Elston Insights

18th February 2022

Private market managers deliver a return premium

- Private market managers continue to deliver a return premium
- Owning managers' shares provides liquid access
- Growing levels of forecast AUM in private markets fuels growth

Evaluating private market performance

Estimating the "illiquidity premium" of private markets versus public markets is complex and cannot be done using public data.

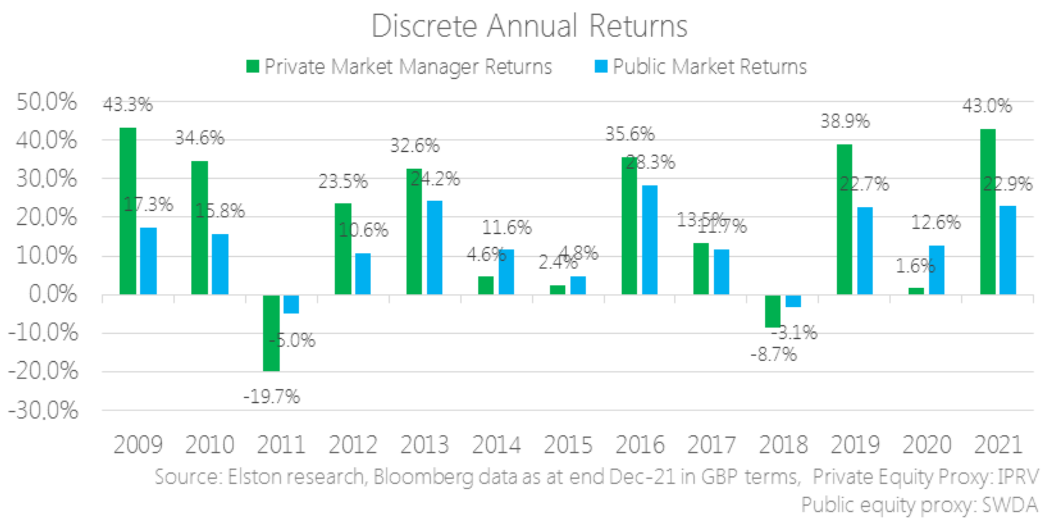
As an alternative we focus on the returns premium of private market managers to public markets.

By comparing the performance of listed private market managers (whose shares are publicly traded) to a mainstream public markets benchmark, we can get a picture of the liquid return premium of the sector as a whole, relative to public markets. Any illiquidity premium generated by a specific fund within a private markets manager would be out of the scope of our analysis.

Private markets (managers) continue to deliver

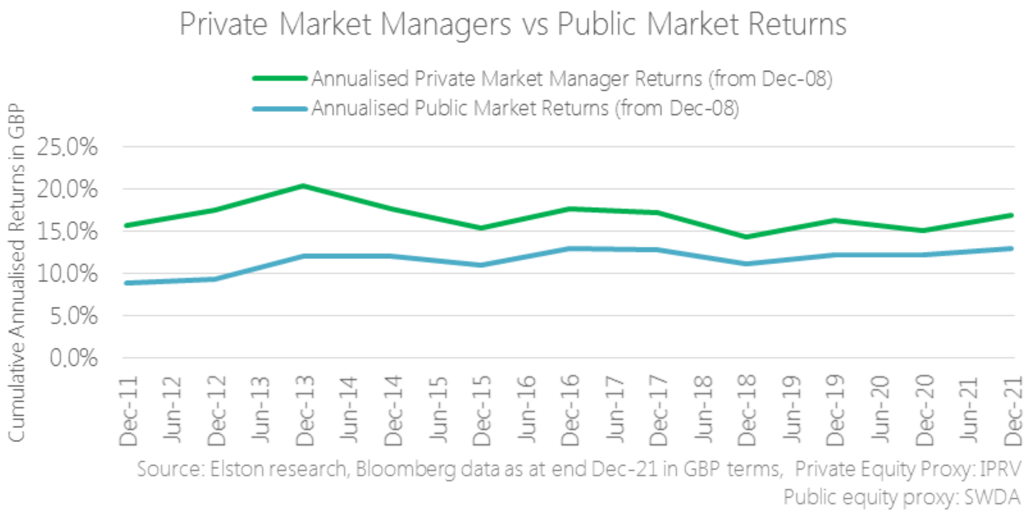
We have updated our long-term public market vs private market manager performance tables. Looking at discrete data, 2021 was a strong year for private market managers in 2021, with +43% return, relative to +23% for public markets, in GBP terms..

