



Wealth investment content

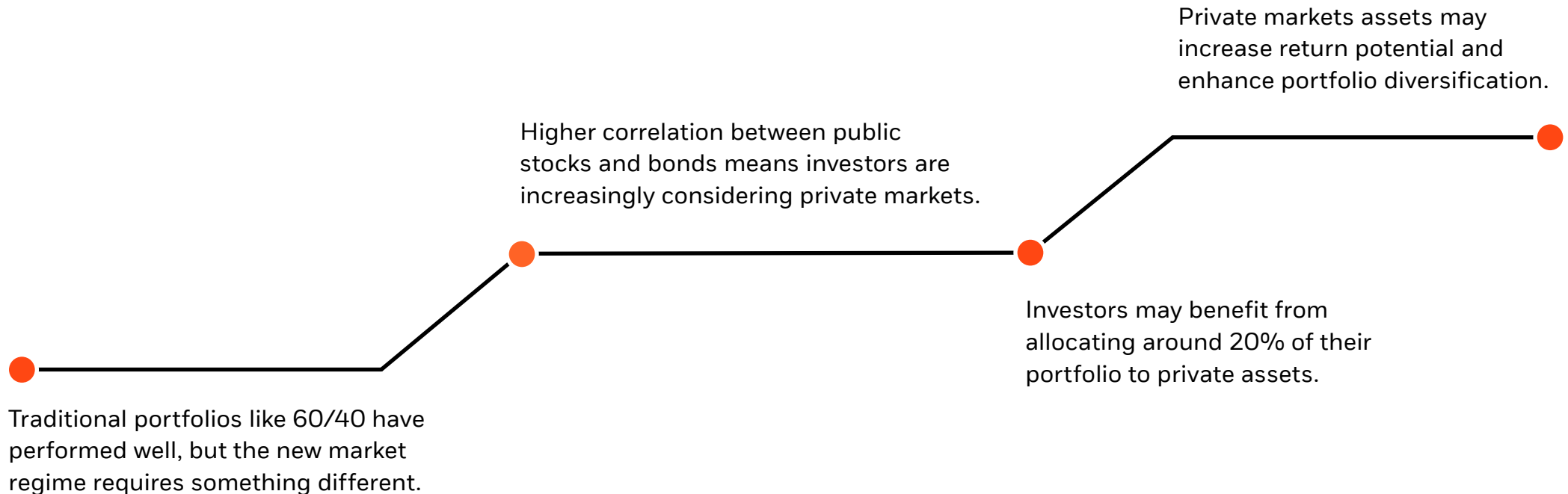
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BlackRock

Rethinking private markets for a new regime

Key takeaways

Why private markets should belong in a wealth investor's portfolio.



Risk: Diversification and asset allocation may not fully protect you from market risk.





Introduction

Private markets are no longer an 'alternative' asset class. In fact, investors may find they are more crucial to a diversified portfolio than ever before.

The BlackRock Investment Institute (BII), which generates proprietary research to provide investment insights to Blackrock's portfolio managers and clients believes that private assets play a tangible role in many investor's portfolios. BII views that adding up to 20% of the entire portfolio to private market assets could be beneficial to clients, moving past the conventional 60-40 split of

stocks and bonds to a 50 equities/30 fixed income/20 private markets split.

That's because markets have changed. The Great Moderation is over: today's higher inflation, higher interest rates and sluggish growth are different from the conditions that investors have known for the past 40 years.

