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Alts Managers Are Missing the Boat on Family Offices

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[**Hannah Grove**]

Hannah Shaw Grove is chief marketing officer at iCapital Network.

Most private fund managers that target institutional and retail market clients are missing the boat on one of the most reliable investor groups that allocates to alternatives: single-family offices. Fund managers often overlook these sophisticated investors, mistakenly lumping them in with other channels and not recognizing the distinct characteristics that make single-family offices an attractive target audience – but one that nevertheless requires a specialized marketing approach.

Large single-family offices can rival institutional investors in size, though they rarely have the same bureaucracy found in similarly sized pension funds, foundations and endowments. At the same time, single-family offices can often be personality-driven and capable of moving quickly on new offerings – traits that are more commonly shared with individual investors. And they often expect the access and pricing privileges extended to large institutions.

Family offices get sandwiched between the institutional and retail marketing efforts

With such varied characteristics, family offices get sandwiched between the institutional and retail marketing efforts at many firms, a suboptimal situation for all parties that can cause the unique characteristics and dynamics of family offices to be viewed as a deviation from the norm rather than something worth accommodating and cultivating.

In iCapital Network's 2017 survey of single-family offices, nearly nine out of 10 respondents said they allocate 10% or more of their total portfolio to alternative investments, including private equity, hedge funds and direct deals. Nearly one-third of single-family offices allocate more than 15% to alternatives.

As a point of comparison, the 17 largest university endowments had an average allocation of 41% to private equity and hedge funds. The 73 largest state-sponsored pension funds allocate an average of 25% to alternatives, which includes a combination of private equity, hedge funds, real estate and commodities, according to Pew Charitable Trust data. Meanwhile, a moderate portfolio managed by an independent registered investment advisor allocated an average of just 5% to alternatives, according to Cerulli Associates. Such data puts single-family offices in a class by themselves.

Interestingly, the commitment to alternatives within family offices increases as the organization's leadership transitions to younger wealth holders. The single-family offices in iCapital's study that were run by second generation family members were more likely to maintain higher overall allocations to alternatives, more likely to be invested in private equity, hedge funds and direct investments, and more likely to increase those investments moving forward when compared to offices run by the first generation.

The more aggressive use of alternatives by second generation-led family offices can be traced, in part, to the wealth dilution that occurs when assets are passed from the founder to multiple heirs, prompting a keener focus on wealth accumulation strategies over and above wealth preservation techniques. Simply put, rising generations are looking for higher investment returns and view alternative asset classes, exposures and strategies as those with the greatest likelihood of delivering outperformance.

For fund managers to benefit from this development, they must understand the distinct priorities, investment appetite and decision-making cycles within each family office in order to provide a timely and curated selection of opportunities that fits the goals of the organization and the needs of the underlying family members.

As family offices change hands to younger leaders, winning their business is best accomplished with dedicated sales and marketing professionals who have the knowledge and flexibility to navigate the family office ecosystem and can adapt readily to evolving sentiments. This specialized focus allows for more personalized engagements, which can lead to stronger partnerships – and in turn maximize the relationship for both parties.