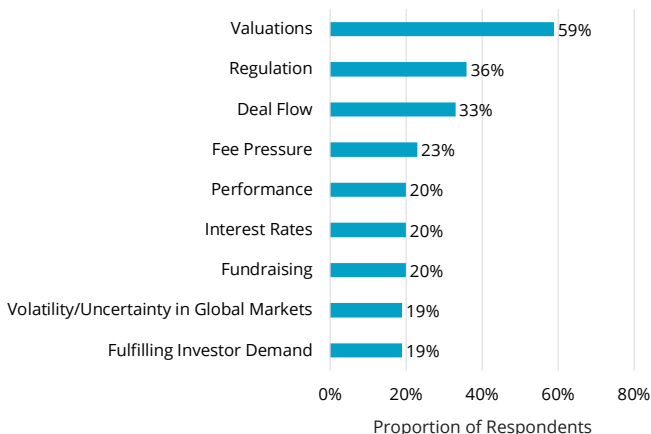
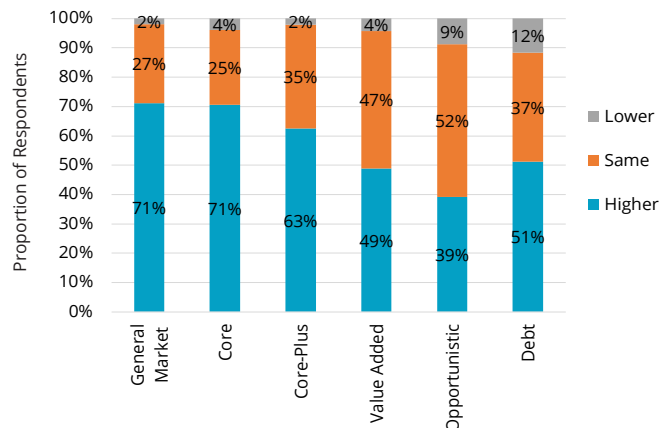


Fig. 2: Key Challenges Facing Unlisted Infrastructure Fund Managers in 2018



Source: Preqin Fund Manager Survey, November 2017

Fig. 3: Fund Manager Views on Pricing for Infrastructure Assets Compared to 12 Months Ago by Primary Strategy



Source: Preqin Fund Manager Survey, November 2017

DEAL ACTIVITY

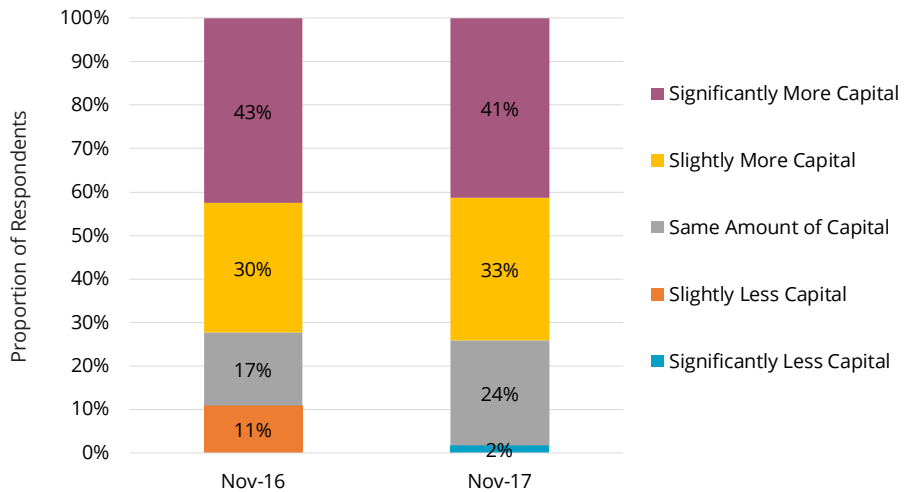
DEAL FLOW AND COMPETITION

As growing numbers of investors look to infrastructure assets, the amount of capital held by managers continues to increase, with dry powder levels reaching a record \$150bn as at June 2017. Among fund managers surveyed, the vast majority (74%) plan to invest more capital in 2018 than they did in the past 12 months, while the proportion that plan to invest less has fallen from 11% in November 2016 to 2% in November 2017 (Fig. 4).

With all this capital available, fund managers are reporting the increasingly competitive nature of the infrastructure market: 81% feel that there is more competition for assets than 12 months ago, particularly for core (81%), core-plus (73%) and debt assets (70%, Fig. 5). The competitive market is further exacerbated by the increasing number of institutional investors becoming involved in the asset class. Fifty-six percent of fund managers reported that they are competing more frequently with institutions than a year ago, compared to 43% that reported increased competition from other fund managers and trade/strategic investors (33%).

As growing competition forces up asset prices, it becomes increasingly difficult to

Fig. 4: Amount of Capital Fund Managers Plan to Deploy in Infrastructure Assets in the Next 12 Months Compared to the Previous 12 Months, 2016 vs. 2017



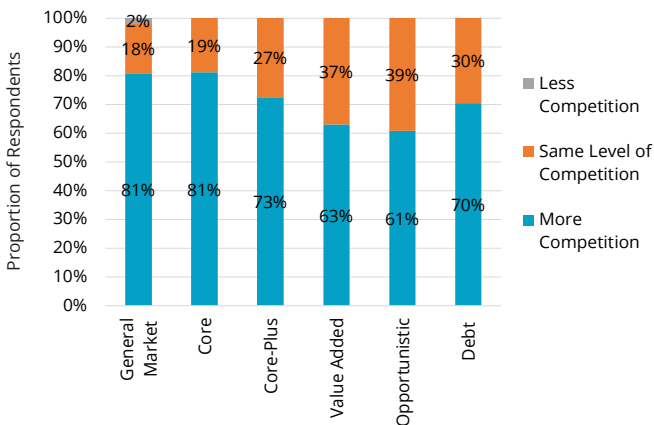
Source: Preqin Fund Manager Survey, November 2016 - 2017

identify assets at compelling valuations. Forty-six percent of fund managers reported that they are finding it more difficult to find attractive investment opportunities than 12 months ago, compared to 2% that are finding it easier (Fig. 6). As a result, fund managers are broadening their searches, with 41% of fund managers reporting that they are reviewing more opportunities than this time a year ago, compared to just 5% that are reviewing fewer.

DEBT FINANCING

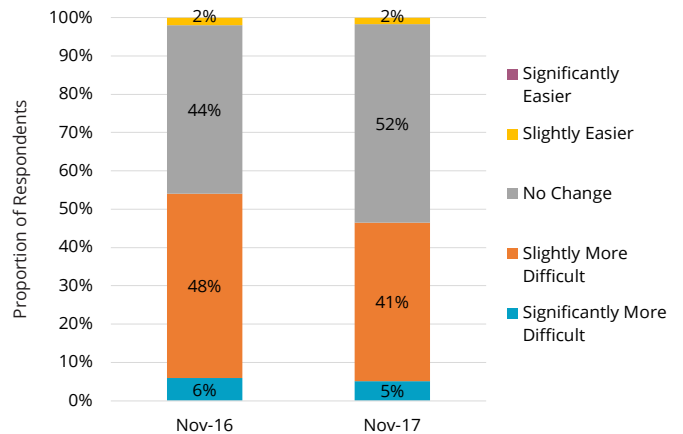
Thirty percent of respondents believe the terms of financing for infrastructure assets have improved from 12 months ago. GPs view banks as a key source of debt financing, with 69% expecting such institutions to provide the majority of, if not all, debt financing for infrastructure transactions in 2018 (Fig. 7). Fund managers also regard institutional investors as an important source of such capital, with 39% of fund

Fig. 5: Fund Manager Views on the Level of Competition for Assets Compared to 12 Months Ago by Primary Strategy



Source: Preqin Fund Manager Survey, November 2017

Fig. 6: Fund Manager Views on the Difficulty of Finding Attractive Investment Opportunities Compared to 12 Months Ago, 2016 vs. 2017



Source: Preqin Fund Manager Survey, November 2016 - 2017



managers expecting them to provide a significant amount of financing. While the infrastructure debt market is still up and coming, 79% of respondents expect infrastructure debt funds to provide financing in 2018, significantly more than the 59% surveyed in November 2016.

ESG POLICIES

Increasing investor attention to responsible investment practices in recent years have made environmental, social and governance (ESG) considerations a key part of the investment process for many fund managers. Eighty-one percent of fund

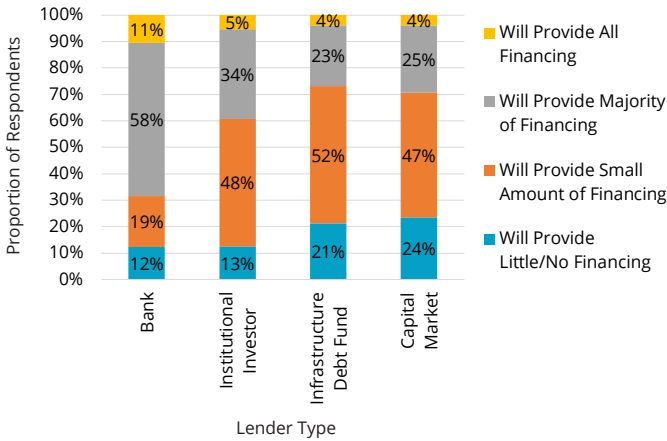
managers reported that they consider ESG criteria for all of their deals, while a further 9% consider them for some deals (Fig. 8). Sixty-one percent of fund managers either occasionally or frequently decide not to invest in an asset due to ESG policies, indicative of the potential impact of such considerations on fund managers' portfolios.

