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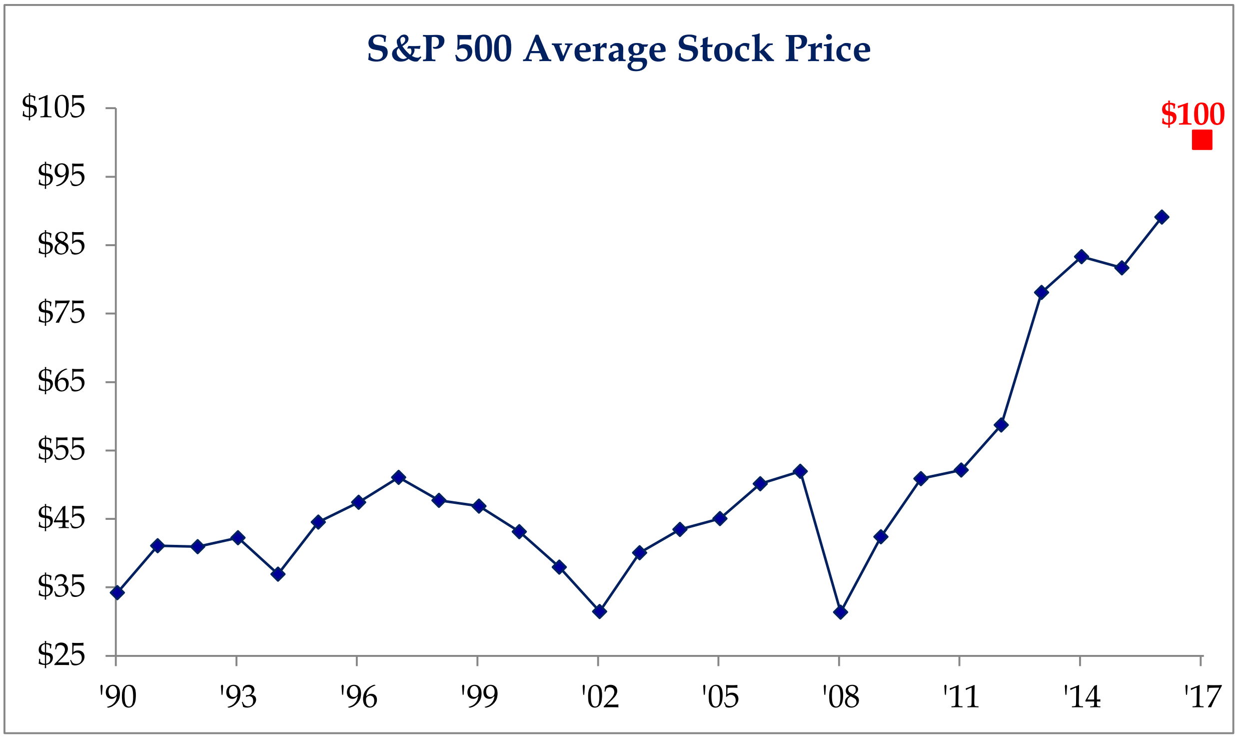
PRIVATE EQUITY MAY BE SAVING RETAIL INVESTORS FROM THEMSELVES

There are some nascent signs that the still gun-shy retail investor is starting to get more interested in the stock market. Schwab has reported a marked increase in the number of brokerage openings in recent months and, as everyone in the civilized world now knows, flows into ETFs and other passively managed vehicles continue at a feverish pace. While that would ordinarily be a worrisome signal that the "dumb money" was about to put in a major market top, in today's world it would obscure the fact that there have been net outflows from domestic oriented equity oriented funds since 2009. In this sense, this has truly been the bull market no one loved. It is a rare occasion indeed when human beings are apathetic about the potential of getting rich. We have thought long and hard about the reasons why this would be so. In the first place, one has to presume that the average guy is still smarting after two fifty percent declines in equity prices in the first decade of this millennium. Such scars are slow to heal. Secondly, the average price of a

Net Flows into Mutual Funds + ETFs ($BN)

Year	Domestic Equity MF	Domestic Equity ETF	International Equity MF	International Equity ETF	Bond	Money Mkt
2009	(27.6)	30.9	29.6	39.6	417.2	(539.1)
2010	(81.1)	46.7	56.7	41.5	262.0	(525.1)
2011	(133.3)	47.3	4.1	24.3	163.7	(124.1)
2012	(159.1)	80.9	6.4	51.9	358.5	(0.2)
2013	18.1	104.1	141.4	62.8	(59.0)	15.0
2014	(60.2)	141.5	85.4	46.6	94.5	6.2
2015	(170.8)	65.4	93.9	109.7	29.4	21.5
2016	(235.4)	167.6	(24.5)	20.1	190.1	(30.3)
2017 YTD	(75.2)	82.2	36.9	94.8	170.2	(100.1)
TOTAL	(924.5)	766.5	429.9	491.3	1626.6	(1276.2)

