July 2025

"In economics, things take longer to happen than you think they will, and then they happen faster than you thought they could." - Roger Dornbusch

From Friday's WSJ:

Stocks Fall as Tariffs, Concerns On Economy Offset Tech Gains

BY SAM GOLDFARB

Rising anxiety about the economic outlook weighed on stock indexes, offsetting big gains for two large tech companies.

Meta Platforms shares soared 11%, while **Microsoft** jumped 4% after both companies reported strong earnings late Wednesday. The results showed off the robustness of their existing businesses as they spend huge sums building out artificial intelligence capabilities.

Buoyed by those gains, major indexes climbed early in the session, only to stumble later on, with even the tech-heavy Nasdaq Composite Index finishing down less than 0.1%.

The S&P 500 slipped 0.4%, while the Dow Jones Industrial Average slid 0.7%.

It was the third straight day of declines for the S&P 500, which ended the month up 2.2%, and the fourth straight drop for the Dow, which rose less than 0.1% in July.

Investors cited concerns about tariffs for the market's reversal. The White House has announced a flurry of trade deals in recent days. President Trump said on

Thursday that he would give Mexico more time to reach an agreement, extending existing tariffs for 90 days. Higher tariffs, though, were poised to kick in for many other countries, including Canada, on Friday at the close.

The impact of existing tariffs, meanwhile, finally seems to be showing up in economic data, pushing up inflation and slowing consumer spending.

A report released Thursday showed core goods prices rising 3.7% on a three-month annualized basis in the Federal Reserve's preferred data series, the highest in almost three years. That came after data on Wednesday showed a measure of domestic private-sector spending cooled meaningfully in April to June.

Interest-rate futures indicated that traders see a 39% chance of a rate cut in September—down from 65% on Tuesday, according to CME Group.

From Global Investment Strategy on Monday:

Peter Berezin's Thoughts Of The Day: Moar Dealz

Thank You Sir, May I Have Another

You have to hand it to Trump. If you had told me at the start of the year that the US effective tariff rate would be around 17% and that most countries would NOT retaliate, I would have said you were crazy.

Yet, that is more or less what has happened (**Chart 1**). Apparently, most countries have decided that rather than poking the bear, they are better off waiting for him to leave office (and perhaps even earlier if Congress or the courts strip him of his ability to unilaterally impose tariffs).

If you have Trump's zero-sum view of trade, this seemingly lopsided victory is unambiguously positive for the US.

I am more circumspect because trade is a positive-sum game where all sides gain from freer access to one another's markets.

Not Out of the Woods

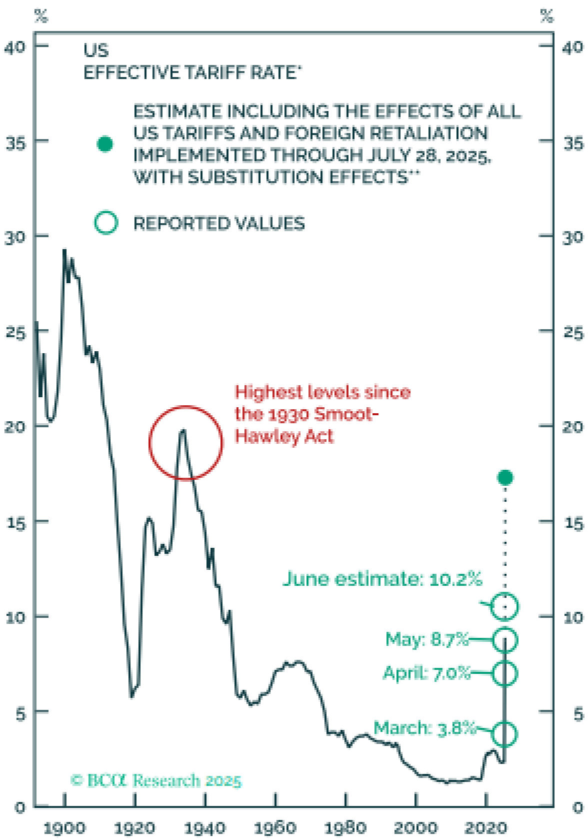
Stocks have rallied since mid-April as the risks of a tit-for-tat trade war have faded, but the US economy is still in a very precarious place. We will get more clarity when the BEA reports preliminary estimates for Q2 GDP on Wednesday (+3%), but right now, it looks as though GDP growth averaged just 1% (1.2%) in the first half of the year.

Despite bouncing back in June, real retail sales were 0.5% lower on a seasonally adjusted basis than in December 2024. Revolving credit growth is slowing, with credit card and auto loan delinquency rates not that far off their GFC highs.

Real income growth is decelerating on the back of weaker

CHART 1

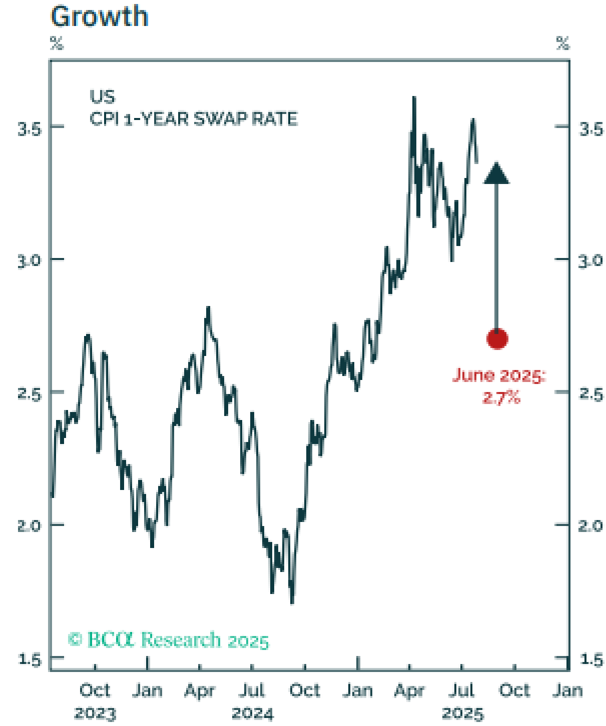
Following The EU Deal, The Effective Tariff Rate Stands At About 17%



* DUTIES COLLECTED AS A PERCENT OF IMPORTS. CALCULATED USING 12-MONTH MOVING TOTALS UNTIL JANUARY 2025, AFTER WHICH THE DATA IS UNSMOOTHED.
SOURCE: US INTERNATIONAL TRADE COMMISSION AND CENSUS BUREAU.
** SOURCE: "STATE OF U.S. TARIFFS: JULY 28, 2025," THE BUDGET LAB AT YALE, JULY 28, 2025

CHART 4

The CPI Swap Market Expects Inflation To Rise, Negatively Impacting Real Income Growth



