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Private Equity in Focus

Private markets carry significant appeal in light of their risk/return profile and low correlation to other asset classes. Long the purview of institutions and certain wealthy individuals, opportunities for access have broadened across an array of sectors and investment vehicles. This white paper explores the unique characteristics of private equity and issues to consider in seeking to add exposure to a diversified portfolio.

We believe private equity constitutes an appealing addition to traditional assets, with an array of options for access and diversification.

Private equity has for many years been an area of broad investment interest, given its attractive risk/return profile and low correlation to other asset classes. However, the practical issue of access has often been a constraint. Strict investor qualification requirements, large investment minimums, long lock-up periods and cash-flow/return patterns have generally limited private equity access to institutions and wealthy individuals who are better positioned to deal with these hurdles. Recently, however, an array of innovations has helped open up the asset class to more investors, enhancing opportunities for diversification and reducing practical constraints to exposure.

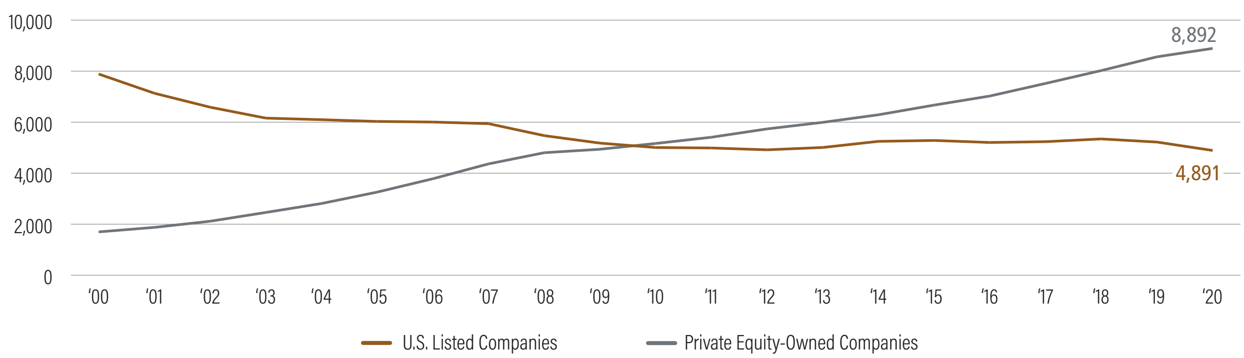
In this white paper, we explore the case for private equity, look at its unique characteristics, discuss key sectors and vehicles, and provide insight on how investors can introduce the asset class into their portfolios.

Private vs. Public Markets

At its most basic level, an investment in private equity means an investment in a company that does not trade on a public exchange. Although this might seem a superficial distinction, it can bring with it dramatically different fundamental characteristics, while opening up a whole new universe of investment opportunities. Keep in mind that the number of U.S. public companies has declined over time, in large part due to expense and regulatory constraints, while the number of private companies has increased in light of their flexibility, control benefits, less shareholder scrutiny and often lower costs. Although still a small fraction of the public market in terms of capitalization, the number of private companies now far exceeds that of their public counterparts.

SHIFT TOWARD PRIVATE FUNDING

Number of U.S. Public vs. Private Equity-Owned Companies



Source: PitchBook and World Federation of Exchanges. Data as of December 2020, the most current available data from the World Federation of Exchanges.

Structural Opportunities

When considering private markets, it's important to understand the various characteristics that allow private equity managers to seek to add value that may not be available within public markets. Here are a few:

Information and Control: Private markets are relatively inefficient, which means that managers can often generate informational advantages. They typically enjoy more direct and transparent governance control, and, thus, have the potential to create value through strategic and operational improvements. Unlike public companies, they generally are not subject to quarterly reporting and can capitalize on long-term time horizons in seeking to generate value.