EXIT ENVIRONMENT

Although there are challenges surrounding sourcing new deals, fund managers believe that the opportunities for exits are currently strong. Forty-two percent of

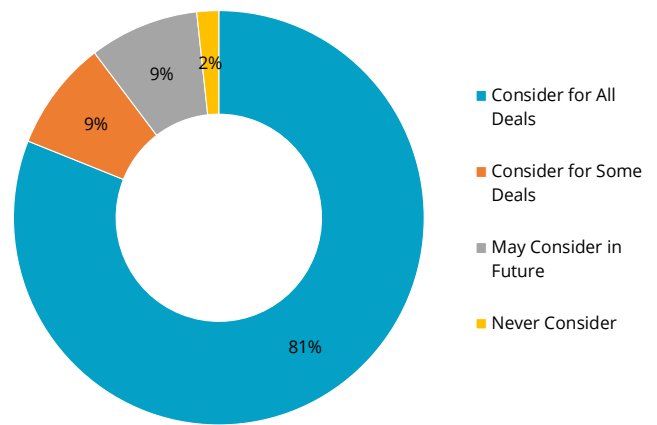
respondents predict that overall the level of exit activity among infrastructure fund managers will increase over the next 12 months (Fig. 9). In terms of their specific plans, among those fund managers planning exits, 44% expect to exit more investments in 2018 than they did in 2017, compared to only 18% that plan to exit fewer (Fig. 10).

Fig. 7: Fund Manager Views on the Importance of Various Types of Lenders as Sources of Debt Financing for Transactions in 2018



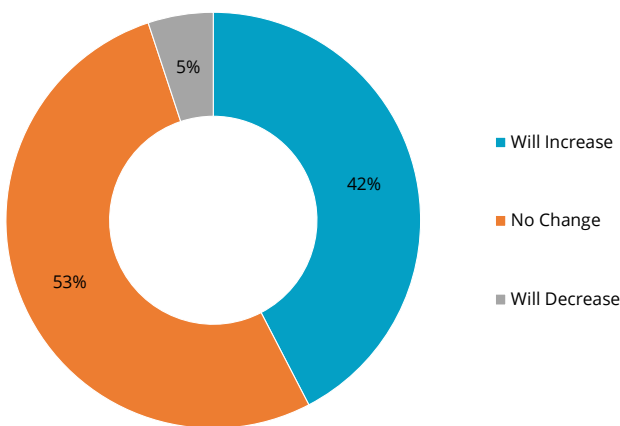
Source: Preqin Fund Manager Survey, November 2017

Fig. 8: Fund Managers that Consider ESG Factors as Part of the Deal-Making Process



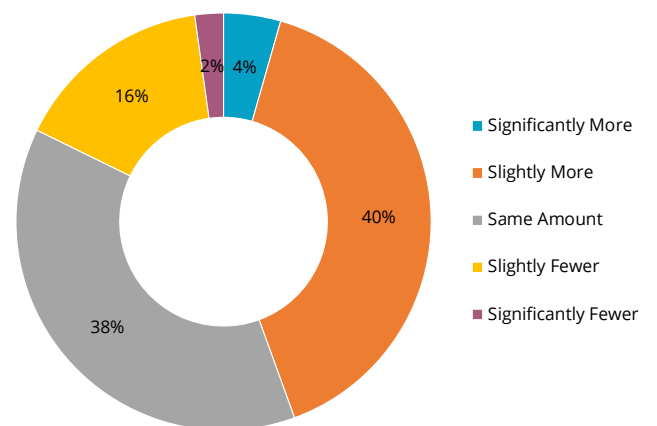
Source: Preqin Fund Manager Survey, November 2017

Fig. 9: Fund Manager Expectations for the Level of Exit Activity in the Next 12 Months



Source: Preqin Fund Manager Survey, November 2017

Fig. 10: Number of Exits Fund Managers Plan to Make in 2018 Compared to 2017



Source: Preqin Fund Manager Survey, November 2017

FUND MANAGER VIEWS ON INVESTOR APPETITE

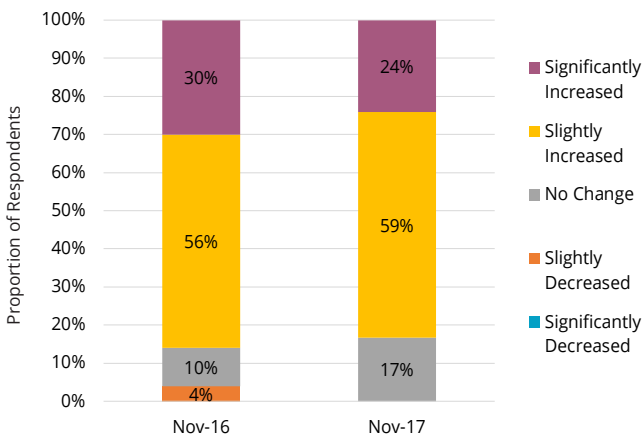
While fund managers have some concerns about valuations, investors' attitudes to the industry remain largely positive. As shown in the **Preqin Investor Outlook: Alternative Assets, H1 2018**, 53% of investors surveyed in December 2017 have a positive view of infrastructure, compared to just 9% that view it negatively. Continuing this positive trend, 93% of surveyed investors also reported that their infrastructure fund investments had met or exceeded their performance expectations over the past 12 months. As a result, investor appetite continues to increase, as reported by 83% of fund managers (Fig. 11).

The increase in demand has come particularly from investors with longer-term liabilities, such as pension funds and insurance companies, which have been attracted by the steady, bond-like returns that infrastructure investments can produce in the current low-yield environment. Seventy-one percent of fund managers noted increased appetite from public pension funds in 2017, while 59% reported increased appetite from private sector pension funds and 51% from insurance companies (Fig. 12). At the other end of the scale, 28% of fund managers noticed less appetite from banks, compared to just 15% that observed

an increase. Broken down by investor location, the increase in investor appetite has come particularly from Asia-based investors (60%) and those based in North America (54%, Fig. 13).

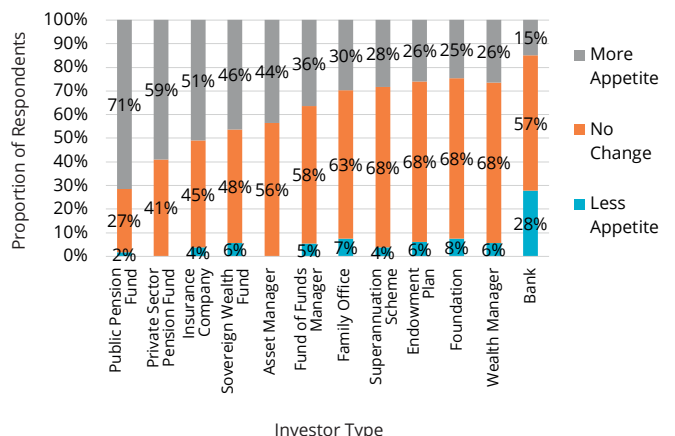
Although investor interest in infrastructure continues to increase, the fundraising market remains competitive. Eighty percent of fund managers believe there is more competition for investor capital than a year ago, including 21% that feel there is significantly more (Fig. 14).

Fig. 11: Fund Manager Views on How Institutional Investor Appetite for Unlisted Infrastructure Has Changed over the Past 12 Months, 2016 vs. 2017



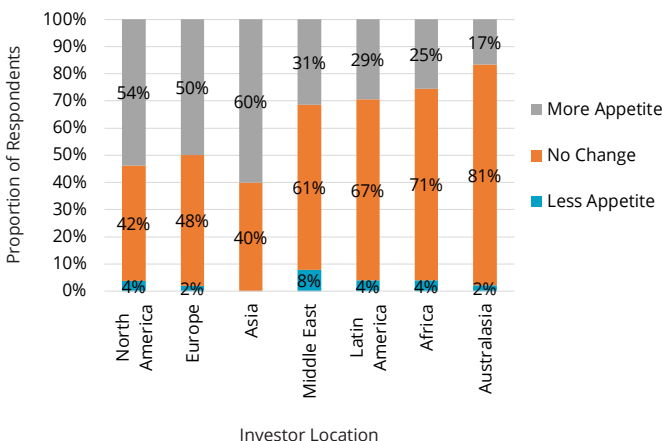
Source: Preqin Fund Manager Survey, November 2016 - 2017

Fig. 12: Fund Manager Views on Whether They Are Seeing More Appetite for Infrastructure from Different Investor Types Compared to 12 Months Ago



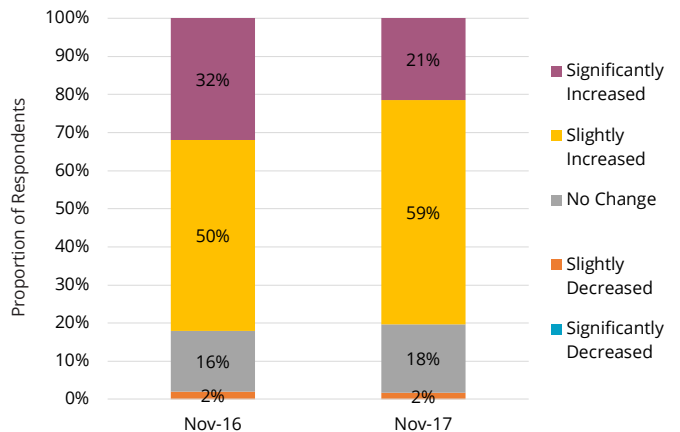
Source: Preqin Fund Manager Survey, November 2017

Fig. 13: Fund Manager Views on Whether They Are Seeing More Appetite for Infrastructure from Investors Based in Different Regions Compared to 12 Months Ago



Source: Preqin Fund Manager Survey, November 2017

Fig. 14: Fund Manager Views on the Level of Competition for Investor Capital Compared to 12 Months Ago, 2016 vs. 2017



Source: Preqin Fund Manager Survey, November 2016 - 2017



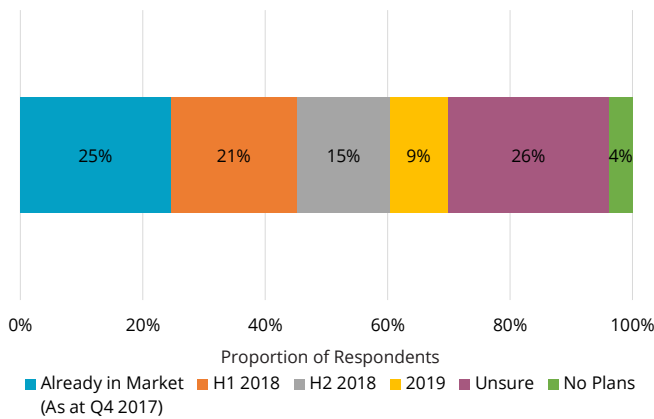
FUTURE PLANS

With strong investor appetite for infrastructure and a favourable fundraising environment, fund managers continue to plan significant launch activity for the year ahead. As shown in Fig. 15, among surveyed fund managers, 25% were already in market with their next vehicle at the end of 2017, while a further 36% were planning to begin fundraising before the end of 2018.

