Harnessing growth potential with private equity funds

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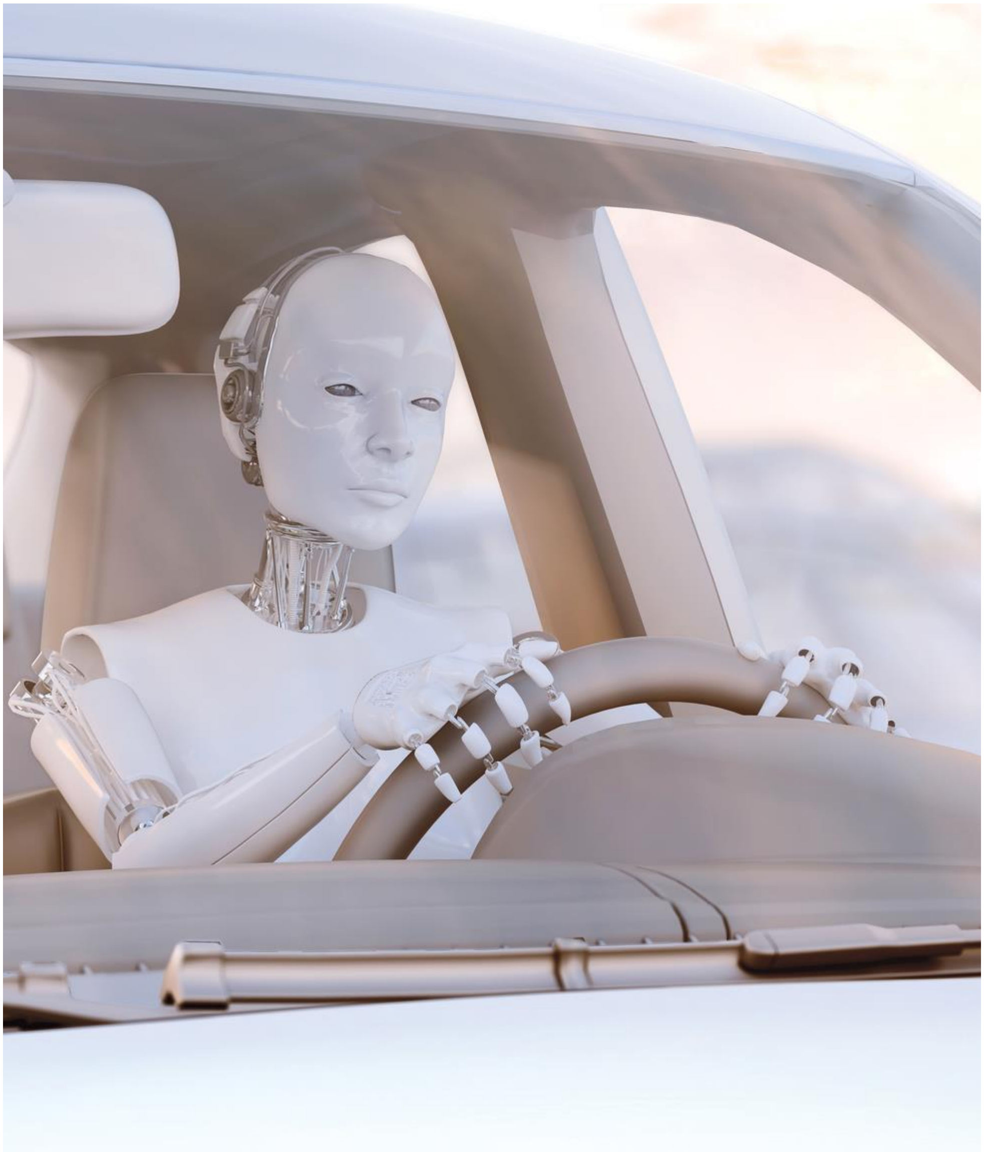


Financing important, constructive changes of relatively established small to mid-sized businesses is as challenging as it can be lucrative. More than ever, fund manager selection is crucial, most notably as the persistence of returns has declined.

Growth investing consists of financing important, constructive changes of relatively established small to mid-sized businesses such as fast expansion, a jump in professionalization, a significant consolidation or a deep transformation. It is as challenging as it can be lucrative. The necessary expertise and resources call for the selection of funds operating in late-stage venture capital, growth capital and small to mid-sized leveraged buy-out ("growth funds"). Past realized fund performance has been rewarding: growth funds outperformed non-growth peers by 14.1% in terms of pooled average net Multiple of Invested Capital (MOIC) and 320 basis points in terms of internal rates of returns (IRR). Timing and favorable market conditions played a limited role. Fully realized growth funds record a lower risk on average, in quartile fund manager selection, and a lower frequency of losses. However, past performance is not indicative of future results. The private equity market has significantly changed over the course of the last decades. As average fund sizes have increased substantially, investment styles of fund managers can drift. They might be tempted to compete for larger and more expensive assets, potentially resulting in lower future performance. More than ever, fund manager selection is crucial, most notably as the persistence of returns has declined.

Introduction

In many respects, private equity (PE) is the optimal investment strategy for harnessing the development potential of an economy. The most obvious case is venture capital (VC), which finances emerging companies (start-ups) that are exploring new markets via innovative products and services. Usually, VC finances start-ups until they are profitable, and eventually listed or acquired. This investment strategy bears significant risks: according to the US Bureau of Labor Statistics[1], 50% of US start-ups created in a given year disappear over the course of the following five years. This percentage is even higher in Europe[2]. Investing in early-stage start-ups is, therefore, a high-risk strategy.

