

Integrating private markets into investment portfolios: unlocking opportunities for long-term growth and resilience.

Thought leadership paper

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Executive summary

- The private market asset classes, such as private equity, infrastructure, private debt and real estate, can provide real value in a holistic investment portfolio.
- No longer confined to an “alternative” asset class, private equity represents a ~ \$11 trillion market, c. 12% of its public counterparts¹. These asset classes are estimated to grow far beyond the public asset classes’ growth rate and are thus poised to represent an ever-growing share of the investable landscape.
- Beyond becoming a ubiquitous asset class, integrating private markets in an investment portfolio offers significant advantages in terms of enhanced diversification, improved risk/reward ratio, and can act as a real stabilizer to portfolio volatility.
- Over the past couple of years, several structural evolutions shine a new light on the traditional 60/40 portfolio model. Compressed bond yields have diminished income and risk-buffering benefits, while equity volatility has increased. Most critically, the negative correlation between stocks and bonds, which underpinned diversification for two decades, has turned positive since mid-2021², challenging the portfolio’s core premise. Additionally, the S&P 500 has reached extreme concentration levels, with the top 10 stocks now representing 41% of market capitalization while contributing only 32% of earnings³ as of December 2025.
- Private markets offer compelling solutions to complement the 60/40 portfolio model in this new environment: enhanced diversification away from concentrated public equity exposure, improved risk-adjusted returns through active management, capture of an illiquidity premium, and inflation-hedging characteristics. This paper demonstrates that strategic allocations to private equity, private debt, real estate, and infrastructure can materially improve portfolio outcomes for institutional investors, family offices, and high-net-worth individuals across diverse risk profiles.



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The challenge: erosion of traditional diversification

Four fundamental shifts challenge the traditional 60/40 portfolio approach:

- **Compressed bond yields:** extended quantitative easing has reduced income generation and downside protection from fixed income allocations.
- **Correlation breakdowns:** the negative equity-bond correlation that underpinned diversification for the last two decades turned positive in mid-2021²—a shift not seen since the 1980s. When inflation dominates, both equities and bonds respond negatively to inflation surprises, moving in tandem rather than offsetting each other.
- **Inflation's impact on real returns:** during high-inflation regimes (>4%), US equities delivered -1.9% real returns and Treasuries -0.1%, compared to 11.0% and 4.1% respectively in low-inflation periods⁴.
- **Increased concentration:** increasing concentration of traditional indices, such as the S&P 500, further erodes diversification³. This concentration is further enhanced as the “Magnificent Seven” (NVIDIA, Meta, Microsoft, Apple, Alphabet, Amazon and Tesla) represent significant exposure to the tech sector.

The value of integrating private markets in a liquid portfolio

Strategic allocations to private equity, private debt, infrastructure, and real estate can materially improve outcomes through several mechanisms:

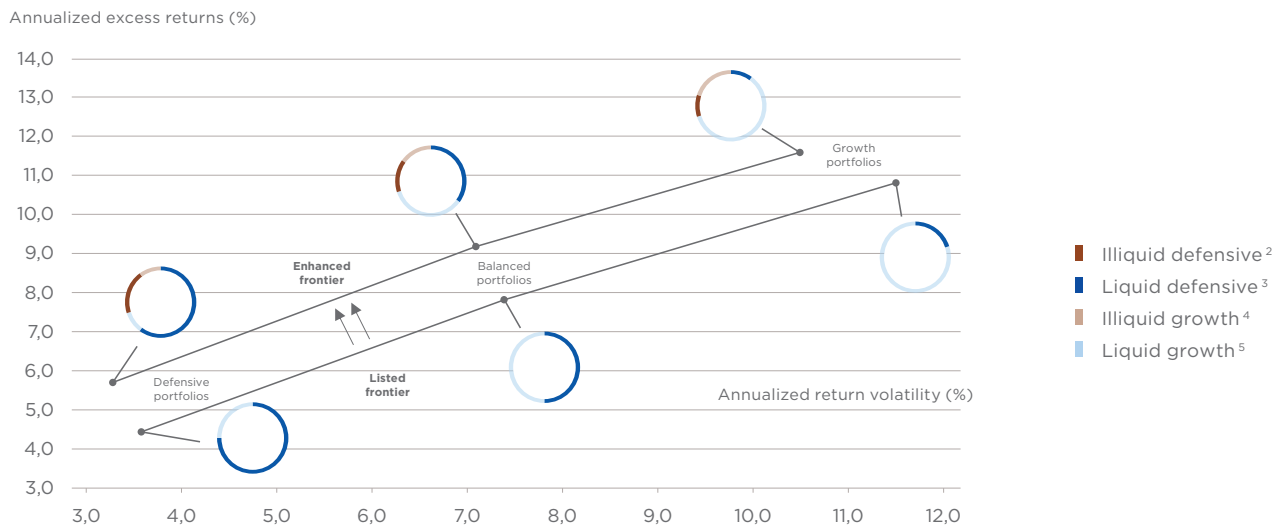
- **Enhanced diversification and access to industries and nimble SMEs:** private markets offer exposure to a deep investable universe (globally, 140,000 private companies with revenues exceeding \$100M, vs. c. 19,000 public companies with the same revenues) and diverse investment profiles which cannot be found in public counterparts, along themes such as regionalization (e.g., local SMEs and supply chain infrastructure), local sovereignty (e.g. mid-market energy providers and digital infrastructure), innovation (e.g. pre-IPO innovative scale-ups). Diversification across investment profiles becomes even more important in periods of high economic and geopolitical volatility.
- **Superior risk-adjusted returns:** portfolios allocating to private funds such as buyout funds have historically delivered both higher returns and lower volatility versus public-only portfolios⁶.
- **Illiquidity premium:** 7-10 years holding periods compensate investors through higher expected returns, particularly valuable for investors who don't face immediate liquidity needs across their entire portfolio.
- **Inflation hedging:** infrastructure and real assets provide natural inflation protection through inflation-linked cash flows and tangible asset backing.
- **The alpha contribution:** importantly, private market returns are not entirely explained by publicly available factors⁶, indicating genuine alpha generation through sourcing, due diligence, operational improvements, and value-creation activities. This points towards the existence of true “savoir-faire” among private markets fund managers.

