Asset Class Investment Strategies

Private Equity

This is a financial promotion. Your capital is at risk, the value of investments may fall and rise and you may not get back the full amount you invested. Past performance is not indicative of future returns.

We recommended a private equity allocation of 18% for those clients able to accept lower levels of portfolio liquidity. This reflects our conviction that private equity will continue to enhance overall portfolio returns by delivering the strongest absolute returns of any asset class. Allocations to private equity vary based on unique client risk and liquidity constraints.

Private equity valuations remain at elevated levels and sponsors have a large pool of dry powder (committed, but uncalled capital), now at $1.5T up from $1.4T a year ago. This excess supply of capital can potentially have an adverse impact on returns due to intensified competition for attractive investments leading to higher purchase prices. We confront this headwind by focusing on "off the beaten path" managers as we have advertised for nearly 20 years now. This includes managers with operationally proactive strategies, particularly those that are targeting middle market businesses, leveraging industry expertise to identify value levers that others might not have available.

Summary

Our private equity (PE) strategy focuses on avoiding the most competitive pockets of the private equity market. We spend most of our time trying to identify who we believe are the winning teams of the future, particularly those targeting the middle market where there is less competition. Overall, our focus continues to be on these five areas:

1. **Middle market buyouts** which target companies in less efficient markets, where it is easier to drive EBITDA growth.
2. **Sector specialists** who have competitive advantages in sourcing and value creation due to deep industry insights. Commitments to sector specialists have

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represented c. 40% of our PE investments in recent years, an allocation we plan to preserve going forward.

3. **Emerging managers** offer opportunities to support young, hungry teams who have been trained by well-established PE firms. These managers are not distracted by legacy portfolios that require time and attention – especially important in the current climate. They often offer (i) favourable terms with strong alignment of interest and (ii) a compelling opportunity to back managers that promote diversity, equity, & inclusion ("DEI").
4. **Next generation VC firms** established by proven founder-entrepreneurs who are closer to the new generation of start-up founders and have more experience in and around the latest technology and start-up platform tools.
5. **Co-investments** offer access to investment opportunities with greater transparency and lower fees than investments made through traditional fund commitments. We seek to access deal flow from our fund relationships, independent sponsors, and other sources.

Asset Class Definition

Private equity is the investment in the equity of private companies. Investment targets are often founder-owned companies, orphaned divisions of public companies, companies which are purchased from public shareholders or start-ups. The core sub-sectors of private equity are leveraged buyouts, growth equity and venture capital. The typical hold period for investments in private equity is five to twelve years.

Role in the Portfolio

Private equity is a key return driver in a diversified multi-asset class portfolio. Private equity investments participate in both economic growth and asset-level value enhancement, resulting in the highest returns of any asset class over the long-term. Over the long-term, private equity and public equity returns are highly correlated, so the outperformance of private equity is largely derived through the long lock-up of capital – the illiquidity premium. Finally, private equity can take advantage of distressed market environments because dry powder is readily available to buy into distressed or over-sold assets.

Investment Thesis

The investment thesis which supports the expectation for higher private equity returns than pubic equity returns is that private company ownership (in contrast with public company ownership) affords company management with the ability to optimise the long-term value of the business through more aligned corporate governance and the ability to sacrifice short-term earnings to the benefit of long-term value maximisation. Increasingly, public company management is forced by their short-term focused investors to prioritise actions on what enables them to beat analysts' quarterly earnings expectations.

In choosing which companies to own, private equity managers (or "GPs" for general partners) have relatively unfettered access to complete legally obtained inside information deeply analysed to inform their investment decisions, in stark contrast to public equity investors who are legally prohibited from acquiring and using company inside information. In addition, private markets are less efficient than public markets, thereby offering more opportunities for gaining an information advantage that enables the purchaser to source valuable assets at a discount to the value they can extract from active ownership.

In this relatively advantaged context, the most skilled private equity GPs are rewarded for: 1) finding opportunities off the beaten path and buying right or buying at a discount to publicly-traded comparable companies (referred to as "proprietary deal sourcing capability"); 2) financial leverage benefits associated with lower cost capital structures from the "right" mix of debt and equity; 3) improved corporate governance, mostly through alignment of interests with management and shareholders; and 4) post-acquisition value creation through cost saving initiatives, market expansion, capital investment, new product development and other actions which extract the full potential from such businesses. We have much higher confidence in outperformance from asset level value creation (growing the pie) than from superior security selection in the highly competitive public equities market (a zero-sum game).

The final element of the investment thesis underpinning private equity is the opportunity for portfolio managers such as Partners Capital to generate outperformance from selecting private equity managers who are the most capable of executing on the four elements described above. High degrees of return dispersion among private equity managers provides the evidence supporting the case for manager selection alpha, combined with a demonstrated ability to assess such capabilities and access what is usually quite rare investment capacity with such firms.

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Golden Rules

Our "Golden Rules" for investing in private equity, which reflect our learning from the past three decades of investing are:

1. Invest in lower middle market strategies where the greatest market inefficiency resides;
2. invest with managers who have demonstrated strong post acquisition operating value-added ("PAOVA") capabilities;
3. invest with young, hungry teams trained by top-tier private equity firms or who are former business owner-operators;
4. invest with the next generation of venture capital talent;
5. co-invest with who we believe are the best-in-class managers to lower fees and access exceptional investments.

These rules, along with the market trends described below, inform our private equity strategy going into 2021.

Market Overview

Asset Class Performance

Private Equity returns were resilient in 2020 because managers pivoted businesses quickly and managed cash flows aggressively to ensure survival, as shown in Exhibit 1. After the outbreak of COVID-19 in March 2020, GPs focused in the first instance on safeguarding existing portfolio companies. Subsequently, new deal activity sharply fell during Q2 and early Q3. Some managers took advantage of the dislocation and made a limited number of downside-protected preferred equity investments into COVID-impacted businesses, but most managers were either content to wait until the long-term economic picture cleared up or were pre-occupied with managing through a host of issues facing their existing portfolio companies. The distressed opportunity did not materialise in 2020 as PE firms had ample capital to recapitalise portfolio companies as needed, often through short-term borrowings offered by banks and private credit sponsors. There have been a few notable distressed transactions including Bain Capital's purchase of Virgin Australia airline.

