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Widening the Aperture: Family Office Investment Insights

This report summarises the findings from the Goldman Sachs inaugural family office survey, conducted in Feb/March 2021.

The findings are organized into three principal areas of discussion: the evolving family office industry, current and future asset allocation, and family office investing themes.

There were more than 150 respondents globally, comprising of ~54% from the Americas, ~23% Europe, the Middle East, and Africa (EMEA) and ~23% Asia.

Executive Summary

Family offices' **asset allocation tends to have outsized exposure to alternative investments**.This reflects their higher return hurdles, patient capital pools, and professional diligence capabilities. On average, respondents' portfolios have a 45% combined allocation to private equity, real estate, private credit, and hedge funds.

About two-thirds of respondents are thinking about a prolonged low-rate environment, and a similar number are monitoring inflation. In both cases, many are reaching for higher returns and higher risk (increasing their allocation to equities, for example).

Almost **half of all respondents** who are focused on low rates **are considering investments in operating businesses**.

Among respondents who are thinking about a potential rise in inflation, **roughly half are investing in hard assets** such as real estate, noting however that property prices have elevated over the pandemic period.

Almost universally, respondents have at least some exposure to private equity. Many family offices invest in private equity through both funds and direct transactions.

The **majority of respondents invest directly in private real estate**. This is an area where family offices tend to exhibit a more hands-on approach, particularly if they have ample experience in owning and operating real estate. Other family offices look to invest through managers who can execute at scale.

Venture capital investing continues to be top of mind among the majority of family offices, directly and through funds.

Respondents' exposure to private credit is lower relative to other alternatives. That said, there is an observation of substantial growth in the private credit space in recent years.

Environmental, social, and governance (ESG) is front and centre, with most respondents moderately to extremely focused on implementing such principles across their philanthropic efforts, workplace policies, and investing strategy. It is anticipated that with regulatory tailwinds, the next generation coming into investment decision-making seats coupled with technological and business innovation, will serve as key catalysts for a continued shift into ESG investments.

While most respondents are not currently invested in cryptocurrencies, interestingly, almost half are considering initiating exposure in the future. Among respondents with no current cryptocurrency exposure, their most cited reason for caution stemmed from skepticism about cryptocurrencies as a store of value. One has to question whether it is the desire to make a quick return which is driving those who have invested to date. However, the volatility of Bitcoin, as an example, is why only the brave venture into this space. Outside of cryptocurrencies, it is expected that family offices will monitor the evolution and potential use cases for other digital assets and blockchain technology more broadly for future investment opportunities.

Family Office Landscape

Family Office Missions

Family offices have long existed in different shapes and sizes, and their investment objectives are just as varied. Still, some priorities stand out. In the case of institutional family offices, most respondents globally consider capital appreciation for multigenerational wealth transfer a primary mission of their family office. Many family offices are looking to acquire similar assets as traditional institutions but with a greater capacity to hold in perpetuity. The second-most-prevalent mission was wealth preservation. Other top priorities included diversification of concentrated wealth or single stock, legacy creation through philanthropic endeavors, development and/or acquisition of operating businesses, and succession planning.

Family Office Capital

Family office assets under management continue to grow rapidly, which has resulted in an increasingly institutionalized approach. In many cases, companies raising capital view family offices as favorable investment partners for a few strategic reasons. First, family offices tend to have long investing time horizons because of their predominant focus on multigenerational wealth transfer.

Second, family office capital tends to be flexible, with sufficient latitude to invest creatively across the capital structure in different asset classes, strategies, and geographies. Family offices tend to be more agile, free from the influence of benchmarks or outside capital constraints.

Third, the decision-making process of most family offices is unique. Lean organizational structures typically allow for expedited decisions without the need for formal, multistage investment committee approvals. In-house expertise can add significant strategic value and create solid ground from which to confidently make transformative investment decisions. Family offices are generally very hands-on with their investments and are also highly collaborative with and reliant on trusted networks for sourcing investment opportunities.

Many family offices are engaging with external and independent advisors (e.g., Generation Private) to provide the appropriate governance structure especially with the establishment of Investment Committees who are responsible for the investment activities of the family office. This is becoming more prevalent particularly where multiple family members are associated with the family office (the multifamily office).

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Asset Allocation

Current Allocations

Family offices can have an aggressive asset allocation strategy, with the bias toward public market equities being partly attributed to the concentration of wealth in companies that have since gone public. On average, global survey respondents have a combined exposure to private equity, real estate, hedge funds, and private credit of about 45% of their portfolio. This larger allocation to alternatives overall aligns with the observation that family offices often have higher return hurdles as well as professional diligence capabilities.

While considering illiquidity risk and higher complexity, many investors believe that investing in private markets can generate incrementally higher returns over public markets. For that reason, some family offices follow the "endowment model."

On the other end of the risk spectrum, the average global respondent's allocation to cash and fixed income was about 19% of the portfolio. Maintaining an allocation to cash and cash equivalents may allow family offices the flexibility to act quickly as opportunities arise and to meet capital calls for their private equity investments. Additionally, fixed income holdings for several family offices include higher-yielding assets.

Positioning for the Future

Despite the idiosyncratic nature of the family office investor base, the survey reveals several areas of focus when it comes to strategically positioning for the future.

