The Wrap Up

Rockin' Around Some Private Equity

After November’s strong performance wiped out three months of losses, unsurprisingly, December has been relatively calm, with small gains and few noteworthy developments (Google had some good news however). Coinciding with an investment we made for our clients this week, we want to look at what we believe is the most underexposed investment strategy: private markets.

What are public markets? The public markets are where companies go to raise capital from a broad pool of investors. There are two types of capital that are issued: equity and debt capital, or in simpler terms, companies are selling shares in their business or they’re selling bonds and raising debt. Once equity and bond investments are issued, there are able to change hands from one investor to another through brokers and dealers who are registered with the exchanges where these shares and bonds trade. There are institutional and retail participants in markets; institutional are pension funds, mutual funds, banks, endowments and hedge funds while retail investors are the individual, non-professional, market participants. The vast majority of people interact with the market via an investment advisor who can buy equities and bonds directly, MFDA advisors who can sell mutual fund products which give individuals exposure to markets via the funds or through self directed brokerages where the individual can buy and sell stocks on their own.

For a multitude of reasons which we will not examine today, public markets have evolved to become what they are and for reasons such as liquidity and price transparency, public markets are the first place to go in order to invest savings. As we have seen over the last few years, markets fluctuate more on a day to day basis than ever before. Furthermore, markets have also become more concentrated, with returns following suit; in the previous decade the FAANGM (Facebook, Apple, Amazon, Netflix, Google and Microsoft) group of stocks accounted for more than a quarter of the S&P 500’s total return. This year, the ‘magnificent seven’ (Microsoft, Apple, Amazon, Google, Nvidia, Meta and Tesla) account for 30% of the weight of the S&P 500 and more than 70% of this year’s return. Put another way, using an equal weight version of the

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S&P 500 (that's where each of the 500 companies hold an equal weight in the index as opposed to the index weight being a proxy of the company's market cap), the return this year would be at 3.5% as opposed to the current 19%. Moving forth, unless you are prepared to concentrate your portfolio (which means taking on potentially more volatility), it will be difficult to keep up with index returns.

The mandates that we are often tasked with include: maximizing return while minimizing volatility incurred to achieve said return. If we only invest in public markets, our concern is that it will become increasingly difficult to balance both objectives. Enter private markets; a place where companies raise equity and debt capital, where there are fewer participants and where holdings do not trade as frequently. You can argue that the real estate you own is a private market asset; it does not trade on an exchange, it does not have to follow reporting requirements and it is fairly illiquid (the process of selling your home is much longer than selling a stock). Entrepreneurs also are in possession of a private asset: their company. Beyond those two examples, however, individuals do not have significant exposure to private markets. Institutions are more keen on investing in private markets. The Canada Pension Plan has a 52% exposure, the Caisse de Depot (that's the money management arm of the Quebec Pension Plan) is 45% exposed and Yale's $40.7B endowment is more than 80% invested in private markets. Ultra high net worth individuals and private family investment offices sit at less than 20% invested in private markets while high net worth individuals are less than 3% invested in the alternatives space (which includes private markets).

Why is it that the largest, most sophisticated investors have such high exposures to private markets while the broader, wealthy individual market, possesses such a small exposure to private markets? We believe that it's due to three reasons: access, liquidity concerns and lack of education on the subject.

Access: private assets do not trade on public markets. There are publicly traded investment vehicles that hold private assets but private pools are only accessible through registered institutions (like large wealth management firms for example).

Liquidity: one of the appealing aspects of private investments is that they do not trade millions of times on a daily basis; that feature is what smooths out daily volatility. The holdings within the private market mandates often do not offer daily or even monthly access to funds and thus, some are intimidated by that liquidity constraint.

Education: it's not just the individual trading stocks on a self-directed platform, many advisors are also uninformed about private markets. We're trying to do our part by educating everyone reading this!

We haven't gone into great depth about what it is that we like about private markets, which mandates we use and how we use them in our portfolio and that's because we want to pique your curiosity. Throughout the year, we've put in effort at introducing the idea to our clients; in those conversations we go into great detail and answer all of the above mentioned questions and more (quick note, thank you all for being so patient when we do have these types of conversations, I know I tend to nerd out over the technical details). We still have more work to do here, which is why we continue to encourage our clients to ask questions about how we use private markets in our investment approach. For those of you who read this on LinkedIn every week, maybe this is the opening you need to reach out to us. Depending on the mandate, our portfolios currently have 15-25% exposure to alternatives and we are happy to report that they have done exactly what they are designed to do and have contributed to this year's small outperformance.

In an era of thematic investments and momentum trades, it's important to have a broader vision in regards to portfolio construction with clearly defined objectives and well thought out ideas that contribute towards both return achievement and risk management.

Healthy Distraction

It’s become apparent to us that a lot of people we know partake in some sort of holiday movie viewing tradition. While we understand that not everyone celebrates the holiday, or appreciates it, we see no harm in watching some of these funny, light hearted features. Never hesitating to share of list of favorite movies, we thought we would share some holiday favorites:

Home Alone 1 & 2

Miracle on 34th Street

Elf

The Santa Clause 1 & 2

Four Christmases

Christmas with the Kranks

It’s a Wonderful Life

National Lampoon’s Christmas Vacation

And now maybe some less traditional (and not necessarily light hearted) movie ideas:

Die Hard

Gremlins

Batman Returns

You’ve Got Mail

Trading Places

Just Friends

C.R.A.Z.Y.

La Guerre des Tuques

We could not include every movie out there but we hope we provided a new idea or two. Have a great weekend!