QUESTION 1 - 4

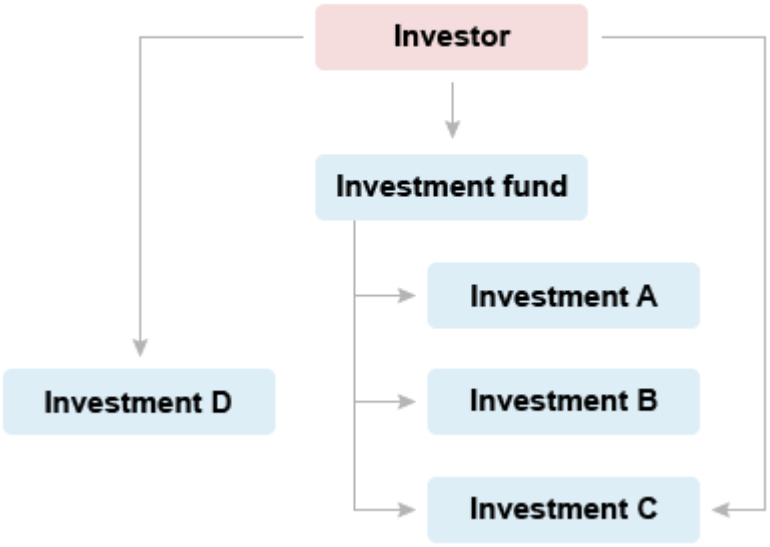
Julia Xiao, CFA, a senior associate at a large bank, is developing a training program for an incoming class of interns. For the first training session, she creates a summary that contrasts the features of public and private investments. She includes the information in Exhibit 1 and distributes it prior to her discussion of private equity and the J-curve effect:

Exhibit 1 Features of Public and Private Investments

Feature	Public	Private
Vehicle structure	Open-end	Closed-end
Return measures	Arithmetic or geometric	Internal rate of return (IRR)
Market liquidity	Liquid	Illiquid

Next, Xiao explains that private investments can be accessed through a commingled fund, direct investment, or a co-investment structure. She presents details about private investment structures and shares a diagram (Exhibit 2) that depicts methods to access private investments:

Exhibit 2 Private Investment Vehicles



Moving on to examples of private equity fund investments, Xiao shows the class a table of return data for portfolio companies in the bank's top private equity fund (Exhibit 3). She challenges the interns to explain what the data illustrates about the performance of the underlying portfolio companies, based on the metrics distributed to paid-in (DPI), residual value to paid-in (RVPI), and total value to paid-in (TVPI).

Exhibit 3 Private Equity Investments ($ thousands)

Investment	Invested capital	Distributions	Net asset value
Project Car	1,250	325	1,300
Project Bridge	1,750	775	1,450
Project Airplane	2,200	1,100	1,725

Xiao concludes by summarizing the differences in risk and return characteristics between public and private investments. She makes the following statements:

Statement 1: Private equity managers tend to be more specialized, and their portfolios exhibit less return variability than public market investments.

Statement 2: Compared with public equity, private equity is less reliant on price appreciation.

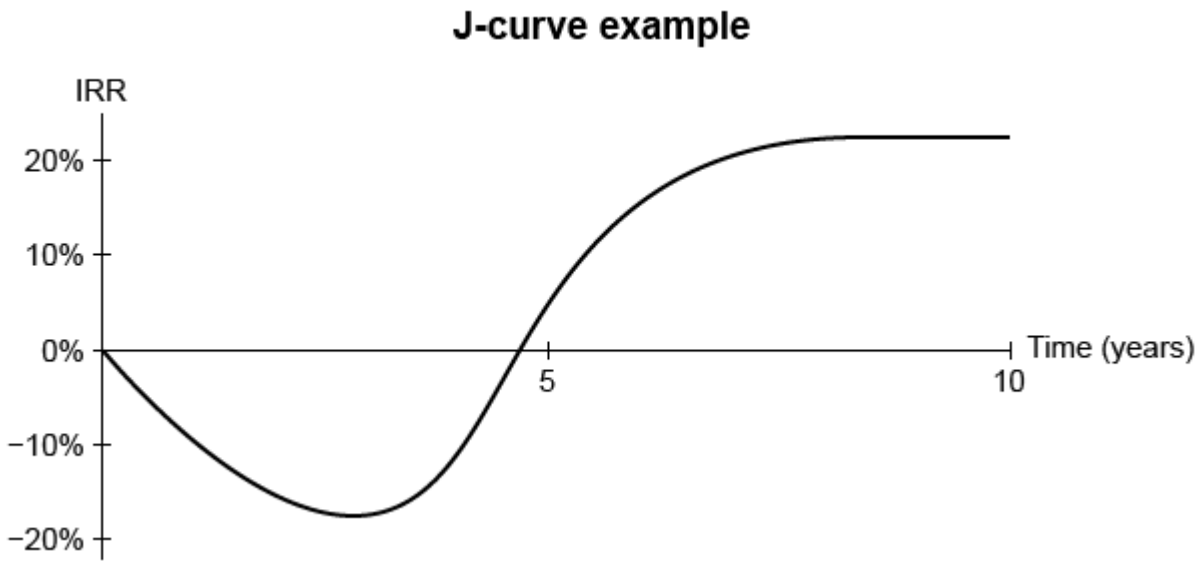
Statement 3: Private investing offers investors access to a broader range of companies, expanding risk and return potential beyond public market investing.

