THE POWER OF ONE: INDIVIDUAL INVESTORS EMERGE AS A FORCE

While the ongoing rise of public markets gets the headlines, private capital returns have been outpacing more liquid strategies. More than ever, those returns are attracting the attention of individual investors and their advisors. Brian Murphy, Managing Director of Portfolio Advisors, discusses the growing options that individual investors have to participate in what historically have been difficult-to-access asset classes.

The private capital asset classes are built on institutional capital. But recently the huge individual-investor marketplace—those with high net worth and not-so-high net worth—have been taking more interest in private capital investments.

This trend could reshape the entire private capital industry. Financial services firms, registered investment advisory firms and the large wirehouses are all aware of the interest in private capital among their clients and are now wondering how active they should be in getting their clients into those asset classes. The answer? The more flexibility, the more comfortable they are with putting their clients into private capital vehicles.

"We've seen a significant move to the high-net-worth side," says Brian Murphy, Managing Director of Portfolio Advisors, a private markets investment specialist that provides private equity, private real estate and private credit investment solutions. "We're not a retail firm but we have worked with some big institutions and done some feeder funds. And through those feeders we now have over 100 family offices and high-net-worth individuals participating in our products."

Individuals around the world are feeling a need to increase their total returns and search for yield. They are underwhelmed by the returns offered by traditional fixed income, and aware that public equities have generally underperformed private equity.

INDIVIDUAL CHALLENGES

Trying to gain entrance to private capital vehicles presents challenges for high-net-worth investors, primarily due to the large ticket size typically required of private equity and similar funds. A retired dentist with USD $50,000 to commit to a fund, for example, may not be worth the administrative hassle for the fund manager.

A second challenge is that many of the funds being raised in the marketplace require a qualified purchaser to participate. That's a USD $5 million wealth threshold for an individual. "It's not uncommon for families to invest $1 million, $5 million, $10 million, even $50 million," Murphy says. "But it's tricky even for a wealthy family. If they're worth $100 million and they want to have 20% of their portfolio in private equity, that's a lot of money. But many funds say, well, you have to write a minimum commitment of $5 million."

That means that particular investors can make only four commitments before using up the entire USD $20 million. And that means the investment is not highly diversified. This is one reason why feeder funds and fund of funds have remained popular. These structures allowed investors who wanted access to the private asset class to diversify across several vintage years and investment styles.

"Some financial advisory firms have a big enough client base with enough client interest that they will actually put a feeder together as a service to their clients," says Murphy. "But it's a tremendous amount of extra work. There are extra costs. These things have to be audited. There is a lot of accounting and legal."

BACK TO THE FUTURE

Regardless of the administrative challenges in the private capital markets, the returns available there will continue to draw high-net-worth individuals, family offices and even slightly lower-net-worth individuals. In a way, it's a return to the old days - most of the private markets started with the backing of wealthy families before opening up to institutional investors. Family offices have been participating in the private capital asset classes for decades. Indeed, it was only in the '70s and '80s that the institutional marketplace really started to develop and grow.

Now that individual participation is picking up, Murphy estimates that hundreds of billions of dollars will flow into the private capital asset classes from individual investors over the next decade.

"I think there will be tremendous demand and it will only continue to grow," says Murphy. "Just as on the institutional side you'll see a bigger percentage of their portfolios moving to the private side, you'll start to see financial advisors moving individuals from zero or a low percentage to 5 percent, 10 percent, even 20 percent. Because there will be better products, there will be more liquidity, and there will be an easier way to access it and generate returns. *