AXXES CAPITAL

Unlocking Growth: The Case for Allocating to Private Markets

Introduction

In the current financial landscape, wealth advisors face the dual challenges of optimizing returns for clients while managing risk. Traditional public markets have exhibited increasing concentration and volatility, prompting a reevaluation of investment strategies.

In this context, private markets have emerged as a more accessible alternative investment class, offering investors unique opportunities for enhanced returns, further diversification, and greater investment options.

This paper outlines the potential advantages of incorporating private investments into client portfolios. It delves into the significant growth and performance potential of private markets, highlights the distinctive characteristics that set them apart from public markets, and discusses how wealth advisors may strategically allocate investments to enhance client outcomes. By understanding the evolving dynamics of private markets and the implications for investment strategies, advisors may better position their clients to navigate the complexities of today's financial environment.

Key Takeaways

01 SIGNIFICANT GROWTH
Private market assets have surged from less than $4 trillion in 2010 to approximately $12 trillion in 2023, largely driven by increasing allocations from institutional investors.[1]

02 ENHANCED RETURNS
Historical data indicates that private equity returns have outperformed public equity benchmarks by 100 to 300 basis points (bps) over the past 15 years[1], while private debt markets have exceeded public debt by nearly 800 bps.[2]

03 GREATER DIVERSIFICATION
Private markets typically offer lower correlation to public markets, providing the potential for lower volatility and increased returns, given investors diversify their sources of returns across a more significant set of opportunities.[3]

04 ENHANCED LIQUIDITY
Newer structures like interval funds offer periodic redemptions and are fully funded upfront, providing greater liquidity options and simplifying access compared with traditional private funds.

05 ACCESS TO UNIQUE OPPORTUNITIES
With over 55,000 private equity-backed companies globally—including over 1,700 unicorns (companies valued at over $1 billion)—investors have access to a wealth of investment opportunities.[4]

06 MITIGATING CONCENTRATION RISKS
With the S&P 500 exhibiting its highest concentration in over 25 years, we believe diversifying into private markets may significantly reduce reliance on a limited number of large-cap stocks.[5]

07 STRATEGIC ALLOCATION POTENTIAL
Advisors may allocate to private investments while maintaining original risk profiles of client portfolios, enhancing diversification and potential returns.

08 PROJECTED GROWTH IN PRIVATE MARKET ALLOCATIONS
Current projections indicate that allocations to private markets by individual investors could increase from 1-2% to 5-10% over the next five years, potentially unlocking an estimated $2.5 trillion in new capital for private investments.[6]

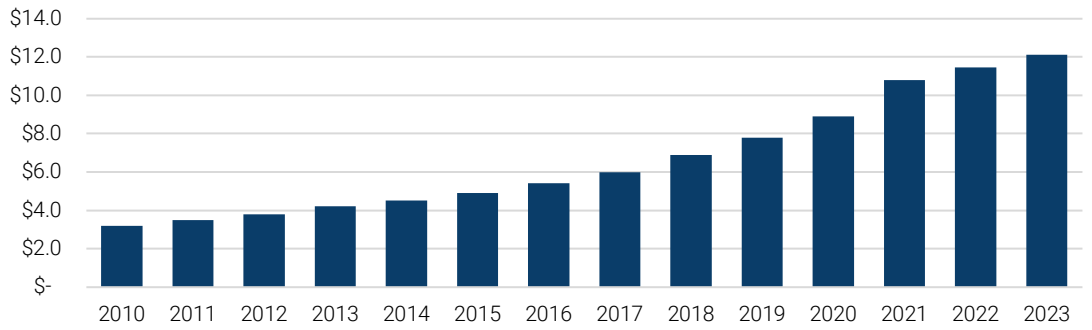
Past performance is no guarantee of future results.
Corresponding footnotes can be found at the end of the white paper.

The Expanding Universe of Private Markets

Understanding Private Markets

Private markets encompass investments not traded on public exchanges, which include private equity, private debt, venture capital, and real estate. Over the past decade, private market assets have surged from less than $4 trillion in 2010 to approximately $12 trillion in 2023.

