Wespath

MARCH 2020

Wespath's Private Equity Strategy: The Evolving Approach

Wespath Benefits and Investments (Wespath) and its subsidiaries, including Wespath Institutional Investments (WII), act on behalf of nearly $25 billion in assets for roughly 100,000 pension plan participants and more than 130 institutional clients. We offer a well-diversified range of funds that seek to help our stakeholders reach their financial goals, while minimizing overall risk and maximizing returns.

Through our fiduciary responsibilities, we are committed to identifying new investment opportunities that will position Wespath's funds for long-term success, which includes constantly staying informed about a wide variety of investable instruments.

As we search for new ways to enhance returns and add diversification to the Wespath funds, we are increasingly turning to alternative asset classes such as private equity.

Investing in this asset class can be more challenging than owning publicly traded stocks and bonds for many reasons. For instance, private equity investments are typically "illiquid." This means that it is difficult for private equity investors to buy and sell positions quickly, which often results in longer holding periods.

> Private equity is a way to hold ownership, or "equity" in privately held companies. Unlike publicly traded companies, shares of privately held companies cannot be bought or sold in the public markets. Private equity investors may participate in several types of deals—examples include buying out existing businesses, turning around a struggling company or providing the initial money needed to fund a startup business.

Accordingly, large financial institutions—especially ones with longer time horizons, including pension funds, endowments, foundations and government-controlled sovereign wealth funds—are consistently the largest investors in the asset class.

But not all institutional investors look at the investment universe the same way. Wespath, for example, is mindful of the missions of its stakeholders and wary of the challenges associated with certain investment strategies.

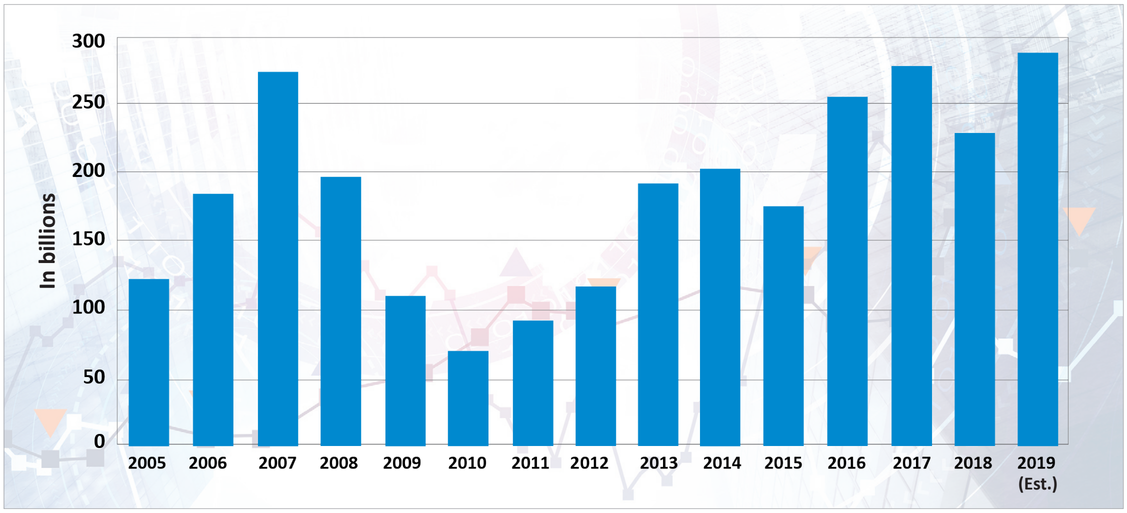
Nevertheless, we believe the benefits of private equity are an important source of diversification to our investment offerings, and we maintain exposure to the asset class through cost-effective methods. Furthermore, our experience with private equity has provided insight into key trends in the asset class that will evolve our offerings in the future.

Brian Boyer, CFA
Director, Private Markets

Brian joined Wespath in September 2003. As the director of Private Markets, he is responsible for overseeing the strategic direction and staff of the alternatives investments programs for Wespath and its subsidiaries, including the asset classes of private equity, real assets and private real estate. Previously, he spent 15 years with First Analysis Corporation, a Chicago-based investment firm. At First Analysis, he was a senior vice president with responsibility for developing public equity research coverage and making venture capital investments in various technology sectors including telecommunications products and services. Brian currently serves on the Northbrook United Methodist Church endowment committee. He received a bachelor of arts degree and a bachelor's degree in Engineering from Dartmouth College, and an MBA from The Wharton School at the University of Pennsylvania. He is also a CFA Charterholder.

