Thirdpath

The State of Private Equity, Part 2B: Challenges and Opportunities for LPs

Tim Lee July 2026
Senior Managing Director, Co-head of Buyouts

The Unexpected Story: The Portfolio That Won't Move

Every LP remembers 2022 slightly differently, but the shape of the story is the same.

Stocks fell in 2022. And then, against everything a career in institutional investing had taught them to expect, bonds fell too, instead of rising to catch them. The hedge that was supposed to be there wasn't. For a portfolio built on the assumption that at least one side of the ledger would hold steady while the other bled, that was a betrayal no one had expected or prepared for.

The second blow came from arithmetic, not markets. As public portfolios cratered and private valuations sat unchanged, marked at what they'd been worth months earlier, private allocations quietly swelled as a share of everything an LP owned, not because anyone bought more private equity, but because everything else got cheaper.

Overnight, allocators who had been comfortably within their targets found themselves over them, capital committed, more being called, and nowhere obvious to find room. The industry gave this a bloodless name: the denominator effect, as if a spreadsheet identity could capture what it actually felt like, being trapped by your own portfolio.

Four years on, that trap has not sprung open so much as calcified. The cash that used to come back every year, distributions, exits, proceeds recycled into the next fund, has slowed to a trickle by historical standards, even as the industry's stock of unsold companies has swollen into the trillions. LPs did nothing wrong. They are simply waiting, in a market that has decided waiting is now the price of admission. That is where this report opens: inside a portfolio that technically performed and still won't move.

But this is not only a story about being stuck. It's also about the plumbing being rebuilt in real time: secondaries and continuation vehicles going from niche workaround to mainstream liquidity tool, infrastructure and data centers emerging as the one segment nobody argues about, and a growing recognition that manager selection, not just asset-class exposure, is where the real dispersion in outcomes now lives.

The LP who understands both halves of this story, the trap, and the tunnel being built to get out of it, is the one who likely comes out ahead.

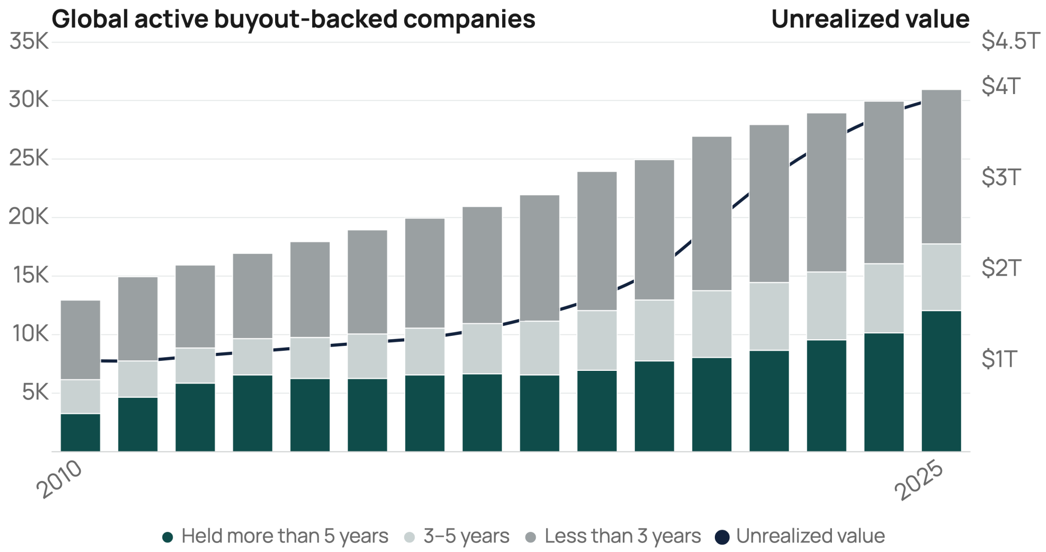
Table of Contents

SECTION I: CHALLENGES FOR LPs

1. Portfolio Liquidity: Distributions Still the Bottleneck

Despite 2025's rebound in deal and exit activity, global PE-backed exit value rose 41% to $1.3 trillion, aided by a nearly-doubled IPO market and the blockbuster Medline offering, the largest PE-backed IPO as of that date[1], cash isn't flowing back to LPs at anywhere near the pace it once did.

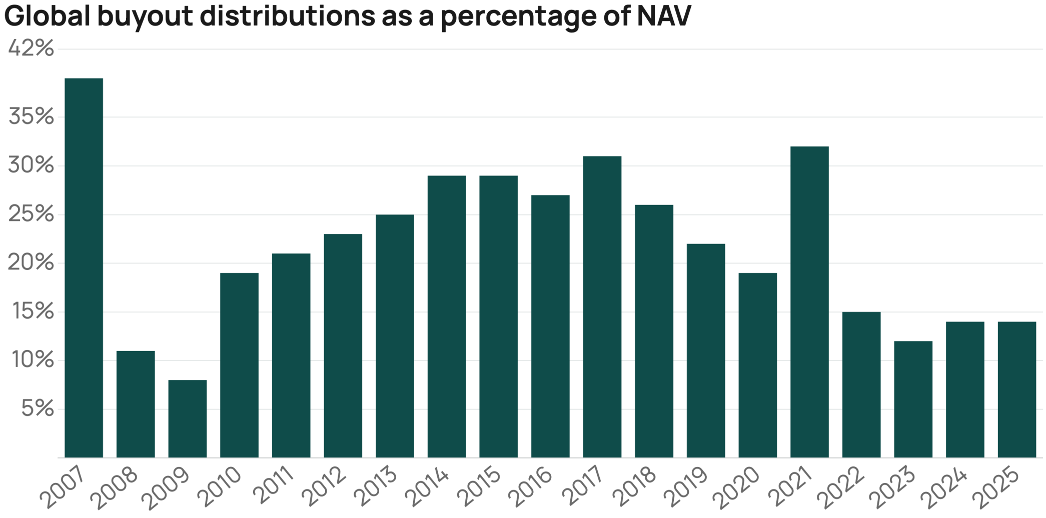
Distributions as a share of NAV have remained below 15% for four consecutive years, a level not seen since the depths of the 2008–09 global financial crisis. The industry's stock of unrealized assets has swelled to roughly 32,000 companies worth $3.8 trillion.[2] Average holding periods at exit have stretched to around seven years, up from five to six years for most of 2010–2021, and almost 40% of all portfolio companies are now held for more than five years, up from 29% in 2019.[2]



Source: Bain[2]

