

Performance of Private Equity Portfolios

Paul A. Strassmann, New Canaan Men Investment Club
May 2, 2016

Introduction to Private Equity Portfolios

Top Hedge Funds Performed Well – April 2016 Status

Names Showing % Portfolio Returns	Type	Last Reported 13-F Filing
Paul Tudor Jones	Hedge Fund	17.46
Robert Karr	Hedge Fund	16.18
Stanley Druckenmiller	Hedge Fund	9.36
Jim Simons	Hedge Fund	7.04
Steve Mandel	Hedge Fund	6.97
Eric Mindich	Hedge Fund	6.73

Top Mutual Funds Have Not Performed Well – April 2016 Status

	1- month %	3-month %	1 year %
U.S. Equity Fund			
Large Value	0.06	-5.2	-7.55
Small Growth	-0.99	-10.66	-14.51
Taxable Bond Funds			
High Yield Bond	0.18	-1.35	-3.61
Preferred Stock	-1.14	-2.52	-2.67

Observations

Stock Market is +58.7% Over Mean Earnings:

Average investor cannot expect gains

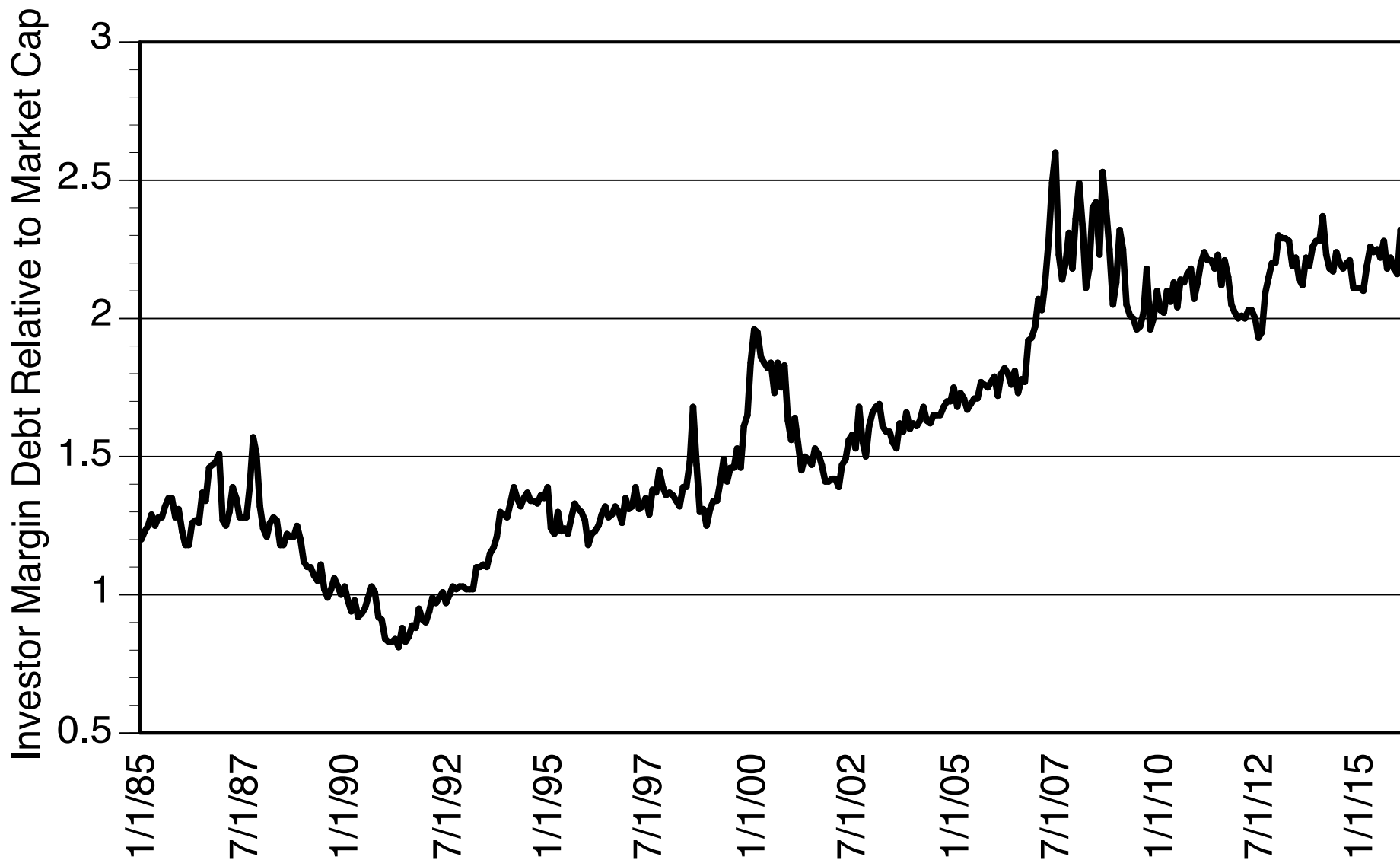
Cheap Debt Encourages Stock Appreciation:

Mutual Funds cannot deliver gains

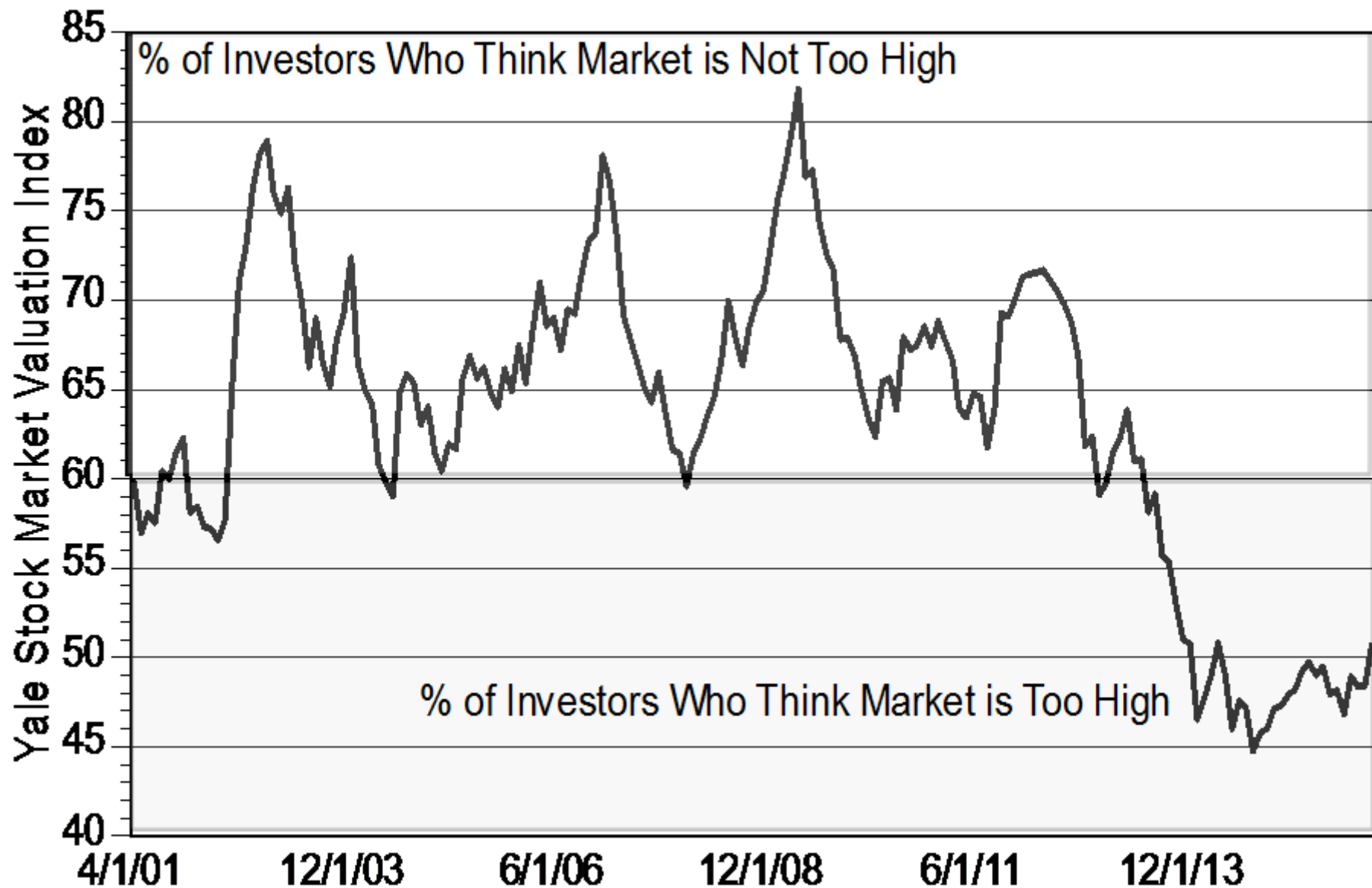
Private Equity Manages \$3.8 Trillion:

Risky, but could be profitable

Increasing Margin Debt Supports Stock Market Growth



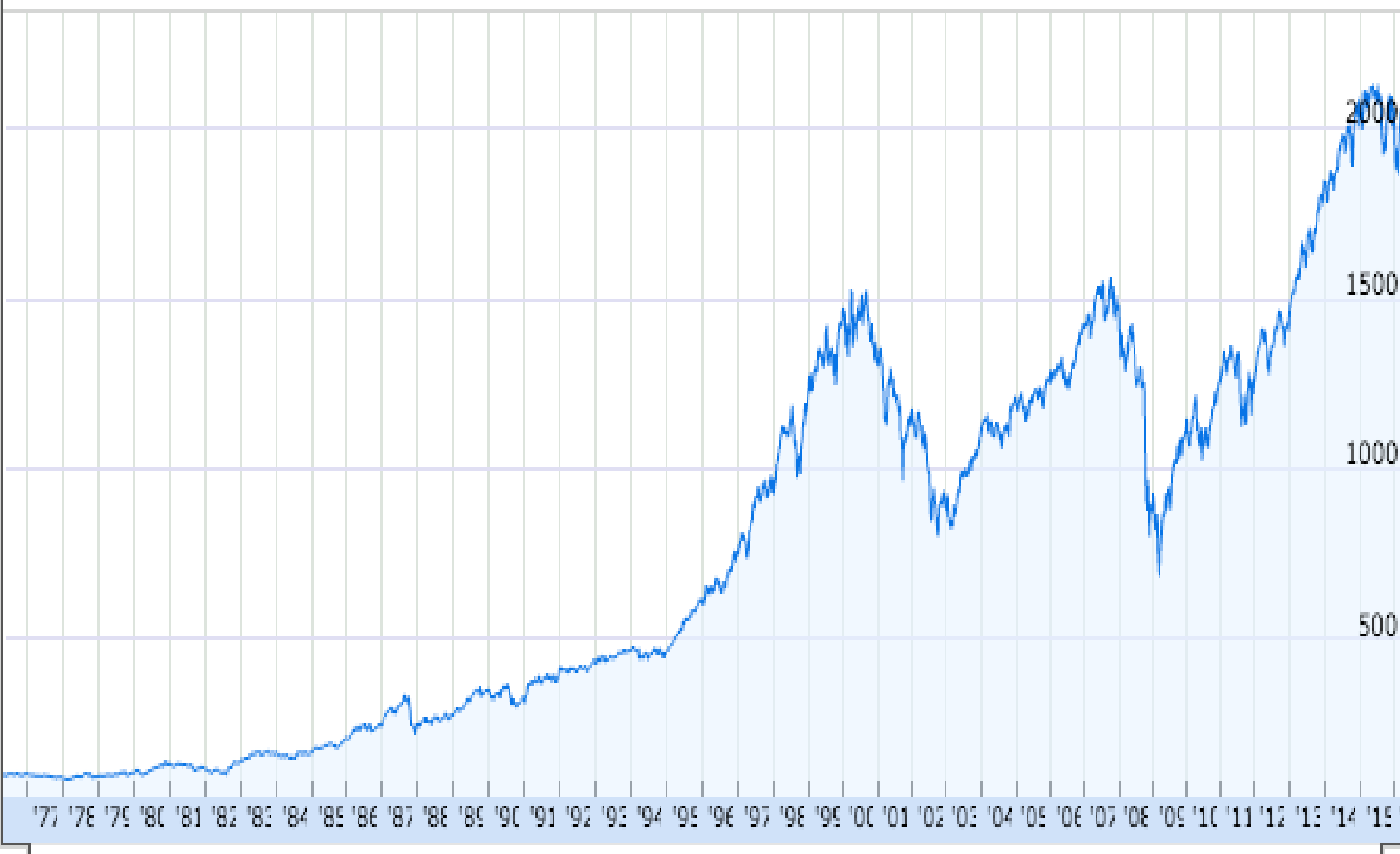
The Critical Issue at This Time: Investor Sentiment