U.S. Private Equity Capital Raised

FIGURE 1



As of November 6, 2019

Source: PitchBook

Private Equity Trends and Investment Benefits

Investors' conviction in private equity is demonstrated in Figure 1, which shows a steady increase in U.S. private equity capital raised from 2010 through late 2019. Approximately $250 billion in U.S. private equity capital was raised in the first 10 months of 2019, putting the year on track to surpass the record set in 2017. One of the drivers of this trend was institutional investors seeking higher returns in light of low interest rates, which have prevailed during the recent economic cycle.

The Wespath funds have certainly attained performance benefits from private equity. Through the third quarter of 2019, the funds' trailing one-year and 15-year aggregate U.S. private equity investments outperformed the Russell 3000 index*—a gauge of the entire U.S. public equity market—during those same periods.

In addition, the funds' international private equity investments, which commenced in 2012, outperformed the MSCI ACWI ex-US IMI index—an international public equity measurement—for the one-year, three-year and five-year periods, as well as since the inception of the strategy*.

Of course, we have also seen periods during which public equity investments outperformed the funds' private equity holdings. During these periods, we still view private equity as an important diversifier because it is typically uncorrelated with public equity and bond investments. Assets that are uncorrelated perform differently under various market conditions. This means that private equity may perform better in a period where public equity is struggling. These diversification benefits make private equity a popular choice for institutional investors looking for unique sources of return and reduced volatility.

U.S. Private Equity Performance

	1 YR	3 YRS	5 YRS	15 YRS
Wespath*	5.9%	9.5%	9.2%	8.9%
Russell 3000 Index	2.9%	12.8%	10.4%	8.8%

International Private Equity Performance

	1 YR	3 YRS	5 YRS	Since Inception April 2012
Wespath*	9.2%	9.5%	9.2%	8.9%
MSCI ACWI ex-US IMI	-1.8%	6.1%	-3.0%	4.7%

* *Historical returns are not indicative of future performance. Investment performance is presented net-of-fees—that is, with the deduction of external investment management fees, custody fees, and administrative and overhead expenses. Performance displayed reflects P Series performance only. For more information on who is eligible to invest in P Series funds, please refer to the Investment Funds Description—P Series, the Summary Fund Description—P Series and the Statement of Additional Information.*

Accessing Quality Private Investments

Institutional investors often access private equity through specialized investment managers, who assemble portfolios of privately held companies.

Private equity investment managers typically possess an area of expertise that provides a competitive advantage. For example, managers can add value to their investments by possessing expertise in a unique or specialized industry sector, access to a proprietary network for sourcing fund deals, or the ability to hire a strong management team to operate the individual companies in a portfolio.

Regardless of the specific area of expertise, industry data confirms that identifying the best performing investment managers is the key to long-term success in private equity. One way to evaluate investment managers is by monitoring their performance over several "fund cycles."

Private equity funds typically have limited "life cycles." This means that private equity managers will raise and invest funds over a predefined window of time. The fund then "closes" to new investments, and the investment manager repeats the fundraising and investment process. Investors should aspire to identify investment managers that have proven their ability to perform well in multiple fund cycles.

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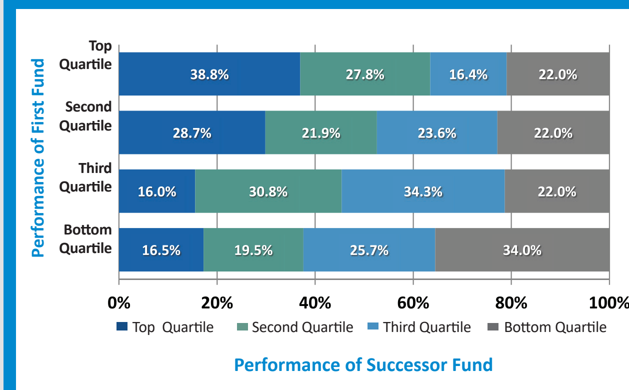
Fund Cycle Performance
FIGURE 2