However, in addition to funds, fund managers are increasingly offering a variety of options to investors looking to boost their exposure to infrastructure. Forty-nine percent of fund managers reported that they are planning to offer more co-investment opportunities to investors in 2018 than in 2017, and 46% plan to offer more separate accounts (Fig. 16).

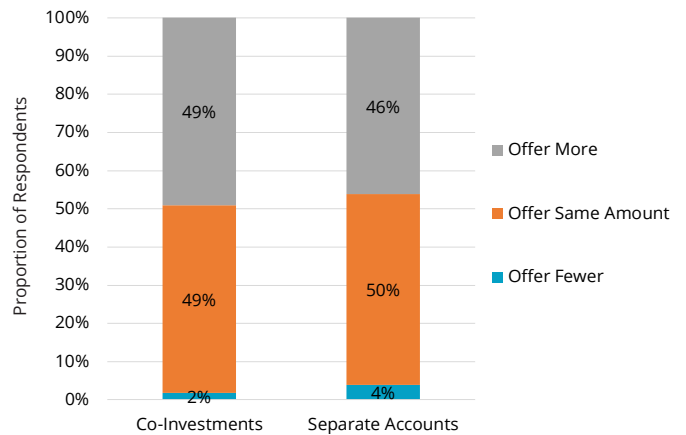
Looking at the opportunities ahead, fund managers view core-plus and value added infrastructure as the most promising strategies, cited by 43% and 35% of respondents respectively (Fig. 17). Geographically, the more established infrastructure markets of North America and Europe continue to present the best opportunities (45% and 40%, Fig. 18).

Fig. 15: Timeframe with Which Fund Managers Intend to Launch Their Next Infrastructure Fund



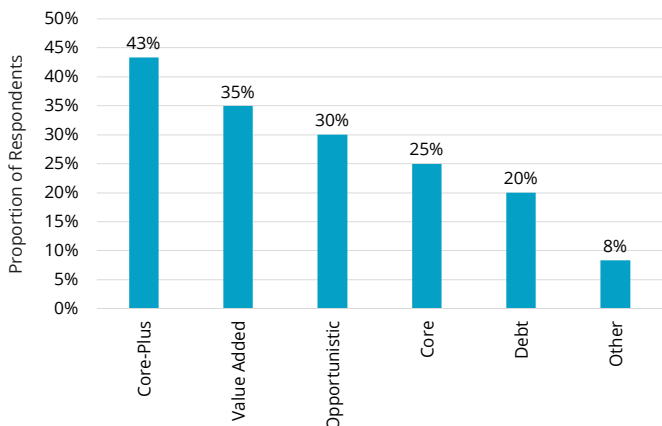
Source: Preqin Fund Manager Survey, November 2017

Fig. 16: Fund Managers' Plans to Offer Infrastructure Co-Investment Opportunities and Separate Accounts in 2018 Compared to 2017



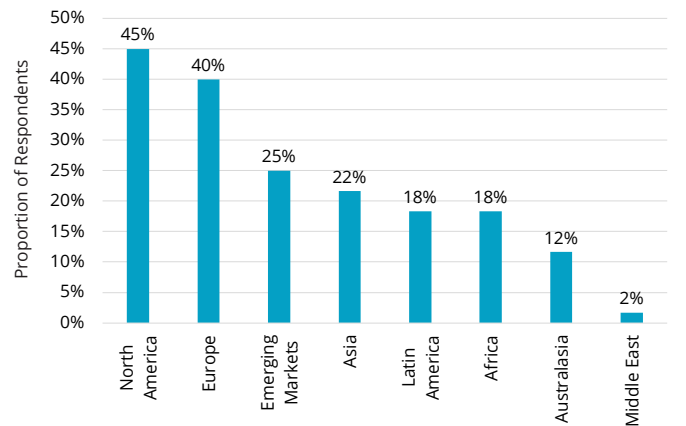
Source: Preqin Fund Manager Survey, November 2017

Fig. 17: Fund Manager Views on the Infrastructure Strategies Currently Presenting the Best Opportunities



Source: Preqin Fund Manager Survey, November 2017

Fig. 18: Fund Manager Views on the Regions Currently Presenting the Best Opportunities for Infrastructure





Source: Preqin Fund Manager Survey, November 2017

ALTERNATIVES ARE EVOLVING AND SO ARE WE.

A BRAND-NEW **PREQIN PLATFORM** IS LANDING IN 2018.

- Redesigned around your needs
- Lightning-fast tools
- Easy in-platform data manipulation
- Same market-leading data and insight

Palo Alto Public Employees Retirement Fund  

ASSETS UNDER MANAGEMENT USD 100,000 mn	INVESTOR TYPE Public Pension Fund	LOCATION Palo Alto, CA, USA	ASSET CLASSES OF INTEREST PE RE HF PD INF NR	LAST UPDATED 30 - Sept - 17
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Snapshot						
ASSET CLASS	INVESTING	NEXT 12 MONTHS	TICKET SIZE (mn)	CURRENT ALLOCATION (mn)	TARGET ALLOCATION (mn)	ALLOCATION DIFFERENCE
Private Equity	Yes	2 - 5 funds/USD 10 - 100 mn	USD 5 - 20	USD 200	USD 300	100 under *
Real Estate	Yes	1 - 3 funds/USD 5 - 60 mn	USD 5 - 20	USD 50	USD 100	50 under *
Hedge Funds	Considering	Plan to Invest	USD 10 - 20	USD 0	USD 20	20 under *
Private Debt	Considering	Plan to Invest	USD 5 - 20	USD 0	USD 30	30 under *
Infrastructure	Yes	1 - 2 funds/USD 10 - 120 mn	USD 10 - 40	USD 100	USD 140	40 under *
Natural Resources	Yes	Plan to Invest	USD 5 - 20	USD 15	USD 30	15 under *

We're excited to share with you how we're evolving. Get in touch to find out more:

info@preqin.com



The background of the slide is a purple-tinted image. The upper portion shows a dense city skyline with various skyscrapers of different heights and architectural styles. The lower portion shows a multi-lane highway interchange with curved ramps and lane markings, viewed from an elevated perspective. The overall aesthetic is modern and professional.

SECTION SIX: PRIVATE DEBT

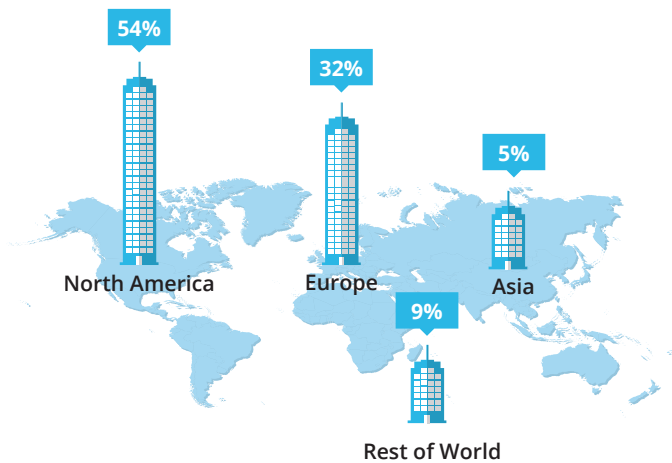
FOREWORD

The private debt industry witnessed considerable growth throughout 2017, with a record \$107bn secured by funds that reached a final close during the year. This Special Report looks at the results of Preqin’s November 2017 survey of 94 private debt fund managers, covering topics such as key issues affecting the industry, competition, investor appetite and future fundraising plans.

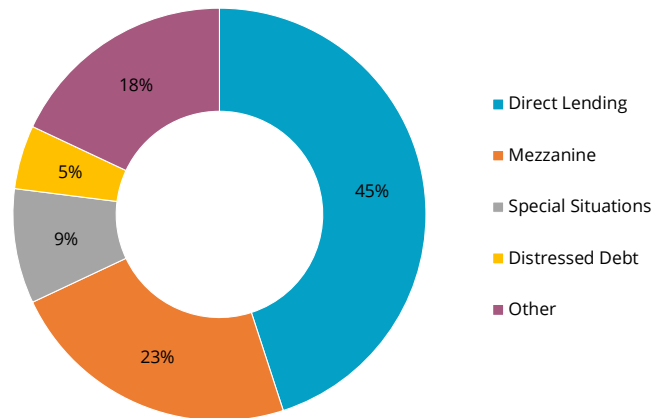
With optimism among the investor community remaining high moving into 2018, fund managers are attempting to capitalize on this, with 346 private debt vehicles currently in market (as at February 2018) targeting an aggregate \$456bn globally. However, ongoing challenges remain for private credit managers, as an evolving credit environment and more competition than ever before is now the reality of private lending; 70% of fund managers are facing greater competition compared to 12 months ago.

Managers are optimistic about their prospects at present: 77% of respondents plan to deploy more capital in 2018 than they did in 2017. Additionally, 92% of managers expect industry assets under management to increase in 2018, again signalling fundraising confidence in the asset class.

