

Can Private Markets Be the Alternative to Lofty Public Market Valuations?

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After two consecutive years of stellar performance in the equity market and further tightening of credit spreads, public market valuations are, as of this writing, well above their long-term averages. Additionally, the US economy keeps firing on all cylinders and inflationary pressures remain, pointing to an environment where interest rates will likely remain higher for longer.¹ This creates challenges for investors and poses a key question for allocation adjustments in 2025: What can one do to enhance potential returns, improve diversification, and mitigate volatility? This paper discusses these critical points in detail.

First, let's examine the challenges by taking a deeper look at the current state of public markets. Take US public stocks, for example: The historical relationship between the S&P 500 forward price/earnings (P/E) ratio and subsequent three-year returns for the benchmark index shows that the current forward P/E ratio of almost 22 implies a 3% inflation-adjusted annualized return over the coming three years (**Exhibit 1**), well below historical averages of around 6.4%. While the S&P 500 delivered gains in excess of 20% in 2023 and 2024, the current technical backdrop suggests a more tempered outlook for the coming years.

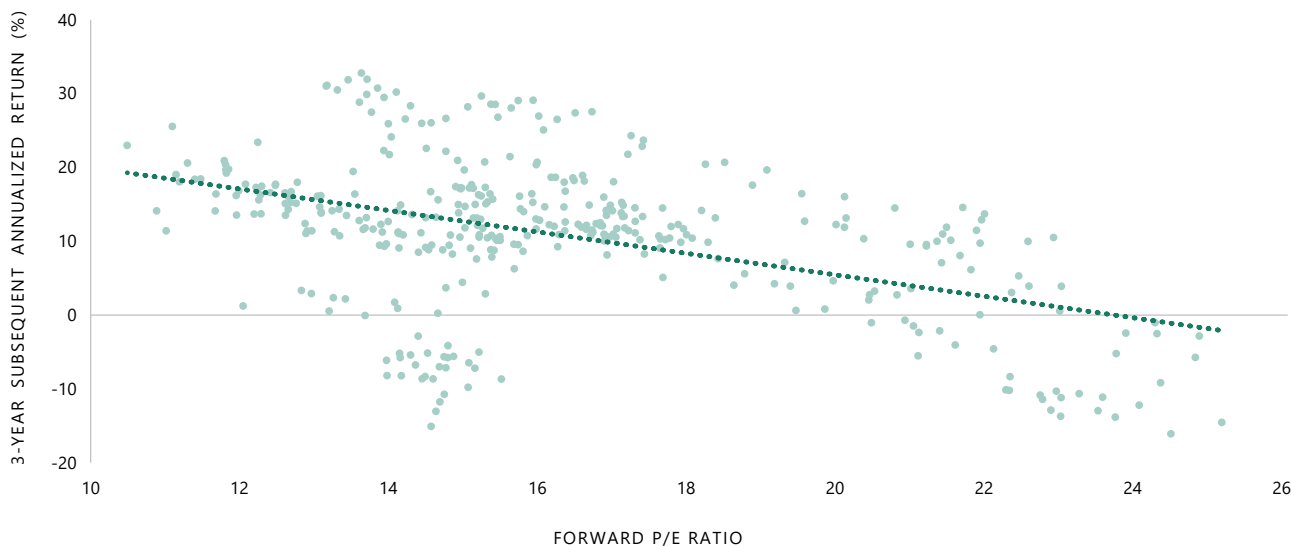
KEY TAKEAWAYS

- ➔ Public markets are expensive and concentrated: Both public stocks and bonds are trading at elevated valuations, offering low risk premia. In equities, performance is increasingly reliant on a small group of mega-cap stocks, amplifying portfolio risks.
- ➔ Diversification is harder to achieve: The rising correlation between public stocks and bonds has practically eroded the diversification benefits of the traditional 60/40 portfolio, leaving investors more exposed to systemic risks.
- ➔ Private markets can enhance portfolio resilience: Private markets can offer access to differentiated return drivers, lower correlations with public markets, and opportunities to improve risk-adjusted return potential, which we believe make them a valuable component of a broader portfolio strategy, especially in light of high public market valuations.

