

March 2024

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. STABILITY: PRIVATE MARKET PRICING HELPS AVOID PUBLIC MARKET NOISE

Inflation-linked private assets like real estate and farmland were one of the few refuges in the market upheaval of the last couple of years, and most private assets avoided the knee-jerk reactions of public markets.

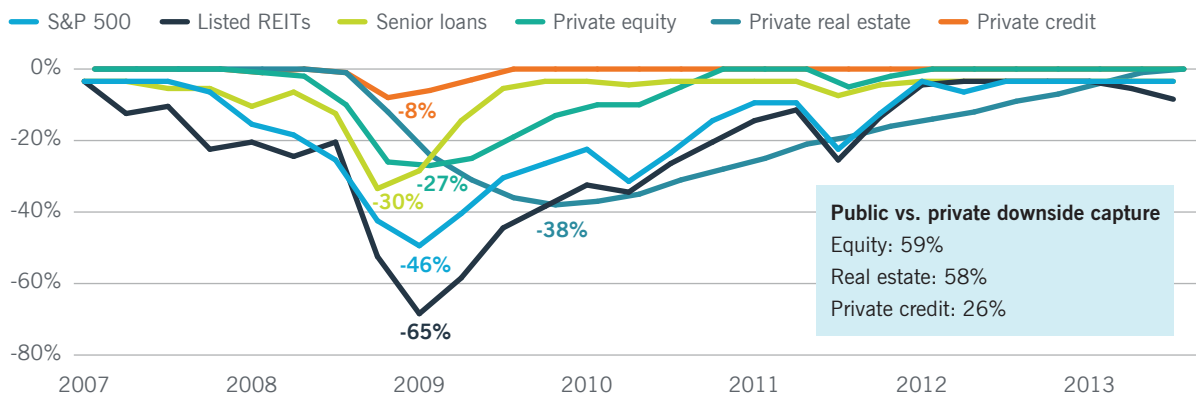
Private markets also provided stability during the Global Financial Crisis. Peak-to-trough, private credit experienced only 26% downside capture versus senior

loans. The private equity and real estate downside capture versus public market equivalents were still beneficial at approximately 60%. More specifically, the S&P 500 was down -46% while private equity values declined only -27%, which with hindsight was more in line with the fundamentals of the period.

Why the difference? Public markets tend to sell off more than fair value because they often rely on the wisdom of crowds and are subject to moments of panic. Private markets rely on the wisdom of experts to reflect economic conditions in their valuations.

Figure 1: What does a downturn look like for private markets?

Maximum drawdowns (%)



Data source: Bloomberg, L.P., 31 Mar 2007 – 30 Sep 2013. Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: listed REITs: FTSE NAREIT All Equity REITS Total Return Index; senior loans: Credit Suisse Leverage Loan Total Return Index; private equity: Cambridge Private Equity Index; private real estate: NCREIF Fund Index - Open End Diversified Core Equity (NFI-ODCE); private credit: Cliffwater Direct Lending Index Total Return. Drawdown capture periods: equities: 31 Dec 2007 – 31 Mar 2009; real estate: 30 Jun 2008 – 31 Dec 2009; private credit: 31 Dec 2007 – 31 Dec 2008. Data frequency is quarterly.

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

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2. 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.

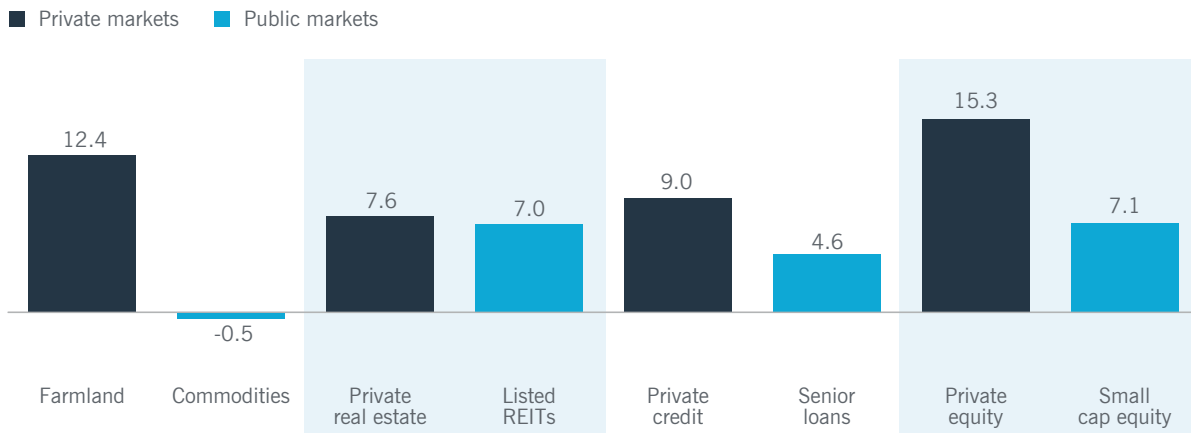
The investment time horizon is generally longer for private markets. In public companies, 87%

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 2: Private markets have outperformed their public counterparts

Total return (%)



Data source: Bloomberg, L.P., Cambridge, Cliffwater, 30 Jun 2004 – 30 Sep 2023. 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-DDCE); **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.



