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2025 Private Markets Outlook: Executive Summary

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Key points

- **Secondaries** exhibit attractive fundamentals and structural advantages.
- **Real estate** has been beaten down and valuations are now more attractive.
- **Private credit** has filled a void that traditional lenders have created.
- **Dispersion of returns** are likely to increase, separating the winners and losers.
- This is a **better environment for allocating capital** than recent years.

We will cover these key points throughout the outlook. We believe that secondaries will continue to benefit from the slowed exits and institutions' need for liquidity. We believe that private real estate valuations have come down to more realistic valuations and there are opportunities in industrials, multi-family housing and life sciences. Private credit managers are well positioned to fill the void banks have left, and to negotiate favorable terms and covenants.

Given the amount of capital that has been raised in the private markets, and the changing regimes, from an environment with easy money and benign inflation, to rapidly raising rates and high inflation, to falling rates and stubborn inflation, we anticipate a larger disparity between the winners and losers in the coming decade. With that said, we believe that managers putting capital to work today can take advantage of more attractive valuations and being a "term-maker" versus "term-taker" (i.e., the ability to dictate terms).

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The global markets

In last year's outlook, we discussed the global backdrop of elevated geopolitical risks, a changing interest-rate environment, tensions due to presidential elections, stubborn inflation, and the Federal Reserve's (Fed's) attempt to navigate a soft landing. Geopolitical risks remain elevated. The war in Ukraine shows no signs of abating anytime soon, the battle in the Middle East is expanding, and Russia, North Korea and China have taken provocative actions.

Going into 2024, many pundits were calling for rate cuts to begin early in the year, and several were calling for as many as six cuts in 2024. The Fed was much more deliberate than expected, waiting until September before beginning to cut, and then making a larger than normal cut of 50 basis points (bps). The expectation is that the Fed will continue to cut rates into 2025. Inflation has leveled off and a recession seems to have been avoided.

Global elections provided changes in leadership in the United Kingdom, France, and the United States among others. The US elections were divisive and unprecedented in many ways. In a rare move, President Joe Biden stopped his presidential campaign after growing concerns about his mental acuity and ability to serve four more years. Former President Donald Trump survived an assassination attempt, while another plot was thwarted. The rhetoric between the two parties was heated throughout, serving to divide America, and to splinter the parties themselves.

With the elevated risks, tensions, and uncertainty, the US markets shrugged off the noise and soared to new heights. The S&P 500 Index was up 21.0% for 2024 (total return, as of October 31, 2024), and bonds, as represented by the Bloomberg US Aggregate Bonds Index, were up 1.9% for the same period.[1] Valuations are elevated, at 24x forward price-to-earnings (P/E) ratio, and the market is anticipating another 120 bps of cuts through 2025.[2]

Private markets results

We have been focused on a few macro themes over the last several years. As private market valuations have reset from their lofty 2021 levels, we believe that allocating capital in the coming year looks attractive across much of the private market's ecosystem. We believe that funds who deploy capital in today's market environment can negotiate favorable pricing, terms and covenants.

Over the long run, based on historical results, we think investors should consider allocating capital to private markets. To illustrate the short and long-term results of private markets and traditional investments, we have compared the one, three-, five-, 10- and 15-year results of private equity, private credit, real estate (equity), real estate debt and secondaries to the MSCI ACWI Total Return Index, and Bloomberg Global Aggregate Total Return Index.

Exhibit 1: Short-Term and Long-Term Returns

As of June 30, 2024

Strategy	1-year	3-year	5-year	10-year	15-year
Private Equity	4.90%	4.84%	16.42%	15.15%	15.90%
Private Credit	8.71%	6.73%	6.23%	5.96%	7.15%
Real Estate Equity	-9.99%	1.02%	2.27%	5.46%	6.62%
Real Estate Debt	8.21%	8.46%	8.37%	8.82%	6.77%
Global Secondaries-All Strategies	3.89%	8.01%	13.97%	12.44%	13.35%
Equity	18.26%	4.41%	9.70%	7.43%	9.34%
Fixed Income	0.49%	-5.91%	-2.45%	-0.85%	0.79%

Sources: MSCI Indices, MSCI Private Capital Solutions, Cliffwater, NCREIF, Bloomberg, Macrobond, PitchBook. Analysis by Franklin Templeton Institute.