Exhibit 1
Private Equity performance has proven resilient

		Q1	Q2	Q3	YT-Sep 2020
By Sub Strategy					
Buyouts	**Small Buyout**	-9.3%	5.9%	8.0%	3.8%
	Mid-Size Buyout	-9.9%	6.8%	9.1%	5.0%
	Large Buyout	-11.8%	10.1%	12.0%	8.9%
	Mega Buyout	-12.6%	9.6%	10.0%	5.4%
	Total	-11.6%	9.2%	10.8%	6.9%
Venture Capital	**Early Stage**	-4.4%	12.3%	12.4%	20.6%
	Balanced	-4.7%	9.6%	11.3%	16.3%
	Late Stage	-3.7%	15.3%	14.4%	27.0%
	Total	-4.2%	12.7%	12.9%	21.8%
Growth Equity		-6.8%	14.0%	12.9%	19.9%
All Private Equity		-10.0%	9.6%	10.6%	9.0%
By Geography					
U.S.		-10.0%	9.7%	10.6%	9.2%
Europe		-11.1%	8.5%	11.1%	7.2%
Rest of World		-8.9%	9.9%	10.0%	10.2%
Reference: Equity markets		-21.4%	19.2%	8.1%	1.4%

Source: *State Street*

Private Equity Market Trends

1. Private Equity buyout fundraising slowed modestly in 2020 but remains near its plateau

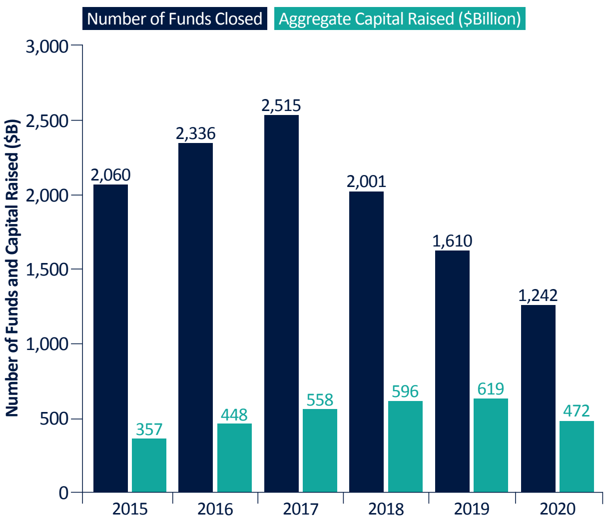
With COVID-19 forcing private equity firms to double down on managing portfolios, PE fundraising experienced its largest single-year decline in the last decade. In 2020, investors committed $472B to 1,242 buyout, growth equity and venture capital funds globally as shown in Exhibit 3. This represents a year-over-year decline of -24% below the record of $619B hit last year due to liquidity constraints experienced in Q2 and the transition to working from home which limited in-person due diligence meetings. Mega funds continue to attract the lion's share of capital, with Apollo having raised a $25B fund, Silverlake $20B and Hellman & Friedman on track for a $20B fund raise early this year. Institutional investors are increasingly gravitating to larger and more established sponsors, and with ongoing social distancing measures continuing to inhibit in-person meetings, this trend will likely continue through 2021.

The lower fundraising levels (and decline in deal activity) propelled dry powder to record levels in 2020, reaching $1.5T for the first time. We forecast continued growth of private equity capital at work primarily based on the assumption that institutional allocation targets will be achieved. This suggests the market will increase from $4.7T in 2020 to $6.6T by 2025.

Pitchbook and other experts are forecasting a rebound in fundraising in 2021 as institutional investors continue to increase allocations to alternative investment classes.

Exhibit 2

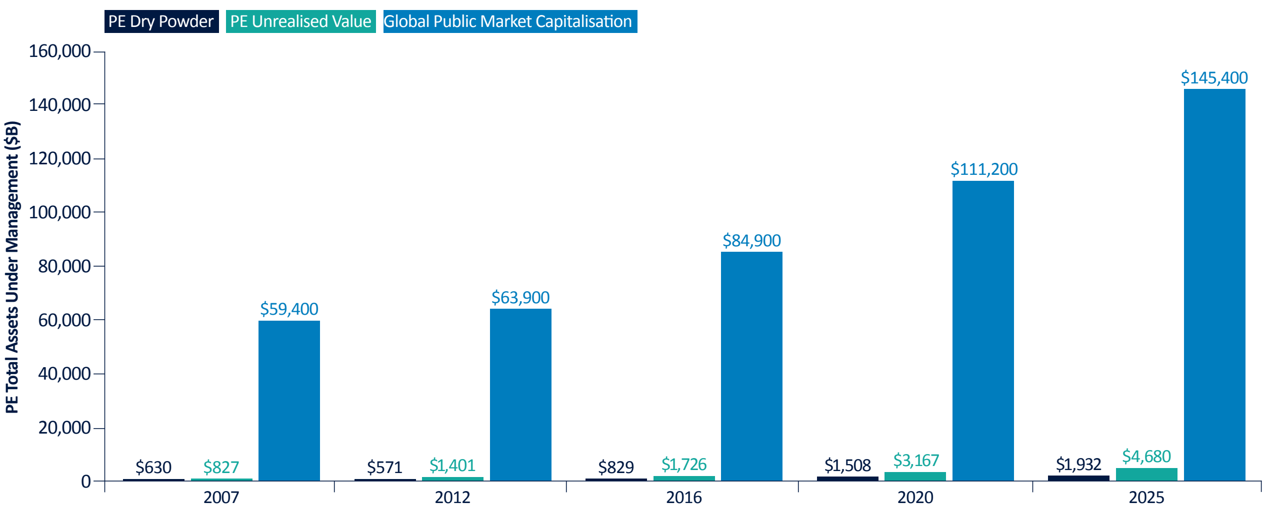
Global Private Equity Fundraising has been slowing



Source: *Preqin Private Equity Online*

Exhibit 3

Private Equity AUM (dry powder plus unrealised value) has nearly doubled in the past 4 years, but still represents <5% of global public equity market capitalisation



Note: *2020 data is as of June 30, 2020*

Source: *PWC, Asset and Wealth Management Revolution: Embracing Exponential Change 2020, Preqin PE online*

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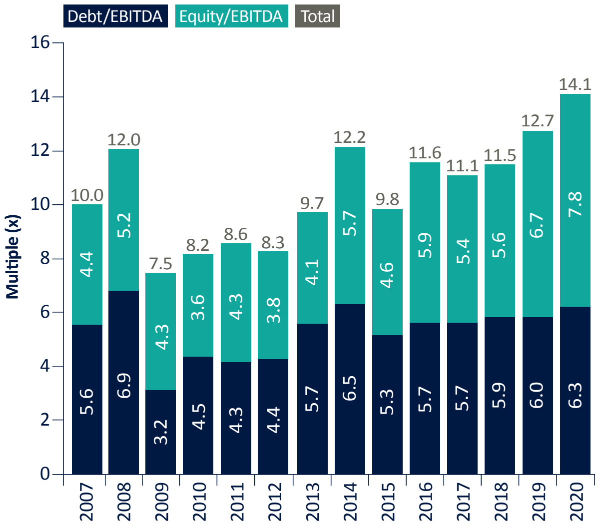
2. Record prices are being paid (again with unprecedented leverage levels

Competition for assets continues to put pressure on average purchase multiples (total enterprise value / EBITDA across large-cap, middle market and small-cap buyouts, which now stand at 12.7x, 9.1x, and 8.1x, respectively, as shown in Exhibit 5. The 3.6 turn difference between multiples paid by large cap and middle market sponsors in 2020 is the largest in the post-GFC era.