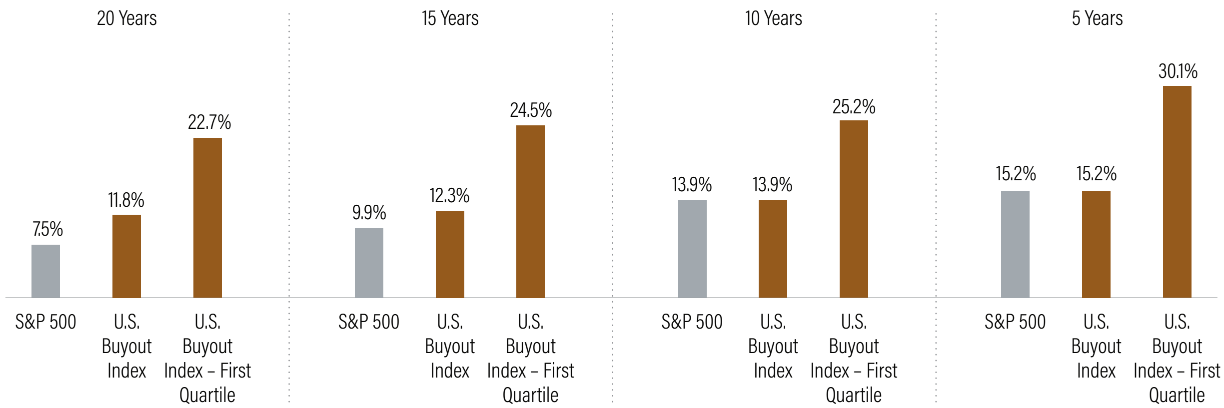
Timing: Private equity managers often spend months sourcing and completing investments, and have various exit opportunities, including trade sales, sales to other private equity funds and initial public offerings (IPOs). The flexibility around the timing of both their entry into and exit from positions may provide for advantages over most public market managers.

Distinct Opportunities: Private companies are often very different from the larger firms that can cope with and thrive on the demands of public ownership. It is far more difficult for a company that is in a changing industry or early in its growth cycle to do well in the public markets, where investors increasingly demand consistent, linear growth in earnings. Often private companies just don't have a publicly investable equivalent. In a public setting, they might be hidden from view as very small divisions of larger companies; as private holdings, their value may be apparent more readily.

In our view, this combination of advantages has been intrinsic to the attractive return history of the asset class. As shown below, private equity (as represented by the buyouts sector) has outperformed traditional equities over multiple timeframes. Of particular relevance is the strength of top-quartile managers, given the wide dispersion of results in the asset class (see box on page 7).

LONG-TERM PERFORMANCE RESULTS

Annualized Returns vs. Traditional Equities: Buyouts



Source: Cambridge Associates. Represents pooled horizon IRR and first quartile return for the U.S. Buyout Index from Cambridge Associates as of December 31, 2020, which is the latest data available. Nothing herein constitutes a prediction of future economic or market environment. Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed. Indices are unmanaged and not available for direct investment. Investing entails risks, including possible loss of principal. **Past performance is not indicative of future results.**

Key Sectors

Given the growth of the private marketplace, we see it as no surprise that a broad variety of companies across industries are available for investment.

Buyouts are perhaps the most well-known segment of the private equity universe, where a manager will purchase control of a company with the goal of generating value by professionalizing the business, improving the management of cash flows, and introducing strategic changes. These may involve acquisitions based on geography or product area, or divestment of noncore businesses. Buyouts typically involve more mature businesses, and investors often expect them to deliver steady returns, supported by a combination of financial and operational improvements.

Venture capital businesses are typically much newer, often with rapidly growing revenues combined with negative cash flows. They usually require regular infusions of capital to expand into new markets or reach new customers. Often, they are still owned by the founders or a small group of "angel" investors, so that venture capitalists come in as minority owners. Given their higher risk, venture funds are likely to include 30 – 40 companies, compared to 10 – 15 for a buyout fund. Typically, just a few large "winners" are expected to more than offset the losers in order to drive overall attractive return potential.