The new market regime is clear when you look at the correlation between public equities and public bonds. A negative correlation between stocks and bonds implies that their returns are moving in the opposite direction, and over the

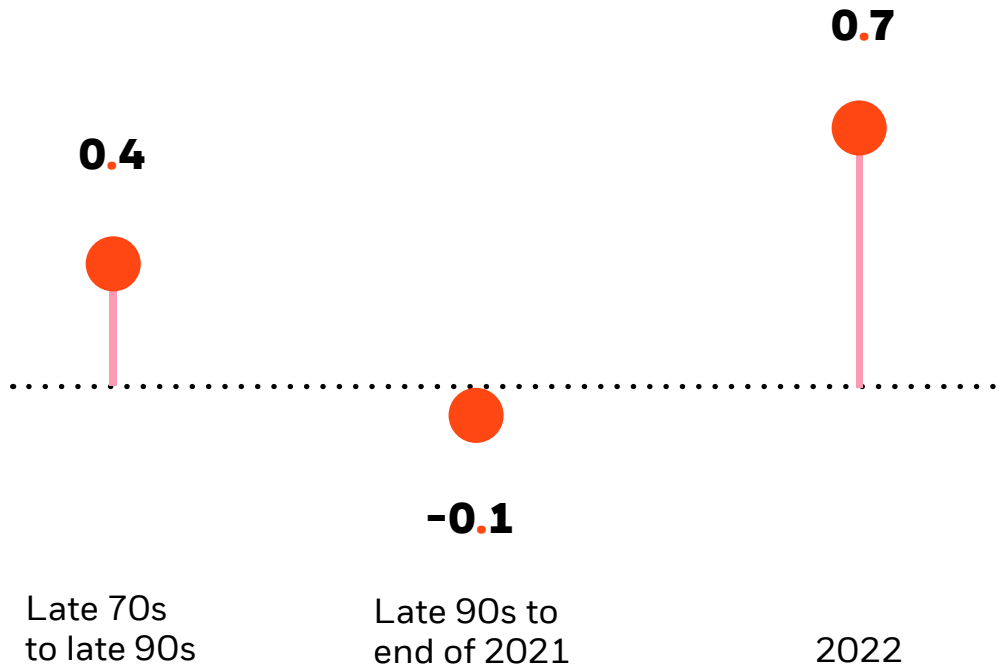
last 40 years up to the end of 2021, investors could rely upon them for a diversified portfolio and reliable sources of returns.

On the other hand, a positive correlation between stocks and bonds implies that their returns are moving in a similar direction, meaning they can no longer provide a reliable source of diversification and returns especially if both stocks and bonds go down at the same time.

And, this is what happened in 2022, both stocks and bonds suffered losses.



Correlation between public stocks and bonds



Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy. Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index.

Additionally, in the wake of the Covid-19 pandemic, most of the developed world struggled with higher inflation, which central banks attempted to dampen by raising interest rates. The macro conditions, together with the policy response, rattled public markets, triggering losses across asset classes.

That level of correlation was a blow to the stocks-and-bonds 60-40. In this new environment, the typically inverted relationship between those public assets is no longer so straightforward. And a new market regime requires investors to consider a new approach.

Source: MSCI USA Index and Bloomberg Barclays US Aggregate Bond Index from January 1977 to December 2022. Stocks: MSCI USA Index, Bonds: Bloomberg Barclays US Aggregate Bond Index. Currency: USD. Using monthly frequency of index data.



Investment options



Private markets' assets can be split into private equity, infrastructure, private credit, and real estate all of which are traded privately and less frequently than publicly traded stocks and bonds on the stock exchange. Private assets can help investors broaden their opportunity set, may increase return potential, and enhance portfolio diversification – and in some cases may also add a healthy dose of inflation mitigation.

Risk: Diversification and asset allocation may not fully protect you from market risk.

Private equity – Investments in privately-held companies.

Private equity as an asset class offers the flexibility to invest beyond traditional buyouts including corporate carve outs, public to privates, distressed, and broken auctions. In today's environment, we see great opportunities in corporate carveouts as companies look to focus on core assets, public-to-private transactions given the correction in public markets, and consolidation strategies as smaller companies struggle.

Infrastructure – Investments or loans that allow investors to receive some of the revenues earned over time by physical projects such as toll roads, power plants or utilities.

The BlackRock Investment Institute Transition Scenario estimates that capital investment into the energy sector will grow to an average of US\$4 trillion a year through 2050, an increase from recent average investment levels of US\$2.2 trillion a year¹. With infrastructure typically performing well during more inflationary environments, this can make infrastructure projects more attractive during periods of rising prices.

