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Media release

Study on performance attribution in private equity

- Adherence to a strategic asset allocation is primary driver for strong performance

Capital Dynamics, a global private asset manager, has developed a new model for measuring performance attribution in private equity. By applying the model to two North American pension fund portfolios, the resulting study reveals that adherence to a strategic asset allocation is the primary driver for strong portfolio performance. As one of the first studies on performance attribution in private equity portfolios, the study asserts that whilst active management can generate alpha, the impact of asset allocation on performance is larger than commonly believed.

Key points from the study include:

- Asset allocation is crucial for building a solid private equity portfolio. Following the strategic asset allocation enhances value and facilitates the management of the portfolio
- Staying the course is paramount; don't pull back in down-markets and don't become bullish in up-markets
- The two pension funds under review both suffered performance deterioration as a result of deviating from their long term planning
- Achieving a positive Manager Alpha through fund selection in a highly diversified portfolio is extremely difficult. Skilled risk management can enable an investor to build more concentrated portfolios that have higher potential to generate outperformance, and direct or co-investment strategies can help to deploy larger amounts of capital

The authors of the study conclude that in order to fulfill their fiduciary duty, pension plans should focus resources on establishing, monitoring and implementing their strategic asset allocation and if necessary, seek additional help to stay the course and deploy capital thoughtfully and deliberately in any market environment.

According to the new model, both funds have been able to collect an illiquidity premium of above 4% IRR by investing in private equity instead of public equity. The strategic asset allocation for both pension funds generated a premium as well, but then both decreased returns through tactical timing of their commitments. Only one of the pension funds was able to strike a positive "Manager Alpha", a term discussed in detail in the study. This is not surprising, as the size of these investors forces them to hold highly diversified portfolios and/or focus on the large cap market, thereby reducing the probability of achieving a positive Manager Alpha.

Mauro Pfister, a Senior Director and Head of Solutions at Capital Dynamics, commented:

"Achieving a positive Manager Alpha is challenging. Even more so, if an investor is required to deploy several hundred millions of dollars every year. With respect to asset allocation, the two case studies illustrate that staying the course of a predefined strategic asset allocation is a wise decision. In both case studies tactical decisions were market cyclical and diminished value. It is in the hands of the portfolio managers to resist the temptation of over-allocating during bull years and try hard to find suitable investments in a bearish environment."

"In the search of market alpha, various large pension funds and insurance companies recently accessed the direct private equity market through active ownership of companies or co-investing along other funds. They hope that these more concentrated portfolios have higher potential to generate outperformance. However, the challenges of direct investing should not be underestimated as the skillset required is clearly different from that of a private equity fund investor."

The full white paper is available on request.

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About Capital Dynamics

Capital Dynamics (the “Firm”) is an independent, global asset manager, investing in private equity as well as clean energy and infrastructure. We are client-focused, tailoring solutions to meet investor requirements. The Firm manages investments through a broad range of products and opportunities including separate account solutions, investment funds and structured private equity products. Capital Dynamics currently has over USD 21 billion in assets under management/advisement¹.

Our investment history dates back to 1988. Our senior investment professionals average over 20 years of investing experience across the private equity spectrum². We believe our experience and culture of innovation give us superior insight and help us deliver returns for our clients. We invest locally while operating globally from our London, New York, Zug, Tokyo, Hong Kong, Silicon Valley, Munich, Birmingham, Seoul and Scottsdale offices.

¹ Capital Dynamics comprises Capital Dynamics Holding AG and its affiliates; assets under management/advisement, as of September 30, 2015 include assets under discretionary management, advisement (non-discretionary), and administration across all Capital Dynamics’ affiliates. Investments are primarily on behalf of funds managed by Capital Dynamics. ² Average years of experience held by Capital Dynamics’ 20 most senior investment professionals.

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