WHITEPAPER | MAY 2021

PUBLIC/PRIVATE INVESTING:

Broadening Opportunity Within Equities

After the dramatic gains experienced in the emergence from pandemic-driven lockdowns, equity investors face key challenges in the form of higher valuations, low and potentially rising interest rates, and reduced long-term return outlooks. As a result, many are widening their array of potential portfolio assets, across both public and private markets. As part of this shift, we believe private equity can serve as a core holding alongside traditional stocks to seek to improve investment outcomes, through differentiated returns enhanced by a potential illiquidity premium.

INVESTMENT STRATEGY GROUP

NB PRIVATE WEALTH

Over the past 10 years, the investment landscape has been characterized by low interest rates and unprecedented liquidity across the globe, which has helped drive significant returns in the equity markets. The past two years' extraordinary actions by central banks and fiscal authorities accelerated these conditions, allowing the global economy and markets to recover, but also pushing valuations of many securities to extended levels. This is particularly true for U.S. large-cap equities following the multiyear run of performance strength. Now we are seeing lower return outlooks across asset classes.

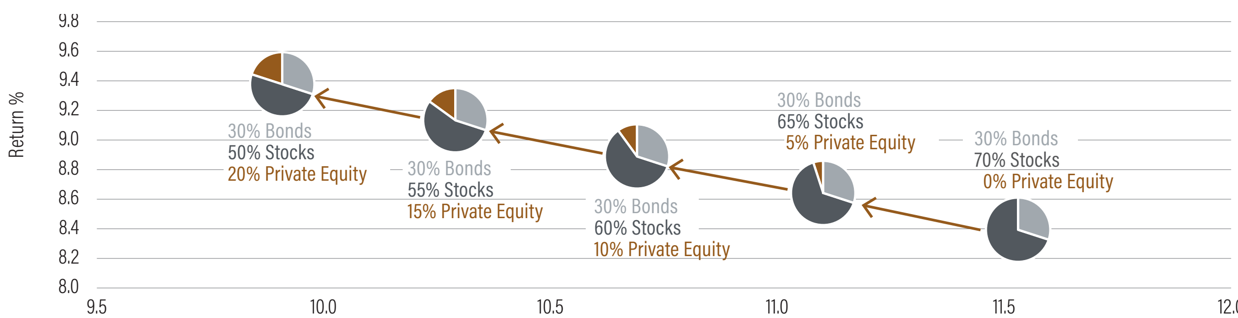
How can investors address these issues? We believe that a crucial element may be to expand the investment universe to maximize diversification benefits, balance risks and capitalize on a broader opportunity set. In the public equity space, this could mean diversifying portfolios away from U.S. large-cap growth stocks, which have consistently led the way since the global financial crisis, and seeking returns from lower-valued geographies and sectors.

More and more, we have seen investors look outside the public markets for incremental return potential and enhanced diversification. While partly driven by today's investment environment, we believe this shift is also structural in nature. Indeed, for a range of investors, we now consider private markets to be a core holding, meaning that they can represent a permanent allocation within long-term portfolios, rather than a more peripheral or "satellite" holding for just a small segment of investors.

A key aspect of their appeal is performance, as private equity has outpaced the the MSCI World Index by 5.4% over the past five years, and 4.3%, 5.6% and 6.2% over the past 10-, 15- and 20-year periods, respectively.[1] As discussed in our recent paper, Private Equity in Focus, private equity can improve risk-adjusted portfolio return outlooks through enhanced potential returns and lower correlation to public market equity and fixed income asset classes. (See the paper for a more comprehensive discussion of the characteristics and benefits/risks of private equity investments.)

PORTFOLIO BENEFITS OF PRIVATE EQUITY ALLOCATION

Risk/Return Profile: Past 25 Years Ending March 31, 2021



Source: Neuberger Berman, FactSet. Data through March 31, 2021. The Bloomberg 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. 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.**

Beyond its appealing risk/return profile, however, a key driver of this evolution toward becoming a core asset for high-net-worth investors is the sheer growth of the private market investable universe, as well as the value created outside the public markets in recent years as companies have stayed private for longer. The decision by managements to remain private has often been a function of increased capital availability and a growing aversion to regulatory challenges and the short-term management focus involved in running a public company.