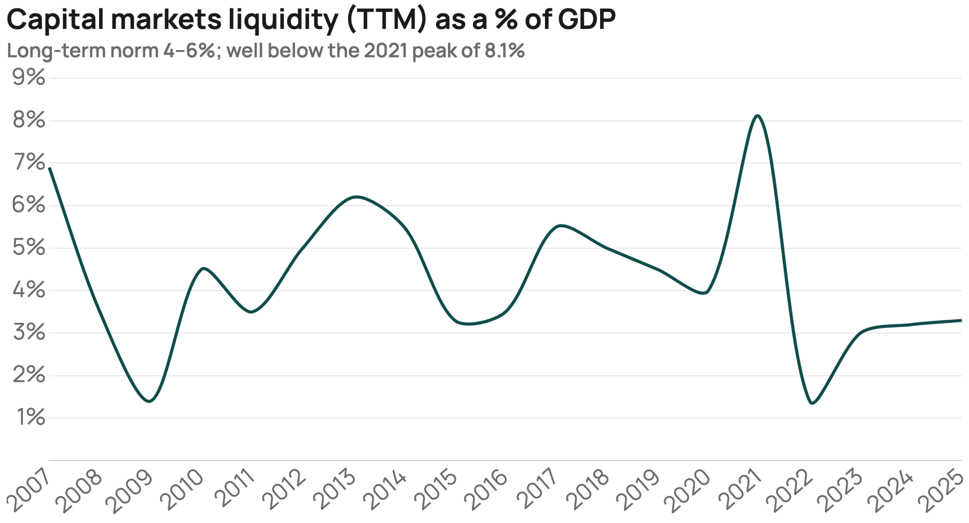
McKinsey's data points to the same imbalance from a different angle: as detailed in "The State of Private Equity, Part 2A: Challenges and Opportunities for GPs," the stock of aging portfolio companies held more than four years has climbed to the highest share of buyout-backed inventory on record.[3] With that much capital tied up in aging portfolios, LPs are left waiting longer than ever to see cash come back, regardless of how strong headline deal and exit values look. The IPO window for PE companies may already be narrowing again due to the Middle East conflict, with H1 2026 shaping up as a quieter IPO market than late 2025 suggested (except the SpaceX IPO).[4]

[1] McKinsey & Company, Global Private Markets Report 2026; Bain & Company, Global Private Equity Report 2026.
[2] Bain & Company, Global Private Equity Report 2026.
[3] McKinsey & Company, Global Private Markets Report 2026.
[4] PitchBook, US PE Breakdown, Q1 2026.



Source: Bain[5]

KKR's capital-markets liquidity indicator, which tracks IPO, high-yield bond, and leveraged-loan issuance as a share of GDP, points to the same conclusion: the indicator is projected to reach roughly 4.7% of GDP by year-end 2026, up from the 1%–3% range of recent years, but still below the 4%–6% long-term norm and well short of the 2021 peak of 8.1%.[6]

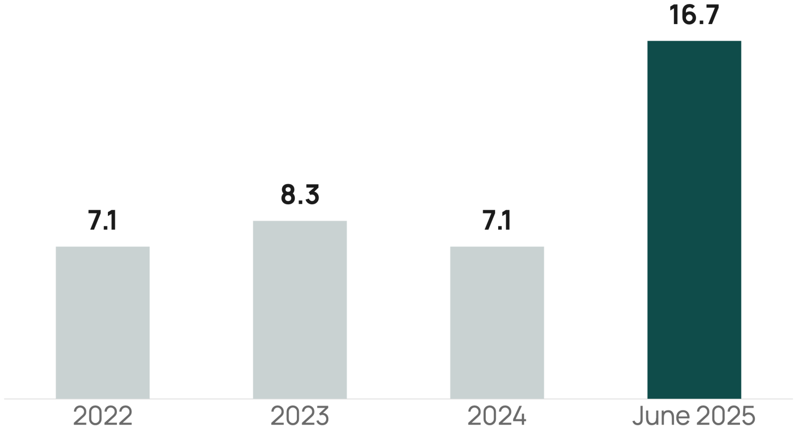


Source: KKR[6]

ORIX puts a number on how long this backlog could take to clear at the current distribution pace: working through the existing inventory of unsold companies would now take 16.7 years, more than double the 7.1 years it would have taken as recently as 2024, an alarming figure if the exit market does not improve.[7]

[5] Bain & Company, Global Private Equity Report 2026.
[6] KKR, Insights Vol. 16.3, "The Divergence Conundrum: Mid-Year Outlook for 2026," June 2026.
[7] ORIX, "NAV and GP Financing in a Shifting Private Equity Landscape: 2025 Recap I 2026 Outlook," April 2026.

Years required to clear the PE inventory backlog



Source: ORIX[8]

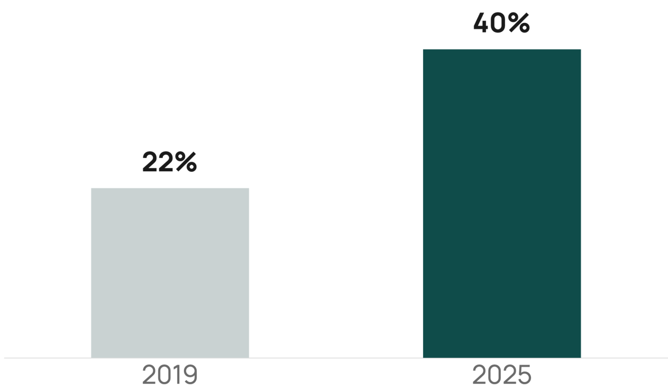
[8] ORIX, "NAV and GP Financing in a Shifting Private Equity Landscape: 2025 Recap I 2026 Outlook," April 2026.

2. Asset Allocation: The Denominator Effect

The classic denominator effect assumes public markets do the damage: equities fall, private marks don't, and PE mechanically balloons to an oversized share of the portfolio.

