

# *Economic & Market Outlook*

## **Executive Summary**

- ~ Great businesses earn high returns on the capital they invest, regardless of structure or industry. Attributes like margins and growth only matter insofar as they contribute to those returns.
- ~ Great businesses are not always great stocks. Returns depend on the price paid and the expectations embedded in that price.
- ~ Growth only creates value when incremental returns exceed the cost of capital. Growth for its own sake is often destructive.
- ~ Private markets are less efficient, which creates both opportunity and risk. Dispersion of outcomes is wide, mistakes are harder to escape, and the cost of being wrong is higher. The flipside is great opportunities exist for those capable of doing the work.

## **Introduction**

It was a good year for capital markets. Bonds appreciated 7%, US stocks 18%, and overseas stocks 33%. What follows in this update are three short essays: what makes a great business, the difference between a great business and a great stock, and how to avoid bad private investments. They are simple reads, slightly academic in nature. Our hope is that you find them illuminating and walk away with a clearer picture of how we think about investing across public and private markets.

### **Part 1: What makes a great business?**

It is a simple question, but answering it succinctly is more difficult than it appears. Our default reaction, and we assume others' as well, is to list attributes: pricing power, recurring revenue, long growth runways, low reinvestment needs, minimal competition, and so on. The problem is that there is no prescribed recipe for greatness. The optimal combination of attributes varies from company to company, and optimizing for one often requires trading off another.

Consider Visa and Costco, both unequivocally great businesses. Last year, Visa converted roughly \$0.65 of every revenue dollar into pre-tax profits. That margin is extraordinary, made possible by an oligopolistic industry structure and powerful network effects. Costco, by contrast, operates in an intensely competitive retail environment and earns only about \$0.04 of pre-tax profit per dollar of revenue. All else equal, higher margins are better, but defining great businesses solely by margin excludes exceptional companies like Costco, which compensate for low margins with extraordinarily high asset turnover. Moreover, there are plenty of high margin businesses that are ultimately mediocre.

Asset intensity provides another useful illustration. Certain businesses can grow without deploying significant physical capital. FICO is a near perfect example. Outside of modest information technology infrastructure and office space, the company owns little in the way of tangible assets. Its core asset is the intellectual property behind its credit scoring algorithm. Over the past decade, FICO has reinvested only about 2.5 percent of revenues back into the business, yet despite that modest reinvestment, free cash flow has grown at a 21.7 percent annual rate. Again, all else equal, lower asset intensity is attractive, but it does not imply that asset intensive businesses are inherently inferior.

Taiwan Semiconductor is the counterexample. It is the most valuable company outside the United States and operates one of the most asset intensive business models in the world. The company owns and operates advanced semiconductor fabrication plants, manufacturing chips for customers such as Apple and Nvidia. The six fabrication plants it has committed to building in Arizona alone are estimated to cost roughly \$165 billion. In total, the company carries approximately \$245 billion of fabrication assets on its balance sheet, or about \$100 billion net of depreciation, along with

roughly \$9 billion of inventory. Over the past decade, approximately 40 percent of sales have been reinvested into plant, property, and equipment. Despite this heavy reinvestment burden, Taiwan Semiconductor has still grown free cash flow at roughly 15 percent per annum.

If you strip these examples down to their essence, the common thread is not margins, asset intensity, or business model. It is the ability to generate high returns on the capital that is invested. The analogy we often use is that of a money tree. Imagine a tree that costs \$100 and reliably produces \$20 of cash each year. You would earn a 20 percent return on your capital. Some trees yield large harvests but grow slowly, similar to Visa. Others yield smaller harvests but can be harvested frequently, similar to Costco. There are many varieties, but the defining feature is the return on the capital invested.

Finance offers a range of metrics to evaluate these money trees. Our preferred measure is return on invested capital, or ROIC, which compares after tax operating profit to the capital, both debt and equity, used to fund a company's operations.

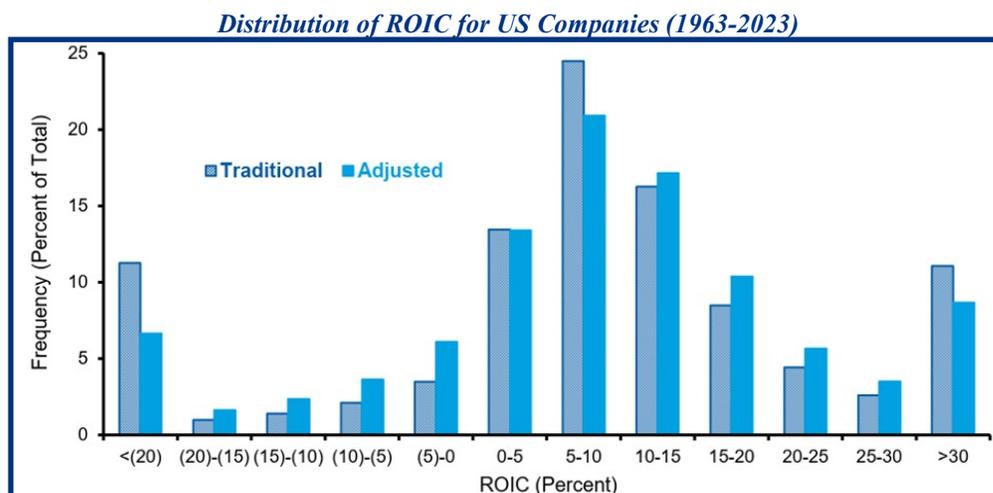
$$ROIC = \frac{\text{Net Operating Profit After Tax (NOPAT)}}{\text{Invested Capital (IC)}}$$

Embedded within ROIC are many of the attributes investors instinctively focus on. Expanding the formula shows this clearly. ROIC can be expressed as operating margins, defined as net operating profit after tax divided by sales, multiplied by capital turnover, defined as sales divided by invested capital. This expansion highlights how different combinations of margins and efficiency can produce similarly attractive returns.

$$ROIC = \frac{NOPAT}{IC} = \frac{NOPAT}{Sales} \times \frac{Sales}{Invested Capital}$$

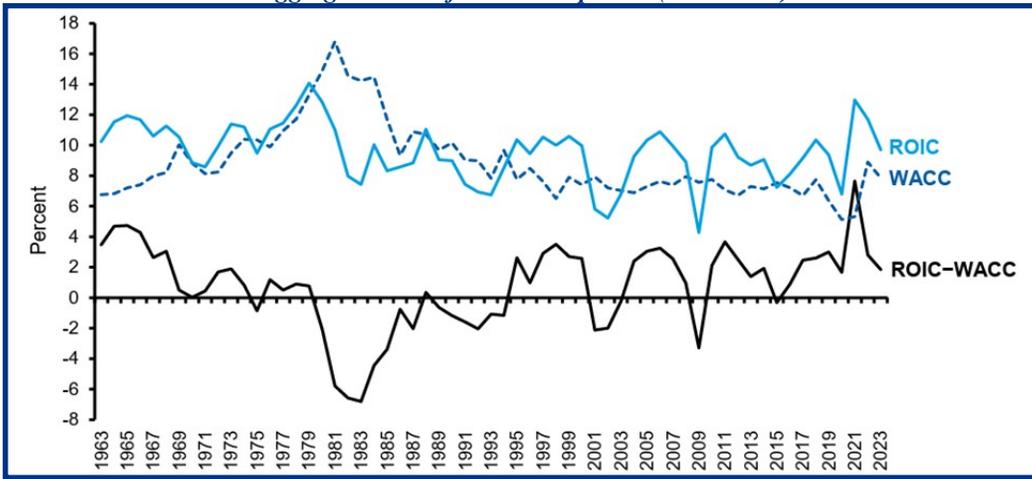
If we wanted to, we could take our expansion further, isolating the effects of working capital, fixed capital and intangibles. The broader point is that every great business reflects a unique combination of underlying drivers that are downstream of profitability. These subcomponents, or attributes, help explain both how returns are generated and how they are protected over time. Great businesses are not those that optimize for a single attribute, but those that sustain high returns on capital over long periods.

