Brookfield

A Guide to Private Equity

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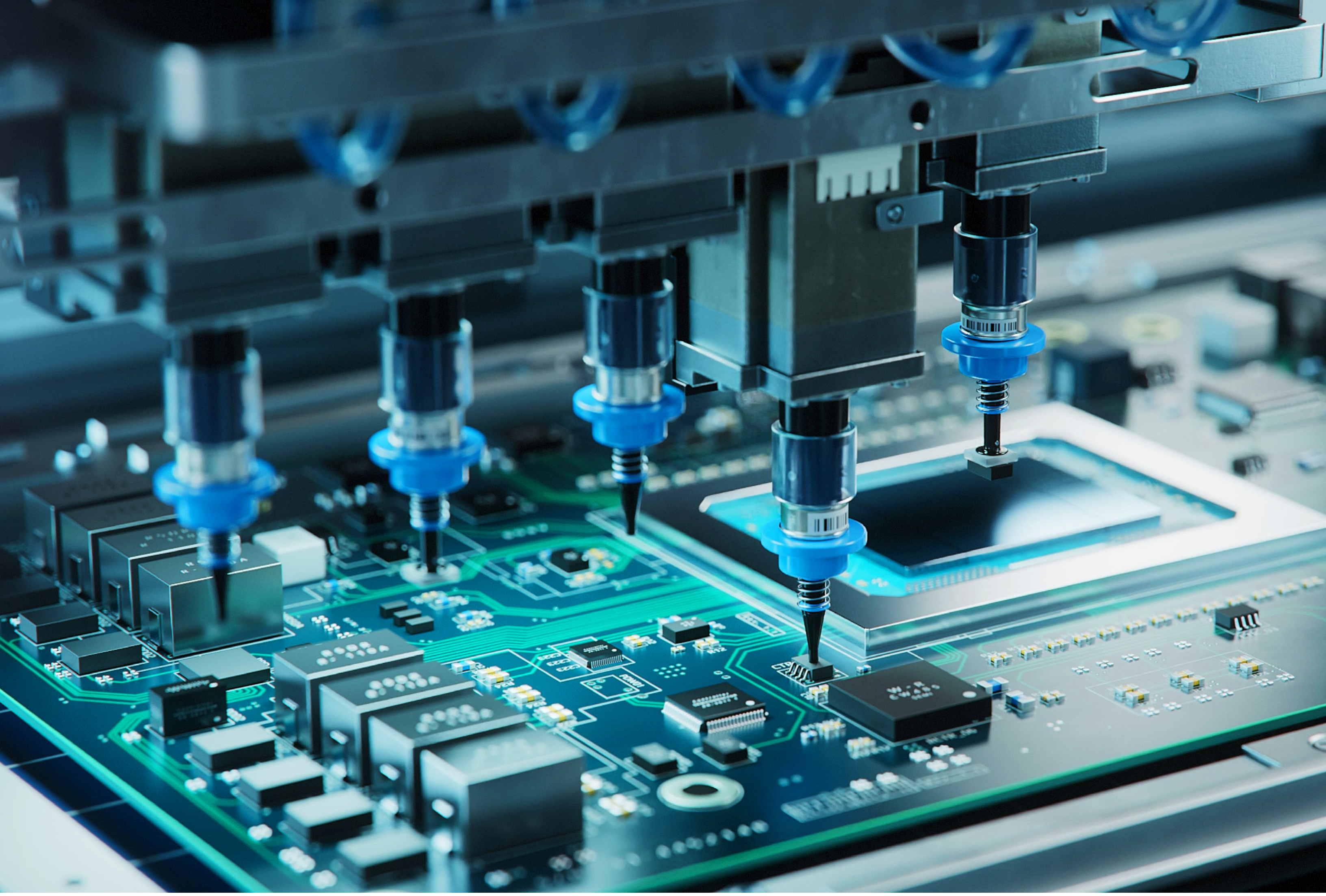

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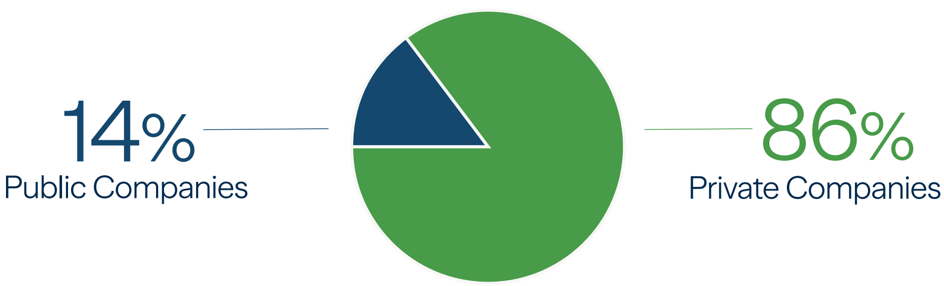
Overview

Private equity (PE) provides investors with access to a broad universe of private companies, many of which are not available through public markets. As the dominant asset class within private markets—representing over 68% of the $17.1 trillion global private asset space[1]—PE offers a pathway to capitalize on growth opportunities in companies that remain privately held. Indeed, the vast majority of global companies generating revenues over $100 million remain privately owned, providing investors with ample opportunity for diversification and returns beyond traditional equities (**Figure 1**).

Figure 1: Over 86% of Firms Globally With Revenues Greater Than $100 Million Are Private

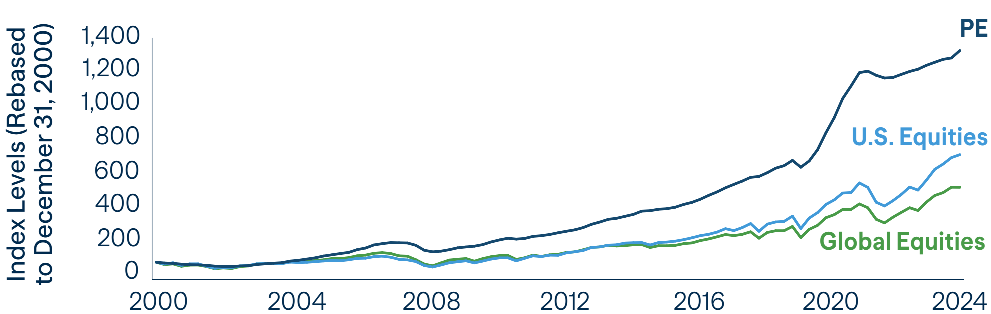


Source: S&P Capital IQ, 2024.

Institutional investors, including pension funds, endowments and foundations, have consistently turned to PE as a reliable driver of long-term portfolio performance, making it a cornerstone of their long-term investment strategies. Indeed, over recent decades, PE has consistently delivered robust returns, notably outperforming public equities in both U.S. and global markets (**Figure 2**). This compelling track record underscores PE's resilience and its critical role in building portfolios designed for sustained growth.

Figure 2: PE Outperforms Public Markets Over Time

Index Returns



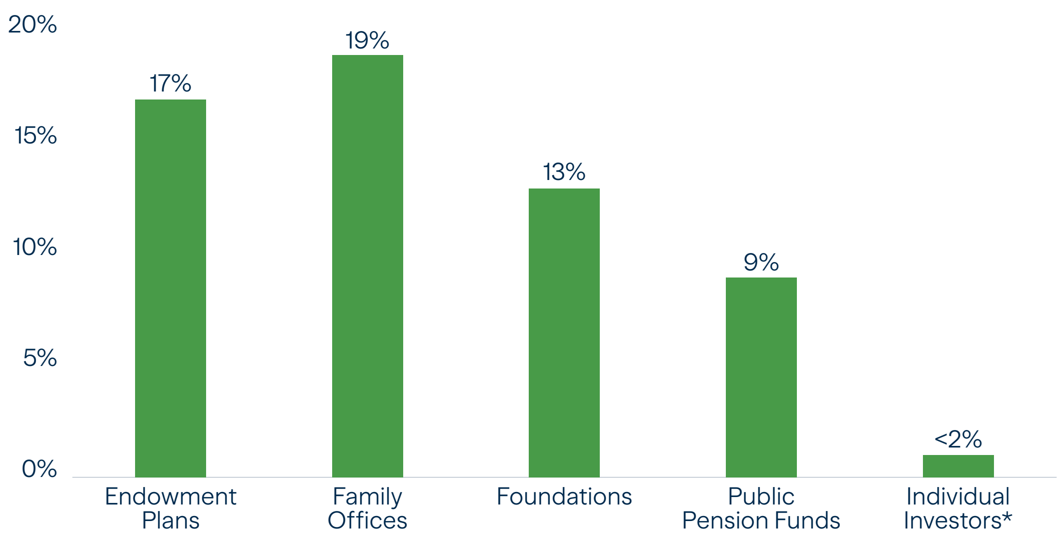
Past performance is not indicative of future results. For illustrative purposes only. Information does not represent returns of a fund. An investor cannot invest in an index. PE represented by Preqin PE Index, Global Equities represented by MSCI World Index, U.S. Equities represented by S&P 500. Please see disclosures for additional information.

