



# Smart Allocations: Advisors' Perspectives on Private Market Investing

Advisors may want to help clients take advantage of private market investments for a variety of reasons, including the potential to enhance a portfolio's return, manage risk, and improve diversification. Yet for clients with the appropriate risk and liquidity profiles, advisors may wonder how to best implement a private market allocation. How can they determine, for example, the appropriate percentage allocation and which part of an existing portfolio it should replace?

We spoke with three advisors on why they invest in private markets and how they allocate to privates within their book of business. Our conversation included Matt Lengel, partner and chief compliance officer of Denver Private Wealth Management, Ryan Fleischer, CIO and founder of Revolution Group, and Zach Unger, senior investment analyst for Financial Enhancement Group.



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## How did your firm get involved in private market investing?

**MATT:** The interval fund structure is what really opened our eyes to the scalability of how we can invest in private markets and get access to their potentially uncorrelated return streams.

**RYAN:** We wanted to offer something that could mitigate risk, while potentially increasing the rate of returns. And do so tax efficiently, but also position-optimized as well, where we're placing different assets across a client's portfolio.

**ZACH:** The evolution of structures from evergreen products to interval funds over the past couple of years opened our minds to what scalability could look like. We realized we could expand the private market allocations that we were implementing in some of our higher net worth portfolios to include even more asset classes in the private market sector, and then democratize our approach across our entire book and make it truly scalable instead of the kind of one-off allocations that we originally started with.

## What are the main drivers you consider when allocating to private markets?

**MATT:** The question is where private market investments fit and how they interact with the rest of the client's portfolio. Interval funds have given us the opportunity to scale private market investments across almost all portfolios. You always have some custom solutions for certain clients, of course, but for the most part, we're model driven, and I would say we're about 15% in privates. Many private companies correspond to small-cap or micro-cap size companies. So, we'll reduce some of our small-cap allocation on the public side and move that into private equity.

**RYAN:** We have models and every one of our clients has their own investment policy. Our mandate is wide and large, so we invest in a lot of different sectors, everything from private equity to private infrastructure to direct lending to asset-backed lending.

## How do you approach diversification of different managers and different sub-asset classes when investing in privates?

**ZACH:** The way that we allocate to private markets, instead of saying we're going to take some from our small caps to allocate to private equity, for example, we will make the allocation pro rata across the entire model and allocate between 10% and 30% of a client's portfolio, depending on what liquidity they're able to give up.

We allocate to all four of the main private market asset classes, equity, credit, real estate, and infrastructure, to varying degrees. We weigh those depending on the client's risk tolerance. And allocations are also based on where we see opportunity in the market.

We think there's a lot of opportunity in real estate and private equity right now, and so almost regardless of risk tolerance, our overweights are swaying toward those two sectors right now, and then we tailor it within a range based on the underlying client's individual risk tolerance.

The aim is to build an allocation that's all weather. We want exposure to all the private market asset classes. They've got different characteristics and different correlations, and we adjust the weightings, accordingly, based on what's going on in the market.

**MATT:** Interval funds that include multiple managers make a whole lot of sense to deliver diversification because concentrated investments create concentrated outcomes. And the whole point of the portfolio is to be more diversified.

**RYAN:** We look at each sub asset class on its own. We don't, for example, consider just because an asset class is producing income, that it's a bond replacement. For private real estate that's producing income, for example, it's coded in our trading systems as real estate.

We're very focused on the purpose of what the client is looking to achieve. You can have too many managers or you can have too few managers, especially, but in sourcing, we're going to try to source from the very best we can. What's going to really move the needle when it comes to the private markets is the ability to source good quality managers.

**ZACH:** When we're building portfolios, we tend to view private equity as the growth driver and private credit as the income producer. Obviously with your hybrid vehicles like real estate and infrastructure, you're going to get a mix, depending on the market environment where you may see more appreciation or more income.

That also influences where we place these positions. We tend to favor Roth IRA money for private equity. We anticipate that that'll be the last bucket that's touched in retirement, so we want to give more growth-minded assets toward those accounts.

On the private equity side, rather than allocating all of our money to one manager, we like to find a co-investment specialist, a secondary specialist and a venture specialist and kind of marry those together. We do that across different asset classes. And then as constraints come in, most notably either liquidity constraints or AUM constraints, we'll pare that back a little bit to a certain point.