As you would expect, the US is populated with businesses of varying quality. The distribution of returns is far from normal, with fat tails of both capital incinerators and financial juggernauts. Most companies struggle to earn returns above their cost of capital. A similar pattern appears in public equity markets. Since 1926, only about 43 percent of equities have outperformed Treasury bills. This is not a coincidence. Even though most companies fail to create excess value, U.S. corporations in aggregate have earned roughly 10 percent on invested capital, which closely approximates the long-term nominal return on U.S. stocks.



Michael Mauboussin, Counterpoint Global

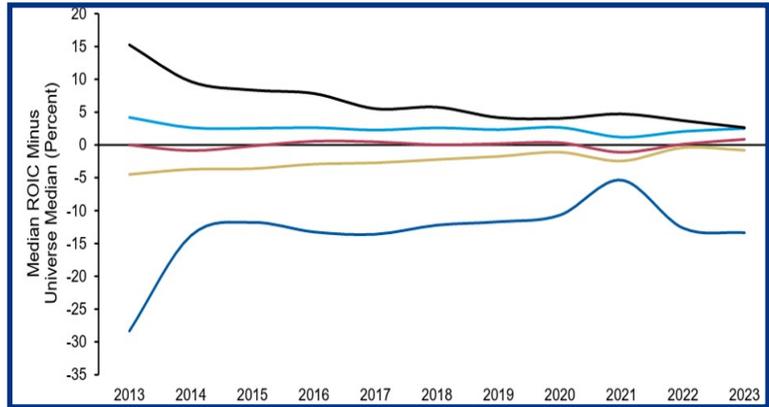
*Aggregate ROIC for US Companies (1963-2023)*



Michael Mauboussin, Counterpoint Global

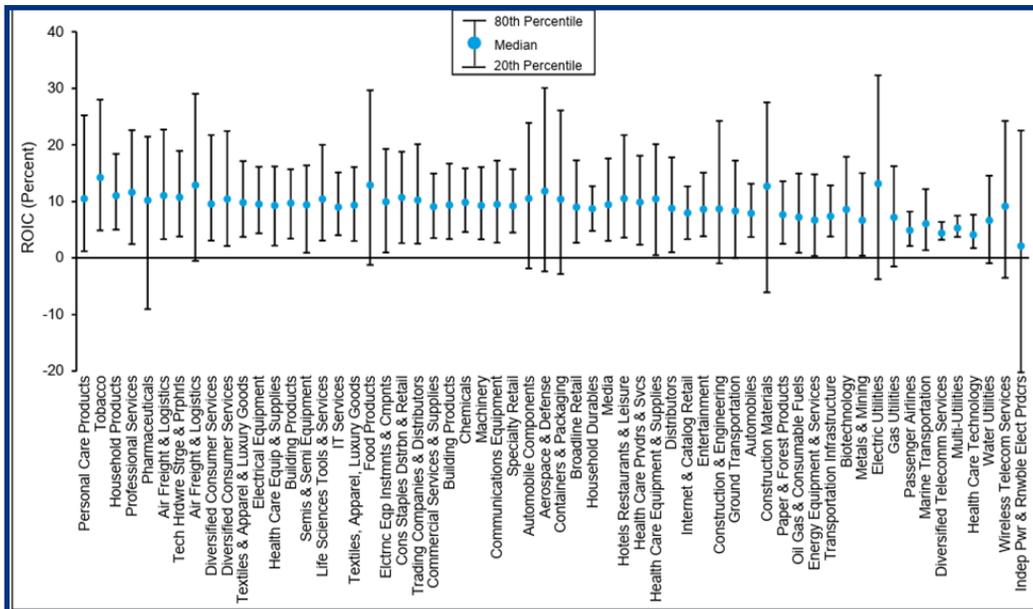
Two observations are worth emphasizing. First, while profitability does tend to mean revert, it does so slowly. Great businesses tend to remain great, or at least good, while poor businesses tend to remain poor, albeit often less so. Second, and perhaps more surprisingly, there is more variation in profitability within industries than across industries. Even industries widely viewed as unattractive contain exceptional companies, while seemingly attractive industries often harbor value destroying businesses. Competition largely explains both patterns. Some companies enjoy structural advantages, such as patent protection or regulatory exclusivity. Others compete along dimensions that rivals struggle to replicate. Costco, for example, operates in retail, but passes their benefits of scale back to the consumer, choosing to instead generate profit from membership economics.

*Regression Toward the Mean by Quintile for US Companies (2013-2023)*



Michael Mauboussin, Counterpoint Global

*ROIC Across Industries*



Michael Mauboussin, Counterpoint Global

We will close with a final observation on growth, one of the most overused and least examined concepts in investing. Growth is not inherently good. It is quite easy to grow revenues while destroying value. A retailer can sell products below cost, benefiting customers while eroding shareholder value. An exploration and production company can increase output by drilling more wells, but if the resulting cash flows fail to cover drilling, completion, and operating costs, the growth is meaningless. Growth is only valuable when the returns on incremental capital exceed the cost of that capital.

This is why we return repeatedly to ROIC. It is the connective tissue that links growth, profitability, and value creation, and ultimately determines a business's quality and long-term potential.

## Part 2: The difference between a great business and a great stock

A great business is not always a great stock, at least not at every price.

During the 1960s and early 1970s, a prevailing belief emerged that certain companies were so exceptional that valuation no longer mattered. These were referred to as "one decision" stocks, implying that an investor could buy them once and never sell. In 1972, Morgan Guaranty Trust, now part of JPMorgan, published a list of 50 such companies, including Coca Cola, Johnson & Johnson, and American Express. Subsequent research by Bridgeway Capital Management found that these companies had averaged returns on equity of roughly 22 percent and compound earnings growth of 22 percent over the prior five years. That era would later become known as the Nifty Fifty bubble.

In 1973, following the Yom Kippur War, OPEC imposed an oil embargo that caused oil prices to quadruple in a matter of months. Inflation surged, real consumption contracted, and a recession followed. The S&P 500 declined 37.3 percent over 1973 and 1974. The Nifty Fifty fared worse, falling nearly 50 percent. While the broader market recovered by 1976, many of the Nifty Fifty constituents did not. Coca Cola, for example, declined more than 64 percent during the downturn and did not break even on a total return basis until 1983.

*Total Return of Coca-Cola (White) & the S&P 500 (orange) After the Nifty-Fifty Bubble*



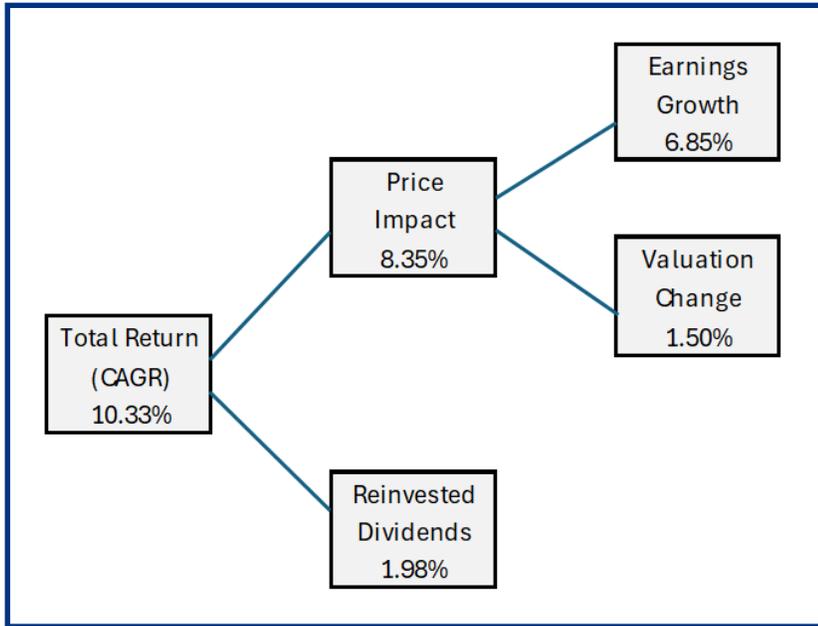
Bloomberg

The lesson is straightforward. No stock is so great that it can be justified at any price. That is the distinction between a great business and a great stock.