Survey Respondents by Headquarters Location:



Survey Respondents by Primary Investment Strategy:





KEY CHALLENGES

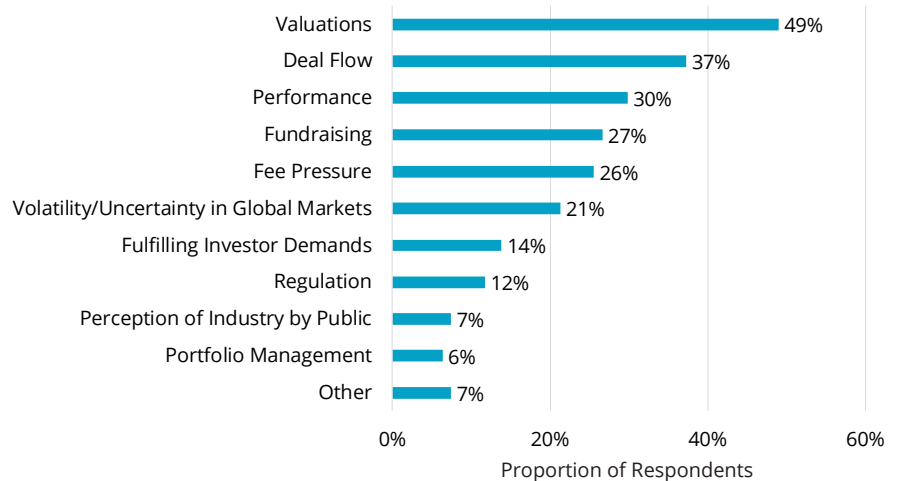
In November 2017, Preqin surveyed 94 private debt fund managers to ascertain the key issues affecting their business and the wider industry at present, as well as their outlook for 2018.

“ Deal pricing remains at the top of the list of challenges across the alternatives industry for 2018

The maturing private debt landscape has offered a host of challenges for fund managers in recent years, with valuations at the forefront, as cited by 49% of fund managers surveyed (Fig. 6.1). Deal pricing remains at the top of the list of challenges across the alternatives industry for 2018, with lofty valuations becoming increasingly commonplace. As deal terms have steadily become more borrower friendly each year, any change to the credit environment could greatly affect the health of current private debt assets.

Deal flow was cited as a key issue by 37% of respondents, with access to high-quality opportunities becoming more difficult to attain in a highly competitive private credit

Fig. 6.1: Key Challenges Facing Private Debt Fund Managers in 2018



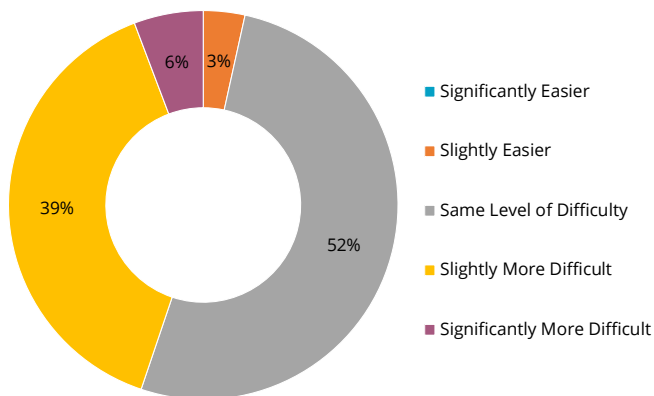
Source: Preqin Fund Manager Survey, November 2017

environment. Further to this, performance was cited by 30% of fund managers as a key challenge in 2018, followed closely by fundraising (27%) and fee pressure (26%). With average fund sizes growing and new managers entering the market as the industry matures, investors can negotiate more modest fees for certain strategies where transparency has also come to lead the conversation.

Just over half (52%) of managers reported the same level of difficulty in finding investment opportunities as 12 months

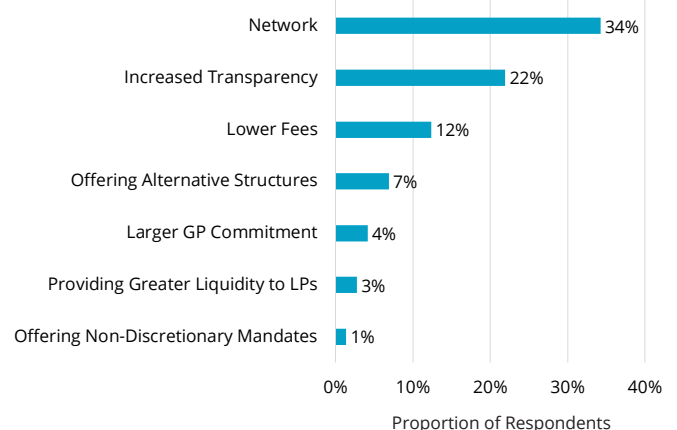
earlier, while 45% feel the process is more difficult (Fig. 6.2). Given the growing levels of participants in the marketplace, managers with great networks and processes in place should have the upper hand in accessing deals, even more so as successful track records continue to grow; 34% of managers surveyed see their network as their most important differentiation factor among peers (Fig. 6.3).

Fig. 6.2: Fund Manager Views on the Difficulty of Finding Attractive Investment Opportunities Compared to 12 Months Ago



Source: Preqin Fund Manager Survey, November 2017

Fig. 6.3: Fund Manager Views on the Most Important Differentiation Factors



Source: Preqin Fund Manager Survey, November 2017

COMPETITION

The private debt market has become increasingly competitive over the past couple of years, as more fund managers have entered the asset class and valuations have continued to rise. A significant 70% of fund managers believe there is now greater competition for transactions than 12 months ago, while no fund managers cited less competition (Fig. 6.4). Among direct lenders specifically, 71% are experiencing more competition (Fig. 6.5).

Only 14% of direct lenders surveyed have seen lending terms become more lender friendly in 2017, while 63% have seen

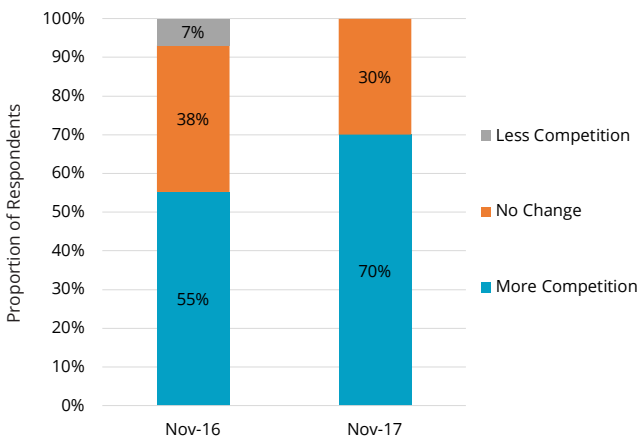
terms become more borrower friendly (Fig. 6.6). Increased levels of borrower-friendly terms would be a result of more potential lenders across certain markets competing to offer attractive terms to a borrower, and on the bottom line this levelling of the marketplace is a positive for most parties involved, limiting covenants and decreasing the likelihood of defaults.

In efforts to find and access investable opportunities, half of survey respondents are reviewing more opportunities now than 12 months ago, potentially expanding their scope in the process (Fig. 6.7). Only 13% are

reviewing fewer opportunities than a year ago and 37% are reviewing close to the same amount of investment opportunities.

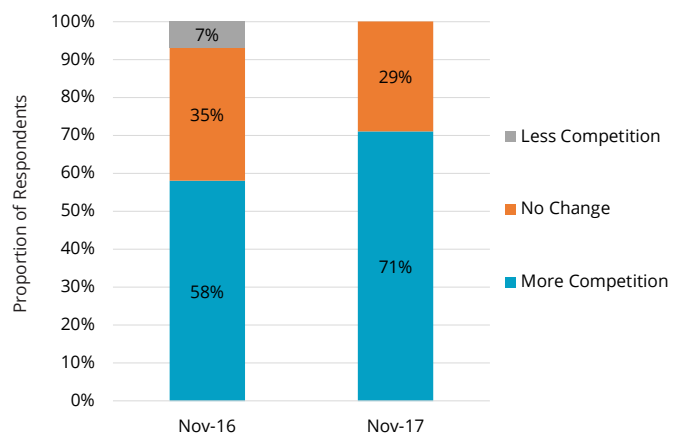
As fund managers appear to be conducting more thorough and diligent searches for accessible lending opportunities, investors have an increasing array of access points for specialized and niche markets. Managers that are heavily differentiated are likely to hold a fundraising and deal-making advantage, as specific expertise in a given region or vertical could be deciding factors in investor allocation decisions.

Fig. 6.4: Private Debt Fund Manager Views on the Level of Competition for Transactions Compared to 12 Months Ago, 2016 vs. 2017



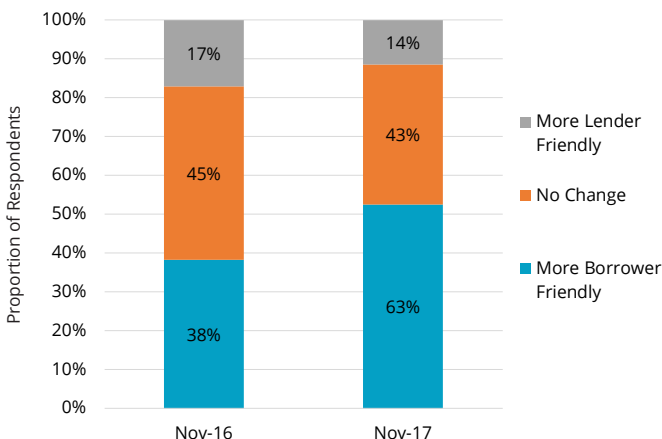
Source: Preqin Fund Manager Survey, November 2016 - 2017

Fig. 6.5: Direct Lending Fund Manager Views on the Level of Competition for Transactions Compared to 12 Months Ago, 2016 vs. 2017



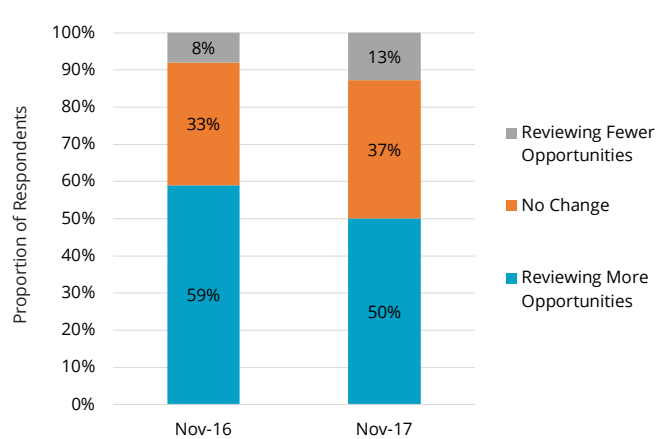
Source: Preqin Fund Manager Survey, November 2016 - 2017

Fig. 6.6: Direct Lending Fund Manager Views on Changes in Lending Terms Compared to 12 Months Ago, 2016 vs. 2017



Source: Preqin Fund Manager Survey, November 2016 - 2017

Fig. 6.7: Fund Manager Views on the Number of Opportunities Reviewed per Investment Compared to 12 Months Ago, 2016 vs. 2017



Source: Preqin Fund Manager Survey, November 2016 - 2017



FUND MANAGER VIEWS ON INVESTOR APPETITE

Looking back on 2017, 76% of private debt fund managers surveyed have seen an increase in investor appetite for private debt exposure in the past 12 months, while only 5% reported a decrease, reflecting the confidence of an expanding investor base (Fig. 6.8). Variations in the timing of fundraising cycles, manager track record, fund strategy, location and other factors certainly contribute to managers' differing experiences while seeking capital; however, the predominant trend in recent years has been institutional investors setting aside larger allocations for private

debt funds across strategies and capital seniorities.