S&P Can Grow Only if Both Earnings and Sentiment Improve

Zoom: [1d](#) [5d](#) [1m](#) [3m](#) [6m](#) [YTD](#) [1y](#) [5y](#) [10y](#) All

May 07, 1976 - Apr 29, 2016 +1953.04 (1921.53%)



Caution: Only Some Hedge Funds are Winners in Past 2 Years

- While the S&P 500 index was up 1.2%, the average hedge fund lost 3%. This was on top of several years of sub-par performance.
- The S&P 500 has now outperformed average hedge funds for 10 straight years with the exception of 2008, when both fell sharply.
- Future growth of S&P 500 and Hedge Funds Risky

Continue Investing in High Return Funds but Track Closely

Name	YTD(%)	1 Year(%)
Natural Resources	13.57	-15.43
Equity Energy	10.82	-24.83
Utilities	9.92	-1.09
Energy Limited Partnership	6.61	-31.15
Communications	6.26	2.19
Industrials	4.93	-2.42
Consumer Defensive	4.87	5.16
Global Real Estate	4.21	-1.08
Real Estate	2.98	3.57
Consumer Cyclical	1.71	-1.34
Financial	-1.12	-3.53
Technology	-1.48	-1.22
Health	-8.6	-12.85

Private Equity Methods

Private Equity Investors Apply in-Depth Analysis

- Fundamental: Industry, market cap, ROA, ROE
- Valuation ratios: P/E, PEG, Shiller P/E, EV/EBIT
- Profitability: Margins, margin growth
- Growth in revenue, EBITDA, EPS, book value
- Valuation percentiles across industry
- Price, Beta, volume
- Dividends: Yield, payout, dividend growth rate
- Insiders: CEO/CFO buys

Private Investors Pursue Well-Defined Strategies

- Buffett-Munger Screener
 - Quality stocks young Buffett would buy
- Ben Graham Net Current Asset Bargains
 - Companies Ben Graham would buy
- Undervalued Predictable Companies
- DCF large margin of safety exists
- Historical Low Price to Sales Ratio Companies
- Predictable companies that with low P/S ratios
- Historical Low Price to Book Value Companies
- Cyclically-adjusted price-earnings (CAPE) Method

Superior Performers Can be Ranked – A Few Stand Out

- Select Investors that have generated big gains
- Superior performance for large portfolios
- Value-oriented
 - Warren Buffett, David Tepper, Bruce Berkowitz,
 - Low portfolio turnover
- Select investors
 - Global macro: Paul Tudor Jones, Louis Moore Bacon
 - Quants: Jim Simons, Steven Cohen, etc.

Insider Information Validated

- Rank of financial strength, profitability and growth of the company
- What other Investors are doing with the stock
- What Insiders are doing with it
- Review 10-year financial history
- Perform Valuations:
 - Absolute valuation with DCF calculator
 - Historical valuation history: P/E, P/S, P/B
 - Relative valuation: how other companies are valued

