



Private Equity Returns for Public Pension Funds

Claire McNeil looks at the performance of public pension funds' private equity portfolios compared to the performance of their investments in other asset classes.

Median Public Pension Fund Returns by Asset Class

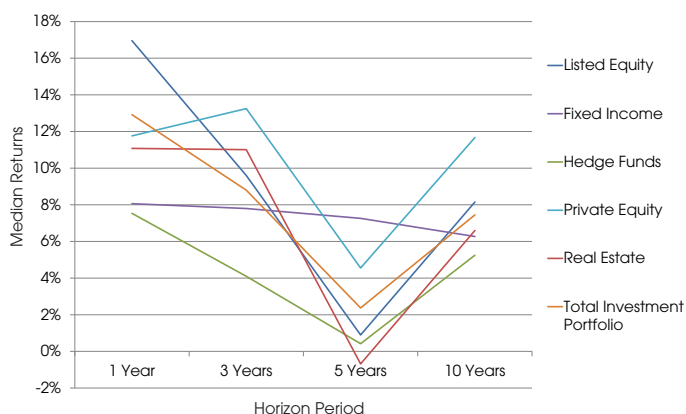
Private equity is an important component within the portfolios of public pension funds as it provides diversification of returns, as well as often outperforming the public market's returns. Fig. 1 shows the median returns public pension plans have earned as of December 2012 (over the defined periods one, three, five and 10 years), split by asset class.

Comparing returns between asset classes with a very long-term time horizon (like private equity) with those with a more volatile, shorter-term time horizon (like listed equity and fixed income) is always challenging, but the data for these pension funds is very informative. Starting with the long-term net returns (i.e. after fees and carry), private equity has been the best-performing asset class for pension funds over three and 10 years. Over a five-year time horizon, private equity has been beaten only by fixed income, and significantly this was during a period of generally falling interest rates, a phenomenon unlikely to be repeated in the near future. Equally significant, the margin by which private equity has outperformed listed equity over three, five and 10 years has been fairly consistent at around the 400 BP level per year. Interestingly, this is frequently the excess return demanded by LPs to compensate them for the illiquidity of private equity investments. In other words, private equity has delivered superior returns to pension funds over the longer term; unsurprising then that Preqin's latest survey of LP attitudes confirms that most investors are satisfied with the returns they have earned on their private equity portfolios and plan to maintain or increase their allocations to the asset class.

The picture becomes less clear over the short term, as shown by the one-year returns in Fig. 1 and the trend in rolling 12-month returns shown in Fig. 2. The second half of 2012 saw very strong performance from listed equities, and this drove the performance of the entire portfolio. Private equity returns tend to lag listed equities over the short term, due primarily to the lag in reporting portfolio company NAVs, and this is shown in Fig. 2. As a result, the one-year private equity returns tend to underperform compared to listed equities in times of strong stock market performance (and vice versa when markets are weaker). It is therefore unsurprising that the one-year and rolling 12-month returns show private equity lagging behind listed equities.

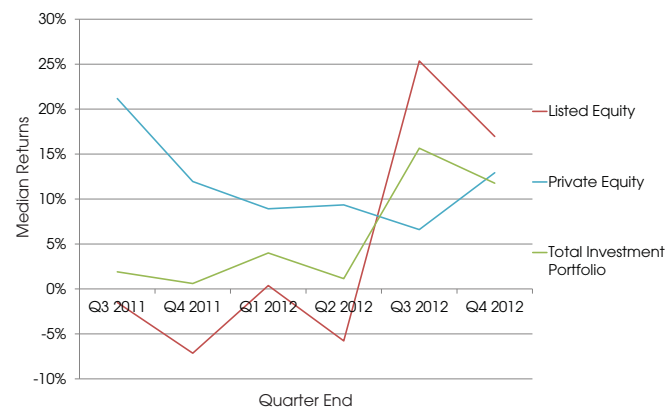
These are significant findings for the private equity industry, and bode well for the future. The evidence from this analysis of net returns for pension funds by asset class shows that private equity has indeed delivered superior returns over the medium and longer term, a point that is clearly not lost on LPs, with the majority of them confirming to Preqin during our recent survey that they are a) satisfied with the returns from their private equity portfolios, and b) plan to maintain or increase their allocations to the asset class. Elsewhere in this edition of Private Equity Spotlight we have shown that the long-awaited upturn in private equity fundraising has started, and this analysis of returns suggests that the improvement should be robust.

Fig. 1: Median Public Pension Fund Returns by Asset Class as of 31 December 2012



Source: Preqin Performance Analyst

Fig. 2: Rolling One-Year Median Public Pension Fund Returns: Private Equity vs. Listed Equity and Total Investment Portfolio



Source: Preqin Performance Analyst

Data Source:

Subscribers to Preqin's [Performance Analyst](#) can click [here](#) to view Horizon IRR data across fund strategy and regional focus, as well as on a one-, three-, five- and 10-year rolling basis, calculated from cash flow data for over 2,300 private equity funds.

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