Combining liquid and illiquid assets: improved risk-return profile

- The benefits of private market allocations extend across the risk spectrum, offering significant portfolio improvements across portfolio types. Analysis of utility-maximizing portfolios⁵ reveals that all investor types, from defensive to growth-oriented, can benefit from strategic private market allocations, with a varying impact. In essence, adding private assets to a liquid portfolio generates an enhanced performance profile.
- According to IFM Investors, a global institutional asset manager, allocating 30% of a portfolio to private assets improves the risk-return profile, as shown in the graph below.

Hypothetical Public and Private Assets portfolio, Q1 2000 to Q3 2024¹

The chart below shows how a portfolio including both Public and Private Assets can achieve a higher return potential compared to a traditional portfolio consisting of public assets only, whilst maintaining a similar level of risk.



¹Source: IFM Investors; optimizing private market asset allocations (April 2025) | ²Private credit and unlisted infrastructure | ³Fixed income and 50% of commodities and credit | ⁴Private Equity and private property | ⁵Equity and 50% of commodities and credit.

Understanding the Illiquidity Premium

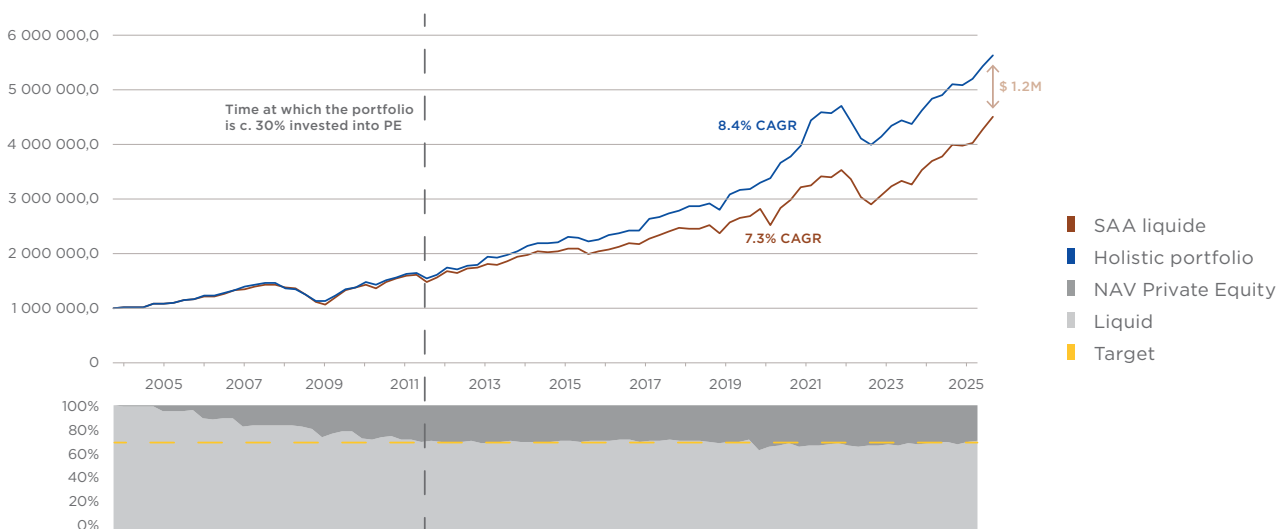
- Private markets require accepting a long-term investment approach and constrained liquidity. Holding periods are typically 7-10 years and, although secondary markets exist, to date they may lack efficiency and often require a performance haircut. On the flip side, investors can expect higher returns. Historically, private equity has outperformed public equity by approximately 300-500 basis points annually, while private debt has delivered roughly 100-150 basis points over comparable high-yield credit⁶. These premiums compensate for reduced liquidity and represent meaningful return enhancement for investors able to accept illiquidity on appropriate portions of their portfolio.

