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Private Markets and Finding the Right Opportunities in 2023

How can investors gain access to a portfolio of unique, privately-owned companies? Where will the best opportunities be in 2023? Are the most interesting options amongst the pre-IPO disruptors, and/or high growth innovation companies? And what is the impact of higher inflation and interest rates, at levels not seen for many years, on private markets valuations, liquidity and expected returns? Hubbis and co-host GAM Investments invited a select group of wealth management leaders and gatekeepers to a private event at the Tower Club in Singapore in March to look at these key issues, and plenty more besides. Hubbis has summarised some of the key points made by Kevin Moss, the San Francisco based Managing Director and Portfolio Manager of Liberty Street Advisers, which manages the fund. Kevin and his team have been running what is now a roughly one billion dollar late-stage private equity fund in the US since 2014, and they are now lending their experience, expertise and relationships to building the GAM LSA Private Shares (Cayman) Fund, also a very similar late-stage venture capital (VC) strategy, which is managed at the master fund level by Liberty Street Advisors. Like its big brother in the US, the GAM fund, launched in March 2022, also invests in a diversified portfolio of leading disruptive privately-owned companies that are in their final non-public funding rounds. The fund is young, but by the end of January this year delivered an impressive roughly 45 percent return since inception in March 2022. Sitting on some 80% cash at the time of the event, Kevin outlined where and how they might invest some of that 'dry powder' as he called it.

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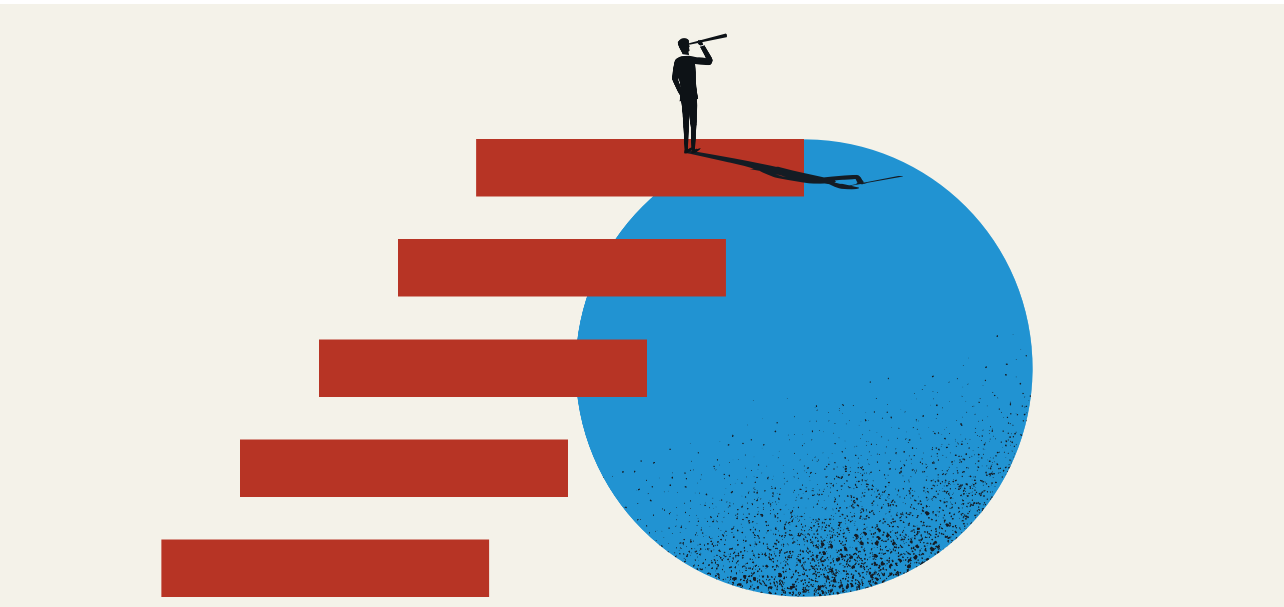
These are some of the topics covered:

- Where are the best opportunities in private markets in 2023?
- Amid global inflationary pressures, will investors benefit from leaning towards private markets for better future returns instead of sticking to the traditional 60:40 portfolio?
- How have these markets re-calibrated themselves given the challenges of last year?
- Which disruptive industries are compelling and interesting today for private clients?
- How do they access these opportunities?
- What's the role of these investments within a diversified client portfolio?
- What are the liquidity restraints?
- What types of firms and sectors are most appealing, and why?



Setting the Scene

From past discussions that Hubbis has held with Kevin Moss and other of his colleagues since early 2022, we learned that the number of listed companies in the US has for several decades been falling, while the number of private companies keeps growing.

