What's So Great About Private Equity?

BY ROBERT KLEINSCHMIDT ON *MARCH 31, 2016*

Over the past few decades, private equity has gained cachet among investors much the way hedge funds did in an earlier era. Many of today's investors believe that private equity represents a new and superior asset class. But it is neither. Far from new, it is the oldest form of equity investing. As for superiority, the lack of liquidity inherent in private equity is one of its primary limitations. In fact, private equity's lack of liquidity was one of the driving forces behind the formation of public equity markets. In addition, and perhaps more importantly, public equity markets provided entrepreneurs with access to capital that private equity did not.

These days, private equity pools can provide needed capital to early-stage companies hoping to exploit an opportunity, or to more mature firms looking to restructure operations, management, or ownership. A limited secondary market in "privates" can also provide some liquidity to investors. But the real draw of private equity is the expectation of outsized returns, which are predicated on a substantial degree of financial leverage, often more leverage than what may be considered prudent in the public markets.

But private equity is not for the risk averse. This combination of reduced liquidity and increased financial leverage means greater risk, and for greater risk, one expects and demands higher returns. Consequently, it is not usually an appropriate investment vehicle for those whose primary investment objective is capital preservation. The public equity markets along with gold and fixed-income securities, on the other hand, have proven to be the enlightened choice for those multi-generational investors looking to protect and preserve their capital.

Notwithstanding the potential risks and limitations of private equity, Tocqueville believes that investments of this kind can sometimes have a place in a successful portfolio. In these instances, what makes these opportunities attractive to us is not that they are private, but that we find no comparable opportunity in the public market. And when there appears a private equity prospect in which our portfolio managers would invest their own funds, we explore it to the fullest. In particular, we vet private equity opportunities for those clients whose portfolios are of such a size that a modest stake in an illiquid private investment will have a negligible impact on the overall liquidity of the portfolio, or in the event of a total loss, on the client's capital. Those clients who choose to join our portfolio managers in a private equity investment can be assured that we will apply the same rigorous monitoring standards that we adhere to for all investments we make on behalf of our clients and ourselves.

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