The total return of a stock can be decomposed into its drivers. The largest component is typically price appreciation, which itself reflects changes in earnings and changes in valuation multiples. Dividends and dividend reinvestment form the second component. Over long periods, fundamentals such as earnings growth and dividends dominate returns. Over shorter horizons, however, valuation changes can exert a powerful influence. This is a mathematical reality. Earnings compound exponentially over time, eventually overwhelming valuation fluctuations, but over short windows, valuation changes can dominate outcomes.

Over the past 30 years, for example, valuations in the S&P 500 have expanded by roughly 55 percent, while earnings have grown by approximately 630 percent. Fundamentals explain about 85 percent of shareholder returns, with valuation contributing the remaining 15 percent.

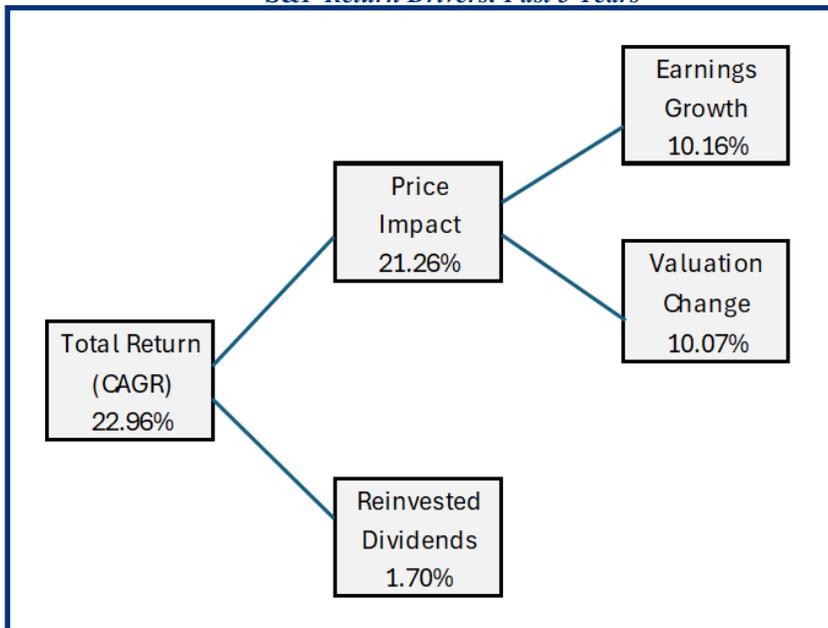
*S&P Return Drivers: Past 30 Years*



*Annandale Capital*

Shorten the time horizon to three years and the picture changes materially. Since the end of 2022, earnings and valuations have each grown by roughly 33 to 34 percent. In this shorter window, valuation expansion accounts for approximately 43 percent of returns. Earnings simply have not had sufficient time to compound and overwhelm changes in market sentiment.

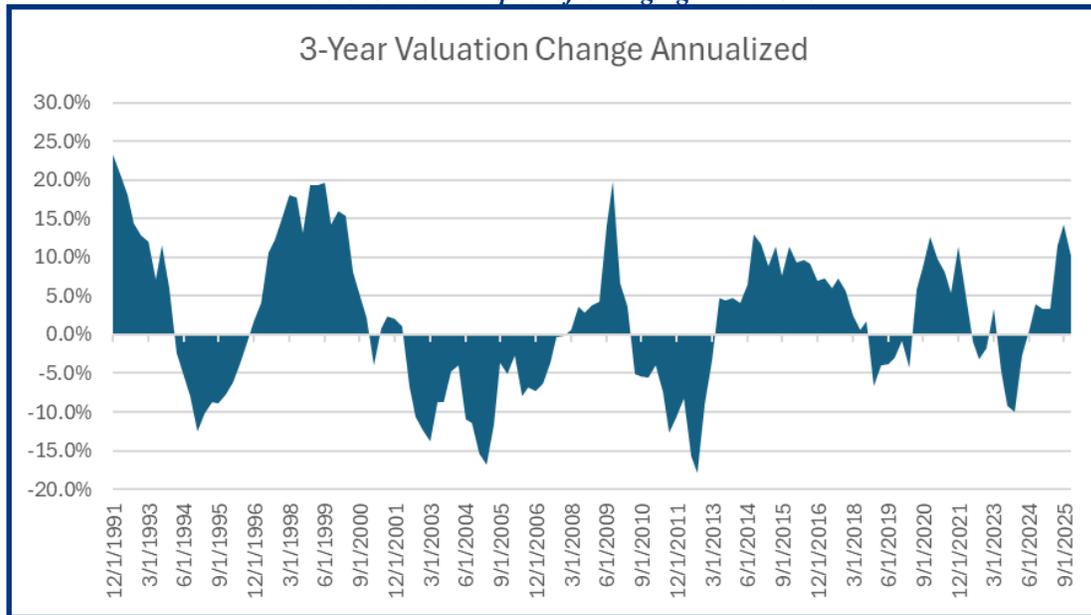
*S&P Return Drivers: Past 3 Years*



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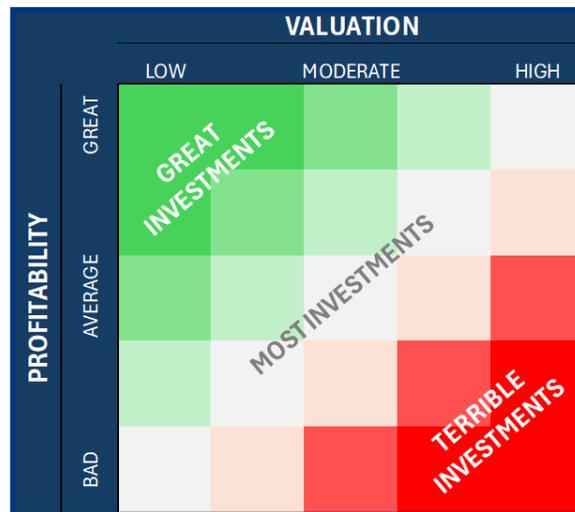
This brings us to valuations, the crux of the matter. Valuations are set by markets, collections of buyers and sellers whose expectations fluctuate over time. When expectations rise, valuations expand, and when expectations fall, valuations compress. The result is an oscillating dynamic in which valuation changes can meaningfully amplify or dampen returns, particularly over short periods. This driver of returns is powerful and inherently unpredictable.

*The Short-term Impact of Changing Valuations*



Annandale Capital

A great stock, therefore, sits at the intersection of a great business and a low valuation. It is a company with low embedded expectations and a strong economic future.



Apple provides a clear modern example. From mid 2012 to early 2013, Apple’s stock price was nearly cut in half. Revenue growth was slowing and margins were compressing, leading the market to question the durability of the iPhone driven business model. At its low, Apple traded at roughly 11 times earnings.

Those concerns were not entirely unfounded. From the iPhone’s launch in 2007 through 2013, product revenue grew at 38 percent annually. From 2013 to today, product revenue growth has slowed to just over 5 percent per year. Gross margins declined from about 40 percent in 2013 to roughly 36 percent last year. What the market failed to appreciate was the emergence of Apple’s services ecosystem. In 2013, services accounted for less than 10 percent of revenue. Today, they represent more than 25 percent. Over the same period, Apple’s return on invested capital increased from roughly 30 percent to 56 percent.

Consider two companies that each grow earnings at 10 percent annually. Company A earns a 10 percent return on capital, while Company B earns 40 percent. To sustain that growth, Company A must reinvest all of its earnings, while Company B need only reinvest 25 percent. Company B is clearly more valuable. It can grow at the same rate, but has 75 percent of earnings leftover for dividends, buybacks, paying off debt, or acquisitions.

