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A Tug of War: Public Versus Private

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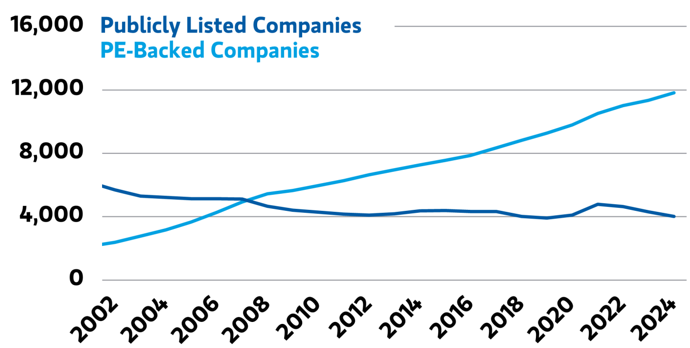
There has been a significant change in the investment landscape in the past two decades with respect to the number of investment opportunities in publicly traded stocks compared to those in private companies. As has been widely reported, the publicly traded company pie is shrinking dramatically as businesses stay private longer. Despite recent market volatility, this trend shows no sign of abating and indicates a clear migration of value creation from public to private markets, rendering an allocation to the latter desirable for investors who can access both private equity funds (including venture capital) and individual private companies through direct co-investments.

Remaining Private for Longer

Between 2000 and 2024, the number of publicly traded US companies fell by over 40%, from 6,917 to 4,010. Conversely, over the same timeframe, the number of private US companies backed by private equity firms grew by more than 600%, from 1,929 to 11,808 (see Exhibit 1). Over 80% of firms in the US with revenue greater than $100 million are private companies (see Exhibit 2). As access to investment capital has grown, companies are choosing to stay private longer—reflecting a mentality that has become commonplace in Silicon Valley and elsewhere. As illustrated in Exhibit 3, over the past 25 years, the average time a company remains private has more than doubled, to 10.7 years.[1] Uber and Airbnb, among the largest technology initial public offerings (IPOs) ever, remained private for 10 and 12 years, respectively, before listing. These household names had already created significant value for investors before their IPOs even took place.

Exhibit 1: Growing Opportunity Set: Diverging Number of Private and Public Companies in the US

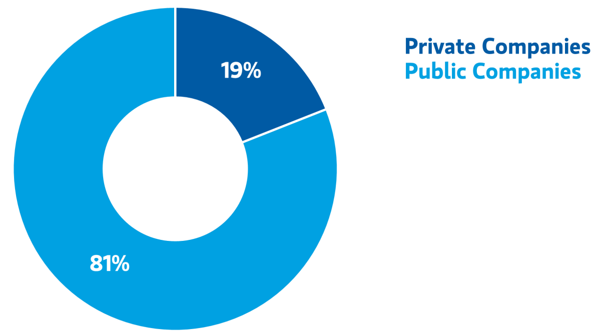


Source: PitchBook data as of Dec. 31, 2024; World Bank data as of Dec. 31, 2024

There are clear structural reasons why the bulk of value creation, innovation and dynamism in the US is taking place in private markets. First and foremost, not only has private capital grown substantially, it has become easier to access. Private mega-financing rounds of $100 million or more have become common, and US private equity fund dry powder (committed capital that has not yet been invested) has grown to more than $1 trillion.[2] Preqin expects private equity assets under management (AUM) to double from $5.8 trillion in 2023 to $12.0 trillion in 2029.[3]

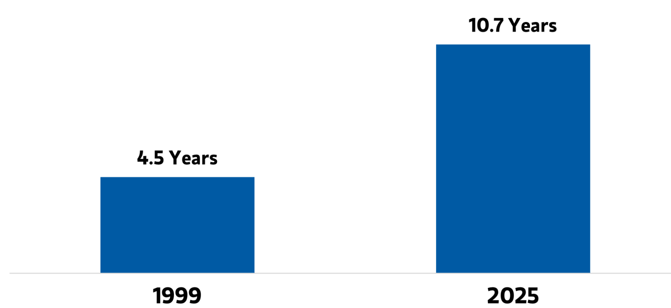
Second, the Sarbanes-Oxley Act significantly increased the regulatory burden and cost associated with being a public company. With the emergence of viable financing, companies are able to put off facing such costs and headaches.

