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Family Offices Shun Hedge Funds, Pile into Private Equity: Report

By Danielle Verbrigghe October 1, 2018

Family offices shifted their asset allocations in 2017 in favor of private equity and away from hedge funds, according to a new report from UBS and **Campden Research**.

Global family office allocations to private equity climbed to 22% of the average family office portfolio. That came as allocations to private equity funds increased an average 2.8 percentage points, while direct investment allocations remained relatively flat. In North America, the average allocation was even higher at 23.9%, including both private equity funds and direct investments.

Family Office Asset Allocation

North American family office asset allocations in 2017

Bonds	15%
Equities	31%
Direct private equity	14%
Private equity funds	10%
Direct real estate	13%
Hedge funds	7%
REITs	2%
Commodities	3%
Cash	5%

Source: UBS and Campden Wealth

This trend may be set to continue, as half of global respondents indicated that they plan to increase their allocation to private equity over the next 12 months.

"We've… continued to see more money flowing into private equity funds versus hedge funds [and] more money looking at direct investments and co-investments," says **Stewart Kesmodel**, head of UBS's global family office division in the Americas. "A very popular and hot topic amongst clients is trying to invest directly into private companies and avoid paying fees into funds."

Meanwhile, global family offices have cut back on hedge fund allocations, extending a multi-year decline since 2015, with a 3.2 percentage point reduction, so that hedge funds now account for 5.7% of the average portfolio globally, or 7.4% in North America.

"Clients have been trying to generate return in a challenging environment," Kesmodel says. "Hedge funds by nature are meant to outperform in bear markets and underperform in bull markets, so its not surprising we see a lot of clients moving away from hedge funds in pursuit of yield."

This could change over time in response to the market, he adds.

A third of family offices are now involved in impact investing, an increase of 4.2 percentage points over the year. Private equity is the main vehicle family offices are using for impact investments. Now, 38% are involved in sustainable investing, with top areas including clean energy, water, gender equality and healthcare, according to the report. Nearly half plan to increase sustainable investments over the next 12 months.

Family offices notched a year of strong portfolio returns, with average growth of 15.5% in 2017, compared with 7% in 2016 and 0.3% in 2015, according to the report from UBS and Campden. In North America, they returned 15.9% in 2017. Private equity was one driver, with an average return of 18% in 2017.

A separate report from Family Office Exchange (FOX), a network of wealthy families that focuses on wealth management, found that family offices are reassessing their traditional approaches to asset allocation. "What's happening because of this very strong appetite for direct investment, that traditional asset allocation approach has kind of been turned on its head," says **Kristi Kuechler**, managing director of the investor market for Family Office Exchange.

Just 31% of family offices surveyed by FOX reported following a top down asset allocation model, with 54% stating they consider both top down and bottom up factors. Only 65% of family office respondents said they were relying on traditional asset class building blocks when managing the overall portfolio.

FOX's pool of family office respondents differed from UBS. For instance, 84% of the family offices surveyed by FOX were in the U.S.

But FOX's survey also found family offices increasing their allocations to private equity funds and paring back hedge funds in 2017.

The interest in private equity does not look likely to abate.

When asked by FOX to predict their anticipated changes to asset allocation in 2018, 43% of family offices said they planned to increase their allocation to private equity funds, while only 8% planned to decrease. Direct investments were also of interest with 30% planning to increase investment, and 4% indicating plans to decrease.

Despite burgeoning interest from wealthy families in direct investments, private equity funds are far from irrelevant, Kuechler says.

"It's not as if families are saying 'we're so gung ho on direct that we're not going to invest in funds,'" Kuechler says. Many family office investors take a core-satellite approach to private equity fund allocation, she adds.

Delegate Advisors, a $1 billion multi-family office, uses both private equity funds and direct private equity deals for wealthy family portfolios, says **Andy Hart**, the firm's president and chief advisor.

"We've been very selective on the types of private equity and private debt," Hart says. "We've also been participating in more later stage, side fund opportunities."

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