Partners Capital Annual Client Meeting

Executive Summary

25th October 2016, 12:00 – 7:00pm
St. Pancras Renaissance Hotel, London

Time	Speaker	Topic
12.00 – 1.00pm	Buffet Lunch	
1.00 - 1.25pm	**Stan Miranda, CEO, Partners Capital**	**Active Investing**
1.25 - 2.05pm	**Ronen Israel, Senior Partner, AQR Capital Management**	**Absolute Return**
2.05 - 2.40pm	**Lars Förberg, Managing Partner, Cevian Capital**	**Public Equity**
2.40 – 3.00pm	Break	
3.00 - 3.35pm	**Manish Chande, Senior Partner, Clearbell Capital LLP**	**Real Estate**
3.35 - 4.10pm	**John Sinik, Managing Partner, Metric Capital Partners**	**Private Debt**
4.10 – 4.30pm	Break	
4.30 - 5.05pm	**Marc Wolpow, Co-Chief Executive Officer, Audax Group**	**Private Equity**
5.05 - 5.50pm	**Paul Dimitruk, Chairman, Partners Capital Nancy Curtin (Close Bros), Lars Förberg, Ronen Israel and Marc Wolpow**	**Panel Discussion on Manager Alignment**
5.50 – 6.00pm	**Stan Miranda, Partners Capital**	**Closing Remarks**
6.00 – 7.00pm	Cocktail Reception	

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.

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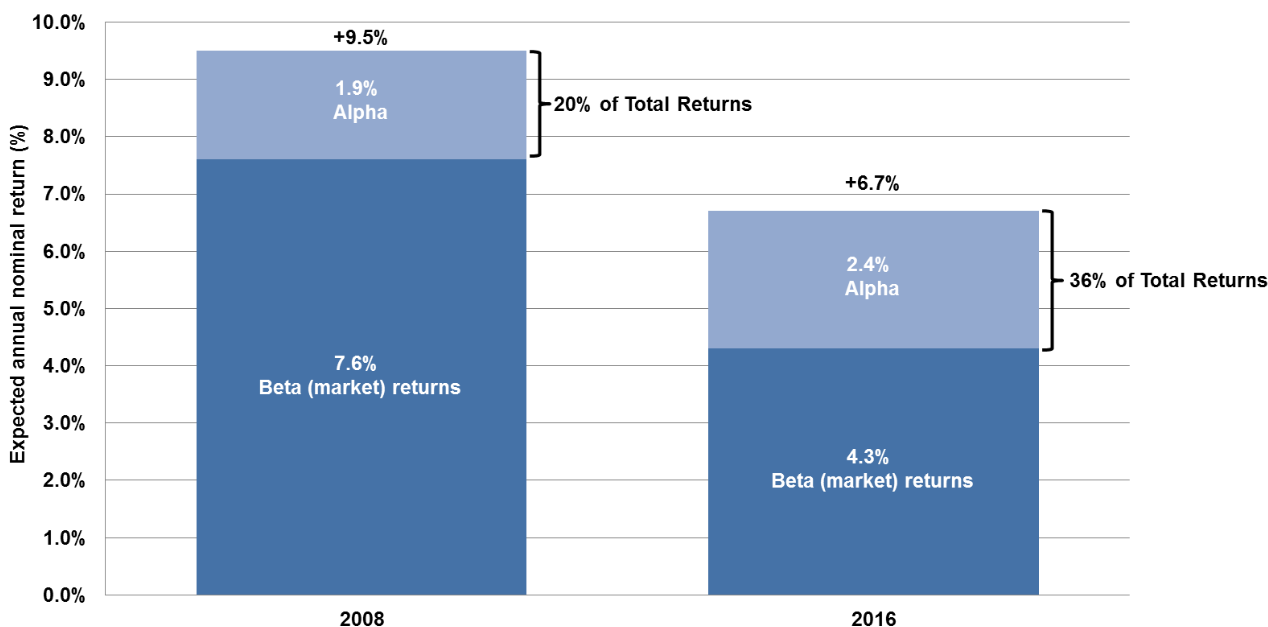
Opening Remarks

Stan Miranda, CEO of Partners Capital

THE FUTURE OF ACTIVE INVESTING

Alpha definition: The investment return you get on top of what you can do cheaply and passively by investing in comparable index-tracking funds.

Alpha is only becoming more important as expected long term future market returns decline. Below we show the average client Investment Policy Statement target portfolio returns looking forward from 2008 and then looking forward from today.



Source: Partners Capital
Note: Returns are shown net of Partners Capital fees. Hypothetical return expectations are based on simulations with forward looking assumptions, which have inherent limitations. Such forecasts are not a reliable indicator of future performance.

Alpha as a proportion of expected total portfolio returns has increased from 20% to 36%.

What has been the recent trend for Alpha?

1. Average Alpha across all asset classes has been in gradual decline over the last 20 years.
2. But the "average" active manager has always underperformed their benchmarks.

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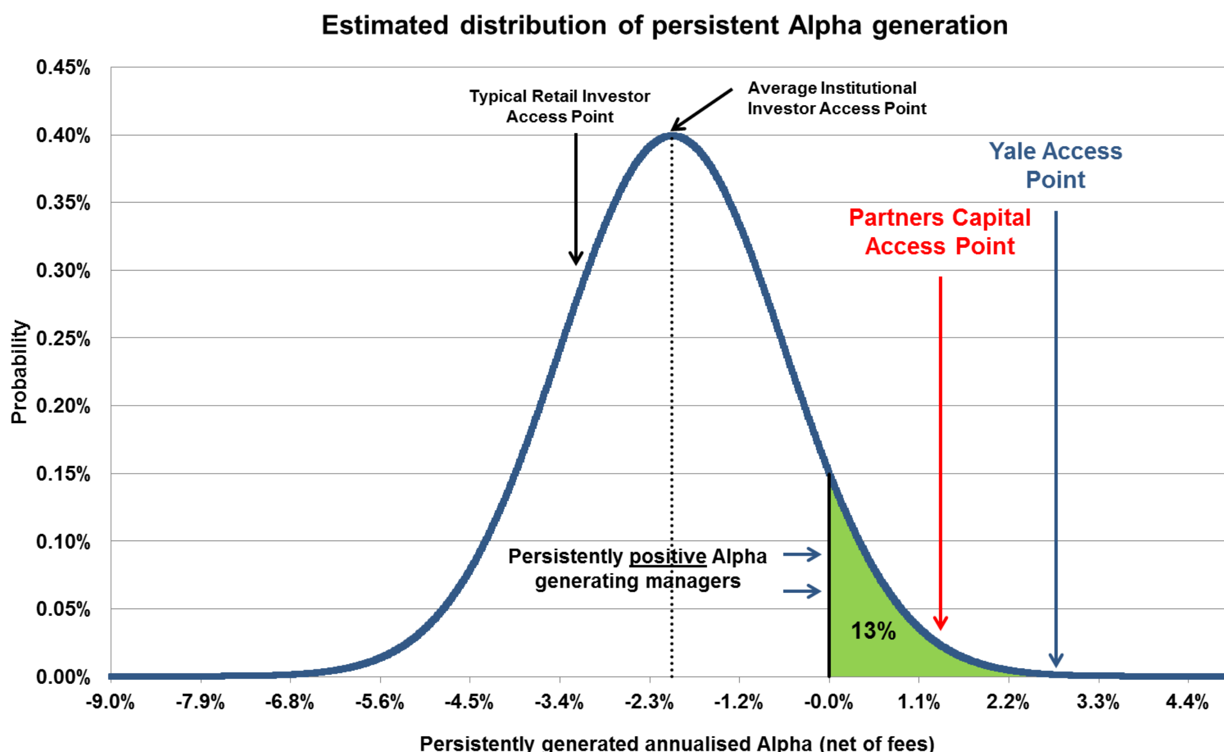
3. True “gem” managers still exist, but the percentage of persistent outperformers is shrinking and 2016 saw a marked reduction.
4. Leading institutional investors (e.g., Yale) have seen reduced Alpha but are still generating ~200 - 300bps p.a.

