RESEARCH
Q4 2017

iCapital NETWORK

SINGLE-FAMILY OFFICES AND ALTERNATIVE INVESTMENTS

Single-family offices, the ultra-private organizations that help the world's wealthiest families oversee their financial and personal affairs, are experienced investors in private equity funds, hedge funds and direct deals.

As founding generations transition their leadership responsibility to successors, an increased appetite for wealth accumulation is emerging and helping to fuel interest in alternative investments as a means to asset growth.

KEY FINDINGS

- **87% of single-family offices surveyed allocate 10% or more** of their total portfolio to alternative investments, including private equity, hedge funds and direct deals.

- **Private equity funds are the most popular type of alternative investment,** with about 41% of single-family offices maintaining exposure, followed closely by hedge funds (39%). About a quarter of single-family offices invest in private companies on a direct basis.

- **About 90% of single-family offices maintained or increased their private equity exposure over the past year,** whether through funds or direct investments. Conversely, the majority (56%) decreased their hedge fund allocations.

- Looking ahead, **66% of single-family offices plan to increase their direct investments,** 47% plan to increase their private equity fund investments, and 37% plan to boost their hedge fund exposure.

- **Single-family offices who have transitioned leadership to the second generation of family members tend to maintain higher allocations to alternatives than first generation family offices,** with 18% of second generation single-family offices allocating over 20% of their total portfolios. **In addition, they tend to make greater use of the full range of alternative investments and have a particular propensity for direct deals,** with 71% having increased their direct allocations relative to last year and 82% intending to do so in the future.

SINGLE-FAMILY OFFICES AND ALTERNATIVE INVESTMENTS

iCapital's 2015 research on single-family offices revealed strong activity and interest in the private equity (PE) asset class, with six out of ten family offices surveyed in that report investing in PE either through funds or on a direct basis. About three quarters of the single-family offices we spoke with further reported that their private equity investments had outperformed their other holdings, and as a result the majority expected to increase their allocations over the following two years.

In light of this and of the fact that alternatives have become a larger part of the investment dialogue over recent years, we conducted follow-up research on this notoriously private cohort to learn more about their interest in and experience with a broader group of alternative investments, including private equity funds, hedge funds and direct deals. In order to make meaningful comparisons, we defined a single-family office as:

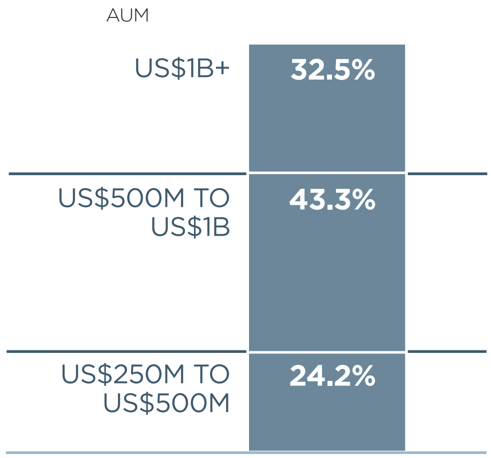
- a separate legal entity distinct from other operating companies and businesses of the ultra-wealthy family
- an entity that serves as a primary source of investment management services either directly or through select third-party managers
- an entity that the ultra-wealthy family refers to as a "family office".

To be included in this study, the single-family offices were actively investing in private equity funds, hedge funds, direct deals or a combination thereof. "Direct deals" as used in this report covers investments in small- and mid-size privately held companies, startups, and other private assets such as intellectual property rights and royalties, but excludes private real estate investments.

In this report, we share data collected from 157 single-family offices during the second half of 2016 and the first half of 2017. Three quarters of the respondents manage $500 million or more (Exhibit 1), providing a perspective of significant wealth that warrants institutional-level investment research and exposures. While these organizations cater to the financial and lifestyle needs of ultra-wealthy families, they tend to behave more like institutions than high-net-worth investors. However, the complexities of managing multi-generational constituencies, as well as the high degree of investment autonomy that family offices enjoy, make for a unique investor profile that requires a dedicated strategy and service offering.

Single-family offices tend to behave more like institutions than high-net-worth investors, but the complexities of managing multi-generational constituencies and a high degree of investment autonomy make for a unique investor profile that requires a dedicated strategy and service offering.