Example of Investment Screen Based on CAPE – March 2016

Sector	Number of Stocks	Shiller P/E
Energy	<u>40</u>	11.70
Financial Services	<u>66</u>	18.60
Industrials	<u>72</u>	21.70
Utilities	<u>30</u>	22.50
Basic Materials	<u>23</u>	23.40
Consumer Defensive	<u>41</u>	23.70
Consumer Cyclical	<u>80</u>	26.90
Technology	<u>63</u>	27.50
Communication Services	<u>11</u>	31.70
Healthcare	<u>56</u>	31.90
Real Estate	<u>23</u>	55.40
S&P 500	<u>500</u>	25.6

Sector Selling and Sector Buying Can be Examined (3/12/2016)

Industry	No. of Net Buys
Semiconductors	 -59
Retail - Apparel & Specialty	 -54
Banks	 -53
Industrial Products	 -49
Asset Management	 -32
Brokers & Exchanges	 -32
Transportation & Logistics	 -29
Chemicals	 -28

Drug Manufacturers	 1
Autos	 2
Entertainment	 3
Airlines	 4
Waste Management	 4
Conglomerates	 8
Online Media	 10
Biotechnology	 31

Stock Prices Tracked for Timing Purchases

February to April From Very Bullish to Quite Negative



Ratio of Insiders Sales to Buys. Readings under 12:1 are Bullish. Those over 20:1 are Bearish. The total top 20 sales and buys are 200,582,135 and 5,538,888 respectively. Source: Thomson Reuters



Sources: Top Chart- Barrons.com, Thomson Reuters, Lower Chart- Big Charts

Imitating Private Equity Portfolios

CEO Purchases Not Advantageous

Top 25 CEO Buys

Bookmark Tweet Like 11 Share

i Top 25 CEO Buys



Insider Purchases Not Advantageous

Top 25 Insider Cluster Sales

Bookmark Tweet Like 11 Share

i Top 25 Insider Cluster Sales



Observations

- Imitating Most CEOs and Insiders Will not Improve Performance.
- Tracking S&P 500 Could Deliver Superior Results Immediately.
- Performance of Selected Investor Funds Can Be Attractive, but Requires Attention.