Of the other key sectors, **growth** companies usually fall somewhere between buyouts and venture in terms of business age and size, with managers working alongside the founders to expand more rapidly, while **special situations** involve the restructuring of distressed companies.

Finally, **private credit** involves privately negotiated loans to companies. This area expanded with the post-financial crisis pullback by banks from private lending, and issuances are commonly seen as part of private equity deals. Companies appreciate the flexibility of private credit, while investors typically receive a higher yield than for similar publicly traded debt in exchange for a degree of illiquidity. Interest payments are typically immediate; therefore, returns are often generated earlier than with private equity investments.

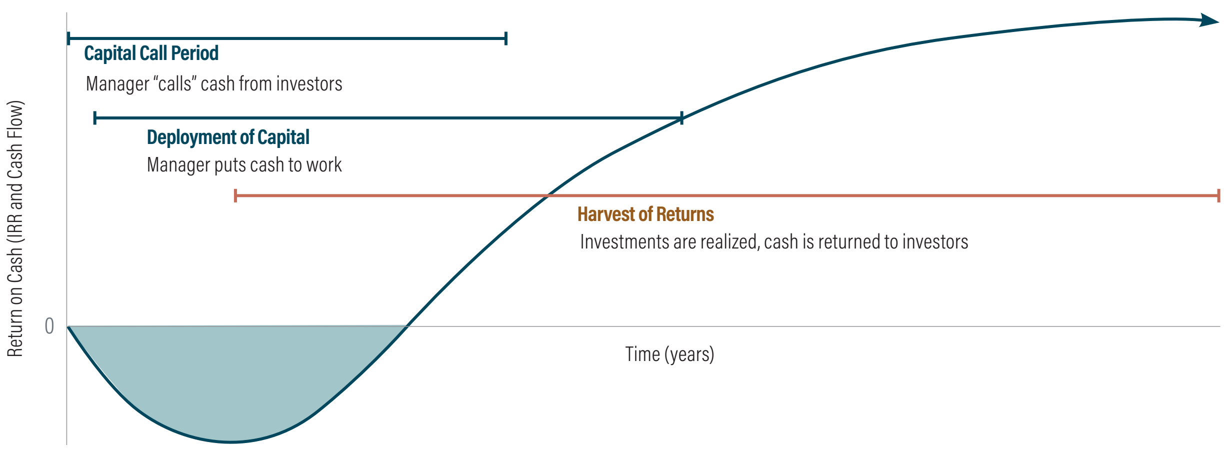
Means of Access

How can investors gain access to such opportunities?

Primary funds, often considered the core vehicle for private equity exposure, place money directly into portfolio companies. Such funds have a life span of around 10 years, with a pattern of cash flows known as the J Curve. The investor makes an initial capital commitment, which the manager draws on for four or five years, after which investments are harvested and, along with any proceeds, are returned to the investor over a multiyear period. For diversification, investors often choose a fund-of-fund structure, which may provide exposure to more companies through multiple primary fund investments.

THE 'J CURVE': CAPITAL CALL, INVESTMENT AND REALIZATION PERIODS

Internal Rate of Return of a Private Equity Fund



For illustrative purposes only.

Co-investment is an increasingly common way to access private equity, where investors invest in portfolio companies alongside a private equity manager or "lead sponsor." In such cases, the manager may not have the capacity to fund an entire deal or may prefer to limit its exposure. The arrangement reduces so-called "blind-pool" risk associated with traditional private equity funds because the investor already knows which company is involved and can conduct specific due diligence. Co-investments typically avoid the fees associated with a primary fund, because the investments are direct. Further, such investments allow the immediate use of capital rather than following the J Curve pattern discussed above. Although concentration and commitment size tend to limit single co-investments to large institutions, the approach is often used in dedicated co-investment funds or within funds of funds and other structures that may incorporate a co-investment allocation.