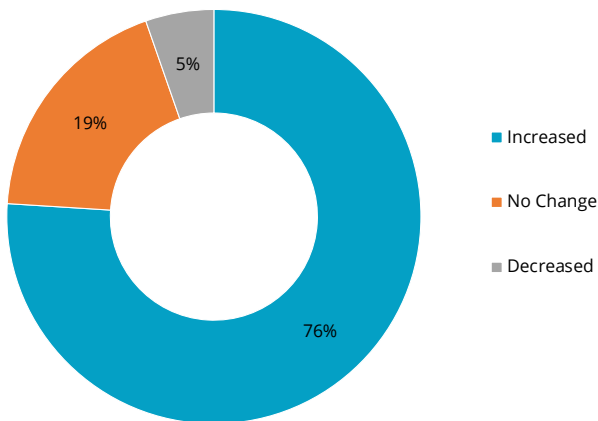
The largest increase in appetite for private debt over the past year was seen from family offices, with 64% of fund managers reporting an increase in interest (Fig. 6.9). Sixty percent of fund managers also saw increased appetite from both public and private sector pension funds. Only 17% of managers saw an increase in appetite from banks, while 19% saw a decrease.

Sixty-five percent of managers experienced an increase in demand for

private debt among investors based in Europe (Fig. 6.10). Fifty-nine percent of respondents noted an increase in investor appetite from investors based in North America, while 44% recorded the same for Asia.

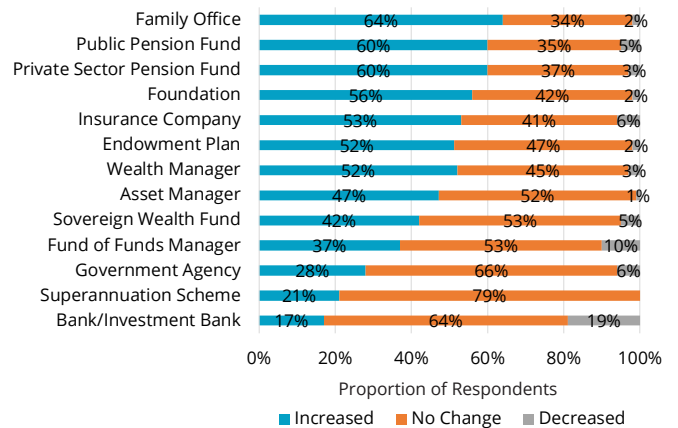
The vast majority (83%) of managers surveyed reported an increase in competition for investor capital over 2017 (Fig. 6.11). The influx of emerging fund managers, larger funds, and fee and performance pressure could all have contributed to the heightened competition for investor capital during 2017.

Fig. 6.8: Fund Manager Views on How Institutional Investor Appetite for Private Debt Has Changed over the Past 12 Months



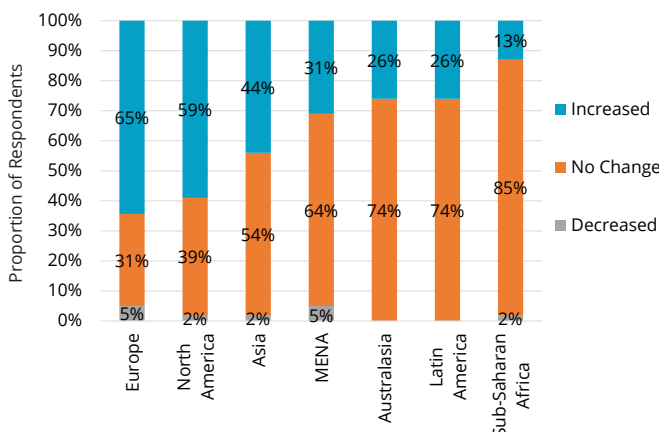
Source: Preqin Fund Manager Survey, November 2017

Fig. 6.9: Fund Manager Views on How Institutional Investor Appetite for Private Debt Has Changed over the Past 12 Months by Investor Type



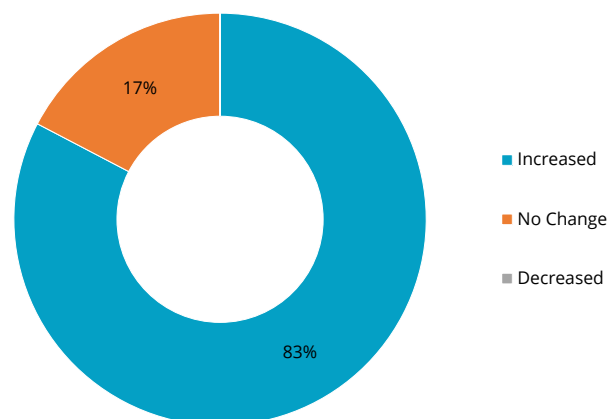
Source: Preqin Fund Manager Survey, November 2017

Fig. 6.10: Fund Manager Views on How Institutional Investor Appetite for Private Debt Has Changed over the Past 12 Months by Investor Location



Source: Preqin Fund Manager Survey, November 2017

Fig. 6.11: Fund Manager Views on the Level of Competition for Investor Capital Compared to 12 Months Ago



Source: Preqin Fund Manager Survey, November 2017

OUTLOOK AND FUTURE PLANS

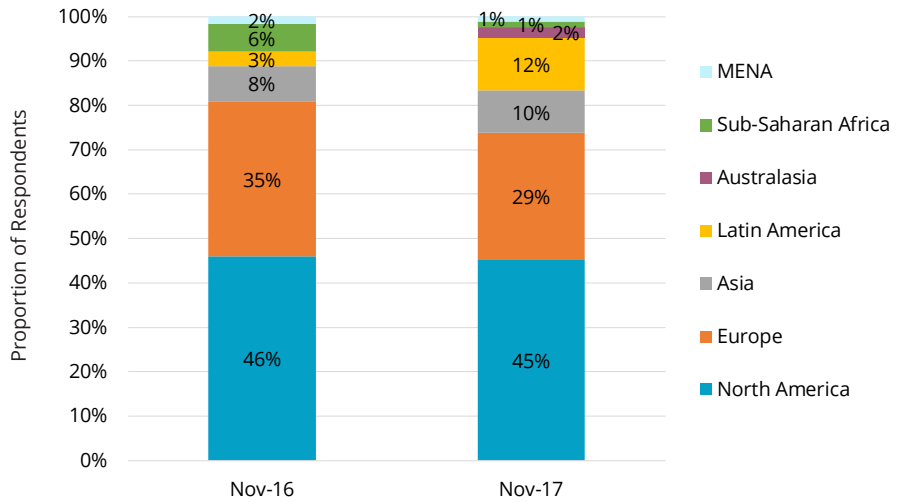
North America remains the region that the largest proportion (45%) of fund managers believe will present the best opportunities in the next two years, followed by Europe (29%), Latin America (12%) and Asia (10%, Fig. 6.12). Latin America has seen considerable expansion in private debt opportunities, as one year ago just 3% of managers believed that the region was the strongest destination for private debt investment.

“North America remains the region that the largest proportion (45%) of fund managers believe will present the best opportunities in the next two years”

The largest proportion (38%) of fund managers surveyed consider environmental, social, and corporate governance (ESG) factors as part of the deal-making process for all transactions, while 25% consider ESG factors for some (Fig. 6.13).

The most prominent factors considered across each of the three areas of ESG

Fig. 6.12: Fund Manager Views on the Region Presenting the Best Private Debt Investment Opportunities over the Next 12-24 Months, 2016 vs. 2017

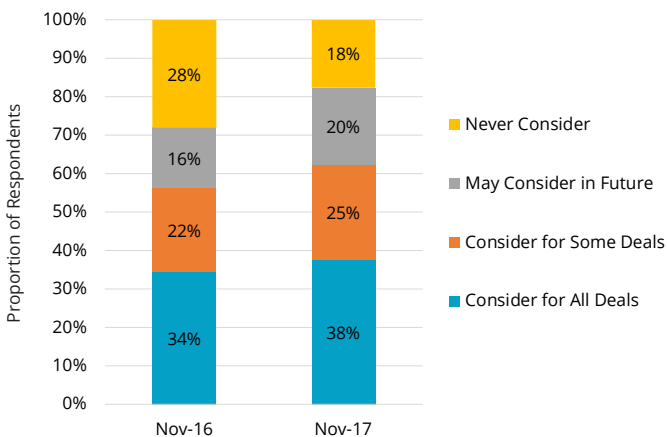


Source: Preqin Fund Manager Survey, November 2016 - 2017

were hazardous waste disposal (46%), human rights (49%) and balanced management structure (61%). ESG factors are likely to become more important to a growing number of fund managers in the near future, as investors are increasingly looking to commit to funds that consider ESG policies. Given the competition for capital within private debt, it could be an advantage for fund managers to apply ESG factors moving forward in order to stand out from the crowd.

