

October 2025

# THE RETAILIZATION OF PRIVATE MARKETS

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Private market assets under management have skyrocketed over the past decade, driven by behemoth institutions. Now, asset managers and innovators are in an arms race to bring huge sums of retail capital to alternatives. What will it mean for everything from returns and fees to global economic stability?



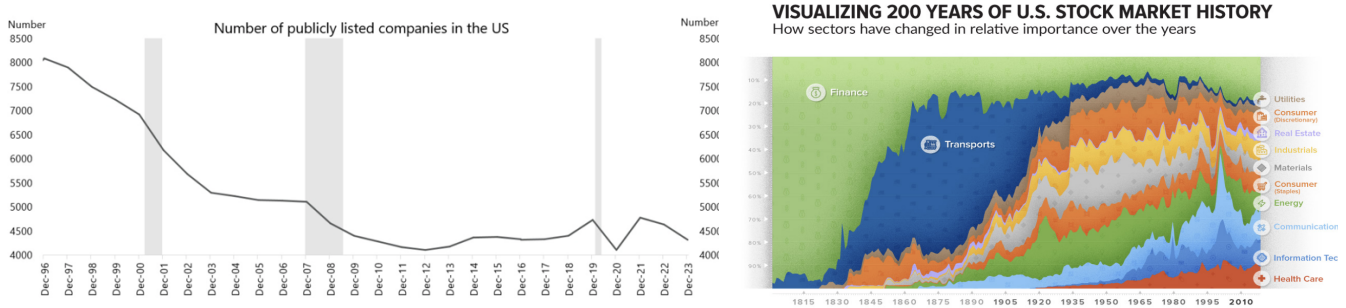
[SageRoad@SageRoadResearch.com](mailto:SageRoad@SageRoadResearch.com)  
[www.SageRoadResearch.com](http://www.SageRoadResearch.com)

# KEY INVESTMENT TAKEAWAYS

CONVICTION	IMPLICATION	POSITIONING
<b>Expect retail inflows to private markets to underwhelm lofty expectations but still prove consequential.</b>	Retailization will alter winner/loser dynamics and lower the overall return potential of private markets.	Portfolio exposure beyond 10% merits more intense scrutiny moving forward.
<b>Retail-targeted funds will underperform.</b>	Prioritizing capacity and liquidity will lower dispersion and in turn, alpha potential.	Manager selection will be even more essential. Look to top-quintile closed-end fund managers and limit exposure to evergreen, hybrid, and semiliquid funds.
<b>Expect private market fee compression to progress faster than it did in public markets.</b>	Fees will be a key differentiator for retail-targeted funds resulting in a race to the bottom.	Weight financial sector public equity exposure towards behemoth banks and away from private-market incumbents.
<b>Private equity performance will continue to deteriorate.</b>	PE performance has been converging with public equity performance. Expect that to continue	Look to middle-market PE for lower-leverage growth opportunities.
<b>Private credit risk will continue to increase as nominal rates stay higher for longer.</b>	Defaults have increased as credit quality has deteriorated amidst greater deal competition.	Look to increase exposure to higher quality, investment grade private credit.
<b>Venture capital AI bubble risk will increase.</b>	Retail capital will concentrate in the frothiest corners of the VC ecosystem.	Take a barbell approach to exposure: late-stage, AI leaders on one end and high-conviction, niche companies not viewed as AI stakeholders on the other.
<b>Increase exposure to infrastructure and natural resources.</b>	Performance resilience and inflation hedging are key virtues and retailization will have a limited impact on those virtues.	Metals and natural gas are our top commodities ideas. Apply a thematic lens to infrastructure exposure.
<b>Macro uncertainty and persistent inflation will continue to drag on real estate performance.</b>	Retailization won't have a meaningful impact on private real estate valuations.	Target smaller, more specialized and localized investors for private real estate exposure. Keep some powder dry in case of an inflation spike or recession threat.
<b>Consider increasing exposure to hedge funds in alts portfolios.</b>	As macro volatility has increased in the post-pandemic investment regime, hedge fund returns have rebounded.	Equity long/short and macro hedge funds appear compelling given their track records of better relative performance during times of high stock dispersion.

# EXECUTIVE SUMMARY

In our first two Sage Road Research reports, we made bullish arguments for increasing private market exposure (learn more about the reports [here](#)). The first report dove deep into the Trump administration’s efforts to deregulate the US economy. The second explored US ambitions to reshore manufacturing. Our private market case boiled down to the same basic equation for both themes. The number of publicly listed companies in the US has shrunk by roughly 50% since the mid 1990s (chart on the left). Both deregulation and reshoring are likely to increase dynamism in sectors far less represented in public markets today than in the past, from industrials and materials to financials and energy (chart on the right). Moreover, that dynamism will generate upside opportunity for small- to mid-sized companies, most of whom sit in private markets. Just consider that there are roughly 240,000 manufacturing firms in the US. The iShares US Manufacturing ETF holds just over 100 companies.

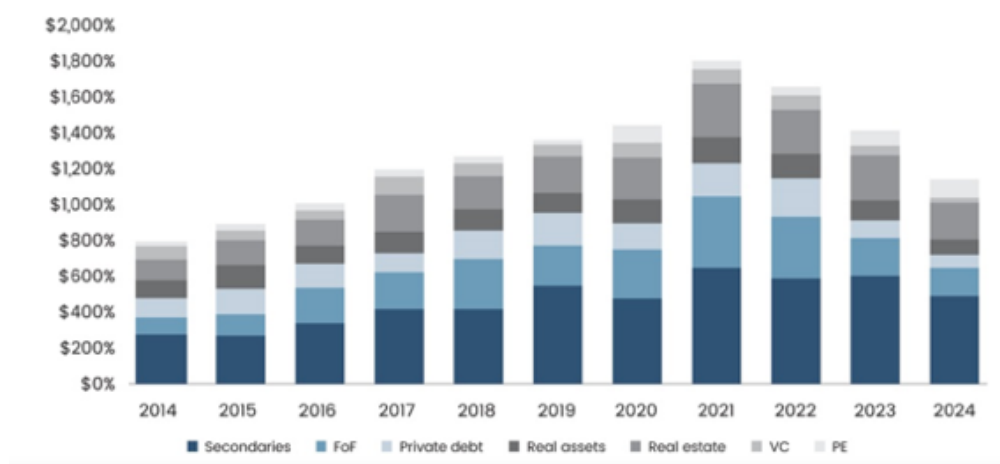


Yet, making that recommendation in both reports tweaked a concern that has been building for us for years. **History attests that rapid AUM growth in asset classes with limited transparency is a recipe for asset mispricing that can lead to losses, if not systemic vulnerabilities.** Private market AUM has skyrocketed over the past decade, roughly tripling between 2013 and 2023. As of year-end 2024, US private equity AUM alone had hit \$3.1 trillion, according to S&P Global. As of March of this year, global private credit AUM had hit \$2.5 trillion, according to the Bank for International Settlements. In 2023, Warren Buffett issued a warning about private equity:

*There’s at least a trillion dollars committed to buying businesses and if you figure they’re going to leverage them 2-for-1 on that, you may have around \$3 trillion of buying power in a US market that’s something over \$30 trillion. And there are all kinds of businesses that are not for sale. So, the supply/demand situation for buying businesses privately and leveraging them up has changed dramatically from what it was 10 or 20 years ago.*

Troubling signs have become increasingly apparent. **In 2024, private market fundraising dropped 19% YoY, the third consecutive year of declines**, according to PitchBook data (chart below). Distributions have also plummeted. Private equity, for one, has typically distributed 30% of net asset value per year. Recently, **those distributions have fallen to 10% of NAV**, according to Verdad Advisors.

**Figure 1: Private Capital Fundraising Throughout the Years (in \$Billions)**



Some of the past decade’s biggest backers of private markets have begun sending loud messages about mounting dissatisfaction. Prominent university endowments are selling private assets at a discount to raise liquidity and increase flexibility. The process has triggered concerns about rampant asset overvaluing—Harvard alum Bill Ackman has speculated that **the university’s endowment may be worth roughly 30% less than claimed**. Meanwhile, the Institutional Limited Partners Association—a trade group that represents some of the US’ biggest pension funds—has launched a campaign demanding greater fee and return transparency from private equity partners, “in a bid to address simmering frustration with the industry’s disclosures,” as *The Wall Street Journal* reported in January. Finally, there’s been the recent collapses of Tricolor and First Brands, which has generated unease about the stability of private credit. To paraphrase Apollo’s Mark Rowan, **“the desire to win in a competitive market” may have led to “shortcuts”** that could trigger more “late-cycle accidents” or worse.

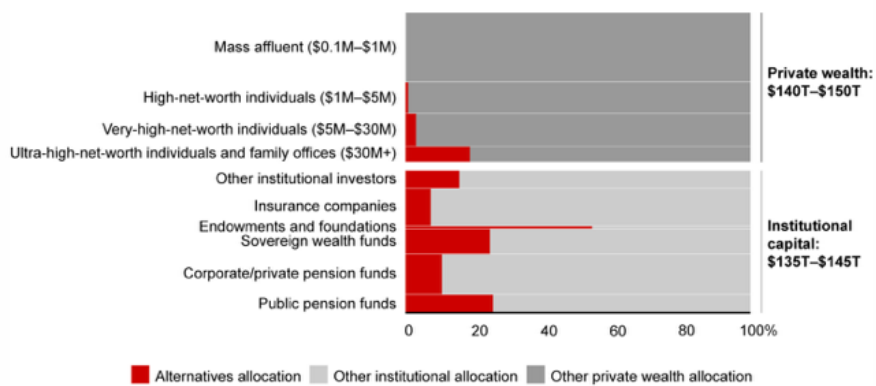
**Industry expectations are that the slowdown in institutional investment in private markets will persist.** In June, State Street released the results of its annual “Private Markets Survey”. Roughly 500 institutional investors participated, including traditional asset managers, private market managers and asset owners across North America, Europe, the Middle East and Asia-Pacific. A key finding: “LPs and GPs both predict a private/public split of

42%/58% in their (or their clients’) portfolios within three to five years’ time, which represents a **slight increase in their respective current allocations of 39%/61% (LPs) and 38%/62% (GPs).**”

In response to dwindling institutional inflows, the industry is turning in a new direction for AUM growth: retail investors. **Individual investors account for roughly 16% of private market AUM despite controlling 50% of all global wealth**, according to Bain & Company estimates (chart below). Now, the Trump administration is rewriting the regulatory playbook to break down obstacles to retail investment. Behemoth asset managers are forging partnerships and authoring product innovations to maximize retail capital recruitment. And tech upstarts are generating novel solutions for retail access, from tokenizing private assets to building exchanges for employees to list private shares.

