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Understanding Private Equity

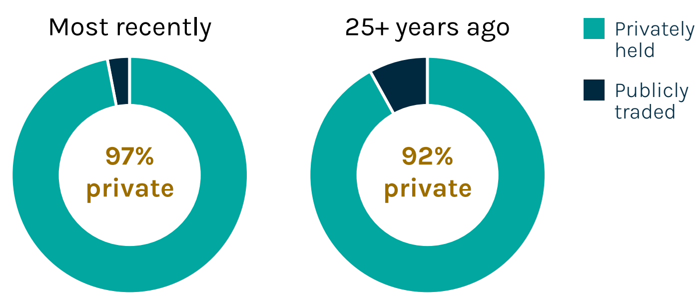
Private equity defined

Private equity offers investors exposure to ownership of companies that are generally not publicly traded. There are varying business models, but often the primary goal of a private equity investment fund is to purchase an asset or company, apply a value creation or growth playbook over four to six years, and ultimately sell that asset or company at a gain. Private equity is most commonly held off-market by an investor or fund, rather than being traded on an exchange like traditional public equity investments. Historically, institutional investors have been the beneficiaries of private equity investments as they seek opportunities for superior long-term appreciation with less volatility relative to public equity investments; however, this is changing as the asset class is becoming more democratized.

The five realities of private equity

#1 The majority of the U.S. economy is privately held.

Over 90% of U.S. companies at scale (100+ employees) are, and always have been, privately held. While the relative proportion of private to public companies has evolved over time, the heart of the U.S. economy lies in its private companies. Investors that invest only in public equity are missing out on a large opportunity set.



Source: FRED St. Louis Fed, U.S. Census Bureau, as of January 1, 2020.

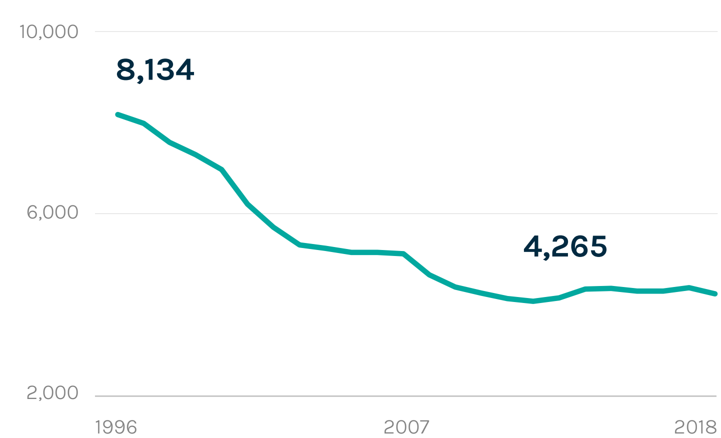
Source: FRED St. Louis Fed, U.S. Census Bureau, as of January 1, 1997.

#2 Companies are staying private longer.

For a number of reasons, including evolving regulation and a deeper universe of private equity investors, business owners today are preferring to stay private for longer—or not go public at all. In fact, the number of publicly traded companies in the U.S. has decreased approximately 50% over the past 25 years, leaving investors with fewer choices and less diversified public company portfolios.

The **classic Wilshire 5000 Index** of the total U.S. stock market today **only has 3,569 holdings**.

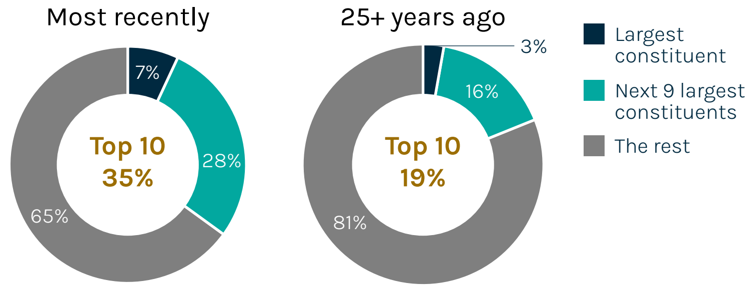
Number of U.S. publicly traded companies is shrinking



Source: FRED St. Louis Fed, U.S. Census Bureau, Wilshire, S&P, Ares. All data as of July 2022. The difference in FRED count and Wilshire count driven by OTC listings.

#3 Private equity markets have historically been more diversified, while public equity markets have become more concentrated.

Public companies today are larger in size and more concentrated in certain industries, such as technology. 25 years ago, the top 10 constituents of the S&P 500 Index represented 19% of its total market capitalization across a variety of industries. Today, the top 10 constituents of the S&P 500 Index represent 35% of its total market capitalization—with the largest single company representing more than 7%—and nearly all are technology companies.



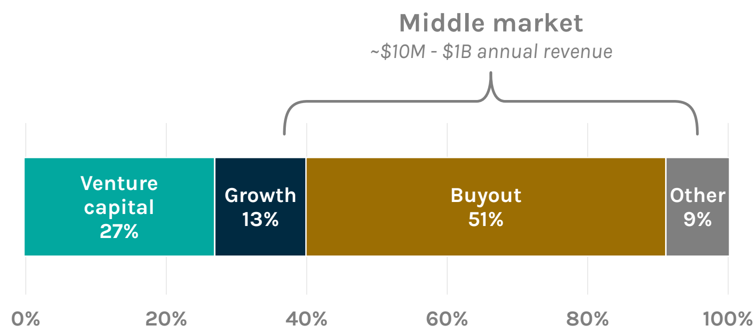
Source: Bloomberg, as of December 31, 2022.

