

Private Investments: Entrepreneurial Investing for Profitable Growth



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This article marks the beginning of a series exploring the economic benefits and risk mitigation associated with private investments in mid-cap debt and equity. It sheds light on the changing landscape of alternative securities, offering promising prospects for both middle-market companies seeking growth capital and savvy investors.

Understanding the Market for Private Investments

There has been a notable rise in demand for private securities (also known as private placements or alternatives), especially fixed-income investment vehicles. This signals a significant shift in economic opportunity for both middle-market companies in need of growth capital and for the investing public. With the continued, steady pullback in bank lending, both family offices and private institutional lenders are turning their attention to private investments.

Registered Investment Advisors (RIAs) in particular are increasingly interested in fixed-income private placements for their clients. Conventional liquid securities investment advisory is experiencing unprecedented fee compression due to AI-driven robo-advisory, as well as the availability of ETF-type investments. This is contributing to the decline of the perceived value of RIAs and, consequently, to a reduction in fees.

The exception to this trend is private placements. Traditionally, private placements in fixed-income securities were the nearly exclusive domain of investment advisors for the uber-wealthy clients of large institutional banks. These advisors would typically recommend an allocation of up to 25% of investable assets into alternative securities created by the institution's banking team and listed internally on their advisor platforms. This alternative asset class generally comes with higher management fees for the advisor due to the higher yields associated with the asset class and the complexity of sourcing and allocating appropriately to this asset class.

New Demand for Alternatives

In the current environment, demand from RIAs for fixed-income private placements for their high-net-worth clients is growing exponentially. Stock market volatility, soaring interest rates, and rising inflation are driving investor interest. The promise of higher investor returns helps an IRA with client acquisition and retention. Additionally, the higher perceived and real value of the advisor in sourcing appropriate high-quality alternatives translates into higher asset

management fees. Everyone wins in this environment.

Sourcing and screening alternative investments presents a universal challenge. There are very few platforms on which institutional investors, family offices, independent advisors, or direct investors can safely source alternatives. As mentioned above, traditionally, alternatives have been platformed with large institutional advisors or banks and are available only for their wealth management advisors and high-net-worth clients. There have been a number of attempts to build independent platforms, but these have mostly been less than satisfactory. The complexities of due diligence, risk assessment, collateral management, and reporting on alternative investments are formidable hurdles.

Navigating Challenges: Sourcing, Screening, and Mitigating Risk

Even moderate-sized family offices and institutional investors find it difficult to source sufficient high-quality deal flow, what to speak of independent RIAs or individual investors. Most are neither large enough nor in the business of attracting alternative investments appropriate to their needs. They therefore struggle to identify suitable deal flows. Organizations dedicated to originating, conducting due diligence, and credit underwriting—such as our group's registered broker-dealer, US Capital Global Securities LLC, and our group's registered broker-lender, US Capital Global Partners LLC, play a crucial role in bridging this gap on a global scale.

Besides just sourcing alternative opportunities, such a specialized organization must also assess them for quality and risk. That screening process forms part of the regulatory responsibility of a broker-dealer and requires years of experience and training of staff, supervisory personnel, and intelligent, clearly structured processes. After an opportunity is evaluated, there is a requirement to design and document an investment security, with a comprehensive list of risk disclosures. This security must meet the requirements of the borrower, investor, and regulator. Additionally, the security needs to be registered with the SEC and, ideally, secure a CUSIP, a unique nine-digit identification number assigned to an equity, debt, and other security so it can be purchased on a major platform like Fidelity or Schwab. Simply listing these alternatives on such a platform can be challenging. If alternatives are not listed, they are difficult for RIAs to purchase and collect advisory fees on them.

Fostering Economic Growth

Beyond individual benefits for the investor and investment advisor, a robust alternative finance market contributes to general economic development and prosperity. Small and mid-market businesses, long recognized as the engine of economic and employment growth, face a funding gap that private placements can help fill. As banks continue to limit their traditional roles, alternative investments become crucial in meeting the growing demand for growth capital.

While venture backing for startups has gained momentum globally, many startups face growth constraints without follow-on investments. A thriving alternative securities market can bridge this gap, supporting sustained growth initiated by venture capital funding.

Conclusion

Private investments hold the key to addressing economic needs for investors, investment advisors, and companies in need of capital. Subsequent articles in this series will delve into specific challenges associated with alternatives and propose solutions and best practices to navigate these complexities, fostering a resilient and thriving investment landscape.

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