Schroders capital

Allocating to private markets – an essential guide

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Marketing material for professional clients only.

As private markets become more accessible, private investors are increasingly considering shifting parts of their portfolio to the space. This guide explores the role private assets can play in portfolios, the key considerations before investing and the options available to investors.

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A changing landscape

Private assets are investments that are not publicly traded on exchanges. These assets can include private equity (companies), real estate (property), infrastructure (assets like airports, roads or wind farms), private credit (loans) and other types of illiquid assets.

The potential benefits of private assets are well known. They can offer a rich variety of investment options and help broaden the investment opportunity set. This includes exposure to global growth themes that may not be as readily accessible via public markets, such as companies developing artificial intelligence technologies, or certain energy transition infrastructure assets.

Private assets can provide a return uplift over public markets and, in some cases, a reduction in risk, whilst also offering diversification benefits by introducing differentiated drivers of returns (as well as traditional statistical measures of diversification). We have explained this at length in our previous piece 'Adding return and lowering risk with private assets'.

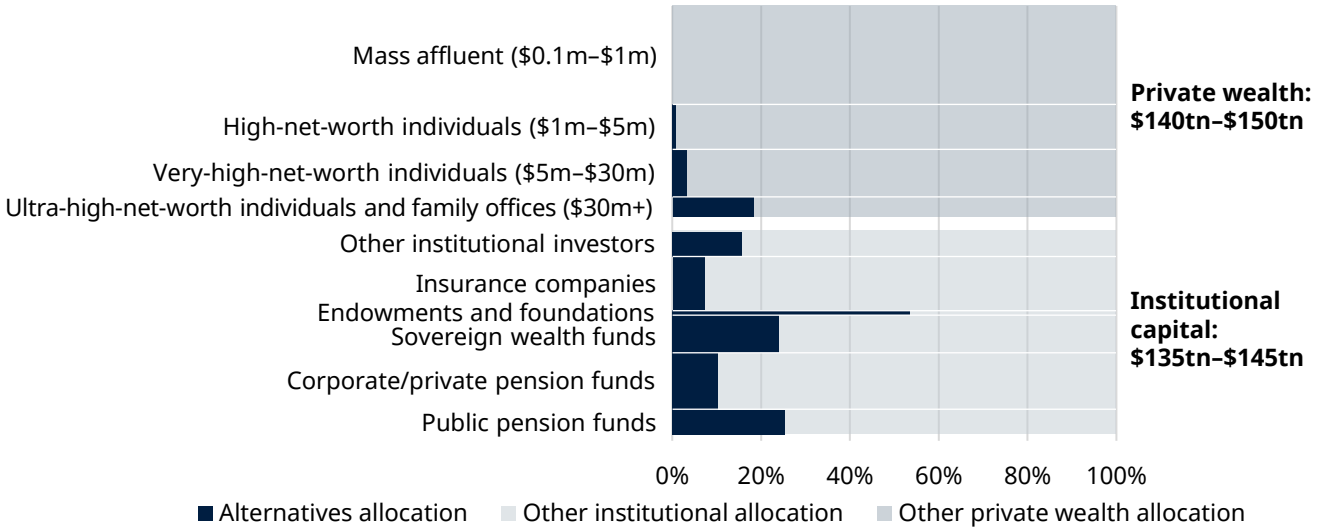
For several decades, institutional investors have been allocating a growing share of their portfolio to private assets, recognising that these characteristics can be used to enhance their portfolios.

However, until recently, private investors have had limited options to access this space as most of the funds were either unavailable or unsuitable. Even for those with existing private market allocations, this would typically only represent a small share of the overall portfolio.

Private investors hold roughly half of global wealth, but they account for just 16% of private markets investments (Figure 1). This highlights how underweight their private markets allocations are versus institutional counterparts[1], with allocations usually not higher than 5%, and that there is scope for allocations to increase.

[1]Source: Bain & Company, 2023.

Figure 1: Global wealth by investor type, 2022



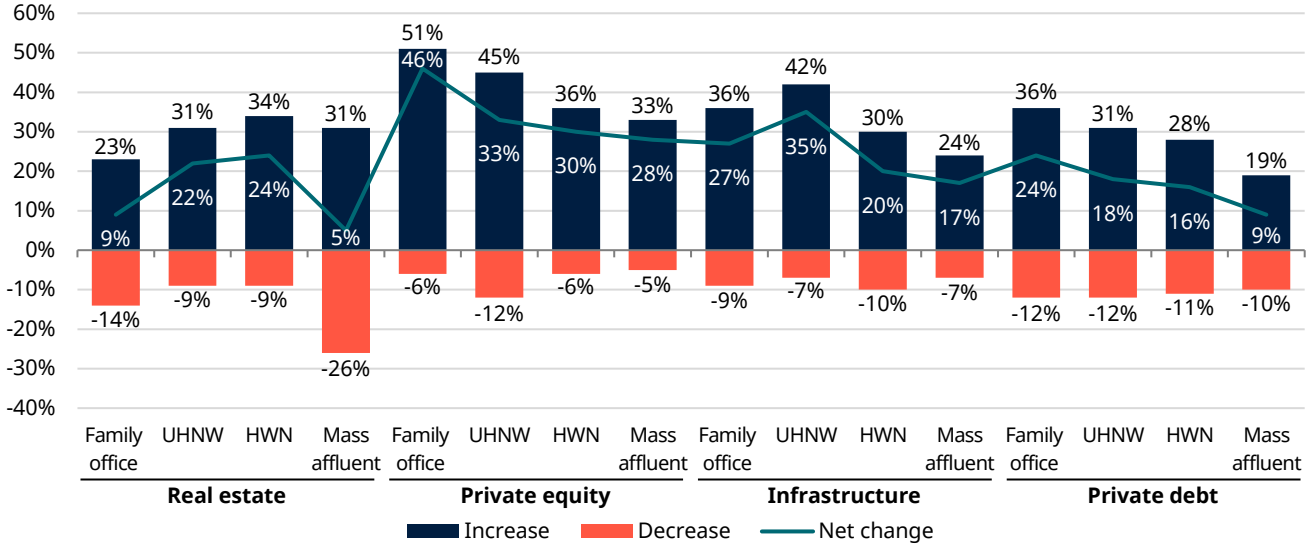
Source: Preqin, GlobalData, Bain analysis.

