Summary: This is the first in a series of three White Papers that explores the costs of unintended portfolio illiquidity and the possible benefits to selling less liquid and illiquid Hedge Fund Limited Partner Interests in a secondary market transaction. Forthcoming White Papers will explore in more detail the costs of unwanted illiquidity and the possible benefits of selling these interests along with the psychological process of making the decision to sell. A final installment will discuss other considerations including structuring and counterparty options. Overall, the reader should walk away recognizing the costs/benefits of using the secondary market for their less liquid and illiquid Hedge Fund LP interests as well as, other considerations when evaluating and trying to access further liquidity.

Hope is Not a Strategy[1]:
When Liquidity Catalyzes Performance
and Provides Other Benefits

Peter Benchley wrote in his highly acclaimed book and later movie, *Jaws*, "Just when we thought it was safe to go back in the water…" Just as Institutional Investors thought they were further and further away from the 2008 Great Financial Crisis (the "GFC"), and it was safe to stretch for yield, including investing in less liquid and niche credit strategies, the Covid-19 virus and consequent economic shutdown hit Institutional Investors with another market dislocation. Despite economic support from Monetary and Fiscal Policies, including the government's unprecedented purchases of corporate credit in the secondary market, the overall credit markets have yet to regain full price recovery and liquidity. Similarly, after looking into the performance of its components, the S&P 500 Index is not as strong as the headline numbers suggests. Many more companies are losing and some, getting crushed. Big tech stocks have made significant gains, but the broad averages are down. As Jim Cramer, host of "Mad Money" recently said, "When you get down into the weeds of this market, what you see is that there are a lot more losers than there are winners. That is the nature of the Covid-19 economy, and now that there is no one in Washington willing to play gardener, maybe it's only a matter of time before the weeds overrun the entire patch."

This paper explores why portfolios today may have too much relatively illiquid credit and other exposures and why Institutional Investors may find they suddenly have too little liquidity (i.e. too much illiquidity) at perhaps the worst possible time. This paper discusses some of the differences Institutional Investors must consider between price and value, including "other" costs to holding less liquid assets, especially at the wrong times, and "other" gains to be had by monetizing them sooner than later.

It's Déjà Vu All Over Again[2]:
Risk-On and Other Trends in a Low Interest Rate Environment

In response to the GFC, the U.S. Federal Reserve and other global Central Banks injected tremendous liquidity into global financial markets, causing interests rates to go nearly to zero (and even below zero for a majority of the world's sovereign debt markets especially when factoring in inflation). As a consequence, many Institutional Investors flocked into less liquid strategies in an effort to find higher yields. Generally, this meant investments

[1] Investor aphorism
[2] Quote attributed to Yogi Berra, MLB catcher and manager (and philosopher)

in less trafficked areas around the periphery of established credit markets previously reserved for those willing to take on more risk and/or illiquidity to stretch for yield. Often times this also meant investing in smaller credits with small or single sponsors and with few other investors, including opportunities in lower and less liquid tranches of structured products, like CDO's, CLO's, ABS, CMO's, CMBS, REIT's, BDC's and the like. Wall Street as well as Hedge, Private Equity, and Direct Lending funds, happily accommodated these capital flows with new and larger investment products, most of which limit investors' liquidity, especially when liquidity is most dear.

Generally, these types of investments entailed swapping risk and/or liquidity in the pursuit of picking up additional yield. This approach worked relatively well for a while, and many money managers pursued and/or were forced to rely on these types of strategies in order to meet their investment objectives, and/or to keep up with others' relative performance. But, just as so many other of the "best laid plans of mice and men", external events come along (in this case, the Covid-19 virus and consequent economic shutdown) that cause unexpected volatility, illiquidity, and other risks for nearly all asset classes but especially for the investments in which investors were already stretching for yield, and especially among investments in certain industries like travel & leisure, oil & gas, retailers, restaurants, commercial real estate, and banking.