Our job is identifying and accessing the alpha generating managers



Source: Partners Capital

What explains the historical Alpha degradation?

1. Macro factors swamping security-specific factors – In particular, central banks have distorted markets.
2. Increasing investor competition as manifested by higher allocations to alternative assets.
3. Zero risk-free rate has taken returns on hedge fund collateral and short borrow to zero.
4. Technology and increased transparency and disclosure which has seen replication of the best managers’ holdings across a wide universe of managers.
5. Regulation has made active managers more cautious about unique information sources.
6. Decreased liquidity from bank trading desks (Dodd Frank) has increased transaction costs.

Technology is disrupting the active investment management business just as it is disrupting any other industry. Specifically it is enabling technology savvy investment firms to systematize (automate) some of the sources of alpha that have traditionally been the result of high cost, labour intensive, manual fundamental research. Examples are many but the biggest are being called “smart beta” and include use of algorithms for identifying stocks, bonds, commodities and other securities that embed value, quality, carry and momentum factors that outperform the broad indices. These have historically contributed to the alpha generated by bottom-up fundamental investors (manual investors). As firms like AQR, Blackrock and Two Sigma find ways

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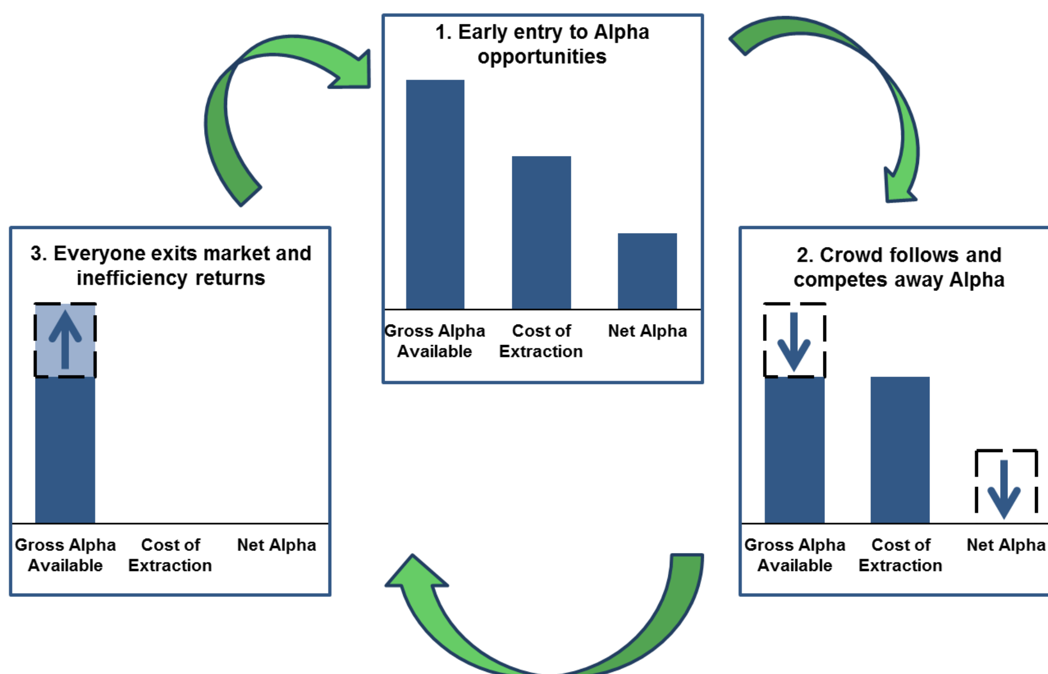
to automate the identification of these and similar sources of alpha, they are able to offer them at far lower fees.

The long term effect of this will be to raise the bar for active managers as their benchmarks will include both the traditional betas and the systematic alpha. With high fixed fees, such active managers will finally have to reckon with their high cost fee structures and high cost organisations. Cheaper sources of truly idiosyncratic (non-systematisable) alpha will emerge and many active managers will shut.

Have markets become too efficient to justify active investing going forward?
Markets will always be "Efficiently Inefficient" as Professor Lasse Pedersen of AQR says in his recent book under the same name. He reminds us that it costs money to exploit alpha and that the natural pressures are for alpha to fall to equal the cost of producing the alpha.



Market equilibrium is where markets are both:

- inefficient enough for active investors to be compensated for their cost, but
- efficient enough to discourage additional active investors

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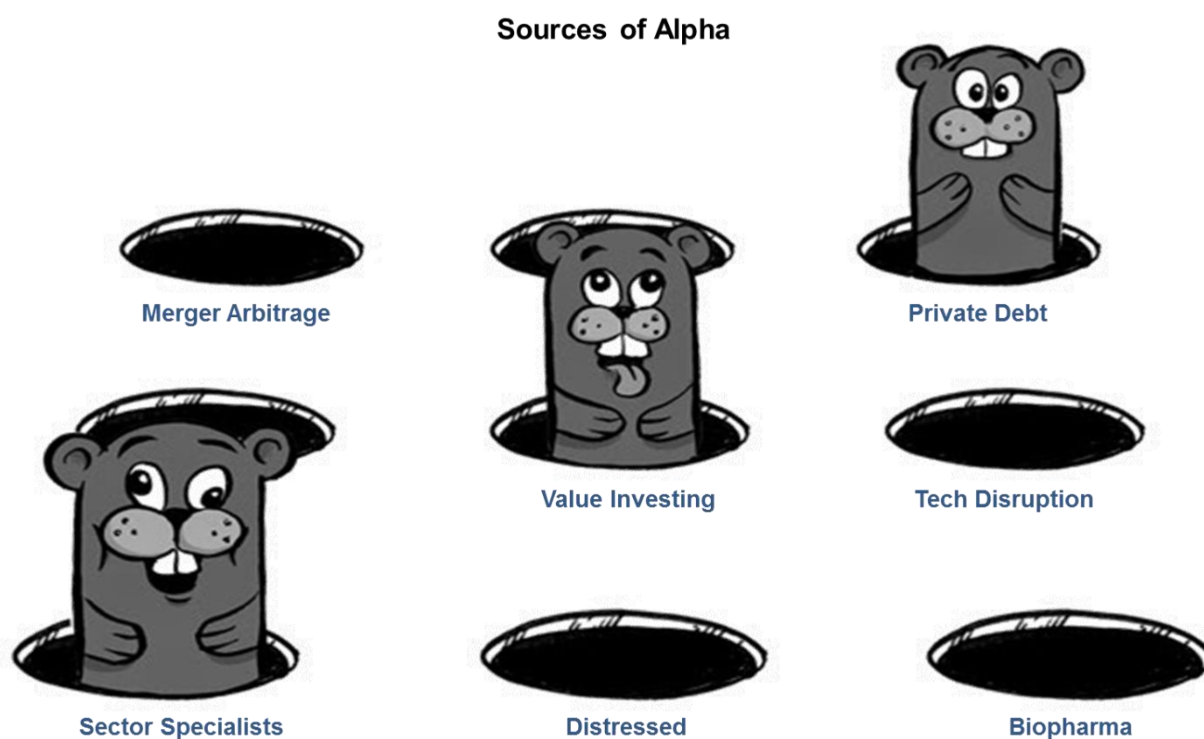
Hence, we always expect to see market inefficiencies will never completely disappear as it is logically impossible. However, exploiting them and generating consistent alpha is akin to the game "whack-a-mole" as opportunities pop up and competition drives them down in cyclical fashion.