Fig.1. Discrete annual returns: private market managers vs public markets



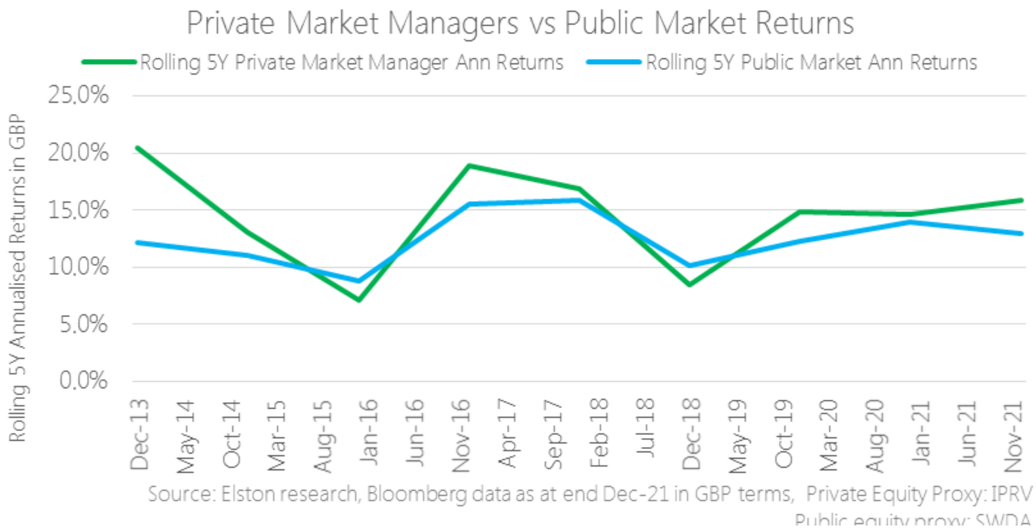
Since December 2008, from when there is sufficient data to enable comparison, the return premium for private market managers over public markets is +4.0% per annum annualised in GBP terms.

Fig.2. Cumulative annualised returns since December 2008



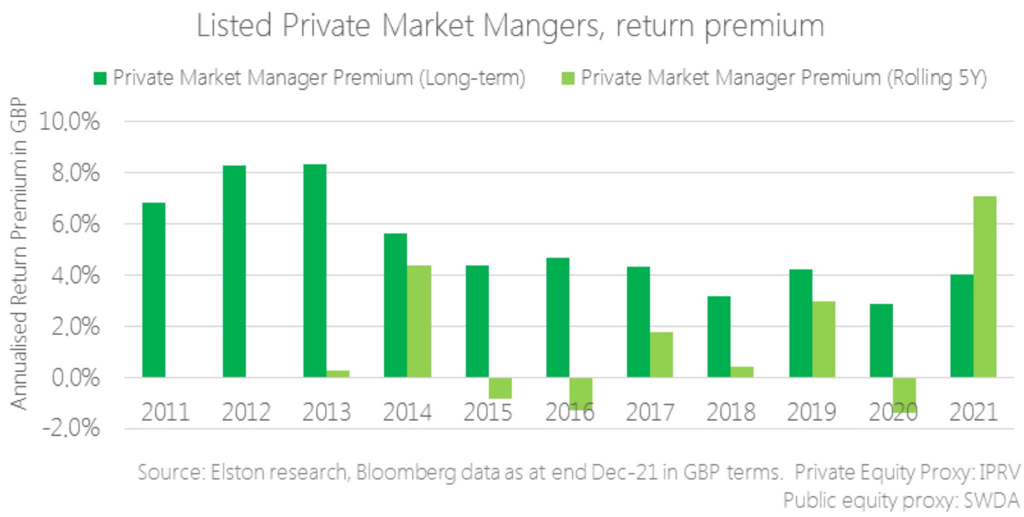
If we look at rolling 5 year periods, the premium increased to +7.1% as at end December 2021, from a slight discount of -1.4% as at end December 2020. So timing of an investment will matter over the short- to medium-term.

