INTRODUCTION TO PRIVATE MARKETS

BY NATIONAL BANK INVESTMENTS

Once reserved for institutions and the elite, private investment offers even more opportunities than the stock market and potentially higher returns.

→ A REPORT BY NATIONAL BANK INVESTMENTS,
IN COLLABORATION WITH HARBOURVEST PARTNERS, LLC.

CONTENT OVERVIEW

- This report sheds light on the evolution of private investment and its value in portfolio construction and diversification.
- It presents the different categories of private investments, which are more widely regarded as “alternative” assets, and their benefits and challenges for both financial institutions and the general public.
- Private markets offer more investment opportunities and allow for more active engagement. There are a variety of value-creating strategies to choose from that take risks and returns into account.
- Finally, this report examines how access to private investments and their more active approach plays an important role in achieving superior long-term returns.

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THE DEMOCRATIZATION OF PRIVATE INVESTMENT

Private markets comprise several asset classes, including private equity, private credit, real estate and infrastructure investments. Unlike public markets, where securities are traded on stock exchanges, these investments are neither made public nor listed according to ratings that determine their value. Historically, these markets were reserved for institutions such as pension funds, endowments and insurance companies. It enabled them to achieve better returns, diversify their portfolios and benefit from opportunities not available on the stock market.

In recent years, more and more people have discovered the advantages of investing in private markets. This paradigm shift was made possible by innovative financial products, regulatory changes and the democratization of investment platforms. As they've evolved, private markets have become an invaluable investment strategy for both institutional and individual portfolios.

THE DIFFERENT TYPES OF PRIVATE INVESTMENT

1

Private equity

This type of investment involves investing in private companies (those that aren't listed on a stock exchange), usually through a private equity company or fund.

→ **Buyout**
Private equity firms regularly acquire companies in whole or in part. They seek to improve performance and profitability through strategic, operational and financial restructuring.

→ **Growth equity**
Some well-established companies look for capital in order to expand, restructure their operations, penetrate new markets or finance a major acquisition without losing control.

→ **Venture**
A hybrid of private equity and private debt, venture capital converts debt into equity for companies in the event of default, usually after venture capitalists and other major backers have been repaid.

2

Private credit

These are loans and other forms of debt that aren't traded on an exchange. They're granted or initiated by non-bank entities, such as private debt funds, insurance companies, pension funds or asset management firms.

→ **Direct loan**
Granted directly to companies, which can use it as growth capital, for refinancing or in a leveraged buyout, direct loans have the advantage of offering flexible terms tailored to a company's needs. As an investment, they can generate higher returns than traditional fixed income investments.

→ **Debt from a company experiencing economic hardship**
This involves investing in a bankrupt or heavily indebted company at a substantial discount in the hope that it'll recover and regain value. This type of investment can be very risky, but potentially very profitable.

→ **Seed capital loan**
This type of loan is offered to startup and high-growth companies that aren't yet profitable or have significant assets. Often used in conjunction with venture capital financing, it offers no control over the company's management. This investment usually comes with warrants or share purchase rights, which allow you to benefit from profits.

→ **Real estate loan**
By lending funds for real estate projects, such as the construction of commercial or residential buildings, you can earn a return through interest and commissions. This type of loan is secured by the financed property, which ensures a certain degree of protection.

3

Real estate investments

This type of investment involves the purchase, management and construction of real estate, which may be commercial, residential, industrial or mixed-use.

→ **Commercial**
Investing in commercial property, such as office buildings, shopping centres, hotels and warehouses, can generate rental income and capital appreciation.

→ **Residential**
Investing in residential properties, such as single-family homes, apartment buildings and apartment complexes, can generate rental income and capital appreciation.

→ **Industrial**
Investing in industrial buildings, such as factories, plants, warehouses and distribution centres, can generate rental income and capital appreciation.

→ **Real estate development**
This involves buying land to build on or renovating existing land to increase its value and appeal.

4

Infrastructure investments

These are investments in sectors that are essential to the functioning of society and the economy, such as transportation, utilities, energy and communications.

- **Transportation**
  Investment in transportation infrastructure, such as roads, bridges, airports and rail networks, generates revenue through tolls, user fees and government payments.

- **Utilities**
  Investment in public infrastructure, such as waterworks, sewers and waste management, generates stable, predictable income.

- **Energy**
  Investment in energy infrastructure, such as power plants, transmission lines and energy storage facilities, comes with the benefit of long-term contracts and public subsidies.