An aging population of private companies

The average age of a company used to be about four years old before listing some two decades or more ago. In fact, Apple listed with revenues of around USD150 million when it was roughly four years old.

By 2022, the average age of a company heading to listing was anywhere between 10 to 15 years. At the same time, the public market has been shrinking – there used to be about 8000 companies trading in the US, and by 2022 the number was roughly half that.

The race for the best opportunities

The market for the most interesting opportunities has been increasingly competitive, as the volume of capital raised for investing in the private markets escalated dramatically, ratcheting upwards sharply year on year since the public market crises of the global financial crisis that set in around 2008.

But Kevin and colleagues with the US fund they manage focus on accessing investment in these private companies while they are still private, but at the later stages, where risks are lower than at the earlier stages, but returns are still robust. Accordingly, the US fund's particular focus is on the two to four years before an IPO or exit via some form of M&A transaction.

Opening the doors to smaller investors

Also, from past interviews and discussions with Kevin, Hubbis had learned that he has long been a very keen advocate of private assets and also of democratising access to such investments.
The US fund is a closed-end interval fund incorporated and regulated in the US that focuses exclusively on late-stage venture capital. And the entry sticker of just USD2500 – the same since inception in 2014 - is very important, as one of The Private Shares Fund's stated mission from the outset was the democratisation of access to such opportunities that normally require far, far larger initial investment amounts, higher fee structures, longer lockup requirements, and significantly more administration and paperwork for investors.

Global demand has been rising

In recent years, Kevin and team have been seeing more demand for private assets across the globe, as more investors have been diversifying their portfolios by including longer-term private asset investment strategies of all type.
Accordingly, they wanted to offer these types of opportunities outside the US into markets such as Asia, hence since early 2022, Liberty has also partnered with GAM Investments to run the new but smaller and similar strategy, the GAM LSA Private Shares (Cayman) Fund.

Reflections...

According to their literature, the GAM LSA Private Shares (Cayman) Fund is a late-stage venture capital (VC) strategy which is managed at the master fund level by Liberty Street Advisors. The fund invests in a diversified portfolio of leading privately-owned companies that are in their final non-public funding rounds.

Late-stage venture capital sits between VC and traditional Private Equity. It focusses on backing already successful companies with established market share, strong management boards and proven products. Investors in the asset class aim to participate in the potential capital appreciation of these dynamic, innovative, and often disruptive companies whilst under private ownership.

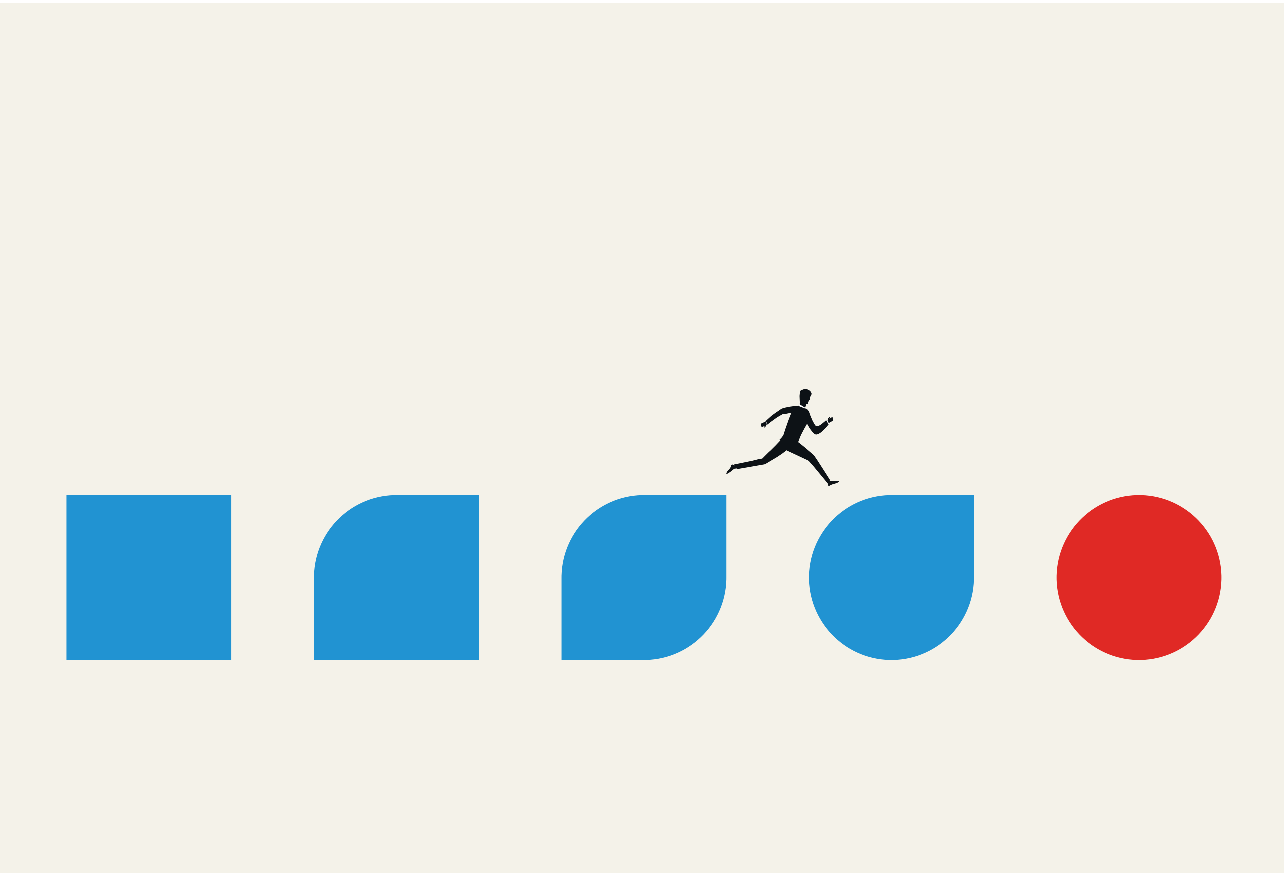
The stated Investment Objective is to seek capital appreciation by investing in the equity securities and equity-linked instruments of certain private, operating, late-stage, growth companies.

