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Editor's Letter

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The Winter 2018 issue of *The Journal of Private Equity* confirms a pattern of continuing expansion in funding power but with a second-half (particularly in the fourth quarter) slowing trend compared to the same period in 2017 according to Christopher Elvin of *Preqin*.[1] Fundraising by type shows buyout, growth, and venture capital led three-quarter results with North America showing a substantial lead over the total growth in Europe, Asia, and the Rest of the World together.[2] Meanwhile, dry powder continues to rise to $1.14 trillion as of October 2018, and Limited Partner (LP) investor's confidence is showing signs of weakening somewhat.[3] (Please refer to "Snapshot" at the back of this issue for more details.)

US economic growth momentum is entering its tenth year driven by increasing business and government investment and growing consumer demand from a now more-fully employed labor force. Beginning in October and into November an increase in the volatility of equity markets suggests a change in expectations. October data for most of the US economic outlook indicators continue to be positive for sustainable growth, but several indicators (e.g., ISM Manufacturing Index), are turning less positive reflecting some uncertainties creeping into future growth expectations leading into 2019.[4] However, so far there is no confirming evidence of a recession anytime soon.

Since the August (Fall issue) theme of *The Journal of Private Equity* there has been a significant increase in US equity market volatility. This change reflects a rising uncertainty among investors and financial advisors. The uncertainty stems from US political mid-term elections and current US economic policy actions. The deterioration in expectations is in response to three key factors. First, the tightening monetary policy with rising interest rates raising borrowing and repayment costs on variable rate loans. Second, a growing government budget deficit elevating its financing requirement that is contributing to rising bond yields and crowding out of private sector borrowing to support business investment. Third, an appreciating US dollar, and a slowdown in global commerce resulting from rising US trade restrictions vis-a-vis our major trading partners. Much attention focuses on a deteriorating US-China relationship. One possible economic risk that may develop from all three of these actions is a potential rise in US inflationary pressure and

[1] Christopher Elvin, "Forward," Preqin Quarterly Update: Private Equity & Venture Capital Q3 2018, p. 3.

[2] Ibid p.6.

[3] Ibid p.3 and p.8.

[4] See for example Deva Panambur, "Third Quarter 2018 Market Newsletter" SARSI, October 15, 2018.

a possible shift in business expectations from continued growth with a full-employment scenario, to a slowdown in economic activity and decision to delay any expansion until the economic and political outlook becomes clearer.

Memories of the 2008 "great recession" have prompted many investment analysists to focus on possible market bubble risks such as rising housing prices; this is occurring, particularly in high-growth cities. Recent continued strong corporate earnings and profits performance make these market fears seem unreal. However, financial and economic markets are susceptible to sudden changes driven by the deterioration in expectations, which, if they persist, may result in fears becoming a reality.

Major US and multinational corporations' performance are currently heavily dependent on continued strong growth in the United States as the rest of the developed, developing, and emerging market countries in the global economy are underperforming. Thus, a slowdown in the US economy would be quickly translated into deteriorating revenue and profit performance and remove any underlying support for major equity markets. On the other hand, if there is a modest slowing in US real GDP growth, this could help calm rising US inflation concerns and help to sustain the US growth cycle for a longer period. In this scenario, venture capital and private equity are well positioned to play a major contributing role.

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In this issue of *The Journal of Private Equity*, we have an interesting collection of articles that explore and analyze several topics and perspectives that offer new insights on how private equity might alter how companies operate and benefit their longer-term performance.

Jeffrey M. Pomerance of SulmeyerKupetz Law and David McCarthy of D.R. McCarthy & Associates explore "Private Equity Investing 2018: *Rethinking the Private Equity Investment Model to Build Value*." Focusing on the US, private equity investing, especially in the middle market, has never been hotter. Market conditions are ideal, and fundraising is at historic levels. Despite this appearance, however, actual results suggest that something is wrong. Portfolio companies are not hitting their expansion targets, with many deals failing even to recover their initial investment. Making it on the "front end" by outsmarting the market or finding that truly undervalued company and watching it appreciate over time may no longer work. The "leverage" game may very well be over; it is certainly not a safe bet going forward. Rather, to continue to bask in significant investment returns, private equity investors need to make it up on the "back end" by working their deals and, in many instances, anticipating and managing problems quickly. In short, the private equity investment model needs to change, with investors taking a more "active" role in improving the performance of their portfolio companies. The authors provide several steps that investors should adopt that, when implemented, can help private equity investors enhance results and reach their return targets.

The exploration of the role and application of artificial intelligence (AI) in venture capital and private equity activities are underway with potentially promising results. The article by John Mathis of Harbor View Advisors reviews "Artificial Intelligence Update—*Gaining Ground across Many Sectors*." Mathis tracks the leading trends in AI, focusing specifically on companies in the financial services, healthcare, and business services arenas. Wide-ranging exploration in the space charted the many breakthroughs and triumphs in developing AI and the roadblocks in commercializing the technology in areas such as self-driving, machine-diagnosing, and the future of autonomous decisions. A clear consensus on the future of AI is automation, particularly where traditional systems are reaching natural limits. For example, in healthcare, hospice has experienced very little innovation. However, the aging population is taxing the hospice system with a heavy burden falling on otherwise productive family members. How can AI add capacity or improve the effectiveness of hospice? It seems inevitable that AI will play a role by progressing quality in the future of our lives.