### Individual investors hold roughly half of all global wealth but account for a much smaller share of private capital AUM

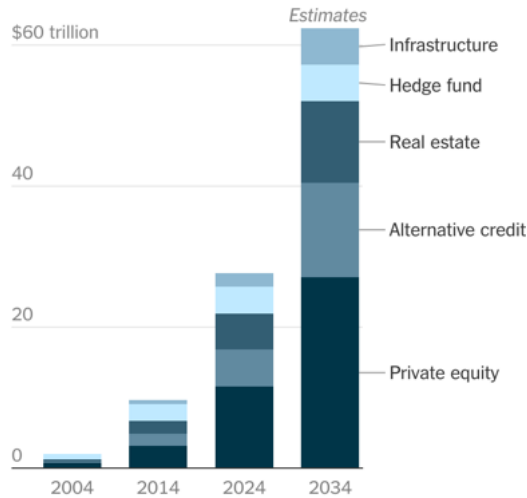
Global wealth by investor type, 2022



Sources: Preqin; GlobalData; Bain analysis

Projections about what this could mean for private market AUM growth are staggering. State Street’s survey results suggest “the ‘retail revolution’ will drive 50% of private market flows by 2027.” Deloitte expects retail investors’ allocations to private markets to reach \$2.4 trillion in the US by 2030, up from \$80 billion today. And Bain projects **retail interest to drive another tripling of private market AUM over the next decade, reaching a total of \$62 trillion globally by 2034.**

**Global private market assets under management**

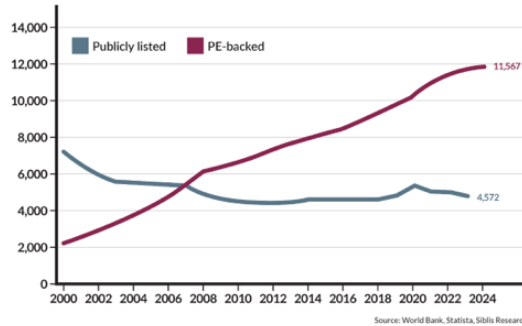


Source: Bain & Company • By The New York Times

Advocates of private-market democratization undoubtedly make a compelling argument: **Why shouldn't mom-and-pop investors have the same access to private market opportunity as institutions and the ultra-wealthy?** Yet, beneath that constructive aim are troubling questions: How much will a flood of retail capital degrade deal quality and exacerbate existing issues with fee and return transparency? Can funds meet the greater liquidity demands of retail investors during a market dislocation or are we one severe sell-off away from an event with contagion potential? What other less obvious vulnerabilities could emerge from this wave of product innovation?

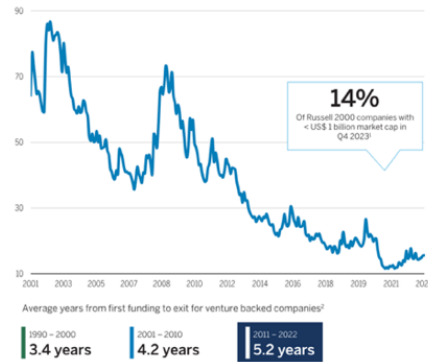
These are some of the questions that inspired this report. **We believe private markets are now an essential diversifier for investors—institutional or retail.** They offer a broader opportunity set than public markets (chart on the left). They offer greater dispersion and therefore, alpha potential. Private and public markets are converging, and we see little chance that progression won't continue. The self-perpetuating cycle that has undergirded the growth of private markets appears nowhere near an end: The more capital that flows to private markets, the longer companies are incentivized to stay private. And the longer companies stay private, the more capital will chase private market opportunity. Just consider that **the average age of venture capital backed companies at IPO has increased by more than 50% since the late 1990s.** That's a lot more growth potential seized in private markets before public market investors have access (chart on the right).

PE-Backed Company Count (Excludes VC) vs Domestic Firms Publicly Listed on NYSE and NASDAQ



Source: Johnson Financial Group

Companies are staying private longer and accruing more value while private  
Percent of Russell 2000 companies < US\$ 1 billion market cap



Source: Wellington Management

However, we also believe **the meteoric growth of private markets over the past decade has been, in part, underpinned by questionable, if not clearly disingenuous claims.** For one, misleading performance metrics like the Internal Rate of Return (IRR) have been bandied about as proof of long-term private market outperformance relative to public markets. **The reality is opaque and highly manager and market-era dependent.** For another, mark downs have been manipulated to create an illusion of lower volatility—or as AQR co-founder Cliff Asness has dubbed the practice, “volatility laundering.”

We believe retailization will increase private-market downside risks, requiring deeper recognition of the asset-classes’ dynamics to realize outperformance. We also believe **the industry is unlikely to provide the necessary transparency to facilitate that recognition.** The incentives are too blinding. Relentless fee compression has depressed profitability for public-market managers. Highly concentrated equity returns have limited the alpha potential of active managers. Persistently low volatility has meant the same for active fixed income managers. Private markets offer higher fees and less benchmark accountability. Which begs the question (as naïve as it may sound): **Is the industry racing to democratize private markets because of the upside potential for clients or because of the upside opportunity for the industry?**

So, we dissected the Trump administration’s deregulatory efforts and the industry’s efforts to position for a retailized future. We dug into private market performance, volatility, and systemic risk factors. We broke down how we see the opportunity set across private market categories, from private equity, private credit, and venture capital to infrastructure, natural resources, and real estate. Overall, we believe retailization will drive AUM growth, but at a lower rate than many prognosticators expect and institutions hope. Performance, liquidity, volatility, and

retail investor risk and opportunity incomprehension will all hold back inflows. Nonetheless, **private market investors will face a more idiosyncratic environment moving forward, one requiring greater scrutiny and more strategic intent in manager, fund, and asset selection.** What follows is our roadmap for investing in that future.

# THE ENABLERS: DEREGULATION AND INDUSTRY INNOVATION.

Deregulation plus product and platform innovation are essential to unlocking retail capital for private market investment. Yet, despite the flurry of recent progress, we believe skepticism and patience are both paramount.

## The politics

*The Trump administration is breaking down regulatory barriers to retail access to private markets. Yet, retailization is neither a new trend nor a US-exclusive trend.*

In early August, Donald Trump signed an executive order, “Democratizing Access to Alternative Assets for 401(k) Investors.” In it, the administration makes its intentions clear:

*Burdensome lawsuits that seek to challenge reasonable decisions by loyal, regulated fiduciaries, and stifling Department of Labor guidance issued since my first term...have denied millions of Americans opportunities to benefit from investment in alternative assets. Such assets are an increasingly large portion of the portfolios of public pension and defined-benefit retirement plans and offer competitive returns along with diversification opportunities...**My Administration will relieve the regulatory burdens and litigation risk.***

The order gives the Department of Labor—in consultation with the Treasury, SEC, and “other Federal regulators”—180 days to come back with a framework for rules, regulations, and guidance that “carry out the policy objectives” of the EO. **As of year-end 2024, US retirement savers had \$8.7 trillion in 401(k) plans**, according to the Investment Company Institute. There’s good reason to believe the administration’s 401(k) deregulation will trigger a significant allocation shift. As Schrodgers found in its 2025 US Retirement Survey, **45% of investors participating in 401(K) plans said they would invest in private equity and private debt investments** if their plan provided access to these assets.

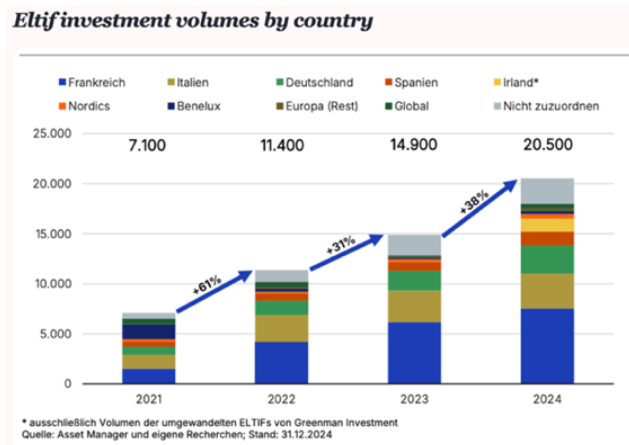
The 401(k) EO is by no mean the only deregulatory effort underway. As BlackRock CEO Larry Fink has said, private assets have long been “locked behind high walls, with gates that open only for the wealthiest or largest market participants.” A panoply of bills are working their way through congress to break down those walls. They include bills trying to expand the investor base for venture capital and raise thresholds for closed-end funds. Yet, **it’s two bills aimed at redefining what it means to be an accredited investor that could prove most impactful.**

Since 1982, only individuals with a net worth exceeding \$1 million (excluding the value of their primary residence) or an annual income exceeding \$200,000 (\$300,000 for households) have been allowed to invest in private markets. **Roughly 18% of US households currently qualify as accredited.** That appears likely to change. In July, the Equal Opportunity for All Investors Act passed the House in a unanimous vote—**striking bipartisanship in an era of extreme polarization.** The bill directs the SEC to create a new pathway for individuals to qualify as accredited investors by passing an exam that tests their financial knowledge, instead of relying solely on wealth-based criteria. It now awaits a Senate vote. Meanwhile, the Accredited Investor Review Act was approved by the House Financial Services Committee in late May. It would revise the Securities Act of 1933, giving the SEC authority to redefine accredited investor parameters every five years. The bill awaits a full house vote.

While Trump and the Republican majority have brought new momentum to retailization, it’s by no means a new trend. For years, **governments across the globe have been taking steps to increase retail access to private markets.** For one, over the past decade-plus, crowdfunding frameworks—rules for how businesses, startups, or individuals can raise money from a large number of small investors—have been put in place everywhere from the US, EU, and Canada to Australia, the UAE, Saudi Arabia, Brazil, and Singapore.

Yet, it’s the EU’s 2015 introduction of European Long-Term Investment Funds (ELTIFs) that provides the best indication of what’s likely to come in the US. Deloitte estimates that **retail investor exposure to private assets in the EU now totals just over \$1 trillion, more than 10 times the exposure of US retail investors.** That’s despite EU retail investors possessing roughly one-fourth the wealth of US retail investors—\$10 trillion versus \$38 trillion—and European households traditionally maintaining a much lower investment risk profile than US households—roughly 80% to 90% of European wealth is typically allocated to guaranteed or low-risk products, according to S&P Global. **As of 2023, the proportion of EU retail client assets invested in private markets stood at 7.7% on average, just below the 9.2% institutional client weighting,** according to a Neuberger Berman survey of European fund selectors. The EU has made efforts to only increase that momentum. In 2024, ELTIF 2.0 took effect, which raised investment maximums, lowered investment minimums, and removed restrictions on cross-border marketing of funds. ELTIF AUM grew 38% last year in the wake of those regulatory changes. It is testament to the

retail appetite for private market opportunity. ELTIFs also reflect the need for patience as deregulation calibrates to match retail investor demand and fund providers innovate to reduce friction and diversify offerings.



## The industry innovations

*Behemoth institutions are forging partnerships and deploying innovative strategies to maximize recruitment and accommodation of retail investment in private markets. Meanwhile, upstart innovators are bringing to market novel solutions that could transform retail access.*

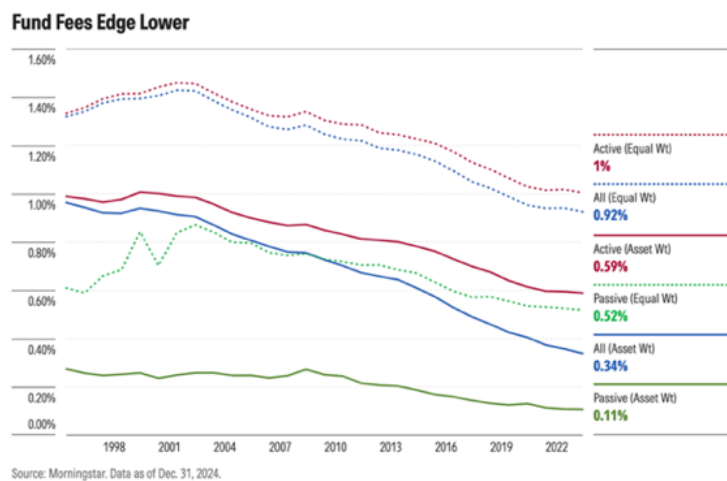
The pace of partnership announcements in recent months has been staggering. For just a few marquee developments:

- In February, State Street and Apollo launched a “first of its kind” private credit ETF, which skirts SEC illiquid investment restrictions by guaranteeing Apollo will buy back loans if needed. They filed for a second private credit ETF in May.
- In April, KKR and Capital Group launched two funds blending public and private credit, the partnership’s first step in a long-term effort to “synthetically [merge public] and private capabilities,” as Capital Group’s CEO Mike Gitlin told *The FT*. They’re now seeking SEC approval for an interval fund that combines public equities and private equity. It is slated for launch in early 2026.
- Also in April, Wellington Management, Vanguard, and Blackstone filed for SEC approval of a multi-asset interval fund, the collaboration’s first step to “broaden access to sophisticated multi-asset portfolios ordinarily available to the largest global institutions.”

