## *Conversations with Commerce Trust* Podcast

## Alternative Investments: Understanding Private Placements – March 12, 2025

**David Hagee**: Hello and welcome to Conversations with Commerce Trust, our show about the markets, investment themes, and economic insights that matter to you. I'm your host, David Hagee, Chief Investment Officer with Commerce Trust. Today we're discussing alternatives (alternative investments), specifically private placements, with Brett Stewart, our Analyst Team Leader, and Adam Emig, our Private Placement Analyst. Welcome to the podcast, gentlemen.

**Brett Stewart:** Hey, David. Thanks for having us.

**Adam Emig:** Yes, thanks.

**David:** Excited to have you guys here. This is a topic we haven't covered before, going into private placements. I think it's something that we're getting a lot of interest in and an area where we could use a little bit of time to walk through everything.

First and foremost, as we talk about private placements, who are these investments for, and what are the requirements for them to get into these investments?

**Brett:** Historically private markets were dominated by large institutional investors. You know, whether that's large endowments and pension funds and foundations and insurance companies. But over the last five to 10 years, we've seen this democratization of the industry that's providing access to invest in private markets.

What was once, you know, just for the large elite institutional investors is now available to the high-net-worth investor. Depending on the asset class and the vehicle, you know there's different types of qualifications that an investor has to meet.

**David:** So as we talk about that, you know, you definitely have an accredited investor, a qualified purchaser. These are requirements for eligibility into investing in these particular vehicles out there. So let's start there.

You know, in terms of history, as you mentioned, we started with large institutions having access to these different vehicles, whether it's, you know, endowments or insurance funds. And then really over the past couple of decades, you've seen some democratization, as you say, of seeing this come down and that high-net-worth individuals [are] beginning to get some access here. Also, we've had a broadening of the providers inside the space.

As we think about it, you know, what are the vehicles that are different than public market securities that people would be investing in, and what are the characteristics surrounding those vehicles?

**Adam:** First let's talk about the structure of this, right. So, you know, [a] traditional vehicle is a closed-end or draw down structure is what it's called. So what does that mean? That means that it's, you know, the fund's going to be a 10 plus year lifetime.

And then, so how it works is the fund is actually making investments on years one to four. So actually call capital on those, you know, the first four years. So the money isn't coming back to investors until they actually start selling those investments. That's typically years maybe somewhere between year five and six is when money starts to come back.

So what does that mean to an investor? Liquidity is lacking, is the biggest thing. So, for example, a mutual fund, if you want to get out of it tomorrow, you can. You can go and sell it. That's not the actual case here. You're actually "stuck," quote – unquote, stuck in these funds you know for about 10 plus years. So that's number one.

Fees too, that's kind of an important thing to touch on here. So, typically, the fees are going to be your classic two (2%) and 20 (20%). So two (percent) is [the] management fee and 20 (percent) is [the] incentive fee for the fund. Now, in saying that, it has come down a bit, I would say. But, in general, that's what they are there.

And then the reporting is different too as well. So, for example, go back to that mutual fund example there, right? So a mutual fund is going to strike a NAV (net asset value) or a price every single day. With these funds, it's generally just every quarter. So you're not getting, you know, updates every day on how these funds are doing or [how] the companies within these funds are doing. So that's going to be delayed there too as well. So that's, you know, the big, you know, the big picture. That is a big difference there that you see within the private markets there.

**David:** So that's a great point. As we explore this asset class, there are some unique characteristics around the vehicles that you would be doing the investing with. As we talk about this though, you know, what is the upside?

Why are people so intrigued by private placements at this point? We'll cover the broad asset classes in just a minute, but, you know, what's the interest here in private placements?

**Brett:** I think some will try to sell you on diversification. But, you know, what we try to preach to our clients is, equity is equity at the end of the day. So, typically, the primary motivation for investing in private markets is to outperform public markets.

And also, you know, you're seeing the number of publicly listed companies come down. Companies are staying private longer and so if you're not investing in private markets, you're leaving a bit out there that's available to invest in.

**David:** Yeah, I think that's a great point, right? That you have to give up some liquidity to invest in these, the fee structure is completely different, but they are designed to outperform public market securities, not that they always will. But not having to report on a quarterly basis gives them a much more strategic view in terms of how they're operating their businesses. And they're making investments inside those businesses too, so really sort of a unique asset class.

As we walk through, it's not necessarily a monolith. There are components to private placements. Maybe we can start out with one of the more popular vehicles or more popular styles out there, the buyout strategy. Can you walk us through that and what our outlook is?

**Brett:** So buyout investing is, you know, simply investing in the equity of privately held companies typically through it's a private placement LP (limited partnership) fund structure. And there's obviously many sub asset classes underneath buyout, you have leveraged buyout, you have growth equity, and you also have the market cap (capitalization) spectrum.

And here is what we kind of mentioned a little bit ago, you know, the goal is to outperform public markets over the fund's life which can be 10 to 12 years. Thinking a little bit about our outlook and thoughts right now given the current environment, I think as we, you know, turn to the new year following the election, you know the general consensus was a more favorable environment. And a lot of that had to do with a friendlier regulatory environment which would hope to boost M&A (merger and acquisition) activity.

I think the one negative we see right now is, that's kind of holding things up a little bit, is all the uncertainty around trade and tariffs and those implications. But, you know, once we get some more certainty around that, I think that's also going to be something that could be a tailwind moving forward as well as declining interest rates. As a lot of buyout transactions tend to use a good amount of leverage and so lower interest rates make those deals look more attractive.

**David:** Great observation that as we see M&A activities start to pick up, whether that be through interest rates maybe going down or whether that just is more sort of animal spirits out there for mergers and acquisitions. These funds tend to pick up activity quite a bit around there.

