

Generation Private – Citi Family Office Survey 2021

The comments below are adapted from the Citi Private Capital Group Family Office Survey 2021, conducted as part of their sixth annual Family Office Leadership Program in June 2021. The survey respondents numbered 197, of which, 156 self-identified as family offices. Comments made within are taken from the report.

Executive summary: Identifying predominant Family Office (FO) themes in a challenging climate

There were four predominant themes observed:

- Concern on rising Inflation topped the list of worries over the next 12 months.
- High cash levels in the face of low-yield environment.
- Continued growth in portfolio allocation to direct investing opportunities.
- A remarkable comeback in portfolio values year over year in a period of high degree of uncertainty.

A few other notable observations include:

- Gradual but less than expected interest in sustainable investing and portfolio alignment with ESG principles (author comments: this is contrary to other surveys we have reported on)
- An expected mix of interest coupled with a high degree of skepticism in crypto assets.

What are the FO expectations in the next 12 months? The survey indicates a sense of cautious optimism despite a wide variety of opposing influences, including concerns around COVID-19, perception of peak market valuations and inflationary issues among other anxieties.

The survey indicated that for many FO's one of their top issues and challenges was the preparation to manage transition to the next generation.

Key Observations and Analysis

Participant Data and Demographics

Of the 197 respondents, 156 were family offices with 40% managing assets in excess of \$500 million. The respondents were comprised of family offices in North America (42%), followed by 22% from EMEA and Middle East, 21% from LATAM and 15% from Asia Pacific.

Investor Sentiment

Unsurprisingly, inflation tops the list of respondents worries over the next 12 months. Previously, there was significant uncertainty about the vaccine development and rollout and while there are multiple COVID-19 vaccines, anxiety about the impact of the virus persists, quite possibly stemming from the uneven rollouts globally as well as the significant concern on highly contagious virus variants.

Asset Class Sentiment

Cash

Based on the responses, FO's continue to hold significant cash, some perhaps hoping to time the markets, others seeking safety and liquidity. No matter what the reason, this can be a potential

detractor to overall portfolio performance given the low-yield environment. It would be prudent for FO's to revisit the main reasons for having such significant cash allocation.

Commodities

Commodities are seen as a hedge against inflation. While overall inflation has yet to recede, there are numerous signs that it will. The commodity boom observed over the past several months is due to a robust global recovery and changing global dynamics. If trade growth continues, one can expect higher investor interest in commodities.

Global Developed Market Equities

While investors appear to have taken a slightly more cautious view in 2021, driven by concerns of high valuation and record territory for indexes especially in the US, there certainly appears to be continued expectation of higher returns in this asset class with investors seeking out key sectors like healthcare, which still trades at a discount and can be defensive.

Global Emerging Market Equities

The continued shift in interest in emerging market equities is clearly observed, driven by the growth and value opportunities and overvaluation of certain sectors in developed markets.

Fixed Income

Across the board, there was a general tendency to underweight fixed income as an asset class, which does not come as a big surprise given the market conditions and inflationary fears.

Hedge Funds

Increased interest and sentiment is in line with observations of improved performance by select hedge fund managers and client desire to position their portfolios to balance opportunity with uncertainty.

Private Equity

Favourable sentiment toward private equity is a continuing theme, although a shift into neutral sentiment seems likely on the horizon given the concerns of an overheated market with too much money chasing too few targets and the ticking clock on deploying funds tied up in Special Purpose Acquisition Companies (SPAC). Within historic periods of economic turmoil, alternative investment managers have been at the forefront of addressing and exploiting periods of dislocation and change as is observed from this sentiment.

Crypto Assets

In general, a conservative approach is observed from respondents, with "wait, watch and learn" the popular approach.

Market to Market Value

A remarkable improvement in portfolio valuations compared to prior years is indicative of the opportunistic sectors that a significant number of respondents have invested in and benefitted from in the past 12 months. This also shows that FOs have reacted to COVID-19 effectively and have made up for losses in the beginning of the pandemic. However, the gains significantly vary based on the assets under management and appear to have direct linkage to scale. Gains also varied across regions,

potentially driven by differing portfolio weights tied to geography.

Portfolio Actions

Analysis of the portfolio actions indicates a definitive shift from caution (sell off and cash conservation) to opportunistic investing in private equity and real estate. Interestingly, use of capital markets for structured products and/or to hedge positions appears to remain at low levels of interest.

