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Buyouts

Major Trends

Unprecedented deal and exit activity: In 2021, total deal activity was $804B, a record year representing 70% more than the $473B for pre-pandemic 2019.[1] Buoyant listed equity markets facilitated record-setting exit activity of $767B – a 92% rise on 2019.[2]

Strong competition for assets driving record purchase prices: Buyout sponsors sought to deploy a record backlog of $910B of dry powder, creating intense competition and helping to inflate purchase price multiples to a new record of 13.8x EBITDA as shown in Exhibit 1.[3] Sponsors paid median multiples of 20.1x and 15.5x EBITDA, respectively, for software and healthcare assets[4], indicating a substantial premium for resilient assets with high growth, high margins, and strong free cash flow generation.

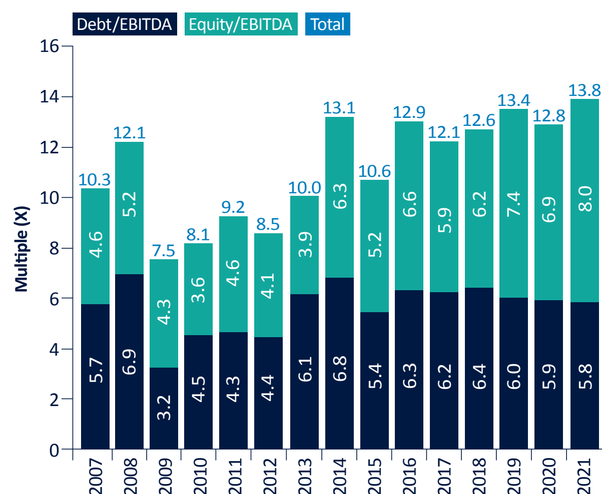
Uncertain macro backdrop drives increased importance of operational value-add: The recent increase in inflation and expected policy response by central banks could increase the cost of debt and/or compress valuations, thus putting the onus on significant earnings growth to create value. Our managers report the most macroeconomic uncertainty in recent memory, including supply chain shocks, geopolitical issues affecting certain deals, volatile growth forecasts, and labor shortages at portfolio companies. As such, we believe post-acquisition operational value add ("PAOVA") is the most persistent source of performance in private equity.

Strong fundraising activity: PE funds raised $822B across more than 2,500 funds driven primarily by large cap / mega-funds with LPs largely concentrating capital in scaling existing relationships.[5] The record fundraising activity is also driven by funds coming back to market at a record pace, with average time frames between PE funds dropping to 3 years in 2021 from 4.5 years in 2014.[6] Approximately 90% of LPs aim to maintain or increase their allocations to PE, which potentially supports additional fundraising growth in 2022 and beyond.[7]

Proliferation of General Partner (GP)-led secondaries / continuation funds: Continuation funds have soared in popularity as a means for GPs to provide LPs with liquidity, to crystallise carried interest at high valuations, and to hold promising assets for longer. There were c.$23B of such deals in the first half of 2021, versus less than $4B in all of 2018, according to estimates from Greenhill and Evercore.[8] Many of our managers have launched continuation funds. In most cases we would elect to sell our holdings unless we have strong conviction in the underlying portfolio company and the go-forward value creation plan, as well as a high degree of alignment with the sponsor.

Exhibit 1

US buyout valuations and leverage levels indicate highly competitive deal environment



Source: *Pitchbook 2021 PE Breakdown*

1. Preqin, 2022 Preqin Global Private Equity Report, January 2022
2. Ibid.
3. PitchBook, 2021 Annual US PE Breakdown sponsors, we have preferred North American buyouts
4. PitchBook Analyst Note: Exploring Global PE Multiples by Sector, July 2021
5. Preqin Private Equity Online 0 6 PitchBook, H1 2021
6. Pitchbook, 2021 Annual US PE Breakdown
7. Preqin, Investor Outlook: Alternative Assets, H1 2021 8 Private
8. Private Equity International, December 2022, Continuation funds: What their growing popularity could mean for PE

US-20231017-3168145

Private Equity
continued

Golden Rules

- Invest in lower middle market strategies where the greatest market inefficiency resides.
- Invest with managers who have demonstrated PAOVA capabilities.
- Invest with young, hungry teams trained by top-tier private equity firms or who are former business owners-operators.
- Co-invest with who we believe to be best-in-class managers to lower fees, mitigate the j-curve, and concentrate exposure in exceptional investments.

