



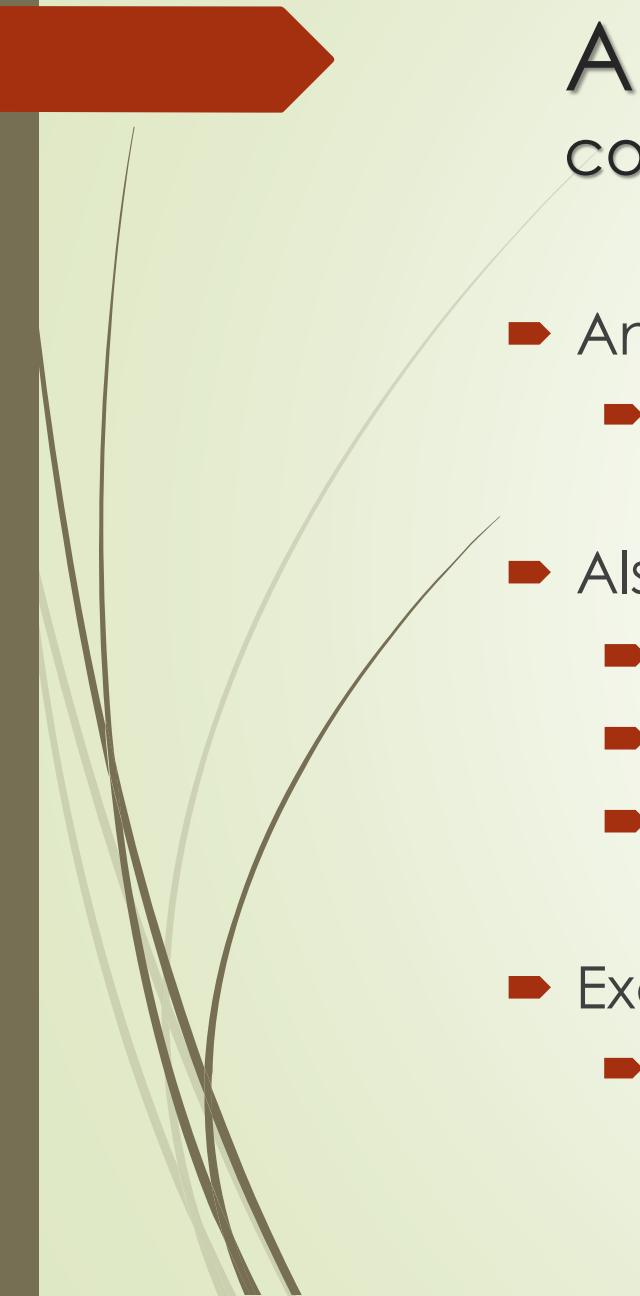
# **Benefits of Alternative Investments**

AAll Houston Chapter SIG – June, 2021



# Alternative Investments - Investopedia

- ▶ An alternative investment is a financial asset that does not fall into one of the conventional equity, income, or cash categories
- ▶ Private equity or venture capital, hedge funds, real property, commodities, and tangible assets are all examples
- ▶ Most alternative investments are unregulated by the SEC & tend to be somewhat illiquid
- ▶ While traditionally for institutional & accredited investors, alt investments have become feasible to retail investors via alt funds, ETFs & mutual funds



