Replicating Private Equity with Value Investing, Homemade Leverage, and Hold-to-Maturity Accounting

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Private equity (PE) funds tend to select relatively small stocks with low earnings multiples as measured by EBITDA. The author shows that publicly traded equities with these same characteristics have historically demonstrated high risk-adjusted returns after controlling for well-known characteristics associated with value stocks. A passive replicating strategy using modest leverage with a multi-year holding period provides a large improvement in risk- and liquidity- adjusted returns over direct allocations to PE funds after fees, suggesting that high historical returns of PE are due to selecting stocks with systematic portfolio characteristics rather than idiosyncratic active management of portfolio companies.

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