- **Communications**
  Investment in communications infrastructure, including fibre-optic networks, cell phone towers and data centres, has profited from the growing demand for data and connectivity.

THE BENEFITS OF PRIVATE INVESTMENT

Better returns

Private markets have historically and consistently outperformed public markets: for time-weighted returns over rolling five-year periods, private equity buyouts generated an average premium of 670 basis points over the MSCI ACWI Total Return Index.[1] Yet private markets investing has traditionally been reserved for institutional investors and ultra-high-net-worth individuals—investors who are able to meet the high investment minimums traditionally associated with private markets.

As regulation evolves and new product innovations are launched, the door to private markets is opening. Structural barriers — such as longer lock-up periods that limit liquidity and the complexities and time required to create a private market portfolio — have been removed. Now, more investors can tap into the potential outperformance and diversification benefits offered by private market investing.

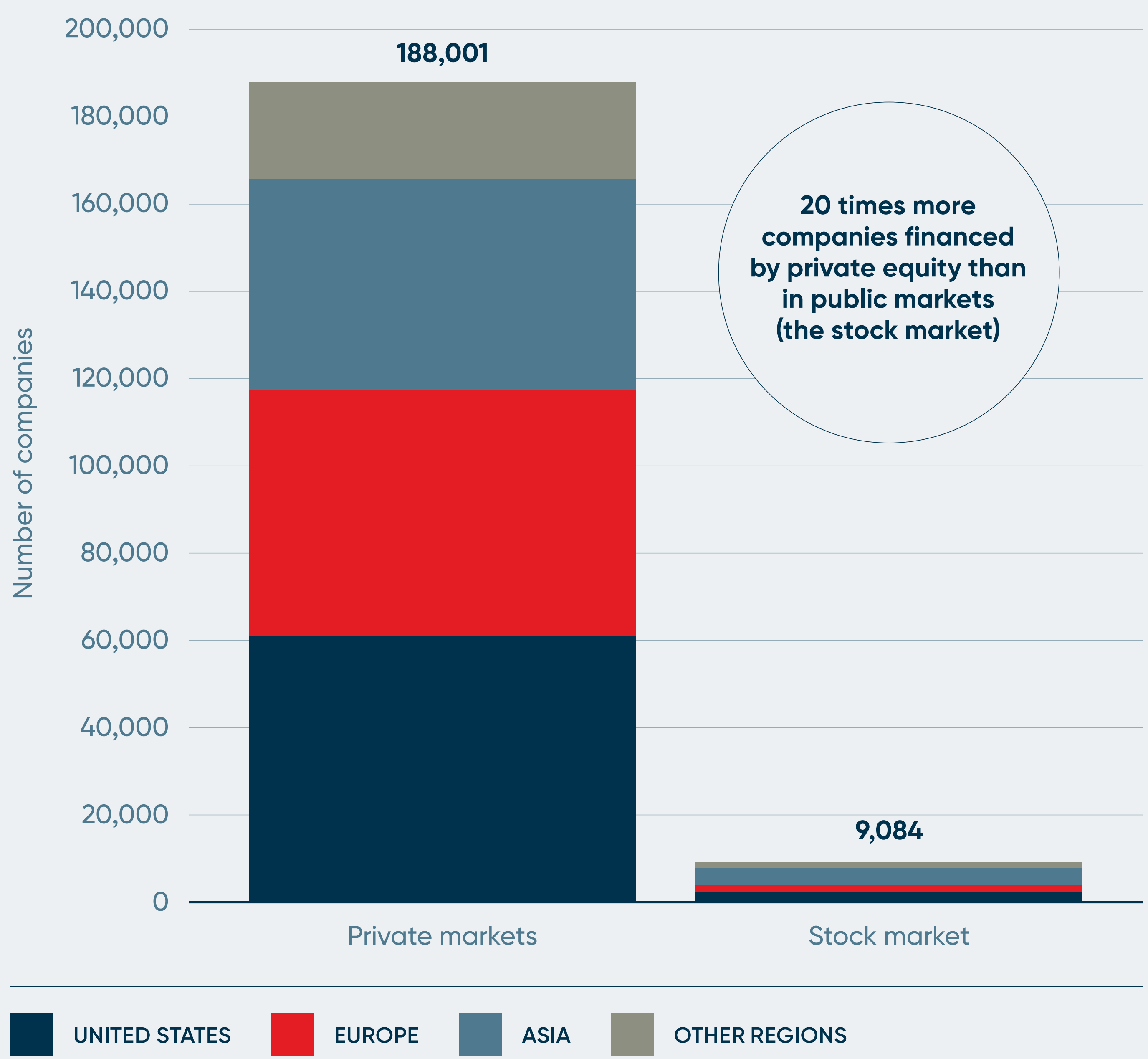
More possibilities

Private markets provide access to approximately 20 times more companies than those included in the MSCI All Country World Investable Market Index (ACWI IMI).[2] Globally, there are nearly 200,000 private equity-backed companies across buyout, growth equity and venture investments. They include early-stage startups, more mature companies and a wide group of formerly listed companies that have decided to return to private ownership.[3]

