

Absolute Insight:

When Did Illiquidity Become Such a Good Idea?

Capital is stampeding into private markets. Illiquidity has become the latest fad, but when liquidity dries up, fads tend to end badly.

“Things tend to be liquid when you don’t need liquidity, and just when you need liquidity most, it tends not to be there.” Howard Marks

Introduction

Few ideas have taken hold in modern investing as firmly as the belief that illiquidity is a virtue. Private equity, private credit, private infrastructure all are sold on the premise that locking capital away creates superior returns and stability. But this is a dangerous myth.

Illiquidity doesn’t eliminate risk. It hides it. It allows complacency, gives managers cover, and leaves investors trapped when mistakes inevitably occur. What looks like low volatility is usually just infrequent pricing. And the longer the lock-up, the greater the opportunity cost.

Liquidity isn’t a luxury for short-term traders. It’s the discipline that forces transparency, accountability, and adaptability. It is, in truth, the real premium investors should value.

Just this week, Bloomberg reported that the Bank of England is preparing to stress-test the private credit market, reflecting mounting regulatory unease over its rapid growth and opaque risk. The move signals a broader recognition that while private credit has boomed on the back of higher yields and limited scrutiny, its underlying vulnerabilities are still largely untested. It’s a timely reminder that even policymakers are beginning to question whether the supposed stability of illiquid assets might, in fact, be masking the next source of systemic fragility.

The Mirage of Low Volatility

Ask any allocator why they like private equity or private credit and you’ll hear the same refrain: strong returns, low volatility, diversification. But scratch beneath the surface and you find that much of the “low volatility” is a mirage.

Private funds mark portfolios quarterly, sometimes less, using models and appraisals that smooth out the bumps. Compare that to daily-dealing liquid funds that mark to market every day. Which one looks smoother? The answer is obvious.

But smoothing doesn’t mean safety. It simply hides the volatility until it comes crashing through. In downturns, the mask slips, valuations gap lower, defaults spike, exits vanish. The supposed diversifiers suddenly behave a lot like the public markets they were meant to hedge.

Independent research from Harvard, Bain, and Cliffwater suggests that once returns are de-smoothed and adjusted for stale pricing, private equity’s true correlation with public equities lies around 0.7, far higher than headline figures imply. That’s not diversification. That’s equity beta, leveraged and fee-laden, masquerading as something different.

The True Costs of Private Markets

Then there are the costs. The “2 & 20” model is alive and well in private equity and debt. Add in fund expenses, transaction fees, monitoring fees, and carried interest, and investors can be paying 3–5% a year in drag. You need a stellar manager just to break even versus public markets.

And let's not ignore dispersion. The gulf between top-quartile and median private equity managers is over 15% annualised (McKinsey Global Private Markets Review 2024). Miss the top tier and you risk a decade of underperformance, locked away in assets you can't exit.

That's the brutal truth: the risk of permanent capital loss in private markets is real. Studies show a quarter of funds fail to return committed capital net of fees. Yet investors continue to pile in, seduced by the promise of double-digit IRRs that may never materialise.

The Opportunity Cost of Being Locked Away

Liquidity is often dismissed as a nice-to-have. In reality, it's everything. Being trapped in an underperforming private fund for 7 to 10 years is the very definition of opportunity cost.

And let's be honest: lock-ups are great, but they're great for the managers, not necessarily for the investors. They guarantee the fund a captive pool of capital, steady fee income, and freedom from redemptions, regardless of performance. For investors, they remove the one thing that matters most in a fast-changing world: the ability to adapt.

When better opportunities appear elsewhere, capital is trapped. When portfolio companies face refinancing cliffs, you're stuck. The optionality to de-risk or hold cash simply isn't there. That is the real opportunity cost.

Who Really Benefits From Illiquidity?

It's often argued that family offices and large pension funds are perfectly placed to invest in illiquids. They have permanent capital, long horizons, and can accept lock-ups in ways retail investors cannot.

But the real question isn't whether they can tolerate illiquidity. It's whether they should.

Illiquidity has another effect too: it allows complacency. Managers can hide behind it. Poor marks or bad decisions don't show up in daily NAVs, so mistakes remain buried until much later. That may suit the managers, it certainly buys them time, but it does not serve the investors.

Family offices may believe they can live with lock-ups, but liquidity still matters. Private equity and private debt may seem clever and superior, but one simple mistake, and we all make them, can last for years. Add to that the opportunity cost of being trapped when better options emerge, and the poor value that comes from paying high fees for opacity, and you have to ask: is it really worth it?

Daily-dealing liquidity isn't just about short-termism. It enforces discipline, transparency, and accountability. It makes mistakes visible quickly, so they can be managed. That's a far healthier framework for long-term wealth preservation than illiquidity disguised as sophistication.

Private Credit: Calm Waters, Hidden Currents

Private credit's narrative is seductive; steady income, floating rates, low defaults. But its boom has coincided with one of the most benign credit backdrops in history.

According to data from PitchBook, Preqin and McKinsey, global private credit assets have surged from roughly \$550 billion in 2014 to more than \$2 trillion by 2023, with forecasts suggesting they could exceed \$3 trillion by 2028. McKinsey's Global Private Markets Report 2025 highlights the continued institutional pivot toward private markets, not just through traditional commingled funds but via SMAs and co-investments, which are quietly accelerating growth.

