CAMBRIDGE ASSOCIATES

US PE/VC Benchmark Commentary

Quarter Ending March 31, 2014

Overview

US private equity and venture capital funds began 2014 with positive first quarter returns, as indicated by the Cambridge Associates LLC benchmark indexes. Compared to their strong fourth quarter performance, private equity and venture capital fund returns were lower for the quarter, as were public equity returns.

For the second quarter in a row the venture capital index outperformed the private equity benchmark. Both indexes outperformed the public markets during the quarter but private equity in particular has struggled against the public indexes over the medium term. Consistent with the long-term investment thesis of these asset classes, private equity and venture capital both handily beat the public markets on ten-year or longer horizons.

The private equity benchmark has been positive the last seven quarters and the venture capital index earned positive results over the last ten quarters. The public markets have been relatively strong since the financial crisis, with the S&P 500 and other key market indexes producing negative returns in only two of the last ten quarters.

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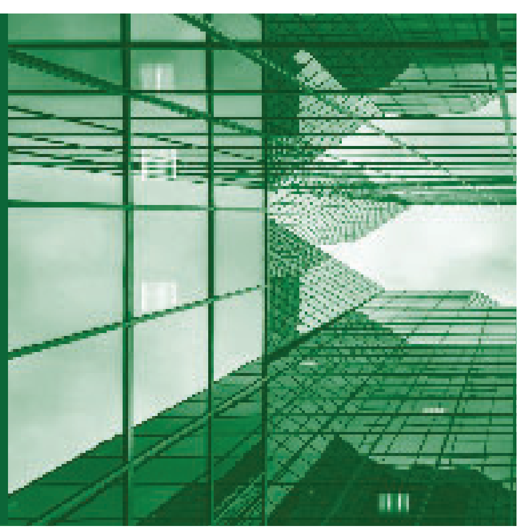

Table 1. US Private Equity and Venture Capital Index Returns

	Qtr	1 Yr	3 Yr	5 Yr	10 Yr	15 Yr	20 Yr	25 Yr
CA US Private Equity	3.1	19.1	14.2	17.4	14.0	12.0	13.7	13.7
CA US Venture Capital	4.9	30.5	15.3	14.1	10.0	18.7	31.7	21.1
DJIA	-0.2	15.7	13.0	19.9	7.5	6.0	10.3	10.9
Nasdaq Composite*	0.5	28.5	14.7	22.4	7.7	3.6	9.0	9.8
Russell 2000®	1.1	24.9	13.2	24.3	8.5	8.9	9.5	9.9
S&P 500	1.8	21.9	14.7	21.2	7.4	4.5	9.5	10.0

Sources: Cambridge Associates LLC, Dow Jones & Company, Inc., Frank Russell Company, Standard & Poor's, and Thomson Datastream.
Note: Because the US Private Equity and Venture Capital indexes are capital weighted, the largest vintage years mainly drive the indexes' performance.
* Capital change only.

The Cambridge Associates indexes are derived from performance data compiled for funds that represent the majority of the institutional capital raised by private equity and venture capital partnerships. The Cambridge Associates LLC US Private Equity Index includes funds raised between 1986 and 2013. Based on the performance data collected, private equity and venture capital returns versus indexes tracking large- and small-capitalization public equities—the Dow Jones Industrial Average, the Nasdaq Composite, the Russell 2000® Composite, and the S&P 500—are shown in Table 1.

First Quarter 2014 Highlights

- As of March 31, 2014, the private equity benchmark outperformed indexes tracking large and small public companies in five of the eight time horizons listed in Table 1. The exceptions were the one, three, and five years ending March 31, 2014. The venture capital index rebounded from the previous quarter to outperform the Russell 2000® and Nasdaq indexes in each of the time horizons except the five year.
- Supported by strong exit markets, including IPO activity, for the second quarter in a row the venture capital index beat all public equity benchmarks. The ten-year return continues to improve as it distances itself from the negative performance experienced by the asset class in the early 2000s after the dot-com bubble burst.