The ability to invest in multiple companies in the early stages of their growth presents an opportunity for significant returns. For private markets, the median private equity enterprise value is projected at $243 million, compared to the median public market capitalization of $2.3 billion.[4]

THE GENERAL PUBLIC NOW HAS BETTER ACCESS TO PRIVATE EQUITY FUNDS AND OTHER PRIVATE ASSETS, SUCH AS REAL ESTATE INVESTMENTS, TO DIVERSIFY THEIR PORTFOLIOS AND POSSIBLY ACHIEVE HIGHER RETURNS.

OPPORTUNITIES IN PRIVATE MARKETS VS. THE STOCK MARKET



Source: Data from PitchBook as at February 2, 2024 and MSCI as at December 31, 2023. Private markets comprising buyout, growth and venture capital companies. Public markets composed of all constituents from the MSCI IMI index.

Active asset management

Private fund managers tend to be more engaged with their underlying portfolio companies. Many have significant shareholdings and the ability to influence decisions. Since private markets aren't required to publicly disclose information, they can optimize returns by influencing both day-to-day operations and long-term value creation strategies.

Three strategies are used to create return premia and optimize returns on investment:

1. **Earnings growth**
   Value derived from operational improvements, such as new product launches, synergies resulting from mergers or acquisitions or global expansion.
2. **Multiple expansion**
   Buying small and/or public companies going through a difficult period at a lower price and reselling them at a higher multiple.
3. **Debt reduction**
   Optimizing capital structure by effectively adding or removing leverage.

A good risk/return ratio

Macroeconomic conditions have a similar influence on private and public assets (see chart). Historically, private equity (buyout and venture) has generated significantly higher time-weighted returns and presented lower downside risk than public markets (MSCI ACWI) over 5-, 10- and 15-year horizons.

This dynamic is due to a combination of factors:

1. Active ownership, which provides support to portfolio companies in challenging markets.
2. A preference for resilient companies.
3. Less reactive private market valuations.

COMBINING POTENTIALLY HIGHER RETURNS WITH LOWER DOWNSIDE RISKS, PRIVATE INVESTMENTS CAN GENERATE BETTER RISK-ADJUSTED RETURNS WHILE PROVIDING PORTFOLIO DIVERSIFICATION.

PRIVATE MARKETS OUTPERFORM THE STOCK MARKET

Source: MSCI and S&P Capital IQ data as of June 30, 2023. All returns in USD. Downside risk represents maximum peak-to-though drawdown over the stated period. Past performance is not a reliable indicator of future performance.

A GATEWAY: PRIMARY INVESTMENTS

The largest and most influential financial institutions base their private asset portfolios on primary investments. More recently, wealth management firms, high-net-worth individuals and even more modest investors have taken advantage of this strategy.

What are primary investments?

These funds are structured like limited partnerships, with a limited partner providing capital and a general partner investing it into underlying portfolio companies. Typically, a fund invests in 10 to 30 companies over a period of 2 to 5 years. Diversified primary portfolios typically consist of 20 to 40 funds, the equivalent of about 500 companies across buyouts, venture capital or growth equity.

THANKS TO A MULTI-MANAGER STRATEGY, PRIMARY INVESTMENTS PROVIDE ACCESS TO STARTUPS THAT BENEFIT FROM VENTURE CAPITAL – COMPANIES THAT RELY ON GROWTH CAPITAL TO EXPAND OR MATURE COMPANIES IN THE PROCESS OF BEING TRANSFORMED OR OPTIMIZED THROUGH A BUYOUT.

COMPANIES THAT HAVE USED PRIVATE EQUITY

SpaceX

Founded by Elon Musk in 2002 with the goal of reducing the cost of space transportation and colonizing Mars, SpaceX has become one of the most innovative and disruptive companies in any venture capital portfolio. Founders Fund and Draper Fisher Jurvetson were the first investment firms to finance it, acquiring shares in 2009 when the company was worth $60 million. In December 2023, a secondary share sale valued SpaceX at $180 billion.

