

Hybrid: Rethinking Risk and Return

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Head of Hybrid Matt Nord shares Apollo's view of hybrid as a risk/reward framework that can provide the flexibility to invest across the capital structure.

Matt Nord explains why demand for flexible capital solutions is growing and why investors are increasingly drawn to hybrid's combination of equity-like return potential and credit-like downside protection.

The View from Apollo features conversations with thought leaders across Apollo and portfolio companies of funds managed by Apollo, each bringing their unique perspectives on current macroeconomic trends, the impact to various businesses and what it can mean for investors.

You've been at Apollo for close to 23 years. Can you tell us about your background?

Matt Nord, Partner, Co-Head of Private Equity and Head of Hybrid: I started in the private equity business and grew up there. I've taken responsibility for putting together our hybrid business, which is now over \$100 billion in assets under management.

Apollo started in private equity, and private credit is now the lion's share of our assets. Most clients are less familiar with the hybrid business. How did it

Matt Nord: It's really important to start with the fact that we think of hybrid more as a risk/reward framework than a particular asset class. When we talk about hybrid, we mean equity-like returns with credit-like downside protection. You tend to be investing somewhere in the middle of the capital structure—still generating rates of return, but with added downside protection.

Why hybrid is so uniquely Apollo is that we've always been unconstrained investors. Even when we started in private equity, we would think about investing up and down the capital structure, across markets, to find the best risk/reward. Hybrid is about this very flexible framework to find the best risk/reward in any market environment. It's very consistent with Apollo's DNA and ethos.

You have dedicated investment teams, so as you talk about the hybrid investment framework, how does that work in practice?

Matt Nord: The open architecture of Apollo is a big competitive advantage. We do have dedicated teams managing different funds—whether they're more hybrid credit funds or hybrid equity funds—but origination comes from across the entire platform. If someone in PE gets a call and determines that the best risk/reward isn't a buyout but a structured equity investment, they can bring in the hybrid team.

Expedia is a good example. And sometimes, credit will identify an opportunity where it makes sense to combine debt with an equity component. So we're originating from the entire platform.

You mentioned Expedia. Can you walk through a few examples of what a hybrid investment actually looks like?

Matt Nord: Sometimes it's a structured equity investment, a convertible security, for instance, where you have a fixed coupon, some appreciation potential, and downside protection. Sometimes it's a structured equity investment in another sponsor's continuation vehicle. Or it might be debt with an equity component, where you have the downside protection of being higher in the capital structure but also participate in the upside through an equity kicker. Soho House is a good example. We provided financing and also took a piece of the equity.

What's really important about our hybrid platform is its scale. Because we've aggregated all the different parts of the business that have this hybrid thematic into over a hundred billion in assets, whoever we're speaking with, another sponsor, a corporate, we can start the conversation by asking, "What are your needs?" and then craft a solution around that. In the case of Expedia during COVID, it was a need for liquidity. More recently, with QXO (a public company looking for capital to fund M&A) or McKesson spinning off one of its businesses, everything starts with creative solutions at scale.

Why is hybrid capital so topical right now? What is it about this particular market environment that's driving the activity you're seeing?

Matt Nord: I think it's relevant for both companies and investors. On the market side, we've seen all of these tailwinds become headwinds. From low interest rates to more normalized rates, from low inflation to higher inflation, and the breakdown in global supply chains. In that environment, companies often don't want additional debt because they don't want to increase leverage, but they also may not want to issue straight common equity if they don't like where their valuation is trading. Hybrid fills that gap.

For the sponsor community specifically, the single biggest issue confronting the private equity industry right now is the need for realizations. The latest estimate I've seen is about \$4 trillion in unrealized NAV across sponsor portfolios. If it's getting harder to take companies public and you may not want to sell at current valuations, hybrid becomes another way to generate liquidity and return capital.

For investors, there's also growing interest because everything in their portfolios has become concentrated and correlated. We've talked about the Mag Seven—maybe it's going to be the Mag Ten soon—but those stocks could represent 35, 40, maybe 50% of the public equity markets. And those same themes around tech and AI show up in private markets as well. Investors see hybrid as an opportunity to generate equity-like returns in a more diversified, less correlated way—with a strategy designed to navigate across different market environments.

We see some investors fund hybrid from the credit side of their portfolio, others from equity. What are the types of businesses and sectors where you're seeing

Matt Nord: Thematically, hybrid is about long-term, durable compounding. You don't need to try to time the market, because we will pivot to where we see the best risk/reward at any one point in time. Sometimes that skews a little more credit, sometimes more equity, and there are even infrastructure-type investments that fit this framework.

One of the biggest things we focus on when we underwrite new hybrid opportunities is downside

protection. We spend a lot of time looking for what we call "HALO" investments—companies with hard assets, low obsolescence risk—and business models that are somewhat insulated from disruption, including AI disruption. Really making sure these are durable, long-term winners, high-quality businesses on trend. That's where we've been most focused.

