Investing Ideas

Institutional Insights

Private companies disrupting the world

Why now may be an opportune time to invest in venture capital

Karin Fronczke
Global Head of Private Equity Investments

Spencer Lovejoy, CFA
Vice President, Investment Product

Benjamin Treacy, CFA
Institutional Portfolio Manager

KEY TAKEAWAYS

- Investing in the growth phase of a private company offers the potential to capture a meaningful portion of the increase in a company's value prior to an initial public offering (IPO).
- The number of publicly traded companies has declined in recent decades while the number of private companies has increased, and many companies are remaining private for longer, resulting in potentially more value accretion before going public.
- Fidelity has over 15 years of experience investing in private companies across its suite of mutual funds and accounts, with notable early investments including Meta (Facebook) in 2011, Spotify in 2012, Uber in 2014, and SpaceX in 2015.
- While many institutional investors have allocated meaningful portions of their portfolios to private markets to meet objectives that may not be achieved through traditional stock and bond portfolios, retail investors have historically had limited access to these markets. The emergence of new strategies, vehicles, and platform technology may encourage access to more optimal allocations, Fidelity has found.[1]
- Fidelity research has also shown that among alternative investments, venture capital may offer a compelling balance between solid absolute performance, strong returns during declining equity markets, and enhanced portfolio diversification.[2]

Potential benefits of venture capital

Fidelity research has found that allocating to private assets, including venture capital, offers the potential to enhance a portfolio's returns, manage downside risk, and improve diversification.[3] Venture capital investing typically denotes direct minority equity investments in private companies. It can begin at the pre-seed stage, when a start-up is just being founded, and extend through the late stage, sometimes called growth stage.

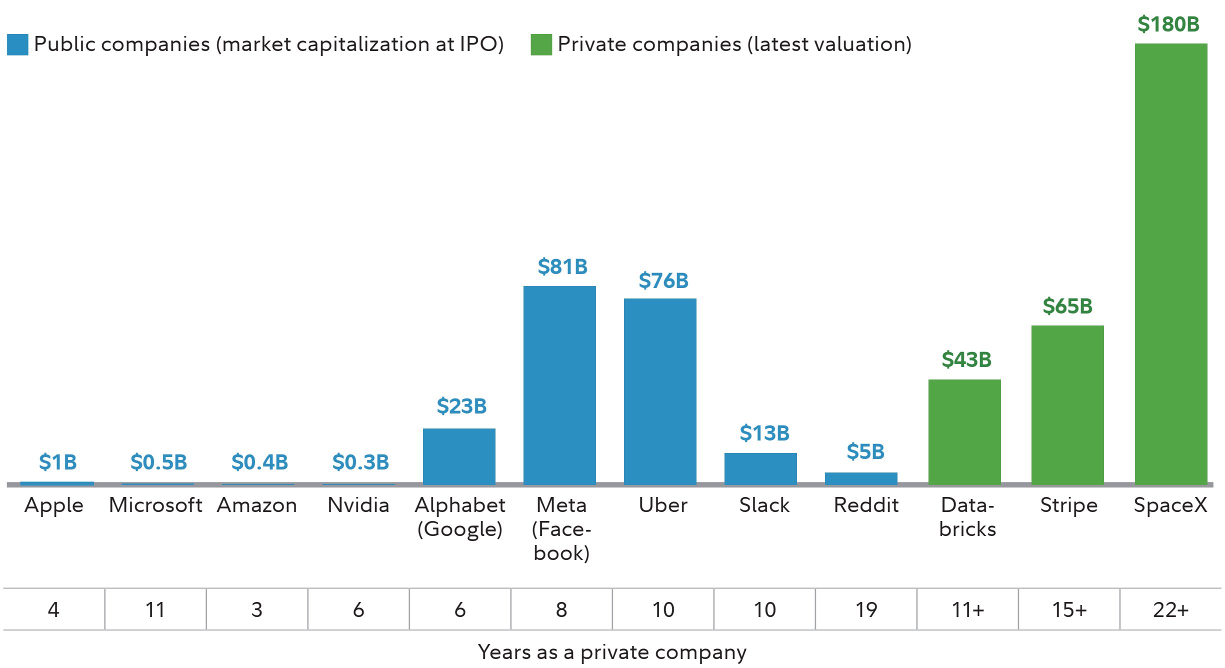
Fidelity INVESTMENTS®

Venture capital investing provides an important source of capital for business owners, and allows investors to diversify their portfolios and participate in the private growth phase of a company's lifecycle. The venture growth stage offers the potential for strong returns, while providing access to more mature, high growth disruptive private companies.