Secondaries are another important strategy for private equity investors that can help with some of the potential drawbacks of primary funds. Investors may seek to sell their holdings in the secondary marketplace for a variety of reasons—including to lock in returns, proactively manage exposures or access liquidity. Over the past couple of decades, the secondary market has gradually expanded and matured to become a standard means through which some investors can make these sales and others can gain access to already seasoned private equity investments, often at a small discount.

Secondaries can provide diversification by vintage year, manager and underlying portfolio company, as well as offer capital efficiency from earlier distributions, making them particularly attractive to investors looking to ramp up their private equity holdings. They also can reduce "blind pool" risk.

Historically, individuals have faced hurdles in accessing private equity due to investor qualification rules and high minimums, as well as long-term illiquidity and the J Curve. However, new structural innovations have begun to mitigate these issues. For example, while traditional private funds typically require a net worth of $5 million, certain registered funds have reduced this figure to $2.1 million, while investment minimums have also been reduced, sometimes to as low as $50,000.

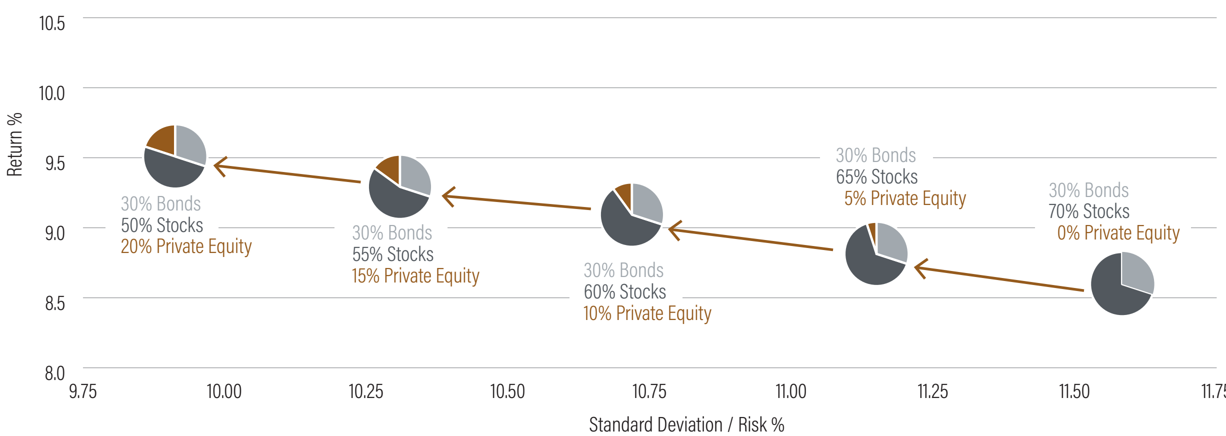
The newer structures can also use the array of strategies above to help with illiquidity and mitigate the J Curve. For example, while primary funds will typically constitute the foundation of a portfolio, the combined use of secondaries and co-investments, along with private credit, can help to both put money to work more quickly and generate income and return on capital in a shorter timeframe than many traditional funds.

Integrating Private Assets Into Portfolios

Historically, private market investments have not only enhanced potential return, but also diversified and reduced overall portfolio risk (see display below). That's particularly relevant in light of the strong performance of traditional asset classes in recent years and, by extension, their reduced return outlooks for the future given high equity valuations and low interest rates. Although private equity has also benefited from price appreciation, it still provides a discount to its public counterparts, while managers tend to have a unique ability to generate value due to structural opportunities we've discussed.