For each period, the top three returns are marked in green, while the bottom three returns are marked in orange. Returns exceeding a year are annualized. The indexes are total returns in US dollar terms. All returns are net of fees, valued on a quarterly basis. The indexes used and methodology for calculating the net of fee returns are in the Appendix. Indexes are unmanaged and one cannot directly invest in them. **Past performance is not an indicator or a guarantee of future results**. Important data provider notices and terms available at www.franklintempletondatasources.com.

We have highlighted the top three asset classes and sub-asset classes for each period in green, and the bottom three in red, to draw attention to the long-term results. Note, recent performance has impacted real estate (equity), and while traditional equity results have been strong recently, they lag private equity and secondaries over the long run.

We believe that real estate (equity) results may likely be more like long-term historical averages, (high single-digit) with higher income than traditional bonds, and low-negative correlation to most traditional investment options.

With respect to the long-term outperformance of private equities versus public equities, we think it is important to explore why this has occurred, and why we think it will persist. According to research from Hamilton Lane,[3] there is a shrinking universe of public companies (roughly 4,000), and a growing universe of private companies. In fact, of all the companies with over US$100 million in revenues, 87% of them are private, and they are remaining private longer. Some will never go public due to the abundance of capital available to them.

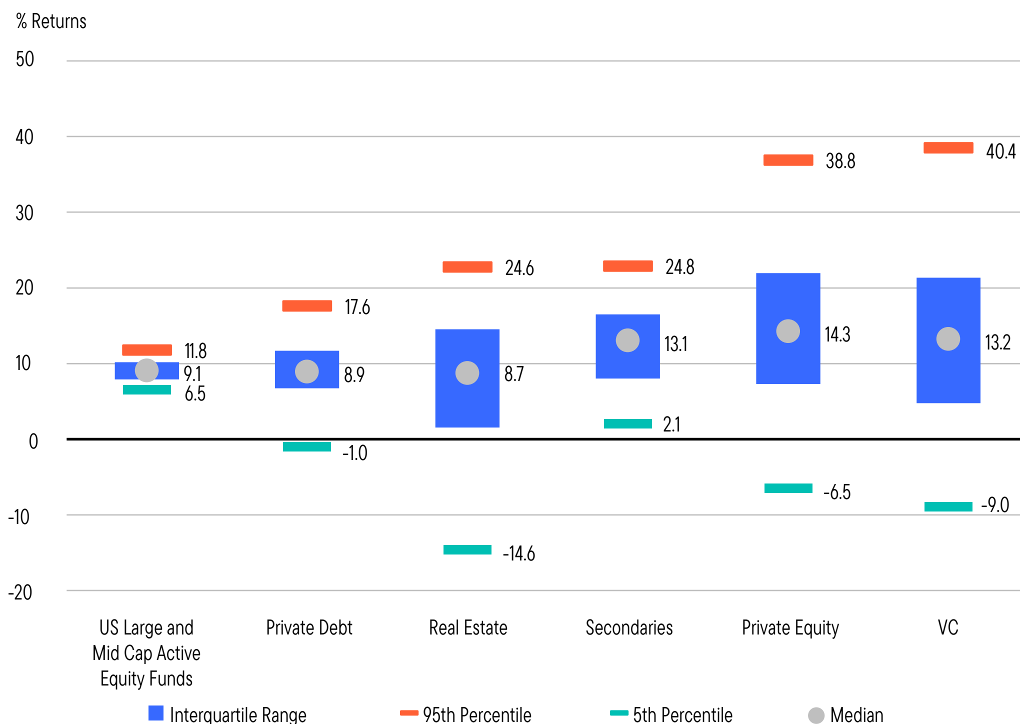
The other important consideration is how private capital can be used to help unlock value over time. In addition to money that can be used to fuel growth, support expansions, investments in research and development, and/or make acquisitions, private equity firms are often deploying seasoned managers who provide valuable human capital to these startups. The long-term commitment to growth is crucial for their ability to unlock value. Rather than answering to shareholders on a quarterly basis, private companies can execute their multi-year strategy.