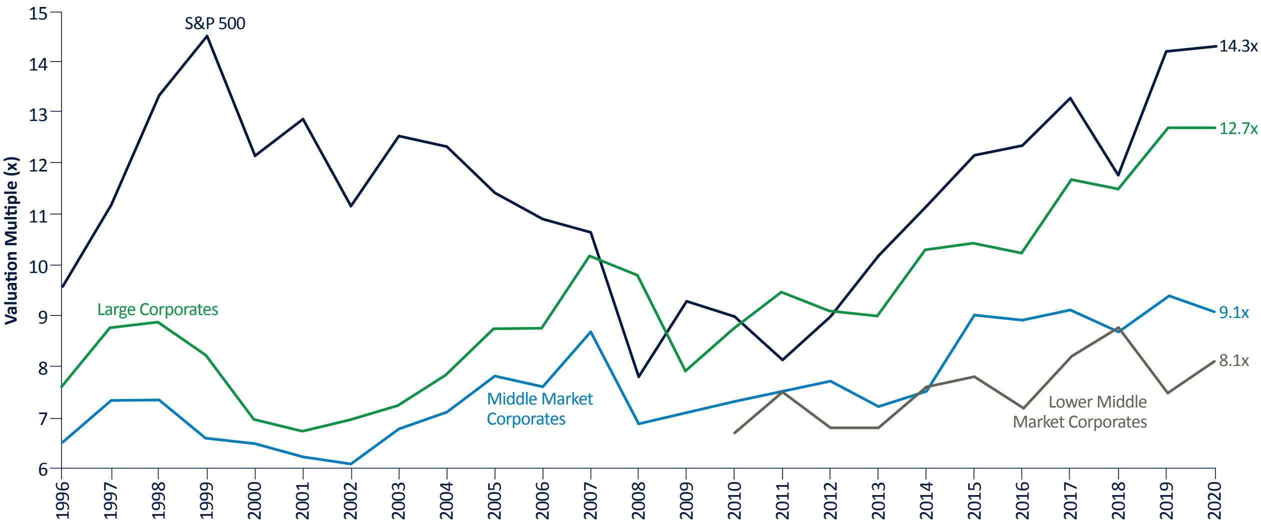
Prices for large cap buyouts have risen far faster than prices for middle market buyouts given that the bulk of the dry powder is sitting with funds of over $1B in assets, according to Bain & Company's 2020 Global PE Report. Nearly 50% of the dry powder is held by the mega funds raising recent vintages >$5B. The availability of debt financing for buyout deals, especially in the large and mega-cap spaces, continues to support the elevated purchase price multiples. In aggregate, in the US leverage levels rose to 6.3x EBITDA in 2020, as shown in Exhibit 5. We believe the headline numbers fail to tell the full story as the multiples are often pro forma for adjustments such as future cost synergies and one-time tax savings incorporated into the purchase price.

Exhibit 5
US buyout leverage levels have plateaued at c. 6x EBITDA



Source: *Pitchbook Annual PE Breakdown*

Exhibit 4
The spread between large buyout and middle market buyout multiples continues to widen



Note:

1. Large Corporates: includes US deals >$500M and price includes deal fees/expenses which are typically between 0.2x and 0.4x EBITDA

2. Middle Market Corporates: S&P Capital IQ M&A Stats Report used for 1996-2009 includes US deals <$250M; For 2010-2020, GF Data includes US deals for companies worth $100-250M TEV. Price includes deal fees/expenses which are typically between 0.2x and 0.4x EBITDA.

3. Lower Middle Market Corporates includes US deals for companies worth $50-100M TEV. Price includes deal fees/expenses which are typically between 0.2x and 0.4x EBITDA

Source: *Bloomberg, S&P Capital IQ, GF Data*

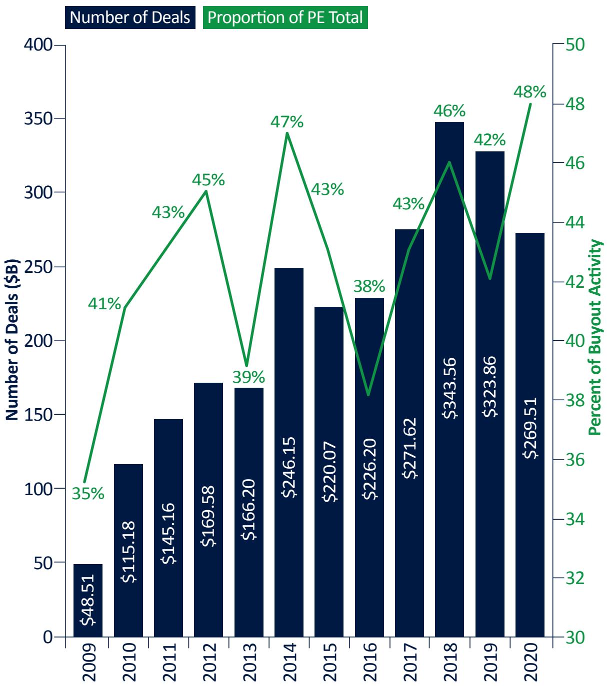
3. Private equity deal-making and exit activity pulls back amid stiff asset competition and COVID-19 dislocation

Elevated purchase price multiples have for several years created headwinds for dealmakers, and COVID-19 perpetuated this trend. In 2020, there were 5,900 buyout deals representing $443B in enterprise value, amounting to a year-over-year decline of -1% and -6%, respectively. These headline numbers are due to the fact that Q4 was the most active quarter on record with nearly 2,000 deals constituting $158B of value after a 30% year-over-year decline in the first half of 2020.

Even with headline deal volume and value declining, there was a resurgence of middle market deals as shown in the Exhibit 6 below. Deals requiring $100-500M of equity increased from 42% of deal activity last year to 48% in 2020. In addition, PE firms have increasingly pursued growth equity deals as a middle ground between venture capital and buyouts, offering the asymmetric upside potential while mitigating downside risk. Blackstone, Bain Capital, and other private equity platforms have launched growth equity funds in the past 12-18 months. According to Pitchbook, the growth equity strategy contributed $62.5B in deal value, up c. +9% from last year, with B2B software growth equity nearly doubling from $11.6B in 2019 to $20B in 2020.

