

Beyond quartiles: The alpha reckoning in private markets



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Can your fund manager really generate alpha, or just ride the market tide?

For decades, private market investors have wrestled with a deceptively simple question, is my fund manager truly skilled, or just riding the wave of the market tide? Standard metrics like internal rate of return (IRR) and total value to paid-in capital (TVPI) promise clarity but rarely deliver. Peer comparisons are distorted by small samples, noisy data, and inconsistent definitions. For LPs, that means one of the biggest risks isn't the market itself, it's misjudging whether they're backing genuine talent or the benefits of a bull market.

Scientific Infra & Private Assets (SIPA), an EDHEC venture, elevates private market benchmarking with robust, market-based indices that reveal true manage skill by measuring alpha. Rather than obscuring performance with quartiles and peer group comparisons, our approach magnifies what matters most, the ability to generate alpha.

Why Peer Group Comparisons Fail and How Market Indices Reveal True Skill?

The limitations of peer group benchmarks are well documented. They are often built on incomplete and inconsistent datasets that result in misleading comparisons that represent only a fraction of the true opportunity available. The quartile boundaries used to classify funds as "top quartile" or "bottom quartile" are particularly unreliable. Statistical analysis shows that with so few data points in most peer groups, the confidence intervals are so wide that almost all funds can be made to look better or worse than they really are. In practice, this means investors cannot rely on quartile rankings to guide their investments.

Peer noise vs. market clarity: the privateMetrics approach

SIPA's answer is to shift the frame of reference. Rather than comparing funds with one another, we propose comparing them with the actual market for private companies and not the narrow slice captured by existing funds. This is the crux of the privateMetrics suite of indices. By constructing benchmarks that track the performance of the investable private market universe, we can provide investors with the tools to calculate Direct Alpha and measure whether a fund genuinely outperforms the market.

Take the private2000 index as an example. It tracks 2,000 private assets across 30 key countries, capturing the broad

market risks which private equity investors are exposed to. By benchmarking funds against this index, investors gain a clear and transparent view of performance relative to the underlying market. Our recent research paper based across 800 buyout funds illustrates the importance of this approach. The average fund's alpha is statistically indistinguishable from zero. This does not mean managers cannot create value it means that on average the performance of buyout funds mirrors that of the market for private companies. Some managers clearly outperform, but others lag behind, and only a market-based benchmark makes it possible to see which is which.

What are the key drivers of returns: market or manager?

Benchmarking against indices that reflect the private market also clarifies the sources of risk and return. Investors in private equity funds face three types of risk: market risk, which reflects the value of underlying companies; cashflow risk, which arises from the timing of capital calls and distributions; and illiquidity risk, which depends on when investments can be entered into or exited. While cashflow and illiquidity risks can be influenced by a manager's skill in structuring, timing, and operational improvements, market risk is inescapable. On average, it explains the bulk of returns. Effective benchmarking requires carefully disentangling market-driven performance from value added through skill.

Turning insight into an advantage

To make these insights actionable, SIPA goes further than providing benchmarks. We publish GP star ratings and league tables based on alpha, giving LPs a transparent and quantitative basis to justify their selection of specific funds and managers. These rankings also allow investors to assess the persistence of skill, tracking whether a GP who generated alpha in one fund is likely to do so again in subsequent funds. Our rankings give managers a fair way to showcase their track record and demonstrate their ability to create value.

Benchmarking without blinders

Private markets can only thrive if alpha replaced IRR to select funds, unlocking the transparency investors need, without losing sight of the unique risks and opportunities that make the asset class attractive. For LPs and GPs alike, this shift represents a chance to move beyond outdated metrics and towards a more data-driven understanding of performance. In a market defined by capital flows and competition, clarity is not just useful it is essential.

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