PitchBook's guide to overcoming four allocator workflow challenges

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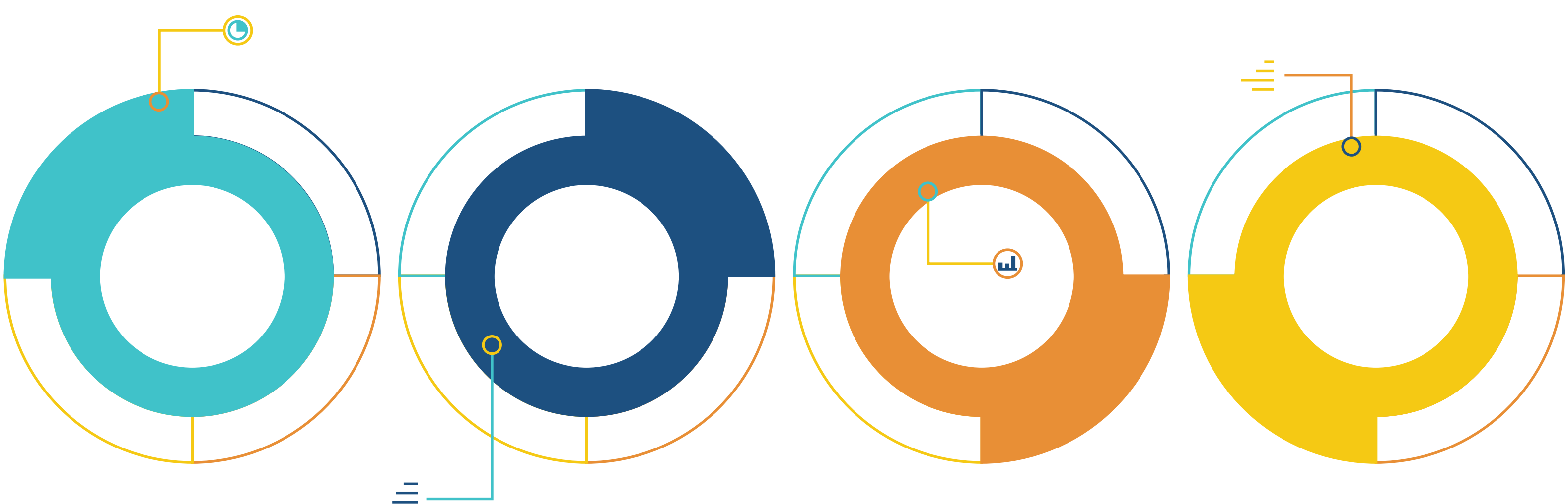
Introduction

Limited partners (LPs) looking to manage or grow their private market portfolios face a variety of unique challenges—from a lack of transparency into the landscape of funds and complex allocation processes to time and resourcing constraints. Of course, allocators with limited bandwidth still need to fulfill their fiduciary duty and can't let any workflow roadblocks stop them.

As the private market space continues to evolve, it has become increasingly important for LPs to utilize high-quality data and insights—every step of the way. In this guide we explore key elements of the LP workflow, highlighting ways allocators can address common barriers and elevate their processes.



The allocator’s highwire act

Allocators—or the consultants they engage as proxies—are walking a tightrope as they work to deploy maximum capital. They must simultaneously keep the right balance in reserve for responding to capital calls from general partners to avoid defaulting on commitments.

At the same time, they must also be mindful of liabilities which can be quite sporadic and unpredictable for certain classes of institutional investors. For example, insurance companies may need more immediate liquidity in the case of an emergency like a widespread weather event. Foundations, by contrast, can sacrifice liquidity and hold assets for an extended period. Allocators walk this fine line in a constantly shifting environment, working to anticipate which direction the market will move in order to keep allocations in balance.

Amid shifting markets and macroeconomic events, there’s more scrutiny being applied to LPs and their allocation decisions than ever before.

Expert insight from PitchBook’s research and analysis team

“Maintaining an allocation while private markets are slow to move valuations, compared to publicly traded assets, makes the private fund allocation experience as much an art as it is a science. Striking that balance between how to manage your allocation, and then setting expectations for cash coming in and cash going out is a challenge.”

