

Open-ended funds are reshaping the secondary market

Private markets

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- Secondary and open-ended funds are rapidly converging, fueled by a surge in demand for liquidity and a broadening of the investor base.
- Secondaries align well with open-ended fund structures by mitigating the typical cash drag while offering diversified exposure to higher-returning private equity.
- Both the secondary market and open-ended funds are poised for growth, serving as key liquidity solutions and gateways to private markets.



Source: Getty images.

Open-ended funds are gaining traction in the secondary market. Baird, a financial services firm, estimates that their allocation to secondaries could reach USD 200 billion in assets under management (AUM) by 2034, an eightfold increase from today.

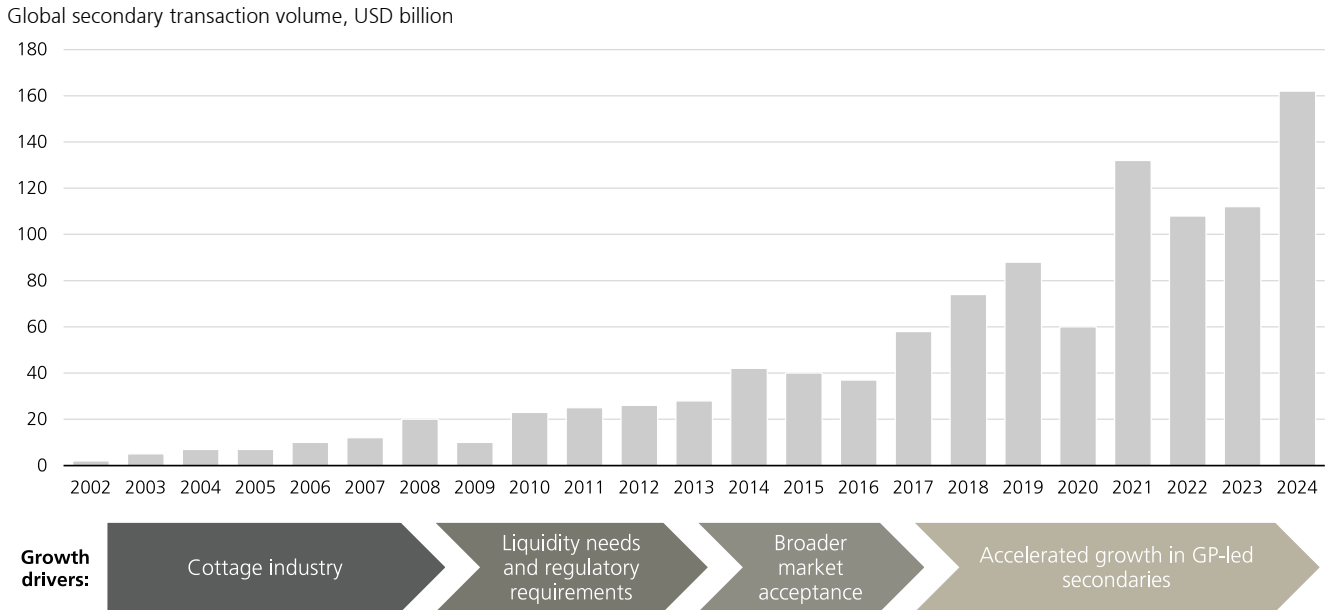
The convergence of secondary and open-ended funds reflects the growing importance of liquidity in private markets. In this note, we explore the mechanisms of secondaries and open-ended funds, examining how open-ended funds investing in secondaries differ from closed-ended ones (see summary in the Appendix). We also analyze current secondary market dynamics and identify key drivers expected to fuel the growth in both the secondary market and the open-ended fund universe in the coming years.

Why secondaries matter

Secondary funds provide liquidity to private markets, which are notorious for their illiquidity. Traditionally, secondary managers buy stakes in private market funds from primary investors (known as limited partners or “LPs”), often at a discount. LPs mostly sell to rebalance their portfolio or meet liquidity needs. A more recent innovation is general partner (GP)-led secondaries, where a fund’s GP engages a secondary buyer to restructure specific assets and offer primary LPs a choice: cash out or remain invested.

Analogies help illustrate the process. Secondary funds function in private markets much like second-hand car dealers. LP secondaries are akin to selling a used car to a dealer in order to buy a new car. GP-led secondaries resemble a car dealership offloading inventory to another dealer to wind down operations or pay off debt.