# A better “Working Definition”

comes from differentiating by Liquidity trade off

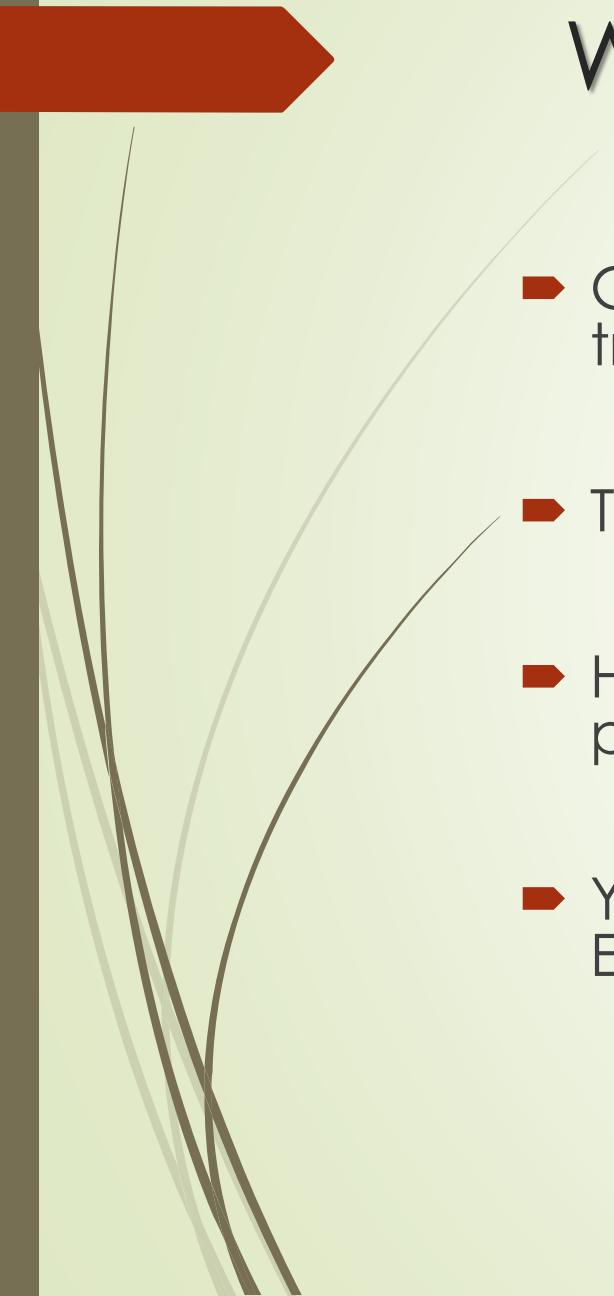
- ▶ Any private market alternative to a public market security
  - ▶ Stocks, bonds, commodities, options, managed futures, forex, etc
- ▶ Also Hedge funds
  - ▶ Relative value, typically Long/Short positions
  - ▶ Diversified as in macro strategies
  - ▶ Hedged or arbitraged positions
- ▶ Examples
  - ▶ Private equity, private debt, annuities, structured settlements, litigation financing, medical royalties, special situations e.g. cloud, etc



# Array of Alternatives - Wells Fargo Advisors

- ▶ Relative value/arbitrage\*
- ▶ Long/short credit & equities
- ▶ Structured credit/asset backed
- ▶ Macro - systematic or discretionary\*
- ▶ Event driven – distress credit or merger arbitrage\*
- ▶ Hedge Funds – directional or market neutral
- ▶ Private equity/debt
- ▶ All with terms sufficiently attractive to trade off liquidity

*\*Items asterisked have a Liquid Alternative but does it have a liquidity premium? For  
For this presentation we will define an Alt as one without liquidity*



# What's different about Alternatives?

- ▶ Generally, alternatives provide a better risk/reward profile as a tradeoff for tying up your liquidity
- ▶ There is no daily “mark to market” on private vehicles
- ▶ However, giving up liquidity forces more confident liquidity planning
- ▶ Yale led the trade-off to LT Alternative Investments for the Endowment world
  - ▶ Averaged 11.8% vs 6.8% peer growth for more than a decade
  - ▶ Almost all their peers have followed suit



# My Background

- ▶ Have been investing in Alternatives ~6 years
  - ▶ Have become very comfortable with them
  - ▶ They avoid being overallocated to Public Markets
  - ▶ This greatly reduces the angst of big market-decline periods
  - ▶ Sleep better at night!
- ▶ Plan to review three opportunities today:
  - ▶ Asset backed Notes
  - ▶ Hines Income Trust
  - ▶ Secondary Annuities