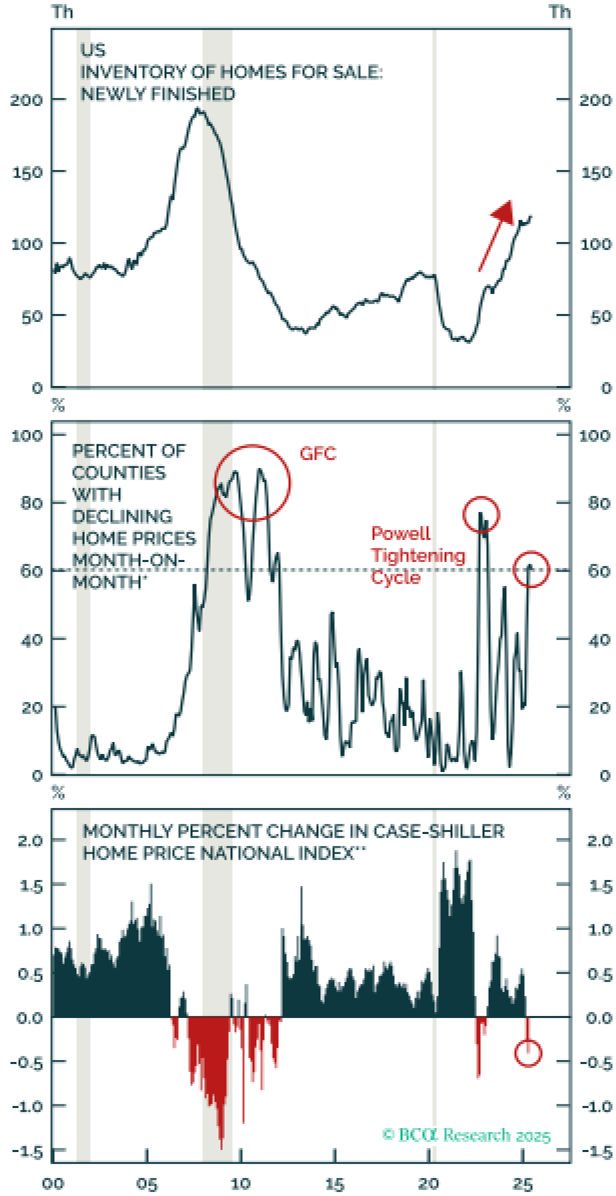
SOURCE: BLOOMBERG FINANCE L.P.

private-sector employment gains and flagging wage growth. The CPI swap market expects inflation to rise to 3.4% by the middle of 2026 **(Chart 4)**. If that happens, real income growth will slow further, putting downward pressure on consumption.

Even though the markets are pricing in 104 basis points of rate cuts over the next 12 months, long-term bond yields and mortgage rates remain stubbornly high. Residential investment fell in Q1 and is almost certain to have fallen in Q2. New home inventories are back to 2009 levels **(Chart 6)**. According to Zillow, home prices declined in more than 60% of US counties over the past three months.

CHART 6

Ominous Signs For Residential Investment



* SOURCE: ZILLOW.
** SERIES IS TRUNCATED AT -1.5%. SOURCE: S&P GLOBAL.
NOTE: SHADED AREAS DENOTE NBER-DESIGNATED RECESSIONS.

AI Capex: A Reality Check

The one part of the economy that is booming is AI investment. On a trailing 12-month basis, capex among the largest publicly listed hyperscalers (Microsoft, Google, Meta, Amazon, and Oracle) has reached $295 billion, equivalent to almost 1% of GDP. This number would be even larger if one included capex among the smaller players and privately held firms such as OpenAI, Anthropic, and xAI.

Unfortunately, there is less to this capex than meets the eye. Much of it represents spending on Nvidia chips and other semiconductor equipment, most of which is not produced in the US. If one looks at data center construction specifically, it only accounted for 0.1% of GDP in the 12 months to May.

Strikingly, overall manufacturing construction has been shrinking since last November. Capex intentions – which tend to correlate with nonresidential business investment and capital goods orders – remain downbeat.

It is possible that capex will pick up if more firms bring back manufacturing production to the US in order to avoid tariffs. Realistically, however, most firms will be reluctant to build new plants unless there is some certainty that the tariffs will stay in place beyond Trump's tenure in office. Such certainty is not forthcoming.

One is reminded of Foxconn's pledge in 2017 to invest $10 billion, and create 13,000 jobs, in a state-of-the-art facility in Wisconsin. President Trump, shovel in hand, attended the groundbreaking ceremony. Seven years later, little has been achieved.

The OBBBA Will Help

The bonus depreciation allowance in the OBBBA should incentivize some additional capital spending. Studies suggest that a similar provision in the 2017 Tax Cuts and Jobs Act had a meaningful impact on investment.

It is doubtful that the OBBBA will offset the drag from higher tariffs, but in tandem with the recent easing in financial conditions, it could keep the US economy afloat for a while longer.

With that in mind, we are moving to a somewhat more agnostic view on our US recession call. While we still think the odds are above 50% that the US economy will succumb to a recession over the next 12 months, in keeping with the title of our recent webcast, we are waiting for the "whites of the recession's eyes" before moving to a fully defensive stance. …

Two from WSJ's Markets A.M., the first on Jul. 28th:

That 70s Show? Stocks Could See a Rerun

By Spencer Jakab

Gas lines, Watergate and—ugh—disco.

The indignities of the 1970s even extended to the stock market. Returns were sapped by the longest and worst stretch of inflation in American history.

The decade saw one of the classic contrarian magazine covers of all time: Business Week's "The Death of Equities" in 1979. The good news—sort of—is that the 1970s weren't as bad as our memories would have us believe.

The bad news: High stock valuations and the possible erosion of Federal Reserve independence could be setting markets up for similarly lousy times.

Middle-aged or older U.S. investors have endured worse real returns than the 1970s without anyone saying the stock market was dead. Although the 10 years beginning in bubbly 2000 didn't see rapid rises in consumer prices, they still ended with a whimper. A $10,000 investment in the S&P 500 at the start of the decade would have been worth just $7,081 by the end of 2009 after including dividends and inflation.

Compare that with 1973 when inflation was about to kick into high gear and the air came out of the Nifty Fifty stock bubble. The real (or inflation-adjusted) ending value of $10,000 by the end of 1982: a not-as-bad $8,327.

How? Consumer prices rose quickly during the 1970s, and there were three recessions between 1973 and 1982, but stock valuations were less frothy. The S&P 500's cyclically adjusted price-to-earnings ratio was 18 times in 1973. That more-reliable P/E measure encompasses 10 years so it reflects at least one complete business cycle.

By the peak of the tech bubble, the adjusted P/E ratio was at an all-time high of 44 times, and the S&P 500's dividend yield was near an all-time low around 1.2%.

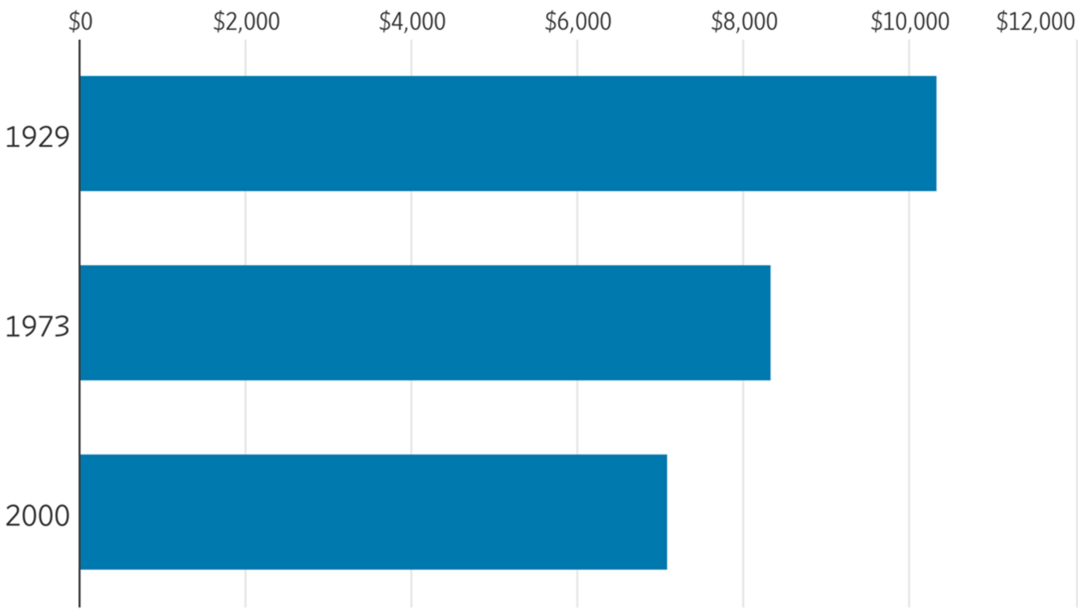
More surprising: Stocks also did better during the Great Depression than during the aughts. They were very expensive at the 1929 peak, but not as much as during the tech bubble. Their real return also was boosted by deflation during the 1930s and dividend yields that were much higher than any seen this century. A $10,000 investment at the start of 1929 actually grew a little to $10,323 in inflation-adjusted dollars 10 years later.