Private Market AUM (in trillions)



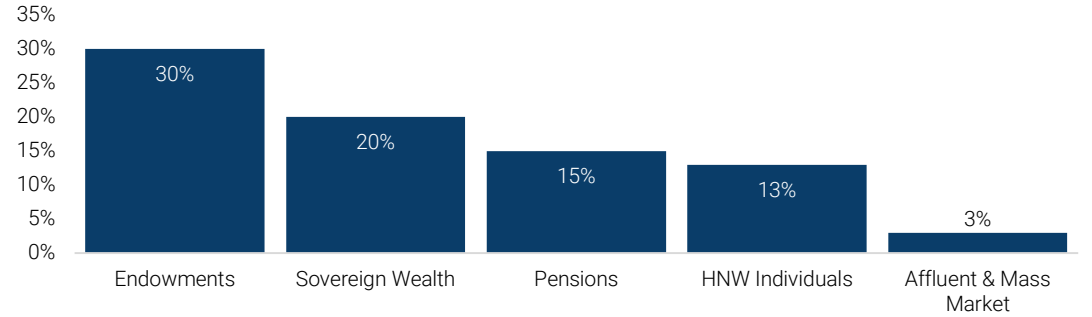
AUM figures are for primary funds only, excluding secondaries and fund of funds, but including dry powder and NAV estimates. Source: Pitchbook, Dec 2023.

This remarkable growth is primarily attributed to institutional investors—endowments, family offices, and pension funds—who typically allocate substantial portions of their portfolios to private investments, often exceeding 30-40%.[7]

As the breadth of product offerings expands, we believe penetration among high-net-worth and retail investors is also poised for significant growth. Currently, allocation to alternatives in private wealth lags institutional allocations.

There are over 18 million accredited investors in the U.S., representing $89 trillion in assets.[8] Currently, these investors only allocate single digits of their portfolios to private investments. Industry projections suggest that allocations could rise to 5-10%. If accredited investors were to allocate an additional 5% to private investments, this could potentially lead to an estimated $2.5 trillion inflow into private markets.

Percentage Allocation to Alternatives by Investor Type (%)



Source: PwC Asset Management Study 2022; Cerulli Associates 2023 U.S. High-Net-Worth and Ultra-High-Net-Worth Report.

Corresponding footnotes can be found at the end of the white paper.

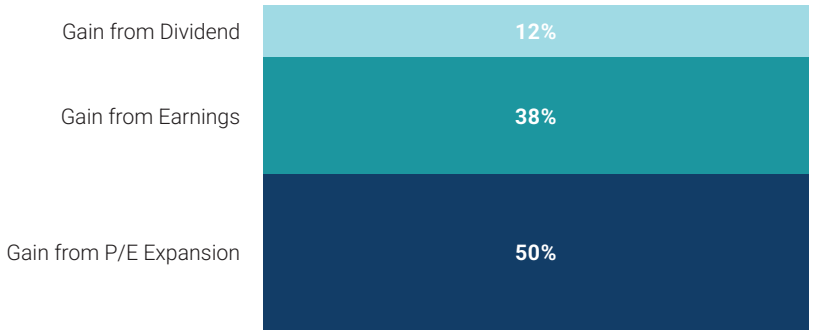
Why Allocate to Private Markets?

01 Enhanced Return Potential

Historical data underscores the potential for favorable returns in private markets. Long-term returns from private equity have outperformed comparable public equity benchmarks by 100 to 300 bps over the past 15 years. Private debt markets have exhibited even more robust performance, surpassing the Bloomberg U.S. Aggregate by nearly 800 bps during the same timeframe.

Furthermore, following the Great Financial Crisis, the S&P 500 has generated an annualized return of approximately 12%, significantly above its long-term average of 6.7%. These returns were driven by a combination of earnings growth (38%), dividends (12%), and multiple expansion (50%).

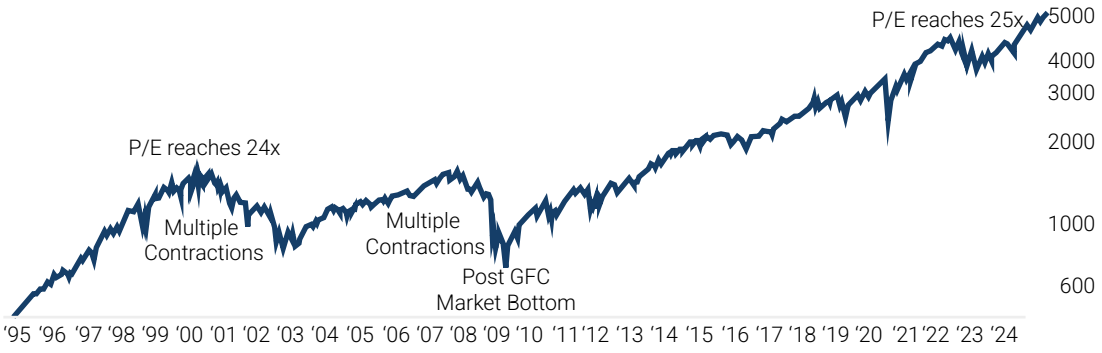
S&P 500 Performance Since March 2009



Source: FactSet, Sept 2024.

