



Private assets on sale: discounts of 45% but where's the catch?

Market perception may not reflect fundamentals

Following a period of exceptional strength in 2020-21, public equity portfolios generally struggled in 2022. The S&P 500 declined by almost 20%, while the Nasdaq Composite fell by 33%. Despite a partial recovery year-to-date, public market valuations remain below their 2021 peaks. In contrast, the private markets appear remarkably unperturbed; the industry has, so far at least, felt scarcely any of the volatility tormenting owners of listed securities.

A delayed reckoning?

Some commentators have looked at this and concluded that private markets are little more than a glorified pyramid scheme, characterised by cosy transactions involving managers selling assets to one another at elevated valuations. Or, they suggest, perhaps the reckoning has simply been delayed and is about to strike at any moment, as managers finally opt to mark

down their portfolios in lock-step with last year's public market declines.

So far, neither story seems plausible. Private valuations follow clear industry standards and are audited annually. As highlighted in a recent note from broker Numis, even in today's markets, portfolio companies are being sold at a premium to carrying value, often to trade buyers from outside the industry. Private valuations generally did not follow the public markets to their extreme highs, so it stands to reason that they should suffer less on the way down. Evidence for this has started to come through in recent weeks, as managers of diversified portfolios, which include venture and growth equity assets, are reporting their latest quarter end results. The detail behind these suggests that the buyout and real assets allocations have posted gains, while venture and growth equity have seen a degree of weakness, resulting in broadly flat net asset values overall.

A niche market pricing in dramatic declines

So why, in one corner of the listed market, are investors pricing in a substantial move lower? Some listed private equity funds are currently trading at discounts of more than 45%, compared to more typical levels of 10-20%. Indeed, the last time we saw discounts at such extremes was during the brief but dramatic sell-off in March 2020. Prior to that episode, we must go all the way back to the aftermath of the Global Financial Crisis of 2008.

Prices fluctuate more than values

Private transactions involving diversified private fund portfolios are clearing at discounts of less than 20%, as reported by Jefferies, and new deal activity is picking up as confidence returns to the market. Yet the mood among public market investors standing on the sidelines remains gloomy. There is a pervasive fear that lower share prices in the listed private equity sector must mean that other investors "know something we don't". This is a common refrain among investors in general, with the mere fact of falling prices often giving rise to a temptation to sell. We should remind ourselves of the famous quote from legendary investor Joel Greenblatt: "prices fluctuate more than values - so therein lies opportunity."

"It's different this time?"

Some commentators claim that the industry is entering an era of structurally lower returns as rising interest rates weigh on valuations and constrain debt availability in the years ahead. Whatever the merits of this argument in principle, it is little more than speculation, as nobody knows where interest rates will be in a year's time, let alone 10 or 20 years from now. And we should remember that the private equity industry emerged, and thrived, during the 1980s and 1990s, when interest rates were much higher than they are today.

During prior periods of extreme discounts in listed private equity, there were always plausible-sounding reasons for caution and doubt, but investors brave enough to take the plunge were rewarded handsomely in the years that followed. Is it different this time?

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