

Perspective from
[Private Markets Insights](#)

Private equity secondaries: A primary allocation in an evergreen private equity portfolio

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Introduction

Private equity is at a turning point in the wealth market, with investors and advisors navigating how best to allocate across its sub-strategies. The growing availability of funds—both evergreen and closed-ended/drawdown—has expanded the investment landscape and offers several advantages for portfolio construction.

In this paper, we outline an approach that positions private equity secondaries as the cornerstone of a core/satellite allocation model, focusing on two key aspects:

1. **Investment merits:** Why secondaries may provide attractive risk-adjusted returns.
2. **Ease of implementation:** How they simplify portfolio construction.

“Diversification is the only free lunch in finance.”

Harry Markowitz, Nobel Prize-winning economist.

The private equity landscape

Private equity refers to primary investments in privately held companies, with the aim of creating long-term value by growing or optimizing these businesses. These companies can range in size and maturity, from startups to large established companies, across a variety of industries and regions (see Exhibit 1 below). As the market has developed, private equity managers have expanded their expertise and built more sophisticated capabilities.

Alongside directly investing in private companies (primary private equity), private equity secondaries has emerged as a distinct asset class. Secondaries involve buying and selling

existing private equity fund interests or portfolios of assets, providing liquidity for the original investors and creating new entry points into established funds. Investor adoption of this asset class continues to grow, as we explored in [Unlocking opportunities: Understanding the growing secondary market.](#)

Exhibit 1: The Private Equity Spectrum

North America		Europe		Asia		Rest of World
Mega Buyout	Large Buyout	Middle Market Buyout	Small Buyout	Growth	Venture Capital	
Technology	Consumer	Industrials	Life Sciences	Financials	Energy	Other Sectors

Investment merits of private equity and secondaries

Understanding the differences between private equity and secondaries can help investors and their advisors assess their respective roles in portfolio construction.

Managing return dispersion

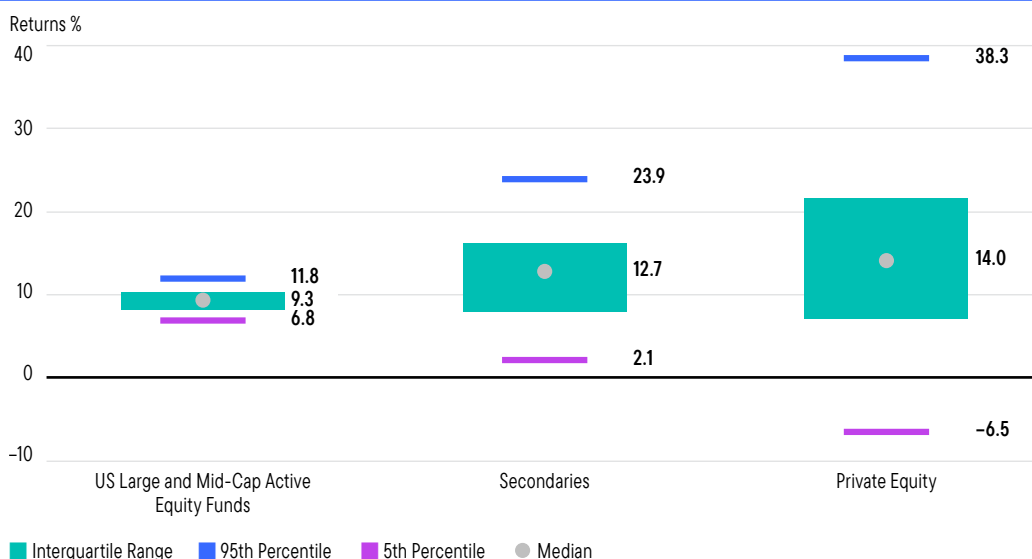
Private equity strategies vary significantly in performance. The difference between the 95th and 5th percentile private equity funds exceeded **4,400 basis points (bps)** compared to **2,200 bps** for secondaries. This is often linked to private equity managers focusing on a particular industry or region and therefore exposing themselves to specific risk factors. For example, technology-focused managers have recently outperformed, while those with larger exposures to traditional retail have lagged.

