The Case for Venture

In 2020, there are 4 very powerful and visible phenomena, the convergence of which is likely to bring tremendous change and disruption, much of which will be at the expense of incumbent business models and with significant investment implications.

First, we are at the end of a 40 year cycle of falling interest rates.

Second, post the Global Financial Crisis of 2008, we are 12 years into the biggest economic experiment ever undertaken by Central Banks in the form of QE, or money printing, without really knowing how this ends. The 1930s offers an analogy for the last time rates were this low, money printing so rampant and the wealth divide so big.

Third, we are only 10 years into exploring the possibilities of cloud computing. Businesses can and are being built from anywhere in the world at minimal cost and very, very quickly - It took the airline industry 50 years to reach 50m customers. It took Pokemon GO just 19 days. It took Lloyds Bank in the UK a century to acquire 7m customers. Paypal added this many in just 3 weeks in April this year (2020). Quantum computing is next.

Last, the younger generation are arriving into the workforce with record levels of student debt and facing real estate prices 4x what they were 25 years ago. With asset prices so far removed from income streams, this generation simply doesn't have access to the same levels of prosperity as the previous one. And so it has to be reimagined. This changes everything – renting over owning, services over assets.

The coincidence of these 4 observations favours private over public, innovation over legacy – the fourth industrial revolution.

And this is starting to get acknowledged…

Cambridge Associates, the leading investment consultants and asset allocators, published an important report in Q1 of 2020 suggesting that an allocation to venture greater than 15% may be appropriate.

October 8th 2020, Goldman Sachs reported on Bloomberg that while the returns from a traditional 60/40 portfolio have delivered 7/8% annualised over the last 10 years, such a strategy will deliver just 2/3% annualised real returns over the next decade. FT has also reported this Sept 2020 talking of a "nuclear winter" for 60/40 strategies.

Which explains the seismic new legislation introduced in the US in May 2020 to allow pension plans, so called 401ks, to invest in private equity and venture capital.

This makes sense – these pension plans and other bigger pools of capital can't possibly generate the 7% returns required to meet their liabilities. But, if they can allocate 10% of their assets to venture, which proposes to earn 30% annual returns, then they can achieve 3%, or half of their target return of 7%, with 10% of their capital.

Since 2012, profit growth in the S&P500 outside of the technology sector has been only 1%. Over the same period, the value of private disruptive technology companies has grown 14 times.

It is estimated that by 2025 there will be 100bn connected devices. The internet of things, quantum computing and artificial intelligence will provide secular tailwinds for the investment landscape for the foreseeable future.

The case for an allocation to venture of 10, 15 or 20% of a portfolio is a matter of preference, but it is clear in 2020 that it can no longer be zero.

Post notes

An academic study recently published in the Institutional Investor in September 2020 explained how with suitable diversification, VC becomes an investment grade asset with less risk and higher average returns than public markets and buyout. This is exactly the Antler approach – Antler invests in the top 1% of 60,000 applications by founders to its platform every year, after due diligence that is on average 40x more extensive than other investors, and at very attractive fixed valuations, to create the levels of diversification described in this report.

One of the consequences of bigger pools of capital – the US pension plans and other – coming to venture is to create "crowding" at the later stage, 2 year pre-IPO part of the market. $2tn of "dry powder" is competing with Softbank money, Growth capital, Late Stage Venture funds to invest in the most exciting opportunities. Unsurprisingly, well-known Silicon Valley VCs are now, as a result, moving earlier stage – where Antler operates – to achieve outsized returns through better priced access. There is a clear strategic advantage in being early stage.