

IPC Private Markets Classroom Series | Practical Asset Allocation
Including Private Markets

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When Does Complication Pay?

A Framework for Asset Allocation Including Private Markets

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PAST PERFORMANCE DOES NOT PREDICT FUTURE RETURNS.

01 As portfolios have grown, they have become more complicated

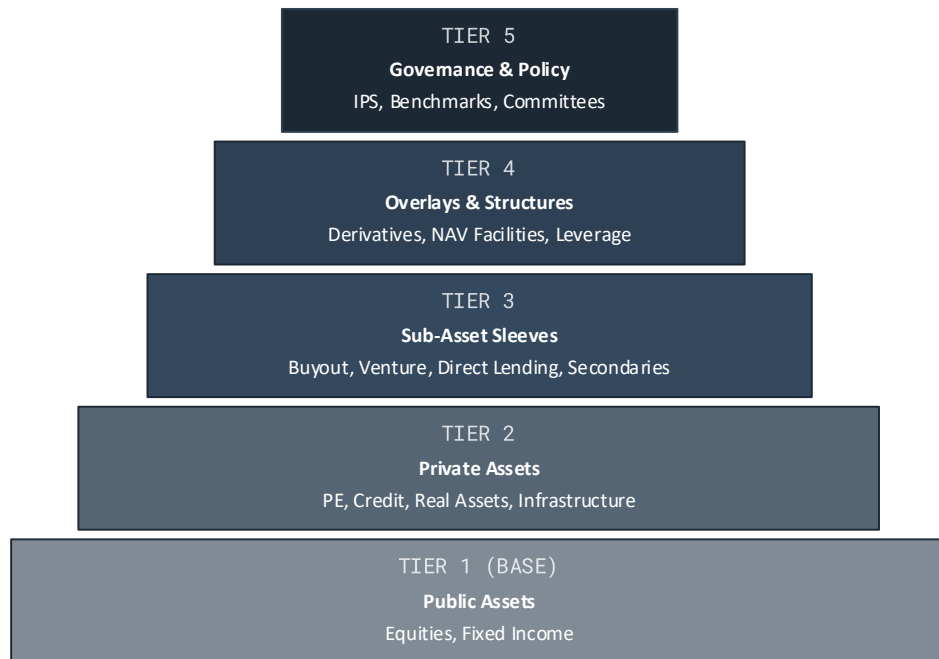
Over the past two decades, institutional allocators have added successive layers of complexity to their portfolios in pursuit of better risk-adjusted returns. Each layer was added with a purpose: private equity for illiquidity premium, real assets for inflation protection, credit for yield, overlays for risk management.

The result is a portfolio architecture that looks less like a simple allocation and more like a stack of interdependent decisions.

CORE INSIGHT

Each layer was added for a reason. The question is whether the whole is worth more than the sum of its parts.

FIG 1. THE ARCHITECTURE OF COMPLICATION



For illustrative purposes only.

02 Every portfolio addition is a "complication"

■ THE COMPLICATIONS FRAMEWORK

We propose a simple but powerful organizing principle: every new asset class, sub-asset sleeve, manager, investment structure, or governance layer is a **complication**. Each complication aims to deliver benefits — but comes with costs and frictions that are often underestimated or ignored entirely.

