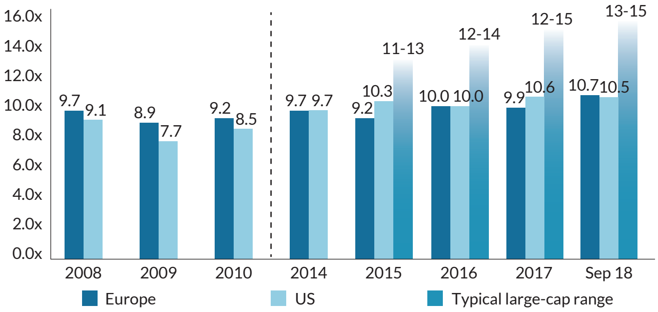
Market commentary

Private equity

A proactive sourcing approach is key in a competitive market.

Despite the increased market volatility in Q4 2018, private equity valuations remained at elevated levels throughout 2018. We attribute this to ever-increasing competition from private equity managers, strategic buyers and new market entrants, encouraged by the search for yield while interest rates remain low and by strong debt markets for leveraged buyouts. High-quality assets typically trade at up to mid-teen EBITDA multiples. In contrast, assets still trading at low multiples tend to be underperforming or operating in highly cyclical sub-sectors.

Average purchase price multiple of pro forma trailing EBITDA for LBOs

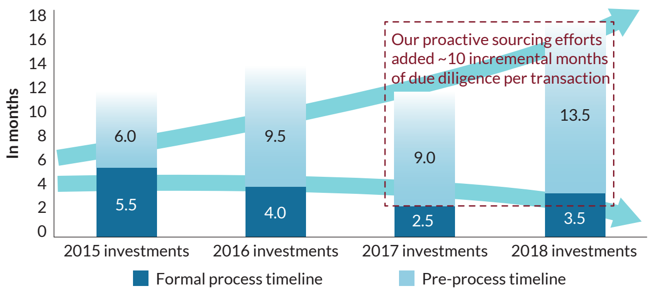


Source: Partners Group; S&P Global Leveraged Lending Review, Q3 2018.

As we do not operate in isolation, elevated valuations are a reality in our underwriting as well, especially given our focus on high-quality assets in high-growth segments. In order to mitigate the risk associated with paying competitive prices, our strategy is twofold.

On the one hand, we remain selective, investing in only around 1% of the private equity opportunities we screen. Increasingly, when it comes to due diligence, we are using the early visibility afforded by our platform and large team, aiming to identify target companies and conduct thorough research on them before they come up for sale. This enables us to source opportunities in a systematic manner according to high-conviction investment themes and develop substantiated value creation and governance plans for our target assets early on.

Wrapping around target assets before the sales process has started



Note: formal vs. pre-process due diligence timelines for Partners Group direct private equity investments (2015-2018).
Source: Partners Group, October 2018.

On the other hand, we maintain our belief that to achieve attractive returns in this environment, private markets investment managers have no option but to excel in their value creation capabilities. For this reason, the focus on highly entrepreneurial ownership and active value creation is a fundamental trait of our investment strategy. That same focus offsets the multiple contraction assumption we use in our underwriting, which has increased from around 0.5x for investments made in 2016 to consistently 1-2x or more for investments made today.

Our current investment themes

In light of the competitive market, we continue to place a strong emphasis on Thematic Sourcing, searching for opportunities according to well developed investment themes. We conduct regular analyses in order to identify those sectors that we believe offer higher value relative to others in today's market. Based on this initial assessment, we systematically map out the

Market commentary

sub-sectors within these sectors that particularly benefit from structural growth or transformative trends and then develop tangible investment themes for each sub-sector with long-term growth prospects.

Examples of investment themes that have enabled us to successfully source recent investments include the growing demand for digital product engineering services, industrial consumables, outsourced manufacturing and discount retail.

We find the most compelling value in assets that combine attractive top-down market trends with bottom-up category leadership, underpinned by the opportunity to create value through entrepreneurial ownership. Within the sub-sectors where we see attractive opportunities, we continue to apply our proven investment focus on platform companies in fragmented markets, niche businesses with potential to gain market share in sub-segments of industries experiencing tailwinds and franchise companies with strong defensive capabilities and high cash flow generation. In many cases, we may identify or grow companies into category leaders that have the potential to outperform over a prolonged period of time.