¹ See Sløk, Torsten, "2025 Economic Outlook: Firing on All Cylinders," December 2024. Available at: <https://www.apolloacademy.com/2025-economic-outlook-firing-on-all-cylinders/>

Exhibit 1: The S&P 500's forward P/E ratio of 21.7 implies annualized 3% returns over the next three years

S&P 500



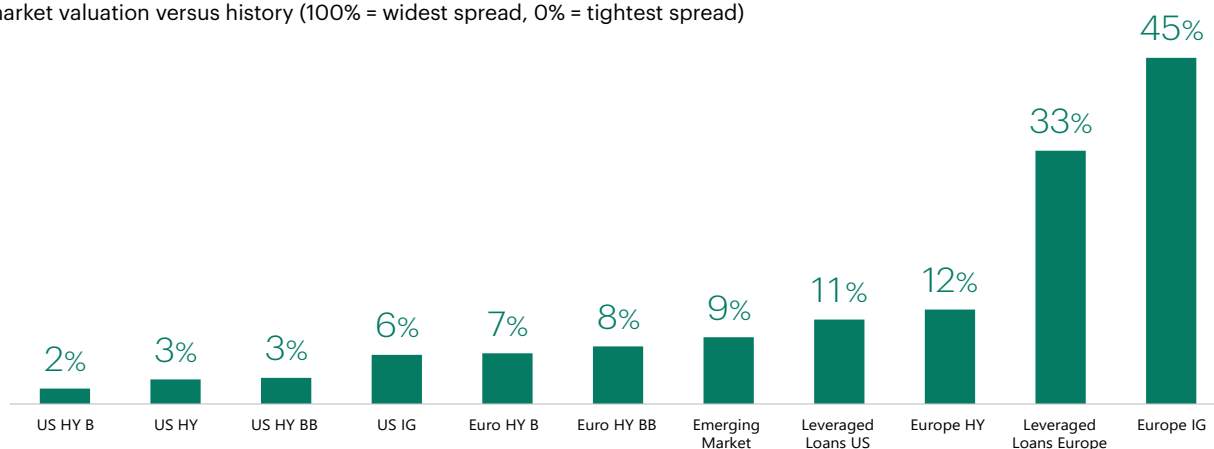
Data as of December 2024.
Sources: Bloomberg, Apollo Chief Economist

In addition, the risk premium for holding public stocks—the difference between the S&P 500 earnings yield and the 10-year Treasury yield—is negative. As of this writing, the index's earnings yield (the opposite of the P/E ratio) has dropped to 3.3% while the yield on the 10-year Treasury was at 4.6%.² In other words, investors are paying to take risk as opposed to being paid to do so.

Public credit markets also face tight valuations. **Exhibit 2** shows how current spreads in different parts of the credit market compare to historical valuations, with high yield spreads currently near the lowest levels seen in decades. Importantly, spreads are tight not so much because of improvements in corporate bond yields, but because government rates have gone up on the long end of the curve.

Exhibit 2: Public credit spreads in the US are near historical lows

Current market valuation versus history (100% = widest spread, 0% = tightest spread)



Data as of December 2024.
Note: US HY, US IG, US HY BB, US HY B, Europe HY, Europe IG, Europe HY BB, Europe HY B are from ICE BofA via Bloomberg. Emerging market USD spread is from Bloomberg, Leveraged Loans US and Europe is sourced from PitchBook. HY = High Yield, IG = Investment Grade. Data for US and European investment grade and high yield categories is from 1996; European leveraged loans data is from 2002; US leveraged loans is from 2008; and emerging markets is from 2002.
Sources: ICE BofA, Bloomberg, PitchBook, Apollo Chief Economist