That's not what's happening this cycle. Public equities have surged, as the strong 5- and 10-year public-market returns show. And yet overallocation is, if anything, worse than it was in 2019. According to Dawson Partners, 40% of institutional North American LPs reported being overallocated to private equity in 2025, an 82% increase from 22% in 2019, even without a public-market crash to blame.[9]

Share of North American LPs overallocated to private equity



Source: Dawson Partners[9]

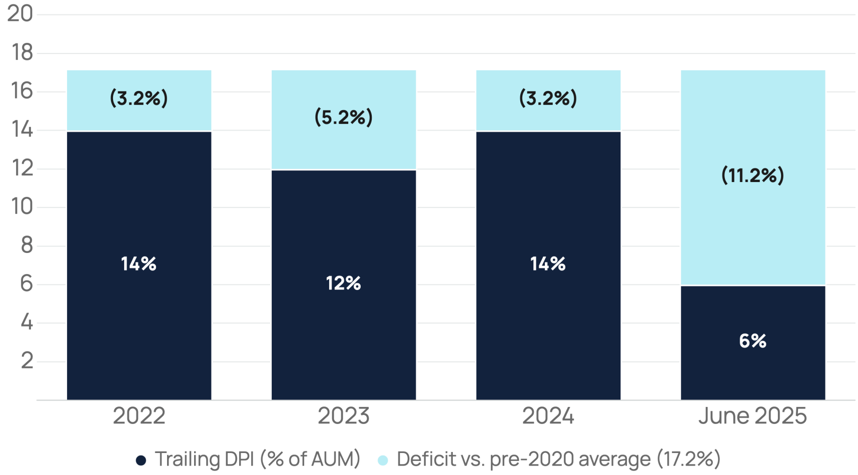
The real driver is the numerator, not the denominator: distributions, which averaged 25% of NAV annually from 2001 to 2025, fell to just 14% from 2022 through 2025, a 44% decline, making this only the third stretch in the twenty-first century (after the dot-com bust and the GFC) that annual distributions have stayed below 20% of NAV.[9] ORIX's own tracking confirms the scale of the shortfall from an independent data set: 12-month trailing distributions fell to just 6.0% of AUM by June 2025, little more than a third of the pre-2020 average of 17.2%.[10] With so little capital coming back, private allocations keep compounding in place instead of shrinking on their own, regardless of what public markets do.

[9] Dawson Partners, "LP Financing Solutions: A Creative Alternative for LPs Looking to Generate Liquidity," Institutional Investor, February 26, 2026 (citing Private Equity International's LP Perspectives 2026 Study; Bain & Company, Global Private Equity Report 2020; MSCI data).

[10] ORIX, "NAV and GP Financing in a Shifting Private Equity Landscape: 2025 Recap I 2026 Outlook," April 2026.

12-month trailing PE DPI (% of AUM)

Stacks sum to the 17.2% pre-2020 average

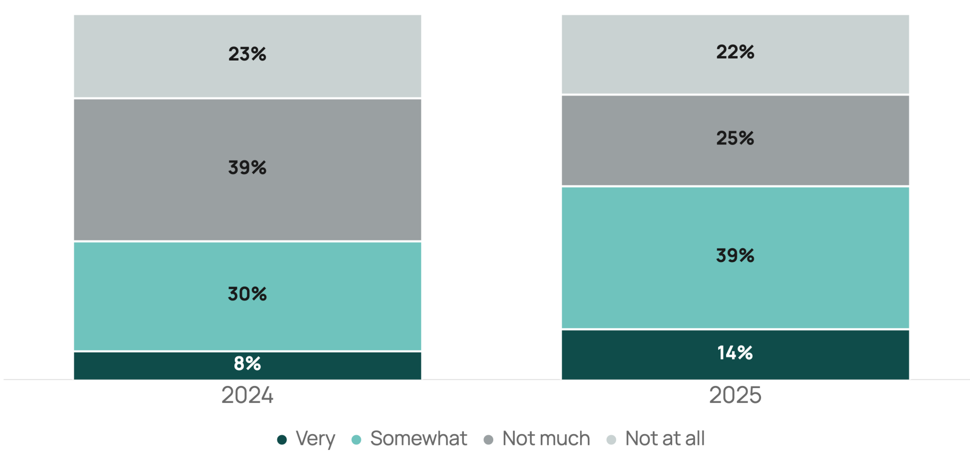


Source: ORIX[11]

That same dynamic shows up mechanically, not just sentimentally, in the fundraising pipeline. LPs' ability to commit fresh capital is constrained by capital they've already promised but not yet funded. In a Private Equity International survey, the share of LPs saying they are "very" or "somewhat" limited from making new PE commitments because of undrawn commitments rose to 53% by late 2025, up from 38% a year earlier.[12] That's a direct consequence of the record 2021–22 fundraising boom: LPs are still funding those vintages while distributions from older funds remain scarce.

To what extent are you limited by your existing, undrawn commitments to private equity from making new commitments to funds?

Share of respondents in each category

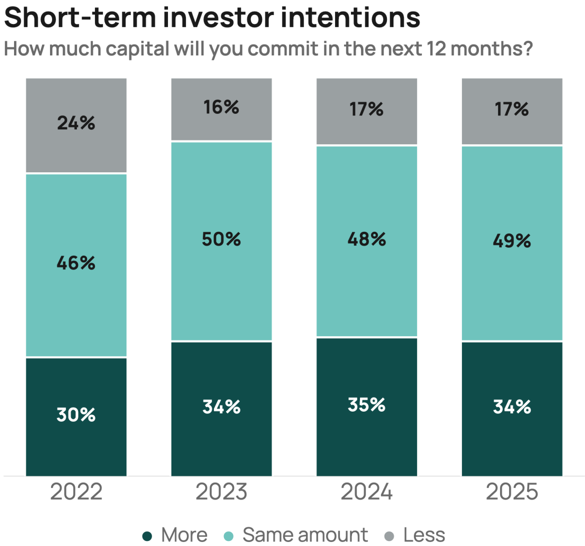


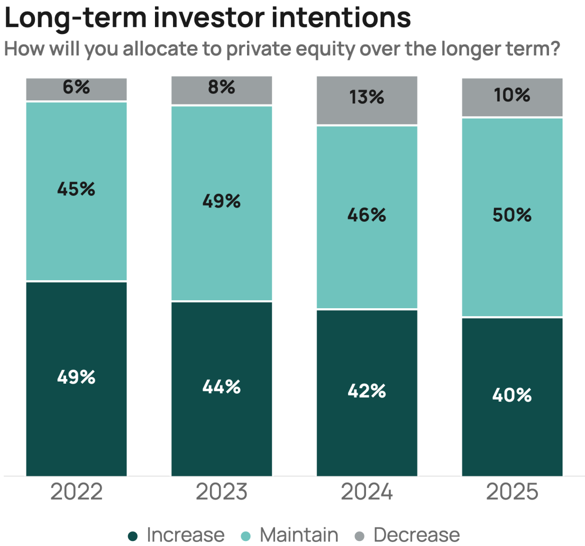
Source: Bain[12]

Yet despite the liquidity constraint, conviction in the asset class remains strong. A majority of LPs surveyed by Preqin say they plan to maintain or increase their private equity allocations both in 2026 and over the long term, with only 17% planning to commit less capital in the next 12 months, down from 24% just three years earlier.[13] Simple math dictates that the amount of capital LPs can commit

[11] ORIX, "NAV and GP Financing in a Shifting Private Equity Landscape: 2025 Recap I 2026 Outlook," April 2026.
[12] Bain & Company, Global Private Equity Report 2026 (Private Equity International's LP Perspectives 2026 Study).
[13] Bain & Company, Global Private Equity Report 2026 (Preqin Investor Outlook Surveys 2022–25).

today is capped by the cash they get back from prior investments, not by how much they want to invest.