- In September, Goldman Sachs and T. Rowe Price announced a collaboration with the former investing \$1 billion in the latter’s stock as they partner “to offer private market products to retail investors,” as the companies said in a statement.

To our mind, the T.Rowe/Goldman tie-up is particularly illustrative of the industry dynamics driving this partnership wave. T. Rowe’s stock has fallen by roughly 50% since 2021, driven in large part by relentless fee compression. Just in 4Q24, T. Rowe saw its annualized effective fee rate drop to 40bps as its higher fee equity mutual funds—rates typically between 60 and 80bps—saw significant redemptions. Goldman gives T. Rowe immediate access to a broad range of higher fee private market capabilities. And T. Rowe gives Goldman access to the retirement funds the Trump administration is poised to unlock for private market investment. Or as Running Point Capital Advisors CIO Michael Ashley Schulman put it to *Reuters*: “**Goldman did not buy a friend, it bought a fast lane into 401(k) distribution** since two-thirds of T. Rowe's assets come from retirement accounts.”

As is well known, relentless fee compression has taken a seismic toll on financial industry profits. Over the past two decades, the average expense ratio paid by mutual fund and ETF investors has been roughly cut in half, falling from 0.83% to 0.34%, according to Morningstar calculations. Just with 0.02% fee compression between 2023 and 2024, the industry lost an estimated \$5.9 billion in revenue. **This suggests that industry revenue would be nearly \$150 billion higher today if fees reverted back to 2005 levels.**

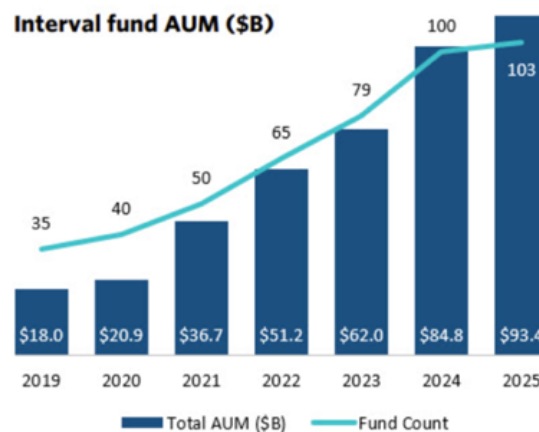


It's clear why so many asset managers view private markets as their fee-compression salvation. According to Prequin calculations, **private equity funds with a 2024 vintage had mean management fee rates of 1.74% for**

**buyouts and 1.93% for growth equity strategies.** As for private credit, the mean investment period management fee was roughly 1.5% for direct lending and 1.7% for non-direct lending funds. Today, **“alternative investments represent 50% of industry revenue despite not even eclipsing one-fifth of the AUM,”** according to CAIA.

Retailization will drive fee compression. According to a 2023 survey by Mergermarket, **91% of PE executives expect democratization to impact fees.** Fees will be a primary battleground for fund differentiation. Given the number of competitors lining up to recruit retail dollars, we could see fees fall faster than they did in public markets, with **our baseline assumption that fees halve in a decade rather than two decades.** New entrants will still realize upside as fees stay higher than for public-market funds. However, it will drag on private-market incumbents. In both are Deregulation and US Reshoring reports, we made bullish arguments for megacap financial institutions. **We’d skew that exposure towards behemoth banks and away from publicly-listed private-market incumbents.**

Private market fund innovation has been accelerating for years. The 10-year closed-end fund structure had always been the bedrock of private market investing. Over the past decade, everything from hybrid funds, parallel funds, and evergreen interval funds to sidecars, feeder funds, and funds-of-private-funds have proliferated. Given blurry lines between fund categories and the opaqueness of private markets, stats encapsulating the growth trajectory of these innovations are difficult to come by. For just a couple that begin to tell the story: Preqin calculates that **40% of the private market funds launched in the 1H23 were hybrid funds, up from 20% in 1H21.** Meanwhile, just between 2017 and 2023, 415 new evergreen interval funds were launched. As of May, evergreen interval fund AUM was nearing \$100 billion, up from just \$18 billion in 2019, according to PitchBook data.



Source: PitchBook and Morningstar • Geography: US • As of January 31, 2025

Asset manager fund innovation has and will continue to revolve around three primary goals, all meant to broaden the investor base for private markets: 1) Make funds more open-ended and therefore, accessible to any interested investor at any time. 2) Lower investment minimums so more wealth cohorts can participate. 3) Increase liquidity and therefore, make funds a better match for the more unpredictable capital needs of individual investors. As CAIA CEO John Bowman summed up about the innovations driving public and private market convergence: **“Asset managers are transforming into multi-strategy hypermarkets.** Specialist or single-strategy investment firms are finding themselves marginalized or risking obsolescence as those lanes blur or disappear completely.”

Yet, it’s not just behemoth legacy asset managers that are participating in the innovation arms race. **Robinhood CEO Vlad Tenev has dubbed private markets, “the greatest remaining iniquity and opportunity in our capital markets.”** In June, Robinhood announced a rollout in Europe of tokenized equities—blockchain-based derivatives of public and private assets. The company plans to tokenize thousands of private assets in the future. As Senior Vice President of Robinhood Crypto Johann Kerbrat told *The NY Times* in July: “This is just the beginning...The beauty of this technology is that we can adapt it to any financial instruments.” Hamilton Lane has also been pursuing tokenization since 2022. This year, it announced partnerships with platforms Securitize and Republic to offer tokenized versions of its private equity funds.

To our mind, **tokens are more likely to play a niche role for retail investors, at least in the short- to medium-term.** They could gain traction enabling fractional ownership and 24/7 trading of well-known and widely-reported-on private companies, namely tech unicorns like Open AI, Anthropic, SpaceX, or Stripe. However, we see them as a poor fit for the diffuse world of private investing, presenting valuation accuracy and underlying liquidity issues, or as *Forbes* columnist Azheem Khan warned in a May op-ed: **“Tokenization may become a way to transfer illiquidity risk under the appearance of innovation.”**

Trading platforms appear the true tech battlefield. **Upstarts are now building secondary digital marketplaces for alternatives in a race to hyperscale and establish user-base moats.** The likes of Moonfare, Opto, and Yieldstreet offer lower-minimum trading platforms for institutions and accredited individuals to invest in private market funds. The likes of Forge Global, Destiny, Augment, Hiive, and EquityZen have platforms that act as middlemen between retail investors and employees of private companies looking to sell shares. Robinhood will undoubtedly enter the fray. Then there are the platforms backed by legacy institutions, from iCapital to Nasdaq Private Markets to Apollo’s private credit platform announced earlier this year. **As Robinhood’s rise in public markets attests, this is likely a winner-take-most race and we’d expect a digital native to win that race and realize meteoric growth.**

Between large institution fund innovations and platform evolution, we expect a spike in retail investment as soon as deregulation unlocks access. However, the sustainability of that growth will come down to the returns private market allocations generate for retail investors and there, we see reason for skepticism. **We expect retail inflows to not meet the lofty longer-term expectations** of the likes of State Street, Deloitte, and Bain cited in the Executive Summary. Retail will drive AUM growth, but not at the rate so many asset managers are betting on.

## THE CONCERNS: PERFORMANCE, VOLATILITY, AND SYSTEMIC RISK.

*The industry's mantra now verges on orthodoxy: private markets outperform in the long term and are less volatile along the way to those higher returns. Yet, some of the numbers bandied about in support of this are dubious at best. We expect private market performance to continue deteriorating in the years ahead. Manager, fund, and asset selection will matter more as retailization accelerates.*

### Do private markets outperform?

In an article in May, the *FT* dissected Internal Rate of Return (IRR) claims made by both KKR and Apollo in 10-K filings. First, they quoted KKR: “From our inception in 1976 through December 31, 2024, our Private Equity and Real Assets investment funds with at least 24 months of investment activity generated a cumulative gross IRR of 25.5%, compared to the 12.2% and 9.5% gross IRR achieved by the S&P 500 Index and MSCI World Index, respectively, over the same period.” As for Apollo, it claims a 39% gross IRR generated by its private equity funds from inception through year-end 2024. The *FT* contextualized these numbers:

***Across almost all regulatory and marketing material filed by private equity, awe-inspiring IRRs are common. Apparently, these private equity firms have managed to defy the laws of mathematics, economics—and reality. Since most people typically don't have a good grasp of compounding, it might be helpful to express these numbers in dollars to show how fantastical they really are. If KKR's first \$31 million fund from 1976 had compounded at 26% a year it would be worth \$2.6 trillion today. Add in its second \$350 million fund and you get \$13 trillion—more than the global PE market. Apollo's first funds would now be worth \$74 trillion, just shy of global GDP.***

**There is no irrefutable, bias-free methodology for calculating private market versus public market returns.** IRR has long been one of the industry's favorite reference points. To again quote the *FT*: "It is a mathematical artefact. It assumes every dollar distributed is reinvested at the same rate it was earned. It's not realistic, not additive, not comparable to market indices—and not designed to be used the way the industry uses it." Meanwhile, unbiased calculations are held back by a lack of data. By and large, private investors don't disclose fund returns nor do private companies report performance. In turn, private-market investment return calculations are predicated on extrapolated data and result in wildly divergent estimates.

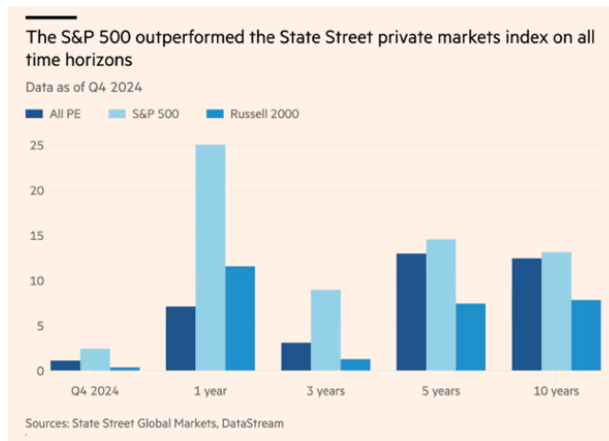
In an often cited 2005 paper, MIT researchers found that private equity buyout funds slightly underperformed the S&P 500. In 2012, Chicago Booth researchers disputed that analysis, claiming new data told a totally different story—between 1984 and 2008, the average US buyout fund outperformed the S&P 500 by at least 20% over the life of the fund. Then in 2023, Tulane University researchers developed yet another methodology they dubbed "direct alpha," which compares cash flows—both contributions and distributions—with what the dollars would have been worth if they'd been invested in a public equity index during the same period. Their conclusion after studying more than 2,400 buyout funds: direct alpha was 3.1% using a broad market benchmark and 1.7% based on industry indexes. To quote a *Bloomberg* synopsis of the finding: "Still good numbers, but for many investors it may be too little reward for locking up cash in illiquid and often leveraged assets for long periods."

To our mind, the private versus public performance debate misses the point and **allocating based on the assumption that private markets outperform is a path to underperformance.** As the legalese goes, past performance is not a guarantee of future returns. The more money that floods to private markets, the more deal competition increases and therefore, the greater risk of performance deterioration. Evidence suggests this has already been the case given the tripling of private market AUM over the past decade. Again, performance methodologies vary. **The exact numbers matter less than the trajectory of the numbers.** And based on many calculations, private market returns are on a downward trajectory.