Exhibit 2: Share of Public and Private Companies in the US with Revenue Greater Than $100 Million



Source: S&P Capital IQ as of Dec. 31, 2024

Exhibit 3: Average Time a Company Remains Private



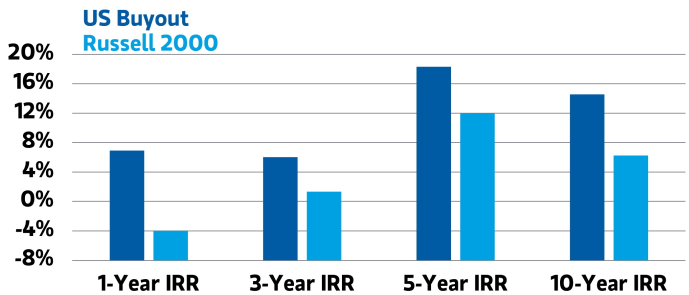
Source: Morningstar, "Unicorns and the Growth of Private Markets," Morningstar Indexes, Jan. 21, 2025

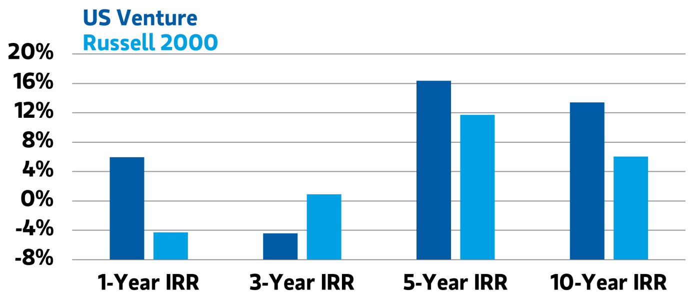
Third, going public subjects companies to the whims of the public markets to such an extent that they may need to focus on navigating near-term volatility—such as that related to "making the quarter"—while continuing to concentrate on their long-term growth strategy. In today's environment, publicly traded equity prices may swing widely if the company misses guidance or underperforms analyst expectations, which could impact growth and spending plans.

Appeal of Private Markets

In addition to companies staying private longer, over the past decade, favorable returns, on an absolute and relative basis, have bolstered private market growth. As shown in Exhibit 4, private investment strategies have tended to meaningfully outperform the Russell 2000 Index over a long period of time. As a result, investor demand has increased substantially, as evidenced by the steady growth in capital raised by private equity managers, along with rising levels of dry powder (see Exhibit 5). Furthermore, as companies have stayed private longer—thereby shielding themselves from the public eye that accompanies being listed and accomplishing strategic objectives in a more patient manner—investment activity has also grown meaningfully.

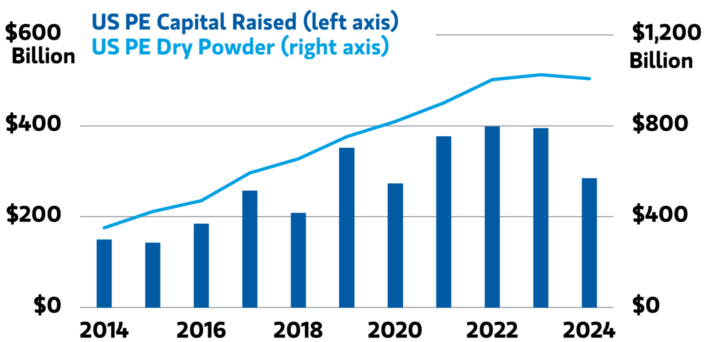
Exhibit 4: Buyout and Venture Capital Strategies Have Outperformed Public Markets Over Time





Note: Net annualized internal rates of return from inception to March 31, 2025; Russell 2000 Index is an mPME index (modified public market equivalent).
Source: Cambridge Associates as of March 31, 2025

Exhibit 5: Growth in Dry Powder and Capital Raised Indicate Strong Investor Appetite for Private Equity



Source: PitchBook capital raised data as of Dec. 31, 2024; dry powder data as of June 30, 2024

Direct Co-investing: Increasing Appeal, Activity and Access

For decades, private equity (including venture capital) was predominantly accessed through fund vehicles, whereby investors could commit capital to a manager and gain exposure to a diversified portfolio of private companies. However, consistent with the substantial growth in private markets, the need for capital at a given company often exceeds a manager's desired allocation across fund vehicles.

Over the last several years, access to private direct co-investments—once the exclusive domain of the largest institutional investors—has grown to encompass both institutions and ultra high net worth individuals, including family offices.