Where will we expect to find alpha in the future?

1. Managers who are most nimble in pursuing new emerging sources of inefficiency – private debt is the perfect recent example.
2. Where systemisation of previously high-cost deep fundamentally-driven research processes has led to lower costs means of alpha extraction and fees reflect those lower costs. Style premia strategies is a good recent example.
3. Technology used to develop a greater cost or skill advantage (e.g., use of "big data" in fundamental research)
4. Sector specialist managers outperforming generalist hedge fund managers and buyout managers.

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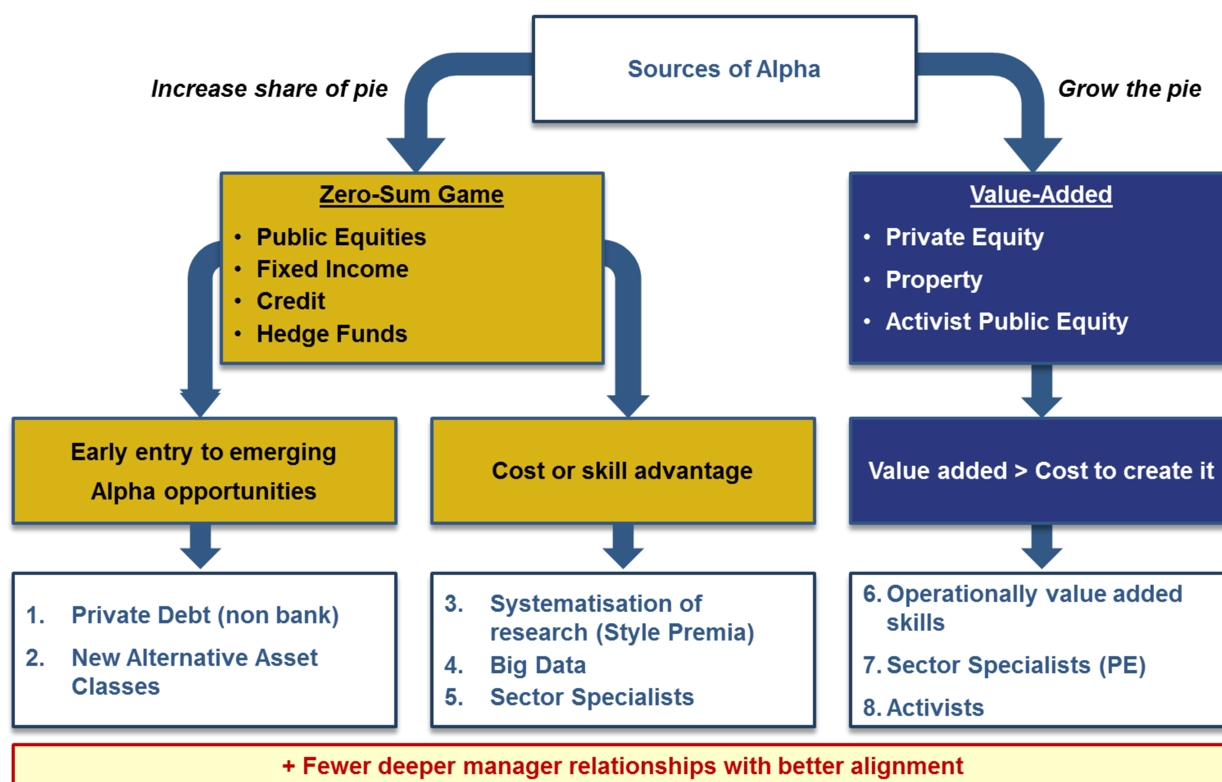
5. Illiquid asset classes where managers add value to their investments (not a zero sum game): private equity, property and activist equity managers.
6. New uncorrelated alternative asset classes such as catastrophe insurance, peer-to-peer marketplace consumer lenders and litigation finance.



Source: Partners Capital

What are we doing about it?

1. **Fewer deeper active manager relationships** – Target the very small minority who persist in alpha generation. There is no substitute for finding the few enduringly great managers who are positioned to continue to produce meaningful net alpha over the market cycle.
2. **Alignment between investors and managers. Pay fees proportional to alpha** – Asset managers should keep no more than half of gross alpha generated. Pressure should be put on management fees in a world of lower interest rates. Performance fee should only be incurred on outperformance over a benchmark or performance hurdle.
3. **Embed portfolios with balanced mix of style factors (quality, momentum and value)** – Use systematic / quantitative strategies where appropriate, to balance styles in the portfolio and replace those managers where a sizable component of manager returns can be replicated through targeting style skews at a lower cost.
4. **Use sector specialists in place of generalist hedge fund managers** – Exploit dispersion where it remains within industries to allocate to sector specialist hedge funds which have an informational advantage compared to the broader market.

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5. **Allocate to “New Alternative Asset Classes”** – Smaller asset classes outside the mainstream investment markets can offer healthy returns with little or no correlation to conventional market betas. These “new alternatives” include insurance and litigation financing.
6. **Higher allocation to private markets** – Private equity will continue to generate alpha over public markets through illiquidity premia, superior manager operating capabilities, and from the presence of highly profitable sub-strategies, such as private equity “tuck-in” investments executed at relatively low multiples.

Summary Conclusions

1. **Alpha is clearly declining – predominantly driven by macro factors and increased competition.**
2. **We are not on our way to 100% market efficiency – that is not possible.**
3. **Alpha is cyclical – it pops up and declines in different areas at different points in time.**
4. **Technology is creating new Alpha opportunities.**
5. **Access to a shrinking universe of persistent Alpha generating managers will be more competitive than ever. Reputation and added-value partnerships will be critical to our access.**

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Speaker #1: Absolute Return Investing (Hedge Funds)

Ronen Israel, Senior Partner of AQR Capital Management

INTRODUCING ALTERNATIVE RISK PREMIA

Ronen Israel is a Senior Partner at AQR Capital Management, a leading systematic multi-asset class manager investing in traditional and alternative strategies managing in excess of $150 billion. He runs the Global Alternative Premia group, which employs various investing styles across asset classes. He has received an Outstanding Article award as part of the 17th Annual Bernstein Fabozzi/Jacobs Levy Awards from The Journal of Portfolio Management in 2015 and the Special Distinction Award as part of the Harry M. Markowitz Prize for the best paper published in the Journal of Investment Management in 2015. Ronen earned a B.S. in economics from the Wharton School at the University of Pennsylvania, a B.A.S. in biomedical science from the University of Pennsylvania's School of Engineering and Applied Science, and an M.A. in mathematics, specializing in mathematical finance, from Columbia.

In the last few years, hedge funds have generated disappointing returns net of their high fees. In addition, these returns have been increasingly correlated with broad markets and therefore failing in their role of providing "absolute returns".

Much of what hedge funds do rely on market beta as well as exploiting certain types of alternative risk premia in markets that offer a persistent long-term excess return. Examples of alternative risk premia that are supported by economic intuition and research include:

a) Value: the tendency of cheap stocks to outperformance expensive stocks
b) Momentum: the tendency for recent outperformance to continue their trend of outperformance
c) Carry: the tendency of high yield to outperform low yield
d) Defensive: the tendency of safe/ high quality securities to outperform risk/ low quality securities

It is possible to define and implement systematic strategies to harvest these alternative risk premia and therefore replicate hedge funds returns at much lower costs. Taken together, these risk premia offer a source of additional uncorrelated returns to portfolios.