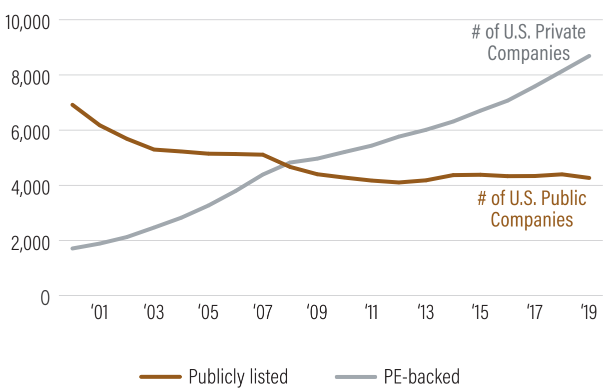
[1] Source: Cambridge Associates. Represents pooled horizon IRR for the Global All Private Equity Index from Cambridge Associates as of March 31, 2021, which is the latest data available. Nothing herein constitutes a prediction of future economic or market environment. A variety of factors may cause this comparison to be an inaccurate benchmark for any private fund and it should not be assumed that any correlations to the benchmark based on historical returns would persist in the future. 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.**

Indeed, many firms have delayed their IPOs to maintain their flexibility at a critical juncture in their development, and by extension have created significant value while still privately owned. Although their characteristics may vary, many private companies are fast-growing and may be engaged in industries and markets that could be particularly vital to the future economy. In addition, they often do not have a publicly investable equivalent, or, if they do exist within a public corporation, may be too small to provide a negligible proportion of the parent company's overall revenue—reinforcing their potency as a potential diversifier.

As the number of private-equity-funded companies has increased in recent years, the number of public companies has declined—making it increasingly clear that mining the private universe may open up extensive opportunities that might otherwise not be available to investors. Those for whom private equity could be appropriate, but who choose not to allocate to the space, may be limiting diversification and return potential in the process.

GROWING PRESENCE OF PRIVATE EQUITY

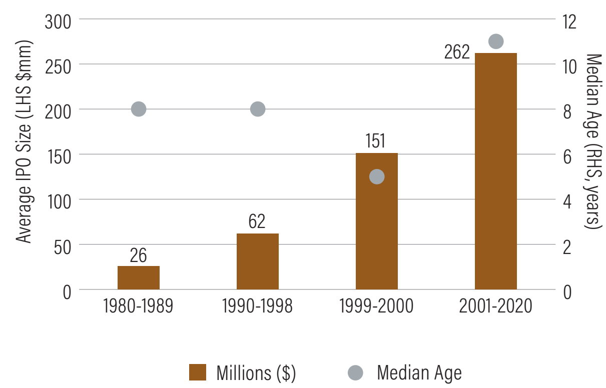
Number of PE-Backed Companies vs. Public Companies



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

COMPANIES WAIT LONGER TO GO PUBLIC

Size and Age of IPO Companies Have Increased



Source: Cambridge Associates, Jay Ritter, Russell, University of Florida, World Federation of Exchanges, J.P. Morgan Asset Management. IPOs with an offer price of at least $5, excluding ADRs, unit offers, closed-end funds, REITs, natural resource limited partnerships, small best-efforts offers, banks and S&Ls, as well as stocks not listed on CRSP (CRSP includes Amex, NYSE and Nasdaq stocks). Average IPO size is defined as the aggregate IPO proceeds during the period shown, divided by the number of IPOs.

Access and Innovation

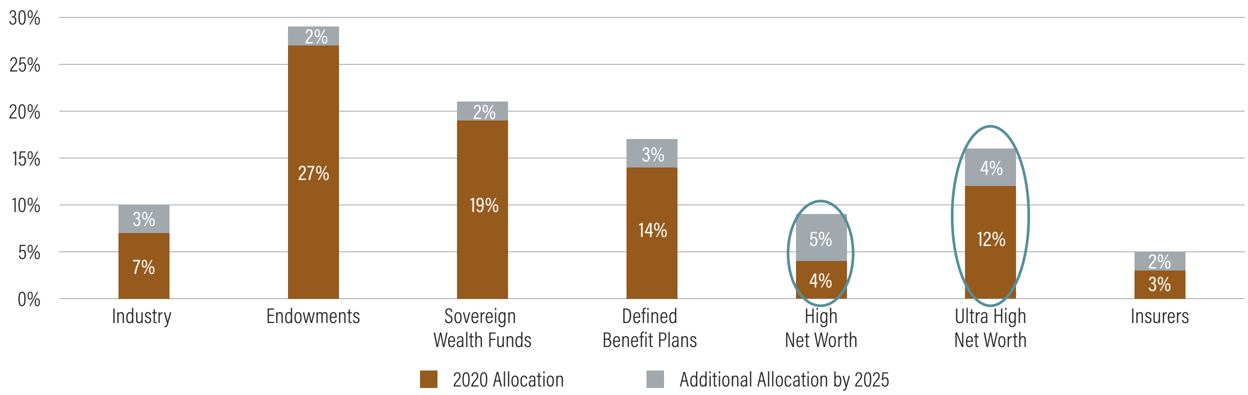
Beyond a broad understanding of their appealing characteristics, most private market investments are also benefiting from structural changes that are increasing access on the part of more investors. Historically, private markets were typically the purview of the largest, most sophisticated investors, but while the segment is still intended for this cohort and involves a higher degree of risk, evolving practices and innovative vehicles have lowered or removed many previous barriers, such as high minimums, investor qualification requirements, long lock-ups and complex tax reporting.