# Today's Case Studies

- ▶ Secondary Annuities
- ▶ Hines Income Trust
- ▶ Hall Real Estate Notes

## Previous Meetings:

- ▶ CAZ Investments (Chapter 10/2019)
  - ▶ Diversified private equity
  - ▶ Hi-Reward/Lo-Risk funds
- ▶ Laureola Life Settlements (SIG 08/2020)
  - ▶ Zero correlation Med-Reward/Lo Risk funds
- ▶ Kaplan MultiFamily Funds (SIG 09/2020)
  - ▶ Low correlation Real Estate private equity
  - ▶ Hi-Reward/Lo-Risk funds



# Hall Asset Holdings – Asset backed 8% Notes

- ▶ HAH is the vehicle for financing Craig Hall's real estate empire
  - ▶ National real estate firm based in Dallas
  - ▶ 40+ years of experience
  - ▶ 100% domestic projects
- ▶ \$50mm Bond Issue with coupon of 8% paid quarterly
- ▶ Term 5 years, 8 months
- ▶ Secured with \$510mm in Net Assets (10 to 1 coverage)
- ▶ First Lien secured on Dallas assets downtown & Frisco, TX

# HAH 8% Notes - Pros and Cons

## ► PROs

- Excellent risk/reward balance
  - Highly attractive returns for the very low risk level
- Accomplished & experienced developer
- Good financing & project management skills
  - Frisco fastest growing town in US
- Good collateral security & asset diversification
- Covenant to maintain minimum 20% liquid assets

## ► CONs

- Lack of liquidity but there are costly surrender conditions
- Inflation is an issue today & can erode the bond value
- Minimum size \$50k

# HAH Conclusion

- ▶ These are highly attractive fixed income vehicles
- ▶ They will compete with LT equity returns at greater safety levels
- ▶ 8% returns fit very well with tax-deferred retirement portfolios where dividends of 3-4% are standard & bonds are barely positive
- ▶ Contact:
  - ▶ Andrew Murdoch, broker
  - ▶ Based in Portland OR
  - ▶ Somerset Wealth Strategies
  - ▶ [amurdoch@somersetws.com](mailto:amurdoch@somersetws.com)
  - ▶ 800-813-4000
- ▶ Additional materials available



