

Institutional Research Group



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How Safe Is the 401(k) Safe Harbor?

New Department of Labor Rules outline fiduciary obligations of 401(k) plan sponsors

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Key takeaways

- **Broader than expected.** The DoL's new rules are not a green light for private market investments in 401(k)s. Instead, they establish a general fiduciary framework applicable to any investment option under consideration for a plan.
- **Fee and performance comparisons remain murky.** The rules attempt to justify higher fees for alternative investments if risk-adjusted returns warrant it, but given how difficult it is to measure forward-looking risk-adjusted returns for newly created products inclusive of private markets, this standard may be difficult to defend in practice.
- **Liquidity risk is untested.** Because private assets have never been widely included in 401(k)s before, the liquidity stress-testing of these new hybrid products remains theoretical. A market dislocation could expose flaws in liquidity models that few fiduciaries could identify in advance.
- **Valuation is a significant vulnerability.** Daily pricing of funds that hold illiquid assets creates a structural tension: Participants transact throughout the quarter, while underlying private assets may only be valued quarterly. This mismatch could invite litigation in volatile markets when valuations may seem to have been inaccurate.
- **Benchmarking is an unresolved problem.** Appropriate benchmarks do not yet exist for hybrid public/private 401(k) products. Composite benchmarks combining the past performance of public and private indexes are imperfect proxies that do not reflect the true cash flow and liquidity realities of these new vehicles.
- **Complexity may be a deterrent.** The rules acknowledge that complexity alone does not disqualify an investment, but overconfidence bias and the risk of being proven wrong after the fact mean that many fiduciaries will likely avoid complex products altogether rather than risk litigation.
- **A safe harbor with limits.** The rules offer plan fiduciaries a process-based legal safe harbor if they can demonstrate prudent diligence across six factors: performance, fees, liquidity, valuation, benchmarking, and complexity. But while the rules will reduce the chance of losing lawsuits, they will not prevent them from being filed.
- **Adoption will happen anyway.** Despite these concerns, private market investments will gradually enter 401(k) plans, driven by the strong commercial incentives of asset managers, recordkeepers, and DC advisors who are actively restructuring their businesses to make it happen.



Background

On March 31, 2026, the Department of Labor's (DoL) Employee Benefits Security Administration issued the rules that were requested by President Trump's executive order (EO) in August 2025, starting the clock on a 60-day comment period for market participants to provide feedback.¹ Despite the EO being titled "Democratizing Access to Alternative Assets for 401(k) Investors,"² the new rules appear to be a framework for defining how fiduciaries of 401(k)s can show that they are fulfilling their fiduciary duty in making any "investment alternatives" available, be they ETFs, real estate funds, or cryptocurrency options. "Alternatives" is in this case being treated like a synonym of "choices" rather than the investment definition of the word that includes the likes of hedge funds, private equity, and cryptocurrencies.³

In saying that "the department's days of picking winners and losers are over,"⁴ the DoL has made the advice general, not specific to private market investments, as was anticipated prior to the proposal. That said, while the EO spoke of including alternative assets as a portion of an "asset allocation fund," the broad nature of the rules could open the door to the use of funds like those in the evergreen universe—dedicated private market funds—assuming that the liquidity requirements of 401(k) plan can be met.⁵ If a fiduciary can make the case that it performed prudent diligence, direct investments in private asset funds might be possible within a 401(k) lineup, as the proposal teases a legal safe harbor if the fiduciary fulfills the requirements as outlined in the rules.

One of the largest pain points for 401(k) sponsors, usually employers, has been the amount of litigation that has been successful in awarding wins to employees feeling that the retirement plans on offer had made poor investment selections and/or that the costs were too high.⁶ The fear of litigation has kept many from expanding 401(k) options, feeling that if they looked too different from peers, they would open themselves up to lawsuits. One of the objectives of the EO was to "relieve the regulatory burdens and litigation risk" around defined contribution (DC) accounts, and the new DoL rules are focused primarily on providing "process-based safe harbors for plan fiduciaries to use when selecting designated investment alternatives."

The big question is if this can work. While I have no legal background, my analysis of the rules is that while they may help provide a defense against lawsuits, they will not stop lawsuits from happening. Because of this, fiduciaries may continue to be conservative in their selection of investment options to avoid the expense and distraction of the lawsuits altogether.

For more background on the issues that come with including private market assets into 401(k) plans, please reference our prior two pieces: [Issues Around Private Assets and 401\(k\)s](#) and [The New Face of Private Markets in Your 401\(k\)](#), which discussed issues around liquidity, valuations, fees, benchmarking, complexity and performance, which coincidentally are the six areas covered by the proposed rules. The rules do not solve the underlying issues; they only point out that fiduciaries should be looking at these areas when evaluating funds to include in their 401(k) line-ups.