For example, traditional private equity funds typically have a shelf life of about 10 years. After an initial commitment, investors make periodic payments as managers seek to deploy capital, and often do not see any returns until several years into the investment process. The wider use of secondaries, or purchases of seasoned private equity companies, has often shortened the timeframe until potential return realization, while managers have generally become more flexible in structuring funds to reduce illiquidity. New investment vehicles have also sought to mitigate multiple access issues. For example, while traditional private funds typically require a net worth of $5 million, certain registered funds have lowered this figure to $2.1 million, and investment minimums have also been reduced, sometimes to as low as $50,000. The newer structures can also use an array of strategies to help put money to work more quickly with the potential to generate income and return on capital in a shorter timeframe.

Over time, these changes have generally contributed to the increased exposure of private equity by individual investors, who appear to have the appetite to increase their allocations in the future (see display).

ALLOCATIONS TO PRIVATE MARKETS APPEAR POISED TO INCREASE

Actual/Intended Allocation to Private Markets by Investor Type



Source: Oliver Wyman, Morgan Stanley Research. Analytics as of March 31, 2021. Private markets include private equity, venture capital, private debt, real estate and infrastructure. High net worth: $1 – 50 million investable wealth. Ultra-high net worth: over $50 million investable wealth. There is no guarantee that estimated allocations will be achieved. Analytics as of March 31, 2021.

To some degree, these changes echo the many innovations seen in public markets over time. We've seen increased access to, and breadth of, public market equity and fixed income investing, including active and passive comingled investment vehicles such as managed mutual funds and ETFs, as well as separately managed accounts. Most recently, companies like Robinhood have facilitated trading across many levels of the investing populace. In our view, private markets, given their unique constraints and characteristics, are unlikely to ever reach this level of access, but the trend toward better access and enhanced flexibility continues.

Blurred Lines: Convergence of Public and Private Markets

The convergence of public and private investments goes beyond the areas we have already discussed. Increasingly, portfolio managers are dipping their toes into both markets in search of opportunity. For example, a growing area of asset management is devoted to pre-IPO (or "crossover") investing, where managers invest in private companies that are expected to go public within a few years, capturing potential for growth as well as rewards tied to a successful IPO. Historically, such pre-IPO investments were predominantly available to institutions and large individual clients. Another trend we've seen is the growing market for "special purpose acquisition companies" or SPACs, where a "blank check" company goes public and uses the assets it attracts to make a purchase of a private company, transitioning the company from a private entity to a publicly listed stock. SPACs are increasingly placing asset managers in a role of facilitating IPOs once dominated by investment banks, as they may lower costs, complexity and disclosure requirements associated with a traditional IPO.

Involvement in both public and private markets can provide other potential advantages as well. Portfolio managers who have ongoing relationships with management and their financial partners may be better able to source deal flow even at times of heightened competition. Asset management firms with crossover capabilities can also leverage a deeper understanding of companies across their lifecycle—from early private stages of venture capital to growth to buyout, and then into public categories of (often) small to mid- and large capitalization. Their experiences in investment across a lifecycle can lead to insights and benefits, whether tied to business or sector fundamentals, or more specific insights regarding disruptive technologies, all of which can enhance potential for long-term investment return.

