Zach Miller ([00:19](https://www.rev.com/transcript-editor/Edit?token=mzS1Uh4HDEfMXpVrJ9AeBesGxvRYlnFMZA2x7CQfwVCU9nwVqXa9JLL70H7Se47yN2MNZ2fAh-Faow59dCO-xvjCdDk&loadFrom=DocumentDeeplink&ts=79.92)):

Hey guys. Welcome back to the NFL Players podcast. I'm your host, Zach Miller. So, last week we talked about venture capital. And this week we're going to talk about hedge funds. Both of these are private investments, private equity that you really need to know the details on this, if you're going to invest in it. Should you allocate? How much should you allocate to your hedge funds? Should you allocate any to it? We're going to answer those questions. Really look at the data, really look at where returns come from, and if it makes any sense to even put them into your portfolio. As you become an NFL player, you're an accredited investor. That means that you have access to investments that the average person doesn't have access to. So, you're going to see a lot of people pitching you these deals.

Zach Miller ([01:02](https://www.rev.com/transcript-editor/Edit?token=RQetKOBZaCBbWjfEzcsf8mGDLG57-cg9WgkQ_lfQbDEeP_H6xeCUv0CP_KQuXrFQ5gFggSKwnk6Q3BqliiXpOlxx-Gs&loadFrom=DocumentDeeplink&ts=122.47)):

You're going to see a lot of people trying to get you invest with them. And before we really analyze this and explore this hedge fund space, I think everyone's been watching the free agency market. And as I said on a previous podcast, you've seen all the teams do the restructuring around veteran deals, pushing money out into the future, Taysom Hill's deal. You really saw that with how they manage the cap space there. And it just proves my point that I made that if teams want to keep you there, you can move the cap space around. You can finagle and move money, so that you have the guy there and push that cap space money out into the future. And so, any team that cuts a guy, because of cap space, they just didn't want the guy, or they didn't want the guy at that price.

Zach Miller ([01:54](https://www.rev.com/transcript-editor/Edit?token=iiXed-KFtn_GKROP1nM-95KHizouvxTEsw_oEavAAL74CV90tva4DIS8yS6vFOZQzxFwNV4_OfDnGe4jdkzFYk8Xnck&loadFrom=DocumentDeeplink&ts=174.93)):

So, once again, I think the owners are also tipping their hand at the future TV deals with the big broadcast networks. I think you're going to see a big deal with those networks signed soon, between the NFL owners and getting those TV packages. So, that'll filter into future cap space. And I think you are going to see big cap numbers down the line. So, that's great news for players and a lot of one-year deals, this year, during free agency, but expect to see a jump once these new TV deals are signed and that cap recovers in the future years.

Zach Miller ([02:55](https://www.rev.com/transcript-editor/Edit?token=KNHwAO1n6mU4J2xzJPBbSW7P81NbzYHc1kMxbL7nd4_BuMWWYfQJhPjQ3-VVCgvH139hpm6Hst8nzbXEk5PHa-CFojw&loadFrom=DocumentDeeplink&ts=235.49)):

So, with that, here we go on hedge funds. So, what is a hedge fund? I mean, you're supposed to be hedging your market risks, right? That's what the word hedge means, is you're not supposed to be as risky as the market. Now, when we look at the data, that doesn't happen to be the case and all the data and everything I cite in here, I'll put in the show notes, all the studies, all the data, all the evidence, because we have to be evidence-based investors. If we want to have the best chance to reach the outcomes we want, and that matter to us, we have to use the evidence, we have to use data to drive our investment decisions. Otherwise you just don't have a real strategy. You don't have a real plan. You're just making it up as you go along, and you don't want to do that.

Zach Miller ([03:33](https://www.rev.com/transcript-editor/Edit?token=BTY58NJMHz7umleWawC5kDDBKa64E9JvRxdZlrGtphCZp7jWRENIEg63oHee8WKfxXq0Q0ZHeGmv5yUJcZkMSMWXUbU&loadFrom=DocumentDeeplink&ts=273.84)):

You want to own your wealth as an NFL player. So, I think the easiest way to analyze this, is just see why hedge funds? What returns do they have to produce to justify allocating to them? And I'll put it in the show notes, like I just said, but really you need about a 16,5% return to outperform just a passive index of the total market, to beat the passive market. So, that's because the two and twenty fee structure, I've talked about in previous podcasts, where they charge a 2% ongoing management fee and then 20% of profits, it really makes the alternative space a really... Well, first of all, it's an extremely profitable segment for the financial services industry and Wall Street loves to charge the two and twenty model and pump it up on CNBC.

