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THE DEMOCRATIZATION OF ALTERNATIVE INVESTMENTS

INVESTMENT NEWS PODCAST FEATURING BNY MELLON | PERSHING

Speaker: David Moss & Aaron Steinberg

Host: Bruce Kelly

Bruce Kelly: Hi, everybody. Welcome back to another episode of the Investment News Podcast, which is a sponsored podcast. This week I'm your host, investment news senior columnist and reporter Bruce Kelly. And we have two great guests from BNY Mellon this week, David Moss, and Aaron Steinberg. We are focusing on alternative investments and gentlemen, how is everyone doing today?

David Moss: Terrific Bruce. Great to be here.

Aaron Steinberg: Yeah. Excellent, Bruce. Thanks so much for having us.

Bruce Kelly: David, why don't you begin? Just tell us a little bit about yourself at the firm and your experience in the industry.

David Moss: Hi, I'm David Moss. I'm a growth ventures partner at BNY Mellon. That's our division for building and managing data and software led businesses and that includes our data vault with nearly 50 trillion in financial assets under data management. Bruce, I joined the bank about five years ago. I co-led our corporate strategy team before this and I've got over 20 years of experience across financial services beginning and alternative asset management, proprietary trading, sales and trading more broadly and security services. It's terrific to be here. Thank you so much for having me.

Aaron Steinberg: Hey Bruce, and thanks for having me again. So, Aaron Steinberg, I work within BNY Mellon's Prime services division. I'm responsible for our new business development team and capital introductions. And I lead a group of folks who is focused on hedge funds and alternative asset managers. We provide financing and securities lending to those managers, and we also do capital introductions. So that's where we introduce investors who are interested in alternatives to alternative asset managers. I've been here for 17 years, and I am looking forward to continuing our discussion on alternatives.

Bruce Kelly: OK. We're talking about alternative investments, gentlemen. Why are private markets and alternatives increasingly demanding so much attention to the marketplace?

David Moss: First, why don't I start off? I think it begins with the overall macro-outlook for private markets or in private markets are still smaller than the public markets. Companies are increasingly choosing to stay private for longer or private forever. Public companies are choosing to go private or in fact, the number of public companies fell by nearly one third over the last 20 years, and there's no sign that that trend is going to change. It's going to continue and accelerate. So, while demand firm companies for private investment is increasing, so is the capital available in private markets. Fundraising has topped $1 trillion annually for all recent years, and there's nearly 25 trillion of invested assets in private markets for a trillion of dry powder. The impact of all this is better performance for investors with less volatility, even after fees, private equity outperforms public equity by 10% for any given vintage, and private credit outperforms public leverage loans by more than 600 basis points and even in 2022, where public markets are double digit declines across asset classes, private markets were down just a couple of percentage points.

Aaron Steinberg: Yeah, Bruce, David made some really great points. Not the least of which is that last one regarding what the markets did publicly in 2022. If you think about alternatives and why the focus on it now, there's really three reasons. One is diversification and portfolios. The second is outsize returns, or at least the hope of outsize returns. And the third is that downside protection, David was just talking about. Also focused on just a better risk return profile. If you think about it, all alternatives are not created equal. Each one of them is set to invest in a with a specific set of guidelines and specific set of results, or risk adjusted results, and so you can't really compare all alts together in one. That'd be like comparing all marathon runners together. Hedge funds are focused on risk adjusted returns and private equity on the other hand is focused on generating multiples on the original investment. Each one of those asset classes has their own behavioral expectations and outcomes, and the best argument for alternatives really is truly around diversification. Nobody is going to complain about market correlation when the markets are just all rising in unison. However, like David mentioned in 2022, when the markets are going down or when there's an issue in a specific asset class or sector, there's always issues for folks when it comes to correlation. But if you have different asset class sleeves that have different behaviors, your equity allocation could be down 20%, but your other asset class leaves aren't affected in the same way. When you think about public markets, when they do sell off, private markets could certainly experience different result. Private equity, private real estate, typically the measure of those returns is that they exit the investment at some time of their choosing and typically or hopefully that's when there's been an uptick in that particular the value of that asset class. They can usually avoid periods in market sell offs and I think that's one of the main driving factors why we're seeing so much additional interest in the alternative space.

Bruce Kelly: We're leading off this discussion with the macro framing of a part of it and wealth management, right? So why are we now hearing in 2024 so much about the intersection of private markets and alternatives and the wealth channel or the individual investor, Aaron? What do you think about that?