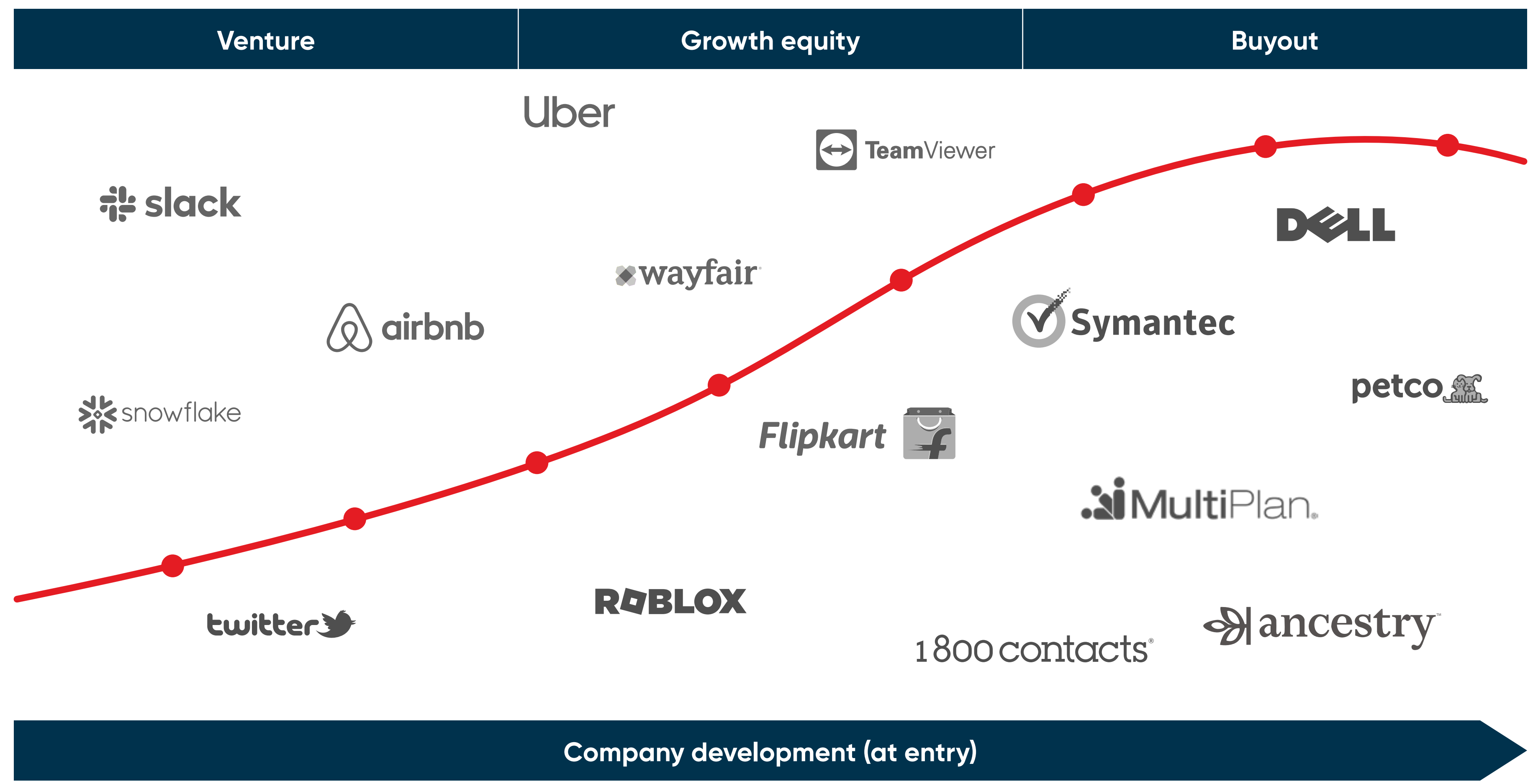
Dell

Almost 30 years after it was created, Dell needed a radical change to regain its competitive edge. In 2013, Silver Lake led a consortium in a $25 billion going-private transaction for a restructuring that included corporate streamlining, product modernization, strategic acquisitions and a reverse takeover. In 2023, after a demerger and the initial public offering of its subsidiary VMware, the latter was acquired by Broadcom for the record sum of $69 billion. This was the largest takeover in the technology sector and one of the most impressive value creations by a private equity firm.

