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Where has all the private equity money gone?

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Tom Stabile asks if the industry is matching its past glory or closing in on investment gluttony

Poor private equity. Like the rest of the investment world, the business took a nasty spill after the financial calamity of 2008. And one vital statistic seems to show the private funds world, unlike most other markets, to be limping still.

Aggregate capital raised for commingled funds closed before 2006 had never topped $365bn per annum, according to Preqin, the data provider, when along came three frothy years of money gushing in: $543bn in 2006, $666bn in 2007 and $686bn in 2008 (mostly in that ill-fated year's first half). Then came the great thud, and fundraising tumbled into a dry well, dropping by more than half and only clawing its way back to $538bn by last year.

So it would seem that private equity's fundraising has not yet recovered to the highs of a decade ago, even in nominal terms. As one fundraising veteran of a large private equity firm lamented on a conference podium earlier this year, "Where has all that money gone?"

But before you give a tender hug to forlorn fund managers, ask them to check their other pockets. As that same fundraising veteran would say moments later off the podium, while the sums flowing into commingled funds may be short of peak levels, there are plenty of clues that investor cash is still pouring into private equity, but this time through the side door.

A decade ago, there were only a few large institutions that had the stomach or ability to pursue more exotic versions of private equity: investing alongside the standard commingled fund in custom "separate accounts" mirroring the main strategy; in deal-by-deal "co-investments"; or simply through direct investments. Post-crisis, however, institutional investors have gone wild over these special arrangements because they often entail lower fees and more control over asset disposition.

There is no consensus over whether institutions on the whole will come out ahead in such arrangements, because they require layers of investment prowess, risk management expertise and staffing resources that few of them have had historically. But in the past two years especially, far more institutions are dabbling in these sidecar structures, and a great many fund managers are deciding that it is worth their effort to keep these big clients happy.

However, as these are largely individual accords, few have a clear sense of how much money has piled in through them in aggregate, and particularly through the most popular and accessible route of co-investments. It is probably quite a lot, says Antoine Dréan, chief executive of Palico, an online marketplace for private equity. He estimates 20 per cent of all private equity deals today have a co-investment element, versus 5 per cent before 2008.

It is not far-fetched to say that along with money heading into these newer investing vehicles, the whole market has approached or maybe even eclipsed its prior fundraising peak.

And it appears private equity is on track to continue growing, even in commingled funds, as smaller institutions and now wealthy private investors are in the client mix.

Indeed, the snapshot today may not be of private equity striving to match its past glory, but instead of it closing in on investment gluttony. As it is, private equity managers control a record $2.6tn of assets, Preqin data show. This includes a record $1.1tn of uninvested capital already raised for their funds, awaiting deals to seal.

Add in the unknown amounts of money sloshing around in co-investments and other non-fund vehicles, and the signs point to a hulking private equity marketplace that will see pricing of assets rumble upward and cash thrown at deals that do not yield the high returns investors expect these investments to produce.

That could lead to unhappy outcomes for many of us — pensioners and workers whose assets are invested through their retirement plan sponsors, wealthy investors increasingly wooed by fund firms, and even the portfolio companies owned by funds that now face far greater competitive pressure.

The private equity market may no longer be recovering. What we do not know yet is if it is already in trouble again.

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