The Truth About Secondaries: Separating Myth from Market Opportunity

Executive Summary:

- **Secondaries are a core component of private market investing, offering liquidity for sellers and compelling benefits for buyers.**
- **As the secondaries market has expanded, so have misconceptions. Many investors new to this space struggle to understand the value of secondary assets and remain uncertain about the future of this evolving private market sector.**
- **This article unpacks what's myth, what's fact, and where the opportunities live.**

The secondaries market has grown into a vital force within private market investing, but many investors misunderstand or underestimate its potential. Here's a closer look at how secondaries work and how Hamilton Lane is identifying compelling opportunities in this rapidly evolving space.

The context

A secondary is a transaction in which one investor sells their existing interest in a private fund to another investor. There are three broad types of secondary transactions:

- LP interests: A buyer becomes a replacement limited partner in an existing fund.
- GP-led continuation vehicles: A general partner creates a new fund to acquire assets from an existing portfolio.
- Complex deals: Customized deals that span multiple strategies or asset types.

The key benefits of secondaries are consistent across all transaction types. Buyers gain discounted access to mature assets with the potential for faster returns and J-curve mitigation. Sellers benefit from early liquidity in an otherwise illiquid asset class.

Because of these benefits, the secondaries market has evolved rapidly, leading to three common myths.

Myth 1: Secondaries Are Sold at a Discount, But It's Not a "Real" Discount

Myth: Secondaries are often purchased at a discount to net asset value (NAV), leading some to believe these discounts artificially boost reported returns without reflecting true value creation.

Reality: It's true that secondary transactions are often completed at a discount to NAV, and yes, that can create an initial unrealized gain for the buyer. But this isn't artificial. It represents real value and can enhance returns for the fund.

The discount can be confusing because it:

- **Highlights a key difference from public markets:** In public markets, stock prices adjust instantly based on trades. In contrast, private equity valuations are set quarterly by the GP based on fair market value and industry-standard accounting principles. When a secondary buyer purchases a fund commitment at a discount, the fund's net asset value remains the same, based on the GP's mark, not the purchase price. If private equity operated like public markets, one discounted sale could suddenly reset the value of an entire fund, creating chaos in a system designed for long-term investing.
- **Reflects a time lag:** When investors sell their stake in a private equity fund, the deal is usually priced based on the fund's most recent reported value, even though that valuation may be several months out of date. Because private equity firms revalue their holdings quarterly—and send those figures out later—there's often a delay between when the valuation was set and when the transaction actually closes. During that window, the underlying companies in the fund might be sold, repriced, or affected by other events. Those changes, whether positive or negative, accrue to the buyer. So, while the seller negotiates a discount based on an older snapshot, the buyer may end up with more (or less) value than anticipated.
- **Emphasizes a short-term metric:** While discounts offer an initial uplift in returns, they represent just one component of secondary transaction returns. In many secondary transactions, future appreciation of the assets represents a far greater portion of secondary returns than the discount, particularly if a secondary manager can buy quality assets and quality fund manager access.

While discounts offer an attractive entry point, true value creation relies on the GP's portfolio management and the buyer's skill in selecting high-quality opportunities.

The Hamilton Lane approach: At Hamilton Lane, our secondary investment strategy is designed to deliver consistent, long-term value to our funds. We target an average closing discount of 15-20%, with approximately two-thirds of the gains anticipated to come from post-purchase appreciation.

HAMILTON LANE CASE STUDY

In this case study, you can see how Hamilton Lane manages relationships to execute deals and provide downside cushion through the strategic use of secondaries.

Background

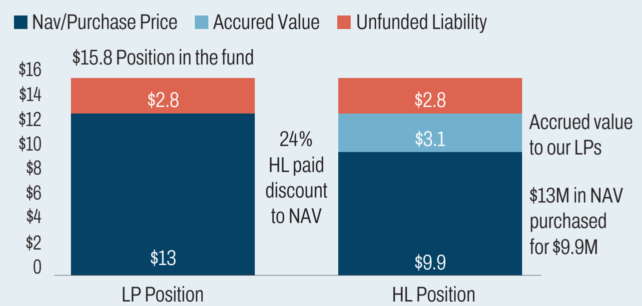
- An LP wanted to sell a mature investment totaling $15.8M. In secondary transactions, pricing is expressed as a percentage of recent net asset value (NAV).
- The LP restricted the offer to secondary investors with strong primary relationships with the GP, which limited competition among buyers.

Transaction

- Hamilton Lane's GP relationship allowed us to purchase, as the secondary buyer, the fund position from the LP, or secondary seller.
- Secondaries are often purchased at a discount to NAV, in this case 24%. This discount allowed us to buy $13M in NAV at $9.9M.

Hamilton Lane's Position

- We received an immediate return of $3.1M, which also provided downside cushion.
- Hamilton Lane will fund all future capital calls and receive future distributions.



This approach emphasizes:

- Rigorous due diligence in selecting high-quality investments with strong growth potential, and high-quality private equity managers with strong track records.
- Opportunistic entry points, capitalizing on discounts driven by market inefficiencies or LP liquidity needs.
- Diversification across funds, strategies, and vintages to mitigate risk and enhance return potential.