Higher rates have repeatedly been credited for that trajectory. However, it began long before the pandemic. As Bain calculated in its 2020 Global Private Equity Report: "Since 2009, when the global economy limped out of the worst recession in generations, US public equity returns have essentially matched returns from US buyouts at around 15%. **US buyout returns have converged with public equity returns over the current cycle,** closing a three-decade gap in performance."

Rising rates have certainly not helped those performance challenges. As the *FT* reported in June, private market funds lagged the S&P 500 for the last three months of 2024, as well as on a one, three, five, and 10-year basis (chart below). **It was "the first calendar year that private market funds have underperformed the stock index**

across all measured time horizons since 2000. The gap in performance last year between the two indices was also one of the largest on record.” As we argued in our reports on Deregulation and US Reshoring (learn more [here](#)), we believe inflation will remain persistently above Fed targets and therefore, rates will remain higher for longer, regardless of a near-term cutting cycle. **This combined with any private market inflow acceleration driven by retailization should continue to put downward pressure on private market returns.**



Source: *The Financial Times*

## Are private markets less volatile?

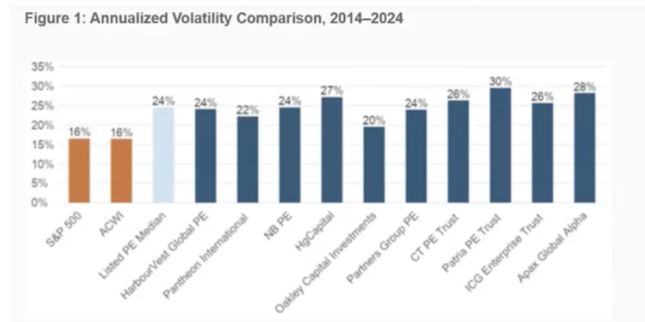
As problematic as many private market performance claims may be, the widespread assertion that private markets are less volatile than public markets requires an even greater suspension of disbelief. It’s hard to imagine that many backers of private markets over the past decade-plus actually subscribed to the lower-volatility assertion. It’s too irrational and easy to disprove. Yes, data reported by the industry suggests private equity investments since the GFC have been far less volatile than the S&P 500. However, **that’s obviously the byproduct of infrequent valuation adjustments, not a reflection of true market-value stability.** In June, the *FT* explored 2022’s reported private credit returns as a reflection of the absurdity of private market valuations:

*The lack of trading and public data permits more...finessing around valuations and allows the industry to put up returns like the [below]. Yes, we are supposed to believe that in a year when equities and bond markets were getting brutalized—with every major segment suffering double-digit losses—private credit somehow magically eked out positive returns.*

	Calendar year returns				
	2020	2021	2022	2023	2024
<b>Global private-equity funds</b>					
Venture capital	33.3%	40.2%	-8.4%	5.9%	5.6%
Expansion capital	58.5%	49.8%	-20.6%	-2.1%	5.1%
Buyout	17.6%	29.0%	-10.9%	4.3%	8.5%
Buyout	24.1%	37.3%	-1.4%	9.7%	5.5%
MSCI ACWI IMI	16.8%	18.7%	-18.0%	22.2%	16.9%
MSCI World Small Cap	16.5%	16.2%	-18.4%	16.4%	8.6%
<b>Global private-credit funds</b>					
Senior	5.9%	15.5%	3.8%	10.2%	6.9%
Mezzanine	6.8%	8.1%	3.3%	12.0%	5.7%
Distressed	8.2%	16.0%	5.3%	10.8%	8.3%
Distressed	5.6%	21.6%	3.5%	9.0%	7.0%
MSCI USD High Yield Corporate Bond Index	7.2%	4.7%	-11.8%	12.8%	8.3%
MSCI USD Investment Grade Corporate Bond Index	10.2%	-1.1%	-15.3%	8.3%	2.5%

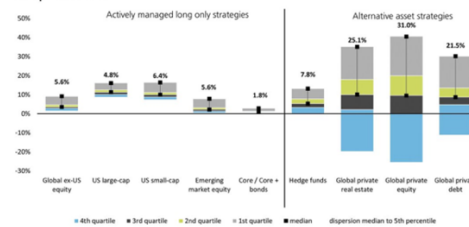
Investing in small, highly-leveraged private companies is obviously riskier than investing in large, less-leveraged public companies. For stats that contextualize the size and leverage differences between private and public companies: Globally, there are more than 215,000 private equity- and venture capital-backed companies versus only 8,800 public companies in the MSCI ACWI. Yet, **the total capitalization of private equity and venture capital is just 12% of public equity markets**, according to HarbourVest. As for leverage, we quote MSCI: “In the 10 years through 2023, **global buyout companies had an average leverage ratio of 1.74**; that is, on average, 74 cents of borrowing for every dollar of equity investment. By comparison, global small-cap public companies had an average leverage ratio of 1.4 over the same period.”

The volatility that results from size and leverage differences is readily apparent in public markets where more leveraged small-cap companies have less predictable and more volatile earnings than less-leveraged large-cap companies (chart on the left). It’s also readily apparent in bankruptcy statistics—**private equity-backed companies accounted for 11% of all US corporate bankruptcies in 2024** despite accounting for 6.5% of the US economy. And it’s readily apparent in the performance of **private market funds listed on the London Stock Exchange, which exhibited volatility roughly eight points higher than the S&P 500 between 2014 and 2024**, according to Verdad Advisors calculations (chart on the right).



To be clear, we do not believe that so-called “volatility laundering” is a pure evil. It can be a positive for investors and allocators. Less reported valuation volatility can translate to less short-term scrutiny from clients, bosses, and boards and therefore, more steadfast commitment by investors to long-term convictions. It is also a symptom of and contributor to the relative inefficiency of private markets, which is an opportunity for skilled managers. From a lack of standardized reporting and infrequent valuation adjustments comes exploitable price disconnects. Data support this potential. **Private market manager dispersion has long been far higher than in public markets:**

Fig. 8: Public vs. private manager fund returns dispersion



Source: Cambridge Associates, Morningstar Direct, UBS. Data covers period from 1 Jul 2008 through 30 Sept 2022.

Which brings us to the implications of democratization. Retail investors lack the research resources or the direct access to private-market stakeholders necessary to scrutinize fund holdings and diagnose the risk factors of private-market allocations. That is, unless private market stakeholders significantly increase publicly-available data. To quote Stamford Finance Professor Amit Seru:

*Private markets run on trust in marks. Institutional LPs have teams of analysts to interrogate those marks, assess leverage structures, and model exit risks. Retail investors do not. Without equivalent access to portfolio-level detail, they are left taking sponsor valuations on faith. **This is dangerous in markets where assets don’t trade, valuations are model-driven, and small shifts in assumptions can change returns dramatically.***

The industry is already preparing to provide greater transparency. For a few examples: Blackrock acquired private market data and insight provider Preqin. JP Morgan has announced it will expand its research offerings to include private companies. And just last month, S&P announced a partnership with Cambridge Associates and Mercer on an analytics platform. As Blackrock’s Larry Fink wrote in his 2025 letter to shareholders: **“Clearer and more timely data will help catalyze the indexability of private markets.”**

It will also likely reduce the inefficiency of private markets and therefore, **compromise the alpha potential that has undergirded allocator enthusiasm over the past decade**. We believe increased efficiency has already played a significant role in the private and public equity performance gap narrowing over the past decade—more capital in private markets has meant more deal competition, more rigorous due diligence, and in turn, more accurate valuing of assets. Retailization will accelerate those efficiency gains. Again, we quote Seru:

*Private equity’s success depends on patient, locked-up capital insulated from the mood swings of public markets. Retail flows bring the opposite: liquidity demands, shorter investment horizons, and a political reflex for heavier oversight. Retail access would invite SEC demands for quarterly valuations, governance boards, and public disclosures...The result: **a once-nimble industry forced into the same straitjacket that constrains public markets.***

We believe **the performance gap between top- and bottom-quintile private managers will always exceed the performance gap in public markets**. It is a natural byproduct of higher-risk investments in small, leveraged companies. They can grow rapidly or fail rapidly. As Morningstar has calculated, the average performance of private equity funds has long been higher than the median performance because “a few big winners [pull] up the average” (chart below). However, **we also believe escalating public/private strategy convergence will translate to increasing performance and volatility convergence**. Meaning, failing to invest with a top private market manager moving forward will mean liquidity constraints alongside par or subpar returns relative to public markets—or to requote *Bloomberg*: “too little reward for locking up cash.”

### PMEs From Major Academic Studies

Average results look better than medians thanks to right skew in returns.

Study	Published Year	Period Examined	Buyout		VC		Buyout		VC	
			Median - S&P 500	Median - R2000V	Median - S&P 500	Median - R2000G	Avg - S&P 500	Avg - R2000V	Avg - S&P 500	Avg - R2000G
Private Equity Performance: Returns, Persistence, and Capital Flow	2005	1980-2001	0.80	N/A	0.66	N/A	0.97	N/A	0.96	N/A
How Do Private Equity Investments Perform Compared to Public	2015	1984-2010	1.09	1.01	0.87	0.87	1.18	1.08	1.23	1.3

Source: Cited academic studies. Data as of 05/31/2025. Averages and medians are inclusive of the whole sample of funds and not vintage-dependent.

Source: Morningstar

## How concerned should investors be about systemic risk?

In June, researchers from Moody's Analytics, Harvard, and NYU released a concerning report arguing that private credit could become "a locus of contagion" in the next financial crisis. We quote the report's opening lines:

*The private credit market has rapidly expanded in recent years, becoming an established source of corporate loans to middle-market firms, a key financing tool for private equity transactions, and a testing ground for new lending strategies...Private credit has thus grown in systemic importance as it develops linkages across the financial system while remaining less transparent, less liquid, and more reliant on structures that make its risks more difficult to evaluate than those of other types of credit intermediaries...While the scale of private credit is still small and fund leverage appears modest, **the direction of travel points toward growing systemic importance as it expands beyond middle-market corporate lending and begins to tap public market funding.***

Moody's is by no means alone in warning about potential financial instability risks that could emerge from the retailization of private markets. By and large, most fear a similar progression: Rapid retail-driven AUM growth will cause private market deal quality and debt profiles to erode. As that progresses, private market opacity will hide mounting risks, leading to a lack of awareness and in turn, a lack of accountability and market correction. That is, until significant market stress triggers accelerating fund outflows that run headlong into the inherent illiquidity of the underlying assets, causing a liquidity crisis with contagion potential. It is a progression with echoes of the GFC.

To be clear, we are not predicting a near-, medium-, or long-term systemic event. Only time will tell whether today's concerns lead to a crisis tomorrow. For some fundamental reasons, we believe private markets remain less prone to systemic-level vulnerabilities than public markets. They're far smaller—\$13.2 trillion in AUM globally versus the roughly \$230 trillion in global fixed income outstanding and public equity market capitalization. Private markets also offer diverse exposure across industries and therefore, present less concentration risk in the event of excessive enthusiasm. However, we do believe **the reasons for systemic concern are also valuable investment considerations—potential catalysts for underperformance even if they never lead to a systemic event.**

Which brings us back to private credit. Especially as rates have risen and macro uncertainty has intensified in recent years, private-credit stakeholders have often sung the same tune about the defensive virtues of private lending. It offers investors regular cash distributions. Those distributions get better as inflation rises because much of the debt is floating rate. Meanwhile, to quote Goldman Sachs: "Lenders in the private markets are less likely to make loans to cyclical companies that are often more heavily impacted during volatile periods...And while private

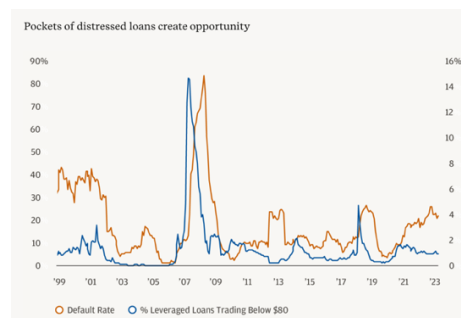
credit mostly lends to smaller, middle-market companies, they aren't lower quality." Finally, even if loans run into trouble, private credit is senior lending—it sits at the top of the capital stack and creditors will be paid back first.

