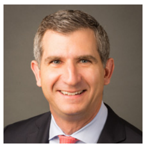
Interval Funds: A New Approach to Alternative Investing

Summary:

- Interval Funds are changing the way investors approach alternative investments and are democratizing exposure to an area of the market that has historically only been available to the world's largest.
- The combination of both public and private assets in one vehicle is very attractive for investors.
- Interval funds can provide a middle ground that offers both private asset exposure and liquidity.

CEFA is joined by Jeremy Held, Senior Vice President and Director of Research for ALPS, Jeremy Goff, Managing Director for Tortoise, and Brody Browe, Managing Director for FS Investments.

Jeremy Held



Jeremy Goff

Brody Browe

Libby Hastert

Announcer: **Welcome and thanks for joining the Closed-End Fund Association for another discussion. Today we will hear from industry experts who share insight on a timely issue affecting the closed-end fund space.**

LH: **In this discussion, we're taking a look at interval funds, an investment structure that lives under the closed-end fund umbrella. To familiarize our listeners with today's experts, I'll provide a quick introduction before turning things over to today's moderator, Jeremy Held.**

Jeremy Held began his career at ALPS in 1996 and has held a variety of leadership roles at the firm over the past two decades. In 2007, he helped launch the firm's asset management division, which has grown to over 17 billion in assets under management. Jeremy is currently responsible for manager selection, product development, and business strategy for ALPS Advisors. Joining Jeremy Held are Jeremy Goff, Managing Director at Tortoise, and Brody Browe, who serves as Managing Director for FS investments.

Jeremy Goff joined Tortoise in 2011 and currently oversees the firm's direct lending business. He is also a member of the direct lending investment committee. He has led the development and launch of Tortoise's interval, indexed, and exchange-traded fund business, clean energy initiatives, as well as its private fund vehicle platform.

Brody Browe is Managing Director of investment management at FS Investments where he leads the firm's institutional group. As a key member of the investment management team, he collaborates with management and fund development contingents to ensure the firm's investment offerings are aligned with the interests of the institutional advisors and their clients.

So with everyone now acquainted with one another, I'd like to go ahead and turn things over to you, Jeremy Held. But if you could start by telling us a bit more about your experience with interval funds, it'd be great if you highlighted why you wanted to join today's discussion. Jeremy?

JH: **Yeah, thanks a lot, Libby, and thanks for having me on this podcast. At ALPS, we really approach interval funds from one of two different perspectives. We are an asset manager, which I'll speak about in a second, but we're also one of the largest service providers of interval funds. We have a sister company that has about 400 different investment management clients where we provide fund administration and back-office services. And we got involved in providing those same services to the interval fund industry several years back, and we've been happy to see that space grow over time. From the asset management perspective, we are also looking at interval funds and hopefully looking to launch two to four of our own interval funds in the next 12 to 18 months. The benefit that we see in the interval fund space is that it really captures the best of both worlds from a liquidity and exposure perspective.**

We're interested in joining this conversation and we're involved in the interval fund space to begin with because we do think it gives investors a unique opportunity to get exposure to private assets that would be difficult to get otherwise, but also with a much better liquidity profile. So we're excited about the space. We think it has a lot of benefit for investors and we look forward to seeing it grow. With that in mind, I'd like to hear from an investing expert who's lately spent a lot of time in the interval fund universe. Jeremy Goff, can you explain how an interval fund differs from the more familiar mutual fund and closed-end fund structures?

JG: Thanks, Jeremy. Sure, happy to share my views on that. The way I view it is that interval funds are a great blend of the traditional closed-end fund that Tortoise is used to managing, along with the traditional mutual fund that we also have managed in the past and still do. Compared to other registered fund structures, they're obviously less liquid than a mutual fund and a traditional closed-end fund, but they're great for more long-term investors that aren't looking to need liquidity quite as often. From our fund's perspective, you can subscribe daily. You only have the option to redeem at certain periods and that's typically between 5-25 percent on a quarterly basis. From a liquidity standpoint, obviously, this is nice for folks that aren't qualified purchasers that aren't getting exposure to traditional private funds in the limited partnership structure.

They can get access to alternatives through this interval fund structure where you couldn't get those illiquid assets into a traditional mutual fund. So it's great from that perspective.