Source: EDGAR, as of December 31, 1996. S&P constituents proxied by SPY holdings.

#4 Most private equity has been in the "middle market."

Instead of market capitalization, the private equity universe is segmented based on company maturity and, by extension, revenue. Companies with 100—5,000 employees are generally of the size and tenure that they can be viewed as the core "middle market." These companies are further along in their lifecycle—consistently generating annual revenue between $10 million and $1 billion—and the majority of these mature businesses are classified as "buyout," the largest type of middle market company by AUM.

Private equity AUM by type

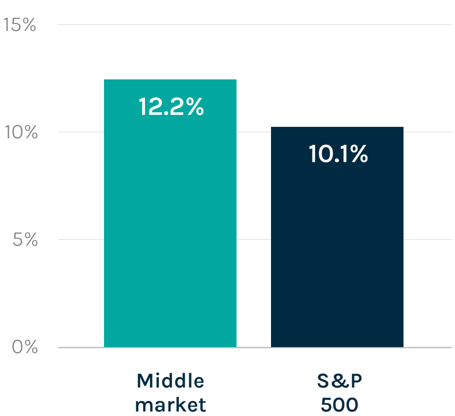


Source: McKinsey as of December 31, 2022.

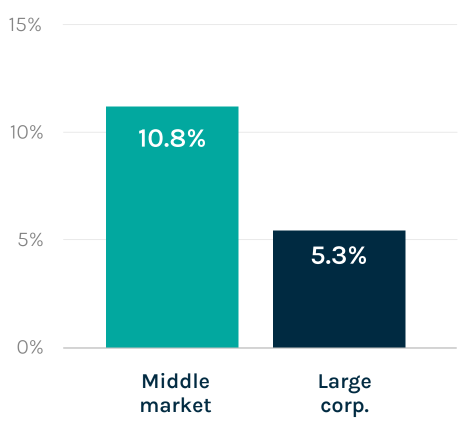
#5 Middle market companies are fundamental to economic growth.

Middle market companies—the vast majority of which are private—represent a major source of economic growth. Middle market companies fuel roughly 80% of U.S. gross domestic product. Notably, these companies have historically provided higher rates of growth than public equity investments.

Revenue growth



Employment growth



Source: National Center for the Middle Market, for the 12-months ended Q2 2022..
"Middle market" includes companies with $10 million to $1 billion in revenues.
"Large corp." includes companies with 1,000+ employees.

Many of today's business owners are turning to private equity firms for growth capital and for the governance structures they offer. Business owners appreciate the long-term focus of private equity boards, and the closer alignment of interests between their company and its investors.

Why is private equity playing an increasingly important role in individual investors' portfolios?

In today's environment, due to the structural changes within public markets and lower forward-looking return expectations of public equities, investors are increasingly searching for ways to improve diversification, reduce correlation and increase returns within their equity allocation. One of the ways they are diversifying their equity risk is by turning to private equity, which today represents a much larger, more diverse and more accessible opportunity set than ever before.

A broader opportunity set

Private equity enables investors to access the growing universe of quality, performing private businesses while participating in the large swaths of the U.S. economy that public market indices miss.

Superior risk management opportunity

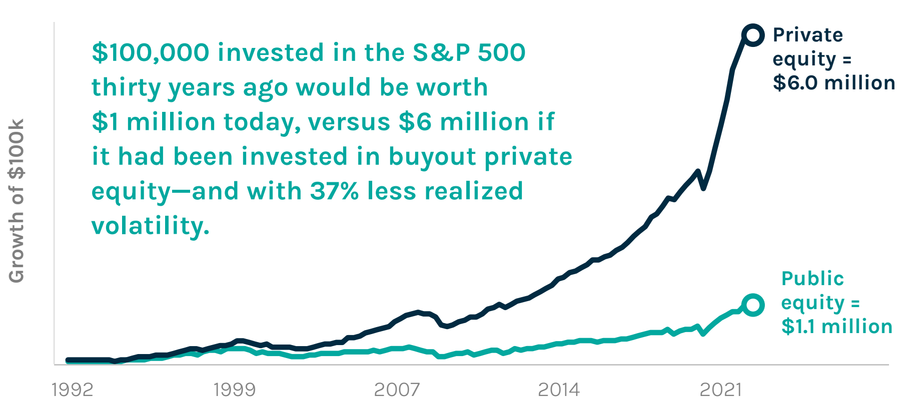
Private equity investments have demonstrated lower downside volatility with reduced correlations relative to public equity investments.[1]

Longer time horizons

Private equity investments tend to have longer time horizons and are valued less frequently. These dynamics can reduce the temptation for individual investors to sell based on short-term price movements.

Private equity has delivered superior performance over time

Private equity investments have demonstrated superior returns on an absolute and risk-adjusted basis, relative to public equity equivalents.



Past performance is no guarantee of future results. See the important risk information below. Sources: Bloomberg, Burgiss. The S&P 500 is comprised of 500 of the largest public companies. The Buyout segment is comprised of "middle market" private equity companies. There are many differences in the risks, and other characteristics between these asset classes.

Ready to learn more?

AccessAres is your resource for education and information about the private markets. Talk to us to learn more about these important asset classes.

[1] Sources: Bloomberg, Burgiss. An investment in private equity is significantly less liquid than an investment in public equity and is not immune to fluctuations, including downward fluctuations.

REF: AM-02526