The Future of "Traditional" Alternative Investments

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Portage

Executive Summary

- **The Future of "Traditional" Alternative Investments**
- **A growing market**
- **Who are the primary customers for alternative investments?**
- **How can investors access alternative investments?**
  - Aggregation Platforms
  - B2C Liquid Alternatives
- **Keys to success in the alternative asset space**
  - Mass Affluent Focused Players
  - High-Net-Worth Focused Players
- **The road ahead**

The Future of "Traditional" Alternative Investments

"The necessity for retail investors to broaden their portfolios across alternative assets and liquidity profiles is more urgent than ever."

The democratization of traditional investing (cash, public equities and bonds), largely enabled by robo-advisors and commission-free brokerages, has fundamentally reshaped how retail investors manage their money.

But with growing correlation among these asset classes, the necessity for these investors to broaden their portfolios across alternative assets and liquidity profiles is more urgent than ever. Despite the potential for alternative assets to outperform public securities and offer the diversification investors need, their adoption remains concentrated with sophisticated ultra-high-net-worth individuals and institutional investors. At the same time, alternative asset managers are actively seeking to capture the untapped demand they perceive among the retail and mass affluent investor base, signalling a mutual interest in bridging this accessibility gap.

Retail investors remain substantially underpenetrated across alternative asset classes such as private equity, private credit, venture capital, real estate, infrastructure, and structured products—the percentage of retail investments allocated toward alternatives currently stands in the low single digits[1,2]. In comparison, institutional investors such as pension funds and endowments allocated 23% and 32% of total assets, respectively, to alternatives.[3] Unlike traditional assets, we believe accessing retail demand requires (i) a simplification of underlying technologies paired with (ii) the right educational tools to help retail investors add alternatives to their portfolios. Depending on the retail segment ("mass affluent" versus "high net worth"), the emphasis on either of these "blockers" is different.

The alternatives retail market is still in its infancy, and this article highlights how technology can change the way alternatives are distributed to retail investors across different segments, with an emphasis on overcoming these two core challenges.

1. McKinsey (2022, February 16). *US wealth management: A growth agenda for the coming decade*. Retrieved from: https://www.mckinsey.com/industries/financial-services/our-insights/us-wealth-management-a-growth-agenda-for-the-coming-decade
2. Investment News (2024, February 7). *KKR sees 'trillions' of retail investor dollars moving to alts*. Retrieved from: https://www.investmentnews.com/alternatives/news/kkr-sees-trillions-of-retail-investor-dollars-moving-to-alts-249077
3. Fidelity (2023, June 23). *A Study of Allocations to Alternative Investments by Institutions and Financial Advisors*. Retrieved from: https://institutional.fidelity.com/app/item/RD_9906996/a-study-of-allocations-to-alternative-investments-by-institutions-and-financial-advisors.html

A growing market

Alternative investment opportunities entering the retail space are not a new phenomenon but an accelerating one. While few expect individual investors to ever reach the same alternative allocation levels as their institutional counterparts, we believe the power of retail lies in its sheer size.

Blackstone estimates that mass affluent retail investors represent roughly **$30 trillion** worth of assets.[4] Macquarie speculates that households between the 90th and 99th percentiles of global wealth amount to a cumulative $42.6 trillion of untapped assets.[5] These numbers translate into potential seismic capital flows with just slight increases in retail allocation. KKR has cited that if individual investor allocation towards alternatives across all wealth bands shifts from 1% to 5%, there could be a **$9 trillion** increase in the size of the addressable market.[6]

While the needs of investors vary significantly by net worth and sophistication, we believe that alternatives must be responsibly sold and positioned as part of a larger, holistic wealth strategy.

