MARCH 2023

The Alternative Investor

Performance
News
Trends
Regulatory updates

Building, Running & Developing Family Offices

In this edition, **Taylor Wessing's James Goold** elaborates on the ins and outs of opening and structuring family offices, **PwC's Christine Cairns** writes about the emergence of the modern family office, **Lutyens Advisory's Charlie Harris** looks at the shift to more illiquid investing and **Y TREE's Johnnie Hampel** dives into the world of data and technology to help make smarter investment choices.

A Brodie Consulting publication in conjunction with Capricorn Fund Managers and RQC Group.

#21

FEBRUARY PROVES A MIXED BAG FOR HEDGE FUNDS

After a strong start to the year, the **HFRI Fund Weighted Composite Index** declined -0.5% in February, led by equity focused managers, as the macro deteriorated. February markets proved problematic to navigate, see-sawing on rate rises and disappointing financial results, and the last full trading week saw the worst loss in US stocks for two months. To see a more in-depth market review click here.

In this environment, the **HFRI Equity Hedge (Total) Index** fell -1.3%, with all sub-indices in the red for the month. The worst performers were **Energy/ Basic Materials**, with the Index down -2.7%, followed by **Quantitative Directional** and **Fundamental Growth**, both -2.6%.

The **Event Driven** strategy was more mixed, with the Index marginally up +0.1%. Within this, **Multi-Strategy** was down -1.1%, while **Event Driven** and **Special Situations** were up +0.6% and +1.0% respectively.

Macro lived up to its uncorrelated billing, with the **Macro (Total) Index** +0.2% and on an asset weighted basis +2.6%. The outperformers were the **Currency** focused managers, with the Index up +3.4%, followed by **Systematic** +0.8%.

There was less movement in **Relative Value**, which closed the month +0.1%. Within this, the best performer was **Multi-Strategy** +0.9% and the worst performer **Yield Alternatives** -0.9%.

Turning to the regions and it is clear that this was a particularly tough month for **Emerging Market** managers, with the Index down -2.5%. The worst performance was **Asia (ex-Japan)**, with the Index falling -3.5%, followed by the **China** and **India** indices, both down -3.0%; closely followed by **Latin America** -2.6%.

Upcoming Industry Events

16 March 2023
Mergermarket M&A Forum Australia 2023

21-22 March
ALFI European Asset Management Conference (Lux)

22 March
Debtwire Restructuring Forum 2023

Click here to see all the listings

$3.4tn

Size of the hedge fund sector at the end of January 2023

Source: eVestment

$2.3tn

Estimated size of the global private debt market by 2027

Source: Preqin

EQT SETS €21BN HARD CAP

EQT has set a €21 billion hard cap for its latest fund, EQT Infrastructure VI. This figure is above the Swedish firm's initial target of €20 billion, with the fund investing in digital, energy, transportation and logistics, environmental and social infrastructure. According to reports, the manager is targeting an IRR of 11% to 15%. One investor, **New Mexico State Investment Council**, is investing $160 million directly into VI and has also committed a further $60 million for co-investing alongside the fund.

OAKTREE TARGETS $10BN

Whichever way you look, **Oaktree Capital** appears to have a degree of involvement. They are certainly fast expanding their business, with the firm's AUM approaching $200 billion. Its latest planned fundraise is for **Oaktree Lending Partners**, a $10 billion vehicle to finance private equity buyouts. The fund will provide loans of $500 million or more in leveraged acquisitions. This comes from an investor letter reported by the **Financial Times** and will take place over the next two years, with majority shareholder **Brookfield** already committing $2 billion.

LOOKING FOR TECH VALUE

Bain Capital has just announced the successful $2.4 billion fundraise for its second Tech Opportunities fund, **Bain Capital Tech Opportunities Fund II LP**. This fund is designed to capitalise on what they see as low valuations in the space. The previous fund raised $1.3 billion in 2020 when *"there were a lot of companies which we just couldn't invest in,"* said ***Darren Abrahamson***, partner on the team. Tech Opportunities II will focus on application software, financial tech and payments, healthcare IT, infrastructure and security. Investors include **New Jersey Investment Council** and New **Mexico State Investment Council**.

APOLLO LAUNCHES SECONDARIES FUND

With the launch of its first dedicated equity secondaries fund, **Apollo** is joining several other big managers in this space. Opportunistic fundraising will start in Q2, with the official fundraise planned for 2024. Last year, Apollo launched the **Sponsor and Secondary Solutions** platform, aka S3, with a team from **BlackRock** and **Abu Dhabi Investment Authority** as a cornerstone investor.

UPDATES (cont.)

THRIVING PRIVATE CAPITAL MARKETS

The global private credit market is now one of the fastest-growing asset classes. According to **Preqin**, this $1.5 trillion industry will hit $2.3 trillion by 2027, with other reports estimating $2.5 trillion by 2025, as established players launch further funds and new players come onto the scene.

Data from the **Global Private Capital Association's** members saw private credit and infrastructure investments hit record levels in 2022.

Rising interest rates have been hugely beneficial, as has the retreat by international banks from such offerings. The US is still the largest and most mature private credit market, covering direct lending, mezzanine lending, distressed and special sits, speciality finance, real asset credit and real estate credit.

Just in the past few weeks, we have seen private credit firms provide $5.5 billion of funding for **Carlyle's Cotiviti** deal, the largest private buyout financing to date. Since we last wrote, two funds have closed combined commitments of more than $10 billion for flagship offerings - LA-based **Crescent Capital Group**, with $8 billion for **Credit Solutions VIII**, and New York based **Willow Tree Credit Partners**, $2.4 billion to finance senior secured floating rate loans. Elsewhere, behemoths, such as **Blackstone** and **KKR**, are raising more regionally focused multi-billion-dollar funds, while the likes of **Janus Henderson** are adding private credit to their future growth strategy. Family offices are also on the case, with news that **Cercano Management** is building out its direct lending arm. The family office, which looks after $10 billion of assets for the likes of ***Paul Allen's*** family (from which it spun out of), views this as the *"biggest growth area"* this year, writes **Bloomberg**.

VC DISAPPOINTS

An underwhelming statistic from last year's fourth quarter was the disappointingly low level of fundraising. This data comes from **Preqin**, which reported that venture firms raised $20.6 billion globally during the quarter, down 65% from a year earlier, making it the worst Q4 since 2013. LPs also only invested in 226 venture capital funds, compared with 620 a year earlier.

DE SHAW & PRIVATE MARKETS

Another firm going through a purple patch is **DE Shaw**, which continues to build out its private market capabilities, having successfully raised $1.1 billion for two new funds. The first is **Diopter**, a private credit-focused fund with $650 million capital commitments to finance bank risk through synthetic securitisation.

