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The case for private markets: three things to know

In this uncertain market environment, investors struggle to enhance returns and reduce risk. Private markets — assets that are not traded on public exchanges, including debt, equity, real estate and real assets — may help achieve those goals. Investors should consider three important benefits as they evaluate allocating to private markets.

1. RETURN AND INCOME POTENTIAL: FUNDAMENTAL LOGIC DRIVES OPPORTUNITY

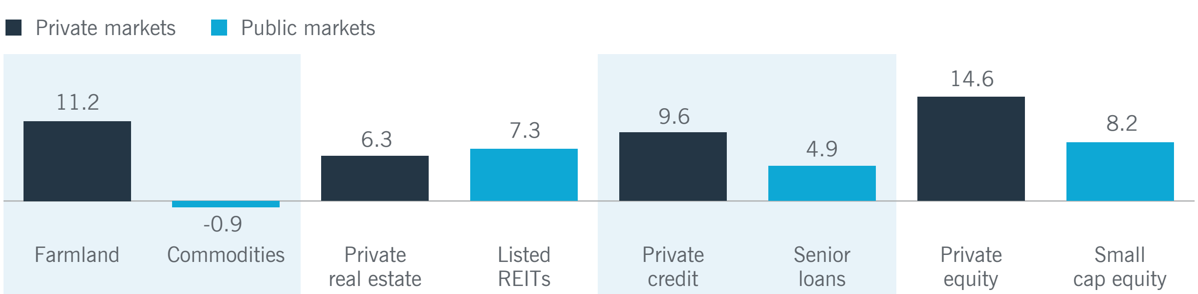
Private markets are perhaps best known for their high return potential compared with similar public assets. Illiquid holdings have often been viewed as a limitation, but that same illiquidity also creates opportunities. Their advantage is grounded in sound fundamental logic.

The investment time horizon is generally longer for private markets. In public companies, 87% of executives view their time horizon as under two years. Many opportunities, including M&A activity and turnarounds, take considerably longer to execute.[1]

Majority or complete ownership in private companies allows interests to be better aligned because management is held more accountable. Similarly, private transactions generally offer far greater transparency to the buyer than what is available to public market investors.

Figure 1: Private markets have generally outperformed their public counterparts

Total return (%)



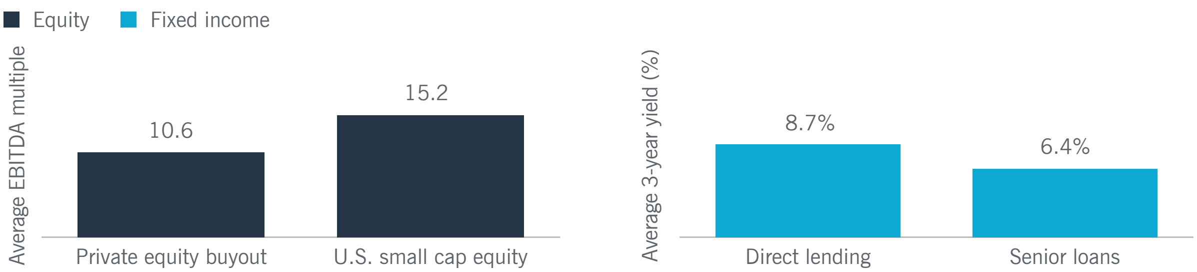
Data source: Bloomberg, L.P., Cambridge, Cliffwater, 31 Dec 2004 – 31 Dec 2024. Most recent data available. **Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: farmland:** NCREIF Farmland Index; **commodities:** Bloomberg Commodity Total Return Index; **private real estate:** NCREIF Fund Index - Open End Diversified Core Equity (NFI-ODCE); **listed REITs:** FTSE NAREIT All Equity REITS Total Return Index; **private credit:** Cliffwater Direct Lending Index; **senior loans:** Credit Suisse Leveraged Loan Total Return Index; **private equity:** Cambridge Private Equity Buyout Index; **small cap equity:** Russell 2000 Total Return Index.

