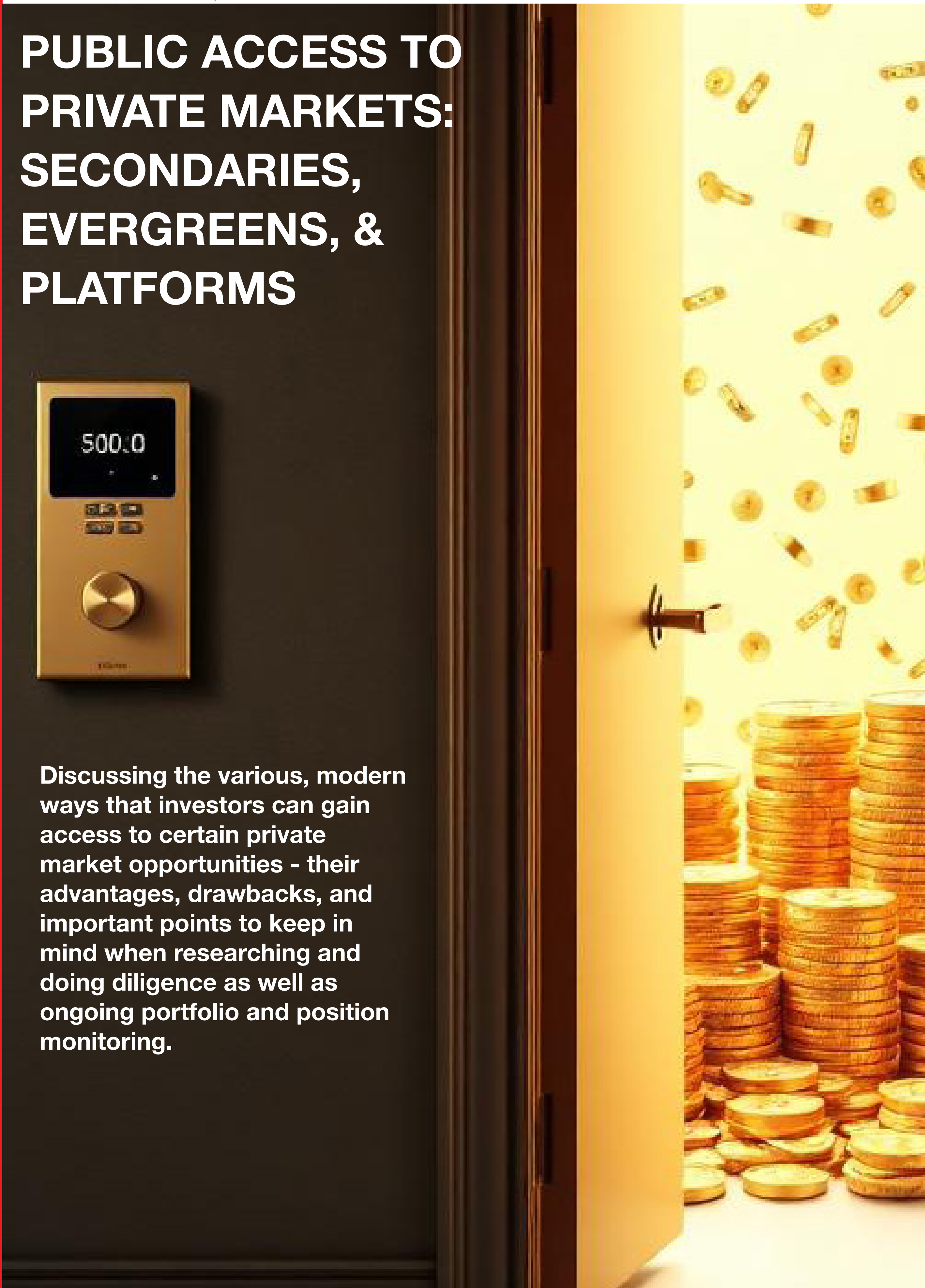
CANADIAN ASSOCIATION OF ALTERNATIVE STRATEGIES & ASSETS

PUBLIC ACCESS TO PRIVATE MARKETS: SECONDARIES, EVERGREENS, & PLATFORMS



Discussing the various, modern ways that investors can gain access to certain private market opportunities - their advantages, drawbacks, and important points to keep in mind when researching and doing diligence as well as ongoing portfolio and position monitoring.