Sub-Strategy Attractiveness

Sector specialists: Favourable view. Specialist capabilities in sourcing, underwriting, and post-acquisition value creation can offset the impact of the highly competitive deal environment. We maintain the view in the current climate that sector specialism is a competitive advantage.

Lower mid-market buyouts: Favorable view. Assets are priced more competitively than large cap assets, enabling managers to capitalise on inefficiency to develop asymmetric risk-reward profiles.

Large cap buyout: Neutral view. Excess capital, higher prices, and increased reliance on public markets for exits make the space challenging. However, there are still opportunities for managers with strong value-add capabilities.

European buyouts: Neutral view. While we have selectively allocated to European sponsors, we have preferred North American PE given what we view as more favourable supply-demand dynamics around innovative technology and healthcare deals. We note that the Preqin North American Private Capital benchmark has outperformed the European Private Capital Benchmark over each of the last 1,3,5, and 10 years.[9]

Asia/Emerging markets buyout: Cautious view. We believe we can generate comparable or better returns in North American buyouts with lower degrees of currency, regulatory, and/or geopolitical risk.

Distressed/turnaround: Cautious view. We prefer to allocate to complex situations generalist buyout managers whom we believe can opportunistically invest during market dislocations but also generate substantial outperformance in stronger markets.

2022 Strategic Priorities

- Deepen relationships with our highest conviction managers: As of 2021, we have 17 manager relationships with over $200M of exposure and our top five manager relationships account for approximately 25% of our total private equity portfolio. We are working to strengthen our relationships with our highest conviction managers to enhance knowledge sharing, reduce fees for our clients, and ensure that Partners Capital is a first-call co-investment partner and solution provider.
- Impact: In Q1 we are launching a new pooled vehicle, the 15 degrees Fund, that will aim to make fund investments and co-investments with a sustainable impact theme.[10] The primary focus will be on environmental impact with a secondary focus on social impact themes such as healthcare, education and financial inclusion.

9 Preqin Private Equity Online
10 Not all investments will necessarily be branded as 'sustainable' or 'impact' investments and investments may have varying degrees of impact.

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Venture Capital

Major Trends

Near-record returns for the 12 months to Q3 2021: Global Venture Capital ("VC") funds returned +75.4% on a one-year trailing basis, as of Q3 2021.[1] This compares to +49.3% for broader Private Equity.[2] The asset class has not produced returns of this magnitude since the late 1990s. Strong near-term performance brings 10-year trailing VC returns to +20.2%, compared to +16.1% for PE.[3] Recently, expectations of higher interest rates have driven a correction in publicly traded technology companies. While we do not yet have visibility of how much this impacts private markets, we expect any sustained volatility to result in mark-downs in the coming quarters.

Exits reached multi-year highs but uncertainty looms ahead in 2022: Total exit value in the US alone surpassed $774B, an increase of more than 2.5x the prior year. Most of these exits, over $681B, were through the public markets.[3] Despite the strong exit environment during the year, post-IPO performance has been volatile. Newly public companies were vulnerable to the correction in technology stocks in the second half of 2021, with high growth non-profitable companies experiencing the largest drawdown. The year ended with just 34% of all US IPOs above their offering price.[4]

Growth in funding and accelerating investment pace: Global VC investment has grown by +41% per annum over the past five years, surpassing $790B in 2021.[5] The acceleration in deployment by both marquee firms and non-traditional investors[6], particularly in later stage funding rounds, is a key driver of capital growth. Non-traditional investors now account for 53% of invested capital in the US.[7]

Rising valuations across stages: The flood of capital into the asset class has led to higher valuations across stages. Median revenue multiples for US early-stage companies have increased from 10.6x in 2016 to 17.6x in 2021, while median late-stage multiples have increased from 7.9x to 20.0x.[8]

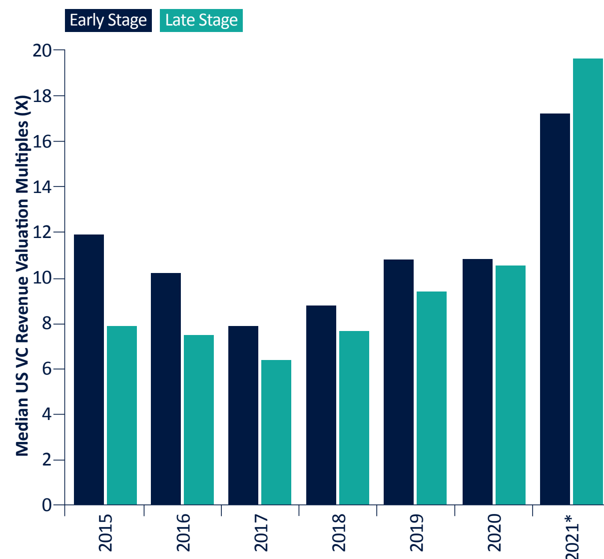
Expansion of the technology sector and accelerating adoption: Digital transformation continues to be a key driver of productivity and growth across industries. Technology-enabled companies are disrupting traditionally non-tech industries, increasing the total market opportunity for the category. Blockchain and climate tech are growing into sizeable markets with VC investment of $33B and $37B, respectively.[9] Furthermore, the COVID-19 pandemic has forced both consumers and businesses to accelerate their adoption of new technology over the near-term.

