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# The Risks and Opportunities of the Influx of Retail Capital into Private Markets

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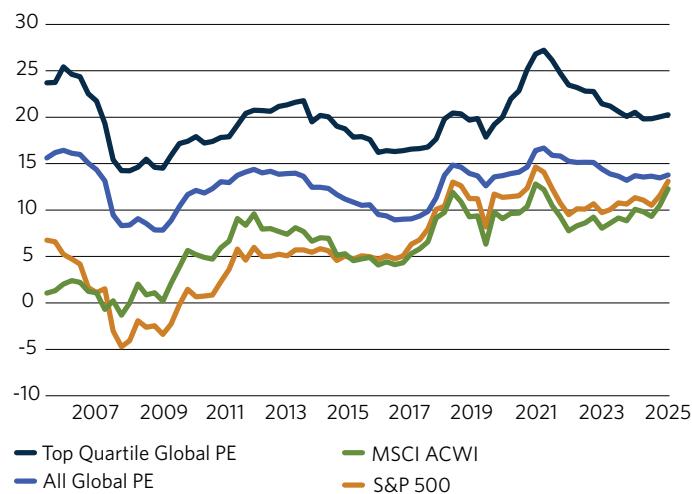
*For decades, private markets have delivered a meaningful premium over public equities, compensating investors for illiquidity and the patience required for long-term investing.*

## EXECUTIVE SUMMARY

That premium has been critical to institutions pursuing their long-term return goals and achieving intergenerational equity (preserving the portfolio's purchasing power for future generations of constituents after accounting for the institution's spending rate and inflation). Over the past two decades, however, that premium has compressed significantly for the broad private equity (PE) universe, narrowing from approximately 700-1,200 basis points in the mid-2000s to as little as 100-200 basis points today (see chart below). While top-quartile managers have proven more resilient, the broad universe has seen the historical premium become increasingly challenged.

### PRIVATE EQUITY OUTPERFORMANCE OVER THE LONG-TERM

Global Private Equity vs Public Markets 10-Year Rolling Annualized Return | Numbers in percent (%)



Source: CapIQ, MSCI. The Global PE returns reflect the rolling 10-year IRR for all direct funds within the MSCI database reported for all vintage years under the asset class categories "Equity" (excluding the "Venture Capital" sub-category); as of September 30, 2025

Interestingly, much of this compression reflects the extraordinary strength of public equity markets, particularly the concentration of returns in U.S. mega-cap technology stocks, rather than a deterioration in absolute private equity performance. Since 1971, the S&P 500 has compounded at ~11 percent annualized. Over the trailing 10 years through 2025, that figure rose to nearly 16 percent per year, inclusive of an annualized return of approximately 23 percent for the three years ending December 31, 2025. However, [the evidence suggests](#) that specific segments of private markets, particularly the lower-middle market, sector-specialist strategies, and early-stage venture capital, may retain

structural advantages that can sustain meaningful premiums for disciplined investors with strong manager selection capabilities. Looking ahead, several converging forces could threaten to compress premiums further given the expected influx of retail capital via 401(k) plans. This has the potential to further contribute to record levels of dry powder, elevated entry multiples, and intensifying LP (Limited Partner) scrutiny of net-of-fee, realized returns.

### COMPRESSED LIQUIDITY PREMIUM

A question of growing urgency among institutional allocators concerns the potential influx of retail capital into private markets via 401(k) plans, and its implications for the forward premium. The evidence strongly suggests that the aggregate private equity premium has compressed relative to its historical levels, driven by several converging forces:

- Capital oversupply:** Global PE dry powder stood at approximately \$1.6 trillion in 2025 and remains historically elevated. Approximately 40 percent of dry powder is now two years or older, hitting a new peak, creating deployment pressure that may lead GPs (General Partners) to accept higher entry prices.
- Multiple expansion:** Median global PE entry multiples have increased from approximately **8-9X EV/EBITDA** in the early to mid-2010s to 10X at the end of 2025, compressing the valuation spread between public and private markets.
- Public market strength:** The S&P 500's extraordinary performance, driven by AI and mega-cap technology, has narrowed the return gap in public market equivalent terms.
- LP scrutiny of realized returns:** Limited partners are increasingly focused on DPI, net-of-fee multiples, and realized returns rather than unrealized paper marks. More than 16,000 PE-backed companies globally have been held for over four years - 52 percent of total buyout inventory - the highest proportion on record.
- Improved transparency:** Better data availability from providers such as MSCI, Preqin, and PitchBook has made it more difficult for mediocre managers to mask

weak performance behind opaque reporting.

And while some of these macro factors have been in play for some time, the recent events surrounding attempts to introduce retail capital to private markets, specifically via 401(k) plans, may further intensify some of these dynamics.

### THE 401(K) EXECUTIVE ORDER: A POTENTIAL STRUCTURAL SHIFT

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On August 7, 2025, President Trump signed Executive Order 14330, "Democratizing Access to Alternative Assets for 401(k) Investors," directing the Department of Labor, SEC, and Treasury to relieve regulatory burdens that restrict defined-contribution plans from accessing alternative assets. In January 2026, the Retirement Investment Choice Act was introduced in Congress to codify the executive order into legislation.

The potential scale of this shift is substantial. The U.S. defined-contribution market holds approximately \$12.5 trillion in assets. Even a modest 1-2 percent allocation to private alternatives would represent roughly half of the entire PE fundraising total in any single year.

However, it is important to recognize that this capital will not enter private markets uniformly. The structural realities of defined-contribution plans - daily valuation requirements, participant liquidity expectations, and the need for recognizable brand-name managers with broad distribution infrastructure, mean that the vast majority of 401(k) capital will flow into the largest, most accessible segments of the market: mega-cap buyout funds, semi-liquid credit vehicles (BDCs), and broadly diversified alternatives products. And these are the segments where premiums are already thinnest.

#### Risks: Forces Driving Further Premium Compression

- **Return compression from scale:** As more assets flow into private markets, there is the potential to drive up entry valuations and compress net returns, most acutely in mega-cap buyout segments where retail-friendly products are easiest to construct.
- **Liquidity mismatch and style drift:** Semi-liquid structures (a likely access point for many 401k investors)

offer redemption optionality that closed-end funds do not. That optionality can constrain investment flexibility and may force suboptimal portfolio decisions during periods of market stress.

- **Crowding into mega-deals:** Retail capital tends to flow to the largest, most recognizable GP brands with the distribution infrastructure to reach wealth and retirement channels, concentrating incremental capital in segments already under competitive pressure.
- **Fee pressure:** The traditional "2 and 20" fee structure is incompatible with the sub-1 percent total expense ratios that dominate the defined-contribution environment, creating intense pressure on management fees and carried interest.

There is, however, a critical nuance when evaluating the impact of retail capital: many retail vehicles offer periodic redemption windows (typically quarterly, with 5 percent gates). Which means the capital entering private markets through these channels is not accepting the same lock-up terms as traditional institutional LP capital. These vehicles may carry redemption risk that fully committed capital does not. The implication is that the "true" illiquidity premium, the compensation for genuinely patient, locked-up capital with no redemption optionality, may compress less than the headline data suggest. Investors who commit truly patient capital through traditional closed-end structures may see their relative advantage increase as the economic distinction between semi-liquid and fully locked-up capital becomes more meaningful.