Fig.3. Rolling 5 year returns, as at Dec-21



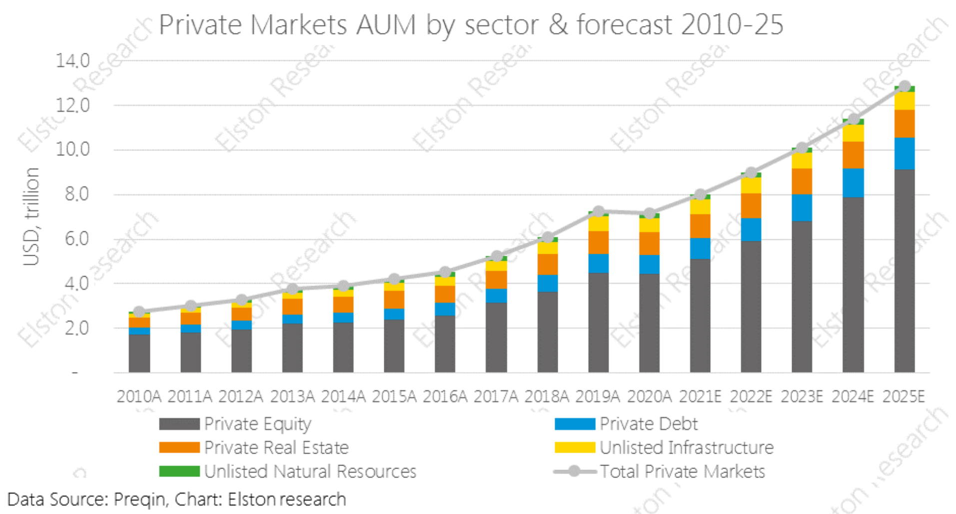
The evolution of the long-term and rolling 5 year return premia between private market managers and public market returns is illustrated below.

Fig.4. Evolving private market manager return premia



Structural growth in private market assets under management should continue to support private market managers' revenues, earnings and hence share price.

Fig.5. Private market forecast AUM expectations, 2020 to 2025.



Private market investment trusts

The other "liquid" way of accessing private markets is by investing into private market investment trusts. However, this creates two additional complexities: which trust to select for that exposure, and the variable premium and discount associated with that trust, which may impact entry and exit prices.

Evaluating the performance of the private market investment trusts, rather than their managers, could be an alternative approach to evaluating private market performance.

The illiquidity premium

Private market funds available to institutional investors are different to daily traded retail funds. They draw down on capital commitments and don't return capital for several years. In the interim, their value is based on an auditor's valuation. Whilst more opaque than for publicly traded funds, this structure is necessarily inherent to the nature and purpose of private market funds.

At its simplest, the rationale for investing in private market funds is for the return enhancement associated with leverage and the so-called "illiquidity premium": the additional rewarded risk for having capital locked up over a few or many years.

When evaluating the performance of investments in private market funds, an Internal Rate of Return figure is used, reflecting the cashflows of an investor in and out of the fund over time.

In order to make this measure comparable to what investors would have got by investing in public markets, private market funds may also show a "Public Market Equivalent[1]" figure, which shows the IRR of an investment in the fund, compared to a theoretical IRR, had the underlying investments of the fund been made into the shares of a public benchmark. Whilst this enables individualised ad hoc performance evaluation for specific funds, it is very hard for outsiders to evaluate the IRR of private market funds in aggregate as performance data is not publicly available for those funds or their PME benchmarks, which will be specific to the cashflow profile and vintage of a particular fund. In short, there is not publicly available way for evaluating private market fund performance.

This is why we find the performance of private market managers, and/or the performance of private market investment trusts inherently interesting.

Methodology

As firm believers in index investing, we use iShares Listed Private Equity UCITS ETF [Ticker: IPRV] as a proxy for private market managers. We compare its performance against iShares Core MSCI World UCITS ETF [Ticker: SWDA] as a proxy for public markets.

We believe that holding shares in private market managers is a useful – and more liquid – proxy for accessing private market exposure for retail investors, rather than private market funds, or indeed private market investment trusts. This is why we have included it in portfolios we have been designing for wealth managers since 2016.

Summary

Comparison of private market funds to public market equivalents is highly specific to each fund, its vintage and the public market benchmark selected. Estimating the illiquidity premium for private markets is complex and not readily achievable.

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[1] https://en.wikipedia.org/wiki/Public_Market_Equivalent

Comparison of the returns of listed private market *managers* to a public benchmark is readily achievable. Whilst that premium may vary depending on the period and term under review, the long-term figures suggest that there is a clear premium.

This continues to support our view that within the Alternatives allocation of client portfolios, a moderate allocation to listed private market managers makes sense to capture this premium in a transparent, liquid and cost efficient way.

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