Private Markets Mythbusters Series

Navigating the evergreen fund frenzy

An investor's guide on what to watch out for when assessing evergreen funds

Private markets investing has undergone several evolutions over the past decades, adjusting to developments in the macroeconomic and business landscape. However, the way investors have accessed private markets investments has remained largely unchanged.

The traditional closed-end fund, a structure popularized in the 1980s, still represents the majority of the industry's assets under management (AUM). While these structures have served institutional investors well, the same cannot be said about retail investors and the private wealth segment.

Such individual investors are responsible for only 16% of alternative investments, despite controlling half of total global AUM.[1] Furthermore, within their overall allocations, just a 5-6%[2] share is dedicated to private markets – compared to 24%[3] for institutional investors. This imbalance has fuelled a growing demand for a type of structure that better serves individual investors – the "evergreen", or "open-end", fund structure.

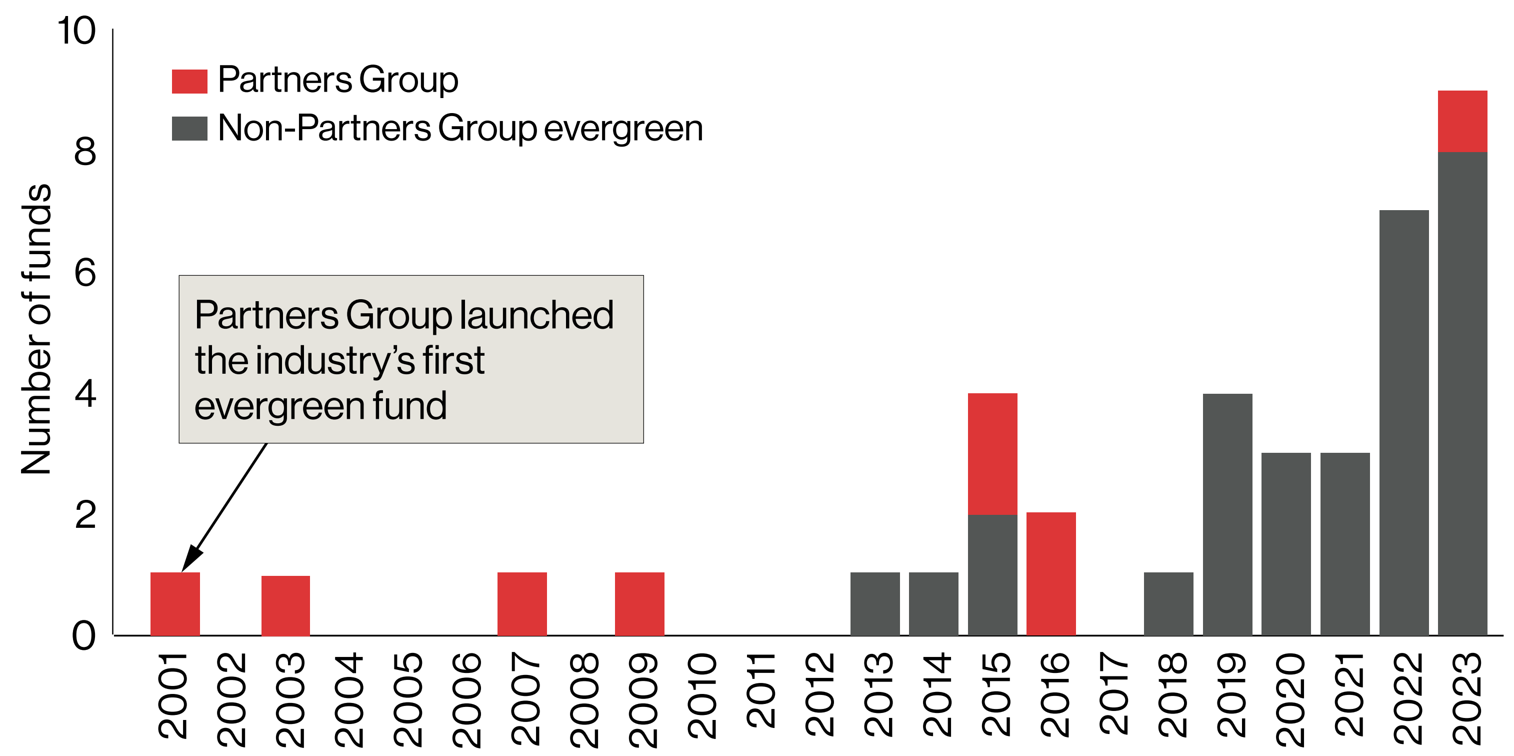
[1] Bain & Company Global Private Equity Report 2023.
[2] McKinsey Global Private Markets Review 2023.

