

SPEAKING OF ALTERNATIVES

S1 EP17: Let's Talk Alternatives in Global Wealth

Private wealth offers growth potential in the coming years and could be a particularly fertile area for alternative investments. Laurie explores the intersection of alternatives and the private wealth market with Stuart Parker, Head of Global Wealth at PGIM, and Dominick Carlino, Global Head of Alternative Investments for Wealth.

>> Welcome to "Speaking of Alternatives," the podcast where we explore the many layers of the alternative landscape. Today, we're going to dive into the intersection of private wealth and alternatives. An exciting and rapidly evolving opportunity, global private market assets is expected to reach 60 trillion by 2032, with the biggest growth coming from the wealth channel, which is projected to grow from the current 4 trillion to over 13 trillion in just a few years. The convergence of alternatives in the private wealth channel is more than just a trend. Asset managers are innovating with product development and evolving their sales and service model to meet the growing demand and expectations of wealth. So in today's conversation, we're going to unpack what is driving this growth, the implications for asset managers, financial advisors, and investors, and how PGIM is positioned in this evolving space. I'm thrilled to be joined by Stuart Parker, PGIM's Head of Global Wealth, and Dominick Carlino, PGIM's Head of Alternatives for Wealth. Stuart and Dominick, welcome. I look forward to this conversation.

>> Look forward to it.

>> So let's start out with your backgrounds. Stuart, you've been in the industry for 30 years. Tell us a bit about how you started in the asset management industry and what's been most exciting for you.

>> Sure. I basically have had two jobs. I started at Citigroup Asset Management in the 1990s and was working in the high-net-worth space. I was working mostly with Smith Barney advisors at that time and also Citigroup private bankers, so I always had an opportunity to work with the high-net-worth space. In the mid-2000s, PGIM hired me to build out its third-party distribution after it sold its broker-dealer (Prudential Securities) to Wachovia, and I've

been building out their third-party distribution ever since. We've started a journey there where we've essentially taken our institutional capability at PGIM, put it into a wrapper of some form -- a vehicle, whether it's a mutual fund, ETF, SMA, and bring it to high-net-worth clients. And we're now doing a similar thing with alternatives, so a pleasure to be here and look forward to the conversation.

>> I didn't realize we shared a common path there from Citi to Prudential, so I look forward to our conversation here. Dominick, we've worked together for many years now. I know your story well, but help our listeners understand your journey.

>> Well, like Stuart, my career started in the mid-1990s, and I started as an investment banker and research analyst, before transitioning to the distribution side. So in 2005, I went to Morgan Stanley and was distributing alternative investment strategies across both institutional and wealth channels there. And then, subsequent to that, I went to Merrill Lynch, where I was distributing alternatives for about 10 years across their private wealth, private bank, and advisory channels. I've been at PGIM for about two years and I'm excited to be partnering with the team here, including Stuart, to grow our alternatives business and open up our institutional capabilities to wealth.

>> That's great. Both of you have decades of experience in this space. You've seen the evolution of private markets and also wealth firsthand. Stuart, how has the wealth segment evolved over time, and what would you say are your priorities for wealth?

>> The history is long and rich of our ability to take institutional capabilities, put it into vehicles that allow for high-net-worth individuals to access that capability, and it's evolving into the alternative space. So going back four or five years, or maybe 10 years, there actually weren't a lot of alternative capabilities in the high-net-worth space; it was mostly long-only, and that is evolving. So that's an exciting part of what's happening. But, at PGIM, we try to do as much as we can to make ourselves as relevant as possible to high-net-worth clients by giving them a broad spectrum of capability. And there is no question that the ability to offer high-net-worth clients the liquidity and transparency of alternatives is exactly where they're going.

>> Alternative investments have been around for many years and have been popular within institutional investing. But now there is growing interest and recognition of the benefit individual investors can gain by extending their diversification further through a variety of alternative assets.

>> According to a recent Mercer survey, 92% of financial advisors currently incorporate alternative investments in their clients' portfolios; 91% plan to increase their allocations over the next two years. Dominick, I'll pose this question to you: Why now do you think that we're seeing the surge in interest for alternatives amongst our private wealth clients? What would you say are the main drivers of growth?

