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PRIVATE EQUITY NAVIGATOR

Private Equity Analysis from INSEAD's Global Private Equity Initiative

April 2017

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INSEAD GLOBAL PRIVATE EQUITY INITIATIVE

(www.insead.edu/gpei)

The Global Private Equity Initiative (GPEI) drives teaching, research and events in the field of private equity and related alternative investments at INSEAD, a world-leading business school. It was launched in 2009 to combine the rigour and reach of the school's research capabilities with the talents of global professionals in the private equity industry. The GPEI aims to enhance the productivity of the capital deployed in this asset class and to facilitate the exchange of ideas and best practice.

INSEAD's global presence – with campuses in France, Singapore and the UAE – offers a unique advantage in conducting research into established markets for private equity, while at the same time exploring new frontiers in emerging markets to arrive at a truly global perspective on this asset class. The GPEI also focuses attention on newer areas shaping the industry such as operational value creation, responsible investing and growth equity, and specific groups of LPs like family offices and sovereign wealth funds.

The GPEI looks to partner with stakeholders in the private equity industry to collaborate on research ideas and projects. Its core supporters are:

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Pevara is a division of eFront (www.efront.com), a leading software provider of end-to-end solutions dedicated to the financial services industry with a recognized expertise in alternative investments, enterprise risk management, and customer relationship management. eFront's solutions serve more than 800 customers in 48 countries, including companies in the private equity, real estate investment, banking and insurance sectors. eFront's primary product suites offer tightly integrated solutions for streamlining the management of alternative investments and corporate risk. Founded in 1999, eFront services clients worldwide from offices in Asia, Europe, the Middle East and North America.

Pevara's data is obtained from actual LP cash flows as opposed to surveys or relying on the Freedom of Information Act to source data. LPs who wish to contribute data to the Pevara Private Equity Index can do so by sending an email to data@pevara.com, after which a Pevara data specialist will discuss the process with them.

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The Private Equity Navigator seeks to balance the presentation of raw data and minimal accompanying commentary with a more engaging (if less rigorous) approach to illustrate key concepts in private equity. Our findings are presented in four sections:

Executive Summary

Welcome to the tenth edition of the INSEAD-Pevara *Private Equity Navigator*, offering a breakdown of the recent PE fund activity and overall industry performance plus a brief update on PE @ INSEAD. As always, our findings are based from data on more than 2,900 funds reported by LPs to Pevara eFront.

We build on the comparison of private equity and public market performance shared in our last edition, but we switch our focus to risk-adjusted returns. With more than 70% of cash-on-cash value realized from funds raised during the 2005-08 boom years, we look back to assess the impact of 'over-exuberance'on performance and on the pace of exits from these funds. Our key findings include:

- In 2016, PE investment activity fell to its lowest global level since 2004, while exit activity pulled back from the record-setting levels seen during the last three years.
- Funds in our dataset have returned more capital than they drew down for 22 consecutive quarters, distributing a record 2.67x more than they called in 2016.
- PE provides attractive risk-adjusted returns relative to public markets for this time period.

The PE industry's investment slowdown continued in 2016. Concerns about high valuations in many countries, with "too much capital chasing too few deals", and geopolitical uncertainties in Europe and the U.S. have steadily eroded PE funds' appetite to deploy.

The exit supercycle persisted in 2016, but the record levels of 2013-15 were not reached. LPs are flush with cash and under pressure to commit capital to new fund offerings in order to maintain their target exposure to PE, which created a favorable fundraising market in 2016.

Although global industry returns through the first three quarters of 2016 fell, the **European funds in our dataset outperformed.** In fact, they have generated higher returns than their North American and Asian counterparts in almost all periods since 2001.

The pace at which PE funds deploy capital on aggregate is negatively correlated with returns. The three fund vintages with the highest percentage of capital called after their first full year of investment (relative to fund commitments) were the three worst performing vintages in our dataset.

Even during periods when public markets outperform PE, the latter's **historically lower volatility of annualized returns** provides a compelling investment case.

As always, we endeavor to provide thought-provoking analysis and commentary on issues discussed with institutional LPs and global fund managers, and not only welcome but encourage readers' feedback. Please send your comments to GPEI-Private.Equity@insead.edu.

Claudia Zeisberger

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Detailed Market Analysis – INSEAD & Pevara Database

The following pages provide an update on the global PE market during 2016.

We first review PE capital call and distribution activity through year-end and follow with observations on PE returns through the third quarter.

We conclude with a comparison of the pace of PE investment and fund performance, and assess the challenge PE firms face when exiting investments made from 2005-07 vintage funds.

PE Market Update

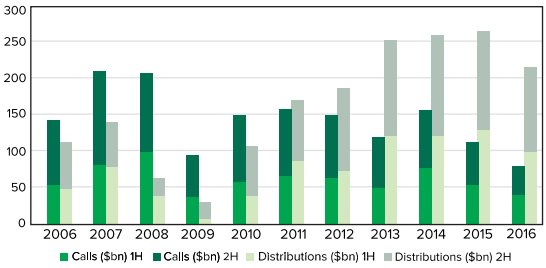
(Activity in 2016)

This edition of the *Private Equity Navigator* begins with a look at PE investment and divestment activity over the past 15 years. These two key indicators are represented by the amount of capital called and the amount distributed by funds in our dataset.

The analysis that follows is based on data provided by 2,945 PE funds investing globally, with total assets under management (AUM) of approximately $1.3 trillion as of year-end 2016, a more-than-adequate proxy for industry activity levels.[1] In line with the global PE industry, our dataset is weighted towards developed markets —the US in particular, as well as Europe—with Asia and the rest of the world making a relatively small contribution.[2]

2016: Slow Year for PE Investments

Fig 1 Annual Global Capital Calls and Distributions



Anaemic investment levels made headlines in 2016 (see Figure 1), with global funds in our dataset calling the least capital since 2004, back in the 'golden age' of PE. This held true across all regions except for Asia, where the amount of capital called in 2016 represented the second lowest total in the past decade (only 2009 was lower). With high M&A valuations persisting in 2016 and geopolitical uncertainty resulting from Brexit and the US elections, PE fund managers were understandably cautious about deploying fresh capital.

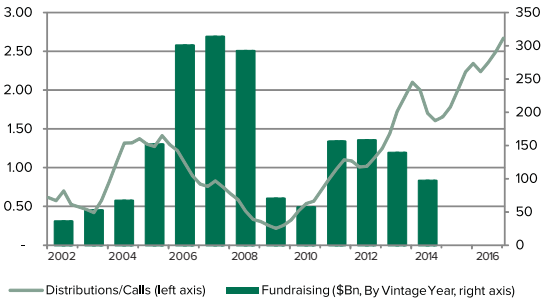
After five consecutive years of record-setting distribution levels, distributions by global funds in our dataset fell 19% (compared to 2015), yet still reached a more-than-respectable $217.7 billion—the fourth year in a row that distributions have topped $200 billion. Looking across regions, the pullback in exit activity was markedly different: European funds in our dataset distributed more capital than in any other year except 2015, while funds in North America produced the lowest level of distributions since 2010.