Exhibit 6

In North America, 2020 was the year of middle market deal, with equity checks of $100M-$500M driving PE activity

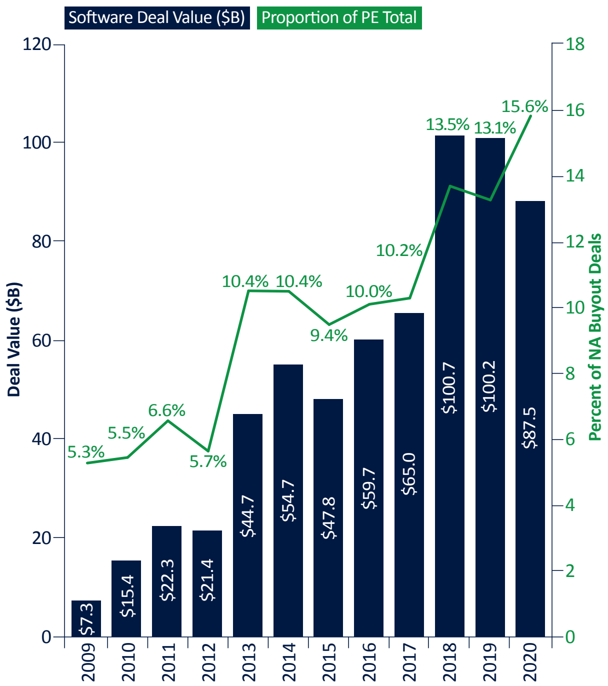


Source: *Pitchbook Annual PE Breakdown*

The economic uncertainty of the pandemic caused funds to flock to the historically recession-resilient sectors, namely software and healthcare. In addition to the virtual environment accelerating technology adoption, LPs and GPs alike recognise that PE firms can generate outsized post acquisition operational value add (PAOVA in software because companies typically have high recurring revenue from long-term contracts which allows the companies to remain profitable while undergoing change in the operating structure of the company. In addition, the business models are similar, so experienced operators can parachute in and recycle the same PAOVA playbooks across their portfolios. As shown in Exhibit 7, the aggregate value of North American software deals has nearly doubled in the past 5 years and now represents c. 16% of all deal volume up from c. 13% three years ago and just 6% eight years ago. Technology buyout sector specialists performed particularly well in the years during and following the GFC returning nearly +27% p.a. in the 2008-2011 vintages versus approximately +15%p.a. for PE generalists and +18% p.a. for PE specialists across all sectors. Healthcare deals still represented a large share of private equity activity at approximately 14% despite a moratorium on elective medical procedures during most of 2020.

Exhibit 7

In North America, Software buyout deals are increasingly popular among Private Equity GPs, a trend accelerated by COVID-19



Source: *Pitchbook Annual PE Breakdown*

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4. ESG and Impact investing

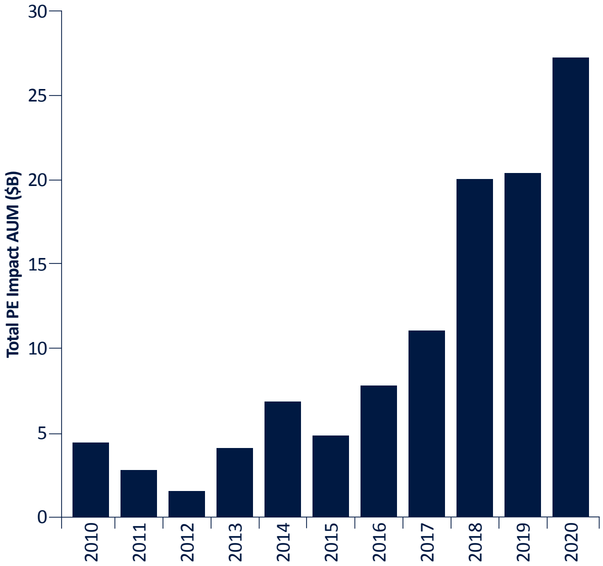
Private equity appears to be the asset class which has most broadly embraced integrating environmental, social and governance factors into their analysis supporting investments and management of their portfolio companies. The cost of addressing greenhouse gas emissions will be a major driver of financial performance for companies crossing virtually all industries, not just the energy industry. Private equity sponsors are majority owners focused on long-term value creation, which we believe affords them a greater opportunity to engage with management teams to understand these factors' impact on the business and craft and execute strategies to most effectively incorporate ESG considerations. Managers are increasingly integrating ESG considerations into their value creation playbooks. We believe integrating into the operational improvement plans should lead to higher valued assets upon exit. Estimates today suggest that less than 10% of the PE industry, measured in AUM, meaningfully measures and reports on ESG. A much larger portion of our current lineup of private equity firms in which our clients are invested, are meaningfully integrating ESG factors into their investment process and reporting on that activity to investors. We expect that within the next three years, ESG integration will be embraced by virtually all private equity firms.

Separate from ESG integration of the PE investment process, institutional investors are shifting their asset allocations in private equity in the direction of high impact sectors such as renewable energy, healthcare, and education. In addition, many generalist firms have launched "impact funds" which are skewed toward these sectors and are focused on companies where they see substantial opportunity for transforming their environmental or social impact in a material way in a broad array of sectors. Bain Capital, KKR and TPG are the most notable new impact fund launches with TPG now on their third fund launch. It is too early to say that such generalist PE firms will be successful in generating the same level of returns from their historical core strategies. The 2005-15 cleantech sector investments proved to be the worst performing sector for private equity in the asset class' history, so investors are wary of a repeat of that experience and are highly selective. However, it is clear that the opportunity set of profitable attractive companies in the power, energy efficiency, transport and scarce resource management sectors that aim to have major environmental impact is considerably larger than it was when too much money chased too few opportunities in the cleantech debacle.

The Global Impact Investing Network estimates that public and private impact investing market size was $715B in 2019[1] and has grown +39% per annum since 2014. As shown in Exhibit 8, we estimate that PE impact fundraising has increased from $5B in 2010 to $27B in 2020. We expect this trend to continue as large PE platforms raise dedicated impact funds.

Exhibit 8

Impact AUM has increased more than five-fold in the last decade



Source: *Global Impact Investment Network*

We expect ESG / impact investing to serve an increasingly important role in our investment program going forward.

5. Venture Capital's exponential growth accelerates in the backdrop of COVID-19

On March 5th, Sequoia Capital sent an email to its founders and CEOs entitled "Coronavirus: The Black Swan of 2020". The note urged portfolio companies to take swift and decisive action to prepare for a downturn that central banks would likely struggle to control. In the weeks that followed, large and small technology startups across the globe shifted their focus from growth to survival. The second quarter opened with sweeping cost reductions in force. Airbnb, which entered 2020 with annual revenues approaching $5.0B and near-term plans for an IPO, reduced its headcount by -25%.[2] Toast, a restaurant management software company that started the year by raising $400M at a $5.0B valuation, reduced its headcount by nearly -50%. Several startups reopened or extended recent funding rounds or turned to debt providers to further bolster their balance sheets. By Q3 2020, the median startup had extended its cash runway from 12 months in Q1 2020 to 20 months, with the largest companies having over 3 years of cash runway.[3]

[1] https://thegiin.org/research/publication/impinv-survey-2020

[2] https://www.svb.com/trends-insights/reports/state-of-the-markets-2020-q4-report