1 Source: BlackRock report Sustainable and transition investing – July 2023, page 9.





Private credit – Loans extended directly to companies, with bespoke contractual terms.

These investments can offer higher rates and more downside protection than comparable bonds. And because many of these loans have floating interest rates, they can potentially offer continued high income in a rising-rate environment.

We believe private credit now presents one of the most attractive markets for private credit with a notable pick up in yields vs public markets and stronger investor protections. In an environment of weak growth, persisting inflation and higher cost of capital, it is important to focus on credit selectivity and quality.

Real estate – Direct investment in institutional-grade residential, commercial, or industrial properties.

Current valuations suggest that investors have a once-in-a-cycle window of opportunity to take advantage of pricing at levels not seen since the global financial crisis. We see opportunities in the value-add segment across regions around the world.

Any forward-looking statements may not come to pass. Please find risk warnings for private equity, infrastructure, and real estate in the risk warnings section at the end of the paper.



How to get started

BlackRock's view is that wealth clients could benefit from an allocation of around 20% to private markets. However, the overall allocation may vary given that every investor's comfort level with risk is different, as is how easily and how often they will need to cash in their holdings.

Portfolios made up entirely of public securities are quick to set up and cash out of because the assets are easily bought and sold. But private markets' assets are longer to buy and to sell – an investor has to make a commitment to the portfolio manager, who invests the money over time.

As investors build their private markets allocation, private equity, real estate, infrastructure, and private credit asset classes can be considered to build a diversified portfolio.

Navigating private markets

Private markets investments have played a core role in institutional portfolios for decades. Now wealth managers, high-net-worth individuals and the mass affluent have begun to actively invest as well.²

Building a robust private markets portfolio isn't easy, however. It's resource-intensive and can come with more opportunities and pitfalls than stocks and bonds.

2 Source: Preqin Press Release, Private Equity Managers Tap Private Wealth Market to Mitigate Weaker Fundraising Outlook – Preqin Global Report 2023, 14 December 2022.



Biggest challenges



Some of the biggest challenges include:

Illiquidity

It's harder to withdraw money as funds are typically locked up for the term of the investment. Investors need to be prepared for a long-term commitment and are usually compensated with premium.

Dispersion

The performance of private markets can vary widely, even within the same asset class. It's important to have a manager who can source the best opportunities from a universe of potential investments.

Complexity

When you increase the number of asset classes you invest in, you need a partner who can oversee the fund managers and investments in your portfolio.

Transparency

Private assets don't come with the same disclosures or real-time trading prices as publicly traded securities. This requires an experienced manager who can assess, track and compare investment choices.