JH: **Yeah, I think those are a couple of great points, Jeremy, and I think as investors look at their universe of different options, right now, outside of the interval fund structure, they really have a binary choice between a series of strategies that may offer them daily liquidity and a whole host of other private strategies that they either may not be eligible to purchase and in many cases offer pretty onerous lockup restrictions. The interval fund structure is really combining the best of both vehicles and gives exposure and access, and I think that you hit on those points well. Brody, from your perspective, where are you seeing interest in this structure and what do you think is generating that interest?**

BB: Yeah, I think that the interest we see is everywhere. So whether it is an independent broker channel, wirehouses, RIAs, or the traditional retail investor, I think it's a great solve for filling out that alternative bucket. So as advisors and their clients get more sophisticated and people start realizing that a 60/40 portfolio might not be ideal, we feel that one of the best ways to access alternatives, obviously specific to the asset class, is the interval fund structure. And allowing you to have thinly traded or private securities that are non-correlated streams of return, you can access them better, and some would argue more safely, because of their liquidity aspects in this structure.

JH: **Yeah, we would agree with that, Brody. And I think that investors for a long time have tried to solve this alternative investment question where they had their traditional investments with stocks and bonds and they're looking for things that aren't as correlated as you mentioned. The liquid alternative craze that took over sort of post-financial crisis did have some benefit, but I think when you look at what alternatives, particularly interval funds, are able to offer, you really can put true alternative assets in this structure. I think that that's a real benefit because I think some investors did get turned off by liquid alternatives. They promised better diversification benefits but didn't always deliver true alternative exposure to private assets. And when you look at the kind of assets you can put inside of an interval fund structure, they really do offer those low correlation benefits investors are looking for. So Jeremy, from your perspective, what investment strategies are available in the interval fund structure and what areas do you see developing going forward?**

JG: When you're trying to tie an illiquid asset into a strategy, I think for most people using interval fund structure, you're using it because you want to provide whatever strategy you have to the masses and not just to one segment of the market, like qualified purchasers or family offices. You really want to bring what you're doing to the broader retail crowd and the mass affluent. So from that perspective, being able to put ... whether or not it's middle-market private equity or we look at renewable energy, or we look at social infrastructure, which would be housing assets, senior living assets, education assets, things of that nature, where we're buying and holding those assets for the long-term ...and whether or not you're clipping a coupon from a fixed-income standpoint or you're just looking for value creation, it makes a lot of sense. And I think in some cases liquidity, and I would argue in the current market, liquidity is overvalued a little bit. Sacrificing a little bit of illiquidity to get access to these certain assets is very attractive. And the interval fund provides that for folks that should be investing in these sorts of things.

JH: **Yeah, and that's a great point. I guess thinking about those different types of assets that you mentioned, and I would pose this question back to you Jeremy and also to Brody, I mean in theory, should investors be thinking about anything that is in a private asset form or is illiquid today, could in theory be eligible for an interval fund structure, so should they be thinking about interval funds as the potential new way to get access to private assets?**

JG: I can start, Brody. I think that is an accurate way to look at it from the way we see it. The beauty of an interval fund versus even a limited partnership that has a defined term is that it's perpetual in nature with longer-lived assets than you would have in a traditional private equity or private limited partnership. So I think the universe of what can go in there will be extremely broad and I'd be interested in Brody's opinion on that.

BB: I think it makes a ton of sense and I think there's a lot of private assets that can be accessed. And I think interval funds are one of many limited liquidity structures that make sense. They seem to have been adopted, so it's an industry trend. You know, you're looking at north of $22 billion, so typically the market coalesces around the structure. I think you're going to find more and more adoption of different asset classes within it.

JH: **And Brody, along with that adoption line, they have really grown quite a bit in assets over the last several years? And how do you see them fitting into an investor's portfolio? Who do you think are the most suitable investors? There's a handful of investors that have been early adopters of this space. Are those the same investors that you think will propel the interval fund space going forward, or do you think that it's going to be a different type of investor that will adopt this structure as it grows?**

BB: I really think it's both. I think what you're going to find, and we've already seen a little bit of this, is RIAs and higher-end RIAs or even family offices that want to replicate their exposures from their LPs can use it as a tool to get sort of the accredited universe into their books, so I think it is a big area of growth for the asset class. I also think there's a big educational lift. I mean we talk about liquidity and liquidity equals risk to some people. And the reality is if you look at daily liquid mutual funds that even if it's not a growing return if it's just fixed income, those structures just aren't ideal for carrying fixed income or any sort of stated maturity contract like that. And I think that the point I'm making is that you could take traditional assets in certain situations, I would argue fixed income, putting them in an interval fund actually in some sense it makes them safer. You don't have a forced selling issue. You don't have the retail clients' liquidity needs and you're not managing the flows. And if that's the case, then you can take a longer-term view and you can take a fixed income, any sort of contract like that to maturity, which is going to be critical. You saw it in the case of Third Avenue, not bad managers, bad structure.

