Hamilton Lane®

Private Markets Survey

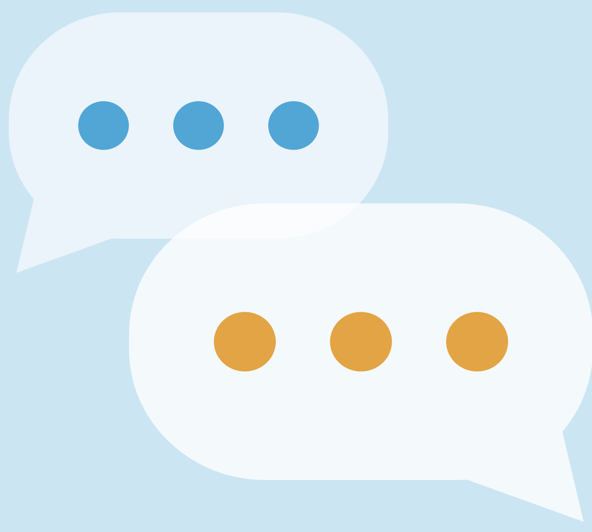
2016 / 2017

Representin’

Hamilton Lane’s Private Markets Survey offers a look into the insights and opinions of the world’s most prominent private markets players. We polled a diverse group of more than 50 global practitioners, including both limited partners and general partners, to gather their thoughts on the current investment environment and how they believe private markets investing will evolve.

What makes this survey so valuable is the diversity, caliber and influence of its respondents: A general partner group with an aggregate of $1+ trillion in AUM and a collection of limited partners from around the world representing more than $2.5 trillion in assets.

>>> It is important to note as you read and consider the responses in this year’s report that the survey was conducted in October 2016, months after the Brexit referendum, but prior to Donald Trump unexpectedly winning the U.S. presidential election. Throughout the coming year, we will closely monitor the impact that the ‘Trump Effect’ is having on the financial markets, as well as the rising tide of populism and nationalism that continues to sweep across the globe.



Give Me the Skinny

Our survey covered a lot of ground, so we've attempted to summarize some of the key takeaways below. (For those who prefer to read our more in depth and – in true Hamilton Lane style – candid analysis, feel free to skip ahead to page 12.)

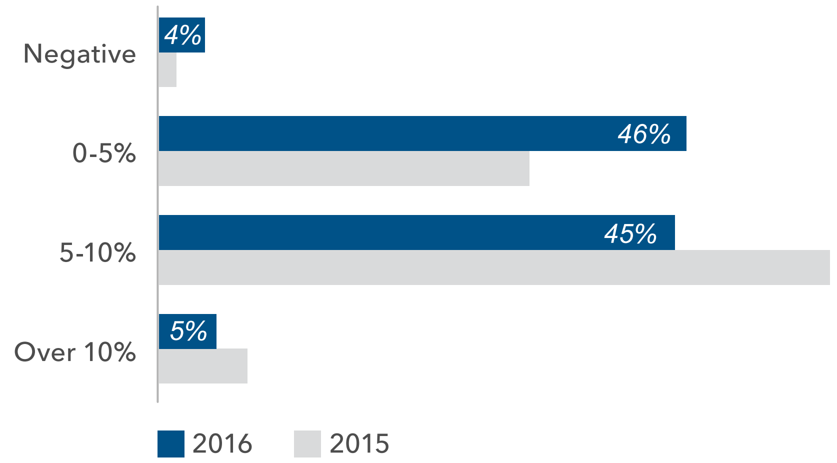
- Investors and fund managers generally optimistic about the private markets, anticipating returns will continue to outpace those of the public markets around the globe
- Outlook for the public markets varies by region: Most anticipate continued strong performance in the U.S.; prospects for the emerging markets slightly less exuberant than last year; uncertainty surrounding Europe pushing return expectations for the region downward
- Vast majority of LPs plan to maintain or increase private equity allocations in 2017
- Private credit remains the hottest sector, with investors bullish on return expectations and allocation plans
- GPs remain confident in future of their businesses; anticipating increased regulation and oversight of investment and operational activities

Global Public Equity Return Expectations

Just Give it to Me Straight

The U.S.: Steady As She Goes

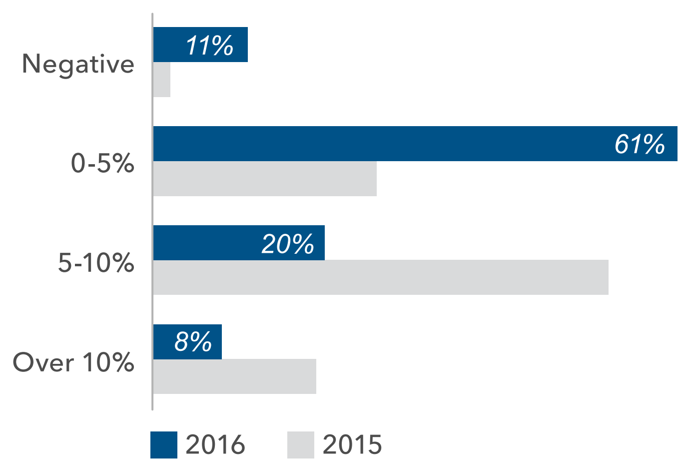
I expect public equity returns in the U.S. over the next three to five years to be:



- U.S. public market return expectations slightly more tempered this year, with respondents almost evenly split in anticipating returns in either the 0-5% range or the 5-10% range for the next three to five years

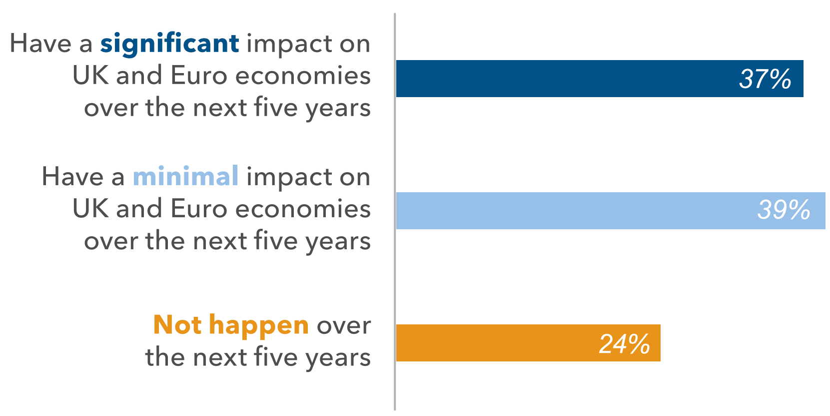
The Eurozone: Proceed with Caution

I expect public equity returns in Europe over the next three to five years to be:

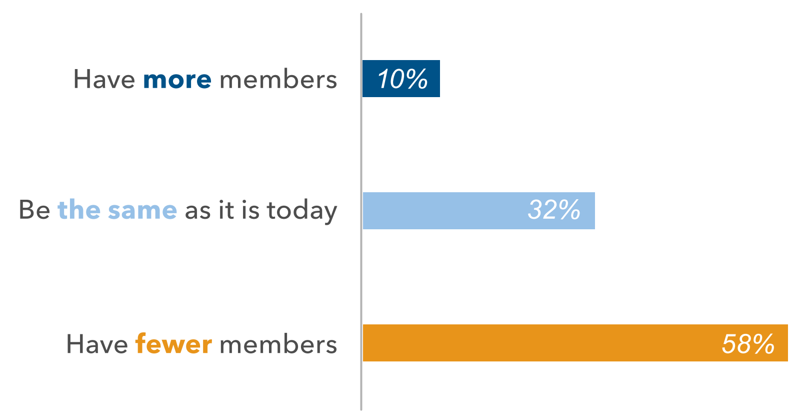


- Severely diminished prospects for European public equity returns, representing a significant reversal of last year's results
- Private markets practitioners divided on the magnitude of Brexit's potential impact and even when or whether it will ultimately occur
- Split expectations for Eurozone's future, although the majority of respondents predict that the region will have fewer members in five years' time

Brexit will:

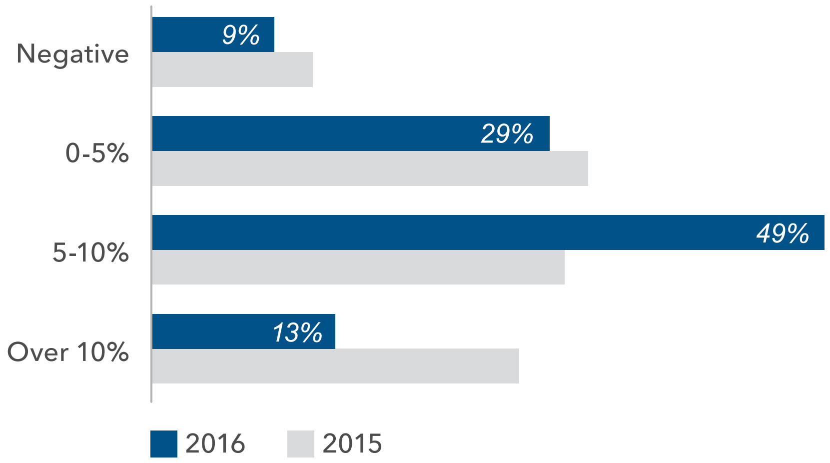


In five years, the Eurozone will:

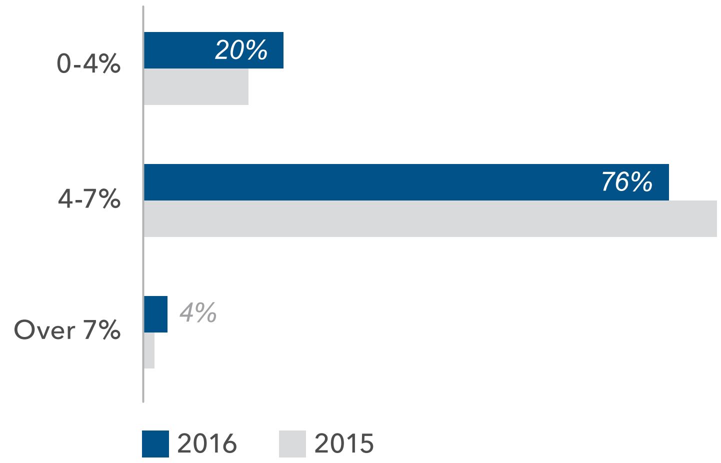


The Emerging Markets: Keeping a Watchful Eye

I expect public equity returns in emerging markets over the next three to five years to be:



What is your expectation for annual GDP growth in China over the next three to five years?

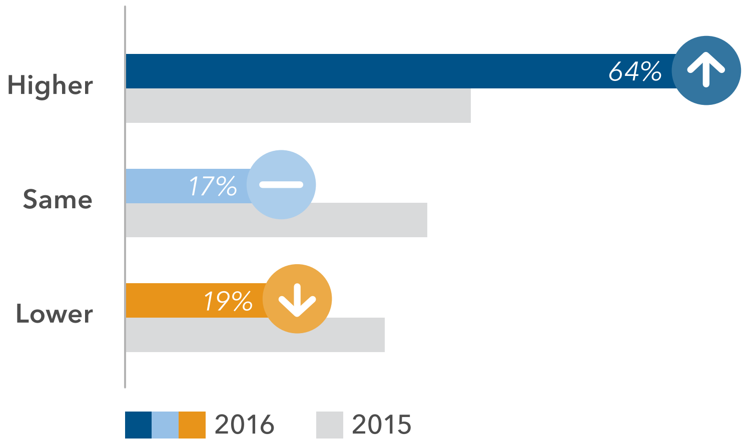


- **Returns in the 5-10% range expected to continue, but the exuberance around emerging markets public equities has abated somewhat**
- **GDP growth in China expected to remain fairly strong over the next three to five years**

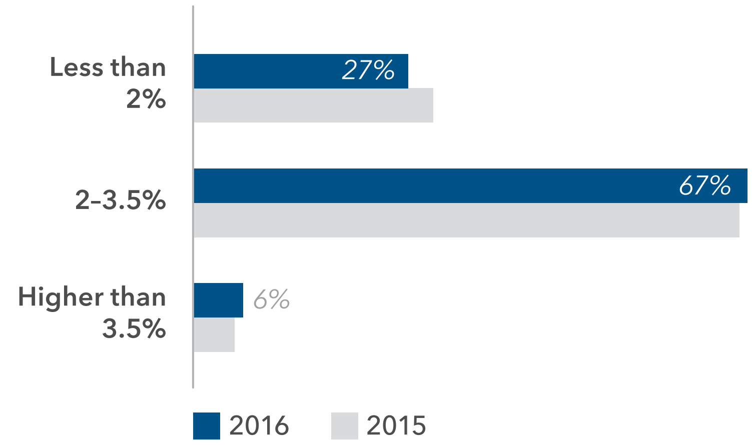
Currency and Interest Rate Expectations

You're Gonna Hear Me Roar

In three years, the U.S. Dollar, against the Yen and the Euro, will be:



The 10-year U.S. Treasury rate, currently around 1.6%, will, in three years, be:

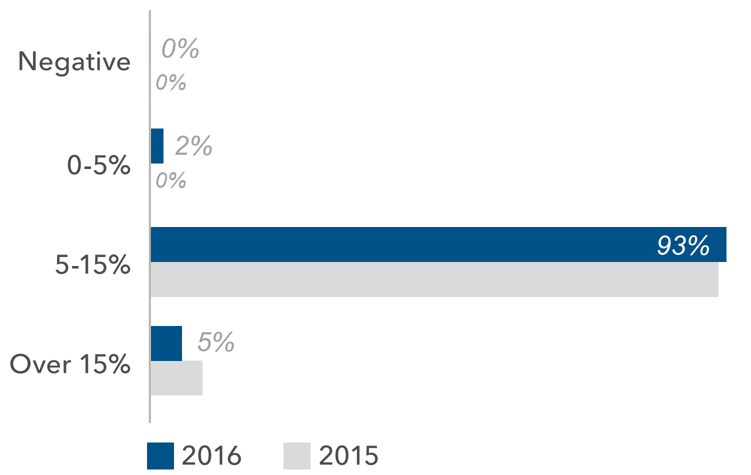


- **Most respondents quite bullish on the strength of the U.S. Dollar, predicting that it will be higher than the Yen or Euro in three years' time**
- **Majority believe that the 10-year U.S. Treasury rate will likely increase compared to current levels**

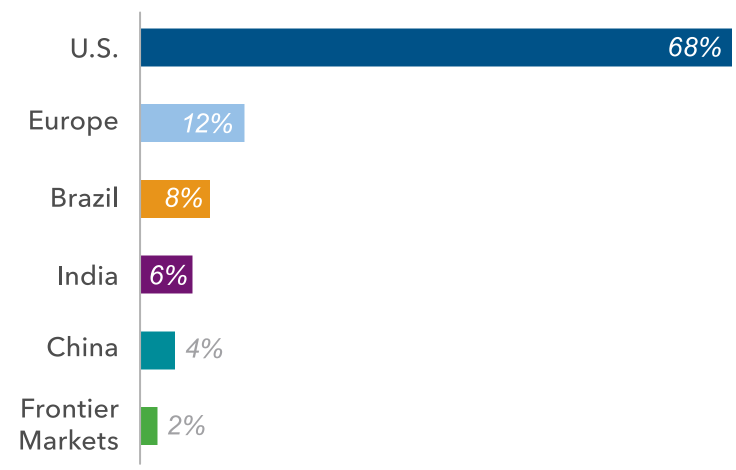
Private Equity Return Expectations

Looking Good, Billy Ray! Feeling Good, Louis!

What is your expectation for private equity returns over the next five years, assuming public equity returns average 5%?



Deals done in which geography will generate the best returns over the next three to five years (regardless of fund geography)?



- **Vast majority of respondents continue to anticipate private equity returns ranging from 5 to 15% over the next five years**
- **With 68% of the votes, the U.S. claims the top spot as the geography most likely to generate the best returns over the next three to five years**

>>> I look good. I mean, really good. Hey, everyone! Come and see how good I look!

Evaluating our own statistics from the Hamilton Lane Fund Investment Database, we see that private equity's absolute performance has remained strong over the last decade. Looking at the 10-year TWR numbers, private equity outpaces the Russell 3000 index by 200 basis points and the MSCI World index by nearly 800 basis points.

