Vanguard

Private Equity Perspectives | August 2025

Vanguard 2025 midyear private equity review and outlook

Authors: Michael Rabinovich | Matt Schweitzer, CFP®, CAIA

- Historical patterns suggest that private equity (PE) underperformance is not uncommon over short time periods and is often followed by strong recoveries, particularly for top-quartile managers.
- Despite a less certain macro backdrop, the long-term case for PE remains compelling, supported by its growth relative to public markets, an expanding and increasingly diverse opportunity set, and a proven model of operational value creation.
- Long-term PE returns compare favorably to public markets, even after the surge in public market performance over the past several years. We maintain our belief that a diversified, global PE portfolio can outperform global public equities over the long term by approximately 350 basis points, or 3.5%, annually. Vanguard's 10-year median expected return for global PE is 8.5%, relative to 5.0% for global public equity, based on the June 30, 2025 running of the Vanguard Capital Markets Model®.

IMPORTANT: The projections or other information generated by the Vanguard Capital Markets Model® (VCMM) regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results, and are not guarantees of future results. Distribution of return outcomes from the VCMM are derived from 10,000 simulations for each modeled asset class. Results from the model may vary with each use and over time. For more information, see Appendix.

Three years does not a vintage make

Despite a compelling historical track record, recent PE underperformance has prompted some to question whether the current period represents a temporary setback or the beginning of a more permanent shift in return expectations. These concerns are particularly acute for funds launched after 2020, given their exposure to high entry multiples, rising interest rates, and a less favorable macroeconomic backdrop. On the surface, such concerns appear to have some merit. As shown in **Figure 1**, public stocks have surged since the end of 2022, setting record highs and decisively outperforming their private market counterparts.

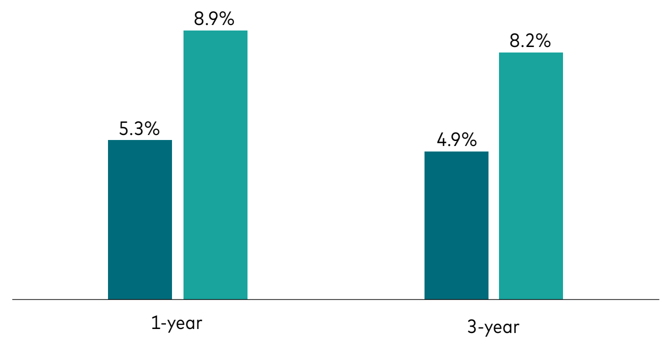
However, as **Figure 2** shows, three years in isolation rarely tells the full story. Zoom out over the longer term, and it becomes clear that—even after the recent jump in public stocks—investors have been well compensated for taking on the illiquidity and active risk that accompanies private equity. Those with the access, skill, and resources to select funds in the top two quartiles of performance would have fared even better over this period.

While investors with mature PE allocations have reaped the benefits of these longer-term trends, those in more recent vintages have likely had a much different experience, given the headwinds previously cited. However, the good news is that—like any active strategy—periods of underperformance are not uncommon, and PE has weathered similar storms before. In fact, the last time PE experienced this level of market dislocation, performance rebounded to generate returns that eventually exceeded the public markets.

FIGURE 1

Global public equity has decisively outperformed global PE in recent years

Annualized performance of MSCI global buyout fund universe vs. MSCI ACWI Index

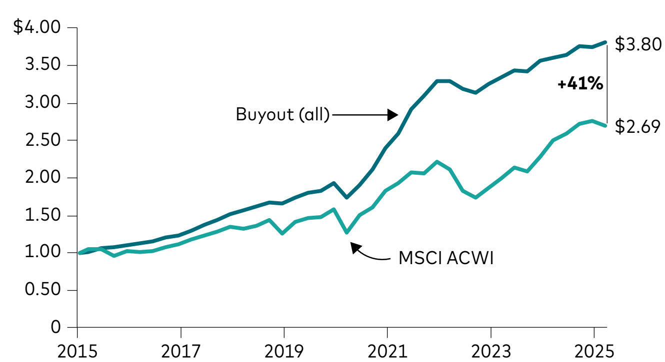


Source: MSCI, as of March 31, 2025.
Past performance is no guarantee of future returns.

