Hamilton Lane

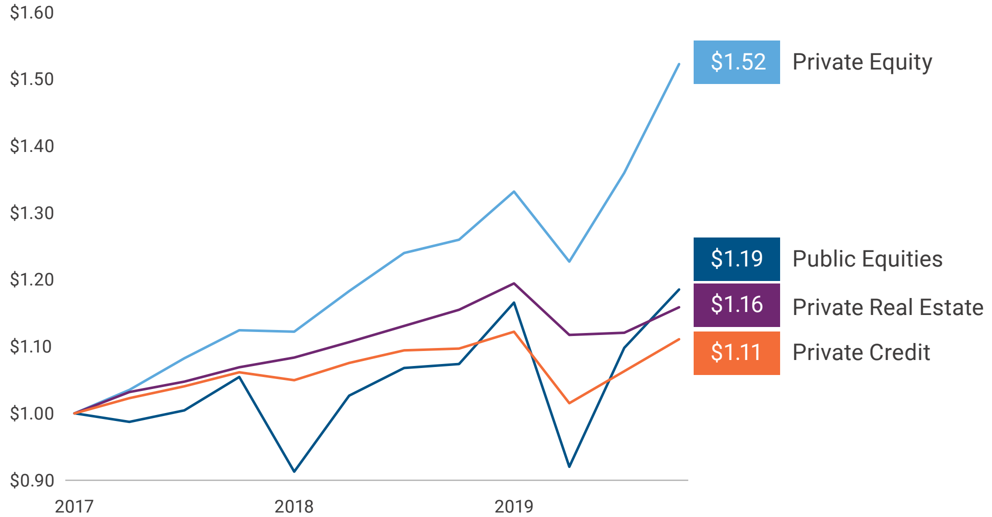
2021 Market Overview: Performance Part I

Sure, there may be other factors driving allocations to this asset class, but what's the main reason to invest in the private markets?

Better performance than the public counterparts. 2020 was a bifurcated year (among other adjectives that come to mind), with the first quarter seeing terrible market action and everyone rushing to their "Global Financial Crisis Handbook on Surviving and Thriving as All Around You Collapses." But this was not like the GFC. Then, the financial system caused the meltdown; the financial system was ground zero. This time, a global pandemic followed by chunks of economies shutting down was the root cause. It may initially have looked and felt the same in the financial markets, but in reality it was quite different.

Adding to that difference was central bank and government activity, injecting massive fiscal and monetary stimulus into economies. In just three months, those entities introduced multiple levels of assistance compared to what they did over two years after the GFC. The result, in public stock markets, was to alter what threatened to be a disastrous 2020 into one during which public stocks reached record levels. As of September 30, 2020, the dollar invested in 2017 was worth $1.19, and as of December 31, 2020, it was worth $1.35 after falling to as little as 92 cents in March 2020. How did the private markets fare in this same environment?

Chart 2.1 What the Markets Have Done



Source: Bloomberg, Hamilton Lane Data (January 2021)
Please refer to endnotes.

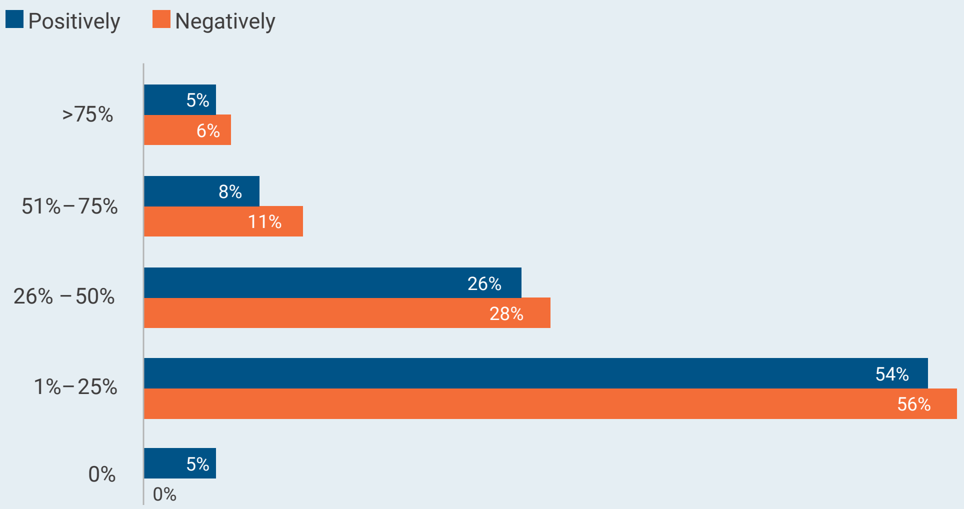
Remarkable, isn't it? Private equity generated a premium of 33% over that same time frame through Q3 2020. Private real estate and private credit performed quite well compared to public equities as you consider their different risk profiles. And, by looking at Chart 2.1, it's easy to see why; the downdrafts just weren't as severe as what occurred in the public markets. Yes, we know, you're thinking that's an optical illusion, a function of bogus accounting and delayed marks. Sure, sure. But if that were actually the cause, the upswing from March wouldn't continue to look so favorable. You'll have to find another excuse to explain why private markets performed better. Allow us to help guide you on that search as you read along.