Dispersion of returns

As noted above, we believe that the dispersion of returns may widen between experienced managers who have navigated through multiple cycles, and those newer to private markets. Historically, private markets have exhibited substantially larger dispersion than traditional options, with the difference between the 95th and 5th percentile traditional equity manager approximately 500 bps; while the difference between the 95th and 5th percentile private equity fund has been over 4,500 bps, and venture capital has been nearly 5,000 bps.

Exhibit 2: Private and Public Market Dispersion of Returns

As of June 30, 2024



Sources: MSCI Private Capital Solutions, Morningstar.

The returns for US Large and Mid Cap Active Equity Funds reflect the annualized returns for the period January 1, 2005 to June 30, 2024. The returns for Real Estate, Secondaries, Private Equity, Venture Capital (VC), and Private Debt are the Internal Rate of Return (IRR) of the funds with vintage years from 2005 to 2018, as of June 30, 2024. **Past performance is not an indicator or a guarantee of future results**. Important data provider notices and terms available at www.franklintempletondatasources.com.

Leading up to 2021, a lot of capital had flowed into the private markets, and private market funds were often forced to pay higher valuations due to the demand and limited supply. Since 2022, the pendulum has shifted, and managers can now dictate price, terms and covenants. However, not all managers have the same level of experience, and depth of resources, to negotiate and put capital to work.

Consequently, we believe that there will be a premium in selecting experienced managers who have historically delivered strong results, and avoiding managers who lack the depth and experience to successfully deploy capital through changing market regimes.

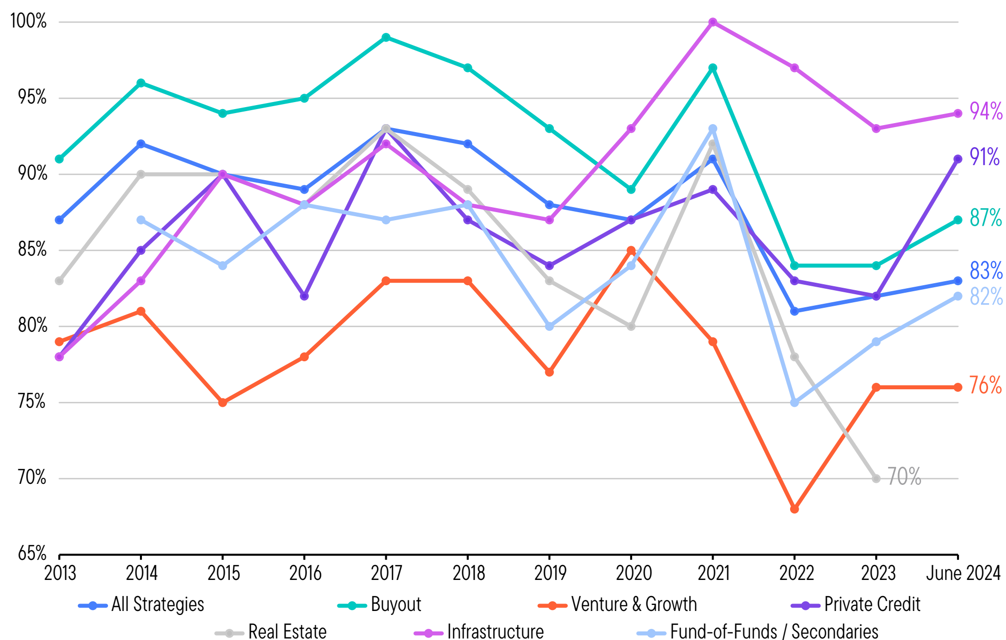
Secondaries: Attractive fundamentals

We believe secondaries look attractive from a valuation perspective and provide several built-in advantages for individuals and institutions alike. As discussed in our mid-year outlook, secondaries have benefited from a deceleration in exits, institutions' need for liquidity, and the fact that secondaries have been available at discounts.