Evergreens work as perpetual capital funds, where investors can subscribe into and redeem out of over time, without otherwise having to wait for the vehicle's termination. The liquidity feature of this structure, as well as the typically lower minimum investment requirement, better caters for the needs of individual investors. (See page 3 for differences between closed-end and evergreen structures.)

Partners Group pioneered evergreen funds more than 20 years ago, and we are a firm believer in their potential to democratize private markets. In recent years, several other market participants have started echoing this viewpoint, resulting in a record number of new evergreen funds launched. In most cases, these funds represent each manager's first foray into this space, making it difficult for investors to assess their ability to successfully run such offerings.

[3] BlackRock Global Private Market Survey 2023.

Evergreen fund launches globally



Note: Includes Private Equity and Private Markets evergreen funds launched since 2000.
Source: Partners Group research (2024). For illustrative purposes only.

In this third paper of our **Private Markets MythBusters Series**, we use our experience to highlight the factors we believe make a successful evergreen fund – capable of delivering attractive returns over the long-term.

By doing this we seek to dismiss the misconception that these structures can be simple adaptations of traditional closed-end strategies. In reality, a successful manager in closed-end funds may not be able to replicate such results in the evergreen space. Most importantly, we intend to equip investors with a playbook that can help them successfully conduct their due diligence and hold managers accountable for their processes and performance.

Looking under the hood

Our approach to assess today's expanding evergreen universe is based on all our learnings over time in the space. In this paper, we break them down into five key elements that we believe make a successful evergreen fund and explain how investors can assess a manager's ability to deliver on them.

What makes a great evergreen fund?

Key questions to ask before investing

1. Focus on direct investments
- Does the evergreen fund predominantly make direct investments?
- Is performance truly sustainable? (Be wary of a track record built on discounted secondaries.)

2. Access to the right investment platform
- Does the manager generate consistent and diverse investment flow?
- Does the evergreen fund have equal access to this investment flow?

3. Disciplined growth
- How fast has the manager been fundraising?
- Does the fund have a healthy mix of mature and young assets?

4. Valuation policy
- Does the manager have its own team responsible for valuations?
- Can it conduct independent monthly valuations and adjust third-party values when necessary?

5. Liquidity management
- Can the manager generate sufficient liquidity in a prolonged stress case?
- Is the evergreen fund routinely and independently stress tested? Has it experienced prolonged market stress before?

1. Focus on direct investments: limiting the role of fund building blocks

In private markets, direct investments refer to transactions in which a manager (acting on behalf of its clients) invests in a company or asset without intermediation. This is in contrast to fund investments, whereby a manager commits capital to a fund managed by a third-party, which typically only deploys the capital over the following three to five years. We believe an evergreen fund should focus on direct investments, because:

- **Direct investments are fully drawn**, with 90-100% of the committed amounts paid in at the time of investment. Conversely, capital committed to a fund is not deployed at the outset but only gradually – which creates an enormous uncertainty over the timing of cash flows. In practice, it can burden an evergreen fund with being "on the hook" for future capital calls. This can force a manager to either keep large cash reserves on hand, or risk running out of liquidity via an overcommitment strategy.

- **Direct investments provide more flexibility**, not only to control the pace of deployment, but also to quickly pivot investment focus toward opportunities presented by the market in real-time. Fund investments, in contrast, reduce this ability for two reasons; firstly, there is no guarantee that a suitable fund would be available when a manager wishes to increase exposure to a certain strategy. Secondly, the evergreen fund would be tied to its previous fund commitments, even if the manager's views have changed in the meantime.

20+ years

Partners Group's experience managing evergreen funds

To illustrate this point, we use the example below in which two different evergreen fund managers – one running a directs-focused approach, the other concentrated on fund investments – seek to take advantage of three available investment strategies.