A less risky approach is to provide capital to profitable (or soon to be profitable) small to mid-sized companies with a high growth rate. These companies are attracting new clients organically and/or by acquiring competitors, on their home market and/or abroad. Later-stage VC and growth capital [3] (GC) provide financing to these usually private[4] companies in exchange for a significant minority ownership with specific economic and shareholders rights. In both cases, PE facilitates growth in new and established small to mid-sized companies.

Defining "growth"

Nonetheless, the concept of growth is not limited to start-ups expanding their national markets or branching out abroad. Growth opportunities can also appear in stable niche markets where more established small to mid-sized companies are active. Niche markets are less competitive and often resilient to macroeconomic events. These market features can lead small to mid-sized companies to become complacent and lack dynamism. For investors, however, this is where investment opportunities lie. Growth can be unleashed when addressing constructive situations such as professionalizing[5], actively consolidating a sector, refocusing, executing a technological leap or shifting to a different business model or market. These are the most frequent opportunities, but other company-specific situations can also count as such.

GC can finance these corporate changes as much as help trigger them. But investors face multiple obstacles in seizing these opportunities. First, they are not easily identified. As small to mid-sized companies are usually not listed, they often fly under the radar of investors. Moreover, these companies require significant expertise to be assessed. As a matter of fact, private corporations generally report on an annual basis only and provide scant information. In this context, fund managers have to deploy a wealth of know-how and experience.

The biggest obstacle is that as these companies are profitable and stable, they rarely seek additional external resources provided by professional investors. Thus, there is no pressure for the management teams to reassess their operations. For example, the sole owner-manager of a mid-sized company might miss signs of an upcoming, significant market shift. In contrast, a board of directors with professional investors could regularly and constructively challenge the CEO on the firm's strategy for the benefit of the company.

1 US Bureau of Labor Statistics (2016, see endnotes).
2 Eurostat (2018, see endnotes).
3 Sometimes referred to as "growth equity".
4 They are usually private but can be public as in the case of private investments in public equities (PIPEs) operated by GC funds.
5 For example, by setting up new processes, outsourcing/insourcing and/or optimizing operations.

The most frequent catalyst of change associated with PE is the transfer of company ownership through a leveraged buy-out (LBO). This type of operation involves the intervention of professional, long-term, active shareholders adding value that is later converted into profits when selling their stakes in the companies they have successfully transformed. LBOs can lead to a majority ownership of the underlying firm, or to a significant minority ownership ("replacement capital"). LBOs are an opportunity for the new owner to reassess the potential of the company and define a new strategy. For example, in "buy-and-build" investments, the acquired company (the "platform") will make "add-on" acquisitions. The owner of the platform can exploit synergies among the different companies of the group. By acquiring smaller, and therefore comparatively cheaper, competitors, the owner also profits from an increase in value of the resulting group that becomes less risky as it gains in size and stability.

Indeed, the consolidation of industrial sectors can unlock growth potential, especially for small to mid-sized companies. A company vertically integrating its providers and distributors can better serve a diverse client base and potentially tap into a new pool of clients. A company horizontally integrating some of its competitors can gain in economies of scale and productivity. As it lowers its costs, it can reduce the price of its products or services. As a result, its market is enlarged to a new group of clients previously priced out.

In this report, we will define "growth investing" as a broad business concept of financing the important constructive changes of relatively established small and mid-sized businesses such as fast expansion, a jump in professionalization, a significant consolidation or a deep transformation. This definition, therefore, excludes the initial launch and early steps of a business (so-called early-stage investing), as well as cost cutting in large companies or downsizing and restructuring of distressed businesses.

How to harness growth?

Investing in growth (as defined above) can be beneficial for at least two reasons, the first being access to a larger investment universe. Though the exact number of active companies worldwide is not known, estimates place that figure at 300 million. Small to mid-sized firms represent a fair share of that total. Thus, they provide investors with a wider, deeper pool of investment opportunities than the 47,000 listed companies. In particular, they:

- Operate on a much wider spectrum of industries, including for example regional chains of fitness studios, racing car maintenance, the production of fishing hooks or funeral home operations. They are often at the forefront of innovation in micro-mechanics, advanced manufacturing, new materials and consumer goods. These companies generally do not go public for multiple reasons. For example, they might operate in niche markets or unfashionable sectors, or not offer the same return for the same risk as expected by investors in listed markets.

- Provide a deeper pool of investment opportunities, as they are more numerous, offer a wider range of opportunities for constructive change, but also because they are everywhere on the globe. Many countries do not have a stock exchange, or list only a select number of diversified financial institutions, commodities producers and retail chain operators. Small to mid-sized businesses reflect the economic potential of local economies that cannot be tapped outside of private equity investing.

Secondly, investing in growth can be beneficial for risk reduction. Small to mid-sized firms are sensitive, as is any company, to operational events such as unpaid invoices, major disruptions of their supply chain or political upheaval. However, their size and agility can also insulate them from macroeconomic events such as recessions, support their early reaction to significant market shifts or help them anticipate the transformation of their industry. For example, exporters in emerging markets can mitigate asymmetric shocks such as local recessions. Spare-part businesses operating on long-term contracts in aviation can overcome global recessions. Many small to mid-sized businesses are positioned to deliver quality products and services as well as being able to absorb shocks by actively managing their prices or by using their relatively comfortable commercial margins. Moreover, growth companies (as defined above) generally rely on proven business models and are much more resilient than start-ups, for example.

Executing this type of PE investment is difficult. Only active investors on the ground are able to operate investments such as a significant capital increase or a transfer of ownership. Investors have to define a plan with management, monitor the execution and act if the company does not deliver as expected. In some cases, this can lead to a change of management. To support their intervention, investors negotiate specific investment terms, such as preferred shares, liquidation rights or other minority ownership rights, especially if they are minority VC or GC investors.

