1 percent. That is the proportion of its turnover that Migros allocates to support cultural activities. The expected benefits for this large Swiss retailer are only image and reputation. 1 percent is also the symbolic share of their assets that Swiss pension funds (PFs) allocated to private equity[1] (PE) in 2016[2]. Why such a reticence to invest more? We refute five spurious myths preventing a serious allocation.

Myth 1: "Performance is insufficient."

According to Cambridge Associates, the net aggregated performance of US LBO, growth, energy and mezzanine funds is 13.39 percent over 25 years, against 8.55 percent for the Russell 3000[3] index (calculated using the PME method[4]). For PE funds of developed markets (excluding the US), the performance over 25 years is 13.14 percent, versus 4.31 percent for the MSCI Europe (PME). For emerging markets, it is 9.05 percent over 25 years, against 6.01 percent for the MSCI World (PME). Performance is therefore plainly not a valid reason to reject PE investments.

1 PE includes venture capital, growth capital, leveraged buyout and turn-around capital.

2 According to Crédit Suisse.

3 Cambridge Associates, 31/12/2016, published on 31/05/2017.

4 The Public Market Equivalent (PME) method applies the cash flows of PE funds to an index. When a fund invests, an equivalent acquisition of index units is done. When this investment is sold, the index units are sold as well. It is then possible to compare performance while completely eliminating the question of liquidity.

Myth 2: "The asset class is illiquid."

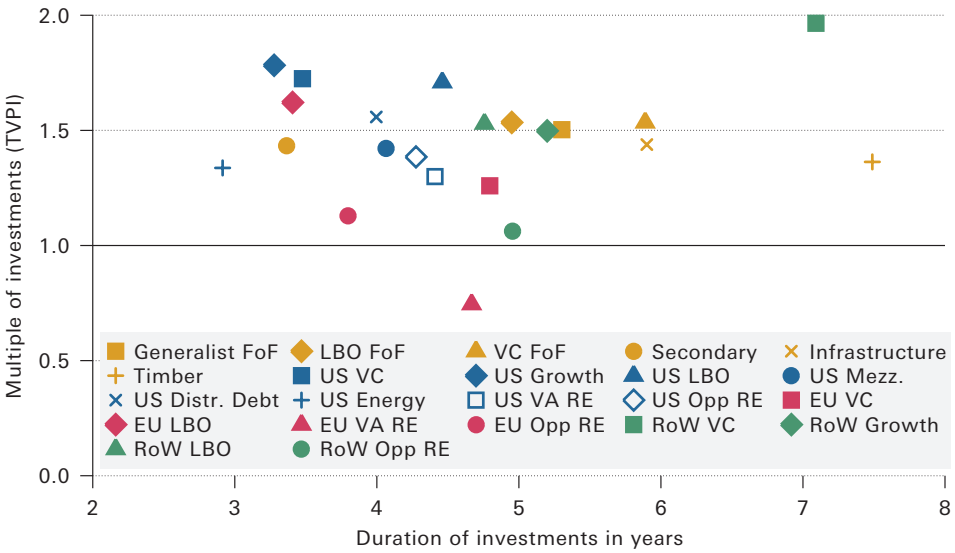
If private market funds[5] are created for eight to fifteen years, they distribute capital after three to six years (Fig. 1) from interest (private debt), rents (private real assets) or the sale of investments (private equity). These flows can be anticipated and modelled (for example, through liquidity at risk). Each PF can therefore structure a portfolio adapted to its specific needs, to preserve its assets over the long term and to regularly pay pensions. In case of a liquidity shock, private market portfolios of significant size can be securitized or, in the worst case, sold on the secondary market. Liquidity therefore should not be seen as an obstacle to invest in PE.

Myth 3: "PE is expensive, increasing a PF's total expense ratio (TER)."

Declaring investment costs as 'high' in general is difficult, since they must be compared to increments of performance. In the case of PE, costs are more than compensated by performance. Moreover, it is possible

5 This includes PE, private debt and private real assets.

Fig. 1: Dispersion of PE strategies based on their performance and duration



"FoF": funds of funds
"VC ": venture capital
"LBO": leveraged buy-out
"mezz.": mezzanine
"Distr.": distressed
"Opp": opportunistic
"RE": real estate
"VA": value add
"RoW": rest of the world

Colour coding: yellow is global, blue is USA, red is Europe, green is rest of the world.

