MILLS WEALTH ADVISORS

Private Markets

Are they the right investment for you?

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Private markets have been shown to offer a premium to public equity markets because of their higher perceived risk and general lack of liquidity. Should qualified investors with a high net worth buy into private markets? This article will look at some of the advantages, disadvantages, and questions investors may want to consider when contemplating strategies.

Private markets pose a set of risk and tax complications not prevalent in public market investments. Higher cost, the inability to sell on a timetable, lack of disclosure, fraud, opaque books, late K1, and a general lack of transparency are just a few factors that may affect private investments and which could ultimately cause investors to lose money. Historically, investors have demanded higher returns to compensate for some of these risks. **However, the illiquidity of private markets provides an opportunity for careful balance sheet affluent investors to increase portfolio returns if they can minimize or avoid the risks.**

At MWA, we ground much of our investing philosophy on evidence-based, peer-reviewed academic studies that have been tested, retested, published, debated, and generally accepted by the academic community.

Public or private, all markets function on the forces of supply and demand. At MWA, we attempt to help our clients assess risk and make opportunistic investments that have a high chance of returning favorable results for the risk assumed. Because private markets dramatically increase the number of potential investments available, and because there are fewer professional investors relative to the potential opportunity set, branching out to private markets increases the likelihood that an investor may uncover a higher-returning, mispriced investment. In addition, private markets, where the opportunity set is vast but information is limited, are monitored much less closely than public markets.

Experience has shown that **although private market investors bear greater risks, often the premium that should be rewarded to investors is instead captured by promoters, managers, and dealmakers.** Why? One of the main factors that keep investors from profiting is the very high investment cost, poor deal structures, and lack of control.

When investors and/or individuals' investment groups have effective control of an investment, they can make changes to protect investment capital or influence outcomes. However, when investing without control, they must take extra precautions.

Numerous studies have validated what many have experienced: Investors often bear the brunt of the financial risk, yet managers, promoters, and dealmakers often capture the private market premium through a risk-free position which can come from poor deal structure, high cost, or unfavorable terms. Careful investors will make sure terms are fair, interests are aligned, players are reputable, and upfront costs are minimized or are paid only following successful outcomes.

We at Mills Wealth Advisors have been investing in private markets for more than a decade, and we have great expertise concerning what works and does not work. We still learn new tricks of the trade every day, but our nationwide network, combined with our disciplined investment process, our broad view of the industry, and our fiduciary relationship, makes our team a valuable resource for our clients.

<u>Strategies that work:</u>

- Aligning interests, as well as laying out and documenting expectations in writing
- Ensuring complete transparency in books and financials
- Audits and audit rights
- When possible, implementing (shorter-term) opportunistic investments
- Investing alongside large institutions in co-investing relationships
- Keeping the total cost below average or participating in profit shares upon success
- Staying one degree away from friends and those who have a lot to lose

<u>Situations to avoid:</u>

- Lack of control
- High cost
- Situations in which managers generate large upfront fees prior to success
- Complex or opaque structures

Diversified, selective, relatively short-term, opportunistic investments could help round out the investment portfolios of investors who have plenty of excess liquidity, but only if they understand what they are getting into. They must consider the disadvantages to private investments beforehand to ensure that they are not later unable to sell. Private markets add complexity, increase tax cost, and may cause tax-filing delays. These disadvantages must be weighed against the potential for increased returns.

If you would like to add a private market opportunity to your portfolio, here are a few of the ways MWA may be able to help.

MWA's Deal-ScopeTM
Private Equity Due Diligence and Origination

- **Sourcing and Origination** — We leverage our team's experience and networks to source and originate attractive, and often proprietary, direct investment opportunities.
- **Screening** — We use strict screening criteria and sector knowledge, insights, and relationships
to analyze investment opportunities and focus our efforts on those that are most attractive.
- **Due Diligence** — Our team can help review existing opportunities pitched to investors. By combining our industry knowledge with that of an experienced attorney, we provide two angles with different specialties to help clients make important long-term investments that are illiquid and hard to sell.
- **Execution and Structuring** — Our skill set in negotiating, structuring, and documenting agreements with co-investors, debt financiers, management teams, vendors, and managers ensures we have the potential to deliver strong outcomes for clients.
- **Management and Governance** — We seek partnerships with capable management teams who share our philosophy and drive to produce outstanding returns in opportunistic markets. Our board level activity, governance frameworks, and operational insights are designed to ensure alignment and performance and to add value, both strategically and operationally.

The MWA investment strategy pairs qualified investors with alternative investment choices in the private market, thereby attempting to lower investment costs and add diversification to a portfolio of public securities. We believe the registered investment advisor is in a position to uncover opportunities and therefore is an attractive source for high-quality information. Private market investments can be lucrative for investors with the liquidity to profit from illiquidity. MWA's origination and **Deal-Scope™** services can help investors who are considering accessing private markets.

The material discussed in this article is for general information only. For specific financial advice, please contact your financial advisor.