By comparison, our own research indicates that globally institutional investors had allocated, on average, 14% of their portfolio to private assets[2].

Whilst there may be a number of factors contributing to this underallocation, the discrepancy is in part because institutional investors have historically had access to a much broader range of solutions, structures, and private asset managers. The options for private investors, advised or otherwise, have been limited.

However, this is currently changing. Regulatory developments for private vehicles, greater availability of educational materials, technology-driven platforms to distribute funds and the prospects for fund 'tokenisation' – are whittling away at the access hurdles. And demand within this space is ramping up. Data demonstrates a strong anticipated growth among family offices, ultra high-net-worth investors (UHNW) and high-net-worth investors (HNW), often from a low base.

Figure 2: Anticipated changes over the next 12–24 months based on survey of private banks and wealth managers



Source: Cerulli Associates Alternative Investments 2023.

We are also seeing funds being launched that focus exclusively on private wealth. These funds include closed-ended or open-ended evergreen structures (or semi-liquid funds) with characteristics designed specifically to appeal to that investor base, offering operational simplicity (such as single capital calls), lower initial investment minimums, greater flexibility around redemptions and liquidity, and regulated fund structures that can be distributed to non-professional investors. We will dive deeper into evergreen structures later in this paper.

[2]Schroders, Schroders Institutional Investor Study 2022.

Rethinking portfolio construction

The traditional 60/40 portfolio, which historically consisted of 60% stocks and 40% bonds, has been challenged over recent years. In 2022, this portfolio mix saw a significant decline in performance, of nearly 17.5% (based on an indicative portfolio of 60% global stocks and 40% global bonds[3]). This poor performance can be partly attributed to the increased correlation between stocks and bonds, with both delivering simultaneous double-digit negative returns for the first time in history. Whilst both stocks and bonds rebounded in 2023, they did so together, further highlighting that increased correlation persists.

This correlation can be attributed to several factors. Firstly, whilst they are now returning towards longer-term averages, the combination of heightened inflation and rising interest rates over recent years has resulted in increased input costs and margin pressures for equities. Furthermore, elevated interest rates have raised the cost of capital and negatively impacted stock markets. On the bond side, the erosion of fixed cash flows due to high inflation, combined with a sharp rise in interest rates that has also negatively impacted bond prices, has led to significant volatility.

Looking ahead, secular trends such as rising debt, deglobalisation, demographics, and disruption in technology as well as energy security, could amplify the probability of the challenging conditions observed in 2022. These factors have significant implications for portfolio construction, underscoring the importance of diversification.

Private assets could assume a critical role in addressing these challenges and adapting to the evolving market structure. By allocating to private markets, investors can capitalise on the themes of high inflation, higher-for-longer interest rates, and disruptive forces. These asset classes have the potential to boost capital growth, enhance income generation, and provide capital preservation. Additionally, private markets can provide diversification benefits to portfolios, helping to mitigate some of the risks associated with traditional asset classes.

Incorporating private assets into a portfolio

Private assets can represent a key part of strategic asset allocation for a private investor, provided necessary consideration is given to the individual risk tolerances and investment time horizons. To determine how much of their portfolio to allocate to private assets, private investors, in common with their institutional counterparts, need to understand what it will mean for their objectives and the impact allocating to these assets will have on the whole portfolio.

1. Understanding risk and return factors

An investor's risk tolerance is fundamental in the strategic asset allocation process. Each asset class will have an individual risk and return, and these should be considered alongside correlations between asset classes when optimising the portfolio for a given risk tolerance.

Figure 3 sets out these correlations and demonstrates how private assets can contribute to portfolio diversification by measuring how different investment options move relative to one another. The lower figures between private markets and public markets suggest that their values move more independently of each other compared to other assets, meaning they are less correlated and provide a source of real diversification in the portfolio.

[3]Source: Global stocks represented by MSCI All Country World USD Total Return Index and global bonds represented by Bloomberg Global Aggregate USD Hedged Total Return Index.

Figure 3: Correlation between private and liquid asset classes for the period 2014–2023

A correlation of 1.0 (technically the 'correlation coefficient') means two assets move in the same way. Smaller values indicate lower correlation between assets. Negative values indicate that assets move in opposite ways.

