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US PE/VC Benchmark Commentary

Quarter Ending June 30, 2014

Overview

During the first half of 2014, US private equity and venture capital funds performed well, with both outpacing public markets, as indicated by the Cambridge Associates LLC benchmark indexes of the two alternative asset classes. Over the first six months of the year, private equity slightly outperformed venture capital, and in the public markets large-cap equity bested small cap. Since the global financial crisis, the private equity and venture capital indexes' results have been mixed versus public markets, but over the long term the private indexes have handily beaten their public counterparts.

The second quarter return of 5.7% for the private equity index was substantially higher than its 3.1% performance in the first quarter, while the 3.0% return for the venture capital index was nearly 2.0% lower than the first quarter. The private equity benchmark has earned positive returns in ten of the last 12 quarters, while the venture capital index produced positive results in 11 of 12. Strong returns for public equity and a healthy IPO market for venture-backed companies have helped to boost valuations for private equity and venture capital alike.

The Cambridge Associates indexes are derived from performance data compiled for funds that represent the majority of the institutional

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Table 1. US Private Equity and Venture Capital Index Returns

	Qtr	YTD	1 Yr	3 Yr	5 Yr	10 Yr	15 Yr	20 Yr	25 Yr
CA US Private Equity	5.7	8.9	22.4	14.5	17.7	14.3	11.9	14.0	13.8
CA US Venture Capital	3.0	8.1	29.2	13.8	14.8	10.3	13.1	34.0	21.4
Nasdaq Composite*	5.0	5.5	29.5	16.7	19.2	8.0	3.4	9.6	9.7
Russell 2000®	2.0	3.2	23.6	14.6	20.2	8.7	8.0	9.8	9.7
S&P 500	5.2	7.1	24.6	16.6	18.8	7.8	4.3	9.8	9.9

Sources: Cambridge Associates LLC, 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.

capital raised by private equity and venture capital partnerships. The Cambridge Associates LLC US Private Equity Index includes funds raised between 1986 and 2014 and the Cambridge Associates LLC US Venture Capital Index represents funds raised between 1981 and 2014. Based on the performance data collected, private equity and venture capital returns versus indexes tracking large- and small-capitalization public equities—the NASDAQ Composite, the Russell® 2000 Composite, and the S&P 500—are shown in Table 1.

Second Quarter 2014 Highlights

- As of June 30, 2014, the private equity benchmark outperformed indexes tracking large and small public companies in six of the nine time horizons listed in Table 1. The exceptions were the one-, three-, and five-year periods ending June 30, 2014. The venture index has had similar success beating the public markets, only trailing in three time periods listed in the table (one quarter, three years, and five years).
- Public companies accounted for a little more than 19.5% of the private equity index, about a 1.5% decrease from the first quarter. Public company representation in the venture capital index was down fairly substantially from the previous quarter at about 18.0% (from almost 23% in the first quarter). Non-US company exposures in the private equity and venture capital indexes have remained fairly steady for the past year, at about 19% in the private equity benchmark and roughly 11% in the venture index.

Private Equity Performance Insights

- Returns for vintage years 2004 through 2012 (which represented 92% of the index's value) were positive for the quarter.
- As of the second quarter, only five vintage years had a weight of at least 5% in the benchmark (Table 2). Among those five, returns ranged from 5.2% to 7.5%; the 2011 vintage was the best-performing while funds formed in 2006 earned the lowest return of the group. Led by 2007, the top five vintage years by size together represented 76% of the index's value. Another three vintages—2004, 2009, and 2012—each represented between 4.0% and 4.8% of the index during the quarter.
- Vintage year 2011 returns were driven by write-ups in energy, which is also the largest sector in that vintage. Consumer and health care company valuation increases both equaled more than $1.1 billion in the 2006 vintage year's return, representing almost 50% of the write-ups in that vintage. For the 2007 vintage, the largest of the group, the consumer, energy, and health care sectors all saw significant write-ups.
- During the second quarter, fund managers called $22.0 billion, the most since fourth quarter 2012 and a 27.6% increase from the previous quarter. Limited partner (LP) distributions equaled $39.7 billion, a 5.6% quarter-over-quarter increase.
- The second quarter marked the tenth consecutive (and 13th out of the last 15) quarter when distributions outpaced contributions. Over that ten-quarter period, the ratio of distributions to contributions was 1.9. Taking into account the longer cash flow cycle of 2004 through June 2014—which encompasses the fund-raising boom, the financial crisis, and the recovery—the ratio of distributions to contributions was 1.1.