For most investors, lower fees, enhanced return profile, reduced "blind pool risk" and the ability to perform one's own additional due diligence are key reasons for accessing direct private investments outside of fund vehicles. Direct co-investing may serve as a tool in investor portfolios while offering attractive return and portfolio construction benefits—not dissimilar to buying individual stocks in one's portfolio to complement fund manager exposure. As such, for larger, more sophisticated investors, direct co-investing has become another mechanism to seek alpha-generating opportunities.

Direct Co-investments: What Are They, and Why Do General Partners Offer Them?

Investors have traditionally participated in private markets via commingled funds. These "blind pools" of capital are usually structured as limited partnerships (LPs) with terms of 10 years or more. As the next step in market evolution, managers or sponsors—typically general partners (GPs) of private equity funds—are increasingly willing to offer capacity in individual deals or in companies that are included in these commingled funds. For example, in the case of a private company that requires $300 million in equity capital, an allocation from a fund manager's diversified fund, in line with its portfolio construction parameters, may account for a portion of the $300 million, while the manager offers the balance of the investment opportunity to co-investors.

Direct co-investment opportunities are increasing due to a combination of factors. First, private equity and venture capital fund managers who would like to pursue bigger deals requiring larger investments may be constrained by portfolio construction guidelines limiting the amount of equity per deal. Second, while fund managers typically offer this additional capacity to their LPs first, managers may have discretion to allocate a portion of excess capacity to other prospective LPs for strategic reasons or for other potential benefits. These may include relationship building and marketing access and capabilities, which may be beneficial in attracting commitments for future fund offerings. As high net worth investors represent a largely untapped white space for private equity funds, Morgan Stanley Wealth Management is well positioned to leverage its scale and reputation to source attractive direct private investment opportunities alongside reputable lead sponsors.

Benefits

Access Point to the Private Markets

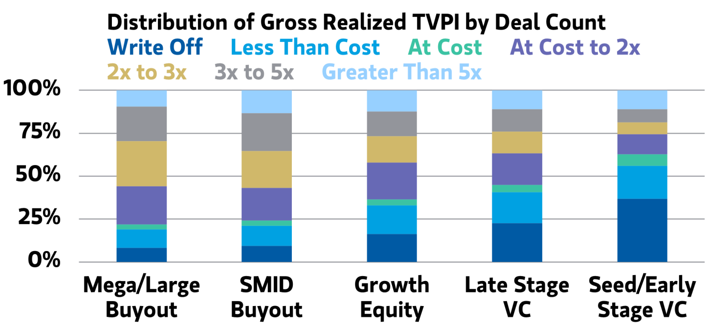
Co-investments offer another point of access to a large, growing opportunity set in terms of the number of private companies, especially compared to the shrinking number of public companies.

Enhanced Return Profile

According to research conducted by Morgan Stanley at Work,[4] 31% of private companies have indicated that an IPO is the most likely form of liquidity event that they will pursue next. As a result, more value is being created in the private stage prior to an IPO. Investors who participate in private transactions stand to capture a potentially greater portion of that value creation than public-only investors. While direct co-investment deals lack the diversification that typically characterizes a commingled primary fund structure, co-investment deals can offer greater upside potential.

As seen in Exhibit 6, data from Hamilton Lane demonstrates a subset of individual deals, across sub-asset classes, generating returns greater than five times invested capital.

Exhibit 6: Realized Dispersion Among Individual Deals Highlights Potential for Both Outsized Returns and Risk



Note: Total value to paid-in capital (TVPI) is a measure of performance.
Source: Hamilton Lane as of March 31, 2025

Fee Alpha

Co-investments are generally offered at no or low fees, which represents an enhancement to the fee structure generally seen in commingled funds (see Exhibit 7). All else equal, reduced fees or no fee with the same exposure means better returns, or "fee alpha." Participation in low- or no-fee co-investment deals, alongside high-conviction managers in instances when investors already have exposure to private markets through fund commitments, effectively and selectively increases exposure to an asset class that investors have already deemed to be attractive, while providing better economics.