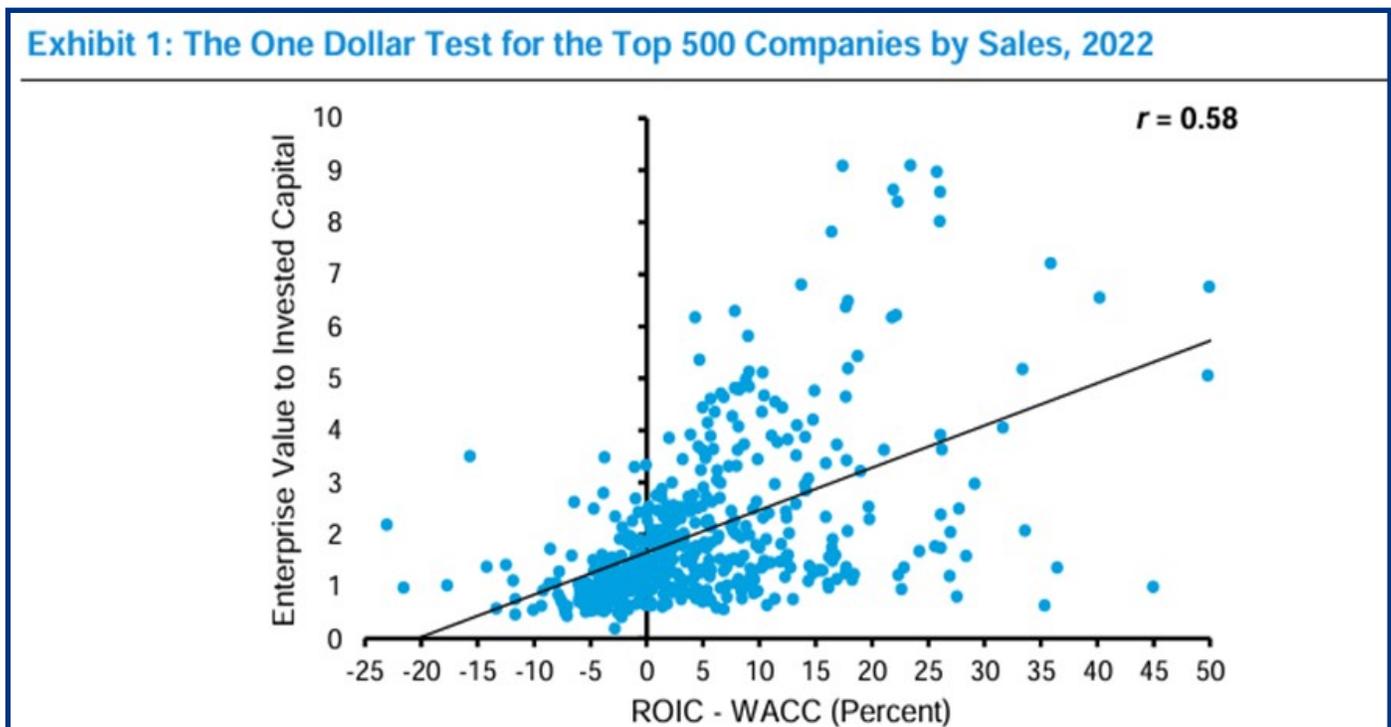
Apple resembles Company B. Beginning in 2013, activist pressure encouraged Apple to initiate an aggressive share repurchase program. Its high returns on capital and low valuation made this possible. From 2013 to today, net income grew at roughly 9.7 percent annually. Diluted shares outstanding declined by 42 percent, or about 4.5 percent per year. As a result, earnings per share grew at a 14.8 percent annual rate. That outcome would not have been possible if Apple were a mediocre business or if it had traded at an elevated valuation.

One final observation is worth noting. Since 2013, Apple's stock has not compounded at 9.7 percent or even 14.8 percent. It has compounded at roughly 25.7 percent annually as its valuation multiple expanded from 11 times to approximately 34 times earnings. This highlights another benefit of low valuations. If expectations improve, valuation expansion becomes an additional tailwind.

In practice, buying great companies at attractive valuations is difficult for two reasons. Future profitability is uncertain, and on average, markets do a decent job of discounting available information. Apple is a clear example of market mispricing, but those are easy to identify in hindsight.

Every business has an economically justifiable valuation. A great company may deserve a premium, while a poor one deserves a discount. When valuations appropriately reflect differences in quality and growth, prospective returns tend to converge. From an investor's perspective, valuation and future profitability should be inseparable, and empirical data suggests that is how the market prices securities.

### *Profitability Largely Determines Valuation*



*Michael Mauboussin, Counterpoint Global*

Our process is therefore not centered on finding a handful of stocks that are both great and cheap. Instead, we focus on avoiding those that are bad and expensive. The distinction is subtle but important. It reflects an acknowledgment that markets tend to work and that minimizing errors can be just as powerful as identifying a few exceptional winners.

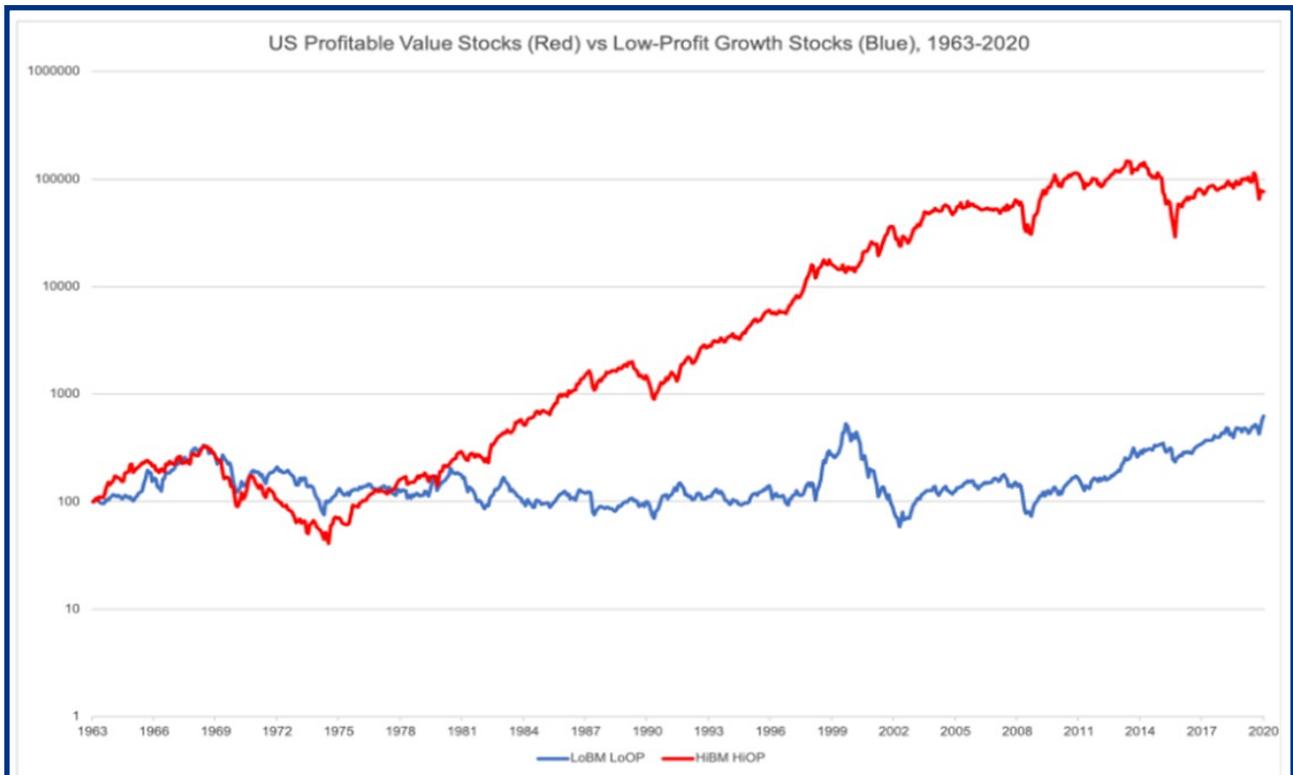
*Historically, Excess Returns Have Accrued to Value Stocks and Highly Profitable Stocks*



Dimensional Fund Advisors

Rather than hunt for needles in a haystack, we prefer to avoid the lump of potentially moldy and decomposing hay. Practically, this results in diversified portfolios tilted toward companies with relatively high profitability, relatively low valuations, or ideally both. We occasionally own inexpensive companies with lower profitability or expensive companies with exceptional profitability. What we strive to avoid are companies characterized by high valuations and low or deteriorating returns on capital.