The other is **Voltaic**, a $450 million closed-end fund - slightly shy of the targeted $500 million - to invest in post-seed or growth equity stage firms. DE Shaw is not new to this game, having first raised a private credit fund in 2008, but has now raised a total of $3.5 billion in the space, including this recent raise.

UPDATES (cont.)

IKE TO LAUNCH FUND

One of the many problems facing giants in alternatives is the difficulties of holding onto talented managers and every year we see 'big name' spin-offs.

An example from the past month is **Blackstone's *Melvin Ike***, a Managing Director in the **Tactical Opportunities Group**, who has left to start a new firm. Tactical Opportunities invests in assets that usually fall out of the firm's more normal scope, such as timber and oil, and today it manages around $34 billion of assets. He joined Blackstone in 2019 from **Third Point**.

STRONG ALTS PERFORMANCE AT MAN

Man Group reported a decent set of results for 2022 that saw its share price pop over 8% on the day.

It increased assets under management from £138.4 billion to $143.3 billion in the final quarter, although this is down from $148.6 billion a year earlier. Alternatives were responsible for much of the growth, bringing in $3.4 billion when group inflows were $3.1 billion in total.

Breaking down its assets (as of 31 December 2022), $46.0 billion (2021: $41.2 billion) is categorised as Absolute Return, $28.8 billion Total Return (2021: $35.4 billion), $20.2 billion Multimanager (2021 $15.0 billion), $31.6 billion Systematic Long-Only (2021: $36.1 billion) and $16.7 billion Discretionary Long-Only (2021: $20.9 billion).

The Absolute Return fund performances were all positive for the year, with **AHL Diversified** the best performing, up 13.1% in this category. Commenting on the results, ***Luke Ellis***, CEO, said that he sees *"significant opportunity for active investment managers, particularly those with the ability to offer alpha irrespective of the direction of prevailing market trends."*

HEADING FOR THE SUN

Dubai's position as a fast growing financial hub is not a new trend, but what is new is its increasing popularity amongst hedge funds. **BlueCrest Capital Management**, **Balyasny Asset Management** and **Millennium Capital** all have offices there and adding to that number, in the last few weeks, is **GoldenTree Asset Management**. According to **Reuters**, around 60 hedge funds are waiting to be licensed, with total assets under management of over $1 trillion. There is even a *"backlog"* said ***Essa Kazim***, governor of the **DIFC**, speaking to **Bloomberg**. Some of Dubai's obvious advantages include on-the-ground access to high net worth (local, regional and expat), institutional and sovereign money, as well as lower licensing fees and capital funding requirements.

JANUARY SEES NET HEDGE INFLOWS

According to **eVestment** data, January investor flows saw $1.14 billion added to hedge funds, a trend that chimes with **Citco's** numbers. Multi-strategy funds were once more the flavour of the month, seeing the most significant net inflows that, in particular, headed to the *'big names,'* such as the **Citadels** (to read more about **Citadel** there is the excellent **Financial Times** article by ***Laurence Fletcher*** - link) and **Millenniums** of this world, while long/ short equity and macro again saw outflows, with the latter marked by *'some large concentrated redemptions.'*

The hedge sector closed the month at $3.433 trillion, a $50 billion increase, largely the result of healthy performances, particularly from the equity managers. However, not all the stats were so upbeat, with Citco's future trade and redemptions data looking high for the first quarter, with a current outflow figure of $11.1 billion.

UPDATES (cont.)

TIGHTER SHIP

With **Citadel** and **Millennium** snapping at its heels, **Bridgewater** has announced the first round of changes in the post-***Dalio*** era. While Bridgewater remains number one by dollar size, for the first time in many years it is under pressure, with its dominance being eroded by the big multimanager funds, which outperformed last year and pulled in the big mandates. **Bloomberg** first reported on the job cuts, with an 8% reduction and a cap on the firm's flagship fund as part of what it termed a *'restructure.'* In addition, there will be increased spend and focus on artificial intelligence, machine learning and sustainability.

SKIN IN THE GAME

Hedge fund managers have been increasing the amount of their wealth invested in their funds. This comes from **AIMA** and **RSM International** data, which surveyed 138 managers and found that small managers are increasingly likely to invest their own capital. This is not that surprising as investors will always want to see *'skin in the game,'* particularly from the smaller managers where there are perceived greater risks as well as different levels of expectation and fund economics. The average investment in 2019 stood at 6% and is now 7% of their total assets under management - for those funds with less than $1 billion assets this figure stood at 9.3%, and for those above $1 billion 7.0%.

The same survey also found that the 2% management and 20% performance fee to be a thing of the past, which chimes with what we are seeing; however, some of the larger managers, and those with the wind behind them, such as **Citadel**, are going the other way by increasing fees and changing redemption terms in certain funds.

ELLIOTT GOES RED

At one point, it looked as **if Elliott Advisors** was about to throw its hat into the ring as one of the bidders for **Manchester United**. If they had, they would have been up against the deep pockets of Qatari Sheikh ***Jassim Bin Hamad Al Thani*** and **Ineos' *Jim Ratcliffe***.

Elliott is not without form in this space, having owned **AC Milan**, which they sold to **Redbird Capital Partners** for €1.2 billion in August 2022, and the numbers touted are undoubtedly in their comfort zone. But they have ruled themselves out of a bid, although they are still keen to be involved from the sidelines offering finance, as have **Oaktree Capital** and **Ares Management**.

However, according to various reports, the sale may still not go through, with the offers not yet close enough to the $5 billion figure the ***Glazers*** are seeking for the club.

ENFORCED TALKS

With their multi-billion dollar stake in **Salesforce** announced last month, **Elliott** has had *"substantive dialogue"* with the CRM giant. Since then, Salesforce has announced accelerating margin targets, capital return and board changes, steps that appear to have reasonably placated Elliott as *"consistent with our recommendations."* The activist has, however, said that *"much work remains... and leadership must now deliver on its promises."* They have also nominated a slate of directors before the window closes on 14 March.

IN THE SPOTLIGHT

Having taken a stake in **Spotify**, **ValueAct** is actively looking for the streaming service to reduce costs across the business. **Bloomberg** described the costs as having *'bloomed'* in recent years, with Spotify investing significant sums in podcast networks. Spotify's response was typically minimalist and to the point, saying, ***"we welcome ValueAct as an investor in Spotify."***

UPDATES (cont.)

TOSHIBA SALE

A long-standing activist position is **Toshiba Corp**, which looks as if it will finally be sold. The company confirmed a bid from the preferred bidder **Japan Industrial Partners** (JIP), with backing from **Orix, Chubu Electric, Rohm** and various Japanese businesses. Until JIP received preferred bidder status, other names in the mix included the likes of **KKR**.

Toshiba's long-term underperformance and various scandals have put the conglomerate under pressure from institutional investors and activists, with both **Farallon** and **Elliott** holding 10% of the firm and having seats on the board. The sale process has never been straightforward, with the Japanese government concerned about Toshiba's nuclear power business being sold to foreign owners. According to **Nikkei**, this deal is reportedly worth ¥2 trillion ($15.2 billion). The sale now needs the support of shareholders.