Over the past 25 years, the investing landscape has changed substantially. The number of public companies has declined by about 43%, to fewer than 4,700.[4] Conversely, the universe of private companies has grown meaningfully. Today there are over 1,500 "unicorns," described as private companies with a valuation of $1 billion or more, representing $5 trillion in value globally.[5] These unicorns are disrupting large, important industries and represent a promising opportunity to become some of the next trillion-dollar public companies, in Fidelity's view.

The rise in the number of these unicorns is a result of private companies staying private for longer periods, potentially accruing greater value prior to an IPO. Exhibit 1 outlines some examples of this trend: industry giants such as Amazon and Google went public at three and six years old, respectively, during the late 1990s and 2000s, whereas more recently a number of notable category disruptors went public much later in their lifecycle, at eight years old or later, including Meta (Facebook), Uber, and Slack. Several of the largest private companies today have been in existence for decades: SpaceX is 22 years old, Stripe is 15, Databricks is 11. In 2024, Reddit went public after remaining private for 19 years.

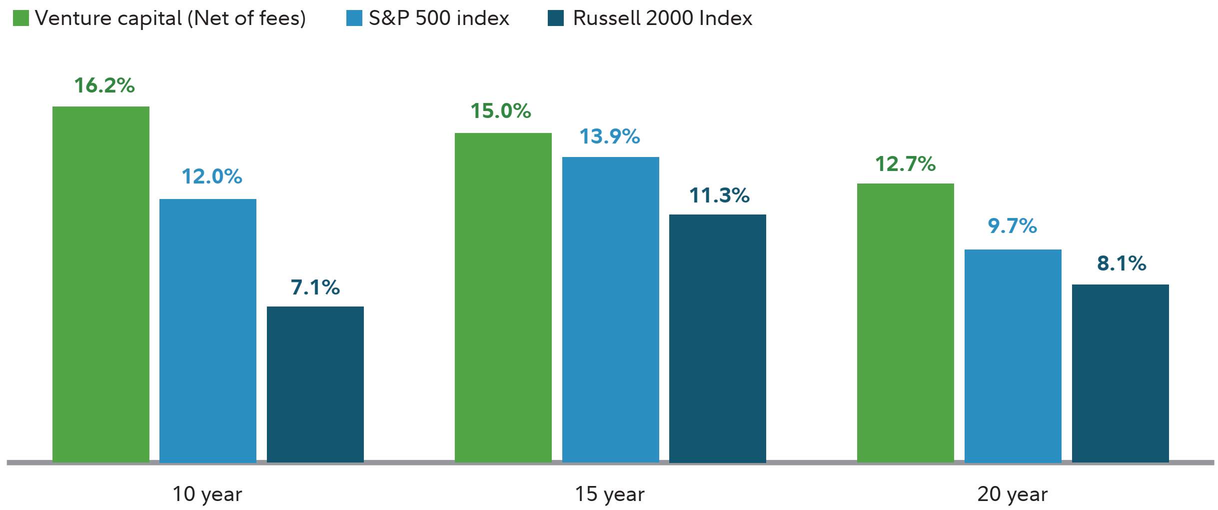
EXHIBIT 1: Many industry giants and category disruptors are staying private for longer, potentially accruing greater value prior to an IPO.



Source: Fidelity Investments. For illustrative purposes only. Third parties referenced herein are independent entities and are not affiliated with Fidelity Investments. Listing them does not suggest a recommendation or endorsement by Fidelity Investments.

Over the past 10-, 15-, and 20-year periods, venture capital has outperformed public equity, with an average return premium of 4%, net of fees, relative to the S&P 500 and Russell 2000 Index (Exhibit 2). This excess return, known as the "illiquidity premium," is the compensation expected by investors for the illiquidity of private assets.

EXHIBIT 2: Venture capital, net of fees, has delivered an average return premium of 4% over public equities over long time periods.



Source: MSCI Private Assets, Bloomberg Finance LP as of Dec. 31, 2023. Venture capital returns represent the pooled Internal Rate of Return net of fees, carried interest, and expenses. Venture capital includes 2,668 funds across all vintages of venture capital in North America. Public index returns are total annual returns gross of any fees. This chart is for illustrative purposes only and there can be no assurance any such trends or correlations will persist in the future. Different methodologies and mechanisms of measuring performance may yield different results. Russell 2000® Index is a market capitalization-weighted index designed to measure the performance of the small cap segment of the U.S. equity market. It includes approximately 2,000 of the smallest securities in the Russell 3000 Index. S&P 500® index is a market capitalization-weighted index of 500 common stocks chosen for market size, liquidity, and industry group representation to represent U.S. equity performance. S&P 500 is a registered service mark of The McGraw-Hill Companies, Inc., and has been licensed for use by Fidelity Distributors Corporation and its affiliates.