Source: Morningstar, MSCI, Preqin, S&P and Brookfield, as of December 2024.

As PE continues to thrive among institutional investors, it is becoming increasingly accessible to individual investors. New opportunities and vehicles are now available for individuals looking to enter this high-growth asset class. Although average individual investor allocations to PE remain below 2% (**Figure 3**), we believe we are on the brink of a paradigm shift, where the democratization of private markets and PE can unlock significant investment opportunities for individuals eager to diversify and build long-term wealth.

Figure 3: Institutional Investors Have Led the Way in PE Allocation

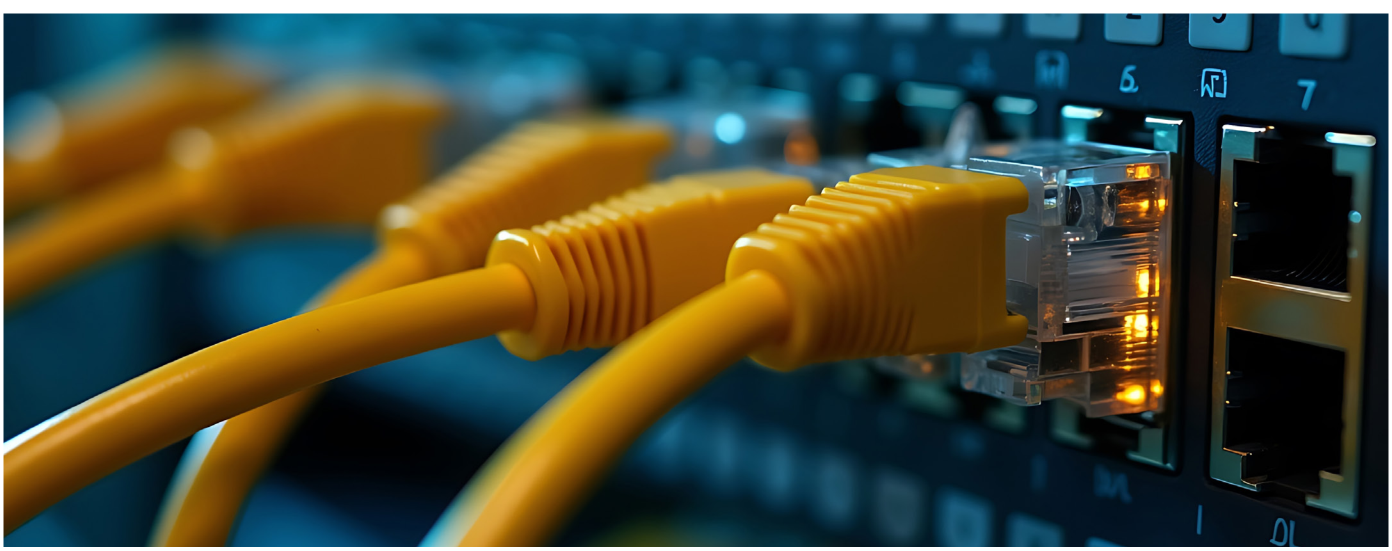
Average Allocation to PE



*The 2% allocation includes all alternatives, of which PE is just one component.

Source: McKinsey & Company, Preqin, as of 2024.

In this paper we discuss PE as an asset class, explore its key characteristics, and explain the roles it can play in an investor's portfolio.



How PE Investing Works

Understanding how PE investing works, particularly in comparison to public equity investing, is foundational for investors exploring this asset class.

Public equity fund managers typically make their investments in public companies based on the strength of their financials, growth prospects and the company's management team's track record. Typically, they take a more passive role in influencing the business, relying on existing management to execute strategies and drive value.

In contrast, PE managers adopt a distinctly active approach. They acquire significant equity stakes in private companies with the explicit goal of creating value through direct involvement in strategic decision-making and operational improvements (see **Figure 4**). PE investing follows a consistent strategy framework: first identifying and acquiring promising businesses, then implementing targeted operational and organizational enhancements to accelerate growth, enhance efficiency, and ultimately increase enterprise value. Eventually, the investor realizes a profit by "exiting," via an initial public offering (IPO) or by selling their investment to another buyer.

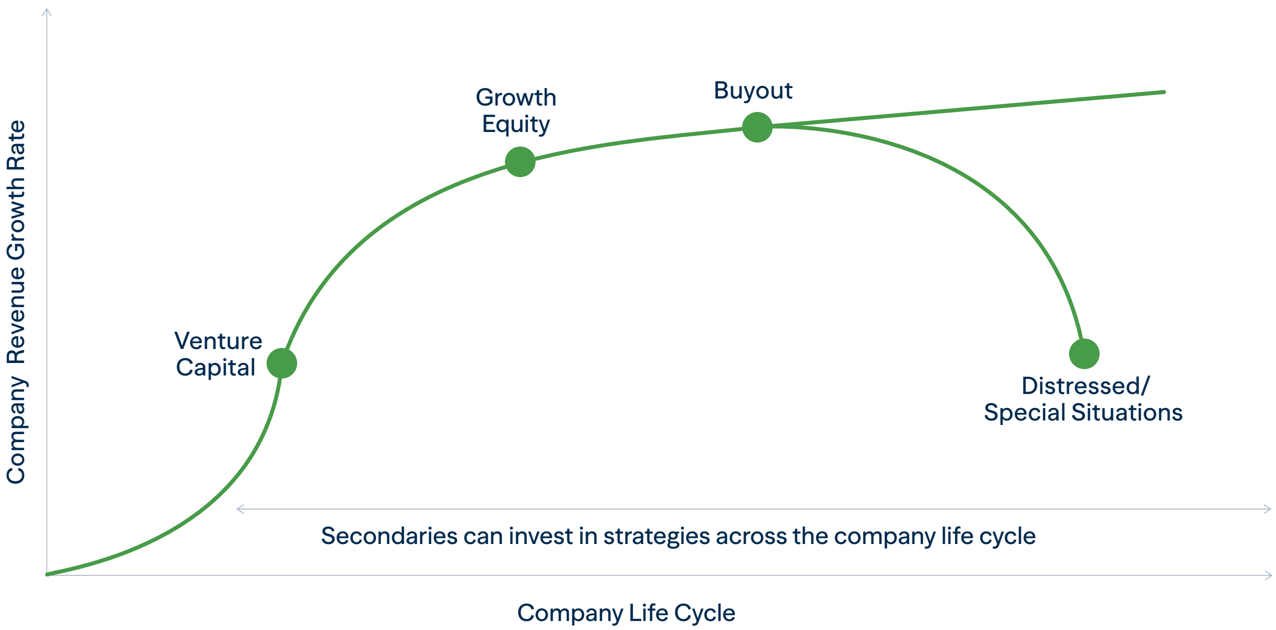
PE typically considers many of the same factors as public equity, such as growth rates, profitability and management quality. However, it also includes unique characteristics—most notably, illiquidity and operational control—that alter its risk/return profile and differentiate it from public equity. These distinctive factors can enhance portfolio return potential, particularly when combined with public equity investments.

Figure 4: Public Equity vs. PE Investments

	Public Company	**Private Company**
Ownership	Publicly Listed and Traded	Privately Held
Liquidity	High	Low
Fund Manager's Ability to Influence Change	Limited, Passive	High, Direct

There are a range of PE strategies, with a corresponding variety of risk levels, largely based on a company's stage of maturity, as shown in **Figure 5**.

Figure 5: PE Strategies Vary in Risk, Typically Reflecting Company's Maturity



Venture Capital: Early-stage firms offering the potential to achieve multiples on an investment. Targets tend to have high revenue growth and are not yet profitable.

Growth Equity: Investing in companies that are on track or nearing profitability and require additional capital to expand.

Buyout: Mature firms (public and private) with room for efficiencies and expectations of growing market share.

Distressed/Special Situations: Investing in the equity/debt of firms in financial distress. Investors aim to take control during a restructuring, implement changes, return the firm to profitability, and make an exit.

