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Mind the Gap: The Strategic Risk of Skipping a Vintage in Private Equity

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Private equity (inclusive of buyouts, growth equity, and venture capital) remains a compelling long-term asset class, but recent periods of muted distributions and below-average returns have created a dilemma for investors: how should future private equity commitments be sized?

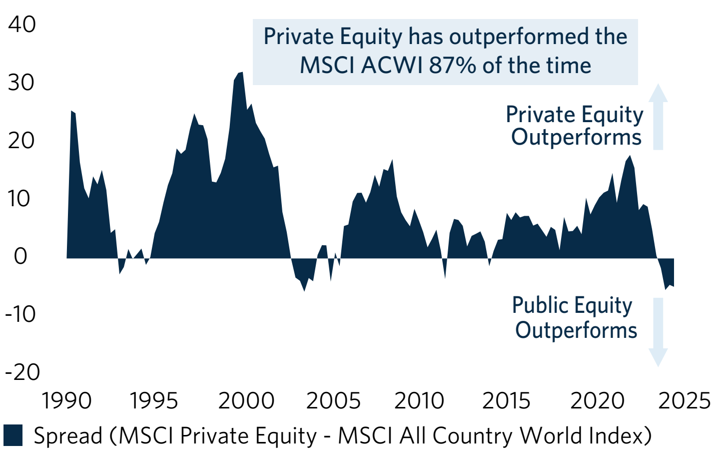
In this article, we emphasize the importance of a disciplined investment plan to build and maintain a diversified private equity portfolio across vintage years. We also underscore the need for a meaningful allocation to the asset class and the importance of manager selection to improve the potential of achieving strong long-term performance.

INTRODUCTION: THE PRIVATE EQUITY COMMITMENT DILEMMA

Following strong performance in 2020 and 2021, private equity markets faced challenges as rising rates, higher debt costs, and valuation corrections reduced returns and liquidity. The chart below illustrates the rolling three-year relative return of private equity versus public equities. While private equity has outperformed public markets in roughly 87 percent of these periods, underscoring its long-term value, the most recent data reflects a period of short-term underperformance.

ROLLING 3-YEAR RETURNS OF PRIVATE EQUITY RELATIVE TO GLOBAL EQUITY MARKETS

Numbers in Percent



Source: Bloomberg, MSCI Private i. Data as of March 2025. MSCI Private Equity represents time-weighted returns for Generalist and Equity asset classes (inclusive of Venture Capital) from MSCI Private i.

Adding to the challenge, the slowdown in distributions has led to extended fund lifespans and potentially higher allocations, disrupting pacing assumptions. The median hold period for U.S. private equity backed companies now stands at 3.8 years, the longest in over 14 years[1]. This is prompting some investors to reassess their commitment plans.

Despite these headwinds, the outlook is more positive. As noted in our most recent fiscal year-end letter, we've been encouraged by the liquidity generated in our portfolios year-to-date and expect favorable conditions to persist. We continue to see attractive opportunities in the lower-middle market segment, while the rise of AI is unlocking exciting opportunities in venture capital. Both areas offer access to innovative, high-growth companies often underrepresented in public markets.

