FAIRPORT FLASH
AN INVESTMENT PODCAST

Episode #37: All Things Alts

Annika Traner:

Welcome to another episode of Fairport Flash. This is Annika Traner, Digital Marketing Manager, bringing you the latest insights from the Fairport investment team. Today I'm joined in the studio by Chief Investment Officer John Silvis. How are you doing today, John?

John Silvis:

I'm doing well. How are you?

Annika Traner:

Good. Thank you. Joining John and myself on the podcast today to discuss all things, alts is none other than Robert Picard, managing director and head of alternative investments in the Hightower Investment Solutions Group. The Investment Solutions Group is an additional resource available to Hightower's nationwide community of advisory businesses. Fairport Wealth included that our investment team can utilize to enhance portfolio construction and asset allocation in both public and private investments. Robert has 32 years of experience on both the buy and sell side, having built multi-billion dollar alternative investment programs at companies like First Republic Wealth Management and the Carlyle Group. Welcome Robert and thank you for joining us today.

Robert Picard:

John. Thank you very much, Annika. Thank you very much for the warm welcome today.

John Silvis:

Yeah, no, I appreciate it. So Annika said, thanks for joining us. As we were kind of talking beforehand here at Fairport Wealth, one of the things that we're excited about in conjunction working with Hightower is the alternative solutions group that you've started. I know, correct me if I'm wrong, you've been there a little over a year now, is that right?

Robert Picard:

That's correct. I'm just on my 14th month.

John Silvis:

So I know when you started, I think you were a one man show, but I assume you've brought on other people on your team as well.

Robert Picard:

Well, first of all, we do have a team. I'm part of Stephanie Link's Investment Solutions team, a number of professionals that helped me and compliment me. I did actually recently hire one of my former colleagues with whom I've worked several years together. Frank Cordy would join me earlier this year. So very excited to have Frank and we continue to build out the team to not only incorporate with Stephanie's team, but to enhance it over the coming months.

John Silvis:

Great. So I thought I'd just start off with really the basic question. So we at Fairport and with our clients historically invested in public, publicly traded securities, equities, ETFs, mutual funds, as well as fixed income instruments like municipal bonds, corporate bonds and those things. So what exactly is an alternative?

Robert Picard:

Great question, John. And the way I look at alternative or the way I define alternative, anything that is not a listed equity or a listed fixed income investment that's regulated by the S E C typically I would consider to be an alternative investment. And then if you took one step further, in addition to the concept of alternative investment, anything that is private or a private market investment is a sub-sector of the alternative investment universe. And what we've been seeing now for several years is that certain segments of investors such as endowments, public pension funds, and most importantly, most billionaires have meaningful allocations into alternative investments in their portfolios.

John Silvis:

Okay, great. So I know I've heard you talk about this before, but for our audience you have a pretty well-defined process. You use, I think you call it pep, p e p, something you've talked about a lot and kind of walk through. Could you kind of walk through that process for us?

Robert Picard:

So it's pretty interesting. So Hightower advisors, we own currently or we have a confederation of 130 plus separate advisor businesses such as your own business, and you are the fiduciary and you have a meaningful amount of autonomy. That said, as you manage your client's portfolios with their best interest in mind and specific to their needs and depending on their demographic, their age and how they're looking to allocate. Our role on the investment solution side is really to provide you and your team and your clients with what we'd like to describe as the best or a differentiated private market solution. And when I refer to my pep talk, p e p, what I'm getting at is that when we present you and your team and your clients with solutions for private market investments, we're typically looking for P E P, which is great performance or top quartile, if not top decile performance where possible.

We're also looking to provide you and our clients with deals that are exclusive to our wealth management platform, meaning that there's a lot of opportunities, there's many wealth management firms. What we're really looking to do is provide you and your clients with opportunities they're just not available at other firms and are unique to Hightower and your team. And then the last P is some people refer to it as people, some people refer to it as preferred terms, meaning that we invest in the best people, but we also try to negotiate on your behalf and on your client's behalf, preferred terms that are typically better than what would you get as an investor investing directly in the fund.

John Silvis:

Yeah. So I will tell you one of the, I think the big advantages for Fairport working with you and your group is those preferred terms you mentioned. I think, I mean, correct me if I'm wrong, but the advantages of the preferred terms and even the preferred pricing can really be beneficial if you compound that over time. So I guess one of the questions I would have for you is a lot of, obviously you go through the fundamental analysis, but a lot of it is also relationships, right? I know you said you're in the business for 30 years. Can you kind of speak to that a little bit? I mean, I would imagine that that's one of the things where it helps get access to some of these alternative investments.

