Family Capital

Cambridge Associates says the "ocean of opportunity is deep" in venture investing

By **Michael Foster** 16th September 2021

Funding and performance records are being smashed across the venture capital world but this is no time to take profits, says sector cheerleader Cambridge Associates.

Chris Ivey, head of the consultant's European private client practice, points to the potential in tech-driven funds: "We believe it is worth staying with the asset class. You need to be disciplined and keep investing at a constant rate."

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He can see why people might be nervous following the surge in performance. Rises in the rate of inflation suggest rises in interest rates could occur, damaging prospects for smaller companies.

But Ivey believes VC deals need to be given time to maximise their potential. He sees immense potential in a new generation of emerging managers and tech-driven funds.

Instead of taking money off the table, Ivey backs diversification across vintages, managers and fund durations. By way of illustration, funds investing heavily in Chinese education have hit problems but those taking a diversified approach to the country have held up.

Co-investing has become more popular for family offices keen to raise their VC game. But Cambridge prefers to offer access to co-investments through its favoured managers, rather than “ad hoc” arrangements.

Ivey says that skill in manager selection managers makes a difference, given that performance dispersion is wider in VC than any other sector.

According to Cambridge's benchmark index, US venture capital generated a stunning return of 32.4% over the 25 years to December 2000, against 9.5% from the S&P 500, 12% from Nasdaq and 13.8% from private equity.

Performance was savaged in the 2000 internet crunch - and 2008 credit crisis - due to the vulnerability of smaller companies to a crisis. Benchmark returns over 20 years slumped to 7.2%, behind the S&P 500's 8.5%.

But investors turning their back on VC in later years missed returns of 13.1% (9.9%) over 15 years and 17.2% (13.9%) over ten.

Three-year returns were 28.2% (14.2%).

Performance in 2020 was 50.1% (18.4%) and a buoyant first half of 2021 has maintained the progress.

Global returns have become more closely correlated with the US, reflecting cross-border flows and the broadly based technology boom.

According to Pitchbook, inflows into US venture capital were $164 billion in 2020, triple compared with ten years ago. The first half of 2021 attracted $150 billion. Non-traditional VC investors like asset managers, corporates and hedge funds starved of listed growth stocks invested record sums. Governments such as France and the UK have encouraged VC investing at a local level. Recent inflows also reflect the $576 billion invested in equities since November, according to Bank of America.

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Cambridge's early interest developed out of its advice to large US educational endowments, including Yale and Harvard, desperate to cover their costs. Cambridge also developed expertise in private equity and real estate and – soon after – impact investing.

Family offices are particularly impressed by Cambridge's support for VC, which chimes with their love of smaller growth businesses.

The Rothschild banking family and the Hall family, famous for Hallmark greeting cards, bought minority stakes in Cambridge. Sofina, a Belgian listed investment company controlled by the Boël family, worth $1.9 billion, acquired a 20% stake in Cambridge in 2018.

In 2019, Cambridge pointed out that family offices would have achieved top-decile performance by putting 40% of their portfolio into private assets.

Ivey says that 50% private asset allocations are not uncommon. “You often see 20% to 30% of them invested in venture - or 50% if you want to add in growth assets.”

He believes the ocean of opportunity is deep. “The argument for technology is strong. It is here to stay and influence every single industry in every single sector. The addressable market for some startups and early stages have proved far greater than people expected. The rising tide is extraordinary and it is our job to find the managers with the best possible chance of success.”

The value of late-stage VC deals rose by a remarkable 85% this year, according to Pitchbook, while early-stage improved by a more moderate, but still large, 35%.

The gains reflect interest in buying into companies targeting a SPAC or IPO. Distributions would chip in 10%.

Ivey says : “The value of our venture positions is very, very high at the moment, but we are trying to manage this in line with our targets.”

Investors can choose to sell their positions through a secondary market that has become increasingly sophisticated. But prices paid can be at a big discount to the ultimate worth of a fund.

Ivey says: “We’ve seen funds hidden away in the corner of portfolios which have multiplied in value over ten or twelve years. It’s not a good idea to sell, unless you need the liquidity.”

Elsewhere, investors need to deal with defections from established firms by managers who want to make their own way in a buoyant market.

Many emerging managers are hyper-specialists and many have promise. According to Ivey: “We have seen a decent spread of emerging managers breaking into the top ten." He says they can provide an important role in freshening up family office returns although it is rare for investors to write off funds that have lost talent.

Pitchbook has found that emerging managers deliver outsized initial returns more frequently than established funds while subsequent returns are less impressive.

Ivey is less convinced that performance tails off. He is more leery of the way funds are now being rolled out every two years to take advantage of demand, rather than the traditional three to four: “The velocity of fundraising is a challenge to which we need to adapt. And the one thing we can control is the amount we are prepared to commit.”

Greater choice also helps Cambridge negotiate fee discounts for funds charging more than the base fee of 2%, plus a performance carry of 20%. Fees can be structured so that the carry increases significantly if funds double or treble.

Fees always creep higher in a boom and Ivey says the best managers always demand the most beneficial terms.

Negotiations between the two sides are inevitable: “There’s always progress to be made.”