FIGURE 2

Global PE has outperformed global equity over the past 10 years

Growth of $1 invested in MSCI global buyout and MSCI ACWI Index

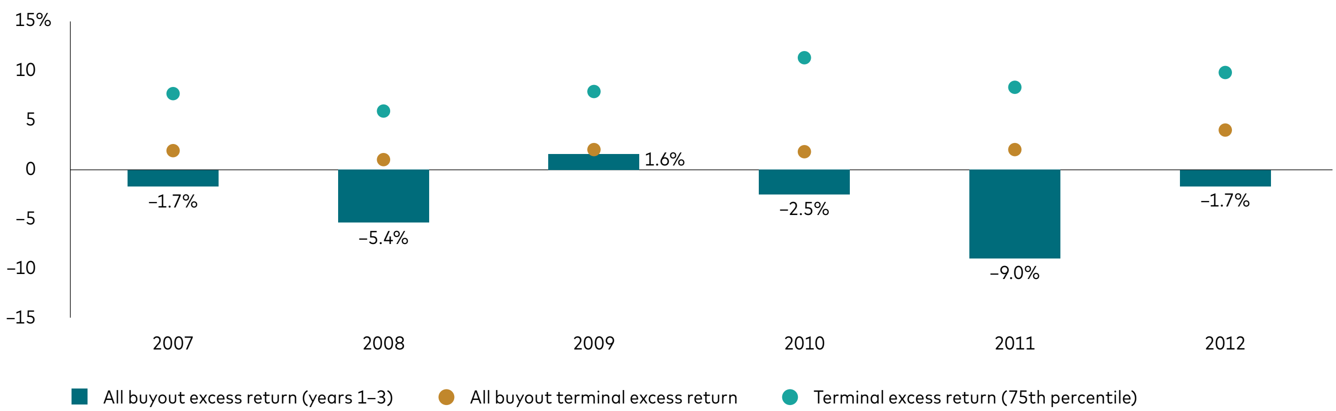


Source: MSCI, as of March 31, 2025.
Past performance is no guarantee of future returns.

As shown in **Figure 3**, PE funds launched around the 2008 global financial crisis underperformed public markets by an annualized average of 3.1% in their first three years of investing, but ultimately outpaced them by 2.1% over their full life. Funds in the top quartile generated considerably larger excess returns, underscoring the importance of strong manager selection amid periods of high uncertainty.

FIGURE 3

Financial crisis-era PE funds lagged public markets early, then outperformed



Source: Vanguard analysis using MSCI data, as of March 31, 2025. Analysis measures Direct Alphas—a common measure of excess returns—for global buyout funds in vintage years 2007–2012, relative to the MSCI ACWI.

Past performance is no guarantee of future returns.

Why now for PE?

We acknowledge that the current phase of the investment cycle stands in stark contrast to the low inflation, near-zero interest rate era of the recent past. A changing landscape has introduced a new set of challenges for PE managers and raised the bar for outperformance. Despite these headwinds, we believe there are good reasons to be optimistic about PE performance:

- Since the start of the century, PE has grown three times faster than public markets and now represents approximately 10% of global equity market capitalization. And with 85% of U.S. companies with revenues of $100M or more privately held, the opportunity set in PE has never been deeper or more diverse.[1]
- Public market valuations—particularly in the U.S.—remain elevated compared to historical levels, leading to a more guarded return outlook for public equities over the next decade. In contrast, purchase price multiples for private companies continue to appear attractive relative to U.S. large-cap stocks. As shown in **Figure 4**, the valuation spread between public and private companies has exceeded its historical average in recent years.

1 See Vanguard (2003).

- From a tactical standpoint, we expect the Federal Reserve to cut short-term interest rates twice in 2025, provided tariff pressures peak over the next few months. The value of global mergers and acquisitions has also surged 30% in the first half of 2025 compared to the same period last year.[2] These developments should help stimulate investment activity and support a recovery in exit markets, leading to a potential pickup in returns.
- We remain confident in the PE operating model, where PE owner-operators work alongside company management to strengthen corporate governance, increase company efficiency, and improve capital allocation. This structure can produce stronger alignment and the potential for higher returns.

