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# Portfolio Construction in the Context of a Global Private Markets Platform



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The success or failure of an individual company is in part determined by the context it operates within. This context can be described as micro-focused attributes of the ecosystem the company is part of (suppliers, customers, competitors, etc.), macro-factors such as geography or industry segment, or even more theoretical elements such as market cycle, geo-political stability, etc. While it's unlikely any individual factor will solely determine the fate of a company, the collective influence of a company's context can be significant. Managing exposure to these factors in an investment portfolio is generally referred to as portfolio construction.

Portfolio construction is particularly important as it relates to co-investments. A co-investment portfolio is comprised of minority equity investments across a number of individual companies. Active portfolio construction is a powerful tool to manage risk exposure while achieving portfolio level objectives. However, effective implementation requires the right organizational structure and process, as well as a specific focus on the elements of greatest influence.

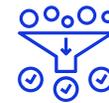
Adams Street has consolidated active portfolio construction responsibilities in a Portfolio Construction Committee ("PCC") and Investment Strategy and Risk Management ("ISRM") team. The PCC has representation of senior leadership across the firm, including each investment team, and establishes high level objectives / investment guidelines for the firm. In addition to supporting broader PCC initiatives, ISRM works closely with investment teams to ensure each mandate is assembled according to plan, and provides regularly scheduled portfolio level analysis and projections in support of better portfolio management. Importantly, the firm believes that both the PCC and ISRM are far enough removed from individual deal decision-making that they're able to maintain an objective, 'arms-length' view of portfolio composition and bring a different perspective to the conversation.

- Leveraging 40+ years of proprietary private markets data, Adams Street is able to forecast a distribution of potential outcomes for portfolios while controlling for specific elements. In addition, ISRM provides insight into the expected liquidity profile and interim period volatility.
- ISRM conducts fundamental investment analysis considering macroeconomic inputs, manager specific factors, and investment strategy differences in support of assessing risk and improving fund level outcomes.

Prior to forming a portfolio, Adams Street establishes a set of objectives to inform asset selection as the portfolio is assembled. These portfolio objectives serve as an investment roadmap, and guide the firm in pursuing the portfolio’s desired complexion. Given markets are dynamic, portfolio objectives are re-evaluated on a regular basis (typically annually) and adjusted to support the current market environment. Prior to adding an investment to a portfolio, each potential investment is considered both within the context of the broader portfolio objectives, as well as for fit with the active portfolio.

- The investment selection process is designed to assess the risks / merits of individual investment opportunities independent of other transactions. Portfolio construction provides a framework to assess the risks / merits across investments, and helps protect portfolios from unintentional levels of exposure to a single risk factor. Active management seeks to ensure a portfolio’s objectives are not compromised as a result of the inherent randomness of investment deal flow.

Through 50 years of managing private market portfolios, Adams Street has developed an informed perspective on key attributes of an underlying portfolio. While there are several topics outlined in the objectives that govern every portfolio, time diversification, company concentration, end market exposure, and lead investor considerations are routinely highlighted as critical metrics to measure. Actively managing each of these elements has the ability to improve the distribution of expected returns without compromising the bottom-up asset selection process.



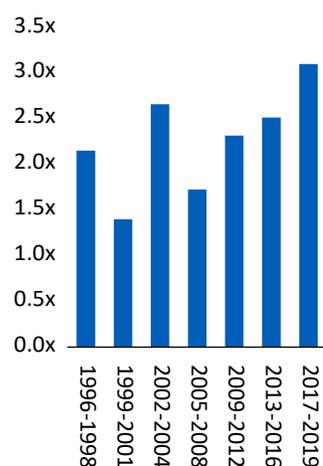
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## Time Diversification

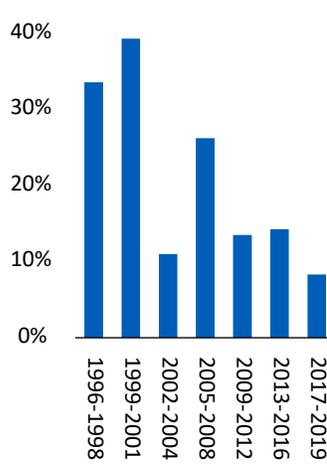
Co-investment capital is typically deployed at the time the investor commits to a deal. Consequently, co-investment portfolio managers have control as to when capital is actually deployed into the market. This control allows for active management of time diversification, and corresponding exposure to different parts of the market cycle. If portfolios are invested too quickly, they may end up overexposed to an undesirable segment of the market cycle. If portfolios are invested over too long of a time period, the inherent cost of committed capital yet to be invested becomes a more meaningful consideration.

