

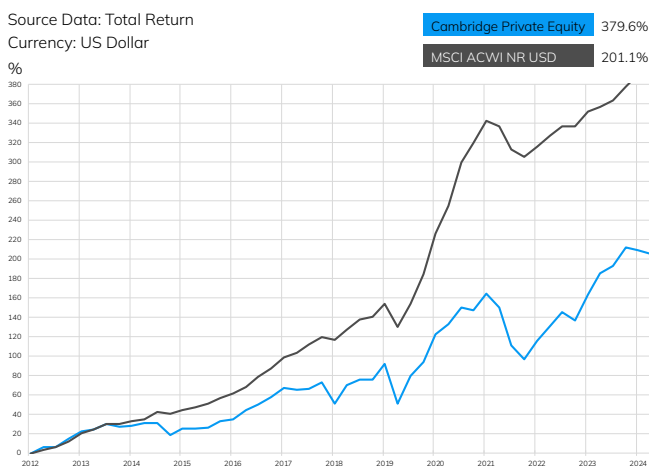
PRIVATE EQUITY

A Review of Evergreen Funds

Introduction

Private equity (PE) has outperformed public equities and other classes over the past few decades. However, unlike institutional investors such as endowments and pension funds, most private clients have not been able to benefit from these higher returns due to structural barriers that have hindered access to PE.

Private Equity Outperformance vs Public Equity, 2012 – 2025



Sources: Morningstar Direct and Cambridge

This review examines the challenges faced by private clients in accessing PE and how evergreen funds have been designed to offer some solutions.

What is Private Equity?

Private equity consists of buyouts and venture capital. Buyouts are where a manager acquires a controlling stake in a company and implements operational improvements. These enhancements may include cost reductions, strategic acquisitions or expanding to new markets. The manager can also drive change by replacing the management team or taking board seats.

The typical strategy is to purchase the company using leverage, then reduce the debt through cashflow improvements and eventually sell the more efficient company at a higher valuation.

'Operational improvements are the most important driver of returns, as using debt and hopes of selling at higher valuations are more reliant on market conditions.'

Some firms also generate short term gains by having the company take on additional debt to pay themselves a dividend as shareholders. This strategy is not as sustainable over the long-term.

Venture capital, the other form of PE focuses on investing in early stage, high growth companies. While VC offers the highest upside of any asset class, it comes with more risk due to unproven business models and sometimes inexperienced management teams.

At the moment the PE exposure of **evergreen funds consists almost exclusively of buyouts.**

Barriers to Private Client Investment

Traditional, private equity funds are closed end funds vehicles with significant minimum investments required. The capital is locked up for a decade or longer, along with added the complexity managing cash flow demands and distributions.

In recent years, managers specialising in private markets have **introduced "evergreen funds" which enable private clients to access illiquid asset classes** such as PE, private debt and infrastructure.

The official reason given for the launch of these vehicles is the "democratisation of finance" in that

smaller investors could access the potentially stronger performance and diversification from private assets.

A more accurate explanation is that many institutional investors already have full allocations to private markets and the managers must therefore attract new money through different types of investors to continue growing assets under management.

The relatively stable management fees from evergreen funds are also attractive for the private equity managers that are publicly listed and need to report their earnings quarterly.

How Evergreen Funds Improve Accessibility

Evergreen funds seek to address the impediments of closed ended private equity funds that have made them less appealing for non-institutional investors.

Liquidity

Evergreen funds seek to offer monthly or quarterly liquidity which is significantly more flexible than a decade or longer in closed end vehicles.

This added liquidity is achieved in many ways including the use of cash reserves, credit lines and limits on redemptions which usually cap withdrawals at 5% of total fund assets per quarter.

Evergreen solutions have the right to suspend dealing and although this “gating” of funds may seem harsh, it is usually a prudent decision to avoid forced sales at depressed prices.

These solutions are clearly more liquid vehicles than traditional private equity funds, even if an investor is not necessarily able to fully redeem during a quarter or even several years.

Return Profile

Evergreen funds also provide immediate exposure to private markets, unlike traditional PE funds. The ‘J-curve’ effect, is where the fund initially has negative returns after raising money from investors, investing these funds, after which it can then take many years before it starts to deliver positive performance and even longer to realise these gains through exits and distributions.