Review of Private Equity

Warren Buffett

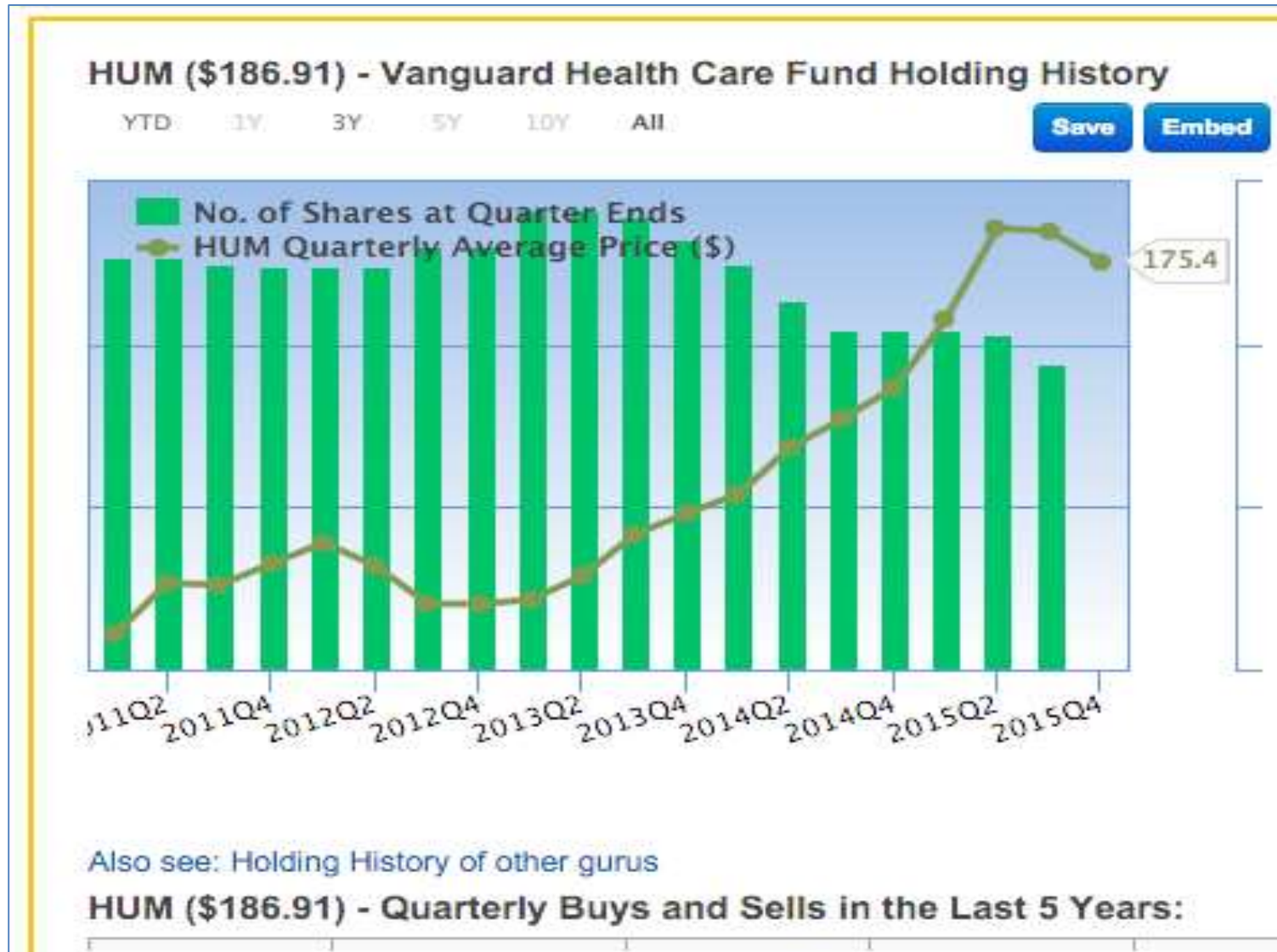
Purpose of Investment Review

- How leading investors can keep the value of their portfolio above long-term sustainable levels.
- Investors reviewed:
 - Warren Buffett - Long term gains: +19.0%/year
 - David Tepper – Long term gains: +26.7%/year

Performance Based on Selected Criteria

Year	S&P 500	Buffett-Munger top 25	Top 25 Undervalued Predictable Companies	Top 25 Historical Low P/S Ratio Companies	Top 25 Historical Low P/B Ratio Companies
2009	24.7	28.6%	55.7%		
2010	11.6	19.5%	20.2%	19.0%	16.4%
2011	0.0	6.0%	-3.3%	-2.0%	-1.9%
2012	11.5	12.0%	5.3%	17.8%	17.6%
2013	31.8	30.4%	24.8%	29.6%	33.2%
2014	11.4	2.9%	11.4%	15.1%	20.0%
2015	-0.7	-10.9%	-0.2%	-3.8%	-4.6%
2016	0.3	13.4%	4.4%	11.2%	7.6%
Total Return	90.62	147.8%	176.0%	119.4%	120.4%

Examine Cases of a Successful Fund Investment



Humana shares appreciated 174% while S&P increased 66%

Successful Investment: HUM Shares Sold as 174% Gain

Period	Bought/Sold (Sh.)	% Change	Qtr. End Shares	Avrg. Price
2011Q1	-200,000	Reduce -3.05%	6,360,094	\$61.2
2011Q3	-100,000	Reduce -1.57%	6,260,094	\$76.1
2011Q4	-50,000	Reduce -0.80%	6,210,094	\$82.65
2012Q3	+300,000	Add 4.83%	6,510,094	\$70.3
2013Q1	+587,000	Add 9.02%	7,097,094	\$71.54
2013Q3	-130,100	Reduce -1.83%	6,966,994	\$91.61
2013Q4	-325,700	Reduce -4.67%	6,641,294	\$98.13
2014Q1	-414,300	Reduce -6.24%	6,226,994	\$103.98
2014Q2	-528,200	Reduce -8.48%	5,698,794	\$118.31
2014Q3	-450,900	Reduce -7.91%	5,247,894	\$127.17
2015Q2	-73,955	Reduce -1.41%	5,173,939	\$185.8
2015Q3	-457,400	Reduce -8.84%	4,716,539	\$184.84
2015Q4	-4,716,539	Sold Out	0	\$175.43
Shares Bought:	887,000	Average Price: \$71.12/share		
Shares Sold:	-7,447,094	Average Price: \$155.29/share		
Current Price: \$186.91 Total Estimated Gain since 2011Q1: 174%				