- As of March 31, 2014, public companies accounted for just over 21% of the private equity index and the venture capital index, a slight decrease from the fourth quarter for both. Non-US company exposures in the private equity and venture capital indexes remained about the same as they were during the prior quarter, 19.3% in the private equity benchmark and 10.3% in the venture capital index.

Private Equity Performance Insights

- Except for vintage years 1996 and 1997, returns for all vintages from 1992 through 2012 were positive for the quarter.
- As of the first quarter, there were six vintage years that represented at least 5% of the benchmark's value. Among those six, returns ranged from 0.9% (2004) to 3.7% (2011). Led by 2007, the top six vintage years by size together represented more than 82% of the index's value (Table 2).
- Accounting for over 16% of the total 2007 vintage year returns, write-ups in information technology (IT) were the largest driver, followed by the consumer and health care sectors. Consumer, financial services, and electronics company valuation increases were responsible for nearly half of the write-ups in the 2005 vintage year. Energy sector holdings were the best performer for the 2008 vintage with by far the largest amount of write-ups, followed by financial services and manufacturing.
- During the first quarter, fund managers called $16.9 billion, the highest amount since fourth quarter 2012. Limited partner (LP) distributions equaled $37.9 billion, an 11% quarter-over-quarter decrease. Despite the decline, the first quarter marked nine straight quarters when distributions outpaced contributions. Over that time period, the ratio of distributions to contributions was nearly 2.0.

Table 2. Private Equity Vintage Year Returns: Net Fund-Level Performance

	Q1 2014 Returns (%)	3/31/14 Weight in Index (%)
2004	0.9	5.2
2005	2.3	13.5
2006	3.5	20.0
2007	3.3	28.3
2008	3.0	10.4
2011	3.7	5.1

Note: Vintage year fund-level returns are net of fees, expenses, and carried interest.

- LPs in the 2007 vintage funds contributed the most capital for the quarter, $4.3 billion or over 21% of the total, which represented the most capital called during quarter. Yet nearly twice this amount of capital ($8.2 billion) was returned to investors for the same vintage year funds—just below the $9.7 billion in distributions led by 2006 vintage year. These significant amounts of capital cycling between investors and fund managers reflect the tremendous amount of funds raised at the peak of the last cycle.
- Except for financial services, all eight sectors representing at least 5% of the private equity index earned positive returns during the quarter (Table 3). Software's 6.3% return was the highest while the -2.1% return for financial services was the lowest. Write-ups in the 2007 and 2006 vintage year funds were the biggest contributors to software's performance. While financial services company write-ups were sizable in vintage years 2007, 2005, and 2008, they were more than offset by the write-downs in vintage year 2006.
- Four sectors—consumer, energy, health care, and IT—made up nearly 60% of the private equity index's value during the first quarter. Combined, these sectors returned 3.4% on a US$-weighted basis during the quarter, roughly equaling the gross return for all portfolio companies. Vintage years 2007 and 2005 were the largest contributors to the return for the consumer sector.
- At nearly $4.5 billion, energy companies attracted the greatest share (26%) of all invested capital during the quarter, which is more than double that sector's long-term norm. Consumer companies came in second, attracting nearly 20% of all invested capital, while the IT sector came in third, garnering 13% of the total.

Table 3. Private Equity Sector Returns: Gross Company-Level Performance

	Q1 2014 Returns (%)	3/31/14 Weight in Index (%)
Consumer	1.6	20.1
Energy	3.3	18.5
Financial Services	-2.1	9.4
Health Care	4.9	11.0
IT	5.8	9.7
Manufacturing	2.9	7.4
Media	4.0	4.9
Software	6.3	5.9

Note: Industry-specific gross company-level returns are before fees, expenses, and carried interest.