We would like to thank the following CAASA members for helping to make this paper possible:

https://www.agf.com/capitalpartners/

https://www.apexgroup.com

https://transcanadacapital.com

https://www.lgtcp.com

https://www.mywealthmanagement.ca

https://www.obsiido.com

https://www.richter.ca

https://www.stonehagefleming.com

About CAASA & This Paper

Inclusive, Active, and Pan-Alternative

The Canadian Association of Alternative Strategies & Assets (CAASA) was created in response to industry requests for a national group to represent the Canadian alternative investment participants, including investors, asset managers, and service providers. CAASA is inclusive in that it welcomes participation from all companies active in the space (400+ members in 2024) who might want to participate in committees and working groups — or simply attend member events — without their employer being a member of the association.

CAASA is very active, organizing numerous conferences, webinars, socials, and podcasts throughout the year. Pan-alternative, for CAASA, encompasses all alternative strategies and assets including hedge funds/alternative trading strategies, private and public real estate (funds and direct), private lending, private equity, infrastructure, development and project finance, digital assets/crypto-assets, weather derivatives and cat bonds, and all aspects of diligence, trading, structuring, dealing, and monitoring alternatives in a stand-alone portfolio and as part of a larger investment strategy.

As with all our papers, we use an external writer to draft it from interviews with participating members and it represents, in the end, our views and not necessarily that of every participating member.

For more information, please visit www.caasa.ca.

Overview

Investors seeking shelter from the volatility of the public markets have often sought refuge in private assets.

There's a clear value proposition when it comes to private equity and private credit. The public markets carry substantial burdens. Public companies must meet the demands of investors on a quarterly basis, and the administrative burden is much higher. Promising companies are increasingly choosing to remain privately-held, and some private companies, like Cargill or SpaceX, are household names.

An investor who chooses to limit themselves to the public markets is therefore denying themselves access to the full range of investment opportunities. On the private markets, the opportunity set is wider, the volatility can be lower, there can be a lower degree of correlation with assets on the public markets, and investors are shielded from the temptation to panic-sell by the illiquid nature of private investment.

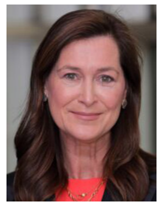
But that same illiquidity poses a challenge. While long-term investors and institutional players like pension funds may be able to take a position for many years, not every investor is able to do so. Perhaps they might need to access their capital sooner, or perhaps they do not feel comfortable taking a years-long bet on a single asset.

There is also an additional diversification challenge. Traditional investments on the private markets have a "vintage" - the year that capital was raised for that fund. A fund's performance is tied to the economic and market conditions in which its capital is deployed, meaning that investment in a single "vintage" locks an investor into those market conditions. Diversification across vintages is necessary, but can be difficult, given the illiquidity of traditional closed-end funds, and the large sums of capital that need to be allocated to them.

With these barriers and challenges, it's unsurprising that some investors have hesitated to dip their toes into private markets. But those investors now have options that may prove more appealing.

Access to private markets is increasingly available through platforms that reduce the amount of capital required to invest. Investments in private equity are increasingly available through secondary funds, which provide a greater number of options and a greater opportunity for diversification. And finally, there are evergreen funds: funds which provide more frequent liquidity, which automatically deploy capital, and which provide instant diversification.

Taken together, these options provide an investor with a greater array of tools with which to build an investment strategy that meets their needs - and these tools are becoming available to more and more investors by the day.