Question 1 of 12

Based only on Exhibit 1, which of the following private investment features *most likely* illustrates the J-curve effect?

- A. Market liquidity
- B. Vehicle structure
- C. **Return measures**

Explanation



The **J-curve effect** refers to the private investment life cycle, characterized by **negative returns** in **early years** when fees are charged on cash held, followed by **increased cash flow** and **income** from investments in **later years**. This effect relates to how private investment returns are measured, using an internal rate of return (ie, a dollar-weighted return), versus how public investments are measured, using arithmetic or geometric returns (ie, a time-weighted return). Public companies also tend to be more mature and trade in more efficient markets, leading to less volatile returns.

Public market investments have greater transparency and availability of data to measure returns, volatility, and correlations, making it easier to analyze portfolios. This is due, in part, to the greater liquidity and transparency typical of public markets. Private investments, in contrast, have little (if any) transparency, limiting the methods of portfolio valuation and price discovery.

(Choice A) Market liquidity is typically very low for private investment portfolios throughout their life cycle, and thus it does not result in a J-curve effect.

(Choice B) Private investment portfolios are typically structured as closed-end vehicles in which capital is drawn down from investors, invested in portfolio companies, and later harvested with distributions made to investors. In contrast, public investments are easily tradeable and may be sold immediately to facilitate needed liquidity.

Things to remember:

The J-curve effect is a feature of private investment returns over time. Private investments tend to have negative returns in early years, followed by increased cash flows and income in later years, while public investments tend to have less volatile returns year to year.

Contrast the features of private and public investments, and discuss characteristics of private and public markets.

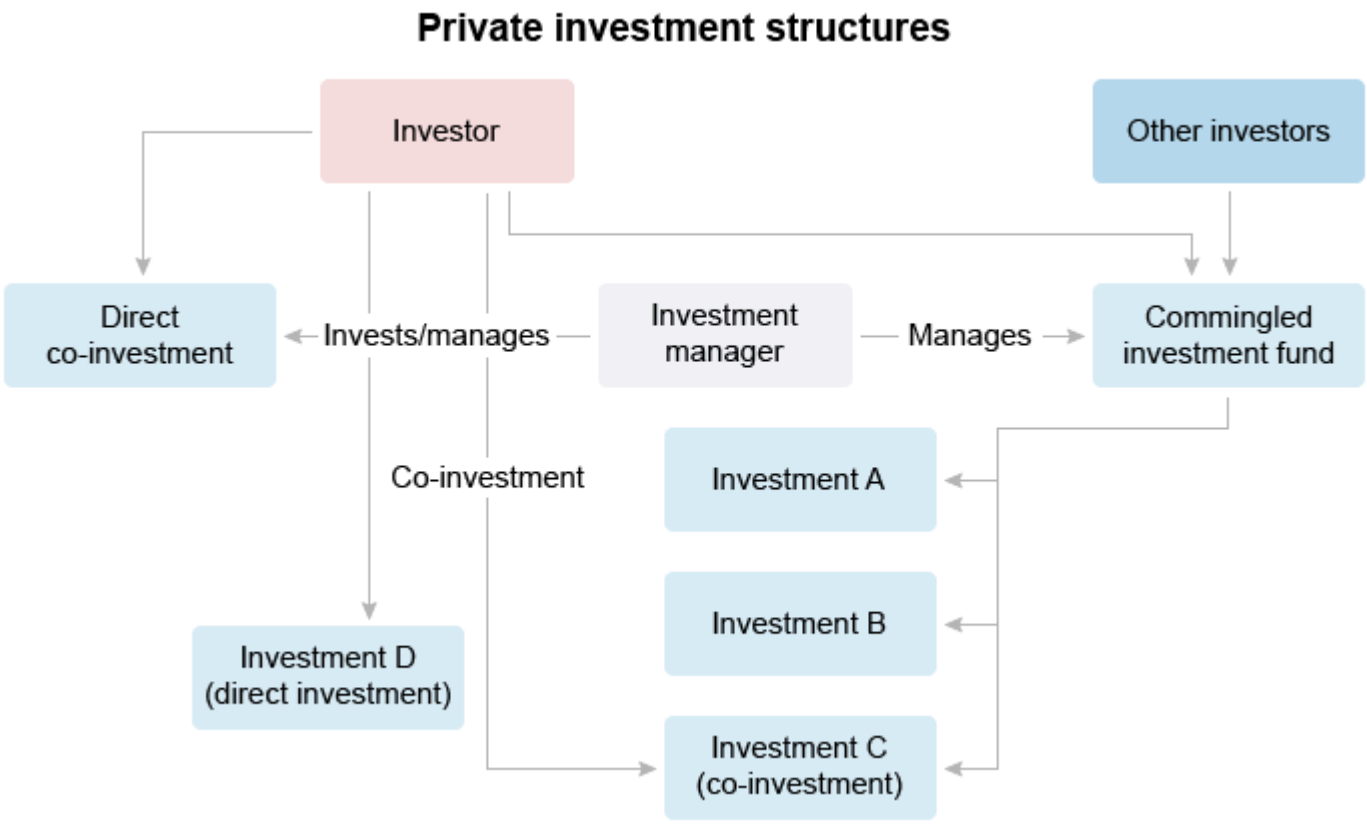
LOS

Question 2 of 12

Based on Exhibit 2, which investment is *most likely* to increase investment exposure while reducing average fees?