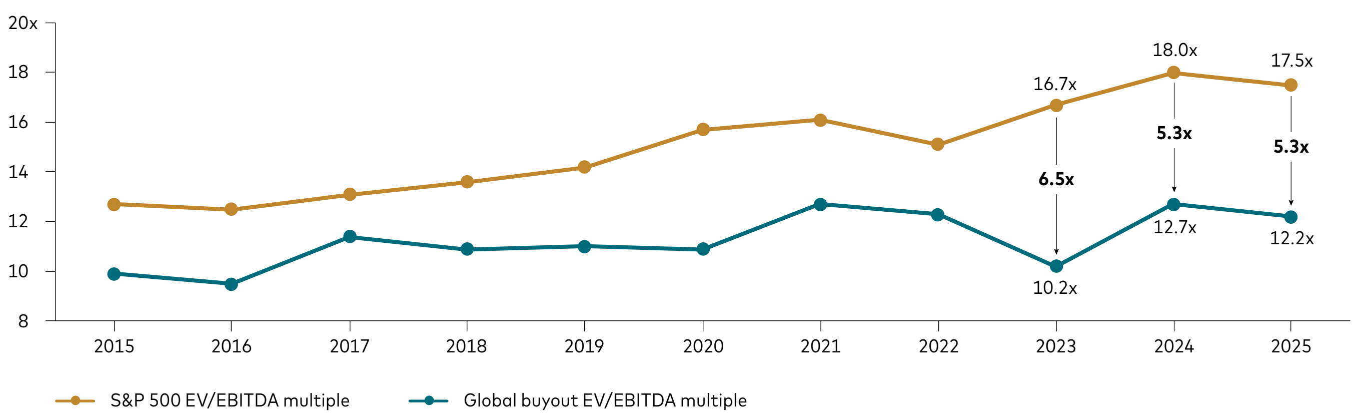
In short, we believe the current trends in performance are likely more cyclical than structural. Does that mean a return to peak 2021 performance levels? While our base case expects returns to improve, such a scenario is unlikely in the near term. Instead, we anticipate a widening in the dispersion of manager outcomes, with future outperformance driven less by beta—such as leverage or multiple expansion—and more by alpha, particularly through operational value creation. In this new environment, investors would be best served by focusing on the factors within their control—namely, partnering with proven managers, maintaining broad diversification, and adhering to a well-designed PE commitment program.

Vanguard's latest capital markets projections

Vanguard's equity return outlook over the next decade, particularly in the U.S., is cautious and the range of possible outcomes is wide.[3] Amidst an environment with a more cautious equity outlook, PE can be a useful tool to deliver outperformance relative to public equities for investors who seek capital appreciation and have a tolerance for active risk and illiquidity.

FIGURE 4

Valuations for private companies remain attractive compared to public markets



Sources: PitchBook and FactSet data, as of March 31, 2025.

2 Source: London Stock Exchange Group, as of June 30, 2025.

3 See Vanguard (2024c).

As shown in **Figure 5**, Vanguard's 10-year return outlook for PE is 6.3%–10.8% (25th to 75th percentile), with a median expected return of 8.5%, relative to 2.0%–8.1% (25th to 75th percentile), and a median expected return of 5.0% for global public equity.

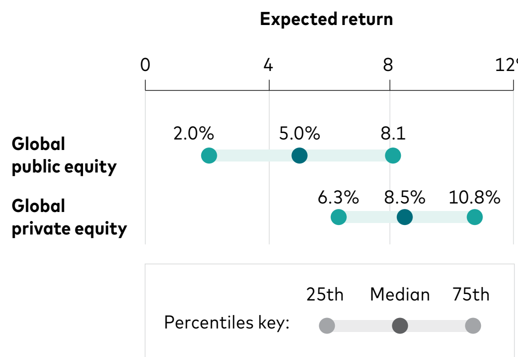
In **Figure 6**, we show that for investors with a long time horizon and tolerance for active risk, PE can generate significant outperformance over an all-public portfolio, even when adjusted for the relatively higher volatility[4] of PE returns. For an investor with a 30% allocation of equity to PE, we forecast that their portfolio generates an additional 0.8%, or 80 basis points, of annual return, while improving the Sharpe ratio, a measure of risk-adjusted returns, by 0.06x, or 27%. This investor's chance of meeting a 6% annual return target rises from 41% to 53%, or 28% higher than if the investor did not have an allocation to PE.

FIGURE 5

Vanguard's 10-year return forecast for global public and PE

10-year annualized forecasts

Range of 25th to 75th percentile of the distribution of likely returns around the median



Note: Global public equity = 60% U.S. equity, 40% international equity—unhedged.

Source: Vanguard calculations, using asset-return projections from the Vanguard Capital Markets Model. PE returns are net of fees.