*Conversely, Highly-Valued & Unprofitable Stocks Exhibit Poor Long-term Returns*

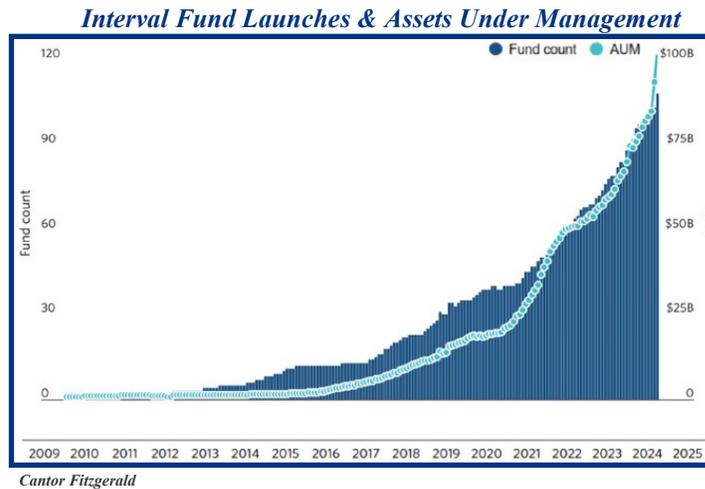
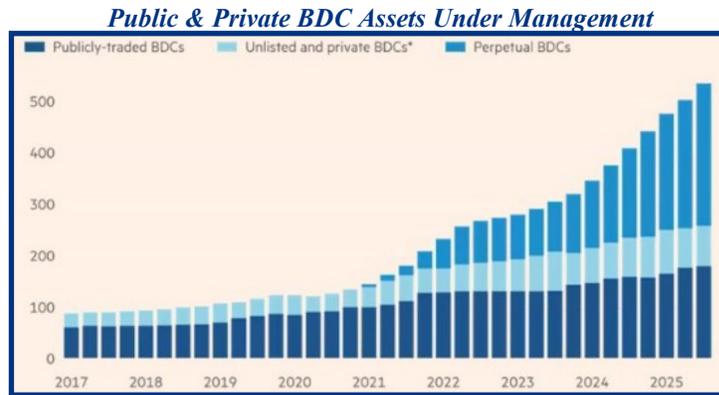


GFM Asset Management

### Part 3: How to avoid bad private investments?

There is a pervasive belief that private markets offer better investment opportunities than public markets. We largely agree with that statement, but we also think most investors underestimate, or outright misunderstand, the risks that come with investing in private assets.

Historically, private markets were the domain of institutional investors and a small group of wealthy individuals. That is changing rapidly. Policymakers are actively pushing to “democratize” private markets, opening new channels for retirement plans and retail investors to participate. At the same time, the pool of accredited investors has expanded meaningfully. In 1983, only about 1.8 percent of households qualified. Today, that figure is north of 22 percent. Large private asset managers are responding accordingly. KKR, Apollo, and Blackstone are rolling out interval funds, BDCs, and other structures that allow them to gather retail capital and charge higher fees.

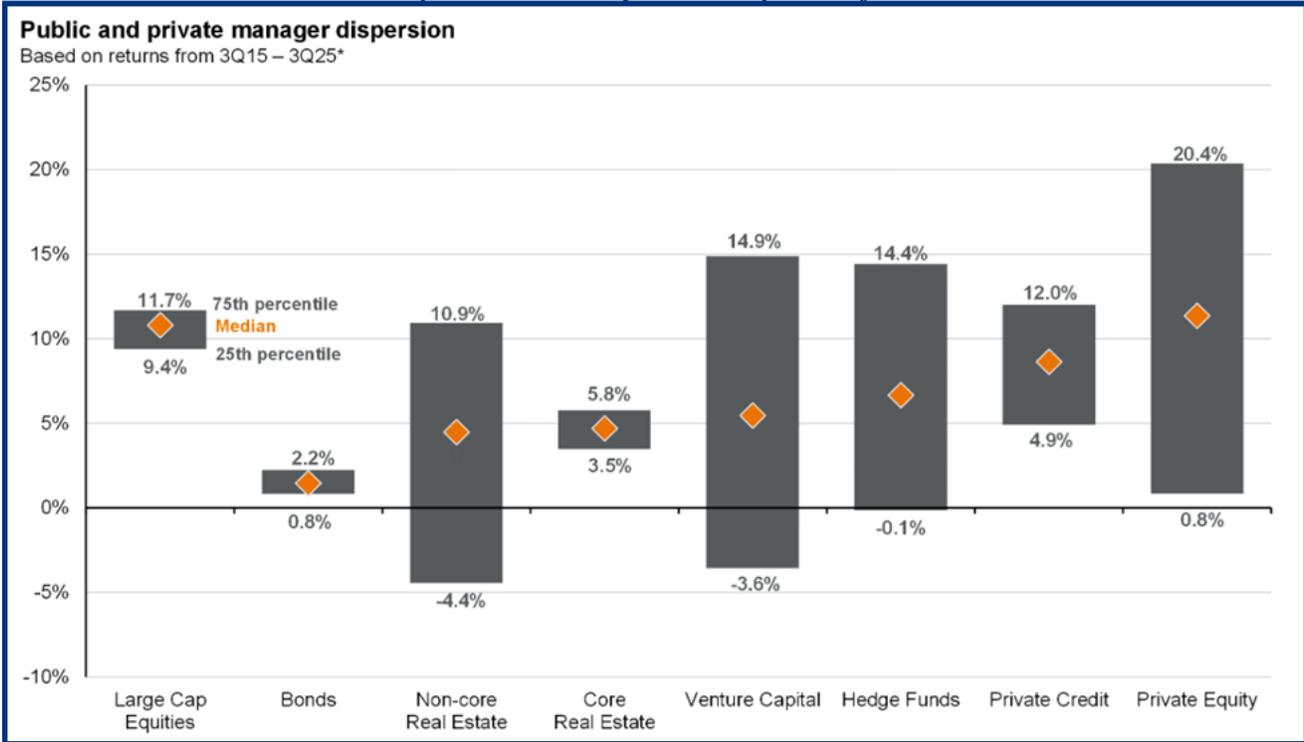


We are not philosophically opposed to this trend, but we think it will come with some painful lessons. The idea that private is categorically better than public is wrong. The opportunity set may be broader, but the risks are also larger, and often far less obvious.

What makes private markets attractive also makes them dangerous. Public equities trade continuously in deep, liquid markets. Apple stock trades tens of millions of shares a day. By contrast, the market for a private company or a single real estate asset is narrow and episodic. Private markets are structurally less efficient, and that inefficiency cuts both ways.

You can see this clearly in the dispersion of outcomes (following page). In large cap public equities, the return gap between top and bottom quartile managers is roughly 2.3 percent per year. In private equity, that spread is closer to 20 percent. If you hire two or three public equity managers, your results will likely cluster around the market. If you invest in two or three private funds, your outcomes can be wildly different.

