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Market Talk: Alternative Investments for Alternative Times

By Mike Skoric

As we see equity markets reaching new highs and bond yields returning to the highest yields in decades, we continue to increase our focus on alternative assets. Specifically, we view private equity and private credit as displaying several attractive qualities. One key benefit from private equity is that it provides investors with typically better risk-adjusted returns. This means either higher returns for certain levels of risk (volatility) or similar returns for meaningfully lower levels of risk. A second key benefit from private equity is that it provides a much broader equity investment opportunity set. As an example of this, Capital IQ reports that of nearly 21,000 domestic companies with annual revenue of over $100 million – less than 13% are public companies while the remaining 87% are privately held. Moreover, this imbalance further accelerated in recent years as an increasing number of public companies have elected to "go private." From a valuation standpoint, private equity companies usually trade at a discount to public market counterparts, while their returns have consistently outperformed their publicly traded peers in both good and bad years.

Meanwhile, with private credit we see an opportunity for generating higher income yields with still modest default rates in absolute terms and also relative to other higher-yielding fixed income investments. These funds typically target yields of 4-5% above more common public market bond alternatives. It should be no surprise then that private credit funds have exploded in popularity in recent years. On the one hand, we saw private credit direct lenders often stepping in and taking the place of banks that have reduced their lending in the last few years, especially in certain market segments – for example to smaller companies or to finance real estate activities. Meanwhile, private credit lenders were able to provide income-starved investors attractive yields in an era of, until recently, record low interest rates and resulting interest income.

Both private equity and private credit investments are available for clients that meet specific requirements with respect to investable assets and/or annual income. For example, "accredited investors" need to have a net worth of at least $1 million, and/or net income of $200,000 Individually (or $300,000 if filing jointly) in the two prior years and going forward. While there are still certain entry constraints, recently we have nevertheless seen a "democratization" when it comes to investment vehicles. In the not-too-distant past investors could only gain access to private market investments using limited partnerships. However, of late there has been a proliferation of open-ended or "evergreen" investment vehicles that offer frequent investment windows, immediate investment of funds (and thus no capital calls), no K-1 reporting, and even opportunities for quarterly liquidity. This has greatly increased the popularity of private investments. However, there are many factors to consider prior to purchasing an alternative investment. All investors should carefully understand the investment decisions they are about to make and educate themselves on the factors and risks involved.