Fundraising taking twice as long during economic downturn
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The economic downturn of 2009 severely impacted the US fundraising industry, with the amount of time taken to raise a fund increasing to an average of 18 months, twice as long as in 2005, according to a report by C.P. Eaton.

More general partners remained on the road seeking a severely limited supply of capital.

The outlook for 2010 is brighter: according to a recent Preqin survey, a majority of LPs plan to make their next allocation to private equity this year, saying that their current private equity investments have met or exceeded their expectations.

Also, now that the associated risks of leverage-generated returns are better understood, LPs and GPs expect a return to private equity fundamentals i.e. value-add strategies and a realignment of interests between LPs and GPs.

However, it is clearly still a buyers market and LPs are most apt to select strategies and managers where they have familiarity with proven pedigrees or realizations versus ones that are opportunistic, novel or emerging, says C.P. Eaton.

Lower- and middle-market buyout and growth equity strategies make up the most broadly popular private equity funds at this time. These funds may be too small for large state plans and sovereign wealth funds, but more LPs talk about these strategies than any other.

Distressed funds have gained significant traction within the past year as managers move to take advantage of numerous distressed sellers offering quality assets. C.P. Eaton says the general consensus is that the opportunity to make significant gains in liquid trading strategies has passed; rather, distressed-for-control remains popular given a wealth of ongoing market opportunities, and given that control funds resemble closed-end private equity funds, they are a natural fit for most investors.

The timing for mezzanine is also very attractive right now, resulting in its growing popularity as LPs see the ability to diversify within the lower- and middle-markets, add downside protection and earn buyout-like returns with less risk. New mezzanine financing requirements over the next five years for private equity activity could amount to USD400bn.

With regard to secondaries, residual effects from the credit crisis continue to apply pressure on managers to unload non-core portfolio holdings. C.P. Eaton says 2010 should see increased deal activity as buyers and sellers begin to align their expectations. New buyers like pensions, endowments and foundations will also continue to make their appetite known.

Real assets strategies stood out in the past year as investors sought strong and stable cash flows with downside protection. C.P. Eaton expects real assets to continue drawing interest as lower commodity prices combined with seller distress should result in a favourable deal-entry environment.

Interest in infrastructure has cooled as the world waits to see if deal flow in North America ever materializes in the volume predicted. Even as states face huge financial problems, the obstacles to privatizing infrastructure (both political and financial) prevailed in 2009. Given that USD90bn in fund capital has been raised over the last five years, and only USD6bn in 2009, LPs are clearly waiting for proof of investment thesis, not to mention that well over half of the USD90bn has yet to be deployed.

After a turbulent 2008, hedge funds responded well in 2009. On average, managers were up 20 per cent, making the past year the best for the industry in a decade. By the second half of 2009, redemptions had

stabilized and investment activity increased as investors positioned to reduce their cash reserves and redeploy cash released by managers who had invoked gate. This trend was confirmed in the third quarter when funds experienced net inflows for the first time since the recession. C.P. Eaton says this year looks to be a promising year for the industry as a renewed focus on liquidity and transparency will continue to drive investor interest among institutional limited partners.

Real estate transaction volume was down significantly from the peak years of 2006 and 2007, largely due to the return of traditional underwriting standards, much higher equity requirements and a nearly nonexistent CMBS market that last saw meaningful issuance volumes in the first half of 2008. For 2010, C.P. Eaton expects to see both fund managers and investors continue to focus on troubled legacy assets as headline transactions (largely work-outs) will begin to set new comparable values enabling investors to mark their existing portfolios.

According to the report, European investors have seemingly retreated from the global stage, focused on local managers on the Continent. C.P. Eaton believes European investors continue to chase alpha but are more protectionist at the same time, supporting European managers in their domestic and global efforts.

Private equity continues to avoid large cap and highly leveraged buyout transactions given rebounding capital markets are unwilling to support significant debt and PIK financing. As a result, institutional investors feel the best opportunities in the space include lower- and middle-market buyout, growth equity and sector and country funds. Distressed, secondary and direct purchases of fund interests on the secondary market have also gained notice and commitments from European LPs.

The majority of European LPs have pushed their 2009 real estate allocations into 2010 due to concern over the global macroeconomic picture and capital adequacy ratios.

2009 was characterized by increased confidence in private equity throughout Asia due to its relative better performance during the financial crisis as compared to the US and Europe. Managers have recognised the significant market potential for China, India and Japan, leading many to establish country-specific funds to take advantage of those regional economies.

In terms of real estate, Asia, especially China, proved itself one of the most resilient property economies globally with its markets and deal rankings in 2009. Seven out of ten of the most active real estate markets in the world are located in China, led by Shanghai, which is recognised by Urban Land Institute Asia as the most attractive market for development or investment in the Asia region for 2010.

Real assets strategies have been relatively slow to gain traction. The need for investment in India, Southeast Asia and other emerging markets is large, but C.P. Eaton does not believe LPs are being offered the right opportunities. Real asset investment in most parts of Asia, especially in terms of infrastructure, is dominated by government initiatives or led by government-owned entities. The private sector has found it difficult to secure deals at an appropriate risk-adjusted return level.

2010 is likely to see a disproportionately positive rebound in fundraising for Asia, especially in private equity and real estate. On the macro front, China and India expect to have GDP growth of nine per cent or greater in 2010, but C.P. Eaton says investors should be wary of the overheating credit market and inflation threat in the region.