Yet, a problematic question remains: **Can those defensive attributes hold as private credit AUM increases?**

Private credit has grown 14.5% annualized over the past decade and now accounts for roughly 9% of all corporate borrowing, according to JP Morgan. Already, **evidence suggests that rapid growth has caused deal quality to erode.** In September, First Brands saw its loans plunge to less than 50 cents on the dollar as reports emerged that the car parts supplier was preparing for bankruptcy. As *FT* commentator Robert Armstrong warned, First Brands may be a symptom of a growing vulnerability:

*Perhaps one lender and one borrower was the standard model in the early days of private credit. But as the sums have got larger and larger, **multiple lenders are participating in deals, increasing the chance of the messy workouts and creditor-on-creditor violence** that characterises public debt markets. This in turn makes one wonder if [one special ingredient of private credit] is as true now as it once was—private lenders write tight, custom contracts that protect them in ways standard contracts of the bond and syndicated loans markets cannot. More generally, First Brands illustrates that there is no magic in credit markets. If a lender is earning above-average returns, most of the extra return is probably coming from either using more leverage or taking more credit risk—not from special skill or innovative product design. **As more and more assets rush into private credit, expect this truism to be demonstrated repeatedly.***

Bigger-picture stats bolster this concern. The share of small, middle-market companies with weak liquidity climbed roughly ten percentage points to over 30% between 2023 and 2024, according to Moody's. Meanwhile, private credit default rates have been rising steadily for years (chart below). Fitch's Privately Monitored Rating default rate—which is based on approximately 300 issuers in its PMR portfolio—rose to 9.5% in 2Q25, up from 7.8% in 1Q25. **That's the highest level since Fitch recorded the first default in the PMR portfolio in 2019.**

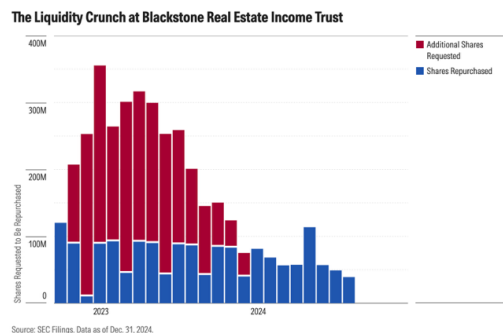


Source: JP Morgan

Does this add up to evidence of systemic risk? Likely not at this point and maybe never. To again quote Armstrong: “Private credit lenders use much less leverage than banks, and do not use short-term deposit funding for longer-term loans, so private lending reduces systemic risk.” Credit quality has worsened, but overall strength is still better than pre-pandemic, according to Moody’s. However, we do believe it is evidence that **private credit investors need to proceed with greater caution and increase the quality of their credit exposure**. As retailization drives continued private credit AUM growth, that will become only more imperative.

Yet, deal quality is not the most cited reason for systemic concern, but rather liquidity risk. The struggles of Blackstone’s Real Estate Income Trust suggest why this is for good reason. BREIT owns and oversees properties—multifamily homes, data centers, industrial real estate, etc. It is a non-traded, semiliquid fund that allows monthly redemptions of up to 2% of net assets under management (no more than 5% per quarter) alongside a very low minimum investment of \$2,500. When the Fed began raising rates in 2022, real estate values fell. This caused a sell-off in publicly-traded REITs—the Vanguard Real Estate ETF fell 26% on the year. BREIT showed reality-defying resilience, rising 8.4% on the year with only one down month (November). Investors clearly didn’t buy that paper stability. They began withdrawing assets to get out while the net asset value was still artificially high. For the next 14 months, redemption requests exceeded quarterly limits (chart below). The fund returned only 43% of what it was asked for, according to *The Economist*. **The event has compromised sentiment towards BREIT ever since**. To quote Morningstar:

*The managers successfully navigated the oversubscription period without incurring significant losses. However, since 2023, BREIT has underperformed public REITs. Its liquidity was supported in part by a \$4.5 billion investment from the University of California’s pension fund in January 2023. That capital could be used to manage redemptions and reduce the need for large asset sales. Investors should not assume that every semiliquid fund can rely on such institutional relationships for support.*



Source: Morningstar

BREIT is by no means the only fund that has instigated liquidity concerns. In 2024, Starwood Capital Group also had to impose redemption restrictions on one of its biggest funds, SREIT. With its NAV falling roughly 40% from its 2022 peak, SREIT was overwhelmed with redemptions. As of June of this year, it had sold off roughly \$1.6 billion worth of property (reportedly at significant discounts) and still had not returned \$850 million of requested capital.

**On a systemic level, liquidity concerns are akin to bank-run concerns.** What happens if a dislocation event causes mass fund redemptions that can't be met and then that snowballs into widespread panic? Again, only time will tell if that concern becomes a reality and we try in our reports to stay out of the realm of speculative fear mongering. Similar concerns have been raised about corporate bond ETFs for years and little has manifested beyond warning signs. However, **we do believe liquidity concerns will increasingly shape the return dynamics of private markets broadly.** In a June op-ed, *Bloomberg* columnist Matt Levine encapsulated why. (Note: he was commenting on the Moody's report quoted above and the sentences in quotation marks are quotes from that report):

*The worry is that “what has helped public markets has traditionally been frowned upon by private markets, which favor illiquidity premiums, price stability, small lending groups and discretion.” If you put retail investors in private assets, you will have to offer them “some degree of liquidity,” and since you don’t want the risk of potential mismatches, you will have to make private assets more liquid. You will need trading desks and secondary markets. **Prices will be less “stable,” as trading creates mark-to-market prices, and it will be harder for issuers to count on “small lending groups and discretion.” And instead of getting paid a premium for taking illiquidity risk, private investors won’t take that risk and won’t get paid a premium. The private markets will become more like the public markets, in good and bad ways.***

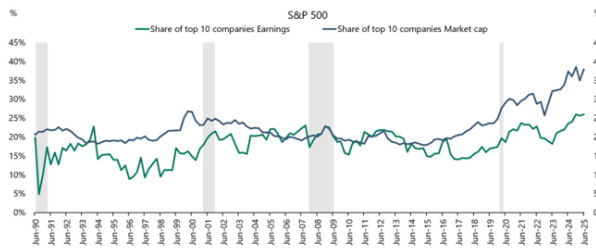
So, what does that mean for investors? On the top line, we **believe allocators should lean into undemocratized private market exposure over retail-targeted funds.** To put more specifics to that: seek closed-end fund opportunities with top-quintile managers and intensify scrutiny of everything from semiliquid funds to evergreen interval funds to hybrid funds. We will dive deeper into that conviction in the next section of this report. One way or another, we believe **today’s systemic concerns will prove increasingly valuable guideposts for private market risk mitigation.** We may not see compelling reason to fear a private-market-driven systemic event in the short term. But we do believe deal quality has declined and will continue to decline. Illiquidity risks will only increase as more novel funds are deployed by more private market stakeholders. Maximizing returns will mean navigating the asset classes’ relative opacity to understand and mitigate those risk factors.

# INVESTMENT CONVICTIONS

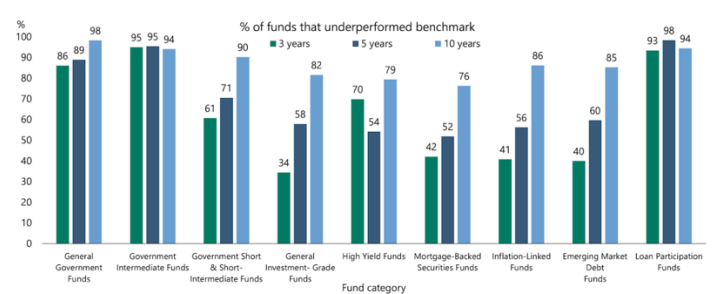
Despite the relatively bearish case we’ve laid out in this report, we maintain our conviction in a statement we made in the Executive Summary: private markets are now an essential diversifier for investors—institutional or retail. They offer a broader opportunity set than public markets. They offer greater dispersion and therefore, alpha potential. Meanwhile, **for most managers, public markets have been an alpha wasteland for almost three decades.** According to S&P data, only three years this century has a majority of active public equity managers outperformed their benchmarks—2005, 2007, and 2009. That tide appears unlikely to turn anytime soon, especially considering that US equity market concentration remains near three-decade highs (chart on the left). Fixed income tells an even more challenging story. According to July analysis from Apollo’s Torsten Sløk:

*Over the past 10 years, 98% of active managers in Treasury fixed income funds have underperformed their benchmark. For active managers in public investment grade credit, the share is 82%, and for active managers in public high yield, the share is 79%. In fact, the data [on the right] below from S&P shows that over the past decade, active managers in public fixed income have underperformed their benchmarks across all strategies.*

Concentration in the S&P 500 rising again



Percentage of public active fixed income funds underperforming their benchmarks



So, how do investors and allocators maximize private market alpha opportunity while mitigating risks in what is likely to prove a more challenging private market investment environment? In the pages that follow, we will dissect how we see opportunities across private market segments: private equity, private credit, venture capital, infrastructure, natural resources, and real estate. But before that dissection, we wanted to lay out strategic pillars that we believe transcend categories. As we’ve argued throughout this report, retailization is poised to progressively alter dynamics that have defined private market performance for decades. **Complacency today**

**could compromise returns for years to come.** Now is not too early to reconsider the assumptions that have been ingrained in private market decision making for decades.

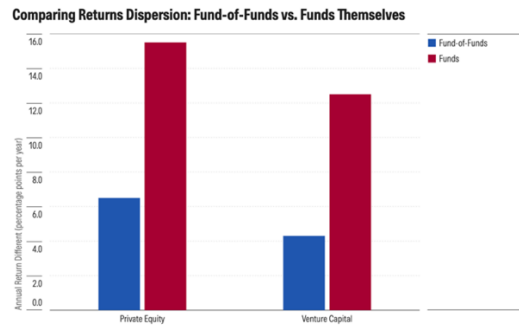
First, we believe many institutions have leaned too far into private markets. As Verdad's Dan Rasmussen has calculated: "If I'm index weighting, I should have about 4 to 5% of my US equity allocation in private equity and **if I'm 60/40 stocks/bonds, then I should have about 3% of my overall portfolio in private equity.**" Given the once largely untapped opportunity set in private markets and the exclusive access institutions and high net worth individuals had to that opportunity set, overweighting private markets made sense. As private market AUM has tripled, that justification has weakened. Retailization will further challenge significant overweights. Based on 2023 estimates, the average allocation to private markets in the US was roughly 17% for public pension funds and 23% for endowments. **We believe exposure beyond 15% merits intense scrutiny moving forward.**

The more private market stakeholders chase retail capital, the less privileged position institutions are likely to have. This is not lost on the industry today. As Anne-Marie Fink, chief investment officer of Private Markets and Funds Alpha at the State of Wisconsin Investment Board, told *Bloomberg* in August:

*It's a greater supply of investors who may negotiate less...**It could mean more competition to get into certain funds, less ability for us to negotiate fees and lower returns if funds chase too many deals.** We want to make sure retail growth doesn't impact the things that matter to us—performance, transparency, alignment and access.*

Which brings us to our second key conviction, one we touched on in the previous section of this report: **allocators should lean into undemocratized private market exposure over retail-targeted funds.** As fund providers try to bring greater liquidity and capacity to retail-accessible funds, it will likely reduce alpha opportunity. As Morningstar noted in a July report:

*You can get a sense of this trade-off—gaining access at the cost of potential upside—by examining the dispersion of private equity and venture capital fund-of-funds returns and comparing that against the performance dispersion of the private equity and venture capital funds themselves. What you find is that **there is a much narrower dispersion of returns among funds of funds than the funds themselves.** That's notable considering that funds of funds can be an outlet for investors lacking the resources to allocate to the top-shelf, hard-to-access private equity and venture capital funds.*



The last point is essential: access to the “top shelf”. As explored previously in this report, manager dispersion is and will continue to be greater in private markets than public markets. Investing with top-quintile managers is essential to realizing outperformance. Generally speaking, **we expect the best managers to prefer more traditional structures like closed-end funds**—structures that can protect long-termism, enable investment flexibility, and preference partnerships with known and aligned investors.