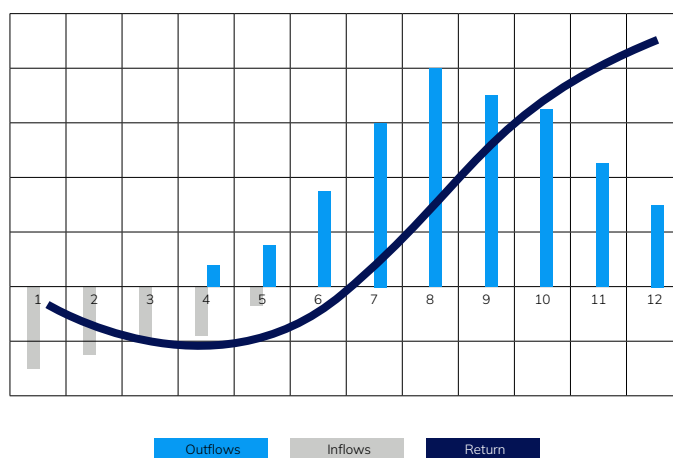
Cash Flow Management

For a traditional PE fund, the manager will call on more capital from investors when they have investment opportunities, as illustrated by the cash inflows for the

fund below. Here, investors must retain cash for these capital calls or sell liquid assets.

Illustrative Lifecycle of a PE Closed End Fund

Illustrative PE Closed End Fund Life Cycle



With closed end structures there is uncertainty when an investor will receive their money back as distributions depend on when the GP can sell each position. Evergreen funds remove this uncertainty as investors contribute their full investment amount upfront.

An evergreen investor need not worry about reinvesting proceeds from distributions, as the fund manager will determine when to deploy to new opportunities. Unlike closed end vehicles, the evergreen fund does not mature. This provides the GP with more control over when to sell assets, which may benefit longer term returns.

Typical Allocations for Evergreen Funds

In addition to private equity, managers often deploy across a range of asset classes including private debt, real estate or infrastructure. They have the added benefit of providing income and improved liquidity, although their historical returns are lower than in PE.

Typical Asset Class Exposures for Private Market Evergreen Funds

Asset Class	Typical Weight
Buyout	70-80%
Venture Capital / Growth	0-15%
Private Credit	0-20%
Real Assets: Infrastructure or Real Estate	0-20%
Cash	5-15%

Main Investment Approaches

(1) Open Architecture

Secondaries and Co-Investments

Evergreen funds often invest in secondaries, which are stakes in older private equity funds.

Typically, private equity managers raise new funds of the same strategy, called vintages, every three to five years. These older vintages can be sold in the secondary market and are more fully invested. They can be expected to provide distributions to investors sooner than the more recent vintages.

Secondaries also offer diversification as they usually contain positions in numerous companies. At times they can also be acquired at discounts from forced sellers which was particularly evident in 2022 when public market volatility forced some investors to sell older private equity vintages at discounted prices.

The **drawback with secondaries is that they are effectively a fund of funds with an additional layer of fees** and the evergreen manager buying them might not be able to conduct thorough due diligence on all the underlying assets.

An evergreen manager may seek to lower costs by participating in co-investments with the underlying private equity managers without having to pay management fees or carry, which performance fees in private equity are called. This also allows a more focused investment than in secondaries.

They enable the evergreen fund to invest in the ideas of many PE managers. They are often large deals and managers need to rely at least partially on the due diligence of PE sponsors with no control on the exit strategy.

(2) In-House Evergreen Strategies

The other approach to managing evergreen funds can only be achieved by the largest PE firms that manage a number of private equity strategies across themes, sectors and regions. Some of these firms have created in-house evergreen strategies, which invest in the firm's own closed end funds or individual deals alongside them.

These managers can provide more focused exposure to their own best ideas than the more diversified open architecture evergreen funds. In these in-house funds

the manager will also know the underlying companies better than the managers making co-investments and will usually have controlling positions in the underlying companies.

Risks and Considerations

While evergreen funds present advantages, there are risks and limitations.

