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# A case for broadening retail access to private markets

By Alfonso Ricciardelli

THE surge in retail investor activity in public markets is a well-documented phenomenon. Digital brokerage platforms and online learning channels are the primary drivers. They often give users the illusion that they can compete with large institutional investors and capitalise on market volatility.

Retail investors in the US comprised 25 per cent of total equities trading volume in 2021, which was nearly double the percentage reported a decade earlier, according to online investing platform Public.

In February 2023, retail investors across online platforms set a new all-time high for weekly inflows; US\$1.5 billion of retail assets poured into the market in a single week, Public reports.

Sadly but predictably, however, only a small minority of retail investors make money through day trading – between 10 and 30 per cent every quarter.

Yet every day, hundreds of millions of dollars are invested through online trading platforms, including those that allow risky binary options trading. Many of these platforms appeal to the same human instincts as sports betting platforms, emphasising the adrenaline of “winning” and “becoming

rich”, as if day trading was a certified tool to make money. Scores of financial influencers (finfluencers) blast “magic” trading tricks on social media, further pushing uninformed retail investors to day-trade.

Easy access to online platforms with limited controls creates an uneven playing field vis-a-vis institutional investors. Retail investors are, in effect, competing against professional institutional traders who have access to top research and data.

The result is the potential for an overwhelming amount of capital chasing the same opportunities in public markets, which may exacerbate stock market bubbles, as we witnessed in the GameStop short squeeze.

## Private markets: an alternative risk-return profile

Private market opportunities offer an alternative risk-return profile that could benefit a retail investor's portfolio through diversification. But these opportunities are often overlooked, and retail investors are underrepresented.

Several factors create a barrier to private markets that is difficult for retail investors to cross. First, private offerings are only available to accredited investors, who meet certain asset or income thresholds.

Second, high minimum investment requirements are common for most private market opportunities, including private equity funds. These requirements run contrary to traditional portfolio allocation recommendations of 5 to 10 per cent in alternative assets.

Finally, a general lack of information and education about private markets perpetuates the myth that private market investments are inherently riskier.

US regulations severely limit access to private offerings, allowing access to only accredited investors and a limited number of non-accredited. The regulators' intention is to protect investors with limited financial knowledge or limited available assets to allocate to less liquid investments. Less sophisticated investors are deemed to be more vulnerable in private markets due to the high level of customisation of investment opportunities.

Unsophisticated investors are able to access online trading platforms, however, including those that offer binary options.

These platforms are built and advertised in the same fashion as sports betting sites. Investors on these platforms typically lose money, data shows, and the odds are stacked against them in these markets, which are characterised



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PHOTO: REUTERS

by massive information asymmetry.

Ultimately, the notions that public markets are inherently less risky or that anyone with a laptop and an Internet connection is a knowledgeable investor are misconceptions. Behavioural finance has already debunked the myth that human beings are rational investors. We know that public market bubbles are exacerbated by investor “heuristics”, which are mental shortcuts or rules of thumb. Such bubbles may have become larger and more frequent since the increase in retail investor participation.

Something also needs to be said about higher minimum allocations. While there are some private market investment vehicles with low minimum investments, most opportunities require investments in the range of millions of dollars. If a traditional portfolio allocates 10

per cent to alternatives, an investor will have to hold substantial amounts of investable assets to access a single private market opportunity. It is hard to see how this does not limit opportunities for diversification.

## Insulated from daily investor sentiment

Private market investments, especially private credit, can offer returns that are not subject to daily market fluctuations, providing much needed diversification in an investor's portfolio. Private markets are more insulated from daily investor sentiment because their performance is driven by more fundamental factors. They present an opportunity for patient capital to be deployed to professionally sourced opportunities that are less correlated to public market oscillations.

In this column, I merely raise the

question of whether the current regulatory framework is conducive to better consumer “welfare”. That is not to say that retail investors should be allowed to seamlessly access private markets. In fact, education is key.

*An Introduction to Alternative Credit*, which I co-edited with Philip Clements for the CFA Institute Research Foundation, is a primer on the credit side. Service providers that offer private investments should offer retail investors more transparency and education.

Ultimately, a more balanced investment strategy that includes private market allocations – subject to well-informed investor decisions – could potentially offer a more stable and diversified portfolio.

The writer, CFA, is a co-founder of Noosk, a platform that allows users to share knowledge-based content