Toshiba

Tokyo Shibaura Denki, now Toshiba Corporation, was founded in 1939 and floated on the stock exchange in 1949. In 2023, it conducted the largest privatization operation in Japanese history. The $15 billion operation was carried out in partnership with Japan Industrial Partners, turning the 148-year-old conglomerate into an owner-managed private company in Japan.

INVESTISSEMENTS INITIAUX EN CAPITAL-INVESTISSEMENT/INITIAL PRIVATE EQUITY INVESTMENTS



Source: HarbourVest. For illustrative purposes only. The red line is indicative of the estimated revenue at the time of initial investment by the HarbourVest Global Fund program. While some of the companies listed have been companies invested in HarbourVest in the past, or may be in the future, the reference does not constitute a recommendation to invest in any of the aforementioned companies or General Partners.

THE BENEFITS OF PRIMARY INVESTMENT

1

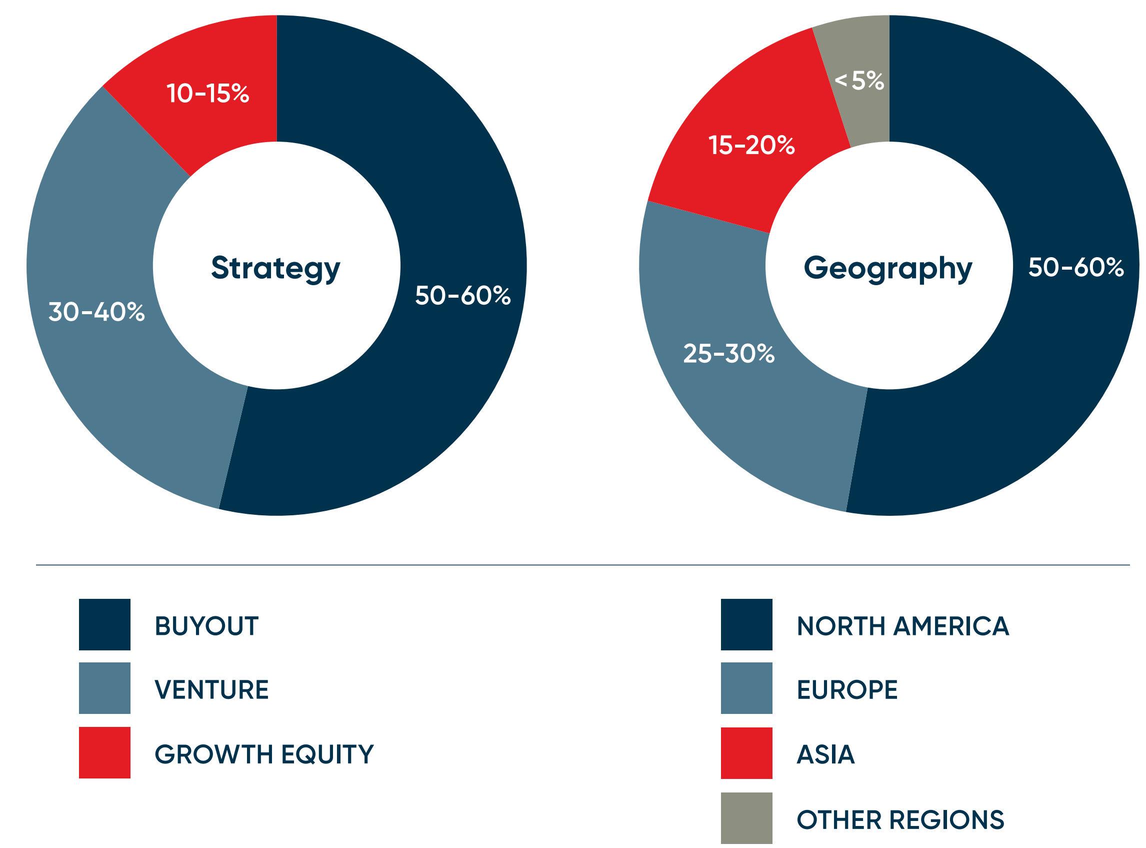
Complementary portfolio diversification

In the United States, the number of companies listed on a stock exchange has fallen by nearly 27% over the past two decades and now accounts for less than 1% of all active companies.[5] Over the same period, private investment in private companies has played an even greater role in the world's financial markets, contributing to more flexible, efficient and profitable business models.

Primary investment strategies make it possible to allocate capital in much the same way as in a stock market portfolio (yield, value, growth and hypergrowth), but with access to even more companies. This provides an opportunity for complementary portfolio diversification, combining different strategies (venture capital, growth capital and buyout capital), regions (North America, Europe, Asia and emerging countries) and investment periods.

