KEYNOTE INTERVIEW

Liquidity constraints continue to fuel secondaries growth

Both LPs and GPs are turning to the secondaries market as they navigate ongoing liquidity challenges, says Pomona Capital's founder and CEO, Michael Granoff

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Q The secondaries market has seen remarkable growth over the past few years. What's driving this, and will those conditions continue?

The supply of secondaries deals is driven by how much money flows into private equity and how much of that turns over. Obviously, huge amounts of capital have gone into private equity over the last decade, such that the market is now measured in trillions rather than billions of dollars. That means almost any turnover rate is going to yield a meaningful supply of deals.

Turnover itself is a function of both secular and cyclical drivers. On the secular side, it's about how comfortable people are with using the secondaries market. When I founded Pomona in 1994, LPs were embarrassed to admit they wanted to sell private equity assets. Today, the secondaries market is a common tool used by LPs to manage their private equity portfolio. In fact, in 2024, about 40 percent of LPs who sold private equity stakes were first-time sellers, according to Jefferies.

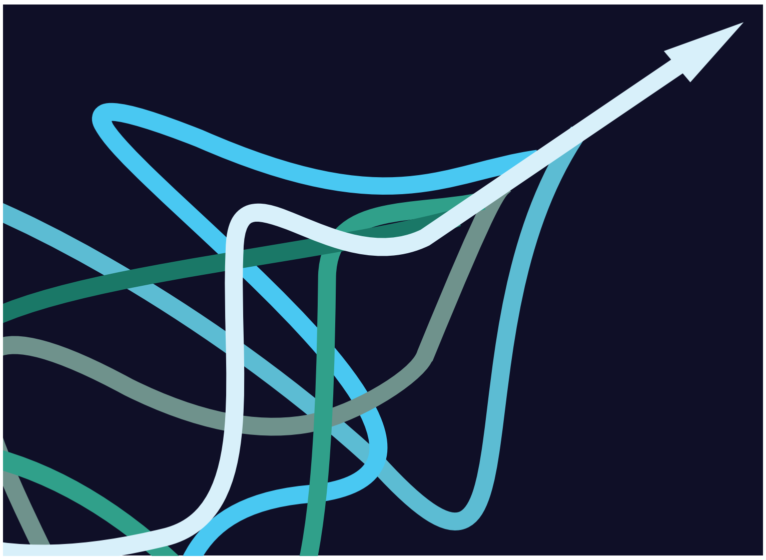
The cyclical side – basically, what's happening in the market right now that's making people want to sell – will also be a factor. Today, a main macro factor is the constraint on liquidity in the private equity ecosystem. These forces affect every investor and every GP, and they are both broad and deep, having lasted a while. GPs are under a lot of pressure to return capital to investors and are turning to tools like the GP-led secondaries market and NAV facilities to do that.

There are other cyclical factors impacting individual investors, with one example being what is happening to universities in the US currently. Right now, many of them are sellers on the secondaries market. That's not because

Q As the market has matured, we're seeing the emergence of more retail products. How will those define the next phase of growth?
The next wave of capital into private equity is likely to come from individuals, not institutions. It could be significant and dramatic, and it has the potential to drive the same kind of generational shift in the industry that we saw when the US government began encouraging pension funds to invest in private equity years ago.

Pomona launched one of the earliest secondaries-focused evergreen funds for individuals, a product that gives individuals access to a portfolio similar to what our institutional investors have. The way we run our business supports that structure, but the retail market behaves differently: it can be more volatile, and investors can 'vote with their feet'. A great deal of capital will flow in, but the trajectory may be messy as the market develops.

For secondaries, this shift could temporarily distort behaviour because the interests of the two investor bases are different. Some may be incentivised to buy the tail ends of funds at bigger discounts to show higher immediate returns, for example. But ultimately, performance of the underlying assets will drive fund performance. Over time, the inflow of capital should benefit the secondaries market.



"Volatility can create opportunities and you need to be nimble and disciplined to purchase funds with quality and growing companies"

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they dislike the assets they are selling, but rather a consequence of how the economic model of elite universities is being challenged by the new administration. The amount of illiquidity that universities can tolerate in their portfolios has changed, increasing supply in parts of the market.