As discussed at the outset of our tale, 2020 was a story of two different realities, and surely many public market investors know that story all too well. Consider how a portfolio overweighted to Amazon and Zoom compared to one overweighted to Lufthansa and Carnival Cruise Lines? **Depending on which side of that equation you were on, the past year (solely looked at from an investment returns perspective) was either positive—or much, much less so.**

Look at this mirror image in the private markets landscape.

Chart 2.2 **GP View**

What percentage of your portfolio was impacted by COVID-19?

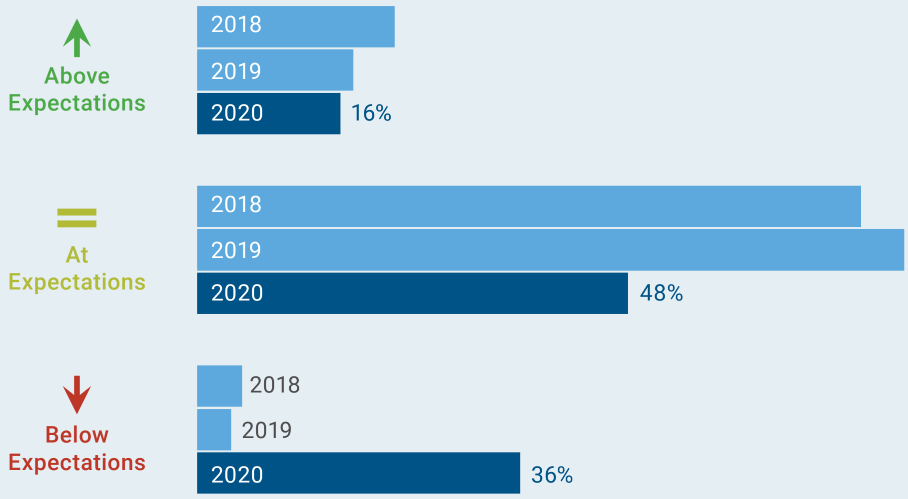


Source: Hamilton Lane General Partner Survey 2020 (December 2020)

General partners report almost identical percentages of companies positively and negatively impacted by COVID-19. These results reflect a stark and remarkable reality, one of those instances where a "picture is worth [more than] a thousand words." We've tracked revenue growth for several years, and in our latest batch of GP responses, we see that COVID-19 shifted portfolio company performance substantially.

Chart 2.3 GP View

How would you describe revenue growth across your portfolio companies over the past year?