ON THE WAR PATH

Given last year's tough markets and disappointing performance, **TCI's *Chris Hohn*** has been relatively quiet. He has since reappeared to take a shot at **Airbus**, in which he holds a 3% stake worth €4 billion. Hohn is calling for the plane maker to drop its plans to purchase a 29.9% stake in **Evidian**, saying that the move *"dilutes the quality of Airbus' business,"* offers *"zero value"* and is *"politically motivated."*

GAME OVER FOR GALLOIS

It is lights off at **Gallois**, once one of the largest crypto-focused quant funds, which has stopped trading and is returning assets to its investors after being caught up in the **FTX** debacle.

Gallois' liquidity crisis was such that half its assets were stuck in FTX and now around 90% of these available assets will be returned, with the remainder kept until *"discussions are finalised."* The rest will be the result of the long-winded liquidation of FTX.

Co-CEO ***Kevin Zhou*** has indicated that investors will be able to sell the fund's claims rather than waiting on the bankruptcy process, which could take years. Gallois will certainly not be the last fund to come a cropper over FTX.

OPINION

IN SYNC – HOW HEDGE FUNDS ACHIEVE ALIGNMENT WITH INVESTORS TO FOSTER LONG-TERM STRATEGIC PARTNERSHIPS

TOM KEHOE, GLOBAL HEAD OF RESEARCH AND COMMUNICATIONS, AIMA

When you strip away the lively discourse around the outsized returns that some alternative investment fund managers can generate, the proactive efforts to align their interests with their investors are arguably the most attractive aspect of their offering.

The entwining of the personal prospects of principals and those that entrust their capital to them is baked into the DNA of alternative investment fund structures, and the most successful managers are those that are most in sync with their clients' demands.

Thus is the title of AIMA's latest research piece, **In Sync: How hedge funds achieve alignment with investors to foster long-term strategic partnerships**' outlines the ways fund managers are adapting their business model in response to increasing competition and the evolving mandates of their investors. This is the third in a series done in collaboration with audit, tax, and consulting firm RSM with this year's research building on the 2019 report, "In Harmony" which examined the same GP/LP investor dynamic, including a time series analysis of how trends have changed.

This year's research is built upon the findings of a global survey of 138 alternative investment fund managers accounting for more than $700bn in assets under management and a second survey of 35 institutional investors that allocate to alternative investment funds.

Every aspect of the GP/LP offering from the fee model and performance incentives to the products offered includes characteristics designed to ensure that when the fund manager does well, the investor does well, and the fund manager only does well when the investor does well.

Among the key findings of this year's report include:

- The definitive form of alignment between hedge fund managers and investors remains "skin in the game" with over 90% of fund managers surveyed investing their own monies into their funds with the average investment standing at 8% of the fund's total assets under management. Not only principals but other key staff are also expected to invest their capital in the fund as a way of demonstrating to their firm and its underlying investors that they are committed to the mission.
- The combination of higher costs and a plateauing of industry headline fees has prompted hedge fund firms to innovate how they charge fees and manage expenses by applying new solutions underpinned by a variety of relationship pricing that reflect the changing needs of the fund manager and their clients.
- The importance of co-investment vehicles is a significant development from the findings of the 2019 survey. Over 90% of investors either engage in this type of partnership or are seeking to do so. Equally, over half of the fund managers are currently utilising a co-investment vehicle with an investor or are open to doing so.
- There has been a clear change regarding the trajectory of widespread adoption of ESG caused by the gravitational pull of macro-economic factors, including geopolitical tensions, and increasing regulatory burdens being experienced globally. A more complex investment market landscape is requiring allocators to answer the thorny issue of squaring their fiduciary duty to their underlying investors with a desire to do good.

Looking ahead to how the GP/LP dynamic will most likely continue to evolve, our research suggests that demands regarding transparency on fund fees and expenses will continue to increase.

Flexibility will continue to be key for alternative investment funds wanting to deepen their partnership with investors. Fund Managers should not lose sight of their ultimate purpose – to help their clients, ranging from pension plans to charitable organisations to meet their investor needs. Put simply, those that are in sync with their investors will succeed and grow.

AIMA's research paper **"In Sync – How hedge funds achieve alignment with investors to foster long term strategic partnerships,"** can be downloaded here.

Tom Kehoe
Global Head of Research and Communications, AIMA

GUEST ARTICLES

ESTABLISHING A FAMILY OFFICE PRACTICAL & LEGAL CONSIDERATIONS

JAMES GOOLD, PARTNER, TAYLOR WESSING

WHY HAVE A FAMILY OFFICE?

Ensuring an international family's global wealth structure meets the family's varied and changing needs can be a daunting task. Many families choose to establish a family office to ensure the family's needs and the relevant legal and regulatory requirements are properly and efficiently met, and to ensure the smooth running of the family's asset holding structures.

The services provided by a family office are varied and may change over time. Services commonly include asset management, co-ordinating tax and wealth planning, administrative and concierge services, and support with philanthropic projects.

> When selecting the most appropriate structure the family's unique jurisdictional, tax and regulatory positions must be considered.
>
> James Goold, Taylor Wessing

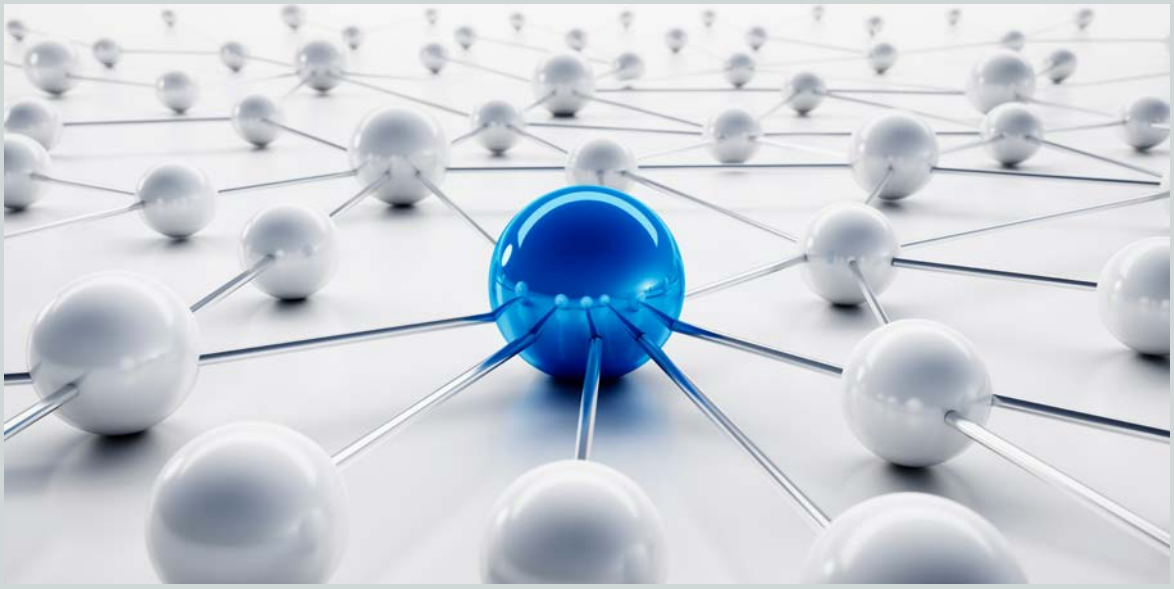
WHAT LEGAL STRUCTURE IS BEST?