Exhibit 7: Relatively Lower Direct Co-investment Fees Lead to "Fee Alpha"

Estimated Fees and Charges as a Percent of Committed or Co-Invested Capital			
	Direct Co-Investment	Co-Investment Fund	Primary Fund
Annual Management Fee	0%-1%	1-1.5%	1.75-2.25%
Carried Interest Charge	0%-15%+	10%-15%	20%+

Note: For illustrative purposes only; not a recommendation.
Source: Morgan Stanley Wealth Management Global Investment Manager Analysis (GIMA) as of April 30, 2024

Great Transparency and Control

Relative to a blind pool commingled drawdown fund, direct co-investing offers greater transparency and control in portfolio construction, as the asset is identified prior to committing capital. First, co-investing offers investors the flexibility to curate exposure across a variety of factors, such as company size, industry sector, geography, environmental, social and governance (ESG) profile and vintage year. Investors can further customize by deal type, including venture capital, growth equity, middle market and private equity/buyout. Second, investors can control the timing and amount of investment for co-investment deals because, unlike for a fund, a material amount of unfunded capital commitments is not required. Advantages to controlling the pace include mitigation of the J-curve (the tendency of private equity funds to post negative returns in the initial years and then post increasing returns in later years when the investments mature). In addition, investors can calibrate investment timing decisions based on a particular view of market trends and dislocations. Third, investors can increase exposure to favored managers through co-investment deals or use them to more sharply focus on opportunities that align with a given manager's expertise and track record. Finally, a co-investment deal could place an investor at a closer vantage point to better understand a manager's sourcing, value creation and other capabilities to inform future allocation decisions.

Multiple Layers of Due Diligence

Multiple layers of due diligence add to the appeal of co-investing, as these deals are typically prescreened by the lead manager in accordance with the lead manager's strategy and investment process. That process typically includes extensive due diligence, underwriting and committee approval. Furthermore, while Morgan Stanley Wealth Management Global Investment Manager Analysis (GIMA) performs a second layer of due diligence, Financial Advisors assess suitability for individual client portfolios. Due diligence efforts may mitigate adverse selection bias by assessing the merits of a particular co-investment deal relative to the core competence of the manager. This may include consideration of whether the deal at hand is typical of the track record of the manager and the partner leading the investment. Given that a particular investment and industry sector are identified prior to commitment, individual clients may also evaluate the opportunity in the context of prior business dealings and experience, thereby providing yet another layer of due diligence before investment.

Implementation

Investors can gain exposure to direct co-investments either through co-investment funds, which are typically diversified portfolios of co-investments within a 10-year fund structure, or through individual co-investment deals.

A co-investment fund is a blind pool commingled drawdown vehicle run by a fund manager entrusted with discretionary authority to take a portfolio approach to offering exposure to minority investments directly in private companies alongside lead sponsors in specific deals. These funds invest in deals at generally low fees or no fee. In turn, the funds charge investors a management fee and carried interest rate at levels typically below standard primary fund amounts. In addition to the lower fee structure, co-investment funds provide investors with diverse exposure to a range of private equity managers to which they may not otherwise have access. Generally, co-investment funds provide strategy exposure to buyout and growth equity investments, while exposure to venture capital investments may be limited.

Individual direct co-investments may involve the use of special purpose vehicles (SPVs), with the SPV investing alongside a lead sponsor's fund vehicle. They run the entire spectrum of deal types—from venture capital, to growth equity, to middle market to buyout. Participation in multiple individual direct co-investments may enable an investor to create a portfolio outside of a commingled fund structure, similar to creating a diversified portfolio with a basket of public stocks. What's more, investors have maximum flexibility to customize the basket of direct investment deals with a view toward establishing the most appropriate and desirable portfolio composition catering to the needs of each individual investor.

Considerations

Direct co-investing is complex and requires a broad skill set and deep relationships and resources to source opportunities, perform due diligence and structure and monitor investments on behalf of clients. It is paramount to understand the range of outcomes, as well as the risk and return, associated with investing in any single company. In the case of venture capital, one generally invests in less mature companies, which may increase both the return potential and risk profile; in the case of leveraged buyouts, higher levels of debt are typically employed, which can also elevate the return and risk profiles.

Important considerations that should play a pivotal role in direct co-investing due diligence include absolute and relative valuation and return profile; sponsor and management team quality and fit; fees; market and company dynamics; geographic exposure; investment thesis and risks. Analysis of expected exit timing, associated illiquidity profile, capital structure, ownership and governance and follow-on exposure (the likelihood of additional capital raise and possible dilution) are also crucial. Once a decision to invest is made, an experienced legal team must review and negotiate transaction terms. Another important consideration is the time required for regular monitoring from post-closing through ultimate exit.