4. Blackstone (2020, January 14). *Expanding Retail Access to Private Markets.* Retrieved from: https://www.sec.gov/files/Panel2-John-Finley-Blackstone.pdf?utm_source=privatecapitalinsider.equifund.com&utm_medium=referral&utm_campaign=private-capital-worldviews-blackstone
5. Macquarie: The Sharpe Advisor (2021, January 26). *Private Market Get Practical Webinar* (Timestamp 7:38). Retrieved from: https://www.sharpe-advisor.com/education#videos
6. KKR & Co. (2023, February 13). *KKR & Co. Inc. Presents at The Bank of America Securities 2023 Financial Services Conference* (Timestamp 08:50 AM EST). Retrieved from Tegus.

Who are the primary customers for alternative investments?

*The greatest opportunities in the alternatives retail market can be found in two segments: **mass affluent investors** (US$0.5-3 million of investable assets) and **high-net-worth individuals** (US$3-30 million of investable assets).*

According to a market analysis published by TechCrunch, the penetration rate of alternative investments remains low among mass affluent investors (approximately 3%) and high-net-worth individuals (approximately 22%), compared to ultra-high-net-worth investors (approximately 46%).[7]

However, these categories have distinct preferences and needs, with investors generally possessing a greater understanding of the role of alternative investments in a portfolio the higher you move up the wealth ladder, as summarized in the chart below:

Underlying customer needs vary across sophistication and net-worth

← **Lower Sophistication** — **Higher Sophistication** →

Mass Affluent	High-Net-Worth+
↘ Education on the benefits of alternatives in building a diverse portfolio	↘ Human in the loop; best distributed by an advisor
↘ Part of a broader, more passive digital wealth offering	↘ Emphasis on breadth and depth of product shelf
↘ Curated portfolios to provide diversified exposure to alts exposure (no single fund / asset class exposures)	↘ Higher importance on brand names within each asset class vs. asset class exposure
↘ Built-in liquidity mechanisms	

→ Seamless digital UX

→ High-powered self-service

→ Some degree of choice in products

7. TechCrunch (2022, September 14). *The alternative asset class needs new infrastructure — who will build it?* Retrieved from: https://techcrunch.com/2022/09/14/the-alternative-asset-class-needs-new-infrastructure-who-will-build-it/?

How can investors access alternative investments?

There are two primary channels for mass affluent and high-net-worth investors to access alternative investments. Each has its strengths and weaknesses.

Aggregation Platforms

*High-net-worth individuals (and their advisors) can take advantage of B2B2C / B2C aggregation platforms such as **iCapital**, **CAIS**, and **Moonfare**, which provide access to feeder funds that invest in underlying funds provided by an asset manager.*

Many of these platforms enable lower investment minimums compared to registered investment advisors, putting investments within comfortable reach for the millionaire class. They perform due diligence and provide access to blue-chip asset managers, so investors can be partly assured of product quality. Tools such as portfolio trackers and document managers make managing investments easy, and features like secondary marketplaces (while still largely underdeveloped) aim to provide liquidity opportunities.

Though these platforms provide more investment choices than the typical product range offered to the mass affluent sector, they still offer fewer options compared to traditional private investing, since investors are limited to funds available on-platform. And even though high-net-worth individuals have larger portfolios and may be able to allocate assets to alternatives for longer periods of time, the issue of illiquidity remains—capital calls and lock-up periods are still to be expected. Investors also need to pay fees for both the asset managers and the platforms themselves, and capital is often called entirely up-front.

Ultimately, we believe these products are suitable for sophisticated investors and those who already work with wealth managers. While these platforms leverage technology to reduce the barriers to accessing alternative investments, they do not help to educate less-sophisticated investors on how to incorporate alternatives into their wealth strategies. Moreover, these individuals will still require separate platforms to access their non-alternative assets. In our view, the need for multiple investment platforms will create friction and ultimately act as a barrier to adoption.

How can investors access alternative investments? (cont.)

B2C Liquid Alternatives

For the mass affluent sector, B2C liquid alternatives are mutual funds or ETF products that attempt to package private investments into liquid products and make them accessible to anyone who can afford the minimum investment.

These investment opportunities, such as the **Fidelity Macro Opportunities** Fund and the **AGF Systematic Global Infrastructure ETF**, provide a general level of portfolio diversification from public securities. There are no restrictions on who can invest, the investment minimums are very low, and the assets are liquid, giving investors a great deal of flexibility.