Private markets rely on the wisdom of experts to reflect economic conditions in their valuations.

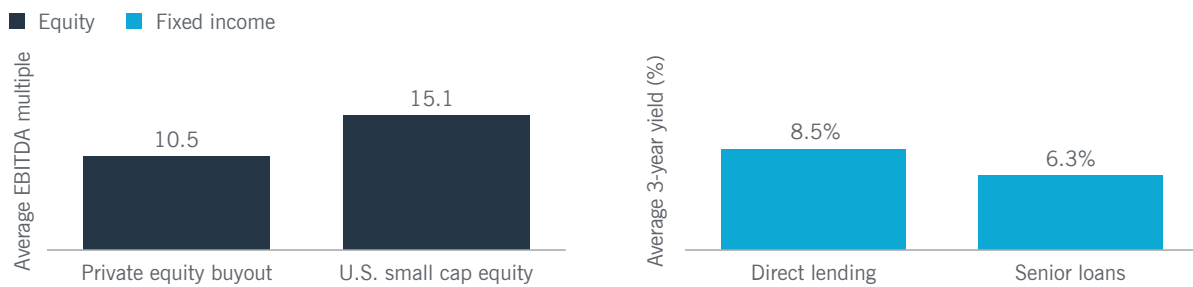
A wider opportunity set is another important factor boosting performance. There are more than 10 times as many private companies as public ones,² and public REITs account for only 9.4% of the approximately \$20 trillion commercial real estate market.³ Illiquidity has historically been a barrier to entry, 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.

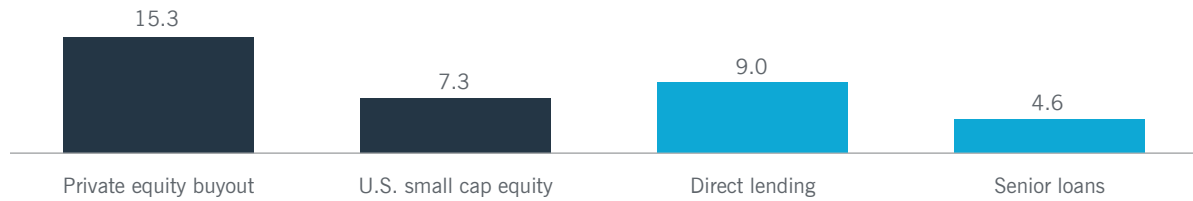
A well understood investing relationship says that, other things being equal, buying assets with lower valuations/higher yields should lead to higher returns.

Figure 3: 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, 30 Jun 2004 – 30 Sep 2023. 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: Credit Suisse Leveraged Loan Total Return Index; private equity: Cambridge Private Equity Buyout Index; small cap equity: Russell 2000 Total Return Index.**



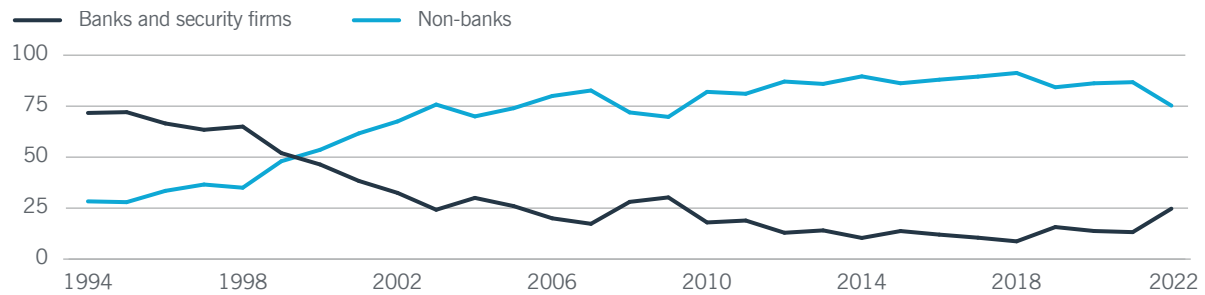
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higher yields should lead to higher returns.*

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.

