Private Investing Market Timing

Most investors will swear on their firstborn child that they seek to partner with investment managers who can create value through varying market conditions. Despite market cycles being a broadly acknowledged inconvenient truth, finding cycle-tested guides to navigate ongoing market turbulence is also widely accepted as a panacea. Identifying investment firms with the personnel, experience, insight, and strategy that have a high potential of generating outsized returns through market cycles is a major part of the puzzle all allocators are trying to solve. It has been my experience that to entice folks to embrace a strategy, typical ingredients needed include a healthy splattering of recency bias, a pinch of simple inferences, and heaping tablespoons of familiarity. A typical investment thesis presentation will, more often than not, contain these ingredients unless the intended audience is a diehard contrarian or investor who viscerally despises walking with a herd.

Due diligence reports and investment committee meetings perennially attempt to deftly tread the thin line between being strategy-specific (bottom-up) and blatantly timing markets (top-down). It is uncanny how some near-term (or ongoing) market truth coincides almost perfectly with the GP's skill set when an investment case is being made. It is almost like magic. So are we just all market timers or not? There is no doubt that "market timing" continues to be a four-letter word (or phrase) in sophisticated investor circles, but it still acceptably appears in multiple guises throughout most investment decision-making processes. An example of this that has had me chuckling to myself almost daily is how imaginative managers are getting with tying their strategy (and its success) somehow to the AI boom. Or the glorious metamorphosis of upstream oil and gas managers who are now parading as bonafide “energy transition” players. Or the historically traditional infrastructure managers who now proudly say “Oh yeah, “digital infrastructure” has always been in our wheelhouse”. I understand that it makes sense for most investors to find GPs who are in sync with the now, but it is a perilous game and a potentially losing strategy to always target the latest craze.

- **GPs have to raise their fund**: You can call GPs many things, but “stupid” should never be on your name-calling list. GPs have come to understand that LPs like to feel that they are getting exposure to the most pertinent things in the market (currently), so many managers link their strategy to ongoing trends. This gets the conversation started. Although being tied to the flavor of the month can have long-term detrimental effects when trying to build a tribe of non-fair-weather investors, the need for capital sometimes makes this approach irresistible. I always tell GPs that discerning LPs, who also tend to be the best long-term partners, can smell a disingenuous trend-chaser from a mile away.

- **Long-term foresight has a harder time being rewarded**: Some grace should be afforded to GPs for choosing the path of least resistance because investment theses that are not steeped in some very visible and low-mental-hurdle theory are typically not quickly rewarded with capital commitments. I get it. For example, AI has been amongst us for many years now, but how dare you tell me about it in 2018? Tell me about it when Nvidia and all other AI derivatives are so scorching hot that everyone and their aunts and uncles have a parlay bet on it.

- **Being too early tends to be frowned upon**: The investment world is filled with cautionary tales of analysts being too cutesy and venturing into opportunities that are not yet baked. Capital draining duration (holding costs), insufficient market validation, unproven technologies, and reputational risks are components of what disincentivize many from taking leaps into areas that are not apparent to the naked

eye. There is a certain currency, that can quickly devalue, needed to explore obscure investment areas. Analysts guard this currency with mother-bear-like care. All it takes is for one (or a few) wild goose chases to fully deplete this currency. Hence, most investors color neatly within the lines and sing in a chorus of sameness until courage and reputation are built up enough to risk some degradation.

- **Just call it "tactical", "dislocation" or "opportunistic" and market time away**: Investors are always clever in finding ways to inoculate themselves from harsh future judgment or reputational erosion. It makes sense that diversification of all forms should be undertaken in portfolios. So having a mix of short- and long-term plays can be accretive to an investment policy. Incorporating "tactical", "dislocation" and "opportunistic" investments allows investors to play the "current market game" without being labeled as amateurishly short-sighted. GPs can (and sometimes do) position their strategies as flexible enough to be focused on long-term plays while also taking advantage of short-term low-hanging fruit.

- **Some semblance of certainty reduces the angst of risk-taking**: Investors (like all humans) generally try to insert as much certainty as possible when making decisions about anything with a high degree of uncertainty. Subtle or blatant market timing numbs the risk nerve and creates a decent excuse cushion when/if things go wrong. So where does differentiation come in? And how does a GP provide reasons for long-term trust in a short-term-centric environment? A track record definitely helps, but the wheat is really separated from the chaff when a GP can clearly articulate why its unique combination of people, processes, and data, positions it for value creation through cycles.

Private market investing will remain as dynamic and intriguing as its many participants. Different types of behavior will inevitably result whenever capitalist principles are mixed with human psychology, disparate incentives, and high expectations. Contradictory statements and actions are a big part of investing that analysts must navigate. "Market timing" falls squarely into the confusing maze of dos and don'ts. Another one that can be delved into in the future is the relevance of "past performance" - where investors stress that past performance is in the past and should not have a lot of weight in decision-making about the future but then base the majority of an investment thesis on the manager's past performance. Hahaha. I think a good parting statement about market timing in private markets is "the periods when most are reluctant to invest tend to be the best times to jump in".

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