

Welcome to the latest episode of Conversations. This year, we're focused on the "The Long View." CEO Damien McIntyre will be joined by investment managers and strategists from across GSFM's partner network to explore the long-term outlook for their respective specialties. While we will continue to monitor and address short-term market noise –recognising its power to shift long-term outcomes –our primary goal is to provide you with a clear, strategic perspective on the enduring trends shaping the future of investment.

Today, Damien is in conversation with Geof Marshall from CI Global Asset Management. Geof leads the fixed income team and private markets group, the latter which is the focus of today's conversation. Geof and Damien discuss the investment case for private markets investment, with an emphasis on the long-term benefits for client portfolios.

Before I hand over, I need to read this important notice:

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Damo and Geof, the floor is yours.

Damien McIntyre

Thank you very much, Tracey, and good morning and welcome to all our listeners. As Tracey pointed out in her introduction, I'm joined by Geof Marshall. This is Geof's second visit to Australia. He joined us last year for our investment symposium in Melbourne and Sydney. Geof is the Head of Fixed Income at CI Global Asset Management and also the co-portfolio manager of the CI Private Markets Fund, which we've just brought to market out here in Australia. So, welcome, Geof. I wonder if I could just ask you a quick question about yourself and your career and how you ended up at CI Global Asset Management.

Geof Marshall

Damo thank you very much for that warm welcome and this is my 20th year at CI. I joined the team in 2006 to run the high-end bond portfolios, progressed into running and managing the fixed income effort and about four years ago, when Mark Andre Lewis our CIO joined, shortly thereafter he asked me to lead this private markets effort where we saw an opportunity in the Canadian market that quite, you know, needed some product leadership. It made a lot of sense.

Mark Andre has a background in portfolio construction as the former head of portfolio construction at the Abu Dhabi Investment Authority. In my background the high-end bond market funds private equity take private and so kind of seeing first-hand what makes a good private equity investment work and maybe where other operators are reliant on a lot of debt or financial engineering, so I think to this product I bring a more practical experience.

Damien McIntyre

You do indeed. Now, there's been a huge increase in not only interest, but investment in private markets. So, I want to ask you two questions. Firstly, how would you describe private markets? And secondly, what's your elevator pitch?

Geof Marshall

Sure, so think of the private markets as simply non-listed businesses or equity or non-syndicated debt. I'd say public markets are actually the exception, that most businesses, at least by number, are private. You can look around the high streets and the main streets, and those are private businesses. Most borrowing and lending is done at the bank level and not through the syndicated bond markets. And so most real estate and infrastructure, venture capital by definition, is private.

So, I think the opportunity set and the pitch is, these are big markets with big opportunities. The public markets are shrinking. More companies are deciding they want to remain private or delist from the equity market. And to the extent that clients and investors have a room in their portfolio to take some illiquidity risk, they can earn that illiquidity premium in their portfolios by investing in the private markets.

Damien McIntyre

Why do you think there's been such a surge in investor interest?

Geof Marshall

I think what happened in 2022 was a catalyst for increased interest in the private market. The S&P 500 was down 18%, the global bond, the US bond market as a proxy for what happened in the bond market was down 13%. Nothing particularly worked, expected diversification failed, and I'd say really with the exception of the private markets, private markets proved much more resilient, partly because the price on a quarterly basis, the price was based on earnings as opposed to what's happening in the public markets and where we might get emotion or overreaction. And I think that kind of gets to the gist of public market investing versus private market investing, you know, public markets are prone to noise, which portfolio managers like myself can take advantage of overreaction but generally see much more fundamental focus investing and valuation in the private markets. So that's real.

Damien McIntyre

Really the advantage for an investor going into the private markets. There just isn't that volatility month to month, quarter to quarter, is there? Really the advantage for an investor going into the private markets.