>> Well, look, I think there's been interest for a long time. To Stuart's point, there's been a dearth of quality supply up until just the past few years, maybe five years. In the early days -- and I'm only going back 10 or 15 years -- there was a little bit of negative selection in the market. Not every asset manager was, you know, willing to provide product and sales and support services to the wealth channel. But we're seeing that increase over time. I think people are seeing the growth opportunity in wealth as a \$500 trillion global market -- much bigger than the traditional channels that they've been selling through historically -- and they view it as a channel that's less exposed to alternatives and growing faster than those institutional channels. So we've seen a lot of investment in product development, a lot of investment in distribution support, education, field engagement, etc. And so the combination of more supply to meet the growing demand, as more advisors and clients get educated on the asset class, I think is spurring a lot of the growth. So as we sit today, we have decent breadth of usage; we don't have good depth of usage. So on average, we're seeing 3% of their clients' portfolios in alternatives, and I think we're all trying to grow that in a thoughtful way.

>> Yeah, that 3% is a number that is widely out there on one hand -- and where we're currently at -- and, on the other hand, a lot of CIOs are talking about an average asset allocation to alternatives ranging from 15 to 30%. So closing that gap is definitely a huge opportunity ahead.

>> I think that this is a trend that's happening for 30 years now, which is that modern investment management

starts in the institutional space and it comes into the high-net-worth space as people put more and more effort into technology and structures and vehicles. And so this is a natural evolution in my view, and one where, to me, why shouldn't high-net-worth individuals have access to alternatives -- which, as you say, can be as much as 30% of the portfolio of an institution. Why shouldn't they have access to that too, both from a diversification and enhanced return spectrum? So I think it's a really exciting time to be here.

>> And picking up on your point about evolution -- and, Dominick, your point about education -- can you comment on how have you seen the education for alternatives in the wealth segment evolve over time?

>> Well, there's been a tremendous amount of investment in education, from wealth managers to asset managers, consultants, others in the industry, all sort of coming together to raise the education level across the board, which is needed. It kind of started with: What are alternatives? And I think we've done a good job educating around the what. Then: Why should I care about this asset class? How do I understand the opportunities and the risks? The opportunities are return enhancement, diversification, and capital preservation. The risks are illiquidity, perhaps volatility, and maybe some opaqueness to the strategies. So we've put a lot of context around those opportunities and risks. And now the hardest part is the how. How do we go from, okay, I understand what it is, why it's good for me and my client -- how do I now incorporate it into my portfolio, and all of the complexities associated with that? That's the piece we're tackling now. How do you incorporate it? How do you size it? How do you fund it? How do you make it scalable? And so that's something that I think, as we continue to invest and products continue to evolve, that's getting easier. It's getting a little more turnkey. We're also leveraging technology in other intermediary partners that have come to the market, making the transactional and operational process easier as well.

>> Recently, increased attention has been given to alternatives as a potential area for growth. With the expansion of alternatives into a variety of new markets comes the essential need for education.

>> There are many headlines out there with the democratization of alternatives in the press. One was just out there from the Wall Street journal saying Wall Street wants to make private markets a little more public. Stuart, how do you think the democratization of private market investing will affect the overall investment landscape?

>> Well, I think it's important to understand what this means. When you think about private markets, particularly in the high-net-worth space, typically, this was only available to clients that had 5 million or more to invest. They'd have all sorts of hurdles in terms of net worth and other things that was limiting to the vast majority of people that potentially wanted access to these asset classes. By virtue of these new structures -- well, actually not so new, but they've been made available to the alternative world to allow for semiliquid and illiquid type of investment strategies, things like tender funds, interval funds, business development companies, nontraded REITs, all offer the ability for individual investors to get in for \$25,000, and then sometimes even less. So it's really broadened out who can have access to these markets, and I think that's what you're seeing more and more.

>> Dominick, anything to add there?

