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Private Equity and the Polls

In November 2024, U.S. voters will head to the polls to elect their president for the next four years, as well as members of Congress. With that prospect in mind, many investors are trying to assess how these elections might affect the performance of their portfolios.

In this paper we examine whether and how past U.S. elections have affected the immediate performance of U.S. private equity, and look at longer-term performance under different administrative regimes.

Executive Summary

- Using Burgiss quarterly private equity fund performance data back to 1984, we find that elevated election-year volatility appears to be attributable to economic and market events rather than the elections themselves.
- We find a pattern of stronger performance in the fourth quarter, on average, which we can attribute in part to underlying patterns of stronger public-market performance, higher levels of distributions from private equity funds, and the majority of audits being based off fourth-quarter numbers; we find no relationship with whether a year included an election.
- While we find a superficial suggestion that private equity performs more strongly under divided governments led by Democratic presidents, the finding breaks down under closer scrutiny: the cyclicality of the asset class is more obviously attributable to the general economic and market backdrop.
- We conclude that, while investors may emphasize sector-specific investment themes based on the results of this November's polls, there is little historical evidence that U.S. elections exert a predictable effect on broad equity market performance, public or private.

As a proxy for the performance of U.S. private equity, we use quarter-over-quarter internal rates of return (IRR) from the database of predominantly buyout and venture capital funds maintained by Burgiss, now part of MSCI.[1] The earliest data we were able to analyze dates back to 1984, giving us a total of 10 election years and 30 non-election years.

Our first step is simply to look at whether private equity performance or volatility is higher or lower than normal during presidential election years. While, on average, performance turns out to be largely similar for election years and non-election years (17.8% and 17.3%, respectively), volatility appears to differ: the annualized standard deviation of quarterly returns during the 10 election years since 1984 is 8.36% versus just 6.34% in the 30 non-election years.

We caution against reading too much into that, however. Before 2000, average volatility was in fact lower in election years. The exceptional volatility seen in certain post-2000 election years drags the whole-period average up, and when we zoom into that period in figure 1, the source of that higher volatility becomes evident—and it doesn't seem to be anything political.

FIGURE 1. SOME ELECTION YEARS HAVE BEEN VOLATILE, BUT NOT ALL

Source: Burgiss, Neuberger Berman. Data as of May 1, 2024.

[1] As of Q4 2023, Burgiss was tracking 4,911 U.S. private equity funds, including 1,679 buyout funds and 2,595 venture capital funds.

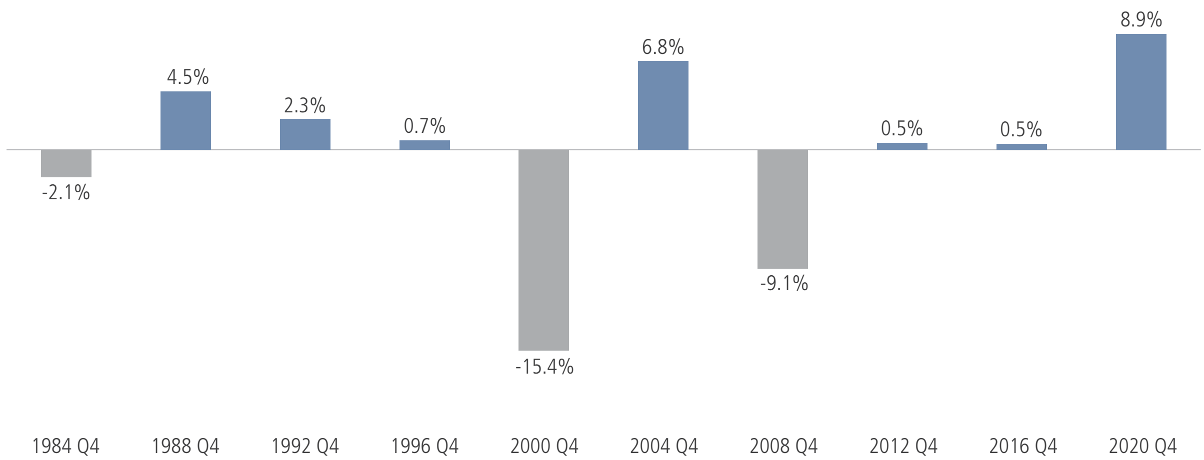
The year 2004 was uneventful in private equity returns. The same was true of 2012, notwithstanding the ongoing eurozone debt crisis. Even 2016 was quiet, against the background of the unexpected rise of Donald Trump as the Republican party's presidential candidate. The volatility was instead associated with 2000 (which saw a historic boom and bust in sectors heavily represented in private equity portfolios), 2008 (the year of one of the worst financial crises of all time) and 2020 (the start of a global pandemic).