While inflation might stay tame today in the face of tariffs and Fed uncertainty, valuation is a cause for concern: The cyclically adjusted P/E ratio just topped 38 times and stocks' dividend yield is a mere 1.2%.

Does that necessarily foretell 1970s-like returns? No: Investors might still be willing to pay today's historically lofty multiple for U.S. stocks in 2034, or at least something a lot higher than after the supposed "death of equities." And some economic force like AI could help earnings grow much faster than expected.

Break out those leisure suits just in case, though.

Value of $10,000 invested in S&P 500 a decade later, adjusted for inflation



Source: Prof. Aswath Damodaran

on July 25th:

Stocks Head for a Meme Reversion

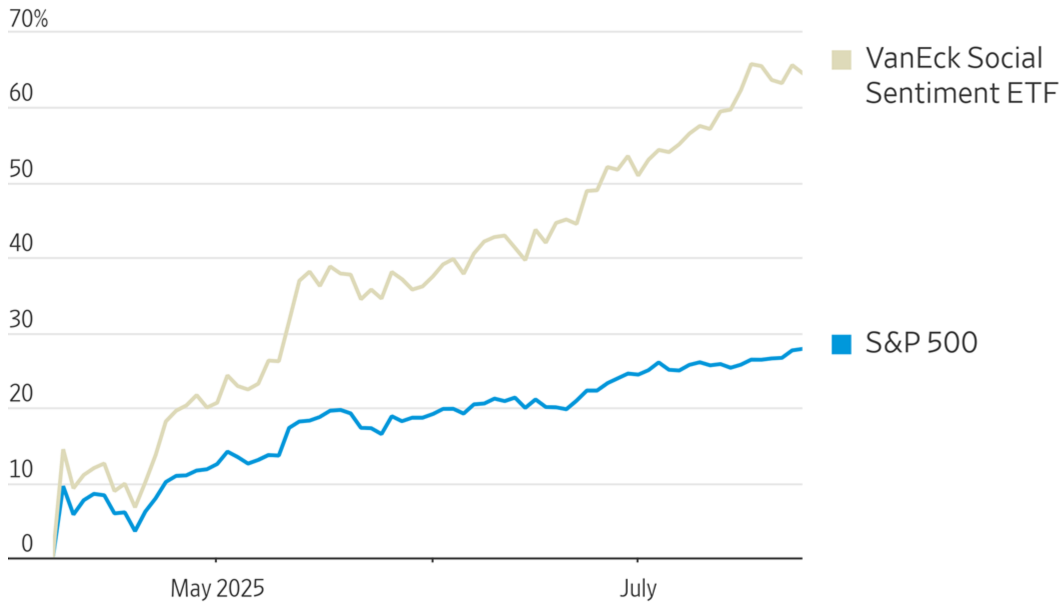
By Spencer Jakab

Dorks are hot stuff on Wall Street.

No, not socially awkward quants making big bucks at hedge funds: "DORK," like "FANMAG" before it, is an acronym for the latest U.S. stocks making waves. It stands for the first letter in the ticker symbols of Krispy Kreme (D), OpenDoor (O), Rocket Cos. (R) and Kohl's (K).

They're much smaller and less promising than Netflix or Amazon, which is what's notable about the wild ride they went on this week. Like GameStop and AMC four-and-a-half years ago, and Bed Bath &

Price since April 8 low



Source: FactSet

Beyond more recently, they're companies shunned by Wall Streeters who can read balance sheets but bought aggressively by individuals who mostly read Reddit posts.

Dork's transformation into so-called meme stocks signals the return of reckless overconfidence, and maybe a last hurrah for this rally.

A refresher on meme stocks: Coordinated buying occurs via social-media, enhanced by call-options bets that act as a force multiplier. Those bets mean options dealers have to buy the stocks too for routine hedging. As the stocks rise, that puts pressure on short-selling hedge funds that borrowed the shares to bet against them. They're forced to quickly repurchase them at a loss—a formula for brief, self-fulfilling rallies.

Dork's results haven't been as spectacular as GameStop, but the storyline is similar: scrappy individuals running circles around pros. It's a fairy tale. Wall Street loves retail frenzies, except for the odd hedge fund that blows up.

Why should more buttoned-down investors care? It's a sign of the times.

"Meme-ing only happens at extremes in sentiment," says social-confidence consultant Peter Atwater, who teaches economics at the College of William and Mary.

Like the original meme craze, speculators have been primed for fearlessness. The Covid bear market in 2020 broke a record by being the shortest ever. Buying the dip, and doing so with the raciest stocks, paid off handsomely for a while.

Stocks' bounce from the Liberation Day wipeout has been similar. Goldman Sachs reported Thursday that its new Speculative Trading Indicator is at its highest since the dot-com bubble and the post-Covid bounce of 2020-2021. An ETF that tracks the 75 stocks with the most social-media mentions, ticker BUZZ, is up by two-thirds since the April low.

Meanwhile, Wall Street's unofficial "fear gauge," the Cboe Volatility Index, or VIX, fell below 15 on Thursday—its lowest in five months. It topped 60 in early April, the highest since the pandemic.

What comes next? Goldman's research says exuberant times can get more extreme for a while. Over a 35-year horizon, sharp rises in speculative trading have preceded above-average three-, six- and 12-month returns for the S&P 500, after which the market has faltered.

The return of meme stocks might fit that timeline again, but it's a warning to edge closer to the exits before the music stops.

Follow-ups

Two from WSJ:

Wall Street's Big, Bad Idea for Your 401(k)

Recent moves by some alternative funds highlight the flaws of offering private assets to public investors

By Jason Zweig
July 25, 2025

Wall Street is promoting a colossal lie.

Money managers are in a desperate race to stuff illiquid, so-called private-market assets into funds anyone can buy, including your 401(k). They say we all can earn high return and low risk with nontraded "alternatives" like private equity, venture capital and private real estate.

A close look at pending moves at two funds reveals how bogus this argument is—and why investors should just say no to this juggernaut of alternative assets.

Bluerock Total Income+ Real Estate Fund is a portfolio with $3.7 billion in net assets that doesn't trade publicly. In early September, its shareholders will vote on the fund's proposal to list its shares on the New York Stock Exchange. Another non-listed portfolio, Priority Income Fund, with total assets of roughly $980 million, is also seeking to go public in the coming months.

Bluerock Total Income+ Real Estate is an "interval fund." This is a structure that generally allows investors to buy as many shares as they wish at any time—but only to sell limited amounts at predetermined intervals, typically 5% of shares per quarter.

Priority Income is a "tender-offer fund," which may—but doesn't have to—redeem up to 2.5% per quarter.

The idea—in some ways a laudable one—is to encourage investors to stay put for long periods, rather than fleeing at the worst possible time. In principle, the managers of interval funds can buy illiquid assets without being forced to sell into a downturn when investors want their money back.