Oscar Vasco, Stephanie Feit, Jesus Bandres, Emily Francis, (of Washington University) Nicolas Falkinoff Gips (of JAG Capital Management), and Diyi "Claire" Chen researched and authored "Micro Cap Assets versus Macro Cap Assets: *The Effect of Asset Size on Financial Performance in Real Estate*." The study explores the investment thesis that microassets outperform macroassets.

Microassets include office and industrial real estate assets acquired at a price between \$1–\$10 million. A macroasset is parcel of real estate acquired at a cost higher than \$10 million. The study used a data sample of 1,025 office and industrial real estate asset transactions. The analysis used transactions captured by CompStak and Co-Star for the period 1993 to 2016, representing approximately 38 cities across different market tiers. The results, with a 90% confidence level, showed that microassets yielded an 8.76% higher internal rate of return than macroassets. The research also found, with a 99% confidence level, that the change in the value of microassets is 15.97% higher than macroassets.

Nevena Simidjiyska, a Partner at Fox Rothschild LLP, examines "CFIUS Expanded—*How will the Broadened Scope Affect Private Equity?*" On August 13th, President Trump signed into law the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA). FIRRMA overhauls and significantly expands the jurisdiction of the Committee on Foreign Investment in the US (CFIUS), which reviews, modifies and has the power to prohibit certain foreign acquisitions and investments in US businesses, including private equity and other fund investments. FIRRMA significantly expands the reach of CFIUS beyond transactions that result in foreign control, gives CFIUS the ability to review a much broader set of industries, and makes the review of certain investments mandatory. The expansion will reshape the way that private equity transactions will be structured going forward.

John M. Collard, of Strategic Management Partners, examines the question of "Why Hire Outside Directors When Private Companies Don't Have To?" He argues the value proposition supports it because it brings change, breaks the status quo, and it can be a rejuvenation. You need the outside advisor's experience and knowledge to increase cash flow and provide valuable guidance, contacts, growth, and credibility. Companies committed to going through significant business change need advice—and new ideas and knowledgeable experience. Outside directors bring an independent perspective, develop strategic thinking and planning, utilize their experience and objectivity, provide their contacts Rolodex, find capital to finance the company, and guide transaction activity. Carefully recruiting well experienced outside directors, you have nothing to lose, and everything to gain by considering their advice when you make decisions that will influence the company's performance. Remember, the key is for the CEO and management team to listen to the information given, factor these inputs into their thinking, and then make decisions.

Khudsiya Zeeshan and Syed Azar of ICBM-SBE University analyze "Industry-Wise Investment Pattern of Select Private Equity Funds in India." The article is an analysis of private equity investment deal values across 24 industries by select private equity funds from 2007–2016. The purpose of the research is to identify any patterns of movement of deal values. The study established the growth rate of deal values and observed the performance of each private equity fund throughout the 10-year period. The focus of the study is to determine the significance of private equity investment for the promotion, growth, and development of industries. In the case of heavy industries such as energy, engineering and construction, and manufacturing, private equity investment becomes inevitable, at least as a supplement to government funding. Due to rising disposable income and purchasing power of people, industries such as BFSI (banking, financial services, and insurance) retail, and other services such as travel, transport, and telecom are also attracting considerable private equity. The role of private equity as an indispensable tool for industrialization is emerging and becoming dynamic. Furthermore, the government's go-ahead attitude toward business and financial reforms is further boosting private equity investment's opportunities and their impact on India's economic development.

Tay Kin Bee of Southern Cross University Australia examines the application of "Discounted Cash Flow Method for Valuing International Chemical Distributors." He asks if special considerations apply to valuation in the case of large global chemical distributors? This study seeks to identify whether Income-based Discounted Cash Flow method based on projected future income would be suitable to value international chemical distributors. The expected companies' enterprise and equity value are compared with the existing companies' valuations. A base, bear-and-bull case scenario is used to establish the range of the company's value for comparison with the existing valuation. This study adopts a single multiple-case study approach where actual financial data from three of the world's largest chemical distributors are used to establish the existing companies' valuation to demonstrate the validity and applicability of the Discounted Cash Flow method for sensitivity analysis.

Tzu-Yi Yang of Ming Chi University, Chin-Mei Chou of Ching Kuo Institute, Andrew Yi-Hung Liang of National Changhua University, and Yung-Heng Lee of Chinese Culture University explore the "Month-of-the-Year Effect Analysis on Taiwan's 28 Major Industry Stocks." In modern society, the stock market plays an essential role among different investment tools. It matches capital supply and demand so that the idle capital existing in the community is employed effectively. That is, the capital supplier can get the dividend and capital gain, and capital demander can grow production and daily business operation activity. Most domestic scholars focused on investigating the influence of seasonal effects on the stock market. This study researches the month-of-the-year impact on the stock market. Regression analysis is used to determine if there is a month-of-the-year significance for 28 major industry stocks in Taiwan between 2008 to 2016. Such information would be helpful to improve purchase and sale activities.

Youness Jouilil and Houda Lechheb of Ibn Tofail University analyze the "Effect of Moroccan Health Insurance on Individuals' Healthcare Utilization and Expenditures: *A Hicket Model*." The author's research examines the effect of Moroccan Health Insurance (MHI) on an individual's healthcare utilization and expenditures. The study used a random sample of 8,000 households produced by the National Observatory of Human Development. The data sample revealed that the RAMED plan insures about 21.1% of the total and that the Compulsory Health Insurance (AMO) covers 22.2%. The results of the study showed that the MHI is a positive influence on the utilization among beneficiaries and reduces the individual health costs, especially among the RAMED recipients. This research helps to establish benchmarks for future government healthcare programs.

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