Although it is possible to develop this expertise on a given market or in a specific industry, it can be very expensive and difficult to do so on a large scale. As a result, investors have delegated this activity to PE fund managers, who provide expertise at a fraction of the cost of investing directly. Fund managers have the network, know-how and resources to successfully execute locally complex investments, from sourcing to exit.

Growth momentum
Growth investing has recently gained momentum. Other segments of the PE market, such as early-stage VC or large and mega LBO, have become very popular and have rapidly gathered significant amounts of capital. As a result, valuations have increased substantially, casting doubts on the future profitability of these investments. At the same time, growth investments as described above benefit from several favorable factors.

First, the valuations of smaller companies tend to be more conservative. Perceived as riskier than their larger counterparts at investment date, their valuation embeds significant discounts to account for this risk. Moreover, the use of debt when acquiring or investing in small to mid-sized companies is limited (or nil in the case of late stage VC or GC). Low interest rates and easily available credit contributed significantly to the inflation of valuations at the larger end of the market, but small to mid-sized companies have been relatively immune from this phenomenon as they are not perceived by lenders to be good recipients for a large amount of debt for an acquisition.

Second, small to mid-sized businesses are often not particularly fashionable. Their industries tend to be misunderstood or ignored. They include, for example, leather manufacturers, precision parts manufacturers or industrial control system producers. And even when they are in fashionable sectors, they still tend to be closed to foreign participants and influence. This is the case, for example, in luxury goods or high technology manufacturing. Expertise is scarce and valued, which means that deal sourcing tends to be proprietary. Lower competition for these companies limits the inflation of valuations.

Third, unlocking the growth potential of small to mid-sized companies leads to an increase in their value which is proportionally much more substantial than for larger firms. Their growth combines significant and rapid business progress with risk reduction as the companies become larger. This mitigates the effect of valuations which tend to rise towards the end of an economic cycle.

Executing growth investing
Although attractive, growth investment opportunities are difficult to grasp. As a result, investors have resorted to selecting funds specialized in late stage VC, GC and small to mid-sized LBO. Fund selection, however, is also challenging. The number of PE fund managers identified by the database provider Preqin globally exceeds 7,000. The majority specialize in growth financing locally and often in a given set of industries. Selecting fund managers, therefore, requires dedicated resources and expertise.

To evaluate this effort, the next sections of this report will focus on three dimensions: performance, risk and the value-add of PE fund managers, comparing funds focused on growth, as defined previously, with their peers out of this perimeter, as well as the overall performance of all PE fund managers. In addition, the final two sections include a regional and more detailed analysis of emerging and established funds. The perspective is global, and the period of reference is 2000-2015[6].

[6] Funds created after 2015 are too recent to provide any meaningful information.

Performance analysis

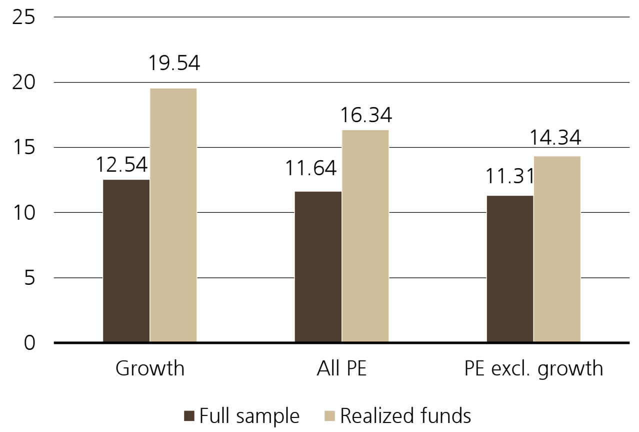
For our performance analysis, three samples will be compared (Table 1). The full sample ("All PE") numbers 2,833 funds gathering USD 2,065bn. The growth sample (as defined above) includes 1,305 funds gathering USD 630bn. The non-growth sample (also referred to as "PE excluding growth") involves 1,528 funds gathering USD 1,435bn.

The two subsets are similar in the number of funds, although the non-growth sample gathers more than twice the assets of the growth sample. Therefore, the average fund size is different: growth funds manage, on average, USD 483m and non-growth funds USD 939m. Growth investing appears as less scalable than large/mega LBO investing. This difference could affect net performances: large funds can better amortize due diligence costs and also charge marginally lower management fees. This could potentially explain lower performance of growth strategies than non-growth.

When comparing all funds over the period considered (Figure 1) growth and non-growth strategies record similar IRR. Growth strategies showed a 12.5% net IRR for all funds tracked "full sample" and 11.3% for non-growth.

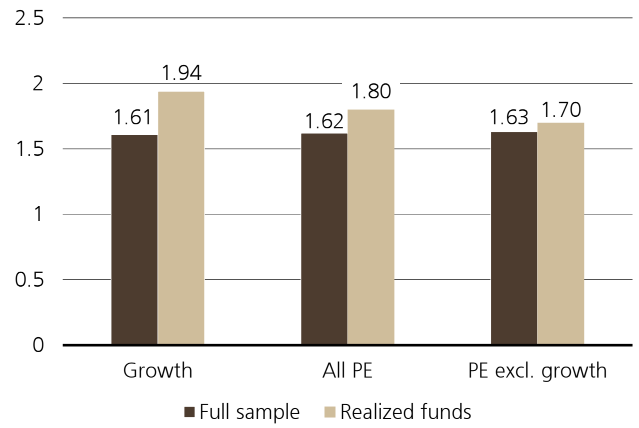
When looking at multiples on invested capital (MOIC[7], Figure 2), the advantage disappears as growth strategies record a 1.61x and PE excluding growth a 1.63x MOIC.