Importantly, alternative risk premia raise the bar on evaluating asset managers as the managers to demonstrate unique sources of return over and above market beta and alternative risk premia to justify their fees. The conceptual picture below shows how alpha generated by asset managers can increasingly be explained by systematic and lower cost sources of returns.

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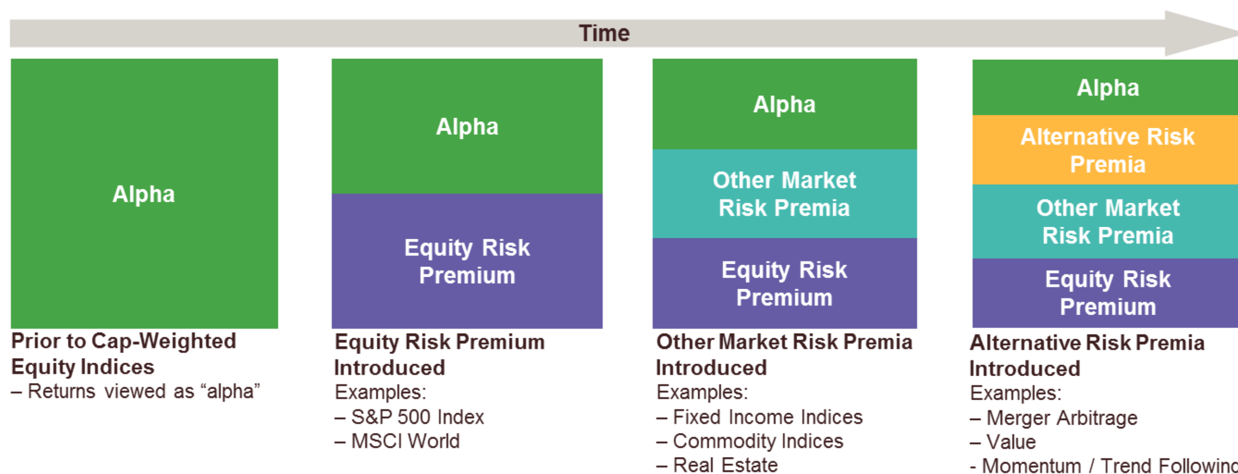
Is Alpha Just Beta Waiting to Be Discovered?

Alternative Risk Premia are returns based on well-known dynamic strategies that can be defined and implemented systematically



Source: Partners Capital

We are not ruling out alpha as markets are "efficiently inefficient" and will always offer opportunities for talented managers. Sophisticated investors who are able to search for and find good asset managers may be able to add value over time.

Fees should vary with how unique ("alpha") the return stream is. Market beta should command the lowest fees, while true idiosyncratic alpha command the highest. Unsurprisingly, alternative risk premia should be somewhere in the middle. These should be full disclosure of fees and better transparency into what the investor is paying for. The fair level of alternative risk premia fees is around 1.5% total fees, with the bulk of the fee being fixed rather than performance related. Ultimately what matters is net of fee returns that are diversifying to the rest of the portfolio - this is even more relevant in a lower expected return environment.

US-20230922-3104261

Speaker #2: Equities Investing

Lars Förberg, Managing Partner and Co-Founder of Cevian Capital

Lars Förberg is a Managing Partner and co-founder of Cevian Capital. Cevian is the largest activist manager in Europe, with approximately $13 billion of assets under management and a track record reaching back to 1996. Cevian takes a deeply fundamental approach to equity investing, and works to create value by improving portfolio companies' operations, strategy, structure, capital allocation, governance and financials. Based in Zurich, he has served on boards of listed companies in 5 different European countries across a wide range of industries, including chemicals, retail, engineering and banking. These projects and others have contributed to Cevian generating a cumulative net return to investors since 2006 of 174% versus MSCI Europe's return over the same period of 42%[1]. However, in line with most other active managers, Cevian has found alpha generation more challenging in the last 5 years. What does the future hold for European activist equity investing?

Cevian are constructive activists. They invest in good and sound companies which are underperforming. Cevian work from the inside to build value and make the company more competitive in the long term. The portfolio is concentrated in 12-15 companies with circa 10-15% ownership in each company. Cevian have followed this approach for 20 years and it will not change.

Cevian look for three things in an investment:

1. Low Price – Only invest if the price of the company is lower than the intrinsic value on a going concern basis.
2. Value Enhancement – Look for an opportunity to add value to the company through a change programme. Design the change programme before investing in the business. Covers governance, operational and strategic changes.
3. Influence – Require an ownership situation where they can influence the company to implement the change programme.

Cevian designed their strategy to take advantage of three shortcomings and inefficiencies in the public equity markets:

1. Public markets are incredibly myopic – Analyst reports look at what the share price is going to be 6 months from now, which is 90% market psychology and 10% company fundamentals. Cevian ask what is the real value of the business in the long run, in 3, 5 or 7 years. The long term view allows them to take advantage of price dislocations.
2. Most capital is from passive investors in the public markets – These investors do not have the interest or expertise to engage with companies to facilitate change. Other investors look for catalysts but Cevian are the catalyst.
3. Most pensions and mutual funds are over diversified – They can never truly understand the companies they own because there are too many of them. None of the companies are really important to them.

[1] Based on the net performance of the 2 year share class with 1.75% / 20% fees between 1 July 2006 and 30 September 2016

US-20230922-3104261

Lars does not believe that Cevian's opportunity has changed materially in the past 10 years. He believes activism in Europe will generate alpha in future for the following reasons:

1. Low competition and barriers to entry – The fund needs long term money, a good performance track record and the support from other shareholders. It is very difficult to build a new fund with these attributes.
2. Not much has changed in the last 10 years and the main changes are positive – Shareholders not only have rights, but also have responsibilities; an example is the Governance Code in the UK.

Danske Bank Case Study:

- Second largest bank in Scandinavia. Based in Denmark, where it does 50% of its business.
- In 2011-2012 the industry was out of favour and Danske Bank was even further out of favour. It had underperformed its peers for a number of years due to a number of high priced and poorly integrated acquisitions.
- The core of the business was very strong. There was a clear opportunity to improve the operations of the business. Most investors would not go near a Danish bank as Denmark had the highest amount of household debt in Europe.
- Bought a 9% stake in 2011-2012 at 60% of book value. The bank was not making money, but they expected to achieve a 12% RoE.
- Cevian's change programme for Danske included corporate governance changes, structure changes, strategic changes and operational changes.
- Wanted to divest some non-core assets, have a cost-cutting programme and change management and board.
- Anchor shareholder in Danske Bank was Maersk. Cevian needed to let Maersk know that Cevian could add value to Danske. Maersk were the primary hurdle to gaining influence.
- Spoke to 200+ people in Ireland and Scandinavia before investing, all CEOs, CFOs and CROs of competitors to get a better picture of the industry and Danske Bank.
- First action of Cevian was to institute governance changes. Cevian initiated several board changes in 2012, including a new Chairman. The entire board was changed between 2011 and 2013, when Lars joined.
- Cevian pushed for a number of operational changes with a focus on profitability.
- The bank was steered from 0% RoE to 12% RoE in 3 years, taking it to the level of the best competitors in Scandinavia.