1 State Street VC Index (USD) Trailing 1 year net IRR as of Q3 2021
2 State Street ALL PE Index (USD) Trailing 1 year net IRR as of Q3 2021
3 State Street Venture Capital Index (USD) and State Street ALL PE Index (USD) Trailing 10 year net IRR as of Q3 2021
4 WSJ, December 2021 "IPOs Had a Record 2021. Now They Are Selling Off Like Crazy"
5 Preqin Private Equity Online
6 "Non-traditional investors" include crossover investors and corporate venture capital.
7 Q4 2021 PitchBook-NVCA Venture Monitor
8 Pitchbook, January 2022 "Why some VCs are hopeful of a pullback in sky-high valuations"
9 CB Insights, February 2022 "State of Blockchain 2021" and HolonIQ,

US-20231017-3168145

Private Equity
continued

Exhibit 2
Median US VC revenue valuation multiples



Source: *Data of Jan 10, 2022, multiple is defined as post-money valuation divided by trailing 12 months revenue*

Golden Rules

- Manager selection is paramount given the wide dispersion of outcomes in venture capital.
- Higher rates of performance persistence are explained by a startup's preference for proven investors and operators, leading to preferential access for a select number of firms. Invest with managers that possess this unique and repeatable access advantage.
- Invest across the startup lifecycle as non-linear growth presents opportunities to capture venture-like return across stages.
- Steady commitment pacing across vintages is essential as innovation is uncorrelated to market cycles.

Sub-Strategy Attractiveness

US and Europe early-stage: Favourable view. Companies raising early-stage financing are more mature compared to prior decades and entry valuations are relatively attractive.

Technology: Favourable view, as digital transformation of the economy remains a dominant global trend and innovation presents outsized return opportunities.

China early-stage: Favourable view. Similar dynamics as US/Europe early-stage market and less regulatory risk than the late-stage market.

US and Europe late-stage: Neutral view given the significant increase in late-stage valuations and increased competition from traditional and non-traditional investors.

China late-stage: Cautious view. Regulatory actions on both sides of the Pacific squeeze China's technology industry and create unpredictability for investors.

Biotech: Cautious view due to lacklustre performance relative to technology funds and ample opportunities in public equities.

US-20231017-3168145

2022 Strategic Priorities

- **Launch a specialised vehicle to streamline investment in VC funds:** We are evaluating the launch of a new vehicle to enable clients to more efficiently invest in access-constrained VC funds that have short fundraising timelines and strict limits regarding the number of limited partners permitted to invest in each fund.
- **Increase exposure to early-stage VC:** Valuation growth in early-stage financing rounds has lagged late-stage rounds and companies can benefit from the increased demand for late-stage opportunities.
- **Identify the next generation of VC talent:** We are constantly seeking to identify highly motivated teams of diverse and experienced investors that are building the next generation of marquee VC firms.

Expected 12-Month Returns

Our 12-month returns by scenario are shown in the table below. However, short-term returns are less relevant for private equity. Over the full cycle we expect our clients will earn an average 12.0% annual return outperformance from manager selection from Private Equity: 6% beta return (based on an equivalent net equity beta of 1.0), 4% driven by the illiquidity premium, and 2% of additional manager alpha.

Exhibit 3

Expected returns by scenario

	Recovery Falters (10%)	Stagflation (10%)	Gradual Normalisation (60%)	Reflation 2.0 (20%)	Expected Value
Private Equity	-12.8%	-7.1%	14.3%	20.5%	**10.7%**
Notes	Assumes 4% alpha and 2% manager alpha over beta of 1.0x DM equity beta.				

Note: *Return assumptions are for the 12 months from 31 January 2022.*

Hypothetical return expectations are based on simulations with forward looking assumptions, which have inherent limitations. Such forecasts are not reliable indicator of future performance.

US-20231017-3168145

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