Aaron Steinberg: Yeah, it's a good question, Bruce. I think we're seeing a convergence of a few different things here. You know the alternative asset managers had historically focused on the institutional channels. That's the space where you get large pensions, endowments, sovereign wealth funds who were allocating to alternatives cause their wallets had been so large. I think there was a study done that said 86% of institutions investing in alternatives. As of as of recently, with only about 25 or 26% of wealth, advisors invested in alternatives and the average portfolio allocation there is about 6% or so. I think what you see happening is 2 things. One you see alternative asset managers thinking more about how to expand their addressable market. So how they can market better to that broader pool of investors within the wealth space? And then you also see the advisors and the wealth community being more interested in these alternative products for the reasons that we mentioned before.

Bruce Kelly: David, what do you think?

David Moss: I think Aaron hit the nail on the head. The institutional allocation to alts and private markets is largely capped out and now is focused on reallocation of existing dollars and looking for more creative ways to invest more coinvest and more separate accounts. If you're looking for a new growth, you have a wealth channel where there's about a trillion dollars invested today out of wealth investors, individual investors into private markets and alternatives. But that's out of an asset pool that's going to reach roughly 100 trillion by 2030. So only about 1% overall. Now if you look at all the surveys, they are done of the advisors. You always get the result 80 to 90%, sometimes 95% advisors say they want to increase their allocation to alternatives, and private markets. Increasingly, their clients are looking for a type of diversified exposure and many of them are targeting a 10% initial allocation where you have that presumption of suitability of the state level, but sometimes even looking at 15 to 20%. So, you're the trillion dollars today and we're looking at the target in the next five to six years. That could be $10 trillion. There's incredible growth that could be unlocked, but it's currently trapped, but the demand is there from both sides of the marketplace. You have asset managers who want to raise assets and that channel, and you've got investors and advisors and the Home Office who want to invest into these products for all the reasons that we talked about before.

Bruce Kelly: So that obviously leads us to you're talking about the challenges here in the marketplace for alternatives. There is clearly an alignment or demand from both asset managers and the wealth channel, wealth management, channel advisors and investors. So why aren't we seeing more rapid growth, Aaron, what do you think?

Aaron Steinberg: Bruce, I think that comes down to a few straightforward things which are making it challenging for people across the wealth spectrum to be more engaged in alternatives. That's the home office folks, the advisors, it's the investors and I think there's really three things that are driving the slow adoption. Access, education, and experience. From an access perspective, the majority of investors still don't have access to the top performing private market and alternative asset managers. That's starting to change as asset managers look to the wealth channel as the next frontier for growth. We're seeing the creation of more products that are geared towards and marketed towards that community. I think the problem of access is one that people are aware of and are addressing. And then education. I think all investors over time have gotten or have had to become more educated on the varied alternative strategies and at multiple levels in visors and investors are learning more about the behaviors of the different asset classes, the behaviors of the different strategies, the specific products and what results are supposed to be generating. And then, of course, the specific funds themselves. And then how do you manage all of that within a larger portfolio allocation? I think access and education are two of the three pieces along with experience that once we continue to close that gap, we'll see more. We'll see more adoption of the alternative asset classes.

David Moss: Aaron, the education piece is super interesting because you've got asset managers who are used to dealing with institutional investors. And you've got an entire ecosystem that's been built around a very low volume of very large investments. And there are now being asked to support, educate, and work with thousands or 10s of thousands of advisors and hundreds of thousands of end investors. So, the ability to provide education on individual products and funds and do that at scale, that's a new behavior. But that experience part that you mentioned at the end, that really comes down to the overall ecosystem, right? We're now delivering the same asset class that always went to those large institutional investors to a channel of investors that are used to something that's highly standardized straight through consumer like experience. So, everything needs to change right from how you discover the product and model it into a portfolio. Execute an investment or a subscription in this case, and then manage all the new life cycle events post investment. Whereas capital calls, distributions, even performance reporting is different. And frankly, the industry is playing catch up right? We're playing catch up to make these investments feel more traditional, but we're not yet there. There are number of new platforms. There are emerging the number of new product structures that are emerging to try to solve this problem, to make the experience feel more elegant, more streamlined, and I'd be remiss if I didn't say that BNY Mellon plays a significant role and that solution across so many different parts of the ecosystem because of who we are. We have our market leading wealth, technology, custody and clearing through Pershing and Wove were the world's most significant provider of fund solutions and servicing. Administration and transfer agency through our asset servicing business and through our investment management business and BNY Mellon advisors, we have services ranging from full research and due diligence to product wrapping and creation to global distribution solutions. We have a really unique combination now allows us to see how this ecosystem comes together, what the pain points are, but then we can play a more meaningful role and helping to solve that.