Exhibit 3: Global Secondary Discounts

Historical Secondary Pricing (% of Net Asset Value)

As of June 30, 2024



Source: Greenhill Global Secondary Market Review Data.

With the strong private equity returns leading up to 2021, many institutions found themselves overallocated to private equity. Coupled with slowing distributions, these institutions often needed to seek liquidity to remain within their investment policy guidelines, and to free up capital to fund future commitments. Secondaries provided that needed liquidity and filled a vital role for institutions.

We believe that there will likely be an acceleration in exits in the coming year. President-elect Trump has signaled a pro-business environment, loosening regulation, lower taxes and spurring growth. Coupled with the lower cost of capital, this should fuel merger and acquisition activity and lead to increased initial public offerings.

While there should be a pickup in exit activity, we believe that institutions will continue to use the secondary market to diversify their private equity holdings and create liquidity to fund future deal flows. Individual investors benefit from the shortened J-curve,[4] shorter period before receiving distributions, and diversification (general partner (GP), vintage, geography, industry, etc.).

Secondaries have become a vital part of the growing private markets ecosystem, matching buyers and sellers of private equity, private credit, real estate and infrastructure, and fulfilling the liquidity needs of institutional investors. Note, while secondary private equity has matured a great deal over the last decade, the secondary market for private credit, real estate and infrastructure are still relatively nascent. We believe that the growth of this important market will continue to evolve and expand.

Private credit: The emergence of a new lender

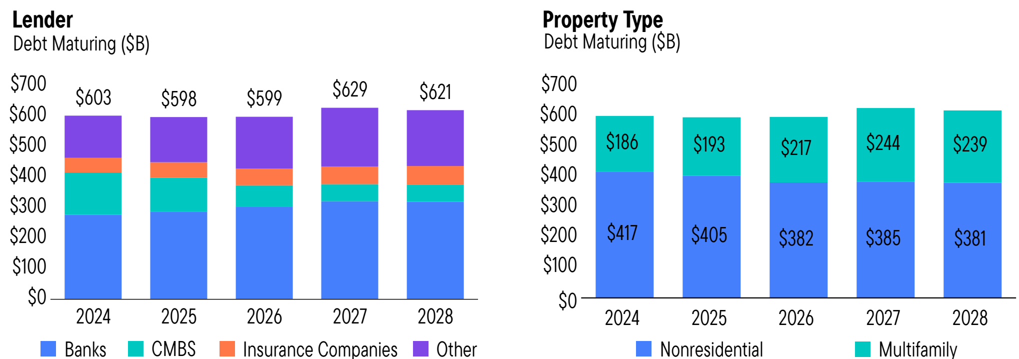
Private credit has experienced significant flows over the last several years, and some have questioned whether too much money is chasing too few deals. The reality is that private credit—in many respects—has filled the void banks created. The private credit industry exploded after the global financial crisis (GFC), when banks were reticent to lend capital. Private credit managers seized the opportunity.

This trend only accelerated after the collapse of Silicon Valley Bank, and concerns about contagion across real estate. With banks unwilling to lend to help refinance troubled assets, private credit managers stepped in to fill the void. This has created an interesting opportunity for commercial real estate (CRE) debt.

According to a Morgan Stanley report, there is a "wall of debt" that will need to be refinanced in the next couple of years. It estimates that the valuations of office and retail could be down by 40% peak to trough, increasing the chance of defaults. The research also notes the wall of debt is scheduled to get worse before getting better, peaking in 2027 at $550 billion.[5]

Exhibit 4: Wall of Debt Maturities for Commercial Real Estate Loans

As of Q1 2024



Source: Trepp.

Other category is primarily comprised of multifamily lending by Fannie Mae and Freddie Mac. This could also include finance companies (private debt funds, REITs, CLOs, etc.), pension funds, government or other sources.

The wall of debt creates opportunities for seasoned lenders. With banks' reluctance to lend, private credit firms now have leverage, and they can negotiate favorable terms and covenants. We believe that this opportunity for seasoned managers with capital to deploy will persist for the foreseeable future.