BENEFITS > COSTS + FRICTIONS

BENEFITS

- Excess returns
- Diversification
- Resilience
- Flexibility

COSTS

- Manager fees
- Internal resources
- Governance burden
- Legal & compliance

FRICTIONS

- Liquidity strain
- Pacing drag
- Delayed rebalancing
- Exposure opacity

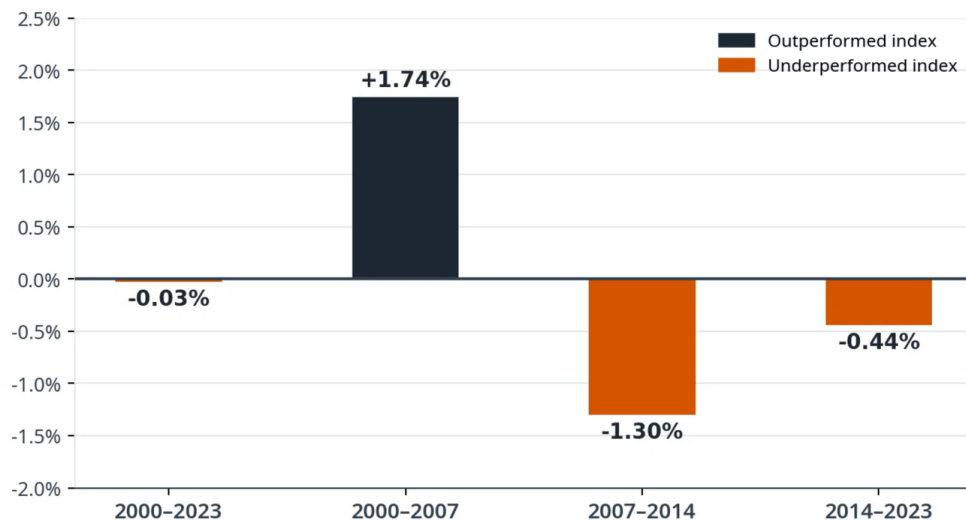
KEY INSIGHT

Costs are visible on the fee schedule. Frictions are invisible until they matter — and they tend to matter most in exactly the moments when you can least afford them.

03 Complexity hasn't reliably paid off — for pensions or endowments

If complexity reliably generated alpha, professionally managed institutional portfolios should consistently outperform a passive benchmark. The evidence — across investor types and time horizons — suggests otherwise.

FIG 2. US PUBLIC PENSIONS: ANNUALIZED RETURN VS. 60/40 INDEX (%)



Source: Aubry & Yin, "How Do Public Pension Plan Returns Compare to Simple Index Investing?" Center for Retirement Retirement Research at Boston College, June 2024.

Different frameworks — Endowment, Canadian, Norwegian, Total Portfolio — are each a response to the same underlying problem. Each simplifies something. Each introduces new trade-offs.

FIG 3. CONSISTENT FINDING ACROSS SIX DECADES & MULTIPLE STUDIES

Study & Investor Type	Period	Annual Gap
Hammond (2020) Avg. US endowment vs. return need	58 yrs FY1962–2019	-1.6%
Ennis (2021) Large endowments vs. passive	12 yrs FY2009–2020	-1.6%
Ennis (2024) All endowment sizes vs. passive	13 yrs FY2009–2021	-1.2 to -2.5%

Consistent pattern: Across six decades, multiple methodologies, and both endowments and pensions, the evidence points in the same direction. The cost of complexity — fees, illiquidity, governance — has broadly offset any alpha generated.

Sources: Hammond, *J. of Investing* (2020); Ennis, *J. of Investing* (2021, 2024).

04 Total Portfolio Approach (TPA): how leading practitioners define it

Total Portfolio Approach has no single canonical definition. Leading practitioners describe it in strikingly different terms — which tells us something important about both its promise and its challenge.

CPP INVESTMENTS

"One unified means of assessing risk and return of the whole portfolio."

– Geoffrey Rubin, Chief Investment Strategist, CPP Investments, CAIA (2024)

NEW ZEALAND SUPERANNUATION FUND

TPA is more a state of mind than a policy or process. Each investment should earn its way into the portfolio.

– Charles Hyde, Head of Asset Allocation, NZ Super, paraphrased in CAIA (2024)

AUSTRALIA'S FUTURE FUND

TPA liberates the investment team to discuss the state of the world and competing opportunities without the constraint of labels or buckets.

– Ben Samild, CIO, Future Fund, paraphrased in CAIA (2024)

KKR GLOBAL MACRO & ASSET ALLOCATION

"A whole-portfolio decision and governance framework that evaluates investment opportunities based on their contributions to total portfolio objectives, rather than within static asset-class sleeves."