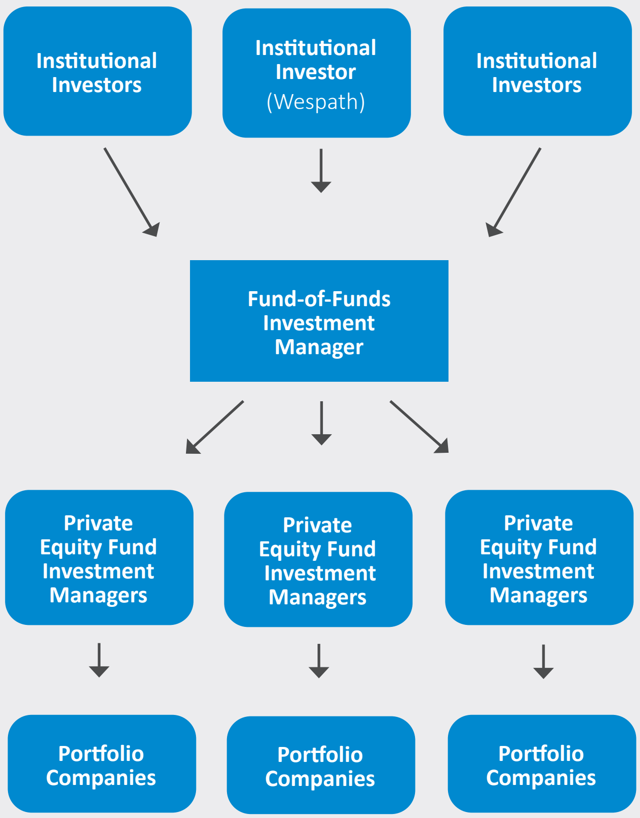
Of course, few are able to produce consistently meaningful returns. Figure 2 shows one indicator of persistence in manager outperformance. The chart highlights that a manager whose first private equity fund (y-axis) achieved performance in the top quartile achieved top quartile or second quartile performance 67% of the time with a successor fund (x-axis). This is in comparison to a manager whose initial fund's performance was in the bottom quartile, who only achieved top or second quartile performance 36% of the time for a successor fund.

Identifying and gaining access to these top quartile managers is therefore critical for institutional investors who want to capture strong private equity performance. Given the vast number of managers available, the task of selecting one that aligns with one's investment objectives can be daunting. We've found that Wespath's approach to private equity investing makes this task less challenging.

Wespath's Approach to Private Equity

Private Equity Fund-of-Funds Structure

FIGURE 3



Wespath first began developing a private equity strategy in 2003 by utilizing a commingled, "fund-of-funds" approach. Figure 3 illustrates the flow of money in the fund-of-funds structure. It begins with institutional investors contributing capital to a combined pool of assets through a dedicated fund-of-funds investment manager that invests the assets by assembling a portfolio of private equity fund investment managers. The private equity investment managers then invest in individual portfolio companies.

The fund-of-funds approach is ideal for institutional investors who may have limited in-house private equity investment resources or a lack of direct relationships with private equity fund investment managers.

For example, Wespath's initial fund-of-funds strategies allowed it to access the in-house expertise, due diligence skills and back-office capabilities provided by the fund-of-funds managers. This delivered further access to high-quality, individual private equity fund managers that may not have been available to us otherwise.

However, as institutional investors gain scale, experience and knowledge over time, they may choose to bypass the fund-of-funds manager and invest directly with underlying private equity fund investment managers. The trade-off in bypassing the fund-of-funds manager is that an investor must commit internal capital in the form of additional investment, legal and other staff to replace the value provided by the fund-of-funds manager. These costs are meaningful and can serve as a barrier to entry for many investors.

Private Equity's Emerging Trend

Some institutional investors are choosing a third route to access private equity: investing directly in underlying portfolio companies.

This method, known as "co-investment," is executed by either investing alongside a private equity fund investment manager, or bypassing the manager completely. Co-investment deals typically result in a more rapid deployment of capital, making the process more efficient. These deals also tend to result in lower total fees paid to investment managers.

The Wespath funds are taking advantage of this emerging trend in several ways. First, our international fund-of-funds manager is sourcing more co-investment deals that we can deploy in our international private equity strategy.