BY CONCENTRATING YOUR PORTFOLIO SOLELY ON THE STOCK MARKET, YOU LIMIT YOURSELF TO JUST 1% OF THESE INVESTABLE COMPANIES.

PRIVATE EQUITY BREAKDOWN BY STRATEGY AND GEOGRAPHY



Source: Preqin, data as of March 31, 2024

2

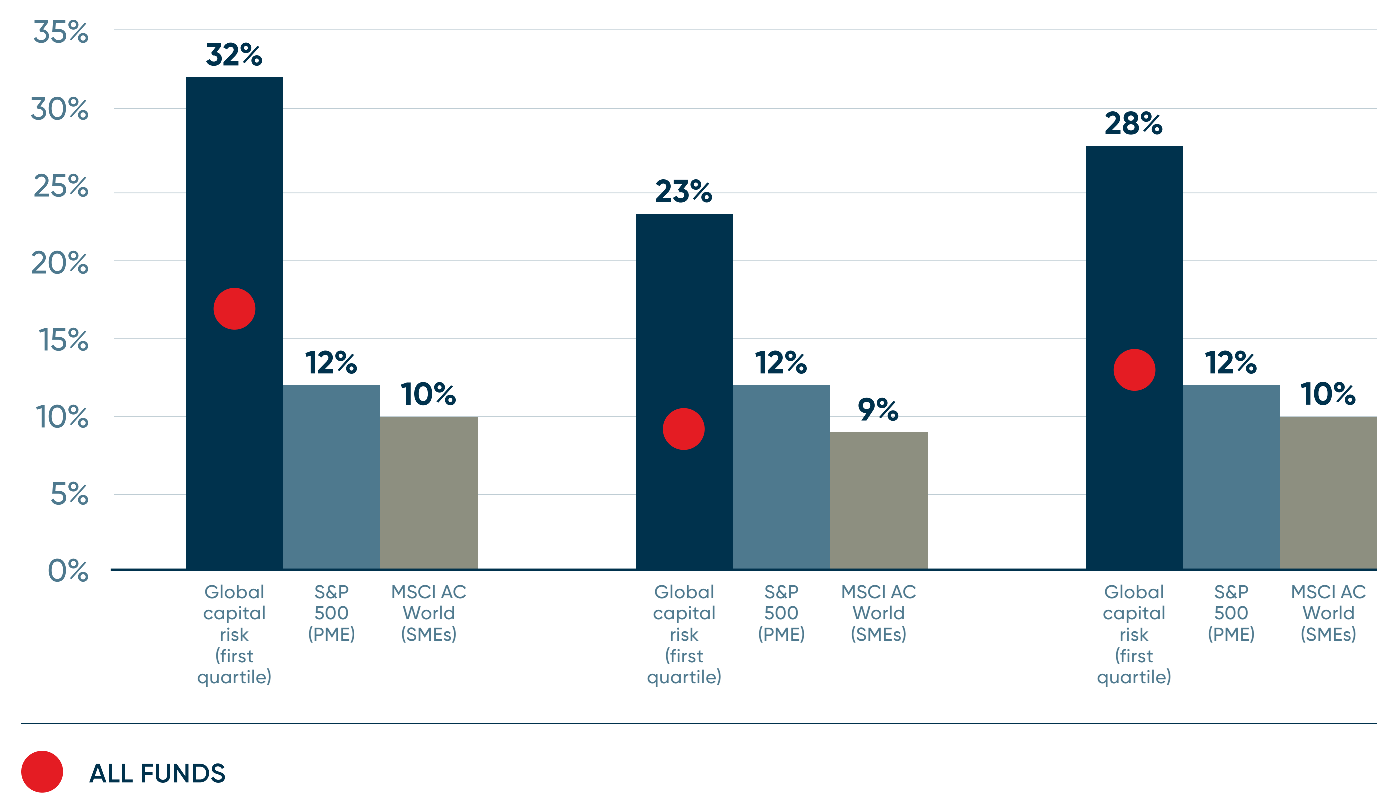
Attractive returns

If contributed to regularly, primary investments potentially generate higher returns over the long term. They offer both absolute and risk-adjusted returns.

Institutions with access to top quartile managers, or that successfully identify new, emerging managers who rank among the top performers, can generate internal rates of return (IRR) of 20% or more over the long term. These primary funds have the potential to generate alpha of 500 basis points against private market indices, which have averaged 15%, and 1,000 basis points of outperformance over comparable public market indices, which have averaged 10%.[6]

TO ACHIEVE SUPERIOR RESULTS WITH PRIMARY INVESTMENTS, IT'S IMPORTANT TO TARGET FUNDS AND MANAGERS THAT PRODUCE CONSISTENT RETURNS IN THE TOP TWO QUARTILES.

