PRACTICAL PRINCIPLES

Benchmarking PE Well: Seven Principles for LP Frameworks

From the LP Gateway forum discussion.

1

Use IRR — not compounded TWR — as the primary PE return metric

Compounded TWR is not appropriate for standalone PE measurement. It ignores cash flow timing and can produce directionally wrong verdicts. Quarterly TWRs may be included in a total-portfolio composite but must not be compounded independently.

2

Always read IRR alongside multiples (DPI and TVPI)

IRRs can be inflated through subscription lines, early distributions, or trading strategies that recycle capital quickly. Multiples cannot be managed in the same way and give an honest picture of how much capital has actually been returned.

3

Apply a one-quarter lag to any public market comparison

PE valuations are struck quarterly and reflect conditions ~60–90 days prior to reporting. Without a lag, you are comparing March PE marks against a June public index. CalPERS, OTPP and PSP all embed this lag explicitly.

4

Match your PME index to where your capital is actually deployed

A market-cap-weighted global index concentrated in US mega-cap tech is not a fair comparator for a European mid-market buyout programme. The PME index should reflect the portfolio's actual geographic and strategy composition.

5

Do not draw conclusions from programmes younger than eight years

Individual funds settle into their final quartile around year six. A staggered portfolio needs ~eight years. Separate mature and less-mature sub-portfolios for reporting — apply full benchmark rigour only to funds old enough for comparisons to mean something.

6

Treat short-horizon results as diagnostic signals, not verdicts

One-year and three-year results flag outliers and monitor trends. They do not provide allocation or programme verdicts. Primary benchmarking decisions belong at the five- and ten-year horizon.

7

Set the illiquidity spread deliberately, not by convention

The premium above a public benchmark must reflect the actual burden of the programme. Too low (e.g. 50bps) and PE will almost always appear to underperform in strong markets; too high and you credit returns the programme may not be earning.

For one-year reporting: use two benchmarks in parallel

BENCHMARK 1

Global public PME

Dollar-weighted PME vs MSCI ACWI (or equivalent), 1-quarter lag. Answers the opportunity cost question without being distorted by public market concentration.

BENCHMARK 2

Global private peer index

Blended Cambridge Associates / Burgiss global benchmark, weighted to strategy mix. IRR vs IRR — eliminates the TWR/IRR mismatch for the peer comparison.