Why venture capital?

- Investing in private companies with high growth potential; number of public companies declining and number of private companies increasing
- Companies staying private for longer, allowing for more value accretion while a company is private
- More than 1,500 "unicorns," representing private companies with a valuation of $1 billion or more, are disrupting large, important industries
- Selective IPO market; private companies have a growing need for capital with shorter cash runways and are leveraging the private markets to raise such capital
- Potential for enhanced return, mitigate downside risk, diversification

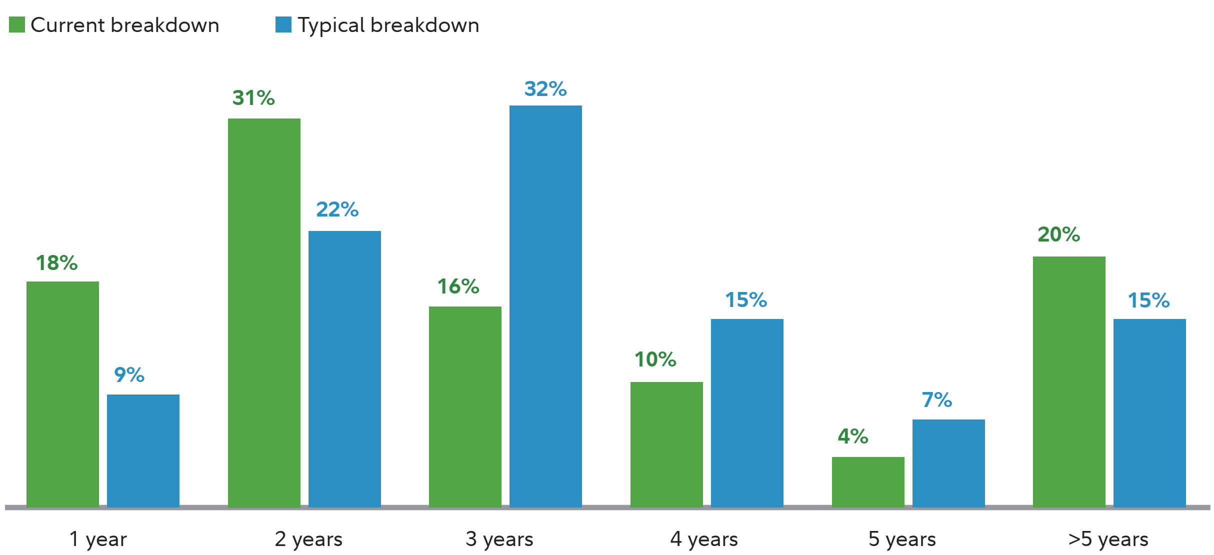
Why now may be a compelling time to invest in venture capital

The IPO market experienced a robust funding environment in 2020 and 2021. However, the IPO market has been relatively selective since then, with only a handful of venture capital-backed companies undertaking IPOs in 2022 and 2023. Despite the size and maturity of many of these businesses, many continue to need capital and are opting to raise financing privately.

The cash runway (the time in years until a company's cash is depleted) for unicorns is now much shorter relative to history (Exhibit 3). A shorter cash runway means many of these companies will have to raise money from investors to continue to grow their businesses. The percentage of companies with less than one year of cash runway is double the typical historical level. For those companies that do not need to raise money to grow their businesses, many have early-stage investors and/or employees who are looking to sell, creating additional opportunities for new investors.

The combination of companies staying private for longer, fewer IPO offerings, and more companies needing capital have created a compelling backdrop for experienced venture investors.

EXHIBIT 3: Available cash for U.S. unicorns is now running light relative to history, as the number of companies with less than one year of cash runway is double the typical ratio.