Given this dispersion, we believe selecting experienced managers who have navigated multiple market cycles and delivered strong performance is crucial when constructing a private equity portfolio. Secondaries offer a solution by providing **broader diversification** and historically **more consistent returns**, with better principal preservation.

Secondaries Have Significantly Less Dispersion Than Primary Private Equity

Exhibit 2: Return Dispersion across Private Equity, Secondaries and US Equities

As of September 30, 2024



Sources: MSCI Private Capital Solutions, Morningstar. Notes: The returns for US large and mid-cap active equity funds reflect annualized returns for the period January 1, 2005 to September 30, 2024. Private equity, secondaries and traditional equities have material differences between them, including varying investment objectives, costs and expenses, liquidity, safety, fluctuation of principal or return, and tax features. The returns for secondaries and private equity are the internal rate of return (IRR) of the funds with vintage years from 2005 to 2018, as of September 30, 2024. **Past performance is not an indicator or a guarantee of future results.** Important data provider notices and terms available at www.franklininvestorsondatasources.com.

Manager selection: The inconsistency challenge

Given the greater variability of returns in private equity compared to secondaries, investors should pay close attention to the track record of private equity managers. But how consistent is performance across private equity vintages?

When committing to a new private equity fund vintage, investors should be cautious about relying on past performance. The analysis below shows that a manager's next vintage is nearly as likely to underperform as it is to outperform, regardless of the success of the current vintage. In fact, for buyout funds that are currently top quartile, the next vintage¹ has an equal likelihood of being in the bottom quartile as it does of remaining in the top quartile.

Exhibit 3: Past Performance Does Not Predict Future Vintage Returns in Buyout Funds (Launched since 2000)

Previous Fund Ranking at Fundraise	Current Fund Ranking				% chance top half	% chance bottom half
	Top 25%	25-50%	50-75%	Bottom 25%		
Top 25%	24.0%	26.4%	25.6%	24.0%	50.4%	49.6%
25-50%	26.2%	20.6%	34.1%	19.0%	46.8%	53.1%
50-75%	22.6%	25.8%	30.1%	21.5%	48.4%	51.6%
Bottom 25%	23.1%	41.0%	15.4%	20.5%	64.1%	35.9%

Source: R. S. Harris, T. Jenkinson et al., "Has persistence persisted in private equity? Evidence from buyout and venture capital funds," *Journal of Corporate Finance*, 81 (2023) 102361. This paper ranks fund performance by comparing IRR (Internal Rate of Return) to the total return if each fund's cash flows were invested in the S&P 500 Total Return Index ("PME" Public Market Equivalent).

But does this trend hold for the major private equity managers? The exhibit below illustrates the vintage performance of five major US managers' flagship buyout strategies relative to the broader US buyout universe. The results reinforce the lack of consistency among vintages

Even Major Private Equity Managers Show Inconsistency in Returns over Time

Exhibit 4: US Buyout Vintage Performance Varies across Major Private Equity Managers

As of September 30, 2024

Vintages	Private Equity Manager				
	A	B	C	D	E
1997-99					
2000-02					
2003-05					
2006-10					
2011-14					
2015-17					
2018-20					

Fund Ranking: ■ No vintage ■ Top 25% ■ 25-50% ■ 50-75% ■ Bottom 25%

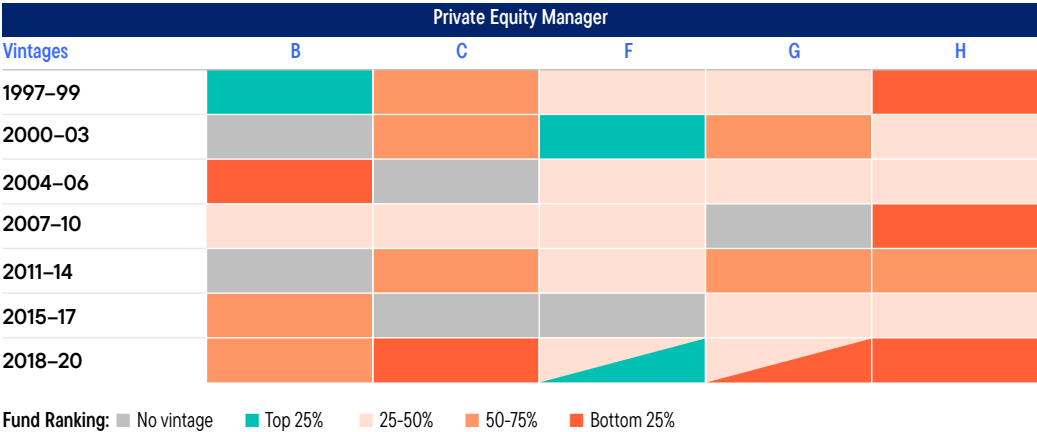
Source: Preqin. Fund ranking based on Net IRR (Internal Rate of Return). Two colours indicate that a manager has two vintages within the respective time period.