– KKR, "The Total Portfolio Approach" (February 2026)

COMMON THREAD

Evaluate every investment by its contribution to the whole portfolio — not by its performance within a silo. Beyond that, the definitions diverge considerably.

The harshest criticism of Total Portfolio Approach is worth taking seriously

The debate over portfolio frameworks is not merely academic. Critics of the Total Portfolio Approach have raised substantive concerns about governance, accountability, and the risk of unconstrained drift.

This is a fair challenge — and it motivates everything that follows. We are not here to advocate for any single model. We are here to offer a framework rigorous enough to answer the question: **when does adding adding complexity actually pay?**

WHY THIS CRITIQUE MATTERS

- Without asset-class benchmarks, it is harder to attribute performance and performance and hold managers accountable.
- Flexibility can become drift — especially under governance structures not structures not designed for it.
- Most US public pensions face political and legal constraints that make full TPA adoption impractical.

THE CRITIQUE

|| *Total Portfolio Approach ignores investment cataloging and benchmarking... the overall impression is that a Total Portfolio Approach portfolio could move anywhere with few, if any, guard rails.*

— Cliffwater LLC
Total Portfolio Approach Looks Backward in Going Forward (2025)

How we define Total Portfolio Approach

A spectrum, not binary – our definition lives in the practical middle

Asset-class silos

Full portfolio awareness

PURE SAA

Fixed target allocations by asset class
Asset classes managed in silos
Interactions between assets largely ignored
Performance measured against asset-class benchmarks

PRACTICAL TPA² Architecture + Accountability Philosophy, Risk View, Engineered Governance

Holistic portfolio view — explicit attention to how each asset affects the whole; holistic 9-step governance structure

Role & factor decomposition — does this asset contribute alpha, beta, risk reduction, or diversification?

Risk budget as constitution — total risk envelope formally set and binding, not discretionary

Governed capital competition — explicit hurdle rates and decision frameworks; complexity must earn its place

Accountability — benchmarks (three tiers), board-ratifiable guardrails, and guardrails, and structured flexibility with drift tolerances



Our definition

PLATONIC IDEAL

Full portfolio awareness at all times
All interactions considered simultaneously on every decision
Real-time portfolio optimization across all asset classes

Critics are right: operationally impossible at scale. A useful ceiling, not a realistic target.

Starting point

The most valuable part of the journey

Theoretical ceiling

"TPA is a philosophy. TPA² is its engineering." — Philosophy meets risk architecture: governed, benchmarked, and board-ratifiable.

Poor governance can cost a large pension fund billions of dollars annually

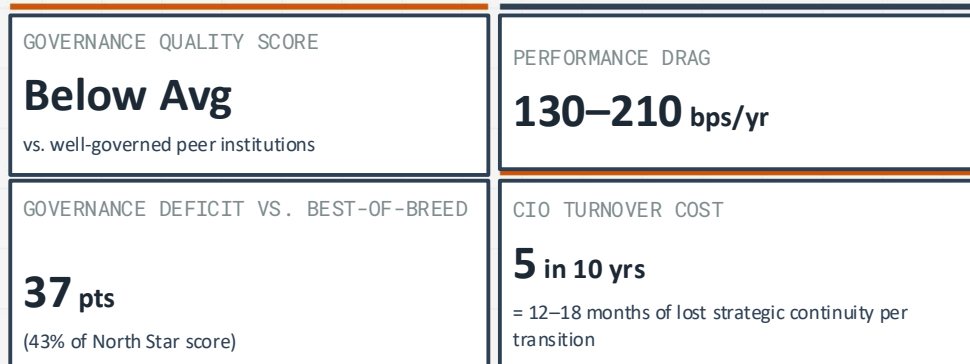
The Complications Framework applies not only to asset classes and investment structures — it applies equally to governance. Governance is a complication: it has benefits (accountability, oversight, strategic continuity), costs (committee time, consultant fees, bureaucratic process), and frictions (slow decision-making, political interference, CIO turnover).

