

INVESTMENT STRATEGIES

The lure of private equity investing comes with these risks

By [Tobias Salinger](#) May 08, 2025, 3:39 p.m. EDT 7 Min Read



The returns of private equity investments will grab any investor's attention, but there are risks to consider before jumping into those vehicles, financial advisors and other experts warn.

Those include the high cost of PE funds, the illiquidity of the investment and the difficulty of performing due diligence without the level of data comparable to public equities. Investments tied to PE — a form of private financing for asset purchases that was first known as a leveraged buyout in the 1970s and '80s and memorialized by the classic business book "[Barbarians at the Gate](#): The Fall of RJR Nabisco" — have outperformed public equities for decades. But PE is a broad category that covers a range of alternative investment asset classes, each of which features specific caveats (and potentially impressive yields).

[Investor interest](#) in private markets has [grown in recent years](#), alongside the related but separate trend of PE firms buying up [wealth management companies](#) in a continuing acceleration [of the industry's consolidation](#).

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Pump the brakes

A pitch based on sophisticated strategies that aren't correlated to public stock prices "all sounds wonderful until you need some money," according to Kashif Ahmed, founder of Bedford, Massachusetts-based advisory firm [American Private Wealth](#). In times of high volatility, advisors and investors are likely to hear much more "fear-based selling" from managers who are "sensing blood in the water, and they're sharks," he noted. While Ahmed says there is "absolutely" a place for PE investments in some clients' portfolios, advisors and investors "have to go in there with your eyes peeled open," he said.

"Sometimes, because you pay more for something, it's very likely that you may be getting something worthy of that cost that's superior. You pay more for a Mercedes versus a Toyota, but you know what you're getting and you're willing to pay for it," Ahmed said. "You really should exhaust all of the low-cost, transparent and liquid options first."

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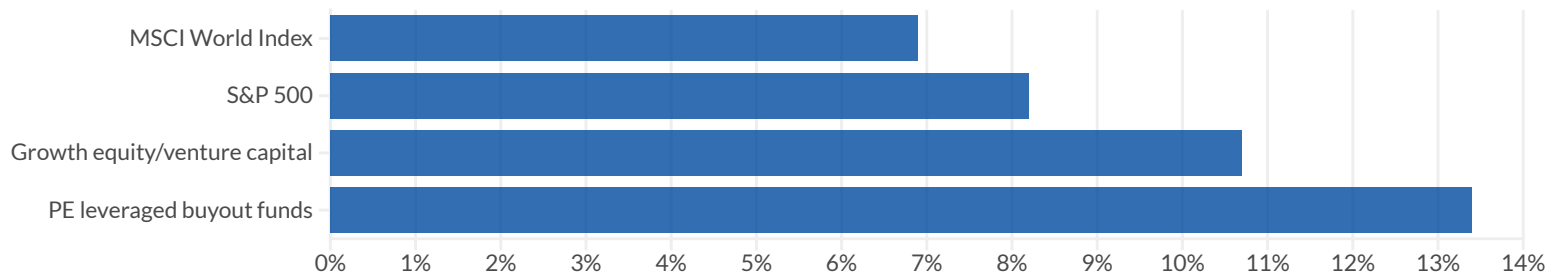
The considerations demand "looking operationally under the hood" of any particular manager and their investments, because "advisors have to be very, very clear on what exactly they're putting their clients' money into," said Toussaint Bailey, [the founder of impact-focused](#) private investing firm [Uplifting Capital](#).

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"Due diligence is a skill, and it takes time and expertise and money," he said. "You are trading something for the compensation that you're going to see in the form of returns."

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The 25-year yield of private equity funds, compared to other benchmarks



Source: [McKinsey & Company analysis of Bloomberg and MSCI data, using "internal rate of return" for PE funds, "Global Private Markets Report 2025," February 2025](#)

Check the numbers ... at least the available ones

And those returns' historical advantage over public markets hasn't actually held true in three of the past four years, which is "a stark contrast to the previous decade, during which [private equity] consistently outperformed public equities," [according to](#) consulting firm McKinsey & Company's latest annual report on private markets.

