



**Level I  
of the  
CFA® Program**

**Private Markets**  
**PRIVATE INVESTMENTS AND STRUCTURES**

## *Learning Outcome Statements*



**LOS** : Contrast the **features of private and public investments** and discuss characteristics of private and public markets.



**LOS** : Discuss **private investment methods** and structures and their uses.



**LOS** : Discuss the difference between **public and private market performance**, and *calculate*, interpret, and discuss the use of performance metrics including **distributed to paid-in**, **residual value to paid-in**, and **total value to paid-in**.



**LOS** : Compare the risk and return of investing in private markets and public markets as part of a **strategic asset allocation**.

## Brief Recap...

- CFA Institute introduced Level III Private Markets Pathway learning modules for managing private investments.
- Institutional investors are increasingly investing in private markets.



Private market AUM grew from under USD 1 trillion in 2000 to nearly USD 12 trillion in 2022.

## Private Market Investment Evolution

Then



Large Investors

Transition through  
Managed portfolios.

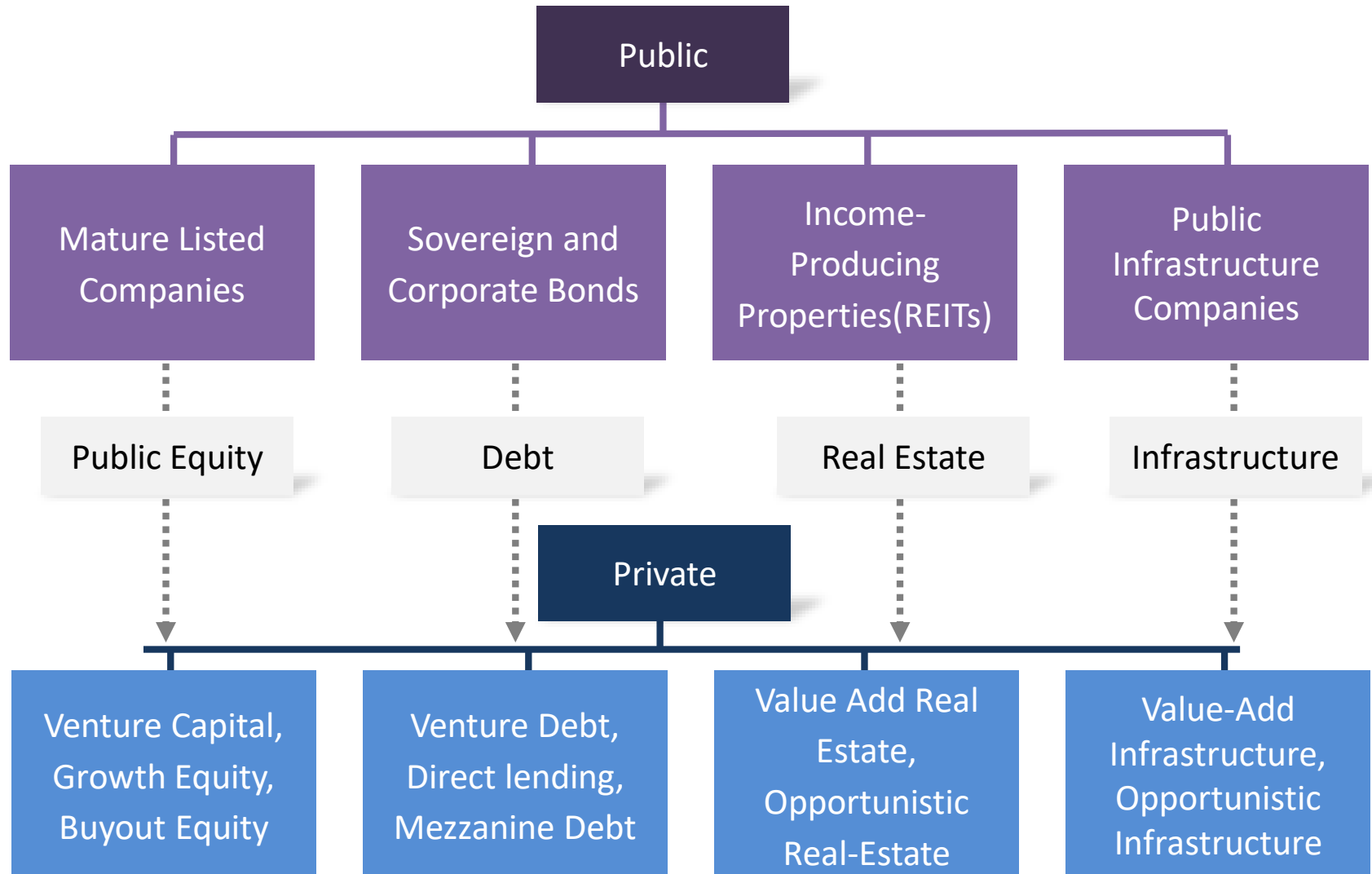


Now



Smaller investors  
and high net  
worth individuals

## Public Vs Private Investments



## Overview of Private Investments



Private investments are **unique, illiquid,** and held for **longer periods.**

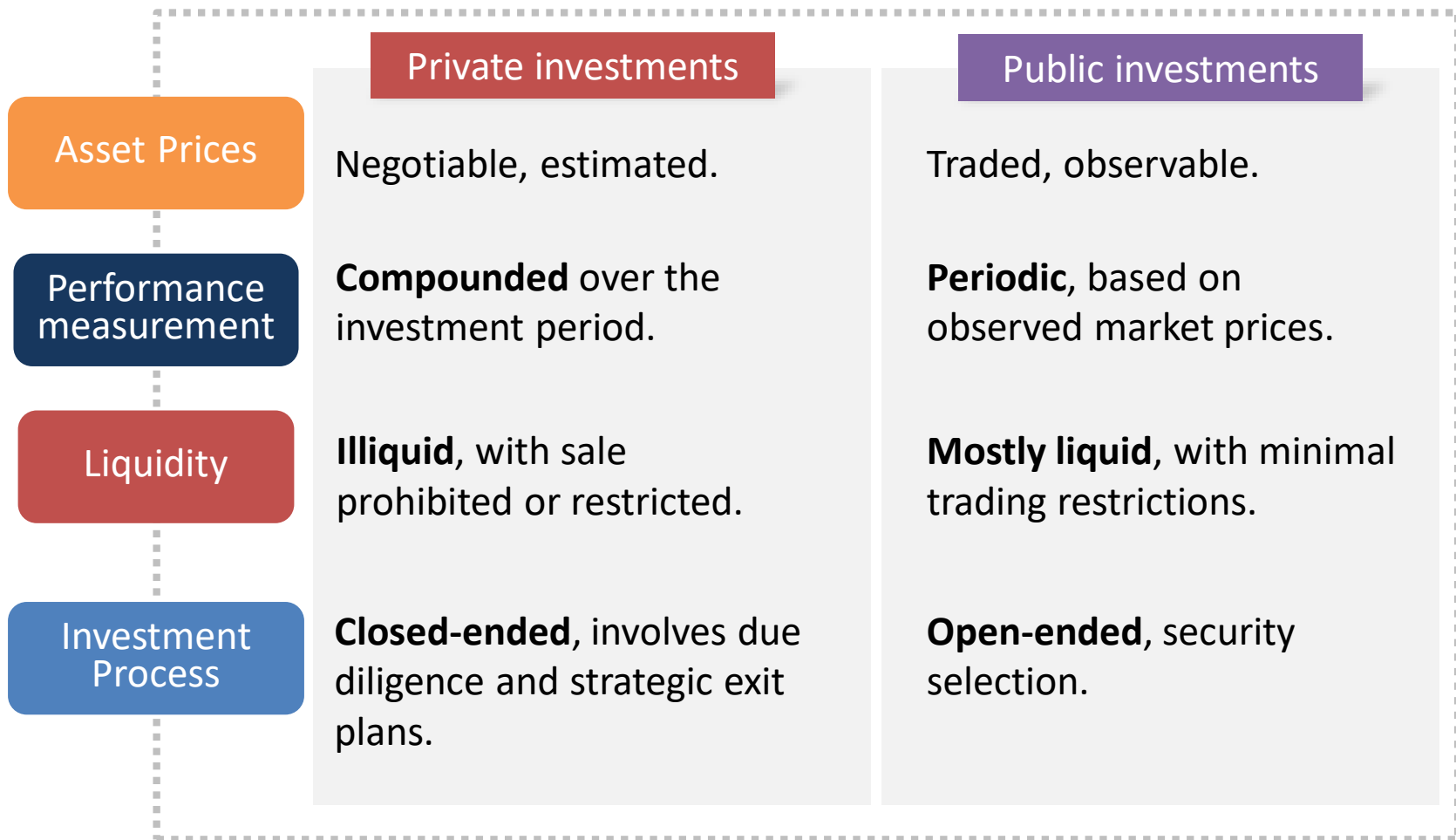
They cover **various company life cycle stages** or project phases.