Figure 1: Global secondary transaction volume set a new record in 2024 at USD 162 billion



Source: Jefferies, Pitchbook, UBS January 2025.

Accelerated secondaries growth

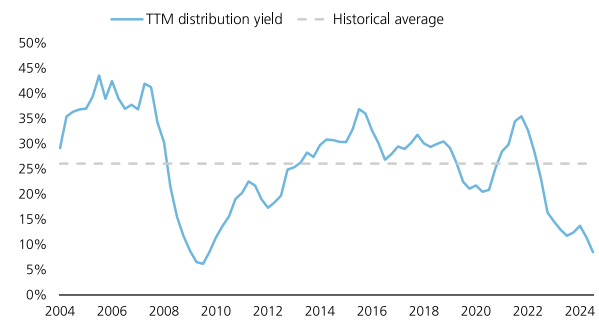
The secondary market, which emerged in the 1980s, has experienced accelerated growth driven by heightened liquidity needs following the 2008 financial crisis, broader market acceptance of secondaries as a portfolio management tool, and the rise of GP-led secondaries as a fourth private equity exit option (alongside trade sales, sponsor sales and public listings). Jefferies reports global secondary transaction volume reached a record USD 162 billion in 2024, a 45% increase from 2023 and more than 20% higher than the previous peak in 2021 (Figure 1).

A key driver is the over allocation of private markets in LP portfolios, stemming from the interplay between the “numerator effect” and the “denominator effect.” The numerator effect arises when private market portfolios significantly outperform public ones, as in 2021, leading to an increase in the overall value of private investments relative to the total portfolio. Conversely, the denominator effect happens when private market values hold steady while public markets tumble, as seen in 2022, leading to a decline in the total value of the portfolio but relatively increasing the allocation to private markets. Both scenarios push LPs to seek liquidity.

High interest rates have exacerbated the liquidity crunch. Since 2022, central banks’ tightening measures have suppressed private market exits. Higher interest rates raise the cost of debt for new deals and reduce valuations of growth-oriented companies by eroding future cash flow values. GPs have delayed asset sales or listings, curbing distributions to investors. Pitchbook, a private markets data provider, reports that US private equity distributions fell to 8% of net asset value (NAV) in the year through 3Q24, down from 26% historically (Figure 2).

Figure 2: High interest rates have exacerbated the liquidity crunch

US buyout fund distributions, as a share of beginning net asset value (NAV)



Note: As of 3Q24. Source: Pitchbook, UBS January 2025.

The appeal of open-ended funds

Although private markets open-ended funds have existed for three decades, their popularity has surged recently. Pitchbook estimates that the number of such funds—also known as evergreen or perpetual funds—has doubled in five years.

These vehicles differ from traditional closed-ended private market funds (Figure 3). Closed-ended funds require investors to commit capital during fundraising, which is then called over time and locked up for a decade or more. These vehicles suit institutional investors such as pension funds and sovereign wealth funds, which have long investment horizons, predictable liquidity needs, and sophisticated cash management capabilities.

Open-ended funds, by contrast, continuously raise funds. Investors make upfront commitments, gaining immediate exposure to private markets without the complication of capital calls. Minimum commitments are much lower and investors can redeem a portion of their capital, typically up to 5% of NAV per quarter.

This flexibility comes at a cost. To meet redemptions, managers must allocate 10-20% of portfolios to cash or liquid securities, which tend to underperform private markets over the long term. To offset the potential cash drag, open-ended funds reinvest distributions into new opportunities, allowing capital to compound over time.

Given their many advantages, open-ended vehicles attract capital from individual investors with shorter investment horizons and less predictable liquidity needs.

Managers, especially publicly listed alternative investment firms, increasingly launch open-ended fund structures, drawn to the contractual fees associated with perpetual capital. They also see an opportunity to target individuals whose allocation to private markets remains low but whose combined wealth totals USD 450 trillion, according to Pitchbook data.

A perfect pairing?

Secondaries align well with an open-ended fund structure by mitigating the drag of idle cash. They generate distributions earlier than primary funds by acquiring stakes in mature funds or companies where value creation is underway. Additionally, LP secondaries are diversified across many funds and hundreds of companies, ensuring steady cash flow.

To meet liquidity needs, open-ended funds typically focus on income-generating strategies like real estate, infrastructure, and credit. Secondaries provide complementary exposure to private equity, a higher-returning asset class. Jefferies estimates that venture capital and buyout strategies make up over 80% of LP secondary transaction volumes.

