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The Secondary Market is Vaulting Over Prior Records

by Lawrence Shoykhet

2024 is expected to be a record year for secondaries, but the market volume should be even larger. The secondary market remains undercapitalized and under-resourced. Investors are unable to transact on all the secondary deals that they want.

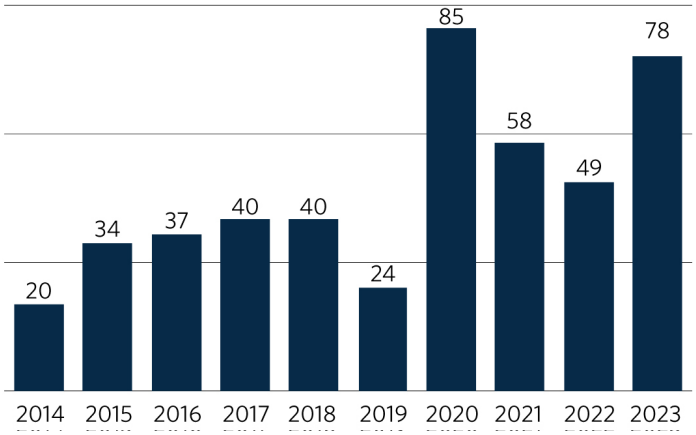
Market volume is up 58 percent from $43 billion in H1 2023 to $68 billion in H1 2024.[1] This $68 billion of volume marks a new record high for the first half of the year, and the velocity of transaction volume does not appear to be slowing down in the second half. Limited Partners ("LPs") are continuing to reduce their overallocations to private equity, rebalancing their portfolios, actively seeking out liquidity, and winding down older positions. In conjunction with this proactive LP push for portfolio-level liquidity, General Partners ("GPs") are continuing to utilize the secondary market for fund-level liquidity. In H1 2024, LP transactions outpaced GP-led transactions 59 percent to 41 percent. Jefferies forecasts that 2024 secondary volume will be $140+ billion.[1]

FUNDRAISING

Over the past ten years, ~$466 billion of secondary capital and ~$12.4 trillion of private capital has been raised globally.[2] According to a Pitchbook article highlighting the lifespan of private equity ("PE") and venture capital ("VC") funds, the average lifespan of PE and VC funds grew to around 13.1 years. Seventy percent of funds with a 2008 – 2013 vintage are not yet dissolved.[3] These funds are between 10-15 years old.