Bruce Kelly: Yeah, David, that leads me right into that leads us rather right into the next. Our next question or our next concern really, so Aaron and David, could you just speak a little bit more about how you see the industry changing given the unique perspective and vantage point of the firm as one of the most prolific providers of wealth and fund management solutions?

Aaron Steinberg: Sure, Bruce, I'll give that a shot. So, I think the first major change that we're seeing, or the major advancement has to do with one of the core tenants we mentioned before, which is access. The expansion of products and structures that just allow a greater portion of investors to access private markets and alternatives. That's where we see the most significant expansion in the market for the ACT funds registered funds like interval and tender funds, they reduce investment minimums, they offer greater little liquidity in some cases and address some of the challenges that people have with performance and tax reporting. That's probably the first thing that I see in terms of advancement. I'm sure David's got some o ther things that he's been seeing.

David Moss: Yeah, I think the product structures are important and they provide partial solutions. But frankly, we want to be able to deliver that elegant experience regardless of what wrapper you buy the product and whether it's an unregistered 3C7 fund, or an interval fund, or a tender funds or a BDC. We want the experience for the advisor in the end, investor to still feel the same and a lot of that comes down to technology and data and workflows. We have roughly 50 trillion in financial assets under data management. We're experts in how you link that data together in those workflows together and what happens today in the market is because of the disconnect between those different parties involved that we mentioned before. You know, 20% of subscriptions come back not in good author at least once. That means the advisor has done the documentation, sent it to a client, the client has signed it, and now it's gone into an ecosystem where it gets kicked back and the advisor has to go back out to his or her client to resign an amended set of documents. We hear stories from clients about managing capital costs and how manual that process is to identify how much money is being called from each account. Then to manually instruct the wire transfer, and then again, Bruce, we come back to your earlier question, why don't we see that demand getting unlocked? It's just not scalable in the current model. This is where those different platforms and providers coming together, streamlining data flows, information flows and frankly the workflows and the processes that happen at the wealth custodian and clear engagement at the funding administrator and transfer agent add the fund sponsor, bringing all those parties together in a much more seamless manner that's going to deliver that elegant experience and that works beginning to happen.

Aaron Steinberg: Yeah, David, I just would add, I think you're right. I think there's a number of solutions that are coming out now. There are looking to address the experience gap and we partner with a number of them. Some offer marketplace, others provide digital subscription services. That's one of the things that reduces some of that friction that you were talking about. Others are just looking to aggregate performance and reporting for folks. And I think our own firm, BNY Mellon, our wealth technology, our Custody solutions fund, admin, transfer agency, we're touching all the different parts of this life cycle and we are playing and are going to continue to play a critical role in delivering a more unified experience to wealth, intermediaries, advisors, investors and candidly to the asset managers themselves, right?

David Moss: Yeah, that's right Aaron. And it's about how you bring it together. Alright, so having those different points solutions still leads with disconnected experience. But how you bring those different parties together to create, you know, frankly, an end-to-end system that makes sense. That's going to be the trick that unlocks this market.

Bruce Kelly: All right. That's great stuff, guys. So, let's talk about the future. We've kind of, I think updated everybody where we are and what's going on with the marketplace. Where do we go from here and what is next?

David Moss: You know, Bruce, I want to end where we began. Maybe and just talk for a moment about the continued macro-outlook and the regulatory tailwinds, right? All signals suggest that private markets will continue to grow and will grow at an accelerated pace. And we need to create pathways for more investors to access and benefit from that growth. It requires an eye towards liquidity management, but these are good investments for most people. Most of us are investing for long term goals, saving for our children's education, saving for retirement. We have an investment outlook that is based on decades and yet we're primarily holding product that has daily liquidity. We're not going to play the 100% of a portfolio into private markets, but it certainly could be 10 to 20% and there's already change happening at the government level to support this. If you look at what happened in the United Kingdom with the Mansion House reforms, increasing pension scheme allocations to private markets, the Department of Labor issued guidance to make it easier for 401K plans to offer more private equity investments. And there's broad bipartisan support in DC to open-up private markets to more investors. The equal opportunity for All Investors Act, which would expand the definition of an accredited investor, and that's the SEC to create an exam for investor accreditation that passed the house last spring with 96% voting to support the ACT, 206 Republicans, 177 Democrats. I think the first thing is there is broad support from the government and from the industry to see the expansion of the space.