EXHIBIT 1 | **Assets Under Management**

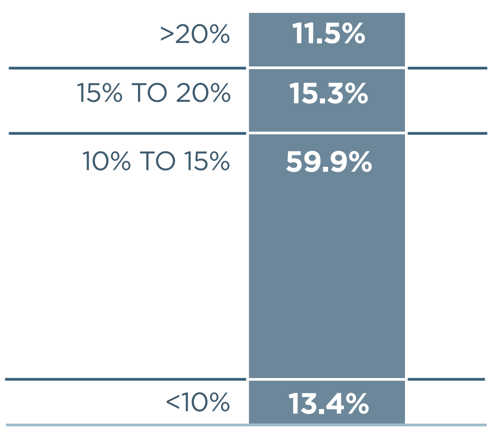


N = 157 SINGLE-FAMILY OFFICES

ALTERNATIVE INVESTMENT ALLOCATIONS

Approximately 87% of single-family offices we surveyed allocate at least 10% of their total portfolios to alternatives. About a quarter allocate 15% or more to alternative investments, consistent with the target allocations of many institutional investors (Exhibit 2).

EXHIBIT 2 | **Percentage of Financial Assets in Alternative Investments**



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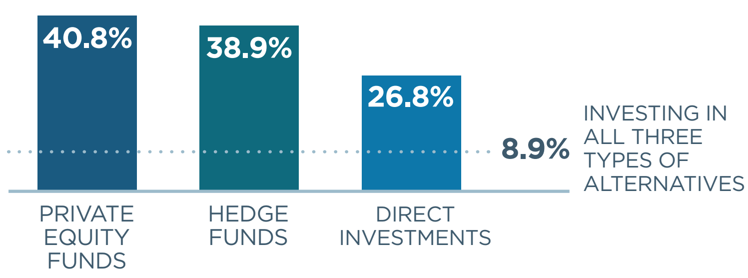
Single-family offices are also comfortable working with a broader range of alternatives than are normally found in high-net-worth portfolios. About two fifths of the family offices we surveyed invest in private equity and hedge funds, and a quarter invest directly in private companies, which may include co-investing alongside managers as well as 'club' deals with other family offices (Exhibit 3). This breadth of exposures more closely approximates institutional strategies than those typically implemented in the high-net-worth channel.

> "Single-family offices are in a unique position in that they have large sums of patient capital and generally lack significant payout commitments. As a result, they have become very comfortable trading liquidity to capture incremental return, and are able to embrace volatility and complexity to their advantage in periods of market dislocation."
>
> **— Lawrence Calcano**
> Chief Executive Officer,
> iCapital Network

EXHIBIT 3 | **Types of Alternative Investments**



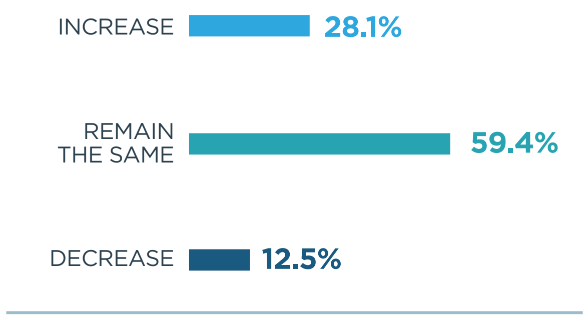
N = 157 SINGLE-FAMILY OFFICES

ALLOCATION CHANGES FROM LAST YEAR

With the investment landscape becoming ever more complex and a number of longstanding investment paradigms facing an uncertain future, it has become increasingly difficult to meet portfolio goals using traditional means. With the intent of better understanding how single-family offices are responding to this environment, we isolated those single-family offices that are active in each of the three kinds of alternative investments—private equity funds, hedge funds and direct deals—and compared their current allocations to those of one year ago.

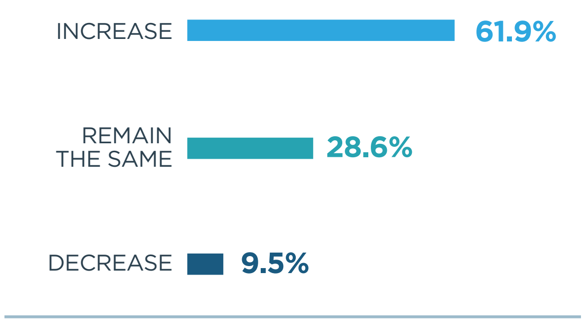
We found that about 90% of single-family offices maintained or increased their private equity exposure, whether through funds or direct investments (Exhibits 4 and 5). Conversely, the majority had decreased their hedge fund allocations (Exhibit 6). This shift away from hedge funds is consistent with the behavior of many institutional and HNW investors who have reduced or eliminated their hedge fund exposure in response to the general underperformance of hedge funds relative to long-only equities over the past several years. However, while retail investors have moved money into public equities, most institutions have tended to favor the private markets, likely chasing the illiquidity premium. In this respect, the allocation changes of single-family offices over the past year again place them closer to the institutional end of the investor spectrum.