Private investments **complement public equity** and fixed-income securities in strategic asset allocation.

**Private market performance** is measured using compounded returns over multiple years.

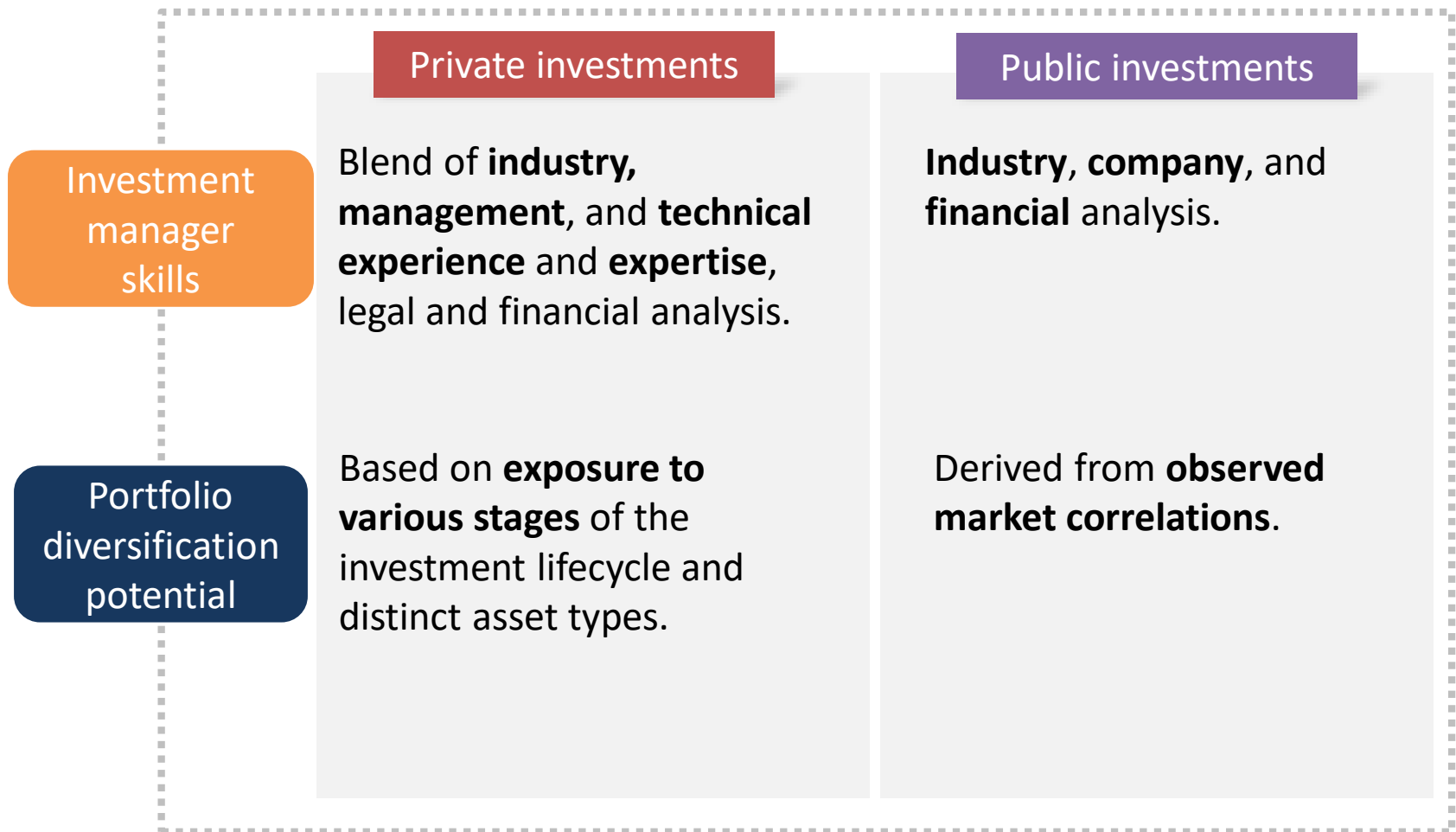
**LOS :** Contrast the features of private and public investments and discuss characteristics of private and public markets.