PRIVATE EQUITY'S RISK/RETURN PROFILE

Past 25 Years



Source: Neuberger Berman, FactSet. The Barclays U.S. Aggregate Index represents bonds the S&P 500 Index represents equities, and the Cambridge Associates Global Private Equity Index represents private equity. The chart shows 25 years of data ending December 31, 2020. Nothing herein constitutes a prediction of future economic or market environment. Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed. Indices are unmanaged and not available for direct investment. **Past performance is not indicative of future results.**

Although individual circumstances vary, we typically favor introducing roughly 7% exposure to the asset class for a moderate investment profile, with the target increasing alongside investor risk tolerance. Still, much depends on the specific portfolio. For example, an investor with a particular desire for income may choose to emphasize private debt and/or other income-oriented private market strategies. Those with more balanced needs could combine income and return-potential-enhancing strategies, while more aggressive investors could lean toward return-focused areas. Note that we fit private markets into a broader "alternatives" bucket where commodities and hedged strategies (designed to reduce market exposure) could also play a role. Below, you can see how we lay out these hypothetical choices at a very high level.

HOW CAN PRIVATE EQUITY FIT INTO A DIVERSIFIED PORTFOLIO?

Hypothetical Allocations Based on Investor Profile

Risk Tolerance	Conservative		Moderately Conservative		Moderate		Moderately Aggressive		Aggressive	
Investment Objective	**Income**		**Balanced Income**		**Balanced**		**Balanced Growth**		**Growth**	
Corresponding Stock/ Bond Portfolio	0% / 100%		25% / 75%		50% / 50%		75% / 25%		100% / 0%	
	Target	Range	Target	Range	Target	Range	Target	Range	Target	Range
Fixed Income	**100%**	**85 - 100%**	**75%**	**60 - 90%**	**50%**	**35 - 65%**	**25%**	**10 - 40%**	**0%**	**0 - 15%**
Equity	**0%**	**0 - 15%**	**25%**	**10 - 40%**	**43%**	**28 - 58%**	**55%**	**40 - 70%**	**75%**	**60 - 90%**
Alternatives	**0%**	**0 - 15%**	**0%**	**0 - 15%**	**7%**	**0 - 22%**	**20%**	**5 - 35%**	**25%**	**10 - 40%**
Commodities	0%	0 – 5%	0%	0 – 5%	0%	0 – 5%	3%	0 – 6%	3%	0 – 6%
Hedged Strategies	0%	0 – 5%	0%	0 – 5%	0%	0 – 5%	3%	0 – 6%	4%	0 – 8%
Private Markets	**0%**	**0 - 5%**	**0%**	**0 - 5%**	**7%**	**0 - 14%**	**14%**	**0 - 28%**	**18%**	**0 - 33%**

Source: Neuberger Berman. For hypothetical and illustrative purposes only. Does not describe the terms or characteristics of an existing product. This material is general in nature and is not directed to any category of investors and should not be regarded as individualized, a recommendation, investment advice or a suggestion to engage in or refrain from any investment-related course of action. Investing entails risks, including possible loss of principal.

We believe diversification is crucial in private equity, and is typically accomplished across asset class, vintage year, strategy, geography and manager. From a practical standpoint, the size of an available portfolio (and the regulatory qualification of a given investor) may dictate the degree to which they can access certain strategies and vehicle types. At the lower range, investors may accomplish private equity exposure through the registered funds discussed above, whereas the higher the asset level, the greater the potential variation of available product, including custom accounts.

Investment time horizon is also an important factor to consider. Depending on the circumstances, those in mid-late career or early in retirement may have more freedom to set aside assets for longer periods, while the same may be said for those interested in growing assets across generations. Some registered private market funds may be designed to offer enhanced liquidity, and can also be an option for those who need access to assets sooner. That said, we have found that investors tend to be conservative and overestimate their need for liquidity—something that a cash-flow analysis can help clarify.

In our view, investors should understand the cash-flow issues associated with private equity. For a majority of private market strategies, there may be a lag between an initial commitment and manager capital calls, and a long timeframe for return of capital and realization of profits. When investing through such structures, we believe investors can typically assume that about 60% to 70% of their committed capital will be invested at any given time, so they may wish to over-allocate in order to hit a given portfolio allocation target, for example committing $1.2 million to $1.5 million to generate $1 million in exposure.