10-Year Asset Class Risk Adjusted Performance - As of 6/30/2016[1]

Asset Class	Annualized Total Return	Annualized Volatility	Sharpe Ratio
Private Equity	9.4%	12.7%	0.51
REITs	7.5%	25.6%	0.18
Domestic Equities	7.4%	17.0%	0.26
High-Yield Bonds	7.1%	11.7%	0.36
High-Grade Bonds	6.9%	6.6%	0.61
Hedge Funds	3.6%	7.7%	0.09
Infrastructure	1.7%	17.6%	< 0
International Equities	1.6%	19.9%	< 0
Emerging Market Equities	1.1%	24.5%	< 0

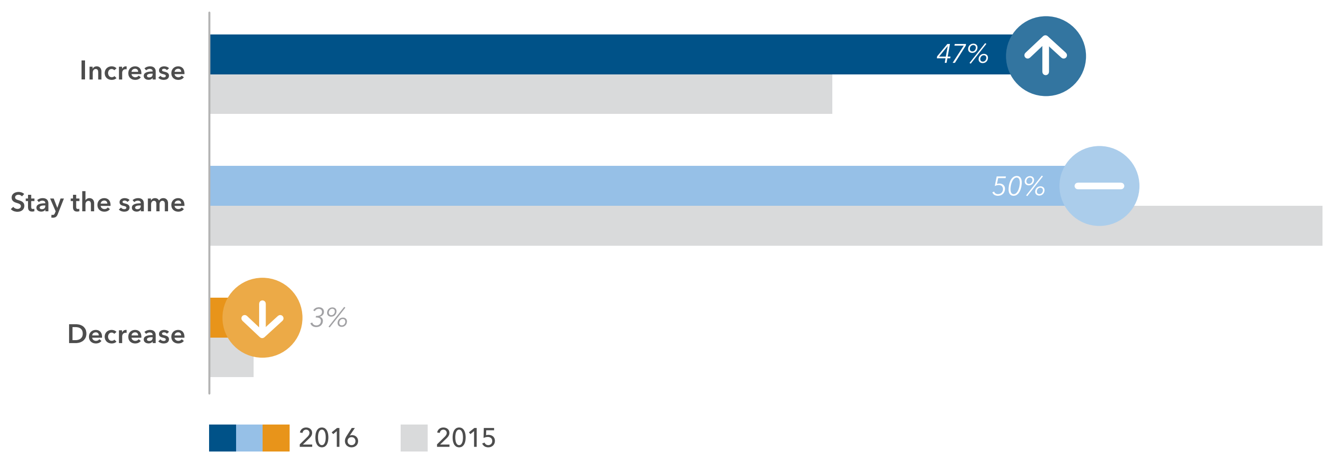
Please refer to endnotes on page 16

Allocation Plans

Just Keep Swimming

LPs **- Your allocation to private equity today is:**

LPs **- Your allocation to private equity for 2017 will:**



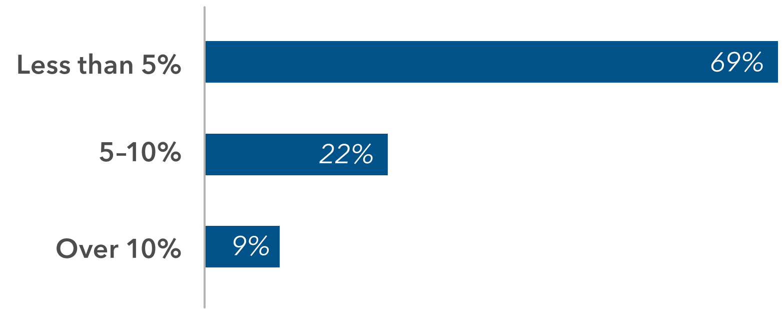
LPs **- If allocation is going up, it is because:**

- **Current allocations to private markets vary, with a growing percentage of LPs planning to increase PE allocations**
- **Increased allocations driven primarily by a belief that PE will outperform the public markets**

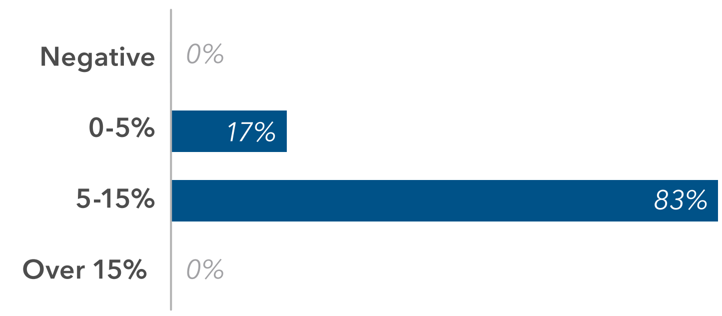
Continued Opportunities Seen in Private Credit

Nobody Puts Baby in the Corner

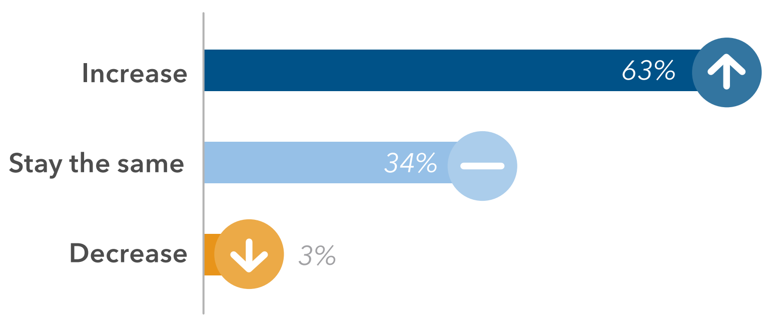
LPs - My current allocation to private credit is:



What is your expectation for private credit returns over the next five years, assuming public equity returns average 5%?



LPs - My allocation to private credit strategies in the next year or two will:

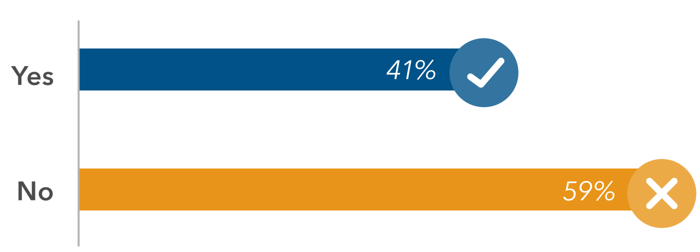


- 97% of LPs polled plan to maintain or increase private credit allocations
- Most LPs anticipating strong private credit returns over the next five years

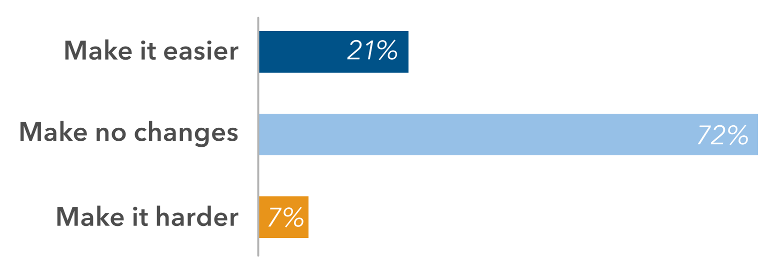
A Look at How LPs are Thinking about Secondaries

If the Price is Right

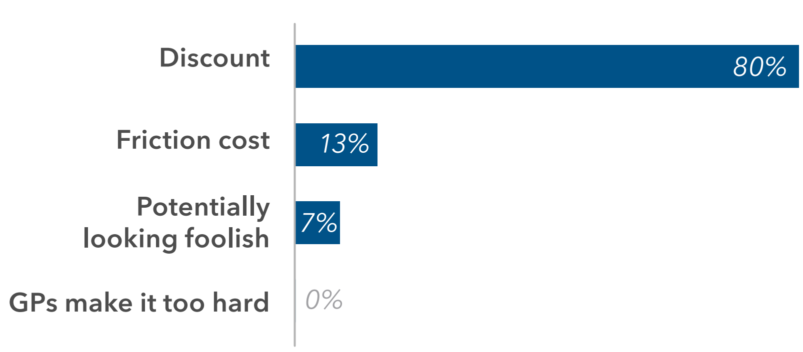
LPs - Have you ever sold a fund position in the secondary market?