A wider opportunity set is another important factor boosting performance. There are more than 10 times as many private companies as public ones,[2] and public REITs account for only 9.4% of the approximately $20 trillion commercial real estate market.[3] Illiquidity has historically been a barrier to entry, with even large private market investors investing only a portion of assets in private markets. Investors therefore face less competition and can negotiate lower equity valuations and higher bond yields.

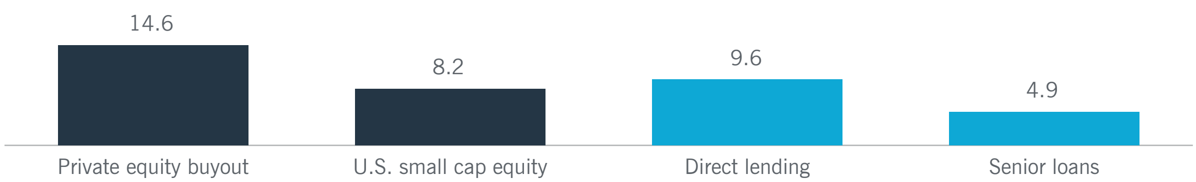
A well understood investing relationship says that, other things being equal, buying assets with lower valuations/higher yields should lead to higher returns.

Figure 2: Less competition has led to lower valuations and higher yields, and ultimately higher returns

Equity valuations and bond yields



Total returns (%)



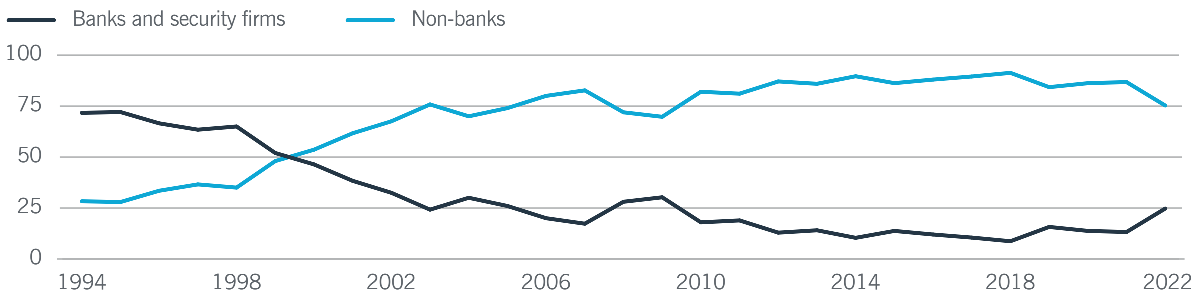
Data source: Bloomberg, L.P., Cambridge, Cliffwater, 31 Dec 2004 – 31 Dec 2024. Most recent data available. **Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: private credit:** Cliffwater Direct Lending Index; **senior loans:** S&P UBS Leveraged Loan Index; **private equity:** Cambridge Private Equity Buyout Index; **small cap equity:** Russell 2000 Total Return Index.

Buying assets with lower valuations/ higher yields should lead to higher returns.

We expect the industry to continue shifting toward private capital and away from traditional financing sources such as banks and equity markets. Non-bank lenders now account for nearly 80% of loan origination versus less than 30% in 1994. At the same time, companies are staying private longer (12 years for IPOs in 2020 versus only 4 years in 1999) and going public at higher valuations (median value of $4.3 billion in 2020 versus $0.5 billion in 1999).[4] The growth previously seen in public markets is now happening in private markets.