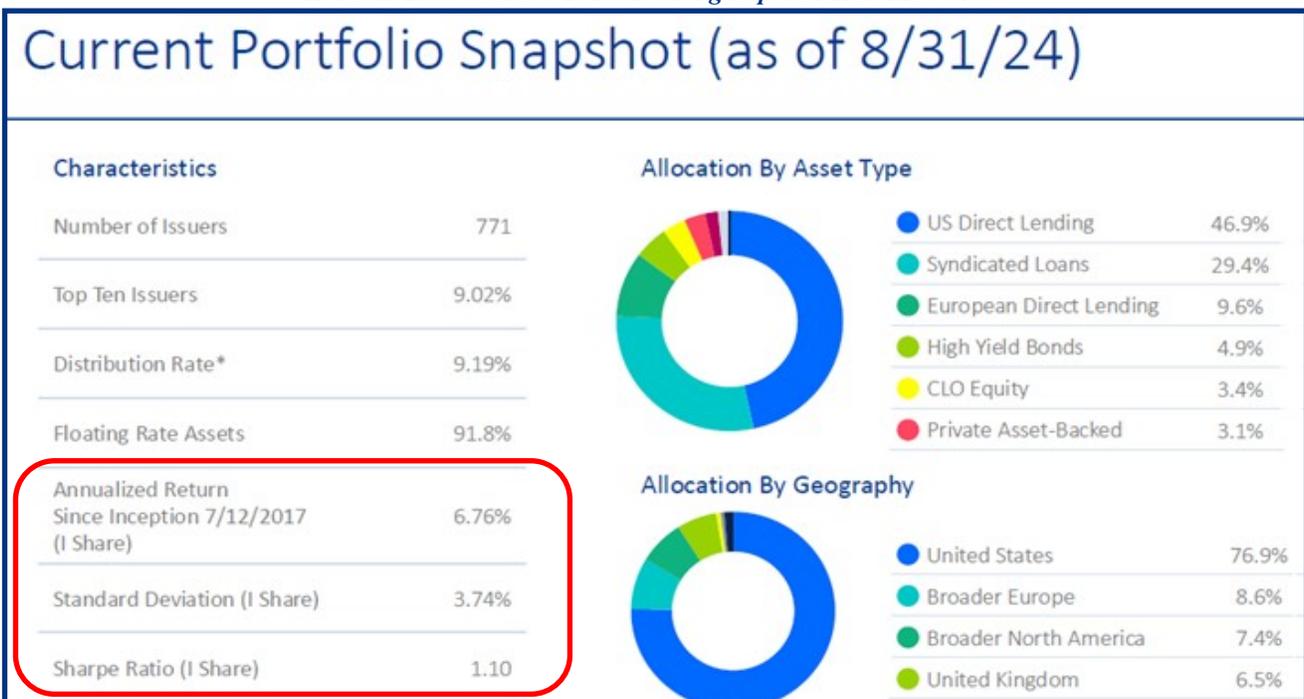
*Private Capital Markets Carry a Wide Dispersion of Outcomes*



Over long periods of time, private markets have outperformed public markets. That part is true. What often gets glossed over is the much wider range of outcomes. Inefficiency creates opportunity, but it also dramatically increases the cost of being wrong.

The additional risk is far from obvious when you read industry publications and marketing materials. Our most recent pet peeve is private funds, typically within credit or real estate, marketing their superior risk-adjusted returns with the use of Sharpe Ratios. The ability to irregularly and subjectively grade your own paper goes a long way here. The reality is private companies tend to be smaller, more leveraged, and often lower quality than their public counterparts, a recipe for more volatility not less.

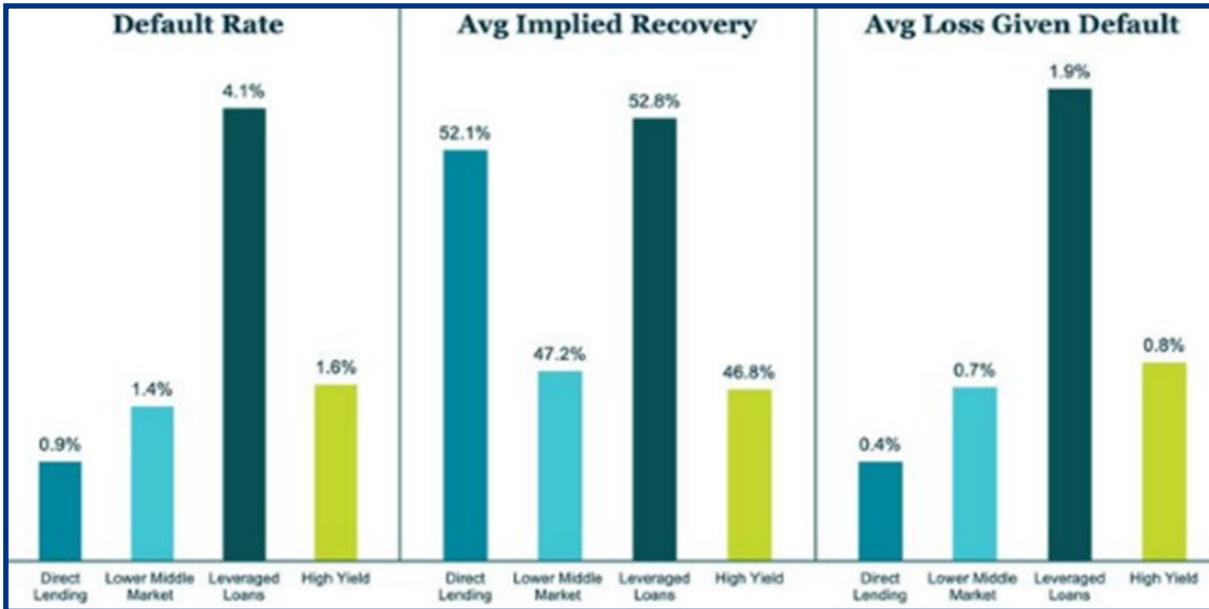
*Random Private Credit Fund Pitching Superior Risk Measures*



Redacted

We recently read a report from KBRA suggesting that direct and lower middle market private lenders experience lower default rates. It is a plausible argument. Private credit often benefits from tighter covenants and greater control over borrower behavior. Still, the numbers struck us as too good to be true until we read the footnote: shifts to payment-in-kind interest and covenant violations were excluded. If a borrower cannot pay, simply roll the interest into principal and declare the loan current. That is another example of grading your own paper.

*Amend & Extend: Default Rate Below Doesn't Account for PIK or Covenant Violations*



KBRA

We see this problem repeatedly in private markets. Just last quarter, BlackRock marked a \$150 million loan to a home improvement roll up to zero overnight. One month earlier, that same loan was marked at par. In prior commentaries, we have highlighted loans to Magenta, a cybersecurity company, that were valued at 79 cents on the dollar by one lender and 46 cents by another, despite being the same underlying asset. In private markets, returns are not real until cash shows up in the account. Until then, skepticism is warranted.

*Renova Debt Went from Par to 0 in a Month*



Bloomberg

One of the biggest and most underappreciated risks in private markets is opportunity cost. In public markets, if an investment goes poorly, returns suffer but capital can be redeployed. In private markets, returns suffer and capital is trapped. That capital cannot be put to work elsewhere when better opportunities emerge. To make matters worse, the fund manager may face misaligned incentives once an investment turns south. We do not raise this to sound alarmist. We regularly invest in private markets. But the stakes are simply higher when capital is locked up.

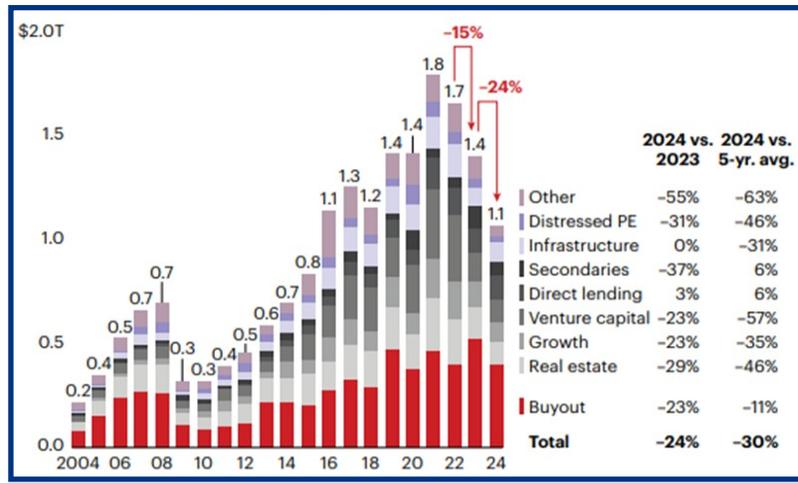
To that end, we follow two rules. The second rule is a corollary to the first.

1. **Always underwrite to a perpetual hold.**
2. **Don't fall for the arbitrage.**

We always ask ourselves if we would be comfortable owning the asset indefinitely. This ties back into our discussion regarding great stocks. If you buy high-quality assets at discounted valuations, liquidity doesn't need to be engineered, it emerges naturally in the form of excess cash flows that can be distributed to investors. Certain investments, like oil and gas minerals, monetize almost by design as the thesis plays out.