Real estate: Valuations have fallen dramatically

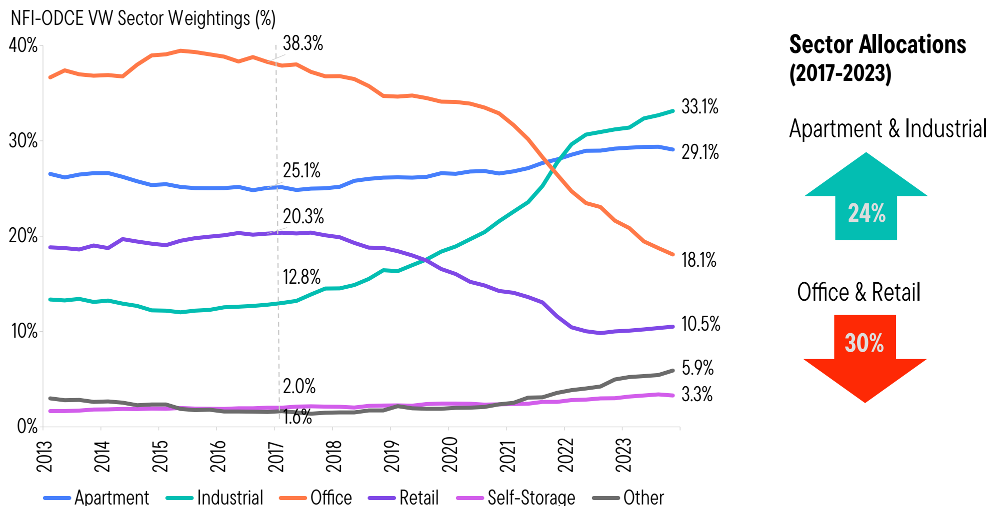
With real estate generating a lot of negative headlines, and ongoing concerns about the office sector, valuations have fallen dramatically over the last several years. While difficult to call market peaks and troughs, it is tough to argue that there are better opportunities to deploy capital today than in the last several years. In addition to the valuation story, falling rates and the lower cost of capital should be a positive for the real estate market (equity and debt).

As we have discussed in past outlooks, we need to dig a little deeper when we begin discussing allocating to private real estate. The office sector has had considerable headwinds which pre-date COVID-19, and the industrial sector has had tailwinds with the explosive growth of ecommerce and re-shoring due to concerns about our supply chains.

As illustrated in Exhibit 5, the office and retail sectors have been falling over the last several years, while the industrial and apartment sectors have been rising. These are secular trends that we think will persist in the coming years.

Exhibit 5: Private Real Estate Sector Allocation in Recent History

As of Q4 2023



Sources: Clarion Partners Investment Research, NCREIF, 2023Q4.

NFI-ODCE VW is NCREIF Fund Index – Open End Diversified Core Equity (NFI-ODCE) Value Weighted. The NFI-ODCE is a capitalization-weighted index based on each fund's net invested capital, which is defined as beginning market value net assets (BMV), adjusted for weighted cash flows (WCF) during the period. Important data provider notices and terms available at www.franklintempletondatasources.com.

Real estate is not a monolithic investment decision—it is a diverse set of strategies that will respond differently to macro and geopolitical trends. We believe that seasoned managers who can identify good properties, at attractive valuations, should thrive in this challenging environment; those who lack the experience and resources may struggle in deploying capital.

