KEYNOTE INTERVIEW

Education unlocks potential

The most successful route to the democratisation of private markets is through transparency, education and access to high-quality investments, say iCapital's Lawrence Calcano and Marco Bizzozero

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Q How has demand for private equity exposure from private wealth clients changed? What have been the primary drivers of this trend?

Lawrence Calcano: We have seen a significant increase in appetite for alternative assets, but, until relatively recently, a lack of access and education has impeded advisers' ability to incorporate these assets into their clients' portfolios. The infrastructure has now evolved so that private wealth investors are able to access institutional-quality products in $100,000 lot sizes, rather than having to commit $5 million-$10 million or more.

Equally importantly, the experience is now highly automated, allowing advisers that may not have large operational teams to manage all the different aspects of investment into alternative asset classes. Private wealth investors have realised that they can access the same high-quality products that institutions can, which has helped drive demand.

Q Do you think this trajectory will continue in light of the current volatile economic environment?

LC: Allocations did slow during the second half of 2022, but advisers are telling us that, in this kind of economic environment, a 60/40 portfolio will struggle to meet investors' objectives. It is these kinds of market dislocations that demonstrate just how important an appropriate allocation to alternatives can be, particularly when it comes to diversification.

In challenging markets, people are always more conservative and less willing to make investments, particularly those that are less liquid. Right now, capital flows may be lower, but the longer-term secular trend involves alternatives playing a more important role in clients' portfolios to achieve their objectives.

Marco Bizzozero: The growing importance of private equity versus public equity is making private markets a long-term, strategic priority for wealth managers. Companies are staying private for longer, and most of the value creation is taking place while businesses are still in private hands. That's driving the urgency around facilitating private wealth access to private markets.

Additionally, the recent valuation reset offers investors the opportunity to build a long-term private equity allocation, which benefits from healthier entry points. After all, history tells us that investing in private equity following declines in public markets can potentially improve risk-adjusted returns. Meanwhile, infrastructure, for example, offers decorrelation from GDP and a natural inflation hedge.

Q To what extent have regulators been keeping pace in facilitating this democratisation process?

LC: A few years ago, regulators broadened their definition of an accredited investor. It used to be exclusively a wealth test, but that has now been expanded to incorporate an individual's knowledge, experience and capabilities. This has expanded the pool of people able to incorporate alternative assets in their portfolios.

As demand for these assets increases, regulators remain focused on ensuring that individuals understand what they are buying. I think this will continue to be an area of focus, and it is something we completely support. It is important to ensure that advisers and their clients who are investing in alternatives understand how these products differ from more traditional investments, especially in areas such as illiquidity and fees. Regulators will ensure that there is complete transparency in these areas.

Q Which sub-asset classes within private markets are most relevant to private wealth investors?

MB: What is most important from a wealth management perspective is a diversified portfolio. That means diversification by strategy – be it private equity, private debt, real estate or infrastructure – as well as diversification across geographies, managers and vintages. Where we add value is in helping our clients build those diversified portfolios in order to potentially improve the quality of risk-adjusted returns. So I don't think there is one particular asset class that stands out – the key is to achieve that all-important diversification.

Q In addition to smaller bite sizes, how else have products evolved to meet the requirements of private wealth investors?

Lawrence Calcano: What we are seeing is advisers wanting to ensure they have access to products that are relevant to all of their clients, not just the wealthiest ones. Their qualified purchaser clients were the first to get access, followed by accredited investors. Today, even sub-accredited investors are able to access these asset classes through some of the more recent innovations such as business development companies and real estate investment trusts.

The alternative asset management community has come together to create structures that allow advisers to offer products across their client base where appropriate, and I think that has been an important evolution on the supply side.

> *"To successfully add alternative products to client portfolios, education is key"*
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> LAWRENCE CALCANO

Q What role does technology play in democratising private markets?

LC: The technology component is hugely important when you consider the fact that, until recently, institutional investors have been almost exclusively the buyers of these products. These buyers have teams of people getting access to information, completing subscription documentation, and so on. Meanwhile, the sell-side had a small number of institutional investors to manage, making it relatively easy to handle capital calls, distributions, etc.

Technology has allowed the buying experience to be streamlined and simplified, and has allowed the sell-side to scale the number of investors they're working with without a huge increase in headcount. This is very much our objective as a firm. We want to make investing in and owning these assets as easy as owning a mutual fund.

Q What reputational risks could democratisation present for private equity?

LC: This is a critical point. We work exclusively with advisers who help their clients make decisions about how best to build and invest in portfolios. That's important, because we strongly believe that the growth of this asset class in the high-net-worth space is predicated on those private wealth investors having successful investment outcomes.

To successfully add alternative products to client portfolios, education is key. This is true on several levels, including ensuring clients understand how these products work in an absolute sense, as well as how they work relative to the investments they are used to making. Everyone has a role to play in terms of that education process – the most important thing is making sure products are structured clearly and transparently in a fashion that is relevant for this audience.

There are clearly consumers that are highly financially literate and are well suited to making these decisions, but equally, there are those that require more support. As an industry, we all need to understand that, and lean into education being a central part of our approach. That, of course, might mean that the most successful path to the democratisation of private markets is not the fastest one.

Getting lots of people to buy products before they understand them is not good for investors, nor for asset managers. What is good for everyone is for people to make investments that they understand, to have positive outcomes, and then to increase their use of the assets. That type of rollout will prove a win-win.

"What is most important from a wealth management perspective is a diversified portfolio"

MARCO BIZZOZERO

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LAWRENCE CALCANO

Q How far do you think the democratisation process will go?

LC: In many respects the term 'alternatives' is actually rather unfortunate, because it sounds like something that an investor can take or leave.

Over time, I believe investors will come to see these assets not as alternative, but as a core part of their allocation. I think a portfolio will come to be comprised of publicly traded stocks, ETFs and private company shares, while a credit or fixed income portfolio will be comprised of corporate bonds, municipal bonds, sovereign or treasury bonds, private credit, structured credit and direct lending. Real estate, meanwhile, will be a mix of publicly traded stocks and private REITs.

Ultimately, therefore, the term 'alternatives' may cease to exist, instead becoming part of one overall allocation. I believe that is the way the industry will evolve, and it will be important for firms such as ours to build the tools required for advisers to create those types of portfolios.

MB: From the perspective of the asset manager, or the GP, taking advantage of technology like ours in order to access this investor group effectively means diversifying the fundraising process while dramatically reducing distribution costs. For the past 20 years, more than 90 percent of fundraising has come from institutions, but managers can now diversify into the pool of wealth management money, which is rapidly growing.

We facilitate access to this vast pool of capital by making it easy. We aggregate all those individual investors from wealth management organisations so that they behave just like a single, large institution would. From the point of view of the asset manager, therefore, the potential for democratisation is enormous. ■

Lawrence Calcano is the chairman and chief executive officer of iCapital, Marco Bizzozero is its head of international.