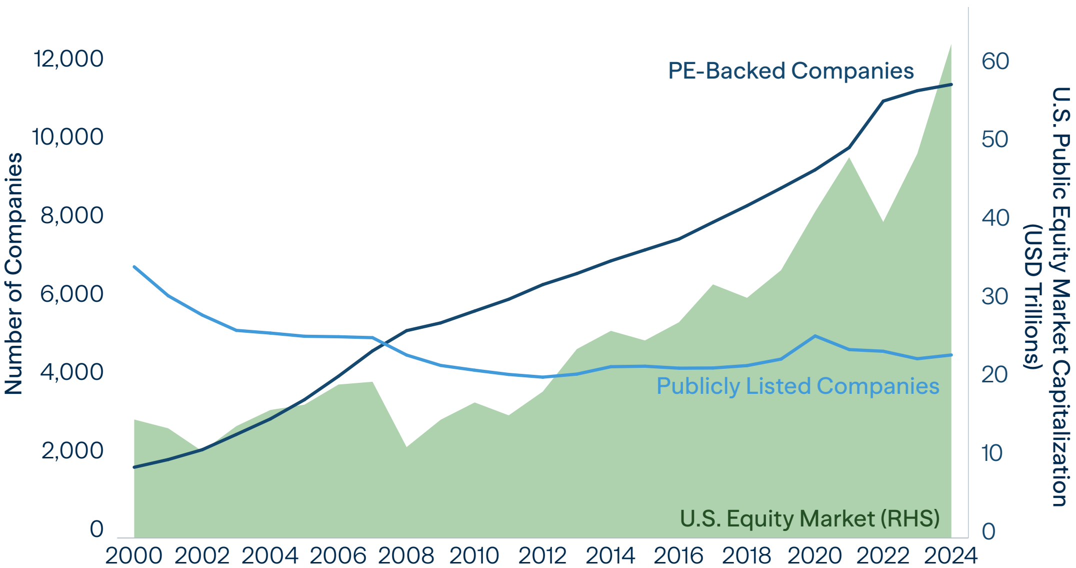
Secondaries: Investing in existing PE funds (or directly in their portfolio companies), hoping to buy exposure at a discount with a shorter timeline to realization.

Source: Brookfield Asset Management. For illustrative purposes only.

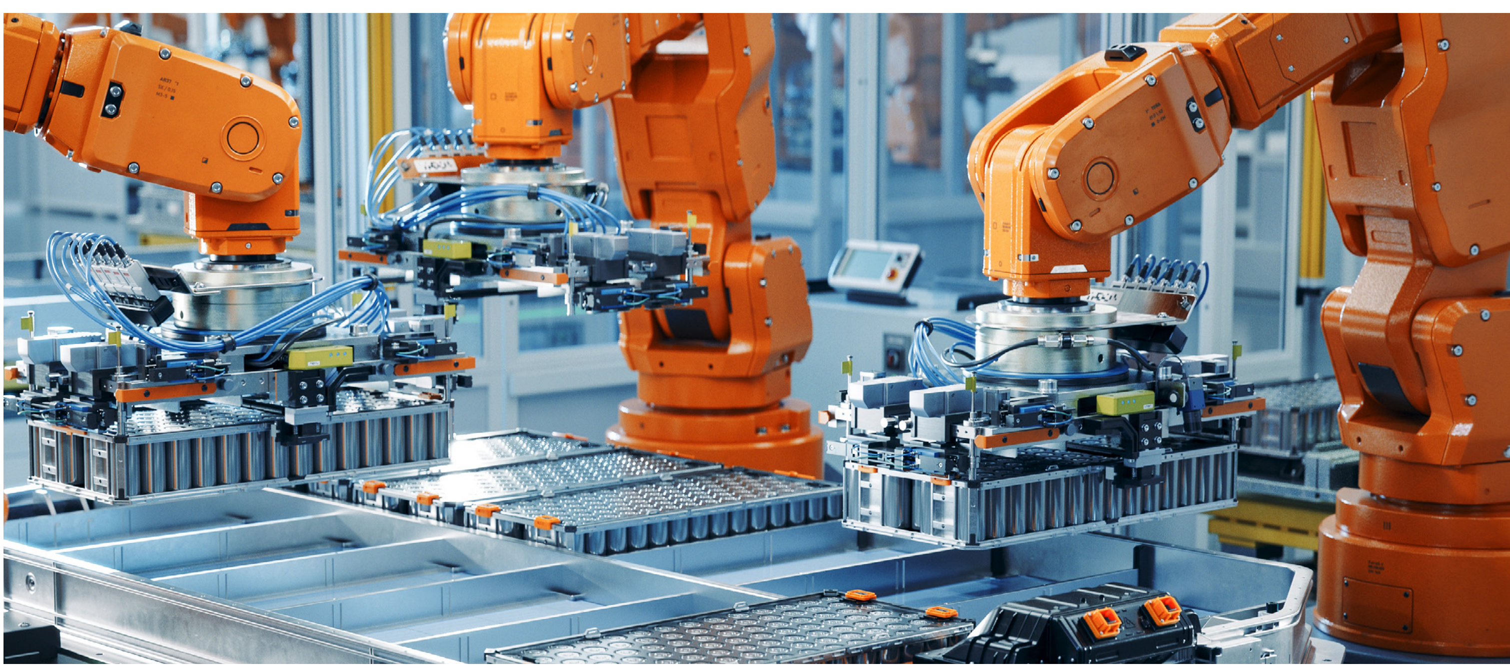
The Public Equity Conundrum: Public Companies Disappearing Amid Surging Equity Markets

Fewer companies are choosing to become or remain publicly listed, even as public equity markets have delivered robust performance and substantial growth. For example, at the start of this century, there were roughly 7,000 companies listed on the NYSE and Nasdaq exchanges; by 2024, this figure had fallen to roughly 4,000. Over the same period, however, the value of these public equity markets quadrupled—from $15 trillion to roughly $63 trillion. Concurrently, PE-backed companies have flourished, increasing from fewer than 2,000 to more than 10,000 (**Figure 6**).

Figure 6: While Public Markets Firms Have Shrunk in Number but Grown in Value, PE-Backed Companies Have Expanded



Source: Federal Reserve Economic Data, Morningstar, PitchBook, World Federation of Exchanges, as of 2024.

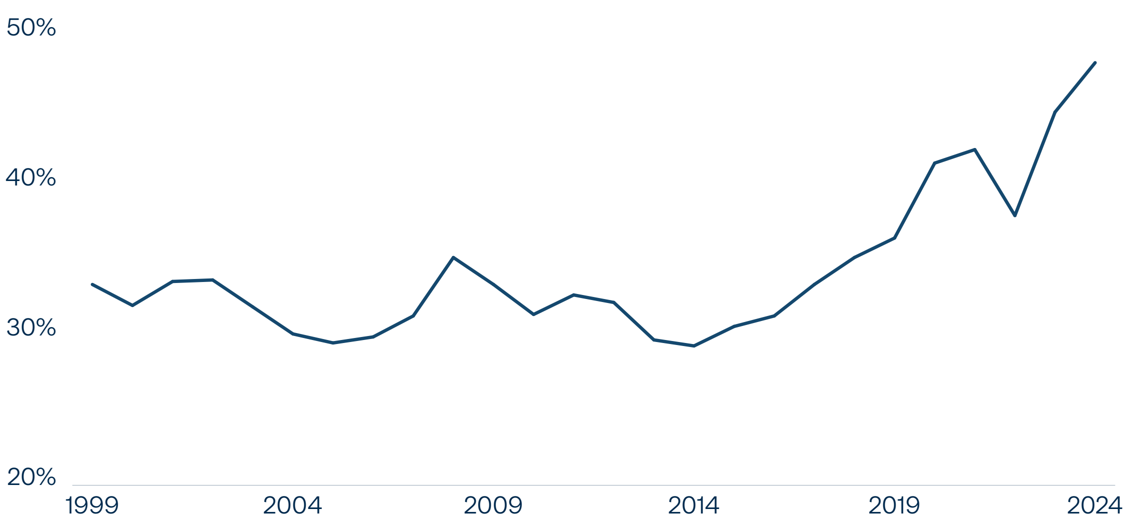


More Capital Chasing Fewer Names: Would You Invest in a Company Trading at 40x Earnings?

As a result of fewer companies remaining publicly listed, the equity markets have become concentrated in an increasingly narrow set of companies. This dynamic has eroded diversification benefits and amplified concentration risks. In fact, market concentration among the top 20 companies in the S&P 500 has reached its highest level in over two decades, with these firms now representing nearly 50% of the index's total market capitalization. Put simply, just 20 out of 500 stocks account for the lion's share of both market performance and risk (**Figure 7**).