	PitchBook Private Capital Indexes							Public market indexes						
Private capital	Private equity	Venture capital	Real estate	Real assets	Private debt	Funds of funds	Second-aries	S&P 500	Global Markets	Global Real Estate	Global Energy	Global High Yield	US Treasuries	
1.00	0.99	0.73	0.52	0.69	0.70	0.60	0.41	0.79	0.80	0.72	0.62	0.74	-0.26	Private capital
	1.00	0.71	0.51	0.60	0.65	0.55	0.36	0.76	0.77	0.69	0.59	0.71	-0.25	Private equity
		1.00	0.33	0.37	0.31	0.46	0.25	0.62	0.60	0.46	0.30	0.50	-0.19	Venture capital
			1.00	0.26	0.25	0.23	0.27	0.41	0.38	0.40	0.24	0.36	-0.16	Real estate
				1.00	0.56	0.39	0.39	0.60	0.61	0.52	0.75	0.60	-0.38	Real assets
					1.00	0.51	0.29	0.57	0.63	0.68	0.53	0.63	-0.20	Private debt
						1.00	0.62	0.42	0.48	0.45	0.29	0.46	0.06	Funds of funds
							1.00	0.37	0.39	0.40	0.38	0.31	-0.09	Secondaries
								1.00	0.97	0.87	0.60	0.87	-0.02	S&P 500
									1.00	0.88	0.65	0.92	-0.04	Global Markets
										1.00	0.56	0.83	0.13	Global Real Estate
											1.00	0.60	-0.52	Global Energy
												1.00	0.07	Global High Yield
													1.00	US Treasuries

Source: Morningstar, Pitchbook – Geography Global. 2024.

Note: Return correlation matrix using adjusted returns using a one-period autocorrelation coefficient (Geltner's procedure – 1993, https://link.springer.com/article/10.1007/BF00161933).
Data as of March 2024. Public indexes aside from the S&P 500 are provided by Morningstar Indexes.

The private assets universe is diverse and there are several ways in which private assets can be incorporated into a portfolio to meet specific portfolio objectives. When doing this, the key sources of risk and return should be understood to ensure that the private assets selected have the right features which help mitigate volatility and provide diversification.

For example, all private assets will typically benefit from a 'complexity premium' (the ability to access and tackle complex situations in the investment process, *if* matched by the appropriate skills) boosting their expected returns versus public market equivalents, however some will have higher sensitivity to factors, like interest rates, than others.

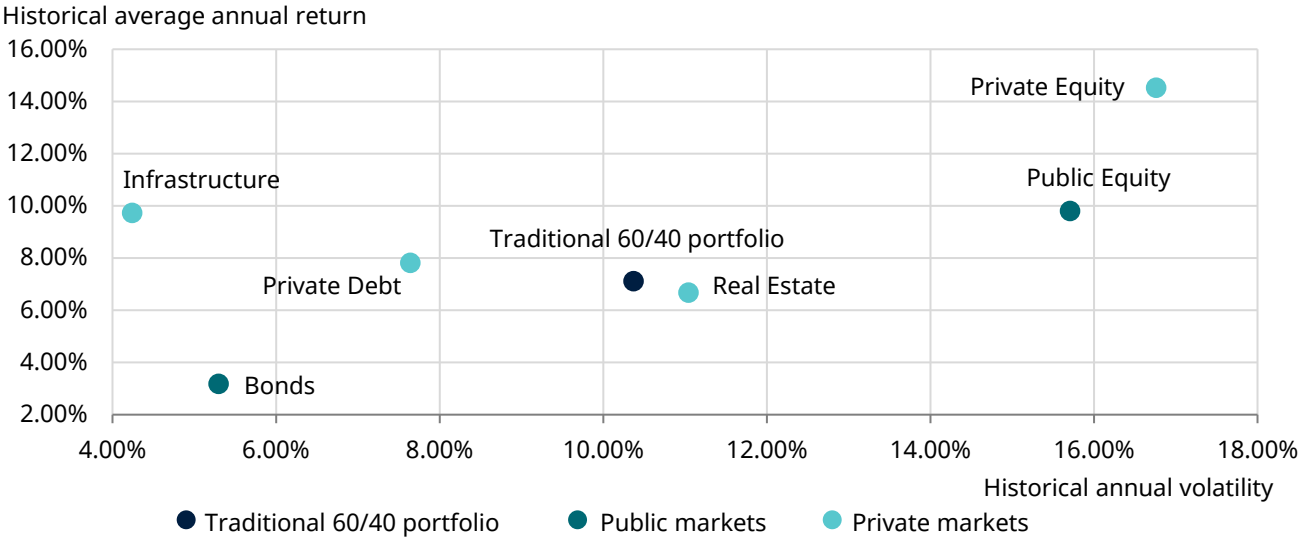
Furthermore, private markets can also be less efficient compared to public markets. Information about private assets is often limited and not readily available to the public. This information asymmetry creates opportunities for skilled investors to uncover undervalued assets and negotiate favourable terms, potentially leading to higher returns.

The diversification benefits of private assets can help offset and dampen volatility within a portfolio. Figure 4 below sets out the return and volatility for the four private market asset classes over a 10-year period, highlighting that these investments have historically had favourable risk-return profiles (and, importantly, fundamentally distinct risk-return profiles compared to public market counterparts), and so that private assets overall have the potential to raise overall portfolio returns while reducing volatility.

Why is de-smoothing returns data important?

