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Adding private market investments to your portfolio

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Classic core portfolios usually don’t include private market investments for liquidity reasons. Nevertheless, it can be a good idea to integrate them into a separate, complementary vehicle due to their diversification and return potential.

I am frequently asked why we do not include private market investments such as private equity, private credit, or privately held infrastructure in our traditional wealth management solutions—even though we regularly highlight the advantages of these asset classes. As part of our advisory process, we assign investors to one of six risk profiles according to their individual risk capacity. This profile determines the allocation between higher-risk assets such as equities and lower-risk investments such as high-quality bonds within the framework of strategic asset allocation. For a medium, so-called “balanced” risk profile, for example, we hold 50 percent globally diversified equities. To achieve diversification, the remaining portions are allocated to 33 percent bonds, 12 percent hedge funds, and 5 percent liquidity.

The main reason why we do not include private market investments in the strategic asset allocation of our traditional wealth management solutions is liquidity: Private market investments are generally illiquid—the investment process typically takes several years to build up, and exiting is not possible in the short term. This contradicts the requirement that a wealth management mandate should be investable and liquidatable at any time.

We therefore prefer to maintain a well-diversified and liquid “core portfolio,” and complement it selectively with private market investments in a separate vehicle. Various types of private market investments can be utilized, ranging from fund-of-funds solutions to investments in individual private equity managers focused on specific sectors or themes. Those who wish to invest systematically and with larger volumes in private equity can do so with a “road map,” which is a strategic plan designed over several years for the gradual development of a self-sustaining PE portfolio.

For larger investment volumes, where it is possible to consciously forgo a portion of liquidity, customized portfolios are available that are based on our strategic asset allocation in the "Endowment Style." This model is inspired by the asset allocation of successful American endowments: In addition to the usual liquid asset classes (5 percent liquidity, 20 percent bonds, 35 percent equities), 40 percent is invested in alternative assets—comprising 15 percent private equity, 8 percent private credit, 4 percent each in infrastructure and real estate, and 10 percent hedge funds.

Regardless of the chosen investment approach, private market investments—with their advantages such as lower volatility and attractive diversification characteristics—can complement a traditional portfolio of publicly traded investments.

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Non-Traditional Assets

Non-traditional asset classes are alternative investments that include hedge funds, private equity, real estate, and managed futures (collectively, alternative investments). Interests of alternative investment funds are sold only to qualified investors, and only by means of offering documents that include information about the risks, performance and expenses of alternative investment funds, and which clients are urged to read carefully before subscribing and retain. An investment in an alternative investment fund is speculative and involves significant risks. Specifically, these investments (1) are not mutual funds and are not subject to the same regulatory requirements as mutual funds; (2) may have performance that is volatile, and investors may lose all or a substantial amount of their investment; (3) may engage in leverage and other speculative investment practices that may increase the risk of investment loss; (4) are long-term, illiquid investments, there is generally no secondary market for the interests of a fund, and none is expected to develop; (5) interests of alternative investment funds typically will be illiquid and subject to restrictions on transfer; (6) may not be required to provide periodic pricing or valuation information to investors; (7) generally involve complex tax strategies and there may be delays in distributing tax information to investors; (8) are subject to high fees, including management fees and other fees and expenses, all of which will reduce profits.

Interests in alternative investment funds are not deposits or obligations of, or guaranteed or endorsed by, any bank or other insured depository institution, and are not federally insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board, or any other governmental agency. Prospective investors should understand these risks and have the financial ability and willingness to accept them for an extended period of time before making an investment in an alternative investment fund and should consider an alternative investment fund as a supplement to an overall investment program.

In addition to the risks that apply to alternative investments generally, the following are additional risks related to an investment in these strategies:

- Hedge Fund Risk: There are risks specifically associated with investing in hedge funds, which may include risks associated with investing in short sales, options, small-cap stocks, "junk bonds," derivatives, distressed securities, non-U.S. securities and illiquid investments.
- Managed Futures: There are risks specifically associated with investing in managed futures programs. For example, not all managers focus on all strategies at all times, and managed futures strategies may have material directional elements.
- Real Estate: There are risks specifically associated with investing in real estate products and real estate investment trusts. They involve risks associated with debt, adverse changes in general economic or local market conditions, changes in governmental, tax, real estate and zoning laws or regulations, risks associated with capital calls and, for some real estate products, the risks associated with the ability to qualify for favorable treatment under the federal tax laws.
- Private Equity: There are risks specifically associated with investing in private equity. Capital calls can be made on short notice, and the failure to meet capital calls can result in significant adverse consequences including, but not limited to, a total loss of investment.
- Foreign Exchange/Currency Risk: Investors in securities of issuers located outside of the United States should be aware that even for securities denominated in U.S. dollars, changes in the exchange rate between the U.S. dollar and the issuer's "home" currency can have unexpected effects on the market value and liquidity of those securities. Those securities may also be affected by other risks (such as political, economic or regulatory changes) that may not be readily known to a U.S. investor.