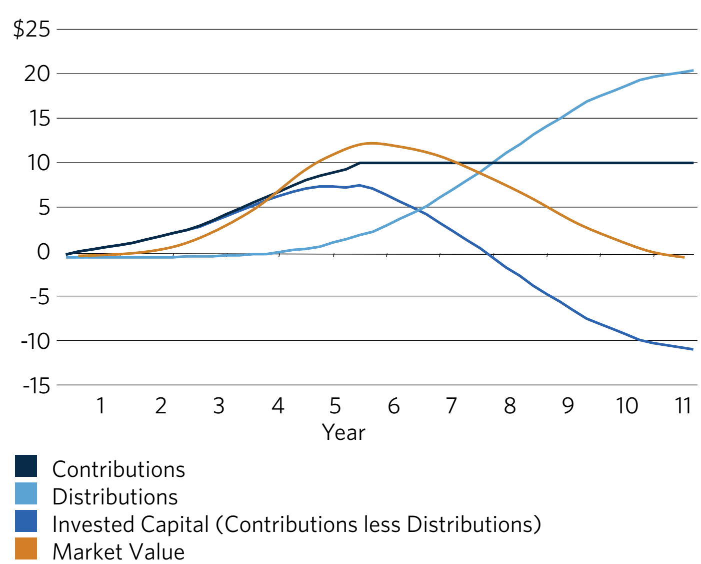
Against this backdrop, investors face a critical decision: how to manage their future commitments to private equity. Pausing commitments may seem like a practical response to recent challenges, but it can create long-term risks, particularly for those seeking consistent exposure and diversification.

WHY VINTAGE YEAR DIVERSIFICATION MATTERS

Private equity funds' capital deployment cycle makes maintaining an allocation to the asset class complex. The graph below illustrates the hypothetical sequence of investing $10 million in a direct private equity vehicle. Investors' commitments are invested over several years as managers find investment opportunities and call capital. Towards the latter half of the funds' life, capital is distributed back to investors as exit opportunities arise. Vintage year refers to the year a private equity fund makes its initial investment.

OVERCOMMITMENT: A KEY CONSTRUCT

Dollars in millions



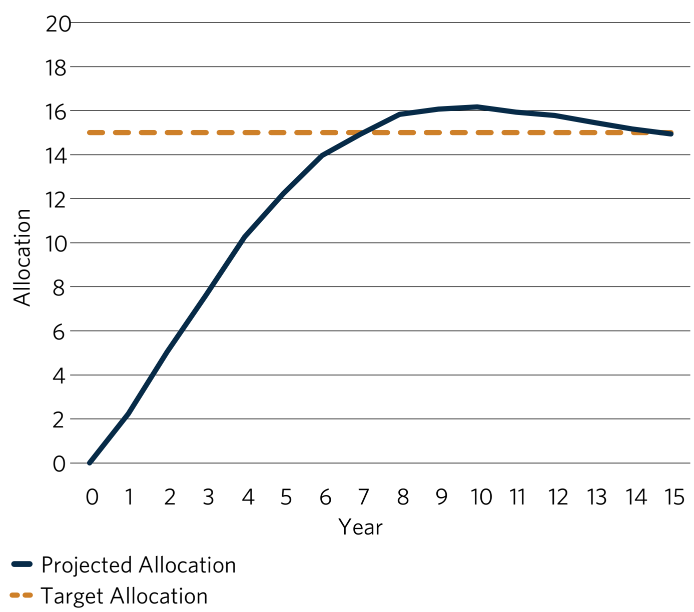
Notes: For illustrative purposes only. Assuming a fund with an overall 15 percent net IRR and a 2.0x multiple on invested capital.

1 Source: Pitchbook as of June 30, 2025.

Consistent commitments are necessary to build and/or maintain a private equity allocation. The chart below models the potential private equity allocation of a $100 million portfolio with a 15 percent private equity target, assuming an 8 percent annualized return and 5 percent annual spend. An average of $3.2 million is committed annually.

HYPOTHETICAL PRIVATE EQUITY ALLOCATION

Numbers in percent



Notes: For illustrative purposes only. Assumes a total portfolio annual growth rate of 3%. Assumes a Growth and Buyouts net multiple of 1.6x and a Venture Capital multiple of 2.2x, both with a 16 year fund life.