De-smoothing private asset returns is crucial for assessing their performance relative to public market investments, as private assets typically exhibit less volatility due to their valuation methods, infrequent pricing and illiquid nature. Unlike public assets, which are traded constantly, private assets are often valued on a quarterly or annual basis, resulting in less visibility of short-term fluctuations. This inherent smoothing can mask the true volatility of private investments. By de-smoothing returns, one can reveal a more representative picture when comparing their risk-return profiles against public markets. De-smoothing techniques can, however, rely on assumptions that may be considered unrealistic, and results can be sensitive to both the data period and the technique used.

Figure 4: Risk return profiles for public and private asset classes (de-smoothed for private assets)



Past performance is not a guide to future performance.

Source: Schroders Capital, 2024. Historical Average Annual Return and Historical Annual Volatility based on data over a 10-year period up to 31 December 2023. Public Equity is represented by MSCI All Country World USD Total Return Index and Bonds represented by Bloomberg Global Aggregate USD Hedged Total Return Index. Global (Traditional) 60/40 Portfolio is based on 60% Public Equity represented by MSCI All Country World USD Total Return Index and 40% Bonds represented by Bloomberg Global Aggregate USD Hedged Total Return Index. Private Equity is represented by MSCI Burgiss Global Private Equity, Infrastructure is represented by MSCI Burgiss Global Infrastructure, Private Debt is represented by MSCI Burgiss Global Private Debt and Real Estate is represented by MSCI Burgiss Global Real Estate. A one-period autocorrelation coefficient has been used (Geltner's procedure – 1993, https://link.springer.com/article/10.1007/BF00161933) to de-smooth each data series for Private Equity, Infrastructure, Private Debt and Real Estate which may lead to a higher Historical Annual Volatility than otherwise.

2. Meeting specific investment objectives

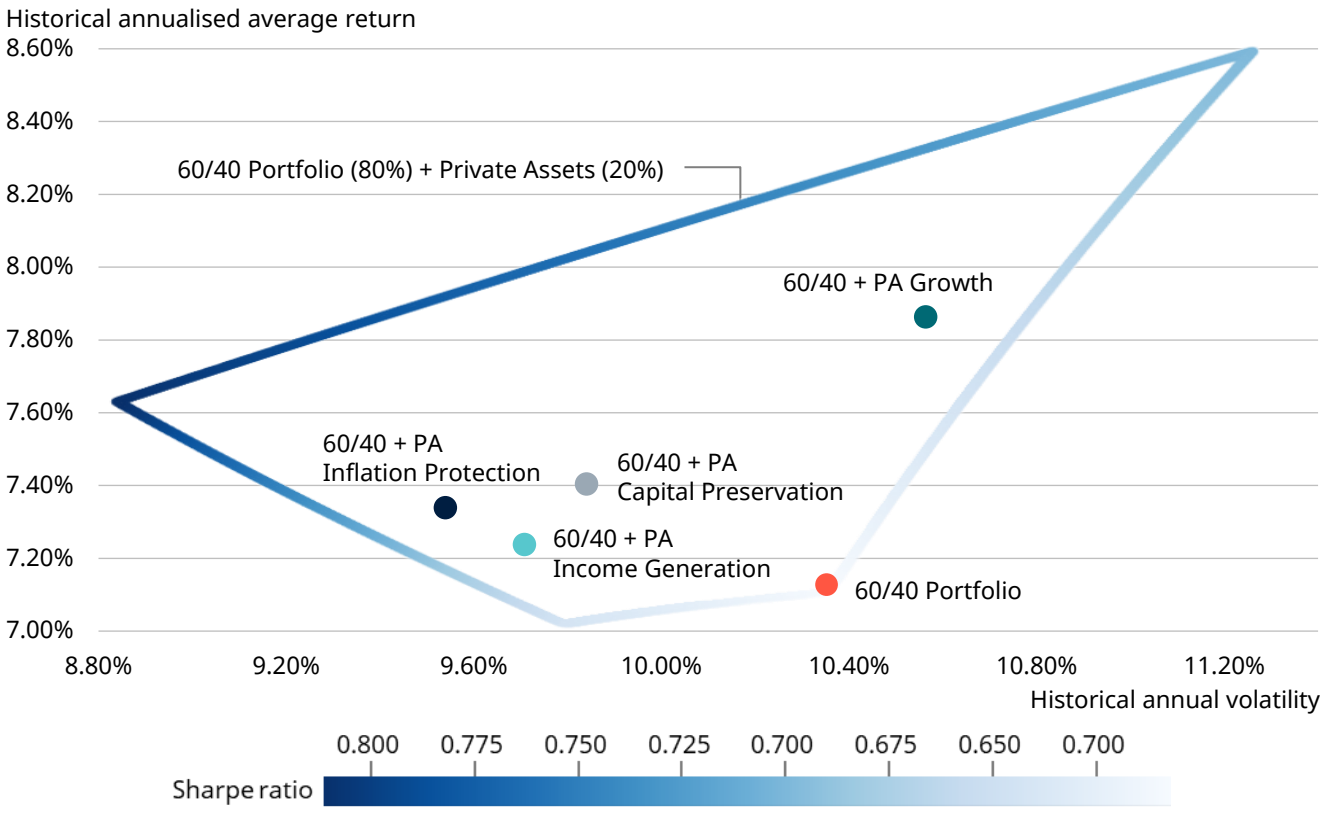
When allocating a portion of an investment portfolio to private assets, the first factors to consider include the size of the portfolio and its original allocation, the risk tolerance and time horizon of the investor, alongside their liquidity and income requirements.