—**Zane Carmean,** Lead Analyst, Quantitative and Funds Research, PitchBook

Considerations for addressing allocator workflow challenges

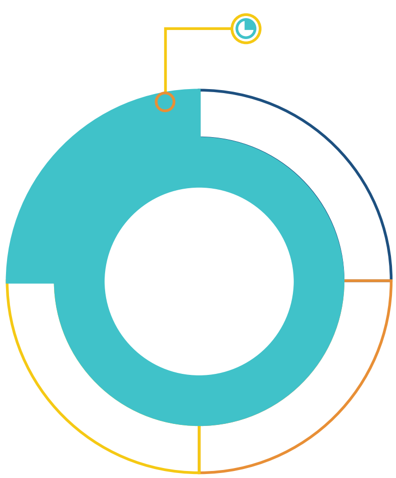
1 Optimize allocations across strategies

LPs are tasked with sourcing a variety of opportunities that align with their goals, objectives, and investment timelines. These may include anything from private equity to venture capital, real estate, private debt, fund of funds, secondaries, and other asset classes across both public and private markets. Of course, each of these assets come with their own unique set of challenges and opportunities, which result in different returns.

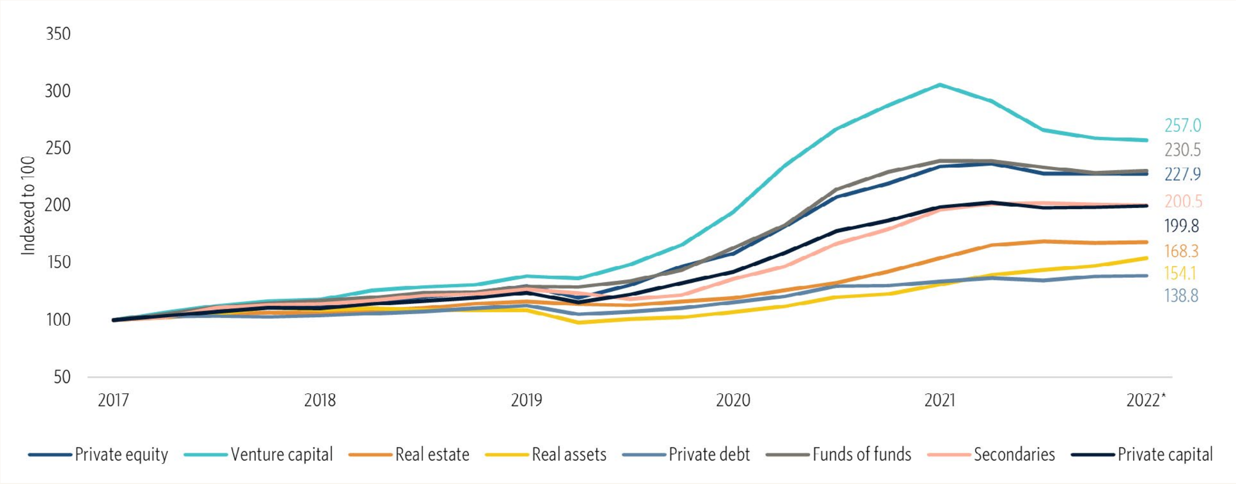
To make matters more complicated, performance and risk are constantly evolving across these strategies.

At the end of the day, LPs need to monitor market conditions and stay on top of new developments if they want to maintain a strong portfolio over time.

PitchBook's Private Capital Indexes can be a helpful reference point.

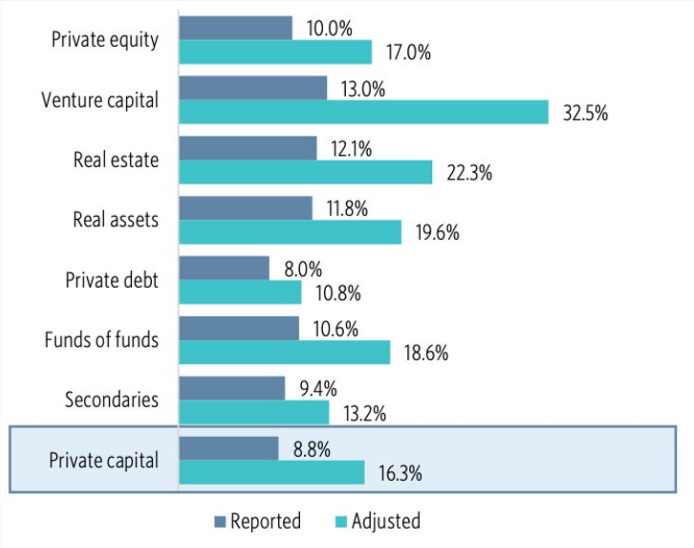


PitchBook Private Capital Indexes 5-year return



Source: PitchBook | Geography: Global
*As of December 31, 2022

Annualized volatility estimates since 2000*



Source: PitchBook - Geography: Global
*As of December 31, 2022

Sample portfolio allocations

While many allocators now dedicate a significant portion of their portfolios to private market investments (often upwards of 30%), the individual breakdown of investments—and their resulting performance—can still vary greatly from one LP to another. The key is to find the right mix for your needs at any given time.