Family offices have joined the rush. UBS data shows allocations to private debt doubled from roughly 2% to 4% in 2023, and six in ten looked to increase exposure further in 2024. Anecdotal evidence suggests this trend continues in 2025. The logic is understandable: higher yields, lower mark-to-market volatility, and the appeal of something that feels differentiated.

But that calm surface hides powerful currents. As the cycle turns, highly levered borrowers face rising costs and weaker covenants. Defaults will climb, recoveries will fall. The same opacity and illiquidity that smoothed performance on the way up will more than likely magnify losses on the way down.

The Fad Effect in Alternatives

The industry has a short memory. Every cycle brings a new “must-own” alternative, and more often than not, disappointment follows.

Hedge funds were the darling of the pre-GFC years. Capital poured in, fee rose, performance lagged, and redemptions surged just when they were needed most. Catastrophe bonds have seen waves of inflows every time spreads widened, only for hurricane seasons to wipe out years of coupons. Mezzanine finance promised juicy yields right before credit cycles turned and recoveries evaporated.

Today’s fad is anything with the word “private” attached. Private equity. Private credit. Private infrastructure. The inflows are extraordinary. But like every fad, too much money chasing too few opportunities leads to weaker terms, inflated entry prices, and lower forward returns. Investors chasing the illusion of high returns with low volatility risk setting themselves up for the same disappointment as every fad before it.

We’ve been here before.

Cyclical Amnesia Amid the Boom

The golden age of private markets was built on cheap money, rising valuations, and abundant liquidity. That era has ended. Higher rates, record dry powder, and tougher exits point to lower returns ahead. Dispersion will widen; opportunity cost will grow heavier.

And yet capital continues to flood in. Investors are still chasing yesterday’s story.

When asked what investors learned from the Global Financial Crisis, legendary value investor Jeremy Grantham replied, “In the short term, a lot. In the medium term, a little. In the long term, nothing at all. That would be the historical precedent.”

This ‘cyclical amnesia’ is as much a feature of markets as liquidity itself. The collective tendency is for investors to forget past pain and any lessons learnt, just as the next herd gathers pace and safety in numbers begins to cloud judgment.

Not All ‘Alternatives’ are Equal: What Liquid Absolute Return Offer investors

Daily liquidity. Transparent pricing. Diversification across genuinely uncorrelated strategies. Explicit risk controls. The ability to hedge, rebalance, and adapt in real time.

Liquid absolute return and multi-strategy funds don’t hide risk; they manage it. They mark to market daily, accept short-term volatility, and manage it with discipline. The outcome: smoother, more consistent returns that investors can actually access.

It’s curious, then, that liquidity, the one feature that offers flexibility, transparency, and control, is so undervalued. Investors still flock to illiquid asset classes that promise “stability” but deliver opacity and inflexibility instead. Perhaps it’s because daily pricing makes risk visible, and visibility makes people uncomfortable. But honest volatility is far safer than hidden fragility.

As I have argued many times in this column, liquid alternatives deserve far more attention than they get. They offer access to the same sophisticated strategies – long/short equity, macro, event-driven, market-neutral – without the lock-ups, opacity, or fee drag of private structures.

In short, they give investors what the best private funds can't: liquidity, adaptability, and genuine diversification.

Conclusion

Private equity, private debt, and other illiquid assets will always have a place, at the right time, in a well diversified portfolio, but their promise of stability is too often an illusion. Fees are high, risks are hidden, and lock-ups benefit managers more than investors. Even family offices and pensions, with permanent capital, should ask themselves whether illiquidity is worth the risk.

By contrast, UCITS liquid alternatives may look less glamorous, more regulated, more transparent, even a little boring, but that's precisely their strength. The investor protections embedded in UCITS, combined with daily liquidity and independent oversight, provide something private markets cannot: control, accountability, and confidence.

When the next cycle turns, liquidity will pay dividends. And those "boring" UCITS structures may prove to be the smartest and most resilient alternatives of all. Not all alternatives are created equally. The sooner investors accept that, the stronger and more flexible their portfolios will be.

The structures evolve, the narratives get smarter, and the rationales become ever more compelling, yet behaviour never changes. It may be the most quoted line in investing, but Sir John Templeton's warning remains the simplest and truest of all: *"The four most expensive words in the English language are: this time it's different."*

Only time will tell, but at this point, I'm not willing to risk it, so will continue to favour 'boring' liquid alternatives.

APOLLO MULTI ASSET MANAGEMENT

Absolute Vision: A Smarter, More Resilient Way to Invest

At Apollo Multi Asset Management, we believe in Absolute Vision—the ability to see beyond short-term market noise and invest with clarity, conviction, and discipline. The financial world is evolving, and traditional investment models are no longer fit for purpose. The once-reliable 60/40 portfolio—built on the assumption that bonds will always hedge equity risks—has failed to deliver real returns in an era of inflation, rising interest rates, and geopolitical uncertainty.

Apollo stands apart as a firm built for the future. We are not bound by benchmarks or outdated conventions. Instead, we take a forward-thinking, multi-asset approach alongside absolute return investing—targeting consistent, risk-adjusted performance throughout the full market cycle.

Founded during the 2008 financial crisis, Apollo has consistently demonstrated the ability to thrive in uncertainty—because we see what others don't.

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