7 Reasons to Invest in Private Equity

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What is a Private Equity Investment?

Private equity investing is defined by equity investments made in companies that are not publicly listed and traded on a stock exchange.

Qualified institutions and high net worth individuals typically invest in private equity through fund structures. These generally take the form of limited partnerships, which are managed by general partners (GPs) who raise capital from investors and invest alongside these limited partners (LPs). The general partners then identify and invest in portfolio companies and generally have a significant level of engagement in their management.

1. THE CHANCE FOR GREATER GAINS

Private equity investments have grown over the last few decades. The primary reason for increased investor interest in private equity investments is the return enhancement potential.

Did you know that private equity has historically outperformed publicly traded equities? [1]

Due to the influx of capital within the private equity space, more companies are increasingly staying private longer than in the past. As a result, once these companies reach the point of going public, they often are more mature and have less future growth potential.

As a result, investors are increasingly looking to private equity to access companies earlier in their lifecycle.

Imagine being able to buy into Apple or Microsoft before these companies went public? This is an example of the kind of growth that some private equity investors might see if they invest in the right private equity funds.

2. PRIVATE EQUITY PERFORMANCE TENDS TO FOLLOW RECESSIONARY PERIODS

As COVID-19 continues to grip the world and with so much in flux, investors are trying to predict the impact this crisis will have on their portfolios.

PitchBook looked at historical data to examine how buyout funds specifically reacted during previous crises, including the Tech Bubble, 9/11, and the Global Financial Crisis (GFC) and concluded that private equity performance tends to follow recessionary periods.[2]

Their data illustrates that crisis-era vintages typically offer the best time to invest in buyout funds. Since GPs are investing at depressed prices, this is likely one of the better times in recent history to allocate to private equity.

3. DOWNSIDE RISK PROTECTION

An often-overlooked benefit of private equity is that it can improve risk management.3

The addition of private equity investments into a portfolio that features publicly traded investments will likely assist in improving risk management. During recessions, two-fifths of publicly listed equities have experienced “catastrophic loss,” defined as a 70% or greater drop from their peak values. Yet less than 3 out of 100 private equity funds have suffered a similar loss.

4. PRIVATE EQUITY INVESTMENTS DO NOT RISE AND FALL WITH THE STOCK MARKET

Stock market investments are typically tied to overall market volatility and fluctuations. Global and domestic economic events can often trigger large-scale market trends.

One of the benefits of private equity investments is they are less affected by immediate economic and market-based trends. The value of private equity investments is tied to company metrics and performance. They are not influenced by swings in the market.

5. POTENTIAL TO GENERATE INCOME

The total life of fund investments typically extends over a period of 10 to 12 years from capital commitment to final distributions. Committed capital is not used immediately, as with typical investments made in the public markets. Rather, cash must be available for investment as portfolio companies are identified and their growth strategies implemented. The distributions vary in timing and magnitude, and occur over the life of the investment.

Laddered consistently and periodically (vintage diversification), a systematically designed private capital portfolio should produce a staggered series of consistent cash flows and liquidity events for an investor. Cash flows can be accelerated with the inclusion of private credit and real assets.

6. ACCESS TO ENTREPRENEURS

Good management and a solid track record mean a lot when it comes to the potential performance of a business. But nothing means quite so much as entrepreneurial vision.

Without entrepreneurial insight and drive, many of the companies we know today would never have existed.

When investors buy stocks in publicly traded companies, they are usually no longer buying into entrepreneurial vision and talent. Instead, they are buying equity in already established companies.

Private equity investments pose the chance for those with capital to access entrepreneurs and invest in their vision. If chosen wisely, these investments pose the potential to generate larger returns.

Such outperformance is often attributed to a combination of operational improvements, active ownership, more direct corporate governance, better alignment of interests, longer investment horizons and financial leverage.

7. ABILITY TO INFLUENCE COMPANY DECISIONS

Another of the top benefits of investing in private equity is the level of influence it allows over company decisions. Investors in publicly traded stocks typically have little say over the inner workings of the companies they invest in.

With private companies, investors have the chance to influence key decisions. In most cases, investors will be able to provide direct input. In others, the private equity investor will control the strategic direction of and set financial targets for the company.

This increased input allows the private equity investor to protect their investment and enhance the growth of their capital.

Private Equity Investments & Your Portfolio

Successful private equity investing requires skillful execution. That means starting with a diversified private equity portfolio allocation strategy, implemented through a disciplined private equity investment program that incorporates top-performing funds and investments.

Constructing a diversified private equity portfolio designed to meet an investor's return and risk objectives requires knowledge of and access to a broad array of private equity investment opportunities—across strategies, geographies, industries and vintage years.

We have partnered with an alternative investment platform who has over 25 years of experience. The platform's manager selection process is conflict-free, as they are not compensated by any of the managers in the program. They seek to identify those with a proven track record, a dedicated risk management process, deep teams and institutional safeguards. The managers on the platform are of institutional-quality, and collectively manage over $1 trillion in industry assets.

1. BlackRock, March 2020. On the Historical Outperformance of Private Equity
2. Crystal Capital Partners, August 2020. Private Equity Performance Tends to Follow Recessionary Periods
3. Crystal Capital Partners, March 2020. Downside Protection with Institutional Alternative Investments

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