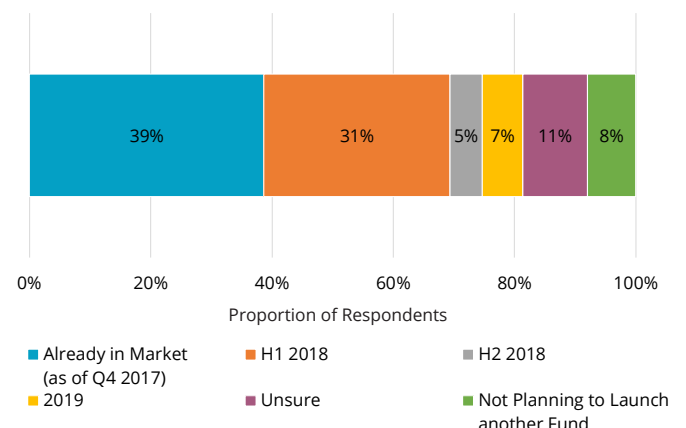
As seen in Fig. 6.14, 39% of respondents were in market with a fund at end of 2017, while 31% were planning to launch a vehicle in H1 2018. With private debt fundraising at record levels in 2017 and investor appetite strong, there is motivation and confidence among managers to raise capital with intentions to enter a healthy, but possibly transforming, credit marketplace. Twelve percent of respondents are planning to launch a fund in H2 2018 or in 2019.

Fig. 6.13: Fund Managers that Consider ESG Factors as Part of the Deal-Making Process, 2016 vs. 2017



Source: Preqin Fund Manager Survey, November 2016 - 2017

Fig. 6.14: Timeframe with Which Fund Managers Intend to Launch Their Next Private Debt Fund



Source: Preqin Fund Manager Survey, November 2017

An aerial photograph of a river delta, showing a network of channels and distributaries. The image is overlaid with a semi-transparent pink color. The text is centered in the upper half of the image.

SECTION EIGHT: NATURAL RESOURCES

FOREWORD

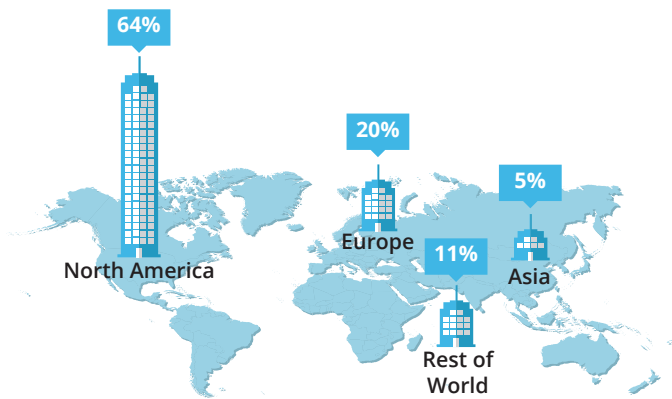
There are over 1,000 natural resources fund managers globally, which together hold approximately \$533bn in assets under management. In November 2017, Preqin surveyed over 50 natural resources fund managers to understand their views on the key issues and challenges facing the industry as well as their outlook for 2018 and beyond.

The continued uncertainty in global markets and its direct correlation to commodity prices, remain the primary challenges for natural resources' fund managers. Twenty-one percent of survey respondents reported that they are finding it more difficult to find attractive investment opportunities compared to 12 months ago, and have noted significantly more competition for energy assets.

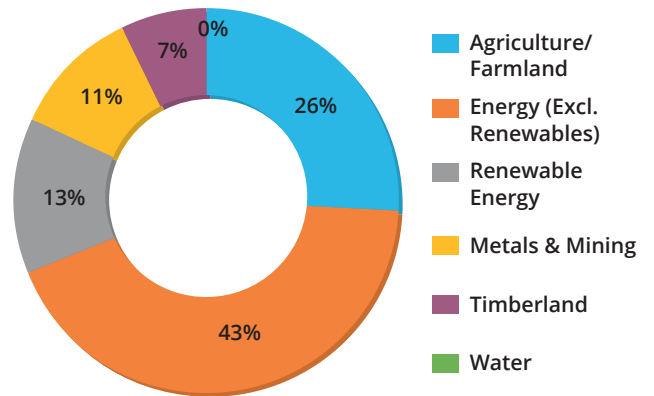
Despite these challenges, fund managers remain optimistic. In addition to the 35% of fund managers that had a fund in market at the time of the survey, another 27% were planning to launch their next fund in H1 2018. The majority (67%) of GPs noted an increase in appetite for natural resources among investors over the past year, up seven percentage points from the previous year's survey.

For the asset class to continue to grow, it is vital that managers are able to demonstrate that they can successfully deploy capital, as we started to see in H1 2017. This, coupled with a considerable number of funds on the road in 2018 and improving investor sentiment, indicates that 2018 will likely be another strong year for the natural resources asset class.

Survey Respondents by Headquarters Location:



Survey Respondents by Primary Natural Resources Strategy:





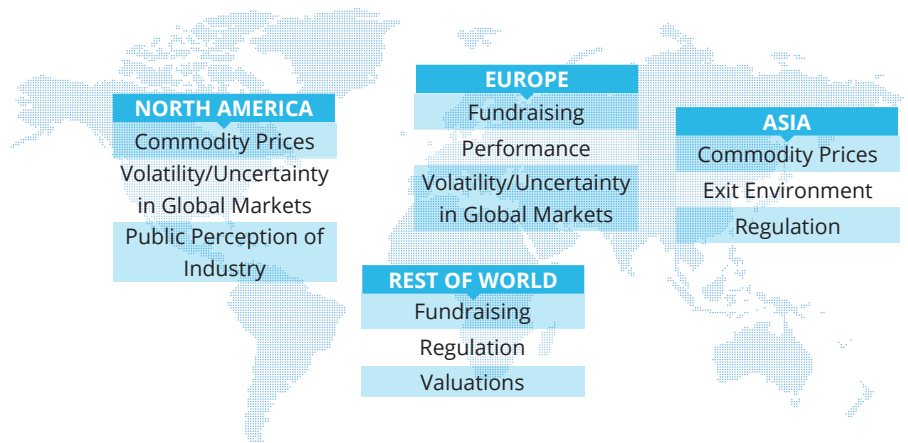
KEY CHALLENGES

The ongoing volatility and uncertainty in global markets remains a key issue in the natural resources industry, and often leads to fluctuations in commodity prices. In our survey both were named by 40% of managers as key challenges facing them in 2018 (Fig. 7.1). Prices for commodities continue to rebound from the lows of 2016 yet, while prices may rise throughout 2018 for energy commodities as well as metals & mining and agriculture products, the volatile nature of the asset class makes predictions difficult. The majority (62%) of fund managers believe that pricing for natural resources assets is higher than 12 months ago.

Public perception of the natural resources industry was cited by 34% of fund managers as a challenge they expect to face in 2018, an increase of 10 percentage points from our November 2016 survey. This has likely become a growing concern in reaction to more awareness and involvement from the public in land rights and environmental conservation platforms, which could be part of the reason why 70% of fund managers now consider ESG factors in every deal.

Broken down by region, North America-based fund managers see commodity pricing and public perception as top issues for 2018, while Europe-based managers

Fund Managers' Top Three Issues for the Natural Resources Market in 2018 by Fund Manager Location:



include fundraising and performance among their top three challenges; managers in both regions include volatility and uncertainty in the global markets in their top three concerns.

Source: Preqin Fund Manager Survey, November 2017

FUND MANAGER VIEWS ON PRICING FOR NATURAL RESOURCES ASSETS COMPARED TO 12 MONTHS AGO

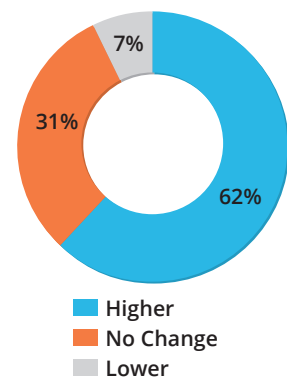
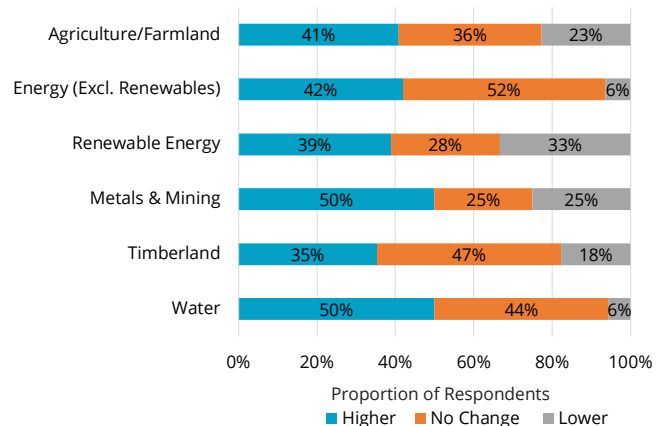


Fig. 7.1: Key Challenges Facing Natural Resources Fund Managers in 2018



Source: Preqin Fund Manager Survey, November 2017

Fig. 7.2: Fund Manager Views on Pricing for Natural Resources Strategies Compared to 12 Months Ago



Source: Preqin Fund Manager Survey, November 2017

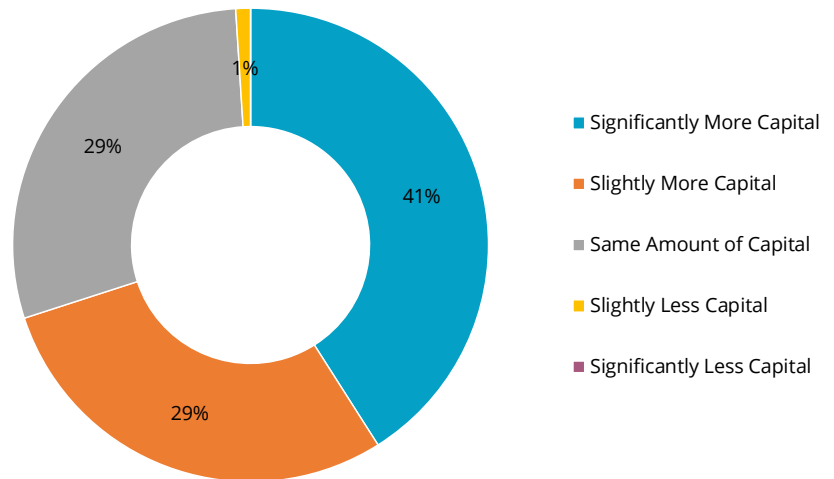
DEAL FLOW AND COMPETITION

With a growth of roughly \$4bn in natural resources dry powder over 2017, fund managers now have significant amounts of capital available to put to work. Seventy percent of survey respondents plan to deploy more capital in natural resources assets in 2018 compared to 2017, including 41% that plan to deploy significantly more capital (Fig. 7.3), indicating competition for assets will likely remain high in 2018. Only 1% plan to deploy less capital in the coming year.

