PGIM

IAS EXECUTIVE SUMMARY

UNCOVERING THE UNOBSERVABLE

HAVE PRIVATE ASSETS OUTPERFORMED PUBLIC ASSETS?

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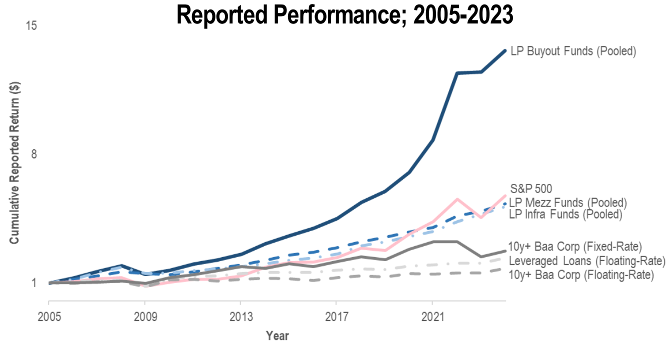
CIOs struggle trying to compare the investment performance of liquid public assets *vs.* illiquid private assets, often a crucial first step in asset allocation decisions. For private assets, while it is known that *reported* returns are smoothed, many CIOs are unaware that reported performance also fails to incorporate many of the *real-world* constraints to achieve and maintain a private asset portfolio allocation. Ignoring these constraints makes private asset reported returns even less meaningful when comparing them with public assets.

Reported cumulative returns suggest that private assets – especially buyout funds – have outperformed public assets by a wide margin from 2005 to 2023. However, this traditional comparison is misleading. To accurately measure the performance that a CIO experiences, the CIO must dig a bit deeper to **uncover the unobserved** *real-world* performance of private assets.

CIOs can rely on our Fair Comparison (FC) framework to uncover the real-world performance of private investment strategies, and then compare private and public investment strategies on a consistent, risk-adjusted basis, enabling better-informed asset allocation decisions.*

Traditional Comparison of Private vs. Public Asset Reported Performance; 2005-2023



Note: Private investment strategy annual returns are 1y IRRs computed by pooling cash flows and NAVs across all funds from all vintages for US buyout funds (minimum $250m capitalization), US mezzanine funds, and global infrastructure funds, respectively. Cumulative returns are calculated by compounding annual returns over the 2005-2023 horizon, assuming a $1 initial investment. Source: Bloomberg, Burgiss, S&P and PGIM IAS. Provided for illustrative purposes only.

Reported performance for a private asset class assumes an investor's allocation is always fully invested in a highly-diverse pool of private assets (*e.g.*, funds). However, there are many real-world constraints that prevent a CIO from experiencing this reported performance.

In practice, to achieve a portfolio allocation to private assets a CIO must follow an **investment strategy**. Such a strategy involves investing in only a subset of funds currently available (not the universe of funds); following a particular commitment pacing strategy; and temporarily holding uncalled and uncommitted capital in another asset class (say, a public market index or cash). Fund-selection uncertainty, commitment pacing, and the investment returns on uncalled and uncommitted capital are crucial contributors to the real-world performance experienced by a CIO which can deviate substantially from reported performance.

Specifically, from 2005 to 2023, the real-world mean and volatility of a buyout investment strategy was 13.4%/y and 17.4%/y, not the reported 15.5%/y and 13.1%/y, respectively. These real-world numbers are closer to public equity performance – intuitively not surprising given their similar underlying economics.

In general, for private assets, reported risk-adjusted returns (*i.e.*, mean/vol ratios) turn out to be overly optimistic and may mislead CIOs into over allocation.

Reported vs. Real-World Performance of Private & Public Investment Strategies; 2005-2023

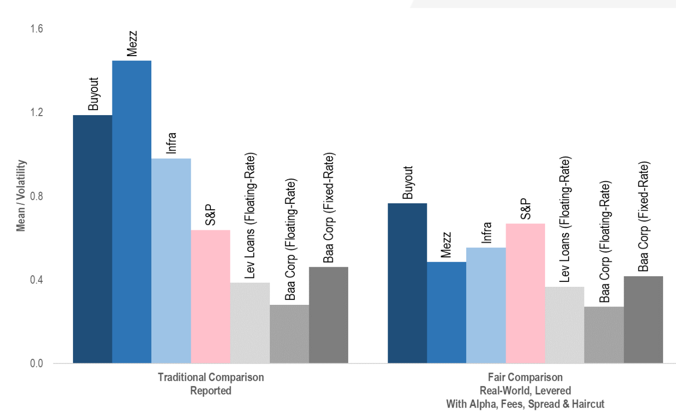
Investment Strategy	Asset	Reported Performance			Real-World Performance		
		Mean (%/y)	Vol (%/y)	Mean / Vol.	Mean (%/y)	Vol (%/y)	Mean / Vol.
LP Buyout Funds	Private	15.5	13.1	1.19	13.4	17.4	0.77
LP Mezz Funds	Private	9.4	6.5	1.45	8.0	10.7	0.75
LP Infra Funds	Private	9.4	9.6	0.98	9.4	15.7	0.60
S&P 500	Public	11.2	17.5	0.64	11.2	17.5	0.64
Leveraged Loans (Floating-Rate)	Public	5.5	14.2	0.39	5.5	14.2	0.39
10y+ Baa Corp (Floating-Rate)	Public	3.9	14.0	0.28	3.9	14.0	0.28
10y+ Baa Corp (Fixed-Rate)	Public	6.3	13.6	0.46	6.3	13.6	0.46

Note: Returns are annualized. Source: Bloomberg, Burgiss, S&P and PGIM IAS. Provided for illustrative purposes only.

To take our analysis a step further, the FC framework can compare investment strategies on an equal volatility basis, accounting for financing costs and public asset manager alpha and fees (which are already reflected in private investment strategy returns).

On a fully fair comparison basis, while a buyout investment strategy still outperformed public investment strategies, the margin was much smaller, a fact hidden from CIOs when relying solely on private asset reported returns.

Fair Comparison of Private vs. Public Investment Strategy Performance; 2005-2023



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* See *Private vs. Public Investment Strategies: Reported and Real-World Performance*, PGIM IAS, May 2023.

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