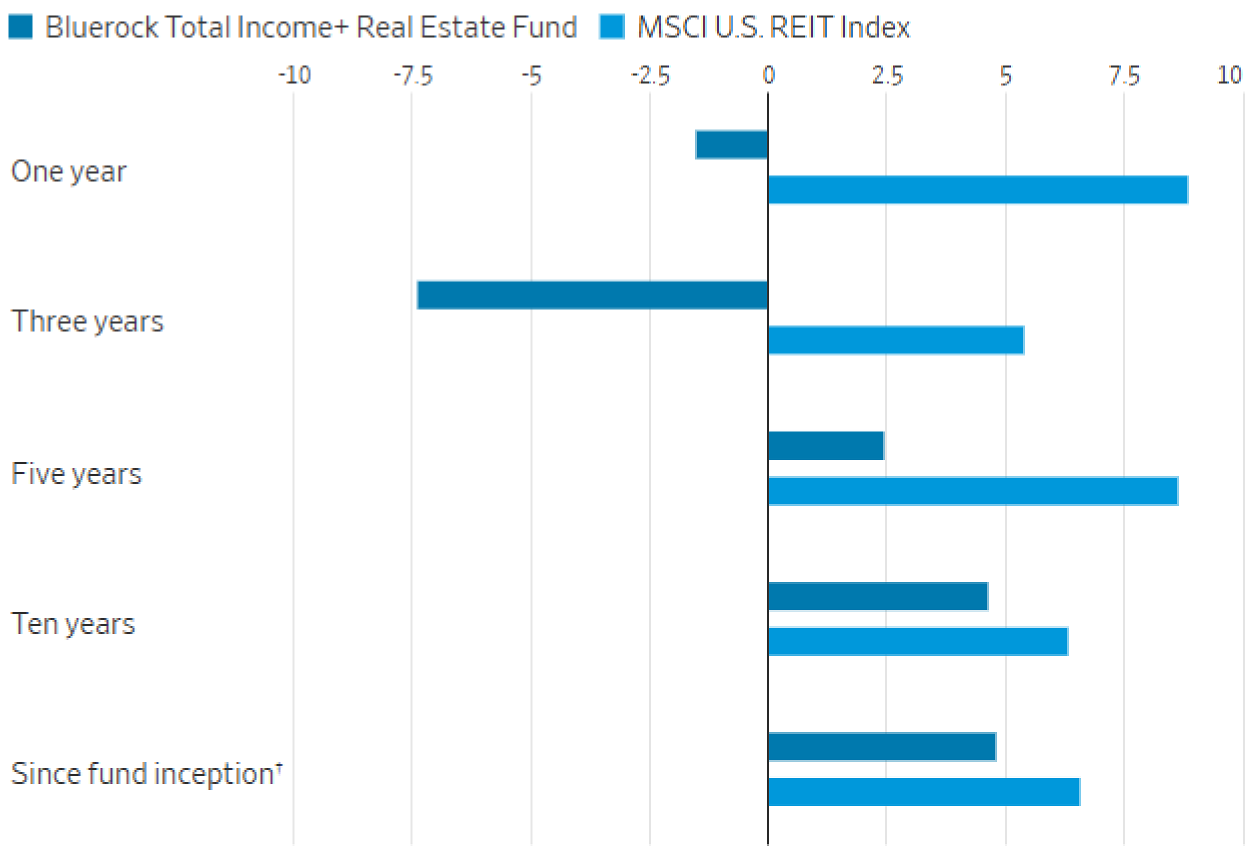
Because private assets don't trade, it's the fund managers—not the market—that determine what they're worth. That enables the managers to report much fewer and lower fluctuations than public funds do. Then they get to declare that private funds are low risk.

That's ridiculous. In the real world, risk is the chance of losing money, which has nothing to do with how often prices are reported. Cliff Asness, co-founder of AQR Capital Management, calls the smooth returns reported by alternative funds “volatility laundering.”

The Bluerock fund, launched in 2012 to invest in private real estate with borrowed money, had years of excellent performance. Then it got hammered after the Federal Reserve raised interest rates sharply in 2022.

Priority Income Fund, which invests in private corporate loans, pays out a high yield at a rate of more than 17%. Its total return, which includes that income and any changes in value, is a different story. The fund lost 19.6% in the first five months of 2025 and 25.1% in the 12 months ended May 31.

Returns for index and fund, select periods*



*Ending June 30, 2025. †Inception date, Apr. 1, 2014. Note: Fund returns for Class I shares
Sources: Bluerock (fund); FactSet (index)

“A direct listing is the right next step to help build upon a solid foundation,” says a spokesman for Priority Income, “as the fund continues to offer consistent and attractive income to shareholders.”

Why does all this matter?

Owning an alternative fund is a lot simpler than selling it. When you own it, you might take the manager’s valuations for granted, even if that’s a bad idea. When you sell it, the valuation matters—a lot. That’s a risk.

Until now, investors have been able to sell their shares back to each of these two funds at “net asset value,” or what the manager claims they’re worth. Even if other investors might disagree with some of those valuations, the manager has stood behind them.

That works until the number of people looking to sell swells and the managers can't raise money because they are holding illiquid or distressed assets.

The answer for these two funds, and for the alternative-asset industry writ large, is to move assets to public markets. There, the price will be set by what *other* investors—not the managers—believe the assets are worth. If that's less than NAV, that's mainly a problem for investors in the fund, not the managers.

"The industry's big selling point has been that you can sleep well at night because your portfolio is marked to NAV," says Leyla Kunimoto, a private investor who blogs about alternative funds at AccreditedInsight.com.

Most of the Bluerock fund's holdings are stakes in other private real-estate portfolios. If it lists and ends up trading at a discount to net asset value, that might signal that the public market doesn't believe the private valuations on dozens of these funds.

No wonder the potential conversion is "being watched very closely" by other alternative funds, says Kunimoto.

Like most such managers, Bluerock marketed its fund partly on the grounds that limited liquidity would insulate investors from volatility.

In a public Q&A document prepared for shareholders, however, Bluerock now says the fund's obligation to cash out at least 5% of shares quarterly at NAV is "creating a 'liquidity mismatch,' " that prevents it from maximizing returns.

"You're telling the people who bought in that it's the structure's fault?" says John Cox, founder of Cox Capital Partners, a firm in Philadelphia that buys illiquid funds. "It's like victim-blaming."

Ramin Kamfar, Bluerock's chief executive, says some of the fund's underlying holdings have restricted redemptions for 12 quarters in a row, preventing Bluerock from raising cash by selling assets.

"No interval fund, whether it holds private equity, real estate or other assets, is designed to provide liquidity under this kind of pressure," says Kamfar. "At some point the ability of the structure to withstand this kind of redemption pressure gets exhausted, notwithstanding the quality of the assets you hold."

In short, an alternative fund can claim to be low risk and to be at least partly liquid—but, sooner or later, it won't be able to sustain both claims at once. That's true here, and for all the other funds hoping to rope in a much wider base of everyday investors.

Remember that as politicians ease the way for alternative funds to land in your retirement plan.

The Stock Market Bargain That's Right Under Your Nose

Big tech stocks have dominated, but one part of the market is too cheap to pass up

By Jason Zweig
July 18, 2025

Will small stocks stink forever?

Little companies are supposed to earn higher returns over time than big ones, but that hasn't been the case for more than a decade. Since the beginning of 2014, the S&P 500 has grown at an average of 13.2% annually; the Russell 2000 index of small stocks has gained just 7.2%.

Many people seem to be throwing in the towel. So far this year, investors have pulled $12 billion out of exchange-traded funds investing in small U.S. stocks, according to FactSet. Meanwhile, investors added $149.6 billion to ETFs that track large U.S. companies.

Money always chases performance, and big stocks have all the momentum—burnished by the artificial-intelligence boom. But what if AI turns out to be a bust, it fails to meet expectations or the biggest stocks end up stagnating? Then investors who didn't give up on smaller stocks will be rewarded.

Let's start by reviewing just how far small stocks have fallen out of favor.

The market value of the five biggest companies in the S&P 500 is nearly five times the combined market value of the Russell 2000 index, according to Steven DeSanctis, an equity strategist at Jefferies. In fact, Nvidia alone—at its recent market value of $4.22 trillion—is 65% more valuable than all the stocks in the Russell 2000 combined.

The 6.6% annualized total return on small stocks over the past 10 years trails large-company performance by 7.3 percentage points, says DeSanctis. (All figures include dividends.)

That's the widest gap going back to 1935.