In addition, we note that traditional private equity investments carry with them a certain degree of administrative complexity that isn't usually present with public market investments. This is evident not only in their cash flow requirements, but also in the tax reporting that is often involved, including K-1 tax forms. In contrast, more liquid alternatives may have simpler tax reporting.

All told, we believe that investors that desire a more accessible approach to private markets may wish to consider a registered fund, although the tradeoff may be a reduced return profile. For those willing and able to accept a greater degree of complexity, consistent subscriptions to traditional vehicles (usually limited partnerships) can help with the pursuit of potentially higher returns (see page 7).

Considering Private Equity

As we have discussed, private markets offer an array of opportunities that may not be available in the public space. The advantages of information and control, timing of entry and exit, and a long-term time horizon have contributed to the asset class' attractive return profile, while its distinct investment characteristics have enhanced its value as a diversifier. In addition, the availability of funds of funds, co-investments, secondaries and private debt has helped with the cash flow challenges of the J Curve, while the introduction of registered fund options has greatly simplified and opened up access to the asset class. That said, the choice of adding private markets exposure will likely come down to the specific circumstances of the individual, including risk tolerance, time horizon, liquidity needs, asset levels and comfort with the segment's unique characteristics. Engaging with advisors is an important first step in assessing whether private equity may make sense as part of your diversified portfolio.

MANAGER SELECTION IS KEY

We believe choosing a quality portfolio manager is valuable regardless of investment type, but it is especially crucial in private equity, where performance dispersion can be significant. According to Cambridge Associates, over the 10 years through December 31, 2020, the average private equity manager returned 13.9% but the average top-quartile manager returned over 10% more, compared to a much narrower gap for managers in public markets. Experience, deal access and performance history are all key characteristics to consider. Given the long-term nature of the asset class, having a team that has worked together for an extended period, and has deep understanding of the private markets and company specifics can make a major difference. Also important is a demonstrated willingness to maintain and expand resources to adapt to a changing landscape. Assuming exposure to private equity makes sense for a given investor, having a quality manager in place can enhance their potential to capitalize on opportunities (and mitigate the risks) in the asset class.

Unpacking Private Market Vehicle Choices

Choosing the appropriate vehicle for private market exposure involves an array of individual considerations, but may boil down to (1) target allocation size and (2) comfort with complexity and the unique characteristics of the asset class.

Registered Funds

Access to multiple segments and managers provides diversification within a single SEC-registered vehicle. Fund structure offers simplified tax reporting, and relatively low investment minimums and qualification requirements.

Subcategories

'Evergreen' Fund	'Drawdown' Fund
Single fund without capital calls and potentially improved liquidity, but often with lower return potential vs. a standard "drawdown" structure. No defined fund life; will consistently allocate to investments over time.	Typical private equity structure, including capital calls and distributions with a defined life (typically 10 years).

Traditional Structures/Limited Partnerships

A range of available approaches, with differing levels of diversification and customization. Depending on the strategy, often include a capital-call period prior to potential distributions (the "J Curve"), and often require long-term investment commitments. Vehicles typically have high minimums and qualification levels, and involve more complex K-1 tax filings.

Subcategories

Commingled/Diversified Fund (e.g., funds of funds)	Individual Funds	Custom Account
Diversification across managers and sectors through a single investment. Regular commitment to ongoing fund vintages typically required to achieve vintage diversification. Traditional cash flow patterns, with some funds providing additional flexibility. The investor may have minimal control over the portfolio.	Private equity exposure through a commitment to multiple individual funds. Often in specific areas such as buyouts, venture, growth, secondaries, co-invest and private debt. Provides extensive investor control, but requires high levels of capital, research and resources.	Hybrid of commingled and individual funds. Affords professional manager involvement in an overall private equity portfolio, with a degree of investor control.

For illustrative purposes only. This material is general in nature and is not directed to any category of investors and should not be regarded as individualized, a recommendation, investment advice or a suggestion to engage in or refrain from any investment-related course of action.

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