We have provided some indicative examples of how investment portfolios can be enhanced to meet specific client objectives. Each example suggests how a private markets allocation could be funded, by allocating from traditional public assets, and which types of private assets would be most suited to the specific portfolio objectives. It should be noted that whilst these examples demonstrate how to provide additional return, enhance income or reduce volatility respectively, all will have reduced liquidity compared to the traditional 60/40 model due to the inherent illiquidity of these assets.

The potential benefits of allocating to private markets can be visualised by plotting the risk and return for different combination of portfolios and constructing an 'efficient frontier'. By demonstrating this graphically, investors can see how incorporating private markets can influence their overall risk-return profile.

Figure 5: Potential outcomes when incorporating private assets in a global 60/40 portfolio

The efficient frontier for a portfolio that includes private assets within a traditional global public assets' portfolio is higher than that of one without private assets. This indicates that, for the same level of risk, a portfolio with the diversification benefits of private assets can receive higher returns than a portfolio without private assets.



Past performance is not a guide to future performance.

Note: The shaded line shows the perimeter of possible portfolios when adding a maximum of 20% of Private Assets to the 60/40 Portfolio, shaded by the Sharpe ratio with a 0% risk-free rate. The top side is the well-known efficient frontier, whereas the other sides close the perimeter of possible portfolios, also known as inefficient frontiers in some contexts.

Source: Schroders Capital, 2024. Historical Average Annual Return and Historical Annual Volatility based on data over a 10-year period up to 31 December 2023. Global (Traditional) 60/40 Portfolio is based on 60% Public Equity represented by MSCI All Country World USD Total Return Index and 40% Bonds represented by Bloomberg Global Aggregate USD Hedged Total Return Index. Allocations for 60/40 portfolio (86%) + PA Growth (14%), 60/40 portfolio (86%) + PA Income Generation (14%), 60/40 portfolio (86%) + PA Capital Preservation (14%) and 60/40 portfolio (86%) + PA Inflation Protection (14%) are as set out in Figure 8. Historical Average Annual Risk and Historical Annualised Average Return for Private Equity is represented by MSCI Burgiss Global Private Equity, Infrastructure is represented by MSCI Burgiss Global Infrastructure, Private Debt is represented by MSCI Burgiss Global Private Debt and Real Estate is represented by MSCI Burgiss Global Real Estate. A one-period autocorrelation coefficient has been used (Geltner's procedure – 1993, https://link.springer.com/article/10.1007/BF00161933) to de-smooth each data series for Private Equity, Infrastructure, Private Debt and Real Estate which may lead to a higher Historical Annual Volatility than otherwise. For illustrative purposes only.

We have selected four indicative private markets portfolios to cater to the specific objectives of private investors, namely growth, income generation, capital preservation, and inflation protection (see Figures 6, 7 and 8 for more details). These portfolios have been designed to complement a global 60/40 portfolio.

Using historical data spanning from 2014 to 2023, we have modelled the risk and return profiles of each portfolio when incorporated into the 60/40 portfolio, with private markets allocation aligned to the average institutional allocation of 14% (as outlined above in this paper).

Figure 5 shows the impact on the overall risk and return of the combined portfolio in each case where an allocation is made to private assets with a range of desired outcomes and asset allocation. The results demonstrate that incorporating a separate allocation of 14% to any of the 'Income Generation', the 'Capital Preservation' and the 'Inflation Protection' portfolios may reduce overall portfolio volatility whilst enhancing the returns, and offering diversification benefits in line with the portfolio objective.

In the case of the growth portfolio, there is a notable increase in return at a slightly higher level of risk, which is consistent with the objectives of a growth portfolio with capital appreciation as its main goal.

For the income portfolio, it is worth noting that the slightly lower return (when compared to the other private asset portfolios) may be offset by factors such as distributions from investments that contribute to liquidity, as well as the overall income generated by the portfolio. These qualitative factors, although not explicitly captured in the modelling due to its focus on total return, are closely linked to the nature of the objective and the types of private assets included.

Additionally, Figure 5 shows how the risk and return of a global 60/40 portfolio can be modified by incorporating a higher private assets allocation of up to 20% (shaded blue line). The efficient frontier (top side) highlights the potential benefits of including private assets in the portfolio and range of risk-return trade-offs that can be achieved. The top-right corner corresponds to a portfolio with the full 20% allocated to private equity, whereas the minimum variance portfolio (left corner) represents a portfolio with 20% of infrastructure equity. The other portfolios in the efficient frontier correspond to pro-rata adjustments of the previous two portfolios.

Figure 6: Average annual returns and volatility of a traditional public assets portfolio vs. private assets portfolios since 2014

From 2014 to 2023 (10-year period)	60% public equity/ 40% bonds	Growth	Income Generation	Capital Preservation	Inflation Protection
Historical average annual return	7.11%	12.56%	8.00%	9.20%	8.72%
Historical annual volatility	10.37%	13.57%	7.00%	7.78%	5.73%

Past performance is not a guide to future performance.