The sharp drop in investment as well as robust exit activity resulted in the highest ratio of fund distributions to calls over any four-quarter period that our dataset has ever produced, at 2.67x as of 31st December 2016. This is the 22nd consecutive quarter that our PE funds have been net distributors of capital, and the seventh consecutive quarter where the ratio exceeded 2x.

The disproportionately high level of distributions suggests that PE funds continue to benefit from robust M&A market demand and valuations while putting capital to work judiciously. The high distribution/call ratio and record distributions over the past four years have also put pressure on LPs to commit capital to new fund offerings in order maintain their exposure to the PE asset class, which has helped drive a favorable fundraising environment.

Considering the level of fundraising in fund vintages immediately preceding the financial crisis (2006, 2007 and 2008) provides additional clues to the record level of distributions/calls (see Figure 2). Assuming an average portfolio company holding period of five years (which does not fully reflect the difficulty GPs have had exiting investments that were made pre-crisis), exits from these vintages should dwarf the calls from the significantly lower fundraising in recent years.

Fig 2 Distributions/Calls Ratio vs. Fundraising



[1] While the PE industry is larger and the data reported here is simply a representative proxy, our dataset is obtained directly from LPs and is hence more accurate than data obtained from a range of other sources. AUM is the sum of all uncalled capital (dry powder) and unrealized value in all funds in the INSEAD-Pevara database; AUM figures are based on actual data prior to 2014, and estimates for 2015 and 2016.
[2] Comprised of North America (53.8% of funds and 63.4% of committed capital to all funds in the Pevara dataset); Europe (36.6% of funds and 29.7% of committed capital); Asia (6.3% of funds and 5.8% of committed capital) and other regions making up the balance.

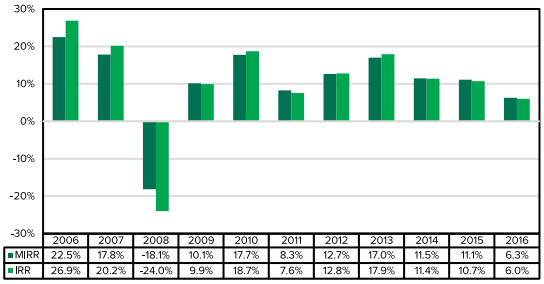
PE Returns & Variance

In this section we analyze the returns generated by our dataset of PE funds on an absolute and relative basis. We begin with an assessment of their annual performance since 2006 and continue with a comparison of fund performance across geographies, zooming in on the U.S. for a comparison of PE and public market returns.

While the performance metric of choice in the PE industry is the internal rate of return (IRR), the metric referred to throughout this section is the modified internal rate of return (MIRR).[3] This more accurately reflects the real cash flow performance realized by PE LPs, in particular by moderating IRRs in instances of extreme out- and underperformance.[4] The IRR generated by our global dataset is presented in Figure 3 for the purpose of comparison.

Global Returns Continue to Pull Back

Fig 3 Annual Global PE Returns



	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
MIRR	22.5%	17.8%	-18.1%	10.1%	17.7%	8.3%	12.7%	17.0%	11.5%	11.1%	6.3%
IRR	26.9%	20.2%	-24.0%	9.9%	18.7%	7.6%	12.8%	17.9%	11.4%	10.7%	6.0%

On the face of it, 2016 was a tough year in the financial markets in general and for private equity investors in particular. Returns to active managers in both public and private markets generally lagged the major benchmarks. PE returns continued to trend lower as participants in an increasingly choppy M&A market struggled to digest the uncertainties of an evolving world.

In the first nine months of 2016, the industry produced an IRR of 6.0%, significantly lower than the 7.5% IRR return registered over the same period in 2015 (see Figure 3).[5] In fact, 6.0% represents the lowest IRR across the first three quarters of a year since 2011, when the industry posted an IRR of 3.7%. This compares with an MIRR of 6.3% for the first nine months of 2016 versus a 4.3% MIRR over the same period in 2011.

Full-year performance is expected to come in below the 2015 figures of 10.7% IRR and 11.1% MIRR if net asset values (NAVs) follow a similar path to the global equity markets. We therefore expect the full-year IRR to come in below 10%, a level seen only in 2011 and during the global financial crisis in 2008. Nevertheless, the industry could surprise us on the upside given its heavy weighting toward the US, where public equity markets rallied in the fourth quarter on the back of bullish sentiment following the presidential election.

Europe Outperforms

Shifting to a regional perspective, Figure 4 compares the average performance generated by the PE asset class in the three main geographic regions of our dataset since 2001. For each region the graph shows the annualized return generated by an allocation to PE made at any point in time and held through Q3 2016.[6] For example, an allocation made at the end of Q3 2006 produced a 10-year annualized return of 10.3% in Europe and 7.9% in Asia. The returns in Figure 4 represent performance produced by cash flows from all funds in our dataset for each region, and thus average regional returns.

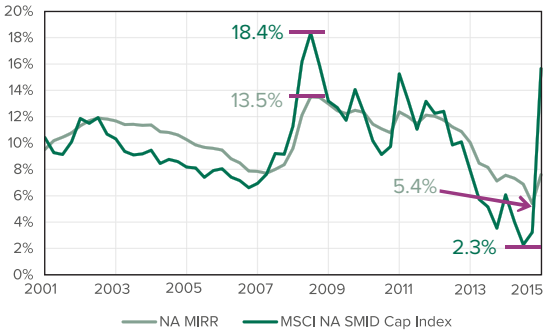
Fig 4 Annualized PE Returns - Regional Comparison

[3] The two main issues with IRR are the re-investment hypothesis on intermediate distributions and the cost of uncalled capital. The MIRR accounts for this by setting a discount rate for uncalled capital and a re-investment rate for distributed capital. For details refer to the December 2013 issue of *Private Equity Navigator*.
[4] This edition uses the net MIRR where possible. Unless otherwise specified, it uses a discount rate for capital calls of 12.0% and equally assumes a re-investmentrate of 12.0%.
[5] 2016 full-year performance will be reported in the next edition, as NAVs for funds in the Pevara dataset are reported with a 3-month lag.
[6] Annualized returns are derived by geometrically linking the quarterly MIRR returns produced by all funds in each geography. This method represents a recognized approximation for PE performance when true time-weighted returns are not available. The MSCI North America SMID Cap Index is comprised of a blend of small and midcap stocks which are broadly comparable to PE portfolio companies.

The most striking observation is the way Europe outperformed both North America and Asia in nearly all time periods. Except for a brief period between 2007 and 2009 (i.e. during the global financial crisis) when European and North American performance converged, allocations to European PE outperformed – at times by a significant margin. While North American funds generated the second best return for most of the time period in Figure 4, fund performance in Asia overtook North American performance for allocations made in 2013 and 2014 after nearly a decade lagging the other two regions.

Risk/Return: Private Equity vs. Public Equity

Fig 5 Annualized Returns - PE vs Public Market - NA



In the October 2016 edition of the Navigator we compared PE performance from our dataset with public equity market performance to gauge the extent of PE's outperformance. We found that returns generated by global PE funds outperformed a comparable public index, while our North America comparison was less conclusive. We now revisit the comparison in the context of risk-adjusted returns.

