Alternative Investment Survival Guide
Part III: Private Investment Case Studies

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To address a few recent questions, we have added a third, and final, segment of our Alternative Investment Survival Guide. In this article, we will step into the role of Chief Investment Officer and offer a few examples of ways that we've seen firms deploy capital into private investment strategies ("Alternatives"). We would first encourage you to review our first two articles where we identify and evaluate the various types of strategies and legal structures used in the Alternatives industry. We, of course, believe it is necessary to understand the nuances of investment strategies and structures to build better investment portfolios for clients while also minimizing the operational burden on the advisor.

While serving as a Registered Investment Advisor's CIO is not our current "day job," it's noteworthy that three of our portfolio managers have similar experience. As a team, we have served as a Director of Private Investments, spending time evaluating private credit and equity investments and building client portfolios, and we have been Co-Portfolio Managers to a private fund of funds.

Case Studies – Thirdline Steps into the Advisory Role

Thus far in this series, we've been talking in generalities. To provide more actionable advice, we're going to walk through three hypothetical clients to show how we would build an alternative investment portfolio for each of them (see Figure 1). Please note that these examples are designed to be over-simplified case studies and leave out certain decision factors that would normally be taken into consideration (e.g., risk-tolerance, timing of planned expenditures, etc.).

Figure 1

Client Category	Net Worth	Key Characteristics
Mass Affluent	$750,000	40 years old, salary of $200,000, qualifies as an "Accredited Investor" but not as a "Qualified Client," still adding materially to savings and hoping to grow wealth, no experience with private investments
High Net Worth	$2.5 million	75 years old, retired, seeking income to supplement social security and pension payments to maintain lifestyle, 80% of investable assets (e.g., liquid net worth) in retirement accounts, taking RMDs, no experience with private investments
Ultra-High Net Worth	$20 million	50 years old, high-income earner ($500K/year) with ~10 working years left, looking to aggressively grow wealth, comfortable with private investments, 80% of wealth is taxable, taxes are a significant concern

Mass Affluent

For the *"Mass Affluent"* client above, we'd look to allocate about 10% ($75,000) into Alternatives with the allocation growing to 20-30% over a 10-year period. This client is a long-term candidate for a heavier allocation to Alternatives, but we would opt to start slowly to introduce the client to a few common categories of Alternatives while educating them on the benefits. Interval Funds are a natural first step into private investments given that many private funds require the client to be a "Qualified Client," and this hypothetical individual does not clear that threshold.

Moreover, Interval Funds offer ease of access, i.e. no subscription paperwork and timely 1099 tax reporting rather than K-1 statements. As a high-income earner, taxes are a material consideration, so we'll allocate more heavily to growth products vs income products.

Sample Alternative Investment Allocation
$75,000 Total (10% of client net worth)

Strategy	Investment Sector	Investment Structure	Allocation
Growth	Private Real Estate Equity	Interval Fund	$25,000
Growth	Private Corporate Equity	Interval Fund	$25,000
Income	Private Asset-Backed Credit	Interval Fund	$25,000

High Net Worth & Retired

For the *"High Net Worth"* client, we'd look to allocate about 20% ($500,000) into Alternatives. Being retired and an "income seeker" with a concentration of assets in tax-deferred retirement accounts, this individual is a natural fit for less tax efficient but lower volatility credit funds/income tools. For this client, preservation is more critical than high returns so we would allocate more to lower risk credit products (e.g., real estate credit and asset-backed credit versus private corporate credit). While this individual could be a candidate for certain private fund vehicles for which they meet the minimum financial threshold, the simplicity of Interval Fund packaging, especially for someone with no private fund experience, leads us to favor "registered" funds that provide access to the private markets.

Sample Alternative Investment Allocation
$500k Total (20% of client net worth)

Strategy	Investment Sector	Investment Structure	Allocation
Income	Private Corporate Credit	Interval Fund	$150,000
Income	Private Real Estate Credit	Interval Fund	$200,000
Income	Private Asset-Backed Lending – Non CRE	Interval Fund	$150,000

Ultra-High Net Worth

For the *"Ultra High Net Worth"* client, we'd look to allocate about 40% ($8,000,000) into Alternatives. We would use a heavier mix of private funds with drawdown structures to mitigate performance leakage, and we would leg into a 40% allocation over 5+/- years to reduce vintage year risk. Given that this client has significant taxable capital and is in a high income-tax bracket, we would focus on traditional growth categories such as Private Equity and Venture Capital, as well as less traditional growth categories like Opportunistic Credit

Sample Alternative Investment Allocation
$8,000,000 Total (40% of client net worth)

	Investment Sector	Investment Structure	Allocation[1]
Growth	Venture Capital	private funds in drawdown vehicles	$400,000/year for 5 years
	Private Corporate Equity	private funds in drawdown vehicles	$400,000/year for 5 years
	Private Opportunistic Debt	private funds in drawdown vehicles	$400,000/year for 5 years
	Private Real Estate Equity	private funds in drawdown vehicles	$400,000/year for 5 years

[1] Returns of capital and gains to be reinvested into new private funds.

	Investment Sector	Investment Sector	Allocation
Income	Private Corporate Credit	Interval Fund, Private Non-Traded BDC's	$1,000,000
	Private Real Estate Credit	Interval Fund, Private Non-Traded REIT's	$1,000,000

A Few Additional Comments on the "Ramp Up" Strategy

As displayed above, a key vintage risk mitigation strategy is that we would buy growth-seeking closed-end private funds over time, approximately over 5 years, and as capital is eventually returned, we'd reinvest into new funds over time as well (pending changes in client objectives).

The challenge to such a "ramp-up" is generating interim returns without undue risk, as the investment capital must remain liquid or semi-liquid during the ramp-up period. One idea is to enter a semi-liquid evergreen credit fund immediately with the capital that is intended for private vehicles and then pull from the evergreen investment as you ramp-up into private closed-end drawdown funds.

In this case, we could recommend interval funds and private non-traded BDC's and REIT's for the interim evergreen fund investments.

As we've highlighted in this series, investing in Alternatives requires a thorough understanding of the risk/return characteristics of various investment sectors, as well as recognizing the implications of packaging. Our team has experience creating, running, and investing in many of these strategies and structures so feel free to reach out if we can be of assistance.

About the authors

Mr. Hutchens is Co-Founder and Managing Director at Thirdline Capital, an investment advisor and manager of a real estate credit interval fund and other private real estate investments. Prior to Thirdline, Mr. Hutchens spent over 15 years at The Holladay Corporation, a Washington, DC-based real estate investment and development firm, where, in his various roles, he led acquisitions, financings, construction projects, and asset management. He spent the two years prior in Walker & Dunlop's capital markets group.

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Prior to joining Thirdline, Mr. Phillips served as Director of Private Investments for Heritage Wealth Advisors, a Richmond, VA-based registered investment advisor, and he served on its Investment Policy Committee. Previously, he served in various senior roles over nine years at Xenith Bank, including head of commercial banking, and was a member of the founding team. Prior to Xenith, he spent eighteen years with large banks in commercial relationship management and credit roles.