

Introduction to private equity and venture capital investing

Private equity and venture capital stands out as two core asset classes, each providing unique ways for investors to participate in the growth and transformation of private businesses at various stages of development. These asset classes offer access to innovation and growth beyond public markets, especially as more companies are remaining private for longer. As private equity and venture capital become more accessible, understanding their fundamentals, benefits, and risks is essential for generating strong risk-adjusted returns for clients, and building a diversified, long-term portfolio.

What is private equity?

Private equity (PE) has emerged as a cornerstone for modern portfolio construction, offering investors access to dynamic opportunities outside of public markets. While traditional equities provide liquidity and transparency, private equity opens the door to direct ownership in businesses with the potential for enhanced returns.

Key benefits to private equity

Private equity offers a unique set of advantages that complement traditional investments, including:



Enhanced return potential

Historically, private equity has delivered higher long-term returns compared to public equities.



Portfolio diversification

Provides access to a wider range of industries and growth-stage companies, many of which are underrepresented in public markets.



Active value creation

Managers often take an active role in improving portfolio companies, driving operational efficiencies, strategic growth, and ultimately, greater value upon an exit.



Exposure to innovation

Many high-growth companies, especially in technology and emerging sectors, remain private for longer, making private equity a primary way to participate in value creation.

Portfolio allocation considerations

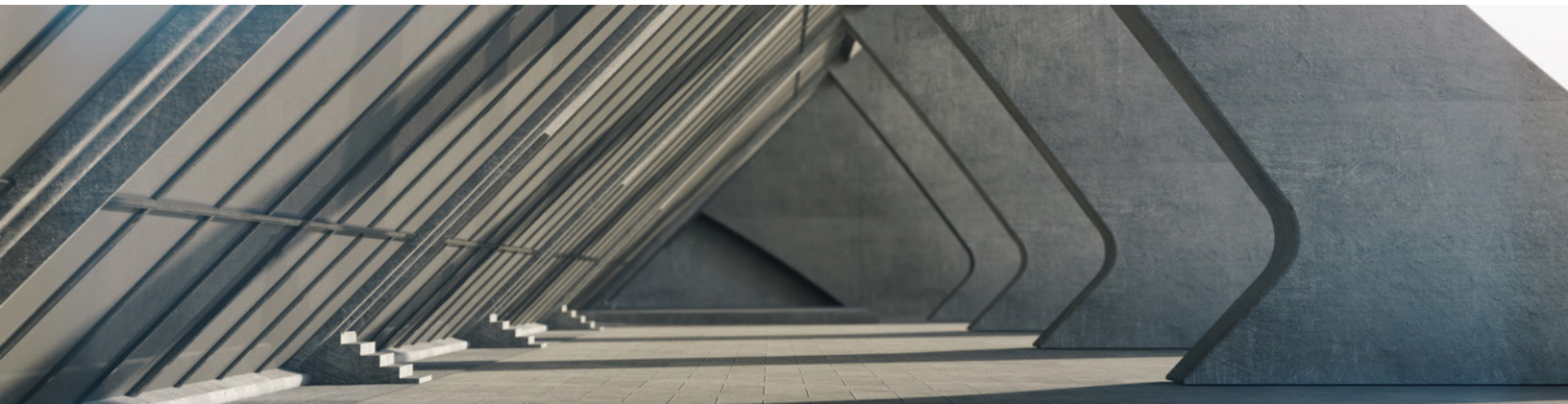
Strategic allocation to private equity can enhance a portfolio, but should be approached thoughtfully therefore, it can be important to:

- **Assess suitability:** Consider time horizon, liquidity needs, and risk tolerance. Private equity is best suited for growth-oriented investors with a longer-term outlook.
- **Start small:** Evergreen funds allow for lower minimums, allowing investors to gradually build exposure rather than directly participating in a closed-ended fund or drawdown fund.
- **Diversify:** Allocate across different managers, strategies (buyout, growth equity, secondaries), and vintages to manage risk.
- **Due diligence:** Prioritize manager selection and seek transparency on fees, strategy, and track record.
- **Monitor and review:** Ongoing monitoring and communication with clients are key to ensuring alignment with portfolio objectives.