The players

Some of the nuance on this topic is around the various players and who is responsible for what. The ultimate fiduciary of a 401(k) plan is the plan sponsor. Most employers do not have investment staff on the payroll with the expertise to evaluate investment products in any great depth, particularly across the six factors named in the DoL rules. Many firms will have a 401(k) committee run by someone from the finance team or an HR benefits person whose background is typically far from the world of investments. Because of this, many employers hire advisors or consultants to inform and assist in their retirement plan decisions, a situation explicitly called out as an accepted norm in the new rules. But the final responsibility for the selection of 401(k) options still lies in the hands of the employer.

The second major group of players are the recordkeepers—the firms such as Fidelity Investments, Empower Retirement, and Vanguard—who handle the accounting of the 401(k) plans, which includes tracking each employee's balances, eligibility, and trades. If a fund is not on the recordkeepers' platform, it is more difficult for the employer to put it on their roster for employees to select, and most do not even try. This puts some of the onus on recordkeepers to ensure they have selections on their platforms that could be reasonable options for the plan sponsors to choose. That said, Fidelity has approximately 18,000 fund and share class alternatives available on their open architecture platform,⁷ putting the responsibility back on the plan sponsor to select a typical 15-30 options for their own plans.

The third group are the asset managers, the ones actually managing the funds that go on a recordkeeper's platform to be selected by the employers. Asset managers must act as fiduciaries to their investors, but they are not in a position to decide the suitability of a product for any particular 401(k) plan or participant. Asset managers will be responsible, however, for providing the details that will fulfill the fiduciary requirements as laid out by the DoL rules.

The rules

While the proposed rules take up 57 pages of the Federal Register, the heart lies in the six relevant factors that should be considered by the fiduciary of a 401(k) plan: performance, fees, liquidity, valuation, performance benchmark, and complexity. Evaluating any one of these factors is not a simple task and looking at all six in an informed and prudent way may be difficult for even the most experienced investment professionals, let alone for the 401(k) committee of the typical employer. It is telling that fees, which it seems should lend themselves to a pretty straightforward comparison of one option to another, garnered the second highest word count of the six factor explanations in the proposed rules. It is important to note that the rules are not a checklist that is easily completed; each factor requires a fiduciary to perform an in-depth analysis.

Each of the rules lays out the proposed standard and then provides examples. To help explain the difficulty of what is being asked of plan fiduciaries, we will provide some of the language of the rules. Taking them in order:



Performance

The proposed rule	<i>"...the fiduciary must appropriately consider a reasonable number of similar investment alternatives and then must determine that the risk-adjusted expected returns of the designated investment alternative, over an appropriate time horizon and net of anticipated fees and expenses, furthers the purposes of the plan by enabling participants and beneficiaries to maximize risk-adjusted return on investment, net of those fees and expenses."</i>
The difficulty	This standard asks plan fiduciaries to do what many investment professionals would struggle to do: reasonably assess and select options from a list of investment products such that they end up with the best outcome. Meaningfully understanding the concept of risk-adjusted returns is itself not a straightforward task. If one tries to use a quantitative approach, the risk and performance metrics will be backward-looking. But executing a qualitative review may be problematic as evidence that performance was properly assessed. If anything, the phrase "risk-adjusted returns" provides some cover because the phrase is so amorphous. What risks did you consider? What returns? In the context of newly-created target-date funds incorporating private markets into their mix, what sort of numbers would truly represent what could be expected from these products? ⁸ If one relies on median returns to state how a multi-asset product might have returned in the past to predict how one might expect the future to play out, then how is one supposed to decide which target date fund is best positioned to maximize returns if they all lean on the same past performance?
The example	One of the examples meant to shine a light on this standard indicates that a long time horizon should be considered, relying most heavily on 10-year historical performance data. While the long-term perspective is laudable, the marketing materials of investment funds usually use a phrase such as "past performance is not indicative of future results" because the SEC believes that performance figures on their own can be misleading. ⁹ There is very little evidence of performance persistence in most areas of the investment universe, ¹⁰ particularly over long periods of time, but this example suggests that looking at 10-year risk and return figures would suffice to meet this standard.
The probable outcome	The employer may enjoy some protection because this rule is so vague, but it may also provide fodder for plan participants to sue when the products end up not providing maximum risk-adjusted returns. Given the difficulty of making risk and return characteristics properly comparable across funds and asset classes, it is likely that funds such as target date funds will tend to look very similar so that nothing appears much riskier than anything else. Also mentioned in the standard is the need to consider the risk capacity of participants in this performance exercise, but some plans have thousands of employees, a fact that may also cause product selection to skew to the middle rather than to any maximization of risk-adjusted returns.
Additional thoughts	Performance evaluation is complicated. Kudos to the folks who drafted the rules, as they call out the fact that IRRs, which is the normal way that private market drawdown funds report performance, should not be compared to time-weighted returns, as outlined in the CFA Institute's Global Investment Performance Standards. ¹¹ This note was not in the actual "Performance" section of the rules, however; it appears much later in "Challenges to Comparing Alternative Asset Performance." For more on investment performance numbers, Benchmarking and Returns: Why Are There So Many Numbers? outlines the different calculations as well as when and why each makes sense in what scenarios. A final thought: The proposal seems to recognize that this is a difficult exercise, saying at the end that "plan fiduciaries may wish to work with an investment advice fiduciary... to understand and evaluate the performance of the investment." This is not the only time this suggestion is made in the rules; we must hope that these advisors have the skills to perform these responsibilities properly.



