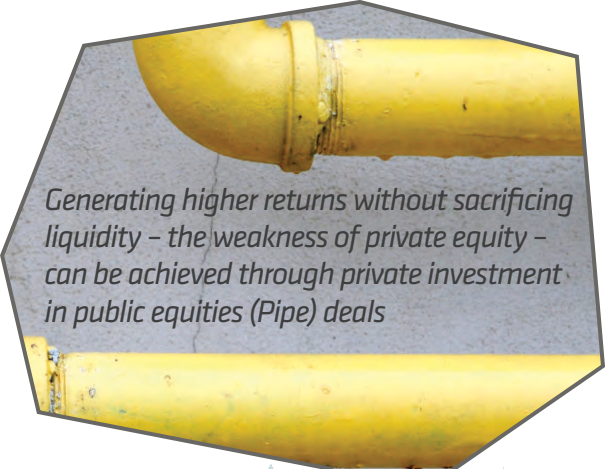



# WELCOME TO THE PRIVATE MEMBERS' CLUB


With compelling yields hard to come by in listed markets, private equity and private debt are increasingly in demand. But what are the risks and where do you see the best plays?



*Generating higher returns without sacrificing liquidity – the weakness of private equity – can be achieved through private investment in public equities (Pipe) deals*



*It's possible that money invested in private equity or debt will come back only in 10 years' time, or won't come back at all*



*Direct lending in the US can offer higher returns and better downside protection than direct lending in some European countries*

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Private equity and 'Pipe' (private investment in public equities) deals have spearheaded our investment process and solutions for high-net-worth individuals ever since we founded FGP Capital in 2009.

We have developed a network of scientists and entrepreneurs, giving us access to a solid pipeline of spin-offs from leading universities (Harvard, Cornell, Oxford, EPFL) and Research Institutes (Pasteur) around the world.

We seek above-average returns in three areas – healthcare, technology and intellectual property – with high barriers to entry that are in need of growth capital. Our direct investments encompass straight private equity transactions (e.g. Oxford Nanopore, Lumendi), privately negotiated convertible bonds (e.g. AB Science) and Pipe deals.

Since stringent regulations (Basel III and IV) tie up significant capital, banks have reduced their lending to companies, leaving this market to dedicated players.

Generating higher returns without sacrificing liquidity – the weakness of private equity – can be achieved through Pipe deals.

The US Pipe deal market is estimated at \$10 billion-\$25 billion a quarter. In a typical Pipe transaction, investors enter into a purchase agreement with a listed company and commit to purchase and receive securities at pre-specified discounted terms, which usually include preferred shares, convertible bonds and free warrants with anti-dilutive provisions.

The advantageous negotiated terms are often more attractive for investors than a direct stock market investment owing to the asymmetric risk-reward structure, protecting in bear markets and providing upside potential through the warrants.

This asset class is therefore becoming part of smart portfolio construction.

For SMEs it provides quicker access to fresh capital than a public capital increase, thereby reducing the risk of a prolonged sell-off and higher dilution for existing shareholders.

Because of Securities & Exchange Commission requirements, Pipe opportunities are not available to unregulated investors. Therefore, we launched our Protective Opportunity fund, which targets 8-15% annual performance with lower volatility than equity markets, no market timing and no leverage.

We have adopted an absolute return approach, matching or outperforming equities in the long run while protecting the invested capital in case of a bear market. Another advantage is the low correlation with equity markets. Our disciplined, bottom-up stock screening process gives a high probability of generating positive returns through the warrants even in a flat or bear market.

Finally, the short duration nature of our Pipe investments allows our fund to offer monthly liquidity.

The current financial environment necessitates the search for new sources of performance. The compression of interest rates, heightened policy uncertainties and the more modest performance of traditional assets across the board are generally the key motivators behind a greater exposure to private equity.

In order to satisfy their performance objectives, pension funds, trusts and family offices seek to diversify their investment spectrum and take more risk.

While 20 years ago the vast majority of investors were able to meet their annual performance target with a conservative portfolio of 75% bonds and 25% equities, the current environment no longer allows for this.

We therefore note that investors' allocations have integrated real estate for the expected yield and private equity for the risk-return profile attractiveness.

In this regard, we develop with clients a comprehensive financial planning strategy that focuses on placing each asset in the overall portfolio context, as well as identifying their investment objectives and future liquidity needs.

We do not overlook the fact that the term of an investment in private equity ranges between 10 and 12 years, that the underlying risk is indeed equity risk, and finally that the higher the share of illiquid assets in the portfolio, the more limited the flexibility to implement risk management effectively.

Today, a constantly increasing demand associated with a diminishing supply and private markets that are not fully hermetic to public ones, result in higher valuation levels for private equity investments.

