CLEARPOINT

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APRIL 2020

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THOUGHTS ON PRIVATE EQUITY INVESTING

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We believe that private investing—in equities, fixed income and hedge funds—will become more important as we move past the COVID–19 crisis. The harm caused by the shutdown in the world economy and the effects on quality businesses, in addition to historically high amounts of leverage in private equity funds, make this a propitious time to invest with skilled private equity managers. The ability of these managers to find businesses, invest at prudent prices, and implement changes to add value, has the potential to add significantly to investment portfolios. Likewise, dislocations in corporate and municipal debt markets and Fed asset purchase and support programs provide opportunities in private credit strategies. We have begun to discuss these opportunities with clients, who can access these investments through our ClearAccess platform or directly.

The article below is an overview of how we think about private equity investing in general. These principles will continue to be important, and perhaps more important, in the months ahead.

CLEARSTEAD CONTINUES TO BOLSTER TEAM WITH NEW TALENT

Aneet Deshpande, Chartered Financial Analyst, joined our firm last month as Managing Director and Chief Investment Strategist. Recently, Aneet spent four years with PNC Capital Advisors as Chief Investment Officer overseeing $53 billion, including 18 mutual funds, 25 investment strategies and an array of customized investment solutions. Aneet will oversee a large part of our Investment Research Team, which includes 14 professionals. He can be reached at adeshpande@clearstead.com.

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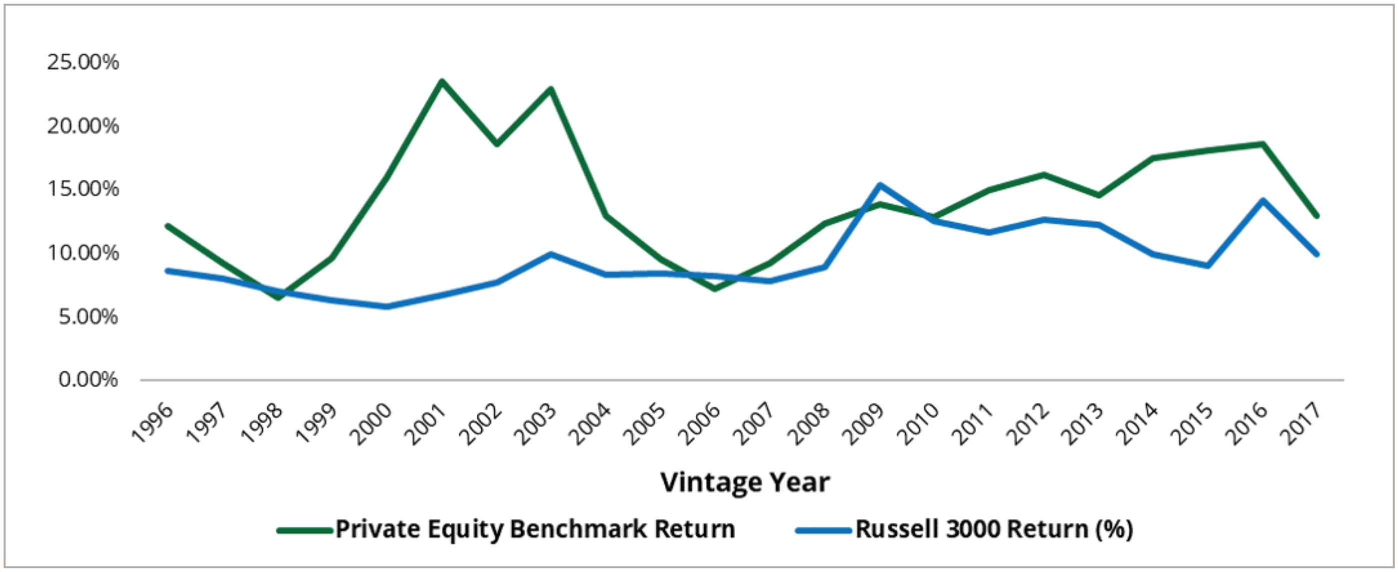
PUBLIC AND PRIVATE EQUITY INVESTING

Despite strong equity markets leading up to 2020, the Pitchbook analysis below shows that private equities performed better than U.S. public equities. Figure 1 shows that on a cash-flow equivalent basis, the Pitchbook Private Equity Benchmark, representing U.S. private equity investments has performed better than the Russell 3000 Index, representing their U.S. public equity counterparts. In this example, every time there was a capital call on private investment, the same amount also was invested in the Russell 3000 Index. Figure 1 shows that for almost every vintage year, U.S. private equity investments have, on average, outperformed the U.S. public equity markets.