SECONDARY FUNDRAISING

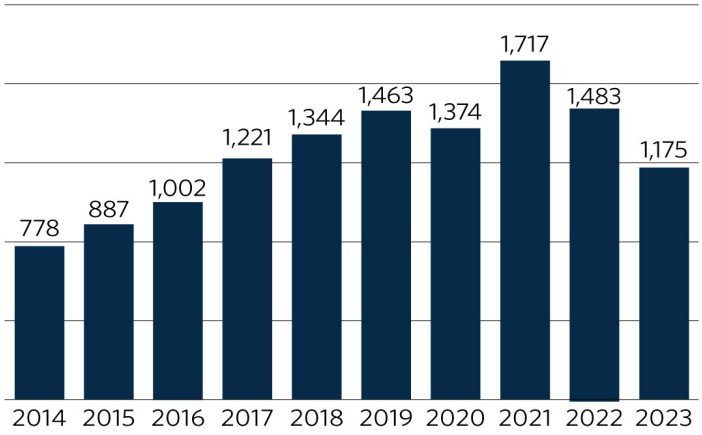
Dollars in billion



Source: Pitchbook 2023 Annual Global Private Market Fundraising Report

GLOBAL PRIVATE CAPITAL FUNDRAISING

Dollars in billions



Source: Pitchbook 2023 Annual Global Private Market Fundraising Report

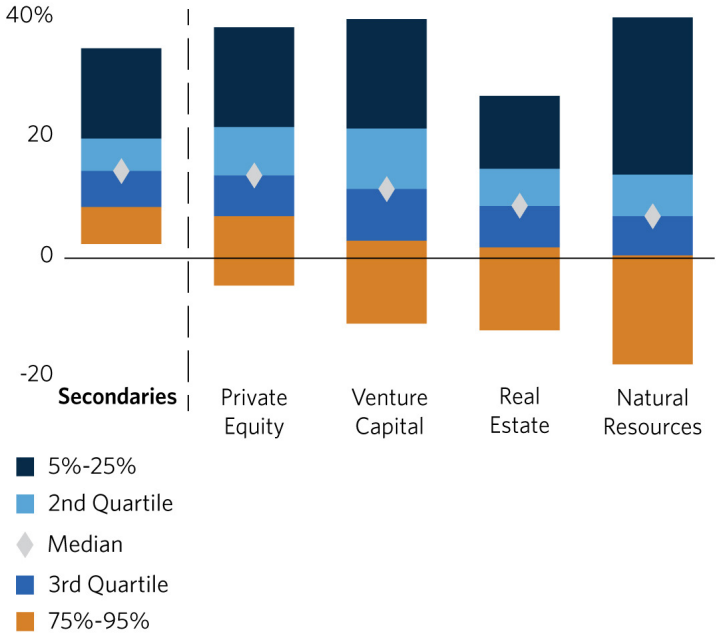
Secondary fundraising is lumpy and concentrated. The outsized amount of secondary capital raised in 2020 and 2023 includes final closes of some of the largest secondary funds. In fact, the ten largest buyers account for 57 percent of the total equity dry powder.[1] Additionally, by the time some of these funds hold their final close, they can be over 50 percent invested.

According to the Jefferies H1 2024 Global Secondary Market report, the capital overhang multiple (ratio of available capital to LTM secondary volume) decreased from 2.3x at the end of 2023 to 1.8x in H1 2024. The amount of dedicated available capital, defined as the sum of equity dry powder, near-term fundraising, and available leverage, is at a record $253 billion heading into the second half of the year.[1]

Irrespective of the two outlier years, aggregate fundraising should be higher for secondary funds. The Bain & Company 2024 Global Private Equity report highlighted that the median return for secondary funds was higher than that of private equity, venture capital, real estate, and natural resources funds. This outperformance comes against the backdrop of lower levels of risk taken. This is measured by 95 percent of secondary funds with vintage years from 2000-2019 having not lost capital as of Q2 2023.[4] Secondary funds value proposition to investors includes the potential for reverse j-curves, diversification, ROI, and shorter duration.