GPs - My future plans to deal with LPs selling a stake in my fund is to:



LPs - The main reason not to sell in the secondary market is:

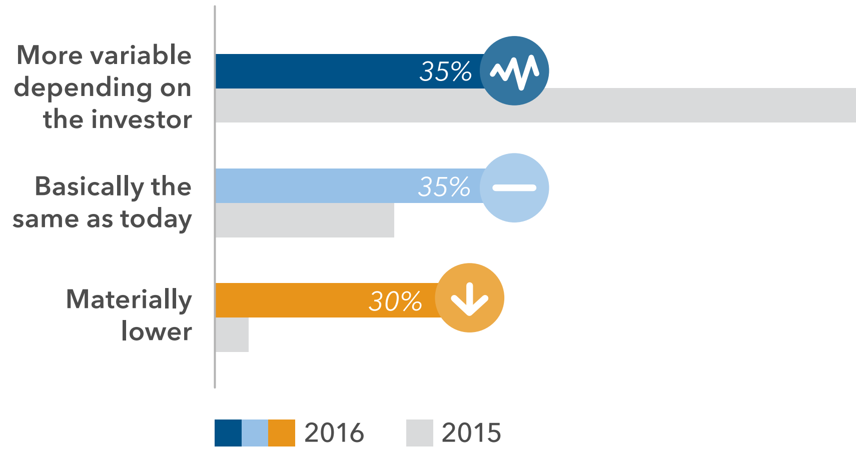


- More than 40% of LP respondents have sold at least one fund position on the secondary market
- Most GPs plan to deal with LPs selling stakes in their funds as they have been or, in some cases, plan to make it easier for investors to do so
- The main reason LPs choose **not** to sell in the secondary market is the discount

Portfolio Construction Plans and Broader Asset Class Considerations

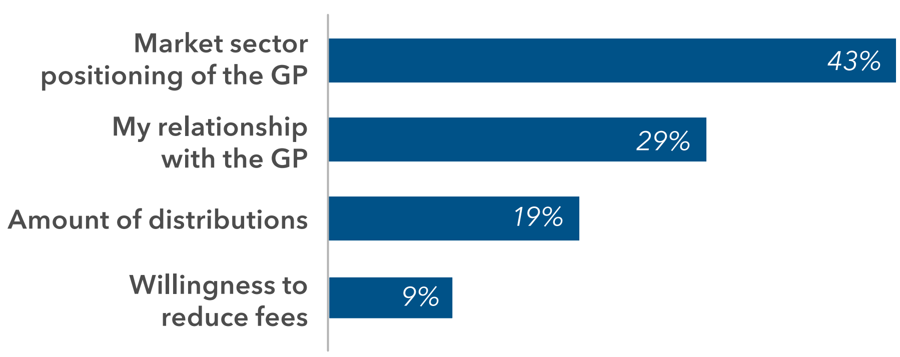
The Secret's in the Sauce

In five years, fees for PE structures will be:



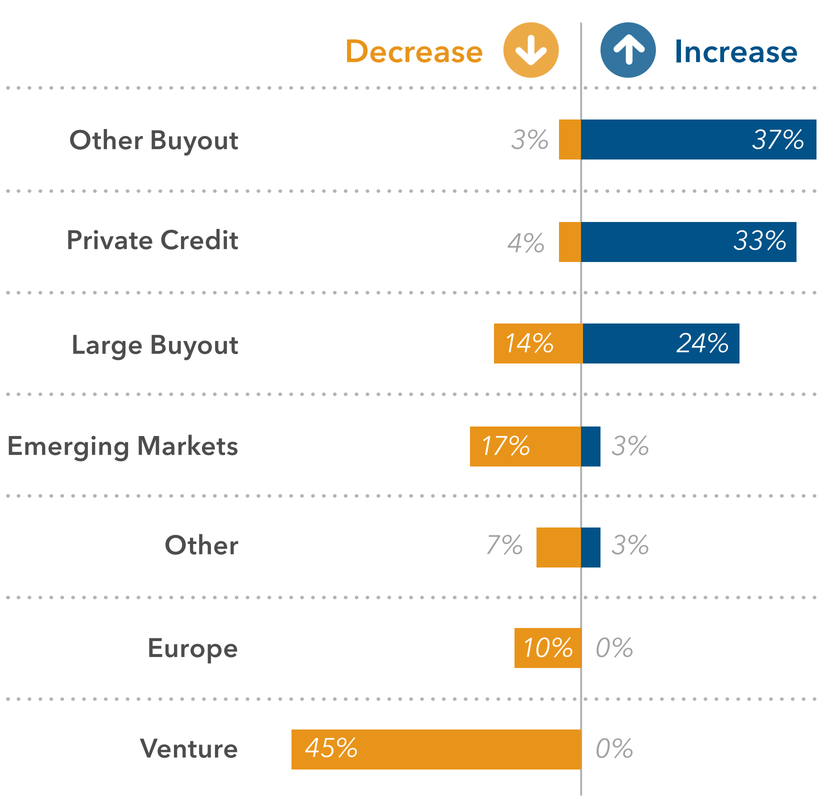
- Compared to last year's results, dramatic increase in those contending that fee structures will be materially lower in five years

LPs - The most important factor, other than track record, in a re-up decision, will be:

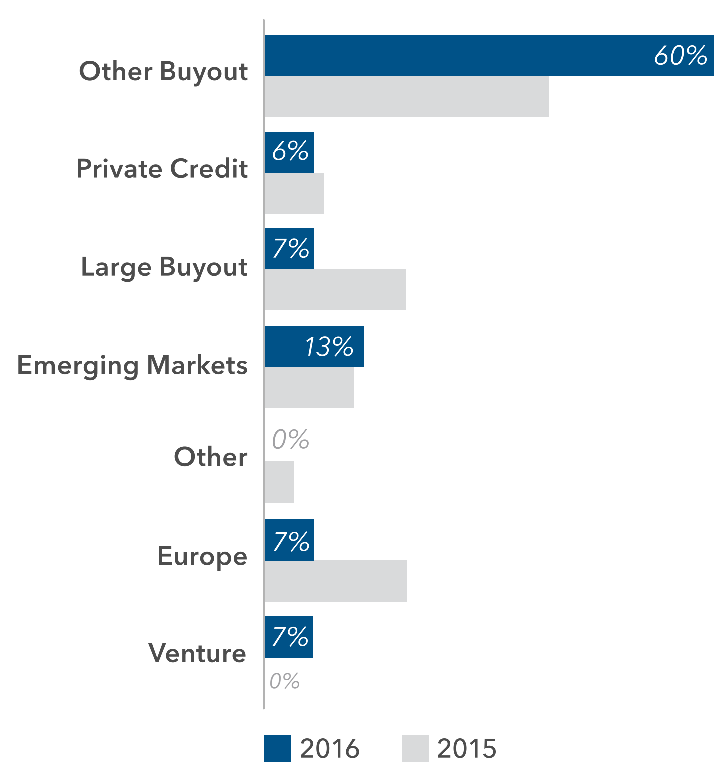


- For the most part, LPs consider the most important factor in a re-up decision (aside from track record) to be the market sector positioning of the GP
- Buyout strategies and private credit likely to see increasing LP investment activity over the next few years
- Allocations to venture and the emerging markets likely to decrease the most over the next two years
- If investing their own capital, GPs would be allocating the most to buyout with private credit far down the list

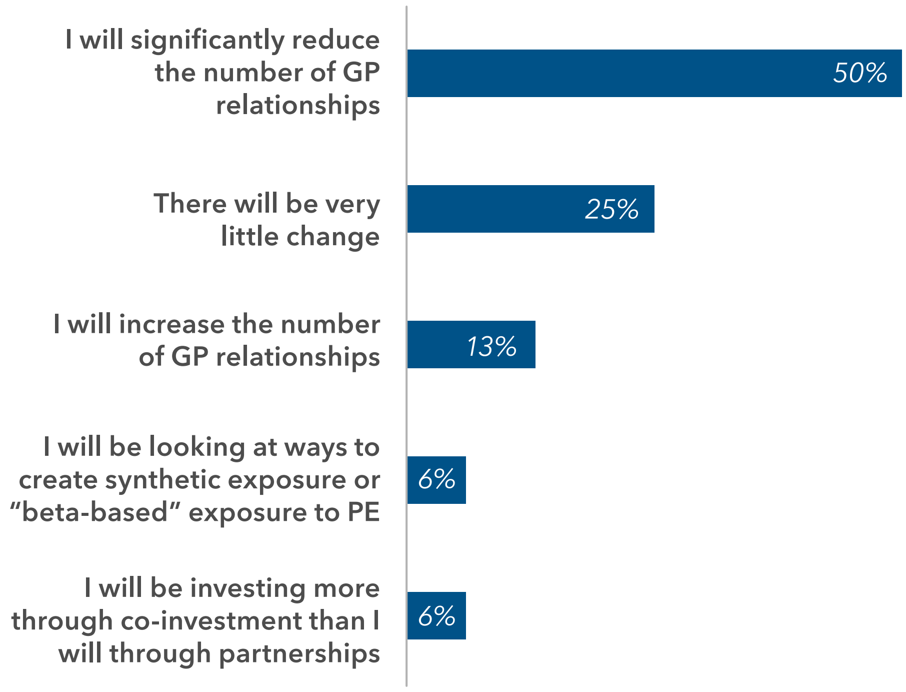
LPs - To which private equity area will your allocation increase/decrease the most over the next two years?



