INVESTMENT U RESEARCH REPORT

The History of Private Equity

In 1901, the World's Wealthiest Investors Created Private Equity… And Turned "Millions Into Billions" Today, Individual Investors Can Finally Profit, Too…

by the *Investment U* Research Team

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The private equity market is on a tear…

Last year alone, 926 companies were added to this ultra-exclusive market for the ultra-wealthy elite. Over the last 12 months, $378 billion has fueled yet another flurry of deals.

And quite a few savvy investors are getting even richer… (See "How to Get Rich on the Private Equity Boom.")

But while the private equity market has ballooned to its current size of $1.3 trillion in recent years… its creation can be traced back to the town of Pittsburgh… and the year 1901.

That's the year J.P. Morgan bought Carnegie Steel Company from Andrew Carnegie and Henry Phipps for $480 million dollars, the first trade on what would become the private market we know today.

In 1907, Phipps founded the Bessemer Trust, a "family office," to invest his $50 million in proceeds in private businesses and other exclusive holdings.

Today, Bessemer Trust continues to invest more than $46 billion dollars in assets for the Phipps family and other mega wealthy American dynasties… To this day, it invests in privately traded companies, and it's even headed by Phipps' great grandson, Stuart Janney.

But it wasn't until after World War II that the private market really began growing…

Private Equity Returns 52,757%, Historically Speaking...

American Research and Development Corp. and J.H. Whitney & Company, two of the earliest venture capital firms, were both established in 1946. ARD was founded by Georges Doriot, the "father of venture capitalism," whose greatest investment was inarguably Digital Equipment Corp., which he bought for $70,000 and sold for $37 million – an increase of 52,757%.

As for J.H. Whitney, its most famous investment was an innovative method for delivering nutrition to U.S. troops, which came to be known as Minute Maid Orange Juice.

However, the private equity movement would not be what it is today, if it weren't for the events of 1958...

The U.S was in the grips of Cold War terror. In an effort to bump up technological advances against the Soviets, President Eisenhower enacted the Small Business Act of 1958. It allowed licensed venture capital firms, known as "Small Business Investment Companies," or SBICs, to borrow money from the government at below-market interest rates. In turn, they had to invest in entrepreneurial ventures.

Meanwhile, a number of independent venture capital firms started establishing themselves as major players. Since they didn't depend on government support, they offered more flexibility… and were therefore more attractive to investors. Sure enough, in a few short years, there were more of these private companies than SBICs.

The Rise of Kohlberg Kravis & Roberts

Then the market got really hot in the 1960s… IPO's were the latest and greatest darlings of Wall Street. Like Digital Equipment Corp., the wildly successful ARD start-up that went public in 1968. But that was only part of the boom…

In 1964, Kohlberg Kravis Roberts & Co. steered private investments in another direction with the first official leveraged buyout, then called a "bootstrap" transaction. In this deal, KKR swooped in and bought Orkin Exterminating Company. It was a revolutionary idea… one that would be all but forgotten until the 1980s.

You see, it all came to a screeching halt in the early '70s. In fact, it was an ugly decade for investments across the board. The government raised capital gains taxes… After the stock market crash of 1974, investors avoided anything new and uncertain…

Additionally, due to the Employee Retirement Income Security Act of 1974 (ERISA), pension funds couldn't participate in any kind of "risky" investments. It got so bad that fund raising reached an all-time low in 1975. According to the Venture Capital Institute, a total of only $10 million was raised for the year.

But what goes down must eventually go up... as was the case in 1978. Time magazine reports that fund raising increased from $39 million in 1977 to $570 million just one year later.

The Institutions Pour Into Private Equity…

But why the sudden rush of money? For one, the government lowered capital gains tax from a maximum of 49% to 28%. Then Washington relaxed some of the hard-hitting legislation from ERISA, thus allowing pension funds to invest in private equity... As a result, institutional investor began piling into these investments.

Fed Ex… Apple Computer… Intel… Genentech… all success stories of this venture capital wave.

At the same time, leveraged buyouts were quickly becoming the preferred vehicle for private capital. Major players were just throwing their hats in the ring… Bain Capital in 1984… Blackstone Group in 1985… Carlyle in 1987… ABRY Partners in 1989. Leveraged buyouts in the 1980s came to epitomize the "ruthless capitalism" and "greed" pervading Wall Street at the time. And one example in particular comes to mind…

In 1989, KKR closed in on a $31.1 billion dollar takeover of RJR Nabisco. It was the largest leverage buyout in history. The event was chronicled in the book, Barbarians at the Gate: The Fall of RJR Nabisco, and later made into a television movie.

And now, according to USA Today,

LBOs are back, only they've rebranded themselves private equity and vow a happier ending. The firms say this time it's completely different. Instead of buying companies and dismantling them, as was their rap in the '80s, private equity firms… squeeze more profit out of underperforming companies.

But whether today's private equity firms are simply a regurgitation of their counterparts in the 1980s… or a kinder, gentler version, one thing remains clear: private equity is now enjoying a "Golden Age." And with returns that triple the S&P 500, it's no wonder they are challenging the public markets for supremacy.

And in a matter of months, you'll be able to share in the profits…

How to Tap Into the "Private Stock Market"

Blackstone Group, one of the largest private equity fund-raising firms in the world, is planning to take itself public. Once the IPO is launched, individual investors will be able to share in the company's profits.

And there is more opportunity on the way…

We are several days away from releasing a special report that explains how individual investors can fully capitalize on the "Private Stock Market"… and capture the gains with considerably less risk.

To be notified when we make it public, sign up for the free Investment U e-letter. We will be sending out a message to readers as soon as it's published on the website.

P.S. Alternative energy investments are researched thoroughly in our premium service, *The Oxford Club*, led by Investment Director Alexander Green. Alex's specific growth stock recommendations have beaten the S&P nearly three-to-one over the past five years. To learn more about *The Oxford Club*, please read about "the club you can't get into."