Another consideration is that having a strong track record in one market does not necessarily translate to another. Among the five major US private equity managers, two have dedicated European buyout strategies. The exhibit below compares their performance, alongside three major European private equity managers, to the broader European buyout universe. Once again, performance varies across managers.

1. Vintage is the year that a fund is offered. There can be differences from one vintage to the next based on the environment.

European Buyout Vintage Performance of Major US and European Private Equity Managers

**Exhibit 5: US Private Equity
Managers' Track Records
Don't Always Translate to
Other Geographies**
As of September 30, 2024



Source: Preqin. Fund ranking based on Net IRR (Internal Rate of Return). Two colours indicate that a manager has two vintages within the respective time period.

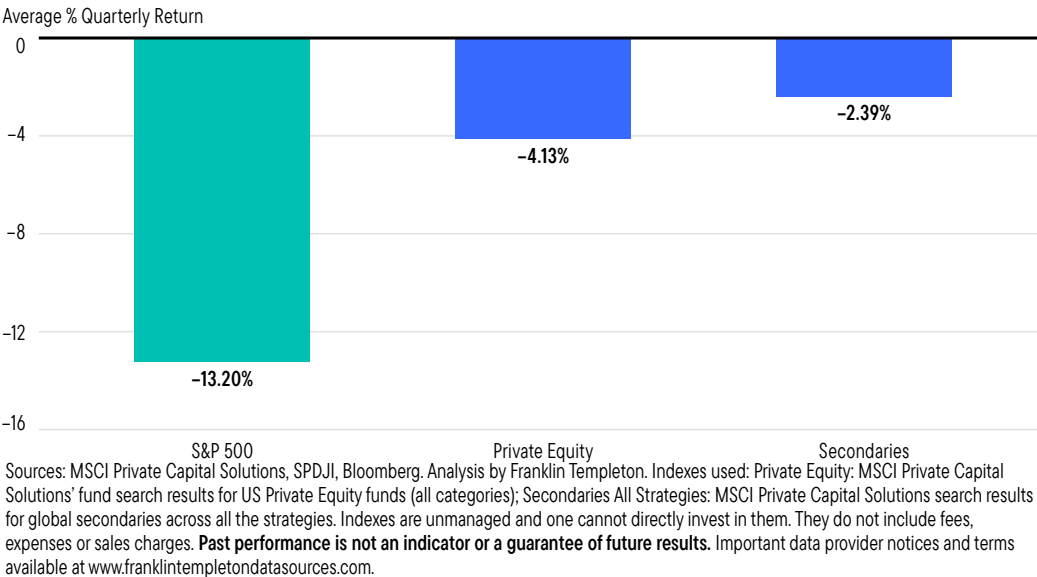
Given this variability in performance across vintages and regions, investors should be cautious about building core private equity exposure with a single manager. Strong returns in one market cycle do not guarantee future outperformance.

Secondaries offer a way to manage this risk. By providing diversified exposure across multiple private equity managers, secondaries help reduce manager concentration risk. Additionally, secondaries managers can negotiate purchase prices that account for the latest available information and adjust for any adverse asset selection by underlying private equity managers. These factors help mitigate downside risk and adjust for performance variability across private equity managers.

Return resilience in market downturns

Both private equity and secondaries have demonstrated resilience during public market downturns. Historical data indicates secondaries may have the potential to offer even greater downside risk mitigation. As shown below, during the 10 worst quarters for the S&P 500 Index since July 2004, average private equity declines were nearly twice those of secondaries.