Geof Marshall

That is, yes, generally positions are marked quarterly, but generally then you don't tend to see the same degree of overreaction, and I think part of it too, Damo, is I think there's things you can do in the private markets when you own a business that you can't do in the public markets. In the public markets, you're managing as a CEO to Wall Street's quarterly EPS target, and that might cause you to make some short-term decisions that over the long term are based on poor fundamentals or poor facts, and I think in the private equity world, you're not under that same pressure, and same thing in the private credit world, generally you see greater alignment between investors.

In the private credit world, no one's looking to short your equity to go along your bonds and affect a restructuring, right? There's much more alignment between the lender and the borrower, so I think at the end of the day, that emphasis more on signal than a noise translates into lower volatility. A lower volatility can translate into, I think, more efficient portfolios. Yeah. It's good.

Damien McIntyre

It's interesting, I often reflect, to some extent it makes me sad when we approach the earnings call for Nvidia and it's almost like the world is waiting for how one stock has performed. And this 90-day shock clock really is a, it's a bad way to run a company. It's also a bad way to value its progress because one quarter is always different to another. Things don't grow in a straight line all the time.

Geof Marshall

You're running to stand still.

Damien McIntyre

Yeah, that's right.

Very much so in the private markets, companies get the time and managers get the time and space to organise their strategy and execute and then hopefully realise that value at a higher price at a later date.

Geof Marshall

And just to add on to that, I think as a, as a GP or as an owner of a private equity business, you can affect change more easily. If you need to replace a CEO, because he or she is not performing, you can do that doing that in the public markets. That's a very big deal to replace a CEO.

Damien McIntyre

Yeah it's a drama, isn't it? Now tell me, CI has really got serious about creating a private market's product. You seeded a multi-strategy with several billion dollars from the balanced funds to get them going. Can you just describe your approach and advantages of that?

Geof Marshall

You know, our approach was, let's do this the right way. We looked at what sovereign wealth funds and some of the large pension plans in Canada were doing where they might be 30 to 50% allocated in private markets. And we realised a lot of investors were taking on the portfolio construction process and skipping multiple steps. So, we really wanted to optimise the portfolios for returns, for volatility and for liquidity. And liquidity is the funny one. Investors don't value it until you don't have it. But it's the thing that gets you in trouble. And so, optimising for those three elements created this strategic asset allocation across private equity, private credit, real estate, infrastructure and venture capital.

A lot of rigorous analysis went into that, correlations, drawdowns, correlations with the public markets, really to get a handle on how much risk we can confidently take. Marc Andre Lewis, PhD in physics, much more of a quantitative background than me, you know, contributed significantly to this process. But that only gets us part of the way. The next kind of step is finding the right managers to fill those risks that we want in the portfolio. And that's where we lean on our US colleagues at the CI business called Corient.

That's a team of about 25 to 30, asset class specialisation in private credit, or private equity, or infrastructure, or real estate. At the heart of what we're trying to do is build portfolios that work very well in the middle of a 60-40 portfolio. Ultimately a 60-40 portfolio can, over the long-term, be expected to increase returns and lower volatility of the overall portfolio. It means we're running these portfolios on a multi-strategy, multi-manager, multi-asset class, multi-vintage, and multi-structure basis. And so, it's multi-structure.

Generally, we're using closed-end funds, but, you know, some evergreen strategies to give us a little bit more liquidity, that helps a lot too. Owning a 10% sleeve in public markets as a liquidity buffer. So that's one year's worth of liquidity for us. At the end of the day, we're trying to do this. We're trying to get it right. We've got a lot of resources we can lean on across the CI, Corient, GSFM, and now Mubadala ecosystems. About a trillion dollars of AUM and AUA. So we've got scale, we've got experience and resources. And, you know, trying to bring an institutional approach to smaller investors.

This is, you know, it's very hard to do this well. Manager selection is incredibly important. In the public markets, manager selection might be a matter of 50 to 150 basis points between what makes a first quartile versus a median manager. In the public markets, where you can't fire the manager, it's 500 to a thousand basis points of alpha. And so getting that manager selection right, as well as the asset allocation for flow construction, you know, this is what we're trying to deliver to smaller investors.