Summary statistic comparison of various commitment pacing scenarios, start years, and simulated portfolio percentile of PE allocation relative to target*

		Time (years) to 20% target			Proportion of quarters within range after ramp**			Average absolute deviation from 20% target after ramp**		
Start year	Portfolio	Fixed scenario	Tactical scenario	Forecasting scenario	Fixed scenario	Tactical scenario	Forecasting scenario	Fixed scenario	Tactical scenario	Forecasting scenario
2000	Top quartile	7.75	7	5.75	39.3%	46.8%	59.7%	3.0%	2.3%	2.2%
	Median	8.5	7.5	6	63.9%	54.1%	86.4%	2.1%	2.4%	1.5%
	Bottom quartile	9	8.25	6	83.6%	59.0%	93.9%	1.4%	2.7%	1.1%
2004	Top quartile	11.5	6.5	4.5	84.4%	95.8%	41.1%	1.4%	1.3%	2.6%
	Median	12	7.25	5	88.9%	91.1%	74.1%	1.3%	1.2%	1.8%
	Bottom quartile	14.5	7.75	5	71.1%	77.8%	92.6%	1.8%	1.5%	1.3%
2008	Top quartile	9.25	7.75	6.75	62.1%	72.4%	45.2%	2.4%	2.0%	2.4%
	Median	10	8.5	6.75	62.1%	93.1%	87.1%	2.2%	1.4%	1.5%
	Bottom quartile	10.25	9.25	7.25	62.1%	93.1%	95.6%	2.1%	1.1%	0.9%

Source: PitchBook | Geography: US
*As of March 31, 2022

**We calculate each metric starting with the end of the predesignated ramp period of seven years, or after target allocation is reached, whichever comes first. Note: Simulated results are for illustrative purposes only.*

We explore this concept in more detail in our [Allocator Solutions report](). In this report, we discuss several case studies simulating portfolio cash flows, performance, and allocation estimations utilizing actual historical private fund data and public index returns. With various starting points and adjustments, outcomes differ across time, market environment, and portfolio management strategy.

2 Source high-caliber fund managers with precise due diligence

In a high-risk environment, LPs are always on the lookout for general partners (GPs) they can trust and who are actively searching for capital. Ideally, potential fund managers will be open, funding, and match the LP's investment thesis.

LPs are now being more cautious about risk management given the tough market environment. In some cases, this means choosing to work with more established GPs that have a consistent track record through previous downturns. LPs might also lean toward greater diversification by committing to fund managers that have multiple fund strategies. Alternatively, they may opt to focus on more re-ups, counting on continued performance from existing GP relationships.

Due diligence checklist for sourcing GPs

As part of the due diligence process, LPs will typically evaluate historical data, as well as more recent news and events. They may ask questions like:

- [ ] How have these GPs fared in the current economic climate to date?
- [ ] Do they have any profitable exits in the past year?
- [ ] Has there been significant turnover in their leadership team?
- [ ] What is the GP's past financial performance? This analysis includes examining its investment capacities, exits, and generated returns.
- [ ] What is the GP's industry knowledge like, and is it compatible with our investment strategy?
- [ ] What are the annual terms and fees of the GP?
- [ ] What is its approach to sourcing investments and co-investors?
- [ ] Are its fund size, industry, VC stage, and geography in alignment with our strategy?
- [ ] Is there any concern regarding "key person" risk?
- [ ] How do existing managers (who are being vetted) perform against others in their peer group?
- [ ] What are its investment preferences?
    - [ ] What types of deals?
    - [ ] What geographies?
    - [ ] Is it a generalist or specialist?
- [ ] Have there been changes to its investment style?

Diving deep on their performance, investors, and strategic direction is critical to making a long-term commitment.