Figure 1: U.S. Private versus Public Equity Market Comparison (Public Market Equivalent – PME)



Source: Pitchbook, report as of 12/31/2019, data as of 12/31/2017. Past performance is no guarantee of future results. Pitchbook analysis compares the Pitchbook private equity universe benchmark to the Russell 3000 Index. Clearstead is making no representation that the performance shown represents what a private equity investment would achieve, and actual returns of private equity managers could be lower or higher than the benchmark performance shown. Indices do not have management fees or expenses, which if applied would cause the performance shown to be lower. Clearstead disclaims any liability for any direct or incidental loss incurred by applying any of the information shown.

So, what has driven these higher returns? Simply put, active management.

ACTIVE MANAGEMENT: SKILL VERSUS LUCK

In Kurt Vonnegut's novel "The Sirens of Titan," a character, Noel Constant, makes a fortune by picking stocks whose initials followed the text of the Bible. Starting with the Book of Genesis, he would take the phrase "In the Beginning," and purchase stocks with names ***I****nternational* ***N****itrate,* ***T****rowbridge* ***H****elicopter,* ***E****lectra* ***B****akeries,* ***E****ternity* ***G****ranite*, without the slightest idea about the nature of these businesses. He was showing some sort of active management since he was not buying an index, but in our industry, this is what we would call luck, not skill.

Finding skill in active management is important because it helps to justify the expense, and skill breeds confidence that past strong performance may persist in the future. There are differences in the nature of what skill is between public and private equity. Generally speaking, active management in public equity means there is an effort to pick stocks that will outperform an investable benchmark, such as the S&P 500 Index or the Russell 2000 Index. Skilled active managers select companies whose value they believe will increase over time and be accretive to the portfolio. The skill is in selection of businesses through analysis and understanding the business landscape that will support them. Largely, the ownership of stock is through observational analysis, and if the thesis changes, the manager is free to sell the stock through the public exchanges, as publicly-traded stocks are highly liquid.

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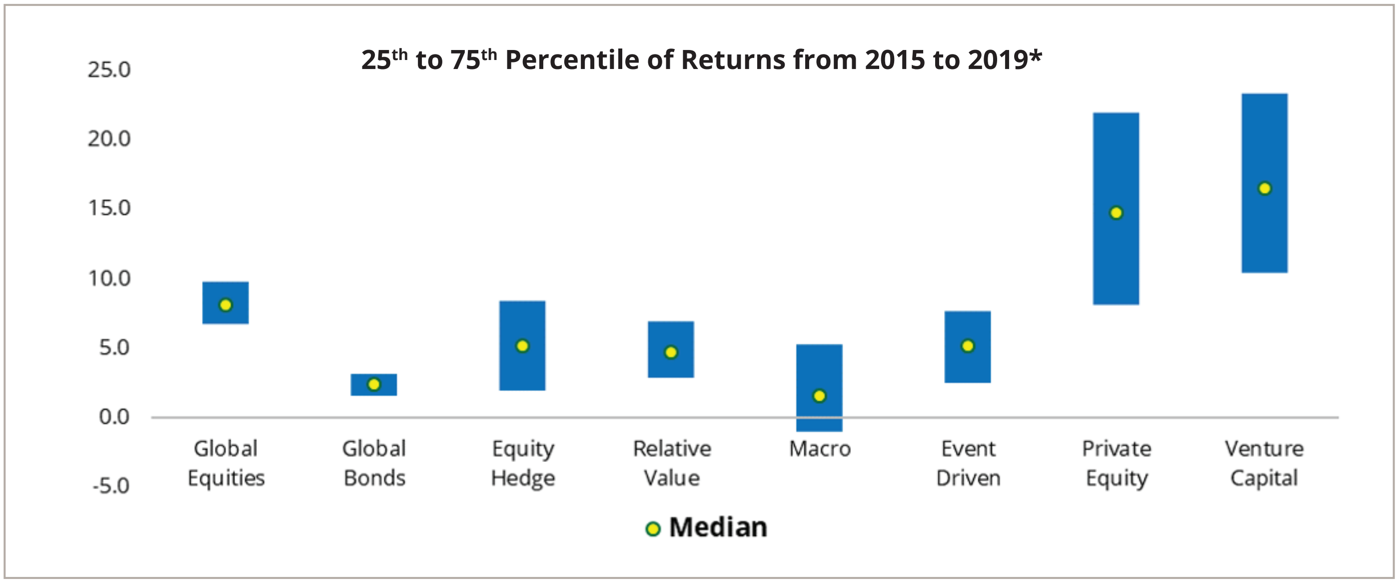
The terms skill and active management take on a different tone in private equity, where capital is typically locked up for many years. Private equity managers can take a minority or majority position in a private company and can make changes that drive an increase in value. And because capital is locked up, these managers can take a long-term view in achieving their goals. That is active management in the private equity world: taking ownership of an asset and transforming it over time.