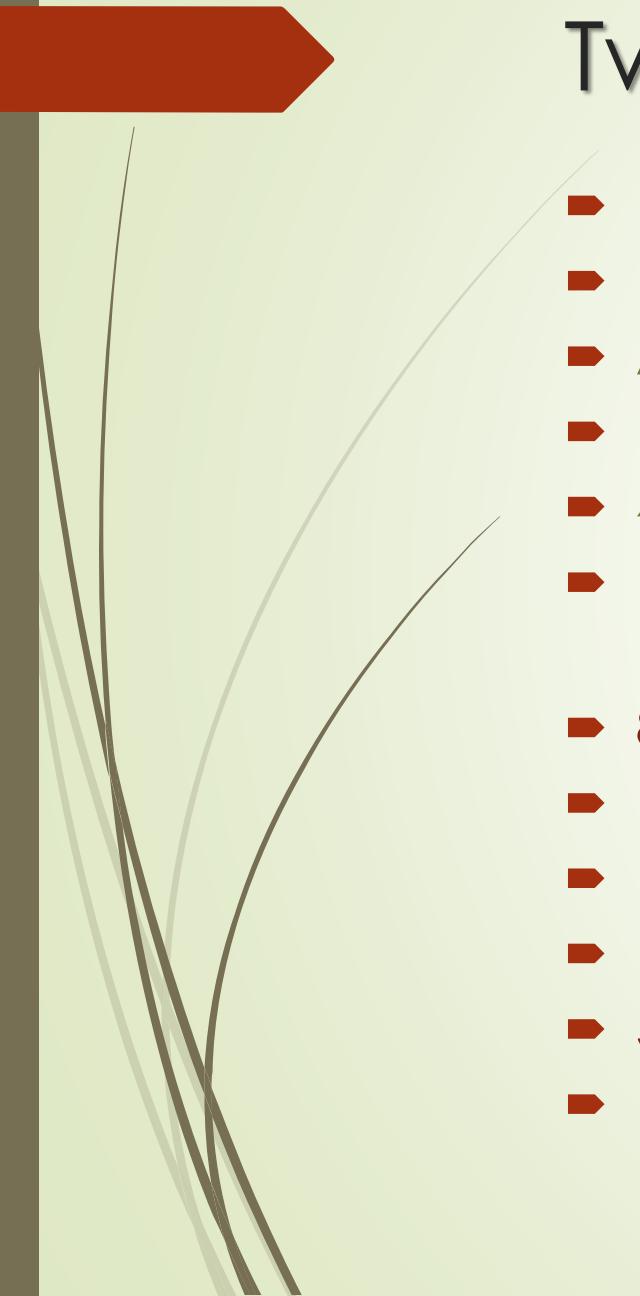
## Secondary Annuities

- ▶ Better returns than traditional annuities
- ▶ None of the obscene sales commissions of annuities
- ▶ Returns in the mid single-digit range
- ▶ Tax free by using Roth IRAs
- ▶ Top Tier Insurance Company holds & administers the payment stream
- ▶ Security is backed by the Ins Co with a formal Court Order & legal opinion
- ▶ Each case is an individual transaction
  - ▶ Function of \$ amounts & timing



# How these Transactions are Sourced

- ▶ An individual suffers a loss & is awarded damages under a legally documented settlement
- ▶ Typically, Hedge Funds buys the settlement from the individual for a fixed \$ amount
- ▶ By law, the transaction must be approved by a Court in the individual's Home State
- ▶ Payment stream is placed in the hands of a top tier Insurance Company to administer
- ▶ The Hedge Fund then sells the wrapped transaction into the Secondary Annuity or "Structured Assets" market
- ▶ Brokers will offer these opportunities to individual investors seeking cash yields &/or longevity insurance



## Two Examples of Secondary Annuities

- ▶ 10 year Prudential Insurance Annuity( 2017-26)
- ▶ Pays ~\$1,200 per month w/no COLA
- ▶ About half way through life cycle
- ▶ Purchased for \$117k in late-2015; pays out ~\$142k
- ▶ 4.25% tax free payout
- ▶ Used for income generation
  
- ▶ 8 year NY Life Insurance Annuity (2028-35)
- ▶ Pays ~\$5k per month w/3% COLA
- ▶ Not yet started drawdown
- ▶ Purchased for \$116k in mid-2015;pays out ~\$298k
- ▶ 5.8% tax free payout
- ▶ Used for income generation & longevity risk