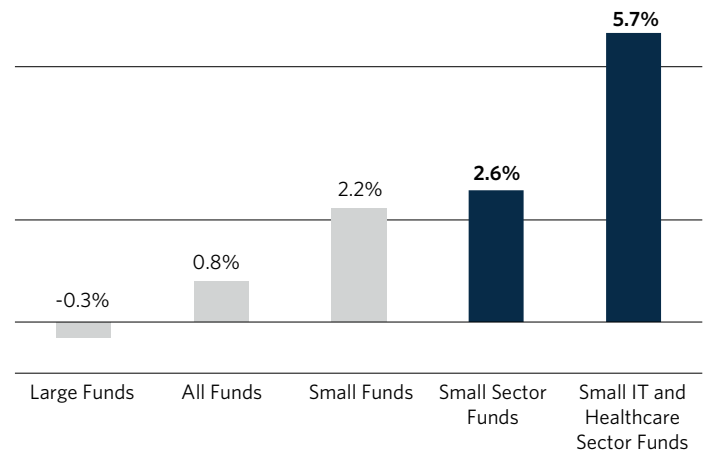
#### Opportunities: Sources of Structural Resilience

- **Persistent lower-middle market inefficiencies:** A disproportionate share of fundraising has concentrated in large, retail-accessible products, meaning the middle and lower-middle market face far less incremental competition. These segments remain characterized by proprietary sourcing, information asymmetry, and operational complexity that may mitigate the risks associated with retail inflows at the large end of the market.

- **Specialization advantages:** Managers with deep sector expertise - healthcare services, industrial technology, business services, and franchising, can maintain pricing discipline and sourcing advantages regardless of aggregate capital flows. Specialization creates moats that generalist capital cannot easily replicate.
- **Proprietary deal flow:** In the lower-middle market, many transactions are sourced through long-standing relationships with founders, family owners, and regional advisors. This type of deal flow is structurally less accessible to the large platforms dominating the retail channel.
- **Structural alpha in smaller transactions:** Smaller deals offer greater scope for operational value creation through professionalization of management, systems implementation, and add-on acquisition strategies. This alpha is less dependent on entry multiples and financial leverage, both of which are more vulnerable to compression.
- **Venture capital insulation:** Early-stage venture capital is nearly entirely insulated from 401(k) flows. The illiquidity, duration, binary outcomes, and extreme dispersion inherent to VC make it fundamentally unsuitable for retail retirement products.
- **Potential exit demand for middle-market assets:** The largest GPs may face mounting deployment pressure from the inflow of 401(k) and retail capital. With more capital chasing a finite set of large-cap deals, middle-market portfolio companies become an increasingly attractive acquisition target for these sponsors looking to deploy their growing pools of cash.

**SECTOR-FOCUSED AND SMALLER FUNDS GENERALLY OUTPERFORM**

U.S. Private Equity Industry Annualized Excess Return<sup>1</sup> over Public Markets | September 30, 2025 | Numbers in percent (%)



Large funds are private equity funds over \$5 billion (79 Funds); small funds represent private equity funds under \$1 billion (1,014 Funds); small sector funds are private equity funds under \$1 billion (531 Funds) that are sector funds (versus generalist) and: small IT and Healthcare sector funds represent private equity funds under \$1 billion that focus on the IT and Healthcare sectors (250 Funds). Source: MSCI Private Capital Intel (“MSCI”). Represents all US Private Equity funds (including all “Equity” funds excluding venture capital) across vintage years 2007-2021 as determined by MSCI (1,440 funds). 1. The Annualized Excess Return is calculated by MSCI using the pooled Gredil, Griffiths and Strucke Direct Alpha method comparing every fund in the set against the S&P 500

The potential introduction of 401(k) capital into private markets is likely to accelerate this bifurcation. Retail-friendly products will concentrate capital in the most accessible, largest-fund segments, precisely where premiums are already thinnest. Investors with access to the lower-middle market, proprietary deal flow, and operationally oriented managers may find their structural advantages amplified rather than diluted.

**CONCLUSION**

The private markets premium is not disappearing; it is migrating. The aggregate premium for the broad PE universe has narrowed, driven primarily by extraordinary public market strength and the growing capital supply targeting large-cap segments. However, the premium remains robust for top-quartile managers operating in the lower-middle market, sector-specialist strategies, and early-stage venture capital.

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