Partnerships: Who and How

Many alternative investments are brought to the public by retail product sponsors who have established agreements with institutional asset managers. The reasoning is simple, major institutional asset managers do not have direct access to public fundraising dollars just as individual investors do not have direct access to the less liquid, more complex world of alternative assets. In evaluating such investments, questions should be raised beyond who the manager of the fund will be; the most important of which may be how the partnership is structured.

The traditional approach to these arrangements has involved the institutional asset manager in the role of sub-adviser. A sub-adviser is defined by Investopedia as "A money manager who works outside of the fund, and is hired by a fund manager to help with an investment portfolio. These sub-advisers are allowed to manage all or some of a fund's assets, and usually are given a set of investment objectives to adhere to when selecting securities." The adviser/sub-adviser model is only one way to bring the expertise of a major institutional manager to the retail space. Another option for a retail/institutional partnership structure is the Joint Venture.

A joint venture (JV) is a business arrangement in which two or more parties agree to pool their resources for the purpose of accomplishing a specific task. This task can be a new project or any other business activity. In a JV each of the participants is responsible for profits, losses and costs associated with it. However, the venture is its own entity, separate and apart from the participants' other business interests. This arrangement, when utilized by a retail sponsor and institutional asset manager to form a new entity, is differentiated from the sub-adviser structure. In evaluating an investment which claims to provide retail investors with access to institutional assets, expertise, and strategies, investors should ask a few key questions to determine just what kind of access they are getting.

Visit cioninvestments.com
for more information.

ASK:

Is the fund directly managed by the institutional partner or is it a fund of funds?

A fund of funds (FOF) is an investment strategy in which a fund invests in other funds instead of investing directly in bonds, stocks and other types of securities. FOFs allow investors with limited capital to tap into diversified portfolios with different underlying assets. However, the returns from these funds may be lessened by investment fees that are typically higher compared to traditional investment funds. This is because their fees include all the fees charged by the portfolio's underlying funds. After allocating the money invested to fees and other payable taxes, the returns of fund of funds investments may generally be lower compared to the profits that single-manager funds can provide.

ASK:

Does the investment manager of this fund have a fiduciary duty to the shareholders?

A manager acting in a fiduciary capacity has both a legal and ethical responsibility to the other party. When a manager accepts a fiduciary duty on behalf of another party, they are required to act in the best interest of the party whose assets they are managing. A fiduciary is required to manage the assets for the benefit of the other person rather than for their own profit, and cannot benefit personally from their management of assets. Surprisingly, many funds are not structured with the manager designated as fiduciary to its shareholders, even with the growing expectation from investors of their managers to act in such a capacity.

ASK:

Does the manager of the fund have a co-investment relief order?

A co-investment relief order allows for funds managed by the institutional asset manager to take a portion of a larger transaction executed by the manager, regardless of scale. This means that larger and established funds under an institutional manager are not treated more favorably than smaller, newer or retail JV funds when it comes to deal access. A multi-billion dollar fund and a recently created fund can both take on a portion of the best deals that the manager is involved in. Without such an order in place, it is impossible for an institutional manager to offer funds available to retail investors a chance to participate in the same deals their largest clients are investing in.

Retail product sponsors have made a concerted effort to bring institutional asset management to individual investors, which is undoubtedly a good thing. Investors should however be aware of the significant risks associated with institutionally managed funds centered around alternative investments. Institutional asset strategies have been utilized for decades by corporate and state pension funds as well as high net worth individuals for their ability to provide alternative sources of return, reduced volatility, and reduced correlation to public equity and bond markets. Individual investors should be aware that institutions may have investment goals and time horizons that are substantially different from retail investors, these funds and strategies are not suitable for everyone. As investors go through the process of evaluating these funds, they should be considering much more than the name of the institution. Ask who and how.

To learn more please contact your financial professional.