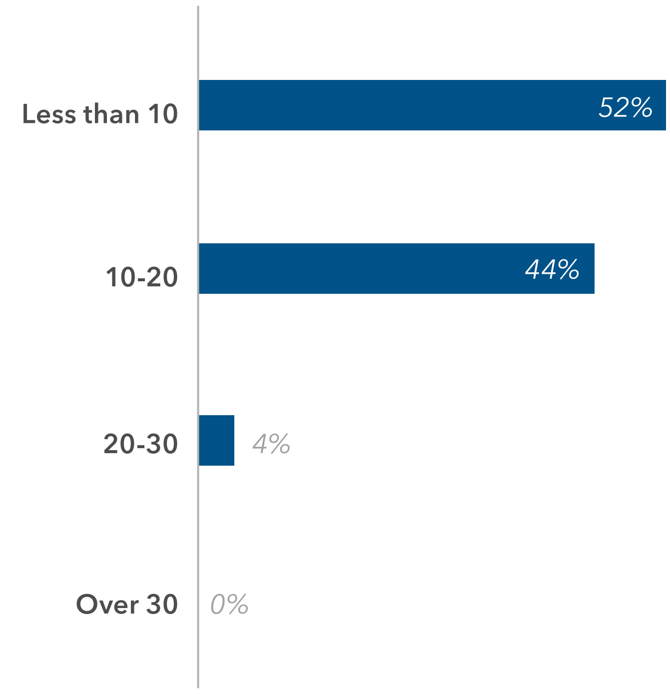
GPs - If you were investing your own money and were an LP, where would you allocate the most capital in the next two years?



LPs - Over the next five years, the biggest change to my PE portfolio will be:



LPs - I am planning to commit to this number of funds in 2017:

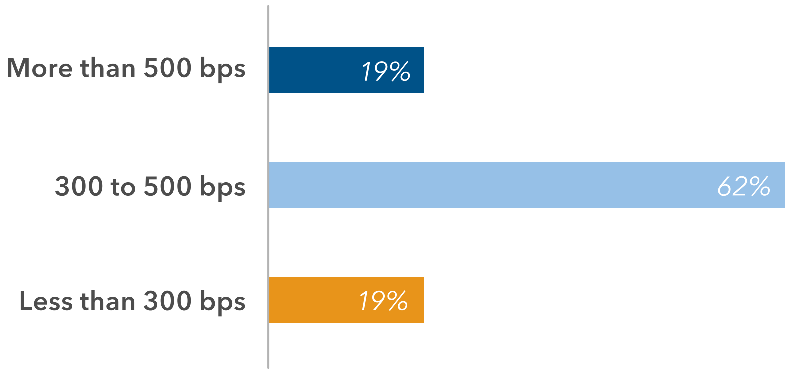


- **50% of LPs plan to significantly reduce the number of GP relationships in their portfolio**
- **More than half plan to commit to fewer than 10 funds in 2017**

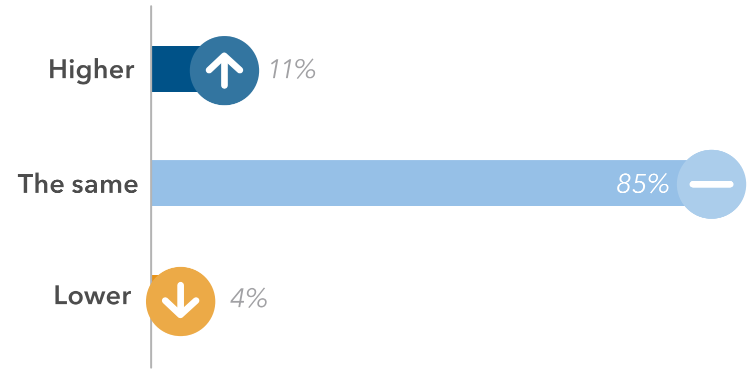
Benchmark Considerations

Too Much Is Never Enough

LPs - Over the next five years, my benchmark return for PE should be a public equity benchmark plus:



LPs - My answer to the previous question is, compared to my current benchmark:

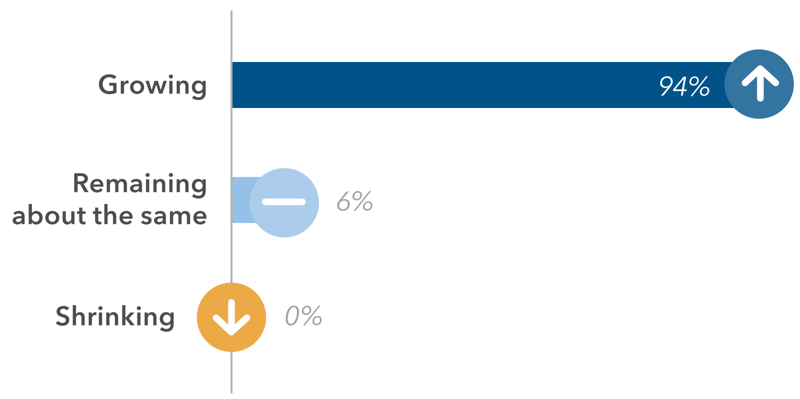


- **The majority of LPs expect PE investments to return anywhere from 300-500 bps (or higher) above their public equity benchmark over the next five years**

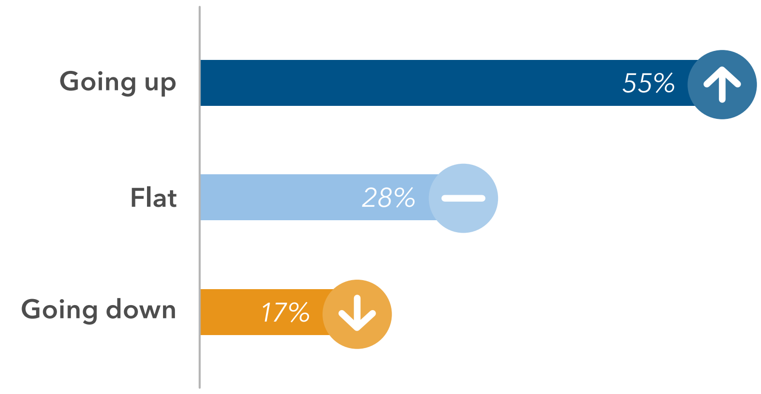
GPs Confident, See Growth in the Industry

May the Force Be With You

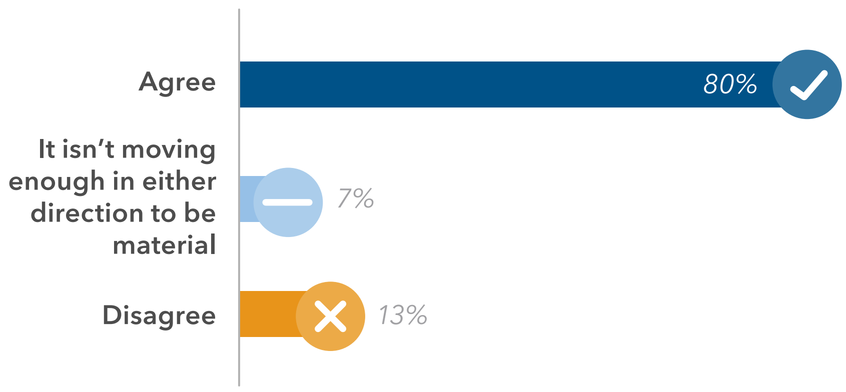
GPs **- Over the next three years, I see my team:**