We assume that:

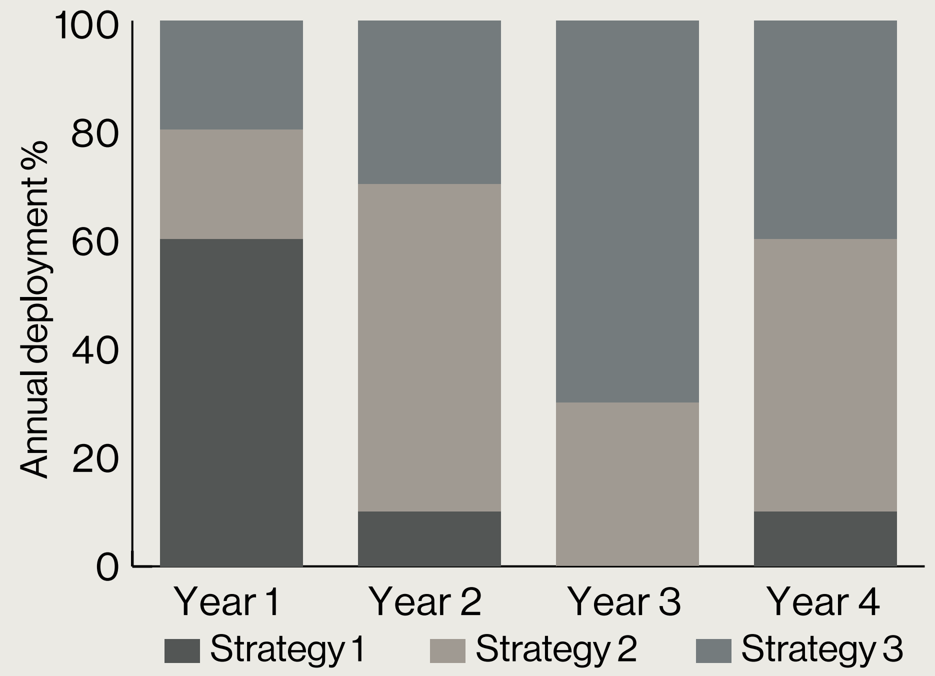
- **Strategy 1** is attractive in year 1 but loses its appeal thereafter
- **Strategy 2** is very attractive in years 2 and 4
- **Strategy 3** is the most attractive in year 3

The charts on the right show how each manager could deploy capital each year, in reaction to such developments.

The same limitations shown in this example are true of evergreen managers who commit to their own internal closed-end funds. While this could somewhat improve the visibility around the timing of future cash needs (compared to third-party funds), it has the same portfolio construction limitations with respect to liquidity and flexibility. Therefore, it is not an adequate substitute to allocations made straight into direct investments.

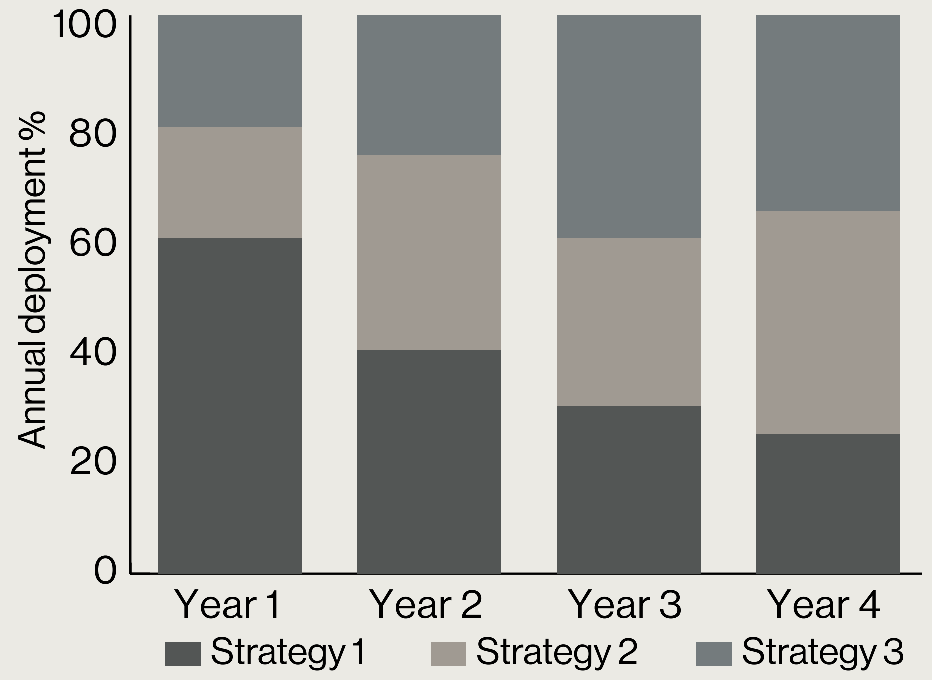
Directs-focused manager

Direct investments give the manager flexibility to change the asset allocation and pivot towards the most attractive strategies over time.