Rethinking how to evaluate manager performance

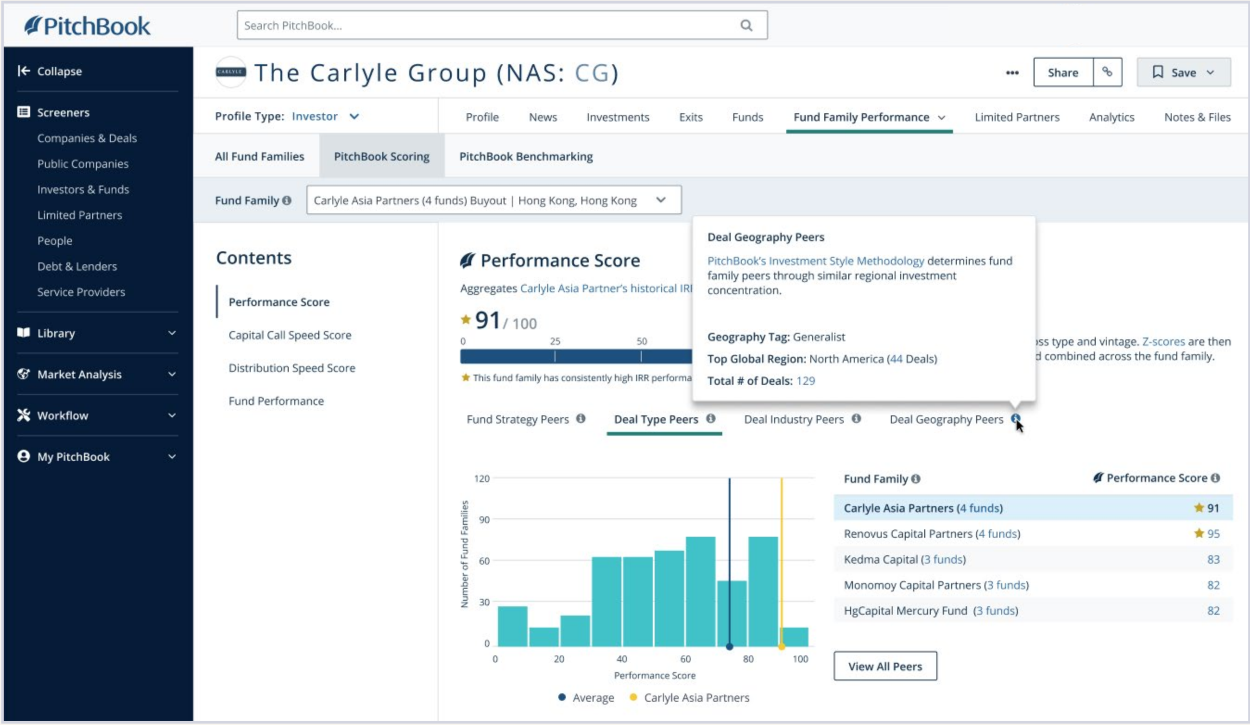
While the checklist above is a great starting point, it can still be difficult to gauge whether a fund manager's performance is up to par. To some extent, LPs can rely on their instincts and expertise at this stage in the process. That said, allocators stand to benefit from access to trusted data-driven insights.

Managers who have demonstrated strong performance persistence might be more apt for fund manager selection. PitchBook's Manager Score deploys a more precise, quantitative framework and scoring system that moves beyond the guesswork of traditional benchmarks. Traditional quartiling provided by benchmarks has limitations and fails to contextualize strategies from different vintage years. PitchBook's methodology deploys the use of z-scores to take into consideration the uncertainty level for each fund's current IRR figure.

Learn more in our recent webinar

PitchBook's Manager score

Sample Manager Score, highlighting a top-performing fund family



Source: PitchBook Platform
*As of August 23, 2023

Manager Score enables LPs to easily discover top-performing managers that they might need to quickly allocate capital to or managers that distribute capital faster than others. This helps allocators identify fund managers through more nuanced parameters before jumping into underlying benchmarks.

What LPs are saying about PitchBook

PitchBook tracks hundreds of PE and VC fund managers, giving LPs insights into investment strategies and historic performance. Access to data such as fund return profiles, investments, IRRs, cash flow multiples, and liquidity events can illustrate a general partner's true strengths and weaknesses—and allow LPs to be strategic in manager selection. Given the longevity of the LP-GP relationship, selecting the right fund manager is an important decision with serious implications.

"PitchBook helps LPs win by allowing me to access information from a third party and not only from the GPs I am analyzing to invest."

—**Manager,** Corporate pension

See how allocators find success in challenging environments with PitchBook

3 Account for shifting markets by contextualizing fund performance

Prior to investing, most LPs evaluate how different asset classes have performed over time. Although past performance does not necessarily indicate future success, it can still be helpful to dig into private and public market metrics over a select period.