Fees

The proposed rule	<i>"...the fiduciary must objectively, thoroughly, and analytically consider a reasonable number of similar alternatives and determine that the fees and expenses of the designated investment alternatives are appropriate, taking into account its risk-adjusted expected returns, net of fees and expenses, and any other value the designated investment alternative brings to furthering the purposes of the plan."</i>
The difficulty	Fee disclosures are not straightforward and maybe not comparable. When provided investment alternatives to add to a 401(k), plan sponsors are usually given the ERISA-mandated fee disclosure that shows the fund's expense ratio. But this often does not provide the whole picture, particularly where funds not registered with the SEC, such as collective investment trusts (CITs), are increasingly being utilized in 401(k) platforms. With the addition of multiple layers of fees for funds that invest across multiple underlying funds, the expense ratio will not tell the whole story. Between the complexity of fees and the difficulty of comparing one fund's disclosed costs to another, fees have been the focal point for many of the lawsuits that have plagued the industry. In How Semiliquid Managers Can Hide Fees , our colleague at Morningstar spoke eloquently on this topic and his main points are fully applicable to the 401(k) product space.
The examples	How much one fund costs versus another seems like a fairly straightforward exercise, but the proposal on fees had more than double the word count of the performance section. Five examples were provided. One said that higher fees may not indicate imprudence if the risk-adjusted returns net of fees justify the cost. This seems specifically aimed at adding alternative investments to 401(k)s, as they will likely come at a higher cost, but we have already outlined that it is especially difficult to determine risk-adjusted expected returns when private markets are involved. Another example indicates that if hedge funds and PE funds are added to a multi-asset fund with the intention of providing downside protection, that may justify higher fees, even though upside may also be limited. While risk-adjusted expected (i.e., forward-looking) returns may be higher, many plan participants may not understand that they are paying more for what could be a lower unadjusted number. In a third example, the proposed rules state that if presented with actively managed funds with comparable costs, the plan fiduciary would be considered prudent in selecting the best-performing of those funds. That seems like a naïve assertion, as the highest past returns may bear little relation to future outcomes for a wide variety of reasons.
The probable outcome	While the rule appears to be designed to provide cover for the higher fees that will likely come from adding alternative investments into 401(k) products, actual outcomes may still call into question the prudence of the decision to accept the tradeoff. Should future alternative investment returns be much lower than the median historical returns—possibly because the products being created that meet 401(k) requirements for liquidity cannot mimic the historical returns of drawdown funds or because the managers providing the best outcomes do not wish to deal with the difficulties of managing 401(k) flows—higher fees may seem like a bad idea, in retrospect, and the rule may not provide the legal protection it hopes to.