GPs **- Ignoring carried interest, cash compensation for investment professionals over the next five years will be:**

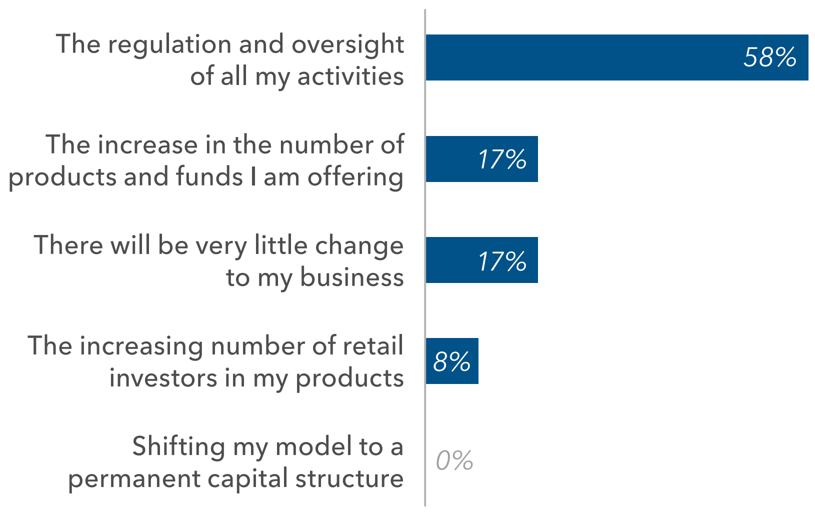


We will be increasingly in a "costs going up/fees coming down" environment.



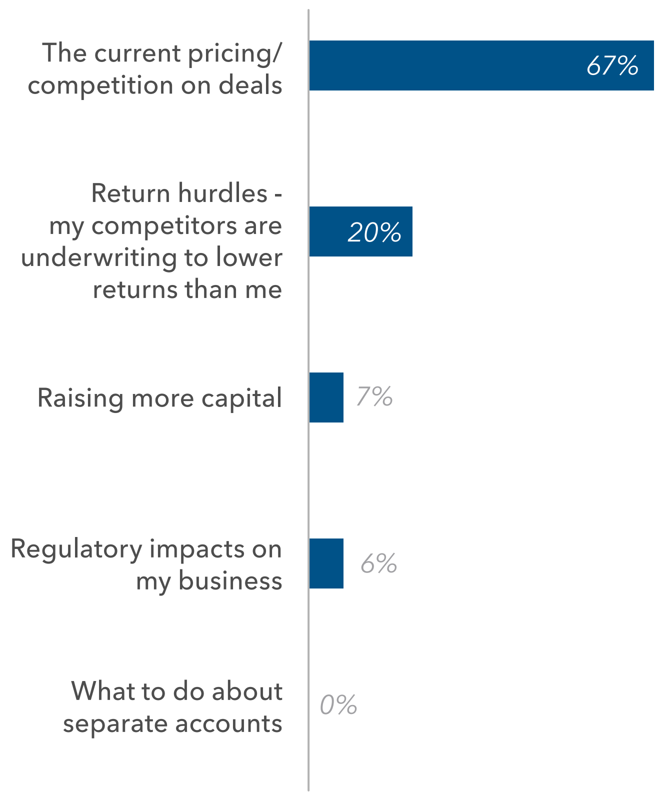
- **GPs maintaining healthy expectations around team growth and compensation**
- **GPs do not see their businesses shrinking, even as the majority foresee an increasingly "costs going up/fees coming down" environment**

GPs **- Over the next five years, the biggest change to my business will be:**



- **The majority of GPs anticipate that the biggest change to their businesses will be increased regulation and oversight of their investment and operational activities**
- **GPs most concerned about the current pricing environment and resulting competition for attractive deals**

GPs **- The biggest PE concern on my mind is:**



Words, Words, Words.

*Less than satisfied with our bulleted approach?
Never fear; additional commentary can be found here.*

It Depends on Where I Am and What I'm Doing

Return expectations for the public markets are varied by geography and largely impacted by political, economic and social developments. In the U.S., expectations about public market returns were slightly more tempered this year, with respondents fairly evenly split in anticipating returns in either the 0-5% range or the 5-10% range for the next 3-5 years. As we've seen, U.S. markets have continued to rally following Trump's victory in November. (At the time of this writing, the S&P 500 was up 6% since election day*.)

This year's survey saw severely diminished prospects for European public equity returns, representing a fairly significant reversal of last year's results. Still uncertain about the ramifications around Brexit, it's clear that respondents are divided on the magnitude of its impact and, indeed, even when or whether it will ultimately occur. When asked about the future of the Eurozone itself, our respondents were once again mixed in their expectations, although most predict that the Eurozone will have fewer members in five years' time than it does today. This combination of uncertainty around Europe is no doubt negatively affecting return prospects for the region over the next few years.

The exuberance around the return potential in the emerging markets seems to have abated to some extent. Even so, respondents continue to foresee solid return potential in these regions, with nearly half expecting returns in the 5-10% range over the next 3-5 years. This is likely in part driven by this group's expectations that GDP growth in China will remain strong over the next 3-5 years and that many of the most commonly-cited EM public indices are disproportionately comprised of Chinese companies (more than 25% of the MSCI Emerging Markets Index). Indeed, while China's 2015 GDP was the weakest it's been in 25 years at 6.9%[1], this is nevertheless a meaningful growth rate, especially when compared to that of other countries, including the United States at 2.4%[2].

What's the (Private Markets) Story, Morning Glory?

While current allocations to PE are mixed across our LP respondents (presumably a reflection of the liability structures and actuarial return targets of a diverse group of limited partners), the majority plan to maintain or increase overall private markets allocations in 2017. The two factors primarily driving this?

1. A conviction that PE will outperform public equity, and
2. A need to increase exposure to PE to account for current under-allocation.

Private markets distributions have been at or near record levels over the past few years, encouraging LPs to grow or maintain their allocations in order to stay in line with strategic allocation plans.

In other general PE news, the secondary market has come a long way from being viewed as the realm of distressed sellers only; today we know investors are increasingly using the secondary market as an active portfolio management tool and a means of rebalancing their portfolios. Concern over discounts may prevent some LPs from selling on the secondary market. While discounts have certainly narrowed since the Global Financial Crisis, there is still a price to be paid for liquidity in most areas of the secondary market.

Once More, with Fee-ling

As the private markets continue to mature, some hallmarks of the asset class – like the oft-discussed 2 and 20 fee structure – will undoubtedly evolve. And, the overall fee discussion will surely continue. As we've said before, there's no debating that private equity is a crazy expensive asset class. The fact that it manages to deliver stronger net returns than other asset classes will not eliminate the fee debate; nor should it.

And, while it seems as though our respondents are in agreement that PE fee structures will change over the next five years, they are decidedly mixed on what that will actually mean. One hint could be the dramatic increase in those contending that fee structures will be materially lower in five years compared to last year's results, which may suggest that industry practitioners are increasingly seeing or anticipating this trend taking place.

All the Fixins' of a Winning Portfolio

Turning more specifically to portfolio construction considerations, LPs view the most important factor in a re-up decision (aside from track record) to be the market-sector positioning of the GP. Given this, what sectors look the most interesting to our LP respondents over the next two years? Private credit, which stands to see increasing activity, along with buyout strategies. This is particularly significant when we look back at last year's results and see that 85% of LPs chose buyouts; a meaningful percentage has now shifted to private credit. (Interestingly, when we asked our GPs where they would allocate the most capital over the next two years if they were investing their own money as an LP, 60% said buyout whereas fewer than 7% responded with private credit.) On the flip side, and very much in line with what we saw last year, venture tops the list of areas where allocations will decrease the most over the next two years. Emerging markets took the next spot for the second year in a row.

* As of January 4, 2017
Please refer to endnotes on page 16

Moving away from specific sectors, let's look at what else is being factored into portfolio construction decisions. When asked about the biggest anticipated change to their PE portfolios, a full 50% of LPs maintained that they planned to significantly reduce the number of GP relationships in their portfolio. This was further supported by the fact that more than half responded that they plan to commit to fewer than 10 funds in 2017. It is very much in line with what's been covered in the media on this topic of late, as well as what we're hearing directly from our LP base.