The legal structure of a family office must necessarily be bespoke – there is no one commoditised solution. When selecting the most appropriate structure the family's unique jurisdictional, tax and regulatory positions must be considered. In the UK, the typical legal form for a family office is either a limited company or a limited liability partnership.

A family office may have several branches or subsidiaries. This may be to divide functions (e.g. if certain jurisdictions provide a better base to perform certain functions), the location of key decision makers or simple geographical proximity to family members located in different countries. Whatever structure is adopted, the ownership of the family office must be carefully considered from the outset, including how the succession of that ownership will operate.

The division of responsibility between family members and specialists employed by (or engaged by) the family office also needs to be carefully considered. A governing board with both family and external representatives is commonly established to ensure that the family's vision is balanced with a degree of objectivity.

The family office may manage the family's investments itself or supervise independent, third party fund managers who provide investment management services. In the latter case, the family office structure



GUEST ARTICLES (cont.)

would tend to be less substantial, and motivated more by geographical concerns. Whereas if the family office acts as an in-house investment manager, the structure would typically be more substantial, enabling the allocation of different functions to personnel with the appropriate expertise. Where a family office manages investments in-house, compliance with regulatory requirements will be key, subject to any specific carve-outs that apply in the local jurisdiction.

HOW SHOULD A FAMILY OFFICE BE FUNDED?

A family office will ideally operate as a self-financing entity (subject to initial start-up capital being provided by founding family members). Family offices will typically charge fees to the entities within the family's wealth structure for providing services and advice.

For a UK family office it is important, for tax purposes, that an arm's length (or commercial) fee is paid for services provided to entities within the family's international wealth structure (whether those entities are offshore or in the UK).

IS THE UK A SUITABLE JURISDICTION?

There are many attractions for locating family office functions in the UK. Its geographical location can assist in supporting family members spread over multiple jurisdictions. Also, and often a key motivator, the UK provides a long-established and highly regarded legal and regulatory infrastructure, along with a substantive network of highly skilled professionals, that are well equipped for supporting the demands of the global family.

That said, given the amount of capital invested through family offices, a number of jurisdictions across the globe are adopting (or have already implemented) entrepreneurial approaches to the tax and regulatory treatment of family offices. Other popular jurisdictions for locating family offices include Monaco, Zurich, Singapore, Dubai, the US and (historically at least) Vienna.

James Goold
Partner, Taylor Wessing

With assistance from **Joshua Boughton**, Associate, Taylor Wessing.

GUEST ARTICLES (cont.)

THE NEW ERA OF FAMILY CAPITAL

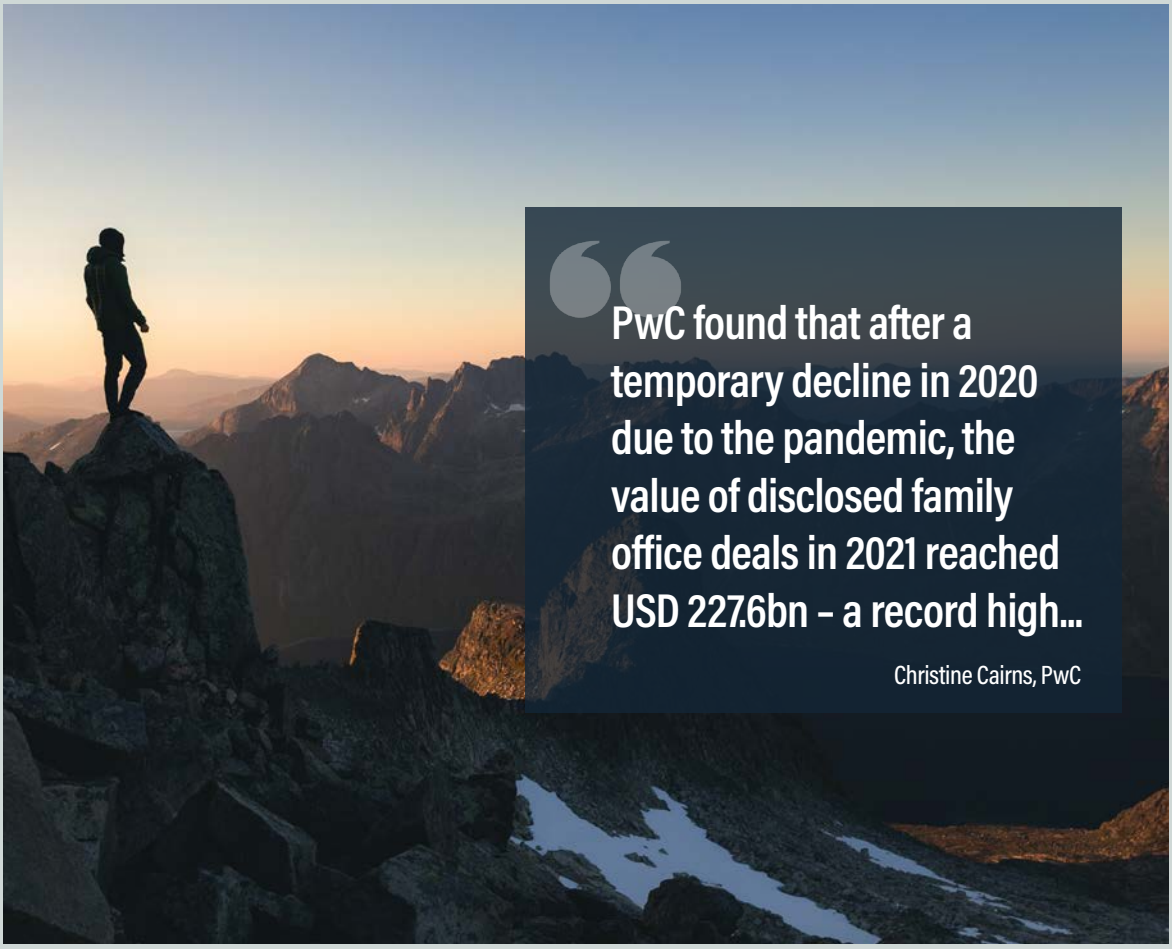
CHRISTINE CAIRNS, PWC, TAX PARTNER

Family offices were involved in an estimated 10% of all deals globally in 2021. In a study of Family Office Deals, PwC found that after a temporary decline in 2020 due to the pandemic, the value of disclosed family office deals in 2021 reached USD 227.6bn – a record high. This marked a turning point, with family office-backed transactions accounting for 10% of the entire deals market for the first time.