Figure 5 follows the same approach as Figure 4. It shows the annualized return generated by PE in North America and that of a comparable public market index for an investment made at any point in time and held until Q3 2016.[7] While PE returns outperformed the MSCI in the years leading up to the 2008 financial crisis, post-crisis performance was more mixed, with public markets outperforming PE in some periods and vice-versa.

In addition to returns, the volatility of an investment must be considered when assessing the risk-adjusted performance of an asset class. As shown in Figure 5, the 8.1% range of returns produced by North American PE (with a minimum/maximum return of 5.4%/13.5%) is significantly lower than the 16.1% range produced by the MSCI during the period assessed (from a minimum of 2.3% to a maximum of 18.4%). While not a precise measure of volatility, this suggests that PE provided a superior risk-adjusted return to investors.

Boom & Bust

Assessing the Impact of Over-exuberance

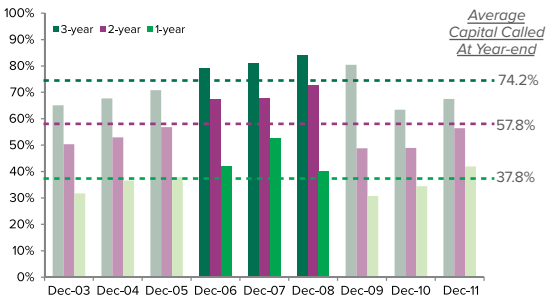
The years leading up to the global financial crisis witnessed a boom in private equity that had never been seen before nor since. Fundraising and investment activity – particularly leveraged buyouts and public-to-privates – proceeded at a scale and pace that dwarfed industry activity in the 1980s, 90s and early 2000s. Investments made during the boom and the impact of the subsequent bust would have far-reaching consequences, especially for performance and fund realizations.

Investment Pace & Fund Performance

One way to quantify the pace of industry investment is to measure the percentage of capital called from funds in the middle of their investment periods. The bars in Figure 6 show the percentage of capital called for all 1-year, 2-year and 3-year-old funds at each calendar year-end from 2003 to 2011.[8] The lines in Figure 6 represent the average amount of capital called at year-end for all 1, 2, and 3-year-old funds in our dataset.

The rapid pace of investment in the last years of

Fig 6 Pace of Capital Called – The PE Boom



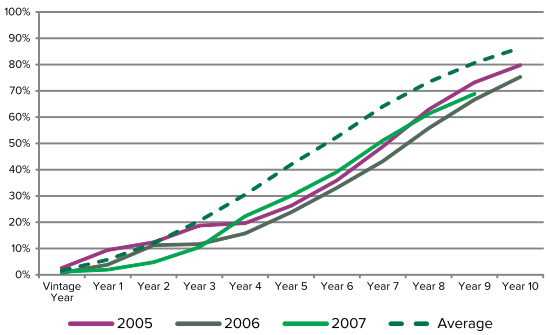
[7] PE returns are again derived from North American fund's quarterly MIRR, with the cost of capital and re-investment rate equal to the long-term return generated by the comparable public index; as a result, any out- or underperformance can be attributed to PE "alpha".
[8] For example, the 1-year-old fund in December 2006 represents the percentage of capital called from all 2005 vintage funds, the 2-year-old fund in December 2006 represent the percentage of capital called from all 2004 vintage funds, and so on.

the PE boom (2006, 2007 and 2008) is clear: the amount of capital called for 1, 2 and 3-year-old funds in these years is well above the average. The sharp drop in the percentage of capital called in 2009 and 2010 represents a swift pullback from investment activity during the global financial crisis and thereafter.

Unsurprisingly, the pace of investment has a strong negative correlation with performance. The three worst performing fund vintages in our dataset since 1995 (1998, 1999 and 2006) had the first, second and third fastest investment pace as 1-year-old funds; and 1998 and 2006 had the second and third fastest pace as 2-year-old funds. While this constitutes an early-warning signal and an opportunity to actively manage a portfolio, the window to act on this information – for example, by executing a sale of an LP interest – is remarkably short.

Realizing Value after the Bust

Fig 7 Realizing Value – Fund Vintages 2005-07



Exuberance during the boom preceding the 2008 financial crisis spurred additional negative fallout for PE portfolios, namely GPs' inability to exit investments from pre-crisis vintage year funds in a timely manner. Figure 7 shows the ratio of realized fund value to total fund value (i.e., [realized value]/[realized + unrealized value]) over time for 2005 to 2007 vintage year funds in our dataset, relative to the average for all fund vintages.[9]

Lines that lie below the average ratio line represent fund vintages that realized value more slowly than the average. Those shown – 2005, 2006 and 2007 – fall far below the average fund line in the years following the 2008 financial crisis, highlighting the difficulty that GPs have had exiting investments made in the pre-crisis boom. These vintages were not selected at random – they represent outliers that diverge the most from the average.

Translating this into dollar terms provides additional insight into the scale of the problem. When the divergence between the realized value/total value ratio for these vintages peaked in December 2013, roughly $155 billion was "trapped" in these funds (i.e., investments that would have been exited and the capital distributed to LPs had these vintages followed the path of the average fund). This $155 billion under-distribution represented 14% of unrealized value across our dataset at year-end 2013, and 10% of the total AUM in our dataset.

[9] Using vintage year 2005 as an example (pink line), the point at "Vintage Year" represents the ratio in December 2005, the point for "Year 1" represents the ratio in December 2006, the point for "Year 2" represents the ratio in December 2007, and so on.

Insights from GPEI's Model Portfolios

In this section, we track the evolution of our two model portfolios to provide insights into their construction and management, and the challenges associated with a growing and maturing portfolio.

Model Portfolios

When the *Private Equity Navigator* was launched in December 2013, we decided to include a section that explained how real PE portfolios are managed by large institutional investors. To do so we created two hypothetical $1 billion portfolios made up of real funds selected from the Pevara database,[10] each with its own mandate.

Portfolio 1 is largely representative of the global PE market, with a geographic focus on the US and a strategy focus on buyouts. Portfolio 2 targets larger exposure to European and emerging market (mainly Asian) managers and to a growth capital investment strategy. To mimic skill in manager selection and augment portfolio returns, we selected only funds from the top three quartiles.[11] The sections below follow the evolution of the portfolios over the years.

We made fresh commitments to three funds in each of our portfolios during the second half of 2016, bringing our annual commitments in Portfolio 1 to $210 million across four funds and in Portfolio 2 to $385 million across six funds.

Key Insights

In this section, we compare the evolution of a model portfolio invested in primary PE fund offerings with the actual evolution of our Portfolio 1. The model portfolio has the same broad investment targets as Portfolio 1, and all fund commitments in the model reproduce cash flow and NAV characteristics of an average PE fund,[11] hence the results provide a (very) rough guide for LPs setting up a PE portfolio. Figures 8a and 8b show the evolution of our model portfolio and Portfolio 1, specifically mapping annual commitments and fund cash flow, as well as cumulative cash flows and portfolio NAVs.

The evolution of both portfolios illustrates several characteristics of PE portfolios. First, building exposure to PE via a primary fund portfolio takes time: NAVs for Portfolio 1 and our model portfolio reached their $1 billion target in eight and nine years respectively. Second, significant cash outflows are required in the early years of constructing a PE portfolio before it will generate cash on a net basis. Annual net cash flows in our model portfolio only turn positive in year 8, while Portfolio 1 has yet to produce significant annual net cash outflows.