Have Elections Affected Fourth-Quarter Private Equity Performance?

If U.S. elections do have an effect on private equity performance, perhaps it is more localized around the time of those elections? Given that U.S. presidential elections are always held in November, we looked at fourth-quarter performance in each election year since 1984. Figure 2 shows how that performance deviated from the average quarterly performance in each respective year.

FIGURE 2. MEANINGFUL DEVIATION OF FOURTH-QUARTER PERFORMANCE IN ELECTION YEARS?

Difference between each year's fourth-quarter return and the average quarterly return for that year

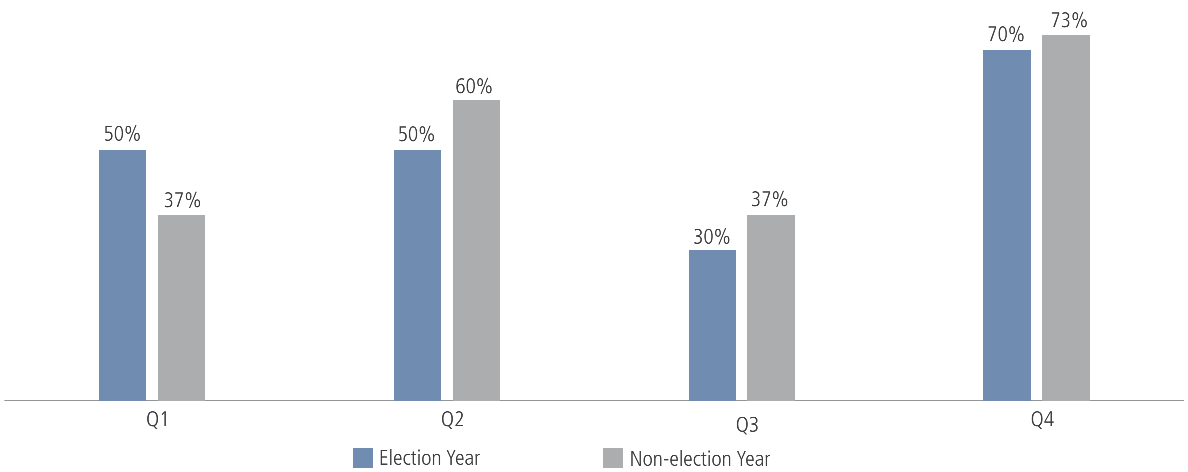


Source: Burgiss, Neuberger Berman. Data as of May 1, 2024. The 1988 performance of one buyout fund was removed as an outlier.

Again, at first glance there appears to be something: in five of the 10 years—1988, 2000, 2004, 2008 and 2020—fourth-quarter returns deviated meaningfully from the rest of the year's performance. We can explain three of the results: the fourth quarter of 2000 was when the dotcom bubble began to deflate, the fourth quarter of 2008 saw the aftermath of the collapse of Lehman Brothers and the fourth quarter of 2020 benefitted from the rebound from the COVID-19 shock.

But that still leaves 1988 and 2004. Perhaps outperformance in these otherwise uneventful years suggests that elections may have exerted an additional effect. We think we can ultimately discount that by showing the probability of any particular quarter outperforming the year's average quarterly performance between 1984 and 2020 (figure 3).