## How important is client education when it comes to private market investments?

**MATT:** The first barrier to entry is typically fees. It's important to help clients understand why they're paying higher fees for some of those underlying investments and help them understand the interval fund structure and how it fits within their portfolio. They need to understand the benefit of an interval fund that invests in co-investments, where it's eliminating carried interest, and how it can get those fees down to 1.25%, 1.5% or so.

**RYAN:** The last two years, the public markets have returned substantial amounts. But we help clients understand the risk and the beta, comparatively. We show them that they are taking far more risk (beta) with higher standard deviation, overall, in the public markets. When you have a drawdown in the public markets of around 10%, they're very thankful they've diversified into privates.

**ZACH:** The liquidity conversation is probably the one that tends to come up the most often. The easiest way for us to answer the liquidity question, or at least the way that we find that it sticks the best with our clients, is to reframe liquidity as an asset that can be sold. If you don't need 100% of your portfolio to be liquid, you can sell some of that in exchange for potentially better risk-adjusted return.

We developed a 10-minute video that's posted to our website, and sent to our clients, that provides a high-level overview explaining the asset classes, and the benefits and risks of including them in portfolios. It's a helpful way to provide a broad perspective on private markets that's easily digestible.

## How do you avoid just getting beta in private markets? Where does the alpha come from?

**MATT:** You have to have the relationships. You have to have people that are doing the due diligence and constantly monitoring the investments. The whole opportunity set is figuring out how to achieve upper quartile performance. If I do the best due diligence in the world and I create the best relationships with money managers in the world on the bond side, hopefully I can squeeze out 25 basis points. If I take that same level of energy and I do that on the private market side, hopefully I'm creating 15%, 20%, or 25% outside returns.

**RYAN:** Just having beta is one thing, but I think our clients expect more than that. We expect more than that. The key is the operator success and being able to get access to some of those operators that not a lot of folks may get access to. Having the relationships and having the connections is really valuable in private markets.

Private markets are very sensitive to sourcing, so where we get our greatest value in the private markets is sourcing high-quality managers. There's about a 15% difference in annualized rate of return from top quartile to bottom quartile managers.\*

**ZACH:** Access to high-quality managers is critical to success. It's important to find managers who have access to strong deals. One of my favorite parts of being a private market investor is the creativity and ingenuity in the types of investable assets. On the private equity side, for example, this is where we try to capture alpha – in these unique asset classes.

Have there been any positive or negative aspects that came as a surprise to your experience in private market investing?

**MATT:** The earlier you start this process, the better, and you're going to have to learn by doing. But I just think that this is where the ball is going in our industry. It's important to be able to have knowledge, a skill base, and frankly, a list of managers that you know and trust.

**RYAN:** I would say it's not so much like an "aha" moment, so much as a conviction it works when it's correctly allocated. There's a reason why the largest, most successful family offices in the world, and the largest endowments in the world, are using private investments. It's because of the potential results. It's not immediate results – no good thing, I believe, happens just instantly. It's patient capital. So, communication with clients is important.

One of the biggest things that I was looking for was how am I going to add substantial value in the commoditized world of wealth management? That's really what we set out to do. If you're not implementing private investments, you're probably going to be left behind. There's going to be another advisor who is going to offer those to your clients, and your clients are going to see the value in that, especially if they're a more sophisticated type of client.

**ZACH:** Private market allocation among RIAs is moving away from being a value-add proposition, something that's maybe unique, and it's moving toward being table stakes, something that you will have to offer to acquire new business.

The structures have evolved, that's the direction that this is heading, and advisors who are on the cutting edge of innovation with how they're allocating are already many years deep into this. I do think that that's the trend.



## Important Information

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\* Source: Data sourced from Cambridge Associates via IHS Markit, annual Pooled IRR quartiles by vintage year as of December 31, 2023 with data pulled in May 2024. Cambridge data is extremely limited and appropriate consideration should be taken when Cambridge data is presented given the quality of the data and the small sample size. See back eVestment data as of December 31, 2023 with data pulled in January 2024. NCREIF data as of December 31, 2023 from Q4 2023 report. With the exception of Core Real Estate, private markets funds raised Vintage Year 2012 to 2021 (2022 and 2023 are excluded as they are too recent). Note that Natural Resources does not have data for vintage years 2020 and 2021. Public markets data for the trailing 10 years as of December 31, 2023. Indices: Cambridge PE & VC Composite, Cambridge Private Credit Composite, Cambridge Infrastructure Composite, Cambridge Natural Resources Composite, Cambridge Real Estate Composite, NCREIF NFI-ODCE, eVestment US Large Cap Equity Universe, eVestment Emerging Markets Equity Universe.