Relative to the smooth annual portfolio cash flows in our model portfolio, the choppy annual portfolio cash flows of Portfolio 1 underscore the unpredictable timing and size of fund distributions from a live fund portfolio. The significant variability of annual commitments in Portfolio 1 underscores the challenge of allocating capital to the PE asset class; even the best GPs only raise capital every three to five years, requiring that LPs adjust their commitment schedule to take advantage of funds in the market.

Fig 8a Model LP Portfolio Evolution ($m)

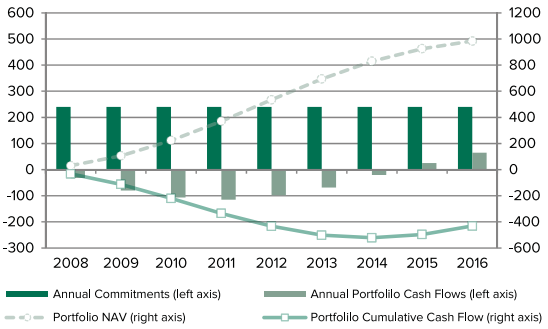
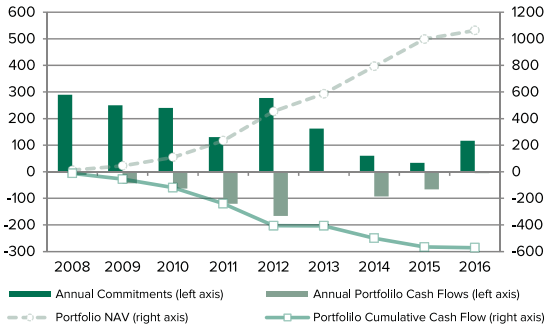


Fig 8b Portfolio 1 Evolution ($m)



[10] A detailed summary of the current geographic and strategy spread of our two portfolios can be found in the Appendix, including the IRR, MIRR, TVPI and NAV of each fund and the portfolio.
[11] For a more detailed look at how the portfolio was created and is managed, as well as the portfolio allocation strategies, please refer to the *Private Equity Navigator* Methodology on GPEI's website.
[12] The model portfolio was constructed with a $1 billion target allocation, annual capital commitments being made to a hypothetical PE fund basket with average cash flow characteristics and a steady evolution of NAV. Commitments were made to the basket on January 1 of each year and we assumed any dollar amount could be committed to the basket.

J-Curves and Portfolio Returns

Figures 9a and 9b display the cash flows (capital calls and distributions) and resulting net cash positions (the J-Curve) for both portfolios. The bars in each chart represent the quarterly calls and distributions for the two portfolios, with calls generating capital outflows and distributions generating cash inflows. To present the development of a classic portfolio J-Curve, only the original 20 funds in each portfolio were included in this analysis.

The J-Curves for both portfolios showed significant upward momentum in H2 2016. Portfolio 1 generated capital calls of $16.3 million in H2 2016 (Q3: $5.5 million, Q4: $10.8 million), compared to distributions of $73.9 million (Q3: $54.1 million, Q4: $19.7 million). The significant cash outflow from this portfolio drove a strong uptick in the J-Curve as its net drawdown decreased from $431.6 million in H2 2016 to $374.0 million in H2 2016.

The J-Curve for Portfolio 2 continued the strong upward momentum of the last two years. In H2 2016, it produced capital calls of $19.6 million (Q3: $6.7 million, Q4: $13.0 million) and significant distributions of $101.9 million (Q3: $36.5 million, Q4: $65.3 million). The portfolio has now distributed more capital than it has called in ten successive quarters, the net drawdown falling from $569.0 million as of June 2014 to $228.9 million as of December 2016. This is reflected in the classic "J" of the cumulative net cash flow curve.

Fig 9a Portfolio 1: Cash flows and J-curve ($m)

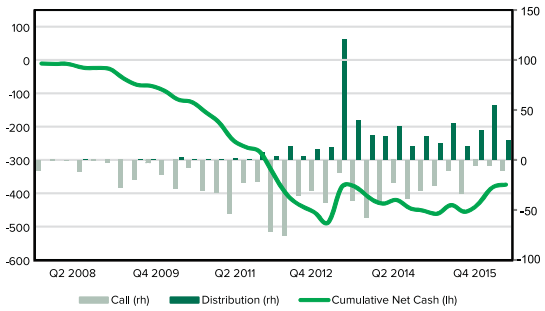
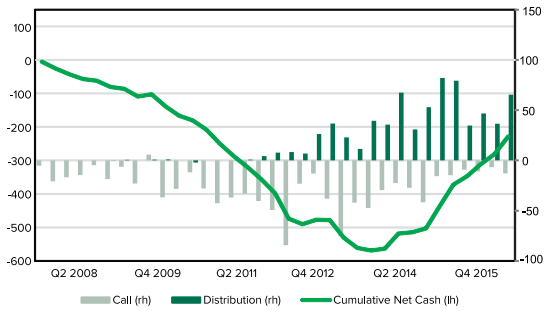


Fig 9b Portfolio 2: Cash flows and J-curve ($m)



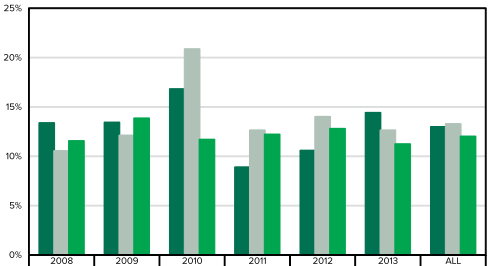
Comparison of portfolio returns

On aggregate the performance of our total portfolios is quite similar, with Portfolio 1 generating a total value to paid in capital (TVPI) of 1.44x (MIRR of 12.7%) and Portfolio 2 a TVPI of 1.48x (MIRR of 12.8%). However, with unrealized returns accounting for 66% and 60% of TVPI in Portfolios 1 and 2 respectively, the jury is still out regarding cash-on-cash performance. The high level of unrealized returns also reflects the immaturity of both portfolios.

When we compare the more mature fund vintages in our portfolios (2008-2013), significant variability in performance emerges (see Figure 10). While the aggregate MIRRs of the vintages remain quite close (13.0% for Portfolio 1 and 13.3% for Portfolio 2), the variability in vintages 2010, 2011 and 2012 is evident from the graph. However, the relative outperformance of Portfolio 2 in these years is largely offset by the steady performance of Portfolio 1 across all vintages.

When we compare the MIRR of fund vintages 2008 to 2013 to the market (i.e. all funds in the Pevara dataset for these vintages), we see that the performance of both Portfolio 1 and 2 are higher overall than the 12.0% return provided by all Pevara funds. However, in many vintages the market outperforms our portfolios, despite the fact that we did not include bottom-quartile funds when we built them. This underscores the challenge of maintaining top-quartile performance in modern PE.