Small but focused

As at the end of January this year, the GAM fund was USD19.6 million in size, having launched in March 2022. The fund has a Management Fee of 1.9%, a Performance Fee of zero and Minimum Investment of USD100,000. Also, as of the end of January, the performance since inception has been approximately 45.44%, and the fund was up almost 20% in the past six months. Allocations as of the end of January, 2.56% in Aerospace, 3.85% in E-Commerce, 8.92% in Security firms, 3.47% in the Transportation sector and cash, or dry powder for new investments sat at just over 81%.

Although the entry ticket is USD100,000, that is what is called 'omnibus' - in other words a private bank or an external asset manager of perhaps multi-family office can spread that USD100000 amongst as many investors as they want, for example 100 investors buying in at USD1000 if they so wish, or perhaps split it into four slices. But importantly, for each investor it is like buying into a mutual fund, for example, they simply confirm the transaction and the documentation is absolutely minimal.

The fund consists of three elements, a Cayman Master fund, and two Cayman feeder funds, one of which GAM Investments sells into Asia, the other one into Australia.



Key target companies and the reasoning behind investment decisions

Kevin told guests that for their well-established roughly USD1 billion fund, he and the investment team take a fairly narrow focus in the venture ecosystem, focusing on late-stage venture capital, and putting it in a structure that is not the typical private equity or traditional venture structure.

2-4 years to exits

"We wanted a slightly different risk-return profile and to also democratise access to the asset class. We are not figuring out what will be the next technology, that is for the specialist VCs who are experts at that. We take them when they are established, matured, and we invest ahead of some liquidity event for a shorter time frame of perhaps two to four years. At this type of stage, they are focusing on execution of their business plan to prepare for that liquidity event."

He explained that such companies do not have to go public, but they do need a liquidity event for exits of the VC money that backs them. "We seize on those opportunities, and onto companies that have real revenues, real growth, that are real businesses." He added that their particular skills centre on selection of the opportunity, valuation and target gains of two to three times over two to four years.

You lose some, but you win much more

Early-stage or VC investors might invest in 100 companies and hopefully a few of them will have incredible returns, while most will fail, he reported.

But he said their own write down rate is far lower, in the 45% to 50% region, and then they also hope to not lose all their invested money in each of those, as they are much more mature financially than the VC type opportunities. And he said the objective is to make returns of 2-3x capital invested on those other 50% to 55% of companies that make the grade, and every now and then also make a 5x-10x return on the best situations.

Healthy returns

This, he said, all translates over a five-to-10-year period time to annualised returns of between 15% and 20%, which is what they are trying to achieve.

He noted that most of their investments never make it to the public market. "In our experience, out of roughly 200 investments to date our realized returns show that 42% have been IPOs and 58% have been M&A exits. "If we have aggregated positive realised gains, we will then make a distribution back to the shareholders and they can either take cash or they can take shares," he added.