FIGURE 3. THERE IS SOMETHING NOTABLE ABOUT FOURTH-QUARTER RETURNS, BUT IT'S NOT U.S. ELECTIONS
Probability of each quarter's return outperforming the average quarterly return for the year, 1984 – 2023



Source: Burgiss, Neuberger Berman. Data as of May 1, 2024.

As figure 2 already suggested, the probability of fourth-quarter outperformance is high. What figure 3 shows us is that the probability of any of the other quarters outperforming tends to be much lower, even though it is of course possible for more than one quarter to outperform the quarterly average—in other words, there is specifically a *fourth-quarter effect* (rather than, say, a first- and fourth-quarter effect, or a second- and fourth-quarter effect). And, most importantly for our purposes, that fourth-quarter effect is clearly visible, and of almost exactly the same magnitude, in both election years and non-election years.

There appears to be *something* notable about fourth-quarter private equity returns—but it is evidently unrelated to U.S. presidential elections.

A Quick Detour: What Accounts for the Fourth-Quarter Effect?

Let's leave the election-year question aside for a moment, and focus on this apparent fourth-quarter effect. To explain it, we need to try to isolate and analyze the factors that determine private equity performance from one quarter to the next.

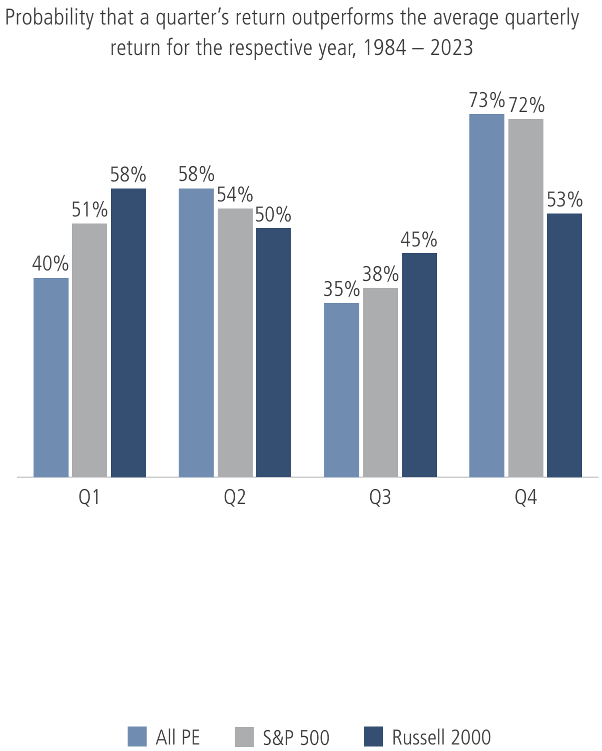
We believe that quarterly performance is measured predominantly based on two main factors: (1) the quarterly growth of net asset value ("NAV") and (2) the net cash flow for portfolio assets in a given quarter. The first factor can be further split into two components irrespective of the valuation method private equity General Partners (GPs) use: The fundamentals that are idiosyncratic to each individual portfolio company (e.g., EBITDA, net debt, etc.) and the valuations of comparable companies in both public and private equity markets.

