A New Era for Private Investments

Democratization of investing is extremely important for investors, and with an increased interest in alternative investments, this will need to become a priority. More infrastructure needs to be in place with decreased barriers to entry for those wanting to diversify their portfolios.

Move Over Institutions. The People Have Arrived.

Democratization – The word speaks to the broad notion of the people controlling systems and resources rather than a concentrated few, in this case, the institutions. Democratization is a concept that has wedged its way into our society over the past few hundred years and is also wedging its way into broader capital markets.

For too long, the financial industry has been dominated by a small, unelected group of actors, which is a damaging trend that needs to change. Increasing access for all investors' to explore new asset classes helps make it possible for them to control their own destiny in the end. One of the best ways to introduce a new level of democratization is through the incorporation of alternative asset classes and strategies.

Even though High-Net-Worth (HNW) individuals may control a considerable amount of assets, these very same individuals are often finding themselves sidelined by the various investment firms and financial institutions they have come to know and trust. Ultimately, for any financial firm to consider itself to be "democratized," rather than a simple autocracy, it must be willing to allow its members to make changes and investments as they see fit.

This is what democratization is really all about. It has become clear that it is time for the financial industry, as a whole, to evolve. The idea that a few special interest groups (or individuals) ought to dictate the ways in which HNW individuals allocate their wealth is simply a thing of the past.

The upside to upping alternative investments

When people hear the term "alternative" investments, they may envision high-risk investments with a very high probability of default. In reality, alternative investments are often well-hedged and protected from risk, may offer the potential for a very high upside with limited downside.

There are alternative investments that relatively conservative wealth managers have recognized to be lucrative. The Russell 2000, a collection of the largest and most innovative companies in the US, has consistently outperformed the S&P 500 (a standard investment metric) over the past ten years. As time goes on, the performance gap between these differing investment classes may likely grow even further apart. Although the Russell 2000 is just one alternative that investors may consider, the need for financial self-determination still remains.

Financial institutions often tend to act conservatively as they work towards a balance between expected return and expected risk, as their boards of directors may require. These financial institutions are often structurally mandated to serve their shareholders rather than act in their investors' best interests. It has become clear that the democratization of investments may benefit nearly all classes of investors.

More axxes, more choice

In the contemporary investment climate, investors have relatively limited access to choosing the investment classes they want to use to allocate their wealth. The foremost factor limiting the selection of assets, something that is essential to the democratization of capital, is the availability of choices. By increasing their exposure to alternative investments, decreasing fees, and decreasing minimum investment levels, investors will gain the ability to control their own financial destiny.

Embracing change

An additional obstacle that has limited investors' ability to access alternative investments is the choices available. It's important to keep in mind that these investments may not even be relatively "high-risk" investment options. But, the pre-existing infrastructure may make it difficult to allocate and move capital toward alternative investments as the investor may desire.

The general resistance to change that has plagued the investment community for both HNW and other investors alike are structural factors that have hindered the alternative investments asset class from evolving. Most notably, the amount of heavy paperwork involved in the asset redistribution process and the high level of integrated reporting/administration have made it very difficult for investors to adjust their strategies with ease.

Furthermore, high levels of illiquidity, arguably a feature of the broader financial system, rather than a bug, has also made it challenging for investors to move their capital from where it held to where they desire it to be. While the best path away from this illiquid, restricting status quo might not be universally identifiable, it is clear that changes will need to be made within the financial industry.

Transparency

One way for financial institutions to restore trust with their investors and improve the overall level of democratization is to increase transparency wherever possible. While what makes a financial institution more "transparent" may not always be clear. Nevertheless, there are a few basic principles that often apply.

By increasing due diligence and access to portfolio construction and analysis, financial institutions will make it easier for investors to identify how they operate and the goals they seek to achieve. Publishing more information alongside providing more transparency to investors will always be more beneficial than publishing less information and avoiding transparency.

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