Damien McIntyre

Can I just explore the practice you have of tactically allocating to asset classes and managers? Obviously, with a public markets product, you can redeem and throw the money around as you see fit. It's not as easy to do, obviously, with private assets. How do you allow for that?

Geof Marshall

We gave ourselves within this strategic asset allocation framework, we gave ourselves room to make tactical tilts in terms of, you know, where we see opportunities. So the best example I can give you, Damo, is just, you know, when

we launched this product in 2023, our strategic asset allocation drove a weight to real estate and we didn't really like real estate at all because what we'd seen, the public markets repriced REITs very quickly given the interest, the change in interest rates. And the only thing that happened in the private markets was the bid-ask spread widened between, you know, where sellers cared to sell and buyers cared to buy and we didn't want to put equity to work in those levels.

And I'd say it's taken about three years for the real estate market to reprice at the private basis. So being underweight at real estate has been accretive to the fund's performance and even the manager selection, kind of the latitude we gave Apollo with their strategy, Apollo Realty Income Solutions, where they can do debt or real estate equity, I think that's because, you know, their intention was out of the gate of 2023 to own mostly real estate first line debt until equity valuation is approved.

So yes, a lot of room to make some changes, you know, around the edges. But you're right. Like we can't make rapid changes around the edges. It's more likely what we want to do with our next subscription, our next inflow. And do we want to lean into one part of the portfolio?

Damien McIntyre

This liquidity sleeve is also important because you're allowing it to fund a mandate in full, aren't you? You cover all the future cash calls that are required?

Geof Marshall

Right, we're not over-committing. That's the trick of a private market investing is how do you get invested because you're making a commitment and you're waiting for your capital to be deployed. I think a lot of institutional investors, they might cheat by using leverage and over-committing and that's not something we want to do with this strategy. We escrow our commitment in cash or T-bills and we've got 10% of the portfolios in the public markets, again, as our liquidity sleeve.

Damien McIntyre

Now there's approximately 15 managers in the underlying strategies and I'm sure you love all those managers equally or at least I hope you do but are there any favourites that you'd like to talk about, any managers in particular that you think do an outstanding job?

Geof Marshall

Yeah, they're all in the portfolio for a specific reason. I built my career around trying to deliver alpha and not particularly interested in beta and that applies to the private markets as well. And, you know, one manager I find very compelling is American Industrial Partners in the private equity space. Soon to be fundraising fund nine. I think their track record goes back about 20 years. And at the heart of what they do is taking cargoes from industrial conglomerates, taking businesses that maybe are public and should be private and fundamentally fixing broken businesses. So finding good businesses having a bad day.

They're not finance bros. They're engineers. They like rolling up their sleeves, figuring out why industrial businesses, whether they're paint companies, shrimp harvesting businesses or krill harvesting businesses, why they're not working, what needs to be fixed on the manufacturing side or logistics side, what will just result in doing well and fixing it. They've got a phenomenal track record. They're very disciplined.

They buy things around seven times. They sell them about seven times. So, they're not reliant on financial engineering or, or multiple expansion; which I would describe as relying on multiple expansions, kind of like relying on hope, but they generally make a three times return on their investments just by fundamentally improving the operations.

Damien McIntyre

Buying for seven and selling for seven is fine. You have to get the earnings of the profitability of the business up and that's their focus. With the flow of capital into private markets, and they've had this spectacular relative performance to public markets, as you described for the liquidity premium you pay, what do you think the relationship of those two, public and private, will be moving forward? Do you think they'll remain in lockstep as they have in the past or will they come close together? What do you think?

