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SUMMER SESSIONS

Refresh your knowledge of essential topics in investing

Introduction to Private Markets

Presented by Josh Lerner

Key Points

- Private capital refers to private investments encompassing a number of asset classes, including venture capital (VC) and buyouts.
- Private capital has many benefits. For example, VC can drive innovation while buyout groups can improve company operations.
- Private markets are cyclical but have historically outperformed public markets both overall and during economic downturns, though the “private equity advantage” may be fading.
- Growth in the private markets can be seen through large increases in fundraising, investment, and dry powder over the past two decades.
- Private markets continue to evolve to meet investor preferences resulting in many innovations, including co-investing opportunities, more robust secondary markets, and the emergence of SPACs.

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Private capital refers to private investments encompassing a number of asset classes. Interests in these assets are typically arranged as limited partnerships with investors referred to as LPs. General partners, or GPs, act as the investment managers, who call and deploy capital from the LPs. Some of the most common types of assets that fall under the private capital umbrella are buyouts, venture capital (VC), real estate, infrastructure, private debt, and natural resources.

Buyouts occur when a buyer acquires more than 50% of a company leading to a change of control. Buyout groups attempt to add value to the newly acquired company (frequently one that is already well established) through operational improvements and usually use debt to magnify their returns. Venture capital funds, on the other hand, manage investments in high-growth opportunities in start-ups and other early-stage companies. VC can be attractive to entrepreneurs as VC groups offer numerous benefits including mentorship, credentialing, and faster scaling, in addition to capital. In fact, VC has had a profound impact on the world and markets, with seven of the ten largest public companies in the world by market cap being VC-backed.

Distinct trends can be observed in the historical performance and behavior of private markets. One of the fundamental characteristics of private markets is cyclicality, which can be observed in performance as well as in fundraising and investment. Interestingly, the highs and lows of fund performance are highly counter-

cyclical. That is, funds raised during peak fundraising years tend to underperform, while funds raised during low fundraising years tend to perform quite well.

Despite this cyclicity, private markets are expanding rapidly. This growth can be seen through large increases in fundraising, investment, and dry powder over the past two decades. This has resulted in more activity and competition as well as larger deal sizes. While private equity continues to outperform public markets on an unadjusted basis (though less dramatically than in earlier decades), how to properly account for illiquidity and risk remains controversial.

The industry is continuing to innovate and change as illustrated by the rise in co-investing, secondary markets, and special purpose acquisition companies (SPACs). Co-investments are investments made directly in a company rather than through a fund, thus avoiding management fees and providing more flexibility and control to LPs. The market is also evolving through increased activity in secondary transactions, which involves the buying and selling of pre-existing LP commitments to funds or fund restructurings. Finally, the private markets are experimenting with new products through the recent rise in SPACs. SPACs are public shell companies set up with the goal of finding a private company to take public via a merger and may offer a way for more investors to access private markets. These new innovations demonstrate how the industry continues to evolve and change to meet investor preferences by offering new products and investment solutions.

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