"[Private credit] is projected to grow from $1.5 trillion to $3 trillion, based on various industry publications (e.g., Preqin), as retail clients will now have access to participate in differentiated and higher alpha opportunities through tailored vehicles. This growth will only be possible if investment managers collaborate with partners and platforms to support the unique nuances of these retail products, i.e., greater reporting, transparency and liquidity. We continue to partner with our clients to deliver our proprietary technology, facilitating access to all retail investment options, allowing banks and wealth managers to seamlessly integrate private investment opportunities into their existing operating models, supporting their distribution channels, and, most importantly, ensuring that underlying assets are properly managed (i.e., valuations, reporting, et al.)"

Regina Gannon
Global Chief Business Development Officer
Apex Group

"We've seen that traditional 60/40 portfolios have under-delivered relative to their expectations. Private equity and private credit have outperformed over longer horizons with lower volatility. Investors are looking for both return enhancement and diversification, and private markets have tended to offer both. They offer compelling benefits, long-term outperformance, income stability, access to niche opportunities you simply can't replicate in private markets … and with platforms evolving, the historical barriers like high minimums and long lockups are coming down."

Chad Larson
Partner and Senior Portfolio Manager
MLD Wealth

Secondaries: a customizable option

Traditional private equity investment follows a cycle. First, a fund raises capital, securing capital commitments from a number of investors. Then, it deploys that capital. It begins to call for capital from its investors, it identifies opportunities, acquires stakes in private companies. At the end of this lifecycle is the 'harvest', when the investment sees a return. In a typical closed-ended fund, this cycle can take 10 to 14 years, though sometimes investors will get their money back earlier.

Under this traditional model, investment returns follow a so-called "J-Curve". Investors see negative returns at first, as they pay fees to the fund manager but do not see sufficient returns to offset those fees. Returns slowly increase, and investors see a positive return at the end of the lifecycle, but they must stay committed the entire time.

Private equity and credit secondaries - that is, stakes in private equity and credit funds sold on a secondary market - offer investors opportunities to enter, or exit, at various points throughout the lifecycle of a private fund. It also allows investors who have entered into a traditional closed-end fund an opportunity to liquidate early, in part or in full.

There is an immediate, and apparent, advantage to this approach. It allows for diversification across vintage years, without having to enter into multiple closed-end funds at the start. The investor can enter at a later point along the "J-curve" and have access to more mature assets, and an investor buying a secondary stake in a fund will have the opportunity to assess how it has performed since its inception - an advantage that a primary investor doesn't have.

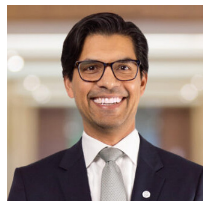
It also allows for diversification across managers. There is a greater range of outcomes on the private markets than on the public markets, and so success in private equity often requires a manager that is able to identify good opportunities and capitalize on them. There is risk associated with over-allocating to a single manager, and acquiring shares on the secondary market allows an investor to mitigate this risk.

And it allows flexibility. Thanks to the existence of secondary markets, a private equity investor is not locked into a sector or a firm. They can reallocate their capital.

But this flexibility can come at a cost. Though some secondary assets are priced at a discount to their Net Asset Value (NAV), occasionally, they will be priced at a premium. An investor can choose to skip the negative returns involved with the J-Curve, but they may have to pay for the privilege.

"Many evergreen funds use the secondary market. This is because the secondary market allows them to acquire diversified portfolios that are more mature. By doing so, they can have additional diversification in the funds, and also the ability to acquire more mature assets, which themselves will exit more quickly."

Pauline Wetter
Partner
LGT Capital Partners



"The trick to understanding secondaries is to understand, while you are buying at a discount, how much of your discount is driven by liquidity and how much is valuation of the assets. Return attribution is really important for investors to understand in secondaries, because once you buy the secondary position and it gets marked back up to the net asset value from that point on, your returns will be solely driven by underlying valuation gains. So, you must understand the expertise and capabilities of the managers. That first pop of return that you get from a secondaries acquisition - that's a one-time pop. This is especially important to understand as many new, evergreen private equity funds are allocating significant capital to secondaries transactions to build their track record."