[3] https://www.census.gov/retail/mrts/www/data/pdf/ec_current.pdf

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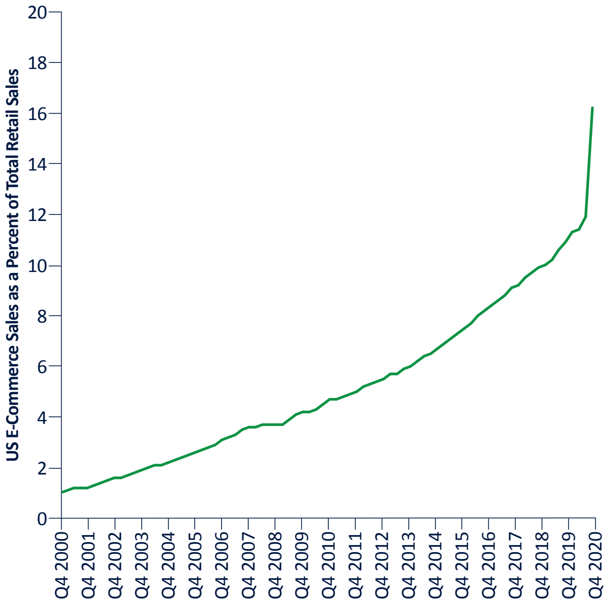
While these defensive actions appeared prudent in the face of a global health crisis, the COVID-19 pandemic ultimately did not materialise as a Black Swan event for the venture capital industry. The pandemic ultimately caused an acceleration of existing technology adoption trends by forcing consumers to buy online and work remotely. US retail e-commerce sales grew by nearly +45[4] year-over-year in the second quarter. Video conferencing platform Zoom experienced growth in its peak daily meeting participants from 10M at the end of 2019 to over 300M by April 2020[5] as working, learning, and socialising from home became the only option in most communities. Mobile banking traffic grew by +85% in April[6] alone. Software became a necessity, rather than a luxury, in underpenetrated industries like education.

Exhibit 9

US retail e-commerce sales grew by nearly 45% year-over-year in the second quarter, as social distancing mandates accelerated its adoption

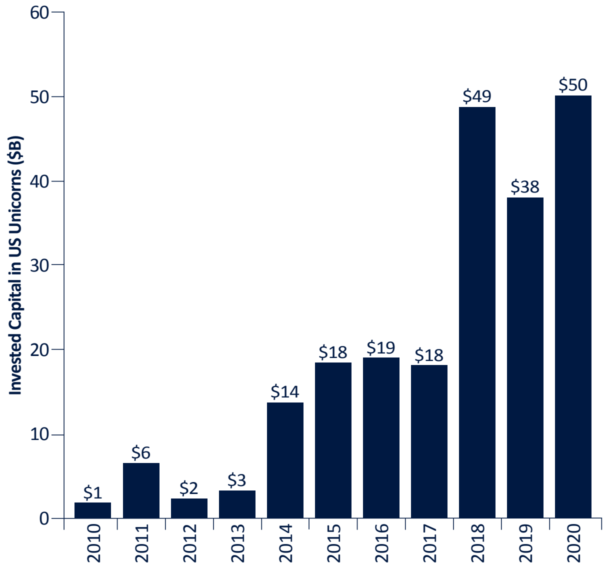


Source: *US Census Bureau*

As these trends materialised, startups and VCs shifted their focus from defense to offense. Investment in "unicorns", private venture-backed companies valued at $1.0B or greater, surged in Q2 and Q3 as investors favored companies that were well positioned to capitalise on the accelerated technology adoption. By the end of 2020, investment in US-based unicorns had reached $50B, representing +30% year-over-year growth and surpassing the previous record for this category in 2018[6]. Overall, venture capital investment grew by +4.0% year-over-year globally,[7] a meaningful turnaround following the melancholy outlook in March.

Exhibit 10

Investment in "unicorns" surged in Q2 and Q3 as investors favored companies positioned to capitalise on rapid technology adoption



Source: *Pitchbook*

Lower discount rates and the prospect of accelerating revenue growth during a time of broader economic contraction meaningfully increased valuations of technology companies in 2020, particularly in software. The average annual recurring revenue ("ARR") multiple for public software as a service ("SaaS") companies increased from 9.8x to 16.6x[8] in 2020. The average forward revenue multiple for public SaaS companies with revenue growth rates in excess of 50% is currently 29.5x.[9]

[4] https://www.businessofapps.com/data/zoom-statistics/#:~:text=Why%20ever%20people%20chose%20the,10%20million%20in%20December%202019.

[5] https://www.paymentsjournal.com/covid-19-gives-digital-banking-a-big-boost/

[6] https://assets.kpmg/content/dam/kpmg/xx/pdf/2020/10/venture-pulse-q3-2020-global.pdf

[7] https://news.crunchbase.com/news/global-2020-funding-and-exit/

[8] https://www.saas-capital.com/the-saas-capital-index/

[9] https://www.bvp.com/bvp-nasdaq-emerging-cloud-index

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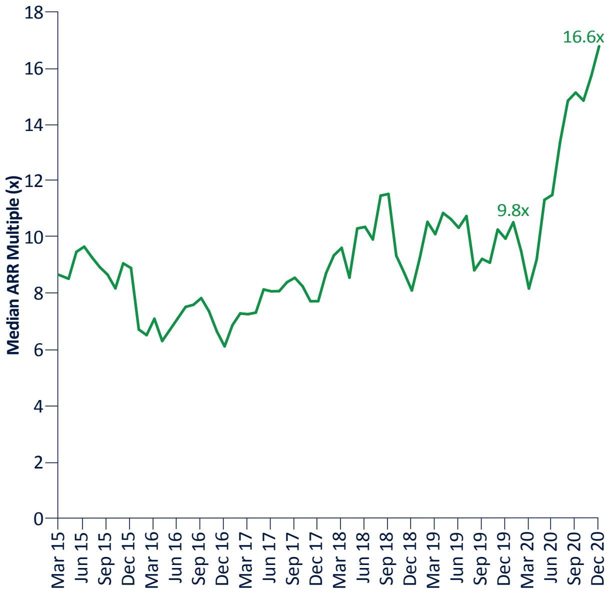
Exhibit 11

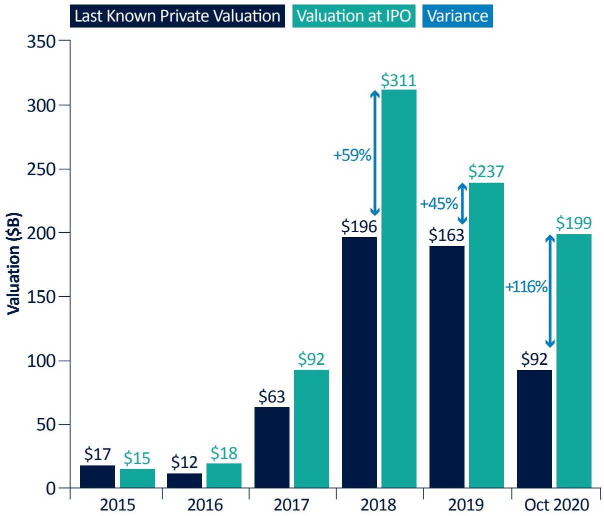
Valuation multiple expansion was most evident in the software sector, as median ARR multiplesor public SaaS companies grew from 9.8x to 16.6x in 2020



Source: *SaaS Capital Index*

Exhibit 12

The valuation increase at IPO or venture-backed technology companies reached its highest level in five years



Source: *Crunchbase, Unicorns get more magical: 2020 cohort shows huge increase in valuation on IPO day*

The latter half of 2020 was also marked by a flurry of venture capital-backed IPOs. Cloud data-storage and analytics provider, Snowflake, completed the largest software IPO in history, valuing the company at $33B. Data analytics software provider, Palantir, finally went public after nearly two decades of VC funding.