EXHIBIT 4 | **Private Equity Funds Allocation Change From Last Year**



N = 64 SINGLE-FAMILY OFFICES

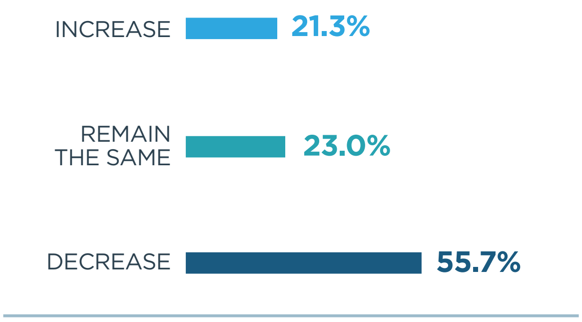
EXHIBIT 5 | **Direct Investment Allocation Change From Last Year**



N = 42 SINGLE-FAMILY OFFICES

> "Unlike private equity fund managers, single-family offices are not constrained by fixed fund lives and often have a longer time horizon when making private company investments. In addition, many single-family offices offer specific industry expertise and proprietary networks from their own experience establishing and growing businesses. Family offices' ability to deliver value beyond simply writing a check, combined with the flexible nature of their capital, can be very appealing from the perspective of company management."
>
> — **Nick Veronis**
> Co-Founder, Managing Partner and Head of Origination & Due Diligence, iCapital Network

EXHIBIT 6 | **Hedge Funds Allocation Change From Last Year**



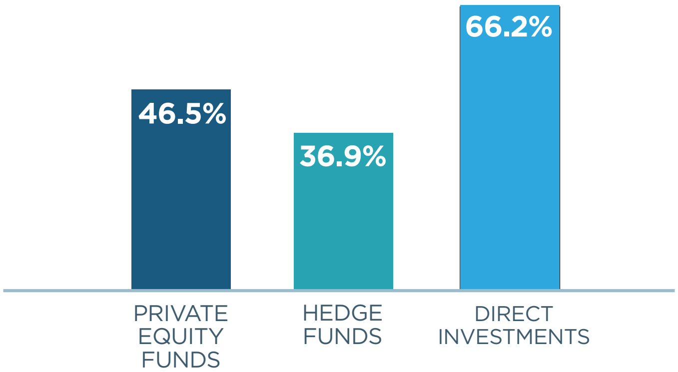
N = 61 SINGLE-FAMILY OFFICES

> **"As smaller hedge funds have established a stronger track record of capturing alpha, a growing number of family offices are increasing their in-house investment staff in order to replicate that success, while selectively seeking partners to help source and vet undiscovered third-party managers."**
>
> **— Eileen Duff**
> Managing Partner and Head of Distribution, iCapital Network

LIKELIHOOD OF INCREASING ALTERNATIVE INVESTMENT EXPOSURE

Looking ahead, we queried the survey population about their intentions for their alternatives allocations over the next three years. Single-family offices are generally interested in increasing exposure to alternatives across the board (Exhibit 7). The role these investments can play in both mitigating risk and enhancing returns is a major driver of their appeal, particularly in today's investment environment. Direct deals are particularly appealing, with two-thirds of the single-family offices surveyed indicating they will participate in more of these transactions going forward (Exhibit 7). One potential reason for the heightened interest in direct investments is the long history of entrepreneurialism within the family office community and the desire to preserve that legacy for future generations. Most family wealth is created through entrepreneurial means, and over the years many single-family offices have developed a particular expertise and presence in specific fields, such as real estate development or manufacturing, allowing them to exploit competitive advantage in areas that they understand well and that align with the family's history and interests. Another reason for the shift towards direct deals is the desire to avoid the fees associated with gaining private equity exposure via third-party funds.

Exhibit 7 | Likelihood of Increasing Investments



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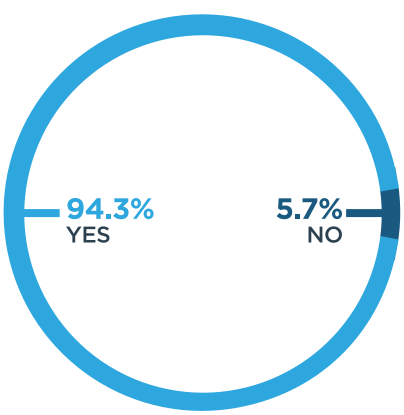
TAX MITIGATION

With tax policies and privacy protocols in motion globally, it is unsurprising that essentially all single-family offices we spoke to are very interested in ways to legally lower the taxes associated with their alternative investments (Exhibit 8). Most single-family offices calculate investment performance on an after-tax, after-fees basis, and are continuously taking steps to minimize investment taxes.