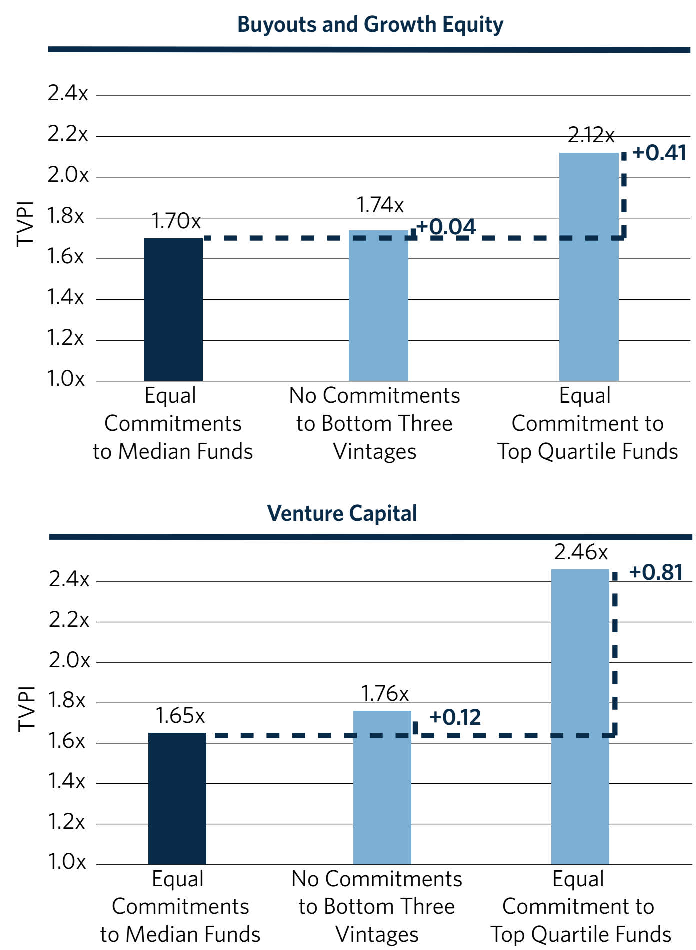
With recent headwinds in private equity performance and delayed distributions, some investors may consider holding off on new commitments until conditions improve. Yet this hesitation can pose unintended risks to the overall portfolio strategy, particularly in two key areas: return potential and portfolio construction.

Return Potential

The cyclicality of markets inevitably affects asset class performance. While some investors attempt to time the markets, doing so is notoriously challenging, specifically in private markets, where both entry and exit points are harder to anticipate. To assess whether a vintage year will perform below median, an investor would have to accurately predict the entry environment over the next several years as well as the exit environment, which may be 6-12 years out.

Even if an investor was able to time vintage years perfectly, the performance improvement would be slight. As seen below, across the 2000-2020 vintage years[2], skipping commitments to the three lowest performing vintage years in buyouts and growth equity would not have significantly improved performance. To move the needle, manager selection—identifying top quartile performers—is a more significant return generator. Venture capital yields a similar result, albeit with a wider return dispersion.

AGGREGATE NET MULTIPLES



Source: MSCI Private i. Data as of March 2025. Burgiss Private i net multiples for Buyouts and Growth Equity as well as Venture Capital across vintage years 2000-2020.

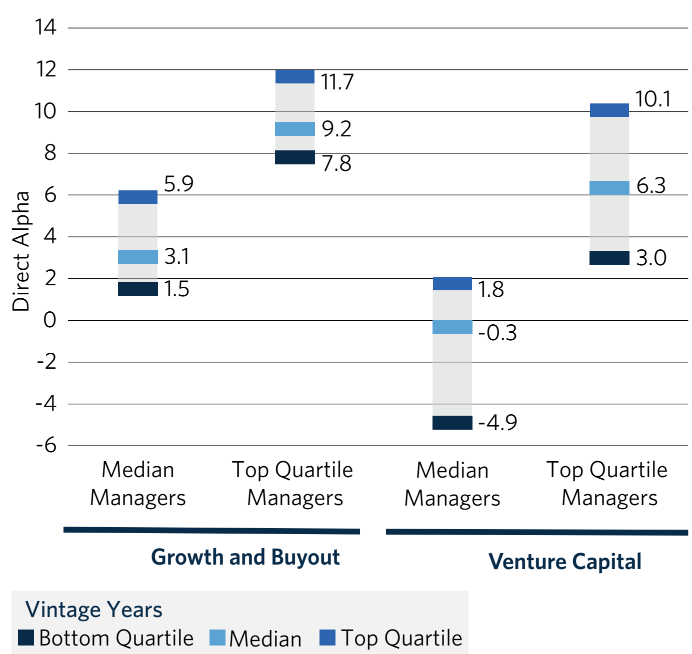
2 MSCI Universe, equal commitments across 2000-2020 vintage years vs. omitting three bottom performance vintages.