Much of that underperformance comes from underexposure to this market's hottest sector. Technology firms constitute nearly 34% of the total capitalization of the S&P 500. In the Russell 2000 and the S&P SmallCap 600, another widely followed index, tech companies make up less than 13% of total value. Financial stocks are the biggest sector in both those benchmarks, at about 19%.

With investors going ga-ga for anything that even seems related to tech and AI, little stocks have been left in the lurch.

The tech-dominated titans in the MSCI USA Mega Cap Select Index are trading at an average of 30.4 times net profits and nearly eight times net worth. The Russell 2000 trades at 18.3 times earnings and two times net worth.

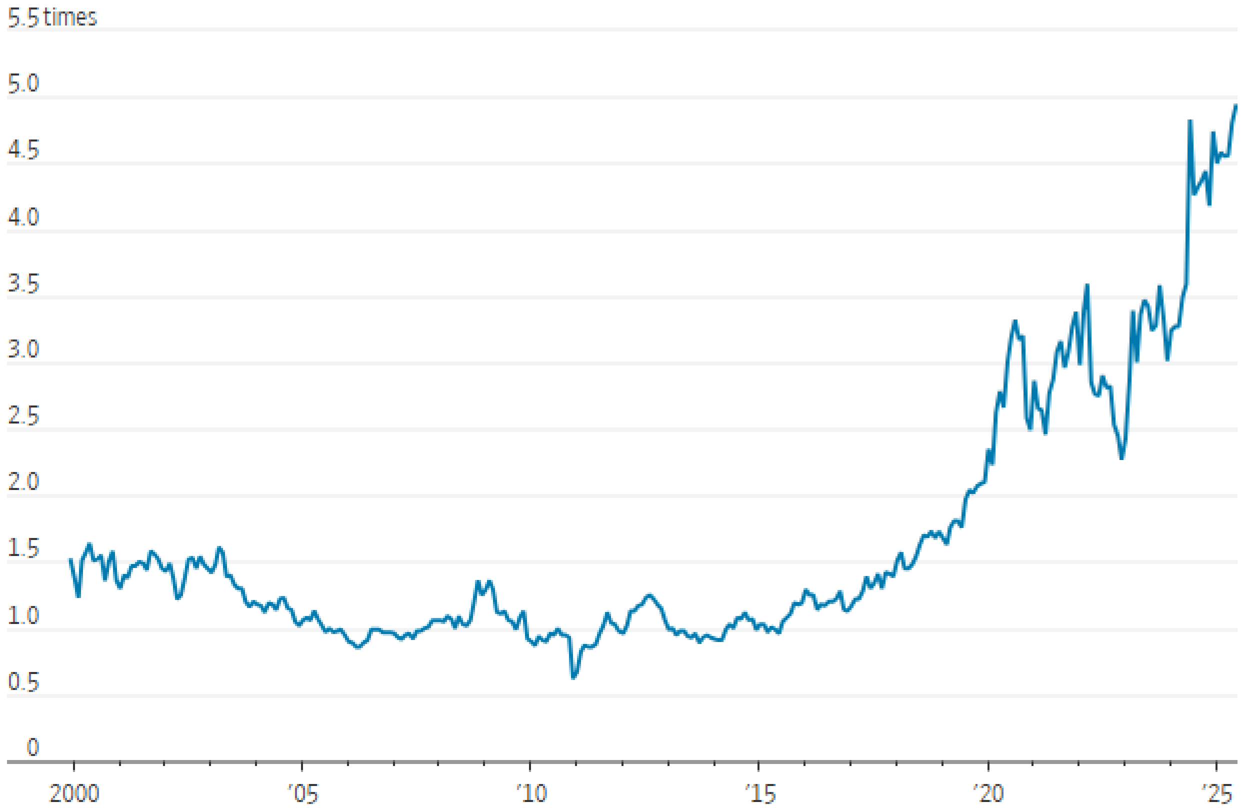
Big tech companies "have a lot of speculation built into them, so there's not a lot of room for error," says Christine Wang, a portfolio manager at Bridgeway Capital Management in Houston.

"They would be severely punished for not meeting expectations."

Smaller stocks, on the other hand, have gotten so cheap relative to the market's giants that "even if you fall from here," says Wang, "you're only falling out of a one-story house now."

Thomas Cole, co-founder of Distillate Capital Partners in Chicago, points out a key difference between this technology boom and the last one, in the late 1990s. "This time, investors are putting extraordinary premiums on established businesses" rather than only on new ventures. Meeting expectations "becomes a much taller order," he says, when companies are already huge.

Ratio of the market value of the five biggest stocks to all small stocks combined



Note: Market value of the five largest stocks in the S&P 500 relative to the total market value of the Russell 2000 index
Source: Jefferies

It's worth remembering, too, that most of the beneficiaries of the internet boom weren't the online providers but rather the consumers: manufacturers, healthcare, service and materials companies that used the emerging technology to streamline their own operations. If the AI boom unfolds the same way, smaller companies could get a bigger boost than the giants.

History suggests that if the market's biggest companies do stumble, the little guys might do reasonably well.

From 2000 through 2002, in the bear market that followed the collapse of the internet boom, the S&P 500 lost 37.6%. The Russell 2000 fell much less, losing 21%, while the S&P SmallCap 600 even squeaked out a 1.7% cumulative gain.

In 2008, the worst year of the global financial crisis, the S&P 500 fell 37%. The Russell and S&P small-stock indexes lost 34% and 31%, respectively.

What's more, if the trade war ends up hurting the international sales of U.S. businesses, small stocks should suffer less. They derive an average of 20% of their revenues from overseas, substantially below the 28% average for the S&P 500, according to Goldman Sachs.

Professional investors love to cite data showing that from 1926 to the present, little stocks outperformed large by an average of roughly 2 percentage points annually.

That's a huge margin, but it's probably overstated. In decades past, brokerage costs were much higher on smaller stocks, and the tiniest companies traded so infrequently that a single buy order could send their prices soaring.

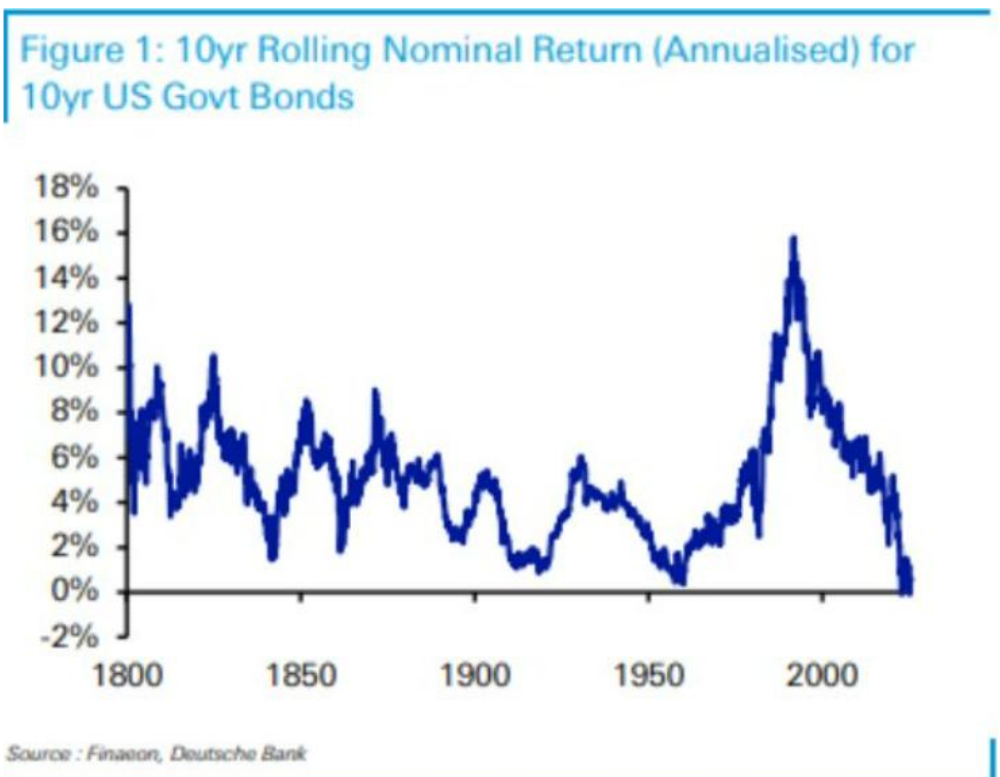
What we can be sure of is that small stocks are cheap relative to the market's much more popular giants. No one can say when that might change, but you don't want to miss it when it does. …

From A Wealth of Common Sense:

Is This the Worst Decade Ever For Bonds?