How we realize relative value potential in private equity

Platform companies

We acquire platform companies or assets with a strong management team and infrastructure in a highly fragmented market and then purchase add-on companies to further grow the platform and benefit from synergies.

Niche winners

We acquire companies in sub-segments of specific industries benefiting from particularly strong products or services and demonstrating an ability to grow disproportionately, often through internationalization. We institutionalize the business and extend the product/service offering.

Franchise companies

We acquire businesses or assets on a stand-alone basis – typically, single assets with value creation potential as well as strong defensive capabilities, high cash flow generation and the ability to quickly de-leverage. We seek to broaden their network and strengthen their positioning.

Corporate sub-sector matrix: relative value focus areas and investable universe

Consumer	Industrials	Healthcare	Bus. & fin. services	TMT
Personalization & customization • Niche market leaders • Co-manufacturing	**Automation** • Vision sensors, micro-electro-mechanical sensors & drives • Industrial consumables	**Ambulatory multi-site** • Employer onsite • Physical therapy	**Financial services** • Off-balance sheet FIs • Payment & transaction banking	**Enterprise software** • B2B enterprise software • PaaS/SaaS models • Cyber security software
Lifestyle & sustainability • Health & wellness • Infant markets • Pet products & services	**Modern logistics** • Integrators • Material handling systems • Machine vision	**Outsourced device manufacturing** • Orthopedics • Multi-line outsourcers	**Business process outsourcing** • Solutions for non-core functions • Technology solutions	**IT services & infrastructure** • IT network & data center services • Internet of things & edge computing
Premiumization & emerging middle class • Aspirational brands • High-growth categories	**Advanced manufacturing** • 3D-printing • Technical components • Predictive maintenance	**Life science supplies and reagents** • Genomics-based supplies • Calibration standards	**Testing, inspection & certification** • New technologies and regulation • Rising end-user expectations	**IT & technology outsourcing** • XaaS ("anything" as a service) • Digitalization • Outsourced product development
Digitalization • Deep customer insights • Channel/product disruption • Customer engagement	**New materials** • Ceramics • Metallurgy • Nanotechnology	**Physician practice management** • Single specialty • Multi-specialty	**Commercial services** • Industrial/onsite services • Residential services	**Big data** • Big data intelligence • Big data analytics • Database platforms

Note: bullet points in black highlight sub-sectors with active investment opportunities. Bullet points in gray highlight future areas of focus for research or investment.
Source: Partners Group, November 2018. For illustrative purposes only.

Market commentary

Private real estate

Providing solutions to complex situations.

In 2018, global real estate transaction activity further increased in the US and Asia-Pacific compared to the previous year, supported by high amounts of available capital. In Asia-Pacific, China and Japan remain the two largest markets. In contrast, European volumes are experiencing a marked slowdown and have fallen across most sectors, driven by lower levels of investment activity in the UK, Germany and Spain.

Since the Global Financial Crisis, low interest rates have supported real estate prices by lowering both borrowing costs and discount rates on future operating income. With the growth of real estate asset values, yields have compressed and are now at the lower end of their historical ranges across many markets. In parallel, global capital values have risen by around 30% since their low point in the cycle in 2009. Looking ahead, the potential impact of rising interest rates on the asset class warrants close attention.

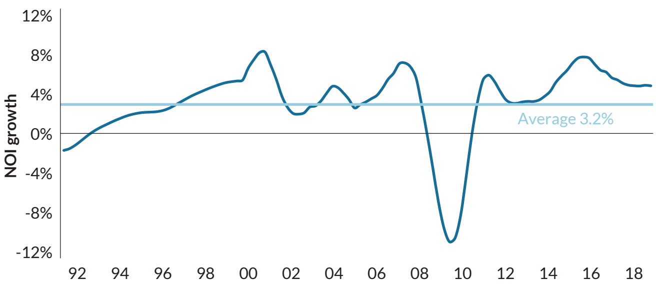
The potential impact of rising rates on real estate

With rising rates in the US and further rate increases expected to come, we are more cautious on the mid-term outlook for US real estate as the spread between cap rates and 10-year US Treasury yields continues to narrow and is now below the long-term average of around 430bps.

Historically, cap rate spreads have acted as a buffer to absorb rate increases without cap rates increasing in lock step. If yields continue to rise – as we expect them to – there will be a reduced capacity to absorb rate increases without upward movements in cap rates. This especially holds true if net operating income (NOI) growth is not able to offset the rate increases.