When governance fails, the costs are not abstract.

CORE INSIGHT

Governance is not a soft add-on. It is a measurable, scorable pillar of portfolio of portfolio performance — and one of the most frequently underpriced underpriced complications in institutional investing.

FIG 4. THE COST OF GOVERNANCE FAILURE (LARGE PUBLIC PENSION – ILLUSTRATIVE)



Source: Illustrative case based on documented governance failures at large US public pension funds. Governance funds. Governance drag estimate based on Ambachtsheer (KPA Advisory): well-governed funds outperform poorly outperform poorly governed peers by 100–200 bps annually.

08 Best-practice governance anchors every decision to investment beliefs

If poor governance is the problem, what does the solution look like? The evidence from the world's best-governed sovereign wealth funds and pension plans — GIC, CPPIB, plans — GIC, CPPIB, Temasek, OTPP — points to a consistent pattern: a beliefs-first, closed-loop investment process anchored by a reference portfolio.

FIG 4. THE 9-STEP CLOSED-LOOP INVESTMENT PROCESS



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09 Seven dimensions allow any asset to be evaluated on the same terms

One of the core practical barriers to total portfolio thinking is the absence of a shared vocabulary across asset classes. Private and public markets use different metrics for the same concepts — **IRR vs. TWR**, **TWR, MOIC vs. wealth generation**, and **loss ratio vs. Sharpe Sharpe ratio** — making apples-to-apples comparison hard.

The following seven dimensions provide a common language. The goal is to be approximately right rather than rather than precisely wrong.

PRIVATE vs. PUBLIC METRIC PAIRINGS

RETURN	VALUE CREATION	RISK
IRR		Loss Ratio
vs.	MOIC	vs.
TWR	Wealth Generation vs. Generation	Sharpe Ratio

APPLICATION

Apply at total-portfolio level or within asset-class teams.

THE COMMON LANGUAGE TAXONOMY

Dimension	Definition	Key Question
Beta	Sensitivity to broad economic risk (equity/credit)	<i>What is my desired sensitivity to equities, equities, credit, interest rates?</i>
Style Factors / Sectors	Returns attributable to investment style or sector tilts	<i>How much of my return comes from size, size, carry, geography, or sector?</i>
Alpha	Excess return unexplained by beta beta or factors	<i>Do I want to concentrate or diversify away consistent alpha?</i>
Risk	Uncertainty vs. expectations; correlation; tail outcomes	<i>How do I bring illiquid assets into a traditional SAA model?</i>
Liquidity	Ability to access cash when needed	<i>Do I need liquidity at the asset level or only at the portfolio level?</i>
Leverage	Tool to maximize risk budget efficiency	<i>Is levered credit a superior use of risk budget vs. public equity?</i>
Deployment	GP controls timing of capital calls and distributions	<i>How do I account for the gap between commitment and deployment?</i>

Allocating Risk, Not Capital

Three-Tier Risk Budget: Macro + Style + Idiosyncratic

The risk budget decomposes total portfolio risk into **three tiers**: macro factor risk (systematic), style factor risk (systematic tilts), and idiosyncratic risk (alpha generation). The reference portfolio concentrates 52% of risk in growth — Polaris rebalances to 45%.

TIER 1 – MACRO FACTOR RISK (88% OF TOTAL)

Growth

45%

Equity, PE, HF beta

Reference: 52% (-7%)

Rates

20%

Duration, FI sensitivity

Reference: 15% (+5%)

Credit

16%

HY, EM debt, loans

Reference: 18% (-2%)

Inflation

15%

Real assets, TIPS

Reference: 10% (+5%)

TIER 2 – STYLE FACTOR RISK – ADDITIVE PREMIUMS (10% OF TOTAL)

Value

4%

HML — compensated premium

Momentum

3%

UMD — compensated premium

Quality

2%

QMJ — compensated premium

Size

1%

SMB — compensated premium

TIER 3 – IDIOSYNCRATIC / ALPHA RISK (2% OF TOTAL)