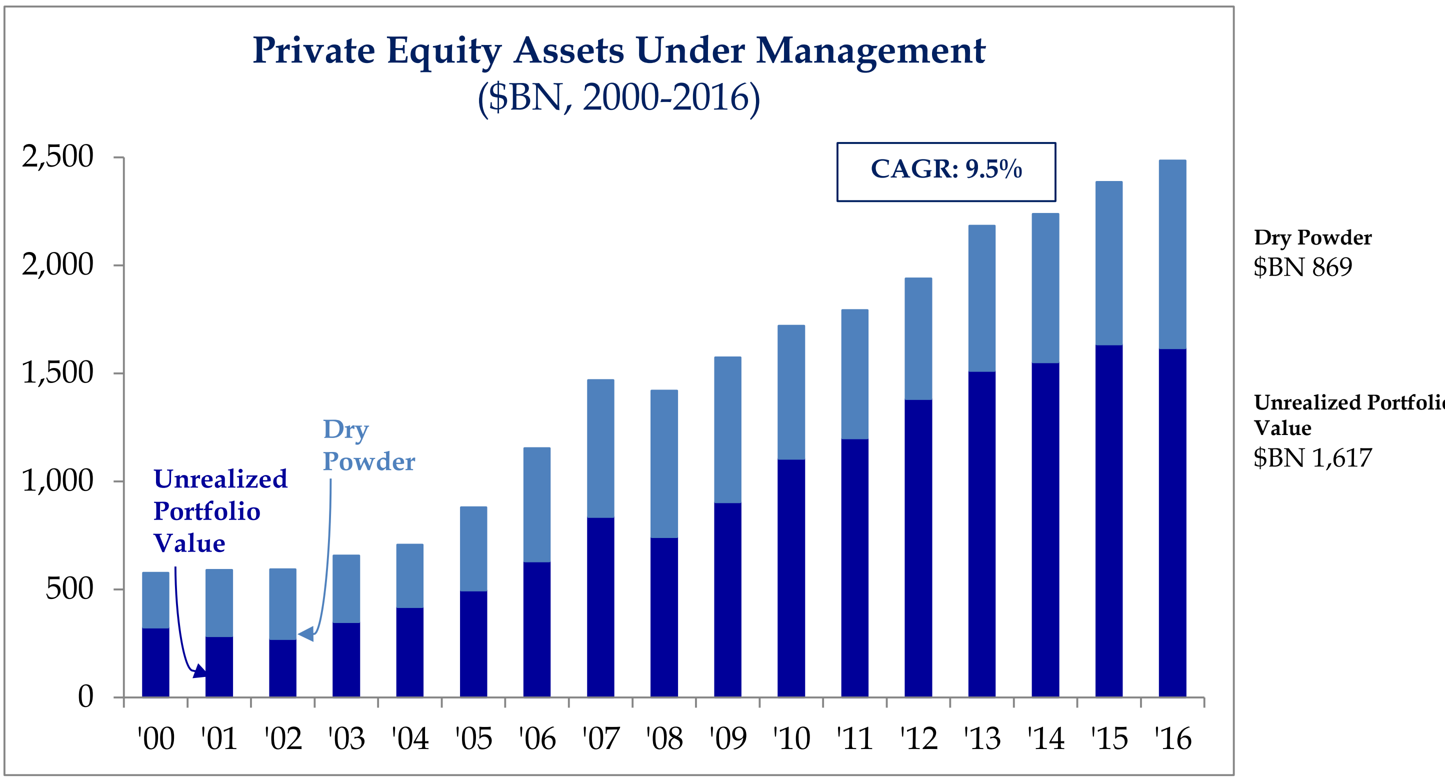
stock in the S&P 500 has never been higher than it is today at $100. While this is of no concern whatsoever to the institutional investor, any financial advisor would tell you that it makes a lot of difference to the little old lady Sandusky, Ohio. For the average investor, a stock that can be bought for $20 a share is simply more attractive than one trading at $1,000. ***Finally and perhaps the most significant reason potential investors have been slow to embrace the cupidity that lies at the center of men's souls is that the most "exciting" "new era" companies are not public.*** While there is little doubt that there would be a long list of individual investors lining up to buy the likes of Uber, Airbnb, and Pinterest regardless of valuation, few people are going to start bragging to their friends and neighbors about the fact that they just bought a round lot of Chicago Bridge & Iron.[1]