Public and Private: Sizing Up the Current Environment

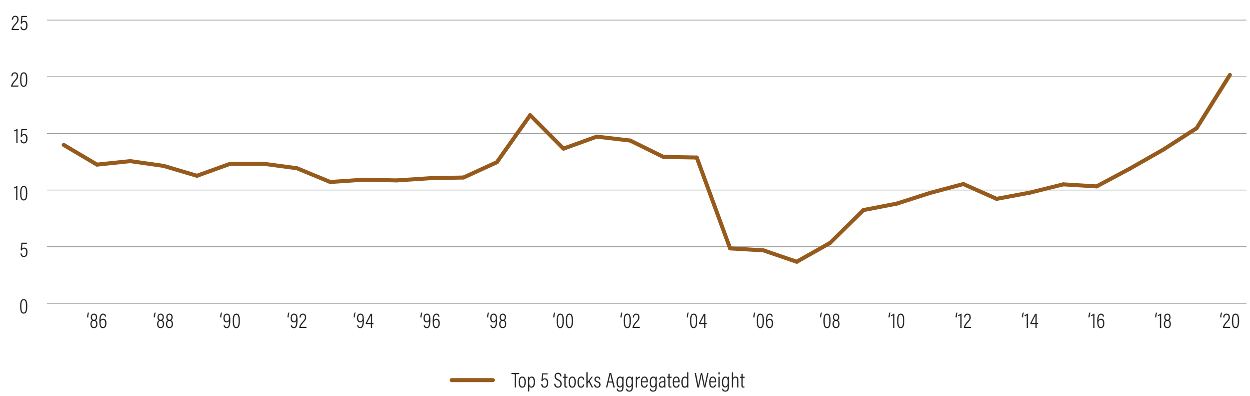
In thinking about the complementary roles of public and private investing, it is worth considering how current conditions may influence approaches moving forward. On the economic front, we believe near-term growth expectations remain healthy, consistent with the early-to-middle stages of an expansion. However, public equity valuations appear relatively full, the yield advantage on non-Treasury fixed income has narrowed, and interest rates are near historical lows—more like the end-stages of an expansion, where opportunities are typically fewer. In plain terms, in our view, this means that medium- and longer-term return outlooks for broad equity indices (and related portfolio exposure through passive vehicles) appear relatively muted.

In searching for additional return potential, therefore, investors may wish to look to new pathways across public and private markets. Within public equities, this may mean an emphasis on active management and diversification, across market capitalization, style (growth vs. value) and geography to help manage risk—in particular the risk posed by the S&P 500, which, as the dominant, market-weighted benchmark for large-cap equities, has become increasingly focused on just a few stocks. Indeed, it is now more concentrated than at any point over the past 35 years, even eclipsing the "dot-com" bubble of the late 1990s (see display).

In our view, active management can help reduce the concentration risk associated with the large-cap index, but also potentially add incremental alpha, or returns driven by nonmarket factors such as individual company success. Maintaining diversification outside the U.S. can also help mitigate such risk, especially where valuations are lower.

THE S&P 500 HAS BECOME INCREASINGLY CONCENTRATED

Index Weighting of Top Five Companies (%)



Source: FactSet, data through October 21, 2021.

The use of private equity as a core asset can help surmount our current outlook for public assets. As is the case with publicly traded securities, we believe it's important to think beyond near-term opportunities to overall portfolio goals and consider how private equity may help to achieve them. This is especially true given the inherent challenge of "timing" exposure to the asset class due to its unique cash flow profile. For many investors, we see appeal in ongoing and regular commitments to the space to maintain an intended allocation over time. Assisting in this process, innovative new fund structures can help access a core, diversified portfolio of private equity investments with a reduced level of complexity.

That said, at the margin we believe that overall private market fundamentals are reasonably attractive in the current climate: Although private equity valuations have increased, they remain below those of public equities. Moreover, private equity managers may be better able to mitigate valuation risk and enhance return potential through a focus on operational improvements that are not typically available to minority public equity shareholders with little control over the company. Given private equity managers' often close involvement with the business in a less regulated context, they also may be able to capitalize on informational inefficiencies to generate attractive absolute and relative returns.