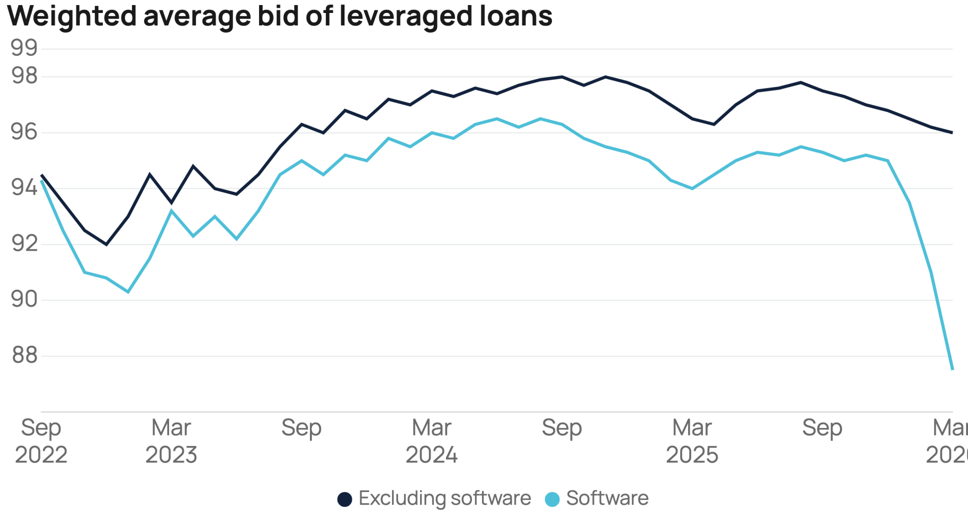
Source: Bain[14]

[14] Bain & Company, Global Private Equity Report 2026 (Preqin Investor Outlook Surveys 2022–25).

3. Asset Quality: The Software Reset, PE's Favorite Sector Under Pressure

Software's decade-long run as PE's favorite sector is facing its first real test.

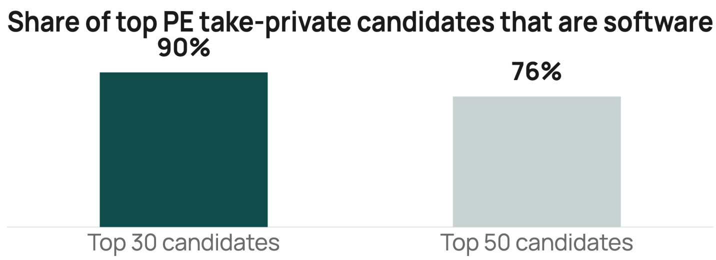
Bids on software-backed leveraged loans fell off a cliff in early 2026, triggered by fears about AI and its impact on subscription-based software businesses.[15] So far, the decline looks more like a perceived risk than a wave of actual credit deterioration, and many software borrowers continue to generate stable, recurring cash flows.[15] The exposure, however, runs deeper. Software has been PE's "go-to investment of the past decade."[15] It's also the largest sector by BDC debt exposure at roughly 20%, meaning LPs carry software risk through both the equity and credit sleeves of their portfolios.[15]



Source: PitchBook[15]

PitchBook's take-private quant screen of the public markets showed that 27 of the top 30, and 38 of the top 50, LBO candidates by fundamental metrics are now software companies.[15]

Whether this represents a buying opportunity or a structural de-rating of PE's darling sector remains an open question. That repricing does highlight a broader rotation: capital is shifting away from software and toward hard assets with an AI tailwind, or assets without AI risk, a trend we'll explore further in Section II's infrastructure opportunity.



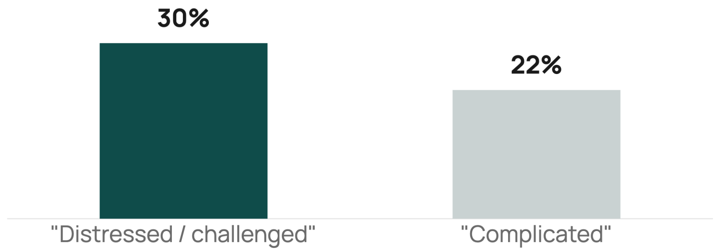
Source: PitchBook[15]

[15] PitchBook, US PE Breakdown, Q1 2026.

4. Continuation Vehicles: Liquidity Tool or Conflict of Interest?

As GP-led continuation vehicles have grown into a mainstream liquidity tool, they have also drawn real skepticism from the LPs who use them. In a McKinsey survey, roughly 30% of LPs characterized assets sitting in continuation vehicles as "distressed" or "challenged," and another 22% called them "complicated," reflecting a persistent worry that CVs can be used to extend the life of underperforming assets rather than to genuinely return capital.[16]

Share of LPs Characterizing Assets held in Continuation Vehicles

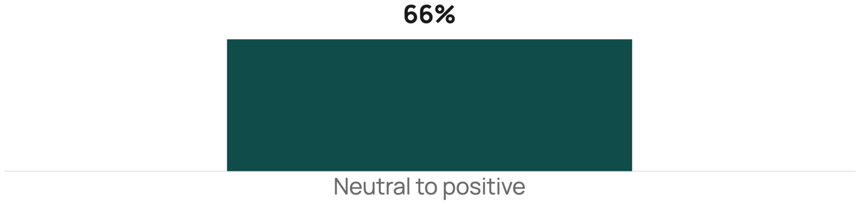


Source: McKinsey[16]

Regulators are paying attention, too. According to UBP, the rapid growth of continuation vehicles has attracted heightened regulatory and investor scrutiny, with regulators specifically flagging inadequate disclosure of the conflicts of interest inherent in a transaction where the same GP effectively sits on both sides of the trade: selling from the old fund and buying into the new one.[17]

Yet the concern does not appear to be a dealbreaker: nearly two-thirds of LPs surveyed by McKinsey report at least a neutral-to-positive view of GPs that use continuation vehicles frequently, and first-quartile continuation funds have actually outperformed first-quartile buyout funds by 0.2x turns of net MOIC in recent vintages, which suggests the real issue for LPs is governance and disclosure, not the instrument itself.[16]

Share of LPs reporting at least a neutral to positive view of GPs' frequent CV use



Source: McKinsey[16]

In our view, financial engineering hasn't left private equity. It has shifted from balance-sheet leverage toward liquidity and structural tools like continuation vehicles, GP-led secondaries, LP-led secondaries, and NAV loans. These tools solve real problems, but they may also carry tail risk in ways that are harder for LPs to see and price properly than leverage ever was.