Manager Selection Alpha

2.0%

Active manager skill, security selection

Portable Alpha Overlay

2.5%

Market-neutral alpha at 15% overlay (IR 0.89)

REFERENCE GROWTH CONCENTRATION

52%

Dangerous single-factor exposure

POLARIS GROWTH ALLOCATION

45%

-7% reduction, better diversified

STYLE FACTOR BUDGET

10%

Additive premiums accepted

Every Basis Point Attributed

The Three-Tier Benchmarking Cascade – Results Governance for the North Star

1

Reference Portfolio

"Did we add value by doing anything beyond holding the passive reference portfolio?"

ATTRIBUTION

$$\text{Total Active Return} = \text{Actual Return} - \text{Reference Return}$$

60/40 MSCI ACWI · Bloomberg Agg · GIC Ref · Norway GPFG 70/30 · Custom LDI

GOVERNANCE OWNER

Board IC + CIO

Annual review · Monthly monitoring

2

Allocation Effect

"Was it worth allocating across assets, assets, factors, geographies, and sectors vs. the reference?"

ATTRIBUTION

$$\text{Allocation Effect} = \sum (\text{Actual Wt} - \text{Ref Wt}) \times \text{Benchmark Return}$$

Russell 3000 · MSCI EAFE/EM · Cambridge PE/VC · Bloomberg Agg

GOVERNANCE OWNER

CIO + Head of Total Portfolio

Quarterly attribution · Annual review

3

Selection Effect

"Did specific managers, vehicles, and and securities add value beyond passive implementation?"

ATTRIBUTION

$$\text{Selection Effect} = \sum \text{Actual Wt} \times (\text{Actual Return} - \text{Benchmark Return})$$

eVestment · Cambridge vintage · Burgiss peers · HFRI

GOVERNANCE OWNER

Asset Class Heads + Manager Research

Quarterly · 3-yr & 5-yr rolling

$$\text{Total Active Return} = \text{Allocation Effect} + \text{Selection Effect} + \text{Interaction}$$

Conflating allocation and selection makes it impossible to tell if value comes from strategy or implementation; the cascade separates them.

Governance principle: Every basis point of return (or cost) must be attributable to a specific decision, owned by a specific person, and evaluated on an appropriate time horizon.

12 New capabilities are changing the cost-benefit calculus

The Complications Framework is not static. The costs and frictions of managing complex portfolios are declining as data quality, analytical tools, and AI capabilities improve. What required simplification five years ago may now be tractable.

FIG 8. THE EVOLUTION OF PORTFOLIO CAPABILITIES

	Before	Now	Implication
Data	Simplification was necessary; private market market data was sparse and delayed	Better data is available across private markets; quarterly NAV estimation, cashflow modeling, factor attribution	More decisions can be examined with evidence rather than intuition
Analytics	Visibility across public and private assets was limited; portfolio implications implications were mostly implicit	Analytical tools can connect decisions across across asset classes; sector and factor exposure exposure visible across the total portfolio	Trade-offs can be surfaced before capital is is committed, not after
AI	Ideas were hard to put into practice at scale; manual processes dominated	AI allows portfolio insights to be generated and tested faster; pattern recognition across large datasets	Interactions between assets can be explored before committing capital

THE HUMAN ELEMENT

Judgment improves — but does not disappear. The framework still requires a human decision-maker who understands the portfolio's purpose.

TPM is not a destination — it is a discipline applied one complication at a time

We began with a question: *when does complication pay?* The answer is not "always" and not "never." It is: **when the benefits of a specific complication demonstrably outweigh its costs and frictions, given your governance capacity, your data infrastructure, and your investment beliefs.**

1 Ask the right question

Not "should I add private markets?" but "what specific problem does this complication solve, and does it solve it better than the alternatives?"