Figure 1: Compared IRR of all PE funds, growth and non-growth strategies
Full samples generate similar IRRs, but realized funds show a more contrasted picture. Growth funds outperform non-growth funds by 320 basis points.



Source : Cambridge Associates, Wellershoff & Partners.

Figure 2: Compared MOIC
MOICs confirm the conclusion drawn from IRRs: full samples appear to have similar performance, while realized growth funds outperform non-growth funds.



Source : Cambridge Associates, Wellershoff & Partners.
[7] Often also referred to as Total Value to Paid In (TVPI).

Table 1: Performance and maturity of PE funds, growth and non-growth strategies (full sample)

	Vintage years	Number of funds	AuM (USD bn)	Average size (USD mn)	IRR (%)	Pooled average MOIC	Maturity* (%)
Growth	2000-2015	1,305	630	483	12.54	1.61x	62.73
PE ex. growth	2000-2015	1,528	1,435	939	11.31	1.63x	65.64
All PE	2000-2015	2,833	2,065	729	11.64	1.62x	64.81

Source: Cambridge Associates, Wellershoff & Partners. * The maturity of funds is calculated by dividing the distributions by the total value of funds.

However, this first glance can be misleading. The full sample includes active funds that can distort performance measurements. PE funds are expected to mark their portfolio to market according to the international private equity valuation guidelines (IPEV). Portfolio companies are, thus, reported at their fair market value. Growth and non-growth strategies apply this approach[8], though funds active at the smaller end of the spectrum, such as with growth investing, tend to be more conservative in their interim valuations. At acquisition time, investors value small to mid-sized firms with discounts and lower multiple ratios. These analytical choices are then reproduced quarter for quarter until exit, for the purpose of consistency. Moreover, large and mega LBO funds routinely engage in so-called dividend recaps[9], enabling them to distribute borrowed cash to investors quickly, therefore boosting IRRs. As a result, the IRRs of active funds at the larger end of the market can temporarily or permanently appear as higher.

To eliminate analytical biases associated with interim valuations and fair market values, we focus on fully realized funds. Growth funds recorded a substantially higher performance (a 19.5% IRR and a 1.94x MOIC) than their non-growth peers (14.3% and 1.70x). Growth funds have a slightly shorter time-to-liquidity[10] (Table 2) than non-growth funds.

"Despite the smaller fund size, growth funds outperformed non-growth funds by a 14.1% higher pooled average net MOIC and an IRR 320 basis points higher."

Table 2: Performance and time to liquidity (realized funds only)

	Vintage years	Number of funds	AuM (USD bn)	Average size (USD mn)	IRR (%)	Pooled average MOIC	Time-to-liquidity (years)
Growth	2000-2011	182	47	259	19.54	1.94x	3.71
PE ex. growth	2000-2009	149	65	436	14.34	1.70x	3.97
All PE	2000-2011	331	112	338	16.34	1.80x	3.89

Source: Cambridge Associates, Wellershoff & Partners.

8 Except early-stage VC, as start-ups do not have positive results that could support this valuation technique.
9 The purpose of a dividend recap is to anticipate distributions to investors. For that purpose, an LBO fund manager decides after a few years of investment to re-leverage a deal. In theory, this is possible because the company has already repaid some of the debt of its acquisition, and its value has increased through the implementation of a plan to improve its operations. The proceeds of this debt increase are distributed to investors.
10 Time-to-liquidity is a function of IRR and multiples measuring the average time between the investment date and distribution to the investors (liquidity event or dividend recap).

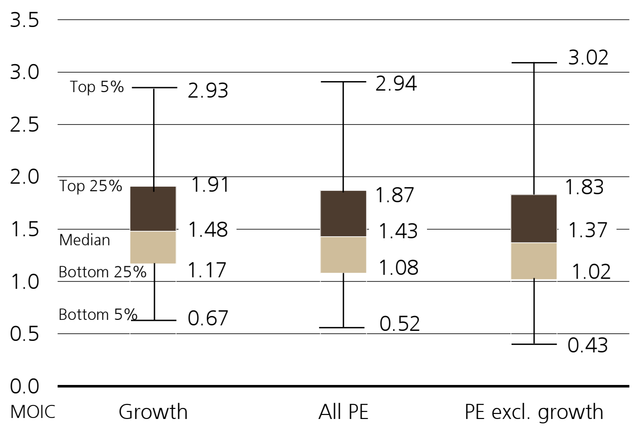
Risk analysis

Past performance is not indicative of future results. The PE market has significantly changed over the course of the last 17 years. In particular, as average fund sizes have increased substantially in the recent past (as seen above in Tables 1 and 2), investment styles of fund managers can drift[11]. They might be tempted to compete for larger and scarcer assets, resulting in higher valuations and, therefore, potentially lower future performance. However, a significant persistence of returns of fund managers[12] associated with strong selection criteria set by investors[13] supports the effective filtering of worse-performing fund managers.

Selection risk
In PE, a high past performance is not necessarily equivalent to a substantially higher level of risk. When looking at the dispersion of returns of fund managers (Figure 3), growth funds are less widespread than their non-growth peers. Growth funds belonging to the top 5% generated lower returns (2.93x) than non-growth funds (3.02x), a difference of 3.1%. However, growth funds of the bottom 5% bracket recorded a 55.8% higher performance than their non-growth peers. In fact, with the exception of top 5% funds, growth funds performed better than their non-growth peers and lost less capital when underperforming. Only the bottom 5% funds lost capital, a feature that is of particular importance to fund investors.