Liquidity

The proposed rule	<i>"...a fiduciary must appropriately consider and determine that the designated investment alternative will have sufficient liquidity to meet the anticipated needs of the plan at both the plan and individual levels."</i>
The difficulty	Illiquid investments in daily traded investments is problematic. The requirement that 401(k) products must be able to absorb capital every pay period and allow participants to rebalance on a quarterly basis means that liquidity management is a necessary function of the proper management of funds serving this space. In Sink or Swim: Interval Funds Liquidity , we discussed the reasons why liquidity management is so important to funds where the underlying assets have a different timeframe than the investors. While interval funds are unlikely to be the primary vehicles in a 401(k) lineup, at least initially, they may be utilized within multi-asset portfolios as vehicle providing private market exposures. In addition, with the increasing use of CITs in 401(k)s, which face fewer rules around illiquid investment limits, it is expected that allocations to illiquid investments may be higher in those products than in registered funds, which still face a 15% rule. ¹² In the normal course of events, more money will be pouring into 401(k) funds than out, given that people make contributions every pay period and retirement is a long way away for most employees. But since rebalancing must be allowed, the possibility that participants may get spooked by roiling markets and attempt to reallocate to safer options must be considered. Beyond retirement, in hard times, employees may be terminated and may choose to move their assets into other funds or take a hardship withdrawal, providing more reasons why individuals withdraw assets when the markets are not in a normal environment. Given that alternative investments have not historically been in most 401(k) offerings, mass redemptions from 401(k) funds in times of stress have not yet occurred, so evaluating the worst-case scenario liquidity of these funds is still very much theoretical.
The example	The example indicates that a written representation from the asset manager of a liquidity risk management plan should be made available, but the plan fiduciary must critically review this plan, potentially with the assistance of a qualified investment professional. Recent months have seen significant redemption requests from semi-liquid private credit funds, each of which confidently believed that their liquidity plans were sufficient, but some have had to restructure. The liquidity profile of 401(k) options that price daily but hold illiquid investments has yet to be tested. Evaluating the proffered plans is thus something few are truly able to assess due to a lack of experience.
The probable outcome	There will be instances in times of severe market stress where bad liquidity models will make themselves known, but it will be difficult for a fiduciary to identify those funds in advance. The proposed requirement to consider liquidity will cause some who are uncomfortable evaluating this element to avoid products with illiquid elements. That said, asset managers are highly motivated to meet any concerns of the plan fiduciaries, as their reputations will be at high risk should their funds not meet the liquidity expectations of the plans and their participants, so we expect comprehensive language will be provided that may be difficult to differentiate in the absence of a crisis.



Valuation

The proposed rule	<i>"...the fiduciary must appropriately consider and determine that the designated investment alternative has adopted adequate measures to ensure that the designated investment alternative is capable of being timely and accurately valued in accordance with the needs of the plan."</i>
The difficulty	Illiquid investments are usually valued quarterly; 401(k) funds allow investors to trade daily. While these rules are intended for all investment options that could go into a 401(k) program, valuation is the most problematic factor when considering the introduction of illiquid investments into products that must accept capital and allow redemptions on a daily basis. This is also something that investors in semi-liquid funds are struggling with, ¹³ but while illiquid assets may only be a minority portion of a multi-asset 401(k) product, the fact that investors are buying and selling stakes in these funds means that valuations are particularly important. Investors must be able to trust that they are transacting at a fair valuation, but valuation policies for illiquid investments can be incredibly difficult to properly assess because they involve judgment calls in the absence of a market-based price.
The example	<p>One of the examples in the proposed rules considers valuation policies on funds that hold both public and private assets. The fiduciary in the example was considered to have met the requirements of prudence by critically reviewing the written statement of the fund manager's valuation policy, which determined the valuation of illiquid investments once per quarter in a "conflict-free, independent process." This seems to open up problems should something macro or micro happen mid quarter that materially degrades the value of an investment, as 401(k) participants transact throughout the quarter via biweekly contributions or rebalancing their accounts as desired. Trades that happen when the market is still deciding what things are worth (i.e., in times of high volatility) may result in poor outcomes for some.</p> <p>Another example explicitly calls out continuation funds as problematic because an asset is traded between vehicles controlled by the same asset manager, so the potential for conflicts of interest is "particularly acute." While there is certainly the potential for conflicts of interest in these transactions, the fact that an external secondaries fund buys the stakes of exiting LPs as part of the deal means that the transaction would not take place if the buyer did not feel it was a price that would provide an attractive investment outcome. It is at least as likely that the exiting LPs are being disadvantaged in these transactions, not the buyers of continuation funds.¹⁴ It is striking that the rules call out continuation funds as difficult to properly diligence but are silent on cryptocurrencies, which can arguably be seen as securities disconnected from fundamental investment considerations.</p>
The probable outcome	During times of market stress—or when investments are written up on exuberant expectations—valuations on illiquid investments will come under scrutiny and those who trade on those valuations would seem to have a case for questioning that they were given a fair price when things play out to their disadvantage. Private market investors have historically been protected in times of valuation extremes because investors were locked into the fund until a liquidity event and they received the proceeds at what an external buyer judged was a fair price for the illiquid assets. The introduction of daily pricing of investments that include illiquid assets seems to open up litigation risks, not provide a safe harbor.



