



# Unlocking the Potential of Alternative Investments in the Wealth Management Channel

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## The opportunity set

Alternative investments present a significant opportunity for the wealth management channel to improve investment outcomes for their clients. With the potential to enhance returns and reduce portfolio volatility, alternative investments can be a valuable addition to a portfolio. They can also be highly effective when markets are experiencing greater volatility, higher inflation and increased correlation with traditional assets. In 2022, the profound value of alternative investments was truly evidenced when the valuations of a traditional 60/40 portfolio dropped by over 15%, while alternatives generally remained flat.<sup>1</sup> Naturally, clients of all levels of sophistication in the wealth management channel, including those who have yet to fully embrace alternatives, took notice and have started to investigate the unique investment opportunities in this asset class.

According to Bain & Company, individual investors held roughly half of global wealth (\$140-150 trillion) in 2022, with a nearly equal amount being held and managed by institutional investors (\$135-145 trillion).<sup>2</sup> However, alternative investment strategies account for a very small percentage of individuals' investable assets (estimated at less than 5%),<sup>3</sup> representing a significant opportunity for growth.

While institutional investors have enjoyed the benefits of the private markets for some time, private wealth investors have lacked efficient education, access and technology to meaningfully participate in the alternative investments market. Fund managers also face substantial headwinds when it comes to accessing the fragmented wealth management channel, with Cerulli estimating there are approximately 290,000 financial advisers in the US alone, managing \$26.9 trillion in individual investor assets.<sup>4</sup>

We believe that increased exposure to alternative investments will give individual investors the same enhanced return potential and broader portfolio diversification that institutions have long enjoyed. However, the wealth management channel has been working with an incomplete set of tools to achieve these goals. As such, a shift in mindset is required: alternative investments should not be merely viewed as bolt-on exposure, but rather, as core holdings in a portfolio, with growth and income allocations across both public and private assets.

## Education

In our 2023 iCapital Financial Advisor Survey, 95% of participating U.S. financial advisers expressed a desire for educational content on alternatives.<sup>5</sup> Concurrently, alternatives managers have also cited the need for educational resources; Cerulli reported that 67% of alternatives managers noted adviser education as a top challenge for their firm's distribution of alternative investments.<sup>6</sup>

To successfully cover the wealth management channel, it is crucial for fund managers to empower advisers with foundational and fund-specific educational resources. Unlike institutional investors, many individual investors also require due diligence support, which is key in the private markets where manager and strategy selection are critical. These resources are necessary for advisers to communicate the value proposition of alternative investments, and how a particular strategy will impact their overall investment portfolios.

## Access and distribution

Historically, the wealth management channel has had limited access to alternative investment strategies due to the typical support model required. Fund managers can provide institutional investors with customised pitch books, arrange one-on-one meetings and spend hours handling follow-up calls. This approach, however, is not scalable in the fragmented wealth management channel.

Technology-enabled platforms, like iCapital, remove the traditional barriers between clients, their advisers and fund managers. With an open architecture platform, iCapital connects fund managers with a wide network of financial advisers, providing a centralised marketplace for private markets investment opportunities. iCapital also offers a dedicated alternative investments distribution team, giving advisers access to knowledgeable alternatives specialists, who can explain alternatives strategies and how they fit within a portfolio, and further support fund managers' distribution efforts.

## Execution

The complexities and administrative burden to offer alternative investment strategies to a large number of investors have also contributed to its limited adoption. However, iCapital is making it possible for advisers to seamlessly integrate private investments. Advisers are

able to offer their clients high-quality funds at accessible minimum investment levels, allowing fund managers to access a larger segment of the wealth management channel, while effectively only dealing with a single entity, just as they would a typical institutional investor.

Technology has also transformed the historically manual and labor-intensive subscription process into an automated and seamless workflow. Furthermore, these technology-enabled platforms can provide streamlined subscription and redemption functionality and connectivity to custodians, fund administrators and other service providers, along with dashboards that provide performance metrics, capital call notifications, cashflow information and automated tax reporting, thereby creating an end-to-end, transparent and fully digital experience.

Cerulli reported that advisers increasingly rely on these platforms for educational and due diligence support, creating a centralised location for advisers to learn, invest and manage their alternative investments. Partnering with a technology-enabled platform also allows fund managers to seamlessly scale their operations and distribution within the private wealth channel.

## Trends in the wealth management channel

Over the past several years, the market for evergreen alternative investment funds has evolved dramatically, providing individual investors greater access to institutional-quality managers through vehicles engineered to meet their needs. These open-ended funds typically provide investors with periodic share redemptions, allowing for greater liquidity than traditional alternative fund structures. Moreover, their open-ended nature, oftentimes designed to draw capital upfront, offers individual investors a more familiar vehicle than the capital call structure of private alternative funds.

As a growing number of individual investors seek enhanced return potential and broader portfolio diversification, we believe there will be shift within the traditional 60/40 portfolio to alternative equity and credit solutions. In our 2023 iCapital Financial Advisor Survey, almost all advisers surveyed (95%) said they plan to maintain or increase allocations to alternative investments in the coming year, with 44% actively planning to increase their allocations.<sup>7</sup> The latter figure jumps to 58% among advisers with at least \$500 million in assets under management.<sup>8</sup>

## Private equity

Across the iCapital platform, we have seen increased interest in private equity strategies, including buyout and secondaries. Individual investors are shifting their exposure from public equity to opportunities in the private equity market as the universe of publicly traded companies continues to shrink and grow older. In the European Union, the number of publicly listed companies fell from its peak of 7,975 in 2001 to 6,538 in 2019, a decrease of 18%.<sup>9</sup> In the U.S., the number of publicly listed companies has fallen from its peak of 8,090 in 1996 to 4,266 in 2019, a near 50% decline.<sup>10</sup>

As more companies are staying private for longer, there is an opportunity for individual investors to invest in private equity strategies and participate in the longer-term fundamental growth opportunities that used to be available in the public markets. In the first half of 2023, we witnessed a reset in private equity buyout valuations start to take effect, offering fund managers an attractive entry point to acquire and add value to portfolio companies. In addition, we have seen greater interest in private equity secondary funds, which can provide an entry point for individual investors seeking direct private equity exposure, but are concerned about the (sometimes significant) gap between making a commitment and receiving distributions.

## Private credit

We have also seen growing investor demand for private credit investment opportunities, including in open-ended structures that offer periodic liquidity, such as non-traded business development companies (“BDCs”). Private credit financing is typically offered with interest payments at a spread above a floating reference rate, which moves in lockstep with the rate increases we have witnessed over the past 18 months. This floating rate structure mitigates interest rate risk for investors and provides protection in an inflationary environment.

Moreover, because private credit managers are typically able to achieve downside protection through due diligence and covenants in their loan agreements, these strategies are appealing to investors seeking uncorrelated sources of return to mitigate risk in their clients’ traditional public stock/bond portfolios. In addition, the non-traded BDC structure provides the opportunity for quarterly liquidity, providing more flexibility to individual investors that may be hesitant to invest in a closed-fund private credit structure.

## Conclusion

The wealth management channel represents a multi trillion-dollar opportunity set, but accessing this client base requires support. As technology and product innovation expand access to alternative investments, advisers have the opportunity to produce improved investment outcomes for their clients. It is essential for fund managers to equip advisers with foundational and fund-specific educational resources, due diligence and tools to understand how alternatives fit within their clients' portfolios. Technology-enabled platforms, like iCapital, connect fund managers and financial advisers with automated, end-to-end alternative investment solutions, allowing both parties to better achieve their goals and objectives.

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## ENDNOTES

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