You know, the other one that more recently has garnered a lot of attention is private credit. Can you walk us through sort of what private credit is and what this opportunity looks like right now?

**Adam:** Yeah, when you're thinking about private credit, it is broad. But I'm going to focus on today is direct lending. That's what most folks think about in private lending. And to David's point, there's kind of a, I want to call it maybe a craze for it here today. It has gotten a lot bigger, especially over the last, call it, five years or so.

So, direct lending private credit all it is is first lien floating rate loans. So this is what the banks used to do back, forever really, right? So just making loans to, you know, to actual firms that are out there. So, you know, obviously after the GFC (Global Financial Crisis) banks started lending less and that's where these actual private credit funds have stepped in to fill the void there, if you will. So that's, you know, that's essentially what private credit is doing here today.

**David:** Yeah, that's great. You know, as we as a bank, take a look at this space, yeah they have started to fill a little bit of a void. But it does feel like that traditional loan out there tends to maybe be a little lower quality as well. So you're getting maybe a little bit more, you know, interest that you're charging folks as well.

So maybe the most exciting area inside privates (placements) is venture capital. Think of Silicon Valley here. You know, can you walk us through the asset class as well as sort of how it looks right now and maybe its more recent history?

**Brett:** So, you know, venture capital, to state it simply, is really just providing capital to startups and early-stage companies and through to later-stage companies, often with the goal of eventually taking them public.

You know, it's generally considered one of the riskier asset classes. And, you know, I would characterize it as a few big winners and many losers. But those big winners are really what helped drive returns for the asset class. As far as kind of where we are right now, 2021 was kind of the boom of venture capital, 2020 and 2021.

Things really came crashing down in '22 (2022). The venture capital space has really been kind of working through that. There's still a lot of dry powder that a lot of the managers are working through. Fundraising is still down. But it, really right now, it's kind of the haves and the have-nots of the venture capital space, where those top-tier venture capitalists are really the ones that are still dominating the industry.

**David:** Yeah, you know, venture has just been a been a really fascinating area to watch. Certainly in hot times, you know, especially, say, around the pandemic, we had a lot of activity there. Another one that I've seen more recently become quite popular is private real estate. Give me a little color on that.

**Adam:** Real estate, I'd almost say has kind of been a dirty word since COVID (COVID-19) really hit, right? Because, I mean, I think folks think that they think about office right first. But I would say the office market is much smaller, you know, than what it used to be. So, classic private real estate was office, multifamily, industrial, you know, malls, things of that nature.

Now it's much more broad, right? You've got towers. You've got data centers. Much much more broad here today, so. But, you know, yes, office is struggling still here today. But I would say, in general, most of the market is doing well. Multi family's, they still do okay. Industrials are doing fine, obviously, I mentioned data centers, towers, and things like that.

I think one area where we are seeing opportunities today is more on the opportunistic side of real estate. So, what's happening? Obviously, some of these properties were funded when rates were at zero. A lot of them have floating rate loans. Obviously as the loans, as the rates have gone up, interest payments have gone up too as well.

So that's hurting some of these investors here today to where the properties actually just is still very strong. Balance sheets aren't, so we actually like, you know, strategies and funds that, you know, are taking advantage of that. Either by, you know, buying some of these, you know, at a discount today or even, you know, buying some that are stressed as well here today.

**David:** Yeah, real estate is always fascinating. And really, these are masterful operators going in there and trying to examine the opportunity set out there.

Last one I'd love to touch on is secondaries (Secondary Market). You have a go at exactly what secondaries are and what that's looked like more recently.

**Brett:** Yeah, you know, I'm always a little hesitant to call secondaries an asset class. You know, I really think of it as more of a strategy that you can apply to a variety of asset classes. But, you know, this has been an evolving and maturing secondary market for private fund interest. To put it simply, this is where you buy someone else's interest in a private fund, often at a discount.

And you can see that discount, you know, widen during times of stress. And so, you know, secondaries is a strategy that can often take advantage of the weaknesses of other asset classes. But in, you know, more benign environments, you know, I think of secondaries as a higher-floor, lower-ceiling approach to private investing.

**David:** Yeah, I think, you know, as we're currently contemplating secondaries inside people's portfolios, it's to speed up that timeframe on getting distributions out there.

You know, that's a great transition to how we should think about privates (placements) inside portfolios. You know, what are some of the challenges and what's been our take on implementing privates (placements) inside portfolios.

**Brett:** Just like we do with public markets, you know, we take a fully customized approach to private investing. You know, every client of ours is going to have a different risk and return profile, a different liquidity profile, and just a different timeline. So really it's about sitting down with your portfolio manager and understanding what asset classes might make sense.

And once we have those asset classes, we can build out a custom portfolio. You know, one of the things that's different with private markets is you can't just invest everything in day one. You have to build it out over time. But, you know, kind of step one is, trying to identify those asset classes that make sense for each unique client.

**David:** Yeah. No, I definitely appreciate that. You know, as we're thinking about things, I think that's the key here for private placement investing and sort of this broader alt (alternative investment) sleeve is one, figuring out how it meshes with your overall asset allocation and helps maybe enhance some returns over time or mitigate some risks over time. But definitely incorporate it into the broader asset allocation.

Then after that, understand the illiquidity that you're entering into as well as some lack of transparency inside these funds where you just don't get that frequent reporting out there. And really after that, it's being methodical like you guys say. Spending time building it out year after year trying to get diversification amongst different styles and strategies and then also getting diversification over time. Just being able to invest in different sets of funds or underlying companies at different points in the economic cycle.

Thanks so much for the interesting discussion today, gentlemen. I really appreciate it.

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Thank you for joining us on Conversations with Commerce Trust. I'm David Hagee, we'll talk again soon.