Investment Views of Warren Buffett

- Believes in a margin of safety above all else
- Only buys top-quality businesses at fair prices
- Thinks that no price is cheap enough for a bad company
- Prefers investments that he can hold forever
- Analyzes stocks as if he were buying the entire business

Invest in:

Simple Business

Has Favorable Long-Term Economics

Has Able and Trustworthy Management

Offers a Margin of Safety

Top Buffett Investments

Company	Industry	Value (\$1000)	% of Shares Outstanding
Wells Fargo & Co	Banks	\$26,076,724	9.45
Kraft Heinz Co	Consumer Packaged Goods	\$23,693,189	26.8
Coca-Cola Co	Beverages - Non-Alcoholic	\$17,184,000	9.24
International Business Machines Corp	Application Software	\$11,151,823	8.43

Owner Earnings According to Warren Buffett

Net Income

+ Depreciation, Depletion, Amortization

+ Other Non-Cash Items

+ Average Maintenance Capital Expense

= Owner Earnings

Buffett-Munger Investment Results

Year	S&P 500	Buffett-Munger Results - top 25
2009	24.71	28.65%
2010	11.65	19.54%
2011	0	6.01%
2012	11.52	12.05%
2013	31.8	30.37%
2014	11.39	2.94%
2015	-0.73	-10.89%
2016	-1.06	12.30%
Total	89.28	145.33%

Warren Buffett Holds 81 Million Shares – 8.43% of IBM

Period	Bought/Sold (Sh.)	% Change	Qtr. End Shares	Avrg. Price
2011Q2	+24,854,744		24,854,744	\$167.09
2011Q3	+32,494,240	Add 130.74%	57,348,984	\$172.6
2011Q4	+6,556,947	Add 11.43%	63,905,931	\$184.68
2012Q1	+489,769	Add 0.77%	64,395,700	\$194.31
2012Q2	+2,249,696	Add 3.49%	66,645,396	\$199.16
2012Q3	+872,500	Add 1.31%	67,517,896	\$197.14
2012Q4	+597,588	Add 0.89%	68,115,484	\$195.06
2013Q1	+6,500	Add 0.01%	68,121,984	\$202.76
2014Q1	+233,100	Add 0.34%	68,355,084	\$184.29
2014Q2	+1,818,894	Add 2.66%	70,173,978	\$188.25
2014Q3	+304,034		70,478,012	\$190.56
2014Q4	+6,493,805	Add 9.21%	76,971,817	\$166.28
2015Q1	+2,593,298	Add 3.37%	79,565,115	\$158.68
2015Q3	+1,468,335	Add 1.85%	81,033,450	\$154.46
2015Q4	0		81,033,450	\$140.46
Shares Bought:	81,033,450	Average Price: \$172.36/share		

IBM Share Price: Current Value = \$140.15; Fair Value = \$289.57

IBM - International Business Machines Corp Fair Value Calculator

1. Fair Value Calculator Tutorial , 2. Fair Value Calculator Updates, 3. Check out the list of Undervalued Predictable
4. Reverse DCF: How It Works

Earnings Per Share : \$ 13.63

Growth Rate In the Next: 10 Years : 8.0 %

Business Predictability



Terminal Growth Rate: 8 %

Years of Terminal Growth: 20

Discount Rate: 10 %



DCF

Reverse DCF **NEW**

Tangible Book Value: \$ -22. ☒ Add to Fair Value

Growth Value: \$ 123.39

Terminal Value: \$ 188.19

= Fair Value: \$ 289.57

Price: 140.15

Margin Of Safety: 52%

180 Indicators Are Favorable – 1996-2015

Fiscal Period	4Q 2015
Revenue per Share	\$83.18
Earnings per Share (diluted)	\$13.42
Dividends Per Share	\$5.00
Book Value Per Share	\$14.77
Return on Invested Capital %	29.2
Net Margin %	16.14
Dividend Payout Ratio	0.368
Revenue	\$81,741
Net Income (Continuing Operations)	\$13,364
EPS (Diluted)	\$13
Total Assets	\$110,495
Total Equity	\$14,262
Price to Book	9.32
Shiller PE Ratio	11.71
Enterprise Value	\$164,761

Warren Buffett's Investment in IBM

1. Potential future +10 year profit >\$1 Billion.
2. Shares can be immediately sold for small gain.
3. Current dividends exceed the cost of capital.

