Tender Funds Offer Alternative Structure And Investments, Plus Flexibility

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed Bob Long, chief executive officer at Conversus. Read the Q & A below as Bob discusses how 'tender funds' give investors access to private markets, which creates improved diversification and generates an investment premium. Long discusses the pros and cons to the fund structure, as well as the challenges of evaluating the funds given the absence of ratings and rankings for the funds.

Bob Long

The podcast can be found on AICA's website by clicking here: https://aicalliance.org/alliance-content/pod-cast/

CHUCK JAFFE: Bob Long, chief executive officer at Conversus is here and we're talking about tender funds and investing in private markets, welcome to The NAVigator. This is The NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator's brought to you by the Active Investment Company Alliance, a unique industry organization that represents all facets of the closed-end fund industry, from users and investors to fund sponsors and creators. And if you're looking for excellence beyond indexing, The NAVigator's going to point you in the right direction. Now today, well we say all facets of the closed-end fund industry, today it's pointing us in the direction of Bob Long, chief executive officer at Conversus, which is part of StepStone. That's a company that works on behalf of institutions to put money to work in private markets, and it is a big player that you probably haven't heard of, but you get to hear about it now. And Conversus specifically, well their role is trying to put the advantages that institutions have into the opportunities for individuals. Now if you want to learn more about how it works, stay tuned because we're going to be talking about tender funds, which you may or may not be familiar with but you can also get more information at Conversus.com. And if you want more information generally on investing in closed-end funds, business-development companies, and interval funds go to AICAlliance.org, the website for the Active Investment Company Alliance. Bob Long, thanks for joining me on The NAVigator.

BOB LONG: My pleasure.

CHUCK JAFFE: We need to start with just a little bit of background on a tender fund, because it's not a regular closed-end fund and it's not a regular interval fund, but it allows you to do what you guys specialize in which is investing in private markets. So explain how a tender fund works and why it's specifically well suited for the alternatives that we're talking about in private markets.

BOB LONG: Sure. So the typical closed-end fund would trade on an exchange and may experience trading at a premium or a discount and has the complexities associated therewith. An interval fund does not trade a like a tender fund, and an interval fund has rigid liquidity requirements that require it to provide liquidity to its investors at certain predetermined intervals to hold a certain amount of cash. And the effect of that is most interval funds cannot invest the majority of their assets into a diversified portfolio of private assets because the private assets just don't generate the required liquidity, so what you end up there with is often significant cash drag in the portfolio. So those structures, interval funds work well for certain types of assets, but when an investor seeks to own a portfolio that is entirely a diversified group of private market assets, the flexibility of a tender fund is a better choice.

CHUCK JAFFE: Let's talk a bit about the assets you can get into, because private markets, well there's a lot of things that go into the alternative category, but not every alternative goes into what you guys define as private markets and into your tender funds.

BOB LONG: Alternatives is the broader term. Private markets refers to private equity, private credit, private real estate, and private infrastructure investing. And those are the four main asset categories covered by StepStone Group, our parent company, on a global basis.

CHUCK JAFFE: You at Conversus are trying to take institutional strategies and make them work for individuals, but individuals have to still be convinced that it's not just stocks, bonds, and cash. So why private markets for an individual who thinks they've got an allocation that works?

BOB LONG: The primary reasons are the diversification benefits of private assets and the return premium that's historically been experienced by those who invested in the top-tier private market assets, those are the two primary drivers. And if I could segue from there, that's frankly fairly well known to most investors. The challenge of course is how do you put that investment strategy into effect? And that's quite difficult for the typical individual investor, there are a couple of reasons. From an investment strategy perspective the private markets are opaque and complex, it's hard to actually get access to top-quality opportunities. And then if you do, you run into structural barriers, for example, high investment minimums, high fees in order to achieve diversification, unpredictable capital calls and distributions. You don't know when your money's going to be called by a fund and when it's going to come back to you, so you have a hard time reaching and staying at an asset allocation target. And then if you get through all that, you get the dreaded K-1 partnership tax reporting which likely comes in October of the following tax year, meaning you have to amend and delay your tax returns. So there are a lot of structural reasons in addition to investment reasons that have historically prevented individual investors from access top-tier private markets.

CHUCK JAFFE: Unlike traditional closed-end funds and interval funds where somebody can go look up a ticker and decide what they want to do, how would you want somebody to evaluate a fund like the stuff that you guys are operating to decide this is a good fit and it's the right thing?