For the asset class as a whole, 21% of fund managers reported that it is now more difficult to find attractive investment opportunities compared to 12 months ago, with none finding it easier (Fig. 7.4). The largest proportion (43%) feel that it is easier to find attractive opportunities in metals & mining at present, followed by energy (23%) and agriculture/farmland (11%) assets. Timberland is the only strategy for which a majority (58%) of fund managers are finding it more difficult to source attractive investment opportunities than 12 months ago.

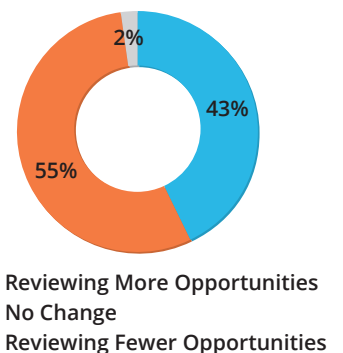
Fund managers are also seeing more competition for transactions compared to 12 months ago: 59% reported that

Fig. 7.3: Amount of Capital Fund Managers Plan to Deploy in Natural Resources Assets in 2018 Compared to 2017



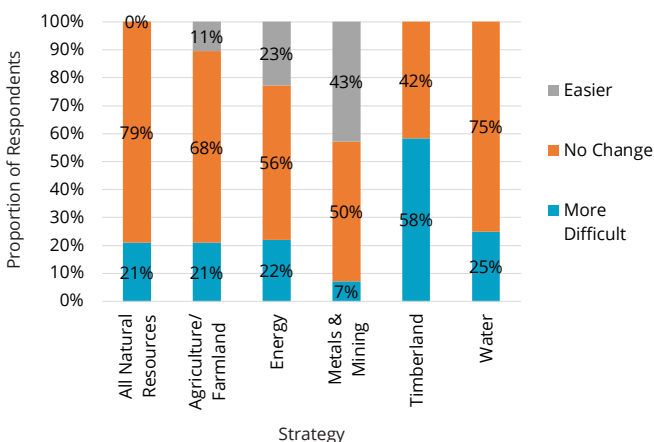
Source: Preqin Fund Manager Survey, November 2017

FUND MANAGER VIEWS ON THE AMOUNT OF INVESTMENT OPPORTUNITIES REVIEWED COMPARED TO 12 MONTHS AGO



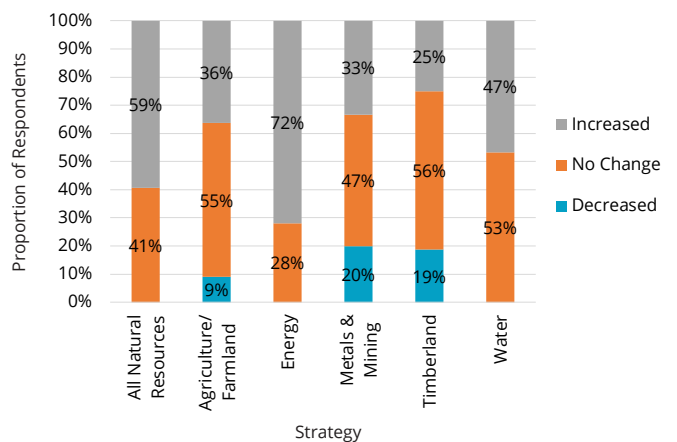
competition has increased, while the remaining 41% have seen no change (Fig. 7.5). Across strategies, an increase in competition was mostly seen for energy (72%) and water (47%) assets. Roughly one-fifth of fund managers saw less competition for either metals & mining or timberland assets. Managers believe the metals & mining sector combines both attractive assets and less competition, and will likely be an area for them to put dry powder to work.

Fig. 7.4: Fund Manager Views on the Difficulty of Finding Attractive Investment Opportunities Compared to 12 Months Ago by Strategy



Source: Preqin Fund Manager Survey, November 2017

Fig. 7.5: Fund Manager Views on the Level of Competition for Assets Compared to 12 Months Ago by Strategy

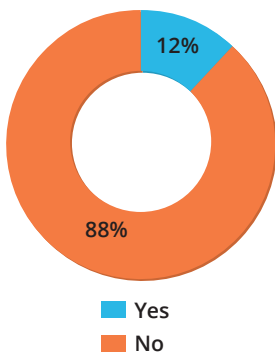


Source: Preqin Fund Manager Survey, November 2017



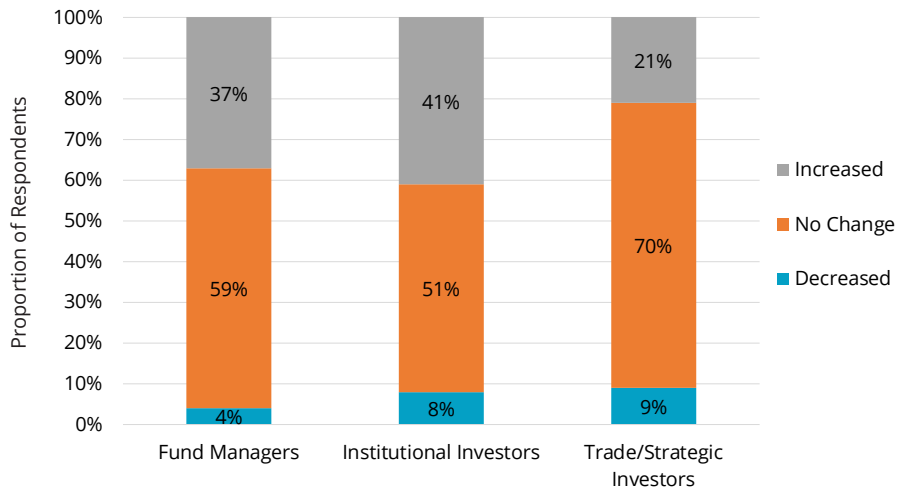
Forty-one percent of fund managers have noticed increased competition among institutional investors in comparison to a year ago (Fig. 7.6). Thirty-seven percent of fund managers have seen increased competition from other fund managers, with just 4% reporting a decrease. However, the majority (88%), of fund managers will not alter their investment strategies based on increased competition.

FUND MANAGERS VIEWS ON WHETHER THEY WOULD ALTER THEIR INVESTMENT STRATEGY DUE TO INCREASED COMPETITION



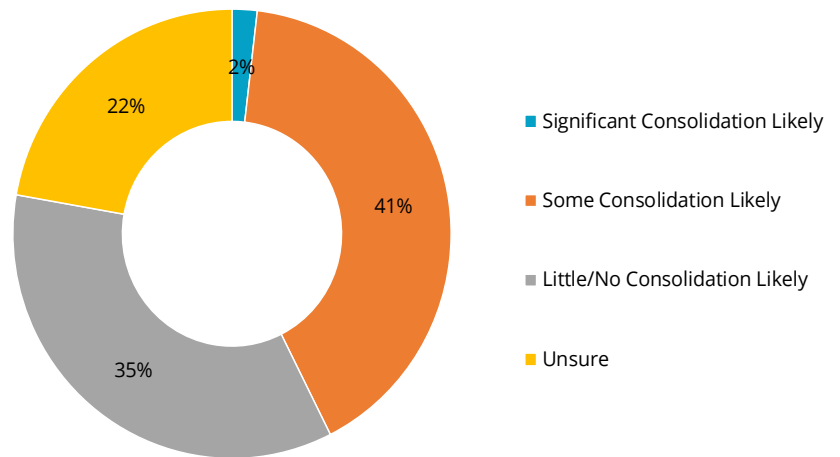
With increasing competition for both natural resource assets and investor capital, 41% of fund managers expect some industry consolidation to occur over the next two years. The next highest proportion, 35%, expect little or no consolidation to occur.

Fig. 7.6: Fund Manager Views on the Level of Competition among Varying Groups Compared to 12 Months Ago



Source: Preqin Fund Manager Survey, November 2017

Fig. 7.7: Fund Manager Views on Industry Consolidation in the Next Two Years



Source: Preqin Fund Manager Survey, November 2017

2018 PREQIN GLOBAL NATURAL RESOURCES REPORT



The **2018 Preqin Global Natural Resources Report** is the most complete and in-depth review of the industry available today. It covers a wide range of topics, with expert commentary, key trends from recent years, historical statistics, league tables and survey results.

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FUND MANAGER VIEWS ON INVESTOR APPETITE

Over 2017, the majority (67%) of fund managers surveyed saw an increase in investor appetite for natural resources compared to the previous year, up from 60% at the end of 2016, (Fig. 7.8).

However, there remains significant variation in appetite across different investor types (Fig. 7.9). The majority of fund managers surveyed have seen an increase in appetite from family offices, public pension funds. Also, a significant proportion (42%) have seen an increase in appetite from asset managers. The largest proportions have seen decreasing

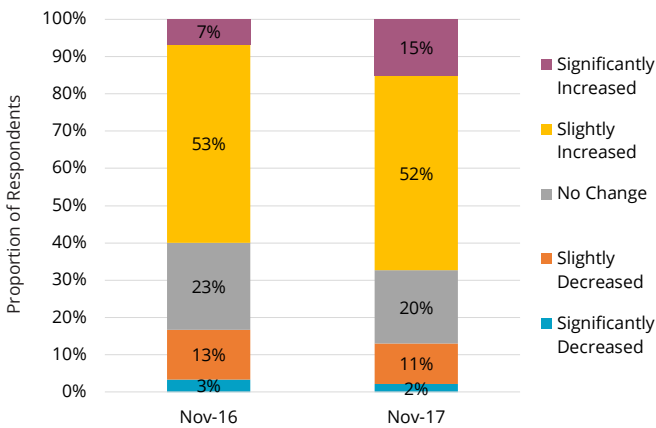
appetite among endowment plans (21%) and banks (16%); however, in the case of endowment plans, more fund managers have seen an increase in appetite (38%) than a decrease. While family offices and asset managers have more freedom to invest across varying risk levels and strategies, endowment plans must be wary of potential market changes and banks must comply with regulatory changes such as the Volcker Rule, under review in the US.