Future Outlook

There appears to be a sense of cautious optimism driven by a wide variety of opposing influences including concerns such as COVID, perception of peak market valuations, and inflationary issues.

Direct Investments

The allocation to direct investments continues to increase. Around 44% of all family offices respondents reported over 25% of their portfolio was assigned to direct investments. Asia Pacific-based FOs appear to invest a significantly large portion of their portfolio in direct investments to amplify returns.

Sectors and Industries

Information Technology, Healthcare, Real Estate, Financials and Energy remain as the top 5 sectors for direct investing as well as the overall portfolio investing for more than two-thirds of the FO respondents with Information Technology topping the list, followed by Healthcare. Year over year, the materials sector has shown a substantial increase in interest which may be attributable to the interest in rare materials required for battery technologies, etc.

Geography and Bias for Investing

There continues to be a fair amount of bias from investors in choosing their home geography for investing despite potential upsides by seeking a global mix. Nearly 44% of respondents indicated their portfolio is overweight with investments in their home geography versus 56% indicating a balanced global allocation.

Sustainability and ESG Investing

FOs are gradually evaluating and aligning their portfolio for sustainability, which perhaps reflects a need for greater engagement especially with the next generation, for whom this is generally a topic of keen interest. To gauge the willingness of FO investors to perhaps consider lower-than-market returns to invest and scale technologies to fight climate change, the survey showed that while a majority would not consider it at this time, they would move somewhat if their peers co-invested. It also appears that FOs managing under \$500 million would be more inclined in taking a more active role. It is possible that larger family offices manage their investment mandates and portfolio strategies distinctly and separately from social investing or link such investments to their philanthropic giving.

Crypto Assets

With regard to crypto asset allocation and given the prominence cryptocurrencies FOs are showing a growing interest in this topic. FO executives are seeking opportunities in the infrastructure and platform space versus cryptocurrencies themselves. The survey indicates that there is a mix of interest and skepticism in investing in crypto.

Next Generation and Other FO Data

Looking at perspectives on some of their biggest issues and challenges in managing their respective FOs, the respondents indicated their biggest challenges were managing transition to the next generation and keeping up with technology. Many respondents also indicated that they are either not fully prepared or working on ensuring that the next generation is fully equipped to take on the family business and carry forward the principal's vision.

Contradictions in FO Investment Strategies

Divergent views on the economy reflect the contradictory views from survey results. The two primary investor concerns from the survey were inflation and COVID-19. It is thought however, though higher, abnormal levels of inflation will persist during the current period of uneven economic growth, the probability that we will reach supply– demand equilibrium in 2022 remains high.

The battle against the pandemic remains more than just a “background” factor for markets. The bond market indicates that sustained inflation is unlikely and when markets prevent fixed income investors from generating positive returns after inflation, equities and alternative investments will play even more important roles in asset allocation.

Given these views, the amount of cash held by family offices makes little sense. The excuses for holding cash reserves (“waiting for future opportunities” or “seeking safety”) are inconsistent with real opportunities in markets, both public and private.

Dividend equities, healthcare and growth companies all stand to benefit from the environment we are now likely to be in for the next several years. Private equity, real estate and certain other sectors of the alternatives market present much better prospects. They are beneficiaries of sustained, low interest rates. Yet, the survey did not indicate a marked FO interest in growing these alternative portfolios. While broadly there is an accelerating interest in direct private investing and co-investments, these are areas that present opportunities and challenges for FOs.

Finally, diversification and quality should be the watchwords of the coming years. As 2022 unfolds, it is expected that returns will flow to areas of the economy that can sustain growth and increase profitability.

Concluding Remarks

There can be no doubt that FOs remain willing to sacrifice medium-term returns to maintain high levels of liquidity. A preference for flexibility, liquidity and the ability to act quickly in the face of opportunity remain the key drivers.

Direct investing in private enterprise has become real. This reflects a deep confidence in the flexibility and strength of the global economy. It also underlines the vital role FOs play in supporting innovation, entrepreneurship and the dynamic development of the stakeholder economy, creating jobs and new solutions to the challenges of our day.

Lastly, given all the coverage and focus from the asset management industry, sustainability and ESG is not a portfolio priority for roughly half of the participants in the survey. Perhaps that reflects the wide extent to which ESG has already been embraced. It may also reflect a need for more in-depth conversations, especially with the next generation, where this is a primary driver of investment allocation.

Adapted from Citi Private Capital Group Family Office Survey 2021, conducted in May/June 2021