One-year horizon IRRs

Select strategies

2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	15-year horizon IRR
Oil & gas 2.2%	Private debt 19.8%	Secondaries 21.5%	Oil & gas 19.6%	Secondaries 15.3%	Venture capital 21.6%	Venture capital 20.5%	Infrastructure 13.5%	Oil & gas 20.3%	Buyout 19.7%	Growth/ expansion 19.0%	Growth/ expansion 19.2%	Growth/ expansion 36.6%	Venture capital 58.8%	Oil & gas 32.3%	Growth/ expansion 14.7%
Secondaries -9.0%	Growth/ expansion 9.0%	Growth/ expansion 20.0%	Secondaries 14.2%	Buyout 14.6%	Real estate 18.8%	Infrastructure 15.2%	Growth/ expansion 13.4%	Buyout 12.5%	Growth/ expansion 18.2%	Venture capital 17.5%	Venture capital 16.8%	Venture capital 36.4%	Growth/ expansion 49.7%	Infrastructure 10.8%	Secondaries 11.9%
Infrastructure -9.2%	Buyout 8.5%	Private debt 18.8%	Venture capital 10.9%	Private debt 14.0%	Buyout 18.1%	Real estate 13.0%	Buyout 13.0%	Private capital 10.2%	Secondaries 16.0%	Funds of funds 16.3%	Buyout 16.0%	Funds of funds 23.5%	Secondaries 46.7%	Real estate 7.7%	Buyout 11.5%
Venture capital -12.0%	Oil & gas 5.1%	Buyout 17.6%	Real estate 9.0%	Private capital 12.6%	Growth/ expansion 16.1%	Growth/ expansion 13.0%	Venture capital 12.5%	Growth/ expansion 10.1%	Private capital 15.1%	Secondaries 14.2%	Private capital 11.7%	Buyout 20.8%	Funds of funds 46.7%	Private debt 4.0%	Venture capital 11.2%
Funds of funds -12.4%	Private capital 2.4%	Oil & gas 17.1%	Private capital 8.1%	Growth/ expansion 12.5%	Private capital 15.9%	Buyout 12.6%	Funds of funds 12.2%	Real estate 9.0%	Real estate 13.3%	Infrastructure 12.6%	Funds of funds 11.5%	Private capital 15.5%	Buyout 44.7%	Secondaries 2.8%	Private capital 10.3%
Growth/ expansion -14.7%	Funds of funds 0.5%	Private capital 15.8%	Buyout 8.1%	Real estate 11.2%	Funds of funds 11.6%	Funds of funds 12.5%	Real estate 11.4%	Infrastructure 8.8%	Funds of funds 12.5%	Buyout 10.6%	Secondaries 9.8%	Secondaries 12.5%	Oil & gas 44.3%	Private capital 0.7%	Funds of funds 10.2%
Private capital -20.9%	Venture capital -0.2%	Venture capital 11.7%	Growth/ expansion 7.8%	Funds of funds 8.0%	Private debt 11.6%	Private capital 12.5%	Secondaries 10.3%	Private debt 8.6%	Private debt 10.6%	Private capital 10.5%	Private debt 8.7%	Infrastructure 8.8%	Private capital 38.3%	Buyout -0.4%	Infrastructure 8.7%
Buyout -22.5%	Infrastructure -4.2%	Real estate 11.2%	Infrastructure 7.4%	Venture capital 7.4%	Secondaries 10.2%	Secondaries 12.4%	Private capital 10.2%	Funds of funds 7.8%	Venture capital 10.0%	Real estate 7.4%	Real estate 7.9%	Real estate 4.0%	Real estate 27.8%	Funds of funds -3.6%	Private debt 7.8%
Private debt -26.5%	Secondaries -9.3%	Infrastructure 7.1%	Funds of funds 7.0%	Infrastructure 7.1%	Oil & gas 7.0%	Private debt 11.0%	Private debt 4.9%	Secondaries 7.2%	Oil & gas 9.7%	Private debt 4.8%	Infrastructure 6.7%	Private debt 3.2%	Private debt 16.2%	Growth/ expansion -6.5%	Real estate 6.8%
Real estate -28.0%	Real estate -35.5%	Funds of funds 5.3%	Private debt 3.3%	Oil & gas 7.0%	Infrastructure 3.5%	Oil & gas -2.7%	Oil & gas -22.2%	Venture capital 0.0%	Infrastructure 7.1%	Oil & gas 3.2%	Oil & gas -11.9%	Oil & gas -20.8%	Infrastructure 15.2%	Venture capital -16.8%	Oil & gas 6.0%