### Cyclicality Inherent in Private Markets<sup>1</sup>

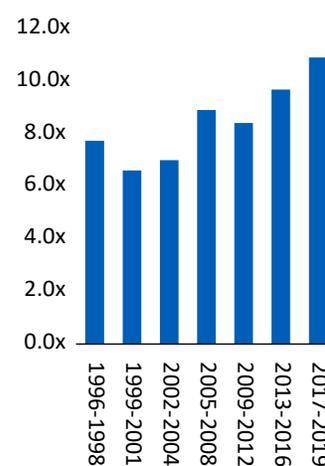
**Multiple of Invested Capital**



**Capital Loss Rates**



**Purchase Price Multiple (EV/EBITDA)**

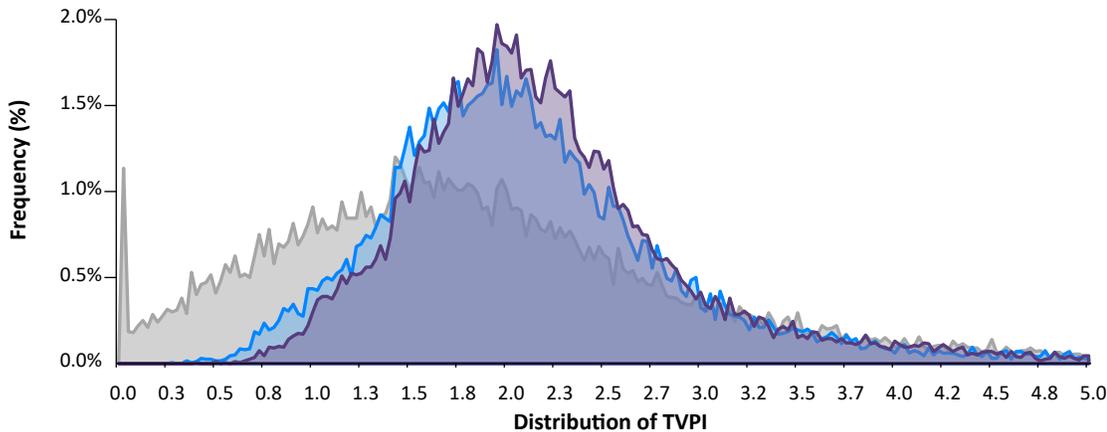


## Company Concentration

Adams Street has designed its investment programs to incorporate diversification such that idiosyncratic risk associated with any one investment should not overly impact portfolio returns, with the goal of conserving the opportunity for outsized portfolio level performance for each portfolio. Given that co-investments are made into individual companies, co-investment managers can directly control the number of companies (and their underlying sizing) within a given portfolio.



### Distribution of Hypothetical Portfolios<sup>2</sup>



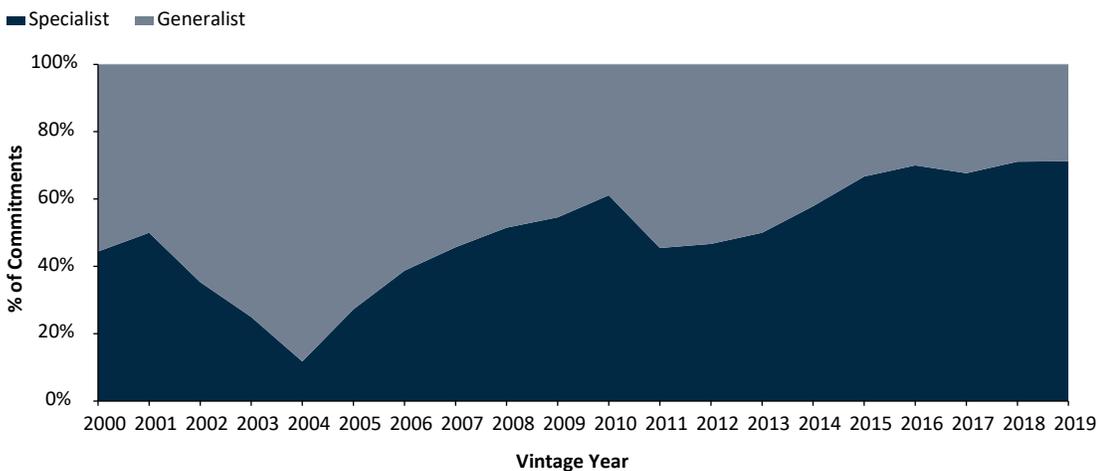
Number of investments	n=5	n=25	n=45
Median:	1.77	2.01	2.07
Mean:	2.17	2.18	2.19
sd:	2.22	0.96	0.75

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## Lead Investor Concentration

Co-investment is generally alongside lead investors that manage the day-to-day activity of underlying companies. A co-investment mandate will typically invest alongside multiple lead investors across the portfolio. Lead investor diversity in a co-investment portfolio allows for a diverse set of underlying companies while still having each company matched with an appropriately specialized lead investor. This has become particularly impactful as private equity firms have increasingly specialized around an area of focus over time. In addition, maintaining a level of lead investor diversity helps ensure a co-investment portfolio is less likely to be overly influenced by events at any single firm.