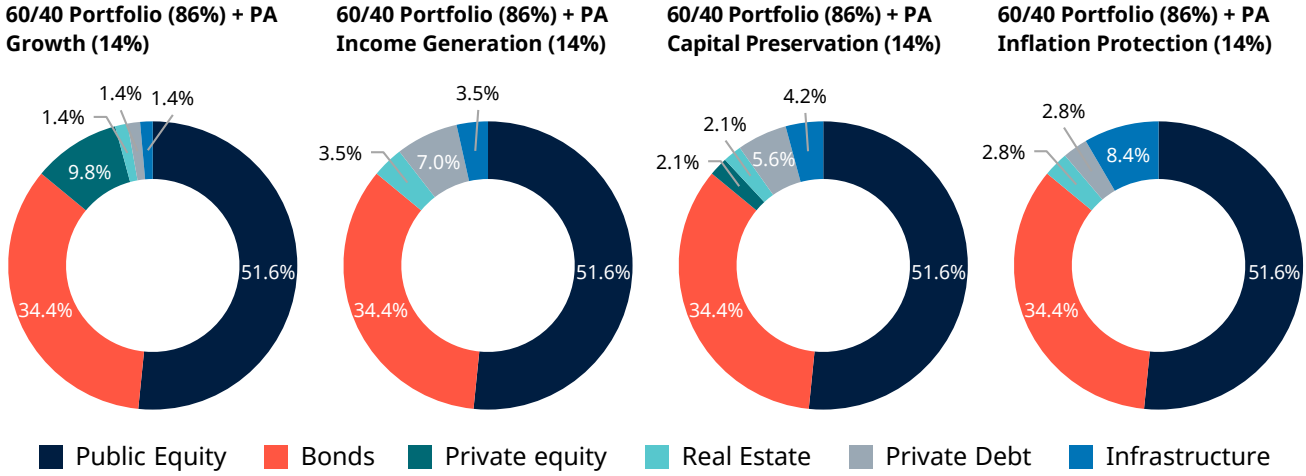
Source: Schroders Capital, 2024. Historical Average Annual Return and Historical Annual Volatility based on data over a 10-year period up to 31 December 2023. Global (Traditional) 60/40 Portfolio is based on 60% Public Equity represented by MSCI All Country World USD Total Return Index and 40% Bonds represented by Bloomberg Global Aggregate USD Hedged Total Return Index. Allocations for Growth portfolio, Income Generation portfolio, Capital Preservation portfolio and Inflation Protection portfolio are as set out in Figure 8. Historical Average Annual Risk and Historical Annualised Average Return for Private Equity is represented by MSCI Burgiss Global Private Equity, Infrastructure is represented by MSCI Burgiss Global Infrastructure, Private Debt is represented by MSCI Burgiss Global Private Debt and Real Estate is represented by MSCI Burgiss Global Real Estate. A one-period autocorrelation coefficient has been used (Geltner's procedure – 1993, https://link.springer.com/article/10.1007/BF00161933) to de-smooth each data series for Private Equity, Infrastructure, Private Debt and Real Estate which may lead to a higher Historical Annual Volatility than otherwise. For illustrative purposes only.

Figure 7: Indicative portfolio allocation weightings for private assets portfolios

	Private equity	Real Estate	Private Debt	Infrastructure
Growth	70%	10%	10%	10%
Income Generation	0%	25%	50%	25%
Capital Preservation	15%	15%	40%	30%
Inflation Protection	0%	20%	20%	60%

Source: Schroders Capital, 2024. For illustrative purposes only.

Figure 8: Indicative portfolio allocation weightings for combined public private portfolios



Source: Schroders Capital, 2024. For illustrative purposes only.

As the data shows, reallocating to private assets within a traditional public asset portfolio can help meet certain specific objectives. For growth, shifting from a 60/40 portfolio into private equity, alongside real assets such as infrastructure and real estate, may improve diversification and expand return potential, albeit with reduced liquidity.

In terms of income, private credit investments, including direct loans to private companies and private debt funds, offer attractive risk adjusted returns and regular coupons, while infrastructure assets, such as renewable energy projects, can provide stable cash flows through long-term contracts.

For capital preservation, reallocating towards private credit and real assets, such as real estate and natural resources, can decrease overall portfolio volatility and provide predictable returns, with private credit often showing lower default rates. Additionally, real estate investments with stable income streams can hedge against inflation, while infrastructure projects usually yield resilient long-term cash flows.

Overall, and as noted earlier, while private assets offer significant benefits, incorporating them into a portfolio typically results in lower liquidity compared to traditional public assets.

Impact objective

Private assets can offer distinct advantages for creating and measuring impact in a more precise manner than public markets due to the closer involvement with, and direct influence on, businesses.

Depending on the investors' portfolio needs, risk tolerance and desired impact level, an allocation to private assets with defined impact goals could consist of private equity funds targeting sustainable solutions and technologies (although we haven't included this objective in the analysis above as this is typically more qualitative). This could incorporate venture capital funds for early-stage or growth companies developing specific sustainable technologies, as well as buyout strategies focused on sustainable businesses.

In a private debt allocation, microfinance investments exhibit a low correlation with conventional markets and asset classes. Microfinance institutions primarily provide loans to small, local businesses that are less impacted by global economic trends, focusing on essential goods and services, often with a specific social impact. Adding floating-rate loans in a portfolio can also provide a valuable hedge against interest rate changes. In addition, microfinance investments offer high portfolio diversification through loans to

numerous microfinance institutions in various countries, with the sector covering more than a million micro-, small and medium-sized enterprises (MSMEs). This broad diversification can yield a low internal correlation with macroeconomic events and conventional markets, along with low default rates and reliable performance.

