Vivaris: SPs to benefit from increase in portfolio allocation to alternatives

North America | Industry

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Recent shake ups across financial markets are compelling investors to chase extra layers of protection and seek portfolio simplicity.

Structured financial products as an asset class are gaining traction among US investors, exemplifying an attractive risk to reward ratio, according to Chris Mizer (*pictured*), chief executive officer and founder of US private equity firm Vivaris Capital.

Mizer talked to SRP about the pivotal selling points as well as risks of alternative asset investing, real estate gaining momentum, and investor behaviour shifts as a result of recent market volatility.

> Alternative assets in general have had better returns historically

What are the main benefits of structured financial products as an asset class to investors?

Chris Mizer: I think there are three significant benefits. The first is that alternative assets in general have had better returns historically than other asset classes like stocks and bonds. Second, they allow you to determine the level of risk you are willing to assume, including having your secured. Otherwise, you typically get a binary return, either a great return or a loss of your investment. The third is that they allow you to participate in the asset class without having to have broad diversification.

Typically, you would need about 40 individual investments, depending upon the standard deviation and correlation of returns to get an average performance from alternative assets, which again have higher returns. However, managing 40 individual investments is a full-time job for somebody, so a perfect product still lets you participate in the asset class and has the benefit of having exposure without having to have broad diversification.

What we do is create the protection so there is the same level of risk as an investment grade security. Even if you were to go into a US government bond, there would be a risk of a credit rating being changed so that there's some revaluation, a risk of inflation or default. With an investment grade level of security, it's safe, secure and collateralised.

Where do you see this gaining traction outside of the US?

Chris Mizer: This concept is fairly new among US investors, and we expect a fair amount of growth among retail and institutional investors. It's a well-established asset class in Asia, especially in Japan and Korea where these kinds of structured financial products have broad distribution. About two thirds of global market is based in Asia and a fourth is in Europe. The balance is in the US, primarily between the largest financial institutions.

What are the potential risks associated with investing in alternative assets?

Chris Mizer: I think the biggest risk is lack of liquidity since you're really making a longer-term commitment, like any other sort of asset going to private equity or venture capital. There's a lockup period after which there are periodic opportunities for redemption.

The other risk is that investors could also be diluting returns by having a portion of the investment going to principal security if they were able to otherwise pick just the winners.

What are Vivaris Capital's areas of focus?

Chris Mizer: We have three areas of focus. We focus on classic merger acquisition buyouts for about 40% of our activity. We create growth for these portfolio companies through acquisitions along with new product and market extensions, and internal initiatives, though that is a portion of what we do. Another 40% lies in growth equity in technology. These could be companies that provide early stage, healthcare and life science products and therapies, applications of artificial intelligence, fintech, or other exponential technologies. The last class is real estate which accounts for about 20% of activity.

How has investment activity in real estate shifted?

Chris Mizer: We have seen a significant amount of institutional money go into real estate over the last few years. Cap rates are quite low because real estate offers security as well as cash-on-cash returns that are competitive with bond yields. Plus, you have the opportunity for some appreciation and leverage from debt financing.

There are fewer value-added opportunities compared to the past. You used to be able to purchase a building that was perhaps 70-80% leased out, improve the experience of the tenants with TIs, and max out in terms of occupancy. Now, such a property isn't nearly as plentiful as it used to be. Even marginal properties are selling for really high prices.

What do investors find particularly attractive or unattractive in terms of real estate as an asset class?

Chris Mizer: I think we're seeing a sector shift from corporate office spaces as Covid-19 accelerated the work from home plan as well as the subsequent movement out of big cities. For instance, the London financial services sector is going to reduce their footprint in the city by about 20% over the next four years, meaning a lot of offices are going to be vacant. Other hubs like New York are obviously following suit. Now, I would say multi-family asset classes are by far the most attractive among institutional investors.

Mature higher priced properties don't have a whole lot of room to grow in the short term, and I think there's going to be a couple years as some of the excess capacity and leverage gets worked out. Retail outlets may undergo repurposing to other mediums such as Amazon fulfilment centres or mixed use developments as many retailers have already declared bankruptcy.

What do you forecast for the rest of the year in terms of the attraction towards these specific products?

Chris Mizer: We are seeing a real increase in demand for these kinds of structured products for two reasons. The first is that alternative assets as an asset class, are becoming much more accepted in terms of overall portfolio allocation. If you go back 20 years, people allocated three to five to seven percent of their portfolio as alternatives, and that included private real estate, and venture capital and private equity funds etc. Now, the best performing institutions and family offices are allocating about 21-30% to alternatives. As the asset class grows, we see a lot more interest in people looking for ways to invest in it in a way that's sensible.

Secondly, we see more interest in structured financial products because the perceived risk to reward ratio of more traditional investments. The stock market is trading at historically unprecedented valuations that we haven't seen since the boom of the late 90s. Bonds have very low yields right now. Real estate is trading at incredibly low cap rates. Investors need to take a lot more risk to get a modest return and there is now a place for investors to put their money. Due to the overall shift in allocation of alternatives, we're seeing more growth, and because there's so few other places to gauge good returns right now, we're seeing more interesting alternative asset options.

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