Our broad estimate suggests that 5% of NOI growth can offset around 25bps in cap rate increase. NOI growth, however, while still above the long-term average of 3.2%, is slowing, as highlighted in the following chart.

Long-term NOI growth in US real estate



Source: Costar, November 2018.

Our prudent underwriting standards take into consideration the impact of rising rates. We currently allow for a 50-100bps cap rate increase over our hold period. In addition, in this competitive environment and against the backdrop of rising rates, our continued focus on investments that have a value-add component provides us with the opportunity to actively drive NOI growth.

In terms of property types, office, logistics/ industrial and residential assets with tangible value creation potential or limited development risk still offer attractive opportunities in many parts of the globe, especially if sourced outside of competitive auction processes. For our older vintage investments, we are seeking exit options to lock in favorable market conditions and strong returns.

Our current investment themes

In spite of the near-record pricing for all main property types globally, we continue to focus on properties and cities benefiting from the transformative trends that will have a lasting impact on traditional real estate and enable superior growth. These include increased urbanization and the resulting demographic shifts generating demand for office and residential space as well as a growing e-commerce sector creating demand for logistics space.

Market commentary

In the residential sector, we like affordable built-to-let properties in expanding cities that attract diverse communities and suffer from a supply shortfall.

In the office sector, we favor assets that require a capital injection for upgrades in cities with competitive rents and high-quality public transportation systems. For office developments, which we pursue very selectively, we like established office hubs outside of the main CBD areas and buildings that have a certain degree of pre-leasing secured.

For industrial assets, we see relative value in XXL warehouses, "last mile" distribution facilities and hybrid office-industrial assets. Demand for these types of assets is increasing on the back of a growing e-commerce sector requiring large storage and distribution facilities. In addition, investments in technological improvements in logistics and distribution centers that allow tenants to enhance their supply chain, product chain and distribution channels are generating further demand for these segments.

Meanwhile, the retail segment is generally outside of our focus given the pressure on the sector from e-commerce.

As markets remain liquid, we prefer to avoid competitive processes as a means of sourcing opportunities in order to avoid crowded segments with low upside potential. Instead, we are further emphasizing our focus on special situations.

We typically seek the following characteristics for these situations: a bespoke structure, i.e. opportunities that others are discouraged from pursuing given their global and complex nature (in a portfolio of assets context); a trigger event, i.e. opportunities that are unlocked by a special situation such as investor fatigue and/or discord; a sourcing angle, i.e. opportunities that can be secured off-market in an exclusive manner; and outperformance potential, i.e. opportunities with clear value-added potential to generate outperformance.

How we realize relative value potential in private real estate

We focus on providing solutions to operating or general partners that do not have the mandate, tenure or means to support asset-level business plans for their existing assets or portfolios. We continue to prefer asset strategies that fall into one or more of the following sub-strategies:

Buy below replacement cost

We target assets with low valuations located in rebounding markets that can be repositioned and then leased-up by under-cutting market rents.

Buy, fix and sell

We seek older buildings in great locations that are in need of owner-oriented asset management initiatives.

Develop core

We target markets with strong long-term fundamentals and trends that support additional absorption to selectively develop properties through ground-up construction.

Real estate sub-sector matrix: relative value focus areas and investable universe

Residential	Office	Industrial	Retail	Other
Residential to let • Expanding cities • Areas with mass market appeal E.g. Vienna	**CBD development** • Cities with supply constraints • Active pre-leasing markets E.g. Seattle	**XXL logistics** • Regional distribution centers • High-bay/cross-docked E.g. Australian East Coast	**Regional shopping centers*** • Premium fashion • Leisure/food & beverage	**Hospitality*** • Diversified portfolios • Properties with established trading history
Residential to sell • Micro living • Amenitized urban locations E.g. Stockholm	**CBD repositioning** • Capex-starved assets • Submarkets with competitive rents E.g. Paris	**Last mile logistics** • Urban infill locations • Flexible assets E.g. Chicago	**District shopping centers*** • Food & non-food • Discount retailer-anchored	**Co-working*** • Flexible offer • Freehold or leased estate
Affordable housing • Key worker housing • Discounted market rents E.g. regional UK	**Non-CBD development** • Established office hubs • Public transport connectivity E.g. Denver	**Light manufacturing** • Hi-tech industries • Established industrial hubs E.g. Shanghai	**Grocery units*** • Convenience offering • Urban infill locations	**Senior housing** • Demographic-driven offering • Independent living E.g. Florida
Student housing • Strong student communities • Off-campus offering E.g. Melbourne	**Non-CBD repositioning** • Areas with good transport links • Properties with adjacent amenities E.g. Sydney	**Hybrid office-industrial** • Space with up to 50% office content • Light product assembly E.g. Raleigh-Durham	**Retail warehouses*** • Mixed product offering • Click & collect potential	**Urban mixed-use** • "Work-live-play" offering • Gentrifying suburbs E.g. Brisbane