## Features of Private and Public Investments



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## Characteristics of Private and Public Markets

### Private Markets

**Low transparency**, with less information on prices and performance.

Generally restricted to **institutional investors** and **high-net-worth individuals**.

**Less regulated** compared to public markets.

**Significant investor influence**, as private fund managers often acquire controlling or significant minority stakes

### Public Markets

**High transparency**, with readily available data on prices and performance.

Open to a broad range of investors, including **retail** and **institutional**.

Subject to **strict regulatory oversight**.

**Limited investor influence**, as public fund managers invest in non-controlling positions.

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## Private Vs. Public Investment Structures

### Public Investment Methods

#### Direct Selection:

Investors choose **individual securities** to invest in.

Investors have the ability to buy or sell these securities on **public exchanges**.

#### Indirect Approach:

Investors delegate security selection to **public fund managers**.

These **managers oversee** portfolios of publicly traded securities.

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## Private Investment Methods



Direct investment



Co-investment



Indirect investment

## Direct Investment



Purchase of **equity ownership stake** or **private debt investment** without intermediaries.



Often used for **controlling stakes** in buyout equity transactions.



Investor **actively** manages business to create value.



Typically used by **large asset owners** due to potential portfolio **concentration risk**.

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## Co-Investment

### Direct Co-investment

- Purchasing an **ownership stake** or **private debt** with one or more partner.
- Offers opportunities to reduce the size of private market portfolio positions, **leverage partners' expertise**, and **reduce fees**.

### Limited Partner co-investment

- Involves investing in a single investment managed by a **private fund manager**.
- Investors with established relationships with **General Partners (GPs)** may get **co-investment rights**.
- Provides the option to co-invest in opportunities **before** they are offered more widely.

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## Indirect Investment



Involves **co-investment** and **fund-based alternatives**.



Allows investors to participate in **private markets indirectly**.



**Limited Partner (LP)** co-investment involves purchasing equity or private debt in a single investment managed by a General Partner (GP).

## Benefits of Co-Investment for LPs



LPs can take a **larger stake in specific assets**.



They gain **deeper insight into GPs' strategies** and due diligence.



Co-investments offer opportunities for **fee** reductions and **active** engagement.

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### Benefits of Co-Investment for GPs



GPs share **investment risk** with LPs.



Co-investments **expand access** to **investor capital**.



They help **attract new investors** outside existing partnerships.

### LPs in Private Market Funds



LPs experience **less liquidity** and long investment holding periods.



LPs must **commit capital** in advance and face uncertain timing of capital calls and return distributions.



LPs involve **incentive compensation** based on performance.



Aligns the **interests** of managers and investors and manages **information asymmetry**.

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## Private Investment Structures

**Less standardized** than public security-based investments.

**New legal entities** are created for specific purposes, e.g., managing a project's lifecycle.

Corporate governance can be **negotiated**.

Allows **minority investors** to secure special provisions like **board seats** or **veto rights**.



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### Take-Private Transactions (LBOs)



A **new acquisition company** is created to acquire the target company.



Transactions are financed with a **high proportion of debt**.