GLOBAL PRIVATE EQUITY 10-YEAR IRR



Source: Burgiss, data for private markets and public market equivalent (PME) as of September 2023. For illustrative purposes only. Past performance is not a reliable indicator of future performance.

3

Structured portfolios

It can take up to 5 years to build a portfolio of 20 to 40 funds, diversified by vintage year, strategy, region and investment type. At the outset, that means investing in private equity firms with a proven track record. They provide access to the largest, most high-profile deals on the private markets.

These core investments can then be complemented with more tactical or specialized funds. These complementary strategies target various categories, including sector-focused funds, seed funds, regional-focused funds, diversified managers and de-mergers, among others. In many cases, these tactical funds have the potential to stand out from the crowd in terms of performance, but may also have greater dispersion in performance, making manager selection all the more important.

BUILDING A PORTFOLIO

Source: HarbourVest. For illustrative purposes only.

U.S. PRIVATE VS. PUBLIC EQUITY 10-YEAR RETURN* DISPERSION COMPARISON

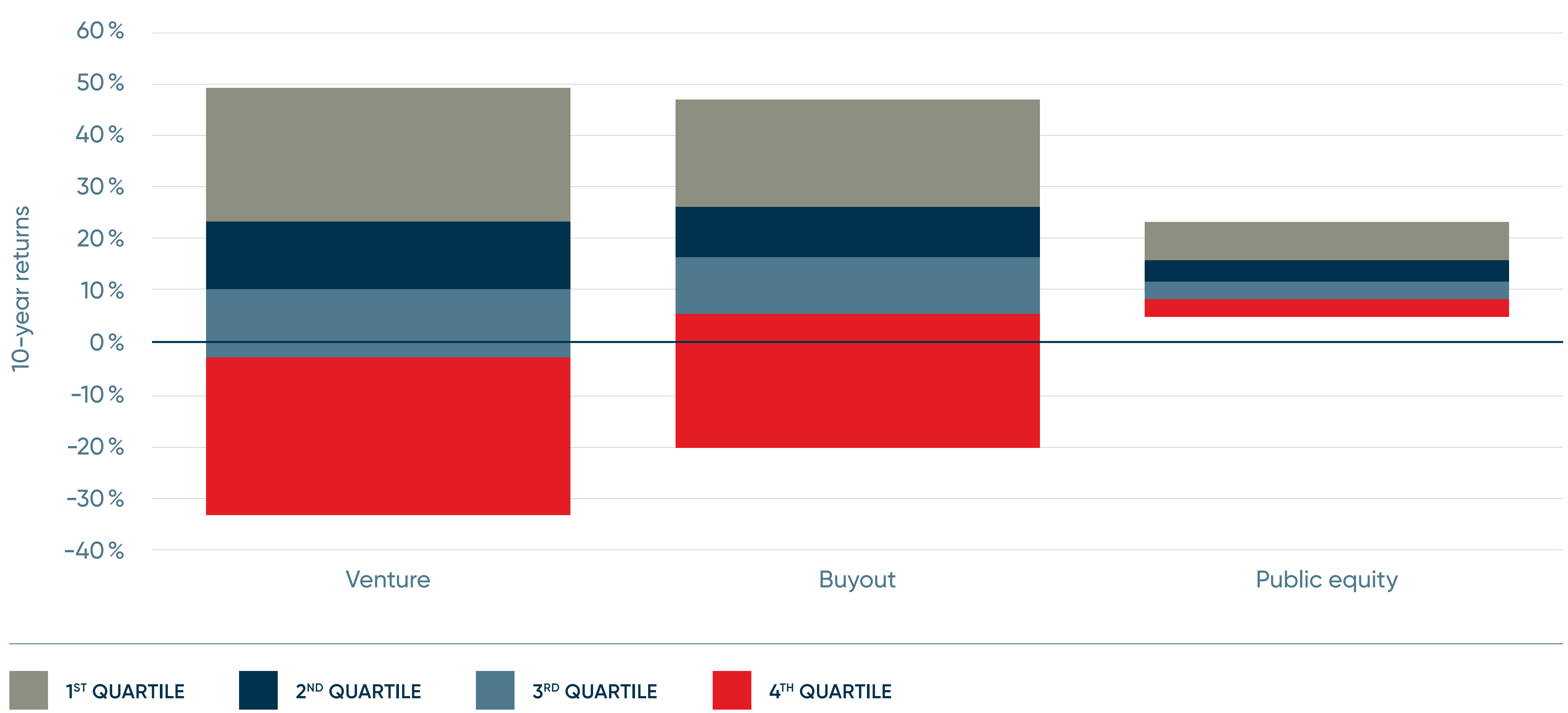


*Chart compares private equity index IRRs versus public market time-weighted returns. Returns are 10-year IRRs for private assets and 10-year annualized compound returns for public market.