US-20230922-3104261

Speaker #3: Real Estate

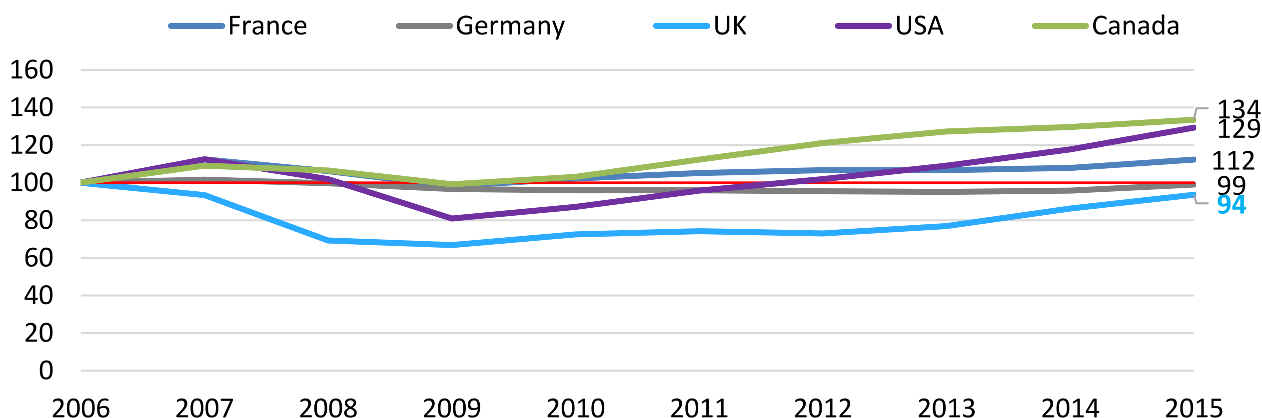
Manish Chande, Co-Founder and Senior Partner of Clearbell Capital LLP

Manish Chande is the senior partner of Clearbell Capital, a UK property investment firm founded in 2007. His session provided an overview of the UK real estate market and the ways in which market practitioners can generate outperformance.

UK Property Market Overview

- While the overall UK property market was valued at £6.2 trillion as of the end of 2015, the vast majority is residential property. The commercial property market, which is a proxy for the size of the addressable market for professional investors, was valued at £871 billion.
- This makes the UK's professionally managed real estate market the second largest in the world after the United States.
- In terms of valuations, the capital values in the UK remain -6% below those levels reached in 2007 prior to the crisis. In contrast, capital values in the US have recovered much more rapidly with valuations 29% above 2007 levels.

Capital Values of Global Property Markets re-based to 100 at 2007 Values



Source: Partners Capital

- This masks considerable variation between the UK property market sub-sectors with central London office space valued at 23% above 2007 values and retail assets valued at -29% below 2007 levels.
- While data since "Brexit" is generally inconclusive, Manish believes that capital values are down by c. -4-6% in the 3 months following the referendum result.

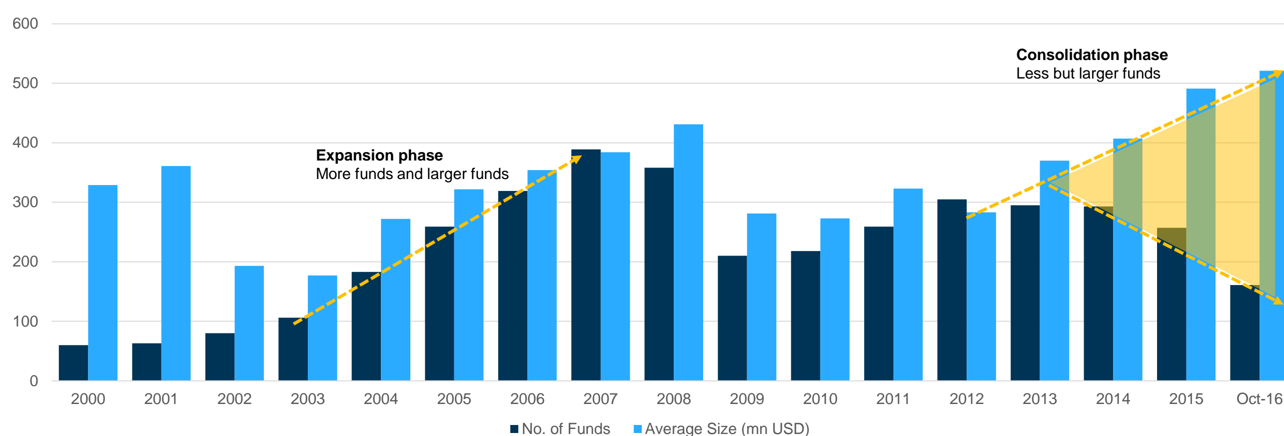
Alpha Generation in the Real Estate Market

- Clearbell define "alpha" in the UK property market as the excess returns over investing passively in a portfolio of "core" UK properties which provide investors with the rental yield and the capital appreciation of the market.
- Clearbell believe there are four ways to generate alpha over and above that return:

US-20230922-3104261

1. Acquire assets below intrinsic value: Manish believes this is possible in the UK middle market which is inherently less efficient than the larger end of the property market. This inefficiency is currently being exacerbated by the consolidation of capital into a smaller number of larger funds. The chart below shows this trend. Since 2012, the number of funds raised per year has halved while the average fund size has almost doubled. This reduces competition for those operating in the middle market but also provides a competitive and well capitalised market in which to sell assets (particularly if middle market participants pursue a "buy and build" strategy).

Global Private Equity Real Estate Fundraising – no. of Funds and Average Size of Funds ($m)

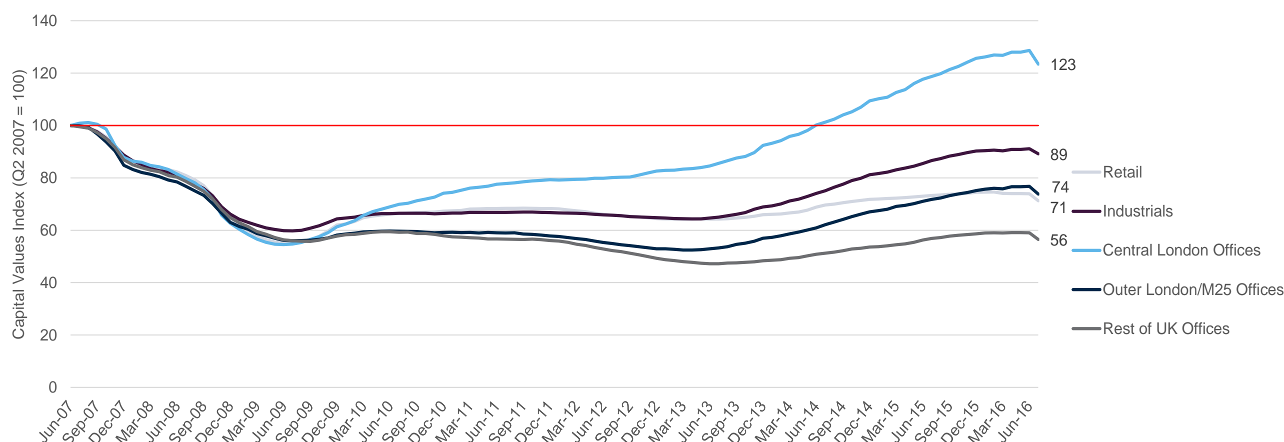


Source: Clearbell Capital LLP

2. Use of leverage: judicious use of financial leverage for those assets that have sufficiently stable cash flow to support it.