This is an exciting space, with new funds working to bring sophisticated investment strategies to the mass affluent market. **Unlimited**, which uses machine learning to break down alternative asset indices to replicate their returns, recently raised $8 million in a Series A funding round.[8] The **StepStone Private Markets Fund** similarly gives individual investors broad access to the private markets, with greater liquidity and asset diversification through a single investment. Major firms such as **Goldman Sachs** and **J.P. Morgan** also offer a variety of alternative funds to help investors diversify their portfolios.

However, the composition of B2C liquid alternatives can be opaque, and investors have little choice in selecting the underlying investments. The combined fund and asset manager fees may make such investments economically unattractive. And there is considerable risk: if too many investors exit, managers could be forced to sell assets at a loss, or investors may be subject to gating.

As we have noted, educating investors on how to incorporate alternatives into their overall wealth strategies is particularly important for accessing the mass affluent sector. However, we are yet to see a well-positioned business in the ecosystem today that is providing the kind of information and advice that mass affluent investors need via technology.

For us, success in this space requires the same level of simplification we have seen in the zero-commission brokerage space, paired with curation and educational tools to help investors access alternative asset classes as part of an overall wealth strategy.

8. Unlimited (2023, May 23). *Unlimited Raises $8M Series A to Continue Expansion.* Retrieved from: https://www.unlimitedetfs.com/unlimited-raises-series-a/

Keys to success in the alternative asset space

We have spoken with many leading and emerging alternative investment providers and platforms targeting retail investors. Given the different needs of mass affluent and high-net-worth investors, we expect winners to emerge in both parts of the market.

Platforms that offer one-off fund access and investment opportunities as a part of a broader "crowdfunding-esque" campaign may struggle to find adoption, since we do not believe asset managers or founders will enter into exclusive distribution agreements with any one "access provider." New infrastructure tools are making it easier to onboard investors and evaluate opportunities, but there needs to be more differentiation in the market across these solutions. Technology providers offering liquidity should position themselves as able to work across platforms, aggregating supply and demand for both individual positions as well as larger "baskets" of positions.

Below, we outline some of the specific challenges that companies focused on the mass affluent and high-net-worth sectors will face.

Mass Affluent Focused Players

We believe the greatest pain point in onboarding mass affluent investors is that many don't know how to think of alternatives as a part of their portfolios in the same way they understand more traditional asset classes — in terms of both the liquidity profile of the asset class ("What do you mean I can't sell whenever I want?") and how alternatives can represent a powerful diversification tool with upside in the form of potentially higher returns.

As such, companies targeting mass affluent investors might face challenges in attracting customers without appropriate liquidity mechanisms in place. With that context, we believe winners will provide a diversified alternatives strategy (not single fund or single asset class) as part of a more comprehensive wealth strategy with an emphasis on education. In many ways, this will mirror the value proposition of robo-advisors, providing the mass market with passive, "plug-and-play" solutions to help investors optimize their diversification and returns.

Keys to success in the alternative asset space (cont.)

In our view, the mass affluent market will be best served by at-scale B2C businesses with established brand trust, who can educate and cross-sell alternative products to existing customers as a one-stop solution. Several incumbent consumer fintech platforms such as **Betterment** and Portage portfolio company **Wealthsimple** already offer alternative investment products, and have seen their customers' existing trust extend directly to new alternative product offerings.

Wealthsimple, in particular, has made multiple notable forays into the alternative space. In 2022, it launched its Venture Fund I in partnership with Accolade Partners.[9] In March 2023, it launched a private credit fund with Sagard, which has a $10,000 investment minimum, in contrast with the $5,000 minimum recommended for the venture fund.[10] And in November 2023 it introduced a private equity fund with the LGT Group.[11]

Since launching last year, Wealthsimple's private credit fund has amassed more than $200 million[12] in assets under management (as of November 2023). This exceeded their initial expectations and highlights the strong demand for access to alternatives, particularly when an existing platform designed for the mass affluent sector creates a specifically curated investment opportunity. We predict that companies that can be a one-stop shop for investment needs for the mass affluent will also generate stickiness, as users may prefer to manage their entire portfolio on one convenient platform.

