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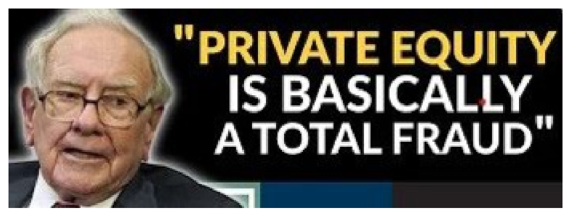
Maybe Warren has a point?

Perhaps you've seen the LinkedIn posts quoting the famed investor Warren Buffett decrying the world of private equity.[1]

One of the criticisms of private equity is that "the clock starts," in terms of performance, when the first investment is made; that is, the committed capital isn't included.

I've challenged this idea, myself. If an asset owner commits, let's say, $20 million, to a partnership, that will exist for seven-to-ten years, where performance only includes actual invested capital, isn't the return overstating the actual performance?



The reason we use the Internal Rate of Return (IRR) for private equity is because the P/E managers do not take the cash into consideration; they don't ever hold it. This, of course, makes sense. Or at least has, for decades. But, is it time for a "paradigm shift"?

When I've brought this up in the past, the response has been of general disinterest. Perhaps because "this is how everyone does it." But should the entire commitment be ever present, until it is reduced at some late date in the partnership, when no further investing will occur? And, perhaps, should time-weighting be used? Wouldn't that make life a lot easier?

We'll always have to deal with the lagged valuations. But if we could justify a switch to time-weighted performance, that would permit the grouping of private and public assets.

Your thoughts are welcome. I'll have more to say on this.

A preview of an upcoming article

One criticism I've had <u>for decades</u> has been with the reporting of net-of-fee performance in GIPS® reports. And my reasoning is pretty simple:

- when actual fees are used, if the manager uses a tiered fee schedule [which most do], the resulting return has zero meaning; it cannot be interpreted
- when model fees are used, while we can interpret the results [since we know what the fee is that was used], it will likely be a lower return than what would occur using actual fees, which no one really likes to see.

The Journal of Performance Measurement®

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I've suggested, on multiple occasions, that managers use actual fees and include the "asset-weighted fee" (AWF)[2]. Perhaps you're not familiar with the AWF. It was once required by the predecessor to the GIPS standards, the AIMR-PPS®. Unfortunately, it wasn't brought along. That doesn't mean firms cannot report it.

Look for an article in an upcoming issue of T*he Journal of Performance Measurement®* where I will demonstrate why this statistic should be shown. Hope you find it of interest.

Consider this a "teaser"!

1. See, for example, tinyurl.com/kxp6cycc
2. For example, in my comment letter on the proposed 2020 version of the GIPS standards. I can provide you a copy of my letter, if you'd like.

TSG'S 2023
INVESTMENT PERFORMANCE MEASUREMENT CALENDAR OF EVENTS

DATE	EVENT	LOCATION
May 23, 2023	Launch of Women in Performance (Cocktail reception) https://spauldinggrp.com/events/women-in-performance-group/	New Brunswick, NJ
May 24-25, 2023	PMAR North America	New Brunswick, NJ
June 22-23, 2023	Performance Measurement Forum	Edinburgh, Scotland
November 9-10, 2023	Performance Measurement Forum	Porto, Portugal
November 29, 2023	Asset Owner Roundtable	Orlando, FL
November 30 - December 1, 2023	Performance Measurement Forum	Orlando, FL

For additional information on any of our 2023 events, please contact Patrick Fowler at 732-873-5700.

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