Private Equity Zags In Market Where Everything Is Moving (Down) Together

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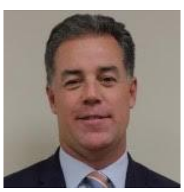
Chuck Jaffe, in this episode of The NAVigator podcast interviewed Timothy Reick, chief executive officer at Liberty Street Advisors – advisor to the Private Shares Fund. Read the Q&A below as Timothy says that private equity is an asset class that is not correlated to the broad stock market, and that individual investors largely overlook its potential role in their portfolios. Reick notes that with private companies waiting much longer both in terms of time in business and the asset size they grow to before turning to public markets – if they ever go that route – investors will find a vibrant market that they can approach in many different ways. Private Shares Fund is an interval fund that pursues mostly late-stage firms, but he notes that the space includes everything from angel investors to companies on the verge of going public, across virtually all businesses and industries.



Timothy Reick

The podcast can be found on AICA's website by clicking here: https://aicalliance.org/alliance-content/pod-cast/

CHUCK JAFFE: Timothy Reick, chief executive officer at Liberty Street Advisors, advisor to the Private Shares Fund is here. We're talking about investing in private growth companies now on The NAVigator. This is The NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator is brought to you by the Active Investment Company Alliance, a unique industry organization that represents all facets of the closed-end fund industry. From users and investors to fund sponsors and creators, if you're looking for excellence beyond indexing, The NAVigator's going to point you in the right direction. And today we are looking in the direction of investing in private companies with Timothy Reick, chief executive officer at Liberty Street Advisors which oversees the Private Shares Fund, which you can learn all about at PrivateSharesFund.com. You can also learn much more about closed-end funds, business-development companies, and interval funds at AICAlliance.org, the website for the Active Investment Company Alliance. Tim Reick, thanks for joining me on The NAVigator.

TIMOTHY REICK: Pleasure to be here. Thanks for having me.

CHUCK JAFFE: Tim, let's start with the basics. Because on to one hand people hear private shares fund, private shares, they sort of think they know what's going on here. But there's a lot more than just the name, explain how the Private Shares Fund works.

TIMOTHY REICK: Sure. So the Private Shares Fund is structured as a closed-end interval fund, which is somewhat a newer product. It's not all that dissimilar from a mutual fund, the difference being that you can purchase that fund daily with a daily NAV, but the redemptions are limited to a quarterly basis and no more than 5% of NAV each quarter. What that allows a fund manager to do, particular in the Private Shares Fund, is to buy securities that are not as liquid as those that trade on the public markets, such as private equity securities. And in our fund the goal is to democratize or provide access to some of these later-stage private growth companies to the average retail investor which normally they haven't been able to do in the past.

CHUCK JAFFE: There's been a lot of changes in private equity over the last 10-15, 20 years. We went from a period where if you wanted to do things with your big company, you were taking it public. And then it changed and it became, hey, if you want to be able to do more with your company, you maybe want to take it private. You want to keep it private. So help us understand the evolution of private equities, and then we can get to which part of the world in private equities you're looking at.

TIMOTHY REICK: Certainly. So investing in private equities, it always and will continue to play an important role in a well-diversified investment portfolio, got the potential to private you with non-correlated, less volatile source of higher returns. But over the last decade or so we think there's more importance than having some exposure to this simply because companies are staying private longer and they're generating significant investor value in the private markets. For example, if you go back to 1999, the median age of a company that stayed private before it went public via an IPO was just four years. Fast forward to today, it's around 11 years. So great evidence that companies are staying in the private markets longer. More importantly, if you go back and look at the average market value of an IPO from back in 1999, most companies, their average valuation at IPO was around $500 million or half a billion. If you look at the end of 2021, the average valuation was over $3 billion, so a six-fold increase. So companies are staying private longer, they are growing larger in those private market. You're unable to capture that segment of growth via public market exposure. The last thing I mention on that is that people are familiar with the term "unicorns". Unicorn simply means a private company with a valuation to exceed one billion dollars. I believe the first unicorn was Facebook. So if you go back just to the end of 2016, which was only seven years ago, there were only 128 unicorns in existence. In the last five and a half years or so, that number has grown to around 1,074, that's as of March 31st. So almost an eight-fold increase. So not only are companies staying private longer, getting bigger longer in the private markets, but there's just a lot more of them that stay private before they go into the public markets.

CHUCK JAFFE: The classic feeling for investors about private equity was if I could get there I was dealing with things that were highly illiquid. Private Shares Fund is an interval fund, so that helps to solve the liquidity issue. But private shares themselves, it's not a fully liquid market, but it's not the old days of private shares never traded, guys kept them on their books without valuations that were trustworthy, things along those lines. That's changed a lot too, hasn't it?

TIMOTHY REICK: It has over the most recent years. There's actually a number of exchanges where individuals can trade shares of privately held companies. For example, executives or people that were early investors. Venture capitalists who may be early on in one of these companies, as they mature, maybe they want to take some chips off the table and they will be looking to offer up their shares for purchase. Or maybe they've become too concentrated in a single position and want to take that some off of their balance sheet and make it available to other purchasers. And additional liquidity is provided in a number of ways; obviously you've got the traditional IPO. We're not going to see a lot of those this year given the market conditions, but you saw a lot of that last year, and that's clearly an easy path to liquidity. But the other thing I think most people don't recognize is roughly two thirds of these companies never make it to the public markets because they get acquired, M&A. A large publicly traded company or even a larger private company may identify the technology or the innovation that this company is exhibiting as a valuable asset to them, and therefore they acquire it in the private markets. That provides cash and liquidity to our fund when that happens. So it really ebbs and flows over time, whether you get liquidity via the public markets, and that's really a function of how receptive they are to IPOs. But there's a continuum, particularly like environments like this where companies may need to make acquisitions to fund their future growth, and some of these private companies may be the targets of that.