This research backs up the emergence of the family office as a key player in the private markets. So much so that even the term "family office" may be better substituted with "family capital" or "family investment firm". Terminology aside, a new generation of family offices are now competing head-to-head for deals alongside venture capital, private equity and sovereign wealth funds.

The traditional "family office" was the protector of family wealth, characterised by passive investing with an emphasis on preservation of capital and a long term horizon. Over the last 30 years, there has been a shift. This shift has been driven in part by the impact of low interest rates on returns and volatility in traditional asset classes, and in part by rapid innovation across multiple new sectors, opening up attractive new areas for family offices to invest in.

However, this alone does not explain the transformation of the "family office" into the "family investment firm". Twentieth century wealth was created by industrial innovation, in sectors such as steel, cars and electricity. By the early 2000s, this was supplanted by the consumer industry, technology and financial innovation, as well as consumer products, globalisation, industrialisation and infrastructure booms in Asia and other emerging markets. Family businesses drove the development of the internet and its ecosystems, led Asia's consumer products revolution and developed its factories, infrastructure and real estate. Global wealth has exploded in the new



GUEST ARTICLES (cont.)

> This evolution is also reflective of a desire for greater control over investment decisions and the ability to make more targeted investments that align with the values and goals of the family, and in many cases of the new generation.
>
> Christine Cairns, PwC

millennium, with more billionaires being created than ever before, and the establishment of more than 50% of current global family offices.

This new generation of modern, ultra-wealthy family offices have deep pools of capital to invest and a more expansive risk appetite than prior generations. In order to gain the edge over other investors (both asset managers and other family offices), those families which first invested in start-ups with blue-chip venture capital or private equity firms opted to set up their own independent operations, creating professional mini "funds" within the family office, establishing effectively another high-performing family business operating alongside the family enterprises that spawned them, with their own professional team, governance, vision and purpose.

This evolution is also reflective of a desire for greater control over investment decisions and the ability to make more targeted investments that align with the values and goals of the family, and in many cases of the new generation. In contrast to passive investment, active investment enables family members to see their capital delivering positive impact in concrete ways, in turn reinforcing family cohesion, and boosting the sustainability of both the family and family enterprise in an increasingly challenging and complex world.

Having reached an all time high in 2021, the growth trend for family office backed deals in 2022 slowed slightly due to the current economic outlook. Notwithstanding this, the modern family office as a key alternative investor is here to stay.

Christine Cairns
PwC, Tax Partner

Christine Cairns is a tax partner at PwC, focusing on private clients and alternative investment funds. She advises on complex international personal tax matters, as well as on tax issues in connection with carried interest, co-investment, management fees, and the impact of fund and deal structures on investors.

Christine works with founders, owners and family offices within the AIF, Fintech, and FS sector more broadly. Over the last few years she has helped a number of her clients structure private investment funds, bringing together her unique expertise and experience in personal tax and funds.

GUEST ARTICLES (cont.)

PRIVATE OFFICE, PRIVATE INVESTMENTS? THE FUTURE OF FAMILY OFFICE ASSET ALLOCATION

CHARLIE HARRIS, LUTYENS ADVISORY

Over the last few years, there has been a slow but noticeable shift in how family offices invest. Although the structural variety within the space means making such a broad claim is risky, the definitive rise in popularity of private investments makes this a trend worth examining in the context of the family office arena.

Although there is no strict 'beginning' to this phenomenon, it is worth emphasising that it is not a trend unique to 2023. Fidelity Investments noted in 2019 that 59% of family offices surveyed would choose to hire their next investment professional from an illiquid asset investment background.

Whilst clearly not only representative of private investments, this figure suggests that the initial push for more diversified asset allocation was not the product of the pandemic's economic pressures as might be assumed. Instead, it is part of a broader change whose future is similarly boundless; Campden Wealth's 2022 Family Office Survey indicated that nearly half (45%) of all European family offices investing in private assets wanted to increase their exposure to the asset class.

However, the specific form these future investments will take is less easy to express through statistics. The enormous diversity in size and budget across the family office space means that direct private equity investments can be highly cost inefficient, or indeed unaffordable, for many family-funded portfolios. They require high volumes of capital not only to fund the investments themselves but also to build in-house teams of sufficient scale and capability to generate returns.

> ...the expense of creating a full investment team means many offices are now choosing to create leaner, more nimble investment functions. This often takes the form of only a few investment professionals.
>
> Charlie Harris, Lutyens Advisory

As such, many younger (or smaller) offices are turning to private investments via institutional managers or co-investments. Choosing investment partners in this respect can often prove simpler than selecting the investments themselves. Despite its expansion over the last 10 years, the HNWI circle is still tight knit, and the relationships forged

GUEST ARTICLES (cont.)

> By pooling their resources, multiple single family offices are collectively able to fund private investments otherwise unaffordable in isolation...
>
> Charlie Harris, Lutyens Advisory

during wealth creation often pave the way for future partnerships between Principals and their offices. This has been seen in the increased prevalence of 'club' deals. By pooling their resources, multiple single family offices are collectively able to fund private investments otherwise unaffordable in isolation, granting them greater access to the private equity market.

Regardless of these variations in form, the widespread increased interest in private investments as a whole begs an obvious question – why this particular asset class? The answer is a composite one. A strong driver is the promise of attractive returns; the 2022 Campden Wealth Survey revealed that on a global basis private investments produced an average net return of c.20% across venture capital, private funds and private equity.

It is worth emphasising that this report was produced from results generated before the onset of 2022's significant inflationary pressures. As such, the continuation of high inflation throughout 2023 means interest in private investments is only likely to increase. Their comparative illiquidity to fixed income means that the latter's lack of appeal in periods of macroeconomic uncertainty will drive higher allocations to private investments as family offices seek to offset risk through portfolio diversification.

Private equity's illiquidity is also attractive given that it offers both a long-term investment option as well as a more tangible one. Whilst at first these may appear to be secondary influences on the investment process, for family offices they represent important considerations. Time horizons for family office investments must cope with a generational outlook rather than the traditional institutional long-term view of 5-10 years. Moreover, the tangible nature of private equity offers an easier introduction to investing for the office's next generation, as close interactions with acquired businesses allow for a more 'hands-on approach'.

The consequence of these incentives is that family offices are now structuring themselves to facilitate this shift in asset allocation. As previously noted, the expense of creating a full investment team means many offices are now choosing to create leaner, more nimble investment functions. This often takes the form of only a few investment professionals whose institutional and cross-asset backgrounds and qualifications give them a quantifiable expertise in the space.