Another benefit is enhanced diversification. Open-ended funds give exposure to the deal flow of a single manager across one or more strategies. Open-ended funds dedicated to secondaries offer access to a broad range of both managers and strategies, providing a more balanced exposure across private markets.

Finally, acquiring assets at a discount is advantageous for open-ended funds, as the difference between the price of a secondary transaction and its book value can lead to an immediate uplift in performance.

Figure 3: Comparison between traditional closed-ended and open-ended funds

	Traditional closed-ended funds	Open-ended funds
Access	During fundraising period	Monthly or quarterly subscription
Minimum commitment	In the millions (direct)	In the thousands
Fund life	10-year term, subject to extensions	Evergreen
Capital deployment	5-year investment period with capital drawn over time	Fully deployed upon subscription
Distribution policy	At manager's discretion; typically after the investment period	Typically accumulating unless distribution share class available
Redemption	Liquidation upon fund term	Quarterly redemption requests, at manager's discretion, subject to gating
Valuation	Quarterly	Monthly
Return profile	Internal rate of return (IRR) or multiple of invested capital (MOIC) on capital called; typically the same for primary investors	Annualized return on capital committed; dependent on time of subscription and redemption

Note: This table represents common features of each private fund structure. For illustrative purposes only. Actual terms may vary by fund and asset class type. Source: UBS January 2025.

Caution amid opportunity

Despite these advantages, investors must carefully evaluate risks. Open-ended funds investing in secondaries tend to be less sensitive to pricing than closed-ended counterparts. To minimize cash drag, open-ended funds face pressure to deploy capital quickly, and bid 400 basis points higher on average, according to secondary advisor Campbell Lutyens. This pressure is particularly intense for larger funds with billions in dry powder (committed but undeployed capital).

A robust deal flow is crucial to maintain quality, especially after strong fundraising months. Implementing a cap on subscriptions is another remedy. While for GPs managing both closed-ended and open-ended funds, establishing a fair allocation policy that ensures equal access to deals is critical.

Another concern is the lag in valuations, as secondary funds rely on figures from underlying primary funds. This can create mismatches when investors subscribe or redeem based on outdated NAVs.

While acquiring assets at a discount provides an immediate performance boost, this effect will fade over time. Therefore, managers must identify quality assets with long-term appreciation potential.

Lastly, while open-ended funds offer liquidity, it is partial. Redemption requests face limits, initial lock-up periods, and early exit fees. In times of market stress, managers may impose gating provisions or suspend redemptions to avoid selling assets at fire-sale prices, protecting remaining investors.

Current secondary market dynamics

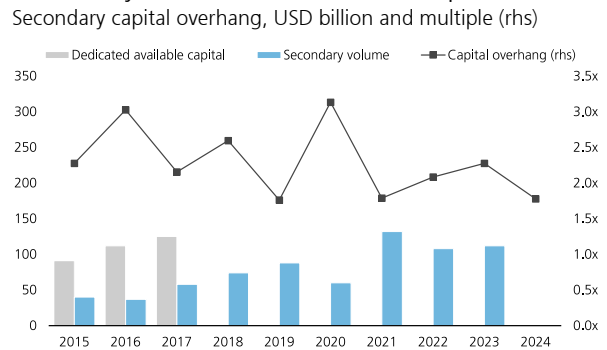
According to Preqin, another private market data provider, closed-ended secondary funds raised a record USD 92 billion in 2023 and USD 56 billion in 2024. This capital is concentrated in a few notable funds, including Lexington’s tenth fund, which raised USD 22.7 billion, and HarbourVest’s Dover Street XI, totaling USD 15.1 billion. In January 2025, Ardian closed its ninth fund at USD 30 billion, marking the largest secondary fund ever raised. Meanwhile, Baird estimates that secondary evergreen AUM amount to USD 24 billion, with USD 11 billion raised in the year leading up to October 2024.

Despite record fundraising figures, the secondary market persistently remains undercapitalized. At the end of 2024, available dry powder accounted for less than two years’ worth of transaction volumes at current levels, resulting in a capital overhang of 1.8x (Figure 4).

While this aligns with levels seen in 2019 and 2021—indicating a normalization relative to previous years—the reality is that the opportunity set coming to market is much larger, with only about half of transactions executed.