Exhibit 8 | Very Interested in Ways to Mitigate Taxes on Alternative Investments



N = 157 SINGLE-FAMILY OFFICES

"Strong investment performance is complemented by thoughtful tax planning, which can play a central role in preserving and enhancing wealth. We are continually evaluating new strategies, creative structuring and the trend toward more cross-border operations in the ongoing search for tax efficiency."

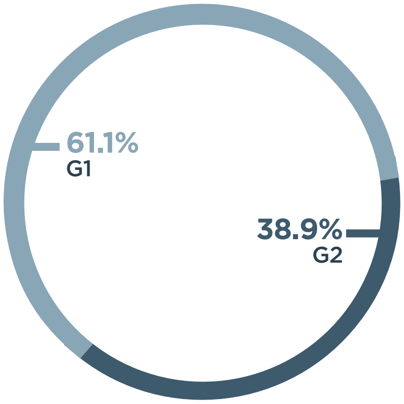
— **Ellie Peters**
Business and Growth Strategist at family investment firm, FFO, LLC

One of the key issues that many single-family offices encounter is a lack of tax planning coordination across various parts of the organization. Family offices are often structured such that discrete groups manage the investment portfolio, the family's philanthropic activities, estate planning, and so on. Increasing visibility and coordination across these functions, together with the use of products such as private placement life insurance and planned giving vehicles such as charitable lead trusts, can aid greatly in minimizing taxes on capital gains.

GENERATIONAL PERSPECTIVES ON ALTERNATIVE INVESTMENTS

With many established single-family offices beginning to transition day-to-day control of operations to second generation family members, the investment preferences of the younger generation are becoming increasingly relevant. In order to learn more about how the two generations view alternatives, we segregated family offices still managed by founding family members (G1) from those that have transferred control and legal ownership of the family office to the second generation (G2) (Exhibit 9).

Exhibit 9 | Generation



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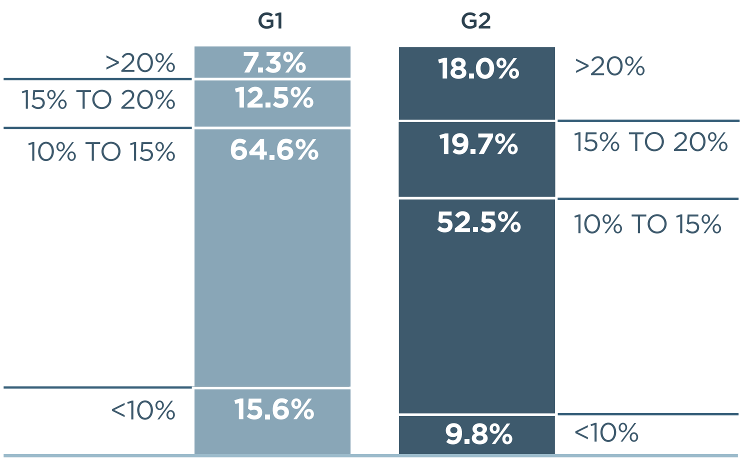
One of the key insights from our research is that second generation-led single-family offices are significantly more interested, active, and likely to increase allocations to alternative investments. This was evidenced by their proportionally greater commitment of financial assets to alternatives, greater use of different kinds of alternative investments, and relatively greater increase in allocations to alternative investments over the previous year, particularly in hedge funds and direct investments in privately held companies.

> "Single-family offices today span several generations, and younger family members bring a different attitude to wealth. The notion that the family office should be actively generating wealth in the same way the original family business did is prevalent, and there is a recognition that one cannot grow intergenerational wealth with an average approach. As a result, these second-generation family offices are constructing increasingly sophisticated multi-asset class portfolios that are global in scope and weight heavily to alternatives."
>
> **— Keith M Bloomfield**
> CEO and Founding Partner of family investment firm, Forbes Family Trust