The continued economic uncertainty promised by 2023 suggests private investments will only continue to grow in appeal for investors. Don't be surprised if family offices, with their lean organisational structures and capacity for swift capital reallocation, take note of the advantages on offer.

Charlie Harris
Lutyens Advisory

Money Maze Podcast

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Curated Podcasts

With Simon Brewer

Over the last month, the **Money Maze Podcast** has released a number of insightful and in-depth interviews via its spin-off series, **'Curated Podcasts - With Simon Brewer'**. As the name implies, these are hosted by ***Simon Brewer***, a well known and experienced industry veteran. Aimed squarely at professional investors, these curated podcasts showcase some of the most innovative firms in finance and beyond.

In January, Simon spoke to ***Matt Smith***, Partner and Investment Director at **Ruffer**. In this episode, Matt commented that *"positive absolute returns will not be achievable for most long only investors in the coming market cycle"*. He then discussed why today's inflation may be the start of a longer-term cycle, likening 2022/23 to the late '60's as opposed to the '70's, adding that this is *"the single greatest threat to investor wealth that we are likely to see in our lifetimes"*. The conversation also covered the dangers of hidden leverage and why a structural market in bonds and equities may characterise the investment landscape for a while. Describing Ruffer as *"an alternative to alternatives"*, Matt discusses how they run a global macro, absolute return strategy and how they discuss return expectations with clients.

In February, Simon welcomed ***Arjun Raghavan, Adam Watso***n and ***Harvey Toor*** onto a Curated Podcast. Arjun is the CEO of **Partners Capital** and Adam is the firm's Co-Head of Asia Pacific; while Harvey is the CIO of **Singapore Management University (SMU)**, a client of Partners Capital and seed investor in one of its pooled investment portfolios.

In this episode, Arjun discusses what he sees as a "*bumpy rise,"* sustainable investing and the flow of assets into Asia - he also sets out the case for structural investment opportunities in Asia and reflected on the region's institutional under-weighting.

Adam elaborates on Partners' geographical reach and the pool of potential investments, which include not only equity and debt, but also important allocations to alternatives and private markets. This took the discussion to how venture capital, real estate and hedge funds also offer access to the heterogeneous opportunities across a region that encompasses 60% of the world's population.

As an institutional investor, Harvey describes the objective of the SMU endowment and explains how their approach has been constructed along the lines of the Yale Endowment Model. He highlights top-down considerations and why SMU invested with Partners Capital, a move that has given the endowment resources, expertise, multi-assets and *"boots on the ground."*

In March, Simon spoke to ***Craig Marshall, Peter Friend*** and ***Constantin Coussios***, who set up OrganOx. This medtech university spin-out firm, backed by the **University of Oxford** and **Oxford Investment Consultants**, is revolutionising how organs are preserved in the critical time period between donation and transplantation. Peter, Professor of Transplantation at Oxford University, and Constantin, Professor of Biomedical Engineering at Oxford University, set up the firm in 2008, with Craig joining as CEO in 2016.

In the episode, the three explain how their Metra product has helped increase liver transplantation success rates globally, and its further applications for kidney transplantation. They also cover how FDA-approval has taken the company onto another level, further applications for the technology and the scale of the market opportunity ahead.

To listen, search **'Curated Podcasts - With Simon Brewer'** in any major podcast app. The episodes are also available on the Money Maze Podcast YouTube channel & via www.moneymazepodcast.com.

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GUEST ARTICLES (cont.)

HOW TO RUN YOUR FINANCIAL LIFE LIKE AN INSTITUTIONAL INVESTOR

JOHNNIE HAMPEL, CO-FOUNDER, Y TREE

It's fair to say institutional investors have some advantages over the rest of us.

They have rigorous efficiency, organisational depth, structure, transparency, scale, a strong process, governance, regulatory scrutiny, data, technology and a vast pool of human and intellectual capital - a list that might seem completely out of reach for individuals.

Let's define first what we mean by an institutional investor in this instance. When we talk about institutions, we mean big endowments (like Harvard and Yale), pension funds and some of the largest family offices, not wealth managers, private banks, asset managers or IFAs.

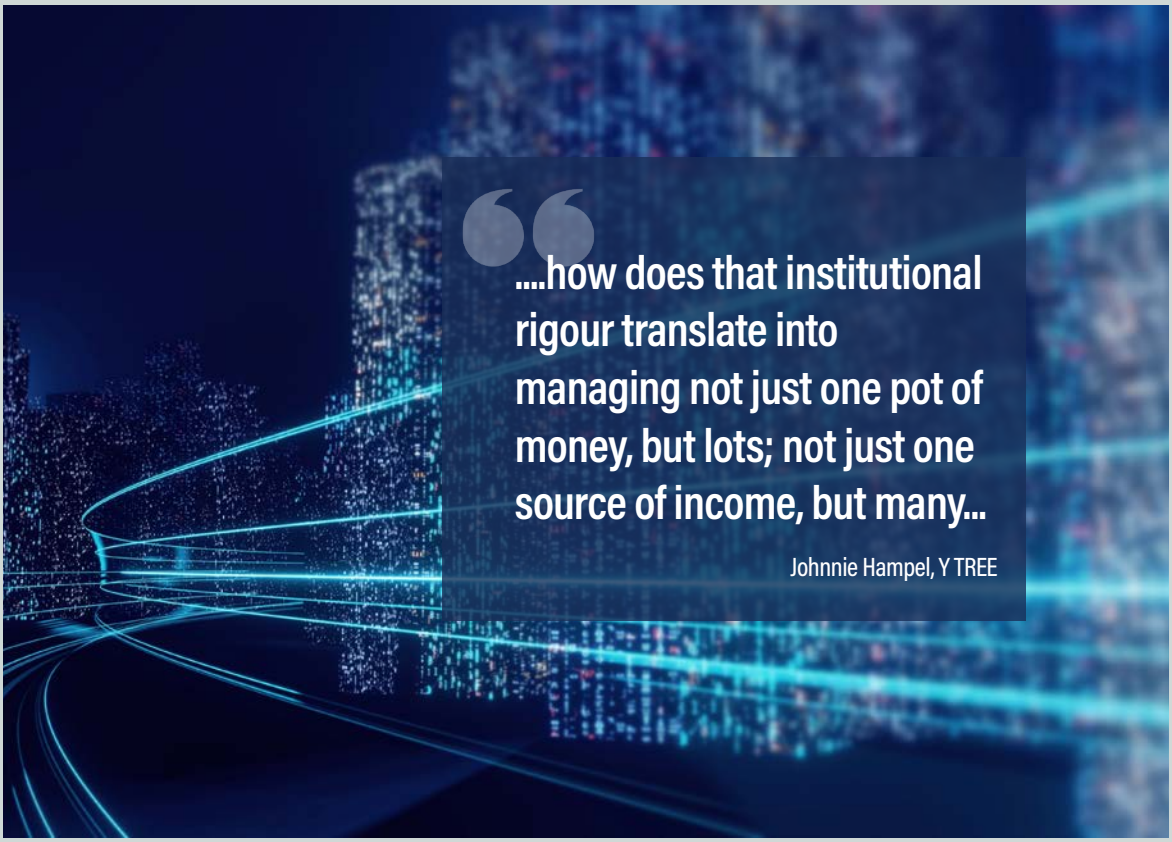
These institutions have significant amounts of data and technology at their fingertips, plus a broad bench of human expertise to manage money effectively. It's this combination that helps optimise returns and unlock value to meet both short- and long-term objectives.