Posted July 13, 2025 by Ben Carlson

Deutsche Bank has a chart that shows we're looking at the worst 10 year period *ever* for U.S. government bonds:



That doesn't seem good.

Being a market returns geek I decided to take this a step further by looking at the returns by decade for various maturities in government bonds to see how the 2020s stack up historically.

Here's the data for 5 year, 10 year and long-term (20+ years) U.S. Treasuries by decade going back to the 1930s:

Bond Market Returns by Decade

Decade	5 Year Treasuries	10 Year Treasuries	Long-Term Treasuries
1930s	4.6%	4.0%	4.9%
1940s	1.8%	2.5%	3.2%
1950s	1.3%	0.8%	-0.1%
1960s	3.5%	2.4%	1.4%
1970s	7.0%	5.4%	5.5%
1980s	11.9%	12.0%	12.6%
1990s	7.2%	7.4%	8.8%
2000s	6.2%	6.3%	7.7%
2010s	3.2%	4.1%	6.6%
2020s	0.4%	-1.2%	-4.4%

Source: Returns 2.0 / Ycharts

A little more than halfway through the 2020s we're on pace for the worst decade in modern economic times.

Not great.

Going from generationally low bond yields to 9% inflation and a massive spike in rates in a short period of time didn't help.

But it's actually worse than it appears.

These are nominal returns. The biggest risk for bonds is inflation because they pay you a fixed amount of income over time. You need to look at the inflation-adjusted returns to really understand how things compare over time.

These are the real returns:

Bond Market Real Returns by Decade

Decade	5 Year Treasuries	10 Year Treasuries	Long-Term Treasuries
1930s	6.6%	6.0%	6.9%
1940s	-3.5%	-2.9%	-2.1%
1950s	-0.9%	-1.4%	-2.3%
1960s	1.0%	-0.1%	-1.1%
1970s	-0.4%	-1.9%	-1.8%
1980s	6.8%	6.9%	7.5%
1990s	4.3%	4.4%	5.9%
2000s	3.6%	3.7%	5.2%
2010s	1.4%	2.4%	4.9%
2020s	-3.5%	-5.1%	-8.3%

Source: Returns 2.0 / Ycharts

A lot of the green from the nominal chart turns red on a real basis.

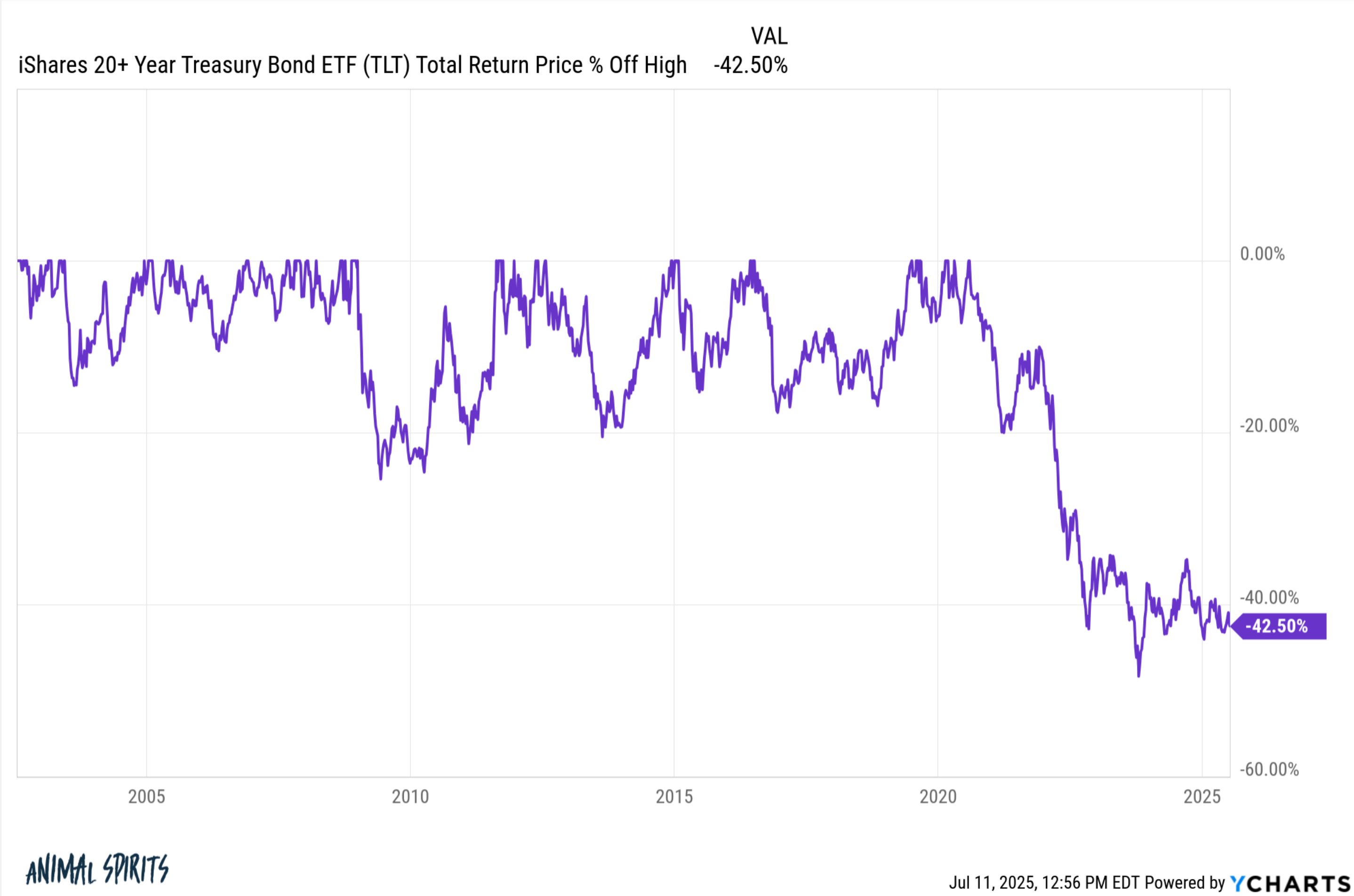
The most glaring example is the 1970s where you had pretty good nominal returns because yields were relatively high but awful real returns because inflation was so high (which is why rates were high in the first place).

In fact, real returns were negative from basically World War II all the way through the inflationary 1970s as rates and inflation wreaked havoc on fixed income investors.

The 2020s look bad on a nominal *and* real basis. This really is the worst decade (so far) ever for government bonds.

How bad is it Ben?!

Long-term Treasuries are still in the midst of a 40% drawdown even after accounting for the income paid out:



They've been in a 40% drawdown since 2022!