NET IRR DISPERSION, BY ASSET CLASS

Vintage years 2000-19, as of Q2 2023

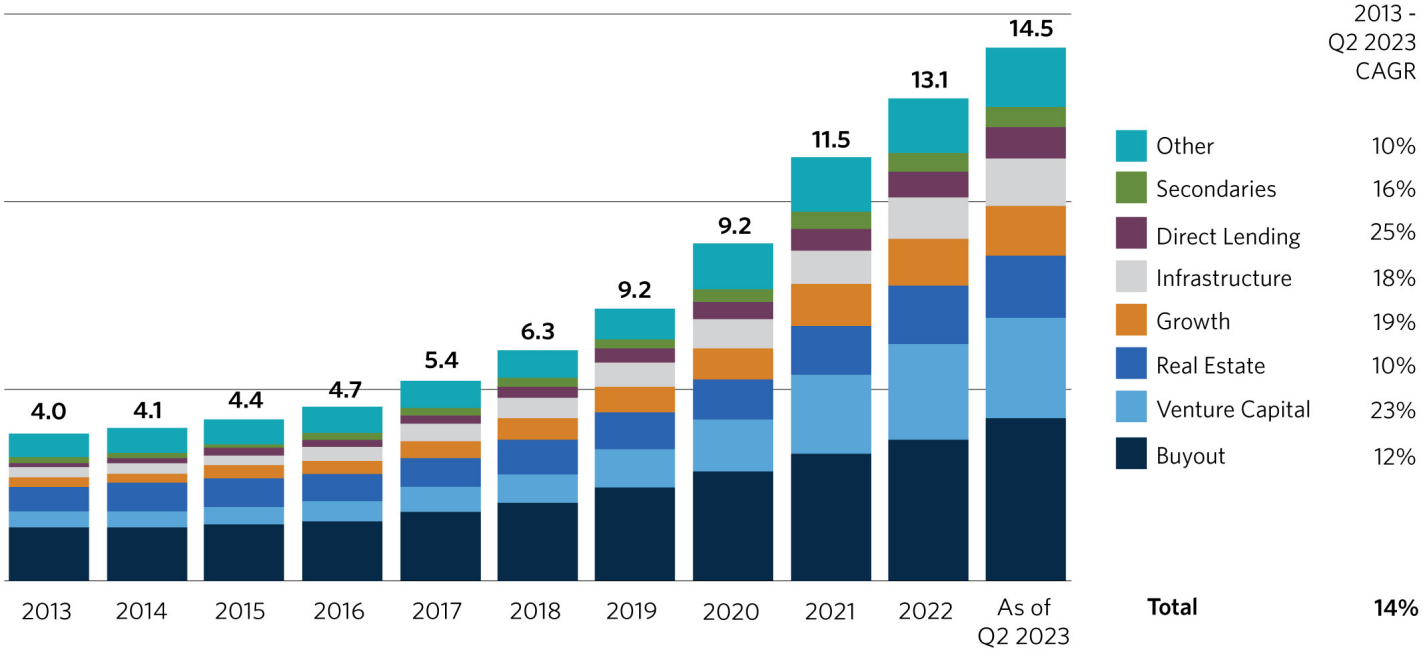


Source: Bain & Company Global Private Equity Report 2024

While the last 24 months represented one of the more challenging fundraising environments in recent history, these short-term challenges do not overshadow the abundant growth the private capital market has seen over the last decade. The overall market has experienced 14 percent annual assets under management ("AUM") growth, from 2013-Q2 2023, and every subset of the broader market has similarly witnessed double-digit growth during this same time period. The two market segments with the most outsized AUM growth during this ten-year period were direct lending (25%) and venture capital (23%).[4] This robust and wide-spread growth has led to fierce competition for investor capital across strategies and highlights the opportunity set for secondaries to continue to capitalize. The strategy has grown AUM 16 percent annually, between 2013-Q2 2023. The secondary market is still only trading a marginal percentage of the overall private capital market, while the growth of secondaries AUM compares favorably to the growth of the global buyout market AUM (12%), as well as the growth of the aggregate private equity market AUM (14%).[4] As such, the go-forward growth opportunity for secondaries over the next decade remains vast.

GLOBAL AUM, BY ASSET TYPE

Dollars in trillions



Notes: Buyout category includes buyout, balanced, co-investment, and co-investment multimanager funds; secondaries includes real estate secondaries, infrastructure secondaries, direct secondaries (PE), and secondaries (PE) fund types; other category includes fund-of-funds, mezzanine, natural resources, hybrid, private investment in public equity, and real assets; excludes distressed private equity

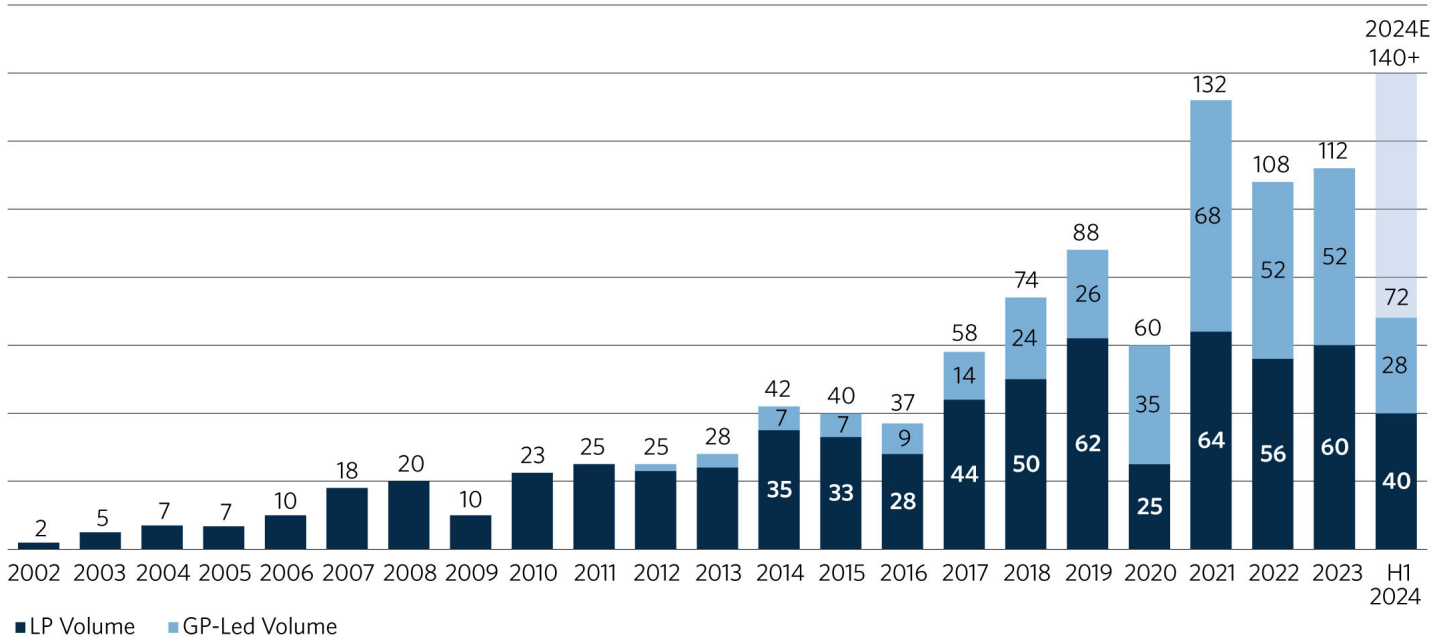
Source: Bain & Company Global Private Equity Report 2024