2 Price the frictions

Costs are visible. Frictions are not. Build the habit of explicitly identifying and quantifying the frictions before committing capital — especially liquidity liquidity strain, rebalancing difficulty, and exposure opacity.

3 Governance is the constraint

The best analytical framework in the world will not overcome a governance structure that cannot act on its conclusions. Investment process, culture, and decision rights are the most important complications of all. complications of all.

***The question is never whether to add complication.
The question is whether this complication earns its place.***

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Sources: Ares QRG; CBRE / Garcia (2025); Center for Retirement Research at Boston College; Burgiss; Cliffwater; Ambachtsheer / KPA Advisory.

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SUPPLEMENTARY MATERIAL

APPENDIX

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How should we think about adding secondaries? secondaries?

Secondaries typically sit at the intersection of multiple portfolio construction problems simultaneously:

Deployment

How do I get capital to work faster?

J-curve

How do I smooth early negative returns?

Diversification

How do I achieve private market beta efficiently?

Factor exposure

How do I manage sector and geographic concentration?

Rather than asking "should we add secondaries?" — the Complications Framework asks: *what specific problem am I trying to solve, trying to solve, and does a secondaries allocation solve it better than the alternatives?*

16 Different types of secondaries can solve different problems.

APPENDIX

The first step in the Complications Framework is to define the benefit precisely. "Secondaries" is not a monolithic category — LP portfolio secondaries, GP-led continuation secondaries, GP-led continuation vehicles, and structured transactions each have a distinct portfolio function.

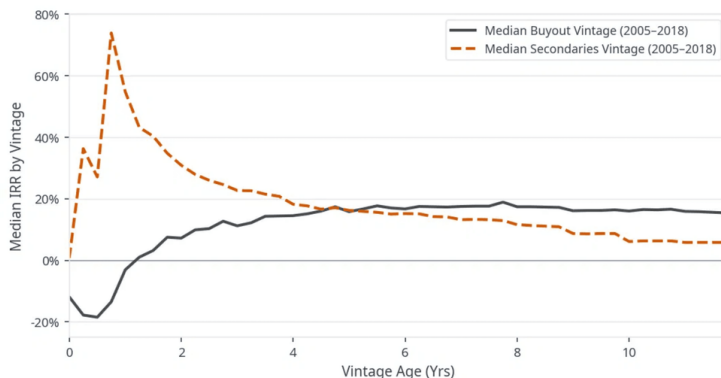
FIG 5. SECONDARIES BENEFITS MATRIX				✓ Best fit	✓ Good fit	— Not primary use
Why Add Secondaries?	LP Portfolios	GP-Led / Continuation	Structured Deals			
Diversified private market beta	✓ Best fit	—	—			
Faster capital deployment	✓ Good fit	✓ Best fit	—			
J-curve mitigation	✓ Best fit	✓ Good fit	✓ Good fit			
Shorter duration	✓ Best fit	—	✓ Good fit			
Unique alpha sources	—	✓ Good fit	✓ Best fit			
Downside protection *	—	—	✓ Best fit			
<i>The most common mistake in secondaries allocation is treating the category as monolithic. An LP portfolio secondary and a GP-led continuation fund are not substitutes — they solve different problems, carry different risk profiles, and belong in different parts of the portfolio conversation.</i>						

* LP portfolio secondaries help reduce idiosyncratic risk through diversification but generally do not provide structural downside protection (preferred return, seniority, or covenant packages). That distinction is reserved for structured deals.

Two of the most common motivations for adding secondaries — J-curve mitigation and faster capital deployment — map to different vehicle types and can be illustrated with empirical and hypothetical data.