*Currently outside of our investment focus.
Note: bullet points in black highlight Partners Group focus areas.
Source: Partners Group, November 2018. For illustrative purposes only.

Market commentary

Private debt

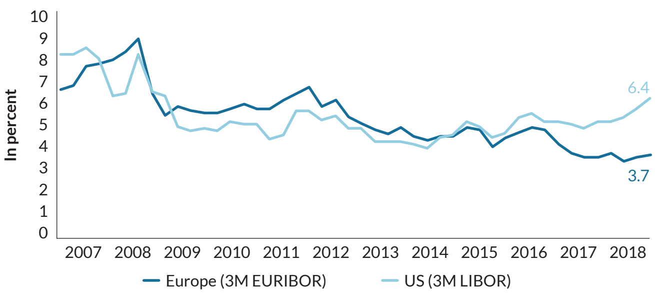
Protecting capital in a competitive market.

Stable demand for financings driven by high transaction activity continues to serve as a tailwind for institutional investors in private debt. Investors have generally increased allocations to floating-rate private debt investments to protect against interest rate increases and obtain stable yield. Overall, the inflow of liquidity into the market, as well as the first steps toward deregulation in the US market, have kept competition for high-quality investments at a healthy level.

US market overview

In the US, demand for second lien remains robust and is even finding its way into syndicated processes. In combination with strong demand for new loans, new issue spreads continue to be tight, although we have noted an uptick to 388bps in Q3 2018. At the same time, the floating 3-month Libor base rate currently stands at 2.5%, providing a positive impact on private debt investment returns for USD investors.

Base rates plus weighted average new issue institutional senior debt spreads



Source: Bloomberg; S&P LCD, Q3 2018.

Leverage levels for buyouts in the US are still high at close to 6x, similar to pre-Global Financial Crisis levels. While equity cushions continue to be very high at around 40%, compared to just over 30% in 2007, prices in the private equity market have increased since then as investors have been willing to pay higher valuation multiples. In this environment, focusing on credit quality is crucial.

Currently, we see relative value in second lien for (upper) mid-cap companies. These businesses often tend to exhibit superior stability and resilience – and the second lien debt is contractually secured. Second lien spreads continue to be attractive at around a 390bps return difference to first lien spreads.

In select cases, investing in preferred equity in attractive sectors with high-quality private equity partners or taking equity kickers to increase returns can be good relative value opportunities. We further expect attractive risk/return profiles in unitranche financings, where we can position ourselves as the sole debt investor in a business and therefore steer terms.

European market overview

Senior leveraged loan volumes in Europe are tracking at roughly the same pace as last year. Leverage levels for buyouts in Europe increased slightly in Q3 2018 to 5.6x. In contrast to the US, this remains well below pre-crisis levels. Moreover, equity cushions in Europe have increased to near-record levels of 47%, although we expect this to normalize and come down slightly in the coming months.

Market commentary

On the back of this supply and demand dynamic, spread levels in Europe have seen upticks in the first three quarters of 2018 to a level of 402bps, although Euribor remains in negative territory. We have further noted an increase in the rate of repayments, with debt often being repaid in one to three years. Early repayments require an even stronger focus on sourcing transactions and re-investing capital going forward.

Unlike in the US, the regulatory environment remains stable, and we observe no deregulation efforts. Relative value remains to be found in mid-cap direct loans, in particular club-style executions, which can offer a premium and solid downside protection, with a small group of high-quality lenders in the club.

Directly placed second lien debt also continues to be an attractive financing solution for issuers of mid-cap transactions given the limited execution risk, the certainty on the terms and conditions of the financing and the comparable cost to syndicated solutions. For these transactions, the flexibility to offer multiple European currencies can give private debt providers an edge.