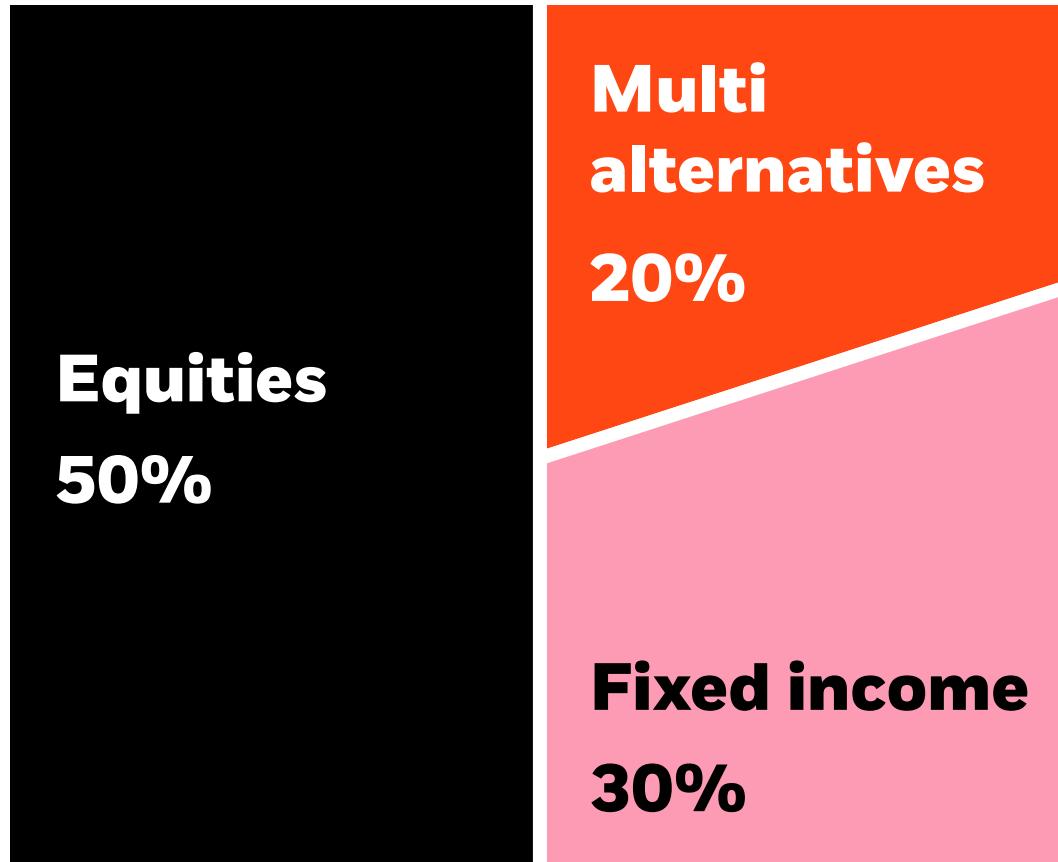
Access

Barriers to investing in private markets can include high investment minimums, limited availability of sought-after funds, regulatory and location restrictions. A partner familiar with all possible legal structures can provide access to more opportunities.



Comparing

Comparing a 60/40 portfolio with a 50/30/20 portfolio (with 20% allocation to multi-alternatives)



	Traditional 60/40 portfolio	50/30/20 portfolio*
Portfolio risk %	11.3	12.7
Expected return %	5.5	7.2%
Portfolio efficiency (return/risk)	0.5	0.6

* with 20% Multi-Alternatives Allocation



In the above, we have compared risk-return outcomes for an illustrative traditional 60/40 (stocks – bonds) portfolio with a 50-30-20 portfolio (stocks-bonds-private markets). The 20% allocation to private markets includes diversified allocation to core sub-asset classes such as private equity, private credit, infrastructure, and real estate equity.