- A. Investment A
- B. **Investment C**
- C. Investment D

Explanation



Participation in private investments can take various forms. Among the most common are commingled funds, co-investments, and direct investments. Co-investments can be further split into direct or limited partner co-investments, which involve management through a GP or an outside partner.

Investment C depicts a co-investment in which the investor has additional exposure **outside the commingled fund structure**. This type of co-investment, also known as a **limited partner co-investment**, is managed by the investment manager, typically at no additional cost to the investor. Limited partner co-investments have the effect of increasing exposure while reducing average fees.

A **direct co-investment** is slightly different in that it involves a co-investment with one or more partners that may manage the co-investment. Direct co-investments are independent of a commingled fund structure.

(Choice A) Investment A sits inside a commingled fund structure: an investment manager, typically a GP, takes in capital from LPs to put in a fund, which then makes various investments.

(Choice C) Investment D depicts a direct investment: the purchase of an ownership stake or debt investment without the use of a partner, investment intermediary, or fund structure.

Things to remember:
Participation in private investments can take various forms, including commingled funds, co-investments, and direct investments. Co-investments can be further split into direct or limited partner co-investments, which involve management through a GP or an outside partner.

Discuss private investment methods and structures and their uses
LOS

Question 3 of 12

Based on Exhibit 3 and the total value to paid-in (TVPI), which investment has the *best* performance?

- A. **Project Car**
- B. Project Bridge
- C. Project Airplane

Explanation

Multiples used to measure value of private investment funds

Metric	How calculated
Paid-in capital (PIC)	$\frac{\text{Capital invested}}{\text{Total capital committed}}$
Distributed to paid-in (DPI)	$\frac{\text{Cumulative distributions}}{\text{Total capital invested (TCI)}}$
Residual value to paid-in (RVPI)	$\frac{\text{Net asset value}}{\text{TCI}}$
Total value to paid-in (TVPI)	$\frac{\text{Cumulative distributions + Net asset value}}{\text{TCI}} = \text{DPI + RVPI}$

Private market fund **multiples** are used to **assess** private investment **performance**, in addition to return measures such as IRR. These multiples ignore the time value of money but provide **more detail** in that they illustrate how much value has been **realized versus unrealized**.

Paid-in capital (PIC) calculates the proportion of committed capital that has been invested, in effect measuring the investment's "age" by how far along it is in the drawdown. Then, as a proportion of capital invested:

- DPI shows the cumulative distributions (ie, how much of the total value has been realized and distributed back to investors).
- RVPI shows the remaining NAV (ie, how much value is unrealized or yet to be exited).
- TVPI shows the total value, both realized and unrealized, as a multiple of the invested capital.

The TVPIs for the private equity investments in Exhibit 3 are:

- TVPI = DPI + RVPI
- Project Car = (325 / 1,250) + (1,300 / 1,250) = 0.26 + 1.04 = 1.30
- Project Bridge = (775 / 1,750) + (1,450 / 1,750) = 0.44 + 0.83 = 1.27
- Project Airplane = (1,100 / 2,200) + (1,725 / 2,200) = 0.50 + 0.78 = 1.28

As measured by TVPI, Project Car has the best performance **(Choices B and C)**.

Things to remember:

Private investments are evaluated by IRR and by multiples on invested capital. The paid-in-capital (PIC) multiple calculates the proportion of committed capital that has been invested. Then, as a proportion of capital invested, additional multiples measure realized value (DPI), unrealized value (RVPI), and total value (TVPI).

Discuss the difference between public and private market performance, and calculate, interpret, and discuss the use of performance metrics including distributed to paid-in, residual value to paid-in, and total value to paid-in.

LOS

Question 4 of 12

Which of Xiao's statements regarding the difference between private and public investments is *correct*?

A. Statement 1

B. Statement 2

C. **Statement 3**

Explanation

Risk and return characteristics of private markets

- Higher risk-adjusted returns
- Greater return dispersion across managers
- Specialized skill required by managers
- Reliant on capital appreciation
- J-curve effect

Publicly traded companies make up only a **small fraction** of the investment universe. Private investments allow investors to access the debt or equity of **private companies, expanding potential risk and return** beyond those available in public markets. One example is venture capital investments, which are very early-stage private companies with high growth potential but also high failure rates.

Use of private investments has grown widely in strategic asset allocations for institutional investors, due to private investments' favorable mix of risk and return characteristics that are generally complementary to public markets' risk and return characteristics. For example, private equity may add higher risk-adjusted returns and diversification to a public equity portfolio, but private equity returns will have more dispersion among managers.

(Choice A) Private investments are made by managers with specialized skills, investing over various stages of a company's life cycle. These factors may lead to greater return variability for private investment managers versus public investment managers.

(Choice B) Private investments have a long investment time horizon and are subject to the J-curve effect, leading to *more* reliance on price appreciation than with public market investments, which are more likely to have stable cash flows.