BENEFIT 1 – J-CURVE MITIGATION

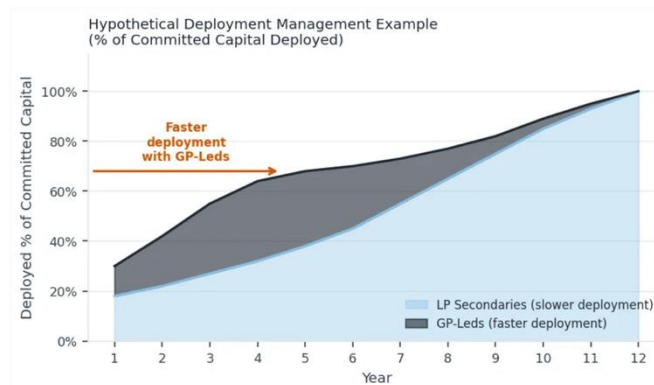
LP-Led & Structured Secondaries · Empirical



Source: Ares QRG Research Database; Preqin. Illustrative representation of median IRR by vintage by vintage age (2005–2018). For illustrative purposes only.

BENEFIT 2 – FASTER CAPITAL DEPLOYMENT

GP-Leds vs. LP Secondaries · Hypothetical



Source: Ares QRG. Hypothetical illustration only. Not based on actual data.

Key point: These potential benefits are not interchangeable — selecting the right secondary vehicle requires first identifying which problem you are solving.

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The costs are on the fee schedule; the frictions are invisible until they are not

Having identified the benefit, the Complications Framework demands equal rigor about costs and — crucially — frictions. Frictions are the category most frequently missed most frequently missed in allocation decisions.

COSTS

(VISIBLE, QUANTIFIABLE)

Management fees to secondaries managers (typically 1.0–1.5% on committed capital)

Cost of a dedicated in-house team (if building internal capability)

Legal, due diligence, and governance overhead per transaction

FRICTIONS

(OFTEN INVISIBLE UNTIL THEY MATTER)

Hard-to-predict capital calls and distributions disrupt liquidity planning

Difficulty rebalancing: secondaries positions cannot be trimmed like public like public equity

Hard to identify and manage sector, geography, and factor exposures across exposures across a portfolio of LP stakes

THE DANGER OF FRICTIONS

Frictions tend to be most costly in exactly the moments when you can least afford them — market dislocations, liquidity stress, or governance transitions.

One of the most consequential applications of the common language framework is recognizing that private credit and private equity have opposite return distributions — and therefore require opposite diversification strategies.

PRIVATE CREDIT (LEFT-TAIL ASSET)			PRIVATE EQUITY (RIGHT-TAIL ASSET)		
<i>Simulated Portfolio Returns</i>			<i>Simulated Portfolio Returns</i>		
Metric	10 Assets	1,000 Assets	Metric	10 Assets	1,000 Assets
Mean	8.8%	8.8%	Mean	23.7%	19.5%
5th Percentile	6.2%	8.6%	5th Percentile	1.1%	16.8%
95th Percentile	9.6%	9.0%	95th Percentile	68.2%	22.6%
Diversification compresses the left tail. Hard to over-diversify in credit.			Concentration preserves the right tail. Over-diversification destroys the upside case for PE.		

In credit, diversify to avoid losers. In equity, concentrate to capture winners. Secondaries can help you achieve private equity beta more efficiently — but only if you know which problem you are solving.

Private Credit Simulations: Please note the simulations above are hypothetical and are for illustrative purposes only and do not represent actual performance. Ares QRG does not provide investment advisory services. Any information provided by Ares QRG is for informational purposes only. Our proprietary model simulates how a structure would perform under a large number of scenarios for return of the underlying collateral, based on historical data. The back tested performance does not represent actual performance, was achieved by retroactive application of a model with the benefit of hindsight, and actual results may vary substantially. For these simulations, we assume a maturity of 3 years, recovery rate of 48%, 2 quarter recovery lag, 10% interest rate, and 1.35% probability of default. Assumptions are sourced from historical private credit performance data from Cliffwater. **Private Equity Simulations:** Source — Ares QRG Research Database. Simulations sample realized investments held in buyout or growth buyout funds in vintage years 1979–2020. Simulations performed by randomly sampling the database with a trial size of 10,000. Portfolio IRRs calculated using average duration by data subset and TVPI of portfolio simulations.