Source: PitchBook Benchmarks | Geography: Global
*As of December 31, 2022

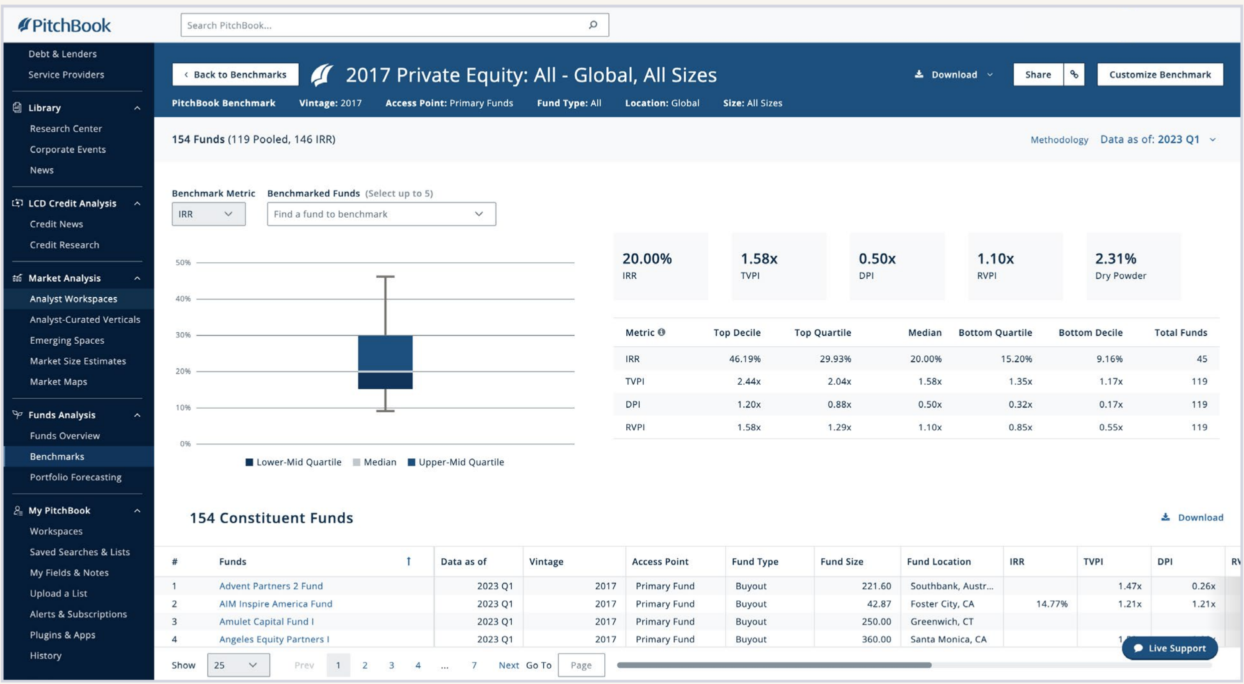
Utilize benchmarking tools

When building their own benchmarks, allocators often must cobble together data from disparate sources, which can take significant time and resources. Even if allocators can reference one source of truth, they may still question the validity of its data if it is not comprehensive enough.

PitchBook's benchmarking tools were built to meet LP needs. The platform's user-friendly dashboard provides pre-curated benchmarks across all private market asset classes, fund strategies, and vintages—so LPs can easily discover the right benchmark for their unique strategy and better assess the performance of other portfolios and fund manager prospects. With full transparency into constituent funds and underlying investment portfolios, we unlock a new level of understanding when it comes to fund attribution.

PITCHBOOK BENCHMARKS

Sample PitchBook Benchmark for all private equity funds, vintage 2017



Source: PitchBook Platform
*As of August 23, 2023

[Discover PitchBook Benchmarks]

PitchBook's Benchmarks reports

Now more than ever, allocators need clear-cut data to help guide their decision-making.

PitchBook's Benchmarks reports provide the industry's most transparent look at private market benchmarks, built using PitchBook's expansive fund performance data. These quarterly reports look at performance through the lens of IRR and cash multiples to provide a holistic view of performance within and between strategies, as well as across vintage years. Private market funds' returns are then measured relative to public market alternatives using a public market equivalent metric.

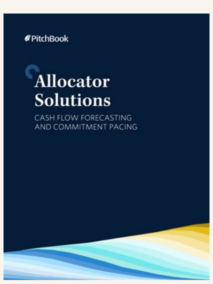
Each quarter, the report is accompanied by analyst commentary featured in the Global Fund Performance and Private Fund Strategies reports.

Download the latest PitchBook Benchmarks report

4 Leverage cash flow modeling to reduce uncertainty and increase efficiency

While LPs need to have cash on hand to fund capital calls, they don't want too much dry powder on hand. This dynamic creates a series of dilemmas. Allocating too little cash to highly liquid assets runs the risk of defaulting on a capital call, which is accompanied by serious financial and reputational penalties. Alternatively, placing too much capital in low-yielding assets, such as a short-duration fixed income portfolio or cash, reduces expected investment returns. Yet, placing uncalled capital in riskier, higher performing assets, such as small cap equities, introduces its own problems. Liquidating those investments to meet a capital call when the market is down would certainly not be ideal for an LP.

