Private markets offer access to underrepresented industries and sectors. (UBS)

Adding private market exposure may help steady portfolio returns

08 May 2024, 2:52 pm CEST, written by UBS Editorial Team

Global investors have faced volatile conditions in recent weeks, with markets pulled in several directions by geopolitical risks, uncertainty over monetary policy, and robust tech earnings. We believe the overall risk-return outlook for equities remains fairly balanced, supporting an in-line equity allocation, and we continue to prefer quality income in our global portfolios.

But with near-term public asset volatility likely to continue, investors seeking smoother returns and who can tolerate lower liquidity should consider adding more alternative assets to their portfolios:

Adding private market exposure may help steady portfolio returns. Locking up capital for longer also has its advantages, giving fund managers more scope to take advantage of market dislocations, and protecting investors from behavioral biases like panic-selling. Public markets offer many examples of fast repricing of risk assets, both up and down; private markets only moderately participated in the move higher, and so far have remained broadly stable. A CIO analysis shows that adding private equity could help reduce the expected swings in an investor's portfolio—the reported volatility—by about 30 basis points per annum over a longer time horizon.

Private equity and debt could deliver strong returns, in our view. We expect private equity and private debt to return around 11% and 9% per year, respectively, over a full business cycle, in excess of many public stock and bond markets. Based on CIO analysis, a balanced investor who replaces up to 10% of their global public equity exposure with private equity exposure could benefit from around 20–30 basis points of additional expected returns each year over the long term.

Private markets offer access to underrepresented industries and sectors. More firms are choosing to stay private, delay listings, or avoid them altogether. Between 2000 and 2023, the number of private-equity-backed companies has risen sixfold to nearly 11,000. This is a trend we think is unlikely to reverse. Overlooking these opportunities risks leaving investors with long-term underexposure to those fast-growing sectors of the economy whose companies choose not to list.

So, we suggest investors with a long-term time horizon and the ability to lock away capital for longer consider adding more private market exposure to their portfolio. Within private markets, entry multiples have moved lower, with particular opportunities to create value in the middle market, and in carveouts and divestures. We like secondaries with solid fundamentals that can capitalize on market needs for liquidity events, and we like thematic growth exposure to healthcare and software. We are more selective in private credit given rates risks, with a preference for senior upper-middle-market and sponsor-backed loans, and a sector tilt to less cyclical exposure. We also like infrastructure assets, with a low correlation to other investments and resiliency both to the economic cycle and to inflationary environments.

Of course, investors considering private market investments must consider important risks around leverage, illiquidity, the potential for defaults, and concentration. We believe strict manager selection, due diligence, and investment monitoring can help address some of these risks.

Main contributors - Solita Marcelli, Mark Haefele, Karim Cherif, Antoinette Zuidweg, Jon Gordon, Jennifer Stahmer

Original report - **Volatile conditions highlight the appeal of alternatives, 8 May 2024.**