Geof Marshall

I think that the correlation of returns will compress as more investors are in both markets. I think the return difference between public markets and private markets might collapse a little bit where private markets are generally outperformed, and that's, I think, you look at the 30-year history of private equity and say, well, 30 years ago, 20 years ago, it was a less efficient asset class, so it was easier to drive outsize returns, and so now it's a bit more of an efficient asset class. But I think the dispersion of returns in private equity will continue to be substantial.

I think we've got a significant maturation of private equity. There's been some comments about there's more private equity funds, there's more private market funds than there are McDonald's in the US. Jim Zelter, the president of Apollo, made the comment last year that a number of GPs have raised their last fund. They just don't know it yet. So a bit of a maturation, a bit of a shakeout in private equity, and it goes to, it's been a tough IPO market, it's been tough to sell investments to distribute them back to LPs, and in that environment, LPs can't reinvest in the next fund until they've gotten their money back, and so private equity is going through a bit of a shakeout.

There will be fewer firms, I think that's a bad thing. Private credit is going through its own maturation, you know, tremendous amount of growth, but I think that growth led to deterioration in underwriting. It was just maybe too much capital came into this asset class at once, too many loans to bad software companies. And then venture capital, I think, is also going through an incredible maturation in terms of when I look at SpaceX, Anthropic, Open AI, these are still companies raising capital because they're burning cash, but they're doing series E, F, G, raising 5, 10 billion dollars at a time. It's kind of a complete rewrite of what is venture capital. These companies are absolutely massive in size.

So, I think the value proposition of why to invest a private market sleeve in your otherwise public market's portfolio in terms of being able to turn hands in and volatility dampening, I think that will persist though over the long term as these companies mature, as these asset classes mature.

Damien McIntyre

Well, it's going to be a fascinating time in public markets in the next six, nine months with SpaceX, OpenAI, and Anthropic all planning to list. And now in Australia, we've got a firm called Firmus, a data centre play. So it'll be very interesting to see how these enormous companies in the private space, how they cope in the public space.

Geof Marshall

And then to add to that Damo, I think as an investment manager, you want your hands in as many pots as you can or you're always looking for information advantage and if you can learn something about an industry or an asset class because you're involved in something similar on the private market side and if that can make you a better public markets investor, I think you should have that resource at your disposal.

Damien McIntyre

Yeah, taking full advantage of that. So just in closing, I wonder if you could just quickly describe how you've constructed the growth fund, because there's two units, there's a growth and an income. Can you just round this out, quickly describe how you've constructed those?

Geof Marshall

The growth fund has private equity at its core at about 35% weight, private credits about 20%. Private credit works well in that portfolio. The returns are slightly lower than private equity in VC, but the duration is shorter. You should get your cash back sooner. And then real estate and infrastructure and VC are equity-like. And so again, that portfolio optimised for returns, volatility and liquidity, but with more of a growth tilt.

Then we try to factor adjust, you know, the exposures that we're looking at. We own funds of Dawson Capital Partners. They're actually based out of Toronto, but they do private equity secondaries. But the way they structure their investments, it looks kind of like private credit. And so, we hold it in the private equity bucket. But when I look at our weights, I'm considering it partly as private credit as well.

The income strategy, I think over the long run will be slightly lower return. It's more built around private credit infrastructure and real estate. It doesn't have venture capital. In the lieu of venture capital, we thought about, you know, royalties as an asset class, whether it's music royalties, legal assets, could be commodity risk, timberlands. We'll see down the road. We only have, you know, one strategy there right now, the fortress legal asset strategy. It looks a lot like private credit.

Right now, the income strategy has a 4% distribution yield. And I think it probably has lower volatility than the growth strategy and maybe a higher sharp ratio at the end of the day. For the time being, the two strategies kind of look similar, but should differentiate over time.

Damien McIntyre

Well, Geof, thank you very much for your time. Once again, welcome to Australia. We're looking forward to a big week talking to our prospective clients and looking forward to great success with this fund. Thank you.

Geof Marshall

Thank you, Damo.