But how does that institutional rigour translate into managing not just one pot of money, but lots; not just one source of income, but many; not just one investment objective, but multiple personal objectives? This is where we're seeing technology come into play, with some of the practices, processes and thinking used across the world's leading institutions increasingly being adopted in the sphere of personal wealth.

ASSET LIABILITY MODELLING

It starts with a rather sexy principle called asset liability modelling (ALM).

Institutional investors are always balancing assets with liabilities. They manage the gap between the two and constantly assess whether they have the enough assets to safely fund their short-, medium- and long-term liabilities. This gap is often measured by the ratio of assets over liabilities, also known as the funding ratio. Institutional investors seek to have a funding ratio of more than 1, which means there is always something in the pot to fund your liabilities should they be required. In an ideal world, this score should be a



GUEST ARTICLES (cont.)

little over 100. That way, you have more than you need in case something goes wrong in the future.

The starting point of any advice should always be what you want to do with your life and what you and your family will spend in the future - your liabilities - rather than investment returns. Essentially, finding the ideal funding ratio and devising and implementing a financial life strategy to fill the gap.

But these calculations are not a manual process. It takes an engine to help us do this for diverse individual circumstances, at scale. Combining knowledge from the fields of computer science, statistics and applied mathematics, the principle of ALM can solve the most complex financial problems. Using technology, it's now accessible and, more importantly, understandable to everyone.

Of course, we can't predict what's going to happen in the future, but we can plan for the worst. By leveraging statistics and big data, it's possible to model how interest rates, inflation, economic downturns and all the rest can impact your current assets and, crucially, your liabilities.

To run your financial life like an institutional investor requires a change in mindset. The question is no longer plainly, "how do I maximise my returns?" But "how can my finances support my aspirations for my life, for my family and for generations to come?"

EFFICIENCY

Sophisticated institutional investors never overlook the power of efficiency. Multiple, marginal gains across risk mix, liquidity, currency, cost and structuring compound to significant value over time.

When you are at the top of the league, every basis point counts.

THE WORLD'S BIGGEST INVESTORS CARE ABOUT THE SMALLEST FRACTIONS

Lower cost

Lowering the costs of your providers (including fund costs, discretionary fund management fees, custody, administration, foreign exchange and transaction costs) by 2% can save you the entire principal first invested when compounded over 20 years.

Reduce underperformance vs market

Investors should be receiving an appropriate level of return, after fees, for the risk being taken. This involves a shift in attitude. When the starting point of your investment strategy is returns, you'll naturally seek out outperformance. Over the long-term, managers seldom outperform consistently. When you add fees and other costs into the mix, you'll likely end up with average market return or less. The biggest determinant of long term performance is the risk taken by an investor - much more than the manager selection - and this risk can often be replicated using low-cost index tracker funds.

Risk

Investors should set a target risk level that is appropriate to generate the returns required to meet long term liabilities and life aspirations and then stress that risk against a number of scenarios (e.g. market falls, inflation, tax changes) to understand their capacity for loss. Once the target risk level has been set it should not change, unless circumstances change (e.g. spend targets, age etc.).

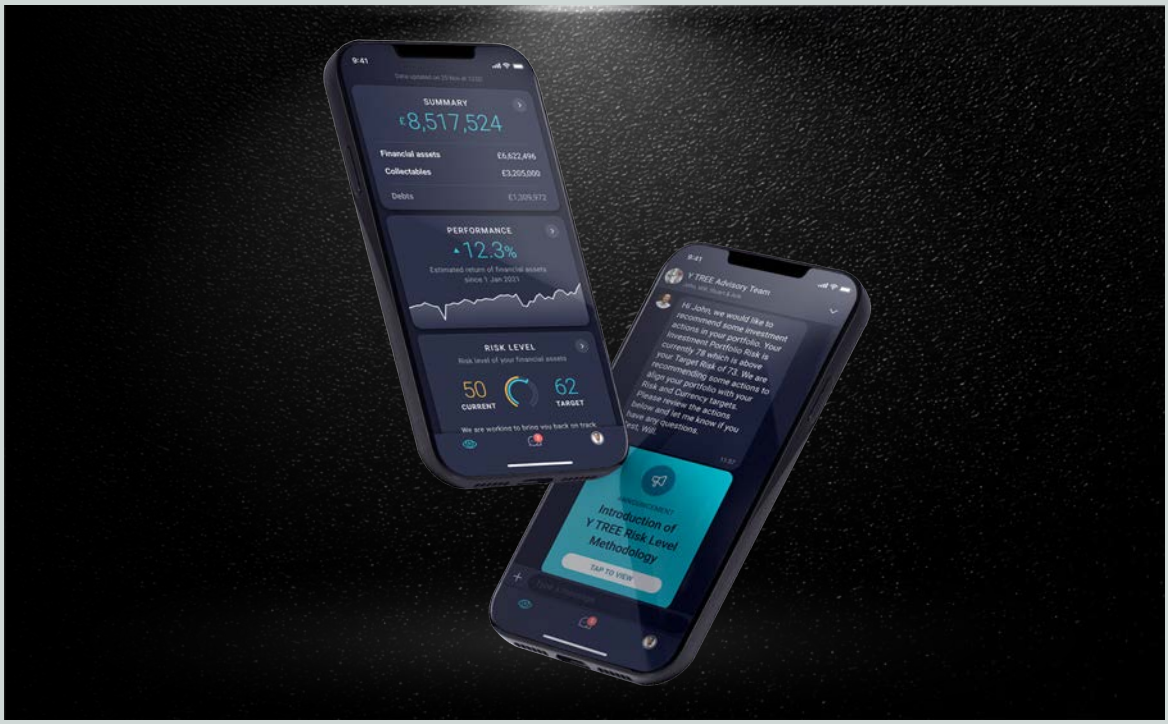
Currency

Investors should match the purchasing power of their assets against their currency of spend/liabilities. This means setting currency targets for a portfolio, in a similar way to setting risk targets.