Fig 10 MIRR Comparison – Fund Vintages 2008-13



	2008	2009	2010	2011	2012	2013	ALL
Portfolio 1	13.4%	13.4%	16.8%	8.9%	10.6%	14.4%	13.0%
Portfolio 2	10.5%	12.1%	20.9%	12.6%	14.0%	12.6%	13.3%
Pevara all funds	11.5%	13.8%	11.7%	12.2%	12.8%	11.2%	12.0%

PE @ INSEAD

This section presents a roundup of the latest in private equity at INSEAD, from recent GPEI research to an update on PE-related events and activities.

The Stars Are Aligning for Socially Responsible Investing

Ian Potter, INSEAD Distinguished Fellow (GPEI) & Managing Partner of Lion City Capital

Calls for a more inclusive style of capitalism are boosting a budding industry.

On the face of it, 2016 was a tough year in the financial markets in general and for socially responsible investors in particular. Returns to active managers in both the public and private markets generally lagged behind the major benchmarks and, in many cases, the performance of socially responsible assets suffered disproportionately.

This was disappointing to proponents of socially responsible investing (SRI) after a strong 2015 when SRI largely kept pace or outdid broad public market indices. The slowdown also reignited common criticisms or misperceptions of the investing style that have come to plague its progress. These include: the notion that there are forced trade-offs between financial and social returns; there is a lack of clarity in the investment process; and the space is dominated by specialist investors, not mainstream ones, starving the sector of significant capital.

This has masked several developments that are reshaping the industry and allowing more meaningful amounts of capital to flow more efficiently to professionally managed opportunities, positioning the industry for more sustained growth. Among these developments are a broader and more sophisticated array of institutional participation; increasing demands from stakeholders for a more inclusive form of capitalism; and tweaks to the interpretation of fiduciary obligations that allow managers to consider the non-financial aspects of SRI in the interest of long-term returns.

The big money is coming

In December 2016, the well-recognized private equity firm TPG announced that it was sponsoring a US$1 billon impact investing fund. Bain Capital, another first-tier private equity general partner, has announced that it expects to launch an SRI themed fund in 2017. Morgan Stanley is approaching final close on its Integro Impact Investing Fund product and even Goldman Sachs is actively invested in the space. What's changed?

The populist movements that burst onto the world stage in 2016 reflect a growing sense of disillusionment with unfettered global capitalism and the desire to balance or redistribute the nature of returns. This can be seen in more 'hands on' or activist policy approaches by governments – whether U.S. President Donald Trump's vocal efforts to 'on-shore' jobs or through fiscal initiatives like the proposed border tax. Asset managers are not immune or insensitive to these larger pressures and are responding with greater efforts to augment their financial return seeking with a broader interpretation of stakeholder interests.

In this regard, a recent U.S. Department of Labour bulletin on the fiduciary duties of Employee Retirement Income Security Act (ERISA) managers is a step forward. This reinterpretation allows for circumstances where the consideration of non-financial factors (including environmental or social factors impacting shareholder value) in long-term positions is permissible, thereby reducing the perceived liability risk of such actions. Other jurisdictions have typically had more lenient and less litigious investment policy approaches but the U.S. controls the largest pool of professionally managed assets so this change is significant.

While this small but meaningful regulatory guidance doesn't address the question of trade-offs between social and financial returns, more elegant approaches are emerging. An example of a more robust taxonomy of decision making can be seen in the approach of the Omidyar Network to triaging different forms of socially responsible investment. A self-described "philanthropic investment firm" rather than a "one-size fits all" firm, they have developed a codified framework that positions possible investments along a returns continuum that will be familiar to many professional asset managers. Having such a rigorous framework allows institutions to gain confidence and thereby focus their investing at the 'commercial' end of the continuum.

What next?

The professional asset management industry changes slowly. Much of what is outlined above was aspirational three years ago. But now it is likely to continue, given the societal pressures for a more thoughtful form of capitalism. While expectations that the assets under management (AUM) devoted to SRI styles as a proportion of overall assets will see a rapid step change are unlikely to be met, it would appear that the hard work of building an industry is underway and growing.

** This article has been modified to fit the layout of this report. For the full version, please visit here.*

Private Secondary Markets a Growing Investment Opportunity

Gautam Seshadri, INSEAD Alumnus & co-founder of Zenprivex

Tech companies want to stay private for longer, which is driving interest and liquidity in secondary markets.

Facebook changed the way many investors access the tech market. The company's rapid revenue growth, its ability to raise unprecedented amounts of private capital at attractive valuations and its ability to defer its IPO filing sparked a vibrant secondary market for its privately-held shares.

Facebook's emergence coincided with a persistently low interest rate environment that allowed the best global private tech companies to access vast, readily-available pools of capital to follow Facebook's lead and remain private. The large supply of late stage, privately-held tech companies caused a proliferation of secondary transactions and, more broadly, the establishment of an organised, global secondary tech market that today encompasses most tech Unicorn companies and many successful non-Unicorns.

A budding market

The increasing depth of the secondary markets is being driven by three key trends.

First is the need for liquidity for founders, employees and angel investors, which is further amplified by the fact that even the most successful private tech companies have chosen to stay private for longer than before. Uber (founded in 2009) and AirBnB (founded in 2008) are still private, and both names are heavily transacted in the secondary markets.

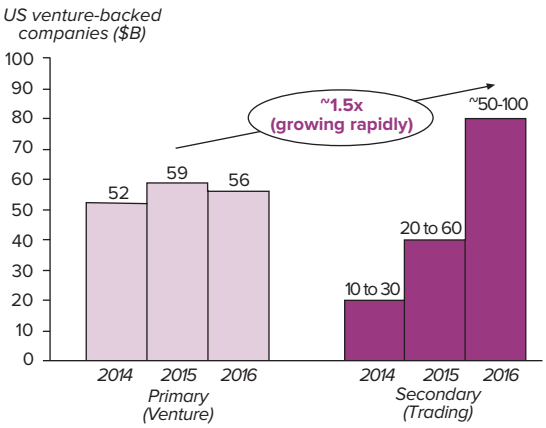
Second, demand is growing from various forms of private (UHNWI's/Family Offices) and institutional wealth (funds/external asset managers etc) unable to access high-quality late stage tech in the primary markets. Historically, the way to access high-quality, mid-to-late-stage opportunities has been by committing capital as a limited partner (LP) to a top-tier Silicon Valley venture capital (VC) fund such as Sequoia Capital, Kleiner Perkins Caufield Byers (KPCB), or Andreessen Horowitz (a16z). Given how a handful of VC funds capture nearly all the Unicorn (and non-Unicorn) return, it is obvious that many different pools of both institutional and non-institutional capital are at a strategic disadvantage vis-à-vis traditional and long-established LP's in VC funds such as large Ivy League endowments or pension funds.

Thirdly, there is a massive, fundamental shift in value capture from the public markets to private markets. Prior to the Google IPO, the best technology companies were going public earlier in their lifecycles, at lower revenues, and at lower valuations. This allowed public investors to capture a disproportionate amount of value relative to private investors. Beginning with the Google IPO, this trend has reversed dramatically, as the lion's share of value has been captured in the private rather than public markets, the recent Snap IPO being a case in point.