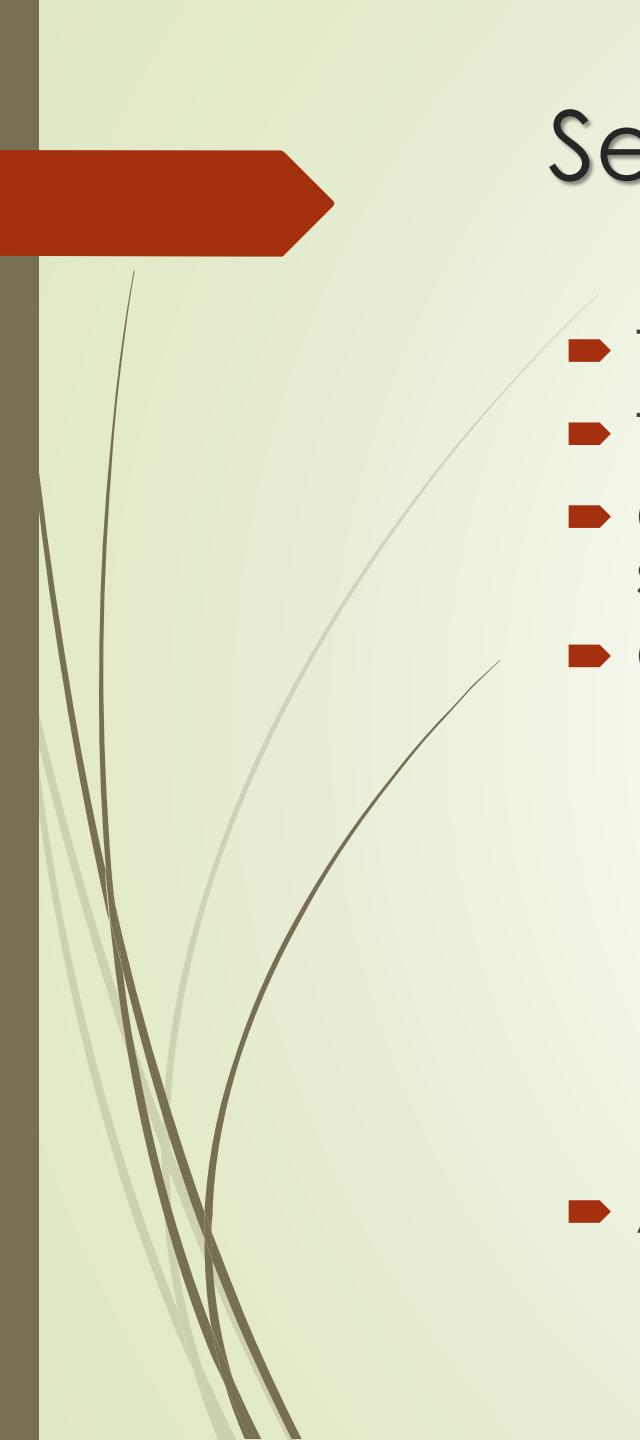
# Secondary Annuity Pros and Cons

## ► PROs

- Excellent risk/reward balance
- Attractive returns for the low risk level
  - Balance Sheet of Insurance Company
- Particularly if a Roth account is used to avoid taxes
- Accomplished & experienced broker (Somerset Wealth)
- Minimum participation is determined by size of CF stream

## ► CONs

- Lack of liquidity but can surrender for 4% fee after 1/1/19
- Inflation



# Secondary Annuity Conclusion

- ▶ These are highly attractive annuities with much lower fees
- ▶ They will compete with LT equity returns at greater safety levels
- ▶ Can customize the CF stream that fits your need for income security
- ▶ Contact:
  - ▶ Andrew Murdoch, broker
  - ▶ Based in Portland OR
  - ▶ Somerset Wealth Strategies
  - ▶ [amurdoch@somersetws.com](mailto:amurdoch@somersetws.com)
  - ▶ 800-813-4000
- ▶ Additional materials available



# Hines Income Trust

- ▶ Hines started RE developing in Houston in 1950's
- ▶ Now a global Real Estate behemoth
- ▶ Remained a private family-run business
  - ▶ with employees as shareholders
  - ▶ Leverage their properties up to ~60% with low cost debt
- ▶ Also sell private interests in the Hines Income Trust under Reg. D from time to time
- ▶ Units are REITs with ~7% returns
- ▶ Also have an equity kicker ~2% from appreciation in property leasing revenue

# Hines Income Trust - Pros and Cons

## ► PROs

- 7-9% income is a good medium-sized reward
  - Relatively low for equity risk
- Accomplished & experienced developer
- Good financing & project management skills
- Global asset diversification
- Have demonstrated growth in returns to offset inflation
- Very low minimum investment of \$2,500

## ► CONs

- Lack of liquidity
- There are monthly limited redemption facilities



# Hines Income Trust Conclusion

- ▶ Excellent track record
  - ▶ High achiever employees compensated partly in stock
- ▶ Operate in 225 cities in 25 countries
- ▶ 7-9% income is a good medium sized reward but relatively low for equity risk
- ▶ Interesting trade-off for Hall 8% bonds over this choice
  - ▶ ~1% higher reward for Hines
  - ▶ Hall credit is rock solid (10:1 Net Assets to Debt)
- ▶ Contact: Keen Butcher at Butcher Financial



# Butcher Financial LLC

- ▶ Another good firm in the Alternatives Business
  - ▶ Where I have invested
- ▶ Has good deal flow where you meet the issuing Principals
- ▶ Tailored to Income Generation needs in niche markets
- ▶ Butcher invests alongside you & monitors developments
- ▶ Contact:
  - ▶ Principal: Keen Butcher
  - ▶ Based: Houston
  - ▶ Phone: (713) 259-1798
  - ▶ E-mail: [keen@butcherfin.com](mailto:keen@butcherfin.com)