Funds-focused manager

Fund commitments lock the manager to strategies that will only be deployed over the next 3-5 years, making it less agile to take advantage of future opportunities.



Source: Partners Group (2024). For illustrative purposes only. There is no assurance that the stated strategy will always materialize.

Secondary investments
There is one fund-focused strategy, however, that is of special relevance to evergreen funds: secondary investments.

In its simplest form, a secondary investment consists of buying private markets exposure via the secondary market. Such transactions can range from stakes in very diversified portfolios of hundreds of assets, to more concentrated single asset vehicles.

To complement a directs-focused strategy, we believe managers running evergreen funds should have the ability to transact on (and maintain a minority allocation to) the secondary market. This is for two important reasons:

- **Stabilizing deployment over time** During times of market stress, private markets transaction activity falls steeply – examples being the Global Financial Crisis, the onset of COVID and more recently across the interest-rate hiking cycle of 2022/23. During such times, an evergreen manager without access to secondaries may struggle to deploy as direct transaction activity would have dried up. This could lead to a deterioration of the fund investment level and an inability to take advantage of market dislocations via discounts.

- **Discount opportunities** Secondary stakes are typically bought at a premium or a discount and rarely trade at their most recent valuation. A discount can be especially advantageous for evergreen funds, since the disconnect between the traded price and book value can be reflected in the evergreen fund unit price upon purchase, resulting in an immediate performance uplift.

In today's environment, secondary discounts exceed historic averages, creating the potential for larger performance uplifts. A manager's ability to tactically invest in secondaries can be a true benefit and is an area we would encourage investors to seek out.

However, there is an important caveat to this. A secondary investment should not be undertaken for the Day 1 write-up potential (discount) alone. Instead, it should be assessed with long-term potential in mind and driven by the quality and maturity of the underlying fund/assets. Indeed, while low-quality secondaries typically come at a higher discount, they will otherwise materially dilute the fund's future return potential.

We encourage investors to carefully inspect any evergreen fund built mostly with secondary transactions undertaken at deep discounts (i.e., 30-50% or more). Such an approach tends to be unsustainable, as most of the investment's potential will already be exhausted on Day 1, rather than developed over time. The question investors should ask is: "How much future performance remains if much of the portfolio's investment potential has already been extracted?" For this reason, we encourage investors to safeguard themselves to make sure they are not left standing if the performance "music" were to stop.

Comparing fund structures

Feature	Closed-end fund	Evergreen fund
Access	Investor commits capital during the fundraising period	Investor subscribes over time, usually monthly or quarterly
Fund life	10-15 years	Perpetual fund
Cash flows	Capital drawn over 3-5 years	100% invested upon subscription
Liquidity	Distributions paid to investor once investments are exited, at manager's discretion	Investors have discretion to issue redemption requests over time
Distribution policy	Typically paid back to clients after end of investment period	Distributions usually automatically reinvested in new investments
J-Curve[4]	Net returns can initially be negative during investment build-up	No J-curve, as investor accesses an already built-up portfolio
Return profile	Net internal rate of return (IRR) on drawn capital	Compounded net return on entire subscribed amount
Fund gates	Not applicable	Limits placed on the magnitude of outflows permitted from the fund

[4] Trendline that shows a fund's initial loss, typically during the first years of the investment period, which is then followed by a dramatic gain in value.
Source: Partners Group (2024).

2. Access to the right investment platform

As perpetual investment vehicles, evergreen funds must consistently invest in new transactions over time to maintain attractive investment levels. For this, they require a strong and constant investment pipeline to maintain a steady deployment pace and ensure diversification.

Therefore, the breadth of a manager's investment engine should be suitably large – both in absolute size and in the number of investment opportunities it generates per year. If this is not the case, an evergreen fund risks being underinvested or very concentrated to just a handful of positions.

