VENTURE CAPITAL - IMPROVING PERFORMANCE AND REDUCING RISK WITHIN A PRIVATE EQUITY PORTFOLIO

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Investing in the Future

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1. OVERVIEW

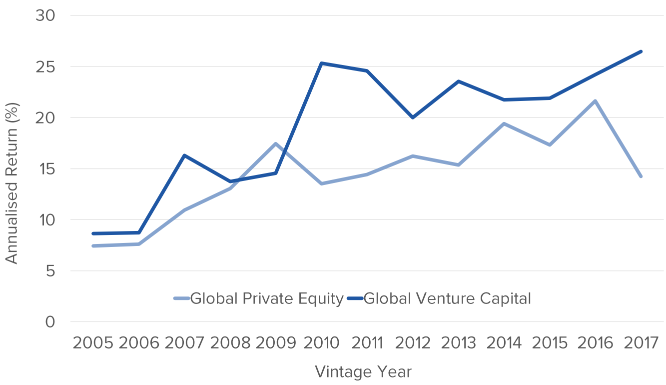
While many investors now view private equity as an integral part of their asset allocation, many choose to focus solely on the buyout part of the asset class. Venture capital is often overlooked, with investors believing it to be too risky and incapable of consistently generating the returns they require.

In reality, the exact opposite is true. Done correctly, an allocation to venture capital can actually reduce risk within a portfolio while at the same time increasing the potential for outperformance.

2. VC PROVIDES INCREASED UPSIDE...

Data from Cambridge Associates shows that the performance generated by venture capital and private equity funds has deviated sharply over the last decade. With technology companies disrupting large parts of the traditional economy, venture capital has significantly outperformed private equity in every vintage year from 2010 to 2017.

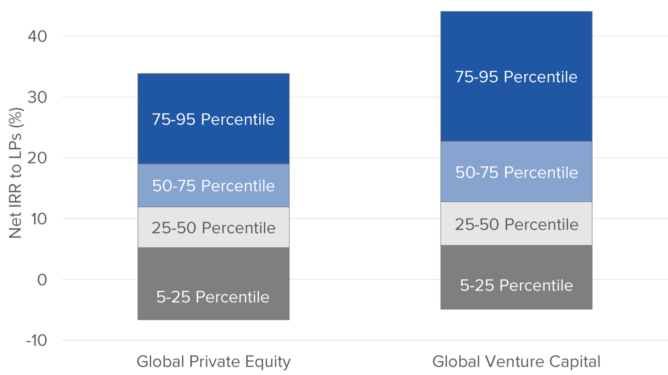
Figure 1 - VC Outperforming Since 2010



Source: Cambridge Associates Investment Benchmarks to 30 September 2020

It's not just at the industry level where venture capital shows greater upside potential. Figure 2 shows the average percentile benchmarks for 2005-2017 vintage year funds, with the best performing venture capital funds significantly outpacing their private equity counterparts. However, perhaps surprisingly, even those venture funds in the 75-95th percentiles show a slight outperformance relative to the least successful PE funds.

Figure 2 - Average Percentile Boundaries
(2005-2017 Vintage Year Funds)

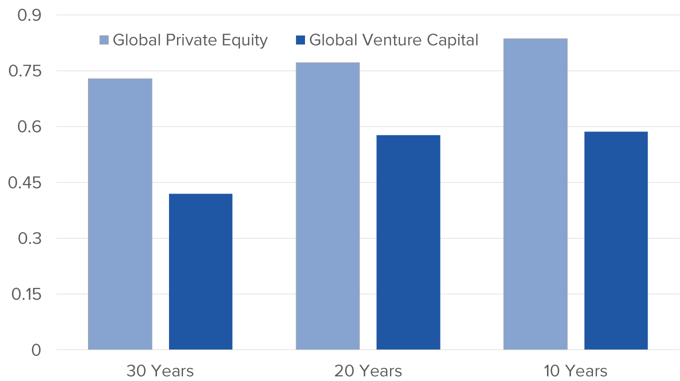


Source: Cambridge Associates Investment Benchmarks to 30 September 2020

3. ...AND CAN REDUCE RISK

In addition to providing strong returns relative to private equity, an allocation to venture capital can also help to reduce risk by adding diversification to an investor's portfolio. Figure 3 shows the correlation of quarterly performance for both the Global PE and VC industries relative to the S&P 500 Index.

Figure 3 - VC Provides Increased Diversification



Source: Cambridge Associates Investment Benchmarks, Yahoo Finance. To 30 Sep 2020.

While the correlation of the private markets has moved closer to the S&P 500 in recent years, venture capital continues to offer investors greater diversification than private equity.

4. PERSISTENCE OF PERFORMANCE

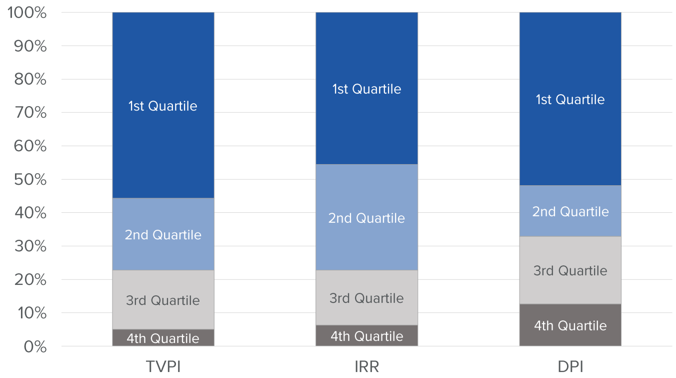
While the venture capital industry in aggregate can provide increased performance and diversification, it is critical to remember that investors ultimately have to pick individual managers and funds. The good news for investors in VC is that multiple studies have shown a relatively high degree of performance persistence from venture firms.

A recent academic study by Tim Jenkinson of the University of Oxford[1] showed that almost **45%** of VC firms whose prior fund ranked in the top quartile were able to repeat this performance with the subsequent fund. This compares to just **33%** of managers within the private equity industry.

These findings are very much in line with VenCap's experience of investing in venture funds over more than 30 years. For more than a decade, VenCap's investment programmes have been heavily focused on just 14 Core VC Managers. Figure 4 shows the quartile ranking of all VenCap's investments in mature Core Manager funds (1995 to 2015 vintage years). Over 50% of funds rank in the top quartile by TVPI, while just 5% rank in the bottom quartile.

[1] Has Persistence Persisted in Private Equity? Harris, Jenkinson, et al. November 2020. Post 2000 funds only.

Figure 4 - Core Manager Benchmarking



79 funds raised by Core Managers from 1995 to 2015 (inclusive). Benchmark is Cambridge Associates US Venture Capital. All data to 30 September 2020. Primary commitments only.

5. SUMMARY

Despite the widespread perception that VC is highly risky, the asset class can actually offer significant outperformance and increased diversification relative to private equity. However, investors need to recognise the wide variation in performance between individual venture funds. Fortunately, the strong persistence of returns within venture means that the quartile ranking of a manager's prior fund is a more meaningful indicator of the likely performance of their current fund.

ABOUT VENCAP

VenCap is an independent investment firm focused on investing in top-tier venture capital funds in the US, Europe, China and India. Since its inception in 1987, VenCap has been an investor in funds that have offered investors early exposure to many of the most significant companies that have been formed in the last 30 years, for example Facebook, Google, Netflix, NVIDIA, Spotify and Zoom.

To find out more about us, please click here. To see our latest fund offering, please click here.