In real estate, impact can be achieved by investing in economic development projects, affordable housing initiatives, green buildings, and sustainable land and forestry management. Meanwhile, infrastructure investments could include assets contributing to the energy transition, low-carbon supply chains, and digitisation. These infrastructure investments can drive sustainable growth and address environmental challenges.

Key considerations when investing in private markets

Once the decision has been made to incorporate private markets into the portfolio, there are some key factors investors need to consider before they start that journey.

Liquidity

Private investments are illiquid; unlike publicly traded stocks, investors can't easily buy or sell (exit) them on a whim. Private markets investments have a limited secondary market, meaning there are fewer potential buyers or sellers, and transactions may take time to complete.

For example, selling private assets may involve discounts to the underlying asset's value and is subject to market conditions and buyer availability, further limiting exit options. Illiquidity risks could also increase during economic downturns or market stress, limiting buyer availability and potentially resulting in longer holding periods or lower returns. At a fund level, new vehicles such as semi-liquid or evergreen funds (as we explain below) have gained traction recently, as they can offer periodic access to capital to investors.

Longer investment horizon

Because of illiquidity, investors in private markets should have a long-term investment horizon and be prepared to hold their investments for an extended period (five to 10 years, or more). This is longer than in a typical public market's investment, though it also depends on the specific strategy. For example, within private equity, the time horizon is matched with how managers plan for portfolio companies to mature and exit strategies (IPO, acquisition) to materialise, while strategies such as secondaries can have lower duration holds compared to direct buyouts.

Holding private assets for the long term avoids the potentially negative impact of frequent trading, which can lead to transaction costs, taxes, and short-term market volatility. This can erode returns and increase risk. By holding investments for the long run, investors can also mitigate the negative effects associated with impulsive decision-making driven by short-term market fluctuations. This approach is beneficial as it helps to counteract the influence of emotional biases on investment decisions.

Complex Due Diligence

Evaluating private market investments requires thorough due diligence on the underlying assets, the investment manager, and the specific fund structure. This process can be more complex and time-consuming compared to investing in publicly traded stocks or bonds.

Due diligence on private market fund managers is also crucial due to the absence of benchmark constraints. Unlike passive funds, which aim to match the performance of a specific market index, and active funds that seek to outperform a benchmark, private markets funds are not tied to a specific benchmark. This gives fund managers greater freedom to construct their portfolios and pursue investment strategies that align with their specific objectives. As a result, private markets funds have more bottom-up dispersion, meaning that the performance of individual investments within the fund can vary significantly.

Here are some key factors to consider when evaluating and differentiating between private markets fund managers:

– **Performance Track Record**: Past performance is not a guarantee of future results. Scrutinise the manager's track record, but also understand their investment philosophy, process, and team expertise.

- **Alignment of Interests**: Ensure the manager's interests are aligned with yours. Look for fee structures that incentivise strong performance and responsible risk management
- **Experience and Expertise**: Evaluate the manager's experience in the specific industry or asset class you're targeting. Assess the team's depth of knowledge and their relationships with other managers, as this may determine their ability to source and execute deals
- **Risk Management Culture**: Understand the manager's approach to risk mitigation. How do they identify, assess, and manage potential risks within the portfolio?
- **Operational Capabilities**: Does the manager have the infrastructure and resources to effectively manage the portfolio companies or assets?

Fees and Expenses: Investments in private markets often come with higher fees compared to public markets (management fees, performance fees, carried interest). Scrutinise the fee structure and its impact on potential returns.

J-Curve Effect: The initial period of a private investment might show negative or low returns due to fees being incurred whilst managers are investing the capital raised and assets in the fund are yet to mature. This should be understood and not mistaken for underperformance – and it can be mitigated in semi-liquid funds that have existing, evergreen portfolios.

Limited Transparency: Unlike publicly traded companies, private companies and assets are not subject to the same level of disclosure requirements. Investors might have limited access to real-time information on the performance of their holdings. This lack of transparency can make it difficult to accurately assess the value of the investment, their liquidity and make informed decisions.

While information about private companies may not be in the public domain, the fund's general and limited partners[4] will have access to all information about it. One of the advantages of not having to make all information publicly available is that private companies can focus their time and resources on operating the business as opposed to fulfilling regulatory reporting requirements.

Types of risks: Whilst private markets can offer higher returns and diversification, they also come with increased complexity and some specific risks that should be carefully considered before any investment decision is made.

New ways for private clients to access private markets

The long-term nature of private markets aligns well with the objectives of many investors who have long-term savings goals, such as pension planning or purchasing a home. There are different routes wealth businesses have been taking to allocate to private markets, based on their clients' needs and level of sophistication. Recent advances in fund structures have led to the rise of new vehicles, particularly open-ended evergreen funds, which have gained popularity among private clients.

Our latest Global Investors Insights Survey[5] indicates that more than half of wealth managers and financial advisers access private markets primarily through listed funds (55%), followed closely by open-ended evergreen funds (51%) and closed-ended funds (48%).

Evergreen open-ended funds are most appealing to those investors who value more flexibility in their investment plans, particularly in case of unforeseen circumstances – their structure allows periodical access to liquidity, which can be a useful tool for those investors getting started in private markets. Unlike traditional closed-ended funds, which have a fixed end term, they provide continuous investments, allowing investors to see their money put to work immediately.

