

# **ALTERNATIVE INVESTMENTS AND THE FINANCIAL TECHNOLOGY DISRUPTION WE'VE ALL BEEN WAITING FOR.**

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## IF YOU'RE OVER THE AGE OF 25, THIS WILL PROBABLY SOUND FAMILIAR:

**You want to watch a movie, so you decide to rent one from your local video store. Blockbuster would seem to be the obvious choice because they promote the greatest access to the most popular new releases. So you get dressed, get in the car and drive to the store only to find that the limited number of copies of the movie you want are all out. You begrudgingly select a different movie, drive back home, put the VHS tape into the VCR and discover that the previous renter wasn't kind and did not rewind. The tape is worn and glitchy, you fall asleep and miss the second half and now need to keep it another night so now when you return it, you're hit with a late fee and reprimanded because, alas, you also forgot to rewind. Ahh, the good old days...**

The system was bad, but at the time it was all we had, so we lived with it. Sometimes we even thought we actually liked it; we didn't know any better. The industry then took a small step when Netflix introduced the concept of DVDs by mail. We would need to plan our viewing selections days in advance, wait for the mailman to deliver then pack them all up on a Monday morning and drop them back in the mail. It was a dreaded weekly routine. No one could fathom that through the

magic of a technology disruption you would one day be able to stream that same movie directly into your home at any time of day and watch it on any device of your choosing.

But this is precisely the paradigm of technology disruption: we can't fathom an innovation until someone else does and presents it to us. So, let's talk about buying and selling alternative or private market investments, shall we?

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## ALTS INVESTING: THE FINAL FRONTIER FOR TECH DISRUPTION

If you thought the antiquated video rental system sounded cumbersome, the alternatives investing process will blow your mind. With nearly every other aspect of our lives completely disrupted and improved upon by tech, the fastest-growing asset class in the financial services sector somehow missed the boat on the digital era

(by a long shot). While investing in a stock, bond, ETF, or mutual fund has become a “point-and-click” experience, investing in an alternative asset bears greater resemblance to filling out a 1040 long-form tax return, then rushing to get it postmarked by April 15th. And yet, the market for alternative investments is on fire.

This begs some questions:

- ***What are the challenges holding back this asset class and why do they make us feel like we’re stuck in 1987?***
- ***Why and how has the industry struggled to provide authentic technology solutions that could fuel sector growth?***
- ***If the sector were to experience a true transformation, what would that even look like?***

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## WHAT ARE ALTS ANYWAY? AND WHY IS EVERYONE TALKING ABOUT THEM?

Anything that’s not a typical stock or bond is considered an alternative asset. Some alts are publicly available, offered in structures that range from mutual funds and ETFs to interval funds, real estate investment trusts, private equity, and hedge funds. Investments in equity or debt of privately owned companies (referred to as private markets) are also alts. Alts can even take the form of one-off niche investments like art, fancy cars or a wine estate.

Whether public or private, alts are sought after for their potential to diversify an investor’s portfolio and generate above-market returns. Morgan Stanley did a fascinating analysis of an annualized 30-year return for different portfolio combos (such as 50-50 stocks/bonds compared to 80-20 stocks/alts or 40-40-20 stocks/bonds/alts). Amazingly, the report found that adding alts to the portfolio mix amounted to a 0.5-1.5% increase in return and a reduced rate of risk.

Beyond their potential to generate higher returns, wealth managers have identified alts as an opportunity to demonstrate differentiated, opportunistic-driven strategies within their practices.

And investment managers are recognizing the opportunity to raise capital with advisors who are allocating higher percentages of alts than ever before and attracting new advisors who have just begun to incorporate alts into their client’s portfolios.

What’s more, that market itself is estimated to grow to \$23.3 trillion in 2027 from \$13.7 trillion in 2023 (Preqin). That’s a compound annual growth rate (CAGR) of 9.3%. In fact, Cerulli Associates report that wealth managers allocated 14.5% of their client’s assets to alt strategies in 2022, and plan to increase allocations to 17.5% in the next two years.

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# WHAT ARE THE ISSUES THAT HAVE KEPT US STUCK IN THE DARK AGES?