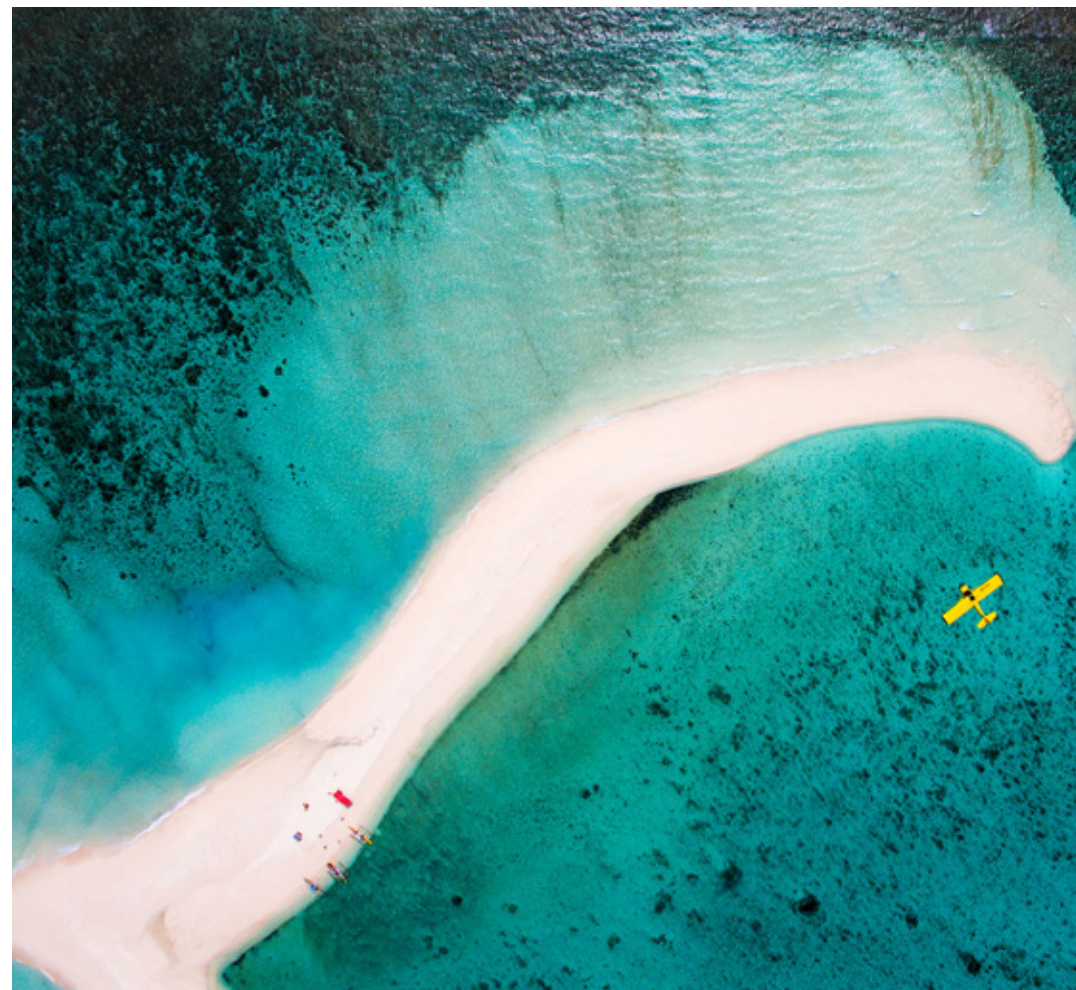
Replacing the 60-40 with a 50-30-20 (stocks-bonds-private markets) portfolio does help improve total risk-return outcomes; with expected return going up from 5.5% to 7.2%, risk increasing from 11.3% to 12.7% and portfolio efficiency increasing from 0.5 to 0.6.

This information is not intended as a recommendation to invest in any particular asset class or strategy or as a promise - or even estimate - of future performance. Forecasts are not a reliable indicator of future performance.

Risk and Capital Market Assumptions data as of 30.06.2023; currency: EUR; time period: 10 years. Return assumptions are total nominal returns. Asset return expectations are net of assumed fees. Fees and alpha are estimates for illustrative purposes only and do not represent any actual fund performance.

Portfolio risk excludes FX risk. Indices are unmanaged and one cannot invest directly in an index.

BlackRock has not considered the specific needs of the client and is not making any recommendation of any particular option. You should consider the most appropriate allocation for your needs.



Why ELTIFs matter

Access is one barrier that's been eased for many European investors. The European Long Term Investment Fund, or ELTIF, allows new investors to gain exposure to private assets as part of their portfolio. The EU recently reaffirmed their commitment to the ELTIF, passing the ELTIF 2.0 regulation which will simplify both portfolio management and distribution of the structure, and is set to accelerate growth materially.

Additionally, ELTIFs are available to high-net worth individual investors across Europe at lower minimum investment levels. That's why, we believe that ELTIFs will keep playing an increasingly important role in building more diversified investment portfolios.

Learn more about ELTIF >

Need help to get started?

Building better portfolios



Designing private markets portfolios, and deploying the right technology to manage them, takes a lot of work.

Only the largest investors have the resources to directly construct and monitor diversified private markets portfolios. So, for investors interested in what private markets can offer, one place to start is with a dedicated private-markets team

A new market regime calls for a more widely diversified and dynamic investment approach, where investors may benefit from considering a whole portfolio view.

A view that goes beyond stocks and bonds and can take advantage of the opportunities found in private markets.

Contact us >



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