

Does private equity deserve its allocation in investment portfolios?

Private wealth perspective

Paul van Hastenberg
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Agenda

1. Personal background
2. Clavis
3. Setting the scene
4. Different perspectives on private equity
5. Drawdowns
6. Implementation
7. Conclusion



1. Personal background

- MSc in Financial Sector Management
- Portfolio manager Van Lanschot
Managing Dutch and European equities for institutional clients
- Portfolio manager Unilever Pension Fund
Managing European equities and manager selector of public equity, private equity and commodity managers
- Director of Equities Uninvest Company
Responsible for public equity, private equity and commodity investments of Unilever pension fund clients of Uninvest Company
- Partner Clavis
Responsible for asset management



2. Clavis

- One of the largest multi-family offices in the Netherlands
- 3 partners, 12 employees
- Currently working for 16 families, all with entrepreneurial background
- Strong presence in structuring as well as coordinating and managing family wealth
- Almost all clients engage in real assets (e.g. private equity, direct real estate or financing of both), but in widely varying shapes, forms and allocations
- Some clients are active in direct deals » less of a role for Clavis
- Others are active in building (fund-of-)fund portfolios » Clavis acts as designer of the strategy and manager of the portfolio



3. Setting the scene

- Focus on private wealth
- High net-worth families almost without exception (former) entrepreneurs, gained their wealth through privately owned companies, i.e. private equity is at the origin of their wealth
- Some have had cash event and have full wealth available for investments, others still run one or more companies and invest the dividends that they receive from their business(es)
- Investable assets range from a few million to hundreds of million, of which part is allocated to real assets; invested individually in single companies, with group of like-minded in single companies, or through fund approach
- Focus of presentation not on multi-billion family offices that have institutional size and team managing the assets



4. Different perspectives on private equity

1. Connection
2. Risk
3. Return
4. Market opportunities
5. Impact investing



4.1 Close connection entrepreneur / investor

- Most private wealth owners have entrepreneurial background, either themselves or previous generation(s)
- Have experience with private equity deals and/or buying real estate
- Therefore much more 'feeling' and closer connection with private equity
- Much more than financial titles in portfolio
- Some high net-worth individuals do not 'trust' financial markets and financial institutions (because of lack of transparency for one) » want to be able to see and touch their wealth
- Investing in private equity significantly increases recognisability of their investment portfolio, feels much more like 'their own' » often very important aspect when dealing with private wealth
- Private equity definitely has role when considered from this angle



4.2 Risk

- Definition of risk of crucial importance » different perspectives:
 - Statistical perspective: portfolio diversification (correlation with other investments less than one) and lower volatility (albeit with totally different time interval) apparent
 - Cash flow risk: illiquidity is probably most discussed risk, but with right allocation and investment horizon, no regulator to apply rules and (in general) lack of significant liabilities most high net-worth individuals can bear this risk
- Basic principle of most private wealth owners is staying wealthy. Capital preservation is often of far greater importance than achieving superior (relative) return
- Private wealth definition of risk: “True risk is permanent loss of capital”
- Private equity’s focus on absolute return and protecting downside meets the goal of not losing money. In daily practice, majority of funds generate return greater than 1x (even in recessionary times)
- Based on definition used, private equity has a role from risk point-of-view



4.3 Return

- Given extremely low interest rates private wealth owners are also on quest for yield (buying German Bunds no longer works)
- More interest in absolute rather than relative return, therefore clear alignment between wealth owner and (absolute) return seeking private equity fund
- From return perspective best of two worlds: access to institutionally sized and run funds, but also clear focus on smaller opportunistic entrepreneurial niche funds (too small for institutional money)
- But obviously manager selection is very important given huge dispersion between top and bottom quartile funds; first line of defence
- In our experience private equity has met the goal of achieving decent absolute returns
- Private equity therefore clearly has a role from return point-of-view



4.4 Market opportunities

- Huge debate about risk and return characteristics of private equity and added value of this category
- However, there are other arguments in favour of private equity
- Private equity provides access to market segments not accessible through public equity investments
- Examples such as early stage venture capital and investments in very small local companies especially appeal to high net-worth individuals
- Investing in the secondary market is another example, where mainly financial institutions sell private equity interests and secondary funds have capital to buy (ideally at attractive prices)
- Private equity therefore provides investment opportunities that the public equity market does not offer



4.5 Impact investing

- Private wealth owners increasingly want to do good while doing well
- They do not want to give money away to charities but want to invest thereby accepting a lower return, i.e. a convergence between philanthropic activities and their investment portfolios
- This is especially true for younger generations
- Private equity provides the opportunity to do so
- Impact investing comes in all shapes and forms; most propositions have an environmental or social angle
- Examples are investing in African farmers in order for them to build a business, investing in start-up companies that provide environmentally friendly technology or to fund privately-owned companies focusing on improving disease medication (improving quality of life)
- Private equity also has clear role from an impact point of view



5. Drawdowns

- There are various reasons for private wealth owners to invest in private equity. However, there are also drawdowns
- Most wealth owners
 - Do not have a proper strategy underlying their private equity portfolio
 - Do not have the right contacts in the private equity world
 - Lack skills to properly judge the feasibility of investments, and
 - Solely react on what is brought to them
- Result is chain of small, often direct opportunistic local investments that need much more handling than they can or are willing to bear
- And since they have trouble overseeing consequences, limited liquidity may be a problem, especially when substantial amounts of capital are invested in private equity (and other forms of illiquid assets)



6. Implementation

- To avoid this trap that almost all high net-worth individuals have run into, proper implementation is key
- Therefore:
 - Start with sensible strategy, designed to benefit from private equity advantages and doing justice to preferences and convictions of family
 - Embed this strategy in the overall investment strategy
 - Provide sufficient diversification within the private equity portfolio
 - Select the right general partners to work with by doing your homework well
 - Limit operational handling (unless wealth owner wants to be operationally involved)



7. Conclusion

- Private equity is almost always at the origin of family wealth
- Very important argument for private wealth owner is feeling connected with his investment portfolio » possibly most important reason to add private equity to strategic asset allocation
- In addition, specific risk and return characteristics of private wealth supports private equity as well
- Lastly, access to specific market segments private wealth owners sympathise with and possibility to get involved in impact investing add to the conviction

Private equity deserves its allocation in private wealth investment portfolios