- Furthermore, investors rarely face 100% liquidity needs simultaneously. Pension funds manage long-duration liabilities, endowments operate with perpetual horizons, family offices maintain multi-generational perspectives, and even private investors typically allocate only a portion of wealth to near-term needs. In essence, most investors do not need 100% liquidity, and by focusing solely on liquid investments they may miss out on potential superior returns. For these investors, substantial portions can be committed to illiquid strategies without jeopardising the ability to meet obligations.
- Furthermore, the absence of daily mark-to-market pricing reduces psychological pressure to react to short-term volatility. This stability helps avoid the performance drag from panic selling during downturns - a well-documented phenomenon in behavioural finance. For investors prone to recency bias and loss aversion, the enforced patience of illiquid allocations can paradoxically improve long-term outcomes by preventing emotion-driven decisions during market stress.

Allocating to private markets: in practice

- To be more concrete, a back-testing exercise performed by Edmond de Rothschild’s research team demonstrates that adding private equity to a portfolio increases returns significantly over the long term.
- The exercise was performed over a c. 20-year period, starting from a fully liquid portfolio to which exposure to private equity was increased steadily from 2004 to plateau at 30% of portfolio NAV in 2011, and then maintained at 30% until Q3 2025. Uncalled cash and distributions were assumed to be invested in Edmond de Rothschild’s liquid Strategic Asset Allocation (SAA).
- As can be seen in the graphical representation below, this back-testing exercise resulted in a -15% improvement of the portfolio’s CAGR over the period, from 7.3% to 8.4%.

Backtest in practice



- However, successfully implementing private market allocations requires careful consideration of commitment strategies. Investors can either have a fixed-commitment strategy (commit a fixed percentage of portfolio value every vintage year), or a dynamic strategy (adjust commitments based on current allocations, observed cash flows, and expected distributions).
- It is clear that the latter, the dynamic allocation strategy, would mostly be reserved for the most sophisticated investors and would be out of reach for private investors. But here is the good news: studies show that “selection strategies focusing on fund and manager characteristics appear to provide more potential for enhanced performance than does commitment timing”⁶. While dynamic strategies can marginally reduce allocation deviations, the improvement is often modest relative to well-designed fixed strategies.
- Therefore, keeping a fixed allocation commitment, which is within reach for most private investors, is by-and-large a complexity-effective allocation strategy.

Conclusion: building resilient portfolios for a new era

- The traditional 60/40 portfolio could benefit from incorporating private assets such as private equity. Compressed bond yields have diminished income generation, while equity volatility has increased downside exposure. Most critically, the breakdown of the negative equity-bond correlation - turning positive since mid-2021² - undermines core diversification precisely when investors need protection most. Simultaneously, unprecedented concentration in public equity indices creates additional portfolio risk, with value creation increasingly concentrated in a narrow set of mega-cap technology companies³.
- Private markets offer evidence-based solutions. Strategic allocations of 10-30% of total portfolio value can materially improve risk-adjusted returns across the risk spectrum⁵. Fund managers’ active and transformational approach, which requires a long-term vision, can offer good alpha potential to complement existing liquid strategies.
- The illiquidity premium compensates rationally for reduced flexibility, with long time horizons and manageable near-term liquidity needs.
- The path forward: we suggest an evolution, not an abandonment, of the traditional framework into a more resilient multi-asset portfolio incorporating private markets as a core strategic allocation. This requires accepting reduced liquidity on appropriate portions of capital, implementing disciplined commitment approaches that balance target achievement with vintage diversification (including fund-of-funds structures). For investors across the wealth spectrum willing to embrace this approach, the evidence strongly supports that private markets can unlock meaningful opportunities for long-term growth and genuine portfolio resilience in an environment where traditional approaches face unprecedented challenges.

Sources: ¹HarbourVest, “How does the size of private markets compare to public markets?” <https://www.harbourvest.com/insights-news/insights/cpm-how-does-the-size-of-private-markets-compare-to-public-markets/> | ²Lombardi, M. J., & Sushko, V. (2023). The correlation of equity and bond returns. In BIS Quarterly Review, December 2023. Bank for International Settlements | ³T. Frawley (2026). The “Great Narrowing” S&P 500 concentration. RBC Wealth Management | ⁴PGIM Quantitative Solutions (2021). Portfolio implications of a higher US inflation regime. PGIM Research Brief | ⁵Joiner, A., van den Bogaerde, F., & Skondreas, C. (2025). Optimising private market asset allocations. IFM Investors Research | ⁶Brown, G. W., Harris, R. S., Hu, W., Jenkinson, T., Kaplan, S. N., & Robinson, D. T. (2021). Can investors time their exposure to private equity? Journal of Financial Economics, 139(3), 561-577.

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