Robert Picard:

Yeah, so what's been happening, I've been doing this now for 32 years, and I would say that it's good to have a seasoned team supporting you. And what I'm getting at is just to give you an idea and a step back, obviously liquid markets, both the public equity markets and the public fixed income markets are very efficient. There's a lot of research that's available for you and your clients. They can make informed decisions when it comes to the private markets. And just to discuss private markets, give an idea of all the companies in the United States today that generate more than $100 million, 87% of those companies are privately owned still. They're still being managed by founders and there is still a meaningful opportunity to generate alpha or generate meaningful returns. Now to invest in those companies, you really want to find seasoned professionals or professional firms that are specialized in identifying, managing and investing across those private equity investments in those private investments and with those founders.

And that's where my benefit of having been doing this for 32 years, I have now a network of fund managers of professionals and others who've been themselves doing this for a very long time. And to a certain degree, look at Hightower, look at Fairport and myself as a partner. And it's very consistent actually with the way Bob Aros has built out. Hightower, which is just as Hightower has a strategic relationship with you, John and Fairport, we approach the private markets world the same way where we want to have preferred relationships with our managers, with our third party managers who invest in those private markets and therefore also negotiate with them preferred terms that ultimately benefit both you and your clients with lower fees than they would typically get if they went directly.

John Silvis:

So for a client that's starting off, adding alternatives to their portfolio, what is the main driving force? I, I've heard it's both either enhancing returns where would help the overall portfolio returns or maybe diversifying with non-coating assets, so it kind of helps smooth out some of that volatility within the portfolio. Is it one or the other or can it be both?

Robert Picard:

Well, I would argue, the way I approach it, and we've been, first of all the original, this concept of 60 40, meaning let's say 60% in equities and 40% into fixed income, right? No one's really quite sure where that asset allocation originated from. It's a bit of a mystery and any number of academics who'd love to take ownership for it. But what we can say is, especially in, for instance, 2022, when it was a very challenging investment environment both in equities and fixed income portfolios that had allocations of five, 10 or 20% allocated to private markets outperformed in a meaningful way. And when you look at the statistics of how private markets contribute and benefit over three years, five years, even 15 years, you'll see that there's a higher risk, a better risk adjusted return, better returns and lower volatility when you add a 20% allocation to private markets.

And now I'm going to answer actually your question. That was sort of a brief intro. I view private markets as complimenting your 60 40. So to a certain degree, if you're investing in equities and public equities, private equity, venture capital and secondary private equity compliment and should be simply additive to your existing public equity portfolio because those are investments that are not available in the public markets typically and have still a significant opportunity investing with founders and investing with these firms that are not well known that have a significant opportunity to generate alpha. On the other side, you have fixed income, or let's say it's 40% allocated to fixed income in public fixed income. What I would do is I would look at your fixed income as core, and then I would have private credits and private real estate, and to a certain degree, certain infrastructure investments bolted onto that fixed income as another solution whereby you're holding your investment for a longer period of time. It's less liquid than your public fixed income, but the net returns that you will generate with that portfolio will compliment your existing fixed or public fixed income portfolio. And typically those returns in our view, should always be somewhere in the high single digits, if not lower to mid-teens return rate of return, which really kind of provides this a little bit of kick to your traditional fixed income portfolio.

John Silvis:

So does time horizon play a role in that, Robert? Meaning I know the institutional investments tend to have a higher percentage, whereas maybe the high net worth families as you or individuals, I think you just mentioned maybe 20%. Does time horizon play a role in that? Obviously these are longer term investments on the alternative side.

Robert Picard:

Yes it does. And this is something you really have to your clients, and I know Fairport has that discussion with your clients on a periodic basis. Just to give to frame it right now, endowments and billionaires have north of 50% allocated to private markets in their portfolio. So very significant allocation. Individual investors on average have less than 5%. So we're actually expecting that disconnect or we're expect, and so certainly imitation is the best form of flattery where with the democratization of alternatives, where there's now more and more solutions that are being made available to accredit investors to invest in private markets. And with the miniaturization of those investments, meaning that where you used to have, you could only invest minimum investment of a million dollars of 5 million into these private market investments. Now you can go as low as $10,000, which suddenly opens up this whole universe to individual investors who traditionally have only had a 5% allocation or under allocated to private markets. They can now to a certain degree imitate the average billionaire and have a higher allocation. Now, what that does to your portfolio though is it forces, I always argue that your client needs to be rewarded for the illiquidity of the private markets portfolio. So meaning the private equity and private credit and real estate to a certain degree that money won't be able needs to be longer term.

John Silvis:

So anywhere between that's the illiquidity premium that you hear people talk about?