Zach Miller ([04:28](https://www.rev.com/transcript-editor/Edit?token=Q7cahKUffZkkhB1l63VsKnAsH2tBxMOp_ah8S7HVJlLq8ACGs3yEKhgWy5SQMQoxIdUVk3GOG2iN4ST0Avd5PcZjX8c&loadFrom=DocumentDeeplink&ts=328.13)):

So, first of all, you got to know that the incentives are misaligned for the end investor there, and as an individual investor, if they have to clear this two and twenty hurdle, just to make profits, and then you factor in the fact of the tax implications of what taxes are putting out there, you really have to know whether that's worth it or not. And so, you always want to try to just make sure your incentives of whoever you're giving your money to, are aligned with yours as an investor. And then, as we talked about in the last episode with venture capital, the venture capital space, you have to have access to the best funds, or it's not worth it. Don't allocate any money to it. The same is true of all of private equity, including hedge funds, unless you're getting access to the best managers and the best funds, there's no point to put any money into it.

Zach Miller ([05:14](https://www.rev.com/transcript-editor/Edit?token=8_DJLHMtzbOw8sgaEflTFfF5DGPFoviDt0LzFXcB6aCh6vKPuYmm_zdtmH-qRG84jozb1dZt2UgqRPcovvBFsXSXSTA&loadFrom=DocumentDeeplink&ts=374.63)):

You can actually just create your own personal hedge fund. And that's what we do here at AWM, is you have, what's called, a protective reserve, and this is the highest confidence, highest reliability of fixed income and highest rated, so that when the market sells off, or when there's a bad turn of events, this protective reserve, protects you from selling assets at distress levels. And this is really just a personal hedge fund you're immunized and protected against downside, whether that's rates going up, rates going down. Whether that's economic shocks, this protective reserve serves as your own personal hedge fund, and you don't have to pay the two and twenty fees. Now, there is a cost, because you have to sacrifice potential upside equity returns in this protective reserve, but it's really your own personal hedge fund. And so, another issue with the hedge funds is the data. There's so much survivorship bias, which basically means that about every year, 17% of hedge funds close up shop. So, they're eliminated from any index or any measurable...

Zach Miller ([07:43](https://www.rev.com/transcript-editor/Edit?token=Ezq03LtdbGXoHJQdYBXiupZaBqMcgYXl7FK6AG3eq_xeS6L1XL8m4wCH2vdDx7MwI_Nf5wagabcGbDkZOvEDs10Unhc&loadFrom=DocumentDeeplink&ts=523.43)):

And with hedge funds, you really need to understand where the risks are and what their sources of returns are, they're coming from. So, in previous podcasts, we've talked about enterprise risk, and this is just the business risk, the risk you take by putting your money with a business that, they might do well, they might not do well. And so, you deserve to be compensated for that. And, there's other premiums there, but the value size premiums, and then credit and term premiums on the fixed income side. But, I don't want to go into too much detail. What the hedge funds do though, is they engineer risk. This is a lower confidence of return, because they're borrowing money. And then, investing that in more enterprise risk. And there's also the illiquidity premium of tying up your money for so long and not be able to have access to it.

Zach Miller ([8:27](https://www.rev.com/transcript-editor/Edit?token=XdLX5aX0Vka3Atv3WZPS72yAm25tccN0XEAlaxsmlSj8-MHumolzVI6P-i2vYD0RY8fcbim8e9UC1rUSu5VI_LD3p3s&loadFrom=DocumentDeeplink&ts=655.47)):

So, they're really engineering more risk that doesn't have as high a confidence, as your enterprise risk. And then, the other thing that hedge funds will try to sell you, is their manager skill. And while there are some managers that have skill, for an individual investor, it's almost impossible to predict who will perform the best ahead of time. And so, if you're not going to get access to the best funds that have proven they can do it year in and year out... Don't even allocate to any of the alternatives or hedge funds, because it's not worth it. Even the venture capital space, only the best people get the best return. So, if you don't have access and you keep in mind, you're competing with the likes of Yale, Stanford, these endowments that want access to this venture capital, these private equity firms, you're competing with them for an allocation.