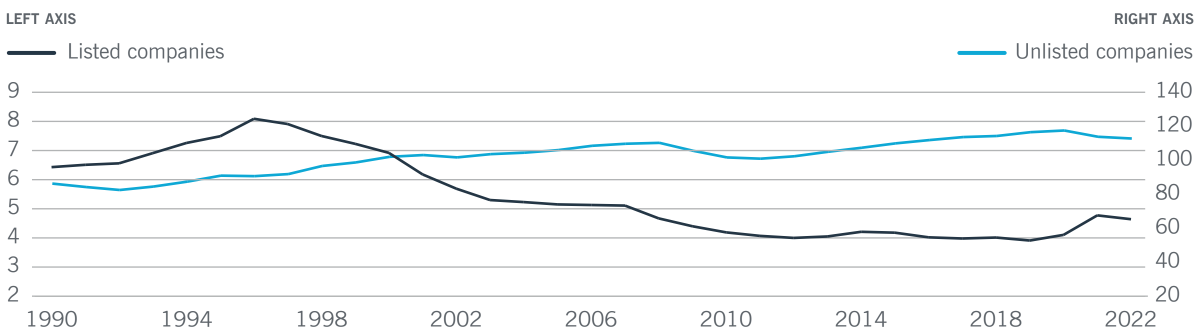
Figure 3: A key element of the private market advantage is a widening opportunity set

Financing sources (%)



Data source: Pitchbook LCD, 31 Dec 1994 – 31 Dec 2022. Non-banks include institutional investors and finance companies. Most recent data available.

U.S. listed versus unlisted companies (000s)



Data source: Listed: World Federation of Exchanges (WFE); unlisted: U.S. Census Bureau, 01 Jan 1990 – 31 Dec 2022. Most recent data available.

> *The growth previously seen in public markets is now happening in private markets.*

2. RESILIENCE: CASH FLOWS CAN INCREASE ALONG WITH INFLATION

Recessions and bouts of unexpected inflation are two of the key downside risks many investors think of when investing. Assets that have provided durable returns across both environments may be attractive portfolio diversifiers.

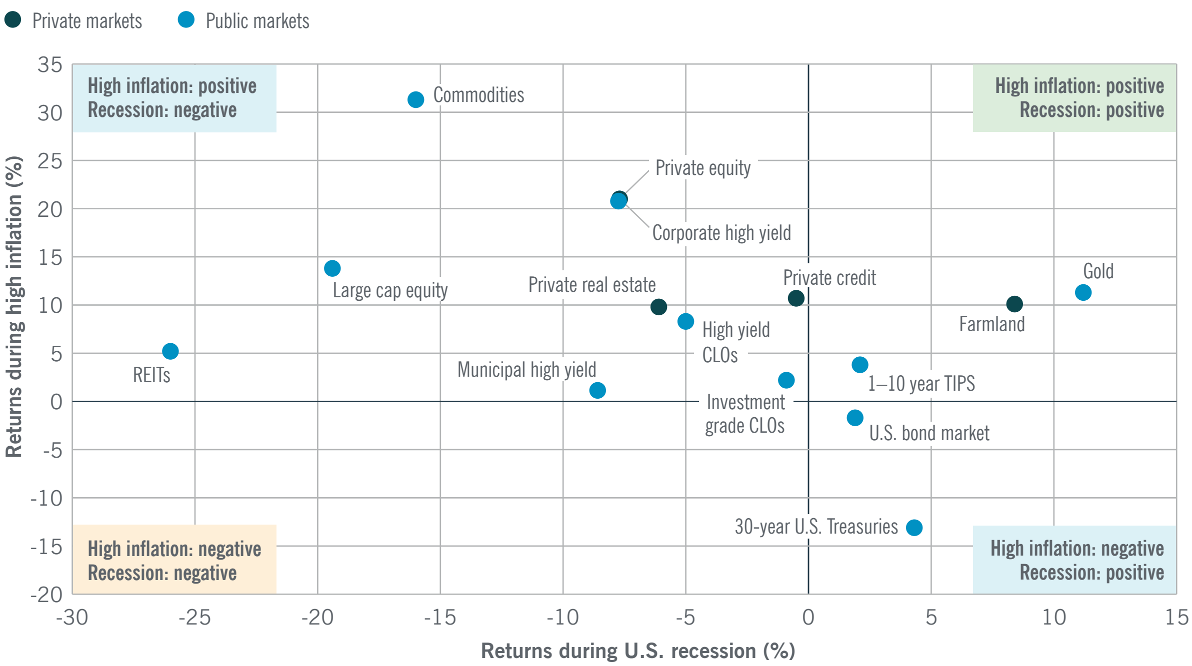
For example, private real estate and farmland provide cash flows that increase with inflation. At the same time, shelter and food are defensive businesses that serve basic needs that consumers prioritize in periods of economic contraction.