FIGURE 6

Private equity offers an opportunity for enhanced risk-adjusted returns

Portfolio risk and return projections with inclusion of private equity

						PE Share of total equity allocation			Difference between 30% PE scenario and 70/30 portfolio	
Median 10-year projections	**U.S. equities**	**International equities**	**Global equities**	**Private equity**	**70/30 portfolio**	**10%**	**20%**	**30%**	**Absolute**	**Percentage**
Return	4.3%	6.1%	5.0%	8.5%	5.3%	5.6%	5.9%	6.2%	0.8%	15.8%
Probability of meeting >6% return target	36.6%	50.6%	41.1%	77.6%	41.4%	44.2%	48.0%	53.0%	11.6%	27.9%
Volatility	14.4%	17.9%	14.3%	22.0%	10.1%	10.6%	11.0%	11.5%	1.4%	13.7%
Sharpe ratio	0.13x	0.23x	0.17x	0.33x	0.21x	0.25x	0.27x	0.28x	+0.06x	26.8%

Note: 70/30 portfolio consists of a 70% allocation to equities (42% to U.S. equities, 28% to non-U.S. equities) and 30% allocation to fixed income (21% to U.S. bonds, 9% to non-U.S. bonds).

Source: Vanguard calculations, using asset-return projections from the Vanguard Capital Markets Model. PE returns are net of fees.

IMPORTANT: The projections or other information generated by the Vanguard Capital Markets Model® (VCMM) regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results, and are not guarantees of future results. Distribution of return outcomes from the VCMM are derived from 10,000 simulations for each modeled asset class. Simulations are as of June 30, 2025. Results from the model may vary with each use and over time. For more information, see Appendix.

4 Vanguard believes the use of "smooth" appraisal-based valuations leads to an underestimation of PE's equity market sensitivity.

Capturing PE's return premium in a more uncertain macro backdrop requires a thoughtful plan. Three actions will be critical for investors to realize PE's return and diversification potential: invest with highly skilled managers, embrace diversification, and adhere to a disciplined commitment program.

To solve for these challenges, investors may wish to consider partnering with a skilled fund-of-funds (FOF) manager. Recent Vanguard research has shown that investing in a low-cost FOF program that delivers broad-based diversification across manager, strategy, vintage, and region can improve downside protection and risk-adjusted returns over time.[5]

In the face of increasing uncertainty, investors may be tempted to alter their PE commitment program. However, much like the public equity markets, timing investments in PE tends to be futile.[6] Recent Vanguard research has shown that PE has historically generated stronger investment results during periods of economic uncertainty, and investors who decrease or pause their commitments during such periods experience lower investment gains. As a result, we believe a consistent PE commitment strategy that allows investors to stay invested through all stages of the market cycle is critical for achieving investment success.

5 See Vanguard (2024a).

6 See Vanguard (2024b).

Appendix

More about the Vanguard Capital Markets Model (VCMM)

IMPORTANT: The projections and other information generated by the Vanguard Capital Markets Model regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results, and are not guarantees of future results. VCMM results will vary with each use and overtime.

The VCMM projections are based on a statistical analysis of historical data. Future returns may behave differently from the historical patterns captured in the VCMM. More important, the VCMM may be underestimating extreme negative scenarios unobserved in the historical period on which the model estimation is based.

The Vanguard Capital Markets Model is a proprietary financial simulation tool developed and maintained by Vanguard's primary investment research and advice teams. The model forecasts distributions of future returns for a wide array of broad asset classes. Those asset classes include U.S. and international equity markets, several maturities of the U.S. Treasury and corporate fixed income markets, international fixed income markets, U.S. money markets, commodities, and certain alternative investment strategies. The theoretical and empirical foundation for the Vanguard Capital Markets Model is that the returns of various asset classes reflect the compensation investors require for bearing different types of systematic risk (beta). At the core of the model are estimates of the dynamic statistical relationship between risk factors and asset returns, obtained from statistical analysis based on available monthly financial and economic data from as early as 1960. Using a system of estimated equations, the model then applies a Monte Carlo simulation method to project the estimated interrelationships among risk factors and asset classes, as well as uncertainty and randomness over time. The model generates a large set of simulated outcomes for each asset class over several time horizons. Forecasts are obtained by computing measures of central tendency in these simulations. Results produced by the tool will vary with each use and over time.

Asset classes and proxy indexes

- **U.S. equity:** MSCI US Broad Market Index
- **Non-U.S. equity:** MSCI All Country World ex USA Index
- **U.S. bonds:** Bloomberg US Aggregate Index
- **Non-U.S. bonds:** Bloomberg Global Aggregate ex-USD Index
- **Private equity:** MSCI ACWI + 350 basis points

References

Vanguard, 2023. *The Diversification Benefits of Private Equity*. Valley Forge, Pa.: The Vanguard Group; available at https://investor.vanguard.com/content/dam/retail/publicsite/en/documents/IMPEPDF_112023_online.pdf.