Many private market investors underestimate how supportive the last few decades were. Until 2022, new capital flowed steadily into private markets. That capital created liquidity for existing holders. Private credit funds could refinance loans into a growing universe of lenders. Private equity funds could sell assets into an ever larger buyer pool. Last year, about half of all North American buyouts, less than \$5 billion in size, were companies trading hands between private equity sponsors. That tailwind is gone. 2021 was the peak, we don't know when that tailwind will reemerge.

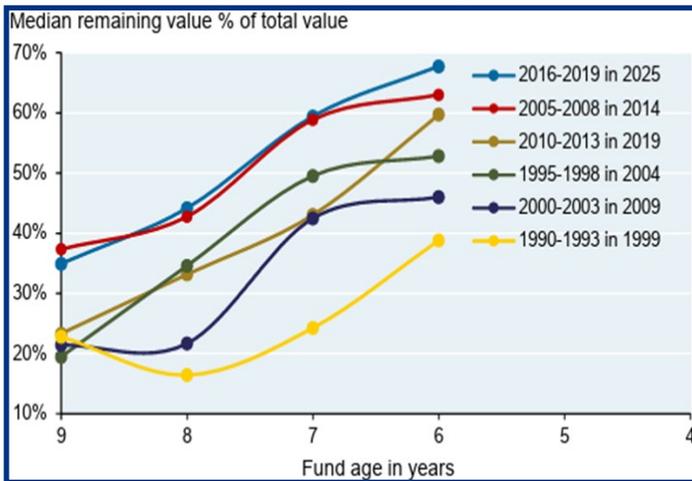
*Fundraising in Private Capital Markets Peaked in 2021*



Bain

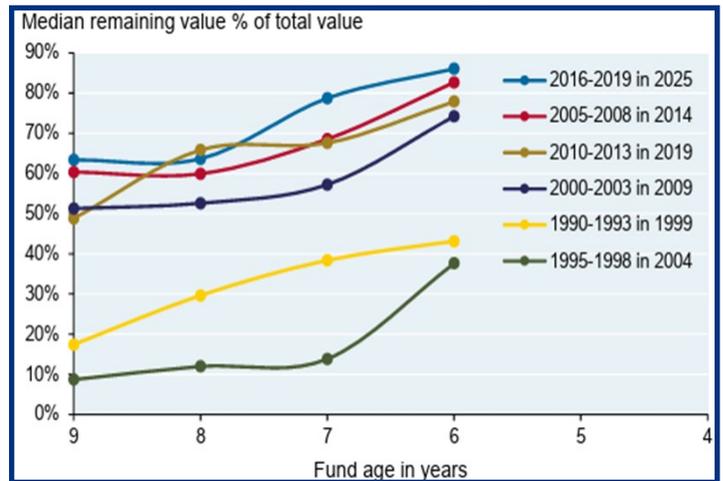
The consequences are now visible. Exits have slowed materially. JPMorgan Asset Management attempted to quantify this by examining how much value remains unrealized in buyout and venture funds across vintages. Their conclusion was sobering. By their measure, six-year-old portfolio companies now account for roughly 68 percent of buyout returns and 90 percent of venture returns. That is the worst reading on record.

*Buyout: Large % of Portfolio Companies Remain*



JP Morgan

*Venture: Large % of Portfolio Companies Remain*



JP Morgan

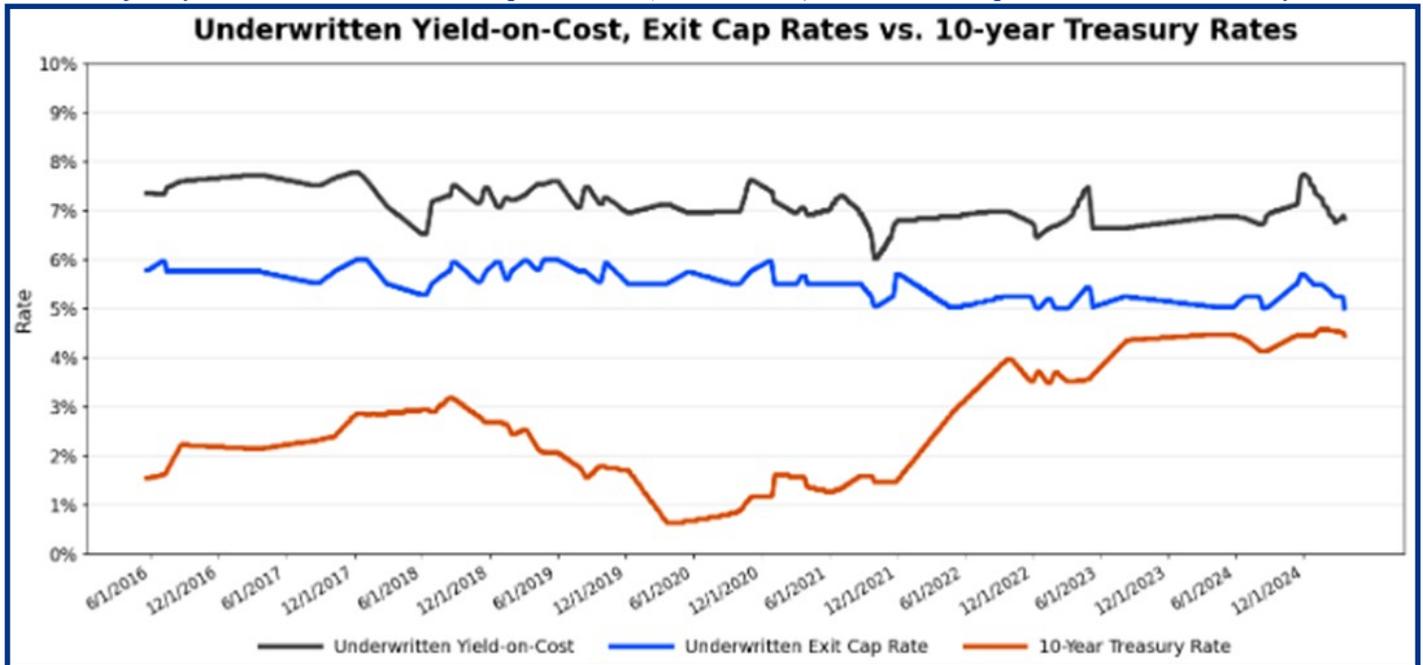
The corollary to rule number one, don't fall for the arbitrage, tends not to be a problem if you underwrote to a perpetual hold. Arbitrage simply refers to the act of taking advantage of price discrepancies. We emphasize it because valuation arbitrage has historically been a meaningful contributor to private market returns.

To be clear, we like arbitrage and frequently benefit from it. Our private equity investments tend to focus on micro-cap and lower middle market businesses where multiple expansion is plausible. Our oil and gas mineral investments often emphasize non-producing acreage that benefits from valuation uplift once production begins. What we refuse to do is underwrite an investment where the economics only work if exit valuations improve. Every investment must stand on the cash flows it can generate over time.

A recent multifamily example illustrates the point. A manager we respect shared assumptions showing they could develop apartments at a 6.7 percent capitalization rate and sell them at a 5.0 percent rate. On paper, that implies a 34 per-

-cent unlevered gain before accounting for any income. The problem is the assumed exit valuation is more aggressive today than it was a decade ago, despite meaningfully higher financing costs. Ten-year Treasury yields have risen from roughly 1.9 percent to over 4 percent. Agency financing likely costs north of 6 percent. Why should exit cap rates remain at 5 percent?

*Multifamily Investor's Historical Development Yield (Yield-on-Cost) and Exit Assumptions vs. 10-Year Treasury Rates*



Redacted

If we ignore the arbitrage and analyze the asset as a long-term hold, the investment is an easy pass. A 6.7 percent yield growing roughly with inflation might produce a gross unlevered return around 9 to 10 percent before fees. After fees, returns fall into the mid-single digits. Leveraging the asset offers little benefit given the narrow spread between yield and financing costs.

We do not maintain a single hurdle rate for private investments. Every opportunity is different. That said, it is hard to justify targeting returns below long-term equity averages, roughly 10 percent, given that public equities represent our opportunity cost. In reality, the bar is usually higher.