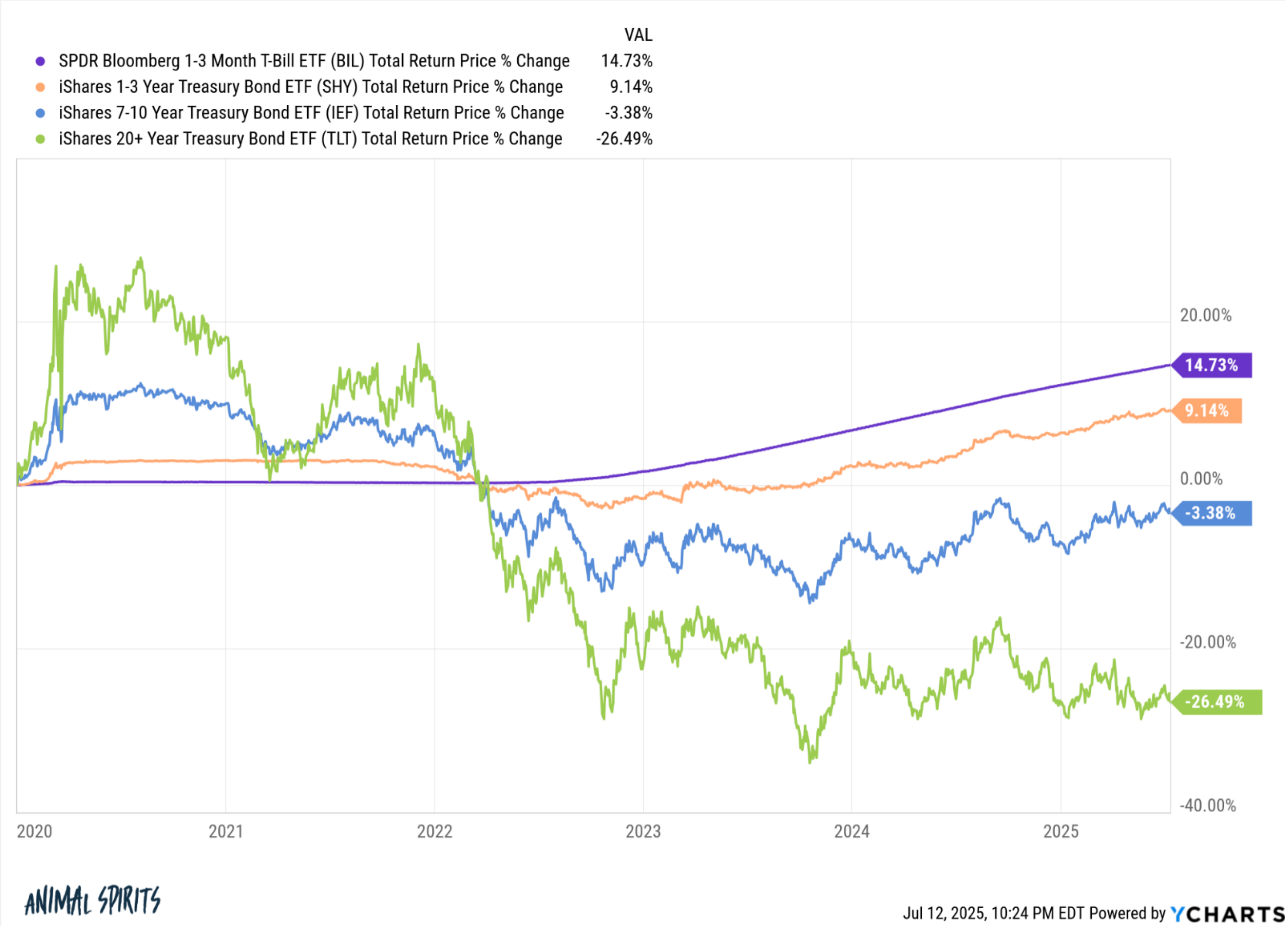
Why aren't more investors freaking out about this?

Can you imagine if the stock market got cut in half and failed to make any serious progress for three years? It would be a daily story in the financial press. Investors would be losing their minds. It would be a full-fledged crisis.

You don't ever really hear anything about carnage in the bond market.

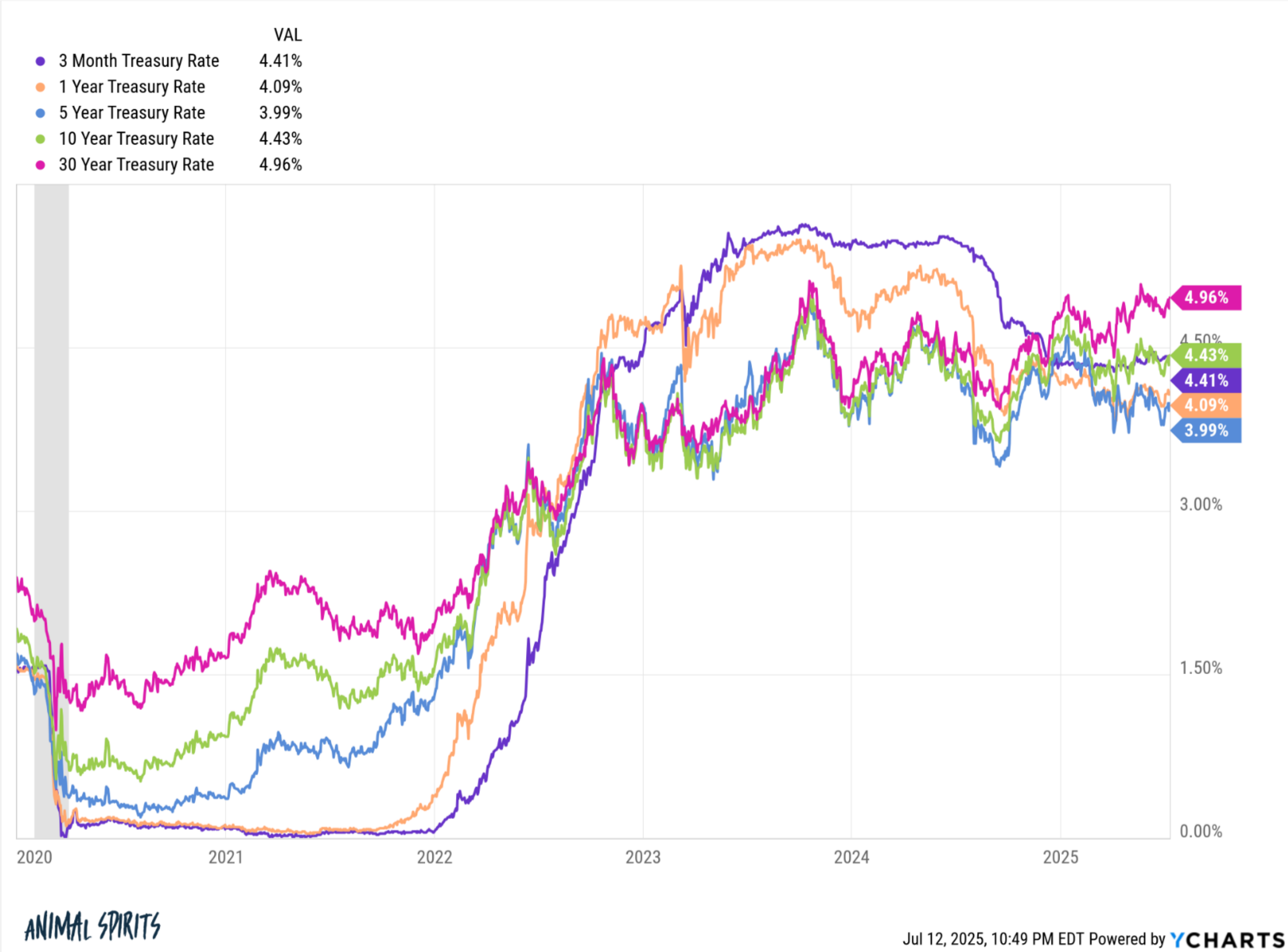
I suppose this is partly because of the way bonds are structured. You can hold to maturity and be made whole (on a nominal basis).