² As of January 17, 2025

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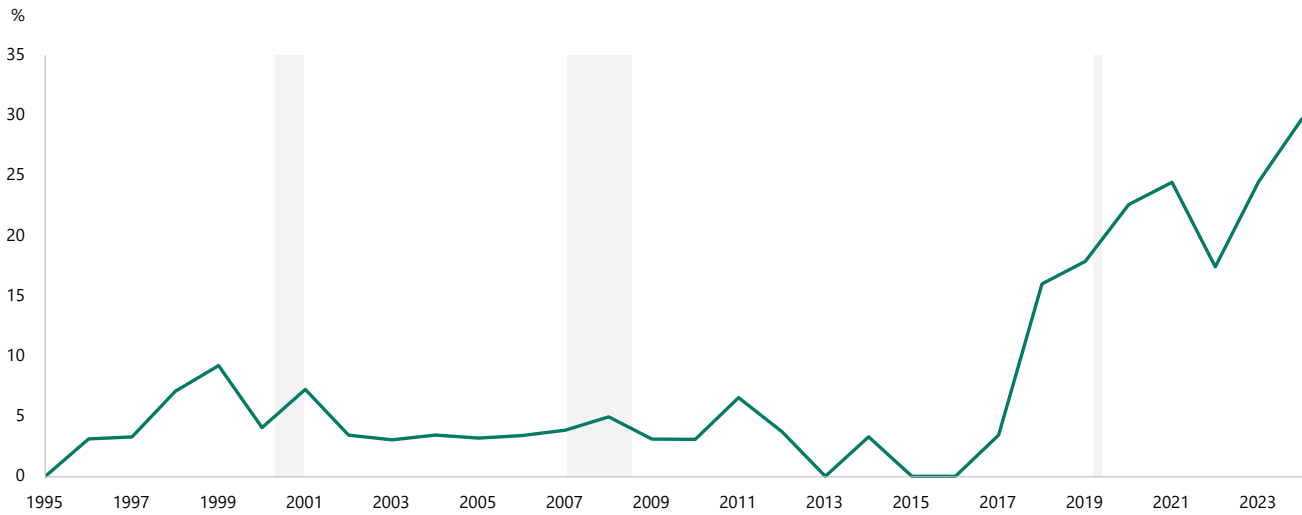
The compression in credit spreads reflects a combination of heightened risk appetite among investors and the implications of the recent US election outcome, which has bolstered market sentiment. However, this dynamic also underscores a critical challenge: tight spreads indicate that investors are not being adequately compensated for the risks they are assuming in credit markets. This parallels the low risk premia observed in public equity markets and suggests that the outlook for public credit is similarly muted.

High concentration continues to be a major problem for public equities

In addition to high valuations, the S&P 500 has become increasingly concentrated (**Exhibit 3**), with a handful of stocks disproportionately driving market performance (**Exhibit 4**). As of the end of 2024, the combined weight of stocks with a 3% or greater share in the index is at its highest level in decades.

Exhibit 3: The S&P 500 is heavily concentrated...

Combined weight of stocks with a weight of 3% or more in the S&P index

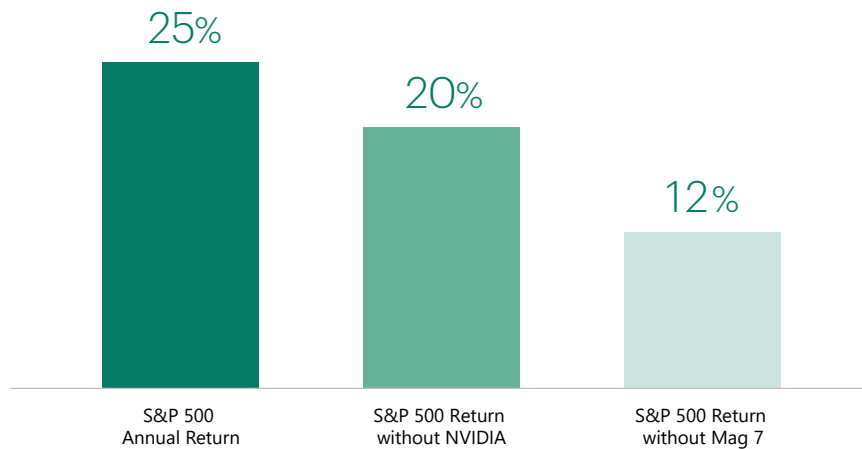


As of December 2024.

Sources: Bloomberg, Apollo Chief Economist

Exhibit 4: ...with a handful of large stocks dominating recent performance

2024 S&P performance



Data is from 12/31/23 to 12/31/24.

Sources: The Wall Street Journal, S&P Dow Jones Indices, Bloomberg

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To put this concentration in perspective, NVIDIA's market cap alone rivals the size of the entire stock market capitalization of many developed economies, including Canada, the UK, and France (Exhibit 5).³

In our view, this level of dependency on NVIDIA and a few other stocks—such as the other remaining members of the “Magnificent Seven” (Apple, Tesla, Microsoft, Alphabet,

Amazon, and Meta)—underscores the fragility of the current market landscape, where performance hinges on a narrow base of contributors. **The bottom line is, investors in public markets are effectively over-leveraged to the earnings and growth prospects of a handful of stocks.** Diversification within public markets becomes increasingly challenging as the concentration trend persists.