Generally, most investors sell private equity assets not because of the assets but because of something happening to them – a liquidity need, a balance sheet constraint or a shift in priorities.

Q How are current macroeconomic factors, such as interest rates and limited exit activity, affecting dealflow and investor appetite in the secondaries market?
People often focus on macroeconomic factors like interest rates and their impact on secondaries, but they actually have less effect than one might think. I have lived through a lot of cycles and can say that today's interest rates are not the anomaly – the near-zero rates we had a few years ago were the anomaly.

In general, it is not higher interest rates that dissuade people from transacting, it's uncertainty. Right now, there is not a lot of interest rate uncertainty, so rates are not constraining the market.

The limited exit environment is a different issue. Sellers today are certainly more motivated than they were a few years ago because distributions have decreased and they need the money, leading them to sell.

Q How do micro-level factors, such as company performance, sector dynamics, or fund concentration, affect what secondaries investors buy and how they manage risk?

In times of volatility, the dispersion of returns between companies and between funds widens. In stable, upward-trending markets, that dispersion shrinks.

We are now in a period of rising volatility, which means buying the broad market is unlikely to be a successful strategy. You need to be selective and look closely at granular company-level data when assessing deals. That makes the job a little harder, because buying the market is not going to be a successful strategy. On the other hand, volatility can create opportunities and you need to be nimble and disciplined to purchase funds with quality and growing companies.

Q How do you see the balance between GP-led and LP-led transactions evolving, and what might that mean for the market's pace of growth?

Both transaction types stem from the same dynamics. Why is there a robust GP-led market? For the same reason there is a robust LP seller market – both are driven by the constrained liquidity across private equity. They are related, but different in terms of the risk and rewards they offer investors.

Our approach is to be agnostic about where we find opportunities, but we are disciplined and selective in what we are looking for. Our investors expect us to deliver four things: a diversified portfolio of high-quality companies, acquired at a material discount and capable of generating liquidity.

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Those four things are arguably the fundamental premise of the secondaries market, and I believe many GP-led deals fall short on some or all of those components: they're concentrated, variable in quality, and often illiquid for prolonged periods. Because of that, GP-led deals represent a minority of what we do.

Also, the GP-led market today is largely unproven with few realised exits. I suspect that the concentrated nature of most GP-led transactions will result in a wider dispersion of returns than in the LP-led market, where diversification mitigates dispersion risk.

Further, sourcing of GP-led deals is very different compared to LP-leds. Everyone sees every GP-led and every GP-led is syndicated. We work hard to find and create proprietary LP-led deals, where we know the companies and the funds well.

Of course, markets evolve, and the GP-led market of today will likely change. Our role is to follow these changing dynamics but keep our approach consistent, seeking both quality and price and near-term liquidity.

Q With more capital entering the secondaries space, are you concerned about increasing competition?

Supply is growing alongside demand, so there is a rough equilibrium. It's not a case of too much money chasing too few deals, and there's certainly not a fire sale going on.

If you look at where new capital is coming in from, most is entering into the GP-led segment. Few new entrants pursue LP-leds because it can be more challenging to execute on LP-led deals. So, if there is more competitive pressure, I would say it is in the GP-led part of the market.

The other new source of capital is retail money, though that's primarily through new products from existing players. We offer a fund that caters to the private wealth segment. This expands our distribution, but it does not change our strategy.

Q Looking ahead, do you believe the secondaries market can sustain its current trajectory, or will growth inevitably normalise?

It's difficult to say whether growth will 'normalise.' Is it likely that the secondaries market, over the next three to five years, will grow rather than staying the same or shrinking? Yes, it is. And it is highly probable that the market will continue to grow over the medium term because of the factors that we have discussed. However, the rate of growth is unclear.

In many ways, the normalisation people talk about is really the transition to a more sustainable, diversified phase of growth.

Regardless, Pomona is not a market share investor – we are highly selective and disciplined, buying funds with underlying companies that meet our quality standard and that we can buy at better than market prices. That turns out to be a very small percentage of the market. We have historically bought about 1 percent of our doable dealflow on an annual basis and so we are not dependent on a certain rate of growth in supply. If we were managing a mega-fund, that dynamic might matter more, but for Pomona, it's about selectivity and quality, not asset gathering. ■