3. Asset Allocation: the selection of those sub-sectors of the market which they believe will outperform due to macroeconomic trends. Manish gave the example of logistics assets which are benefitting from the trend towards online retail. The chart below shows the dispersion in values by sub-sector in the UK since 2007 which highlights the value that can be created through successful asset class selection.

UK Capital Values by Sub-Sector Re-Based to 100 at June 2007 Levels



Source: Clearbell Capital LLP

US-20230922-3104261

4. Value-added asset management: Clearbell believe that the greatest source of potential alpha generation is the active management and re-positioning of the underlying assets. This can include re-leasing the asset or capital expenditure to improve the quality of the property. However, it can also include roll-up projects. Manish outlined a recent example executed by Clearbell. This included the acquisition of a portfolio of 10 sub-scale assets near urban conurbations, re-positioning them as distribution warehouses to serve the e-commerce sector and selling them as a larger portfolio to a mega-cap private equity real estate firm. The re-positioning project was completed within 15 months generating a 27% IRR.

- Manish concluded the session by showing industry level data of top performing European private equity real estate funds. Over the last 15 years, they have generated +6.8% outperformance versus core property funds (which were used as a proxy for the "market" return).

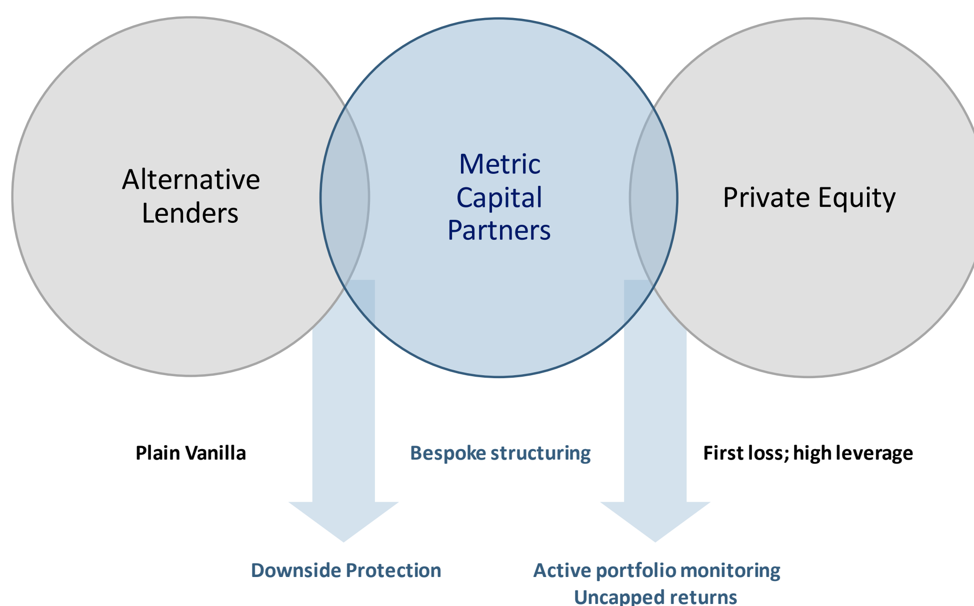
US-20230922-3104261

Speaker #4: Private Debt Lending

John Sinik, Managing Partner of Metric Capital Partners

Partners Capital first met Metric in 2011 when it was just an idea for John Sinik. John was previously a Partner at Towerbrook where he invested in European private equity transactions, and Global Head of Corporate Credit at UBS. Although Partners Capital did not invest in Fund I, they invested in Fund II and the position is held in the Phoenix II fund as well as directly by some clients.

Metric is a European special situations private debt manager which fills the space between more vanilla direct lending funds and private equity for small companies in Europe. These companies are typically unable to obtain financing from banks or vanilla direct lending funds as a result of a variety of issues which make them "non-bankable" (e.g. complex ownership, capital structure, complex business model, transformational/post-turnaround status). At the same time, the business owners may not want to sell to private equity. Metric offers a bespoke and structured financing solution which generates contractual return with downside protection, but also equity upside at little to no cost. Metric's position in the capital structure will be senior to equity / management, but will take a hands-on private-equity style approach. Of 18 investments, Metric is on the Board of all of them and chairs 7 of the 18 boards.



Source: Metric Capital Partners

Today, Metric has raised €700 million in capital and has a team of 18 staff of which 16 are investment professionals, 6 of which have worked with John previously. They have just bolstered their operating capabilities by hiring a former McKinsey partner.

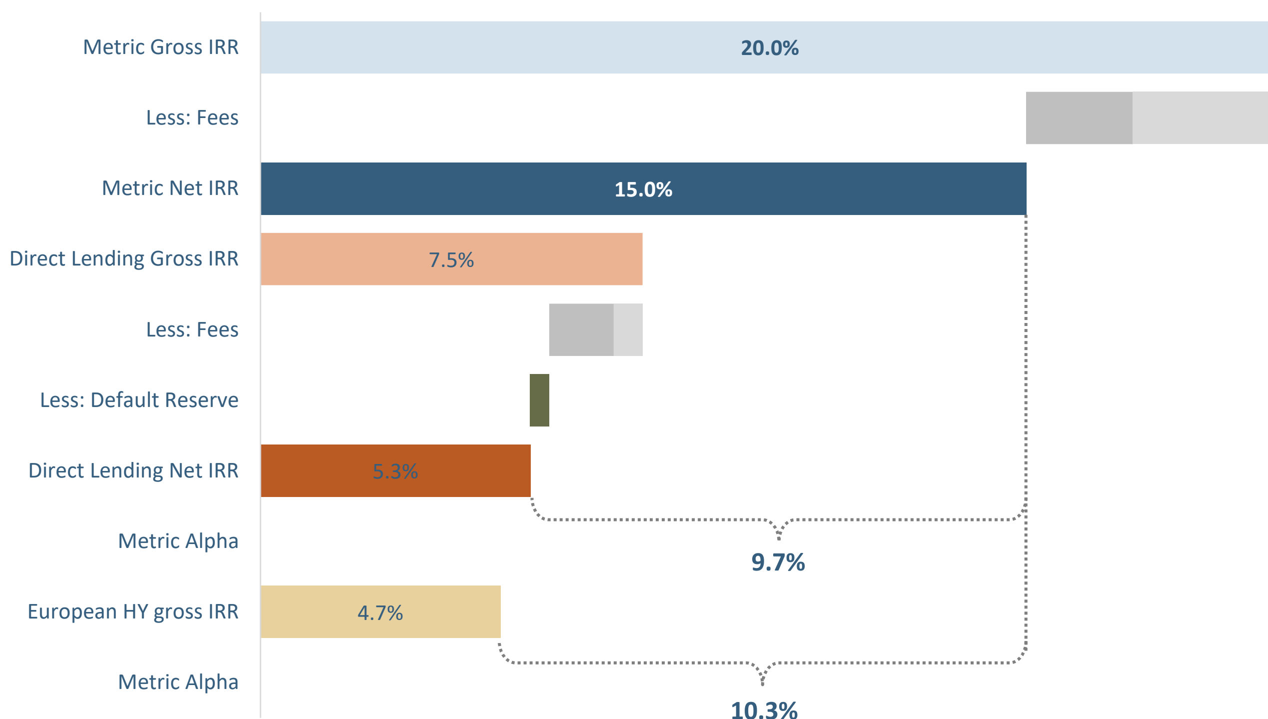
Sourcing is one of the key areas of differentiation. The team includes John Connolly who was the former Global Chairman of Deloitte and the Head of Deloitte UK, and also Peter Connolly (full time) who was the former Global Managing Partner at Clifford Chance. Small companies naturally do not have access to investment banks and so naturally turn to their lawyers and accountants for financial and strategic advice.