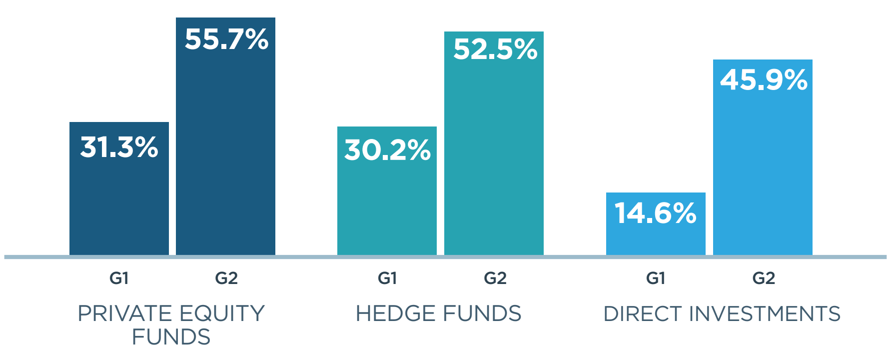
About 40% of second generation single-family offices are investing 15% or more of their total portfolios into alternatives, compared to 20% of first generation single-family offices that are investing at similar levels (Exhibit 10). This difference is driven by a sophisticated subset of second generation family offices who are allocating over 20% of their financial assets to alternatives. Second generation single-family offices in general are also inclined to invest in more types of alternatives, particularly direct deals (Exhibits 11.1, 11.2).

Exhibit 10 | Generational Split— Percentage of Financial Assets in Alternative Investments



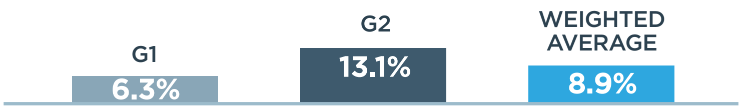
N = 157 SINGLE-FAMILY OFFICES

Exhibit 11.1 | Generational Split— Types of Alternative Investments



N = 157 SINGLE-FAMILY OFFICES

Exhibit 11.2 | Generational Split—Investing in All Three Types of Aternative Investments



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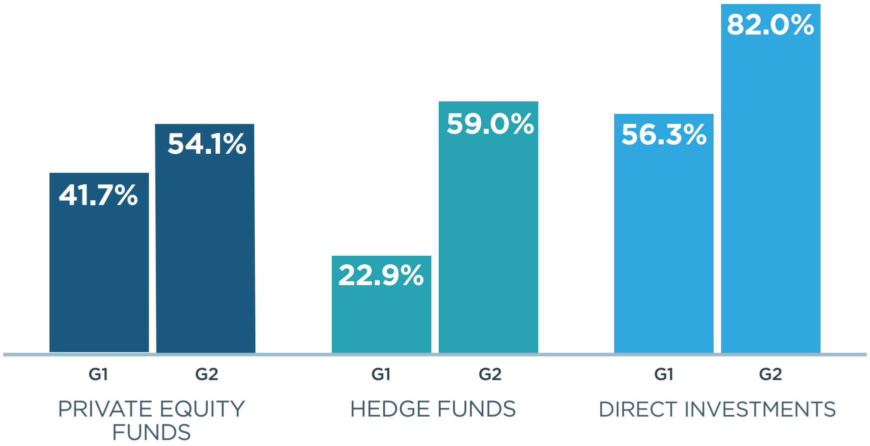
Going forward, a larger percentage of second generation single-family offices are much more likely to make greater use of the full range of alternative investments, with the biggest generational distinction occurring with direct investments, followed by hedge funds (Exhibit 12). These forward indications mirror what family offices have actually done over the past year. Almost a third of second generation single-family offices surveyed increased their hedge fund exposure, compared to just a tenth of first generation single-family offices (Exhibit 13). Even more striking, 71.4% of second generation family offices increased their direct investment allocations relative to last year, compared to less than half of the first generation family offices surveyed (Exhibit 14).

Exhibit 12 | Generational Split—Likelihood of Increasing Alternative Investments



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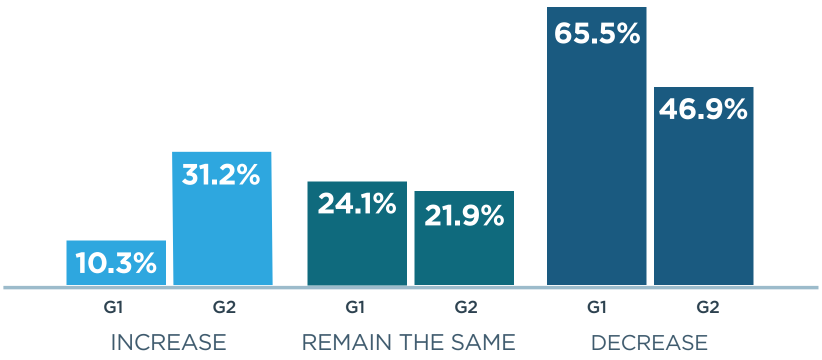
"Younger generations are technologically savvy, operate in real time, value entrepreneurship and prize relationships. They typically prefer to exercise greater control over operations than former generations did and understand the importance of efficiencies and connectivity. Especially in light of increasing return and volatility headwinds, they have adopted an opportunistic mindset and are focused on enhancing their investment and wealth management capabilities, while keeping fixed costs low."