Conversely, assets such as long Treasuries and commodities are volatile and tend to add value only in recessionary or inflationary periods, but not in both environments. And neither one has offered compelling long-term returns.

Granted, there is no perfect solution. Guarding against inflation and recession requires accepting at least one trade-off among illiquidity, high volatility and lower returns. We believe, other things being equal, that illiquidity is an advantageous trade-off, as investors typically have unused capacity for illiquid investments.

Figure 4: Private real assets have provided a cushion from inflation and recession

Total returns (%)



Data source: Bloomberg, L.P., Cambridge, Cliffwater, 31 Dec 2004 – 31 Dec 2024. **Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: commodities:** Bloomberg Commodity Total Return Index; **corporate high yield:** Bloomberg U.S. Corporate High Yield Total Return Index; **farmland:** NCREIF Farmland Index; **gold:** Bloomberg Gold Subindex Total Return; **high yield CLOs:** JPMorgan Collateralized Loan Obligation BBB Index; **investment grade CLOs:** JPMorgan Collateralized Loan Obligation Index; **large cap equity:** Russell 1000 Index; **listed REITs:** FTSE NAREIT All Equity REITS Total Return Index; **municipal high yield:** Bloomberg Municipal Bond High Yield Total Return Index Unhedged; **senior loans:** Credit Suisse Leveraged Loan Total Return Index; **private credit:** Cliffwater Direct Lending Index; **private equity:** Cambridge Private Equity Index; **private real estate:** NCREIF Fund Index - Open End Diversified Core Equity (NFI-ODCE); **U.S. bond market:** Bloomberg U.S. Aggregate Total Return Index; **1-10 year U.S. TIPS:** Bloomberg U.S. Treasury Inflation Notes 1-10 Yr. Total Return Index; **30-year U.S. Treasuries:** Bloomberg U.S. Treasury Bellwethers 30-year Total Return Index. **High inflation** is defined as the calendar quarters in the top quartile of inflation as defined by the Consumer Price Index. **U.S. recession** is defined as the calendar quarters in which change in real GDP was negative.

3. STABILITY: PRIVATE MARKET PRICING HELPS AVOID PUBLIC MARKET NOISE

Market uncertainty over the last few years has made the stability of private markets increasingly attractive. Including these assets in a diversified portfolio helped create a steady path even as markets cycled up and down.

In 2022, inflation-linked private assets like real estate offered a rare refuge. Private credit also fared well, cushioned by floating rates.

In volatile times, daily liquid assets tend to sell off more than fair value. For example, during the Global Financial Crisis, the S&P 500 declined -57% while analyst expectations for cash flow were only down -26%. Private equity values reflected fundamentals, declining -27%.

Why the difference? Public markets rely on the wisdom of crowds but are subject to moments of panic. Private markets rely on the wisdom of experts to reflect economic conditions in their valuations.