>> I would just add, I think, initially on the institutional side and now more in wealth, we're looking at these investment opportunities as sort of a continuum of opportunities to gain exposure, either through public markets or private markets. So we've seen relative shrinkage in the public markets, while the private markets have grown pretty materially. And so I think wealth -- and investors generally -- like the idea of putting together more liquid public market exposures when the opportunity set's better there, or having the ability to pivot towards private market exposures, get a liquidity premium, get sort of a tactical beta or alpha premium there. And so I think that institutional mindset is permeating to wealth, and they're viewing it as a much more relative value opportunity across those markets.

>> Recently, the White House issued an executive order democratizing access to alternative assets for 401(k) investors. What are your thoughts on this development and its implications for investors?

>> I actually think it's very positive. Retirement plans, pension plans have had access to alternative investments for decades, as we've spoken about. Why shouldn't individuals and 401(k)s also have access to those types of exposures? The challenge is you really have to be sure that clients know what they're getting, both in terms of risk but in terms of liquidity and the like. And so I think what you're going to see is -- and I think the executive

order laid this out -- was that you'll see private market exposure be embedded into multi-managed accounts, multi-asset type accounts, you'll see it within target date funds -- so that it's not an individual sleeve that someone is buying but that has its own set of risks, but it will be within the context of an overall portfolio, which I think is exactly what retirement clients should have. And so I think it's exciting. I think it's going to lead to interesting product development ideas of potentially combining public and private; public markets adding more liquidity, private markets still giving you that exposure. I think you're going to see some real innovation in the space, and candidly, you already have. So I think it's a positive.

>> That's great. And PGIM has a large DC business as well. You want to comment on that?

>> Yeah, we do. We actually have been an innovator in the alt and DC space. We actually launched one of the early funds in the space, a real estate fund in 2006, so we have nearly 20 years of experience bringing alternative strategies into the defined contribution market. The overall AUM within the market is relatively small relative to the size of the market -- call it 65 billion of alts exposure over a \$14 trillion denominator, very much underexposed, less than 1%. We see, you know, the growth continuing there over time.

>> We've spent a lot of time in the retirement space. It's one of the core competencies of our firm. And we've done some work around this where if you can add just 50 basis points or 100 basis points -- so a half percent to a percent of excess return to a retirement plan -- it can actually add years to your ability to provide income. So this is a big deal. Being able to increase returns and lower volatility in a retirement plan is a really big deal, so I look forward to seeing the innovations to come here. And final thought, I would just say the education needed on the brokerage taxable nonretirement side is the same that's needed for all the stakeholders within DC and the broader retirement market. Whether it's a plan sponsor or a consultant, advisor, they all need education to make sure a position is right to the end client.

>> So alts and DC is definitely one of the major trends in the alt and wealth space, what are other trends that you're seeing out there?

>> There's a lot. We talked about the public and private convergence; that's a big one. We've seen a lot of product development in that regard. We've seen a lot of strategic partnerships, acquisitions facilitating that trend and enabling firms to bring together their respective capabilities into a joint sort of public and private product development engine, if you will. We've seen a lot of growth in the evergreen structures. Stuart talked about some of these BDCs, tender offer funds, interval funds -- they have become the most dominant structure within alternatives, supplanting the traditional 3(c)(7) QP closed-end fund. And we think that demand will continue, and that's making alts more accessible to wealth, which is supporting the trend toward wealth and enabling access to a much larger degree.

>> Private and public alternatives also seem well-suited to areas of the investment world that can benefit from asset-liability management, including insurance.

>> It's a very important trend. The intersection of private markets and insurance is another major trend, something that's near and dear to our hearts because we've been tying those things together for decades. And now we're seeing other asset managers getting into the insurance space, either through partnerships and/or acquiring insurance companies. Everyone's trying to find or tap into these larger asset pools which have an ability to source liabilities against which they can manage assets. That's been our business -- sourcing liabilities, matching assets against those, and making sure they're matched up. And now others are seeing that, and the market's coming to us in that regard. And then there's increased interest in tax-advantaged strategies of one type or another. Insurance-linked securities is part of that. Different types of exchange funds are part of that -- 1031 exchanges. There's a number of existing and emerging opportunities for tax-advantaged strategies as well.