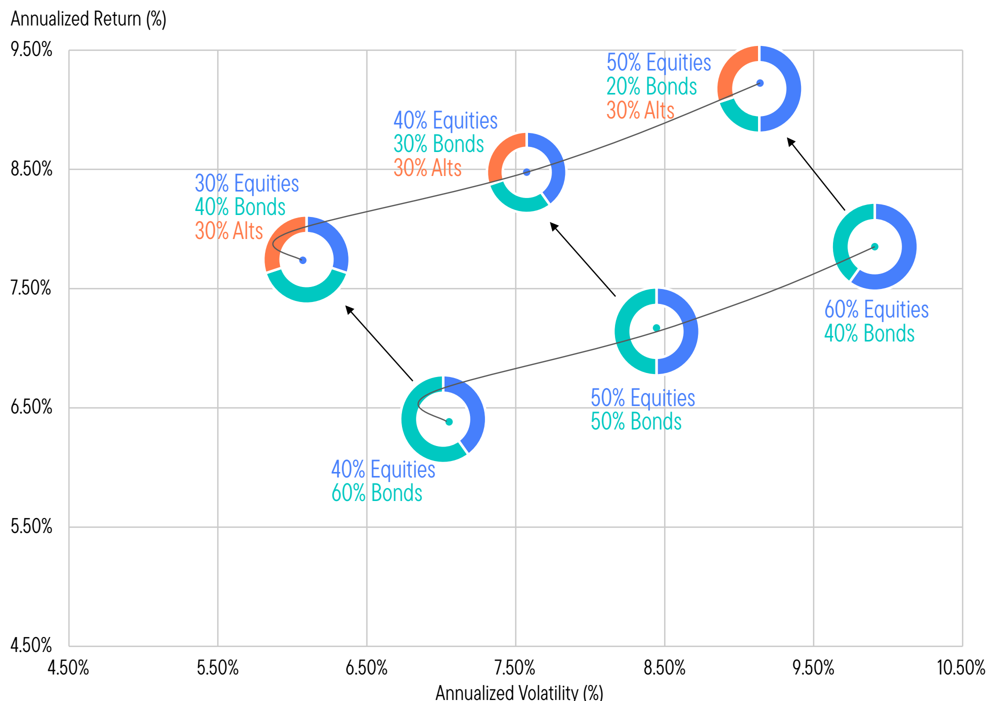
Summary

We see attractive opportunities across the private markets. With product evolution making these investments more accessible to a larger group of investors, and with more flexible features, advisors should consider allocating to these versatile and valuable tools.

Exhibit 6: Efficient Frontier Analysis

Annualized Volatility and Returns

As of June 30, 2024



Sources: MSCI Private Capital Solutions, SPDJI, NCREIF, Bloomberg, Cliffwater, Macrobond. Analysis by Franklin Templeton Institute.

Quarterly data analysis from Q4 2004 to Q2 2024; 30% allocations to Alternatives split evenly among Private Real Estate, Private Equity and Private Credit.

Indexes used: Private Credit: Cliffwater Direct Lending Index; Private Real Estate: NCREIF Fund Index Open End Diversified Core Equity (ODCE) Index, US Stocks: S&P 500 Total Return Index, US Bonds: Bloomberg US Aggregate Index (Total Return); Private Equity: MSCI Private Capital Solutions' fund search results for US Private Equity funds (all categories). Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results**. Important data provider notices and terms available at www.franklintempletondatasources.com.

Historically, combining private and public markets in a meaningful way has provided higher returns and lower risks than a traditional portfolio. The efficient frontier analysis in Exhibit 6 illustrates the impact of including a 30% allocation to private markets, evenly divided between private equity, private credit and private real estate. The addition increases the return and lowers the risk of a traditional-only portfolio.

This executive summary is designed to stand on its own, providing our outlook and rationale for private markets. We have shared the short and long-term results, macro trends, and where we see the best opportunities to allocate capital today. We want to thank **Lexington Partners**, **Clarion Partners**, **Benefit Street Partners**, and **FT Ventures** for sharing their insights in developing this outlook.

As always, to learn more please visit Knowledge Hub | Alternatives by FT. And if you haven't already done so, please subscribe to the ***Alternative Allocations*** podcast series to hear from industry experts about allocating capital.

