US CAPITAL GLOBAL
ASSET MANAGEMENT & CORPORATE FINANCE ®

Social separation as a result of the global pandemic has accelerated interest in digital marketplaces and alternative income investments

The global pandemic is driving increased interest in digital marketplaces due to social separation disrupting the normal face-to-face investment sales process. Concurrent public market volatility has also driven a higher volume of inquiries into alternative investments. In this article, Jeffrey Sweeney, Chairman and CEO at US Capital Global, explains how the investment and wealth management industries are being compelled to consider what makes for a successful digital marketplace, and what is important when looking for an investment in alternatives.

By Jeffrey Sweeney, Chairman and CEO at US Capital Global

We are seeing increasing interest from the independent broker-dealer network and investment advisors considering alternative investments for their clients, and how to source and distribute those opportunities. Traditional avenues for private alternative investment distribution relied primarily on events, conventions, and retreats, bringing broker-dealer distributers and investment advisors together to showcase investments. Now, unable to distribute alternative investments in these traditional face-to-face or event-driven channels, there is an impetus to more rapidly embrace digital platforms and display methods for garnering interest in alternative investments.

Further pressure to adopt more contemporary digital distribution methods is exacerbated by what we see in the economy as an increasing demand for investments in alternative fixed-income securities. There are several important considerations in the adoption of digital marketplaces, not least of which is making sure there is appropriate vetting of both the security and the counterparties. The key is the value of the assets on the platform and the professionals in the ecosystem, not just the technology.

At US Capital Global, years ago we thought a more efficient and technologically innovative methodology for securities distribution was necessary to enhance our traditional methods of securities sales. In January 2016, the recent change in regulations to allow general advertising of private securities was the impetus for us to launch **our online digital private securities marketplace**. Our global experience with online digital platforms and corresponding digital marketing technology over the years has shown us what works and what doesn't.

Digital Marketplaces – It's about the Ecosystem

Increased demand for, and the disruption of, alternative investments in traditional sales channels is driving growth in interest and in the implementation of digital marketplace platforms. Using a digital marketplace isn't just about the basic website functionality; it's about the professional ecosystem behind the offered securities and the diligence around those securities by regulated counterparties and other financial professionals. Alternative investments are private placements, and there is a mature regulatory and best practice infrastructure around this sector that should be understood, respected, and adhered to. The ecosystem includes a full range of financial professionals and their functions, broker-dealers, financial advisors, valuation accountants, KYC services, transfer agents, custodians, lawyers, etc. As most of these professionals are licensed and regulated, they may provide various forms of third-party representation, due diligence, attestations, and warranties.

Risk Containment – Valuation

Investments involve risk. It is important to understand how regulated counterparties can and cannot mitigate risk. How an investor or advisor successfully mitigates risk can separate a smart and prosperous investor from someone who loses money. The regulated ecosystem and a digital marketplace can only do limited, but essential, things to mitigate certain aspects of risk. Risk mitigation provided by electronic or any regulated distribution channel can assist investors or their advisors to choose investments by providing adequate and accurate objective information on the investment opportunity itself and the quality of the counterparties offering that investment.

By ignoring the regulated ecosystem and relying solely on issuer-led investment representations, we believe an unnecessary level of risk is added to the equation. Risk is better understood through traditional and commonly accepted mechanisms of professional valuation ranges, verified financial reporting, and principal background and credit checks, to name a few. Other key elements of risk in private securities include fraud, misrepresentation, transaction security, visibility, and reporting. For fraud and misrepresentation, regulated broker-dealers are responsible for the due diligence to disclose bad actors, accurate financial representations, supply chain verifications, and a myriad of other assessments depending on the specific offering.

Counterparty Roles in Risk Containment

Here are three regulated counterparties to consider in risk containment of the underlying security: the financial advisor, the asset manager, and the custodian. Registered investment advisors are often the proxy for direct investor interest in private placements. Their role is to conduct investment analysis and make recommendations to investors about risk, rate of return and suitability. Is the asset fundamentally a good fit for the investor, his portfolio, and strategy? In the case of funds, collective investment schemes, and derivatives, they will rely on the role of the asset manager to conduct due diligence for suitability, fraud, sound financials, and clear risk disclosures.

The regulated asset manager is responsible for an accurate representation of the risks for balancing risk tolerance matched with potential rate of return for the investment. For traditional transactional security, issuers and investors rely on appropriately capitalized custodians and related licensed transfer agents to ensure that securities are safe and not lost or transferred in fraud or error. In traditional "electronic" markets (which may be managed by computerized ledgers), if there is an error, or some sort of transactional fraud, the records can be reviewed or audited and erroneous transfers corrected.

Finding Value – Alternative Investments

The current economic landscape is marked by modest returns and increased market volatility. In this landscape, focusing on best practices in alternative investments, especially private credit securities, can help to at least reduce the counterparty risk of these transactions so the investor or investment advisor can determine if this investment is appropriate for them. Alternatives are financial assets that do not fall into one of the conventional investment categories, such as listed stocks, rated bonds, and cash. Alternative investments include private equity, real estate, commodities, and derivatives contracts, not the publicly listed stocks and registered bonds of traditional investors. They are a standard component of institutional investor portfolio strategies, and are increasingly of interest to individual investors because they can have a low correlation with standard asset classes and offer potentially higher yields.

Developing an 'Alt' Strategy

What part should alternatives play in an overall strategy? It's all about balancing investor suitability and investment risk. Is the investment appropriate for a given investor's financial condition and investment goals and what is the probability of failure or loss? At US Capital Global, we prefer the following criteria for selecting investments:

- Strong, competitive position of company in their industry with diversified customer base.
- Good company leadership and management.
- Trailing cash flow or stress tested proformas to demonstrate ability to make general financial coverage as a secondary form of security.
- Assets available to liquidate in the event of default, to recover investment.

Investing "Digitally" in Uncertain Times

When we consider alternative investments, we don't have as many of the traditional high-touch market features that we are used to with conventional securities. Under these circumstances, it's key to leverage the financial professional roles behind digital marketplaces, and it's especially critical to focus on higher-value, asset and cashflow-rich opportunities when considering alternative investments.

555 Montgomery Street, Suite 1501
San Francisco, CA 94111 United States
Tel: +1 (415) 889-1010
www.uscapglobal.com
info@uscapglobal.com
@uscapglobal