OVER THE PAST 50 YEARS, THE ROLES OF PUBLIC AND PRIVATE CAPITAL MARKETS HAVE CHANGED SLOWLY BUT PROFOUNDLY.

Since the 1960s, public equity markets have gradually morphed from being the primary source of growth financing for corporations to being more of an income-bearing asset for investors and an acquisition currency for corporations.

1960

In the year 2000, private asset equity equated to approximately 5% of market capitalization of U.S. public equity markets.

Smaller number of wealthy private investors funding high risk new ventures.

PUBLIC ASSET INVESTMENTS

PRIVATE ASSET INVESTMENTS

PRIVATE ASSET MARKETS

PRIVATE ASSET MARKETS

PUBLIC ASSET INVESTMENTS

PRIVATE ASSET MARKETS

PRIVATE ASSET MARKETS

In the year 2000, private asset equity equated to approximately 5% of market capitalization of U.S. public equity markets.

Many investors looking for superior risk-adjusted returns expanded private asset markets and provided large-scale funding of growth and innovation.

Today, private assets equate to more than 20% of market capitalization of U.S. public equity markets.

INVESTORS LOOKING TO PRIVATE ASSETS FOR EXPOSURE TO GROWTH EXPECT ILLIQUIDITY RISK, WHICH IS GENERALLY COMPENSATED BY HIGHER RETURNS.

The illiquidity risk premium on private assets is a natural feature of their investment model for which investors are generally compensated over the cycle, subject to manager selection.

INVESTORS IN PUBLIC ASSETS MAY ALSO FACE ILLIQUIDITY RISK, BUT IT MAY BE MORE CYCLICAL AND IT MAY NOT ALWAYS BE FULLY COMPENSATED.

The point at which excess returns on an illiquid public asset doesn’t offset the probability of being forced to sell at a loss.

Possible uncompensated illiquidity ahead!

EVALUATING AND MANAGING ILLIQUIDITY RISKS TO HELP BUILD STRONGER PORTFOLIOS

COMPENSATED for illiquidity by higher return if investor stays the course.

END OF INVESTMENT CYCLE

POSITIVE CASH FLOW

PRIVATE ASSET INVESTMENTS

EARLY

ECOnOMIC CYCLE

LATE

PUBLIC ASSET INVESTMENTS

BEWARE

ILLIQUID PUBLIC MARKET

E.G. HIGH YIELD BONDS

ILLIQUID PUBLIC MARKET

E.G. HIGH YIELD BONDS

J.P. Morgan Asset Management
Investors with allocations to both private and public assets may face cash demands that are best covered from the public asset side of the portfolio.

Larger and more sophisticated investors are more likely to hold illiquid private assets, so we are sensitive to illiquidity in public assets. There is no economy of scale for illiquidity risk.

$50 MILLION ENDOWMENT

$1 BILLION ENDOWMENT

More able to access investment managers proven to deliver above-average performance

Likelihood of a particular illiquid asset in portfolio. If forced to sell, trade size likely to be bigger

LARGER PORTFOLIO DISADVANTAGES

LARGER PORTFOLIO ADVANTAGES

Recognizing and planning for cyclical illiquidity risk in public markets is prudent for any investor navigating a sophisticated multi-asset portfolio through the cycle.

An investor will always want to avoid being a forced seller in illiquid markets, private or public.

But in times of market weakness, it may be more desirable to preserve illiquid positions in private than in public markets.
PORTFOLIO INSIGHTS

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