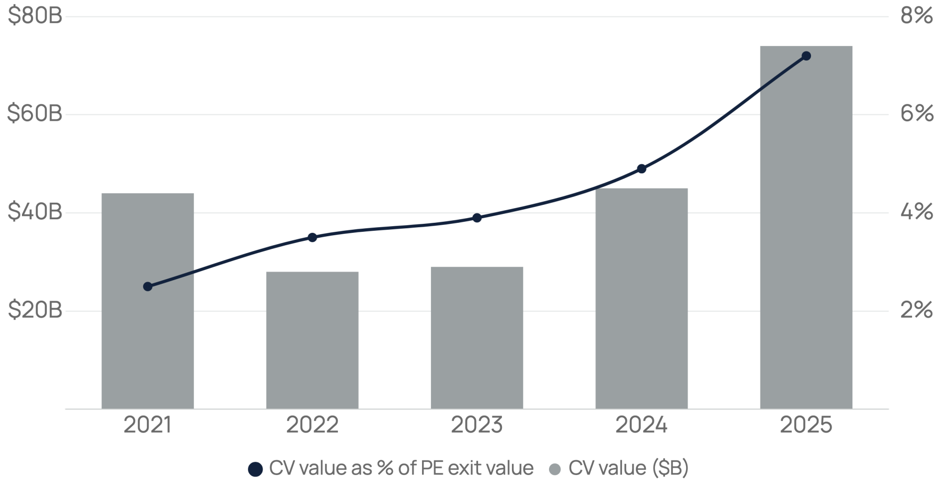
[16] McKinsey & Company, Global Private Markets Report 2026.
[17] UBP, Private Markets Outlook 2026.

SECTION II: OPPORTUNITIES FOR LPs

1. New Tools: Secondaries & Continuation Vehicles Go Mainstream

Secondaries have evolved from a niche workaround into structural market infrastructure. In 2025, GP-led continuation vehicle (CV) transaction value grew 62% YoY, a 37% CAGR since 2022. CVs now account for less than 10% of total PE exit value.[18] More than half of GPs cite the need to return capital to existing LPs as the primary driver behind their most recent CV.[18]

PE continuation-vehicle value and share of exit value



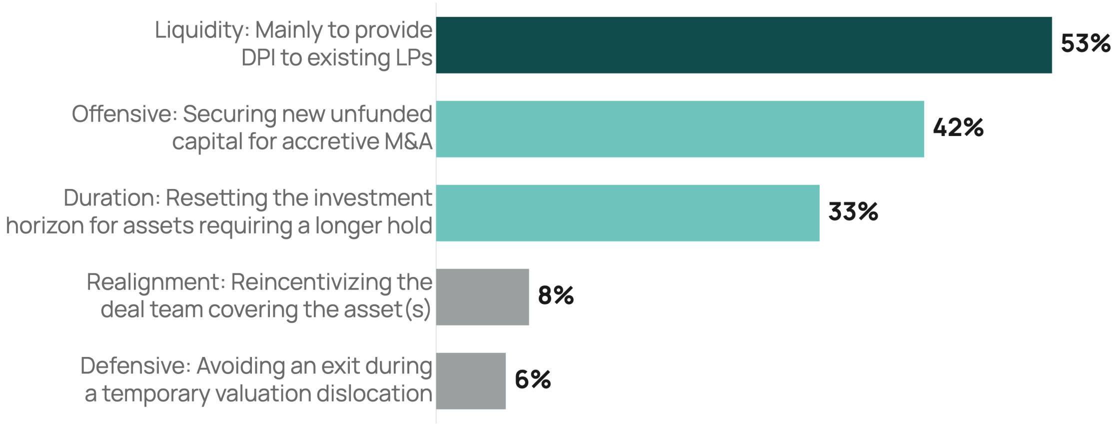
Source: Bain[18]

That translates directly into liquidity options for LPs. Secondaries transaction value across GP- and LP-led vehicles grew 41% YoY in 2025.[18] In terms of total sponsor-backed exit volume, GP-led secondaries have grown from 6% in 2020 to a projected 16% by 2026.[19]

LPs remain selective about how much of this liquidity mechanism they'll tolerate from any one GP, but as a category, secondaries are now a permanent fixture of the liquidity toolkit rather than an emergency valve.[18] The governance concerns some LPs raise about GP-led continuation vehicles specifically, which we discussed in Section I, do not appear to have slowed that growth.

[18] Bain & Company, Global Private Equity Report 2026.
[19] UBP, Private Markets Outlook 2026 (Jefferies).

Primary strategic driver for GPs' most recent continuation vehicle



Source: Bain[20]

Pricing data reinforces that shift from workaround to infrastructure. According to UBP, LP-led secondary pricing for buyout funds has held in the low-to-mid 90s as a percentage of NAV through H1 2025, significantly higher than credit, real estate, or venture secondaries, which indicates that sellers are no longer forced into deep discounts to generate liquidity.[21]

Secondary market pricing (LP-led), % of NAV

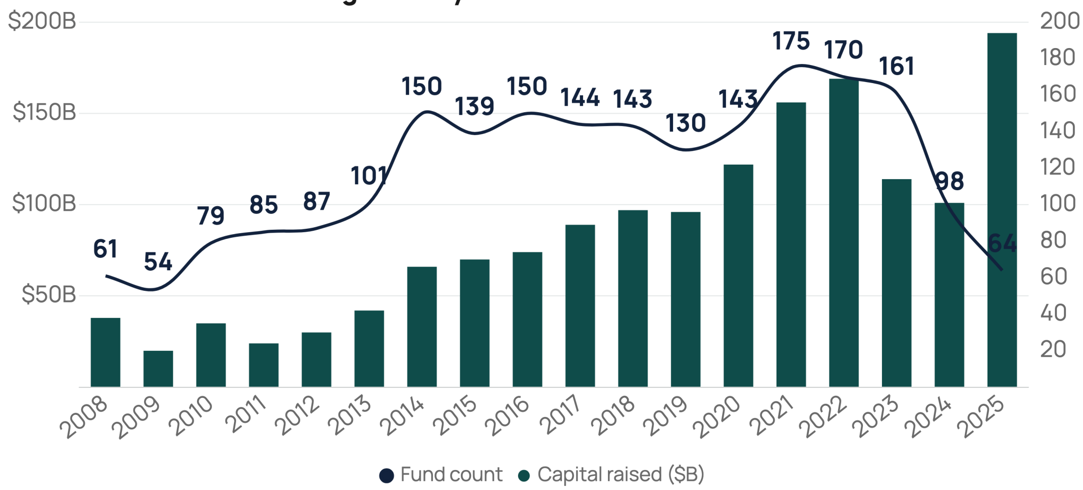
Source: UBP[21]

[20] Bain & Company, Global Private Equity Report 2026.
[21] UBP, Private Markets Outlook 2026 (Jefferies).