Things to remember:
Private investments add risk and return characteristics that are complementary to those of public market investments inside of a strategic asset allocation. Private investments may have wider dispersion of returns, rely on capital appreciation, and experience a J-curve effect.

Compare the risk and return of investing in private markets and public markets as part of a strategic asset allocation.
LOS

QUESTION 5 - 8

Phillipe Renaux, an associate at a fund of funds manager in Western Europe, is discussing potential managers for his portfolio with his colleague, Fernando Sanchez. Renaux is excited about Ahrendt Partners, a private credit manager he has identified, and notes that the Ahrendt team:

Attribute 1: employs skilled lawyers to review documents and negotiate terms.

Attribute 2: leverages the firm's equity research to enhance fundamental analysis.

Attribute 3: conducts in-depth, bottom-up analyses and fully underwrites each credit.

Sanchez, having a public equity background, is less familiar with private market investing, particularly regarding structuring transactions and how clauses can protect debt positions. Renaux explains that when a company is sold, in the private markets the debt is usually refinanced due to a clause in the private debt agreements that mandates the repurchase of existing debt upon a change in ownership.

Ahrendt is currently in the pre-commitment stage and is soliciting new limited partners for Ahrendt Credit Fund II. As part of their due diligence, Renaux and Sanchez are reviewing the past performance of Ahrendt Credit Fund I (ACFI), which had a 5-year life and recently closed. Exhibit 1 shows ACFI's year-end cash flows, which are a simple sum of the cash flows from its underlying investments, along with a comparable public market index and the index's annual returns.

Exhibit 1 Past performance of Ahrendts Credit Fund I

Year	Cash Flow (CAD millions)	Public Market Index	Public Market Index Return
0	−70	100	NA
1	−50	120	20%
2	0	115	−4.17%
3	10	105	−8.70%
4	20	130	23.81%
5	125*	150	15.38%

*Year 5 cash flow represents the fund's exit value

Sanchez calculates ACFI's IRR using the information in Exhibit 1 and compares it to the compound annual return of the public market index. After reviewing ACFI's IRR, Sanchez questions whether the fund's cash flows are an appropriate basis for calculating the fund's IRR. Renaux responds that a public market equivalent (PME) methodology should have been used for the IRR calculation and makes the following comments:

Comment 1: With a PME method, the choice of public market index is irrelevant.

Comment 2: A PME method simulates public market investments by assuming that cash outflows are invested in a public index and cash inflows are sold.

Comment 3: The IRR resulting from a PME approach assumes interim cash flows can be reinvested at the IRR rate, offering a realistic view of cash flows from private investments.

Renaux calculates ACFI's IRR using a PME method that compares the fund's asset values with the compound annual return of the public market index.

Question 5 of 12

Which attribute is *most critical* when evaluating a private, as compared to a public, credit manager?

A. **Attribute 1**

B. Attribute 2

C. Attribute 3

Explanation

Skills required of public vs. private fund managers

Public	Private
• Market analysis • Regulatory compliance • Portfolio management of publicly traded securities	• Operational experience • Industry expertise • Due diligence • Negotiation skills • Navigation of complex legal frameworks

The **skill set** required for **private fund managers** extends well beyond security analysis. Effective managers possess significant operational experience and industry expertise, which are crucial for making informed investment decisions. Many have hands-on experience in starting, growing, or restructuring businesses and can provide vital insights into assessing potential investments and associated risks.

Moreover, private fund managers leverage extensive industry relationships, which enhance due diligence and negotiation capabilities and enable access to valuable information and opportunities. They also bring diverse qualifications in legal, accounting, and tax matters, allowing them to navigate the complexities of private investments where contracts are often less standardized than in public markets.

Due to the variability of legal frameworks in private markets, private fund managers must conduct additional **legal analysis**, often **utilizing** an in-house legal team or **external lawyers**, to thoroughly understand investment agreements, compliance requirements, and associated risks. This comprehensive legal review safeguards investors' interests and empowers managers to effectively navigate the challenges of private market investments.

(Choices B and C) Leveraging equity research enhances fundamental analysis for all fund managers, not just private market managers. Similarly, comprehensive bottom-up analyses and thorough credit underwriting are essential practices in the decision-making process of a wide range of investment managers.

Things to remember:
Private fund managers often possess operational experience and industry expertise, and have legal, accounting, and tax qualifications to navigate complex investments. In addition, they protect investors' interests by leveraging industry relationships for due diligence expertise and conducting thorough legal analyses to understand agreements and compliance.

Contrast the features of private and public investments, and discuss characteristics of private and public markets.
LOS

Question 6 of 12

A private debt agreement clause that mandates the repurchase of existing debt upon a change in ownership is *most likely* relevant to:

A. venture debt.

B. a leveraged loan.

C. **a leveraged buyout.**

Explanation

Comparison of leveraged buyouts (LBOs), venture debt, and leveraged loans

	LBOs	Venture debt	Leveraged loan
Purpose	Acquiring a company with minimal equity investment	Providing additional capital for growth	Financing acquisitions, refinancing existing debt, or funding capital expenditures
Risk profile	High risk due to substantial debt relative to equity	High risk due to the nature of early-stage companies	Higher risk compared to traditional loans due to credit rating and loan structure
Debt structure	Multiple layers, including senior secured loans and subordinated debt	May include warrants or equity kickers to compensate for high risk	Often secured by the borrower's assets with covenants to protect lenders
Control and ownership	Significant changes in ownership and control	No change-of-control issues	No change-of-control issues

When a company is sold through a leveraged buyout (LBO), existing debt is typically refinanced due to **change of control clauses** that require the repurchase of debt upon a **change in ownership**. These clauses protect lenders by mitigating risks associated with potential changes in the company's financial health after an acquisition. As a result, lenders maintain control over credit quality while the refinancing process allows new owners to negotiate favorable terms that align with their operational strategies.