Robert Picard:

That's right. Correct. So 2, 3, 5, 10 years that therefore you need to be rewarded in a meaningful way with higher returns to justify your clients parking those assets in that portfolio. But the benefit of course is that with that illiquidity premium over a longer period of time, it will provide you with a meaningful impact or meaningful benefits for your overall portfolio returns over those periods of time.

John Silvis:

Okay. So you mentioned a couple things in there and I kind of want to circle back to it Again. I would think this is kind of alternatives 1 0 1 for our clients. You mentioned what we here at Fairport call buckets, we always call 'em buckets, basically asset classes. So you mentioned a couple relative to the alternative side, you mentioned real estate, private credit, private equity, and I know internally you just had a rollout of an infrastructure one. Would those be kind of the four main areas that you would focus on? So if we're building out a client portfolio and you're kind of building a model relative to the alternatives, are those kind of the four areas?

Robert Picard:

Yeah, I break it out to equity and fixed income. So I look at equity as being a combination of private equity, potentially venture capital, which are very early stage investments with potentially higher risk, which should be to a certain degree warrant a smaller allocation. And then secondary private equity where you're actually taking advantage of secondary sales of private equity, which typically sell at a discount, which could give you the opportunity to generate a higher return in a shorter period of time. And that, I believe compliments your equity portfolio. Then on the other side, when we're talking fixed income.

John Silvis:

Can I interrupt you there for a second? So that would be part of that 60% you were talking about earlier in the 60/40?

Robert Picard:

That's correct.

John Silvis:
Okay, go ahead, sorry.

Robert Picard:

And then on the fixed income side, you'll have your traditional public fixed income, and then on the fixed income side, on the private market, fixed income, I look at private credit as part of that private real estate because both private credit and private real estate, very often, not only are you investing in assets in some cases, parts of the capital structure of a company or in some cases in a series of buildings, whether it be multi-family homes, multi-family rentals, whether it be single family rental developments or potentially industrial office parks, that is also often paying you an income per quarter.

John Silvis:

So you're almost similar to a bond in that bond alternative so to speak.

Robert Picard:

That's correct, exactly. It compliments your bond alternative. And then of course you have the opportunity with the right investment manager that those real estate investments will eventually appreciate in value also. So you'll get that double whammy where you'll be earning income. And then you'll also hopefully, especially in this environment with where there's been inflation that's been present for the past two years where the asset backed security, whether it be aircraft, aircraft leases, whether it be buildings, all of that inflation environment very often will be a good hedge against inflation because they typically appreciate, they inflate their prices inflate too. So it's beneficial to your clients.

John Silvis:

And where would you stick the infrastructure?

Robert Picard:

So some people it's, this is a great question, John, and you could argue both sides. Some people say is make it an equity investment. They consider it to be a real asset of some sort. I consider it still more of a fixed income investment because infrastructure's considered, could be cell phone towers, could be cable lines, could be highways, certain ports and shipping yards. So some people will consider that to be equity. Some people will consider it fixed income. I consider it more fixed income. Okay. Because of and others.

John Silvis:

And that's more that 40% that we're talking about in the 60/40. So to kind of break it down. That's

Robert Picard:

That’s correct

John Silvis:

So I kind of want to circle back a little bit. I know you've mentioned this and you've discussed this before, but for the benefit of others at the end of last year, there was a little bit of a, if you want to call an issue with some of the real estate funds and some of the gates being closed, so to speak, on the Bee REITs of the world. Any thoughts on that? Do you think if you're a long-term investor, is that something to be concerned about? It seems like it's kind of dissipated somewhat. I guess those things will happen at times.

Robert Picard:

So it's a really interesting point in time in the history of capital markets because I mentioned earlier this concept of democratization of private markets, meaning that they're being made available, solutions are being made available that were traditionally only reserved for university endowments and billionaires are now being made and available for ins, high net worth investors. And they're also being miniaturized, meaning that rather than having a 5 million investment, you can invest with as small as a $10,000 investment. So what occurred late last year was this innovation that occurred with Blackstone was at the forefront of that innovation along with K K R Apollo and several other well-known private equity firms where they created what we call private real estate investment trusts or private REITs where they miniaturized the minimum investment, which is 10 to 25,000 depending on which private real estate investment trust you're looking at.