So I think the interval fund solves for two things. One, private assets, thinly traded securities, but also you can make the argument on less liquid, sort of high-yield, fixed income, different sorts of CLOs, that makes a ton of sense in that structure, too. So I think you'll find adoption in traditional assets. I think you'll find adoption in higher end sort of RIAs and I think there'll be a new investor class that'll come up as we sort of have this educational lift across the industry.

JH: Great points. And I think the investor behavior point is a really important one because the initial obvious benefit is that the liquidity of the wrapper matches the liquidity of the underlying investment. The ability to put private assets in this structure makes a lot of sense, but in terms of just allowing fund managers to do what they do best and not having them managed to shareholder flows, but actually have them manage to the opportunities that are out there in the market, I think is going to be a big benefit that investors get in interval fund space going forward. So, Jeremy, CEFA has started an initiative to provide information on interval funds. How available is the information right now and what sources should financial advisors be looking at and investors, what do they have at their disposal?

JG: I think folks like CEFA are doing a great job of spreading the word and educating investors. I know we spend a particularly large amount of time, the folks that are out marketing our products spend a lot of time just educating folks on what an interval fund is. If you look at some of the larger interval fund managers some of the folks who have been doing for a while, they're the best resources for what these things are. They tend to publish papers on the structure itself and why it's useful. So I would look to folks that are managing those funds, at their websites and things of that nature as a good resource.

JH: Thanks for that information. And it's definitely a space that's moving a lot. I know we talked about it being north of $20 billion and that number seems to be changing on a weekly and monthly basis. What concluding remarks do you guys have? I'll start with you Brody in terms of just what investors should be thinking about in terms of the benefits of the interval fund structure and then how it might apply and be used in a portfolio. So I'll start with you, Brody.

BB: Yeah. I think the investors, or probably more importantly advisors and how they're presenting to investors, obviously need to outline ... the asset class, or the structure I should say, now that it can be bought with a ticker at many different financial institutions. So we need to do a good job of educating the end client on the limited liquidity and why the limited liquidity. So to my point before, you know, why would we be in a structure like this? Are we accessing non-correlated streams of return? Are we accessing thinly traded securities, private assets that are acting non-correlated or better said diversified? So I think it falls upon all of us in the asset manager industry to educate and help FAs educate, and then I think the structure will take on even greater adoption. To Jeremy's point, we spent a tremendous amount of time and you could find this stuff on our website, on white papers and the benefits of illiquidity which would fall in this bucket. And I think it does fall upon all of us in the industry to do that, and that will just help the asset or the structure grow.

JH: Jeremy, what would you say to respond to that?

JG: I would just echo a lot of what Brody said. I think that paying attention to what the structure is and understanding the underlying liquidity of the assets in the structure and why the structure itself has limited liquidity, particularly in the more retail market, I think there tends to be this negative connotation associated with illiquidity. And the fact is, is that there are huge benefits to illiquid investments, even done so in a more, what I'll call moderate way, through the interval fund structure that investors should be aware of. And I just don't think they are in a quality way all the time, and so that education is extremely important.

JH: At ALPS, we 100 percent agree with that too, and we were fortunate enough to be early in the advancement and proliferation of ETFs a little over 20 years ago and we really look at what's happening with the interval fund structure as democratizing exposure to a broad range of investors to private assets in the same way that ETFs really democratized some of that exposure 20 years ago to different asset classes that investors didn't have on the liquid side. The ability for investors now to look at the universe of potential products and say we want exposure to a certain asset class and not be limited by structure, I think is really going to be liberating for investors. It's going to allow advisors to build better portfolios. We see this space solving a big need for advisors and investors and we're looking forward to watching it grow.

LH: Well, Jeremy, thanks for moderating and I also want to thank today's speakers for discussing what's becoming an increasingly interesting place in the investment space. Just having listened in, I would certainly agree that interval funds are a really exciting opportunity for today's investor, so we're looking forward to seeing where things go in that space.

Announcer: Thank you for joining us. We hope will stop by again for news on this ever changing space. Until next time, connect with us on Twitter at @CEFAssociation or by searching for the Closed End Fund Association on LinkedIn or YouTube.

Disclosure

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