Figure 5: Private markets have contributed to a diversified portfolio

2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Private RE 15.0%	HY Bonds 17.1%	Non-U.S. Stocks 27.2%	U.S. PE Buyout 10.5%	U.S. LC Equity 31.5%	U.S. PE Buyout 22.2%	U.S. PE Buyout 40.2%	Private RE 7.5%	U.S. LC Equity 26.3%	U.S. LC Equity 25.0%
U.S. PE Buyout 10.8%	U.S. PE Buyout 13.6%	U.S. LC Equity 21.8%	Private RE 8.4%	Non-U.S. Stocks 21.5%	U.S. LC Equity 18.4%	U.S. LC Equity 28.7%	Private Credit 6.3%	Non-U.S. Stocks 15.6%	Diversified Portfolio 12.7%
Private Credit 5.5%	U.S. LC Equity 12.0%	U.S. PE Buyout 18.9%	Private Credit 8.1%	Diversified Portfolio 19.5%	Diversified Portfolio 12.3%	Private RE 22.2%	Cash 1.5%	Diversified Portfolio 15.3%	Private Credit 11.3%
Munis 3.3%	Private Credit 11.2%	Diversified Portfolio 15.3%	Cash 1.8%	U.S. PE Buyout 18.1%	Non-U.S. Stocks 10.7%	Diversified Portfolio 17.5%	U.S. PE Buyout -1.4%	HY Bonds 13.5%	U.S. PE Buyout 8.8%
Diversified Portfolio 2.3%	Private RE 8.8%	Private Credit 8.6%	Munis 1.3%	HY Bonds 14.3%	Core Bonds 7.5%	Private Credit 12.8%	Munis -8.5%	Private Credit 12.1%	HY Bonds 8.2%
U.S. LC Equity 1.4%	Diversified Portfolio 8.5%	Private RE 7.6%	Core Bonds 0.0%	Private Credit 9.0%	HY Bonds 7.1%	Non-U.S. Stocks 7.8%	Diversified Portfolio -11.0%	U.S. PE Buyout 10.6%	Non-U.S. Stocks 5.5%
Core Bonds 0.6%	Non-U.S. Stocks 4.5%	HY Bonds 7.5%	Diversified Portfolio -1.2%	Core Bonds 8.7%	Private Credit 5.5%	HY Bonds 5.3%	HY Bonds -11.2%	Munis 6.4%	Cash 5.3%
Cash 0.0%	Core Bonds 2.7%	Munis 5.4%	HY Bonds -2.1%	Munis 7.5%	Munis 5.2%	Munis 1.5%	Core Bonds -13.0%	Core Bonds 5.5%	Core Bonds 1.3%
HY Bonds -4.5%	Cash 0.3%	Core Bonds 3.5%	U.S. LC Equity -4.4%	Private RE 5.3%	Private RE 1.2%	Cash 0.0%	Non-U.S. Stocks -16.0%	Cash 5.1%	Munis 1.1%
Non-U.S. Stocks -5.7%	Munis 0.2%	Cash 0.8%	Non-U.S. Stocks -14.2%	Cash 2.2%	Cash 0.5%	Core Bonds -1.5%	U.S. LC Equity -18.1%	Private RE -12.1%	Private RE -1.4%

Data source: Bloomberg, L.P., 31 Dec 2024. **Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: U.S. PE buyout:** Cambridge U.S. Buyout Index; **U.S. LC equity:** S&P 500 Index; **Non U.S. stocks:** MSCI ACWI Index; **private credit:** Cliffwater Direct Lending Index; **private RE:** NCREIF ODCE Index; **cash:** Bloomberg U.S. Treasury Bill 1-3 Months Index; **core bonds:** Bloomberg U.S. Aggregate Index; **high yield bonds:** Bloomberg U.S. Corporate High Yield Index; **municipal bonds:** Bloomberg Municipal Bond Index; **diversified portfolio:** 40% U.S. LC equity, 7% U.S. PE buyout, 10% Non U.S. stocks, 8% private credit, 5% private RE, 2% cash, 10% core bonds, 4% high yield bonds, 14% municipals. Diversification does not assure a profit or protect against loss.

Enhancing portfolios with private investments

Allocating to private markets can be challenging and may not be appropriate in every case. Private strategies may have unfamiliar features and terms and management logistics.

However, we believe that the role of private investments in a diversified portfolio is more important today than ever. As the name suggests, private markets can only be accessed through deeply established relationships, requiring clients to partner with experienced asset managers that can navigate this market effectively.

For more information, please visit nuveen.com.

Endnotes

Sources

1 Data source: McKinsey & Company, *Measuring the Economic Impact of Short-Termism*, February 2014.

2 Data source: listed: World Federation of Exchanges (WFE); unlisted: U.S. Census Bureau. Most recent data available.

3 *Estimating the size of the Commercial Real Estate Market in the U.S.*, NAREIT, 30 Jun 2022. Most recent data available.

4 Data source: Boston Consulting Group and iCapital, *The Future is Private*, March 2022.

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