Airbnb ended its rollercoaster year with an IPO at a $47.0B valuation, more than 2.5x the valuation struck for the company in April 2020. By mid-December, US stock exchanges had hosted 120 venture capital-backed IPOs worth nearly $260.0B,[10] as private companies and their investors sought to capitalise on the expansion of public market valuation multiples. The valuation premium offered by the public markets reached its highest level in five years, with the average unicorn seeing a +116% increase in valuation between its last known private round and its valuation at IPO[11] in 2020 relative to +45% in 2019. The broader adoption of IPO alternatives, such as the reverse merger with a publicly traded shell companies (or SPAC), also enabled less mature startups to capitalise on the strong demand for technology companies among public market investors.

The current venture capital landscape presents new opportunities and challenges for investors. 2020 may represent an inflection point for technology adoption and we are still in the early innings of digital transformation for many industries. Even after the sales growth experienced in 2020, e-commerce represents less than 15% of the $5.5T+ US retail market. SaaS revenue is estimated to represent less than 20% of enterprise software spend globally. The vast majority of market value still sits with incumbents in the financial services, healthcare, entertainment, and transportation sectors. These large and underpenetrated markets present a significant opportunity for innovative, tech-enabled challengers. At the same time, rising valuations and the rapid capital deployment across the industry suggests that indiscriminate investors may give back gains in the years to come, despite the favorable growth environment.

10 https://pitchbook.com/news/articles/2020-vc-in-charts

11 https://www.bvp.com/atlas/state-of-the-cloud-2020

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2021 Investment Strategy

Middle market buyouts

Our historical focus on middle market buyout funds continues for 2021 for three key reasons: 1) clearer opportunities for value creation, 2) lower reliance on leverage, and 3) lower purchase prices. Middle market companies tend to compete in niche sectors offering multiple value creation vectors including acquiring accretive and transformational add-ons, upgrading management teams, and expanding the company's total addressable market or product set. Middle market deals are less reliant on leverage to boost returns, minimising risk. Finally, by professionalising a middle market business, one can expect to achieve higher multiples as well as higher earnings upon exit. Since 2008, middle market funds generated +1.3% alpha over the average buyout fund and +1.1% of alpha over the broader private equity market in the State Street Buyout Index.

Sector specialists

Sector specialists should have competitive advantages in sourcing and value creation relative to generalist buyout firms which allows them to outperform in all market environments. Exhibit 13 evaluates the returns of specialists and generalists across the past 10 vintages. On average, specialists generated +200 bps of alpha over generalists. The key drivers of specialist alpha are technology and healthcare managers, which have produced +6.6% and +6.2% of annual outperformance, respectively, in the past 10 years.

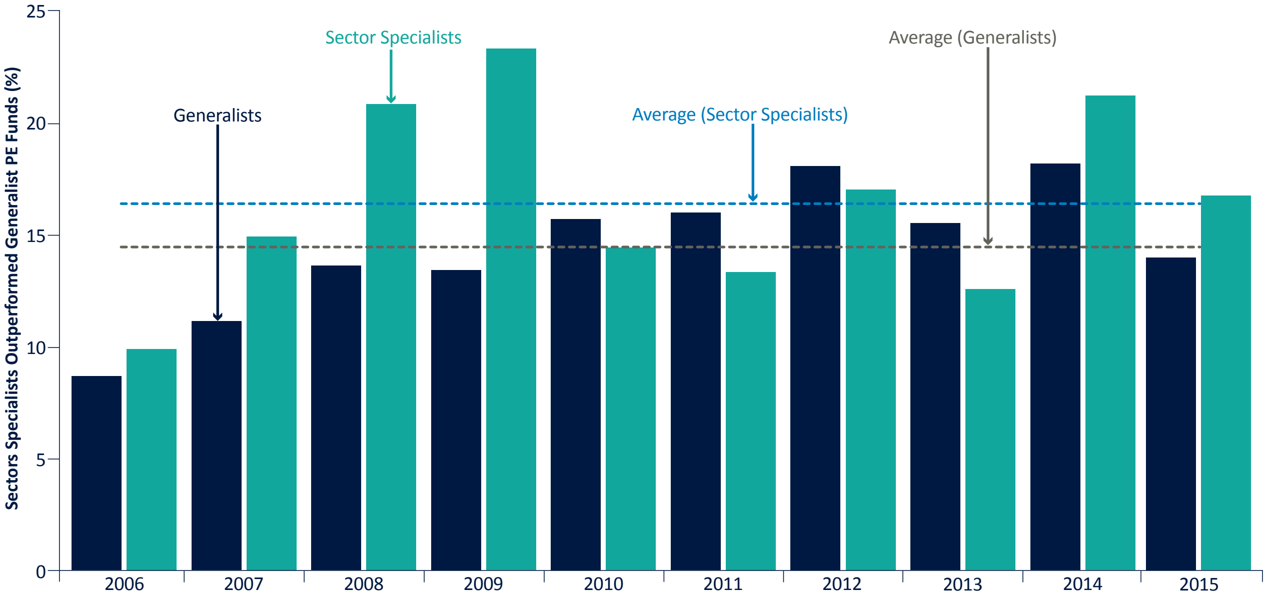
Emerging managers

Although Partners Capital has been committing regularly to emerging managers (defined as the first or second fund of a given GP) since the inception of our PE program, they have remained a relatively small part of our overall dollar value of investments. We view an increased allocation to emerging managers as a way to get exposure to lower middle market ("LMM") deals that are more inefficiently priced and present lower valuation and lower risk of multiples declining at exit – something particularly important at this point in the cycle. Almost all emerging manager investments have us backing individuals or teams that have spun out from top PE firms. We aim to back teams that have worked together before, who we believe have an extraordinary established track record and are looking to pursue an investment strategy similar to what they did before. Very often, the spun-out team is seeking to return to a situation similar to what they experienced earlier in their predecessor firm's history which manifested a less competitive market and some of that firm's highest returns.