Surplus cash reinvestment

Investors tend to hold too much cash, confusing cash and

GUEST ARTICLES (cont.)



liquidity. By taking an institutional approach to liquidity management, investors should hold minimum cash to meet short term liabilities (a cash buffer). Technology feeds can show when cash inflows exceed that buffer and the excess should be invested automatically to avoid the opportunity cost of holding excess cash. Liquid investments can always be sold to generate cash required for liabilities.

Improved diversification

Multi-asset class portfolios can reap the benefits of diversification but looking through asset classes to "market exposures" is critical to understanding your risk level and risk mix.

Tax optimisation

The amount of tax you pay over a lifetime has a material impact on your wealth. We believe in making intelligent decisions about tax, informed by insight and experience, including making use of allowances, fitting risk in each tax wrapper to its tax profile, ensuring efficient account structure and ownership, as well as devising efficient accumulation or decumulation strategies.

Illiquidity budgeting

Private markets can provide exposure to market risks and access to higher returns than public markets through an illiquidity premium. Having an institutional process helps determine an appropriate long allocation and a budget for commitments to each vintage.

Dynamic risk level rebalancing

Institutional investors recognise how difficult it is to time markets and so do not attempt to time short-term market movements; instead they automatically rebalance their portfolios (unemotionally) back to their long-term target risk levels after positive or negative market performance.

MEANING

Implementing technology and data into wealth management practices will help make the process more appropriate, efficient and transparent, and ultimately build value. But what's the point of all this process if it's not life changing?

We really believe that money is only meaningful when it's being spent on what matters most to individuals, families and communities.

The real wonder of an institutional process and greater efficiency is the extra wealth it generates. That extra wealth can be the difference that unlocks real change in society because it enables us to invest more deeply in our businesses, in philanthropy and in future generations. Managing your money effectively not only means you can enjoy the life you want to live, but it helps spread that wealth further, and for better.

Johnnie Hampel

Co-Founder & Head of Client Relations, Y TREE

Visit y-tree.com to find out more.

REGULATION

Presented by RQC GROUP

SEC DIVISION OF EXAMINATIONS ANNOUNCES 2023 PRIORITIES

The U.S. **Securities and Exchange Commission's Division of Examinations** (the 'Division') announced its 2023 examination priorities, while also highlighting that during 2022 it examined approximately 15% of the registered investment adviser population.

Areas highlighted by the Division include:

- The new Marketing rule, introduced in 2022, including policies and procedures and compliance with substantive requirements.
- For advisers to private funds issues including an adviser's fiduciary duty, compliance programs, fees and expenses, custody, conflicts of interest, use of alternative data and disclosures regarding portfolio strategies, risk management, and investment recommendations and allocations.
- A focus on Environmental, Social, and Governance ('ESG') related advisory service and fund offerings including whether funds are operating in the manner set forth in their own disclosures. In addition, the Division will assess whether recommendations of ESG products to retail investors are made in the investors' best interests.
- Reviewing advisers' practices to prevent interruptions to mission-critical services and to protect investor information, records, and assets, including cybersecurity issues associated with the use of third-party vendors.
- Examinations of advisers using emerging financial technologies or employing new practices, including *"technological and on-line solutions to meet the demands of compliance and marketing and to service investor accounts"*. This includes a focus on trading in crypto or crypto-related assets.

The Division publishes its examination priorities annually to provide transparency into its risk-based approach, including the areas it believes present potential risks to investors.

There are approximately 15,000 registered investment advisers, based in the U.S. and globally. The SEC has the authority to examine registered investment advisers regardless of domicile.

NFA ORDERS U.K. FIRM GMG BROKERS LTD AND TWO EMPLOYEES TO PAY FINES TOTALLING $350,000

A London-based **National Futures Association** ('NFA') Member introducing broker, **GMG Brokers LTD** ('GMG'), and an **Associated Person** ('AP') staff member were recently fined for allegedly violating NFA Compliance Rules by engaging in deceptive conduct, failing to observe high standards of commercial honor and just and equitable principals of trade, and acting contrary to their customers' best interests through misleading communications.

Additionally, they were found to have engaged in trading activities that placed GMG and the staff member's interests—as well as the interests of a "favored" GMG customer —ahead of other customers to generate additional brokerage fees.

The AP accused of misleading investors was ordered to pay $125,000 and required to withdraw from the NFA membership for a minimum of 120 days.

The NFA's complaint also charged the firm and another staff member, a supervising principal and AP, with failing to supervise. This brought a penalty of $225,000, with the supervising principal sharing liability with the firm and required to pay $50,000.

This case demonstrates that the NFA – which has multi-jurisdictional reach and regulates buy-side as well as sell-side firms – can sanction firms based outside of the U.S.

FCA LOOKING TO IMPROVE ASSET MANAGEMENT REGULATION

The **Financial Conduct Authority** ('FCA') is seeking views on improving the UK regime for asset management regulation, which would better meet the needs of UK markets and consumers, and support the UK's position as a world-leading centre for the asset management sector.

The UK asset management industry comprises around 2,600 firms, managing around £11 trillion in assets. However, the rules for UK asset managers come from various EU directives and regulation, such as **AIFMD**, **UCITS** and **MIFID**, plus UK-originated requirements. This framework has evolved over time and isn't always clear or coherent as it might be. Sometimes, the regulatory outcome might be the same but there are technical differences in the requirements for different firm types, for example, regarding conflicts of interest. The FCA is contemplating whether to create a common framework of rules for all asset managers.

Regarding *'professional funds'*, the FCA notes that whilst there is not an intention to significantly change the AIFMD

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REGULATION (cont.)

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framework, there is the option to change the thresholds at which firms must apply the more substantive full-scope UK AIFM regime, as opposed to the 'sub-threshold' regime. This might lead to more firms falling into the latter.

The FCA is also looking into changes related to UCITS funds and authorised fund managers and depositaries, and technology and innovation including improving investor engagement through technology.

The FCA is seeking responses by 23 May 2023.

FCA PROVIDES FEEDBACK ON IFPR IMPLEMENTATION

The **Financial Conduct Authority** ('FCA') published initial observations on how firms are implementing the **Investment Firms Prudential Regime** ('IFPR'). These observations focus on the **internal capital adequacy and risk assessment** ('ICARA') process and reporting under IFPR.

The FCA found that progress has been made in understanding the requirements. However, there are some areas for improvement:

- Firms in an investment firm group generally opted to complete an ICARA on a group or consolidated basis. However there was insufficient consideration of firm-specific risks and harms, and financial resource requirements of individual firms wasn't addressed.
- A lack of consistency in ensuring that the ICARA process is fully integrated in the firm's approach to managing financial resources to mitigate the risk of harms from operations.
- Wind-down planning assessments remain weak in terms of scope and quantification.
- There is inconsistent and inaccurate date submitted to the FCA in regulatory reports.

The FCA is continuing with this review and intends publishing a conclusion report after its completion.

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