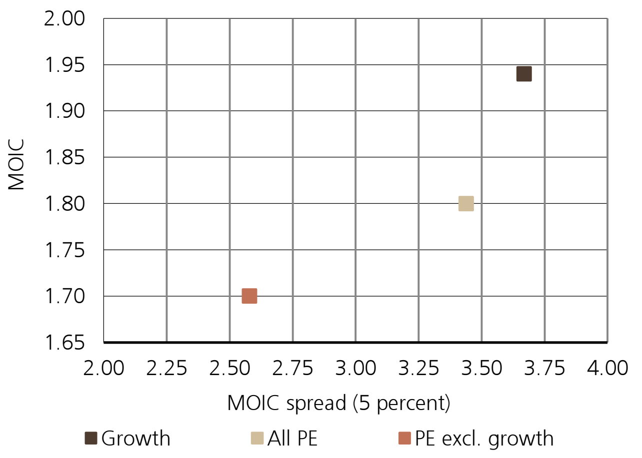
As a consequence, growth funds exhibit both higher risk and return when looking at extreme fund manager selection risk[14] (Figure 4), while non-growth funds look more conservative. This conclusion might be biased by a few statistical outliers in the top and bottom 5% categories. When focusing on the most frequent fund manager selection risk[15] (Figure 5), growth funds appear as less risky and more profitable than their non-growth peers.

Figure 3: Dispersion of returns (realized funds)
Growth funds have a lower dispersion of returns than non-growth funds. Except for the top 5%, growth funds perform better than their peers.



Source: Cambridge Associates, Wellershoff & Partners

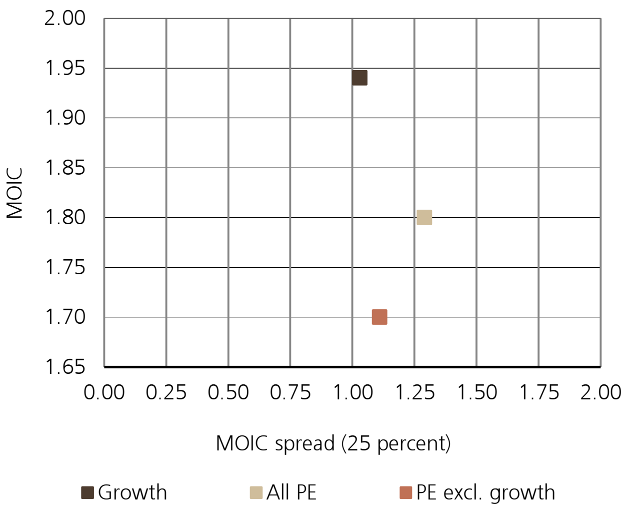
Figure 4: Extreme fund selection risk (realized funds)
Returns and extreme fund selection risk appear as highly correlated. However, extreme selection risk gives a strong weight to potential statistical outliers.



Source: Cambridge Associates, Wellershoff & Partners

[11] And investments can be pro-cyclical, as shown by Robinson and Sensoy (2016).
[12] Kaplan and Schoar (2005). This persistence remains but has decreased more recently, as documented by Braun et al. (2012). and Kaplan and Sensoy (2015).
[13] Korteweg and Sorensen (2017).
[14] This risk is calculated as a spread of MOIC of top 5% funds and bottom 5% funds.
[15] This risk is calculated as a spread of MOIC of top 25% funds and bottom 25% funds.

Figure 5: Most frequent fund selection risk (realized funds) When focusing on the most frequent fund selection risk, growth funds appear as less risky than their peers, while generating a comparatively high performance.



Source: Cambridge Associates, Wellershoff & Partners

Indeed, simplified Sharpe ratios (Table 3) confirm that growth strategies are also significantly more attractive on a risk-adjusted basis. The gap is particularly visible for non-growth strategies. Not only is the MOIC lower on a pooled average basis, but the dispersion of returns based on quartiles is significantly higher. Therefore, the effort required by non-growth strategies to reach the equivalent of the MOIC of growth strategies is much more significant as the pooled average is lower and the dispersion of returns is higher.

"Fully realized growth funds recorded higher performance and a lower risk associated with quartile fund manager selection."

Table 3: Simplified Sharpe ratio (realized funds)

	Vintage Years	Number of funds	AuM (USD bn)	IRR (%)	MOIC	MOIC spread (25%)	Simplified Sharpe ratio
Growth	2000-2011	182	47	19.54	1.94x	1.03x	1.88
PE ex. growth	2000-2009	149	65	14.34	1.80x	1.29x	1.40
All PE	2000-2011	331	112	16.34	1.70x	1.70x	1.53

Source: Cambridge Associates, Wellershoff & Partners

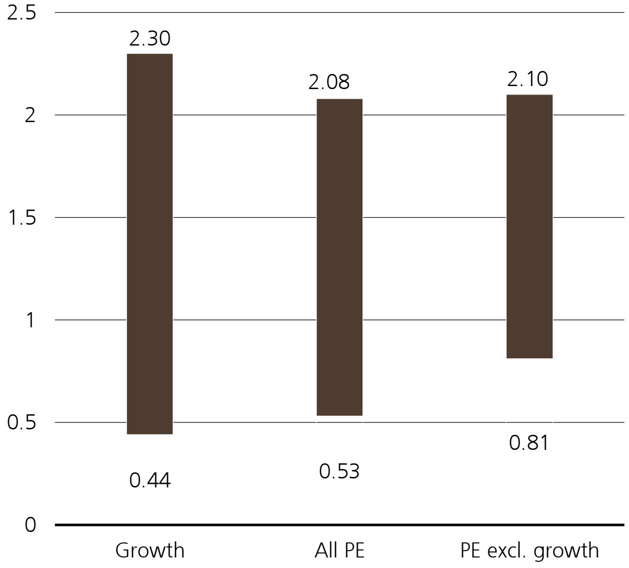
Overall fund performance risk
At first sight, growth strategies exhibit a higher volatility in the evolution of the pooled average MOIC over time (Figure 6). However, this conclusion has to be treated with caution. While growth strategies record a pooled average performance for vintage year 2008 (counting three funds only) of 0.44x, non-growth strategies do not have enough liquidated funds in that year to provide performance data. Excluding 2008, none of the vintage years of growth funds lost capital and the lowest was 1.49x for the vintage year 2006. Non-growth strategies record two vintage years with capital loss: 2003 and 2004. Therefore, although growth strategies appear to be more volatile (and thus risky) on a pooled average basis, a more refined analysis concludes that non-growth strategies are, in fact, more volatile. When comparing similar vintage years, the gap is 0.81x between the highest MOIC and the lowest MOIC for growth strategies, while it is 1.29x for non-growth strategies.