You referenced the global industrial renaissance and supply chain themes. Can you pull that thread a little further?

Matt Nord: If you aggregate the capital needs across digital infrastructure, AI, and the energy transition, the numbers are in the tens of trillions of dollars. Those numbers are so large that companies are going to need to access every pool of capital available, investment-grade financing, internally generated cash flow, some common equity, and also a significant amount of hybrid and other structured capital. We've helped finance companies like xAI buying chips, and this is true across the platform, particularly in data centers and AI, it tends to be credit at the top of the capital structure or hybrid in the middle.

We've talked a lot about the fact that the returns on some of the AI spend may be uncertain, and that uncertainty is really an issue for equity. By staying at the top or middle of the capital structure, we believe we're generating very strong returns while also maintaining meaningful downside protection.

That resonates today. We're still in a performing economy, and investors want to take risk. But the challenge is on the valuation side. How do you think about p

Matt Nord: You want to stay invested, but maybe in a more defensive way. You don't want to max out your leverage, or you want more equity cushion if there's uncertainty around valuations. Hybrid plays into that notion of staying invested and still generating attractive absolute returns—and very strong risk-adjusted returns—but doing it in a somewhat more defensive way.

What are some common misconceptions about hybrid, or has anything changed in how the market approaches it?

Matt Nord: Historically in the deal business, hybrid may have been thought of as the fallback option. You'd try to sell the company, you'd try to IPO, and if those didn't happen, you'd consider hybrid. But that's changed significantly. If you look at deals like QXO or the Keurig Dr. Pepper financing, roughly \$8 billion across different parts of the capital structure, these are world-class businesses executing very large transactions. Bankers and the deal community are now considering hybrid solutions alongside other potential alternatives. The volume of flow we're seeing has increased dramatically.

Are you seeing the same shift on the investor side?

Matt Nord: It's been a journey. Hybrid actually benefits from an interesting supply-demand imbalance in its favor. Historically, investors who allocated according to strict asset-allocation frameworks would say, "Well, it's not quite PE, and it's not pure credit. I'm not sure where to allocate from." That meant relatively limited capital formation around hybrid on the supply side. But for all the reasons we've been discussing, there's massive demand for creative solutions. That's one of the reasons why, especially with our platform, we're seeing an enormous amount of opportunity right now.

Going forward, I think investors are going to take more of a total portfolio approach, and for those who do, hybrid works really well within that framework.

What do you mean by a total portfolio approach?

Matt Nord: That you're not thinking about allocating capital according to a strict asset-allocation framework. You're thinking about your total portfolio, about returns and the risk characteristics across the whole thing. And for hybrid, you have credit-like downside protection, typically some yield component, equity upside, and you're navigating across different asset classes, geographies and industries to find the best risk/reward at any one period of time. Some of the most sophisticated institutional investors have actually been the earliest adopters, because they already think this way.

At the end of the day, the question is: what's the risk-adjusted return you want to see in your portfolio?

Matt Nord: Right. I don't really care what you call it. If it's amazing risk/reward, go get it.

Going back to the whole ethos of the firm, we always talk about excess return per unit of risk. This notion of being flexible to pivot to the best risk/reward is very much in our DNA. A lot of our balance sheet capital is invested in these hybrid strategies. There's no greater demonstration of conviction than putting your own capital alongside your investors, and that's exactly what we do. We're often the largest or one of the largest investors in everything we manage, and that's definitely true of our hybrid ecosystem. As investment professionals across the firm, we commit to our hybrid strategies. We're very much eating our own cooking.

What excites you most about what's on the horizon for hybrid?

Matt Nord: As much as we've seen growth in hybrid and increased interest in it, I still think we're very, very early days in what this business can become. I just don't think the need for sponsor solutions is going to change anytime soon. The IPO market will open and close, sponsors will sell assets here and there, but that number is so large, and there's such a need for creative solutions that it's going to be a massive tailwind for hybrid. On the corporate side, whether it's companies de-leveraging their balance sheets, funding M&A, or family-owned businesses needing structured capital, I don't see the uncertainty going away, and I don't see the need for creative solutions going away. Our ability to source from the entire Apollo platform and then provide multi-billion-dollar solutions is a meaningful competitive advantage. There just aren't many firms in the world that can start every conversation by saying, "What are your needs?" and then move fast and actually deliver.

Against today's backdrop of concentrated and correlated exposures, stretched valuations, this idea of prioritizing risk/return, having flexibility of capital, a

Matt Nord: For our investors, you don't need to try to time the market. With our platform and our ability to pivot through drawdown strategies and evergreen structures, our goal is to keep compounding capital over the long term by continuously finding the most compelling risk/reward.

Note: The responses above have been edited for clarity and concision and do not represent a verbatim transcript of the podcast.

Apollo's Hybrid Value business provides flexible, creative and partnership-driven capital solutions to help companies and shareholders achieve their goals. Hybrid Value works with entrepreneurs, management teams and private equity sponsors to seek to deliver debt solutions and equity capital in all market environments.

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