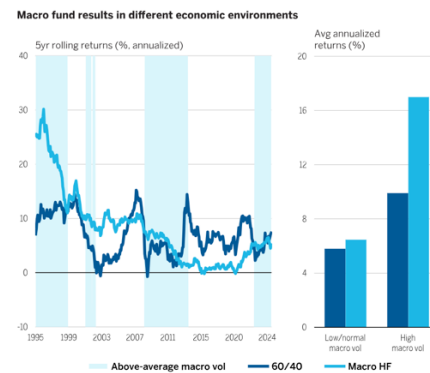
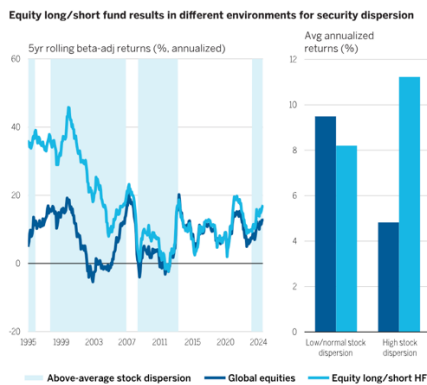
Generally speaking, closed-end funds offer more alpha potential than open-end funds. As MSCI calculated studying both: “Looking at a five-year measurement period from 2015 to 2020, **the 5th-to-95th-percentile spread in time-weighted returns for closed-end funds was 29%, compared to only 5% for open-end funds.**” As private-market stakeholders lean into open-end structures to accommodate retail dollars, we expect open-end fund dispersion to only decrease. Meanwhile, closed-end fund dispersion could increase as retail-driven AUM growth drives up deal competition and the best managers find ways to exploit froth while others fall victim to it.

This also plays a role in our next conviction: **lean into smaller, middle-market and more niche strategies.** We will dive deeper into this conviction as it relates to private equity in the pages to come. However, we believe it applies across private market segments. There are both retailization-related and thematic reasons undergirding this conviction. By and large, smaller, middle-market funds will be less inclined toward retail capital recruitment and therefore, are likely to lend institutions more fee negotiating leverage and present fewer conflicts of interest. Moreover, a niche focus is likely better equipped to avoid froth as retail investors drive up AUM, targeting overlooked opportunity instead of hunting where the crowds are gathering.

As for the thematic side of the equation, smaller funds are likely better suited to this economic environment—able to act with greater agility amidst persistent inflation and rates volatility. Then, there’s AI. As we dissected in our report on US Reshoring (learn more [here](#)), AI is likely to prove a democratizing force. **There will be many small companies that can realize AI-driven outperformance under the guidance of private market investors.**

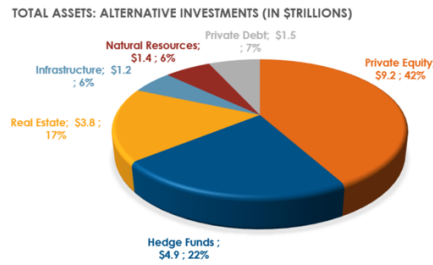
Which brings us to our final conviction: **consider increasing exposure to hedge funds in alts portfolios.** This report is focused on private markets so we will keep our remarks on hedge funds brief. They delivered lackluster returns during the post-GFC investment regime as stable growth, low inflation, and low rates limited exploitable dispersion. As macro volatility has increased in the post-pandemic investment regime, hedge fund returns have rebounded. To quote Goldman Sachs calculations: “Hedge funds have outperformed traditional 60/40 portfolios on a one-, three-, and five-year absolute basis, and even more so on a risk adjusted basis. **In the period from 2020 to 2024, 60/40 returns fell from 6.1% to 5.5%, while hedge fund returns increased from 4.8% to 9.3%.**”

We expect the stock/bond correlation to remain persistently in positive territory during this inflationary era, a seismic shift versus the past two decades when the stock/bond correlation remained in negative territory. In turn, we expect hedge fund outperformance relative to 60/40 portfolios to persist. In particular, **equity long/short and macro hedge funds appear compelling given their track records of better relative performance during times of high stock dispersion** (charts below). Of course, manager selection is paramount, especially given skyrocketing fees. As *Bloomberg* reported in August: “Passthrough-fee expenses disclosed to investors by the five biggest multistrat funds soared almost 40% over the past seven years.” As our former colleagues from Wellington have written about how they approach hedge fund manager selection: “We think the manager selection process should include both qualitative and quantitative analysis and focus on what we refer to as the ‘three Rs’: 1) the role the manager’s strategy will play in the overall allocation, 2) the risks the manager takes, and 3) the residual alpha potential (i.e., manager skill).”



Now, on to our key convictions private market segment by segment. What follows is not intended as a holistic roadmap to investing in each segment, but rather an opportunity to highlight how retailization will influence winner/loser dynamics. In our past reports on Deregulation and US Reshoring, we have highlighted more specific investment convictions across asset classes, regions, and sectors. By and large, those convictions are also relevant

to private markets. We will continue to provide actionable specifics in our reports to come. Finally, one more reference point of value—a chart from CAIA that shows a segment-by-segment breakdown of private market AUM percentages:



## Private Equity:

In one form or another, we came across this quote repeatedly researching this report: “Many private equity players have raised their last fund, they just don’t realize it yet.” Arguably, this is the most challenging downcycle in the industry’s history. According PWC estimates from June, **PE firms have roughly \$3 trillion invested in 30,000 companies and in a typical M&A cycle, \$1 trillion would have already been put back into the market.** There have been some bright spots in 2H25, led by the largest leveraged buyout in history—Electronic Arts. Yet, with under \$900 billion in exits so far this year, the industry is still far below the \$1.5 trillion annual exit run rate pace that would be required to truly begin unwinding its \$3 trillion asset pile. Distribution challenges have sapped fundraising. Currently, more than 18,000 private capital funds are seeking \$3.3 trillion, according to Bain. Through the first half of 2025, PE funds worldwide had secured just over \$420 billion, according to S&P Global.

Rapidly rising rates in 2022 and 2023 catalyzed the industry’s struggles. Excessive enthusiasm during the low-rate regime, peaking during the COVID years, is playing a major role in the severity of the downturn. Bloomberg published the following anecdote in September. It encapsulates the industry’s struggles broadly:

*When Insight Partners tried to raise another \$20 billion flagship fund, it found itself offering mea culpas. Months into the campaign, the software-focused private equity firm conceded **it had invested too quickly before interest rates rose, buying assets near a market peak.** Executives vowed to focus on returning capital. But contrition wasn’t enough for some clients. Even after*

*trimming ambitions to \$12.5 billion from \$15 billion for an era of fewer deals, the firm's 13th fund closed in January with about \$11.5 billion.*

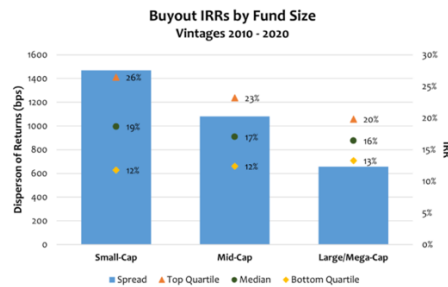
In June, the FT's editorial board published a call to action for the industry. The op-ed was titled: "It's time for private equity to go back to basics." Since 2023, many have hoped a macroeconomic shift is all that's required to revive the industry's fortunes. Yet, the Fed started a cutting cycle in 2024 and dealmaking saw only a slight resurgence. Then Trump came to office promising a pro-business agenda led by deregulation and still the response has been muted. As we've argued previously, we believe we are in a new investment regime, one defined by persistent inflation and macroeconomic uncertainty. Investors cannot count on a return to PE's Goldilocks-era heyday. We're in agreement with the FT:

*Rather than twiddling thumbs, some PE firms are resorting to innovative—and risky—methods of generating liquidity...This includes creating so-called continuation vehicles and net-asset-value loans...These strategies buy time, but they are just a sticking plaster...**To thrive, PE will increasingly need to go back to its roots: unearthing companies with potential and building real operational value.***

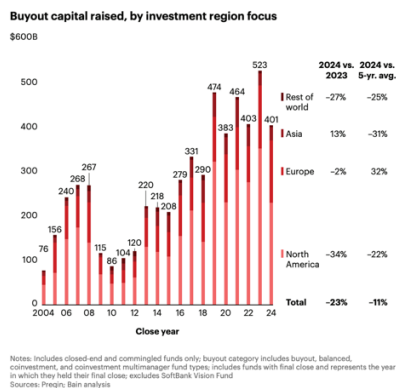
As we've explored throughout this report, there are myriad reasons for today's intensified retailization push, not least of which is Donald Trump's reelection and the deregulation agenda he's brought to office. Nonetheless, retailization does fit in the "sticking plaster" category. The PE industry has a pressing need to look for a "greater fool"—to convince retail investors to buy what institutional investors are refusing. A retail-driven influx of capital could enable the PE industry to delay a reckoning with the miscalculations that led to today's downcycle. However, that may only make investments more vulnerable to macroeconomic turbulence or a market dislocation event.

This is a key reason why **we believe investors and allocators should shift attention towards middle-market funds**—funds aimed at the basics: finding companies with growth potential and then giving them the tools to realize that growth. This opportunity is already evident. Just look to the largest pension fund in the US—CALPERS. Three years ago, it "recomposed its buyout portfolio from mostly mega-size to more middle-market firms," according to *Bloomberg*. Returns have followed, with **CALPERS realizing "the highest private equity return among its peers in 2024**, up from 17th out of 30 in 2022." And it's clearly not just CALPERS. As CAIA's Bowman noted at Milken's Global Conference this year: "Growth or middle market is still a small piece of [AUM], but it's now about half of where the fundraising is coming from. This is where the cool kids are."

As Penn Mutual has calculated, small-cap and mid-cap buyout funds have long offered greater alpha potential. To quote their report: “When examining funds incepted between 2010 and 2020, **median and top quartile small-cap buyout funds—defined as those with a fund size below \$1 billion—have outperformed funds focused on mid-cap and large/mega-cap companies by a material margin.**” Smaller companies have higher growth potential. They generally trade at lower valuation multiples. They often operate in more niche markets and require less leverage to buy, keeping them relatively insulated from macro volatility. Of course, they also present more downside risk, which contributes to wider dispersion amongst small-cap and mid-cap managers (illustrated in the dots plotted on the bars in the chart below). To again quote Penn Mutual: “Proper due diligence and manager selection are critical in identifying and accessing top-performing funds while avoiding underperformers.”