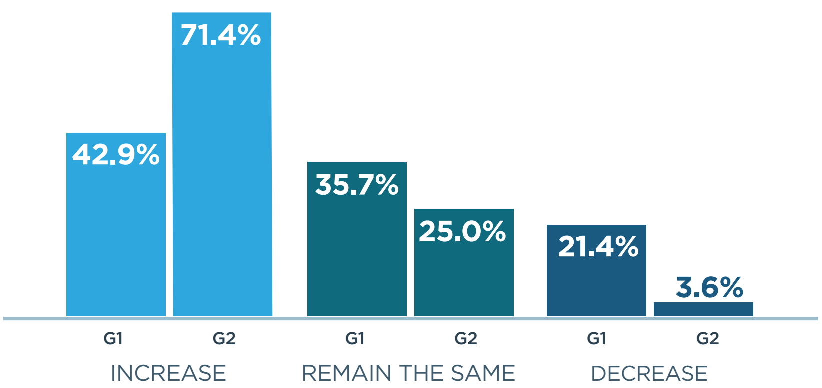
— **Usha Bhate**
Executive Director,
Family Office
Investor Relations,
Institutional Investor, Inc.

Exhibit 13 | Generational Split—Hedge Funds Allocation Change From Last Year



N = 61 SINGLE-FAMILY OFFICES

Exhibit 14 | Generational Split—Direct Investment Allocation Change From Last Year

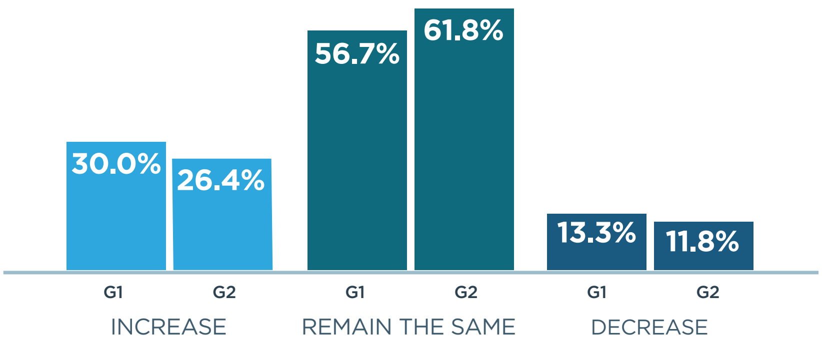


N = 42 SINGLE-FAMILY OFFICES

"Single-family offices have varying goals with their direct deal programs—some are looking to diversify away from the traditional family industry, while others may be trying to find strategic investments that can generate synergies with the family business or simply utilize their expertise in a particular sector to uncover overlooked gems. But in general, they are all seeking to access assets that can grow much faster than standard stocks and bonds, and often, faster than the alternative investments they make via third party funds."

— **Hannah Shaw Grove**
Managing Director and Chief Marketing Officer, iCapital Network

Exhibit 15 | Generational Split— Private Equity Funds Allocation Change From Last Year



