INVESTMENT FUNDAMENTALS

Understanding interval funds.

Interval funds are closed-end mutual funds designed to give retail investors access to illiquid assets that are typically restricted to institutional investors. In exchange for this access, investors must agree to restrictions on when and how much of their money they can withdraw at a given time.

Why interval funds?

Like traditional mutual funds, interval funds provide a convenient way for investors to access the benefits of a professionally managed portfolio. The most distinct difference is that investors may only withdraw their assets from an interval fund at certain prearranged periods or 'intervals' and for a predetermined number of shares each time.

Interval funds also provide access to generally illiquid asset classes such as real estate, private equity, and structured credit. Traditional mutual funds cannot invest more than 15% of assets in illiquid investments[1]. Since interval funds are not limited to this 15% cap, they provide an opportunity for the average investor to add a range of diversifying illiquid assets to a traditional equity/bond portfolio.

What are the redemption intervals?

In general, an interval fund will free a portion of its shares (between 5% and 25%) for investors to withdraw funds on a pre-defined schedule. The timing may be monthly, semi-annually, or quarterly.

Shareholders receive notification and details of upcoming redemption windows during which the fund manager will repurchase shares that investors wish to redeem for cash. It is investors' prerogative to redeem shares of the fund and notify the manager of their intent by the stated deadline. Note however that only a specific portion (e.g. 5% - 25%) of the fund is available for redemption. If investors' orders surpass what the fund offers, shares are liquidated on a pro rata basis, which means that shareholders may not be able to redeem their desired number of shares at a given time.

[1] Per the Securities and Exchange Commissions rule 22e-4 related to the classification of funds' portfolio investments, "A fund is not permitted to purchase additional illiquid investments if more than 15 percent of its net assets are illiquid investments that are assets." https://www.sec.gov/divisions/investment/guidance/secg-liquidity#:~:text=to%20this%20requirement.-,Limitation%20on%20Illiquid%20Investments,illiquid%20investments%20that%20are%20assets.

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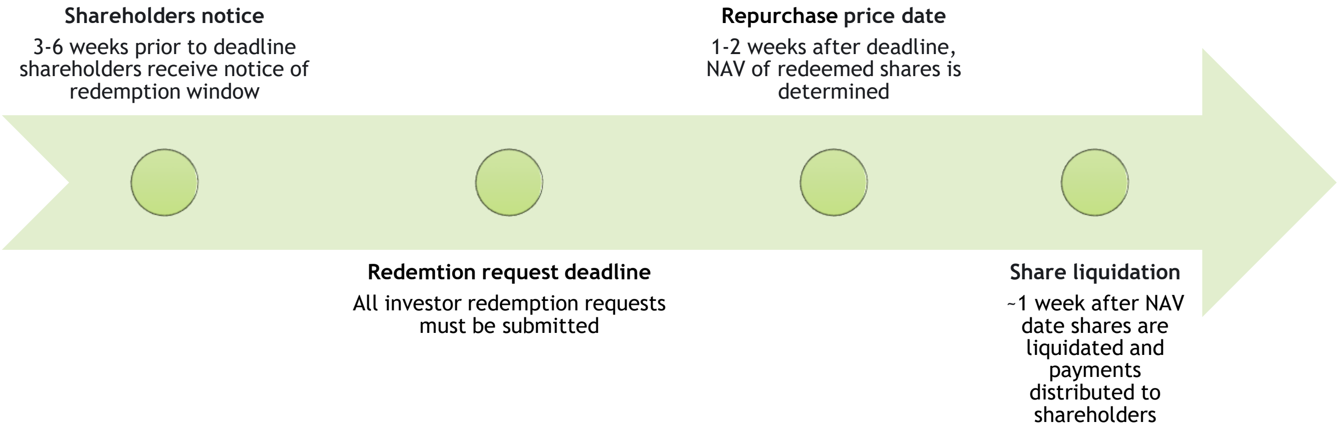
Example redemption interval



Shareholders notice
3-6 weeks prior to deadline shareholders receive notice of redemption window

Redemtion request deadline
All investor redemption requests must be submitted

Repurchase price date
1-2 weeks after deadline, NAV of redeemed shares is determined

Share liquidation
~1 week after NAV date shares are liquidated and payments distributed to shareholders

Source: SEI. For illustrative purposes only. Individual funds will each have their own unique repurchase offer schedule.

What are some of the risks?

While there are risks to any investment (complexity of assets, fees, sensitivity to macroeconomic factors), generally the foremost risks of an interval fund are its limited liquidity windows and set number of redeemable shares. Unlike a traditional open-end mutual fund that has daily liquidity, investors cannot liquidate a portion or all their shares at their discretion. Rather, they may have a little as one day every quarter to submit a redemption request. For certain investors, this can be a drawback if they need to liquidate shares more frequently or with little lead time.

Moreover, because interval funds free only a portion of their assets during each redemption period, investors may find that they can only redeem a fraction of their investment at any given time. In such instance, an investor may need to wait until the next quarter before liquidating some or all their remaining shares. As such, it is important that investors read the fund's prospectus to understand the terms and timing of the open redemption windows.

The bottom line

Interval funds can be attractive tools for investors seeking to diversify their portfolio by purchasing potentially higher-yielding assets uncorrelated to equity or bond market movement. However, like all strategies, there are risks to consider. In large part, the risk of an interval fund is the limited liquidity made available on pre-determined (and sometimes long) intervals. If investors are able to accept a longer-term investment horizon, an interval fund may be an effective means to add diversification and uncorrelated returns to an investment portfolio.

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Glossary

Asset Class: A group of securities that share similar characteristics and behave similarly in the marketplace. The most common asset classes are stocks, bonds and cash equivalents. Asset classes are generally governed by the same rules and regulations.

Private equity: An alternative investment class that invests in or acquires private companies that are not listed on a public stock exchange.

Structured credit: Pools of similar debt obligations such as loans and mortgages are packaged into interest-bearing securities backed by those assets and issued to investors who receive the resulting cash flows.

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Important information

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Investing involves risk. Alternative investments are subject to a complete loss of capital and are only appropriate for parties who can bear that risk and the illiquid nature of such investments.

Interval funds shares have no history of public trading and will not list its shares for trading on any national securities exchange. There is no secondary market for the fund's shares. The shares are, therefore, not readily marketable. Even though the fund will make periodic repurchase offers to repurchase a portion of the shares to provide some liquidity to shareholders, you should consider the shares to be an illiquid investment. An investment in the fund is suitable only for long-term investors who can bear the risks associated with the limited liquidity of the shares. The number of distributions that the fund may pay, if any, is uncertain.

Alternative investments:

- often engage in leveraging and other speculative investment practices that may increase the risk of investment loss
- can be highly illiquid
- are not required to provide periodic pricing or valuation information to investors.
- involve complex tax structures and delays in distributing important tax information
- are not subject to the same regulatory requirements as mutual funds; and
- often charge high fees.

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