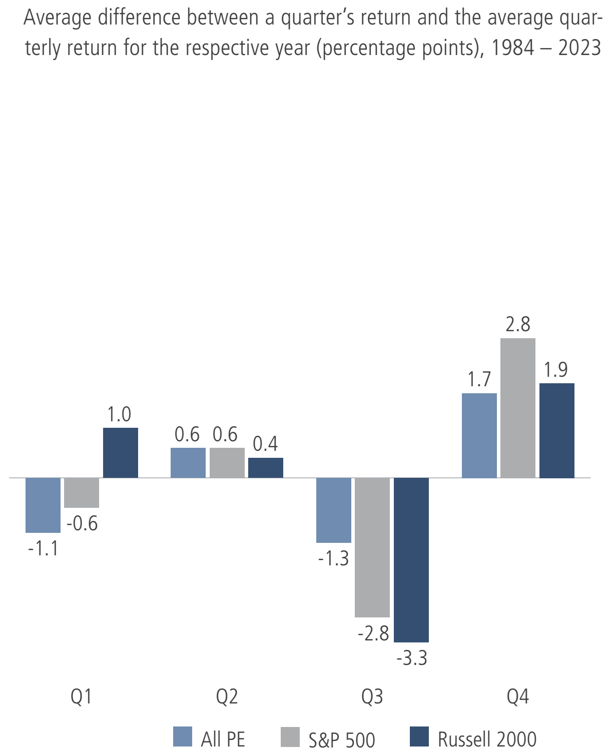
Given that this research utilized fund-level data, we did not analyze the impact of idiosyncratic factors in the explanation of the fourth quarter effect we uncovered. One observation we *can* make is that the majority of private investment vehicles are audited once a year, usually based off fourth-quarter numbers. We believe this heightened scrutiny, coupled with the ability to compare three completed quarters of actual financials with budgeted annual targets, allows GPs to take a closer look at the valuation of their holdings, which likely contributes to at least some of the outperformance we find in the data.

In addition, we looked more closely into public equity performance and the distribution activities of private funds.

Figure 4 suggests there is a fourth-quarter effect in public equity markets similar to what we have observed in private markets—more pronounced in the S&P 500 Index, while slightly less so in the small-cap Russell 2000 Index. It shows up both in the probability that the fourth quarter outperforms the average quarterly return in any given year, and in the magnitude of fourth-quarter excess returns.

FIGURE 4. A FOURTH-QUARTER EFFECT IN PUBLIC EQUITY PARTLY EXPLAINS THE EFFECT IN PRIVATE EQUITY





Source: Bloomberg, Burgiss, Neuberger Berman. Data as of May 1, 2024.

In other research, we have found that public equity performance is positively, albeit not perfectly, correlated with private equity performance. Although this relationship includes a certain lag, this likely explains part of the fourth-quarter effect we see in private equity. Moreover, the public market data underline a phenomenon that was evident but slightly less pronounced in private equity: not only has the fourth quarter tended to be better than average, the third quarter has tended to be markedly *worse* than average.

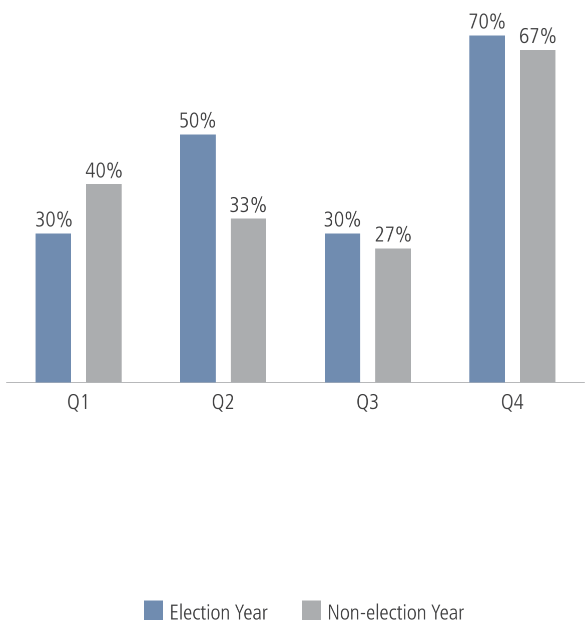
This seasonality in the performance data is intuitive. In the northern hemisphere dealmakers tend to be away from their work during the third-quarter summer months before catching up in the fall and making a special effort to complete transactions by the end of the year—not least to meet bonus-calculation deadlines. These fluctuations in mergers, acquisitions and IPOs can have an impact on index-level performance.

This intuition is also supported by similar seasonal patterns in distributions from private equity funds.