Venture Capital Performance Insights

- With the exception of vintage years 2002 and 2013, the first quarter returns for all vintage years from 2000 on were positive. There were seven vintage years that made up at least 5% of the benchmark's value, with returns ranging between 2.1%, achieved by the 2004 funds, and 6.1%, achieved by the 2005 funds (Table 4). The seven years represented over 75% of the index's value.
- IT and software dominated write-ups in the best-performing vintage, 2005. Returns for the largest vintage years, 2006 and 2007, were driven most by higher valuations for health care companies. Software company valuation increases also helped boost the 2007 vintage's performance.
- Venture capital fund managers called more than $3.5 billion from investors during the first quarter, which was slightly less than previous quarter but 15% higher than the same period in 2013. Distributions from venture funds were nearly $7 billion, a 75% jump from the same period a year ago, and the highest quarterly distribution since third quarter 2000. This was the ninth quarter in a row that distributions exceeded contributions.
- Funds formed in 2008 and from 2010 to 2013 were responsible for over 77% of the total capital called during the quarter. More than $891 million was called from 2012 funds, representing over 25% of total capital called. Distributions from 2000, 2003, and 2007 vintage year funds totaled over $3.3 billion, representing about 47% of the total from the quarter. At over $1.4 billion, the 2007 funds distributed more than 43% of the top three vintage fund's total.

Table 4. Venture Capital Vintage Year Returns: Net Fund-Level Performance

	Q1 2014 Returns (%)	3/31/14 Weight in Index (%)
2000	3.7	7.7
2004	2.1	7.3
2005	6.1	9.2
2006	3.8	14.5
2007	4.6	14.4
2008	4.4	14.1
2010	4.6	8.2

Note: Vintage year fund-level returns are net of fees, expenses, and carried interest.

Table 5. Venture Capital Sector Returns: Gross Company-Level Performance

	Q1 2014 Returns (%)	3/31/14 Weight in Index (%)
Health Care	11.1	26.2
IT	2.6	33.9
Software	9.8	18.0

Note: Industry-specific gross company-level returns are before fees, expenses, and carried interest.

- IT, health care, and software—the three sectors composing at least 5% of the value of the index—had positive returns in the first quarter (Table 5). This quarter, media fell below the 5% threshold for determining meaningfully sized sectors. A substantial spread separated the highest return earned by the health care sector (11.1%) from the lowest posted by IT companies (2.6%). Vintage years 2006–09 accounted for over 66% of the total value of health care company write-ups.
- On a US$-weighted basis, the three sectors that represented 78% of the index's value earned 7.0%, slightly outperforming the gross return for all portfolio companies.
- IT, health care, and software attracted about 79% of the total capital invested during the quarter. The percentage is slightly higher than the 77% long-term norm for the three sectors combined. ■

About the Indexes

Cambridge Associates derives its US private equity benchmark from the financial information contained in its proprietary database of private equity funds. As of March 31, 2014, the database comprised 1,137 US buyouts, private equity energy, growth equity, and mezzanine funds formed from 1986 to 2013, with a value of nearly $635.7 billion. Ten years ago, as of March 31, 2004, the index included 531 funds whose value was roughly $150.8 billion.

Cambridge Associates derives its US venture capital benchmark from the financial information contained in its proprietary database of venture capital funds. As of March 31, 2014, the database comprised 1,494 US venture capital funds formed from 1981 to 2013, with a value of roughly $165.6 billion. Ten years ago, as of March 31, 2004, the index included 981 funds whose value was about $45.5 billion.

The pooled returns represent the net end-to-end rates of return calculated on the aggregate of all cash flows and market values as reported to Cambridge Associates by the funds' general partners in their quarterly and annual audited financial reports. These returns are net of management fees, expenses, and performance fees that take the form of a carried interest.

Both the Cambridge Associates LLC US Venture Capital Index® and the Cambridge Associates LLC US Private Equity Index® are reported each week in Barron's Market Laboratory section. In addition, complete historical data can be found on Standard & Poor's Micropal products and on our website, www.cambridgeassociates.com.