LP VOLUME

In H2 2022, CF Private Equity wrote a white paper postulating that LP-led secondaries are core to the secondary market. Re-evaluating the market landscape approximately two years later, it is evident that this still rings true today. LP-led secondaries accounted for $40 billion of H1 2024 volume, representing 59 percent of the total first half volume and 60 percent growth YoY.[1] This impressive growth and outpacing relative to GP-led transactions was buoyed in part by investors' desire and need for liquidity and the belief that investors should take a more active role in managing their private equity portfolios.

SECONDARY TRANSACTION VOLUME

Dollars in billions



Source: Jefferies H1 2024 Global Secondary Market Review

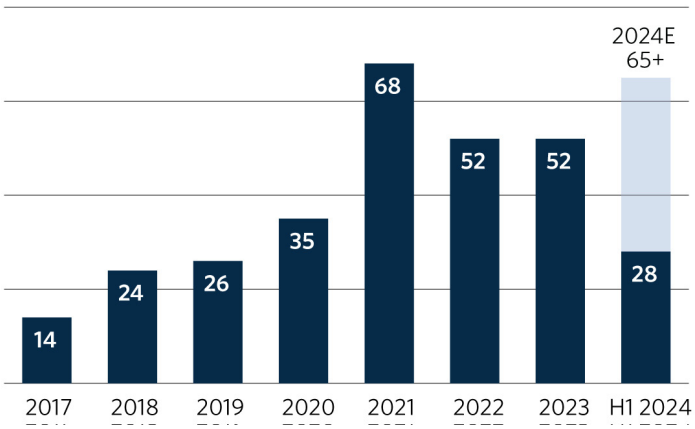
LP-led secondaries will continue to remain core to the market and volume is expected to continue to grow. The percentage of first-time sellers continues to increase, rising from 39 percent in 2023 to 45 percent in H1 2024. The number of large transactions coming to market also continues to increase, rising from six $1B+ transactions in H1 2023 to ten in H1 2024. [1] This signals the potential for continued secondary market participation from large LPs desiring liquidity.

GP VOLUME

Over the past seven years, the largest evolution of the secondary market has been the establishment and adoption of the GP-led market. This market segment has evolved from a new innovation, representing $14 billion of transaction volume in 2017, to an established complement to the LP-led transaction segment, representing $28 billion of transaction volume in H1 2024 alone. For the LTM period ending H1 2024, GP-led volume was $62 billion, and this would represent the second highest year on record, only lagging the $68 billion achieved in 2021 at the height of the market.[1] The entrance of new market participants and a lack of many viable alternative exit paths has helped fuel the continued steady growth of the GP-led market. Consequently, the $28 billion of H1 2024 volume, which represents 56 percent growth YoY, not only points to the private equity market's continued wide-spread adoption of GP-led secondary transactions, but also reaffirms that the secondary market's current growth is balanced and complementary.[1] GP-led transactions are another tool in the toolkit for GPs.

