Private Markets: Cutting through the Jargon

The terminology of private markets need not be daunting. Making an upfront effort to demystify commonly used terms can help unlock the benefits of private equity, private credit, and other alternative investment strategies.

PERFORMANCE MEASUREMENT

Multiple on Invested Capital (MOIC)

Gross Pooled MOIC for Global Buyouts, by Year of Exit
(multiple of starting capital)

Definition
The total return on a fund expressed as a multiple of all money invested. For example, a $100,000 investment returning $150,000 has a 1.5x MOIC.

Why It Matters
Allows investors to measure how much value a fund has created. MOIC can be expressed as a gross or net metric. Net MOICs are generally net of fees and carry (also called "carried interest"). Often best used at the end of a fund’s life.

Source: CEPRES Market Intelligence, June 2021. Because private market firms self-report their results, indices that reflect aggregate long-term returns are subject to "survivorship" bias. Self-reporting may inflate historically reported private market returns, as funds with the worst results may close. There can be no assurance that an allocation to alternatives would yield returns or protect capital. Past performance does not guarantee future results.
**PERFORMANCE MEASUREMENT**

**Internal Rate of Return (IRR)**

IRR measures performance in a way that accounts for periodic contributions and distributions.

**Why It Matters**

IRR accounts for cash flow into and out of the fund over time. By contrast, public-market returns are often expressed as an annualized number (which can also be true of some perpetual alternative funds). IRRs may be more relevant after the end of a fund’s investment period.

**TIME HORIZON**

**Vintage Year**

The inception year of an investment fund. The IRR will be calculated starting from the vintage year through the lifespan of the fund.

**Why It Matters**

The IRR of each vintage is likely to vary—investors should look across vintages as they assess a manager’s skill and ability to deliver performance.”

Source: Cambridge Associates, December 2020. Because private market firms self-report their results, indices that reflect aggregate long-term returns are subject to “survivorship” bias. Self-reporting may inflate historically reported private market returns, as funds with the worst results may close. There can be no assurance that an allocation to alternatives would yield returns or protect capital. Past performance does not guarantee future results.

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DOCUMENT OVERVIEW

Illustrative Term Sheet

Term Sheet

Investment Objective

Management Fee

Incentive Allocation

Subscriptions

Redemptions

Definition
The term sheet lays out the basic summary of a fund, including the investment objectives, management fees, subscription and redemption windows (if applicable), and other vital information.

Why It Matters
Knowing how to interpret a term sheet is essential for evaluating a fund. Investors should understand the ownership structure, time horizon, possibility of capital calls, and potential lockups. Understanding fee structures helps evaluate alignment of interests.

CAPITAL FLOWS IN SEMI-LIQUID FUNDS

Lock-up Period

REDEMPTION WINDOWS

START

END

LOCK-UP PERIODS

Definition
Some alternative funds are semi-liquid in nature. The lock-up period is a window of time during which an investor may not withdraw capital in semi-liquid funds.

Why It Matters
Investors should factor in lock-up periods as they anticipate their liquidity needs over time.

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**TIME HORIZON**

### “J” Curve

The “J” curve describes the tendency of private equity funds to deliver negative returns in early years as capital is called, and investment gains in later years as investments in portfolio companies mature.

**Why It Matters**

Alternative funds require capital inflows from the investor in the initial years of the fund – the bottom “curve” of the “J.” In later years, as investments mature, returns may have risen, as represented by the upper portion of the “J.”

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**TIME HORIZON**

### Capital Call

Capital calls supply cash at moments when attractive opportunities present themselves and/or portfolio companies need a cash infusion.

**Definition**

When money pledged by limited partners/investors is collected so that it can be invested or otherwise deployed by the general partner.

**Why It Matters**

Investment Period
Manager puts cash to work

Harvest
Investments are realized, cash is returned (if the fund is successful)

**Note:** For informational purposes only. These statistics are not meant to be predictive of the performance of any particular fund, nor are they meant to suggest that all private funds result in positive returns or may avoid loss of principal. Private equity investments involve significant risk and typically high levels of leverage. Hypothetical performance results have many inherent limitations and no representation is made that any investor will, or is likely to achieve, results similar to those shown. Each investor’s cash flows and returns will differ and may result in a total loss of principal. There can be no assurance that an allocation to alternatives would yield returns or protect capital. Past performance does not guarantee future results.

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TIME HORIZON

Investment Period

Definition
Typically the first 3-to-5 years of an alternative fund with a 10-year term. This is when capital calls and deployment of committed capital take place.

Why It Matters
Investors should anticipate the need to make contributions during the investment period.

Harvest Period

Definition
Typically the last 3-to-7 years of an alternative fund with a 10-year term. Period when the fund can manage or exit existing investments, but cannot initiate new ones.

Why It Matters
Ensuring the harvest period aligns with investors’ portfolio objectives and liquidity needs is vital.

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QUALITATIVE EVALUATION

Operational Intervention

**Definition**
Effort by a private-equity manager to add value to a portfolio company. Operational interventions may include procurement upgrades, addition of data science tools, enterprise systems or sustainability initiatives, and/or replacing company management.

**Why It Matters**
A private-equity manager’s ability to carry out operational interventions successfully is a distinguishing characteristic and is generally expected to be the most important source of PE manager alpha.

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QUALITATIVE EVALUATION

General & Limited Partner

**Definition**
General partners (GPs) manage a private equity fund, select its investments, and attain capital commitments from limited partners (LPs). Limited Partners are generally institutional investors often with no discretion over the choice of investments.

**Why It Matters**
The Limited Partnership Agreement (LPA) contains important information about fund governance. It describes limitations on the types of investments, fees, liability, and other considerations.
**Carried Interest**

**Definition**
A performance fee and contractual right which entitles the general partner of an investment fund to share in the fund’s profits, if any, over a pre-determined performance hurdle.

**Why It Matters**
Carried interest helps improve the alignment of incentives between general partners and other stakeholders in a fund.

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**Waterfall Capital Distribution**

There can be multiple tiers of capital distribution in alternative funds. Each determines the timing and amount of money the LP or GP receives: (1) Return of Capital, (2) Preferred Return, (3) Catch-up, and (4) Carried Interest.

**Return of Capital**
As long as a fund generates a return, LPs get back at minimum all of their invested capital. If the fund calls and invests $1 million of an LP’s money and receives $1.2 million from the investment, LPs are first entitled to receive back $1 million.

**Preferred Return**
Funds usually have a stated preferred return or hurdle rate. As long as a fund makes a return as great as or greater than the preferred return, LPs are entitled to the returns of the fund up to the preferred return. Preferred return for many PE and RE funds is 8%. In the case of the above $1 million investment, LPs would receive $1 million return of capital and are entitled to $80,000 of the remaining $200,000 (8% of $1,000,000). $120,000 of fund profit remains.

**Catch-up**
Once LPs receive their 8%, the GP receives the next 2% of fund profits so they can “catch-up” and maintain an 80/20 split.

**Carried Interest**
After the preferred return and the “catch-up”, any profits are split by the LPs and the GP, usually 80% for LPs and 20% for the GP. Final results: $1,160,000 for LPs and $400,000 for the GP.

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