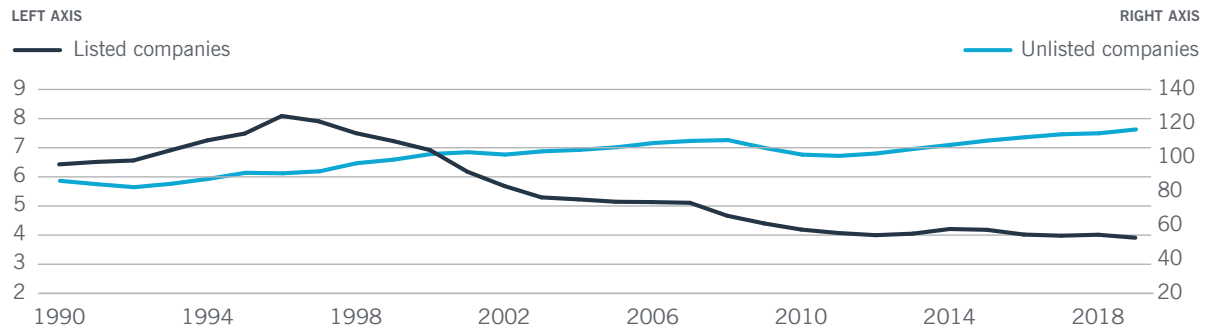
Figure 4: A key element of the private market advantage is a widening opportunity set

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 2021. Most recent data available.



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3. RESILIENCE: CASH FLOWS CAN INCREASE ALONG WITH INFLATION

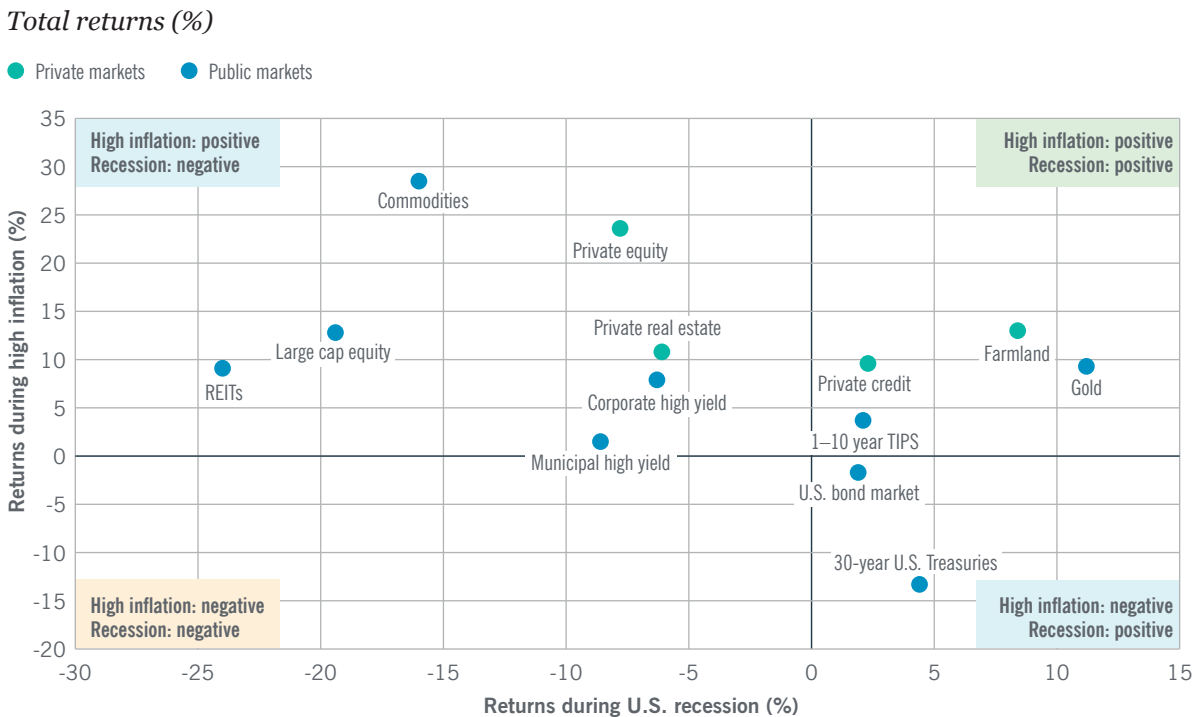
Recessions and bouts of unexpected inflation are two of the key downside risks many investors think of when investing. Assets that have provided durable returns across both environments may be attractive portfolio diversifiers.

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 perform 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 5: Private real assets have provided a cushion from inflation and recession



Data source: Bloomberg, L.P., Cambridge, Cliffwater, 30 Jun 2004 – 30 June 2022. 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; 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.



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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.](https://www.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.*, NARIET, 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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Important information on risk

Investors should be aware that alternative investments are speculative, subject to substantial risks including the risks associated with limited liquidity, the use of leverage, short sales and concentrated investments and may involve complex tax structures and investment strategies. Alternative investments may be illiquid, there may be no liquid secondary market or ready purchasers for such securities, they may not be required to provide periodic pricing or valuation information to investors, there may be delays in distributing tax information to investors, they are not subject to the same regulatory requirements as other types of pooled investment vehicles, and they may be subject to high fees and expenses, which will reduce profits. Alternative investments are not suitable for all investors and should not constitute an entire investment program. Investors may lose all or substantially all of the capital invested.

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