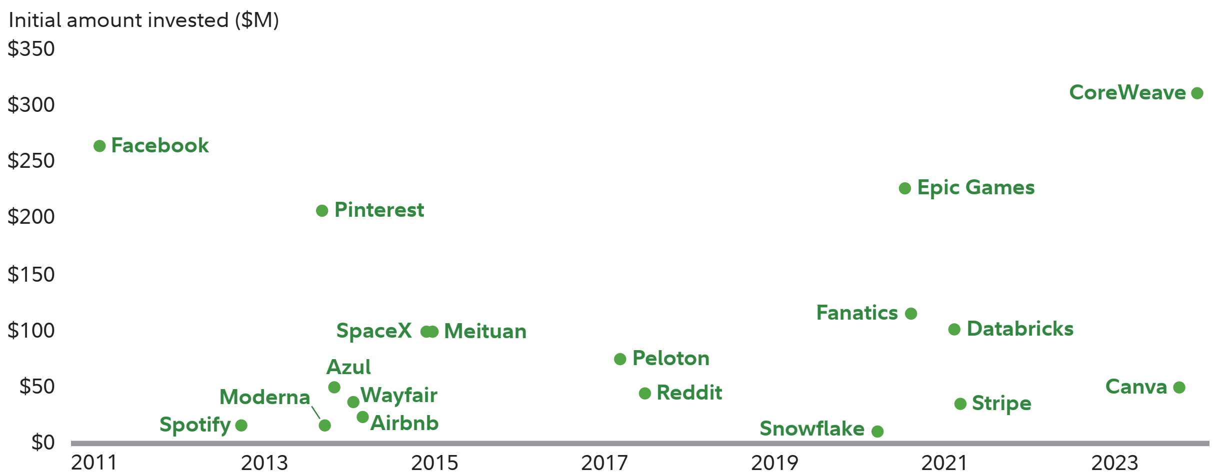


Sources: PitchBook SVP; Bloomberg Finance LP, Morgan Stanley Research, as of Sept. 30, 2023.

Fidelity's approach to venture investing

Fidelity is one of the largest active public equity investors in the world, with more than $1 trillion in equity fund assets. Over the last 15+ years, Fidelity has also been a substantial investor in private companies. The firm has focused on rapidly growing category disruptors and has made more than 600 investments in about 350 companies, representing approximately $28 billion deployed and 200+ exits, most often through an IPO. Over this time, Fidelity has created a robust due diligence and investment process and has had access to, and invested in, some of the most notable category disruptors, including the companies outlined in Exhibit 4.

EXHIBIT 4: Fidelity has invested in noteworthy private companies.



Includes information for investments made by various Fidelity mutual funds and accounts in the aggregate; no single account made all investments. For illustrative purposes only and does not represent all investments made. Third parties referenced herein are independent entities and are not affiliated with Fidelity Investments. Listing them does not suggest a recommendation or endorsement by Fidelity. Source: Fidelity Investments.

Within the broader venture capital investing universe, Fidelity typically targets mid- to late-stage/growth-oriented private companies that operate in a large total addressable market, have an established product market fit, financial scale, a seasoned and experienced management team, and a durable competitive advantage. Fidelity will invest across sectors but has recently emphasized investments in Artificial Intelligence (AI), Data, Consumer Internet, Social Media, Space Exploration, and Defense. Fidelity typically invests in companies where it sees a two- to three-year horizon to an anticipated exit, most often via an IPO.

Investment implications

Venture capital investing can provide access to rapidly growing private companies that are disrupting large, important industries and may become potential future public market leaders. Within a multi-asset class portfolio, alternative investments, including venture capital, offer the potential to enhance a portfolio's returns, manage downside risk, and improve diversification. As one of the world's largest asset management firms, Fidelity has built considerable research and investment capabilities across public and private equities, and continues to expand its alternative investment capabilities across asset classes and product structures to provide investors new opportunities to access the private markets. The firm offers an expanding lineup of alternative investment strategies to institutions, advisors, and wealthy individuals.

For more about investing in venture capital or alternative investments, please contact your Fidelity representative.

Why private investments in artificial intelligence (AI) may be attractive

- AI has become a thematic trend, a component of equity market returns, and a potential source of economic productivity gains that could benefit several industries other than technology.
- Large, publicly traded companies that are developing AI technologies represent just a portion of the total number of investment opportunities related to AI.
- Several private companies, including companies such as Coreweave, Anthropic, and Canva are also developing AI technologies and are an interesting way to invest in this thematic trend.

For more, please see "Accessing the breadth of AI-related investments," May 2024.

Authors

Karin Fronczke
Global Head of Private Equity Investments

Spencer Lovejoy, CFA
Vice President, Investment Product

Benjamin Treacy, CFA
Institutional Portfolio Manager

1. Fidelity Investments, "A Study of Allocations to Alternative Investments by Institutions and Financial Advisors," May 2023. **2.** Fidelity Institutional Wealth Adviser, "Alternative Investments and Their Roles in Multi-Asset Class Portfolios," 2023. **3.** Ibid. **4.** Number of publicly-listed companies: World Bank—World Federation of Exchanges, 2022. The number of companies in the U.S. with more than 50 employees: Bureau of Labor Statistics, Distribution of Private Sector Firms by Size Class, March 2023. **5.** Unicorns defined as those companies valued at $1 billion or more. Crunchbase data as of 12/31/23 (https://www.crunchbase.com).