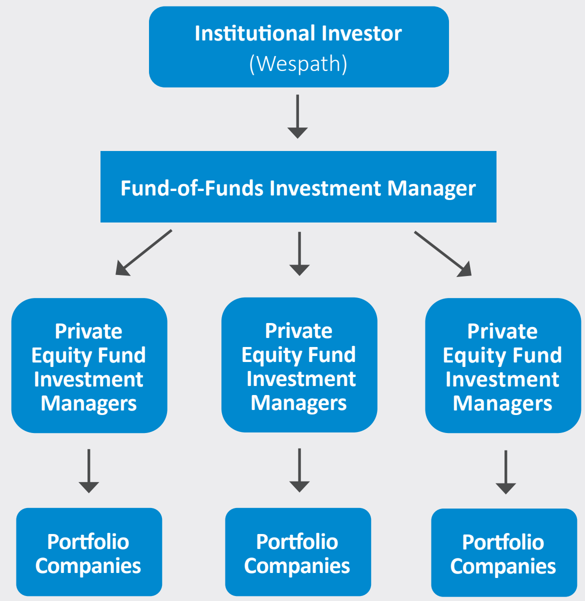
Second, in U.S. private equity, Wespath and its subsidiaries have created a unique $150 million "fund-of-one" separate account program for the Wespath funds. This is similar to the previously described fund-of-funds structure, but the Wespath funds are the sole investor. It is shown in Figure 4.

While not quite co-investment, this fund bypasses the commingled structure, giving the Wespath funds the flexibility to both participate in more co-investment deals, and gain more transparency about our exposure to direct private equity investment managers.

Indeed, this separate account allows Wespath staff to receive financial statements directly from the underlying private equity investment fund managers, providing us with more proprietary research and data on portfolio investments and the strengths and weaknesses of each investment manager. This translates to Wespath staff gaining more experience and expertise with the private equity asset class.

Private Equity Fund-of-One Structure

FIGURE 4



In addition, this new structure gives us access to annual meetings that include direct discussion with individual investment fund managers. We are now building closer relationships with the underlying managers in anticipation of ultimately making direct commitments to some of these managers in future funds.

What's Next

Wespath believes that private equity is a key contributor to a diversified investment portfolio. Our private equity investment process has evolved over time as we thoughtfully search for innovative methods to achieve strong investment returns, while acting as a prudent fiduciary on behalf of our stakeholders.

This search led us to adopt the fund-of-funds structure and begin to build the knowledge base and connections necessary to evolve with the industry and capture strong performance over the long-term. To that end, Wespath and its subsidiaries are constantly assessing the trade-off between direct investing with fund managers and co-investments versus the merits of continuing to engage fund-of-funds managers. Given the long-term nature of investing in private equity, Wespath is most likely to follow a path which involves a gradual transition between these two approaches.

While acting on behalf of our stakeholders whose missions have varying financial objectives and long-term goals, we must continue to diversify our investment options to account for new opportunities and risks around the world.

About WBI

Wespath Benefits and Investments (Wespath) is a not-for-profit agency that has been serving The United Methodist Church (UMC) for over a century. In accordance with its fiduciary duties, Wespath administers benefit plans and, together with its subsidiaries, including Wespath Institutional Investments, invests nearly $25 billion in assets on behalf of over 100,000 participants and over 130 United Methodist-affiliated institutions (as of December 31, 2019). Wespath funds invest in a sustainable manner that supports long-term value creation while having a positive impact on the environment and society and upholding the values of the UMC. Wespath maintains the largest reporting faith-based pension fund in the world.

Wespath BENEFITS | INVESTMENTS

wespath.org

About WII

Wespath Institutional Investments (WII) is a not-for-profit subsidiary of Wespath Benefits and Investments (Wespath), a general agency of The United Methodist Church (UMC). WII provides investment solutions for institutional investors related to the UMC, including foundations, children's homes, older adult facilities, higher education institutions and healthcare organizations. WII offers diversified global exposure to its world-class investment managers through a family of daily priced funds. WII's investment process proactively incorporates the consideration of environmental, social and governance (ESG) factors into investments across asset classes and in the selection of external asset managers.

Wespath INSTITUTIONAL INVESTMENTS

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