And two, they've also made it available to accredit investors. But what what's happened is they're still buying, they're making real estate investments which are not liquid. And in the event of a period of uncertainty or market uncertainty or real estate uncertainty, especially in an environment with rising interest rates, one could be concerned that real estate would drop in value. And what happened was many of these investors who are invested for the first time over the past five years in these strategies or in these investment funds, ultimately there is liquidity, meaning they can sell a certain amount of the investment every quarter. It's called a tender offer structure. But what happened was for the first time and after they had tremendous performance because these funds had generated almost 20% net a year over multiple years after tremendous performance last year. And at the end of last year, a number of investors started to redeem, which caused almost what we'd call a running the bank, except there's a mechanism with these funds where they're able to suspend redemptions or sales and basically perform those sales on an orderly basis every quarter.

And this is not necessarily new to the private market world. This has been happening for the past 20 or 30 years. And typically when it would happen, it would be a lot of controversy, C N B C, lumber, Bloomberg, and other shows would exactly, wall Street Journal would pick up front page material, suspension of redemptions, no liquidity. People want to get their money, they're rushing for the exits. And it was typically, and going back 20 years from now, having been doing this for 30 years, 20 years ago, that would've been the end of the fund, meaning that immediately people would've been like, I'll never invest with that manager ever again. But a lot of that behavior was because investors were misinformed or ill-informed about the liquidity aspect. They wrongly thought they could get out any time. And what we've found now since this past episode of redemptions from both the Blackstone Private REIT and the Starwood Private reit, we've been very surprised even though some of the news shows have been spoke about it for the first few days, it disappeared relatively quickly.

And I think what I conclude from that lack of interest from the market was that investors are much better informed now. They recognize the fact that these are long-term investments and that it's in nobody's interest, especially when dealing with real estate to have forced sales, which only hurt all the investors because basically the investments drop in value when forced sales. And what this has done is actually the Blackstone portfolio, which is surprisingly well positioned in the sense they don't have any office commercial or office space. It's all multifamily, single family rental and telecommunications, all of that. What I mean, data centers, meaning servers which are being housed and rented out for benefits. All of that has benefited the investors. They've done extremely well and there hasn't been an outcry. And I think it's good to have in your portfolio stable money. I'll give you an example of my late father who passed away 10 years ago.

He was the perfect market indicator on when to buy or sell the market because anytime he said Rob, he had a little German accent, he'd say, Rob, I think I want to buy the market. I always knew that was the time to sell. Yeah. And whenever he said, I think I'm really scared I needed to sell the market, I knew that was time to buy. And he was the perfect counter integrator. And I think what's the benefit of a lot of these private investment opportunities is it forces us to be longer term investors and be more patient with our money and avoid this concept of immediate gratification. And listen, we've all just been through this episode of Silicon Valley Bank with First Republic Private Wealth Management. I'm an alumni of First Republic Private Wealth Management. I could never imagine having worked there knowing their net promoter score level that there would be a run on that bank because the high net worth clientele there, the private bank was well regarded by their clients, but you could see people to a certain degree panicked and pulled their deposits. And fortunately, I think what's good now about private markets is there's a certain requirement to take a long-term view, which I think is good for our economy, it's good for our capital structure, and it's good for our ecosystem to keep stable capital in our economy.

John Silvis:

So just to reiterate that, one of the things you said is it's long term. So as we look at these alternative investments, you're looking at a timeframe of three plus years or more. And again, that's how you benefit from that, the illiquidity premium that you mentioned earlier.

Robert Picard:

That's correct. And I would emphasize not just the way we all need to be longer term views, I think it's much better for our economy, our local economy and our national economy, that our investments and our investors take a longer term view. And frankly, that should be, it shouldn't be quarterly. I mean, I think it's perfectly reasonable to have liquidity as needed and stay a majority of your portfolio liquid. But at the same time, I think it's a really great exercise for our economy, for our companies and for our borrowers to have three, five and 10 year paper available.

John Silvis:

So I'm going to shift gears a little bit here, but I know you've talked about cybersecurity fund before. One of the big things over the last, I guess what three months is AI, or artificial intelligence. Is there an area that you think that's beneficial in the private markets? I know a lot of those tend to be very small companies that are looking to capture a certain part. Is there a way for the average investor to play that area or invest in that space?

Robert Picard:

Absolutely. So Fairport Wealth, you now today have access to a number of private investment opportunities and your clients that are specifically fee-based, meaning that we are traditionally, especially, we just spoke about long, long-term nature of private investments. We believe there are long-term five to 10 year tailwinds in the cybersecurity space. Just to give you an idea, there's an increase of ransomware of a thousand percent per year, which is absolutely frightening. There is the average time it takes for a company to discover that they've been hacked or that there's someone who's been in there or stealing data, I thought it was 2, 3, 4 or five days. The average length before they discover they've been hacked is one year. And it's clear to me that all technology, especially with investing in and most of the s and p today, a lot of it's overweight technology. If there's one area in technology where I believe there's five to 10 year tail ones, it's cybersecurity because it's actually incumbent at the board level of public companies and to certainly private companies, to have a fiduciary responsibility to ensure safe technology and cybersecurity protections.