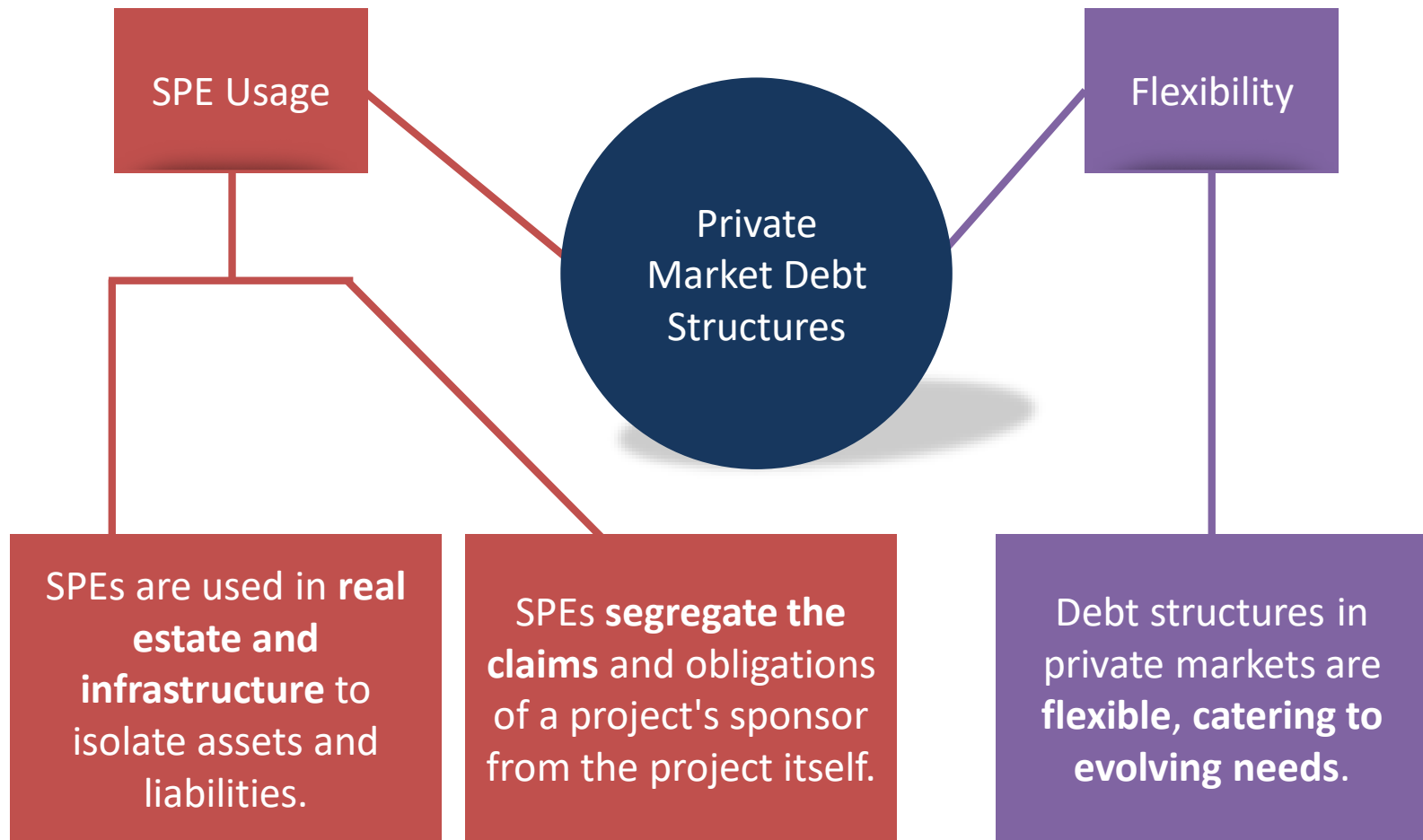
This debt often leads to **refinancing of the target's existing debt**.



After acquisition, **long-term financing is negotiated** and entities may merge into a **new entity**.

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## Debt Structures and SPEs in Private Investments



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## Private Vs. Public Investments and Return Metrics

### Public Markets Performance



Include **listed equity** and debt securities from **mature issuers** with stable cash flows.



Often feature **periodic dividends** for equity and fixed coupons for non-callable debt securities.



**Price transparency** and liquidity enable consistent measures of income and asset appreciation.



Allows for **comparative analysis** and exploitation of arbitrage opportunities.

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## Private Markets

- ◆ Include **private equity and debt, real estate, and infrastructure** investments across various company life stages.
- ◆ Performance measurement is complicated by:



1

Illiquidity

2

Lack of price  
transparency

3

Dissimilarity  
among  
investments in  
the same asset  
class.

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## Private Market Performance

- Best measured over a multiyear holding period.
- Due to the combination of positive and negative cash flows.
- Internal Rate of Return (IRR) is a common measure applied in such a case

IRR

- The discount rate that makes the net present value (NPV) of a series of cash flows **equal to zero**.

- $$NPV = 0 = \frac{CF_1}{(1 + IRR)^1} + \frac{CF_2}{(1 + IRR)^2} + \dots + \frac{CF_n}{(1 + IRR)^n}$$

IRR Assumption

- Assumes **interim cash flows** are reinvested at the IRR rate.