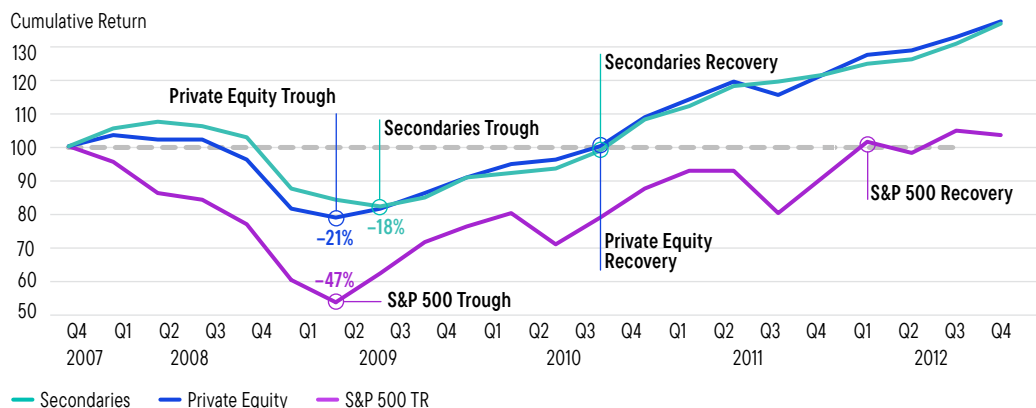
**Exhibit 6: Average
Performance in the 10 Worst
S&P 500 Quarters**
July 1, 2004–September 30, 2024



Looking at two major market events—the global financial crisis (GFC) and post-pandemic market correction—secondaries once again provided greater downside risk mitigation and shorter recovery periods, compared to both public and private equity.

Exhibit 7: Private Equity and Secondaries Performance during the GFC

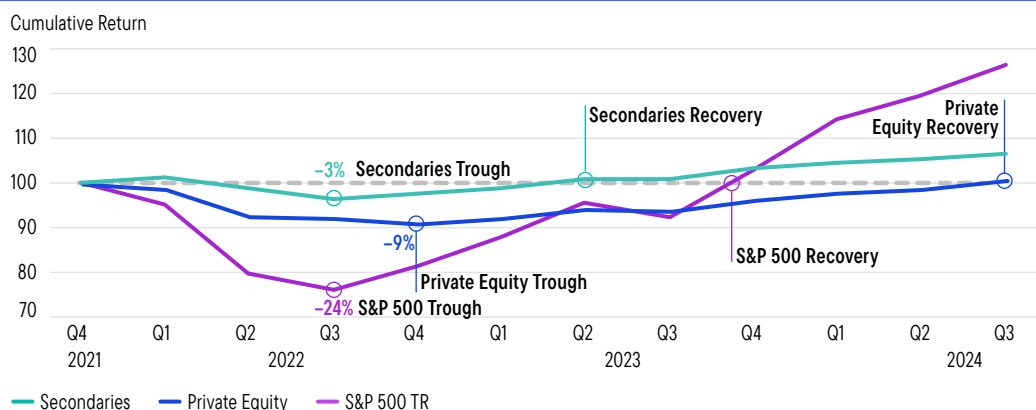
Q2 2007–Q4 2012



Sources: MSCI Private Capital Solutions, SPDJI. Analysis by Franklin Templeton. Indexes used: Private Equity: MSCI Private Capital Solutions' fund search results for US Private Equity funds (all categories); Secondaries All Strategies: MSCI Private Capital Solutions search results for global secondaries across all the strategies. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results.** Important data provider notices and terms available at www.franklintempletondatasources.com.

Exhibit 8: Private Equity and Secondaries Performance During the Post-Pandemic Market Correction

Q4 2021–Q3 2024



Sources: MSCI Private Capital Solutions, SPDJI. Analysis by Franklin Templeton. Indexes used: Private Equity: MSCI Private Capital Solutions' fund search results for US Private Equity funds (all categories); Secondaries All Strategies: MSCI Private Capital Solutions search results for global secondaries across all the strategies. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results.** Important data provider notices and terms available at www.franklintempletondatasources.com.