Aaron Steinberg: Yeah, David, if you don't mind, I would just add, I think the other part of this, you make some really good points about government regulatory support. I think the other piece of that that will come with that is just to continue the evolution of the products, more registered products, more easily accessible. The education will come along with that. There are BDC and operating company models emerging in private equity, but we're also seeing hybrid structures that could create additional liquidity. And let's not forget the tokenization part of this, right? I think as we're talking about private markets, private funds, certain structures that have been traditionally used in the alternative space, one of the things that we haven't really touched on tokenization or digital assets, but there's a number of folks who have been exploring the idea of tokenizing some of these private markets and private funds. And the one of the reasons for that or not the least of which is the idea of the secondary market and liquidity, if we can tokenize some of these funds and give people an opportunity to take funds that maybe a little bit less liquid or have those longer time horizons like you mentioned, and provide them with some liquidity via, tokenization and fractions and things like that, I think that'll give the market a little bit more comfort as well in adopting some of these products.

David Moss: Yeah, I think with ultimately comes down to is you've got asset managers who are looking to raise capital through this channel. You've got investors who want to invest in these products, and you've got a regulatory environment and the market environment that wants to, you know, support the bringing together of those two parties. You've got all the makeup for incredible growth, right? And moving from that one trillion to call it 5 trillion or more in investment from the wealth channel into private markets. What we're really solving for is how do you make that experience feel easy and seamless and frankly elegant, right, and how you deliver a consumer like experience and products that historically have not been consumer friendly, or consumer built. And the product evolution is going to help that. It's about the ecosystem that how you bring the different parties to that ecosystem together, whether it's consortiums, new technology solutions, new approaches to how we connect the dots and work together. But it's all about addressing the investor, the advisor, the Home Office experience and making that seamless and making these products more accessible, easier to halt. This is a cool space, right? This is one of those rare situations. Where you've got everything aligned. We have asset managers who are looking to raise assets from a certain channel. We've gotten investors in that Channel who want, yeah, there's a tremendous amount of demand and you've got all the brother economic reasons that this is good, right? It's going to fuel growth. It's going to make it cheaper for companies to invest in their own growth. So, it's all coming together and increasingly the different parties and that the ecosystem we're talking to each other and we're working on ways to make this feel easy and seamless and to overcome some of the pain points in the friction that there are keeping that demand trapped. I think over the next call it, 12 months, but really over the next two to three years, we're going to see an unlock of investment and unlock of growth unlike anything that we could have in recent history. That's pretty amazing. If that doesn't get us excited about this space and the about what this can mean for a private market, what it can mean for the wealth channel, frankly, what it means for individual investors. And like I don't know what gets you excited if it's not this.

Bruce Kelly: That's great guys. Thanks, David and Aaron, before we sign off, I just want to mention the upcoming INSITE Conference from Pershing, which is a great conference. I've been to many times over the years, so if any listener wants to learn more about the latest trends in alternative investments for advisors and individual investors. David, Aaron and their teams are going to be in Nashville, which is a lot of fun from June 4th to 6th for Pershing's annual INSITE Conference. And they're going to be there talking about these topics and much more. It's as I mentioned, it's a really great event. It provides an opportunity to hear from world class speakers and network with everyone you want to meet with the Fintech people, industry experts and advisors. Check out pershing.com for more information.

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Now to wrap it up, I just want to say that was another great episode of the Investment News podcast. We want to thank our special guests, David Moss, growth ventures partner at BNY Mellon, and Aaron Steinberg, head of Business Development and Capital introductions within BNY Mellon's Prime Services division. Gentlemen, thank you so much for hopping on board this morning.

David Moss: Thank you, Bruce.

Aaron Steinberg: Bruce, thanks so much for having us. Yeah.

Bruce Kelly: Aaron, I think this is a two time for you, right?

Aaron Steinberg: It is. Thanks for having me back. I appreciate it. I don't often get invited back places.

Bruce Kelly: You get, you get. You get a special Gold Star man for a repeat performance there, you know.

Aaron Steinberg: No, I appreciate that, Bruce. Thank you.

Bruce Kelly: And this week it this was a sponsored podcast by being sponsored by BNY Mellon Pershing. You can find this podcast and all the others at investmentnews.com, as well as Apple, Spotify, Google Play, leave us a review on Apple. Please follow us on Spotify, my Twitter or ex handle is at BDNEWSGUY. Stay tuned. We'll be talking to you real soon.