Assuming uncommitted capital is instead allocated to public equities, we evaluate the opportunity cost of skipping vintages using a metric called direct alpha. This metric compares the annualized returns of private equity funds to public market returns, matching the timing of capital calls and distributions. The median performing growth/buyout manager has produced a return above public markets across all vintages with only one exception[3]. This means that even in lower returning vintages, median growth/buyout managers have been able to outperform the public markets and add excess returns to a portfolio. This return data is inclusive of the current challenged three-year period for private equity performance[4].

Venture capital tells a slightly different story with median managers failing to produce excess return over public markets in 11 of the 21 years. In venture capital, if you're allocating just for the sake of allocating, you will likely be disappointed. Importantly, top quartile venture capital managers were able to generate returns over public markets in all but one vintage year, with an average of +6.1 percent net annualized over all vintage years, underscoring the importance of investing with top performing managers.

DIRECT ALPHA VS. MSCI ACWI

Numbers in percent



Source: Bloomberg, MSCI Private i. Data as of March 2025. Burgiss Private i direct alpha for Buyouts and Growth Equity as well as Venture Capital across vintage years 2000-2020 as compared to MSCI All Country World Index.

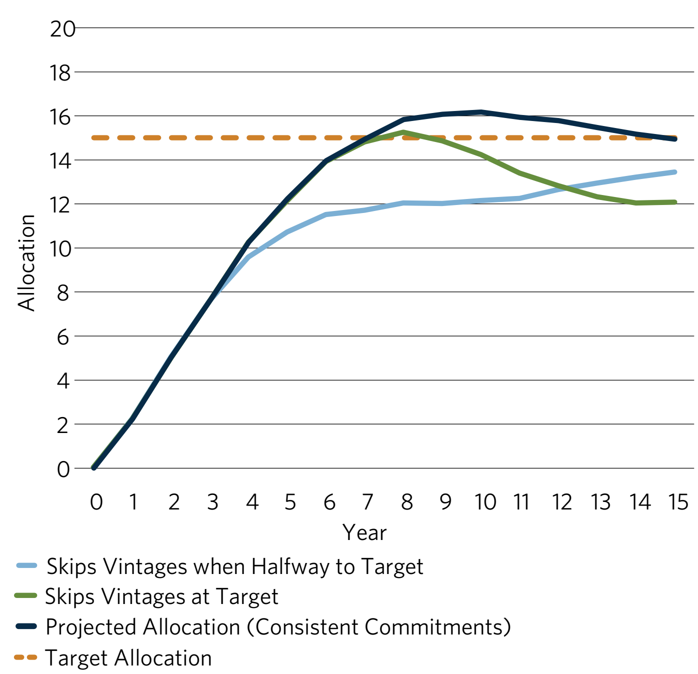
Portfolio Construction

The second challenge with skipping vintages centers around portfolio construction. Due to the unpredictable timing of capital calls and distributions, building and maintaining an allocation to private markets is far more complex than managing public assets. The irregular nature of these cash flows turns commitment planning into a multi-period optimization challenge in which skipping vintages or being too conservative risks under-allocation and missed return potential, while being too aggressive can introduce liquidity risks.