Therefore, future results will certainly be lower than the norm. In particular, our analysis shows vintages that precede a market peak by one to three years are the worst performing. We currently see that some managers are gradually positioning their portfolios more defensively.

Since 2008, it has become clear that dedicated mandates have taken some market share from funds of funds as the former offer greater investment flexibility and enable the customer to become more involved in the decision-making and to benefit from a more favourable fee structure.

By contrast, the most sophisticated investors will generally opt for more concentrated strategies and the ability to invest directly through co-investments.

Finally, we believe private equity will not escape the trends observed in the asset management industry, namely lower expected returns, fiercer competition and customer demand for greater transparency and personalisation.



**STEFAN BRÄGGER**  
Polaris Investment  
Advisory AG  
Zurich

With low interest rates, and fully valued public equity and fixed income markets, investor interest in private debt is growing.

Private debt can offer investors high and predictable levels of income with comparatively low volatility, low correlation to the general stock market and – most importantly – low risk of capital loss.

Investments in first-lien senior secured debt provide floating interest rates and strong downside protection when compared with junior debt and equity.

Many Swiss investors are now turning their attention to direct lending in the US and throughout Europe.

Direct lending in the US can offer higher returns and better downside protection than direct lending in some European countries.

The general level of interest rates in the US is significantly higher than that found in Europe. The US legal system provides stronger protections for a senior secured lender than what is available in some European countries.

The lower middle-market segment in the US offers a particularly attractive supply/demand balance for direct lending, with a large number of potential borrowers and a more attractive risk/return profile.

However, investors in private debt need to be aware of the higher illiquidity, different investment styles, short historical track record and high hedging costs to CHF, and they must also monitor net returns as fee models can differ widely.



**FRANÇOIS MEYLAN**  
Melyan Finance  
Lausanne

We invest in private equity, but only at the request of clients. In general, we suggest they invest 3-5% of their portfolio in the sector.

I do not systematically propose investments into private equity to clients because – and I think this goes for many of my colleagues – we have an ageing clientele and private equity means a long investment horizon.

Some clients have requests about specific companies, predominantly in the healthcare tech and pharma sectors.

It is important to note that in Switzerland you have pension funds that have started to invest more into private equity, so we are also pushed to follow this trend. If not, we have seen some investors from Chinese funds come to take our place in investing in the space.

One notable evolution is that some Swiss pension funds have decided to sustain private equity indirectly through a platform bias, through groups that are themselves invested in private equity. That is a better way to access the market, in my view.

Pension funds have a long-term investment horizon and are therefore better positioned to do this. For instance, Nest Foundation Collective in Zurich has decided to put a certain percentage of assets into Swiss private equity.

My concern is that private equity could once again become the fallback as investors look for returns in an environment where markets are expensive and there is low yield. The market comes back in cycles, like hedge funds or commodities. I worry because it would mean the financial industry has learnt nothing.

There is a lot more supply in the market than demand, so once again it shows the industry is working according to supply without really analysing demand.



**DR. MARCEL RÜEGG**  
Integral Finance  
Altendorf

Our clients are increasingly tired of investing only in traditional asset classes such as equities or bonds. If we discuss their portfolios, we would usually spend 20 minutes on liquid assets, while private equity discussions might take hours.

Our clients are entrepreneurs and are grateful to have the opportunity to make money and invest while also having an impact on the environment, helping society and advancing technology.

We invest in about 30 companies in the private equity space. One example is a firm that produces Nespresso-compatible capsules made from biomaterials. These capsules are much better for the environment than those made from plastics or aluminium, which may also have a negative impact on your body.

On the private debt side, we prefer to invest through funds. For example, Invictus Capital Partners is a group we like as we really trust their solid processes and investment decisions.

The company allocates mainly to US mortgages, a sector where banks are not so active anymore because of tough regulatory requirements.

One of the biggest issues with private equity and debt investments is illiquidity. First and foremost, the family office adviser needs to understand the liquidity needs of clients and whether they can put away money for long periods of time.

Personally, I am also trying to make clients understand the risks involved, because it's possible that money invested in private equity or debt will come back only in 10 years' time or won't come back at all.

Instead of diversifying in a 'spray and pray' fashion, analyse how and where, with your network, you can easily contribute more value to the investment: opening new distribution channels, referring significant clients, adding know-how or products, opening new markets, replacing vendors, making operations more efficient.

In some private equity names you invest once and everything goes well, but very often you need to invest three or more times because either revenues are below expectations or costs ramp up faster than you expect.

If you do decide to venture into the sector never work alone and make sure you have a good and trusted network. Flying in good weather conditions is easy, but you should be ready for turbulence because the trip may likely become longer.