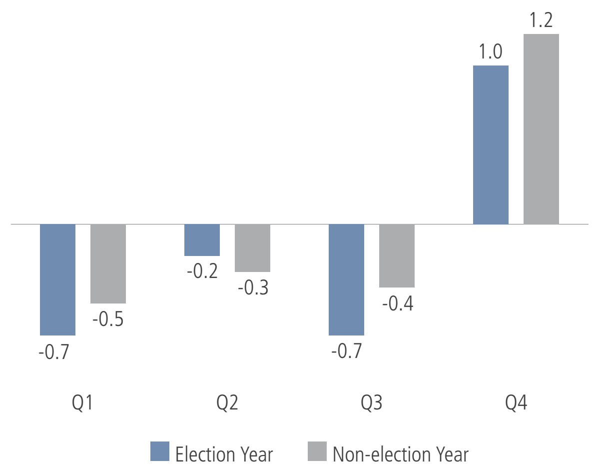
Figure 5 shows how each quarter's average level of distributions (as a percentage of prior quarter NAV) has related to the average quarterly distribution for the whole of the respective year. Fourth-quarter distributions are *more likely to be larger* than the respective year's average quarterly distributions, during both election and non-election years. And when we look at *how much* those quarterly distributions deviate from the average for the year, we again find the fourth quarter outperforming in both election and non-election years.

FIGURE 5. FOURTH-QUARTER DISTRIBUTIONS TENDED TO EXCEED THE AVERAGE IN BOTH ELECTION AND NON-ELECTION YEARS

Probability that a quarter's distribution-to-NAV ratio is higher than the average quarterly distribution-to-NAV ratio for the respective year, 1984 – 2023



Average difference between a quarter's distribution-to-NAV ratio and the average quarterly distribution-to-NAV ratio for the respective year (percentage points), 1984 – 2023

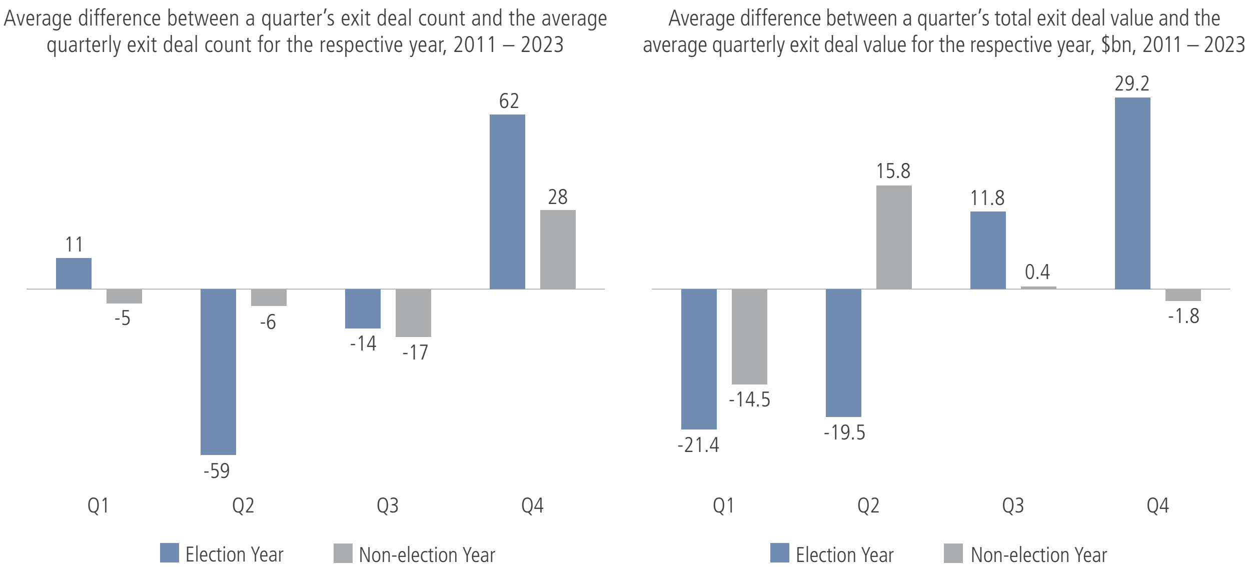


Source: Burgiss, Neuberger Berman. Data as of May 1, 2024.