Performance benchmark

The proposed rule	<i>"...the fiduciary must appropriately consider and determine that each designated investment alternative has a meaningful benchmark and compare the risk-adjusted expected returns, net of fees, of the designated investment alternative to the meaningful benchmark."</i>
The difficulty	Backward-looking composite indexes of public and private assets cannot replicate the experience of a 401(k) product with daily flows. Benchmarking is a complicated topic. ¹⁵ The typical US-based non-investment professional is likely aware of the S&P 500 and the Dow Jones Industrial Average indexes but may not understand why those indexes are not meaningful to the evaluation of many investment options. In the case of the products being created now that include private market assets for 401(k) offerings, appropriate benchmarks are a big question. Composite benchmarks will be used—some amalgam of private and public market past performance—but given that the evaluation of performance needs to be evaluated over a meaningful time horizon, the products themselves will not have a long enough history to compare to the composite benchmark. While this is the best anyone can do while these products are still in their infancy, it does not feel like it enables an adequate evaluation of an investment product's prospects.
Additional thoughts	The selection of a benchmark seems like the least of the obligations of a plan fiduciary and probably should be incorporated into the performance analysis section, as the topics are intertwined. Asset managers, recordkeepers, and those who advise plan fiduciaries will create collateral that provide benchmark comparisons for the products being created for 401(k) plans, but the reality is that cobbling together public and private benchmarks does not truly reflect the realities of funds holding illiquid investments and offering daily pricing and the ability to rebalance at any time. If the fiduciary responsibility is to pick a meaningful benchmark for products that mix liquid and illiquid investments, the most appropriate one would be an index made up of these hybrid products, as it will reflect the true experience of the funds rather than an approximation that will not take into account the cash flow situation faced by these funds. The rules indicate that the composite is enough, but it could easily be argued that it is not an adequate representation of what investors will experience.

Complexity

The proposed rule	<i>"...plan fiduciaries are not precluded from prudently selecting sophisticated investment strategies that may be complex." Also, "...the fiduciary must appropriately consider the complexity of the designated investment alternative and determine that it has the skills, knowledge, experience, and capacity to comprehend it sufficiently to discharge its obligations under ERISA and the governing plan documents or whether it must seek assistance from a qualified investment advice fiduciary, investment manager, or other individual."</i>
The difficulty	This standard does not take into account the overconfidence bias that many individuals have about their ability to understand complex topics. ¹⁶ A lack of understanding of investment complexity is a common issue when the root causes of financial crises are dissected after the fact. ¹⁷ It seems a difficult task to prove that a plan fiduciary, or its advisors, know, in advance, enough about some products to properly evaluate them.
The example	The examples cite fee complexity and the selection of a product that is substantially similar to a target date fund, but customized and more expensive. The complexity of the underlying investments is not considered in the examples, but probably should be in the final rules, as it is this complexity that could be the most difficult to evaluate.
The probable outcome	If losses occur that eventually are determined to be related to complexity, the DoL assurance that complexity is not a disqualifying characteristic will not be taken well. It is likely that complexity will continue to be a factor slowing the adoption of alternative investments into 401(k)s, as plan fiduciaries who know they do not know enough will choose to avoid the issue entirely.



Will the safe harbor work?

The analysis in this paper was designed to pick apart the rules as they currently stand, questioning whether the stated intent to provide a legal safe harbor for plan sponsors bore up under scrutiny. While the questions raised will slow the adoption of products with private markets exposure into 401(k)s, adoption will definitely happen, if only because the asset managers, recordkeepers, and DC advisors are highly motivated for this to happen and are reorienting their businesses to meet this goal.¹⁸ In light of the DoL rules, there is no doubt these players are all creating (or have already created) written documentation that all involved hope satisfies the fiduciary needs of plan sponsors.

As the heart of this paper explains, however, there seem to be some obvious areas where a plan participant could reasonably have cause to question whether their plan sponsor did enough work or had or enlisted the proper expertise to evaluate the options. Instead of stopping lawsuits, the proposed rules are only designed to make them easier for an employer to win. The success of previous 401(k)-related lawsuits may have hinged on the presence of a jury, or settled due to the threat of one. Assuming that most juries are not made up of investment experts, it may have been relatively easy to convince one that the employer did not do enough diligence simply because the fund underperformed or provided a bad outcome in some other way. The expectation that good and bad investments can be identified as such in advance is an assumption many may make, even though very smart and experienced people throughout the investment world select and manage funds, and in every measurement period some do much better than others. These perceptions will not be changed by these rules.

In the face of the continued ability to file lawsuits that challenge employers on their investment lineup decisions, many plan sponsors will still probably fear litigation and the cost and distraction it brings. We expect many to remain conservative in their 401(k) fund lineups, not wanting to look too different from other plans for fear of opening themselves up to what will likely still need to be worked out in the courts.



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