Pensions Prepare for the Worst as PE Hits New Highs

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Pensions are moving with caution during this period of massive flows into the private equity industry. Though they remain committed to the asset class, high asset prices are stoking fear that the market may be on the brink of a fall.

Private equity fundraising this year is at $269 billion, while buyout fundraising is at $184 billion, placing both on pace to surpass the full-year record set in 2007, according to a Preqin report. This activity has been buoyed by massive fund closings, including **Apollo Investment**'s $24.7 billion Fund IX, the largest close in history, according to **Christopher Elvin**, Preqin's head of private equity products.

"The fundraising picture demonstrates the enormous demand investors currently have for private equity investments," says Elvin. "Other fund managers have also reported that their latest funds have been heavily oversubscribed, and the record pace of fundraising in the industry does not show any signs of slowing in the second half of the year."

This has many in the industry concerned that the market has begun to top out and is on the precipice of a fall. At TPG Capital, all investments are now being examined with the expectation of a moderate recession in 2019, CIO **Jonathan Coslet** said at a Pension Bridge private equity conference on Tuesday.

All the money flowing into the space is a huge concern, TorreyCove Capital Partners' CEO **David Fann** said at the conference.

"It's really scary out there," Fann said. "If history repeats itself, sometime in the next 24 months we're going to have a downturn and it's going to be severe."

Pensions have taken notice and begun preparing for a market event. The California Public Employees' Retirement System (CalPERS) cut its private equity allocation from 10% to 8% late last year in anticipation for market uncertainty in the U.S. and Europe, as reported.

However, concerns about a downturn aren't a reason to jump completely out of the asset class, **Alex Done**, deputy CIO and head of private markets at the **New York City Retirement Systems**, said at the conference.

"We're concerned and that leads us to be very cautious with regards to the asset class and how we think about deploying capital in this environment," Done said. "Contrary to some theories out there, private equity is not dead and we certainly believe in the long-term attributes and return expectations of the asset class."

Instead, the city's five plans are cutting their list of managers and easing into private equity targets. The plans are currently underweight, but Done says there's no rush or pressure to hit the target.

"If we come in under our target that's OK," Done said. "We're not going to chase investments, certainly not in this environment."

In addition, the plans are looking at what is driving their managers' returns, and asking what managers are bringing to the table. Currently, there are a ton of managers performing well, but part of that is attributable to a hot market. The idea is to see what sets a manager apart, Done said.

Funds can also prepare by looking to managers who have a history of good performance through down cycles in the market, and for strategies that may be insulated from a wider market downturn, Fann said.

"You've got to be able to zig and zag," Fann said. "Now's the time to really think hard and be disciplined about how you build your program — do a lot of introspection about how much risk you can really, truly take."