There were also perfectly good alternatives for those who didn't want to accept duration risk from longer-term bonds when yields were on the floor:



Short-term Treasuries and T-bills have been a no-brainer alternative with higher yields and far less volatility.[1]

Another reason bond investors aren't freaking out is because yields are much higher now than they were when this whole mess began back in the pandemic:



Bonds aren't a screaming buy by any means but yields in the 4% to 5% range are much better than they were throughout most of the 2010s and early-2020s.

The first half of this decade showed some of the worst returns we've ever seen in bonds. Now that we've lived through that unpleasant period, expected returns are higher.

Sure, rates could continue their ascent and inflation could come roaring back. That would ding bonds again.

But starting yields are now much better than they were in 2020 so the remainder of the decade should see much better returns from here.[2]

[1]Plus, most investors in long-term Treasuries are pensions, insurance companies and yield speculators.

[2]Let's say annual returns for the 10 year are 4.5% for the remainder of the decade, which is close to the current yield. In that case the entirety of the 2020s would be an annual return of around 1% per year.

From Verdad:

When Private Funds Are Publicly Traded

Evaluating the performance of listed private equity funds on the LSE

By Daniel Rasmussen with Julia Grinstead

Private equity funds exhibit average annual volatilities around 10%, significantly below public equity markets.

Private equity boosters love this statistic. “Private equity (PE) seems to contradict the investment maxim that greater reward only comes with increased risk,” argue State Street Global Advisors. “On an observed basis, private equity has higher returns and lower volatility than public equities.”

But a growing chorus of critics argues that the asset class’s volatility numbers are understated and the industry is guilty of — to quote Cliff Asness — “volatility laundering.” Researchers at AQR estimated that PE could have a true volatility of 20-25%.

The debate between the two camps is heavy on theoretical questions about “de-smoothing” and public market equivalents, and it can be hard to know empirically who is right.

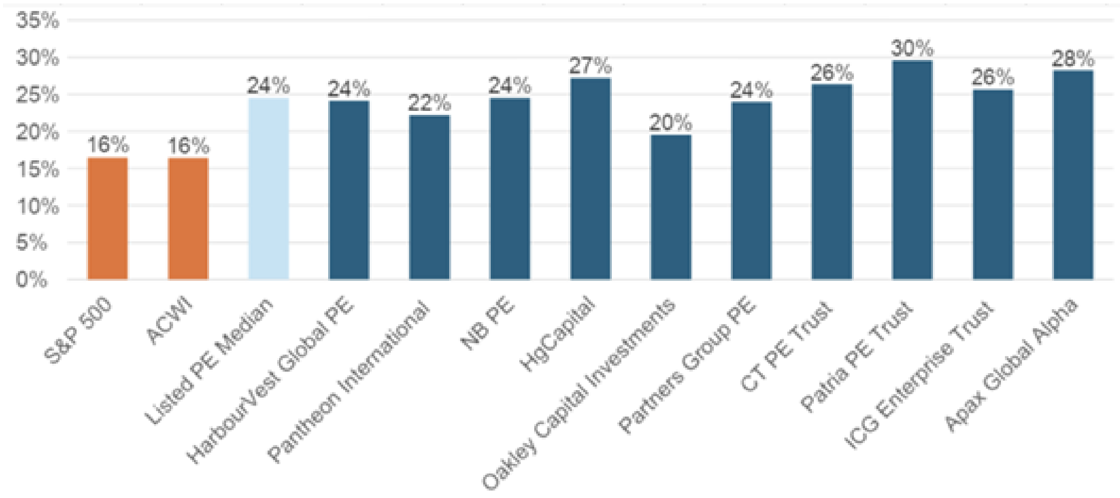
We believe that there is a clear way to resolve this debate. Since 1987, private equity funds have been publicly listed and traded on the LSE. These funds publish an internally calculated NAV but also have market-traded share prices. We can look directly at the volatility of the traded funds, compare to the listed NAVs, and get a real-life example of just how private equity assets trade when they are listed publicly. This is increasingly important as Vanguard and others prepare to launch publicly traded funds that include private equity assets.

We looked at 10 of the largest and most liquid London-listed private equity funds: HarbourVest Global Private Equity (HVPE), Pantheon International (PIN), NB Private Equity Partners (NBPE), HgCapital Trust (HGT), Oakley Capital Investments (OCI), Partners Group Private Equity (PEY), CT Private Equity Trust (CTPE), Patria Private Equity Trust (PPET), Apax Global Alpha (APAX), and ICG Enterprise Trust (ICGT).

These are not obscure no-name private equity sponsors but rather comprise a list that includes marquee brand-name firms and even includes funds-of-funds that own diversified holdings. Take, for instance, HarbourVest Global PE: HVPE is a closed-end fund managed by HarbourVest Advisers L.P. that typically invests its capital across numerous partnerships, vintage years, industries, and strategies. As of 2024, HVPE has a 62% geographic exposure to North America. Based on data from Capital IQ, HVPE shares have returned about 13% per year since inception. HVPE seems a relatively standard PE fund compared to the rest of the market, with a diversified portfolio and a high NAV value.

Examining the volatility of these listed funds’ stock prices compared with that of their NAV estimates, one comes to a very different conclusion regarding the risk of holding these assets. Traditional reporting by these PE funds has their NAV average at 14% volatility, about 0.9 times the market average of 16%. By annualizing the volatility of the stock trading price, one can see in the figure below that the market volatility is closer to 24%, or 1.5 times the market average.

Figure 1: Annualized Volatility Comparison, 2014–2024



Source: Capital IQ

The volatility of listed private equity looks comparable to AQR's estimate—and to how small-cap equity indices trade. This is unsurprising, given that private equity portfolio companies tend to be low-margin, leveraged micro-caps, a riskier and higher volatility exposure than, say, the S&P 500.

This data set doesn't just allow us to evaluate the true volatility of private equity, however. We can also look at the discounts to NAV to better understand the extent to which public markets believe that private equity NAVs are accurate. This is also an increasingly relevant question as U.S. congresswoman Elise Stefanik is now probing whether college endowments should be allowed to use NAVs rather than, say, recent secondary market transactions as the sole source of valuation for private assets.

The chart below shows aggregate market cap–weighted discount to NAV of this group of private equity funds.

Figure 2: Market Cap–Weighted Discount to NAV for Listed PE Funds

Source: Capital IQ

Today, these listed PE funds trade at 70 cents on the dollar! This is a massive gap relative to NAV that suggests quite a high degree of skepticism about reported NAVs. Even more remarkable, as recently as 2021, these funds were trading at 90 cents on the dollar. Public markets appear to have grown significantly more skeptical of private equity over the last four years.

Market observers attribute this change to rising interest rates shifting investor preferences toward more liquid assets, coupled with growing concerns over the perceived opacity in the underlying assets of portfolios. This shift in investor sentiment has led to greater scrutiny and caution around illiquid and opaque assets like PE funds. As a result, investors demand a higher liquidity premium, meaning a higher discount to NAV, to compensate for the elevated risk and reduced liquidity. This increased required return enhances the widening discount, pushing down the market prices of PE fund shares relative to their reported NAVs.

PE managers have taken note of this shifting investment landscape. Funds-of-funds tend to trade at larger discounts than direct PE, reflecting their higher fees and lower transparency. In response to depreciating discount values, many funds, such as Pantheon International, have begun reallocating portfolios toward direct investments to improve efficiency. Moreover, several PE funds have initiated share buybacks, boosting value for remaining shareholders.

Although the publicly traded universe is a small sample of the PE market, we believe we can nevertheless draw several meaningful conclusions, not least of which is that a healthy skepticism of PE's reported NAV and volatility is necessary to understand the true risk of these funds' portfolios.

Public equity markets don't seem to buy what the private markets are selling. This could be a problem as PE funds try to exit their massive inventories either through IPOs or partnerships with firms that have broad retail distribution.