Vanguard, 2024a. *Benefits of a fund-of-funds strategy in private equity*. Valley Forge, Pa.: The Vanguard Group; available at https://corporate.vanguard.com/content/dam/corp/research/pdf/benefits_of_a_fund_of_funds_strategy_in_private_equity.pdf.

Vanguard, 2024b. *Power in Persistence: Staying the Course with Private Equity Commitments*. Valley Forge, Pa.: The Vanguard Group; available at https://corporate.vanguard.com/content/dam/corp/research/pdf/power_in_persistence_staying_the_course_with_private_equity_commitments.pdf.

Vanguard 2024c. *Vanguard economic and market outlook for 2025: Beyond the landing*. Valley Forge, PA.: The Vanguard Group; available at: https://corporate.vanguard.com/content/dam/corp/research/pdf/isg_vemo_2025.pdf.

Legal notices

All investing is subject to risk, including the possible loss of the money you invest. Diversification does not ensure a profit or protect against a loss.

The communication is for informational purposes only and does not constitute an offer or solicitation to purchase any investments solutions or a recommendation to buy or sell a security, nor is it to be construed as legal, tax, or investment advice.

Private investments involve a high degree of risk and, therefore, should be undertaken only by prospective investors capable of evaluating and bearing the risks such an investment represents. Investors in private equity generally must meet certain minimum financial qualifications that may make it unsuitable for specific market participants.

Private equity is generally only accessible to ultra-high-net-worth investors, either through direct investment or partnership with a private equity firm, which invests in a private equity fund. Only accredited investors who meet specific qualifications outlined in federal securities laws qualify to invest in private equity funds. Certain private equity funds require investors to meet the definition of "qualified purchaser" in addition to being an accredited investor.

With private equity ("PE") investments, there are five primary risk considerations: market, asset liquidity, funding liquidity, valuation, and selection. Certain risks are believed to be compensated risks in the form of higher long-term expected returns, with the possible exceptions being valuation risk and selection risk. For selection risk, excess returns would be the potential compensation, however, limited partners ("LPs") must perform robust diligence to identify and gain access to managers with the skill to outperform. PE investments are speculative in nature and may lose value.

Market risk: Private equity, as a form of equity capital, shares similar economic exposures as public equities. As such, investments in each can be expected to earn the equity risk premium or compensation for assuming the nondiversifiable portion of equity risk. However, unlike public equity, private equity's sensitivity to public markets is likely greatest during the late stages of the fund's life because the level of equity markets around the time of portfolio company exits can negatively affect PE realizations.

Though PE managers have the flexibility to potentially time portfolio company exits to complete transactions in more favorable market environments, there's still the risk of capital loss from adverse financial conditions.

Asset liquidity risk: Various attributes can influence a security's liquidity; specifically, the ability to buy and sell a security in a timely manner and at a fair price. Transaction costs, complexity, and the number of willing buyers and sellers are only a few examples of the factors that can affect liquidity. In the case of private equity, while secondary markets for PE fund interests exist and have matured, liquidity remains extremely limited and highly correlated with business conditions. LPs hoping to dispose of their fund interests early—especially during periods of market stress—are likely to do so at a discount.

Funding liquidity risk: The uncertainty of PE fund cash flows and the contractual obligation LPs have to meet their respective capital commitments—regardless of the market environment—make funding risk (also known as commitment risk) a key risk LPs must manage appropriately. LPs must be diligent about maintaining ample liquidity in other areas of the portfolio, or external sources, to meet capital calls upon request from the General Partners ("GPs").

Valuation risk: Relative to public equity, where company share prices are published throughout the day and determined by market transactions, private equity NAVs are reported quarterly, or less frequently, and reflect GP and/ or third-party valuation provider estimates of portfolio fair value. Though the private equity industry has improved its practices for estimating the current value of portfolio holdings, reported NAVs likely differ from what would be the current "market price," if holdings were transacted.

Selection risk: Whether making direct investments in private companies, PE funds, or outsourcing PE fund selection and portfolio construction to a third party, investors assume selection risk. This is because private equity doesn't have an investable index, or rather a passive implementation option for investors to select as a means to gain broad private equity exposure. While there are measures an investor can take to limit risk, such as broad diversification and robust manager diligence, this idiosyncratic risk can't be removed entirely or separated from other systematic drivers of return. Thus, in the absence of a passive alternative and significant performance dispersion, consistent access to top managers is essential for PE program success.

Connect with Vanguard®
vanguard.com

Certified Financial Planner Board of Standards Inc. owns the certification mark CFP® in the U.S., which it awards to individuals who successfully complete CFP Board's initial and ongoing certification requirements.

PEMRO 082025