Associated risks and considerations for private equity investments

While private equity can be rewarding, there are risks to be considered prior to investing, which include:

Risk consideration	Explanation
Less liquid	▪ For closed-end funds, investments are typically locked in for longer periods of time upwards of 8-12 years. ▪ Quarterly redemptions can be available in evergreen funds, at the discretion of the manager and are typically 5% of the Net Asset Value (NAV).
Complexity and manager selection	▪ Private equity structures and strategies require specialized knowledge and careful manager selection. ▪ Experienced managers can have better deal sourcing, operational expertise, and networks, which can directly impact outcomes. Due diligence can be critical. ▪ The gap between the best and worst performing managers can be substantial.
Higher fees	▪ Funds often charge higher management and performance fees. ▪ May feature potential lock-up or early redemption charges.
Risk of loss	▪ There is the risk of capital loss (like all investments that are not principally protected). ▪ Outcomes can vary widely depending on manager skill and market conditions.



What is venture capital?

Venture capital (VC), is the engine behind many of the world's most transformative companies. As a subset of private equity, venture capital focuses on early-stage and high-growth businesses, often in technology, healthcare, and other disruptive sectors, where the potential for exponential returns is balanced by higher risk. For investors seeking to capture the next wave of innovation, venture capital offers a compelling, albeit specialized, opportunity with its own unique set of risks.

Key benefits of venture capital

Venture capital brings distinct advantages to a modern portfolio that go beyond the benefits of private equity which include:



Access to high-growth opportunities

Venture capital provides early exposure to companies shaping the future, from artificial intelligence to life sciences and many more.



Potential for outsized returns

Few successful investments can drive returns for a fund, with the top-performing venture capitalists often generating significant alpha.



Portfolio diversification

Venture capital investments are typically uncorrelated with public markets, offering diversification against traditional equity volatility.



Catalyst for innovation

Venture capital fuels the growth of new business models and technologies, enabling investors to participate in the value creation of the innovation economy.

Portfolio allocation considerations

Strategic allocation to venture capital requires a disciplined approach due to its higher risk reward; therefore, it is important to remember:

- **Position sizing:** Venture capital is typically a small, high-octane allocation within a broader portfolio (often single digits).
- **Diversification:** Diversifying investments across managers, strategies, and vintages can help manage risk and maximize potential for success.
- **Manager selection:** Focus on experienced, top-quartile managers with proven track records in sourcing and exiting investments. Stray away from one-off managers who have limited success or track records.
- **Long-term mindset:** Venture capital can be best suited for investors with a longer-term horizon, higher risk tolerance, and the ability to weather volatility.
- **Ongoing education:** Go above and beyond, by staying informed about trends, technology, and market cycles to make informed allocation decisions.

Associated risks and considerations for venture capital investments

While venture capital has the opportunity for robust returns and can be appealing to many investors seeking strong capital appreciation, it is not without its own unique set of risks.

Risk consideration	Explanation
Higher risk	Principle investment loss is higher than private equity.
Less liquid	- Closed-end venture capital funds often require a commitment of 10+ years. - Returns are realized upon successful exits such as an IPO, acquisition, or secondary markets. - Quarterly redemptions can be available in evergreen funds, at the discretion of the manager and are typically 2.5% of the Net Asset Value (NAV).
Manager dispersion	- The gap between top- and bottom-performing venture capital managers is wider than other private asset classes. - Manager due diligence is essential with a strong historical track record.
Limited access	- Early-stage venture capital remains less accessible to retail investors. - Later-stage and diversified funds are becoming more available, with typically tighter liquidity profiles compared to other private market asset classes.
Transparency	- Information on private startups, especially very early-stage investments, is traditionally limited. - Ongoing monitoring and reporting is evolving but can vary widely based on manager skill and market conditions.

The bottom line

Private equity and venture capital can be powerful tools for investors seeking to capture growth, diversification, and innovation outside of public markets. With more companies staying private for longer, there is the opportunity for greater capital appreciation of wealth prior to an IPO or an acquisition. However, private equity and venture capital require careful consideration, due diligence, and a long-term perspective to unlock their full potential.

For more information on private equity and venture capital investing, speak to your Advisor, or visit cibc.com/gam-alternatives

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