BOB LONG: It's a good question and there's several elements to that. The first thing is to look for a fund that we would broadly define as investor-centric. So what does that mean? I think that means efficient, it means convenient, it means transparent. Let me break those down a little bit. Efficient frankly means inexpensive, that the overall fee load makes sense for the value proposition you're receiving. And when you evaluate any sort of closed-end fund be it tender, interval, or a traded closed-end fund, you really need to look closely, there's not a lot of standardized reporting about fees. You need to look at the fees that the manager, the sponsor, the person who's name on the fund is charging. You need to look at these so-called acquired fund fees or the look-through fees to see what any underlying managers, and there typically are if you have a diversified portfolio, what they're charging. You need to look at administrative expenses. And then in our space there may be some acquisition fees or disposition fees and that sort of thing that you need to look at really closely. You also need to consider the investment strategy, can the sponsor of the closed-end fund actually deliver? Does it have the capabilities to do that in terms of the mix of assets it invests in? As just one example from our particular corner of the closed-end fund world, we invest in secondaries, buying funds on the secondary market. We also make direct co-investments, typically on a no fee and no carry basis alongside leading general partners. Well, the fact that our parent StepStone makes $20+ billion of commitments to news funds, primary funds on an annual basis, that's what drives our access to secondaries and co-invests. And so whether it be evaluated in our fund or others, understanding the mix of capabilities is very important to understanding and evaluating a tender fund.

CHUCK JAFFE: Traditional mutual funds and ETFs have Morningstar. Tender funds, there's not a lot of comparison. So even though obviously you like the things that you work with, if somebody is new to tender funds and they hear us talking about them and they want to go do some research, how many should they look at? How should they decide that like, "Yup, this manager can get it done"? Or is there something more specific because they don't have the easy tools that exist in others parts of the market to help them?

BOB LONG: You're correct, those tools don't exist. There are some fund trackers available online that provide some basics, but I think what's really important is to look both at performance and fees, those are the two things. And the prospectus for each closed-end fund does have a standardized fee table where you can examine that, and then most funds run by reputable sponsors have a fairly consistent performance reporting that has the right disclosures and the right standardizations. So I'd encourage investors to look at those two things but also to think about how the fund matches with their overall investment allocation. For example, there are numerous real estate oriented funds, are you trying to get access to real estate? Or do you find that there are publicly available options that allow you to access for example, exposure to real estate or infrastructure? So in searching for a closed-end fund you should refine your thinking that determines what it is that you really want to look at. There aren't good ways to access the private equity world for example, other than through closed-end funds.

CHUCK JAFFE: Help my audience set some expectations here. They know what they're getting when they're buying stocks and bonds. They know what they're getting when they buy most investment types, when they buy and ETF or they buy a traditional mutual fund or even a closed-end fund. But here they're looking for both structure and assets and they're making a change, and quite honestly it's refining a portfolio but it's not like somebody wakes up this morning and goes, "Hold it, I'll never reach my goals if I don't have a tender fund." So help them understand what a tender fund is going to do for them.

BOB LONG: Here's the way I think about it. With a closed-end fund, be it a public BDC, a REIT or a European listed fund of private assets, you can trade those everyday but you may not like the price, they often trade at a meaningful discount to net asset value. On the other end of the barbell, you can make a commitment to a private market's fund and you're locked up for 10 to 15 years with essentially no liquidity for an individual investor. A tender fund is a hybrid, it sits in between, it allows you to get the return premium of private market assets with quarterly liquidity on typically 90 days' notice. So it's a hybrid, it's a compromise, it doesn't have all the benefits of either extreme but we think it has a useful place in peoples' portfolios.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. I am Chuck Jaffe and you can check out my show on your favorite podcast app or at MoneyLifeShow.com. To learn more about interval funds, closed-end funds, business-development companies, and yes, tender funds, go to AICAlliance.org, the website for the Active Investment Company Alliance. They're on Facebook and LinkedIn @AICAlliance. Thanks to my guest, Bob Long, the chief executive officer at Conversus, which is a StepStone company. You can learn more at Conversus.com and on Twitter @StepStoneGroup. The NAVigator podcast is new every Friday, follow along on your favorite podcast app and come back next week to learn more about investing with closed-end funds. Until that time, stay safe and happy investing!

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To request a particular topic for The NAVigator podcast please send an email to: TheNAVigator@AICalliance.org

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