2. New Segment: Infrastructure and Data Centers: The Standout Opportunity

Infrastructure was the standout fundraising story of 2025. The strategy raised nearly $200 billion, even as private equity and venture capital continued to face fundraising headwinds; six of the ten largest private capital funds closed globally in 2025 were infrastructure vehicles, and the top three infrastructure funds alone accounted for more than a third of the year's total.[22] Bain's fundraising data tells the same story: infrastructure fundraising grew 58% year-over-year in 2025, even as buyout fundraising fell 16%.[23]

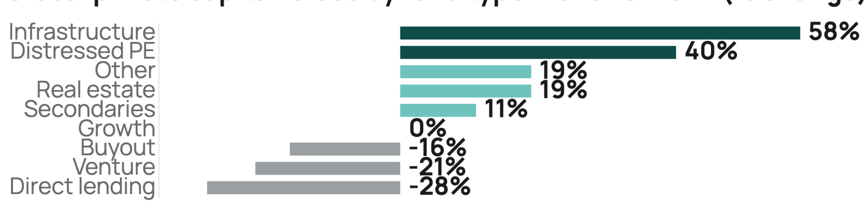
Infrastructure fundraising activity



Source: SEB[22]

Not surprisingly, much of the growth came from AI-adjacent demand. Digital infrastructure linked to AI, such as data centers, power generation, and grid connectivity, has emerged as a distinct allocation theme, offering investors infrastructure-like risk and return with exposure to the AI capex cycle. As we discussed in the software-sector challenge in Section I, this is the flip side of that story: capital rotating toward asset-heavy businesses. Half of 2025's infrastructure capital was raised in North America, with a further 40% from European managers, and dry powder grew only modestly to $417 billion even as deployment activity kept pace with inflows, a sign that capital is being put to work rather than stockpiled.[22]

Global private capital raised by fund type: 2025 vs. 2024 (% change)



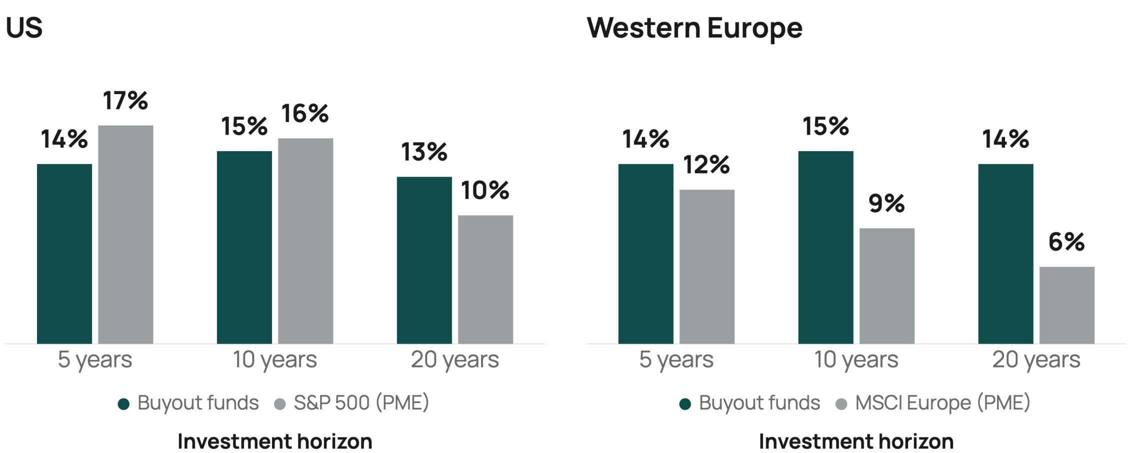
Source: Bain[23]

[22] SEB Manager Selection, 2026 Private Markets Report.
[23] Bain & Company, Global Private Equity Report 2026.

3. Asset Allocation: Public vs. Private Equity, Diversification Is Still a Good Pitch

Despite a tough fundraising and liquidity environment, private equity's return case remains intact over the long run. US public equities have modestly outperformed buyout funds at the 5- and 10-year horizons (17% vs. 14%, and 16% vs. 15%, respectively), but buyout funds actually lead over a 20-year horizon (13% vs. 10%). Geographically, private equity outperforms public-market equivalents across every horizon shown in Western Europe, including a wide 14% vs. 6% gap over 20 years.[24] Top-quartile funds beat public-market averages by an even wider margin in both regions.[24]

End-to-end pooled net IRR as of Q3 2025



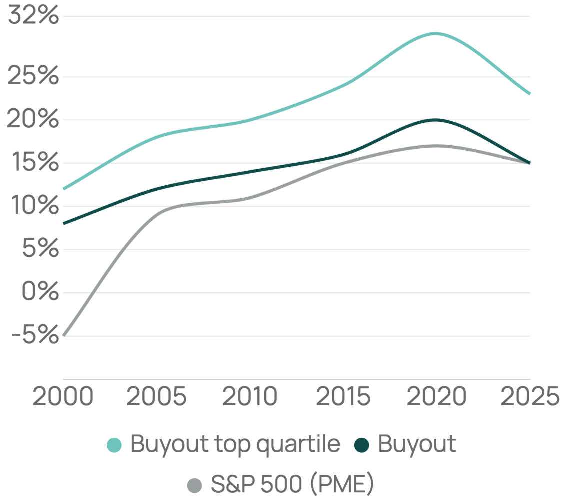
Source: Bain[24]

That outperformance is precisely why LPs continue to show up. But when asked directly what they value most about private equity, LPs in Preqin's June 2025 Investor Outlook Survey pointed to diversification, not returns, as the top rationale for investing in the asset class.[24]