Let's revisit the $100 million portfolio from earlier to explore the allocation impact of skipping one Fund of Funds vintage year (or two consecutive vintage years). Below we demonstrate three scenarios: (1) consistently committing to prudently build out the allocation to target, (2) deciding to skip when halfway to target and, (3) skipping when already at target.

HYPOTHETICAL PRIVATE EQUITY ALLOCATION

Numbers in percent



3 Public markets measured as MSCI All Country World Index; private equity funds within MSCI Universe 2000-2020 vintage years.
4 Past performance is not indicative of future results.

Notes: For illustrative purposes only. Assumes a total portfolio annual growth rate of 3%. Assumes a Growth and Buyouts net multiple of 1.6x and a Venture Capital multiple of 2.2x, both with a 16 year fund life.

The impact of skipping vintage years results in a persistent private equity underweight between 2-4 percent relative to the consistent committer. Even if latter commitments were increased to compensate for the commitment gap, a ~2 percent underweight would remain for 5+ years. For those investors who are targeting total portfolio returns of inflation plus spend, a multi-year decreased private equity allocation could be detrimental in achieving intergenerational equity.

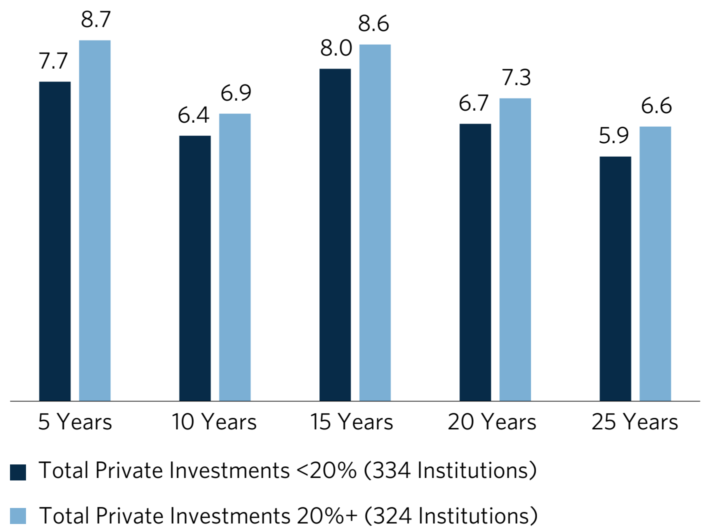
CONCLUDING THOUGHTS

Building a private equity allocation that can meaningfully impact portfolio outcomes requires both time and discipline. It starts with committing a significant portion of capital to the asset class, then prudently diversifying across multiple vintage years to fully capture its return potential.

The power of maintaining a consistent private investment allocation is evident in the most recent NACUBO-Commonfund Study of Endowments. As shown in the chart to the right, among 658 higher education institutions, those with higher private investment allocations have compounded an annualized total portfolio return +0.7 percent above their peers over 25 years. For a $100 million endowment spending 5 percent annually, this difference translates into approximately $24 million in additional ending market value and $13 million in incremental spending capacity.

ENDOWMENT PERFORMANCE BY PRIVATE INVESTMENT ALLOCATION

Numbers in percent



Source: 2024 NACUBO-Commonfund Study of Endowments and Commonfund Portal. The NACUBO-Commonfund Study of Endowments (NCSE) is an analysis of financial, investment and governance policies at endowed institutions of higher learning. All rights reserved. For fiscal year 2024, 658 institutions representing $873.7 billion in endowment assets participated. For additional information on the NCSE data shown please go to https://nacubo.org/research/2024/nacubo-Commonfund-study-of-endowments

We believe the asset class will continue to play an important role in driving long-term returns. However, the decision to allocate to private equity is only the first step. Success also depends on selecting high-quality managers, and, importantly, committing capital consistently through market cycles to avoid the pitfalls of market timing and capture the full benefits of the asset class.

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