>> There's definitely a lot going on, a lot of themes. Picking up on one of those, we talked about the proliferation of evergreen offerings -- there's about 288 interval funds (registered funds) out there, about 50 still going through registration. Stuart, how do you balance expanding that access and that scale with the needs of more of a personalized approach in the wealth segment?

>> The most important thing we think about as an asset manager, to deliver any product, is: Do we have an

edge? Do we have a core capability in that space where we can actually add value? So what we find ourselves doing is, if there are things out there that may be garnering a lot of assets or maybe they're very popular -- if we don't think we can do it, we don't offer it. And so that's sort of a guiding principle for how we think about product development writ large. Now, having said that, if we think we can add value and we can offer it in a vehicle that can be large and scaled, so be it. We have mutual funds that are \$50 billion. We have other capabilities that are actually much smaller than that. So it's really a function of: Can we do it well? And then: Do we think it fits a need of our clients?

>> Great. Dominick, back to you. We talked about a lot of the opportunities, a lot of exciting trends out there. On the flipside, what do you see as some of the challenges in the space -- from the perspective of an asset manager or financial advisor or client sifting through all of the choices out there?

>> Yeah, there is a lot of choice. The pendulum has really swung from the negative selection I described earlier on to the glut of options in any particular category. So, I think it starts with: Do I have the right asset allocation? Do I have the right asset classes and strategies represented within my allocation? And then, how do I fill the bucket? And you want a manager that has a particular skill and scale and differentiation within each category and can exploit the opportunity the strategy presents, but also is sort of diligent about the risks that it presents as well. And that's something that we're very thoughtful about and very careful with. In terms of the structural element of it, if you find a strategy you like, if you find a sponsor and manager that you think can prosecute the strategy as well or better than others, then can they manage within this evergreen structure -- which, again, is the dominant structure today -- can they manage some of the nuances of those structures like liquidity management, you know, the higher velocity evaluations that are required? It requires someone who is a good steward of capital. There's lots of managers that are good at generating returns and finding opportunities, but do they manage the risks well? Risks of the strategy, risks of the structure as well.

>> Also, when we think about distributing to the high-net-worth channel through financial intermediaries, whether it's a private bank, a large wirehouse, broker/dealer, or registered investment advisor (RIA), almost all of them have research departments that look at strategies like ours and others, but look at strategies under a

microscope. And they're really trying to make sure that the strategies that they ultimately end offering to their end clients are of the highest quality, are delivering on what they promise. And so that partnership, I think, is really important. In addition, those intermediaries tend to be the ones that are actually creating asset allocation and financial plans for end investors. And so we fit right into that and work closely with those broker dealers, those advisors to be sure that we're, together, bringing the best portfolio to the end client.

>> That's great. So let's turn to our team out in the field. We have our distribution team with their ears to the ground, talking with clients. We've asked them to gather some questions from the floor. Let's go through a few of those right now. First, Stuart, what does it mean to be part of an insurance company? Particularly from an asset-liability management perspective, how does it differentiate with other alternative firms that are doing some of these tie-ups in the industry?

>> I think that the best way to think about this is Prudential is a large US insurer. We have a general account that is about \$400 billion. That means that we have gone out and made promises in the form of insurance plans to literally millions of clients, and our assets, that 400 billion, is backing those liabilities. And so there are millions of people that are depending upon us to deliver on what we promise. And I think that that's an excellent heritage in terms of the way we think about managing money. We want to be able to grow your assets, for sure, but we also want to do it in a way that is as risk-mitigated as possible, given the asset classes that we traffic in. In addition, by virtue of the fact that these are long-dated liabilities, we have been in this space, this private market space, for literally decades. And so having that experience of being able to deliver risk-adjusted returns that meet our clients' needs and objectives is a core competency that we bring to the public markets as well.

>> So, Stuart, PGIM manages over a trillion in public and private credit. What does that mean for the end client, and what types of opportunities do you see going forward?

