

Illiquid “Non-Public Market” Investing

In the changing landscape of investing, not every investor wants to have their entire balance sheet in the public equity or debt markets. This has been true for institutional investors (think college endowment funds) for decades and is carrying over to family offices and ultra-high net worth families. While the idea may be appealing to some, it is important to consider the many moving parts as one evaluates their options.

The landscape for non-tradeable investments is wide and continues to grow. Some of the popular investment categories are:

Hedge Funds

- Credit
- CTA
- Event-Driven
- Long/Short Equity
- Merger Arbitrage
- Multi-Strategy
- Structured Credit

Private Markets

- Private Equity
- Private Credit
- Secondaries
- Distressed
- Impact Investing
- Infrastructure
- IPO & Pre-IPO

Real Estate

- Lending
- Residential: Multi-Family Housing, Class A, Class B, Low Income
- Commercial
- Industrial

But before you make any decisions, you must first determine: What are the goals for these illiquid assets

you are planning to integrate into your portfolio? Without a clear understanding of your goals, you will be attempting to allocate capital without a purpose or objective which will make it difficult to measure success. Key considerations here are:

- Who (individually, trust, LLC, FLP, etc.) is going to be making the investments?
- Are you investing by yourself or making investments with other family members?
- If investing with other family members:
 - Do you all have the same risk budget?
 - Do you all have the ability to commit the same capital?
 - Do you have similar goals and time frames?

One of the common reasons investors allocate to these markets is to obtain a return exceeding that which can be earned in the public markets. After all, at the very least you are taking on illiquidity risk and there should be a return premium for this. Questions you should consider about your intentions are:

- Does a compelling opportunity exist to invest via an illiquid or less-liquid structure?
- How am I going to measure success?
- What is the illiquidity premium I am earning?
- What is the time horizon for the assets I am investing?
- Do I want to have active participation in the investment with a management or board of directors role?
- Do I want to be a passive (limited partner) investor?
- Am I investing to stay involved?

After you have determined why you are looking to make these investments you can think about what you are going to invest in. As noted above, the private investment landscape is wide and continues to expand. You need to consider how you want to be allocated from a type, sector, geographical location, and stage perspective. The investment decisions you make related to illiquid investments need to be made in the context of your entire balance sheet (investable assets, personal real estate, business ventures, life insurance and all other assets) and can't be looked at in isolation. One also needs to consider how they are going to invest:

- Do I want to invest directly, in a fund or co-invest?
- Am I interested in a control or minority position?
- Is there a preference for startup or established investments?
- Am I investing in a company or the individual (perhaps a friend) who is starting/running the investment?

As you prepare to make the investment, extensive due diligence needs to be performed before making a commitment. When thinking about due diligence, most people focus solely on the investment thesis or strategy. With private investments, there is an equally if not more important component: Operational due diligence, which digs into the individuals running the investment - their backgrounds, auditors, corporate documents, succession plans and compliance matters, among others. Even the strongest investment strategies can suffer complete failures due to improper operational management. Due diligence is what leads many investors to outsource and use third party managers and invest in access funds. Some large family offices will hire an extensive internal team to evaluate opportunities, similar to what many of the endowment funds do.

Once you make the investment, ongoing monitoring equally as important as the initial due diligence.

- What reporting will you receive from the investment?
- How will valuations be done?
- Is there a secondary market for your investment?
- Do you have access to the management team?

This brief overview just begins to scratch the surface of the considerations involved in making investments in non-public markets. This decision needs to be made in conjunction with your overall balance sheet, taking into consideration the goals, risk profile and time horizon of each individual investor, trust and/or entity involved.