Interval Funds Provide Access to Investments Normally Unavailable to Retail Investors

By Mike Schnitzel

Many asset classes offered today through interval funds have historically only been available through private LP structures and have generally not been accessible to retail investors. An increasing number of interval funds however, can offer access to these strategies for investors who may not be accredited according to panelists from a recent roundtable discussion at the ***Summer Summit*** hosted by the Active Investment Company Alliance. Contributor Mike Schnitzel conducted phone interviews with the three panel participants, plus one of their colleagues, to get a more in-depth look at interval funds.

Interval funds by definition have some sort of liquidity restriction. Most allow investors to withdraw money quarterly while providing a notice of an intention to redeem 30 days in advance. This structure, said Gregg Bell, co-founder and principal at A3 Financial, allows a manager to think a little bit longer term and align the investment pieces with the goals of the end investors and their capital. "As a result of that view, the exposure to unique cash flows, unique assets and risk-return profiles is accessible to an investor base that would not necessarily have that same option to get into a particular strategy without the interval fund structure as a whole."

Being able to manage redemptions helps managers avoid selling assets at inopportune times, according to Jeremy Goff, managing director and chief development officer at Tortoise Advisors. "When you invest in illiquid assets, it is important to have assets locked up because selling at inopportune times damages the investment," Goff said. "An interval fund allows for some level of liquidity for rebalancing. The benefit is you get the opportunity to invest in assets that would only be offered to qualified purchasers under normal circumstances. Investors are protected from forced selling and erratic behavior."

Christian Munafo, chief investment officer and portfolio manager at SP Investments Management, said he explicitly tells advisors that they need to look at his fund with a 3-5 year time horizon because the underlying investments need time to grow. "It's a longer-term strategy, so frequent utilization of the redemption feature could hinder our ability to execute our investment strategy," he said. "We offer 5% redemptions per quarter, which provides our clients liquidity and our portfolio stability." He noted that investors in interval funds likely avoided losses during the volatility in March and April caused by the Covid-19 pandemic. Psychologically, such volatility often spooks investors to sell when they shouldn't, he said.

"When you look at historical performance of public and private assets, these highly volatile periods become the best times to invest," Munafo said. "By having our interval structure in place that prevents investors from selling more than 5% of assets of the overall fund, it almost protects them from themselves."

Lars Soderberg, co-founder and principal at A3, said there was a lot of forced selling in March which created opportunities for people who had capital on hand. He was in agreement with the sentiment that interval funds can help protect investors from making bad decisions based on emotion. "Retail investors almost always do the wrong thing at the wrong time because they're scared," he said. "The interval fund structure prevents that and almost prevents investors from selling irrationally."

Soderberg said his fund could have been formed using an LP structure, but that setting it up within the interval framework makes things more transparent for investors. "We have full '40 Act registration, so there is a lot of oversight private funds don't have to follow," he said. "We have an independent fund board. There is plenty of regulatory oversight."

In addition to transparency, another advantage certain yield-oriented interval funds might provide is income generation with potentially less risk than investing in today's traditional bond funds. "Retail investors have very little access to quality income strategies these days with interest rates so low," Soderberg said. "People are going to either accept more risk and reach for returns, or they can try our strategy which provides quality income that is real and meaningful with less risk."

During the panel discussion, Bell noted that market conditions make it challenging for investors to generate income from investing in bonds. "The global bond market, we're talking about $60 trillion of debt and 86% of that is yielding less than 2%. From an investor's perspective that seeks income, that's a real dilemma."

Strategies pursued by interval funds typically include investments in assets such as insurance-linked notes, catastrophe bonds, litigation funding-focused strategies, niche credit, reverse mortgages, and some pre-IPO structures, Bell said. "You get a breadth of non-traditional strategies within an interval fund." Goff's fund focuses on credit and typically focuses on privately originated debt, he said. Assets he focuses on include investing in schools, affordable senior living, and low carbon project finance. "These are direct placements we convert into bonds, and because of their nature we can issue bonds tax exempt," Goff said. "We are usually the only holder of those bonds. It's debt that has a CUSIP, but we don't really trade it." Doing so generates returns of more than 6.5% that are tax exempt, versus a typical bond return of 4% or so, he said.

Munafo's fund focuses on late-stage venture capital and growth-oriented companies, he said. Typically, investments such as those are available only to large institutions, family offices and accredited investors. "The interval structure democratizes access to these assets," Munafo said. "It's very disruptive in terms of the ability for us to invest in these through the interval structures. We provide access with as little as a $2,500 commitment with a ticker that trades daily through brokers such as Fidelity and Schwab. The SEC has been vocal around making private type investments available to Main Street, and through this fund structure we do that."

We are appreciative of Northern Trust for sponsoring this content.

NORTHERN TRUST

Dtisclosure: The opinions of the speakers / presenters are their own opinions and may not be the opinions of AICA. Listed closed-end funds and business development companies trade on exchanges at prices that may be above or below their NAVs. There is no guarantee that an investor can sell shares at a price greater than or equal to the purchase price, or that a CEF's discount will narrow or be eliminated. Nonlisted closed-end funds and business development companies do not offer investors daily liquidity but rather on a quarterly or semi-annual basis, often on a small percentage of share. CEFs often use leverage, which can increases a fund's risk or volatility. The actual amount of distributions may vary with fund performance and other conditions. Past performance is no guarantee for future results.