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

	Q2 2014 Returns (%)	6/30/14 Weight in Index (%)
2005	6.9	12.4
2006	5.2	18.8
2007	6.2	28.0
2008	5.6	10.8
2011	7.5	6.2

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

- All vintage years from 2006 through 2013 called more than $1.0 billion each in second quarter. Funds raised in 2011 and 2012 combined to call more than $11.4 billion, or 52% of total capital called. Vintage years 2002 and 2004 through 2008 all distributed more than $1.5 billion during the quarter. Together, funds raised from 2005 through 2007 distributed $26.9 billion, or 68% of the total.
- All seven sectors representing at least 5% of the private equity index earned positive returns during the quarter (Table 3). Energy's return of 9.4% was the highest while financial services' return of 2.1% was the lowest. Energy company write-ups in five vintages (2005, 2007, 2008, 2010, and 2011) were higher than $1.0 billion, which boosted the sector's performance. Write-ups for financial services companies, a fraction of what they were for energy companies, were driven largely by two vintages, 2007 and 2008.
- Consumer and energy companies attracted roughly one-third of all invested capital during the quarter, which is slightly higher than what has been invested in the sectors over the long term.

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

	Q2 2014 Returns (%)	6/30/14 Weight in Index (%)
Consumer	3.7	19.8
Energy	9.4	19.3
Financial Services	2.1	9.0
Health Care	7.5	11.4
IT	7.0	9.7
Manufacturing	5.9	7.0
Software	7.5	6.0

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

Venture Capital Performance Insights

- The range of quarterly returns for the top-sized vintages in the venture capital index was quite wide. The best return of the group (vintage year 2011) was 20.0%, while the worst (vintage year 2004) was -2.2% (Table 4).
- For the best-performing vintage, 2011, software sector write-ups were the primary driver of performance and for the lowest performer, 2004, write-downs in IT companies more than offset write-ups in media and health care.
- Upticks in health care valuations were the main drivers of performance for two of the three largest vintage years, 2006 and 2007, and IT and health care were the biggest contributors to the return for 2008.
- Venture capital fund managers called $3.8 billion from investors during second quarter, a 4.2% increase over the previous quarter. Distributions from venture funds were $6.7 billion, a 4.4% decrease from first quarter, when distributions hit the highest quarterly output since fourth quarter 2000. Distributions surpassed contributions for the tenth quarter in a row.
- Funds formed in 2008 and 2010–13 were responsible for 77% of the total capital called during the quarter; each of these five vintages called more than $350 million. Distributions from 2004, 2006, and 2007 vintage year funds totaled over $4.1 billion, representing 61% of the total from the quarter. The 2007 funds alone distributed more than $2.2 billion.

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

	Q2 2014 Returns (%)	6/30/14 Weight in Index (%)
2000	-0.4	7.2
2004	-2.2	6.4
2005	4.7	9.4
2006	2.9	14.3
2007	2.0	13.2
2008	3.6	14.5
2010	6.2	8.8
2011	20.0	5.0
2012	9.0	5.4

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

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

	Q2 2014 Returns (%)	6/30/14 Weight in Index (%)
Health Care	4.2	26.8
IT	3.2	32.7
Software	8.5	18.9

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

- All three sectors that represented at least 5% of the value of the index had positive returns in the second quarter (Table 5). The best return was earned by the software sector while the lowest was posted by IT companies, with more than 5 percentage points separating the returns for the two sectors. Write-ups for software companies were fairly widespread across the index, with five vintage years having at least $300 million in write-ups on investments in the sector during the quarter. Two other sectors, electronics and media, each accounted for more than 4% of the index.
- IT and health care—the two largest sectors by dollar value in the venture capital index—attracted more than $1 billion each to combine for 64% of the total capital invested during the quarter. The percentage is about 5% higher than the long-term norm for the two 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 June 30, 2014, the database comprised 1,152 US buyouts, private equity energy, growth equity, and mezzanine funds formed from 1986 to 2014, with a value of nearly $642.8 billion. Ten years ago, as of June 30, 2004, the index included 539 funds whose value was roughly $148.0 billion.

Cambridge Associates derives its US venture capital benchmark from the financial information contained in its proprietary database of venture capital funds. As of June 30, 2014, the database comprised 1,508 US venture capital funds formed from 1981 to 2014, with a value of roughly $167.2 billion. Ten years ago, as of June 30, 2004, the index included 992 funds whose value was about $47.5 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.