(Choice A) Venture debt typically does not create change-of-control issues because it is structured as a loan without granting lenders ownership rights. The flexible terms of venture debt agreements and a focus on financial performance contribute to a framework where change-of-control concerns are minimal.

(Choice B) A leveraged loan typically does not create change-of-control issues because it is also structured as a loan without granting lenders any ownership rights. However, it often forms part of the long-term financing resulting from the change-of-control clause in an LBO.

Things to remember:
A leveraged buyout (LBO) allows buyers to make significant purchases with minimal capital. When a company is sold through an LBO, existing debt is often refinanced due to change-of-control clauses. These clauses protect lenders by managing risks related to the company's financial health after an acquisition and enable new owners to negotiate terms aligned with their operational strategies.

Discuss private investment methods and structures and their uses
LOS

Question 7 of 12

Which of Renaux's comments regarding PME methods is *most likely* correct?

A. Comment 1

B. **Comment 2**

C. Comment 3

Explanation

Public market equivalent (PME) methodology: calculating IRR

Advantages	• Provides a relevant benchmark for comparing private equity performance to public market investments • Addresses cash flow timing issues by simulating performance in a liquid market environment
Disadvantages	• Assumes interim cash flows can be reinvested at the IRR rate; may not be realistic for private market investments • Choice of public market index can significantly affect the results

The IRRs of private investments often reflect irregular cash flow timing, complicating comparisons with public market returns and hindering accurate performance assessment. The **public market equivalent (PME)** methodology addresses this difficulty by translating uneven cash flows into returns comparable to public market indices.

With PME, **cash outflows** are treated as though they were **invested** in a public index, whereas **cash inflows** are treated as **sales**. This process allows the calculation of a terminal value at the end of the fund's life. The IRR is then derived using the private fund's actual cash flows and the PME-determined terminal value. Investors use the IRR to assess private equity performance compared to public market returns.

(Choice A) In a PME method, the choice of public index is crucial as it provides the relevant benchmark for comparing private equity performance. By aligning with the characteristics of private investments, PME offers a more accurate assessment based on public market performance.

(Choice C) The assumption that interim cash flows can be reinvested at the IRR is less realistic for private market cash flows, which are often limited and illiquid, resulting in an inaccurate assessment of investment performance in private markets. However, it is valid in liquid public fixed-income markets, where stable reinvestment opportunities exist.

Things to remember:
Irregular cash flows for private investments can complicate comparisons with public market returns. The public market equivalent (PME) methodology translates uneven cash flows into returns comparable to public market indices. Investors can assess private equity performance by computing the IRR based on the fund's actual cash flows and the terminal value derived from the PME.

Discuss the difference between public and private market performance, and calculate, interpret, and discuss the use of performance metrics including distributed to paid-in, residual value to paid-in, and total value to paid-in.

LOS

Question 8 of 12

Using a PME methodology, ACFI's IRR is *closest* to:

A. 6.1%

B. **6.9%**

C. 8.4%

Explanation

Year-end asset value calculation of a PME for Ahrendt Credit Fund I (in CAD millions)

Year	Beginning Value	Public Market Index Return (%)*	Return	Cash Flow**	Ending Value***
0				−70.00	70.00
1	70.00	20.00	14.00	−50.00	134.00
2	134.00	−4.17	−5.59	0.00	128.41
3	128.41	−8.70	−11.17	10.00	107.24
4	107.24	23.81	25.53	20.00	112.77
5	112.77	15.38	17.34	0.00	130.12

* Return = Beginning value × Public market index return

** A negative cash flow represents an investment, while a positive cash flow represents a distribution.

***Ending value = [Beginning value × (1 + Public market index return)] − Investment + Distribution

The **public market equivalent (PME)** methodology compares the performance of private equity or private funds against public markets by simulating how the fund's cash inflows and outflows would have performed if invested in a public market index.

The IRR calculation using PME is based on actual cash flows except for the final (ie, terminal) cash flow. The final cash flow is the fund's terminal value derived from the returns of the public market index. This approach offers a direct benchmark, enabling investors to evaluate whether the private fund outperformed or underperformed relative to the public market index. The IRR for ACFI can be calculated using the cash flows from Year 0 to Year 4 given in Exhibit 1, along with the terminal value of 130.12. Consequently, ACFI's IRR using PME is approximately 6.9%.

(Choice A) 6.1% is ACFI's IRR based on the cash flows in Exhibit 1.

(Choice C) 8.4% is the compound annual return of the public market index.

