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PRIVATE EQUITY FOR INSTITUTIONAL INVESTORS: A FRAMEWORK FOR EVALUATING YOUR OPTIONS

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In recent decades, sophisticated institutional investors — including many leading endowments and foundations — have shifted their asset allocations toward private markets in search of higher returns and increased diversification.

Perhaps the most well-known proponent of this approach was David Swensen, who managed Yale University's endowment for over three decades. When Swensen took the helm at Yale in 1985, approximately 65% of the portfolio was allocated to U.S. equities, 15% to U.S. bonds, and nothing to private equity. By the end of his tenure, U.S. equities, bonds, and cash represented less than 10% of Yale's target allocation. Largely through private markets, Yale reported returns during Swensen's tenure that exceeded those of traditional 60/40 stock and bond portfolios.

Yet Swensen himself acknowledged the difficulty of executing this strategy successfully. In his landmark book, Pioneering Portfolio Management, he wrote:

While illiquid markets provide a much greater range of mispriced assets, private investors fare little better than their marketable security counterparts as the extraordinary fee burden typical of private equity funds almost guarantees delivery of disappointing risk-adjusted results.

- David Swensen

PRIVATE EQUITY INVESTING: UNIQUE CONSIDERATIONS

Beyond high fees, a portfolio that includes private equity may present additional challenges that make it prohibitive for many investors:

- **Liquidity:** Private equity investments are illiquid, with limited ability to exit.
- **Diversification:** Building a truly diversified private equity portfolio requires years of consistent commitment.
- **J-Curve:** Returns are typically negative in the initial years of investment.
- **Duration:** Private equity funds today may be locked up for 12 to 15 years or more.
- **Cash Flow Timing:** Investors do not control when capital is called, and the timing may not align with their needs.

To make private equity investing worthwhile, it must deliver the return advantages of private markets at reasonable fees — while credibly addressing these challenges.

EVERGREEN FUNDS: A MORE ACCESSIBLE APPROACH

For many investors, "evergreen funds" offer a more practical path to private equity exposure. Evergreen funds are structured as registered investment companies that reinvest profits from company exits into new opportunities rather than distributing them — creating a continuously invested, "evergreen" portfolio.

This structure addresses several of the concerns associated with traditional private equity:

- Fees are sometimes less than half those of traditional limited partnership funds.
- Liquidity is available on a periodic basis, though subject to some restrictions, such as early redemption penalties or limits on the percentage of the fund that can be redeemed at one time.
- Diversification is built in from day one — some evergreen funds invest across several hundred companies through primary investments, secondaries, and co-investments, spanning multiple vintage years, sectors, and geographies.
- J-Curve risk is reduced, as investors can participate in fund returns from the outset.
- Capital commitments are not required, allowing investors to retain control over the timing and amount of their cash flows into and out of the fund.

It is important to recognize that an evergreen fund's underlying investments are still illiquid, and thus may carry more risk than portfolios consisting entirely of public equities and bonds. Any investment decision should be made in the context of the investor's overall goals and risk tolerance.

TRADITIONAL LIMITED PARTNERSHIP PRIVATE EQUITY

Some investors may find the structure and potential return profile of traditional limited partnership vehicles attractive. In these cases, we recommend a deliberate, stepwise approach: first evaluating the full range of options — including fully liquid portfolios, evergreen funds, and traditional limited partnership structures — before committing to any approach. We can guide your committee through the pros and cons of each and help ensure that any decision to pursue limited partnership private equity is made with full understanding of what that commitment entails.

FUND SELECTION

Leading private equity firms offer investors several strong options, but structure, performance history, and fees vary significantly. Careful due diligence is essential to selecting the fund that best meets an investor's specific needs. It is equally important to consider any private equity investment in the context of the overall portfolio — how it will contribute to both performance and risk management.

For many investors, the best starting point is education. Over the course of a few meetings, we can help determine the appropriate approach for your organization. We are here to support you at every step — from initial evaluation through commitment and ongoing management.

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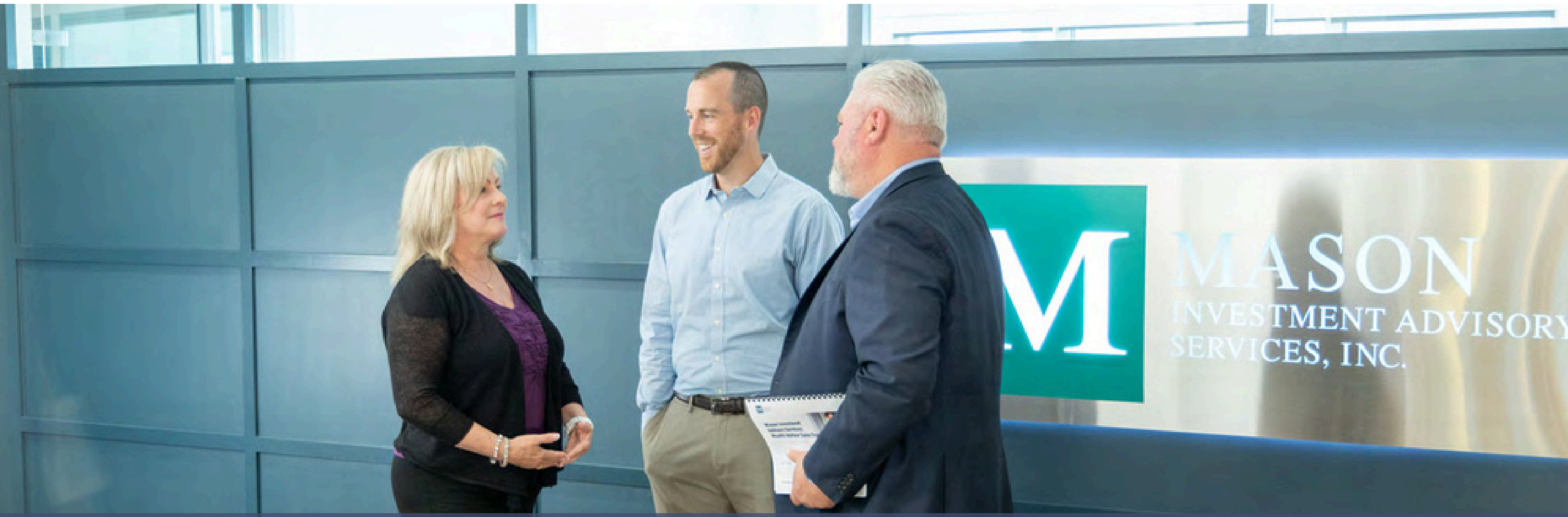

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