The Sector Darling: Private Credit

At Hamilton Lane, we're fond of making bold predictions. In our latest annual Market Overview, we made a few around the private credit space in particular: (1) that no area of alternative investing would experience as much growth and transformation as debt investing and (2) that allocations to private credit will become as large or larger than allocations to private equity and real estate over the next five years.

Looking at the input from our survey group, it seems we might be on to something. Not only do the vast majority of respondents anticipate private credit generating meaningful returns over the next five years, but a full 97% of LPs plan to maintain or increase their private credit allocations, which are currently less than 10% of portfolios. Investors are increasingly attracted to private credit for a variety of reasons, not the least of which is that the strategy alleviates some of the challenges faced by investing in traditional private equity, including providing faster J-curve mitigation.

GP, Where Art Thou

Turning now to our GP respondents, let's look at how they're thinking about their businesses and their plans for the future. Generally speaking, GPs don't seem to be concerned about their businesses; they're confident about their prospects and are maintaining healthy expectations around the growth of their teams and compensation.

How does this jive with what we just covered in terms of LPs' plans to consolidate their number of GP relationships? Again, we think this speaks to the overall evolution and growth in the asset class, including the increasing number and diversity of private market investor participants. GPs do not see their businesses shrinking, even as the majority foresee an increasingly "costs going up/fees coming down" environment.

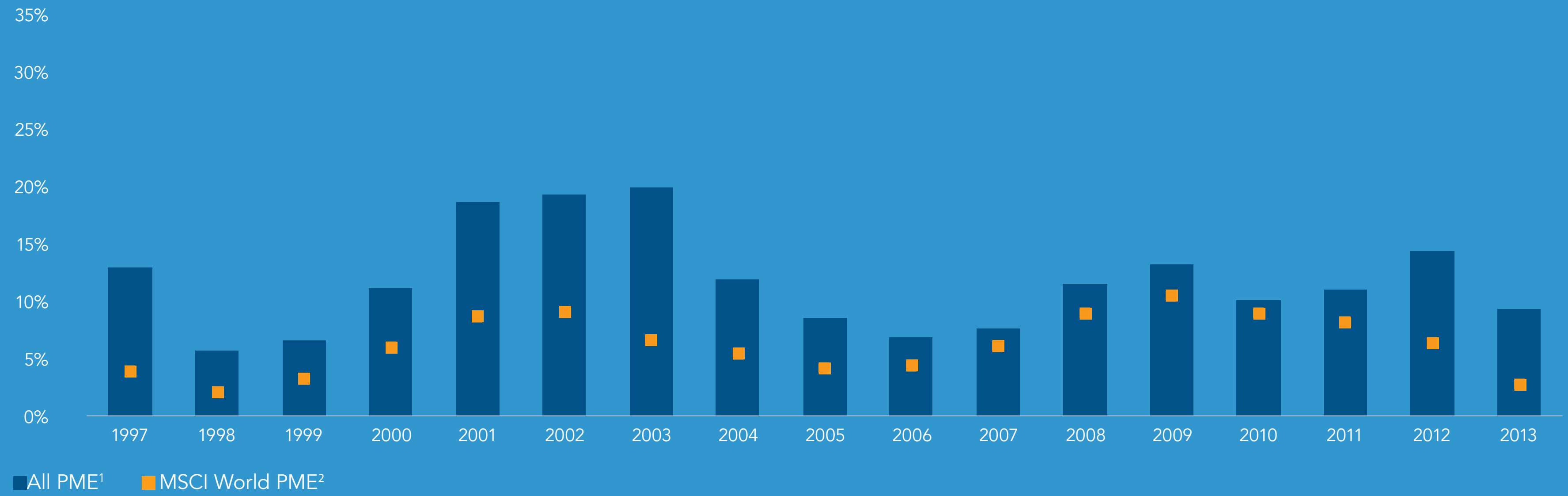
Despite their confidence, GPs believe changes are inevitably headed for the industry. The majority anticipate that the biggest change to their businesses will be increased regulation and oversight of their investment and operational activities. In the coming months, we'll start to see the impact on this theme in the U.S. when Trump's administration takes office. It's important to note, however, that GPs don't necessarily view increased regulation as concerning – rather, just as the biggest change to how they will operate. Instead, what most concerns GPs is not, in fact, their own businesses, but rather their portfolio companies and, specifically, how they're affected by the current pricing environment and resulting competition for attractive deals.

So, What's It All Mean?

What are the key takeaways from our Private Markets Survey? On a macro level, market volatility persists, impacted largely by social, economic and political events around the globe, causing people to be cautious and concerned about the future. With that said, private market participants continue to be sanguine about expected returns for this asset class and about the prospects for the broader financial industry. While certain sectors and regions may be more attractive than others, PE is still a compelling place to invest and an attractive asset class for LPs who are hoping to generate more of the outsized returns that they've enjoyed for so long.

Private Equity IRR vs. PME

By Vintage Year

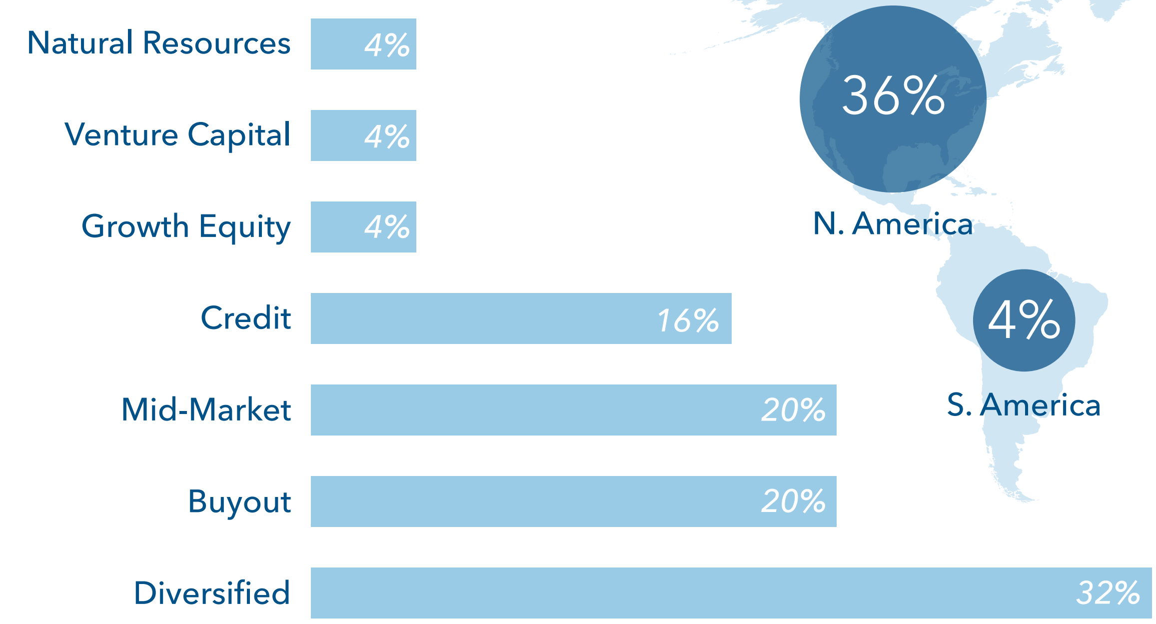


Source: Hamilton Lane Fund Investment Database, MSCI. As of 6/30/2016 (December 2016)
Please refer to endnotes on page 16