While the current Covid-19 crisis may be different than the GFC, and the GFC may be different than the prior Enron, Dot Com, Long Term Capital, and other crises that many of us older institutional managers experienced firsthand, there are rhymes. The most notable commonality among these crises is the difference in outcomes for Institutional Investors who entered each crisis with liquidity or accessed liquidity during the crisis in order to limit losses and play some offense with the opportunities presented during the crisis. As to the latter point, we are reminded in the words of Charles Dickens, "It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity, it was the season of light, it was the season of darkness, it was the spring of hope, it was the winter of despair." And, the same can be said about the markets before, during and after there is turmoil and dislocation; it can be the worst of times, but also, it can provide for the best of opportunities, especially for those with liquidity to take advantage of the bargains that often results.

A Goal Without a Plan is Just a Wish[3]:

Regaining control through secondary liquidity

J.R.R. Tolkien, the author of the Hobbit, said, "It does not do to leave a live dragon out of your calculations, if you live near him." Investors know market dislocations happen, and that in the last thirty years dislocations seem to happen more frequently than the history books and financial models would suggest. Institutional Investors must plan ahead, assuming times of stress are potentially around the corner, not just to preserve capital during these dislocations but also, to be in a position to take advantage of opportunities that come from them. Access to liquidity and potential restrictions on the ability to access liquidity must be monitored such that Institutional Investors know what liquidity is available to them at all times. Holding non-core illiquid assets at the wrong time, especially inadvertently, comes with "opportunity costs" which can disrupt more than just an organization's investment strategy and performance but also, every layer of an organization, including the lives of its beneficiaries.

Oscar Wilde said, "The cynic knows the price of everything and the value of nothing." Secondary sellers that focus solely on the price available to sell their "gated", "suspended", "side pocketed", or "tail-end" LP interests,

[3] Quote attributed to French author Antoine de Saint-Exupery

may be missing the true costs/benefits of selling versus not selling, and the potential value of a secondary market sale may have not just to the portfolio but also, to the organization itself. The following table outlines a partial list of common reasons why Institutional Investors might be well served to consider selling some or all of their less liquid and illiquid LP interests, especially when inadvertently bloated and occupying the wrong relative size in the portfolio (too small or too big) and at the wrong times:

Figure 1: Reasons to Sell into the Secondary Market (Independent of Price)

Problem	Impact
1. Limited Upside	Research[4] has shown that tail-end fund interests retain very little remaining upside potential (given their small relative size), and in many cases suffer from value erosion due to fees
2. Opportunity Cost	Immediate liquidity (even at a discount) can be redeployed to exploit new, more attractive opportunities which may involve less risk and nonetheless, potentially higher returns and quicker liquidity to redeploy again and with better, more reliable Investment Managers
3. Wasted Time	The decision to terminate the fund has been made, yet the assets linger, demanding the attention of investment staff, operations personnel, and even the Board comes with an "opportunity cost" as well, i.e. time might be better and more productively spent on bigger, and proactive issues and not on inadvertent illiquidity
4. Optics	The optics of having to repeatedly report on a "stub" position, such as a gated, suspended, or side-pocketed hedge fund interest, or a tail-end PE position versus having an "intentional" portfolio
5. Reputation Risk	Often, residual hedge fund interests or tail-end private debt/equity funds were implemented by an Institutional Investor's predecessor, but ultimately how it behaves in the future is part of the new PM and/or Board. An immediate sale preserves the new PM's from inadvertent risks he need not hold. Lingering assets may also have "Headline Risk", especially among less sophisticated beneficiaries, which can harm an organization's image
6. Loss of Knowledge	Institutional knowledge of long-lived assets may degrade over time as staff changes or internal assets, committed to understanding and monitoring them, are reallocated
7. Transparency Issues	Oftentimes, the manager with side-pockets and tail-end funds are either embarrassed to discuss or concerned not to let the "world" know what they must sell, and the assets that tend to be put in them, do not lend themselves to accurate projections of duration or valuation
8. Size Relative Size	Stub positions might be small in comparison to each original size (E.G. an original 5% allocation, may only Gate, Suspend or Side-Pocket 10-20% of their withdrawals, meaning, at most, a 1% position), and thus when compared to the Institutional Investor's total asset base, selling these, even a deep discount to the manager stated alleged NAV, may not have a material effect on overall performance
9. Ownership Issues	Often, residual hedge fund interests or tail-end private debt/equity funds were implemented by an Institutional Investor's predecessor, but are constraints on the PM who inherits them
10. Termination	Long-lived or slow-pay LP interests can impede the wind-down of an investment vehicle. Secondary market liquidity solutions can help managers more expediently terminate a vehicle