With the continued maturation of the PE market, there now exists a large pool of well-trained and experienced executives who received their training at large, brand-

Exhibit 13

Sector specialists have outperformed generalist private equity funds



***Note:** Emerging manager defined as a first or second fund <$1B*

***Source:** Preqin Private Equity Online*

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name firms. A number of them each year decide to strike out on their own and raise their debut funds, and they constitute the primary target of our emerging managers program. While we are backing new firms, the people leading them are all but new to the PE industry. The typical profile is a team (who in the majority of cases worked together at the same firm previously) headed by partners in their late-30s/40s and that have at least 10-15 years of PE experience. All 6 of our 2020 commitments are headed by former partners at well-respected firms. We reviewed over 70 similar funds in North America alone last year, indicative of the deep pool of opportunities.

A key reason to pursue emerging managers is to access high quality lower middle market (LMM) buyout exposure, which is difficult to achieve otherwise as successful LMM GPs either raise larger funds (moving to the MM segment) or are not taking new LPs. As mentioned previously, we believe LMM exposure is additive to returns as there typically is less competition and lower entry valuations. In addition, there are ample opportunities for value creation, particularly if the company is ripe for its first round of professionalisation.

As shown in Exhibit 14, empirical data shows that emerging managers outperform established ones by ~1% IRR on average, despite the start-up risk. This is due to the more favorable LMM beta mentioned above, more motivated teams, better alignment of incentives with shareholders, appropriately-sized funds and fewer distractions from legacy portfolios.

The potential manager selection alpha available with emerging managers is also materially higher than elsewhere as evidenced by the higher performance dispersion among emerging managers.

Finally, our observation has been that emerging managers tend to embody a more diverse and inclusive team than the larger long-established firms and, as one of their larger investors, we can engage proactively to promote what we believe to be best-practice in diversity, equity and inclusion policies to a team that is generally more receptive to LP input.

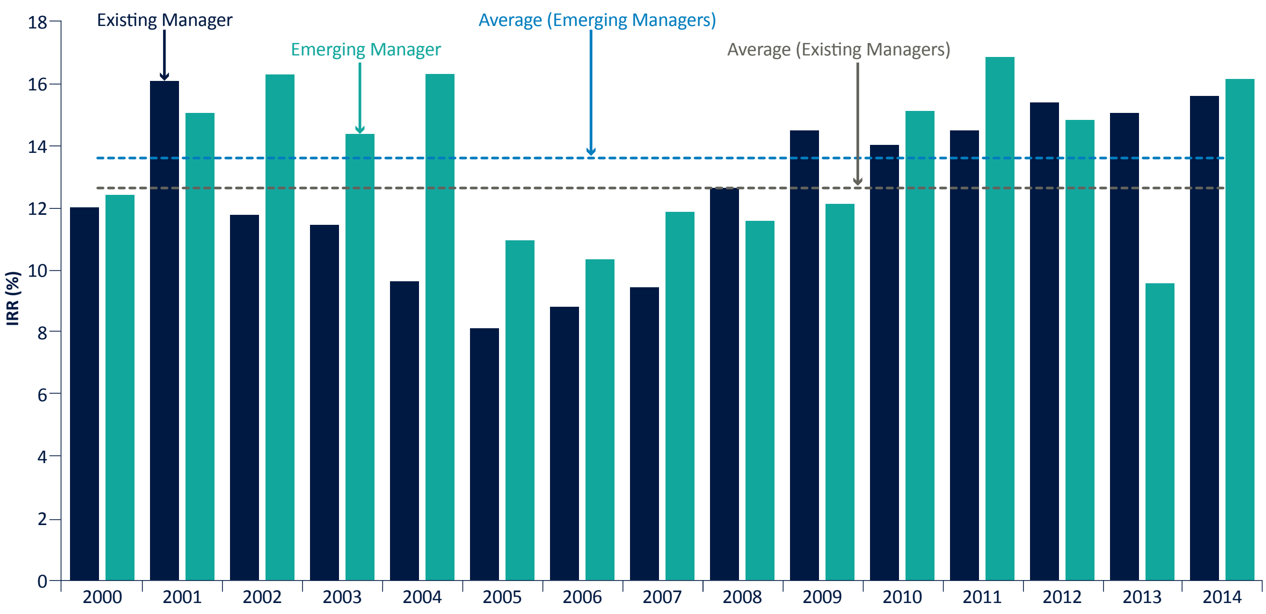
Next Generation Venture Capital firms

Our target allocation to venture capital remains at 20% (10% to early stage / late stage VC and 10% to growth equity) of our total allocation to private equity.

We continue to allocate to both established firms and the next generation of venture capital talent. The core component of our VC program has been to maintain or

Exhibit 14

Emerging managers have outperformed their predecessor funds



Source: *Preqin Private Equity Online*

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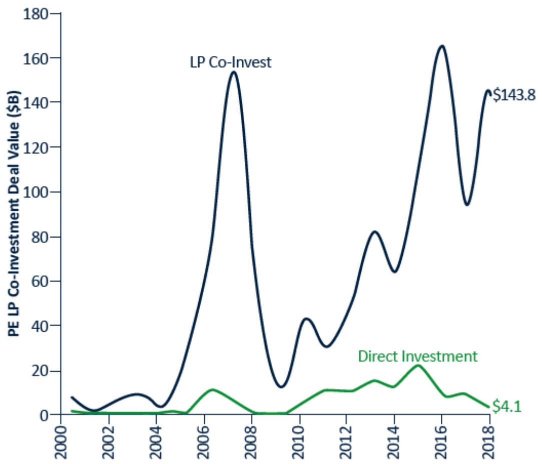
increase exposure with a few successful, established firms that have generated strong performance persistence. We seek to supplement our allocation to established managers with those who we view as the next generation of venture capital talent. This category focuses on emerging managers that we believe have the potential to outperform, in large part due to smaller fund sizes and heavy skews towards early-stage investments. Within this category. we have backed a spinout from our established manager lineup, a well-regarded angel investor and operator, and the former head of strategic investments for a large technology company in China. We expect to continue to opportunistically add emerging managers that meet our criteria in the coming years.

Co-investments

Co-investments offer LPs the ability to select transactions with full access to the sponsor's due diligence, our own second set of eyes applied to that due diligence and reduced fees compared to private equity fund investments. LP appetite for co-investing is at an all-ti me high. In an Intralinks – SS&C survey, 64% of LPs indicated that direct or co-investment was their preferred mechanism of accessing private equity deals, driven by increasing potential returns, improving alignment of interest, and more rapidly scaling their private equity programs. As shown in Exhibit 15, LP co-investment volume has increased nearly ten-fold since 2009 from c.$15B to c.$143B in 2018.

Exhibit 15

Co-Investment market has grown tenfold since the GFC



Source: Pitchbook

Our track record demonstrates both key benefits of co-investments: reducing fees and offering additional diligence data that we believe can increase deal selection alpha.

A key driver of the potential to generate positive deal selection alpha by co-investing is the inefficiency of deal flow. GPs typically offer co-investments to a small subset of their LPs, of course selecting their largest and most value-adding LPs, but with a bias toward those who are seasoned co-investors set up to respond quickly with high certainty of taking up the capacity. Due in part to these factors, Partners Capital is frequently one of a small number or the only co-investor presented with an actionable opportunity.