We believe repeating these returns over the next 15 years appears unlikely; to achieve similar results, the price-to-earnings (P/E) multiple would need to double from its current 25x to 40x, which many consider unlikely.

S&P 500 Index 1995-2024



Source: Stockcharts, Inc.

Past performance is no guarantee of future results.

02 Diversification and Risk Management

We believe private markets offer dynamic diversification opportunities within traditional portfolios. Their performance is often less correlated with public markets, which may help mitigate overall portfolio volatility.

RISK AND RETURN PROFILES

Private markets encompass various asset classes, such as private equity, private debt, real estate, and venture capital, and each offers a different return and risk profile (see *Key Private Market Strategies* section for further descriptions). Real estate and venture capital investments are particularly noted for their low correlation to public equities, making them effective tools for diversifying investment portfolios.

Asset Correlations 2000-2023

	S&P 500	US Treasuries
Private Debt	0.73	-0.41
Venture Capital	0.49	-0.36
Secondaries	0.23	-0.09
Private Credit	0.64	-0.42
Real Estate	0.35	-0.17
Real Assets	0.41	-0.24

Source: Pitchbook, Dec 2023; FactSet, Dec 2023.

03 Enhanced Liquidity

A new wave of investment structures—led by interval funds—is reshaping how investors gain access to private markets.

LIQUIDITY MANAGEMENT

Unlike traditional private equity investments, which often require long-term commitments and may involve complex subscription documents and capital calls, interval funds provide required periodic redemptions, typically on a quarterly basis. Tender offer funds also provide liquidity options, although they do not guarantee the same periodic redemption structure as interval funds.

Interval funds have also simplified the investment process for wealth advisors and their clients, reducing the administrative complexities often associated with traditional private placements and tender offers and offering more efficient ticker symbol execution. This ease of access encourages more investors to participate in private market opportunities.

Past performance is no guarantee of future results.

Below is a comparative chart illustrating the differences between interval funds, traditional private placements, and tender offer funds.

Structural Characteristics of Various Funds					
Key Points	Open-End Fund	Listed Closed-End Fund	Interval Fund	Non-Listed Closed-End Fund	Typical Private Fund (Drawdown)
1940 Act Registered	☑	☑	☑		
Continuously Offered	☑		☑		
Daily Valuations[9]	☑	☑	☑		
1099 Tax Reporting	☑	☑	☑	☑	
No Performance Fees[9]	☑	☑	☑		
No Capital Calls	☑	☑	☑	☑	
Investor Suitability	None	None	None[10]	Qual. Purchaser Acc. Investor[11]	Qualified Purchaser
Investment Minimum	$	$$	$$	$$	$$$
Liquidity	Daily	Exchange Traded	Periodic (~quarterly)	Periodic (~quarterly)	Periodic / Illiquid
Illiquid Securities	15% Max	No Max Limit	75%-95% Max[12]	75%-95% Max[12]	No Max Limit

Source: BlackRock; Wells Fargo Securities, LLC.