Figure 7: The S&P 500 Has Become More Concentrated Over the Past Decade

Top 20 Companies' Share of the S&P 500 by Market Cap

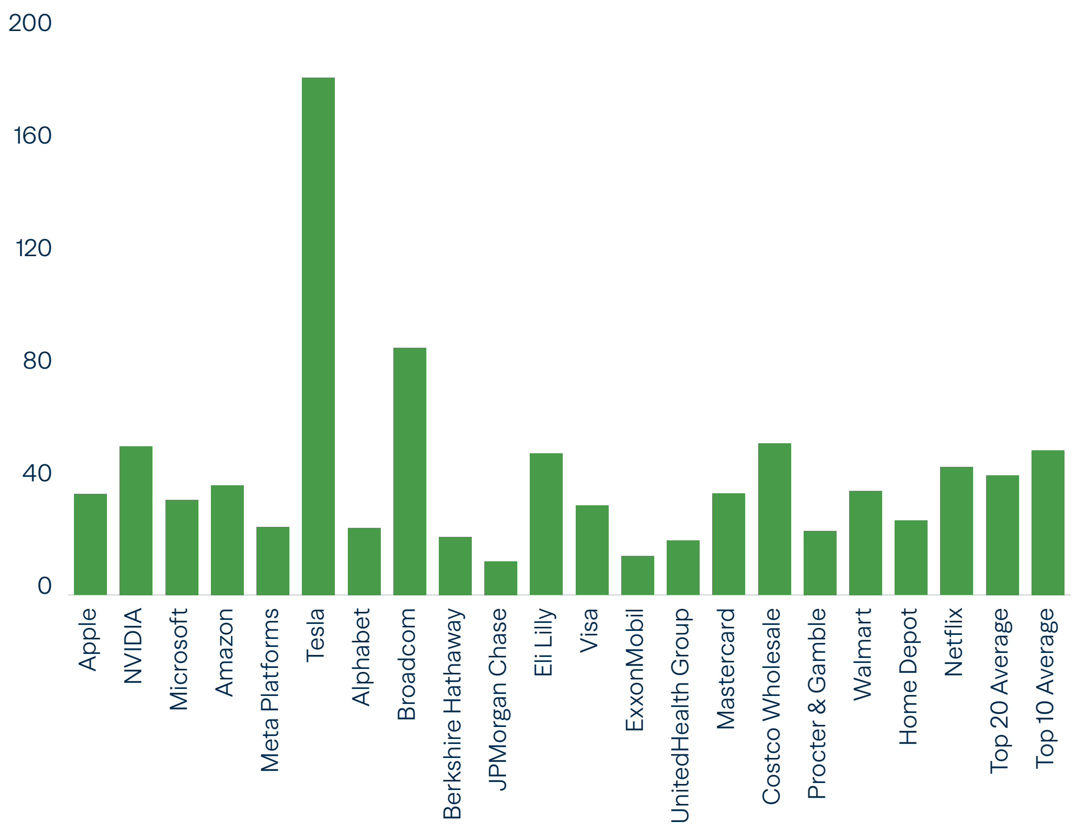


Source: Bloomberg, as of December 2024.

Unsurprisingly, this concentration of capital has elevated valuations, with the average price-to-earnings (P/E) ratio of the top 20 companies in the S&P 500 surpassing 40x, and the largest 10 companies exceeding 50x (**Figure 8**). While such elevated multiples reflect strong investor confidence in these leading companies' future growth prospects, they also heighten concerns around valuation sustainability and the associated risks of market concentration. Not surprisingly, investors have sought portfolio diversifiers to balance their portfolios.

Figure 8: Public Valuations Appear Stretched by at Least One Measure

Top 20 Largest Companies' P/E Ratios



Past performance is not indicative of future results.

Source: Bloomberg, as of December 2024.

A PRICE-TO-EARNINGS (P/E) RATIO is a valuation metric used to assess how much investors are willing to pay for each dollar of a company's earnings. A high P/E ratio often signals strong growth expectations but can also suggest overvaluation. The average P/E ratio of the S&P 500 Index over the past 50 years has been approximately 16-20x.

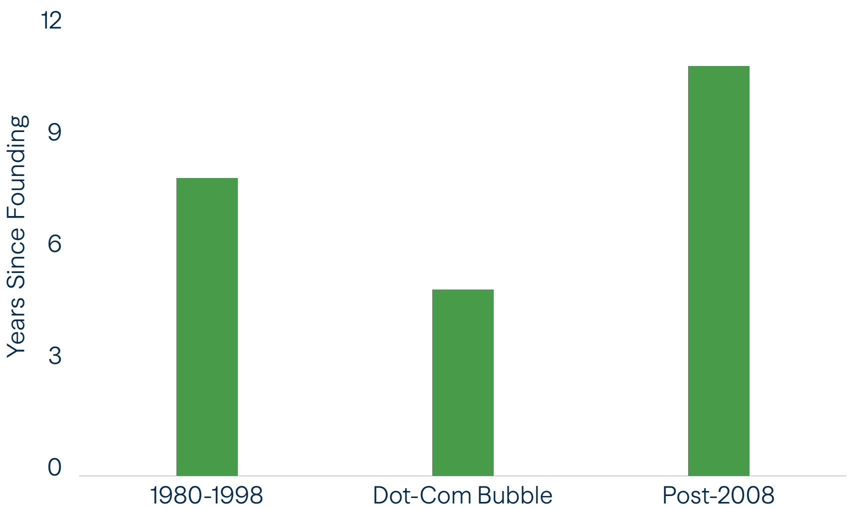
To explain these observations, we have seen several notable trends that have driven companies to remain privately held, fueling significant growth in private financing.

Where Did the Public Companies Go? They Stayed Private.

As noted earlier, several trends over the decades have led companies to remain private (**Figure 9**). The tide began to shift after the dot-com bubble burst, along with the WorldCom and Enron scandals, prompting Congress to pass the Sarbanes-Oxley Act.

Figure 9: Shifting Regulations and Market Dynamics Are Incentivizing Companies to Stay Private Longer

Median Age of a Company at IPO



Source: Jay R. Ritter, "Initial Public Offerings: Median Age of IPOs Through 2023" 2024.

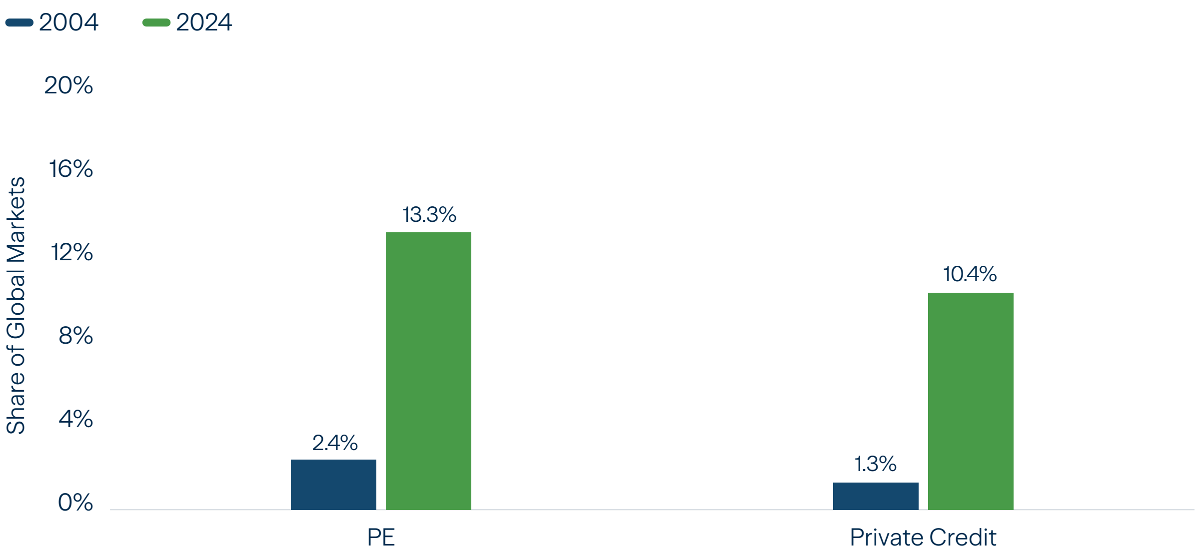
The median age of a company at the time of its initial public offering was eight years in the 1980s and for most of the 1990s, although it fell to five years during the dot-com bubble. However, since the 2008 financial crisis, companies now, on average, are 11 years old at their IPOs.

The Sarbanes-Oxley Act imposed stricter financial disclosure requirements and corporate governance standards, but it also significantly increased regulatory and compliance costs for public companies. While the legislation introduced additional compliance burdens that led some companies to go private, the overall number of public companies remained relatively stable, primarily due to the limited availability of comparable alternative funding sources.

