KKR Releases “Regime Change: The Role of Private Equity in the ‘Traditional’ Portfolio”

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New Macro Report Highlights Importance of Harnessing the Illiquidity Premium in a Low Return Environment

NEW YORK--(BUSINESS WIRE)-- KKR, a leading global investment firm, today announced the release of *Regime Change: The Role of Private Equity in the ‘Traditional’ Portfolio* by Henry McVey, CIO of KKR’s Balance Sheet and Head of Global Macro and Asset Allocation (GMAA) and Racim Allouani, Head of Portfolio Construction, Investment Risk Management and Quantitative Analysis at KKR. This latest *Insights* piece is the third installment in a series dedicated primarily to portfolio construction. Importantly, while the prior two portfolio construction pieces focused more on role of Private Credit and Real Assets, this note focuses largely on the benefits of adding Private Equity exposure to a diversified portfolio, including comparisons to the traditional 60/40 model and to KKR’s original 40/30/30 benchmark (40% stocks, 30% bonds, and 30% Alternatives such as Private Credit, Real Estate, and Infrastructure). In almost all instances, adding Private Equity exposure to a diversified portfolio not only boosts absolute returns but also helps deliver better risk-adjusted returns, especially for investors who are concerned about inflation.

“From our perch, Private Equity makes a lot of sense for buy and hold investors, especially retirement focused investors who want to compound capital at more efficient tax rates than many income oriented products provide. We also believe that, if our team is right in our assumptions about lower forward returns across capital markets, the value of the illiquidity premium, especially in Private Equity, will become more important,” said McVey and Allouani.

As part of their analysis, McVey and Allouani spend a significant amount of time outlining the critical drivers of Private Equity’s strong performance in recent decades, so that both institutional and individual investors can better understand its role when thinking through their asset allocation goals. According to McVey and Allouani, the following drivers of Private Equity performance warrant investor attention:

- **Sector Allocation:** Private Equity sector exposures are often meaningfully different from those of Public Equity indices and can often be a significant source of alpha. Broad sector compositions in different vintages of Private Equity funds also tend to be more dynamic than public markets indices, which can take much longer to adjust. This allows private markets investors to be more nimble in pursuing value creation opportunities at the right time.
- **Timing Effect of Deployment and Exits:** Timing of investments has been a key contributor to Private Equity’s absolute and relative performance over the past three decades. We believe that maintaining disciplined linear deployment can help create portfolios that are more balanced. That said, as we look forward, we believe that Private Equity Managers can be even more proactive in systematically exiting portfolio investments in fully priced markets.
- **Company Selection and Value-Creation:** Much of the dispersion in performance among Private Equity Managers comes down to their ability to create value through operational improvement, strategic vision, employee engagement, and sturdy capital structures. The average difference between top and bottom quartile managers across vintages has been around 13% historically, compared to around 5% for active Public Equities managers.

Links to access this report in full as well as an archive of Henry McVey's previous publications follow:

- To read the latest Insights, click here.
- To read prior installments in our portfolio construction series, click here and here.
- For an archive of previous publications, click here.

About Henry McVey

Henry H. McVey joined KKR in 2011 and is Head of the Global Macro, Balance Sheet and Risk team. Mr. McVey also serves as Chief Investment Officer for the Firm’s Balance Sheet, oversees Firmwide Market Risk at KKR, and co-heads KKR’s Strategic Partnership Initiative. As part of these roles, he sits on the Firm’s Investment Management & Distribution Committee and the Risk & Operations Committee. Prior to joining KKR, Mr. McVey was a Managing Director, Lead Portfolio Manager and Head of Global Macro and Asset Allocation at Morgan Stanley Investment Management (MSIM). Learn more about Mr. McVey here.

About Racim Allouani

Racim Allouani joined KKR in 2015 and oversees Portfolio Construction, Investment Risk Management and Quantitative Analysis across KKR Private and Public Markets. Prior to joining KKR, he spent five years at the hedge fund of Lombard Odier as a senior quantitative portfolio analyst and risk manager, covering equity and credit long/short strategies. Prior to that, he was at Arden Asset Management, a fund of hedge funds, in the portfolio optimization group. Mr. Allouani also previously held positions at Deutsche Bank in equity research and Bank West LB in fixed income research. Learn more about Mr. Allouani here.

About KKR

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