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Macro Roundup Artcile

Headline: The Dispersion Delusion

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Tweet: .@verdadcap @verdadcap_quant argue that private equity returns are primarily driven by the small cap asset class returns showing that random samples of the cheapest 5% and the most profitable 5% levered micro-cap stocks produce similar returns to private equity.

Summary: We compare the median returns of private equity against simulated micro-cap portfolios of 20 stocks that are selected from the cheapest 5% and the most profitable 5% of companies within each year. Within our micro-cap data, there are typically 30-50 stocks in the top 5% of any given year, and the factor-ranked simulations randomly select from this opportunity set when forming the 20-stock micro-cap portfolios over the course of three years (at a pace of 6-7 investments per year). For context, there are over 2.3 million businesses with more than five employees in the United States. So if the private equity industry focuses on the top 5% of that universe, the PE opportunity set would have plentiful investment targets, with over 116,000 firms. This target list represents more than 6x the 18,000 firms actually owned by PE today. Therefore, we believe our 5% sampling provides a good representation of the opportunities available to PE. Value characteristics appear to have the biggest impact on micro-cap returns, boosting the median return from 10% in a totally random sample to 18% in a value-ranked sample of 20 stocks. Quality also seems to matter, with an improvement of 4pp in the median return from 10% in a totally random sample to 14% in a profitability-ranked sample of 20 stocks. Related: It's Mostly a Paper Moon: Alternative Investments Review and Private Equity Operational Improvements and Private Equity Fundamentals

Primary Topic: Financial Markets

Topics: Database, Financial Markets, GDP, Op-Ed/Blog Post, Weekly

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