IDENTIFICATION OF SKILL AND THE ILLIQUIDITY PREMIUM

The identification of skill is easier in the private equity markets than the public equity markets because of the control element. For the private equity analyst, due diligence questions can include: "What did you do with the assets?" "What did you do to grow scale?" "What did you do in challenging situations to turn the business around?" These types of questions can help the investor assess the actions taken by the manager to drive profits or respond to market movements or unexpected situations. In this way, an analyst can link the outcome of the investment with actions taken by the manager, whereas in public market investing, this connection is more tenuous. Some evidence of skill in private equity investments is shown in Figure 2.

Figure 2: Performance Dispersion in Public and Private Asset Classes



Source: Morningstar, Pitchbook, Hedge Fund Research. *Global equities (large cap) and global bonds dispersion are based on the World Large Stock and World Bond Morningstar categories, respectively. Manager dispersion represented ranges from 25th to 75th percentile of returns and is based on: 2015-2019 annual returns for global equities, global bonds, hedge funds. U.S. private equity and U.S. venture capital are represented by the 2014 vintage year internal rate of return (IRR) and are as of 3/31/2019. Data as of December 31, 2019 unless otherwise noted. Past performance is no guarantee of future results. This material is for informational purposes only and does not consider the investment objectives or financial situation of the person receiving this information. A person seeking information about an investment strategy represented in these materials should contact a financial professional to help evaluate as to whether it is consistent with a person's investment objectives, risk tolerance, and financial situation.

Figure 2 shows that the performance dispersion between managers in the 25th percentile and 75th percentile is much greater for private equity and venture capital than for public market global equities. The wide dispersion highlights that skills vary widely among private equity investment managers and the importance of good manager selection through deep due diligence. Skills also may vary widely among public equity managers, but in the private equity world, the translation into returns can be more direct because of the hands-on nature of private equity investments.

In addition, we find that in private equity investments, a good track record for a given manager seems to persist, whereas the ability to consistently outperform is more elusive in managers in public equity. This makes sense because of the element of control by the private equity manager. Manager skill here is not only about assessment of what may be a good investment, as in the case of public equity investing, but *transformation* into *better* business through control and timing. These actions include assignment of talented leadership, achieving operational efficiency, better use of technology, and achievement of scale, to name a few. These skills can be repeatable and can be applied to multiple businesses in a private equity portfolio, and presumably, the skills of the same team could persist from one vintage year to another.