SUMMARY:

IBM purchase an example of a hedge fund bet.

Warren Buffett's Investment in IBM

1. Potential Profit in +10 years >\$1 Billion.
2. Shares can be immediately sold for small gain.
3. Current dividends exceed the cost of capital.

SUMMARY:

IBM purchase an example of a private capital bet.

Review of Private Equity

David Tepper

Tepper, the Top Distressed Debt Specialist

- Tepper earned a reputation for producing some of the highest quick returns amongst fund managers.
- Tepper fund, Appaloosa Investment, produced a 26.7%/annual returns since 1993.
- Current portfolio: \$ 5 billion.

Tepper follows Ben Graham

- Pick companies whose market values are less than two-thirds of net cash value.
- During the past 12 months, companies generate positive operating cash flow.
- Companies may well go under as economic conditions worsen.
- Accept high risk with high gain.

Graham Number for Goodyear Tire & Rubber Company (GT)

- Graham Number is a figure that measures a stock's fundamental value by taking into account the company's earnings per share and book value per share.
- The Graham number is the upper bound of the price that a defensive investor should pay for the stock.
- Graham Number for 2014 = \$ 45.87/share

GT - Goodyear Tire & Rubber Co	2011	2012	2013	2014	2015
Tangible Book per share	-2.29	-3.81	1.21	10.67	12.09
Operating Margin %	4.48	4.46	6.66	8.34	10.13
Retained Earnings \$000	\$1,187	\$1,370	\$1,958	\$4,343	\$4,570
PE Ratio	11.39	20.01	10.82	3.24	29.97
Highest Stock Price	\$17.89	\$13.81	\$23.85	\$28.66	\$35.00

Buy Shares Low Sell Quickly at Multiple of Purchase Price

GT (\$32.25) - Quarterly Buys and Sells in the Last 5 Years:

Period	Bought/Sold (Sh.)	% Change	Qtr. End Shares	Avrg. Price
2012Q4	+14,345,610	Add 0.22%	14,345,610	\$12.31
2013Q1	+885,191	Add 6.17%	15,230,801	\$13.54
2013Q2	+6,769,199	Add 44.44%	22,000,000	\$13.67
2013Q3	-3,156,846	Reduce -14.35%	18,843,154	\$19.1
2013Q4	-6,688,233	Reduce -35.49%	12,154,921	\$22.15
2014Q1	-873,825	Reduce -7.19%	11,281,096	\$25.45
2014Q4	-1,042,380	Reduce -9.24%	10,238,716	\$24.84
2015Q1	-251,300	Reduce -2.45%	9,987,416	\$26.15
2015Q3	-4,058,327	Reduce -40.63%	5,929,089	\$30.01
2015Q4	-3,790,039	Reduce -63.92%	2,139,050	\$32.82
Shares Bought:	22,000,000	Average Price: \$12.78/share		
Shares Sold:	-19,860,950	Average Price: \$25.64/share		
Current Price: \$32.25 Total Estimated Gain since 2012Q4: 106%				

Buy Very Low, Sell for Large Gain

GT (\$32.25) - David Tepper Holding History

YTD

1Y

3Y

5Y

10Y

All

Save

Embed



Summary of Private Equity Portfolios

Current Investment Guidelines

- Continue Investing in High Return Funds but Track Closely. Risks are High.
- Select High Performance private investors or an Insider opportunity. Devote substantial time to detailed analysis. Risks are Very High.
- Reduce the volatility of portfolio until stock market reaches more acceptable P/E. Risks are Acceptable.