For investors, direct co-investment opportunities are often presented with tight timeframes—sometimes just weeks before final decision and funding are required. Importantly, individual direct co-investment opportunities lack diversification and entail the risk of partial or full capital loss. Therefore, investors must weigh the tradeoffs of potential upside return versus risk. That is why it is highly advisable to invest in a basket of direct co-investments within a private market and alternatives allocation and to size exposure appropriately. Diversifying by vintage year across a range of deals is also strongly advised.

Bottom Line

Today, private markets are responsible for a substantially higher portion of innovation and value creation than in prior years, which makes them attractive for investors pursuing alpha. As private market portfolios mature and return enhancement continues to be a primary investment objective, investors may seek to augment their exposure by accessing direct co-investments in targeted sectors and strategies alongside favored fund managers at more attractive fees. Since individual direct co-investments may be deemed high risk, investors are well advised to deploy a portfolio approach tailored to their own needs. In this manner, investors will be better equipped to balance the potential for upside return against sizable downside risk while seeking to benefit from significant potential diversification flexibility.

Endnotes

[1]"Unicorns and the growth of private markets," 2025. Morningstar. January 21, 2025. https://indexes.morningstar.com/insights/analysis/blt81d5614b4c2ccd2b/unicorns-and-the-growth-of-private-markets.

[2]"2024 Annual US PE Breakdown" 2025. PitchBook. January 14, 2025. https://pitchbook.com/news/reports/2024-annual-us-pe-breakdown.

[3]"Preqin 2025 Global Report: Private Equity" 2025. Preqin. December 10, 2024. https://www.preqin.com/insights/global-reports/2025-private-equity.

[4]"Liquidity Trends: Perspectives From Private Company Leaders" 2025. Morgan Stanley at Work. May 2025. https://www.morganstanley.com/atwork/articles/liquidity-trends-report.

Disclosure Section

IMPORTANT DISCLOSURES

For index, indicator and survey definitions referenced in this report please visit the following: https://www.morganstanley.com/wealth-investmentsolutions/wmir-definitions

Glossary

Drawdown refers to the largest cumulative percentage decline in net asset value or the percentage decline from the highest value or net asset value (peak) to the lowest value net asset value (trough) after the peak.

Illiquidity premium is the extra yield investors expect to earn for giving up control to liquidate their capital for a certain period of time.

Internal rate of return (IRR) is the interest rate at which the net present value of all the cash flows (both positive and negative) from a project or investment equal zero. Internal rate of return is used to evaluate the attractiveness of a project or investment.

J-curve effect refers to a "J" shaped section of a time-series graph in which the curve falls into negative territory and then gradually rises to a higher level than before the decline.

Total Value to Paid in Capital (TVPI): Sum of distribution to paid in and residual value paid in, i.e., distributed cash and securities plus the value of the limited partner's remaining interest in the partnership.

Vintage Year: Typically refers to the year or period in which a fund initiated investments and typically used as reference period for performance review.

Volatility is a statistical measure of the dispersion of returns for a given security or market index. Volatility can either be measured by using the standard deviation or variance between returns from that same security or market index. Commonly, the higher the volatility, the riskier the security.

Hypothetical Performance

General: Hypothetical performance should not be considered a guarantee of future performance or a guarantee of achieving overall financial objectives. Asset allocation and diversification do not assure a profit or protect against loss in declining financial markets.

Hypothetical performance results have inherent limitations. The performance shown here is simulated performance based on benchmark indices, not investment results from an actual portfolio or actual trading. There can be large differences between hypothetical and actual performance results achieved by a particular asset allocation.

Despite the limitations of hypothetical performance, these hypothetical performance results may allow clients and Financial Advisors to obtain a sense of the risk / return trade-off of different asset allocation constructs.

Indices used to calculate performance: The hypothetical performance results in this report are calculated using the returns of benchmark indices for the asset classes, and not the returns of securities, fund or other investment products.

Indices are unmanaged. They do not reflect any management, custody, transaction or other expenses, and generally assume reinvestment of dividends, accrued income and capital gains. Past performance of indices does not guarantee future results. Investors cannot invest directly in an index.

Performance of indices may be more or less volatile than any investment product. The risk of loss in value of a specific investment is not the same as the risk of loss in a broad market index. Therefore, the historical returns of an index will not be the same as the historical returns of a particular investment a client selects.