Post-Global Financial Crisis: Capital Markets Have Become Much Deeper

However, the landscape shifted dramatically after the global financial crisis and the introduction of the Dodd-Frank Act, including the Volcker Rule, which further heightened governance and compliance costs for public companies while restricting traditional bank funding sources. As banks stepped back from certain financing activities, private capital stepped forward, offering companies an alternative source of funding. Private capital often provided more flexible terms and fewer regulatory burdens than public markets, enabling many businesses to remain private longer or avoid public listings altogether. Indeed, the share of global capital markets accounted for by PE and private credit has grown significantly over the past two decades (**Figure 10**). For example, the PE share of the total global equity market has grown from 2.4% in 2004 to over 13% in 2024, while private credit's share of total outstanding global corporate debt rose from 1.3% to 10.4% over the same period. This growth in private market financing has allowed companies to scale their operations or pursue new initiatives without resorting to public markets—a path that was previously far more challenging.

Figure 10: PE and Private Credit Have Grown Significantly, Relative to Public Markets



For illustrative purposes only. Information does not represent returns of a fund. An investor cannot invest in an index. PE is represented by PE assets under management, as reported by Preqin. Private Credit is represented by private credit assets under management, also as reported by Preqin. Global Markets comprises global public equity markets, represented by MSCI ACWI IMI, and global corporate bond markets, represented by ICE BofA Global Corporate Index and ICE BofA Global High Yield Index.

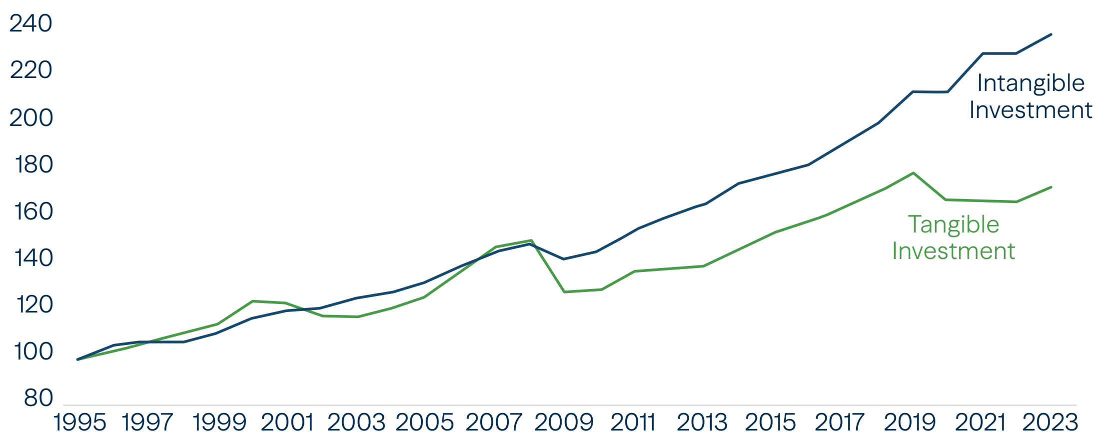
Source: Bank for International Settlements, ICE Data Indices, MSCI, Preqin, World Bank, as of 2024.

Figure 10 illustrates the growth of private capital by showing PE's share of global public equity markets and private credit's share of global corporate bond markets. Over the past two decades, both segments have expanded significantly, highlighting the increasing role of private markets in global capital formation.

Shifting focus to intangible capital in the knowledge-based economy. As intangible capital becomes more important to business success in today's global economy (**Figure 11**), staying private has increasingly become a competitive edge.

Figure 11: As Intangible Capital Grows in Importance, Companies Are Staying Private to Maintain a Competitive Edge

Total Intangible and Tangible Investment 1995-2023, Indexed (1995=100)



Tangible vs. Intangible Capital

Definition & Examples	**Tangible Capital:** Physical assets like buildings, machinery, inventory, equipment and land.
	Intangible Capital: Non-physical assets such as intellectual property, software, brand value, knowledge and patents.

Note: Intangible and tangible investment have been aggregated over the sample countries: EU-22, India, Japan, the United Kingdom and the United States. Estimates are in terms of chain-linked volumes (reference year 2015). See Endnotes for definition of EU-22.[2]

Past performance is not indicative of future results.

Source: WIPO and Luiss Business School, "World Intangible Investment Highlights," June 2024.

According to a Federal Reserve study,[3] companies become increasingly reluctant to go public as intangible capital assets grow more important to their business. Public firms are required to provide regular reporting and disclosures; these disclosure regulations aim to protect investors and facilitate a fair capital market. However, these same disclosures may inadvertently reveal strategic insights or proprietary business models—especially when it comes to intangible assets that are difficult to protect through patents or trade secrets. While private companies are still held to rigorous accounting standards such as GAAP or IFRS, they are not subject to the same public reporting obligations—allowing them to maintain greater discretion over competitively sensitive information. This discretion can be a meaningful competitive advantage, particularly for innovation-driven businesses. This contrasts with "old economy" companies that simply produce a good or service for sale and would not be required to reveal any confidential information on their manufacturing process, for example. The bottom line is that more and more companies have decreased their dependency on public funding at a time when they have more incentives to remain private.

How Does PE Create Value?

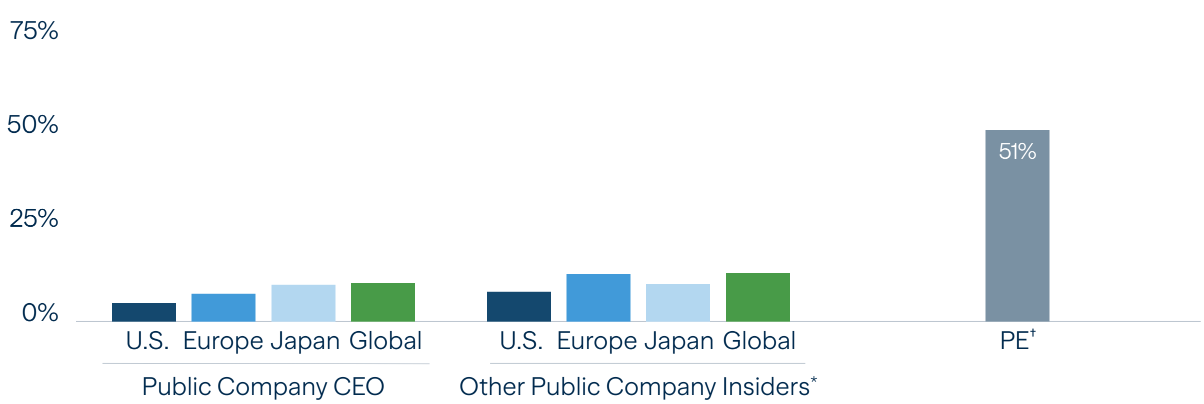
As discussed earlier, PE has consistently delivered strong returns relative to public equities. This strong performance has made PE a core allocation for many institutional investors seeking enhanced returns and portfolio diversification. But what makes PE investing distinct, and how does it generate this outperformance?

Below are five key factors that explain how PE managers create value beyond what is typically seen in public markets.

1. Active involvement of General Partners.
PE General Partners (GPs) play a hands-on role in driving value creation within portfolio companies through financial and operational improvements. In contrast, public investment fund managers typically adopt a more passive approach, with minimal involvement in the day-to-day operations of the companies in which they invest. Moreover, GPs typically have strong incentives, particularly from a compensation standpoint, to create value for investors and lead to an eventual profitable sale. Of course, executives of publicly traded firms are also usually well compensated if the firm performs well. However, research has actually shown that they typically don't own enough equity to incentivize greater sensitivity to maximizing shareholder value[4] (**Figure 12**).

Figure 12: PE Managers Typically Hold Greater Ownership Stakes Than Public Company CEOs

Average Percent Ownership of Company Equity



*Corporate officers excluding the CEO, directors and those holding more than 5% of the outstanding stock. † The typical PE buyout strategy purchases 51-100% of a firm's equity.

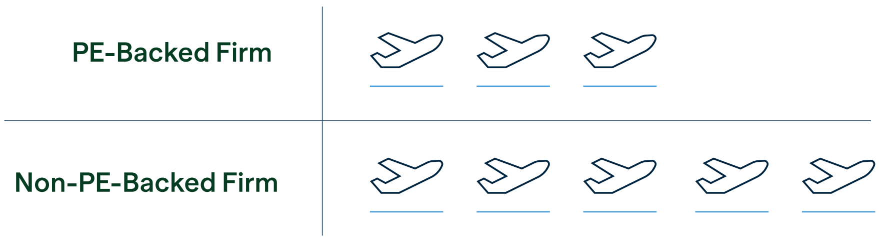
Source: Aswath Damodaran, "Insider and Institutional Ownership Data," NYU Stern School of Business, January 2025.

