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Private Equity: Perception versus reality

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As traditional assets perceived as "safe havens" (i.e., US Treasuries and the US dollar) appear increasingly uncertain and equity markets reach new highs almost daily, many investors are turning their focus to alternative investments. Not only gold, but also hedge funds, private credit, private equity, and high-quality global real assets can enhance a portfolio's risk-adjusted returns.

With growing uncertainty surrounding assets traditionally perceived as "safe havens" (i.e., US Treasuries and the US dollar) and in light of new record highs in public market valuations, investors are increasingly seeking alternatives. As an asset class, private equity is well positioned to benefit from falling benchmark interest rates and a more favorable regulatory environment, which could occur if the US Federal Reserve lowers rates and deregulation advances in the US. In our view, private equity is a valuable tool for investors to enhance long-term returns, both on an absolute and a risk-adjusted basis, and to gain early access to innovative, privately held companies that may hopefully mature into market leaders in their industries.

However, over the past three years, private equity investors have faced challenges. Returns have noticeably weakened, falling short of expectations. This has led to discomfort among investors and raised the question of whether such strategies can continue to deliver attractive returns. We would like to address these concerns and clarify some common misconceptions.

Many investors expect private equity to provide a steady stream of distributions, with portfolios typically achieving annual distribution rates of 20 to 25 percent toward the end of their investment horizon—measured as a percentage of their net asset value (NAV). In recent years, however, distributions have dropped to just 10 to 15 percent. We see several reasons for this decline: higher interest rates limit the use of leverage, economic uncertainty slows down IPOs, and there are fewer acquisitions overall, as CEOs are more hesitant when it comes to investments as well as mergers and acquisitions.

Currently, funds worldwide are holding record levels of unrealized NAV, totaling around USD 3 trillion, with about USD 2 trillion of that in the US. While this may sound dramatic, much of it is due to the age of the funds: around 25 percent of unrealized NAV comes from funds launched less than three years ago, and about half is from funds younger than five years. These younger portfolios are still in their build-up and maturation phase and are not yet ready to deliver robust returns. Older funds—those over five years—generally produce solid liquidity, in some cases even above historical averages. Furthermore, the recent slowdown may also be a counter-movement following a period of above-average distributions.

Looking ahead, we expect that earnings will rise in the coming year. If the Fed begins cutting rates in September as anticipated, this should lead to greater flexibility for acquisitions. A more stable macroeconomic environment could revive IPOs and investments. The past few months already suggest a turning point: Exit activity picked up again at the end of 2024 and the beginning of 2025, but only the coming months will show whether this trend will actually continue.

For investors, it is crucial to accept the natural volatility of private asset cash flows and not to react to short-term trends. Private equity is not a metronome—it is more like a symphony with both crescendos and pauses. Consistent capital allocation and diversification across different vintages remain the most reliable strategies we see for managing risks. Instead of trying to time the market, steady annual commitments help smooth out fluctuations and support portfolio growth. Aligning with individual liquidity needs is essential—in private equity, capital is often tied up for more than a decade. Combining private equity with shorter-term investments such as private credit or real estate can provide additional liquidity where needed. Ultimately, patience, good preparation, and discipline will help investors benefit from the long-term potential of private equity as the market finds its rhythm again.

Non-Traditional Assets

Non-traditional asset classes are alternative investments that include hedge funds, private equity, real estate, and managed futures (collectively, alternative investments). Interests of alternative investment funds are sold only to qualified investors, and only by means of offering documents that include information about the risks, performance and expenses of alternative investment funds, and which clients are urged to read carefully before subscribing and retain. An investment in an alternative investment fund is speculative and involves significant risks. Specifically, these investments (1) are not mutual funds and are not subject to the same regulatory requirements as mutual funds; (2) may have performance that is volatile, and investors may lose all or a substantial amount of their investment; (3) may engage in leverage and other speculative investment practices that may increase the risk of investment loss; (4) are long-term, illiquid investments, there is generally no secondary market for the interests of a fund, and none is expected to develop; (5) interests of alternative investment funds typically will be illiquid and subject to restrictions on transfer; (6) may not be required to provide periodic pricing or valuation information to investors; (7) generally involve complex tax strategies and there may be delays in distributing tax information to investors; (8) are subject to high fees, including management fees and other fees and expenses, all of which will reduce profits.

Interests in alternative investment funds are not deposits or obligations of, or guaranteed or endorsed by, any bank or other insured depository institution, and are not federally insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board, or any other governmental agency. Prospective investors should understand these risks and have the financial ability and willingness to accept them for an extended period of time before making an investment in an alternative investment fund and should consider an alternative investment fund as a supplement to an overall investment program.

In addition to the risks that apply to alternative investments generally, the following are additional risks related to an investment in these strategies:

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- Managed Futures: There are risks specifically associated with investing in managed futures programs. For example, not all managers focus on all strategies at all times, and managed futures strategies may have material directional elements.
- Real Estate: There are risks specifically associated with investing in real estate products and real estate investment trusts. They involve risks associated with debt, adverse changes in general economic or local market conditions, changes in governmental, tax, real estate and zoning laws or regulations, risks associated with capital calls and, for some real estate products, the risks associated with the ability to qualify for favorable treatment under the federal tax laws.
- Private Equity: There are risks specifically associated with investing in private equity. Capital calls can be made on short notice, and the failure to meet capital calls can result in significant adverse consequences including, but not limited to, a total loss of investment.
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