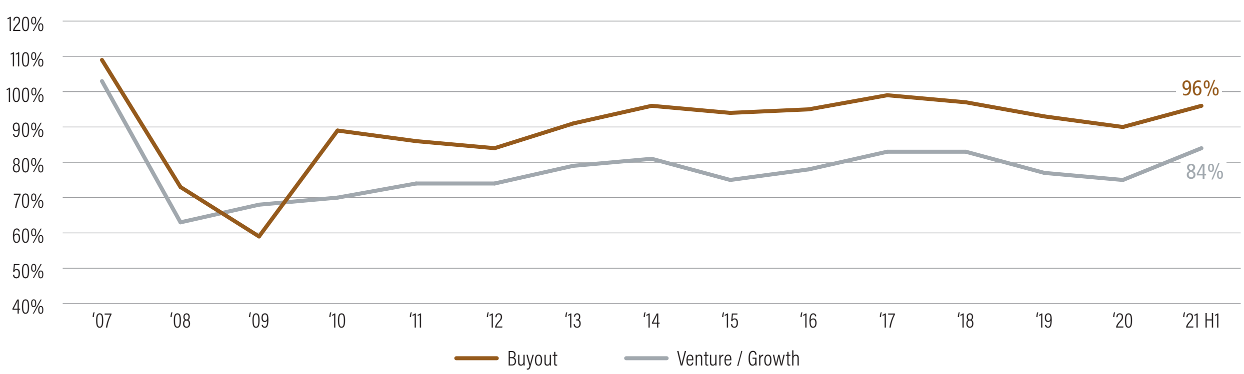
Current Opportunities

In line with our approach to private equity as a dedicated strategic allocation, we believe investors should consider, where appropriate, consistently committing to core private equity strategies such as traditional buyouts, co-investments and other diversified solutions.[2]

Importantly, the broad variety of investment strategies and characteristics within the private universe can enable a bespoke approach to risk/return that may cater to an individual's unique circumstances. With this in mind, a number of opportunities currently appear particularly interesting to us. Secondaries, which involve the purchase of existing, seasoned private equity investments further along in their lifecycle from investors desiring liquidity, can provide an effective way to access broadly diversified exposure to the asset class, and historically have produced attractive risk-adjusted returns relative to traditional primary buyout funds.[3] In addition, investments are often sold at a discount to net asset value—something that may be compelling in light of current, more elevated valuation levels. Investors with an information and deal-sourcing advantage through a broad network of relationships may even further improve the discount they receive in relation to intrinsic value.

SEASONED COMPANIES AT A DISCOUNT

Secondary Market Prices: Average High Bid (% of NAV)



Source: Jeffries, as of July 2021. Indices are unmanaged and not available for direct investment. Investing entails risks, including possible loss of principal. **Past performance is not an indicator, guarantee or projection of future performance.**

Risk can be mitigated through broad diversification across strategy, investment manager (general partner), vintage year and sector/industry. Given that underlying portfolio companies are already established and well-vetted, the investor typically enjoys a level of transparency that might not be available in more traditional buyout investments, while the duration of the investment lock-up and the potential return of capital may also be quicker, helping to reduce cash at risk and increase flexibility.

A second area of interest involves privately negotiated, structured debt and equity solutions for private equity-backed companies. Often, these customized transactions are in the form of preferred stock. They allow investors to access high-quality companies at attractive entry valuations versus traditional equity holders, while receiving credit-like protections such as contractual minimums returns through non-cash yields (paid in more of the same preferred securities rather than cash). The investment sits above the common equity holders in the capital structure (though junior to debt), offering improved risk management. At the same time, the unique, bespoke nature of the transactions allow for the potential of equity-like upside through features such as convertibility and warrants.[4]

[2] Buyout funds typically involve the purchase of companies with the goal of generating value by professionalizing the business, improving the management of cash flows, and introducing strategic changes. In a co-investment, investors commit capital directly to portfolio companies alongside a private equity manager.

[3] Source: Preqin as of May 2021. Based on median net IRR and standard deviation of Net IRR for vintage years 2007 – 2016.

[4] For a deeper dive into these structured capital solutions, see our Private Credit team's paper, Private Debt, Capital Solutions and the Early-Cycle/Later-Cycle Paradox, August 2021.

In all of these areas, investors can benefit from investment managers with deep relationships across the private equity ecosystem that can help source less competitive deal flow and, therefore, enhance potential returns and reduce valuation risk.

Conclusion: Finding Opportunity

Many believe that return outlooks have decreased across public market asset classes. However, in our view substantial opportunities exist on a strategic and tactical basis that can help enhance return potential for investors willing and able to diversify across public and private markets and to move further out on the risk-return spectrum. In a potentially more volatile environment, diversification will likely be crucial, while selectivity as to managers and strategy can better position investors for the opportunity to generate performance over the long term.

The S&P 500 Index measures the performance of the 500 largest U.S. companies, and captures approximately 80% coverage of available market capitalization.

The Bloomberg Barclays U.S. Aggregate Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities.

The Cambridge Associates LLC U.S. Private Equity Index is a capitalization-weighted composite IRR of the buyout, venture, and special situations fund performances reported to Cambridge Associates; all historical IRRs are subject to, and regularly undergo, revision.

Cambridge Associates Global All Private Equity Index is based on data compiled from 2,450 private equity funds, including fully liquidated partnerships, formed between 1993 and 2016. Internal rates of returns are net of fees, expenses and carried interest.

The MSCI World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets. As of June 2007, the MSCI World Index consisted of the following 23 developed market country indices: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the United Kingdom and the United States.

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