The secondary advantage

Both the liquidity and depth of the private secondary tech markets is increasing rapidly (see chart below). This nascent asset class seems poised to grow significantly over the next 5 to 10 years, analogous to the Global Corporate Bond Markets, where secondary trade volume has grown to ~5X to 7X of primary volume as new technology increased transparency and accessibility to entirely new types of investors such as hedge funds, external asset managers, and active institutional portfolio managers such as PIMCO.

The future of the tech secondaries market may well be defined by the ability of technology to equip the growing tribe of neo-investors in this asset class with the tools to sustainably bridge the opacity and information asymmetry that has historically plagued this market.



** This article has been modified to fit the layout of this report. For the full version, please visit here.*

Mastering Private Equity

By Claudia Zeisberger, Michael Prahl & Bowen White

With a foreword by Henry Kravis, Co-Chairman and Co-CEO of KKR

Mastering Private Equity: Transformation via Venture Capital, Minority Investments and Buyouts was written with a professional audience in mind and provides a valuable and unique reference for investors, finance professionals, students and business owners looking to engage with private equity firms or invest in private equity funds. From deal sourcing to exit, LBOs to responsible investing, operational value creation to risk management, the book systematically distils the essence of private equity into core concepts and explains in detail the dynamics of venture capital, growth equity and buyout transactions.

This book combines insights from leading academics and practitioners and was carefully structured to offer:

- A clear and concise reference for the industry expert
- A step-by-step guide for students and casual observers of the industry
- A theoretical companion to the INSEAD case book *Private Equity in Action: Case Studies from Developed and Emerging Markets*

Accolades For Mastering Private Equity

"Mastering Private Equity teaches the fundamentals & best practices of PE investing and ensures a deeper understanding of the PE dynamics for professionals from various backgrounds. It shows the potential the asset class has for building better and stronger companies and thereby acting as a force for good for the economy overall."

Professor Ilian Mihov,
Dean of INSEAD

"This is a powerful book, clear on the fundamentals and rich on insight. It accurately describes how private equity works – it also provides nuance on how private equity really works."

Alan MacKay,
Managing Partner GHO Capital and
current Chairman of the British Venture Capital Association

"Mastering Private Equity pulls back the shroud of mystery surrounding private equity - a succinct yet comprehensive source of information for the expert reader."

Jim Leech C.M.
Chancellor, Queen's University and
former CEO, Ontario Teachers' Pension Plan

With guest comments by senior PE professionals from the firms listed below:

Abraaj • Adams Street Partners • Apax Partners • Baring PE Asia • Bridgepoint • The Carlyle Group
Coller Capital • Debevoise & Plimpton LLP • FMO • Foundry Group • Freshfields Bruckhaus Deringer
General Atlantic • ILPA • Intermediate Capital Group • KKR Capstone • LPEQ • Maxeda
Navis Capital • Northleaf Capital • Oaktree Capital • Partners Group • Permira • Terra Firma

8th Annual INSEAD Asian Private Equity & Venture Capital Conference

The 8th Annual INSEAD Asian Private Equity Conference was held in Singapore on 4 November 2016. The sold-out conference attracted over 300 participants and more than 20 speakers, including five INSEAD alumni, from top private equity firms such as The Abraaj Group and KKR.

"Achieving Outsized Returns in Asian Private Markets" was the overarching theme for this year's conference; the conference was opened by Mr. Ilian Mihov, Dean of INSEAD, who shared a brief overview of the private equity landscape in Asia. He noted that Asia has become a region of interest for the private equity and venture capital industry with significant inflows of capital from investors eager to gain exposure to the region's robust economic growth and expanding consumer classes. Although regional funds have

struggled in recent years amid slowing economic growth, intermittent tense political situations and a competitive deal environment, the fundamentals remain in place as GDP growth in Asia continues to outperform the global average. With vast liquidity, increasing competition and higher valuations, a fund manager's ability to generate unique alpha has become a key differentiator.

In his keynote address, Mr. Nainesh Jaisingh, Managing Director and Global Co-Head of Standard Chartered Private Equity, shared a perspective on how private equity in Asia has changed over the last 16 years. Having seen private equity through a few cycles in Asia, he contended that the industry is here to stay and that private equity will be a fourth pillar of growth for Asia, alongside government, private enterprise & families, and multi-national corporations. He noted the increasing number of buyouts in Asia as a significant development, citing regional family firms' increased willingness to exit their business to financial buyers like private equity. Given the steadily-improving capital markets in Asia during recent decades, he believes that players will

continue to monetize assets in the region and unlock wealth over the next 10 to 15 years.

These addresses were followed by four panel discussions on different aspects of private equity with a common theme of capturing value and returns in Asia. The four panels were:

- Value creation – challenges faced in identifying and extracting value in APAC given the diversity of the region;
- Doing deals – how alpha can be generated through the different stages (winning, structuring and exiting) of a private equity deal;
- Venture capital – trends of the VC industry and insights into delivering continued strong venture capital returns; and
- Limited Partners – outsized return requirements... or moderated expectations?

During the fourth panel on Limited Partners, there was also a separate track on private equity careers to allow students to learn more about the opportunities and challenges of a career in the industry. The conference concluded with a cocktail reception.

The IPEC team also hosted its first Asian Annual Gala Dinner at the Fullerton Hotel on the evening prior to the conference with Yong Kwek Ping, CEO of Inventis Investment Holdings, as the distinguished guest.

Congrats to the team on a job well done!

Case Studies

"On one hand, we were very excited about the Hussmann opportunity. On the other, the rapid performance deterioration during the bidding process made J.L. and I feel like we were trying to catch a falling knife."

"Differentiation Beyond Price: CD&R's Strategy in Acquiring Hussmann" examines sourcing, deal structuring and return strategies with an inside look at Clayton, Dubilier & Rice's (CD&R) "recipe for bubbles".

In 2011, Ingersoll-Rand (IR) decided to divest its refrigeration equipment subsidiary, Hussmann International. However, the routine auction process for the non-core asset went awry when both Hussmann's performance and external finance markets weakened significantly during the due diligence period. After not seeing eye-to-eye with the initial auction winner, IR engaged exclusively with a lower bidder, CD&R.

The challenge for CD&R is to develop a deal structure that can meet both parties' needs, offering enough value to IR to keep them from walking away, yet taking into account the increased riskiness of Hussmann's recent performance to justify CD&R's valuation.

This case aims to build awareness of the challenging private equity landscape and prompts readers to consider ways to source and structure deals in order to maintain attractive returns in an overpriced acquisition atmosphere.

For more information, please visit the case site *here*.

"Since launching its private equity program in 2005, Future Plan had struggled to achieve its target allocation to the asset class and returns had been disappointing."

"Hitting the Target: Optimizing a Private Equity Portfolio with Partners Group" charts how Partners Group's expertise, services and a novel holding structure offered a solution to the needs of a medium-sized European pension fund.

In 2011, Partners Group is nearing the end of a year-long process for a new mandate from European pension fund Future Plan. The pension fund has struggled with its 6-year old private equity program, consistently falling short of its target allocation, generating poor returns and seemingly always a step behind the best opportunities in the market.

With an interest in expanding its private equity activity to include private equity secondary and direct investment strategies, Future Plan begins a competitive manager search process with one goal in mind: to achieve its target return to the asset class by 2014.