Source: Cambridge Associates, Wellershoff & Partners

to adapt fees by matching them with the capital effectively at work (and not just committed), which means that the TER can be controlled and adjusted. Though this requires some effort, a PF's TER alone is not an obstacle to invest in PE.

Myth 4: "The asset class is poorly adapted to PF."

The endowment of Yale University has the same targets as a PF and Yale allocates 23.4 percent[6] of its assets to PE. Its average annual performance over 20 years is 12.6 percent (12.9 percent over 30 years[7]). The asset allocation of Yale's endowment has generated an excess average annual performance of 1.7 percent per year compared to the median performance of other endowments over the past 30 years. These results are within reach of Swiss PFs, especially in a context of reduced yield, leading to a constant increase of retirement age. Avoiding PE investments is in essence equivalent to depriving individuals of their right to enjoy a healthy and early retirement.

Myth 5: "PE is risky."

Direct private equity investments are indeed risky. Funds-of-funds (or the equivalent through mandates) are not: they are the equivalent of ETFs for PFs, but actually with lower associated risks than an index (Fig. 2). Only 6.9 percent of funds-of-funds exhibit a negative IRR (of -20 percent at most). In fact, PE funds-of-funds are less risky than ETFs of listed stocks.

Thus, the risk-return profile of PE investments matches the requirements of Swiss PFs. To have a real impact on a PF's performance, the PE allocation has to be significant. Current regulations allow Swiss PFs to deploy up to 15 percent of their assets under management in alternatives. We recommend that they deploy at least 5 percent to make a difference. //

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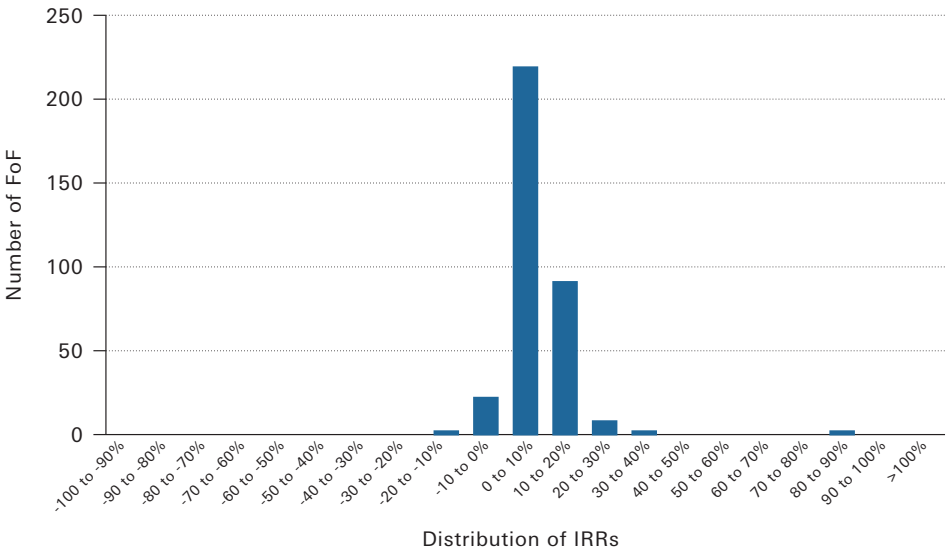
6 Average asset allocation from 1997 to 2015, according to the endowment's annual reports.

7 In 2016, it was 11.5%, compared to 3.4% for Swiss pension funds, according to UBS.

Fig. 2: Distribution of PE funds-of-funds based on their internal rate of returns



The graph shows that direct private equity investments are indeed risky. Funds-of-funds (or the equivalent through mandates) are not: they are the equivalent of ETFs for PFs, but actually with lower associated risks than an index. Data from Cambridge Associates as of 06/2016. N = 346.

Source: Cambridge Associates, Wellershoff & Partners