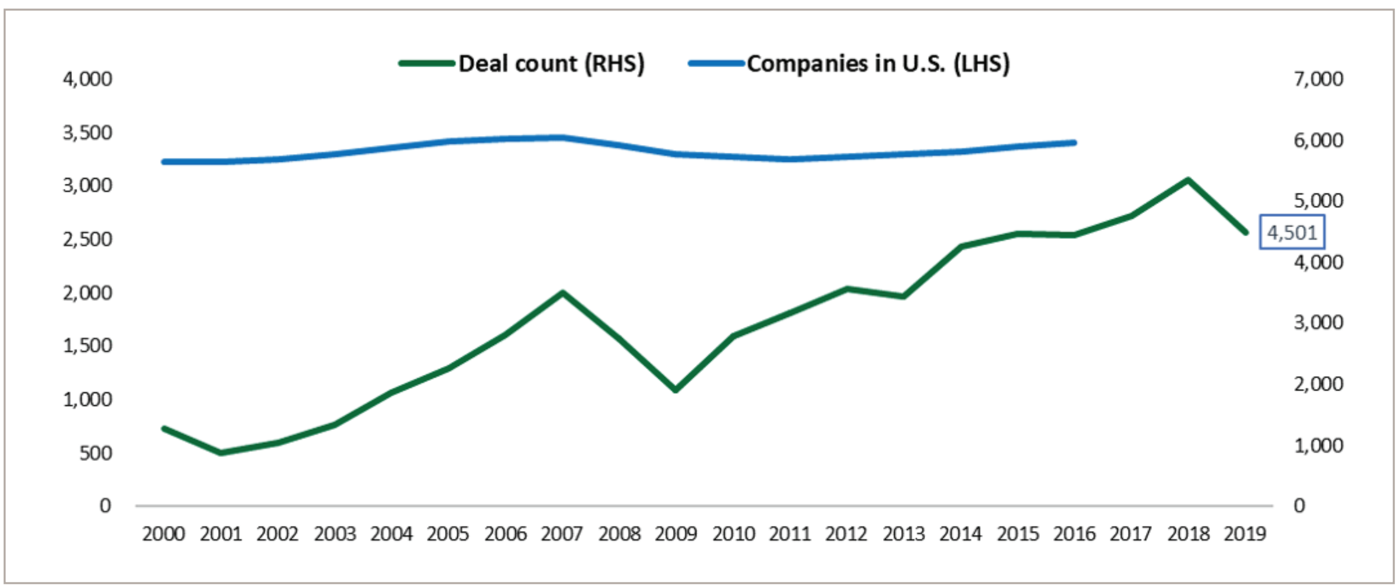
Changes that drive value take time, and time is what the illiquidity of private vehicles can provide. Our industry often speaks of the illiquidity premium, which is understood as the enhanced returns that investors should expect from having capital locked up for some time period. To be sure, the premium does not exist because of illiquidity alone. Imagine buying a highly liquid S&P 500 ETF and locking the shares for the next ten years. At the end of the ten-year period, the performance of that investment would be almost the same as the S&P 500 Index (minus the deduction of manager fees). The illiquidity premium of private equity investments comes from transformations that can take place because there is no concern about outflows of capital. The money is *committed* for multiple years to allow *skilled* managers to *actively manage* the assets. The higher returns that can result are in essence a part of the illiquidity premium.

CURRENT ENVIRONMENT: ISN'T PRIVATE EQUITY RISKY?

There are risks to any investment, whether private or public, as owning equity in a company is having a stake in the future of that firm. When one owns public equity, there is comfort in having intra-day liquidity, but there can be risks of market gyrations and lack of control of the outcome. Market volatility can be less of a concern in private equity markets, but there can also be risks that come with *having control* and the process of transforming a company. Both forms of owning equity have risks, but private equities can seem riskier because they are less transparent and less accessible.