The case explores the rationale behind making investment decisions, key challenges faced by institutional investors when constructing a private equity portfolio, and the different characteristics of primary, secondary and direct PE investments.

For more information, please visit the case site *here*.

PE Events @ INSEAD

Future PE Events

Southeast Asia Private Equity Conference 2017

The Greater China Centre for Private Equity is holding its flagship conference in Singapore. This event will convene some of the region's largest names in the private equity space comprising limited partners, general partners, VC firms, investment banks and investment professionals. The conference will be held at ONE°15 Marina Club Singapore on 4-5 May 2017. Use the code **INSEADGPEI2017** for a discount off the regular price. Learn more *here*.

15th Annual INSEAD Private Equity Conference, Europe

Into its 15th year, this annual conference hosted by INSEAD's Private Equity Club (IPEC) has become Europe's largest MBA-led private equity conference and has evolved into an exceptional forum for discussions about the latest PE industry developments. This year's conference – under the theme "Navigating Macro Headwinds in the Pursuit of Growth"– will be held at INSEAD's Fontainebleau campus on 27 May 2017. Learn more *here*.

SuperReturn South & Southeast Asia, Singapore 2017

SuperReturn South & Southeast Asia is part of the SuperReturn Series – the world's leading private equity & venture capital events. Professor Claudia Zeisberger will moderate a panel on "Where is the region heading? What are the expectations over the next 2-3 years and what would unlock faster growth?" at the conference. The conference will be held from 12-14 June 2017. Learn more *here*.

7th Annual AVCJ Private Equity & Venture Forum, Singapore 2017

After China and India, Southeast Asia is poised to become the next battleground for private equity and venture investors, as global players look to expand into the region. The 7th annual AVCJ Singapore Forum will provide an unrivalled in-depth analysis and debate on the latest trends, challenges and opportunities for private markets investors attracted to Southeast Asia. The forum will be held at The Westin Singapore on 19-20 July 2017. Learn more *here*.

AVCJ PRI ESG Forum 2017, Hong Kong

The 3rd Annual AVCJ PRI ESG Forum will take place on 13 November 2017 in Hong Kong. Last year's event gathered more than 110 of the industry's leading figures for a day of education, benchmarking and the exchange of ideas on how GPs operating in Asia can utilise ESG principles. Attendees heard from 30 of the most experienced and successful ESG practitioners from across the globe. Learn more *here*.

Past PE Events

Invest Europe - INSEAD Single Family Office Day, Geneva, 2017

Invest Europe and INSEAD hosted an invitation-only Single Family Office Day on 28 March 2017. This year's event focused on the impact of geopolitical changes, following Brexit and the US elections, on family offices and their approach to investing. Professor Claudia Zeisberger spoke on the challenges faced by LPs when growing their PE portfolios and shared the school's latest research on this topic.

8th Annual INSEAD Asian Private Equity & Venture Capital Conference, Singapore 2016

The 8th Annual INSEAD Asian Private Equity Conference was held in Singapore on 4 November 2016. The sold-out conference attracted over 300 participants and more than 20 speakers, including five INSEAD alumni from top private equity firms. The conference discussed issues pertinent to the private equity landscape in Asia, focusing on achieving outsized returns in the current economic conditions.

APPENDIX

Portfolio 1:

- Strategy: Buyouts 75.3%; Growth 2.6%; Venture 13.1%; Others 9.0%
- Geography: North America 65.7%; Europe 28.8%; Asia 3.5%; Other Emerging Markets 1.9%

Fund	Vintage	Strategy	Geography	Committed	Called	Remaining	Distributed	NAV	TVPI	IRR	MIRR	Quartile
Fund 1	2008	Buyout	US	90.00	(86.82)	3.18	139.30	47.02	2.15x	23.60%	17.08%	1st
Fund 2	2009	Buyout	US	90.00	(76.46)	13.54	44.29	107.22	1.98x	16.89%	14.92%	3rd
Fund 3	2010	Buyout	US	90.00	(93.36)	0.00	85.92	78.30	1.76x	24.05%	16.69%	1st
Fund 4	2010	Buyout	US	180.00	(79.99)	100.01	96.30	46.27	1.78x	27.93%	17.98%	1st
Fund 5	2011	Buyout	US	90.00	(53.81)	36.19	9.47	55.88	1.21x	6.47%	9.08%	3rd
Fund 6	2012	Buyout	US	90.00	(70.12)	19.88	4.54	103.96	1.55x	21.46%	16.63%	1st
Fund 7	2008	Buyout	W. Europe	70.00	(64.96)	5.04	20.43	68.89	1.37x	8.40%	10.22%	2nd
Fund 8	2009	Buyout	W. Europe	70.00	(62.90)	7.10	48.48	42.46	1.45x	10.77%	11.35%	3rd
Fund 9	2011	Buyout	W. Europe	70.00	(61.99)	8.01	0.01	64.89	1.05x	1.59%	5.88%	4th
Fund 10	2008	Venture Capital	R.o.W	10.00	(10.00)	0.00	1.80	6.03	0.78x	(4.29%)	1.46%	4th
Fund 11	2008	Venture Capital	US	15.00	(14.36)	0.64	9.59	9.79	1.35x	7.36%	9.64%	3rd
Fund 12	2008	Venture Capital	W. Europe	15.00	(14.70)	0.30	4.88	14.58	1.32x	6.28%	8.90%	2nd
Fund 13	2012	Venture Capital	W. Europe	15.00	(11.24)	3.76	0.00	13.61	1.21x	8.06%	9.82%	2nd
Fund 14	2012	Buyout	Asia/Pacific	15.00	(14.26)	0.74	0.49	20.70	1.49x	13.89%	13.30%	3rd
Fund 15	2012	Late/Expansion	R.o.W	20.00	(19.71)	0.29	6.46	21.13	1.40x	14.38%	13.23%	2nd
Fund 16	2010	Late/Expansion	Asia/Pacific	20.00	(8.44)	11.56	0.96	6.70	0.91x	(1.96%)	0.85%	4th
Fund 17	2012	Opportunistic	Asia/Pacific	20.00	(14.79)	5.21	0.09	15.32	1.04x	1.17%	3.85%	3rd
Fund 18	2009	Distressed Debt	US	40.00	(41.20)	0.00	31.76	20.09	1.26x	10.56%	11.49%	3rd
Fund 19	2012	Mezzanine Capital	US	40.00	(54.85)	0.00	2.67	37.96	0.74x	(11.49%)	(3.38%)	4th
Fund 20	2011	Distressed Debt	W. Europe	40.00	(27.97)	12.03	0.48	40.16	1.45x	10.56%	10.94%	3rd
Fund 42	2013	Buyout	US	50.00	(36.15)	13.85	15.95	32.78	1.35x	26.55%	17.70%	1st
Fund 45	2013	Buyout	US	50.00	(45.06)	4.94	0.01	54.39	1.21x	10.76%	11.28%	2nd
Fund 46	2013	Buyout	US	50.00	(44.97)	5.03	21.22	32.71	1.20x	15.05%	13.26%	1st
Fund 47	2013	Buyout	US	50.00	(32.91)	17.09	6.61	33.47	1.22x	11.67%	11.80%	2nd
Fund 59	2015	Buyout	US	40.00	(16.97)	23.03	0.00	18.15	1.07x	6.38%	8.43%	
Fund 61	2015	Buyout	W. Europe	20.00	(7.67)	12.33	0.00	9.14	1.19x	15.50%	14.29%	
Fund 66	2014	Buyout	US	60.00	(34.75)	25.25	2.00	40.17	1.21x	18.68%	15.70%	1st
Fund 70	2016	Venture Capital	W. Europe	50.00	(7.83)	42.17	0.00	6.64	0.85x	(18.19%)	(14.72%)	
Fund 71	2016	Venture Capital	W. Europe	50.00	(3.43)	46.57	0.00	2.46	0.72x	(47.43%)	(25.46%)	
Fund 72	2015	Venture Capital	W. Europe	50.00	(14.53)	35.47	1.23	12.47	0.94x	(8.92%)	4.57%	
All				1,560.00	(1,126.20)	453.21	554.94	1,063.32	1.44x	13.97%	12.65%	2nd