04 Access to Unique Opportunities

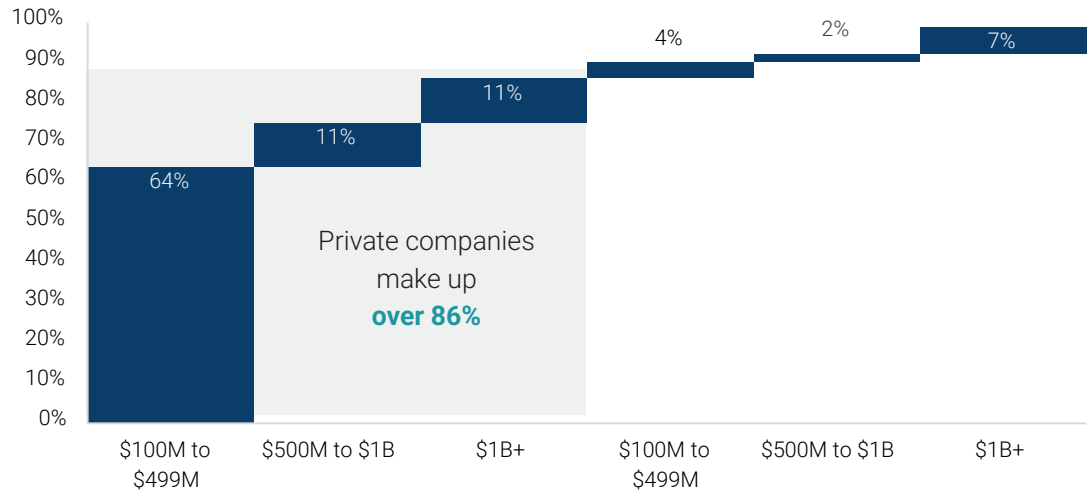
With over 55,000 private equity-backed companies globally—more than seven times the number of publicly traded firms in the U.S.—private markets present a vast array of investment opportunities.[3] This includes niche markets and emerging industries often unavailable through public channels.

Conversely, as the number and value of venture- and private equity-backed firms continue to grow, the number of publicly listed firms is declining. In the 1980s and 1990s, the U.S. boasted over 6,000 publicly traded firms; this number has decreased to approximately 3,700 today.[4]

Private companies outnumber publicly traded ones across most revenue segments. 86% of U.S. companies with over $100 million in revenue are private.

Past performance is no guarantee of future results.
Corresponding footnotes can be found at the end of the white paper.

Breakdown of U.S. Private and Public Companies by Revenues



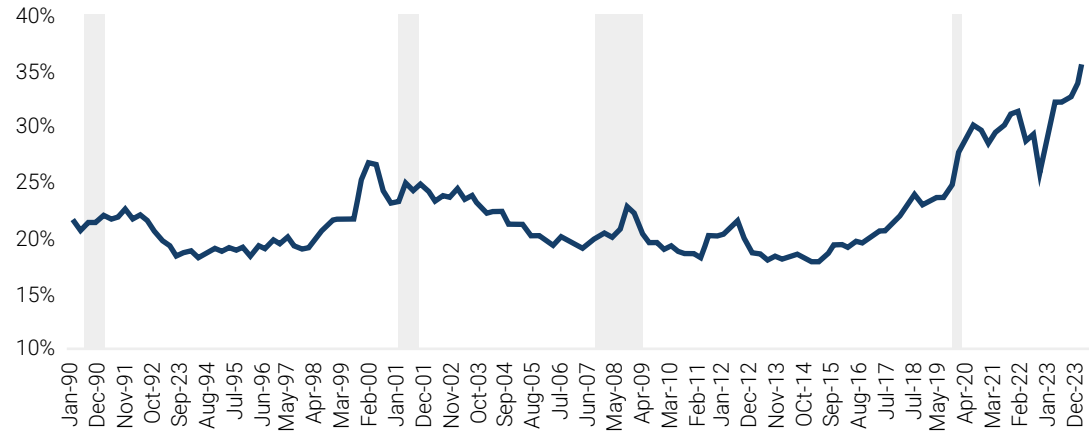
Source: S&P Capital IQ, ICapital Alternatives Decoded, with data based on avalability as of February 2023.

05 Mitigating Concentration Risks

The S&P 500 index has experienced its highest concentration in over 25 years, with the top 10 companies accounting for more than 35% of its total weight. This concentration heightens the risk for investors who rely heavily on a limited number of large-cap stocks. By diversifying into private markets, investors may significantly reduce this risk and enhance the resilience of their portfolios.

S&P 500 Share of Top 10 Companies by Market Cap

- The top 10 names represent nearly 35% of the index weight today.
- The top 4 names represent nearly 25% of the index - the most skewed since 1964.



Source: JP Morgan: "2023 Market Insights".

Corresponding footnotes can be found at the end of the white paper.

Emerging Trends in Private Markets

The evolving investment landscape indicates a significant trend in which private companies increasingly opt to remain private. Many firms that have gone public recently were over 10 years old at their IPO, reflecting a shift from historical averages where companies typically went public at around 5-7 years of age.[13] This delay often allows these firms to build robust business models and achieve substantial market share, leading to more robust valuations during their IPOs.