Moreover, CEOs of publicly traded companies are routinely well compensated even if the firm struggles, often receiving a "golden parachute" if fired or asked to resign by the board. In contrast, PE investors provide strong equity incentives to the management teams of their portfolio companies. A General Partner of a PE firm managing a portfolio company typically receives 20% of the gains on the portfolio company—in short, there is a strong incentive in the compensation structure to succeed. At the same time, leverage puts pressure on managers not to waste money.

PE investors also are usually more actively involved in governance than public company directors and public shareholders. Moreover, PE firms typically leverage their industry expertise, operational capabilities and cost discipline to add value to their portfolio companies. One real-world example of the increased efficiency that a PE firm can bring comes from a 2012 study that explored the use of private company planes as a proxy for wasteful managerial excess. The study found that PE-owned firms were 25% less likely to own a private plane, and those that do typically have 40% fewer private planes than their publicly traded counterparts[5] (**Figure 13**).

Figure 13: PE's Cost Discipline Is Reflected as PE-Backed Firms Operate With 40% Smaller Fleets Than Their Public Peers

Average Fleet Size



For illustrative purposes only.

Controlling for size, industry and location, PE-backed firms maintain significantly smaller private plane fleets than their publicly listed peers. Although private plane expenses typically represent a small fraction of total costs and can enhance executive productivity, they can also signal potential excess in overall management behavior, serving as a proxy indicator of broader management inefficiencies.

2. Long-term focus.
Private firms also prioritize long-term value creation and are better positioned to make future-oriented investment decisions that maximize value. Conversely, public firms often face pressure to meet short-term earnings expectations, which can lead to suboptimal decision-making driven by immediate performance concerns.

3. Operational expertise and role as change agent.
PE managers excel at optimizing a firm's resources by reallocating capital to its most productive uses—for example, closing unprofitable factories while expanding in high-growth areas to drive revenue. Indeed, in today's elevated rate environment and muted market for transactions, PE managers need to prioritize operational improvements and margin expansion rather than relying solely on financial engineering and multiple expansion. We believe that value creation must be driven by deep operational expertise and meaningful business transformation.

Three critical areas to focus on to enhance company operations include:

- **Commercial strategies:** Conduct a top-to-bottom review of a company's products and services, global sales territories, acquisition strategies and governance practices. Opportunities exist at even the best-run businesses, including making refinements to pricing, focusing on the highest-quality growth investments, and optimizing the company's go-to-market approach.

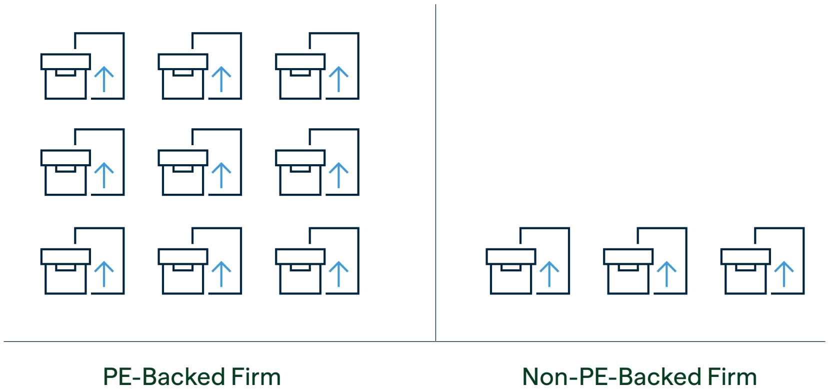
- **Organizational structure:** Align the company's structure with its business strategy, optimize the corporate hierarchy and headcount, and ensure strong management is in place.

- **Manufacturing operations:** Implement best-in-class processes, increase productivity, and reduce fixed expenses to make high-quality products at a competitive cost.

As outsiders, PE managers are often able to more effectively implement changes and battle organizational inertia. In fact, a 2014 study that analyzed U.S. leveraged buyouts from 1980 to 2005 showed that target firms' productivity grew by 210% compared with their counterparts in the same industry[6] (**Figure 14**).

Figure 14: PE-Backed Companies Achieved a 3x Productivity Boost Through Operational Transformation

Annual Output



For illustrative purposes only.

This occurred largely as a result of eliminating less productive businesses or stores and creating more productive ones, as well as launching new products and expanding geographically.

4. Market inefficiencies.

Relative to public markets, PE markets are more complex, less transparent and have fewer investors to arbitrage away market inefficiencies, potentially creating conditions for additional returns.

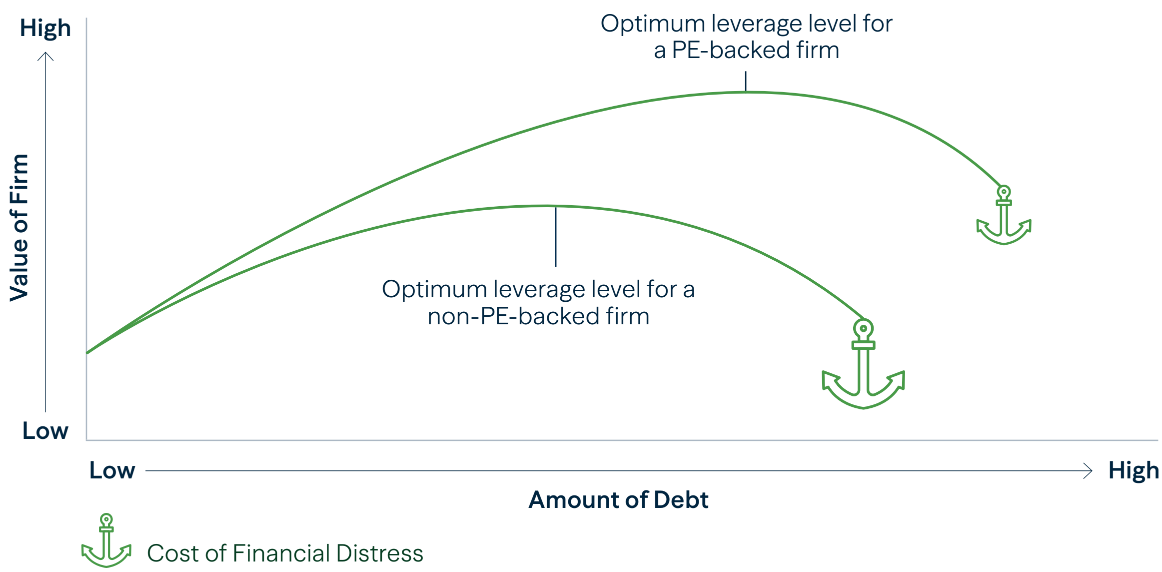
5. Optimization of leverage and financial flexibility.
PE firms are often able to use leverage more effectively than traditional companies—not just to amplify returns, but to better manage financial risk. Research shows that experienced PE managers can reduce the **expected cost of financial distress**[7]—the risks and expenses associated with carrying debt—through active involvement, operational control and restructuring expertise.

This means PE ownership can do one of two valuable things:

- **Reduce the risk associated with a company's existing debt,** effectively making the business more resilient at current leverage levels; or
- **Take on a more optimized level of debt**—higher than a typical company could—without increasing risk, thereby increasing enterprise value.

In other words, by lowering the downside risk of debt, PE firms can unlock more of its upside potential (**Figure 15**).

Figure 15: PE Enhances Value by Optimizing Leverage and Reducing Financial Distress Costs



For illustrative purposes only.

As a company takes on more debt, its value initially tends to rise due to reduced tax burdens. However, there is a critical trade-off. Excessive debt ultimately lowers company value by increasing the likelihood of bankruptcy and the expected costs associated with financial distress.

Critics sometimes argue that PE-backed companies overuse debt due to an option-like payoff structure. However, studies suggest that under PE ownership, companies actually *carry higher levels of optimal, value-maximizing leverage*. This is recognized by lenders, who often extend greater flexibility to PE-backed firms—even when covenants are breached—due to the sponsor's strong reputation, repeated deal flow, and demonstrated ability to protect and grow enterprise value.[8]

Unlocking Portfolio Potential With PE

PE not only drives value creation at the company level but also enhances portfolio performance by boosting return potential and improving diversification. Yet how should investors approach allocation?

Institutional investors, on average, allocate between 9% and 19% to PE, while individual investors allocate a far smaller 2%—a striking gap. This difference underscores the evolving role of PE in sophisticated portfolios.

A recent Preqin investor survey[9] found that over 60% of institutional investors allocate to PE, citing its potential for higher absolute returns, stronger risk-adjusted performance, and meaningful diversification benefits (**Figure 16**). As public markets become increasingly concentrated, PE offers a compelling alternative for investors seeking long-term, resilient growth.