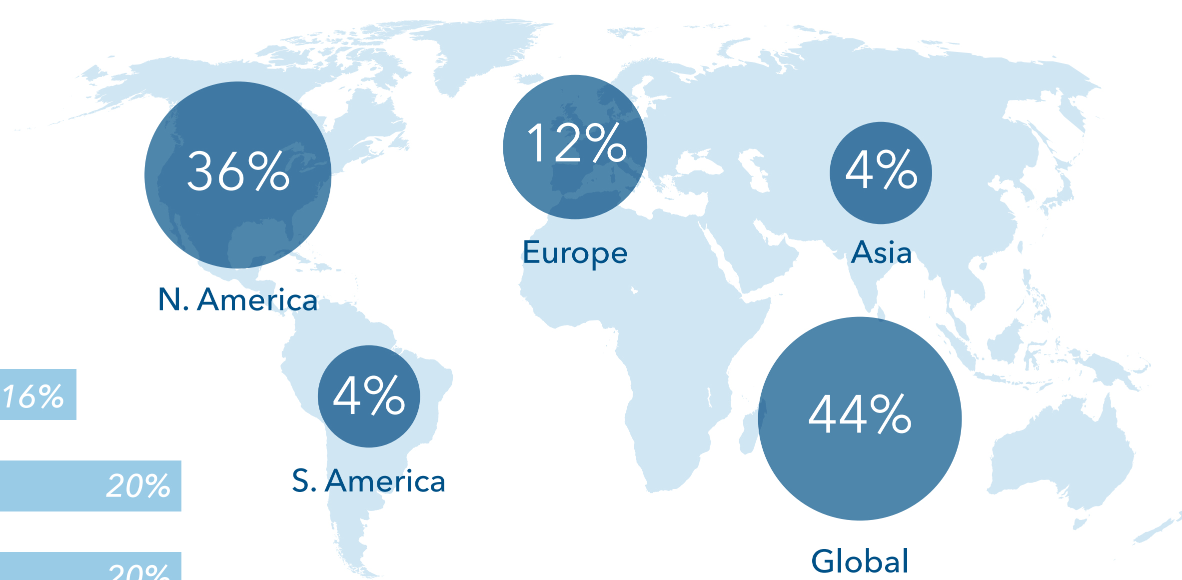
Hamilton Lane is a significant investor and allocator of capital to many of the premier general partners across the private markets spectrum. Additionally, our position as a discretionary manager and consultant to some of the world's largest and most sophisticated limited partners gives us unique access to be able to gather and share market intel.

25 GPs

$1.2T Represented



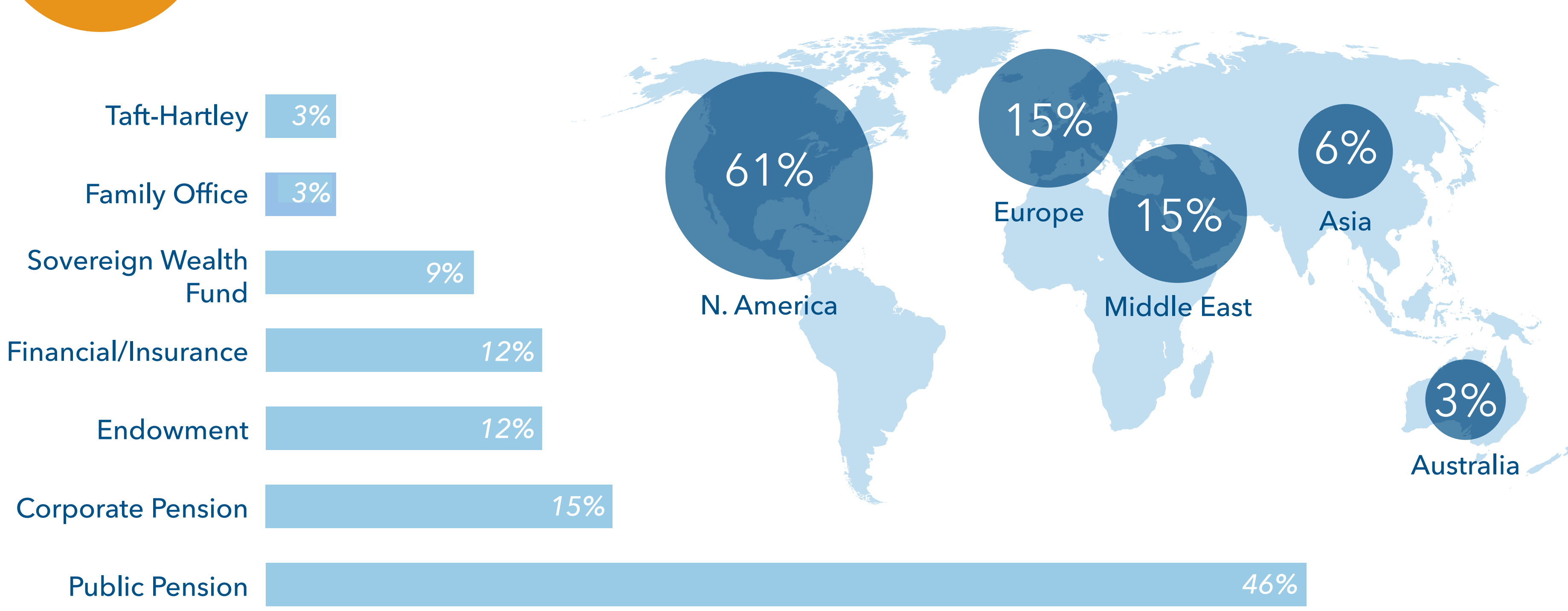
Regions of Investment Focus



33 LPs

$2.7T Represented

Regions of Investment Focus



Hamilton Lane

Thank you for reading the 2016/2017 Private Markets Survey. We hope this proves an informative and useful reference tool, and we would encourage you to contact anyone at Hamilton Lane should you have questions or feedback.

Who We Are

Hamilton Lane is an independent alternative investment management firm providing innovative private markets solutions to sophisticated investors around the world. The firm has been dedicated to private markets investing for more than two decades and currently has 285+ employees operating in offices around the world.

With over $314 billion in total assets under management and supervision, Hamilton Lane offers a full range of investment products and services that enable clients to participate in the private markets asset class on a global and customized basis. The firm has been named an Inc. 5000 Fastest-Growing Company and a "Best Place to Work in Money Management" by Pensions & Investments for five consecutive years.[1]

www.hamiltonlane.com

[1] As of December 31, 2016

Our Mission & Values

We enrich lives & safeguard futures

Do the right thing

Integrity, candor and collaboration

The pursuit of excellence

A spirit of competition that inspires innovation

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Endnotes

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[1] The Hamilton Lane All Private Equity Index tracks the performance of private equity strategies including buyout, venture capital, credit, and other special situation strategies. The index excludes real estate, fund-of-funds, and secondary fund-of-funds. The Russell 3000 Index tracks the equity performance of the 3,000 largest U.S. companies. The MSCI World Ex U.S. Index tracks large and midcap equity performance in developed market countries, excluding the U.S.. The MSCI Emerging Markets Index tracks large and mid-cap equity performance in emerging market countries. The Barclays Aggregate Bond Index tracks the performance of U.S. investment grade bonds. The Credit Suisse High Yield Index tracks the performance of U.S. sub-investment-grade bonds. The FTSE/ NAREIT All Equity REIT Index tracks the performance of U.S. equity REITs. The Dow Jones-UBS Commodities Index tracks the performance of a broad basket of commodity futures contracts.

Desmoothing is a mathematical process to remove serial autocorrelation in the return stream of assets that experience infrequent appraisal pricing, such as private equity. Desmoothed returns may more accurately capture volatility than reported returns. The formula used here for desmoothing is:

rD(t) = (r(t) - r(t-1) * p) / (1- p)

where: rD(t) = the desmoothed return for period t

r(t) = the return for period t

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[1] The Wall Street Journal: http://www.wsj.com/articles/china-economic-growth-slows-to-6-9-on-year-in-2015-1453169398

[2] CNN: http://money.cnn.com/2016/01/29/news/economy/us-economy-gdp-fourth-quarter/

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[1] The Hamilton Lane All Private Equity Index tracks the performance of private equity strategies including buyout, venture capital, credit, growth equity and other special situation strategies. The index excludes real estate, fund-of-funds, and secondary fund-of-funds. Net IRR is net of all management fees, carried interest and expenses charged by the general partners of the funds in the index.

[2] The index presented for comparison is the MSCI World, calculated on a Public Market Equivalent (PME) basis. The PME calculation methodology assumes that capital is being invested in, or withdrawn from, the index on the days the capital was called and distributed from the underlying fund managers. Contributions were scaled by a factor such that the ending portfolio balance would be equal to the private equity net asset value. The scaling factor is found by taking the sum of all shares sold (SS), the sum of all shares purchased (SP) and calculating the number of shares the ending value is worth (SEV). Dividing SEV + SS by SP solves for the PME scaling factor. The scaling of contributions prevents shorting of the public market equivalent portfolio in order to match the performance of an outperforming private equity portfolio. Realized and unrealized amounts were not scaled by this factor. The MSCI World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets. The index is presented merely to show general trends in the markets for the relevant periods shown. The index is unmanaged, has no expenses and reflects the reinvestment of dividends and distributions. The spreads are provided for comparative purposes only.

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As of January 10, 2017