Ash Lawrence
Head of AGF Capital Partners
AGF Management Ltd

Evergreens: Liquid and user-friendly

Investors allocating to secondaries have the advantage of flexibility and customizability. They can select investments that perfectly fit their investment objectives and their risk tolerance, reviewing fund performance to date. This is an approach that has advantages, but it requires a substantial amount of due diligence and management to ensure that it delivers.

Evergreen funds, by contrast, are much more user-friendly.

They are, as their name suggests, 'evergreen'. Instead of the traditional private equity lifecycle, where PE funds raise capital, call it, deploy it and then distribute returns to the partners, evergreen funds are constantly in motion. As their investments show returns, they reinvest.

Evergreen funds are typically much more liquid than traditional closed-end funds. Where a traditional private equity investment may require capital to be locked in for a decade or longer, evergreens may offer monthly or annual liquidity. Since they are constantly deploying capital, they are instantly diversified across vintages. Capital is constantly being deployed, and so an investment is not locked into the market conditions of any single year, and the fund's holdings will naturally be at various levels of maturity. Since all earnings are immediately reinvested, there is also a compounding effect.

Evergreen funds may also acquire some of their assets on the secondary market, providing a further level of diversification.

There is an obvious advantage to this structure: it is familiar. It feels, and behaves, much like a mutual fund. It has similar advantages in that it provides instant diversification and simplicity of user experience. But investors should be aware that despite superficial similarities, evergreens are not mutual funds.

Mutual funds are constructed from assets traded on the public markets, and as such, have substantial liquidity. But although they may be at varying stages of maturity, the assets that evergreen funds are constructed from are illiquid. This presents a fundamental liquidity risk. Despite having access to periodic liquidity, there is a risk that an investor may not be able to access their money or that poorly managed liquidity may force a sale of illiquid assets at a discount, impacting returns.

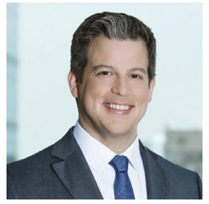
Investors looking to allocate to evergreen funds should perform substantial due diligence on the fund's managers, on their historical performance, on the portfolio itself and how it is managed. Investors should also pay special attention to caps on redemptions to ensure that they are comfortable that an evergreen fund is stable and will be able to deliver the liquidity that it promises.

"The main diversification benefit is, depending on the strategy or the structure of the evergreen, you can have primary fund exposure, you can have secondary exposure, which would be a combination of GP-led deals as well as LP portfolios, you can maybe have a little bit of venture, and you'll have buyout and growth equity…so all in all, that's a really nice, diversified portfolio."

Mat Powley
Partner, Private Capital
Stonehage Fleming

"Evergreen funds are invested in many different private companies, and each of them has a different level of maturity. An investor can come into the portfolio, and it's a diversified portfolio. Some of these companies are ready to exit, some of them are young. And so, through the fact that you diversify the pool of private companies, it allows for more flexibility, because you have the ability to buy back an investor that wants to get out."

Pauline Wetter
Partner
LGT Capital Partners



"If you look at our portfolio, we've got investing guidelines for all asset classes (Real Estate, Infrastructure, Private Equity and Credit), and we also include a liquidity sleeve, which could be invested in liquid alternatives such as REITs, listed infrastructure, emerging market debt, high yield bonds and cash. Within that sleeve, the main objective is to never run out of money, to take care of capital calls and distributions, and have an appropriate pacing exercise to understand what the future needs of the fund are. And within that liquidity sleeve, you're able to also provide liquidity to your clients and give them access to something that they usually don't have through closed-end funds, so they have the ability to rebalance if they need it.."

Rémi Tétreault
Associate Vice President
Trans-Canada Capital

"The evergreen funds do allow for immediate deployment with daily or monthly or quarterly subscriptions. And this segment's growing. It's $350 billion in size already. Nearly double that in the last five years. So, it is a great way to dip your toe in."