Figure 16: Key Motivations Behind Institutional Investment in PE

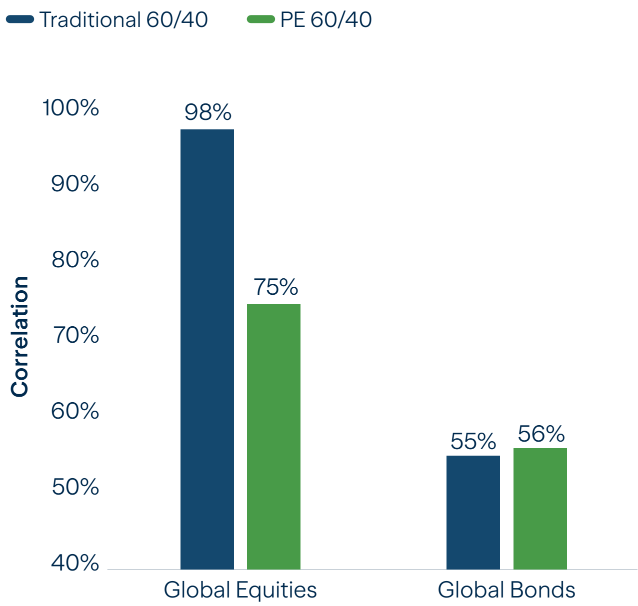
Based on a 2024 Preqin survey of institutional investors, including asset managers, family offices, public pension funds, insurance companies, banks, sovereign wealth funds, foundations, private-sector pension funds, funds of funds, endowments and superannuation schemes.

Source: Preqin.

In other words, while some investors may focus on improving their portfolio's return potential, others prioritize PE's ability to diversify traditional equity and bond holdings (**Figure 17**).

Figure 17: The 60/40 Portfolio Has Exhibited a Strong Correlation With Global Equities, Limiting Its Diversification Benefits

PE Lowers Correlation to Global Equities, With Similar Correlation to Bonds

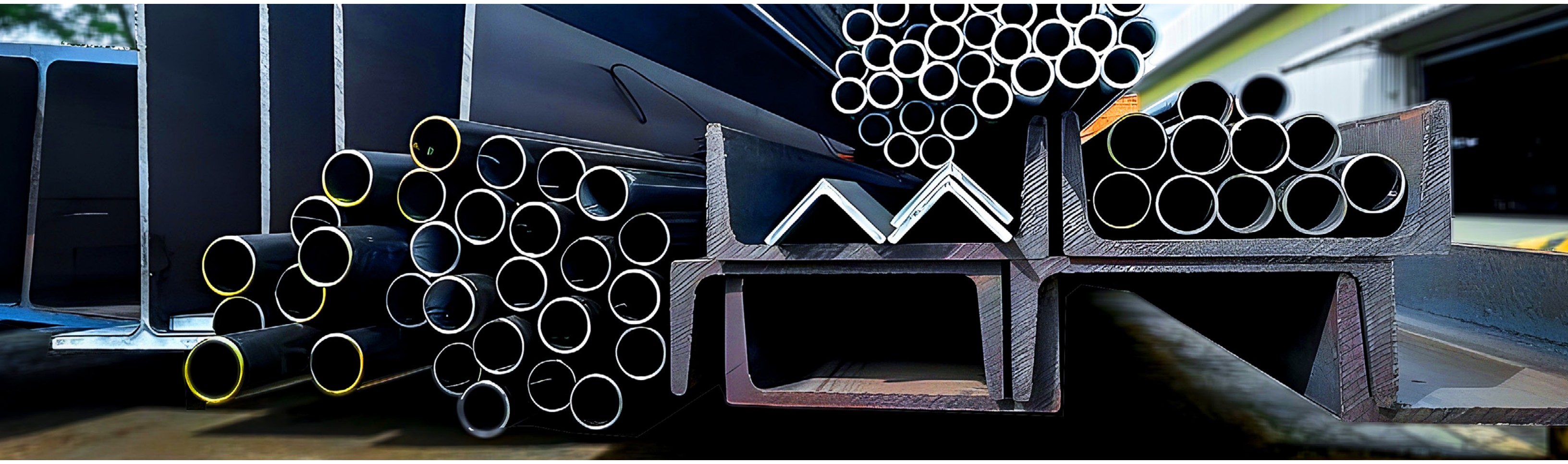


	Traditional 60/40	PE 60/40
Return	5.6%	7.5%
Risk	12.0%	5.8%
Sharpe	0.37	1.08

Past performance is not indicative of future results. For illustrative purposes only. Information does not represent returns of a fund. An investor cannot invest in an index. Global Equities represented by MSCI World Index, Global Bonds represented by Bloomberg Global Aggregate Bond Index, Traditional 60/40 represented by 60% MSCI World Index and 40% Bloomberg Global Aggregate Index, PE 60/40 represented by 60% Preqin PE Index and 40% Bloomberg Global Aggregate Bond Index for the period between January 1, 2008, and December 31, 2024.

Source: Bloomberg, Morningstar, MSCI, Preqin, as of December 31, 2024.

Whatever the reason, investing in PE alongside public stocks aims to offer an effective way to enhance return and diversification potential in a portfolio.



Balancing Opportunity and Liquidity in PE Allocation

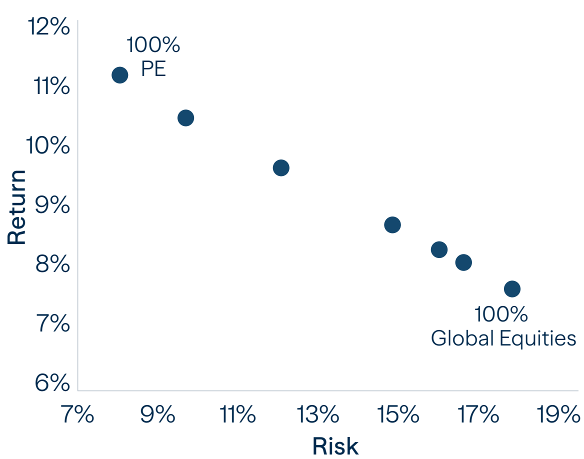
The optimal allocation to PE depends on an investor's goals, risk tolerance and time horizon. While PE offers compelling return potential and diversification benefits, it also comes with unique risks—most notably, illiquidity risk. Unlike public equities, PE investments often involve lock-up periods or exit restrictions, making them better suited for investors with longer investment horizons.

As **Figure 18** illustrates, incorporating PE into a portfolio generally improves the Sharpe ratio, enhancing risk-adjusted returns. However, the trade-off is liquidity constraints over the investment's life span. For investors with **longer time horizons and minimal liquidity needs**—for example, those who won't need access to capital for the next 10 years or who have other reliable liquidity sources outside their investment portfolio—a higher allocation to PE, even 50% or more, may be appropriate.

Conversely, investors with **known or recurring liquidity needs**—such as planned expenses or a need for regular portfolio withdrawals—should generally maintain a more modest allocation, often 15% or less, to preserve flexibility and meet those obligations comfortably.

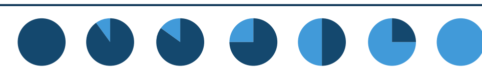
Figure 18: The Risk–Liquidity Trade-Off of PE Allocation

Enhancing an Investor's Portfolio With PE



PE Allocation Spectrum: Aligning With Investor Objectives

Higher Liquidity Needs, Shorter Time Horizon* ⟷ Lower Liquidity Needs, Longer Time Horizon*



Global Equities	100%	90%	85%	75%	50%	25%	0%
PE	0%	10%	15%	25%	50%	75%	100%

HIGHER RETURN/LOWER RISK →

DECREASING LIQUIDITY →

Return	7.7%	8.2%	8.4%	8.8%	9.8%	10.6%	11.3%
Risk	17.8%	16.6%	16.0%	14.9%	12.1%	9.7%	8.1%
Sharpe	0.37	0.42	0.45	0.51	0.71	0.97	1.26

*Other considerations include, but are not limited to: return objective, risk tolerances, etc.

Past performance is not indicative of future results. For illustrative purposes only. Information does not represent returns of a fund. An investor cannot invest in an index. Annualized return and risk (measured by standard deviation, a measure of the amount of variation of the values of a variable about its mean) for the period January 1, 2008, through December 31, 2024. Global Equities represented by MSCI World Index, PE represented by Preqin PE Index. Please see disclosures for additional information.

Source: MSCI, Preqin. As of December 31, 2024.