Source: Hamilton Lane General Partner Survey 2020, 2019, 2018 (December 2020)

Editorial Note

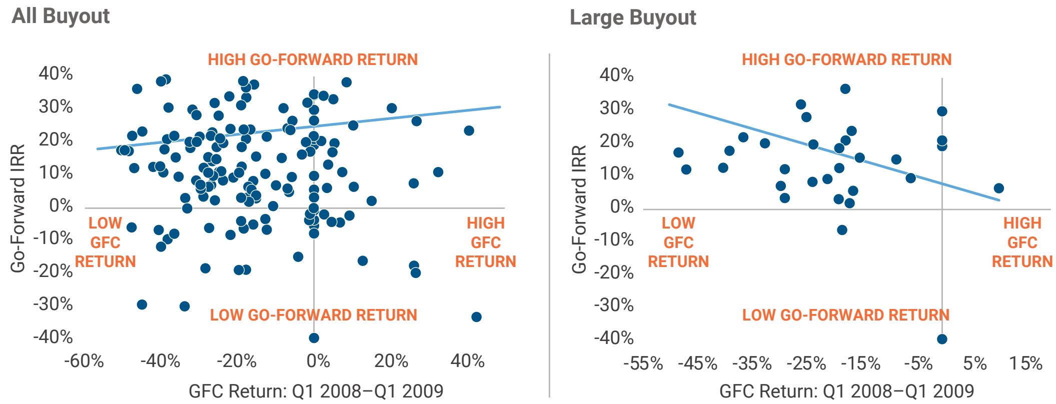
When you consider how well the private markets performed in a year when our GPs report that more than one-third of companies had revenue that was below expectations, we'd argue that general partners delivered on what they are paid to do.

We've learned a lot this year — from teleconferencing etiquette, to virtual schooling techniques that keep the peace among siblings, to just how much television a single human can stream and still manage to live a productive life. **We've also learned that if you repeat something often enough, even if it's blatantly false and a total fabrication, some people will believe it.** Regardless, we've always preferred to use facts to determine accuracy and, while that ruins our chances of becoming members in good standing of QAnon, it might help us make better investment decisions. Here's one "truism" we've heard time and again: "If you took big markdowns in a crisis, it negatively affected your long-term performance."

This statement is associated with the view that private equity is only good in downturns thanks to accounting magic. The theory's corollary is that, if those funds took the markdowns that the all-knowing observer knows they should have taken, well, then, we'd see lousy performance. But is that true? Like, *really* true?

We took a look at GFC performance figures, since that gave us a longer time frame with which to judge the data. During the GFC, the period from Q1 2008 to Q1 2009 witnessed severe markdowns, with fund performance down, on average, almost 20%. What happened after that?

Chart 2.4 GFC Markdown vs. Go-Forward Performance



Source: Hamilton Lane Data (January 2021)

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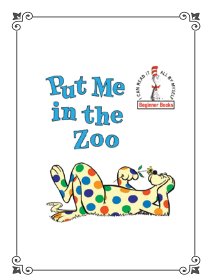
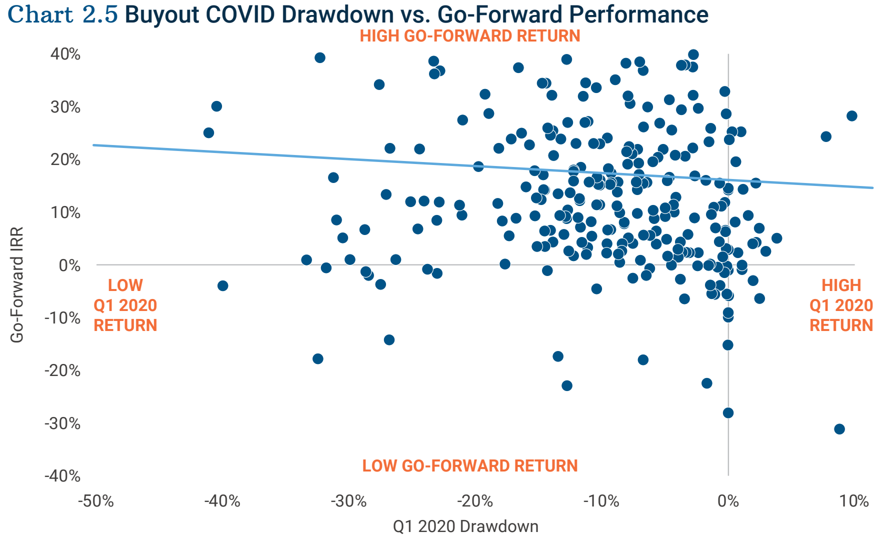
No, you don't need to call your optometrist because you are seeing spots. What you're looking at is data illustrating that there is little impact on go-forward returns for buyout funds based on GFC markdowns. Surprised? So were we. Perhaps we shouldn't have been given it's only a short period and there's more than enough time to recover; still, it does dent the argument that private equity only does well because it artificially mutes downturns. It doesn't much seem to matter whether a manager took larger or smaller markdowns. The same is true of the venture space. The size of the markdown had almost zero correlation to the go-forward fund performance.