Things to remember:

A public market equivalent (PME) method compares private equity fund performance to public markets by simulating how the fund's cash flows would have performed if invested in a public market index. Using PME, the IRR calculates the fund's hypothetical return, replacing its exit value with a terminal value based on the index. This gives investors a clear benchmark to assess whether the fund outperformed or underperformed against public markets.

Compare the risk and return of investing in private markets and public markets as part of a strategic asset allocation.
LOS

QUESTION 9 - 12

Jorge Ochoa is a banker at Hedrick Bank, a large private bank, where he primarily assists high-net-worth (HNW) individuals. He works closely with Peter Dillon, an investment specialist, who recommends adding several new private investments to Ochoa's HNW portfolios. Ochoa asks about the implications of adding a new private equity position versus a new public equity position in the equity portfolio. Dillon responds:

Statement 1: Among different private equity investments, diversification benefits from investing in buyout equity investments is less common.

Statement 2: Private equity investments tend to exhibit above-trend growth due to managers' industry-specific skills in selecting and managing investments.

Statement 3: The performance evaluation of an equity portfolio with a new private equity investment should occur annually after receiving the audited statement.

Dillon recommends that Ochoa's clients partner with Maehara Capital Partners, a US-based real estate private equity firm, to acquire equity stakes in data centers. Maehara has 15 years of experience in this sector and has launched two successful funds. Through his connection with Dillon, Ochoa can provide his clients access to Maehara's new fund with a lower minimum investment. Clients will also benefit from reduced fees and the guidance of seasoned investment partners.

As part of the due-diligence process, Ochoa asks Dillon to provide Maehara's fund performance history. Dillon presents the year-end NAV, capital called, and distributions to limited partners (LPs) for the Maehara Real Estate Fund II (MREFII) over its seven-year life cycle, shown in Exhibit 1.

Exhibit 1 Selected Information on Maehara Real Estate Fund II (USD millions)

Year	0	1	2	3	4	5	6	7
NAV		80	135	160	185	150	115	60
Capital called	30	60	50	10				
Distributions		0	0	0	20	40	50	60

When evaluating MREFII's performance, Ochoa points out that the fund has underperformed relative to a publicly traded REIT index throughout its life cycle. However, Dillon argues that this direct comparison is not entirely fair, citing several important factors:

Factor 1: Delays in cash outflows from liquid investments can reduce the IRR.

Factor 2: A declining interest rate environment may slow or pause capital deployment.

Factor 3: Private funds from different vintage years would allow for more accurate performance comparisons due to the varying economic conditions they experienced.

Question 9 of 12

Which of Dillon's statements regarding the addition of a new private equity position is *most likely* correct?

A. Statement 1

B. **Statement 2**

C. Statement 3

Explanation

Features of public vs. private investment

Feature	Public	Private
Asset prices	• Traded, observable	• Negotiated, estimated
Performance measurement	• Periodic	• Compounded over holding period
Liquidity	• Mostly liquid, with few trading restrictions	• Illiquid, with sale prohibited or restricted
Investment process	• Open-end, security selection	• Closed-end, with due diligence, value creation, and exit
Investment manager skills	• Financial analysis	• Industry, management, and technical expertise • Legal and financial analysis
Diversification potential	• Based on correlations of observed periodic returns	• Based on different company and investment life cycle phases, as well as unique asset types

Private equity investments tend to show **above-trend growth** due to the **specialized skills** of managers in **selecting** and **managing investments**. These managers leverage deep industry expertise to identify promising opportunities and actively implement operational improvements and strategic initiatives within portfolio companies. Their alignment of interests with investors, along with a focus on long-term value and rigorous due diligence, enhances the likelihood of sustained growth, even in challenging economic conditions.

(Choice A) Diversification benefits from investing in buyout equity are common as timing differences in private equity's relative outperformance—arising from the skills of private managers in selecting, acquiring, financing, restructuring, and selling companies—can result in a weaker correlation with public equity investments.

(Choice C) Private investment performance measurement is conducted through compounding performance evaluation over the measurement holding period. This approach involves assessing the returns by calculating the total gain or loss over the entire duration the investment has been held, which is essential due to the illiquid nature and longer investment horizons of private investments.

Things to remember:

Private equity investments often show above-trend growth due to managers' specialized skills in selecting and managing investments. The expertise managers possess enables them to identify opportunities and implement strategies that enhance value.

Contrast the features of private and public investments, and discuss characteristics of private and public markets.