By combining disciplined underwriting with a focus on long-term fundamentals, Hamilton Lane helps private wealth clients navigate the complexities of the secondary market, turning discounts into meaningful opportunities for portfolio growth.

Myth 2: Secondaries Are "Cast-Offs" from Institutions Trying to Get Out of Private Equity

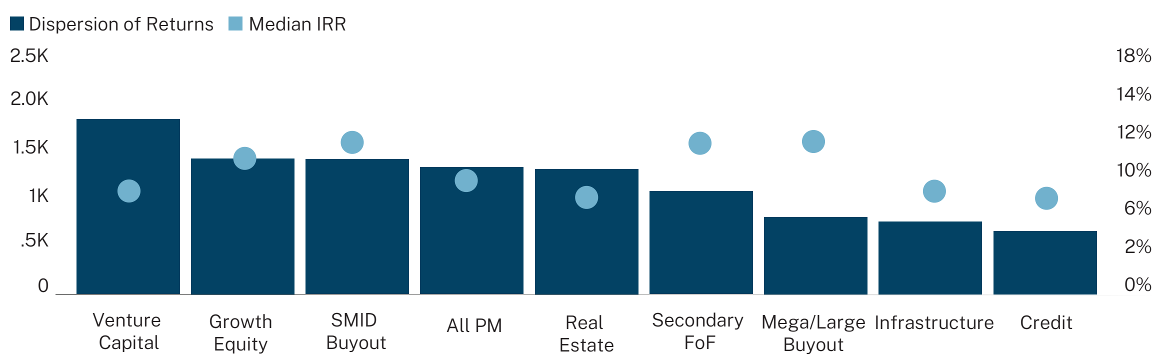
Myth: Some critics suggest that secondaries are low-quality assets that institutions unload to exit underperforming private equity investments.

Reality: The quality of secondaries spans the full spectrum, just like any other asset class. These facts dispel the "cast-off" myth:

- **Institutional sources still fund the bulk of secondaries.** Most secondary capital comes from institutional investors*, including pension funds, sovereign wealth funds, and endowments, which have a long track record of investing in secondary funds.
- **Portfolio management and liquidity needs are driving most of today's deals.** Over the years, the rationale for selling on the secondary market has evolved from an investor being distressed to portfolio management. For example, in today's market, distributions from closed-end funds are at lows not seen since the Great Financial Crisis (GFC)*, creating unusual pressure for liquidity. This has created secondary market opportunities with high-quality deals available at discounts.
- **Secondaries have historically offered strong returns.** (see chart). The track record of secondaries highlights the potential opportunity.

This chart shows that not only are secondary funds competitive in terms of Internal Rate of Return (IRR), but they also have a lower dispersion of returns compared to other strategies, potentially reflecting the relative maturity of secondary assets.

Dispersion of Returns by Strategy
Vintage Years: 1974-2018, Ordered by Spread of Returns



Source: Hamilton Lane Data via Cobalt (March 2025)

The Hamilton Lane Approach: At Hamilton Lane, we focus on sourcing high-quality secondary opportunities. Our competitive edge lies in our proprietary data platform—think of it as our proprietary version of the Bloomberg Terminal for private markets. With insights into more than 164,000 portfolio companies**, we bring unmatched transparency and context to every transaction.

For over three decades, we've worked with many of the industry's top general partners. This gives us access to detailed historical data—like how a company or a manager has performed during different market cycles. That level of insight goes directly into our due diligence process, helping us separate signal from noise and identify secondaries with real long-term value.

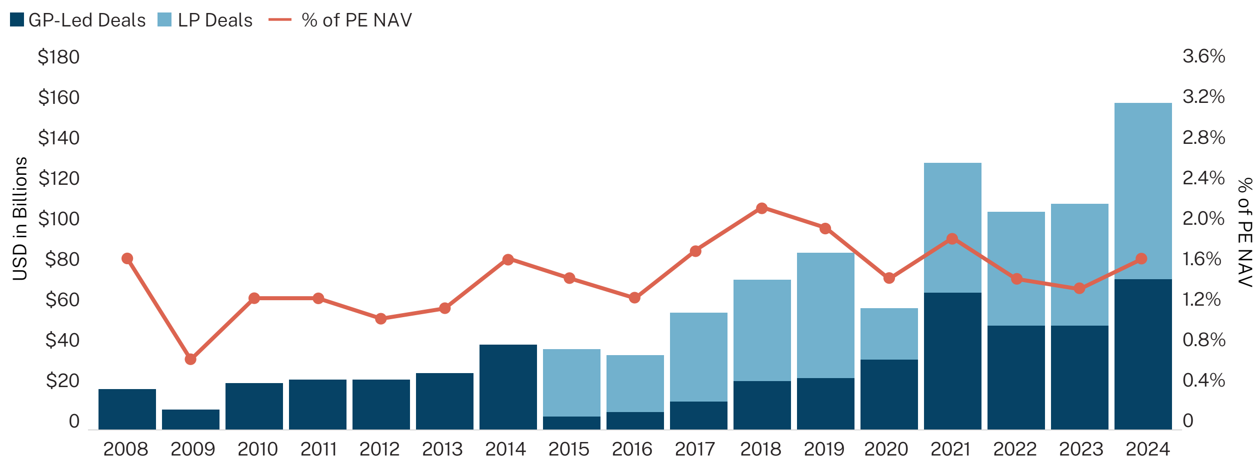
Myth 3: Secondaries Are a Temporary Market Phenomenon

Myth: A common misperception is that secondaries are only cyclical trends driven by temporary market conditions, such as liquidity constraints or shifts in investor sentiment.