The assumed return rates in this analysis are not reflective of any specific investment and do not include any fees or expenses that may be incurred by investing in specific products. The actual returns of a specific investment may be more or less than the returns used in this analysis. The return assumptions are based on hypothetical rates of return of securities indices, which serve as proxies for the asset classes. Moreover, different forecasts may choose different indices as a proxy for the same asset class, thus influencing the return of the asset class.

Risk Considerations

Investing in the market entails the risk of market volatility. The value of all types of securities may increase or decrease over varying time periods.

This analysis does not purport to recommend or implement an investment strategy. Financial forecasts, rates of return, risk, inflation, and other assumptions may be used as the basis for illustrations in this analysis. They should not be considered a guarantee of future performance or a guarantee of achieving overall financial objectives. No analysis has the ability to accurately predict the future, eliminate risk, or guarantee investment results. As investment returns, inflation, taxes, and other economic conditions vary from the assumptions used in this analysis, your actual results will vary (perhaps significantly) from those presented in this analysis.

Alternative investments involve complex tax structures, tax inefficient investing, and delays in distributing important tax information. Individual funds have specific risks related to their investment programs that will vary from fund to fund. Clients should consult their own tax and legal advisors as Morgan Stanley Wealth Management does not provide tax or legal advice.

Alternative investments often are speculative and include a high degree of risk. Investors could lose all or a substantial amount of their investment. Alternative investments are appropriate only for eligible, long-term investors who are willing to forgo liquidity and put capital at risk for an indefinite period of time. They may be highly illiquid and can engage in leverage and other speculative practices that may increase the volatility and risk of loss. Alternative Investments typically have higher fees than traditional investments. Investors should carefully review and consider potential risks before investing.

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Venture Capital investments involve a high degree of risk and are not appropriate for all investors. Financial and operating risks confronting startups are significant. While targeted returns should reflect the perceived level of risk in any investment situation, such returns are unrealized and based solely on the startup's own estimate of the current value of its fund investments, are not verified or audited by third party valuation, and do not represent actual return of capital or gain, may never be realized and/or may not be adequate to compensate an investor for risks taken. Loss of an investor's entire investment is possible and can easily occur. Moreover, the timing of any return on investment is highly uncertain given the illiquid nature of venture capital investments. The venture capital market is highly competitive and the percentage of companies that survive and prosper is small. Startup investments often experience unexpected problems in the areas of product development, manufacturing, marketing, financing, and general management, among others, which frequently cannot be solved. In addition, startups may require substantial amounts of financing, which may not be available through institutional private placements, the public markets or otherwise.

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Equity securities may fluctuate in response to news on companies, industries, market conditions, and general economic environment.

Yields are subject to change with economic conditions. Yield is only one factor that should be considered when making an investment decision.

Because of their narrow focus, **sector investments** tend to be more volatile than investments that diversify across many sectors and companies.

Asset allocation and diversification do not assure a profit or protect against loss in declining financial markets.

Rebalancing does not protect against a loss in declining financial markets. There may be a potential tax implication with a rebalancing strategy. Investors should consult with their tax advisor before implementing such a strategy.

IPO securities: Investment in initial public offerings (IPO) exposes the portfolio to additional risks associated with companies that have little operating history as public companies, as well as to the risks inherent in those sectors of the market where these new issuers operate.

Environmental, Social and Governance ("ESG") investments in a portfolio may experience performance that is lower or higher than a portfolio not employing such practices. Portfolios with ESG restrictions and strategies as well as ESG investments may not be able to take advantage of the same opportunities or market trends as portfolios where ESG criteria is not applied. There are inconsistent ESG definitions and criteria within the industry, as well as multiple ESG ratings providers that provide ESG ratings of the same subject companies and/or securities that vary among the providers. Certain issuers of investments may have differing and inconsistent views concerning ESG criteria where the ESG claims made in offering documents or other literature may overstate ESG impact. ESG designations are as of the date of this material, and no assurance is provided that the underlying assets have maintained or will maintain and such designation or any stated ESG compliance. As a result, it is difficult to compare ESG investment products or to evaluate an ESG investment product in comparison to one that does not focus on ESG. Investors should also independently consider whether the ESG investment product meets their own ESG objectives or criteria. There is no assurance that an ESG investing strategy or techniques employed will be successful. Past performance is not a guarantee or a dependable measure of future results.

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