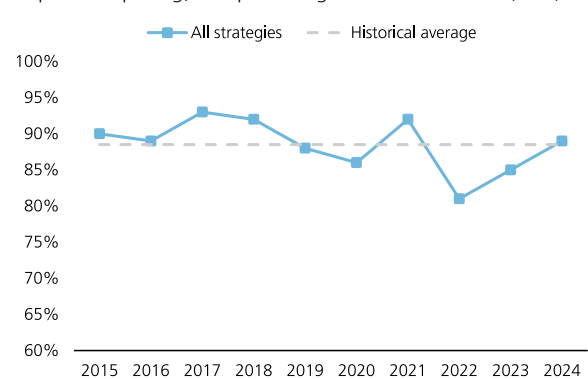
Strong public markets, high levels of available capital, and the inclusion of higher-quality and younger vintage portfolios are driving price compression. Average discounts to NAV stood at 11% at the end of 2024, consistent with the 10-year historical average, but down from 15% in 2023 and 19% in 2022 (Figure 5). Discounts typically widen during market disruptions, as LPs’ urgent need to sell benefits GPs, and a subdued market outlook raises concerns about inflated valuations. Conversely, discounts tend to narrow as competition among secondary buyers intensifies and the quality of underlying assets improves. Strong public markets also contribute to narrower discounts as buyers underwrite higher projected exit multiples.

Figure 4: Despite record fundraising, the secondary market remains undercapitalized



Source: Jefferies, UBS January 2025.

Figure 5: Discounts are back to historical levels



Source: Jefferies, UBS January 2025.

Long-term growth prospects

The secondary market and open-ended funds are poised for growth, driven by evolving market dynamics, demand for liquidity, and a broadening investor base.

The “denominator effect” has subsided with the recovery of public markets. However, the demand for secondaries has evolved from being merely cyclical to becoming a fundamental aspect of private markets. Greenhill, an investment bank, forecasts global secondary transaction volume will grow at 10% per year, nearing USD 250 billion by 2028 (Figure 6).

Currently, only about 1% of private assets are traded in the secondary market, suggesting considerable room for growth. Jefferies reports that 40% of LPs utilizing the secondary market in 2024 were first-time sellers.

Primary funds are increasing in size, which is expected to lead to larger transactions in the secondary market. According to Pitchbook data, the average global private equity fund size surpassed USD 1 billion as of 3Q24.

Transaction volumes are also diversifying beyond equity-focused strategies. Credit and infrastructure secondaries are experiencing strong growth as their primary markets expand and as new secondary funds dedicated to these strategies emerge.

GP-led transactions are another area of rapid expansion, now accounting for half of secondary market activity. GP-led structures offer an additional liquidity solution to LPs, particularly in a prolonged high-interest-rate environment. According to Pitchbook, GP-led secondaries accounted for 3.8% of private equity exits in the year through October 2024 with 89 transactions, up from just 0.2% in 2018 with six transactions.

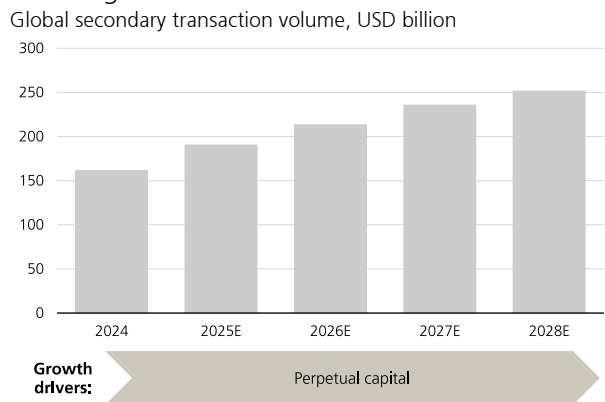
The growth of open-ended funds, meanwhile, is supported by regulation, with the US Investment Company Act of 1940, the European Long-Term Investment Fund (ELTIF), and the UK Long-Term Asset Fund (LTAF) establishing a framework around accessing long-term investment opportunities, promoting investor confidence.

Open-ended funds are establishing themselves as a more accessible gateway to private markets. According to Pitchbook, evergreen structures currently manage USD 1.1 trillion in assets—a fraction of the USD 14.3 trillion held by closed-ended funds and less than 1% of global individual wealth. If just 5% of that wealth were allocated to open-ended funds, private markets could grow by more than USD 20 trillion (Figure 7).