## LACK OF EDUCATION

Financial advisors have a fiduciary obligation to meet the needs of their clients, but it can be difficult to locate the right opportunities. They're trained to understand the value of stocks and bonds. But with thousands of alternative products on the market, which are the right ones? Who are the managers? What funds, strategies, and structures are they offering? And once a product is finally selected, how long will it take to get educated on the highly complex memorandums unique to that particular investment? And besides, how do alternative investments fit into a client's overall portfolio anyway?

## MISSED CONNECTIONS

Looking at it in reverse, investment managers are also challenged to locate the tens of thousands of financial advisors who are seeking these investment opportunities. Because they are often stratified in their own wealth management practices, the process of connecting with them is incredibly onerous. Sadly, this means parties with mutually aligned interests are left incapable of finding one another.

## STRAINED COMMUNICATION

Because alts are, by definition, alternatives to standard stocks, bonds and each other, they all exist within their own disparate ecosystems. No common language or technology connects the different parties. This forces investment managers, fund administrators, wealth managers, custodians, and even reporting aggregators to rely on cumbersome paper and manual interactions to communicate with one another. To complicate things further, many of these products are private—meaning all access to information must be stringently controlled due to regulatory and compliance considerations.

## AN UNFUNNY COMEDY OF ERRORS

In addition to the struggle of paper-based communications, advisors and investment managers face high error rates and processing challenges. Many subscription documents are completed by hand (some overup to 100 pages in length) and subject to intense supervision and compliance reviews. Processing times easily run six to eight weeks or more, with error rates approaching 60 percent. What other modern-day experience results in error rates of this magnitude?

## A BAD FIT

Once an investment and account have been established, a fresh problem presents itself: the value of the investment will not properly "fit" within any client portfolio management reporting software, making it difficult for clients to understand performance or the value of their portfolio as a whole.

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***There's not enough technological attention committed to connecting investing processes or streamlining the full capital life cycle.***

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## COMING UP SHORT

When you take stock of all these issues, a trend reveals itself. There are not enough investment managers who can afford to be represented on automated technology platforms. Not enough product structures that have technology solutions tailored to their specific needs (each having their own regulatory requirements and nuanced processes). Not enough opportunities for wealth managers to easily locate and include alts in their client's portfolios. Not enough returns that could otherwise be generated.

Not enough technology pointed at the need to eliminate the pervasive problems of friction and inefficiency. There's not enough technological attention committed to connecting investing processes or streamlining the full capital life cycle.

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***...there is far too much untapped opportunity being left on the table.***

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(What about managing an account after it has been onboarded? What about reporting? What

about transfers? Redeeming? Tendering?) There are not enough technology firms that truly understand the business issues, know what questions to ask and have the wherewithal to execute a solution. There are not enough wealth managers willing to deal with the heartburn until these challenges are resolved. And because of all these "not enoughs," there is far too much untapped opportunity being left on the table.

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## **BEWARE: SOLUTIONS THAT DON'T ACTUALLY SOLVE**

When an industry is so riddled with problems, there's no shortage of folks who will step in with promises to fix them. But all too often, these fixes are insufficient. Consider this analogy: When the movie rental industry transitioned from VHS to DVD, did it really solve all of the issues that plagued the consumer? Or did it merely provide superficial answers to a select few concerns? After all, DVDs were still vulnerable to scratches. Sending them back still required a trip outside. And renters were still held responsible for the ones that went unreturned. Perhaps there were marginal improvements, but many of the underlying issues still remained. It is in this same vein that several "solutions" have been proposed to fix the plight of the alt investments industry.

### **PDF PUFFERY**

Some have stepped up to offer users the benefit of e-signatures, promising a way to escape the paper-based slog of alts investing. But this is merely a band-aid of sorts because a PDF-based process only digitizes the miscommunication that's so rampant throughout the industry. It does nothing to solve the systemic issues behind it.

### **RESTRICTED ACCESS**

Others promise easy access to alts, only to reveal that the access is limited to certain products. This is because they are commercially backed platforms designed to keep investors beholden to particular product families.

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***They're preventing the industry as a whole from evolving by leading people to believe they're investing in "new and modern" technology when, in fact, they're simply providing "same but different."***

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### **HIGH COSTS**

And even still, implementing these alts technology "solutions" has proven costly. In fact, the fees alone can sometimes prove so disproportionately expensive that they lower the performance of the funds, thus eroding the brand of the investment and wealth managers who take these products to market.