That said, new PE evergreen structures are emerging to bridge the gap between traditional illiquid PE funds and fully liquid public markets. These funds, which are offered on a perpetual basis and provide greater liquidity than traditional closed-end drawdown funds, are becoming more widely available—giving investors increased flexibility while maintaining exposure to PE's long-term return potential (**Figure 19**).

With individual investors currently allocating less than 2% on average to PE, there remains a significant opportunity to enhance portfolio diversification and return potential. Additionally, a growing range of PE vehicles—including both traditional funds and newer, more liquid structures, such as evergreen funds—are better suited for individual investors, who typically have higher liquidity requirements than institutional investors.

Figure 19: Investment Vehicles Tailored to Meet Investor Goals and Requirements

Vehicle	Evergreen PE Funds	Traditional PE Closed-End Drawdown Funds
Description	Open-ended private market funds with no fixed life. They continuously accept capital and recycle proceeds into new investments.	Fixed-life funds where investors commit capital up front, which is drawn down over time to invest in a portfolio.
Liquidity	**Moderate**—typically offer periodic (e.g., quarterly) liquidity windows with redemption limits. No guaranteed liquidity, but more flexible than traditional PE structures.	**Low**—capital is locked up for 7–12 years with distributions occurring during the fund's harvest phase. Secondary markets exist but are limited and may require discounts.

Higher Return Potential/Lower Liquidity →

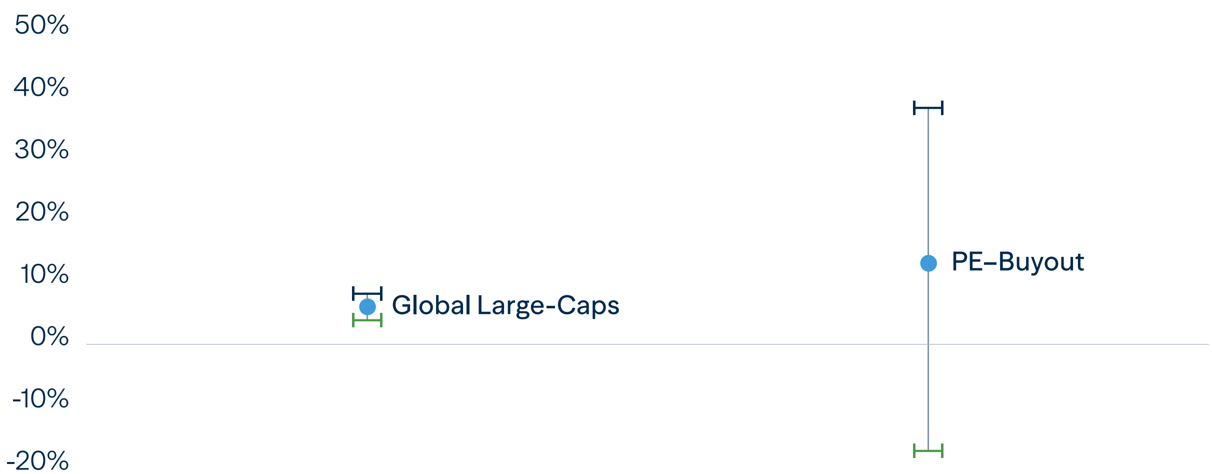
The Performance Gap in PE: Why Manager Selection Matters

While PE offers the potential for higher returns, investors must navigate significant variability in manager performance. Unlike public equities—where the gap between the best and worst managers is typically around 3%—PE has seen performance spreads as wide as 55% (**Figure 20**). This highlights the critical importance of manager selection in capturing true alpha.

To effectively narrow down the list of potential investment managers, it is essential to first determine which type of investment vehicle best aligns with your specific objectives and requirements. For instance, if an evergreen PE vehicle is the most appropriate structure for your needs, focus on managers who offer such vehicles and demonstrate a thoughtful approach to implementing them. This targeted strategy supports a more efficient and aligned manager selection process.

Figure 20: Why Manager Selection Matters: PE's Higher Returns Come With a Wider Performance Gap

Annualized 15-Year Return



Past performance does not guarantee future results. Performance range displays top 95%, bottom 5% and median of manager returns. Data shown are 15-year annualized returns. Global Large-Caps are represented by their respective Morningstar peer group of U.S. open-end funds with a 15-year track record. PE represented by respective Preqin peer group of PE Buyout Funds. Private asset class returns are based on net IRR from a population of private funds with vintages from 2010 to 2015 and that are classified as liquidated, with a minimum 95% of capital called, and distributions paid in (DPI) > 0.

Source: Morningstar, Preqin, 2024.

To maximize potential success, below are some of the considerations an investor should take into account when selecting a PE manager.

1. Sources of return

Evaluate how the manager drives returns—whether through leverage, strategic timing of entry and exit, or hands-on improvements to business operations. Consider managers who focus on operational improvements, which may achieve a more repeatable, positive investment outcome than those leaning heavily on financial structuring or market momentum.

2. Operational expertise

Leading managers create value by improving how businesses operate—not just how they're financed. This includes refining strategy, streamlining processes and enhancing commercial execution. Those with a repeatable playbook for operational upgrades often unlock stronger cash flow and long-term growth than those focused solely on financial structuring.

3. Deal sourcing and pipeline

The best managers don't rely on auctions—they leverage industry knowledge and relationships to uncover opportunities before they hit the market. Deep sector expertise helps them identify promising businesses early, while strong networks often lead to proprietary or priority deal flow. Combined with a disciplined screening process, this gives them a competitive edge in finding quality investments at better valuations.

4. Track record

Long-term performance is a key indicator—but it is depth and consistency that matter most. Scaled managers with decades of deep industry experience tend to show strength across cycles, sectors and fund vintages. Rather than relying on a handful of standout deals, they demonstrate a repeatable model. Look for realized results, not just paper gains, and evaluate whether past success stems from strategic execution or favorable timing.

Conclusion: The Evolving Role of PE in Investor Portfolios

A well-balanced portfolio should include both public equities and PE, as each plays a distinct role in generating returns and managing risk—particularly important in today's shifting investment landscape. While public equities have recently delivered exceptional returns, the increasing concentration of gains among fewer stocks underscores the importance of broader diversification. Relying solely on public markets moving forward could leave investors vulnerable to heightened volatility and risk, further strengthening the case for integrating PE into a thoughtfully diversified portfolio.

Indeed, this shift is already underway. Institutional investors have long recognized PE's ability to enhance returns and lower portfolio correlation, and individual investors are now following suit. Furthermore, new PE structures—such as evergreen funds and other liquidity-friendly vehicles—are making the asset class more accessible, addressing past concerns about illiquidity.

As PE continues to expand beyond its traditional institutional stronghold, investors of all sizes now have the opportunity to harness its benefits: higher return potential, improved risk-adjusted performance and a valuable counterbalance to public market volatility. In an era of evolving capital markets, those who thoughtfully integrate PE into their portfolios have the potential to be better positioned for the future.

Endnotes

1. Preqin, as of September 2024.
2. The EU-22 economies are Bulgaria, Croatia, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Italy, Latvia, Lithuania, Luxembourg, the Kingdom of the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain and Sweden.
3. Sara Casella, Hanbaek Lee and Sergio Villalvazo, "Disclosure Regulation, Intangible Capital and the Disappearance of Public Firms," Finance and Economics Discussion Series 2023-050, Board of Governors of the Federal Reserve System, June 30, 2023.
4. Jess Edgerton, "Agency Problems in Public Firms: Evidence from Corporate Jets in Leveraged Buyouts," *Journal of Finance* 67, no. 6, December 2012.
5. Edgerton, "Agency Problems in Public Firms."
6. Steven J. Davis et al., "Private Equity, Jobs, and Productivity," *American Economic Review* 104, no. 12 (December 2014): 3956–90.
7. Sharjil Haque, "Does Private Equity Over-Lever Portfolio Companies?" Finance and Economics Discussion Series 2023-009, Board of Governors of the Federal Reserve System, 2023.
8. Sharjil Haque and Anya Kleymenova, "Private Equity and Debt Contract Enforcement: Evidence from Covenant Violations," Finance and Economics Discussion Series 2023-018r1, Board of Governors of the Federal Reserve System, March 2023.
9. Preqin, "Investor Outlook: H1 2024," March 2024.

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Preqin PE Index captures in an index the return earned by investors on average in their PE portfolios, based on the actual amount of money invested in private capital partnerships. Historical data points are not recalculated as time passes, except for the latest two quarters available, which are preliminary. The preliminary quarters are finalized at a three-quarter lag coinciding with the full constituency for the as-at date being met. The universe of funds for each quarterly point in the index may change over time depending on data availability.

S&P 500 Index is an equity index of 500 widely held, large-capitalization U.S. companies.

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