Reality: The secondary market has evolved into a permanent fixture in private markets. Its growth reflects structural changes, including increased private equity allocations and the need for flexible portfolio management.

Since 2009, the private equity secondaries market has achieved a compound annual growth rate exceeding 20% driven by increasing allocations to private equity, evolution of transaction types such as the introduction of GP-led transactions, and a heightened demand for sophisticated portfolio management solutions.

Secondary Market Volume



Source: Jefferies Secondary Market Review (January 2025), Hamilton Lane Investment Database (January 2025)

As capital inflows from institutional and private wealth investors into private markets continue to grow, the need for liquidity, diversification, and vintage-year balancing will become increasingly critical. Far from being mere discounted assets or distressed sales, today's secondary transactions reflect a sophisticated and strategic approach to private markets investing.

The Hamilton Lane Approach: Hamilton Lane has long recognized the secondary investment opportunity for our investors. With 24 years of experience in secondary investments, we have delivered high-quality investments that align with our clients' long-term goals.

Our proprietary data system, extensive network, and rigorous vetting process enable us to identify and secure high-quality secondary opportunities. We prioritize long-term performance, ensuring our clients capitalize on market dynamics while mitigating risks.

Conclusion:

The secondary market has transformed from a niche liquidity tool to a dynamic engine for portfolio optimization.

With innovative structures and consistently strong performance, secondaries offer both buyers and sellers compelling benefits. As investor needs continue to shift, secondaries are poised to remain a cornerstone of modern portfolio management.

[1]Source: Pitchbook Q3 2023 Global Private Markets Fundraising Report. Average number of funds raised over the trailing 3 years.

Strategy Definitions

All Private Markets: Hamilton Lane's definition of "All Private Markets" includes all private commingled funds excluding fund-of-funds, and secondary fund-of-funds.

CI Funds: Any fund that either invests capital in deals alongside a single lead general partner or alongside multiple general partners.

Co/Direct Investment Funds: Any PM fund that primarily invests in deals alongside another financial sponsor that is leading the deal.

Corporate Finance/Buyout: Any PM fund that generally takes control position by buying a company.

Credit: This strategy focuses on providing debt capital.

Distressed Debt: Includes any PM fund that primarily invests in the debt of distressed companies.

EU Buyout: Any buyout fund primarily investing in the European Union.

Fund-of-Funds (FoF): A fund that manages a portfolio of investments in other private equity funds.

Growth Equity: Any PM fund that focuses on providing growth capital through an equity investment.

Infrastructure: An investment strategy that invests in physical systems involved in the distribution of people, goods, and resources.

Late-Stage VC: A venture capital strategy that provides funding to developed startups.

Mega/Large Buyout: Any buyout fund larger than a certain fund size that depends on the vintage year.

Mezzanine: Includes any PM fund that primarily invests in the mezzanine debt of private companies.

Multi-Management CI: A fund that invests capital in deals alongside a lead general partner. Each deal may have a different lead general partner.

Multi-Stage VC: A venture capital strategy that provides funding to startups across many investment stages.

Natural Resources: An investment strategy that invests in companies involved in the extraction, refinement, or distribution of natural resources.

Origination: Includes any PM fund that focuses primarily on providing debt capital directly to private companies, often using the company's assets as collateral.

Private Equity: A broad term used to describe any fund that offers equity capital to private companies.

Real Assets: Real Assets includes any PM fund with a strategy of Infrastructure, Natural Resources, or Real Estate.

Real Estate: Any closed-end fund that primarily invests in non-core real estate, excluding separate accounts and joint ventures.

ROW: Any fund with a geographic focus outside of North America and Western Europe.

ROW Equity: Includes all buyout, growth, and venture capital-focused funds, with a geographic focus outside of North America and Western Europe.

Secondary FoF: A fund that purchases existing stakes in private equity funds on the secondary market.

Seed/Early VC: A venture capital strategy that provides funding to early-stage startups.

Single Manager CI: A fund that invests capital in deals alongside a single lead general partner.

SMID Buyout: Any buyout fund smaller than a certain fund size, dependent on vintage year.

U.S. Mega/Large: Any buyout fund larger than a certain fund size that depends on the vintage year and is primarily investing in the United States.

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VC/Growth: Includes all funds with a strategy of venture capital or growth equity.

Venture Capital: Venture Capital incudes any PM fund focused on any stages of venture capital investing, including seed, early-stage, mid-stage, and late-stage investments.

Index Definitions

MSCI World Index: The MSCI World Index tracks large and mid-cap equity performance in developed market countries.

DISCLOSURES

As of January 31, 2024