Furthermore, it is also imperative that the evergreen fund receives equal access to the investment platform, as any other investment offering a manager may have.

Surprisingly, it is not rare to find examples of managers that favour their flagship closed-end funds over their evergreen equivalent, giving the former a right of first refusal on transactions.

Such allocation "waterfall", in which the evergreen fund is formally deprioritized, is not in the best interest of investors. Instead, we strongly advocate for a full pro-rata allocation policy – where any fund or investment mandate, open-end or closed-end, has equal access. Prospective evergreen investors should make sure they are not at risk of receiving only a subset of investments.

3. Disciplined growth: the key to long-term success

The capital required to support an evergreen's ongoing investment activity is sourced from a combination of new investor subscriptions (inflows) and the proceeds from selling past investments (exits).

As evergreen funds can accept inflows on an ongoing basis, a manager might be tempted to capitalize on the current momentum around evergreens by fundraising as much as possible. However, maximizing fundraising at any cost can create portfolio imbalances. For instance, by accepting disproportionately large inflows, a manager may be forced to make significant near-term investments to remain fully deployed – thereby creating a highly concentrated fund.

Based on our experience, a more disciplined approach to growth can pave the way to a more diversified portfolio – achieving a healthy balance between younger and mature assets. That is because:

Partners Group's evergreen experience

More than 20 years experience managing private markets evergreen funds across multi-asset class and dedicated single-asset class strategies. Over this time we have launched several industry firsts:

- First Private Markets Evergreen Fund
- First European Private Equity Evergreen
- First US 1940-Act Private Equity Fund
- First Daily Traded Private Market DC Funds

We continue to innovate and aim to launch several new evergreen funds in 2024:

- Private Equity Growth Evergreen
- Next Generation Infrastructure
- Impact Evergreen (PG Life)
- ELTIF-compliant Evergreen
- Royalties Evergreen

Source: Partners Group (2024). Some of the programs may not be open for marketing in the US and other jurisdictions.

- Mature assets (more than two years old) usually compound returns at a higher rate (vs. younger assets), as they stand to benefit in the near-term from value creation initiatives put in place over prior years. In addition, mature investments are more likely to be exited sooner, contributing to fund liquidity.
- Younger assets typically represent a fund's medium-term prospects for returns and liquidity. However, in the near-term younger assets would typically compound at a lower return, as they have not had time to benefit from the manager's value creation initiatives. A fund that has fundraised too quickly and, as a result, has had to make larger investments would tend to see a "diluted" return trajectory in the near-term due to a concentration to younger assets.

Striking the right balance between younger and mature assets has a clear knock-on effect on a fund's ability to deliver liquidity and returns. This can only be achieved by balancing disciplined fundraising and careful investment sizing over the years.

4. Valuation assessments: more accurate and frequent

The valuation of private markets investments is a topic of increased interest in recent years. We note that market participants tend to differ quite significantly in their approach to valuation frequency, and the extent to which public markets moves are reflected.

Managers of closed-end funds generally only conduct quarterly valuations (and sometimes only annually), since such funds are not actively traded. Therefore, they have less obligations as to how their investments are valued.

By contrast, evergreen funds typically offer a monthly unit price, based on which investors can subscribe to and redeem against. Therefore, it is imperative that investment valuations accurately reflect the health of the underlying assets and the market environment.

When an evergreen fund is not perceived to be valued fairly, investors would be incentivized to redeem if they think published prices are too high; or to subscribe if they think fair value lies above the reported valuation. Both scenarios would be to the detriment of existing unitholders as they open up the possibility of arbitrage.

This is why we believe any manager offering an evergreen fund should have the ability to consider valuation-relevant events in real-time and to apply changes where appropriate. In March 2020, for example, Partners Group's valuations team reflected the impacts of COVID in our portfolio assets within around ten days, adjusting them significantly downwards in-line with public markets movements. We also adjusted downwards the valuations we received on our minority holdings (controlled by third-party managers) where relevant.

In our view, managers unable to conduct frequent fund valuations are not equipped to credibly offer evergreen funds. In times of market volatility, these managers can end up either publishing stale valuations from external managers, thereby risking fairness to investors, or having to suspend trading altogether (eliminating the possibility for investors to redeem).