In short, LPs need to know—with some level of confidence—the maximum amount that they should keep on hand for capital calls at any given moment. That way, they can thread the needle of investing just the right amount of capital in stable but probably low-return assets to meet capital calls.



REPORT

Allocator solutions: Cash Flow Forecasting and Commitment Pacing

[Read the report]

Common cash flow forecasting methods

Many LPs create rough models to estimate how their fund commitments will be called down and how the capital will come back. They assume about 20% per year will be called down from a fund, which will start giving back capital around years four or five. The rate will increase beyond that before declining in the fund's last few years. This back-of-the-envelope approach to modeling can feel about right, but it's not driven by real data.

This was fine when the stakes weren't so high, and private market investments were minimal. Rough models built in Excel, in-house or by a third party, were sufficient to anticipate expectations of call downs and distributions. Historical data, statistical analysis, and probability simulations necessary for more robust modeling didn't exist in one place.

However, to truly understand an entire portfolio cash flow scenario, LPs need nuanced models. Layering in new fund commitments adds complexity and requires a different model altogether: a commitment pacing model.

Expert insight from PitchBook's research and analysis team

"What I wouldn't have given in my work as an allocator to have the cash flow forecasting and commitment pacing tools in PitchBook. Those and other features are incredibly helpful when it comes to understanding the dynamics of the private markets, diving deep on managers, and testing different ideas to better inform allocation strategies."

—**Hilary Wiek,** Senior Strategist, PitchBook, previously an asset owner, manager, and investment advisor

Portfolio Forecasting—a new solution for cash flow forecasting

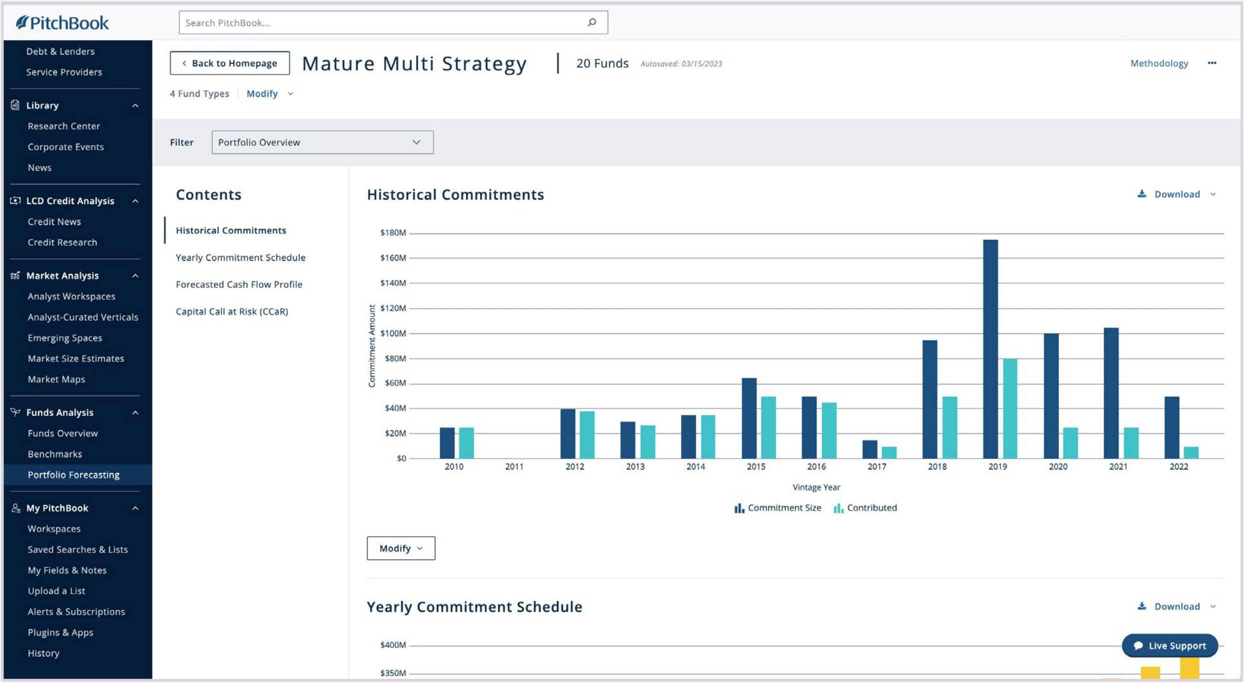
In an environment of higher allocations and elevated risk, LPs and consultants need more insights than ever. Roadblocks they experience when making allocation decisions, pressure they're under to get it right, and current market shifts all speak to the need for more robust cash flow forecasting intel.