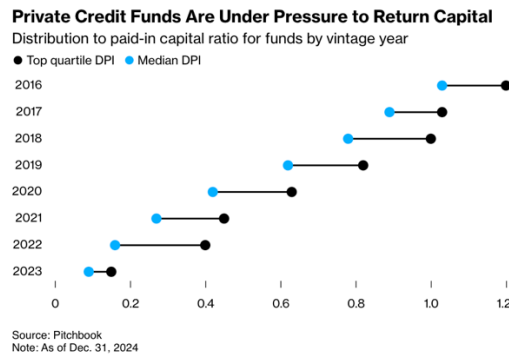
We also believe that **investors and allocators should be looking to globally diversify their PE exposure.** The fundraising spike from 2019 to 2023 and the froth that resulted was largely a US phenomenon. We believe Europe is worthy of attention. A resurgent fiscal impulse across Europe should generate upside opportunity for PE. As Citi estimated in July, **Europe’s fiscal spending could contribute an additional 3% to European EPS growth over the next five years.** Alongside policy uncertainty in the US, this is already driving enthusiasm for European dealmaking. As the *FT* reported in late September: “In Europe, optimism is resurgent...Flows that would have gone to the US only a few months ago [are] now being reallocated to Europe.”



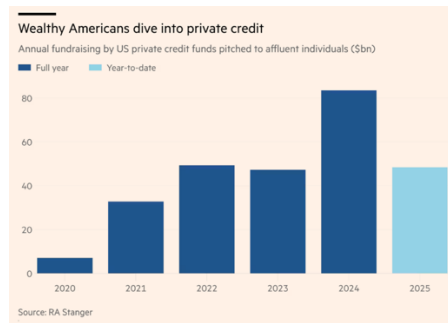
## Private Credit:

Like private equity, private credit markets are showing signs of weakness. The private credit default rate spiked from 3.6% in 2023 to 8.1% in 2024 and reached 8.4% as of August of this year, according to Fitch Ratings. Meanwhile, borrowers are increasingly taking steps to delay default, with “11% of all loans by business-development companies receiving payment-in-kind interest income at the end of 2024,” according to WSJ reporting. PIK payments are the equivalent of IOUs to creditors, replacing cash interest. Finally, distributions are suffering for the same reasons they’ve suffered in private equity—a drop in M&A limiting opportunities to cash out. As Bloomberg reported in September:

*Funds formed in 2016 reported a median DPI above 1 as of Dec. 31, meaning investors have at least received the same amount they’ve contributed, according to Pitchbook data. Subsequent vintages, however, are still well below that target, with funds formed in 2020 or later showing median DPI of less than 0.6, the data shows.*

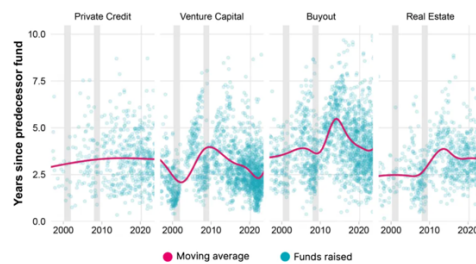


Yet, unlike private equity, private credit investors have seemingly not been deterred by signs of weakness. Fundraising in 2024 came in below pandemic-era highs, but still exceeded \$233 billion. Then in 1Q25, fundraising exceeded any quarter in 2024. As PitchBook noted: “In Q1, capital raised for private credit accounted for roughly 20% of total capital raised across private markets—an increase from the previous quarter.” **It appears that democratization is already contributing to that inflow stability.** As the FT reported in late August: “Affluent individual investors in the US have pumped \$48 billion into private credit funds in the first half of this year, already surpassing the entire haul in 2023 and on pace to eclipse the high-water mark of \$83.4 billion set in 2024.”



There is compelling reason for faith in the relative stability of private credit. As Danielle Poli, assistant PM for Oaktree’s global credit strategy told *Bloomberg* earlier this month: **“Lenders are not lending to each other and leverage has been relatively contained.”** Meanwhile, private credit has no track record this century of cyclical downturns, as the chart below from MSCI illustrates. It’s also not a monolith—private credit encapsulates many different strategies with different risk profiles. AUM growth can sustain even as investors shift exposure to lower-risk lending. This is apparent today. For one, asset-based lending—where loans are backed by anything from music royalties to aircraft—has been growing rapidly, with private financial assets originated and held by non-banks globally related to household and business credit hitting \$6.1 trillion in 2024, up from \$5.2 trillion in 2022.

Cyclical fundraising gaps for venture capital, buyout and real estate



Closed-end funds in the MSCI Private Capital Universe. Vertical grey bars denote U.S. recessions. Moving average of the gaps in fund formation is a smoothed average.

Nonetheless, we do believe caution is merited today. The modern private credit ecosystem has never been tested by an environment like this—one defined by macroeconomic unpredictability with an acute threat of deepening stagflation. As we’ve dissected in this report, we believe at least some of the enthusiasm towards the segment is predicated on misconceptions. We agree with Kynikos founder Jim Chanos, who told the *FT*: **“With the advent of private credit, institutions [are] putting money into this magical machine that gives you equity rates of return for senior debt exposure...High yields for seemingly safe investments should be the first red flag.”**

Private credit has been one of the fastest growing segments of the financial system over the last 15 years and is **now more than 10 times larger than it was during the GFC**. Whether warnings from Moody's, Fitch, and S&P about excessive risk taking in credit markets or headline-grabbing blowups by the likes of First Brands and subprime auto lender Tricolor Holdings, we see clear reasons for concern about default risk in private credit markets. To quote Jamie Dimon speaking about private credit in mid-October: "When you see one cockroach, there are probably more. Everyone should be forewarned on this one." In turn, **we believe it's time for deep scrutiny of existing exposure and greater caution with future investments**.

To our mind, this means seeking exposure to higher quality, investment-grade debt. It means more scrutiny of covenants. It means reducing exposure to strategies like secondaries and continuation funds that add distance between lenders and borrowers. Most of all, **it means transparency is paramount—allocating with lenders and to funds with defensible risk assessments**. Of course, managing risk in private credit is difficult due to the opacity of the market. Tricolor was an obvious warning. Just this year, it had its bonds rated by firms like Kroll Bond Rating Agency and S&P Global Ratings, with the least risky tranches receiving triple A and double A ratings, respectively. Then the company collapsed. As Citadel's Ken Griffin warned in an interview with *Bloomberg* earlier this month:

*The challenge with private credit is that you lose the mark-to-market feedback loop you have in public-market securities...That market-to-market journey is a really important indicator to the quality of your investment decision making. That's gone. With so much money being deployed in private credit, it worries me whether or not we're allocating capital thoughtfully.*

To our mind, complacency is the greatest risk in private credit markets. Proceed with caution and most of all, rigor.

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## Venture Capital:

No private market segment appears better positioned to realize AUM growth from retailization than venture capital. Retail takes concentrated, high-conviction positions and by and large, their conviction sits in tech. Just consider the public-market exposure of retail investors to understand the potential scale of interest—in 2024, US markets saw roughly \$265 billion in net new inflows from self-directed retail investors and slightly more than 25% of that went into just six tech stocks—AMD, Nvidia, Tesla, Apple, Amazon, and Palantir, according to Vanda Research. Already, retail-targeted VC funds have attracted notable retail interest. For one, ARK Invest's ARK Venture—a closed-end fund with a \$500 minimum investment, accessible through SoFi—raised more than \$100

million in its first two years. Robinhood is now getting into the fray, announcing in September that it filed with the SEC for a fund which will “allow every retail investor access to make money on the hottest startups.”

Yet, **we do question how ambitiously the venture capital ecosystem will embrace retailization.** It’s a more limited opportunity set relative to other private market segments. It involves even more speculation and patience—handing large amounts of capital to companies with little, if any revenue. It involves a lot of losers, a small number of huge winners, and a lot of competition for exposure to those winners. As PCM Encore Founder Mark Paulus said to PitchBook in June:

*[Retailization] could entice venture firms—especially those focused on early-stage investing—to raise more capital than they can deploy effectively...If there’s consumer demand for it, [someone will try and fill the gap]. But are they getting the Sequoias or Benchmarks of the world? Or are they getting the equivalent of SPVs and SPACs?*

Today, venture capital is facing challenges. Depressed M&A and plummeting IPOs have limited distributions, challenging investor enthusiasm. In 2022, 2023, and 2024, there were just 38, 54, and 72 IPOs, respectively, according to calculations by the University of Florida’s Jay R. Ritter (which only includes IPOs with an offer price of at least \$5 and listed on either the NYSE or NASDAQ). Over the past 45 years, only 2008 to 2010 saw a lower three-year IPO total. There are signs of life—through mid-October, the number of IPOs and the proceeds from those IPOs have already exceeded 2024 totals. Nonetheless, fundraising has been depressed. After banner years in 2021 and 2022, fundraising plummeted in 2023 and fell further in 2024. The downtrend appears to have continued in the first half of this year. **Roughly \$26 billion was raised as the sector’s fundraising declined 33.7% YoY,** according to PitchBook.

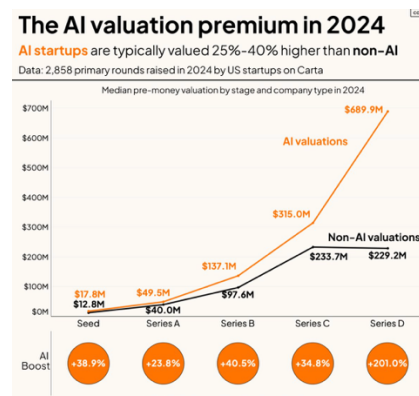
Yet, that fundraising challenge has not compromised the amount of capital being doled out to startups. VC firms still have copious dry powder after record fundraising in 2021 and 2022. According to Carta, **VC funds with a 2022 vintage still possessed 33% of raised capital as recently as September.** In 1Q25, total deal value hit \$162.8 billion, putting 2025 in line to be the second highest year ever for US startup deals. **AI is driving that dealmaking enthusiasm, with nearly 65% of deployed capital going to AI startups.**

We expect the venture capital push for retailization to be led primarily by digital natives and new entrants. As a May *Bloomberg* headline read: “It’s never been harder to make it in venture capital.” YTD, **“emerging managers” are on pace to raise less money than in any other year in a decade.** As deregulation progresses and options for

retail VC access increase, we expect upstart venture capitalists to look to retail channels while legacy leaders remain largely focused on institutional fundraising.

So, what does this mean for how investors and allocators should approach venture capital? We believe a barbell approach is merited. **On one end of the barbell would be high-conviction, later-stage AI stakeholders**—the unicorns with the growth rates and potential AI moats necessary to validate lofty valuations as business models mature. **On the other end of the barbell would be high-conviction, niche companies not viewed as AI stakeholders**—companies authoring game-changing technologies, yet neglected amidst AI enthusiasm and therefore, accessible for more reasonable valuations.

Obviously, there is already reason for concern about excessive AI VC enthusiasm. **Some early-stage AI companies are commanding valuations at between \$400 million and \$1.2 billion per employee**—“breathtaking” as Bryan Yeo, group CIO at Singapore sovereign wealth fund GIC, told *Reuters* this month. The chart below shows the incredible divergence between AI and non-AI startup valuations as of December of last year.



As is the case in public markets, price-insensitive retail participation is likely to exacerbate valuation concerns. This may not prove a long-term problem for the AI stakeholders with the traction and business model viability to justify lofty valuations through EPS growth. In fact, **it likely means that private market investors simply seize even more value pre-IPO**. However, we do believe it could result in more early-stage startups that may have a compelling concept, but not a viable path to revenue generation.