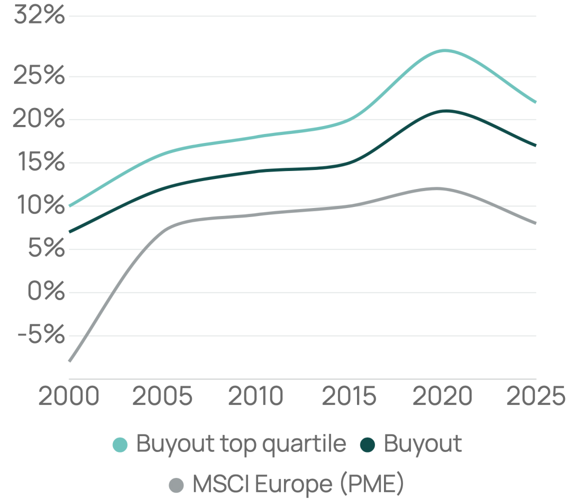
For LPs navigating a period of muted public-market comparisons and elevated cross-asset correlation, that diversification case may be the more durable argument going forward.

[24] Bain & Company, Global Private Equity Report 2026.

US: 10-year horizon IRR



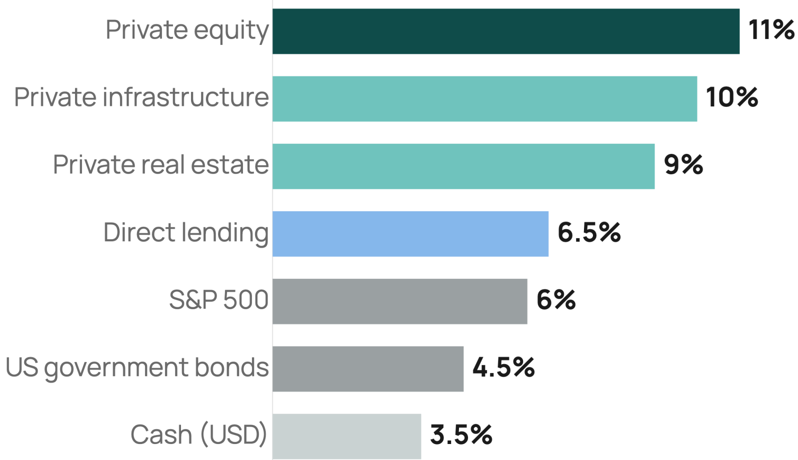
Western Europe: 10-year horizon IRR



Source: Bain[25]

KKR's multi-asset forward return estimates reinforce the same conclusion. They project private equity to generate among the highest expected returns of any asset class KKR tracks over the next five years, modestly ahead of private infrastructure and comfortably above core fixed income, direct lending, and cash.[26]

Expected returns over the next five years, by asset class



Source: KKR[26]

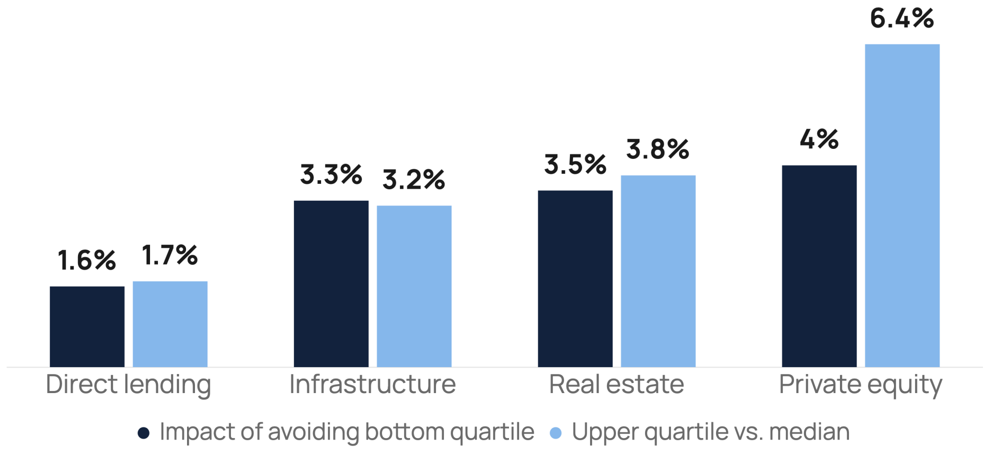
[25] Bain & Company, Global Private Equity Report 2026.

[26] KKR, Insights Vol. 16.3, "The Divergence Conundrum: Mid-Year Outlook for 2026," June 2026.

4. Manager Selection: Dispersion Is Highest in PE vs. Other Asset Classes

Manager selection matters more in private equity than in almost any other private asset class. According to Cambridge Associates, the spread between top-quartile and median private equity managers across 2017–2021 vintage years was 6.4%, and the benefit of simply avoiding bottom-quartile managers was 4.0%. Both gaps are the widest of any private asset class measured, ahead of real estate, infrastructure, and direct lending.[27]

Historic manager dispersion in private markets



Source: KKR[27]

In private equity, more than almost anywhere else in private markets, avoiding bottom-quartile managers is itself a source of return.

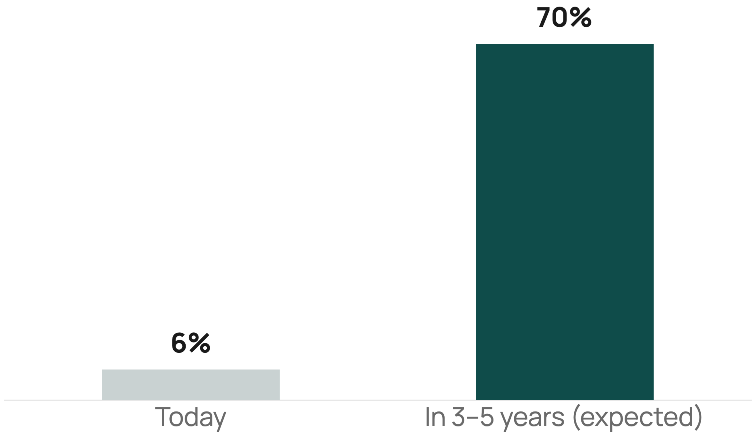
The takeaway for LPs is straightforward: in a lower-return environment, which manager an LP selects matters more than which asset class it allocates to. That reinforces the case, explored elsewhere in this report, for focusing on specialists, harvesting the complexity premium (discussed in Part 2A), and backing AI-forward managers, which we discuss next.

[27] KKR, Insights Vol. 16.3, "The Divergence Conundrum: Mid-Year Outlook for 2026," June 2026 (Cambridge Associates).