Our current investment themes

In the US, mid-market and upper-mid-market direct loans have continued to offer the most attractive return potential in private debt. Having access to broad deal flow from high-quality private equity partners remains key to investing selectively and building well diversified credit portfolios with downside protection. Moreover, we remain focused on identifying certain attractive sub-sectors, particularly within IT, healthcare and business services, which exhibit defensive characteristics.

In Europe, we continue to offer tailor-made structures to meet company-specific needs and to back category winners in our debt portfolio with add-on acquisition financing, searching for attractive opportunities with appropriate downside protection. Both strategies provide us with a competitive advantage among other sources of financing.

In Asia-Pacific, demand for cross-border financing remains strong as private equity firms in Asia continue to acquire US and European assets. We also continue to see demand from private equity firms in Australia and the broader Asia-Pacific region for unitranche structures. Unitranche debt, which combines elements of both senior and subordinated debt into a single stretched senior tranche, has provided a competitive and differentiated offering for sponsors as compared to traditional bank offerings, which remain conservative in this space.

Liquid loans: diversification and active management

While we did see somewhat of a pullback in secondary loan pricing levels in mid-2018, in general, our investments in the liquid loan market have been focused on the primary market, where we can leverage relationships from our direct loan business. We have taken advantage of the weaker market during this time to invest in primary loans at reasonably attractive pricing levels.

We used the relative strength of the secondary loan market throughout most of H1 2018 to reduce holdings in existing names above par in order to make room for primary allocations, with the aim of generating additional return and a more diversified portfolio of liquid loans.

How we realize relative value potential in direct and subordinated loans

Offer tailor-made structures

We offer flexible and tailor-made capital structures that support companies' specific cash flow profiles and working capital needs.

Target attractive sub-sectors

We target sub-sectors within industries where we see above-average sector resilience and where we have the depth of experience and high confidence in underlying growth fundamentals.

Support buy-and-build strategies

We support successful sponsors and management teams that are familiar to us in their buy-and-build strategies by providing add-on acquisition financing in a timely manner, particularly under strict time constraints.

Market commentary

Private infrastructure

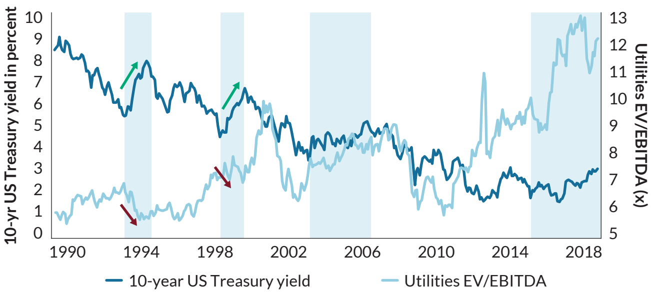
Focusing on the right trends.

The infrastructure asset class has experienced an impressive growth trajectory, with both transacted volumes and available capital growing at a high pace over the past few years. The continued increase in demand from investors has led to more competition in the sector and is putting upward pressure on valuation multiples. In turn, this is leading to lower overall expected returns, particularly for core operating assets.

Investors justify paying high prices by pointing to the quality of the underlying assets and the long-term nature of infrastructure investments – a compelling argument in the past few years' low-yield environment. However, as interest rates are set to rise in the US and potentially elsewhere, and as the promise of further growth in valuations appears to be slipping away, the risk of overpaying is high.

Looking at how public utilities have performed during past rate hike cycles, it becomes clear how sensitive infrastructure valuations are to interest rates. The following chart illustrates two findings: valuations are cyclical, and periods of rising rates have usually coincided with declining valuation multiples.

Infrastructure sensitivity to rising rates: public utilities



Note: shaded areas mark periods of Fed rate hikes.
Source: Partners Group; Bloomberg, August 2018.

For Partners Group as an investor, these observations have two main implications. On the one hand, we ensure that we maintain our portfolio's exposure to rising interest rates at a minimum. This means that we select investments with inflation-linked or correlated revenues and low correlation to GDP and hedge the cost of debt. Additionally, in order to limit the potential impact of buyer discount rates at exit in light of rising rates, on average, we have prudently assumed over 10% multiple contraction in the underwriting of our investments over the last two years.