Regarding the neglected corners of the market, we’d again apply a thematic lens. **Durable trends will drive durable long-term growth even if they’re not the trends the market is currently fixated on**. This includes smart infrastructure, construction efficiency, and manufacturing automation. It includes climate mitigation and

adaptation. It includes transportation, defense, and healthspan. **We believe we're in the early stages of unprecedented digital-and real-world convergence.** It's something we dissected in our US Reshoring report. It will continue to be a focus for Sage Road Research. As the often-repeated Peter Thiel quote goes: "We wanted flying cars, instead we got 140 characters." AI may be essential to unlocking the opportunity to advance how we construct and interact with the built world. But it won't just be AI pure-plays that profit from physical-world innovation. We believe AI enthusiasm is distracting market participants from that opportunity.

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## Infrastructure and natural resources:

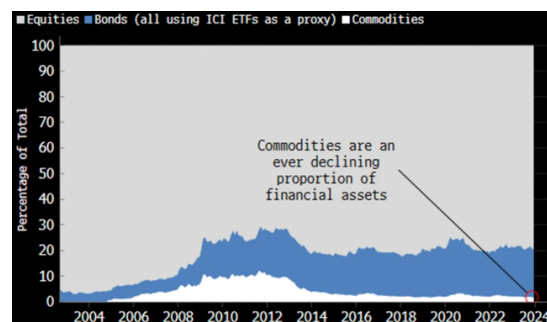
In both our Deregulation and US Reshoring reports (learn more here), we presented in-depth arguments for why we believe investors and allocators should consider increasing exposure to infrastructure and natural resources. We won't retread all of the ground we covered in those reports. But for a handful of stats that undergird our bullishness:

- The American Society of Civil Engineers has estimated that the US has an "infrastructure investment gap" of nearly \$2.6 trillion this decade that, if unaddressed, could cost the US \$10 trillion in lost GDP by 2039.
- After roughly two decades of stagnation, US electricity demand growth reached 2% in 2024, with 3 to 4% annual load growth possible by the end of the decade.
- Globally, there have been only four new major copper discoveries in the last decade, only one mining company has a greenfield project underway, and brownfield expansions are yielding lower-grade copper.
- Since 2015, EVs and battery storage have surpassed consumer electronics to become the largest consumers of lithium, together accounting for 30% of total current demand.
- Today, 92 countries are engaged in conflicts beyond their borders, the highest number since WWII.
- The globe suffered 58 \$1 billion-plus natural disasters in 2024 and 73 in 2023.

While infrastructure and natural resources are distinctly different private market segments, the same megatrends are likely to increase outperformance opportunity for both in the years to come, from the AI buildout to profligate global fiscal spending to climate adaptation and mitigation to deglobalization, global electricity undersupply, and transportation innovation. Meanwhile, as the stats above suggest, both infrastructure and commodities production have suffered from persistent underinvestment, especially since the GFC.

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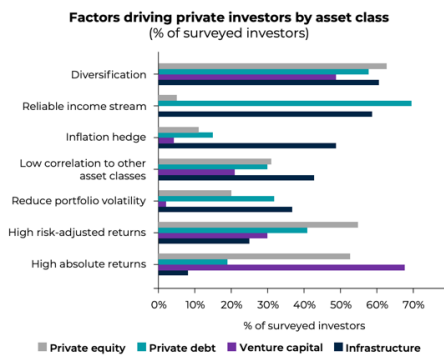
Commodities have long been neglected by market participants. **As of early 2024, commodities accounted for just 1.7% of total portfolios relative to equities and bonds**, down from a 21<sup>st</sup> century peak of roughly 10% during the GFC, according to Bloomberg calculations (chart below). While the right level of commodity exposure is dependent on the economic environment, sub-2% exposure is too little in an inflationary era, especially considering the thematic tailwinds cited above. To quote a *Bloomberg Professional Services* study: “The ideal range for an allocation to commodities from the 60/40 portfolio is between 4% to 9%...**The appropriate allocation to commodities as an inflation hedge comes to 6.7%.**” That precise number is undoubtedly debatable, but clearly many investors and allocators remain underexposed to commodities in alts portfolios. **We remain bullish on natural gas and metals, led by copper and gold, but also including aluminum, nickel, zinc, lithium, and silver.** Retailization doesn’t change that conviction—retail investors have long had avenues to commodity exposure. We do not believe further democratization will alter their influence meaningfully.



The infrastructure opportunity is less neglected by investors. **Over the past decade, infrastructure fund AUM has increased almost five-fold, to \$1.3 trillion**, according to Preqin. Yet, in recent years, infrastructure funds have faced similar fundraising challenges to the rest of private markets. Last year, fundraising fell 15% YoY to reach its lowest level in a decade. There is good reason to believe that weakness will be short lived. As McKinsey wrote in their 2025 Global Private Markets Report: “**Infrastructure appears to be the asset class in which the greatest number of investors want to increase allocations** in the next 12 months (selected by 46% of the total respondents), according to the McKinsey LP Survey.” Meanwhile, unlike private equity and private credit, the dealmaking environment has remained robust. **Capital deployment accelerated in 2024 and infrastructure deal value increased by 18% YoY**, making 2024 the second-highest year on record (behind 2022).

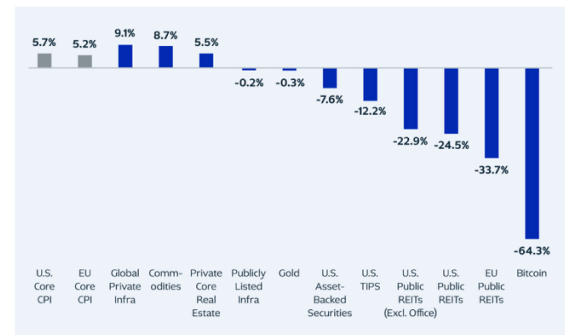
All of the key virtues that drove the spike in private infrastructure AUM over the past decade remain equally or even more compelling today given inflation’s persistence and the mounting threat of stagflation. Those virtues include diversification, reliable income, inflation hedging, low correlation, and low volatility (chart below on the left). Post-pandemic performance has validated those virtues (chart below on the right). To quote KKR:

**Over the past 10 years, private infrastructure has outperformed every asset class except private equity...Infrastructure’s inherent resistance to inflation, plus the essential nature of the underlying assets, helped it weather the recent high-rate and high-inflation period better than most other traditional inflation hedges during the steepest part of the recent inflationary cycle.**



Source: World Bank

EXHIBIT 3: Annualized Returns by Asset Class, 4Q2021 - 4Q2022



Source: KKR

**It appears the democratization of infrastructure is lagging other private market segments.** In March, Hamilton Lane announced its infrastructure evergreen fund (HLPIF) was now open to retail investors, making it “the first private infrastructure offering available to retail (non-accredited) investors in the US with a minimum as low as \$500.” Given the scale of the infrastructure opportunity ahead—the need for data centers, energy-grid expansion, infrastructure hardening, transportation evolution in the age of autonomy, etc.—we see less chance of infrastructure valuation distortion due to retail capital than in other private market segments. We continue to believe Blackrock’s Larry Fink is correct in asserting: **“Infrastructure investing is at the beginning of a golden age.”**

## Real estate:

We’d make a similar argument about private real estate fund democratization as we did about commodities: retail investors have long had avenues to real estate exposure. We do not believe further democratization will alter their influence meaningfully, as least not in the short- to medium-term. Nonetheless, we do believe the performance history of retailized products offers important strategic considerations for private market real estate exposure moving forward.

It's been a tough few years for real estate investing as rising rates ran headlong into valuations inflated during the pandemic era. **In 2024, returns for closed-end real estate funds remained negative, with a pooled IRR of -1.1% through 3Q24**, according to McKinsey. Open-end funds fared even worse, with a gross return of -1.6% through year-end 2024, their second annual decline since the GFC. The poor performance has pulled down fundraising. For one, **global closed-end fundraising declined 28% to \$104 billion in 2024, the lowest annual total since 2012.**

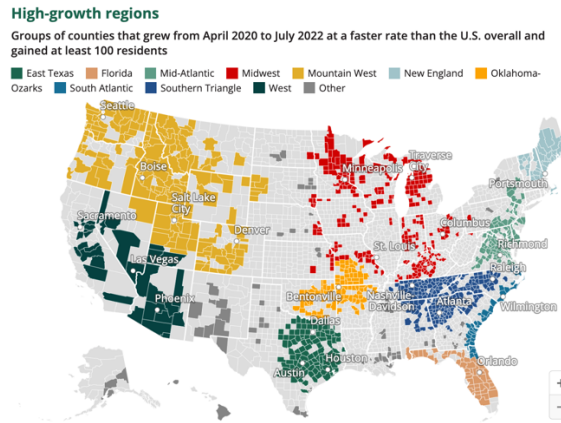
Further pain appears likely for private real estate funds. We don't expect much relief from interest rates even if the Fed cuts more through year-end. Persistent inflation will keep nominal rates higher for longer and continue to challenge real estate valuations predicated on pre-pandemic rates. Meanwhile, there's been a persistent valuation gap between public and private real estate funds for the past few years. It remains today. As the National Association of Real Estate Investment Trusts noted in September: "The public-private cap rate spread reached its peak at 243 basis points in the third quarter of 2022... After nearly three years, **the cap rate spread has remained wide; it stood at 132 basis points as of the second quarter of 2025.**" Eventually, private market funds will have to face reality and close the valuation gap.

Obviously, real estate is a diverse sector. Even as private market real estate investments have languished in recent years, there have been bright spots, with everything from manufactured homes to senior housing to data centers approaching or exceeding double-digit returns in 2024, according to McKinsey. In an asset class with an aggregate global value of roughly \$380 trillion, there will always be upside to seize.

We believe two interrelated convictions detailed earlier in this report should be top-of-mind for private real estate exposure: 1) Lean into smaller and more niche real estate funds; and 2) allocators should lean into undemocratized private real estate exposure over retail-targeted funds. **In a higher rate environment, we expect real estate opportunity to be narrower and more idiosyncratic.** It will require closer attention to thematic factors to identify those opportunities. The recent outperformance of data centers and senior housing are evidence of this. In future reports, we will document where real estate convictions intersect with the themes we're dissecting.

We've already done this in our past reports. As we argued in our US Reshoring report, an increase in manufacturing CAPEX should prove a tailwind for Midwest real estate. The Midwest has the highest concentration of production occupations, with an employment share almost one and half times the national average, according to the Bureau of Labor Statistics. It is also home to many of the most undervalued housing markets in the country, where local households spend far less on housing costs as a share of income than the national average. To add another thematic conviction, one personal to us: **at a time of intensifying demographic headwinds, invest where population is still growing.** For one, the Mountain West (where we live) has seen roughly 3% population growth this decade, nearly two-and-a-half percentage points higher than the national average.

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Source: Economic Innovation Group

We believe **smaller, more specialized and localized private market real estate investors will be better equipped to maximize returns in this environment.** This appears to be a contrarian conviction. We recently had a conversation with a close contact who is raising capital for a Mountain West real estate fund, pitching pensions, endowments, and high-net-worth individuals across the country. Despite his track record of above-market returns, he's run into resistance as allocators are still anchored to more traditional, Northeast and West Coast real estate markets. Bigger-picture stats also suggest a retreat to larger, broader-exposure funds as rates have risen and risk has increased. **In 2024, funds greater than \$1 billion accounted for roughly 64% of the overall fundraising total, up from 51% in 2022,** according to McKinsey. Through 1H25, two Blackstone funds have accounted for nearly 20% of the \$110 billion raised, according to PERE.

More narrowly focused real estate exposure has long had greater alpha potential. Prequin has long tracked private real estate performance by fund size and for much of this century, **the IRR of funds with less than \$200 million in assets has exceed that of funds with \$1 billion or more in assets by six percentage points or more.** To our mind, it's time to think small in private real estate and keep some powder dry in case a significant growth slowdown or spike in inflation really depresses the market, generating buy low opportunities.

# From Author

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