Exhibit 5: Public equity returns are all about NVIDIA

Market capitalization of NVIDIA versus total equity market capitalization of select countries



Data as of January 17, 2025.

Sources: Bloomberg, Apollo Chief Economist

NVIDIA's market cap rivals the entire equity market capitalization of several countries, highlighting the fragility of a market heavily reliant on a handful of large tech stocks.

³ As of January 17, 2025

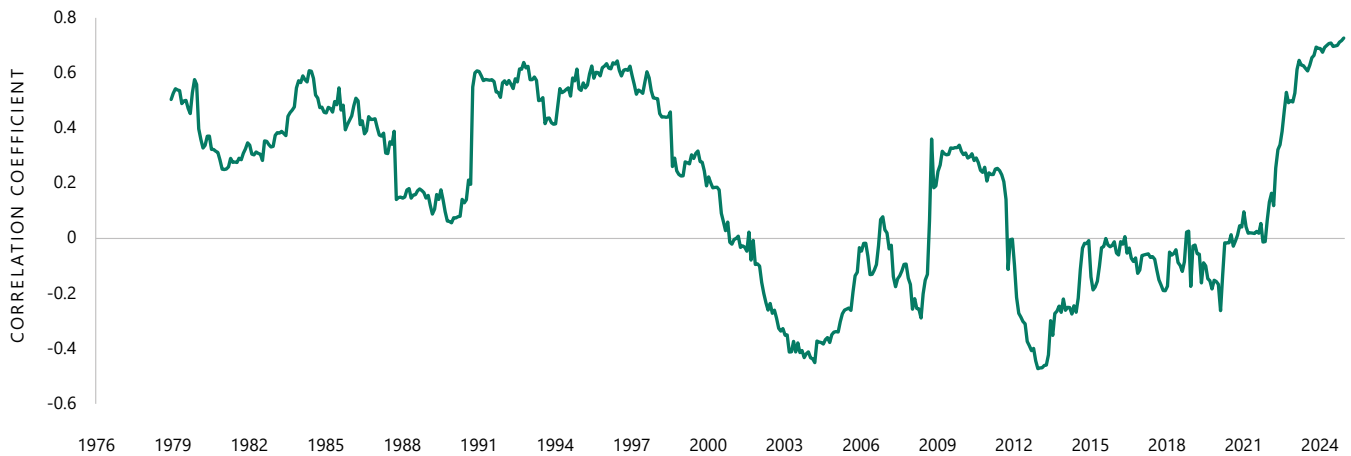
Public stocks and bonds remain highly correlated

Adding to the challenge of elevated valuations and concentrated returns is the rising correlation between public stocks and bonds. Historically, the negative correlation between these two asset classes provided diversification

and a natural hedge within the traditional 60/40 portfolio framework. But that relationship has broken down in recent years. For example, in 2022, stocks and bonds fell together and in 2023, they rose together. Bigger picture, the three-year rolling correlations between stocks and bonds have reached their highest levels in decades (**Exhibit 6**).

Exhibit 6: Finding diversification in public markets has become more difficult

Rolling three-year correlations between stocks and bonds



Data as of December 2024.

Note: Stocks are represented by the S&P 500 Index; bonds are represented by the Bloomberg US Aggregate Bond Index.

Sources: Bloomberg, Apollo Chief Economist

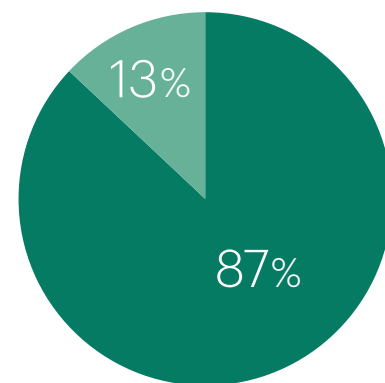
Private markets can offer the potential for ballast and diversification

High valuations, concentrated equity markets, and the convergence of public bond and stock performance have, in our view, eroded the diversification benefits of a traditional 60/40 portfolio construction, leaving investors more exposed to systemic risk, especially during periods of market stress. Enter private markets.

By shifting allocations from public to private assets, investors can gain access to an expansive and increasingly diverse universe of investment opportunities. In fact, private markets have become an increasingly important component of the broader economy—87% of US companies with revenues greater than \$100 million today are private (**Exhibit 7**). At the same time, the number of publicly listed companies in the US has declined from a peak of more than 8,000 in 1996 to just over 4,000 in 2024.⁴

Exhibit 7: 87% of US firms with revenues greater than \$100 million are private

Share of public and private companies in the US, with revenue greater than \$100M



■ PRIVATE COMPANIES ■ PUBLIC COMPANIES

Data as of May 2024.