Interestingly, for mega buyouts, larger markdowns are more closely associated with *better* go-forward returns. There, the harder you fell, the better you did longer term. (Curious. Maybe big trees don't always fall hard….) We don't have a great way to explain the phenomenon and we wouldn't call the statistical significance as solid as that showing the sun always rises in the east, but we do suggest secondary buyers take note of that data.



Is there any initial data from the COVID-19 experience? If you saw spots in the earlier chart, maybe we can all channel Dr. Seuss for this next one.

Chart 2.5 Buyout COVID Drawdown vs. Go-Forward Performance

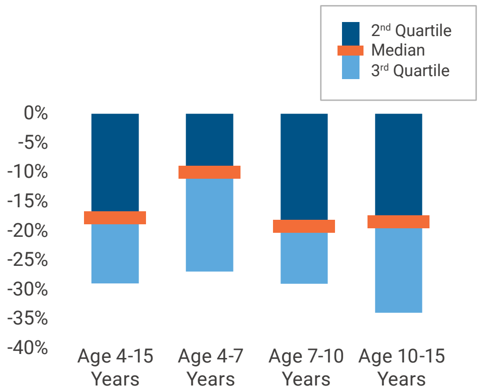


Source: Hamilton Lane Data (January 2021)

If we were forced to draw a conclusion from Chart 2.5, we'd say that high markdowns are associated with higher future returns, though it's not a statistically significant relationship. Perhaps it's too early to tell, or maybe the relationship doesn't hold in the COVID-19 environment. It would be easier to draw a conclusion the data doesn't support (wasn't that the cool thing to do in 2020?), but we won't do that here.

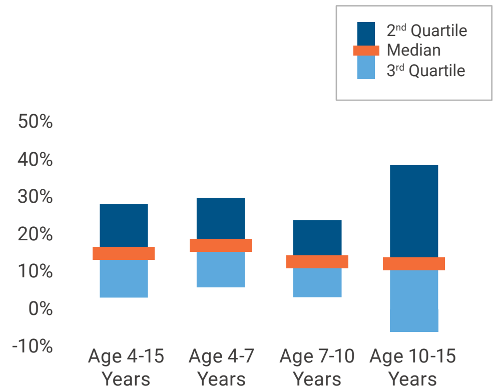
Coming back to post-GFC performance, we took a look at whether the age of the fund made any difference.

Chart 2.6 Buyout GFC Markdown Dispersion of Returns by Fund Age



Source: Hamilton Lane Data (January 2021)

Chart 2.7 Buyout GFC Go-Forward Dispersion of Returns by Fund Age



Source: Hamilton Lane Data (January 2021)

Younger funds were less impacted by initial markdowns, and their post-GFC performance was arguably better than the oldest funds. Part of this makes sense, in that younger funds have more uncalled capital both to make new investments at lower prices and to support portfolio companies. This certainly accounts for some of the post-GFC performance. However, that doesn't account for the smaller markdowns in existing portfolio companies.

Read more in our next excerpt or request a full copy of the 2021 Market Overview here.

Endnotes

Chart 2.1: MSCI World used as proxy for public equities.

Strategy Definitions

All Private Markets: Hamilton Lane's definition of "All Private Markets" includes all private commingled funds excluding fund-of-funds, and secondary fund-of-funds.

Corporate Finance/Buyout: Any PM fund that generally takes control position by buying a company.

Credit: This strategy focuses on providing debt capital.

Private Equity: A broad term used to describe any fund that offers equity capital to private companies.

Real Estate: Any closed-end fund that primarily invests in non-core real estate, excluding separate accounts and joint ventures.

Disclosures

As of February 16, 2021