Privilège Management SA

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VENTURE CAPITAL: ADDING VALUE TO YOUR PORTFOLIO

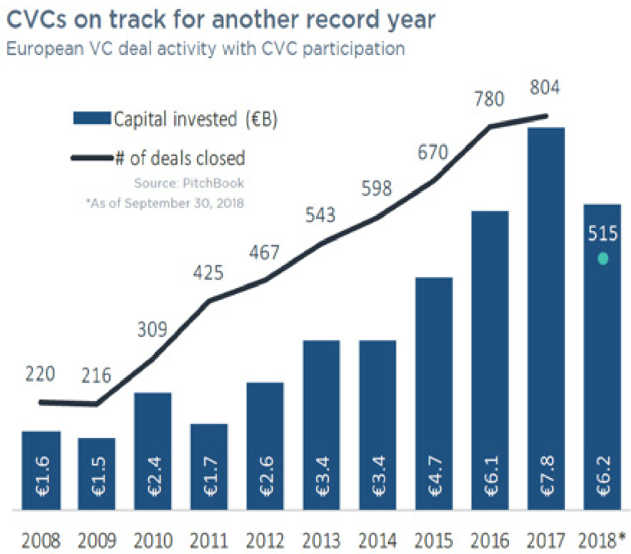
As practitioners active since 2014 in venture capital investing, we are beginning to see a definite change of attitude on the part of our HNW clients toward venture capital. This does not surprise us. In fact, investors, especially those who are professionally advised, appear to know we are presently in the middle of a transition whereby central banks are gradually raising interest rates (FED), or already mapping out their exit strategy (ECB). Therefore, it is difficult to imagine traditional asset classes providing the returns that investors expect. Such a paradigm shift would obviously require fundamental changes in the asset allocation.

In our view, one such change is the resort, among other things, to illiquid alternatives, like venture capital, for investors who are sophisticated enough to forego liquidity in exchange for returns. There is already evidence that HNW individuals and family offices are beginning to find venture capital to be an attractive investment alternative, and there are very good reasons for this.

In addition to being largely uncorrelated from traditional markets, venture capital has many other attractive features. In fact, with technology evolving ever more rapidly, many large corporations are finding it difficult to keep up with changes. Therefore, there is a trend for large corporations to invest in innovative start-ups as a way of partially outsourcing R&D.

In the US, corporate venture capital (CVC) tripled between 2011 and 2016[1]. The numbers are even more impressive in Europe where, since 2008 up to 2017, CVCs have increased by almost five-fold in terms of capital invested, while the number of deals closed has increased by 3.7 times during the same time frame.[2]

For 2018 we only have CVC data up to the third quarter, but as the chart below shows, it looks like the final number will be close or even exceed the 2017 record.



The rush to innovate will ensure an ample supply of new start-ups from which to choose and a correspondingly large number of investment opportunities.

Another good reason to invest in venture capital is that it affords the possibility of investing in pure plays in nascent technologies. This is no small ad-

1 According to Forbes magazine.

2 From PitchBook

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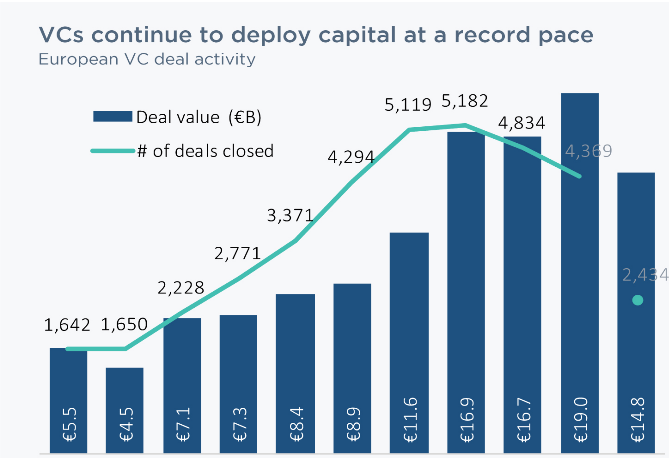
vantage. In fact, while large companies may be active in new technologies like, for example, health-tech or artificial intelligence, such technologies represent too small a part of the company to have a significant impact on the company's growth rate and, therefore, stock price returns. With venture capital, however, you can find pure plays in new technologies and benefit to the full extent of the growth potential that early stage technologies possess.

Europe (which obviously includes our home base Switzerland) is ideally suited to start-up activity because of the large pool of scientific and engineering talent its universities produce. Additionally, Europe is a manufacturing powerhouse specialised in high end products and equipment. This means that manufacturers need to stay ahead of the pack in technology to justify the higher prices they charge for their products. According to *Dealroom* we are at record levels in terms of billion-plus valuations in Europe. This is a clear indication of the quality of the companies that populate the venture capital universe in Europe and, as the chart below shows, investors are taking notice!



Venture capital investing is also a way of shielding the portfolio from geopolitical and political risks. Geopolitics has become increasingly impactful in the financial markets due to the aggressive use of sanctions and the increasingly bellicose rhetoric which characterises the international political discourse. Start-ups are largely immune because they are typically not global players and their value is mostly determined by the intellectual property they possess.

In Europe, 2018 has also been a very good year for exits, with exit values as at September 2018 already approaching the 2014 record.

The venture capital scene in Europe is evolving rapidly. As we mentioned at the outset, ultra-high-net-worth (UHNW) and high-net-worth (HNW) individuals are beginning to show considerable interest in this asset class, but portfolios are still under-exposed, particularly if we consider that, according to a survey by KKR, UHNW individuals in the US allocate 46% to alternative investments (these include hedge funds, private debt, private equity, venture capital and other illiquid alternatives). Pension funds allocate 24%, while HNW individuals have 22%. If history is a guide, Europe should trend in that direction. In fact, we are already seeing the size and number of venture capital funds increasing, but there is also a lot of institutional support for start-ups.

All the stars are aligned for venture capital to become a permanent feature in UHNW, HNW and institutional portfolios. Moreover, investing in venture capital is the most efficient way of harnessing the return potential offered by an era of unprecedented technological disruption!

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