# XA Investments' Flynn Sees Rapid Growth In Interval Funds Using Alternatives

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed Kimberly Flynn, managing director of alternative investments at XA Investments. Read the Q&A below as Kimberly says that demand for alternative investments as a means of adding diversification to a portfolio has spurred tremendous growth in interval funds, whose limited liquidity makes them an ideal vehicle for many types of less-liquid securities. Flynn notes that there are 190 interval- and tender-offer funds in existence today, but that 27 new funds are in registration, many from companies just entering the interval-fund space. Flynn says it's still very early – 'maybe the second inning' – in the current interval-fund growth cycle, which will force investors and advisers to do heightened due diligence to make sure the new issues can perform up to expectations.

Kimberly Flynn

The podcast can be found on AICA's website by clicking here: [https://aicalliance.org/alliance-content/pod-cast/](https://aicalliance.org/alliance-content/pod-cast/)

CEFAdvisors will be holding their 46th consecutive closed-end fund, business-development company, and interval fund research call for the second quarter of 2023 on July 19th at 2PM Eastern Standard Time. Register to attend live or for the replay at CEFAdvisors.com/quarterly. The session is approved for 1.5 hours continuing education credit.

**CHUCK JAFFE:** Kimberly Flynn, managing director of alternative investments at XA Investments is here, and we're talking about interval funds now on The NAVigator. Welcome to The NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator is brought to you by the Active Investment Company Alliance, a unique industry organization that represents all facets of the closed-end fund industry from users and investors to fund sponsors and creators. If you're looking for excellence beyond indexing, The NAVigator's going to point you in the right direction. And today we are pointed directly at alternative investments and interval funds with Kimberly Flynn, managing director of alternatives at XA Investments, and you can learn about the firm at XAInvestments.com. If you want to learn more generally about interval funds, closed-end funds, and business-development companies go to AICAlliance.org, the website for the Active Investment Company Alliance. Kim Flynn, welcome back to The NAVigator.

**KIMBERLY FLYNN:** Thanks Chuck, great to be back.

**CHUCK JAFFE:** So we have seen a lot of interest in alternatives and that has led to more demand for interval funds, because alternatives, that's an environment where they can thrive, in interval funds. So explain just a little bit about the demand that we've seen, the growth we're seeing in this market, and why alternatives and interval funds are kind of a match made in investment heaven.

**KIMBERLY FLYNN:** Absolutely. So interval funds have been in demand, especially in the last 18 months, we all saw the performance of traditional stock and bond portfolios in 2022, and so it's helpful to understand what an interval fund can do that a mutual fund cannot. So interval funds are a type of closed-end fund, but it's a bit of a misnomer because they are open ended and continuously offered, and they're really a great house or wrapper for alternative investments that tend to be less liquid or even illiquid. And so the interval fund market is growing rapidly, especially among independent financial advisors who are looking to diversify their client portfolios, and the growth we've seen in the market is tremendous, interval funds are growing at about a compounded annual growth rate of 12%. We've seen the number of funds grow, the first interval funds came to market in 1993, and there really wasn't much adoption of that structure, partly because there wasn't as much demand for alternative investments in the Gogo stock days of the nineties and 2000s. So now in the market today there are 190 interval funds and tender-offer funds, tender-offer funds are just a similar sister structure to the interval fund, but 190 is quite a few. What we also observe is 27 new funds in the SEC registration process right now, so that market is just growing tremendously, there's a lot of new fund sponsors entering the marketplace, leaders in the alternative investment arena. For example, earlier this June we saw Brookfield file for an infrastructure tender-offer fund, which is really interesting in this environment right now where inflation is top of mind and infrastructure is a type of alternative that can benefit client portfolios in an inflationary environment.

**CHUCK JAFFE:** So we've got the increase in demand for interval funds, but we also have the increase in demand for alternatives, and a lot of that has been driven by what we've seen happening broadly on the market, et cetera. So explain how those two things have happened, what we've seen and what that's meant in terms of the proliferation of alternatives, and specifically the types of alternatives that we're now seeing that much more demand for.

**KIMBERLY FLYNN:** Yeah, I think in the last 10 or 15 years there's been talk of giving individual investors access to alternatives, but it's been largely liquid alternatives, things like commodity futures or managed futures. But really true institutional alternatives, things that you might find in a pension or an endowment fund, things like private real estate, private credit, private equity, those were alternatives that could really only be accessed in a private fund format. And you know, really what's important now today is that the burden for saving for retirement has shifted squarely to each person's own shoulders. With the decline in defined benefit plans in the US and the rise of 401(K)s as the method for people saving for retirement, what people don't realize is, is with that huge macro shift in the market came a change in terms of the vehicles or the engines for growth in terms of retirement savings. Pension and endowment funds have long been using illiquid alternatives to drive higher total returns, but individual investors need similar opportunities and need access to some of these higher returning strategies. And if you think about what's in your 401(K), it's mostly traditional strategies in a mutual fund type package, and the mutual fund wrapper just doesn't work for things like private real estate or private equity.

