North Sky
CAPITAL

Fourth Quarter 2015

Quote of the Quarter:

"If your ship doesn't come in, swim out to it."

– Jonathan Winters

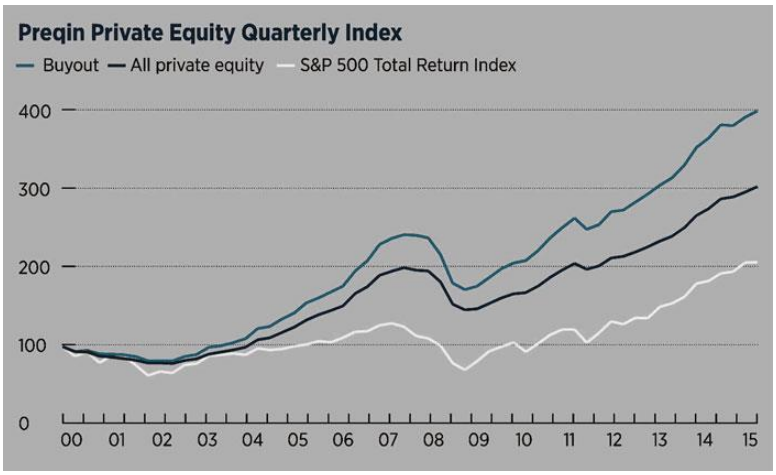
Buyouts Beat Everybody

Whether you are a trustee of a pension plan, a CIO of an endowment or foundation or an individual investor saving for retirement, your stock and bond investments likely have you feeling anxious about how you are going to meet your long-term investment goals. It also looks like 2015 is going to be very similar to 2011. In 2011, long-term investors were faced with similar prospects (but even greater volatility), and we wrote the following in our fourth quarter 2011 commentary:

> "…if investors don't invest in private equity and other alternatives, where are they going to get enough investment return to pay the bills? Three-month Treasuries yield 0.01%, the 10-year yields 2.04% and the S&P 500 has been exactly flat for 2011 (1258 opening on Jan. 3, 2011 vs. 1258 closing on Dec. 6, 2011). While the emotional side of the brain is steering many down too conservative a path, the logical side should be counter-balancing it with a longer term, practical view."

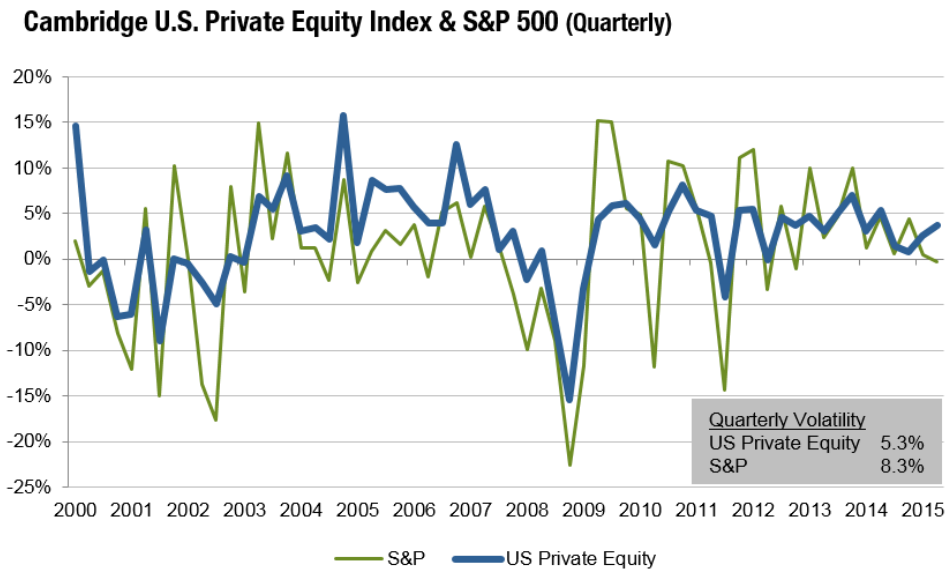
In 2015, the three-month Treasury is still near zero, the 10-year Treasury is still at 2% and the S&P 500 is again flat for the year. For those investors who allocated 60% to public equities and 40% to bonds, their 2015 return, after fees, might be negative.

Of course most institutional investors enlist the help of other asset classes like buyouts, venture capital, distressed debt, infrastructure and real estate. The reason is obvious from the chart below, prepared by Preqin.