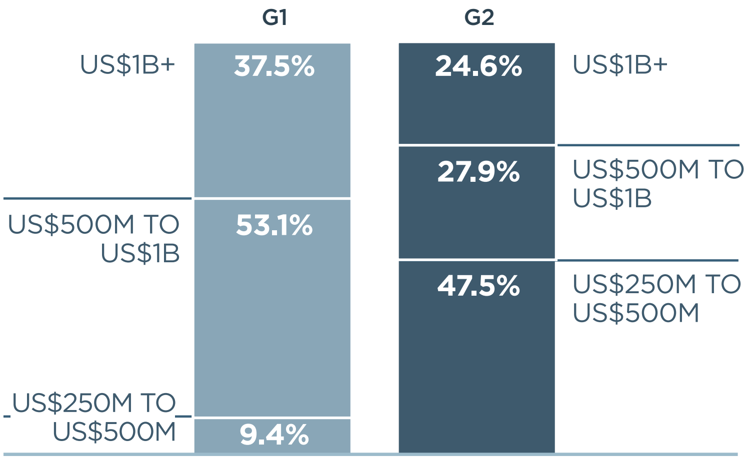
N = 64 SINGLE-FAMILY OFFICES

There are several possible reasons for the more aggressive use of alternatives by second generation-led single-family offices. First generation family offices are generally established with the intent of overseeing and protecting much of the family's financial assets, but may not be seen as significant engines of wealth creation. Family office founders by definition have amassed their personal wealth through other business ventures, in contrast to their heirs who, while they may have established professional careers, often view the family office as a more meaningful driver of their wealth and are thus relatively more interested in employing alternative investments to actively grow assets. The varied and often extensive professional experience of heirs is also a driving force behind the growing institutionalization of many family offices, as these younger family members seek to adopt the best practices they have encountered in other organizations.

We also noted a pronounced overall difference between the two generations with respect to the assets they are managing. Generally speaking, the first generation single-family offices are investing greater sums. Nearly half of second generation family offices manage between $250 million and $500 million, the lowest AUM band, compared to 9.4% of first generation family offices (Exhibit 15). Slightly more than half of first generation single-family offices fall in the intermediate range of $500 million to $1 billion AUM, compared to only about a quarter of second generation family offices, and more first-generation family offices are managing over $1 billion as well (Exhibit 16).

> "As single-family offices insource more investment functions and look to leverage their competitive advantages in the marketplace, they will need to hire dedicated staff and incorporate more risk management and stress testing into day-to-day processes. Family offices that are institutionalizing in this way require a range of services that have been historically been associated with full-fledged asset managers and go far beyond the traditional advisory relationship, including prime brokerage and specialized reporting capabilities."
>
> **— Angelo Robles**
> Founder and CEO,
> Family Office Association

Exhibit 16 | Generational Split— Assets Under Management



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These differentials are driven in part by wealth dilution from the founder of the family office to multiple heirs. Lesser absolute amounts of wealth may also be contributing to the shift in mindset from wealth preservation to wealth accumulation, driving a reexamination of investment strategies and allocations as well as institutional best practices. Simply put, second generation single-family offices appear to be actively looking for higher returns and expect alternative investments to provide them.

"Our goal is wealth generation via long-term outperformance, and over the years it's become clear that high quality, meaningfully sized private capital allocations, as popularized by the endowment investment model, are important to achieving that. What's also become clear as we've gained experience with less-liquid alternatives is that it's critical to be able to identify and access top quartile managers — it's only the top tier PE and VC firms that really deliver on the value proposition and are able to drive that outperformance."

— **Peter G Sasaki**
Managing Member of family investment firm, CGS Associates LLC

IMPLICATIONS

In addition to providing a snapshot of how single-family offices are investing in alternatives and their interest in these investments going forward, the research data in this report may have some future implications for those seeking to work with this sophisticated cohort.

SINGLE-FAMILY OFFICES

As single-family offices transition leadership between generations we can expect to see younger family members, who have demonstrated more interest in growing their wealth rather than simply protecting it, become more actively involved in investment strategy and execution rather than relying on professionals employed at or by the family office. Given rising allocations to a variety of alternatives, single-family offices will need to enhance their internal infrastructure to enable comprehensive alternative investment sourcing, diligence and monitoring, as well as facilitate the more complex operational processes associated with these investments. While in the past family single-family offices were largely content to build alternatives allocations using third-party managers and renegotiate fees in cases of underperformace, we are increasingly seeing these organizations hire portfolio managers directly and establishing their own in-house funds. Family offices are beginning to resemble asset managers in some respects as they seek to optimize their allocation mix and maximize returns, and will benefit from more robust systems to support these efforts.

WEALTH ADVISORS

Single-family offices have demonstrated a strong appetite for alternative products not found in the traditional range of advisor offerings. Succeeding as a partner or outsourced provider to these ultra-affluent families will require wealth advisory professionals to significantly upgrade the breadth and depth of their product suite, and to employ technology in innovative ways that meet the preferences of younger family members and allow for the more efficient servicing of these increasingly complex organizations.

ALTERNATIVE ASSET MANAGERS

Single-family offices and wealthy families represent a serious and substantial pool of capital for alternative asset managers, but act very differently from the average high-net-worth individual. While funds will continue to be part of their portfolio mix, their appetite for direct deals either on a co-investment basis or as part of a sourcing network is growing rapidly, particularly as the second generation takes the reins. Many second generation family members are beginning to view their family offices the way the previous generation viewed the family operating company, as “the” family business. Recognizing single-family offices’ desire for greater control over their investments, at less cost, will be necessary to creating partnerships that are appealing to them. In addition to co-investment, separate accounts and other structures commonly used to capture institutional assets are likely to become more common.