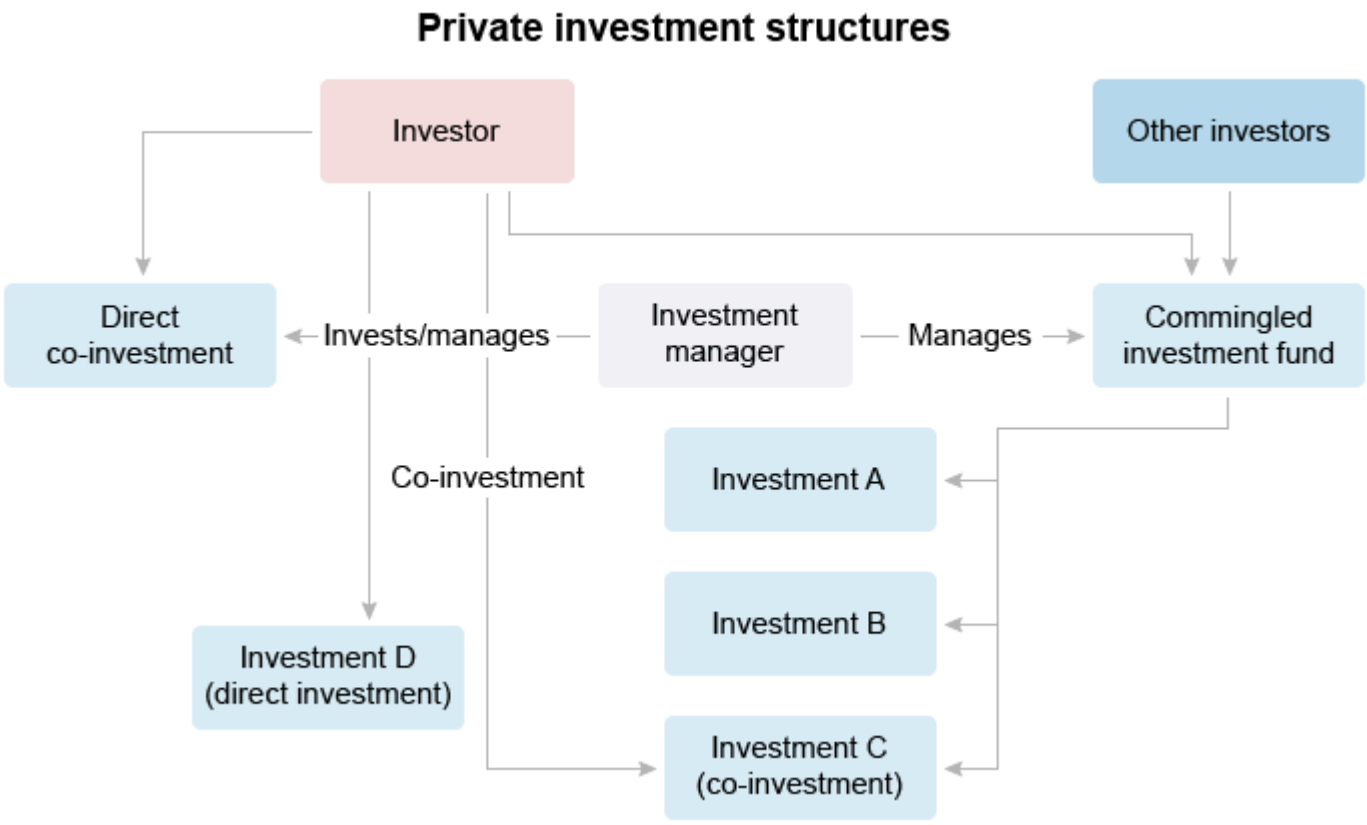
LOS

Question 10 of 12

Which private market investment method is *most appropriate* for Ochoa's clients to invest in Maehara's new real estate fund?

- A. Direct investment
- B. **Direct co-investment**
- C. Commingled investment fund

Explanation



In private markets, co-investment is a strategic approach that allows investors to participate more actively in specific deals. It can take two primary forms:

- **Direct co-investment**: Investors invest alongside partners, often private fund managers or institutional investors, in specific projects or acquisitions. This approach offers investors more ability to negotiate terms, influence strategic decisions, and align interests with partners. In addition, it typically incurs **lower fees** compared to traditional fund investments. Investors benefit from the expertise of their investment partners while making **lower commitments** to their private market investments.
- LP co-investment: An LP purchases an equity stake or private debt investment in a single opportunity managed by a general partner (GP). Although LPs lack direct control over investment decisions, they can participate in co-investment opportunities, which benefit investors with established GP relationships by providing early access to high-quality deals. LP co-investment rights incentivize

larger LPs to commit significant capital, allowing GPs to attract more substantial investments while offering LPs deeper involvement in lucrative projects.

(Choice A) Direct investment involves purchasing an equity stake or private debt directly, without partners or intermediaries.

(Choice C) A commingled investment fund is a collective vehicle that pools capital from multiple LPs, managed by a GP who makes investment decisions based on a defined strategy. This structure allows LPs to benefit from a diversified portfolio without direct management involvement and access investment opportunities that may otherwise be unavailable while incentivizing the GP with management and performance fees.

Things to remember:
Co-investment in private investments allows active participation through two forms: direct co-investment and LP co-investment. Direct co-investment lets investors purchase stakes alongside partners with lower commitments, offering greater control and lower fees.

Discuss private investment methods and structures and their uses
LOS

Question 11 of 12

The total value to paid-in of MREFII as of the end of Year 4 is *closest* to:

A. 1.10

B. 1.23

C. **1.37**

Explanation

Multiples used to measure value of private investment funds

Metric	How calculated
Paid-in capital (PIC)	$\frac{\text{Capital invested}}{\text{Total capital committed}}$
Distributed to paid-in (DPI)	$\frac{\text{Cumulative distributions}}{\text{Total capital invested (TCI)}}$
Residual value to paid-in (RVPI)	$\frac{\text{Net asset value}}{\text{TCI}}$
Total value to paid-in (TVPI)	$\frac{\text{Cumulative distributions + Net asset value}}{\text{TCI}} = \text{DPI + RVPI}$

Total value to paid-in (TVPI) is a critical metric of ROI, measuring the total value generated relative to the capital invested by investors. A larger TVPI shows that the fund has created more value compared to the capital invested, indicating more effective management and stronger investment choices. Conversely, a smaller TVPI may signal inefficiencies within the investment strategy.