Note: For companies with last 12-month revenue greater than \$100M by count.

Sources: S&P Capital IQ, Apollo Chief Economist

⁴ Sources: World Bank, WFE, Haver Analytics, Apollo Chief Economist

Within this growing space, we believe that the focus in 2025 should be on private market strategies across equity, credit, infrastructure and hybrid opportunities that can deliver tailored solutions and potential enhanced risk-adjusted returns. In the remainder of this paper, we take a deeper look at each individual opportunity.

The growing momentum of private equity

Private equity remains well-supported by a market hungry for liquidity. Despite the “higher-for-longer” environment, rates have come down from their recent highs and cheaper borrowing costs could drive a surge in private equity deals as sponsors aim to deploy recently raised capital and managers capitalize on improved valuations.

The private equity secondary market, particularly GP-led transactions—where general partners negotiate asset sales with secondary buyers—has been the fastest-growing segment since 2018, driven by innovation and a slowdown in traditional exits like IPOs and M&A during periods of higher rates.

These transactions, which accounted for nearly half of secondary market activity in 2022 and 2023, are expected to remain strong even in normalized conditions as they become integral to the private market ecosystem. The evolving secondary market can offer potential for attractive risk-adjusted returns compared to other private market strategies.

The yield advantage in private credit

We continue to see a clear and sustained delta between credit spreads in the public and private markets—that is, investors can earn a premium for lending in the private markets (**Exhibit 8**).

The maturing debt landscape has undergone a notable transformation in recent years, driven by shifts in market dynamics and investor behavior. Unlike previous maturity walls, the 2024/25 cohort saw significant reliance on private markets and innovative financial structures. Notably, over \$40 billion in syndicated loans were refinanced through private markets since 2022, and distressed debt exchange activity reached a record \$44 billion by the end of 2024.⁵ As 2025 progresses, we expect investors will turn their attention to the next sub-investment grade maturity wall, with over \$620 billion of high yield bonds and loans set to come due in 2026 and 2027.⁶ This suggests a large opportunity for private credit to reprise its role as an alternative financing option for companies with upcoming maturities.

Additionally, we don't believe that private credit is inherently riskier compared with public debt markets. Both can be risky and “safe.” It all depends on which part of the risk spectrum one is investing. As we have written in a recent paper,⁷ the emergence of Private Investment Grade Credit (Private IG)

Exhibit 8: BDC yields are higher than those of high-yield bonds



Data as of January 2025.

Sources: Bloomberg, Apollo Chief Economist

⁵ See Cortese, John; Bittencourt, Rob; Grewal, Akila; Gupta, Shobhit; Barak Harif, Tal. “2025 Credit Outlook: Defying Gravity,” January 2025. Available at: <https://www.apolloacademy.com/2025-credit-outlook-defying-gravity/>

⁶ Sources: JPMorgan, Bloomberg, S&P/IHS Markit

⁷ See Cortese, John; Grewal, Akila; Gupta, Shobhit; Barak Harif, Tal. “Demystifying the Opportunity in Investment Grade Private Credit,” December 2024. Available at: <https://www.apolloacademy.com/demystifying-the-opportunity-in-investment-grade-private-credit/>

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is opening doors for many investors to consider adding private credit as a core component of their fixed income portfolios (as opposed to being deployed peripherally in a, say, “alternatives” bucket). Also, private transactions are generally negotiated on a bilateral basis and allow lenders to secure stronger legal and contractual protections.

The rise of hybrid capital solutions

Hybrid investments are emerging as an attractive solution within the private markets landscape, offering a blend of private equity and private credit characteristics. These strategies combine multiple asset classes into holistic solutions that aim to deliver returns between those traditionally associated with private equity and credit. Hybrid solutions may be “packaged” in distinct ways, however. We see them falling into two distinct groups:

Macro-level solutions: These include strategies that traditionally deploy capital across a variety of private markets, including debt and equity, into one single portfolio. These tend to have a return profile that is similar to public equities but with lower volatility.⁸ We believe these strategies can be particularly attractive in the current environment, where lofty public market valuations can fuel volatility in the coming months. As we have written in a previous paper,⁹ these strategies also tend to exhibit higher correlation to inflation, an important trait, in our view, in times of recalcitrant price pressures.