US-20230922-3104261

Metric spend a lot of time with lawyers and accountants as their primary source of deals. Although John would not go as far as to say that the deals were proprietary, he did note that they were all exclusively negotiated as Metric do not participate in auction processes.

Deal example – Metric lent money to Gavle Container Terminal in Sweden. Metric provided a senior secured term loan with the last dollar of exposure at 3.9x EBITDA. The loan yielded a 16% IRR (combination of cash and PIK and fees), but also gave Metric 9.5% of the equity at no cost. Banks would not finance the company because it did not have 3 years of audited financials as a recent corporate carve-out, and also the land was not owned by the company but was on a 33 year concession. The company could have raised private equity funds, but didn't want to sell. Metric conservatively valued the company at 9x EBITDA, although the company ultimately realized a 14x multiple upon sale. Metric benefited from a make-whole and the equity upside, which resulted in a gross 47% IRR return, or a 37% net of fees.

How do Metric generate alpha? The drivers are in the sourcing networks, the bespoke structure of the deals and the hands-on approach to portfolio management. Based on the expected return of the fund at 20% gross (compared to 30% gross IRR realized for 8 deals), Metric expect that the fund can generate 10% alpha vs. unlevered vanilla direct lending net of fees, and a similar amount vs. the European high yield indices (gross of fees).



Source: Metric Capital Partners

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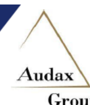
Speaker #5: Private Equity Investing

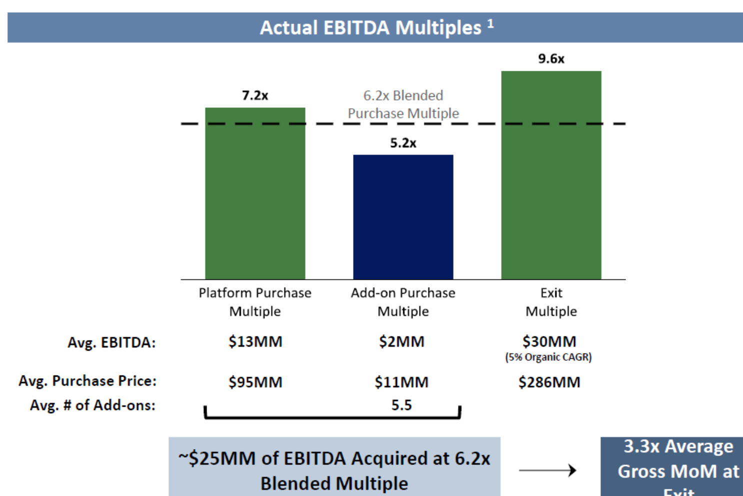
Marc Wolpow, Co-Chief Executive Officer & Co-Founder of Audax Group,

- Marc Wolpow, co-CEO and co-Founder of Audax Group presented on the US LMM buyout firm's buy-and-build strategy and how it has consistently generated alpha.
- Since inception in 1999, Audax has purchased 99 platform companies and 511 add-on acquisitions.
- The basis of the strategy is to purchase a platform business with approximately $100M of EBITDA at an average market multiple, and to "buy-down" the purchase price multiple and add value through strategic add-on acquisitions. The result is a pro-forma purchase price of 6.2x EBITDA, currently 3x+ cheaper than the average multiple of middle market businesses.

The Audax Approach – Buy & Build



We transform lower middle market businesses



1) Data for the 43 companies realized via a sale process to a third-party strategic or financial buyer, as of October 7, 2016 for Private Equity Funds I, II, III, and IV. Excludes Private Equity Fund I venture transactions (2000-2002). Data does not reflect realized losses, or instances where a portfolio company generated dividends, but has not been sold.

- Audax has built and organized it business to support this strategy with respect to sourcing (30% of resources dedicated to sourcing) and execution. With a dedicated sourcing team and 15 years of network-building, Audax has created a barrier to entry for the breadth and depth of its strategy.

US-20230922-3104261

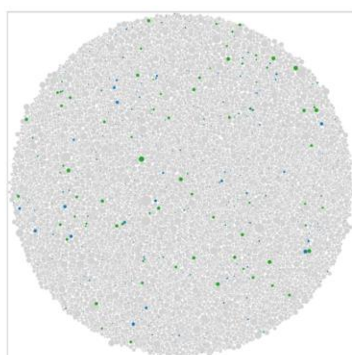
The Audax Approach – Optimized for Buy & Build

Deal team is supported by functional specialists and Audax Group resources

1) Audax Private Debt includes Audax Subordinated Debt, which does not finance Audax Private Equity transactions, and Audax Senior Debt, which may finance a minority interest in the senior debt of an Audax Private Equity transaction.

- Since 2000, Audax has reviewed close to 20,000 deals through close to 2,200 intermediaries. It has executed on over 600 and no intermediary has represented more than 2.7% of Audax's flow.

Audax Deal Source Summary

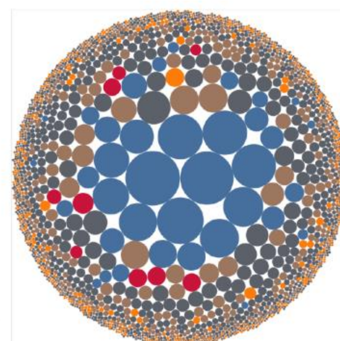


Deal Designation:
Closed Add-On Deal
Closed Platform Deal
Logged Deal (Not Closed)

Size represents EBITDA of deal
= $200MM EBITDA deal

- More than 2,200 different firms have submitted deals to Audax
- Collect 50+ data points for each deal
- No deal source accounts for more than 2.7% of total deal flow
- Since 2015, reviewed 3,800 deals from 900 sources

Deal Source Type:
Bulge Bracket Bank
Regional Investment Bank
Investment Bank
Broker
Other



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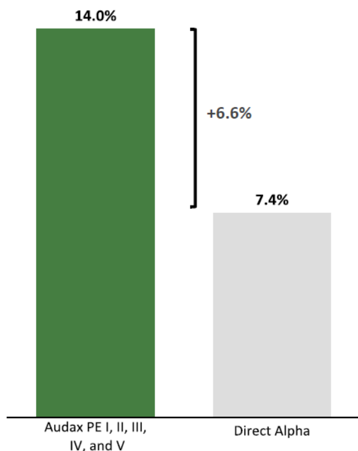
- As a result of its strategy, Audax has generated top quartile performance in each of its buyout funds and has delivered over 700 bps of direct alpha.

Public Market Equivalent (PME) Analysis

Audax PE Net IRRs vs. S&P 500 Total Return Index
June 30, 2016



- Direct Alpha is an industry-recognized public market equivalent ("PME") methodology that measures a private equity fund's outperformance versus a public market index

For illustration purposes only. Returns are net of management fee, carried interest, and expenses. Net returns are calculated based on timing of investor contributions and distributions plus the unrealized value of remaining investments. As a 2012/13 vintage fund, Fund IV is in the first half of its expected term and, as a 2015/2016 vintage fund, Fund V is in the initial stage of its investment activities. Fund V is also borrowing under a credit line with respect to certain investments, which could have the effect of increasing its net IRR. As additional Fund IV realizations occur and as Fund V makes additional investments, the reported performance of each Fund (including each Fund's net IRR) is expected to change. The reported performance of each Fund should be viewed accordingly. The Audax Net IRR shown above was calculated by aggregating cash flows from several Audax funds to create a composite net IRR. Therefore, no investor has received the stated IRR.