In this case, TVPI as of the end of Year 4 is calculated as:

$$\text{TVPI} = \frac{20 + 185}{150} \approx 1.367 \approx 1.37$$

(Choice A) 1.10 incorrectly calculates TVPI by subtracting the USD 20 million distribution from the fund instead of adding it ((185 − 20) / 150).

(Choice B) 1.23 incorrectly calculates TVPI by not including the USD 20 million distribution in the calculation (185 / 150).

Things to remember:
Total value to paid-in (TVPI) is a key metric of ROI for private equity and venture capital performance, measuring total value generated relative to capital invested. A larger TVPI indicates that the fund has created more value compared to the capital invested, indicating more effective management and stronger investment choices.

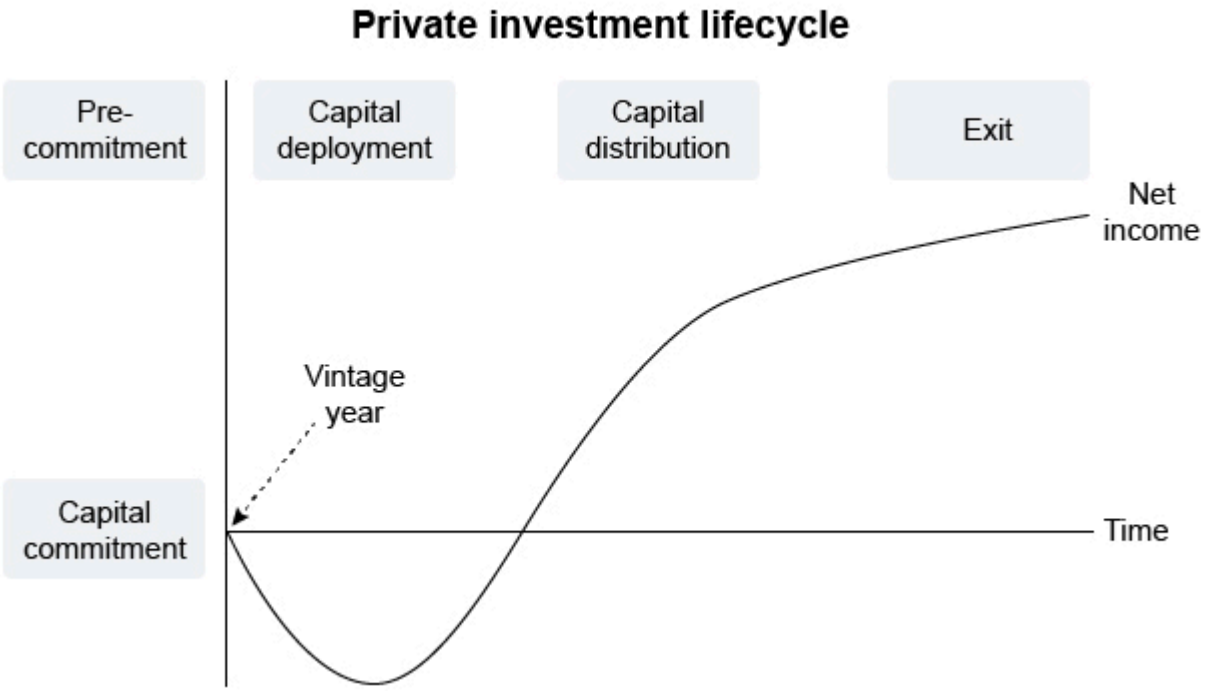
Compare the risk and return of investing in private markets and public markets as part of a strategic asset allocation.
LOS

Question 12 of 12

Which factor cited by Dillon regarding the private fund performance comparison is *most likely* correct?

- A. **Factor 1**
- B. Factor 2
- C. Factor 3

Explanation



Comparing the performance of a private investment to a public investment is challenging when capital raised by a private equity fund is not deployed immediately. **Committed capital** may remain **uninvested**, impacting IRR and creating uncertainty around capital call timing, complicating performance assessments. Unlike public markets, which provide real-time data, private investments often take time to realize their value, making direct comparisons difficult.

External market conditions can also complicate performance comparisons. Economic fluctuations and investor sentiment influence capital deployment timing. For instance, private fund managers may invest quickly in favorable conditions, whereas rising interest rates and/or risk aversion can slow capital deployment, highlighting the direct impact of market factors on capital call timing **(Choice B)**.

(Choice C) The vintage year is crucial for assessing private investments, allowing for comparisons of similar investments made concurrently and helping investors achieve diversification across different investment life cycles within a private market allocation.

Things to remember:
Comparing private market performance to public markets is difficult when capital is not deployed immediately, since uninvested capital can impact IRR and create uncertainty around capital calls. External

factors, such as economic fluctuations and investor sentiment, further complicate this comparison. Therefore, the vintage year facilitates comparisons and diversification across investment life cycles.

Compare the risk and return of investing in private markets and public markets as part of a strategic asset allocation.
LOS