Approximately two-thirds of respondents globally are actively thinking about persistently low interest rates, and a similar portion are thinking about an increase in inflation. While simultaneous focus on the potential for sustained low rates and for rising inflation may seem inconsistent, the extraordinary stimulus that has been injected into markets worldwide has respondents preparing for both outcomes. In the survey, many respondents reported reaching for more risk in search of higher returns.

Many family offices are investing in hard assets. While the hard assets category traditionally includes precious metals, art, and other collectibles, real estate is still the primary preferred alternative asset to combat the risk of wealth erosion from rising inflation.

Of the global respondents who are focused on low rates, 44% reported they are looking to invest in operating businesses. Increasingly, families have shown an appetite for outright acquisitions of, or majority stakes in, businesses with stable cash flow that can fund growth and future acquisitions.

Investing Themes

Alternative and Private Investments

Family offices, like other investors in alternatives and private markets, are seeking more upside, given their return hurdles, especially as interest rates remain at historically low levels globally. Investors continue to allocate more to private equity and other opportunistic asset classes.

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Most respondents in the survey invest in private equity. Globally, there are a wide range of investment approaches, and many family offices invest both through managers and directly.

Venture capital investing is a significant area of interest among family offices that participated in the survey with more than 90% of respondents indicating they invest in the asset class.

Venture capital debt is another area of interest, as it serves as a way for investors to potentially increase exposure to high-growth technology companies, and possibly benefit from monetization of convertible or preferred debt into equity as companies reach later stages in their life cycles.

Despite venture capital opportunities being difficult to source and evaluate, the survey suggests that family offices globally are roughly split between investing through managers and going directly.

Among family offices, private credit has historically seen a smaller allocation relative to other alternative asset classes. In periods of challenging market dynamics, there has been a pickup in interest in more bespoke, higher-risk credit products, such as mezzanine and preferred financings.

Of the family offices that reported they invest in private real estate in the survey, more than 60% globally indicated they invest directly versus through managers. Families will often feel comfortable investing directly if they have a history of being real estate owners and developers. Nevertheless, some family offices recognize that it may be difficult to execute strategies effectively on their own in an increasingly competitive and rapidly evolving market.

Direct Investing

Broadly speaking, interest has shifted toward gaining direct exposure to alternatives and private investments, and it is expected that this trend will continue. Appetite for direct investing is on the rise given the perceived ability to be more selective, gain increased transparency and control and pay lower fees. As a result, many large family offices have been building out their direct investing capabilities to conduct due diligence and manage direct private deals.

Unsurprisingly, family office interest is concentrated in sectors where they have direct or indirect operating expertise. It was also found that many family offices are acutely focused on acquiring family-owned/controlled or founder-led businesses.

It is worth noting that about 40% of respondents globally expressed interest in special purpose acquisition companies (SPACs) and in private investments in public equity (PIPEs). The space presents an interesting interplay between family offices' direct public and private portfolios.

Digital Assets

The digital assets landscape has experienced significant growth, and family offices' focus on the space has grown in tandem.

While just a small portion of the survey respondents have exposure to cryptocurrencies to date, almost half indicated they may be interested in initiating exposure in the future. Additionally, the survey indicated family offices are interested in getting exposure not only to cryptocurrencies but also to innovation in the digital asset's ecosystem.

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Outside of cryptocurrencies, it is expected that family offices will continue to focus on monitoring the evolution and potential-use cases for other digital assets and blockchain technology more broadly.

Environmental, Social and Governance (ESG) Investing

ESG continues to gain traction across the family office investor base. When it comes to implementing ESG principles, many respondents globally indicated they are moderately to extremely focused on doing so through their philanthropic efforts, workplace policies, and investing strategy.

Historically, there has been a distinction between families' investment and philanthropic objectives, but there is now a greater alignment between the values and frameworks applied to both pools of capital. Across the investing universe, ESG strategies tend to fall into three primary buckets—alignment (i.e., benchmark-aware portfolio strategy that screens for ESG factors), integration (i.e., active portfolio strategy that incorporates ESG factors as a driver of portfolio outperformance), and impact (i.e., investments that produce sustained alpha as well as positive social or environmental outcomes). There has been an observed shift in investor preferences from passive alignment to active management, as ESG-integrated investments have, on average, outperformed the broader market in recent years.

In addition to the rollout of ESG-driven regulations, it is anticipated that an increased presence of next-generation leaders in investment decision-making will serve as a key catalyst for a continued shift into multifaceted ESG portfolio implementations. Generally, younger family members have a greater focus on the environmental and social impact of underlying investments, in addition to their focus on returns. This rise in demand is paired with a growing universe of sustainable investment opportunities, given the pace of technological and business innovation.

Concluding Remarks

As agile and largely unconstrained investors, family offices have a fair degree of flexibility in managing and preserving their wealth. This survey of family offices around the world identified how they take advantage of these inherent characteristics. Broadly speaking, family offices tend to be more aggressive in seeking superior returns but also more long-term oriented given their lack of defined investing timelines and absence of outside interference.

It will be interesting to see what may change in the years ahead, given that the family office constituency will increasingly define the investment universe in which it operates.

Source: Widening the Aperture – Family Office Investment Insights, Goldman Sachs, 2021