Power up your portfolio with private investments

One of the golden rules of investing is to not put all your eggs in one basket. In other words, diversify your portfolio.

Diversifying means buying securities from multiple asset classes (i.e., equities, fixed income, cash) and different industry sectors, geographical areas, and investment styles. When you diversify, it helps to reduce risk, although it doesn't eliminate it.

Where it gets interesting are the possibilities for diversification as physicians become wealthier.

How to diversify if you have significant assets

For the average investor, diversification means owning (whether directly or through mutual funds and exchange-traded funds) a mix of traditional, publicly traded stocks and bonds.

As you accumulate more assets, you can start expanding the asset classes you invest in and consider alternative investments: a diversified set of investment opportunities with risk and return characteristics that differ from traditional investments such as publicly traded securities.

These different asset classes provide additional diversification benefits because they have a lower correlation to traditional asset classes. In other words, they do not react in the same way when there are changes in the market or economy.

This gives you the chance to generate potentially greater long-term returns. How much you allocate to alternative investments would, of course, depend on your individual situation.

One area that's becoming more accessible to wealthier investors is private investments.

What are private investments?

Private investments are part of what are known as non-traditional or "alternative" investments.

Private equity consists of investing in companies that are not publicly traded. Researching, acquiring and managing these types of investments is difficult.

For individuals, the easiest way to invest in these companies is to buy units of funds that invest in them themselves.

Private equity funds invest in different types of private companies. These may include start-ups seeking venture capital, mature companies looking to expand, or companies that need capital to restructure. Ultimately, a private equity fund aims to bring about positive change in companies and create long-term value.

You can also invest in private real estate funds. These funds invest in different types of real estate, such as office buildings, residential, commercial and industrial buildings or hotels. Private real estate funds may include properties from different regions around the world.

For the most part, private investments have typically been reserved for sophisticated institutional investors such as pension funds, since the minimum investment amount is prohibitively expensive.

However, these strategies are becoming available to qualified, high-income Canadian investors.

An option worth considering

Before you venture into the world of private investments, take the time to find out more. Several factors should be considered.

First, private investment funds require a minimum investment that can be substantial and are only open to investors for a limited period of time. After this period, no new investments are accepted.

Second, you must be patient. Private investment funds typically require a holding period of seven to 10 years or more to ensure sufficient financing of the investment strategies that are implemented. It is a very illiquid investment that is suitable for those who can commit for several years in the hopes of getting better long-term returns.

Finally, remember that private investments are not subject to the same rigorous rules as publicly traded securities.

One of the most compelling reasons to invest in private investments comes back to the increased diversification benefits for a portfolio. When you think of eggs in a basket, private investments are simply another basket you can use.

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