"In fact, even after excluding the so-called Magnificent Seven, the benchmark S&P 500 returned over 17% through the first and third quarters of 2024, outperforming all private equity sub-asset classes," the report said. "When analyzed over a longer period of 10 or 25 years, however, the buyout sub-asset class has historically outperformed public equities, which likely explains [limited partners'] continued support for the asset class (in addition to it providing LPs diversification opportunities)."

In general, PE has produced returns "well above those of the public equity market" for the past two dozen years, to the tune of about five percentage points annually over U.S. stocks during that span, [according to](#) a guide last month by Amy Arnott, a portfolio strategist for research, technology and asset management firm Morningstar. On the other hand, Arnott pointed out that "measuring returns for private equity is not straightforward," since the common metric of a vehicle's "internal rate of return" doesn't follow the same standards as the data for public vehicles. In addition, many funds carry big fees, have high minimum investments and "accredited" or "qualified" investor requirements and offer a "wide dispersion of returns for private equity versus their public counterparts," she wrote.

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Even the experts go back and forth

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faculty director of the Polsky Center for Entrepreneurship and Innovation; Savina Rizova, co-chief investment officer and the global head of research with [Dimensional Fund Advisors](#); and Robert Novy-Marx, a professor of business administration at the University of Rochester's [Simon Business School](#), engaged in a spirited discussion about the merits of PE and other private investments. They all agreed that the assets can provide diversification to certain portfolios.

Sometimes, the disadvantages of PE may even prove beneficial, according to Kaplan, who brought up the example of stock sell-offs during the financial crisis of 2008 and the pandemic in March 2020 that locked those investors out of subsequent bull market gains.

"Liquidity is a two-edged sword. And what do I mean by that? You know, they view illiquidity as bad. Now, for some people, illiquidity is good," Kaplan said.

"With private equity, you were stuck, and that was a good thing. So, for some people, particularly individuals, there's, I think, an illiquidity advantage, rather than a disadvantage, for some of their assets."

He and the other panelists also called out the potential impact of the high fees that render the returns much lower in context.

"There are people who want to get into these assets, but there are opportunities for people to make things available that weren't available and to market them, and often at high fees," Novy-Marx said. "The importance of fees in these things cannot be understated. I do have skepticism about some of the vehicles that are being marketed to people who shouldn't obviously be using them and the costs they will pay for them."

In addition to the fees, PE displays "a lot of dispersion between the top and bottom quartiles," Rizova said.

"There is a lot of due diligence that people would have to do in general across different private asset classes," she said. "The things you should be looking at are not just the exclusive fees, but also all the additional fees that are going to be charged to a fund or a portfolio, affiliate transactions, conflicts of interest, allocation policy in detail across different funds that few firms have, capacity, as well as the buy-hold-sell decision process for what is in the portfolio and what can be in the portfolio. So a lot of details under the hood to assess it, and there is even more when it comes to a specific asset class within private."

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Portfolio fit over product pitch

All of the complicating factors mean that most clients working with an advisor likely haven't run through all of the other options besides PE, according to Ahmed. And the high barriers to entry should provoke some accompanying suspicion for the PE sales pitches, he said.

"You have to question, why are they coming downstream, why are they dangling this in front of financial advisors and investors?" Ahmed said. "If you truly, truly have something great, most people tend to keep it to themselves."

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Toussaint Bailey is the founder of impact-focused private investing firm Uplifting Capital. *Uplifting Capital*

The potential returns of PE are high, but they bring risks alongside the opportunities, Bailey noted. His company embodies the wide universe of available strategies, given that [Uplifting deploys capital](#) with "an eye toward our investment return being driven by things that are good for people and the planet," he noted. However, Uplifting has focused on being "a portfolio allocation and construction exercise" rather than a product sale, and what fits a client with a net worth of \$5 million or above won't always work well for the mass market, he said.

"There's this hurdle about what's available and what can be done," Bailey said. "We have a ways to go before we are able to truly duplicate the experience of institutional investors in retail portfolios. But there are certainly a lot of people trying."

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