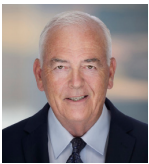




ALTs Education is not THE Answer



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One man's opinion.

At the IPA Vision 2025 conference in September, Mark Goldberg presented his third annual Alts Leaders survey results. The survey reflected insights and future outlook of key decision-makers at wirehouses, independent broker-dealers and registered investment advisors (RIAs).

For interval fund sponsors, due diligence officers and industry executives, Mark's survey may well be the most important document of the year.¹ One of Mark's insights was that there are now 20 different product structures within the Alts space and a wide variety of asset classes and investment strategies, ranging from private equity, real estate, sports, secondaries, oil & gas and others. In private credit alone, there are more than half a dozen different flavors, including asset-backed lending, direct lending and structured credit.

In subsequent sessions at the IPA conference, these same key-decision makers were on panels and asked how to expand the use of alternative investments. The first and often the only answer was "Education".

I beg to differ.

Education is surely part of the answer, but there are other critical components to increasing the adoption of Alts.

Imagine that you are the CIO of a \$2 billion RIA, supporting a dozen advisors, or the manager research analyst for a large wirehouse team. Given your existing job responsibilities, how do you deal with 20 different sector choices, each with multiple fund sponsors, nuanced strategies and inconsistent reporting? How much research/time does it take to realize that one unleveraged credit fund has a 10% net yield and a competitor with an 11.5% net yield is 40% leveraged?

And adding Alts can be expensive for the financial advisor – both time and money. One New York metro firm has \$1.8 billion AUM and holds an above average 35% of those assets in alternative investments. All the due diligence is done in house. When faced with the plethora of new offerings, the only solution was to add staff/expense.

Decades ago, Mark Goldberg was very helpful in me joining SEI to help introduce an early turnkey asset management platform (TAMP) program to the marketplace. At the time, SEI and Russell were the two largest consultants to pension plans, endowment and sovereign wealth funds.

For two years, the SEI teams met with many of the most sophisticated firms and told them how they could access strategies and managers that SEI was providing to large clients such as the Ford Foundation, IBM and dozens of the largest

institutions. SEI pitched more diversification, institutional managements with impressive track records and reputations and the potential for better performance and investor outcomes. Sound familiar?

For almost three years, nothing happened.

Finally, we turned the message 180 degrees. We presented a TAMP as a better business and personal solution for the financial advisor. We made the case that if the financial advisor oversaw the SEI TAMP portfolios, he or she would have more time to focus on client support, business development and live a more balanced life. Instead of spending the day at the office and then accessing Morningstar at night, he or she had time for family or hobbies.

Billions of dollars flowed in. The lesson learned is that you must make it easy for the financial advisor.

In most cases, the first question an advisor asks after hearing about an Alt fund is “where does it go in a client’s portfolio?” As Alts get increasingly accepted by Target Date Funds for defined contribution plans, those sponsors are going to ask the same question.

A significant part of the answer is model portfolios. Until now, such efforts have been fragmented and small. A few innovative firms are leading the way on this front. Opto Investments in New York uses its technology to build white label and model portfolios which incorporate private market investments. Conway Investment Research in St. Louis is an OCIO for RIAs and banks. With about \$1.3 billion in assets, Conway creates “curated alts lists” and portfolios for their clients. Last summer, Opto and Conway came together and announced a formal partnership to provide RIAs with an end-to-end solution for expanding private markets access.

More recently, CAIS and iCapital are moving in several different directions at the same time. Each firm is building model portfolios while at the

same time creating a “marketplace” for a broad spectrum of Alt products. Think Amazon for Alts with reporting. As TAMPs have proven, models will grow if the marketplace sees real value.

Morningstar just issued its first Medalist ratings on a half dozen interval funds. There are 300+ such interval and tender offer funds in the market. One curious aspect is that three of the six funds were launched this year and have yet to develop a track record. Morningstar has historically remained skeptical of the Alts space since the days of public limited partnerships, but the greater acceptance of interval funds by the marketplace is driving an economic decision by Morningstar given the long-term secular decline of mutual funds.

So, what is the answer?

My view is that greater transparency and visibility will be helpful to all parties. In April, XA Investments launched the industry-first interval fund index (INTVL) to help provide transparency. A number of other index providers have followed suit and are working to launch a variety of evergreen Alts focused indices. Such

Interval funds?



indices are a good start – but more is required to actually address the issue at hand. How do we make Alts adoption easier for the financial advisor to actually move the needle here?

A lack of standardized reporting for alternative investment products makes it challenging to make comparisons between Alts products. I propose that IPA, ADISA, Blue Vault or some other interested party work with key sponsors to create a voluntary, advisor use-only report format. While smarter minds than mine can work the details, here is an outline of the items that would be included:

1. Fund Structure
2. Year Formed
3. Firm AUM
4. Fund AUM
5. Investor Suitability Restrictions, if any
6. Asset Class / Sector
7. New Capital Received (not commitments)
8. Distributed Capital
9. Return for the period
10. Current Yield
11. Distributions (most recent and year-to-date)

12. 3-Year Return (Annualized)
13. 3-Year Distributions (Annualized)
14. 5-Year Return (Annualized)
15. 5-Year Distributions (Annualized)
16. Liquid (Daily) Assets \$\$ / %
17. Structural Leverage (at fund level)
18. Effective Leverage (underlying investments)

Through Alternative Intelligence technology, advisors and due diligence staff can sort and dissect this core data to narrow the choices from an ever-expanding universe.

In conclusion, product innovation is presenting a growing number of private market investment opportunities today to a broader range of investors. In the future, wide-spread adoption by defined contribution and similar plans will benefit investors and sponsors.

Models and education are certainly part of the answer. That and the engagement by quality sponsors, the reduction or the removal of the operational roadblocks and the major regulatory revisions on the horizon all lead to optimism.

About the Author

Paul Dunn is a Senior Advisor at XA Investments, Chicago. With decades of alternative experience, XAI consults to investment sponsors and platform managers on the structure, distribution and management of non-traditional portfolios and funds. Most important, XAI provides judgment to their clients as to the likelihood and paths to success.

Over 44 years Paul has served as President of a \$1 billion RIA, several broker-dealers, a bank and an institutional investment manager. He is a graduate of Brown University and holds a Juris Doctor from Suffolk University School of Law. He and his family reside in Orange County, CA.

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Sources & Notes:

¹ Contact Mark Goldberg for a copy of his survey results: mgoldberg@i-Qmail.com