Chad Larson
Partner and Senior Portfolio Manager
MLD Wealth

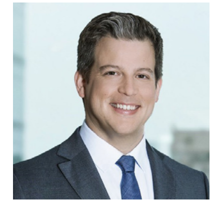
Liquidity and its trade-offs

Investors seek the private markets because illiquid assets come with an illiquidity premium: the increased risk requires an increased reward to make it worthwhile. Evergreen funds that promise liquidity to their investors must maintain a portion of their portfolio in liquid assets to make good on that promise.

That means that at least a portion of an evergreen fund will be invested in the public markets, or may simply be cash. A fund may also have a line of credit that it can draw upon in an emergency.

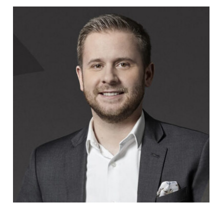
Even if the liquid assets are selected to mimic the performance of the fund's private assets, for that section of the portfolio, an investor exchanges the illiquidity premium that comes with private assets for the flexibility that liquidity offers.

This might mean lower returns than an equivalent closed-end fund.



"People that need liquidity over the short term shouldn't look to the private markets or should be very careful if they go the evergreen route in terms of making sure that the fund can offer the desired liquidity. And they should really pay attention to redemption fees and penalties as well. So, while evergreen funds are interesting, there's always a mechanism to protect the fund and its existing investors. You might have quarterly liquidity, but that doesn't mean that it will come without redemption fees."

Rémi Tétreault
Associate Vice President
Trans-Canada Capital



"The number one tradeoff is, if you're going to have an evergreen fund that is holding 10 and sometimes even 20 per cent cash or public securities or other types of liquid assets, you're likely giving up either the return stream that you're trying to get with that evergreen, or some of that pure exposure to the fund."

Spencer Clark
Head of Private Markets & Thematic Investments
Richter Family Office

"The risk, from my perspective, is that the manager is forced to deploy capital. … If you're an evergreen, and you're bringing in these inflows, you have to deploy it, or be sitting on potentially 20 to 30 per cent cash, which will dilute returns. To my mind, that's part of the risk, because you need to find deals to do, and if there are no good deals, you're going to be doing bad deals."

Mat Powley
Partner, Private Capital
Stonehage Fleming

Democratized access

Traditional private equity investment, through a closed-ended fund, was traditionally the domain of institutional investors. Institutions can afford to lock away capital for ten to fifteen years to see an investment through its entire lifecycle - and they have access to the tens of millions of dollars that can be the price of entry.

But while institutions command a great deal of capital, there is a large pool of untapped capital in the private wealth space. New platforms are helping private wealth access private markets.

Technology is democratizing access to private markets, allowing individuals, and not just institutions or family offices, to access a greater suite of opportunities. The universe of private assets is vast, encompassing all companies not listed on the public markets.

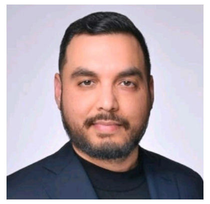
Platforms can therefore provide a *curation* service, enabling advisors, or individuals, to select from a series of funds that have been pre-selected. They can also provide an education service. Advisors may be aware of the value that private markets can provide to their clients, but they may not be familiar with the breadth of assets and strategies available. Platforms can provide this information, helping advisors deliver solid private markets options to their clients.

They can also provide a streamlining service. Private markets can be very document-heavy. Platforms like Apex Global can help reduce the friction involved with the private markets on advisors and investors, leveraging AI technology to summarize disclosures, and reducing the administrative burden of managing many documents.

But platforms can do more than curate, educate, and streamline. As technology advances, they can also lower barriers to entry - even creating a retail market for private assets.

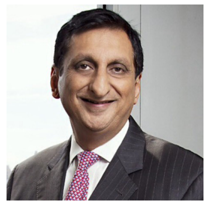
One potential innovation is fractional ownership where a platform takes a large stake in a private equity fund and sells small, fractional shares as ‘secondary’ investments to retail investors. Where a private equity investment on the primary markets may cost, at a minimum, tens of thousands of dollars, a fractional stake could cost as little as a thousand. Some firms are working on allowing those fractional stakes to have substantial liquidity, through blockchain technology, where a digital token could represent fractional ownership in a private equity fund. These fractional stakes could then be traded on, or between, blockchains, like other digital assets are traded today.