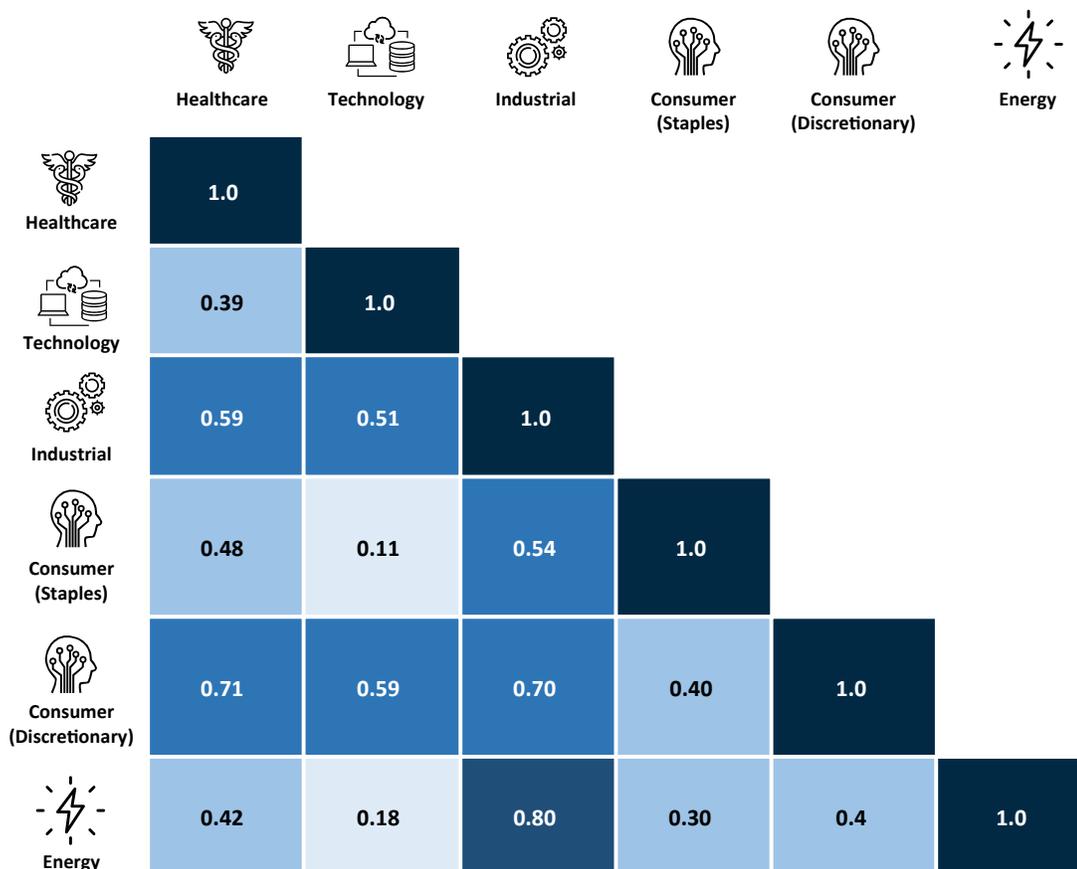
### Percentage of Adams Street Commitments by General Partner Type<sup>3</sup>



## End Market Exposure

Adams Street’s co-investment activities encompass a broad range of end markets (industry sectors or geographies). Portfolio construction guidelines pertaining to end market exposure ensure diversification, but also capture the investment team’s perspective of specific end market’s outlook. ISRM works closely with the investment teams to actively manage exposure to any particular end market, taking into consideration historical market correlations as an indicator for how the portfolio may behave going forward. For larger concentrations, a more granular analysis of subsector trends is oftentimes warranted.

### Correlation of S&P 500 Sectors 1-Year Returns (2011-2021)<sup>4</sup>



Portfolio construction is a critical component of the long term success of a co-investment program. Adams Street has intentionally embedded the intersection of top-down portfolio management and bottom-up asset selection into the fabric of the firm. Consequently, there is a coordinated effort to develop, execute against, monitor, and adjust portfolio construction objectives for each investment mandate. The processes in place help drive decision-making to the individuals with the most relevant expertise. We believe the result of these processes is meticulously cared for investment vehicles that are designed to better withstand the turbulence of a dynamic market environment while still seeking to deliver best in class performance. ■



1. Source: S&P Global Market intelligence and Multiple of Invested Capital and Capital Loss Rates are from the Adams Street Portfolio.
2. Source: Adams Street Partners. The return data presented herein is simulated, hypothetical fund-level return data based on actual historical returns of companies in the historical portfolio company sample. Based on the set of companies in Adams Street's database, as of 6/30/2021. This database consists of (i) companies that Adams Street Partners has invested in on a primary basis and are part of its investment portfolio in addition to (ii) companies in which Adams Street Partners did not invest. This return data is for illustrative purposes only. It does not reflect actual performance of any Adams Street Partners fund or any private equity fund in which an Adams Street Partners fund of funds invests. There can be no guarantee that a fund of funds constructed in a manner similar to the simulation presented herein will achieve returns in the ranges of the hypothetical fund of funds performance presented herein. Portfolio company returns are measured as the ratio of value at liquidation to initial cost of the GP's investment in the portfolio company and are gross of all fees, expenses and carried interest. Past performance is not a guarantee of future results.
3. As of June 30, 2019. Commitments by funds in which Adams Street client portfolios invested on a primary basis. Source: ASPIRE as of June 30, 2019. Three year trailing % of commitments.
4. Source: S&P/CapIQ as the source and state that correlations are based on 10 years of daily data, as of October 2021.



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