US-20230922-3104261

PANEL DISCUSSION ON MANAGER ALIGNMENT

Paul Dimitruk, Nancy Curtin (CIO, Close Bros), Lars Förberg, Ronen Israel and Marc Wolpow

Paul Dimitruk, Chairman of Partners Capital

The panel was brought together to address the central issue of the alignment between LPs and GPs (Investors and Managers) over their respective interests. What we will try to discern is whether the there is a decent possibility of alignment—or not—between LPs and GPs and what would an optimal alignment look like that balances the two sets of interests.

Our panellists are three of our speakers today, Marc Wolpow representing Private Equity, Lars Forberg representing Public Equity, and Ronen Israel representing Absolute Return plus Nancy Curtin representing the LP's point of view.

There is a natural tension between (1) the GP's very understandable desire to maximize commercial opportunity for themselves and their firms and (2) the widely recognized principle that the investment industry should embed standards of behaviour that steer GPs to make reasonable efforts to deliver to the LPs a fair-share of the benefits derived from the relationship (i.e., net alpha). Add to this that we expect our managers to attract and retain first class teams, have the appropriate enterprise infrastructure, and have the organizational stability and resilience that sophisticated LPs demand. So how do we reconcile the GP's

US-20230922-3104261

desire to run a robust, highly profitable business and the LP's desire to reduce the 'cost of ownership' in their manager allocations and benefit from a larger share of the gross alpha?

Q1. What are the 'right' fees that LPs should be paying such that GPs are incentivised but that they don't take all the benefit?

- Fees should be commensurate to the value being added. Beta should be cheap. True alpha 'idiosyncratic and unique return' you should be highly rewarded. Systematic sources of return should be priced in the middle, at a fair fee, they aren't idiosyncratic true alpha so they shouldn't be priced in the same way. (RI)
- For bulk beta, fixed fees are the most appropriate. (RI)
- For true alpha, performance fees should rule the day, they should be in excess of cash and also perhaps in excess of the bulk beta or alternative beta returns. (RI)

Q2. What other sources of alignment are there between LPs and GPs apart from fee structures?

- Incentive structures should be designed to optimise the performance of the GP. You have to understand the motivations of the GPs you invest in. (MW)
- Carry allows GPs to hire better people, compensate them for performance, invest in better sourcing and therefore generate higher returns. (MW)
- The investor scrutiny on Audax is different today at age 17 to what Audax was when it was founded. (MW)
- In the early days, when Audax wanted to earn as much as possible they included deal closing fees, however now they don't think deal closing fees lead to the correct alignment of incentives. (MW)
- Marc Wolpow is surprised that LPs don't ask to see the income statements, balance sheets, or tax returns of managing GPs. When Audax buy private businesses they ask to see these things from the owners. This gives an insight into honesty and also into the ways people might behave when they are given a large amount of money. (MW)
- A management fee in Private Equity is a loan against the carry, Audax had one LP saying they would take a high management fee and low carry as in a 0% interest environment they'd rather make the loan than give up the upside. (MW)
- Fees will price where supply and demand intersect, Marc Wolpow is unsure that there's a management fee that's too much, he knows there's net performance which is too low. If you aren't getting the performance then don't invest in the fund. (MW)

US-20230922-3104261

Q3. Another aspect of alignment is that GPs maximise management fees when fund AuM is large, however there's a general acceptance that alpha degenerates as size increases. How can GPs handle this conflict?

- On the one hand activists need the clout to buy large stakes in their target companies to get the influence they need. They also need to be able to work over a large span of market caps. (LF)
- There are situations where the opportunity is too large for the fund and they will bring in co-invest money, e.g. Cevian in Danske Bank. (LF)
- Important not to create distorted incentives for employees, want people to be aligned to the best interests of the clients and therefore of the firm. (RI)
- If you hire people who love what they do and you create the right culture and environment such that they can grow and blossom and be rewarded for what they do, this is in itself an incentive structure that will keep your team working hard without having to create overly distortionary incentive schemes. (RI)
- Some of the information asymmetry captured in lower mid-market space, come from the channels of information generated from both credit and private equity arms, so it enhances their information flow to have both funds. (MW)
- It all boils down to return, shouldn't be judged a priori but should be judged on data. (MW)
- Size can enable an organisation to invest in trading, better operations, they can negotiate better terms with counterparties and better financing. (RI)
- Important to ensure large firms have core investment philosophy that is consistent. (RI)

Q4. Could you each give an example, if there are none then just say none, of where LPs have added value to your business or the way you're doing things?

- When Cevian were launching Cevian II they had a dialogue with investors regarding the optimal lockup period for the fund due to the conflicting interests of LPs and GPs in activist funds regarding lockup periods. Decided after dialogue with LPs they shouldn't have an evergreen structure.
- There have certainly been times where clients have come to AQR and suggested they look into something and that's triggered research and new ideas, and these have led to new strategies. (RI)
- Best thing an LP can do is be a good strategic partner, the information flow has to be two way, sticking with the investment process through the short-term performance fluctuations. (RI)
- There is a subset of LPs, through their due diligence and their questioning which helps you develop your thinking and get a better view of yourselves, these LPs are limited in number and they get the biggest allocations. (MW)

US-20230922-3104261

Closing Remarks

Colin Pan, Chief Investment Officer of Partners Capital

As many of you know, this has been one of the most difficult years for manager alpha. 2016 can perhaps be best summed up by a quotation attributed to Churchill who said: *"If you are going through hell, keep going."*

It is in periods such as these that our team is pushed to work harder and think smarter, so that we can better position our client portfolios for the challenges that lie ahead.

Our 55 person investment team, under the guidance of our Internal Investment Committee and our asset class heads, has had an extremely busy year. We are constantly pressure testing our existing line-up of managers in the search for better investment opportunities, better managers, and better alignment with our managers.

This year, we have logged over 1300 meetings and calls with managers, both existing and prospective. Few of our peers or competitors can profess to have this breadth of coverage across three continents, all in the pursuit of exceptional investment opportunities.

This year, we have approved 10 new liquid managers, but more importantly we have redeemed 17. These redemptions reflect situations where the opportunity set may have moved on, where the team dynamics have changed, or where we believe a manager no longer justifies their fees. We are cognizant not to throw babies out with the bathwater, but the bar we set is extremely high.

This year, we have continued to allocate to private markets with 10 new commitments to private funds, ranging from best-in-class sector specialists in healthcare, software and consumer, to emerging managers who may one day be the next generation of "gems". We continue to believe that private markets offer the best long-term return potential, and devote considerable resources to identifying what we believe to be are the best opportunities in private equity, private debt, real estate and alternative alternatives.

This year, using the full weight of our $18 billion in buying power, we have successfully negotiated fee discounts with 5 managers and are in the process of negotiating with several others. This is on top of another 10 successful fee negotiations in 2015. As a reminder, all of these discounts accrue 100% to the benefit of our clients.

As you can see, there is no complacency at Partners Capital. We take a difficult year in our stride and see it as an opportunity to emerge stronger for tomorrow's challenges. We will not get every decision right, and even the best managers can only profess a hit rate of 60%. But we work tirelessly to improve our investment process with every manager that we approve, and every decision that we make.

Our mission is to deliver the most advanced proven institutional investment strategy to our individual and institutional clients. While investing in today's environment seems to be getting harder, we hope that today's presentations gives you a sense of how the Partners Capital team and our asset managers are working to overcome these challenges and to generate superior performance for our clients.

US-20230922-3104261

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US-20230922-3104261

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US-20230922-3104261