Nearly two-thirds (63%) of fund managers saw increased appetite from North America-based investors over the past

year, followed by those based in Asia (37%), Australasia (35%) and Latin America (32%, Fig. 7.10). Aside from North America, the majority of fund managers saw no change in the level of investor appetite for the asset class, a positive sign for those with funds in market given the strong levels of fundraising over recent years.

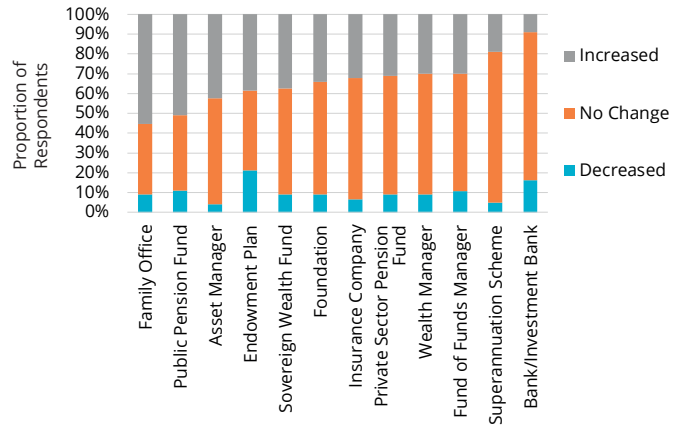
Despite this, the high number (241) of funds in market has intensified competition among natural resources fund managers. Three-quarters of respondents have seen an increase in the level of competition for investor capital in the past year (Fig. 7.11).

Fig. 7.8: Fund Manager Views on How Institutional Investor Appetite for Natural Resources Has Changed over the Past 12 Months, 2016 vs. 2017



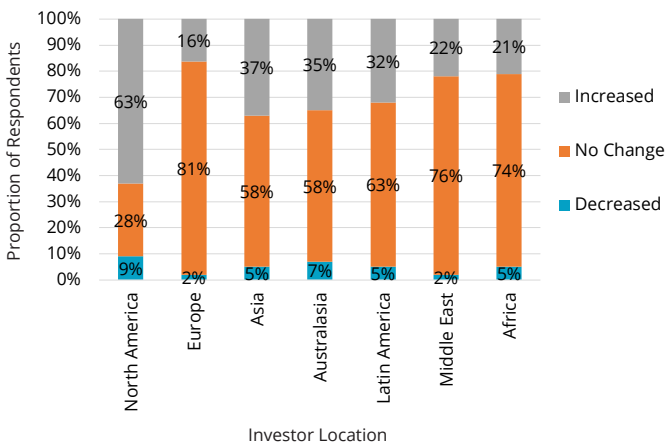
Source: Preqin Fund Manager Survey, November 2016 - 2017

Fig. 7.9: Fund Manager Views on How Institutional Investor Appetite for Natural Resources Has Changed over the Past 12 Months by Investor Type



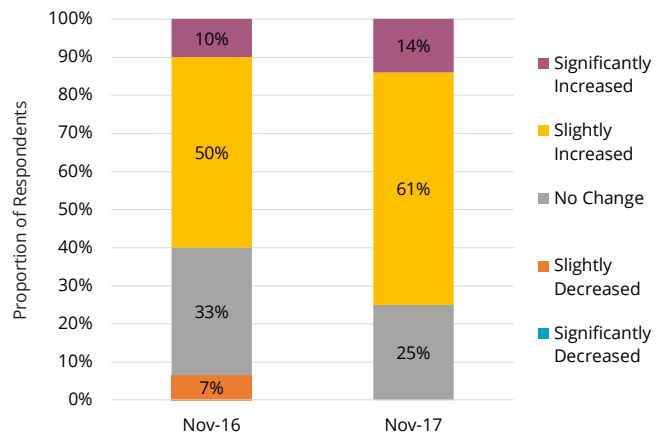
Source: Preqin Fund Manager Survey, November 2017

Fig. 7.10: Fund Manager Views on How Institutional Investor Appetite for Natural Resources Has Changed over the Past 12 Months by Investor Location



Source: Preqin Fund Manager Survey, November 2017

Fig. 7.11: Fund Manager Views on the Level of Competition for Institutional Investor Capital Compared to 12 Months Ago, 2016 vs. 2017



Source: Preqin Fund Manager Survey, November 2016 - 2017



OUTLOOK AND FUTURE PLANS

As fund managers look ahead to 2018, global volatility and its effect on commodity prices will be key challenges for the natural resources industry, as will the public perception of the asset class and increasing competition. Still, 71% of fund managers expect industry assets under management (AUM) to continue to grow over 2018, compared to just 6% that believe it will decrease (Fig. 7.12).

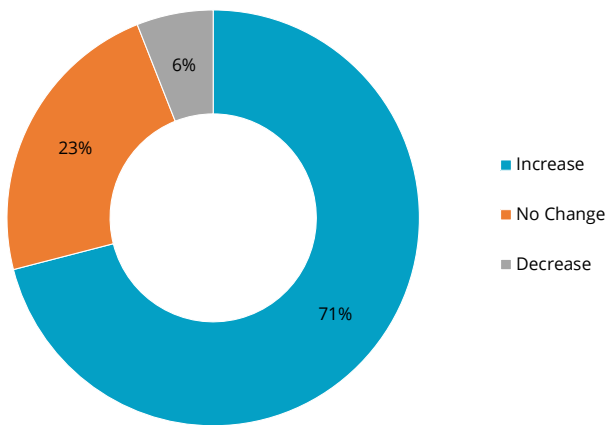
At the time of this survey, fund managers were already well on their way to raising

more capital. Over one-third (35%) were already in the market with their next natural resources fund, with another 27% planning to begin fundraising in the first half of 2018.

Fund managers surveyed by Preqin also predict a strong exit environment in the coming year. Over half of fund managers expect to see increased exit activity throughout 2018, compared to just 9% that expect it to decline.

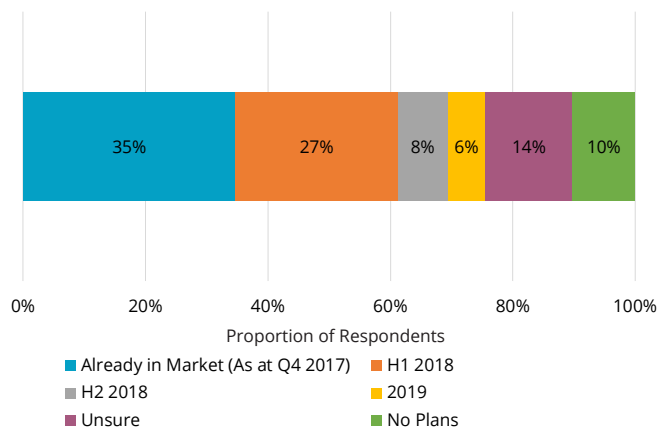
As investors become increasingly sophisticated and seek alternative structures within natural resources, fund managers will look to offer more separate accounts, co-investments and joint ventures over 2018. In this period of increased peer competition, these alternative structures are viewed as a way for fund managers to differentiate themselves.

Fig. 7.12: Fund Manager Views on How Unlisted Natural Resources Industry AUM Will Change over 2018



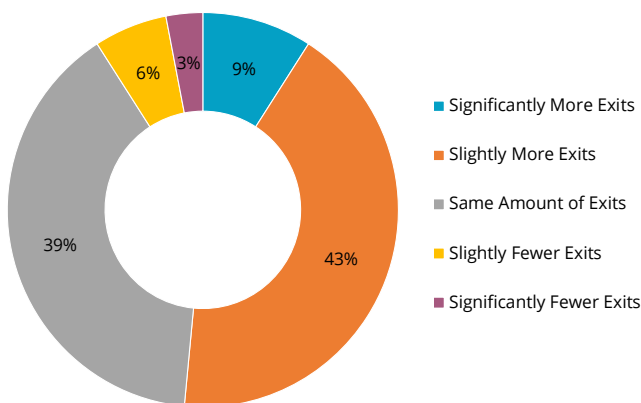
Source: Preqin Fund Manager Survey, November 2017

Fig. 7.13: Timeframe with Which Fund Managers Intend to Launch Their Next Natural Resources Fund



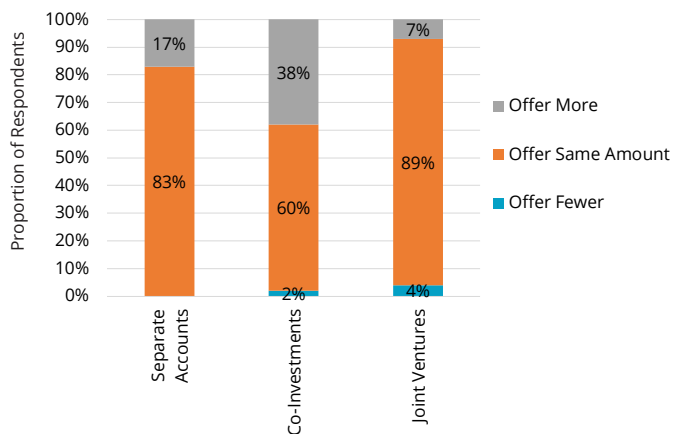
Source: Preqin Fund Manager Survey, November 2017

Fig. 7.14: Fund Managers' Planned Level of Exit Activity in 2018 Compared to 2017



Source: Preqin Fund Manager Survey, November 2017

Fig. 7.15: Fund Managers' Plans to Offer Alternative Structures to Investors in the Next 12 Months Compared to the Past 12 Months



Source: Preqin Fund Manager Survey, November 2017



PREQIN FUND MANAGER OUTLOOK: ALTERNATIVE ASSETS

H1 2018

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