BlackRock's Larry Fink says to own alternative assets. But timing is everything.

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By Mark Hulbert

BlackRock's CEO tells investors to hold private assets such as hedge funds and real estate. Just know that bigger funds may not be better.

Larry Fink, the chairman and chief executive of asset-management giant BlackRock (BLK), offered some timely portfolio advice in his annual letter to investors. In that letter, Fink proposed an alternative to the traditional 60/40 stock-bond portfolio, specifically 50% stocks, 30% bonds, and 20% private assets.

Private assets? Sometimes also referred to as alternative assets, private assets are different from publicly traded assets such as stocks and bonds. The category includes private equity, hedge funds, private credit and real estate -anything that doesn't trade on a public exchange. Traditionally private assets have only been available to institutional and high-net-worth investors.

Fink's advice coincided with a new study recently circulated by the National Bureau of Economic Research (NBER) regarding private-equity investment returns.

The NBER study found an inverse relationship between private-equity fund size and performance. The authors were blunt in their conclusion: "Larger funds do larger deals, which perform worse."

This study highlighted the challenge investors face when trying to put Fink's advice into practice. On the one hand, alternative asset funds with an impressive record over the long term are likely to have become so large that their subsequent performance will be mediocre at best.

The alternative is to invest in smaller and younger funds, which by definition will have a shorter track record. Determining which of the younger and smaller funds are worth owning is not easy; even if you have done the digging to find these relatively unknown funds, you won't have any way to determine whether they will be one of the few that produce outstanding returns.

It's hard to see how BlackRock can escape this quandary as it endeavors to give individual investors access to private assets. To the extent that the firm attracts more assets to the various private-investment vehicles it creates, it will have to focus on larger and larger deals.

Consider the past performance of the various BlackRock funds focusing on private assets. The firm's iShares Listed Private Equity UCITS, which is sold to European investors, produced a 10-year U.S.-dollar-denominated return through the end of 2024 of 12.0% annualized, compared with 13.1% for the S&P 500's SPX total return.

Also lagging behind the S&P 500 is the BlackRock Private Investments Fund, which is available in the U.S. only to institutional investors. It doesn't have as long a history as the European UCITS fund, but over the three years through 2024, it produced a 6.8% annualized return, compared with 8.9% for the S&P 500.

Lagging behind the S&P 500 doesn't have to be a fatal flaw. If a private-equity investment is sufficiently uncorrelated with the U.S. equity market, for example, its below-market return can nevertheless play a crucial role as part of a diversified portfolio that beats the S&P 500 on a risk-adjusted basis. But it's not clear here that this prerequisite holds. The correlation coefficient between the S&P 500 and the BlackRock European UCITS fund over the last decade, for example, is 96% - almost 1:1. Yet over the past decade, the fund has been 52% more volatile than the S&P 500.

Fever pitch

BlackRock may have an additional motive for making a big push into private assets

A 2023 study in the Review of Financial Studies suggested that BlackRock may have an additional motive for making a big push into private assets. Interest in alternative investments has grown markedly in the past few years, and the firm would have the incentive to exploit that heightened interest by launching new products on which it can charge much higher fees.

The study, entitled "Competition for Attention in the ETF Space," was conducted by Itzhak Ben-David of The Ohio State University, Byungwook Kim of the University of California Irvine, Francesco Franzoni of the University of Lugano in Switzerland, and Rabih Moussawi of Villanova.

In an email, Ben-David argued that the waxing and waning of the investor sentiment cycle is crucial to understanding when investment firms such as BlackRock launch narrowly focused and more expensive products.

During the up phase of that cycle, for example, investor sentiment builds on good news and becomes more bullish as the recent past is extrapolated into the indefinite future before reaching peak exuberance. That's when exchange-traded fund providers often bring their specialized ETFs to market, Ben-David noted - just before the down phase of the sentiment cycle begins.

Consistent with this possibility, he continued, is the heightened recent interest in private assets. As you can see from the chart above, the trend over the past 15 years has been steadily upward, and in recent years this upward pace has accelerated. By emphasizing private markets, BlackRock may actually be more of a follower than a leader.

Mark Hulbert is a regular contributor to MarketWatch. His Hulbert Ratings tracks investment newsletters that pay a flat fee to be audited. He can be reached at mark@hulbertratings.com

More: BlackRock CEO Larry Fink's annual letter is out. What he didn't say is most notable.

Plus: Larry Fink proposes an alternative to the 60/40 portfolio. It means more fees.

-Mark Hulbert

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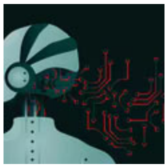

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