The chart is illustrative and, in essence, says an investment of $1 in buyouts, a basket of many alternatives and the S&P 500 would have turned into $4, $3 and $2, respectively. Note, Preqin's label of "All Private Equity" encompasses all the funds it tracks in the following areas: buyouts, venture capital, venture debt, growth equity, distressed debt, infrastructure, secondaries, real estate, real assets and private debt.

Private equity volatility is also lower. Let's revisit a chart we initially included in our fourth quarter 2011 commentary, updated with returns through June 30, 2015.



Cambridge's data suggests that private equity has only 64% of the volatility of the S&P 500. The S&P 500 has had wild swings from quarter-to-quarter, while private equity moves were muted. The public equity downturns were often severe—there are ten instances where the S&P 500 dropped by 10% or more in this data set. Incorporating private equity into the mix helps to reduce the angst (and sometimes panic) that stock market drops tend to induce.

It is worth noting that allocation policies are crucial. While buyouts easily outperformed during the time period shown in the first chart, other asset classes may have been the winner in any given year or across other time periods. So no one is advocating for allocating 100% of investable assets in a single asset class like buyouts. However, determining the right amount to allocate to buyouts or infrastructure or other alternatives is subjective, and it is always interesting when such data crosses our desks. Recently, the over 155 institutional investors in the Private Equity Growth Capital Council (PEGCC) released data that showed **the average allocation to private equity within their group was 9.3%.**

The top 10 pension funds in the PEGCC ranked by private equity returns (annualized over 10 years) were as follows:

Top 10 Pension Funds by Private Equity Returns

1.	Massachusetts Pension Reserves Investment Trust Fund	17.93%
2.	Teacher Retirement System of Texas	17.80%
3.	Minnesota State Board of Investment	16.20%
4.	Houston Firefighters' Relief and Retirement Fund	16.00%
5.	Iowa Public Employees' Retirement System	15.70%
6.	San Francisco Employees' Retirement System	15.69%
7.	Virginia Retirement System	14.60%
8.	Oregon Public Employees Retirement System	14.54%
9.	New York State and Local Retirement System	14.53%
10.	Utah Retirement System	14.50%

If you would like to read the full PEGCC report, click here.[1]

Yearend Wrap-Up

Overall, 2015 was another good year for investors in our funds, with solid exit activity across the more mature funds creating additional distributions to investors. Namely LBO II, VC II, LBO III, VC III and VC IV made distributions to investors ranging from 15-34% of contributed capital during the year (average of 24%). The balance of exits from stock sales (IPOs) vs M&A activity seemed to tip toward stock sales this year. This is a reflection of the high level of IPO activity that occurred within our funds over the last two years. Even though the IPO market cooled in 2015, our underlying fund managers continued to prudently and methodically sell down their publicly-traded stock holdings post-lockup.

Our more recent funds also made demonstrable progress:

- **Alliance Fund I** (2010) made its final investment early in the year and is now in harvesting mode. We have exited several of our investments and are in negotiations to profitably exit several more holdings at the time of this writing.
- **Clean Growth Fund III** (2013) made steady progress with two new secondary investments and two new direct investments (Scodix and AFC). We are reviewing additional investment opportunities that, if completed, would result in the fund being fully invested.
- **PEP V** (2014) made its tenth fund commitment recently. Nine of the ten commitments are to buyout funds, each pursuing a distinct strategy. We also completed our second direct investment during the year and have several additional direct investment opportunities under review. The fund is off to a strong start.
- **Alliance Fund II** (2015) made its first two investments, totaling $45 million, in the form of structured debt investments that will support the construction of several hundred MWs of solar PV systems across the USA.

We believe these funds are well-positioned for the current investment environment.

New Website

We recently redesigned our website to better highlight our three investment strategies: clean energy infrastructure, traditional private equity and cleantech / impact investing. Please take a moment to check it out here.

Upcoming Events

We are regular speakers and attendees at key industry conferences. We hope to see you at these upcoming events:

Dec. 15-16 **CORPaTH Summit & Crystal Globe Awards,** Las Vegas, NV
www.corpath.org

Mar. 9-11	**Annual Women's Private Equity Summit,** Half Moon Bay, CA www.womensprivateequitysummt.com
Apr. 14-16	**IBEW Construction & Maintenance Annual Conference, Washington,** DC www.ibew.org
Apr. 26-27	**Impact Capitalism Summit,** Chicago, IL www.impact-capitalism.com
May 4-5	**Family Office Exchange – Wealth Advisors Forum, Miami, FL** **www.familyoffice.com**
May 23-25	**US SIF Annual Conference 2016,** Washington, DC www.ussif.org

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1. PEGCC Report: http://www.pegcc.org/app/uploads/2015-pension-fund-analysis.pdf

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