**CHUCK JAFFE:** With the growth of interval funds, we've seen more demand for alternatives, we see that folks want to get them in the right way, but do folks, especially the retail public, but even some of the financial advisors, truly understand what they're getting? I mean, we've got the new funds but the funds haven't really been stress tested at this point, and a stress test is when an interval fund is going to make people who aren't used to it go crazy.

**KIMBERLY FLYNN:** Well, I agree with you, and so the retail investor experience with alternatives is limited, and that's why there's a lot of focus from fund sponsors on education in terms of how you should be using alternatives in the portfolio. In a diversified portfolio they have a role to play, but because of the illiquid nature, that's really the risk, Chuck, that I think you're putting your finger on. You can't count on being able to sell these investments in any given week or any given quarter, investors need to be thinking about a long-term allocation to alternatives and the interval fund structure allows them to access it in a 1940 Act registered closed-end fund structure that has a lot of benefits like a 1099, so that's better than getting a K-1 with a private fund, but nonetheless, the use of those alternatives does come with tradeoffs around liquidity. Most of the interval funds have a mechanism for allowing investors in on a daily or monthly basis, but the exits can be limited to quarterly, subject to proration. And so you want to be thinking about an allocation to alternatives that's longer term in nature so that to the extent that you needed to sell securities, you wouldn't be relying upon the interval fund allocation for that liquidity. So it's really important that fund sponsors be talking with financial advisors, and then consequently financial advisors be talking with investors, because I think the allure of higher returns coming from alternatives is why there's a lot of interest in growth, but there is this risk, there is this tradeoff that is very real and we want investors to understand that tradeoff.

**CHUCK JAFFE:** We do, because of course in the past retail investors didn't have access to alternatives, that's what they're getting through this. That said, they're still called alternatives, although depending on who you talk to they can be large chunks of a portfolio. They're alternative by asset class, but they're mainstream when you're saying, "Hey, you should have 10-20% of a portfolio in alternatives." So what kind of growth have we got, both for alternatives and for intervals when it comes to alternatives? Because not every alternative needs the interval structure or benefits from that liquidity lock up because it needs it to be a better investment. So are we getting to a spot where we're going to come close to saturation or what we see? Or the industry will throw a bunch of stuff out there and then we'll see in time what sticks?

**KIMBERLY FLYNN:** We've already seen a product evolution, so a lot of financial advisors have been using the REIT structure, the BDC structure, I know you talk about those types of investments on your program. And the reason that investors like those types of alternatives is that there is ease of access, but a REIT can only hold real estate and a BDC can only hold loans of US private companies, and so they're limited. An interval fund is really open to any asset class, so you could have a private credit strategy. Now we do see a lot of, you're talking about these alternatives moving into mainstream, private credit I think is an area which has moved faster, farther into the mainstream than things perhaps like infrastructure or venture capital. But there's a lot of appeal for these types of alternatives that you can't find in a REIT or a BDC wrapper, and so we think that it's really early, maybe second inning on the interval fund market just in terms of what we expect to see more of. Because it can house any structure, any strategy, you're seeing a lot of alternative managers and also a lot of traditional investment managers say, "Hey, what strategy do we run that's going to fit in this structure?" Because the SEC won't let you put something that's highly liquid or that should otherwise be packaged up into a mutual fund for investors, so you're really going to see a wide variety across the liquidity spectrum of different types of alternatives from a host of different managers. And so among that, like you said, there's not enough track record right now to figure out which are the best performing, which are the worst performing, and a lot of financial advisors are relying upon the track record of the fund sponsors themselves. So it does require additional due diligence before investors or advisors can get comfortable because these are relatively new products.

**CHUCK JAFFE:** Well, second inning means there's a lot more that we're going to have to talk about, we'll have to do that down the line as we watch how it plays out. Meanwhile, Kim, thanks so much for joining me on The NAVigator.

**KIMBERLY FLYNN:** Thanks Chuck.

**CHUCK JAFFE:** The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. And yes, I am Chuck Jaffe and you can check out my show by going to MoneyLifeShow.com or by looking for it on your favorite podcast app. To learn more about interval funds, closed-end funds, and business-development companies go to AICAlliance.org, the website for the Active Investment Company Alliance. They're on Facebook and LinkedIn @AICAlliance. Thanks to my guest, Kimberly Flynn, managing director of alternative investments at XA Investments. The firm is online at XAInvestments.com and on Twitter @XAInvestments. The NAVigator podcast is new every Friday, follow along on your favorite podcast app to make sure you don't miss an episode. We look forward to bringing you more closed-end fund talk next week, and until then, happy investing everybody.

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