Faculti Summary
https://faculti.net/capital-commitment/

This video discusses the complexities and risks associated with investing in private equity, particularly focusing on two main types of risk: commitment timing risk and commitment quantity risk.

1. **Commitment Timing Risk**: This video risk arises from the uncertainty of when a general partner will call for committed capital. Investors (limited partners) do not know when their money will be needed, which can lead to liquidity issues.

2. **Commitment Quantity Risk**: This video risk involves the fluctuating value of the investor's overall portfolio by the time the capital is called. For instance, if an investor commits a portion of their wealth to private equity but their overall wealth decreases, the committed amount may represent a larger percentage of their now smaller portfolio, putting financial strain on them.

The speaker describes a model developed to analyze these risks, emphasizing that commitment quantity risk is particularly costly for investors since it can lead to substantial proportions of their portfolios being tied up in illiquid investments at inopportune times. They found that commitment quantity risk is not diversifiable through multiple fund investments due to synchronized financial market movements affecting commitment ratios.

This video also touches upon how private equity investments typically require upfront commitments, creating a disconnect between initial ownership percentages and actual portfolio distributions upon capital calls, which directly impacts investors' liquidity.

In response to these challenges, the speaker suggests under-allocating to private equity and potentially using co-investment opportunities at the time of capital calls to manage risk effectively. This video strategy allows investors to retain flexibility and adjust their commitments based on the prevailing market conditions, making it a prudent approach for better managing liquidity needs connected with private equity investments.

Overall, the text reflects on the importance of modeling these risks and adapting investment strategies accordingly, while also noting a trend toward more frequent co-investment offers that help investors mitigate pressure from capital commitments.