These findings on private equity distributions support our earlier findings on private equity performance: the fourth quarter is significant whether it is an election year or not.

Some more recent data suggests there may be potential for this to change, however. Distributions from private equity funds follow from the sale of fund assets, and Pitchbook provides data on those exits back to 2011, shown in figure 6. Both the average number of deals and their average total value tend to increase dramatically during the fourth quarter—but this fourth-quarter effect, particularly when it comes to total deal value, is very much concentrated in election years.

FIGURE 6. THERE HAVE BEEN MORE, AND BIGGER, PRIVATE EQUITY EXITS IN RECENT ELECTION-YEAR FOURTH QUARTERS



Source: Pitchbook, Neuberger Berman. Data as of May 1, 2024. Exit type includes Corporate Acquisition, Public Listing and Sponsor Acquisition; deal type includes Buyout/LBO, Add-on and PE Growth/Expansion for U.S.; data available from Q1 2011 to Q4 2023.

This is by far the strongest election-related result we have found in the data, and it appears to contradict what we see in the longer-term data for private equity distributions, in figure 5. However, the average spike in election-year fourth-quarter activity in figure 6 is largely due to what happened in 2016 and 2020, with the effect being meaningfully bigger in 2020 than in 2016. Notably, the 2012 presidential election was won relatively predictably by the incumbent; the 2016 election platforms were highly polarized, but the result was unexpected, given opinion polling; and the 2020 election was both highly polarized and unpredictable throughout the campaign. Nevertheless, given the lead time it requires to line up a deal exit and the incentives to crystalize distributions as they become possible, we still have to conclude that it is unlikely GPs purposefully delayed exit decisions until after election results were known.

These observations raise the question whether there is any way to predictably profit from the seasonality we have discovered. While the nature of the asset class makes "timing" private equity market exposure very difficult, the development of more active and liquid private equity secondary markets is making it a more realistic prospect. Exit data from recent election years may suggest that seasonal volatility in distributions and performance could become more pronounced if elections continue to be perceived as unpredictable and high-stakes. Overall, however, our findings suggest that investors should not be tempted to try to time or limit exposure just because a presidential election is being held.

Is Longer-Term Performance Affected by Different Administrative Regimes?

So far, we have focused on quarterly performance and the immediate effect of presidential elections. This may be too short a time over which to see any meaningful impact, given the illiquid and long-term nature of private equity investments.

In this final section, therefore, we turn to a different question: Was longer-term performance affected by who won these elections?

We took the 40 years since 1984 and put each of them into one of four categories:

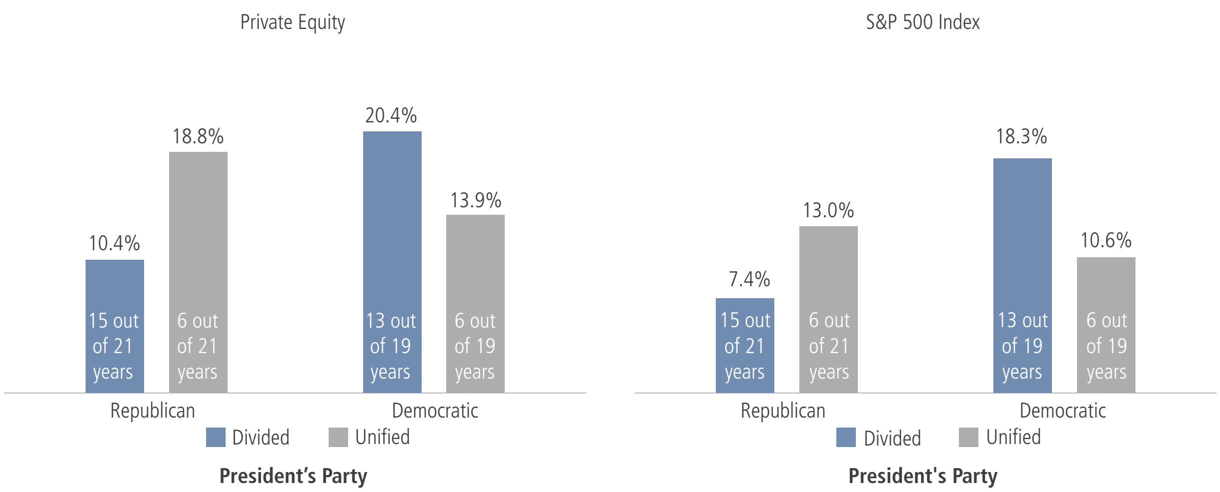
- Divided government[2] led by a Democratic president
- Unified government led by a Democratic president
- Divided government led by a Republican president
- Unified government led by a Republican president