Conclusion

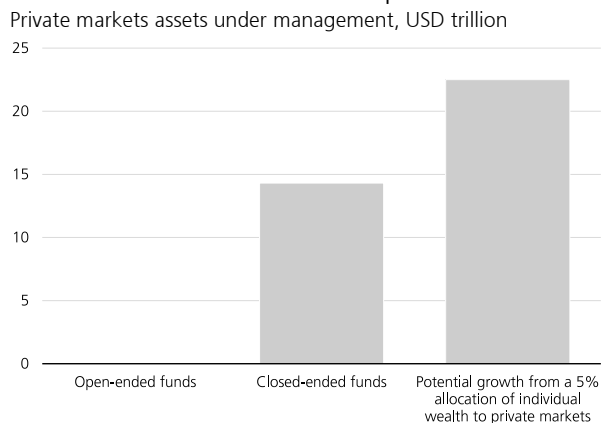
The convergence of secondary and open-ended funds represents a significant evolution in private markets, driven by increasing demand for liquidity and a broadening of the investor base. The secondary market, with its ability to provide liquidity and diversify portfolios, continues to mature and expand. Open-ended funds, with their flexible structure and continuous fundraising capabilities, offer a compelling alternative to traditional closed-ended funds. As these markets evolve, they will increasingly provide essential liquidity and diversification in private markets, creating significant opportunities for investors.

Figure 6: The secondary market could see 10% annual growth



Source: Jefferies, Greenhill, UBS February 2025.

Figure 7: Open-ended funds have the potential to add over USD 20 trillion to private markets



Note: Open-ended funds as of 3Q24. Closed-ended funds as of 1Q24 and excluding secondaries and fund-of-funds to avoid double counting. “Potential growth” based on Pitchbook forecasts. Source: Pitchbook, Preqin, UBS January 2025.

Appendix

Benefits of secondary funds

- Accelerated exposure: Secondary managers deploy capital more quickly than typical primary funds by targeting mature fund stakes and assets, providing faster exposure to private markets.
- Diversification: Acquired fund interests are usually highly diversified across geographies, strategies, managers and vintage years, which helps reduce the variability of returns.
- Early liquidity: Secondary funds acquire stakes in existing funds or portfolio companies that are close to or already generating cash flows, allowing them to start distributing capital faster than primary fund investments.
- Reduced blind pool risk: By purchasing mature fund stakes, managers can thoroughly analyze underlying investments before committing, thereby reducing the so-called blind pool risk.

Benefits of open-ended funds

- Continuous fundraising and immediate exposure to private markets.
- Lower minimum commitments, making them more accessible to individual investors.
- Flexible capital redemption options, allowing investors to redeem up to 5% of NAV per quarter.
- Compounding of returns through reinvestment of distributions.

Benefits of open-ended funds investing into secondaries compared to other strategies

- Better suited to mitigate cash drag, as secondaries generate steady cash flow.
- Complementary to income-generating strategies like real estate, infrastructure and credit by providing exposure to higher-returning private equity.
- Diversification across multiple managers, ensuring a more balanced exposure to private markets.
- Transactions acquired at a discount automatically translate into a performance uplift.

Considerations for secondary funds

- Leverage: Secondary funds may use leverage at either the fund or deal level to partially finance transactions, potentially enhancing returns but also increasing risk.
- Limited control: Managers purchasing existing LP stakes in a portfolio often lack control over the exit timing of the underlying assets.
- Single-asset risk: Funds focused on single assets, such as GP-led continuation funds, require a more sophisticated skill-set to navigate conflicts of interest and the negotiation process between GPs, existing and selling LPs, and the new buyer.
- Valuation risk: The success of a transaction is influenced by deal dynamics and pricing. Portfolios are assessed quarterly, and the pricing relative to NAV can differ between the last valuation and the closing date. Higher discounts to NAV may also indicate distress at the asset level.

Considerations for open-ended funds

- Managers must allocate 10-20% of portfolios to liquid assets, potentially underperforming private markets.
- Redemption options can be limited with restrictions, lock-up periods, and early exit fees.
- Potential for gating provisions or suspension of redemptions during market stress.

Considerations for open-ended funds investing into secondaries compared to closed-ended secondary funds

- Pressure on managers to deploy capital quickly to minimize cash drag, especially for larger funds with significant dry powder.
- Valuations can lag, with mismatches in NAV figures when investors subscribe or redeem.
- Performance uplift driven solely by price discounts are temporary and unsustainable over the long term.

Appendix

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