[4] "Watch Your Tail End", Upwelling Capital Group and Adams Street Partners, December 2019.(URL: https://www.adamsstreetpartners.com/wp-content/uploads/2019/06/Tail_End_Research_Report_-_2019_-_Upwelling_Capital_Group.pdf)

“Sell your losers and cut your losses quickly,” is a common mantra among talented Institutional Investors, and yet, the most common mistake is to say, “Once it gets back to par, I will sell it.” The above table highlights ten costs and/or benefits associated with monetizing less liquid and illiquid assets, especially in times of market stress. These can affect performance as well as every layer of an organization, including the lives of its beneficiaries. In summary, besides the opportunity costs of trapped capital, one loses the time spent monitoring, administering, and discussing unintended residual fund interests; time which could better be spent elsewhere within the portfolio and organization, developing and executing more timely strategies and better investments. Moreover, there are optical, reputation and other costs associated with maintaining residual fund interests including leftover side-pockets or tail interests often demand a disproportionate attention of Board members and beneficiaries.

An Ounce of Action is Worth a Ton of Theory[5]:
Translating Hope into Action

The sustained low interest rate environment of the last fifteen years has lured many Institutional Investors into less liquid credit strategies to find higher yields. The Covid-19 virus and consequent economic shutdown has cause unexpected volatility, illiquidity, and other risks for nearly all asset classes but especially for the investments in which investors were already stretching for yield, and especially among investments in certain industries like travel & leisure, oil & gas, retailers, restaurants, commercial real estate, and banking. Institutional Investors would be wise to plan ahead and constantly evaluate their liquidity and options for access to it in times of market dislocation, especially when their portfolios may be knocked off balance and access to liquidity may be difficult to achieve but deeply valued. Institutional Investors would do well to remember that “Hope is not a strategy” and resolving unwanted illiquidity proactively can have many benefits. It may help to rebalance portfolios to be more consistent with pre-set portfolio construction guidelines and discipline, and to redeploy capital in ways more likely to achieve investment objectives and other benefits.

***About Dorchester Capital Advisors**: Founded in 2001 as a Fund of Hedge Funds by two former Hedge Fund managers to manage their own and friends’ capital, Dorchester has evolved over the years. Through its primary multi-manager platform, Dorchester has been an early and ongoing investor with many Alternative Investment Funds. Since 2008, Dorchester is among the first firms to participate in size in the secondary market for Limited Partner Interests in Hedge, Credit, Private Equity, Real Estate, and other Alternative Investment Funds. Dorchester works with Limited Partners, Institutional Investors, Brokers and General Partners to proffer customized solutions as well, including investing in GP-led tender and buyout offers, fund restructurings, and fund level debt and preferred equity financings. Dorchester has invested in direct, carve-out and co-investments with General Partners, Limited Partners, and other investors. Dorchester believes it is one of the few firms with the requisite size, insight, analytics, sourcing, intermediate term capital, experienced personnel, and track record to be an important counterparty in this ongoing and evolving secondary market for Limited Partner Interests. Over the years, Dorchester has earned its reputation as a reliable and collaborative counterparty and Limited Partner.*

[5]Quote attributed to Ralph Waldo Emerson