Access Isn't Everything

The Wall Street Journal recently reported that an increasing number of accredited investors are seeking to invest in private markets. Historically, these investors have only allocated approximately 2% of their investible assets to private markets, which is considerably lower than the programmatic, double-digit allocations across institutions like pensions and endowments.[1] This spread in allocations to private markets stems from differences in these investors' structure and time horizon, as well as their respective approaches to decision making and evaluating risk.

Pension plans and endowments are generally considered perpetual vehicles, maintaining their investment programs to meet a prospective book of liabilities (either short or long term) or provide capital for strategic programs several years in the future. They can afford to take an extremely long-term perspective on markets and individual assets and view the illiquidity in private market investments as an acceptable risk and return proposition. Over the last decade, this approach to aligning views and capital goals has been adopted by a wider cohort of investors, including high-net-worth individuals. People, of course, are not perpetual entities, and invest in accordance with certain goals they have in their lives.

Across high-net-worth individuals, differences in investment goals should warrant differences in approach and risk and return expectations. Illiquidity can be considered as one factor in an investor's approach, typically as a premium (i.e., greater expected returns than liquid assets) or an opportunity cost (i.e., committing capital for several years precludes investors from deploying that capital elsewhere in the interim). Another common factor to consider is an investment's size, which we can assess through several lenses (e.g., size of the market, size of the underlying asset, size of the transaction, etc.). All these definitions would allow investors to draw distinctions between larger and smaller deals, which each have their nuances, but the size of the underlying asset is the most common.

Investment size is a large driver behind differences in portfolio composition across institutions and individual investors. Larger institutional investors are generally incapable of considering lower- and lower-middle market opportunities as most have concentration limitations embedded in their investment policy agreements. For example, a smaller fund targeting $400 million and investing in companies with less than $25 million in EBITDA would be inaccessible to an institution seeking to invest $100 million, if they have a concentration limit set to 20% of commitments. It would make much more sense for this institution to target investments in larger funds (>$1 billion). Further, this limitation is why many institutions have extremely large, diverse portfolios, invested across several funds, or establish pooled "emerging manager programs" to invest in smaller opportunities.

Conversely, it's more challenging for high-net-worth individuals to invest in larger funds, since capacity is largely consumed by institutions, and investment minimums are significantly more than most individuals can afford on their own. However, strides have been made recently to provide access to large funds through technology-based allocation platforms, such as iCapital or CAIS. These services allow large funds to target wealthy individuals and registered investment advisors (RIA), two cohorts of investors that they wouldn't traditionally approach. The benefit for large funds is that they're able to diversify their LP base away from institutional capital, in which allocations are defined by investor policy agreements and have little flexibility. The benefit for investors is that large funds are typically managed by reputable and successful firms (e.g., Blackstone, Carlyle, KKR, etc.), and many perceive that these funds are less risky than smaller funds. However, individual investors have greater flexibility and evolving priorities, and their decision to allocate to private markets could be meaningful. In such cases, smaller, differentiated investment options could have a

[1] "Wealthy Investors Pile Into Private Equity to Escape Stock Volatility" https://www.wsj.com/articles/wealthy-investors-pile-into-private-equity-to-escape-stock-volatility-11653561000;

material impact on an individual's livelihood, either positively or negatively. While lower- and lower-middle market opportunities should outperform their larger peers[2], there are thousands of investments to choose from, which can be daunting for many investors. This is where an investment platform like Altera may add value to qualified investors and RIAs seeking investments in private markets.

Altera is a private markets investment firm and institutional due diligence platform focused exclusively on the lower- and lower-middle market. We believe that qualified investors should have access to best-in-class investment opportunities in private markets, and by providing clients with a frictionless investor experience, lower investment minimums, proprietary market research, underwriting guidance, and access to differentiated solutions across private equity, private credit, and real assets, Altera helps to bridge the gap between high-net-worth individuals and institutions.

About the Author

Tim Godin
Senior Associate

Tim Godin is a Senior Associate at Altera, where he performs investment due diligence, sources manager relationships, and conducts market research across all asset classes. Tim is also a member of the Investment Committee.

[2]According to the NAICS Association, there are over 200,000 companies in the United States with revenues >$5M, which presents a broad universe of potential investment opportunities for lower- and lower-middle market sponsors. Generally, if there is less competition for a deal, a sponsor can acquire an asset for less, which provides a downside margin of safety and potential multiple expansion if sold at a comparable price to larger assets. It's important to note however, that this is a guideline for expectations – every transaction is different, and sponsors can deploy many different investment strategies, some of which may not align with this framework.