These superficial tech solutions aren't simply making false promises. They're preventing the industry as a whole from evolving by leading people to believe they're investing in "new and modern" technology when, in fact, they're simply providing "same but different."

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## WHAT DOES A TRUE SOLUTION LOOK LIKE?

It's clear that a true industry-wide solution is needed. But for a system so fundamentally antiquated, what would that solution even look like? How would it need to work, and what exactly would it do?

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***Truly disruptive technology can create an opportunity for each party to compete and win.***

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### CONNECT THE UNCONNECTED

To create a harmonious, operational ecosystem, it's imperative to empower every market participant to connect with one another. By implementing technology to translate and unify the many disparate languages of each asset, it would be possible to transmit data in a method and format that makes sense for all parties, allowing information to move seamlessly and efficiently. This would eliminate the need to rekey the same information again and again, and ultimately, it would achieve true end-to-end connectivity between wealth managers, investment managers, fund administrators, transfer agents, custodial parties and reporting platforms.

### EMPOWER COMPLIANCE AND OPERATIONS

Enormous efficiencies can be gained by automating today's manual, error-prone processes, if only someone could figure out how to do it. Pulling data from one source to populate another, running data validation checks in real time, enforcing suitability requirements, dynamically routing transactions according to highly personalized workflows, and formatting data to be fed directly into internal or 3rd party systems would all enable compliance and operations to do what they need to do: systemically enforce policies, log and evidence controls, and streamline processes.

### CREATE VALUE, NOT COSTS

The implementation of well-thought-out technology has the potential to create truly transformational value. Imagine better investing experiences. Elevated brands and trust. Higher levels of efficiency that reduce the cost of doing business. Improved security and compliance. Growth for each party. Imagine an ecosystem where meritocracy rules. One where wealth managers can differentiate and grow their practices. Investment managers can unlock new distribution channels and market segments. And investors can achieve higher returns thanks to lower fees. Truly disruptive technology can create an opportunity for each party to compete and win.

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***A true solution must allow investment managers and wealth managers to select the services that support their respective strategies so they can be empowered to captain their own ships and chart their own course.***

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### BUILD YOUR BUSINESS

Not everybody works in the same way. A true solution must allow investment managers and wealth managers to select the services that support their respective strategies so they can be empowered to captain their own ships and chart their own course. Data rooms, selling agreement controls, offering materials. Electronic PPM delivery. Subscription. Supervision workflows. Electronic signatures. Maintenance. Transfers. Redemptions. Tenders. Account monitoring. Tax documents. Capital Calls. Distributions. All should be available and accessible.

And the same goes for partners. With the freedom to work with any and all preferred partners, every product structure, investment type and distribution channel becomes fair game. A true solution is one that can support the entire capital life cycle, making alts easier to buy, easier to own, and easier to sell.

Think of it this way: a turbo-tax-like experience where incorporating one's own brand, data, forms, compliance and operational processes, and other personalized dimensions enables an end-to-end digital experience for advisors and investors of all types.

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## A COMPETITIVE ADVANTAGE

It's hard to see beyond the circumstances of your current reality when you're smack in the middle of it. Think about it like this: most everyone in this sector is still in the Blockbuster. A few adventurous souls have progressed to renting DVDs. But meanwhile, Netflix has come up with the technology to deliver all-digital, unprecedented access to any and all of the video content one could ever ask for. As a consumer, this is a technology disruption of life-changing proportions.

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*Joe Ujobai is CEO of Alternative Investment Exchange (AIX), the only enterprise technology platform built specifically to transform the alternative investments marketplace.*

### COME FROM THE RIGHT PLACE

A technology solution designed to truly and completely disrupt the alts industry could never come to be without a comprehensive understanding of the industry's plight—without it, the fixes would surely miss the mark. The only people who can possibly know how to truly cure the plague of the alts industry, are those who have experienced it for themselves. They are the ones uniquely equipped with the know-how to forge the path forward—and with the empathy to show others the way.

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***Most everyone in this sector is still in the Blockbuster.***

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Now imagine how the industry could be transformed with the same level of unprecedented access to buy, sell, and manage alts products—free from the paperwork, the endless back-and-forth, the NIGOs, and the weeks spent waiting—and, ultimately, provide an unprecedented competitive advantage to those who embrace the change.

To learn more about how AIX could help you, contact us or [visit aixplatform.com](https://aixplatform.com)

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