Value-at-risk
More than a variation of returns, it is the prospect of losing capital that affects most investors. Growth strategies have a particularly strong track record in that respect: 13.1% of fully liquidated growth funds lost, on average, 46% of their capital while 51% of fully liquidated non-growth funds (Figure 7) lost, on average, 44% of their capital. In terms of profit, 86.9% of growth funds earned 105% of their capital. As a matter of comparison, 49% of non-growth funds earned 93% of their capital.

The lower risk of growth strategies comes from the low occurrence of losses, not from the average loss, which is similar to non-growth strategies. Similarly, the high occurrence of profits explains the attractiveness of growth strategies, although they also tend to be more profitable (12.9% more on average).

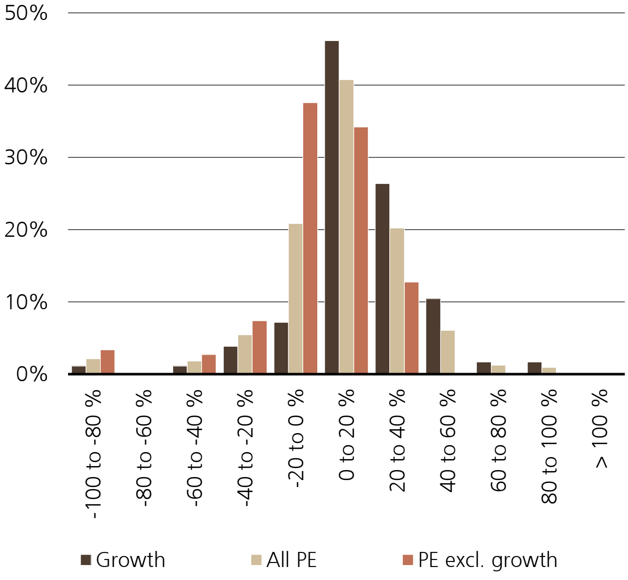
"The lower risk of growth strategies comes from the low occurrence of losses, not from the average loss, which is similar to non-growth strategies."

Figure 6: Dispersion of pooled average MOIC (realized funds) The dispersion of pooled average MOIC over time looks high for growth funds. However, data is skewed by the vintage year 2008 which is factored in for growth funds and not for the peer group.



Source: Cambridge Associates, Wellershoff & Partners

Figure 7: IRR distribution (realized funds)
Non-growth liquidated funds lost capital 51% of the time and growth liquidated funds 13.1% of the time. Losses are equivalent, given a loss. Returns are higher for growth funds than non-growth funds.



Source: Cambridge Associates, Wellershoff & Partners

Value Add

The high performance of growth strategies could theoretically be attributed to luck, that is to say, to market timing, as well as to a general trend towards higher valuations of assets, or, in other words, a favorable market tide. The Public Market Equivalent[16] (PME) method supports such an assessment. When benchmarked against the MSCI World (Figure 8), growth funds recorded an outperformance of 0.72x and non-growth funds 0.42x. Using the S&P500 as a benchmark, growth funds slightly increased their outperformance to 0.74x and non-growth funds to 0.47x. The MSCI World performance reached 41.4% of the realized profit of non-growth funds, while it represented 23.4% of the realized profits of growth funds. The conclusion is that timing and favorable market conditions played a relatively limited role in the performance of growth funds, while non-growth strategies benefited twice as much from these external factors, and not from direct value add due to fund managers.

"Timing and favorable market conditions played a relatively limited role in the performance of growth funds."

Regional analysis

Geographically, the outperformance of growth funds originates outside of North America (Figure 9). The performance gap is the most obvious in developed markets excluding North America and Western Europe ("DM"), as well as in emerging markets ("EM"). Non-growth strategies have been significantly underperforming in these two regions. Once adjusted for selection risk (Figure 10), the picture changes substantially. Growth funds outperform their non-growth peers in all markets, including in North America. On a risk-adjusted basis, the most attractive market was Western Europe, by a very significant margin (Figure 10).

While it would be tempting to draw definitive conclusions from historical data, some caution has to be applied. First, the vintage years are limited to 2000-2011, and only liquidated funds are tracked in the sample. Second, the US dollar is the currency of reference, and foreign exchange effects might explain some of the performance, highlighted notably in Figure 9. The Modified Public Market Equivalent (mPME) method is used to assess the value add of fund managers by geographical region (Figure 11). The results confirm that there was indeed a value creation in North America, and that again non-growth strategies benefited more from external positive factors (timing and valuations) than growth strategies. The mPME method also shows that the value added is significant in Western Europe, while the gap with non-growth strategies remains limited. The gap, however, is confirmed and even increases when looking at DM and EM.

"On a risk-adjusted basis, growth funds outperformed their non-growth peers in all markets."

[16] The Public Market Equivalent was developed and refined to compare the performance of private equity funds with indexes of listed stocks. To avoid analytical biases associated with the timing and duration of investments, the method mimics the cash-flow patterns of private equity funds by buying and selling the index in parallel as a shadow portfolio. Cambridge Associates further refined the method by eliminating some of its methodological anomalies with its modified PME (mPME) method, which is the most advanced to date and whose results are used in this report.