Secondaries have also exhibited lower correlation to public markets than private equity, potentially further enhancing portfolio diversification.

Exhibit 9: Secondaries Provide Greater Diversification to Traditional Assets

10 Years Ending September 30, 2024

	US Stock Correlation	US Bond Correlation
Private Equity	0.65	0.07
Secondaries	0.51	-0.16

Sources: MSCI Private Capital Solutions, SPDJI, Bloomberg. Analysis by Franklin Templeton. Indexes used: Secondaries All Strategies: MSCI Private Capital Solutions search results for global secondaries across all strategies, US Stocks: S&P 500 Total Return Index, US Bonds: Bloomberg US Aggregate Index (Total Return), Private Equity: MSCI Private Capital Solutions' fund search results for US Private Equity funds (all categories). Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results.** Important data provider notices and terms available at www.franklintempletondatasources.com.

Why secondaries suit an evergreen structure

Secondaries are particularly well suited for evergreen structures due to their:

- **Attractive portfolio diversification:** Exposure across managers, vintages, regions and sectors can potentially dampen volatility.
- **Reduced blind pool risk:** Unlike primary private equity funds, secondaries invest in existing assets with known performance histories.
- **Earlier cash flows and enhanced compounding:** Acquiring interests in established funds leads to potentially earlier and more frequent re-investment opportunities which can improve long-term returns.
- **Liquidity management:** Broader access to the private equity market enables potentially larger opportunity set for ongoing capital deployment.

Secondaries can provide greater diversification, making it a strong foundation for an evergreen private equity allocation.

Conclusion: Building a resilient private equity allocation

Allocating to a single evergreen vehicle can reduce operational complexity when constructing a private equity portfolio, as we outlined in our [previous paper](#). However, relying on a single private equity manager may not be optimal for investors seeking a best-in-class evergreen allocation. This approach concentrates risk with one manager and potentially limits exposure to a narrower subset of private equity strategies. While investing across multiple primary strategies can enhance diversification, it also increases operational burden and may still leave gaps in portfolio construction.

Most evergreen private equity funds aim to provide broad exposure across a manager's platform, spanning multiple geographies and sectors. However, as outlined earlier, private equity managers exhibit inconsistent performance across different periods and segments of the market. Diversified secondaries managers, in contrast, construct portfolios across sectors, geographies and industries, offering exposure to a wide range of private equity managers. This approach can provide greater diversification, making secondaries a strong foundation for an evergreen private equity allocation. Selecting a secondaries manager with broad coverage is key to ensuring a well-diversified portfolio.

While primary private equity strategies can deliver outperformance, their variability in returns suggests they should only be pursued when advisors have high conviction in a manager's expertise within a specific market segment. In such cases, closed-ended/drawdown funds with targeted investment strategies may be a more suitable access point than evergreen structures, which can include legacy assets and potentially a broader investment remit beyond a manager's core specialties.

Contributor



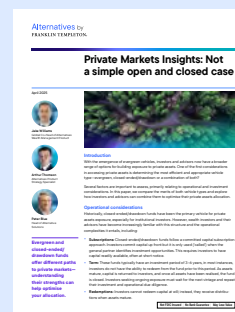
Tony Davidow, CIMA®
Senior Alternatives
Investment Strategist
Franklin Templeton Institute

Additional reading:

Private Markets Insights: Not a simple open and closed case

Evergreen and closed-ended/drawdown funds offer different paths to private markets—understanding their strengths can help investors optimize allocations.

[Download PDF](#)



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Alternative strategies are complex and speculative, entail significant risk and should not be considered a complete investment program.

Depending on the product invested in, such investments and strategies may provide for only limited liquidity and are suitable only for persons who can afford to lose the entire amount of their investment. **Private investments** present certain challenges and involve incremental risks as opposed to investments in public companies, such as dealing with the lack of available information about these companies as well as their general lack of liquidity. There also can be no assurance that companies will list their securities on a securities exchange, as such, the lack of an established, liquid secondary market for some investments may have an adverse effect on the market value of those investments and on an investor's ability to dispose of them at a favorable time or price.

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