On the other hand, we focus on investments that have a value-add component, providing us with the opportunity to actively shape business strategy and manage operations to increase profitability. We have long emphasized the need for investors in this environment to build value rather than buy it, and we continue to seek opportunities to create value through our three key strategies: operational value creation, platform expansion and building core. These strategies allow us to actively achieve multiple expansion in our assets by de-risking and scaling up their asset base and leveraging non-market-based drivers such as earnings growth.

Our current investment themes

In terms of originating and executing investments, we continue to focus on the global trends that we believe will generate attractive infrastructure investment opportunities for some time to come. These include the global shift toward clean and more efficient energy, the need for ancillary infrastructure business services and the disruption in traditional energy resource flows as a result of the shale gas revolution in the US. The latter has significant implications not only for the energy industry itself but also for the transportation industry.

Market commentary

Across all our key sectors, we continue to search for value in non-core segments of the market. Currently, we see particular value in services-focused infrastructure businesses, such as transport logistics or energy management businesses and infrastructure companies providing ancillary power services. We also continue to overweight the renewable power sector as well as assets and services in the midstream space, including storage and export logistics for natural gas and gas products.

Regardless of the sector or sub-sector, all potential investment opportunities must be underpinned by the opportunity to create value during our ownership. Active value creation in infrastructure requires extensive resources and operational capabilities. We are able to leverage our global platform to access a proprietary toolkit of best practices, benchmarks and service providers not only in infrastructure but also across private markets.

We have a large in-house Industry Value Creation and Asset Management team that acts as an integral part of our investment underwriting. During the hold period, these operational specialists are active as board members, advisors and coaches to management in our infrastructure projects and companies. In addition, we thoroughly screen potential external board members for our assets and are highly selective in terms of their relevant experience and value-add to the asset.

How we realize relative value potential in private infrastructure

Capitalize on platform expansion opportunities

We look for investments that offer us the opportunity to build scale, for example through investing in fragmented markets that have the potential for consolidation and platform-building.

Proactively build core

We seek out opportunities where strong long-term fundamentals in a particular market support the demand for building a select type of infrastructure, for example due to evolving infrastructure needs or changing market fundamentals.

Focus on operational value creation

We focus on investment opportunities that offer us the potential to enhance operational value through growth and efficiency improvements. A key source of these opportunities is the ongoing trend for corporate owners of infrastructure to sell assets as part of a restructuring.

Infrastructure sub-sector matrix: relative value focus areas and investable universe

	Transport/logistics	Power	Energy infrastructure	Social infra/PPPs	Communications
Services	**Transport logistics** • Integrated supply chain services • Multi-modal transportation • Air/rail/water transportation equipment leasing	**Ancillary power** • Distributed generation • Installation of power supplies • Utility scale battery storage	**Energy management** • Metering/sub-metering • Energy equipment leasing • Utility location services	**Public services** • Transport solutions: mobility as a service • Digitization of public services • Smart cities	**Specialty communications** • Emergency communications • Network management & monitoring
	Ports • Port operations • Terminal logistics development • Automation of towage & freight handling	**Renewable - wind/solar** • Building core offshore wind • Platform expansion of onshore wind & solar • Integrated renewables platforms	**Transmission** • Electric transmission • Smart grids • Stand-alone transmission networks	**Health** • Public/private health services • Elderly care/child care • Medical facilities	**Fiber** • Wholesale connectivity • Network builds for Telcos • End-user/bridging rural divide
	Surface transportation • Public transportation • Roads & short line rails • Next generation mobility: parking/eVehicle infrastructure	**Renewable - other** • Hydro • Waste-to-energy solutions • Biomass	**Distribution** • Gas & electric utilities • District heating/cooling • Piped energy distribution systems	**Housing & education** • Building & convenience utilities • Higher education asset concessions • Student/military housing	**Data centers** • Hyperscale data centers • Asset carve-outs from strategics • Regional/edge data centers
Assets	**Airports** • Terminal concessions • Regional airports • Consolidation opportunities for fixed-base operators	**Conventional** • Thermal generation that is complementary to renewables • Gas • Co-generation	**Midstream** • Gathering & processing • Pipelines for refined products/ natural gas/natural gas liquids • Storage solutions	**Civic and utilities** • Waste(water) treatment/disposal • Community & sports facilities • Local government facilities	**Towers/masts** • Support 5G and higher data rates • Telecom towers, small cells • Net-co solutions: asset carve-outs from Telcos

Note: bullet points in black highlight Partners Group focus areas.
Source: Partners Group, November 2018. For illustrative purposes only.