Easy access

And he explained that the main US based fund that he runs – which was first launched in 2014 and that today has AUM of around USD1 billion - is structured as a '40 Act Fund' in the US, which typically carries management fees, but no performance fee. It can be sold at the click of a button like a mutual fund.

"For investors to hit a button and suddenly have exposure across our portfolio of private companies for them was like seeing fire for the first time," Kevin quipped. "Some people ask why they are not having to fill out numerous sub-documents. But the structure, which is actually a closed-end interval fund, operates just like an open-ended mutual fund when you purchase it; you can buy it every day at the end of day NAV, however, you can only sell it quarterly and that comes with a cap of 5% of the net assets of the fund."

A stable ship

"The fund is not presented as liquid, but it is semi liquid, and we are as transparent as we can be,"

Kevin Moss
Liberty Street Advisors

he said. "This helps advisors and investors re-balance portfolios and have some liquidity, as this is and should be considered as a long-term investment, but you are not actually locked up for ten to fifteen years as you would be in traditional venture."

No stress or strain

He reported they have some 30,000 plus shareholders in this main US fund. "We run the fund with some 10% to 12% cash and are obliged by regulations to have 5% cash available at all times to meet redemptions. We have a line of credit if necessary to cover that 5% cap, but we have not used that funding option. We never want to get to a point where we are obliged to sell any positions other than at the times we deem best."

The GAM fund – a mirror vehicle in many ways, but just setting out

Kevin told guests that the GAM LSA Private Shares (Cayman) Fund represents a very similar strategy as their big US fund, but it is far newer, having launched in March 2022.

"Again, it operates just like an open-ended mutual fund, on the way in, you can buy it every day at end of the day NAV, but you just cannot sell it every day. You can only sell it four times a year typically at the end of each quarter. In the US, this structure is called a closed-end interval fund."

Big brother's footsteps

While the major US fund is now worth around one billion dollars, the new GAM fund is only about USD20 million at this stage and is 80% is cash, opening the door hopefully to plenty of smart investments at today's valuations, which are considerably more accessible than in the years preceding the 2022 markets slump.

The fund has the considerable advantage of the experience and relationships Kevin and colleagues have built up through the big US fund, which helps gain access to some of the better opportunities. They hope to gain significant additional investment and momentum in the GAM fund, and believe that with late-stage private company secondary transactions down on average 30-50% and less new money chasing deals, this is a good time for investors to diversify into this type of opportunity.

Good timing

"I'm excited about the GAM LSA Fund because it is a great time to deploy capital, as prices in these markets are so dislocated, and I think this will end up being a very good vintage, just like most times of uncertainty and volatility tend to be when looked at many years later," Kevin explained.

He explained that in the US fund, they had 97 companies as of March 9, and had also managed to get directly onto the cap table of companies like Elon Musk's SpaceX, which is the type of very rare opportunity that such funds crave.

He told guests that it was a unique experience making an investment in SpaceX as the company required diligence on our fund to allow us onto the cap table.

He explained that this was an example of the influence the US

fund has in opening doors to the better opportunities. It comes from running a major fund, and as a result the GAM fund will be able to leverage off of our access.

"We have a pro rata allocation policy in place such that anything we buy for the US fund, we can make a smaller and pro rata allocation to the GAM LSA fund," he told guests.

Selecting the right opportunities is the key

Kevin offered guests some brief insights into their selection and rejection process that they have honed over the years since 2014.

He said until the market slumps of 2022, it had been a challenging few years, because of the high valuations and the frantic chase of more and more new money hunting for new private deals.

"During that huge bull market, we had to pass on a lot of companies due to valuations, even though they were really good companies," he reported. "We also looked closely at governance, and I can report we did pass on FTX, as it did not pass our due diligence checks, and did not have a board we thought relevant, even though it had been assembling an array of notable investors."

However, he did report they have had other investments over the years that did not work out. He said nobody is perfect and there will be loses in any portfolio of investments.

Kevin has two other senior portfolio managers alongside him, in the form of Jonas Grankvist as portfolio manager and Christian Munafo, Chief Investment Officer. This small team of decision makers is supported by three analysts, as well as an experienced CFO and Joe Malizia, who specialises in origination of deals. ■

For more on Kevin and private markets, see these Hubbis reports:

Liberty Street Advisors Managing Director Kevin Moss on Democratising Access to Late-Stage Private Markets
And:
The Compelling Case for Investors Upsizing their Allocations to Private Equity
And:
Liberty Street Advisors' Christian Munafo on the Drive to Democratise Private Markets Access