Our biggest worry surrounding the “democratization of privates” is poorly understood or opaque incentive structures. We were shocked to see Blackstone raise over \$100 billion in assets for its real estate fund BREIT. It’s a highly lucrative vehicle for Blackstone. For retail investors, they can collect a 5% selling commission and there are ongoing distribution/servicing fees as high as 0.85%. Those fees made us nauseous, but the real problem is the calculation of its management fee, 1.25% of net asset value (NAV), and 12.5% carried interest (based on NAV). Per the fund’s prospectus, “we calculate NAV per share in accordance with the valuation guidelines that have been approved by our board of directors... The Adviser is ultimately responsible for determining our NAV. All our property investments are appraised annually by third party appraisal firms in accordance with our valuation guidelines.” Yes, there is an independent appraisal, but that appraiser is picked by the fund, compensated by the fund, and the fund has the final say on the NAV that is published, which drives Blackstone’s revenues. Hopefully, they will be good stewards, but they’re incentivized to inflate asset values.

**As a rule, we strive to invest with good people who naturally will do the right thing,** but we put our faith in incentive structures. We love the saying, “show us the incentive and we’ll show you the outcome,” and we think retail investors would be wise to adopt that mindset.

There are obvious issues, like alignment of interests. How much is the general partner investing in the fund? How material is that investment for the general partner? But there are a host of issues most investors fail to ever account for.

Consider the broader business models at work. Private lenders must generate sufficient loan volumes to deploy their funds. If the lender develops a reputation for being “difficult to work with” or “too demanding” their origination volumes will suffer, and so will their ability to grow the business. A vertically integrated real estate firm likely has higher costs, and as a result, needs to pursue a certain level of activity to pay their employees, regardless of the opportunity set. Another variant of this conflict plays out with every fund raise. Does the general partner want to deliver great returns or build a large fee-paying asset base? Investment opportunities aren’t infinitely scalable, and there is a point where more assets under management equates to lower returns but potentially better economics for the general partner.

Incentives matter most when an investment goes south. If a fund is no longer capable of earning carried interest or raising their next fund, will it be incentivized to sit on legacy assets? The recent dearth of fund monetizations has led to the rise of continuation vehicles, essentially a second private equity fund that an asset or portfolio can be sold into to restart the clock. Continuation vehicles offer legacy investors liquidity, but they also allow the general partner to reset their economics. In such a case, is the general partner incentivized to low ball the valuation of the asset (or assets) being contributed, so that their hurdle to earning carried interest is lower going forward? You would think continuation vehicles would offer lower prospective returns since the assets have been partially derisked, but the statistics suggest otherwise.

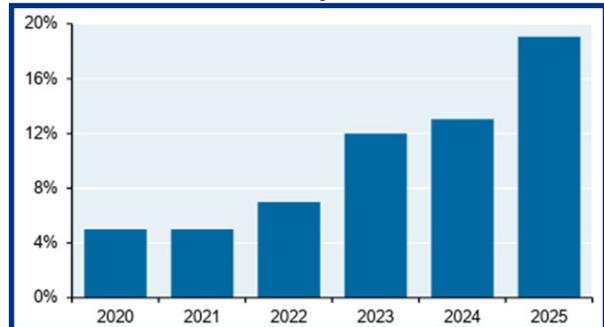
*FT Headline on Rise of CVs*

**Private equity firms sell assets to themselves at a record rate**

So-called continuation vehicles set to account for a fifth of sales by the sector in 2025

Financial Times

*CV's Share of PE Exits*



JP Morgan

*Evercore's Findings on the Performance of CV's vs. PE Buyout Funds*

**Q2 2025 Continuation Fund Performance Metrics**

Continuation Fund Performance Quartile by Vintage Year

Year	N	DPI				TVPI				Net IRR					
		1st Q	Median	3rd Q	Mean	N	1st Q	Median	3rd Q	Mean	N	1st Q	Median	3rd Q	Mean
2018	18	1.932	1.592	1.029	1.316	18	2.450	1.942	1.560	1.995	18	28.0%	21.5%	7.6%	24.0%
2019	34	1.127	0.352	0.000	0.654	34	2.440	1.858	1.430	1.885	34	27.0%	16.0%	9.9%	22.9%
2020	39	0.829	0.293	0.000	0.532	39	2.194	1.780	1.425	1.790	39	29.6%	17.0%	10.7%	23.7%
2021	90	0.400	0.028	0.000	0.328	90	1.940	1.449	1.070	1.460	87	22.8%	14.5%	5.1%	17.8%
2022	73	0.010	0.000	0.000	0.051	73	1.677	1.320	1.131	1.420	72	23.2%	13.9%	7.1%	16.9%
2023	54	0.040	0.000	0.000	0.080	54	1.600	1.464	1.290	1.500	51	37.6%	24.7%	19.3%	30.3%
2024	79	0.001	0.000	0.000	0.031	79	1.340	1.230	1.100	1.303	62	49.2%	28.2%	13.5%	34.3%
<b>Total</b>	<b>387</b>	<b>0.255</b>	<b>0.000</b>	<b>0.000</b>	<b>0.276</b>	<b>387</b>	<b>1.810</b>	<b>1.420</b>	<b>1.160</b>	<b>1.521</b>	<b>363</b>	<b>29.6%</b>	<b>19.2%</b>	<b>8.9%</b>	<b>23.6%</b>

Performance by Fund Type and Vintage Year (1<sup>st</sup> Quartile)

**TVPI**

**DPI**

**Key Findings**

- A key output for the Study is the Continuation Fund Performance Quartile Table, which shows **vintage-by-vintage performance for Continuation Funds since 2018** and has started to provide investors with early insights into the return profile of the asset class
- The Study further analyzed CV performance based on composition, CV size, geography and underlying company sector:
  - ❑ Average TVPIs across geography, CV size and sector of underlying asset(s) do not differ statistically
  - ❑ Average TVPIs for single-asset CVs (“SACVs”) are generally higher than multi-asset CVs (“MACVs”), which is in line with the higher risk premium typically associated with concentration.
  - ❑ Consistent with prior studies, **MACVs are continuing to show earlier DPI than SACVs**, driven by greater diversification and higher likelihood of earlier realizations
- While still early days, **top performing SACVs are starting to exhibit outperformance potential** associated with a **positive selection bias** of best performing assets

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At the end of the day, what makes a great private investment is no different than what makes for a great stock, attractive valuations and quality assets, but the lack of liquidity and interplay with fund sponsors creates unique risks. The cost of mistakes is higher. Contrary to our process for public equities, we prefer to take the “needle in the haystack” approach, making only a few investments each year. We must feel confident that our capital is better served in that specific opportunity than in public markets.

## Conclusion

All three essays point to the same underlying idea, even though they approach it from different angles.

What ultimately matters in investing is not narratives, labels, or structures. It is the relationship between capital, returns on that capital, and the price you pay to access those returns.

In public markets, that relationship is expressed through return on invested capital and valuation. Great businesses are those that can reinvest capital at high rates for long periods of time. Great stocks are those same businesses purchased when expectations are low and prices are reasonable. The mistake investors repeatedly make is confusing business quality with investment quality, forgetting that even exceptional economics can be overwhelmed by excessive optimism and price.

In private markets, the same logic applies, but the consequences of getting it wrong are amplified. Capital is locked up, markets are subjective, incentives are complex, and exit liquidity is uncertain. Returns that look attractive on paper can disappear once you strip away leverage, arbitrage opportunities, and optimistic assumptions about future valuations. In that environment, underwriting to durable cash flows and economically justified prices is not conservative, it is essential.

Across both public and private markets, the discipline is the same. Focus on cash flows, returns on capital, and opportunity cost. Be skeptical of growth that requires ever increasing investment. Be wary of returns that depend on someone else paying a higher price in the future. And above all, recognize that the cost of mistakes rises dramatically as liquidity falls.

The temptation in investing is to search for complexity, new structures, or clever ideas. In our experience, the edge comes from applying a small number of principles consistently, across market cycles and across asset classes. Avoiding obvious errors, paying reasonable prices, and insisting on real economics may not be exciting, but over time, it works.

As always, we value the confidence you have placed in us. Please reach out if you have any questions.

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