5. Liquidity management: the moment of truth

Liquidity is the lifeblood of an evergreen fund. Managing it, therefore, is extremely important and requires dedicated resources to get right. Evergreen funds offer investors liquidity either via fund gates (which define the maximum investors can redeem in aggregate over time) or via redemption queues. It is crucial for investors to have confidence in a manager's portfolio construction, since the way capital has been invested will determine whether an evergreen fund will be able to successfully service outflows.

However, it is important to highlight that only over long periods of market stress will it become clear which managers have truly prepared. Therefore, prior to deciding on an allocation, investors should establish whether a manager stringently stress tests its portfolios under a range of scenarios. This can be done, for example, by asking the manager to demonstrate a credible ability to generate sufficient liquidity in a prolonged and severe stress case (more than twelve months). Crucially, the manager should be able to do so while minimizing any negative impact on portfolio returns. These include, for example, avoiding uncoordinated fire sales of assets on the secondary market, as well as carefully applying mechanisms designed for steering liquidity in line with previous transparent communication.

While the best acid test would be to look at a manager's history of steering evergreen funds through times of significant stress and volatility, there are very few who can credibly claim a successful track record of liquidity management in such times.

The liquidity check list

Portfolio construction

- Is the portfolio adequately diversified?
- Are there single-asset or investment-year concentrations?
- What are the levels of unfunded commitments?

Investor base

- Has the investor base grown in a disciplined way?
- What is the ratio of long-term to new investors?
- Is the investor base diversified by region and type?

Liquidity mechanism

- Are the liquidity mechanisms transparently disclosed?
- Has the manager ever failed to deliver on the fund terms?
- Is there a specialist team responsible for managing liquidity?

Experienced management

- How long has the team responsible been constructing evergreen portfolios for?
- Has the fund been successfully managed through a crisis period before?
- Can the manager demonstrate investment level steering expertise?

Source: Partners Group (2024).

Preparing for the evergreen journey

The increased interest in evergreen funds in recent years is a truly positive development for private markets investors. We are confident that managers with credible operational and investment means to address the topics raised in this paper will be capable, and indeed in the best position, to deliver attractive and sustainable long-term performance.

For example, we at Partners Group have built several evergreen funds that have successfully delivered double-digit annualized net returns to clients for well over a decade. Looking ahead, we believe evergreen funds will remain well placed to capitalize on future market opportunities.

Nevertheless, most investors are only at the beginning of their evergreen explorations. To exacerbate their challenges, they are faced with the difficulties of carrying out due diligence on a rapidly expanding marketplace without a well-established or generally accepted playbook.

We hope this paper serves as a guide on what investors should be looking out for, helping them analyze what is under the hood and hold evergreen managers to account. By asking the right questions, we believe this can equip investors to make their evergreen journey a successful and enduring one.

Next time in our *Private Markets Mythbusters Series*

Bespoke fund financing solutions, such as the use of credit facilities, have become increasingly common in private markets. In recent times, there has been heightened investor scrutiny associated with their use.

In the next paper of our *Private Markets Mythbusters Series*, we explore the genesis behind their use, and what impacts such fund financing solutions can have on both investments and investors themselves. Finally, we explore how the measured use of credit facilities can actually assist investors in managing their cash flows and also have positive impacts on investor outcomes over the long-term.

Email **research@partnersgroup.com** to receive the next papers in our Mythbusters Series.

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About Partners Group

Partners Group is a leading global private markets firm. Since 1996, the firm has invested USD 210 billion in private equity, private real estate, private debt and private infrastructure on behalf of its clients globally. Partners Group seeks to generate superior returns through capitalizing on thematic growth trends and transforming attractive businesses and assets into market leaders. The firm is a committed, responsible investor and aims to create sustainable returns with lasting, positive impact for all its stakeholders. With USD 147 billion in assets under management as of 31 December 2023, Partners Group provides an innovative range of bespoke client solutions to institutional investors, sovereign wealth funds, family offices and private individuals globally. The firm employs more than 1,900 diverse professionals across 20 offices worldwide and has regional headquarters in Baar-Zug, Switzerland; Denver, USA; and Singapore. It has been listed on the SIX Swiss Exchange since 2006 (symbol: PGHN). For more information, please visit www.partnersgroup.com or follow us on LinkedIn or X.

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