Source: MSCI, data as June 30, 2023, and Refinitiv, data as of December 11, 2023. Public equity reflects Refinitiv screening of 1,941 US-domiciled US equity mutual funds. Past performance is not a reliable indicator of future results.

UNDERSTANDING THE RISKS

Compared to other asset classes—notably listed equities, but also fixed income securities, hedge funds, private debt, real estate and infrastructure investments—private equity is by far the most dispersed type of investment. This is particularly true for venture capital, but also growth capital and buyout capital. Properly managed, they offer significant advantages. Poorly managed, they can result in significantly lower returns, be time-consuming and demand attention.

EVERYTHING YOU SHOULD KNOW BEFORE INVESTING

→ Build or buy?

Primary investments require a great deal of time and resources: you need to know how to find, evaluate and select the right funds, make judicious investments and carefully monitor their progress. The decision to build or buy a portfolio should be based on your access to investments. If you decide to buy, this should also determine your choice of provider. You can achieve results more quickly by entrusting the task to an institution with an established relationship with portfolio managers. Remember that due diligence — the analysis of risks and rewards — is one of the key factors in creating value for primary investments.

→ Leveraging data

Established private equity firms have the advantage of extensive databases to inform their decisions on asset allocation, manager selection, portfolio construction and management, and transaction pricing. And the providers they do business with benefit from this privileged information.

→ Choosing complements

Many strategies rely on a portfolio of primary investments complemented by 30% to 50% of secondary investments or co-investments, i.e., a direct stake in a company. As well as enabling backward vintage year diversification, accelerated funding and J-curve mitigation, this asset pooling can generate long-term capital appreciation while improving the money multiple and IRR.

→ Selling on secondary markets

Primary funds usually have a longevity of 10 years, sometimes more. Over the past decade, secondary markets have expanded and matured, offering a variety of solutions for people who want to divest assets for liquidity or reinvest their capital elsewhere after the initial value-creation phase. Although selling assets on secondary markets often comes at a discount to their net asset value, you can optimize their price by being patient and scheduling a withdrawal at a more optimal time.

WHEN CHOOSING A PROVIDER, IT'S IMPORTANT TO CONSIDER THEIR ACTIVE PORTFOLIO MANAGEMENT.

THE TAKEAWAY

For decades, major institutions have successfully invested in private markets through primary investments. This strategy is one of the most effective ways to invest in the most influential companies of today and tomorrow while promoting capital growth and IRR in underlying portfolios.

Primary investments offer:

- More investment opportunities than the stock market
- Higher return potential than a comparable stock market portfolio including stocks, bonds and other investment instruments such as exchange-traded funds
- The flexibility to choose a variety of investment themes and sub-strategies

Sources

[1] "Evergreen funds: Accessing private markets alpha," HarbourVest. Data from MSCI as at June 30, 2023. The average spread was calculated between the return on buyouts by private equity funds and the total return of the MSCI ACWI Index (World, all countries) over rolling five-year periods between December 31, 2001 and June 30, 2023. Past performance is not a reliable indicator of future results.

[2] "Evergreen funds: Accessing private markets alpha", HarbourVest. Source: Data from PitchBook as at February 2, 2024 and MSCI as at December 31, 2023. Private markets made up of companies using buyout capital, growth capital and venture capital. Public markets composed of all constituents of the MSCI IMI Index.

[3] "Evergreen funds: Accessing private markets alpha", HarbourVest. PitchBook, data as of February 2, 2024.

[4] Data from PitchBook and MSCI as of September 30, 2023. Private placements may involve buyouts, expansion investment or venture capital. The median company value for private markets is defined as the sum of the absolute differences between private and public sector exposures for transactions backed by private placements over the period 2018 to 2022.

[5] "Why Your Favorite Companies Are Privately Held", Business Review.

[6] "Accessing private markets through primary fund investing: The path to capital appreciation and IRR", *HarbourVest*.

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