5. New Approach: Backing the AI-Forward GPs, A New Selection Criterion

AI capability is emerging as a real point of differentiation among GPs, and a criterion LPs can underwrite today. According to McKinsey, only 6% of GPs currently say AI is delivering high impact in their own internal operations and investment processes. However, 70% expect high impact within three to five years, implying a rapid buildout is coming.[28]

Share of GPs reporting AI delivers high impact on operations



Source: McKinsey[28]

For LPs, that gap between today's modest AI adoption and tomorrow's expectations is the opportunity: identifying and backing the cohort of GPs already investing in AI capability now, ahead of the broader buildout, may offer a durable edge similar to the specialist premium.

The firms worth watching are the ones already embedding AI into underwriting and value creation rather than treating it as a side initiative. Bain notes that leading GPs are using AI to drive down costs at the firm level, exploring how the technology can transform deal sourcing, due diligence, and value creation.[29]

For LPs conducting manager due diligence, concrete questions, such as how a GP is using AI in diligence today, and how it plans to embed AI into portfolio companies, are becoming as relevant to manager selection as track record and sector focus.

[28] McKinsey & Company, Global Private Markets Report 2026.
[29] Bain & Company, Global Private Equity Report 2026.

Key Takeaways

Challenges for LPs: Liquidity, not conviction, is the binding constraint.

Opportunities for LPs: New liquidity tools, AI-focused investments, and AI-forward manager selection.

Conclusion

The report opened inside a trap: a historically reliable hedge that broke in 2022, a denominator effect that followed, and a portfolio that, four years later, still hasn't started moving the way LPs are used to. That description holds.

Distributions as a share of NAV have sat near record lows for four consecutive years, holding periods keep stretching, and undrawn commitments are boxing in LPs' ability to commit fresh capital, even as most say they want to maintain or grow their private equity allocations. Software, long viewed as the industry's most-favored sector, is facing its first real valuation reset, and the continuation vehicles many GPs use to manage their own liquidity needs are drawing real scrutiny over disclosure and conflicts of interest.

But the exit being built out of that trap is real, and it is arriving faster than the industry expected.

Secondaries and continuation vehicles have evolved from a niche workaround into structural market infrastructure, giving LPs a genuine release valve rather than an emergency one. Infrastructure and data centers were the standout fundraising story of 2025, and private equity's long-run return case remains intact relative to public markets, keeping the diversification argument alive even in a muted comparative environment.

Perhaps most tellingly, the data increasingly shows that manager selection, not just asset allocation, is where LPs can add the most value in private equity specifically: dispersion between top- and bottom-quartile managers is wider in PE than in any other private asset class, and AI capability is quickly emerging as a new, forward-looking criterion for identifying tomorrow's top managers today.

We believe the LPs who come out ahead will be the ones who stop waiting for the portfolio to move on its own and start using the tools now available, including better manager selection, more comprehensive liquidity mechanisms, and new segments to diversify into.

The trap that opened this report is real. So is the way out.

Thirdpath

We provide investors with access to differentiated private markets opportunities across primaries, secondaries, direct investments, co-investments, independent sponsors, and GP seeding & stakes, underpinned by alignment, disciplined execution, and data-driven insight.

INVESTMENT TEAM

Tim Lee
Senior Managing Director, Co-head of Buyouts

Sam Howard
VP, Alternative Credit

Serina Yu
Senior Managing Director, Co-head of Buyouts

Dylan Li
Analyst, Investments

LEGAL & OPERATIONS TEAM

John McGuinness
Managing Partner, Co-COO, GC and CCO

Thalia Gietzen
CFO & Co-COO

Brey Jones
Managing Partner, Managed Accounts

Bret Awbrey
VP, Finance

Sources

1. Bain & Company, Global M&A Report 2026.

2. Bain & Company, Global Private Equity Report 2026.

3. Dawson Partners, "LP Financing Solutions: A Creative Alternative for LPs Looking to Generate Liquidity," Institutional Investor (online), February 26, 2026, https://www.institutionalinvestor.com/article/sponsored-content/lp-financing-solutions-creative-alternative-lps-looking-generate.

4. KKR, Insights Vol. 15.4, "High Grading: Outlook for 2026," December 2025.

5. KKR, Insights Vol. 16.3, "The Divergence Conundrum: Mid-Year Outlook for 2026," June 2026.

6. McKinsey & Company, "2026 M&A Trends: Navigating a Rapidly Rebounding Market," February 2026.

7. McKinsey & Company, Global Private Markets Report 2026.

8. ORIX, "NAV and GP Financing in a Shifting Private Equity Landscape: 2025 Recap | 2026 Outlook," April 2026.

9. PitchBook, 2026 US Private Equity Outlook.

10. PitchBook, US PE Breakdown, Q1 2026.

11. SEB Manager Selection, 2026 Private Markets Report.

12. UBP, Private Markets Outlook 2026.

Disclosures

This material is for informational and discussion purposes only and is not intended as an offer or a solicitation of an offer to buy any security, investment product, or investment advisory service. The information contained herein does not constitute investment, legal, regulatory, tax, accounting, or other professional advice and should not be relied upon as such.

Unless otherwise noted, all information, views, and opinions expressed are as of the date of this report and are subject to change without notice. There can be no assurance that the views expressed herein will prove to be correct or that the trends described will continue. Past performance is not indicative of future results.

This material reflects the views of Thirdpath and is based on information believed to be reliable; however, Thirdpath makes no representation or warranty, express or implied, as to the accuracy, completeness, or fairness of the information or opinions contained herein and accepts no liability for any direct or indirect losses arising from its use.

Certain information has been obtained from third-party sources, which have not been independently verified. Any forward-looking statements included herein are based on current expectations, estimates, assumptions, and projections and involve known and unknown risks and uncertainties that may cause actual outcomes to differ materially. Words such as “may,” “should,” “expects,” “believes,” “estimates,” “anticipates,” or similar expressions are intended to identify forward-looking statements. Any projections are, by their nature, hypothetical, and are provided solely for illustrative purposes.

All investments involve risk, including the potential loss of capital. Risks may include, but are not limited to, market risk, credit risk, liquidity risk, interest rate risk, valuation risk, and conflicts of interest. Diversification does not guarantee profits or protect against losses.

This document is confidential and intended solely for the use of its intended recipients. It may not be reproduced, distributed, or disclosed, in whole or in part, without the prior written consent of Thirdpath. All information provided is as of July 2026, unless otherwise indicated.

Thirdpath

Read more on thirdpath.com