>> I was going to mention this when we talk about our differentiation, being able to say -- I don't know of a larger manager out there with more than 1.1 trillion in public and private credit -- that allows us to think about markets, about returns, about how we want to structure portfolios for clients that can span the spectrum of public and

private markets, which are obviously blurring as we speak today. But also, look up and down the capital structure of these different balance sheets to determine, where do we think the best value is? And I think having that holistic view is advantageous in terms of how we think about creating returns for clients, structuring products for clients, and the like. I think income in all its forms is going to be important for high-net-worth individuals for the rest of our careers. And so being able to think in those terms, both from a borrower's perspective but also from an investor's perspective, I think is a true differentiator.

>> That's great. So, Dominick, if you were to put on some of your previous hats, what would you say is necessary to win in the alternatives and wealth space? There's a lot of managers in the space today.

>> We already talked about a couple of topics that I think are important. One is scalability. Our wealth management partners have a certain amount of manufacturing capacity, and there's a certain amount of shelf space that they can offer. And so they want managers that are scalable. Their advisors and their clients want managers that are scalable, too, because it provides efficiency of practice. So, what does it mean to be scalable? It means you have a breadth and depth of product capabilities, a number of different investment opportunities, with ample capacity across, is sort of one thing. Sales and service support, they need us as asset managers to align with them in the asset allocation advice on the what, how, and why of alternative investments, as well as in the field engagement, bringing that education to the field, providing pre- and post-sale support, with an emphasis on post-sale -- we don't just sort of sell and go away. And they want you to help provide leverage to the advisor because they're very busy, they're capacity constrained. And so they need scalability at their level, too. You know, having fewer manager partners to work with, you can bring a breadth of solutions, is preferred.

>> I couldn't agree more, especially in this market -- having that robust sales and service model, being able to be there at the point of sale but, more importantly, with the after sales is critical in alternatives. Stuart, let's end with you here on one more question from the field. Looking ahead, what is one bold prediction you have for the future of alternatives in the wealth management space?

>> I don't know how bold it is, because you've mentioned so many stats about people saying how this is going to

grow, and alternatives will grow in the wealth space. I am just a big believer in that, candidly, and I think there's a couple of reasons why. It's not a finger in the air saying where can this all lead. The fact of the matter is, and I've seen this in a number of different product categories in my career, that there are a couple of things that are tailwinds to this business. First and foremost, and you mentioned this earlier, just the sheer product development that is happening in this space, where people are going after, trying to create products of semi-liquid and illiquid-type investments, it's just inevitable that financial intermediaries and their clients are going to want access to that. And so that is going to force the home offices to grow their menus, if you will, of options. The second thing is, this ability to go from 3% of asset allocation to the desired goal of 15 to 20% -- you pick a number -- it's obviously a multiple of where we are today. If you think about that, that is a major tailwind. Regardless of what happens in the markets, that is where people are going to want to continue to invest. So I feel like, from a manufacturing/supply perspective, from the demand perspective, this is a bit of a perfect storm. So I agree with the numbers that Bain has come up with, I agree to the numbers that you cited earlier, I think that this is going to be a space that is worth watching and is going to definitely benefit from the evolution in high-net-worth.

>> Well, with that, I want to recap today's conversation with key takeaways that I got from this conversation. First, just like you said, Stuart, the growth of alternatives in wealth will continue, and it's going to be driven by the demand from wealth clients that are looking for diversification access, the potential for enhanced returns on the demand side. On the supply side, like you said, the managers are proliferating and innovating with product development. And we talked about this earlier, regulatory tailwinds like the executive order, more awareness, more education are just going to propel this growth. The second point is, with the proliferation of solutions, asset managers need to be thoughtful in providing the right strategies and the right structures. So it's important to offer the necessary information and education so that advisors and clients can conduct their thorough due diligence and understand the underlying strategies and how it fits within a portfolio context. With that, I want to thank you, Stuart, and thank you, Dominick, for a great conversation, great insights in the space. And, to our listeners, thank you for tuning into this episode. Join us next time, where we will be discussing all things asset-backed finance on "Speaking of Alternatives."

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