And that's one of the reasons why we're investing in that sector. The other area would be artificial intelligence, where we're seeing early stage companies venture that are still being run by founders and others. We have a lot of opportunities coming, whether it be chat, G B T. It's funny, I sent a note on the board of a private club and we wanted to send a note, and I have a tendency to send emails that come across as being a little business, I'd say overly businesslike. So I was able to just enter into chat GT saying, this is what I want to say, but please make it much friendlier and accommodating. And it sent the most beautiful note that was very picard, but at the same time very friendly and was very well received, let's put it that way. And I just think it's a question of time before we get more and more enhancements to the AI side.

And then lastly, there's one piece that I really want to add, which I think is a very exciting theme, which has to do with the fact that since the pandemic and even to certainly before the pandemic, we've identified the fact that our supply chain has to a certain degree moved overseas. And what we believe is happening right now in a long-term trend and a long-term theme for us on investment solutions with Stephanie Link is the reshoring of manufacturing. Meaning that where we've been most of your career, John, in my career, we've, we've been supporting globalization of the world economy. We're now seeing that reverse and we're seeing to a certain degree that de-globalization and we're seeing billions, hundreds of billions of dollars being invested in manufacturing and bringing the supply chain back to the United States. And one of the themes that we're playing is investing in companies that provide robotics and automation support for manufacturing. And that's a key theme.

John Silvis:

Yeah. Well, just to put a point on it, we're in Cleveland, Ohio, so here in Ohio they Intel's bringing chip manufacturing. I think it's going to be 20 billion investment. Governor DeWine was part of the CHIP act and everything. So yeah, I agree with you. We're definitely reshoring here and it's a big opportunity here in our state as well. But, so one final question. We talked a lot about the alternatives, and there's a couple different areas or levels, I guess, of alternatives. I know there's something called an accredited investor versus a qualified purchaser. Can you give us briefly an understanding which one of those which is and how they're different?

Robert Picard:

So again, with the caveat that the rules do change periodically. Currently, the accredit investor is referred to individuals who have an income that's greater than $200,000 in each of the past two years, or whose joint income with a spouse is greater than $300,000 for those years, and that they'll have a reasonable expectation of having that same income over that period of time. Now, the qualified purchaser is a much higher level of or threshold to qualify for investments. And that's typically going to be, if I remember correctly, and it changed I think relatively recently, it's typically it's achieved when the individual has a minimum of 5 million in assets that do not, if I understood correctly, do not include your personal residence. Now, it can include a vacation home, but that 5 million cannot include your personal residence. That's a very high threshold, and that's typically for some of the more sophisticated funds that require a qualified person. But I think real, what I think is important to communicate to your clients is the fact that distinction between QP qualified purchaser and a credit investor and what investments they can make that change is slow. That Gulf is changing, meaning that with democratization and miniaturization, accredit, investors are starting to get access to the very same investments that qualified purchasers are access to. Therefore getting the exposure to the same type of strategies that your average billionaire or average university endowment would typically invest in.

John Silvis:

Well, listen, Robert, I appreciate your time. This has been great. I hope this has been beneficial to everybody that's listening. I want to point out for our clients out there, anyone listening, if you have questions, talk to your advisor about it. You can reach out to us a lot of the points that Robert mentioned as far as process goes. We have materials we can send you, we can walk you through them. Be happy to do that. Again, I think, as I said earlier, this is kind of an educational process and I think this is a great first step. So I really appreciate your time today. Is there anything else that we didn't cover that we should have, Robert?

Robert Picard:

Just to cover the fact that you are a phenomenal chief investment officer, Mr. Silvis. Oh, and thank you. We're very lucky. We're very lucky to have Fairport Wealth as a part of our platform and really excited to work with you and work with your clients. Really appreciate it. Well, thank

John Silvis:

Well thank you very much and have a great day. Thank you.

Annika Traner:

Thank you, Robert.

Robert Picard:

All right. Bye-bye.

Annika Traner:

Thank you again, John and Robert, and a big thank you to you, our listeners. We hope you learned something new about alternative investments today. As always, if you have any questions on the topics we discussed, please don't hesitate to reach out to a member of your Fairport Wealth team. For the latest updates from our investment team, follow us on LinkedIn, Facebook, or Twitter, also known as X, and look for the hashtag investing with Fairport. Be on the lookout for a special episode of the Fairport Flash later this month, hosted by our very own intern, Kennedy Whitaker. Thanks again and take care.