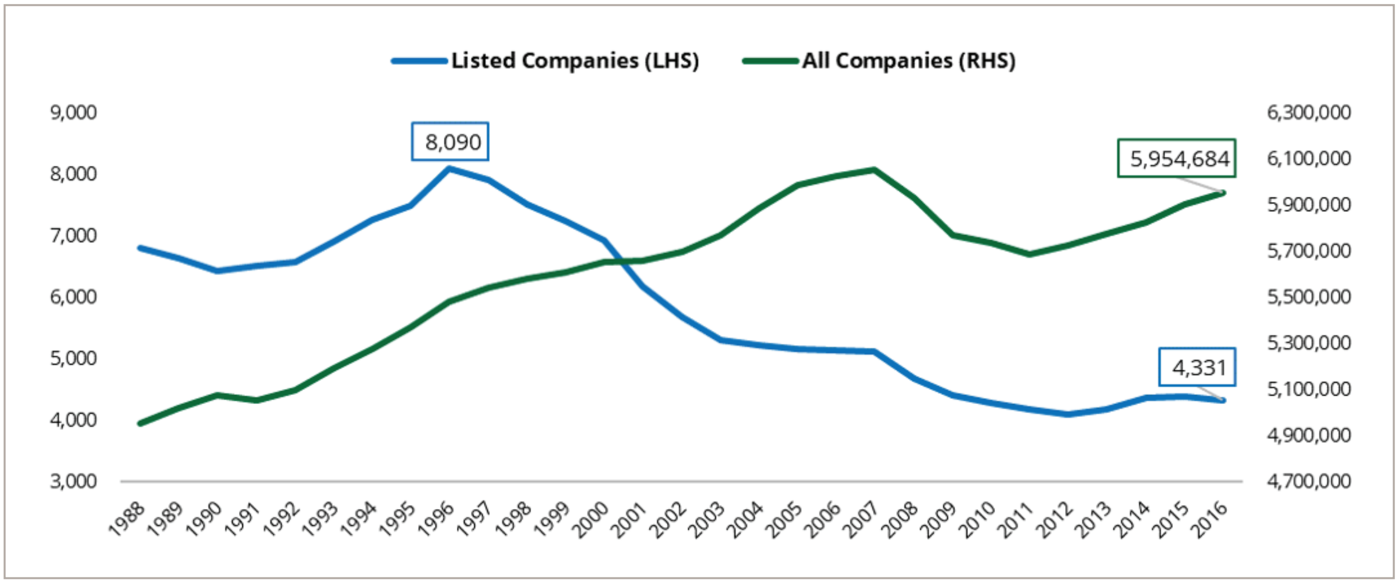
Heading into 2020, there was much talk in the marketplace about private equity, about the record high dry powder, multiples, increasing fund sizes, and record fund raises. This might suggest we are at market highs, which would warrant caution. To be fair, we see oversubscriptions and one-and-done closes that signal a record high demand for private equity investments, but we also see *deal flow that could support the demand*, the very investing opportunities that are not channeled into the public markets via IPO or merger. Figure 3 shows that since 2000 deal flows for private equity have been increasing, as the number of businesses in the U.S. have increased, and Figure 4 shows fewer of those businesses are reflected in the number of publicly traded companies over the years.

Figure 3: Total Companies in U.S. versus Private Equity Deal Count



Source: Pitchbook, U.S. Census Bureau. As of 12/31/2019.

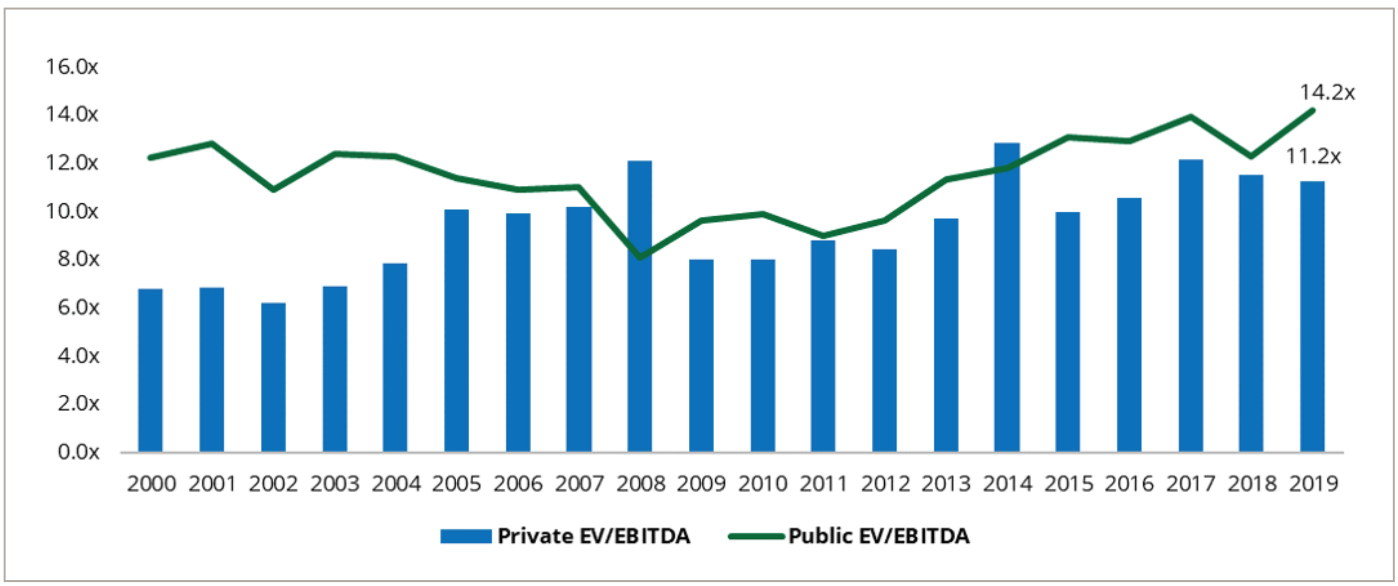
Figure 4: Total Count of Businesses in the U.S. versus Publicly Listed Companies