Contributors

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Appendix: Methodology for Exhibit 1

Asset Class	Index	Methodology for net returns
Equity	MSCI ACWI Total Return Index	A fee of 1.46% p.a. is subtracted from the quarterly returns
Fixed Income	Bloomberg Global Aggregate Total Return Index Value Unhedged USD	A fee of 0.43% p.a. is subtracted from the quarterly returns
Alternative Investments:		
Private Equity[1]	MSCI Private Capital Solutions - US Private Equity (all categories)	The returns are based on PE fund returns that are net of fees
Private Credit	Cliffwater Direct Lending Index	A fee of 1.342% p.a. is subtracted from the quarterly returns. Additionally, a carried interest percentage of 16.844% is charged on positive returns. This fee and carried interest is average for private credit funds during 2014 to 2022 (data from PitchBook). In case of a negative quarterly return, carried interest is not charged until losses are reversed. The hurdle rate to charge the carried interest is 6% p.a., based on data provided in iCapital's article titled 'Understanding Private Market Fund Distribution Waterfalls', dated January 20, 2023.
Real Estate Equity	NCREIF Fund Index Open End Diversified Core (ODCE) Total Index	Net returns as reported by the index provider.
Real Estate Debt	PitchBook search results for US Real Estate Debt funds	Returns are net of fees.
Secondaries	MSCI Private Capital Solutions search results for global secondaries across all the strategies within the secondary market.	Based on fund returns, which are net of fees.

[1] Generic US PE return series for all equity categories (buyout/growth/VC etc.) Sources: MSCI Indices, MSCI Private Capital Solutions, Cliffwater, NCREIF, Bloomberg, Macrobond, PitchBook. Analysis by Franklin Templeton Institute. The indexes are total returns in US dollar terms. Indexes are unmanaged and one cannot directly invest in them. **Past performance is not an indicator or a guarantee of future results.** Important data provider notices and terms available at www.franklintempletondatasources.com.

Endnotes

1. As of October 31, 2024. Sources: SPDJI, Bloomberg. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results.**
2. As of October 31, 2024. Sources: SPDJI, CBOE, Bloomberg. There is no assurance that any estimate, forecast or projection will be realized.
3. Source: "Private Market Investing: Staying Private Longer Leads to Opportunity." Hamilton Lane. April 14, 2022.
4. The "J-curve" is the term commonly used to describe the trajectory of a private equity fund's cashflows and returns. An important liquidity implication of the J-curve is the need for investors to manage their own liquidity to ensure they can meet capital calls on the front-end of the J-curve.
5. Source: "A $1.5 Trillion Wall of Debt is Looming for US Commercial Properties." Bloomberg. September 1, 2024.

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All investments involve risks, including possible loss of principal.

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Investments in many alternative investment strategies are complex and speculative, entail significant risk and should not be considered a complete investment program. Depending on the product invested in, an investment in alternative strategies may provide for only **limited liquidity** and is suitable only for persons who can afford to lose the entire amount of their investment. An investment strategy focused primarily on privately held companies presents certain challenges and involves incremental risks as opposed to investments in public companies, such as dealing with the lack of available information about these companies as well as their general lack of liquidity. Diversification does not guarantee a profit or protect against a loss.

Risks of investing in **real estate investments** include but are not limited to fluctuations in lease occupancy rates and operating expenses, variations in rental schedules, which in turn may be adversely affected by local, state, national or international economic conditions. Such conditions may be impacted by the supply and demand for real estate properties, zoning laws, rent control laws, real property taxes, the availability and costs of financing, and environmental laws. Furthermore, investments in real estate are also impacted by market disruptions caused by regional concerns, political upheaval, sovereign debt crises, and uninsured losses (generally from catastrophic events such as earthquakes, floods and wars). Investments in real estate related securities, such as asset-backed or mortgage-backed securities are subject to prepayment and extension risks.

An investment in **private securities** (such as private equity or private credit) or vehicles which invest in them, should be viewed as illiquid and may require a long-term commitment with no certainty of return. The value of and return on such investments will vary due to, among other things, changes in market rates of interest, general economic conditions, economic conditions in particular industries, the condition of financial markets and the financial condition of the issuers of the investments. There also can be no assurance that companies will list their securities on a securities exchange, as such, the lack of an established, liquid secondary market for some investments may have an adverse effect on the market value of those investments and on an investor's ability to dispose of them at a favorable time or price.

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Equity securities are subject to price fluctuation and possible loss of principal. Small- and mid-cap stocks involve greater risks and volatility than large-cap stocks.

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