[2] "Divided government" is when the president's party is the minority in one or both Houses of Congress. "Unified government" is when the president's party is in the majority in both Houses of Congress.

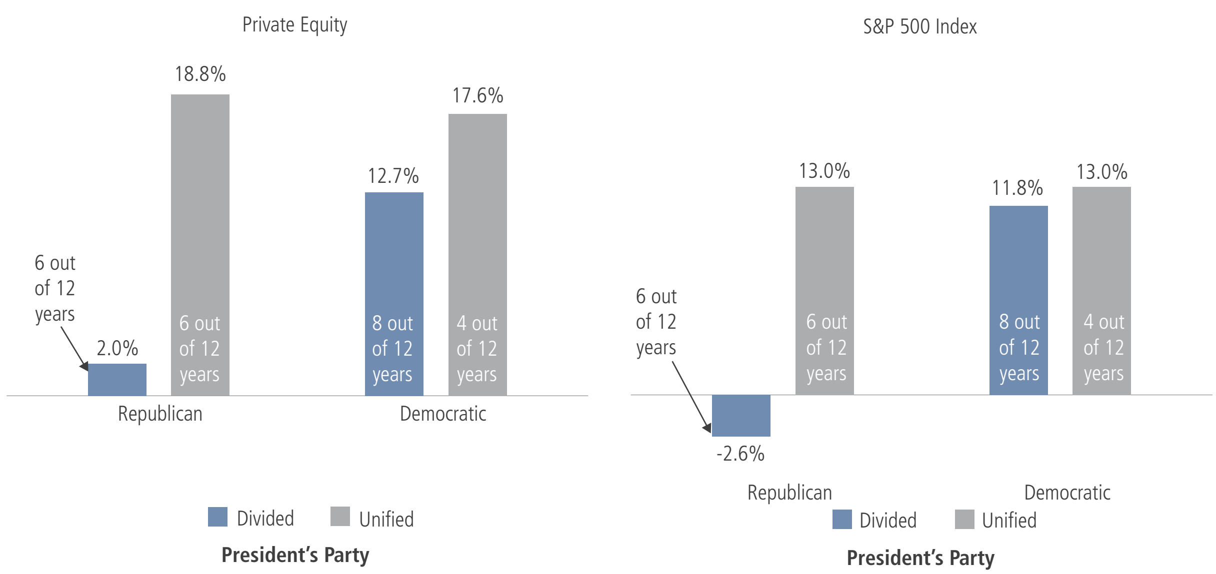
We then measured the average calendar-year return achieved under each of these four administrative regimes, for U.S. private equity funds and the S&P 500 Index. We also split the results into two periods, 1984 – 2023 and 2000 – 2023, because private equity became a more mature asset class[3] and unified government became much more the norm in the later period.[4] The results are shown in figure 7.

FIGURE 7. HAVE PRIVATE MARKETS PERFORMED DIFFERENTLY UNDER DIFFERENT ADMINISTRATIVE REGIMES?

Average calendar-year returns under respective administrative regimes, 1984 – 2023



Average calendar-year returns under respective administrative regimes, 2000 – 2023



Source: Bloomberg, Burgiss, Neuberger Berman. Data as of May 1, 2024. Year 1999 is removed from the private equity results as an outlier, as the return was 99.6%.

[3] For example, the number of U.S. private equity funds tracked in the Burgiss database prior to Q2 2000 is below 1,000, and prior to Q1 1996 is less than 500. Today, more than 4,000 funds are tracked.