# Alternative Investments - Pros and Cons

## ► PROs

- All the attractions of traditional investments but improved risk/rewards
- Greater diversity in Portfolio & lesser market swings
- Potential tax opportunities by investing through IRAs

## ► CONs

- Lack of liquidity
  - Time your investments to meet your income needs
- Need to be selective on Terms & Conditions in due diligence
- Most insist on minimum investment levels



# Why make Alternative Investments?

- ▶ Take advantage of better investment risk/reward profiles than market vehicles
  - ▶ Both ends of risk/reward spectrum
    - ▶ Med-Risk/Hi-Reward and Lo-Risk/Med-Reward
  - ▶ Enjoy the benefits of better deals in the private markets
- ▶ Better portfolio diversity by lowering public market exposure
  - ▶ Lowers risk & improves returns
  - ▶ Lessens volatility & drawdown exposure when markets collapse
  - ▶ Avoids sequence risk early in your retirement years



# **Additional Questions?**



# Laureola Fund

- ▶ Private equity specialized mutual fund with \$36mm AUM
- ▶ Domiciled in Bermuda, operations in US, advisors in UK & elsewhere
- ▶ 100% focus on Life Settlement Policies
  - ▶ They only exist in the USA
- ▶ Model is to buy policies cheap, maintain them in a portfolio & cash them in as they expire
  - ▶ Fund has unique niche in sub \$1mm policies & with impaired lives
- ▶ Fund has 183% growth since inception; with 21.5% CAGR
- ▶ Highest month 7.3%; lowest month(0.3)%
  - ▶ Only one month with a loss in 5+ years!
  - ▶ Highest year 31.9%; lowest year 13.1%
- ▶ No bad debts; all highly rated US Insurance companies



# Laureola Fund – Tax Issue

- ▶ Section 408(a)3 of US Internal Revenue Code states that “no part of the trust fund will be invested in insurance contracts”
  - ▶ Cannot be held in 401(k)s or IRAs
- ▶ Three leading custodians and at least two tax attorneys have become comfortable in supporting Fund ownership:
  - ▶ Laureola is a mutual fund in which an investor subscribes so there is “no direct ownership of life insurance policies”
  - ▶ Life settlement business did not exist when S.408 was written
  - ▶ However, certain State rulings discourage investing in life insurance policies (AR, KY, OR)
- ▶ The IRS is chronically short of audit people
  - ▶ When IRS agents are assigned to jobs, they will always prioritize higher \$ potential than this small fund

**“IRS has bigger fish to fry”**



# Personal discussion with Midland IRA

- ▶ Midland emphasized that discussion was not a legal opinion and that we should not rely upon it:
- ▶ “They are very comfortable with Laureola & with other funds in this space
- ▶ They believe that owning shares in a mutual fund (or as a partner in a partnership) vs owning the policies/contracts directly is a key differentiator for them
  - ▶ This is why they became comfortable with being a custodian in this area
- ▶ They have been providing custodial services in this segment for a number of years & are very comfortable in adding new accounts for Laureola investors”

# Pros and Cons of Life Settlements

## ► PROs

- Good returns
- Low volatility
- Zero correlation to Public Markets

## ► CONs

- Illiquidity, tenure varies by fund
- Competition has driven down returns more recently
- Potential IRS challenge
- Minimum \$100k

# Laureola Fund Conclusion

- ▶ The Fund is a very attractive investment vehicle
- ▶ Performance has been stellar with very low volatility
- ▶ Not quite such a clear cut decision as the Hall Notes!
- ▶ Contact:
  - ▶ John Swallow, Investor Relations Director
  - ▶ Laureola Fund Advisors
  - ▶ Based in UK
  - ▶ Phone +44 (0) 7473 668 439
  - ▶ [John.Swallow@LaureolaAdvisors.com](mailto:John.Swallow@LaureolaAdvisors.com)
- ▶ Additional materials available