Portfolio 2:

- Strategy: Buyouts 54.6%; Growth 19.8%; Venture 13.2%; Others 12.4%
- Geography: North America 39.1%; Europe 29.3%; Asia 28.2%; Other Emerging Markets 3.4%

Fund	Vintage	Strategy	Geography	Committed	Called	Remaining	Distributed	NAV	TVPI	IRR	MIRR	Quartile
Fund 21	2008	Buyout	US	90.00	(95.84)	0.00	107.03	33.53	1.47x	8.37%	9.81%	3rd
Fund 22	2010	Buyout	US	90.00	(79.99)	10.01	96.30	46.27	1.78x	27.93%	17.98%	1st
Fund 23	2012	Buyout	US	90.00	(90.31)	0.00	19.08	120.82	1.55x	15.55%	14.63%	2nd
Fund 24	2008	Buyout	W. Europe	70.00	(61.69)	8.31	68.80	22.33	1.48x	11.04%	11.56%	2nd
Fund 25	2009	Buyout	W. Europe	70.00	(67.33)	2.67	76.99	35.12	1.67x	12.54%	12.31%	2nd
Fund 26	2009	Buyout	Asia/Pacific	60.00	(58.37)	1.63	49.11	21.39	1.21x	5.06%	8.25%	2nd
Fund 27	2010	Venture Capital	US	30.00	(33.60)	0.00	11.31	163.32	5.20x	55.96%	38.18%	1st
Fund 28	2011	Venture Capital	US	30.00	(26.40)	3.60	24.08	15.10	1.48x	24.28%	16.06%	1st
Fund 29	2009	Late/Expansion	US	30.00	(30.42)	0.00	35.48	31.47	2.20x	20.75%	16.66%	1st
Fund 30	2011	Venture Capital	R.o.W	20.00	(18.50)	1.50	35.56	13.46	2.65x	74.13%	28.95%	1st
Fund 31	2012	Buyout	W. Europe	70.00	(39.20)	30.80	1.47	48.10	1.26x	7.74%	8.88%	3rd
Fund 32	2011	Buyout	R.o.W	40.00	(23.36)	16.64	0.40	20.88	0.91x	(2.87%)	3.39%	4th
Fund 33	2011	Late/Expansion	Asia/Pacific	30.00	(16.58)	13.42	1.15	15.31	0.99x	(0.17%)	1.41%	4th
Fund 34	2010	Late/Expansion	Asia/Pacific	30.00	(11.69)	18.31	0.09	11.58	1.00x	(0.02%)	1.76%	4th
Fund 35	2009	Late/Expansion	Asia/Pacific	30.00	(42.00)	0.00	35.39	25.95	1.46x	11.00%	11.54%	2nd
Fund 36	2011	Late/Expansion	W. Europe	40.00	(36.06)	3.94	0.00	40.20	1.11x	4.33%	7.94%	3rd
Fund 37	2008	Late/Expansion	W. Europe	40.00	(39.16)	0.84	33.70	24.64	1.49x	8.99%	10.32%	2nd
Fund 38	2010	Distressed Debt	US	50.00	(45.19)	4.81	21.12	43.97	1.44x	11.81%	11.91%	1st
Fund 39	2012	Buyout	Asia/Pacific	40.00	(36.60)	3.40	20.94	31.73	1.44x	17.14%	14.70%	2nd
Fund 40	2011	Distressed Debt	W. Europe	50.00	(72.77)	0.00	58.19	29.63	1.21x	11.11%	11.70%	2nd
Fund 41	2013	Buyout	W. Europe	30.00	(23.17)	6.83	4.20	25.72	1.29x	17.25%	14.81%	1st
Fund 43	2013	Buyout	US	50.00	(36.15)	13.85	15.95	32.78	1.35x	26.55%	17.70%	1st
Fund 44	2013	Late/Expansion	Asia/Pacific	10.00	(7.37)	2.63	0.65	6.43	0.96x	(2.26%)	3.42%	3rd
Fund 48	2013	Buyout	W. Europe	50.00	(26.32)	23.68	0.01	27.99	1.06x	2.98%	5.99%	3rd
Fund 49	2013	Distressed Debt	US	40.00	(5.88)	34.12	1.42	3.86	0.90x	(4.13%)	1.57%	4th
Fund 50	2013	Buyout	Asia/Pacific	20.00	(6.39)	13.61	0.00	6.40	1.00x	0.06%	2.06%	3rd
Fund 60	2015	Buyout	US	30.00	(19.00)	11.00	4.59	16.71	1.12x	13.42%	12.68%	
Fund 62	2015	Late/Expansion	Asia/Pacific	40.00	(15.22)	24.78	0.11	12.43	0.82x	(16.05%)	(7.26%)	
Fund 63	2015	Late/Expansion	Asia/Pacific	30.00	(11.40)	18.60	0.00	10.55	0.93x	(8.62%)	(2.35%)	
Fund 64	2015	Late/Expansion	Asia/Pacific	25.00	(8.97)	16.03	0.07	9.65	1.08x	7.74%	8.92%	
Fund 65	2015	Buyout	W. Europe	30.00	(23.50)	6.50	0.00	29.85	1.27x	31.90%	27.20%	
Fund 67	2014	Buyout	Asia/Pacific	60.00	(21.25)	38.75	1.54	20.05	1.02x	2.32%	9.12%	2nd
Fund 68	2014	Buyout	W. Europe	60.00	(23.66)	36.34	14.29	21.28	1.50x	25.01%	20.16%	1st
Fund 69	2014	Late/Expansion	Asia/Pacific	40.00	(27.04)	12.96	0.42	24.81	0.93x	(3.77%)	1.53%	4th
Fund 73	2016	Venture Capital	US	75.00	(18.82)	56.18	0.00	19.01	1.01x	1.98%	4.44%	
Fund 74	2016	Real Estate	Asia/Pacific	75.00	(26.16)	48.84	(2.00)	25.41	0.90x	(10.56%)	(10.65%)	
Fund 75	2014	Venture Capital	US	75.00	(43.68)	31.32	11.74	45.14	1.30x	27.63%	18.48%	1st
All				1,740.00	(1,269.02)	515.92	749.17	1,132.85	1.48x	14.34%	12.84%	2nd

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