
KEYNOTE INTERVIEW

Private funds play catch-up on scenario analysis



Asset owners struggle with scenario analysis on their private equity investments, but new technologies will improve efficiency, says State Street's Jesse Cole

Carrying out scenario analysis, forecasting and modelling on private fund investments is an onerous and often time-sensitive task for asset owners and managers. It can take weeks to pull unstructured data on a range of underlying investments – by which time, it might be too late to feed the data into the models for analysis and stress testing.

Jesse Cole, global head of private markets at State Street, argues that technology is the answer to this dilemma. Cole tells *Private Equity International* that integrated platforms can be a huge time saver and allow investors to focus on proactively managing their portfolios.

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Q Why are asset owners focused on scenario analysis, modelling and forecasting in relation to their investments in private funds?

Private market asset owners tend to have small teams and are often managing private market investments alongside other asset classes. They must meet the expectations of their constituents – the boards and leadership teams – who are asking how they monitor their private market products and how they evaluate the risks.

However, there is an increasing list of factors outside of their control (for example, interest rates, geopolitical events) that may have an effect on their investments in private markets. Asset owners and managers face challenges in answering, 'What if this happens? How am I going to respond to that? Should I be repositioning my portfolio?' They need to be able to assure their constituents that they are on top of risks associated with these issues and are protecting their investments.

Asset owners need a tool that captures all the information they require in an efficient way, and which allows them to evaluate how scenarios or macro events can impact underlying

investments. They need that to make more informed decisions. They might not be able to divest, but they need to understand the risks so they can perhaps hedge or rebalance into another product set, for example.

Q Why can it be difficult for private fund managers to respond quickly to scenario analysis requests from investors?

It really comes down to the fact that most private market products are still presenting data in an unstructured way. Often the data is not digitised, but is on a spreadsheet or paper. It is difficult to capture the data and put it in a system, and then to compile and align it with other investment data. That process is expensive, and it takes a lot of people and a lot of time. State Street conducted a survey – *Private Markets: A Silent Revolution* – in which 42 percent of asset owners said it is impossible or very difficult to run forward-looking scenario analysis, modelling or stress testing.

More and more, people expect things to be done quickly. In some asset classes, that is easy. In public markets, there is readily available information. The public markets are quite mature in terms of what data is available and how that data is available in a digital form. So, it is frustrating for asset owners that it is harder and more time-consuming to get that information on private market investments.

The business reality of private markets is that every investment uses a complex and bespoke valuation model. Private fund managers have lacked a strong way to scale sending information back and forth into these disparate models, and that is fundamentally the biggest gap in this space. While Excel is a fantastic tool for modelling in private markets, it lacks the scale for aggregation with a high volume of investments and iterations.

Q How do you expect asset owners' approaches to scenario analysis to change as new technologies and platforms are developed?

The trend towards the democratisation of private markets will drive industry stakeholders to expect more transparency, comparable data and insight into that data, just as they would expect in the public markets. There is going to be a continued push for technology and platforms that can take care of gathering and tagging data, as well as organising information, in an efficient way.

In addition, there is going to be continued demand from asset owners to be able to evaluate their private markets portfolio from many different perspectives, including an ESG lens. Private markets are going to have to catch up with public markets at some point. The way society is heading, everything is in real-time, so investors will put more value on being able to have immediate access to the data they need. There is going to be pressure for that, and I think we will see a lot of investment in accelerating the digitisation of data.

The granular data needed for forecasting and stress testing also has much broader applications. It provides transparency on fees, and it helps investors understand fund structures and their expected returns. We can also see that the regulators in the US are pushing for greater transparency. Technology is going to help create that level of transparency, not just with forecasting, but in the products, in performance, and other underlying structural information about private markets.



Q How can scenario analysis become quicker and more efficient, so that it helps asset owners in their decision-making?

One of our clients walked us through how they ran a scenario analysis across 50 assets before they had our platform. It took three weeks and a 10-person team to do it. The risk is that by the time the team gets everything together, things have changed again and the analysis is redundant.

The only way to speed up the process is technology. That is fundamental and it comes down to the main ingredients. First, as an asset owner or asset manager, you need to collect the data. Next, you need a process to bring that data into a digital environment and to ensure it is organised in one place in an efficient way. Then, you need to have the technology to flexibly analyse and evaluate and stress test your portfolio, across not just private markets but other asset classes too.

You must be able to do that for a variety of different factors to understand your exposure to a particular type of event – so the tagging of the data is important. There is a whole lot that must be done right to be able to perform that task quickly and to be able to flexibly manage the data, adjust the data and

manipulate the data. The only way to do that is through technology.

It sounds simple but in reality it is not. Asset owners need a system that does not just give them information but that also allows them to understand how the analysis was put together. They need to be able to understand the results of the analysis, the richness of the data and the tagging behind it. It is about having a bottom-up view of the data, so they have all the granular details. From that, asset owners can be in a much better position to make an informed decision.

Q What other practical benefits can new technologies provide?

A technology platform that can store all the data needed for scenario analysis in one place will clearly help asset owners and managers save time in not having to gather data that is spread across an organisation. It also enables the sharing of portfolio analytics with multiple parts of the organisation allowing more self-service to questions.

Then there is the opportunity cost and the risk cost to consider. As an asset owner or asset manager, when you can do things in a timelier fashion, you have more room to be proactive, not just reactive. If you are managing an overall investment portfolio, you are not just reacting to what the market is saying is going to happen, you are also thinking about your strategy and where you want to go and where you feel like there is opportunity.

Technology can also help with emerging analytic lenses like ESG reporting. Having a technology platform in place allows investors to respond to these faster. State Street AlphaSM for Private Markets is already solving these challenges for asset owners and managers.

Q Is the private equity industry ready to invest in technologies to help with scenario analysis?

“Part of the challenge is that private equity managers use different data infrastructures”

Yes. There is no doubt that asset managers want improved transparency through technology.

However, it is one thing for asset managers, or asset owners, to want a technology and another to hope they can just flip the switch and see it go to work. Part of the challenge is that private equity managers use different data infrastructures, and it is not as simple as looking on the shelf and finding a technology that is ready to go. What the industry needs is flexible technology solutions. Ultimately, there is an opportunity for technology and service providers, such as State Street, to provide solutions to make scenario analysis, modelling and forecasting easier.

We help asset owners avoid re-engineering their entire enterprise and make it easy to get the information into an environment that they can manage with analytics tools. Our approach is to be creative and flexible, because it will take time for the industry as a whole to become more digitised. Being able to provide a solution for asset owners is about being able to meet them where they are at today, so they can start taking advantage of these tool sets. ■

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