[4] There were 10 years of unified government between 2000 and 2023, six under Republican Presidents and four under Democratic Presidents. Between 1984 and 1999, there were only two years of unified government. We categorize each year according to the offices held up to any November election held in that year, and account for the tie-breaking power to the Vice President in 50/50 splits of the Senate as a "unified government" (such as in 2021 – 2022). In addition, we have classified the entire year of 2001 as Democratic Senate given that Democrats retained control of the Senate for the majority of that year.

At first glance, there is no uniform picture as to whether the broader equity markets perform better under a divided or a unified government. The data do appear to confirm the so-called "Presidential Puzzle" identified in several academic studies of the public equity markets: U.S. stock markets tend to perform better under Democratic than under Republican presidents, despite the conventional wisdom that Republican policies are more *laissez-faire* or pro-business.[5] However, research also indicates that the difference in returns may be explained less by the policies that different administrations implement and more by when they get elected.[6] For example, unified Democratic governments were elected in 2008 and 2020, during the Global Financial Crisis and COVID-19, and the immediately subsequent years of recoveries, 2009 and 2021, saw a 30.0% average annual return for private equity and a 27.6% average annual return for the S&P 500 Index.

The above data also highlight the apparent differences between Republican- and Democrat-led governments. For the Republican side, the story is straightforward: across public and private markets, as well as across the different timelines that we analyze, a unified Republican government coincided with more positive gains in equity markets than a divided government under a Republican president. Under Democratic presidents, markets performed better, on average, when government was divided.

However, that, too, breaks down upon closer inspection. The comparative "underperformance" during divided Republican governments is largely explained by the very poor performance in just two years, 2001 and 2002, when the dotcom bubble deflated. Similarly, if we remove the runup to the dotcom bubble years of 1995 through 1999, which saw a divided Democratic government, by showing data only from 2000 onward, it appears that markets have done better under *unified*, not divided, Democratic leadership.

What, if anything, can we learn from these observations?

On balance, markets seem to have mildly preferred unified governments. All other observations seem vulnerable to excluding certain key years of outlier performance from the sample. That could be an example of the truth being revealed by smaller sample sizes: if the relationship between investment performance and administrative regime is random, a smaller sample size can make that randomness clearer.

Ultimately, while politicians of all stripes may deserve some credit for supporting or at least not derailing economic cycles, it is the economic and market backdrop that determines investment performance rather than who is running the government or whether it is unified or divided.

Conclusion: Seasonality and Cyclicality, but No Historical Electoral Effect

In this paper, we set out to identify whether there has been any relationship between U.S. elections and the performance of U.S. private equity portfolios.

We looked at the question in two ways, asking whether immediate performance was affected during election years and election quarters, and whether longer-term performance was affected by the administrative regimes returned by those elections.

While we did find some seasonality in private equity performance—the fourth quarter of the year has seen stronger performance and more distributions from private equity funds, on average—this effect does not appear to be related to the electoral cycle. And while there is a superficial suggestion that private equity performs more strongly under Democratic presidents, the relationship does not stand up to scrutiny. Instead, both the seasonality of private equity returns and their longer-term cyclicality are more obviously attributable to the general economic and market backdrop.

Heading into a U.S. election season that looks likely to be consequential in many ways, we conclude that investors should continue to follow their strategic private markets allocation plans. There may be valid inferences to draw about tailwinds and headwinds for certain sectors and industries based on the results of November's polls, but there is little historical evidence that they will exert a predictable effect on broad market performance or the relative attractiveness of private equity as an asset class.

[5] See Santa-Clara and Rossen, 2003, "The Presidential Puzzle," *Journal of Finance* 58, pp.1841 – 1872.

[6] See, for example, Pastor and Veronesi, 2019, "Political Cycles and Stock Returns," https://www.nber.org/papers/w23184, who conclude that time-varying risk aversion, which influences both voter behavior and stock market returns, can explain the "presidential puzzle".

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