Figure 8: mPME value add (realized funds)

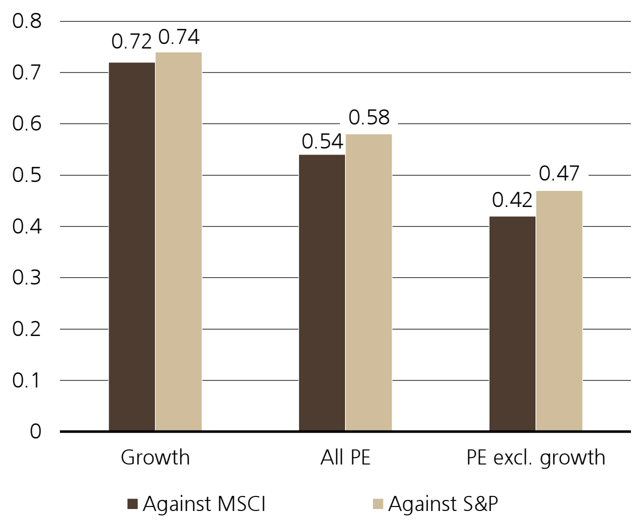
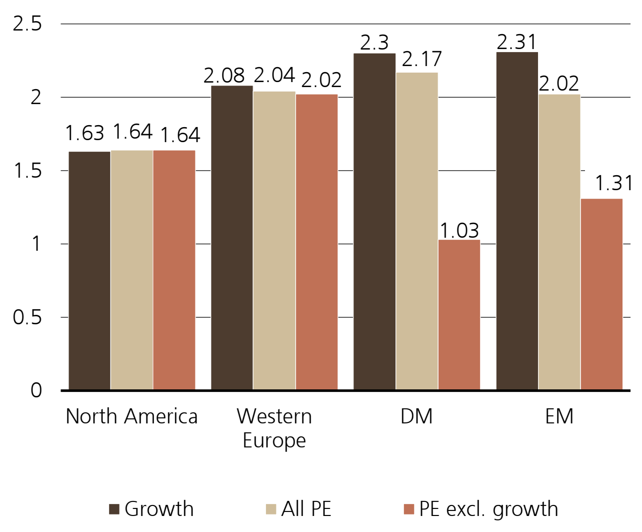


Figure 9: MOIC by geographical region (realized funds)



Source: Cambridge Associates, Wellershoff & Partners

Figure 10: Simplified Sharpe ratio by geographical region (realized funds)

Once adjusted for the most frequent selection risk, the performances of growth and non-growth funds diverge substantially. Growth funds outperform their peers on every market.

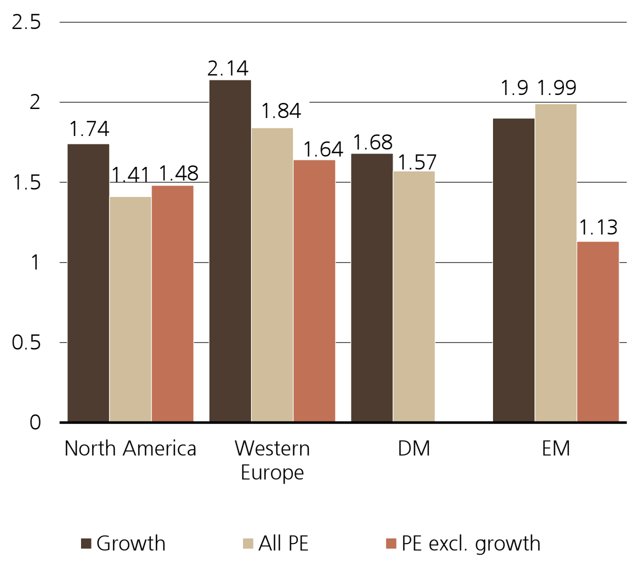
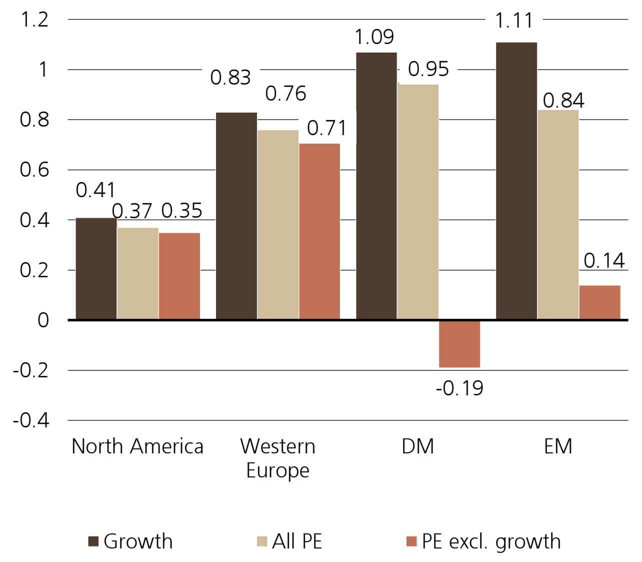


Figure 11: mPME value add against MSCI World by geographical region (realized funds)

The value add against indexes of growth funds is particularly visible in DM and EM. It also appears in the US and Western Europe, as growth funds leave behind their peers.