ABOUT THE SAMPLING METHODOLOGY

When conducting research with limited and hard-to-reach populations (like single-family offices and high-net-worth individuals) it is virtually impossible to rely on probability sampling, which involves random selection. In these cases, it is accepted practice in applied social science research to employ non-probability sampling. The research data presented in this report was collected using a non-probability purposive sampling approach called chain-referral sampling, wherein qualified research subjects act as “recruiters” for other research subjects with similar demographics, psychographics and other defined criteria. Despite the use of statistical controls, the risk of this approach is that subgroups in the target population that are readily accessible may be overweighted.

CONTRIBUTORS

Lawrence Calcano is Chief Executive Officer of iCapital Network. He began collaborating with iCapital shortly after its founding in 2013 and formally joined the company in 2014 to lead the firm's key strategic and business development initiatives. Mr. Calcano was a partner at Goldman, Sachs & Co., where he spent 17 years, most recently serving as the co-head of the Global Technology Banking Group of the Investment Banking Division. Mr. Calcano serves on the Boards of the Mental Health Association of New York City, Capitol Acquisition 3, a Special Purpose Acquisition Company, and Make-A-Wish Foundation of Connecticut. He was named to the Forbes Midas List of the most influential people in venture capital in 2001, 2002, 2004, 2005 and 2006. Mr. Calcano received a BA from Holy Cross College and graduated from the Amos Tuck School of Business at Dartmouth as a Tuck Scholar.

Nick Veronis is Co-Founder and Managing Partner of iCapital Network where he oversees Origination and Due Diligence. Nick spent 11 years at Veronis Suhler Stevenson, a middle market private equity firm where he was a Managing Director responsible for originating and structuring investment opportunities. At VSS, he specialized in the business information services sector and helped spearhead the firm's investment strategy in the financial software and data sector, including its investment in Ipreo. Nick was previously an operating advisor to Atlas Advisors, an independent investment bank based in New York. He began his career as a financial journalist for The Boston Business Journal, was a reporter for The Star-Ledger, and an associate in the New Media Division of Newhouse Newspapers. He holds a BA degree in economics from Trinity College.

Eileen Duff is Managing Partner and Head of Distribution for iCapital Network where she is responsible for sales and relationship management supporting the RIA, broker-dealer, private banking and family office communities. Prior to joining iCapital, Eileen was Head of Alternative Investments, North America at Credit Suisse, where she oversaw the origination and distribution functions for private equity, hedge funds, and other key alternative asset classes, and grew the Alternative Investments platform to more than $8 billion in AUM. Previously, Eileen was with Donaldson, Lufkin & Jenrette where she was responsible for global marketing in the private client group. She is a graduate of University of Delaware.

Hannah Shaw Grove is Managing Director and Chief Marketing Officer of iCapital Network. Prior to joining iCapital Hannah spent eight years consulting to private clients and family offices while conducting and publishing seminal research on the high-net-worth markets. She is the author of 11 books, a founder of *Private Wealth* magazine and has been a regular contributor to Forbes.com, *Elite Traveler, Robb Report Lifestyle, Worth,* and *Financial Advisor*. Previously Hannah was Managing Director and Chief Marketing Officer of Merrill Lynch Investment Managers (merged with BlackRock) and held a series of strategic management roles at Prudential, Financial Research Corporation (acquired by Strategic Insight) and Fidelity Investments. She is a member of the High-Net-Worth Advisory Board of the Hedge Fund Association and the former chair of the research committee of the Investment Company Institute. She was graduated cum laude from Harvard University with an ALB in humanities.

RESEARCH ADVISOR

Russ Alan Prince is President of RA Prince & Associates, Inc., a globally-recognized research and consulting firm specializing in the study of private wealth creation and management. Mr. Prince is the author of 55 research-based books, including his most recent — *The High-Functioning Single-Family Office* (2016) and *Becoming Seriously Wealthy* (2017). He is Executive Director of *Private Wealth* magazine and the Family Office Association Research Institute and writes the Serious Money blog for Forbes.com. Prince received an MBA with distinction from Columbia Business School and an MA in sociology with a concentration in research methodologies from the State University of New York at Stony Brook. **www.russalanprince.com**

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For general inquiries, please contact:
212-994-7400 | info@icapitalnetwork.com

For investor relations, please contact:
212-994-7333 | ir@icapitalnetwork.com