CHUCK JAFFE: Within private equity, what are the areas that you gravitate towards? Where are the opportunities?

TIMOTHY REICK: So within private equity there's a lot of different avenues. You've got the angel investing if you will. Or the joke, two guys in a garage, that's really early stage. And then you've got mid-stage and obviously late stage. We tend to focus more on the late stage, these are companies, doesn't have to particular demonstrate a number of years of existence, but we want to see that they've got revenues anywhere from $50 million or up. They've got a definable business model with customers, and not just an idea, an idea is really more early stage. And then we want it to be innovative growth, and historically I think investors looked at that and thought just technology. And while innovative growth certainly is technology, what you find today is every sector of the marketplace. Whether it's utilities or farming or transportation, healthcare, biotech is impacted by disruptive technologies. And so we're agnostic as to where a company may fall sector-wise, we just want to make sure that the company is demonstrating a great product or service that's disruptive, that will help improve any given business, and that it has, as I mentioned earlier, existing revenue, existing customer base. So we're just not going to go to that early stage where it's really just an idea with no proof of concept so to speak.

CHUCK JAFFE: Is that part of what makes the Private Shares Fund different? I mean, I know you can't totally give us the secret sauce here, but there are other funds that try to do what you do, they just don't seem to do it the same way.

TIMOTHY REICK: I think a lot of the traditional avenues for folks to gain exposure to this market was more in a private placement, or an LP if you will. Those tend to be vehicles where they have maybe a 10-year life, the first three or four years they're calling capital as they make investments. The next three or four, they're helping growth those businesses. And the last three or four they're harvesting them, they're selling them to someone else or taking them public if you will. Typically you see maybe 10-15, 20 investments in those and they've done very well, but they're burdensome. They have K-1s, they have accreditation requirements, so not every individual investor has the ability to invest in those, and they're not evergreen. It means when they call your capital, they invest in 10, 15 or 20 companies, that's what you get. If a great opportunity comes up shortly after they've called all the capital for that private placement, well, guess what? That's going to be in the next fund, and if you don't participate in that next fund, you may not own that individual company. So the evergreen nature of the closed-end interval fund, it allows an investor, for example, if you purchased the fund's share tomorrow, you would have one share in the fund and you would have exposure immediately to the 95 companies or so that we currently have in the portfolio. And as long as you remain a shareholder and we make new investments you'll continue to gain exposure to those new ideas. So it's just structurally different. And one other thing I wanted to point out, if you look at asset allocation to private markets or private equity, there's been kind of a big misbalance. Endowments are as high as 25%, sovereign wealth funds are 15%, defined benefit plans have about 10%, and even high net worth individuals have 5%. But your typical retail investor or individual has less than 1% exposure to private markets. And we think in the structure of the private shares fund, which allows for individual and retail investors to buy shares of this fund, they can help gain some exposure to, in our opinion, this attractive portion of the marketplace.

CHUCK JAFFE: One last question about that. Private equity, how is that correlated to the rest of the market? Because right now plenty of people are looking for things that are not necessarily moving in sync with the market. This is part of a potential asset allocation that, as you point out, individual investors underrepresented there. You can't of course talk about what you expect performance to be, but how correlated is performance and results of private equity to the rest of the market?

TIMOTHY REICK: Excellent question. Depending on which private equity, obviously angel investing or early investing has a different correlation than late stage, but in any form that you look at, the private markets tend to be highly uncorrelated to the broader equity markets. There's not what you see in some of the public markets where one company in a given industry reports some bad news or a challenge to their business model, and that same afternoon the other 15 companies in that sector all go down in sympathy with it. You also tend to have, as I mentioned, stickier money in private equity. The traditional vehicle to gain exposure to this is LPs, where it's locked up. People understand and appreciate that this type of investing has a long-term investment horizon. I don't know what that means to a lot of folks these days. I'm sure you'd agree that long-term investment horizon is probably shortened for a lot of people over the last 15 or 20 years. But we truly believe if you're not looking to be exposed to this space for at least two to five years, a full market cycle, it may not be an appropriate investment for you. Whereas public markets trade often at the whim of the news or today's headline or what have you, and you just don't see that in the private markets.

CHUCK JAFFE: And of course you also don't see that with the interval structure which is designed to make it that you can hang on through some of those tough times. Tim, really interesting stuff, thanks so much for joining me on The NAVigator to talk about it.

TIMOTHY REICK: My pleasure, Chuck.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. And yes, that's me, you can check out my hour-long weekday podcast on your favorite podcast app or by going to MoneyLifeShow.com. To learn much more about interval funds, closed-end funds, and business-development companies go to AICAlliance.org, the website for the Active Investment Company Alliance. They're on Facebook and LinkedIn @AICAlliance. Thanks to my guest Timothy Reick, chief executive officer at Liberty Street Advisors which oversees the Private Shares Fund, which you can learn about at PrivateSharesFund.com. The NAVigator podcast is new every Friday, ensure you don't miss anything by following us on your favorite podcast app. And until we do this again next week, happy investing everybody.

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