Roughly 60% of venture-backed companies are now choosing to stay private longer than a decade, allowing them to develop and scale without the pressures associated with public market expectations.[14] This extended private phase often results in companies being more strategically positioned when they finally enter the public markets, contributing to significantly higher IPO valuations.

Historically, venture-backed companies pursuing IPOs would typically exit into the Russell 2000 Small Cap Index. However, since 2017, there has been a noticeable increase in firms going public at higher valuations. Noteworthy examples include Rivian, Spotify, Uber, and Roblox, which have bypassed the small-cap universe to enter public markets as mid- or large-cap corporations. Consequently, investors—particularly those focused on small-cap equities—are missing out on the excess returns that private markets may provide. This dynamic partially explains the recent performance lag between U.S. small caps and large caps.

Furthermore, as companies delay their IPOs, the pool of private equity-backed firms has expanded dramatically. Today, there are more than 55,000 private equity-backed companies globally, compared to about 3,700 publicly traded companies.[3] This substantial number presents a significant number of investment opportunities that wealth advisors may tap into for their clients.

We believe the venture capital landscape is also shifting, with investors increasingly seeking access to private markets to capture growth opportunities before companies go public. The number of private companies valued at over $1 billion—the so-called "unicorns"—continues to grow, exceeding 1,700 worldwide.[4] With private companies often outperforming public counterparts in growth metrics, advisors may strategically position their clients to benefit from this expanding opportunity set.

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Key Private Market Strategies

01 Private Equity

OVERVIEW

This strategy focuses on established companies seeking growth, restructuring, or operational improvements. Private equity investments typically involve acquiring controlling stakes in companies, allowing investors to implement strategic changes to drive value.

MARKET DYNAMICS

The average age of private equity-backed firms has increased over time, which we believe indicates a trend of companies delaying their IPOs. This trend allows investors access to substantial growth before these firms transition to public markets, often resulting in a more favorable exit.

TYPES OF INVESTMENTS

Growth Equity
Funding for established companies aiming for significant expansion.

Buyouts
Acquiring a controlling interest, often involving significant operational overhaul.

RISK/RETURN PROFILE

Moderate to high, depending on the firm's age, market conditions, and the operational strategies implemented.

02 Private Debt

OVERVIEW

This strategy involves loans to companies outside traditional banking channels, often at higher yields than public debt markets. We believe private debt may be an attractive option in environments where interest rates are low.

TYPES OF DEBT

Direct Lending
Providing loans to middle-market companies focusing on secured and unsecured loans.

Mezzanine Financing
A financing hybrid that ranks between debt and equity and typically includes a form of equity participation.

Distressed Debt
Investing in the debt of companies facing financial challenges, often acquiring it at a deep discount.

RISK/RETURN PROFILE

Typically, higher returns than public debt, but also higher risk, particularly in distressed scenarios.

Past performance is no guarantee of future results.

03 Real Estate

OVERVIEW

Real estate investment encompasses various income and capital appreciation strategies. We believe these investments play a critical role in portfolio diversification.

INVESTMENT STRATEGIES

Core
Focused on high-quality, stabilized properties with strong occupancy rates, typically in prime locations.

Core Plus
Involves properties that are slightly less stable but offer opportunities for improvement.

Value-Add
Targeting properties needing renovations or repositioning to enhance value.

Opportunistic
Strategies focusing on development/ redevelopment projects.

RISK/RETURN PROFILE

Varies widely; core strategies typically have lower risk/return profiles, while value-add and opportunistic strategies offer the potential for much higher returns, albeit with greater risk.

04 Venture Capital

OVERVIEW

Venture capital involves investing in early-stage companies with high growth potential. These investments are typically made before significant revenue generation and are characterized by a high level of risk and the potential for substantial returns.

INVESTMENT STAGES

Seed Stage
Initial funding for product development and market entry.

Early Stage
Funding for scaling operations and increasing market share.

Growth Stage
Investing in more established firms looking to expand further.

RISK/RETURN PROFILE

Often the highest among private market strategies due to the nascent nature of the businesses involved.

Past performance is no guarantee of future results.