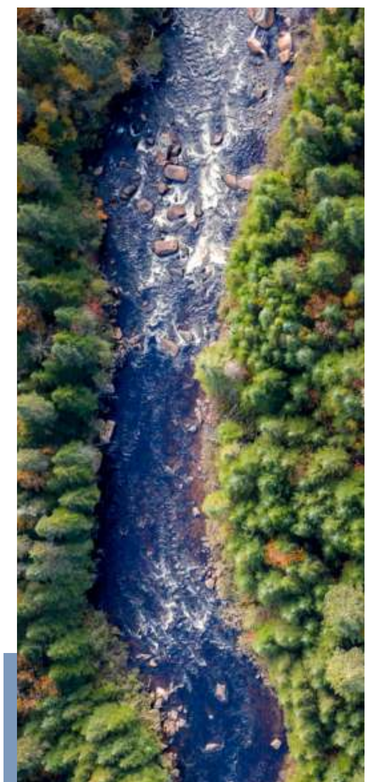
In general, we believe the strongest platforms can deliver both individual opportunities as well as suitable basket funds for investors to choose from. We note, however, that no platforms offer an attractive, comprehensive alternatives solution for the mass affluent market today.

9. Wealthsimple (2022, April 6). *We Made It So You Can Be a Venture Capitalist Even if You Don't Have a Billion Dollars*. Retrieved from: https://www.wealthsimple.com/en-ca/magazine/venture-capitalist-fund
10. Advisor.ca (2023, March 22). *Wealthsimple launching private credit fund with Sagard*. Retrieved from: https://www.advisor.ca/investments/products/wealthsimple-launching-private-credit-fund-with-sagard/
11. Investment Executive (2023, November 22). *Product roundup: Wealthsimple launches private equity fund*. Retrieved from: https://www.investmentexecutive.com/news/products/product-roundup-wealthsimple-launches-private-equity-fund/
12. Wealthsimple (n.d). Retrieved from: https://www.wealthsimple.com/en-ca/private-credit

Keys to success
in the alternative asset space (cont.)

High-Net-Worth Focused Players

High-net-worth individuals are more likely to exhibit sophisticated investment practices and understand the role of alternative assets in their portfolio. For this segment, liquidity, education, and one-stop investment tools become less important product features. Instead, these investors will seek exposure to more aggressive alternative strategies provided by best-in-class asset managers.



Products for high-net-worth investors are best distributed through traditional wealth platforms like RIAs, in partnership with platform entrants like **iCapital**, **CAIS**, and **Moonfare**, that provide a more diversified product shelf paired with the required infrastructure for a modern, integrated experience.

In our view, the space displays winner-takes-most dynamics, and teams that are highly skilled at acquiring and onboarding complementary assets will be able to improve their technology stacks and network effects further. This can be seen with iCapital's 12 acquisitions to date, which include the additions of Artivest and its offering of alternative products and strategies, as well as SIMON, a distribution platform focused on structured investments.[13]

We still see tremendous emerging opportunities in this space across key enabling technologies around portfolio and risk management, with leading players such as **EdgEvooq** and **Canoe Intelligence**.

13. Pitchbook (n.d). Portage analysis of Pitchbook data.

The road ahead

The entire alternatives space is forecasted to continue its staggering growth, with retail investors' involvement expected to grow even faster. In the coming years, we expect to see many new companies and platforms provide access to alternatives.

Strong technology-driven solutions are likely to stand out in the marketplace, and the most attractive offerings will likely combine access with information and education. Mass affluent investors in particular will benefit from education around alternative investments. But no matter where they fall on the wealth ladder, few investors are well-positioned to invest in alternatives responsibly without some level of advice and curation.