Effective cash flow forecasting models empower LPs to make more accurate predictions about capital call timing and amounts, paving the way for fewer missteps and reducing exposure to less-than-ideal returns.

That's why we built PitchBook's Portfolio Forecasting functionality. Created with extensive cash flow and historical fund data, Portfolio Forecasting uses a baseline normalized cash flow profile for each private market asset class to anticipate and model portfolio and commitment pacing data.

PORTFOLIO FORECASTING

Sample overview of Portfolio Forecasting, highlighting historical commitments for a mature multi strategy portfolio



Source: PitchBook Platform
*As of August 23, 2023

LPs can use Portfolio Forecasting to:

- Automate cash flow forecasts with customizable data and analytics
- Plan future commitments to meet allocation targets and minimize liquidity events
- Integrate existing funds into calculations and seamlessly manage your portfolio
- Run hypothetical forecasts using Monte Carlo simulation and Capital Call at Risk Analysis to prepare for worst-case scenarios

Learn more about Portfolio Forecasting

Expert insight from PitchBook's research and analysis team

"Reliable, thorough, objective historical data; statistical analysis; and probability simulations all in one robust model have been a boon to allocator confidence and success."

—**Zane Carmean**, Lead Analyst, Quantitative and Funds Research, PitchBook

Conclusion

It is not easy to navigate changing market conditions and maintain a well-balanced allocation across different strategies—while also accounting for different liquidity needs over time. On top of this, LPs also need to diligently source GPs and evaluate their performance prior to committing any capital. These workflows can be time consuming, and still leave LPs wondering whether they have made the right allocation decisions. Particularly when working with limited information or inconsistent data, allocators may encounter issues with cash flow forecasting and commitment pacing later down the line.

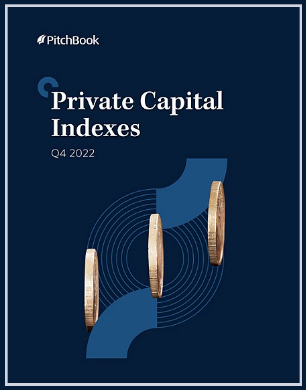
While we understand that LPs will always face some challenges, we hope this guide—along with PitchBook's extensive research into private capital market performance—can serve as a helpful resource.

To learn more about how PitchBook can help address your current allocation challenges, please contact us at **info@pitchbook.com** or **request a free trial**.

Appendix

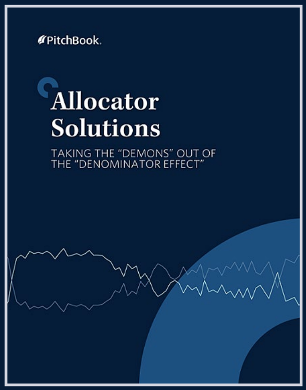
Q4 2022 PitchBook Private Capital Indexes

Read the report here



Allocator Solutions: Taking the "Demons" Out of the "Denominator Effect"

Read the report here

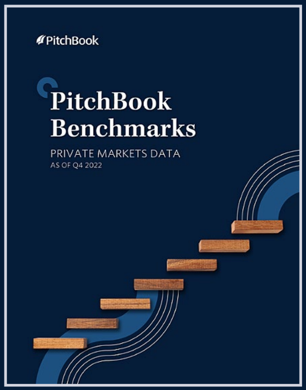


PitchBook Global Manager Performance Score League Tables

Read the report here

PitchBook Benchmarks (as of Q4 2022)

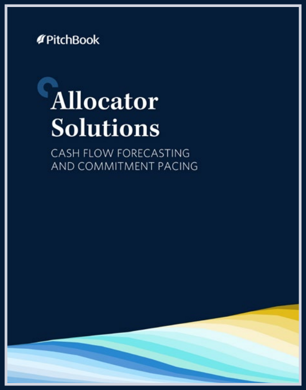
Read the report here



Appendix

Allocator Solutions: Cash Flow Forecasting and Commitment Pacing

Read the report here



How private market allocators find success in a challenging environment with PitchBook

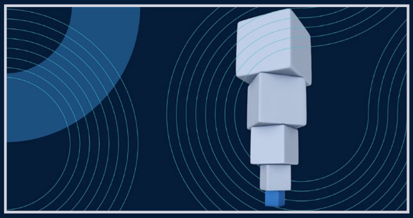
Read the blog here

Analyst Q&A: What is Portfolio Forecasting and why is it important?

Read the blog here

What asset allocators need to know about the denominator effect

Read the blog here



Why allocators should rethink manager benchmarking

Watch the webinar here