Private Equity Risks

It remains to be seen how much of the strong PE returns over the past 15 years was driven by interest rates declining and whether performance will remain as strong without this tailwind.

Lower interest rates benefitted PE as companies are often acquired with debt and therefore more equity will need to be used to finance deals while at the same time the underlying companies will have to use a larger portion of their operating profits to pay interest costs.

At an asset class level, there were material inflows as allocators looked for riskier investments in the low yield environment.

PE fees remain high. Evergreen funds typically charge management fees of 1% to 1.5% and performance fees of 10% to 15%, often after a hurdle rate of 5% to 8%. Total costs can reach 4% per year, significantly exceeding public equity fund costs.

Despite this private equity funds have outperformed public equities net of fees, however, this still does not guarantee outperformance in the future and the fee burden in evergreen funds is significant.

Evergreen Fund Risks

There is a liquidity mismatch as the underlying assets are illiquid while the funds offer more frequent redemptions. The risk is that during periods of stress, managers may suspend withdrawals and investors must be prepared that an exit is not always possible. The investment segment is still quite young and many evergreen managers do not have experience in managing semi-liquid products

For many clients this might be their first experience with illiquid assets. For open end property funds some retail investors did not have the long term orientation

or experience required for successfully investing in the approach. Educating investors in evergreen funds will

be crucial to limit the possibility of negative surprises for all parties involved.

'An investor could probably sell during normal times when there are no meaningful outflows, however it could also take several years to fully redeem during a period in which other investors in the fund are also trying to exit.'

Despite an investor not necessarily being able to fully redeem during a quarter or even several years, these are clearly more liquid vehicles than traditional private equity funds.

Why Consider Evergreen Funds?

However, evergreen funds offer many benefits including potentially stronger returns.

There are several structural reasons why private equity could continue to outperform public equities and provide diversification benefits compared to liquid market investing.

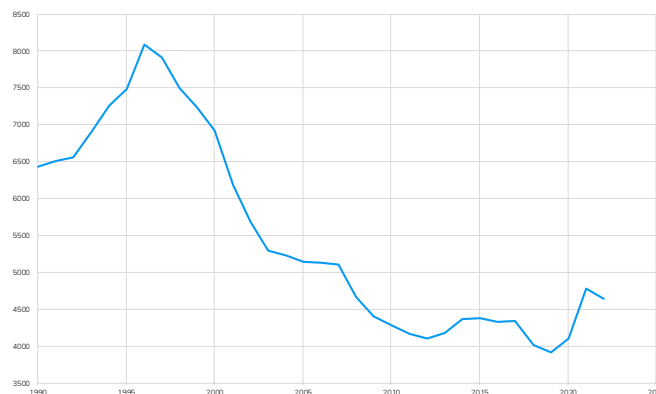
The stale pricing in private markets can give the impression of lower volatility and correlation with other asset classes, however we would not consider this true diversification. A more relevant diversification benefit of holding private companies arises from having exposure to companies of different sizes, maturities and business models than what is available in public equity markets.

The number of publicly listed U.S. companies has nearly halved since the 1990s as private firms now have more options when raising capital, they remain private for longer, capturing more value before going public. Investors limited to public markets face a shrinking opportunity set.

Private equity also aligns management incentives with long-term performance. Unlike public companies, where executives may focus on short-term earnings targets, firms backed by thoughtful PE firms tie management compensation to long-term value creation and force

management to buy shares with their own money as opposed to just receiving stock options.

The Number of Publicly Listed Companies in the US: 1990 – 2022



Source: World Bank

Evergreen Advantages

Compared to traditional PE funds, evergreen structures provide:

- Improved liquidity which can support portfolio construction
- Greater transparency by eliminating blind pool risk
- Diversification across vintages, sectors and geographies in one vehicle

While evergreen funds may not fully match the performance of closed-end PE vehicles, they can offer a good entry point for investors seeking private market exposure without the rigid constraints of traditional structures.

Conclusion

Although long term analysis is limited as many evergreen PE funds have been launched in the past few years, given the shrinking public market opportunity set and the potential for enhanced returns, evergreen funds can offer an attractive solution for private investors who lack access to closed-end PE funds.



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