Micro-level solutions: These include strategies that traditionally invest in structured and bespoke solutions developed for companies seeking capital. For example, hybrid capital is increasingly relevant in addressing the capital needs of companies whose capital structures are inadequate for the current higher level of borrowing costs. When seeking refinancing today, companies that borrowed heavily during the long period of rock-bottom rates could see a significant increase in their loan-to-value (LTV) ratios—say from 40% to as high as 75%—sharply increasing the risks of distressed

exchanges and payment-in-kind (PIK) alternatives. In these types of scenarios, hybrid capital can devise structured solutions—traditionally involving both debt and equity—that can provide much-needed financing to re-structure the company’s capital structure at more suitable LTVs of, for instance, 40% to 45%, all the while increasing borrower resilience, improving interest coverage, and potentially enhancing downside protection for the lender.

As the 2026/2027 sub-investment grade maturity wall approaches, the addressable market for hybrid strategies is expected to expand significantly. We anticipate these solutions will play an increasingly critical role in navigating the heightened refinancing challenges, offering companies the flexibility to adapt while delivering attractive opportunities.

Infrastructure: Building the future

Private infrastructure has shown resilience in times of market stress and provided downside protection with low correlation to other major asset classes (as well as enhanced inflation protection).¹⁰ In addition, there are powerful macroeconomic tailwinds bolstering infrastructure spending today, including federal initiatives and the global need to update aging infrastructure.

The 2021 US bipartisan infrastructure law authorized \$1.2 trillion for transportation and infrastructure spending, with \$550 billion of that figure going toward “new” investments and programs. Although that sounds like a large sum (and it is), estimates suggest that the global need to update aging infrastructure shows an \$88 trillion funding gap by 2040,¹¹ a void that will very much likely have to be filled by private capital.

In particular, we see a broad opportunity set in digital infrastructure, where increasing computing power from generative AI and related technologies is driving heightened demand for data centers and electricity.

⁸ See O’Mara, Matt; Black, Keith. “Beyond Beta: How to Use Alternatives to Replace Public Equity,” May 2023. Available at: <https://www.apolloacademy.com/beyond-beta-how-to-use-alternatives-to-replace-public-equity/>

⁹ Idem.

¹⁰ See Sløk, Torsten; Lacagnina, Vittorio. “Infrastructure Investing: Embracing Complexity in Times of Structural Change,” March 2023. Available at: <https://www.apolloacademy.com/infrastructure-investing-embracing-complexity-in-times-of-structural-change/>

¹¹ Apollo Chief Economist, Global Infrastructure Outlook, Global Infrastructure Hub, 2020

Conclusion

The 60/40 portfolio became the standard allocation for investors for one reason: because it worked. The inverse correlation between high-performing stocks and lower-volatility bonds helped the 60/40 portfolio offset volatility and produced strong returns for more than four decades. However, in today's environment, elevated valuations, rising correlations between stocks and bonds, and concentrated equity markets challenge the effectiveness of this traditional approach.

Instead of reallocating 10% of a portfolio from one highly correlated public asset class to another, the diversification potential offered by private markets could be considered. Private assets can provide differentiated return drivers, lower correlations with public markets, and opportunities to enhance portfolio resilience in periods of market stress.

Additionally, with public equity market valuations at historically high levels and bonds trading at tight spreads, we believe rebalancing into private markets becomes even more attractive. Allocating prudently to private strategies across equity, credit, infrastructure, and hybrid solutions can not only mitigate the risks of elevated public market valuations but also capture opportunities in an expanding and evolving investment universe.

By rethinking traditional asset allocation and embracing the flexibility and the potential diversity of private markets, investors can unlock long-term growth and resilience, which can allow their portfolios to be well-positioned for the challenges and opportunities ahead.

As the 60/40 portfolio faces challenges from rising correlations and lofty valuations, private assets can offer a potential pathway to enhanced diversification, resilience, and long-term growth.

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Alexander Wright is Partner and Global Wealth Strategist. Previously, Alexander was a portfolio manager for Apollo's closed-end funds, CLOs and private BDC. Prior to joining in 2011, he was with GSC Group where he served in a variety of different roles, most recently as Chief Administrative Officer, Chief Financial Officer, and Head of US Corporate Debt. Before that, Alexander was with IBJ Whitehall Bank & Trust Corporation and Chemical Banking Corporation.

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