Partners Capital's 2021 private equity co-investment strategy continues our pursuit of low-fee opportunities alongside partners whom we believe to be best-in-class emerging managers and sector specialists investing in our target themes including technology, technology-enabled services, life sciences, and China.

Alongside our historic practice of co-investing with managers with whom we have a fund commitment, we have increased our investment activity with managers with whom we do not have a fund commitment. These may be independent or fund-less sponsors or funds seeking capital outside of their LP base as they seek to expand their network of potential future investors. In these deals, we are sometimes the only co-investor or one of a small number of potential partners shown these opportunities, which often come with attractive terms and frequently are among a manager's highest conviction investments.

ESG and Impact Investing

ESG Integration. We believe that managers who assess and improve the environmental, societal and governance characteristics of all of their portfolio companies, in addition to deploying their PAOVA playbook, have the potential to generate higher levels of outperformance. We look for managers that not only incorporate ESG factors into their due diligence but work proactively with their portfolio company management teams to tackle the challenges and opportunities that environmental and social factors will present to their businesses. We also expect high quality PE firms that we back will work hard to measure the impact that their portfolio companies are having on the planet and society and actively improve the impact they are having over time.

Investing in High Impact Sectors. We believe that private equity investments in high impact sectors such as environmental impact, resource efficiency, healthcare, financial inclusion and education have strong potential for outperformance. Within the environmental impact sector, we look for managers focused on investing in the most critical components of the decarbonisation value-chain, these businesses generally being supported by favourable regulatory tailwinds. Examples include energy management software, electric vehicle components,

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fleet telematics, sustainable packaging, smart building management software, etc. We seek to avoid Environment Impact investors focused on low-yielding infrastructure investments, commodity-like sectors (e.g., biofuels) or those sectors facing high levels of regulatory uncertainty. We also prefer investors in proven businesses and shy away from venture capital end of these high impact sectors, although many of these businesses will be technology solutions to decarbonisation, education, and healthcare. We are careful not to underwrite strategies which have a lower return expectation or higher risk than what we typically target for our private equity program.

Private Equity Portfolio Construction

Exhibit 16 contains our framework for an optimally constructed private equity portfolio. Our ongoing monitoring and analysis of the best performing private equity portfolios continues to make the case for a well-diversified portfolio across the key dimensions of strategy (e.g., buyouts, growth equity, venture capital), market capitalisation (deal size), sector, geography, holding type (primary fund, secondaries and co-investment), and manager maturity. With a few notable exceptions, we do not believe that any significant subsector of the global private equity business can be ignored without running an unnecessary risk of underperforming vs. the average private equity investor. Blanket policies such as avoiding large cap buyouts, Asian private equity or healthcare buyouts have cost investors dearly in relative performance at various points in the past. The target allocation proposed here may vary by vintage and represents a rolling forward five-year target and reflects targets for our largest portfolios.

— **Strategy:** Our largest target allocation is 40% to sector specialist buyouts which is our most significant overweight relative to the PE market weight of 13%. There are four key sectors where we make specialist allocations: technology, consumer, healthcare, and industrials. We most consistently allocate to technology as the historical track record and quality of current opportunities are most compelling. We target 30% to generalists who have developed "multi-sector specialist" capabilities around key deal types (e.g., corporate carve-outs, buy-and build) or skillsets (PAOVA, digital strategy, or talent management). Our long-term target to the combination of growth equity and venture capital is 20%. A smaller percentage of VC funds pass our due diligence, so in certain years we may meaningfully deviate from our target. Our VC strategy is primarily US and B2B-focused with an even distribution between early and late-stage funds. We may opportunistically allocate to distressed managers if more compelling opportunities become available as they did in the post-GFC vintages.

— **Sector:** We invest broadly in line with the PE industry mix of sectors with a 35% allocation to technology representing 10% higher than the PE market. This reflects our access to extraordinary managers in this sector, with a particular skew towards software businesses where private equity firms make excellent owners due to their well-developed PAOVA playbooks.

— **Market Capitalisation:** We believe lower middle market / middle market deals have greater inefficiencies in sourcing a stronger score for PAOVA by professionalising companies as the first institutional owner. Our 40% and 30% allocations to lower middle market and middle market constitute 16% and 6% overweights, respectively, relative to the broader PE market. But we continue to have relationships with large-cap buyout firms including software specialists and multi-sector specialists, almost always in possession of heavily resourced in-house operational teams with proven track records of growing earnings of their portfolio companies.

— **Geography:** Our target exposure is roughly two-third to US investments (10 percentage points more than the broader industry) largely due to the robust deal flow and greater ability to generate PAOVA. For Condor and our larger clients investing directly into primary funds, we generally intend to commit to at least one manager in Europe and Asia per year.

— **Holding Type:** The 10% target to secondary interests in funds and deals represents what we expect for a mature PE portfolio. Many of our clients will have higher allocations in their early years of ramping up, but rarely more than 25%. The 10% base level reflects the confidence we have in a very small number who we view as extraordinary secondary fund investors where we have deep relationships, we can leverage by comparing notes on the broader industry. We are targeting 25% to co-investment based on our projected future flow of opportunities. This leaves the remaining 65% targeting primary fund investments.

— **Manager stage (primaries only):** We continue to have conviction that the high dispersion in emerging managers creates a strong opportunity to identify teams who can outperform over the broader PE market as well as are aligned with our DEI mission. As such, we have increased our strategic asset allocation (SAA) to emerging managers from 20% to 25%. With the entire roster for any given vintage, we hope to identify 3-5 emerging managers each year. Our emerging manager program is primarily focused on lower middle market / middle market buyouts.

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Exhibit 16
Dimensions of portfolio construction

Portfolio Construction Dimension	PE / VC Market	Target Forward 5–Year Average Exposure
Strategy		
Specialist Buyout	13%	40%
Generalist Buyout	37%	30%
Venture Capital (early and late stage)	21%	10%
Growth Equity	19%	10%
Distressed / Special Sits / Other	11%	10%
Market Capitalisation (buyout investments only)		
Small/Lower Middle Market	24%	50%
Middle to Upper Middle Market	24%	30%
Large/Mega Cap	52%	20%
Sector		
Technology (inc. software, hardware)	37%	35%
Business Services	10%	10%
Consumer (inc. consumer tech, retail)	15%	20%
Healthcare	13%	15%
Industrials	12%	15%
Other	14%	5%
Geography		
North America	55%	65%
Europe	17%	25%
Asia including China	25%	10%
Emerging Markets	3%	—
Holding Type		
Primary Fund	78%	65%
Secondary	5%	10%
Co-investment	16%	25%
Manager Stage (primary investments only)		
Emerging Managers (Fund I or II)	13%	25%
Mature Managers	87%	75%

Note: Sector allocations in PE/VC market are based on buyout only.
Source: *Preqin Private Equity online. Data was compiled based Preqin sample of the average dollar-weighted commitments in the last 5 years.*

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