Challenges and Considerations

While we believe the advantages of private markets are compelling, several challenges warrant consideration:

01 LIQUIDITY

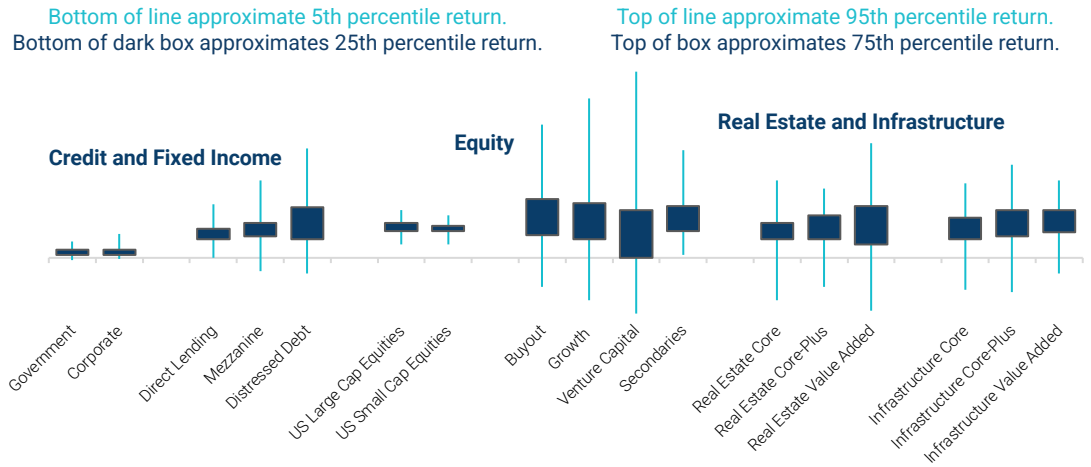
Although traditional private investments often require a long-term capital commitment, we believe newer structures like interval funds have alleviated some liquidity concerns. Unlike conventional private equity funds that may impose capital calls, interval funds are fully funded at the outset. Additionally, they offer periodic liquidity through scheduled redemptions, allowing investors to redeem a portion of their investment at designated intervals. Advisors should still assess clients' cash flow needs and ensure that they have adequate liquidity, as the illiquidity of certain assets may still impact overall portfolio liquidity.

02 DUE DILIGENCE

We believe selecting the right managers in private markets is crucial, as manager performance may vary significantly. Given the significant return dispersion across private strategies, advisors must conduct thorough due diligence to ensure they choose managers who may navigate the complexities of the private market landscape. This includes evaluating potential managers' investment philosophies, historical performance, and alignment with client objectives. Given the less transparent nature of private investments, robust research is essential to mitigate risks and enhance investment outcomes.

Annualized Returns, Long Term Horizon

Dispersion of returns is significantly greater for private managers versus public managers.



For illustrative purposes only. Return variance is not fully comparable; some are based on IRR, others annualized returns. Funds may have differing time horizons—most 10-year time horizons.
Source: S&P; Morningstar; Bloomberg; Pitchbook.