Market cap and valuation sources for companies in Exhibit 1: Apple, Microsoft, Amazon, Nvidia, Meta (Facebook), Uber, Slack, Reddit, S-1 filings. Databricks and Stripe: company websites. https://www.databricks.com/company/newsroom/press-releases/databricks-raises-series-i-investment-43b-valuation and https://stripe.com/newsroom/news/employee-liquidity-feb-2024. SpaceX: CNBC, https://www.cnbc.com/2023/12/13/spacex-value-climbs-to-180-billion-higher-than-boeing-verizon.html

Intended for investment professional or institutional investor use only. Not for distribution to the public in any form.

Risks

Private Placements are illiquid investments and involve a high degree of risk. A fundamental premise of venture capital investing is the acceptance of illiquidity and a higher degree of risk than is generally inherent in public stock or bond investments, with the possibility of higher returns.

Alternative investment strategies may not be suitable for all investors and are not intended to be a complete investment program. Alternatives may be relatively illiquid; it may be difficult to determine the current market value of the asset; and there may be limited historical risk and return data. Costs of purchase and sale may be relatively high. A high degree of investment analysis may be required before investing. Participation in a Private Placement requires a long-term commitment, with no certainty of return.

Stock markets are volatile and can fluctuate significantly in response to company, industry, political, regulatory, market, or economic developments. Foreign markets can be more volatile than U.S. markets due to increased risks of adverse issuer, political, market, or economic developments, all of which are magnified in emerging markets. These risks are particularly significant for investments that focus on a single country or region.

Past performance and dividend rates are historical and do not guarantee future results.

All indices are unmanaged. You cannot invest directly in an index.

Index definitions

S&P 500 index is a market capitalization-weighted index of 500 common stocks chosen for market size, liquidity, and industry group representation to represent U.S. equity performance. S&P 500 is a registered service mark of The McGraw-Hill Companies, Inc., and has been licensed for use by Fidelity Distributors Corporation and its affiliates.

Russell 2000 Index is a market capitalization-weighted index designed to measure the performance of the small cap segment of the U.S. equity market. It includes approximately 2,000 of the smallest securities in the Russell 3000 Index.

Information provided in, and presentation of, this document are for informational and educational purposes only and are not a recommendation to take any particular action, or any action at all, nor an offer or solicitation to buy or sell any securities or services presented. It is not investment advice. Fidelity does not provide legal or tax advice.

Before making any investment decisions, you should consult with your own professional advisers and take into account all of the particular facts and circumstances of your individual situation. Fidelity and its representatives may have a conflict of interest in the products or services mentioned in these materials because they have a financial interest in them, and receive compensation, directly or indirectly, in connection with the management, distribution, and/or servicing of these products or services, including Fidelity funds, certain third-party funds and products, and certain investment services.

Views expressed are those of the authors as of June 2024, based on the information available at that time, and may change based on market and other conditions. Unless otherwise noted, the opinions provided are those of the author and not necessarily those of Fidelity Investments or its affiliates. Fidelity does not assume any duty to update any of the information.

Third-party marks are the property of their respective owners; all other marks are the property of FMR LLC. Third parties mentioned are independent entities and not affiliated with Fidelity Investments.

The Chartered Financial Analyst (CFA) designation is offered by the CFA Institute. To obtain the CFA charter, candidates must pass three exams demonstrating their competence, integrity, and extensive knowledge in accounting, ethical and professional standards, economics, portfolio management, and security analysis, and must also have at least 4,000 hours of qualifying work experience completed in a minimum of 36 months, among other requirements. CFA® is a trademark owned by CFA Institute.

This material may be distributed through the following Fidelity Investments® entities, none of whom offer direct exposure, clearing or custody of digital assets: Fidelity Distributors Company LLC; National Financial Services LLC or Fidelity Brokerage Services LLC (Member NYSE, SIPC); Fidelity Institutional Wealth Adviser LLC; and FIAM LLC. Institutional asset management is provided by FIAM LLC and Fidelity Institutional Asset Management Trust Company. None of these entities offer direct exposure to digital assets, nor do they provide clearing or custody of such assets.

Personal and workplace investment products are provided by Fidelity Brokerage Services LLC, Member NYSE, SIPC.

1153630.1.0 1.9912524.100