Source: The World Bank, U.S. Census Bureau. As of 10/2/2019.

Additionally, because there seems to be so much liquidity, it may suggest to some market participants the frothy nature of the private equity environment[1]. However, the other side of the assessment would be more discipline on the part of the private equity managers with a more measured approach to deploying capital at high multiples. As shown in Figure 5, since 2000 the multiples have been high for U.S. private equity buyouts, but the multiples for public equity markets have been higher in most years.

Figure 5: U.S. Private Equity Buyout Multiple versus U.S. Public Equity Multiple



Source: Pitchbook, Bloomberg. The "Public" market is represented by the Russell 3000 Index. Private market data as of 9/30/2019; Public market data as of 12/31/2019.

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While comparing multiples between public and private equity markets may give us a general view, there are limitations. For example, an investor can buy an index fund that replicates the Russell 3000 Index, but there is no equivalent in private markets, as private equity investing is asset-specific. While the 11.2x private equity multiple as of 9/30/2019 is an average number and can tell us something about the general private equity investing environment, there is a distribution of deal multiples around it that can make asset selection by managers a significant part of active private equity management. Talented private equity managers can acquire companies at a discount, especially when deals are complex, the situations are challenging, and pricing can become less efficient. Deals are not uniform in private equity markets and there can be room for managers to add value as they source investment opportunities.

We understand investing in private equity can be challenging, and some investors may not have the same confidence they do in public equity markets. Private equity investing requires accepting greater illiquidity over a longer time and research to find the best managers. Clearstead has experience with private equity investing and has made it accessible through our ClearAccess platform. Our approach for both private and institutional clients includes thorough education on the benefits and risks of private equity investing and why we believe it can be important to achieving investment objectives.

Notes:

(1) Dry powder as of end of 2019: $1.45 trillion (Preqin)

MARKET BENCHMARK RETURNS

March 31, 2020		1M	3M	12M	YTD
US Large Cap	S&P 500	-12.4%	-19.6%	-7.0%	-19.6%
US Small Cap	Russell 2000	-21.7%	-30.6%	-24.0%	-30.6%
Developed Intl	MSCI EAFE	-13.3%	-22.8%	-14.4%	-22.8%
Emerging Intl	MSCI Em Mkt	-15.4%	-23.6%	-17.7%	-23.6%
Real Estate	NAREIT	-20.8%	-25.4%	-18.2%	-25.4%
Core Fixed	BarCap Agg	-0.6%	3.1%	8.9%	3.1%
Short Fixed	BarCap 1-3Yr	0.3%	1.7%	4.5%	1.7%
Long Fixed	BarCap LT G/C	-3.0%	6.2%	19.3%	6.2%
Corp Debt	BarCap Corp	-6.6%	-3.1%	5.1%	-3.1%

Source: Bloomberg

The performance data shown represent past performance. Past performance is not indicative of future results. Current performance data may be lower or higher than the performance data presented.