Source: Cambridge Associates, Wellershoff & Partners

Further analysis

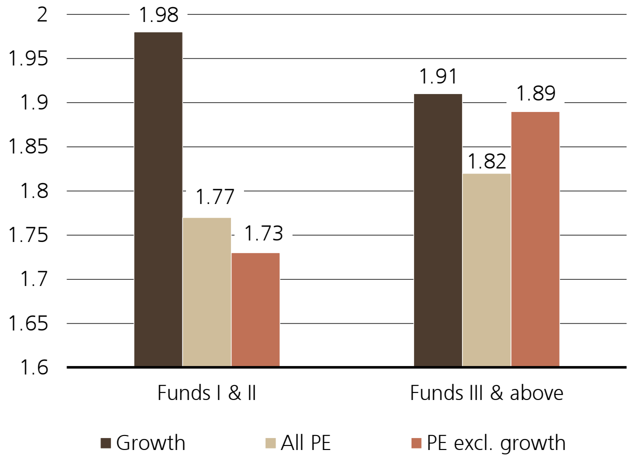
The performance of growth funds seems to be driven by emerging fund managers, launching their first or second fund (Figure 12). They outperformed, by far, their non-growth peers. More established growth fund managers seem only to marginally outperform their non-growth peers.

However, a closer look shows that the dispersion of performance of emerging fund managers is significant for growth strategies and, once adjusted for risk (Figure 13), the performance of emerging non-growth fund managers catches up with that of emerging growth fund managers. Simplified Sharpe ratios also show that the outperformance gap adjusted for risk in favor of emerging growth fund managers actually increases for established growth fund managers. This is of particular importance for putting into perspective the challenge of fund selection as well as reaching or beating pooled average performances.

A value add analysis confirms that emerging growth fund managers generate a specific performance, notably as compared with their non-growth peers. Some of this specific value add remains with established fund managers. Growth fund managers who have succeeded in raising three funds or more were, in general, able to beat the MSCI World by a significant margin and by a little bit more than their non-growth peers (Figure 14).

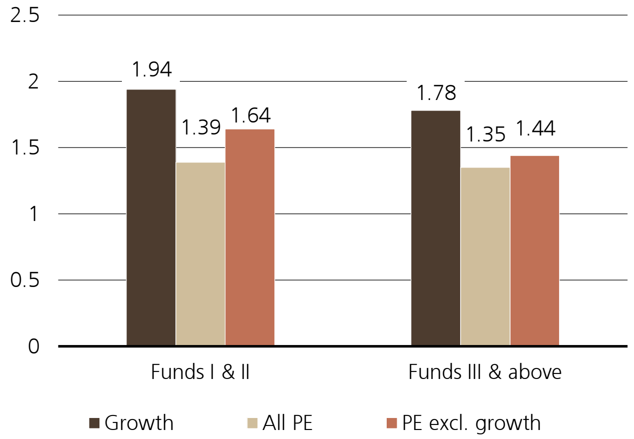
"On a risk-adjusted basis, emerging and established growth managers outperformed significantly and in the same magnitude their non-growth peers."

Figure 12: MOIC of emerging and established fund managers (realized funds)



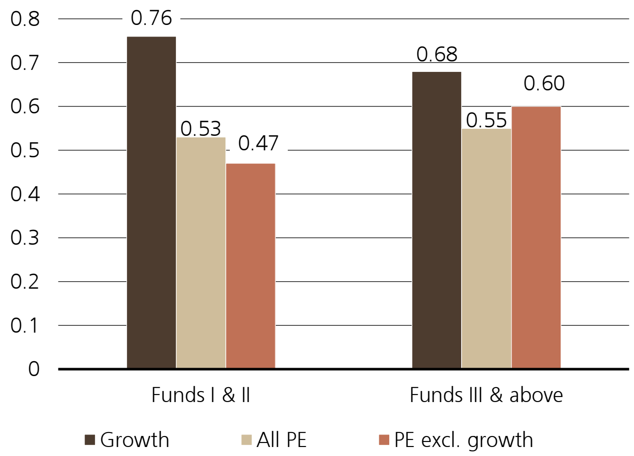
Source: Cambridge Associates, Wellershoff & Partners

Figure 13: Simplified Sharpe ratio of emerging and established fund managers (realized funds)
Once adjusted for the most frequent fund selection risks, the performance of emerging and established growth funds is well ahead of non-growth peers.



Source: Cambridge Associates, Wellershoff & Partners

Figure 14: mPME value add against MSCI World of emerging and established fund managers (realized funds)
The value add against the MSCI World of emerging and established growth funds has been substantial. While non-growth established funds caught up, growth funds still generated a higher value add.



Source: Cambridge Associates, Wellershoff & Partners

Endnotes

Indices used
For the purpose of the mPME analyses, we used the following indices:

- MSCI World. This index of 1,649 mid and large caps captures approximately 85% of the free float of the stock exchanges of Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the UK and the US.
- S&P500. This index includes 500 large-cap US companies and captures approximately 80% of the market capitalization of listed companies in the US.

Cambridge Associates categories

- Growth strategies include: "VC: Late/Expansion stage", "Growth Equity", "Buyout: Small Cap" and "Buyout: Mid Cap".
- Non-growth strategies include: "VC: Early Stage", "VC: Multi-stage", "Buyout: Large Cap" and "Buyout: Mega Cap".
- "All PE" includes growth and non-growth strategies.

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Regional classifications

- North America: USA and Canada, North America global funds.
- Western Europe: Andorra, Austria, Belgium, Cyprus, France, Germany, Gibraltar, Greece, Ireland, Italy, Liechtenstein, Luxemburg, Monaco, Portugal, San Marino, Spain, Switzerland, The Netherlands, The United Kingdom, Developed Europe global funds.
- Developed Markets (ex North America and Western Europe): Australia, Hong Kong, Israel (since 2010), Japan, New Zealand, Singapore, APAC Developed global funds, Global developed funds.
- Emerging markets: Africa, APAC emerging, Europe emerging, Latin America & Caribbean, Middle East emerging and Global emerging funds.

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