A few months ago, *The Wall Street Journal,* with no sense of irony, put on its front cover a "chart" of Uber's valuation. I put the word chart in quotes because it looks unlike any other chart you've ever seen. In stair step fashion, Uber's valuation shouts higher from its inception, punctuated only occasionally by relatively short periods of rest. At no point since the company's initial round of funding did the chart show the valuation to ever decline, it simply reflected the value the last round of investors had to pay. In an instant, one could see the siren song of private investments for professionally managed pensions, endowments, and foundations. Equity exposure with no possibility of volatility, disappointment, or embarrassment. Now, THAT, my friends, is a thing of beauty! My colleagues in the private equity business assure me that the rules for valuing such investments have been tightened up meaningfully in recent years but I'm not so sure. The

[1] I remain an owner. Sadly, my recent speculation has just become a long-term holding.

tape is a demanding taskmaster, certainly more demanding, it would appear, than other private equity firms. In recent years, it was not unusual to see more than 60% of private equity exits be made to other sponsors. In this regard, it could be reasonably assumed that the most attractive aspect of private equity investments is their opacity. The ability to conflate the concepts of volatility with risk has no doubt contributed to the rapid rise in the size and scale of the industry, especially since the financial crisis. A study by *The Economist* estimated that the number of firms formerly known as corporate raiders totaled 50 in 1990 and merely 100 in 2000. Today, it is estimated that there are more than 4,000 private equity firms in the world, 95% of them residing in the United States.



Two weeks ago we hosted over 100 fresh faced interns among our clients for Strategas' Third Annual Intern Conference. As you would expect, we had them fill out a brief survey and the results were fascinating, especially when it came to which asset class they expected to outperform over the next 10 years. A remarkable 52 out of those responding chose private equity. Historically, new college and business school graduates have had a notoriously bad habit of choosing fields that were just about to peak. All this suggests that the real valuation problems lie not in the public markets but in private investments. The recent travails of Blue Apron and Snap also make one wonder. Favored tax treatment of carried interest and near-zero interest rates for the past eight years have only served to increase the valuation of leveraged investments. In this way it can be assumed that the current love affair among fiduciaries and the private equity industry has resulted in return assumptions that are likely to turn out to be far too optimistic. While the little guy will eventually feel the pain in one way or another, he is unlikely to experience it from the public markets any time soon.

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Which asset class will provide the best returns over the next 10 years?	
Private Equity	50.0%
Hedge Funds	12.5%
Public Equities	11.5%
Real Estate	9.6%
Commodities	6.7%
Fixed income	4.8%
ETFs	1.9%
Cryptocurrencies	1.9%
Cash	1.0%

Endowments Asset Allocation (Dollar-Weighted Average)

Year	Equities	Fixed Income	Alternatives	Cash/Other
2002	50%	23%	24%	2%
2003	49%	21%	27%	2%
2004	51%	17%	28%	4%
2005	48%	17%	32%	3%
2006	48%	15%	35%	2%
2007	47%	13%	37%	2%
2008	40%	13%	46%	1%
2009	32%	13%	51%	4%
2010	31%	12%	52%	5%
2011	33%	10%	53%	4%
2012	31%	11%	54%	4%
2013	34%	10%	53%	3%
2014	36%	9%	51%	4%
2015	35%	9%	52%	4%
2016	35%	8%	53%	4%

**Source: NACUBO-Commonfund Study of Endowments ('09-'16) and NACUBO Endowment Study ('02-'08)*

Strategas' Chicago Investment Forum Survey Results

1) At what level will the S&P 500 be 12 months from now?

Avg. 2,534 High: 2,850 Low: 2,000

2) At what yield will the 10 Year U.S. Treasury be 12 months from now?

Avg. 2.56% High: 3.25% Low: 2.00%

3) What will the price of Gold be 12 months from now?

Avg. $1,278 High: $1,450 Low: $1,099

4. What will the price of Oil be 12 months from now? (Current: $50.30)

Avg. $50.73 High: $65.00 Low: $30.25

5. What is the biggest risk to the markets for the rest of 2017?

#1: Geopolitical Landscape #2: DC Gridlock #3 Trump

6. What will the U.S. corporate tax rate be in 2018? (Current: 35%)

Avg. 29.1% High: 35% Low: 20%

7. Will Donald Trump make it through all four years of his presidency?

Yes: 71.2% No: 21.4% No Opinion: 7.4%