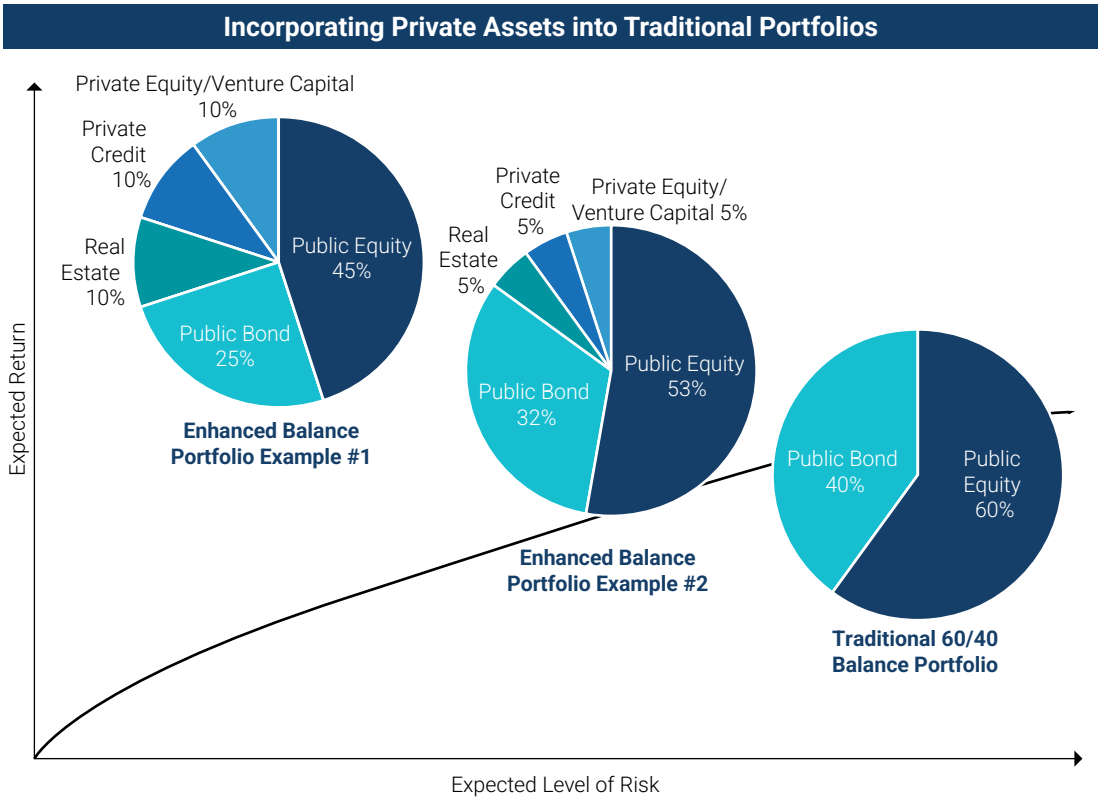
03 REGULATORY CONSIDERATIONS

Private funds operate under a different regulatory framework than public funds, often facing fewer regulations. While this may present unique opportunities for enhanced returns, it also introduces potential risks. Advisors must navigate these complexities diligently, ensuring compliance with applicable regulations while effectively leveraging the benefits of private market investments. This involves staying informed about regulation changes and understanding the implications for client portfolios.

Integrating Private Markets into Client Portfolios

Determining Appropriate Allocations

Assessing clients' liquidity needs and risk tolerance is essential when contemplating private market investments. Allocations may vary widely, depending on individual investor circumstances. For wealth advisors, we believe integrating private markets into client portfolios is not just an option but a strategic necessity. Below are examples of model portfolios incorporating allocations to private investments within a traditional portfolio framework.



Correlation vs S&P 500

Public Bonds	-0.11
Private Credit*	0.64
Private Real Estate*	0.35
Private Equity*	0.75
Venture Capital*	0.49

Illustrative purposes only. Not drawn to scale. *Adjusted for 'return smoothing' (using a lagged correlation) per Pitchbook calculations due to the fund's less frequent, disparate valuation adjustments to underlying assets to better reflect risk-return trade-offs. Source: Pitchbook; Axxes Capital.

We believe that by implementing these strategies, advisors may enhance diversification, access non-correlated assets, and potentially improve the expected return/risk ratio of the overall portfolio while maintaining the original risk profile.

Conclusion

As the investment landscape evolves, wealth advisors must adapt to avoid being left behind. We believe allocating to private markets provides access to unique investment opportunities, enhances diversification, and holds the potential for superior returns. The emergence of new vehicle structures, such as interval funds, has made private market investments more accessible, allowing advisors to offer clients greater liquidity and flexibility while still capturing the benefits of this asset class.

By incorporating private markets into client portfolios, we believe wealth advisors may better serve their clients' interests and strengthen their investment strategies for the future. Embracing these opportunities positions wealth advisors for success in a competitive market and ensures their clients may confidently navigate the complexities of today's financial environment.

Endnotes

1. Pitchbook, Dec 2023.
2. Bloomberg, Jan 2023.
3. Pitchbook, NYSE and Nasdaq, Sept 2024.
4. Pitchbook, Sept 2024.
5. JP Morgan: "2023 Market Insights".
6. McKinsey & Co: "Global Private Markets Report", 2023.
7. Equable Institute for Pensions, Dec 2022; Global SFW, Dec 2023; CapGemini World Wealth Report, Goldman Sachs.
8. DQYDJ.com.
9. Interval funds and listed BDCs may vary by fund.
10. Typically, interval funds are not legally required to impose investor suitability. However, because of their relative illiquidity, individual distributors may require clients to meet certain criteria, e.g., Accredited Investor standard.
11. Investor Suitability may vary by fund.
12. There may be some limitations, as funds must maintain liquid assets sufficient to meet repurchase offers.
13. Jay Ritter, University of Florida, Dec 2023.
14. Hamilton Lane, Private Market Investing: Staying Private Longer Leads to Opportunity, April 2022.

Important Disclosure Information

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