GP-LED TRANSACTION VOLUME

Dollars in billions



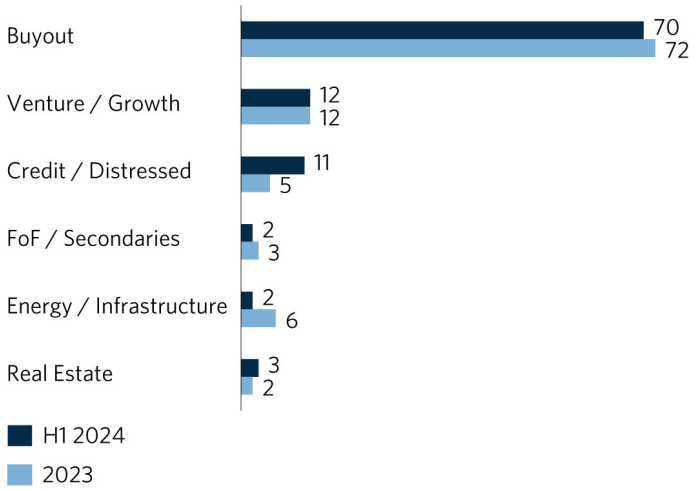
Source: Jefferies H1 2024 Global Secondary Market Review

WHAT IS BEING SOLD?

The secondary market is expected to vault past previous records in 2024 due to the continued uptick in selling activity by LPs to satisfy their overarching need for liquidity. While transaction volume increases and the market continues to evolve, the strategy mix of LP portfolios being sold has stayed relatively static. The market continues to be driven by buyout funds, which accounted for 70 percent of total H1 2024 transaction volume, down 2 percent versus 2023. This is followed by venture/growth, which represented 12 percent of transaction volume and was flat compared to 2023. The majority of the remaining transaction volume was represented by credit secondaries, which made up 11 percent of transaction volume and represented the strategy which exhibited the largest growth compared to 2023.[1]

TRANSACTION VOLUME BY STRATEGY

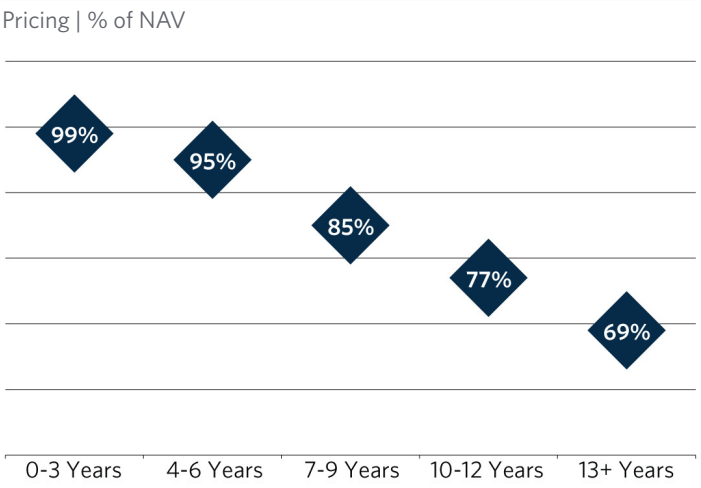
Numbers in percent



Source: Jefferies H1 2024 Global Secondary Market Review

Buyout funds continued to make up the majority of secondary portfolios which transacted. The average age of these funds sold shifted down from 7 years in 2023 to 6.4 years in H1 2024.[1] The driving factor behind this market shift is that younger funds typically command more attractive pricing than older vintage funds, and in a time when liquidity is hard to come by, price and liquidity maximization is top of mind for investors.

AVERAGE BUYOUT PRICING BY AGE OF FUND



Source: Jefferies H1 2024 Global Secondary Market Review

CONCLUSION

Looking ahead to the end of 2024, all signs point to a robust secondary market that is on pace to vault past 2021's record $132 billion of transaction volume and set a new high.[1] Given the amount of primary capital raised over the last 10 years, ~$12.4 trillion, and the continued long-life of tail-end funds with over $750 billion in NAV, the secondary market is on a path to doubling in the not so distant future.[2,5] The market remains constrained by its ability to raise enough capital for all the existing opportunities, despite the strategy's strong historical performance. Investors need to see secondaries as a key allocation in their portfolios.

Endnotes

1 Pitchbook 2023 Annual Global Private Market Fundraising Report, March 2024

2 Pitchbook 2023 Annual Global Private Market Fundraising Report, March 2024

3 Andrew Woodman, "Zombie funds could rise again, but there are antidotes", Pitchbook, April 20, 2023

4 Bain & Company Global Private Equity Report 2024, March 2024

5 Data provided by Jefferies from Preqin as of August 2023

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