FOCUS ON PRIVATE EQUITY

THE ROLE OF PRIVATE EQUITY IN A VOLATILE WORLD

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This article is excerpted from a recent Altegris-KKR webinar, *Populism, Political Change and Investing*. A previous excerpt featured KKR's *Global Trend Watchlist for Private Equity*.

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We live in a world of increasing complexity—one in which technological revolutions are unmaking and remaking every industry. The private equity model offers a way to adapt to, and potentially benefit from, these profound changes.

Private equity can also continue to help investors advance toward their financial goals despite a challenging climate. Since the 2009 market bottom, global public equity markets have seen tremendous appreciation driven primarily by quantitative easing and much lower interest rates around the world. With interest rates currently near all-time lows and equity market valuations at historically high levels, we believe financial market returns are unlikely to repeat the past eight years' performance over the next eight years. In our view, this suggests that investment strategies with return-enhancing capabilities could play an increasingly important role in investors' portfolios.

INVESTMENT FOCUS

In our view, financial markets are currently between fairly valued and richly valued, depending on where one believes interest rates are headed. In this climate, investors need to be especially cautious about the assets they acquire and the prices they are paying.

We believe companies with strong and defensive business models have the ability to grow value during difficult times as high-growth competitors stumble and strategic investment opportunities arise.

HOW PRIVATE EQUITY CAN HELP INVESTORS ENHANCE PORTFOLIO RETURNS:

1 **A longer-term approach to investing.**	2 **Investing in less efficient markets.**	3 **Exercising control over investments.**
Investors that have a longer time frame to create value tend to be more committed, more thoughtful in their decision-making, and more deliberate in seeking ways to increase a company's value over a long-term horizon. In an environment like the one we see ahead, having a long-term approach to investing allows an investor to make thoughtful and deliberate decisions that can compound value over many years.	In the US, there are about 27,500 companies with 500 or more employees—and only about one-fifth of them are public. This means a private equity manager operates with a universe of more than 23,000 large, private companies in the US alone.[1] Many of these companies are family-owned businesses that can benefit from professional management. Similar opportunities exist in Asia and Europe, where markets are even less efficient and valuations are lower than the US.	Those who invest in public companies are often seeking to "buy and flip," hoping the stock is poised for a near-term rise. Private equity managers largely seek to buy and control their companies, with an eye towards fixing or improving their operations. By having the ability to exercise control over an investment, a skilled operator can execute its strategic plan and maximize value creation over a long-term time horizon.

THE ALLOCATION QUESTION

Private equity is a long-term and illiquid investment, so in our view the allocation question really comes down to an investor's time horizon and liquidity needs.

We believe private equity should be viewed as a substitute for public equity, rather than being placed in an alternative or uncorrelated bucket. Most of the astute investors we see are investing between 5% and 30% of their total equity allocation to private equity. That translates to between 3% and 18% of a 60% stocks/40% bonds portfolio. That size allocation may actually be conservative for some, given that we are living longer and much later into retirement. We believe the potential impact of relative outperformance will be a core driver for investors to increase their private equity allocations in the years ahead.

[1] Source: US Bureau of Labor Statistics, as of March 2015; World Federation of Exchanges, as of March 2016.

Past performance is not indicative of future results. Diversification does not ensure profit or protect against loss in a positive or declining market. There is no guarantee any investment will achieve its objectives, generate profits, or avoid losses.

RISKS AND IMPORTANT CONSIDERATIONS

It is important to note that all investments are subject to risks that affect their performance in different market cycles. There are significant differences between public and private equities, which include but are not limited to, the fact that public equities have a lower barrier to entry than private equities. There is also greater access to information about public companies. Private equities typically have a longer time horizon than public equities before profits, if any, are realized. Public equities provide greater liquidity whereas private equities are considered highly illiquid.

It should be noted that private equity may not be suitable for everyone. As with any investment, there are numerous risks to investing in private equity including the possible loss of principal. Private equities generally are more expensive to purchase and own than public equities, which if taken into account would decrease private equity performance shown.

Nevertheless, for those investors who understand the risks, and have available risk capital, private equity can provide an opportunity to enhance their portfolio returns.

An important part of understanding and implementing private equity today is assessing the potential benefits as well as the risks. Equity securities are subject to market risk, or risk of loss due to adverse company news, industry developments, and general economic decline.

In addition, private equity is considered speculative therefore subject to a unique set of risks. These risks include, but are not limited to, liquidity risk and lack of a secondary market to trade securities, management risk, concentration and non-diversification risk, foreign investment risk, lack of transparency, leverage risk, and volatility.

ABOUT ALTEGRIS

Altegris is an investment research firm, with deep expertise in alternative manager selection, structuring unique solutions, and providing portfolio management and oversight. Beginning with an analysis of the current and anticipated investment environment, our solutions are based on themes that we believe solve the most important client needs. For more information about the Altegris family of alternative solutions, visit www.altegris.com.

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