Zach Miller ([9:14](https://www.rev.com/transcript-editor/Edit?token=7FEv2YMwz2hAo1b4qpcxdkNO_tflbA9j1NCzrO7T1NBr6bkCcgsAs7_OXa0grljFDkpYydCpjVtR53o_Pu3d_hcz9gs&loadFrom=DocumentDeeplink&ts=703.14)):

So, unless you can get a special access to these alternative investments, it's really not worth it. You're better off doing it with a low cost, low tax protective reserve on your own with a tailored custom portfolio and not even having any allocation to alternatives. So, unless you can get the best access, you really have to understand that you're not going to have a very high confidence in these returns. And especially if you concentrate, if you concentrate and you're not diversified in your alternatives, you only get one shot at it. So, you might not have very good returns or you could have great returns and you have to question, is it worth it? As an NFL player, you've already done well, you can start saving and start really building your wealth. Does it make sense to be throwing Hail Marys?

Zach Miller ([10:00](https://www.rev.com/transcript-editor/Edit?token=ZGOWss9X-zqXgf0WQY-LJPsrMy4chYiM7O7JmOLv6HH6mctVZBO6YP9N--6skLOsdlvYW49whecYxM_mTArr6waJPpg&loadFrom=DocumentDeeplink&ts=749.5)):

Does it make sense to be throwing deep bombs when you're already ahead by three, four scores. You have to really think about that analogy as, if you're allocating to alternatives, what's the point? Are you trying to protect against risk? Are you trying to diversify? Because really, risk is not a great measure for a portfolio for an individual investor. Maybe it's a good measure for volatility, is a good measure for a casino in Vegas, but really what you're worried about is uncertainty. And those negative outcomes that really can cause a disastrous financial consequence. And so, protecting against those, you actually need to rely on that protection. And that's what the value of a protective reserve is, is to be able to have that, so you don't have to sell equity assets in a downmarket, in distress prices.

Zach Miller ([10:50](https://www.rev.com/transcript-editor/Edit?token=lhrR2wjmzHa7NjGU-4Xjxfypi13kHwEoapeIQPgeLpLR8vKO1kO8M3k6DD6YFZg92tQV4mGiRhDEjnBVsMXP6M_-iiA&loadFrom=DocumentDeeplink&ts=799.29)):

So, to sum it all up, you really have to have a team that allocates this with a process. You can't willy-nilly, just do all these direct placements and private placements with no strategy. You need to have a comprehensive financial strategy. That if you do want to allocate to alternatives, make sure you have the access and then keep it to a smaller percent of your portfolio, then your public equity and your public fixed income. So, you really have to have the strategy in place, so that you get the expected returns that you deserve and have high confidence in them, because that is the core of your investment strategy. Not relying on some random investment you placed here, random private equity deal there, or the hedge fund that's not actually hedging. It's really just increasing your market risk. So, I...

Zach Miller ([12:27](https://www.rev.com/transcript-editor/Edit?token=4zGAAn2aqIUNb1OQElciM1r-s6SeH8w9k5eqNlejHYu8sQggDL6ymV2IQ9hHCpSHy2CWwFDi-_kMqUkPcK-3EdhSv5I&loadFrom=DocumentDeeplink&ts=896.69)):

One other thing to note about the hedge fund space, is the fact that the turnover is just so massive, it's like the NFL. 17% of hedge funds each year, fold up shop, they go out of business. So, this stuff doesn't get accounted in the data either. There's definitely some bias in the data, when you look at hedge fund returns and keep in mind that to justify those fees and extra taxes, you really have to do that much better. The data shows about 16,5% over a passive portfolio. Just to even justify allocating to the hedge funds. And then, I mean, the core fundamentals are always true of all investing, you've got to keep your expenses low, keep your taxes low, stay longterm invested. Don't be fooled by Wall Street. Don't get tricked by, hedge funds have so much money to allocate to their marketing and they have some of the smartest people, because that's where the money is. Don't be fooled and tricked into thinking that, just because they're complex means that they're doing some strategy, that's going to generate some return that you couldn't get in the public markets.

Zach Miller ([13:27](https://www.rev.com/transcript-editor/Edit?token=00c0uthu4qm5k_Il9NsrSj2H32UK9snSSj3B90R-aNcm3GcMwKHLmzn-KwvAtDsgOcgNNp3P2WnwHUbSMWxh7_chcto&loadFrom=DocumentDeeplink&ts=958.88)):

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