Closed-ended listed funds, however, can be more beneficial to those investors who want to have their investments readily accessible. However, share prices may fluctuate independently of the Net Asset Value (NAV), potentially leading to selling shares below NAV. Many investors prefer this structure for the chance to profit from pricing discrepancies. Liquidity challenges have historically

[4]General partners (GP) are investment professionals responsible for managing the fund while limited partners (LP) are the external investors that provide the capital for private investments.

[5]Schroders' Global Investor Insights Survey questioned 1,755 wealth managers and financial advisers among other investor groups in 31 different locations across EMEA, UK, US, Asia Pacific, Latin America, between June and July 2024.

arisen in adverse market conditions, but careful portfolio construction may mitigate these issues.

Evergreen funds can also serve as an effective allocation tool. They can complement traditional closed-ended programmes for a diversified private market approach or serve as a core portfolio that aligns with clients' risk appetites. Investors can choose a single multi-private asset evergreen fund or separate allocations.

For those clients opting for the closed-ended listed route, there are more customisable investment programs that allow for yearly adjustments in investment selection based on the market outlook. However, they require a multi-year commitment, making them suitable for those private clients who are willing to invest over a longer term. We will discuss these private markets programs further in a separate article.

Key benefits of evergreen open-ended funds

Access to typically inaccessible asset classes

The semi-liquid space offers a wide range of strategies. They can offer access to private asset classes that are typically less accessible to private investors, such as private equity, real estate, or infrastructure and balance the liquidity needs of the underlying investor with the need to lock-up capital to enable investments into typically illiquid assets.

Periodic redemption windows

By offering redemption windows and allocating a portion of their assets to more liquid investments, semi-liquid funds provide investors with periodic liquidity options. This provides investors with some flexibility to adjust their investment plans to accommodate changes in individual circumstances. While these funds do not lock up capital, it is important to note that redemption windows may be infrequent and subject to limitations, making them more suitable for longer-term investors.

Easier access

Compared to traditional illiquid fund structures, semi-liquid funds don’t have long lock ups, have low minimums and no capital call drawdown structures, simplifying the process of investment for less sophisticated clients.

Diversified exposure

Some semi-liquid funds can be highly diversified by geography, sector, and asset type. Within a single asset class, a fund manager can target specific strategies to tackle parts of the markets that are less crowded, offering more opportunities for diversification. For example, we believe the small and mid-sized private equity buyouts offers a broader and more attractive set of investment opportunities than large ones.

Liquidity explained

Investors should bear in mind that the underlying investments within semi-liquid funds remain illiquid, requiring a long-term commitment.

Liquidity in a semi-liquid fund comes from two sources:

1. Investor subscriptions and redemptions
2. Investment distributions

Subscriptions and redemptions are at the fund’s Net Asset Value (NAV) with entry and exit points (and rules around those points) that have been developed to provide liquidity in a controlled manner, typically with a cap on how much can be redeemed at any given time, often 5% of NAV. This removes the volatility or market beta compared to listed closed-ended funds, which rely on a secondary market for liquidity.

The liquidity management in a semi-liquid fund is achieved through portfolio construction and liquidity management tools. Portfolio construction provides the first line of defence. A well-constructed portfolio, one that is diverse by

geography, sector, type, and vintage, can also engineer a level of 'natural liquidity' that is regular and consistent. When we ran various simulations across our private equity investment programmes, we found that in all but the more extreme market situations, the level of natural liquidity was more than sufficient.

As a second line of defence, semi-liquid funds often use tools such as redemption caps or the possibility to suspend subscriptions and redemptions so the manager can better control liquidity within the fund and protect existing investors in the fund.

These mechanisms should be explained clearly to investors at the start. An associated objective is that by using these liquidity tools, it helps to moderate investor behaviour in the event of market stress events. If an investor knows they would have to wait three to six months before they can exit a fund, they are less likely to exit impulsively.

Liquidity management also needs to be considered in terms of cash subscriptions to the fund, as cash balances can lead to a performance drag.

Conclusion

Incorporating private market investments into multi-asset private wealth portfolios needs a strategic approach, particularly as these markets continue to grow and evolve. The events of 2022 underscored the perils of insufficient diversification, a concern likely to persist in the face of changing market dynamics, geopolitical instability and advancing technologies.

We have explored portfolio optimisation to suggest how private market investments could be incorporated, while recognising that each client's unique circumstances – particularly their willingness to embrace illiquidity – will significantly influence allocation decisions.

Nevertheless, private markets are increasingly growing their footprint in the global capital markets. This carries significant implications for future portfolio construction, especially for wealth clients, which have historically underweighted this space compared to their institutional counterpart. The availability of more accessible investment products in the market is making this transition easier.

Schroders can provide access to a diverse range of assets, both listed and private, across various asset classes. This allows investors to diversify their portfolios effectively and explore opportunities across different types of assets. Additionally, Schroders has extensive experience in designing wealth-focused products across different markets, allowing us to effectively bring private market opportunities to private investors through well-designed and regulated fund structures.

Every client is unique, with varying objectives, constraints, existing exposures, and levels of experience. As in public market investments, investors wanting to allocate to private assets need to conduct thorough due diligence and seek personalised advice from financial advisors or wealth managers when making investment decisions. Explore how we can help private clients access private market.

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