At present, the capital in the private wealth segment of the market is entering through advisors, and to have access at all, one generally needs to be an accredited investor. But the trend is clear: the market is becoming more and more accessible to individual investors.



“So, all of these large private equity firms, they hadn’t really thought through the administrative and operational infrastructure to deal with hundreds of thousands, if not millions, of retail clients. Now, a lot of technology providers and platforms are coming to market to solve that. That’s happening now in real time, we’re seeing innovation take place across the board. We really built our platform with the intention of serving thousands and thousands of individual investors and advisors, so we were comfortable bringing our minimums down to allow for broader distribution.”

Nimar Bangash
Co-Founder & CEO
Obsiido



“Retailization of private assets is going to happen, irrespective of whether it happens in three, six, nine or 12 months. So, when you fractionalize ownership, it enables more people to invest, i.e. instead of investing $100,000 or $200,000, one can invest $10,000, $20,000 or even $1,000 and participate. This allows for a wider market and investors to enjoy “alpha”. Apex’s platforms make this possible at scale, by leveraging blockchain, DeFi, AI and tokenization technologies; providing transparencies on the underlying assets to the investors and also facilitating liquidity via various distribution and liquidity channels, i.e. digital exchanges, etc.”

Sanjay Vatsa
Super Regional Head - Americas
Apex Group

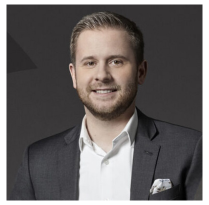
Caveat emptor

Even if private markets are becoming more accessible to individual investors, they have not become less complex. Despite platforms providing greater access through advisors and even retail channels, and despite tools like evergreen funds providing greater liquidity, private markets are fundamentally illiquid.

Like with any investment, an investor must understand the thing they are investing in, understand the risks they are exposed to, and ensure they are well-diversified and that their investments meet both their risk tolerance and their investment objectives.

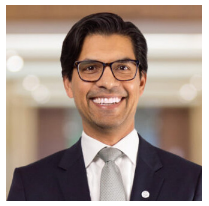
With respect to private assets, that must include an assessment of liquidity risk. Even if an evergreen fund offers quarterly or annual liquidity, redemption caps may mean that an investor may be unable to access their capital

Institutions who have the internal capacity to do this due diligence and to fully understand the risks and rewards of private assets will find that evergreen funds and secondary markets offer them an even greater number of tools with which to build a portfolio. Individuals, however, should tread carefully, only entering the space with the advice of a trusted advisor.



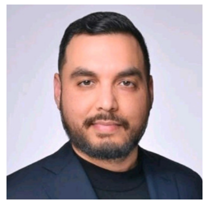
"A key risk to some of these strategies is when you're providing liquidity to an asset that is not liquid, which is essentially what evergreen is trying to do, is that portfolio management component. You can run into trouble managing your cash, managing your exits and offering the opportunity for investors to get out. And so, I think we've been very careful how we've thought about evergreens."

Spencer Clark
Head of Private Markets & Thematic Investments
Richter Family Office



"I think that's important for people to understand that cycles turn. Private assets are not a trade like public securities, it's not a short-term investment. So, if you are going to invest in private assets, even if it's in an evergreen fund where you can redeem, we believe investors should always take a longer-term view."

Ash Lawrence
Head of AGF Capital Partners
AGF Management Ltd



"Retail investors are continuously underestimated in terms of how smart they are, in terms of how they can make decisions, and I believe that institutional capital is overestimated in terms of how smart they are and how good they are at allocating capital. Because fundamentally, when trouble occurs, institutional money is trying to rush out the door as well."

Nimar Bangash
Co-Founder & CEO
Obsiido

Read our other CAASA papers and primers, available at caasa.ca under the Resources:Publications tab